Eurozone PMI falls but remains well above 50 as supply chain problems ease

Falling service sector activity reflects the impact of Omicron on the economy, but manufacturing problems eased. We do expect GDP growth to weaken in 1Q, but there are quite a few silver linings to current developments

France's La Defense business district

The eurozone PMI has held up fairly well during this wave of the pandemic. Remaining comfortably above 50, there is little indication of a contraction like we saw last winter. Still, we are expecting growth to slow further this quarter as catch-up effects fade, restrictions impact services, and supply problems remain an ongoing hurdle.

Reduced activity on the back of rapidly rising Covid-19 cases has had an impact on the service sector. With new restrictions in place in the large eurozone economies, activity is dropping in the sectors that are affected most drastically. This is mainly in hospitality and tourism, but also in retail to some degree.

The major news out of the release is that manufacturers are again noticing some abatement in supply chain problems. The manufacturing PMI jumped from 53.8 to 55.8, which indicates that after cautious signs of improvements in December, things have materially improved in January.

Manufacturers mentioned that less critical inputs were experiencing shortages and also said that transportation delays were easing, according to Markit. Still, problems remain and backlogs of work are still increasing.

This is important from an inflation perspective. While businesses do still report strong rises in selling prices, easing supply chain problems are helping to limit producer price growth. While consumer inflation for goods is set to rise further in the months ahead, businesses did report the weakest rise in input prices since April, which could help to slow consumer inflation later in the year.

All in all, while growth is affected negatively by the new restrictions in place, there is a silver lining to this PMI release. The improvements in manufacturing should help dampen the downside from services as Omicron affects economies more, meaning that the current Covid-19 wave is likely to affect the economy less negatively than the wave from the previous winter.

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