Germany's economy: is an industrial recession less contagious than before?

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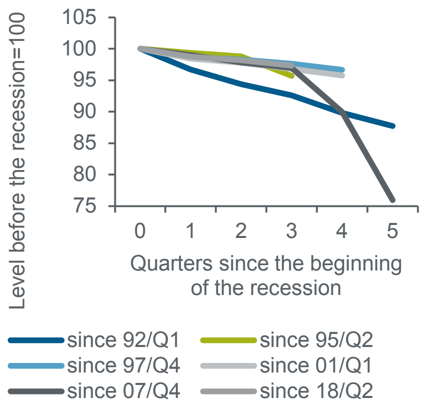
Growth despite industrial recession

The German economy grew 1.4% in 2018, a reasonable result that is in line with the average rate since unification. It was achieved even though manufacturing, the mainstay of Germany's export economy, slid into a recession in the middle of the year, which is continuing to this day. A further slowdown in real economic growth is generally expected for 2019, but no contraction. In June the median rate predicted by 28 professional forecasters from banks and economic research institutes for the current year was 0.8%, with a range between 0.4% and 1.1%. The consensus for 2020 is for growth to recover to 1.4%.

A looser connection?

The rather minor dent in growth being forecast despite declining industrial output over three consecutive quarters is historically remarkable. All of unified Germany's previous recessions (1993, 2003 and 2009) were closely linked to pronounced phases of weakness in manufacturing. But this time it can be argued that, thanks to many years of rising employment and wages growth, domestic demand is so strong that the economy is better equipped to handle a slump in international demand than in the past. The weak global economy would nonetheless hit the export industry, but further dampening effects would remain limited. Is such relative equanimity really justified? In the following we will explore this question by embedding the current constellation in its historic context. The answer will be particularly relevant as the major international risks such as Brexit, geopolitics and US trade conflicts so far do not appear to be subsiding.

Figure 1: Real gross value added by manufacturing



Sources: KfW Research, Destatis

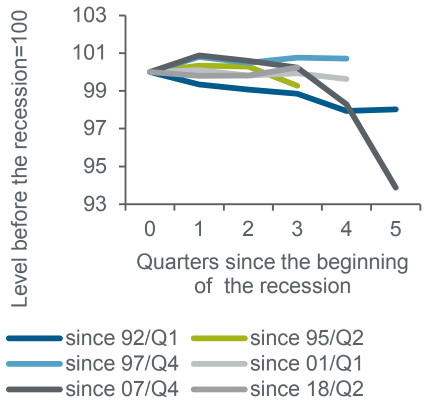
Current industrial recession is historically unremarkable, but ...

Gross value added by manufacturing dropped for at least three consecutive quarters in six instances since 1991 (Figure 1). The current industrial recession is negligible compared with its predecessors. Clearly diverging patterns appear only in the recession period that began in the first quarter of 1992 when the post-unification industrial deconstruction in eastern Germany appeared to significantly exacerbate the consequences of weak global demand, and the penultimate industrial recession from the fourth quarter of 2007. Whereas those three quarters were still unremarkable after the outbreak, industrial output in the two subsequent quarters – at the height of the global financial and economic crisis in the winter half of 2008/2009 – collapsed at a rate previously unseen.

… so is current GDP

If we compare that with the economic growth rates in the same periods, however, the current development also remains within the historic trend (Figure 2). In particular, the current GDP growth path is by no means pointing upward as positively as would have been expected under the hypothesis that the connection between the industrial and the overall business cycle is now looser. This is an expression of the persistently high cyclical relevance of manufacturing that is understandable in light of the external interrelationships.

Figure 2: Real GDP



Sources: KfW Research, Destatis

Potential for disappointing growth is uncomfortably high

For a country with such a large economy, Germany remains an extremely open and externally vulnerable economy with a record high ratio of exports to GDP (2018: 47.1%) and a continuing very high export surplus (2018: 6.6% of GDP). It would therefore be grossly reckless to attempt to base the hoped-for economic recovery from the second half of 2019 merely on more robust domestic demand compared with the past. What is also necessary is an easing of global tensions and a prompt end to the industrial recession. In other words: in the face of the present global economic climate, unfortunately, the potential for disappointment is uncomfortably high. ■