November rebound in German industry comes too late to avoid another quarter of stagnation

The recently reported rebound in German industrial production and exports is a welcome relief, but it will likely come too late to prevent another quarter of stagnation

German industrial production increased by 1.5% in November, recovering from a 0.4% decline in October. However, industrial production is still down almost 3% on the year. The rebound was across all sectors.

At the same time, exports grew by 2.1% MoM in November, while imports dropped by more than 3% MoM.

This rebound in industrial activity unfortunately comes too late to avoid another quarter of stagnation or even contraction.

No substantial improvement in sight

Currently, any data point that isn't negative is considered positive news for the German economy, and this morning's industrial data is no exception. However, today's increase is not an indication of a recovery; it's more of a technical rebound following two months of contraction, highlighting the ongoing slump in German industry. There would need to be another small increase in December to avoid another quarter of shrinking industrial production. A highly unlikely scenario given that several companies stopped production in December as a result of surging energy prices.

Looking at the broader picture, the German industry has been the best example of the entire economy's problems over the last few years: stuck between cyclical and structural headwinds and finally realising that the old macro business model of cheap energy and easily accessible large export markets is no longer working.

Five years after the onset of the Covid-19 pandemic, German industrial production remains about 10% below its pre-pandemic levels. Manufacturing capacity utilisation is at lows comparable only to those seen during the financial crisis and the initial lockdowns. This paints a rather unflattering picture of a nation known as an industrial powerhouse.

Looking ahead, besides some rather technical rebounds, a substantial recovery of German industry is not in sight, yet. Inventories have continued to increase, instead of turning, and have now been at elevated levels for more than a year. At the same time, order books have also not started to recover; the important turning of the inventory cycle has still not started.

Add to this looming tariffs and the expected modern version of 'beggar-thy-neighbour' policies by the incoming new US administration, and the outlook for German industry remains anything but rosy. Not just because of the potential impact on German exports, but more so the effect on German investments if companies were to move production to the US.

What will 2025 bring?

Next week will bring the first estimate of German GDP growth in 2024 and it currently looks as if the economy will have had another year of meagre contraction. It would be the first time since the early 2000s that the German economy contracted in two consecutive years.

Will 2025 be another year of contraction or a year of turnaround? Hope for the German economy comes from two sides: a more modest approach to the anticipated beggar-thy-neighbour policies in the US, and a surge in confidence and growth in Germany after the elections. Regarding the latter, the more optimistic scenario includes a new government that agrees on structural reforms, investments and looser fiscal policy. Whether looser fiscal policy also means a reform of the constitutional debt brake or just some workarounds via exemptions or special purpose vehicles depends on the outcome of the elections.

Given the growing consensus across most parties on the need for more investments, we see looser fiscal policies in Germany materialising, at the latest in 2026. Even if based on current polls, forming a government coalition after the elections will already be a challenge. Just to make up for the investment gap accumulated over the last decade, Germany would need additional investments of 1.5% GDP per year over the next 10 years. This is not all public investments, but the government will have to play an important role in providing public goods like infrastructure and education and creating incentives for private investments. Currently, the most likely outcome after the elections is at least an infrastructure investment fund.

At the same time, however, it is also becoming increasingly clear that even in a best-case scenario with reforms and investments, any new government will not try to overhaul the old economic business model, but rather try to rejuvenate the old one. Less red tape, some tax cuts to stimulate spending and investments, possibly attempts to lower energy costs and infrastructure investment – all of which feature in any European economist's wish list, and a growth booster for the economy.

Whether these measures will really be sufficient in competing against China and the US is a completely different question. What Germany would get is a refurbished model of its economy – clearly better than the old one with cracks, battery failures and very few gadgets, but also not a shiny, sprinkling new model that makes the competition speechless.

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