

Euro-Area Recovery Still Export-Dependent

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The euro-area recovery remains sluggish and is heavily dependent on external support. While exports to most regions are now rising at a rapid pace, shipments to the US continue to stagnate—partly reflecting the euro’s recent overvaluation.

Although official figures for the whole of the euro area have not yet been released, data from Germany, France, Spain and the Netherlands (66% of the total) suggest that the recovery remains heavily dependent on external demand. Consumption, investment and inventories all had a negative impact in the fourth quarter. Indeed, the only reason the economy grew at all—and by just 0.1%—was because exports rose by 1.6%. This outstripped a 0.6% gain in imports, allowing net trade to boost GDP by an estimated 0.5% points during the quarter.

The importance of foreign demand to the upswing is evident in other indicators. For example, while euro-area exports rose by 8.7% between the second and fourth quarters of last year, manufacturing output rose by just 2.3% over the same period. Part of this gap is likely to reflect lower inventories. But the size of the gap may indicate that domestic demand is lagging behind foreign demand.

That is certainly the message from factory orders data. Since the second quarter of last

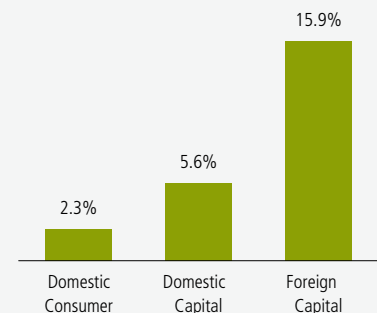
year, foreign capital goods orders have increased by 15.9% (**Display 1**). Over the same period, domestic capital goods orders have risen by 5.6% and domestic consumer goods orders have risen by just 2.3%.

Survey data from early 2010 suggest that this trend is continuing (**Display 2**). In February, the output component of the more export-dependent manufacturing purchasing managers’ index (PMI) rose to 56.9, the highest since early 2007 and well above the long-term average for this series (53.0). By contrast, the output component of the services PMI slipped back to 52.0 and is now below its long-term average (53.7).

So where is the export impetus coming from? The good news is that, with one important exception, it is broadly based. In the six months between May (the trough for euro-area exports) and November 2009 (the latest date for which a full country breakdown is available), euro-area exports to other western European countries rose by 7.9%, exports to eastern Europe were up 6.3% and exports to Asia rose by 6.9%

Display 1
Foreign Demand Leads the Way

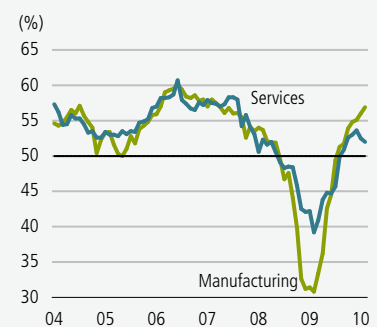
Change in Factory Orders, Q2:09 to Q4:09



Capital goods data include automobiles.
 Source: Haver Analytics and AllianceBernstein

Display 2
Manufacturing Drives the Cycle

Output Components of Purchasing Managers’ Indices



Source: Haver Analytics, Markit and AllianceBernstein

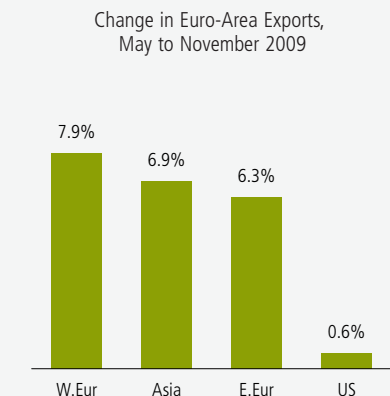
(Display 3). These three regions are all of roughly the same importance for euro-area trade and, in total, account for 71% of total exports.

The one important area of weakness for euro-area exporters has been the US (12% of total trade). Between May and November, euro-area exports to the US rose by just 0.6%. Indeed, the situation is even worse than that. Data for December show that while overall exports rose strongly in the final month of the year, exports to the US slipped back. As a result, total exports are now 11.8% higher than they were in May but exports to the US are 1.1% lower.

Finally, it's important to consider how these changes have affected the level of exports. Because external trade fell so heavily in late 2008 and early 2009, the recent revival leaves the level of exports 16.0% below the peak level reached in 2007 **(Display 4)**.

But this masks some important differences between regions. Whereas exports to Asia have recovered so quickly that they are now back close to peak levels, exports to the US remain almost 30% off their highs. Part of this reflects crowding out from low-cost competition from Asia, compounded by the weakness of US demand over this period. But it is hard to believe that the overvaluation of the euro has not also played a major role. We continue to think that the euro needs to fall further against the US dollar. ■

Display 3
Broad Based Export Gains... but



W.Eur is Denmark, Norway, Sweden, Switzerland and the UK.
E.Eur is eastern Europe.
Source: Haver Analytics and AllianceBernstein

Display 4
Exports to the US Still Very Depressed



Source: Haver Analytics and AllianceBernstein

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