

Flash Comment

Euro area: strong PMIs, but the ECB will still extend QE

The euro area PMI figures for October were strong, and in line with the latest signals they suggest that GDP growth in the euro area in H2 16 will be stronger than initially expected after the UK's vote to leave the EU. The manufacturing PMI increased to 53.3 in October from 52.6 in September and is hence at the highest level since April 2014. The service PMI also rose and was 53.5 in October from 52.2 in September, which is the highest level since January this year.

The composite PMI new orders index, which is a good leading indicator for economic activity, points to euro area GDP growth close to 0.5% q/q in Q4. The figures are overall likely to be slightly better than the ECB's previous expectations of 'a continued moderate but steady recovery', thereby supporting the hawkish members' view that more easing is not necessarily needed. Note that the ECB's executive board member Sabine Lautenschläger at the end of September said 'At the moment, I do not see any need for any additional stimulus', see *interview*.

The hawkish ECB members' stance was also supported by the composite PMI employment index which increased to 52.5 in October from 52.0 in September indicating that the euro area unemployment rate will continue to decline and eventually lift wage growth. The PMI employment index was also higher in Germany where it reached the highest level since 2011. The figure indicates continued progress in the German labour market, but despite the very low German unemployment rate (below the estimated structural/NAIRU level) it has not yet resulted in higher wage pressure and hence higher core inflation in Germany.

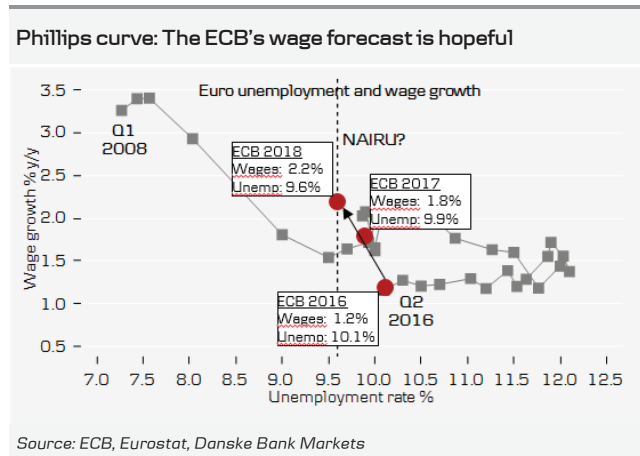
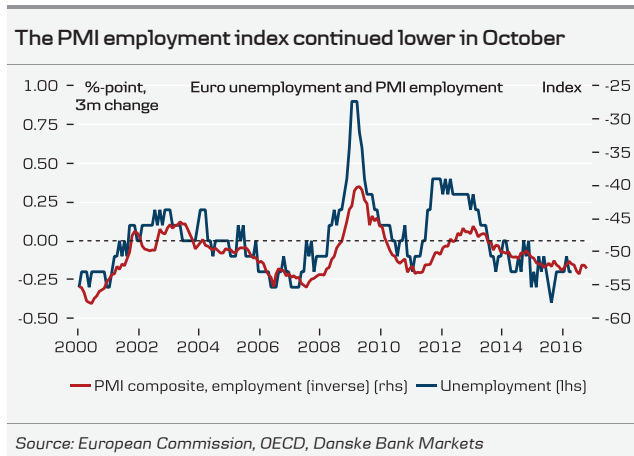
In our view, it will take a very long time before the stronger economic activity results in strong upward pressure on euro area wages. This should keep core inflation subdued and implies the ECB in our view will not conclude it has seen 'a sustained adjustment in the path of inflation' hence it should extend its QE purchases beyond March 2017. The ECB believes wage growth will pick-up significantly in coming years, but although the unemployment rate continues lower, we expect the trend in wage growth to be much slower than the ECB projects – especially as long as the German wage pressure remains modest. See more in our *ECB review: No ECB QE tapering discussion – we expect QE extension*, 20 October.

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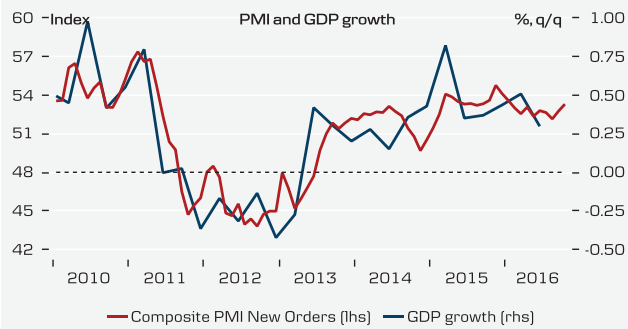
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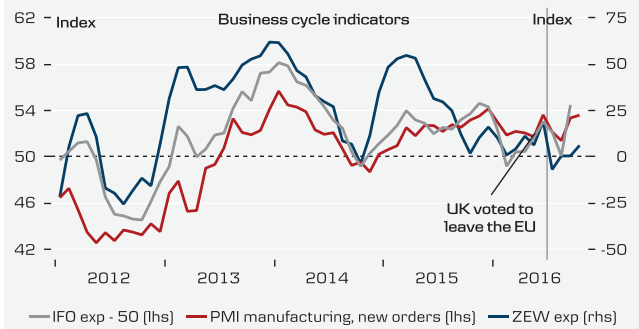
Euro area activity indicators

Composite PMI, new orders point to solid GDP growth in Q4



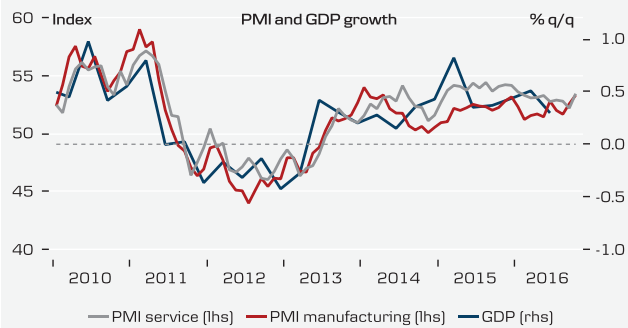
Source: Eurostat, Markit PMI, Danske Bank Markets

Manufacturing PMI back at the pre-Brexit vote level



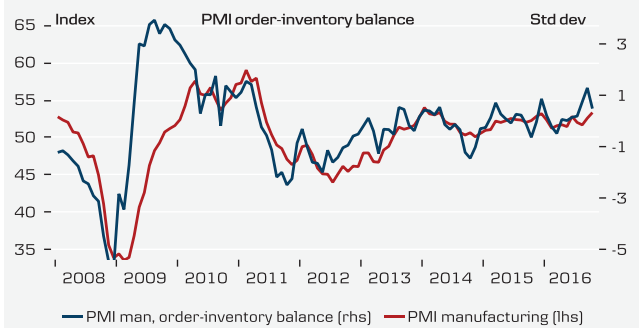
Source: IFO, Markit PMI, ZEW, Danske Bank Markets

The service PMI increased after the latest downward trend



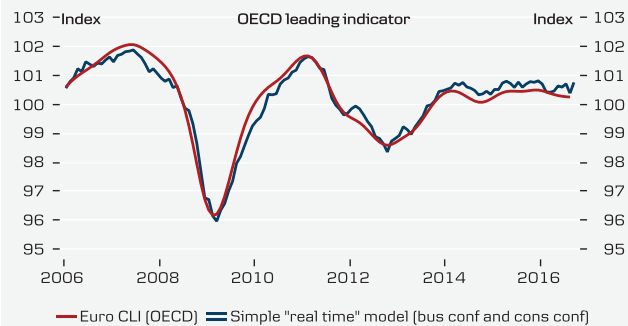
Source: Eurostat, Markit PMI, Danske Bank Markets

The order-inventory balance still suggests a higher man. PMI



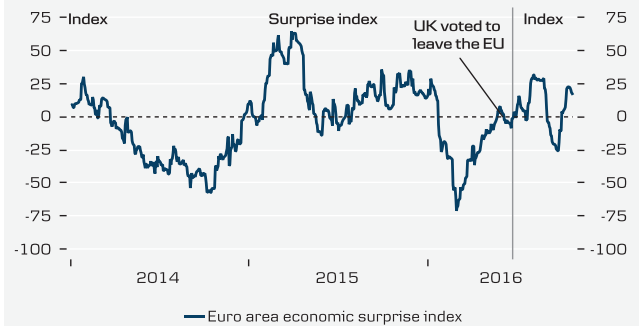
Source: Eurostat, Markit PMI, Danske Bank Markets

A 'real time' model also points to continued solid GDP growth



Source: European Commission, OECD, Danske Bank Markets

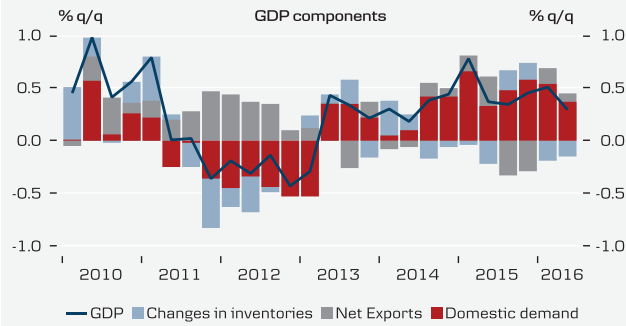
Overall data has surprised on the upside recently



Source: Bloomberg, Danske Bank Markets

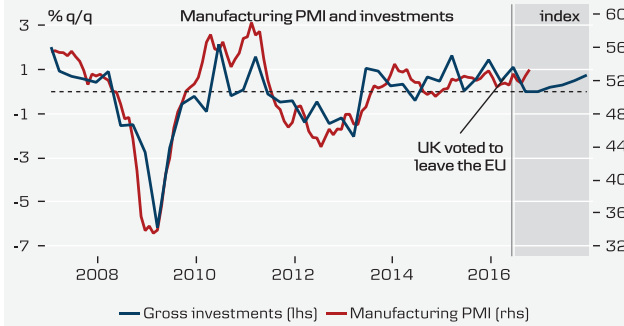
Euro area growth forecasts

Domestic demand remains the main driver of GDP growth



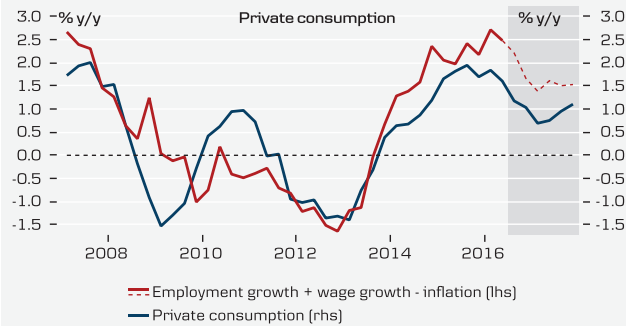
Source: Eurostat, Danske Bank Markets

Man. PMI suggests investments could surprise on the upside



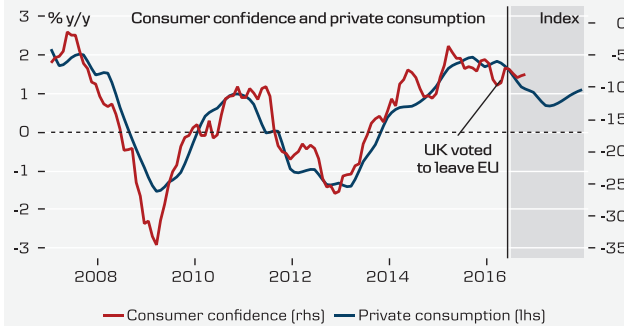
Source: Eurostat, Markit PMI, Danske Bank Markets

Private consumption will weaken on lower real wage growth



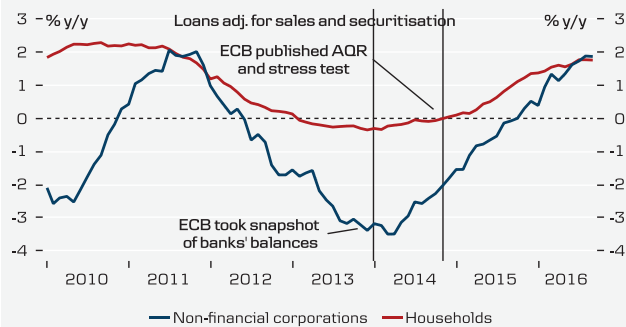
Source: ECB, Eurostat, Danske Bank Markets

Consumer confidence has been resilient to the Brexit vote



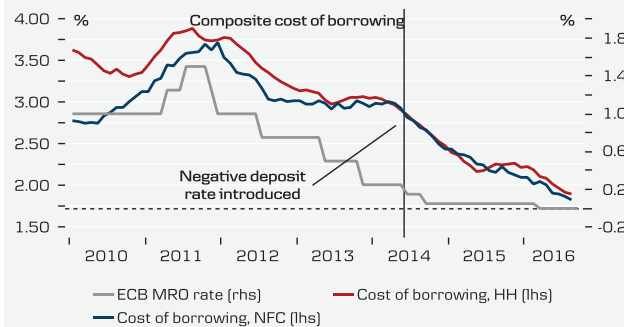
Source: European Commission, Eurostat, Danske Bank Markets

Highest loan growth since 2011



Source: ECB, Danske Bank Markets

Historical low cost of borrowing



Source: ECB, Danske Bank Markets

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Expected updates

None.

Date of first publication

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