PRIME

Contraction Eased

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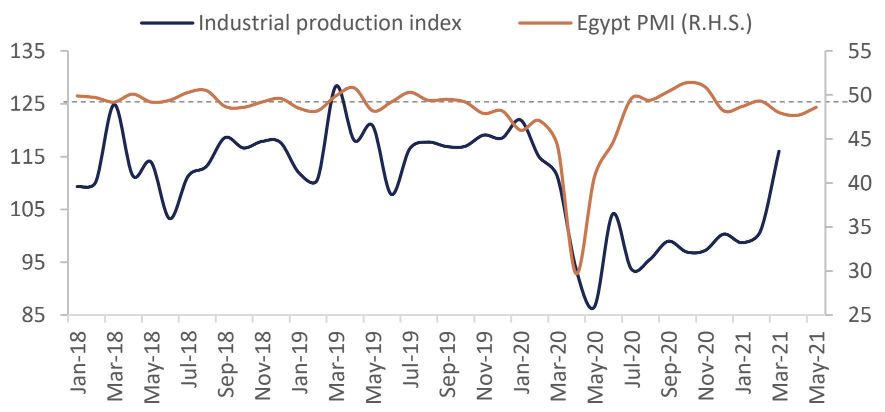
The contraction in private-sector activity seen since the end of 2020 extended in May, despite the slight improvement. The private-sector PMI index rose in May to its highest reading since February 2021, but it remained in the contraction territory for the sixth consecutive month. The contraction in private-sector activity eased as the headline PMI index picked up to 48.6 in May from 47.7 in April 2021. The reading came consistent with our expectations that the pandemic-related implications and the impact of May's partial lockdown measures weighed on demand and hence private-sector activity.

The output is still falling, and upward pressures on input costs continue. The breakdown of headline sub-indices indicate that domestic demand is pressured by the COVID-19 turmoil as labor market dynamics remain weak and new orders are still in contraction for the sixth consecutive month. Moreover, the private sector is also still pressured by a surge in global commodity prices as the prices of most raw material accelerated in addition to the cost of input shortages and higher freight costs. The weak demand undermined the ability of all firms to pass these costs to their end consumers. Yet, the survey indicates that some firms managed to do so, which will likely be reflected in May's inflation prints.

We still don't expect future PMI readings to leave contraction territory before summer ends. The expected boost in the tourism sector this summer should set the stage for a faster rebound in private-sector activity, in view of the Russian travel ban to the Red Sea coming to an end and the wider vaccination coverage. Yet, the private-sector activity needs a fast, large-scale recovery in domestic demand, which is not expected to be seen before end of 2021. The new budget of FY22, which will begin next month, introduces initiatives supporting domestic demand and the private sector, including the increase in public wages and a new export subsidy program. However, the growing risk of higher inflation will keep the CBE's monetary stance in a "wait and see" mode over the coming few months.

Chart 1: PMI contraction eased in May, while IPI is still below pre-COVID-19 levels



Source: PMI Markit, CAPMAS.

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