Talking point

German industry: Upbeat end to 2014, improved outlook for 2015

February 6, 2015

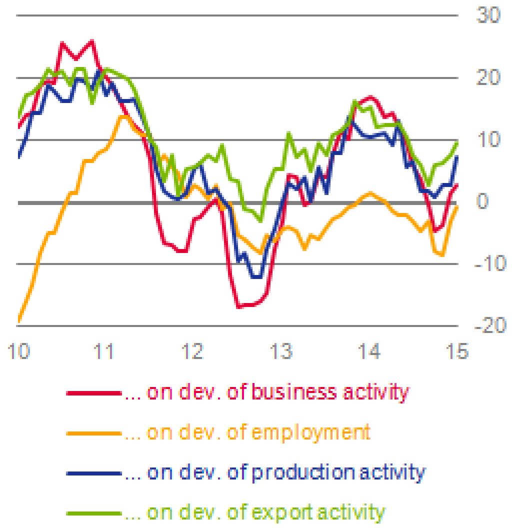
Manufacturing output in Germany rose by 1.9% in real terms in 2014. Q4 helped to end the year on an upbeat note, as a decline in output at the end of 2014 – which we had still been forecasting in autumn – did not materialise. The outlook for 2015 has also improved. German industry is getting a boost from the depreciation of the euro, which is materialising faster and more heavily than expected, as well as from the surprisingly steep drop in the oil price. We have therefore recently raised our forecast for manufacturing output in 2015 in real terms ¾% to 1.5%.

German manufacturing output rose by 1.9% in real terms in 2014. This enabled the losses from 2012 (-1.1%) and 2013 (-0.1%) to be cancelled out. Q4 performance was a contributory factor. Production rose by a seasonally adjusted 0.5% qoq. Back in the autumn we were expecting a small decline in production in Q4, not least because at that time the business expectations of industry were being lowered significantly in light of the economic and geopolitical risks. In fact, domestic industrial output came in better than assumed beforehand.

Of the major industrial sectors the automotive business posted the largest output growth in 2014 (+4.5%). The metals industry (+3.2%), electrical engineering (+2.5%) and mechanical engineering (+0.8%) were also able to increase their output. It was a disappointing year, however, for the chemicals industry (excluding pharmaceuticals), where output trended downwards over the course of 2014 and fell by 2.9% overall. Domestic business was especially disappointing in the chemicals sector. The pharma industry, by contrast, boosted its output by 5.7%. In the German food business domestic output expanded marginally.

German industry: Sentiment indicators at a turning point

Company expectations, balance of positive and negative company reports



Source: ifo Institute

Weak euro and oil price decline supporting German industry

We have recently raised our output forecast for 2015 from ¾% to 1.5% in real terms. Important drivers are the surprisingly steep decline in the oil price as well as the euro's softening against the dollar and other currencies, which is occurring faster and more strongly than expected.

The euro's depreciation against the US dollar enhances the price competitiveness of products made in Germany. This benefits above all export-intensive sectors that sell a substantial volume of products outside the eurozone and/or have a large share of domestic value added. Some examples include the automotive, mechanical engineering, electrical engineering and chemical industries. Certain upstream industries also benefit indirectly, such as metals and plastics. The export-intensive pharmaceuticals industry is also a beneficiary of the weak euro. In 2014, three of the four most important foreign markets for German pharmaceuticals companies were outside the eurozone, these being the US, the UK and Switzerland. The sharp appreciation in the Swiss franc is particularly beneficial to German pharmaceuticals manufacturers. True, German companies will have to start paying more for imports from outside the eurozone due to the weaker euro. On balance, though, the effects of the weaker euro are positive for domestic production.

Lower oil prices feed through positively to German industry via several channels. Firstly, they bring cost relief to sectors in which oil is used as a raw material in the production process (e.g. chemicals and plastics). And secondly, they stimulate both the domestic German economy and major export markets, since these are predominantly oil importers. Households have increased financial resources at their disposal for consumption of other products thanks to declining mobility and energy costs. Moreover, business customers of German industry will enjoy enlarged scope to boost their own investments. However, cheap oil is not good news for all sectors: companies that produce machinery and equipment for, say, the development of new oilfields will probably book fewer new orders in the coming months. However, the net effect on German industry remains positive.

Recovery in the course of

Manufacturing, real production index, 2010=100, seasonally adjusted

Sources: Federal Statistical Office, Deutsche Bank Research

A glance at the individual industrial sectors shows that in most cases both the business expectations and capacity utilisation have risen of late. Overall, we expect German industrial orders to pick up in the coming months. Both the automotive industry and mechanical engineering are set to increase their output by roughly 2% in 2015. We believe that electrical engineering output will probably grow by 1.5% in 2015. The metals sector will likely expand by more than 1%. Chemicals production could be boosted by 1.5%; however, this would not make up for the setbacks in 2014. We forecast that 2015 will see an increase in food production of roughly 0.5% in real terms.

Despite the generally positive outlook risks do remain in the market. Tougher EU sanctions on Russia remain a political option; a renewed military escalation of the crisis in east Ukraine cannot be ruled out either. Negative repercussions for eastern European members of the EU and ultimately Germany would be the consequence. From a structural point of view German companies should not view the seemingly comfortable cushion of a weak euro as an excuse for resting on their laurels. Instead they must continue to try and constantly improve their own products, in order to hold their own in the world market.

In the short term Germany's strong export focus means that it benefits more from the euro's weakness – which is being stoked by the expansionary monetary policy of the ECB – than most EU peripheral states whose economies are far more focused on the eurozone. This should not come as a surprise to either the ECB or external Anglo-American market participants who have been calling for quantitative easing by the ECB for many months. Nor should we be surprised that Germany's foreign trade surplus, which is being criticised by many advocates of an expansive monetary policy by the ECB, is widening in 2015 due to the weak euro – and of course supported by lower oil prices.

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