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EUROZONE OUTLOOK REMAINS POSITIVE DESPITE PMI CORRECTION

Berenberg Macro Flash

Eurozone PMI, June

	Composite	Manufacturing	Services
Actual:	55.7	57.3	54.7
Previous:	56.8	57.0	56.3
Consensus:	56.6	56.8	56.1
Berenberg:	56.6	56.7	56.1

The sun is shining, the economy is sweet: The Eurozone economy is having its best quarter in more than six years, according to flash PMIs, despite a correction in activity among service providers in June. Eurozone fundamentals look good. Demand is growing at home and abroad. Meanwhile, there is a good chance that economic reforms in France trigger institutional adjustments in the Eurozone that could underpin stronger growth in the currency union as a whole.

Upside risks to our forecasts: The upswing may have gained further momentum in the second quarter. Taken at face value, the quarterly average of the PMI composite output index of 56.4, after 55.6 in Q1, suggests an acceleration in the rate of expansion to 0.6-0.7% qoq for GDP in Q2, up from 0.6% in the first quarter and 0.5% in Q4 2016 (see chart 1). This suggests some upside risk to our conservative forecast of 0.4%. After two strong quarters of business investment growth (3.4% and 1.3% qoq in 2016 Q4 and 2017 Q1, respectively), we expect a little moderation in capital spending growth in Q2 (0.5%). The PMI is a good timely indicator for GDP qoq growth. Other soft data, including consumer confidence, that reached the highest level since 2001, also indicate the recovery is firming. We still expect the current levels to exaggerate the underlying activity in the economy. The PMI's lower levels in June may be the first sign that soft and hard data will converge in the months ahead.

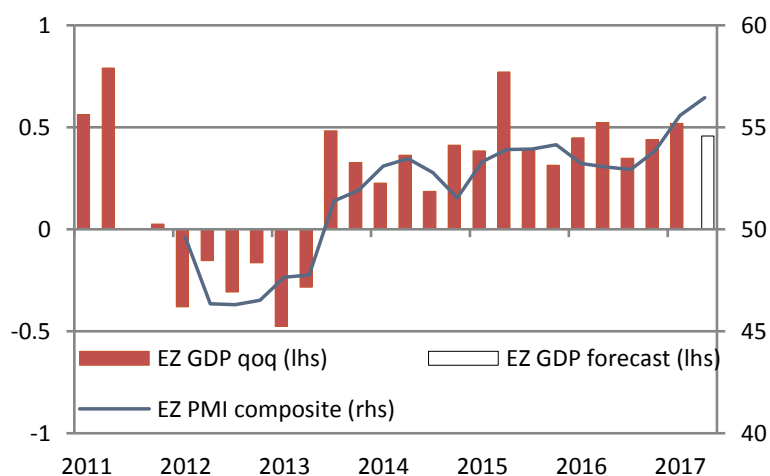
It doesn't get much better for manufacturing, while services loose some momentum: Sales of manufacturing firms rise from one high to another as the global upswing and the still competitively valued Euro raise foreign demand for Eurozone exporters. No wonder that optimism hit a new high. The PMI surveys find that growth could be even stronger, but supply does not hold up to demand despite strong employment growth (by almost the same two-decade high rate in May). Business activity expanded by less than previously among service providers, but remained robust indicating the broad-based upturn. After all, the survey suggested that the service sector created the most jobs since early 2008. The improving labour market and rising household income should drive consumption, and, therefore, more business for service providers of which a great deal operate in the retail sector.

The upturn is broad-based across the Eurozone. Despite indicating slower growth in June, the PMIs for both Germany and France, the only countries for which separate flash PMIs are published, and the rest of the region registered multi-year highs in Q2. 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. Sources: Markit, Eurostat, Berenberg forecasts.

German PMI, June

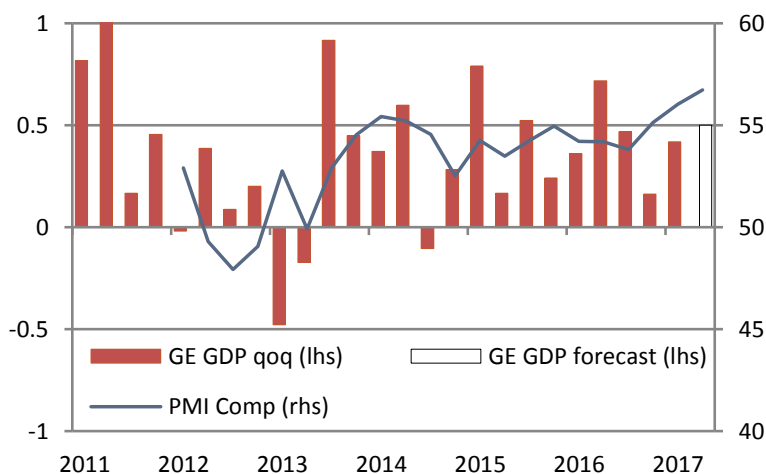
	Composite	Manufacturing	Services
Actual:	56.1	59.3	53.7
Previous:	57.4	59.5	55.4
Consensus:	57.2	59.0	55.4
Berenberg:	57.2	59.0	55.4

Services take a breather while factories operate at full throttle: The composite PMI suffered a small setback in June after reaching a multi-year high in June. Activity was down to 56.1, after 57.4 in the previous month. Still, the Q2 average of 56.7 compares to a 56.0 average for Q1, the highest since Q2 2011. The manufacturing sector registered only a small slip and activity remains impressive in the c59-point region. While growth in output and exports slowed slightly, backlogs lengthened further and total orders (exports and domestic orders) expanded by more than in the previous month. Any further slips should be put into the perspective: Activity among German manufacturers is so high that it probably won't accelerate much further. Data for service providers, on the contrary, 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 56 without a clear pattern of stronger momentum. In June, outstanding and new business increased at the slowest rate since January or September 2016, respectively. 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 0.5% in Q2 after 0.6% in Q1 (see chart 2).



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



Quarterly average for PMI. Sources: Markit, Eurostat, Berenberg forecasts.

French PMI, June

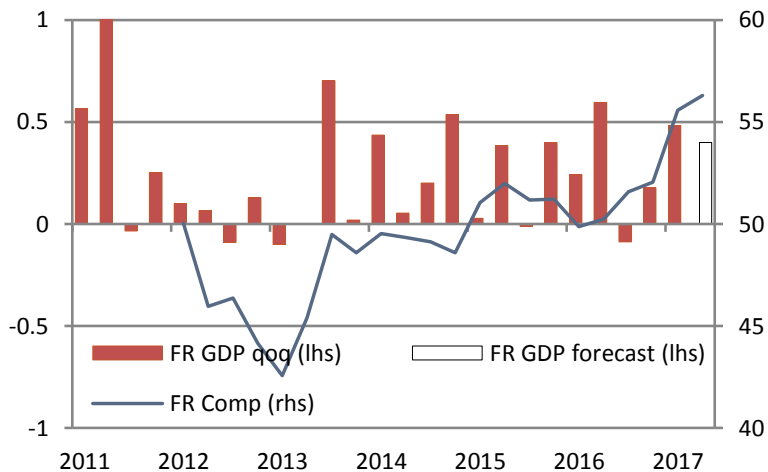
	Composite	Manufacturing	Services
Actual:	55.3	55.0	55.3
Previous:	56.9	53.8	57.2
Consensus:	56.7	54.0	57.0
Berenberg:	56.7	54.0	57.0

French business activity eases, but remains rosy: The French PMI in June surprised slightly on the downside after the six-year peak of the composite index in May. A further pick-up in activity in manufacturing (55.0 after 53.8 in May) could not offset a slowdown among services providers from 57.2 to 55.3 in the previous month. This is nothing to worry about. Taken the last three months together the PMI composite rose to 56.3 in Q2, after 55.6 in Q1. The French PMIs are not a close tracker of French GDP growth. Still, they and that GDP growth in Q1 was revised up to 0.5% qoq point to an upside risk of our Q2 forecast of 0.4% (see chart 3). The prospects of the French economy look as promising as it can get: President Macron and his political movement won a majority in the parliamentary elections last Sunday and look set to overhaul the country with a slew of labour market reforms. Firms across both the manufacturing and service sectors sent a particularly upbeat message with respect to employment which recorded the sharpest rise for almost ten years. The ongoing cyclical recovery, which looks set to gather further pace as new orders increased sharply at both manufacturers and service providers, may make Macron's reform task easier.



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



Quarterly average for PMI. Sources: Markit, Eurostat, Berenberg forecasts.

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