

# Eurozone manufacturing

## Eurozone manufacturing recovery masks widening two-tier economy

- Eurozone manufacturing output growth at 29-month high in January.
- Disparities between national manufacturing sectors widen.

### France and Germany lead the pack, but Spain, Ireland and Greece fall behind.

The Markit Eurozone Manufacturing PMI rose to a two-year high of 52.4 in January, supported by the strongest growth in production and new orders since mid-2007. However, underlying the robust picture painted by the headline reading, disparities between the national manufacturing performances widened. In a sign of a growing two-tier nature of economic performance within the Eurozone, countries reporting an increase in output all saw their rates of expansion accelerate, whereas nations where production fell all reported faster rates of contraction.

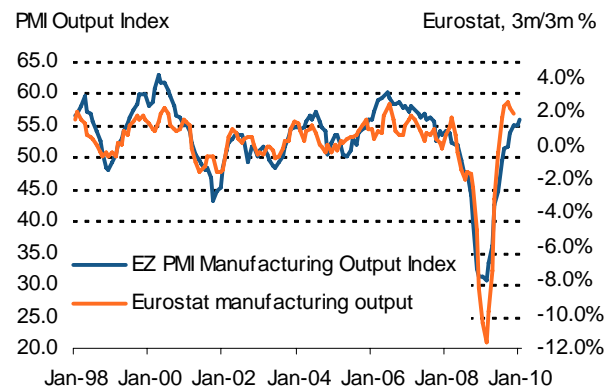
French and German manufacturers are still leading the recovery, while growth of output is now being recorded in Italy, the Netherlands and Austria as well. The strongest output growth was in France, where the rate of expansion hit a nine-and-a-half year high. Germany, Italy and the Netherlands posted their strongest gains in production for almost two-and-a-half years, while the rate of expansion in Austria reached a 22-month peak.

But the recessions in Spain, Ireland and Greece are ongoing, and PMI data indicate that rates of contraction accelerated in each of these nations in January.

### Double-dip in Greece, Ireland and Spain?

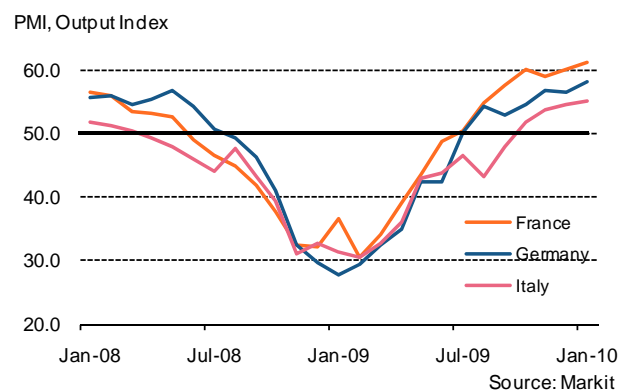
Eurozone PMI data indicate that Greek, Irish and Spanish manufacturers were the worst performers in January, with all three countries showing signs of slipping back (or further) into recession for their manufacturing economies. Greek manufacturers reported a contraction in output for the fourth month in a row, with the rate of contraction the fastest since April last year. Spanish manufacturing output meanwhile fell for a sixth straight month. These nations also recorded the steepest drops in total new orders amongst the Eurozone nations covered by the PMI survey.

### Eurozone Manufacturing Output



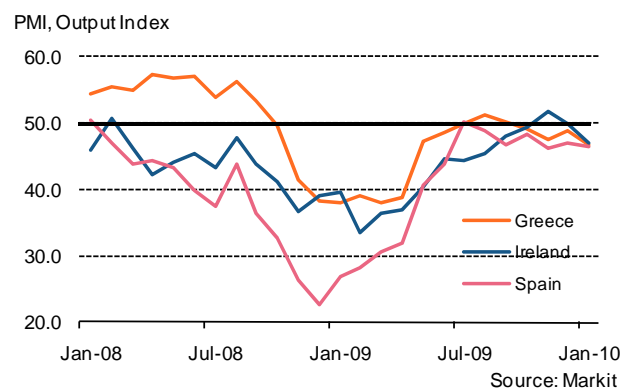
Sources: Markit, Eurostat

### Big-3 manufacturing exit recession



Source: Markit

### Greece, Spain and Ireland struggle to cross the line



Source: Markit

While growth in Germany, France and Italy has been supported by strong growth of new export orders, fuelled in turn by improved economic growth in key exports markets such as the US, UK and Asia, the January PMI data show that Greece and Spain are the only euro area nations covered by the survey to see a further drop in new export orders.

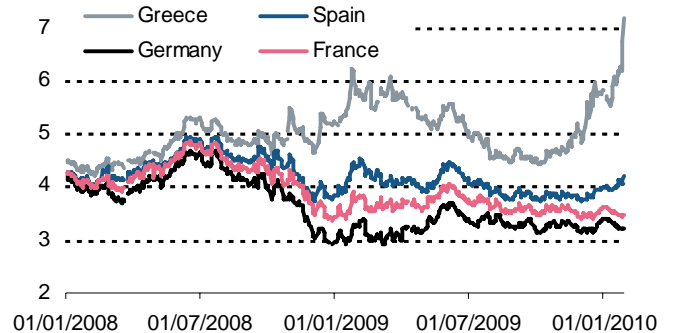
The disappointing performance comes at a time when the economic and financial fundamentals for the peripheral countries in the euro area are under close scrutiny. Greece, Spain and Ireland are already expected to run higher structural budget deficits as a percentage of GDP than the big-three Eurozone economies in 2009, 2010 and 2011 according to the EU statistics agency Eurostat, and deteriorating economic performance will most likely put further pressure on government finances as tax revenues fall and social security spending rises. This has affected the yields on 10-year government bonds. The yield for Greek sovereign debt was over 7% at the end of January – a high for the period since the euro was first introduced. Similarly, for Spain, the yield was around 4.2%, its highest level since mid-2009. Moreover, the yields for Greece and Spain rose by over 130 and 20 basis points respectively in January. During the same period, yields for Germany, France, the UK and the US all declined. The increase in Greece was, however, broadly similar to that of Japan (which was also up by over 130 basis points).

Markit credit default swap (CDS) data also point to a deterioration in the international market's perception of Greece and Spain. The risk premium paid to insure against default on Greek sovereign debt rose to a record 404.3 on 28<sup>th</sup> January (i.e. the annual cost of insuring EUR10 million of Greek government debt against default for five years now costs EUR404,300), much higher than Germany (36.4) and France (52.5). The risk premium on Spanish sovereign debt meanwhile rose to 138.4.

Financial and economic conditions in Greece, Ireland and Spain are likely to remain much weaker than the big-three for the immediate future. As the ECB are expected to continue to focus on conditions at the aggregate level when rate setting, these national disparities are a cause for concern. The danger for Greece, Spain and Ireland is how their economies will cope when monetary conditions begin to tighten given the failure to recover under current conditions.

### Ten-year government bond yields

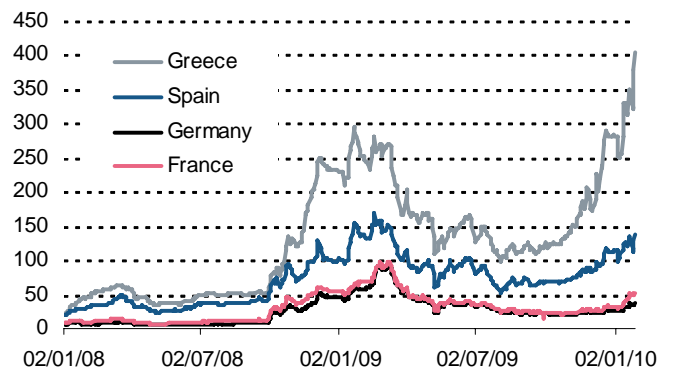
10 YR Benchmark Government Bond Yield (%)



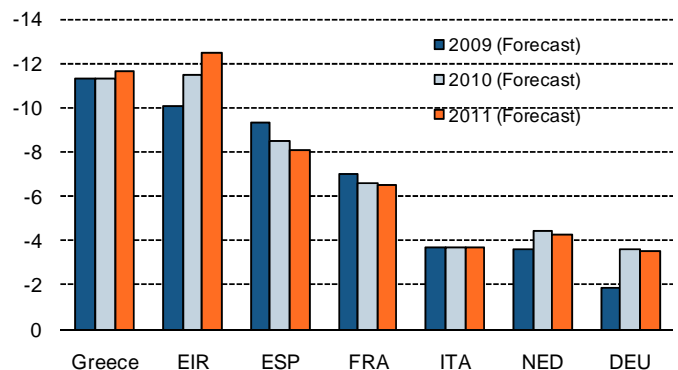
Source: Reuters EcoWin

### Markit CDS spreads

Premium paid for default protection (basis points)



### Budget Deficits (% GDP):



Source: Eurostat European Economic Forecast (Autumn 2009)

---

## Rob Dobson

### Senior Economist

Markit

Tel: +44 1491 461095

Email: [rob.dobson@markit.com](mailto:rob.dobson@markit.com)

For further information, please visit [www.markit.com](http://www.markit.com)

The intellectual property rights to this report provided herein is owned by Markit Group Limited. Any unauthorised use, including but not limited to copying, distributing, transmitting or otherwise of any data appearing is not permitted without Markit's prior consent. Markit shall not have any liability, duty or obligation for or relating to the content or information ("data") contained herein, any errors, inaccuracies, omissions or delays in the data, or for any actions taken in reliance thereon. In no event shall Markit be liable for any special, incidental, or consequential damages, arising out of the use of the data. Markit is a trademark owned by the Markit group.