

Germany: The end of a golden decade

The economy shrank by 0.1% QoQ in the second quarter. Inevitably, the discussion about fiscal stimulus will get more heated



It's official: the German economy shrank by 0.1% quarter-on-quarter in the second quarter of the year, from +0.4% QoQ in the first quarter. On the year, the economy still grew by 0.4%, calendar and seasonally adjusted. GDP components will only be released at the end of the month, but available monthly data and the press release of the Statistical Agency suggest that private and government consumption were slightly up but trade and the construction sector were a drag on growth.

End of golden decade

Today's GDP report definitely marks the end of a golden decade for the German economy. Since the end of the 2008/09 recession, the economy has grown by an average of 0.5% QoQ every quarter. In fact, the economy grew in 35 out of the last 40 quarters. However, under the surface of these impressive headline numbers, a worrisome trend has emerged. Since 3Q 2018, the economy has been in a de facto stagnation, with quarterly GDP growth at an average of zero percent.

Today's GDP report definitely marks the end of a golden decade

for the German economy

Trade conflicts, global uncertainty and the struggling automotive sector have finally brought the German economy down on its knee. In particular, increased uncertainty, rather than direct effects from the trade conflicts, have dented sentiment and hence economic activity. Who remembers that one year ago, the biggest problem for the German economy was supply-side constraints? Last summer the entire economy was close to overheating; now the lack of demand has become a pressing issue. Even worse, this transition has taken place without the expected boost to investments. While the slowdown of the industry is not really new, recent developments show that the resilience of the domestic economy to external shocks is crumbling. Profit warnings, first lay-offs, an increase in short-time work schemes, falling consumer confidence and weaker activity in the service sector have sounded the alarm bells.

Let's be clear: the fact that the German economy is currently in stagnation is not the most disconcerting message after a long period of strong growth. It is the weakening of the domestic economy that is most worrisome.

What's next? Worsening, external relief or fiscal stimulus?

There is no need to panic, but instead to act. Looking ahead, the future path of the German economy highly depends on external events and government action. Obviously, any relief in the ongoing trade conflicts would benefit the German economy. Companies could still use extremely favourable financing conditions and invest. However, the principle of hope is not enough. The pressure on the German government to act will increase. However, any fiscal policy reaction will be more complicated than in 2008/09, when a typical Keynesian stimulus package kick-started the economy. At that time, state measures such as bank bailouts, scrapping and short-time working were successful because the economy was fundamentally sound. This time around, there are structural problems or at least challenges. Just think of digitalisation, infrastructure or the automotive industry. Therefore, Germany needs a two-pillar stimulus package: a short-term stimulus and an increase in the long-run growth potential. The buzzwords are well-known: digitisation, climate protection, energy transition, infrastructure and education.

Germany needs a two-pillar stimulus package: a short-term stimulus and an increase in the long-run growth potential

But will it happen? Even though it's still the end of summer and not every single media report implies policy changes, there seems to be growing support to agree on measures to tackle climate change in September, reduce the so-called solidarity tax and discuss additional investments into digitalisation. Don't forget that there is ample fiscal room for manoeuvre. The government's interest payments have dropped from 2.7% of GDP in 2008 to some 0.8% of GDP this year. The government could run fiscal deficits of some 1 ½% of GDP and the debt-to-GDP ratio would still stabilise at 60%. Running deficits instead of surpluses is currently still more than one bridge too far for the government. But some fiscal loosening looks in our view more likely than many might think. Otherwise the outlook of the German economy will basically be determined by external

factors.

Today's GDP data marks the end of a golden decade for the German economy. It was a decade of strong growth on the back of earlier structural reforms, fiscal stimulus, globalisation at its peak and steroids provided by the ECB in the form of low-interest rates and a relatively weak euro. This decade, in which strong German growth looked so effortless, is coming to an end.

However, like every end, there is a new beginning. The next months will show whether it is a beginning for the better or the worse.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.