GERMANY

RECESSION LURKING BEHIND GROWTH?

Of the Eurozone's four major economies, Germany has the least positive growth outlook for 2022. Its economy is expected to grow by around 2% this year, whereas we are forecasting around 3% in Italy and France, and around 5% in Spain. Germany also has a lower Q4 2021 growth carry-over, greater exposure to the economic repercussions of the war in Ukraine, and pre-existing supply-chain problems in its manufacturing industry. The fall in the ifo index in March, particularly the business expectations component, illustrates well these headwinds, and this decline serves as a recession alert.

Among the Eurozone's big four economies, Germany has the greatest exposure to the economic repercussions of the war in Ukraine that Russia has been waging since 24 February. According to our dependency indicator[1], Germany's average score is 15.5, as opposed to 11.7 for France, 13.3 for Italy and 12.1 for Spain. The most dependent country is Lithuania (average position of 20.2) and the least dependent is Ireland (9). Germany's dependency stems in particular from the large proportion of its gas imports that come from Russia. Germany's openness to trade also means that its exports are more vulnerable to retroactive effects caused by problems in the worst-affected countries and by the recessionary shock in Russia and Ukraine themselves. Energy also makes up a relatively large proportion of Germany's HICP (11.7% in 2019 as opposed to 10.5% for the EU, 9.2% for France and Italy and 11.6% for Spain). This partly explains why inflation is much higher in Germany (7.6% year-on-year in March according to Eurostat's preliminary estimates) than in France (5.1%). Although the forthcoming rise in food prices also needs to be monitored, food makes up only 9.8% of Germany's HIPC, making Germany less exposed to this source of inflationary pressure than France (14.6%), Italy (15.9%) or Spain (17%).

The impact of Germany's dependency can be seen in the most recent business climate surveys, and it comes in addition to the difficulties arising from Germany's higher exposure to manufacturing, which was already suffering from supply-chain problems before the war in Ukraine broke out. In particular, the ifo index fell sharply in March, to the extent that the "business cycle clock" now shows the economy nearing recession because of deteriorating business expectations (chart 2).

It is possible that this large decline in the business climate indicator is sending an excessively pessimistic signal. Reassuringly, the labour market is unaffected so far, with recruitment remaining difficult and hiring intentions robust. Germany's fiscal policy also provides significant protection against the impact of the war. The 22% increase in Germany's minimum wage – to EUR 12 per hour from 1 October this year – will arrive late relative to the current inflationary shock, but will still cushion the blow to households' real incomes caused by higher prices.

The recession risk is higher in Germany than in France, for example, because of Germany's aforementioned greater dependency and because its economy already contracted in Q4 2021 (-0.3% q/q). However, if a recession happens, it may only be a "technical" one, i.e. two or three consecutive quarters of falling GDP, and not a prolonged one. This is the best that can be hoped for at the moment, but the risk should be monitored carefully.

Another negative for Germany is that its Q4 2021 growth carry-over (1.1%) is much lower than that of France (2.4%), Italy (2.3%) or Spain (3.2%), which will automatically drag down Germany's average annual growth in 2022. Overall, we expect Germany's economy to grow by around 2% this year, whereas growth should be close to 3% in France and Italy and around 5% in Spain. By comparison, our forecast for Germany is lower than the ifo's baseline scenario (3.1%) but similar to the ifo's alternative scenario (2.2%) and that of the German government's panel of "wise men" (1.8%). However, large carry over effects mean that the various economies' growth figures are less comparable than usual, including for 2023 when growth should strengthen in Germany (3.4%) and exceed that of the other three countries, where it is likely to continue falling to 2-3% according to our forecasts.

GROWTH & INFLATION

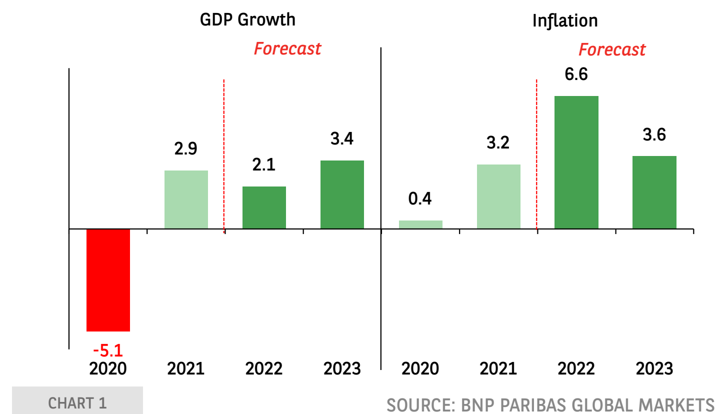

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

GERMANY: IFO BUSINESS CYCLE CLOCK SINCE 2017 (BALANCES ADJUSTED FOR MEAN VALUE, SEASONALLY ADJUSTED)

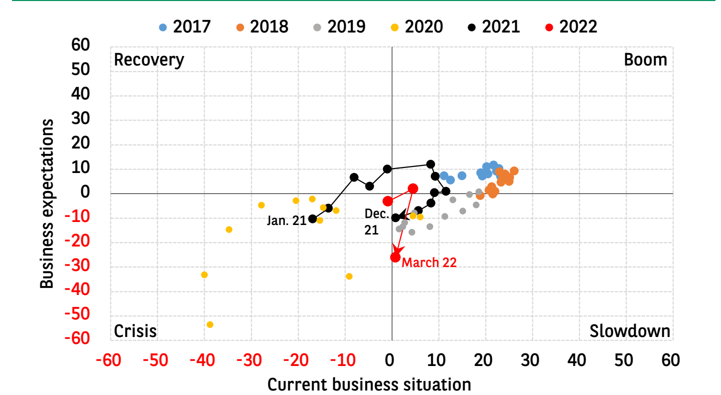

CHART 2 SOURCE: IFO, BNP PARIBAS

11 April 2022

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1 The higher the figure, the greater the dependency. These scores represent averages of each country's positions across each of the 23 variables we consider in our mapping (see EcoFlash 22-07).