

# WEEKLY ANALYSIS

## RECESSION IN THE EURO ZONE IN Q2?

GDP contraction? Recession likely in Q2. Leading indicators are down. Households remain concerned. Price indices are rising. The ECB is taking a tougher stance. Mixed outlook for the euro. Stocks likely to consolidate over the summer.

### Key points

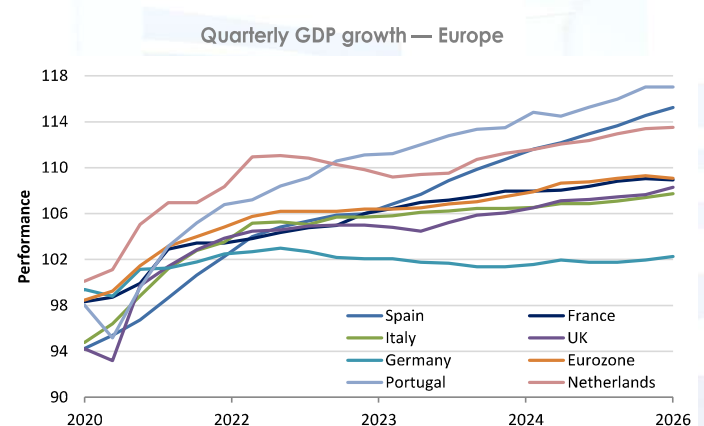


- Eurozone GDP contracted by  $-0.2\%$  in Q1
- Growing risks of a technical recession as early as Q2
- Leading indicators point to weakness
- Household confidence marked by uncertainty
- Inflationary spiral driven by rising PPI
- The ECB raises rates by  $0.25\%$  and adopts a harder tone
- Rising bond yields and risk premiums
- The euro strengthens against the Swiss franc but weakens against the dollar
- Positive reaction in the securitized real estate market
- Equities likely to consolidate over the summer

### Eurozone GDP contracted by $-0.2\%$ in Q1

Hopes for a recovery were dashed during the first three months of the year, due to the combined effects of an imported energy shock and the collapse of manufacturing activity. While consensus estimates had pointed to  $+0.3\%$ , eurozone GDP ultimately contracted by  $-0.2\%$  in Q1, weighed down by Germany's surprise contraction ( $-0.2\%$ ) and Ireland's accounting-related slump ( $-12.1\%$ ). Excluding this latter shock, GDP would likely have been around  $+0.2\%$ . This start to the year thus marks a setback, erasing the optimism of Q4. The surge in gas and oil prices linked to tensions in the Middle East logically acted as a tax on consumption, while inflation rebounded to  $+2.8\%$ , derailing the ECB's planned rate-cut strategy. Private business investment ( $-0.4\%$ ) suffered from these persistently tight financial conditions. Overall, the bloc has shown structural vulnerability to global supply chains, even though the resilience of the labor market is still protecting households from a shift toward rising unemployment. PMI business surveys are sending negative signals, with the manufacturing index plunging to a two-year low. This downturn dashes hopes for upward convergence, exacerbating the regional divide between the countries of the South and those of the North. Spain ( $+0.6\%$ ) and

Italy ( $+0.3\%$ ) are limiting the damage thanks to tourism, while France is also contracting ( $-0.1\%$ ). On the whole, purchasing managers' confidence has plummeted due to sparse order books. These trends confirm the scenario of prolonged stagnation, in which Europe's traditional engine of production refuses to start, undermined by a chronic cost-competitiveness deficit. Germany epitomizes this general slump with growth of  $-0.2\%$ . Its heavy industry is stifled by high infrastructure costs and the structural shift in trade flows with China. This lethargy in Germany's manufacturing sector is depriving Italy and Central European countries of their traditional subcontracting opportunities. Ultimately, the first quarter of 2026 does not reflect a mere temporary adjustment, but rather a full-fledged economic setback caused by external headwinds. Uncertainty over U.S. tariffs compounded disruptions in maritime trade flows, ultimately paralyzing investment and putting industrial projects on hold. The worrying aspect is that while the services sector managed to keep the economy afloat last year, it is now showing tangible signs of running out of steam in the face of eroding real wages. That said, while the ECB's annual projections have been revised down to below  $+0.8\%$ , we anticipate that second-quarter growth will be negative, plunging the eurozone into a potential recession. As for the second half of the year, it will depend on a possible easing in commodity prices, but growth will likely be below  $+0.5\%$ .



Sources: Bloomberg, BBGI Group SA