



Economic Update Germany

4 October 2011

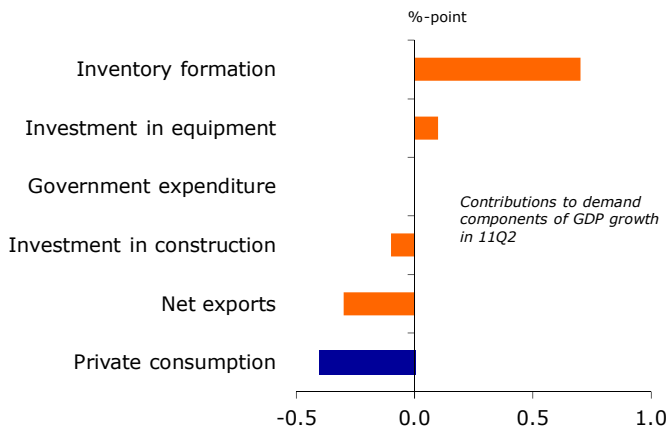
Are we waiting for Godot?

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 growth in 11Q2 was nothing short of disappointing, especially given the sharp contraction in consumption amid improvement in the labour market. It seems to us that waiting for German consumers to spend more is like waiting for Godot (referring to the play in which two characters wait endlessly and in vain for someone named Godot to arrive).
- Of course, the ongoing labour market recovery and expected fall in inflation in 2012 may spur consumer spending. This is on the condition that sentiment rebounds in a meaningful way.
- Tighter financial conditions and falling leading indicators suggest that activity will remain soft throughout 11H2.

Source: Reuters EcoWin, Rabobank

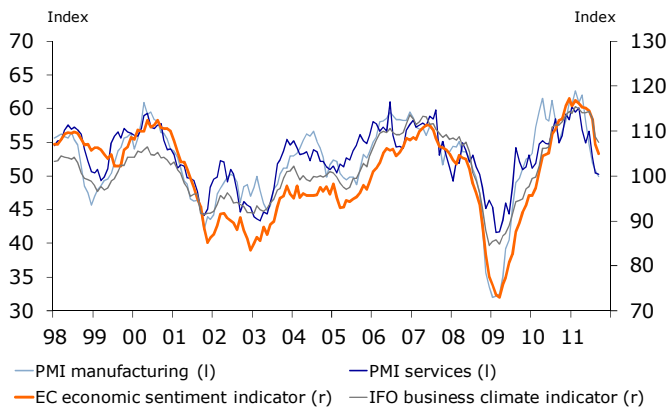
Recovery slowed sharply in 11Q2...



The recovery in Germany came to a sudden halt in 11Q2 as GDP edged only 0.1% q-o-q higher after 1.3% q-o-q in Q1. As we mentioned before, the slowdown in Germany's growth was to be expected as part of the pick-up in activity in Q1 was due to a weather-related surge in construction investment and a sharp rise in government consumption. Neither was likely to be sustained. That said, private consumption, down 0.7% q-o-q, was the chief disappointment of Q2, in view of only mildly retreating consumer confidence and a continually improving labour market. It seems rising inflation and the escalating debt crisis in the Eurozone periphery led to a sudden buyers' strike during the second quarter.

Source: Reuters EcoWin

...and the macro outlook is not improving...



Unfortunately, the outlook for the German economy is not getting much brighter. All major economic indicators continued to head South in September. The Economic Sentiment Indicator (from the European Commission survey) fell to its lowest level since May 2010. Meanwhile, the IFO index and the PMI corrected markedly lower following all-time record highs in early 2011. Finally, the ZEW economic expectations indicator fell for the seventh successive month to its lowest level since December 2008. Taken together, the current levels of business sentiment are signaling a softening of activity in 11H2. It is still uncertain though whether the economy will enter an outright recession.

Source: Reuters EcoWin

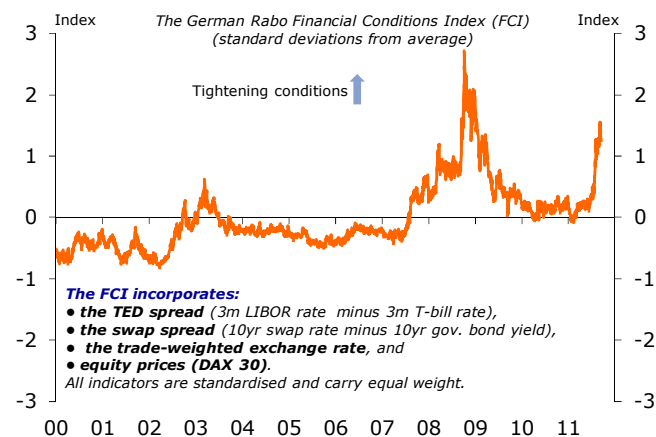
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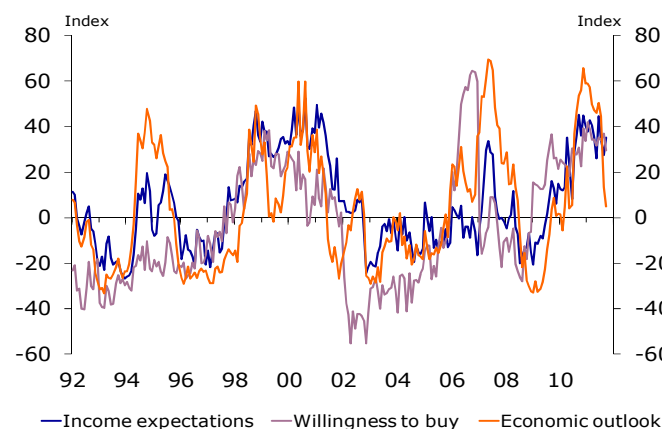
...especially due to tightening of financial conditions



Source: Reuters EcoWin, Rabobank

Germany's financial conditions are tightening at an alarming rate. This is particularly due to the country's massive exposure to the hard-hit European periphery countries. According to the latest available data, the exposure of German banks to Greece, Italy, Ireland, Portugal and Spain amounted to USD 522bn (or 16% of GDP) in 11Q1. As a result, banks' funding costs are being adversely affected. The only piece of good news is that the ECB is not expected to add insult to the injury by hiking the policy rate. This, in turn, is expected to push the euro slightly lower (to 1.33 EUR/USD by the end of 2011 from 1.35 EUR/USD currently), which at least gives German exporters some breathing space.

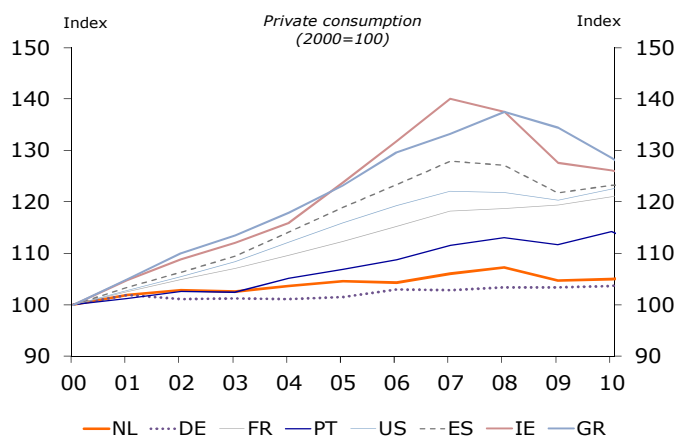
Concerns about the outlook are hurting retail sales



Source: Reuters EcoWin

On the face of it, the fact that the GfK consumer confidence index remained unchanged in September is cause for cheer. But looking at the breakdown, one can hardly ignore the plunge in the economic outlook sub-index, which in August recorded the largest monthly drop since the series began. Economic expectations dropped further in September. The sub-index reflecting consumers' willingness-to-buy also registered a large drop. Against this backdrop, it is no surprise that retail sales declined 2.9% m-o-m in August. It seems the recent escalation of the eurozone debt crisis, increasing concerns about the pace of global growth and the rise in inflation are still keeping consumers away from shops.

Will Godot (read German consumer) finally arrive?



Source: Reuters EcoWin

Waiting for German consumers to spend more is like waiting for Godot (referring to the play in which two characters wait endlessly and in vain for someone named Godot to arrive). Between 00Q1 and 11Q2, private consumption in Germany rose by only 6% while the average for the OECD countries was 24%. Even the ongoing improvement in the labour market has not resulted in the much-hoped for increase in consumer spending. The brighter labour market prospects going forward (as suggested by employment intentions of businesses and vacancy data) and the expected fall in inflation next year may still entice households to finally loosen their purse strings. Of course, not until confidence recovers.

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