Three of Europe's biggest economies are probably in recession — and the ECB is out of bullets

Reuters/Jason Cairnduff

- **Three of Europe's largest economies — Germany, Italy, and the UK — are either in recession or are on the verge of it, which could spell danger for the eurozone.**
- **Germany, Europe's industrial backbone, is stuttering. The unemployment rate has risen for the second time in three months.**
- **The UK economy contracted for the first time since 2012, as output fell 0.2% in April to June.**
- **Italy's debt crisis is only being made worse by political uncertainty.**
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Europe could be about to hit a crisis, as three of its largest economies are tanking at the same time. What's more, the European Central Bank looks like it's out of bullets to fire the economy up.

What happened?

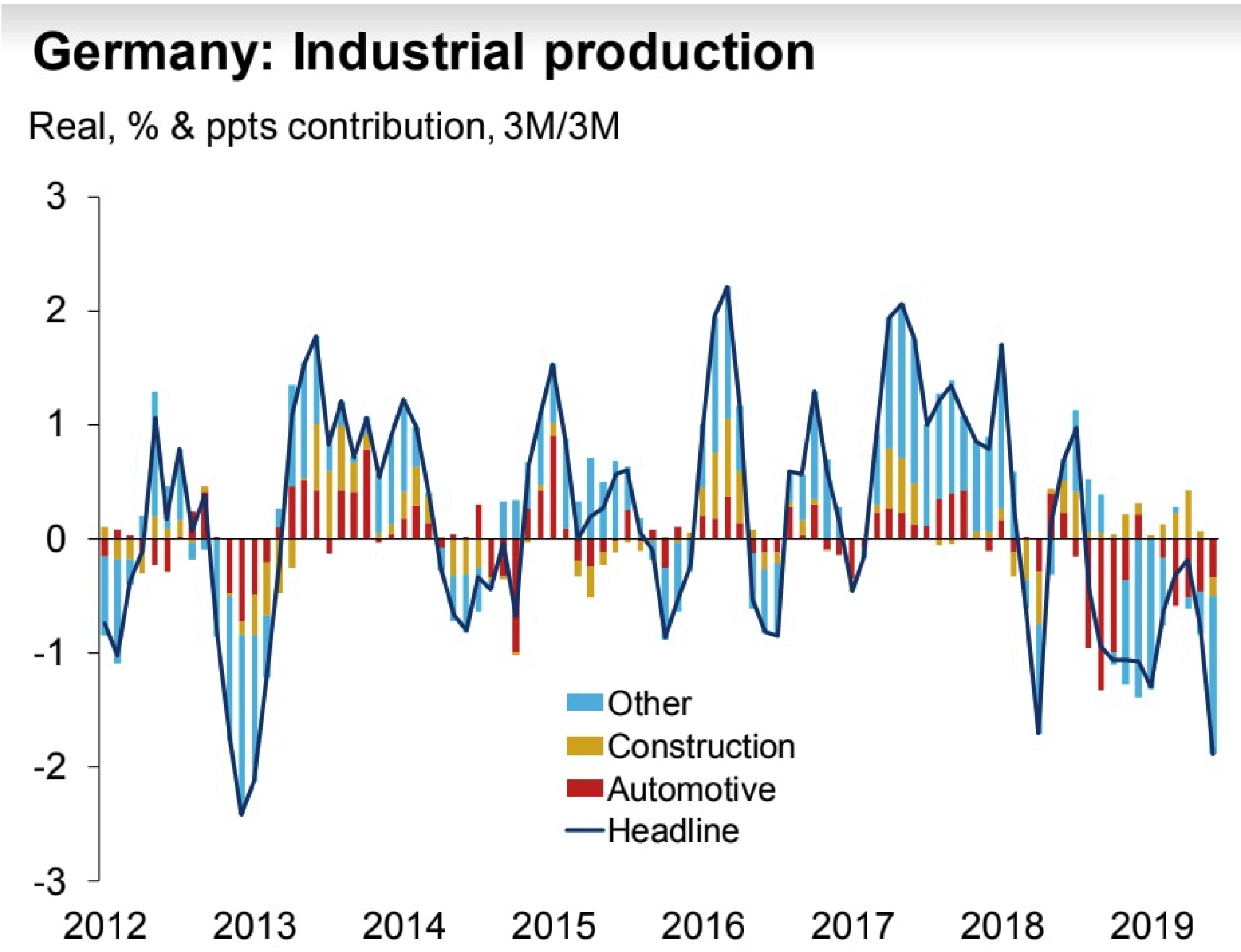
Germany is Europe's biggest economy. Germany is very much reliant on foreign exports, which means that it's a victim of slowing global trade from the China-US trade war.

On Wednesday, Germany reported that industrial production declined 1.5% month on month in June. According to Oxford Economics, "All the main sectors, excluding construction, fell over the month as trade tensions continued to impact the sector."

In Q2 industrial production fell 1.9% quarter on quarter, which the economists said is "the largest quarterly decline since 2012."

"Our German GDP indicator now points to a contraction in Q2," as factory orders decline, it said.

That is having an effect on jobs. HSBC chief economist Stefan Schilbe wrote in a recent note that unemployment had risen in July, the second increase in three months. The slowdown, as Schilbe put it, is beginning to "leave a (modest) mark on the labor market."



Oxford Economics/Haver Analytics

The UK is not faring much better.

The UK economy contracted for the first time since 2012 in Q2, a clear sign of the effects of the uncertainty “no-deal” Brexit is having on the UK economy.

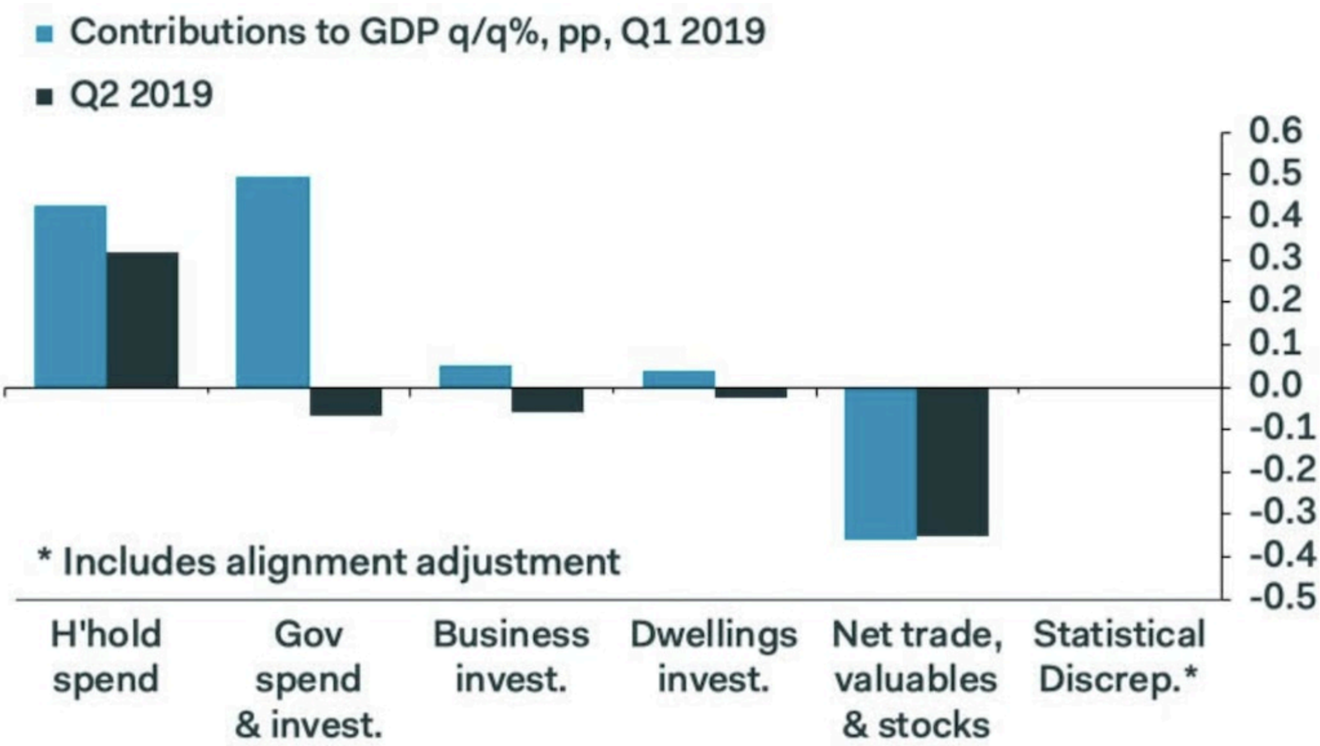
“**Confidence over the health of the UK economy was dealt a gut-wrenching blow** this morning,” Lukman Otunuga, Senior Research Analyst at FXTM, said on Friday.

Business investment has fallen for five of the past six quarters.

“The economy has been propped up instead by the government and households,” Ranko Berich, Head of Market Analysis at Monex Europe, said in a note on Friday. “This is a plainly unsustainable situation for the economy, and highlights the extent to which Brexit has already taken a significant toll.”

The pound fell 0.4% against the US dollar on the news.

“Today’s disappointing GDP figure is set to raise alarm bells over Brexit dragging the UK economy deeper into the abyss. This unfavorable scenario may prompt the Bank of England to cut interest rates sooner than anticipated, in an effort to revive the UK economy,” Otunuga said.



Pantheon Macroeconomics

Italy, meanwhile, is having a tumultuous time of its own.

On Friday, Italy’s deputy prime minister called for a no-confidence vote in its government. It sent markets plunging, and bond yields rocketing, 17 basis points to 0.225%.

Italian debt to GDP is over 130% — historically high — and it doesn’t look like it’ll improve.

“There is little that Italy’s government can do to prevent its debt ratio from rising. For a number of reasons, not least of which is its membership of the eurozone, the three paths to debt reduction – faster GDP growth, fiscal austerity, and higher inflation – are either closed off or likely to be ineffective. Accordingly, we think that Italy will eventually be forced into a debt restructuring or outright default,” Capital Economics said.

Capital Economics, Reinhart & Rogoff (2011), “From Financial Crash to Debt Crisis”, IMF, Refinitiv.

Can the ECB do anything to save this mess?

Not really.

The European Central Bank will likely cut rates in September and ease the pressure on Europe by loosening policy, but it probably won’t do the trick.

Interest rates are already negative, at -0.4%. Going further negative would create logistical problems that might, counterintuitively, reduce further bank lending (because banks would lose money by doing so). The ECB doesn’t have many weapons in its arsenal to provide a stimulus to Europe.

As a result, Europe looks pretty stuck.

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