

Germany Business Forecast Report Q2 2014

<https://marketpublishers.com/r/G4DD61B9176EN.html>

Date: February 2014

Pages: 47

Price: US\$ 1,195.00 (Single User License)

ID: G4DD61B9176EN

Abstracts

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Core Views

We remain slightly above consensus on German real GDP growth in 2014, as we expect the incipient recovery to continue over the next few quarters. We believe that more distributive policy proposals by the new coalition government jeopardise much of the fiscal progress made over the last decade. Stronger growth and the long-term nature of these proposals imply limited impact on the current administration's debt and deficit targets, but if implemented would increase the fiscal burden for future generations.

Since Germany's massive current account surpluses are being channelled into unproductive overseas investments we believe the country is squandering its large net savings. This trend will reverse modestly over the next few years, but structural factors will prevent more efficient use of sustained surpluses, to the detriment of Germany's long-term growth potential. **Major Forecast Changes** We have made no major changes to our forecasts this quarter.

Key Risks To Outlook

Our core scenario envisages that the incipient recovery in economic activity is sustained over the next few quarters, as improved manufacturing output feeds through into stronger domestic demand. However, a slowdown in export growth on the back of slumping emerging market demand could choke off this recovery, which would mean our above-consensus growth forecast for 2014 is too optimistic. External (particularly Chinese) demand and euro trajectory also pose threats to Germany's external account and net export outlook.

Our view is for a moderation in demand from China and a slight unwinding of euro strength over the course of 2014, which combined with steadily rising real incomes will lead to a moderation in export growth over the next few quarters. If the euro proves stronger than we currently anticipate and/or Chinese demand falls by more than currently expect, this could see Germany's current account surplus narrow by a much more rapid pace than we currently expect, hurting growth in the process.

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Assertive Foreign Policy: More Rhetoric Than Reality

Germany's recent shift towards more assertive foreign policy is a result of political expediency, growing pressure from the international community and an attempt to improve Franco-German relations. Since the policy lacks support from the domestic electorate and contradicts the government's own fiscal objectives, we believe it will ultimately disappoint Western allies that want Germany to play a larger role in global peacekeeping.

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Regional Outlook

More Eurosceptic Voices Following EU Parliament Election

We expect eurosceptic and populist parties to perform well in the May 22-25 European Parliamentary election, leading to a greater presence of nationalist and pro-withdrawal forces. That said, the pro-EU centre-right European People's Party and centre-left Progressive Alliance of Socialists and Democrats will continue to form the two largest political blocs.

Long-Term Political Outlook

Difficult Decisions Ahead

Although it is one of the most stable countries in the world, Germany must make some difficult political choices over the next 10 years. Some of these, such as how to deal with a rapidly ageing population, can be addressed without threatening political stability, while others, such as re-defining Germany's role in Europe, could prove more destabilising.

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German domestic demand will recover from a poor Q413 in early 2014, despite weaker external demand from emerging markets.

We maintain our above-consensus real GDP growth forecast of 1.9% for this year, but expect growth to slow to a tepid 1.5% by

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Since the global financial crisis a much larger proportion of Germany's massive current account surpluses has been channelled into unproductive overseas investments, implying that the country is squandering its large net savings. While this trend will reverse modestly over the next few years, structural factors will prevent more efficient use of sustained surpluses, to the detriment of Germany's long-term growth potential.

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More distributive policy proposals by Germany's new government jeopardise much of the fiscal progress made over the last decade.

Stronger growth and the long-term nature of these proposals imply limited impact on the current administration's debt and deficit targets, but if implemented would increase the fiscal burden for future generations.

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