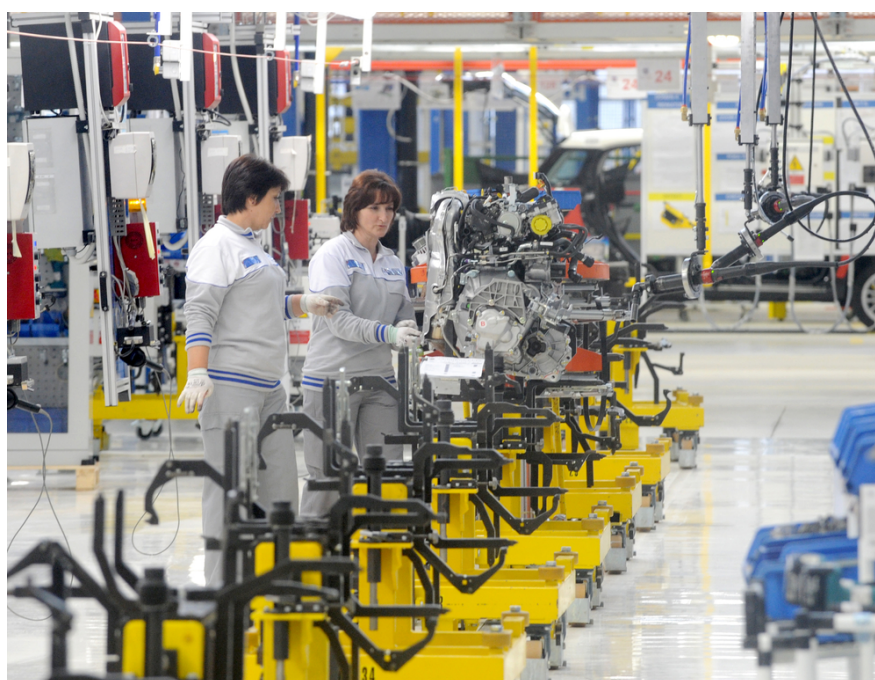


Germany: Industrial setback in June but 2Q growth on track

The June drop in industrial production is too small to affect a solid growth performance over the entire second quarter



Broad-based decline

German industrial production took a hit in June, dropping by 0.9% month-on-month from 2.4% MoM in May. On the year, industrial production was still up by 2.5%. The drop in industrial activity was broad-based. After three strong months, activity in the construction sector also weakened, declining by 3.2% MoM. At the same time, exports held up relatively well despite the delayed impact from last year's euro strengthening and trade tensions, remaining flat in June after a 1.8% MoM increase in May. As imports increased by 1.2% MoM, the seasonally-adjusted trade surplus narrowed to €19.3 billion, from €20.4 billion in May.

After yesterday's disappointing new orders data, speculation about an imminent downswing in the German economy has gained new momentum. Intuitively, weak June data can be associated with trade tensions. However, in our view, it's not so straightforward. Analysis of the German economy requires more nuance. Here is our take on the state of the economy:

GDP could still outperform eurozone

1. Despite this week's disappointments, comparing economic activity data with first quarter data still points to solid growth in 2Q. Construction, industrial output and consumption should all be growth drivers, not drags, in the second quarter. Therefore, next week's GDP data could easily outperform the eurozone's 0.3% growth rate.
2. Looking at bilateral trade data, German exports have gone through a slight structural shift since the start of the year. While the share of German exports to the US is currently lower than in 2017, the share of other eurozone countries like the Netherlands, Italy or Spain has actually increased.
3. At least in the short run, weakening demand for German products, as illustrated by yesterday's disappointing new orders data, could actually bring some relief. In particular, the manufacturing sector has been suffering from severe supply-side constraints, with capacity utilisation at its highest level since early 2008 and a lack of qualified workers and equipment. Order books are still richly filled and it would take a while before a protracted decline in demand shows in activity data.
4. Trade tensions are weighing on sentiment, not on activity. Obviously, trade tensions are the biggest threat to the German economy at the current juncture. Not so much due to tariffs or the possibility of tariffs but simply due to the fact that a potential trade war brings uncertainty and uncertainty brings a delay in investment decisions.

All of this means that reading and understanding the German economy has become more complex. The long series of one-offs explaining the monthly, often highly volatile, ups and downs of German macro data since the start of the year has further complicated things. Just think of the harsh winter weather, strikes, timing of Easter and long weekends. For now, the only thing certain is that the economy has lost its status as a stellar performer but that doesn't mean at all that it's become an underperformer. Complexity does not mean failure.

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