GERMANY: HARD DATA

INDUSTRY SLUMP RAISES RISK OF TECHNICAL RECESSION AT THE END OF 2018

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SUMMARY

- German industrial production (including construction) fell by 1.9% m-o-m in November, extending the decline to five out of the six last prints. Year on year, industrial production was down by 4.6%, the worst performance since November 2009.
- Some idiosyncratic factors were likely at play in November. But even considering these factors, confidence surveys show that there is a clear underlying weakness in the German industrial sector.
- While industrial production data does point to a technical recession in Germany, other hard data and surveys do not. On balance, all the data currently available point to virtually no growth in Q4. This is weaker than what we projected for Q4, partly due to a slower than anticipated recovery in the automotive sector.
- Looking ahead, German fundamentals remain healthy and will continue to support consumer demand. Moreover, fiscal policy will turn more supportive in 2019. But for a trade-oriented manufacturing-heavy economy like Germany's, the external environment remains key. Uncertainty has not completely disappeared in this regard. We expect the German economy to grow at 1.5% in 2019, with risks tilted to the downside.

Berlin, we might have a problem

German industrial production (including construction) unexpectedly fell by 1.9% m-o-m in November, extending the decline to five out of the six last prints. To make things worse, the October drop was revised downwards to -0.8% m-o-m, from -0.5%. Year on year, industrial production was down 4.6% in November, the worst performance in nine years. Production was hit by weakness across the board, but the 4.1% m-o-m drop in output of consumer goods was the main culprit. Production of capital and intermediate goods fell by 1.8% m-o-m and 1.0% m-o-m, respectively. Outside core manufacturing, the weakness persisted too, with output in the energy and construction sectors slipping by 3.1% m-o-m and 1.7% m-o-m, respectively.

Some idiosyncratic factors were likely at play in November. The below-average water levels on the River Rhine may have had an impact on energy production and chemical goods output. The Economy ministry also said the slump was exacerbated by calendar effects. There were a lower number of available working days in November due to the timing of public holidays. Moreover, unusually warm weather necessitated less energy production. **But even considering these factors, confidence surveys show that there is a clear underlying weakness in the German industrial sector**, reflecting in part the capacity constraints it faces and rising global uncertainty amid the trade conflict between the US and China.

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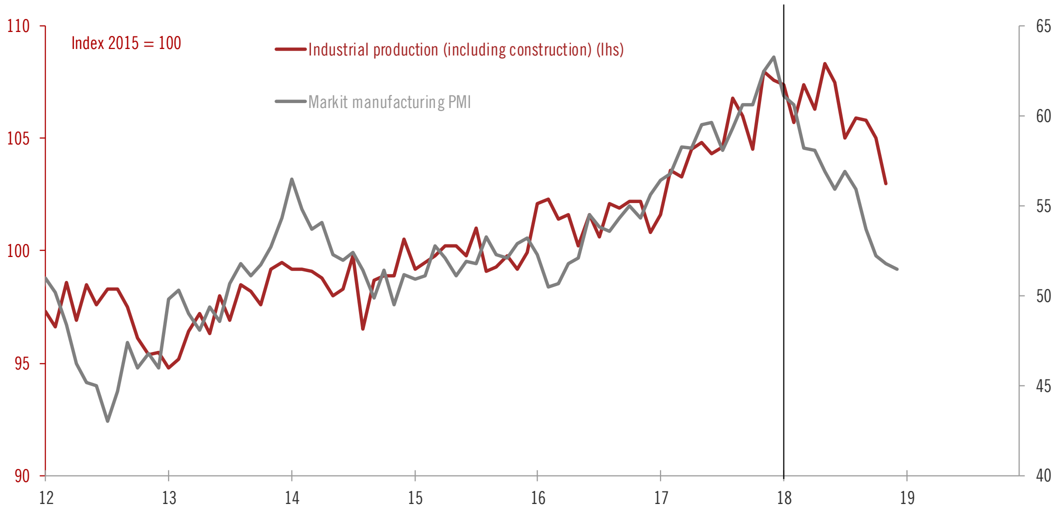
CHART 1: GERMAN INDUSTRIAL PRODUCTION AND MANUFACTURING PMI

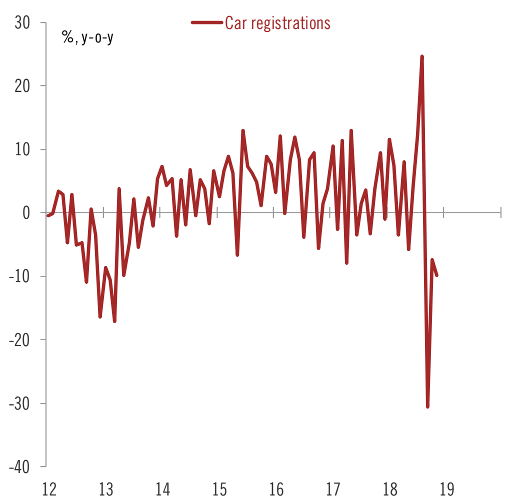


Source: PWM - AA&MR, Destatis, IHS Markit

Only timid signs of normalisation in the auto industry

The new Worldwide Light-Vehicle Emissions Testing Protocol (WLTP) for cars led to considerable output declines in the German auto industry in Q3. **A glance at hard data shows only timid signs of normalisation in Q4**. Auto production fell by 1.8% m-o-m in November and latest data on car registrations disappointed (see Chart 2).

CHART 2: GERMAN CAR REGISTRATIONS



Source: PWM - AA&MR, Destatis

CHART 3: GERMAN MANUFACTURING ORDERS

Source: PWM - AA&MR, Destatis

On the bright side, orders in the automotive sector strengthened in November (see Chart3), mainly due to improved domestic and non-euro area demand. But the **environment remains challenging**. **The threat of US tariffs has not completely disappeared**. And even though we do not expect the Americans to impose tariffs on German cars, the uncertainty is likely to continue weighing on sentiment until then.

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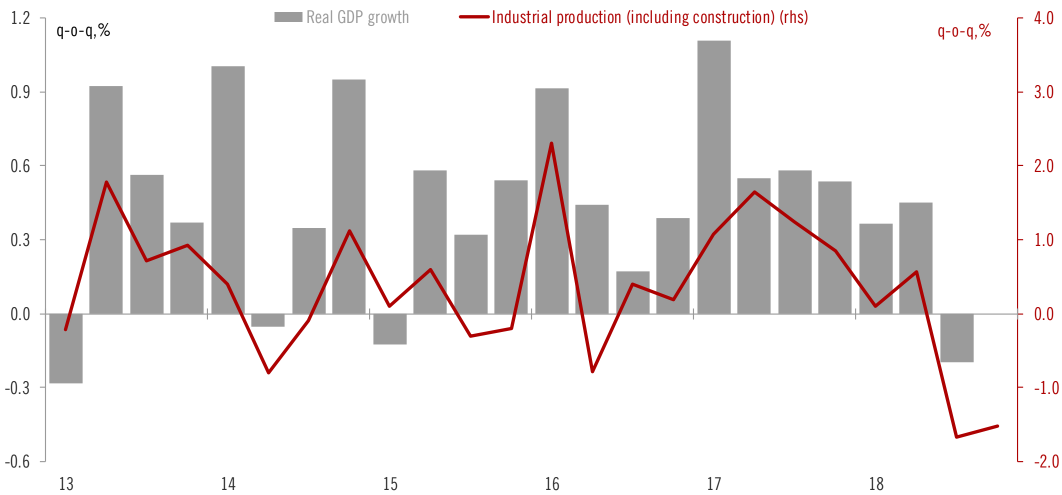
Remember the word "technical"

At face value, the downturn in industrial production data **clearly increases the risk that Germany entered a technical recession (defined as two consecutive quarters of negative growth) in the second half of 2018**. Taking October-November data together, industrial production fell by 1.5% q-o-q in Q4, only slightly better than the 1.7% plunge in Q3. Industrial production will need to have risen by 5.4% m-o-m in December for the sector to have avoided recession. We expect industrial production to have rebounded last month, but an increase of such magnitude seems highly unlikely.

While industrial output data does point to a technical recession (see Chart 4) **in Germany, other hard data and surveys do not**. Trade data published yesterday disappointed, but imports significantly underperformed exports, pointing to a positive contribution from net exports. The latest releases on retail sales and consumer confidence surprised on the upside. On balance, **all the data currently available point to virtually no growth in Q4**. This is weaker than what we projected for Q4 previously, partly due to a slower than anticipated recovery in the automotive sector. The publication of 2018 full-year GDP results by the statistical office next Tuesday will provide a first official indication of Q4 growth.

Looking ahead, **fundamentals (labour market, credit conditions…) remain healthy** in Germany and will continue to support consumer demand. Moreover, fiscal policy will turn more supportive in 2019. But for a trade-oriented manufacturing-heavy economy like Germany's, the external environment remains key. Uncertainty has not completely disappeared in this regard. German manufacturers were hit by weakening external demand in 2018, notably in key markets like China, but also by global uncertainty stemming from trade tensions and Brexit turmoil. Should trade tensions ease, we might see a rebound in external demand for German goods in early 2019.

CHART 4: GERMAN INDUSTRIAL PRODUCTION AND REAL GDP GROWTH



Source: PWM - AA&MR, Destatis

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