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Europe’s Surge Signals Hope for Economic Recovery

By CARTER DOUGHERTY

FRANKFURT — The European economy bounced back with unexpected strength in the second quarter, buoying hopes that a worldwide recession was drawing to a close.

The sharp improvement from the first quarter underscored just how far Europe and indeed the global economy had come since a harrowing free fall in late 2008. Underlying the strong reading were solid performances in France and Germany, each of whose economies grew slightly in the second quarter, according to government data released Thursday.

Though very dependent on government spending, Asia has shown sharp improvement recently. Some leading forecasters expect growth of up to 9 percent in China this year and more than 10 percent next year. Meanwhile, the brutal contraction early this year in the United States has eased, with signs pointing to modest growth in the second half.

The economy of the 27-country European Union shrank 0.3 percent in the three months ended June 30, for an annual rate of roughly 1.2 percent. The 16 countries that use the euro registered a 0.1 percent decline for the second quarter, or an annual rate of roughly 0.4 percent.

Despite being in negative territory, the European data looked much better than in the first quarter of this year, when both the European Union and the euro zone contracted 2.5 percent from the last three months of 2008.

The significant easing of the recession put Europe roughly on a par with the United States, where the economy shrank at an annual pace of 1 percent during the second quarter. Economists said Europe got some help from government programs, like premiums being paid to scrap old cars for new cars — their own “cash for clunkers” programs — as well as greater demand for exports in China.

But most of all, the performance represented the ebbing of a financial shock that rippled through economies worldwide after the collapse of Lehman Brothers in September 2008 and the subsequent chaos in financial markets, economists said.

Europe still faces the possibility that its recovery could slow or even stall in early 2010 because of lagging efforts to repair its banking system and sharply rising unemployment. Nonetheless, the sunnier picture in Europe, particularly in Germany and France, has given the region a leg up sooner than most economists expected.

Because of its sharply different recipe for combating the recession, Europe is likely to have slower growth than the United States by 2010, economists predict.

By next year, the lion’s share of an $800 billion spending program in the United States will kick in, dwarfing the outlays in Europe, which resisted such approaches out of fear of becoming heavily mired in debt. About $100 billion in tax rebates gave the United States a boost toward to recovery in the last few months.

“We will really see the difference in recoveries next year,” said Thomas Mayer, the chief European economist for Deutsche Bank. “That will be when the U.S. bounces back more quickly than Europe.”

Underlying the strong reading were solid performances in France and Germany, each of which grew 0.3 percent in the second quarter, government data showed. Germany’s economy, the largest in Europe, will still probably contract about 6 percent for the full year, economists say.

Within the euro area, France and Germany are helping balance out much weaker performances in Italy, a perpetual laggard, and Spain, where a collapsing housing market has brought an acute recession.

Eastern Europe, particularly Hungary and the Baltic countries, remains deeply troubled. And the once-mighty British economy still faces a steep rise in unemployment, though it, too, could return to modest growth in the third quarter, economists said.

The new figures for Germany come after four consecutive quarters of contracting output, implying that the country’s recession, its worst since World War II, has ended.

The surprise expansion in Germany — most economists had expected a flat or slightly negative reading — reflects gains for the country's exporters from growth in Asia and what may be a bottoming of the downturn in the United States. Industrial production has also received a fillip from programs that give auto buyers a 2,500 euro ($3,541) bonus if they swap older cars for newer, environmentally friendly models.

"Stimulus is working a bit, but there is also a rebound because of global trade," said Erik Nielsen, chief Europe economist at Goldman Sachs in London.

But other developments are weighing on the European outlook, creating uncertainty about how the economy will shape up in 2010. News last week that German exports had leapt 7 percent in June over the previous month foreshadowed the positive reading on gross domestic product.

But that masked an overall collapse of orders from abroad; German exports in June were down 22 percent from the period a year earlier.

And unemployment is expected to rise sharply this year as government programs that kept people on private payrolls throughout Europe begin to expire.

Already, the euro area's unemployment rate stands at 9.4 percent, its highest level in 10 years, and the anemic growth of the coming quarters will not be enough to arrest the slide. That, in turn, could drag down consumer confidence or even generate political backlash in Europe, economists said.

"Growth is not going to get where it needs to be to the point where companies do not have to fire their surplus workers," said Julian Callow, the chief European economist at Barclays Capital.

Neither can Germany depend on fiscal stimulus to kick-start domestic demand.

The government of Chancellor Angela Merkel, skeptical of greater spending and inclined to blame the United States for the crisis, approved two small stimulus packages, worth about 73 billion euros, late last year and in early 2009. France also carried out several modest spending plans.

The financial system is another cloud on the horizon, though it may be healing more rapidly than expected.

The International Monetary Fund has criticized Europe for not moving quickly enough to recapitalize banks and clear balance sheets of bad assets. But the European Central Bank is projecting lower losses in Europe than the I.M.F., and it has published data suggesting that credit flows are easing.

“We have to worry about tighter credit less than we thought we did earlier in the year,” Mr. Callow said.