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EUROZONE PMIS CARRY STRONG MOMENTUM INTO Q2

Berenberg Macro Flash

Eurozone PMI, April

	Composite	Manufacturing	Services
Actual	56.7	56.8	56.2
Previous	56.4	56.2	56.0
Consensus	56.4	56.0	55.9
Berenberg	56.5	56.2	56.1

Eurozone business activity rises to six-year high, despite political risks stemming from the upcoming French elections. According to flash PMIs, the upswing registered in Q1 may gain further momentum in the second quarter. Taken at face value, the composite output index of 56.7 suggests a rate of expansion of 0.7% qoq for GDP in Q2, up from 0.6% in the first quarter (see chart 1). This compares to our forecasts of 0.4% for both quarters. While the PMI is a fairly good coincident indicator for GDP qoq growth and other soft data also point to a firming recovery, the hard data (such as industrial production and retail sales) have been more subdued this year – which is why we err on the side of caution, for now, especially in the face of immediate political risks.

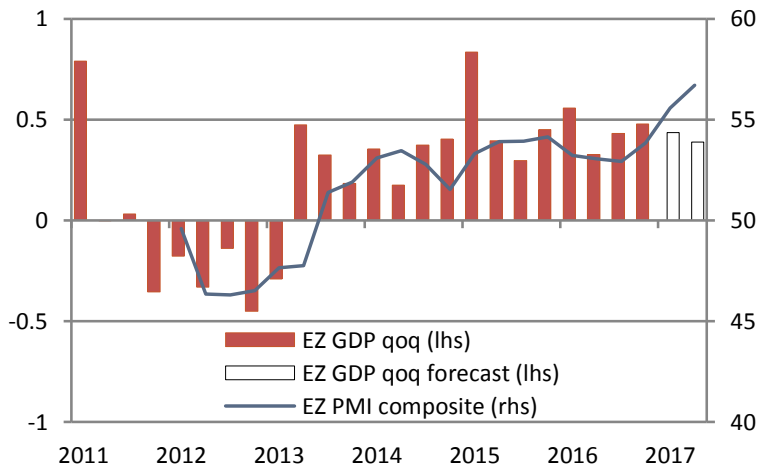
Sellers' markets: The further acceleration in activity was broad-based – both manufacturing and services contributed. Manufacturing continues to benefit from the competitively valued exchange rate, with the reading for exports rising to the strongest level since April 2011. Job creation remained strong in both sectors, with employment gains in manufacturing the highest since 2000. This underpins higher consumer confidence and household spending – with positive impetus especially for service providers. Although prices charged rose slightly slower than March's near six-year high, inflationary pressures remain elevated as many markets turn into a sellers' market – businesses do not have to carry the burden of rising costs (alone) as they can increasingly pass it on to their customers. We need to watch these changes closely as they may signal a gradual rise in underlying inflationary pressures. We expect core inflation to pick up from its recent 0.8% average to slightly above 1% by late 2017.

The PMIs numbers softened in Germany, while the rest of the Eurozone, France in particular, seems to weather the political uncertainty encouragingly well. Most businesses will have likely based their rising optimism on hopes that a pro-business reformer (Macron or Fillon) will become the next French president. For more on Germany and France, see below.



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Chart 1: Eurozone – PMI composite, GDP (qoq, in %) and Berenberg GDP forecast (qoq, in %)



Quarterly average for PMI, April 2017 as a proxy for Q2. Sources: Markit, Eurostat, Berenberg forecasts.

German PMI, April

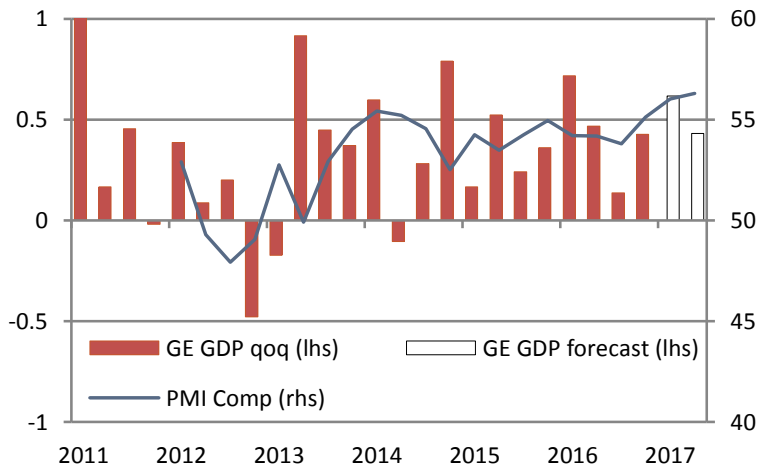
	Composite	Manufacturing	Services
Actual	56.3	58.2	54.7
Previous	57.1	58.3	55.6
Consensus	56.8	58.0	55.5
Berenberg	57.2	58.3	55.7

Although services drive German activity lower in April, picture remains rosy: The composite PMI fell to 56.3, after 57.1 in the previous month, but remains above the Q1 average of 56.0, which was the highest since Q2 2011. While the manufacturing sector registered only a slip and activity remains impressive in the c58-point region, data for service providers may hint at a softer expansion in the next couple of months. The PMI services picked up in October after its Brexit-dip in August and September. Since then it has hovered between 53 and 55 without a clear pattern of stronger momentum. In April, both outstanding and new business fell, and the outlook is the least optimistic since last November. While this is slightly at odds with an economy that enjoys a period of solid growth, near full employment and rising wages, it supports our view of slightly softer growth of 0.4% in Q2 after 0.6% in Q1 (see chart 2). But let's not forget that the level of expansion remains strong overall.



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Chart 2: Germany – PMI composite, GDP (qoq, in %) and Berenberg GDP forecast (qoq, in %)



Quarterly average for PMI, April 2017 as a proxy for Q2. Sources: Markit, Eurostat, Berenberg forecasts.

French PMI, April

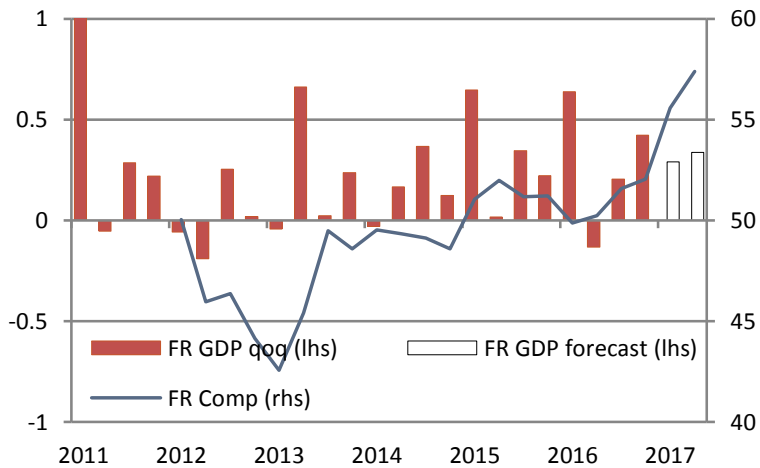
	Composite	Manufacturing	Services
Actual	57.4	55.1	57.7
Previous	56.8	53.3	57.5
Consensus	56.2	53.1	57.0
Berenberg	56.7	53.2	57.3

As the country votes, French businesses remain confident: French PMIs in April signal more momentum at the start of Q2. A strong acceleration in activity in manufacturing (55.1 after 53.3) and a further improvement in services (57.7 after 57.5) drove the composite to 57.4 (after 56.8 in March and 55.6 in Q1), indicating the strongest rate of growth in almost six years. Save a major shock in the first round of elections this Sunday, leaving a pairing between the two radicals Le Pen and Melenchon, activity in the French private sector should solidify on: new business rose for the tenth consecutive month to the highest level since May 2011. Manufacturing benefitted particularly from an inflow of orders from abroad thanks to a competitively valued euro. To accommodate higher current and future output, businesses rose in both major sectors of the economy are taking on more staff. The trend we have observed since November last year continues. The rate of job creation quickened to a 68-month high. That the amount of unfinished work rose with backlogs increasing to 14 months shows strong underlying demand. Businesses raised their 12-month outlook to a series high. Businesses see the road ahead also rosier since selling prices increased for the first time in five years. What we have observed in more and more parts of the Eurozone seems to take place in France, too. Despite the slightly weaker link between French PMIs and GDP qoq growth than in the Eurozone case, this year's numbers suggest an upside risk to our call for a rate of expansion of 0.3% for Q1 and Q2 (see chart 3).



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Chart 3: France – PMI composite, GDP (qoq, in %) and Berenberg GDP forecast (qoq, in %)



Quarterly average for PMI, April 2017 as a proxy for Q2. Sources: Markit, Eurostat, Berenberg forecasts.

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