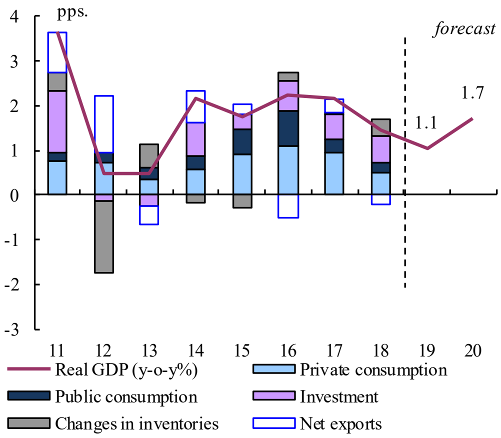
2.5. GERMANY

After averaging 2.1% over the period 2014-2017 Germany's GDP growth slowed to 1.5% in 2018. The slowdown was caused mainly by weakening export growth and growing consumer restraint, particularly in the second half of the year.

Private consumption growth disappointed despite improving labour market conditions, including higher wage growth and record high employment. The slump in private consumption in the second half of 2018 can be traced to the delays in ensuring environmental compliance of new passenger cars. Equipment investment, by contrast, grew vigorously in response to high capacity utilisation rates. The construction sector continued to boom, with confidence at an all-time high in late 2018.

With world trade and global economic growth cooling down this year and next, export growth is unlikely to soon regain the dynamism of 2014-2017. This is also likely to restrain new business investment. Indeed, high frequency indicators point to a continued deterioration in business sentiment in the manufacturing sector, with declining orders and a worsening export outlook. On the other hand, housing investment and private consumption should continue to sustain a moderate upswing helped by the positive developments on the labour market and fiscal measures boosting household incomes. Overall, real GDP growth is expected to cool further to 1.1% in 2019. In 2020, a strong calendar effect should help annual growth to rebound somewhat to 1.7%, though the quarterly dynamics would remain relatively subdued due to further moderation of demand and tightening of labour supply.

Graph 2.5: **Germany - Real GDP growth and contributions**



Downside risks are related to weaker than anticipated growth in foreign trade, muted investment, poorer business and consumer confidence, and slower or weaker take-up of the planned fiscal stimulus. On the other hand, the remarkable strength on the labour market constitutes an upside risk.

Headline inflation picked up to 1.9% in 2018 driven by energy prices, whereas core inflation remained unchanged at 1.5%. Headline inflation is expected to average around 1.5% in 2019-2020, as energy inflation moderates further. Wage growth has been strengthening but would likely moderate again if the outlook remains subdued, which should keep core inflation from rising much further.