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Eurozone: PMI hints at faster growth and sends hawkish signal to the ECB

Consumers are ignoring the purchasing power squeeze for now as reopening effects boost service sector growth while manufacturing cools. We now expect the ECB's first rate hike to be in the third quarter

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There were a lot of reasons to expect a more significant weakening in the PMI this month. Weak consumer confidence, high inflation, supply chain disruptions and tightening financing conditions were all set to have a negative effect on output this month. But the PMI indicates that the economy has proven to be quite resilient to these factors. It increased from 54.9 to 55.8 in April. This is mainly because of strong reopening effects still benefiting the eurozone economy.

The services PMI increased from 55.6 to 57.7, helped by sectors that still benefited from fewer Covid restrictions. So despite the record drop in real wages, consumers still seem eager to spend some of their savings built up during the lockdowns now that restrictions have eased.

Manufacturing did feel the impact of the war though. A sharp decline in the index from 53.1 to 50.4 corresponds to stagnating output growth and was driven by high prices and supply chain disruptions. The car sector was particularly hard hit again but other sectors also saw production hiccups due to input shortages related to the war and the new lockdowns in China. The survey also reported weakening demand for goods, which is a sign of a more structural slowdown.

The eurozone economy continues to face challenges ahead. Prolonged high inflation will start to weigh more on household consumption over time with weaker demand for goods spilling over into services demand when catch-up demand fades. Also, investment will be weighed down by higher interest rates and weakening credit conditions in the coming months. Supply chain problems are already an issue now and are set to remain problematic given the build-up of containers in Shanghai and continued disruptions related to the war.

Nevertheless, this is a clear hawkish signal to the European Central Bank. With this PMI signalling continued economic recovery, risks to the inflation outlook remain skewed to the upside and that is likely to be another argument for the ECB to move faster than initially expected. We now expect a first hike to happen in the third quarter and another one in the fourth but keep a close eye on the growth environment as outperformance of expectations could mean more hawkish surprises are in store.

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