

PMIs and GDP

Bewildering GDP trends

- **Rising GDP in France and Germany contrasts with further falls in the UK and the US.**
- **Improvements likely to reflect short-term rebound and government stimulus factors.**

First estimates of GDP have thrown up some surprising trends. While the US and the UK continued to contract, posting 0.3% and 0.8% quarter-on-quarter declines respectively, France and Germany have returned to growth, both enjoying 0.3% increases in GDP. The growth in France and Germany – which together account for nearly half of Eurozone GDP – caused the Eurozone to contract by a mere 0.1% in Q2.

Charts 1 to 5 in this note plot these quarterly changes in GDP against equivalent rates of change calculated from PMI data (the latter derived using a simple regression analysis of the PMI index against quarterly rates of change of GDP to identify best fit).

The charts show that in all cases, the PMI surveys understated the extent of the recent downturns. Generally speaking, the steeper the decline in GDP, the greater the error in the PMI's signal. While we still suspect that these early estimates of GDP may be subject to some upward revisions, it is possible that surveys such as the PMI, which capture the direction of change in a company's output (asking if output rose, fell or remained unchanged) rather than quantifying this change, are unable to accurately track the magnitude of change when changes are very extreme – as has been the case in recent months¹.

However, we believed that this disengagement of the relationship of the PMI and GDP would disappear once growth moved back into 'normal' ranges. However, this does not yet appear to have been the case, as the Q2

Chart 1: United Kingdom

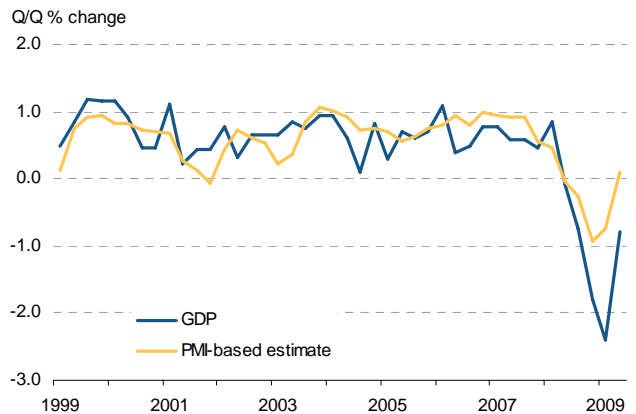


Chart 2: United States

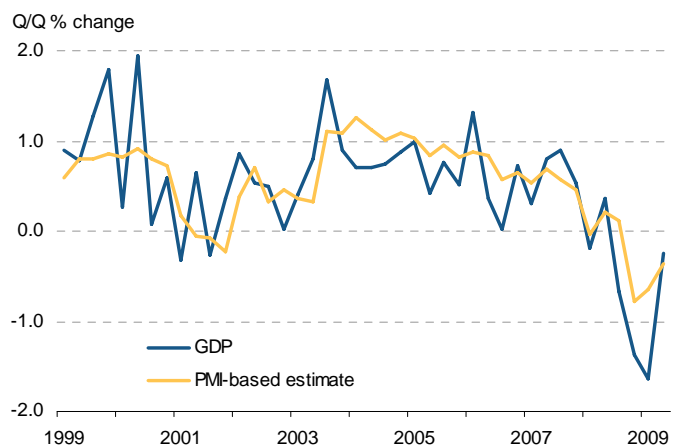
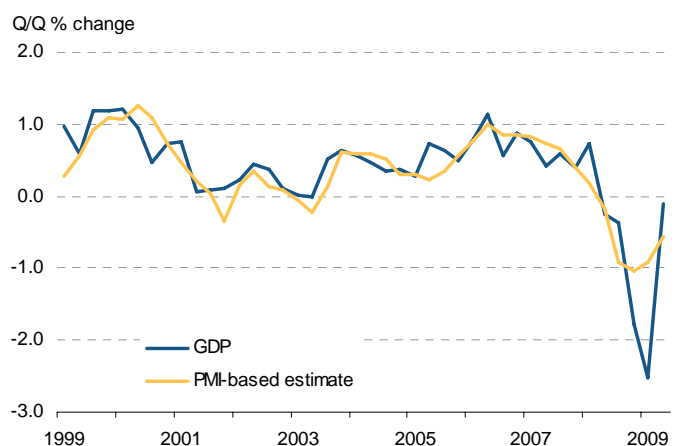


Chart 3: Eurozone



¹ This has been explored in many research papers and is discussed in more detail on our commentary site.

GDP developments also present a puzzle. In the case of the US, Germany and France, the PMI appears to have understated the trends in GDP for Q2, while in the UK it continues to overstate GDP.

Not only do the GDP data look to be at odds with the PMI trends, but it is also hard to reconcile a sharp drop in UK GDP with rising GDP in France and Germany if one looks at the exchange rates facing exporters in these countries, with an historically weak pound contrasting with an historically strong euro.

Looking at detailed monthly data on manufacturing output, exports, retail sales, construction and car sales (see table), the increases in GDP in France and Germany are clearly difficult to explain. This suggests that higher government spending and strong services growth may have been key drivers of the Q2 expansion. More will be known once detailed data on GDP are published in early September.

However, one of the advantages of the PMI surveys is their ability to identify turning points in business activity, due in part to their low noise to signal ratio. In this respect the surveys have performed exceptionally well, clearly indicating a steady and impressive rebound in business conditions over much of this year, indicating that we are over the worst.

The PMI surveys suggest that the underlying trend is one of a short-term growth spurt driven by stimulus policies, notably the car scrappage schemes, and a natural bounce-back from very harsh cost reductions by businesses and, to a lesser extent, households, during the height of the downturn. Restocking should play a major role: the PMI surveys suggest that inventory levels continued to fall in July. The restock has not yet commenced.

The situation beyond this rebound is more uncertain, but likely to be one of subdued growth as stimulus packages are unwound as governments seek to reduce expenditure, at the same time as credit constraints and high unemployment restrict the pace of expansion.

The precise divergences in GDP trends between countries do little to alter this longer-term story, which applies more or less universally in the West.

Chart 4: Germany

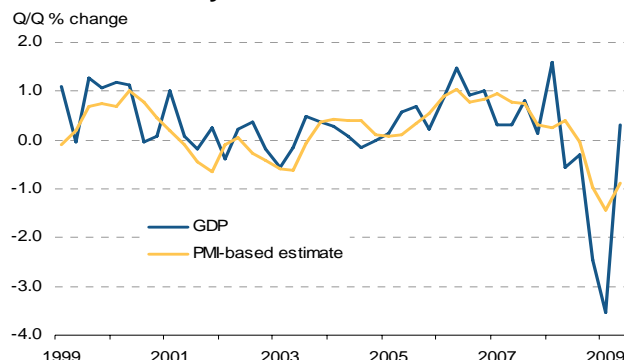


Chart 5: France

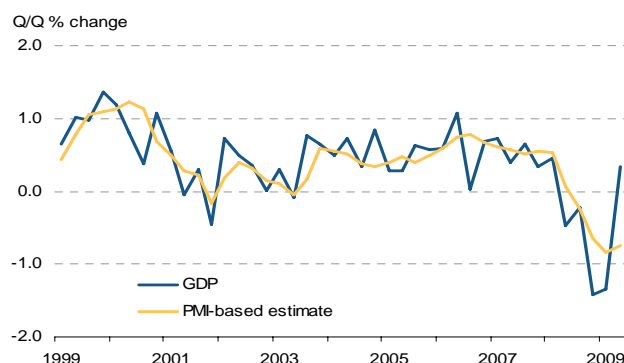


Table 1:

Country	Data	Q1*	Q2*
US	GDP	-1.6	-0.3
	Manufacturing output	-6.0	-2.5
	Retail sales	0.2	-0.7
	Car sales	3.4	11.7
	Exports	-11.5	-1.3
UK	GDP	-2.4	-0.8
	Manufacturing output	-5.5	-0.2
	Retail sales	0.4	0.7
	Car sales	-6.0	n/a
	Exports	-7.5	-2.0
Eurozone	GDP	-2.5	-0.1
	Manufacturing output	-8.4	-2.5
	Retail sales	-0.8	-0.4
	Car sales	-1.7	n/a
	Exports	-15.2	-1.4
Germany	GDP	-3.5	+0.3
	Manufacturing output	-13.9	-0.5
	Retail sales	-0.8	-0.1
	Car sales	+11.5	-0.6
	Exports	-13.3	-2.1**
France	GDP	-1.3	+0.3
	Manufacturing output	-8.8	0.2
	Retail sales	-0.5	1.2**
	Car sales	0.1	-0.1
	Exports	-12.0	-1.7

Sources: Markit, ISM, Eurostat, INSEE, FSO, Ecwin.

See notes section on page three for * descriptions

Notes

PMI GDP growth rates are implied rates derived from regression

*quarterly rates of change for monthly data series are calculated as the % change between average index readings for each quarter

** Q2 average is based on data for April and May only

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