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Eurozone

Shock slump in industrial output in July, but surveys point to gradual upturn

- **Official data show 1.5% drop in industrial production in July**
- **Output falls in Germany, France and Italy**
- **Data have been volatile this year; PMI points to gradual recovery**

A surprise fall in industrial production across the euro area in July represents a hugely disappointing start to the third quarter. The data call into question the region's recovery that was signalled after GDP rose a stronger-than-expected 0.3% in the second quarter. There is clearly a risk that GDP could contract again in the third quarter, as some of this second quarter growth proves to have been only temporary (or perhaps even illusory).

More reassuringly, recent business surveys point to a gradual underlying improvement in business conditions across the region, indicating that a nascent recovery is indeed underway. But these weak official numbers serve as a reminder that the economy is treading a bumpy path and will further take pressure off the ECB to consider tightening policy any time soon.

Steep production fall

Industrial production fell 1.5% across the euro area in July against analysts' estimates of a 0.1% increase. Compared to a year ago, production was 2.1% lower, disappointing analysts who were anticipating a more modest 0.1% decline.

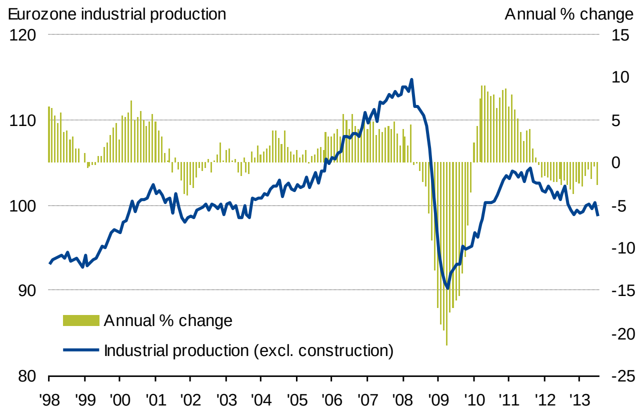
The decline takes production back to its lowest since April 2010.

Output fell 2.3% in Germany, more than offsetting the 2.2% rise seen in June, and dropped 0.6% France after a 1.5% fall in June. Output also declined in Italy, down 1.1%, but rose modestly in Spain, up 0.1%, helping to recover some of the 0.6% loss seen in June.

Reassurance from business surveys

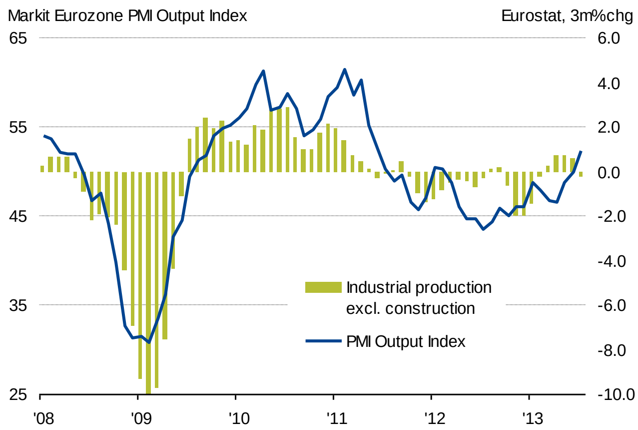
The official data and business surveys have contrasted in recent months. The official data showed a surprisingly strong (0.6%) increase in production in the

Eurozone industrial production



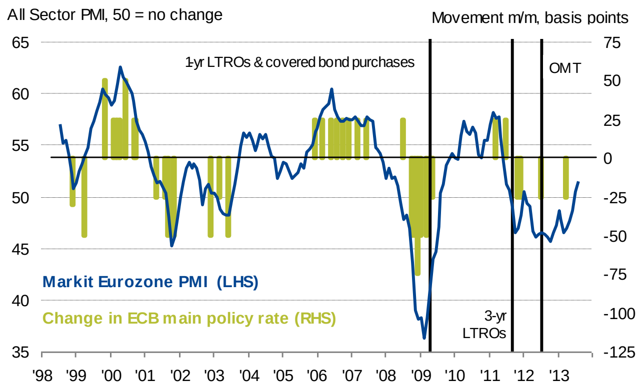
Source: Eurostat (via Ecowin)

Official data and Markit PMI compared



Sources: Markit. Eurostat.

ECB policy decisions and the PMI



second quarter, from which there appears to now be some form of payback in terms of output, possibly as firms adjust stock levels down due to weaker-than-expected sales. PMI data, in contrast, have followed a less volatile path than the official data. Having merely signalled an easing in the rate of decline in the second quarter, the surveys suggest that the goods-producing sector continued to recover in July and August. Markit's manufacturing PMI rose to its highest for just over two years in August, with accelerating growth of new orders suggesting factories will continue to ramp-up production in September. The PMIs in fact suggest that it is likely that we will see output rise in all of the largest member states in the third quarter, led by Germany.

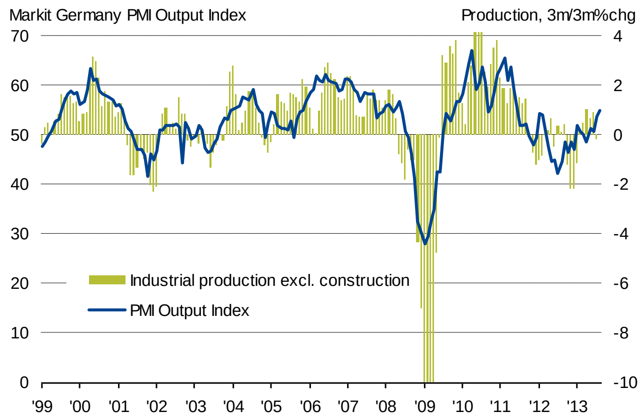
However, even the business surveys suggest that growth is only very modest and a sustained recovery is far from assured at this stage.

ECB 'ready to act'

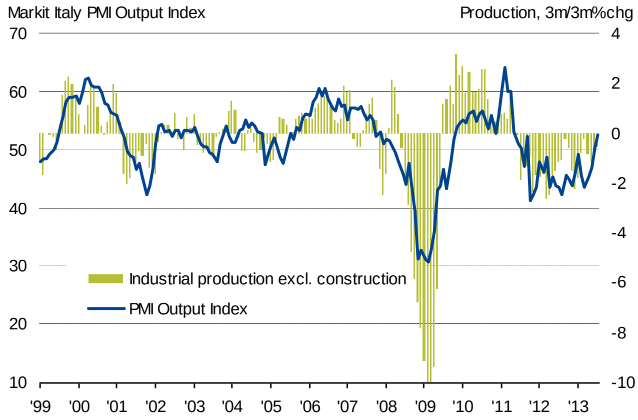
Policymakers at the ECB will therefore be eager to stress that policy will not be tightened for the foreseeable future and that they remain ready to act if the recovery shows further signs of faltering. Even the PMI data, which have in the past had a close correlation with changes in monetary policy, remain far below levels that have previously been consistent with tighter policy, despite the recent upturn (see chart), and in fact suggest that further policy action should not be ruled out, especially if borrowing costs in the periphery continue to rise.

National PMI and official data compared

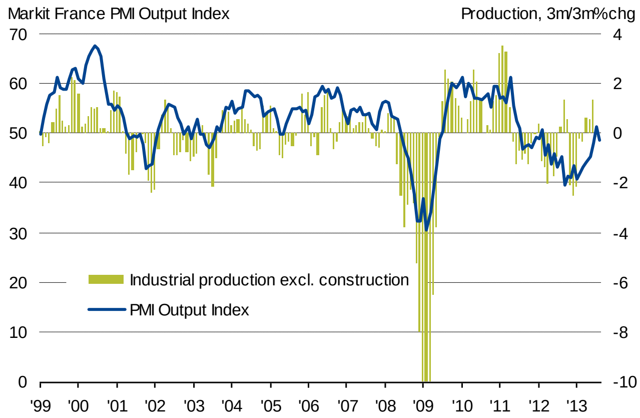
Germany



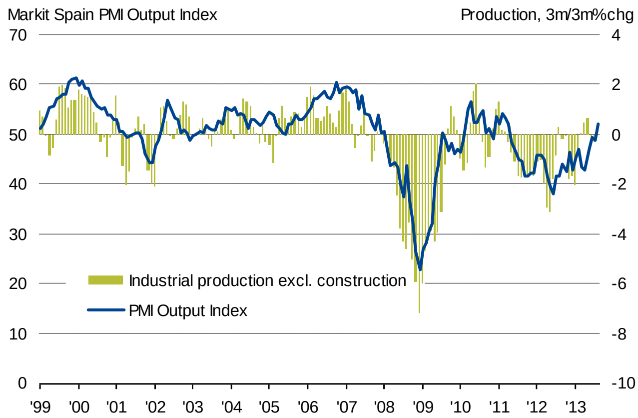
Italy



France



Spain



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