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Markit Economic Research

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Eurozone

Eurozone stuck in low gear as economy grows by just 0.2% in first quarter

- **Eurozone GDP rises 0.2% in Q1, with Q4 also revised down to 0.2%**
- **Strong growth in Germany and gathering recovery in Spain contrasts with stagnation in France and contraction in Italy and the Netherlands**
- **ECB will be minded that PMI points to better growth in Q2**

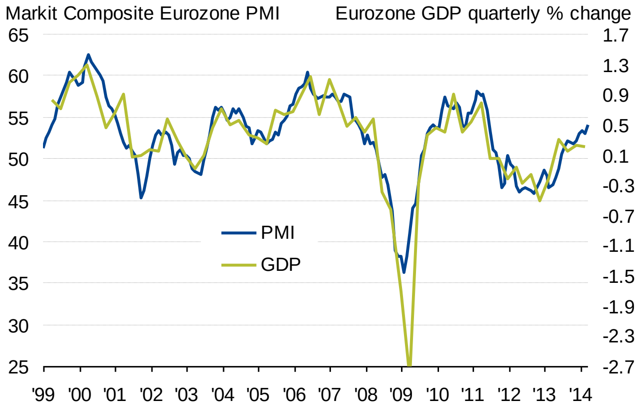
The Eurozone economy expanded 0.2% in the first three months of the year, below expectations of a 0.4% increase. Growth of GDP in the first quarter was identical to that seen in the final quarter of last year, which was revised down from 0.3%. Although the economy has now grown for four consecutive quarters, the pace has failed to accelerate to anything other than lacklustre over this period. The data therefore add to the likelihood of the ECB taking action at its June meeting to inject more stimulus into the economy. However, the case will ultimately be decided on the inflation outlook, which itself depends on the extent to which the ECB's economists will decide that signs of the recovery gaining strength in the second quarter will be offset by deflationary forces.

Very divergent trends across the varying member states in the first quarter also highlight the ongoing challenge faced by a central bank seeking to achieve an appropriate monetary policy stance for the region as a whole. In particular, better than expected growth in Germany contrasted with a weaker than hoped for performance in France and surprise economic contractions in Italy and the Netherlands.

Growth of gross domestic product in Germany accelerated to a three-year high of 0.8% in the first three months of the year against expectations of a 0.7% rise, while hopes for a 0.1% increase in France were dashed as the official data showed stagnation. Italy meanwhile contracted by 0.1% compared to expectations of a 0.2% rise and the Netherlands saw a shock 1.4% slump. Spain grew by 0.4%.

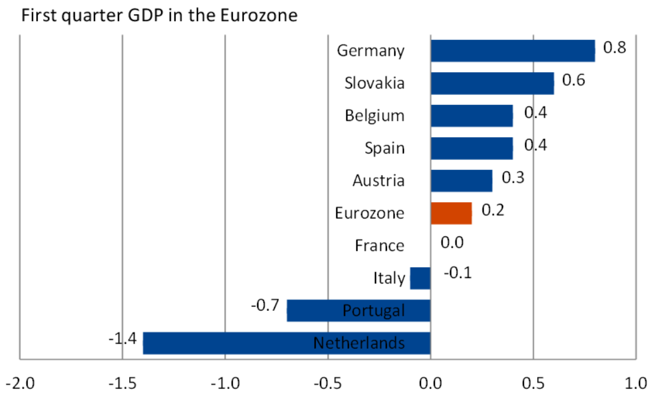
The official data confirm the divergent trends indicated by the business surveys, which also suggest that these differences persisted into the second quarter.

Eurozone GDP and the PMI



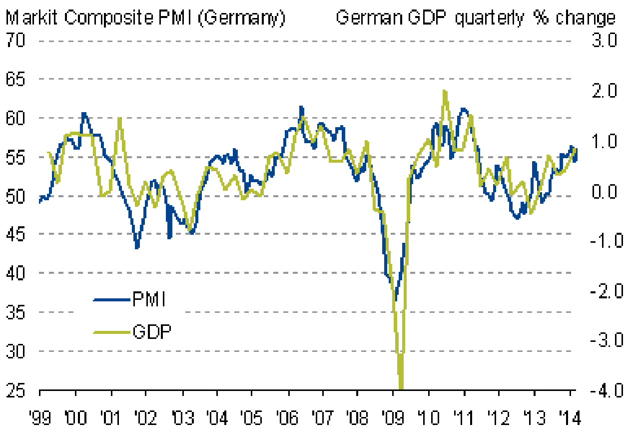
Sources: Markit, Eurostat.

Growth by country



Source: Ecowin.

Germany



Source: Markit, Ecowin.

However, like the surveys, the official data also signal a slow underlying economic recovery for the region as a whole that appears to be steadily gaining momentum. The Eurozone PMI hit a three-year high in April, rising to a level broadly consistent with GDP expanding at a quarterly rate of 0.5% at the start of the second quarter.

Although no detailed data were available, Germany's growth was attributed to strengthening domestic demand, contrasting with a weakening domestic picture in France, where a contraction was only avoided by rising government spending and an inventory build-up. The French economy was dogged by ongoing weakness of consumer spending and business investment, revealing a sustained lack of confidence in the country's economic outlook.

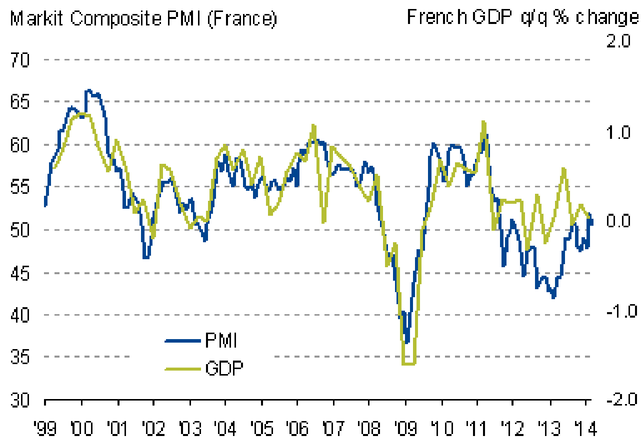
France has pointed to the strengthening euro as an impediment to the region's recovery, a complaint lent some support by the indication that trade also acted as a drag on the German economy. However, the GDP data also highlight the need for economic reforms to boost growth in the weakest economies and in particular France, where a day of public strikes over pay added to the struggle the French government faces in implementing change. The weakness of the French economy at the start of the year raises the prospect that the country will miss its modest 1.0% growth target for the year, adding to the need to even greater reforms. Spain in contrast, having enacted many reforms and having boosted competitiveness in manufacturing in particular, upped its 2014 growth forecast to 1.4%.

The large drop in Dutch GDP was blamed on lower gas consumption (the country is a major producer and exporter of gas) arising from the milder than usual weather across northern Europe. Certainly, the Dutch manufacturing PMI pointed to strong growth in the first quarter, albeit with signs of the pace of increase weakening at the start of the second quarter.

ECB ready for action?

At face value the disappointing data for some countries raises the likelihood that the ECB will feel further action is required to boost the region's recovery and help ensure inflation, confirmed at 0.7% in April, does not fall further. However, these GDP data are backward-looking numbers and policymakers have made it clear that any decision to cut interest rates or take less conventional action to stimulate growth will rest on the new medium-term staff projections for inflation. It is likely that the inflation outlook will have to be downgraded materially to convince the ECB's Governing Council of the need for any aggressive action in the face of the region's steady, albeit hesitant, economic recovery.

France

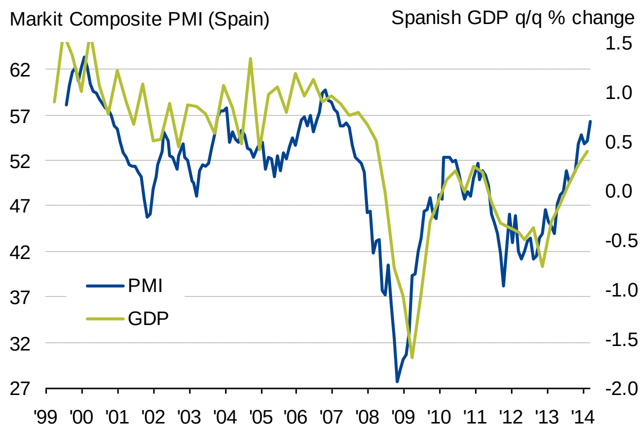


Source: Markit, Ecowin.

Italy

Source: Markit, Ecowin.

Spain



Source: Markit, Ecowin.

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