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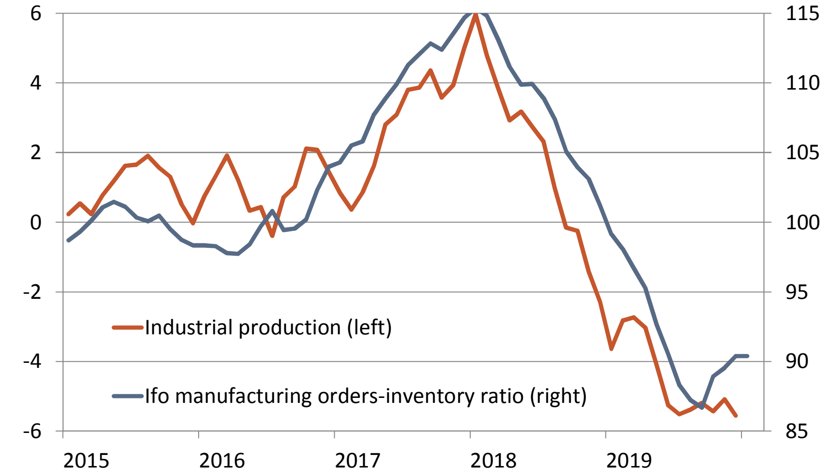
7 February 2020

German downturn: looking beyond the dark December

German industrial production versus orders-inventory ratio among manufacturers



Production excl. construction, yoy change in %, left. Orders over inventories (each indexed at 2015=100) among manufacturers, right. Three-month averages. Sources: Destatis, Ifo, Berenberg

- **A Christmas collapse?** German retail sales and industrial production plunged by 3.3% and 3.5% mom, respectively, in December while factory orders slumped by 2.1%. Export orders even dropped 4.5% mom. Following the data, we revise our estimate for German Q4 GDP from +0.1% to -0.25% qoq. However, the December data likely overstate the weakness significantly. Most of the forward-looking indicators such as the Ifo orders-inventories ratio (see chart) still support our call that the worst of the downturn in Europe's biggest economy could be over by Q2 2020.
- **Retail sales still on track:** Germany's statistical office regularly struggles to correctly assess the Christmas shopping season in its first estimate of December sales. As a result, the preliminary data are usually revised up strongly later on, on average by 2ppt in the past four years. If we adjust the December 2019 preliminary data accordingly, the yoy increase for that month would be 3.3%, in line with the 3.0% average for the year as a whole.
- **Orders – the downturn is easing:** The factory orders data for December also give a misleading impression of the situation in late 2019. Most of the 13.9% mom slump in export orders from other Eurozone countries reflects the extreme volatility in demand for airplanes and spacecraft (think Airbus). Abstracting from the monthly volatility, the intake of total factory orders receded merely by 0.6% qoq in Q4 after a 0.8% qoq contraction in Q3 and even worse falls in the two previous quarters. The official orders data thus match the results of the recent surveys of purchasing managers in manufacturing. According to Markit, the decline in new orders, while still not quite over yet, eased significantly in H2 2019 and January 2020. The very weak data for industrial output in December are likely affected by an unusual timing of the Christmas holidays which prompted many workers to take more days off than usual.
- **No coronavirus debacle yet:** Beyond the damage to travel and tourism, the pandemic looks set to interrupt some cross-border supply chains. February and March data for German industry will likely show a noticeable impact, with up to 0.1% possibly cut from Q1 GDP. The only relevant data point available so far offers some consolation, though. The German manufacturing PMI rose to an 11-month high of 45.3 in January, slightly revised up from a first estimate of 45.2. This indicates that companies that reported their results right ahead of the 24 January cut-off date, and thus partly after the virus scare had hit the headlines, had not turned negative yet. The underlying modest improvement in industrial confidence that started last autumn seems to have continued at least through most of January.
- **The case for modest optimism:** Unless the virus pandemic paralyses key parts of global industry for more than, say, two months, the temporary losses in manufacturing outside China will likely be largely recovered in the months thereafter. As long as trade tensions do not flare up badly again in 2020, expect German manufacturing output to expand modestly from Q2 onwards. The inventory correction, which subtracted a massive c0.9ppt from German GDP in 2019, will likely peter out no later than Q2 2020. With solid support from a fiscal stimulus of up to 0.5% of GDP this year, an ongoing if moderating rise in employment and a less negative outlook for trade, German growth could recover from the Christmas contraction to annualised rates close to the 1.5% trend later this year.

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