The spread of the coronavirus threatens to stall manufacturing sector recovery

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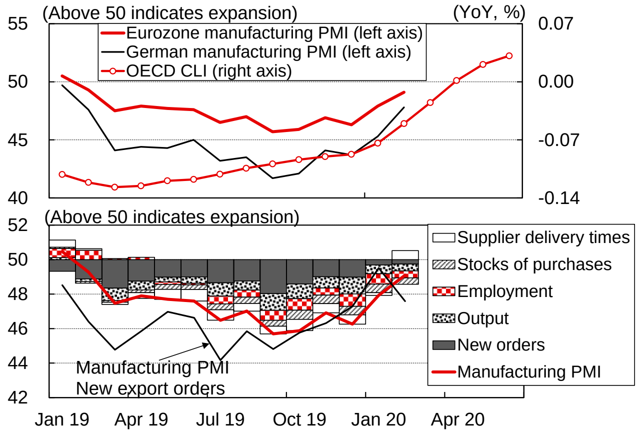
In Q4 2019, Eurozone GDP growth recorded a post-European Debt Crisis low, at 0.1% QoQ. A number of major Eurozone countries saw growth slump: quarterly German growth was 0.0% QoQ on the back of shrinking exports and slowing private and government consumption, Italian GDP shrank by 0.3% QoQ, and in France (where growth had been comparatively robust) the economy shrank by 0.1% QoQ. We must bear in mind that growth in both Italy and France was affected by inventory adjustments, and large scale strikes which have taken place in France since December 2019 have dragged on private consumption. This suggests that the slow growth rate in the Eurozone is the result of temporary factors, and that the general trend remains close to the OECD's Confidence Leading Indicator (CLI): a continued path of moderate recovery lasting into mid-2020 (Chart 1).

Since early this year, manufacturing PMIs have shown clear signs of improvement, and new orders, output and supplier delivery times even improved in February despite the global spread of the coronavirus. We could take this as a sign that the manufacturing sector remains on track for a recovery. However, close examination would suggest otherwise. While the overall figure for orders (which measures both external and domestic demand) has improved in February, export orders have plunged. This is likely to be the result of reduced import demand in China. Supplier delivery times are intended as a measure of supply-side pressure, and longer delivery times are usually a sign of improving economic sentiment. However, on this occasion, it is possible that the improvement in the component reflects coronavirus-induced disruption to supply chains rather than higher demand for finished goods.

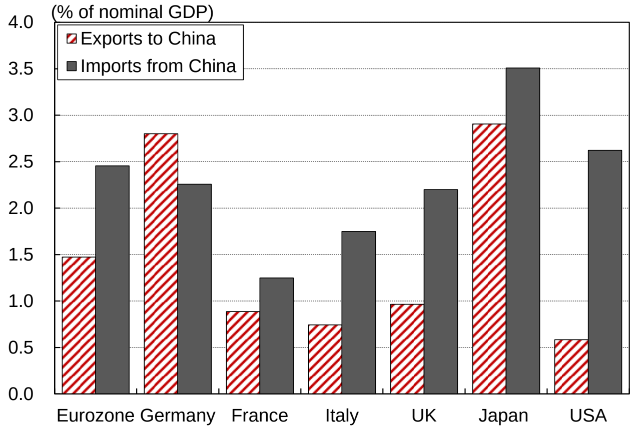
If we examine trade data for major economies, Germany stands out as having high exports to China relative to GDP (Chart 2), meaning that it is particularly vulnerable to fluctuations in the Chinese economy. If disruption to Chinese supply chains continues into the long-term, Germany, and thus the Eurozone as a whole will be impacted on both the supply-side and the demand-side of the economy. We therefore recommend keeping a watchful eye on future developments, especially now that the virus has spread to Italy and other parts of Europe.

Chart 1: Eurozone Manufacturing PMIs, and OECD CLI



Note: OECD CLI estimates trend for the coming six months
Source: OECD, IHS, MUFG Bank Economic Research Office

Chart 2: Key Developed Economies' Trade with China



Note: Based on data from 2018
Source: National statistics offices, MUFG Bank Economic Research Office

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