German economy remaining strong amidst uncertainties

By Claus Michelsen, Martin Bruns, Marius Clemens, Max Hanisch, Simon Junker, Konstantin Kholodilin, and Thore Schlaak

ABSTRACT

Although the economic boom in Germany is over, a recession is not looming. The economy is still expected to grow by 1.0 percent this year despite its recent weaker performance. Consumption remains a mainstay of the economy; the average annual increase in the number of employees is likely to be just under half a million. At 1.5 percent, inflation is barely dampening purchasing power and together with fiscal policy stimuli, it will lead to a noticeable increase in private consumption. Foreign demand, on the other hand, is developing moderately due to China's weakening economy and the fact that the industrial sector is losing momentum in many important export markets. The enormous political risks will dampen corporate investment as well.

The economic boom in Germany has come to an end, as the global economy is losing considerable momentum. While consumption is still increasing robustly in many countries, demand for capital goods is decelerating worldwide. Thus, the global slowdown is particularly affecting the German economy with its focus on these goods. Moreover, Germany is facing strategic challenges in the medium term as a main location for the automotive industry: for example, some passenger car models especially in demand on global markets, such as SUVs, are already being produced in other countries. This industry in particular has already been slowing down the German economy over the past six months due to significant production declines. The new WLTP certification procedure and accompanying delay in certification contributed to this. However, these problems have now been solved and production is likely to at least be partly made up for. There have been signs of a recovery since the end of 2018, but catch-up effects may not be noticeable until spring 2019 as production in the industrial sector declined again at the beginning of 2019. For this reason, GDP growth will remain weak in the first quarter (Figure). Despite stronger growth rates over the further course of the year (Table 1)—which are supported by high order backlogs in the industrial sector—the German economy will grow by only 1.0 percent this year. In 2019, growth is likely to be stronger at 1.8 percent (Table 2), although without the additional three and a half working days it would only be 1.4 percent. In the wake of weaker growth rates, the recently high utilization of overall capacities is normalizing.

Overall, German exports will increase moderately. In the USA, the upward trend is continuing at a slower pace, and in China, where the economy had recently weakened, monetary and fiscal stimuli are likely to gradually take effect starting mid-2019. The rest of the euro area economy will also grow at a somewhat slower pace than before.

Domestic consumption in particular is rising noticeably. Continuing employment growth and wage increases are boosting incomes, and the average number of employees will rise by 470,000 in 2019 and by 280,000 in 2020. On a monthly basis, wages are rising by about three percent per year. Inflation is also developing favorably for the consumer:

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Table 1

Use of GDP, quarter-on-quarter growth rates

Price, seasonally and working-day adjusted, in percent

	2018				2019				2020			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	0.4	0.2	−0.3	0.2	0.5	0.7	0.5	0.3	0.3	0.3	0.3	0.3
Public consumption	−0.4	0.8	−0.3	1.6	0.3	0.5	0.4	0.4	0.6	0.5	0.3	0.3
Gross fixed capital formation	1.0	0.6	0.4	0.9	0.7	0.8	0.7	0.7	0.6	0.6	0.6	0.6
Investment in machinery and equipment	2.2	0.3	0.0	0.7	0.7	1.3	1.0	0.9	0.8	0.8	0.8	0.8
Construction investment	0.8	0.9	0.7	1.3	0.7	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Other investments	−0.5	0.3	0.2	0.5	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Change in inventories[1]	0.0	0.3	0.8	−0.6	−0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic uses	0.4	0.7	0.8	0.0	0.4	0.7	0.5	0.4	0.4	0.4	0.4	0.4
Net Exports[1]	0.0	−0.2	−0.9	0.0	−0.2	0.0	0.0	0.0	−0.1	−0.1	−0.1	−0.1
Exports	−0.2	0.8	−0.9	0.7	0.5	0.9	0.8	0.6	0.5	0.5	0.5	0.5
Imports	−0.3	1.5	1.3	0.7	1.2	1.0	0.9	0.8	0.7	0.7	0.7	0.7
GDP	0.4	0.5	−0.2	0.0	0.2	0.6	0.5	0.3	0.3	0.3	0.3	0.3

1 Contribution to GDP growth in percentage points.

Source: Federal Statistical Office; DIW spring projections 2019; forecast from 2019 Q1 onward.

Table 2

Key economic indicators for the German economy

	2015	2016	2017	2018	2019	2020
Real GDP[1] (percent change over previous year)	1.7	2.2	2.2	1.4	1.0	1.8
Domestic employment (1000 persons)	43,071	43,642	44,269	44,838	45,242	45,494
Unemployed (ILO concept)	1,949	1,775	1,621	1,472	1,321	1,180
Unemployed (BA concept)	2,795	2,691	2,533	2,340	2,171	2,044
Unemployment rate[2] (ILO concept)	4.6	4.1	3.8	3.4	3.0	2.7
Unemployment rate[2] (BA concept)	6.4	6.1	5.7	5.2	4.8	4.5
Consumer prices	0.5	0.5	1.5	1.8	1.5	1.7
Unit labor costs[3]	1.8	1.2	1.5	2.6	3.2	1.4
Government budget balance[4]						
in billion EUR	23.9	28.7	34.0	58.0	42.9	37.1
in percent of GDP	0.8	0.9	1.0	1.7	1.2	1.0
Current account balance, in percent of GDP	8.9	8.5	8.0	7.4	6.6	6.5

1 Price-adjusted, chain-linked
2 As a share of domestic labor force (ILO), resp. Civilian labor force (BA)
3 Compensation of employees (national concept) per hour worked over real GDP
4 According to ESA 2010

Sources: National and international institutions; DIW spring projections 2019; forecast from 2019 onward.

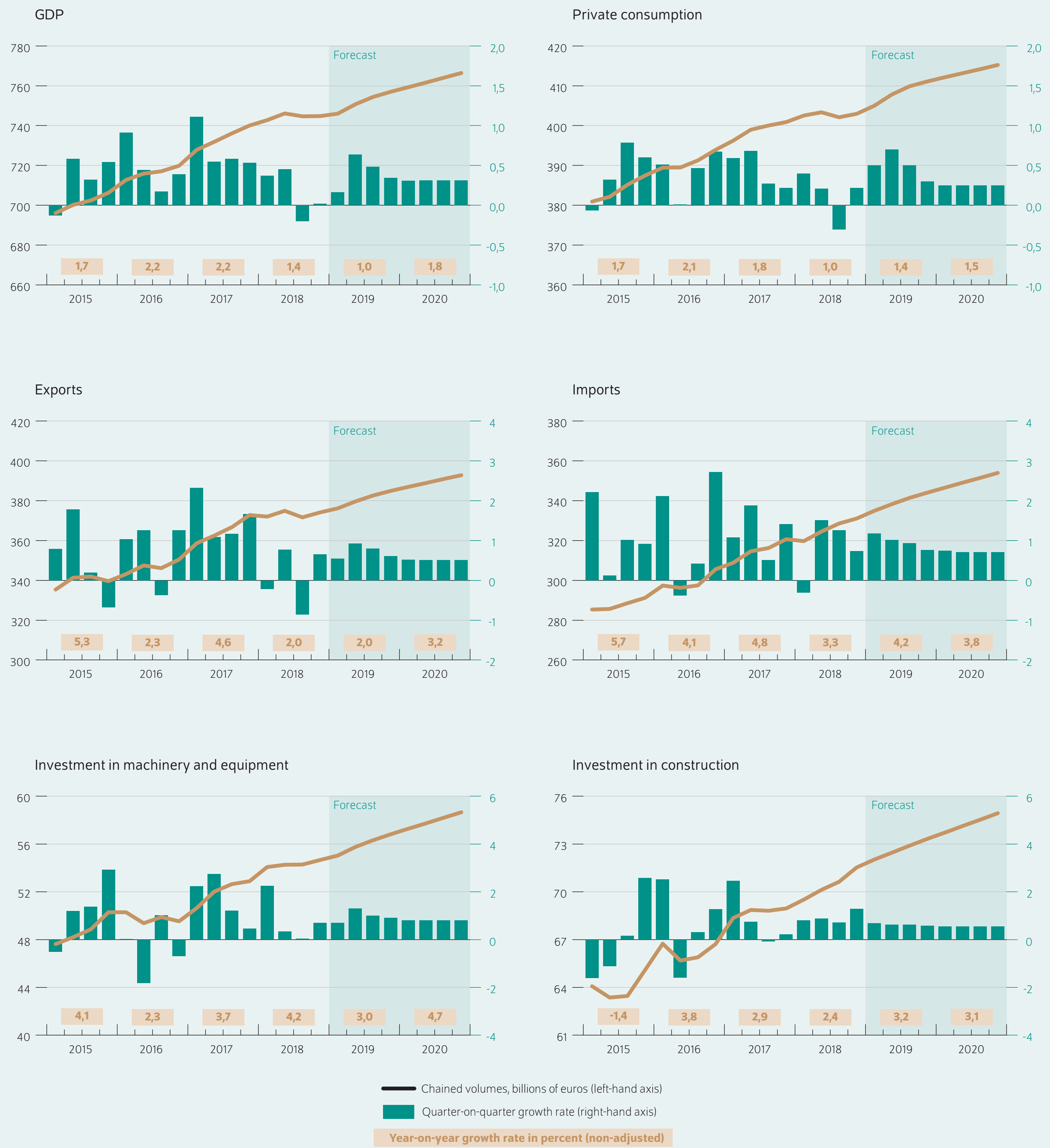
it is likely to be 1.5 percent in 2019, thus putting relatively little strain on purchasing power, before rising slightly to 1.7 percent in 2020. In addition, private households are experiencing an income boost as a result of new laws; in particular, financing health insurance by splitting the costs equally between employers and employees has brought employees a noticeable increase in their net income since the beginning of 2019. The state is also significantly expanding its consumption.

Corporate investment, on the other hand, is increasing only moderately: in view of the currently high risks, companies are likely to be cautious in expanding their production capacity. Investments in residential and public construction, however, are continuing to develop dynamically.

The risks and uncertainties for the present forecast are currently high. The outcome of the Brexit negotiations is still unknown, and a no-deal Brexit cannot be completely ruled out. The risks of an escalated trade dispute between the EU and the USA are looming, and the USA may increase tariffs on vehicles imported from the EU. Lastly, only a small portion of temporary production losses can be made up for, if at all, when global demand weakens more sharply than expected. The latter is also a risk factor, as has recently been signalled by the worsening economic sentiment in many countries.

Figure

GDP and use of GDP
Seasonally and working-day adjusted



Sources: Federal Statistical Office; DIW spring projections 2019; forecast from 2019 Q1 onward.

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

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

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

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