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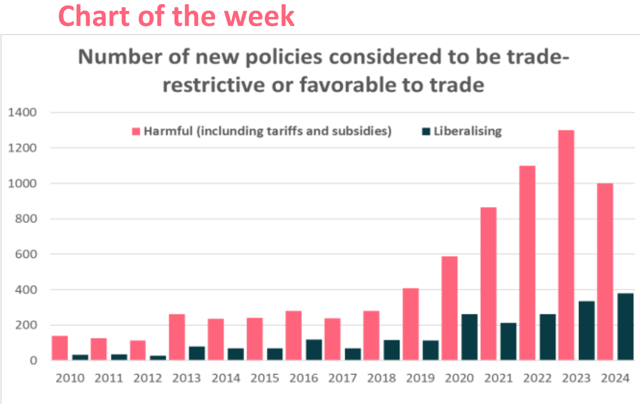
Topic of the week: Where does the divergence in business surveys in the Eurozone come from?
by Aline Goupil-Raguénès

- In normal times, business surveys provide consistent signals about the dynamics of economic activity;
- For the past few months, surveys have been diverging. According to S&P Global, the economic situation in France seems deteriorated, while according to INSEE, the Banque de France, and the EC, economic activity is close to its long-term average;
- This divergence mainly stems from the sample size. INSEE surveys 15 times more companies than S&P Global, and the Banque de France surveys 8 times more;
- It is even more problematic that the current context is characterized by a strong heterogeneity in sectoral dynamics;
- It's essential to have a large sample in order to fully understand the overall dynamics of economic activity;
- In this context, the results of the S&P Global survey should be put into perspective.

Market review: ECB: A First Rate Cut and Then What?
by Axel Botte

- ECB will cut rates by 25 bp this week but inflation is creeping higher;
- Treasury auctions faced with poor demand, US curve bear steepens;
- JGB yields top 1%;
- Sovereign and credit spreads remain stable.

Chart of the week



The number of new policies considered restrictive to global trade reached a record in 2023 (1,300). The year 2024 started off with a bang, notably with the decision of the Biden administration to increase tariffs on certain Chinese products, including a 100% tax on electric cars, to which China responded.

The European Union's response, following its investigation into Chinese subsidies, is expected to be more measured. The trade war is intensifying, with the risk of weighing on global growth.

Figure of the week

5

The IMF has revised upward its growth prospects for China to 5% in 2024, up from 4.6% previously, due to strong growth in the first quarter and new government support measures. This corresponds to the growth target set by the government.

Source: IMF

Topic of the week

Where does the divergence in business surveys in the Eurozone come from?

Business surveys are very useful for understanding the cyclical dynamics of economic activity, identifying potential turning points, and making growth forecasts. In normal time, the S&P Global survey, national surveys, and the European Commission survey provide a consistent signal on the activity dynamics. However, in recent months, a divergence has occurred among them.

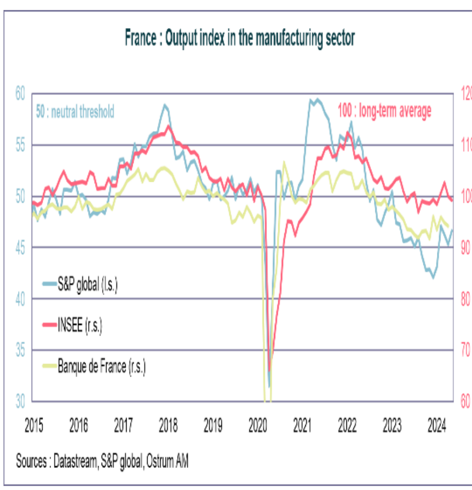
Survey Divergence: The Case of France

According to the S&P Global survey, activity contracted significantly in the autumn of 2023...

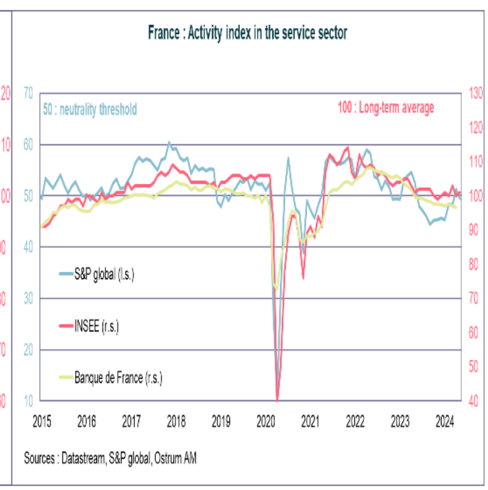
While business surveys usually provide a consistent signal on activity, there has been a divergence among them for several months. In the case of France, the PMI index from the S&P Global survey has significantly deteriorated throughout 2023, falling well below the neutral threshold of 50. The decline occurred in October 2023 in the manufacturing sector and in June in the services sector. The survey indicated a clear contraction of activity at the end of 2023, as the indices were well below 50: 42.1 in the manufacturing sector and 45.7 in services. Since then, they have improved to indicate a still deteriorating situation in the manufacturing sector (PMI of 46.4 in May), while the services sector tends to stabilize.

... this contrasts with the business surveys conducted by INSEE and the Bank of France

This contrasts with the surveys conducted by INSEE and the Banque de France. The business climate index of INSEE and the activity index of the Banque de France indicate a weak activity dynamic over the same period, but by no means a strong contraction. The indices remain close to 100, which corresponds to their long-term average, or move away from it in much smaller proportions than the S&P Global PMI in the case of the manufacturing sector index of the Banque de France.



Sources : Datastream, S&P global, Ostrum AM



Sources : Datastream, S&P global, Ostrum AM

The same observation applies at the European level

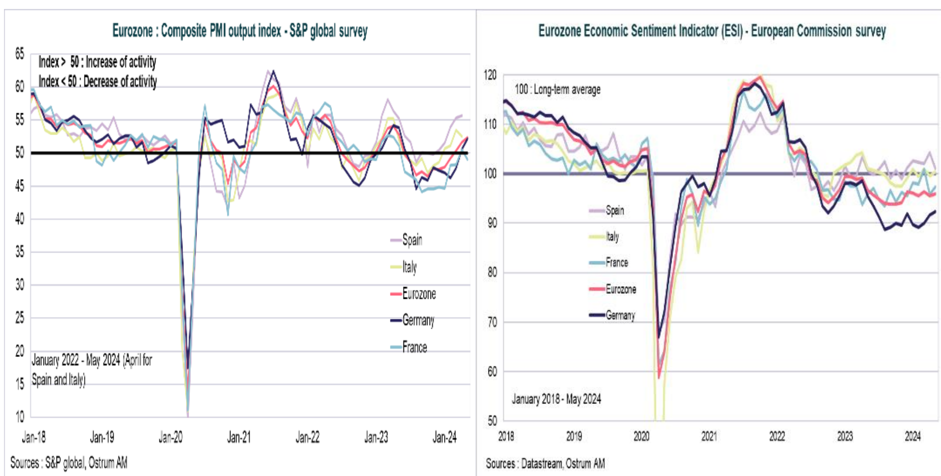
According to the S&P Global survey, the economic situation in France is as deteriorated as that of Germany at the end of 2023, or even more so

The European Commission survey compiles national surveys by harmonizing them to make them comparable across countries. For France, the European Commission uses the INSEE survey, for Germany, it uses the IFO survey, and for Italy, it uses the ISTAT survey.

Here too, divergences appear between the surveys when comparing countries. In the S&P Global survey, the French composite index (which includes the manufacturing and services sectors) reveals a very deteriorated situation in 2023 as it is well below 50. It is even lower than the German index from September 2023 to January 2024.

According to the European Commission's survey, the situation in France is much better than that in Germany

However, in the European Commission survey, the French economic sentiment index is indeed below its long-term average but close to that of the Eurozone and slightly lower than Italy's index. However, it is much higher than that of Germany, which is well below its long-term average. The situation in France appears more deteriorated than in Germany in the S&P Global survey (graph below on the left), which is not the case in the European Commission survey (graph below on the right). However, the GDP figures revealed nearly stagnant quarterly growth in France for 5 consecutive quarters, low growth in Italy (0.9% and 1% respectively on average in 2023), while German growth slightly contracted (-0.2%). The INSEE survey thus better captured the cyclical dynamics at work in France than that of S&P Global.



A significant difference in sample size

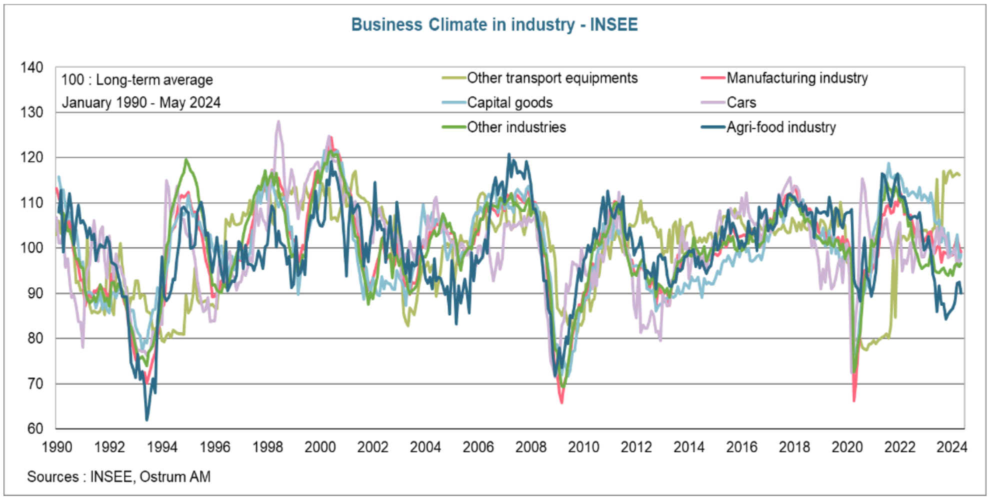
INSEE surveys between 15 and 20 times more companies than S&P Global

An article published on the INSEE blog provides some insights into the explanation for these divergences (https://blog.insee.fr/les-enquetes-de-conjoncture-se-valent-elles-toutes/). The main reason is a much smaller sample size in the S&P survey compared to that of INSEE. INSEE surveys between 15,000 and 20,000 companies each month, while the S&P Global interviews less than 1,000 (around 400 in the manufacturing and services sectors and 150 in construction), and the Bank of France surveys around 8,500 per month.

The difference in sample size has a significant impact in the current environment. After the two major shocks related to the Covid-19 crisis and the energy shock, sectors of activity are experiencing very contrasting cyclical situations, especially in the industry. If the business

This difference has a significant impact in the current context of very strong cyclical heterogeneity between sectors

climate in the manufacturing industry has been close to its historical average since the beginning of 2024, it has reached a historical high in the "Other transport equipment" sector, i.e. excluding automobiles. This is related to the rebound of the aerospace sector, which has not yet returned to its pre-pandemic level. However, the business climate in the agri-food sector is well below its long-term average, reflecting a deteriorated conjunctural situation. Food prices have seen a sharp increase due to the consequences of the war in Ukraine, putting pressure on the consumption of food products. Germany and Spain also experience significant sectoral heterogeneity.



The dispersion of activity indicators in the industry has reached a peak since 1995, excluding the health crisis

The dispersion of activity indicators in the industry sector is very high. According to INSEE, it has reached a peak since 1995, excluding the Covid-19 crisis. In this context, it is important to have a large sample to properly take into account the situation of each sector and capture the conjunctural situation of the entire industry. Otherwise, the results would be biased by focusing on only a part of the sectors.

Another reason for these divergences between surveys lies in the data processing. In the S&P Global survey, the activity PMI indices are calculated by taking weighted averages of the various opinion balances. INSEE and the Banque de France, on the other hand, conduct a factor analysis and principal component analysis to extract the common trend in responses.

Conclusion

The discrepancies in the results between the S&P Global surveys and the national and European Commission surveys in 2023 mainly stem from the sample size. INSEE surveys 15 to 20 times more companies than S&P Global, and the Banque de France surveys 8 times more. In the current context marked by very strong heterogeneity in cyclical situations among sectors, particularly in the industry, it is essential to have a sufficiently large sample size to properly integrate these strong divergences and provide a coherent overall activity indicator. The results of the S&P global survey, which are highly valued by market participants, should therefore be put into perspective in the current context of strong cyclical heterogeneity among sectors.

Aline Goupil-Raguénès

Market review

ECB: A First Rate Cut and Then What?

The ECB is going to cut rates despite high inflation fueling a sharp rebound in long-term rates in the euro area. Stocks are declining, but spreads remain unchanged.

The monetary policy remains at the heart of the game. The ECB is expected to proceed with an initial rate cut this week. Conversely, the Fed is delaying monetary easing while pushing back on the idea that the neutral rate has increased. The FOMC is thus giving itself the necessary flexibility to achieve its dual mandate. The US economy experienced a probably temporary, soft patch in March-April. Europe growth is gaining strength with a pickup in inflation. In this context, bond yields are rising to the detriment of equity markets, but without prejudice to sovereign or credit spreads.

US data depicts a moderation in growth towards the end of the first quarter. US growth has been revised downward to 1.3% in Q1. Household spending on durable goods fell (-4.1%) in the three months to March. On the other hand, residential investment and business R&D spending were stronger than initially estimated. The trade balance however continues to weigh on GDP growth. The goods trade deficit indeed deteriorated to $99 billion in April. Activity is thus expected to plateau at 2% between April and June. The PCE deflator, roughly unchanged for the last 5 months, stood at 2.7% in April. The core index is at 2.8%. In the euro area, the 25-bp rate cut on June 6 is a done deal. The next steps could prove to be more uncertain given the pickup in inflation (2.6% in May) and collective wage negotiations at their highest (+4.7% in Q1). The path to the 2% inflation target remains fraught with obstacles. Downunder, the persistence of inflation had already changed the rhetoric of the RBA and RBNZ early on this month. This rebound in prices is also accompanied with signs of stronger growth, including in Germany where the pickup in activity is expected to continue in the second quarter.

In the financial markets, renewed tensions on long-term bond yields have left their mark. The 10-year T-note has risen above 4.60% following difficult Treasury bond auctions. This demand deficit is surprising, especially as the Fed will now reinvest a larger portion of maturing Treasuries. In turn, the rise in Japanese 10-year yields above 1% significantly alters the behavior of Japanese institutions, penalized by the cost of hedging on foreign bond investments. Surprisingly, European sovereign bond markets have not suffered from the decline in Japanese investment abroad. For example, the syndication of 10 billion euros of 10-year Spanish Bonos attracted more than 125 billion euros of orders. The Bund has reached 2.70% due to the hedging flows of new bond issuances and stronger inflation in most countries. The elevated volatility of rates contrasts with the perfect stability of spreads. The imminent downgrade of France by S&P does not even provoke a reaction from market participants. The 10-year OAT is trading below 50 basis points. In credit markets, the May supply totals 115 billion euros. This high number, marked by the presence of US corporate issuers, was well absorbed by markets: spreads are low thanks to the continued inflows into the asset class. High yield spreads have widened slightly despite ongoing positive flows into the asset class. The iTraxx Crossover fluctuates between 290 and 300 basis points. Equity markets have corrected (1 % in Europe) with the exception of major US technology companies. The growth factor was hit by the rebound in European rates.

Axel Botte

Main market indicators

G4 Government Bonds	03-Jun-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	3.04%	-1	+11	+63
EUR Bunds 10y	2.58%	+3	+9	+56
EUR Bunds 2s10s	-45.7bp	+4	-3	-7
USD Treasuries 2y	4.82%	-13	+0	+57
USD Treasuries 10y	4.41%	-6	-10	+53
USD Treasuries 2s10s	-41.1bp	+7	-10	-4
GBP Gilt 10y	4.24%	-3	+1	+70
JPY JGB 10y	1.07%	+4	0	-25
€ Sovereign Spreads (10y)	**03-Jun-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
France	47bp	+1	+0	-6
Italy	131bp	+3	0	-36
Spain	72bp	-3	-1	-24
Inflation Break-evens (10y)	**03-Jun-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR 10y Inflation Swap	2.25%	+3	-1	+12
USD 10y Inflation Swap	2.59%	+3	0	+17
GBP 10y Inflation Swap	3.78%	+4	+4	+25
EUR Credit Indices	**03-Jun-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
EUR Corporate Credit OAS	108bp	-1	-4	-30
EUR Agencies OAS	55bp	-1	-3	-15
EUR Securitized - Covered OAS	58bp	-1	-5	-21
EUR Pan-European High Yield OAS	334bp	-1	-34	-65
EUR/USD CDS Indices 5y	**03-Jun-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
iTraxx IG	52bp	+0	-2	-7
iTraxx Crossover	291bp	+3	-14	-22
CDX IG	50bp	+1	0	-6
CDX High Yield	334bp	+6	-4	-22
Emerging Markets	**03-Jun-24**	**1wk (bp)**	**1m (bp)**	**2024 (bp)**
JPM EMBI Global Div. Spread	381bp	+9	+7	-3
Currencies	**03-Jun-24**	**1wk (%)**	**1m (%)**	**2024 (%)**
EUR/USD	$1.087	0.138	1.050	-1.5
GBP/USD	$1.278	0.055	1.825	0.4
USD/JPY	JPY 156	0.423	-2.029	-9.7
Commodity Futures	**03-Jun-24**	**-1wk ($)**	**-1m ($)**	**2024 (%)**
Crude Brent	$78.9	-$4.0	-$3.6	3.5
Gold	$2 338.8	-$12.2	$37.1	13.4
Equity Market Indices	**03-Jun-24**	**-1wk (%)**	**-1m (%)**	**2024 (%)**
S&P 500	5 275	-0.56	2.87	10.6
EuroStoxx 50	5 005	-1.06	1.71	10.7
CAC 40	7 999	-1.64	0.52	6.0
Nikkei 225	38 923	0.06	1.80	16.3
Shanghai Composite	3 078	-1.46	-0.85	3.5
VIX - Implied Volatility Index	13.40	12.32	-0.67	7.6

Source: Bloomberg, Ostrum AM

Additional notes

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