PICTET 1805

Flash Note

Euro area: Flash PMI

Momentum slows at the start of Q3

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The composite flash PMI fell to 55.8 in July from 56.4 in May, below consensus expectations (56.2). The headline dip was entirely driven by the manufacturing index.

Composite PMI declined in Germany and France, while activity was pretty strong elsewhere in particular in peripheral countries. Markit mentioned that growth perked up, registering the second largest monthly rise in output in the past decade.

The euro area composite PMI is now consistent with GDP growth of 0.59% q-o-q in Q3, cooling from the pace of over 0.7% signalled by PMI for the second quarter.

We are keeping unchanged our GDP growth forecast at 1.9% for 2017 as a whole. We continue to see a number of headwinds leading to a modest slowdown in the pace of economic expansion for the rest of this year, but growth should nonetheless remain comfortably above potential, at around 1.75% in annualised terms.

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Entering the second half of 2017, **PMI surveys for the euro area eased somewhat, suggesting that momentum slowed at the start of Q3**. But private sector conditions remain pretty strong, with the index at elevated levels by historical standards**.**

The composite flash PMI fell to 55.8 in July from 56.3 the previous month, below consensus expectations (56.2). Notably, this was the lowest reading observed since the start of the year. The headline dip was entirely driven by the manufacturing index, which fell to 56.8 in July from 57.4 in June. By contrast, the services index remained stable at 55.4. The **PMI's forward-looking components remained pretty strong, despite edging down in July. The bright spots came from new export orders and employment** *(see Table 1)*.

Table 1: PMI headline indices and sub-indices

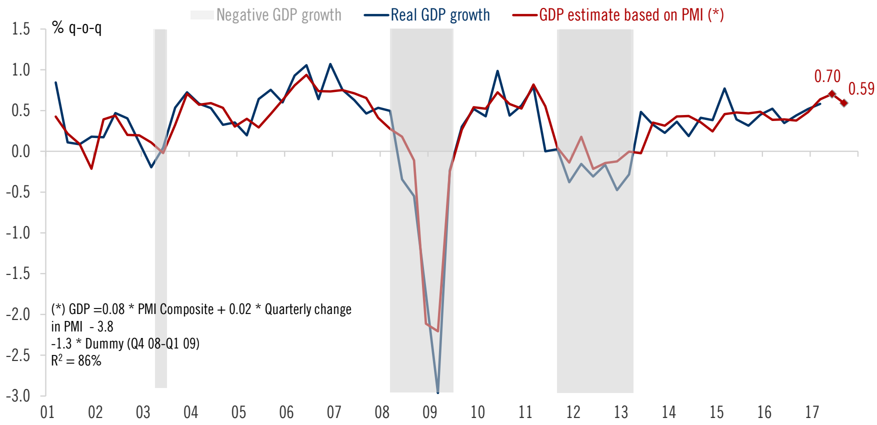
Euro area PMI indices		July (Flash)	June	3 months before	Monthly move
Composite	**Headline**	**55.8**	**56.3**	**56.8**	↓
	New orders	55.5	56.0	55.9	↓
	Employment	54.3	54.5	54.3	↓
Manufacturing	**Headline**	**56.8**	**57.4**	**56.7**	↓
	New orders	57.1	58.7	57.7	↓
	New export orders	57.4	57.4	57.5	↑
	Employment	56.1	55.9	55.5	↑
	Output prices	53.9	54.3	55.4	↓
	Input prices	57.9	58.4	67.1	↓
Services	**Headline**	**55.4**	**55.4**	**56.4**	→
	New business	54.9	55.1	55.2	↓
	Employment	53.7	53.9	53.8	↓

Source: Pictet WM – AA&MR, Markit

At 55.8, the **composite PMI is consistent with GDP growth of 0.59% quarter-on-quarter (q-o-q) in Q3** (*see Chart 1*), cooling slightly from a pace of over 0.7% signalled for Q2 (euro area Q2 GDP data will be published on 1 August). Soft data continue to be much more upbeat than hard data, but the divergence is narrowing. We are keeping **unchanged our GDP growth forecast at 1.9% for 2017 as a whole.** We continue to see a number of headwinds leading to a modest slowdown in the pace of economic expansion for the rest of this year, but growth should nonetheless remain comfortably above potential, at around 1.75% in annualised terms.

Price pressures eased somewhat as both input and output prices decreased in July. This adds to our belief that the ECB will be in no rush to taper its policy and will wait to secure a more convincing trend in core inflation. We continue to expect a slow tapering starting in Q1 2018 and a one-off deposit rate hike in June 2018, but risks are tilted towards a delay. Specifically, we see a growing risk that a tapering announcement will be postponed to October, if not December.

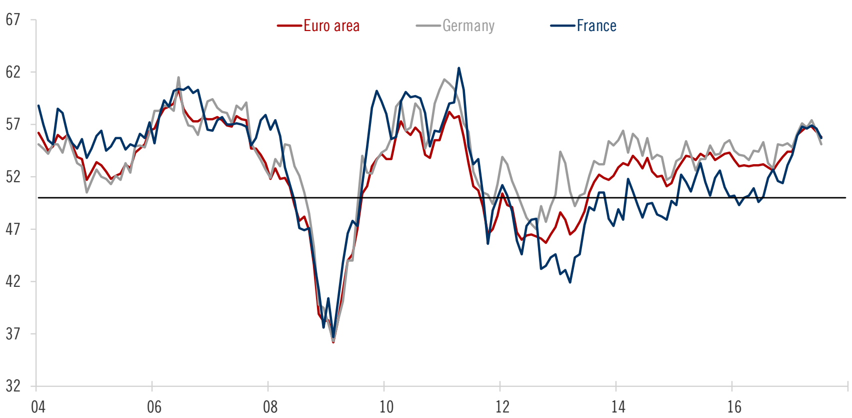
Chart 1: real GDP growth and GDP estimate based on PMI



Source: Pictet WM – AA&MR, Markit

In France, **the composite PMI declined by 0.9 to 55.7 in July, below consensus expectations** (56.4) and marking a further fall from May's six-year peak. Notably, this was the lowest reading observed since the start of the year. The headline index was again constrained by a fall in the services PMI (-1.0 to 55.9). By contrast, the manufacturing index (+0.6 to 55.4) edged up to a 75-month high. The breakdown by sub-indices showed that the slowdown predominately reflected softer growth in new orders at service providers. Importantly, **employment posted a sharp rise in the manufacturing sector, with firms noting** "***the quickest rise in staff numbers for nearly 17 years***". Services providers increased their staffing levels as well, even though the rate of growth softened from June's multi-year high. Overall, **business confidence remained strong entering the second half of the year**, despite edging down. At 56.7, composite PMI point to a slight slowdown in Q3 GDP growth, from the expected strong figure for Q2 (+0.5% q-o-q; to be published on 28 July).

Chart 2: composite PMIs



Source: Pictet WM – AA&MR, Markit

In **Germany**, **the flash composite PMI index declined from 56.4 in June to 55.1 in July**, much lower than consensus expectations (56.3). The decline was driven by both the manufacturing sector (-1.3 points to 58.3) and the services sector (-0.5 point to 53.5). Both sectors reached their lowest levels since January. The breakdown showed that new manufacturing orders softened somewhat, despite an increase in new export contracts. In this regards, manufacturing firms continued to report "*high demand from markets in both Europe and Asia*". The rate of job creation remained historically sharp. Overall, the easing seen in July follows the strongest quarter in six years. Q2 GDP data will be published on 15 August. At 55.1, the **composite PMI signals a slowdown in the pace of expansion entering in the second half of 2017**, but underlying momentum remains robust in Germany.

Finally, Markit indicated that economic growth outside Germany and France "*perked up, registering the second largest monthly rise in output in the past decade. Growth was accompanied by further solid employment gains.*"