European economy falters as divisions mount

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Recent figures from leading economic institutes point to a pronounced decline in economic activity in the 16 European countries which constitute the euro zone.

A key indicator of economic development, the purchasing managers index (pmi), covering manufacturing and service sectors in the euro zone, fell from 56.2 in August to 53.8 in September—its lowest rate since February.

At the same time, the European Union's statistics office in Luxembourg announced that European industrial orders decreased by 2.4 percent in July compared to the previous month.

The pmi drop in September is regarded by analysts as an indication that the European economy will continue to remain frail in the remaining months of this year.

The latest figures came after the release of data for the second quarter of 2011 which indicated a certain revival in the European economy. The unexpected increase in growth in the second quarter was largely fuelled by Germany, which posted a 2.2 percent surge in economic activity largely due to its dynamic export industry.

The growth figures had been greeted by European leaders and broad layers of the media as proof that Europe was finally emerging from two years of slump following the financial crisis of 2008.

Now, however, the jubilation of the previous month has evaporated and the second quarter figures are being called a temporary "technical correction."

Commenting on the latest figures, economic analyst Chris Scicluna declared: "Major industrialised nations had a bit of a bounce-back earlier this year, but what we are now facing up to is that it wasn't sustainable. There is no obvious engine of growth…. We are seeing the scarring effect of the crisis."

In particular, the fall in the pmi and European industrial orders reveals the dependence of Europe's strongest economies on the world economy as a whole. Increasing fears of a long period of stagnation of the US economy, combined with a slowdown in the growth of China and the Asian tiger economies, have had negative repercussions for the leading European powers.

Deutsche Bank European economist Gilles Moec declared: "Germany is very sensitive to gyrations in demand from the US, China and so on. France would suffer from secondary effects."

Warning Germany, in particular, that no country could emerge from the crisis on its own, Moec concluded, "The story from all this is that there is no such thing as 'decoupling.'"

Leading countries outside the euro zone also recorded negative figures. The British Bankers Association announced that net consumer credit, mortgage approvals, and bank lending to companies all fell in the month of August, while inflation in Great Britain continues to increase.

The weaker figures for the Eurozone economy were accompanied by new concerns about the ability of a number of peripheral European countries to repay their debts and implement stringent austerity programs.

On Thursday, data released in Dublin revealed that the country's gross domestic product (GDP) shrank 1.2 percent for the three months to June compared with the previous quarter, reviving fears that the country may tip back into a full-blown recession.

In response, investors dumped Irish government debt, sending yields on four-year Irish bonds to over 5 percent. The increased interest rates being demanded for its bonds only add to the long term indebtedness of Ireland.

Ireland is generally credited with having imposed the most draconian austerity program in Western Europe, but in the face of renewed pressure on the country's banks and financial markets, the Irish central bank governor declared last week that the government would have to make even deeper budget cuts.

The Irish data in turn sent shockwaves through Europe's weaker countries, leading to a sharp rise in the yield on Portuguese 10-year bonds.

In Spain, Finance Minister Elena Salgado announced new austerity measures in an attempt to reduce the euro region's third largest budget deficit. Salgado declared that the government was intent on cutting state expenditure by 8 percent.

A freeze is to be imposed on all pensions, and government ministries have been ordered to reduce their budgets by 16 percent. The aim of the new budget is to reduce the country's deficit to 6 percent of GDP—a figure that is still twice the limit imposed by the European Union.

Expressing the concern of the financial elite that no concessions be made with regard to the implementation of austerity measures, one leading financial analyst declared, "Markets are looking for the hair shirt from the periphery economies…. We're not seeing the zeal to cut that we had earlier on this year."

Salgado said she was sticking to a forecast that the Spanish economy will expand 1.3 percent next year—a figure regarded by experts as completely unrealistic and twice the growth forecast made by the International Monetary Fund. Reflecting investor unease over the situation, the spread between Spanish and German 10-year bonds remains twice the level of a year ago.

Investor concerns about the ability of peripheral European countries to repay their debts is compounded by the fact that European banks themselves need to raise unprecedented amounts of capital in order to overcome the deficits run up in the wake of the 2008 financial crisis. An estimated $1.7 trillion in euro-area bank debt will be due in 2010 and 2011—a figure far higher than the debts of banks in the US, the UK and elsewhere.

The only light in the tunnel for the European economy was more positive economic data from Germany. A new poll of German managers indicated an increase in business confidence, and the IMF increased its growth forecast for Germany to over 3 percent this year.

But Germany continues to remain the exception to the rule, with a number of commentators pointing out the dangers to the future of the European project as a whole as economic and social differences widen across the continent.

In the coming weeks and months, cuts in social spending, pensions and wages, combined with increased taxes, will take effect in much of Europe, further choking domestic consumption and slowing economic growth.