



Florian Hense, Economist | florian.hense@berenberg.com | +44 20 3207 7859

EUROZONE PMIS: ECONOMY STARTS 2018 WITH 12-YEAR-RECORD GROWTH

Berenberg Macro Flash

Eurozone PMI, January

	Composite	Manufacturing	Services
Actual:	58.6	59.6	57.6
Previous:	58.1	60.6	56.6
Consensus:	57.9	60.3	56.4
Berenberg:	57.9	60.3	56.4

If the Eurozone's new year resolution was to do even better this year, it seems to be off to a good start: January survey data point to a further pick-up in momentum at the start of the year with the PMI composite rising to 58.6, after 58.1 in December and 57.2 in Q4. A pick-up in momentum among service providers offset smaller gains in activity in the manufacturing sector. While the gains in the services index matched the drop in the manufacturing index, as services makes up a bigger share of the economy (roughly three times as much), the overall PMI composite rose. With employment growing strongly and wage growth gradually edging up, confidence and spending are on the rise – this drives demand for domestic services. At the same time, strong foreign demand for Eurozone products compensates for a loss in cost competitiveness amid a stronger euro. All in all, this suggests a continued above-trend expansion in 2018. Given the strength of the recent PMI data, the upside risks to our GDP calls of 0.6% qoq in Q4 2017 and Q1 2018 are rising (see chart).

The PMI surveys have two implications for tomorrow's ECB meeting: First, underlying price pressures are building, gradually and not only in Germany – the PMI input and output price index reached 7-year highs. While the recent uptick is partly due to higher oil prices, producers' pricing power has also risen. As demand is outpacing supply growth, businesses start to raise prices that go beyond just passing on the higher input costs. This smells like the demand-pull inflation the ECB is looking out for, even if this is early on. Second, the surveys do not signal that the stronger euro had an impact on businesses' activity or outlook. The ECB may, therefore, not need to use its words tomorrow too carefully when being asked on the next steps. However, we still expect Draghi to use some verbal intervention to slow down further gains after the euro crossed 1.23 US dollar this morning.

German businesses sustained strong activity into 2018: The German PMI composite slipped only marginally in January from its 6.5 year peak in December (58.8 after 58.9). The strongest gains in seven years among service providers offset slightly weaker momentum in the manufacturing sector. The small correction among manufacturers comes after activity had risen to the highest seen over the past two decades, thanks to a marked pick-up in demand for German exports amid the cyclical upswing across the globe. As Germany enjoys its golden decade with above-trend growth, record-high employment and a fiscal surplus, an unusually long government building process does not deter the economy from running at full throttle. And there is no obvious reason why this should change. Businesses look with strong optimism towards 2018 and have not lost their taste for expanding their production capacity – job creation showed the second-steepest rise in private sector employment since 1998.

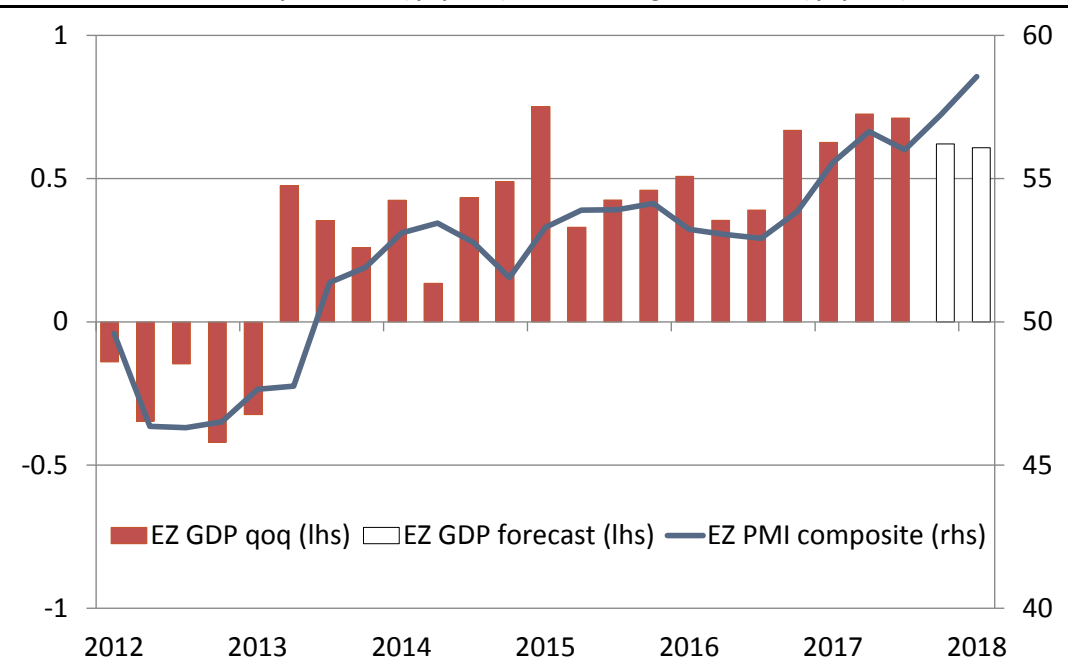


MACRO NEWS

The French economy continued its strong run at the beginning of 2018: The PMI composite was broadly unchanged in January (at 59.7 after 59.6 in December). While a bit shy of November's 6.5 year peak (60.3), it was above the Q4 average (59.1) and among the highest recorded in the survey's 20-year history. Weaker growth among manufacturers was offset by stronger services momentum. As in the previous months, backlogs lengthened further despite strong job creation. Forward-looking indicators bode well for the new Year: new orders rose at the highest pace since April 2011, and business confidence, despite a small slip, remained elevated. If surveys continue to come in roughly at the buoyant end-of-2017 pace, we could start 2018 on the same strong footing as the previous year, with GDP expanding at 0.6% qoq or more, rather than 0.5% as we expect so far.

Outside Germany and France, business activity accelerated to the fastest pace since July 2006.

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



Quarterly average for PMI, January PMI as proxy for Q1. Sources: Markit, Eurostat, Berenberg forecasts.

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Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com