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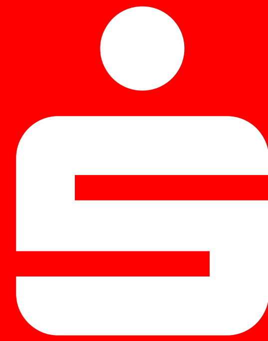

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Emerging Market Foreign-Currency Debt: A Risk to the Global Economy?

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The escalation of the situation in Turkey has given rise to apprehensions that there could be contagion effects and an across-the-board emerging-market crisis. There are a number of parallels between Turkey's predicament and certain countries saddled with high current-account deficits and heavy (dollar-denominated) foreign debt.

However, Turkey-specific causes predominate. In view of the credit-driven boom in an increasingly overheating economy and of already surging inflation rates, the Turkish central bank ought to have taken action at an earlier date, implementing resolute key-rate hikes. Instead, the lira depreciated sharply, setting the stage for a classic currency crisis. The central bank has now finally acted, raising its benchmark rate sharply.

An inflationary and recessionary impetus has been unleashed, nevertheless. All the same, there are only limited transmission channels linking Turkey with the German economy, both in terms of trade and in terms of banking exposure.

What is more dangerous is the persisting threat of an escalation in the global protectionist spiral. However, this threat has, of late, been focussing upon the US-Chinese bilateral relationship; Germany, and Europe in general, appear to have moved out of the firing line a little. The ifo Business-Climate Index has responded to this in a very relieved manner. And it is a fact that German GDP growth continues to be very much on track, broadly supported by all expenditure-side components.

Emerging Market Foreign-Currency Debt: A Risk to the Global Economy?

The situation in Turkey has escalated

The economic and financial situation in Turkey has escalated into a full-blown crisis in recent weeks. This has been particularly evident from the exchange-rate trend. In the wake of a creeping depreciation which had been taking place over a longer period, the Turkish lira began galloping downhill: its external value eroded abruptly by roughly one-third in the second week of August, whether in relation to the US dollar or to the euro.

The trigger here was the US announcement of new trade restrictions aimed directly at Turkey. However, this was merely the spark igniting the tinder of a crisis which, from a fundamental point of view, had been building up for a long time. The self-reinforcing interplay between political and economic developments in Turkey has played a role here.

The centralised concentration of power under the new presidential system and the forcing-into-line of the judiciary and the press, at the latest after the foiled coup attempt of 2016, are evidence that Turkey is leaving the path of a society engaged in an open democratic discourse. This has increasingly undermined investor confidence in the dependability of the system as well as in the rule of law.

Political and economic factors have interacted as a negative feedback loop in the Turkey crisis

Tangible economic reasons need to be adduced too. For years, Turkey has been running a very high current-account deficit. Per se, such a deficit is not necessarily a negative sign in dynamically growing economies: on the contrary, the mobilisation of international savings for the catch-up process in threshold countries is, in principle, efficient and a win-win-scenario for all parties involved.

Macro data of Turkey, real change in percent

	2015	2016	2017	2018*
GDP to market prices	5.9	3.2	7.4	5.1
Private consumer spending	5.3	3.7	6.1	5.9
Government consumption expenditure	2.9	9.8	4.4	6.9
Gross fixed capital formation	9.3	2.2	7.3	8.1
Exports	4.3	-1.9	12.0	8.7
Imports	1.5	3.8	10.1	13.2

Source: OECD

And it is a fact that the Turkish economy has been registering very vigorous growth right up to the present: real GDP growth of 7.4 percent has been reported for 2017. Yet there have recently been more and more indications that the credit-driven boom is causing the economy to overheat.

At 5.6 percent of GDP (2017), the current-account deficit has reached a magnitude which definitely does set the warning bells ringing. Indeed, the shortfall in the Turkish current account may even cross the six-percent threshold in 2018.

A high current-account deficit as a typical crisis-triggering phenomenon

Such a gaping hole in the current account is a rare phenomenon for such a "large country" as Turkey (where the domestic economy plays the dominant role). Even small countries such as the Baltic states or Iceland, which ran up deficits of this magnitude in the 2000s, encountered problems as a result of such pronounced disequilibria. Otherwise, the following examples of OECD countries with current-account deficits in excess of the 6 percent of GDP mark can be found in the years since 2000:

- Portugal: from 2000 to 2011;
- Ireland: from 2007 to 2008;
- Greece: from 2000 to 2011;
- Spain: from 2005 to 2008;

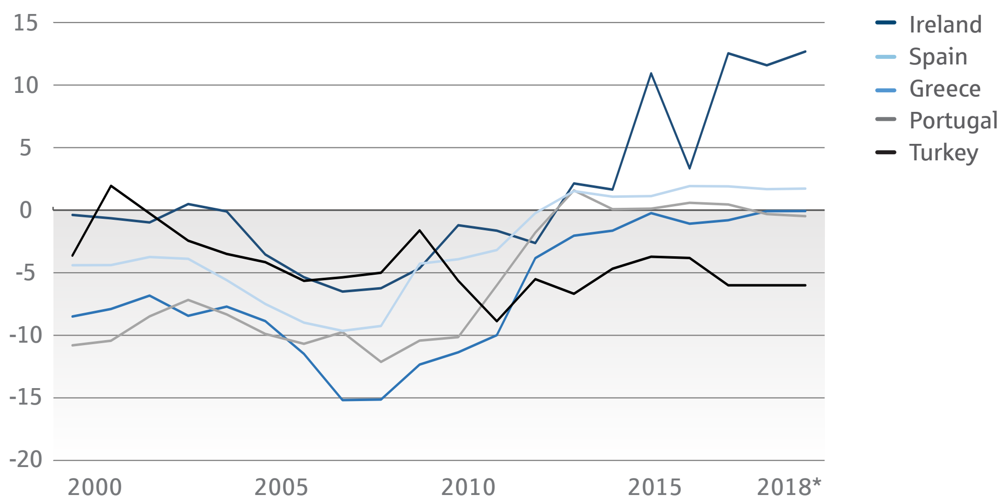
These happen to be precisely the countries which got into difficulties during the European sovereign debt crisis and which then required assistance from support programmes.

Current-account deficits of that dimension constitute a danger zone

It would appear that persistent current-account deficits in the vicinity of 6 percent of GDP (which simply reflect capital imports of the same magnitude) are the start of a kind of danger zone, which can easily tip the economy concerned into crisis.

At the very least, foreign indebtedness with such momentum requires a highly sustainable economic policy, capable of maintaining the confidence of foreign investors, without even the shadow of a doubt creeping in.

Current account balances of the crisis countries of the European sovereign debt crisis and Turkey, as a percentage of GDP, *OECD forecast



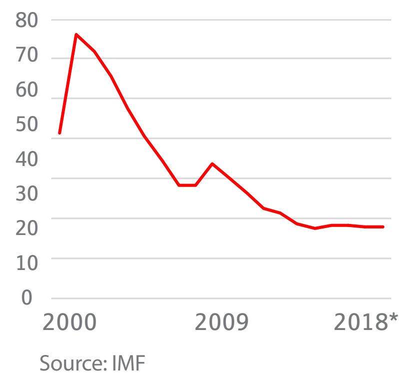
Public debt is not the problem in Turkey

Granted, one has to credit the Turkish authorities for the fact that it was not a large pile of public debt which induced the capital inflows. Indeed, Turkey's public-sector debt is decidedly moderate by international standards at below 30 percent of GDP.

It has rather been private-sector indebtedness – at both private households and enterprises – which has expanded very sharply. To a large degree, capital imports flowed via loans into construction activities, including infrastructure investment (thereby revealing a certain proximity to the public sector after all).

Overall, this credit-driven demand growth has also caused domestic inflation to ratchet upwards. After a stable decade, the twelve-month rate of change for Turkish consumer-price inflation moved into the double digits again for the first time in 2017 – in itself, already an unmistakable sign that the economy was overheating.

Turkish national debt, as percentage of GDP, * IMF forecast



Source: IMF

Surging inflation and debt growth would have called for an earlier key-rate hike

The Turkish central bank ought to have tightened the monetary reins at an earlier point in time

Such overheating would have urgently needed to be counteracted by the monetary custodians. However, key-rate increases failed to come through for a long time. In spring 2018, the Central Bank of Turkey did finally take action but remained "behind the curve," allowing itself to be left behind as inflation took off. In the summer of this year, the government's increasing interference in the central bank's affairs then gave rise to doubts about whether the monetary custodians could act autonomously and whether the necessary dose of key-rate medicine would be administered.

Currency depreciation is the inevitable escape-valve in such situations

In such situations, investors – who are skittish creatures – very quickly depart in search of safer havens. The slump on the Turkish foreign-exchange market is a clear illustration of this adage.
In other words, the escalation in Turkey is an entirely classic, foreseeable and home-made currency crisis.

Exchange rate of the euro to the Turkish lira

Source: ECB

But there is a signal difference between Turkey and the countries which ran into problems during the European sovereign debt crisis: the country on the Bosporus is not part of a currency union. This rules out certain transmission channels and institutional consequences. For better or worse, Turkey has an independent currency with a flexible exchange rate.
If the authorities fail to use the interest-rate instrument in a situation when the economy is overheating because of a credit-driven boom and when inflation is accelerating, pronounced currency depreciation is the only alternative or, to put it differently, the inevitable consequence.

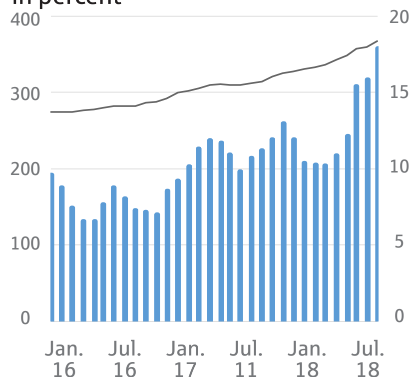
Where around 4 Turkish lira were being exchanged for 1 euro during a large part of 2017, the bilateral exchange rate already shifted to Turkey's detriment in the first half of the present year, falling to around 5.5 to 1. The lira then fell off a cliff at the beginning of August, undershooting to such an extent at one point that TRY/EUR was trading at 8 to 1. The situation calmed down a little afterwards, with the lira initially stabilising at a level of about 7 to 1. Further depreciation in September took the Turkish currency back down in the direction of 7.5 to 1.

Emergency measures are only suitable to safeguard short-term bank liquidity…

…but not to stabilise the currency in a sustainable way

In the acute stress phase witnessed in August, the Central Bank of Turkey (TCMB) initially supported the domestic banking system by injecting liquidity. The Turkish central bank raised borrowing limits for the interbank money market while lowering its minimum-reserve requirements. This did stem the panic at first. However, such measures are not suitable to lastingly stabilise the local currency in the medium term. On the contrary, the expansion of liquidity might well put further pressure on both inflation and the exchange rate.

Turkish consumer price index,
Change compared to previous year, in percent



Change compared to previous year in percent (right scale)
Index, 2003 = 100

Source: Turkish Statistical Office

Inflation and depreciation necessitated the 13th Sept. key-rate move

But even if a further escalation can be staved off, the lira depreciation which has occurred already means that there is strong pressure in the pipeline – an impulse which will probably further stoke domestic inflation in Turkey further down the line. Given that Turkey's import ratio is almost exactly one-quarter of GDP, it is immediately apparent how heavily lira depreciation can affect the overall price development, in straight mathematical terms, via the import-price channel.

The first estimate of the August inflation rate – a twelve-month rate of change of 17.9 percent – already showed that a further acceleration had taken place. By then, at the latest, the inflation projection for the current year which the Turkish central bank had published at the beginning of July - 13.4 percent - was evidently out of date. When TurkStat released the August inflation rate, the monetary authorities immediately felt compelled to issue a statement that they would soon be adjusting the monetary-policy stance.

It was obvious that Turkey would not be able to avoid a marked interest-rate increase. However, the authorities attempted to delay tightening policy for long enough after the August escalation to be able to save face, justifying the key-rate hike without any direct relation to the bout of market turmoil.

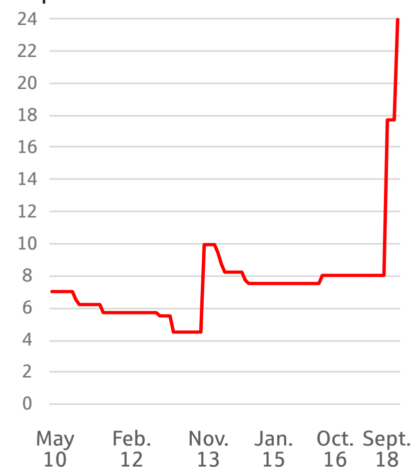
At its regular meeting in September, the Turkish central bank's monetary-policy committee resolved to push up the benchmark one-week repo rate by 625 basis points, from 17.75 percent to a new level of 24 percent.

The benchmark one-week repo rate has been hiked by a hefty 625 basis points!

This big step demonstrates growing resolve

By taking this action, the central bank managed to get back "ahead of the curve" – from a real-interest-rate perspective. Moreover, it showed undeniable resolve. This step fulfilled, or even over-fulfilled, market expectations. That is made clear from the reaction in the exchange rate: the lira recovered slightly, heading back up to a parity of approximately 7 to 1 at first, though backtracking again in the following week.

Turkish Central Bank,
key interest rate one week repo
in percent



Source: Central Bank of Turkey

Yet President Erdogan had opposed such a step on the very morning of the hike, decrying high interest rates as a "tool of exploitation." How is this contradiction to be interpreted?

Either the president and the central-bank officials reached a behind-the-scenes agreement beforehand and then simply geared their official statements to different target groups for maximum publicity effect. Or else the central bank has deliberately acted against Erdogan's declared will. A positive view would have to be taken of the latter scenario as well to the extent that it would testify to the central bank's independence and demonstrate that the institution is functioning. At any rate, at least the technocrats have understood what is necessary. Thanks to an interest-rate step of such decisive proportions, foreign-exchange markets are likely to be reassured for the time being. This should at least put a damper on capital outflows.

That does not, of course, mean that Turkey is now out of the woods. On the contrary, a contraction of the real economy and burdens for highly-indebted sectors continue to remain probable, albeit with a different variable mix from this point onwards.

But the recessionary impulse is already at work

Inflation looks like spinning further out of control in the first instance

Higher key rates are not going to engineer a trend reversal in inflation all that soon either. Even if the forthcoming surge in import prices is only passed along in part to final consumers, it is thoroughly realistic to expect consumer-price inflation to drift up towards 25 percent.

Purchasing-power losses for Turkish consumers are going to be correspondingly high. What is more, those consumers and companies who have incurred debts on a US dollar or euro basis will see their debt-service costs shoot up, in many cases threatening their livelihood.
Even if a downward spiral into crisis can be prevented, a recession, or certainly a pronounced growth slowdown, looks to be in store for Turkey. The GDP growth rate already slowed down to 5.2 percent in the second quarter - and that was before the summer turbulence.

The recent key-rate increase will have the effect of depressing macroeconomic growth further. Indeed, the growth losses entailed by such a step were the original reason why the government was opposed to it. This was not very forward-looking or sustainable, though, for the braking shock will now be all the more substantial as a result.

Turkey has only a limited direct trade weight from the German perspective

A recession in Turkey would also signify a setback for foreign trade in Germany and the wider euro area. However, the direct impact would be limited from a quantitative point of view. Just 1.9 percent of German exports were shipped to Turkey in 2017; the country on the Bosporus accounts for only 1 percent of global economic output.

At the beginning of September, Turkey and a consortium of German companies issued a joint announcement that a large-scale order, the subject of negotiations for quite some time, to modernise Turkey's railway infrastructure had been awarded (high-speed rail link between Istanbul and Ankara, modernisation of signalling technology etc.). This major order is designed to signal to the markets that trade and cooperation are proceeding unchecked. At the same time, however, it can already be construed as a kind of stabilising economic-stimulus package.

Germany has only limited banking exposure to Turkey

Furthermore, German banks have only a limited exposure to Turkey

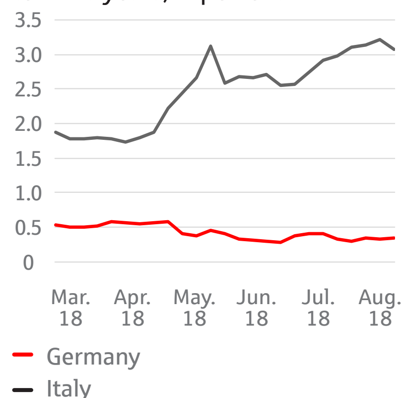
A second transmission channel potentially conveying the disruptions in Turkey to Germany, and to the euro area as a whole, is the banking sector. At the moment, Turkish banks are having to contend with a triple whammy of rising default rates, interest-rate increases and the exploding lira value of their hard-currency debt.

This will likewise take a toll on foreign banking institutions; however, Germany's banks have only a decidedly limited exposure to Turkey.
According to Deutsche Bundesbank's External Stock Statistics, measuring the assets and liabilities of the banking sector, German banking institutions have claims of just over EUR 20 billion on Turkish counterparties. Data from the Bank for International Settlements (BIS) confirm a roughly similar figure: depending how foreign subsidiaries are consolidated in group financial statements and depending on the ultimate risk carrier, the BIS puts the sum at either USD 17 billion or USD 25 billion. In these statistics, the banking sectors from France, Italy and Spain show larger exposures to Turkey, in the latter case also because one Spanish banking group has a significant stake in a major Turkish bank.

Contagion effect via third countries

However, the most dangerous contagion path, which could turn the Turkey crisis into a crisis of decidedly supra-regional importance, does not involve direct exposures but rather developments in third markets. This is because investors handling international portfolios could also punish countries with similar risk profiles.

Yields on German and Italian government bonds, Remaining term 10 years, in percent



Source: Thomson Reuters Datastream

In the euro zone, Italy has already sustained a rise in risk premiums on its government bonds. This updraft in yields may partly have been driven by renewed safe-haven flows in response to the escalation in Turkey. However, the widening spread on Italian debt instruments mainly reflects enduring uncertainty about the political course in the country itself, above all with regard to how the public-debt burden is to be dealt with. By contrast, Italy does not have a current-account deficit; in that respect, the boot-shaped peninsular is in an entirely different position to the country on the Bosporus.

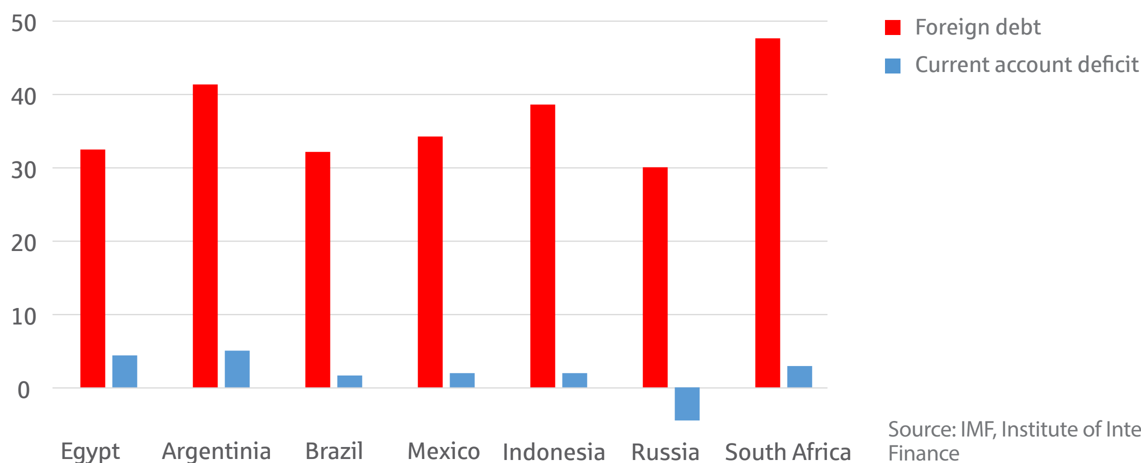
Emerging countries with a high volume of dollar-denominated debt would be vulnerable

The situation is more similar to that in Turkey in certain other emerging markets: a number of threshold economies have been running a high current-account deficit and seeing their pile of debt grow rapidly in recent years. What is more, the debt accumulated by these countries is frequently denominated in US dollars. This potentially subjects the countries concerned to pressure from two sides:

- Debt service will become more expensive if the local currency depreciates;
- The Federal Reserve's progressive monetary-policy normalisation, inter alia by means of key-rate hikes, will have an impact on the interest level itself.

Countries potentially vulnerable in this way include Argentina, Mexico, Brazil, South Africa, Egypt, Indonesia and Pakistan, but also Russia (the latter does not, admittedly, have a current-account deficit but rather an oil-supported surplus). In sum, these “light heavyweights“, the world economy’s second line of countries, could certainly provoke a global economic shock. Fortunately, though, the situations in these individual countries are marked by highly specific characteristics.

External Debt and Current Account Balance of Selected Emerging Markets 2018, in percent of GDP



Source: IMF, Institute of International Finance

Furthermore, most of these countries are presumably well aware of their vulnerability and – unlike Turkey – have not (at least, not as categorically) ruled out cooperating with the International Monetary Fund. By way of illustration, Argentina has recently struck a deal with the IMF, even though this surely cannot have been easy for either side (for the South American country but also for the Washington-based institution) in view of the tensions riddling their relationship in earlier decades.

A Janus-faced trade conflict

The big imponderable, which is continuing to keep the world economy on tenterhooks, is the protectionist-inspired trade conflict originating in the USA.

Will oil be poured on the waves of the NAFTA dispute?

However, there have also been a number of encouraging signals on this front of late. After signing a temporary trade-policy armistice with the EU, the USA has now also reached an agreement with Mexico on a revised version of the existing NAFTA rules. It is still unclear in what form Canada can be roped into the new deal. Striking an advance deal with Mexico to put pressure on Canada is presumably mainly a result of President Trump’s negotiating tactics. At the end of the process, though, the NAFA rules may well be largely preserved, even if they are no longer formally called “NAFTA” in order to enable the US president to save face.

A trade-policy armistice between the EU and the USA?

Regarding the Trump-Juncker "deal" struck in July, many details still have to be clarified. For instance, it is unclear which companies, acting autonomously within a market economy, are effectively going to be forced to buy more liquified natural gas and more soybeans from the USA, which is one of the commitments which EU dealmakers have signed up to. And how the automobile industry, an important sector (above all for Germany), is to be treated is an issue still being negotiated. Will it be treated as an exception in the bilateral agreement? In view of its weight, that could call in question the WTO conformity of the proposed treaty. Or will reciprocal tariff reductions be agreed on, with the EU being obliged to lower its hurdles – which are higher in the case of automobiles – as a disproportionate concession? At any rate, the new proposals are certainly moving back more in the direction of trade liberalisation.

A very important breakthrough in this direction is the free-trade agreement which the European Union has by now concluded with Japan. This deal has been eclipsed to some extent in media reports and public perception because of the fixation on the trade action originating in the USA. It is all the more important, then, that the whole rest of the world should aim at further integration instead of getting mired in trade isolationism, not least as a signal to the USA.

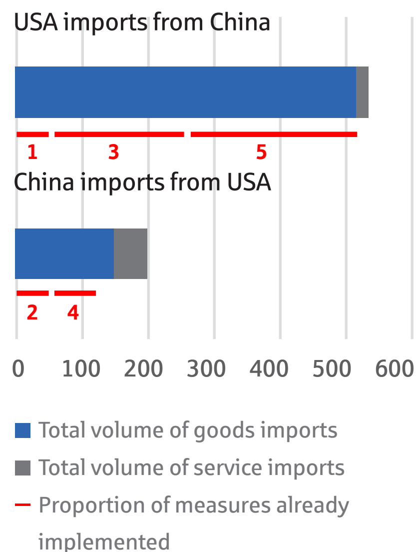
Key elements of the EU-Japan Free Trade Agreement

- Elimination of up to 99 percent of customs duties on EU exports, approx. 1 billion euros in customs duties annually
- Elimination of up to 100 percent of all duties on Japanese imports into the EU
- Opening of the Japanese market to agricultural exports from the EU, e.g. cheese, wine, beef and pork.
- Opening up service markets such as financial services, telecommunications and transport
- Access for EU companies to procurement markets of 48 major Japanese cities
- Removing existing barriers to public procurement in the rail sector
- Improved protection of intellectual property rights in Japan and of high-quality European agricultural products
- Protection of sensitive economic sectors through transition periods (e.g. automotive sector)

What is more, Japan's importance should not be underestimated. After all, it is the world's fourth-largest or fifth-largest economic area (after the US, the EU and China), depending on whether India's aggregate economic output is measured at market prices or on a purchasing-power-parity basis.

Stages in the trade conflict between the USA and China

Retail value in US$ bn. in 2017



- ■ Total volume of goods imports
- ■ Total volume of service imports
- – Proportion of measures already implemented

1 US tariffs already implemented (25%; mainly technology goods; 50 billion)

2 Counter tariffs already implemented by China (25%; e.g. soybeans, passenger cars)

3 Counter tariffs (initially 10%, 25% from 2019 onwards, including food, chemicals, textiles, 200 billion)

4 Counter tariffs threatened by China (between 5 and 25 %, $ 60 billion)

5 Threatened punitive tariffs USA ($267 billion)

Source: Bundesbank estimates, Office of the United States Trade Representative, White House Statements

JEFTA is an important milestone for world trade

Naturally, a new deal-adjusted world-trade system would, in whatever form, be a patchwork - a second-best solution by comparison to a system evolving along genuinely multilateral lines, like the one for which the USA used to be the leading exponent for decades.

But vibrant multilateralism would be an even better solution

China and the USA: locked in an increasingly bitter trade standoff

The United States has various special political relationships - with Iran, for example, or latterly with Turkey. However, the real battlefield for rounds of tariff increases appears increasingly to be centring on the bilateral relationship between China and the USA. The two giants of the world economy are caught in a cycle of mutual escalation. True, there have recently been offers of talks and more conciliatory signals; but it remains to be seen how credible these turn out to be. The escalating tariff skirmish has inflicted a certain degree of damage already.

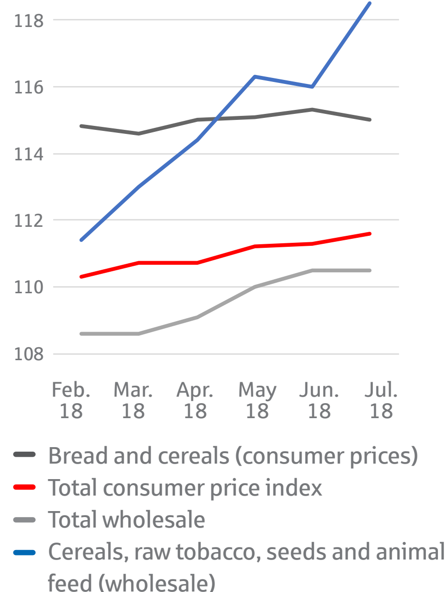
Admittedly, the fact that the main conflict, between the USA and China, is not taking place in their own backyard limits the immediate damage and blockages for Germany and the wider EU. However, there are absolutely no grounds for Europeans to view the trans-Pacific conflict with some kind of malicious glee. For one thing, the danger of protectionism proliferating on a global scale remains a very real one. Even if there was only a bilateral standoff between the two superpowers, the world economy would still suffer negative indirect effects. At the very least, cyclical momentum in these two key engines of the world economy would be impaired. Should they become “poorer”, moreover, this would generate less demand for German products.

For another thing, there is a threat of redirected goods flows – for instance, overproduced Chinese steel, locked out of the USA and therefore dumped on the rest of the world market – having a distorting effect and accordingly damaging the international division of labour.

The heat wave has had a detrimental effect on the 2018 harvest

A further disruptive factor which has had an immediate impact on the real economy this summer was the unusual weather pattern. A heat wave and drought afflicted many regions in the northern hemisphere, persisting for an uncommon length of time in Central Europe too. As well as making conditions for inland shipping more difficult because of the low water levels in important transport arteries and the lack of cooling water for power plants and industry, this has had particularly significant repercussions on the 2018 harvest. Many food categories have been affected, including feed for livestock.

Price indices for individual consumption and wholesale in Germany, 2010=100



Source: Destatis

Looking beyond the immediate burdens resulting for the sectors affected, the most interesting question from the macroeconomic point of view is how such harvest failures will feed through to prices. The impact is already observable in the case of wholesale prices for some food commodities but it is not yet showing up in full at the retail-price level. If scarcer food means more expensive food, can this spark a return of inflation?

Such a price stimulus would be dampened by the fact that crop losses have occurred in a situation in which the price trend for fresh food had previously been tending to point downwards. Although the twelve-month rates of change for food have been overshooting the overall rate of consumer-price inflation for some time now, the gap has been closing (August 2018: +2.5 percent yoy; May 2018: +3.5 percent yoy). True, this relief is probably going to drop abruptly out of the picture in the new figures.

Nevertheless, the growth rates for food will not have as strong an impact on overall consumer-price inflation as one might have expected on account of the dramatic harvest situation and the stock-market prices of individual commodities. In the relevant part of the basket of goods and services at private households, other value-added components play a bigger role, as does the broad mix, than in the case of pure wheat.

To date, crop losses have only shown up to a more pronounced extent in the prices of individual raw materials

Furthermore, it would be wrong, qualitatively speaking, to view higher prices for food products as “inflationary” in this situation determined by real factors. After all, the purchasing power of money is not being eroded. What we are rather seeing is a change in relative prices, indicating a change in scarcity ratios. Such a phenomenon will not drive up the inflation rate in a sharp and lasting fashion; on the contrary, it will presumably generate a countervailing base effect in one year’s time.

Could higher food prices prove a starting-point for a broader-based rise in inflation?

And yet this special price stimulus has surfaced in a special situation. The extremely expansionary monetary policy of recent years has not yet translated into higher prices. For a long time, the very ample supply of liquidity was left unused. In the interim, however, macroeconomic capacity utilisation has recovered, and is now indeed easily above-average in Germany. Inflation has picked up as well, with headline rates recently converging with the ECB’s target. On the other hand, the trend reversal in interest rates is very far from having been initiated in the euro area – indeed, it has just been virtually ruled out for a further year.

A higher capacity-utilisation rate, zero interest rates and extremely ample liquidity are a fertile breeding ground for inflation

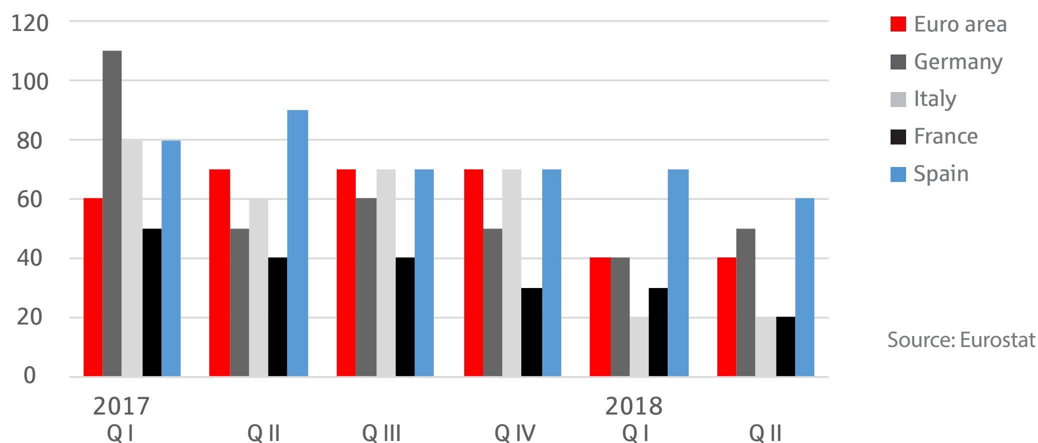
In such a constellation, a price stimulus – even if it derives from readily explicable special developments – could possibly spark a broader-based rise in inflation. If inflation rates were to move higher, this could be a wake-up call for economic agents to start thinking in inflation-correcting categories again to a greater extent, for instance during wage negotiations. Low nominal interest rates could also be perceived quite differently – as even lower real interest rates.

In the USA and the UK (in the latter case, as a result of sterling depreciation in the wake of the Brexit vote), it is certainly true that one-off effects have already revived inflation in the medium term, even causing it to overshoot to a certain extent. For this reason too, the Federal Reserve will be continuing on its rate-hike path this year. At all events, greater vigilance is warranted as the spectre of inflation begins to stalk the globe again.

The euro area was no longer so dynamic during the second quarter

Economic activity in Germany is in robust shape, but things are not looking as rosy in the euro area as a whole. The 0.4 percent growth rate registered by the EMU in the second quarter of this year has to be described as a disappointment – for it is benefiting from the favourable pace of growth in the Federal Republic (+0.5 percent). By contrast, France and Italy each only posted a growth rate of 0.2 percent in the second quarter. In short, the handsome growth momentum distinguishing the euro area in 2017 could not be maintained. On the other hand, the development is not poor enough to stand in the way of monetary-policy normalisation.

Quarterly growth of selected euro countries,
seasonally and calendar adjusted in percent



German growth continues to be broad-based

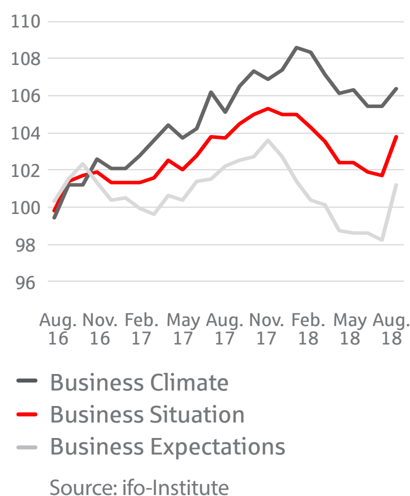
The upswing in Germany is now looking more homogeneous over time…

…and is broad-based in qualitative terms, being widely distributed across all expenditure-side

With growth coming in at 0.5 percent in Q2, Germany continues to look in good shape - better than the relatively patchy monthly indicators over the quarter had suggested. Revised readings for the preceding quarters were also released at the same time as the new national-accounts data. On a revised basis, the growth rate for the opening quarter of 2018 works out at 0.4 percent, compared with an original estimate of 0.3 percent. By contrast, the trend for 2017 was shifted down to some extent.

On balance, the upswing in Germany is therefore looking more homogeneous over time. The supposed setback at the beginning of the year was not all that much of a dent. It is also pleasing that growth is distributed very widely across all expenditure-side components – from private consumption to plant-and-equipment investment to exports (at least on a gross basis in the latter case). And given Germany's high current-account surplus, it is not bad at all that import growth has been stronger, putting something of a brake on aggregate growth in purely mathematical terms. Indeed, the pick-up in imports could well be interpreted as a sign of the strength of domestic demand in the Federal Republic. The breadth of demand across all expenditure-side components is lending additional robustness to the mature upswing, which has not witnessed any negative GDP growth for 13 quarters now (indeed for as long as eight years on a year-on-year basis).

ifo Business Climate Germany
(2015=100, seasonally adjusted)



Source: ifo-Institute

Despite less incoming orders, sentiment has improved markedly

Incoming orders are in reverse gear

But orders on hand are in excellent shape

Having already contracted in June, incoming orders in the manufacturing sector were once again in reverse gear in July. Foreign orders were responsible for the decline. By contrast, domestic orders were on a positive trend again in July. According to figures from the German Electrical and Electronic Manufacturers' Association (ZVEI), the order intake was buoyant on both the domestic and foreign fronts in the important electrical-engineering industry. In addition, forward order books broadly remain at an excellent level in most sectors.

Sentiment indicators are expressing relief: Germany is on the sidelines in the conflict over protectionism

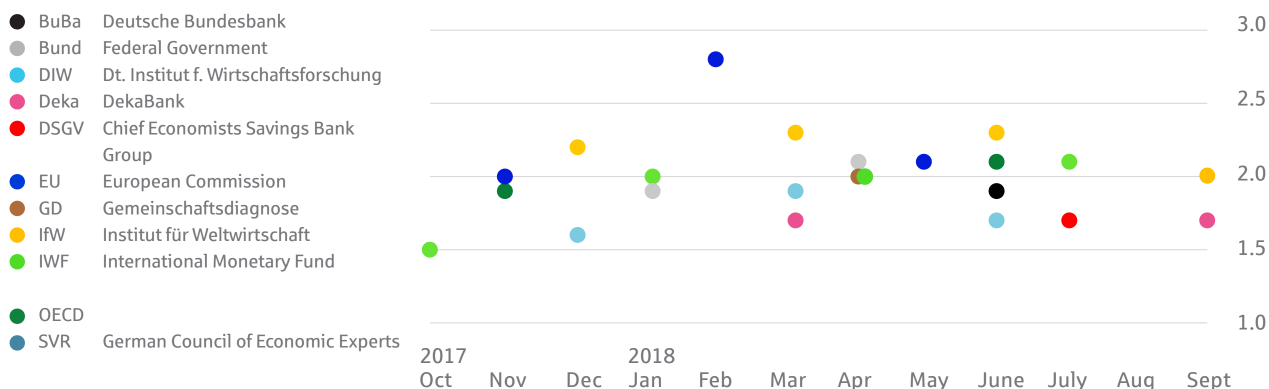
On top of this, sentiment in German industry has improved markedly again, as can be gauged from the brisk upward jump in the ifo Business-Climate Index published at the end of August. Both the current-business-situation and the business-expectations components of the ZEW Index, tracking Germany and Europe in general, have also moved higher in lockstep. This improvement in sentiment-indicator readings is probably an expression of relief that Germany is no longer in the front line with regard to the protectionist threats. Let us hope that this constellation remains in place.

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

	2016	2017	2018[1]	2019[1]
Global trade volume	+2.2 %	+5.1 %	+4.8 %	+4.5 %
Gross domestic product - world	+3.2 %	+3.7 %	+3.9 %	+3.9 %
USA	+1.5 %	+2.3 %	+2.9 %	+2.7 %
Japan	+1.0 %	+1.7 %	+1.0 %	+0.9 %
China	+6.7 %	+6.9 %	+6.6 %	+6.4 %
EU	+2.3 %	+2.0 %	+2.3 %	+2.1 %
Euro area	+1.8 %	+2.4 %	+2.2 %	+1.9 %
Germany	+1.9 %	+2.5 %	+2.2 %	+2.1 %

[1] International Monetary Fund forecasts as available from July 2018, otherwise April 2018, working day adjusted

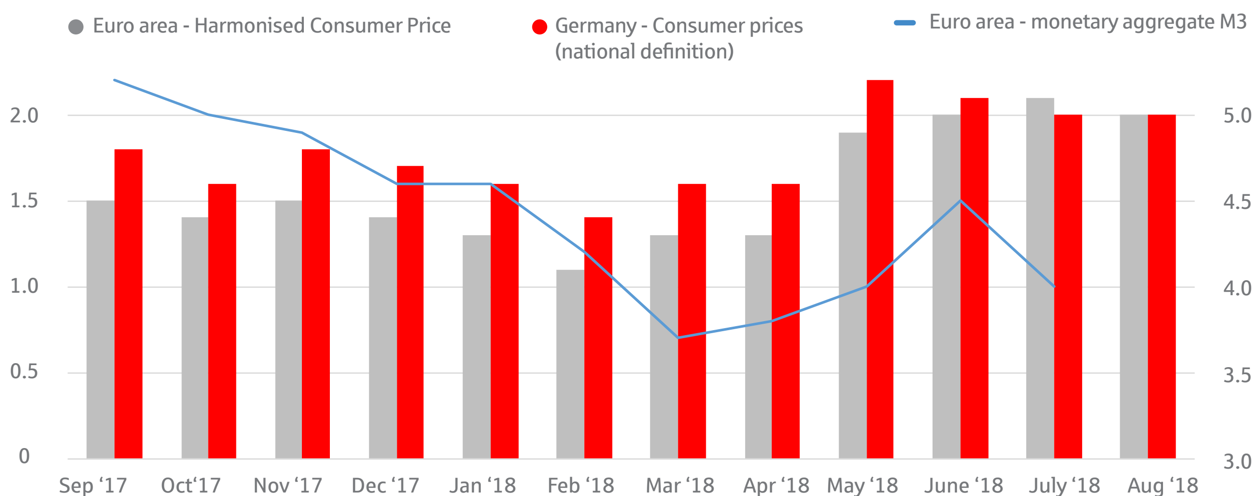
B. Projections for 2019 German economic growth, in %



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

	Year 2017	Q III - 2017	Q IV - 2017	Q I - 2018	Q II - 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	+ 2.4 %	+ 2.6 % + 0.7 %	+ 2.5 % + 0.6 %	+ 2.1 % + 0.4 %	+ 2.2 % + 0.4 %
Germany Gross domestic product	+ 2.2 %	+ 2.2 % + 0.6 %	+ 2.2 % + 0.5 %	+ 1.4 % + 0.4 %	+ 2.3 % + 0.5 %
Private consumption	+ 1.8 %	+ 1.9 % + 0.1 %	+ 1.2 % + 0.2 %	+ 1.6 % + 0.5 %	+ 1.0 % + 0.3 %
Gross fixed capital formation	+ 2.9 %	+ 2.9 % + 0.4 %	+ 2.8 % + 0.3 %	+2.2 % + 1.4 %	+ 3.4 % + 0.5 %
Exports	+ 4.6 %	+ 4.9 % + 1.2 %	+ 4.7 % + 1.7 %	+ 2.2 % - 0.3 %	+ 4.2 % + 0.7 %
		Level not rate of change; seasonally-adjusted quarterly figures			
Savings rate	9.9 %	9.9 %	10.1 %	10.0 %	10.2 %

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



E. Monthly economic indicators for Germany

	May '18	June '18	July '18	Aug. '18	Sep. '18
CPI (national definition)	Percentage change year-on-year				
Consumer-price inflation	+2.2 %	+2.1 %	+2.0 %	+2.0 %	-
- without food and energy (core inflation)	+1.6 %	+1.4 %	+1.4 %	+1.3 %	-
Producer prices for industrial goods	+2.7 %	+3.0 %	+3.0 %	-	-
Import prices	+3.2 %	+4.8 %	+5.0 %	-	-
Sentiment indicators					
ifo Business-Climate Index	102.3	101.8	101.7	103.8	-
ZEW Economic Sentiment Index	-8.2	-16.1	-24.7	-13.7	-10.6
Incoming orders	Percentage change year-on-year				
Manufacturing industry	-0.4 %	+1.3 %	+2.0 %	-	-
domestic	-2.2 %	-0.7 %	+3.6 %	-	-
foreign	+1.0 %	+2.7 %	+0.8 %	-	-
Capital-goods producers	-0.2 %	+0.0%	-0.8 %	-	-
Production	Change yoy (adjusted for working-day variations)				
Producing sector as a whole	+3.0 %	+2.7 %	+1.1 %	-	-
thereof: construction	+3.3 %	+1.2 %	+4.0 %	-	-
thereof: industrial sector	+ 3.6 %	+3.3 %	-0.6 %	-	-
Foreign Trade	Percentage change year-on-year				
Exports	-1.3 %	+7.8 %	+7.7 %	-	-
Imports	+0.9 %	+10.2%	+12.0 %	-	-
Labour market	Unemployment rate; change relative to the same month of previous year				
Unemployment Rate	5.1 %	5.0 %	5.1 %	5.2 %	-
Jobless total	-182	-197	-193	-194	-
Actively employed (working in Germany)	+605	+580	+574	-	-
Regular employees paying social insurance	+746	+704	-	-	-

F. Commodity, foreign-exchange and other financial markets

	May '18	June '18	July '18	Aug. '18	19.09.2018
Oilprice Brent in US $	76.98	74.41	74.25	72.53	78.22 (17.)
Exchange rates					
US-Dollar / EUR	1.1812	1.1678	1.1686	1.1549	1.1667
Japanese yen / EUR	129.57	128.53	130.23	128.20	130.94
Equity Markets					
German stock index DAX, EOM figures	12,605	12,306	12,805	12,364	12,219
Percentage change year-on-year	-0.08 %	-0.15 %	+5.67 %	+2.56 %	-2.73 %
Money-market and capital-markets rates					
Overnight money (EONIA)	-0.36 %	-0.36 %	-0.36 %	-0.36 %	-0.37 % (17.)
1-month rate (EURIBOR)	-0.37 %	-0.37 %	-0.37 %	-0.37 %	-0.37 % (18.)
3-month rate (EURIBOR)	-0.33 %	-0.32 %	-0.32 %	-0.32 %	-0.32 % (18.)
Running yield on German government bonds with a residual maturity of ten years	0.44 %	0.33 %	0.43 %	-0.35%	0.49 %
Bank interest rates, new business					
Overnight deposits for private households in Germany and in the euro area as a whole	0.02 % 0.04 %	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	0.36 % 0.36 %	0.30 % 0.34 %	0.27 % 0.32 %	- -	- -
Rates on 5-year corporate loans of up to EUR 1 m in Germany and in the euro area as a whole	1.95 % 1.86 %	1.97 % 1.81 %	1.93 % 1.81 %	- -	- -

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