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EUROZONE ECONOMIC ROUGH PATCH SPREADS

Berenberg Macro Flash

The economic slowdown which began in the Eurozone core in spring is spreading. The currency area's PMI manufacturing declined from 51.8 to 50.7 in August, its lowest level since July last year. Sentiment declined across most of the region, with Italy now joining France below the 50 mark. In Germany and Spain, manufacturing activity continued to expand, but at slower rates. The few bright spots included record new orders in Spain and Greece returning above the neutral 50-mark for the first time since May. The uncertainty caused by Russia's aggression in Ukraine now hurts all, but the underlying differences between strong Germany and the reformed periphery on one side and reform laggards Italy and France on the other side continue to shine through. The latest escalation of Russia's aggression, and the likely stepping up of Western sanctions and Russian countersanctions, indicate that the overall weakness could get worse. On the other hand, the weaker euro and strong growth in the US and other important export markets may act as a stabiliser.

As manufacturing is globally integrated, external factors usually matter most for the monthly volatility. However, persisting inter-country differences can be attributed to structural domestic weaknesses such as inflexible labour markets. The crisis in Eastern Ukraine has weighed particularly on German manufacturers in recent months. The manufacturing PMI fell to 51.4 in July, from 52.4 in July and a peak of 56.5 in the beginning of the year. Unfortunately, the rest of Eurozone manufacturing is not immune. The "Putin effect" on Germany compounds the home-made problems in the weakest members, particularly Italy (PMI manufacturing fell to 49.8 from 51.9) and France (46.9 from 47.8), where serious structural reforms are needed to allow companies regain competitiveness. Where these reforms have taken place, for instance in Spain and Greece, manufacturers fared better. In Spain, the manufacturing PMI fell to 52.8, but new orders were growing at their fastest pace since 2007. And in Greece, the volatile measure rose to 50.1 in August, above France and Italy. A solid expansion in Greek manufacturing output and a modest increase in orders partly corrected the dip in sentiment in June and July.

Manufacturing PMI

Index level	AUG	JUL	JUN	MAY	APR	MAR
Eurozone	**50.7**	**51.8**	**51.8**	**52.2**	**53.4**	**53.0**
Italy	49.8	51.9	52.6	53.2	54.0	52.4
Spain	52.8	53.9	54.6	52.9	52.7	52.8
Germany	51.4	52.4	52.0	52.3	54.1	53.7
France	46.9	47.8	48.2	49.6	51.2	52.1
Greece	50.1	48.7	49.4	51.0	51.1	49.7

Source: Markit