

Eurozone

Manufacturing growth softens in July, but sector continues to buzz with activity

- **PMI data signal slower, but still strong, manufacturing output growth in July**
- **Strength of demand continues to stretch capacity, despite near-record jobs growth**
- **Recent data highlight how PMI offers major timing advantage over EC surveys**

Eurozone factories were buzzing with activity again in July, according to PMI survey data. At 56.6, the headline PMI came in slightly below the earlier flash estimate, slipping to a four-month low, but this is still an encouragingly buoyant reading. The survey's output index (just one of the five components of the headline PMI) indicates that manufacturing output was growing at an annual rate of approximately 4%–5% at the start of the third quarter, sustaining the best production growth spell that the region's factories have seen for six years.

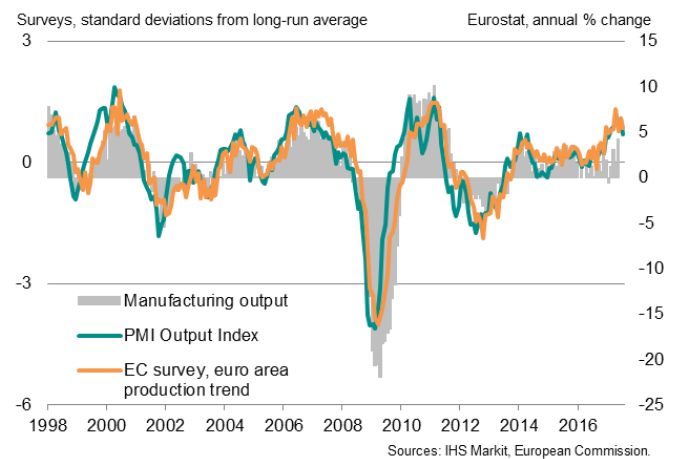
Germany clearly remains a major driver of the upturn, with only neighbouring Austria and the Netherlands enjoying faster rates of expansion, but this is a broad-based revival. Even Greece saw activity rise, albeit marginally, enjoying its first back-to-back monthly improvements for three years.

Capacity stretched despite record job gains

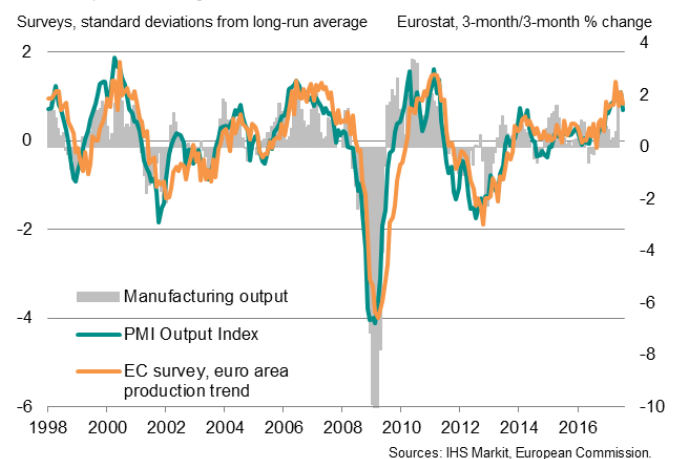
Employment growth meanwhile continued to run at one of the highest rates seen for at least 20 years in July, with the hiring boom underscoring the current ebullient mood within euro area factories. Future optimism among producers dipped slightly in July but continued to run at one of the highest levels seen for at least five years.

Despite the near-record rise in employment, companies continued to struggle to meet order book growth, with capacity constraints both at factories and their suppliers having become increasingly widespread in recent months. While the survey showed that price pressures eased in July, the stretching of capacity suggests that inflationary pressures could pick up again if demand continues to outstrip supply.

Manufacturing surveys compared to official data: annual output growth



Manufacturing surveys compared to official data: quarterly output growth



Survey comparisons

The recent upturn in the PMI is slowly being confirmed by official Eurostat data, the latest numbers for which showed manufacturing output surging 1.3% in May. The less volatile three-month on three-month growth rate consequently surged to 1.5%, its highest for over two years and just marginally shy of a six-year high. The improvement in the official data closes a gap which had opened between the official data and stronger survey numbers earlier in the year.

The upturn in the PMI is also being confirmed by other survey data, notably those financed by the European Commission. A recent [European Commission-funded paper](#) looks at the relative performance of European Commission survey data and the PMI, comparing the predictive capabilities of the surveys against official data. The study finds broadly similar performances but overlooks one major aspect of the PMI surveys: timing. The study only looks at coincident and one-month lead correlations. However, while the highest correlation of the EC survey data with euro area manufacturing production (91%) is achieved when the survey data are compared with the official annual growth rates with no leads or lags, **the PMI achieves its strongest correlation (87%) with a lead of some three months.**

The lead of the PMI over EC data is clearly visible when charted. Examples of this timing advantage include the following, which uses three-month averages to determine survey turning points:

- The PMI signalled the start of the 1998/99 downturn one month ahead of the EC survey and correctly signalled the brevity of the downturn, bottoming-out four-months ahead of the EC survey.
- The PMI signalled that the rate of decline of manufacturing output during the global financial crisis bottomed out in February 2009, two months ahead of the EC survey.
- The PMI indicated that the manufacturing recession ended in September 2009, but it was not until April 2010 that the EC survey turned positive.

It therefore seems that, for a marginal trade-off in terms of correlation, the PMI surveys offer a significant timing advantage to investors, business planners and policymakers over other survey data.

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