Euro-Zone Growth Slows to 2-Year Low

By ALEX BRITAIN and PAUL HANNON

LONDON—Falling activity in Italy and Spain dragged economic growth in the euro zone to its weakest since the region emerged from recession two years ago, a closely watched survey of business activity showed Monday.

In the latest in a string of data that suggests the economy is now faltering, Markit Economics said its final composite Purchasing Managers’ Index, a gauge of manufacturing and services activity for the 17 nations that use the euro, fell to 50.7 in August from 51.1 in July.

That means the euro zone’s private sector economy posted its weakest growth since August 2009, when it began recovering from a severe recession. A PMI reading above the neutral 50 threshold indicates an expansion in business activity.

Fears over a renewed downturn in the region—sparked by government austerity measures linked to Europe’s debt crisis, and thrift among consumers and businesses—have heightened speculation that the European Central Bank may have to slow or even suspend its program of interest-rate increases.

The ECB began exiting its emergency stance of ultra-loose monetary policy in April, with rate increases that month and again in July that lifted the key rate to 1.50% in a bid to stifle inflation. The bank’s next meeting is Thursday, with no change to monetary policy expected.

ECB President Jean-Claude Trichet’s press conference shortly after the announcement will be closely watched for any clues on the bank’s stance on inflation and growth.

Markit economist Chris Williamson said Monday’s PMI figures suggest the euro-zone economy “almost ground to a halt” in August.

"The turnaround in the euro-zone economy has been alarmingly abrupt since the surging pace of growth seen earlier in the year,” he said.

Mr. Williamson said that based on these figures, gross domestic product growth in the third quarter is unlikely to exceed the weak 0.2% rate posted in the second quarter. "A contraction [in GDP] in the final quarter looks a distinct possibility unless business and consumer confidence improve noticeably in coming months," he said.

Separately, retail data for the euro zone showed that sales rose for the second straight month in July, although volumes remained below levels recorded a year earlier.

The European Union’s official statistics agency Eurostat said retail sales were up 0.2% from June, but were down 0.2% from July 2010.

Economists surveyed last week estimated that sales fell 0.2% month-to-month, but rose 0.1% year-to-year.

Eurostat also revised its figures for June, and now calculates that sales rose by 0.7% month-to-month and fell by 0.7% year-to-year. It previously estimated

The pickup in sales for the second straight month is unlikely to herald to start of a sustained rise in consumer spending, analysts said. The unemployment rate remains high, economic growth slowed in the second quarter and with the currency area’s fiscal crisis deepening, consumer confidence weakened sharply in August.

"The prospects for... retail sales look far from promising in the near term at least, given a sharp dip in consumer confidence in August, some increasingly unfavorable labor market developments and squeezed consumer purchasing power,” said Howard Archer, an economist at IHS Global Insight.

The weaker outlook has made it unlikely that the European Central Bank will raise its key interest rate in coming months, despite the fact that the inflation rate continues to exceed its target. The central bank’s governing council meets Thursday.

Eurostat said that while food sales fell by 0.4% in July, sales of non-food products rose by 0.5%. Total sales were unchanged in Germany and Spain, but up 0.6% in France.

Among those euro-zone members pursuing tough austerity programs and receiving loans from the EU and the International Monetary Fund, Portugal saw sales rise 2.2% and Ireland saw sales rise 0.5%. However, sales remained 5.3% and 2.6% respectively below levels recorded in July 2010.
