

## Germany: Solid growth, fragile politics

Strong final quarter shows German economy is powering ahead



The first estimate of 4Q GDP growth confirmed the strong performance of the German economy in 2017. According to the statistical office, the economy grew by 0.6%, from 0.7% in 3Q. Judging from monthly data, growth in the final quarter of the year was mainly driven by net exports, investment and public consumption. Over the entire year, the economy grew by 2.2% (2.5% when adjusted for working days). This is the strongest annual growth performance since 2011. What is more, of the last 36 quarters, the economy grew in 33, with an average growth rate of 0.5% QoQ. An impressive performance. The strong 4Q performance also means that without any growth in the next four quarters, annual GDP growth in 2018 would come in close to 1%.

### There's still room for more

Looking ahead, the same fundamentals which have supported growth in 2016 and 2017 should still be in place in 2018. The only question is how much additional stimulus low interest rates, the strong labour market and the recent upswing of the entire Eurozone economy can still provide to the mature cycle of the German economy. In our view, still a lot. The German economy still has some upward potential as the output gap is positive but not extraordinary high compared with previous cycles, capacity utilisation is above its historical average but still lower than in 2007 and investments have only started to increase this year. Judging from previous cycles, the economy could continue its current pace for at least one or two more years, without showing signs of overheating.

Obviously, there are also risks to this positive outlook for the German economy, just think of a protectionist wave coming from the US, a sharp appreciation of the euro or renewed political tensions, geopolitically, in the Eurozone or domestically. Interestingly, the last one has clearly moved up on the scale from “remote” to “clear possibility”.

## It's all about politics these days

While the German economy remains solid as a rock and is as exciting as watching a live broadcast from a high-speed train ride, following German politics is currently better than binge viewing tv series like “House of Cards”, “Scandal” and “Madame Secretary”. Since Election Day on 24 September, there has hardly been a single day without interesting and unexpected twists and turns. In this regard, the latest highlight has clearly been the earthquake in the SPD since the presentation of the coalition agreement one week ago.

Yesterday, the era of Martin Schulz ended as he officially stepped down as party chairman, hoping to get SPD party members to discuss the content of the coalition agreement and no longer personnel issues. In our view, financial markets attach a too low probability to a possible “no” from SPD members on another grand coalition. With the new unrest in the party and the long-held scepticism of many party members against joining another coalition with Angela Merkel’s CDU, the outcome of the vote will in our view be extremely close.

## Germany's two faces

These days, Germany clearly shows two different faces: the well-known one of a strong and high-performing economy and the unknown one of fragile politics. It looks as if in the future any German *Schadenfreude* on political chaos in other European countries will be very muted.

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