# German economy defying a turbulent and uncertain environment

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

**ABSTRACT**

After a turbulent summer, marked by a weak second and a likely stronger third quarter, the German economy should return to an average pace of growth and end up with a growth rate of 0.9 percent in 2019. Despite the more subdued pace, capacity utilization remains high; employment growth is continuing, albeit more slowly; and the trend of foreign demand is weakening but remains buoyant overall. In this economic setting, companies are expanding their investments, yet are likely to act cautiously due to imminent upheavals in global trade.

After stagnating in the second half of 2018, the growth rate of the German economy picked up at the beginning of 2019 (Figure). The late Easter holidays weighed on economic activity in the second quarter, but this will likely be compensated for in the third. Over the further course of the year, the economy should increase at rates close to the long-term average (Table 1), and capacity utilization will remain high. In this respect, DIW Berlin confirms its cautiously optimistic assessment of the situation.[1] GDP is expected to grow by 0.9 percent[2] on average this year. However, two contrasting sub-trends underlie the overall economic development: the service sector is performing strongly while there is a pronounced industrial slump.

Service providers are benefiting from strong domestic consumption, which is being driven by the sustained rise in employment and noticeable wage increases. The average number of employed persons will rise by 435,000 in 2019, with nominal wages per capita rising by 2.8 percent. However, the increase in the number of employed is likely to lose momentum: Next year, it is expected to be only a quarter million people. Inflation is likely to remain low at 1.5 percent this year and 1.7 percent next year. Thus, as in recent years, it will not have an overly dampening effect on purchasing power. Fiscal policy measures will also give an extra boost to private households' consumption in 2019.[3] For example, implementing equal split costs for statutory health insurance between employers and employees at the beginning of 2019 boosted income and thus private household spending. Further transfers—pension and child benefit increases—are due in the middle of the year, which should also have an impact. The additional measures coming into force in 2020 will have a significantly lower impact. Overall, consumption is losing momentum, and the production of consumer-related service providers will expand less buoyantly going forward.

**1** Cf. Claus Michelsen et al., "German economy remaining strong amidst uncertainties," *DIW Weekly Report*, no. 11/12 (2019) (available online; accessed June 5, 2019. This applies to all other online sources in this report unless stated otherwise).

**2** The 68-percent confidence interval resulting from the forecast errors of the previous five years is between 0.4 and 1.3 percent for this year and between 1.3 and 2.1 percent for next year.

**3** For calculating the economic stimulus, see Ferdinand Fichtner et al., "Deutsche Wirtschaft: Aufschwung hat an Breite gewonnen, wird aber an Fahrt verlieren – Grundlinien der Wirtschaftsentwicklung im Winter 2017," *DIW Wochenbericht*, no. 50 (2017), Box 2, pg. 1169f (in German) (available online).



DOI: https://doi.org/10.18723/diw_dwr:2019-22-3

Figure

## GDP and use of GDP

Seasonally and working-day adjusted


Source: German Statistical Office; DIW summer projections 2019.

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 | 0.2 | 0.3 | −0.1 | 0.3 | 1.2 | −0.3 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Public consumption | −0.3 | 0.7 | −0.3 | 1.3 | −0.3 | 0.4 | 0.4 | 0.5 | 0.5 | 0.4 | 0.3 | 0.3 |
| Gross fixed capital formation | 1.1 | 0.6 | 0.5 | 0.8 | 1.1 | 0.8 | 0.7 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 |
| Investment in machinery and equipment | 2.2 | 0.3 | 0.0 | 0.7 | 1.2 | 1.0 | 0.9 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 |
| Construction investment | 0.9 | 0.8 | 0.9 | 1.0 | 1.9 | 0.6 | 0.6 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 |
| Other investments | −0.5 | 0.3 | 0.2 | 0.5 | −1.1 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Change in inventories[1] | 0.1 | 0.3 | 0.8 | −0.6 | −0.6 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Domestic uses | 0.4 | 0.7 | 0.8 | 0.0 | 0.2 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| Net Exports[1] | 0.0 | −0.2 | −0.9 | 0.0 | 0.2 | −0.2 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exports | −0.2 | 0.8 | −0.9 | 0.6 | 1.0 | −0.9 | 1.4 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 |
| Imports | −0.3 | 1.5 | 1.3 | 0.7 | 0.7 | −0.6 | 1.2 | 0.8 | 0.7 | 0.7 | 0.7 | 0.7 |
| GDP | 0.4 | 0.5 | −0.2 | 0.0 | 0.4 | 0.1 | 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 summer projections 2019; forecast from 2019 Q2 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 | 0.9 | 1.7 |
| Domestic employment (1000 persons) | 43,071 | 43,642 | 44,269 | 44,841 | 45,276 | 45,520 |
| Unemployed (ILO concept) | 1,949 | 1,775 | 1,621 | 1,469 | 1,336 | 1,193 |
| Unemployed (BA concept) | 2,795 | 2,691 | 2,533 | 2,340 | 2,233 | 2,116 |
| Unemployment rate[2] (ILO concept) | 4.6 | 4.1 | 3.8 | 3.4 | 3.1 | 2.7 |
| Unemployment rate[2] (BA concept) | 6.4 | 6.1 | 5.7 | 5.2 | 4.9 | 4.6 |
| 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 | 3.3 | 1.3 |
| Government budget balance[4] | | | | | | |
| in billion EUR | 23.9 | 28.7 | 34.0 | 57.3 | 40.3 | 31.8 |
| in percent of GDP | 0.8 | 0.9 | 1.0 | 1.7 | 1.2 | 0.9 |
| Current account balance, in percent of GDP | 8.5 | 8.4 | 8.0 | 7.3 | 7.0 | 6.9 |

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 summer projections 2019; forecast from 2019 onward.



One reason for the industrial slump is car manufacturers' sluggish production since fall 2018. While production is usually in line with sales, which have risen sharply, of late it has remained extremely subdued. It seems that previously accumulated inventories accounted for most of the vehicles sold.[4] As overstocking is corrected gradually, it is likely to be accompanied by somewhat more marked production expansions.

Incoming orders have also been declining across the board for quite some time; in the mechanical engineering sector especially, orders have dropped over the last six months. This is probably due to lower demand from China, which has been weakening since the beginning of 2019. However, Chinese demand will probably stabilize over the further course of the year due to the Chinese government's economic policy stimuli.[5] Once demand has stabilized, orders should begin to improve again, with the current slack in order inflow resulting in lower production only temporarily. The industry

**4** Cf. Box 1 of Claus Michelsen et al., "Deutsche Wirtschaft derzeit besser als ihr Ruf – Grundlinien der Wirtschaftsentwicklung im Frühjahr 2019," *DIW Wochenbericht*, no. 11 (in German) (available online) for more information.

**5** See Claus Michelsen et al., "Global economy and the euro area: protectionism weighing on trade and investment" *DIW Weekly Report*, no. 22/23/24.

is likely to continue working off the exceptionally high stock of orders for some time to come.

In addition, despite contradictory signals and high political risks, demand from abroad has proved remarkably robust to date, and will most likely remain such in the forecast period. This also applies to corporate investments, which have increased strongly recently, as overall capacity utilization remains high and the current financing conditions are having a stimulating effect.

Industrial activity is expected to pick up over the course of the forecast period while service sector stimuli are likely to weaken somewhat. Overall, economic growth remains stable just below the long-term average. Average annual growth in 2020 will again be higher at 1.7 percent (Table 2). However, 0.4 percentage points are attributable to a higher number of workdays next year.

The risks remain elevated. The further course of Brexit is unclear, and a potential no-deal Brexit would severely impact the German economy. Trade disputes originating in the USA are the biggest threat. Should the USA's dispute with China intensify or the European Union become involved, this will likely place a greater burden on trade flows and investments than in the past—affecting Germany notably.

**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

**JEL:** E32, E66, F01

**Keywords:** Business cycle forecast, economic outlook

## 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  June 13, 2019



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