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Eurozone: PMI drops below 50 in July, confirming recession worries

The sharp decline in the composite PMI from 52 to 49.4 indicates that recessionary pressures are becoming more widespread in the eurozone economy. For the European Central Bank, this confirms our view that it will only hike another 50 basis points in total this year



Yesterday marked the end of negative rates in the eurozone as the ECB raised interest rates by 50 basis points. In the statement, the ECB recognised that after having accomplished this, it will now be completely data-dependent moving forward and determine on a month-by-month basis how much rates will need to be increased.

Well, on day one of the ECB's data-dependent approach, the data is not looking great. The eurozone composite PMI has fallen below 50 – from 52 in June to 49.4 in July. This, according to the survey, signals contraction. This adds to our expectation of a eurozone moving rapidly towards a (shallow) recession.

The manufacturing sector is still experiencing the toughest environment at the moment. Production dropped sharply in July according to the survey and new orders are also on the decline. Perhaps more problematic is that service sector growth is also slowing substantially – the services

PMI dropped from 53 to 50.6, which is roughly in line with stagnation. While a strong tourist season could save the third quarter from contraction, weak German activity does put that view in doubt. Overall, the picture therefore shows weakness in activity across the board, which is resulting in sharp inventory run-ups and weaker hiring demand.

In terms of inflation, the PMI shows some easing of price pressures even though they do remain elevated. Global demand easing and easing of Covid constraints in China are helping supply chain problems to moderate, and weakening domestic demand in the eurozone is also making it harder for businesses to price through higher input costs to consumers. Of course, it is hard to predict the peak in inflation as it is so dominated by energy price developments, but early signs of alleviating price pressures make expectations of an inflation peak in the second half of this year reasonable.

For the ECB, today's PMI confirms our view of a modest set of rate hikes. After yesterday's 50 basis points, we only expect the ECB to hike a further 50 basis points in total as recessionary pressures are already cooling the economy quite significantly.

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