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Germany remains mired in stagnation

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The summer of 2024 delivered the sobering realisation that the German economy remains mired in stagnation. Sentiment indicators are languishing at low levels and there is no fresh momentum being generated. Germany has now been traversing the "vale of tears" for as long as five years. Activity in key sectors such as industry is still below pre-pandemic levels.

True, a recovery is still being projected for 2025, primarily thanks to a revival in consumption due to resurgent purchasing power of incomes on the back of wage increases and a simultaneously slower rise in prices. But growth is not going to be all that exuberant even here. Although the 2025 GDP forecasts for Germany remain in positive territory, they have recently drifted downwards a little nevertheless.

Above all investment remains paralysed. The framework conditions for the pending technological transformation appear all too unpredictable, to say nothing of the elevated geopolitical risks. Lower key interest rates - an easing pivot has now taken place in most major currency areas - may well provide a little tailwind. The inexorable fact remains that the effect of interest rates, like that of the contemplated subsidies, is being overridden by the prevailing uncertainties.

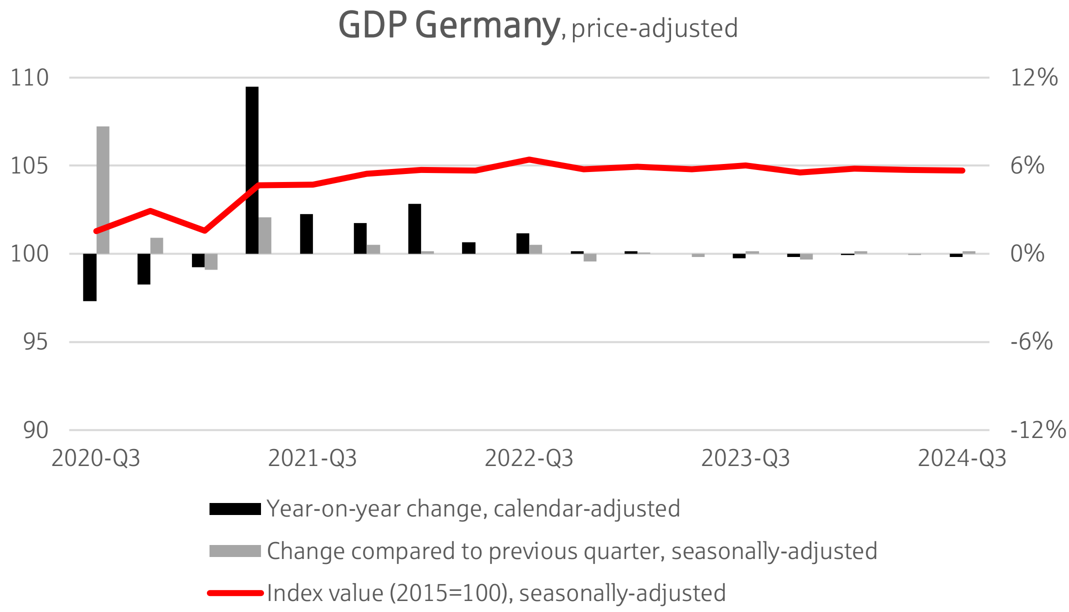
Germany remains mired in stagnation

GDP of second and third quarters of 2024 shows meagre performance

The summer of 2024 brought yet another reality check for the German economy. The hopes that burgeoned at the beginning of the year and persisted through the spring - that the long-awaited upswing would finally take shape in Germany - have unfortunately been dashed in the interim.

Germany's economic indicators have been sagging on a broad front

To make matters worse, the setback has occurred across a broad front: industrial production, incoming orders, export demand and sentiment indicators all went into reverse, in some cases significantly. GDP, the most comprehensive measure of aggregate economic output, grew slightly by 0.2 per cent in the third quarter according to a flash estimate by the Federal Statistical Office on October 30. A further contraction had previously been feared. However, the GDP for the second quarter was revised down again with the new report. Thus, the overall development in both quarters was not positive.



Source: Destatis

Germany is at the lower end of the international growth league-table

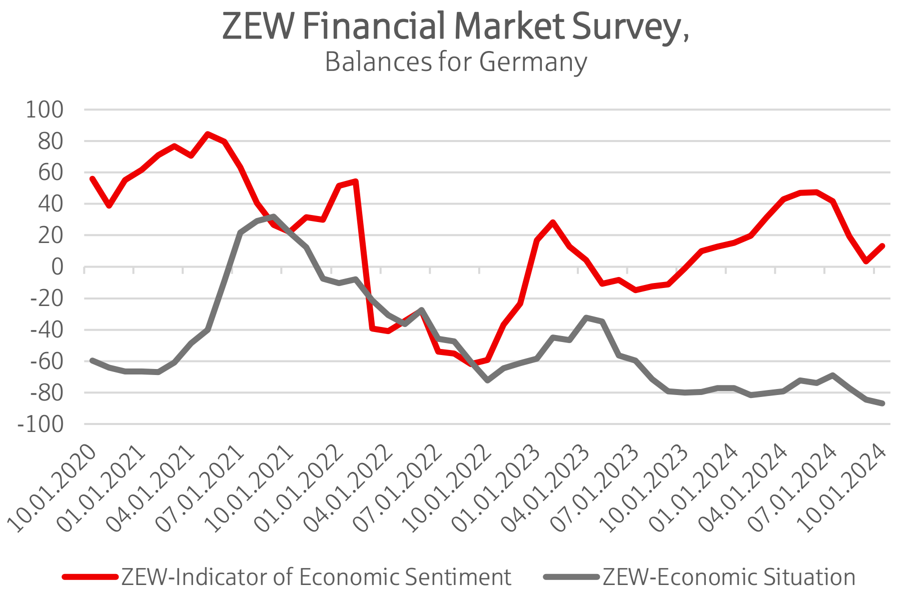
Overall, during the last eleven quarters, the German economy has witnessed four instances of marginal quarter-on-quarter contraction, six instances of modestly positive growth, and one flat zero, resulting in a virtually symmetrical pattern of oscillation around the zero line. The stubborn stagnation scenario is dragging on and on - for too long for it to be comfortably categorised as a "cyclical" phenomenon, especially as the individual swings are very slight in absolute terms and do not exhibit the pattern typical of an "economic cycle." What we are rather seeing is a sustained structural absence of growth forces. The contrast to other countries is particularly striking, regardless of whether one looks at the European or the global growth league-table. Where various other economies were initially hit harder than Germany in economic terms during the pandemic, almost all of them emerged from the crisis in more dynamic style.

In the Federal Republic, on the other hand, a glance at the medium-term time horizon reveals that the economy tumbled into the slough of stagnation even prior to the pandemic. The coronavirus-related slumps in GDP suffered during 2020 were more or less made up for in 2021 and 2022. But since then, the trend in aggregate economic output has only moved sideways. At least reading, the 2019 level was barely being surpassed. 2024 as a whole will also prove to be another lost year from a macroeconomic growth point of view. In certain sectors of the German economy - and this definitely includes such important ones as manufacturing industry - the picture is even gloomier. The output level in that domain is even significantly below what was being achieved in the late 2010s.

German industry is in even worse shape than the overall economy

Sentiment has been deteriorating sharply

Although the "structural weakness" narrative is not new, more cold water was poured over upswing hopes during the summer months, with an economic recovery having to be postponed even further. A look at the sentiment indicators reveals the degree of disillusionment, exemplified in this case by the trend in the ZEW Financial Market Survey during recent months, while the situation is not much different in the case of other mood-tracking gauges such as the ifo Business Climate Index or the relevant purchasing managers' indices.



Source: ZEW

The ZEW Financial Market Survey's current-conditions sub-index lost ground continually in the months from August to October. Given the state of the current indicators tracking German economic activity, this is understandable and hardly surprising. And yet it is remarkable to see that the ZEW six-months expectations component likewise collapsed in August and September. For the two sub-indices usually move in countervailing directions to a certain extent. If the current baseline is in worse shape, then an improvement - read: cyclical recovery - should

ZEW Index: At times, current-conditions and expectations have not been moving in countervailing directions logically be easier to achieve than from an already favourable starting-position. But even this comforting countervailing mechanism failed to materialise in the surveys concerned. The fact is that the six-months expectations component also lost traction. Hopes of a near-term improvement evaporated. It was not until the October ZEW survey that the sub-index charting expectations stabilised slightly. Yet even that sub-index is only just into positive territory. Any anticipated recovery is therefore projected to prove weak.

Slight positive growth in Q3 prevented the declaration of a technical recession.

The fact that the GDP growth rate remained slightly positive in the third quarter spares us from declaring a technical "recession.” The conditions for this were almost met. However, the term does not really fit the current situation anyway. Although the situation on the labour market is showing slight signs of weakness, it remains stable for the often-rehearsed demographic reasons, with the weakness more closely resembling a supply-side bottleneck in structural terms. We are not experiencing an economic cycle; it is simply that the woeful tale of sluggish value creation and weak productivity is dragging on and on, which is ultimately far worse than a sharp but corrective short downturn.

The latest Joint Forecast by the Chief Economists envisages stagnation over 2024 as a whole

Whole-year 2024 is likely to prove a lost year as far as German economic growth is concerned. Even a slight improvement on the growth front towards the end of the year could barely lift the overall annual GDP rate above the zero line. The latest Joint Forecast by the ten Chief Economists of the Savings Banks Finance Group is therefore predicting that GDP will come in flat at precisely zero per cent. This is also the figure projected by the International Monetary Fund in its current edition of “World Economic Outlook.” The German government is indeed even more cautious/pessimistic, forecasting a rate of (negative) expansion of -0.2 per cent for this year. On the other hand, the government in Berlin is more optimistic for 2025 than either the Chief Economists or the IMF.

Whether German aggregate economic output ends up being a few decimal places into positive territory or, as is now more likely, on the negative side of zero in whole-year 2024 does not in any way change the qualitative message. The order of magnitude can hardly be altered any longer. The annual figure has already been largely set in stone.

Considering that purchasing power has increased, German private consumption has been disappointing

Private consumption expenditure is likely to make, or have made, a small positive contribution to macroeconomic growth in 2024. Household consumption is, nevertheless, a bitter disappointment, returning a projected average annual real growth rate of just 0.5 per cent. After all, 2024 has been the year in which the purchasing power of incomes has recovered significantly. 2022 initially saw purchasing power cratering due to runaway inflation, which was strongly outpacing income growth. 2023 brought the first compensatory effects, with the two variables moving roughly in lockstep. In 2024, incomes began to catch up, with noticeable and enduring real wage growth being recorded, on balance.

Joint Forecast by the ten Chief Economists of the Savings Banks Finance Group

Germany	Forecast for 2024	Forecast for 2025
Gross domestic product [1]	0.0	0.9
Private consumption	0.5	1.1
Government consumption	2.0	1.1
Construction investment	-3.0	0.1
Investment in machinery and equipment	-4.3	0.8
Exports	0.3	2.0
Imports	-0.7	2.4
Number of employees [2]	45,980	46,000
Unemployment rate [3]	6.0	6.1
Consumer price inflation [4]	2.5	2.3
Core rate of CPI [4] (ie, excluding energy, food, alcohol, tobacco)	3.0	2.5
Savings rate [5]	11.7	11.5

1) GDP + subdivisions: real, non-calendar-adjusted year-on-year change, in %.
2) Number of employed persons with place of work in Germany, in thousands.
3) Unemployment rate as defined by the German Federal Employment Agency (Bundesagentur für Arbeit), in %.
4) Change compared to the previous year, in %.
5) Savings rate of private households, as a % of disposable income.

Since the national savings rate is rising again - the DSGV Chief Economists are forecasting that German citizens will squirrel away 11.7 per cent of their disposable incomes in 2024 - a large proportion of income growth has not (at least, not yet) found its way into consumption. It would appear that consumer confidence in the Federal Republic is still shaky after the inflationary hump which had to be negotiated, and with numerous geopolitical risks and unpredictable framework conditions remaining unchanged, or even becoming more acute.

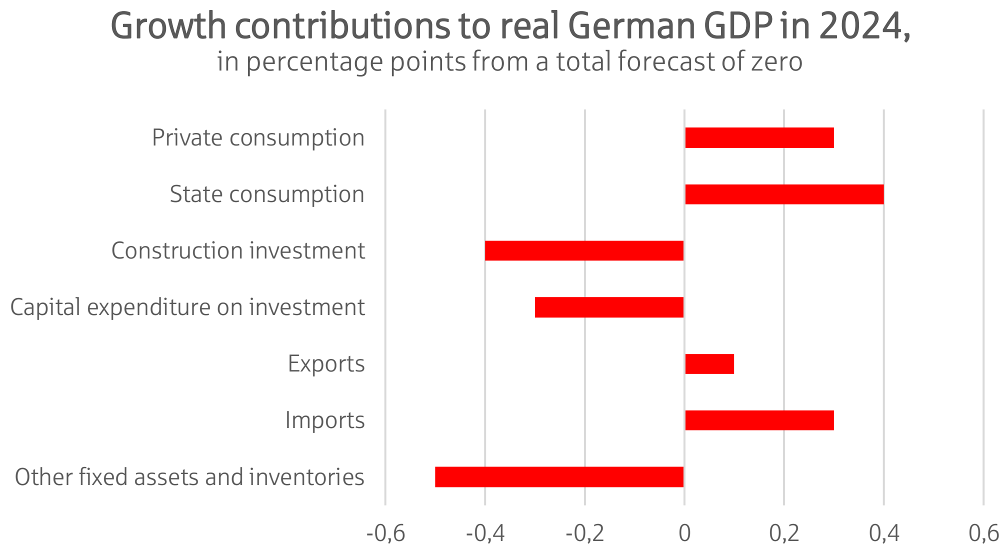
Investment is being paralysed by uncertainty…

A certain sensitivity to risk scenarios applies *a fortiori* in the case of investment activity. On this score, the Chief Economists anticipate declines in both the “construction investment“ and the “investment in machinery and equipment” categories in whole-year 2024. For much of the year, the high level of interest rates is also likely to have been a contributory cause here. However, there is hope for a turnaround on the latter front. The ECB implemented the first cuts in euro area key policy rates in the new cycle during this summer. As to longer-term refinancing for companies, the preceding rate increases during 2022 and 2023 were not as pronounced as in the case of key interest rates anyway. This is because such peak rates, with their successful mitigating effect on price levels, were increasingly recognised as being temporary, as inflation progressively eased, with this downside then being duly priced into longer-term yield levels. Nevertheless, investment activity is currently weak and is likely to remain so.

… and lower interest rates or subsidies only help to a very limited extent in such dire straits

The straight arithmetical growth contributions from foreign trade require explanation

In the above figures from the DSGV Chief Economists' Joint Forecast, foreign trade is making a clearly positive contribution to German macroeconomic growth. However, it would, paradoxically, be wrong to conclude that this was due to the strength of export demand: although it has admittedly stayed on the right side of zero, export growth is decidedly weak. The rate of German export growth is much lower than the growth rate of the global economy or of the country's sales markets. The inference is that Germany is continuing to lose market share internationally.



Source: Joint Forecast of the Chief Economists of the Savings Banks Finance Group

German imports were in decline over the first half of 2024 and are accordingly projected to decrease in the year as a whole, with the latest Joint Forecast pencilling in a rate of change of -0.7 per cent. Methodologically speaking, imports have a negative bearing on the German GDP equation. This is because they are an input - a kind of "advance payment" - for the German economy and the offsetting item for large swathes of final domestic consumption. If imported goods are consumed, for example, then this is a transitory item; at most additional value-added stages, after the import stage, will have a net effect on GDP. In the current case, this means that a decline in imports will (in arithmetical terms) increase GDP (when weighted in terms of the volume relationship between imports and GDP) by +0.3 percentage points.

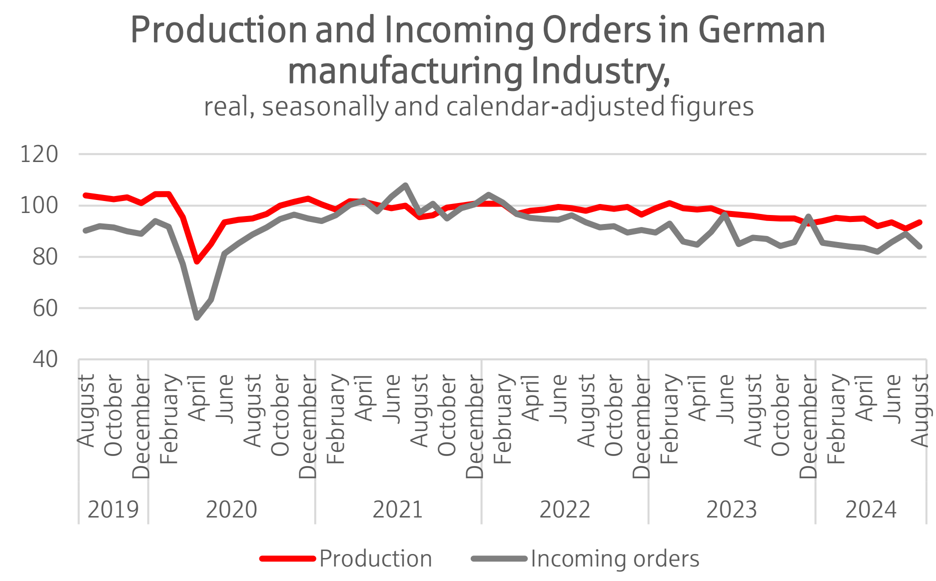
Methodologically speaking, a decline in imports has a positive effect on GDP growth…

… but this "positive decline" is being skewed negative this time round by a decline in the inventory ratio ("changes in inventories" item of GDP)

However, this still provides an incomplete picture of the import-logistics chain and of how it is reported in the national accounts. The inventory ratio ("changes in inventories" item of GDP) also plays a significant role in the interplay. If the various growth contributions to the above trend forecasts for final expenditure items of GDP are added together, we would actually expect, and indeed arrive at, a positive growth rate. This would be in the order of +0.5 per cent instead of zero. The root cause of the discrepancy is the expected development in the inventory cycle. Although "changes in inventories", like "other investments', are not usually explicitly inquired about in our Joint Forecasts, we have established a common understanding regarding the interpretation of the above data in the present survey. According to this, the DSGV Chief Economists are indeed expecting a palpable decline in these residual variables, particularly on the inventory-cycle side.

This is very plausible, the reason being that inventory accumulation at German companies was very high during 2023. This effect was due to the replenishing of inventories in the aftermath of pandemic-related supply bottlenecks and of other logistical disruptions. It would appear that this process of restocking was concentrated on 2023 and has now largely run its course during 2024. That would also explain the declining volume of imports: fewer imported goods have been stockpiled by corporate Germany this year. The arithmetically positive contribution to GDP made by lower imports and the negative contribution chipped in by inventory investment largely offset one other, leaving overall macroeconomic growth oscillating drably around the already lamented flat zero.

The structural weakness afflicting manufacturing industry has still not been overcome



Source: Destatis, Deutsche Bundesbank

The German automotive industry is struggling to come to terms with structural change

The most recently available numbers show that German industrial production has recovered somewhat. However, the positive growth logged in August was, in actual fact, just a rebound from the previous month's growth losses. This rhythm also conceals special factors such as the early factory holidays in some car-manufacturing plants. It is well known that the medium-term outlook is difficult, especially for the automotive industry - this was made patently clear, at the latest, by the announcements from the management of Volkswagen Group.

The sluggish order intake underscores, moreover, that growth opportunities for German manufacturing industry as a whole are currently limited. During the pandemic and in the recovery phase afterwards (marked by supply-side bottlenecks), a solid order backlog continued to support production for a good long time. By now, however, the trend in incoming orders has been on a downward trajectory for so long that the cushion of orders has been exhausted, with the demand side now morphing into the limiting factor impeding expansion.

Growth in the euro area as a whole is more intact than in Germany

The global economy will, in all likelihood, continue to grow moderately despite all the wars and geopolitical risks. In its October edition of "World Economic Outlook," the International Monetary Fund assumes aggregate global purchasing-power-parity-weighted GDP growth rates of 3.2 per cent for both 2024 and 2025.

The economic situation in China is looking unusually shaky. The property market in the People's Republic continues to weigh heavily on the situation there. However, the recently adopted government stimulus packages should definitely shore up economic activity, at least in the short term.

The new U.S. administration will need to rein in the high federal budget deficit

In the USA, how trade policy, economic policy and fiscal policy are going to shape up going forward remains a dramatic question ahead of the presidential election. Whether a Harris or a Trump Administration assume the reins of office, either will have to address the excessive federal budget deficit, currently corresponding to over seven per cent of U.S. GDP, although we have not heard any really helpful proposals from either camp during the election campaign, but instead unsustainable campaign promises on the spending side from the Democrats and equally unsustainable pledges on the revenue side from the Republicans. The financial markets will continue to keep a close eye on developments. False signals from politicians could well trigger crisis-like reactions on financial markets.

By comparison, the euro area is putting in a rather inconspicuous performance at present. Here too, we are admittedly seeing spikes in risk premiums in some countries; but the overall picture is looking calmer. Growth momentum is certainly not overwhelming, it is true; but considering the fact that Germany, the eurozone's largest economy, is slowing down pan-EMU growth considerably, the recovery in the other corners of the currency area would appear to be intact.

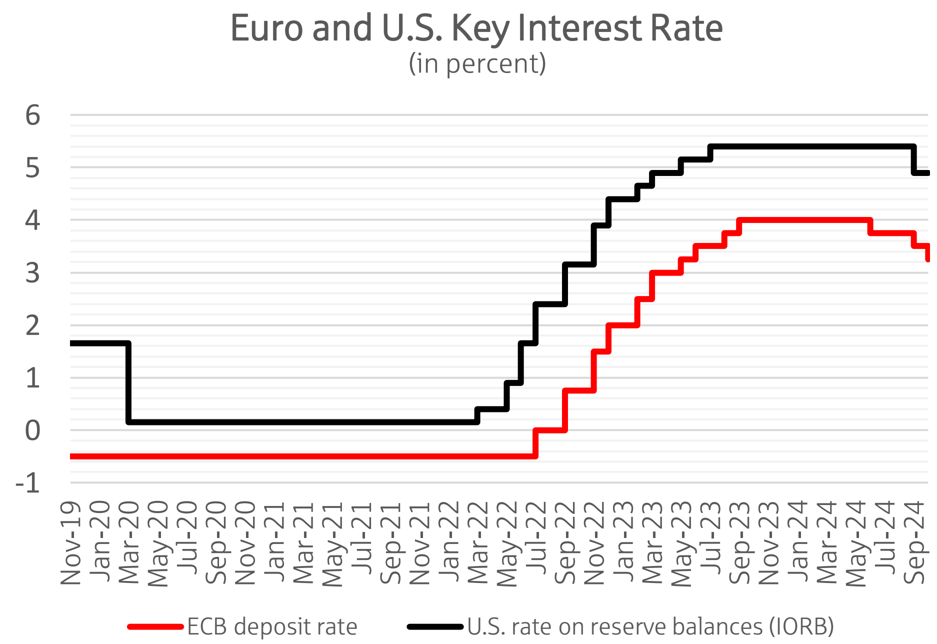
Joint Forecast by the ten Chief Economists of the Savings Banks Finance Group

euro area	Forecast for 2024	Forecast for 2025
Gross domestic product [1]	0.8	1.2
Private consumption	1.0	1.4
Government consumption	1.1	0.8
Gross fixed capital formation	-0.9	1.3
Exports	1.3	2.5
Imports	0.0	2.9
Exchange rate [2]	1.09	1.12
Oil price [3]	83.0	86.5
Consumer price inflation [4]	2.5	2.3
Core rate of CPI [4] (ie, excluding energy, food, alcohol, tobacco)	2.9	2.4

1) GDP + subdivisions: real, non-calendar-adjusted year-on-year change, in %.
2) US dollar/euro currency pair.
3) Barrel price of Brent crude oil, in US dollars.
4) Change compared to the previous year, in %.

The latest Joint Forecast by the Chief Economists of the Savings Banks Finance Group predicts growth rates for the euro area of 0.8 per cent in the current year and 1.2 per cent in the coming year. As in Germany, the upswing is expected to be primarily underpinned by private consumption on the back of the recovery in purchasing power which is taking place. At a zone-wide level, exports have already been on a better trajectory during the current year than has been the case in Germany.

The time window currently available for rate cuts has been made use of



Source: ECB, FRED St. Louis Fed

Investment is admittedly also predicted to decline in the wider euro area in 2024, but not as sharply as in Germany, and is expected to then make a comeback during 2025.

The fact that inflation has moved down close to central-bank target levels is opening up leeway for policy rate cuts

This autumn, meanwhile, the world's major central banks have been making use of the currently open time window (a function of lower inflation rates) to continue on the easing cycle to which they pivoted during the summer. The European Central Bank cut its three benchmark key rates by a further 25 basis points in October, a mere five weeks after the previous policy rate cut. The latest loosening step was prompted by disinflation's encouraging progress down the proverbial "last mile" leading to price stability. In some cases, consumer-price inflation has even dipped to below the respective central bank's target variable.

Annual inflation rates as of September 2024	HICP	Core rate of CPI [1]	CPI
U.S.	2.4%	3.3% [2]	–
euro area	1.7%	2.7%	–
Germany	1.8%	3.0%	1.6%

1) ie, stripping out the volatile components energy, food, alcohol and tobacco
2) For the U.S., core rate excluding energy and food
Source: Destatis, Eurostat, U.S. Bureau of Labor Statistics (BLS)

All the same, the latest crop of lower inflation readings may well mark interim lows, with CPI potentially edging higher again in the coming months. The most recent drop in inflation rates has been primarily due to the base effects of falling energy prices. By contrast, services inflation is still surging at a decidedly rapid pace and is therefore continuing to keep core inflation rates well above the target level.

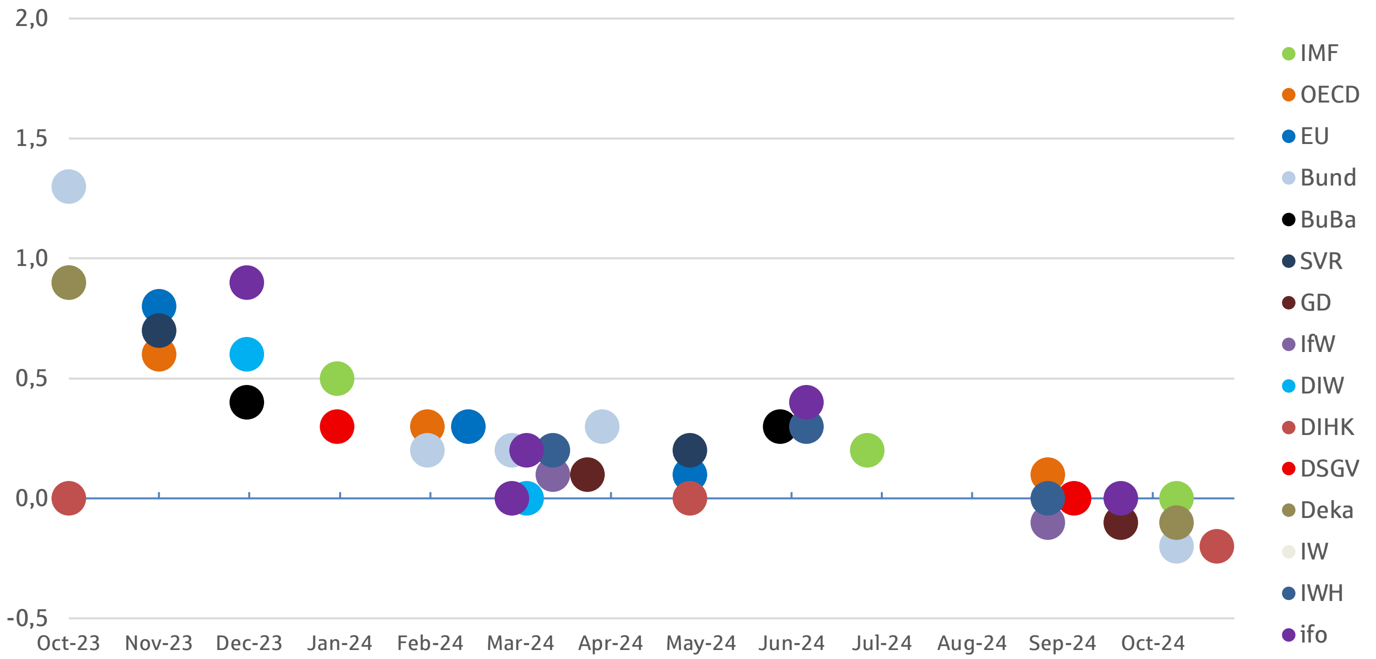
At the end of the day, though, there seems at the moment to be a consensus between the Federal Reserve and the ECB to continue down the rate-cutting path in unison, partly in order to limit the impact of divergent interest-rate trends on the euro/dollar exchange rate. It remains to be seen, though, whether the rate cuts actually implemented will ultimately be able to prove as steep, and "terminal rates" as low, as market forwards are currently pricing in, not least because of the, as yet, unanswered question of whether - and, if so, how - a consolidation-oriented fiscal policy will flank the monetary-policy path.

A. Growth in the world's economic regions, year-on-year change

	2022	2023	2024*	2025*
Global trade volume	5.7%	0.8%	3.1%	3.4%
Global GDP	3.6%	3.3%	3.2%	3.2%
USA	2.5%	2.9%	2.8%	2.2%
Japan	1.2%	1.7%	0.3%	1.1%
China	3.0%	5.2%	4.8%	4.5%
euro area	3.3%	0.4%	0.8%	1.2%
Germany	1.4%	-0.3%	0.0%	0.8%

* Forecasts by the International Monetary Fund from October 2024

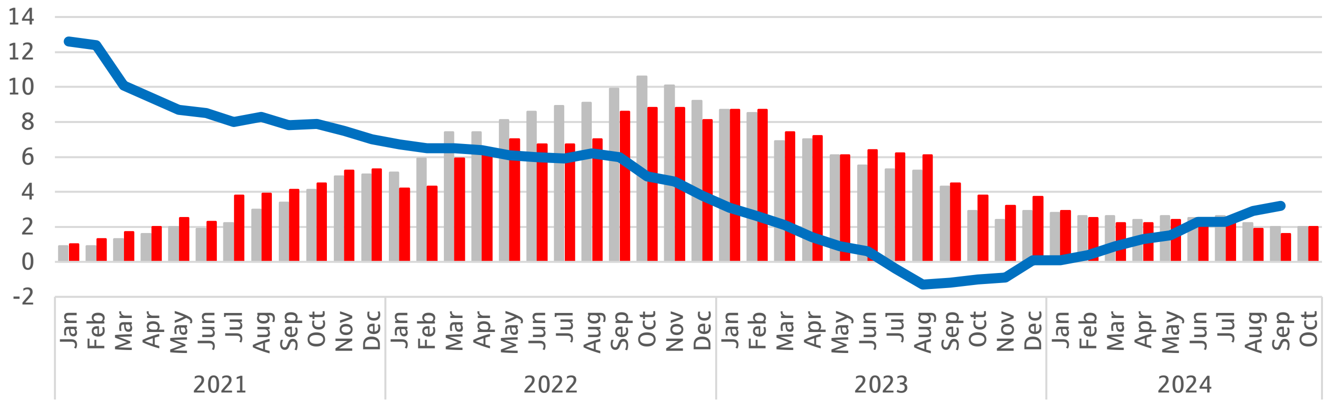
B. Forecasts for economic growth in Germany for 2024, in %



C. GDP in Germany and in the euro area

	2023 Real GDP growth year-on-year	Q IV - 2023	Q I – 2024	Q II - 2024	Q III - 2024
		real GDP growth compared to the same quarter of the previous year and seasonally adjusted real GDP growth vs. the previous quarter			
euro area GDP	+0.4%	+0.0% +0.1%	+0.2% +0.3%	+0.7% +0.2%	+0.9% +0.4%
Germany GDP	-0.3%	-0.4% -0.4%	-0.8% +0.2%	+0.1% -0.3%	+0.2% +0.2%
Private consumption	-0.4%	-0.2% +0.0%	+0.8% +0.3%	+0.1% -0.2%	– –
Gross fixed capital formation	-1.2%	-2.3% -1.4%	-3.5% +0.1%	-2.9% -2.2%	– –
Exports	-0.3%	-2.5% -0.9%	-2.2% +1.3%	+0.3% -0.2%	– –
		Level, not rate of change; quarterly figures, seasonally adjusted			
Savings rate	10.4%	10.8%	11.0%	11.3%	–

D. Consumer prices and money supply M3, annual rates of change, in %



E. Monthly economic indicators Germany

	June	July	August	September	October
Prices (national definition)	Change compared to the same month of the previous year				
Consumer prices	2.2%	2.3%	1.9%	1.6%	2.0%
– excluding food and energy (core inflation)	3.3%	3.3%	3.0%	3.0%	–
Producer prices of commercial products	–1.6%	–0.8%	–0.8%	–1.4%	–
Import prices	0.7%	0.9%	0.2%	–	–
Sentiment indicators					
ifo Business Climate Index	88.6	87.0	86.6	85.4	86.5
ZEW Financial Market Survey	47.5	41.8	19.2	3.6	13.1
Incoming orders	Change compared to the same month of the previous year				
Manufacturing industry	–14.6%	11.1%	–6.7%	–	–
domestic	–10.0%	13.6%	–11.0%	–	–
external	–17.6%	9.2%	–3.7%	–	–
Capital-goods producers	–17.6%	13.2%	–5.1%	–	–
Production	Working day-adjusted change vs. same month of previous year				
Overall producing sector	–3.7%	–5.6%	–2.7%	–	–
thereof: construction	–3.5%	–5.6%	–3.8%	–	–
thereof: manufacturing industry	–4.2%	–6.1%	–3.1%	–	–
Foreign trade	Change compared to the same month of the previous year				
Exports	–8.1%	5.6%	–2.9%	–	–
Imports	–9.0%	4.8%	–5.3%	–	–
Labour market	Unemployment rate and change in the jobless total compared to the same month of the previous year (in 1,000)				
Unemployment rate (seasonally-adjusted)	5.8%	6.0%	6.1%	6.0%	6.0%
Unemployed persons	+172	+192	+176	+179	+183
Employed persons (place of work in Germany)	+166	+155	+136	–	–
Employees subject to social-security contributions	+143	+150	–	–	–

F. Commodity, foreign exchange and financial markets

	July	August	September	October	4 November
Brent oil price in US dollars	85.15	80.36	74.02	71.87	–
Exchange rates					
US dollar / EUR	1.0844	1.1012	1.1106	1.0904	1.0904
Japanese yen / EUR	171.17	161.06	159.08	163.20	165.47
Stock markets					
German share index DAX, end-of-month level	18,509	18,907	19,325	19,077	19,147
Change compared to the same month of the previous year	+12.5%	+18.6%	+25.6%	+28.8%	
Money market & capital market interest rates					
Call money (€STR)	3.663%	3.663%	3.557%	3.338%	3.163%
Running yield on federal bonds:					
– with a residual maturity of one year	2.95%	2.71%	2.44%	2.46%	2.47%
– with a residual maturity of ten years	2.35%	2.30%	2.21%	2.46%	2.47%
Interest rates of banks, in new business					
Overnight deposits of private households in D	0.41%	0.51%	0.55%	–	–
for comparison: in the euro area as a whole	0.38 %	0.38 %	0.37%	–	–
Deposits of private households up to 1 year in D	2.94%	3.12%	3.22%	–	–
for comparison: in the euro area as a whole	3.02%	2.98%	2.97%	–	–
Corporate loans up to € 1 million over 5 years in D	4.35%	4.46%	4.35%	–	–
for comparison: in the euro area as a whole	4.25%	4.15%	4.12%	–	–

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