



# Economic Update Germany

## 6 November 2012

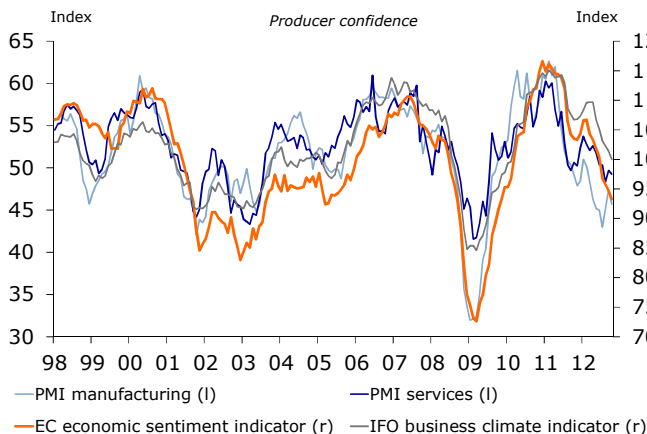
### Dark clouds are gathering?

year-on-year change (%)	'11	'12	'13
Gross Domestic Product	3.1	¾	1¼
Private consumption	1.7	1	1¼
Government consumption	1.0	1	1¼
Investment	6.4	-¼	2½
Exports	7.9	3¾	3¼
Imports	7.5	2¾	3¾
Inflation	2.5	2½	2
Unemployment (%)	7.1	6¾	6¾
Government balance (% GDP)	-1.0	-½	0
Government debt (% GDP)	81.7	82	80

- The business sentiment indicators are all weakening, pointing towards softer growth in 12Q4.
- Hard data are more resilient than expected. This may be caused by moderate restocking following improving economic visibility.
- Also exports remained remarkably strong and will probably contribute positively to growth in 12Q3; for the fourth quarter downside risks remain present.
- A strong rise in house prices results in a positive wealth effect, which may lead to a pick up in household consumption going forward.
- Consumer confidence is on an improving trend amid worsening labour market conditions.

Source: Reuters EcoWin, Rabobank

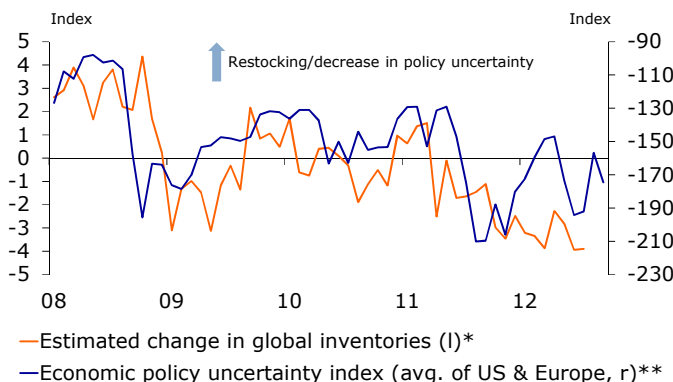
### Business sentiment is turning negative...



Business sentiment indicators are pointing to a worsening of economic conditions in 12Q4. The composite PMI fell to 48.1 in October, down from 49.2 in the previous month. The latest reading is only a 2-month low though, and close to the 12Q3 average. The IFO indicator continued its downward trend for the 6<sup>th</sup> successive month (down to 100 from 101.4 in September). The business expectations sub-component was flat (still at its lowest level since mid-2009), but the assessment of the current situation deteriorated significantly. Also the ESI indicator continued to head south reaching its lowest level since end-2009. All in all, it seems that the economy has made a poor start to the fourth quarter.

Source: Reuters EcoWin

### ... although decline in production is still modest ...



Both industrial production and manufacturing orders are slightly declining, but have proven more resilient than what would be suggested by the leading indicators. One reason for this may be the rebuilding of inventories. Historically, changes in global inventory levels have been positively correlated with economic policy uncertainty. Most recently, we see economic policy uncertainty falling, especially thanks to ECB's measures. On basis of past form, we can expect a global restocking to take place following the improvement in economic visibility. The German companies have probably benefited from this temporary boost. Note that output growth will slow down once restocking is complete.

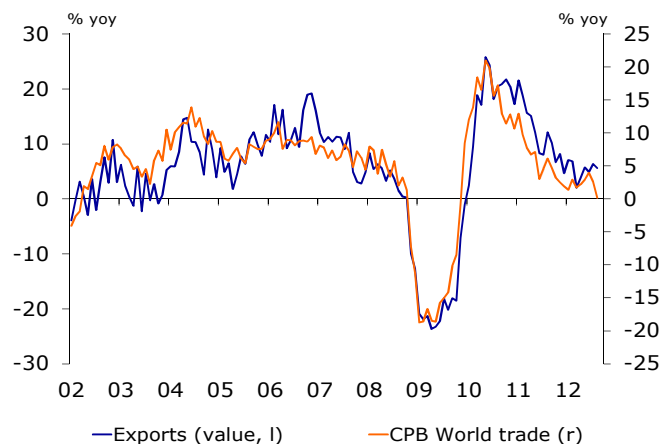
\*Index based on deviations between global industrial production and retail sales.  
 \*\*Index based on frequency with which terms like 'economic policy' and 'uncertainty' appear together in the media and the dispersion of forecasts of future government spending and inflation.

Source: IMF; Baker, Bloom, and Davis (2012)

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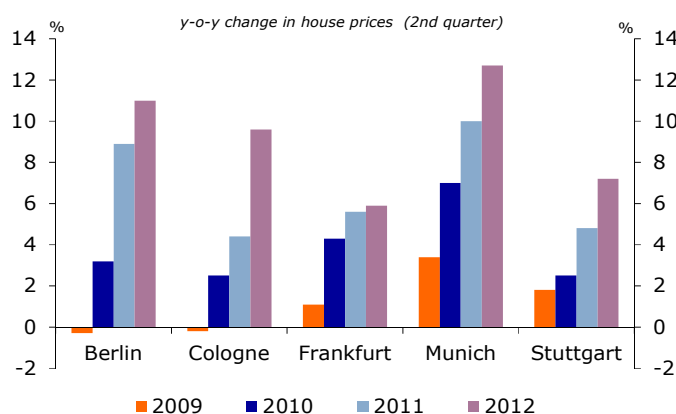
... thanks to strong external demand



Source: Reuters EcoWin, CPB

Supported by a possible global restocking process and a weak euro, the German exports were remarkable strong in July (+0.4% m-o-m) and August (+2.4% m-o-m). Imports continued to move roughly sideways. Therefore we expect net exports to remain a growth driver in 12Q3. The regional breakdown in August shows that exports to Europe ex. eurozone members (+6.8% y-o-y) and non-EU countries (+13.0% y-o-y) continue to outperform those to the Eurozone (-3.1% y-o-y). For 12Q4 it is uncertain whether exports will continue to grow robustly, as downside risks are still present, notably the tail-risk that the US falls off the fiscal cliff and the euro crisis escalates once again.

Rising house prices may bolster consumption growth



Source: Immobilienscout 24

The strong rise in house prices that was observed in 2011 has continued in 2012, especially in the five biggest cities. Nonetheless, at the moment we do not see a bubble emerging, as simple metrics such as price-to-income or price-to-rent ratios do not point to an overvaluation in the property market. In addition, housing investment is not driven by easy credit, but merely reflect portfolio rebalancing of investors who are looking for a better return than they can receive on, say, German government bonds or bank deposits. Welcome side effect of the rising house prices is that consumer spending may pick up owing to the positive wealth effect.

Rising unemployment is not weighing on sentiment



Source: Reuters EcoWin

The labour market has remained fairly resilient so far but is showing signs of weakness. The number of unemployed has been growing for 5 months in a row (October +20,000). This suggests that the country is not isolated from troubles in the other European countries. The jobless rate did not change in October (6.9%) and is still near its lowest level since reunification. Combined with solid wage increases, the above factors caused the GfK consumer-climate indicator to rise to 6.3, a five-year high. This is certainly positive but we cannot be sure whether Germans will actually loosen their purse strings because the relationship between consumer confidence and spending is very weak.

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