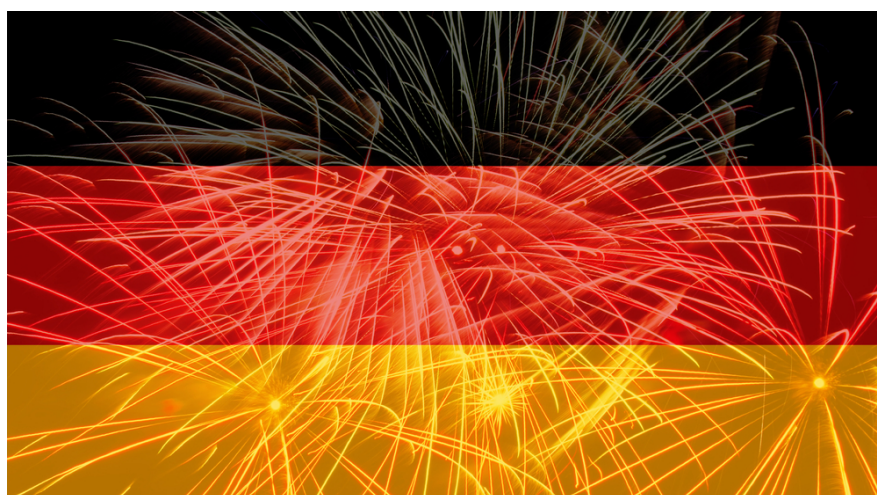


## Germany: The neverending boom

The German economy grew by 2.2% (2.5% when adjusted for working days) in 2017. A strong performance by an economy firing on all cylinders



The German statistical office just continued its strange habit of releasing GDP data for the entire past year before actually publishing fourth quarter data. According to these numbers, German GDP increased by 2.2% in 2017, from 1.9% in 2016. Adjusted for differences in working days, German GDP increased by 2.5%, from 1.9% in 2016. In our view, this outcome suggests that the German economy has probably grown by some 0.5% QoQ in the fourth quarter.

### Exceeding expectations - how come?

Today's GDP data marks the end of a remarkable year for the German economy. A year ago, consensus forecasts for German growth were around 1.5% for 2017. Now, GDP growth is likely to come in at around 2.5%. How could the German (and the Eurozone) economy surprise so positively?

A year ago, the German recovery already looked rather stretched. Sentiment indicators stagnated and political risks were rising from Brexit and the upcoming Dutch and French elections. Meanwhile, the new US administration was fuelling fears of possible trade wars. One year later, the lesson is clear: "it was not politics, but economics, stupid". A real Trump-spirit, strong labour market, low interest rates and low inflation pushed the domestic economy into sixth gear. Also, instead of suffering from protectionism or a Trump trade war, exports surged to new record highs and the long-awaited investment pick-up finally kicked in. The result: the strongest annual growth

performance since 2011. Of the last 35 quarters, the economy grew in 32, with an average growth rate of 0.5% QoQ. An impressive performance.

## Strong growth despite reform complacency

The growth performance is even more impressive given that it has been achieved without any significant structural reforms during the last ten years. In this regard, the German economy is actually a good example of how an economy can benefit extensively from earlier reforms; at least if the external circumstances are right.

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, a relatively weak euro, strong domestic momentum 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, capacity utilisation is above its historical average but still lower than in 2007 and investments have only started to increase this year. At the same time, however, this strong growth performance has led to reform complacency. Under the surface of strong growth, deficiencies in areas like digitalisation, services and education have emerged. The next government still has the unique opportunity to tackle these challenges in good times and not wait until the bad times have started.

## Unique opportunity to bring forward new change in good times

It's not only the economy that is in an excellent starting position, sound public finances are also able to support change. For the first time since the 1950s, the German government recorded a fiscal surplus in four consecutive years. According to the statistical office, the fiscal surplus came in at 38.4bn euro (1.2% GDP) in 2017, from 0.8% GDP in 2016. While German austerity fetishists will love it, these numbers should also whet political parties' appetite for spending and investment. Or put more positively, sound public finances should make finding a compromise in the coalition talks in Berlin a bit easier.

All in all, with today's numbers, the economic year 2017 can almost be filed away. Too much looking in the rear-view mirror brings the risk of being sidetracked and losing sight of hurdles on the road ahead. The next German government should use this unique opportunity for new structural reforms and investments. Otherwise, Germany could soon see that the recent strong growth period was just a last hurrah.

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