Euro Economics Weekly

Taking Stock of the Industrial Cycle

- The stability in industrial confidence in August was a surprise to us, given the widespread declines in other sectors. The slowdown of the last few quarters has been gradual, which has enabled industrialists to adjust their production function accordingly. Hence the manufacturing sector appears better prepared to weather further erosion in demand than if inventories had been elevated.

- Nevertheless, the outlook remains challenging for the following reasons: i) a likely decline in industrial sentiment given the weakening in demand forecasts and expectations, ii) a deterioration in the volume of orders pointing to more falls in industrial production, iii) periphery countries that have been able to export their way out of recession will have to face the weakness in economic activity spreading to France and Germany (Guillaume Menuet, see page 2).

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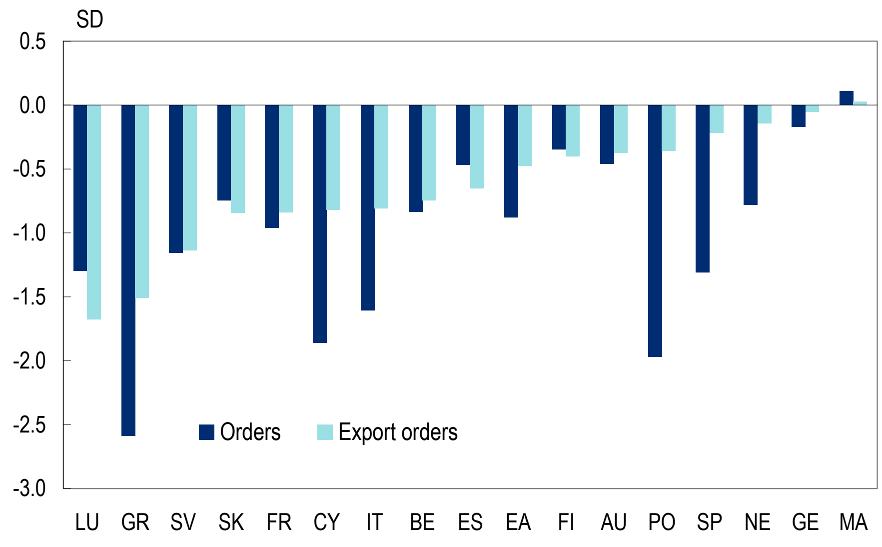
With thanks to Carla Clifton

Figure 1. Citi Market Forecasts

	$/€	Euro Repo	10-yr Bunds	£/€	U.K. Bank Rate	10-yr Gilt-Bund	SKr/€	SEK Policy Rate	NOK/€	NOK Policy Rate	SFr/€	CHF Policy Rate	CHF Spread vs Bunds
4Q 12	1.21	0.25	1.20	0.78	0.50	20	8.20	1.00	7.32	1.50	1.20	0.00	-70
4Q 13	1.20	0.25	1.80	0.78	0.50	25	8.12	1.00	7.22	2.00	1.20	0.00	-110

Source: Citi Research

Figure 2. Euro Area — Order Books and Export Orders, Aug 2012



Sources: European Commission and Citi Research

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Taking Stock of the Industrial Cycle

We expect the ECB to react to the latest evidence of falling economic sentiment by cutting interest rates further

The latest round of European Commission surveys revealed that economic sentiment in the euro area had declined again in August. A marked 1.8-point slide in the headline measure of confidence for the euro area to 86.1 (-1.5 std), a three-year low, illustrates just how weak the picture is ahead of the ECB's Governing Council meeting on September 6. With leading indicators pointing to additional weakness ahead (please refer to Euro Economics Weekly: Six Months On: Reiterating Our Bearish Case, 20 July 2012), we believe that the ECB will have little choice but to lower its main policy rate by 25bp to a new low of 0.5%.

The stability in industrial sentiment was a surprise given the broad softening elsewhere

The stability in industrial confidence during August was a surprise to us, given the widespread declines in other sectors, with services sentiment falling by two points to -11, while consumer sentiment deteriorated significantly, recording a 3-point slide to -25. Sentiment in the retail trade and construction also declined, with falls of 2 and 4 points to -17 and -33, respectively.

We investigate whether the level of finished goods stock is adequate and which countries are managing to refocus their economy towards exports

This note investigates the position of the euro area industrial sector in the economic cycle. We review the relationship between the level of orders and stocks of finished goods to gauge the degree of imbalances. We investigate which countries are more likely to experience a significant drop in industrial production in the event of a decline in demand. Finally we focus on the differences in export situations to determine whether the countries most in need of a positive contribution through net trade are being successful in their endeavors.

We conclude that the outlook will remain challenging

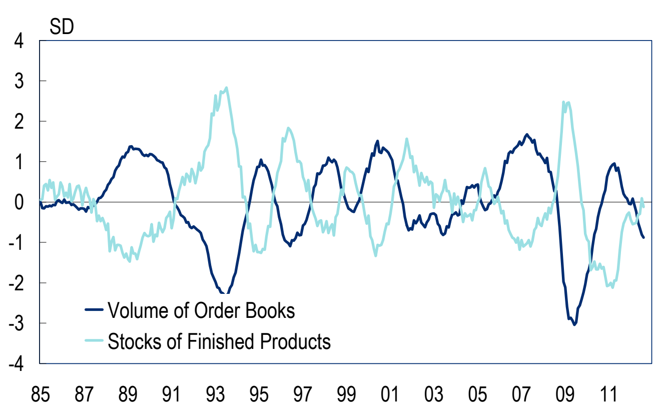
We conclude that the outlook remains challenging due to i) a likely decline in industrial sentiment given the weakening in demand forecasts and expectations, ii) a deterioration in the volume of orders pointing to more falls in industrial production, iii) periphery countries that have attempted to export their way out of recession will have to face the weakness in economic activity spreading to France and Germany.

How do we gauge the state of the industrial cycle?

The erosion in order books continued, but at a rate that does not suggest a disorderly contraction

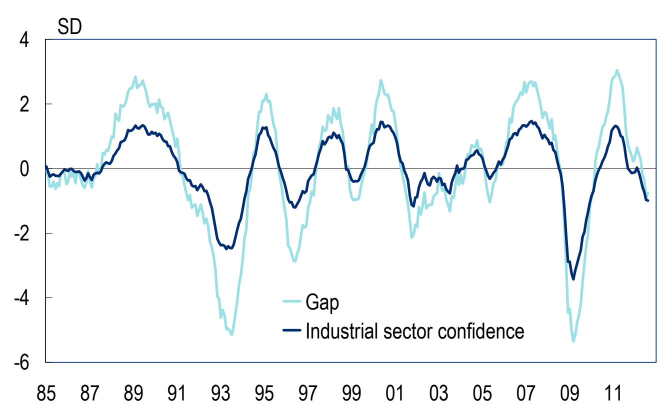
The August EU Commission survey reported a modest one-point drop in euro area orders books, in keeping with the relative stabilization in the business climate measure (-1.21 from -1.27 in July), whereas all other sectors recorded significant falls in sentiment. At -0.8 std in the third quarter to date, the orders situation is not significantly different from the -1.0 std reading for the overall industrial confidence indicator (see Figure 3). That both metrics are close to one another depicts a situation of gradual slowdown, rather than a disorderly contraction, in our view.

Figure 3. Euro Area — Order Books and Stocks of Finished Goods, 1985-Aug 2012



Sources: European Commission and Citi Research

Figure 4. Euro Area — Industrial Cycle Position Indicator and Confidence, 1985-Aug 2012



Sources: European Commission and Citi Research

Early reluctance to cut production was probably the main factor behind the uptick in stocks during the spring

Industrialists' judgment on the level of inventories had been largely stable until May 2012, when there was a sudden increase in the proportion of respondents indicating an excessive level of finished goods. Since then, we have only witnessed a partial correction in the level of finished products. Indeed, manufacturing production has continued to expand, albeit modestly, growing by 0.5% between April and June.

Orders to stocks gap: a lead indicator of industrial production

On the importance of understanding the relationship between orders and stocks

Orders and stock levels are normally inversely correlated: when faced with an unexpected increase in demand, industrialists first rely on stocks of finished goods before adjusting industrial production upward to recreate an adequate buffer. Vice versa, when orders suddenly decline, manufacturers are often unable or unwilling to adjust their output immediately, leading to some excessive inventory build. The current situation appears to differ from the recent past[1], in the sense that inventories have never been so close to their long-run historical average for such a low volume of orders.

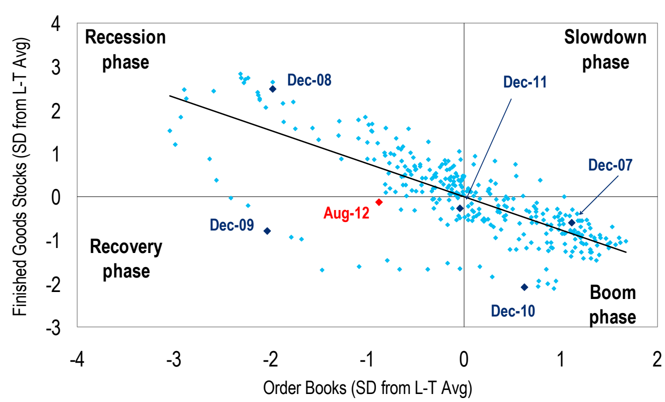
The gap between orders and stocks is a coincident indicator of business confidence and plays a useful role in confirming turning points

We approximate the degree of imbalances in the manufacturing sector by subtracting the standardized inventories series from the volume of orders. Periods in which demand is accelerating (typically coinciding with improving industrial sector confidence) see a positive reading, whereas those in which demand is declining (and sentiment falling) are characterized by a negative reading. The gap of -0.8 std in August is modest by historical standards, with the latest reading showing some slight narrowing for the first time in six months (see Figure 4).

We see limited downside risks to our industrial production forecasts

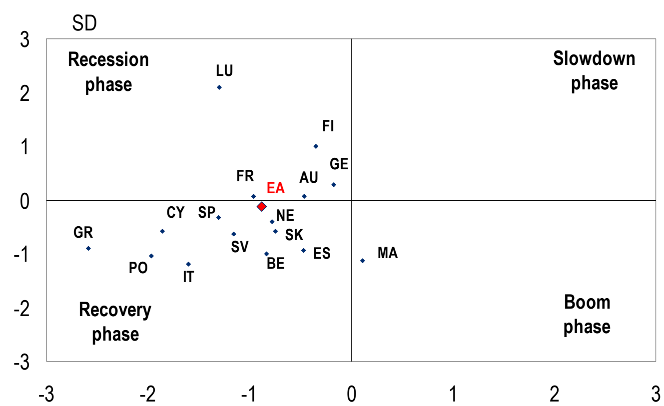
Going forward, the main risk, in our view, is of a fresh series of declines in new orders, requiring industrialists to cut production in order to limit the increase in their stocks of finished goods. At the same time, the absence of a significant inventory overhang ought to limit the extent of the fall in industrial production. The scatter plot on Figure 5 indicates that for the current level of orders, industrialists had historically been relying on a slightly larger inventory cushion[2].

Figure 5. Euro Area — Order Books and Stocks of Finished Goods, 1985-Aug 2012



Sources: European Commission and Citi Research

Figure 6. Euro Area and Member States — Order Books and Stocks of Finished Goods, 1985-Aug 2012



Sources: European Commission and Citi Research

[1] Perhaps with the exception of 2003, when the economy was essentially treading water in the aftermath of the bursting of the tech bubble.

[2] However, using a reduced sample limited to either the last five or ten years reveals that the August reading is very close to the best fit line.

Are there significant differences between member states?

All but one of the euro area members are currently experiencing below average levels of orders

Turning to the national series, it is clear when looking at Figure 6 that the overwhelming majority of euro area member states feature either in the recession (top left quadrant) or recovery (bottom left quadrant) phases of the industrial cycle. In August, industrialists indicated that the volume of order books stood below long-term average levels, ranging from an extremely challenging position in Greece (-2.6 std, a level almost identical to that experienced for the whole euro area in the autumn of 2009) to a situation very close to historical trends in Germany (-0.2 std) and Malta (+0.1 std).

There appears to be more disparity in the stocks position

For stocks of finished goods, the picture is more heterogeneous: no periphery country was reporting an excessive situation of finished products, which should limit the downward adjustment in their national rates of industrial production. The highest levels of finished goods stocks were found in Luxembourg (2.1 std) and Finland (1.0 std). While Germany (0.3 std) as well as France and Austria (0.1std) also reported stock levels slightly in excess of their historical average, the adjustment here ought to be muted, under a scenario of stabilizing order volumes.

Periphery countries have already reduced their stocks of finished products putting most of them in the recovery quadrant

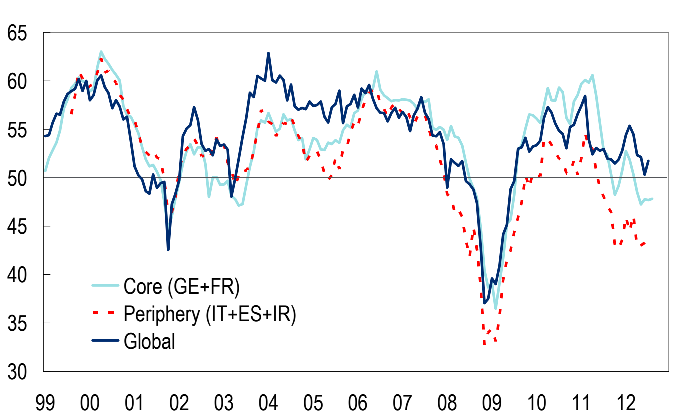
This scatter plot suggests that the peripheral countries facing the most difficult economic conditions have seen a significant adjustment in their manufacturing sector already. While core and soft core countries have managed to weather the storm relatively well so far, there is a risk that a prolonged period of uncertainty due to the lingering euro area sovereign debt crisis could lead to further falls in orders.

Can countries continue to export their way out of the recession?

Portugal has been one of the outperformers, alongside Spain

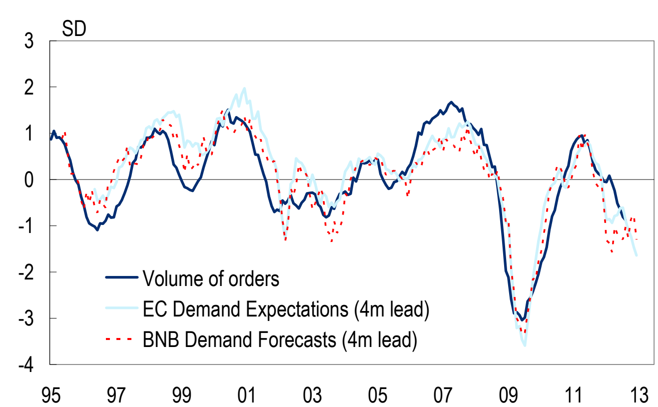
For the first time in five months, the EC survey showed an improvement in euro area industrialists' assessment of export order books August. The uptick was modest on aggregate, amounting to a 0.1 std gain to -0.5 std (see Figure 2 on the Front Page illustrating the relative position of overall order books and those specifically related to exports compared to their long-term average). The larger the difference between the two series, the more optimistic one should be about a country's ability to export its way out of its recessionary conditions. The biggest beneficiary was Portugal (+0.6 std to -0.4 std), with the country now ranking fifth out of 17 euro area member states, closing in on Spain's third position with -0.2. According to this gauge, prospects for Portugal and Spain look better than those of Italy and Greece.

Figure 7. Selected Countries — Composite PMI, 1999-Aug 2012



Sources: Markit, Eurostat and Citi Research

Figure 8. Belgium and Euro Area – Volume of Orders, Demand Forecasts and Expectations, 1996–Aug 2012



Sources: European Commission, National Bank of Belgium and Citi Research

Could periphery countries benefit from the tentative recovery in global demand suggested by the global Composite PMI?

But how sustainable will this be? On a global PMI basis, July saw the first rebound in the composite measure since February with a 1.4 point uptick to 51.7 (see Figure 7). This should be welcome news for countries needing to rely on export demand to move away from the recession originating in a contraction in domestic demand. Our global growth forecasts were little changed in the Global Economic Outlook and Strategy - August 2012, with overall GDP growth of about 2.5% in 2012, accelerating to 2.8% in 2013.

Given the importance of intra-EU trade in the export mix, we believe that slowdown in Germany and France could be too much of an obstacle

Yet, for peripheral countries, the bad news is that both the euro area's two largest economies, Germany and France, have experienced some turbulence: both composite PMI measures have been below the 50 level implying a contraction in economic activity for the last four and six months respectively. None of these economies are in recession yet, but we believe for France at least, a mild double-dip recession is likely, starting in the third quarter.

Demand prospects are taking a turn for the worse

Demand forecasts are deteriorating again in Belgium, suggesting that global demand dynamics are weakening again

A useful gauge of the strength of global demand is also provided by the monthly business survey conducted by the National Bank of Belgium. As a very open and small economy, the euro area's sixth largest member state is well connected to the global cycle and is often used a leading indicator for the euro area. In August, the economic outlook was reported to have deteriorated for the second month running, leaving the composite index some 0.7 std below its historical average. In addition, our composite indicator aggregating the responses on demand forecasts posted a 0.5 std decline to -1.7 std. This was the largest monthly fall for 11 months, with each of the four sectors reporting more negative prospects with regard to market demand (see Figure 8).

At the euro area level, the picture looks even worse as it includes responses from many businesses located in the periphery

An equivalent series[3] computed using the EU Commission survey shows that expectations have deteriorated again in August, falling to their lowest level since July 2009; each of the subcomponents showed readings between -1.4 and -2.0 std[4].

Conclusions

The slowdown of the last few quarters has been gradual, which has enabled industrialists to adjust their production function accordingly. Hence the manufacturing sector appears better prepared to weather further erosion in demand than if inventories had been elevated. Nevertheless, the outlook remains challenging for the following reasons:

- The stabilization in industrial sentiment is unlikely to last given the further weakening in demand forecasts and expectations
- Under a scenario of a further deterioration in the volume of orders, industrial production would continue to decline, albeit modestly, given the relatively low level of stocks in the euro area
- Periphery countries that have been attempting to export their way out of recession will probably find it harder going forward given the expected weakness in economic activity spreading to France and Germany

[3] Both the Belgian and EC series enjoy maximum correlation with order volumes at a 4-month lead.

[4] Note that in the EC survey, a similar trend was visible across sectors. The manufacturing production expectations series fell to a 3-year low. The same applied to the expected business situation in retail trade and to expected demand in the services industry. For households, their perception of the general economic situation for the next 12 months fell to a 38-month low.

Key Economic Indicators (3 September – 7 September 2012)

During The Week		**Forecast**	**Last**
09:00	UK: Halifax House Prices, Aug		
Monday 3 September		**Forecast**	**Last**
07:30	Sweden: PMI, Aug	50.8	50.6
08:00	Norway: PMI, Aug	50.1	48.7
08:15	Switzerland: Retail Sales, Jul		
09:00	Norway: Credit Indicator C2, Jul	7.0% YY	7.1% YY
09:00	Euro Area: Manufacturing PMI, Aug Final	45.3	44.0
09:30	UK: Manufacturing PMI, Aug	45.5	45.4
11:00	Ireland: Industrial Production, Jul		
18:00	Italy: Budget Balance, Aug		
	US: Labor Day Holiday		
Tuesday 4 September		**Forecast**	**Last**
06:45	Switzerland: GDP, 2Q		
09:00	Spain: Unemployment, Aug		
09:30	UK: Mergers & Acquisitions involving UK Companies, 2Q		
10:00	Euro Area: Industrial Producer Prices, ,Jul	0.3% MM, 1.7% YY	-0.5% MM, 1.8% YY
Wednesday 5 September		**Forecast**	**Last**
07:00	Finland: GDP, 2Q		
08:15	Switzerland: Consumer Prices, Aug		
09:00	Euro Area: Services PMI, Aug Final	47.5	47.9
	Composite PMI, Aug Final	46.6	46.5
09:30	UK: Services PMI, Aug	51.0	51.0
10:00	Euro Area: Retail Sales, Jul	-0.3% MM	0.2% MM
11:00	Ireland: Unemployment, Aug		
14:00	Canada: Bank of Canada Monetary Policy Outcome		
Thursday 6 September		**Forecast**	**Last**
06:30	France: ILO Mainland Unemployment Rate, 2Q	9.8%	9.6%
	Mainland Unemployment Change	65K	86K
08:30	Netherlands: Consumer Prices, Aug		
08:30	Sweden: Riksbank Monetary Policy Outcome	25bp Cut to 1.25%	1.50%
08:30	Sweden: Services Production, Jul	0.1% MM	-0.2% MM
10:00	Euro Area: GDP, 2Q Details	-0.2% QQ, -0.4% YY	Unch QQ, Unch YY
11:00	Germany: Incoming Orders, Jul	0.2% MM, -4.5% YY	-1.7% MM, -7.7% YY
12:00	UK: MPC Outcome		
12:45	Euro Area: ECB Outcome (Press Conference at 13:30)		
	Greece: Unemployment Rate, Jun	23.5%	23.1%
Friday 7 September			
06:45	Switzerland: Unemployment, Aug		
07:00	Germany: Trade Balance, Jul	€14.5 Billion	€16.2 Billion
07:00	Germany: Labour Cost Index, 1Q-2Q		
07:00	Germany: Insolvencies, Jun		
07:45	France: Trade Balance, Jul		
08:00	Spain: Industrial Production, Jul	-6.4% YY NSA	-6.9% YY NSA
08:30	Netherlands: Industrial Production, Jul		
09:00	Norway: Manufacturing Production, Jul	-1.2% MM	0.8% MM
09:30	UK: Industrial Production, Jul	2.0% MM, -2.3% YY	-2.5% MM, -4.3% YY
	Manufacturing Output, Jul	2.5% MM, -1.8% YY	-2.9% MM, -4.3% YY
09:30	UK: Producer Input Prices, Aug	1.7% MM, 1.2% YY	1.3% MM, -2.4% YY
09:30	UK: Producer Output Prices, Aug	0.2% MM, 1.8% YY	0.0% MM, 1.7% YY
	Excluding Tax, Aug	0.2% MM, 1.5% YY	0.0% MM, 1.4% YY
	Ex Food, Drink, Tobacco, Energy, Aug	0.0% MM, 1.2% YY	0.0% MM, 1.3% YY
09:30	UK: New Construction Orders, 2Q		
09:30	UK: BoE/GfK Inflation Expectations, Aug		
11:00	Portugal: GDP, 2Q Details	-1.2% QQ, -3.3% YY	-0.1% QQ, -2.3% YY
11:00	Germany: Industrial Production, Jul	-0.5% MM, -3.7% YY	-0.9% MM, -0.2% YY
	Greece: GDP, 2Q Details	-6.2% YY NSA	1Q: -6.5% YY NSA
14:00	Belgium: GDP, SA WDA, 2Q Details	-0.6% QQ, -0.4% YY	0.2% QQ, 0.4% YY

Sources: National statistical offices, central banks and Citi Research

Economic Indicators

Euro Area			
Sep 3 09:00 London Time	***Manufacturing PMI, Aug Final*** We expect a confirmation of the flash estimate.	**Forecast: 45.3**	**Prior: 44.0**
Sep 4 10:00 London Time	***Industrial Producer Prices, Jul*** After two months of consecutive declines, increasing commodity prices (mainly energy) are likely to lead to an increase in producer prices. However, with still benign base effects, we expect the YY rate to edge down further to 1.7%, the lowest reading since March 2010.	**Forecast: 0.3% MM, 1.7% YY**	**Prior: -0.5% MM, 1.8% YY**
Sep 5 09:00 London Time	***Services PMI, Aug Final*** ***Composite PMI, Aug Final*** We expect a confirmation of the flash estimates.	**Forecast: 47.5** **Forecast: 46.6**	**Prior: 47.9** **Prior: 46.5**
Sep 5 10:00 London Time	***Retail Sales, Jul*** Following gains in the two previous months, we expect a contraction in retail sales in July. The drop in the retail PMI in July supports our forecast.	**Forecast: -0.3% MM**	**Prior: +0.2% MM**
Sep 6 10:00 London Time	***GDP, 2Q Details*** We expect a confirmation of the flash estimate. The details, out for the first time, probably will show that falls in consumption (-0.4% QQ) and gross fixed capital formation (-1.2% QQ) mainly contributed to the contraction in GDP. By contrast, net exports and increase in inventories probably made a positive contribution to GDP compared to the previous quarter (by 0.1 points each).	**Forecast:-0.2% QQ, -0.4% YY**	**Prior: Unch% QQ, Unch% YY**
Germany			
Sep 6 11:00 London Time	***Incoming Orders, Jul*** Following a larger than expected and broad based fall in incoming orders in June, we expect only a small increase in July, mainly led by a rebound in domestic orders. Note that because of the timing of school summer holidays there are distortions in the seasonal adjustment procedure during the summer, which often lead to unexpected swings during this period.	**Forecast: +0.2% MM, -4.5% YY**	**Prior: -1.7% MM, -7.7% YY**
Sep 7 11:00 London Time	***Trade Balance, Jul*** The seasonally adjusted trade surplus is likely to narrow after increasing in June. Compared to the previous month, we expect a fall in nominal exports by 0.9% but imports are likely to be up by 1.2% MM, partly reflecting the increase in oil prices.	**Forecast: €14.5 Billion Surplus**	**Prior: €16.2 Billion Surplus**
Sep 7 11:00 London Time	***Industrial Production, Jul*** We expect a second consecutive fall in industrial production led by a contraction in manufacturing output. Energy and construction output probably increased compared to the previous month. Note that because of the timing of school summer holidays there are distortions in the seasonal adjustment procedure during the summer, which often lead to unexpected swings during this period.	**Forecast: -0.5% MM, -3.7% YY**	**Prior: -0.9% MM, -0.2% YY**
France			
Sep 6 06:30 London Time	***ILO Mainland Unemployment Rate, 2Q*** ***Mainland Unemployment Change (000s)*** A fourth successive quarter of job losses are on the cards. We forecast a 65K increase in the mainland unemployment figure, enough to push the jobless rate back to a twelve-year high of 9.8%. The new government is facing a very challenging situation where confidence is weakening and the private sector is destroying jobs as a result of limited visibility and worries about the consequences of the lasting euro area sovereign debt crisis. Latest surveys of employment intentions showed that the private sector remains risk-averse.	**Forecast: 9.8%** **Forecast: 65K**	**Prior: 9.6%** **Prior: 86K**
Belgium			
Sep 7 14:00 London Time	***GDP, SA WDA, 2Q Final*** Business surveys had not pointed to such a sizeable contraction, suggesting that some one-off factors could be at play. Despite our forecast of a likely technical rebound in 3Q (0.1% QQ), we have lowered our 2012 GDP forecast by 0.3ppt to -0.2%. We see no real prospect of improvement in 2013 (-0.2%, unchanged from our July forecast). The August BNB survey showed a modest drop in business sentiment, but demand expectations fell back towards their lowest level of 2012 last seen in March. Not a particularly good omen for the rest of 2012.	**Forecast: -0.6% QQ, -0.4% YY**	**Prior: +0.2% QQ, 0.4% YY**
Greece			
Sep 6	***Unemployment Rate, Jun*** We expect the Greek unemployment rate to continue to increase in June driven by further falls in employment (as a result of continued weakness in the economy) and by further increases in the size of the country's labour force.	**Forecast: 23.5%**	**Prior: 23.1%**
Sep 7	***GDP Details, 2Q NSA*** It is possible that the flash estimate for Greek GDP growth for 2Q 2012, which showed the country's economy contracting by 6.2% YY (on a non-seasonally adjusted basis) will be revised as has often been the case in the past. However, we do not expect the revisions to change the direction of travel for Greek GDP and believe that the figures will confirm that the country's economy has continued to contract markedly in 2Q.	**Provisional: -6.2% YY**	**Prior (1Q): -6.5% YY**
Portugal			
Sep 7 11:00 London Time	***GDP Details, 2Q*** We expect the final GDP reading for 2Q 2012 to confirm the flash estimate of a 1.2% QQ contraction and a 3.3% YY contraction. Domestic demand is expected to have contracted more sharply in 2Q than in 1Q, driven in part by a sharper YY fall in investment than in 1Q. We further believe that the second reading for the country's GDP growth in 2Q will confirm that net trade continued to make a significant positive contribution to YY GDP growth in 2Q, driven by a larger YY fall in imports which more than offset the weaker YY increase in exports in 2Q.	**Provisional: -1.2% QQ, -3.3% YY**	**Prior: -0.1% QQ, -2.3% YY**

Economic Indicators

Spain			
Sep 7 08:00 London Time	***Industrial Production, Jul NSA***	**Forecast: -6.4% YY**	**Prior: -6.9% YY**
	We expect that industrial production (NSA) continued to experience large YY falls in Spain in July. Manufacturing PMIs have stabilised in the last two months at low levels, and surveys report further declines in industrial orders and production trends in previous months pointing to continuing weakness (firms' assessment of production developments and order books over the past three months in July had their worst reading since Sept-09 and March 2010, respectively).		
Sweden			
Sep 3 07:30 London Time	***PMI, Aug***	**Forecast: 50.8**	**Prior: 50.6**
	Reflecting the slight improvement in euro area PMI in August, we also expect Swedish PMI to improve marginally. With a Swedish export share of 40% to the euro area and 70% to all of Europe, sentiment, though, is likely to decline ahead.		
Sep 6 08:30 London Time	***Service Production, Jul***	**Forecast: 0.1% MM**	**Prior: -0.2% MM**
	Momentum in services production has been weakening of late and contracted by 0.2% QQ in 2Q, the weakest outcome since 3Q 2009. The declining trend is in line with most survey indicators; service sector PMI was below 50 in every month in 2Q, but rebounded strongly in July to 54.8, the highest reading since May 2011. With the July increase in service PMI to a large extent being driven by an improving order inflow, this suggests stronger growth in service production this month.		
Sep 6 08:30 London Time	***Riksbank Interest Rate Decision***	**Forecast: 1.25%**	**Prior: 1.50%**
	The Riksbank interest rate decision on 6 September is a very close call, in our view, especially following the release of the surprisingly strong 2Q GDP report. We see several arguments for a 25bp rate cut already at next month's meeting – including a weaker international growth outlook, more expansionary policies from other central banks, a rapid appreciation of the krona combined with already very subdued domestic core inflation, decreasing capacity utilization, and the fact that the Riksbank opened the door for a September rate cut in the July MPR (which signalled a 30% probability of such a move) – but acknowledge that there is a clear risk that the Bank will prefer to postpone the rate cut to October, pending further clarification on the severity of the downturn. Either way, rates are likely to fall further in subsequent months.		
Norway			
Sep 3 8:00 London Time	***PMI, Aug***	**Forecast: 50.1**	**Prior: 48.7**
	PMI is expected to improve in August, having stayed below 50 for two consecutive months and hence signalling a contraction in the Norwegian industry. However, as the PMI survey tends to be rather volatile (especially around holidays), it is better to look at the average for a few months to gauge the underlying trend. In trend terms, momentum in the manufacturing sector has been weakening lately with sentiment falling below its long-term average (of 54) in June, however, the overall index remains broadly at 50 (49.8 on a 3-month moving basis in July).		
Sep 3 9:00 London Time	***Credit Growth Indicator C2, Jul***	**Forecast: 7.0% YY**	**Prior: 7.1% YY**
	The latest lending survey from Norges Bank pointed to still solid demand for credit, in particularly from households, likely driven by the relatively low levels of interest rates, low unemployment, and increase in house prices. Hence, we expect credit to households to remain in the area of 7% YY in July, while we expect credit to non-financial enterprises to moderate slightly from the current 6.8% YY pace.		
Sep 7 09:00 London Time	***Manufacturing Production, Jul SA***	**Forecast: -1.2% MM**	**Prior: 0.8% MM**
	The 17-day-long oil and gas conflict over pension rights and associated output losses will weigh on overall industrial production in June and even more so in July. Our model points to a strong decline in July in line with the weak reading for July PMI (48.7). Note, though, that the monthly growth rate is extremely volatile.		
United Kingdom			
Sep 3 09:30 London Time	***Manufacturing PMI, Aug***	**Forecast: 45.5**	**Prior: 45.4**
	We expect little change in the PMI in August, remaining for the fourth consecutive month below the 50-mark and thus signifying a slowing pace of activity.		
Sep 5 09:30 London Time	***Services PMI, Aug***	**Forecast: 51.0**	**Prior: 51.0**
	It is unclear how this index will be affected by the Olympics. Anecdotal evidence suggests that economic activity was sluggish in early August, which may be a negative. Our forecast is for this index to stay around July's level, which was the weakest since late 2010.		
Sep 7 09:30 London Time	***Industrial Production, Jul*** ***Manufacturing Output, Jul***	**Forecast: +2.0% MM, -2.3% YY** **Forecast: +2.5% MM, -1.8% YY**	**Prior: -2.5% MM, -4.3% YY** **Prior: -2.9% MM, -4.3% YY**
	The sharp drop in industrial production and manufacturing output in June probably reflected the Queen's Diamond Jubilee, which led to fewer working days (one bank holiday was deferred from May to June and there was an extra one-off bank holiday in June as well). The last time there was a similar event, in 2002, only part of the ground lost in June was reversed in July, and we expect a similar pattern this year.		
Sep 7 09:30 London Time	***Producer Input Prices, Aug***	**Forecast: 1.7% MM, 1.2% YY**	**Prior: +1.3% MM, -2.4% YY**
	Recent gains in commodity prices, especially oil, probably will send input prices higher again, tilting the YY rate back into positive territory after negative readings in the past two months. These cost pressures will feed through to CPI inflation in coming months.		

Economic Indicators

United Kingdom Continued			
Sep 7	***Producer Output Prices, Aug***	**Forecast: 0.2% MM, 1.8% YY**	**Prior: 0.0% MM, 1.7% YY**
09:30	***Output Prices Ex Tax, Aug***	**Forecast: 0.2% MM, 1.5% YY**	**Prior: 0.0% MM, 1.4% YY**
London Time	***Excluding Food, Drink, Tobacco, Energy, Aug***	**Forecast: 0.0% MM, 1.2% YY**	**Prior: 0.0% MM, 1.3% YY**

Surveys suggest that manufacturers' expectations for their selling prices have weakened recently, which suggests that core output prices (excludes food, drink, tobacco, energy) will remain subdued. However, recent gains in oil prices may well cause the headline output price inflation rate to edge up slightly, although a figure in line with our forecast would still keep headline output price inflation much lower than a year ago (August 2011: 6.0% YY).

Sources: National Statistical Offices, National Central Banks, Bloomberg, and Citi Research forecasts.

Recent Research Publications	Author	Date of Publication
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Chief Economist Publications		
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Notes

Notes

Appendix A-1

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