Greece sinks further into recession as European economy falters

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16 August 2010

The Greek economy sank further into recession in the second quarter of this year. According to the latest figures from the Greek statistics bureau, the economy shrank by 1.5 percent April through June, as compared to the first three months of this year. This decline follows a prior fall in Greek gross domestic product (GDP) for January through March.

The Greek economy declined by 3.5 percent in the second quarter compared to the same period a year ago.

The Greek statistics bureau acknowledged that the decline in GDP was largely a result of the austerity program dictated by the International Monetary Fund and the European Union and implemented by the social democratic PASOK government. Prime Minister George Papandreou has cut wages in the public sector and raised the value added tax to record levels. The resulting slump in consumer demand has been accompanied by a collapse in the country's construction industry and a steep fall in revenues from tourism.

The deepening crisis in Greece has resulted in near-record levels of unemployment. Official unemployment now stands at 12 percent, an increase of 43 percent compared with one year ago.

Hardest hit by the jobs crisis are younger workers, with 32.5 percent of all workers between 15 and 24 unemployed in May. Even these figures disguise the real scale of the jobs crisis, since they do not take into account those working part-time but seeking full-time work and those who have given up looking for work because of the lack of jobs.

With the recession gathering speed in Greece, production levels fell across Europe in June. Factory output dropped by 0.1 percent, although economists had anticipated an increase.

According to the figures released by the European Commission, the slowdown in the growth of industrial production was not limited to smaller, weaker economies such as Greece, but also applied to the continent's larger economies.

French industrial output faltered in the second quarter of this year, rising by just 0.8 percent. Production in the French auto industry was down by 7.4 percent in June following the end of the government's "cash for clunkers" subsidy program. A business confidence survey conducted by the Banque de France at the start of this week indicated a slowdown in the rate of recovery in French manufacturing and services in the second half of 2010.

Olivier Gasnier, economist at SocGen, declared that the French figures were an "unpleasant surprise." He said they were particularly disappointing "because we have the impression that recovery is already flagging and that is even before the budgetary adjustments have kicked in."

Spain and Portugal also recorded second-quarter slowdowns in their economies.

Financial markets reacted immediately by driving up the interests rates on the bonds of a number of the most exposed European economies. In the past month, interest rates paid by Ireland have nearly doubled, while interest rates have risen markedly for Greek, Portuguese, Italian and Spanish sovereign debt.

The signs of a slowdown in the European economy coincided with weaker economic data from the US and China. In response, European investors have withdrawn funds from high-risk European economies and moved them into so-called "safe havens" such as German bonds, whose prices rose sharply last week.

Reflecting the growing unease, the Euribor-Eonia spread, a common measure of banking sector risk in Europe, climbed this week to its highest level since

September last year, with markets anticipating further economic turmoil in the coming months.

The only positive trend in European production emerged in Germany, where figures published this week showed an economic growth rate of 2.2 percent in the second quarter, the highest quarterly increase since German reunification two decades ago. The German GDP figure lifted the growth rate for the 16-nation eurozone to 1 percent in the second quarter, a higher rate than had been forecast.

The German figures have been greeted with euphoria and self-congratulatory pronouncements by bankers, government officials and sections of the German media, but as *Financial Times* columnist Wolfgang Münchau pointed out recently, the German economic recovery is more "mirage" than "miracle."

Münchau noted that the recovery in Germany has taken place against the background of a record postwar fall in German production of 5 percent in 2009—a decline much more pronounced than that of most other European economies. He wrote that the country could return to its production levels of 2007 only if it maintained a growth rate of 2.5 percent for 2010 and a similar rate for 2011. However, there are many factors indicating that it will prove impossible for Germany to maintain such a level of growth.

Germany was able to regain some economic ground in the early part of this year due to stimulus subsidies made available to employers by the government. But as is the case in France and many other European countries, these subsidies, such as short-time working, have largely come to an end.

Germany's export industry also benefited in recent months from the fall in the value of the euro, which at one point declined to near 1.20 per dollar. In recent weeks, however, with concern growing over the prospects for the US economy, the euro has risen toward the 1.30 per dollar mark. The strengthened euro makes German exports less attractive on world markets.

Warning that Germany's rebound was not reflected in Europe as a whole, David Owen of Jefferies International pointed out, "Germany is only 30 percent of the system. The other 70 percent are struggling. The headwinds facing the system are still immense."

The president of the European Central Bank, Jean-Claude Trichet, issued his own warning last week, predicting that the euro-zone economy would be "much less buoyant" in the second half of the year.

The strength of the German economy is also its Achilles heel. Germany's relatively expensive exports can find buyers only under conditions of expanding markets. But urged on by the German government, one European nation after another has introduced drastic austerity programs, which will inevitably depress economies and choke off consumer demand, with far-reaching longer term implications for German exports.

The latest figures recording a slowdown in growth in most of the eurozone mean lower state revenues, which will increase pressure from the financial markets for governments to introduce even more severe public spending cuts.

For its part, the German government insists that the latest GDP figures vindicate its policy of withdrawing all forms of stimulus and intensifying austerity measures. Along these lines, German economists have harshly criticised the mildly reflationary measures announced last week by the US Federal Reserve.

Germany's main business newspaper *Handelsblatt* quoted a economist from Barclays who described the Fed's policy declaration as an "act of desperation" and warned that a downturn in the US would have massive repercussions for the German economy.

In a commentary in last Wednesday's edition, the *Handelsblatt* correspondent in New York expressed his wholehearted support for the imposition of severe austerity measures in the US, approvingly citing a recent interview given by former US Treasury Secretary Robert Rubin.