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EUROZONE PMIS SIGNAL SLUMP HAS MORE ROOM TO RUN

Berenberg Macro Flash

Eurozone PMI, July

	Composite	Services	Manufacturing
Actual:	**51.5**	**53.3**	**46.4**
Previous:	52.2	53.6	47.6
Consensus:	52.2	53.3	47.7
Berenberg:	52.1	53.3	47.6

Another setback: After some tentative signs in the past two months that the Eurozone slowdown was about to come to an end, latest PMI data suggested the slump has more room to run and deepen yet further in Q3. The PMI composite fell from 51.8 in May and 52.2 in June to 51.5 in July (see Chart 1). We – and markets – had expected no change versus June. According to the PMI survey, the manufacturing sector experienced the worst month since December 2012 amid trade tensions, geopolitical worries, a hard Brexit risk, with the car sector struggling. Both current output and new business expanded at a slower pace, while export orders dropped. German manufacturers were particularly hit, but also their French competitors felt the brunt.

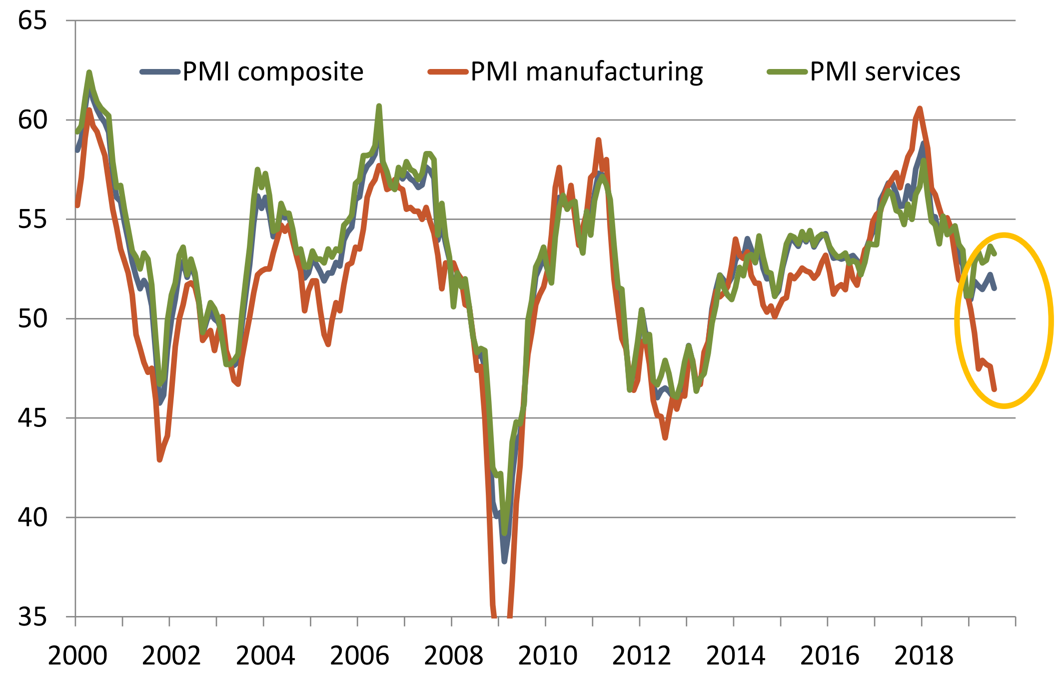
Resilient domestic demand underpinning growth economy: The still-solidly performing domestically-orientated services continue to keep the economy above the water for now. Employment is expanding at a slowing but healthy pace. Consumer confidence rebounded in July from -7.2 to -6.6, edging higher since the December 2018 low of -7.8 over the past couple of months (see Chart 2). The three-month average of annual growth in bank lending flows to (non-financial) businesses rose to 3.5%, the highest since 2008. This all reflects stable domestic demand.

When does the gap between crocodile's mouth close? The question is how long domestic demand will provide an offset to the weak industrial output across the Eurozone. The yawning gap between the performance of manufacturers versus service providers will have to close at some point – like a crocodile's wide, open mouth (see Chart 1). The more the situation for manufacturers deteriorates, the greater the risk that services eventually softens materially, too. Those services closest to industry, such as logistics, are suffering already and, according to the PMI, employment growth slowed to a three-year low. If weaker momentum spreads to even more parts of the domestic economy, the Eurozone would be in trouble.

Downside risks to rebound over H2: Special factors had raised GDP growth to a 0.4% qoq pace in Q1 2019. As these effects go into reverse, we look for growth to slow to a mere 0.1% qoq in Q2 – German GDP probably declined 0.1% qoq. Thereafter, Eurozone growth could return to a 0.2% gain in Q3 followed by 0.3% qoq in Q4 2019 if trade tensions between the US and China/EU ease, the Chinese stimulus starts to take effect and political risks in Europe (hard Brexit and Italy's budget) do not blow up. The PMIs highlight the downside risk to those calls (see Chart 3).

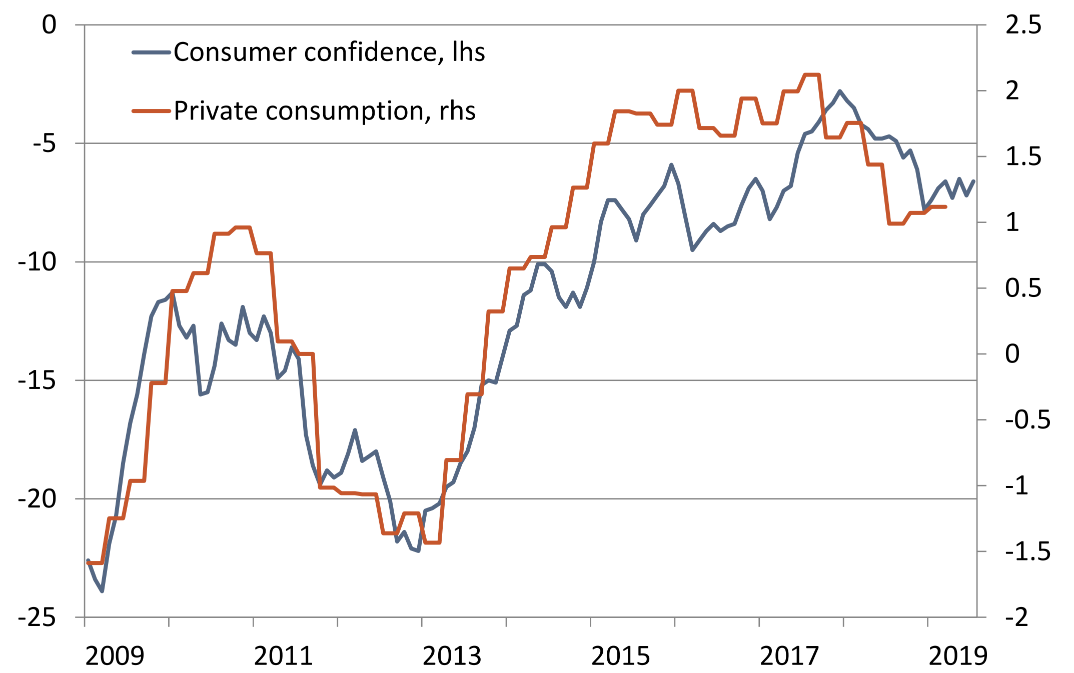
ECB – chance of doing more: In response to weak growth and still subdued inflation we so far expected the ECB to wait for a deposit rate cut and a re-launch of its net asset purchases until September. Today's PMIs raise the chance that tomorrow the ECB does more than just vowing to keep rates at "present or lower" rather than just at "present" levels, for two reasons: 1) Historically, the ECB has cut rates in response to similarly low readings of the PMI composite (see Chart 4). 2) According to the PMIs, input cost and output price inflation also decelerated further in July.

Chart 1: Eurozone PMI composite, manufacturing and services



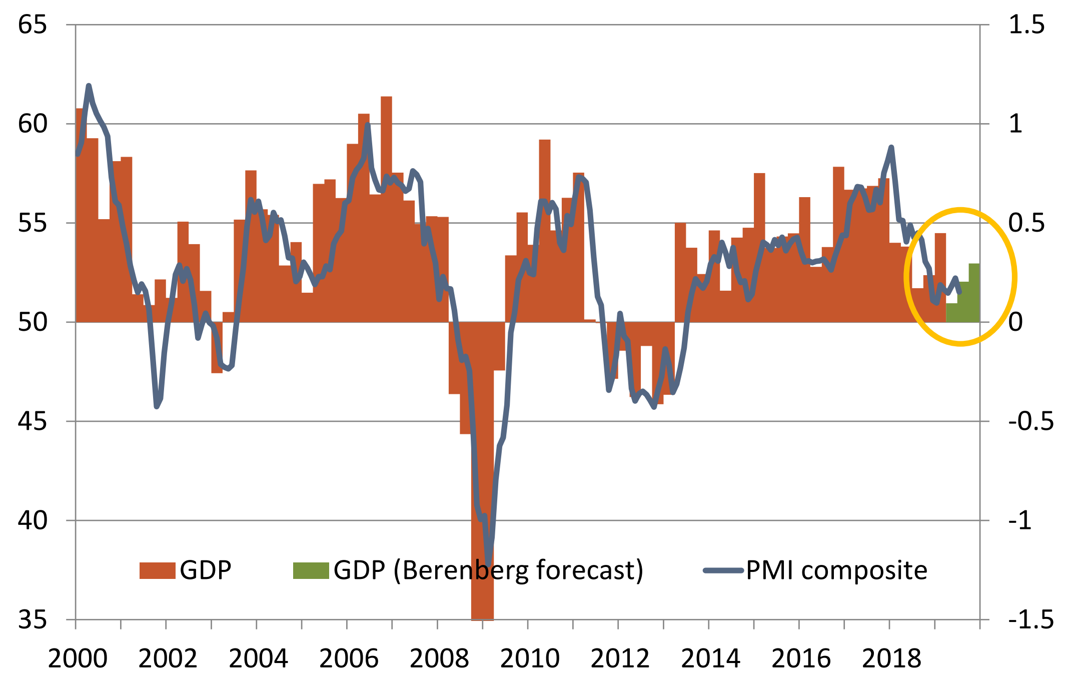
50=no change. Source: Markit

Chart 2: Eurozone consumer confidence and private consumption



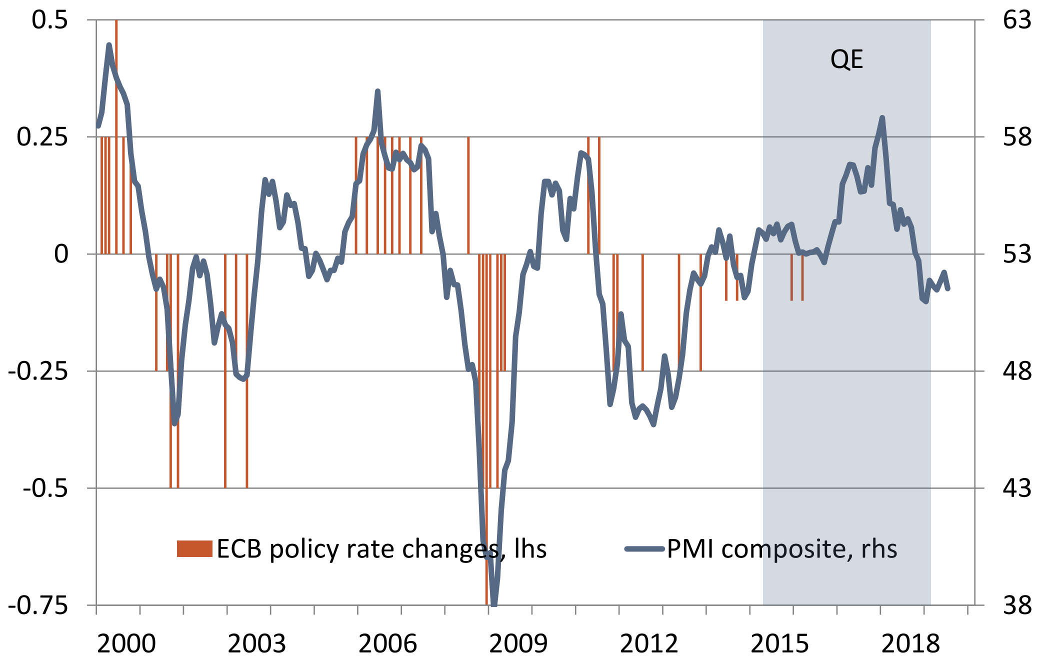
Index level for consumer confidence. Yoy change of (real) private consumption in %. Sources: European Commission. Eurostat

Chart 3: Eurozone PMI composite versus GDP (qoq, in %)



PMI composite (50=no change), left-hand-scale, GDP growth qoq in %, right-hand-scale. Source: Markit, Eurostat

Chart 4: Still in easing territory



Ppt change in refi rate until 2014, in deposit rate from 2015. For PMI composite, a value above/below 50 signals expansion/contraction. Source: ECB, Markit, Berenberg

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