# 5. GERMANY

## Growth momentum maintained

*Supported by robust employment and consumption, the German economy is forecast to maintain the growth momentum over the forecast horizon although a slight (technical) slowdown is expected next year. The solid labour market, resilient exports and booming construction investment are expected to provide a boost to growth and support equipment investment. The current account surplus is projected to ease slightly while remaining at a historically high level. The budget will remain in surplus supported by a decreasing interest bill and buoyant revenues.*

### Temporary slowdown after a stronger-than-expected start in 2016

Germany's quarter-on-quarter real GDP growth rate slowed from 0.7% in the first quarter of 2016 to 0.4% in the second quarter in seasonally and working day adjusted terms. The contribution of foreign trade strengthened, largely due to a decline in imports. Private and public consumption slowed down, while investment posted a decline.

Economic activity is likely to have grown moderately in the third quarter, supported by factors such as rising employment and household incomes (including pension increases). Monthly indicators for foreign trade, retail sales, industrial production and construction for July and August send mixed signals and point to a temporary standstill. However, a swift recovery in business sentiment and in firms' employment expectations in September points to sustained activity growth in the coming quarters. The robust labour market, favourable financing conditions and still sizable expenditure boost linked to immigration are also expected to contribute to growth. 2017 may see a slowdown until the relative weakness of the second half of 2016 is overcome, and also due to fewer working days. Overall, real GDP is expected to increase by 1.9% in 2016, 1.5% in 2017 and 1.7% in 2018.

### Consumption growth to remain solid

Employment is expected to continue growing at a steady pace alongside the expansion of the economy. The actual number of asylum seekers in 2015 has turned out significantly lower than originally estimated (890 thousand instead of 1.1 million) and the rate of new arrivals has fallen substantially. The integration of refugees into the labour market will be staggered over a number of years and is not expected to significantly affect employment dynamics over the forecast horizon. Still, a proportion of them could add to the labour force and marginally slow down the decline in unemployment. With energy prices no longer depressing price dynamics, real household consumption is forecast to slow down somewhat, but to remain relatively strong thanks to the continued rise in employment and real labour incomes. The latter will be boosted by the update of the minimum wage next year. The household saving rate is expected to remain close to its current high level over the forecast horizon despite the low rates of return. Government consumption growth is expected to slow as the number of asylum seekers arriving declines.

### Some volatility in investment dynamics

Private investment declined in the second quarter of 2016 after positive surprises in the two preceding quarters. The trend in orders of investment goods points to a weaker phase in equipment investment in the second half of 2016. This is expected to be overcome over the course of next year as export growth recovers somewhat and replacement needs mature, but downward risks related to policy uncertainty, including with regard to the 'Brexit' negotiations, could weigh on this prospect. Construction investment, particularly in housing, is projected to continue growing relatively strongly as factors stimulating both supply and demand, including rising prices and low interest rates, remain in place.

### Historically high current account surplus to edge down slightly

Exports held up well in the first half of 2016, while imports underperformed due to weaker than expected consumption and investment growth. Data for July and August suggest more subdued export growth for the remainder of the year. All in all however net exports are set to contribute positively to GDP growth, in contrast to what was expected in spring. Over the course of next year, exports are forecast to pick up again as foreign demand improves. Together with stable domestic demand growth, this should also spur import growth. Overall, net trade is expected to detract slightly from growth over the next two years. In addition, the positive terms of trade benefits from low oil prices are also set to fade. As a result, Germany's trade surplus should start to gradually decline.

### Headline inflation to pick up

With the effect of oil prices fading, headline inflation is projected to pick up in 2017 (1.5%). Firming domestic demand and wage growth should ensure that core inflation rises in both 2017 and 2018.

### Moderate decreases in budget surpluses

Total revenue is expected to increase as percentage of GDP over the next couple of years. However, increases in the basic personal allowance and child allowances as well as an adjustment of the income tax brackets, to offset the impact of fiscal drag, will weigh on the revenue growth. At the same time, current expenditure (% of GDP) is set to increase in 2016-2018 as the continued decline in interest expenditure will be counteracted by growing pension payments. Public investment is expected to grow slightly as a result of additional funds earmarked for infrastructure investment and social housing, while capital transfers are set to decrease slightly in 2017 due to proceeds from the broadband spectrum auction resulting in negative capital expenditure.

Overall, the headline balance, though decreasing, is expected to remain in surplus over the forecast horizon. The structural surplus is projected to decrease by around ¼ % of GDP in 2016, and to stay around ½ % of GDP in 2017 and 2018. The gross debt-to-GDP ratio is set to fall from 71.2% in 2015 to around 63% in 2018.

*Graph II.5.1:* **Germany - General government budget balance and gross debt**

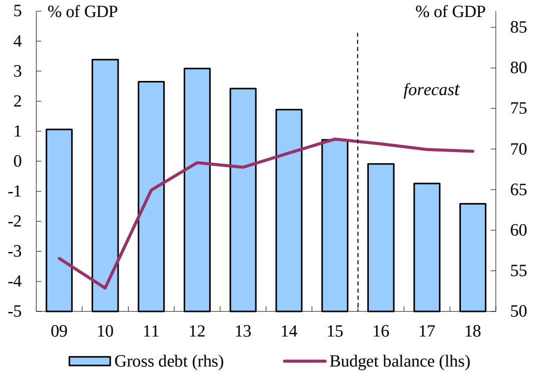


*Table II.5.1:*

**Main features of country forecast - GERMANY**

| | | 2015 bn EUR Curr. prices | 2015 % GDP | 97-12 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|
| GDP | | 3032.8 | 100.0 | 1.4 | 0.5 | 1.6 | 1.7 | **1.9** | **1.5** | **1.7** |
| Private Consumption | | 1636.0 | 53.9 | 0.9 | 0.7 | 0.9 | 2.0 | **1.7** | **1.4** | **1.4** |
| Public Consumption | | 583.7 | 19.2 | 1.2 | 1.2 | 1.2 | 2.7 | **3.9** | **2.8** | **2.5** |
| Gross fixed capital formation | | 603.8 | 19.9 | 1.0 | -1.1 | 3.4 | 1.7 | **2.5** | **1.9** | **2.9** |
| of which: equipment | | 200.2 | 6.6 | 2.7 | -2.1 | 5.5 | 3.7 | **1.6** | **1.1** | **3.6** |
| Exports (goods and services) | | 1418.8 | 46.8 | 6.3 | 1.9 | 4.1 | 5.2 | **2.6** | **2.8** | **4.2** |
| Imports (goods and services) | | 1189.3 | 39.2 | 5.2 | 3.1 | 4.0 | 5.5 | **2.8** | **3.9** | **5.4** |
| GNI (GDP deflator) | | 3098.8 | 102.2 | 1.5 | 0.5 | 1.4 | 1.7 | **2.0** | **1.5** | **1.7** |
| Contribution to GDP growth: | Domestic demand | | | 0.9 | 0.4 | 1.4 | 2.0 | **2.2** | **1.6** | **1.9** |
| | Inventories | | | -0.1 | 0.5 | -0.1 | -0.5 | **-0.4** | **0.0** | **0.0** |
| | Net exports | | | 0.5 | -0.4 | 0.3 | 0.2 | **0.2** | **-0.2** | **-0.1** |
| Employment | | | | 0.6 | 0.6 | 0.8 | 0.9 | **1.2** | **0.9** | **0.9** |
| Unemployment rate (a) | | | | 8.4 | 5.2 | 5.0 | 4.6 | **4.4** | **4.3** | **4.2** |
| Compensation of employees / head | | | | 1.3 | 1.8 | 2.8 | 2.4 | **2.0** | **2.6** | **2.4** |
| Unit labour costs whole economy | | | | 0.6 | 1.9 | 2.0 | 1.6 | **1.3** | **2.1** | **1.6** |
| Real unit labour cost | | | | -0.3 | 0.0 | 0.2 | -0.3 | **-0.3** | **0.4** | **-0.2** |
| Saving rate of households (b) | | | | 16.2 | 16.3 | 16.7 | 17.0 | **17.3** | **17.2** | **16.9** |
| GDP deflator | | | | 0.9 | 2.0 | 1.8 | 2.0 | **1.5** | **1.6** | **1.8** |
| Harmonised index of consumer prices | | | | 1.6 | 1.6 | 0.8 | 0.1 | **0.4** | **1.5** | **1.5** |
| Terms of trade goods | | | | -0.3 | 1.8 | 1.7 | 3.1 | **2.5** | **0.1** | **0.1** |
| Trade balance (goods) (c) | | | | 5.7 | 7.5 | 7.7 | 8.7 | **9.0** | **8.8** | **8.6** |
| Current-account balance (c) | | | | 3.2 | 6.9 | 7.5 | 8.5 | **9.0** | **8.7** | **8.5** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | | 3.2 | 6.8 | 7.5 | 8.4 | **8.9** | **8.6** | **8.4** |
| General government balance (c) | | | | -2.2 | -0.2 | 0.3 | 0.7 | **0.6** | **0.4** | **0.3** |
| Cyclically-adjusted budget balance (d) | | | | -2.0 | 0.1 | 0.5 | 0.8 | **0.6** | **0.6** | **0.5** |
| Structural budget balance (d) | | | | - | 0.1 | 0.8 | 0.8 | **0.6** | **0.4** | **0.5** |
| General government gross debt (c) | | | | 65.9 | 77.5 | 74.9 | 71.2 | **68.1** | **65.7** | **63.1** |

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