GERMANY

A REBOUND – BUT WHAT HAPPENS NEXT?

German growth is expected to be supported, in the short term, by the upturn in the country's industry, which should offset some of the loss of production associated with the rise in the cost of energy following the outbreak of the war in Ukraine. As an open economy, Germany is also expected to benefit from the rebound in growth in the eurozone since the beginning of 2024. However, in the longer term, German growth potential is likely to continue to suffer from labour shortages, from the weight of its industry (weakened by the low-carbon transition), and also from the consequences of insufficient investment against a backdrop of a surge in new competitors.

Germany returned to positive growth in Q1 2024 (+0.2% q/q, as seen in France), barely below the eurozone (+0.3% q/q). However, this figure is assessed differently when we take into account the 0.5% contraction in GDP observed in Q4 2023. GDP in Q1 2024 is therefore 0.3% lower than in Q3 2023. GDP is even 0.1% below the activity level in Q1 2022 (i.e., before the war in Ukraine began), highlighting the fact that Germany is among the countries that suffered the most from the rise in energy prices. This decline is largely due to industry, production of which remained, on average in Q1 2024, nearly 5% below the level seen in February 2022.

2024: YEAR OF THE REBOUND

Business climate surveys indicate a fairly clear economic upturn. The composite PMI, at 52.4 in May 2024, is at its highest level for 12 months. And even though German industry remains a weak link, the «production» component of the manufacturing PMI rebounded to 48.9 in May, a 13-month high.

The PMI for export conditions (based on the average PMI of Germany's customer countries, weighted by their share in German exports) rebounded to 51.9 in May, its highest level for more than two years. This is an improvement, following a Q1 marked by a contribution of exports to growth of 0.5 percentage points, after a decline observed in the previous three quarters.

It is not surprising that an economy whose exports account for nearly 50% of GDP is benefiting from an improvement in overall business conditions. Exports to the US are already bolstering German foreign trade, which has played its part in a major development: the return of the eurozone as the biggest supplier to the US, ahead of China. For Germany, exports to the US represent a real growth driver: +5.6% y/y over the first four months of 2024 to the US and +40.4% compared to the same period in 2019 (compared to +3.2% towards China versus 2019). At the same time, exports to the eurozone are beginning to rebound.

The relative decline in energy prices provides further support, in particular the price of electricity for industry (+42% in February 2023 compared to its level in August 2021, the recent drop having «absorbed» only one third of this increase). Consequently, production in energy-intensive sectors, still heavily penalised in 2023, may now rebound: +7% in February-March in chemicals compared to the average production level observed in 2023. There is also additional potential for a rebound as production in this sector remains 7% below the level seen in February 2022.

WEAKENED GROWTH POTENTIAL

The German economy is no longer benefiting from the same support as in the past. The country prepared to fully benefit from China joining the WTO in 2001 and from enlargement of the European Union to Central Europe in 2003, by adopting the Hartz reforms (2003-05). By transforming the labour market, these reforms have helped to contain the cost of labour and gradually achieve full employment (the unemployment rate reached 5% at the end of 2018).

Between 2005 and 2018, Germany created nearly 5.6 million jobs, or 430,000 jobs per year, compared to 180,000 per year between 2018 and 2023.

GROWTH AND INFLATION

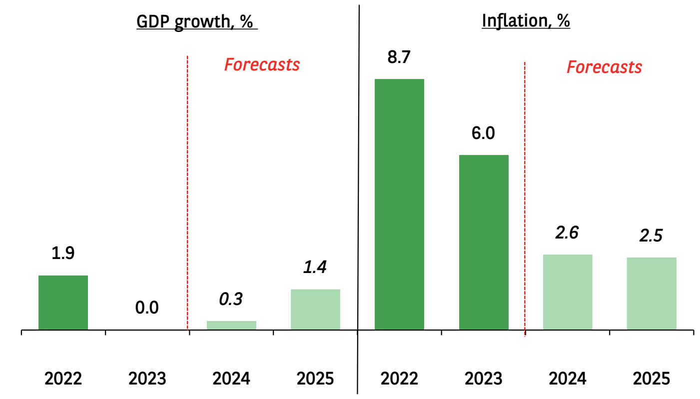

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

Moreover, the proportion of companies considering that labour shortages penalise their production reached 20% in services and 16.5% in industry on average over this period (whereas this proportion was previously residual), according to the European Commission survey.

At the same time, in Q1 2024, investment in machinery and equipment was 5% below the level seen at the end of 2018. However, this is not the result of a «substitution» effect in favour of services, as investment in market services has not progressed between the two dates. A shift towards increased demand for services, which the German economy does not seem to be taking on either from the point of view of household consumption (unlike France), which was 1.4% lower in Q1 2024 than its level at the end of 2018.

While German potential growth has weakened from an accounting point of view (less labour and capital intake), the same does not apply for the country's competitive positioning, which is protected for the time being. Of course, Germany is facing an issue of export opportunities, with increasing competition from China and the US. While its market share in global exports remained at 8% between 2010 and 2018, despite China's rise in power, this share fell to 7% in 2023, falling below that of the US (8.5%). However, this can be explained in particular by the partially temporary drop in industrial production (chemicals in particular) while, at the same time, German price competitiveness has remained, according to the Bundesbank's calculations. This represents a robust result according to various methodologies. In addition, non-price competitiveness (investment in R&D, robot equipment rate) remain favourable for Germany. However, the clear catch-up by China confirms the emergence of this new competitor, particularly in sectors traditionally among the best performing in German industry (automotive, chemicals).

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