Flat Growth in Bloc Fuels Recession Fears

By BRIAN BLACKSTONE

FRANKFURT—The euro-zone economy barely grew in the third quarter despite a temporary bounce in Germany and France, raising fears that the euro bloc may already be sliding into recession as businesses and consumers cut back on spending in response to Europe’s escalating debt crisis.

The euro zone remains marked by a deep divide between the vulnerable southern periphery, including Italy, Spain and Greece, and the more prosperous north. But as the debt crisis threatens larger countries such as Italy a new problem has emerged: Ever fewer countries have expanding economies, adding to pressure on the currency bloc.

Gross domestic product in the 17-nation euro zone grew 0.6% at an annualized rate during the third quarter, according to figures released by European Union statistics agency Eurostat, the weakest expansion since the region exited from recession more than two years ago and well below growth rates registered in the U.S. and Japan.

Germany’s economy recovered to post a 2% annualized growth rate, double the second quarter’s pace. France grew 1.6% after stagnating in the second quarter.

Those two countries account for half of euro-zone GDP, indicating that the rest of the euro bloc, as a whole, contracted. Austria barely grew, while Dutch GDP fell. Spain and Belgium were largely flat last quarter. Portugal’s recession deepened, with activity falling at a 2% rate. Italy and Greece didn’t release GDP figures, but many analysts believe Italy’s economy contracted, based on monthly spending and production figures.

"There is a lot of slowdown, that is clear," said José Gonçalves, owner of JPC Elásticos SA, a Portuguese maker of specialty elastics for clothing. Sales at his 50-person company, based outside Porto in the heart of Portugal’s textile region, rose slightly from year-earlier levels through the summer, but “in September and October we suffered a gap” from this year’s sales targets, Mr. Gonçalves said.

Across the euro zone, industrial production advanced robustly in July and August before plummeting in September. Surveys from
The euro-zone economy grew at a meager pace in the three months to the end of September, aided by pickups in consumer spending in Germany and France. Paul Hannon discusses with Mike Casey on Markets Hub.

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Among the drag factors that could tip the euro zone into recession: The region's banks face further write-downs on their Greek bond holdings, with unknown spillover effects on other euro nations' bond markets. The falling values of Italian government bonds have yet to work their way through the banking system and economy, analysts say.

The economic outlook is increasingly uncertain in France, which has said it will raise taxes and cut spending next year to bring its deficit down.

"People are really down," says French luxury retailer Patrick Lifshitz, who owns three cashmere-clothing boutiques in Paris. He says consumers' sour mood is made worse by French leaders' calls for added austerity policies to protect the French government's coveted triple-A credit rating. "It doesn't make people want to go out and spend money," he says.

Mr. Lifshitz—whose sweaters, cardigans, gloves and coats sell for between €300 and several thousand euros ($400 and several thousand dollars)—says demand is sharply lower for lesser-priced sweaters as the middle class cuts back on new spending on luxury items. That has been offset by continued demand, mostly from foreign customers, for his high-end items such as crocodile-skin gloves, he says.

"People staying at the Ritz are not so concerned, but the secretary around the corner who buys one sweater per year? She's not buying any more," he says.

After two strong years of growth, Germany's economy is expected to stall this winter. But analysts say Europe's largest economy is well positioned to weather a soft patch or even mild contraction without too much damage.

"There is no upswing anymore, but there is no recession either," said Volker Treier, chief economist at the German Chambers of Industry and Commerce in Berlin. Germany's official statistics office said on Tuesday that last quarter's GDP rise was driven mainly by consumer spending, though it didn't provide details.

"We have a much better domestic economy compared to last year...we have waited a long time for that," said Mr. Treier, who expects Germany's economy to grow around 1% next year.

That should be enough to keep unemployment low and help Germany withstand a Europe-wide recession. But it won't do much good for neighboring countries such as the Netherlands and France, whose exporters could do with more dynamic demand in Germany, and even less for struggling Southern Europe.