

Euro Focus: Germany is facing a perfect storm

At the start of the year, we singled out the German economy as one of the eurozone's shining growth stars. The war in Ukraine has changed everything. Recession is the new base case



Dangerously low water levels on the Rhine in Germany are yet another recessionary factor for the country

The German economy is quickly approaching a perfect storm. The war in Ukraine has probably marked the end of Germany's very successful economic business model: importing cheap (Russian) energy and input goods, while exporting high-quality products to the world, benefitting from globalisation. The country is now in the middle of a complete overhaul, accelerating the green transition, restructuring supply chains, and preparing for a less globalised world. And these things come on top of well-known long-standing issues, such as a lack of digitalisation, tired infrastructure, and an ageing society, to mention a few.

In the coming weeks and months, these longer-term changes will be overshadowed by shorter-term problems: high inflation, possible energy supply disruptions, and ongoing supply chain frictions. Last but not least, since the summer the shorter-term problems have become larger as low water levels and a new gas levy have added to inflation and recession concerns.

Low water levels

Like 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. Barges can no longer be loaded at full capacity but at a maximum of one-third and some routes will be cancelled. But there's more: industry facilities on the Rhine River shores will increasingly have problems using 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 less 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 and high energy prices

The German government announced a gas levy for households and businesses, which will come into effect in October. 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.

Almost half of all German households are heated using gas and it remains an important energy source for industry. According to government estimates, the levy will lead to an additional cost of around 500 euros 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. Households and corporates will be facing energy bills two to four times that of recent years. The government is currently discussing additional compensation measures for lower-income households, possibly an increase in child benefits, income tax reductions or direct financial support.

Recession has become inevitable

An economic recession in Germany was already our base-case scenario at the start of the summer, due to high energy and commodity prices, ongoing supply chain frictions, and the war in Ukraine. With these latest developments, the question is no longer whether the economy will enter a recession; the only question is how deep it will be.

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