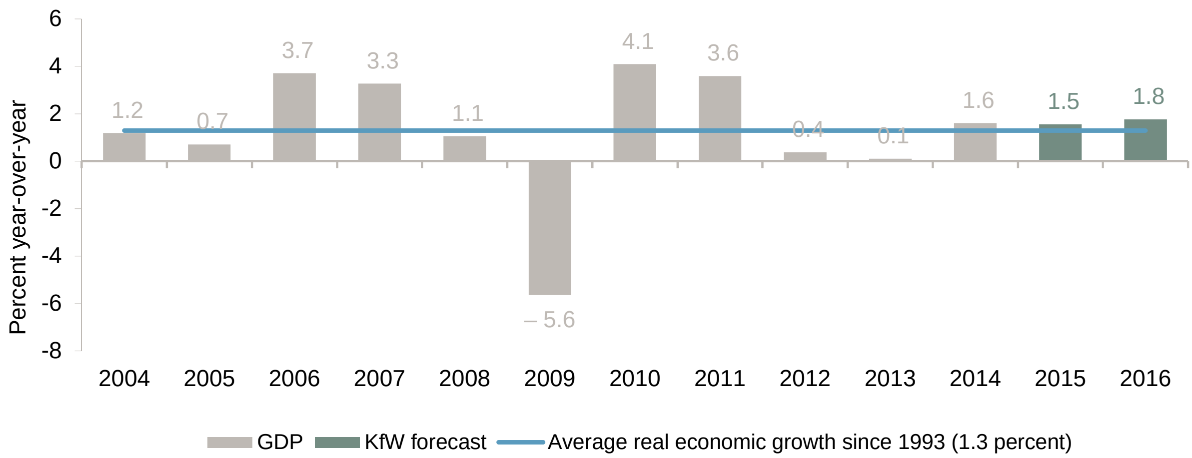
Frankfurt, 1st June 2015

KfW Business Cycle Compass Germany

A solid upturn – no more, no less

- ***KfW Research confirms its cautious growth forecast of 1.5 % for 2015; the main reason is moderate second quarter growth of 0.2 %***
- ***GDP growth to accelerate to 1.8 % in 2016***
- ***Consumer spending remains the main source of impetus; corporate investment should pick up from a low level***
- ***Export growth is rather subdued because of continuing weak global trade – despite stimulating effects from the euro depreciation***
- ***Risks and opportunities of the forecast are balanced – the exchange rate-driven stimulation of exports could turn out stronger than anticipated, while an escalation of the Greek debt drama would damage the economy***

Gross domestic product, price-adjusted



Source: Destatis, calculations KfW Research

External trade slows economy down to trend growth

After the strong finish to the year 2014, the German economy has returned to normal growth rates. In the first quarter of 2015, gross domestic product (GDP) adjusted for price, seasonal and calendar effects grew by 0.3 % on the final quarter of 2014 – the same rate as the long-term post-unification average but less than half the rate of the previous quarter (+0.7 %). Destocking and foreign trade slowed economic momentum down to trend growth. Despite flagging global trade, exports increased noticeably (+0.8 %), mainly due to the depreciation of the euro. However, as imports grew considerably faster at the same time (+1.5 %), the trade balance reduced quarterly growth by 0.2 percentage points. Export growth is likely to continue, also because demand from the euro area can be expected to increase further. Nevertheless, Germany's export growth rates will be lower than in pre-crisis years because global trade growth and economic momentum in big emerging countries such as China, Brazil and Russia are experiencing a structural slowdown. As imports are likely to grow more strongly thanks to the healthy domestic economy, foreign trade will ultimately contribute little to Germany's growth in both 2015 and 2016.

Consumer spending and the job market are the key drivers

Consumer spending is a reliable mainstay of the economy, which started the year with a healthy plus of 0.6 % in the first quarter, seamlessly continuing the dynamic development of the second half of 2014. The main driver is the continuing good job market development. For the first time ever, in 2015 the number of people in employment in Germany is expected to reach the 43-million mark and the unemployment rate will likely drop to a new all-German low for the fourth consecutive year. At the same time, decent wage increases combined with capital gains of real estate owners, very low interest rates and low inflation will increase consumers' real spending power. Consumer spending will therefore remain strong over the forecast period until the end of 2016. Subsequently, however, momentum is likely to slow on a high level because the additional impetus from the now ended oil price decline will likely subside.

Private investment is growing but public investment weakness persists

Investment also developed positively in the first quarter – but only in the private sector (households and companies). Residential construction increased by 1.3 % on the previous quarter, slightly favoured by the unseasonably mild weather. It will continue on an upward trend because of households' good income situation and the low-interest environment. Nevertheless, the increases will likely flatten out because residential construction has now reached a very high level after five years of uninterrupted and, at times, very strong growth.

What is particularly encouraging is that corporate investment has increased noticeably again for the first time in a year (+2.1 %). It is a start but much more needs to happen in order to overcome the present weak level of corporate investment on a sustained basis. We are confident that companies will continue expanding their investments as the economic environment in Europe improves. In the short term, however, the increase is likely to be rather subdued because underlying uncertainties, such as the tension with Russia, have not been clarified and neither has the unclear situation in Greece. In addition, industrial capacity utilisation has decreased slightly at the beginning of the second quarter, which also points to what initially will likely be a return to a more moderate development.

Public investment, on the other hand, dropped by 1.3 % at the beginning of the year. A rapid reversal is overdue because after three years of cutbacks, from 2012 to 2014, significantly more public investment is now necessary to make public services and the infrastructure fit for the future.

Second quarter with only moderate growth

In the current second quarter of 2015, the German economy is expected to once again expand moderately at a similar rate as in the first quarter. We anticipate growth of just 0.2 %.

Our assumption is corroborated by the weakness in incoming orders in the first quarter (-1.6 % on the previous quarter) but also primarily by the unfavourable initial level of industrial output, the most important monthly economic indicator. Following the sharp decline of 0.8 % in March, it entered the second quarter with a noticeable underhang of 0.5 percentage points. This underhang must first be overcome before industrial output grows at all in the second quarter. For the construction industry we expect a minor rebound in the spring after the extra boost from unseasonably good weather at the start of the year.

Forecast for 2015 and 2016: respectable growth

For the second half of the year, however, we are optimistic that quarterly rates will accelerate to an average of just under 0.5 %. Overall, Germany will probably grow by 1.5 % in 2015 (1.3 % adjusted for calendar effects); in 2016 GDP growth should increase to 1.8 % (1.7 % adjusted for calendar effects). We therefore confirm the previous forecast we issued three months ago both for this year and for next year. The reliable impetus coming from domestic consumption provides a solid underlying momentum. During the further course of the forecast period, it will be reinforced by continuing economic consolidation in the euro area – still by far the most important sales market for German products – which together will generate decent growth. In the euro area, the start to the year has been a positive one. For the first time since 2010, all five big euro countries have grown at the same time again, headed by Spain with a quarterly plus of 0.9 %.

Greek debt drama and exchange rate – the big unknowns

We believe the risks and opportunities of this forecast are balanced. “Third country effects” of the exchange rate, in particular, may yield a positive surprise. If the euro depreciation boosts exports of important European partner countries more strongly or quickly than we anticipated, this would also benefit Germany indirectly as the improved economic performance in the partner countries would also cause their demand for German goods to continue rising. On the downside, the precarious situation in Greece is the big unknown in our forecast. A further “muddling through” as before will likely remain without any significant impact because all parties have long grown accustomed to it. In the worst case, however, if the debt drama escalates to a “Graccident”, a poorer real growth outcome would have to be expected. In that case we assume that, in particular, enterprises that have been unsettled by such prospects would put off planned investments for the time being – not so much because of Greece itself but because such a development would likely weigh on the European economy overall and throw financial markets into considerable turmoil, at least temporarily.

Author: Dr Klaus Borger, +49 (0) 69 7431-2455, klaus.borger@kfw.de
Press contact: Christine Volk, +49 (0) 69 7431-3867, christine.volk@kfw.de