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ECONOMY

German Economy Shows New Signs of Softening, Raising Broader Fears

Industrial production drops unexpectedly as several factors continue to weigh on the global economy

Workers assemble parts onto a Macan sports utility vehicle in the bodyshop inside the Porsche factory in Leipzig, Germany, in December. PHOTO: KRISZTIAN BOCSI/BLOOMBERG NEWS

By Tom Fairless and Paul Hannon

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FRANKFURT—Fresh signs of a weakening German economy are raising fears that last year's slowdown could spill into 2019, deepening the challenges facing policy makers in Europe and the U.S.

Industrial production in Europe's largest economy dropped unexpectedly in November, according to data released Tuesday, the latest reflection of a confluence of headwinds facing the global economy including trade tensions and weakening demand from China.

German factories aren't alone in feeling those effects. A monthly survey released by the European Commission on Tuesday found business confidence fell sharply in the final month of 2018, with French, Italian and Spanish manufacturers joining their German counterparts in downgrading their expectations.

Signs of a slowdown in Europe and China have prompted falls in global markets, despite continuing signs of strength from the U.S. economy. The disconnect presents the Federal Reserve with a tricky choice: focus more on the domestic economy and keep nudging interest rates higher to combat inflationary concerns, or pay greater attention to stresses abroad and in markets, and hold rates steady—or even nudge them lower.

Europe's deepening slowdown is a similar headache for the European Central Bank, which is trying to wean the 19-nation eurozone economy off years of monetary stimulus and ease toward higher interest rates. In 2018, the currency area grew ever more slowly than the ECB's economists had expected. Officials at the central bank must judge whether a recent run of particularly disappointing data signals that the economy is sliding toward recession or a period of lower growth.

The ECB has long argued that its four-year program of bond purchases was the primary driver of the eurozone's economic recovery. Having ended those purchases in December, that boast may come back to haunt policy makers.

"The impact of QE is something we all underestimate," said David Folkerts-Landau, chief economist at Deutsche Bank. "My instinct is to say we are in a much more precarious position in Europe than we thought."

Production in Germany's key industrial sector, adjusted for inflation and seasonal swings, fell 1.9% in November from the previous month, the country's statistics agency said Tuesday. Economists polled by The Wall Street Journal had expected a 0.3% gain.

It was the second consecutive monthly fall in German industrial output and comes after data Monday showed a drop in new manufacturing orders.

"Today's industrial production data has clearly increased the risk of a technical recession in Germany in the second half of 2018," said Carsten Brzeski, an economist at ING in Frankfurt.

A technical recession consists of two consecutive quarters of declining economic output. Germany's economy shrank in the third quarter of the year for the first time since 2015, dented by weaker exports and the impact of new emissions standards on automobile production. Italy's economy also contracted in the third quarter, and is also at risk of ending the year in recession.

German officials have played down signs of economic softness, attributing them to temporary factors that would soon fade. The economy ministry said Tuesday that the drop in industrial production partly reflected extra vacation days as well as bottlenecks in the key auto sector.

However, there are broader signs of a more durable economic slowdown across Europe, and that is reflected in souring business and consumer sentiment.

With economic growth having hit a decade high in 2017 as exports surged, eurozone manufacturers started 2018 in a more upbeat mood than at any time since they were first surveyed in 1985. They ended the year in a quite different mood, helping lower the European Commission's Economic Sentiment Indicator—an aggregate measure of consumer and business confidence in the eurozone—to 107.3 in December from 109.5 in November, reaching its lowest point since January 2017.

The collapse in confidence as 2018 drew to a close suggests growth is unlikely to rebound in the early months of this year.

Economists estimate that the eurozone economy grew 1.9% in 2018, a slowdown from the 2.4% expansion recorded in 2017. Economists at 30 banks and research firms monitored by Consensus Economics have steadily lowered their 2019 projections over recent months, and now expect the combined gross domestic products of the eurozone to increase just 1.6% during 2019.

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