›› Weak momentum amid higher risks

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- External trade is again below average
- Export activity will pick up as the global economy improves ...
- ... but downward risks have increased

External trade indicator

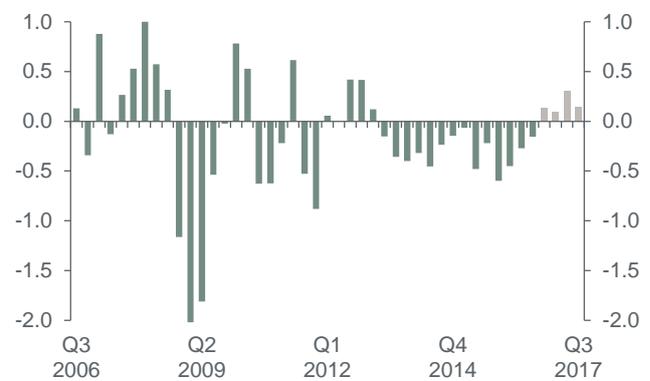**Balance of normalised export and import momentum**

Forecast for 4th quarter 2016 to 3rd quarter 2017.

Source: KfW

The indicator of Germany's external trade activity computed by KfW, the KfW External Trade Barometer, fell to 99.4 points in the third quarter of 2016. External trade was therefore below average and less dynamic than forecast. This was caused by imports, which increased at a lower rate than expected. Foreign trade activity will likely pick up in the coming four quarters if it is influenced by underlying factors alone, such as the development of the domestic and global economy, Germany's international competitiveness and incoming export orders. But this will be just barely sufficient overall for trade to return to an average level of activity at the end of the forecast period in the third quarter of 2017.

This forecast is fraught with considerable uncertainty, however. First, this is applies in the short-term for the fallout from the Brexit vote. Rising costs of imports due to exchange rate movements and a decline in the willingness to invest in the United Kingdom may weigh on German exports. Second, the election of Donald Trump as the next US president has increased the risk of protectionist measures. Their scope and direction will determine whether and how severely they would affect German exports. After all, the USA was Germany's most important export market in 2015. In addition, the potential introduction of tariffs would also give rise to the threat of an international spiral of trade policy measures and retaliatory measures. Irrespective of the extent to which measures will ultimately be taken, in the longer term the environment will likely become more trade-unfriendly.

In the next four quarters, exports will probably become increasingly more dynamic because the outlook for the global economy is brightening. Developing and emerging market economies in particular are expected to grow more strongly next year than this year. After all, almost 30 % of German exports are shipped to this group of countries. Growth in the industrialised countries will remain on the level of 2016 and thus generate roughly the same momentum in export demand as this year. In addition, competitiveness will be bolstered by the weakness of the euro, which will continue for the foreseeable future.

The economic situation in Germany will be roughly the same next year as this year and will ensure a healthy state of domestic demand. Accordingly, demand for imports will presumably recover from the weakness in the third quarter of 2016 but remain below average into the second half of 2017. With this trend Germany reflects global trade, which has lost its momentum since 2012. It remains to be seen whether the imponderables of international politics will undermine the otherwise stable development. ∎

Methodological appendix: Construction of indicators

The external trade indicator is the simple average of the export sub-indicator and the import sub-indicator. The value 100 marks the long-term average. Values above / below 100 represent above-average / below-average growth of imports and exports compared with the previous year.

The indicator as the balance of export and import momentum is the difference between the export sub-indicator and the import sub-indicator. If the value is positive (negative), exports develop more strongly (less strongly) than imports, whereas both factors grow at the same rate when the value is zero.

The indicators and the underlying estimation models are based on quarterly figures. The forecast period comprises four quarters.

Export sub-indicator
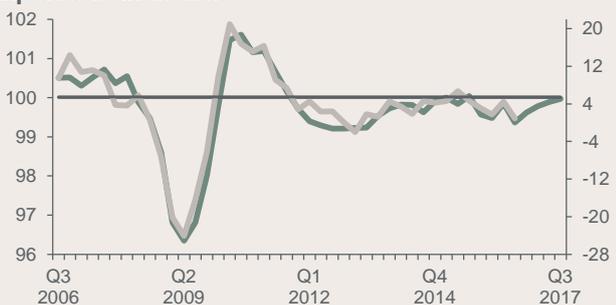
Export sub-indicator (left side)
Real goods exports (y-o-y, in per cent, right side)

Import sub-indicator

Import sub-indicator (left side)
Real goods imports (y-o-y, in per cent, right side)

Source: KfW

The sub-indicators for imports and exports are obtained from the respective estimated values of an ordinary least squares estimation. All variables used in the estimation are computed as variations on the previous year's quarter and normalised to a mean value of zero and a standard deviation of one based on the period from Q1 1995 to the current margin. The import and export series of the balance of payments statistic are used as dependent variables and deflated with the export and import price index. The explanatory variables used in the export estimation equation are the non-domestic new orders in manufacturing, the Deutsche Bundesbank's indicator of price competitiveness vis-a-vis 56 trading partners and the export-weighted economic trend in the destination countries of German exports on the basis of IMF data and national statistics – where available.

The explanatory variables for imports are the economic situation in Germany, the domestic new orders in manufacturing, the Baltic Exchange Dry Index as an indicator of international transport costs and a dummy variable. The latter assumes a value of 1 between Q2 2002 and Q1 2006 in order to take into account two structural breaks in the import equation.

Table: Description of variables applied

Description	Forecast	Source of the underlying data
Goods imports and exports based on the balance of payments statistics		Thomson Reuters Datastream: Deutsche Bundesbank
Economic situation of Germany's trading partners weighted with the value of exports	Forecasts based on the IMF's World Economic Outlook and internal economic forecasts; forecast export weights on average for the past four quarters	Thomson Reuters Datastream: IMF, national source.
Germany's real gross domestic product	Forecast according to KfW Business Cycle Compass Germany	Thomson Reuters Datastream
Non-domestic new orders in manufacturing	Autoregressive model	Thomson Reuters Datastream: Federal Statistical Office
Domestic new orders in manufacturing	Autoregressive model	Thomson Reuters Datastream: Federal Statistical Office
Indicator of Germany's price competitiveness against 56 trading partners	Autoregressive model	Thomson Reuters Datastream: Deutsche Bundesbank
Baltic Exchange Dry Index	Autoregressive model	Thomson Reuters Datastream: Baltic Exchange