Brave face put on eurozone setback
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Eurozone politicians put on a brave face after yesterday's growth figures showing the first quarterly contraction in the 15-country economy since the launch of the euro. Their measured optimism was not entirely misplaced, analysts said.

"It is out of the question to talk of recession," Christine Lagarde, finance minister, told French national radio after figures showing French gross domestic product fell by 0.3 per cent in the three months to June.

In Germany, Michael Glos, economics minister, argued the 0.5 per cent contraction in the eurozone's largest economy had been expected (Berlin leaks had suggested yesterday's data would be significantly gloomier).

Germany had boosted its international competitiveness and resistance to economic shocks, he argued, and the government would stick to its forecast of 1.7 per cent growth overall in 2008, after 2.5 per cent last year.

Most economists expected the current weak patch to be protracted. Earlier this month Jean-Claude Trichet, European Central Bank president, warned that the third quarter would he "particularly weak". Fears of a technical recession - two consecutive quarters of negative growth - appeared well-founded.

But yesterday's comments by political leaders reflected a belief that the current weakness largely reflects external shocks - soaring commodity prices and the US slowdown. The second quarter could have marked a low point in eurozone fortunes.

"The issue is whether this [slowdown] is a knee-jerk reaction to an inflation shock or something nastier," said Gilles Moec at Bank of America. "For the time being I don't see evidence that it is a downwards spiral."

Direct effects on the real economy of the global credit squeeze are still hard to discern in countries such as Germany.

With the exceptions of Spain and Ireland, collapsing housing markets are not an overwhelming concern either - although the French market shows signs of wobbling.

Moreover, with oil prices having fallen recently and the euro now depreciating steadily, prospects for the eurozone could brighten. Labour market conditions "are still broadly favourable", the ECB added in its monthly bulletin yesterday.

But divergences between the main eurozone countries are becoming increasingly an issue. In coming months, France was more at risk of a recession than Germany because of the deteriorating French labour market, said Mr Moec.

Despite the official optimism in Paris, Francois Fillon, French prime minister, was concerned enough to convene a meeting of ministers during the normally sacrosanct summer break to examine measures to buoy the French economy. Although the prime minister cited a few encouraging factors that supported the government's expectation of growth for 2008 of 1.7 per cent - such as the level of business loans - few analysts believe this target is achievable.

Laurence Boone, economist at Barclays Capital, estimated French GDP would grow by just 1.2 per cent this year. "The main engines that have supported growth over the past three years have run out of steam - consumption and business investment.

And the fuel that has driven those engines • moderate inflation and falling unemployment is no longer there." France's labour market contracted for the first time in four years in the second quarter.

In Spain, the recent deterioration, on the back of a housing market correction, has appeared more dramatic - but largely because it was previously among the eurozone's best performers. An unprecedented mid-August cabinet meeting yesterday agreed to abolish wealth tax as part of a series of measures aimed at reviving investment and spending.

Jose Luis Rodriguez Zapatero, prime minister, also promised to speed up the approval process for public works, reduce bureaucracy in the services sector and provide state loans to help low-income families into their first home.

Spanish GDP rose by just 0.1 per cent in the second quarter. But despite inflation of 5.3 per cent, ministers believe falling oil prices should take pressure off consumers by the year-end.

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