EDITORIAL

EUROZONE: WHAT'S BEHIND THE REBOUND IN THE SERVICES SECTOR BUSINESS CLIMATE?

In the longer run, the business climate in industry and services are highly correlated but in the short run large divergences can at times be observed. This has been the case in recent months following a strong rebound in services and a far weaker improvement in industry. Services cover a variety of activities and those that are very correlated with manufacturing have seen a weaker performance as of late. Tourism and recreation have low correlation with manufacturing and have been very dynamic. This may reflect there is still post-Covid-19-related pent-up demand and/or a combination of a pick-up in wage growth and a still strong labour market. Whether this can last will to a large degree depend on how the overall economic environment influences the labour market outlook.

Despite a high correlation in the longer run between the business climate in industry and services, in the short run large divergences can at times be observed.The European Commission's business surveys show a widening gap in recent months between services and industrial confidence (chart 1) on the back of a strong improvement in the former between November last year and January 2023 whereas the recovery in industrial confidence was far more subdued. The purchasing managers' index in services has rebounded significantly since its low point in November 2022 -from 48.5 to 55.6 in March- but the rebound in the manufacturing PMI has been shortlived -from 46.4 in October to 48.8 in January and 47.1 in March.

The dynamism in services -which is more outspoken in the PMI data than in the European Commission survey- is a welcome development from the perspective of GDP growth[1] but one wonders whether it can last in view of the weakness in manufacturing. Services cover a variety of activities, some are very correlated with manufacturing, others far less. Based on data for February, the latest month for which these data are available, chart 3 shows a negative relationship between the value of the PMI output index for a given sector in services and its correlation with the manufacturing PMI: within services, sectors that are closely correlated with manufacturing have a lower output PMI than sectors that are less correlated[2].

In its comment on the March PMI release, S&P Global reported that backlogs of work have been accumulating in services on the back of new business but have been declining in manufacturing due to a fall in orders[3]. The latter point is a source of concern and suggests that in the absence of an improvement in the business climate in manufacturing, the industry-sensitive parts of services could see a weakening of activity.

1 Services (including non-market services) represent 73.3% of value added in the Eurozone (data for 2021). Source: European Commission
2 Sector data are shown for Europe considering they are not available for the Eurozone. The correlation has been calculated with the manufacturing PMI for the Eurozone covering the period January 2022-February 2023.
3 Source: Service sector revival powers eurozone growth higher in March, S&P Global Flash Eurozone PMI, 24 March 2023.

EUROZONE: CONFIDENCE IN INDUSTRY AND SERVICES

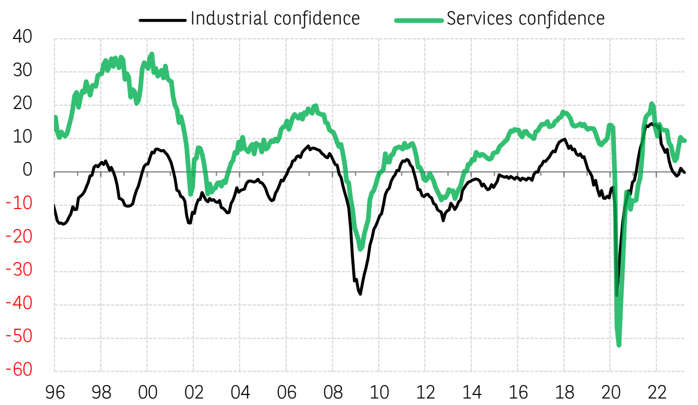

CHART 1

SOURCE: EUROPEAN COMMISSION, BNP PARIBAS

EUROZONE: MANUFACTURING AND SERVICES PMI

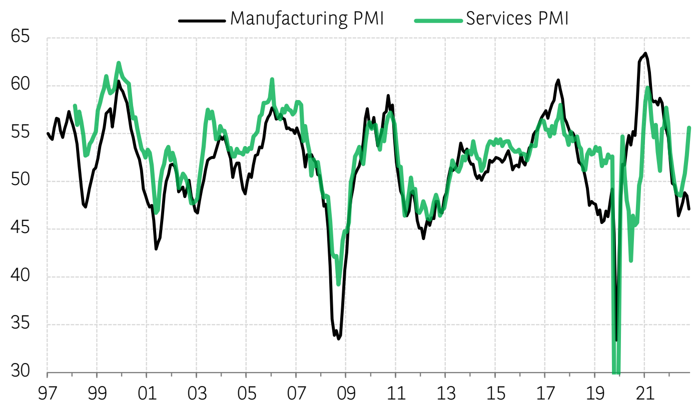

CHART 2

SOURCE: S&P GLOBAL, BNP PARIBAS

> In the absence of an improvement in the business climate in manufacturing, the industry-sensitive parts of services could see a weakening of activity.

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Admittedly, other sectors within services are very dynamic, most notably tourism and recreation. This may reflect there is still post-Covid-19-related pent-up demand and/or a combination of a pick-up in wage growth and a still strong labour market. Whether this can last will to a large degree depend on how the overall economic environment influences the labour market outlook. Slow disinflation, rising interest rates and tighter lending conditions imply some caution is warranted in this respect.

William De Vijlder

EUROPE: SECTOR PMIS AND CORRELATION WITH MANUFACTURING PMI

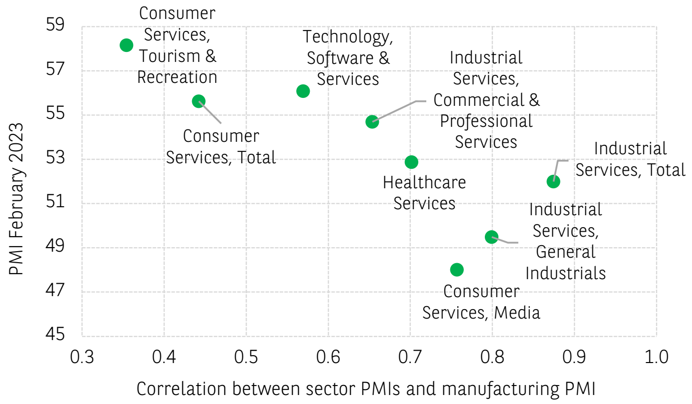

CHART 3 SOURCE: S&P GLOBAL, BNP PARIBAS