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Eurozone

France returns to recession and Germany's growth disappoints

- **France returns to recession as GDP falls 0.2% in first quarter**
- **German sees weaker than expected 0.1% return to growth**

The eurozone's two largest economies fared worse than expected at the start of the year, piling further pressure on the ECB to act soon to do more to reinvigorate growth.

Germany returned to growth, as expected, but only just managed to avoid falling back into recession after GDP rose a meagre 0.1% against expectations of a firmer 0.3% rise. France meanwhile succumbed, slipping back into recession as GDP fell by 0.2% for a second successive quarter. Analysts had been expecting a 0.1% decline.

The French contraction would have been even larger had it not been for a 0.3% increase in public sector consumption. Household spending fell 0.1%, its first fall since the second quarter of last year, business investment dropped 0.8% and exports fell by 0.5%.

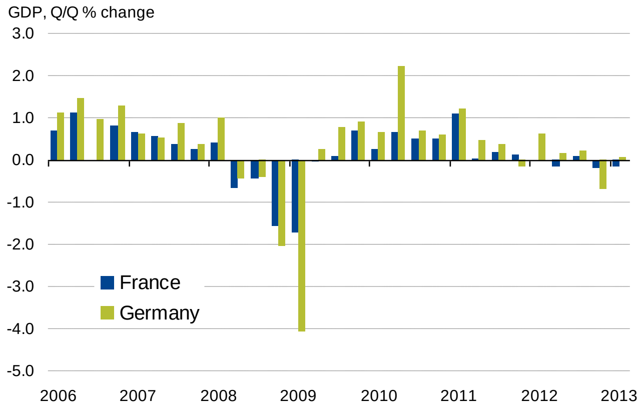
The downturn in France signalled by the provisional first quarter estimate was less severe than signalled by the PMI and INSEE business surveys, meaning the surveys suggest the underlying health of the economy is worse than even these disappointing GDP figures are currently suggesting. Further weakness may therefore lie ahead. The PMI surveys remained firmly in contraction territory in April, pointing to a weak start to the second quarter and raising the possibility of a third successive quarterly GDP decline.

While Germany narrowly avoided a slide back into recession, the outlook is far from encouraging. The return to growth in Germany in the first quarter had been signalled in advance by the PMIs, which had risen to a one-and-a-half year high in January. Since then, the PMI has gradually fallen, dropping back into contraction territory in April to indicate a heightened risk that GDP could contract again in the second quarter. The IFO survey has likewise deteriorated.

The downturn in France at the end of last year was less steep than previously thought, with fourth quarter GDP revised up from -0.3% to -0.2%. However, in Germany, the 0.6% drop in fourth quarter GDP was revised to a steeper 0.7% decline.

The worse than anticipated start to the year will clearly worry policymakers at the ECB. The central bank has already responded to signs of a renewed weakening in the region's economy, cutting its main policy rate to a record low of 0.5% on 2nd May, but today's data will add to calls that more action is required beyond what many see as a token gesture of a rate cut. The focus is turning to how the ECB might possibly emulate recent successful-looking efforts by the Bank of England to stimulate lending to small and medium sized companies.

French and German GDP



Source: INSEE via Ecowin

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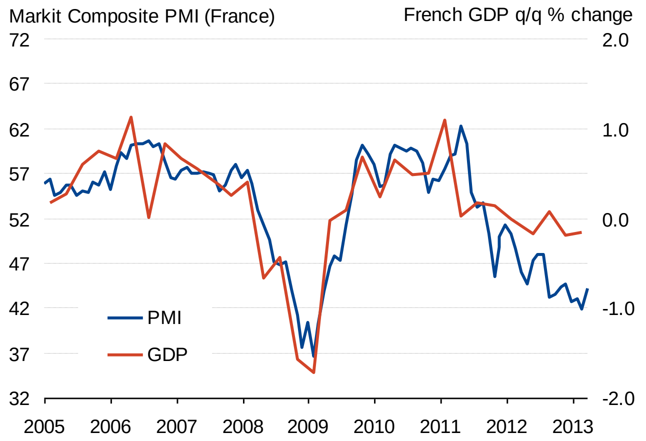
German GDP and the PMI

France GDP and the PMI



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