Germany – is this the turning point?

Dr. Jörg Krämer
Dr. Ralph Solveen

The slight increase in real GDP in the first quarter and the improved sentiment among companies point to a recovery in the German economy, especially as the burden from monetary policy and energy prices is easing. We have therefore raised our growth forecast for Germany slightly this week. However, the weak trend of orders in construction and industry to date and the poor mood among consumers suggest that growth will not speed up until the middle of the year. In addition, the momentum is likely to be restrained because monetary policy will only loosen slightly and the numerous structural problems remain largely unresolved.

Signs of hope: growth in Q1 …

Since last fall, many institutions and economists have significantly lowered their economic forecasts for Germany. It is therefore remarkable that the German government recently did not reduce its growth forecast for this year any further, but instead increased it slightly from 0.2% to 0.3%. We also raised our forecast this week, which was justifiably well below the consensus forecast for most of last year. We now expect the German economy to stagnate this year instead of shrinking by 0.3%. This upward revision was mainly due to the fact that, contrary to original expectations of a renewed drop, the **GDP** increased slightly by 0.2% in the first quarter compared to the fourth quarter of 2023. This has improved the starting point for our 2024 forecast.

… and better sentiment among companies

In addition, the Ifo business climate has risen three times in a row by now. As a consequence, the 6-month average has turned upwards, which has usually been a reliable turning signal in the past. However, the mood has not only improved in Germany, but also in many other countries. The combined PMI for the manufacturing and service sectors in the eurozone has risen four times in a row and has clearly left the recession zone behind. The global purchasing managers' index for the manufacturing industry has also recovered somewhat since the turn of the year.

This time probably not an "expectations bubble", …

Skeptics will object that the improvement in the indicators merely reflects mostly positive expectations that are not yet substantiated by an improved economic situation. They might fear an expectations bubble, as it was observed in the Ifo business climate in the winter half-year 2022/23 (Chart 1). While companies revised their business expectations for the subsequent six months significantly upwards at the time, they hardly improved their assessment of the current business situation. In fact, there was no upswing afterwards, but the economic downturn continued.

Chart 1 - Ifo: Firms gain hope

Subcomponents of the Ifo business climate for Germany, 2015=100

Source: Ifo, S&P Global, Commerzbank Research

This false signal in business expectations can be explained above all by the extensive decline of Russian gas supplies some time after the start of the Russian war against the Ukraine. Fears of a gas shortage initially prevailed, causing business expectations to plummet. As it slowly became clear in autumn of 2022 that an energy crisis could be avoided thanks to alternative gas supplies and savings, sentiment recovered again. Therefore, the rise in business expectations in the winter half-year 2022/23 mainly reflected relief over the avoidance of gas shortages and was not a signal of a cyclical upturn.

… but a recovery signal

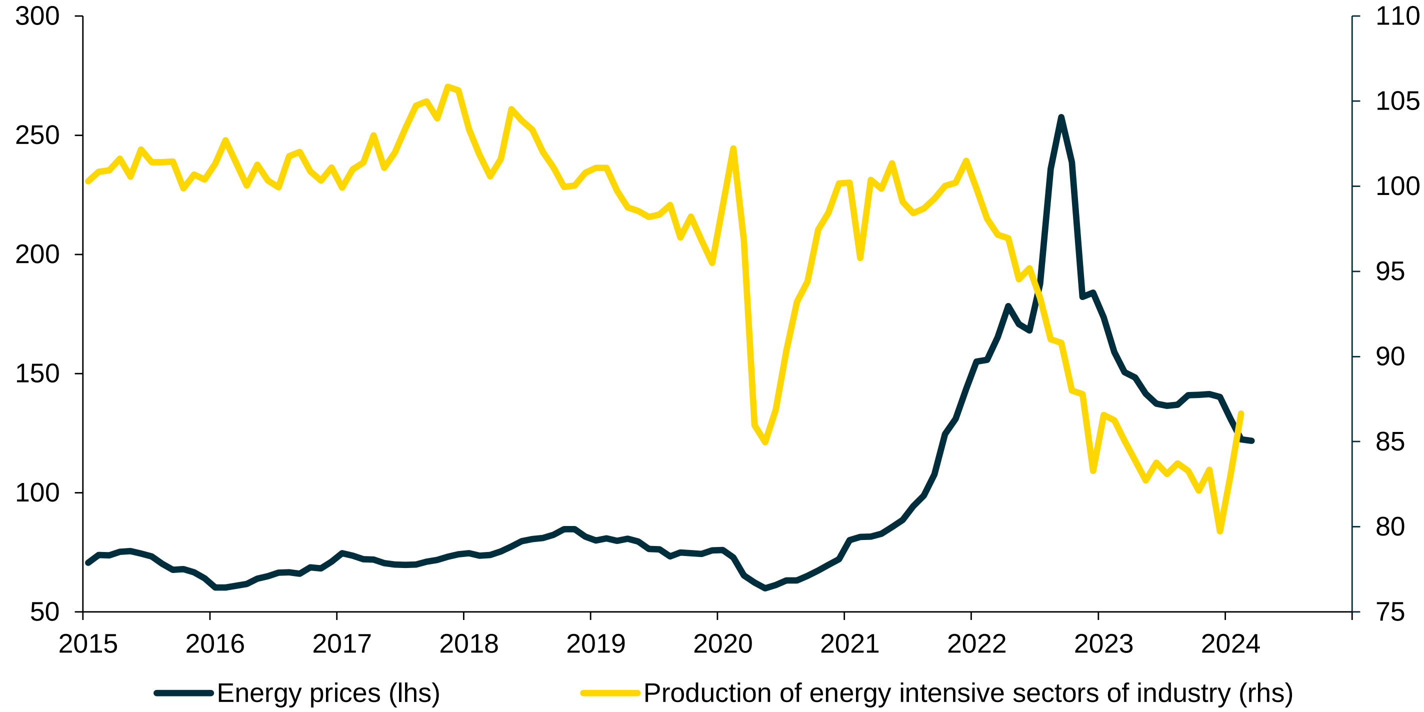
This time, however, the recovery in sentiment indicators is likely to signal an economic recovery. This is because two negative factors that previously caused the downturn have now become less significant:

- ***Key interest rates:*** The bulk of the ECB's interest rate hikes, which began in mid-2022, are more than a year past. Companies have increasingly become accustomed to higher interest rates. This also applies to most Western countries, which explains the slight recovery in the global PMI for manufacturing.

- ***Energy prices:*** The weighted energy prices of German companies were more than three times higher at its peak in autumn 2022 than at the beginning of 2021 amid fears of an energy crisis. It has since reversed around two thirds of the increase, which is mainly due to the normalization of gas and electricity prices (Chart 2). As a result, production in the energy-intensive industrial sectors has recently recovered somewhat, even if it is unlikely to return to its original level due to the relocation of production facilities.

Chart 2 - Energy prices much lower, but still high

Energy prices: Average of producer prices for lignite, natural gas, heating oil and electricity weighted by the share of energy consumption in industry in 2021; production of energy-intensive industrial sectors; monthly figures and 2015=100 in each case



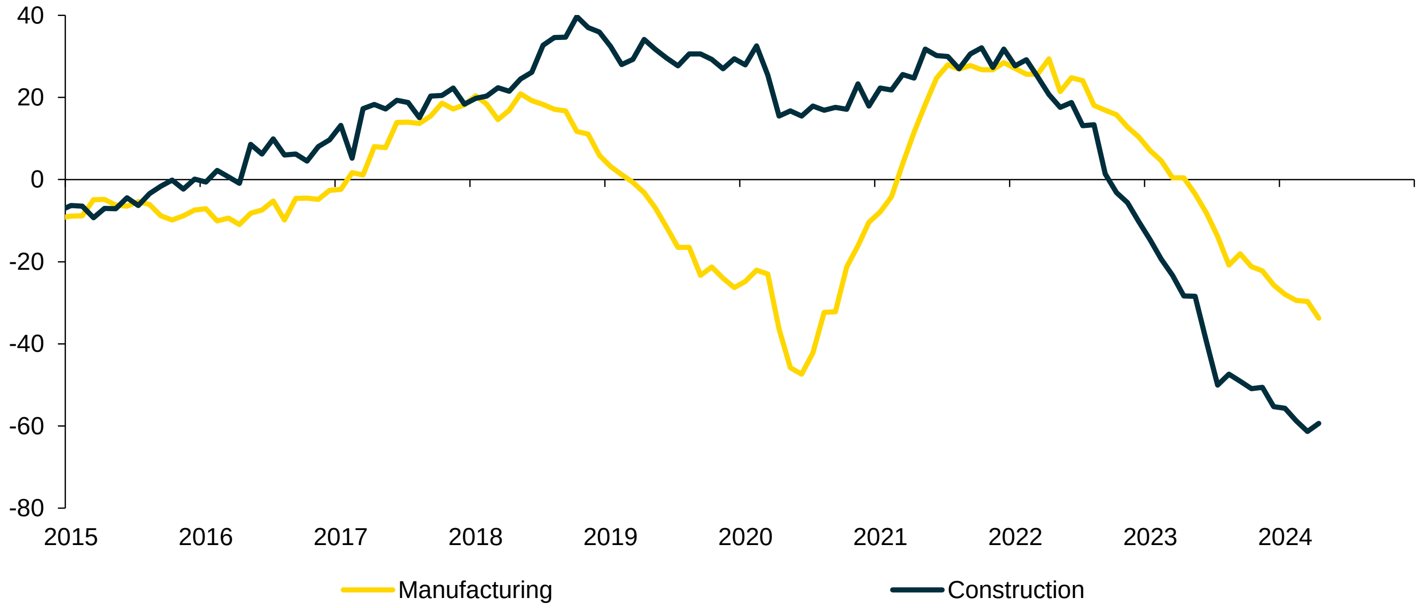
Source: destatis, Commerzbank Research

But the recovery is still a little way off ...

The easing pressure from these factors is therefore a good reason to expect the economy to pick up again in the medium term. However, real GDP is unlikely to increase further in the second quarter, but only starting from the middle of the year. This is because companies' order books do not yet appear to show any signs of an upturn in demand. In the Ifo survey, even more industrial companies stated in April that they assess their order books as "too small". Negative assessments also clearly dominate in the construction sector (Chart 3). Against this backdrop, the assessment of the situation by companies has not yet improved significantly. In the industrial sector, the respective sub-component of the Ifo business climate was even worse than in the autumn of 2020, three and a half years ago.

Chart 3 - No turn-around in assessment of order backlog yet

Assessment of the order backlog in the Ifo survey, proportion of companies that describe it as "relatively large" minus the proportion of companies that consider it "too small", in percentage points



Source: Ifo, S&P Global, Commerzbank Research

The hard figures available so far also suggest that real GDP will stagnate in the second quarter. The trend in incoming orders in the industry has pointed downwards until recently, casting doubts over the sustainability of the fairly strong increase in production in the first two months of this year.

The same applies to construction. Incoming orders appear to have stabilized at a low level. However, activity in building construction has not yet adjusted to the previous slump in orders, meaning that a decline can be expected here for some time to come. The strong increase in production in February is likely to merely reflect the unusually mild weather and will therefore be corrected again in March (see also data preview).

Caution is also still warranted with regard to consumption. It is true that the purchasing power of many private households is increasing again following the stronger rise in wages and lower inflation. Nevertheless, private consumption fell in the first quarter. Private households are evidently still very unsettled by the recent surge in consumer prices. The GfK consumer climate index remains at a disastrously low level and has not yet signaled a turnaround, even though it has risen slightly in the last three months.

The current combination of more positive sentiment indicators and rather weak "hard" figures are not unusual for a turning point and they are not an argument against a recovery in the course of this year. However, they do suggest that the recovery will take a few more months and that the German economy will probably stagnate at best in the second quarter before a recovery sets in during the second half of the year.

... and is unlikely to be particularly dynamic

A number of factors suggest that this recovery is unlikely to be particularly dynamic. Unlike many upward movements in the past, it will hardly receive any tailwind from monetary policy. It is true that the ECB is likely to cut its key interest rates starting in June. However, given that the core inflation rate will probably remain stubbornly above its inflation target, this is unlikely to be the start of a full-blown cycle of interest rate cuts. Instead, the cuts only represent a correction of the current rather high level of key interest rates by around 100 basis points in total. As a result, there is unlikely to be any noticeable revival in demand in the construction sector.

Another argument for only a moderate recovery are the numerous structural weaknesses in the German economy, which are significantly impairing its competitiveness. A prominent example of this are the still high energy prices despite the decline in recent months, which is why many energy-intensive industries are more likely to invest outside Germany. In addition, there are other wellknown weaknesses such as high taxes on profits compared to many other countries, extensive and complicated regulation and high wage costs compared to other countries.

The consequences for the eurozone and the ECB

Following a probable stagnation in the second quarter, the German economy should recover somewhat from the middle of the year onwards. This picture also applies in principle to the eurozone, although growth there is always slightly higher due to Germany's structural problems.

The moderate recovery of the economy is making it easier for companies to pass on higher wage costs to consumers. This effect increases inflation risks and supports our forecast that core inflation will settle at 3% rather than 2% at the end of the year. Nevertheless, the ECB is likely to cut its key interest rates at the beginning of June, as it has in fact already announced this move. We expect three further rate cuts of 25 basis points each between now and the beginning of 2025, as some time will pass before the ECB realizes that the inflation problem has not yet been solved.

Research contacts (E-Mail: firstname.surname@commerzbank.com)

Chief Economist
Dr Jörg Krämer
+49 69 136 23650

Economic Research

Dr Jörg Krämer (Head)
+49 69 136 23650

Dr Ralph Solveen (Deputy Head; Germany)
+49 69 9353 45622

Dr Christoph Balz (USA. Fed)
+49 69 9353 45592

Dr Vincent Stamer (Euro area, World trade)
+49 69 935345800

Dr Marco Wagner (ECB, Germany, Italy)
+49 69 9353 45623

Bernd Weidensteiner (USA, Fed)
+49 69 9353 45625

Christoph Weil (Euro area, France, Switzerland)
+49 69 9353 45589

Tung On Tommy Wu (China)
+65 6311 0166

Interest Rate & Credit Research

Christoph Rieger (Head)
+49 69 9353 45600

Michael Leister (Head Rates)
+49 69 9353 45610

Rainer Guntermann
+49 69 9353 45629

Hauke Siemßen
+49 69 9353 45619

Ted Packmohr
(Head Covered Bonds and Financials)
+49 69 9353 45635

Marco Stoeckle
(Head Corporate Credit)
+49 69 9353 45620

FX & Commodities Research

Ulrich Leuchtmann (Head)
+49 69 9353 45700

Antje Praefcke (FX)
+49 69 9353 45615

Tatha Ghose (FX)
+44 20 7475 8399

Charlie Lay (FX)
+65 63 110111

Michael Pfister (FX)
+49 69 9353 45614

Thu-Lan Nguyen (FX, Commodities)
+49 69 9353 45617

Carsten Fritsch (Commodities)
+49 69 9353 45647

Barbara Lambrecht (Commodities)
+49 69 9353 45611

Tung On Tommy Wu (China)
+65 6311 0166

Other publications (examples)

Economic Research:	Economic Briefing (up-to-date comment on main indicators and events) Economic Insight (detailed analysis of selected topics) Economic and Market Monitor (chart book presenting our monthly global view)
Commodity Research:	Commodity Update (comment and news on commodities markets, two times per week) Commodity Spotlight (detailed analysis and forecasts of commodities markets)
Interest Rate & Credit Research:	Ahead of the Curve (flagship publication with analysis and trading strategy for global bond markets European Sunrise (daily comment and trading strategy for euro area bond markets) Rates Radar (ad-hoc topics and trading ideas for bond markets) Covered Bonds Weekly (weekly analysis of the covered bonds markets)
FX Strategy:	Daily Currency Briefing (daily comment and forecasts for FX markets) FX Hot Spots (ad hoc analysis of FX market topics)

To receive these publications, please ask your Commerzbank contact.

Analysts

Dr. Jörg Krämer
Chief Economist
+49 69 136 23650
joerg.kraemer@commerzbank.com

Bernd Weidensteiner
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

In accordance with ESMA MAR requirements this report was completed 3/5/2024 07:18 CEST and disseminated 3/5/2024 07:18 CEST.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank's non-US branch offices mentioned in the document.

Please note that the author(s) certify that (a) the views expressed in this report accurately reflect their personal view about the subject securities and issuers; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: **https://commerzbank.bluematrix.com/sellside/Disclosures.action***

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and has been prepared for recipients who, like professional clients according to MiFID II, have the experience, knowledge and expertise to understand information related to the financial markets. The document does not take into account specific circumstances of any recipient and the information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document is not for distribution to retail customers and has been issued or approved for issue in the United Kingdom by Commerzbank AG, London Branch, which is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

United States: To the extent this report is distributed to U.S. investors, it is restricted from being sent to U.S. retail investors. Commerz Markets LLC ("CMLLC") is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. For securities purposes, Commerzbank AG provides this report as a third-party report, therefore the involved research analysts may not be registered with FINRA and the reports are not subject to the full provisions of FINRA Rule 2242. Any securities transactions by US investors resulting from this report must be effected with CMLLC. CMLLC is a member of FINRA and SIPC. Banking and swap services in the U.S. will be provided by Commerzbank AG in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. Commerzbank AG is not a member of SIPC and is a provisionally registered swap dealer with the CFTC.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerzbank AG and/or Commerz Markets LLC deals pursuant to the international dealer exemption. The information contained herein is not permitted to reference securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, as Commerzbank AG and Commerz Markets LLC operates under the international dealer exemption pursuant to National Instrument 31-103. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Switzerland: Neither this research report nor the information contained herein should be regarded as personal recommendations for transactions in financial instruments within the meaning of the Financial Services Act.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore ("SFA") pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a "financial advisory service" within the meaning of the Financial Advisers Act, Chapter 110 of Singapore ("FAA") and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

Japan: This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to "professional investors" as defined in Section 2(31) of the FIEA and Section 23 of the Cabinet Ordinance Regarding Definition of Section 2 of the FIEA. Please note that Commerzbank AG, Tokyo Branch has not participated in its preparation. Any instruments referred in this report cannot be introduced by the Branch. You should contact the Corporate Clients division of Commerzbank AG for inquiries on availability of such instruments.

Australia: Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313.

Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

People's Republic of China (PRC): This document is furnished by Commerzbank AG and is only intended for eligible entities in the PRC. No-one else may rely on any information contained within this document. The products and services in this document only apply to entities in the PRC where such products and services are permitted to be provided by PRC laws and regulations. For any person who receives this document, the information in this document shall neither be regarded as promotion or solicitation of the business nor accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication, and the recipient is advised to seek independent advice from its own professional advisers about the information contained herein and shall understand and abide by PRC laws and regulations while conducting any related transactions.

Commerzbank Offices

Frankfurt	**London**	**New York**	**Singapore**
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	128 Beach Road
Mainzer Landstraße 153	30 Gresham Street	New York,	#17-01 Guoco Midtown
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000