



Economic Forecast Germany 2014/15

(November 2014)

Berlin (gtai) - As a result of the worldwide economic slowdown, the German economy is growing slower than expected. Industrial production in particular is expected to be restrained. Private consumption will again be the major factor driving growth in 2014. The high levels of domestic demand should offset the inhibitory effect foreign trade is having on gross domestic product (GDP). Manufacturing companies' expectations have deteriorated continuously since the start of the year, according to the Ifo Business Climate Index.

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1 Overall economic outlook

Development of gross domestic product

Germany has not yet seen a strong recovery in investment. Furthermore, the global economy's performance is moderate and the Eurozone is growing more timidly than expected. As a consequence, the German government revised expected GDP growth for 2014 down to 1.2% in its autumn projection. The German economy is expected to expand next year by 1.3%. At the same time, investment is likely to be up 3.2% in the current fiscal year compared to last year and the federal government expects comparable growth in 2015. Private and government consumption are also seen as important economic stimuli. Both areas are expected to grow by more than 1% in both 2014 and 2015.

Economic development 2013-2015 (real change over the previous year in %)

	2013	2014 *)	2015 *)
GDP	0.1	1.2	1.3
Exports (goods only)	1.6	3.2	4.4
Gross fixed capital formation	-0.7	3.2	3.3
Private consumption	0.8	1.0	1.4

*) 2014 2015: Forecast

Source: Federal government autumn projection

Like 2013, GDP in 2014 and 2015 is also expected to be driven strongly by domestic demand. This is mainly due to imports currently growing faster than exports and the dampening effect on GDP that the trade balance will probably have in 2014 and 2015. The economic institutes' joint analysis project group expects the negative demand effect caused by the trade imbalance to reduce GDP in both 2014 and 2015 by -0.2%. However, the negative momentum in foreign trade will be offset significantly by consumption and fixed asset investment.

Due to the economic dip, employment growth is slowing and consumer prices are likely to rise only slightly in the medium term. The economic institutes expect an inflation rate of 1% for 2014. Next year should see inter alia the effect of the minimum wage lead to a price increase of 1.4%. Despite the continued favorable financing conditions, weaknesses are emerging in private investment. The economic institutes' joint analysis expects the German economy to be underutilized in 2015. In addition, uncertainties abroad have influenced predictions for the development of the German economy. Both political instability in certain export markets and the uncertain economic dynamics in China and the Eurozone have the potential to dampen German exports in 2015. However, the federal government and the institutes expect exports to increase in 2015, although this is likely to be smaller than the growth in imports.



The International Monetary Fund (IMF) revised down its April 2014 forecast for global economic growth by 0.3 percentage points to 3.3% and expects the global economy to expand in 2015 by 3.8%. Following the slowdown in growth in 2012/13, the IMF expects renewed positive economic developments in the Eurozone in 2014 (+0.8%) and 2015 (1.3%).

Key economic data

Indicator	2012	2013	2014.
GDP (nominal, bn. euro)	2,750	2,810	2,899 1)
GDP per capita (euro)	33,569	34,219	34,767 2)
Population (million)	80.5	80.8	80.8

1) Federal government autumn projection, 2) IMF projection

Source: Federal Statistical Office

Investments

Both the federal government and the research institutes expect a significant increase in fixed capital investments in 2014 which will boost domestic demand in 2015. The economic institutes see potential for a sharp rise in equipment investments in particular, namely 3.8% in 2014 and 4.1% in 2015. However, too much should not be read into this as capital spending declined sharply in previous years and this represents the beginning of a much-needed catching up effort. The weak sales expected for the second half of 2014 are having a damping effect and slowing investment.

Construction spending stagnated in 2013 but grew significantly more than expected in 2014 (3.3%) following a strong start due to the mild winter. This positive trend is expected to continue in 2015 as housing (2014: 3.4%; 2015: 2.2%) and public construction (4.3%; 4.6%) are likely to expand considerably. Historically low interest rates and the rise in real incomes gives hope that private investment will increase, in housing especially. Commercial construction picked up considerably in the first half of 2014 but is expected to stagnate in the second due to a lower willingness to invest. Commercial investments are expected to have grown by 2.7% come the end of the year.

Consumption

The German government expects households' real final consumption expenditure in 2014 to be up 1% on 2013. The economic institutes expect slightly weaker growth of 0.8% in 2014. The increase in private consumption would thus be similar to those in the past three years. The institutes expect even higher levels of private consumer spending in 2015 and are forecasting a rise of 1.4%.



The reason for households' willingness to spend more again in 2014 is higher disposable income, which are likely to expand in real terms by 1% during the year. In the coming year, the research institutes' joint analysis expects private consumption to increase more strongly. The introduction of the minimum wage and higher pensions will create a 1.5% increase in disposable income in real terms in 2015.

Government spending is expected to grow by 0.2% in both 2014 and 2015 - minimally higher than in 2013. Public construction spending is expected to see considerable growth due the strong order situation in the second half of 2014 to achieve growth of 4.3% over the year. Similarly positive figures and growth of 4.6% can be expected in 2015. This will be welcome news for the public construction sector following the barren period from 2011 to 2013.

Foreign trade

Foreign trade developed dynamically in 2014. The economic institutes predict that exports grew by 3.2% and imports by 4.2% compared to the previous year. Exports of goods and services are growing at the same speed while for imports only goods are seeing significant growth - with the import of services even decreasing. It is helpful that price competitiveness only worsened slightly in 2014 (-0.5%) with the trend expected to reverse in 2015 due to a weaker euro. As a result, price competitiveness is expected to increase by 0.6%.

Overall, German exports in 2014 are performing below potential due primarily to continued weakening demand in the Eurozone and the slowdown in the world economy. Furthermore, the stuttering trade with Russia has had a negative effect on several German export-dependent industries. Exports to the Eurozone are set to recover next year according to the economic institutes which will have a positive effect on total exports. The strong growth in imports expected for 2014 (4.2%) and 2015 (5.7%) mean net exports will likely continue to have a negative effect on GDP in both years.

German foreign trade (in EUR billion; real change in the 1st half of 2014 compared to the first half of last year in%)

	2012	2013	1st half of 2014	Change
Imports	905.9	898.2	459.0	2.2
Exports	1,095.8	1093.1	558.4	2.4
Balance of trade	189.9	194.9	99.4	

Source: Federal Statistical Office



Exports by commodity group (in EUR billion; change in the 1st half of 2014 compared to the first half of last year in %)

SITC product category	2012	2013	1st half of 2014	Change 2014/13
0 Food / live animals	48.7	51.5	25.5	0.7
5 Chemicals and related products	171.0	172.7	89.4	2.2
.51 Organic Chemicals	24.0	24.3	12.4	-0.2
.54 Medicinal and pharmaceutical products	56.0	57.0	29.5	5.5
.57 Plastics in primary forms	23.3	23.6	12.4	1.7
6 Manufactured goods classified chiefly by material	142.6	139.2	71.0	-0.4
.67 Iron and steel	27.4	24.9	12.2	-7.9
7 Machinery and transport equipment	528.9	523.7	265.8	2.2
.71 Power-generating machinery and equipment	42.2	41.0	21.1	2.8
.72 Machinery specialized for particular industries	47.9	46.8	22.9	-3.1
.74 General industrial machinery and equipment, and machine parts	78.5	79.4	40.2	2.1
.77 Electrical machinery, apparatus and appliances	80.0	80.9	40.8	1.0
.78 Road vehicles	183.0	182.1	96.6	6.8
8 Miscellaneous manufactured articles	109.8	111.4	55.6	2.6
.87 Professional, scientific and controlling instruments and apparatus	36.2	37.0	18.6	2.4

Source: Federal Statistical Office

2 Industries overview

Capacity utilization in the manufacturing sector has fallen slightly since the middle of the year and is currently at 83.7%, according to the Ifo Institute. The institute's business climate index has declined steadily since May 2014 and businesses' economic expectations are weakening further.

The assessment of the current situation worsened in the manufacturing sector in particular where business expectations have deteriorated significantly since the beginning of the year. The wholesale sector, however, saw this trend reversed thanks to the recent positive business environment. In the retail sector, conversely, the climate continues to worsen. For the main construction trades, the business situation and expectations remain stable.



Mechanical and plant engineering

The first three quarters of 2014 saw mechanical engineering production stagnate. The order situation for companies in the industry has improved to date. According to the VDMA German Engineering Association, business was boosted primarily by several major contracts in the 3rd quarter. Overall, new orders in the last quarter were up 5% year-on-year. New orders grew by 2% on aggregate in first three quarters compared to the same period the previous year. Turnover in the industry has increased by 1.1% in real terms to date in 2014. For the fiscal year, the VDMA expects turnover to increase by EUR 4 billion to a total of EUR 210 billion. Moreover, employment in the mechanical engineering branch hit a new high in August with over 1 million people employed in the industry.

Automotive industry

The German automotive industry's outlook for the remainder of 2014 remains positive. This is due to the consistently favorable market developments, despite the economic hurdles in international business with Russia and Brazil. The US and China in particular are boosting German car exports. Total exports up to October 2014 rose by 4% and the VDA German Association of the Automotive Industry expects the recent strong growth in exports to continue until the end of the year. Domestic business also developed solidly through to October. With 3% more new registrations and 4% more orders, the industry can look forward to reflecting on an overall strong 2014. This reflects, among other things, the growth in production in Germany. Since the start of the year, 4.7 million cars have rolled off assembly lines - an increase of 4%.

Chemicals

The upturn in international trade gave the chemical industry a solid third quarter, giving hope for an overall positive 2014. The German Chemical Industry Association (VCI) expects the dynamic international trade to continue in the fourth quarter and reports that its members are satisfied with the current business situation. However, the strong recovery expected for the second half of the year has so far failed to materialize. Domestic business in particular has slowed, which together with falling prices for chemical products will likely moderate growth rates. For 2014, the VCI expects production to increase by 1.5% and sales to grow to EUR 192.5 billion (+1%) despite falling prices (-1%).

Construction industry

Employment in the construction industry in 2014 and 2015 should remain stable at around 760,000 workers, according to the Central Association of the German Construction Industry



(ZDB). This is thanks to the strong construction market. For the current fiscal year, the ZDB expects turnover to grow by 2.8%. This would mean the main construction trades generating EUR 98.1 billion. The positive trend is expected to continue in 2015 when the expected 2% growth in turnover would lead to the EUR 100 billion mark being broken. Residential construction is expected to have given the industry the greatest boost in 2014 with expected growth of 4.5%, followed by public construction (+3.5%) and commercial construction (+2.5%). The ZDB expects both residential and public-sector construction to grow solidly in 2015 by 2.5%. Only commercial construction is expected to stagnate.

Electronics and electrical engineering

Despite good growth figures in the first three quarters, business sentiment has cooled somewhat in the electrical industry. According to reports from the German Electrical and Electronic Manufacturers' Association (ZVEI), businesses expect weaker performance over the next five months. However, this should not obfuscate the previous success had in 2014. From January to August, the industry recorded growth in turnover (+2.1%), production (+1.7%), exports (+2.8%), imports (+5.4%), and new orders (+0.3 %). These are consistently positive trends compared to the weak 2013. Overall, ZVEI expects turnover of EUR 170 billion for 2014 and real production growth of 2%. Employment and producer prices in the industry are expected to remain unchanged in 2014.

Information and Communication Technology

The German ICT market is likely to conclude 2014 with an increase in turnover of 1.6%, according to the German Association for Information Technology, Telecommunications and New Media (BITKOM). This would mean the sector having a volume of EUR 153.4 billion. However, developments in the various industry segments differ significantly: IT hardware and software, for example, will probably grow by just under 6%, making the IT sector the major driver of industry's overall growth in 2014. In contrast, telecommunications is likely to have a weak year (-0.9%). Likewise, consumer electronics will close 2014 with sales expected to be down (-1.5%). BITKOM expects employment to increase by 10,000 jobs.

Environmental technology

Despite solid sales in the heating market, industry representatives still see an ongoing modernization backlog in Germany. According to the Federal Industrial Association of Germany House, Energy and Environmental Technology (BDH), of the 20.5 million heating systems in Germany, 71% are in need of modernization. Germany's transition to renewable energy – the *Energiewende* – has so far bypassed the heating market, where gas will remain the dominant energy source in 2014. In the BDH's view, the modernization rate of 3% is too



low for the *Energiewende* to make decisive progress in the in the area of energy consumption.

Medical technology

The German industry association for optical, medical and mechatronic technologies SPECTARIS expects turnover to increase by 1.6% in the German medical technology industry in 2014. This would bring the industry volume to EUR 25 billion for the first time. The export rate is high as usual at 68%. The autumn survey carried out by the German Medical Technology Association (BVMed) showed that its member companies are enjoying strong international trade in 2014. The survey revealed further that 64% of the companies expect export conditions to be even more favorable in 2015 than in 2014. Thus, the prospects for the medical technology industry are positive for the coming year.

Logistics

Approximately 40% of logistics providers expect their results in the final quarter of 2014 to be up on the previous quarter. In the coming year, the industry expects continued expansion of capacity and employment, albeit less than seen in 2014. For the first time in a long time, current business sentiment scored higher than medium-term expectations in the German Logistics Association (BVL) logistics indicator. According to the BVL, this is mainly due to the deteriorating macroeconomic situation. Logistics companies would be affected significantly by the weaker order situation in the industry as well as reduced trade with Russia and the Eurozone. Notwithstanding, turnover (EUR 230 billion) and employees (2.85 million) are forecast to be up in 2014.

Wind energy

The first half of 2014 saw 650 new onshore wind turbines installed with a total capacity of 1,723 MW. This brought the total number of wind turbines in operation in mid-2014 to 24,193 with a combined capacity of 35,389 MW. The 66% growth in the construction of new windfarms compared to the first half of 2013 is enormous. This suggests that 2014 will be a very successful year for the wind energy industry. Schleswig-Holstein saw the greatest expansion in wind power capacity. About a quarter of the new capacity in Germany was installed in the state. The state of Lower Saxony is still ranked first in terms of total installed capacity with 7,819 MW online. New offshore wind capacity was also added in the 1st half of 2014: 30 new turbines and 108 MW were connected to the grid.



Food and Nutrition

Weaker-than-expected exports, stagnant prices, and increased competitive pressures have dampened sales growth in the food industry so far in 2014. The Federation of German Food and Drink Industries (BVE) has highlighted disappointing earnings for companies in the sector despite a stable domestic market. Although the production index increased in both Q2 (+3.3%) and Q3 (+1.4%), the slight revenue growth in Q2 (+0.6%) was followed by a slump in Q3 (-3.3%). In particular, weak price development and a reduction in food exports in Q3 are likely to dampen the mood in the sector for the 2014 financial year.