BDI
The Voice of German Industry

QUARTERLY REPORT GERMANY

German economy losing steam.

Good performance in 2016 not at risk.

Quarter IV / 2016

- **Despite a slowdown in the rate of growth during the course of the year, we still believe that our growth forecast of 1.9 percent for real GDP in Germany this year is realistic.**
- **The German economy continued to grow, though at a slower pace.** Third-quarter GDP increased by 0.2 percent over the previous quarter after inflation, seasonal and calendar adjustments. In **comparison to the previous year**, economic output rose by **1.7 percent** after calendar adjustments, following 1.8 percent in the second quarter.
- **Towards the end of the year, the only factor still driving growth was the domestic economy.** This trend is set to continue in the fourth quarter, making the growth contribution of **consumption expenditure** the key determinant of overall performance.
- **The healthy development in construction investments are the only factor contributing to growth in investment in noncurrent assets.**
- The **trade balance** is set to be slightly negative given the 2.5 percent increase in imports and stagnating exports throughout the year.

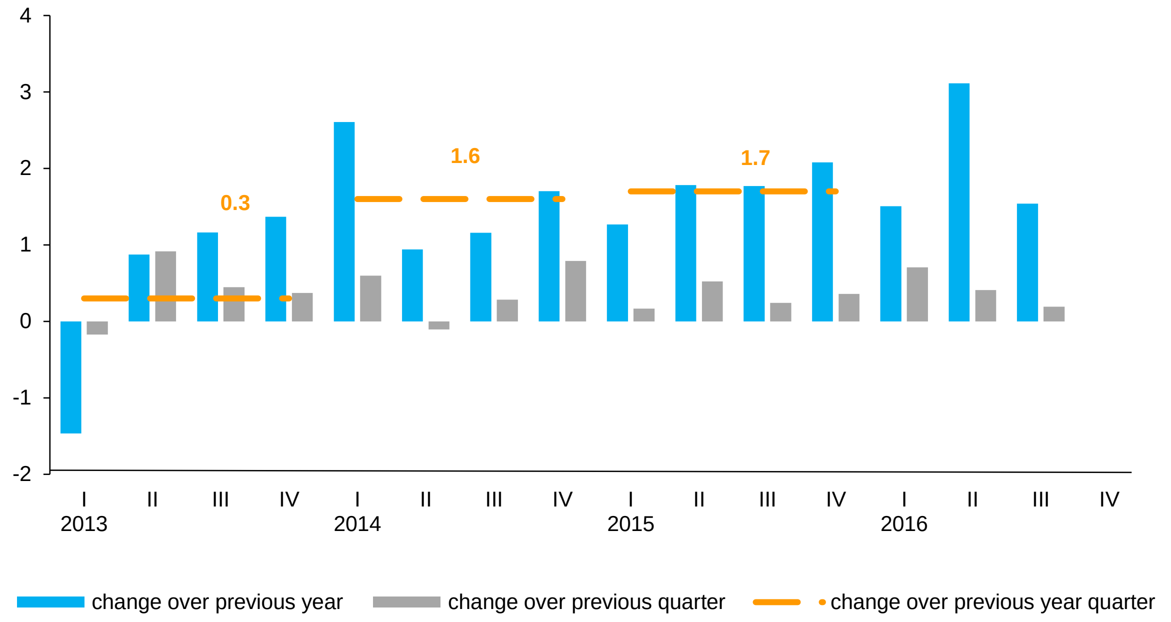
Content

The German economy

German economy losing steam slightly

In the **third quarter**, economic growth tailed off slightly. **Gross domestic product** increased 0.2 percent over the previous quarter after inflation, calendar and seasonal adjustments, after rising 0.4 percent in the second quarter and 0.7 percent in the first quarter of the year. However a year-on-year comparison relativises this slow-down in growth. In year-on-year terms, third-quarter growth was up by 1.5 percent. When adjusted for calendar effects, output grew by 1.7 percent, following an increase of 1.8 percent in the second quarter. According to preliminary data, the third-quarter economic output was generated by a workforce of 43.7 million people. That is 388,000 more people or a 0.9 percent increase year-on-year.

Growth in real GDP, quarterly basis in percent



Source: Federal Statistical Office

On the production side of GDP, gross value added increased in the third quarter in all economic sectors compared with the previous year. The strongest growth was recorded by the information and communications sector with an increase in gross value added of 2.9 percent alongside a slight increase in employment. Financial and insurance service providers, in contrast, while achieving higher value added of 2.5 percent, recorded job cuts of 18,000 employees. Sectors where value added increased along with new jobs were public services, education and healthcare (up 197,000 employees), corporate services (up 123,000 employees) and trade, transport and hospitality (up 94,000 employees). In the production and manufacturing sectors, employment decreased for the first time in three years despite increasing its output.

On the expenditure side, GDP was again driven by consumption. Private households spent 0.2 percent more than in the previous quarter after price, season and calendar adjustments. Public sector spending increased by one percent. This amounts to an increase in **consumption expenditure** of 0.6 percent overall. Taken as a whole, **investment activity** stagnated in the third quarter, after recording a decrease in the previous quarter. Increased investment in **construction** (up 0.3 percent) and in **other assets** (up 0.6 percent) compensated for the weak **capital expenditure on equipment** (down 0.6 percent). Overall, the domestic economy thus contributed 0.5 percentage points to growth. The **trade balance**, on the other hand, pulled GDP growth down. Exports slipped down 0.4 percent over the previous quarter after season and calendar adjustments. Imports increased by 0.2 percent over the same period resulting in a negative contribution to growth of 0.3 percentage points.

Foreign trade: stagnating exports and flagging imports

In the third quarter 2016, **exports** of goods and services dropped year-on-year (country-specific seasonally adjusted data not available) by a total of 1.09 billion euros or 0.4 percent. Exports to countries outside the euro area registered particularly strong fluctuations. Exports to China increased by 1.49 billion euros or 8.4 percent. Exports to Switzerland (up 752 million euros) and to Japan (up 450 million euros) also recorded clear increases. Also pointing upwards were exports to the eastern European EU member countries Romania, Poland and Hungary. Within the euro area, exports to Italy increased by 853 million euros or 6.1 percent and to Belgium by 412 million euros or 4.2 percent. Exports to the United States, on the other hand, dropped markedly by 3.04 billion euros or 10.3 percent as did exports to the United Kingdom which were down 1.07 billion euros or 4.7 percent. The slump in exports to Saudi Arabia (down 823 million euros) and the United Arab Emirates (down 1.26 billion euros) which amounts to more than 30 percent in each case is accounted for by the decrease in oil prices.

Imports from Romania, the Czech Republic, Hungary, Austria and Poland increased overall by a remarkable two billion euros. The strongest nominal growth in imports was recorded in trade with Switzerland (up 705 billion euros or 7.1 percent) and Japan (up 689 billion euros or 14 percent). Imports from Italy increased by 647 million euros or 5.3 percent. Imports from raw material countries, including the Netherlands (down 1.74 billion euros or 7.8 percent), Russia (down 658 million euros or nine percent) and Norway (minus 440 million euros or 11.4 percent), all registered clear decreases. Imports from the United Kingdom (down 990 million euros), the United States (down 945 million euros) and China (down 881 million euros) were also down year-on-year.

The most recent figures show exports dropping by 4.1 percent in October 2016 compared to October 2016. The drop in imports was less marked, only falling by 2.2 percent. In the first ten months of this year, Germany still exported 0.3 percent more goods and services than in the same period last year. Exports to EU countries that are not in the euro area showed above-average growth, increasing 2.7 percent. Exports to euro area countries were 1.1 percent higher than one year ago. Exports to non-EU countries dropped by 1.7 percent. Imports were just below last year’s figures. In the first ten months of this year, Germany imported 0.5 percent fewer goods and services overall compared with last year. Non-EU imports rose by 0.9 percent, due largely to increased imports from EU countries outside of the euro area. In the same period, imports from non-EU countries dropped 3.1 percent.

Development of exports and imports in selected countries in Q3 2016
Year-onyear change

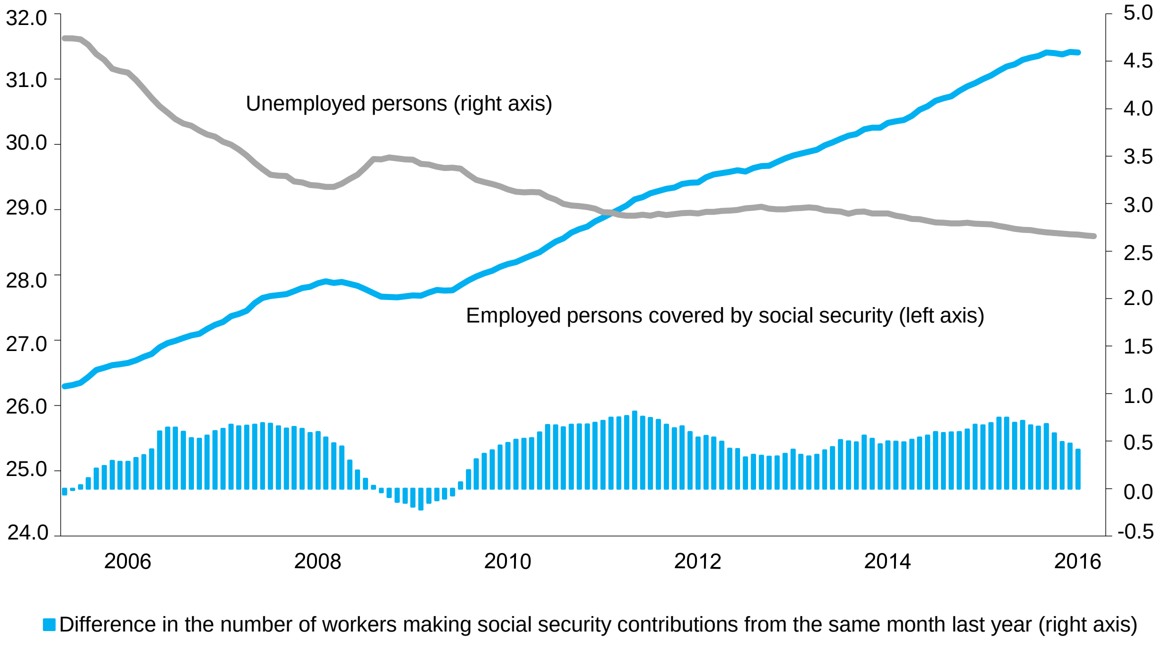
increase (+) or decrease (-) in exports				increase (+) or decrease (-) in imports			
	in million euros		in %		in million euros		in %
China	19 252	+ 1 487	+ 8.4	Switzerland	10 676	+ 705	+ 7.1
Italy	14 742	+ 853	+ 6.1	Japan	5 614	+ 689	+ 14.0
Switzerland	12 808	+ 752	+ 6.2	Italy	12 800	+ 647	+ 5.3
Japan	4 836	+ 450	+ 10.3	Romania	3 264	+ 504	+ 18.2
Belgium	10 115	+ 412	+ 4.2	Czech Republik	10 158	+ 472	+ 4.9
Romania	3 466	+ 328	+ 10.5	Hungary	6 260	+ 352	+ 6.0
Sweden	5 846	+ 307	+ 5.5	Austria	9 772	+ 336	+ 3.6
Russia	6 011	+ 257	+ 4.5	Poland	11 613	+ 327	+ 2.9
Poland	13 521	+ 225	+ 1.7				
Hungary	5 773	+ 224	+ 4.0	France	15 421	- 320	- 2.0
				Finland	2 230	- 342	- 13.3
Brazil	2 175	- 372	- 14.6	Norway	3 412	- 440	- 11.4
Netherlands	19 665	- 503	- 2.5	Russia	6 681	- 658	- 9.0
Saudi-Arabia	1 636	- 823	- 33.5	China	23 389	- 881	- 3.6
UK	21 546	- 1 068	- 4.7	USA	14 326	- 945	- 6.2
U. A. Emirates	2 896	- 1 258	- 30.3	UK	8 623	- 990	- 10.3
USA	26 550	- 3 036	- 10.3	Netherlands	20 670	- 1 744	- 7.8
Total	**297 600**	**- 1 088**	**- 0.4**	**Total**	**235 353**	**- 464**	**- 1.3**

Source: Federal Statistical Office

Labour market: Employment gains only in services

According to preliminary data from the German Federal Statistical Office, the **number of employed** rose to 43.84 million individuals in October 2016. This means that around 348,000 more people (or 0.8 percent) had a job than at the same time last year. The number of employees in **regular jobs subject to social security contributions** has risen further. According to the latest projections by the German Federal Employment Agency, in September 2016 (latest available data) a total of 31.74 million people were employed in such jobs. That is 407,000 or 1.3 percent more people than one year before.

German labour market*



*seasonally adjusted in million

Source: Federal Employment Agency

Broken down according to industry, employment gains were primarily seen in the service sector. The largest absolute increases were in nursing and social services, with 92,900 (4.3 percent) more jobs compared to last year. Other business services created 61,000 (up 4.4 percent) new jobs and skilled corporate services 54,700 new jobs (up 2.4 percent). Another 100,000 jobs were created overall in healthcare, childcare and education, and in public administration. Notable decreases in employment were registered by financial and insurance service (down 26,000 or 2.6 percent) and in the metals and electrical industries (including steel) with 14,000 or 0.3 percent less jobs. Employment in other categories largely declined versus the previous year. The number of **self-employed** (including contributing family workers) decreased by 30,000 or 0.7 percent in the third quarter to 4.32 million. Preliminary calculations by the Federal Employment Agency (BA) indicate that the number of **individuals exclusively employed in low-paid jobs** dropped in September 2016 by 42,000 or 0.9 percent to 4.77 million. In November 2016, 2.53 million people were registered as unemployed with the Federal Employment Agency (BA) – slightly over 100,000 people or 3.8 percent fewer than in the same month last year. The **unemployment rate** in November 2016, according to the Federal Employment Agency's figures, was at 6.1 percent, which corresponds to an ILO unemployment rate of 4.1 percent.

Industrial activity

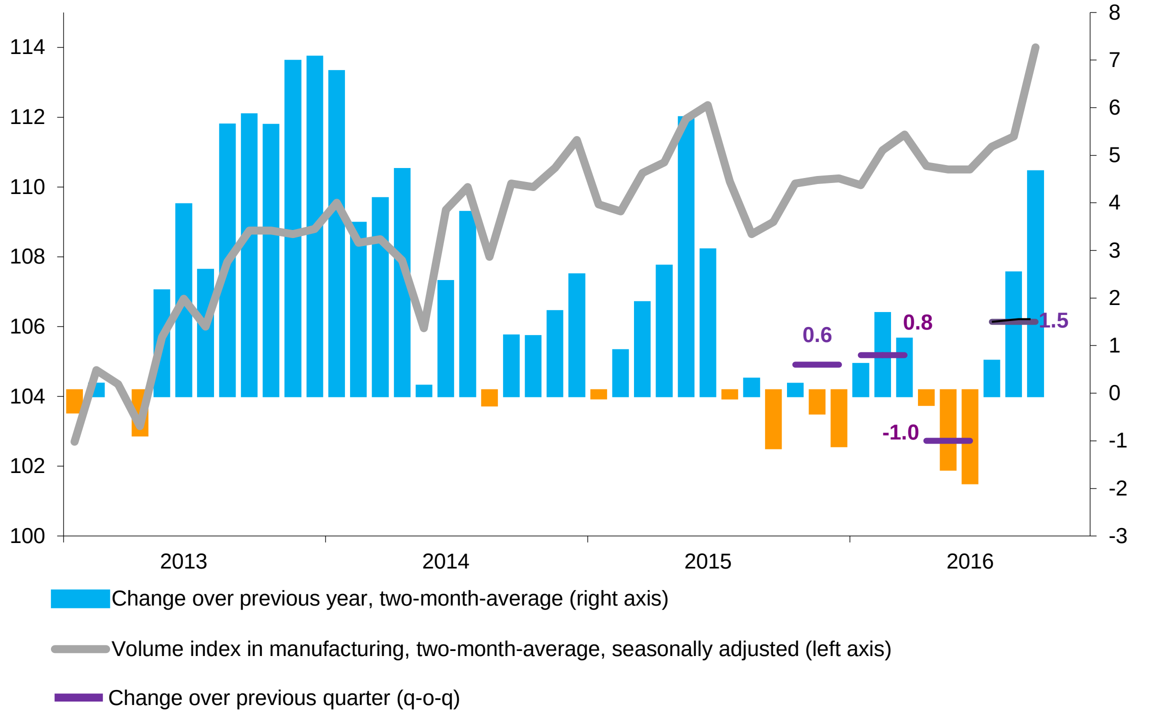
Industry receives substantially more orders in October

According to preliminary figures, **incoming orders** in the German industrial sector rose 4.9 percent month on month after inflation, calendar and seasonal adjustments. Incoming orders in September had dropped by 0.3 percent following an upwards revision. Even excluding large orders, incoming orders for manufacturing recorded a healthy increase in orders in October. Domestic orders experienced their largest increase in four years, surging up 6.3 percent. Orders from abroad increased 3.9 percent, with the greatest dynamics largely coming from countries outside of the euro area (up 6.3 percent). In contrast, demand from within the euro area stagnated.

The two-month comparison, which smooths out volatility, shows a 2.6 percent rise for the period September/October 2016 compared with July/August 2016 in incoming orders. The order volume increased for the third consecutive month both compared with the previous period and compared with the previous year. Judging by the trend in incoming orders, the weak period seen during the summer should be over by the beginning of the fourth quarter.

Among the main groups of industrial goods, producers of **intermediate goods** saw an increase of 2.7 percent in incoming orders for the period September/October 2016 compared with July/August 2016. Domestic orders, up 2.3 percent, did not increase as much as incoming orders from abroad (3.2 percent). Foreign demand stands out particularly in a year-on-year comparison. It has now increased for eight consecutive months, growing by six and seven percent in the last two months.

New orders, manufacturing



Source: Federal Statistical Office

Demand for **capital goods** grew for the fourth time in succession, with orders increasing by 2.5 percent in the period September/October 2016 compared with July/August. Demand for capital goods was particularly strong among domestic companies (up 4.5 percent). Foreign companies ordered 1.4 percent more capital goods. A year-on-year comparison also shows increased demand for capital goods across the board.

Producers of consumer goods recorded an increase in orders of 2.2 percent in the period September/October 2016 compared with July/August. Domestic orders rose by two percent following four consecutive months of decline. They are now just about level with last year's figures. Foreign orders increased for the fourth time in succession, this time going up by 2.4 percent. This is also the fourth consecutive hike for foreign orders in a year-on-year comparison.

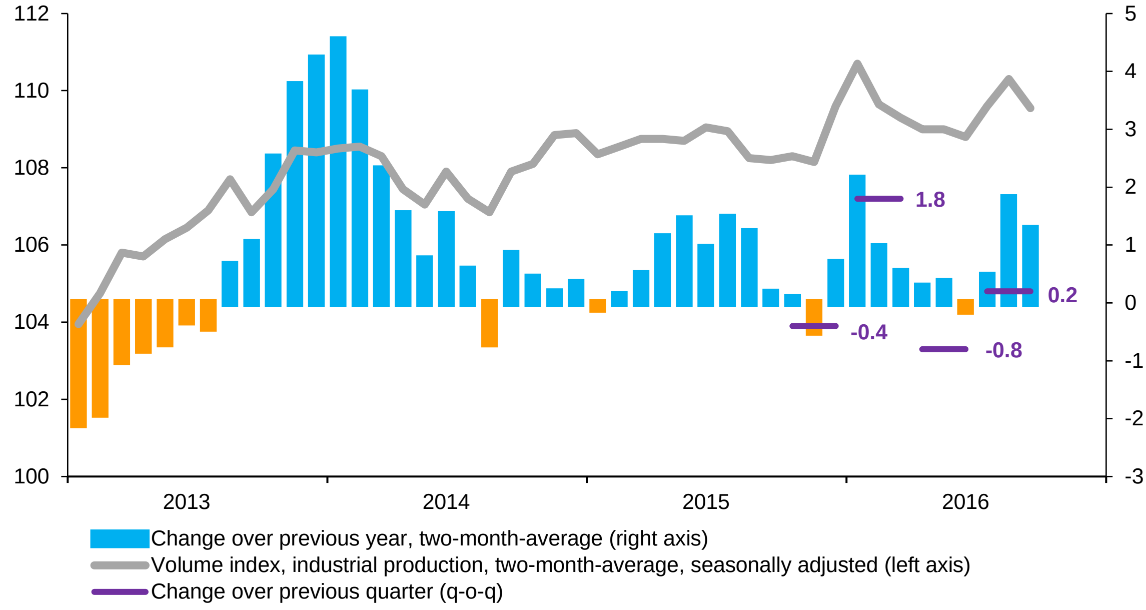
After a very strong start to the year, orders for German industry slowed down considerably during the summer months, due to the difficult external environment. The weak phase seems to have been overcome. For three months in succession now, incoming orders in industry are showing a solid upward trend. If the order volume at the end of the year matches the average of the last three months, industrial companies will have gained just under one percent more orders than last year. Unlike last year, orders from abroad would once again be the driving force behind this development.

Industrial production likely to pick up towards the end of the year

Preliminary figures show that **industrial production** increased 0.3 percent in October 2016 over the previous month after inflation, calendar and seasonal adjustments, following a drop of 1.6 percent in September. **Energy production** contracted by 0.5 percent, according to the most recent data. **Construction activity**, on the other hand, increased by a clear 1.8 percent. Industrial production remained almost level, just nudging up 0.1 percent. Among the main industrial sectors, only the producers of intermediate goods decreased their output (down 0.5 percent). Capital goods producers expanded their production by 0.5 percent. Consumer goods production increased minimally compared to the previous month, edging up 0.1 percent.

The less volatile **two-month comparison** paints a similar picture. Production activity stagnated overall in the production sector, just failing to reach last period's level. **Industrial output**, on the other hand, increased by 0.2 percent in the period September/October 2016 compared with July/August. The two-month comparison shows a 1.5 percent increase compared to the same two-month period in 2016. Among the main industrial sectors, only producers of consumer goods lowered their output slightly, slipping down 0.1 percent. The producers of intermediate goods increased their production by 0.5 percent compared with the same period last year while producers of capital goods registered a 0.2 percent increase. That said, production increased in the last three months in all the main industrial sectors compared with last year.

Industrial production



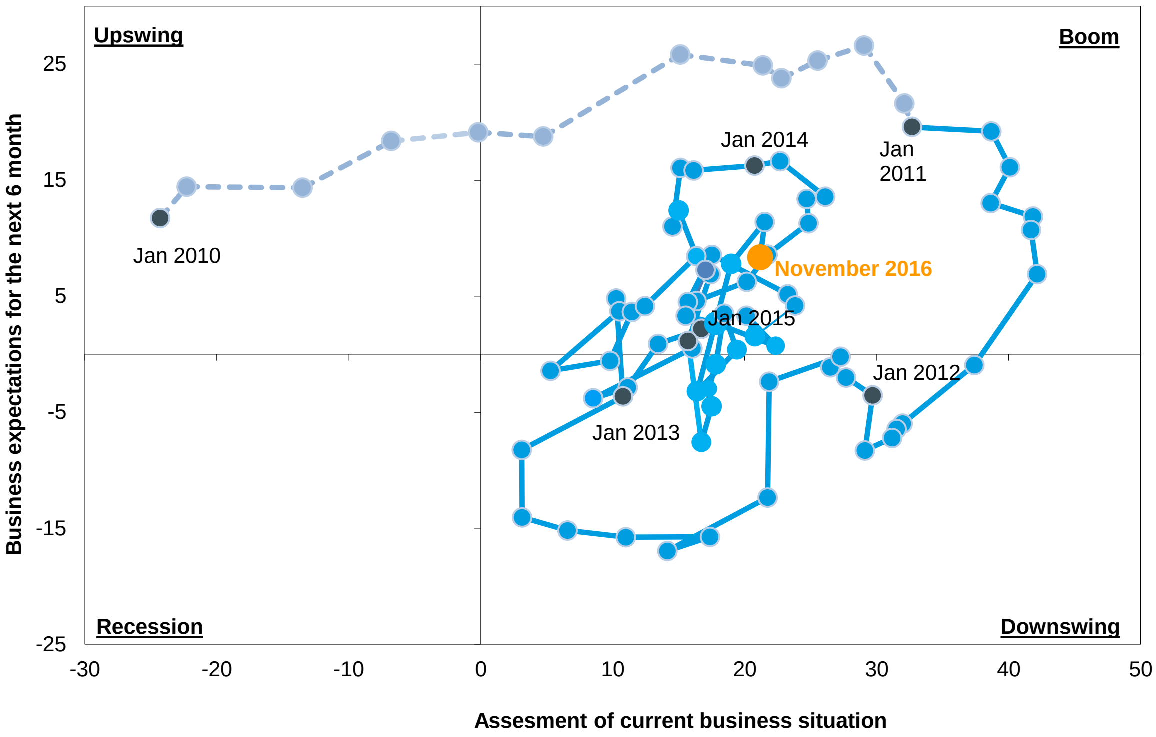
Source: Federal Statistical Office

Industrial activity had not really gathered momentum at the beginning of the fourth quarter. However there are some signs indicating a vigorous pick-up towards the end of the year. These include the upward trend in incoming orders seen recently which should be reflected in an expansion of production in the coming months, and secondly, the Purchasing Managers' Index for German industry is still pointing to an expansion of production as is the Ifo Business Climate Index for manufacturing. Industrial production for the year overall is therefore highly likely to exceed the figures for last year.

Industrial capacity utilisation remains high

Notwithstanding the slight decrease in industrial production at the beginning of the fourth quarter, industrial capacity utilisation (not including food and beverage production and tobacco processing) increased in the fourth quarter 2016, reaching its highest level since the third quarter 2011. At 86.3 percent, capacity is still being utilised 2.3 percentage points more than in the long-term average. The majority of companies believe their capacities are still sufficient to meet demand over the next twelve months. However, the proportion of companies with sufficient capacities has dropped for the third consecutive time. Industry's current order backlog has dropped slightly and is now at an average of just 2.8 months.

ifo Business-Cycle Clock
German manufacturing*



* Balances, seasonally adjusted

Source: ifo Institut

Business climate at year high despite Brexit vote and Trump election

Britain's vote to leave the European Union and the outcome of the presidential election in the United States do not seem to have affected sentiment in German industry. The Ifo Business Climate Index was able to maintain the year's high recorded in October at 110.4 points. The businesses surveyed were again more satisfied with their current business situation, although they are not quite as optimistic about the coming months as they were previously. Sentiment remains good in almost all industries. Sentiment in wholesale has improved markedly, primarily due to a clear improvement in expectations. Wholesalers are also more satisfied with their current business situation. The business climate in retail also improved, thanks largely to a rosier assessment of the current business situation. Business prospects in retail, on the other hand, have clouded over somewhat. The sentiment indicators point to a continued boom in construction. The business climate in the building industry proper improved for the seventh consecutive time in November, reaching a new record high. The assessment of the current situation and expectations of the future course of business have both brightened considerably. The Business Climate Index in manufacturing, after recording the highest level of the year so far in October, dropped again. The companies assess the current situation as slightly worse and are also not quite as optimistic about the future course of business, largely due to deflated export prospects.

Outlook

Following a strong start to the year, the growth rate of the German economy has decreased steadily. In recent months, the only factor still driving growth was the domestic economy. This trend is set to continue in the fourth quarter, making the growth contribution of consumption expenditure the key determinant of overall performance. Investments should make a small contribution to growth though only on account of the good performance of the construction industry. The trade balance is set to be slightly negative given the increase in imports.

Consumption expenditure should experience substantial growth of 2.8 percent year-on-year in real terms after calendar and seasonal adjustments. Private consumption is being buoyed by further employment gains, higher incomes and higher social benefits. The consumer climate index tracked by consumer research organisation GfK has stabilised on a high level. The stable employment situation is the major contributor to keeping consumer confidence stable. Based on the trend seen so far this year, private consumption spending should increase in 2016 overall by 2.2 percent.

The public sector is continuing to boost demand particularly with increases in social benefits and expenditure for provisions for refugees. We expect **public sector spending** to increase slightly more than so far and, based on the growth seen in the first three quarters, now believe that an annual growth of 4.3 percent is plausible.

We do not expect to see much impetus coming from gross **fixed capital formation** this year, although it should reach 2.5 percent despite the weak period in the middle of the year. Investment in equipment (excluding inventories) could also pick up slightly towards the end of the year, following its weak performance during the summer. The producers of capital goods are again recording more domestic orders than in the summer months. An increase of 1.6 percent seems within reach based on the performance throughout the year so far. Construction investments should however reach well above previous year's levels in the further course of the year. The low interest rate, the high availability of residential property loans and the high rate of employment are all factors that point towards a clear growth of investments in private residential construction. We are expecting an increase here of four percent compared with last year. Public sector construction should also grow this year, in contrast to last year, in view of the work needed on infrastructure, to increase nursery capacities and the increased federal funds for construction investment. Non-residential construction is set to stay on a low level, but we are not anticipating a decline. We are expecting an overall increase this year in construction investments of around 2.9 percent.

Despite the difficult external environment this year due to numerous political crises and several specific problems in large emerging countries, the negative impact on foreign trade is likely to be moderate. German **exports** even increased slightly in the first ten months of this year. In view of the somewhat improved export prospects reported in industry recently, it now seems more likely that the overall annual result will be slightly in the black rather than slightly in the red. Strong domestic demand has led to a considerable increase in **imports** over the course of the year. But in the second half of the year, the rate of growth in imports slowed down considerably. Based on the national economic data available so far, we expect an increase in imports for the year 2016 of 2.5 percent which means that foreign trade will pull down economic growth slightly. All in all, we maintain the GDP forecast we made in autumn of 1.9 percent growth for 2016.

Imprint

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Basic data for national accounts

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

			2015		2016		
	2014	2015	Q3	Q4	Q1	Q2	Q3
Consumption	1.0	2.2	0.6	0.6	0.8	0.5	0.6
-Private Consumption	0.9	2.0	0.6	0.4	0.6	0.2	0.4
-Public Consumption	1.2	2.7	0.7	1.2	1.1	1.2	1.0
Investment	3.4	1.7	0.1	1.6	1.6	-1.6	0.0
-Machinery and Equipment	5.5	3.7	0.4	1.8	1.1	-2.3	-0.6
-Construction	1.9	0.3	-0.2	1.9	2.3	-1.9	0.3
-Other	4.0	1.9	0.6	0.4	0.9	0.7	0.6
Domestic Demand	1.4	1.6	0.8	1.0	0.7	-0.1	0.5
Exports	4.1	5.2	-0.0	-0.7	1.4	1.2	-0.4
Imports	4.0	5.5	1.1	0.6	1.5	0.1	0.2
Total	1.6	1.7	0.2	0.4	0.7	0.4	0.2

Contribution to growth (in percentage points)

Consumption	0.7	1.6	0.4	0.4	0.6	0.3	0.4
-Private Consumption	0.5	1.1	0.3	0.2	0.3	0.1	0.2
-Public Consumption	0.2	0.5	0.1	0.2	0.2	0.2	0.2
Investment	0.7	0.3	0.0	0.3	0.3	-0.3	0.0
-Machinery and Equipment	0.4	0.2	0.0	0.1	0.1	-0.2	0.0
-Construction	0.2	0.0	0.0	0.2	0.2	-0.2	0.0
-Other	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Domestic Demand	1.3	1.5	0.7	0.9	0.7	-0.1	0.5
Net Exports	0.3	0.2	-0.5	-0.6	0.0	0.5	-0.3

Source: Destatis