Germany: Consumption is the new export

Consumption and construction saved the economy from a technical recession in the third quarter

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The second estimate of 3Q GDP growth confirmed that the German economy had indeed avoided a technical recession at the last minute. GDP growth came in at 0.1% quarter-on-quarter, from -0.2% QoQ in the second quarter. On the year, the economy grew by 0.5% (calendar adjusted) in the third quarter. What is new are the GDP components. Third quarter growth was driven by strong private (+0.4% QoQ) and public (+0.8% QoQ) consumption. Activity in the construction sector grew by 1.2% QoQ, while investments dropped by 2.6% QoQ. At the same time, net exports were positive while inventory build-up shaved 0.7 percentage points from quarterly growth. The strength of private consumption, in particular, remains an important anti-recession insurance for the entire economy. In fact, private consumption has been growing consecutively every quarter since the start of 2014.

Recession avoided thanks to election gifts

One main reason why the economy has avoided recession is a long list of election gifts, often criticised as not increasing the long-term growth potential of the German economy. Over the last two years the government has agreed increases in child allowances, pensions and study allowances as well as some tax relief and more money for health care, elderly care and schools. For 2019, all of this has amounted to a fiscal stimulus of some 0.5% of GDP. So much for the urban legend that the German government is allergic to the idea of short-term fiscal stimulus.

Looking ahead, even though the German economy has avoided a technical recession, there are few signs of an imminent rebound for the weakened industrial sector. In fact, the economy has fallen into a de facto stagnation, with quarterly GDP growth averaging a meagre 0.1% QoQ since the third quarter of last year. Counting on only consumption and construction to offset the industrial downturn and on a possible rebound in global trade to cover the structural changes and disruption facing several key sectors of the entire economy might be a risky gamble. Therefore the debate on additional fiscal stimulus will continue, not in the sense of a short-term recession-fighting package but rather in the sense of a long-term investment package, tackling the structural weaknesses of the economy. In this regard, it was remarkable that earlier this week the German business association, BDI, and the trade union, DGB, normally not natural companions, presented a plea for not only an investment package of €450 billion over the next 10 years but also for a more flexible interpretation of the constitutional debt brake. €450 billion over 10 years would more than double the currently planned investment expenditures, bringing annual public investment spending to more than 2% of GDP. In a first reaction Chancellor Angela Merkel refuted these calls, saying that the economy would also be able to grow with the current budget plans. Still, below the surface there has been a significant turn in Germany this year regarding fiscal policy, away from strictly saying 'no' towards more flexibility. Some more fiscal stimulus next year and in subsequent years still looks likely.

Times can change

In the short run, however, the economy will continue to flirt with stagnation or even recession. After 10 years of almost unstoppable growth, this is not necessarily the end of the world. However, some time ago a growth model mainly driven by consumption and construction would have received quite some criticism. Particularly from one country: Germany. Do we need more evidence that times can change?

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