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Strong start to the year, subdued outlook

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The German economy's strong start to the year can largly be attributed to economic impulses coming from the domestic economy. However, positive special effects - including the rather mild winter, catch-up car purchases and expansive fiscal measures supportive of private consumption - probably helped beautify the Q1 result. As soon as these expire, the growth dynamics of the German economy could prove to be rather more subdued. As today's ifo and PMI results for the month of May confirm, Germany's export-oriented growth model, which specializes in capital goods, continues to be under pressure in the face of cooling global GDP growth, lingering auto sector problems and growing risks for world trade. There are initial signs that the industrial weakness is slowly spreading to the service sector. Overall, we continue to expect German GDP growth to come in at 1% in 2019.

The GDP breakdown published today shows that the German economy's strong start to the year was primarily driven by positive impulses coming from the domestic economy. Private consumption grew by a whopping 1.2% in real terms – the highest growth rate observed since 2011. Capital expenditure on plant and equipment and construction also grew strongly, by 1.2% and 1.9% respectively. Only government consumption declined slightly (-0.3%). Foreign trade is also likely to have supported GDP growth, thanks to a more dynamic development of exports (1.0%) compared with imports (0.7%).

However, we assume that positive special effects also played a role in beautifying the Q1 result. Construction activity, for example, is likely to have benefited from the relatively mild weather conditions, while private consumption benefited both from car catch-up purchases and expansive fiscal measures supportive of consumption that came into force at the beginning of the year. Once these special effects fade out, the growth dynamics of the German economy could prove once again more subdued.

Today's disappointing ifo and PMI survey results for the month of May, show that Germany's export-oriented growth model, which specializes in capital goods, continues to be under pressure in the face of cooling global GDP growth, lingering auto sector problems and growing risks for world trade. The ifo Business Climate Index again deteriorated by 1.3 points to 97.9. While companies revised their assessment of the current business situation significantly downwards, already weak business expectations for the coming six months remained unchanged. The German PMI for industry, on the other hand, registered at 44.3 points, the second lowest level in seven years. Despite a slight easing in the month of May, industrial production, new export business and incoming orders are still clearly declining. Both economic surveys provide initial indications that the weakness of German industry is slowly beginning to spread to the service sector. Overall, we continue to expect German GDP growth to come in at 1% in 2019.

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