



Economics Group

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Economic Activity in Eurozone Stagnated in Q2

The Eurozone's three largest economies (Germany, France and Italy) either stagnated or contracted in Q2. Will the ECB eventually ease policy further?

Underlying Growth Pulse in the Eurozone is Anemic

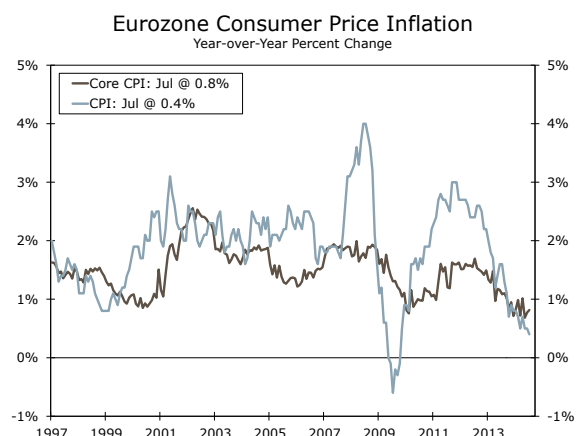
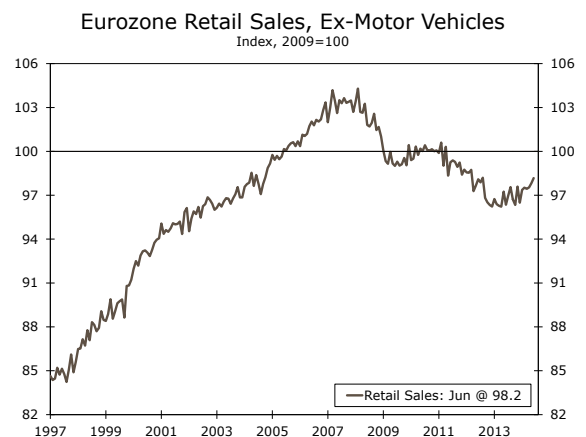
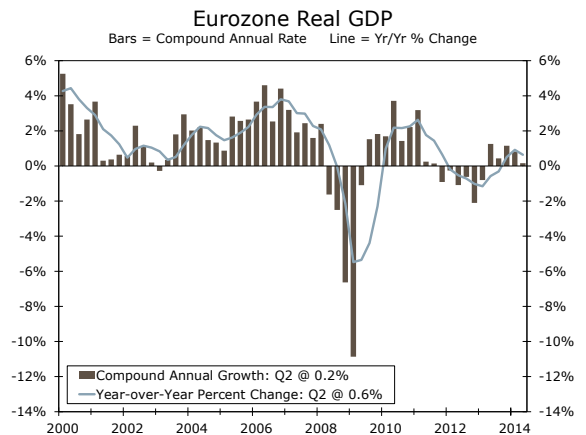
Data released this morning showed that real GDP in the 18 countries that comprise the euro area was essentially flat on a sequential basis in the second quarter (top chart). Although one weak quarter can sometimes be explained by transient factors—real GDP in the United States dropped 2.1 percent at an annualized rate in Q1 due, at least in part, to the severe winter—the 0.7 percent year-over-year GDP growth rate shows that the underlying pulse of economic growth in the Eurozone is anemic.

The weak outturn in the second quarter was foreshadowed last week when Italian statistical authorities announced that real GDP in that country fell 0.2 percent (not annualized) on a sequential basis in the second quarter. Data released today showed that real GDP in France was flat again in the second quarter. Moreover, real GDP in France was up only 0.1 percent on a year-ago basis in Q2, showing that the French economy has stagnated over the past year. The German economy, which has been the growth engine of the Eurozone over the past few years, contracted 0.2 percent (not annualized) in Q2 relative to the previous quarter. Without growth in Spain, (where real GDP rose 0.6 percent in Q2), and the Netherlands (up 0.5 percent) the overall euro area result would have been even weaker than it was.

A breakdown of euro area real GDP into its underlying demand components will not be available until next month. Real consumer spending in the Eurozone likely edged higher in second quarter, but monthly data on retail spending suggest that the growth pulse remains weak (middle chart). Investment spending probably contracted in Q2, and with uncertainties related to the Russian-Ukrainian crisis still high, the outlook for capex does not appear to be positive. Indeed, the Eurozone economy likely will continue to limp along for the foreseeable future.

Will the ECB Ease Further?

With CPI inflation already barely above zero percent—in July consumer prices in the euro area were up only 0.4 percent on a year-ago basis (bottom chart)—weakness in real GDP will not do much to alleviate concerns that the Eurozone is on the cusp of slipping into a mild deflationary environment. For now, the European Central Bank (ECB) appears content to bide its time, waiting for the program that is intended to jumpstart bank lending to kick in later this year. However, if growth momentum in the euro area continues to wane or if CPI inflation falls even further, the ECB may be forced to act. Until now, the ECB has appeared to be reluctant to engage in a Fed-like program of quantitative easing (QE). However, events may ultimately force the ECB's hand. QE in the Eurozone, should it occur, likely would weigh on the euro.



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