

Eurozone

Where now for the periphery?

Eurozone recovery ongoing in February

February final PMI data from Markit confirmed that the Eurozone economy continued to recover from its deepest post-war recession. At 53.7, the Eurozone Composite Output Index – covering private sector manufacturing and services – pointed to an increase in business activity for the seventh successive month. The average reading so far in Q1 2010 is broadly consistent with GDP growth of around 0.4%¹.

Two-track recovery leaving Greece behind

However, PMI data also indicate that the recovery remains two-tiered, with the core of France and Germany leading the way, while peripheral countries such as Spain, Ireland and Greece lag behind.

Germany saw activity rise at the fastest pace since August 2007 and, despite easing to a five-month low, growth in France still ran at a similar clip to Germany. Our recent research note² highlighted how Germany and France, especially in manufacturing, were not only benefitting from the supportive inventory cycle but also from boosting their export competitiveness through cutting selling prices and raising productivity.

This has been less evident in Spain, Ireland and Greece, all of whom saw their downturns continue in February. Conditions in Greece deteriorated markedly. Greece recorded the lowest manufacturing PMI readings for output and new orders of all nations and was the only country to report a reduction in export orders. Meanwhile, Spain and Ireland have only recently started to report meaningful export gains.

Given that they use the same currency as their main trading partners, Spain, Ireland and Greece can only raise their relative export performance by similarly boosting their price competitiveness and productivity. However, even if this could be sufficiently achieved, there are increasing signs that domestic market conditions elsewhere in the Eurozone may not have recovered sufficiently to aid recoveries in these nations.

Chart 1: Eurozone PMI vs. Eurostat GDP

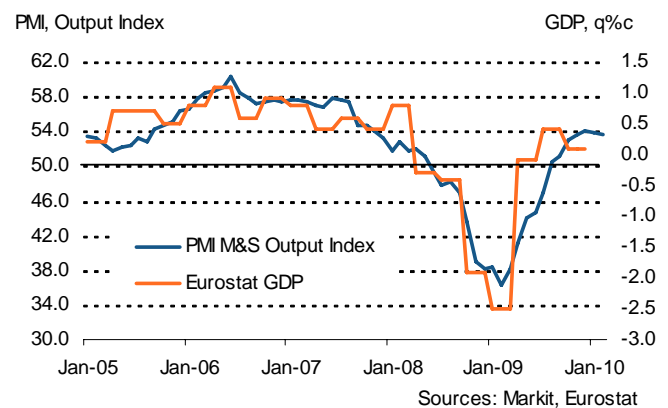


Chart 2: National PMI M&S Output

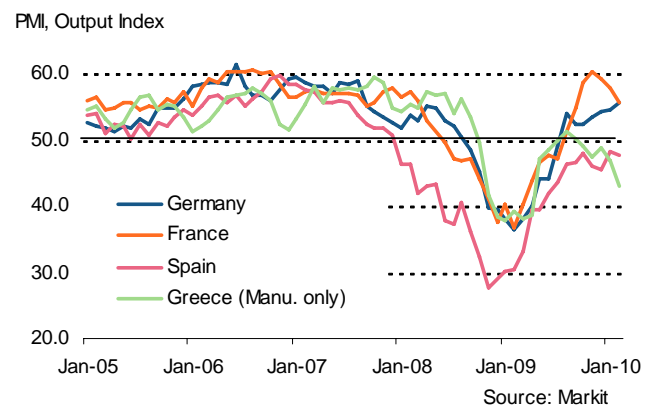
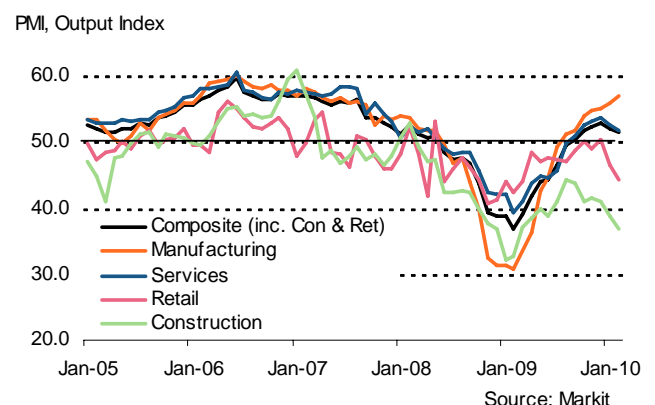


Chart 3: PMI sector breakdown



¹<http://www.markiteconomics.com/MarkitFiles/Pages/ViewPressRelease.aspx?ID=6189>

²http://www.markit.com/assets/en/docs/commentary/markit-economics/2010/mar/EZ_periphery_10-03-01.pdf

Domestic markets remain weak, limiting scope for export recovery at the periphery

At present, the recoveries in the Eurozone nations remain manufacturing-led, as opposed to being towards the more 'domestic-facing' construction, retail and service sectors.

PMI data signalled that Eurozone manufacturing production rose at the fastest pace since March 2007. The recovery in the service sector remained fragile, business activity expanded at the weakest rate in five months and at a much slower pace than manufacturing output. PMI data also indicated that the performances of the construction and retail sectors remained weak, with rates of contraction accelerating in February to the fastest in about a year.

This suggests that domestic demand within the Eurozone remains fragile. The retail PMIs indicated that the German consumer sector is particularly weak, as

like-for-like sales fell at the fastest pace in over a year. French and Italian retailers fared little better, reporting declines in sales values. Manufacturing PMI data also suggest that, since the turn of the year, growth within the sector has been strongest amongst producers of capital and intermediate goods. Further emphasising the weakness of the domestic consumer across the Eurozone, the rate of expansion in consumer goods output has been lacklustre in comparison.

There is also the issue that labour markets across the Eurozone are still not at the point of recovery. It therefore remains to be seen not only whether Spain, Ireland and Greece can raise competitiveness sufficiently to benefit from an export-led recovery, but also if their key euro area trading partners can provide any significant source of demand for their exports.

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