

5. GERMANY

Firming growth supported by consumption

Supported by robust employment, consumption, construction and exports, Germany's growth momentum is expected to remain strong. The general government budget is set to remain in surplus and the gross debt-to-GDP ratio to further decline. Policy uncertainty, including the trade policies of major trading partners, represents a downside risk to the growth forecast.

Strong start to 2017

After solid growth in late 2016 (0.4% q-o-q in 2016-Q4), available indicators suggest that economic activity strengthened further in the first quarter of 2017 and higher growth momentum is likely to continue in the coming quarters. Survey indicators for industry and construction improved further in early 2017. Consumer confidence recovered from a short-lived slump in February, as inflation started to moderate in March. Improving global growth, the strong labour market, favourable financing conditions, construction activity, and further public expenditure increases are expected to sustain the rate of economic growth. Overall, real GDP is expected to increase by 1.6% in 2017, slightly less than in 2016 only because of fewer working days, and by 1.9% in 2018.

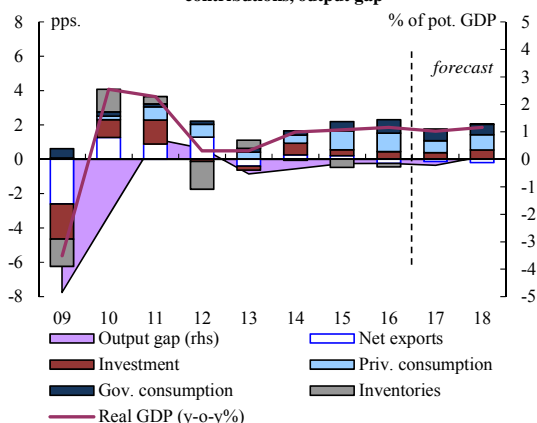
Employment and consumption growth to remain resilient

Data for employment growth in 2016 were revised upwards compared to the initial estimates, pointing to less slack in the labour market than originally estimated. Net job creation is expected to continue, bringing the labour market closer to full employment. The integration into the workforce of the refugees that have been arriving since 2015 will be staggered over a number of years and is not expected to significantly affect employment dynamics over the forecast horizon. In 2016, refugees accounted for less than 0.1 pps. of employment growth and for 0.15 pps. of the unemployment rate. With energy prices rising again, real household consumption is forecast to slow down somewhat but to remain resilient, thanks to the continued rise in employment and despite modest real wage growth. The latter may eventually be supported by the tightening labour market while remaining moderate over the forecast horizon. The household saving rate is expected to remain high. Also, government consumption growth is expected to remain relatively strong, linked to the refugee related expenditures.

Investment dynamics set to pick up

Construction investment, both public and private, rose considerably in 2016. By contrast, growth dynamics for investment in machinery and equipment remained subdued. This, however, is expected to change over the course of next year as replacement and capacity-increasing needs become more pressing due to the rising rate of capacity utilisation. Downward risks related to policy uncertainty, including with regard to trade relations with Germany's key trading partners, could weigh on this prospect. Construction investment is projected to continue growing relatively strongly, as factors stimulating both supply and demand, including rising house prices and low interest rates, remain in place.

Graph II.5.1: Germany - Real GDP growth and contributions, output gap



Current-account surplus to decline

Domestic demand growth strengthened in 2016 and imports increased more than exports. With the slowing down of the improvement in its terms of trade, the widening of Germany's current account surplus came to a halt. Exports are forecast to pick up again as foreign demand increases and to be an important driver of economic activity and investment. Together with strong domestic demand, this should also lead to stronger import growth due to the significant import content of exports. Overall, net exports are expected to

detract slightly from growth over 2017 and 2018. In addition, the positive terms of trade benefits from low oil prices are set to dissipate. As a result, Germany's trade surplus should start to gradually decline relative to GDP.

Headline and core inflation to pick up

With the increase in oil prices, headline inflation is projected to pick up in 2017 (1.7%). Firming domestic demand and wage growth should contribute to rising core inflation in both 2017 and 2018 from the low levels (of around 1.0%) observed throughout most of 2015-16.

Budget surpluses to remain but decrease

The revenue ratio is expected to stay flat over 2017-2018, constrained by some adjustments to the personal income tax tariff. At the same time, the current expenditure ratio is set to grow, as increasing social transfers more than offset the effect of declining interest expenditure. Public investment expenditure is expected to continue increasing.

Overall, the budget surplus is expected to decrease over the forecast horizon. The structural surplus is projected to decrease to around 0.6% of GDP in 2017 and around 0.3% of GDP in 2018. The gross debt-to-GDP ratio is set to decrease substantially from 68.3% in 2016 to around 63% in 2018, driven by budget surpluses and favourable macroeconomic developments.

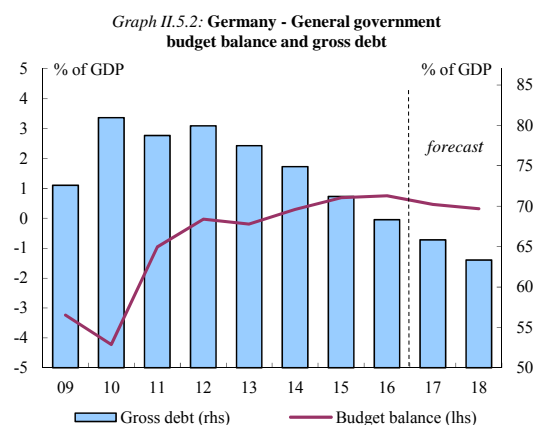


Table II.5.1:

Main features of country forecast - GERMANY

	2015			Annual percentage change						
	bn EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	3032.8		100.0	1.4	0.5	1.6	1.7	1.9	1.6	1.9
Private Consumption	1636.0		53.9	0.9	0.7	0.9	2.0	2.0	1.3	1.7
Public Consumption	583.7		19.2	1.2	1.2	1.2	2.7	4.0	3.2	3.0
Gross fixed capital formation	603.8		19.9	1.0	-1.1	3.4	1.7	2.3	1.9	2.7
of which: equipment	200.2		6.6	2.7	-2.1	5.5	3.7	1.1	1.4	2.8
Exports (goods and services)	1418.8		46.8	6.3	1.9	4.1	5.2	2.6	3.7	3.9
Imports (goods and services)	1189.3		39.2	5.2	3.1	4.0	5.5	3.7	4.8	5.0
GNI (GDP deflator)	3098.8		102.2	1.5	0.5	1.4	1.7	1.7	1.6	1.8
Contribution to GDP growth:										
Domestic demand				0.9	0.4	1.4	2.0	2.3	1.7	2.0
Inventories				-0.1	0.5	-0.1	-0.5	-0.2	0.0	0.0
Net exports				0.5	-0.4	0.3	0.2	-0.2	-0.1	-0.2
Employment				0.6	0.6	0.8	0.9	1.2	1.0	1.0
Unemployment rate (a)				8.4	5.2	5.0	4.6	4.1	4.0	3.9
Compensation of employees / head				1.3	1.8	2.8	2.4	2.3	2.5	2.6
Unit labour costs whole economy				0.6	1.9	2.0	1.6	1.7	1.9	1.7
Real unit labour cost				-0.3	0.0	0.2	-0.3	0.2	0.5	0.1
Saving rate of households (b)				16.2	16.3	16.7	17.0	17.3	17.2	17.1
GDP deflator				0.9	2.0	1.8	2.0	1.4	1.4	1.6
Harmonised index of consumer prices				1.6	1.6	0.8	0.1	0.4	1.7	1.4
Terms of trade goods				-0.3	1.8	1.7	3.1	2.3	-1.4	0.1
Trade balance (goods) (c)				5.7	7.5	7.7	8.7	8.8	8.3	8.0
Current-account balance (c)				3.2	6.9	7.5	8.5	8.5	8.0	7.6
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				3.2	6.8	7.5	8.4	8.5	8.0	7.5
General government balance (c)				-2.2	-0.2	0.3	0.7	0.8	0.5	0.3
Cyclically-adjusted budget balance (d)				-2.0	0.1	0.5	0.8	0.8	0.6	0.3
Structural budget balance (d)				-	0.1	0.8	0.8	0.8	0.6	0.3
General government gross debt (c)				66.0	77.5	74.9	71.2	68.3	65.8	63.3

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.