German economy surprises in the third quarter

The German economy avoided a technical recession in the third quarter, showing unexpected growth. However, this does not change the fact that the economy remains stuck in stagnation

A recession has been avoided. Has all the drama just been exaggerated? After a stream of negative economic news, the German economy just posted a positive surprise.

According to the just-released flash estimate, the German economy grew by 0.2 % quarter-on-quarter in the third quarter, from an initial -0.1% QoQ in the second. On the year, the economy shrank by 0.2%. This positive surprise is somewhat dampened by the downward revision of the second quarter's contraction to -0.3% QoQ, from the initially reported -0.1% QoQ.

As a result, although a technical recession was avoided, the German economy remains barely larger than it was at the start of the pandemic. According to the statistical agency, the unexpected growth was driven by both private and public consumption.

Germany remains a magnet for negative macro news

If at first glance today's data brings some relief, the German economy currently remains a magnet for negative macro news. Since the start of the pandemic, quarterly growth has stagnated on average. And at the risk of sounding like a broken record, 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 original reasons for the current situation. In a world in which, at least in manufacturing, China has become the "new Germany", Germany's old macro business model of cheap energy and easily accessible large export markets is no longer working.

One, two, three years of stagnation

Looking ahead, there is very little reason to expect any imminent relief. In fact, the increasing number of insolvencies and individual company announcements of upcoming job restructurings are still hanging like the Sword of Damocles over what has been one of the few strongholds of the economy in recent years: the labour market. The case of Volkswagen suggests that the labour market could be turning swiftly and wage growth could decline. Job security instead of wage increases could soon be the new mantra in the German labour market. This morning's labour market data showed the weakest October performance of the labour market since the late 1990s.

On a more positive note, last week's rebound in the PMIs and the Ifo index suggests that the German economy can at least avoid a severe recession and is rather likely to move horizontally over the coming months. The main risks are possible US tariffs on European goods and a self-reinforcing negative loop on the back of more disappointing corporate news and few new policy answers from the German government.

Speaking of the German government, the awareness that the economic weakness is more than a cyclical dip has finally arrived. The step towards formulating policy answers, however, has not yet been made, at least not in a unified and coherent manner. Yesterday, for example, there were two different meetings with both Chancellor Olaf Scholz and Finance Minister Christian Lindner. Unfortunately, no clear results emerged from these discussions. It looks a little bit like "everything, everywhere, all separately". Today's positive surprise shouldn't blind German policymakers. As long as there is no clear policy guidance, an end to the stagnation looks unlikely.

All in all, today's GDP data brings welcome relief to the battered German soul. However, it doesn't take away the fact that the economy remains stuck in stagnation. At least it is not falling into a severe recession. It's the small things that matter these days.

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