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EUROZONE PMIS: INDUSTRIAL SLUMP PERSISTED THROUGH AUGUST

Berenberg Macro Flash

Eurozone PMI, August

	Composite	Services	Manufacturing
Actual:	**51.8**	**53.4**	**47.0**
Previous:	51.5	53.2	46.5
Consensus:	51.2	53.0	46.2
Berenberg:	51.2	53.0	46.2

Still a way to go yet: While surprising a little on the upside on the back of solid services, Eurozone August PMIs showed that the industrial downturn is not yet bottoming out (see Chart 1).

Another big decline in manufacturing activity: The August PMI is the first print since the sudden escalation in trade tensions in early August, when Donald Trump proposed 10% tariffs on the remaining $300bn of Chinese imports not yet exposed to US tariffs (due September, others by mid-December). Combined with weak Chinese data it is no surprise, producers remain very pessimistic about future growth prospects. This rattles global financial markets and weighs on trade-oriented manufacturers, especially in Europe and East Asia. Manufacturers reported another big – albeit smaller than in July – decline in activity. The PMI for overall Eurozone manufacturing was, once again, dragged down by export-dependent Germany. Given the low prospect of a partial deal between the US and China to defuse trade tensions over the next six months, the industrial slump probably has not yet fully run its course. It could still deepen yet – especially if something else goes badly wrong, say the US imposes tariffs on EU car exports later this year.

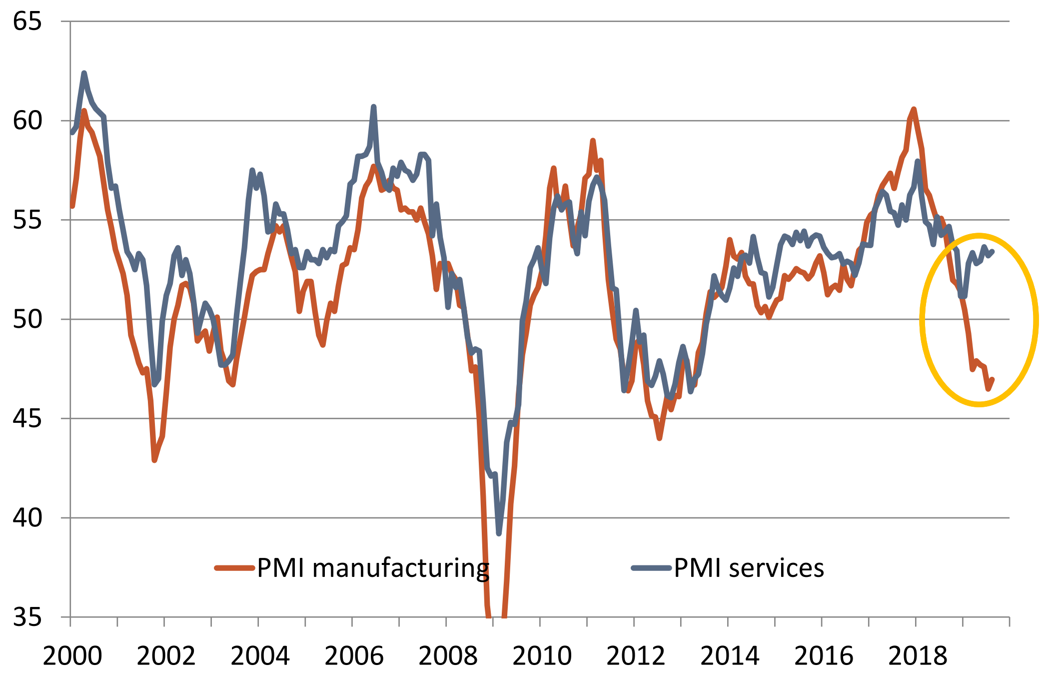
Services hold up well: The resilient service sector PMI data suggests activity among the domestic parts of the economy remains firm. Supported by rising employment, strong gains in real incomes and low financing costs, consumption and housing investment are holding up well. But for how long will domestic demand provide an offset to the weak industrial output? The yawning gap between the manufacturers and services will have to close at some point (see Chart 1).

Growth in H2 likely to be below H1 pace: Services will probably struggle to take the slump in the manufacturing sector completely in its stride. If we are unlucky, industrial weakness will spread to services, labour markets and consumer confidence in a major way. This highlights the recession risk. Service providers most exposed to industrial producers, such as logistics, are already feeling the heat. Aggregate employment growth slowed to a 4-year low in Q2. Going forward, it does not look better: The press release for the Eurozone PMIs showed that businesses "are showing greater reluctance to take on additional staff". The average for July and August of the Eurozone PMI composite (51.7) is slightly below the number for Q2 (51.8) when the economy expanded by less than 0.2% qoq. We expect economic growth in H2 2019 (0.1% qoq in both Q3 and Q4) below the pace of the first half of the year (0.3% qoq on average, see Chart 2).

France – a bright spot. Versus Germany, France is more dependent on its domestic market. France is thus less exposed to the downturn in global trade and investment. Of course, a fiscal stimulus boosting disposable income at the beginning of this year also helped.

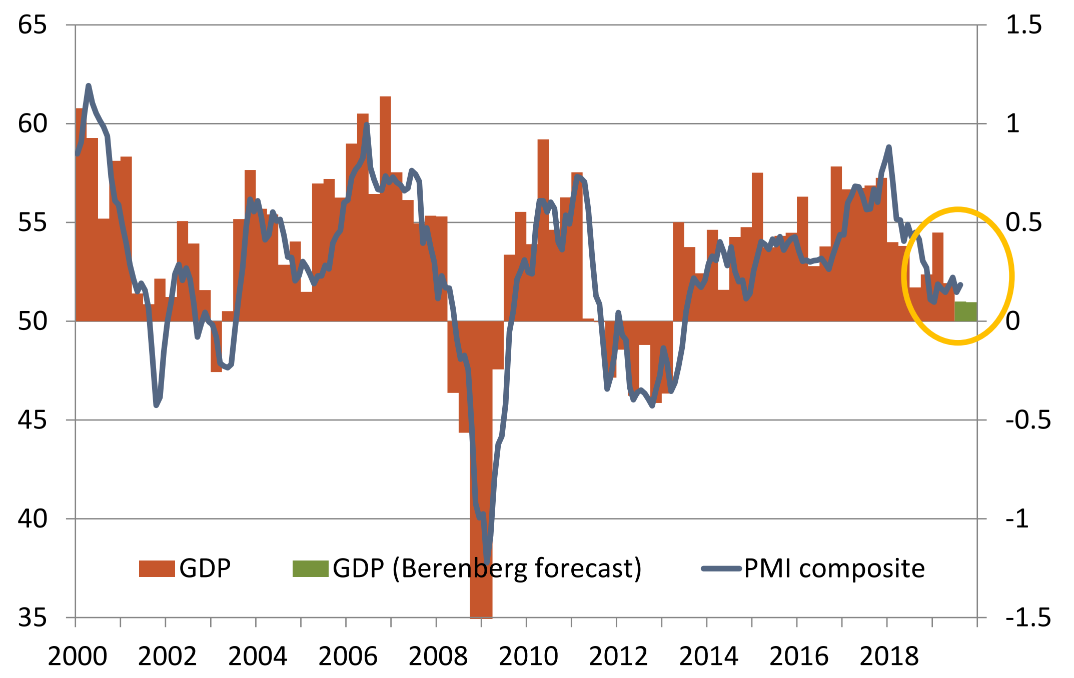
ECB action: We look for the ECB to announce a policy package at its next meeting on 12 September. A 10bp cut in the deposit rate looks most likely. Historically, the ECB has cut rates in response to similarly low readings of the PMI composite (see Chart 3). The ECB may also announce the relaunch of net asset purchases of say €40bn per month. According to the PMIs, both input cost and output price inflation remained "subdued" in August. The account of the July meeting published later today may provide more insight.

Chart 1: Eurozone PMI manufacturing and services



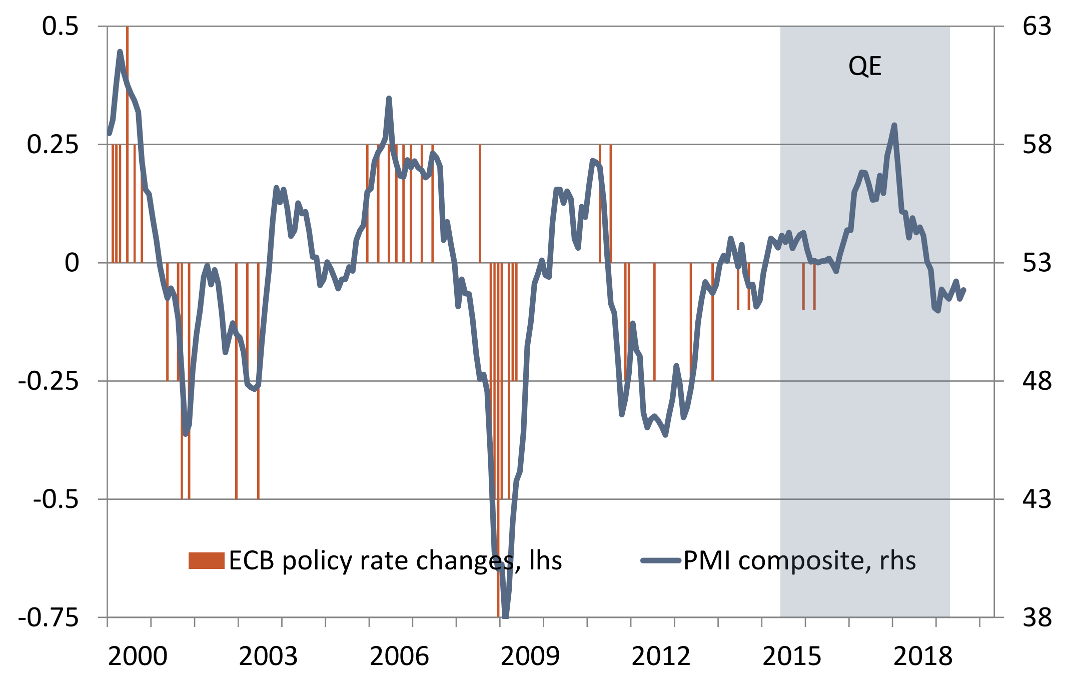
50=no change. Source: Markit

Chart 2: 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 3: 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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