

»» Germany's real growth in 2016 and 2017: not spectacular, but reliable

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- KfW revises its forecast for Germany's real GDP growth in 2016 downward to 1.7 % (previous forecast +2.0 %), taking into account the recent increase in uncertainty
- Initial forecast for GDP growth in 2017 is 1.8 %; working day effects mask accelerating growth
- Domestic demand set to remain solid, whereas external environment gradually improves; exports and corporate investments are on the rise
- Risks: lengthy political controversies in Europe (Brexit, migration, reforming countries), geopolitics and terror, absence of global economic recovery

Germany's price-adjusted gross domestic product



Source: Destatis, KfW Research

Stable economic growth thanks to domestic demand

In 2015 the German economy grew at stable quarterly rates of 0.3 to 0.4 % in all four quarters. Temporary drops in exports and, consequently, industrial production, as in last year's final quarter, were more than offset by strong domestic demand. This is not likely to change in the near future because the most important drivers of the strong domestic economy are still intact. Both private consumption and private residential construction are benefiting from a growing workforce, rising real incomes and persistently very low interest levels. In addition, immigration is creating a steadily rising need for affordable rental housing, particularly in the economically attractive conurbations.

At the same time, public consumption expenditure (including

expenditure on human resources and social transfers in kind) caused by the influx of refugees is inevitably rising noticeably. The expected drop in the general government surplus from the multi-year high of 2015 (0.6 % of GDP) is stimulating the German economy without placing undue strain on public finances. The national budget will remain roughly balanced.

KfW's forecast for 2016: slight downward revision, partly for technical reasons ...

Irrespective of the practically unchanged quality of our prediction, we revise our economic forecast for 2016 downward to 1.7 % (previous forecast: +2.0 %). One third of this downward revision, or 0.1 percentage points, is due to the most recent official revision of data and hence only

retrospective. According to current calculations, GDP growth across 2015 was somewhat flatter than previously assumed, accordingly slowing the momentum carried over from 2015 (statistical overhang) in the overall annual growth rate of 2016.

... but also because of the recent increase in uncertainty

The remaining 0.2 percentage points of our downward revision is our response to the recent rise in uncertainty as a result of the intense financial market turmoil that broke out after the turn of the year. We do believe that the concern over the state of the Chinese and global economy expressed by this turbulence is exaggerated. Nevertheless, it is plausible that businesses feel unsettled by this development and, in particular, postpone investment plans in the short term. The expectations-based declines in the KfW-ifo business climate index in January and February are one indication of this. They turned out particularly pronounced in the heavily export-oriented manufacturing sector, although enterprises received significantly higher orders in the final quarter of 2015 (+1.0% on the preceding quarter) and industrial capacity utilisation in early 2016 is at the highest level of the last four years.

Against this background we expect economic momentum to remain comparatively subdued for the time being – despite rather more favourable preconditions fundamentally – and pick up again in the course of 2016 as soon as the tension eases.

Initial forecast for 2017: +1.8%

Our outlook for 2017, which we are publishing for the first time, is also positive. We expect Germany's price-adjusted GDP to grow 1.8%. Our optimism is based on the expectation of continuing positive consumer spending and domestic demand combined with gradual but continuing improvements in the external environment. The general focus on the currently weak big emerging economies, such as China, Russia and Brazil, diverts attention from the fact that many smaller countries have already returned to better growth this year so that the global economy can be expected to grow slightly more strongly than in 2015. We expect the heavyweights to at least stabilise in 2017 so that the pace of global growth can accelerate further.

That will benefit German exports and, as a consequence of the resulting increase in capacity utilisation, boost corporate investments. Since import growth can also be expected to remain relatively strong thanks to strong domestic economic

performance, the contribution of foreign trade will remain near zero on balance – a healthy development given Germany's very high current account surplus, which recently exceeded 8% of GDP (2015: 8.2%).

Above-average real growth

At 1.7% in 2015, and 1.7 and 1.8% predicted for 2016 and 2017, respectively, Germany's real growth would not exactly be spectacular, especially considering the strongly accommodating monetary policy and the favourable euro exchange rate over this period. Nevertheless, it appears reliable and the rate we predict would be well above the long-term trend growth in post-unification Germany (+1.3%). Since the crisis in Europe has still not been fully overcome – despite a recovering economy – and amid the generally difficult and only gradually brightening global outlook, it is something to be quite satisfied with.

Working day effects conceal added momentum

Moreover, Germany's customary focus on non-calendar-adjusted annual GDP growth rates masks the accelerated momentum we expect to set in during the forecast period. The reason is that part of the upturn or downturn in production is not caused by the cyclically relevant demand variations but exclusively by the change in the number of working days compared with the previous year. Depending on the calendar days on which public holidays fall, these sometimes fluctuate significantly (2015: +2.3 working days; 2016: +1.0; 2017: -2.0). If we account for the resulting calendar effect, Germany's real growth rises from 1.4% in 2015 to a predicted rate of 1.6% in 2016 to 2.0% in 2017.

Downward risks have global sources

The risks are predominantly European and global. Lengthy debates in Europe over the influx of refugees, setbacks in the reforming countries or increasing nervousness, at least in the lead-up to the referendum on the Brexit announced for 23 June 2016, may undermine trust in the recovery just as much as unfavourable geopolitical developments, such as new terrorist attacks. What cannot be ruled out either is that the very low oil price and the volatility on the financial markets put a higher strain on the global economy overall than previously assumed. If these risks were to materialise, Germany's real growth in 2016 and 2017 could be much lower than in 2015, particularly because global financial markets would not be expected to calm down under these conditions. Businesses would remain anxious and reluctant to invest or recruit staff. ■