German GDP growth of -0.4% proves that a recession is in the making

The third estimate of German GDP growth in the final quarter of 2022 shows that celebrating resilience was a bit premature. A technical recession is in the making

We've previously had German GDP estimates of stagnation, of -0.2%, and -0.4%. Now we know the third estimate of German GDP growth in the final quarter of 2022 was the correct one. As just released by the German statistical office, the German economy contracted by 0.4% quarter-on-quarter in the fourth quarter of 2022, from +0.5% in the third quarter. This is the first contraction since the first quarter of 2021. On the year, GDP growth came in at 0.9%.

Recession is in the making

The economic contraction is no surprise. What is interesting in today's GDP report are the details. Private consumption without lockdown savings languished under high inflation and energy prices and fell by 1% quarter-on-quarter, from +0.7% in the third quarter. Capital investments plunged by 2.5% QoQ, from 1.3%. Net exports, government consumption and a large inventory build-up prevented the economy from falling into a deeper contraction.

The German economy has surprised by showing more resilience than feared, despite facing a long series of crises. However, while this resilience, driven by fiscal support and warm winter weather, has prevented the economy from falling into a deep recession, it is definitely no guarantee for a strong rebound anytime soon. In fact, even though sentiment indicators have increased in recent months, there is overwhelming evidence of a still weak economy. The second consecutive drop in the Ifo's current assessment component, a falling PMI manufacturing and, as reflected in this morning's data, weak consumer confidence and a willingness to spend close to historical lows, all confirm our view that the German economy will contract once again in the first quarter.

Recession in the short term and subdued recovery afterward

Looking beyond the first quarter, the latest improvement in soft data suggests that the German and eurozone economies are in the middle of a typical cyclical recovery, while we fear that we are actually in the middle of a structural transition. If we are right, any rebound this year will be softer and more short-lived than many expect, and subdued growth rather than a strong rebound remains the base case. Or in other words: not falling off the cliff is one thing; staging a strong rebound, however, is a different matter. In Germany, industrial orders have weakened since the start of 2022, consumer confidence, despite some recent improvements, is still close to historic lows, the loss of purchasing power will continue in 2023, and the full impact of monetary policy tightening still has to unfold.

Today's numbers mark the first part of what could become a technical recession in Germany. We think that the risk of yet another contraction in the first quarter and, thus, a technical recession is high and that the German economy is still miles away from staging a strong rebound.

Author

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de