



BDI

The Voice of
German Industry

QUARTERLY REPORT GERMANY

Strong start, solid prospects.

Normal tempo expected following a bullish beginning

Quarter II / 2016

- **The German economy started the year with a bound.** In the first quarter of 2016 GDP rose 0.7 percent from the previous quarter after calendar and seasonal adjustments. This was 1.3 percent more than the figure for the same quarter last year.
- **Economic developments are primarily determined by domestic factors.** Private consumption, bolstered by unbridled employment growth, better pay and low inflation, remains a main driving force behind these developments. The **public sector**, which is responsible for a good quarter of all consumer spending, should generate plenty of demand.
- **We are expecting a moderate upturn in investment activity this year.** Developments in **construction investments** were primarily positive. Given the murky prospects for foreign trade, however, investments in equipment are likely to experience only modest growth. **Net exports** will probably make a negative contribution to growth.
- **Overall, this year's real economic output is likely to be 1.7 percent higher than last year.** After a bullish start to the year in the first quarter, we expect the second quarter to proceed in a more subdued manner. But the German economy seems likely to recover its normal pace in the second half of the year.

Content

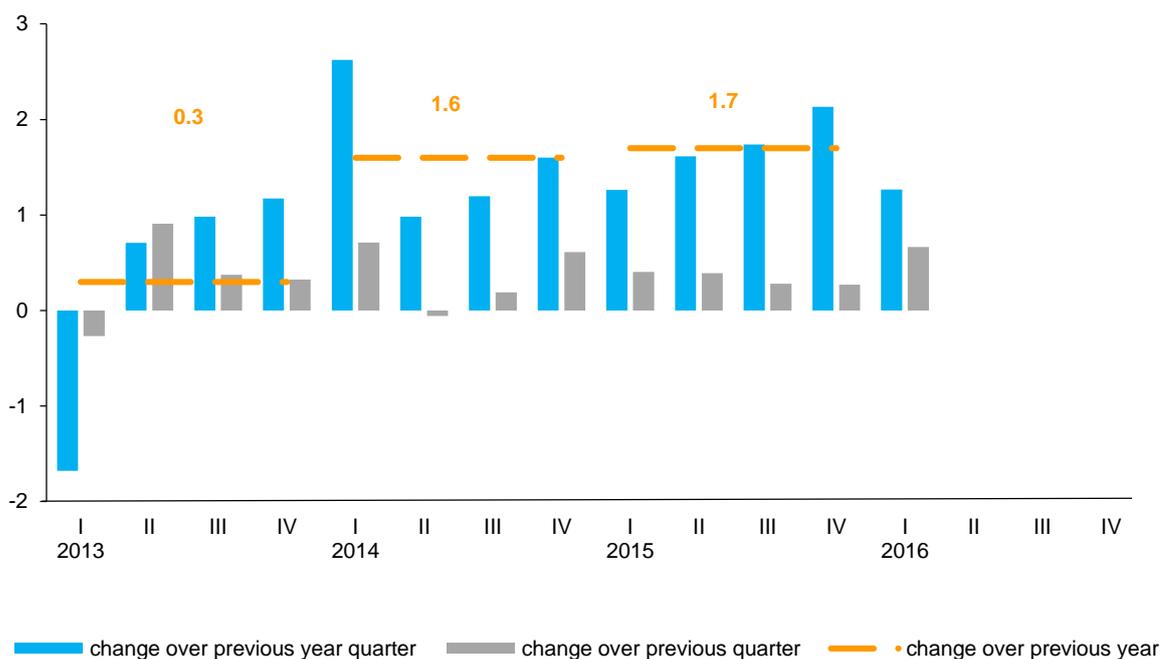
The German economy	1
Gross domestic product grew significantly in the first quarter of 2016	1
Record surplus in foreign trade balance this March	2
Labour market: employment growth in almost all sectors	2
Industry	3
Industry receives more orders	3
Impressive production increase in the first quarter despite current weaknesses	4
Industrial capacity utilisation remains high	6
Business climate continues to improve	6
Outlook	7
A positive start to the year raises hopes	7
Sources	9
Imprint	10
Basic data for national accounts	11

The German economy

Gross domestic product grew significantly in the first quarter of 2016

The German economy started the year well, with considerable growth. In the **first quarter of 2016, gross domestic product** grew by 0.7 percent after inflation, calendar and seasonal adjustments in quarter-on-quarter terms, after having already grown 0.3 percent in the fourth quarter of 2015. Year-on-year, economic output increased by 1.3 percent. When adjusted for calendar effects, the growth rate was 1.6 percent. On the supply side, a workforce of 43.1 million people generated the economic output. That is 533,000 or 1.3 percent more people than last year. The gross value added increased in all economic sectors. Financial and insurance service providers experienced the strongest growth. In that sector, gross value added was up for the first time in five quarters (2.5 percent). Growth was also above average in the information and communications sector (up 2.3 percent), followed by the corporate services sector (up 1.8 percent), and the trade, transport and hospitality industry (up 1.2 percent). In the two last-named sectors, the growth in value added was accompanied by rising employment. In the industrial sector, however, the increase in gross value added was below average (0.7 percent).

Growth in real GDP, quarterly basis in percent



Source: Federal Statistical Office



On the consumption side, GDP was dominated by domestic factors. On an inflation, calendar and season-adjusted basis, household consumption expenditure increased by just 0.4 percent quarter-on-quarter. The public sector consumed 0.5 percent more than in the previous quarter. Gross fixed capital formation grew for the third consecutive time, most recently by 1.8 percent. Capital equipment spending (up 1.9 percent) and construction spending (up 2.3 percent) both rose. That meant that in the first quarter of 2016, half of the overall contribution

to growth came from these investments. Unlike in the two previous quarters, net exports had very little (negative) effect on GDP growth. Exports rose one percent after calendar and seasonal adjustments; imports a little more, at 1.4 percent. This resulted in a negative contribution to growth of 0.1 percentage points.

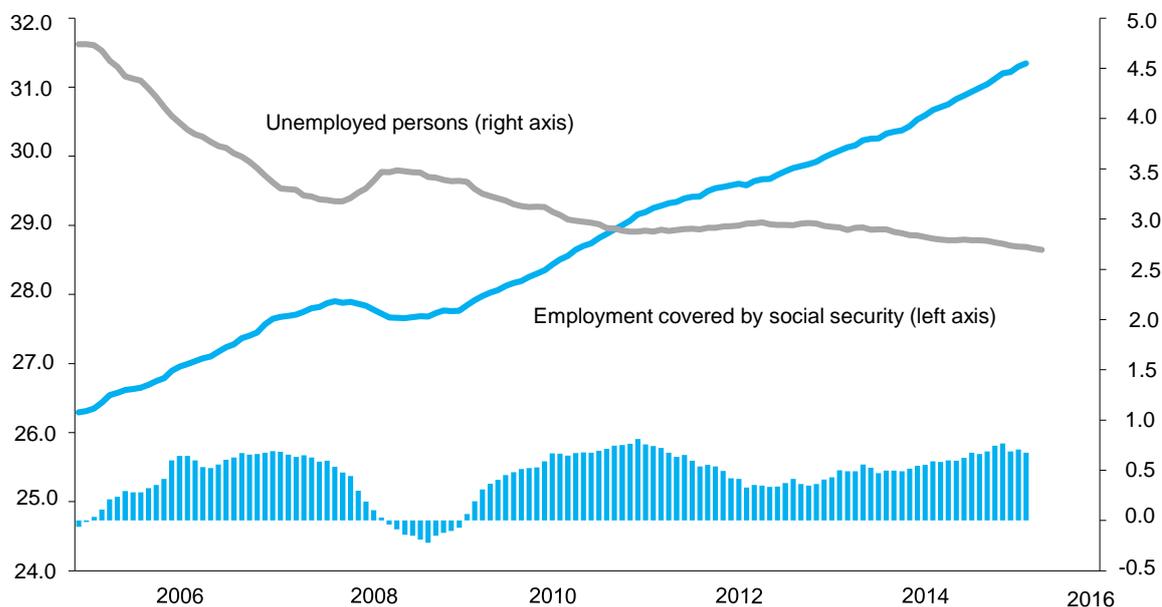
Record surplus in foreign trade balance this March

In March 2016, exports decreased by 0.5 percent versus the same month last year. Since imports fell considerably more in the same period (down 4.3 percent), the foreign trade balance experienced a record surplus of 26 billion euros. In the first three months of this year, Germany imported 0.7 percent more goods and services than in the same period last year. Exports to EU countries outside the euro area increased most (4.8 percent). Goods exports to euro area countries were 1.4 percent higher than one year ago. Exports to non-EU countries dropped by 2.1 percent. Imports developed similarly. In the first quarter of 2016, imports rose by a total of 0.3 percent versus the same quarter last year. Germany imported 4.8 percent more from EU countries outside the euro area, and one percent more goods from the euro area than it did a year ago. Imports from non-EU countries dropped by 3.2 percent.

Labour market: employment growth in almost all sectors

According to preliminary data from the German Federal Statistical Office, the number of **employed** rose to a record 43.36 million individuals in April 2016. That means that around 556,000 more people (0.5 percent) had a job than at the same time last year. The rise in employment chiefly reflects an increase in regular jobs **subject to social security contributions**.

German labour market*



■ Difference in the number of workers making social security contributions from the same month last year (right axis)

*seasonally adjusted, in million

Source: Federal Employment Agency



According to the latest projections by the German Federal Employment Agency, in May 2016 (latest available data) 31.21 million people were employed in such jobs. That is 672,000 or 2.2 percent more people than last year. The number of jobs rose across nearly all sectors. The largest absolute increases were in healthcare/social services, with 111,000 (5.3 percent) more jobs. There were 77,000 new jobs in other business services (up 5.9 percent), 65,000 in wholesale and retail (up 1.5 percent), and 57,000 in skilled corporate services (up 5.9 percent). Employment declined minimally (down 4,000 or 0.6 percent) in mining, energy and water supply and waste management and in financial and insurance service providers (down 6,000 or 0.6 percent). Employment in other categories declined versus the previous year. The number of **self-employed** (including contributing family workers) decreased by 41,000 or 0.9 percent in the first quarter to 4.31 million. Preliminary calculations by the Federal Employment Agency (BA) show that the number of **individuals exclusively employed in low-paid jobs** dropped in March 2016 by 54,000 or 1.1 percent to 4.78 million. This decline was probably a consequence of the introduction of a statutory minimum wage. In May 2016, 2.66 million people were registered as unemployed with the Federal Employment Agency – almost 98,000 fewer than in the same month last year. The **unemployment rate** declined by 0.3 percentage points to six percent.

Industry

Industry receives more orders

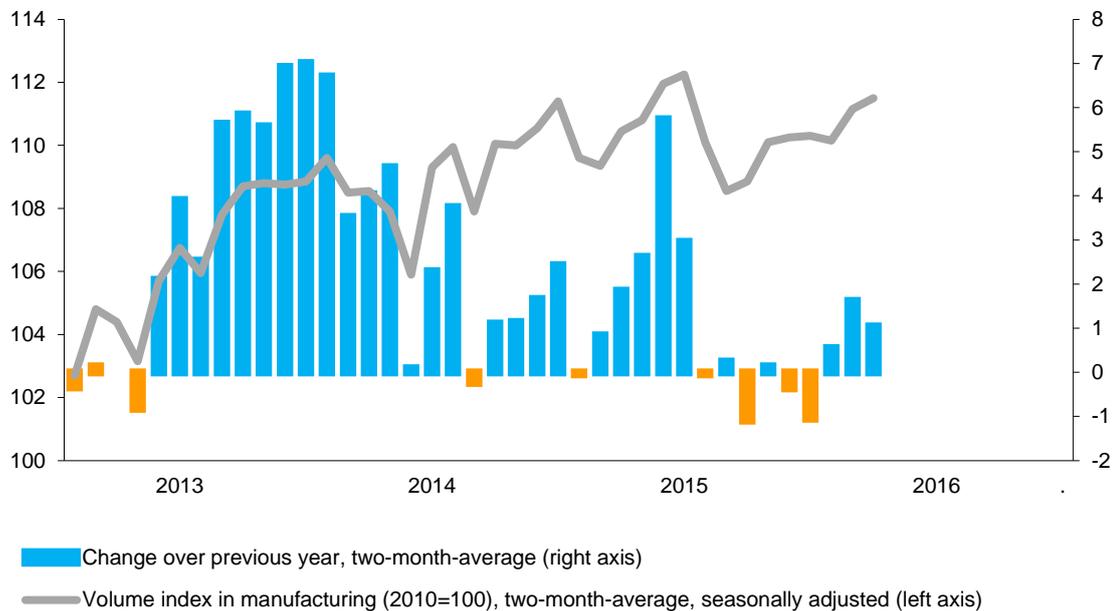
According to preliminary figures, **incoming orders** in the German industrial sector rose by 1.9 percent from February to March 2016 after inflation, calendar and seasonal adjustments. That was the biggest increase since June 2015. In February, incoming orders had dropped by 0.8 percent following an upwards revision. The volume of large orders in March was slightly above average. Domestic orders were 1.2 percent lower, while orders from abroad rose sharply (4.3 percent), particularly those from non-EU countries (up 6.2 percent). Countries in the euro area ordered just 1.1 percent more industrial goods.

A **two-month comparison**, which smooths out volatility, shows an improvement of 0.4 percent for orders from December 2015/January 2016 to February/March 2016. There was a slight upward trend in incoming orders; since the new year the figure has again been consistently higher than last year. While domestic orders have been declining slightly for the past three months and are not able to keep up with last year's level, demand from abroad has been very stable. For five months now, foreign orders have risen continuously versus the same period last year and are now much higher.

Among the main groups of industrial goods, producers of **intermediate goods** experienced no change in the two-month comparison from December 2015/January 2016 to February/March 2016. Foreign demand did decline for the third consecutive month, most recently by 0.2 percent, but domestic orders for intermediate goods rose for the first time in two months.

For the fifth time in a row, a two-month comparison revealed an increase in demand for **capital goods** and accompanying higher growth rates. Towards the end of 2015, demand for capital goods was particularly high among domestic companies, but since December 2015, most orders have come from abroad. Most recently, orders from abroad were 2.4 percent higher than in the previous period.

New orders, manufacturing



Source: Federal Statistical Office



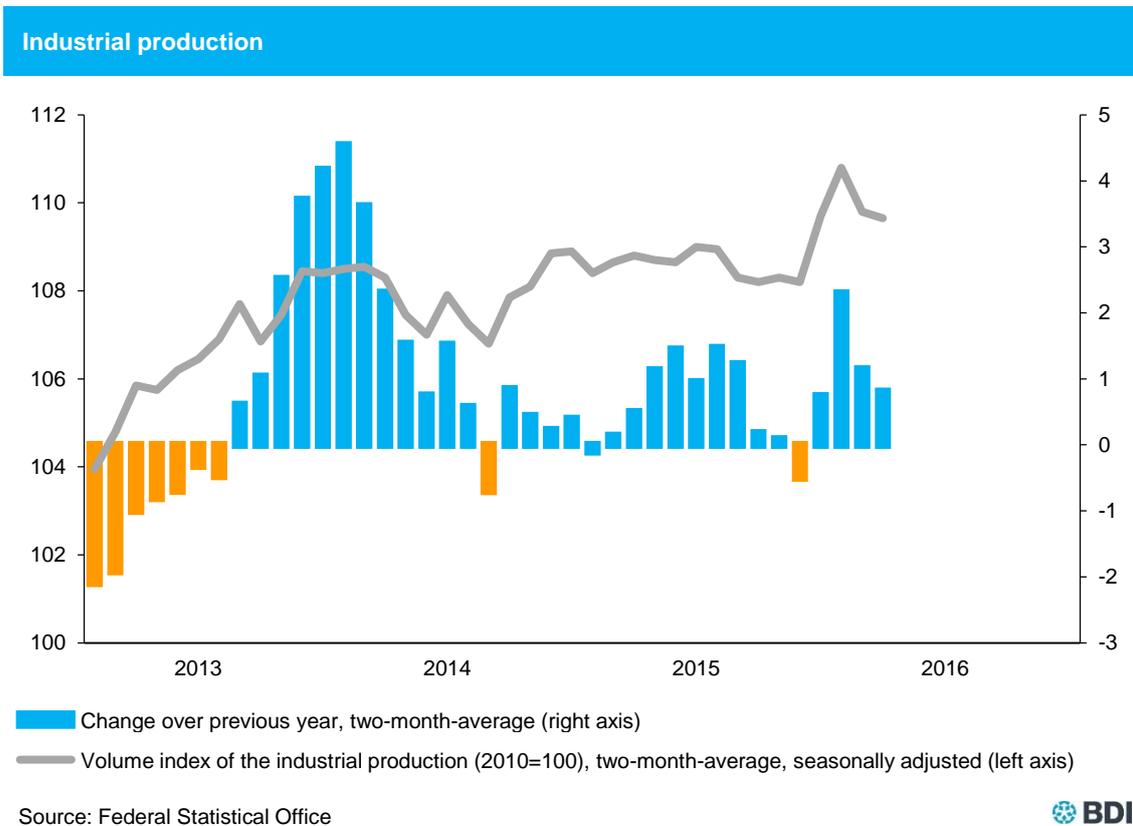
When it comes to **makers of consumer goods**, however, a two-month comparison from December 2015/January 2016 to February/March 2016 shows a sharp decline. For the second time in a row, domestic orders fell slightly. After five months of strong growth averaging 5 percent, orders from abroad declined substantially (down 5.9 percent). However, the index of new orders remains above last year's level.

The German industrial sector started this year with a gain in new orders. Given the difficult foreign trade environment, the robust rise in orders from abroad was a pleasant surprise. The weak phase in the second half of last year should soon be overcome, and this is already leading to improved business expectations for companies.

Impressive production increase in the first quarter despite current weaknesses

Preliminary figures show that **production in manufacturing** slipped 1.3 percent from February to March 2016 after inflation, calendar and seasonal adjustments. The February figure was revised downward to 0.7 percent. **Energy production** expanded by 0.3 percent, according to the most recent data. **Production in the construction sector** declined by 3.2 percent in March following previous production increases due to the mild winter, while **industrial production** decreased in all the main manufacturing sectors. Producers of intermediate and capital goods reduced production by 1.2 and 1.3 percent respectively. Consumer goods production was slightly lower than in February 2016; overall, industrial production dropped 1.2 percent from February to March.

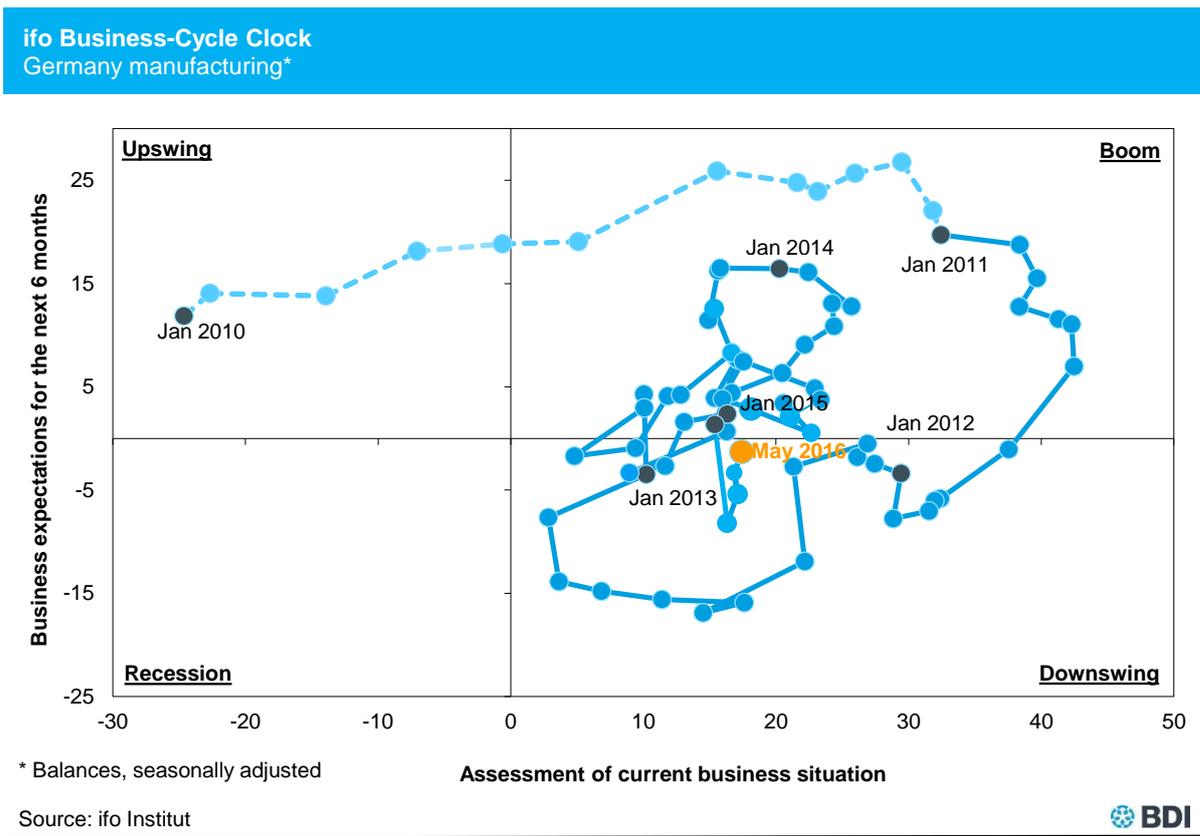
A **two-month comparison**, which smooths out volatility, shows that production in manufacturing retained the same level of production between February and March. The **construction sector** benefited from the mild weather and expanded production by almost 2 percent. Output in **industrial production** did not change between the periods December 2015/January 2016 and February/March 2016. For the third time in a row, the two-month comparison exceeded the previous year's level. The producers of intermediate goods in the **main manufacturing sectors** upped their production by 0.2 percent. Makers of consumer goods produced 0.1 percent more goods. Capital goods production, on the other hand, declined slightly, by 0.3 percent.



The German industrial sector started this year well. In the first quarter of 2016 it was able to expand production by almost two percent year-on-year (after calendar and seasonal adjustments). Although dynamic growth is not expected in industrial production this year, there are many signs that this year's production level is likely to be slightly higher than last year's. The poor showing in incoming orders for industry since the second half of 2015 seems to be behind us. In the first three months of this year, industrial companies received one percent more orders than last year. After six months' decline in the number of orders from abroad, foreign demand recently experienced growth. In the euro area, in particular, there was much greater demand for industrial goods. A look at the sentiment indicators suggests that an increase in production is on its way. For example, the Purchasing Managers' Index for German industry rose a little more than one point. Given the economic developments in German industry's key export markets and the export estimates for the industrial sectors that primarily export goods abroad, it seems likely that average industrial production figures for 2016 will be 0.75 percent higher than last year (BDI 2016a).

Industrial capacity utilisation remains high

The increase in production led to an appreciable rise in capacity utilisation. In the first quarter of 2016, industrial capacity utilisation (not including food and beverage production and tobacco processing) increased by 0.8 per cent. That is the highest level since 2013. In the second quarter, capacity utilisation dipped slightly, but at 85.3 percent, capacity is still being utilised 1.3 percent more than the long-term average. A majority of companies believe their capacities are still more than sufficient to meet demand over the next twelve months. At an average of 2.9 months, industry's current order backlog is already higher than the annual average for 2015 for the second consecutive quarter.



Business climate continues to improve

The mood in all four leading trade and industry sectors improved in May 2016. For the first time in three months, most companies are taking an optimistic view of the future. After a decline in April, the wholesale and retail Business Climate Index rose again in May. Overall expectations and assessments of the situation have improved. The construction Business Climate Index reached its highest level since 1991. As well as positively assessing the current situation, the companies surveyed also reported that they have a more optimistic view of the future. In the manufacturing sector, the business climate improved for the third time in a row. This positive attitude derives from the primarily positive assessment of the current business situation that has been manifesting itself in increases in industrial production in the past few months. In general, there was a drop in the ifo Business Climate Index only when industry's business expectations declined. Although most of the companies surveyed were cautious in their business expectations, the number of pessimists has certainly decreased.

Outlook

A positive start to the year raises hopes

The German economy started the year with a bound. It seems set to experience robust demand and employment levels for the rest of the year. This will be most apparent in positive developments in the service sector, particularly in information and communications and in finance. The manufacturing sector, on the other hand, increased by just 0.7 percent in real terms compared to the previous year. However, since our last assessment at the beginning of the year, things are not looking so good for foreign trade. On the basis of data recorded in October 2015, we can only expect the global economy to move sideways and can no longer count on any further recovery. The global financial markets' massive corrections in their expectations at the start of this year already priced in the expected weak developments (BDI 2016b). Of course, this has major consequences for economic forecasts.

In the upcoming months, economic development in Germany will primarily be determined by domestic factors. **Consumer spending** seems likely to rise **2.3 percent** this year. Bolstered by unbridled employment growth, better pay in leading sectors of almost 2.5 percent, and low inflationary pressure, **private consumption** will remain the driving force behind these developments. The pension increases from summer 2016 of a little over four percent in the western Länder and around five percent in the eastern Länder should also boost consumption. Disposable income looks set to grow by around three percent. All in all, **private consumer spending** should increase by **two percent** this year. We are sticking by our forecast. Demand should also receive a boost from the **public sector**, which is responsible for a good quarter of consumer spending. **Public sector spending** is expected to rise by **3.2 percent**, following an increase of 2.8 percent last year. Important factors in this regard are increased social security payments and, in particular, greater spending on refugees. It is still difficult to gain a proper overview of the situation, but total spending on refugees by all regional authorities is likely to be something over 20 billion euros. We are upping our forecast in this area by 0.2 percentage points.

This year, we expect a moderate upturn of **2.4 percent** in **investment activity** (gross fixed capital formation) and are slightly lowering our expectations. After the considerable inventory effects last year (minus 0.5 percent), this year we are expecting a neutral effect from a change in inventories. Developments in **construction investments** were primarily positive. The prospects for housing construction remain good. Public sector construction should also step up somewhat. However, the outlook for commercial construction is more chequered, because German companies have little scope for investing in new buildings. This year we envisage an overall increase in construction investments of around **2.5 percent**. Following the mild spring, we have slightly raised our estimate, which was previously 2.3 percent. It is much more difficult to assess developments in **capital equipment spending**. Given the murky prospects for foreign trade, we anticipate a loss of momentum. After the powerful growth of the past two years (2014: up 4.5 percent; 2015: up 3.6 percent), we predict growth of just **2.3 percent**. We consider this a very cautious estimate and believe that there is certainly scope for improvement in investments in both equipment and construction. Alongside foreign trade developments, which are so difficult to predict, investments in expansion are likely to increase slightly due to the historically high level of capacity utilisation. **Expenditure on other assets** (software, R&D) has generally been experiencing fluctuations and seems likely to rise by **2.4 percent** (2015: 2.7 percent). The first quarter was below trend, but this is likely to recover.

The prospects for **foreign trade** have dimmed considerably over the course of this year so far. Downgrades for global economy, global trade, industrial production, the economies of key neighbouring countries, and the slight real appreciation of the euro (instead of the slight devaluation expected at the start of the year) have all contributed to a situation that will keep growth in check, particularly **export growth**. In our recent "bottom up" analysis of industrial production and the export of German goods, we forecasted an increase in production of 0.75 percent and nominal growth in exports of two percent year-on-year (BDI 2016a). We expect **real exports of goods and services** to rise **2.2 percent** over last year's figure. In the first quarter, that figure was only up 1.5 percent over last year. A certain degree of invigoration is expected in the second half of the year.

Thanks to powerful consumer spending, **real imports of goods and services** will be higher than exports. However, given the significantly downgraded export prospects, imports will increase more modestly than had been assumed at the start of the year. We are correcting that prediction and now expect growth of **3.7 percent** over last year. In the first quarter, that value was 3.1 percent more than last year.

BDI forecast for 2016 and comparison: real economic output, change over previous year

	BDI	Federal Government	European Commission
GDP, real	1.7	1.7	1.6
Consumption	2.3	-	-
- Private Consumption	2.0	1.9	2.0
- Public Consumption	3.2	3.5	2.9
Investment	2.4	2.3	2.5
- Construction	2.5	2.3	-
- Machinery and Equipment	2.3	2.2	1.8
- Other	2.4	2.5	-
Exports	2.1	3.2	2.3
Imports	3.7	4.8	4.4
Net Exports, economic output	-0.6	-0.4	-0.6

Sources: Federal Government, European Commission (May 2016), own calculations



At current prices, **net exports** (exports minus imports) of goods and services will probably decline by around ten million euros compared to last year. In general, the decline in the import price, currently down five percent from last year's figure, is likely to lead to an appreciable difference between current prices and real terms. This will very probably result in **net exports** making a negative contribution to growth; we envisage a reduction of **0.6 percent**. However, there is a great deal of uncertainty surrounding this figure. Market estimates fluctuate between minus one percent and almost zero.

Given the numerous corrections in various areas, we are adjusting our assessment for the year slightly downwards (1.9 percent) from the figure we gave at the start of the year. Overall, this year's real economic output is likely to be 1.7 percent higher than last year. After a bullish start to the year in the first quarter, we expect the second quarter to proceed in a somewhat more subdued manner. But the German economy seems likely to recover its normal pace in the second half of the year, if there are no nasty surprises. The main short-term risk is that of the British people voting to leave the European Union (BDI 2016b)

Sources

BDI (2016a). Industry Report. Berlin. April.

---(2016b). Global Growth Outlook. Berlin. June.

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Basic data for national accounts

GDP (price, seasonally and calendar adjusted) Change over previous period, in percent

	2014	2015	2015				2016
			Q1	Q2	Q3	Q4	Q1
Consumption	1.1	2.1	0.4	0.3	0.7	0.5	0.4
- Private Consumption	0.9	1.9	0.3	0.1	0.8	0.4	0.4
- Public Consumption	1.7	2.8	0.7	0.7	0.7	0.9	0.5
Investment	3.5	1.7	1.5	-0.5	0.1	1.4	1.8
- Machinery and Equipment	4.5	3.6	1.9	0.6	0.2	1.0	1.9
- Construction	2.9	0.2	1.4	-1.7	-0.3	2.0	2.3
- Other	3.1	2.7	0.7	0.6	0.7	0.7	0.2
Domestic Demand	1.3	1.6	0.6	-0.2	0.6	0.9	0.8
Exports	4.0	5.4	1.5	1.8	0.3	-0.6	1.0
Imports	3.7	5.7	2.2	0.6	1.1	0.5	1.4
Total	1.6	1.5	0.4	0.4	0.3	0.3	0.7

Contribution to growth (in percentage points)

Consumption	0.9	1.6	0.3	0.2	0.6	0.4	0.3
- Private Consumption	0.5	1.0	0.2	0.1	0.4	0.2	0.2
- Public Consumption	0.3	0.5	0.1	0.1	0.1	0.2	0.1
Investment	0.7	0.3	0.3	-0.1	0.0	0.3	0.4
- Machinery and Equipment	0.3	0.2	0.1	0.0	0.0	0.1	0.1
- Construction	0.3	0.0	0.1	-0.2	0.0	0.2	0.2
- Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Demand	1.2	1.5	0.6	-0.2	0.6	0.8	0.8
Net Exports	0.4	0.2	-0.2	0.6	-0.3	-0.5	-0.1

Source: Destatis