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GERMAN ECONOMY ENJOYING A LITTLE BOOM

Berenberg Macro Flash

German GDP, Q1 (qoq, in %)

Actual:	**0.6**
Previous:	0.4
Consensus:	0.6
Berenberg:	0.7

More (hard) evidence that Germany got off to a strong start in 2017: Hard data is now starting to more closely match the improvements in the soft data in recent months. Real GDP growth accelerated in the Eurozone's largest economy to 0.6% qoq in Q1, after 0.4% in the previous quarter, in line with consensus expectations. While no detailed quantitative (expenditure) breakdown was published today, the German statistical office reported that economic activity picked up in Q4 on the back of gains from all pillars demand, with a particularly strong showing for business investment (both construction and equipment) and exports.

Healthy prospects for 2017: Due to concerns that the Brexit referendum in the UK would hit exports, the German economy experienced a soft patch last summer. But by Q4 it was back on track, with the economy expanding at around trend of 0.4% qoq. And by Q1 growth was at full throttle thanks to an uptick in investment (especially in construction due to mild weather this winter) and as foreign demand also provided a positive contribution – after being a drag on growth over the last two quarters. While we expect the rate of expansion to normalise over the rest of the year, with growth returning toward trend, the strong first quarter can propel the German economy to maintain its solid 2016 growth rate for real GDP of 1.8%.

Can it get any better than this? Yes. While the big boost to real consumption growth from the large fall in the oil price some two years ago has faded, as some tailwinds go, others come. Political risks are likely to remain modest as long as Brexit negotiations don't go badly wrong. In fact, the underlying fundamentals suggest that the risks to our outlook for growth in household consumption, investment and GDP are a little to the upside.

Healthy economic fundamentals continue to drive private consumption. The labour market has probably never been in a better shape. Strong employment and modest wage gains are driving increases in households' disposable income, confidence and spending. With such low unemployment we might expect stronger wage growth. But this could be a lagged effect. Settlements for workers in the private and public sector have remained moderate, despite a drop in the size of the labour force in 2016 Q4 for the first time since 2010. This may partly owe to the fact that some employers already have an eye on the refugees turned job seekers. After all, the big bulk of refugees that entered Germany between September 2015 and April 2016 is about to enter the labour market – and, by raising the supply, a growing labour force can weigh down heavily on wage growth. Labour demand is currently expanding by more than supply, as vacancies hit an all-time high in Q1 2017 (1.064m, +75k yoy and +9k qoq). This is encouraging as labour demand typically drops during the winter months. As demand outpaces supply, the labour market should tighten, raising employee wage bargaining power and causing wage growth to accelerate. Private consumption also benefits from policy measures, such as the introduction of income tax cuts of €15bn at the beginning of the year.

The environment for business is bright. Among Germany's major trading partners, the rest of the Eurozone, US and emerging markets, the upswing gathers pace, and even in the UK, activity is likely to hold up at a lower, but still decent level. That not only boosts German exports which benefit from a still competitively valued exchange rate (the euro was down by -1.3% versus the US dollar in Q1 compared to Q4 and -3.4% versus Q1 2016). As the recovery broadens and firms, businesses start expanding their production capacity with more conviction as they believe that long-term investments will pay off (for more on the dynamics of investment catching-up and complementing consumption, see What is missing from the upswing?). Although German industrial production was down in March from the previous month, Q1 was up by 0.9% versus Q4, thanks to a solid increase of capital goods by 1.1% during the 3 months. For the coming quarters it helps that the key risk we stressed in our outlook in early January, political uncertainties, are either out of the way (Wilders in the Netherlands, Le Pen in France) or have receded further (protectionism and currency wars led by Trump). No wonder that leading indicators such as the Ifo, PMI and ESI have reached multi-year highs. Even if the soft data may exaggerate the upswing, we expect continued improvement in the hard data. For Germany's soft spot, the lacklustre performance in capital spending, with the investment share in GDP hovering around and most of the time below 20% for the last 15 years, this would be a leap forward.

German GDP (in %)

	Q1 17	Q4 16	Q3 16	Q2 16	Q1 16	Q4 15
qoq	**0.6**	0.4	0.1	0.5	0.7	0.4
yoy	**1.7**	1.8	1.7	1.8	1.9	1.3

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