



Economic Update Germany

6 December 2011

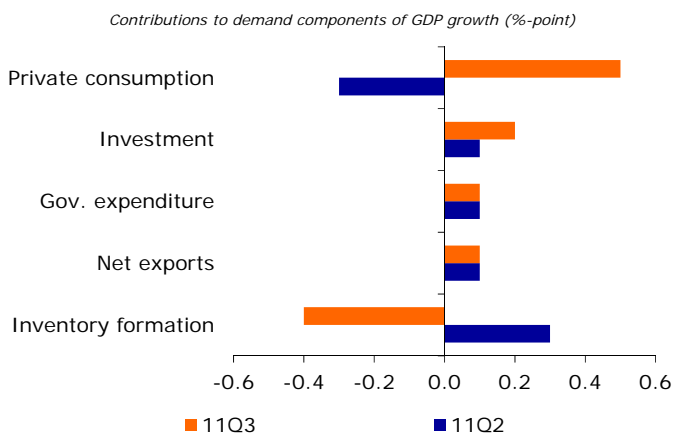
Is consumption picking up due to optimism or fear?

year-on-year change (%)	'10	'11	'12
Gross Domestic Product	3.5	2¾	1
Private consumption	0.4	¾	¾
Government consumption	1.9	1¾	½
Investment	5.7	6	3¾
Exports	14.4	8	5
Imports	12.8	7	5½
Inflation	1.2	2½	2
Unemployment (%)	7.7	7	6½
Government balance (% GDP)	-3.3	-2	-1¼
Government debt (% GDP)	83.2	82½	81

- Germany's 11Q3 growth (+0.5% q-o-q) testifies to the country's economic resilience.
- Private consumption was the biggest contributor to GDP growth. Although this was partly due to the disappointing performance in 11Q2.
- There are recent signs that healthier macro conditions are enticing consumers to open their wallets. But anecdotal evidence suggests that the pickup in spending can also be due to scare-stories in the German media that inflation is on the rise.
- In the short-term, higher private consumption, regardless of its underlying cause, may provide a buffer against any rapid move towards recession.

Source: Reuters EcoWin, Rabobank

Has Godot finally arrived?



Source: Reuters EcoWin

GDP growth in 11Q3 strengthened from the previous quarter's 0.3% to 0.5% q-o-q. Amazingly, private consumption was the main driving force. But before celebrating the long-awaited economic rebalancing, we must remind ourselves that private consumption's stellar performance was a pay-back after a very disappointing growth figure in 11Q2 (-0.6% q-o-q). Looking beyond the volatility, we observe that consumption rose by only 0.2% since 11Q1. As an aside, we are a bit concerned with the strong contraction of inventory formation since it appears that companies decided to run down their inventories and sell from stock owing to the growing uncertainty about the demand outlook.

'Crisis, what crisis?' ask the German consumers



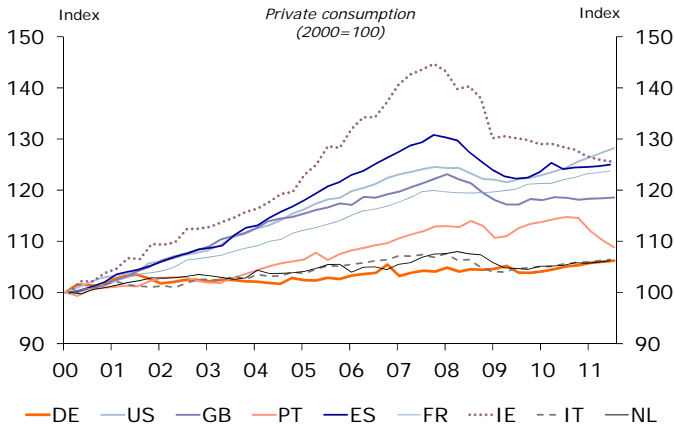
Source: Reuters EcoWin

That was the title of an article in the Financial Times on the 30th of November. The recent rise in (i) retail sales (+0.7% m-o-m in October), (ii) nominal car sales and repairs (+3.8% m-o-m in October) and (iii) consumer sentiment (both the EC and GfK indices rose in November) has led some to conclude that Germans are opening their wallets. Of course, consumption must pick up given that households are not facing the structural headwinds (repairing balance sheets amid harsh austerity measures and a worsening labour market) that most of their counterparts are facing in the other advanced economies. The jobless rate fell to 6.9% in November – a record low since unification.

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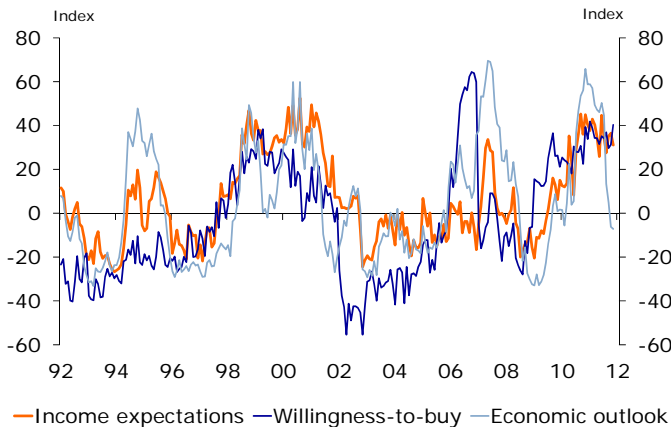
Or is it fear of hyperinflation that drives spending?



Source: Reuters EcoWin

It is great news that German households are responding to their healthier macro conditions. But is there a more subtle reason behind their extra spending? Anecdotal evidence suggests that consumer concerns about price stability are providing an incentive to invest in cars, houses, or furniture to safeguard the value of their money. Nowadays, German news is filled with stories that inflation may spiral out of control thanks to ECB's unconventional policies. Given that Germany is still haunted by its hyperinflation experience in the early 20th century (inflation was 211,427,400,987% in 1923), it is not too difficult to imagine that such scare-stories may be playing a role in consumption behaviour.

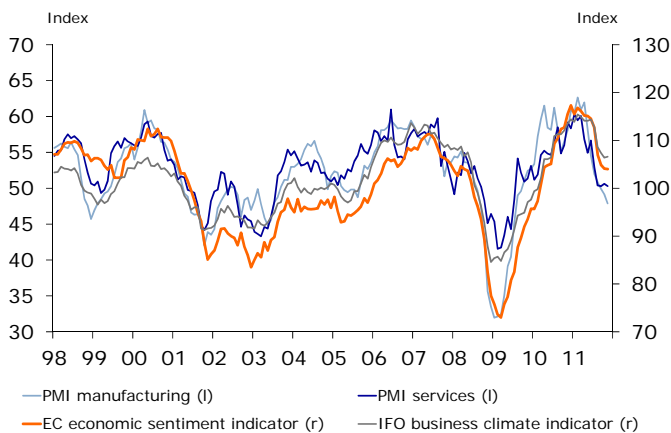
What's underneath the bonnet?



Source: Reuters EcoWin

The claim made above can be partly backed by consumer survey data. The rise in both the GfK and the EC consumer sentiment indices in November was solely due to a solid rebound in the willingness-to-buy sub-component. Meanwhile, the sub-index reflecting consumers' assessment of economic prospects has slipped, and the component reflecting income expectations for the next 12 months has also lost some ground. Moreover, in the EC survey we see that consumers are also getting gloomier about the job market and expect prices to rise over the next 12 months. It seems a bit strange to us that consumers are feeling less upbeat about the outlook and, at the same time, wish to spend more.

Higher spending *might* help prevent a recession



Source: Reuters EcoWin

In our view, it greatly matters if Germans are spending due to optimism or fear. In the former case, consumption growth is durable so long as employment growth and purchasing power do not tank. But if higher spending is due to fear then consumers will spend less as soon as inflationary pressures subside and the ECB starts to move away from its unconventional policies. In the short-term, robust private consumption growth, regardless of its cause, may provide a buffer against any rapid move towards recession. In our baseline scenario, Germany's GDP is expected to contract in 11Q4. The jury is still out on whether GDP will contract in 12Q1 as well given the recent resilience in leading indicators.