Growth rate of German economy normalizing after prolonged economic boom

By Claus Michelsen, Christian Breuer, Martin Bruns, Max Hanisch, Simon Junker, and Thore Schlaak

ABSTRACT

The German economy continues to perform well although the boom has ended. However, at 1.5 percent, German GDP will increase this year at a lower rate than expected at the beginning of the year. Nevertheless, concerns about an imminent recession should give way to the assessment that the pace of the German economy is normalizing after years of above-average growth due to robust foreign demand and increasing employment levels. A gradual reduction in high capacity utilization will be accompanied by lower GDP growth; in the short term, however, this will be overshadowed by catch-up effects in the automotive industry following production and delivery problems and by the fiscal income boosts at the beginning of 2019, the most important being reduced social security contributions.

To what extent is the German economy weakening? New orders in the industrial sector have been declining all year and ifo Institute's Business Climate Outlook fell for the third time in a row in November. A technical recession—defined as two consecutive quarters of declining economic output—is possible at the end of the year under such conditions. After all, GDP shrank in the third quarter already (Figure). However, this was mainly due to temporary problems in the automotive industry: bottlenecks in the new model certification process negatively affected vehicle production over the summer.

However, the production and sale losses are likely to be partially made up for, probably around the turn of the year. This will boost economic output in the winter half-year and be reflected in stronger growth in consumption, exports, and corporate investment. Above all, however, the two pillars of the previous, pronounced upswing remain intact: exports and private consumption. Therefore, the economy is not facing a recession; rather, its growth is normalizing after years at an above-average pace.

The global economic boom already passed its peak this past spring.[1] Despite increasing trade barriers, foreign demand is still on the upswing: although export growth rates are no longer as high as last year, they are only gradually declining (Table 1).

Employment growth is slowing down: an important, cyclically sensitive factor is the number of temporary workers. After years of a clear upward trend since peaking last November, growth has fallen. Since temporary employment is mainly used in the industrial sector to bridge cyclical peaks, this indicates a slowdown in employment growth, as temporary agency work is reduced first and foremost during a downturn. However, this does not necessarily indicate a recession in this case. On the contrary, companies appear to be increasingly seeking to expand their core workforce. In contrast to the winter of 2012/13, when Germany actually did slide into a mild recession, the industrial sector has

1 Cf. the report in this issue by Claus Michelsen et al., "Global economy and the euro area: uncertainty weighs on trade and investment," *DIW Weekly Report* no. 50/51/52 (2018): 506–508.

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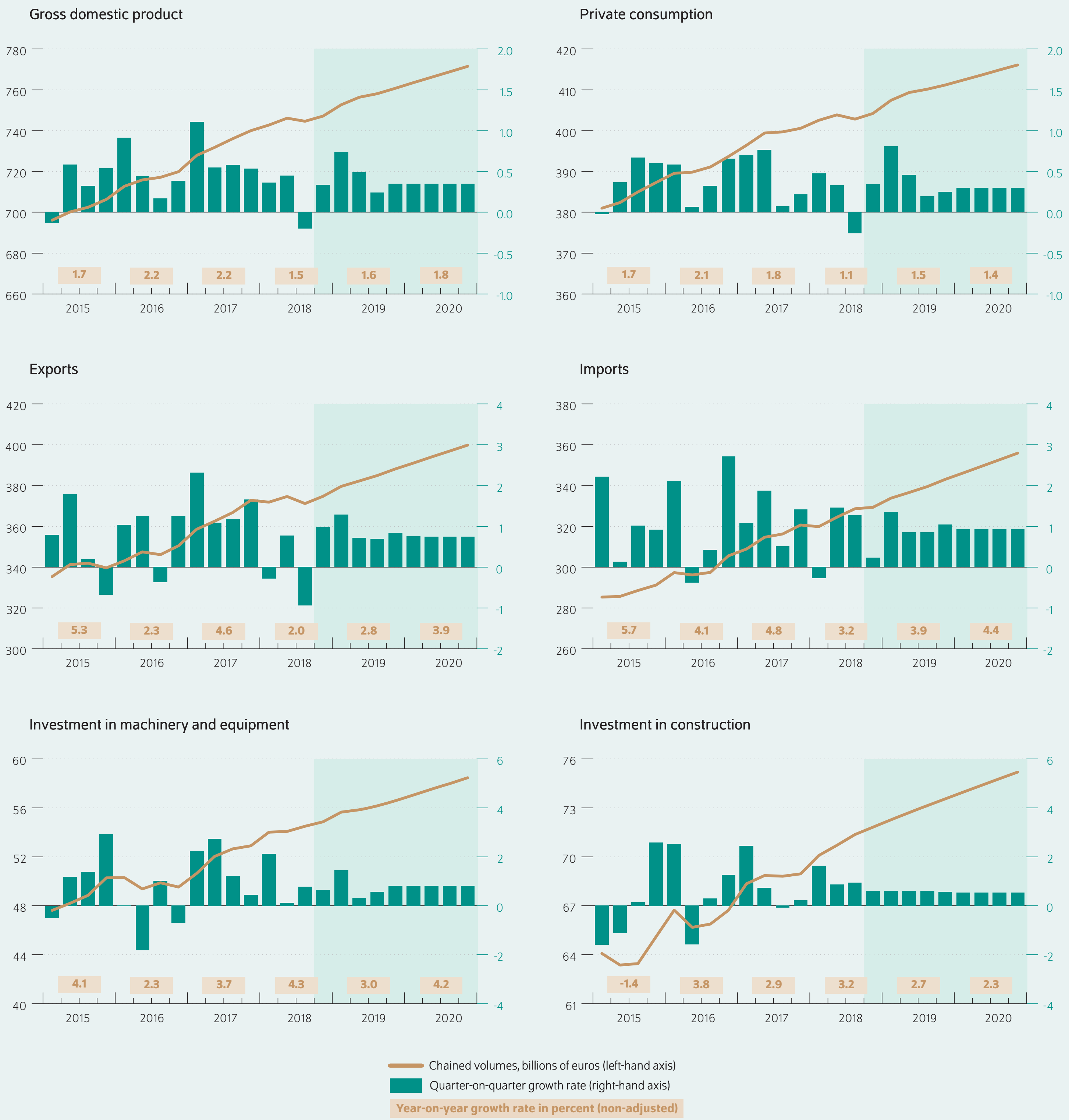
Figure

Gross domestic product and use of gross domestic product
Seasonally and working-day adjusted



Sources: Federal Statistical Office; DIW Economic Outlook Winter 2018, forecasts from fourth quarter 2018 onward.

Table 1

Use of gross domestic product, quarter-on-quarter growth rates

Price, seasonally, and working-day adjusted, in percent

	2018				2019				2020			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	0.5	0.3	−0.3	0.3	0.8	0.5	0.2	0.2	0.3	0.3	0.3	0.3
Public consumption	−0.5	0.8	0.2	0.5	0.6	0.5	0.3	0.5	0.5	0.5	0.3	0.3
Gross fixed capital formation	1.4	0.5	0.8	0.6	0.9	0.6	0.6	0.7	0.7	0.7	0.7	0.7
Investment in machinery and equipment	2.1	0.1	0.8	0.6	1.5	0.3	0.6	0.8	0.8	0.8	0.8	0.8
Construction investment	1.6	0.9	0.9	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Other investment	−0.5	0.3	0.2	0.7	0.8	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Change in inventories[1]	−0.1	0.2	0.7	−0.4	−0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic uses	0.4	0.7	0.8	0.0	0.7	0.5	0.3	0.4	0.4	0.4	0.4	0.4
Net exports[1]	0.0	−0.2	−1.0	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports	−0.3	0.8	−0.9	1.0	1.3	0.7	0.7	0.8	0.8	0.7	0.7	0.7
Imports	−0.3	1.5	1.3	0.2	1.4	0.8	0.8	1.0	0.9	0.9	0.9	0.9
Gross Domestic Product	0.4	0.5	−0.2	0.3	0.7	0.5	0.2	0.4	0.4	0.4	0.4	0.4

1 Contribution to gross domestic product growth in percentage points.

Sources: Federal Statistical Office; DIW Economic Outlook Winter 2018, forecasts from fourth quarter 2018 onward.

Table 2

Key economic indicators for the German economy

	2015	2016	2017	2018	2019	2020
Real GDP[1] (percent change over previous year)	1.7	2.2	2.2	1.5	1.6	1.8
Domestic employment (1,000 persons)	43,071	43,642	44,269	44,844	45,194	45,448
Unemployed (ILO concept)	1,949	1,775	1,621	1,468	1,298	1,158
Unemployed (BA concept)	2,795	2,691	2,533	2,341	2,170	2,049
Unemployment rate[2] (ILO concept)	4.6	4.1	3.8	3.4	3.0	2.7
Unemployment rate[2] (BA concept)	6.4	6.1	5.7	5.2	4.8	4.5
Consumer prices	0.3	0.5	1.8	1.9	2.0	2.0
Unit labor costs[3]	1.8	1.2	1.5	2.5	2.6	1.8
Government budget balance[4]						
in billion EUR	23.9	28.7	34.0	56.1	45.9	38.4
in percent of GDP	0.8	0.9	1.0	1.7	1.3	1.1
Current account balance, in percent of GDP	8.9	8.5	8.0	7.3	7.1	6.9

1 Price-adjusted, chain-linked.
2 As a share of domestic labor force (ILO), resp. civilian labor force (BA).
3 Compensation of employees (national concept) per hour worked over real GDP.
4 According to ESA 2010.

Sources: National and international institutions; DIW Economic Outlook Winter 2018, forecasts from 2019 onward.

accelerated its employment growth since the turn of the year 2017/18. Companies' confident employment expectations also indicate a sustained, albeit slightly declining, increase in employment.[2] The unemployment rate is slightly over five percent on average this year and will continue to decrease significantly until 2020 (Table 2).

Workers continue to benefit from noticeable wage increases while the labor market situation is favorable. For this reason alone, consumption remains a pillar of growth. In addition, changes in the social security scheme decided on by the German Federal Government will come into effect at the beginning of 2019. This will result in a noticeable increase in the income of private households, which they are likely to spend on both domestic and foreign goods and services.

In the wake of these developments, corporate investment is still trending upward; however, in view of the enormous

2 The ifo Institute's expectations index for employment in the manufacturing sector is currently only slightly below its historical high, although it is trending slightly downwards.

geopolitical risks, for example with regard to future trade relations, it will be difficult for them to break away from a low level. Only residential construction investments by private households are continuing an upward trend unhindered.

Altogether, the German economy will grow by 1.5 percent[3] this year—despite the third quarter setback—almost as strongly as the long-term supply-side trend, and the high degree of overall capacity utilization will only gradually fade. In the autumn forecast, the drastic production cuts in the automotive industry were not anticipated to this extent; the forecast was therefore higher by three-tenths. Despite temporarily higher inflation due to the price of oil, inflation will average 1.9 percent for this year.

In 2019, fiscal stimuli will boost the economy. This overshadows the fundamental tendency of the growth rate to normalize, and, therefore, the slight over-utilization of capacity is hardly diminishing, with growth of 1.6 percent. The catch-up effects in the automotive industry are also likely to boost growth. However, the forecast for 2019 is lowered by one-tenth since it is assumed that only part of the production shortfalls will be compensated for and the overall trend is slightly weaker than had been expected in the autumn. In view of the persistently high level of capacity utilization, inflation will pick up somewhat over the course of the year, reaching an annual average of two percent.

In 2020, the German economy will grow by 1.8 percent, which is partly due to a higher number of working days. Without these (three and a half) additional days, the increase would be only 1.4 percent, lower than in the preceding years. Foreign demand continues to weaken slightly, employment growth is slowing somewhat, fiscal stimuli are running out, and monetary policy is less expansionary. Although over-utilization is declining somewhat in the face of this slowdown, inflation remains at two percent.

Fiscal policy will be expansionary, especially in the coming year, but the public sector will still generate high surpluses; these will fall from 56 billion euros this year to 38 billion euros in 2020.

The present economic forecast is subject to a high degree of uncertainty. The extent and timing of possible catch-up effects in the automotive industry can hardly be quantified using the available data and are therefore based on assumptions; if there were no catch-up effects, the growth rate in the coming year in particular would be lower. Possible effects connected to the diesel problem and the associated driving bans are not assumed, but could dampen the economy. In addition, the open German economy would be particularly affected if trade links become more severely restricted than previously, for example as a result of the conflicts between the United States and China or Brexit.

3 The 68-percent confidence interval resulting from the forecast errors of the previous five years is between 1.3 and 1.8 percent for this year and between 1.0 and 2.1 percent for next year.

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