

# German industry holds up, but not enough to stop a recession

A small increase in industrial production in May is too little to take away our recession fears for the German economy



On the year, industrial production was down 1.4%

Industrial production just wrapped up an entire batch of weak May macro data in Germany. Output increased by 0.2% month-on-month in May, from an upwardly revised +1.3% MoM in April. On the year, industrial production was down 1.4%. Compared with the first quarter, however, industrial production is still down. Weak activity in the construction sector could be another drag on the entire economy. We continue to expect a contraction of the German economy in the second quarter.

## Solid confidence indicators but too weak hard data

At face value, absolute levels of most leading indicators suggest that the German economy should have grown in the second quarter. However, supportive factors for the economy such as post-lockdown reopenings and filled order books have been losing momentum rapidly. Weaker global demand, supply chain frictions, and high inflation denting consumption are hitting the German economy. In fact, consumer confidence is already in clear recession territory and it looks as if the rest of the economy is quickly following suit.

This week's macro data have increased the risk that the economy has already dropped into recessionary territory in the second quarter. Order books have continued to shrink, retail sales remained weak, the trade balance showed a monthly deficit for the first time since 1991, and now, despite today's small increase, industrial production remains too weak to be a growth driver.

## Question is not if but how long the economy will be in recessionary territory

Looking ahead, even if the current holiday mood wants to make us believe that all is well, the outlook for the German economy is anything but rosy. Currently, in the base case scenario with continuing supply chain frictions, uncertainty and high or higher energy and commodity prices as a result of the ongoing war in Ukraine, the German economy will be pushed into a technical recession. 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. A scarce silver lining – not only for the German industry but for the entire economy – is the green transition and the need for investment. Actually, these investments are urgently needed as the three pillars of Germany's successful economic business model – exports, industry and energy – have become Germany's Achilles' heel.

Needless to say that currently there are more downside than upside risks to the outlook. The single largest risk is further disruptions to Germany's energy consumption and a complete stop in the Russian gas supply. Currently, Germany's gas reserves are filled by less than 60%. To get through the winter without any Russian gas, the government intended to have reserves filled up to 90%. A target that increasingly looks unachievable. It will not take until the winter before the energy crisis will escalate further. The government's decisions to bail out an energy company and to change the so-called pricing adjustment mechanism, which allows firms to pass on costs to the consumer, as well as the fact that NordStream 1 will be – temporarily – offline as of next Monday, are just a few illustrations of what could become a perfect storm. It's probably time to dig out all these different estimates of the economic impact a full ban on Russian gas and oil could have on the economy.

All in all, this week's macro data were yet another disappointment for the German economy. The main question is no longer whether the economy could contract this year but rather for how long it will be in recessionary territory.

### Author

#### Carsten Brzeski

Global Head of Macro

[carsten.brzeski@ing.de](mailto: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](http://www.ing.com).