GERMANY

STANDORT DEUTSCHLAND?

The German economy is affected by the transmission of the inflationary shock to household consumption. However, the underperformance of the German economy also reflects more structural difficulties, reminding the "Standort Deutschland"[1] debate. These difficulties began in 2018 shortly before the first European regulations aimed at adapting the automotive sector to climate change were implemented. Manufacturing output has never returned to the November 2017 peak and production capacity in the sector has declined. Against a backdrop that is still difficult, we expect another recession in the second half of 2023.

In Q2 2023, Germany narrowly avoided a third consecutive quarter of GDP contraction (0% q/q, after -0.4% in Q4 2022 and -0.1% in Q1 2023). Over the last three quarters, consumption trends (private and public) have been very close to those of GDP. While the high level of inflation has affected private consumption, public consumption has failed to drive growth as well. At the same time, exports (which account for almost half of German GDP) fell by 1.1% q/q in Q2, back to their Q4 2021 level.

As well as underperforming in the short term, German growth has also been disappointing for several years, and the reasons are likely to persist in the quarters ahead. According to our forecasts, the second half of 2023 will see another moderate recession (-0.1% q/q in both Q3 and Q4).

INDUSTRIAL CORE UNDERPERFORMANCE

The main economic surveys are deteriorating again after a slight improvement in spring. In industry, they fell below their October 2022 level (they were then penalised by a peak in inflation at 11.6% y/y according to the harmonised index). Contrary to 2022, according to the Ifo survey, companies are less worried about the future ("expectations" component at 77 in October 2022 compared with 83 in September 2023) but more about the current situation: -2 in September compared with 13 in October 2022 in industry and 9 compared with 21 in October 2022 in services. In both cases, the indicator is at its lowest since spring 2010.

Household spending intentions remain weak: they are being penalised by the rise in interest rates and are therefore not benefiting from the relative disinflation (6.4% y/y in August 2023). Demand became the number one limiting factor for production (according to the European Commission) in the first three quarters of 2023 in intermediate goods sectors (chemicals, plastics/rubber, metals, wood/paper), while supply constraints remain a major headwind for transport equipment and machinery and equipment. With labour shortages affecting fewer sectors, job creation decreased (42,000 jobs created in Q2, after an average of 94,000 over the previous four quarters).

The problems faced by German industry seem structural. Manufacturing production peaked in November 2017, shortly before the introduction of the first European environmental standards in the automotive sector (WLTP standards) in September 2018. In the first half of 2023, manufacturing production was 8.3% below its level at the end of 2017 (-11% in the automotive and metals sectors, -15% in chemicals). In Q2 2023, investment in machinery and equipment only exceeded the level at the end of 2017 by 1.3% (compared to +16% in France). As a result, in Q2 production capacity (which only decreased from Covid onwards) remained 6% lower than its previous level (an unprecedented phenomenon). With industry accounting for almost a quarter of the German economy, its underperformance affects GDP: In Q2 2023, GDP was only +1.3% above its level at the end of 2017, compared with +5.1% for the eurozone and +4.2% for France.

GROWTH & INFLATION

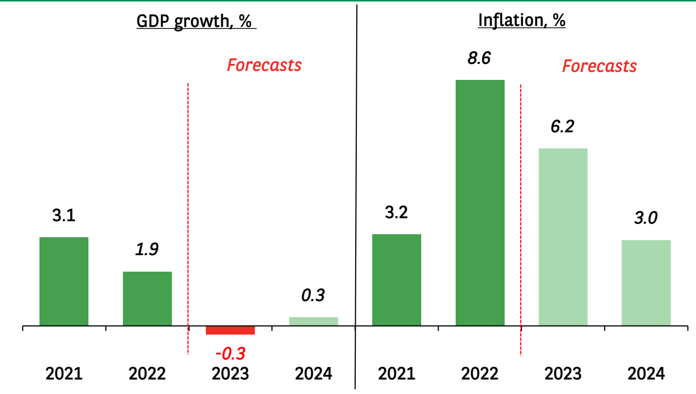

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

POOR PROSPECTS FOR THE EXPORT SECTOR?

Between the end of 2017 and Q2 2023, German exports of goods and services increased by 4%. This total increase masks a smaller increase for goods alone of 1.3%, i.e. the same change as GDP. However, between 2012 and 2017, cumulative GDP growth (nearly 11%) was largely supported by exports (+22%), particularly in goods (+19%). Exports therefore lost their role as a growth driver.

The loss of market share in China, particularly in the automotive sector, is one of the explanatory factors. Germany accounted for 4,2% of Chinese imports over the last twelve months (to the end of August 2023), 1 percentage point lower than two years earlier (at the same time, France's market share remained stable at 1.4%).

In terms of investment, the dynamics of the main competitors contrast with the sluggishness seen in Germany. However, since statistical series are not measured in the same way, the comparison remains imprecise. In China, growth in investment (fixed-asset investment, or FAI, which is not measured in real terms), in the manufacturing sector is clearly erasing the shock of the Covid-19 pandemic: in this sector, between January and August 2023, FAI was 37% higher than its level over the same period of 2017 (135% in electronics, 100% in electrical equipment and almost 60% in chemicals). In the United States, the manufacturing sector's investment in construction (nominal data here again) grew by 76% y/y in January-July 2023, and more than tripled in electrical, electronic and IT equipment (supported by the Chips Act). In Germany, on the contrary, industrial investment in buildings fell by 1% y/y (and by 6% compared with 2017) in Q2 2023. These developments, although difficult to compare, let expect a continued erosion in German market shares.

Stéphane Colliac stephane.colliac@bnpparibas.com

1 'Standort Deutschland' is used to refer to Germany as a place of production. This expression was used for the first time in the early 90s, when this question was first asked. We are asking it again today.