Just when you thought things couldn't get worse in Germany...

This summer break has not helped to improve the German economy's outlook. To the contrary, two new risk factors can be added to the long list of risks and challenges: low water levels and a gas levy. It will need an economic miracle for Germany not to fall into recession in the second half of the year

Low water levels in Germany and extreme weather are putting a dent in shipping and trade

Returning from the summer break always helps when looking at the bright side of economic prospects. Less stressed economists make less pessimistic forecasts is an often heard truism. Well, at least when you follow the German economy, no summer break in the world can have been long enough to make the short-term economic forecast more optimistic. To the contrary, two new downside risks have been added to a long list of risks and challenges for the German economy: low water levels and a gas levy.

Low water levels

As many parts of Europe, Germany has been hit by a long, unprecedented drought. Water levels have been dropping continuously over the summer and last week, the water level on the Rhine River fell under the critical 40 cm mark. Barges can no longer be loaded at full capacity but at a maximum of one-third and some routes will be cancelled. This is not where it stops. Industry facilities at the shores of the Rhine will increasingly have problems to use water for cooling.

Back in 2018, low water levels shaved off some 0.3 percentage points of German GDP growth over two quarters. However, back then, the low water period only came in late-September. This time around, low water levels have come earlier and there is little rain relief in sight. To make things worse, waterways are essential for coal transportation, which in turn is needed to offset fewer gas from Russia. This means that unless the weather brings any substantial relief, the low water levels will do more economic harm than in 2018. We expect the low water levels to shave off at least 0.5 percentage points of GDP growth in the second half of the year.

Gas levy

This morning, the German government announced a gas levy for households and businesses, which will come into effect in October. This surcharge was set at 2.4 euro cents per kilowatt hour. Current gas prices are around 17 euro cents. This levy is meant to cover the additional costs incurred by gas providers, as higher wholesale gas prices couldn't be passed through to consumers, yet. It is still unclear whether this surcharge is including or excluding VAT.

Almost half of German households are heated using gas and gas remains an important energy source for industry. According government estimates, the levy will lead to an additional cost of around 500 euro per year for a four-person household. However, don't forget that next winter, energy providers will be able to pass through higher energy prices to consumers as they can adjust prices once a year. The government announced that it is looking into compensating measures for lower income households, possibly an increase in child benefits, income tax reductions or direct financial support. Such measures could smoothen the negative impact of the levy on growth but not on inflation. With this new gas levy, we now expect headline inflation to reach double-digit levels in the final quarter of the year.

Recession, now almost for sure

A recession of the German economy had already been our base-case scenario at the start of the summer. High energy and commodity prices, ongoing supply chain frictions and the war in Ukraine were reasons. The fact that the entire German economic business model is currently up for renovation will also weigh on the economy's growth prospects in the coming years. With the new levy and the impact from the low water levels, inflation rates at double-digit levels almost look like a done deal for the final quarter of the year and it would need an economic miracle to avoid a recession in the second half of the year. For the entire year, we now expect GDP growth to come somewhere between 0.5% and 1%. There have been better moments for German economists to return from their summer break...

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