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Eurozone PMI suggests worsening economic conditions

The eurozone PMI suggests contracting economic activity at the start of the third quarter. Overall, this fits a trend of weakening survey indicators over recent months and increases the recession risk for the bloc. The survey continues to suggest moderating price pressures, but the impact of wages on services will remain a concern for ECB hawks

Survey data became progressively bleaker during the second quarter and the July PMI continues that trend. The June composite PMI stood at 49.9, broadly signalling stagnation, but in July the PMI dropped to 48.9, indicating contraction. Demand in the eurozone is falling for both goods and services according to the survey, with services new orders dropping for the first time in seven months while the decline in new orders for manufacturing steepened further.

France and Germany look particularly bleak with output PMIs signalling contraction, which is offset slightly by the rest of the eurozone. We don’t have more details yet, but this could be due to more tourism-dependent economies profiting from a somewhat stronger summer period. Still, the positive tourism effect doesn't seem strong enough to counter weakening in the economy elsewhere.

We have previously argued that the eurozone economy has been in a stagnation-type environment, and the recent two quarters of minimal negative GDP growth should not be taken as a broad recession given the strength of the labour market. The July PMI suggests that recession risk has increased though. With expectations of output weakening further, the outlook for the coming months is sluggish at best.

The inflation picture coming from the survey is very similar to recent months. Price pressures are cooling, but more so for goods manufacturers than services providers. Rising wages continue to keep price pressures elevated for services, resulting in a slower downward trend. Dropping input costs are helping to bring inflation expectations down much faster for goods at the moment. This confirms our view of a materially lower inflation rate towards the end of the year but keeps hawkish concerns about the effect of wages on inflation alive.

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