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GERMAN GDP: STRONG H1, MODERATION LIKELY IN H2

Berenberg Macro Flash

German GDP, Q2 (qoq, in %)

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

Running at full steam: In the first half of this year the German economy grew by the fastest annualised pace (2.7%) since 2013. A first estimate showed that real GDP expanded by 0.6% qoq in Q2, after an upward revised 0.7% in the first quarter. The German statistical office reported that economic activity picked up on the back of firm gains from all pillars of domestic demand while trade acted as a drag. Over the rest of the year we expect a return to more sustainable rates of expansion of c0.5% qoq. Business sentiment may have reached somewhat of a peak in the summer, capacity constraints are an issue in some sectors of the industry and the recently less weaker euro limits the upside potential of exports.

Healthy gains in consumption drive domestic demand: The German statistical office provided only a qualitative assessment of the GDP drivers today. A quantitative breakdown will be published on 25 August. According to the press release private consumption increased markedly. The labour market has probably never been in a better shape. Strong employment gains are driving increases in households' disposable income, confidence and spending. Retail sales were up by 1.3% in Q2 compared to the previous quarter. Consumption should continue to hold up in Q3. Wage gains have been modest so far. But this should change eventually. Labour demand is currently expanding by more than supply with vacancies hitting new highs in July. As demand outpaces supply, employees' bargaining power should rise with wage growth likely to accelerate. Private consumption also continues to benefit from policy measures, such as the introduction of income tax cuts at the beginning of the year. Further measures to boost households' purchasing power may be in the cards after the general election in less than six weeks. The government's consumption also contributed to demand as it "increased markedly" according to the press release.

Business investment also up thanks to increased spending in machinery and construction: Despite drops in June, industrial production of capital goods was up by 1.3% while construction output was up by 2.7% in the second quarter compared to Q1. Germany's major trading partners, the rest of the Eurozone, US and emerging markets, enjoy a solid upswing. That does not only boost German exports. 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 Germany's soft spot, the lacklustre performance in capital spending at home, with the investment share in GDP hovering around and most of the time below 20% for the last 15 years, this would be a step forward.

Trade acts as a drag: Stronger exports were more than offset by considerably larger increases in imports. There are a number of reasons for this. The German households are in a favourable position to consume more Spanish ham, French wine and Italian cheese. The non-Eurozone imports have also increased as the less weaker Euro (+3.4% versus the US Dollar in Q2 compared to Q1) has made it cheaper for Germans to travel to the UK or the US. While import growth may have accelerated, exports may have increased by less than previously. The less favourable exchange rate costs exporters some competitiveness vis-à-vis non-Eurozone competitors.

Some moderation in H2 likely: For the remainder of the year we expect some slowdown in the pace of expansion down to around 0.5% qoq which would be closer to the trend rate of 0.4%. Survey data such as the Ifo and GfK have hit new record highs in July and suggest that growth, including export growth, will hold up. This poses an upside risk to our call of a less exuberant pace in H2. We see two reasons that neutralise this upside risk and make us stick to our calls. Firstly, the weaker PMI and ZEW for two consecutive months suggest we may have reached somewhat of a peak of sentiment, and therefore also growth. Secondly, the stronger Euro will likely weigh on net exports, even though Germany may be less affected than other countries as its exporters compete with other countries less on a price level.

German GDP (in %)

	Q2 17	Q1 17	Q4 16	Q3 16	Q2 16	Q1 16
qoq	**0.6**	0.7	0.4	0.3	0.5	0.6
yoy	**2.1**	1.9	1.9	1.9	1.9	1.8

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