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Economics Group

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Eurozone Recession Comes to an End

Real GDP in the Eurozone rose 0.3 percent (not annualized) in Q2, which was stronger than most analysts had expected. Growth likely will remain positive, albeit relatively sluggish, in coming quarters.

Eurozone GDP Stronger-Than-Expected in Q2

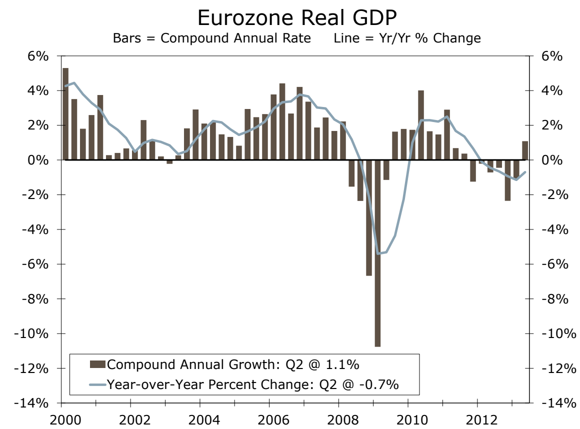
Data released this morning showed that real GDP in the Eurozone rose 0.3 percent (1.1 percent at an annualized rate) on a sequential basis in the second quarter, which was stronger than the market consensus forecast had anticipated (top chart). If recessions are defined by consecutive quarters of negative GDP growth, then the second recession in the Eurozone in the past five years appears to have come to an end. However, the level of real GDP in the Eurozone remains 3 percent below its peak five years ago, and the holes in the heavily indebted economies (i.e., Greece, Ireland, Italy, Portugal and Spain) remain even deeper.

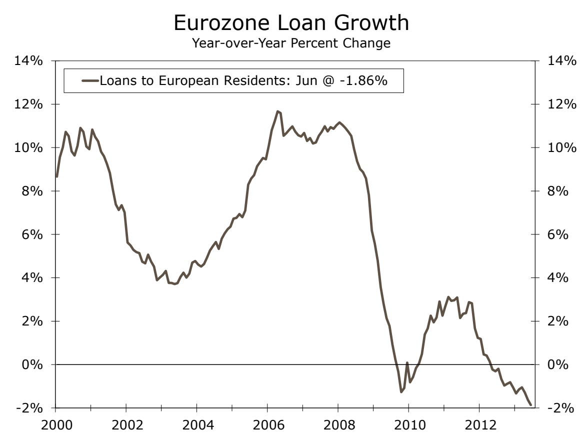
Among individual countries, GDP growth was stronger-than-expected in Germany (0.7 percent) and France (0.5 percent), and rates of contraction in Spain, Italy and the Netherlands were slower in Q2 than they were in Q1. A detailed breakdown of overall Eurozone real GDP into its underlying demand components will not be available for a few weeks, but preliminary data from Germany and France show that real consumption expenditures rose in the second quarter. Therefore, it appears that the rise in real GDP in Eurozone in Q2 was driven, at least in part, by domestic demand rather than solely by net exports. In other words, the rise in Eurozone real GDP appears to have some staying power, at least in the near term.

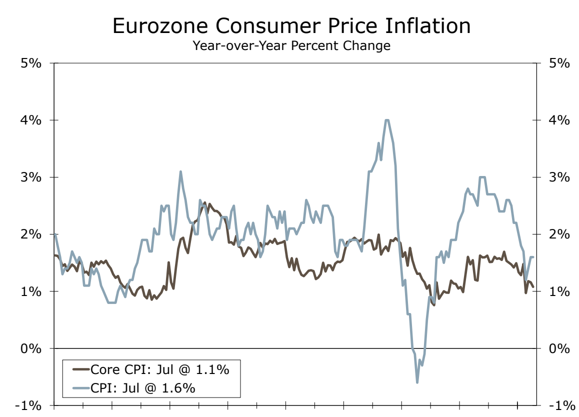
That said, the Eurozone is not completely out of the woods yet. For starters, the banking system remains very weak, especially in the highly indebted countries. Loans are down 2 percent on a year-ago basis (middle chart), and lending to small and medium enterprises (SME) has essentially ground to a halt in some countries. Moreover, the incipient recovery in economic activity is very fragile. Even a minor exogenous shock (e.g., a rise in energy prices from current levels) could send the Eurozone back into recession again.

ECB to Remain on Hold "For as Long as Necessary"

We project that GDP in the overall euro area will continue to expand, although we expect growth will remain rather sluggish. As noted above, lending remains very weak and fiscal policy will remain restrictive in many economies. Due to benign inflation (bottom chart) and weak economic growth, the European Central Bank (ECB) has vowed to maintain an accommodative monetary policy stance "for as long as necessary." Indeed, we believe that the ECB will maintain its main policy rate at 0.50 percent through the end of next year. The euro has edged higher against the dollar over the past month, but we look for it to depreciate modestly against the greenback in coming quarters as real GDP growth in the Eurozone lags behind growth in the United States and as the ECB maintains an accommodative monetary policy stance.







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