Florian Hense, Economist | florian.hense@berenberg.com | +44 20 3207 7859

GERMAN GDP: TOUGH 2019 – BETTER DAYS TO COME

Berenberg Macro Flash

2019 has been the worst year for the German economy since 2013. According to the first full-year GDP estimate of Germany's statistical office Destatis, real German GDP expanded in line with expectations by 0.6% in 2019, after 1.5% in 2018 and 2.8% in 2017. Destatis will publish a first set of Q4 GDP data on 14 February. Baring major revisions to the first three quarters of the year, the economy probably grew by c0.1% qoq and 0.4% yoy in Q4 compared to 0.1% and 0.5% in Q3, respectively.

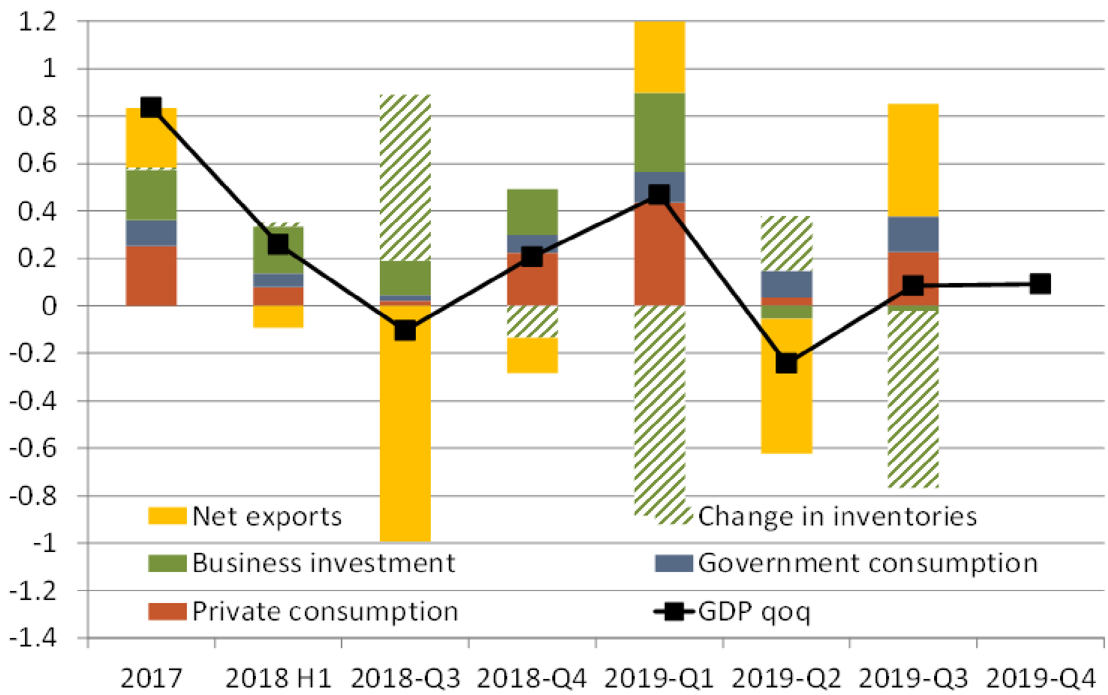
Challenging external environment: As in 2018, trade tensions, the Brexit mess and the slowdown in China have taken a heavy toll on Germany's export-driven and manufacturing-heavy economy over the past two years. Net exports subtracted from growth (0.4ppt like in 2018) as real imports – albeit slowing down further (from 3.6% in 2018 to 1.9% in 2019) – outpaced exports (0.9% after 2.1% in 2018) for the fifth consecutive year. On top of the drag from foreign trade and different to 2018, businesses cut down their stocks significantly – amid lower production and an involuntary build-up in inventories in late 2018 – and shaved a further c0.9ppt off GDP growth in 2019 (vs. a +0.3ppt contribution in 2018).

Solid domestic demand: Final domestic demand saved the day for the whole economy holding up at 2% in 2019 (contributing 1.9% to GDP growth) vs. 1.7% in 2018. All components of domestic demand supported growth in 2019 – to different degrees, though. On the back of slowing, but sustained employment gains (c1%), accelerating real wage growth and fiscal boosts to household income, private consumption rose by 1.6%. Government expenditures increased by 2.5% amid higher pensions, public sector worker pay and day-do-day spending. Similar to the last few years, as a surge in tax revenues outstepped the gradual increase in German public spending, Germany recorded the fifth consecutive fiscal surplus (1.5% – down from 1.9% in 2018). Low interest rates and positive trends in households' wealth drove construction investment higher by a buoyant 4%. Equipment investment was only marginally up relative to 2018 by 0.4% as it came to a screeching halt throughout the year reflecting the drop in business confidence.

Outlook for 2020: The gap between weak foreign trade and largely robust domestic demand cannot last. Something has to give. If the downturn in trade and manufacturing were to last, domestic demand could soften significantly in 2020. In our view, however, the gap will probably narrow mostly by a gradual upturn in manufacturing. The ambitious "phase one" US-China trade deal to be signed today and the end of political gridlock in the UK support the hope that the German economy will fare better in 2020 than in 2019. A range of financial and economic indicators point to a gradual economic recovery for 2020. If Trump also refrains from raising US tariffs on German cars, the situation could stabilise further. Just like the downturn in global trade hit Germany more than any other major advanced economy, the return of mostly positive economic fundamentals prevailing over political risks could make a bigger difference for the Eurozone's biggest economy. After another weak Q1 (0.1% qoq) and soft Q2 (0.2%), we expect GDP growth to return to its trend rate of 0.4% in H2 2020. Our call for annual growth in 2020 (0.6%) reflects largely the weak carry-over from 2019. In 2021 we expect German GDP to expand by 1.5%.

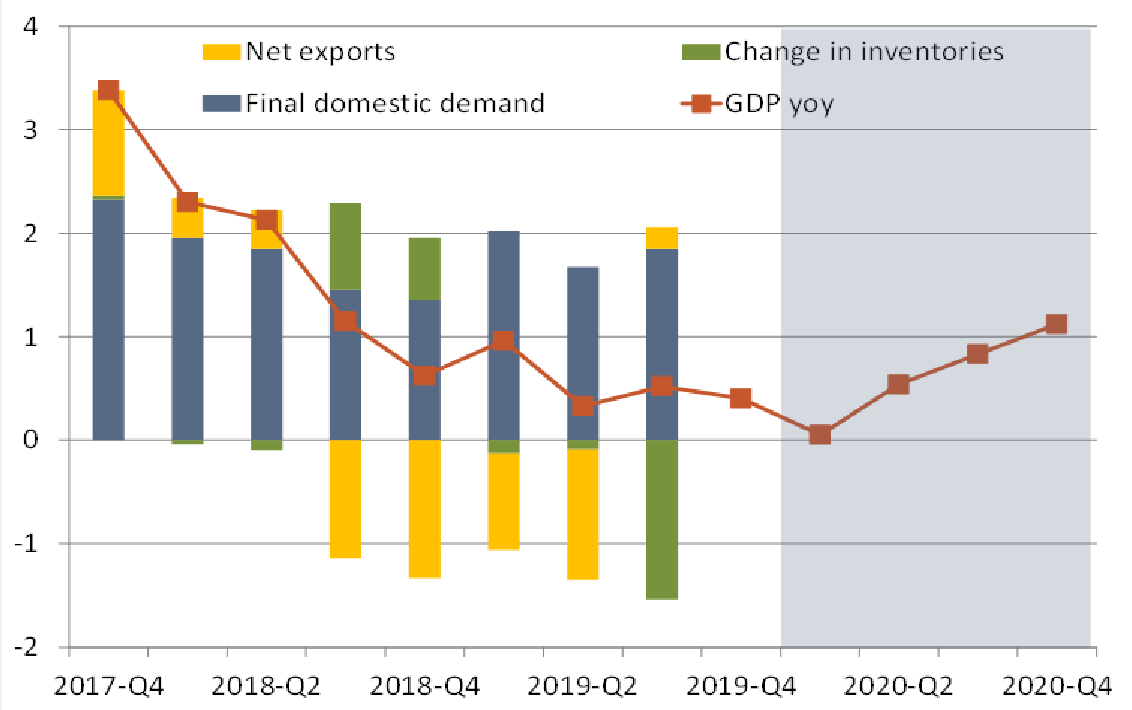
Golden decade over? Germany continues to enjoy its golden decade which started in 2010. With a rising participation rate and the successful integration of – mostly European – immigrants, Germany continues to cope well with its demographic challenges. The "Agenda 2010" and other reforms of around 2004 are still paying off nicely. The trend remains solid. Still, the new normal for German growth may be below the trend of the past decade amid continued global economic policy uncertainty and challenges for the domestic automotive sector. In addition, because of small-scale reform reversals and a propensity to raise entitlements, Germany looks set to gradually lose its edge as one of the world's top-performing advanced economies in the next decade.

Chart 1: German qoq GDP growth and its contributions by expenditures



Qoq GDP growth in %, contributions in %-points. No breakdown for Q4 2019. Source: Eurostat, Berenberg

Chart 2: German yoy GDP growth and its contributions by expenditures



Yoy GDP growth in %, contributions in %-points. No breakdown for Q4 2019. Berenberg projections from 2020 Q1 onwards. Source: Eurostat, Berenberg

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7859
www.berenberg.com
florian.hense@berenberg.com