Germany: The black eye just got blacker

The year 2018, which started off with expectations of the best growth performance since 2011, ended with a big stinker.

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According to the first official estimate of fourth quarter GDP growth, the German economy just narrowly escaped a technical recession. GDP growth came in at zero, from -0.2% QoQ in 3Q. Year-on-year, GDP growth came in at 0.9% and 0.6% when adjusted for seasonal effects and working days. The growth composition will only be released at the end of the month but according to available monthly data and the statistical agency's press release, investments, private and public consumption were the main growth drivers, while net exports remained flat.

The weak performance of the German economy in the second half of the year is the result of (too many) one-offs, surfacing structural weaknesses and external uncertainties. Just think of cars, low water levels in main rivers, the trade conflict between the US and China, Brexit or the lack of investment in digital and traditional infrastructure, delays of railways and airlines as well as hardly any significant new structural reforms in the last ten years. What a list! However, it is still not necessarily the end of a long positive cycle.

Not losing our optimism

Looking ahead, there are still plenty of reasons to remain optimistic. Not only were there some encouraging data signals under the surface of recent macro data, there are also fundamental reasons to remain optimistic: the labour market is strong, consumers' willingness to spend at its highest level since April last year, order books are still richly filled and companies still report assured production close to record highs. 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. Add to this the positive fiscal stimulus provided by the government and there is a good counterweight to the latest drop in sentiment.

Don't forget politics

In the meantime, German politics is getting interesting (once again). In the very unique situation that no single party leader is actually member of the government, all parties are preparing for the upcoming European Elections and state elections in Bremen in late-May as well as for state elections in three Brandenburg, Thuringia and Saxony. Particularly, the European Elections and the Bremen elections will be crucial for the federal government as they will decide on the future of the SPD. Bremen is the last stronghold for the SPD, as it has ruled there since 1946. The upcoming elections explain the SPD's latest energetic efforts to present new policy proposals like higher pensions, an unconditional minimum pension and a further softening of previous labour market reforms illustrate an attempt to move to the political left wing. It seems obvious that these proposals will not easily find support from the CDU. However, if the SPD's attempt to move further towards the political left wing eventually receives positive feedback from the voters or at least party members, it could be the trigger to eventually exit the government towards the end of the year. For the time being, last night, the leading figures of the three coalition parties met for the first time this year. Keeping it quiet after last year's permanent quarrels apparently had the highest priority. How long this truce will last, however, is unclear. A fall of the current government coalition before the official end of its term in 2021 remains part of our German risk list.

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Back to today's GDP data. The German economy escaped a technical recession with the smallest margin possible. The black eye just got blacker. Still, the upside from today's data is that it can hardly get worse. Economic fundamentals remain solid and from here on, chances of a (gradual) rebound are still much higher than chances of yet another disappointment.

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