

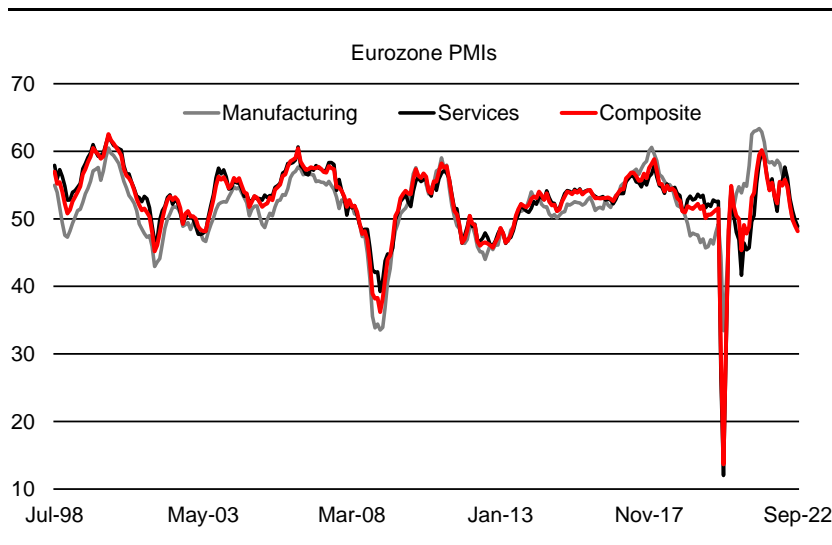
Eurozone PMIs: monetary policy trade-off keeps worsening

- Eurozone PMIs for September indicate a further weakening of growth momentum and rising likelihood of a recession at the turn of the year. The composite PMI dropped further into contraction territory, to 48.2 from 48.9, its lowest reading since early 2021 (UniCredit and consensus: 48.2). The manufacturing sector remains under pressure with no signs of a turnaround soon, while the deterioration in services activity gathers pace amid intensified erosion of purchasing power of households and the fading of the reopening effect. At a country level, France recorded a moderate acceleration in economic growth from a low level, while in Germany the downturn intensified. The press release signals that outside of these two countries, output contracted in September. Evidence that the latest surge in energy bills is already affecting firms' input and output prices further worsens the trade-off faced by monetary policy.
- The outlook for the manufacturing sector remains bleak, as both new orders and output indices declined further below the 50 threshold and the balance between new orders and inventories does not point to an improvement ahead. Ongoing weakness in demand, exacerbated by expenditure switching away from goods, continues to reduce stress on supply chains. In services, business expectations remain on a steep downward trajectory.
- The PMIs indicate that the latest energy-price shock is already feeding through to pipeline price pressure. Input and output price indices inched higher both in manufacturing and in services, following some months of easing from the peaks. The labor market remains resilient, as firms' hiring plans do not seem to be particularly affected by the deterioration in activity. The main uncertainty here is whether this simply reflects a lagged response of employment to output, or the frictions generated by the pandemic have led to a structurally tighter labor market. The jury is still out.
- The ECB will take notice of the increased likelihood of recession (which, strangely, is not part of its baseline scenario), but PMI details regarding prices and employment will certainly not pass unnoticed in Frankfurt. The October rate decision remains a very close call between a hike of 50bp and 75bp.

In greater detail:

The composite PMI declined to 48.2 from 48.9, with the indices for the manufacturing and services sectors down to 48.5 and 48.9, respectively.

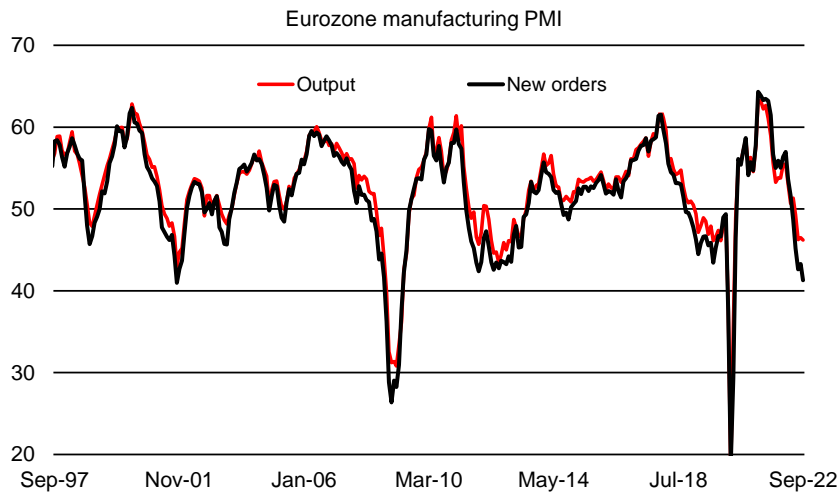
CHART 1: RECESSION BECOMES INCREASINGLY LIKELY



Source: IHS Markit, UniCredit Research

In the manufacturing sector, output and new orders indices point to intensifying contraction. The output index declined to 46.2 from 46.5, while the new orders index dropped to 41.3 from 43.3.

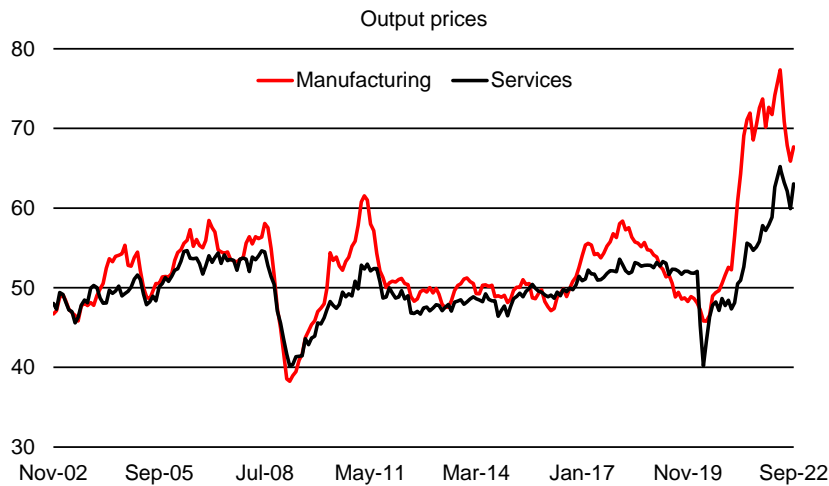
CHART 2: MANUFACTURING DOWNTURN ACCELERATES



Source: IHS Markit, UniCredit Research

The latest surge in energy prices is already affecting pipeline price pressure, following some months of moderation from the peak. This worsens the policy trade-off for the ECB.

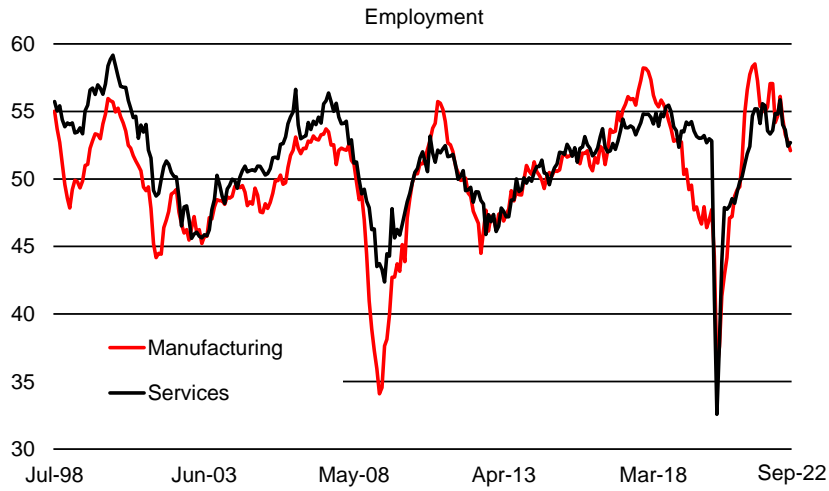
CHART 3: SOARING ENERGY BILL ALREADY FEEDS THROUGH



Source: IHS Markit, UniCredit Research

Firms' hiring intentions remain resilient, as the employment index holds comfortably above 50 both in manufacturing and in services. Lagged response to weakening activity, or structurally tighter labor market after the pandemic?

CHART 4: LABOR MARKET STILL IN GOOD SHAPE



Source: IHS Markit, UniCredit Research

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This report was completed and first published on 23 September 2022 at 12:50.

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