

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



Today's data could support the case against more ECB rate cuts

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

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial

Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.