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Andrew Wroblewski
Chief Economist, Eurozone and UK

London
+44 20 7959 3244
awroblewski@decisioneconomicsinc.com

Eurozone: Much weaker activity and broadly so.

A near-stagnation for the Eurozone as a whole?

For the third month in a row, flash PMIs pointed to a marked slowing in private sector activity for the Eurozone. While these July numbers showed M/M declines similar to May and June they fell to levels consistent with near-stagnation for the Eurozone as a whole. As notably, while some momentum was still clear in France and Germany, activity even in these vanguards seemed to dissipate clearly. However, the theme of greater weakness elsewhere was still very much evident, as output growth outside of France and Germany contracted for the second successive month and by the most since August 2009 while there was a further marked softening in new orders, actually falling for the first time in almost two years as far as the factory sector is concerned.

Specifically, the manufacturing PMI once again very much undershot expectations, slumping 1.6 points to a 22-month low of 51.4, the fourth fall in the last five months, all coming from the 11-year high seen in March. Notably, the headline figure fell back below the long-term average, but with more ominous signs offered by the survey break-down. Indeed, the ratio of manufacturing new orders to inventories, which acts as a guide to near-term output developments, fell further (albeit still the lowest since April 2009), seemingly as stocks of finished goods reacted to disappointing sales and orders. Indeed, the weakness in overall orders was partly attributable to export orders suffering the first drop since July 2009.

Meanwhile, the flash services PMI also undershot expectations and more markedly so as its headline dropped 2.3 points to 51.4, a 22-month low and also back below its long-term average. Less negatively, expectations within the sector saw not further drop, but still remained at two-year lows.

Not a result of temporary factors

Given the further and geographically broader erosion it looks less and less likely that temporary factors (such as the disruptions to supply chains emanating from the earthquake in Japan) are the root cause. Admittedly, it may still be the case that the PMI data, having exaggerated previous activity, are now further unwinding previous froth. However, the continued falls and the fact that the PMI data have fallen below their long-term averages (now even in France) suggest something more sinister.

Softer global economy accentuating domestic headwinds

Indeed, the further sharp and broader fall on the manufacturing side will be seen as additional evidence of a softer global economy hitting the export orientated factory sector, a development that highlights that export sensitive Eurozone activity is as much vulnerable to policy tightening abroad as to what is happening domestically. In addition, the deterioration in business confidence in the service sector suggests that a more fundamental slowing in the pace of economic growth is occurring, possibly linked to the on-going headwinds provided by fiscal consolidation and banking sector fragility.

ECB reaction

To date, ECB thinking has very much reflected the strength in the Eurozone-wide PMI data, in regard to both prices and activity, rather than the further signs of economic divergence highlighted by survey numbers. To some extent this is understandable given the Eurozone-wide remit of the ECB. However, especially as a series of setbacks have now been signaled, which are also starting to encompass Germany and especially France, these latest survey readings will cause increasing reverberations in terms of the clear slowing in both activity and now also price pressures. Notably, the weakness in these numbers provide a more economic fundamental rationale for the ECB to prevaricate: these PMI readings are now even further below levels historically associated with ECB hiking.

Market worries

For markets, however, the most important facet may still be the deeper fragility in activity seen outside of France and Germany. This is especially the case now that ratings agencies (last month in the case of Italy) have started to put countries on guard of a downgrade at least partly due to their slow economic growth backdrops. As a result, these PMI data may only serve to reinforce these worries as they highlight the lack of growth in peripheral countries without which debt sustainability looks to be very tenuous.