



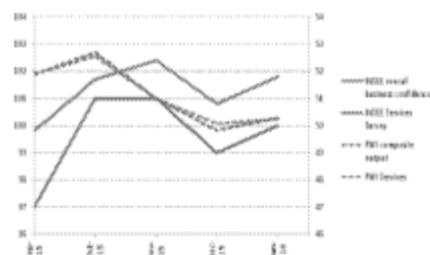
Italy was the main disappointment relative to expectations in the January PMI print. The 2.2 point decline in the composite PMI was the sharpest monthly fall since August 2014. Both services (53.6 vs 55.3 Dec, 54.2 exp) and manufacturing (53.2 vs 55.6 Dec, 54.9 exp.) saw steep declines. However, we must note that the decline comes after an unexpected rise to a new post-2011 high in December.

At the 53.8 January level the Italian composite PMI is still consistent with +0.3% qoq growth, just below our +0.4% qoq Q1 call. Credit conditions in particular continue to be supportive of ongoing above-trend growth in Italy in 2016 but we do expect growth to slow as we move into 2017 given this and the lower oil price are likely to become less strong tailwinds in the medium-term

Spain saw a contrasting performance across sectors. The composite PMI was essentially unchanged on the month (55.3 vs 55.2 Dec) but this was comprised of a 0.5 point monthly decline in the services to 54.6 (exp 54.4) and a strong 2.4 point rise to 55.4 in the manufacturing index. These are a 13-month low and an 8-month high respectively. One month's worth of opposite moves is too little on which to draw firm conclusions but it does appear that the outperformance of the services sector thanks to a very strong domestic recovery is coming to an end (Figure 6).

We expect a normalization of Spanish GDP growth in 2016 from the very impressive +0.9% qoq seen on average during 2015. The largest reasons for this are the credit dynamics. With the economy returning to positive credit growth, the credit impulse (yoy change in credit flows) is bound to slow³. Indeed, in Q4 2015 it fell to 3pp of GDP, around half the level seen on average in the previous four quarters. The uncertain political situation following the December election could also weigh⁴. The January level of the PMI is just below our expected +0.6% qoq Q1 GDP growth in Spain, although it should be noted that the PMIs have underestimated the pace of GDP growth by about 0.2pp in recent quarters (including with the +0.8% qoq preliminary Q4 estimate) so the risk could in fact be marginally to the upside of our expectation.

Figure 5: French surveys: contrasting performance of PMIs and INSEE



Source: Deutsche Bank, Markit, INSEE, Haver Analytics

Figure 6: Services outperformance may be coming to an end in Spain



Source: Deutsche Bank, Markit, Haver Analytics

³ While the improvement of banks' balance sheets has helped to rapidly slow the pace of deleveraging over 2014-15, it is unlikely that such a pace of improving credit growth can continue into positive territory which would require banks to increase their lending (and balance sheets) and potentially lead to a return of private debt imbalances that were a leading cause of the crisis in Spain.

⁴ See Spain article in 29 January Focus Europe for more details, available at http://pull.db-gmresearch.com/p/2253-BA11/86530447/DB_FocusEurope_2016-01-29_0900b8c08ab790a6.pdf.