

# Eurozone

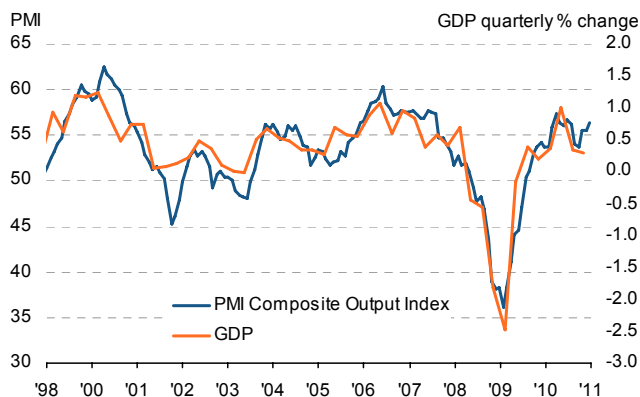
Bad weather subdued growth in Q4. Expect (lopsided) acceleration in Q1.

- Eurozone GDP rose a disappointing 0.3% in Q4.
- Bad weather most likely caused weaker than expected growth.
- PMI data signal upturn in Q1, but recovery remains lopsided.

Eurozone economic growth failed to accelerate, as many had expected, towards the end of last year. GDP growth was unchanged in Q4 on the sluggish 0.3% quarterly rate of increase seen in Q3. Growth disappointed in Germany, France and Italy, with GDP rising 0.4%, 0.3% and 0.1% respectively. Mixed signals came from the periphery; while Spain grew 0.2%, Portugal slid back into contraction, with GDP dropping 0.3%, and Greece remained firmly in recession, posting a 1.4% quarterly decline.

Business surveys such as Markit's Eurozone PMI suggest that the weaker than expected Q4 GDP number should not cause too much alarm. The PMI has rebounded in recent months, suggesting GDP growth will have accelerated again at the start of 2011.

## Eurozone



We estimate that GDP growth is running at a quarterly rate of approximately 0.7%. However, bad weather in December across northern regions caused a temporary drop in output (which we believe caused GDP to underperform relative to the PMI), which will be

at least in part reversed in the first quarter, putting an upside risk to this prediction.

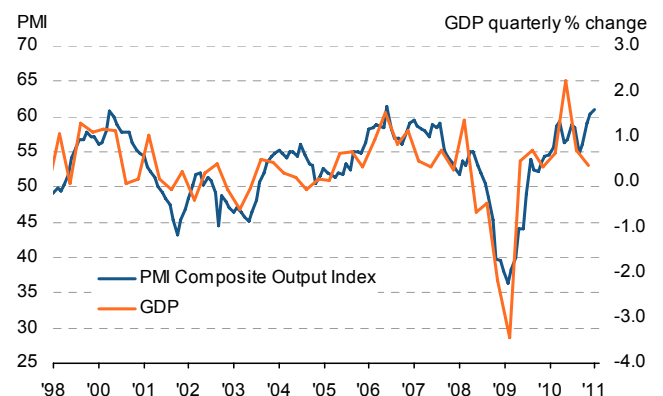
While the Eurozone's overall performance therefore appears to be one of robust growth, the latest GDP data confirm the worrying lopsided nature of the recovery across the singly currency area. Ongoing weakness in the debt-laden peripheral countries contrasts with strong underlying expansion in Germany, with France sitting somewhere in the middle. This of course means policymakers remain in a dilemma; above-target inflation is putting pressure on the European Central Bank to raise interest rates but the periphery looks to be in need of further stimulus.

## Germany

Germany GDP came in slightly below expectations, expanding just 0.4% in the final quarter of 2010. This represents a slowdown on the 0.7% increase seen in Q3. However, this is likely to have merely represented a soft-spot in a firmer underlying growth trend.

Adverse weather undoubtedly hit growth in December, and the Q4 weakness in part probably reflects some pay-back from the surge seen earlier in the year (GDP exhibited a far more volatile trend than business surveys such as the Markit PMI throughout 2010).

## Germany



Given the strong rebound in the PMI to a near-record high in January, economic growth is likely to have accelerated in early-Q1, setting the scene for a solid

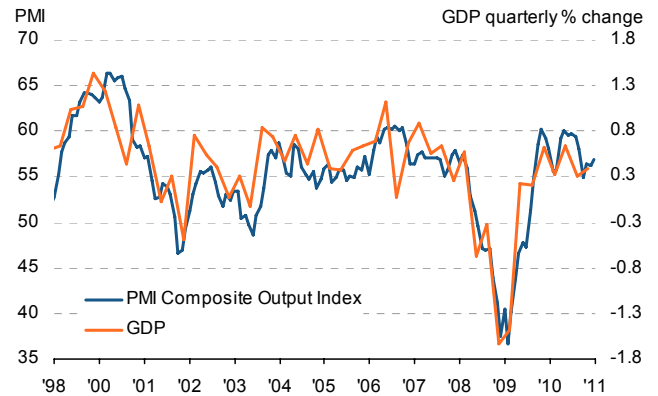
start to 2011. GDP growth of 1% would not be a surprise in Q1, with an even stronger reading possible if the business surveys remain at current elevated levels in February and March, and weather-hit sectors such as construction rebound sharply from the snow disruptions in December.

## France

French GDP grew a disappointingly mediocre 0.3% in the final quarter of 2010, unchanged on the rate seen in the third quarter and below our estimate of 0.5%. The big surprise was the strength of domestic demand, which showed a 0.7% increase. This buoyancy most likely reflected car scrappage incentives, the ending of which could cause household consumption to have a far less positive contribution to growth in early-2011. This may, however, be offset by the rebuilding of inventories. After a sharp drop in stock levels depressed the GDP reading in Q4, we expect to see manufacturers refilling their warehouses again in coming months as exporters benefit from rising global trade flows.

While overall economic growth is therefore likely to have remained lacklustre in France in January compared to early-2010, subdued in particular by consumer spending, GDP growth looks set to pick up modestly in Q1 to around 0.5% – a solid but unspectacular performance.

## France



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