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Euro-zone economy returns to expansion

Third-quarter gains welcome, but show fragility of recovery

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AND BRIAN BLACKSTONE

BERLIN—The euro-zone economy returned to modest growth in the third quarter, marking an apparent end to five quarters of recession, but the region's recovery looks set to be anemic, economists said.

Economic activity in the 16-nation euro-currency zone expanded at an annualized rate of 1.5% in the period from July to September, according to calculations based on data from the European statistics agency Eurostat. Germany, Europe's biggest economy, led the recovery, expanding at an annualized rate of 2.9%, thanks to strengthening exports and business investment.

Many European economies grew for the first time since early 2008, including Italy, Austria and the Netherlands, joining Germany and France, which returned to growth in the second quarter.

However, Friday's growth figures weren't as strong as expected, particularly in France, where the economy expanded at an annualized rate of only 1.1% last quarter, around half of what economists had hoped.

Economists expect most European countries to post growth in the fourth quarter, too, thanks to a revival in world trade and improving business confidence. But many analysts say growth in 2010 will be mediocre, with the euro-zone economy struggling to expand by much more than 1%.

"Europe is likely to be the weakest region for global expansion next year," says Julian Callow, chief European economist at Barclays Capital in London.

That could slow the global recovery in 2010, since the euro zone accounts for more than a fifth of world economic output. Rising unemployment, the end of government stimulus measures and the strong euro are set to weigh on Europe's recovery next year, although few analysts expect the euro zone to fall back into recession immediately.

The euro-zone economy expanded 0.4% in the third quarter, Eurostat said, translating into a 1.5% annualized rate, as calculated by J.P. Morgan in London.

Detailed breakdowns aren't available yet for most countries, but the meager rises in gross domestic product—a measure of total output of goods and services—suggest consumers and many business sectors are still feeling the pain from Europe's deepest recession since the 1930s.

"The crisis is still here, still impacting our daily life," said Gerolamo Caccia Dominioni, chief executive of Italian knitwear maker **Benetton Group** SpA. Benetton's revenue climbed 13% to €609 million ($910.3 million) in the third quarter from a year earlier, while net income jumped 43% to €54 million, the company said.

Despite the improvement, Mr. Dominioni said he expects a long, slow recovery. In Italy, consumers are cutting spending as fears mount over potential job losses, he says.

Although business surveys show that activity is picking up, the recovery is starting from a very low level, after much of corporate Europe suffered steep declines in output in late 2008 and early 2009. Many companies have excess capacity for the year ahead, despite the return to growth, so economists expect unemployment to keep rising.

Other factors constraining Europe's recovery include banks' restrictive lending, the end of government stimulus measures over the next year, and the strong euro, which makes it harder for European exporters to compete abroad.

Growth rates in Europe currently lag behind those of the U.S. economy, which expanded at an annualized rate of 3.5% in the third quarter, although many analysts expect the U.S. to grow at a more moderate pace in coming quarters.

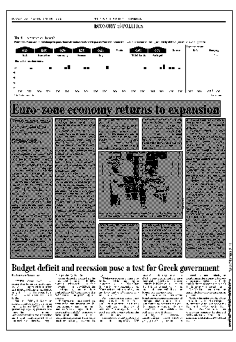
Europe has no widely recognized authority that declares when recessions begin and end, as the National Bureau of Economic Research does in the U.S. Instead, economists and policy makers in Europe assume a recession is over when quarterly GDP starts rising again after a slump, provided the rise isn't a brief anomaly.

Friday's patchy growth data support the European Central Bank's caution about the recovery. ECB officials recently emphasized the uncertainty of the economic outlook, noting that fiscal-stimulus policies will expire while many banks and businesses are trying to reduce their indebtedness.

Within Europe, Germany appears to be benefiting most from the revival of world trade. Germany's large capital-goods industries mean it benefits directly from rising investment spending in China and other emerging economies.

Machine-tool maker Ernst Ludwig Emde GmbH, based in Germany's Ruhr Valley industrial heartland, is currently enjoying fast-growing sales to China's automobile industry. The recovery in sales has been gathering steam since July, said Horst Gabriel, chief executive of the company.

Revenue in 2009 will be down by 25% or more compared with last year, despite the present improvement, Mr. Gabriel said. He worries that business investment will stagnate in Europe and the U.S. in months ahead, but is more confident about emerging economies.


Euro-zone economy returns to expansion
Budget deficit and recession pose a test for Greek government

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"Ten years ago, our main export market was Western Europe. In recent years it was Eastern Europe. Now it's China," he said.

European countries that—unlike Germany—had real-estate and consumer-spending bubbles are struggling the most. Spain's economy was still shrinking at an annualized rate of 1.2% in the third quarter, although that was slower than the previous pace of contraction.

Ireland, while like Spain enjoyed stellar growth during the boom years, doesn't report third-quarter GDP until next month, but economists at IHS Global Insight expect contractions in the third and fourth quarters.

Ireland's property sector is starting to stabilize following an "awful" period early this year, said Guy Hollis, Dublin-based managing director of CB Richard Ellis, a commercial real-estate consultant.

Meanwhile the euro zone's main consumption-driven economy, France, is growing—but at a slower-than-expected pace, due to households' increasing caution in the face of rising unemployment. French consumer spending stagnated in the third quarter, a disappointment given that car sales have been rising strongly thanks to cash-for-clunkers incentives.

—Stacy Meichtry in Rome contributed to this article.

An employee arranges a window display at a Benetton store in Rome. 'The crisis is still here, still impacting our daily life,' said Gerolamo Caccia Dominioni, Benetton's CEO.