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The German Economy: Economic Activity Spurred by Private Consumption and Construction

German economic activity remains robust due to strong domestic demand. IWH forecasts gross domestic product (GDP) to increase by 1.3% in 2017. The growth rate is half a percentage point lower than in 2016 due to calendar effects and a negative contribution of external trade. Consumer price inflation also remains modest (1.3%). “Unemployment is expected to increase slightly due to a protracted integration of refugees into the labor market”, says Oliver Holtemöller, Head of the Department Macroeconomics and IWH vice president.

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Forecast for Germany: Key Economic Indicators

	2015	2016	2017	2018
percentage change over previous year (price adjusted)				
private consumption	2.0	1.9	1.3	1.4
public consumption	2.7	4.2	2.6	1.6
gross fixed capital formation	1.7	2.1	1.5	2.8
machinery and equipment	3.7	1.2	1.0	3.7
construction	0.3	2.5	1.6	2.4
other	1.9	2.7	2.5	2.6
inventory accumulation ^a	-0.5	-0.3	0.0	0.0
domestic demand	1.6	2.1	1.6	1.7
foreign balance ^a	0.2	-0.1	-0.3	-0.1
exports	5.2	2.5	2.9	4.0
imports	5.5	3.2	4.4	5.0
gross domestic product	1.7	1.9	1.3	1.5
for information: world production	2.9	2.5	2.9	2.9
United States	2.6	1.6	2.4	2.5
euro area	2.0	1.7	1.6	1.4
percentage change over previous year				
hours worked	0,9	0,6	0,4	0,8
hourly union wages	2,4	2,1	2,1	2,2
hourly actual wages	2,6	2,8	2,7	2,4
unit labour costs ^b	1,5	1,4	1,8	1,7
consumer price index	0,2	0,4	1,3	1,5
1 000 persons				
employment (domestic)	43 057	43 496	43 755	44 043
unemployment ^c	2 795	2 692	2 706	2 863
in %				
unemployment rate ^d	6.1	5.8	5.8	6.1
unemployment rate BA ^e	6.4	6.1	6.1	6.4
in % of nominal GDP				
general government overall balance	0.7	0.6	0.4	0.1
current account balance	8.3	9.0	8.6	8.5

^a Contribution to GDP growth in % (Lundberg component). – ^b Per hour (IWH calculations). – ^c Federal Employment Agency (BA) concept. – ^d Unemployment in % of labour force (domestic). – ^e Unemployment in % of civilian labour force (Federal Employment Agency (BA) concept).

Source: Federal Statistical Office; Eurostat; Bureau of Economic Analysis; 2016, 2017 and 2018: forecast (as of December 14, 2016).

The global economy

Global economic activity has revived recently. Stock market confidence is currently high. At the same time, yields on fixed income securities have grown significantly worldwide. Financial market deregulation, economic stimulus, tax cuts and infrastructure programs that have been proposed during the election campaign are expected to support the US economy and to boost US inflation. Fiscal policy supports economic activity in other countries as well, for example in Japan. In the euro area, fiscal policy is also expansive, albeit only slightly.

World production is likely to preserve the momentum picked up in the third quarter throughout the winter of 2016-17. In the further course of 2017, the effects of real income gains from the 2014-15 oil price slump will be phasing out in the energy importing countries. This will slightly dampen the expansion of global demand. "Risks over the forecasting horizon result from the intended financial stimulus in the US: Other economies could face considerable problems due to a further appreciation of the dollar, rising financing costs and the withdrawal of capital towards the US, says Holtemöller. "In addition, the British vote to leave the EU and the victory of a declared opponent of free trade in the US presidential elections have the potential to affect international economic relations sooner or later."

The German economy

Gross domestic product expanded by less in the third quarter of 2016 than in the first half of the year. The expansion is increasingly being driven by domestic demand instead of exports. The main contributions came from private and government consumption as well as from investment in construction. Exports have decreased in autumn while investment by companies was stagnant. The German economy is likely to have caught up the temporal slowdown in autumn. Orders from abroad have increased again while retail sales and business confidence have also recently risen. Over the forecast horizon, the German economy is likely to continue its moderate upturn, driven primarily by domestic demand. Against the backdrop of a sustained increase in employment and income, private consumption will continue to grow robustly. Along with the low-interest environment and the improved financial situation of the local authorities, these fundamental factors will have a positive impact on construction with both residential and public construction expanding markedly over the forecast horizon. Following the revival in global economy activity, exports are expected to start growing again, with investment in equipment driven by a rising rate of capacity utilisation. Export dynamics, however, will not match that of previous upswings, since the expansion of world trade is rather sluggish. Similarly, business investment will remain relatively modest given that utilisation of capacities is only slightly above-average. Since, on the other hand, imports will be stimulated by domestic demand, foreign trade will contribute negatively to growth in all of the three projected years. The German current account surplus, which is expected to be roughly 9% in relation to gross domestic product on average during 2016, is likely to fall slightly by the year 2018.

Risks to the German economy are mainly due to international developments. Global trade activity has been showing signs of weakness for some time now. In

addition, there may be a setback if, on the one hand, the British economy is hit more strongly by the Brexit decision than it currently appears. On the other hand, political instability and structural economic problems in important euro area countries could result in a resurgence of the debt and confidence crisis. In general, Germany as an export-oriented economy has a lot to lose, if the global political movements that oppose globalisation are gaining importance.

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The Halle Institute for Economic Research (IWH) – Member of the Leibniz Association was founded in 1992. With its three research departments – Macroeconomics, Financial Markets, and Structural Change –, the IWH conducts economic research and provides economic policy recommendations, which are founded on evidence-based research. With the IWH's guiding theme "From Transition to European Integration", the institute's research concentrates on the determinants of economic growth processes with a focus on efficient capital allocation in a national and European context. Particular areas of interest for the institute are macroeconomic dynamics and stability, microeconomic innovation processes, productivity and labour markets, the dynamics of structural adjustment processes, financial stability and growth and the role of financial markets for the real economy.

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