

Europe plunges into recession

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The European Central Bank yesterday cut interest rates for the second time in less than a month. The ECB, meeting in Frankfurt, cut the benchmark lending rate by half a percent, to 3.25 percent from 3.75 percent, and is predicted to cut the rate to 2.5 percent by April.

Prior to the move by the ECB, the Bank of England made a shock decision to cut interest rates in the UK by 1.5 percent to 3.0 percent, its lowest rate since 1955.

The interest rate cuts are yet another attempt to stimulate the economies of Europe, amidst reports that the continent was entering a recession and had already suffered its worst slump for 15 years.

All previous measures to encourage banks to step up lending to pump-prime the economy have failed. The euro-zone economies have committed a combined US\$1.7 trillion to protect the region's banks and this does not include measures taken such as Britain's £500 billion package and other stimulus measures such as German Chancellor Angela Merkel's proposal to inject €50 billion into the economy. Even so, interest rate cuts have often not been passed on and banks have been depositing record amounts of money overnight with the ECB rather than lending to each other, even after they have been given hundreds of billions in taxpayers' money.

In its half-year report issued Tuesday, the European Commission admitted that the 15-member euro-zone economy—worth US\$12.2 trillion—was probably already in recession for the first time since the currency's inception in 1999.

The euro-zone's economy—both the manufacturing and service industries—contracted by 0.2 percent in the three months to July and would probably continue to contract for the next two quarters. The commission statement said, "In 2009, the EU economy is expected to grind to a standstill."

Joaquin Almunia, European economic and monetary affairs commissioner, warned, "The horizon that this forecast offers is dark."

In an extraordinary admission of incompetence and

bewilderment, euro-zone chairman Jean-Claude Juncker told the European Parliament in Brussels, "Recession awaits us, and we didn't think that recession lay in waiting. We were badly mistaken with the different sequences of this crisis.... The headwinds we were facing turned into a veritable storm."

According to the EC, the Irish, Spanish and UK economies will all contract next year, while Germany (Europe's largest economy), France and Italy will stagnate. Growth in 2009 is projected at just 0.1 percent. For 2010, the commission predicted the euro-area economy would expand by 0.9 percent.

Investment is set to fall amid slowing demand and tightening credit standards. Unemployment will rise to 8.4 percent next year across the euro-zone from 7.5 percent in September and will rise still further in 2010. Budget deficits are also expected to widen. Executive and consumer confidence has slumped to a 15-year low.

Economists at BNP Paribas and Citigroup said the EU was still overly optimistic and predicted that the euro-area economy will shrink next year. Jacques Cailloux, chief euro-area economist at Royal Bank of Scotland Plc in London agreed, stating, "Today's new GDP forecast of 0.1 percent for 2009 by the European Commission still looks too optimistic to us.... A recession in 2009 seems now unavoidable."

Neville Hill, economist with Credit Suisse in London, was more specific, predicting the economy would shrink by 0.3 percent next year. "The idea that the euro-zone will not see negative year-on-year growth seems contradictory to all the data," he said. "We're in the midst of one of the most synchronised global recessions we've ever seen."

French Prime Minister Francois Fillon also admitted that France, the euro-zone's second largest economy, faces "a context of quasi-recession."

The European Union leaders are meeting today to formulate a recovery plan and to hopefully coordinate their position before a summit of world leaders hosted by President George W. Bush on November 15. Speaking for the EU, Economic and Monetary Affairs Commissioner

Joaquín Almunia urged, "We need a coordinated action at the EU level to support the economy similar to what we have done for the financial sector."

But there remains widespread concern that the EU has not been able to formulate such a combined response to the financial crisis and will not be able to do so now that the recession is hitting the manufacturing sector. All measures taken so far have been purely national in scope and have the impact of plunging the economy into beggar-thy-neighbour competition for markets and investment. Germany, which alone has not suffered a rise in employment, in particular wants to utilise its economic advantage against its rivals and has opposed any cross-border response.

Euro-zone manufacturing activity sank to record lows in October, with output, new orders and the number of purchases falling at the steepest rate in 11 years. This is the fifth consecutive month of a contraction in manufacturing.

The Markit Euro-zone Purchasing Managers' Index for the manufacturing sector fell to 41.1, a record low. All countries within the euro-zone saw new orders and manufacturing output fall, with Germany, France, Italy, Spain, Austria and Ireland experiencing record falls. The Markit index for the service sector also revealed that activity in October fell to its lowest level since the index was first compiled a decade ago.

"The surveys continue to show record pessimism," said Guillaume Meneut of Merrill Lynch.

Retail sales also fell in September by 0.2 percent from August, and by 1.6 percent compared to September 2007. Of the 15 euro-zone economies, Germany suffered the biggest drop in retail trade from August, falling 2.3 percent. The biggest annual fall came in Spain, where spending has fallen 7.1 percent.

New-car registrations, a major indicator of economic health, have fallen in Germany, France, Spain and the UK. The number of newly registered cars in Germany fell by 8 percent in October. Orders for new cars in Germany dropped 12 percent. Car exports declined 10 percent last month, while foreign orders fell by 24 percent. French car sales fell by 7 percent. New-car sales in the UK were down by 23 percent from October last year, the largest monthly fall in 17 years. Spanish car sales have fallen by fully 40 percent.

European companies also cut jobs at the fastest rate since January 2002. Stocks of finished goods awaiting sale reached a record high. Even as the report was issued, shares across Europe were in a steep decline that has

continued against a background of even bigger falls in Asia and the United States.

The economic crisis is leading to a massive rise in job losses. Ireland's unemployment reached its highest level in a decade in October, at 6.7 percent. Unemployment in Spain has reached a 12-year high of 11.9 percent, an increase in the number of those claiming jobless benefit of 37.5 percent.

Unemployment in Britain is set to reach 7.1 percent, according to the EC, which predicts that the UK will be the worst-hit economy in Europe. Unemployment will increase by 25 percent in 2009 to 2.25 million. The commission predicted a contraction in the UK of 1 percent and revised its prediction on unemployment upwards by almost 1.5 percent. Only Estonia and Latvia are expected to suffer deeper recessions next year.

The commission's report spoke of a "budget deficit and debt spiral," with the budget deficit rising to 5.6 percent of GDP next year, about £80 billion, and 6.5 percent, or £94 billion, in 2010. New figures from the Halifax showed house prices fell by another 2.2 percent in October, pushing the drop in house prices to 13.7 percent annually. Activity in the service sector shrank in October for the sixth month in a row. Services are the backbone of the UK economy, accounting for more than half the GDP. Manufacturing also shrank by 1.3 percent in the last quarter and has fallen for seven consecutive months.



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