

The NewsLine

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EUROZONE

Good PMIs bolster case for tapering from April

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Today's survey results confirm that the eurozone economy is ticking over nicely. In early December the ECB will probably outline its tapering plans more specifically. Hopefully it will start to taper in April 2017, which would anyway mean an extension of the bond purchasing program beyond March of next year.

The composite purchasing managers' index for manufacturing and services in the eurozone rose strongly in October to 53.7 points – the highest level since the end of last year. The improvement stemmed mainly from Germany, not from France (see below). In the other eurozone countries covered by the survey sentiment picked up but remained at a lackluster level. Overall, we are still penciling in eurozone GDP growth of 1.5% this year.

In Germany the composite index jumped from 52.8 to 55.1 – mainly thanks to services but also aided by the industrial sector. The strong rise in orders from abroad illustrates that the world economy is getting back into gear. Jobs growth is being accompanied by rising order books. Today's survey results support our forecast of around 2% growth in Germany this year.

Although the French purchasing managers' index for manufacturing and services slipped slightly from 52.7 to 52.2 points, a closer look reveals that the positives outweighed the negatives. The PMI for the industrial sector not only finally breached the 50-point mark, but leapt to 51.3 points. By contrast, the PMI for the services sector fell appreciably after the steep rise seen the previous month, but at 52.1 points is still at a relatively high level. On another positive note, incoming export orders are now at a level not seen since May 2011. We are sticking with our forecast that, after the blip in the second

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quarter, the pace of growth will accelerate to around 0.4% in the coming quarters and that GDP growth of 1.4% in France this year is achievable.

All in all the eurozone economy is ticking over nicely and although the pickup in inflation over the coming months will be largely due to oil price base effects this is still likely to help anchor inflation expectations. Today's PMI figures also contain pointers to rising inflationary pressure. At the final Governing Council meeting of this year and together with the release of the latest projections in early December, the ECB should raise the prospect of tapering from April 2017 (in the absence obviously of completely unexpected events). Achievement of inflation "close to but below 2%" is not a prerequisite. Rather, the aim is to gradually lower the curtain on monetary policy's ultra-loose crisis mode. The challenge for the ECB will be not to spook the bond market too much, particularly as the Fed is likely to continue nudging up rates cautiously. On the one hand the key is to provide the markets with a degree of guidance, on the other the ECB will be keen to maintain flexibility with regard to the modalities/speed of tapering.

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