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LOWER EUROZONE PMIS SUGGEST REBOUND MAY COME LATER

Berenberg Macro Flash

Eurozone PMI, May

	Composite	Manufacturing	Services
Actual:	54.1	55.5	53.9
Previous:	55.1	56.2	54.7
Consensus:	55.1	56.1	54.7
Berenberg:	55.1	56.2	54.7

Softer Eurozone PMI raise uncertainty over chance of a rebound …: Having shown signs of stabilisation in April, May saw a renewed and unexpected slowdown in manufacturing and services growth according to the PMI surveys. The composite PMI for the Eurozone dropped from 55.1 in April to 54.1 in May, the weakest in 18 months (see chart 1). It was below our and consensus' expectations of a stable reading. All key parts of the surveys, including new orders and backlogs of work, grew at a reduced pace in May. One-off factors may have once again distorted the PMIs (timing of public holidays in Germany and strikes in France). Next month's data may provide a clearer picture of the underlying momentum. Yet, the continued US-led trade tensions in combination with higher input costs (especially oil prices) weigh on sentiment and activity. The recent political uncertainty in Italy does not help either.

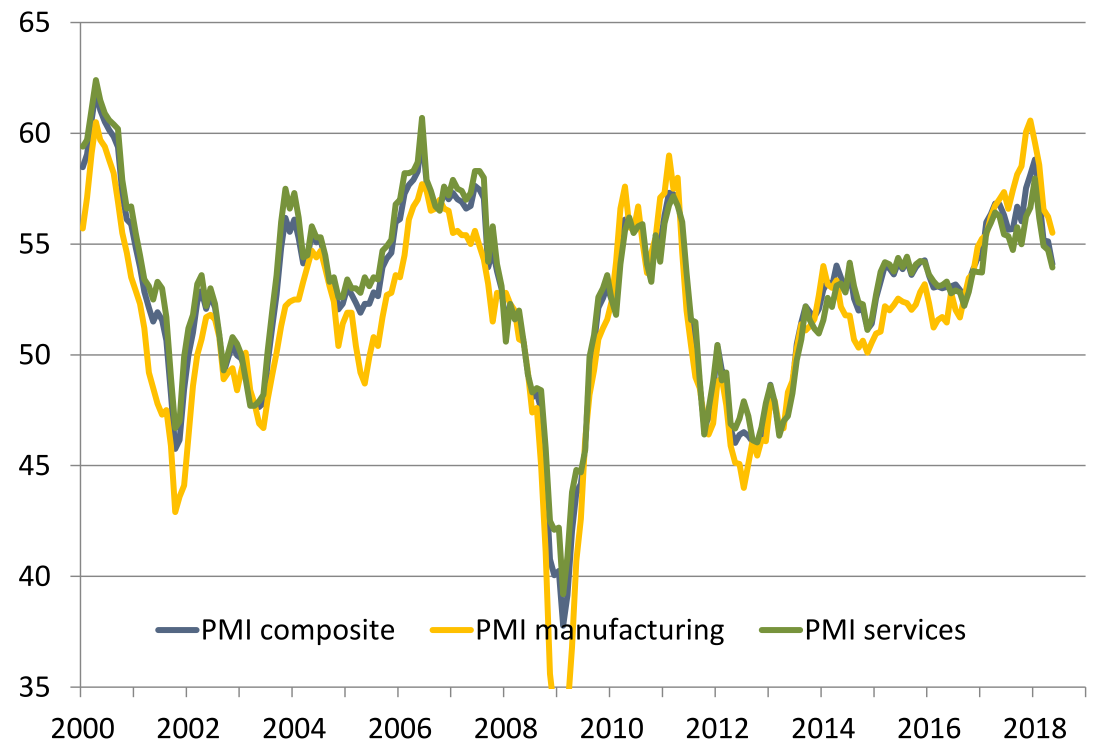
… it may just come a bit later: Taken at face value, the Eurozone PMIs point to an economy that is carrying less momentum now than a few months ago. However, the PMIs and other data have overestimated the official estimate of real GDP growth over the last couple of quarters, including the most recent one for Q1 of 0.4% qoq (for evidence on the overestimation of GDP indicators versus actual yoy GDP growth at the turn of the year, see chart 2). Survey data can be volatile and only provides a guide to current economic activity. We still expect an economic rebound later this year after the weakish Q1, towards growth rates of around or above 0.5%, but it may take more time. The modest further dip in the PMIs for May highlights the risks around that call.

Trade tensions continue to weigh on Eurozone businesses: In nine days, on 1 June, the exemption from tariffs on steel and aluminium granted to EU producers by US President Trump will end. The EU's trade commissioner Malmstrom recently raised doubts that the European proposals to open its markets wider to US products would be sufficient to make these exemptions permanent. These tariffs are too small to matter for the economic outlook – even the direct costs of a few rounds of tit-for-tat would not derail the current healthy upswing. The real risk, however, stems from the uncertainty about the future trade regime. Recent moves by the US and China had suggested that relations were heading into the direction that would see Trump get his deal for somewhat enhanced mutual market access between the US and China. While this remains our base case (chance of 50%), the risk of these tensions to continue to linger is real (35%). We attach a risk of 15% to the worst-case scenario of a trade war.

Higher input costs also weigh on Eurozone businesses: 20 consecutive quarters of GDP growth have left their mark on the labour market. While the unemployment rate of 8.5% suggests that there is still slack in the labour market, wage pressures have slowly been building. Meanwhile, the rise in the oil price from 65 USD a barrel of Brent at the beginning of the year to around 80 has contributed to higher input costs for businesses. Since pricing power remains limited given strong competition and recently weaker demand growth, output prices have not kept pace with input costs – squeezing businesses' margins and curbing their hiring plans.

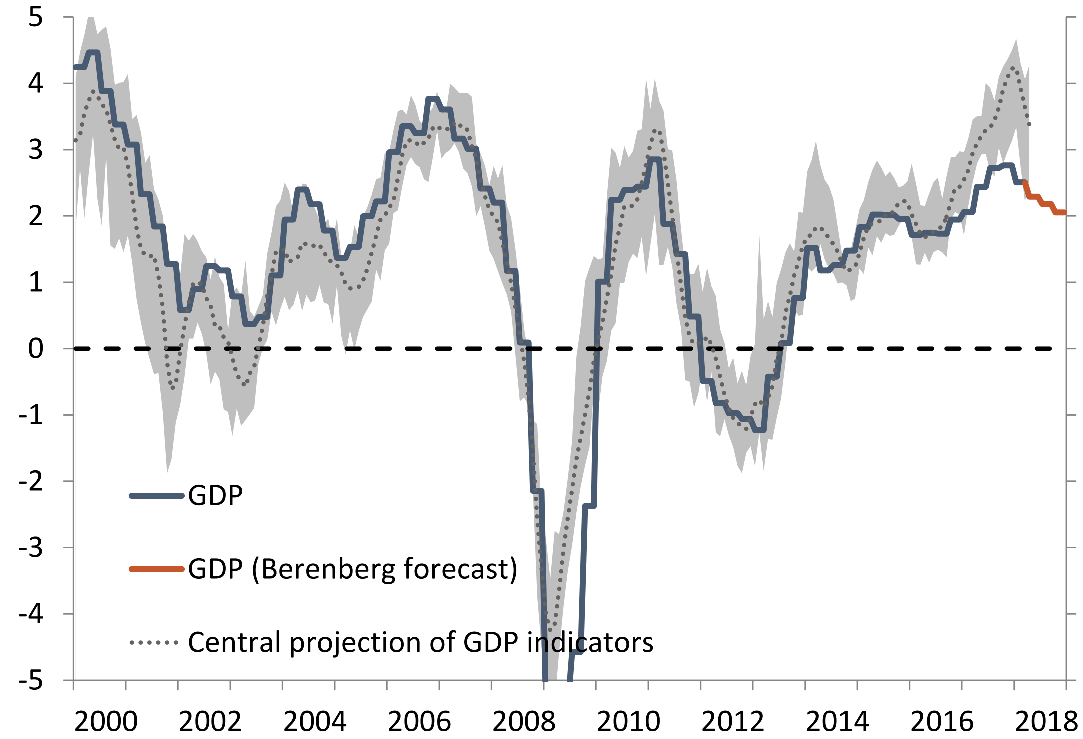
Growth slowed in both Germany and France: Germany's recent slowdown continued in May across both manufacturers and service providers. According to the press release of the PMI surveys, "the timing of public holidays during the month had led to workers taking days off to bridge the holidays and weekends". Manufacturers stressed weaker export sales and the pressure on margins due to higher input costs (oil prices and wages) and limited means to pass it on to customers. Services' order growth was reported be to be weaker, too. The unexpected drop in the French composite PMI from 56.9 in April to 54.5 in May, the lowest level since January 2017, was driven by weak numbers from services. The continued country-wide strikes are likely to have weighed on service providers' activity. Once the labour dispute is settled and the strikes come to an end in the summer, we expect a reversal of the data. A source of concern would be if the strikes were to drag on and activity were not to reverse. On a positive note, French manufacturers posted stronger growth than in the previous two months on the back of higher output, employment and new orders.

Chart 1: Eurozone PMI composite, manufacturing and services



Source: Markit

Chart 2: Eurozone GDP growth (yoy, in %), Berenberg forecast and range of GDP indicators



Quarterly data for GDP, monthly data for leading indicators. Yoy GDP growth in %. Trimmed range (25 to 75% quartile) of GDP indicators is normalised and then rebased using standard deviation and mean of GDP growth. Sources: Eurostat, European Commission, Ifo, Markit, Berenberg calculations

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