

## German economy surprises to the upside

German GDP growth in the first quarter of 2022 came in higher than expected, reflecting a solid start to the year. However, do not expect this positive trend to continue



Recession avoided. According to the statistical office's flash estimate, the German economy grew by 0.2% quarter-on-quarter in the first quarter of 2022, from -0.3% QoQ in 4Q 2021. On the year, the economy grew by 3.7%. However, don't forget that even with this small growth surprise, the German economy is still below pre-pandemic levels. GDP components will only be released later in May but according to the statistical office, investment was the main driver of growth.

### Worse times ahead

With the war in Ukraine, today's GDP growth data has never been more backward-looking. The much more interesting question is how the economy will perform in the second quarter and beyond, against the backdrop of high energy and commodity prices as well as continuing and new supply chain frictions. Soft indicators for industrial and business activities have been painting a surprisingly positive picture, while consumer confidence dropped to an all-time low.

We find it hard to share the optimism reflected in some of the soft indicators. Supply chains are still disrupted due to the Shanghai lockdown and the war in Ukraine. Some might be disrupted for good. Elevated uncertainty and fear will weigh on both supply and demand in the coming months.

Real disposable incomes of households will suffer, and companies will have increasing difficulties dealing with the costs of higher energy and commodity prices, putting corporate profit margins under pressure.

Even worse, with high energy and commodity prices for a protracted period, potential energy supply interruptions, an acceleration of deglobalisation, a possible new cold war, and an export-orientated economy highly dependent on energy, imports will of course suffer. Government support schemes will dampen the adverse impact of the war but will not be able to avoid stagflation. In such a scenario, the German economy would have trouble returning to its pre-pandemic level this year.

So let's not get overly enthusiastic about today's German GDP numbers. Of course, meagre growth is better than no growth, but the fact that the contraction in the fourth quarter of 2021 was not even offset and the still rather downbeat outlook clearly argue in favour of modesty.

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