The German economy can still grow after all

The German economy grew by 0.2% quarter-on-quarter in the first three months of the year but structural weaknesses will put a speed limit on the recovery

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The economy can still grow. Just as some German children have been asking their parents whether they remember a time when the economy was actually growing, the first estimate of 1Q GDP growth came in at 0.2% quarter-on-quarter, from a downwardly revised -0.5% QoQ in the fourth quarter. On the year, the German economy was still down by 0.2% when corrected for working days. There are no estimates for the GDP components but judging by the available monthly data, growth in the first quarter was mainly driven by the construction sector and net exports.

Structural weaknesses put speed limit on the recovery

The words 'optimism' and 'German economy' together in one sentence have been a rarity for a long while. However, for a few weeks now, optimism has returned to the German economy. Today's GDP growth data is almost just the natural next step of stronger sentiment indicators and a pick-up in activity since the start of the year. The cycle has definitely started to turn for the better. This cyclical turning point has been led by strong activity in the construction sector on the back of mild winter weather and a technical rebound in trade and industrial production. Judging by this morning's March retail sales data, even private consumption finally seems to be showing the first tentative signs of a rebound. This cyclical upswing looks set to continue in the second quarter.

With growth returning, the sun finally shining and two German football teams in the semifinals of the Champions League, is everything suddenly hunky-dory again in Germany? Was all the talk about structural deficits and challenges overdone? Well, not really. There are still several cyclical factors that are dragging down economic activity. Higher oil prices as a result of the military conflict between Iran and Israel, as well as the ongoing tensions in the Red Sea, are likely to weigh on industry and exports once again. Also, the increasing number of insolvencies and individual company announcements of upcoming job restructurings are fuelling the risk of a weakening labour market this year. Finally, besides the potential cyclical headwinds, Germany's well-known structural weaknesses will not disappear overnight and will limit the pace of any rebound this year.

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