

**ECONOMICS:** EUROPEAN PERSPECTIVES—JUNE 25, 2010

# Euro-Area Survey Data Remain Resilient

■ **Darren Williams**  
 Senior European Economist—Global Economic Research

Although euro-area survey data weakened in June, the declines were very modest and most indicators remain at healthy levels. In our view, the overall message is one of a gradual transition to a more modest pace of expansion. Indeed, the market is probably exaggerating the downside risks to euro area growth.

One of the key questions facing financial markets is whether Europe can withstand the twin pressures of accelerated fiscal tightening in the southern periphery and the adverse impact of increased financial and credit-market stress. Our view is that these factors are likely to dampen growth in the second half of the year, but that a strong global economy and easy monetary conditions should prevent a double dip. It's still early days but, so far, most of the data have been consistent with this view.

The most timely insights into underlying economic conditions in the euro area are provided by survey data. We can split the surveys into several groups. There are surveys, like the purchasing managers' indices (PMIs), that are highly correlated with economic growth. These coincident indicators are complemented by several leading indicators. These are less highly correlated with economic growth but do have some predictive power. The most closely watched of these are the expectations components of the German Ifo and ZEW surveys.

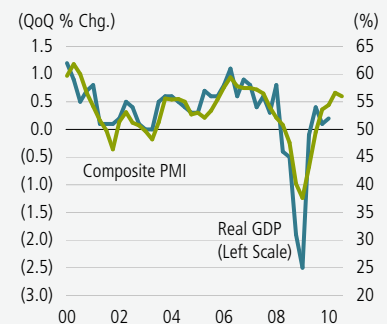
Finally, there is consumer sentiment. As a lagging indicator, we often find consumer confidence less helpful than other survey data. But consumer spending represents almost 60% of euro-area GDP, and this means that big shifts in sentiment can have important ramifications for the economic outlook.

The good news is that we have June data for all of the indicators mentioned above. The coincident indicators have been fairly resilient. The manufacturing PMI for the euro area as a whole fell to 55.6 in June from 55.9 in May. But this is still a solid reading in an historical context. The same is true for the services PMI, which fell to 55.4 in June from 56.2 in May.

By combining the output components of these indices, it is possible to construct a composite PMI covering the bulk of euro area production. In June, this fell to 56.0 from 56.4 in May. According to our estimates, this is broadly consistent with quarter-on-quarter economic growth of 0.6 to 0.7% (**Display 1**).

Display 1  
Composite PMI Points to Solid Growth

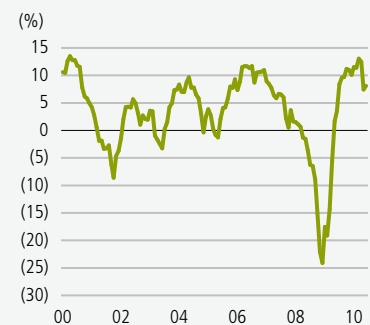
Euro-Area Composite PMI and Real GDP Growth



Source: Haver Analytics, Markit and AllianceBernstein

Display 2  
Gap Between Orders and Inventories Points to Slower Pace of Expansion

Euro-Area Manufacturing PMI: Orders less Inventories



Source: Haver Analytics, Markit and AllianceBernstein

Although we use the PMIs as coincident indicators, the difference between the orders and inventories components of the manufacturing PMI does have a slight lead over the headline index. In June, the gap between the two rose to 8.1 from 7.4 in May. This is below March's cyclical peak of 13.0, but is a healthy reading in an historical context **(Display 2)**.

The key expectations surveys in the euro-area are compiled from very different sources. While the Ifo Institute surveys a broad range of companies, the ZEW polls financial-market participants. Because of this, the surveys have different properties. The Ifo index is very highly correlated with German and euro-area economic growth but has a relatively short lead time. The ZEW has a longer lead time but is more volatile and sends more false signals.

The expectations components of the Ifo and ZEW surveys both fell in June. But that's where the similarity ends. The drop in the Ifo index was small and the series is still well above its long-run average. The fall in the ZEW survey, by contrast, was more pronounced and the series is now back at its long-run average **(Display 3)**. Companies, buoyed by the euro's fall, seem to be less concerned about the outlook than those working in volatile financial markets.

Over the last year, consumer confidence has recovered from the lows reached in early 2009. But this has been a sluggish process and, for the last few months, the index has moved sideways at fairly low levels on an historical basis **(Display 4)**. This pattern of broad stability continued in June, when confidence rose to -17 from -18 in May and -15 in April. It seems that adverse coverage of the sovereign debt crisis has yet to have a meaningful impact on consumers.

The overall picture that emerges from the June survey data is of an economy that is still growing quite strongly but with some signs that momentum is starting to slow.

The softness in some of the June data may be a spill-over from the sovereign debt crisis. But it may also reflect a natural maturing of the economic cycle, with the massive boost from inventories starting to fade and sluggish final domestic demand unable to fill the gap.

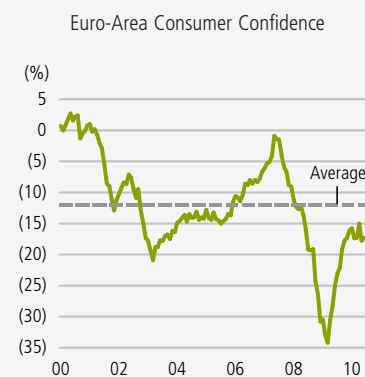
But none of the indicators are yet flashing major warning signs. We can see this by comparing recent developments with the period after Lehman Brothers collapsed. In October 2008, the composite PMI fell by three points to 43.6, the expectations component of Ifo was down five points to 81.3, the ZEW dropped by 22 points to -63.0 and consumer confidence fell by five points to -24. And most of these indicators fell heavily again in November. In comparison with this set of numbers, recent euro-area survey data have been remarkably resilient. Further tests may lie ahead. But, so far, most of the evidence suggests that markets are exaggerating the downside risks to euro-area growth. ■

Display 3  
Leading Indicators Start to Turn



Source: Haver Analytics and AllianceBernstein

Display 4  
Consumer Confidence Moves Sideways



Source: Haver Analytics and AllianceBernstein

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