CAPITAL ECONOMICS

GLOBAL ECONOMICS UPDATE

PMIs: Clear signs that services activity is now slowing

- **July's flash PMIs suggest that activity slowed further at the start of Q3. Industry remains the weak spot, but the outlook for the services sector has also deteriorated noticeably. And while this seems to be weighing somewhat on employment growth and price pressures, services inflation is still too high.**
- The latest flash PMIs suggest that activity in advanced economies continued to weaken at the start of Q3. Our estimate of the DM composite PMI fell to a six-month low of 51.3 in July from 52.2 in June, which at face value implies that activity was still expanding in aggregate in DMs in July, albeit at a slower pace than last month. The composite PMI fell in the US, UK and euro-zone, but was unchanged in Japan. (See Chart 1.) And in the euro-zone's case, the PMIs suggest that activity contracted for the second consecutive month.
- **The decline in the composite PMIs were driven by weaker activity in the services sector.** Although the DM services activity PMI remained above the 50 no-change mark – indicating expansion – in July, the pace of growth slowed compared to last month. (See Chart 2.) Meanwhile, the output component of the DM manufacturing PMI ticked up slightly, but still points to a sharp contraction in output. (See Chart 2 again.)
- **The outlook for economic activity also seems to have deteriorated further, mainly due to weak prospects for demand.** The PMIs suggest that new orders for manufactured goods continued to fall in July. And although new orders in the service sector were still accumulating, they rose at the slowest pace since February. (See Chart 3.) Meanwhile, supply recovered further as backlogs fell at their fastest pace in 3 years.
- **Weaker demand in the services sector has contributed to slower employment growth and more subdued price pressures. But labour markets are still tight, which is keeping wage growth and, in turn, services inflation elevated.** The employment components of the services PMIs still point to further employment gains in most DMs. And although the PMIs suggest that firms are increasing services output prices at a slower rate, they still point to historically high rates of inflation. (See Chart 4.)
- **The upshot is that while this batch of PMIs provides central banks with some encouraging signs that demand is softening, it will not have been enough to dissuade the Fed, ECB, and Bank of England from delivering further rate hikes this week and next.**

Chart 1: Composite PMIs

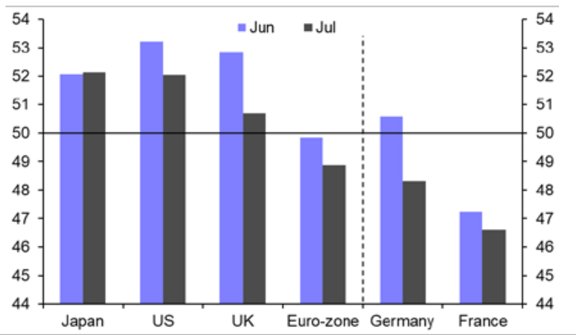


Chart 2: Flash DM PMIs: Output

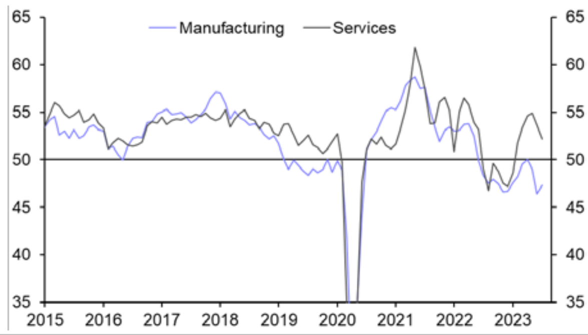


Chart 3: Flash DM PMIs: New Orders

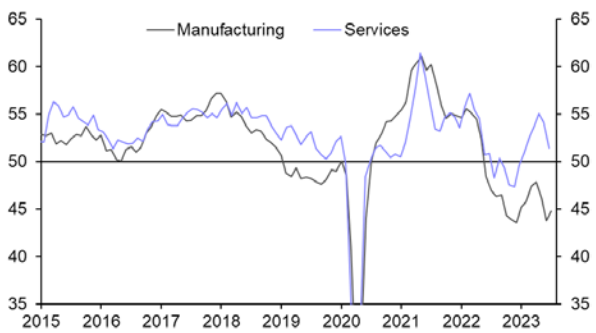
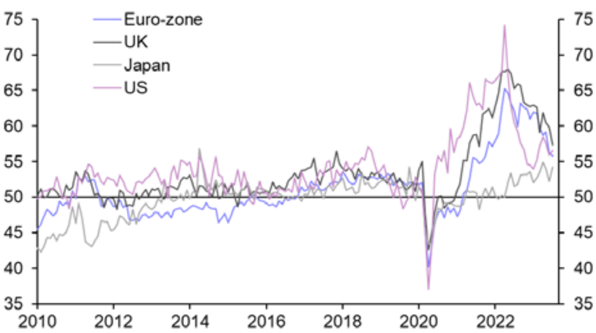


Chart 4: Flash Services PMIs: Output Prices



Sources: S&P Global, Refinitiv, Capital Economics

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