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GERMAN GDP: NEAR-TERM DENT, BUT UNDERLYING TREND HEALTHY

Berenberg Macro Flash

German GDP, Q1 2018 (qoq, in %)

Actual:	**0.3**
Previous:	0.6
Consensus:	0.4
Berenberg:	0.4

The German economy did not dodge the bullet in Q1: As in many other European economies, GDP growth in Germany slowed down in Q1, to 0.3% qoq after 0.6% in Q4 2017 and 0.8% in Q1-Q3 2017 on average (see chart). We and consensus expected growth to come in at 0.4%. According to the Destatis press release, "positive contributions" came from domestic demand, while foreign trade was "less dynamic". The first release of German GDP does not provide a detailed breakdown but only a qualitative assessment – more detailed results will be released on 24 May. The weakish result for Q1 probably owes to four factors, in the following order: (1) a return to normal after a stellar 2H2017, (2) one-off factors, (3) trade tensions and (4) a stronger euro. Looking ahead, we expect a rebound in the economy during H2 to growth around 0.6% qoq and more sustainable rates around 0.5% qoq for 2019.

Return to normal: For an economy with a speed limit (potential growth rate of supply) of not more than 0.4% qoq, an expansion at twice the rate can only be sustained for a long period if slack and idle resources characterise the economy. This is certainly not the case for the German economy. After 8 years of growth capacity utilisation and unemployment rate are at multi-decade highs and lows, respectively. There is hardly any spare capacity left. Wage deals this year, including the most recent one for construction workers, suggest that it is harder for employers to find new, qualified workers. Some moderation in growth in response to supply constraints is nothing to worry about.

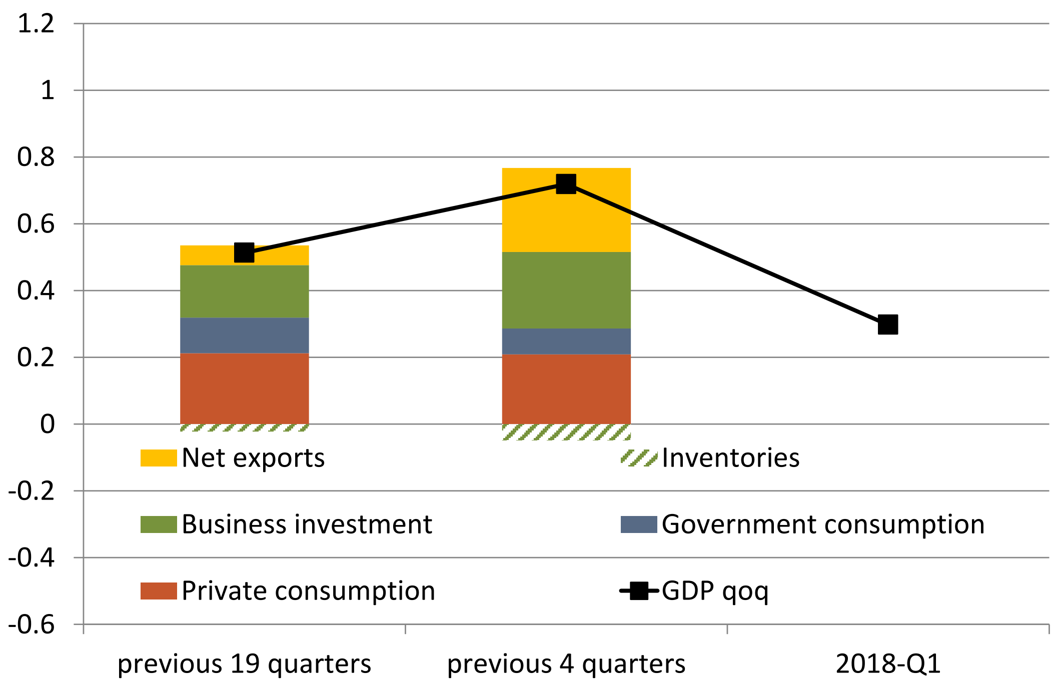
Blame the weather, the flu and ... a lack of government: Amid a strong global upswing, a growth rate at or below trend as in Q1 is still unusual. Unusual factors weighing on growth in Q1 were the weather (snowy and cold) and the number of workers suffering from the flu epidemic. Some workers did not make it to the factories, so industrial production was flat qoq after 1.2% qoq for the last 4 quarters. Meanwhile, less shoppers found their way to the stores (retail sales were down by 0.9% qoq after growth of 0.6% for the last 4 quarters). Private consumption thus contributed only a marginal amount to GDP growth in Q1. On top of that, for the first time in 5 years government consumption was a drag on GDP, according to the Destatis press release. Remember that Germany did not have a government in Q1, so a few government initiatives may have been halted in the first three months of the year.

Trade tensions and euro weigh on sentiment, but not (much) on investment: The German economy relies on free trade and open borders more than any other major advanced economy. Protectionist risks stoked by US President Trump were going to hit Germany and its export-oriented economy first and most. While the risks have been so far just that, risks, they have weighed on business confidence. German sentiment came down from the sky over the last couple of months. A stronger euro (up 6.3% over the course of 2017 in trade-weighted terms) also did not help, compressing some exporters' margins which already suffer from higher input costs. As a consequence, some German champions may have postponed investment decisions.

Still, a long backlog of past orders, current production constraints and more expensive labour caused German businesses to expand their capacities – investment grew substantially according to the press release.

Oil prices prevent full bounce-back, moderation over the medium-term: The recent rise in oil prices will temporarily weigh on private consumption and will prevent a full bounce back from the exceptional factors that hit output in Q1. In H2, a general rebound in activity should set in as trade tensions ease (Trump reversed sanctions against a Chinese tech giant over the weekend) and the exporters take relief from a euro that is in US dollar terms closer to the 1.20 than the 1.25. Still, supply constraints suggest growth will slowly adjust to rates which are lower, but still healthy and above trend over the medium term. We expect the economy to expand by 0.5-0.6% qoq for the rest of this year and 0.5% in 2019 qoq.

Chart: Contributions to German GDP growth (qoq, in percentage points)



Contributions to GDP growth in percentage points. No breakdown for Q1 2018. Source: Eurostat.

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