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# Europe Finds Slope Ahead Is Growing Ever Steeper

By LIZ ALDERMAN AND JACK EWING

PARIS — Europe has had a rough ride since Greece confessed it falsified its books to join the euro. Now the economic situation is set to worsen, as the sovereign debt crisis started by that revelation in January 2010 threatens to send the euro zone into its second **recession** in three years.

Greece, Ireland, Portugal and Spain are already in downturns or fighting to escape them, as high unemployment and austerity measures bite. But in the last few weeks, Germany and France, the Continent's powerhouses, have also started to falter, hurt as struggling banks tighten their lending and orders for business from the indebted countries of Europe ebb.

"The sovereign debt crisis is like a fungus on the economy," said Jörg Krämer, the chief economist at Commerzbank, who last week joined the growing crowd of analysts who are now predicting that Europe is headed for a recession. "I thought it would be just a slowdown, as is not unusual after a recovery. But I have changed my mind."

The euro zone economy has already slowed to essentially no growth. It could stay in a slump, many economists say, at least through next spring. If that happens, tax revenues are likely to fall and unemployment is expected to rise, making it even more difficult for Europe to deal with the sovereign

debt crisis and protect its shaky banks.

Worse, emerging markets that are important customers for European exports, like China and Brazil, are tightening credit to prevent their economies from overheating. The United States, another main market, is stuck in its own economic rut.

In a sign of how quickly the ground is shifting, the European Central Bank on Thursday could well lower interest rates — just a few months after it started raising them in what is now seen as a misguided effort to stem incipient inflation.

Distress is increasingly evident across Europe. Philippe Leydier had been feeling more upbeat about his business until this summer, when orders for his French company's corrugated boxes suddenly began to slide. Orders fell further last month as auto parts makers, electrical engineering firms, farmers and other industries reduced production.

“The euro crisis and the financial crisis linked to the debt of European countries is serious,” said Mr. Leydier, whose Lyon-based box and paper manufacturing firm, Emin Leydier, often provides an early signal of seismic shifts in economic activity. “European governments need to find a solution — and fast.”

In Italy, which has the euro zone's third-largest economy, after those of Germany and France, a €45 billion austerity program has many worried about a recession. Paolo Bastianello, the managing director of Marly's, a clothing retailer, has also seen his hopes fade.

At the start of the year, Mr. Bastianello was more optimistic that Europe might escape its troubles and that Italy's dysfunctional government would seriously tackle the country's problems. “But the turbulence of the markets and the uncertainty about this abnormal mass of public debt just scare people away from buying,” he said.

Not everyone is so pessimistic, especially in Germany. But even there, indicators are pointing to slower growth.

German executives say sales remain healthy, at least so far. “We don’t see any impact on our business,” said Roland Busch, a member of the management board of Siemens, the electronics and engineering giant based in Munich.

“The economy is cooling down but not more than that,” said Mr. Busch, who oversees a unit that supplies traffic-control systems, street cars and other products for public works.

Expecting demand for urban infrastructure improvements to grow, Siemens plans to add about 150 people over the next two years to its 850 employees at its complex in Sacramento, California, that makes light rail cars.

Bucking the trend almost everywhere else in the developed world, unemployment in Germany continues to fall, and there are shortages of skilled workers in several key sectors.

“We know Germany is an exception,” said Jörg Köther, a spokesman for the IG Metall union.

Jens Weidmann, who runs Germany’s central bank and serves on the executive board of the E.C.B., predicted last week that the nation would hit “a soft patch” but escape recession.

Others are not so sure: Goldman Sachs forecast Tuesday that Germany and France would both shrink. Commerzbank believes growth will slow almost to zero in the fourth quarter of 2011, but not decline. At best, though, it expects Germany to grow by no more than 1 percent in 2012.

The International Monetary Fund is a little more optimistic, predicting growth of 1.3 percent next year in Germany after a healthy 2.7 percent pace this year.

But the I.M.F. recently acknowledged that it, too, had overestimated the rate of recovery. It now forecasts that growth in the euro zone will slide to 1.1 percent in 2012, after a 1.6 percent gain this year.

Italy’s economy should be flat, the Fund predicts. In Spain, where tens of thousands of protestors have called on the government to ease its austerity plan, the I.M.F. expects growth to pick up to 1.1 percent

next year from 0.8 percent this year.

Still, unemployment in Spain remains at 20 percent, and youth unemployment nearly twice that rate. Pfizer, the U.S. pharmaceutical giant, said last week it would cut 220 jobs there.

One of the few bright spots in Europe may be Ireland, which has stuck to a tough austerity program required by its €85 billion bailout. Some analysts see Ireland already on the rebound.

Ireland's austerity programs have helped it tackle the massive deficit it took on when Dublin agreed to guarantee the debts of all its major banks. Its borrowing costs are shrinking and exports have surged in recent months.

But the domestic economy remains moribund, while the fragile export recovery could be sabotaged by slowing in the global economy.

"We're not out of the woods yet," said Cathal O'Leary, who heads the fixed-income group at the Dublin-based brokerage firm NCB. "We are so reliant on the export side of our economy that global and European growth is of the utmost interest to the continued success of the Irish economy."

The economy is worse in Portugal, which is also operating under a bailout agreement with the E.U. and the I.M.F. The I.M.F. warned newly installed Prime Minister Pedro Passos Coelho that Lisbon still needed to find €1 billion more in budget savings. But further austerity may only deepen the downturn, with Portugal's economy expected to fall 1.8 percent this year and 2.3 percent in 2012.

João Figueiredo, the owner of a small ship repair yard in Lisbon, anticipates his first annual loss since 2002. "There are now many clients who are late in their payments and whose money I will probably never see," he said.

The worldwide dimension of the financial crisis, Mr. Figueiredo added, made the outcome even more uncertain. "We're now in the middle of a crisis that started in American real estate and then crossed over to Europe, and it seems really nobody has any idea where this will go next and for how long."

Portugal's slump convinced François Libner, the president of Libner SA, a French manufacturer of delivery truck bodies, that it was hopeless to keep trying to sell there.

He re-oriented his business toward Germany when growth in Portugal, Greece, Spain, and Italy started to trail off last year. Mr. Libner figures it will take at least a decade for any real growth to return, particularly in Spain and Greece, which he classifies as "a catastrophe."

Mr. Libner is hopeful that Paris' efforts to bring its own deficit and overall debt into line with European rules should allow France to keep its triple-A bond rating, so long as European leaders figure out a way to contain the [debt crisis](#) to Greece. If that happens, he said, Europe could rebound quickly, as investors regain faith in the euro project.

But if it doesn't, and Europe's banks get further ensnared in the crisis, he shudders to think of the implications.

"We can pay for Greece, but not for all of Europe," Mr. Libner said. If the crisis gets bigger, he added, "we won't have the means to pay for all of this."

*Jack Ewing reported from Frankfurt. Raphael Minder contributed reporting from Lisbon and Gaia Pianigiani from Rome.*



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