



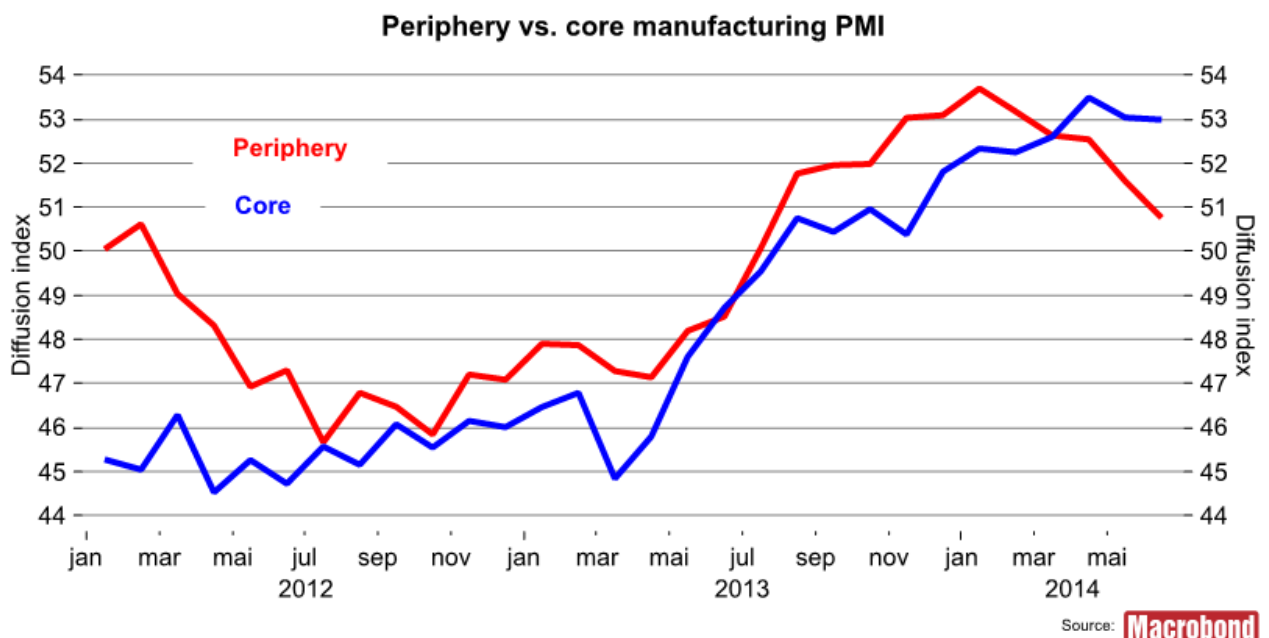
Eurozone: Pigs fly and eagles land

Torgeir Høyen, Fund Managers Skagen Tellus

There has been a turnaround in the Eurozone: **Presently the so-called periphery is probably growing faster than the so-called core.**

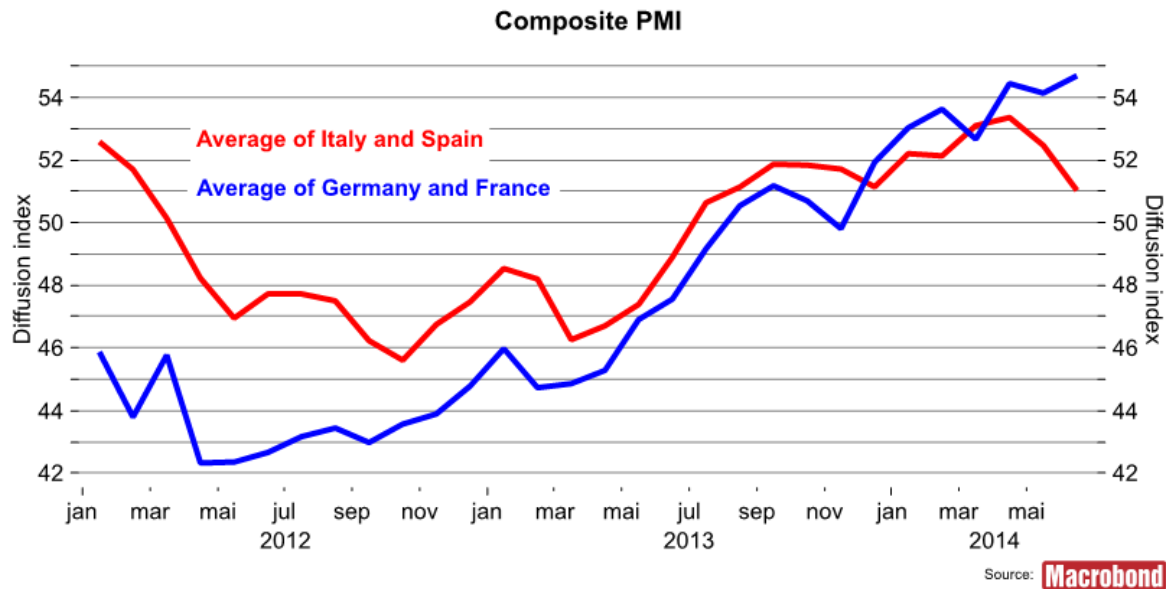
I've used Markit's Manufacturing PMI data to show this. The "periphery" is a simple average of the PMIs in Greece, Ireland, Spain and Italy. The "core" encompasses the Netherlands, Austria, France and Germany. (Markit does not produce PMI data for the rest of the Eurozone countries).

Since March the speed of growth in manufacturing has been higher in the periphery than the core. It will be interesting to see to what extent that is still the case when the July numbers are out on Friday.



A limitation with the numbers above is that they only refer to the manufacturing sector. (Markit does not have PMIs for the service sectors in more than a handful of Eurozone countries).

The figure below shows the average of the composite PMI for respectively Italy and Spain and for Germany and France. Composite PMI is constructed out of manufacturing and services PMI, by weighting their relative importance for GDP. The impression is the same. Growth has been accelerating and is higher in the “periphery” than in the “core”.



As for GDP growth we do not yet have the numbers for Q2 (except Spain, where GDP grew 0.6%). Eurostat does not calculate quarterly GDP for Greece. Hence, I focuses only Italy and Spain vs. Germany and France.

In Q1 the sum of GDP in Germany and France grew 0.5% and the sum of GDP in Italy and Spain grew 0.1%.

I expect these ranking to shift in Q2 – the periphery is probably going to grow faster than the core, both in narrow and broader sense.

How is the ECB going to respond to this? They will of course welcome the good news that pigs can indeed fly, but they are getting worried that some of the eagles, especially Germany, seems to prepare top land. (France, of course, never took off.)

In their traditional monetary policy they are going to focus as before on inflation and growth in the Eurozone as a whole. And it's important to remember that Germany and France together are huger economies than Italy and Spain. (The relative importance of the core vs. the periphery grows if a broader notion of the core and the periphery is used (as I did with the PMI numbers above).

The combined GDP of Germany and France was almost 100% higher than the combined GDP and Italy and France in Q1.

Upshot: We should expect ECB nervousness of a slowdown in the core as dominating the euphoria of a new life in the periphery.

Monetary policy is going to be “accommodative”. As in the US, the ECB is more or less out of

ammunition if there is a new slowdown. Trying to heal a new recession with monetary means will be like pulling on a string. Hence, they will try to do their utmost to convince markets that ultra-easy money is here to stay.

