Germany: Getting away with one black eye

The German economy had its weakest performance in five years but seems to have avoided a technical recession

A weak performance

The German economy had its weakest performance in five years in 2018, growing by only 1.5% YoY. This is the result of the just-released first estimate for the entire year. An official estimate of fourth-quarter growth will only be available in February but with 1.5%, it looks as if a technical recession could only just have been avoided. At the same time, the statistical agency recorded a record high fiscal surplus of 1.7% GDP.

A lot is about cars

Details of the annual growth composition are less relevant. What matters most is the fact that the slowdown of the German economy in the summer has been lasting longer than anticipated and seems to be more than only a temporary blip. The main reason for the unexpected cooling of the economy in the second half of the year is cars. Missed deadlines for the admission of new emission standards have led to an enormous inventory build-up in the second and third quarter of the year and a consequently very weak sales and now production performances. Also, the announced ban on cars with old diesel engines for several German cities has not only weakened car sales but also led to precautionary savings of households over the summer months.

Finally, still remotely related to cars, the drop in global oil prices initially did not bring relief to German customers as cheaper oil did not reach gas stations or heating oil companies due to the low water levels in many German rivers.

But there is more

Obviously, there is more to the German economy than cars. Increased uncertainty stemming from the trade conflict between the US and China as well as from Brexit has also weighed on the German economy. Nevertheless, the problems in the automotive industry illustrate the wider problem of the German economy: the slowdown is a combination of one-off and structural factors. Just think of the harsh winter weather, unusually high sickness leaves due to the flu, the timing of Easter and vacation, strikes and now recently low water levels in main rivers but also of the lack of investment in digital and traditional infrastructure, delays of railways and airlines or hardly any significant new structural reforms in the last ten years.

The future path of the economy clearly depends on which factors weigh more. If they're one-off factors, then a rebound of the entire economy looks plausible. Is they're structural , then the German economy should be prepared for a longer-lasting period of underperformance.

Getting away with one black eye

Looking ahead, there are still plenty of reasons to remain optimistic, even for German industry: despite the recent deflation of new orders, order books are still richly filled and companies still report assured production close to record highs and while capacity utilisation has dropped to its lowest level since the third quarter of 2017, the lack of equipment still is a more limiting factor to production than the lack of skilled workers. In addition to this, the recent pick-up in orders in the automotive industry and favourable financing conditions in the entire economy also bode well for at least solid industrial and investment activity in 2019. Needless to say that in the short run the biggest risk to this optimistic outlook is a disorderly Brexit which would come at the most inconvenient time for the German economy.

It currently looks as if the German economy could get away with one black eye but these days, economic strength in Germany doesn't come effortlessly.

Author

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