German economy leaves stagnation behind

The details of first quarter GDP growth illustrate that the cycle has turned, but it's a very gradual transition

The second estimate didn't change anything; the German economy left the period of stagnation behind in the first quarter of the year. The return to growth benefited from the GDP downward revision for the fourth quarter and a pick-up in construction activity as well as net exports. In more detail, GDP growth came in at 0.2% quarter-on-quarter, from a downwardly revised -0.5% QoQ in the fourth quarter. On the year, the German economy was still down by 0.2% when corrected for working days.

Activity in the construction sector increased by 2.7% QoQ, while both private and public consumption dropped by 0.4% QoQ. As activity in the construction sector clearly benefited from the mild winter weather and not yet a fundamental improvement, first quarter growth brings some relief but is no reason to be overly cheerful, yet.

Structural weaknesses put speed limit on the recovery

The words 'optimism' and 'German economy' together in one sentence have been a rarity for a long while but now optimism has returned to the German economy. Today's GDP growth data is almost the natural next step of stronger sentiment indicators and a pick-up in activity since the start of the year. The cycle has definitely started to turn for the better. However, before getting overly excited, even after today's GDP data, the economy is still not yet back to its early 2022 level. In fact, German GDP growth has been zigzagging around zero since the Russian invasion of Ukraine.

Looking ahead, the German economy should gain more momentum. Strong wage growth should fuel a cautious recovery in private consumption and even the inventory cycle should gradually start to turn positive. However, this cyclical improvement does not mean that everything is suddenly hunky-dory again in Germany. There are still several cyclical factors potentially dragging down economic activity. Higher oil prices as a result of the ongoing military conflicts in the Middle East could easily weigh on industry and exports once again. Also, the increasing number of insolvencies and individual company announcements of upcoming job restructurings are fuelling the risk of a weakening labour market this year. Finally, besides the potential cyclical headwinds, Germany's well-known structural weaknesses will not disappear overnight and will limit the pace of any rebound. We currently expect the German economy to grow by some 0.3% this year.

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