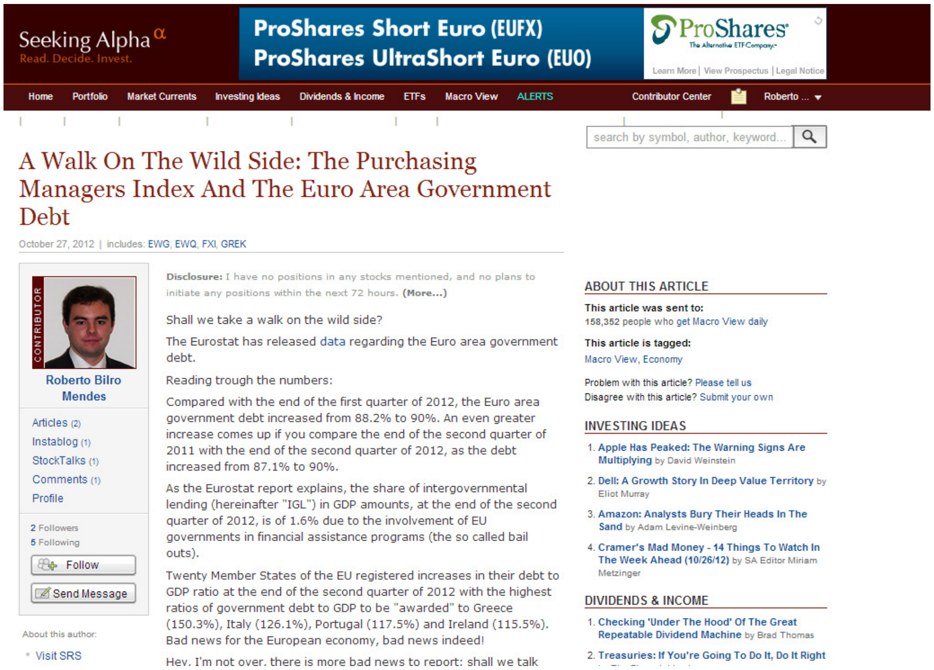

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A Walk on the Wild Side: The Purchasing Managers Index and the Euro Area Government Debt

October 27, 2012
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| includes: EWG, EWQ, FXI, GREK

Shall we take a walk on the wild side?

The Eurostat has released data regarding the Euro area government debt.

Reading trough the numbers:

Compared with the end of the first quarter of 2012, the Euro area government debt increased from 88.2% to 90%. An even greater increase comes up if you compare the end of the second quarter of 2011 with the end of the second quarter of 2012, as the debt increased from 87.1% to 90%.

As the Eurostat report explains, the share of intergovernmental lending (hereinafter "IGL") in GDP amounts, at the end of the second quarter of 2012, is of 1.6% due to the involvement of EU governments in financial assistance programs (the so called bail outs).

Twenty Member States of the EU registered increases in their debt to GDP ratio at the end of the second quarter of 2012 with the highest ratios of government debt to GDP to be "awarded" to Greece (150.3%), Italy (126.1%), Portugal (117.5%) and Ireland (115.5%). Bad news for the European economy, bad news indeed!

Hey, I'm not over, there is more bad news to report: shall we talk about the Purchasing Managers Index (the "PMI")?

Behind door number 1: Eurozone dropped from 46.1 to 45.8, revealing an even greater contraction than expected.

Behind door number 2: China shows capability to recover from a slowdown in its economy and presents now at a PMI level of 49.1, increasing from 47.9.

One awful sign on one hand but also what could be a good sign from China at last, but we will get there.

Let's skip ahead to Europe again and talk about German PMI that also contracted, dropping from 49.2 to 48.1 signaling a further moderate reduction in overall private sector business activity. But why does German keeps contracting?

The answer lies with China, because, as you can read on the article "European Economic Conditions Worsen: Not Good for U.S. Firms" by John M. Mason, the slowdown in China's economy actively affects the reported decrease in new order intakes during October. China continues, and will continue, to be the top importer for German products. So perhaps the signs of China PMI improvement can act like an oxygen mask. Nevertheless, let's not forget China is still below neutral PMI point (50), and is still struggling to get from contraction to expansion.
Add to this data the economic and political problems exploding all over Europe and you get a pretty nasty cocktail. Everyone is holding breath with the intense rumors of a 2 years extension of Greece funding program by the International Monetary Fund. Spain is yet to fully regain market trust, and will most likely be requesting a bail out. In Portugal, as I reported lately, everyone is waiting for the approval or rejection of the State Budget for 2013, with major social protests gathering outside the parliament against the austerity measures and with a really tough budget on discussion, France's economy is also contracting… Europe's hopes lies now with German: but will Angela Merkel's conservative approach be enough to stop contraction and bring stability into European soil? Can Germany put a stop to the Euro government debt and to the European PMI contraction? The answer is most likely to be negative!

Add to the cocktail just a pinch of the troubles the U.S. companies are experiencing due to the European crisis and you have the full picture: this is a global crisis!

All and all, Europe has reached a dangerous point because the solution no longer lies in its capabilities, it's a burden to be carried almost exclusively by German shoulders… and Germany still needs China, U.S. and other markets to become stronger in order to be able to reach PMI expansion and then maybe reach out for some less troubling times.