Industrial data shows German economy was headed for contraction before Middle East war

Industrial production dropped in February, illustrating the unexpected difficulties German industry is up against while trying to gain positive momentum. The economy seems to have fallen into contraction once again

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German industrial production struggled to gain momentum even before the war in the Middle East started. In February, industrial production dropped by 0.3% month-on-month, from an upwardly revised stagnation in January. On the year, industrial production was unchanged. The February drop was mainly driven by weaker production in the pharmaceuticals and electronics industries, while production in the automotive industry rebounded. Due to the cold winter weather, activity in the construction sector dropped by more than 1% MoM. At the same time, however, exports staged a strong rebound, surging by 3.6% MoM. As imports increased by almost 5% MoM, the trade surplus narrowed somewhat – but at €19.8bn, it remains at historically high levels.

German economy on track for yet another quarter of contraction

This morning's macro data is the last release to paint a picture of the German economy before the war in the Middle East began. It's a picture of a very reluctant, hesitant consumer, but of a manufacturing sector that is struggling to gain positive momentum. The only piece of evidence currently keeping our ketchup bottle comparison alive was yesterday's industrial orders data, confirming that order books in the defence industry continue to fill. At least some support for our long-held view that the fiscal stimulus will increasingly reach the real economy.

While the start of the year has been more cumbersome than expected, six weeks of war in the Middle East have only worsened the picture once again. The war in the Middle East and soaring energy prices have again exposed the fact that Germany is one of Europe's largest net importers of energy. Some 6% of its oil imports stem from countries in the Middle East. The so-called energy-intensive industries in Germany account for some 17% of industrial gross value added and employ just under one million people.

Admittedly, large corporates are currently probably still hedged against soaring oil prices, but SMEs are not, nor is there a hedge against deficits of physical oil. There is already anecdotal evidence of surging tarmac prices and upcoming supply frictions. As in 2022, this first inflation wave – from higher energy prices to knock-on effects on transportation and food, as well as products that need oil – is already in full swing. It is not only hitting consumers but also the first line of companies that, due to contractual obligations, are unable to pass through higher costs immediately. Also, remember that in 2022, several energy-intensive companies reduced or halted production as high energy prices made production uneconomical. Last but not least, gas reserves are currently at their lowest level at this time of the year in five years, which could bring a cost-push for corporates and households next winter.

All in all, February's macro data shows that even without the war in the Middle East, the German economy was unfortunately on track for yet another quarter of contraction. To make things worse, the war in the Middle East, no matter how sustainable yesterday's announced ceasefire will prove to be, will leave clear marks on the German economy over the next few months. As much as we were hoping to finally comment on some good economic news from Germany, it is a bit like waiting for a German train these days: definitely delayed and uncertain whether it will ever arrive.

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