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German economy supported by domestic demand as concerns persist over external environment

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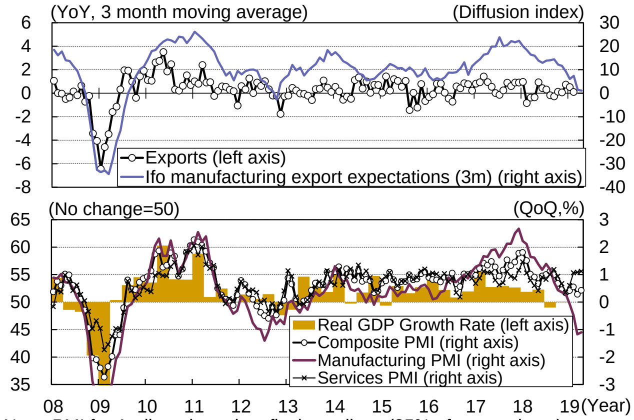
Growth remains modest in the Eurozone economy. Real GDP growth slowed down to around 0.1%-0.2% QoQ in the latter half of 2018. Corporate sentiment has deteriorated since the start of this year, with manufacturing PMIs below the 50 no-change mark (indicating contraction) for the three months to April. It was in this context that on 9 April, the IMF revised its GDP growth forecast for the Eurozone for 2019 to 1.3% YoY, down from January's 1.6% YoY.

The growth forecast for Germany, the largest economy in the region, was revised down by a particularly large margin, from 1.3% YoY in January to 0.8% YoY in March, due to the IMF perceiving that weakness from the latter half of 2018 would carry on into mid-2019. The German government also revised its own growth forecast for 2019 on 17 April from 1.0% YoY to 0.5% YoY. As a backdrop to these revisions to GDP growth forecasts, we can point to the fact that Germany's economy (which is heavily reliant on exports) was particularly vulnerable to deterioration in sentiment linked to the tough export environment. In fact, according to the Ifo, German manufacturers' export expectations for the next three months have fallen to the same level as during the Global Financial Crisis (GFC). This can be viewed as the consequence of events such as the slowdown in the Chinese economy (Chart 1). The Chinese economy is now showing signs of stabilising, but considering other external factors including Brexit and US-China trade tensions, we must be prepared for the risk of a downturn resulting from sluggish external demand.

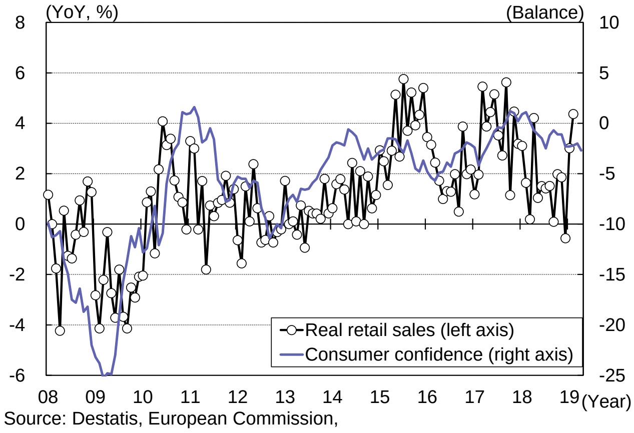
When looking at the German economy, we can't ignore the retail and service sectors, which make up approximately 60% of GDP. Service PMI has improved to a robust level since early 2019, and consumer sentiment remains stable, very different trends than during the GFC (Chart 2). In terms of hard data, real retail sales growth has also recovered from the start of this year. In addition to external factors, we should watch out for a spike in political instability around the European Parliament Elections in May. However we expect the German economy to avoid a slowdown and continue to support growth in the Eurozone on the back of steady domestic demand.

Chart 1: German Exports, Manufacturing Export Expectations, PMI and Real GDP Growth



Note: PMI for April are based on flash readings (85% of respondants)
Source: Destatis, Ifo, IHS Markit, MUFG Bank Economic Research Office

Chart 2: German Real Retail Sales and Consumer Confidence



Source: Destatis, European Commission,
MUFG Bank Economic Research Office

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