TOWARDS A DOUBLE DIP?

Germany experienced a technical recession in Q4 2022 (-0.5% q/q) and in Q1 2023 (-0.3% q/q), driven by a contraction in household consumption (-1.7% then -1.2%). Although the main cause of this recession was not its industrial core, the German economy showed signs of weakness which hindered growth. While disinflation should allow household consumption to recover in Q2, economic surveys however, are pointing to a further deterioration, which once again exposes the German economy to a risk of recession in H2.

The long-expected recession finally materialised in Germany, in Q4 2022 and in Q1 2023. Household consumption led the way, firstly by helping avoid recession, despite deteriorated business climate indicators from spring 2022, and then by nurturing recession, even though the upturn at the beginning of the year recorded by the IFO and the ZEW may have suggested that growth might not be negative in Q1. Down sharply in Q1, public consumption strongly affected growth at the beginning of 2023.

A COMBINATION OF CONSTRAINTS ON BOTH SUPPLY AND DEMAND

The overview of the German economy at the beginning of 2023 is of an economy that is still gridlocked. The high volatility of economic indicators should not mask their weakness. The sharp contraction in industrial production last December was offset by an upturn in Q1 2023, but the average (mobile average over 6 months) remained relatively unchanged. Factory orders were flat in Q1, and decreased in April 2023 to their lowest level since May 2013.

At the same time, the opening of a new Tesla plant in Berlin in 2022 enabled a ramp-up at the end of the year, which continued over the first five months of 2023 (an increase of 11% y/y in new vehicle registrations). However, while this additional production capacity has occasionally made it easier to deal with accumulated order books, the supply constraints that companies are facing are still significant; these constraints are restricting production for 68% of companies according to the European Commission. However, in Q1 2023, automotive production remained 11% below its level observed at the end of 2017.

THE MOMENTUM SEEN IN SERVICES IS MISLEADING

The German services PMI continues to diverge quite significantly from the manufacturing PMI, unlike in other countries where this previously significant gap has recently narrowed, particularly in France. However, the IFO business climate survey shows that the momentum seen in services is primarily associated with sectors linked to tourism and leisure, while business services were more aligned with the significantly more moderate momentum seen in the manufacturing sector. Also, a comparison of the European Commission survey on services for the various countries in the EU shows that the tourism and leisure sectors are gaining more momentum in Germany than elsewhere.

A SHIFT FROM WHAT FEELS LIKE SUSTAINABLE RECOVERY TO WHAT FEELS LIKE BACKSLIDING

Although not widespread, the current momentum seen in some services in Germany should still benefit the country's growth. In addition, the recent disinflation should give households more purchasing power, and encourage us to consider an upturn in household consumption in Q2, after a sharp drop previously (-2.9% if we add together contractions in Q4 2022 and Q1 2023).

GROWTH & INFLATION

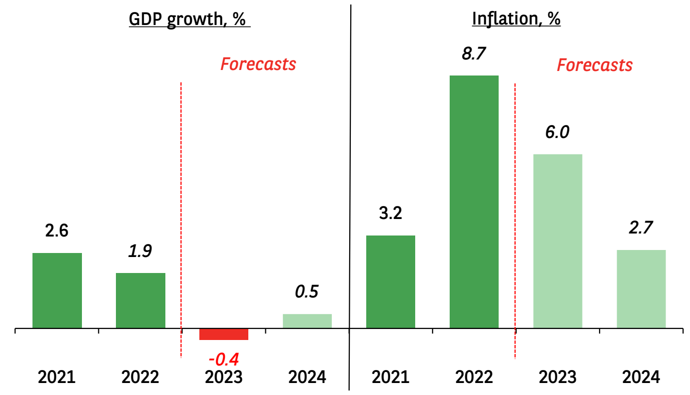

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

However, while industrial production data, new factory orders and economic surveys had suggested a marked recovery in growth up until February, the outlook is now very different. The probability of a drop in growth in H2 2023 has increased. Just as in other European countries, this expectation stems from the increasingly visible impact of the ECB interest rate hikes, in line with what the transmission time frames had suggested, with a maximum effect on the economy from H2. Economic surveys confirm further cooling. While household confidence, measured by the GFK Institute, has seen its synthetic indicator recover, households' willingness to buy returned in May to the low level seen when inflation was in double digits.

This downturn should be moderate (0% q/q growth in Q3, then -0.1% q/q in Q4 according to our forecasts), in particular because the momentum of the labour market has not diminished in recent months, with 155,000 job creations in Q1, and because leading indicators (recruitment difficulties, employment prospects at three months) have remained relatively on track. But the underperformance of German GDP since the end of 2017 highlights the country's dependence on sectors penalised by recent developments, including the chemical and automotive industries (production of which remains, respectively, 15% and 11% lower than at the end of 2017). This explains why German growth has remained below the European average since then, and is expected to stay there in 2023.

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