

Strong Domestic Economy and Weak Trade

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The German economy turned in a surprisingly strong start in 2016. But this energetic beginning is deceptive. The relatively weak development of the global economy and the weak dynamics of global trade are putting a strain on export companies. And the strong domestic economy will not be capable of completely offsetting the negative external balance.

According to the estimate by the Federal Office of Statistics released on May 24, Germany's gross domestic product grew by 0.7 percent over the previous quarter. The mild winter fostered brisk construction activity, and companies invested heavily in equipment.

This led to an impressive 2.3-percent increase in gross investments, which is significantly more than the 0.7 percent predicted by the Handelsblatt Research Institute (HRI). But the increase is mainly attributable to pull-forward effects. This theory is supported by incoming orders in manufacturing, which shrank by a notable 2 percent in April. And the prediction of all other components of GDP was very well.

This is why the HRI sees no reason to discard its previous view of the business cycle for 2016 and 2017. We are sticking to our contention that the export economy, the traditional driver of growth, is consistently under-performing, due to weak global growth. The development of the external balance, that is, the balance of exports and imports, validates this assessment. We are adhering to this skeptical view for the next 18 months.

Nevertheless, because of the striking base effect of the first-quarter growth rate on annual results, we feel the need to revise our growth forecast upward by 0.2 percentage points for each year – to 1.5 percent for this year and 1.2 percent for 2017.

Private consumption, which is supported by continued slight increases in employment and strong wage development, remains the primary driver of growth. On the other hand, high government consumption is stimulating GDP development, partly as a result of spending to cope with the influx of refugees.

The balanced federal budget, which is primarily due to the monetary policy of the European Central Bank and has only been addressed to a minor extent in fiscal policy, will not be put up for renegotiation in 2017, an election year in Germany.

We expect an average inflation rate of 0.6 percent this year and 1.4 percent in 2017. This is where the rise in crude oil prices is making itself felt. Second-round effects on price development, as a consequence of strong wage increases, have not emerged yet.

By no later than this fall, a significant number of refugees who have been granted the right of residence will be crowding into the German job market. For this reason, we see the current decline in registered unemployment petering out in the coming months, as well as a slight increase in this job market indicator, together with a continued moderate increase in employment.

The government will counteract registered unemployment to keep the number of the unemployed below the magic limit of 3 million people. This is consistent with Labor Minister Andreas Nahles's announcement that she aims to create 100,000 new jobs with a nominal pay of €1 per hour.

The ECB has signaled its intention to prolong this interest-free period. It has begun to purchase corporate bonds. For this reason, a significant change in monetary policy is not to be expected within the timescale of our prognosis. In addition, the HRI assumes that the U.S. central bank, the Fed, will keep its Federal Funds Rate stable for the foreseeable future, contrary to its announcement in December 2015.

This is for two reasons: Weak economic data was recently released for the United States, and the U.S. presidential election is coming up. As a result, the HRI expects the euro to continue to appreciate slightly against the U.S. dollar.

A risk factor for the economy and financial markets is the June 23 referendum on whether the United Kingdom will remain in the European Union. We anticipate a vote in favor of remaining in the E.U., but by a slim margin.

It is difficult to credibly calculate the consequences of a Brexit. Because many calculations are used for propaganda purposes, there is an astonishingly wide range of published scenarios. On this sensitive issue, in particular, economists would have been well advised to heed the advice of British statesman Horace Walpole (1717-1797): "The wisest prophets make

sure of the event first.” For this reason, a Brexit is not taken into account in the HRI’s prognosis.

Real growth rates in percent	2014	2015	2016	2017
GDP	1,6	1,7	1,5	1,2
Private consumption	0,9	2,0	1,9	1,4
Government consumption	1,7	2,5	2,4	1,4
Gross fixed capital formation	3,5	2,2	3,5	2,4
- Machinery and equipment	4,5	4,8	3,4	1,9
- Construction	2,9	0,3	4,6	3,5
- Residential construction	3,3	1,6	5,1	5,5
- Non-Residential construction	2,4	-1,5	3,9	0,5
Exports	4,0	5,4	2,0	2,2
Imports	3,7	5,8	4,0	3,6
Unemployment in millions	2,9	2,8	2,74	2,93
Employment in millions	42,7	43,0	43,4	43,5
Unemployment rate in percent	6,7	6,4	6,2	6,6
Government budget balance in percent	0,3	0,7	0,1	0,0
Inflation rate in percent	0,9	0,3	0,6	1,4