Germany: Recession avoided – for now

The German economy is showing some unexpected resilience, however it is a long way off displaying a strong economic recovery

Olaf Scholz has served as German chancellor since December 2021

The German economy started the new year with positive news. Kind of. According to the first very tentative estimates by the statistical office, the economy avoided a contraction in the fourth quarter and 'only' stagnated. The positive effects of the post-lockdown rebound seem to have outweighed the negative impact of the war in Ukraine and surging energy and food prices.

Even though this first estimate could still be subject to revisions, it definitely shows that the German economy has been more resilient despite a long series of crises in 2022, which threatened to push the economy into a deep recession. The reason for this resilience is not so much the structure of the economy but rather a simple policy recipe that the German government has successfully used over the last 15 years and perfected recently: fiscal stimulus. Contrary to common belief and what German governments have often preached to other European governments: in times of crisis, the government prefers outright fiscal stimulus. This was the case during the financial crisis, during the Covid-19 pandemic and now as a response to the war and the energy crisis. What German governments perfected during the pandemic and last year's crisis is the use of big ballpark figures, hoping that eventually not all the money will have to be used. During the pandemic, outright fiscal stimulus amounted to more than 10% of GDP. Last year, after some months of hesitation, the government decided on several stimulus and price cap packages, amounting to a total of some 8% of GDP. The announcement effect and the actual money saved the economy from falling into recession, at least for now.

Not falling off the cliff is one thing, staging a strong rebound, however, is a different matter. And there are very few signs pointing to a healthy recovery of the German economy any time soon. First of all, we shouldn't forget that fiscal stimulus over the last three years stabilised but did not really boost the economy. Industrial production is still some 5% below its pre-pandemic level and GDP only returned to its pre-pandemic level in the third quarter of 2022. Industrial orders have also weakened since the start of 2022, consumer confidence, despite some recent improvements, is still close to historical lows, and the loss of purchasing power will continue in 2023. Finally, like every eurozone economy, the German economy still has to digest the full impact of the ECB rate hikes. Demand for mortgages has already started to drop and in previous hiking cycles it didn't take long before the demand for business loans also started to drop.

While the German economy will still have to cope with the delayed impacts of last year's crises, there are a few positive developments: the reopening of China could help the battered export sector, and the prospects of decreasing inflation rates could support private consumption. However, when it comes to inflation, do not forget that households will not benefit from lower gas wholesale prices but are only now confronted with the pass-through of the energy price surge of 2022. At the same time, wage growth of at least 5% year-on-year this year and another 3-4% next year as well as the pass-through of high energy prices to other sectors of the economy will leave core inflation stubbornly high.

Germany's economic outlook for this year looks complicated, to say the least, with an unprecedentedly high number of uncertainties and developments in opposing directions. And there is more. Let's not forget that the German economy is still facing a series of structural challenges which are likely to weigh on growth this year and beyond: energy supply in the winter of 2023/24 and the broader energy transition towards renewables, changing global trade with more geopolitical risks and changes to supply chains, high investment needs for digitalisation and infrastructure, and an increasing lack of skilled workers. This long list embodies both risks and opportunities. If historical lessons from previous structural transitions are of any guidance, even if managed in the most optimal way, it will take a few years before the economy can actually thrive again.

The German economy in a nutshell

	2021	2022F	2023F	2024F
GDP	2.6	1.9	-0.1	0.5
Private consumption	0.4	4.9	0.6	0.5
Investment	1.0	0.4	0.4	4.0
Government consumption	3.8	2.3	6.5	4,2
Net trade contribution	0.7	-1.4	-1.4	-1.0
Headline CPI	3.1	8.7	5.5	2.8
Unemployment rate (%))	3.6	3.2	3.5	3.3
Budget balance as % of GDP	-3.7	-2.6	-4.5	-2.5
Government debt as % of GDP	71.0	72.0	70.0	68.0

Source: Thomson Reuters, all forecasts ING estimates

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