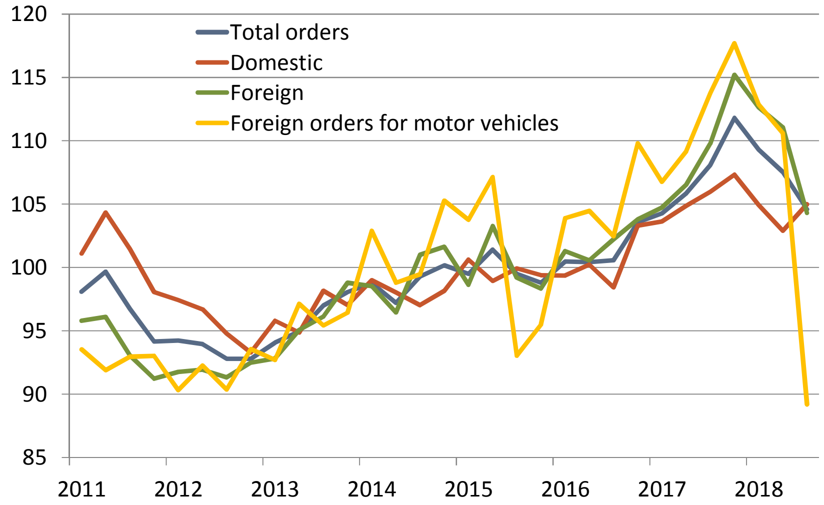
6 September 2018

German orders: feeling the strain

German manufacturing orders: the weakness abroad largely reflects car sector issues



Volume indices, 2015=100; quarterly averages; last value: July 2018. Source: Bundesbank

- **A stern warning:** The inflow of new orders for German manufacturers often serves as a bellwether for the Eurozone business cycle. With its big export-oriented manufacturing sector, Germany is more exposed to the vagaries of the world than most other countries. Also, many German companies specialise in cyclically-sensitive products such as machine tools and cars. After declines in the first half of 2018, the further drop in factory orders in July highlights the downside risks to the economic outlook for Germany and the Eurozone as a whole.
- **Trump hurts:** Trade tensions reached their peak in July as US President Donald Trump threatened ever more loudly to impose a 20% punitive tariff on car and car-part imports from the EU. Export orders for German motor vehicles plunged by a stunning 19.3% in July relative to their Q2 2018 average (see chart). Domestic orders for German motor vehicles receded by a mere 1.2%. This suggests that trade tensions are weighing heavily on the sector.
- **Mostly about cars:** According to Germany's Ministry of Economics, the car sector accounts for roughly two-thirds of the recent decline in factory orders. Beyond the trade-war threat, manufacturers are struggling to meet the stricter EU emission testing requirements that came into force on 1 September. This acts as a temporary drag on the sector. Once companies have retooled their cars accordingly, they are likely to recoup some of these losses over time.
- **A comfortable cushion:** German manufacturing orders are correcting from a very high level. Partly due to labour shortages, many companies were not able to meet the unusual surge in orders they had received late last year. Despite a slower inflow of new orders, the backlog of unfilled orders thus reached a cyclical high in May and June. Even with fewer new orders now, companies do not need to curtail production significantly, at least not yet.
- **Will it get much worse?** The worst of the trade tensions between the US and the EU should be over with the truce which Trump and the EU concluded on 25 July. The rebound in Germany's Ifo index for August supports the hope that this should raise business confidence and activity. However, the still-escalating dispute between the US and China and the crisis in some emerging markets could overshadow this for a while. In 2017, Germany sold 3.3% of its goods exports, equivalent to 1.3% of its GDP, to vulnerable emerging markets (Turkey, South Africa, Argentina and Brazil).
- **The strength at home:** Despite the pull from solid domestic demand in the US, the export outlook could remain wobbly until vulnerable emerging markets stabilise their currencies, and hence their economic outlook, and until the US and China start to negotiate seriously instead of hurling new tariffs at each other. We expect this to be the case either shortly before or after the US mid-term elections on 6 November. In the meantime, robust domestic demand due to more public and private investment and gains in real disposable incomes should tide Germany over during the correction in foreign orders without a major additional slowdown in growth. Still, the risks are rising.

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