

Eurozone manufacturing

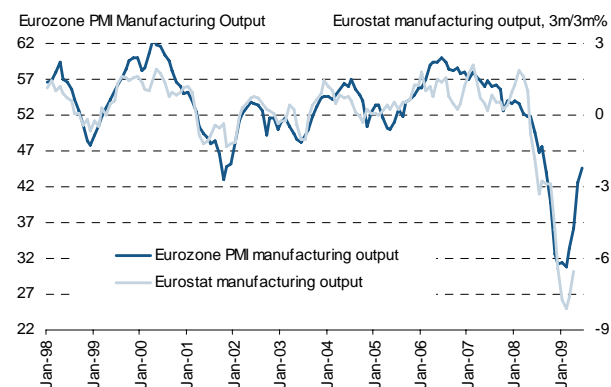
PMI data are consistent with an easing in Eurozone manufacturing output contraction as we move into Q3, but member states see different trends

- PMI data point to a further easing of the manufacturing downturn.
- France and the Netherlands are seeing a near-stabilisation of output...
- ... but rates of decline in Germany, Spain and Italy are still running close to previous survey records seen after 9/11.

Orders:inventory ratio rises

The Eurozone Manufacturing PMI for June (final data) indicated that the rate of contraction continued to slow from February's record pace, registering the smallest drop in output for ten months. The improvement in the PMI has begun to be reflected in official data. The most recently published data from Eurostat¹ showed that the rate of contraction in the latest three months compared with the previous three months eased from a peak of -8.1% in February to -6.6% in April (see chart 1). While the rate of contraction at the height of the downturn has been steeper than that indicated by the PMI's Output Index, the timing of the turning point in the official data has been precisely signalled in advance by the PMI.

Chart 1: Eurozone manufacturing output¹

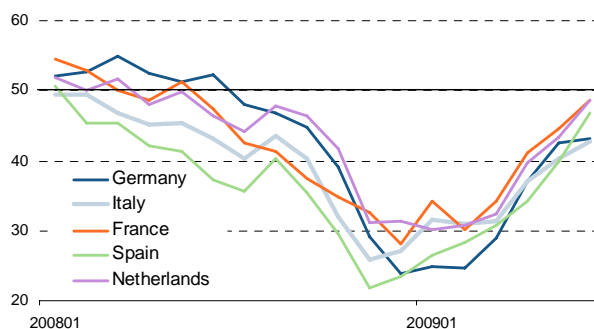


¹ Industrial production excluding construction

Box 1: Manufacturing new orders and inventories

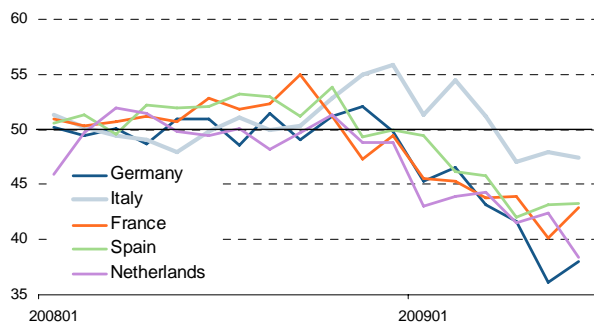
PMI Manufacturing New Orders

Diffusion index, 50 = no change on previous month



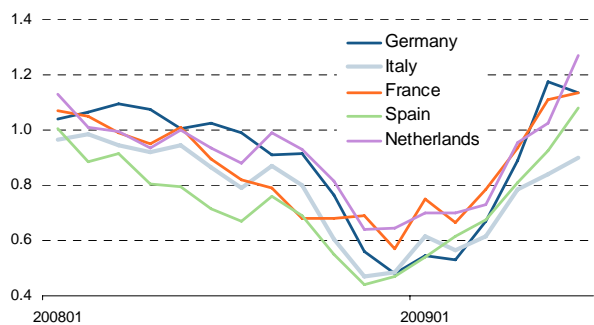
PMI Manufacturing Stocks of Finished Goods

Diffusion index, 50 = no change on previous month



PMI Manufacturing Orders:Inventory Ratio

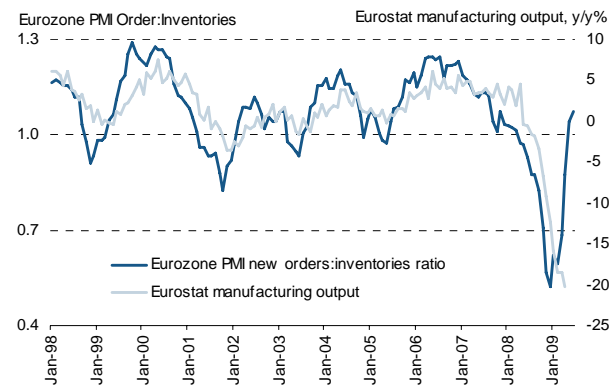
Diffusion index, 50 = no change on previous month



The PMI's Output Index therefore suggests that the official data will continue its easing trend during Q2, although, even up to June, the PMI has a long way to go before stabilising: the PMI Output Index has only just risen above the previous record low, hit in the immediate aftermath of 9/11 (and the PMI itself remains below its 9/11 low, reflecting particular weakness in the Employment Index component of the PMI during the current downturn).

The scale of lost output is illustrated by the official data for April, which indicated that output was some 20.3% down on a year ago – a record decline. However, there are signs that this rate will ease – possibly markedly – in coming months. The PMI survey's ratio of new orders to inventories tends to move in advance of the annual rate of change in official data, and has provided advance warning of every significant turning point in the official data since PMI data were available at the start of 1998 (see chart 2). This ratio has risen from a low of 0.52 in December to a 19-month high of 1.08 in June. This provides a strong indication of a turning point in the official annual rate of change in manufacturing output and bodes well for a continuation of the easing trend into Q3.

Chart 2: Output and inventories



The orders:inventory ratio has risen due to the combination of falling stock levels and a slower rate of deterioration of order books. Companies have deliberately run down stocks to reduce costs during the downturn, and this destocking continued at a near-record rate in the Eurozone in June. Meanwhile, the rate of deterioration of order books at Eurozone manufacturing companies has slowed markedly in recent months, easing from a record rate of contraction in December to the weakest for a year in June.

Wide national variations in performance

These trends of stock depletion and slower rates of decline in order books have been evident in all main Eurozone national economies (see box 1). The stock run-down has been noticeably less severe in Italy (and commenced later than in the other countries), meaning Italy consequently recorded the lowest orders:inventory ratio of the five largest euro countries in June, while the Netherlands had the highest ratio.

These order:inventory ratios help to explain the divergences in national output trends within the euro area (see chart 3). While the Netherlands and France are already showing signs of output stabilising in June, rates of decline in Germany, Spain and Italy remain strong by historical standards of the survey.

Chart 3: PMI Manufacturing Output Index

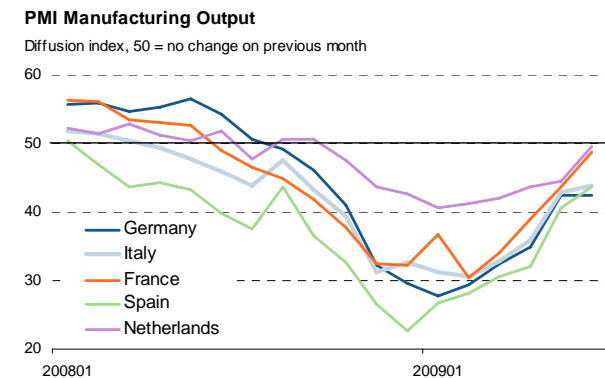
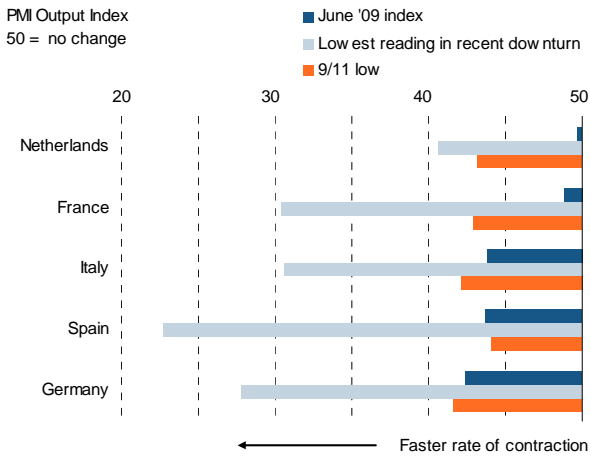


Chart 4 plots the latest (June) readings from chart 3 against the lowest readings seen during the current downturn. The chart also includes the lowest readings observed in the immediate aftermath of the terror attacks of 9/11, which for all surveys represented previous survey record lows.

While the rate of decline of output has clearly moderated sharply since the peak rates of contraction seen in the latest downturns, rates in Italy, Spain and Germany remain similar to the previous peaks seen after 9/11, and in the case of Spain even exceeds the 9/11 peak.

Chart 4: PMI Manufacturing Output Index



The sub-par performance for Italy can therefore be largely explained by the orders:inventory ratio, and in particular the delay in dealing with the overhang of excess stocks. Spain is meanwhile most likely suffering disproportionately due to the impact of its distressed property and construction sectors, while Germany is struggling largely as a result of its dependence on export, especially of investment goods, global demand for which has fallen particularly sharply during the recession.

The national divergences heighten the risk of a protracted road to recovery for the Eurozone as a whole, and suggest that for some member states, particularly Germany, Spain and Italy, any return to growth looks like it remains a long way off.

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