

Flash Note

Europe chart of the week – PMIs

Still little good news below the surface

Pictet Wealth Management - Asset Allocation & Macro Research | 24 August 2018

Below the surface of stabilising euro area PMIs, we see little evidence yet of a broad-based rebound in business taking shape, supporting our revised GDP growth forecast of 2% in 2018.

Cross-country growth divergence appeared to have increased in August, with Italy and possibly Spain underperforming Germany and France. Moreover, forward-leading indicators including new export orders failed to improve.

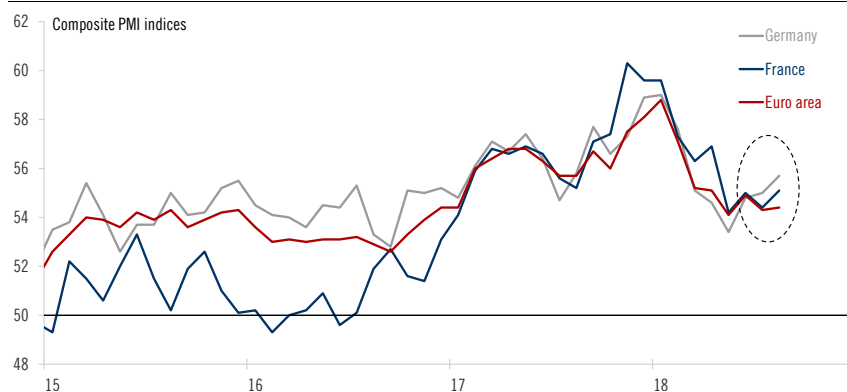
Although wage and cost pressure intensified in most countries and sectors, the ECB might find itself in a delicate situation if rising input prices are not passed on to consumer prices eventually due to weaker final demand and/or margin constraints.

Although euro area flash PMI indices came in roughly in line with expectations in August, some details were less positive than the headline numbers, suggesting that downside risks have not yet disappeared. True, at face value, the small rise in the euro area composite PMI index, from 54.3 in July to 54.4 in August, is consistent with resilient real GDP growth, close to the 0.4% q-o-q pace recorded in Q2. But, the change in PMI sub-components across countries and sectors was less encouraging.

First, the relatively larger rebound in French and German indices (+0.7 point on average in August) implied renewed weakness in the periphery, with Markit indicating that **future business expectations fell to a five-year low outside the two largest countries**. Second, forward-leading indicators in the manufacturing sector in particular failed to improve, with new export orders falling slightly further, suggesting that **weaker foreign demand and trade tensions continued to weigh** on sentiment. Last but not least, price pressures were seen as intensifying in most countries and sectors amid **growing signs of 'bad inflation'**, i.e. rising commodity prices, wages and other input costs that were only partially passed on to consumer prices because companies were still constrained in terms of margins.

Leading euro area indicators have broadly stabilised during the summer, at levels consistent with **our revised forecast of 2% GDP growth in 2018**. But, the balance of risks remains tilted to the downside. Crucially, (geo-)political uncertainty, trade tensions and higher input prices are not conducive to higher corporate investment spending, which we still see as the key ingredient to stronger euro area growth over the medium-term.

Euro area composite PMI indices bolstered by Germany and France



Source: Pictet WM – AA&MR, Markit

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