

# Eurozone Watch

## GDP growth slows down

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**Eurozone GDP grew only moderately in Q2, confirming that the economy was hit by slower world trade growth and fiscal consolidation at home. Growth is expected to remain sluggish in the second half of the year. Although the impact of high oil prices and supply-chain problems in Japan should wane, the escalating sovereign debt crisis and the recent turmoil on financial markets is likely to hurt confidence and activity. The slowdown in growth strengthens the case for a pause in the ECB's rate hike cycle.**

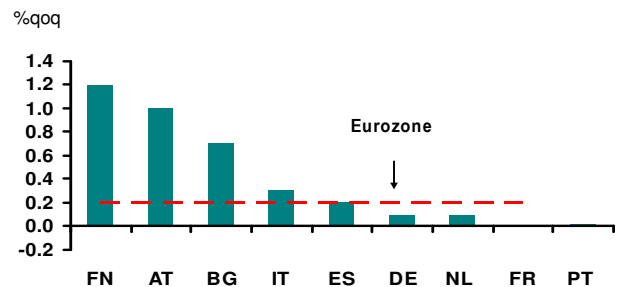
Eurozone GDP grew by 0.2% qoq in Q2, following a 0.8% expansion in Q1. This was below the consensus forecast of 0.3%, but no huge surprise after a number of major countries had published weaker-than-expected growth figures.

Although there were some one-off weather-related downward factors at play (the jump in residential investment we saw in Q1 probably came to a halt in Q2), the slowdown largely reflects weaker world trade growth due to the past rise in oil prices, supply-chain problems in Japan and monetary policy tightening in some major emerging economies. On top of that, the eurozone economy is being hit by fiscal policy tightening.

The country breakdown was mixed and no longer showed the typical differences between a strong northern core and a weak southern periphery. For instance, Spain (0.2% qoq) and Italy (0.3%) outperformed Germany (0.1%) and the Netherlands (0.1%). Belgium (0.7%), Austria (1.0%) and Finland (1.2%) were positive outliers, while the Portuguese economy was surprisingly resilient, performing in line with France (0.0%).

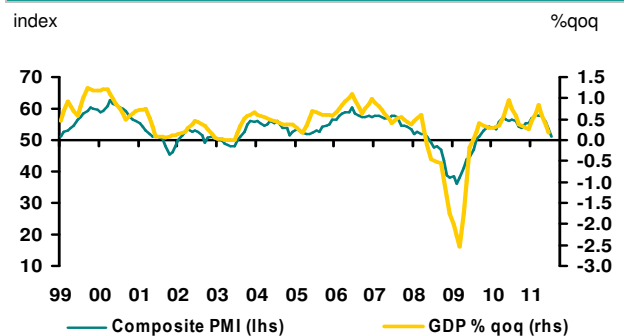
Looking forward, the outlook for the second half of the year is not very rosy. Although the impact from oil prices and the problems in Japan should wane, the escalating sovereign debt crisis and recent turmoil on financial markets is likely to hurt confidence and activity. Indeed, we expect the economy to remain sluggish in the second half of the year, while the risks are tilted to the downside. Action by policy makers to contain the debt crisis should lay the foundations for a gradual recovery next year, but if policymaking is slow or indecisive, the uncertainty will continue, and the economy will deteriorate further, implying there is a considerable risk of the economy falling into recession. The slowdown in growth strengthens the case for a pause in the ECB's rate hike cycle. We expect the central bank to keep interest rates on hold for the rest of the year.

### GDP growth in Q2 in selected member states



Source: Thomson Reuters Datastream

### GDP growth and composite PMI



Source: Thomson Reuters Datastream

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