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Markit Economic Research

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Eurozone

Eurozone shows unconvincing rise from recession as GDP expands in Q2

- **GDP rises 0.3% in second quarter, led by Germany, France and Portugal**
- **Data likely overstate upturn, but region looks to be on the mend**

The Eurozone pulled out of recession in the second quarter, ending a one-and-a-half year period of contraction. Gross domestic product rose 0.3% in the three months to June, according to official data from Eurostat, reversing a 0.3% decline seen in the first three months of the year, leaving GDP 0.7% below the level of a year ago.

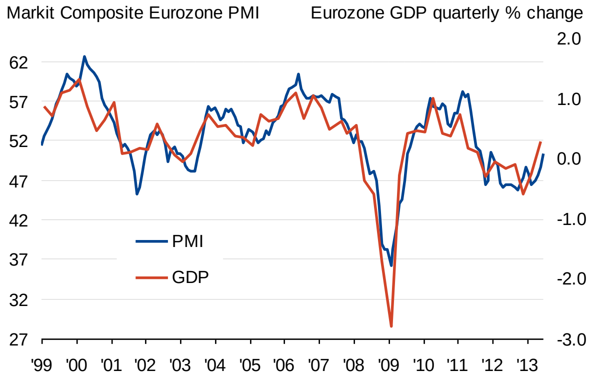
However, the GDP increase looks likely to overstate the true health of the Eurozone economy in the second quarter. In particular, the increase looks to be based on unsustainable factors, notably a weather-related upturn and a record jump in car output. The upturn also sits in contrast to weaker business survey data (notably in France, where the largest question marks hang over the GDP data). This combination of temporary-looking growth drivers and the contrast with the survey data suggests that the impressive performance may not be repeated in the third quarter.

Nevertheless, while there is some evidence that the second quarter GDP number overstates the true underlying health of the Eurozone, there's little doubt that the region is slowly mending. While the PMI data remained weak in the second quarter, the composite PMI hit a near two-year high in July, moving into positive territory for the first time since January 2012 as the German recovery gained momentum and downturns eased in France, Italy and Spain.

Growth divergences

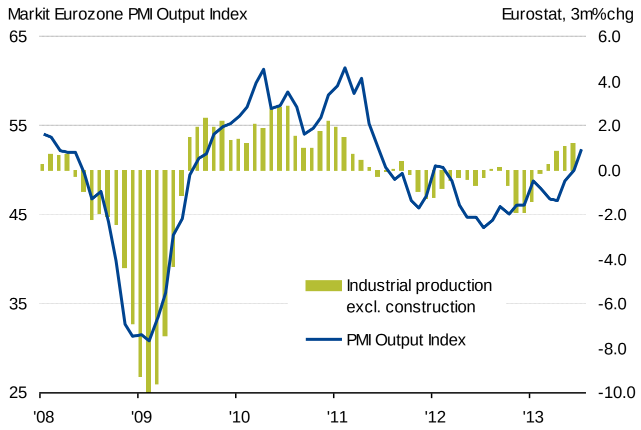
Growth was led, surprisingly, by Portugal, which saw GDP rise by 1.1% in the second quarter, followed by France and Germany, where increases of 0.7% and 0.5% respectively were seen. Austria and Belgium eked out small gains. However, GDP fell again in Italy, Spain and the Netherlands, highlighting how the impressive regional average masked ongoing strong variations in economic performance.

Eurozone GDP and the PMI business survey



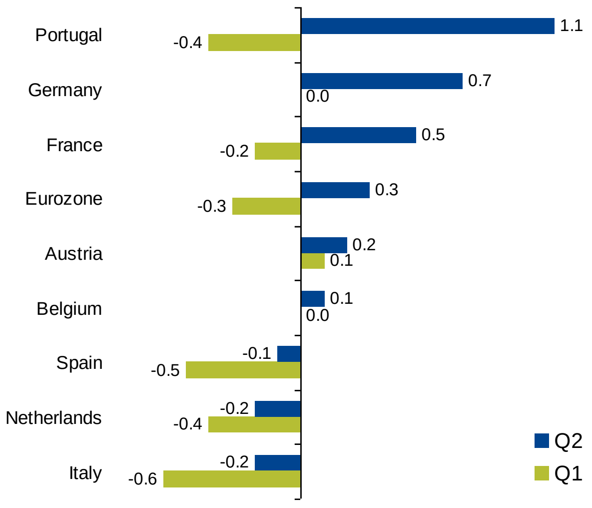
Sources: Markit, Eurostat.

Industrial production



Sources: Markit. Eurostat.

Quarterly GDP growth rates



Sustainable growth?

The variations in national performance underline the fragility of the upturn, especially when deeper looks at the data suggest that the strength of growth in both France and Germany looks somewhat unsustainable.

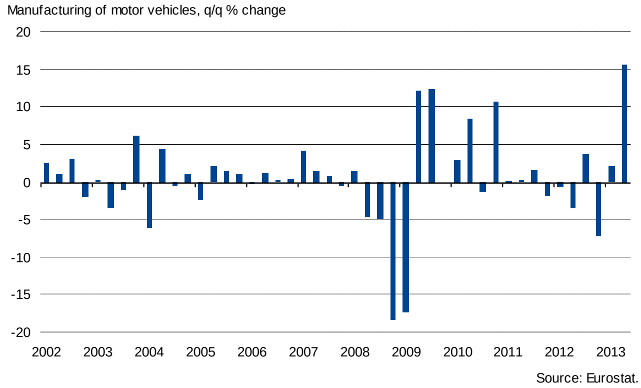
The volatile industrial production was driven by a surprisingly strong jump in production of durable goods, led in turn by a 15.7% surge in car production – the largest ever increase seen since data were first available in 1991. This increase not only looks unsustainable but is also at odds with the PMI data, which tend to give a better picture of the underlying health of the manufacturing sector as a whole. Reassuringly, however, although the manufacturing PMI data remained weak in the second quarter, a return to growth is clearly evident in July (see chart), suggesting the goods producing sector is on course to expand in the third quarter.

Perhaps most striking, however, are the jumps in GDP in austerity-encumbered Portugal and France, both of which leave question marks over what the underlying growth drivers were of such robust rates of expansion in these countries. (In fact, besides the volatility in the German numbers, almost all of the divergence between the weaker PMI signal for the second quarter and the contrasting GDP expansion can be explained by the variance in the French PMI and GDP numbers (see charts on page 3).)

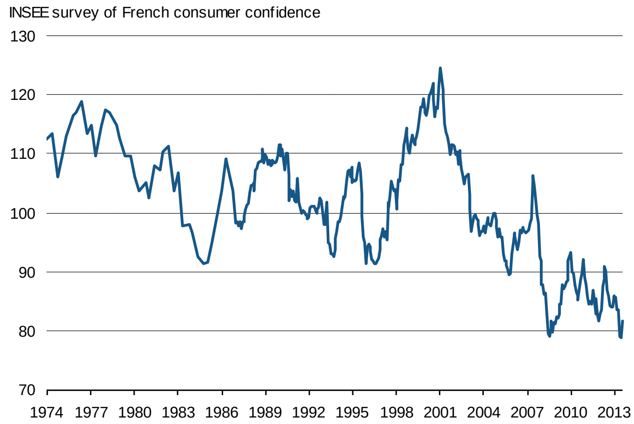
The robust French data in particular contrast markedly with PMI data which, although having bottomed-out earlier in the year, pointed to an ongoing deterioration of output in the second quarter. The government's statistics body, INSEE, assigned the 0.5% GDP increase primarily to rising domestic demand and an upturn in inventories. Both of these could fade in the third quarter: INSEE themselves note that consumer confidence remains close to its all time low (see chart), and inventories will be cut unless demand moves higher.

Finally, there is also some evidence that the upturns in Germany and France reflected a rebound in domestic spending after adverse weather deterred shoppers at the start of the year; something which would not be especially noticeable in the manufacturing and services PMIs and is again a growth driver that would be only temporary.

Eurozone car production

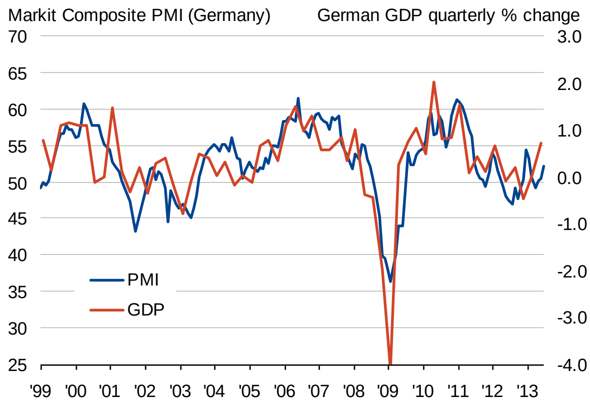


French consumer confidence

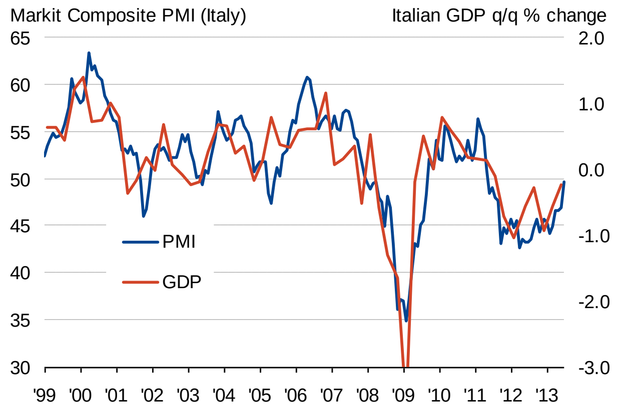


GDP and PMI comparisons

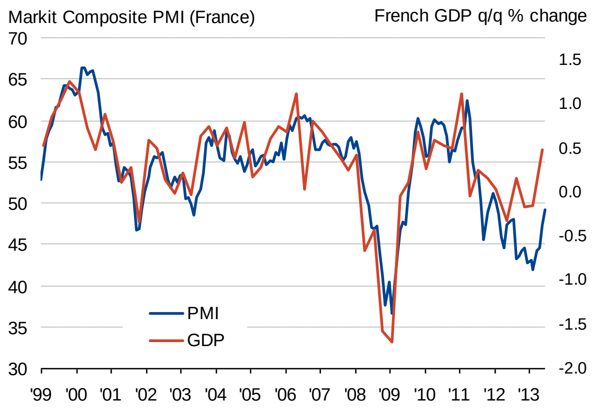
Germany



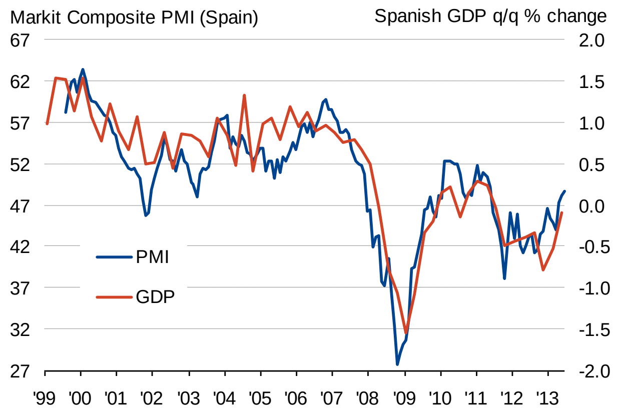
Italy



France



Spain



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