Recession Stalks Europe's Weakening Economy

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LONDON (AP) — The European economy has stalled, and is likely to start shrinking soon, just when eurozone countries need help the most.

Growth slowed nearly to a stop this summer, and a recession afflicting small countries like Greece and Portugal threatens to spread to some of Europe's stronger economies as financial market uncertainty erodes confidence among businesses and consumers.

The slowdown will lower living standards and increase concerns that larger European countries like Italy and Spain will go bankrupt, possibly breaking up the 17-nation club that uses the common euro currency.

It's also bad news for Europe's big trading partners: the U.S. and Asia.

Until earlier this year, it seemed the eurozone might pull through the debt crisis without too much damage to its economies. While bailed-out countries like Portugal and Greece were in recession, most others were still enjoying solid growth. The troubles were contained.

But as the market chaos intensified, so did its economic impact. Statistics released Tuesday showed eurozone economic growth at a paltry 0.2 percent in the third quarter, and other surveys are all pointing in one direction — down.

"The economic slump will accelerate in the coming months," said Christope Weil, an economist at Commerzbank. "The uncertainty caused by the sovereign debt crisis is lying like mildew upon the eurozone economy."

While they share the same currency, the eurozone economies are not all performing the same. Germany and France continue to grow, but more slowly — at 0.5 percent and 0.4 percent. The Netherlands, traditionally a competitive economy, unexpectedly saw its economy contract in the third quarter. Data for Italy was not ready yet, but is expected to show its economy stagnating.

Even though Germany and France, Europe's twin engines of growth, are still growing, they are unlikely to defy the drag of the debt crisis much longer.

Extended bouts of financial volatility, of the kind that has hounded Europe for three years, make financial planning more difficult for businesses and households. Consumers will spend less if concerned about losing their jobs and companies will cut down on investment.

Getting credit also becomes more difficult, as banks worry about big losses on government bonds and reduce the amount of money they lend. That stifles new business ventures and makes mortgages harder to come by.

Amid all this, governments are cutting public sector payrolls and slashing spending to lower their debt loads.

The end result is a self-reinforcing downward spiral of fear that is pushing Europe's overall economy into recession.

"People are uncertain," said Ferdinand Fichtner of the German Economic Institute DIW. "That is poison for growth."

The European Commission warned recently that unemployment in the eurozone — now at 10.2 percent — would remain high for the foreseeable future.

A recession is bad news in itself, but is particularly worrying in Europe now because it complicates the continent's efforts to cut its debt, the very thing that triggered all the turmoil.

Governments need their economies to grow if they are to pay down their debts — austerity measures tend to weaken growth in the short-term.

Fears that the slowdown in growth will worsen the debt crisis was evident in financial markets on Tuesday, with many countries' bond yields rising, increasing their costs of borrowing. An increase in bond yields shows waning investor confidence in a country's ability to repay its debts.

Italy's benchmark 10-year bond yield rose back above the dangerous threshold of 7 percent on Tuesday despite the presence of a new technocratic government that planned to push through reforms. Spain's equivalent yield hit 6.3 percent. Even France's rose, to 3.7 percent, despite the country's high AAA credit rating — the clearest sign that investors are worried that the debt crisis will not stop spreading.

The eurozone's economic performance compares poorly with those of its peers. The United States grew three times as fast, by a quarterly rate of 0.6 percent in the third quarter, according to Tuesday's release by Eurostat, the EU statistics agency. Japan boomed by 1.5 percent, though largely making up for lost output after a devastating earthquake and tsunami in March.

Europe's financial and economic problems, however, could drag down U.S. and Asian performances as well.

Paul Dales, senior U.S. economist at Capital Economics, estimates that a recession in Europe would shave about half a percentage point off U.S. growth in 2012. Others have similar estimates.

U.S. growth is already too weak to lower the U.S. unemployment rate, now at 9 percent. One result is that the economy remains vulnerable to outside shocks. Dales estimates the U.S. economy will grow a scant 1.5 percent in 2012.

Europe's troubles will also likely cut into U.S. exports — not only to Europe but also to other markets, such as China, where products are assembled and shipped to European countries. A survey last week by the Federal Reserve showed that European banks with operations in the United States are tightening lending.

But several factors should limit the damage. Only about 13 percent of U.S. exports are shipped to eurozone countries. And shipments to Europe's most troubled countries are even smaller: Only 1.1 percent of U.S. exports are shipped to Italy, and only 0.1 percent go to Greece.

U.S. banks haven't lent much to other banks or governments in Europe's most troubled countries. Dales said U.S. banks had much greater exposure to Asia during that region's financial crisis in the late 1990s than they now do to Europe, and the U.S. economy "sailed through" that crisis.

But if the European financial crisis worsened significantly — for example in the event of a messy Greek default — the U.S. and Asia would likely be indirectly affected by a freeze in global credit markets. That is what happened after investment bank Lehman Brothers collapsed in 2008. Banks were worried to lend money to each other, causing some of them to fail.