Current Issues

International topics

Deutsche Bank Research

November 2, 2009

German industry

Recovery on its way but capacity utilisation still low!

Green shoots. At mid-year the German economy put the worst recession since World War II behind it and returned to slight growth. Nonetheless, the downswing was so severe that output in the manufacturing industry will still be down about 20% yoy in 2009. Supported by the economic stimulus programmes it is estimated that production will grow by 5% in 2010 – but from a very low base.

Export industry revives. However, the upturn is not attributable solely to government stimulus at home. In Asia especially the economic dynamic has already picked up again. Exports, the growth engine for German industry before the crisis, are not yet back to a gallop but a slight canter appears realistic next year.

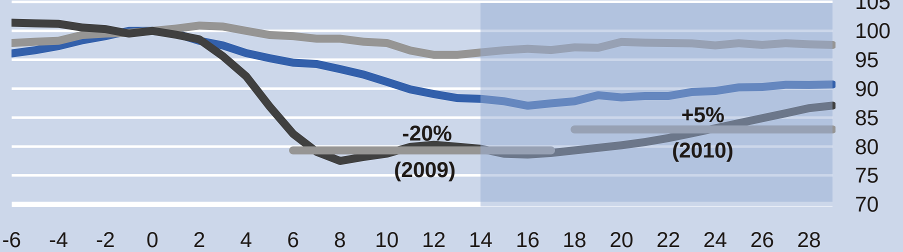
Consumer goods industry with higher risks. The capital goods sectors were hit particularly hard by the recession. Private consumption in Germany remained surprisingly stable and has helped many consumer goods sectors through the crisis. As unemployment will inevitably rise in 2010, consumer goods manufacturers will not profit from the recovery as much as the capital goods industry.

Construction industry benefits from economic packages. Germany did not witness the exaggerations on the housing markets as in Spain, Ireland or the UK, so there is less need for adjustments. Furthermore, the economic stimulus packages launched in Germany are benefiting the construction industry, especially civil engineering and restoration and modernisation work. A slight increase in output is therefore likely in 2010.

Upswing: Too strong a word. The signs of an improvement are clearly visible; this is also reflected in our growth forecast for the manufacturing industry (+5%). Nonetheless, its dimension should not be overrated. The level of capacity utilisation in Germany is very low at around 70%. Such growth in production, though visible, will only take a little of the strain off companies that have been hit particularly hard. This is recovery, but we are not yet out of the woods.

Comparison of recessions: very deep fall in 2009

Real production index*, smoothed, German manufacturing industry



* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.

Sources: German Federal Statistical Office, DB Research

www.dbresearch.com

Authors
Josef Auer
+49 69 910-31878
josef.auer@db.com

Philipp Ehmer
+49 69 910-31879
philipp.ehmer@db.com

Eric Heymann
+49 69 910-31730
eric.heymann@db.com

Tobias Just
+49 69 910-31876
tobias.just@db.com

Uwe Perlitz
+49 69 910-31875
uwe.perlitz@db.com

Editor
Tobias Just

Technical Assistant
Sabine Berger, Angelika Greiner

Deutsche Bank Research
Frankfurt am Main
Germany
Internet: www.dbresearch.com
E-mail marketing.dbr@db.com
Fax: +49 69 910-31877

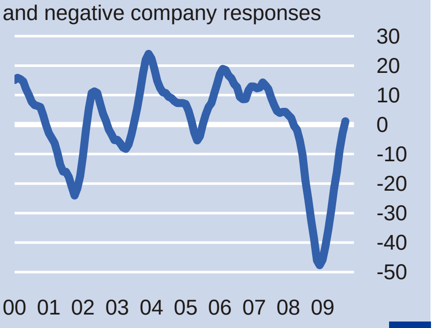
Managing Director
Norbert Walter

Macroeconomic environment[1]

2009: The worst recession for 60 years …

Germany's price-adjusted gross domestic product (GDP) contracted for four quarters in succession, sinking by just over 6.5% between the second quarter of 2008 and the first quarter of 2009. There were massive slumps in demand especially after the financial crisis escalated in the wake of the Lehman bankruptcy. GDP plunged 3.5% qoq alone in the first quarter of 2009. The drivers during the last upswing - exports and private investment – now proved to be the biggest burdens given the synchronous global downturn in production. Private consumption, by contrast, has remained stable in Germany so far.

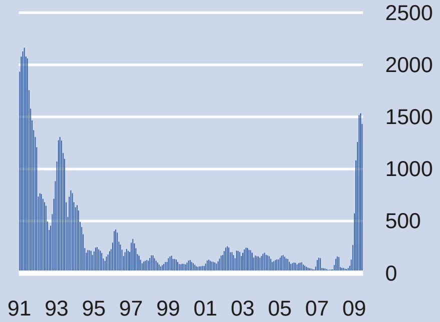
Industry sentiment is improving
Business expectations, balance of positive and negative company responses



Source: ifo Institute 1

That private consumption did not fall as in other industrial countries (US, UK, ES) is due to the fact that Germany did not witness the exaggerations on the housing markets that had led to an artificially inflated level of consumption. An added factor is that the prolongation of state benefits for short-time workers has so far very effectively delayed and in some cases even averted the adjustments on the labour market. The unemployment rate rose a "mere" 0.6 percentage point between September 2008 and September 2009 to now 8%. The number of people in gainful employment had only fallen by just over 200,000 by summer 2009. However, the number of unemployed is likely to rise in 2010, as the benefits for workers on short time are only being paid for a limited period and the course of the economy so far is not sufficient for many companies to survive without downsizing their workforces.

Short-time working very high
Number of workers on short time , in '000

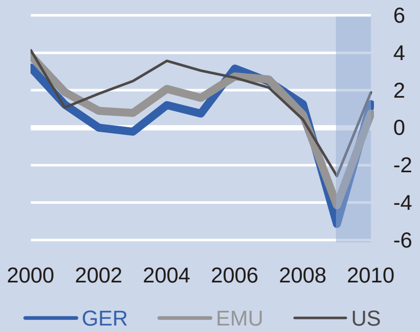


Source: Federal Employment Service (BA) 2

… has ended

All the same, the severest adjustments in production should be behind us. GDP already grew slightly in Germany in the second quarter of 2009. This is also reflected in companies' business expectations. New orders have been picking up again since May 2009, too. The expansive monetary and fiscal policy has obviously been a contributing factor. And even though at times the general impression was that loans were being rationed, this is not borne out by the statistics for Germany. In the first half of 2009 German banks' lending to firms and households did not fall but rose, despite reduced borrowing requirements for expansion.

In unison: upwards!
Gross domestic product, real, % yoy



Source: DB Research 3

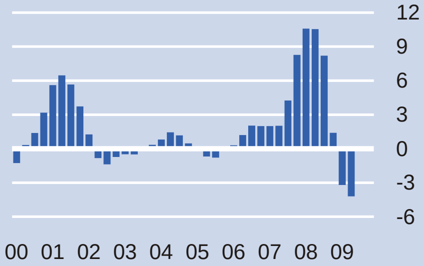
No easy upswing but a hard climb

Nonetheless, there are still appreciable risks to the upswing in 2010. Firstly, the economic stabilisation has been bought with huge support packages. The resulting pull-forward effects, especially from the car scrapping incentive, naturally mean that this demand will be lacking in future. And, obviously, the steep rise in public debt is at the expense of future consumption.

All in all, after plunging sharply in 2009 (by a total of over 5%) Germany's gross domestic product will probably see moderate growth of just over 1% in 2010. The upswing will therefore be an arduous climb.

[1] For details see: Gräf et al. (2009). Economic outlook 2009/10. German economy – recession ended. Deutsche Bank Research. Current Issues. Frankfurt am Main.

Prices come down again
Producer price index, food & beverages, % yoy

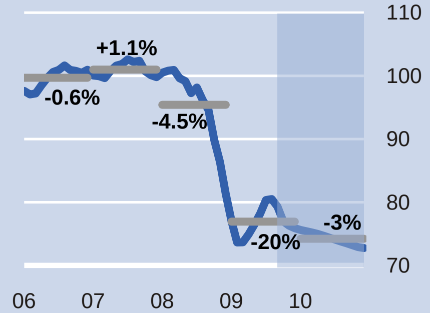


Source: German Federal Statistical Office 4

Food industry defies the crisis
Real production index, smoothed, food & beverages, 2005=100

Sources: German Fed. Statistical Office, DB Research 5

Production plummets
Real production index, smoothed, textile industry, 2005=100



Sources: German Fed. Statistical Office, DB Research 6

Downward trend unbroken
Real production index, smoothed, clothing industry, 2005=100

Sources: German Fed. Statistical Office, DB Research 7

Food & beverages: Haven of stability

Germany's food & beverages industry has come through the crisis relatively well. It has not seen the dramatic slumps witnessed in other industrial sectors. At constant prices domestic production will probably more or less stagnate this year (2008: +0.2%). As the demand for food and beverages is very inelastic, rising unemployment, declining disposable incomes and a higher savings ratio will not affect the industry as much as manufacturers of consumer durables for instance (e.g. furniture). We expect growth of about 2% in production next year – also due to a statistical overhang. The flip side is that the sector profits less than proportionally in the upswing phase.

Obviously, the crisis has left its mark on the food & beverages industry, too: consumers are opting more often for low-priced products. This is dampening qualitative growth. Consequently, the already high price pressure in the industry, driven by food retailers' market power and the growing importance of discounters, is intensifying. Producer prices came down appreciably in the first half of 2009 after rising strongly in 2008. Although 2009 has seen some relief on the costs side as the prices of many agricultural raw materials and energy have come down from their levels in 2008, retailers are taking advantage of this situation to demand price cuts. This is reinforcing the consolidation process in the industry.

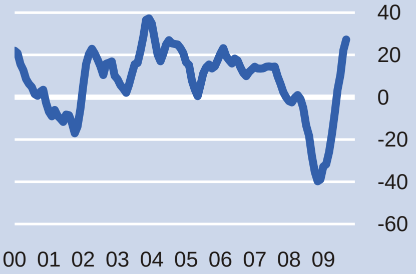
Textiles: Pronounced downtrend

The German textile industry felt the full impact of the economic crisis. Production in 2009 is likely to be down 20% in real terms although it has seen a slight recovery of late. A negative factor for the industry is that because of the recession the demand for technical textiles in other industrial sectors – the most dynamic segment within the industry in the years before the crisis – has fallen off. In addition, in times of crisis household demand for home furnishings (e.g. carpets, curtains) declines since they are non-essential goods whose purchase can be postponed. Not least of all, the migration of production to countries outside Germany is continuing; this holds especially for clothing textiles. We expect a drop of about 3% in German textile production in 2010.

Clothing: Structural problems predominate

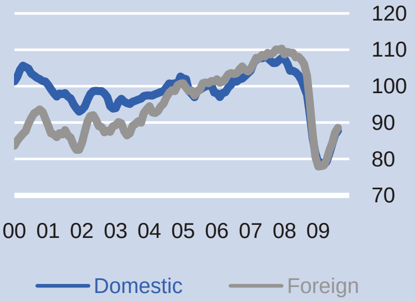
Production in the German clothing industry is still on the decline. The current economic crisis has made no special imprint as it is the industry's structural problems that are the predominant factor. More and more factories are being relocated to low-wage countries outside Germany. Germany is only competitive for the manufacture of small lots or very high-quality clothing. This trend is already well advanced. Most of the clothing sold in Germany is produced abroad. All the same, German companies can operate successfully in this environment by exploiting the advantages of foreign production and the liberalisation of the international clothing trade. All in all, we expect production in the clothing industry to decline by 14% in 2009 and by 10% next year.

Chemicals back in positive territory
Business expectations, balance of positive and negative company responses



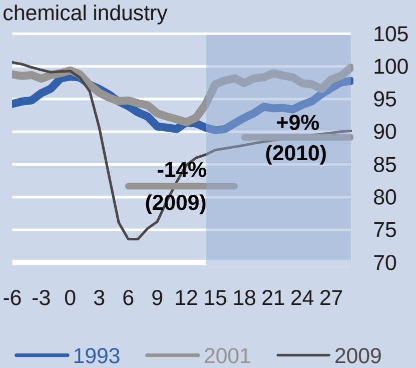
Source: ifo Institute 8

On the rise again
New orders, chemical industry, 2005=100, smoothed



Sources: German Federal Statistical Office 9

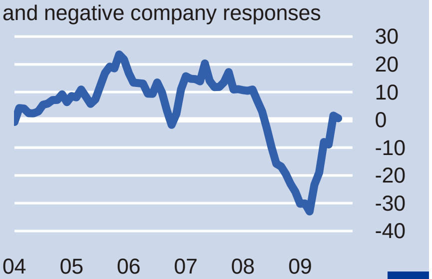
Steep fall
Real production index*, smoothed, chemical industry



* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.

Sources: German Fed. Statistical Office, DB Research 10

Pharma slightly positive
Business expectations, balance of positive and negative company responses



Source: ifo Institute 11

Chemical industry on the up

The German chemical industry also suffered a sharp downturn in production after the international financial crisis escalated in September 2008. Between September 2008 and January 2009 output in the chemical industry (seasonally adjusted) plunged overall by one-fourth, and companies' business expectations were deep into double-digit negative territory. Both domestic and foreign business was affected. Capacity utilisation fell to only about 70%, a drop of roughly 15 percentage points versus mid-2008. With the launch of the economic support programmes (like the car scrapping incentive), from which the chemical industry benefited indirectly, business expectations already began to brighten early on and production picked up again as customers began to build up stocks. Nonetheless, we estimate that for the full year 2009 production in the industry will still be down 14% yoy in real terms.

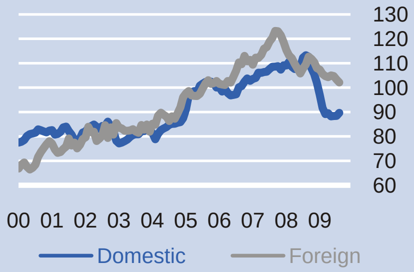
The trend in production in the chemical industry will continue to head upwards next year. The industry will receive tailwind from important user industries (e.g. vehicle manufacture, electrical engineering). For 2010 we expect production in the chemical industry to rise 9% at constant prices due to the appreciable statistical production overhang this year (+7%) and the expected slight general economic recovery. Despite the rising trend, at the end of 2010 production in the chemical industry will still be nearly one-tenth below the high August 2008 level. However, there will be very wide differences from segment to segment. High growth rates are likely in basic chemicals, the biggest segment accounting for 60% of the industry's total output. The paints & coatings segment should benefit from modernisation programmes (e.g. at schools, etc.). After a strong downturn in 2009 the more consumer-oriented segments such as body care products, on the other hand, are likely to see little growth given the slight downward trend in private consumption.

Pharma industry less vulnerable

Production in the largely cyclically resistant pharmaceutical industry should witness an only relatively small decline of 2% in 2009 (chemicals: -14%). Although the OTC (over-the-counter) market is suffering from the weakness of private consumption in Germany, the setbacks have been compensated to some extent by government measures (stocking up on influenza vaccines and inoculation programmes in the connection with the so-called swine influenza epidemic); however, vaccines currently account for only about 5% of the public health insurers' total expenditures on pharmaceuticals. Another stabilising factor for the pharmaceutical industry is the large number of chronically-ill people (e.g. 7 million diabetics) who need to take pharmaceuticals on a permanent basis.

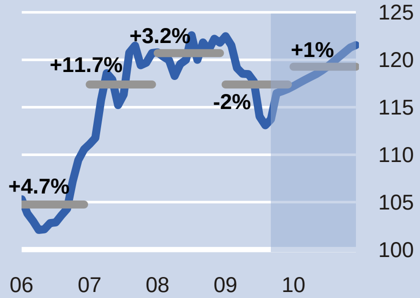
We expect the upward trend in production to continue in 2010 as export business revives. Given an export ratio of around 60%, the industry relies to a large extent on the development of foreign markets. The expected stronger demand for pharmaceuticals should have a positive impact on capacity utilisation in the industry, which, at 83% at the last count, was already high compared to the chemical industry. In addition, there could be a little more leeway for price increases again. As more active substances are going off-patent in 2009/2010 than in 2007/2008, pharmaceutical companies have

Foreign demand much better
New orders, pharmaceutical industry, 2005=100, smoothed



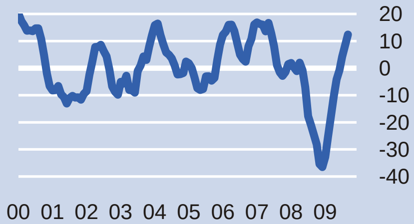
Source: German Federal Statistical Office 12

Only a small dip
Real production index, smoothed, pharmaceutical industry, 2005=100



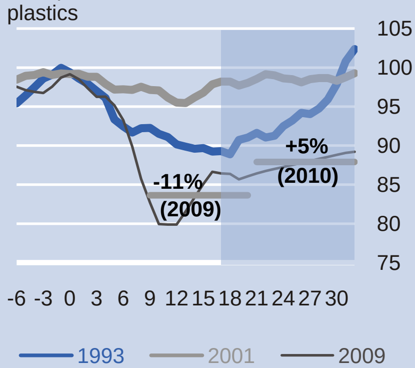
Sources: German Fed. Statistical Office, DB Research 13

Plastics industry positive again
Business expectations, balance of positive and negative company responses



Source: ifo Institute 14

Heading up
Real prodcution index*, smoothed, plastics



* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.

Sources: German Fed. Statistical Office, DB Research 15

been stepping up their search for new drugs. However, often the new products are merely "mock" innovations, i.e. previous preparations are just modified a little so that they can be patented again.

Plastics industry turns up again

The plastics industry has suffered in 2009 from the production setbacks in important user industries. On our estimates production will be down 25% in the automotive industry and down 22% in the electrical engineering industry this year. Output in the construction industry is likely to be 3% lower than last year. The production setbacks have affected virtually all segments of the plastics industry – from engineering plastics, via packaging, through to construction plastics. Owing to the drop in demand and the stiff competition in the industry producer prices have fallen in 2009 for the first time since 2004 (by an average of about 3% yoy between January and September 2009). Business expectations in the industry have picked up strongly again since the beginning of 2009 and were well into positive territory at the last count. However, it will take some months for this development to be reflected in production. We therefore expect production to still be down 11% in 2009.

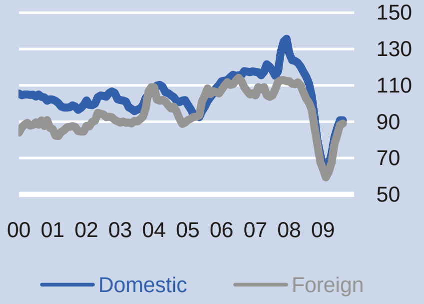
For 2010 we estimate real growth of 5% in production in the plastics industry, although much of this will be due to the relatively high starting level at the beginning of 2010 (statistical overhang: +3%). Nonetheless, at the end of 2010 production will probably still be one-tenth lower than at the beginning of 2008. Higher energy prices are likely to be a burdening factor for the industry although its energy costs as a percentage of gross value added are only slightly higher than for industry generally.

Growth in metal and metal-working

The industry has been hit in 2009 by the poor level of activity in the German capital goods industry, especially in the automobile industry. The steel industry is expected to produce 34 million tonnes of crude steel, which is about one-fourth less than last year. At the last count six of the 15 smelters in Germany were shut down and the others were only operating at reduced capacity. The existing production facilities have a capacity of 53 million tonnes of crude steel. Metal and metal-working has probably suffered the biggest drop in production of the main industrial sectors, with a decline of 29% in real terms. Parallel with the downturn in crude steel output, the average selling prices for the main steel grades also plummeted. In mid-September 2008 they were still about two-fifths up year over year but fell sharply since then. By mid-2009 they were already two-fifths lower than a year earlier, and were back down to their mid-2006 level.

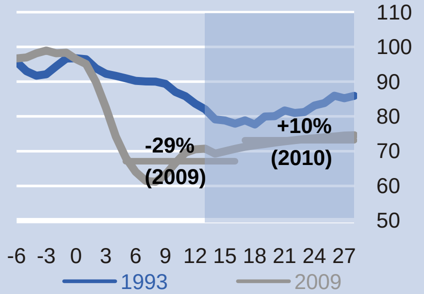
In view of the dynamic trend in new orders and the business expectations among companies in the industry a strong 10% rise in production appears likely in 2010. Nonetheless, at the end of 2010 the industry will still be about one-fourth short of the high mid-2008 level. The metal and metal-working industry will receive tailwind from alternative power generating technologies. The German wind power industry today already consumes almost one million tonnes of steel a year, which is about three times more than the shipbuilding

Over the worst
New orders, metal and metal-working, 2005=100, smoothed



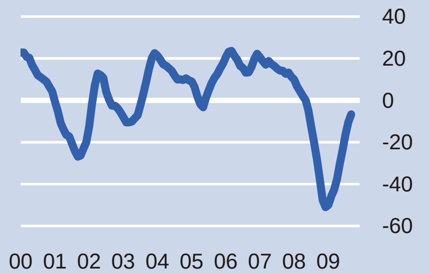
Source: German Federal Statistical Office 16

Deep plunge
Real production index*, smoothed, metal and metal-working



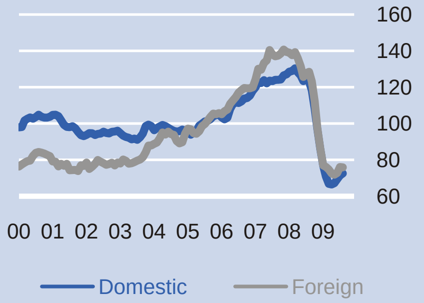
* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.
Sources: German Fed. Statistical Office, DB Research 17

Mechanical engineering: first positive signs
Business expectations, balance of positive and negative company responses



Source: ifo Institute 18

Sharp downturn over
New orders, mechanical engineering, 2005=100, smoothed



Source: German Federal Statistical Office 19

industry. In addition to new installations, more and more old generators are being replaced with modern technology (so-called repowering). The operators of wind power generators have therefore become an important customer group for the steel industry.

Engineering industry in a deep trough

While production in the German mechanical engineering industry rose by 38% in the five growth years through to 2008, it is expected to see a sharp drop of 27% in 2009. The slump in production is a reflection of the freeze on capital investments witnessed in almost all markets and regions in the wake of the Lehman collapse. This was due not only to the extreme uncertainty caused by the financial and economic crisis. An added factor was the globally high and in some areas excessive level of capital investment during the almost synchronous economic upswing in the years prior to the crisis, so when the boom was over the need for new capital investment was low anyway. This holds both for the big commodity exporters like Russia and for important industrial customers such as the automotive industry.

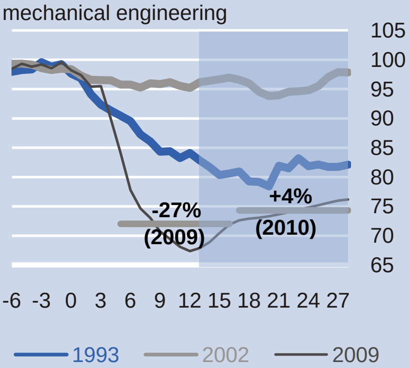
A comparison of the last three recessions in the mechanical engineering industry shows that the latest crisis is by far the deepest. Almost all segments of the industry have had to cut back production at double-digit rates in 2009. Manufacturers of smelter and rolling mill equipment have probably fared better. They have benefited from the fact that it has taken longer to work off the order backlog. Manufacturers of gas, steam, water and wind turbines, too, are still profiting from the special situation in the market for new energy systems. Machine tool manufacturers, on the other hand, have suffered much more severe setbacks. While the mechanical engineering industry as a whole is particularly cyclical, the cycles in the machine tool segment are far more pronounced. As it produces capital goods for manufacturers of capital goods, it is exposed to business cycles with a built-in amplifier effect as it were.

Slight recovery at a very low level

However, there have been first positive signs of late. With the gradual recovery of the world economy business expectations in the industry have improved in recent months and will probably gradually return to positive territory again. Order intake should have touched bottom now, too. Confidence visible again in major user industries will also lead to new orders again in the coming months. Companies are now slowly beginning to build up stocks. Interest rates are relatively low at present. The investment freeze could thaw as signs emerge that the low interest phase is drawing to an end. Moreover, the recovery of prices for industrial and energy raw materials will stabilise the situation in the producer countries and, with time, will also enable them to start investing in modernising or expanding their productive capacities again.

The better future order volumes could allow growth of 4% in production in the mechanical engineering industry in 2010. That would mean that the industry's production would contract for only one year, and thus not as long as in earlier cycles, but the downturn was never so abrupt and steep before, so a slight recovery at the very low level appears quite probable. However, it will very likely take more than three good growth years to regain the old high 2008 production level. Moreover, the mechanical engineering industry's present weakness will also cause the gap versus China, the new

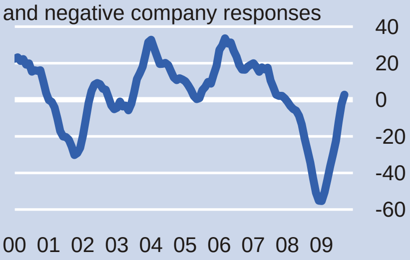
Recovering only slowly
Real production index*, smoothed, mechanical engineering



* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.

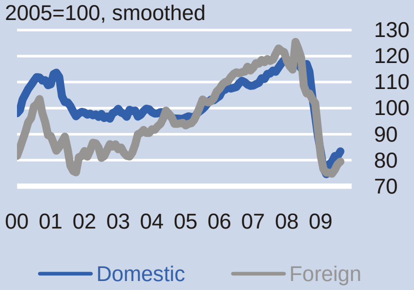
Sources: German Fed. Statistical Office, DB Research **20**

Electrical engineering: better times ahead
Business expectations, balance of positive and negative company responses



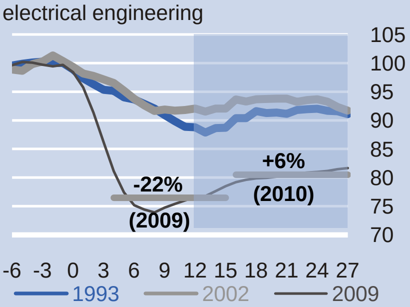
Source: ifo Institute **21**

Order intake stabilises
New orders, electrical engineering 2005=100, smoothed



Source: ZVEI **22**

Hefty downswing
Real production index*, smoothed, electrical engineering



* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.

Sources: ZVEI, DB Research **23**

No. 1 in the global engineering industry, to widen. Chinese manufacturers are benefiting from the buoyancy of their home market.

Electrical engineering back on track in 2010

The electrical engineering industry is primarily a capital goods industry. Capital goods account for almost 80% of its production, while consumer goods are of minor importance only. The sector posted above-average growth rates in the industrial boom phase in the years 2004 to 2008. The electrical engineering industry offers typical cross-sectional technologies and is closely entwined with other sectors of German industry. As a result, the sector was unable to escape the general downswing in manufacturing industry in 2008. It was no less able to decouple from its primary cause – weak foreign demand. Growth therefore levelled off in the course of 2008 and witnessed a first strong quarter-on-quarter drop in production in the fourth quarter. Production sank from month to month from September last year to spring 2009. Signs that the trend was bottoming out only emerged in the months May to August. The cumulative year-over-year drop in production in the first eight months of 2009 was 24%. According to figures published by ifo Institute, capacity utilisation is currently just 72%, which is over 10 percentage points below the long-term average.

The leading indicators, however, suggest that the situation is improving. With a cumulative year-over-year drop of 33%, order intake is still clearly lagging the trend in production. However, the bottom here was already reached in March and orders booked of late have picked up appreciably from their level at the low point of the down cycle. Business expectations are back into positive territory again. After the sharp slump at the end of 2008 the indicator has recovered more and more since January 2009 until now.

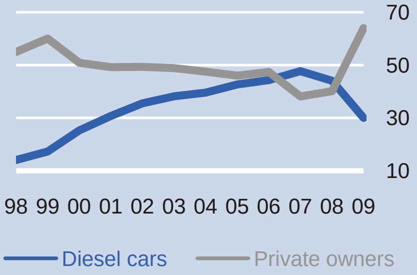
2010: Recovery after one of the industry's deepest crises

After the poor first half of 2009 the industry can no longer avoid posting its worst crisis since World War II. However, production should pick up a little by the end of the year – from a level comparable with that reached four years ago. The economy as a whole is gradually reviving and the electrical engineering industry, with its capital goods bias, should be one of the first to emerge from the present recession. We estimate that for the full year 2009 production will be down 22% in real terms, with 6 percentage points of that being attributable to the statistical underhang at the turn of the year 2008/2009.

The industry is likely to start off 2010 with a slight overhang. Production could continue to pick up in the course of the year. The investment climate is favourable thanks to the economic stimulus programmes and low interest rates. Investment in plant and equipment in Germany should rise in 2010. We expect growth of 6% in production next year. However, this growth is from an extremely low base. With this nominally high growth rate the industry would only recoup just over one-fifth of this year's downturn. The level before the outbreak of the crisis a year ago is unlikely to be reached again before 2014.

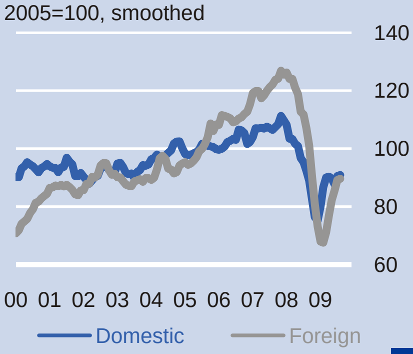
Auto industry: production suffers in 2010 from weak domestic market

Scrapping incentive causes strong shifts in market share
Diesel cars and private owners as % of new car registrations in DE



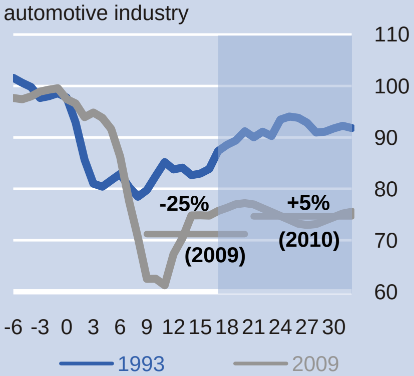
Sources: KBA, VDA, DB Research **24**

Orders pick up again
New orders, automotive industry, 2005=100, smoothed



Source: German Federal Statistical Office **25**

Current recession much deeper than in 1993
Real production index*, smoothed, automotive industry



* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.

Sources: German Fed. Statistical Office, DB Research **26**

Germany's automotive industry plunged into its deepest recession of the post-war period in mid-2008. Real domestic output – based on the production index – is expected to fall by one-fourth in 2009 (2008: -3.8%). The main reason is the sharp downturn in demand in almost all the major automobile markets (except China) and vehicle segments. This has affected Germany's export-oriented auto industry, including suppliers, particularly hard. Car exports (in units) are likely to contract by about 25% this year.

In Germany, too, the demand for vehicles continued to plunge through to the beginning of 2009. In the passenger car segment the situation changed abruptly with the introduction of the car scrapping premium. It proved to be a successful economic policy instrument. Thanks to the government cash incentive for new car purchases (EUR 2,500 if the buyer scrapped an at least nine-year-old car at the same time) new car registrations in Germany will probably be boosted by over one-fifth in 2009 and reach their highest level since 1999. The car scrapping premium has prevented an even steeper slump in domestic production in 2009 and – together with the prolongation of state benefits paid to workers on short time – helped to stabilise employment in the industry. Nonetheless, the car scrapping incentive is questionable from the aspect of free market principles (e.g. distortions in competition versus other sectors). Also conspicuous are the visible trend aberrations it has caused: in 2009 more small cars, more petrol models and more foreign car brands have been purchased by a higher proportion of private owners than in the years before. This makes production planning more difficult for companies.

Big question mark over exports as potential growth driver

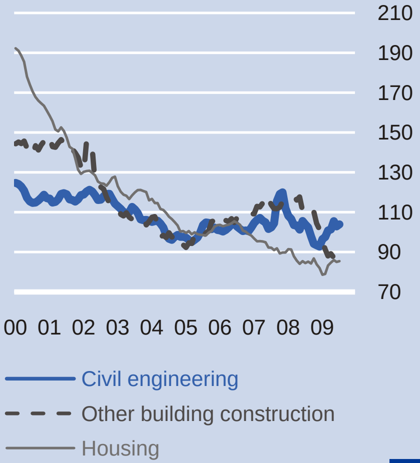
The automotive industry has to reckon with declining new passenger car registrations in 2010 due to the purchases that were brought forward because of the scrapping premium. Unit sales in Germany could then plunge by up to 30% and have an adverse effect on production levels.

The industry is therefore pinning its hopes for 2010 on exports. Many important export markets are currently showing signs of recovery – at a very low level – which should continue in 2010. However, in many cases this development is supported by incentive schemes that are due to be phased out in the next few months. Furthermore, unemployment is likely to rise in most countries. These two factors will dampen the demand for automobiles. All in all, vehicle exports from Germany will probably pick up again in 2010 but will not regain the 2008 level by a long way yet.

All in all, we expect growth of 5% in automobile production in Germany in 2010, much of which will be attributable to a statistical overhang. After the steep downturn at the end 2008 and the beginning of 2009, when many plants shut down completely for a time, production has already trended upwards again in the past months; the same holds for orders and business expectations, too. We expect a further moderate upward trend in production through to the end of the year. In the first half of 2010, however, production is likely to see a dent owing to the then weak domestic demand from private individuals. On the other hand, support should be felt in 2010 from reviving demand for vehicles from commercial customers and the end of the recession in the commercial vehicle segment. In addition, new models presented at the IAA 2009 should stimulate demand.

Construction affected to differing extents

Building construction headed down, civil engineering up
New orders, 2000=100, sa, smoothed

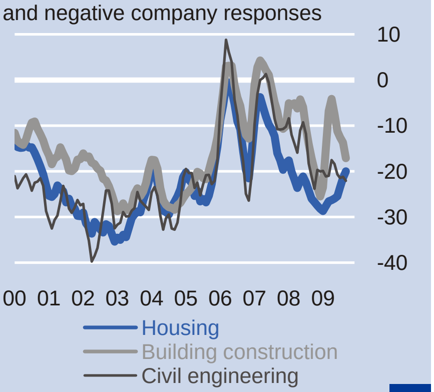


Source: German Federal Statistical Office 27

After strong growth rates in 2006 (5.2%) and 2007 (2.9%) the financial crisis already began to impact the German construction markets in the course of last year: construction output only increased by about 0.7% in 2008. In the first eight months of 2009 output in the construction industry (output of companies with at least 20 employees) was down roughly 3.5% yoy.

With this performance the construction industry came off fairly lightly compared to many capital goods industries and also compared to many other European construction markets. This is due to the fact that there had been no exaggerations previously on the construction and property markets in Germany. In fact, the industry had only just emerged a few years ago from the difficult ten-year adjustment process that followed in the wake of the post-unification boom. In that period through to 2005 the construction industry had already contracted by a good 25% at constant prices.

Pessimists predominate
Business expectations, balance of positive and negative company responses



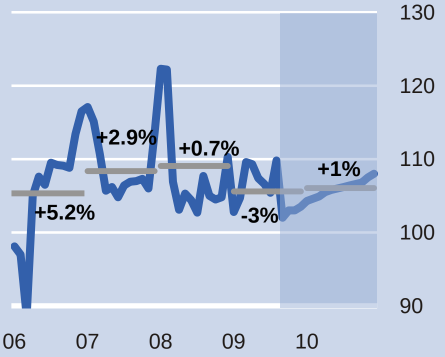
Source: ifo Institute 28

Nonetheless, the construction industry has not been left completely unscathed by the crisis: commercial projects especially were shelved or abandoned owing to the reduced demand for space and difficult financing conditions. Although the very low interest rates are making it easier for people to buy properties, the persistently high risks on the labour markets deter potential home owners. This has left its mark on residential construction: in the first half of 2009 housing permits both in the single and two-family home segment and in multifamily housing were appreciably down from the already very low level in the same period last year. At almost 9%, the decline in the owner-occupied home segment was even much more pronounced than in the multifamily housing segment (-4.7%).

Outlook at best guardedly optimistic

Consequently, business expectations in the construction industry are still very poor. The expectations for the next six months are only slightly above the level at the low point of the crisis. Still, the economic support programmes are evidently beginning to take effect. These programmes are benefiting modernisation and restoration work much more than new building projects. Total construction investment, which also includes small firms in the building trade, already picked up in the second quarter of 2009 versus the first quarter.

Construction: slow recovery
Production, construction industry, 2005=100



Sources: German Fed. Statistical Office, DB Research 29

We estimate that construction output in 2009 will be nearly 3% lower than last year. Next year, when the support measures for infrastructure projects should take effect, small growth of about 1% could be possible again. The growth in total construction investment should be slightly higher owing to the greater weight of modernisation and restoration work. However, there are two important qualifications that need to be made here. Firstly, local government authorities face considerable losses of revenue. This will also adversely affect public construction activity. Secondly, the forecast for 2010 assumes an upturn on the housing markets. This is based on the expectation that more people will consider property to be a safe investment again. However, the stronger the impact the recession has on the labour markets in 2010, the less weight this argument will have. There is therefore a significant risk that construction output could contract again in 2010.

Conclusion: upswing too strong a word

In the past twelve months the manufacturing industry witnessed the worst recession for 60 years. Orders, especially for capital goods, slumped sharply both at home and abroad. Many markets only began to stabilise towards the middle of the year, helped also by massive economic support programmes running into the billions. Since then production has picked up a little again. Nonetheless, output in 2009 is still likely to about 20% lower on a price-adjusted basis than last year.

The outlook for next year is guardedly positive. Sentiment in industry has brightened appreciably and production is picking up strongly again in some important upstream sectors, especially the chemical industry. Nonetheless, setbacks are likely at the turn of the year because the scrapping incentive for old cars for instance was – rightly – introduced only for a limited period of time. All in all, relatively strong growth of about 5% – from the very low level reached in mid-2009 – should be feasible for the full year 2010.

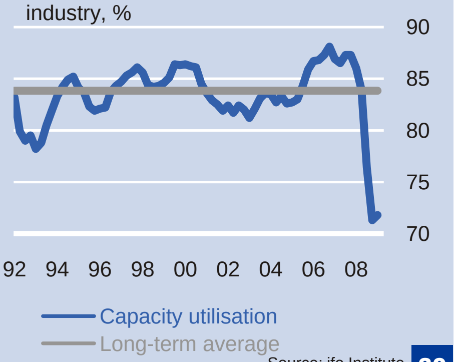
This forecast growth rate does not mean good times, however. It is only comparable to a very limited extent with the similarly high growth rates of the boom years 2006 and 2007. It signals an improvement in the industry but not a return to good health as yet: even with 5% more production the level of capacity utilisation in the industry will still be at least 8 percentage points below the long-term average at the end of 2010. This would be a more pronounced deviation than during the recession in 2002/2003. So many companies will remain under very high adjustment pressure next year as a number of support measures will have expired.

But, finally, there is another small ray of hope. In the course of the financial and economic crisis there might have been overreactions on the downside. As a result, there could be a "trampoline effect" on the upside in 2010, in which case our baseline forecast would be too conservative. However, so far this is a positive scenario with a small degree of probability at best. But it is worth mentioning all the same!

Josef Auer (+49 69 910-31878, josef.auer@db.com)
Philipp Ehmer (+49 69 910-31879, philipp.ehmer@db.com)
Eric Heymann (+49 69 910-31730, eric.heymann@db.com)
Tobias Just (+49 69 910-31876, tobias.just@db.com)
Uwe Perlitz (+49 69 910-31875, uwe.perlitz@db.com)

Underutilised!

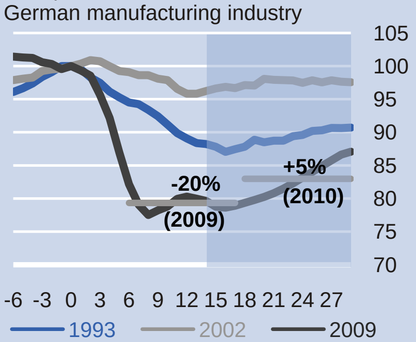
Capacity utilisation in the manufacturing industry, %



Source: ifo Institute 30

Comparison of recessions: very deep fall in 2009

Real prodcution index*, smoothed, German manufacturing industry



* Month 0 (=100) represents the point in time when the crises come to be reflected clearly in the production figures for the sector.

Sources: German Fed. Statistical Office, DB Research 31

Forecast for major industrial sectors

Sector	NACE	Gross value-added	Export ratio	Energy dependence	Producer prices	Production 2007	2008	2009	2010
		EUR bn, 2007	%, 2008	Share of energy costs in gross output, %, 2007	last 12M, % yoy	% yoy	% yoy	% yoy	% yoy
Food & beverages	10	32.4	20.2	2.3	-2.0	3.0	0.2	0	2
Textiles	13	4.1	45.7	3.0	1.1	1.1	-4.5	-20	-3
Clothing	14	2.3	40.9	0.5	1.1	-8.1	-14.6	-14	-10
Chemicals	20	33.5	60.1	3.4	0.1	1.8	-3.8	-14	9
Pharmaceuticals	21	15.9	56.1	1.0	0.0	11.7	3.2	-2	1
Plastics	22.2	16.2	39.1	2.5	-1.2	6.4	-1.9	-11	5
Metal and metal-working	24	24.8	38.7	5.2	-9.8	3.5	-1.1	-29	10
Mechanical engineering	28	74.2	57.6	0.8	2.8	10.7	5.0	-27	4
Electrical engineering	ZVEI definition	61.3	45.5	0.7	-1.4	9.1	4.9	-22	6
Automobile	29	74.1	62.2	0.7	0.6	6.5	-3.8	-25	5
Manufacturing	10-33	519.6	46.7	1.8	-0.6	6.2	1.0	-20	5
Construction	41-43.1	88.3*	-	-	2.0**	2.9	0.7	-3	1

* Total construction industry
** Construction price index for residential buildings

Sources: German Federal Statistical Office, DB Research

Printed by: HST Offsetdruck Schadt & Tetzlaff GbR, Dieburg

ISSN Print: 1612-314X / ISSN Internet and e-mail: 1612-3158