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EUROPEAN PMIS: RESILIENT DECEMBER - SETBACK IN JANUARY?

Berenberg Macro Flash

The major European economies fared better than expected in the first two weeks of December according to the latest PMI surveys published today. The surprisingly strong improvement in the composite PMIs for the Eurozone reflects the easing of the tough virus restrictions across some major economies such as France as well as strong manufacturing activity. Lengthening delivery times caused partly by transport bottlenecks also played a role, artificially raising the results for manufacturing, especially in Germany and the UK. The Eurozone PMI composite index rose from 45.3 in November to 49.8 in December, the UK equivalent increased from 49.0 to 50.7. European economies may suffer another setback over the comings weeks as tighter restrictions are (likely to be) re-imposed and global supply chains hit capacity constraints. The apparent resilience of the PMIs in early December, however, reinforces our conviction that the outlook from spring onwards looks unusually bright.

Driven by a recovery in **services** subindices (Eurozone service subindex rose from 41.7 to 47.3), PMI composite indices gained across Europe as some restrictions to daily life were lifted in early December.

- The gains were especially pronounced in **France**. The French composite index surged from 40.6 in November to 49.6 in December. The service sector jumped even more – from 38.8 in November to 49.2 in December. France had imposed a national lockdown in November and opened up its non-essential shops again in December. France also recorded its first increase in employment in months.
- The **UK,** which went beyond the mere opening of non-essential shops when virus restrictions were eased at the start of the month to allow bars, restaurants and hotels in some regions to go about their business, registered a smaller increase in its PMI service index (up to 49.9 from 47.6). However, relative to France which was hit hard, the UK recovered from a higher initial level. However, the re-imposition of tighter restrictions in some key regions such as London as well as rising Brexit uncertainty may have weighed on the gains in December.
- **Germany** surprised to the upside, especially in the hard hit services sector. The German composite index rose from 51.7 in November to 52.5 in December while the German service subindex increased rom 46.0 to 47.7. Different to France and the UK, Germany had slightly tightened its restrictions in December.

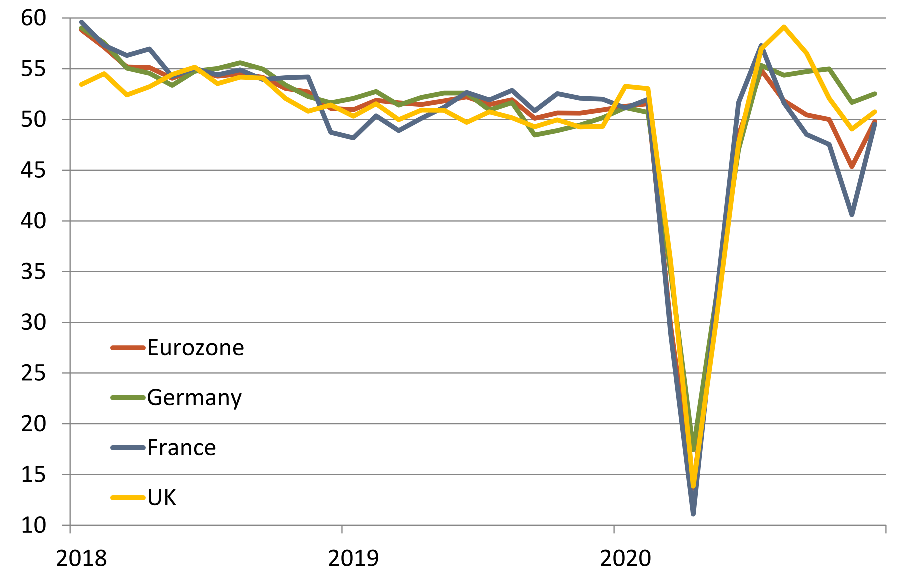
Output in the **manufacturing** sector gained (further) momentum in December. The Eurozone manufacturing headline subindex rose from 53.8 to 55.5, in Germany from 57.8 to 58.6, in France from 49.6 to 51.1 and in the UK from 55.6 to 57.3. But the unexpectedly strong readings only partly reflect a genuine rise in activity supported by sustained gains in foreign demand from, in particular, China. The rise also reflects an additional factor. The headline PMI manufacturing subindices rose by more than the output-only (composite, services and manufacturing) indices. Beyond output, the manufacturing headline subindices also incorporate orders, stocks of purchases and delivery times. The Covid-19 pandemic has massively disrupted global supply chains and the usual shipping schedule that ensures that goods flow between producers and final consumers. Supply-side disruptions boosted the headline manufacturing indices by more than the output-only indices, or in the case of Germany and the UK despite a fall in the output-only indices, as delivery times lengthened. In the case of the Eurozone they lengthened to one of the greatest extents seen in the survey's near 24-year history. In the UK, amid inventory build-up ahead of Brexit delivery times at UK ports lengthened by the third most since 1992.

Near-term downside risk #1 – virus trends: Covid-19 infections have been rising again in most major European countries for the past two weeks. Countries have re-introduced tighter restrictions again or will likely do so after Christmas the latest. The strong seasonality element of the coronavirus suggests continuously high infection rates and thus restrictions in coming weeks and months. Tighter restrictions will hurt economic activity in the weeks ahead.

Near-term downside risk #2 – supply constraints: The press release to the PMI surveys highlight the issues we reported on last Friday (see surging shipping costs – good or bad news?). Signs of supply problems in manufacturing are showing up as global transport has hit capacity constraints. As a result, some major producers are unable to fully meet the rising demand among firms to replenish stocks in anticipation of a robust global rebound in 2021. The usual seasonal uptick in spending around Christmas adds additional demand-side pressure.

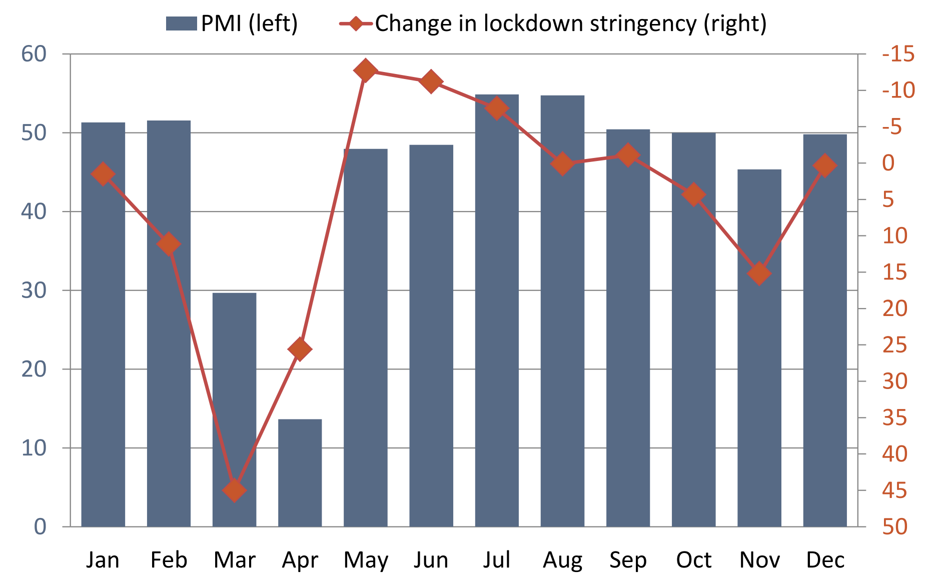
Medium-term outlook remains exceptionally bright: We expect infection rates to come down in spring with the advent of warmer weather and the on-going or soon-to-start inoculation for SARS-CoV 2. As a result, countries will probably be able to loosen restrictions again in spring without the fear of having to re-impose them significantly again as more people get vaccinated. At the same time, the dislocations in global logistics and supply chains will not last forever. Early next year, conditions should stabilise as demand patterns normalise and the high prices induce shipping companies to transport empty containers to where they are needed. Consequently, re-imposed restrictions and emerging supply constraints could trigger a renewed PMI in early 2021 and delay the much-anticipated recovery. But they will unlikely have a significant impact on the medium-term outlook as any near-term disappointments due to extended virus risks will be offset by faster catch-up growth thereafter.

Chart 1: European composite purchasing managers' indices (PMIs)



50=no change. Source: Markit, Berenberg

Chart 2: Changes in stringency of restrictions vs. changes in PMI



PMI, left hand scale. Oxford University lockdown stringency indices, 0 to 100 (most stringent), mom change in points, right hand scale, inverted. Oxford University collects information on policy responses (containment and closure, economic and health system policies), scores their stringency and aggregates scores into a stringency index. Source: Markit, Oxford University, Berenberg

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