15 April 2024

Research Global

Manufacturing recovery to continue into the summer

- **Our checklist for the global manufacturing cycle points to further upside in the coming months - but also tentative signs of a peak during H2.**
- **A softening in some leading indicators is broadly in line with our expectation of a temporary and mostly inventory-driven upturn rather than a new manufacturing boom. Easing financial conditions continue to provide support, though.**
- **The manufacturing recovery underpins commodity prices and provides some lift to goods inflation. However, we don't expect a new strong inflationary impulse from this channel as it would normally require a stronger manufacturing upturn.**
- **We see only limited impact on bond yields as the manufacturing recovery is set to be moderate - and is largely expected by markets. The lift to global manufacturing fits with our view of short-term upside risk to EUR/USD.**

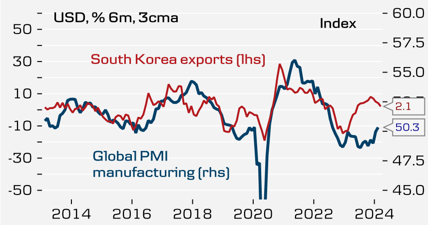
As we highlighted in *Research Global: manufacturing cycle has turned - more to come*, 7 February, the global manufacturing recession in 2023 was coming to an end. Over the past couple of months we have seen further signs of this with PMI manufacturing rising in both US, Europe and China. The upturn has come fairly late compared to signals from some leading indicators, which could be due to some interest rate sensitive sectors, such as construction and energy-intensive activity, has taken a bigger and longer hit this time relative to other manufacturing. That seems to be the case in Germany where energy-intensive production has clearly underperformed. But with financial conditions easing, we may finally see some improvement here as well.

Looking ahead, we expect to see further upside in global manufacturing PMIs going into the summer. The signals from leading indicators such as Asian exports, order-inventory balances and financial conditions all suggest that there is still more to the upturn.

However, we also see tentative signs of slowing momentum showing up in the second half of the year. The growth rate in Asian exports has started to taper off and the order-inventory balances have also rolled over suggesting that the lift from the inventory cycle is set to fade on a 3-6 months horizon. Finally, US goods consumption has had a weak start to the new year after a decent run in the second half of 2023. It broadly fits with our expectation that the manufacturing recovery is not the beginning of a new boom but that it will peak at a lower level than normal and probably also have a shorter duration.

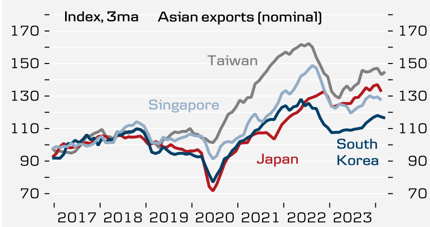
Of course, it could turn out that the softer Asian export data lately is just a pause in a further upward trend. That will also depend on how much monetary easing we are likely to get from central banks. If inflation suddenly drops faster again, we could see more easing and thus more support to growth. We could also see European consumers recover stronger.

Global PMI to rise further in coming months but softer signals for H2



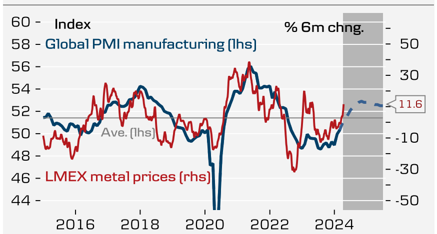
Source: Macrobond Financial, Bank of Korea, S&P

Asian exports have lost some momentum again



Source: Macrobond Financial

Global PMI to rise further before peaking



Source: Macrobond Financial, S&P. Note: past performance is no guarantee of future performance

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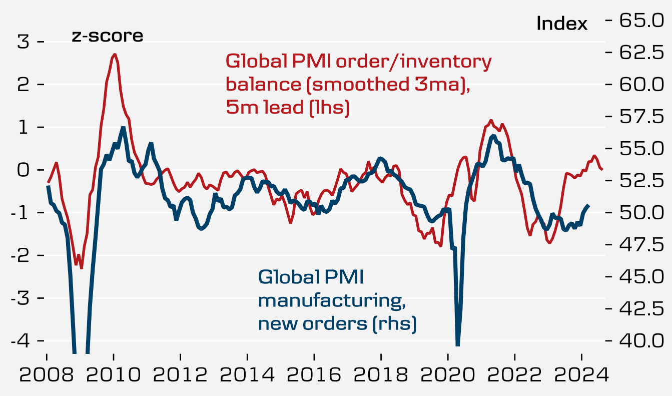
and add to goods demand or that the bounce-back in energy-intensive production is stronger than expected. But for now, we lean towards the manufacturing upturn being of a milder nature than the normal recovery and that we will see some moderation again going into 2025.

Market implications

A resurgence in industrial activity could add further upward pressure on **long-end rates** through 1) rising break-even inflation rates (especially in the short end) and 2) additional upward pressure on the policy rate trajectory pricing. However, following a pro-longed period of industrial setback, particularly in Germany, some recovery in manufacturing PMIs is most likely already factored into market expectations. Assuming our call for a moderate industrial rebound plays out, this will most likely mean that any additional upward pressure on rates, stemming from this part of the economy, will be short-lived.

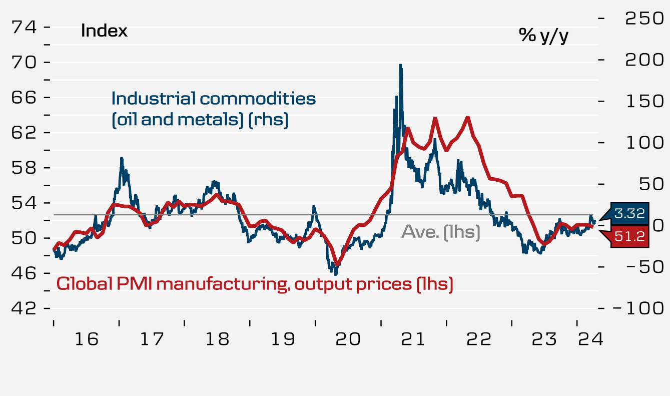
Further improvements in the global manufacturing sector, coupled with easing financial conditions, typically create a positive environment for **EUR/USD**, which aligns well with our near-term upside risk view for the cross. Nevertheless, we maintain a bullish outlook on the USD from a strategic perspective, and we forecast EUR/USD to reach 1.03 in 12M.

Order/inventory balance starting to roll over



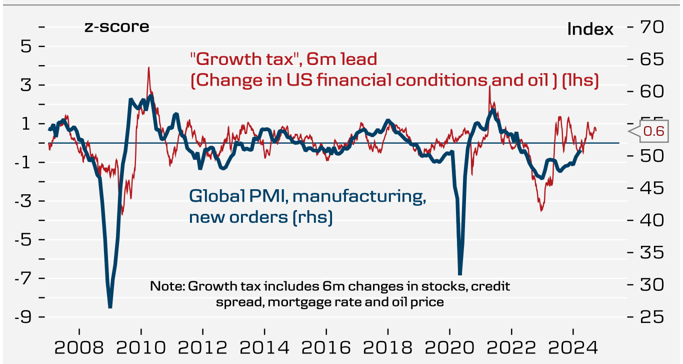
Source: Macrobond Financial, S&P, Danske Bank. Note: Z-score measures the order/inventory balance in standard deviations.

The best is behind us in terms of goods disinflation



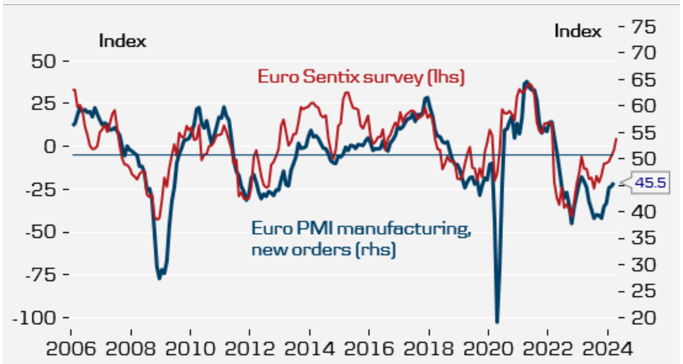
Source: Macrobond Financial, S&P, Danske Bank.

Easing of financial conditions provides support for growth



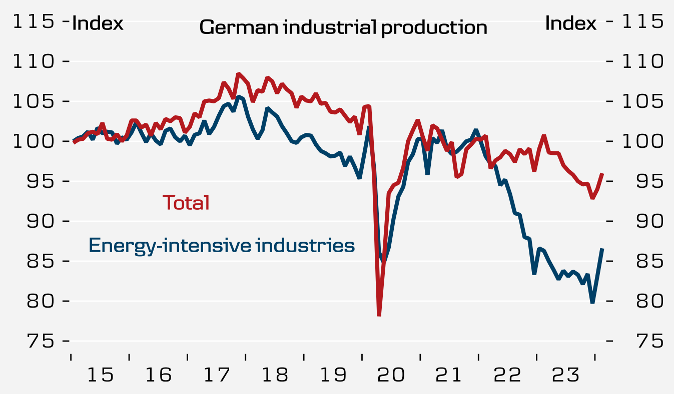
Source: Macrobond Financial, Bloomberg, Danske Bank

Sentix point to rising euro PMI



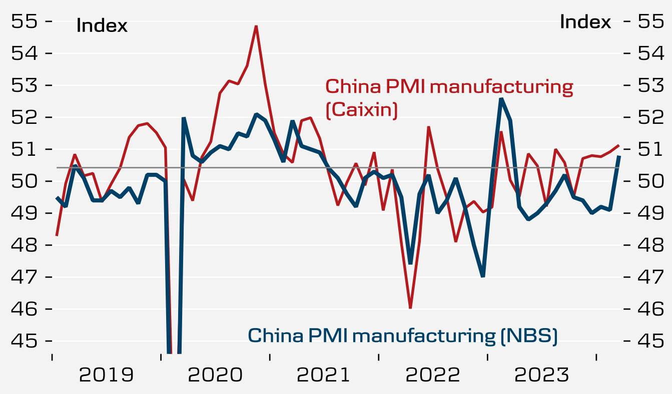
Souorce: Macrobond Financial, Bloomberg, Danske Bank

German energy-intensive production has taken a substantial hit but signs of turnaround



Source: Macrobond Financial, S&P, Danske Bank

China PMI manufacturing off to a decent start in 2024



Source: Macrobond Financial, S&P, NBS

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