German industrial disappointment continues

German industry disappointed in May, indicating that the entire economy could have fallen back into negative territory in the second quarter

In the first months of the year, optimism had returned to the German economy. Growth in the first quarter and improving confidence indicators as well as a large dose of wishful thinking had given rise to this new optimism. As the second half of the year has just started, optimism has given way to more realism. The German economy is losing steam again.

After disappointing sentiment indicators for June, this morning's industrial production data was another cold shower for the optimists. Industrial production dropped by 2.5% month-on-month in May, from 0.1% MoM in April. On the year, industrial production was down by almost 7%. The drop was mainly driven by falling production in the automotive industry and another weakening in the construction sector. In fact, activity in the construction sector has dropped for three months in a row. As depressing as these numbers are, let's not forget that the month of May had an exceptional number of public holidays. Still, it would need a stellar performance by industrial production in June, with MoM growth of some 5%, to prevent a negative quarter for industrial production.

Economy loses steam before even getting close to full speed

Unfortunately, there is still very little evidence of a turn in the inventory cycle. Instead, inventory levels remain close to record highs and order books are becoming thinner and thinner. Yesterday's industrial orders data for May showed the fifth monthly drop this year. Since the start of the Russian invasion of Ukraine, German industrial orders have, on average, dropped by 0.7% every single month. Uncertainty in German industry, as measured by the European Commission's business survey indicator, is the second highest in the eurozone. Only Cyprus has a higher reading.

Looking ahead, even if today's numbers have increased the chances for the German economy to fall back into negative territory in the second quarter, it would be premature to give up on the German economy. Strong wage growth should fuel a cautious recovery in private consumption, and even though the inventory cycle hasn't turned yet, it won't take a lot to see at least a weak rebound in industrial activity later this year.

At the same time, however, there are still several cyclical factors potentially dragging down economic activity. Higher oil prices as a result of the ongoing military conflicts in the Middle East could easily weigh on industry and exports once again. Also, the increasing number of insolvencies and individual company announcements of upcoming job restructurings are not only fuelling the risk of a weakening labour market this year but also argue against a strong industrial rebound. Finally, besides the potential cyclical headwinds, Germany's well-known structural weaknesses will not disappear overnight and will limit the pace of any rebound.

All in all, after an encouraging start to the year, the German economy has not been able to meet the high expectations and is losing steam again far before reaching full speed. German football supporters will be hoping that the parallels between the German national team and the German economy will not hold, for once.

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