GERMANY

DARK CLOUDS GATHERING

The question is no longer whether or not Germany will slide into recession, but rather when and to what extent. The surprising resilience of German GDP in the 2nd quarter should not disguise the significantly worse outlook for the rest of the year. With continuing supply constraints, the new risk of energy shortages, rising production costs and high and widespread inflation that severely reduces household purchasing power, Germany is unlikely to avoid a fall in its GDP. However, the extent of the downturn should be limited.

German GDP in fact exceeded expectations in the 2nd quarter by stabilising (+0.1% q/q), contrary to the expected fall. This was largely due to support from public consumption, which once again rose sharply (+2.3% q/q). The other drivers of domestic demand, private consumption and investment, have seen declines (-1.6% and -2% respectively below their levels at the end of 2019).

The prospects for Germany over the second half of the year are seriously threatened by the risk of energy shortages, particularly from 2 September, the date from which Gazprom has decided to shut down its gas deliveries via the NordStream1 pipeline. Although gas stocks should be replenished by early November, which will offer some security over the short term, they will only provide enough cover for two months' consumption. If there is a risk of a "blackout" the German government could voluntarily ration the supply to the industrial sectors, which consume the most energy. Four major sectors appear to be particularly energy-intensive: the chemical industry, wood/paper production, the metalworking industry, and rubber/plastic production (*Chart 2*). Even a partial shutdown of these industries would have a major impact on the country's activity since, on the one hand, they represent almost a third of the industry sector's added value (31.9%, i.e. 6.2% of GDP) and, on the other, they are also suppliers to a large number of other sectors.

The first indicators available for the current quarter already show a fairly significant decline in economic activity. Manufacturing production (-1% m/m in July to -4.8% below its pre-crisis level) and new orders for industry (-1.1% m/m in July, a drop of -9.3% since the start of 2022) are down. In terms of external trade, the deterioration is just as noticeable with a sharp reduction in the trade surplus (-800 billion euros over one month in July to 5.4 billion euros compared to around 20 billion euros at the end of 2019). Surveys confirm the decline in activity at the end of the 3rd quarter. August PMIs are down in both industry and services, with both sectors now below their technical expansion levels. Analysts surveyed in early September by the ZEW have revised their assessment of the current situation downwards (-1.8 pts m/m to 54.3) as well as their expectations for the next six months (-1.5 pts m/m to 55.3). Over 2022 as a whole, growth in GDP should be around 1.4% thanks to a carry-over effect of +1.8% at the end of Q2, but GDP is then expected to contract over the second part of the year. On the other hand, activity is expected to be more or less stagnant in 2023, with an expected growth rate of just 0.4%.

Germany is also having to cope with very high inflation. The harmonised consumer price index rose by +8.3% over one year in August. The energy shock has spread very rapidly to manufactured goods, which rose 14.7% y/y. Inflationary pressures are likely to continue for the rest of the year and inflation is expected to reach +8.1% on average over 2022, before slowing significantly in 2023, to +4.7%.

Although prices are continuing to increase, income paid to employees (including wages and bonuses) slowed in nominal terms in the 2nd quarter (+2.9% y/y following +4% y/y in Q1) due to the reduction in the distribution of bonuses, which resulted in a very sharp fall in earnings in real terms (-4.4% y/y following -1.8% y/y in Q1). Faced with such a decline in purchasing power, the government of Olaf Scholz announced new measures worth 65 billion euros (or 1.8% of GDP) on 4 September. These included: an energy allowance for pensioners (300 euros) and for students (200 euros), a further reduction in VAT on gas (from 19% to 7%), and the extension of the rail transport subsidy. With total expenditure exceeding 3.5% of its GDP according to Bruegel estimates, Germany is now one of the most interventionist countries in Europe against the backdrop of the inflationary shock and the energy crisis.

GROWTH & INFLATION

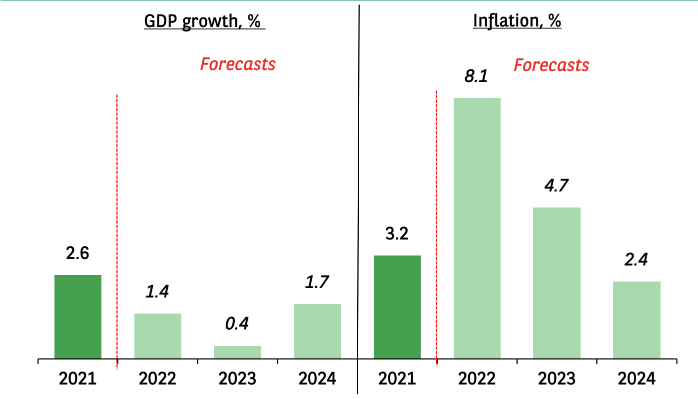

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

GERMANY: INDUSTRIAL ENERGY INTENSITY INDEX

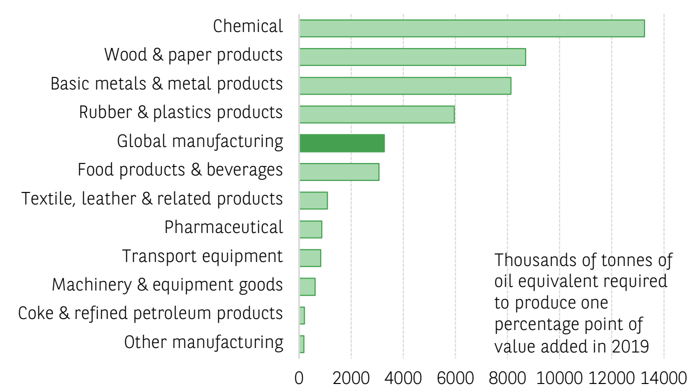

CHART 2 SOURCE: ANNUAL SURVEY OF INDUSTRIAL ENERGY CONSUMPTION (ASIEC, 2019), CALCULATION BNP PARIBAS

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