DIW Weekly Report 11+12 2019

AT A GLANCE

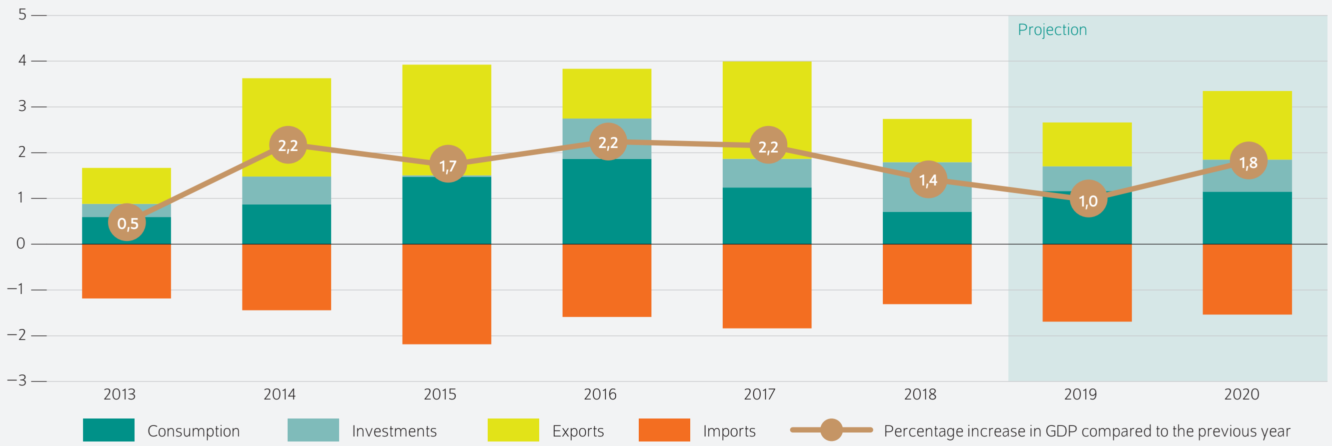
# German economy growing despite uncertainties and risks; global economy continuing to cool down

By Claus Michelsen et al.

- German economy continuing to grow despite economic slowdown; DIW forecasts growth of 1.0 percent for 2019, 1.8 percent for 2020
- Global economy weakening due to trade conflicts, Brexit; German export industry particularly affected
- Domestic economy supporting growth: employment growth continuing, private consumption strong, also thanks to low inflation, construction industry booming
- Public budgets expected to close with surpluses of almost 43 billion euros in 2019 and 37 billion euros in 2020
- Investments in digitization and R&D could boost growth potential and provide stimuli against an economic slowdown

**Economic boom in Germany is over, but private consumption is supporting growth**

Individual GDP components' contribution to growth in percentage points




Source: Authors' own surveys and calculations.



## FROM THE AUTHORS

*In many places, growth is increasingly being driven by consumption rather than investment. This is bad for the German industrial sector, which primarily exports capital goods. That explains why the German economy is being affected by developments such as those in China and parts of the euro area so strongly.*

*— **Claus Michelsen**, Head of Forecasting —*

## MEDIA

**Audio Interview** with Claus Michelsen (in German)

**www.diw.de/mediathek**

# German economy growing despite uncertainties and risks; global economy continuing to cool down

**By Claus Michelsen, Guido Baldi, Martin Bruns, Marius Clemens, Geraldine Dany-Knedlik, Hella Engerer, Marcel Fratzscher, Stefan Gebauer, Max Hanisch, Simon Junker, Konstantin Kholodilin, Malte Rieth, and Thore Schlaak**

According to DIW Berlin estimates, the German economy will continue its solid growth performance in 2019 and 2020. Overall, however, the economy is cooling noticeably and production capacity utilization is returning to normal. This is primarily due to the global economy weakening; it has been strained by China's weakening economy, trade conflicts, and political uncertainties such as Brexit. The German economy will be particularly affected by these developments, as it specializes in exporting capital goods. However, the German economy will likely gradually make up for its dip in growth, helped by the fact that private households have been benefiting from fiscal policy stimuli since the beginning of 2019 and the increasing signs of a recovery in the automobile industry. Nevertheless, DIW Berlin has lowered its growth forecast for the German economy to 1.0 percent for this year in light of the gloomier business expectations in many sectors. The outlook for 2020 remains unchanged, however, with GDP forecasted to grow by 1.8 percent.

In the short term, non-recurring effects will dominate the German economy. For example, the automotive industry struggled with weaker sales until winter 2018 due to a delay in certifying their fleet, which was required to adhere to the new vehicle emission and fuel consumption standards prescribed by the Worldwide Harmonized Light Vehicle Test Procedure. However, the latest sales figures show that the sector is gradually compensating for this slump. The chemical industry also appears to be recovering after production slumped in the autumn due to low water levels on inland waterways. Moreover, fiscal policy is boosting economic growth: some of the Grand Coalition's decisions, such as financing health insurance by splitting the costs equally between employers and employees, have resulted in strong income growth for private households since the beginning of the 2019, increasing private consumption.

The domestic economy will continue to support growth over the further course of the forecast period. The labor market is showing no signs of weakening, and employment growth is continuing uninterrupted. In 2019, employment should reach a new record level and the unemployment rate of 4.8 percent should reach a further low since German reunification. Real wages are developing strongly—growing by 1.5 percent—also due to the low inflation rate of 1.5 percent. The construction industry is booming, and despite the uncertainties, companies are investing in expanding their production capacity.

However, the currently harsh external economic environment is negatively impacting sentiment. Nearly all sentiment indicators have declined significantly in recent months. Primarily industrial companies' business expectations are declining globally while the service providers remain confident. There are many reasons for these poor expectations: in the USA, fiscal policy stimuli are gradually waning and the federal government shutdown slowed economic growth. In Europe, the Italian economy is of particular concern, as growth has lagged well below expectations. In Asia, the Chinese economy has weakened recently. Globally, investment goods—one of the German economy's specializations in foreign trade—have lost momentum in particular. This loss of momentum is especially troublesome for the German economy and is partly a result of the uncertain economic environment, although the trade disputes between the USA and China have calmed down. Signs of trouble remain, however, as the conflict between the USA and the European Union over EU automobile exports to the USA is flaring up again. The introduction of tariffs would pose a considerable burden for the German economy. Ongoing discussions about Brexit will continue to burden the economy. In view of the economic slowdown and low inflation, the European

 DOI: https://doi.org/10.18723/diw_dwr:2019-11-1

Central Bank has already announced that it will continue to provide expansionary monetary policy stimulus. The Federal Reserve has also indicated it will reduce the pace of interest rate hikes in reaction to the weaker economic development in the USA.

The situation is no longer as advantageous as it was a year ago and risks to the forecast have increased significantly, affecting the international environment. China's government has announced comprehensive economic stimulus packages to support the economy, although if and when these packages will have an effect remains to be seen. Domestic economic forces remain intact in the other export markets, where the slowdown is mainly due to a lack of stimuli from the manufacturing sector. If the weakness in the industrial sector—which is probably caused by uncertainty to a large extent—were to spread to the service sectors as well, global demand could lose further momentum, and the German economy would suffer as a result. However, the German economy is already also facing major challenges in some key industries: for example, German automobile sales were lower, primarily due to certification problems. However, it may also be the case that Germany is increasingly losing ground in global competition: high-revenue car models such as SUVs are predominately being manufactured outside of Germany, and diesel vehicle sales are also slowing in view of the debate on particulate matter. If, for these reasons, the production declines of summer 2018 turn out to be more permanent than thought, this would mean significantly lower overall economic growth in Germany.

Despite these risks, however, DIW Berlin stands by its fundamentally positive assessment of the economic situation, which is largely based on the continued strength of the German domestic economy. Public budgets should therefore continue to close with substantial surpluses. Nevertheless, the financial leeway is shrinking. The surplus will probably fall from 58 billion euros in 2018 to around 37 billion euros in 2020.

At the same time, the level of debt has fallen significantly after years of budget consolidation and is now below 60 percent of annual economic output, in line with the Maastricht criteria. The interest rate level, which remains extremely favorable, opens up opportunities for financing investments which are necessary and highly profitable, thus generating important triggers for growth. Moreover, an investment stimulus would support the cooling economy. Yet it is not just a matter of updating transport infrastructure to compensate for the wear and tear over the years; the aim must be to push ahead with projects necessary for future development, for example in the areas of digitization and R&D, which would increase growth potential and competitiveness.

**Claus Michelsen** is head of the Forecasting and Economic Policy department at DIW Berlin | cmichelsen@diw.de

**Guido Baldi** is a visiting researcher at the Forecasting and Economic Policy department at DIW Berlin | gbaldi@diw.de

**Martin Bruns** is a research associate at the Forecasting and Economic Policy department at DIW Berlin | mbruns@diw.de

**Marius Clemens** is a research associate at the Forecasting and Economic Policy department at DIW Berlin | mclemens@diw.de

**Geraldine Dany-Knedlik** is a research associate at the Forecasting and Economic Policy department at DIW Berlin | gdanyknedlik@diw.de

**Hella Engerer** is a research associate at the Forecasting and Economic Policy department at DIW Berlin | hengerer@diw.de

**Marcel Fratzscher** is president of DIW Berlin | mfratzscher@diw.de

**Stefan Gebauer** is a research associate at the Forecasting and Economic Policy department at DIW Berlin | sgebauer@diw.de

**Max Hanisch** is a research associate at the International Economics department at DIW Berlin | mhanisch@diw.de

**Simon Junker** is deputy head of the Forecasting and Economic Policy department at DIW Berlin | sjunker@diw.de

**Konstantin Kholodilin** is a research associate at the Macroeconomic department at DIW Berlin | kkholodilin@diw.de

**Malte Rieth** is a research associate at the Macroeconomic department at DIW Berlin | mrieth@diw.de

**Thore Schlaak** is a research associate at the Forecasting and Economic Policy department at DIW Berlin | tschlaak@diw.de

## LEGAL AND EDITORIAL DETAILS

DIW BERLIN

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
**www.diw.de**
Phone: +49 30 897 89–0 Fax: –200
Volume 9 March 15, 2019

Publishers
Prof. Dr. Tomaso Duso; Prof. Marcel Fratzscher, Ph.D.; Prof. Dr. Peter Haan; Prof. Dr. Claudia Kemfert; Prof. Dr. Alexander Kriwoluzky; Prof. Dr. Stefan Liebig; Prof. Dr. Lukas Menkhoff; Dr. Claus Michelsen; Prof. Karsten Neuhoff, Ph.D.; Prof. Dr. Jürgen Schupp; Prof. Dr. C. Katharina Spieß

Editors-in-chief
Dr. Gritje Hartmann; Mathilde Richter; Dr. Wolf-Peter Schill

Reviewer
Karl Brenke

Editorial staff
Renate Bogdanovic; Dr. Franziska Bremus; Rebecca Buhner; Claudia Cohnen-Beck; Dr. Daniel Kemptner; Sebastian Kollmann; Matthias Laugwitz; Dr. Alexander Zerrahn

Sale and distribution
DIW Berlin Leserservice, Postfach 74, 77649 Offenburg
leserservice@diw.de
Phone: +49 1806 14 00 50 25 (20 cents per phone call)

Layout
Roman Wilhelm, DIW Berlin

Cover design
© imageBROKER / Steffen Diemer

Composition
Satz-Rechen-Zentrum Hartmann + Heenemann GmbH & Co. KG, Berlin

ISSN 2568-7697