Euler Hermes Economic Research

Country Report

Germany

Home-made growth

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Executive summary

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- Q1 GDP growth picked up to +0.8% q/q and the breakdown showed a shift back to domestic demand as main contributor. We expect economic growth at +1.9% in 2014, driven by a strong rebound in investment and improving private consumption.
- Economic activity should be propped up by: (i) measures implemented by the new coalition that should provide a boost to household purchasing power (minimum wage, increased retirement pensions), (ii) favourable financing conditions and (iii) an improving business climate.
- However, international trade dragged down GDP growth in Q1 and unfavorable terms of trade may persist during the year. Indeed a strong euro, high energy prices and dynamic wages weigh on Germany's competitiveness, especially compared to Japan and the U.S.

Strong GDP growth in Q1 contrasting with moderate economic performances in 2013

In 2013, economic growth slowed down to +0.5%, pulled down by the continued decrease in investment and unfavourable international trade. However, the German economy gained momentum in Q1, with GDP growth reaching +0.8% q/q, driven by strong domestic demand. Private consumption rose by +0.7% and government consumption increased by +0.4% but surging investment was the main driver of growth, increasing by +3.2%. However, external demand deteriorated sharply (export expansion slowed down to +0.2% while imports rose by +2.2%) reducing GDP growth by -0.9pps. EH expects this trend to continue broadly throughout 2014: net exports should contribute negatively to GDP growth (-0.7pps) but buoyant investment (+6.2%) and relatively strong private consumption (+1.5%) should allow economic growth to reach +1.9% this year. In 2015, we expect domestic demand to remain the main driver of growth and international trade to have a neutral effect on GDP growth, thanks to stronger external demand.

Table 1: Key economic forecasts

Germany		share	2012	2013	2014	2015
GDP		100%	0.9	0.5	1.9	2.0
Consumer Spending		56%	0.7	1.0	1.5	1.7
Public Spending		19%	1.0	0.4	0.7	0.8
Investment		17%	-1.3	-0.7	6.2	5.0
Stocks	*	0%	-0.6	0.2	0.6	0.0
Exports		52%	3.8	1.1	4.1	5.4
Imports		45%	1.8	1.6	6.3	6.1
Net exports	*	7%	1.1	-0.2	-0.7	0.0
Current account	**		199	206	201	196
Current account (% of GDP)			7.4	7.5	7.1	6.8
Employment			1.1	0.6	1.0	1.0
Unemployment rate			6.8	6.9	6.6	6.5
Wages			2.9	2.5	3.0	2.6
Inflation			2.0	1.5	1.1	1.4
General government balance	**		2	0	3	6
General government balance (% of GDP)			0.1	0.0	0.1	0.2
Public debt (% of GDP)			81.0	78.3	76.4	75.1
Nominal GDP	**		2 668	2 742	2 827	2 896

Change over the period, unless otherwise indicated:
*contribution to GDP growth **EUR bn

Sources: National statistics, Euler Hermes

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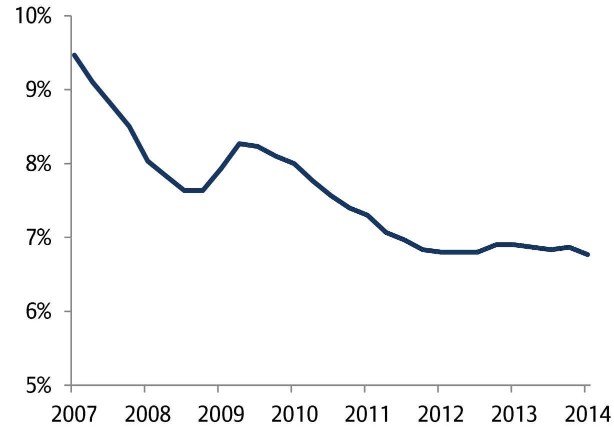
Several factor to boost household spending

In 2014, we expect private consumption to be one of the main drivers of growth (contributing +0.9pps to growth) as suggested by the improvement of consumer confidence in Q1 (Eurostat consumer confidence increased from -2.2 at end-2013 to +2.3 in March and GFK consumer climate survey from 100.1 to 102.8). Moreover, continued improvement of the labour market (unemployment rate decreased to 6.8% in Q1) suggests households should be less cautious in the mid-term, all the more so as wages increased strongly during the past two years. The introduction of a minimum wage in early 2015 (8.50€/hour) should provide a further boost to household purchasing power.

Chart 1: Unemployment rate

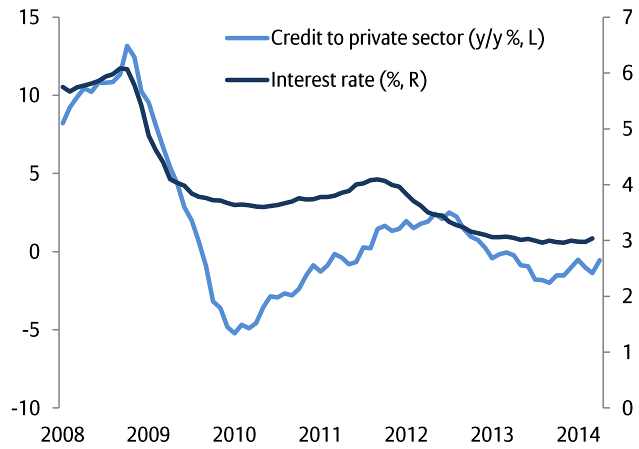


Sources: Destatis, Euler Hermes

Positive outlook for the private sector

Most business climate indicators improved during the beginning of the year though some marked a slight deterioration in May, and industrial production rose by 4.1% y/y in average during the first three months of the year. The strong rebound of investment in Q1 suggests firms are anticipating good prospects. Favourable financing conditions should allow this trend to continue: interest rates remain very low and credit to the private sector, though still in negative territory, is gradually improving.

Chart 2: Credit to private sector and interest rate

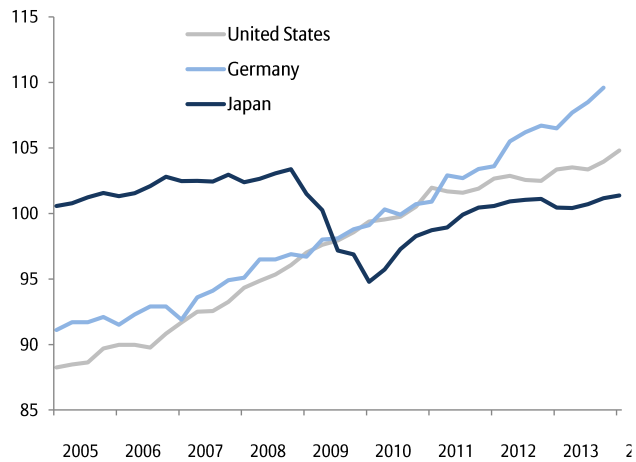


Sources Bloomberg, Euler Hermes

But exporting firms face headwinds

Exports slowed sharply in Q1 and the export order-book level remained very low (index at -9.7 in May). This trend can partly be explained by the deteriorating competitiveness of Germany, especially as compared to the U.S. and Japan, its two main competitors. A (too) strong euro (particularly as compared to the continuously depreciating yen) is one of the reasons, as well as increasingly dynamic wages in the manufacturing sector.

Chart 3: Manufacturing hourly index



Sources: IHS Global Insight, Euler Hermes

Healthy public finances

In 2013, the country managed to reach balanced government finances and should be able to post a slight fiscal surplus in 2014 and 2015, despite the increase in public expenses asked for by the new coalition government (higher retirement pensions, lowered retirement age, increase in infrastructure and education spending). The increase in government revenue that may be generated by a more dynamic business activity should be enough to make up for higher spending.

General Information

GDP	USD3399.589bn (World ranking 4, World Bank 2012)
Population	81.89 million (World ranking 15, World Bank 2012)
Form of state	Federal Republic
Head of government	Angela MERKEL (CDU)
Next elections	2017, legislative

Strengths

- Production and export of high-end products
- Relative export diversification (products and partners)
- Important expenditures in innovation and R&D
- Structural external surplus
- Healthy public finance
- Strong manufacturing base (1/4 of GDP)

Weaknesses

- Ageing population
- Dependence to net exports
- Relatively high exposure to the Russia-Ukraine conflict

Trade structure

By destination / origin

Exports		Rank		Imports
France	9%	1	10%	Netherlands
United States	7%	2	8%	China
Netherlands	6%	3	7%	France
China	6%	4	6%	Belgium
United Kingdom	6%	5	5%	Italy

By product

Exports		Rank		Imports
Cars And Cycles	11%	1	5%	Crude Oil
Engines	5%	2	5%	N.E.S. Products
Miscellaneous Hardware	5%	3	4%	Pharmaceuticals
Pharmaceuticals	5%	4	4%	Electrical Apparatus
N.E.S. Products	5%	5	4%	Cars And Cycles

Source: Chelem

Risk Dimensions

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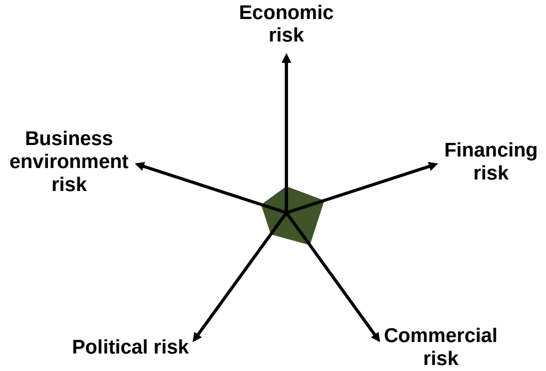

Source: Euler Hermes

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