Germany's reopening party disturbed by supply chain frictions

The German economy rebounded in the second quarter, albeit at a slower pace than expected. Despite the downside risks to growth, we expect the economy to return to pre-pandemic levels before the end of the year and today's data shows that growth parties on the back of reopenings can easily be disturbed by other factors

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The flash estimate of German GDP growth in the second quarter confirmed important trends of the second quarter: the rebound in economic activity with the lifting of restrictions which was undermined by the negative impact from supply chain frictions. As a result, the economy grew by 1.5% quarter-on-quarter but 1Q growth was revised down to -2.1% QoQ.

On the year, GDP growth came in at 9.2%. According to the available monthly data as well as the German statistical agency's press statement, growth in the second quarter was mainly driven by private consumption and government expenditures.

Economic activity since the start of the pandemic has been closely linked to restrictions and social distancing. Therefore, the rebound of the German economy does not come as a surprise. However, this rebound is weaker than suggested by buoyant confidence indicators.

The reason for this gap between soft and hard data is clearly the long list of supply chain frictions, starting with the problems of the 'Evergiven' in the Suez Canal, continued with delays in production and delivery of microchips and semiconductors and could now be problems with the waterways due to heavy rains. The only good thing about these supply chain frictions is that eventually, they will end.

As order books are richly filled and inventories are still low, activity in the German industry will accelerate. At the same time, however, sentiment in the service sector is still far off from record highs and rather mute, while consumer spending could be undermined by higher inflation in the second half of the year.

Three factors to determine the outlook for the German economy

Looking ahead, three factors will determine the outlook for the German economy: the delta variant, supply chain frictions and inflation.

Any new restrictions on the back of the delta variant could easily derail a further acceleration of the economy. However, with the upcoming elections, we don't expect any significant new restrictions that could undermine domestic economic activity. Yesterday's announcement of stricter restrictions for returning travellers falls exactly into this category. Regarding supply chain frictions, it currently looks as if these problems could easily last until the end of the year, potentially putting a cap on growth. Finally, with headline inflation in our view moving further to 4% and above, it could dent private consumption.

Despite the above downside risks to growth, we expect the German economy to return to pre-crisis levels before the end of the year. Today's GDP data, however, show that growth parties on the back of reopenings can easily be disturbed by other factors.

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