Germany: A recession is coming

The economic impact of Covid-19 and financial market turmoil make a technical recession in Germany look all but inevitable. We expect the Germany economy to shrink by more than 1.5% YoY in 2020

Source: Shutterstock

In one word: Panic

The ZEW index, gauging financial analysts' sentiment and take on the economic situation, plummeted in March, recording the sharpest monthly decline ever.

The ZEW index fell to -49.5 in March, from +8.7 in February, and is now at its lowest level since December 2011.

As in all European countries, the situation is Germany is fast-moving. Yesterday, chancellor Angela Merkel announced the so-called general guidelines for a lockdown of Germany. All shops will be closed except for groceries, pharmacies, banks and gas stations. No more gatherings, no tourism either domestically or internationally, no church services and even playgrounds should be closed. Cultural and sport events are also no longer allowed. Restaurants can stay open, but only until 6pm.

There is no end date attached to these measures. However, the fact that these are guidelines illustrates how the federal structure of the country is currently hampering swift decisions. It is the regional states which are responsible for the implementation of the measures and implementation differs across the different states.

Economic impact of Covid-19 and financial market turmoil

The economic impact of all of this remains hard to assess. It is the archetype of a fast-moving environment. Just this morning, a large car manufacturer announced temporary production stops and more will follow.

> *In our view, the German economy is likely to experience a recession in the first half of the year*

With the lockdown, there will be a sharp fall in private consumption to at least 4% compared with the levels at the end of last year. The exact timing of the lockdown in the different regional states and obviously the eventual length of the lockdown will determine how the contraction in consumption and activity will be spread across Q1 and Q2.

In our view, the German economy is likely to experience a recession in the first half of the year, in terms of the plain GDP data, we are probably getting close to numbers seen during the financial crisis. Back then, the German economy fell by 1.6% QoQ in 4Q08 and 4.7% QoQ in 1Q09, mainly driven by a sharp fall of exports. In the current crisis, the hits will come from several sides. Based on the currently available information, we now expect the German economy to shrink by more than 1.5% YoY in 2020.

More fiscal response to come

The German government's reaction to the economic impact of Covid-19 and the ongoing financial market turmoil has been very similar to that of other governments. It is currently a combination of investments in R&D to find a vaccine and to equip the health care sector, a stepping up of already existing longer-term investment plans, tax deferrals, an easing of the hurdles to apply for short-time work schemes and an increase in government support for these schemes as well as bank guarantees and liquidity support of more than €500bn.

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An impressive package, which still might not be enough to cushion the economic impact from Covid-19, particularly the loss of income and demand. In this regard, it is remarkable that last night in a TV talk show the German Minister of Economic Affairs, Peter Altmaier, promised that no single job would be lost due to Covid-19. Definitely not an easy promise to make.

We take the government's measures and communication as clear evidence that this 'whatever-it-takes' is credible. We expect more traditional fiscal stimulus in the months ahead.

Think of tax forbearance, temporary tax cuts or the government taking over rent or other cost payments from SMEs. Even additional measures will in our view be insufficient to avoid a recession in the first half of the year but they could pave the way towards a solid path to a strong recovery.

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