Strong industrial data alleviates recession risk in Germany

German industrial production rose much more than expected in February. A technical recession has now been avoided, but we're expecting only subdued growth in the months ahead

This week's batch of hard economic data for February shows a strong comeback for German industry. Industrial production is the latest data point, released this morning, coming in at 2.0% month-on-month, from 3.7% MoM in January. On the year, industrial production was up by 0.6%. Production in the energy-intensive sectors increased by 1.9% MoM but is still down by some 12% compared with February 2022. Activity in the construction sector increased by 1.5% MoM.

German industry seems to have woken up from hibernation and has by now more than made up for the sharp plunge in December. The strong rebound seems to be driven by the reopening of China, strong activity in the automotive sector and a more general ongoing reduction of backlogs. Despite the strong rebound, however, industrial production is still slightly below its pre-pandemic level.

Technical recession avoided but only subdued growth ahead

Earlier this week, both exports and imports – in nominal terms – also surged in February. More importantly, the trade surplus was significantly higher in the first two months of the year than in the final quarter of 2022. At the same time, however, retail sales continued their winter descent. Taking all these data points together paints an economy that is en route to avoiding stagnation in the first quarter. It is, however, also an economy with a growing divergence between consumption and industrial activity. While the former looks like a structural feature on the back of still high inflation, the jury is still out whether the latter is just a short-lived rebound or a somewhat longer-lasting catching up.

Yesterday, leading German economic research institutes slightly revised upward their growth forecasts for 2023 to 0.3%, from -0.4%. While this created a collective sigh of relief in German media, we remain more cautious. Admittedly, this week's strong industrial data take away the risk of a technical recession. However, despite the recent surge in new orders, the inventory build-up as well as the expected slowdown of the US economy argue against too much industrial optimism. It would not be the first time that the German (and the European) economy starts the year on a positive note, just to lose momentum over the course of the year. Finally, don't forget that the recent financial turmoil and broader impact of the most aggressive monetary policy tightening in decades will weigh on economic activity.

More generally speaking, it doesn't really matter whether German GDP growth for the entire year comes in with a small contraction or meagre growth. What is more important is that the ongoing war in Ukraine, ongoing structural changes, continued geopolitical tensions and an ongoing energy transition are the main drivers of what seems like subdued growth for a long time.

Nevertheless, ahead of the long Easter weekend, today's industrial production data are a welcome sign of relief and evidence that German industry is more resilient than often feared.

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