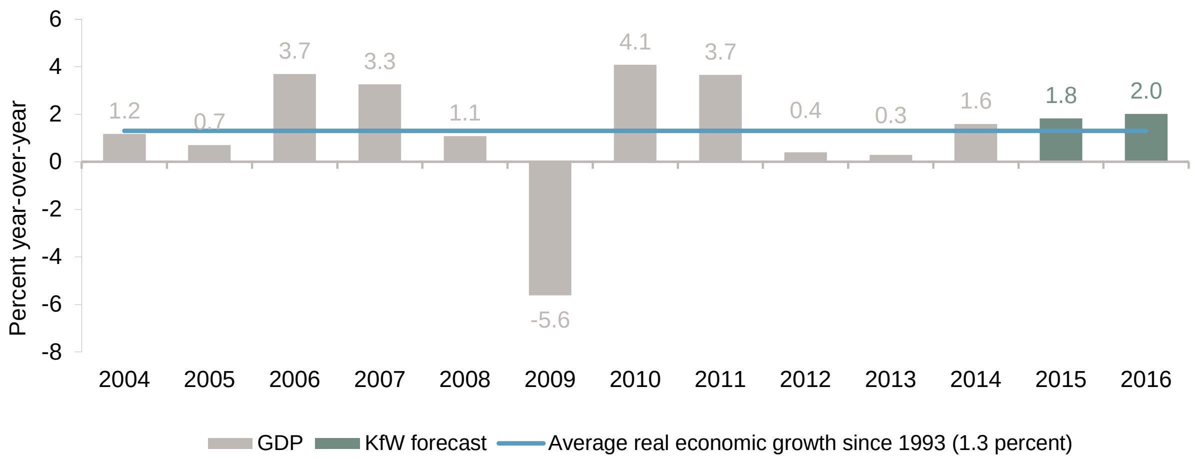
Frankfurt, 25th August 2015

KfW Business Cycle Compass Germany

Germany's economic engine still purring

- ***KfW Research raises 2015 growth forecast for Germany from 1.5 to 1.8 %, expects real GDP to grow 2.0 % in 2016.***
- ***Growth is well above the long-term trend rate. German GDP growth has averaged just 1.3 % per year since 1991.***
- ***Higher export performance pushes second-quarter growth to a robust 0.4 %.***
- ***Reluctance of companies and public authorities to invest should gradually fade. High net immigration continues to resurrect rental housing construction.***

Gross domestic product, price-adjusted



Source: Destatis, calculations by KfW Research

Germany remains Europe's growth engine

Based on the latest economic data, we expect real GDP growth of 1.8 % for 2015 (1.6 % adjusted for calendar effects). This is not a boom but well above the average 1.3 % growth rate since unification. The German economy has thus recovered well from its weak phase of the years 2012 and 2013. The trend shows yet again that the German economy has weathered the financial crisis more successfully than most other countries in the EU. Since the slump in 2009, Germany has grown at a faster rate each year than the euro area and the economic area of the 28 EU states.

We expect slightly higher GDP growth of 2.0 % for 2016 (1.9 % adjusted for calendar effects). We also expect Europe to continue on its path of recovery. The growth weakness in emerging and developing economies should fade in the coming months; global momentum, however, is expected to remain subdued overall.

Exports and consumption bolster GDP growth

Since early 2014, the euro has significantly depreciated against the currencies of major German trading partners, losing between 15 and 20 % against the currencies of the USA, the UK and China, Germany's biggest export markets outside the euro area. That has not only given a stronger-than-expected boost to exports but also permitted some price increases. German export prices in June were 1.3 % higher than the previous month, after falling for two consecutive years.

For various reasons, household consumption expenditure remains a reliable pillar of growth. Employment grew by a further half a percent in the first half of 2015 against the previous year and is anticipated to continue rising moderately until the end of the year. The parties to collective agreements have negotiated substantial wage and salary increases of 2 to 3.5 %. The crude oil price has fallen sharply and the cost of fuel oil has dropped by a good 30 % since 2014. That will continue to drive consumption in the second half of the year as well.

Corporate investment is gradually picking up

In anticipation of continuing growth in demand, both on the domestic market and from abroad, businesses will gradually shed their restraint and start investing again. The gradual strengthening of the growth forces in the European economies will increase their confidence in the stability of the euro area, especially if the reforms announced in Greece also bear fruit. The financing conditions for more investments remain favourable in any case.

Investment programmes strengthen public investments

Public investments have fallen for three consecutive years. The KfW Municipal Panel 2015 shows a significant and growing municipal infrastructure investment backlog of around EUR 132 billion. In a bid to strengthen municipal investments, the federal government this year launched an investment initiative for municipalities that offers a total of EUR 15 billion up to the year 2018 in the form of financial relief and investment programmes targeted first and foremost at financially weak municipalities to help revive their investment activity. The European Fund for Strategic Investments proposed as part of the Juncker Plan is also designed to promote investments in infrastructure projects from autumn of this year. Combined with higher tax revenues resulting from the stronger growth, these initiatives will help to lift municipal investments considerably from their low level in the second half of 2015 and in 2016.

Housing construction continues to benefit from net immigration

Investments in the construction of dwellings have increased by almost 20 % from 2010 to 2014 thanks to low interest rates, rising purchasing power and high net immigration. We expect another increase this year as well. Strong net immigration will continue to boost the construction of new rental housing in particular. The number of construction permits for new rental homes supports this assessment, having increased by 5.4 % in the first half of 2015 on the same period last year.

Opportunities and risks for the economy are balanced

The new rescue package for Greece has been accepted and the Greek government has already initiated reforms. That demonstrates a readiness to cooperate and goodwill on both sides. For the time being, it has removed the acute uncertainty that the debt drama might escalate and weigh on the European economy. Nevertheless, the issue is not yet over, especially since early elections in Greece have now been announced for September. If the uncertainties start increasing again, it could once again sour the mood among investors.

The economic risks outside the euro area are currently shaped by developments in China, as the financial markets are reacting nervously to the turbulence on the Chinese share market and the devaluation of the renminbi. Contagion effects on other emerging economies would delay the economic upturn for the group of developing and industrialising countries, with corresponding negative impacts on export demand for Germany. The renewed drop in the oil price could act as a counterweight if the positive impetus of low oil prices for importing countries turns out to be stronger than currently expected.

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