

Germany Business Forecast Report Q4 2013

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Abstracts

Core Views

We remain slightly above consensus on German real GDP growth in 2013 and 2014, as we expect economic activity to show further signs of recovery in H213 into next year.

We still believe a grand coalition between Germany's centre-right CDU-CSU and the centre-left Social Democratic Party remains the most likely outcome following the September general election. Under such a government we would expect a slight reduction in the administration's focus on fiscal austerity both at home and for periphery eurozone states, although the change from current policy trajectory would very likely be modest. We expect Germany's current account surplus to peak in 2013, as exports to Asia will be affected by China's painful economic rebalancing, and imports are likely to rise in line with a strong private consumption story.

Major Forecast Changes

We have modestly revised up our current account surplus forecast for 2013 from 6.9% to 7.0%, although still expect the surplus to narrow beyond this year.

Key Risks To Outlook

We see downside risks to our 2013 and 2014 real GDP growth forecasts mainly from external factors, with the outlook for German exports clouded by questions over Asian demand. Although we expect strengthening domestic demand to mitigate the impact of a weaker external climate, exports still comprise more than 50% of GDP, and headline growth could be hit harder than we currently anticipate.

There is a risk that the Free Democratic Party, the junior member of the current

governing coalition, is able to pass the 5% threshold for legislative representation in the upcoming federal elections, in turn threatening our expectations of a grand coalition. The main risk to our fiscal forecasts is that the German economy, particularly private consumption, performs better than we currently anticipate. This would reduce the need for higher levels of fiscal expenditure (either at home or in periphery eurozone states), while boosting fiscal revenue. Weakening labour market indicators suggest to us that this is unlikely to happen over the next 18 months, but beyond 2013 there is a chance that the German consumer will start spending.

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While a grand coalition between the centre-right and centre-left is still the most likely result of Germany's September 22 federal elections, a continuation of the current governing coalition remains a realistic scenario. However, regardless of whether the Free Democrats, the junior coalition members in the current government, can pass the electoral threshold, investors expecting a significant policy shift beyond 2013 will be disappointed.

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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 redefining Germany's role in Europe, could prove more destabilising.

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Germany's current account surplus will peak in 2013, as stronger consumption and dwindling export growth is expected to drive the surplus lower over the next few years. The country will remain a net exporter for many years, but the likelihood of much slower demand in some key export markets will see more local firms choose to focus on serving domestic rather than external demand.

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