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EUROZONE: STRENGTH AT HOME LIFTS PMIS IN JUNE

Berenberg Macro Flash

Eurozone PMI, June

	Composite	Manufacturing	Services
Actual:	54.8	55.0	55.0
Previous:	54.1	55.5	53.8
Consensus:	53.9	55.0	53.8
Berenberg:	54.1	55.5	53.8

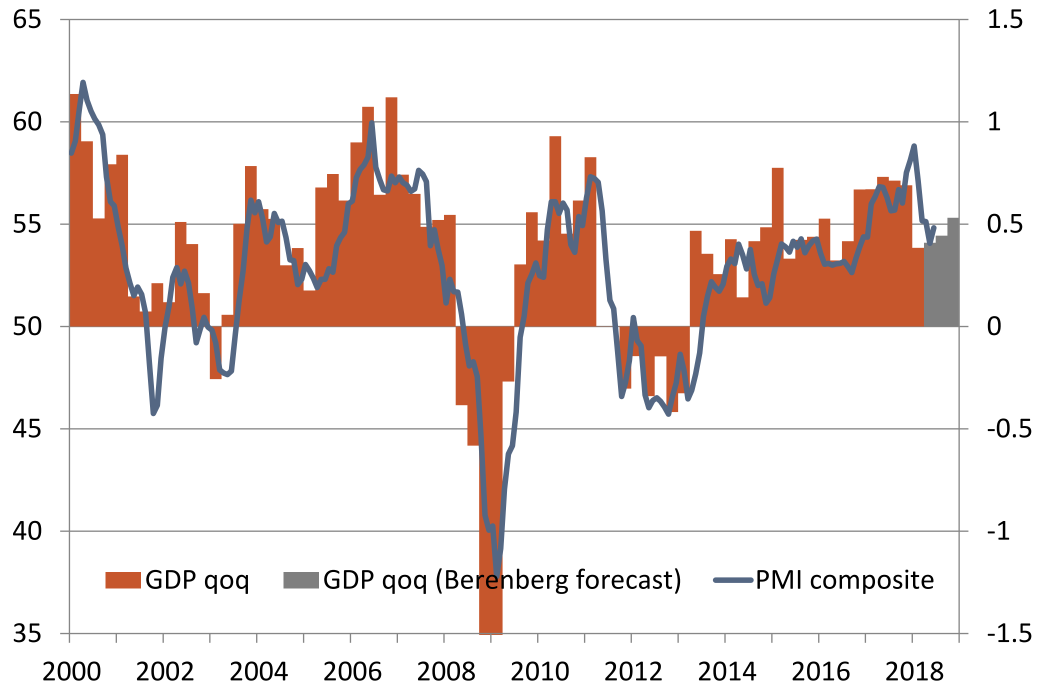
A ray of hope: Back in May, we argued that June's PMI surveys could provide a clearer picture of the underlying momentum of the economy after losses (February and March), some stabilisation (April) and then again some losses (May): After an unusually high number of holidays distorted the picture in May, the June PMIs offer a ray of hope. They draw a picture of diverging dynamics among manufacturers (weaker) and service providers (stronger) as trade war threats hurt the international outlook while a strong labour market supports domestic demand. Taken at face value, the average of the monthly PMI composite for Q2 suggests growth at 0.4-0.5% qoq. This is in line with our call for Q2 and Q3. The survey data which exaggerated growth in Q1 is now in line with the hard data (see chart). From Q4, we expect some reacceleration to 0.5% as the trade tensions fade.

Manufacturers weaker again: Export-oriented manufacturers continue to suffer from the sword of protectionism hanging over them. The external environment is less positive than at the beginning of the year. According to the PMI surveys, output growth among manufacturers slipped to the lowest since November 2016. Forward-looking indicators did not improve either: order inflows dropped to their lowest levels in 22 months, export growth remained at its 1.5-year low of May and sentiment about the year ahead dropped to the lowest since 2015. Manufacturers referenced trade tensions and political uncertainty according to the PMI press release.

Service providers stronger: The underlying fundamentals of the domestic economy of the Eurozone, including the expansion's drivers of employment, disposable income and consumption, however, remain robust. Domestic oriented service providers register a pick-up in their activity according to the PMI surveys. Activity rose at the fastest rate since February. Interestingly, prices charged showed the second-largest monthly rise of the previous decade. This points to some pricing power. Service providers enjoyed the fastest jobs growth since October 2007.

Growth has moderated in 2018, but the upswing remains healthy: In Q1, it had started as mainly a temporary dent to growth in Q1 (severe weather and flu) with the stronger euro and financial market volatility adding to the headwinds. In Q2, it turned into a more fundamental issue as trade tensions stoked by US President Trump intensified and dampened business confidence, especially among export-oriented manufacturers. This caused us to lower our GDP growth forecast from 2.5% to 2.1% for 2018. As Trump did not strike deals with China, the EU and the rest of the world over the last couple of weeks, uncertainty about the outlook continues. This will likely weigh on spending and investment decisions and, therefore, demand in Q3, too. The PMI and other soft data will, therefore, likely show no significant improvement in manufacturing activity throughout the summer. For Q2 and Q3, we expect GDP growth at 0.4% qoq, as in the first quarter, with risks broadly balanced. From autumn onwards, expect new orders to increase at a similar rate as output – which is currently not the case according to the PMI survey – and demand growth to recover to levels at around 0.5% qoq. Our base case presumes that Trump strikes deals or firms get used to the noise – even though the trade war risk is not negligible. Thereafter, capacity constraints will start to kick in, weighing on medium-term growth as labour force growth slows and productivity gains do not offset it.

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



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

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