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Western European Economic Indicators and Insights

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Eurozone: GDP Contracts Modestly

Modest Contraction, Marked Downside Risks?

Q2 Eurozone GDP numbers failed to echo the very downbeat messages from business survey data seen in the last few months, instead suggesting that while the Eurozone economy contracted afresh, it did so only modestly. Indeed, GDP fell 0.2% in Q/Q terms, matching expectations. *The result implies that the Eurozone economy has just about avoided recession* as this fresh fall came after the (unrevised) flat reading of the previous quarter, interspersed the drop seen in Q4 last year. Even so, the Q2 Y/Y rate fell afresh, the -0.4% result being the softest since end-2009. This flash estimate, however and as usual, came with no breakdown on either the output or expenditure side.

Peripherals Only a Little Worse

Less surprisingly (given that much of the numbers had already been released for these countries) the geographical details showed no greater weakness among the peripheral countries, save for Portugal. Indeed, unadjusted numbers for Greece showed no more sizeable Y/Y fall, albeit still a momentous 6.2% decline, while Spanish GDP contracted at a little-changed pace of 0.4% Q/Q. Italy saw continued clear recession, albeit with the rate of fall easing a touch to -0.7% Q/Q.

Core Solidity?

More notable, given the very downbeat business survey readings for the core countries, was the continued and unexpected relative resilience in France (unch Q/Q) and Germany (slowing to 0.3%). More encouraging was the continued modest growth seen in the Dutch economy, helped by an improved export performance in this very trade-orientated economy and by a further swing in inventories. *Indeed, solid export signs seen in Germany and to some extent France provide perhaps the main ray of hope regarding the Eurozone economic outlook*, the question being (amidst softer global growth signs) whether such resilience can continue.

Surveys Too Downbeat

Perhaps this resilient Q2 Eurozone GDP reading should be seen as a further indication of the shortcomings of survey data, the latter having pointed to a much worse backdrop for the last two to three quarters. This is a reminder that these surveys are far from accurate in calibrating the pick-ups and softening in cycles, instead being more designed in establishing turning points. Even so, the fact that the business surveys once again proved too pessimistic in gauging overall Eurozone activity in Q2 does not mean that their message can or should be ignored. Instead, these *surveys are clearly pointing to clear, if not growing, downside risks to activity as well as the fact that while the contraction in the economy overall may be modest there is still no end in sight to the (modest) recession.*

ECB Reaction

This will surely be the interpretation that the ECB will put on the economic backdrop, when the Council next meets on 6 September, ie the same day that Q2 GDP details are made available. Therefore these details may come too late to be fully incorporated into the scheduled quarterly update of economic projections the central bankers are due to make next month. However, especially if the round of survey data due in the interim shows continued weakness (as the latest ZEW numbers today imply) this Q2 GDP result is not likely to prevent the ECB into making a further downward revision to the growth picture for 2012 from the range with a mid-point of -0.3% seen in the June update.

DE View: *The question may be the extent to which the ECB starts to pencil in a longer recession, making a greater downward revision to its 2013 forecast, possibly down toward the flat picture DE sees for next year*, rather than the modest recovery (a range with a mid-point of 1.0%) hitherto envisaged. If so, and as DE expects, the ECB will use this softer activity backdrop to point to a much softer inflation outlook into next year, possibly encompassing a risk

of actual deflation. This will give the ECB rationale for the likely further rate cut it may announce on 6 September as well as the array of added unconventional measures it has already hinted are on the way.