GERMANY

IN A NEW INDUSTRIAL RECESSION

While there were signs of a rebound in German growth at the beginning of the year, the industrial recession was back from Q2 24, with a negative impact on the labour market that is now noticeable as the unemployment rate is rising. Against this backdrop, and following the withdrawal of support for the purchase of electric vehicles in December 2023, households have increased their level of savings. However, there are still modest signs of a rebound, with a slight increase in demand. At the same time, the government's awareness of the stalling of German industry could lead to the return of support measures.

The German economy is stuck in a stagnation that has lasted for almost two years. Q2 2024 GDP was even below the peak seen in Q3 2022 (by 0.5%). Between these two dates, household consumption fell by 0.9% and investment by 4.2%. External demand is not providing any relief. We can see actually that exports fell less than imports (-0.6% compared to -2.8%). At the same time, no other eurozone country has recorded such a stagnation. These figures therefore point to significant underperformance by Germany.

INDUSTRIAL RECESSION IS BACK

During this period, German industry experienced two recessions. The second one is underway. In Germany, industry and construction account for nearly one third of GDP (compared to one fifth in France). Their impact on growth is therefore significant. After a first recession between Q2 and Q4 2023, production in these sectors had rebounded slightly (+0.4% q/q) in Q1 2024. Contraction resumed in Q2 (-1.2% q/q) and a rebound in Q3 is unlikely. In July, industrial production reached its lowest level (excluding the Covid period) since April 2010. The IFO Business Climate Index fell in September to a level (-21.6) that was only lower during the recessions seen in 1993, 2009 and the Covid period.

At the same time, the capacity utilisation rate in industry was down from 86% in Q1 2022 (the start of the war in Ukraine and the resulting energy shock) to 77.4% in Q3 2024 (after 80.2% in Q2 2024). By comparison, in the eurozone, these rates were 82.8% in Q1 2022, 78.9% in Q2 2024 and 77.7% in Q3 2024.

These developments are meaningful, especially as they add to the Covid shock and to a significant loss of activity already before the pandemic: on average over the last 3 months, industrial production was 15% lower than the record seen in Q4 2017 (20% in metallurgy and 19% in automotive). This weakness is likely to lead to new site closures (already envisaged in the automotive sector), even though production capacities experienced an initial decrease of 6% following the Covid period (unprecedented apart from the reunification period), according to our calculations.

HOUSEHOLDS ARE TAKING THE HIT

The situation in industry is eroding one of Germany's greatest successes in recent years: the return to full employment. Admittedly, unemployment remains low and the main constraint facing the services sector remains the lack of labour (more so than the lack of demand). However, in industry, labour constraints have reduced and the unemployment rate has rebounded, rising from 3% - level seen pre-Covid and just a year ago - to 3.7% in July 2024. An increase that might continue if we believe the IFO survey's Employment Barometer, which fell to 94.8 points in August 2024. Excluding the Covid period and the 2008 crisis, this was a low not seen since 2005, i.e., just before the introduction of the Hartz reforms contributed to a sharp decline in unemployment in Germany.

According to the European Commission survey, German households do not believe in a recovery in activity: they have a negative perception of the economic situation in the past twelve months as well for the next twelve months. In August 2024, only 6.6% of households were willing to make major purchases in the immediate future, according to the European Commission, a proportion that has been consistently below 10% since March 2022, and which had rarely fallen below this level before.

GROWTH AND INFLATION

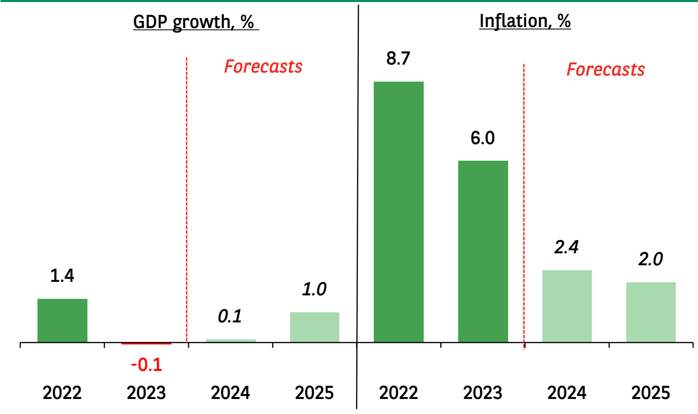

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

The fall in inflation, which reached the symbolic 2% y/y mark in August 2024 (according to the harmonised index) compared to 6.4% a year earlier, is having only a limited impact on consumer confidence and consumption for the time being. According to Eurostat, the household savings rate even increased, to 21.2% in Q1 2024, compared to 19.9% a year earlier (and 18.2% at the end of 2019), of which almost half in financial savings (unprecedented percentage outside the Covid period).

ON THE VERGE OF A REBOUND?

Will 2025 see an end to stagnation? There are reasons for hope, albeit these are yet to be confirmed.

The first reason relates to demand. The new orders index in industry rebounded in June-July. This index is quite volatile; a 6-month average can help reduce this volatility. With this calculation, a rebound emerged in July 2024 (+1.2% m/m). Admittedly still limited, it interrupted the near-continuous fall seen since May 2022.

The second reason could come from the policy mix. The ECB cut its key rate again by 25 bps in September 2024. At the same time, we could see the return of help to buy electric vehicles. An urgent decision to end this support was taken in December 2023 in order to reduce the budget deficit (following the judgment of the Federal Constitutional Court in Karlsruhe). However, over the period December 2023 - August 2024, electric vehicle registrations fell by 36%. Volkswagen recently announced the potential closure of one of its plants in Germany, which would be a first. Following this announcement, the German government has therefore taken on the issue, and measures to support the sector might be forthcoming.

Stéphane Colliac
stephane.colliac@bnpparibas.com