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Embargoed: 09:00 UTC 06/11/2019

IHS Markit European GDP Nowcasts

Update 6th November 2019: Euro area economy stagnating as divergences remain at the country level

Summary: 6th November 2019

Following this morning's release of final October PMI data for the euro zone, as well as a first look into business conditions for Italy and the UK for October, we provide our first comprehensive outlook for the fourth quarter.

The early signal from our dynamic-factor model points to a shallow fall in economic output across the euro area in Q4. If our contraction estimate for Germany in the third quarter comes to pass, we would see the recession here extend into year-end. By contrast, the robust performance in France is expected to persist, while slight growth is apparent for Italy at this early stage of the nowcast cycle.

The eurozone Composite Output PMI recorded 50.6 in October, broadly signalling stagnation. However, it is within the forward-looking components where real signs of weakness lie as new business fell for a second successive month. We are currently projecting a fractional decline in economic activity of -0.03% for the fourth quarter in the euro area, reflecting the soft fundamentals seen within October survey data. We stress however that these early-stage estimates are prone to revisions as data availability increases. Nevertheless, downside risks to economic output are clear.

Across the single-currency region, France was the best-performer in October from a PMI perspective. This was also the case with our nowcast, where another solid quarter-on-quarter expansion is anticipated in Q4. We currently have growth projected at 0.36%q/q for France, which would be an acceleration from Q3. Additionally, it seems Italy is set to carry its growth trend on following the upside surprise last quarter. Our Q4 nowcast here has been upwardly revised to 0.08% as a result of stronger Services PMI and GDP figures.

On the other hand, Germany looks set to retain its status as the clear weak link among the euro area major economies. If our Q3 call of contraction comes to fruition, which we will find out next week, then Germany will see out 2019 in recession. A decline in economic output of -0.12%q/q is projected amid forecasts of disappointing trade flows and further manufacturing malaise over the next couple of months. Furthermore, evidence of spillover into the domestic economy via services was seen once again in today's PMI data.

Lastly, despite the great difficulty in point estimating UK GDP through-out 2019, our dynamic factor model has consistently straddled the 0% flat-line, either showing idle growth or slight contraction. The latter is the case for Q4, with a decline of -0.02%q/q estimated. An improvement in sterling has pulled the nowcast into less negative territory, while PMIs for October were also slightly up from September.

Next Nowcast Update: November 15th

Latest Nowcasts by Country/Region (%chg q/q)

	Q4 2019	*Change Since 23/10*
Eurozone	-0.03	0.05
Germany	-0.12	0.13
France	0.36	-0.02
Italy	0.08	0.09
UK	-0.02	0.04

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Methodology Notes

In July 2019 we introduced two nowcasting models for the eurozone and the UK and soon after we were able to extend our coverage to include updates for France, Germany and Italy. The models utilise a range of data widely used to track economic developments and provide timely estimations of quarterly GDP growth.

The GDP Nowcasts are based on a dynamic factor model combined with Kalman filtering techniques in a similar vein to the model employed by the New York Fed in estimating US GDP growth https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr830.pdf. Such an approach has gained increasing popularity in recent years in a variety of econometric applications by providing a particularly flexible framework to deal with the two inherent problems in nowcasting (widely referred to in the academic literature as mixed-time frequencies and dataset jagged edge structures).

Several tranches of data are included in our models: data from survey providers ('soft'), data from official statistics offices ('hard') and several indicators linked to financial conditions.

Broadly speaking, the inclusion of survey data in the model provides timely, monthly updates on current economic conditions. These are directly comparable with official data relating to economic growth, employment and inflation, and crucially are not revised after first publication. These indicators therefore play a vital role in understanding how economic activity is currently shaping up. See here for a discussion https://cdn.ihs.com/www/pdf/Nowcasting-Eurozone-GDP.pdf

In contrast, official data included in the models are published with a lag compared to the surveys, with the latter generally only available between 4 and 10 weeks in advance of the official data release.

However, official data such as industrial production figures are crucial in understanding economic growth outcomes due to their widespread use in creating official GDP statistics. As such, these indicators provide a key role in understanding first estimates of GDP, arguably adding greater quantitative colour to the nowcasts compared to more directional indications provided by survey data.