Euro zone contracted by massive 2.5 pct in Q1

Euro zone economy contracted by massive 2.5 percent in Q1, fourth straight decline

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LONDON (AP) -- The economy of the 16 countries that use the euro shrank by a massive 2.5 percent in the first quarter as the recession tightened its grip all across the continent. Key export engine Germany saw output swoon.

The euro zone has now seen output decline for four consecutive quarters. After modest 0.2 percent decreases in the second and third quarters of 2008, gross domestic product declined by 1.6 percent in the fourth quarter.

But the recession has deepened as global trade has dropped off sharply, with exporters like Germany, the euro zone's biggest economy, badly hit. In the first quarter, Germany's economy shrank 3.8 percent as demand for its high value goods, such as cars and machinery, collapsed.

The first quarter drop in the euro zone, compared to the quarter before, was far more than the consensus expectation just a few days ago, when most economists were predicting a quarterly decline of around 2 percent. But figures Wednesday already showed that industrial production -- key to the European economy -- was suffering worse than expected.

The drop in the euro zone is bigger than the 1.6 percent decline recorded in the U.S., which is widely seen as the epicenter of the deepest recession since World War II. Many analysts argue that the European economy is too dependent on exports as opposed to domestic demand, and that its policymakers have been slower than their counterparts in the U.S. in responding to the crisis with increased government spending.

On an annual basis -- comparing the first quarter with the same quarter a year ago -- the euro zone economy contracted by 4.6 percent, over three times as bad as the 1.4 percent decline recorded in the fourth quarter of 2008.

No part of Europe appears to be immune. Even when the other 11 countries that have not signed up to the euro are included, the European Union still saw output shrink by a quarterly 2.5 percent. On a year-on-year basis, the 27-country EU economy contracted by 4.4 percent, against the 1.4 percent recorded in the previous three month period.

The biggest casualties in Europe's recession so far were Latvia and Slovakia, which both saw output shrink by a quarterly rate of 11.2 percent. Latvia was already suffering from a collapsed real estate and credit bubble when the recession hit last year.

France is now officially in recession, after revisions confirmed that output has shrunk for four straight quarters. In the first quarter of 2009, French GDP declined by 1.2 percent.

Meanwhile, Britain shrank by 1.9 percent in the first quarter, slightly more than the 1.6 percent recorded in the fourth quarter of 2008, while Italy contracted by 2.4 percent.

Governments across the continent are hoping that big interest rate reductions, fiscal stimulus measures and efforts to prop up the banks will mean that the first quarter of 2009 marked the nadir of the recession.

"This sharp decline very probably will not be repeated," German government spokesman Thomas Steg said of his country's figures at a regular news conference in Berlin. "We will now wait and see what happens, but there are clear indications that the first quarter will have been the most difficult."

Recent surveys have begun to hint that businesses and consumers are becoming a little bit less pessimistic -- though they are nowhere near optimistic at this point. As a result, there are some tentative hopes that the European economy may start to grow again towards the end of this year.

"As soon as the boost from lower inflation and interest rates starts kicking in, households and firms will have more scope to make some of the decisions presumably postponed because of heightened uncertainty -- if the boost to income is actually spent," said Daniele Antonucci, European economist at Capital Economics.

However, given that Europe's economy is so dependent on exports, much will depend on how quickly the world economy recovers and the U.S. in particular, though the recent rise in the euro against the dollar will have done little to ease concerns in businesses across the euro zone -- a more expensive currency makes Europe's exports less competitive in the international marketplace.

One bright spot for Europe's hard-pressed exporters was the fall in the value of the euro following the release of all of Friday's GDP data, by around a cent to $1.3560.

Elsewhere, the statistics office said inflation in the euro zone was steady at 0.6 percent in the year to April, unchanged from the previous month and well below the European Central Bank's mandate to keep inflation "close to, but below" 2 percent.

As a result, analysts think the European Central Bank will keep its benchmark interest rate at the current record low of 1 percent through the rest of this year at least. But if growth doesn't begin many analysts think the bank, the euro zone's chief monetary authority, may well be compelled to unveil more unconventional measures such as buying assets from banks to get them lending to businesses and homeowners again. The bank last week it said it may make purchases of certain asset-backed bonds.

"With inflation seemingly under control in the euro area -- indeed deflation could still be a worry -- the European Central Bank would do well to follow the lead of the Bank of England and the Federal Reserve in easing its monetary policy further," said Arek Ohanissian, an economist at the Centre for Economic and Business Research in London.

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