German economy contracts as Europe slides closer to recession

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The latest figures released by the Eurostat statistics agency confirm that Europe is moving closer to outright recession. According to the Eurostat report released Thursday, industrial production in May and June of this year fell by 0.3 percent in the euro zone and 0.1 percent in the 28-member European Union (EU).

The main factor in the decline was the contraction in German industrial production. Germany is Europe's main economy, providing more than a quarter of the euro zone's output. Its economy shrank by 0.2 percent between April and June, following a weakening of demand for German exports and decreased investment. The decline in German exports reflects in turn slowing demand in its main markets—in particular, Europe and Asia.

The contraction of the German economy is the first since the end of 2012. In recent years, Germany has been widely described as the locomotive crucial for European recovery. Now, the locomotive is spluttering to a halt.

The ailing state of the German economy is most directly reflected in the slump of the country's main Dax index, which lost nearly 1,000 points (9 percent) over the past month.

The situation in other leading European economies is no better, or worse. France, the euro zone's second biggest economy and Germany's largest export market, stagnated between April and June, recording zero growth. In response to the latest figures, the French government declared it was halving its forecast for gross domestic product (GDP) growth for 2014 to just 0.5 percent. Paris declared that it would also fail to meet its budget deficit target of 3.8 percent of GDP, which it has already renegotiated with the EU due to its floundering economy.

The euro zone's third largest economy, Italy, is also back in recession. According to the Italian statistics office Istat, economic performance in the second quarter fell by 0.2 percent. The drop follows a decline of 0.1 percent in the first quarter, signaling that Italy is officially in recession.

The fourth biggest euro zone economy, Spain, was the worst hit of the bloc, with a 0.8 percent drop in industrial production.

Future economic indicators point to further decline. Estimates of business confidence are sinking across the continent, most notably in Germany. Six years on from the financial crisis of 2008, unemployment and youth unemployment hover around European highs, and inflation continues to fall, as prices stagnate amid deepening economic gloom.

In Spain, with official unemployment at a record rate of around 25 percent, consumers have empty purses, which is expressed in a highly unusual zero inflation rate.

The most significant indicator of a new economic catastrophe for the continent is the continuing slump in corporate investment which contracted by 0.8 per cent across the euro zone, notching up a 10th consecutive quarter of negative growth. Household investment plunged even more dramatically, by 2.4 percent.

Commenting on the investment figures, one leading French economist declared: "Confidence is completely absent today both on the business and household side. I don't see anything that would change this in the near future."

The shrinking of the European economy and the slashing of millions of jobs is a direct product of the austerity measures imposed on Europe by Berlin, the EU bureaucracy in Brussels, and governments across Europe since the outbreak of the crisis of 2008.

At the same time, however, new political factors, most notably the US-EU trade sanctions launched against Russia, but also the current conflicts in the Middle East, are fueling the crisis in Europe. Despite efforts by the financial press and leading European governments to play down the effect of EU sanctions on Russia and Moscow's retaliatory sanctions, there are already indications that both the Russian economy and its European trading partners are being harmed.

One of the main casualties of the EU-US trade war is likely to be EU agricultural exports to Russia, which totalled $15.8 billion in 2013. According to the *International Business Times*, Poland, Norway and Netherlands are already among the "hardest-hit" economies due to the Russian food import ban.

Polish economic growth slowed by half in the second quarter of this year, compared to the January-to-March period, according to a Bloomberg survey, and the Polish zloty has fallen on currency markets. The currencies of other eastern European countries with trade links to Russia, notably the Czech koruna and the Hungarian forint, have also suffered significant losses in the past month.

On Monday, Morgan Stanley sent out a report downgrading its outlook on Hungarian and Romanian debt, warning that eastern Europe is "vulnerable to a protracted conflict, especially in case of further escalation." Citing the growing tensions between the EU and Russia, the report continued: "These developments shift the risks around growth to the downside."

Eastern Europe is a major market for many western European countries, most significantly Germany. A deepening economic slump in the region will in turn intensify the crisis of the euro zone.

The Russian response to EU sanctions is also likely to bury any hopes of recovery in the European country hardest hit by the crisis: Greece. Russia is Greece's biggest trading partner, largely due to gas and oil exports. Total trade between the two nations reached €9.3 billion ($12.5 billion) in 2013, surpassing total trade between Greece and Germany.

Investors and businesses with trade ties to Russia are also worried that the sanctions war could be stepped up in the next period. EU leaders are due to meet in Brussels on Friday to discuss the crises in Ukraine and Iraq, with the option of even more sanctions against Russia on the table. The parliament in Kiev is adopting its own sanctions against Russia, including a stop to Russian energy supplies to Europe across its territory, which would have devastating consequences for European economies.

As the European economy founders, major investors are rubbing their hands together in glee. Last week, European Central Bank (ECB) head Mario Draghi indicated that the ECB was prepared to switch from its policy of near-zero interest rates to a policy of Quantitive Easing (QE) should European economic prospects worsen.

As has been the case with all of the policies introduced by the ECB, a switch to QE—i.e., pumping up to a trillion euros into the markets—will provide a fresh bonanza for investors and finance sharks while doing doing nothing to raise workers' living standards.

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