

Eurozone

Industrial production falls in May and business optimism wanes

- Eurozone industrial production slides 1.1% in May after 0.7% rise in April
- Production 0.1% lower so far in Q2 compared to Q1
- Holidays may have exaggerated May weakness, but surveys also point to slowing growth in June and drop in business optimism

Eurozone industrial production fell sharply in May. Although the decline is likely to have been temporary, the disappointing numbers add to evidence that economic growth in the region is slowing. Business optimism and hiring intentions have cooled from the three year highs seen earlier in the year, led by darkening clouds forming over the French economic horizon in particular.

The recovery clearly remains weak and vulnerable to further set backs unless business and household confidence picks up in the 'core' countries of France and Germany. While the latter may be buoyed by the World Cup football success, there seems little in prospect to lift the mood in France. The region's second largest economy therefore looks set to continue to act as a drag on the region's recovery throughout the second half of 2014.

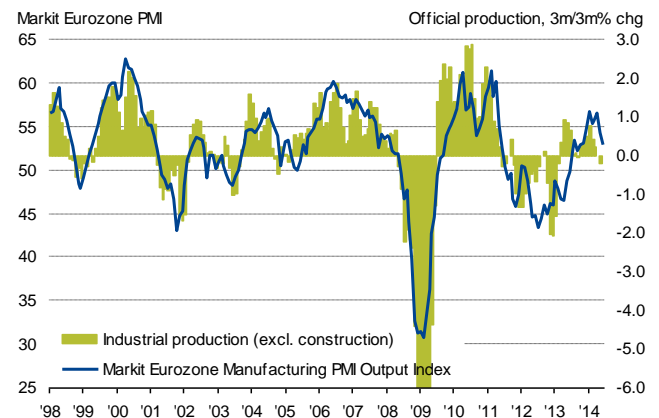
Downturn likely to be temporary

[Data from official statistics body Eurostat](#) showed industrial production across the region falling 1.1% in May, reversing a 0.7% rise in April (revised from 0.8%). The decline was more or less in line with expectations, according to a poll by Reuters, in which a 1.2% fall was predicted. Output collapsed 1.4% in Germany and by 1.3% and 1.2% in France and Italy respectively. Spain saw a 0.9% decline. Portugal fared worst of all, however, with a 3.6% decline.

Compared to a year ago, output across the region was just 0.5% higher in May. The latest three months have seen output fall 0.2% on the previous three months, which is the first decline seen since February of last year on this basis.

Output in the second quarter so far is 0.1% lower than in the first quarter.

Eurozone production and the PMI



There's a strong likelihood that the decline exaggerates the current weakness of the industrial sector in the region, given the number of holidays taken in May. With incidences of public holidays falling on Thursdays, many workers are reported to have also taken the Friday off as well, meaning a stronger than usual downturn for the month. Such extra holidays are notoriously difficult to fully account for when seasonal adjusting economic data.

We therefore expect production to have rebounded in June, and for the industrial sector to have made a positive, albeit disappointingly modest, contribution to the economy.

Business optimism cools, led by gloom in France

While the sector may not necessarily be in decline, it is clear that some slowing of growth is evident. Markit's [Manufacturing PMI](#) for June showed the sector growing at its weakest rate for seven months.

Markit's [Business Outlook survey](#), published today, also shows optimism about future business activity and hiring in the eurozone having cooled in June from the three-year peaks seen earlier in the year, though it should be noted that optimism remained high by historical standards, and well up on this time last year. The number of companies expecting business activity to rise in the coming year exceeded those expecting a decline by 33%. This represents a disappointment compared to the net balance of +39% seen in the

previous survey, conducted in February, but is a marked improvement on the figure of +21% recorded in June of last year.

The overall dip in confidence masked divergent trends between member states. In particular, weakening optimism in the 'core' contrasted with a more upbeat assessment of future prospects in the 'periphery'.

France, which had seen business optimism hit a near three-year high earlier this year, saw confidence about future activity tumble to the lowest for a year, with firms now planning to cut employment and investment in the year ahead.

Optimism also fell sharply in **Germany**, though remained high by standards seen since the recession. Investment intentions also held reassuringly steady at a post-crisis high.

In contrast, business optimism in **Spain** held at the post-crisis high seen earlier in the year, with investment and hiring intentions spiking to new records. Optimism meanwhile hit a three-year high in **Italy**, with employment and investment intentions also rising.

The Outlook survey findings corroborate the latest PMI survey results. These showed the weakening growth in June being led by a renewed downturn in France and a softening in the pace of expansion in Germany. Outside of these two 'core countries' the performance of the manufacturing economy has improved, with growth the fastest since 2007 in June, according to the PMI surveys.

The outlook survey therefore suggests this trend of the 'periphery' outperforming the 'core' may persist in coming months.

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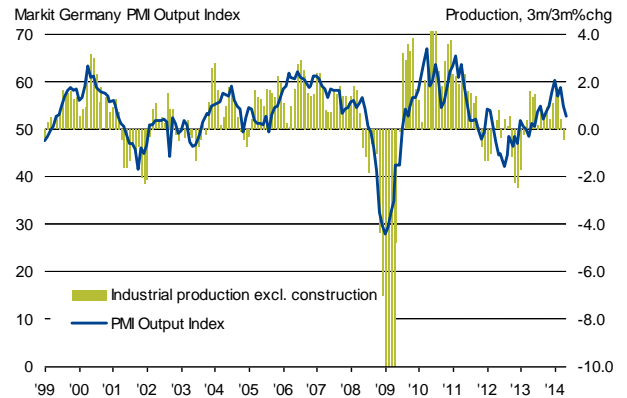
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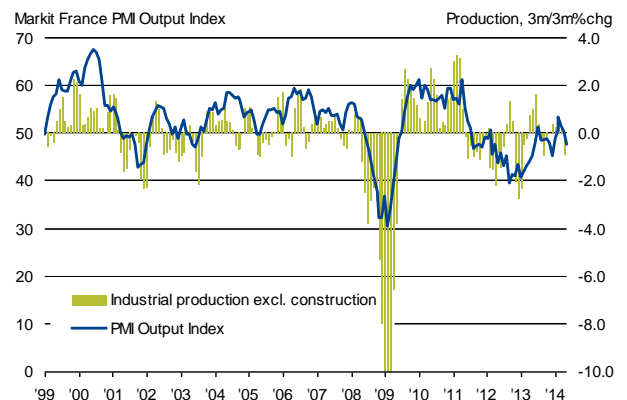
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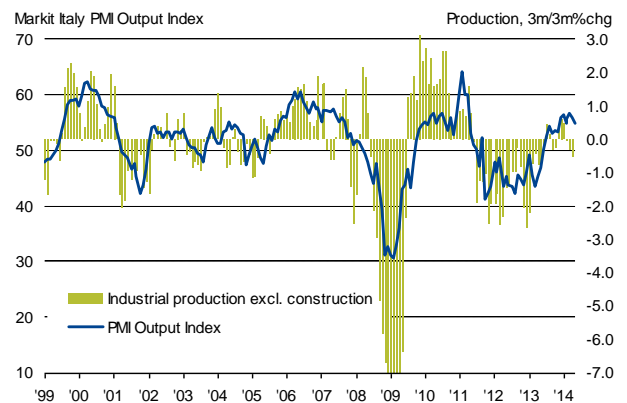
Germany



France



Italy



Spain

