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ECONOMY

Trade War Takes Toll on Economic Growth in Germany, China

Weak economic data in Germany and China show the magnitude of the impact of tensions between Washington and Beijing

BMW i3 electric automobiles at a factory in Leipzig, Germany. Troubles in Germany's auto sector have weighed on the country's economy. PHOTO: KRISZTIAN BOCSI/BLOOMBERG NEWS

By Bojan Pancevski in Berlin and Tom Fairless in Frankfurt

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Fears rose of a spiraling economic slowdown in Europe and Asia after Germany said its economy shrank in the second quarter and China reported a raft of weak data.

The bad news from two industrial powerhouses that are closely interlinked by trade and foreign investment added to market concerns about the state of the global economy that have prompted a flight into safe assets. U.S. stocks and bond yields fell on Wednesday.

The European Union, with a weakening Germany at it core and the mounting prospect of losing the U.K. as a member without a negotiated exit on Oct. 31, looks particularly fragile. Recent eurozone data showed growth in the narrower group of countries that use the euro had all but ground to a halt.

In Germany, gross domestic product contracted 0.1% in the three months to June, with economists and government leaders largely blaming the cool-down in Germany's export-driven economy on the uncertainty caused by the U.S.-China trade war and the prospect of an abrupt Brexit.

Meanwhile, the jobless rate in Chinese cities rebounded in July to its highest level since regular reporting of the data began, and figures on factory production, consumption, property investment and other key readings were lower than expected.

Economists and government planners said China's dispute with the U.S. has dented confidence among its manufacturers, despite a surprise jump in exports in July. Anticipation is growing that China will have to deploy additional stimulus measures to keep the economy growing by its 6-6.5% target.

The Chinese data could portend more pain for Germany, whose car makers and capital-goods manufacturers are among the most successful Western businesses in China. The country was Germany's third-largest export market last year after the U.S. and France.

The persistent weakness of the Chinese economy means Germany's will likely stagnate through next year, said Jörg Krämer, chief economist at Commerzbank in Frankfurt, who expects German GDP to grow just 0.8% in 2020.

Price-adjusted exports to China from the eurozone rose by an average of 14% on the year in 2017, but that slowed to 1.5% in the five months through May 2019, according to Commerzbank.

The latest data from Germany adds pressure on governments to unleash stimulus measures of their own.

"The new figures are a wake-up call and a warning," said Germany's minister of the economy, Peter Altmaier, in a statement. "We are in a weak growth phase but not yet in a recession, which we can avoid if we take necessary measures. Politicians and businesses must now act together."

Berlin has faced pressure to loosen its strict fiscal policy to help drum up consumer demand and investment at home to offset the slump in exports. It has resisted so far, though it is planning moderate tax cuts and a new environmental policy, to be unveiled this fall. Mr. Altmaier said Wednesday corporate tax should be reduced, and investment into digitization and future technologies accelerated—a contentious topic of discussion in the government.

Central banks in Asia already have begun cutting interest rates. India and New Zealand were among the first, ahead of the Federal Reserve's rate cut in late July, and they cut rates again last week along with Thailand and the Philippines.

The latest data from Germany will likely now heap additional pressure on the European Central Bank to launch a new stimulus package at its next policy meeting on Sept. 12 to help revive confidence. ECB President Mario Draghi has promised a series of new measures, which could include interest-rate cuts and hundreds of billions of euros in bond purchases.

"Trade conflicts, global uncertainty and the struggling automotive sector have finally brought the German economy down on its knee. In particular, increased uncertainty, rather than direct effects from the trade conflicts, have dented sentiment and hence economic activity," said ING's chief economist for Germany, Carsten Brzeski.

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Early indicators and business sentiment surveys point to another weak performance in the third quarter. That could potentially indicate a recession, defined by economists as two consecutive quarters of shrinking output.

Attention is now focusing on just how far the trade dispute between Washington and China will go.

One U.S. official involved in the talks said a new round of face-to-face talks with China in Washington next month is unlikely to progress if Beijing continues to resist making structural changes to allow U.S. businesses to compete on what they say is a more even footing.

Wall Street, though, received a lift this week after the Trump administration suspended plans to impose new tariffs on about $156 billion in goods from China, including smartphones, laptops, toys, videogames and other goods, that were supposed to take effect on Sept. 1. "We're doing this for Christmas season, just in case some of the tariffs would have an impact on U.S. customers," President Trump said. The Dow Jones Industrial Average rose 1.4% on Tuesday before falling again on Wednesday. The yield on the U.S. 30-year Treasury bond fell to a record low.

The mood is more downbeat in Germany and much of the rest of Europe. German manufacturing output has been shrinking this year despite a small gain in GDP in the first quarter. Several large German companies have blamed U.S.-China trade tensions for disappointing results, including software maker SAP SE , chemicals company BASF SE and engineering group Siemens AG .

The yield on the German government's 10-year bond touched a fresh record low of minus 0.624% in Wednesday morning trading, according to Tradeweb.

In the eurozone, seasonally adjusted industrial production fell 1.6% in June from May, and dropped 1.5% on month in the wider EU, according to estimates from Eurostat, the EU statistical office.

Seasonally adjusted gross domestic product grew 0.2% in the eurozone and the EU in the second quarter of 2019 compared with the previous quarter, the Eurostat estimate said. The economy grew 0.4% in the eurozone and 0.5% in the EU in the first quarter.

A loading terminal in the port of Hamburg, Germany. PHOTO: FABIAN BIMMER/REUTERS

Germany was the only eurozone country whose economy shrank. Outside the eurozone, Britain and Sweden also contracted.

Some EU exporters ultimately might benefit if China's businesses decide to switch U.S. products for European ones, some analysts say. But the uncertainty surrounding the trade conflict between the world's two largest economies appears to set to continue overshadowing whatever happens in Europe, Asia and other parts of the economy.

Companies in particular will likely find it difficult to plan and invest without knowing how the trade tensions will play out.

"This is especially difficult in an export-oriented economy like Germany's," said Clemens Fuest, president of the Ifo institute, an independent economic think tank.

—Grace Zhu contributed to this article.

Corrections & Amplifications
The yield on the German government's 10-year bond touched a fresh record low of minus 0.624%. An earlier version of this article incorrectly stated that the yield was 0.624%. (Aug. 14, 2019)

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