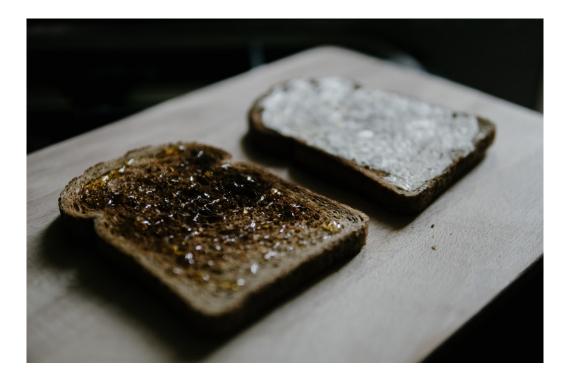


November 15, 2018

Disruption to Germany's bread-and-butter industries dents growth



Yesterday, a second release of Eurostat data confirmed that the 19-nation Eurozone grew at a pace of 0.2% in the third quarter - the weakest performance since 2013, when the bloc was in the midst of a government debt and banking crisis. Whilst Italy registered no growth at all, surprisingly, Europe's growth locomotive - Germany - was the main detractor. For the first time in three years, the German economy contracted, shrinking by 0.2% from July through September.

However, what is crucial to note, is that Germany's economy has not taken a U-turn - rather a temporary detour because of various idiosyncratic factors that are currently plaguing Germany's manufacturing industry.

First and foremost is the introduction of new EU emission tests on vehicles. This has overwhelmingly affected car production – often considered the jewel in the crown of the

nation's manufacturing sector. In order to comply with the new guidelines (which were introduced following 'Dieselgate', the scandal over illegal levels of German vehicle emissions), carmakers have had to slow production until they clear a backlog of hundreds of thousands of new vehicles which must be tested against the new environmental criteria. As a result, these unsold vehicles have been placed in temporary car lots, resembling scenes from the US of 'unsold car graveyards'. According to the Financial Times, Volkswagen, the largest German carmaker, had a quarter of a million unsold vehicles parked all over Europe through summer.

But there is another factor affecting the German economy which has received less media coverage: the country is facing a severe drought which has left rivers such as the Rhine and the Elbe at record low levels. This has been described as a 'crisis unseen since the start of record keeping in 1881', with Germany's key waterways now too shallow to facilitate the transport of goods. The disruption of oil shipments to German cities along the Rhine has been so acute, that the government has released strategic fuel reserves, which, by law, may be tapped in order "to relieve a local crisis situation". Reserves of gasoline, diesel and jet fuel have all been unlocked. This has also obliged certain companies to scale back activities – for example, the industrial giant Thyssenkrupp has cut back production at its Duisburg plant because of a reduced supply of raw materials. Supply chains will remain disrupted until there is very heavy rainfall which restores water levels. Of course this will seep into near-term GDP readings.

However, analysts widely view these factors as temporary and expect industry output – and GDP – to bounce back. We believe that the German economy is robust enough to absorb the current blow to its bread-and-butter industries. As Tobias Buck aptly wrote a while back in the Financial Times, Germany 'is a country that takes pride in the solidity of its public finances, in balanced budgets and high savings rates, in the fact that society as a whole knows how to delay gratification, tighten its belt and wait for jam tomorrow.'

So whilst Germany waits for the jam, what will be crucial is the ECB's take on the situation and whether they will consider this blip when forming their 2019 strategy at their vote mid-December. We believe that the ECB will stick to its guns in that it will end its mass bond buying this year, but we could potentially see a more cautionary approach taken with regard to other elements of its QE exit, whilst the German economy remains stuck in a low gear.

The caveat to all this however, is that Germany is largely exposed to industrial exports. If Trump doubles down on his protectionist rhetoric and a global trade war materializes, Germany's path of future growth becomes a lot more uncertain.

Disclaimer

All financial data and/or economic information released by this Publication (the "Publication"); (the "Data" or the "Financial data and/or economic information"), are provided for information purposes only, without warranty of any kind, including without limitation the warranties of merchantability, fitness for a particular purpose or warranties and non-infringement of any patent, intellectual property or proprietary rights of any party, and are not intended for trading purposes. Banque Internationale à Luxembourg SA (the "Bank") does not guarantee expressly or impliedly, the sequence, accuracy, adequacy, legality, completeness, reliability, usefulness or timeless of any Data. All Financial data and/or economic information provided may be delayed or may contain errors or be incomplete. This disclaimer applies to both isolated and aggregate uses of the Data. All Data is provided on an "as is" basis. None of the Financial data and/or economic information contained on this Publication constitutes a solicitation, offer, opinion, or recommendation, a guarantee of results, nor a solicitation by the Bank of an offer to buy or sell any security, products and services mentioned into it or to make investments. Moreover, none of the Financial data and/or economic information contained on this Publication provides legal, tax accounting, financial or investment advice or services regarding the profitability or suitability of any security or investment. This Publication has not been prepared with the aim to take an investor's particular investment objectives, financial position or needs into account. It is up to the investor himself to consider whether the Data contained herein this Publication is appropriate to his needs, financial position and objectives or to seek professional independent advice before making an investment decision based upon the Data. No investment decision whatsoever may result from solely reading this document. In order to read and understand the Financial data and/or economic information included in this document, you will need to have knowledge and experience of financial markets. If this is not the case, please contact your relationship manager. This Publication is prepared by the Bank and is based on data available to the public and upon information from sources believed to be reliable and accurate, taken from stock exchanges and third parties. The Bank, including its parent,- subsidiary or affiliate entities, agents, directors, officers, employees, representatives or suppliers, shall not, directly or indirectly, be liable, in any way, for any: inaccuracies or errors in or omissions from the Financial data and/or economic information, including but not limited to financial data regardless of the cause of such or for any investment decision made, action taken, or action not taken of whatever nature in reliance upon any Data provided herein, nor for any loss or damage, direct or indirect, special or consequential, arising from any use of this Publication or of its content. This Publication is only valid at the moment of its editing, unless otherwise specified. All Financial data and/or economic information contained herein can also quickly become out-of- date. All Data is subject to change without notice and may not be incorporated in any new version of this Publication. The Bank has no obligation to update this Publication upon the availability of new data, the occurrence of new events and/or other evolutions. Before making an investment decision, the investor must read carefully the terms and conditions of the documentation relating to the specific products or services. Past performance is no guarantee of future performance. Products or services described in this Publication may not be available in all countries and may be subject to restrictions in some persons or in some countries. No part of this Publication may be reproduced, distributed, modified, linked to or used for any public or commercial purpose without the prior written consent of the Bank. In any case, all Financial data and/or economic information provided on this Publication are not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law and/or regulation. If you have obtained this Publication from a source other than the Bank website, be aware that electronic documentation can be altered subsequent to original distribution.

As economic conditions are subject to change, the information and opinions presented in this outlook are current only as of the date indicated in the matrix or the publication date. This publication is based on data available to the public and upon information that is considered as reliable. Even if particular attention has been paid to its content, no guarantee, warranty or representation is given to the accuracy or completeness thereof.

Banque Internationale à Luxembourg cannot be held liable or responsible with respect to the information expressed herein. This document has been prepared only for information purposes and does not constitute an offer or invitation to make investments. It is up to investors themselves to consider whether the information contained herein is appropriate to their needs and objectives or to seek advice before making an investment decision based upon this information. Banque Internationale à Luxembourg accepts no liability whatsoever for any investment decisions of whatever nature by the user of this publication, which are in any way based on this publication, nor for any loss or damage arising from any use of this publication or its content. This publication, prepared by Banque Internationale à Luxembourg (BIL), may not be copied or duplicated in any form whatsoever or redistributed without the prior written consent of BIL 69, route d'Esch I L-2953 Luxembourg I RCS Luxembourg B-6307 I Tel. +352 4590 6699 I www.bil com

