Is Europe´s Economic Power House in for a Bumpy Ride?

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There´s no doubt that Germany is a global player, the fourth largest economy in the world, part of the Champions League, competing with the US, China and Japan. Germany regularly challenges China – a much larger economy – for the title "export champion of the world". Investors find Germany highly attractive, and analysts find the economy overall to be highly competitive. Indeed, Germany's record of steady economic growth, low unemployment and social stability have made it Europe's economic power house.

Will Germany continue to enjoy smooth sailing, or is it headed for a bumpy ride?

The case for smooth sailing

There are indeed multiple arguments supporting the idea of continued smooth sailing.

- First, the German budget will be slightly in surplus (officials call this a "black zero"). This should certainly be positive for the economy. Unlike other countries (e.g. Greece) there is no threat that there will be major cutbacks, impacting social services, state pensions, etc.
- Second, interest rates are likely to remain extremely low, thus stimulating investment as a result of the low cost of borrowing.
- Germany´s economy benefits from a well-trained and highly productive labour force. Via its dual education system ("*Berufsschulsystem*") youth unemployment is kept in check. Couple that with good labour relations ("*Mitbestimmung*"), and the result is a stable social climate.
- While other European countries have lost jobs over the last years and are challenged by their unemployment rates, employment in Germany is at an all-time high: according to *Bundesbank* statistics, the German unemployment rate remained stable in 2014, fluctuating between 6.6 and 6.8 %. Today, in January 2015, the unemployment rate stands at 6.4%, the lowest since 1991, and a figure which is the envy of many other countries within the EU.
- Finally, Germany enjoys a robust entrepreneurial culture, driven by the large number of medium-sized businesses ("*Mittelstand*") who continue to invest in technology.

Clouds on the horizon

Despite all these good news there are clouds on the horizon threatening to put an end to smooth sailing.

- First, the stability of the euro and the European Union is uncertain. Depending on the outcome of the elections in Greece, the question of whether Greece should or could remain in the euro zone arises anew. In addition, the UK may hold a referendum on whether to leave the EU entirely.

- Second, we are likely to see continued weaknesses in key export markets, not only in Germany´s EU trading partners, but especially in Russia and the Ukraine. A potential collapse of the Russian economy would have a significant negative impact on the financial services and industrial sectors in Germany. And after many years of double-digit growth, the economy in China has been slowing down. Again, not good news for Germany´s exporters.
- An economy depends critically the availability of labour. As mentioned above, Germany thrives based on its skilled labour force. But the country is faced with demographic challenges as well. The population is ageing, early retirement is popular, and unless migration policies stimulate the influx of skilled labour from outside Germany, there will be a labour shortage in the years to come.

2015: another difficult year?

This time last year, forecasts predicted Germany would grow 2% in 2014. The result fell short – indeed industrial output actually fell in Q2 and Q3. But Germany did not fall into recession. Overall, the economy grew 1.3% in 2014.

This bumpy ride in 2014 has shaped consumer, corporate and investor expectations for 2015. Consumers ended 2014 in a buoyant mood, thanks to the strong employment market (91% of those surveyed said they felt secure in their job). When asked, consumers expressed confidence that the economy would continue to expand. More concretely, consumers spent more at Christmas: retail sales surged at the end of 2014, giving a strong impetus to 2015.

Corporates are cautiously optimistic for 2015. Large firms such as Deutsche Post, SAP, Siemens and Merck expect moderate growth, led by strong export performance particularly to the United States. The automotive industry - Germany´s premier industry which boasts handling one-third of global automotive research and development – is even more optimistic. This confidence should lead to further increases in employment. According to the *Ifo-Institut*, an economic research institute which publishes a periodic employment barometer, German companies are planning to recruit more staff in 2015. These plans even extend to mid-sized companies: although they are not as optimistic as larger companies, about one-third of the mid-sized companies surveyed are planning to recruit staff and increase investment in 2015 and beyond.

Investors continue to find Germany attractive, especially relative to other euro zone countries. The investor confidence index ended 2014 on a high note. Close to half of the investors surveyed expect that Germany will become an even more attractive business location, while only 13% expect deterioration. However, nearly one-fifth say that in order to keep attracting investors, Germany needs to focus on research, development, technology and innovation. This is the overriding priority, followed by education and training.

Outlook for 2015

So what are the forecasts for 2015 and beyond? In numeric terms, official estimates of growth range from 1% by the German government´s expert council (”*Sachverständigenrat*“) to 1.5% by the *IMF* and *OECD*. Some private consultancies forecast growth of 1.6%.

However, the ride may well be bumpy. The relatively smooth sailing over the last few years may be over. But on balance, the strengths of the German economy will allow it to weather the storms that the dark clouds could contain.