Economic Update Germany

7 June 2011

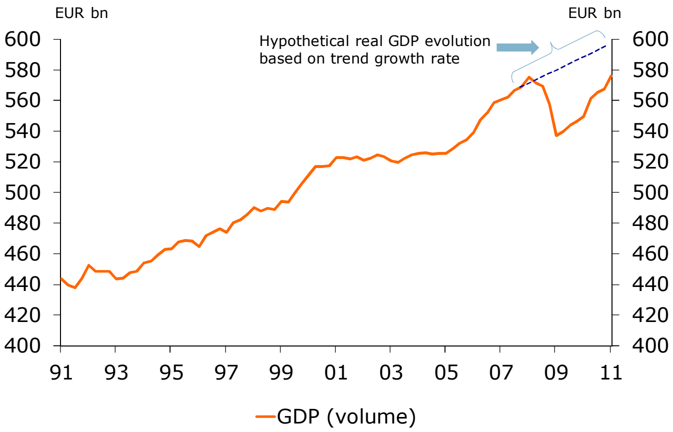
Otto Normalverbraucher still cautious

year-on-year change (%)	'10	'11	'12
Gross Domestic Product	3.5	3¼	2
Private consumption	0.4	1¾	1½
Government consumption	1.9	2	1
Investment	5.7	6½	3¾
Exports	14.4	8½	6¼
Imports	12.8	7	6¾
Inflation	1.2	2½	2
Unemployment (%)	7.7	6½	6
Government balance (% GDP)	-3.3	-2	-1¼
Government debt (% GDP)	83.2	82½	81

Source: EcoWin, Rabobank

- Germany's economic growth momentum continues to surprise on the upside. But the pace of growth will return to more sustainable levels going forward.
- The labour market recovery is chugging along. The unemployment rate reached 7% in May, the lowest level since reunification (1991).
- A number of factors (e.g. labour hoarding and stagnant growth in labour force) have helped pushed unemployment downwards.
- Despite the healthy development in job market conditions, consumers are becoming more pessimistic. This is partly explained by higher inflation and the ongoing crisis in the eurozone periphery.

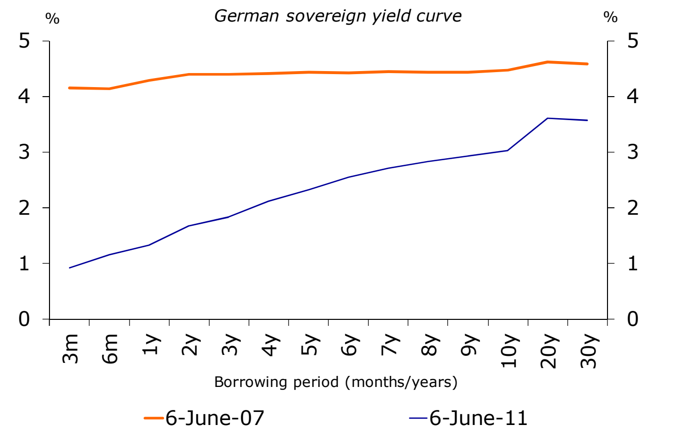
GDP reaches pre-crisis levels but not pre-crisis trend



Source: Reuters EcoWin, Rabobank

Germany's economic growth momentum continues to surprise on the upside. GDP grew 1.5% q-o-q during 11Q1, after average growth in 10Q4 (0.4%). Even better, the surge in activity was very broad based with all demand components, with the exception of inventories, contributing positively to the headline figure. Demand components in 11Q1 have contributed to the quarterly growth figure in the following order: investment 0.9%, net exports 0.5%, private consumption 0.2%, government consumption 0.2%, and inventories -0.4%. We must point out that even though Germany's GDP has now reached its pre-crisis *level*, it still remains well below its pre-crisis *trend* (around 3.5%).

Don't expect spectacular growth to continue



Source: Reuters EcoWin, Rabobank

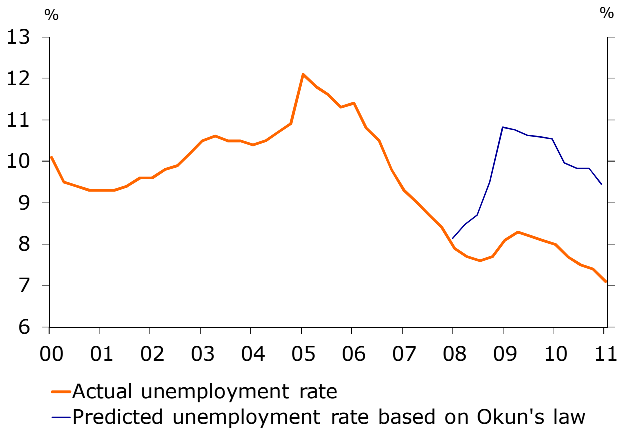
To be sure, the pace of growth seen in Q1 cannot be sustained and a normalisation of growth in Q2 is to be expected. Part of the pick-up in activity was due to a weather-related surge in construction investment and a sharp rise in government consumption. Neither is likely to be sustained. What's more, higher inflation, a stronger euro, as well as a soft patch in global growth owing to monetary and fiscal tightening around the world will dampen the momentum further during 11H2; though this should be seen as a moderation rather than a genuine slowdown. Note that economic growth continues to be supported by healthy labour market developments and, especially, historically low interest rates.

www.rabobank.com/kennisbank

Shahin Kamalodin
Tel. +31 (0)30 – 2131106
S.A.Kamalodin@rn.rabobank.nl

7 June 2011

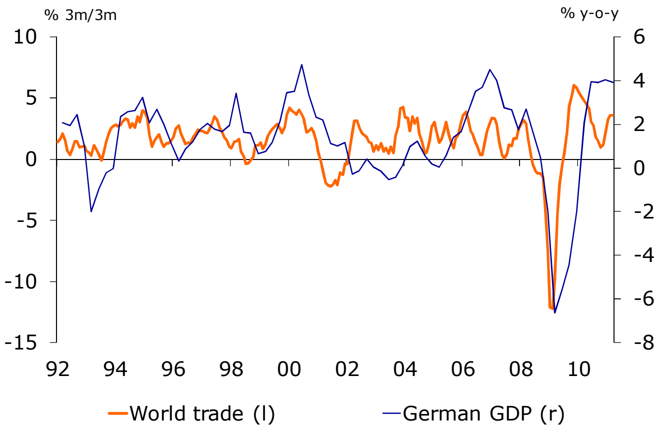
The *Arbeitsmarktwunder* continues unabated...



Source: Reuters EcoWin, Rabobank

Germany's labour market is continuing to defy economic theory. As we mentioned time and again, the drop in the jobless rate to its lowest level since reunification is remarkable in light of the country's severe GDP contraction during 2008-09. To demonstrate this, we calculated what the jobless rate would have been if the labour market had reacted to GDP growth as it did during 2000-07. Based on the relationship between output growth and unemployment (known by economists as Okun's law), our estimate shows that the jobless rate would now have been around 9.4%. This was the very reason why almost all economic forecasters, including ourselves, expected unemployment to rise.

...due to a number of important factors...

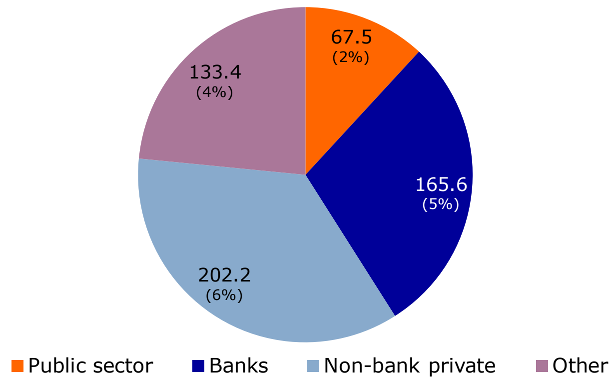


Source: Reuters EcoWin, CPB

The labour market turned out to be more resilient than previously feared due to a number of reasons. First, labour market policies before and during the crisis certainly helped. Second, German firms decided to hoard labour (enabled by *working-time accounts* and healthy cash balances) given their bad experience during the 2006-07 economic boom when they faced difficulties finding qualified personnel. Third, the country's demographic influences —a virtually stagnant labour force since the crisis— dampened joblessness. Finally, the quick rebound in global demand enabled firms to prevent mass layoffs. This would be unavoidable in case of a permanent shock (e.g. a housing market bust).

...but this is still not cheering households

German banks' exposure to Greece, Ireland, Portugal and Spain end-2010 (USD bn, % of Germany's GDP expressed in brackets)



Source: BIS, Rabobank

Sadly, the drop in the unemployment rate is not fueling optimism amongst German households. The GfK consumer climate indicator for June slipped for the third month in a row from 5.7 to 5.5 and retail sales dropped 2.1% between February and April. This is perhaps due to the sharp rise in inflation (2.3% in May, up from 1.1% in 2010). Another factor that could dampen consumers' optimism is the ongoing crisis in the eurozone periphery. Not only are households afraid of higher taxes in the future in case the periphery countries default on the official bailout money, but they are also unsure how hard their banking sector will be hit given their massive exposure to these hard-hit countries.

www.rabobank.com/kennisbank

Shahin Kamalodin
Tel. +31 (0)30 – 2131106
S.A.Kamalodin@rn.rabobank.nl