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Western European Indicators and Insights

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Andrew Wroblewski
Chief Economist, Eurozone and UK

London
+44 20 7959 3244
awroblewski@decisioneconomicsinc.com

EUROZONE: No longer contracting?

France and Germany to the rescue?

The January flash PMIs suggest that Eurozone economic activity stabilized into the current quarter. Indeed, the aggregate PMI reading for the Eurozone was slightly stronger for the third successive month, but still consistent with contracting activity outside of France and Germany, albeit with the rate of contraction being the softest in four months.

Specifically, the manufacturing PMI bounced 1.8 points to 48.7, the second rise in a row and far stronger than the 0.5 point December gain. Notably, while the headline figure remained well below the long-term average, there were less ominous signs offered by parts of the survey break-down, including a continued but less steep fall in overall orders which led to the forward-looking order/inventory ratio rising to a seven-month high and with a fresh (but marginal) rise in the job-count.

More notably, the flash services PMI also overshot expectations in hitting a five-month high, showing a third successive and larger rise of 1.7 points, to 50.5. In addition, service sector respondents saw confidence about the coming year swing from the weakest since March 2009 to the highest since last August.

As for price pressures, these remained modest, with overall prices charged falling for the fourth successive month, despite higher input costs.

Downside risks still not materializing any further

At face value, the survey data suggest that the Eurozone may even be able to avoid any further contraction in the current quarter after the almost-certain fall of approximately 0.5% Q/Q in the fourth quarter. Therefore, these survey data do suggest that while downside economic risks are still very much evident they are yet to materialize any further. Partly this seems to be result of resilience in Germany and (to a lesser extent) France, with the German PMI readings moving more clearly back to the more upbeat activity levels that other alternative-sourced surveys (such as IFO) have for some time been pointing to. All of which underscores the shortcomings of surveys such as these PMIs in that they are designed primarily to identify turning points rather than calibrate the extent to which pick-ups or slow-down then ensue. In this regard, it is notable that the PMI data for manufacturing are much more downbeat than actual factory sector data have proved to be, albeit with the clear divergence between Germany and much of the rest of the Eurozone still very apparent whatever the data-source.

Survey echoes ECB thinking

Regardless, the rest of the Eurozone is still contracting, albeit less abruptly. As a result, these numbers will still be causing some consternation within the ECB, but less so than hitherto. Indeed, the PMI data (alongside hints of an improvement in consumer confidence) add to the signs of a tentative stabilization in activity that the central bank pointed to at its press conference earlier this month. Even so, it is clear that any such stabilization is still at low levels, still implying that risks of more than a mild recession remain, (particularly outside of France and Germany).

Will pick-up last?

As for the causes of this stabilization, less weak global economic conditions are implicit in the survey findings as may be the dampened turmoil in Eurozone financial markets. More specifically, it seems companies are eating into backlogs in order to sustain output while also making heftier discounts to boost sales. The former (of course) cannot be sustained for ever, while the latter should add to the disinflation backdrop that has evidently resumed in the Eurozone. Even so, these PMI data will make the ECB feel more justified in continuing its wait-and-see approach, albeit with the central bank still very aware that the fragile growth backdrop could easily see peripheral bond market turmoil intensify again.