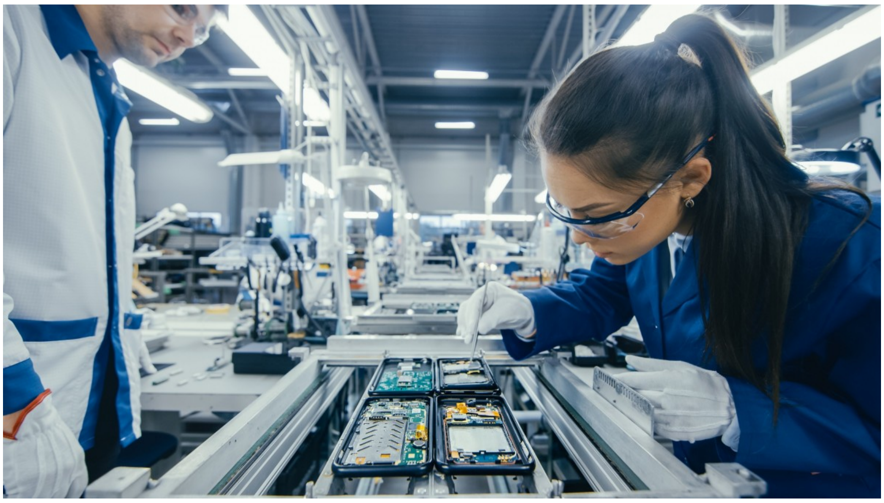
German industrial data points to end of stagnation in the first quarter

While sentiment indicators in German industry have been stuck at low levels since late last summer, this morning's industrial data already points to an end of stagnation in the first quarter



Industrial data increased by 2.1% month-on-month in February, the second monthly increase in a row. On the year, industrial production was still down by 4.9%. Today's improvement in industrial production was driven by almost all sectors except for energy production. Activity in the construction sector benefitted from the mild winter weather and a general improvement in the real estate sector, surging by almost 8% month-on-month.

At the same time, exports lost some of their January gains in February, dropping by 2% MoM from 6.3% MoM in January. February imports increased by 3.2% MoM, narrowing the trade balance to €21.4bn from €27.6bn in January. Don't forget that this is in nominal terms and not corrected for high inflation. To put this trade data into perspective: on the year, exports were down by more than 5% and imports by almost 9%.

End of cyclical downswing, not of structural weakness

What we are currently seeing in German industry is a cyclical improvement, not a structural one. In fact, industrial production is still some 8% below its pre-pandemic level. Interestingly, German trade is experiencing shifts in global trade and geopolitical tensions. The share of exports to the US increased to more than 10% of total exports in 2023, while the share of exports to China dropped to 6%, significantly below pre-pandemic levels. At the same time, Germany exported more to Poland, the Czech Republic and Hungary than to the US.

Looking ahead, as much as today's industrial data is a balm for the German economic soul, this is not yet the start of a significant recovery. In fact, last week's industrial orders data indicated that, except for bulk orders in December, demand for German industrial goods has not yet turned around. Also, after an initial inventory correction at the turn of the year, the expected inventory reduction has stalled again. Still, somewhat lower interest rates, anticipating the upcoming European Central Bank rate cuts, lower gas and electricity prices, and the resilience of the US economy should bring more relief to German industry over the coming months. Even if partly offset by higher oil prices and supply chain frictions due to the Suez Canal conflict and geopolitical tensions. Needless to say that the structural challenges – like shifts in global supply chains or from manufacturing to services, as well as the green transition and policy uncertainty – will not disappear overnight.

Economy could have left stagnation earlier than expected

With two months of hard data for the first quarter, there is finally a reason for moderate optimism that at least the cyclical downswing has come to an end. In fact, industrial production is now up on the quarter, and the surge in activity in the construction sector in particular sends an encouraging signal. While private consumption has been a drag on the economy in the first months of the year, today's data provides hope that the economy could already have left stagnation in the first quarter.

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