



# Economic Update Germany

5 April 2011

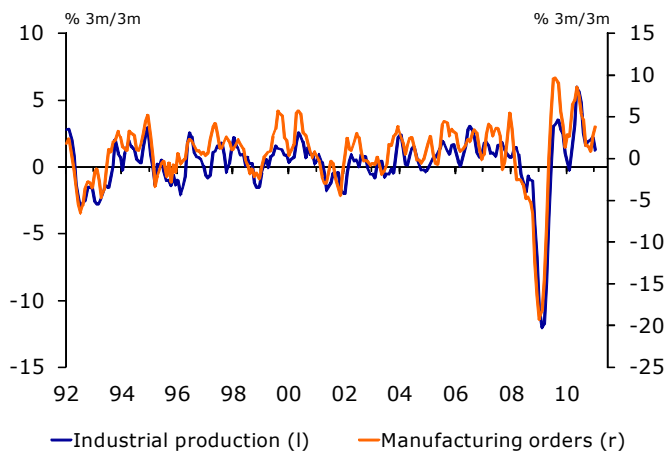
Has growth peaked?

year-on-year change (%)	'10	'11	'12
Gross Domestic Product	3.5	2½	1¾
Private consumption	0.3	1¾	1¼
Government consumption	2.3	1¾	1
Investment	5.7	7½	3¼
Exports	13.8	8¾	5½
Imports	12.4	8¾	5½
Inflation	1.2	2	2
Unemployment (%)	7.7	7	6½
Government balance (% GDP)	-4.0	-2½	-1¾
Government debt (% GDP)	74.5	76	77

- Industrial production rebounded sharply in January and is expected to grow further in the remainder of 11Q1, especially given the robust rise in real manufacturing orders.
- Producer sentiment has fallen slightly in March. However, we are wary to draw definitive conclusions since it may just be a single blip.
- Labour market dynamics are continuously improving, which bodes well for the German job-seekers.
- The drop in consumer sentiment (ahead of the Japanese earthquake) is somewhat disturbing.
- Retail sales declined during February amid accelerating consumer price inflation.

Source: EcoWin, Rabobank

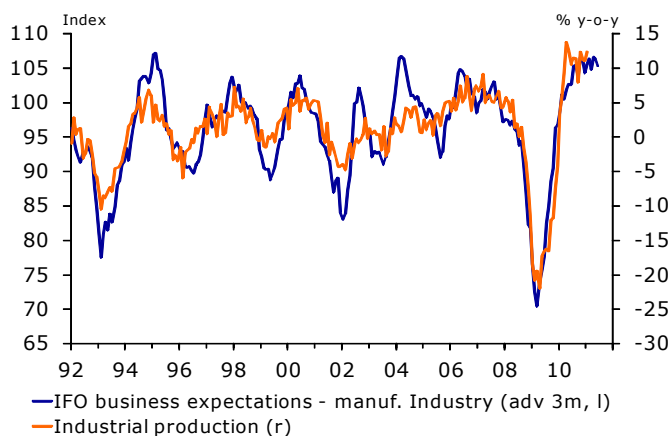
Upswing in German industry is continuing unabated...



Industrial production (IP) rebounded sharply during January (1.8% m-o-m), after contracting 0.6% m-o-m in the previous month. Unsurprisingly, December's weakness was entirely due to poor weather conditions. This is borne out by construction rocketing by 36.3% m-o-m, more than recouping December's plunge of -24.2% m-o-m. If output stays broadly unchanged over the remainder of the quarter then, other things equal, this would reduce quarterly GDP growth by around 0.2%-points in 11Q1 compared to 10Q4's 0.4% gain. However, given the strong surge in real manufacturing orders in January (2.9% m-o-m), we cannot imagine IP stagnating in February and March.

Source: Reuters EcoWin

...yet some worrying signs are emerging



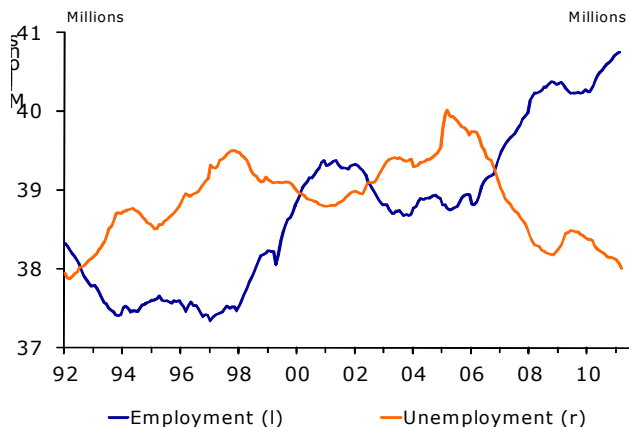
The IFO business climate index retreated slightly in March, from February's post-reunification-high. The decline was due to the fall of the sub-index reflecting six-month expectations. The data corroborates the message given by the PMI release in March, which shows the composite index dropping from 60.9 to 60.6. It is too early to draw strong conclusions based on data in a single month, but we have to admit that the downside risks to growth are rising. These include a significant widening of Middle East troubles disrupting oil supply, a major escalation of radiation problems in Japan, or the upcoming monetary and fiscal tightening in the eurozone.

Source: Reuters EcoWin

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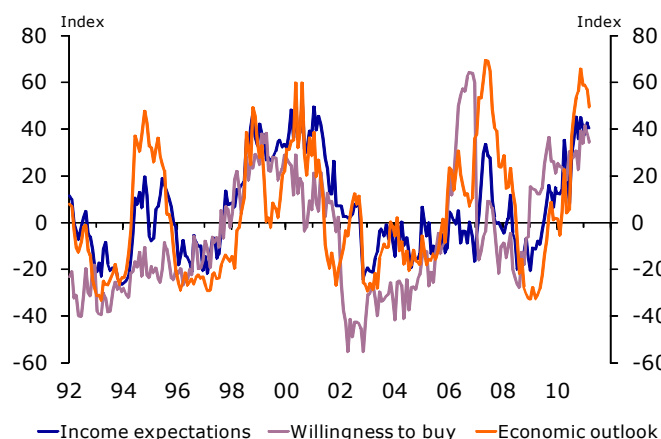
Labour market conditions are improving further..



Source: Reuters EcoWin

German unemployment declined by 55,000 m-o-m in March, broadly the same rapid pace as in February (54,000). The unemployment rate has fallen from 7.3% to 7.1%, which is the lowest level in post-reunification history (since 1991). Based on leading indicators (e.g. PMI or EC sub-index for employment and vacancy figures) we expect unemployment to continue to decline throughout the year. In particular, the labour agency notes that, apart from the strong recovery, demographic influences –a fall in working-age population– are dampening measured joblessness. We must stress that the pace of decline may slow slightly in the coming months should the downside risks mentioned above materialise.

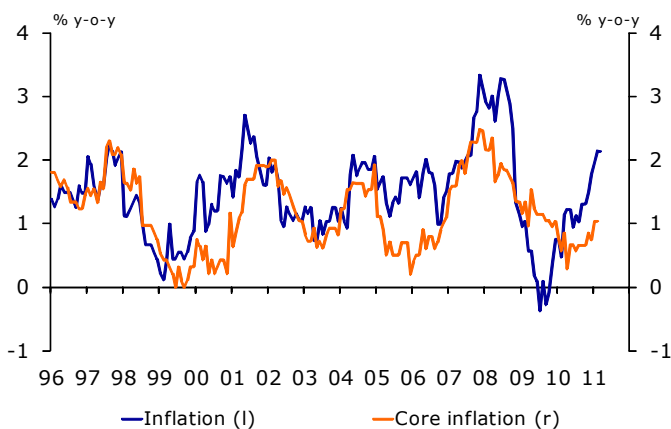
...but consumers remain sombre about the outlook...



Source: Reuters EcoWin

The GfK consumer climate indicator for April – calculated from March survey results– has slipped from 6.0, its the highest level since October 2007, to 5.9, thus interrupting a 10-month upward trend. The key components have all deteriorated at the data edge. The sub-index reflecting consumers' assessment of economic prospects –which does not enter the GfK index directly but is usually positively correlated with 'income expectations'– has worsened considerably, from 57.1 to 49.5. Note that the survey was conducted before Japan was hit by the mega quake. The resulting nuclear debacle may further dent consumer sentiment. Hardly good news for Germany's already weak consumer spending.

...which is leading to disappointing retail sales figures



Source: Reuters EcoWin

Retail sales volume posted a disappointing decline of 0.3% m-o-m during February. Disturbingly, retail sales growth has paused again even though labour market conditions are continuously improving. Accelerating inflation (2.1% y-o-y in March) seems to be the main culprit as it has a dampening effect on purchasing power. Real monthly earnings increased by 1.5% y-o-y in 10Q4 while consumer prices were rising by 1.5% on average over the quarter. Against this background, there is a risk that rising inflation further dampens real wage growth going forward. On a positive note, the recovering labour market may lend impetus to nominal wage growth given workers' greater negotiation power.

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