MACRO NEWS 23/05/19

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

# EUROZONE BUSINESSES WEIGH CONFLICTING TRADE TRENDS

## Berenberg Macro Flash

**Eurozone PMI, May**

| | Composite | Services | Manufacturing |
|---|---|---|---|
| **Actual:** | **51.6** | **52.5** | **47.7** |
| Previous: | 51.5 | 52.8 | 47.9 |
| Consensus: | 51.7 | 53.0 | 48.1 |
| Berenberg: | 51.7 | 53.0 | 48.1 |

**German Ifo, May**

| | Business climate | Expectations | Current assessment |
|---|---|---|---|
| **Actual:** | **97.9** | **95.3** | **100.6** |
| Previous: | 99.2 | 95.3 | 103.4 |
| Consensus: | 99.1 | 95.0 | 103.5 |
| Berenberg: | 99.4 | 95.0 | 103.7 |

**As Eurozone businesses weigh the escalation in US-China trade talks with the US reprieve on tariffs on European cars by up to six months, they continue to tread very carefully.** Whereas activity among Eurozone purchasing managers stayed almost unchanged in May (PMI composite at 51.6 after 51.5 in April, see chart 1), German Ifo business sentiment dropped significantly from 99.2 to 97.9 (see chart 2). The two separate surveys both suggest that export-oriented manufacturing remains weak whereas domestically-oriented services continue to do much better. For the month of May, both reports show signs of a stabilisation at a low level in manufacturing and some contagion from manufacturing to the services sector (see chart 3). Taken at face value, the stable PMI surveys may suggest GDP growth in Q2 could come in similar to the positive surprises in Q1. However, as the positive one-offs that had boosted Q1 GDP will partly go into reverse in Q2, we look for significantly more subdued GDP growth in Q2 of 0.2% qoq for the Eurozone after 0.4% in Q1.

**German activity expanded by a little bit more than previously, but remained overall in only modest growth territory** according to the PMI surveys (PMI composite at 52.4 in May after 52.2 in April). The gap between service providers and manufacturers closed a little, but remains yawning. While activity gains among service providers slowed a little, manufacturers' business was less downbeat than previously thanks to improving indicators for output, total and export orders. If this continues, manufacturers' outstanding business and incentives to hire should pick-up again. At this stage, we do not read much into a third straight monthly decrease in this sector's employment. The Ifo index, however, highlights the risk for the German economy. While business expectations did not fall further (unchanged at 95.3), the assessment of the current situation dropped significantly (from 103.4 down to 100.6, see chart 2). It indicates that Q2 growth will indeed fall short of the Q1 pace.

**In France activity returned to services-led growth for the first time in six months** (PMI composite at 51.3 in May after 50.1 in April). A recovery in orders, outstanding businesses and expectations, albeit still subdued, raise hopes that the return to growth should not be just a one-off and activity could pick-up further. Manufacturing production and export orders continued to fall, but by less than previously.

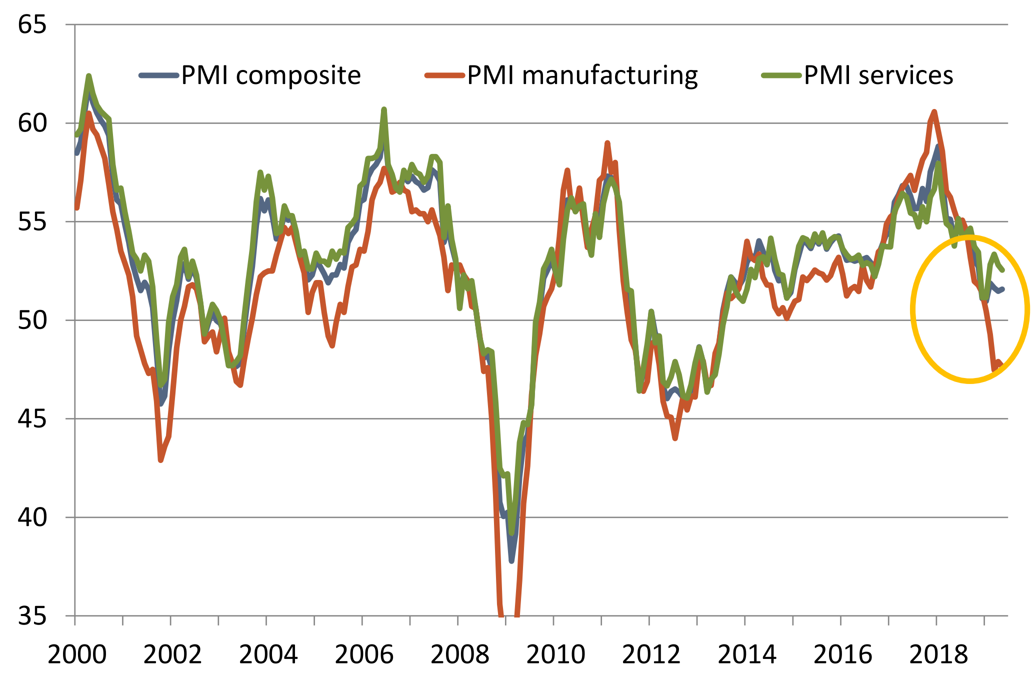
**The rest of the Eurozone remains a source of concern** with growth close to stagnation and orders falling for the first time in almost six years. As most Eurozone countries have close trade ties to Germany – and catch a cold when the German Mittelstand sneezes, some of them lack the rock-solid domestic fundamentals of their bigger neighbour that drive consumption and investment anyway, almost no matter the external headwinds.

**Soft data vs. hard data:** In 2018, the hard data had mostly come in weaker than the soft data had suggested, partly due to one-off drags. In Q1, it was all in reverse. Almost across the board in the advanced world, the hard data defied the softer surveys. The Eurozone was no different and surprised to the upside with GDP growth of 0.4% qoq in Q1 (see chart 4). If the current surveys are anything to go by, and for lack of any hard data, Q2 should play out as Q1 did – the average for April and May of the PMI composite is unchanged from Q1 at 51.5. That would not be too bad. But there is a catch.

**Q2 unlikely as good as Q1:** While the domestic side of the economy held up very well, in both cases positive one-offs provided a tailwind in the first quarter of this year. An unusually mild winter gave construction an outsized boost and the late timing of Easter shifted Easter holidays fully into Q2. In Germany a number of fiscal measures and consumers catching up on their car purchases added to an unsustainable rise of 1.2% qoq in household spending as a second reading showed earlier today. Abstracting from these effects, the performance looked a little more subdued. So, we should not read too much into the positive Q1 and instead take the continued weak level of the soft data seriously. With one-off boosts likely to be absent and Eurozone industry still struggling, we thus expect Q2 to be a weaker quarter with qoq growth of 0.1% in Germany and 0.2% in both France and the Eurozone. Our forecasts for German, French and Eurozone growth of 0.8%, 1.2% and 1.1% for 2019 remain below the Bloomberg consensus of 0.9%, 1.3% and 1.2%, respectively, owing largely to our lower Q2 calls.

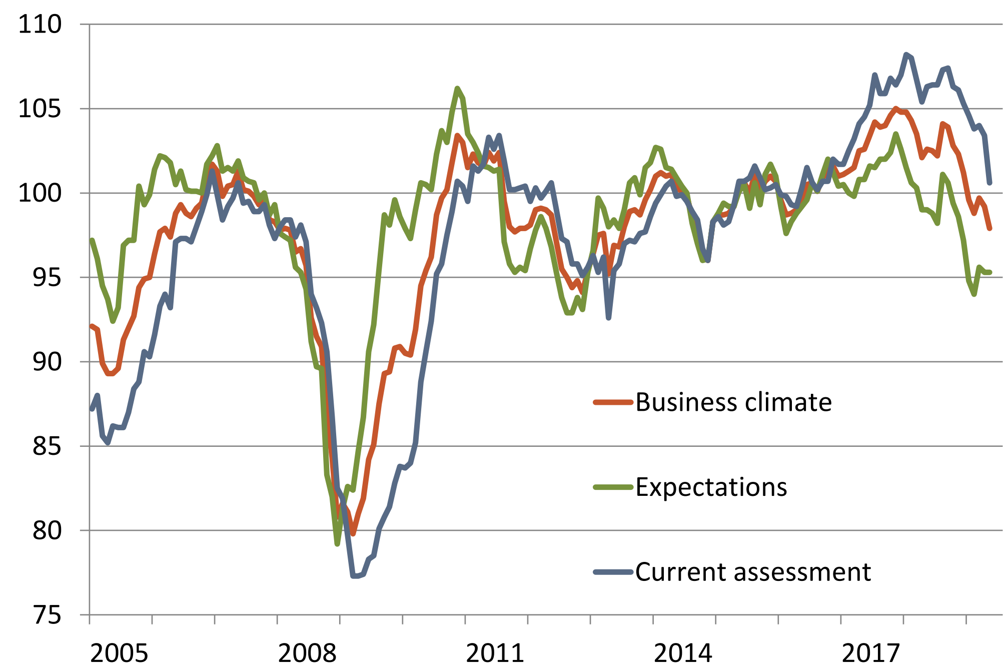
**Chances for a sustained recovery in H2:** Whereas the US and China are both playing hardball, US President Trump has delayed his decision about punitive tariffs on car and car part imports from the EU, Japan and others by up to six months. While US-EU talks could make headlines over the autumn, on balance, the reprieve supports the call that manufacturing and growth could turn up again modestly in the Eurozone during the second half of the year. The Chinese stimulus, which is already in the pipeline but only starting to show up in some data, should add to that.

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



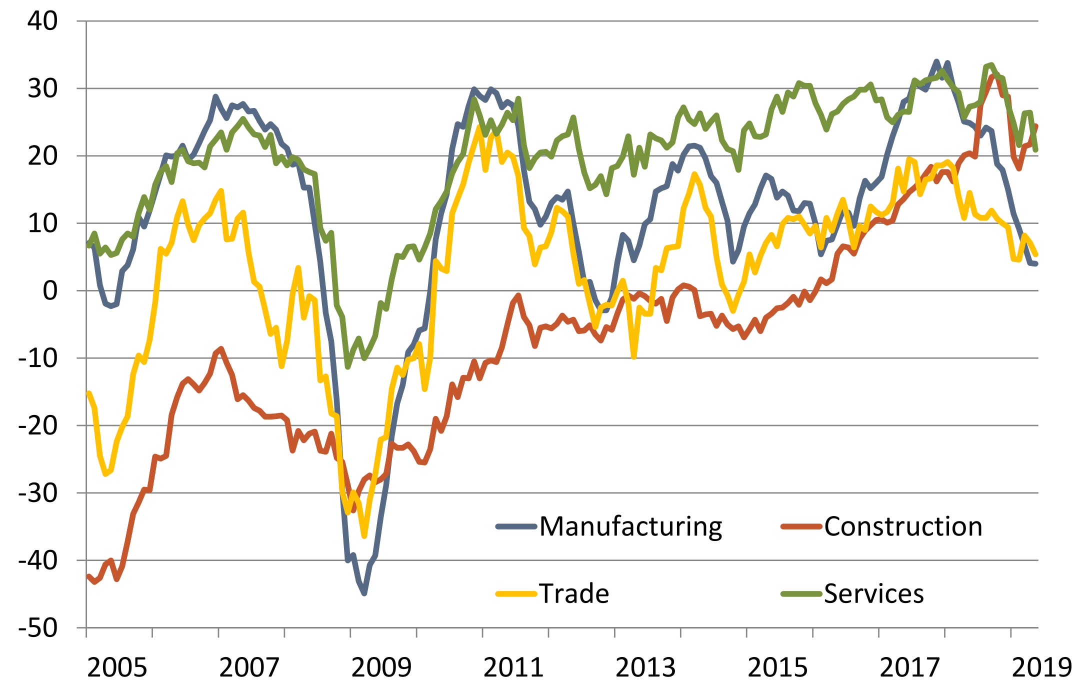

*Source: Markit*

**Chart 2: Ifo business climate, current assessment and expectations**



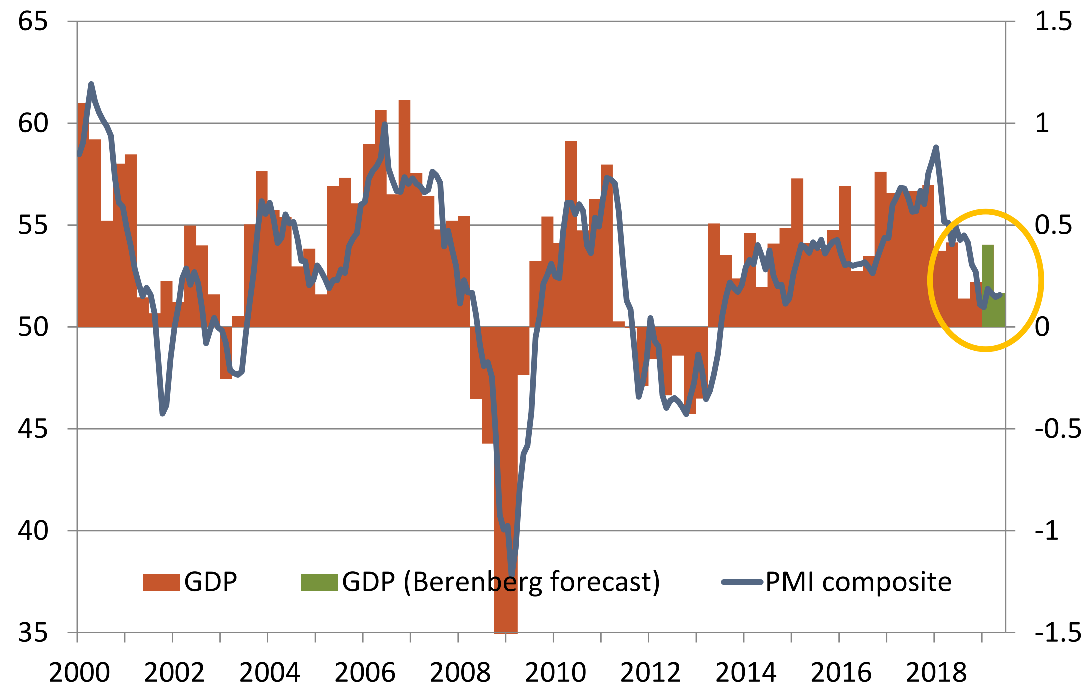

*Indexed at 2015=100. Source: Ifo*

**Chart 3: Ifo business climate by sector**




*Source: Ifo*

**Chart 4: Eurozone PMI composite versus GDP (qoq, in %)**




*Source: Markit*

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