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Euro Area PMI | Europe

The Energy Shock has arrived

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EA composite PMI dropped in April (48.6 from 50.7) well below expectations. We track 1Q26 EA GDP forecast at 0.1%Q and think activity will stall in 2Q26 (0.0%Q).

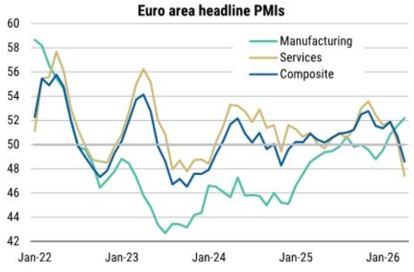
March EA PMIs | A very large step down: EA composite PMI printed at 48.6 in April down from 50.7 in March (Exhibit 1 and Exhibit 2), a very large miss vs expectations (MSe: 50.7, consensus: 50.1). All countries declined in sync, with a similar narrative. We see four main takeaways from the print. First, there is a rather sharp contrast between very soft services and solid manufacturing PMIs. We suspect some services are already feeling the impact of the energy shock because of lower consumer demand and/or direct impact on input costs (eg transport). Second, the level of April PMIs is consistent with our forecast that EA GDP will stall in 2Q26. We stress that the energy shock is hitting PMIs more rapidly than in 2022 (Exhibit 3), and that is despite the magnitude of the shock being so far significantly less than four years ago. Third, prices charged increased meaningfully. PMIs might be leading actual (core) HICP inflation by a couple of months so, at this stage, this mostly reflects risks of indirect/second round effects that could materialise by the end of the year if energy commodity prices do not ease. Ultimately, and that´s our fourth point, the print illustrates the dilemma for central banks facing higher inflation but softer activity. On our baseline, the ECB will hike in June and September (see our preview of the April meeting here).

Exhibit 1: Euro area composite PMIs dropped in April-26

	Actual Apr-26	MS Forecast Apr-26	Consensus Apr-26	Prior Mar-26
Euro Area Composite PMI	48.6	50.7	50.1	50.7
EA Manufacturing PMI	52.2	50.6	50.9	51.6
EA Services PMI	47.4	50.6	49.8	50.2
Germany Composite PMI	48.3	51.9	51.2	51.9
France Composite PMI	47.6	48.8	48.6	48.8
Rest of euro area	49.5	-	-	50.8

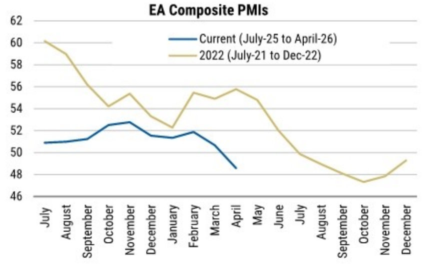
Source: S&P Global, Morgan Stanley Research forecasts

Exhibit 2: Services PMIs down and Manufacturing up in April-26



Source: &P Global, Morgan Stanley Research

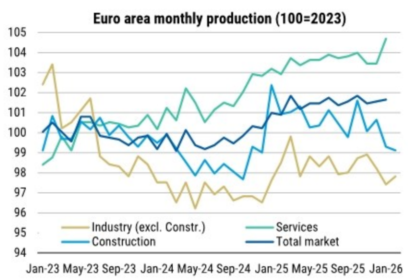
Exhibit 3: Moving down more rapidly than in 2022



Source: S&P Global, Morgan Stanley Research

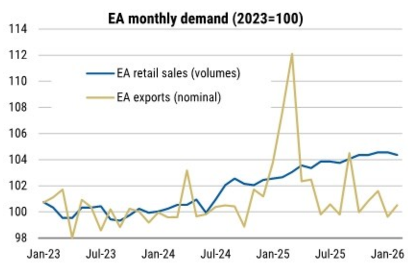
Our short-term growth forecasts | 1Q26 at 0.1%Q: With the data we have received over the past weeks, we slightly lower our forecast for 1Q26 EA GDP growth to 0.1%Q (0.2%Q previously), below the ECB March projections at 0.3%Q. The print is due on Thursday 30 April, on the day of the ECB meeting. Services activity was strong in January (Exhibit 4) but mostly on the back of what seems to be a one-off surge in information & communication. From the March-April services PMIs (and other surveys such as Insee in France), we suspect activity will look soft in that sector in the last weeks of the quarter. Elsewhere, we flag that construction and industrial output are meaningfully down in the first two months of 1Q26 (to some extent contrasting with solid PMIs). On the demand side, things also look subdued with stable retail sales and declining exports in Jan-Feb. Our nowcasting model (Exhibit 6) has been trending down as data was received, even though it continues to see slight upside risks to our baseline view.

Exhibit 4: Industrial and construction activity dropped in January-February



Source: Eurostat, Morgan Stanley Research

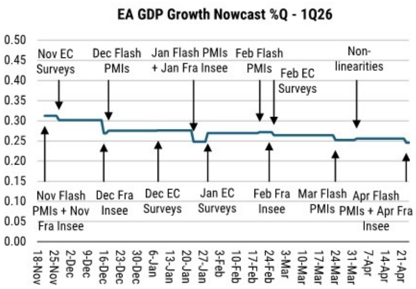
Exhibit 5: Retails sales and exports have low momentum



Source: Eurostat, Morgan Stanley Research forecasts

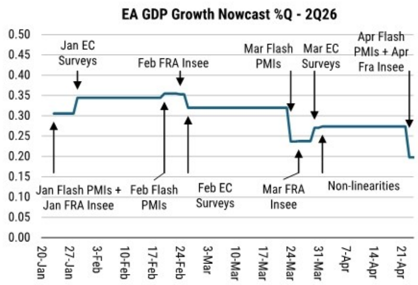
2Q26 flat at 0.0%Q: As for 2Q26, our rule of thumb is that PMI at 50 is consistent with EA growth at 0, and each 1pp above/below 50 signals 0.1pp more/less growth. PMIs at 48.6 in April would thus suggest quarterly growth around -0.1%Q. Our current forecast is for a flat print (0.0%Q) and we will refine our estimates when more information becomes available. There is an apparent contradiction with our nowcasting tool which sees 2Q26 at 0.2%Q (Exhibit 7), but we suspect the nowcast could be underestimating the impact of higher energy prices on specific sectors of the economy. Lastly, we note the ECB March-26 baseline expected 2Q26 at 0.1%Q and we think today's PMIs flag potential downside risks to this view.

Exhibit 6: The data flow has continuously pushed our 1Q26 nowcast down



Source: Haver, S&P global, Morgan Stanley Research estimates

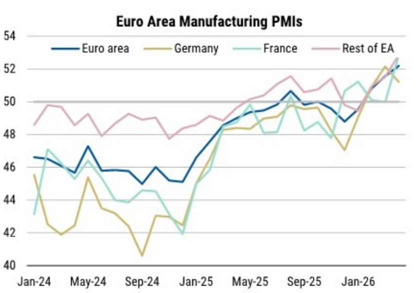
Exhibit 7: Our 2Q26 nowcast softened and we see more downside risks ahead



Source: Haver, S&P global, Morgan Stanley Research estimates

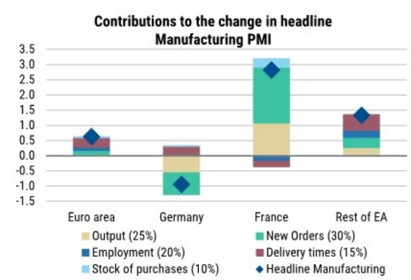
PMIs Manufacturing | Resilient, can this last? As much as the large drop in services PMIs (see below), the resilience of headline manufacturing across all countries was also a surprise today, with EA standing at 52.2 from 51.6 last month (Exhibit 8). This came on the back of still solid output (52.2 from 52.0) and orders (51.4 from 51.0). Businesses do report a sharp increase in input prices, but this does not seem to affect activity. Time will tell whether this reflects actual robustness of the manufacturing cycle, for instance on the back of the German fiscal package or the defence push across Europe, or whether the negative demand effects from the energy shock just take time to arrive.

Exhibit 8: Manufacturing PMIs looked solid across Europe...



Source: S&P Global, Morgan Stanley Research

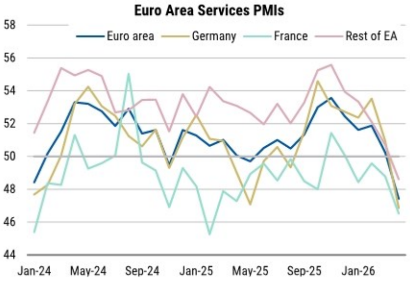
Exhibit 9: ... as output and orders did not move much from recent high levels



Source: S&P Global, Morgan Stanley Research

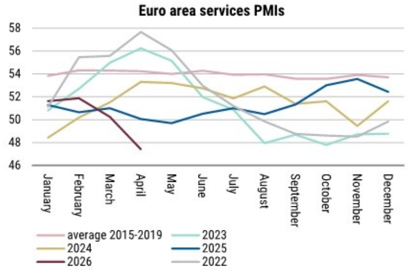
Services | A very soft print: While the manufacturing sector was more resilient than we anticipated, services PMIs surprised again on the downside. Like in March, the drop was broad-based across countries and subcomponents, suggesting this reflects a true change in sentiment within the sector. This confirms that we are in a very different environment than in March-22 (Exhibit 11) when consumer demand for services was lifted by a strong rebound post-Covid. What we likely see today is the short-term consequences of the negative shock to real disposable income from higher energy prices, as well as strong cost-push in some sectors (eg transport).

Exhibit 10: Services PMIs declined again in all countries in April...



Source: S&P Global, Morgan Stanley Research

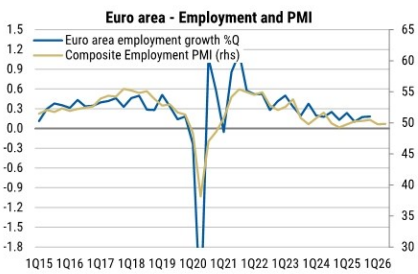
Exhibit 11: ... which is in sharp contrast with their resilience in the first months of 2022



Source: S&P Global, Morgan Stanley Research

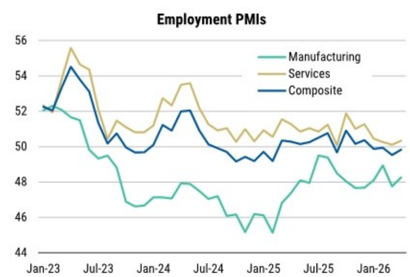
PMI Labour market: Downside risks? Despite the stark deteriorating of headline numbers, the composite employment PMIs was resilient in April, slightly up to 49.8 from 49.6 in March (Exhibit 13). On our estimates, this level is consistent with flat employment, slowing down from positive job creations observed until the end of 2025 (Exhibit 12). Labour demand is usually reacting with a lag to activity, so we see risks of further deterioration in the labour market in the coming months if activity stalls.

Exhibit 12: April PMI would be consistent with almost stable employment



Source: S&P Global, Eurostat, Morgan Stanley Research

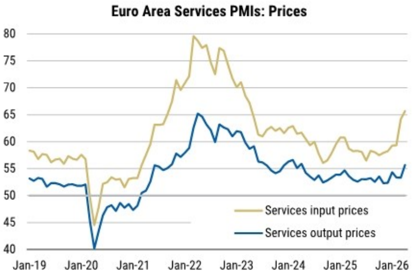
Exhibit 13: Employment PMIs moved sideways in April



Source: S&P Global, Morgan Stanley Research

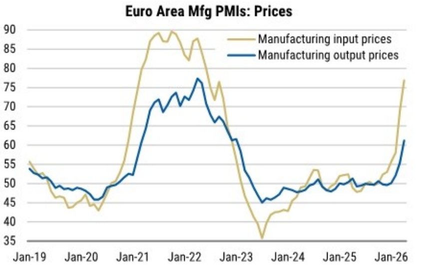
PMI Prices | Upside risks from higher input prices: It did not come as a surprise that input prices increased again meaningfully both in services (Exhibit 14) and manufacturing (Exhibit 17). More interesting is the reaction of output prices. They moved up very meaningfully in manufacturing (61.2 from 55.4) and also in services (55.7 from 53.3). We note some contrast across countries, with prices charged in German services firmly up (60.5 from 53.8) while they were almost stable in France (50.6 from 49.8).

Exhibit 14: Services output prices moved up in April...



Source: S&P Global, Morgan Stanley Research

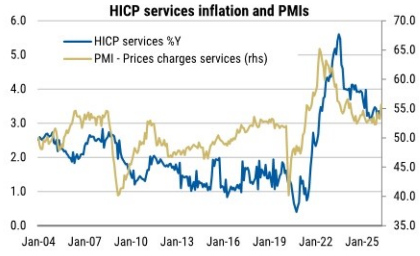
Exhibit 15: ... and even more so in the manufacturing sector



Source: S&P Global, Morgan Stanley Research

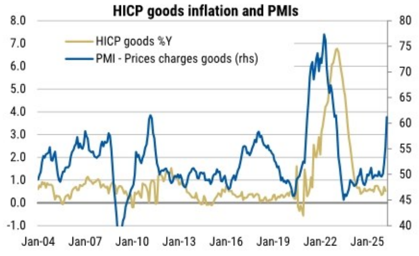
Is the PMI a good signal for inflation? A word of caution: The key question here is of course whether the data today is a useful signal for actual HICP. If we look back at 2022-23, the answer looks like a clear yes: PMI prices charged in services and manufacturing sectors lead services and goods inflation respectively, by ca 10 months (Exhibit 16 and Exhibit 17). But this relationship has not always been like that and it might also depend on the magnitude of the cost shock. For instance, in 2016-17 PMI manufacturing output prices moved up meaningfully but HICP inflation for goods remained low. For services, we note PMIs have not always been a reliable guide to the actual level of inflation. For instance, the current levels were also observed in 2006-07 and 2018-19, with ultimately very different HICP services inflation. This early signal from PMIs will thus need confirmation in actual data.

Exhibit 16: PMIs have not been a very reliable guide of the actual level of services inflation



Source: S&P Global, Eurostat, Morgan Stanley Research

Exhibit 17: Increasing manufacturing prices charged do not always come with higher inflation



Source: S&P Global, Eurostat, Morgan Stanley Research

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