FINANCIAL TIMES

Last updated: April 23, 2012 10:55 am

# Eurozone economic activity contracts

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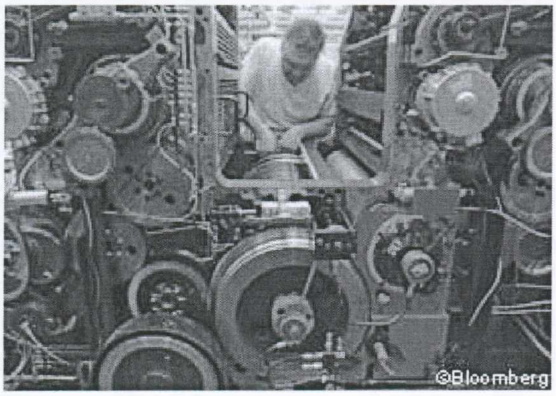
By Ralph Atkins in Frankfurt




Eurozone economic activity has contracted unexpectedly sharply this month, pushing the region deeper into recession and dashing hopes that action to combat its debt crisis would soon pave the way for a gradual recovery.

Purchasing managers' indices for the 17-country bloc fell for a third consecutive month to the lowest level for five months, pointing to an intensification of the economic contraction which started in the final three months of last year, when the eurozone debt crisis was at its most intense. Economists had expected a modest improvement.

Conditions in manufacturing were the worst for almost three years, with even German industry faring badly.

The deterioration will disappoint eurozone policy makers, especially the European Central Bank, which has forecast a gradual economic recovery this year and shunned calls from the International Monetary Fund for further action to stimulate economic growth. The ECB is instead awaiting the impact of its injections of more than €1tn in three-year loans into the eurozone financial system.

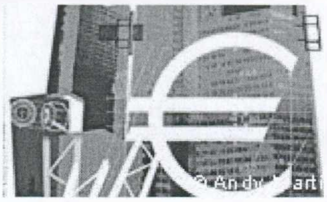
The results "clearly indicate that the eurozone economy remains in dire straits", said Martin van Vliet, economist at ING in Amsterdam. "Our base case scenario is still for a gradual return to modestly positive growth in the second half of this year, but with the lingering debt crisis and the ongoing drag from fiscal policy, the risks are clearly skewed to a more protracted recession."

The purchasing managers' indices showed Germany and France, the eurozone's two largest economies, increasingly feeling the impact of the debt crisis. France saw a sharp deterioration in the performance of its service sector in April, while in Germany the latest weakness was in manufacturing, hit by softer demand from European neighbours.

In depth

**Eurozone in crisis**

But the survey also showed conditions deteriorating further in the crisis-hit eurozone periphery countries, "which will inevitably raise concerns about the impact of deficit-fighting austerity

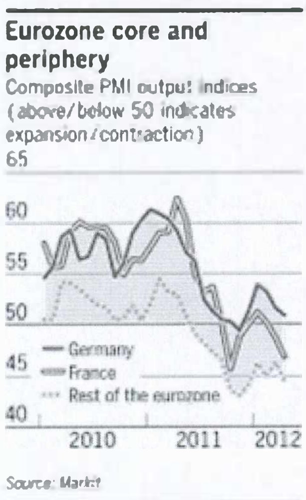


As storm clouds blow towards Italy and Spain, European leaders seek to contain the crisis

measures", said Chris Williamson, chief economist at Markit, which produces the survey.

Eurozone prospects "also do not look good", he added. "Business confidence slumped lower and companies cut headcounts at the fastest rate since early 2010 in order to reduce capacity to meet lower workloads."

Hit by the economic "shock" effects of the region's debt crisis, eurozone gross domestic product contracted 0.3 per cent in the final quarter of 2011 compared with the previous three months. Figures for growth in the first three months of this year, due to be released next month, are expected by economists to confirm a technical recession – defined as two consecutive quarters of contraction.




Monday's purchasing managers' indices suggested the second quarter had started on a still weaker note. The "composite" index, covering services and manufacturing, fell from 49.1 in March to 47.4 in April. A figure below 50 indicates a contraction in economic activity. The eurozone manufacturing index fell from 47.7 in March to just 46 – the lowest in 34 months.

The indices are regarded as up-to-date indicators of growth trends and are frequently cited by Mario Draghi, ECB president. However, the gloomy readings for Germany have clashed with the more upbeat picture shown by the business climate indicator published by the Munich-based Ifo institute. April's Ifo index, released on Friday, showed optimism rising for a sixth consecutive month and at a historically high level.