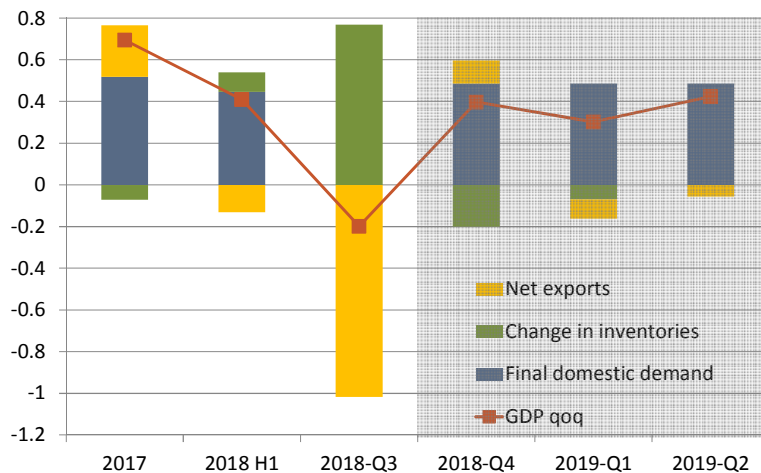


30 November 2018

German economy: beyond the year of shocks

German GDP growth and its components



Average qoq change of GDP in %. Contributions of GDP components to qoq growth in % points. Berenberg forecasts from 2018 Q4 onwards. Sources: Eurostat, Berenberg

- A tale of shocks:** Long seen as a pillar of strength, the German economy slowed even more sharply than the Eurozone as a whole this year– from a 2.5% yoy gain in real GDP in 2017 to just 1.2% yoy versus 1.7% yoy for the Eurozone in Q3 2018. To some extent, this is par for the course: compared with its Eurozone peers, Germany's export-dependent economy reacts more strongly to external shocks, such as the trade tensions, the softness in China or the recession in some emerging markets, including Turkey. For the near term, the outlook remains decidedly wobbly. But if trade tensions ease somewhat and Brexit as well as Italian issues do not end in complete disasters, the still-solid domestic fundamentals should propel German growth to slightly above trend again from Q2 2019 onwards.
- Q3 – a quarter to forget:** The 0.2% qoq contraction in German Q3 wildly exaggerates the extent of the cyclical slowdown. As car makers adjusted belatedly to new emission-testing standards (the worldwide harmonised light vehicles test procedure), the output of the German car sector plunged by 7.4% qoq in Q3. Passenger car exports even fell by 18.9% yoy. Cars account for 14% of German industrial output. Including some likely knock-on effects on related sectors, car sector problems shaved off around 0.35ppt from German GDP in Q3. Otherwise, German GDP would have expanded by close to 0.2% qoq in the quarter.
- The oil factor:** Compounded by a weaker euro, the price for a barrel of Brent crude oil surged by 25% between Q1 and Q3 2018. As a result, headline inflation rose from 1.3% yoy to 2.1% over the same period. The miniature oil shock constrained gains in real disposable income. As a result, a decline in private consumption offset relatively healthy gains in business investment and government consumption in Q3, leaving final domestic demand flat.
- Near-term outlook:** Leading indicators project a further cyclical weakening for Q4 2018 and Q1 2019. After a 21% yoy fall in German goods exports to Turkey in Q3, the rate of decline may well worsen to -40% yoy in Q4. On its own, this would reduce Germany's yoy rate of GDP growth by 0.3ppt. Brexit uncertainty could weigh on investment more than before. However, a snapback in car production could add at least 0.1ppt to real GDP in Q4 and Q1. The 0.7% yoy rise in German car exports in October suggests that the rebound has started. Courtesy of the 30% decline in oil prices since September, private consumption should pick up again in late 2018 and more so in early 2019. We thus expect GDP gains of 0.4% qoq for Q4 and 0.3% for Q1 2019, despite still-softening cyclical dynamics.
- Beyond the near term:** The risks still loom large. If the US threatens tariffs on car imports, the confidence shock could subtract 0.1-0.2ppt from German GDP growth in 2019. If the US imposes such tariffs, the impact could be 2-3 times larger. A disorderly Brexit would also hurt substantially. However, in our view there is an 80% chance that the UK will avoid a hard Brexit. The worst of the trade tensions should be over once the US and China start to talk seriously to each other again. With the impact of the US fiscal stimulus fading, the political rationale for ending the painful trade tensions should strengthen in the US. Turkey and other emerging markets will likely hit bottom early next year. Helped also by an oil price tailwind, the outlook should brighten again from spring 2019 onwards.

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