GERMANY

WHEN WILL GROWTH RETURN?

The cyclical slowdown in the German economy, which is similar to the one being experienced in the Eurozone, is part of a longer-term stagnation, with Q3 2022 standing out as the last quarter with significant growth. Even so, this figure is biased upwards, as the period benefitted from the post-Covid rebound. While the rise in energy prices was steep enough in 2022 to highlight the clear weaknesses of the German economy, which is specialized on energy-intensive sectors, some of these weaknesses had existed earlier. Against this backdrop, the prospect of a return to growth, which is our scenario for spring 2024, due to the drop in inflation in particular, is still shrouded in deep uncertainty and downside risk.

The German economy can be described as in a protracted period of stagnation, with growth missing since Q4 2022. Destatis' preliminary estimates even give a negative figure for the fourth quarter of 2023 (-0.3% q/q) and for 2023 overall (-0.1%).

Household consumption (which is lower than pre-COVID levels unlike a number of European countries, including France) and exports are just two of the poorly performing areas and have both followed the same downward trajectory as GDP since Q4 2022. Demand (both internal and external) is therefore declining, as confirmed by the European Commission's survey, which stated that, in Q4 2023, demand was a factor limiting production for 23% of industrial companies (+10 points in 6 months).

Of course, Germany, like its partners in the Eurozone, is suffering as a result of the consequences of the inflationary shock. It is therefore selling less both in the country itself and in its neighbours and, at the same time, it is beginning to see sales decline outside of the Eurozone, particularly in China (an 8.6% y/y decrease in exports in nominal terms over the first 11 months of 2023). China's willingness to opt for subsidised local production over imports is well known, and this will be further strengthened by the lead taken by Chinese manufacturers in developing electric vehicles.

GROWTH & INFLATION

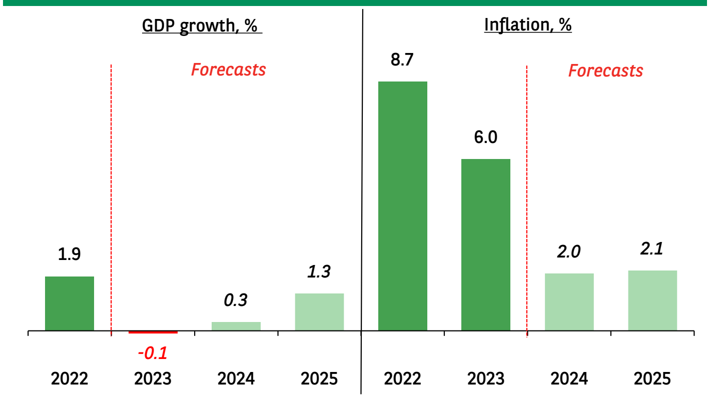

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

THE WORST HAS PASSED (OR HAS IT?)

Germany experienced some of the fastest disinflation out of all countries in 2023, notably because of a favourable base effect (energy prices were largely passed on to consumer and producer prices until November 2022 before dropping sharply), but also because inflationary momentum has largely faded away since the end of 2022. As a result, inflation (harmonised index) plunged from its peak of 11.6% y/y in October 2022 to 3.8% y/y in December 2023 (and 6.4% last August). More specifically, seasonally adjusted data show that prices only increased by 0.6% between June and December 2023 (compared to 3.1% between December 2022 and June 2023, and 3.6% between June and December 2022). Inflationary momentum has therefore disappeared.

Business climate surveys (IFO and ZEW) displayed a slight improvement, on the expectations component, giving credence to the idea of a future cyclical upturn. However, these expectations are still tentative and have been triggered by anticipated monetary easing. Although our central scenario includes a first policy rate cut by the ECB in April (by 25 basis points, with a total of 125 bp expected in 2024), when combined with falling inflation, will it be enough to kickstart German growth?

After all, there are still headwinds, not least because budgetary policy is expected to weigh on activity. Therefore, the ruling from the Karlsruhe Constitutional Court, which led to items which up until now were accounted for outside the budget being reintegrated into German public finances, did not alter the decision to reinstate the rule limiting the budget deficit to 0.35% of GDP from 2024. This resulted in some budgetary support being abruptly withdrawn, most notably some of the support for greening the economy, including an aid programme for purchasing electric vehicles being curtailed earlier than planned. This ruling and the decisions taken in response to it have dented consumer confidence, which has barely recovered despite the recent disinflation and runs counter to the trends seen in other countries: the balances of opinion among German households on the economic situation were still significantly below their historical average for both the last 12 months (-42) and the next 12 months (-29) in the European Commission's survey in December 2023.

However, disinflation could well boost optimism among households, with the balance of opinion in the GFK household survey on willingness to buy bouncing back to -8.8 in December from -15 in November (a level where the indicator had been hovering for 18 months).

MAKING UP FOR LOST TIME IS HUGELY DIFFICULT

Any rebound is expected to be cyclical. From a structural standpoint, the factors that have caused Germany to underperform compared to its European neighbours for nearly 6 years are still there. Greening the economy is a big challenge for the country to be delt with as soon as possible, in that it profoundly calls into question the established order and the German economy is still specialized on energy-intensive sectors that emit CO2, including the automotive, chemical and metal industries. One of the risks for the country is that the drop in emissions goes hand in hand with a more pronounced wave of de-industrialisation (and offshoring) than the one that has already taken place, as measured by the drop in industrial production capacities between the end of 2017 and the end of 2023, which we estimate at -6%.

According to Agora Energiewende, CO2 emissions from German industry fell by 12% in 2023, a phenomenon that the think tank states is primarily due to the concomitant reduced manufacturing output, particularly from energy-intensive sectors (with chemicals and pharmaceuticals down 8.2% y/y, and wood and paper down 13.4% y/y over the period from January to November 2023).

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