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Declining eurozone PMI: More ammunition for ECB doves

The Eurozone PMI declined from 52.2 to 51.5 in July, thanks to deepening manufacturing contraction. If the European Central Bank takes this release seriously at tomorrow's meeting, it would nudge them more towards quick action



Source: Shutterstock

Has the ECB already made its mind up about the course of action or can the July PMI still change things? Difficult to say, but surely governing council members will take note of it. As the second quarter has likely come in weak, this is an important first look at how the third quarter has kicked off and it does not look good.

Growth concerns remain significant

The economy is still growing, but the pace remains weak in the third quarter. With manufacturing dropping sharply according to the PMI (drop from 48.5 to 47), concerns about the growth environment remain significant. Even though service sector activity remains strong for now, the

question is how long that can be maintained when industrial production experiences a prolonged decline.

The strong service sector performance is in part driven by the surprising performance of the Eurozone labour market. As long as job and wage growth remains solid, the service sector will benefit from improving household consumption. The PMI indicates weakness in employment growth though, with manufacturing employment in Germany dropping sharply according to the indicator and falling for the third month in a row for the Eurozone as a whole. That foreshadows moderation in the service sector, making a swift recovery of growth unlikely.

Finally, the PMI signals a weakening inflation outlook with easing input prices on the industrial side. This has its impact on selling prices as businesses indicate slower inflation from both the industry and service sector side. As inflation pressures decline, the inflation outlook seems to be weakening if anything at the moment. All in all, the PMI paints a picture of an economy that is flirting more with the downside than with swift recovery. More ECB stimulus seems to be a done deal, but the timing remains an exciting question. If the ECB has yet to decide whether it is already tomorrow or September when it will act, this PMI has given the doves on the governing council even more ammunition.

Author

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

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