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EUROZONE: Contracting continues?

First sign of damage from higher oil prices?

Even more clearly highlighting the message of the previous set of data, the March flash PMIs suggest that Eurozone economic activity is contracting afresh. Indeed, the aggregate PMI reading for the Eurozone softened for the second successive month more now even more consistent with contracting activity for the whole Eurozone and to a clear-cut fall outside of France and Germany.

Soggier factory and services sector

Specifically, the manufacturing PMI fell for the first month in four, actually unwinding half the gains made in those preceding three months, falling 1.3 points to 47.7. Notably, while the headline figure therefore moved further below the long-term average, there were more ominous signs offered by parts of the survey break-down, including a steeper and broad (domestic and export side) fall in overall orders led to a further fall in backlogs, the latter auguring ill for output in coming months. Partly as a result, there was continued weakness on the job front.

Possibly more gloomily, the flash services PMI also undershot expectations in sliding further from the five-month high set in January. Specifically, it fell 0.1 point to 48.7, a much less marked drop than seen in February. Worryingly, service sector new orders fall afresh, albeit with one area of optimism coming in the further rise in business expectations, which rose for the fifth successive month but only still to the highest since last July.

As for price pressures, these also showed mixed messages but with overall prices charged falling for the fifth successive month, despite higher input costs.

Recession continues

These PMI flashes will obviously disappoint. At face value it is hard to ascertain whether this PMI numbers are pointing to fresh deterioration or merely suggesting that the early year pick-up was anomalous: the January readings are the only figures in the last the seven months not consistent with Eurozone GDP contracting.

As such, the data certainly hint that the Eurozone GDP fell further in the current quarter, one question being whether it will be a fall greater or less than the 0.3% Q/Q drop posted in Q4 last year. Despite the fact that the average Q1 PMI readings are less weak than the previous quarter, a larger GDP contraction looks to be on the cards this quarter, albeit no more than around a drop of 0.5%.

Conflicting messages

Even this is still largely guesswork, especially given the contrasting messages from other survey data, most notably the ever-more upbeat German Ifo readings seen of late, which not only point to the likelihood that the German economy at least may have recovered this quarter, but that activity in that economy is actually above par. This merely extends further the puzzling divergence between German Ifo and PMI readings seen of late. But conflicting messages are evident even in these PMI numbers, with German data pointing to weaker foreign orders, while the opposite was the case in France.

Regardless, these and other survey data continue to suggest that the Eurozone economy outside Germany and France is still contracting clearly and perhaps more severely. As a result, these numbers will still be causing fresh consternation within the ECB, as they conflict somewhat with apparent signs of a tentative stabilization in activity that the central bank has pointed to of late. In particular, they imply that whatever good that recent ECB liquidity measures have done to stabilize bond markets and banking systems has done little to bolster overall Eurozone real activity.

GDP contraction to extent beyond this quarter

In particular, the weak (if not weaker) real activity backdrop in the Eurozone may be a reflection of the impact of the fragile, if not softer, consumer spending backdrop. Indeed, the impact of the recent rise in fuel prices may have dealt an immediate and adverse impact on household spending power, something that may also have had a clear and rapid negative effect on business psyches. If so, the question may be not so much whether Eurozone GDP in the current quarter contracts a little more or less than in Q4, but whether any further fall lies head. Most likely it does, with the best hope (now) for the Eurozone being that activity starts to stabilize only by mid-year.

ECB reaction

Such a backdrop clearly has implications for the ECB which has started to talk more hawkishly and openly in regard to the latest rise in oil prices. Whether or not these PMI data are indicative or not of downside risks materializing more clearly, they clearly highlight the extent to which those risks remain so concentrated to the downside.