



Economic Update Germany

3 July 2012

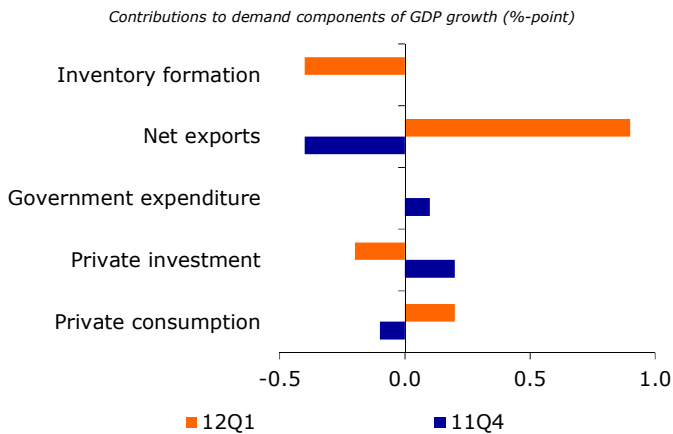
Temporarily recoupling with the eurozone

year-on-year change (%)	'11	'12	'13
Gross Domestic Product	3.2	1	1¾
Private consumption	1.3	1	2
Government consumption	2.3	1½	1¼
Investment	8.0	3¼	4¾
Exports	9.5	4¼	5¼
Imports	7.8	5¾	7
Inflation	2.5	2	1¾
Unemployment (%)	7.1	6¾	6½
Government balance (% GDP)	-1.0	-¾	-½
Government debt (% GDP)	81.5	79	77½

- GDP increased by 0.5% q-o-q in 12Q1.
- Activity is likely to be far weaker in Q2. Even a minor contraction in GDP cannot be excluded.
- Manufacturing output, exports and orders dropped in April. Soft data available till June also point to weaker economic conditions.
- The labour market is starting to react to weaker activity. Unemployment rose for the third month in a row in June.
- That said, consumer sentiment is being supported by the tight labour market, falling inflation and German football victories in the first half of June. As regards the latter, the defeat against Italy may weigh on sentiment in July.

Source: Reuters EcoWin, Rabobank

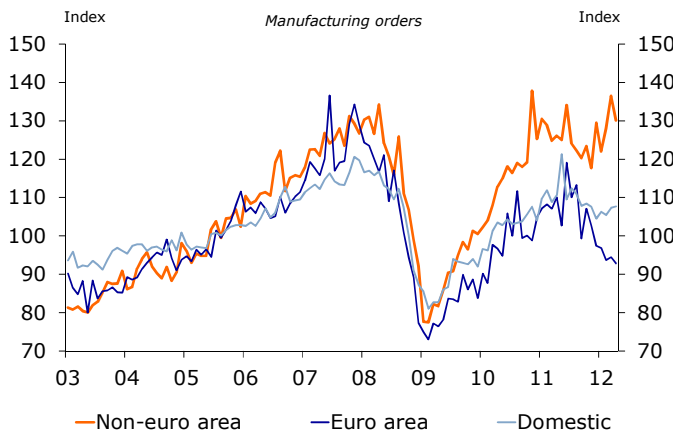
GDP grew robustly in 12Q1 thanks to net exports



Source: Reuters EcoWin

Germany's GDP increased by 0.5% q-o-q in 12Q1 (-0.2% in 11Q4). The main driver of growth was net exports that added a whopping 0.9%-point to the headline figure. This was partly due to the depreciation of the euro, which dropped by 5.5% on a trade-weighted basis between June 2011 and March 2012. Also private consumption contributed positively to GDP growth thanks to robust employment growth and relatively high wage settlements. Private investment and inventory formation acted as a drag on activity. This was expected as the debt crisis increased uncertainty about future demand. Finally, government consumption stagnated amid fiscal tightening measures.

Going forward, hard data point to weaker activity...



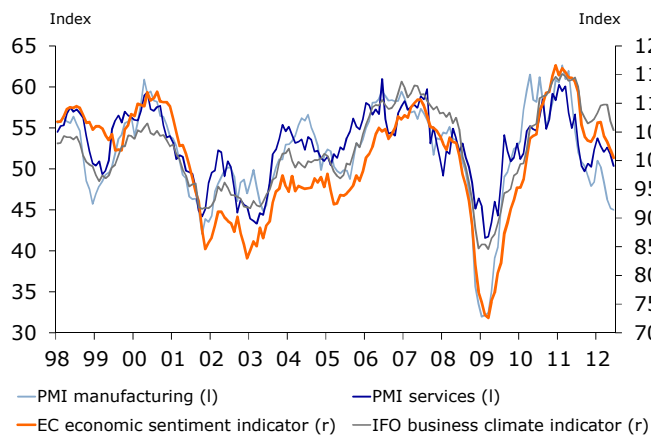
Source: Reuters EcoWin

The German economy made a poor start to the second quarter. Manufacturing output was down 2.4% m-o-m in April after +1.1% in March – suggesting that a mild downward trend in manufacturing activity is now present. External trade momentum also weakened during April. Exports declined 1.7% m-o-m, unwinding part of the 4.8% cumulative gain during January–March. More importantly, total orders declined 1.9% m-o-m in April, after +3.2% in March. The breakdown shows that domestic orders continued to grow (+0.4%) but euro area (-1.8%) and non-euro area (-4.7%) orders were sharply down. The latter is worrying given that extra-eurozone exports accounts for 60% of German exports.

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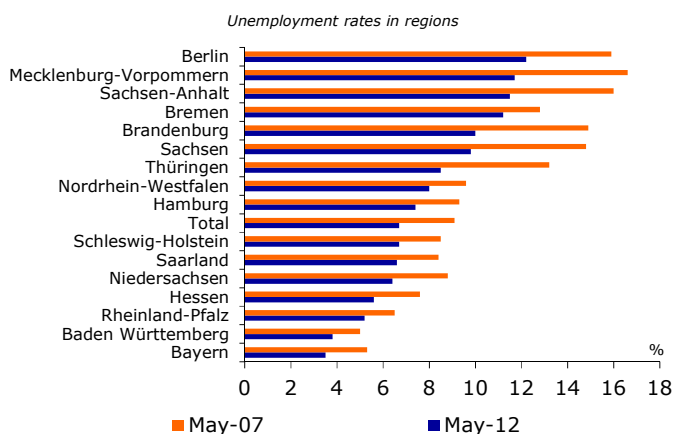
...same goes for soft data...



Source: Reuters EcoWin

Economic visibility improved as we suspected in the previous economic update. Overall, all the indices now show the growing concerns about the eurozone debt crisis and waning global demand. The June manufacturing PMI decreased to 45, the lowest level in 3 years and far below the 50-mark. The IFO index decreased as well in June, albeit less sharply. Mind you that this was due to a fall in the expectations sub-index (declined from 100.8 in May to 97.3 in June). Meanwhile, the EC economic sentiment indicator dropped for the fourth month in a row. Against this weak economic backdrop, we believe Germany's GDP will at best stagnate in 12Q2. A minor contraction of output cannot be excluded.

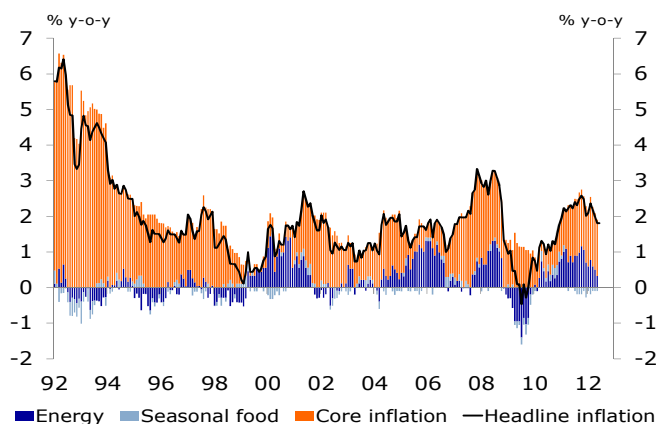
...and the labour market is responding negatively...



Source: Reuters EcoWin

German unemployment rose by 7,000 in June after increasing by 19,000 during April-May. What's more, vacancies declined by 5,000 to 489,000 in May. This series had peaked at 506,000 in January, ending a period of two-and-a-half years of ongoing increases. Worsening labour market dynamics make us conclude that the *Arbeitsmarktwunder* is taking a pause. To be sure, given how tight the labour market is in some regions (e.g. in Southern Germany), it should not be too surprising that unemployment cannot continue to fall at the pace seen previously. Of course, the job market is also reacting to weaker activity and falling business sentiment.

...but consumers are still relatively optimistic



Source: Reuters EcoWin

The GfK consumer climate indicator for June has increased from 5.7 to 5.8 (the long-term average is 4.6). The remarkable optimism of German consumers stems mainly from the robust labour market and falling inflation (down to 1.8%, from 2.1% in January). We should also take note of the fact that the survey has been conducted during the first half of June. The significance of this is that the *Mannschaft* won two matches during this period so some football related feel-good factor may have driven confidence upwards. The usual disclaimer is that consumer sentiment and consumption growth have a weak relationship. Besides, the defeat against Italy may have already weighed on sentiment in July.