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Dampers at all turns: 2019 starts out as burdened as 2018 ended

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Author:
Dr. Holger Schulz
Holger.Schulz@dsgv.de

Global economic growth, and international trade in particular, lost momentum in 2018. This has not failed to take its toll on the Germany economy either: at just 1.4 percent, German GDP turns out to have expanded more sluggishly than in the first official estimate.

The special effects from last summer (registration problems in the automobile industry) led to involuntary inventory investment. On its own, the inventory component (0.6 percentage points) accounted for virtually half of aggregate GDP growth. Consumption only grew moderately in 2018 despite the persistently excellent labour-market situation and rising wages in Germany. The only vigorous expenditure-side component last year was investment activity, which remained decidedly robust towards the end of the year as well.

More employed persons once again working more hours and a larger real capital input translated into a merely modest increase in production. This raises the question of why the productivity gains generated by those omnipresent new phenomena digitalisation and technological progress are not making themselves manifest. Headway on this score could hardly be measured on the basis of the macroeconomic numbers during 2018.

2019 has started out weighed down by a number of burdens, including enduring uncertainty over Brexit and the various trade disputes. Incoming orders and sentiment indicators are being adversely affected. However, construction is continuing to boom and, in conjunction with mounting wages and other buffers, is having a stabilising effect.

Dampers at all turns:
2019 starts out as burdened as 2018 ended

Global economic growth less robust in 2018 than the year before

Now that the initial outturns for the 2018 gross domestic product are available in most countries, the conclusion to be drawn is that 2018 produced a weaker macroeconomic performance than the year before. It is true that the International Monetary Fund sees 2018 global aggregate economic output only slightly lower at 3.7 percent – just 0.1 percentage points weaker than in the previous year. However, the Fund's figures suggest that world trade generated noticeably less vigorous momentum than in 2017 (4.0 percent as against 5.3 percent). The reason for this growth slowdown is quickly found – the escalation in trade conflicts witnessed over the course of last year.

Trade is being weighed on more heavily than production

In the emerging markets, the trend in growth momentum was not uniform. India saw a spurt in growth, and has been the frontrunner among major economies for some years now – rates of expansion have recently been in excess of 7 percent. On the political front, it is true, the Indian government's interference with the workings of the central-bank have caused some ructions. However, the macro outlook for the sub-continent in the coming years remains favourable.

Economic growth of selected countries and economic areas

	2017	2018
World Trade Volume	5.3	4.0
World Output	3.8	3.7
Advanced Economies	2.4	2.3
USA	2.2	2.9
Japan	1.9	0.7
Canada	3.0	2.1
United Kingdom	1.8	1.4
Euro Area	2.4	1.8
Germany	2.2	1.4
Emerging Market Economies	4.7	4.6
China	6.9	6.6
India	6.7	7.0

Source: IMF, federal statistical offices

By contrast, China moved into a somewhat lower gear in 2018, with annual growth coming in at 6.6 percent. All the same, growth rates in excess of six percent are still very handsome – provided, that is, that one is prepared to take the official figures at face value. The Middle Kingdom's true vulnerability does not lie in a gradual slowdown in macroeconomic activity but is rather a function of potentially problematic qualitative factors. Mention should be made here, on the one hand, of the heavy credit commitments and credit linkages of domestic enterprises and, on the other hand, of the relatively pronounced setbacks suffered by Chinese foreign trade late last year.

How things develop on this count during 2019 will hinge to a decisive extent on the trade-policy negotiations still going on with the USA. For the moment, the deadline has been extended here, and a summit on this issue looks to be in the offing. The parties involved now appear to be a good deal more willing to attempt to forge a deal to curb the conflicts and to dismantle the obstacles thrown up in the way of free trade.

Other nations, such as Argentina or Turkey, already sustained very marked country-specific crises during 2018 – crises which are likely to drag on in the present year. On balance, though, the emerging markets remain on a positive growth trajectory in spite of numerous special developments.

Sino-US negotiations have now entered their crucial phase

The industrialised nations are on a downward trend

In terms of collective country groups, it was above all the industrialised nations which saw growth dwindling during 2018. The only exception here among the major economies was the USA. However, the peak growth performance stateside is partly to be explained by the fiscal stimulus arising from the corporate-tax reform – how sustainable this fiscal boost proves to be is quite another story.

USA is by now the growth leader among the industrialised nations

Japan, Canada and most European countries, whether within the EU and the narrower euro area or on the peripheries outside the Community, posted slower growth in 2018. In the case of the United Kingdom, the uncertainty spawned by the Brexit process is quite unmistakable. Yet the euro area economy also expanded quite a lot less dynamically than in the previous year (1.8 percent as against 2.4 percent). Nevertheless, the 2018 annual growth rate for the eurozone is, on balance, still high enough to indicate an ongoing upswing. It also proved possible to push down the euro area unemployment rate further.

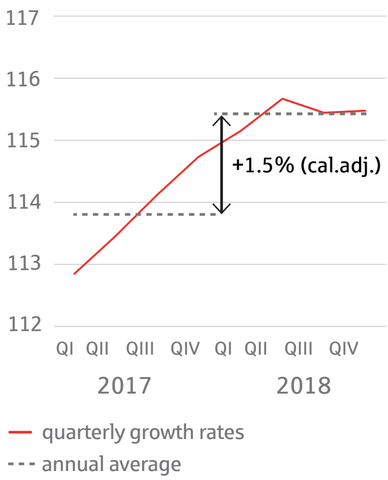
That said, there are significant disparities between the individual euro area members regarding the level and pace of GDP and the labour-market constellation.

The Italian economy has slipped back into recession

In Italy's case, the feared event has occurred: GDP growth turns out to have been marginally negative in both the third and fourth quarters of last year. The boot-shaped peninsular is therefore officially back in recession. It has become evident that the unsettling fiscal and economic policy being run by the pan-populistic governing coalition is not suited to the task of allowing the country to grow "unconventionally" out of an unsustainable debt situation.

All the same, Italy is far from being the only country to experience an anaemic second half to the year in 2018. And it is that which, in a general sense, is causing concern about the cyclical situation in the European, as well as the broader global, economy: the intra-year trend turns out to have been pointing downwards almost everywhere.

Real German economic growth, index values (2010=100), seasonally adjusted



Source: destatis

German economic growth stagnated during H2 2018

The loss of momentum charted over the course of last year also applies quite uncontrovertibly in the case of the German economy. In the previous issue of this publication, we already looked into the question of whether the slightly negative GDP growth rate registered in the third quarter of 2018 was merely a short-term "dent" triggered by special factors or whether a trend reversal was slowly taking shape. The answer to this question now sounds more pessimistic.

In the wake of the official set of national-accounts figures for the fourth quarter of 2018, published on 14th February, we know that the showing in the final quarter of last year was not much better than in the third quarter: it was only with great exertion that the seasonally-adjusted quarter-on-quarter rate of expansion managed to claw its way up to zero in Q4.

At any rate, the hoped-for rebound, involving autumn's production losses being recouped, has not taken place during the winter either. The absolutely flat growth rate recorded by Germany in the fourth quarter does at least mean that a technical recession – which would have had to be proclaimed if growth had contracted in two successive quarters – has been avoided.

Growth was absolutely flat in the final quarter of last year

In qualitative terms, it is true, it would not have made much difference to an appraisal of the cyclical situation if GDP growth had been a decimal place lower. Even though growth rates in Germany have recently been similar to those in Italy, a quite different view has to be taken of the baseline in Germany's case. In the country north of the Alps, the capacity-utilisation rate continues to be above-average. Order books are well-stocked in many sectors. The labour market is looking strong, characterised more by supply bottlenecks than by joblessness. Public finances are very solid. The situation on the ground feels markedly different to the lie of the land during a recession.

The lie of the land feels more comfortable than in a real recession

And yet it is a fact that the situation in Germany too is by no means pervasively robust. Sentiment indicators have lost a noticeable amount of ground. Declining exports, dwindling export expectations and sluggish incoming orders from abroad clearly indicate through which gateway the cyclical slowdown is reaching the German economy.

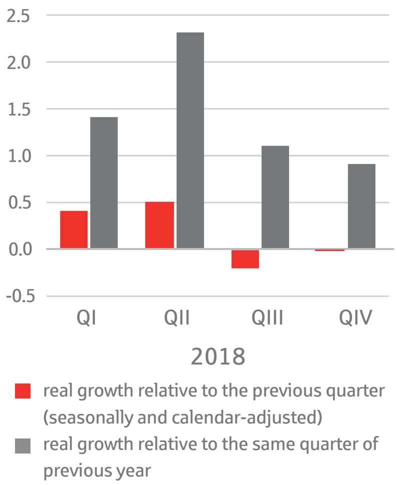
Sentiment has been dented nonetheless - the waves of uncertainty are taking their toll

The ever more evident signs of weakness are seeping into ever more spheres, even into the official statistics which looked to already be set in stone.

Annual rate is lower than first reported – no overhang for 2019

Destatis' "zero point zero"Q4 GDP growth estimate from mid-February was weaker than the Federal Statistical Office itself had been anticipating back in January. Even though a separate rate for the fourth quarter had not been officially computed at the time, Destatis' initial annual GDP estimate for 2018 from January implied a growth rate of approximately 0.2 percent for the final quarter. Of course, initial provisional GDP projections are almost invariably not entirely in line with the definitive outturns – since they are for a long time subject to revisions, they are, de facto, more extrapolations than hard evidence. It would seem that the latest readings from the production front were not sufficiently high to buttress the figure signalled by the very first estimate.

German economic growth,
percentage change



Source: destatis

The upshot is that the annual GDP growth rate for 2018 altered as well once the new "best guess" for the fourth quarter (flatlined growth) had been factored in. Only five weeks later, the 1.5 percent rate of change announced in January had been shaved to 1.4 percent.

The latest estimate regarding the annual GDP growth rate for Germany in 2018 is 1.4 percent

The 1.5 percent growth rate only survives after rounding to one decimal place if working-day variations are adjusted for. The calendar effect between 2017 and 2018 was minimal in any case, accounting for less than one-tenth of a percentage point, but rounding now provides for this little one-decimal-place difference.

The growth rate remains at 1.5 percent after adjustment for working-day variations

A further consequence of the fact that growth in the final quarter of 2018 has ultimately been reported to be more anaemic than initially conjectured is that the statistical growth overhang likewise turns out to be slighter. In fact, 2019 has started out without any tailwind at all at its back. GDP was not higher in the final quarter than on an annual average and so the customary effect that a higher baseline is already reached if there is a steady upward trend over the course of the year failed to materialise when 2018 gave way to 2019.

This – along with the fact that the empirical outlook going forward has clouded over – is a reason why there has been a greater downward bias of late in macroeconomic projections.

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Forecasts for 2019 are drifting downwards

In their joint forecast for Germany published on 22nd January[1], the Chief Economists of the Savings Bank Finance Group projected a 2019 growth rate of 1.3 percent. According to the two-year outlook presented for the first time in this format, growth should then accelerate to 1.5 percent in 2020. For the euro area as a whole, the Chief Economists predict growth rates of 1.5 percent in both years.

Joint Economic Forecast of the Chief Economists of the Savings Banks Finance Group
(published 22nd January)

Increase in %	2019	2020
Euro Area		
GDP	1.5	1.5
Germany		
GDP	1.3	1.5
priv. consumption exp.	1.4	1.5
gov. Consumption exp.	1.8	1.6
Construction Investment	2.6	2.3
Equipment-Investment	2.4	2.8
Exports	2.4	2.6
Imports	3.5	3.4
Consumer Prices (HICP)	1.7	1.8
Core Inflation	1.4	1.7
Savings Rate in %	10.5	10.3
Unepmloyment Rt. in %	4.9	4.8

With respect to the expenditure side of GDP, the Chief Economists are assuming that the upswing – which the main scenario sees remaining basically on track, albeit with slower momentum – is going to be largely underpinned by domestic demand. Foreign trade is not expected to have an expansionary effect on aggregate growth, at least not on a net basis: the Chief Economists reckon that import growth will outstrip growth on the export front in both 2019 and 2020.

At the same time, the DSGV's Chief Economists warn that there is a likelihood of no less than 25 percent of a recession rearing its ugly head over the

[1] Further details and materials relating to the Chief Economists' joint economic forecast can be found on the DSGV homepage at www.dsgv.de/newsroom/blog/ein-langer-wirtschaftsboom-wird-auf-die-probe-gestellt---jetzt-i.html

forecast horizon, i.e. this year or next. A number of things could go wrong, causing the trend to prove poorer than in the still moderately positive main scenario.

There is a 25 per cent percent risk of a recession!

Other economic-watchers are adopting similar positions. In the January update of its “World Economic Outlook”, the International Monetary Fund postulated almost identical growth readings for Germany (1.3 percent in 2019 and 1.6 percent in 2020) and also emphasised the upward tilt in risks. More recent forecasts are tending to drift down even further on account of the persistently poor news inflow during the first two months of 2019.

The Federal Government’s Annual Economic Report, released on 30th January, only envisions a growth rate of 1.0 percent for the present year. Admittedly, this projection explicitly prices in a certain “safety markdown” to hedge for the possibility of a disorderly Brexit process. In the Annual Report presented on 27th February, Deutsche Bundesbank argues that 2019 growth will likely be “considerably lower” than the 1.6 percent figure assumed in the previous projection from December. This would presumably also mean “below the potential growth rate.”

2019 forecasts for German GDP:
- The IMF is adopting a similar position to the DSGV’s Chief Economists
- The Federal Government is even more cautious
- The Bundesbank is intending to lower its outlook

A Sword of Damocles continues to hover above foreign trade

Further disruptions, for the German automotive industry especially, could emanate from the USA. True, the threat of special tariffs being slapped on German car exports has been potentially looming since last summer, but it receded into the background for a time and was no longer taken quite so seriously. However, the approach being concocted by the Trump administration has recently become more concrete:

The US threat to slap tariffs on German automobile imports is becoming more tangible

The transparently cooked-up – not to say completely trumped-up – accusation is that imports of German vehicles endanger US security interests. The findings of the Commerce Department’s probe into the national-security risks of auto imports mean that the US Administration has cleared a further hurdle in its quest to set such tariffs to active mode.
If additional tariffs of 25 percent were indeed levied, that would entail painful sales and margin losses for German manufacturers. The impact on the sector would be considerable. However, the repercussions for foreign trade as a whole would be different on a macro view. At that level, countervailing effects – e.g. via corresponding exchange-rate reactions – would come into play, at least in the medium term onwards.

Tariffs are proving an unsuitable tool to reduce the US trade deficit

The current-account balance is determined by the level of capital imports

The US trade and current-account deficits are hardly being reduced by the impact of tariffs. The fact is that these imbalances are inevitable as a result of the USA's hunger for capital. The financial deficits of both the private and the public sectors in the United States necessitate heavy capital imports, especially now that tax cuts have been implemented. By definition, owing to the mechanics of foreign-trade balances, such capital imports have to be offset by corresponding current-account balances. Merchandise import surpluses in the rest of the world are needed to fuel additional American consumption. And such a surge of US demand will run its course across tariff borders too, even with tariffs resulting in distorted, inefficient structures.

The empirical evidence confirms the theory: deficits are widening rather than narrowing

That the overall US trade deficit cannot be eliminated through protectionism unless other policy areas (especially debt behaviour) are adjusted is demonstrated by the 2018 trend in the US current account. As yet, there is no trace of the deficit having been reduced by the measures already put into effect. Quite the contrary: the deficits are widening.

On the basis of the data for the first eleven months of the year which are already available, the US goods and services deficit amounted to USD 552 billion from January to November; in the same eleven months of the previous year, the figure was actually lower at USD 500 billion.

US foreign trade balances*,
* in billions of US dollars

Source: destatis

* January-November of each year (December 2018 is pending)

If the focus is solely on merchandise trade, the metric which the US administration prefers in its efforts to prove that the situation is "unfair", the trend is, in fact, very similar. In absolute terms, the – even higher – US trade deficit in goods is also on the increase. In the first eleven months of 2018, the trade gap amounted to USD 789 billion as against USD 723 billion in the same period of 2017.

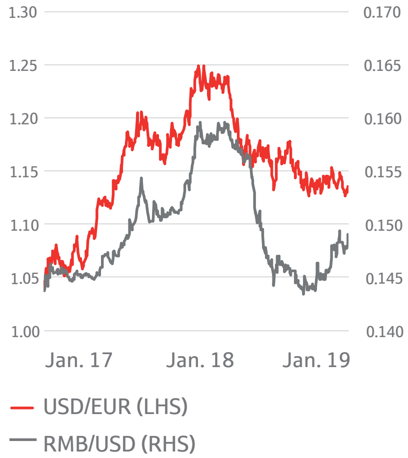
Protectionist measures imposed on individual countries and individual goods categories get counteracted by compensatory shifts in other goods flows. Assuming flexible exchange rates, this offsetting mechanism works inter alia via US dollar appreciation. If the USA uses tariffs to lock out German cars, other countries and other sectors of the world economy will become more competitive due to currency depreciation and will supply more until a new equilibrium is reached.

Third sectors which are not subject to US tariffs, including Germany's chemical, mechanical-engineering or electrical-engineering industries, might well have the last laugh. But it would be wrong to complacently expect such an outcome. If the hoped-for impact on the US trade deficit continues to fail to materialise, the Trump administration could well start administering a further round of the wrong medicine, extending its tariffs to other sectors. Escalating trade wars ultimately produce a whole multitude of losers.

No major exchange-rate fluctuations to date

In view of these turbulent trade-policy times, steep interest-rate differentials and upheavals such as Brexit, it is nothing short of amazing how steady the trend on foreign-exchange markets has proved to be over the past few months. The most important bilateral exchange rate for the world economy, the US dollar/euro cross rate, has been very tightly range-bound over the past twelve months, oscillating between USD/EUR 1.23 and USD/EUR 1.13.

USD/EUR Exchange Rate (LHS) and RMB/USD Exchange Rate (RHS)



Source: Bundesbank, Fed

It is true that the greenback has appreciated marginally against Asian currencies, the Japanese Yen and the Chinese Renminbi, since last March's turning-point. Yet the shifts in currency relations have not been as large as one might have expected.

More pronounced fluctuations have only occurred with the currencies of genuine crisis countries (Turkey, a case in point, has already been mentioned above). But these are idiosyncratic developments which are to be ascribed to the specific country and not to the dollar in general.

Special developments in medium-sized countries and their currencies

At least exchange-rate forecasting has not (at least, not yet) become an additional volatile complication for exporters and importers in agitated trade-policy times. Indeed, exchange rates have rather been a stabilising factor over the past few years. Naturally, this may prove to have simply been the lull before the storm if asymmetric recessions indeed lie ahead and if the various trade conflicts escalate further.

How the expenditure side of German GDP broke down in whole-year 2018 and in the final quarter in particular

Domestic demand turns out to have expanded by 1.8 percent in 2018

In such a global economic environment, and against a background of simmering trade disputes, it is not a great surprise that German foreign trade already failed to make a positive contribution to aggregate growth in 2018. On an annual basis, net exports (-0.4 percentage points) detracted from domestic demand (which grew by 1.8 percent in real times), leading to the GDP growth rate of 1.4 percent referred to above.

Private consumption and government consumption both posted a growth rate of 1.0 percent in 2018

The net-export contribution was most sharply in reverse gear on a year-on-year comparison in the fourth quarter, but the good news is that this burden has not become even more onerous of late. Moving on a seasonally-adjusted basis from the third to the fourth quarter, the contribution was flat, no longer knocking anything off aggregate growth: exports and imports both increased by 0.7 percent in the final quarter of 2018.

But consumption was not particularly strong over the course of last year either. At 1.0 percent in real terms, government consumption remained moderate; an acceleration ought to kick in on this score in 2019 thanks to various planned expenditure measures.

The weakness which was more surprising – as well as being more significant in volume terms – was that shown by private consumption. This GDP component also chalked up growth of 1.0 percent, but one is tempted to reformulate "of just 1.0 percent." After all, a far higher propensity to consume would have been possible in view of the favourable labour-market situation and of the upward trend in wages. One year ago, most relevant forecasts were still envisaging almost twice as high a rate of expansion for private consumption. The flipside of such decided consumer restraint was a further increase in the savings ratio at private households: Germany's households put 10.4 percent of their disposable incomes aside for the proverbial rainy day last year.

The presuppositions for consumption remain favourable in 2019

There is a good chance that private consumption could morph into a mainstay of macroeconomic demand during 2019. The constellation on the labour wage continues to be highly auspicious, and further income growth is already in the pipeline.

Will the inventory swing prove to be a burden?

A further noteworthy special development over the course of 2018 which has implications for the trend going forward relates to inventory investment. Where, on balance, inventory liquidation to the tune of EUR 7.2 billion had taken place in German industry in 2017, 2018 saw a net inventory build-up of no less than EUR 14.6 billion[2] . This inventory swing made a major contribution towards stabilising 2018 GDP – by as much as 0.6 percent on an inflation-adjusted basis. As a result, almost half of 2018 GDP growth is attributable to the swing in the inventory cycle!

Almost half of 2018 macroeconomic growth was fuelled by inventory accumulation!

This dovetails well with the narrative about the special developments in the automobile industry in the summer of last year when production had to be largely stockpiled on account of the adjustment to new car-registration rules. Looking forward, the inventory unwind associated with this could constitute a further burden, for GDP as well – aggravating the lack of a statistical growth overhang from 2018 alluded to above.

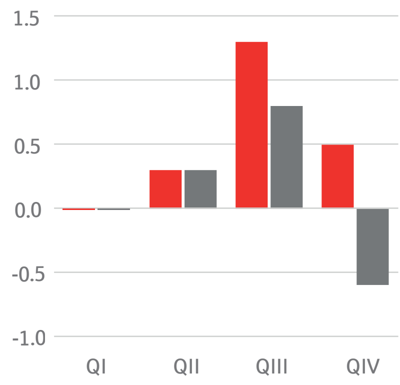
By contrast, a more favourable view is to be taken of developments at the present juncture – here the interpretation should actually be the other way round. It is true that the growth contribution in year-on-year terms (0.5

[2] This data, and the data following, refers to changes in inventories including net acquisition of valuables.

percentage points towards aggregate GDP) was still almost exactly the same in the final quarter of 2018 as in the year as a whole. But the reversal of the development had already been initiated. Relative to the peak in inventory accumulation in the third quarter, the growth contribution from the inventory component was already clearly negative on a direct quarter-to-quarter comparison at -0.6 percentage points. It follows that the flat growth rate of 0.0 percent reported for GDP in the final quarter would have been well into positive territory without the inventory effect – i.e. if geared to effective final demand.

The inventory swingback effect has probably therefore been largely absorbed already – not in the year-on-year figures, admittedly, but at the level of current quarter-on-quarter momentum.

Growth contributions of Changes in inventories* to real GDP 2018, percentage change



- real growth relative to the same quarter of previous year
- seasonally and calendar-adjusted real quarter-on-quarter growth

* These and all following information refer to changes in inventories including acquisitions less disposals of valuables

Source: destatis

Capital investment is looking decidedly strong

The strongest GDP component, indeed the principal pillar of aggregate 2018 growth, was investment in fixed capital, which recorded real growth of 2.6 percent. This strength was underwritten by construction investment, which was up by 2.4 percent, but above all by plant-and equipment spending (+4.2 percent). Although the category "Other intangible fixed assets," under which such items as patents or software are subsumed, has gained ever more structural importance, and an ever greater share of the aggregate investment volume, in recent years, this component made only a below-average contribution in 2018, growing by a mere 0.4 percent in real terms.

There has recently been a renaissance of classic capital investment: in construction and machinery

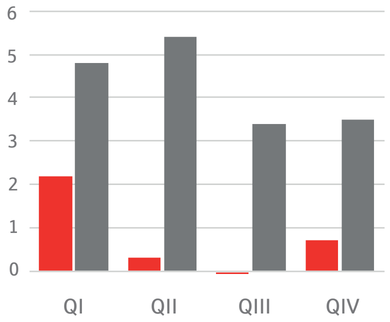
One can conclude that in the current mature phase of the upswing, with capacities needing to be adjusted to utilisation levels, there has recently been a renaissance of classic capital investment, i.e. in construction and machinery.

Moreover, investment activity in these two categories remained strong in the final quarter of 2018, actually speeding up in Q4, even though the overall decline in cyclical momentum and the dent in sentiment were already clearly evident by that time.

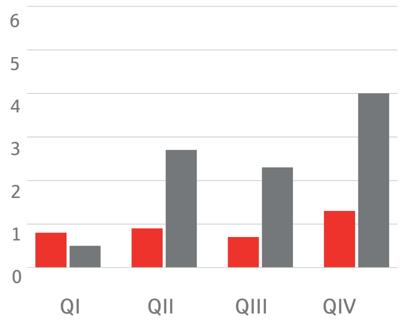
Investment activity remained strong right through to the end of the year

In the fourth quarter, plant-and-equipment investment once again expanded by 0.7 percent on a seasonally-adjusted quarter-on-quarter basis. In the case of construction investment, growth even weighed in at 1.3 percent. Thanks to this show of strength at the close of the year, the capital-investment time series will definitely be benefiting from significant statistical growth overhangs in 2019.

real growth rates of investment in machinery and equipment, percentage change



real growth rates of construction investments, in percent



relative to the previous quarter (seasonally and calendar-adjusted)

relative to the same quarter of the previous year

Source: destatis

The "productivity puzzle" became even more acute in 2018

However pleasing the trend in investment activity and the resurgent growth of the capital stock are, this has sobering implications for total factor productivity.

Where have all the productivity gains from digitalisation gone?

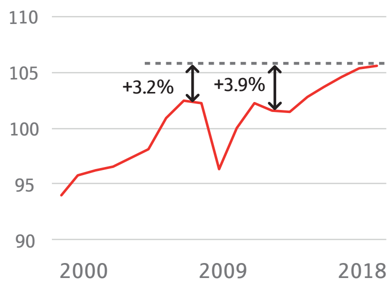
2018 was yet another year marked by a strong surge in employment – and, this time round, with respect not only to the workforce size but also to the number of hours worked. In addition to this, the real capital input has grown on the back of the boost in investment activity. In the light of such growth in factor inputs, a GDP growth rate of 1.4 percent is decidedly disappointing. In arithmetical terms, there is virtually no residual for the item "technological progress" – and this although the economies of industrialised nations, under the aegis of digitalisation, are in the throes of such change and are supposed to be experiencing a strong step change in productivity.

… they are not, at any rate, showing up yet in the macroeconomic data

One way of interpreting this is to argue that measurement errors are playing a role – that the traditional value-added methodology fails to capture all the products and blessings of, for instance, the platform economy. But the productivity gains concerned ought to show up in some area of the overall economy, if only through the conduit of indirect financing via data processing or advertising.

On the basis of the conventional national-accounts figures, at any rate, a "productivity puzzle" certainly remains to be solved.

Labour productivity per person in employment, Index (2010=100)



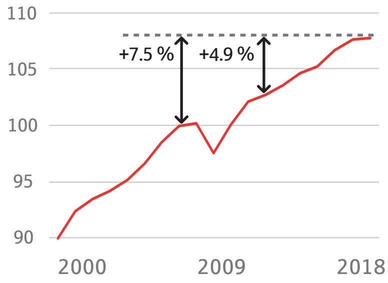
Source: destatis

Labour productivity per employee in the German economy is just 3.2 percent higher today than it was ten years ago[3]. Even if the "speed bump" constituted

[3] This data, and the data following, refers to information from Destatis, Fachserie 18, Reihe 1.1, cut-off date January 2019. It is based, in other words, on the initial estimate of 2018 German GDP (reported to be +1.5 percent). In the wake of the recent (February) downward revision (+1.4 percent), the definitive productivity-growth figures are likely to prove somewhat more underwhelming still.

by the Great Recession of 2009 is stripped out of the equation and if the focus is put on the steady trend which prevailed from 2012 to 2018, the cumulative growth rate is still only 3.9 percent over these six years. Far more spectacular growth rates were registered in earlier decades.

Labour productivity per hour worked by person in employment, Index (2010=100)



Source: destatis

Per hours worked, the performance looks a tick better because the average number of working hours has trended down over the past decade. On an hours-worked basis, productivity growth works out at 7.5 percent in the 2008-2018 period and at 4.9 percent in the period since 2012. As to 2018 taken on its own, productivity gains have been doled out in truly homeopathic doses: 0.2 percent per employee or a mere 0.1 percent per hours worked.

Higher labour and capital inputs but output is scarcely any higher

If the production factor capital is added to the equation, the incremental growth in labour productivity is more than explained and accounted for by the resurgence of growth in the capital stock. However, the current sets of figures provide no evidence of qualitative productivity growth via technological progress.

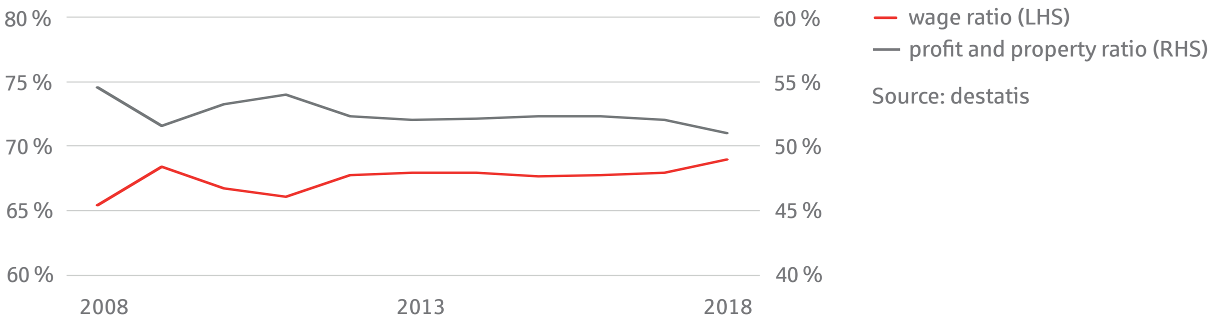
The wage ratio has increased

The gap is closing again

Wages are rising nevertheless – of late, distinctly more strongly than productivity. On average across the entire economy, wages – whether on a gross or a net basis – climbed by 3.2 percent in 2018. In view of the prevailing scarcity of labour, this is definitely an outcome in keeping with market laws. Yet it does have certain distributional-policy implications. The still favourable earnings situation of companies is likely to be eroded a little. The gross wage ratio moved up to 69.0 percent in 2018 (2017: 67.9 percent).

Yet the favourable trend in wages ought to help to stabilise consumer demand in the present, more critical, economic situation. The recent 8-percent wage increase package for public-sector employees (even if split over the long duration of the treaty) fixes the trajectory in this way. The long term also increases calculability for employers as well as employees.

German national income by income type



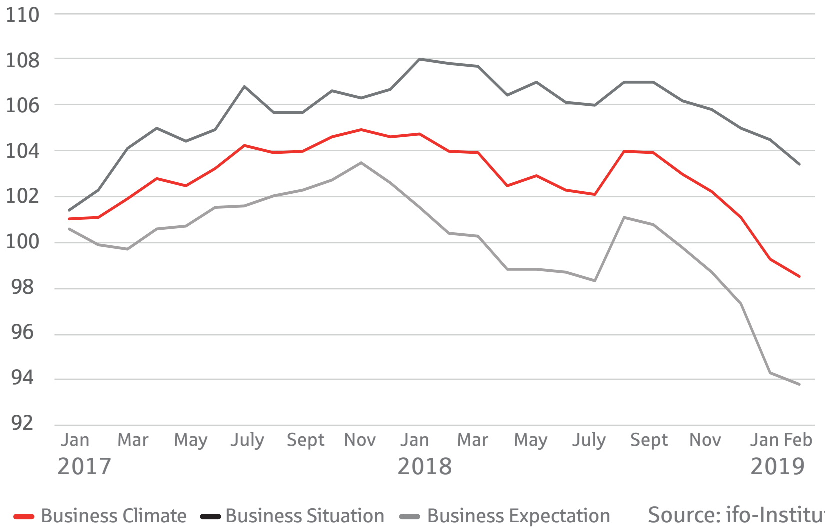
Source: destatis

Sentiment has soured noticeably in the early stages of 2019

The fact that the sentiment indicators have lost further ground in the early stages of 2019 indicates that the cyclical situation is still shaky and that a cyclical turning-point may have been reached, making the term “short-term dent” sound too euphemistic.

Whether one takes one’s bearings by the ifo Business-Climate Index, the ZEW Index or the various purchasing-managers’ surveys, the mood of disenchantment has become more entrenched in recent months.

Ifo Business Climate Index (2015=100, seasonally adjusted)



Source: ifo-Institut

However, there are structural disparities on the sentiment side. For example, the mood is distinctly better among service-providers and in the building trade than in the industrial sector. This is, of course, no big surprise to the extent that it is above all industry which, on account of its high degree of export orientation, is being affected by the slowdown in the global economy and by the imponderables of the smouldering trade conflicts along with Brexit.

The mood is better among service-providers and above all in the building trade than in the industrial sector

A divergence in trends is likewise evident at the level of incoming orders. The order intake in manufacturing industry once again fell to a noticeable extent in December, undershooting the December 2017 level by no less than 10.8 percent. Foreign orders on their own even declined by 13.0 percent (domestic orders: -7.0 percent).

A positive contrast is provided by the persistently favourable trend in the construction sector. The number of orders booked here soared by 13.2 percent in seasonally-adjusted month-on-month terms in December, thereby overshooting the December 2017 level by 10.3 percent. These new incoming construction orders are swelling the already very comfortable order backlog in this sector.

A mixed conclusion

Solicitudes and stabilisers

2019 started out weighed down by the same burdening factors which were already in play during 2018. Brexit and the trade conflicts originating in the USA are now approaching their culmination. The slower pace of global economic activity has already left its mark on Germany. Both sentiment, orders and actual output are under pressure, above all in the industrial sector with its pronounced export-orientation.

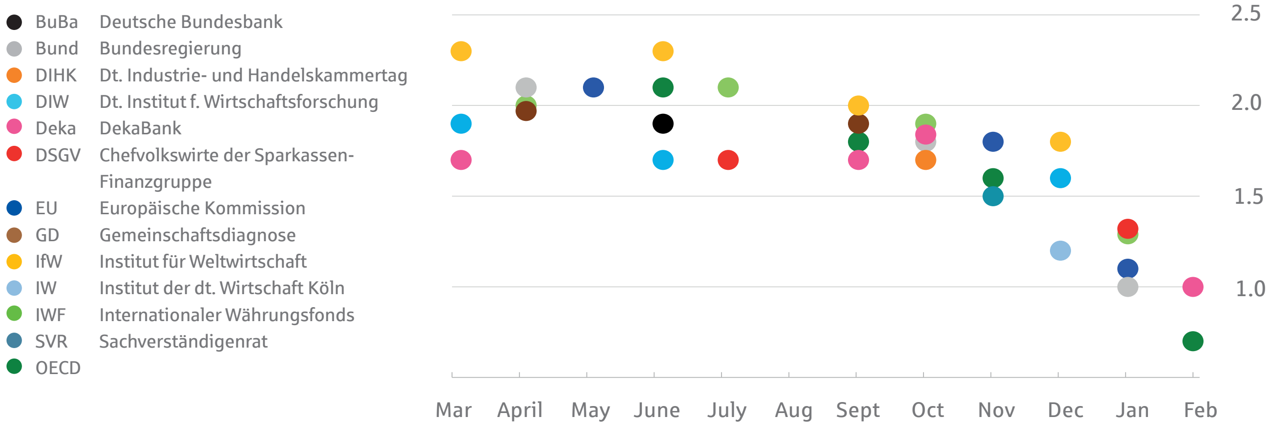
On the upside, Germany can continue to rely on sturdy buffers: the booming labour market, the earnings position at domestic companies, a high savings rate, reserves on the public-finances front. These factors will provide the resilience needed to weather any dramatic setback.

A. Growth in global economic regions. percentage change in year-on-year terms

	2017	2018	2019[1]	2020[1]
Global trade volume	+5.3 %	+4.0 %	+4.0 %	+4.0 %
Gross domestic product - World	+3.8 %	+3.7 %	+3.5 %	+3.6 %
USA	+2.2 %	+2.9 %	+2.5 %	+1.8 %
Japan	+1.9 %	+0.7 %	+1.1 %	+0.5 %
China	+6.9 %	+6.6 %	+6.2 %	+6.2 %
EU	+2.0 %	+1.9 %	+2.0 %	+1.8 %
Euro area	+2.4 %	+1.8 %	+1.6 %	+1.7 %
Germany	+2.2 %	+1.4 %	+1.3 %	+1.6 %

[1] International Monetary Fund projections. January 2019. otherwise October 2018. adjusted for working-day variations

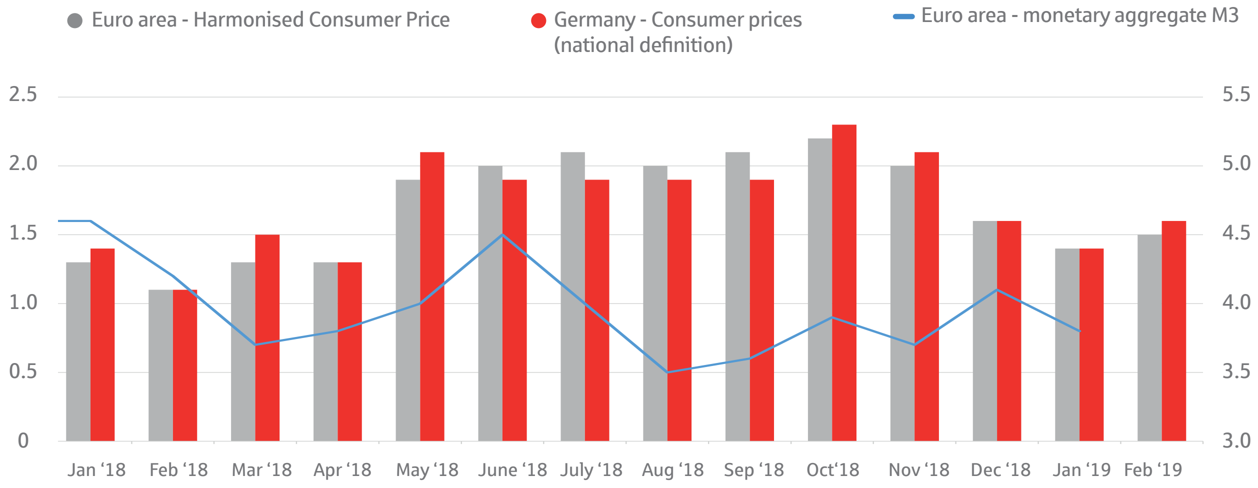
B. Projections for 2018 German economic growth. in %



C. GDP in Germany and in the euro area as a whole

	Year 2018	Q I - 2018	Q II - 2018	Q III - 2018	Q IV - 2018
	real yoy	real growth relative to the same quarter of previous year and seasonally-adjusted real quarter-on-quarter growth			
Euro area Gross domestic product	+ 1.8 %	+ 2.4 % + 0.4 %	+ 2.2 % + 0.4 %	+ 1.6 % + 0.2 %	+ 1.2 % + 0.2 %
Germany Gross domestic product	+ 1.4 %	+1.4 % + 0.4 %	+ 2.3 % + 0.5 %	+ 1.1 % - 0.2 %	+ 0.9 % + 0.0 %
Private consumption	+ 1.0 %	+ 1.7 % + 0.4 %	+ 1.0 % + 0.2 %	+ 0.2 % - 0.3 %	+ 1.0 % + 0.2 %
Gross fixed capital formation	+ 2.6 %	+ 1.8 % + 1.0 %	+ 3.2 % + 0.6 %	+ 2.4 % + 0.4 %	+ 3.0 % + 0.9 %
Exports	+2.0 %	+ 2.2 % - 0.2 %	+ 4.3 % + 0.8 %	+ 1.2 % - 0.9 %	+ 0.4 % + 0.7 %
		Niveau. nicht Veränderungsrate; Quartalszahlen saisonbereinigt			
Savings rate	10.4 %	10.0 %	10.2 %	10.6 %	10.9 %

D. Consumer-price inflation (LHS) **and monetary aggregate M3** (RHS), percentage change year-on-year



E. Monthly economic indicators for Germany

	Oct. '18	Nov. '18	Dec. '18	Jan. '19	Feb. '19
CPI (national definition)	Percentage change year-on-year				
Consumer-price inflation	+2.3 %	+2.1 %	+1.6 %	+1.4 %	+1.6%
- without food and energy (core inflation)	+1.8 %	+1.5 %	+1.1 %	+1.3 %	-
Producer prices for industrial goods	+3.3 %	+3.3 %	+2.7 %	+2.6 %	-
Import prices	+4.8 %	+3.1 %	+1.6 %	+0.8 %	-
Sentiment indicators					
ifo Business-Climate Index	102.8	102.2	101.0	99.1	98.5
ZEW Economic Sentiment Index	-24.7	-24.1	-17.5	-15.0	-13.4
Incoming orders	Percentage change year-on-year				
Manufacturing industry	+2.2 %	-3.4 %	-10.8 %	-	-
domestic	-0.1 %	-2.5 %	-7.0 %	-	-
foreign	+3.9 %	-4.2 %	-13.0 %	-	-
Capital-goods producers	+1.1 %	+0.1 %	-10.2 %	-	-
Production	Change yoy (adjusted for working-day variations)				
Producing sector as a whole	+0.5 %	-4.0 %	-3.9 %	-	-
thereof: construction	+0.4 %	-0.7 %	-4.1 %	-	-
thereof: industrial sector	+1.0 %	-4.5 %	-3.9 %	-	-
Foreign Trade	Percentage change year-on-year				
Exports	+8.7 %	+0.1 %	-4.4 %	-	-
Imports	+10.8 %	+3.9 %	-0.4 %	-	-
Labour market	Unemployment rate; change relative to the same month of previous year				
Unemployment Rate	4.9 %	4.8 %	4.9 %	5.3 %	5.3%
Jobless total	-185	-182	-175	-165	-173
Actively employed (working in Germany)	+526	+509	+488	+ 477	-
Regular employees paying social insurance	+700	+666	+708	-	-

F. Commodity, foreign-exchange and other financial markets

	Nov. '18	Dec.'18	Jan. '19	Feb. '19	06.03.2019
Oilprice Brent in US $	64.75	57.36	59.14	-	64.44 (4.3)
Exchange rates					
US-Dollar / EUR	1.1367	1.1384	1.1416	1.1351	1.1329 (5.3.)
Japanese yen / EUR	128.79	127.88	124.34	125.28	126.80 (5.3.)
Equity Markets					
German stock index DAX, EOM figures	11.257	10.559	11.173	11.516	11.581 (5.3.)
Percentage change year-on-year	-13.5 %	-18.2 %	-15.2 %	-7.4 %	-
Money-market and capital-market rates					
Overnight money (EONIA)	-0.36 %	-0.36 %	-0.37 %	-0.37 %	-0.37 % (1.3.)
1-month rate (EURIBOR)	-0.37 %	-0.37 %	-0.37 %	-0.37 %	-0.37 % (4.3.)
3-month rate (EURIBOR)	-0.32 %	-0.31 %	-0.31 %	-0.31 %	-0.31 % (4.3.)
Running yield on German government bonds with a residual maturity of ten years	0.33 %	0.25 %	0.15 %	0.15 %	0.14 % (6.3.)
Bank interest rates, new business					
Overnight deposits for private households in 0.03 Germany and in the euro area as a whole	0.02 % 0.03 %	0.02 % 0.03 %	0.02 % 0.03 %	- -	- -
Deposits of up to 1 year for private households Germany and in the euro area as a whole	0.30 % 0.29 %	0.28 % 0.31 %	0.28 % 0.34 %	- -	- -
Rates on 5-year corporate loans of up to EUR 1 m in Germany and in the euro area as a whole	1.91 % 1.80 %	1.85 % 1.76 %	1.94 % 1.79 %	- -	- -

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Editor
Deutscher Sparkassen- und Giroverband
Abteilung Volkswirtschaft, Finanzmärkte
und Wirtschaftspolitik
Charlottenstraße 47
10117 Berlin
Telefon: 030 20225-5300
DSGV-Volkswirtschaft@DSGV.de
www.DSGV.de

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Responsible
Pia Jankowski – DSGV
Head of Department Economics, Financial Markets
and Economic Policy
Pia.Jankowski@dsgv.de

Dr. Reinhold Rickes – DSGV
Head of Economics
Reinhold.Rickes@dsgv.de

Author
Dr. Holger Schulz
Holger.Schulz@dsgv.de

Note
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