German economy avoids summer recession, but a winter recession is looming

The German economy grew by a meagre 0.1% quarter-on-quarter in the third quarter, just avoiding an official technical recession. However, the latest developments suggest that a winter recession is still looming

Beyond this winter, the German growth outlook will heavily depend on the new government's ability to strengthen the domestic economy amid a potential trade war

The positive surprise just got less positive. The second estimate of German GDP growth in the third quarter showed that the economy only just avoided a summer recession. GDP growth came in at 0.1% quarter-on-quarter, from +0.2% QoQ in the first estimate. Given that the economy shrank by 0.3% QoQ in the second quarter, today's headline number shouldn't be taken as a sign of a rebound, but rather as a confirmation that the German economy is stuck in stagnation and is now hardly any larger than at the start of the pandemic more than four years ago.

What is new today is the GDP components showing that private consumption and inventory build-up were the main drivers of the economy in the third quarter, while net exports and investments were a drag. The large contribution of inventory build up over the last two quarters in particular does not bode well for the next quarters as soon as inventory reduction takes place.

Winter recession looming

You have heard it before that the current state of the German economy is the result of both cyclical and structural headwinds. The pandemic and the war in Ukraine have accelerated the structural weakness but are not the core reasons for the current situation. In a world where China has become the "new Germany" – at least in manufacturing – Germany's old macro business model of cheap energy and easily accessible large export markets is no longer working. The negative news flow of recent months with company restructurings, a still-growing number of insolvencies and even the collapse of the government illustrate the toll four years of stagnation can take.

Looking ahead, there is very little reason to expect any imminent change for the economy. In fact, the expected economic policies of the incoming US administration as well as continued policy uncertainty as a result of the German government's collapse are likely to weigh on sentiment in Germany. Whether it's the prospects of tariffs or US tax cuts and deregulation indirectly undermining German competitiveness, it's hard to see how US economic policies will not be negative for the German economy.

On a more positive note, a new government could – emphasis on could, not will – finally end the current economic policy paralysis in Germany and provide the country with the long-awaited economic policy certainty and guidance on how to restore growth and competitiveness. The policy prescriptions of deregulation, lower taxes, reducing red tape and investments in infrastructure, digitalisation and education are all very well known. Implementing them without at least temporarily deviating from the fiscal debt brake currently looks like an almost impossible challenge.

Even if the German economy avoided a summer recession, a winter recession is looming. Looking beyond the winter, the German growth outlook will heavily depend on the new government's ability to strengthen the domestic economy amid a potential trade war and even stronger industrial policies in the US.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de