Euler Hermes Economic Research

Country Report

Germany

Economy humming

General Information

GDP	USD3,467bn (World ranking 4, World Bank 2016)
Population	82.7mn (World ranking 16, World Bank 2016)
Form of state	Federal Republic
Head of government	Angela MERKEL (Acting Chancellor)
Next elections	2022 presidential; 2021 legislative

Strengths

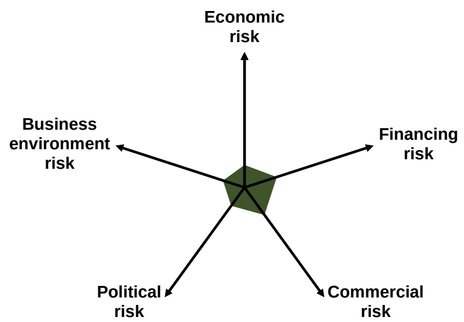
- Low systemic political risk
- Good regional and international relations; EU and EMU membership
- Healthy public finances
- Strong manufacturing base (one quarter of GDP)
- Production and export of high-end products
- Adequate export diversification (products and trade partners)
- Current account surpluses since 2002

Weaknesses

- Aging population
- Dependence on exports
- Low investment-to-GDP ratio (20% in 2016)
- Vulnerability to slowdown in Chinese demand, especially investment spending

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total; 2016)

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

By product (% of total; 2015)

Exports		Rank		Imports
Cars And Cycles	12%	1	5%	Cars And Cycles
Pharmaceuticals	6%	2	5%	Electrical Apparatus
Engines	5%	3	4%	Pharmaceuticals
Electrical Apparatus	4%	4	4%	Engines
Vehicles Components	4%	5	4%	Plastic Articles

Sources: Destatis, Chelem

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Bright growth outlook

The German economy clearly moved up a gear in the first nine months of 2017. In the third quarter real gross domestic product notched up a seasonally and calendar-adjusted increase of 0.8%. As the Federal Statistical Office has also revised up the sequential rate for the first quarter 2017 to 0.9% (previously 0.7%), annual average growth in 2017 looks set to come in at 2.6% (in calendar-adjusted terms). This is the strongest growth rate since 2010, when the economy recovered in the aftermath of the Global Financial Crisis of 2008.

Since then, German economic growth has been driven largely by private and public consumption. Over the same period, cumulative gross investment has made virtually no contribution to growth. This year, however, the prospects are good that both construction and machinery investment will provide a substantial boost to growth. Rising capacity utilization, the improved equity bases and healthy liquidity positions of companies, and favorable financing conditions should at last give a lift to machinery and equipment investment. Given sizeable pent-up demand, the investment cycle could last for a while, meaning, so to speak, that the next and probably last stage of the German growth rocket will ignite.

Overall the growth outlook for the Eurozone's biggest economy remains very favorable. Sentiment among German businesses is still very upbeat. The Ifo business climate index rose to a new record high of 117.5 points in November from 116.8 points in October. The recent rise was due to far more optimistic business expectations, while companies assessed their current situation slightly less positively than in the prior month. Other indicators such as above-average capacity utilization and full order books in the industrial sector clearly point to an ongoing economic boom. Real GDP run rates are unlikely to come down considerably in the coming quarters. For 2018 we have penciled in growth in the German economy of 2.5% in calendar-adjusted terms.

Positive trend on the labor market to continue

In the absence of dark clouds on the economic horizon, we expect the positive trend on the labor market to persist next year. However, the momentum is likely to be weaker than this year. On average in 2018 we expect the jobless total to decline by 94,000 to 2,442,000, following a drop of around 153,000 this year. The smaller decline next year is linked not least to the expected rise in jobless registrations by refugees as, among other things, numerous integration courses will come to an end in the coming months.

The increase in the number of people in work in 2018 is also likely to be somewhat more moderate than this year. We are penciling in 530,000, corresponding to a rise of 1.2%. For comparison: This year the annual average increase will be around 650,000, up 1.5%. According to the Federal Employment Agency, the ongoing jobs growth stems exclusively from the increase in jobs liable to social insurance. Other forms of employment such as self-employed and those exclusively in mini-jobs are on a downward trend.

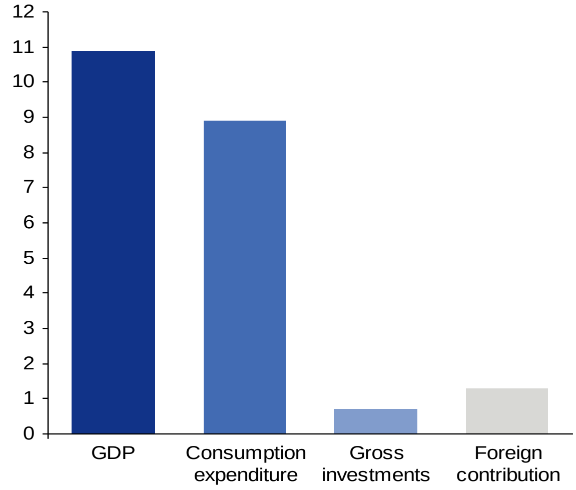
Key economic forecasts

Germany		*weight*	**2015**	**2016**	**2017**	**2018**
GDP		*100%*	**1.5**	**1.9**	**2.6**	**2.5**
Consumer Spending		*55%*	**1.6**	**2.1**	**2.1**	**1.5**
Public Spending		*19%*	**2.9**	**3.7**	**1.1**	**1.6**
Investment		*20%*	**1.0**	**2.9**	**4.5**	**5.1**
Construction		*9%*	-2.0	2.5	4.5	4.1
Equipment		*11%*	3.7	3.2	4.5	5.8
Stocks	*	*-1%*	**-0.3**	**-0.1**	**0.0**	**0.1**
Exports		*48%*	**4.7**	**2.4**	**4.9**	**4.5**
Imports		*41%*	**5.2**	**3.8**	**5.3**	**4.8**
Net exports	*	*7%*	**0.2**	**-0.4**	**0.2**	**0.2**
Current account	**		**260**	**259**	**246**	**230**
Current account (% of GDP)			*8.5*	*8.3*	*7.6*	*6.9*
Employment			**0.9**	**1.3**	**1.5**	**1.2**
Unemployment rate			**6.4**	**6.1**	**5.7**	**5.4**
Wages			**2.3**	**2.2**	**2.3**	**2.1**
Inflation			**0.3**	**0.5**	**1.7**	**1.8**
General governme	**		**19**	**26**	**30**	**32**
General government balance (% of GDP)			*0.6*	*0.8*	*0.9*	*0.9*
Public debt (% of GDP)			*70.9*	*68.2*	*65.3*	*62.8*
Nominal GDP	**		3,041	3,139	3,269	3,401

Change over the period, unless otherwise indicated; * contribution to GDP growth; ** euro billions

Sources: National statistics, IHS, Allianz Research

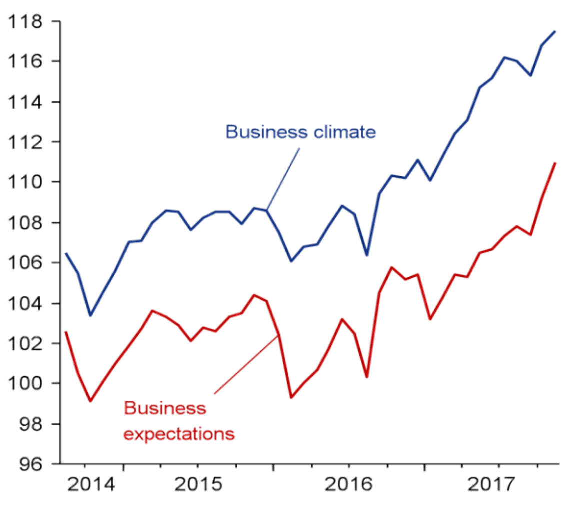
Cumulative growth and contributions of different components since 2008* (in ppts)



** Annual average 2017 on annual average 2008*

Sources: Federal Statistical Office, Allianz Research

Ifo index: Manufacturing (2005=100)



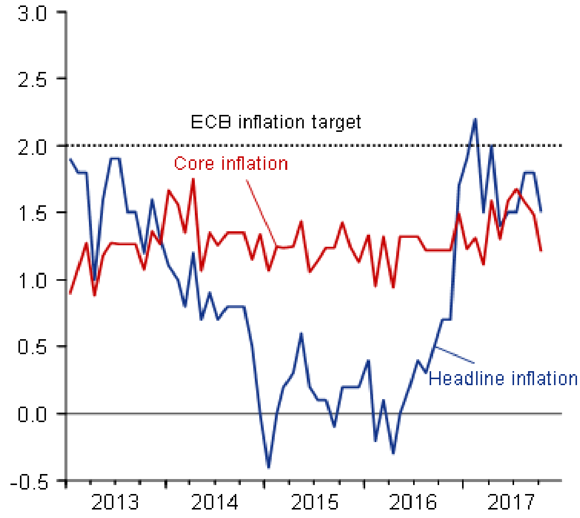
Sources: Thomson Reuters Datastream, Allianz Research

Inflation remains subdued

Inflation in Germany remains subdued. Despite a favorable economic situation and low unemployment, there are still no signs of a sustained pickup in the inflation rate. The Phillips curve, which captures the negative correlation between unemployment and inflation rates, has no notable empirical relevance to Germany at present. This is due to the fact that wage growth in Germany has not yet picked up appreciably, in spite of falling unemployment. This means that in 2017 real wages per employee are likely to increase by a good 2.5%, following rises of 2.4% in 2016 and 2.8% in 2015. One reason for the moderate rise in wages in recent years is large-scale labor migration to Germany, especially from the EU, which has led to a sharp increase in the labor force. Moreover, inflation rates combined with the fall in commodity prices have severely dampened inflation expectations, which play a key role in wage negotiations.

As the labor force is set to increase at a slower pace in the future than in recent years (and in the medium term will probably even fall), and inflation expectations should normalize again, actual earnings are expected to grow more strongly. However, we do not see this leading to a sustained acceleration in inflation in 2018. According to our estimates, the consumer price index will rise by 1.7% this year and 1.8% next year. Commodity prices should have only a limited impact on the inflation rate.

Inflation and core inflation (% y/y)



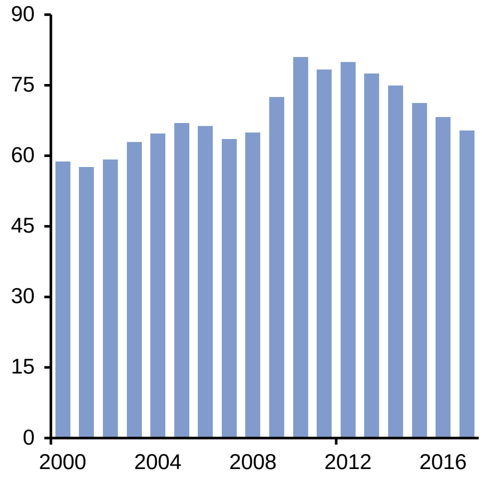
Sources: Thomson Reuters Datastream, Allianz Research

Further government budget surpluses

In 2017, the government budget surplus is set to reach a new all-time high of EUR 30.3bn; there had already been surpluses in the three preceding years. This is attributable in part to a lower increase in government spending, due in particular to lower additional spending in relation to refugees. Revenues are continuing to enjoy robust growth (+4.0%) as a result of the positive macroeconomic developments, albeit at a slightly lower rate than 2016 (+4.4%). For 2018 we expect a government budget surplus of the same order of magnitude as this year. For the purposes of this forecast we have factored in only fiscal policy measures that had already been decided before the Bundestag elections last September.

Total public debt, which rose to 81% of GDP in 2010 in the wake of the global financial crisis, has since fallen steadily to 68.2% of GDP in 2016.

Public sector debt, as % of GDP



Sources: Eurostat, Allianz Research

Last review: 2017-12-01
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