

Box 9

A CLOSER LOOK AT THE RECOVERY IN EURO AREA SERVICES

Growth has returned to the euro area economy since the second quarter of 2013. An important driver behind the recovery has been growth in the services sector, which accounts for about three-quarters of total value added. The economic recovery in the euro area has been uneven across the main economic sectors. Real activity in the services sector, as measured by the chain-linked index of value added, has been above previous peak levels since the second quarter

of 2011, whereas in industry, and in particular construction, it is still clearly below previous peak levels.¹ Against this background, this box takes a closer look at the recent recovery in the euro area services sector. It describes the main drivers of the recovery up to the second quarter of 2014. It also assesses the sustainability of the recovery in the near term on the basis of the latest survey evidence.

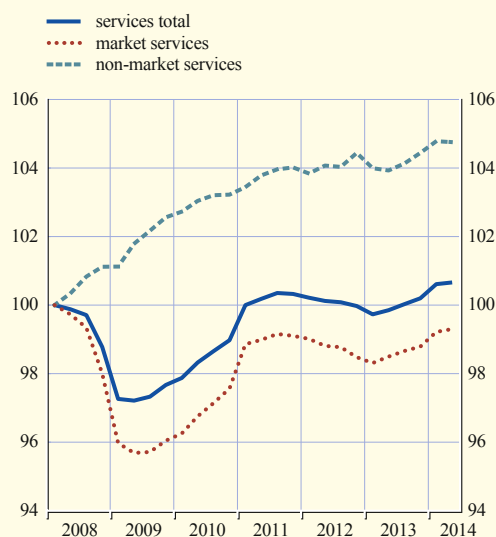
Real value added developments up to the second quarter of 2014

Developments in real value added show that the current recovery in euro area services has been particularly driven by market services, which account for about three-quarters of total services value added. The real value added of market services was, in the second quarter of this year, 1.0% higher than in the first quarter of last year (see Chart A). Non-market services (public administration, education, health care and social services) contributed less to the current recovery, against a background of fiscal consolidation efforts. This notwithstanding, the real value added of non-market services stood in the second quarter 0.7% above the level recorded in the first quarter of last year. These euro area developments mask notable cross-country differences. For example, looking at the four largest euro area countries, in the second quarter of this year market services real value added in Italy was 0.4% lower than in the first quarter of 2013, whereas it was 1.2% higher in France, 1.4% higher in Germany and 2.3% higher in Spain. For non-market services, this range across the largest countries varies between -0.7% for Spain and 1.6% for France.

Striking differences also exist for the main subsectors of market services (see Chart B). The strongest growth since the first quarter of last year was recorded for trade, transport, accommodation and food services as well as

Chart A Euro area value added for total services, market services and non-market services

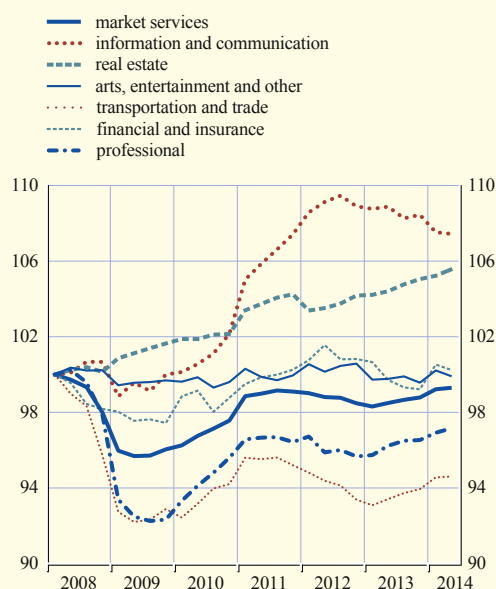
(chain-linked index; 2008 Q1 = 100)



Source: Eurostat.

Chart B Euro area market services value added across subsectors

(chain-linked index, 2008 Q1 = 100)



Source: Eurostat.

¹ For more details, see "Euro area sectoral activity since 2008", *Monthly Bulletin*, ECB, Frankfurt am Main, May 2014. Besides value added, turnover data is available for a few services subsectors, but they refer to nominal developments and are therefore not covered in this box.

professional, business and support services. Both subsectors have picked up comparatively well since the start of the current recovery. These service activities include a broad range of both business-to-consumer and business-to-business services. Some of these are largely sheltered and are linked to demand from households (such as retail trade and food services) while others are exposed to (global) business-to-business developments (such as air and sea cargo transportation or business travel). Business services are benefitting from a need for consulting and advisory activities in an environment of strong restructuring and mergers and acquisitions. Real estate services activity has also contributed to the recent recovery in services, while the real value added of financial and insurance services as well as the arts, entertainment and other services has remained broadly unchanged since the first quarter of last year. The real value added of information and communication services has declined somewhat.

Survey evidence for the third and fourth quarters of 2014

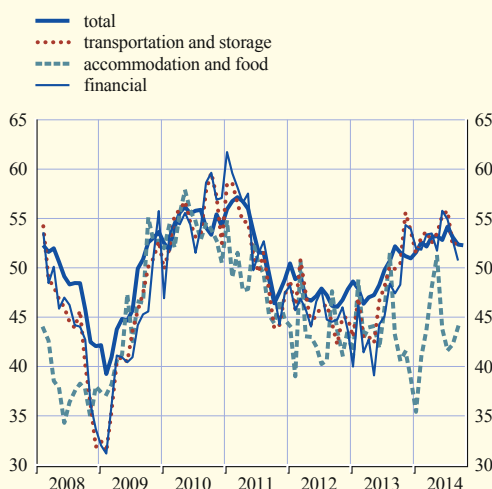
Given that real value added in services grew in the second quarter of this year compared with the previous quarter by only 0.05%, surveys can provide some insight into the recovery in services for the second half of this year.

Chart C plots the Purchasing Managers' Index (PMI) services business activity index for total market services and selected subsectors. The PMI services business activity index is a widely monitored survey indicator, as it provides an early signal of the growth of value added in services.² The total services business activity index was above the theoretical "no-change" threshold of 50 in the third quarter and at the start of the fourth quarter, indicating further growth in the market services sector. However, the momentum of market services growth has in recent months slowed down slightly, as in October the PMI services business activity index was at its lowest level since July this year. The chart also shows that significant differences across subsectors have remained. A comparatively low level of business activity is recorded for accommodation.

Chart D plots, on the basis of European Commission DG ECFIN surveys, the evolution of demand expected in the months ahead for total (non-financial) services and selected subsectors and the evolution of demand (turnover) expected in the next three months for financial services. Expected demand for total services between July and September came down compared to June, but returned in October close to the June level, which was the highest since the summer of 2011. The October level thus clearly remained on balance positive, suggesting that the recovery in the service sector is expected to continue.

Chart C PMI services business activity for total market services and selected subsectors

(monthly diffusion index)



Source: Markit.
Note: "Financial" refers to financial service activities, insurance and pension funding and auxiliary activities.

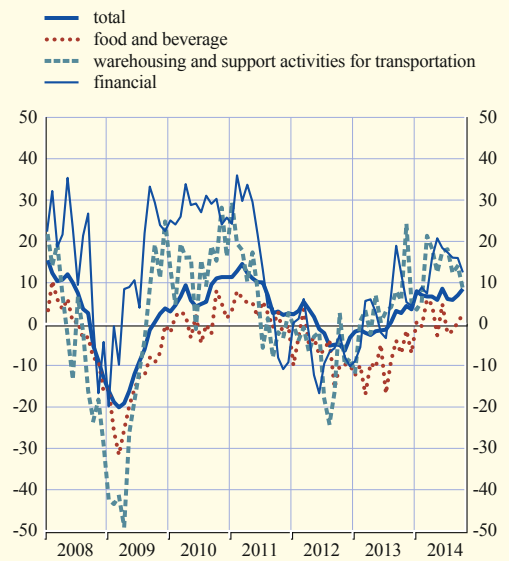
² See also the box entitled "Euro area sectoral value added growth and the Purchasing Managers' Index", *Monthly Bulletin*, ECB, Frankfurt am Main, April 2014.

Again, differences across subsectors exist. Comparatively strong, albeit slowing, demand is expected for warehousing and support activities for transportation as well as financial services, while comparatively low demand is foreseen for food and beverage service activities.

In sum, real value added data up to the second quarter of this year show that the recent recovery in the services sector is mainly driven by market services, which, in turn, benefited most from a pick-up in transportation and trade as well as professional, business and support services. Survey data up to the first month of the fourth quarter of this year show that the recovery in the services sector is expected to remain on track despite a slowing down in overall services growth. PMI services business activity indices and data on demand expected in the months ahead show that food services are expected to be comparatively weak.

Chart D Evolution of services demand expected in the months ahead for total and selected subsectors

(monthly percentage balances)



Source: European Commission DG ECFIN services and financial services surveys.