

The NewsLine

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MACROECONOMICS | FINANCIAL MARKETS | ECONOMIC POLICY | SECTORS

EUROZONE

PMIs nothing to write home about, but firm

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Although economic momentum in the second quarter is likely to slow somewhat compared with the start of the year, the eurozone economy remains well on the road to recovery. However, political uncertainties are exerting a drag. Inflation is set to remain extremely low for the time being and the ECB will stick to its expansionary policy. Yields can therefore be expected to remain low and the euro exchange rate relatively favorable for economic growth.

The composite PMI for the manufacturing and services sectors in the eurozone came in at 52.9 points in May, leaving it practically stable since February. Whereas the survey results in Germany and France picked up clearly on the previous month, there were evidently sharp drops in the other eurozone countries covered by the survey. The relatively buoyant start to the year in the eurozone with quarterly GDP growth of 0.5% was in part a technical reaction to the fairly weak final quarter 2015. Although the economy is likely to be somewhat less dynamic going forward, we are still penciling in growth of 1.7% this year (two tenths more than last year and slightly above the potential growth rate).

In Germany both the manufacturing and the services PMI improved, with the German composite index climbing to 54.7 points, the highest level since August last year. Although the PMI survey shows that the number of people in work has now been growing for 31 months on the trot, wage settlements to date have not been excessive but have tended to reflect second-round effects of low inflation (agreement on moderate nominal wage increases in view of

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low past and expected inflation). Overall we still see Germany well placed to notch up GDP growth of a good 2% in 2016.

The French purchasing managers' index for the manufacturing and services sectors climbed fairly sharply to 51.1 points. However, this was primarily thanks to the services sector, whereas the PMI for manufacturing is still languishing at an unsatisfactory 48.3 points. Following the good start to the year with quarterly GDP growth of 0.5%, we expect a slowdown to 0.3-0.4% in the coming quarters and average growth of close to 1.5% in 2016 as a whole. Striking is the encouraging development in investment by non-financial corporations in France (even in the hypothetical event that it stagnates in the next three quarters, the full-year increase would still come in at almost 3%).

All told, prospects remain mixed: the upswing in the eurozone is under way, but is being weighed down by uncertainty (cue: Brexit, Grexit, growing influence of populist parties, mounting diffidence with regard to European integration, etc.). In the second half of the year inflation rates in the eurozone are likely to move well above zero, but the ECB's 2% benchmark will remain out of reach. The ECB's ultra-loose monetary policy is anchoring eurozone yields at a relatively low level. And with the Fed poised to continue tip-toeing towards a normalization of monetary policy, there is likely to be little change in the relatively weak euro (in the region of 1.10-1.15 USD/EUR).

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