

# DIW Weekly Report

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## AT A GLANCE

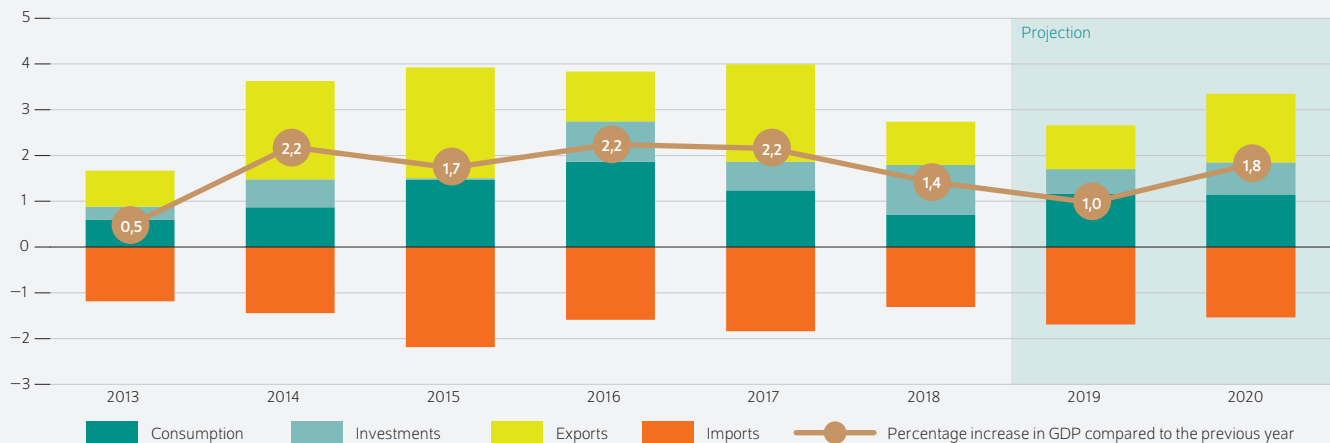
# German economy growing despite uncertainties and risks; global economy continuing to cool down

By Claus Michelsen et al.

- German economy continuing to grow despite economic slowdown; DIW forecasts growth of 1.0 percent for 2019, 1.8 percent for 2020
- Global economy weakening due to trade conflicts, Brexit; German export industry particularly affected
- Domestic economy supporting growth: employment growth continuing, private consumption strong, also thanks to low inflation, construction industry booming
- Public budgets expected to close with surpluses of almost 43 billion euros in 2019 and 37 billion euros in 2020
- Investments in digitization and R&D could boost growth potential and provide stimuli against an economic slowdown

### Economic boom in Germany is over, but private consumption is supporting growth

Individual GDP components' contribution to growth in percentage points



Source: Authors' own surveys and calculations.

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### FROM THE AUTHORS

*In many places, growth is increasingly being driven by consumption rather than investment. This is bad for the German industrial sector, which primarily exports capital goods. That explains why the German economy is being affected by developments such as those in China and parts of the euro area so strongly.*

— Claus Michelsen, Head of Forecasting —

### MEDIA



Audio Interview with Claus Michelsen (in German)  
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# German economy growing despite uncertainties and risks; global economy continuing to cool down

**By Claus Michelsen, Guido Baldi, Martin Bruns, Marius Clemens, Geraldine Dany-Knedlik, Hella Engerer, Marcel Fratzscher, Stefan Gebauer, Max Hanisch, Simon Junker, Konstantin Kholodilin, Malte Rieth, and Thore Schlaak**

According to DIW Berlin estimates, the German economy will continue its solid growth performance in 2019 and 2020. Overall, however, the economy is cooling noticeably and production capacity utilization is returning to normal. This is primarily due to the global economy weakening; it has been strained by China's weakening economy, trade conflicts, and political uncertainties such as Brexit. The German economy will be particularly affected by these developments, as it specializes in exporting capital goods. However, the German economy will likely gradually make up for its dip in growth, helped by the fact that private households have been benefiting from fiscal policy stimuli since the beginning of 2019 and the increasing signs of a recovery in the automobile industry. Nevertheless, DIW Berlin has lowered its growth forecast for the German economy to 1.0 percent for this year in light of the gloomier business expectations in many sectors. The outlook for 2020 remains unchanged, however, with GDP forecasted to grow by 1.8 percent.

In the short term, non-recurring effects will dominate the German economy. For example, the automotive industry struggled with weaker sales until winter 2018 due to a delay in certifying their fleet, which was required to adhere to the new vehicle emission and fuel consumption standards prescribed by the Worldwide Harmonized Light Vehicle Test Procedure. However, the latest sales figures show that the sector is gradually compensating for this slump. The chemical industry also appears to be recovering after production slumped in the autumn due to low water levels on inland waterways. Moreover, fiscal policy is boosting economic growth: some of the Grand Coalition's decisions, such as financing health insurance by splitting the costs equally between employers and employees, have resulted in strong income growth for private households since the beginning of the 2019, increasing private consumption.

The domestic economy will continue to support growth over the further course of the forecast period. The labor market is showing no signs of weakening, and employment growth is continuing uninterrupted. In 2019, employment should reach a new record level and the unemployment rate of 4.8 percent should reach a further low since German reunification. Real wages are developing strongly—growing by 1.5 percent—also due to the low inflation rate of 1.5 percent. The construction industry is booming, and despite the uncertainties, companies are investing in expanding their production capacity.

However, the currently harsh external economic environment is negatively impacting sentiment. Nearly all sentiment indicators have declined significantly in recent months. Primarily industrial companies' business expectations are declining globally while the service providers remain confident. There are many reasons for these poor expectations: in the USA, fiscal policy stimuli are gradually waning and the federal government shutdown slowed economic growth. In Europe, the Italian economy is of particular concern, as growth has lagged well below expectations. In Asia, the Chinese economy has weakened recently. Globally, investment goods—one of the German economy's specializations in foreign trade—have lost momentum in particular. This loss of momentum is especially troublesome for the German economy and is partly a result of the uncertain economic environment, although the trade disputes between the USA and China have calmed down. Signs of trouble remain, however, as the conflict between the USA and the European Union over EU automobile exports to the USA is flaring up again. The introduction of tariffs would pose a considerable burden for the German economy. Ongoing discussions about Brexit will continue to burden the economy. In view of the economic slowdown and low inflation, the European

Central Bank has already announced that it will continue to provide expansionary monetary policy stimulus. The Federal Reserve has also indicated it will reduce the pace of interest rate hikes in reaction to the weaker economic development in the USA.

The situation is no longer as advantageous as it was a year ago and risks to the forecast have increased significantly, affecting the international environment. China's government has announced comprehensive economic stimulus packages to support the economy, although if and when these packages will have an effect remains to be seen. Domestic economic forces remain intact in the other export markets, where the slowdown is mainly due to a lack of stimuli from the manufacturing sector. If the weakness in the industrial sector—which is probably caused by uncertainty to a large extent—were to spread to the service sectors as well, global demand could lose further momentum, and the German economy would suffer as a result. However, the German economy is already also facing major challenges in some key industries: for example, German automobile sales were lower, primarily due to certification problems. However, it may also be the case that Germany is increasingly losing ground in global competition: high-revenue car models such as SUVs are predominately being manufactured outside of Germany, and diesel vehicle sales are also slowing in view of the debate on particulate matter. If, for these reasons, the

production declines of summer 2018 turn out to be more permanent than thought, this would mean significantly lower overall economic growth in Germany.

Despite these risks, however, DIW Berlin stands by its fundamentally positive assessment of the economic situation, which is largely based on the continued strength of the German domestic economy. Public budgets should therefore continue to close with substantial surpluses. Nevertheless, the financial leeway is shrinking. The surplus will probably fall from 58 billion euros in 2018 to around 37 billion euros in 2020.

At the same time, the level of debt has fallen significantly after years of budget consolidation and is now below 60 percent of annual economic output, in line with the Maastricht criteria. The interest rate level, which remains extremely favorable, opens up opportunities for financing investments which are necessary and highly profitable, thus generating important triggers for growth. Moreover, an investment stimulus would support the cooling economy. Yet it is not just a matter of updating transport infrastructure to compensate for the wear and tear over the years; the aim must be to push ahead with projects necessary for future development, for example in the areas of digitization and R&D, which would increase growth potential and competitiveness.

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# The global economy and the euro area: weak international trade, robust domestic demand

By Claus Michelsen, Guido Baldi, Geraldine Dany-Knedlik, Hella Engerer, Stefan Gebauer, and Malte Rieth

## ABSTRACT

The current global economic environment remains harsh. Global growth rates stagnated in the fourth quarter of 2018, particularly affected by foreign trade. DIW Berlin's forecast indicates global economic growth of 3.7 percent for 2019 and 3.6 percent for 2020. Positive stimuli are expected from catch-up effects (in the European automobile industry, for example) and the continued positive development on the labor markets, which will support consumption. However, the outlook for international trade is dominated by trade conflicts, political uncertainties, and a weaker Chinese economy. Although the trade conflict between the USA and China is beginning to ease, there are signs of a dispute between the USA and the European Union over EU automobile and car part exports to the USA. In Europe, the possibility of a no-deal Brexit and the political situation in Italy are causing uncertainty. Against this backdrop, monetary policy is likely to be expansionary in the forecast period.

The global economic expansion weakened further in the final quarter of 2018 (Figure). Growth rates mostly stagnated or declined slightly in both developed and emerging market economies. A number of uncertainties likely contributed to this, and foreign trade was particularly affected. In addition, temporary factors dampened growth in some major economies.

Non-recurring effects, such as the federal government shutdown in the USA, will no longer be an issue in the forecast period (2019 and 2020). There will probably be catch-up effects, in part because the European automotive industry is likely to partially make up for last year's production losses. Domestic demand remains largely intact in most countries, and the situation on the labor markets is continuing to improve, albeit at a slower pace. In addition, lower energy prices are likely to result in increased purchasing power gains for private households in 2019.

In contrast, the global economic environment remains harsh. Trade conflicts, political uncertainties, and a weakening Chinese economy are shaping the outlook for international trade, which will probably remain weak, dampening corporate investment activity. As a result, the global production expansion is likely to slow to 3.7 percent in 2019 and to 3.6 percent in 2020 (Table).

Against this backdrop, monetary policy is likely to be expansionary in the forecast period. There are signs that central banks are shifting away from planned increases in key interest rates in both the USA and the euro area, which will provide favorable financing conditions in the two economic areas and many emerging markets. Fiscal policy will also be slightly stimulative, although the effects of the tax cuts in the USA are coming to an end and Japan has planned a consumption tax hike for 2019.

Overall, the global economy is facing a series of risks. While the trade conflict between the USA and China is cooling down, there are signs of a dispute between the USA and the European Union over EU automobile and car part exports to the USA. An escalation involving reciprocal tariff increases would burden exports and investments in both regions. In

addition, the likelihood of a no-deal Brexit occurring at the end of March 2019 remains high, which would make trade between the two economic areas more difficult and negatively impact production. Lastly, the political situation in Italy, the third-largest economy in the euro area, is creating further uncertainties in Europe. The agreement between the EU Commission and the Italian government recently eased the situation somewhat, but the economy would be slowed down if Italian financing conditions deteriorate again.

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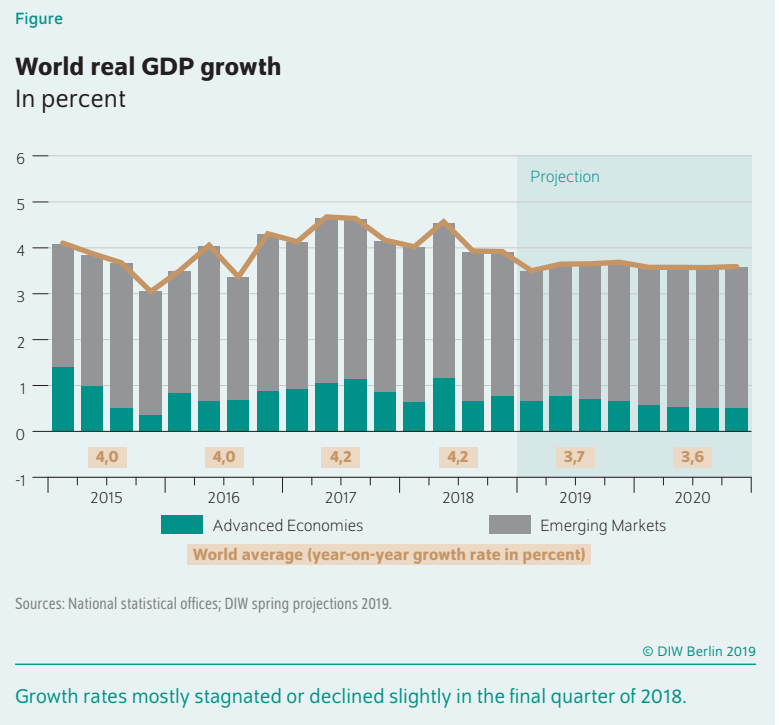
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JEL: E32, E66, F01

Keywords: Business cycle forecast, economic outlook

Table

### Real GDP, consumer price inflation, and unemployment rate in the world economy

In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Change over previous year in percent											
	2017	2018*	2019	2020	2017	2018*	2019	2020	2017	2018*	2019	2020
Euro area	2.5	1.7	1.3	1.5	1.4	1.7	1.5	1.7	9.0	8.2	7.8	7.5
without Germany	2.5	1.8	1.4	1.5	1.4	1.7	1.5	1.5	11.4	10.4	10.0	9.8
France	2.3	1.5	1.5	1.5	1.1	1.8	1.5	1.5	9.4	9.1	8.7	8.4
Italy	1.6	0.8	0.4	1.0	1.3	1.2	1.0	1.1	11.3	10.6	10.4	10.3
Spain	3.0	2.5	2.3	2.0	2.0	1.7	1.7	1.6	17.2	15.3	14.3	14.1
Netherlands	3.0	2.5	1.8	1.7	1.3	1.6	2.4	1.9	4.8	3.9	3.7	3.7
United Kingdom	1.8	1.4	1.2	1.4	2.7	2.4	2.0	2.1	4.5	4.2	4.4	4.4
USA	2.2	2.9	2.4	1.8	2.1	2.4	2.0	2.0	4.4	3.9	3.7	3.5
Japan	1.9	0.7	1.0	0.9	0.6	0.8	1.1	1.2	2.8	2.4	2.4	2.4
South Korea	3.1	2.7	2.7	2.4	1.9	1.5	2.0	2.7	3.7	3.8	3.0	3.0
East-central Europe	5.0	4.5	3.6	3.3	1.7	2.2	2.4	2.8	4.6	3.7	3.4	3.3
Turkey	7.4	2.6	-0.2	2.9	11.2	16.3	15.9	12.3	10.9	10.8	11.8	11.8
Russia	1.6	2.0	1.8	1.9	3.5	3.1	4.6	4.1	5.1	4.7	4.6	4.5
China	6.8	6.6	6.2	6.0	1.4	1.7	2.3	2.4	4.0	4.0	4.0	4.0
India	6.4	7.5	6.1	5.7	3.5	3.9	5.8	6.1				
Brazil	1.1	1.2	1.0	1.1	3.4	3.7	5.3	6.5	12.8	12.3	8.4	6.2
Mexico	2.3	2.2	2.0	1.6	6.0	4.9	4.1	3.2	3.4	3.3	4.8	4.8
Developed economies	2.3	2.2	1.9	1.6	1.8	2.0	1.8	1.9	5.3	4.8	4.6	4.4
Emerging markets	5.6	5.6	5.0	4.9	2.8	3.3	4.2	4.2	5.2	5.0	4.8	4.6
World	4.2	4.2	3.7	3.6	2.4	2.8	3.2	3.3	5.3	4.9	4.7	4.5

\* Based in part on preliminary data

Sources: National statistical offices; DIW spring projections 2019.

# German economy remaining strong amidst uncertainties

By Claus Michelsen, Martin Bruns, Marius Clemens, Max Hanisch, Simon Junker, Konstantin Kholodilin, and Thore Schlaak

## ABSTRACT

Although the economic boom in Germany is over, a recession is not looming. The economy is still expected to grow by 1.0 percent this year despite its recent weaker performance. Consumption remains a mainstay of the economy; the average annual increase in the number of employees is likely to be just under half a million. At 1.5 percent, inflation is barely dampening purchasing power and together with fiscal policy stimuli, it will lead to a noticeable increase in private consumption. Foreign demand, on the other hand, is developing moderately due to China's weakening economy and the fact that the industrial sector is losing momentum in many important export markets. The enormous political risks will dampen corporate investment as well.

The economic boom in Germany has come to an end, as the global economy is losing considerable momentum. While consumption is still increasing robustly in many countries, demand for capital goods is decelerating worldwide. Thus, the global slowdown is particularly affecting the German economy with its focus on these goods. Moreover, Germany is facing strategic challenges in the medium term as a main location for the automotive industry: for example, some passenger car models especially in demand on global markets, such as SUVs, are already being produced in other countries. This industry in particular has already been slowing down the German economy over the past six months due to significant production declines. The new WLTP certification procedure and accompanying delay in certification contributed to this. However, these problems have now been solved and production is likely to at least be partly made up for. There have been signs of a recovery since the end of 2018, but catch-up effects may not be noticeable until spring 2019 as production in the industrial sector declined again at the beginning of 2019. For this reason, GDP growth will remain weak in the first quarter (Figure). Despite stronger growth rates over the further course of the year (Table 1)—which are supported by high order backlogs in the industrial sector—the German economy will grow by only 1.0 percent this year. In 2019, growth is likely to be stronger at 1.8 percent (Table 2), although without the additional three and a half working days it would only be 1.4 percent. In the wake of weaker growth rates, the recently high utilization of overall capacities is normalizing.

Overall, German exports will increase moderately. In the USA, the upward trend is continuing at a slower pace, and in China, where the economy had recently weakened, monetary and fiscal stimuli are likely to gradually take effect starting mid-2019. The rest of the euro area economy will also grow at a somewhat slower pace than before.

Domestic consumption in particular is rising noticeably. Continuing employment growth and wage increases are boosting incomes, and the average number of employees will rise by 470,000 in 2019 and by 280,000 in 2020. On a monthly basis, wages are rising by about three percent per year. Inflation is also developing favorably for the consumer:

Table 1

**Use of GDP, 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	0.4	0.2	-0.3	0.2	0.5	0.7	0.5	0.3	0.3	0.3	0.3	0.3
Public consumption	-0.4	0.8	-0.3	1.6	0.3	0.5	0.4	0.4	0.6	0.5	0.3	0.3
Gross fixed capital formation	1.0	0.6	0.4	0.9	0.7	0.8	0.7	0.7	0.6	0.6	0.6	0.6
Investment in machinery and equipment	2.2	0.3	0.0	0.7	0.7	1.3	1.0	0.9	0.8	0.8	0.8	0.8
Construction investment	0.8	0.9	0.7	1.3	0.7	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Other investments	-0.5	0.3	0.2	0.5	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Change in inventories <sup>1</sup>	0.0	0.3	0.8	-0.6	-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	0.4	0.7	0.5	0.4	0.4	0.4	0.4	0.4
Net Exports <sup>1</sup>	0.0	-0.2	-0.9	0.0	-0.2	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Exports	-0.2	0.8	-0.9	0.7	0.5	0.9	0.8	0.6	0.5	0.5	0.5	0.5
Imports	-0.3	1.5	1.3	0.7	1.2	1.0	0.9	0.8	0.7	0.7	0.7	0.7
GDP	0.4	0.5	-0.2	0.0	0.2	0.6	0.5	0.3	0.3	0.3	0.3	0.3

<sup>1</sup> Contribution to GDP growth in percentage points.

Source: Federal Statistical Office; DIW spring projections 2019; forecast from 2019 Q1 onward.

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Table 2

**Key economic indicators for the German economy**

	2015	2016	2017	2018	2019	2020
Real GDP <sup>1</sup> (percent change over previous year)	1.7	2.2	2.2	1.4	1.0	1.8
Domestic employment (1000 persons)	43,071	43,642	44,269	44,838	45,242	45,494
Unemployed (ILO concept)	1,949	1,775	1,621	1,472	1,321	1,180
Unemployed (BA concept)	2,795	2,691	2,533	2,340	2,171	2,044
Unemployment rate <sup>2</sup> (ILO concept)	4.6	4.1	3.8	3.4	3.0	2.7
Unemployment rate <sup>2</sup> (BA concept)	6.4	6.1	5.7	5.2	4.8	4.5
Consumer prices	0.5	0.5	1.5	1.8	1.5	1.7
Unit labor costs <sup>3</sup>	1.8	1.2	1.5	2.6	3.2	1.4
Government budget balance <sup>4</sup>						
in billion EUR	23.9	28.7	34.0	58.0	42.9	37.1
in percent of GDP	0.8	0.9	1.0	1.7	1.2	1.0
Current account balance, in percent of GDP	8.9	8.5	8.0	7.4	6.6	6.5

<sup>1</sup> Price-adjusted, chain-linked

<sup>2</sup> As a share of domestic labor force (ILO), resp. Civilian labor force (BA)

<sup>3</sup> Compensation of employees (national concept) per hour worked over real GDP

<sup>4</sup> According to ESA 2010

Sources: National and international institutions; DIW spring projections 2019; forecast from 2019 onward.

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it is likely to be 1.5 percent in 2019, thus putting relatively little strain on purchasing power, before rising slightly to 1.7 percent in 2020. In addition, private households are experiencing an income boost as a result of new laws; in particular, financing health insurance by splitting the costs equally between employers and employees has brought employees a noticeable increase in their net income since the beginning of 2019. The state is also significantly expanding its consumption.

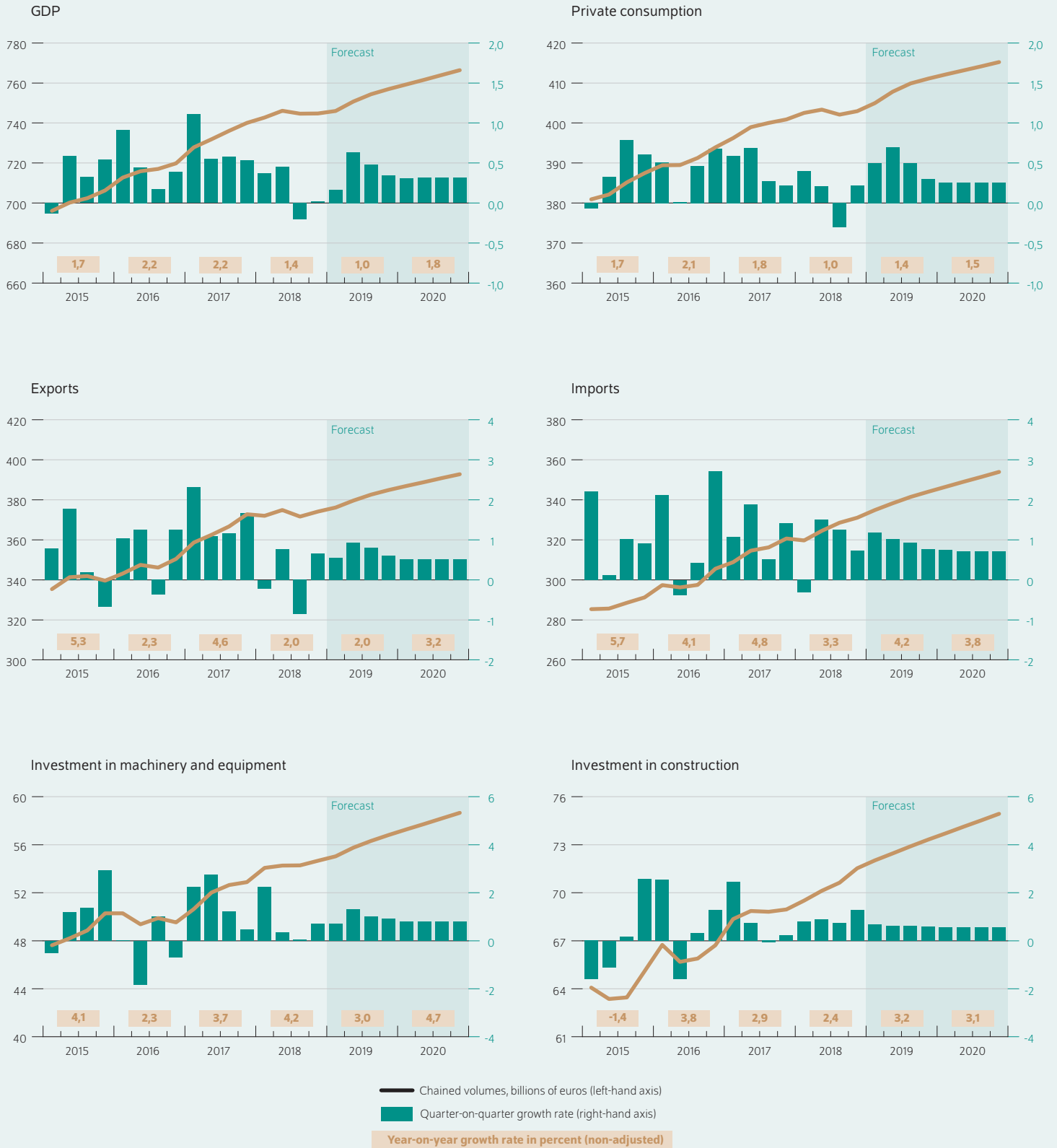
Corporate investment, on the other hand, is increasing only moderately: in view of the currently high risks, companies are likely to be cautious in expanding their production capacity.

Investments in residential and public construction, however, are continuing to develop dynamically.

The risks and uncertainties for the present forecast are currently high. The outcome of the Brexit negotiations is still unknown, and a no-deal Brexit cannot be completely ruled out. The risks of an escalated trade dispute between the EU and the USA are looming, and the USA may increase tariffs on vehicles imported from the EU. Lastly, only a small portion of temporary production losses can be made up for, if at all, when global demand weakens more sharply than expected. The latter is also a risk factor, as has recently been signalled by the worsening economic sentiment in many countries.

Figure

**GDP and use of GDP**  
Seasonally and working-day adjusted



Sources: Federal Statistical Office; DIW spring projections 2019; forecast from 2019 Q1 onward.

## GERMAN ECONOMY

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