

## Germany: And this is just the beginning

The worst contraction of the German economy since 2009 is not where the current crisis will end. The second quarter will be more dreadful



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The German economy shrank by 2.2% quarter-on-quarter in the first quarter, the sharpest drop since the first quarter of 2009, when the economy contracted by 4.7% QoQ. On the year, the German economy contracted by 2.3%. GDP components will only be released at the end of the month but according to available monthly data and the press release of the German statistical office, the construction sector and government consumption were the only growth drivers. Private consumption, investments and exports all were a drag on the economy.

Today's number does not come as a real surprise. Industrial data for March and earlier GDP reports from other eurozone countries as well as the first estimate for the eurozone as a whole (-3.8% QoQ) already indicated the potential size of the German slowdown. The fact that the German slowdown is less accentuated than in most other eurozone countries provides very little comfort. Two weeks of lockdown as well as supply chain disruptions on the back of lockdown measures elsewhere brought the German economy to its knees.

### **Data will get worse even if the worst might already be behind us**

Looking ahead, things will get worse before they get better. To be more precise, incoming data will be worse, even though the worst might already be behind us. If today's data are the result of two

weeks of lockdown, three more weeks of lockdown and a very gradual lifting of some measures do not bode well for the second quarter. However, more real-time data, such as Google mobility data, shows that activity had already accelerated by mid-May. While (social and economic) activity slowed down to 60% of its January level during the peak of the lockdown, it has now returned to more than 80%. The timing of the lifting of the lockdown measures as well as the huge fiscal support by the German government (more than 30% of GDP) support the view that the German economy could leave the crisis earlier and stronger than most other countries. Still, there is no reason for complacency or hubris.

## More differences than similarities with 2008/9

Contrary to the 2008/9 crisis, out of which Germany emerged faster and stronger, the economy entered the current crisis with more structural weakness. In 2008/9, Germany had just implemented structural reforms and was just at the start of a positive cycle. This time, it was at the end of a very mature cycle and in need of investments and new reforms. Also, back then, the Asian countries, which were hardly hit by the financial crisis, rebounded quickly and helped Germany's export-led recovery. There won't be any sugar daddy this time around. Consequently, the destiny of the German economy and its recovery depends more than ever on fiscal policy. Up to now, the government's fiscal reaction has been much faster and stronger than in 2008/9. To ensure a lasting recovery, however, more stimulus will be needed. In this regard, the current discussion in Berlin about a new stimulus package is good news. For the time being, things will get worse before they get better. Once they get better, the German economy is likely to move faster and stronger out of the starting blocks than the rest. However, a fast start alone will not win the marathon.

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