German economy falls back into contraction

A disappointing shrinking of the German economy in the second quarter illustrates how difficult it will be to escape the current dismal combination of both cyclical and structural headwinds

Germany's economic growth in the second quarter was as underwhelming as the country's modest medal tally at the Paris Olympics so far. According to the first estimate, the German economy fell back into contraction as GDP growth dropped by 0.1% quarter-on-quarter in the second quarter of the year, from +0.2% QoQ in the first quarter. On the year, GDP growth was down by 0.1%. Details will only be released next month but it looks as if investment and the construction sector were the biggest drags on the economy. The biggest caveat to this first estimate, however, is that there are no single hard data points for the month of June available, yet, and the statistical office used a model-based approach to fill the gap. As the hard macro data for the month of May looked slightly blurred by the high number of public holidays, a positive surprise in June and hence an upward revision of today's GDP growth estimate is still possible.

Stuck in stagnation

The German economy started the year with optimism. First-quarter GDP growth surprised to the upside, and confidence indicators improved, giving rise to hopes that the pessimism of the last few years was left behind and that the discussion on whether or not Germany was Europe's sick man could be shelved again. In truth, however, GDP growth in the first quarter was driven by the mild winter weather and a downward revision of fourth quarter GDP. Hence, it was not what we would call a sustainable and healthy growth story from the start. Today's data shows that the story hasn't improved. Germany has gone through a very mild recovery that actually never was. In fact, the size of the German economy is currently smaller than two years ago.

Between hope and despair

Looking ahead, the German economy will continue to hover between hope and despair. The recent drop in sentiment indicators points was clearly a disappointment. With both the US and the Chinese economies losing momentum, along with new trade tensions, there is very little hope for a strong export-driven recovery. Also, weak industrial orders, high inventory levels and precautionary savings are still weighing on the economy. On top of that, the increasing number of insolvencies and individual company announcements of forthcoming job restructurings are still hanging like the Sword of Damocles over the labour market this year.

However, despite a weak start to the second half of the year, don't rule out potential positive surprises. In fact, extremely weak May data could have been exaggerated due to many public holidays and long weekends. Plus, only a small improvement in industrial order books is needed to get industrial production growing again, admittedly from low levels. The highest increase in real wages in more than a decade should also loosen even German consumers' traditionally very tight wallets eventually.

All in all, today's data once again confirms that Germany is the growth laggard of the eurozone. Caught between cyclical and structural headwinds, there is no easy way out of this long stagnation. Nevertheless, a rebound in the second half of the year is still possible, even though it is highly unlikely that it will be a strong one.

Author

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

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