Italy unexpectedly returned to recession and German factory orders dropped the most since 2011 as slowing global growth and rising tensions with Russia over Ukraine threaten the euro area’s recovery.

Italy’s economy shrank 0.2 percent in the second quarter after contracting 0.1 percent in the previous three months. German orders slid 3.2 percent in June from May. Both reports were worse than forecast by economists in separate Bloomberg News surveys.

The figures come on the eve of the European Central Bank’s August interest-rate meeting, two months after it announced an unprecedented package of stimulus measures including a negative deposit rate and targeted loans to banks. Those policies will take time to have an impact, leaving the economy at risk as war in Ukraine and U.S. and European Union sanctions against Russia undermine business and investor confidence.

“Today’s data are a serious reason for concern and confirm that the euro-area recovery is still sluggish at best,” said Joerg Kraemer, chief economist at Commerzbank AG in Frankfurt. “Evidence is mounting that risks to the ECB’s economic outlook are to the downside.”

The euro slid to its weakest against the dollar in nine months after the reports. The single currency fell as low as $1.3333 and traded at $1.3342 at 1:19 p.m. Frankfurt time.

Italian Downturn

The renewed recession in Italy, the euro area’s third-biggest economy, will weigh on the region’s second-quarter gross domestic product figures. The currency bloc’s economy expanded 0.2 percent in the three months through March, and the ECB predicts growth of 1 percent this year.

Second-quarter GDP data are scheduled to be published on Aug. 14 along with figures for Germany and France, the region’s biggest economies. Spain (SPNAGDPQ), the fourth-biggest economy, has already reported growth of 0.6 percent for the period, beating estimates and marking a fourth straight
The euro-zone recovery, which began in spring last year and has gradually spread around most of the currency area, has not yet taken hold in Italy,” said Christian Schulz, senior European economist at Berenberg Bank in London. Countries such as Spain “were out of the blocks fast and have put themselves at or near the top of the euro-zone growth table courtesy of their sweeping reforms in the last three years. Italy continues to struggle.”

**German Outlook**

While Germany has so far led the regional recovery, it is feeling the pain of increasing political tension. The European Union agreed last week on its widest-ranging sanctions yet over Russia’s backing of rebels in eastern Ukraine. Russia counts Germany as its biggest trading partner in Europe.

German Vice Chancellor Sigmar Gabriel this week blocked a deal for Rheinmetall AG to build a military training center east of Moscow in light of the sanctions. The contract has a value of more than 100 million euros ($133 million) and the Dusseldorf-based company had planned to build more facilities in Russia.

The Economy Ministry said in today’s report that geopolitical risk led to “reticence” in placing factory orders. The Bundesbank has cited such risk as contributing to a probable stagnation of GDP in the second quarter. Those data are also scheduled to be released next week.

“The manufacturing-sector outlook does not look encouraging,” said Evelyn Herrmann, European economist at BNP Paribas SA in London. “Geopolitical tensions, which have intensified again in July and showed in the latest set of Ifo business climate, could furthermore dampen the momentum.”

**Global Slowdown**

German business sentiment dropped for a third straight month in July to the lowest level since October, according to the Munich-based Ifo Institute. Investor confidence as measured by the ZEW Center for European Economic Research in Mannheim declined for a seventh month.

Separate data today showed further signs that global growth may be lower than investors expect. The pound fell after U.K. industrial production in June rose at half the pace economists forecast. Output climbed 0.3 percent from May. Another report showed U.K. shop prices fell by a record 1.9 percent on an annualized basis in July. Still, the country’s house prices climbed at the fastest pace in almost eight years, according to Halifax.

The International Monetary Fund last month cut its outlook for global economic growth in 2014, predicting an expansion of 3.4 percent, down from its 3.6 percent forecast in April.
ECB officials are gathering in Frankfurt today and will announce their monthly interest-rate decision tomorrow. They'll leave the benchmark rate unchanged at a record low of 0.15 percent, according to all 57 economists in a Bloomberg News survey. Policy makers including Governing Council member Ardo Hansson have indicated the central bank will refrain from further action until the impact of the latest stimulus is clear.

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