Euler Hermes
Economic
Research

Country Report

Germany

A moderate recovery continues

General Information

GDP	USD3,730 bn (World ranking 4, World Bank 2013)
Population	80.6 mn (World ranking 16, World Bank 2013)
Form of state	Federal Republic
Head of government	Angela MERKEL (CDU)
Next elections	2017, legislative

Strengths

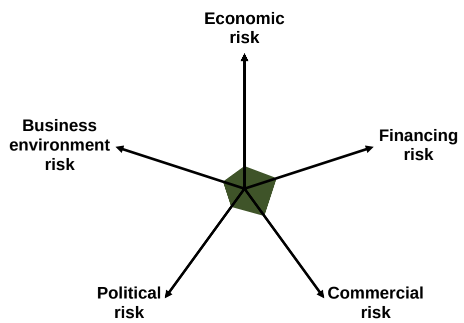
- Low systemic political risk
- Good regional and international relations; EU membership
- Healthy public finances
- Strong manufacturing base (one quarter of GDP)
- Production and export of high-end products
- Adequate export diversification (products and trade partners)
- Current account surpluses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

Weaknesses

- Ageing population
- Dependence on exports
- Declining investment-to-GDP ratio (20% in 2014)
- Proximity to the Russia-Ukraine conflict
- Vulnerable to slowdown in Chinese demand, especially investment spending
- Exposure to Eurozone growth

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total; 2013)

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

By product (% of total; 2012)

Exports		Rank		Imports
Cars And Cycles	11%	1	6%	Crude Oil
Engines	5%	2	5%	Natural Gas
Miscellaneous Hardware	5%	3	4%	Electrical Apparatus
Pharmaceuticals	5%	4	4%	Pharmaceuticals
Electrical Apparatus	4%	5	4%	Cars And Cycles

Sources: Destatis, Chelem

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Outlook for moderate recovery ...

After very strong growth of seasonally adjusted real GDP of +0.8% q/q in Q1 2014, the economy lost momentum in the following two quarters. GDP contracted by -0.1% q/q in Q2, followed by a modest +0.1% q/q increase in Q3. The sharp slowdown was partly due to a mild winter which led to considerable frontloading of construction activity in Q1, but was also a result of the weaker-than-expected recovery in external demand. However Q4 saw a pick-up of economic recovery with GDP growth of +0.7% q/q. The main contributions for full year growth came from consumption (+0.7pps), investment (+0.7pps) and net exports (+0.4pps). Going forward, domestic demand is likely to remain robust while the recovery of external demand will continue to be gradual. Euler Hermes expects full-year real GDP growth of +1.7% in 2015 and +1.6% in 2016, ongoing geopolitical tensions pose some downside risks to this outlook.

...supported by a turnaround in sentiment surveys

Germany's economy continues to show evidence that the sentiment crisis that began in spring 2014 is behind it. Most recently, the February 2015 Composite Output PMI increased for the third month in a row to 53.8, driven by services which rose to 54.7. The manufacturing component increased, albeit only moderately, to 51.1, pointing to soft industrial production growth in Q1/2014. In line, the IFO index increased in February for a fourth month in a row (106.8 vs. 106.7). Companies assessed their current business situation slightly less positive than in January (111.3 vs. 111.7) but that keeps the index still well above historic average. All in all, the major sentiment indicators took a breath in February after the strong gains in the recent months but remain favourable pointing to continued expansion.

Domestic demand remains the main growth driver despite the soft private investments...

After an overall solid performance throughout 2014 (+1.2% y/y) consumer spending is set to be the major contributor to GDP growth in 2015. Key driver of this development should be a continuation of strong wage growth (+3.3%) supported by the introduction of a sector wide minimum wage (increasing wages by 1.6pps alone) and a further favourable development of the labour market seeing the unemployment rate decreasing to 6.6%. Further spending drivers should be an estimated 2014/2015 oil price drop of 25% in EUR terms. The windfall gains in Q4/2014 (-20% q/q in EUR terms) seem to have surprised consumers, as the saving rate increased to 9.8% (from 9.2% in Q3/2014), which might lead to further spending increases in the following quarters.

2015's fixed investment is likely to be soft due to two main drags on private investment: (i) uncertainties related to the Eurozone recovery and geopolitical risks (Russia-Ukrainian crisis and Middle East); and (ii) the introduction of social policies (minimum wages and pensions) which we expect will weigh on margins and increase the skilled labour supply bottleneck. While industrial production slowed since the beginning of 2014, the capacity utilization rate decreased in Q4-2014 to its long time average. Without a more certain environment EH expects companies to be reluctant to add much to their capital stock.

Construction investment currently operates in particularly favorable environment - QE driving record low mortgage and interest rates- should see

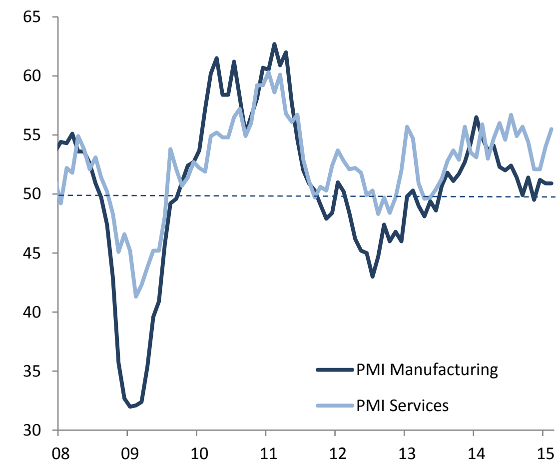
Key economic forecasts

Germany		weight	2013	2014	2015	2016
GDP		*100%*	**0.2**	**1.6**	**1.7**	**1.6**
Consumer Spending		*55%*	**0.9**	**1.2**	**1.9**	**1.2**
Public Spending		*19%*	**0.7**	**1.1**	**1.1**	**0.8**
Investment		*20%*	**-0.4**	**3.4**	**1.3**	**2.1**
Stocks	*	*-1%*	**0.1**	**-0.4**	**-0.3**	**0.0**
Exports		*45%*	**1.7**	**3.8**	**4.5**	**4.2**
Imports		*38%*	**3.2**	**3.3**	**4.1**	**3.9**
Net exports	*	*7%*	**-0.5**	**0.4**	**0.5**	**0.4**
Current account	**		**192**	**192**	**170**	**185**
Current account (% of GDP)			*6.8*	*6.6*	*5.7*	*6.1*
Employment			**0.6**	**0.9**	**0.8**	**0.6**
Unemployment rate			**6.9**	**6.7**	**6.6**	**6.5**
Wages			**2.5**	**3.0**	**3.3**	**2.4**
Inflation			**1.5**	**0.7**	**0.3**	**1.3**
General government balance	**		**4**	**12**	**6**	**3**
General government balance (% of GDP)			*0.1*	*0.4*	*0.2*	*0.1*
Public debt (% of GDP)			*76.7*	*75.0*	*74.0*	*72.7*
Nominal GDP	**		2 814	2 908	2 971	3 043

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

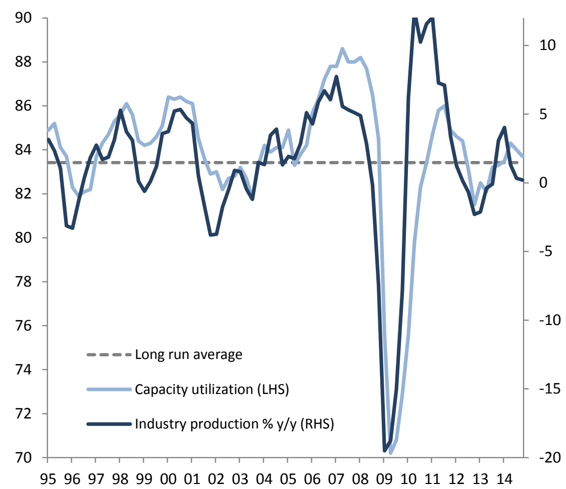
Sources: National statistics, IHS, Euler Hermes

Purchasing Managers' Index (PMI)



Sources: Markit, Euler Hermes

Capacity utilization rate and industrial production



Sources: Ifo, DEstatis, Euler Hermes

construction investment continue to expand , albeit continuing the slower pace of 2014 (3.1% y/y) following the high base of growth in 2013 (9.1% y/y).

... but external demand will also contribute

Export growth has held firm steadily risen in the course of 2014, reaching +2.0% q/q in Q3 and +1.2% q/q in Q4, suggesting that a positive impact from the EUR weakness and second round effects from lower oil prices have more than offset the adverse effects of the Russian crisis. With global trade accelerating slightly (+4.0% in 2014 from +3.3% in 2013) we see German exports increasing mildly in 2015 to +4.5% from +3.8% in 2014. Given the improvement in household purchasing power, imports are expected to increase stronger, accelerating to +4.1% in 2015 from +3.3% in 2014. As a result, net exports should contribute +0.5pps to overall growth in 2015. The current account balance will remain firmly in surplus. Euler Hermes forecasts annual surpluses of around 6% of GDP in 2015-16.

Deflation risk limited

On the back of lower food prices and falling energy prices, headline inflation has gradually fallen from +1.3% y/y in January 2014 to -0.4% y/y in January 2015 while it picked up slightly again in February 2015 to +0.1% y/y. German inflation remains above the Eurozone average (-0.3% y/y in February), which is well below the ECB's target (close to 2%). Euler Hermes forecasts average annual inflation to soften slightly from 0.9% in 2014 to 0.3% in 2015. However, given the expected recovery of oil prices, headline inflation should approach the ECB's target by 2016. Downside risks to this forecast include a sustained period of low oil and energy prices.

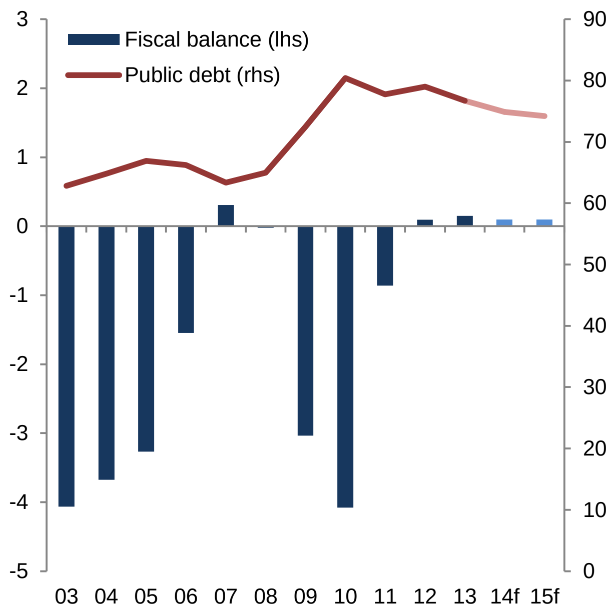
Public finances are healthy

In 2014, Germany achieved a small fiscal surplus of EUR12 bn (+0.4% of GDP). In line with the government's target of balanced budgets, Euler Hermes forecasts only slight fiscal surpluses in 2015-2016, despite the increase in public spending under the new coalition government (higher retirement pensions, lowered retirement age, some increase in infrastructure and education spending), as stronger growth should generate higher revenues as well. Calls for a significant public spending increase appear, at present, likely to go unheeded.

Insolvencies are expected to rise in 2015

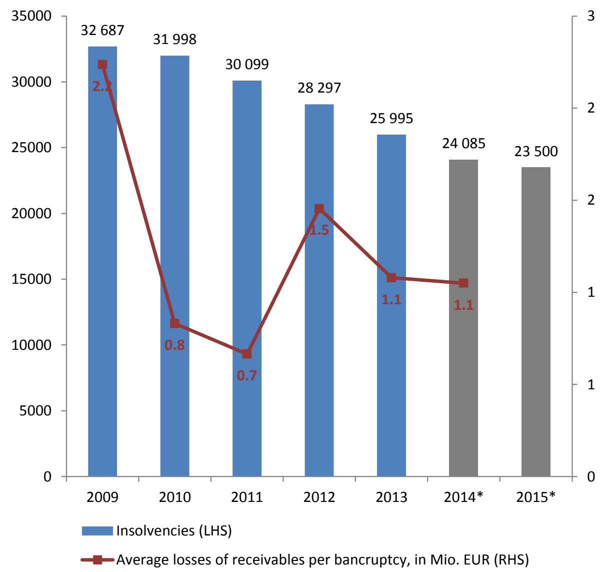
After five years of continuous decrease, the number of corporate insolvencies is forecast to increase by -2% to around 23,500 cases in 2015. DSOs increased from 62 days in 2013 to 72 days in H1 2014 while the average expected loss of receivables per insolvency remained stable at 1.1 Mio. EUR in 2014 but notably higher compared to 0.7 million euros in 2011.

Fiscal balance and public debt (% of GDP)



Sources: Deutsche Bundesbank, Euler Hermes

Corporate insolvencies and loss of receivables



Sources: Destatis, Euler Hermes

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