

Box 7

RECENT DEVELOPMENTS IN EURO AREA SERVICES ACTIVITY

The services sector is by far the largest economic sector in the euro area. In 2007 services value added accounted for around 71% of total value added in the euro area.¹ By way of comparison, the share of industry excluding construction was about 20% and the construction and agricultural sectors had relatively small shares, at 7% and 2% respectively. This box provides an overview of the breakdown of the services sector in terms of value added in the euro area. It reviews the growth performance of the main services activities in recent years and discusses the signals provided by surveys regarding euro area services activity at the start of 2008.

Sub-sector breakdown of services

According to the NACE classification,² the euro area services sector encompasses three main sub-sectors: trade and transportation services, which in 2007 accounted for 29% of total services value added in the euro area, financial and business services (39%) and the “other services” sub-sector (32%). Although this breakdown provides no strict separation between private and public services, the former two sub-sectors are usually referred to as “market services”, while the latter comprises mainly government-related services. The largest fraction of value added in trade and transportation services is provided by wholesale and retail trade and repair of motor vehicles, followed by transport, storage and communication services, while hotel and restaurant services account for a somewhat smaller share of value added in that sub-sector. Financial and business services include real estate, renting and business activities as well as the smaller financial intermediation services segment. The very diverse activities subsumed under the other services sub-sector include, in particular, health and social work, public administration and defence and education.

Developments in services value added in recent years

Since the start of the current economic upswing in mid-2003, euro area services value added has expanded somewhat less strongly than value added in industry excluding construction (see Chart A). This reflects the stronger cyclical movement of the industrial sector, while, from a longer-term perspective, the services sector generally displays slightly stronger growth than the industrial sector. The pace of growth of market services was, however, even in this period almost as fast as that of industry. Among the market services sub-sectors, value added in financial and business services rose most strongly, but trade and transportation services also showed significant growth, while value added growth in the other services sub-sector clearly lagged behind (see Chart B).

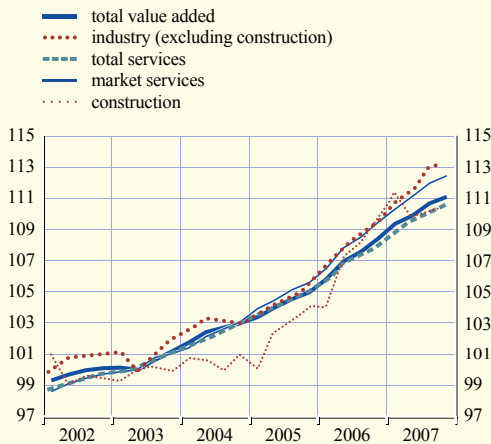
In view of its much larger size, the services sector has clearly been the largest contributor to overall value added growth in the euro area since mid-2003, despite showing somewhat slower growth than the industrial sector. On average in this period services contributed 0.4 percentage point to quarterly value added growth in the euro area, which compares with an average 0.1 percentage point quarterly contribution of industry excluding construction.

1 See also the box entitled “The sectoral composition of euro area growth” in the ECB’s Annual Report 2005.

2 NACE is a system for classifying economic activities in the European Community.

Chart A Value added in the main euro area economic sectors

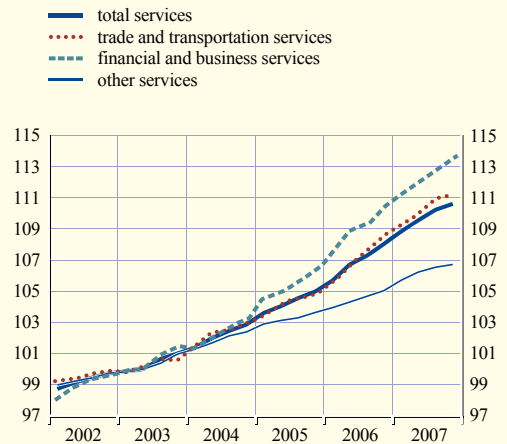
(index; Q2 2003 = 100)



Sources: Eurostat and ECB calculations.

Chart B Value added in the main euro area services sub-sectors

(index; Q2 2003 = 100)



Sources: Eurostat and ECB calculations.

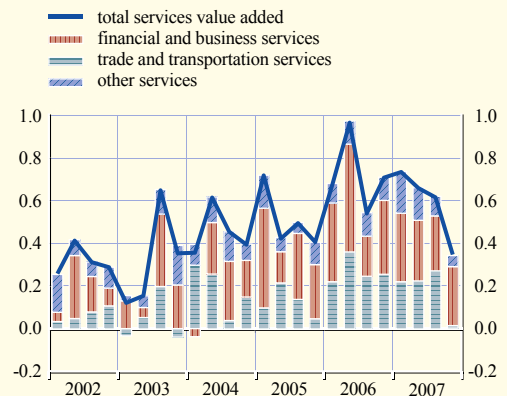
Focusing on 2007, in the first three quarters of that year services value added expanded at an average quarterly rate of 0.7%, before slowing to 0.3% in the fourth quarter. As Chart C shows, financial and business services and trade and transportation services were the main contributors to services growth also in 2007. The significant deceleration from the third to the fourth quarter was mainly on account of trade and transportation services, which stagnated in the fourth quarter, having shown strong growth of 0.9% in the previous quarter. The trade and transportation services sub-sector is generally the most volatile of the services sub-sectors, and the sharp drop in growth seen in the fourth quarter suggests that deteriorating fundamentals for this sector, such as higher oil prices and the appreciation of the euro, may have taken their toll.

Services indicators have weakened since mid-2007

Surveys point to further deceleration in services growth momentum in the euro area at the start of 2008. Both the European Commission's services confidence indicator and the services business activity index of the Purchasing Managers' Survey have posted sharp falls since mid-2007 and declined further in the first quarter of 2008 (see Charts D and E). Both indicators have fallen to levels that are clearly below their long-run averages, suggesting relatively moderate underlying growth in services in the first quarter of 2008 and at the start of the second quarter. However, some of the more pessimistic survey results may not be fully in line with actual developments, as the

Chart C Growth in services value added and contributions of the main sub-sectors

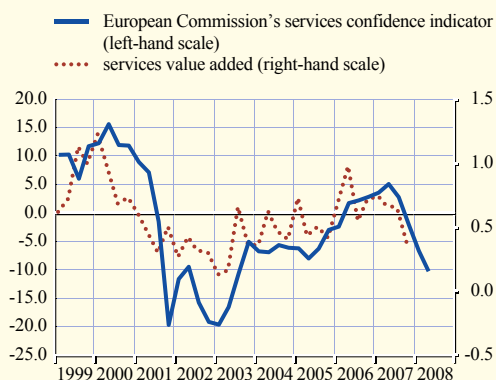
(quarter-on-quarter percentage changes and percentage point contributions)



Sources: Eurostat and ECB calculations.

Chart D Services value added growth and the European Commission's services confidence indicator

(quarter-on-quarter percentage changes; percentage balances)

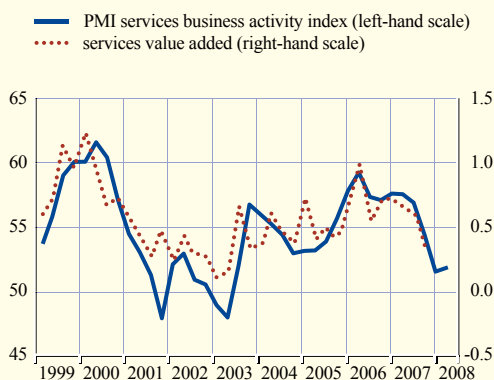


Sources: Eurostat and European Commission Business and Consumer Surveys.

Notes: The Commission's services confidence indicator is mean-adjusted. The survey data for the second quarter of 2008 refer to April.

Chart E Services value added growth and the PMI services business activity index

(quarter-on-quarter percentage changes; percentage balances)



Sources: Eurostat and NTC Economics.

Note: The survey data for the second quarter of 2008 refer to April.

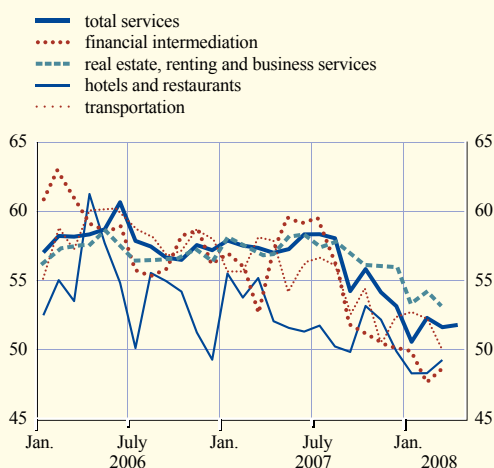
survey responses were given in periods of significant stock market volatility. This increases the uncertainty surrounding interpretations of the results, but does not change the picture of slowing growth momentum in the services sector.

More detailed survey information on services sub-sectors suggests that the slowdown in services growth may be relatively widespread across services activities rather than being concentrated in one or two sub-sectors. The indices for business activity in services sub-sectors from the PMI survey for instance display sharp falls in all the main services activities covered, albeit starting at different points in time (see Chart F). The index for financial intermediation shows the sharpest decline, which began after the outbreak of the financial turmoil in August 2007. By contrast, the indices for transportation services and hotel and restaurant services had already shown a declining trend since the start of 2007. Finally, the index for real estate, renting and business services has also clearly fallen recently.

The diversity in services activities, together with the differences in the timing and pace of the slowdown of these sub-sector indices, points to the existence of a number of underlying factors. As briefly mentioned above, given the kind of activities subsumed under the trade and transportation services sub-sector, a number of events are likely to have contributed to the broad-based falls in the corresponding sub-sector indices. The

Chart F Business activity indices of services sub-sectors

(percentage balances)



Source: NTC Economics.

surge in oil prices, slowing growth in foreign demand and the appreciation of the euro may all have dampened activity, in particular in the transportation services segment, whereas food price shocks may have adversely affected activity in the hotel and restaurant services segment. The survey results also point to a sharp fall in activity in the real estate, renting and business activity segment, which could be partly related to housing market slowdowns in some parts of the euro area.

The link between the start of the financial turmoil and the drop in the index for financial intermediation services is particularly clear from the timing of these events. This index shows the steepest fall, declining to quite a low level. But efforts to ascertain to what extent these developments have actually materialised in the “hard” data are hampered by the lags in the availability of more detailed national accounts data. Nevertheless, it is important to recall that given the relatively small share of financial intermediation services in total euro area value added (around 5%), the direct impact of even a large fall in value added in that segment on total euro area value added growth would be relatively limited, although indirect spillover effects could be greater.

To sum up, value added growth in the euro area services sector slowed at the end of 2007 and surveys point to a further decline in the first quarter of 2008, which would be consistent with relatively moderate growth momentum in that sector in the first quarter and also at the start of the second quarter. These developments appear to be relatively broad-based across services activities, probably owing to the various shocks that have affected the euro area economy in the recent past. Given the unusually high degree of uncertainty currently surrounding the economic situation, it could, however, be the case that confidence effects may have unduly influenced survey results in the first quarter of 2008.