Euro zone economy contracts at record pace

By Nick Beams
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Data released on Thursday by Eurostat showed that the euro zone economy contracted by 3.8 percent in the first quarter compared to the last three months of 2019, an annualized fall of 14.4 percent.

This is the largest shrinkage on record and far exceeds the annualized drop in the US economy of 4.8 percent over the same period. The biggest falls were in France, where separate data showed the gross domestic product (GDP) fell by 5.8 percent in the March quarter compared to the previous one, and Spain, where the GDP shrank by 5.2 percent over the same period.

France’s Office for National Statistics said the fall in the French economy was driven by an “unprecedented” contraction in household consumption spending of 6.1 percent and an 11.8 percent drop in investment.

The GDP for Germany, the euro zone’s largest economy, is expected to contract by 6.3 percent for the year, with data showing that retail sales fell at the fastest rate in more than a decade despite a lift in online sales and increased food purchases.

The country’s employment agency reports that more than 10 million workers have been registered to have part of their wages paid by the government, and a quarter of the workforce has either been sent home or is working reduced hours.

The euro zone GDP figures for the second quarter will be much worse because lockdowns across the region, resulting from the coronavirus pandemic, only began to take effect from the first weeks in March.

Jessica Hinds, European economist at Capital Economics, told the Financial Times the contraction in the first quarter “will pale in comparison with the complete collapse that will surely be recorded in Q2.”

Meeting on Thursday as the new GDP figures were being released, the governing council of the European Central Bank (ECB) took the same road as the Fed in the US, committing itself to pump more money into the markets, though there was some criticism from finance circles that it was falling short of the action taken by its American counterpart.

ECB President Christine Lagarde said the euro zone economy could contract by as much as 12 percent this year and the shape of any recovery was highly uncertain.

“The euro area is facing an economic contraction of a magnitude and speed that are unprecedented in peacetime,” she said.

The ECB left its interest rate unchanged, but indicated it would provide four-year loans to banks at an interest rate of minus 1 percent—effectively paying them to borrow money.

There was some criticism from financial circles that the ECB did not expand its €750 billion Pandemic Emergency Purchase Program (PEPP), through which it buys government debt and corporate bonds, to more than €1 trillion.

Signalling that the financial markets want more, Andrew Cunningham, an economist with Capital Economics in London, said the ECB’s failure to upscale the PEPP “will leave investors with nagging doubts about its commitment to underwrite government borrowing during the coronavirus crisis.”

The ECB has so far used €100 billion from the program since it was introduced in mid-March, indicating that at the present rate it will run out by October. But the ECB statement said the governing council was “fully prepared to increase the size of the PEPP and adjust its composition by as much as necessary and for as long as needed.”

In her remarks to the press, Lagarde underscored this commitment. “Let us understand the whole firepower which the ECB has available, which is north of €1 trillion,” she said. The ECB would use the “full flexibility to deploy this firepower” where it considered there was a “particular risk” of a tightening of financial conditions.
Lagarde indicated the program could be extended beyond the end of the year and be used to purchase the corporate bonds of so-called “fallen angels,” that is, companies whose debt was previously rated as investment grade but had dropped to below that level. She said the purchases would be carried out in a “flexible manner” over time, and across asset classes and among jurisdictions.

Lagarde’s remarks were aimed at finally quelling the storm of controversy set off at the previous ECB meeting when she said it was not the task of the central bank to close the spread on the yields of government bonds. This was seen as a lack of commitment to support Italian government debt, on which interest rates tend to rise higher than those of Germany and the northern economies because of concerns over the stability of the Italian financial system and the level of government debt.

Answering a question as to whether it was now ECB policy to control spreads on government debt, Lagarde said “we will use any and all flexibility” to make sure that monetary policy was “properly transmitted to all jurisdictions, from east to west, from north to south, to all sectors of the economy.”

The situation in Italy sounds a warning about what is to come and its impact on the working class across Europe. At the end of last year, Italian public debt stood at more than 130 percent of GDP and is expected to grow still further as a result of the pandemic.

On Tuesday, Fitch Ratings downgraded Italy’s credit rating to just one notch above junk status. It warned that “downward pressure on the rating could resume if the government does not implement a credible economic growth and fiscal strategy that enhances confidence that general government debt/GDP will be placed on a downward path over time.”

Given the massive contraction of the Italian economy and the euro zone as a whole, the only way this ratio can be reduced is by slashing government spending on vital social services. That is, the working class, not only in Italy but across Europe, will be made to pay for the money provided to corporations and the financial system.

This is a matter not of prediction, but of the historical record. In the immediate aftermath of the financial crisis of 2008, governments in the major economies committed themselves to stimulus packages to “save” the economy. But by June 2010, once the immediate financial crisis had passed, there was a decisive shift and a turn to austerity programs. This led to the slashing of public spending, not least in health care systems, creating the disastrous conditions exposed by the pandemic.

Today, with the bailout measures going far beyond those of 2008–2009, finance capital will demand, as the Fitch statement indicates, that these measures be implemented even more ferociously and broadly.

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