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# THE CORE DRIVES EUROZONE PMIS HIGHER, JUST

## Berenberg Macro Flash

Eurozone PMI, August

| | Composite | Manufacturing | Services |
|---|---|---|---|
| **Actual:** | 54.4 | 54.6 | 54.4 |
| Previous: | 54.3 | 55.1 | 54.2 |
| Consensus: | 54.5 | 55.2 | 54.4 |
| Berenberg: | 54.5 | 55.2 | 54.4 |

**The Eurozone economy is split by sectors and countries:** So far, the continued headwinds for doing business abroad are not weighing on business at home, according to the Eurozone PMI surveys in August. Thanks to decent gains, and a bigger share in the composite index and the economy, domestically oriented service providers (54.4 after 54.2 in July) managed to offset slower activity among manufacturers (54.6 after 55.1) (see chart 1), thereby driving also the PMI composite higher (54.4 after 54.3). The Eurozone PMI surveys, however, suggest that whether the domestic economy is resilient to risks from elsewhere depends on the Eurozone country. Whereas momentum in Germany and France improved, PMIs elsewhere in the Eurozone point the other way.

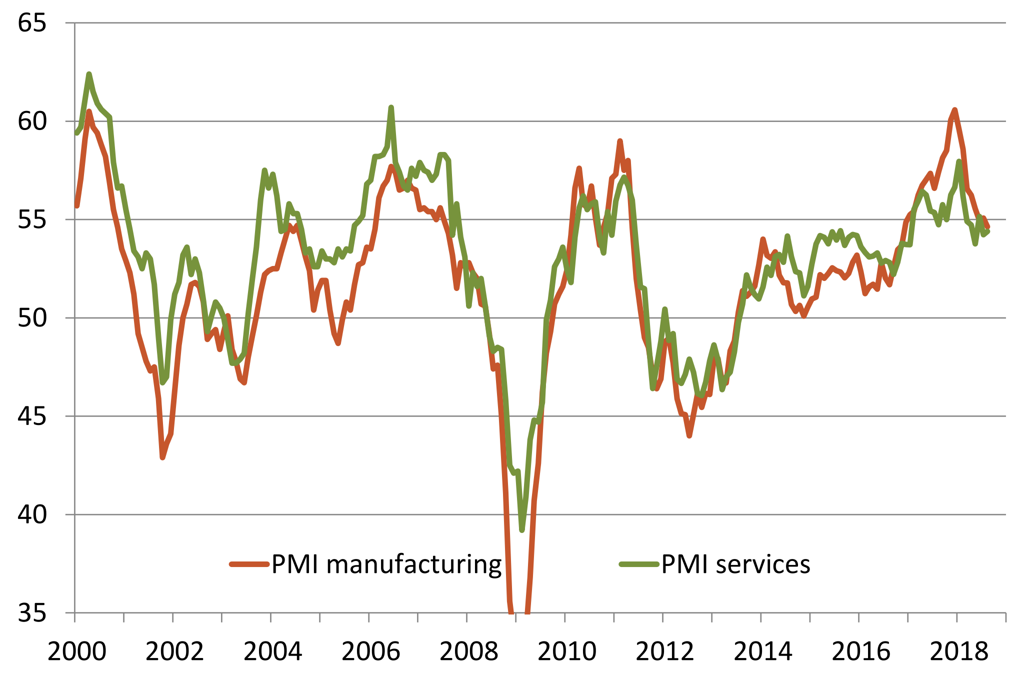
**Stuck in the middle = growing at trend:** In sum, the Eurozone economy will unlikely enjoy a significant pick-up in activity, nor will it suffer from a further slowdown in Q3 (see chart 1). Given the solid fundamentals and healthy cyclical dynamics, this is somewhat disappointing. Yet, taking into account the series of shocks (trade tensions, Turkey, Italy, oil price), there is not more in the tank right now. Going forward, the question will be whether the stronger or weaker Eurozone countries will lead the way or, put differently, whether the Eurozone economy will slowly pick up speed in late 2018 or not.

**Germany and France resilient, rest of Eurozone weak:** In Germany, continued strong employment and wage growth drove service providers' business higher by the most in 6 months (55.2 after 54.1). The German PMI manufacturing slipped slightly but remained in solid growth territory (56.1 after 56.9). In France, the PMI composite increased to a four-month high. Both services and manufacturing subindices gained thanks to robust demand at home and a renewed uptick in exports (55.7 after 54.9 and 53.7 after 53.3, respectively). The PMI survey painted a very different picture for the rest of the Eurozone, where both output and new order growth slowed to 22-month lows and expectations hit a five-year low.

**Oil and a cocktail of risks:** Trade tensions continue to weigh on Eurozone business confidence with the continued US-Chinese spat overshadowing the progress between the US and the EU. As of today, the US is slapping a 25% tariff on another set of Chinese imports worth of $16bn, and China has reacted in kind which brings the imports affected by tariffs for each side to around $50bn. The Turkey crisis has added to the uncertainty about the outlook, possibly more in Southern Europe than in Germany and France as reflected in the PMIs. The occasional noise from the Italian budget opera does not help either. The lower business confidence may have fed through to lower activity such as weaker trade growth and more conservative investment decisions. While capital formation has held up encouragingly this year, it remains subdued for this stage of the cycle – utilisation levels are close to their 10-year highs and equipment has turned into a supply constraint besides labour shortage (see chart 2). The main pillar and driver of demand, private consumption, benefits from the strong employment gains and pick-up in wages. The currently higher inflation due to the past rise in the price of oil, however, is driving a big wedge between nominal and real consumption, limiting its contribution to real GDP growth.

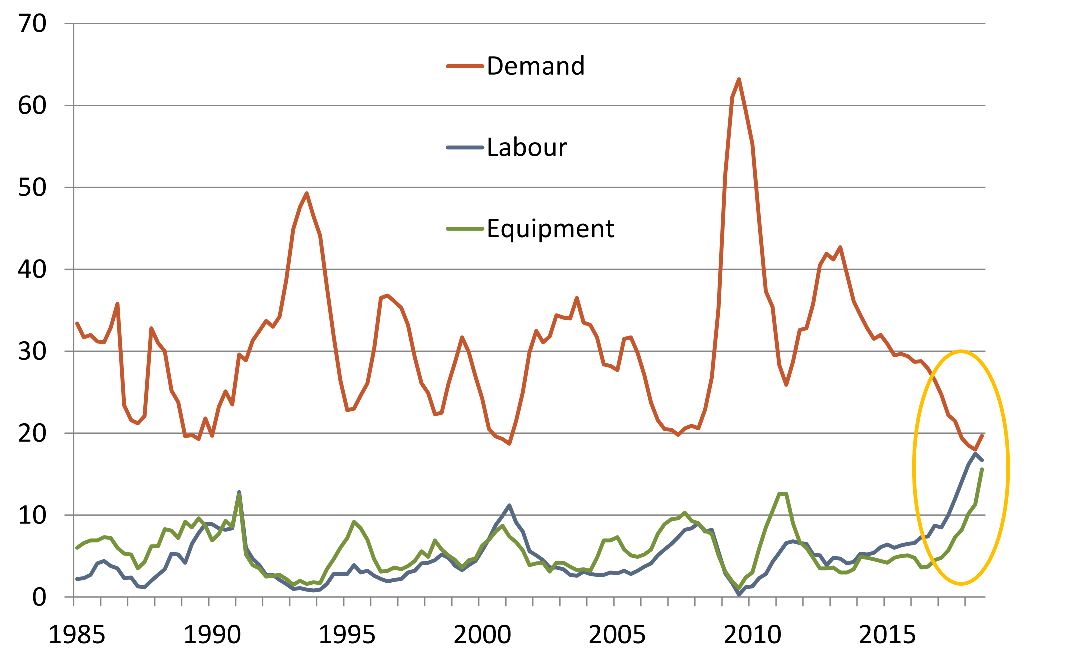
**Pick-up in activity later this year?** After a stellar performance in 2017 with quarterly growth rates of 0.7% qoq on average, Eurozone growth has dropped to a pace of just below 0.4% in both Q1 and Q2 in 2018 – largely due to a lower contribution from net trade with domestic demand holding up nicely. Growth at around trend, in annualised terms 1.5%, will also likely be the cruising speed in Q3 (see chart 3). So far, we expected some pick-up at the end of this year (Q4 2018 and 2019: 0.5% qoq and 2% annualised) as long as the trade war fears would fade, the spillovers of the Turkey crisis would remain somewhat limited and energy prices would not climb to new highs. Forward-looking indicators of the PMI (order growth and optimism) pointing to possibly more quarters of Eurozone growth just at around trend pose some downside risk to that call.

**Chart 1: Eurozone PMI manufacturing and services**



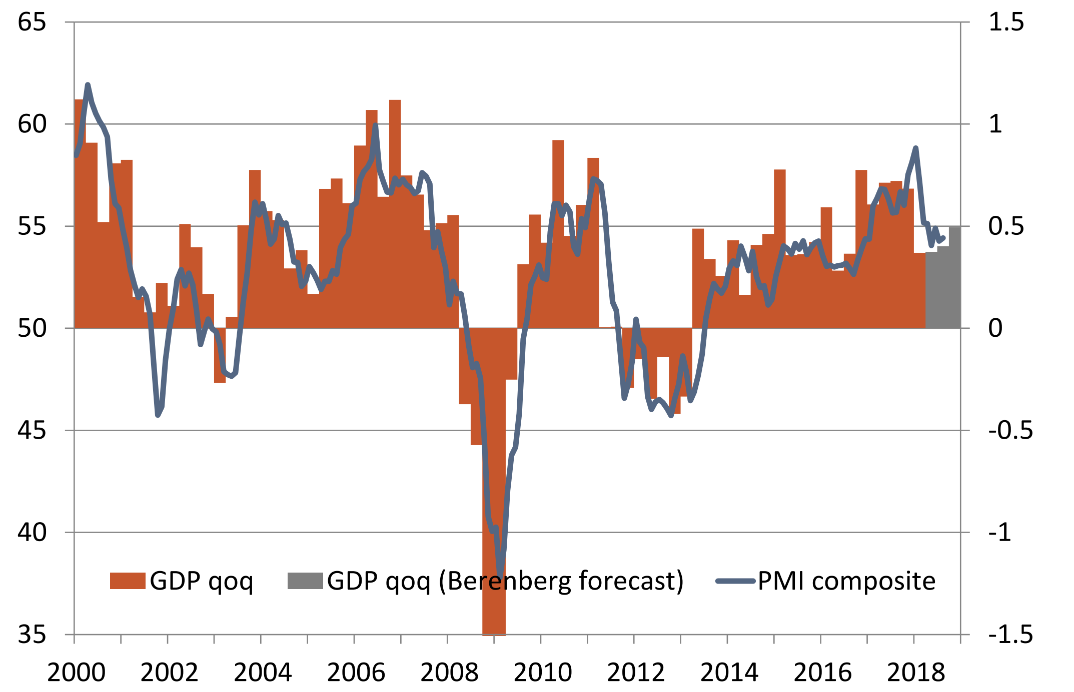

*Source: Markit*

**Chart 2: Limiting factors to production**




*The answers "demand", "labour" and "equipment" refer to the European Commission's economic sentiment survey's question of what limits the production of Eurozone manufacturing companies. Source: European Commission*

**Chart 3: Eurozone PMI composite, GDP growth (qoq, in %) and Berenberg forecast**




*Quarterly data for GDP, monthly data for PMI. Sources: Markit, Eurostat, Berenberg calculations*

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