NEW ZEALAND
FOREIGN AFFAIRS & TRADE
Manatū Aorere

Germany economic update: going through an unprecedented energy crisis

MARKET REPORT

January 2023

Summary

- As anticipated, Germany is having a hard time weathering the economic storm triggered by the Russian invasion of Ukraine. The German economy has continued to grow modestly but is now expected to enter a (mild) recession.

- German business and consumer confidence has been shaken by the events, and this could impact both New Zealand's exports and imports. For now, bilateral trade is recovering slowly, thanks in part to New Zealand re-opening for German tourists and students.

Report

Germany is the world's fourth largest economy, the largest economy in the European Union (EU) and our number one trading partner in the bloc. As foreshadowed in the last economic update in March 2022, the German economy has been impacted by its dependency on relatively cheap Russian energy (>50% of gas imports). Russian coal and oil imports have now been largely banned, and Russia has halted much of its regular gas exports to Germany. To cushion the effects, the German Government has succeeded in filling national gas storage facilities before the northern winter, and has secured alternative supplies (such as liquefied natural gas) from other countries. Nevertheless, energy has been both scarce and expensive in recent months, and this could continue this year. This has short- and longer-term implications for the German economy, and potentially also for our bilateral trade with Germany.

German economy 2022/2023: still modestly growing but likely to enter recession

What could have been a year of strong recovery and significant growth post-COVID has turned into a struggle to keep the German economy afloat. So far, quarterly growth has remained positive, arguably thanks to post-pandemic catch-up consumption that has outweighed the negative economic effects of the Russian invasion of Ukraine. The German economy finally reached pre-pandemic levels in Q2 last year and was still growing at 0.4% (in real terms) in Q3. However, with high energy prices finally reaching consumers growth is forecast to turn negative during the northern winter and potentially remain negative or stagnant in 2023. Most forecasts predict a (mild) recession for next year, with GDP growth anticipated to be between -0.75% and +0.3%. This is not as bad as earlier predictions, but still marks one of the worst outlooks for any country in Europe, although there is a high degree of uncertainty in the confidence of the forecast.

These headline figures do not fully reflect the shocks and shifts facing the German economy. As a result of energy prices increasing, consumer price inflation peaked at 10.4% in October, and consumer confidence reached its lowest level since records began in 1991 (although this seems to be recovering now). The savings rate has dropped to pre-pandemic levels, but this is driven by a need to pay higher energy and food bills rather than by increased demand for consumer goods and services. Real wages are down by nearly 5% year on year, and whilst the Government has announced generous support for employees, families, students and pensioners to mitigate the effects of high energy prices, this will not fully compensate for the loss of purchasing power. Private consumption is therefore forecast to drop in real terms this year, although this is expected to be somewhat mitigated by increased net migration to Germany (more refugees have already arrived than during the 2015/16 migration crisis).

German businesses are equally feeling the pressure, with producer price inflation recently peaking at 45%, a record in German post-war history. Industry production – in particular fertilisers, chemicals and steel – and future orders have been decreasing, with business confidence reaching its lowest level in October since 2020 (although there has been some recent recovery). Many businesses report they are struggling and fear for their ongoing viability as a result of high energy prices. Investment decisions are being postponed. To the extent they have the market power to do so, businesses are increasing prices for their products to compensate for increased input costs.

In response, the Government has announced subsidies for gas and electricity costs, acknowledging that Germany's economic model (import cheap energy, produce high-quality industrial goods and export them) is at stake. While this will mitigate the energy price shock it will add to public debt levels. Many economic observers expect Germany's competitiveness to decrease compared to the US, and a loss of wealth. As the major growth engine of Europe, Germany's slowing economy will have impacts for Europe more broadly.

Germany's economic headwinds could affect our recovering bilateral trade

Our exports to Germany have yet to recover fully following the pandemic. For the September year 2022, New Zealand goods and services exports just exceeded NZD1 billion (+9% year on year; -40% compared with 2019), with our tourism and education services only just returning to market. Meat exports increased by over 50%, whereas exports of medical equipment dropped after the pandemic-induced peak demand. Travel and education are beginning to recover, with German tourist arrivals in October reaching more than half of the 2019 level. Demand remains high despite high flight prices and availability challenges; evidence from the northern summer season suggests fewer Germans travel but spend more.

Likewise, New Zealand's imports from Germany, worth NZD3.6 billion, are recovering gradually (+2% year on year; -20% compared with 2019). Ongoing supply chain issues, full order books and challenges related to the Russian invasion of Ukraine could result in delivery delays and rising prices of imports from Germany, such as vehicles or chemicals.

More info

More reports

View full list of market reports from MFAT at www.mfat.govt.nz/market-reports

If you would like to request a topic for reporting please email exports@mfat.net

To get email alerts when new reports are published, go to our subscription page.

To learn more about exporting to this market, New Zealand Trade & Enterprise's comprehensive market guides cover export regulations, business culture, market-entry strategies and more.

To contact the Export Helpdesk

email exports@mfat.net

call 0800 824 605

visit Tradebarriers.govt.nz