Eurozone: PMI drops slightly as inflation pressures remain

The composite PMI fell from 55.8 to 54.9 in May, still signalling decent expansion. With inflation pressures remaining close to all-time highs, this keeps hawkish pressure on the ECB to act quickly despite growth concerns

Christine Lagarde, president of the European Central Bank

Squeezed purchasing power, weak consumer confidence, and tightening financial conditions are just a few of the headwinds the eurozone is facing at the moment. Nevertheless, the PMI doesn't indicate that this is translating into a contracting economy so far, but we do see the first signs of weakness coming through. This is mainly because of the service sector still profiting from fading pandemic restrictions. The May data showed some weakening as the service sector PMI fell from 57.7 to 56.3. While still signalling strong expansion, it is a sign that the reopening boom has started to fade.

The manufacturing PMI signalled stalling growth in April, but the indicator improved modestly in May from 50.7 to 51.2. Bugged by input shortages related to the war in Ukraine and lockdowns in China, the sector is having problems with production. At the same time, new orders also decreased for the first time since mid-2020, showing early demand concerns.

Inflationary pressures are barely abating though. Input costs have slightly dropped from record highs, and selling price expectations remain close to April's record high. Some early signs of improvement are unlikely to translate quickly into a fading inflation rate. Moreover, hiring intentions remain strong for now, which will add to labour shortages and subsequently to wage pressures.

For the ECB, this is a hawkish signal. The growth outlook is clearly worsening, but the current impact of high inflation and the war is not yet contractionary according to the survey. We have seen ECB doves pushing back at a 50 basis point hike in July, but this PMI release will likely continue the conversation about whether President Christine Lagarde's promise of no more negative rates by the end of 3Q will already be accomplished at the July meeting, or whether it will be 25bp in July and again in September. The next stop in terms of the ECB's data-driven lift-off is May inflation data, due out next week.

Author

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com