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EUROZONE PMIS: TAKING A LITTLE BREATHER AFTER MARKET CORRECTION

Berenberg Macro Flash

Eurozone PMI, February

	Composite	Manufacturing	Services
Actual:	57.5	58.5	56.7
Previous:	58.8	59.6	58.0
Consensus:	58.4	59.2	57.6
Berenberg:	58.4	59.2	57.6

Taking a little breather: The market sell-off and surge in volatility in early February took a toll on business sentiment in February for the Eurozone, Germany and France. According to the PMI surveys, both manufacturers and service providers signaled a slower pace of output and order growth. But, the correction in the level of activity and optimism was only small – the PMI composite dropped from 58.8 in January to 57.5. This follows a strong run over the last couple of years, with an euphoric sprint recently to a 12-year high in January. Our three key takeaways: First, the soft data has been a little bit excessive over the last couple of months and has come down to earth. Second, we expect the correction to have no major impact on the current momentum of the economy. Third, the February level still remains at a level that suggests the economy will continue to grow well above trend.

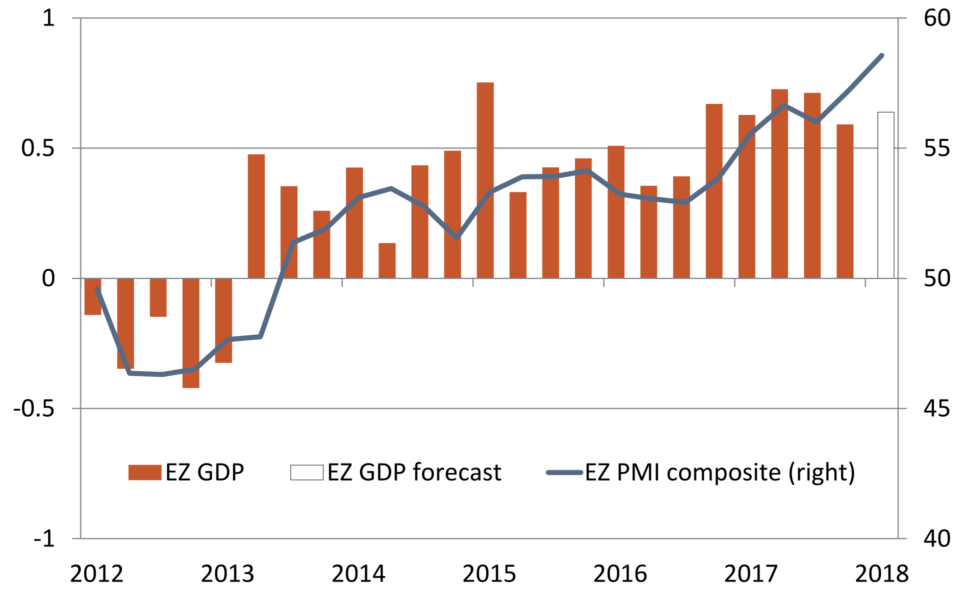
Equity market sell-off will unlikely show up in hard data: The lower PMI surveys (and yesterday's ZEW and ESI consumer confidence) confirm our expectations earlier this month that the equity market correction would weigh a little on confidence. When rises in asset prices are coupled with excessive gearing, a fall in the values of assets can have negative balance sheet and wealth effects. But this is not a major risk today, certainly not in the Eurozone. We thus expect only a temporary and modest impact on confidence, and an even smaller one, if any on the hard data. The rise in two key PMI subcomponents, namely business optimism about the year ahead rising to a survey high and pricing power improving, suggests that businesses are not planning to curtail investment. We look for the economic cycle to maintain its current momentum of GDP growth of 0.6% per quarter for most quarters of this year.

Soft data realigns with hard data: The Q1 average of 58.2 (based on strong January and the correction in February) remains comfortably above the Q4 average of 57.2. If the PMIs do not moderate much further in March, Q1 looks set to be the best quarter in 12 years, according to the PMI surveys. Despite the correction in February, the soft data still suggest that the economy could expand by up to 0.8-0.9% in Q1 (see chart below). The correction in financial markets and sentiment surveys should help to realign the soft data with the hard data. We had stressed previously that surveys measure the breadth rather than the depth of the expansion and could, therefore, overestimate the actual pace of growth – in Q4 2017 and, probably, also in Q1 2018.

Both German and French business activity shifted down a gear. The **German** PMI composite fell in February from its January high (57.4 vs. 59.0), but continues to indicate robust growth in the eurozone's largest economy. The average of January and February is still above the Q4 level (58.2 vs. 57.6). The 12-month ahead optimism among service providers even spiked higher from its January level. Manufacturers' optimism suffered slightly from slower growth of export orders and outstanding business, but both remain elevated. Capacity constraints likely weigh on the pace of expansion in Germany as businesses struggle ever more to find people to hire (smallest gain in overall employment) and have to turn down extra business. We expect domestic demand to keep the German economy growing strongly at around 0.6% qoq in H1 2018. GDP growth will, however, moderate slightly in the second half of the year to 0.5% qoq as supply growth does not keep up with demand growth. In **France**, both output and the amount of new orders expanded at a slower pace than recently (4 month low). Taking January and February together, the Q1 level of the PMI composite (58.7) is just a bit shy of the Q4 level (59.1), but well above the long-term average of 53.9. Nevertheless, French businesses created more jobs in February than January according to the PMI survey. As the unfinished work keeps piling up this is likely to continue and could drive French unemployment further below 9% (8.9% in Q4). As long as the pace by which the activity expands does not fall much further, we could start 2018 on the same strong footing as the previous year, with GDP expanding at 0.6% qoq.

Outside Germany and France, business activity also moderated, but still registered the second best level in nearly 12 years.

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



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

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