Focus Germany

German GDP up 0.5% in 2013 – despite slowdown in H2

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German GDP up 0.5% in 2013 – despite slowdown in H2. We have lifted our forecast for 2013 GDP growth in Germany from 0.1% to 0.5%. This is not based on a more bullish assessment of H2's growth dynamics, though. Our call results instead from the growth surge due to one-off effects in Q2 (0.7% yoy) and from revisions to the 2012 performance as these produced a smaller statistical underhang and thus lead to a higher annual average for 2013.

Investment behaviour of German households: Markedly higher risk aversion in the course of the financial crisis. The trend towards higher-yielding investments witnessed during the 1990s came to an end at the latest when the financial crisis erupted. Since then households have preferred to make their financial investments in the form of cash and deposits at financial institutions, that is in investments that carry very little or no risk. This does reduce the risk of making a loss, but the downside is a low return. Households in the peripheral eurozone countries have displayed considerably greater risk tolerance with their financial investments. Accordingly, their financial assets have risen considerably faster in recent decades. Of late, however, a trend towards increased risk aversion can also be observed there, too. At 187% of GDP or EUR 123,100 per household the total financial assets in Germany correspond to a lower mid-table ranking by European standards. Including real assets in the analysis alters the picture very little. The typical German household ranks at the bottom end of the European rankings with respect to total assets. This is primarily due to the fact that fewer than half of German households own their own home.

Germans no longer world's keenest holidaymakers. In 2012 the Germans were overtaken by the Chinese as the world's most avid holidaymakers. But by no means have the Germans lost their appetite for foreign travel. On the contrary, expenditure on trips abroad has risen by 9% in euro terms since 2005. Expenditure was up noticeably especially over the last two years, which can probably be attributed to markedly higher disposable income as well as falling unemployment. Thanks to Germany's positive economic situation characterised by low unemployment rates and rising disposable income, another increase looks possible for 2013. Strongly rising incomes are also the reason why the Chinese can spend increasingly more money on foreign travel. Their tourism expenditure has grown fivefold since 2005. In per capita terms, however, China still lags considerably behind Germany. But here, too, Germany has been outstripped, this time by Australia. Despite the growing shares of other destinations, more than half of German travel expenditure is accounted for by EU countries. Spain, Italy and Austria remain the most popular holiday destinations. Among the non-EU countries, Turkey in particular is registering rising tourism revenues from German travellers. All in all, domestic tourism probably plays a more important role than foreign travel, especially if money spent by visitors to Germany is included. Depending on the definition applied, domestic tourism generates between a good 4% and up to 10% of total economic output in Germany.

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Euroland	-0.6	-0.4	1.0	2.5	1.5	1.5	1.3	1.6	1.6	-3.7	-3.0	-2.5
Germany	0.7	0.5	1.5	2.0	1.6	1.6	7.0	7.0	6.9	0.2	0.0	0.2
France	0.0	-0.2	1.1	2.2	1.1	1.5	-2.2	-2.2	-1.9	-4.8	-3.9	-3.3
Italy	-2.4	-1.7	0.6	3.3	1.6	1.5	-0.5	0.8	1.0	-3.0	-3.2	-2.9
Spain	-1.6	-1.5	0.5	2.4	1.6	1.6	-1.1	0.5	0.3	-10.6	-6.2	-5.3
Netherlands	-1.3	-1.1	0.4	2.8	2.6	1.7	10.1	8.2	8.0	-4.1	-3.9	-3.3
Belgium	-0.3	-0.1	0.9	2.6	1.2	1.5	-1.6	0.5	1.0	-3.9	-3.0	-3.0
Austria	0.8	0.4	1.4	2.6	2.0	1.8	1.8	2.5	2.8	-2.5	-2.1	-1.8
Finland	-0.8	-0.7	1.1	3.2	2.3	2.1	-1.8	-1.0	-1.0	-1.9	-2.3	-1.8
Greece	-6.4	-4.5	0.5	1.0	-0.5	-0.2	-3.4	-1.0	0.0	-10.0	-4.9	-3.7
Portugal	-3.2	-2.6	0.5	2.8	0.6	1.1	-1.8	0.5	1.5	-6.4	-5.7	-4.6
Ireland	0.2	0.7	1.8	1.9	0.8	1.3	4.4	4.0	4.0	-7.6	-7.6	-5.3
UK	0.2	1.4	2.1	2.8	2.7	2.1	-3.8	-2.8	-2.4	-5.5	-6.5	-6.0
Denmark	-0.4	0.4	1.5	2.4	1.1	1.8	5.6	5.0	5.0	-4.4	-2.0	-2.0
Norway	3.0	2.3	2.6	0.7	1.8	1.9	14.1	13.0	12.5	10.1	12.0	12.0
Sweden	1.1	1.5	2.0	0.9	0.2	1.4	5.9	7.0	7.0	-0.7	-1.0	-0.5
Switzerland	1.0	1.5	1.5	-0.7	-0.4	0.5	13.6	13.0	13.0	0.4	0.3	0.3
Czech Republic	-1.2	0.0	2.0	3.3	1.7	1.9	-2.5	-2.3	-2.5	-4.4	-3.1	-2.7
Hungary	-1.7	0.4	1.1	5.7	1.9	2.5	1.7	1.2	0.5	-2.0	-2.7	-2.6
Poland	1.9	0.8	2.5	3.7	1.3	2.2	-3.5	-2.3	-3.1	-3.9	-3.6	-3.3
United States	2.8	1.6	3.2	2.1	1.5	2.2	-3.2	-3.2	-3.5	-6.6	-3.8	-3.2
Japan	2.0	1.6	0.9	0.0	0.1	2.5	1.1	1.5	2.8	-9.5	-9.3	-7.3
World	3.1	2.8	3.8	3.3	2.9	3.4						

*Consumer price data for European countries based on harmonized price indices except for Germany. This can lead to discrepancies compared to other DB publications.
Sources: National Authorities, Deutsche Bank

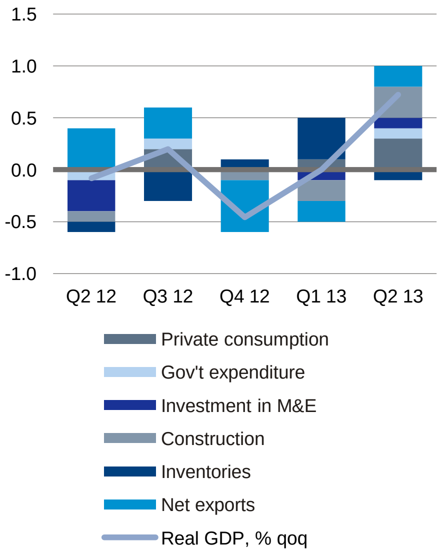
Forecasts: German GDP growth by components, % qoq, annual data % yoy

						2012				2013			
	2010	2011	2012	2013F	2014F	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F
Real GDP	4.0	3.3	0.7	0.5	1.5	0.7	-0.1	0.2	-0.5	0.0	0.7	0.3	0.3
Private consumption	1.0	2.3	0.8	0.9	1.0	0.0	0.0	0.3	0.1	0.2	0.5	0.4	0.3
Gov't expenditure	1.3	1.0	1.0	0.8	0.7	0.4	-0.5	0.6	0.1	0.1	0.6	0.1	0.1
Fixed investment	5.7	6.9	-2.1	-1.2	3.4	-0.4	-1.9	0.1	-0.6	-2.1	1.9	0.4	0.6
Investment in M&E	10.0	5.8	-4.0	-2.5	4.1	-0.4	-3.7	-0.6	-0.3	-2.1	0.9	0.5	1.0
Construction	3.2	7.8	-1.4	-1.1	2.2	-0.5	-1.0	0.5	-1.0	-2.2	2.6	0.3	0.3
Inventories, pp	0.4	-0.1	-0.5	0.2	0.0	-0.1	-0.1	-0.3	0.1	0.4	-0.1	-0.1	0.0
Exports	15.2	8.0	3.2	1.7	6.5	1.7	1.4	0.5	-1.6	-0.7	2.2	2.0	2.3
Imports	12.5	7.4	1.4	2.5	6.7	0.1	0.7	0.1	-0.9	-0.4	2.0	2.3	2.7
Net exports, pp	1.7	0.7	0.9	-0.2	0.3	0.8	0.4	0.3	-0.5	-0.2	0.2	0.0	0.0
Consumer prices*	1.1	2.1	2.0	1.6	1.6	2.1	1.9	2.0	2.0	1.5	1.5	1.7	1.6
Unemployment rate, %	7.7	7.1	6.8	6.8	6.6	6.8	6.8	6.8	6.9	6.9	6.8	6.8	6.8
Budget balance, % GDP	-4.1	-0.8	0.2	0.0	0.2								
Balance on current account, % GDP	6.3	6.2	7.0	7.0	6.9								

*Inflation data for Germany based on national definition. This can lead to discrepancies to other DB publications.
Sources: Federal Statistical Office, German Bundesbank, Federal Employment Agency, DB Research

Broad based growth in Q2 2013 | 1

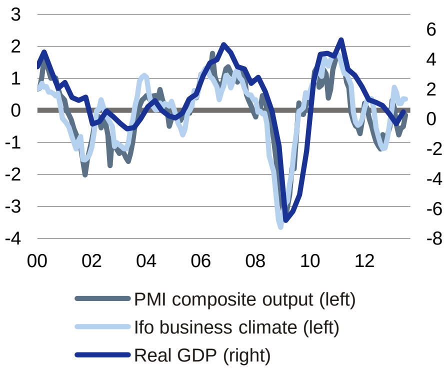
Contribution to real GDP growth, qoq, pp



Source: Federal Statistical Office

Growth prospects: Mixed sentiment | 2

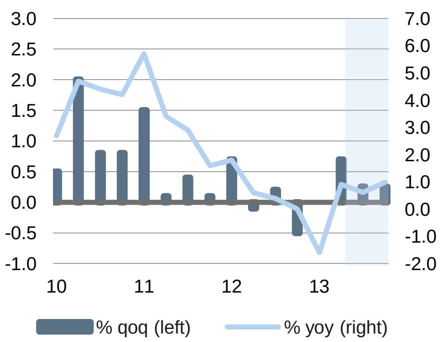
Standardised values (left), % yoy (right)



Sources: Federal Statistical Office, Markit, DB Research

Moderate growth expected in H2 | 3

Real GDP



Sources: Federal Statistical Office, DB Research

German GDP up 0.5% in 2013 – despite slowdown in H2

We have lifted our forecast for 2013 GDP growth in Germany from 0.1% to 0.5%. This is not based on a more bullish assessment of H2's growth dynamics, though. Our call results instead from the growth surge due to one-off effects in Q2 (0.7% yoy) and from revisions to the 2012 performance as these produced a smaller statistical underhang and thus lead to a higher annual average for 2013.

GDP jumped 0.7% in Q2

German GDP climbed somewhat faster than expected in Q2 at 0.7% qoq (0.9% yoy). The growth stimuli came mainly from the domestic economy, adding 0.5 of a percentage point (pp) to GDP. This was evenly divided between private consumption and fixed investment, each of which contributed 0.3 pp. A decrease in inventories reduced the growth figure by 0.1 pp.

Domestic economy – more stable, but not dynamic

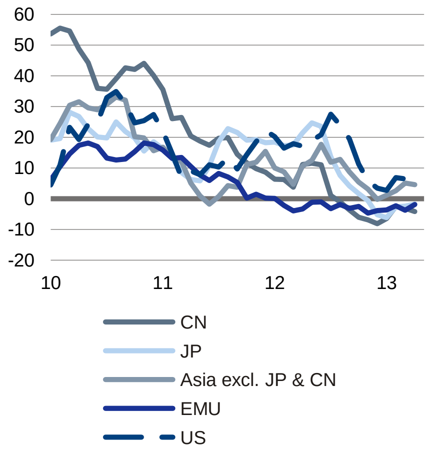
Private consumption increased by 0.5% qoq on the back of a similarly paced increase in real disposable income. Some 80% of the expansion in disposable income is attributable to the 2.6% higher income from operating surpluses and self-employment. This was due to the jump in nominal GDP (1.6% qoq), which led to a 1.4% decline in unit labour costs per unit of turnover. Net wages and salaries edged up by only 0.5%. In year-on-year terms, disposable income rose by 2.4%. Deducting for inflation the reading was a rather modest 0.6%. The 1.9% qoq pick-up in fixed investment was driven almost entirely by construction investment, which with an increase of 2.6% was able to recoup most of the decline in the winter half that had been triggered by the unusually poor weather conditions. Investment in machinery and equipment posted an increase of 0.9% after having fallen by a total of 8% over the preceding six quarters.

"Supplementary trade items" impact net exports

By contrast, net exports' positive contribution to growth (0.2 pp) came as a bit of a surprise. Looking at nominal goods trade, exports were nearly flat in Q2 (+0.1% qoq), while imports were up by 1.4%. So if price developments had been factored in there should have been a noticeable decline in the external contribution. However, in the national accounts the external contribution records services (e.g. tourism) and so-called "supplementary trade items" under goods trade. These supplementary trade items, which in recent years have gained in significance in observation periods of less than a full year, are explained above all by the trading in electricity and gas contracts on the Leipzig energy exchange. If one of the buyers or sellers is a non-resident, these transactions are recorded as an export or import, respectively, in the balance of payments. Thus, they are automatically included in the national accounts trade figures, even though they are actually asset transactions and not goods or services produced or consumed in the current quarter. Moreover, it is difficult to adjust for the prices of these transactions (at current cross-border prices). Unfortunately, these supplementary trade items are not simply marginal factors that might only be of interest to a few statisticians or economists. The given transactions have a significant impact on the external contribution and thus also on quarterly GDP growth. However, the fluctuations in trading tend to cancel each other out over the longer term, so they have less of an influence on annual average growth.

German exports by region 4

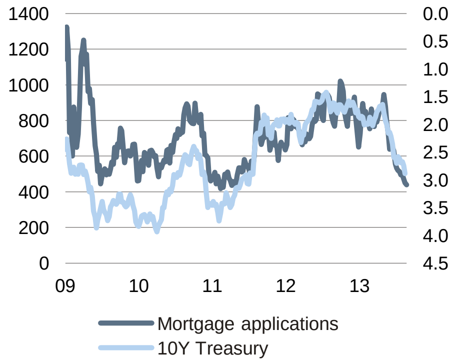
3M average (% yoy)



Source: Federal Statistical Office

US mortgage applications 5

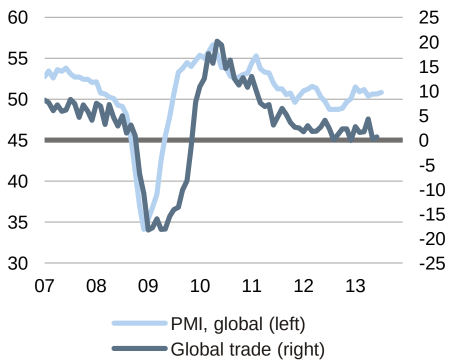
Index, 03/1990=100 (left), %, inverted (right)



Sources: MBA, Global Insight

Global growth indicators 6

Index (left), % yoy (right)



Sources: Statistics Netherlands, Markit

Dubious increase in industrial production

The marked increase in industrial output in June and in Q2 as a whole (2.8% qoq) was driven by 10.9% growth in car production in Q2. Nonetheless, this exorbitant jump is reflected in neither turnover revenues, exports nor new car registrations in the quarter. Rather, there are concrete indications of an error in the figures reported to the Federal Statistical Office. However, this was taken into account in the Q2 GDP calculations, so this should not give rise to any risk of revisions needing to be made.

Leading indicators point to slower expansion in Q3

Estimates of GDP growth in Q3 based on regressions to the ifo business climate index and/or the purchasing managers index point to a quarterly rate of between ¼% and ½%. However, these models harbour sizeable margins of error. Taken together, this (limited) information underpins our expectation of growth rates in the vicinity of 0.3% in Q3 and Q4, which is more or less in line with the potential rate.

Global risks have picked up again

The forecast for performance up to year-end is based on the assumption of a global recovery and stabilisation in the rest of the eurozone. The much improved Flash PMIs in China and the eurozone in August suggest that the global PMI is poised to rise by about one point (July 50.8). However, considering the growing risks this trend may tend to weaken in the near term. In the US, the roughly 100 basis point climb in interest rates triggered by the Fed tapering debate that began in May is showing a noticeable impact on mortgage business. Since May, mortgage applications have fallen by around 40%. While the housing market still looks robust, a two-months comparison (June/July vs April/May) indicates that building permits, housing starts and new-home sales are slightly on the decline. German exports to the US have eased again following a strong spurt in May and June, and are now up by only 2% on the year-earlier reading. The tapering debate has led to substantial outflows of capital from the emerging markets. In some countries (India, Brazil) it is becoming obvious that the capital inflows of recent years have masked structural problems. German exports to Asia have fallen 3.3% in the two-months comparison May/June vs March/April (-5.7% yoy). Global trade was up merely ½% yoy in May/June. Even if world trade has started to pick up a bit recently in similar fashion to the global PMI, the environment for German exporters is likely to remain tough. Should the situation in Syria escalate further, it would bring further pressure to bear at least in the capital markets and on the price of oil.

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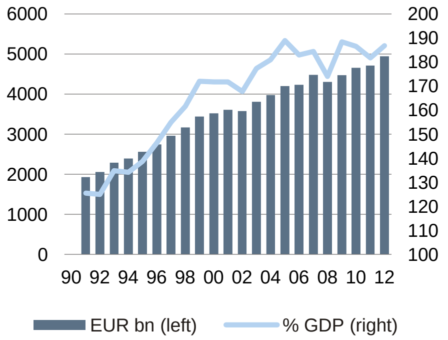
Investment behaviour of German households: Markedly higher risk aversion in the course of the financial crisis

- The trend towards higher-yielding investments witnessed during the 1990s came to an end at the latest when the financial crisis erupted.
- Since then households have preferred to make their financial investments in the form of cash and deposits at financial institutions, that is in investments that carry very little or no risk.
- This does reduce the risk of making a loss, but the downside is a low return.
- Households in the peripheral eurozone countries have displayed considerably greater risk tolerance with their financial investments. Accordingly, their financial assets have risen considerably faster in recent decades.
- Of late, however, a trend towards increased risk aversion can also be observed there, too.
- At 187% of GDP or EUR 123,100 per household the total financial assets in Germany correspond to a lower mid-table ranking by European standards.
- Including real assets in the analysis alters the picture very little. The typical German household ranks at the bottom end of the European rankings with respect to total assets. This is primarily due to the fact that fewer than half of German households own their own home.

Germany: Households' financial assets 1

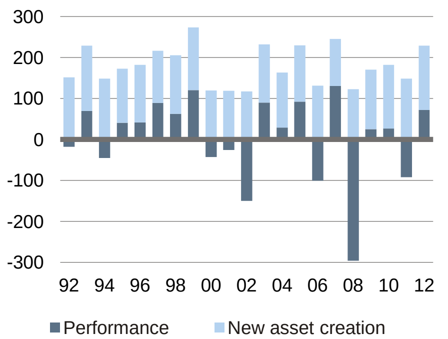
EUR bn (left), % GDP (right)



Source: Deutsche Bundesbank

Germany: Households' financial assets 2

EUR bn



Sources: Deutsche Bundesbank, DB Research

After shrinking in 2008 during the financial crisis German household financial assets have risen continuously since then. In 2012 they rose by nearly 5% to EUR 4,939 bn or 187% of GDP. The creation of new financial assets worth EUR 157 bn and appreciation of existing assets by nearly EUR 72 bn contributed to that. This is equivalent to a return of 1.5%. Since 1996 the average yield has been 0.3%.

The increase in private financial assets is pleasing, but it comes as little surprise. In the last five years average household savings, which are the basis of financial asset acquisition, amounted to more than EUR 170 bn per annum.[1] The lion's share – some EUR 150 bn per year – went during this period into formation of private financial assets, so the value of financial assets only declined during exceptional years when there were extreme losses in value, for example as occurred in 2002 (recession) and 2008 (financial crisis). In 2002 the value destruction came to EUR 150 bn, and in 2008 it even totalled nearly EUR 300 bn, while new investments only amounted to EUR 120 bn.

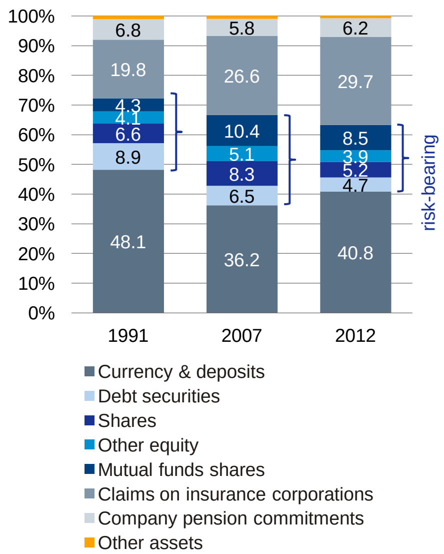
Extremely conservative investment style

In addition, it has turned out that the already high risk aversion of German investors increased further when the financial crisis erupted, after their investment style had become “more Anglo-Saxon” in the 1990s by preferring higher-yielding instruments. All the same, even at this time the investment style of German households could still be described as conservative. One look at the composition of financial assets impressively illustrates the shift.

[1] One financial accounting equation states that: Savings – new investment in real assets + borrowing = New investment in financial assets. Last year household savings came to EUR 180.7 bn, new investment in real assets, especially in residential real estate and land, EUR 39.5 bn and net borrowing of EUR 15.8 bn. Accordingly, this left EUR 157 bn which was allocated to the various asset classes. See Deutsche Bundesbank (2013). Financial accounts for Germany – 2007 to 2012. Special Statistical Publication 4.

Germany: Structure of financial assets 3

Share, %



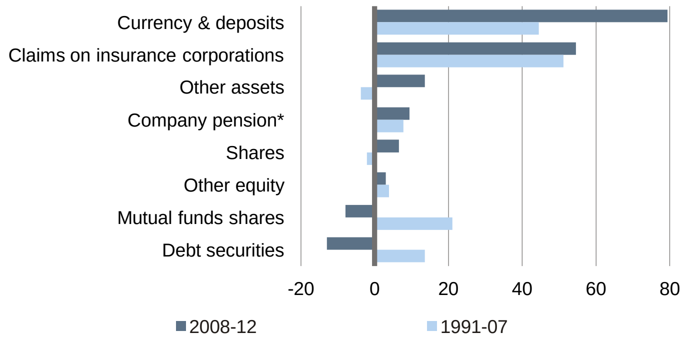
Source: Deutsche Bundesbank

After risk-free asset classes (cash) and investment instruments with a relatively low risk, such as deposits at financial institutions[2], became considerably less important between 1991 and 2007, private investors moved heavily into these types of asset again from 2008. Average new investments in cash and deposits reached nearly EUR 80 bn per year between 2008 and 2012, while from 1991 to 2007 almost only half as much – an average of EUR 44 ½ bn p.a. – was invested in these asset types. The cash and deposits share of total household financial assets thus rose recently to nearly 41% again, after having fallen nearly 12 percentage points from 48% to 36% between 1991 and 2007.

The opposite trend could be observed for risk-bearing assets such as debt securities, shares and other equity as well as mutual funds shares. Between 2008 and 2012 households sold an average net volume of these four asset types of around EUR 11 ½ bn per year, after having made an annual net investment of EUR 36 ½ bn in these instruments between 1991 and 2007. Accordingly, the share of all financial assets constituted by these four asset types fell by 8 percentage points to 22.4% between 2008 and 2012, whereas it had risen by about 6 ½ percentage points to 30.4% between 1991 and 2007.

Germany: Acquisition of financial assets 4

Average net acquisition per year, EUR bn

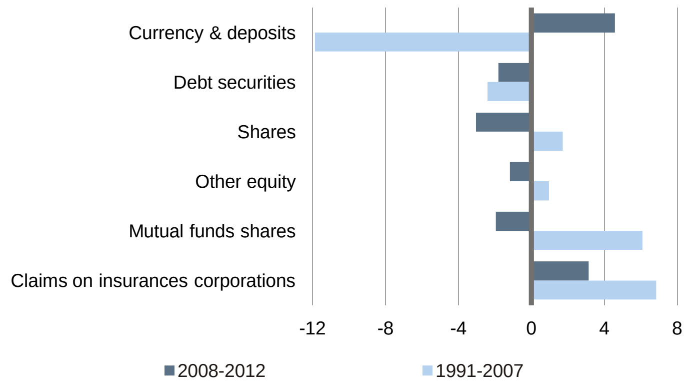


*Claims from company pension commitments

Source: Deutsche Bundesbank

Germany: Structure of financial assets 5

Change of shares, pp



Source: Deutsche Bundesbank

Equities: A neglected asset class

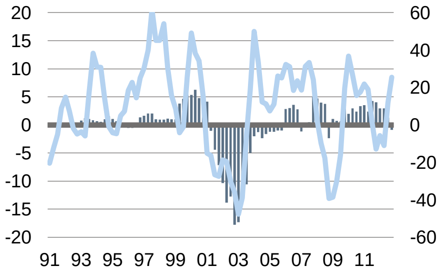
Unlike in other European countries, direct investment in equities by German households is negligible. The rule which states that shares should be bought when they are cheap and sold when the prices are high is largely ignored by German households. Only in 2009 and 2011 did declines in the Dax coincide with net share purchases.[3]

During the bull market from 1994 to 2000 retail investors entered the equity market. The equity holdings of Germany's households nearly trebled in value during the dotcom bubble, from just over EUR 170 bn at the end of 1994 to over EUR 500 bn at the end of March 2000. This growth was driven not only by net purchases totalling about EUR 54 bn, but above all by capital gains of more than EUR 280 bn. During this period, the share of investment in equities in private portfolios increased accordingly, from 7.2% to a record 14.5%.

[2] The deposits at financial institutions include sight deposits, time deposits, savings bonds and savings deposits.
[3] See Gräf, Bernhard and Stefan Schneider (2011). German households: Strong savers but weak investors. Current Issues. DB Research. Frankfurt am Main. June 14, 2011.

Germany: Households' net purchases of shares & Dax 6

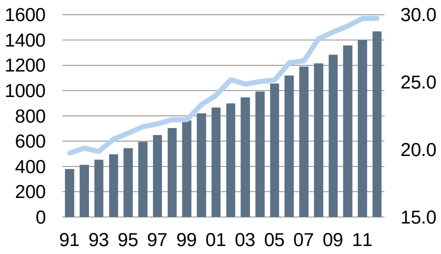
EUR bn (left), % yoy (right)



Sources: Deutsche Bundesbank, Global Insight

Germany: Households' claims on insurance corporations 7

EUR (left), % (right)



Source: Deutsche Bundesbank

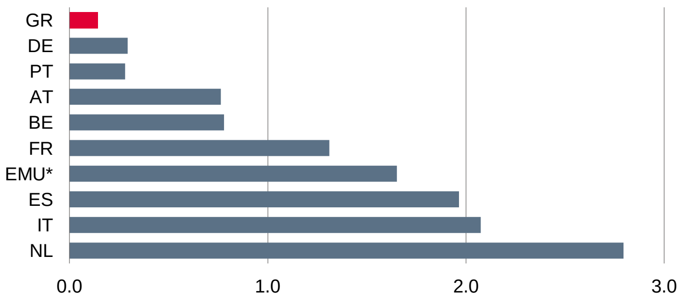
Disappointed by heavy losses after the dotcom bubble burst – the Dax slumped 53% between March 2000 and March 2003 – retail investors made net disposals of equities totalling EUR 126 bn between 2001 and 2005. Accordingly, the number of direct shareholders fell from its record high of 6.2 million in 2000 to 5.1 million in 2003 and currently hovers at just 4 ½ million. Since peaking at 14.5% at the end of March 2000 the proportion of financial assets constituted by directly held shares had thus shrunk to about 4 ½% by the time the financial crisis erupted and at last count it was slightly above 5%. However, the net purchases between 2009 and 2011 averaging EUR 18 bn or around 12 % of new investments, show that shares appear to be attracting more interest again.

Insurance policies: The Germans' favourite!

Apart from the currency and deposits held at financial institutions the asset class that benefits most from the elevated risk aversion of German households is insurance. Insurance products are moreover the only investment type that almost continually increased its share prior to and since the eruption of the financial crisis. The claims of German households on insurance corporations have thus risen from EUR 380 bn in 1991 to EUR 1,469 bn at last count, and their share in total financial assets has climbed from nearly 20% to almost 30%. Unlike with other asset classes there has been relatively little fluctuation in the annual new investment in insurance products and it has averaged around EUR 50 bn per year since 1991, which is due to the long duration of the insurance contracts signed with constant contributions.

Return on households' financial assets 8

1996-2012, % p.a.

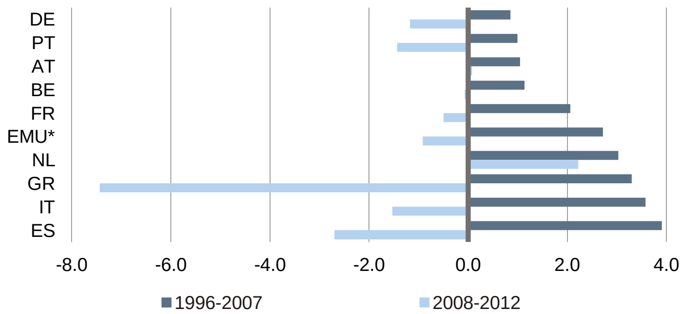


*) Excluding Germany

Sources: Eurostat, DB Research

Return on households' financial assets 9

% p.a.



*) Excluding Germany

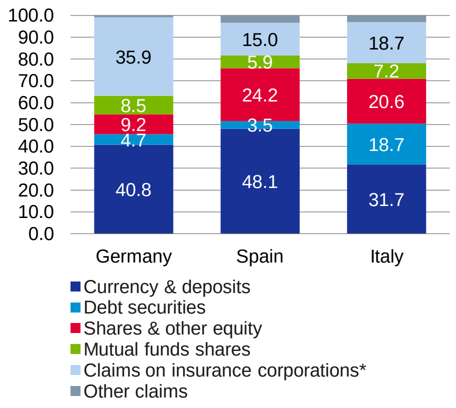
Sources: Deutsche Bundesbank, DB Research

The downside: One of the lowest returns in the eurozone

The investment style of German households that can certainly be described as very conservative of late may temporarily limit losses, but at the same time it brings with it a low return. The return on private financial assets calculated for the period 1996 to 2012 from portfolio adjustments and financial investments is one of the lowest in the eurozone at just 0.3% p.a. (see chart 8). Although this figure is heavily influenced by the value impairment since the financial crisis erupted – between 2008 and 2012 it amounted to -1.2% p.a. – but even during the preceding 12 years the return on financial investments for households came

Households' financial assets 10

2012, %

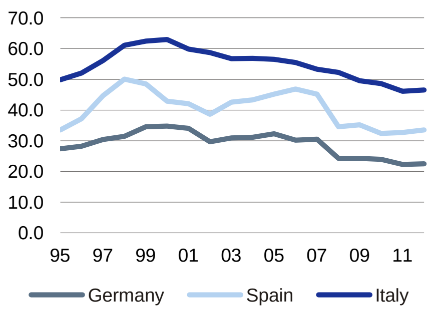


*) Including claims from company pension commitments

Sources: Deutsche Bundesbank, Banca d'Italia, Banco de Espana

Bonds, shares, other equity and mutual funds shares 11

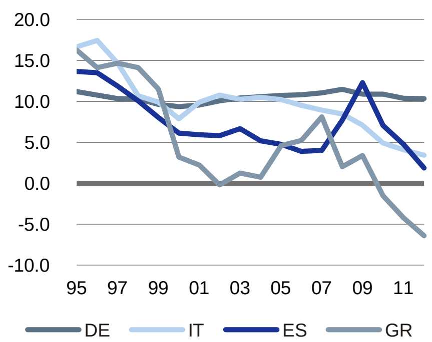
% of total financial assets



Sources: Deutsche Bundesbank, Banca d'Italia, Banco de Espana

Household savings rates 12

% of disposable income



Source: OECD

to just +0.9% p.a. and thus lagged a very long way behind that of the countries on the euro area periphery. For example, households in Greece earned an average annual return on their investments between 1996 and 2007 of 3.3%, while in Italy the figure was 3.6% and in Spain no less than 3.9% p.a. The reason for this is the higher proportion of riskier and thus higher-yielding financial investments in these countries. The proportion of total household financial assets constituted by debt securities, shares, other equity and mutual funds shares was nearly 30% in Germany and over 40% in Spain between 1995 and 2012. In Italy these investment instruments in the period stated actually represented more than half of all financial assets, at around 55%.

Greater risk appetite in the peripheral countries

There are considerable differences especially in direct equity investments and other equity, whose share of household financial assets in Italy and Spain is about twice as high as in Germany, as well as in debt securities. The EUR 696 bn of debt securities held by Italian households at the end of 2012 was nearly three times as high as those held by their German counterparts. As a share of financial assets this amounted to 18.7%, compared with 4.7% in Germany and 3.5% in Spain. This reflects the high sovereign debt in Italy, which has exceeded 100% of GDP since the early 1990s, and the high internal financing ratio.

Financial investments and returns determine asset performance

The development of financial assets is determined by annual new investment that comes from savings as well as from the appreciation in the value of the portfolio, i.e. via the return on assets. Although German households boast the highest savings ratio by international standards, the growth in private financial assets in Germany has been merely below par compared to those in the eurozone's peripheral countries, which is largely due to the lower return on financial investments. For instance, financial assets in Germany grew by only around 90% between 1995 and 2012, whereas the increase in Italy was roughly 130% and no less than 180% in Spain. Around half of the difference in growth between Germany and Spain (a good 40 percentage points) is due to the difference in returns (0.3% p.a. in Germany compared with 2.0% p.a. in Spain).[4] The remaining 50% of the difference can be explained – despite the lower propensity to save in the peripheral countries – by the much faster growth in incomes there. For instance, nominal GDP growth in Spain and Greece was some two-and-a-half times higher than in Germany between 1995 and 2012, despite the latest downturn in these countries.

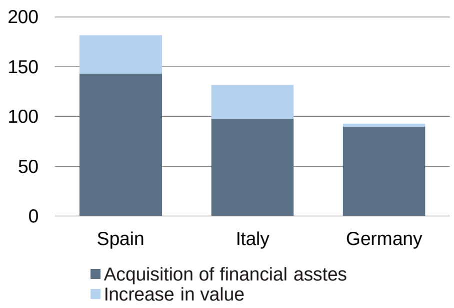
Financial crisis leaves its mark

The financial crisis left its mark on the financial assets of the eurozone's peripheral countries. On the one hand, their value fell sharply in some cases. On the other, households curtailed their saving significantly on account of the (in some cases) deep recession and the sharp increase in unemployment, which resulted in financial asset creation slowing down heavily and even turning negative. This applies above all to Spain and Greece, where the rise in unemployment was the highest. In both countries households made net withdrawals from financial assets last year. In Spain the figure was more than

[4] See also De Bonis, Riccardo et al (2013). Household aggregate wealth in the main OECD countries from 1980 to 2011: what do the data tell us? Occasional Papers. Number 160. Banca d'Italia. April 2013.

Contribution to growth of financial assets 13

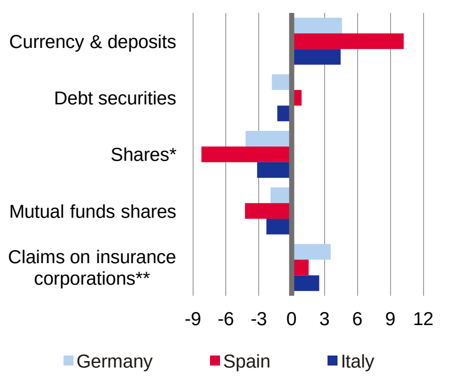
1995-2012, pp



Sources: Deutsche Bundesbank, Banca d'Italia, Banco de Espana, DB Research

Changes in composition of households' assets 16

Share in financial assets, change 2008-2012, p



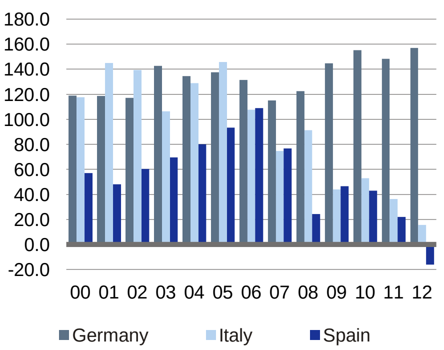
*) Including other equity
**) Including company pension commitments

Sources: Deutsche Bundesbank, Banca d'Italia, Banco de Espana

EUR 16 bn, while in Greece the total was slightly higher than EUR 10 bn. Accordingly, financial assets in Greece shrunk further in 2012, while portfolio performance in Spain ensured that Spanish financial assets more or less stagnated in 2012.

Acquisition of financial assets 14

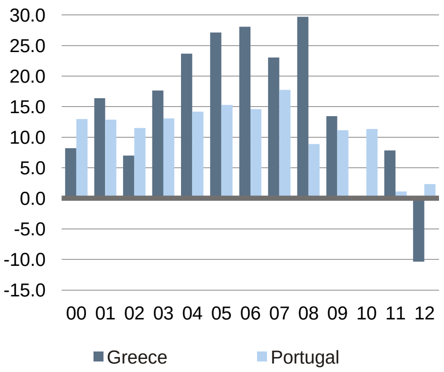
EUR bn



Sources: Deutsche Bundesbank, Banca d'Italia, Banco de Espana

Acquisition of financial assets 15

EUR bn



Source: Eurostat

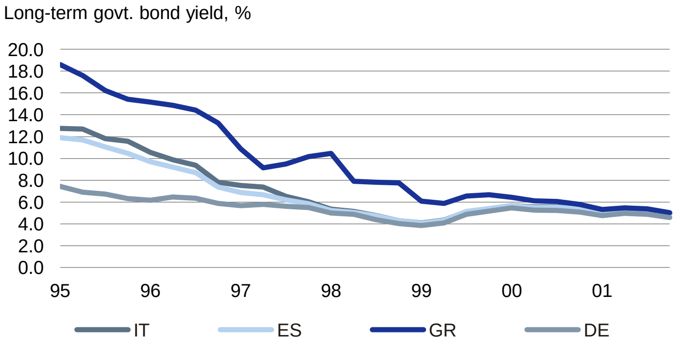
Has risk aversion increased recently in the peripheral countries as well?

But has risk aversion increased there, too – as in Germany? The answer is something of a categorical yes and no. One look at the changes in the asset structure appears to confirm this assumption. The structure of financial assets in the peripheral countries has shifted in a similar direction, in some cases to an even greater degree than in Germany. For example, the share of cash equivalents (currency and deposits held by financial institutions) has risen in Spain over the last five years by more than 10 percentage points, which is more than twice as fast as in Germany, and at 48% it is currently much higher than the German figure (nearly 41%). In Greece this increase was even considerably more pronounced. There, the share of cash equivalent assets rose by nearly 23 percentage points. Greek households currently hold 75% of their financial assets in the form of currency and deposits at financial institutions. At the same time the share ratios of Spanish and Greek households have fallen by 8 percentage points and 20 percentage points respectively.

One look at the financial asset creation figures reveals, however, that Greek households made new investments of nearly EUR 5 bn per year in shares and other equity in the period 2008 to 2012, which represented nearly 60% of new investments and was much higher than the new investments of nearly EUR 3 ½ bn p.a. between 1995 and 2007. The steeply declining share ratio in Greece is consequently due to the collapse in the Greek stock market which lost some 85% in value between 2008 and 2012. Despite the new investment the value of the equity investments held by households therefore fell from almost EUR 92 bn in 2007 to EUR 18 ½ bn in 2012. Moreover, Greek households have reduced their holdings of currency and deposits at financial institution over the past three years by a total of nearly EUR 20 bn. Both courses of action seem to make economic sense. On the one hand, shares should be bought when they are cheap. On the other hand, with an unemployment rate of about 27% Greek households are having to fall back on their private assets more heavily in order to cushion the impact of the deep recession.

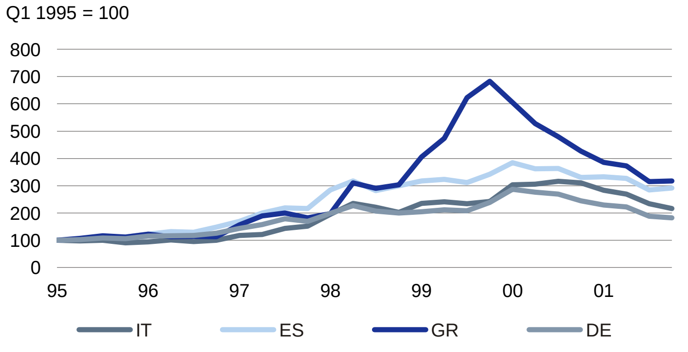
In Spain, too, and especially in Italy households have invested appreciably more in shares and other equity since 2008 than in the years preceding the crisis. Including new investment in debt securities and mutual funds shares Spanish households have, however, reduced their holdings of risk assets and Italian households have drastically limited their new investments. In addition, the holdings of currency and deposits at financial institutions in Spain and Italy increased by a further significant amount, which means that risk aversion can probably be presumed to be greater in both countries.

Government bond yields 1995 - 2001 17



Source: IMF

Equity markets 1995 - 2001 18



Source: IMF

EMU: German financial assets currently occupy a lower midtable ranking

The size of financial assets depends on households' ability and willingness to save, and the institutional framework, such as the structure of the statutory pension scheme and thus the need to conduct one's own individual retirement planning, the special country-specific types of savings promotion and in general on the choice of investment instrument whose yield and/or appreciation in value are co-determinants of the performance of privately held financial assets. On top of this there are also one-off effects, such as the huge profits that households amassed in the southern peripheral countries in the run-up to the introduction of the euro when the convergence of long-term capital market yields to the German level led to considerable increases in the prices of debt securities, and also in the equity market, especially in Greece, hefty price increases were recorded. Accordingly, household financial assets increased in Spain and Italy by 13% and 15% p.a. respectively between 1995 and 1999, and in Greece they even rose by more than 26% per year, while financial assets in Germany only grew by 6 ½% p.a.

The situation at present is as follows: German household financial assets at 185% of GDP are more than 20 percentage points lower than the euro area average and thus occupy a lower midtable ranking. The highest financial assets relative to GDP are found in the Netherlands (331% of GDP), Belgium (273%), Italy (237%) and Portugal (234%). The average German household has financial assets of EUR 123,100. The only larger euro area countries where financial assets are lower are Spain, Portugal, Finland and Greece, with Greek household financial assets of just EUR 58,900 being just half the size of those in Germany.

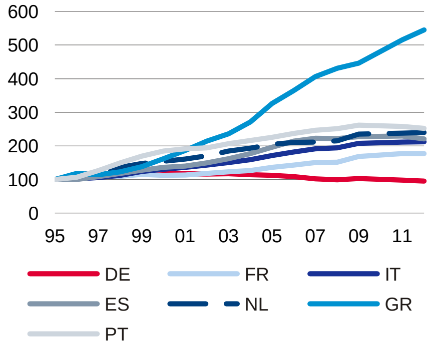
Households' financial assets 19

2012	EUR bn	% of GDP	Per household EUR
Luxembourg	59	132	270,800
Netherlands	1,984	331	266,200
Belgium	1,026	273	221,300
Ireland	320	196	188,200
France	4,226	208	152,200
Italy	3,723	237	146,700
Austria	524	169	142,500
EMU 12	19,449	208	139,500
Germany	4,940	185	123,100
Spain	1,781	170	102,100
Portugal	387	234	96,300
Finland	220	114	86,300
Greece	259	133	58,900

Source: National central banks, Eurostat

Households' debt 20

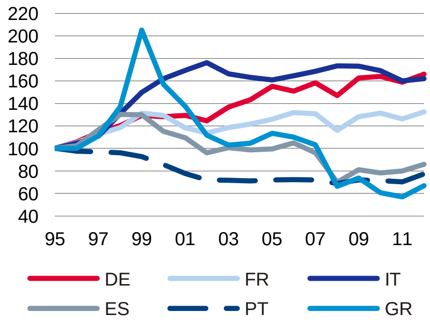
% of GDP, 1995 = 100



Source: National central banks

Net financial assets 21

% of GDP, 1995 = 100



Source: National central banks

German position on net financial assets only slightly better

Germany did not jump on the bandwagon of credit-financed excesses that preceded the crisis. Thanks to the moderate borrowing by households (before and after the crisis)[5] their indebtedness in 2012 was just under 59% of GDP and thus 15 percentage points lower than the record level in 2000 and 4 percentage points lower than the 1995 level. Household debt in Germany was more than 10 percentage points below the EMU average in 2012 and much lower than in the Netherlands (139%). As is the case with financial assets, the Dutch top the rankings for liabilities as they have taken on a high debt load in recent years in order to fund buying their own homes. Austrian households have the lowest debt relative to GDP at 54%, a figure that is marginally lower than that of German households. The sharpest increase in liabilities since the mid-1990s has been posted by Greek households whose debt relative to GDP is nearly six times higher at over 70%, whereas for Italian and Spanish households the ratio has more than doubled.

Net financial assets are the product of financial assets minus financial liabilities. Thanks to their low debt the position of German households improves slightly according to this measure compared with that based on gross financial assets. With net financial assets of 127% of GDP German households remain at a midtable ranking and some 10 percentage points below the eurozone average. The highest net financial assets are found in Belgian households (216%), while those in Finland are at the other end of the scale (46%).

Households‘ net financial assets, 2012, EUR bn 22

	Liabilities	Financial assets	Net financial assets		
					Per household
	EUR bn	EUR bn	EUR bn	% of GDP	EUR
Germany	1,566	4,940	3,373	127	84,100
France	1,395	4,226	2,831	139	101,900
Italy	931	3,723	2,792	178	110,200
Spain	903	1,781	878	84	50,400
Netherlands	833	1,984	1,151	192	154,400
Belgium	213	1,026	813	216	175,300
Ireland	183	320	137	84	80,600
Austria	169	524	355	114	96,600
Portugal	166	387	221	134	54,900
Finland	133	220	88	46	34,300
Greece	137	259	122	63	27,800
Luxembourg	24	59	34	77	158,000
EMU 12	6,653	19,449	12,795	137	91,800

Sources: Eurostat, National central banks

Total assets present a rather different picture

An ECB report[6] on the asset situation (financial assets, real estate assets and other real assets) of households in the euro area found that German households are among the “poorest” in Europe in terms of total assets and thus are even worse off than indicated by the financial assets criterion used up until now. This is mainly due to the below-average real estate assets of German households and the investment behaviour of households.

[5] See Rakau, Oliver (2013). Focus Germany. Structural improvements support exceptional position. Current Issues. DB Research. Frankfurt am Main. July 1, 2013.

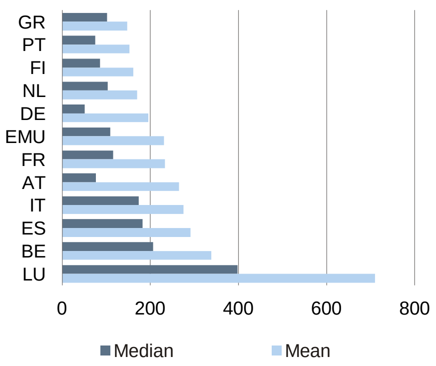
[6] See The Eurosystem Household Finance and Consumption Survey. Results from the first wave (2013). Statistics Paper Series. Number 2. European Central Bank. April 2013, and Vetter, Stefan (2013). Focus Germany. GDP forecast: Uptick in Q1, slippage in Q2. Current Issues. DB Research. Frankfurt am Main.

A number of statistical obstacles prevent a simple comparison of ECB data in the euro area with the previously discussed financial assets. For instance, the information on total assets is based on a household survey – in contrast to the financial assets – and not on a centrally managed constantly updated database, as real assets (primarily real estate, but also cars, for example) are not recorded comprehensively in all countries. For example, annual information is available for Italy and Germany, whereas in other countries this is only the case to a limited extent. Furthermore, the survey data comes from the period 2008-2010, i.e. prior to the euro crisis in part. Especially the data for peripheral countries has probably changed considerably since then, because for example property prices have undergone a significant correction.

According to the ECB report, German households in 2010 ranked at the bottom end of the 11 countries surveyed (8th place) with average net total assets of EUR 195,000 (mean). By comparison, the average figure for a euro area household was EUR 231,000. The wealthiest households were in Luxembourg (EUR 710,000). This is probably skewed by the size of the country and its heavy sectoral concentration on the financial industry, though. Belgian households (ranked second), however, although they are more comparable with German households, have much larger assets (EUR 339,000) than the Germans. Mean total assets are lowest among Greek households (EUR 160,000).

Household wealth: Germany at the lower end of the ranking 23

Net wealth per household, '000 EUR



Source: ECB

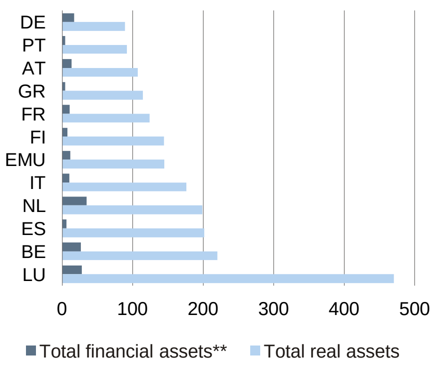
When the ECB report was published, however, the high level of media interest was focused on a different statistic. If the comparison is based on the median rather than the mean, German households were the poorest and their assets of EUR 51,000 were less than half as much as households in the euro area overall (EUR 109,000). The median asset value is that of the household for which there are exactly as many households with more assets as there are with fewer assets. In other words, the median indicates the level of assets that a *typical household* possesses, while the mean indicates the *average amount of assets owned by all households*.

Median or mean: Everything is relative!

Large differences between the mean and the median are a sign of a highly unequal distribution of wealth. In Germany mean total assets are nearly four times the median value, while in Austria they are three-and-a-half times higher. In the euro area they are only twice as high. One can therefore conclude that the more affluent households in Germany have much larger assets than the average (median) household. In the euro area as a whole the relative wealth of the more affluent compared with the average household is less pronounced. Regardless of the definition of average assets, however, the ECB data shows that German households are among the less affluent in the euro area. This is largely confirmed by the data on financial assets discussed above as well.

Real assets outweigh financial assets by far; Germany at the lower end 24

Median* wealth, real assets, '000 EUR per household



* Based on those households that report to own financial and real assets
** Excl. pension claims

Source: ECB

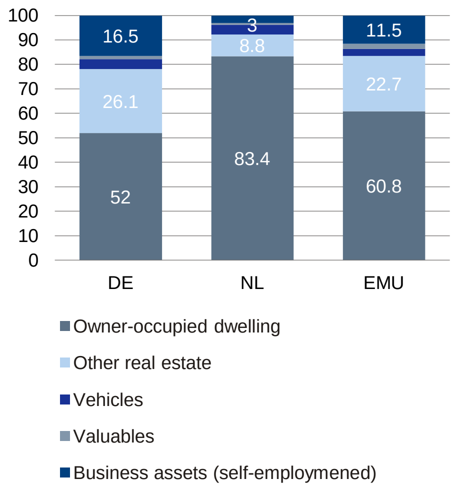
Germany lags behind on real assets

The poor standing of German households in terms of total assets is largely due to their low level of real assets, which in all the countries surveyed are far more significant than financial assets[7] (judging by the median). For German households the ratio is 5:1, while the euro area average is no less than 13:1. The EUR 89,000 of real assets owned by the typical German household (median) are lower than those of the households in all other EMU countries, where the

[7] According to the ECB survey, Germany's financial asset statistics are somewhat better than the figures discussed at the beginning of the report. Since the figures do not, however, fundamentally alter the picture – especially as regards the marked differences in real estate assets – we shall not discuss them further.

Composition of real assets: Own home is the largest component 25

Share in real assets, households, %



Source: ECB

average is EUR 144,000. This is not only due to German real estate prices being on the low side and affordable by global standards.[8] The owner-occupied property of an average German household is worth EUR 168,000, while the average for the euro area is EUR 180,000. The big difference between German households and other European households is that the former rarely live in their own homes. At 44% the German home-ownership ratio is the lowest and at 82% the ratio is highest in Spain (EMU: 60%). The German ratio is further reduced by the east-west divide (east: 33.7%; west: 47.1%). On account of this low home-ownership ratio the home of one's own represents just 52% of the real assets of a German household compared with the EMU average of 61% and the Dutch household figure of 83%.

Conclusion: Assets set to increase, returns to remain low

The title of our report "German households: Strong savers but weak investors", which was published in 2011, still applies today. The returns on German financial assets were the lowest of all the European countries between 1996 and 2012. Given the current low-interest-rate phase, which will probably extend well into 2014, and the accompanying low propensity to invest in risk-bearing, higher-yielding asset classes, such as shares, the growth in financial assets in Germany will probably continue to be driven by savings. Low interest rates may dampen the German savings rate over the long term, but there has been little evidence of this to date, which has a lot to do with the ongoing uncertainty concerning the euro crisis and the looming demographic challenges facing Germany.

Real assets, a large proportion of which are comprised by real estate, are likely to also grow in Germany. The continuing normalisation of the German residential property market is being reflected in solid price increases. We expect this trend to continue for the foreseeable future, even though it may slow down from its recent rate. This should have a positive impact on the real assets of German households. Furthermore, the current sharp increase in building permits should also be reflected in increased real estate assets in future. This could narrow the gap to other European countries in this asset class in the medium term.

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[8] See Möbert, Jochen and Heiko Peters (2013). Talking Point. No bubble in Germany's residential property market.

Germans no longer world's keenest holidaymakers

Commuter trains are less busy. Fewer people eat in corporate canteens these days. And quite a few emails trigger automatic absence notifications. Have you noticed any of these signs lately? Yes, it is still summer holiday season. But exactly where have your colleagues and neighbours gone, and how much are they spending on their holiday? Is the statistical data up to date and at all informative? To what extent are travel patterns influenced by the business cycle and/or disposable income, and what is the contribution of tourism to the overall economy? We are going to discuss these and other questions in this “holiday special”.

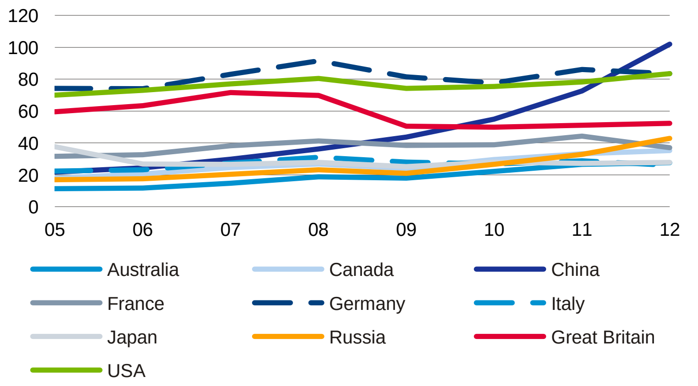
China overtaking Germany as travel champion

One of the big regular features in the media is the role of the Germans as the world's most avid travellers. However, in 2012 Germany was dethroned by China, according to IMF balance-of-payments (bop) data (see textbox 7 for an explanation of the balance of payments), and even the US has managed to overtake Germany after having come in a very close second behind the “world champion” in the seven preceding years. Since 2005, Chinese expenditure on foreign travel has grown nearly fivefold, from just over USD 20 bn p.a. to over USD 100 bn. This is a reflection of the strong rise in incomes in China, which is expected to continue. Hence, the Chinese seem to have embarked on another “Long March”. Compared with China, the 12% increase in German foreign travel in the period mentioned above looks rather meagre (US: +19%).

In light of the huge differences in population numbers, per capita data is a more meaningful measure when comparing travel patterns of different nations. According to these statistics, though, Germany is well ahead of China and the US. With per capita spending of approx. USD 1,200 per year, the Australians are at the top of the 2012 ranking.[9] Like Canadians, Germans spent an average USD 1,000 on international trips, while the figure was only USD 270 for US citizens and USD 75 for the Chinese.

Chinese overtake Germans as world’s top travellers … 1

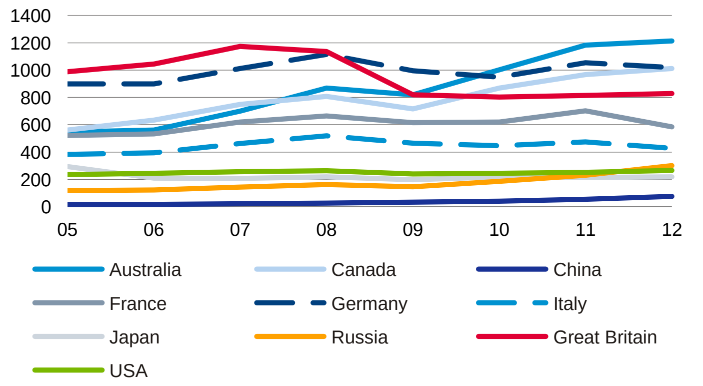
Expenditure on international travel, EUR bn



Sources: IMF, UNWTO, BEA

... but remain way behind in per capita terms 2

Expenditure on international travel per capita, EUR bn

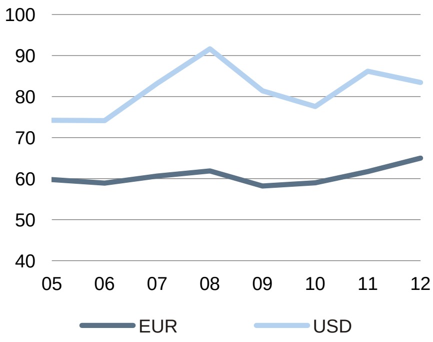


Sources: IMF, UNWTO, BEA

[9] We restricted the ranking to those countries that are under the top-10 in absolute spending.

Currency effects can create distortions 3

Germany: Expenditure on international travel, bn



Sources: Deutsche Bundesbank, IMF

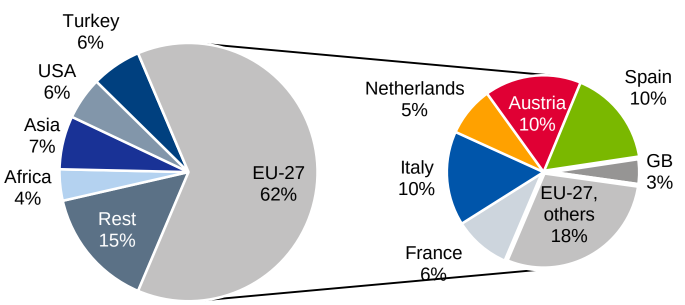
However, these comparisons are distorted in many respects. Countries that do not use the US dollar as their currency, for instance, will experience a currency effect. In 2012, this effect led to travel expenditure in Germany falling by 3.5% in US dollar terms, while they rose by 5.3% when calculated in euro. Furthermore, a country's size and location are major factors of influence. Given the fact that their own country has much to offer for tourists, Americans spend a larger part of their holidays “at home”, which means that the money they spend on travel does not appear in the international statistics. By contrast, Germans can go quite far abroad by travelling a few hundred miles. In the case of Australia, the country's isolated geographical location pushes up travel expenditure as practically every trip abroad will include an (expensive) flight. Last but not least, the differences in the amount of paid leave play an important role in travel budgets. If, for instance, a US employee has fewer holidays at his or her disposal than somebody working in Germany, this will – ceteris paribus – have a negative impact on travel expenses per capita. And finally, it should be noted that the data basis includes not only private but also business trips. In Germany, for instance, the share of business trips in overall travel was over 12% in 2011, according to the IMF.[10]

Spain and Austria are the Germans' favourite destinations

Data on travel expenses quoted above from the balance of payments is also provided in a regional breakdown by the Bundesbank. In 2012, it says more than 60% of foreign travel expenditure went to other EU countries. With shares of approx. 6% each, the US and Turkey were the most popular destinations outside the EU. At 7% and 4%, respectively, Asia and Africa still were of relatively little significance. Due to a lack of data and statistical inaccuracies, however, the Bundesbank is not in a position to publish data for all destinations. Within the European Union the most popular travel destinations by far were Spain, Austria and Italy, each accounting for roughly 10%. They were followed by France (6%), the Netherlands (5%) and the UK (3%).

Spain, Austria and Italy are Germans' favourite (foreign) destinations 4

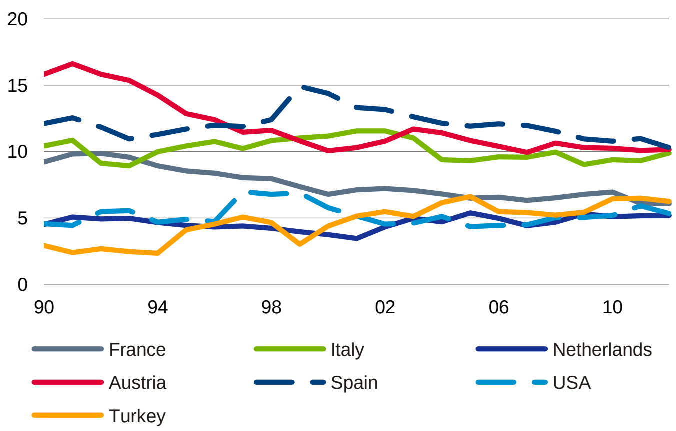
Share in expenditure on international travel by region, 2012, %



Sources: Deutsche Bundesbank, DB Research

Top 7 destinations: Spain has lost considerable ground since 1999 5

Share in expenditure on international travel by region, %



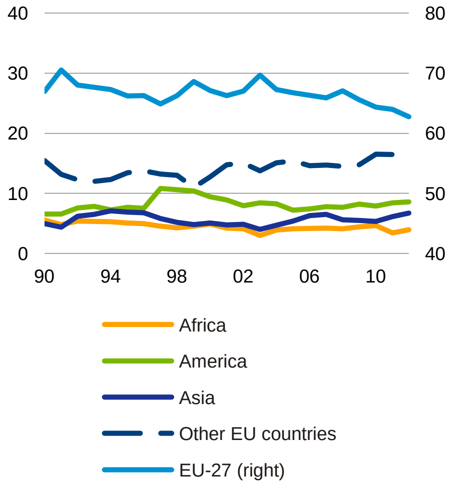
Sources: Deutsche Bundesbank, DB Research

10 However, no consistent data is available on the different kinds of trips for all countries.

Understandably, the popularity of individual destinations has changed over time. Particularly important, of course, are price shifts between various destinations with similar tourist attractions. The price is a major criterion when it comes to deciding between countries offering pure beach holidays on the Mediterranean. In addition, rising incomes can induce changes in travel patterns, as for instance inter-continental holidays may become more affordable. Changing preferences on the part of tourists also lead to shifts in travel flows. As the share of office jobs rises, for example, more people seek physically active holidays, and playing sports is not always easily possible at all holiday destinations. Besides this demand effect there has been a rising trend towards travel under a certain "motto", i.e. holidays focussing on certain activities (such as hiking, cycling, horse riding, golf or scuba-diving). Another aspect is demographic developments. Senior citizens, for instance, whose share in the German overall population is growing, enjoy different holidays than younger people. Also, political and military conflicts as well as other external shocks (e.g. natural disasters) are often the cause of fluctuations in tourism flows, even though these are frequently of a temporary nature.

Other European countries benefit, while EU countries lose out 6

Share in expenditure on international travel by region %

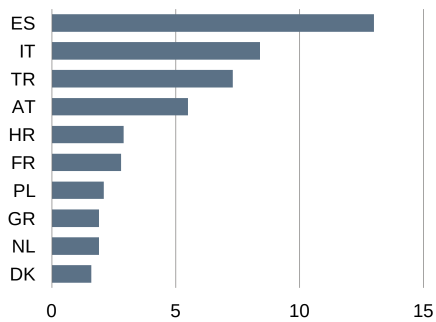


Sources: Deutsche Bundesbank, DB Research

The most striking development regarding travel expenditure by Germans in the various destination regions is the declining share of the EU-27 countries. Since 2000 their share has fallen by 4 percentage points to 62% recently. The main beneficiaries are other European destinations, whose share has risen by 3 pp to just over 16%. This is attributable first and foremost to the considerable increase registered by Turkey. German expenditure for trips to Turkey grew from EUR 2.5 bn in 2000 to more than EUR 4 bn in 2012 (representing a share of 6.2%). Naturally this figure is influenced by trips made by people of Turkish descent living in Germany. Among the seven major destination countries (chart 5) the declining share of expenditure on travel to Spain is particularly striking (2000: 14.4%; 2012: 10.3%). Among the top 7, higher shares were registered for Turkey and the Netherlands.

Spain is the most popular foreign destination 7

Germans' favourite holiday destinations* abroad, 2012, share in %



*Trips lasting 5 days or more

Source: DRV

By and large, the amount of money spent by Germans abroad matches the data collected by the German Travel Association (Deutscher Reiseverband, DRV) and Forschungsgemeinschaft Urlaub und Reisen (FUR) regarding German travel behaviour. According to these associations, German citizens went on 69.3 million holidays (longer than 5 days) in 2012; so unlike in the balance-of-payments statistics, business trips and short breaks are not included. 69% of all travel was to foreign countries.[11] The four most popular holiday destinations were Spain (with a share of 13%), Italy (8.4%), Turkey (7.3%) and Austria (5.5%). These are exactly the same countries that take up the first four places in the statistics on travel expenditure. However, there are also significant differences. Austria's share in holiday travel, for instance, is considerably smaller than its share in travel-related expenditure made by Germans. In part this can be due to the fact that Austria is the most popular foreign destination for short breaks. While these short trips are not included in the above-mentioned statistics on holiday travel, the money spent during such breaks is recorded in the balance-of-payments statistics. Another reason may be that, in the case of Austria, many of the trips are winter holidays, which tend to be more expensive on average.

Other deviations between the balance-of-payments statistics and the data on the most popular holiday destinations can be explained with different types of travel or different duration as well as the impact of business trips. At 6%, the US for instance accounts for a relatively large share of German travel expenditure. However, the country does not feature at all in the top 10 most popular locations. This discrepancy can be attributed to the fact that a holiday in the US will probably be a longer one than a European trip, which usually leads to more

[11] According to the statistics, more than three-quarters of the short breaks of less than five days (a total of 74.5 million holidays in 2012) are spent in Germany.

money being spent on an American holiday. Moreover, the US is also an important destination for business travel, which – however – is not included in the holiday statistics. The UK and the Netherlands are more examples of destinations whose share in expenditure, according to the bop statistics, is larger than their significance in the ranking of preferred foreign holiday destinations.

Travel expenditure in the balance-of-payments statistics 8

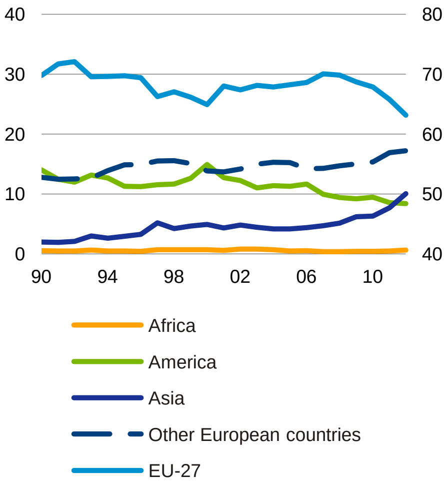
"The German balance of payments measures all economic transactions between residents and non-residents in terms of value within a specific period of time, and thereby provides information on Germany's economic linkages with other countries." (Deutsche Bundesbank)

The balance of payments is subdivided into the following sub-accounts: current account, capital account, financial account, errors and omissions). Travel expenditure by Germans abroad are registered as services imports or expenditure in the current account.

The current account is dominated by trade in goods. In 2012, Germany exported goods worth EUR 1.1 tr. Revenues from services exports came to "only" EUR 213 bn, EUR 30 bn of which was accounted for by the travel sector. Goods imports amounted to EUR 910 bn in 2012. Expenditure on or imports of services came to EUR 216 bn, of which EUR 65 bn was spending on travel in foreign countries.

EU visitors with ever smaller share in total travel revenues 9

Share in travel revenues by region of origin, %



Sources: Deutsche Bundesbank, DB Research

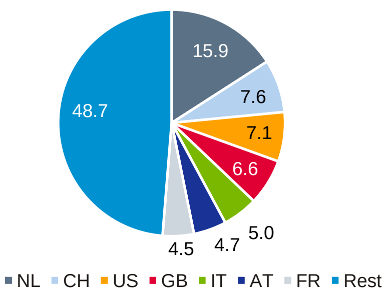
The Dutch love Germany (as a holiday destination)

The data provided by the Bundesbank also allows us to analyse travel flows in the opposite direction: How much do visitors from other countries spend in Germany? Similar to the expenditure side, the share of the EU countries came to roughly 62% in 2012, However, this level is considerably below the nearly 70% average registered over the last ten years. The share of money spent in Germany by Asian tourists has doubled recently, to 10% in 2012. Over the past ten years it had hovered just under 5%. The largest share spent by foreigners in Germany came from Dutch holidaymakers. Their share in total tourism revenues stood at 12% last year, followed by the French (8%), Austrians and Americans (7% each) as well as Italians and the British (4% each).

If one compares these figures with overnight stays of foreign visitors in German tourist accommodation establishments, there are both similarities and differences. For instance, the Dutch also rank first in the overnight stay statistics. At almost 16% (2012), their share in total overnight stays is even higher than their share in tourism revenues. This could be due to the fact that in 2012 one-quarter of all Dutch tourists stayed at camping sites, while the figure was only slightly over 3% for all other foreign visitors. Guests from Switzerland (7.6%) rank second in the overnight stay statistics, with their share in expenditure (11%) even exceeding that figure. This implies that visitors from Switzerland spend more money per day on average than the Dutch. The fact that tourists from the US (7.1%), the UK (6.6%), Italy (5%) and Austria (4.7%) hold the following ranks is basically in line with the balance-of-payment statistics. With a share of 4.5%, France only ranks seventh, which differs markedly from its share in travel revenues. In the case of France this divergence between overnight stays and bop statistics is difficult to explain. A "simple" explanation could of course be that French tourists spend an above-average amount of money when visiting Germany. An alternative or additional reason could be that a relatively large share of the visits paid by French tourists are day trips which do not include an overnight stay. By the way, the most popular federal states for foreign visitors staying overnight are Bavaria, Berlin and Baden-Wuerttemberg in that order.

Dutch boast highest number of overnight stays in Germany 10

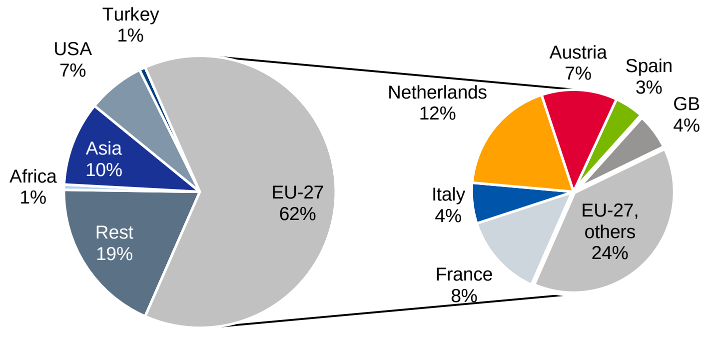
Overnight stays in German tourist accommodation by country of origin, 2012, share in %



Source: National statistical office

The Dutch love Germany (as a holiday destination) 11

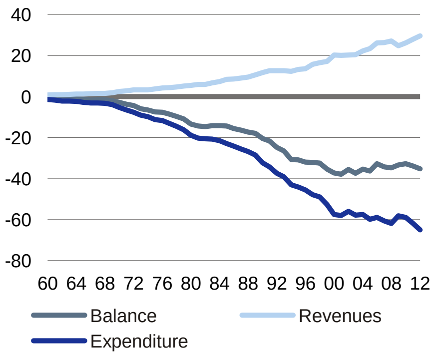
Share in international travel revenues by region of origin, %



Sources: Deutsche Bundesbank, DB Research

International tourism: German net expenditure exceeds net revenues 12

Travel revenues and expenditure, EUR bn



Sources: Deutsche Bundesbank, DB Research

Germany records deficit in foreign travel

A comparison of Germany's revenues and expenditures in foreign travel as a whole shows that, even in 1960, Germans spent more money on holidays abroad than foreigners visiting Germany. This deficit widened massively between 1960 (EUR 500 m) and 2001 (EUR 38 bn); this is an increase of 11.4% p.a. Since then the deficit has been hovering around a level of EUR 35 bn. In 2012 this corresponded to 1.3% of GDP, with expenditures amounting to 2.5% of GDP and revenues to 1.1%. In 2012, the deficit widened particularly versus the other EMU countries, which means that German tourists helped reduce internal imbalances within the monetary union. However, as the imbalances are considerably larger in goods trade than in services, the macroeconomic effect is relatively small.[12]

Domestic tourism an important factor, but poor statistical database

Official statistics suggest that the amount of money spent by Germans on holidays and business trips in their home country is significantly higher than their spending on tourism abroad. According to the Federal Ministry of Economics and Technology (BMWi), tourism expenditure in Germany came to a total of EUR 278 bn in 2010, of which EUR 242 bn was money spent by Germans in their own country. This is more than four times the amount spent on foreign travel (2010: EUR 59 bn).[13] However, the comparability of these data is limited. In contrast to balance-of-payments data, there are no regularly updated statistics on expenditure on domestic tourism and business travel. These figures are taken from a study commissioned by the Federal Ministry of Economics and Technology. The definition of tourism expenditure is very broad – albeit well justified and based on international standards which includes among other things spending on products that are required for or purchased during the holiday (ranging from fuel and food to souvenirs).

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12 See also Gräf, Bernhard and Heiko Peters (2013). The worst is (probably) over. Current Issues, Focus Germany. Deutsche Bank Research. Frankfurt am Main.

13 See Bundesministerium für Wirtschaft und Technologie (2012). The Economic Impact of Germany's Tourism Industry. Key figures from a high-revenue, cross-sectoral industry. Berlin.

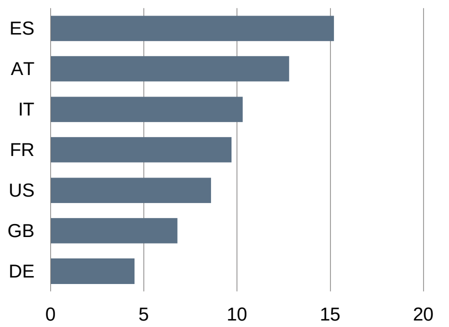
The above mentioned study also describes the contribution of domestic tourism to Germany's overall economic output. The production of goods and services purchased by domestic and foreign tourists in Germany in 2010 *directly contributed* 4.4% to Germany's overall gross value added. This equalled roughly the contribution made by Germany's construction industry. Including the *indirectly* generated value added, for instance through the production of food to be sold to tourists, the share in value added rises to just under 10%.

In addition to the report by the Economics Ministry, the DRV also refers to the Deutsche Zentrale für Tourismus (DZT) which uses a narrower definition of travel outlays by Germans in Germany.[14] According to the BMWi survey, this definition does not include expenditure by domestic (private and business) day travellers, for instance. Neither does it include the cost of overnight stays in prevention and rehabilitation clinics or spending by the under 15 year-olds (e.g. for school trips) and people travelling in camper vans who do not use camping sites. According to the DRV, this domestic tourism expenditure by Germans came to “only” just under EUR 70 bn (2011) and only marginally exceeded spending on foreign travel under this definition.

Due to the large discrepancy between these figures and the absence of longer time series on the development of domestic tourism, there is some uncertainty as to the actual size of the market. In addition, diverging definitions and distinctions play a major part. The poor data basis also results from the fact that tourism services are cross-sectoral. For instance, tourists use services provided by the transport industry as well as by the hotel and catering trade. Moreover, tourists account for turnover in the retail trade, which is not registered separately, however, but must be estimated. On balance, official German statistics do not automatically provide reliable information on the economic significance of domestic tourism.

Tourism especially important in Spain 13

Contribution of tourism* to GDP, 2012, %



*Direct, indirect and induced effects

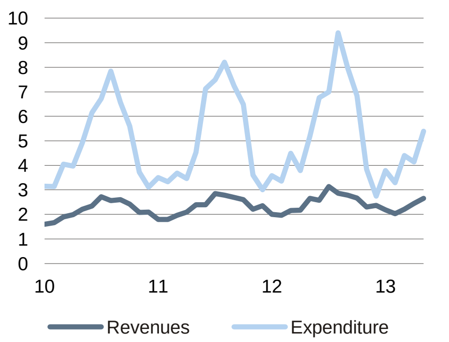
Source: WTTC

An international comparison based on identical definitions is made possible by the data provided by the World Travel & Tourism Council (WTTC). According to this data, tourism with its direct, indirect and induced effects contributes 4.5% to Germany's GDP.[15] Compared with other countries, the sector thus is of minor significance in Germany. According to the WTTC, tourism contributes more than 15% to overall economic output in Spain, for example. The figure is 10.3% in Italy and 8.6% in the US. The WTTC puts the global average at approximately 14% (all data are for 2012). Although – or actually because – Germany has held the title of world travel champion for years and years, its domestic tourism market is relatively small compared with many other countries.

Rising incomes likely to fuel travel activity in 2013

Travel payments with pronounced seasonal profile 14

Travel services, EUR bn



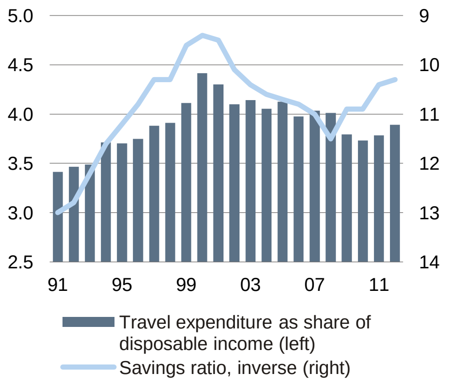
Source: Deutsche Bundesbank

As data availability is limited for the domestic travel market, the following discussion from a business cycle perspective will be restricted to expenditure by Germans on foreign travel.

German expenditure on foreign travel rose by 4.7% in 2011 and by 5.3% in 2012. These were the strongest increases since 1999/2000, even though a basis effect following the massive slump in the recession year of 2009 played an important part. 2013 will probably see yet another strong jump. Expenditure was up by an average of almost 3% in the first five months of the year compared with the pre-year period. This increase is insufficiently reflected in chart 14 as travel expenditure, in particular, is subject to a pronounced seasonal pattern. It is therefore important to point out that no data has yet been published by the Bundesbank for the important summer months.

14 See DRV (2013). Fakten und Zahlen 2012 zum deutschen Reisemarkt. Berlin.
15 See WTTC (2013). Travel & Tourism. Economic impact 2013. Germany. London.

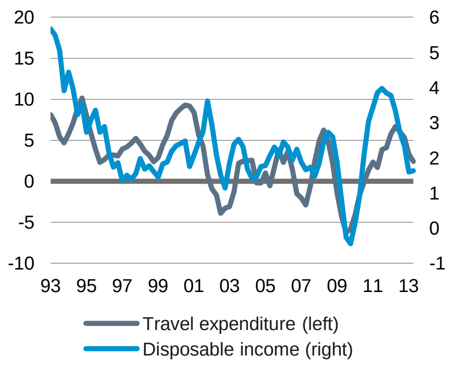
Share of travel expenditure in incomes has inched up recently 15



Sources: DB Research, Deutsche Bundesbank, national statistical office

Incomes and travel expenditure noticeably correlated 16

Nominal, % yoy, mov. 4Q average



Sources: DB Research, Deutsche Bundesbank, national statistical office

Like the two preceding years, 2013 will probably see tourism expenditure benefit from a substantial increase in disposable incomes. These were up by 3.3% in 2011 and by 2.3% in 2012 and will probably rise by approx. 2.5% in the current year.[16] However, this connection between incomes and travel expenditure is not a stable one. Tourism expenditure, in particular, is much more prone to fluctuations than incomes. This suggests that income elasticity is relatively high. To be on the safe side in economically difficult times, households are likely to first of all cut discretionary spending on travel, for instance, and thus prefer cheaper and/or shorter holidays abroad or a – usually less expensive – holiday in their own country. When affected by unemployment, many people will cancel their holidays altogether. A “naive” regression of annual growth rates of expenditures to those of incomes, however, can only explain approx. 33% of the fluctuations of travel spending. In part, this is due to the fact that travel expenditure fails to be captured in the statistics when a domestic holiday is taken.

The connection described above can be underscored by another regression, however. If, in addition, one includes the rate of unemployment as an explanatory variable besides incomes, the explanatory power rises from just over 30% to just under 50%.[17] The (inverse) correlation with the savings ratio (chart 15) also points in this direction. But a reliable forecast remains impossible on this basis. For those travelling on the spur of the moment, the weather is another important factor in the decision to stay at home or go abroad. Be that as it may – based on our forecasts of unemployment and growth of disposable incomes, many factors point to another increase in foreign travel expenses in the order of approx. 5%. This would push the share of travel in disposable incomes back up to 4%, after falling from 4.5% in 2000 to 3.7% in 2010. With growth of disposable income having slowed noticeably to less than 2% recently (see chart 16), the outlook for travel expenditure in 2014 has at least become a little less buoyant.

When this article is published, Germany's main holiday season will be coming to an end. Commuter trains and corporate canteens will be busier again, and workers will get back to their “normal” routines. No matter how interesting an economic analysis of the tourism industry may be – what's most important for holidaymakers is whether their individual and very different expectations of the “best time of the year” will actually be met. On that happy note, we hope all our readers have (had) a great holiday!

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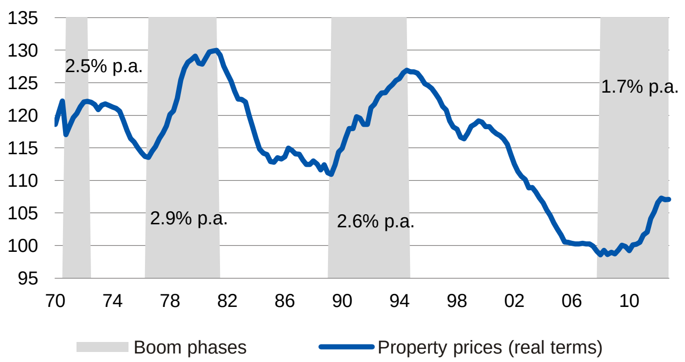
[16] See Rakau, Oliver (2013). Sentiment indicators – another setback in spring. Deutsche Bank Research. Current Issues, Focus Germany. Frankfurt am Main.

[17] There is an obvious correlation between the rate of unemployment and disposable incomes. Hence, the informative value of such a simple regression is limited from a statistical point of view.

Chart of the month

Residential property prices in Germany

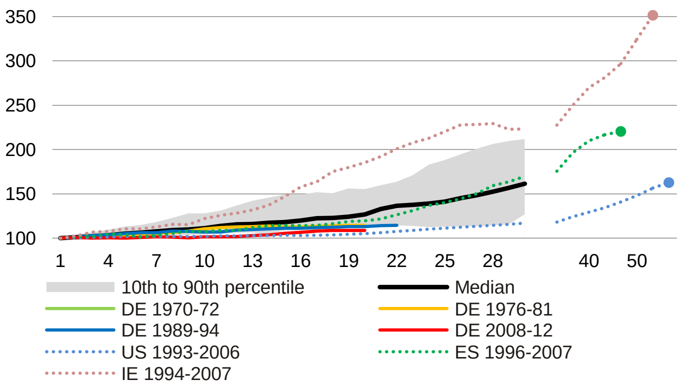
Index 2010=100



Sources: OECD, DB Research

Increases in property prices

Beginning of boom phase=100, duration (in quarters)



Sources: OECD, DB Research

No bubble in Germany's residential property market

After having fallen between 1994 and 2008, prices in Germany's residential property market have since risen in real terms, with the increase being quite pronounced in several urban areas. This has pushed the German housing market into the focus of national and international investors. Concerns have been voiced that a bubble may be about to form. However, if one compares price increases in real terms in Germany with similar phases in other OECD countries, current developments are at the lower end of the scale and should be seen as a normalisation of the price level.

Since the 1970s Germany has seen four periods characterised by strongly rising house prices (boom phases[18]). These developed in situations where income and inflation expectations or financing conditions changed substantially, though. During the first phase of rising prices at the beginning of the 1970s the German economy was humming along and there was full employment. The boom phase at the end of the 1970s − 1976 to 1981 − coincided with the oil crisis, during which inflation rose by a cumulated 25% (roughly 5% p.a.) and property prices were up a cumulated 14% (approx. 3% p.a.) in real terms. In the years following German unification, attractive depreciation conditions led to massive investment in residential property in eastern Germany, which caused the boom between 1989 and 1994. The fourth growth phase began with the onset of the global economic crisis in 2008, with the real increase in prices having picked up somewhat since the start of the European sovereign debt crisis.

Compared with past housing boom phases (in real terms) in the OECD countries between 1970 and 2012 it turns out that Germany was at the lower end of the scale with price increases of around 2-3% p.a. in real terms. During the boom phases in the OECD countries the median price increase per year was approx. 8%, with the increases in the bottom decile amounting to less than 4% p.a. and increases in the top decile to over 15% p.a. In terms of duration, the boom phases averaged approximately 5 years. Hardly surprisingly, particularly long phases were frequently followed by especially painful adjustments. The property price bubbles in the US (1993-2006), Spain (1996-2007) and Ireland (1994-2007) built up over a long period of time and, after the

[18] In this article we define boom phases as periods of rising prices lasting for at least six quarters.

bubble had burst, led to massive distortions in the markets in 2006 and 2007. Prices rose by a cumulated 250% in real terms in Ireland (20% p.a.), 120% in Spain (11% p.a.) and 60% in the US (5% p.a.).

OECD data shows that low real interest rates and strongly rising incomes fuel the increase in property prices. Long-term real interest rates of 0% and robust – but not rising – incomes suggest that the current boom phase in Germany will likely continue and could become the longest boom phase on record by far. The ECB's extremely expansionary monetary policy in response to the euro crisis has pushed interest rates down to a historically low level while business activity has been relatively robust in Germany. However, this has not yet triggered a credit boom because borrowing conditions are comparatively steep, one example being the relatively high deposits required for mortgages. Nonetheless, investment in property has become more attractive than fixed-income instruments. Even though the lion's share of property investment is made by residents, Germany's higher GDP growth rates compared with other industrial countries in Europe are likely to attract foreign investors, too. Moreover, with the euro crisis far from over, Germany is still seen as a relatively safe haven for investments.

Which factors could herald the end of the price increases? First, the demographic shift, as demand for property falls as people grow older and supply increases. This effect could be held up somewhat by continued immigration in the course of the euro crisis. Secondly, the cycle could be influenced by regulation. Thirdly, an end of the euro crisis could also put an end to rising property prices. As soon as the economies of the larger euro-area countries pick up speed again, investment outside of Germany could become increasingly attractive. In addition, economic recovery in the euro area will probably raise investor interest in financial market products compared with property. It is hard to tell, though, how long national property markets will take to adjust.

As the rise in prices has so far not been driven by credit growth and we do not expect any credit-financed price upswing either, the financial system is unlikely to be adversely affected if the price increases were to peter out. Also, German house prices have so far risen only very moderately by international standards, which can simply be regarded as a normalisation of the German market.

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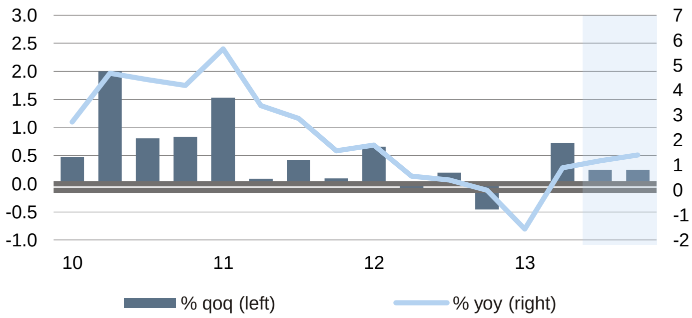
Chartbook: Business cycle (1)

Real GDP growth

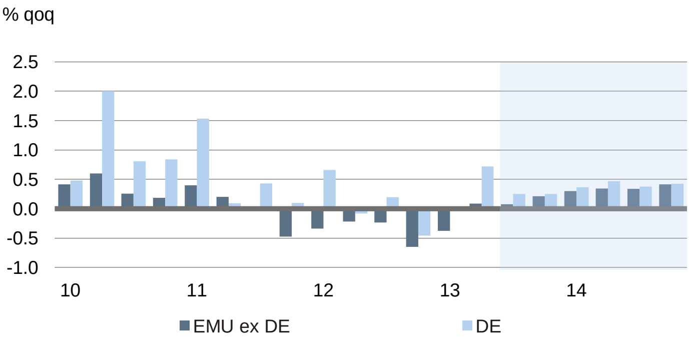


Sources: Federal Statistical Office, DB Research

— In Q2 GDP grew by 0.7% qoq and thereby ends the growth weakness of the winter half. Domestic demand contributed 0.5 pp to overall growth mainly thanks to a weather related bounce-back in construction. Consumption also grew strongly. Investment in machinery & equipment grew moderately after declining strongly for 6 quarters. Net exports added 0.2 pp to overall growth due to statistical quirks.

— *Due to revisions to previous quarters the weakness in the winter half has become less pronounced. Together with the somewhat better than expected Q2 growth this lifts our forecast for 2013 from +0.1% to +0.5% (2014: +1.5%).*

GDP growth: DE vs EMU



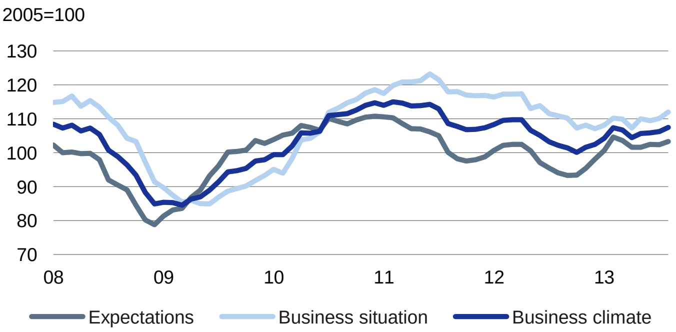
Source: Eurostat

— Euro area GDP grew by 0.3% qoq in Q2 ending the 6-quarter recession. Germany (+0.7% qoq) and France (+0.5%) contributed strongly. In Italy (-0.2%) and Spain (-0.1%) the GDP contraction became less severe.

— Considering the remaining adjustment needs in several EMU countries and almost stagnant global trade the EMU economy should barely grow in H2.

— *Despite modestly positive growth, in H2 EMU GDP should decline again in 2013 (2012: -0.6%). However, due to higher than expected Q2 growth we lifted our forecast to -0.4% from -0.6%.*

Ifo index - total economy

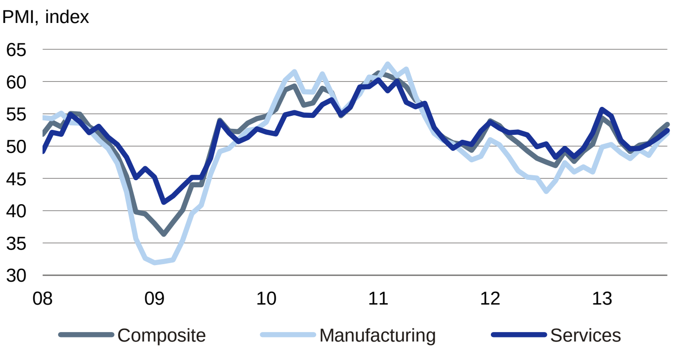


Source: ifo

— In August the ifo index rose for the fourth consecutive time. The business situation improved more strongly than business expectations. Still, expectations are above their historic average suggesting a GDP expansion in Q3 at around trend growth rates (0.3% qoq).

— The increase of the ifo was driven by the manufacturing sector's assessment of the business situation, while the sectors expectations improved only slightly. The (volatile) business climate of the wholesale sector rose strongly. The construction ifo fell for the fifth month running, while the retailing ifo remained roughly unchanged. Both remained on elevated levels pointing to decent domestic traction.

Purchasing Manager Index



Source: Markit

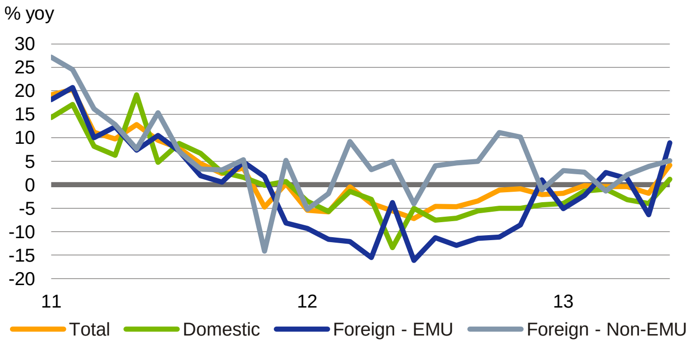
— The composite PMI rose again in August narrowing the gap to the ifo index further, which had been somewhat more optimistic than the PMI lately. However, the PMI has not regained the high levels seen in Jan./Feb.

— The manufacturing PMI rose further into expansionary territory in July (52.0 vs. 50.7 prev.). New orders improved (54.2), as export orders rose for the first time in 6 months (53.4).

— The services PMI showed a decent improvement as well (52.4 vs. 51.3 prev.). However, the employment prospects remained weak in both sectors.

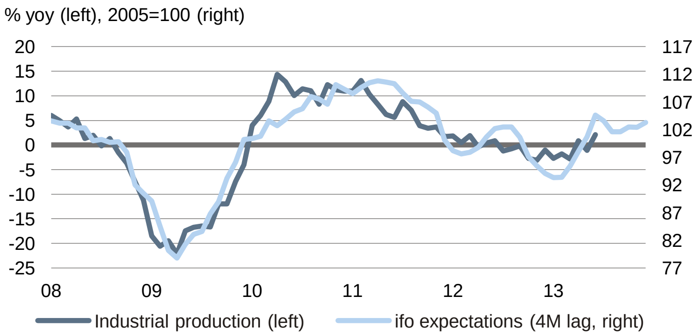
Chartbook: Business cycle (2)

New manufacturing orders



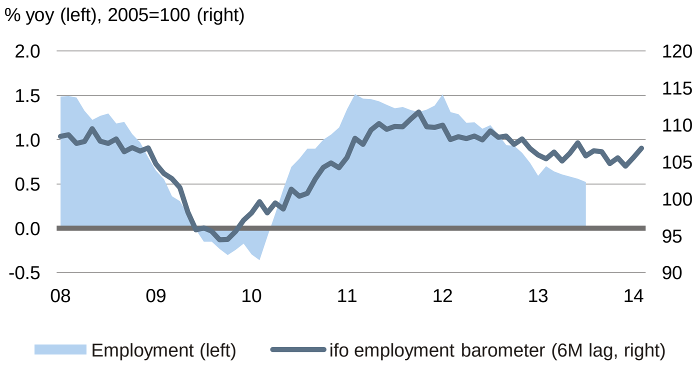
Source: Federal Statistical Office

Industrial production and ifo expectations

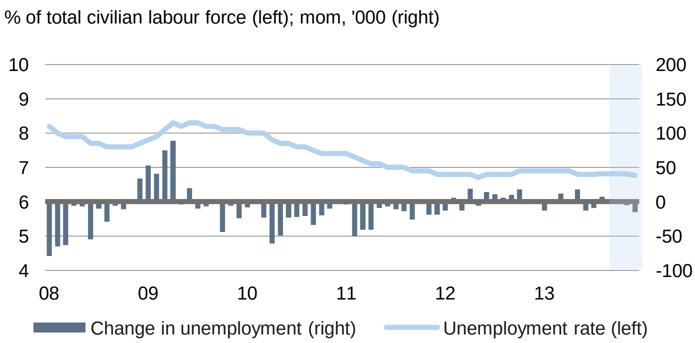


Sources: ifo, Federal Statistical Office

Employment and ifo employment barometer



Unemployment



Sources: Federal Employment Agency, DB Research

— Big-ticket orders at the air show in Paris brought about a surge in new orders. Compared to May orders were up 3.8% in June. Core orders (excl. airplanes, ships and trains) rose only 0.1%. In Q2 as a whole orders accelerated to +1.2% qoq compared to +0.4% in Q1.

— July orders should see a countermovement. The strong yoy-change (June: +4.3%) should therefore weaken again.

— Still, business surveys (ifo, PMI) point to an upward trend in orders. However, surveys have painted a too rosy picture lately. Therefore, we only expect a moderate improvement in orders going forward.

— Industrial production recorded a strong plus of 2.4% mom in June, which is, however, overstating the underlying dynamic due to catch-up effects after the bridging day filled May. Still, this is the fourth increase in five months. In Q2 (+2.8%) industry contributed strongly to GDP growth. However, auto production was likely overstated due to misreporting.

— Due to the unusual seasonal effects the numbers are likely to draw a too rosy picture currently. Production was still 1.9% below its previous year's level (non-seasonally adjusted). Still, sentiment indicators, capacity utilization in Q3 and the somewhat brightening prospects for global trade point to moderate production increases in H2.

— The weak economic development in the winter half (GDP growth Q4 -0.7% qoq; Q1 +0.1% qoq) currently weighs on the labour market which follows economic activity.

— Employment growth slowed to 0.5% yoy in July 2013. The level of employees subject to social security payments is up 1.2% yoy.

— Given the continued healthy mom-increases (+23,000 on average from January to July) employment marks record highs (41.8 m).

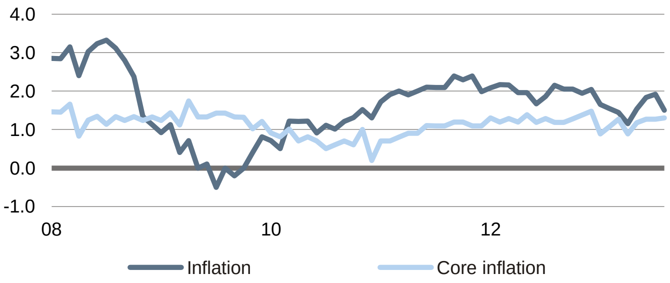
— In August the number of unemployed rose slightly by 7k after it had fallen by 7 and 12k in the two months before. The unemployment rate stayed at 6.8% for the fourth month running.

— Leading indicators were above their Q2 averages in July and August. They more or less point to a sideways trend in the coming months. We expect the labour market to improve in autumn 2013. The unemployment rate should average 6.8% in 2013 after 6.8% in 2012.

Chartbook: Business cycle (3)

Inflation rate and core inflation rate

% yoy (core inflation only available since 2011 due to alteration in statistical collection)



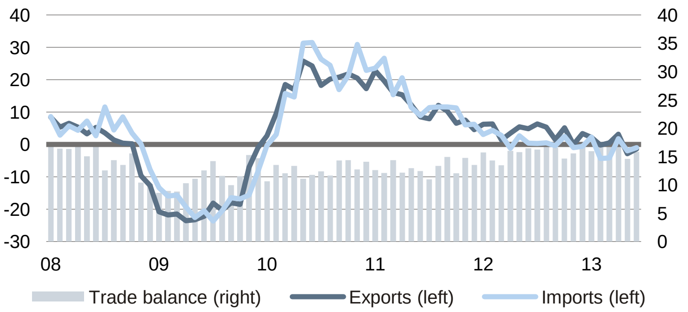
Sources: Federal Statistical Office

— Inflation fell to 1.5% yoy in August from 1.9% in July. The drop was primarily due to the slowdown in the energy prices increase from 2.9% to 0.4%, which resulted from a base effect as energy prices were roughly unchanged, compared to July. Food prices also slowed somewhat (4.9% vs. 5.7% prev.). Core inflation remained at 1.3%.

— *Given the moderate GDP growth and the expected stability of the oil price, consumer price inflation will probably be muted over the coming month. We recently raised our inflation forecast for 2013 to 1.6% as food prices have remained stronger than we had assumed.*

Merchandise trade

% yoy (left), EUR bn (right)



Source: Deutsche Bundesbank

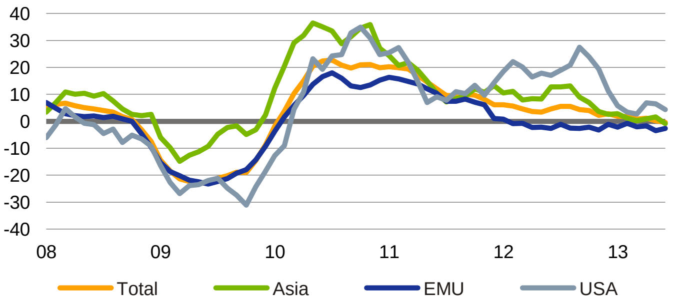
— The trade balance surplus recovered to EUR 15.8 bn in June. However, as in May it stayed below its Q1 average of EUR 16.8 bn.

— In June exports were 2.1% and imports were 1.2% below June 2012 volumes. Overall the foreign trade dynamic was weak in H1 and in a yoy-comparison exports and imports fluctuated around zero.

— Exports rose modestly in June (+0.6% mom) compared to May, but could not compensate for the weakness in May (-2.0%). Imports fell 1.0% after strong increases in the three months before.

German merchandise exports by destination

Merchandise exports, % yoy, 3M moving average



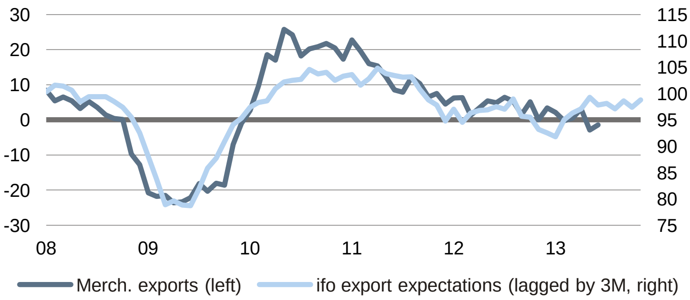
Source: Deutsche Bundesbank

— German exports moved broadly sideways lately as exports to Asia (especially China) and the US slowed strongly since mid-2012 no longer overcompensating declining exports to EMU.

— Since the onset of the euro crisis EMU's share in German exports has dropped by almost 10 percentage points to around 37% (Asia 16% and the US 8%), as the crisis economies have reduced their imports from Germany significantly since 2008 (2012 Spain: -36%; Italy: -10%; Portugal: -24%).

Exports & ifo export expectations

% yoy (left), index (right)



Sources: Deutsche Bundesbank, ifo

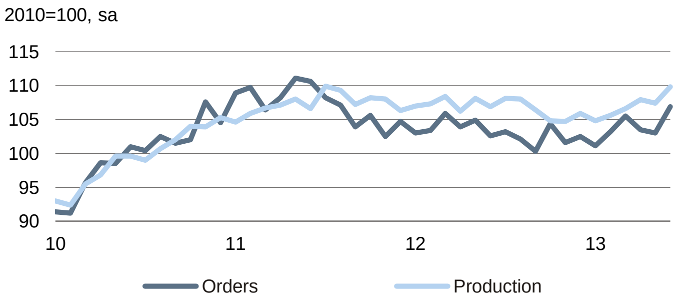
— In August export expectations rose slightly above their historic as well as their H1 average. Still, the overall trend has been sideways since the start of the year.

— Ifo export expectations point to muted trade dynamics. Export orders according to the PMI as well as the global PMI (both somewhat above 50) also do not suggest a strong recovery in world trade.

— In the coming months German import growth might be slightly higher than export growth due to the stabilisation of commodity prices, the end of destocking, the high level of employment and increases in real income.

Chartbook: Sectors

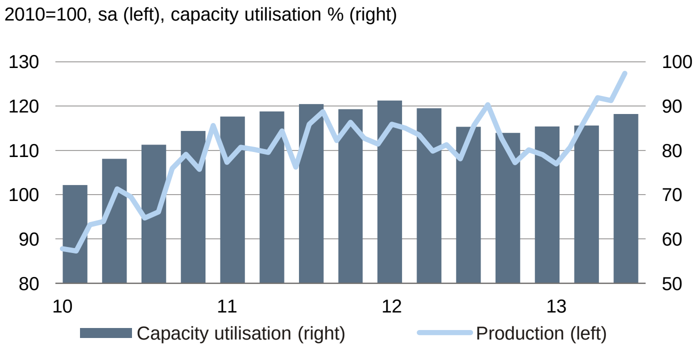
Manufacturing: Output and order intake



Source: Federal Statistical Office

- Industrial production in Germany was 2.6% higher in Q2 2013 compared to the average level of Q1 2013. The order intake rose by 1.6% qoq in real terms.
- Demand from the EMU increased of late due to big-ticket orders in the aircraft industry. However, German industry should receive further stimulus primarily from non-European demand during the remainder of 2013.
- We expect real industrial output to increase by 1% in 2013 (2012: -1%).

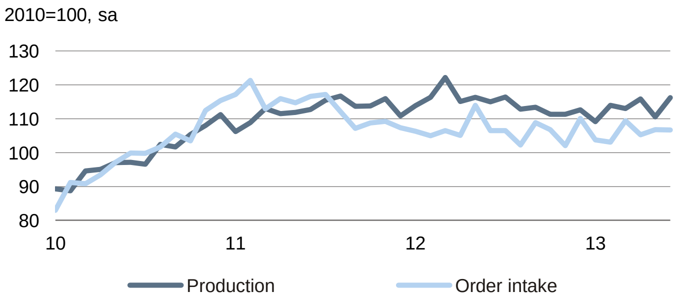
Car industry: Production and capacity utilisation



Sources: Federal Statistical Office, ifo

- Recent production numbers in the German automotive industry seem to be exaggerated due to problems with data collection. The officially reported production data was up 11% in Q2 2013 compared to the Q1 level.
- Due to this statistical problem we stick to our forecast of domestic production in the automotive industry increasing by 4% in 2013.
- Business expectations remain above the zero line. Capacity utilisation has increased for the third time in a row in Q3 2013.

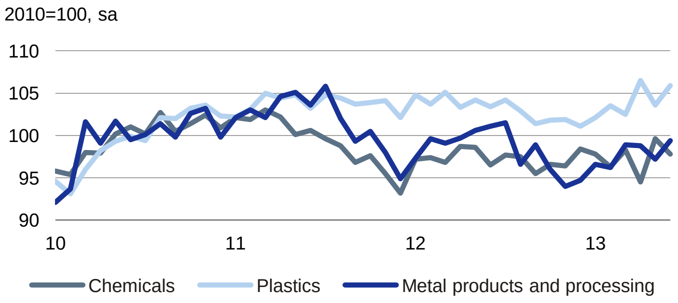
Mechanical engineering: Order intake and output



Source: Federal Statistical Office

- Order intakes in the mechanical engineering industry have sent mixed signals over the last few months. A gradual stabilisation of the euro area and the expected accelerating growth in China could support foreign demand in 2013.
- However, for 2013 as a whole we expect mechanical engineering output to decline by roughly 1% (2012: +1.3%), with output trending upwards in the course of the year; production in Q2 2013 already increased by 2% qoq.

Production: Early cycle sectors

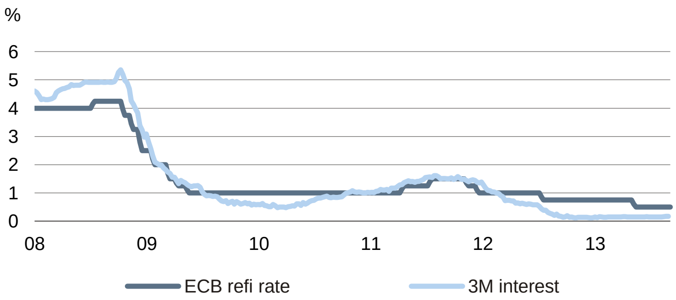


Source: Federal Statistical Office

- The early-cycle sectors still show only restrained signs of a growth rebound.
- In Q2 2013, plastics production exceeded the level of the previous period by 2.6%. Business expectations increased again of late.
- Output in the metal industry rose by 1.3% qoq in the Q2 2013. The sector could post a marginal increase in full year 2013.
- Production in the chemical industry is expected to increase by 1% in 2013 (2012: -2.6%). Output declined again in June, though.

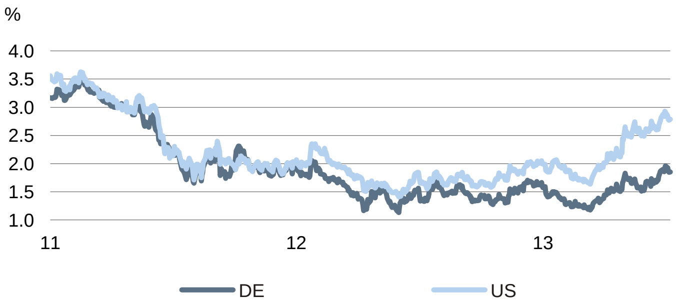
Chartbook: Financial markets (1)

EMU: Refi rate & 3M Interest



Sources: ECB, Global Insight

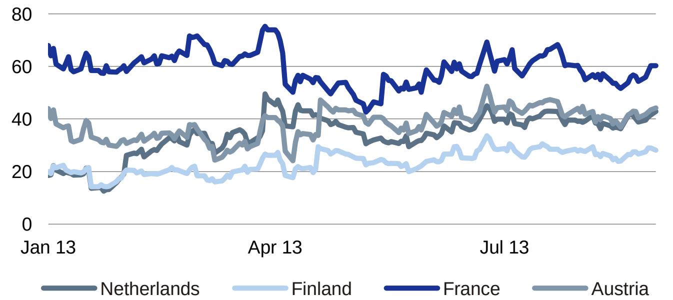
US and German government bonds: 10Y yields



Source: Global Insight

EMU: Bond yield spreads (i)

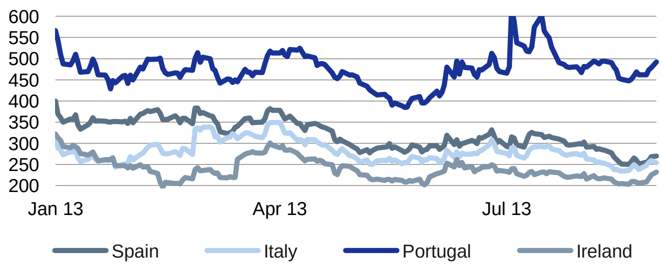
Versus German govt. bond yield, basis points



Source: Global Insight

EMU: Bond yield spreads (ii)

Versus German govt. bond yield, basis points



Source: Global Insight

— The ECB press conference on August 1 was pretty much a non-event. Mr. Draghi's partly circular answers to questions on the ECB's forward guidance (announced at the July press conference) illustrate the problems which can result from the new communication strategy over the medium term. The suggestion that the ECB's monthly repetition of the forward guidance could depend on the market's interest rate expectations also did not help to clarify matters.

— However, interest rates are set to remain low for an extended period of time. Given the continued weakness of monetary indicators the next ECB meeting on September 5 is unlikely to reveal a different message.

— Hints by Chairman Bernanke that the Fed might start slowing down its monthly purchases of USD 85 bn of treasuries and MBS in the coming months ("tapering") and that it might stop the program altogether by mid-2014 increased the market volatility. 10y treasury yields have risen from 1.6% at the beginning of May to a temporary peak of 2.9% and stand at 2.8%.

— German bund yields have also been pushed higher by the US sell off. Since early May yields increased from 1.2% to 1.9%. The US/German yield spread more than doubled to around 90 bp.

— Triggered by the Fed's tapering debate the global interest rate cycle seems to have turned.

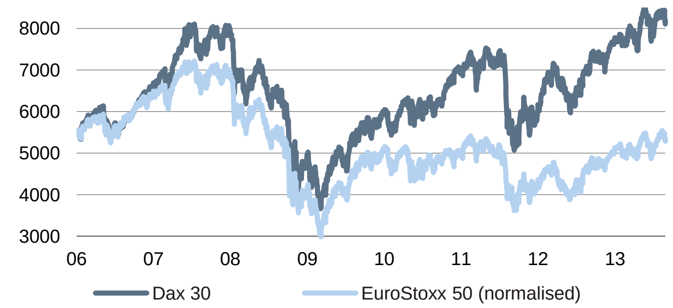
— Since the beginning of May yields of the EMU core countries have increased by 40 to 70 bp. Spreads versus Germany rose between 10 and 20 bp.

— By contrast, peripheral spreads have narrowed. Especially since July better economic indicators and hopes that the EMU recession would end have also had a dampening effect on spreads.

— In Portugal the spread is still higher than early May. During the peak of its political crisis the spread hit 600 bp, but has dropped to below 500 bp lately.

Chartbook: Financial markets (2)

Equity indices

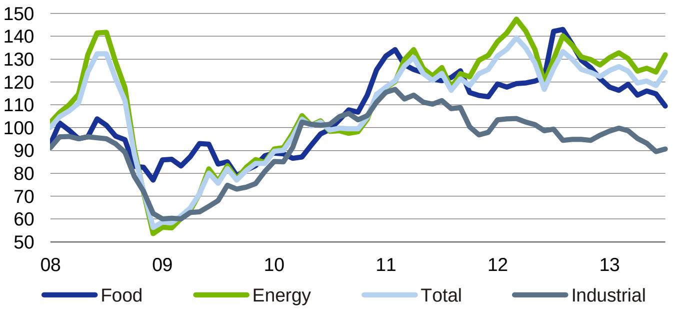


Sources: Global Insight, DB Research

- Concerns about an imminent US-lead attack on Syria caused the Dax to fall last week from its temporary high of around 8,400 to around 8,100. Thereby, the index breached the range it traded in over the last one and a half months. The same story roughly holds for the EuroStoxx50.
- Our equity strategists have a 2013 year-end target of 8000 for the DAX and 315 for the Stoxx600.

Raw material prices

HWWI index, 2010=100, based on EUR

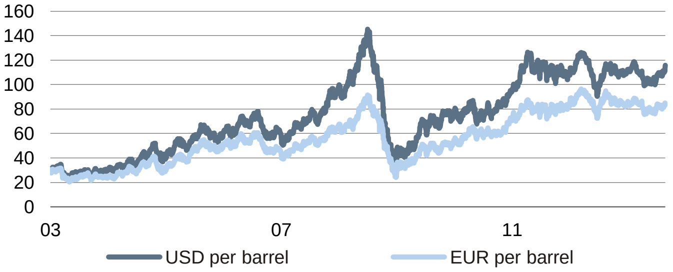


Source: HWWI

- Raw material prices have dropped strongly until the start of July given concerns about Chinese growth and the debate about Fed tapering, based on the perceived link between QE and inflows into commodities. Since we expect China and the global economy to pick up somewhat in H2 raw material prices could see a modest increase again. First signs of that emerged when metal prices reacted to better data out of China. Due to worries over Syria the oil price rose strongly last week.
- Since their peak last August food prices have dropped by almost 1/3. Although the decline has slowed during 2013 they are still around 20% lower than a year ago. However, the food price component of the CPI increased in several EMU countries recently.

Oil price

Brent Blent, USD or EUR per barrel

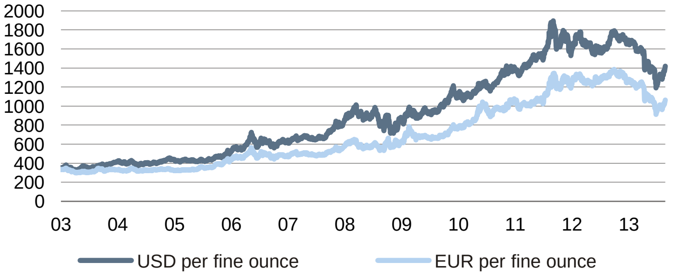


Sources: Global Insight, Reuters, DB Research

- Due to events related to Syria the oil price rose strongly last week. However, its current level is not markedly above its 2012 average. Given Egypt's control over the Suez Canal lingering unrest in Egypt is also weighing on prices.
- Due to the strong increase of oil supply thanks to the expansion of production of shale oil in the US our commodities analysts expect an oil price of USD 107 per barrel Brent at Q4 2013. Currently, the oil price amounts to USD 113 per barrel Brent.

Gold price

USD or EUR per fine ounce



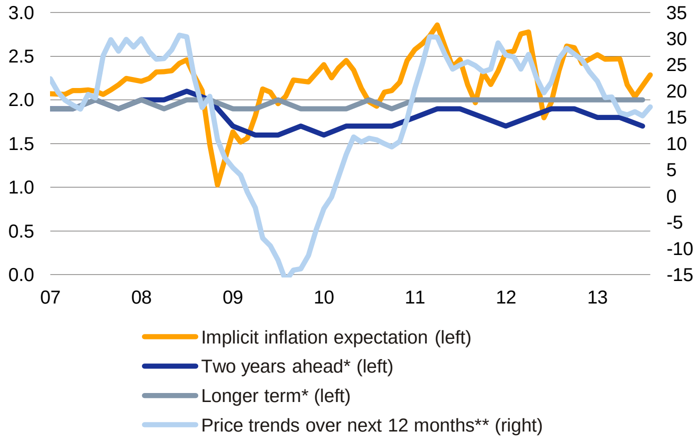
Sources: Global Insight, Reuters, DB Research

- Gold as a safe haven has become more expensive lately with the price rising to about USD 1,400 per fine ounce. Still the price remains around 20% below last year's high (Oct, 4, 2012; USD 1,792 per fine ounce). This collapse has been triggered by the announcement of the Fed to taper off QE3 in the course of 2013, higher real interest rates and abating concerns about inflation.
- Our commodities analysts expect the gold price to amount to USD 1,300 per fine ounce at Q4 2013. Nevertheless, the gold price is expected to decline yoy (eop) by the fastest pace since 1997.

Chartbook: Financial markets (3)

Inflation expectations Eurozone

% yoy (left), balance of pos. and neg. responses (right)

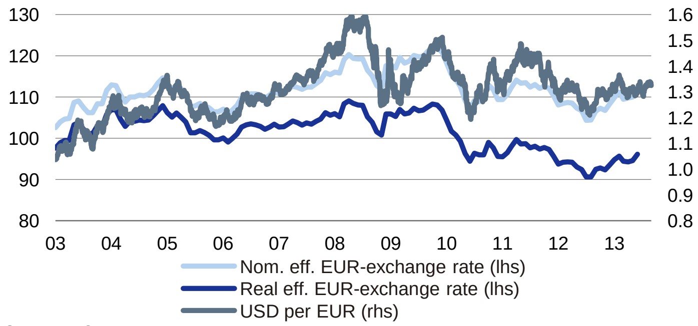


* ECB Survey of Professional Forecasters, ** EC Consumer Survey

Sources: ECB, EU Commission, Bloomberg

Exchange rate development for the EUR

1999Q1=100 (left), USD per EUR (right)



Sources: ECB, Reuters

— Contrary to lingering inflation concerns in the general public the private forecasters of the ECB survey expect no increase of the EMU inflation rate. The expected inflation rate in 2 years has fallen from 1.8% to 1.7%, while it held steady at 2.0% in 5 years.

— The implied inflation rate for the next 10 years – calculated as the difference between the yield of 10Y German government bonds and the yield of inflation-protected bonds – hovers between 2 and 2 ½% since the beginning of 2011.

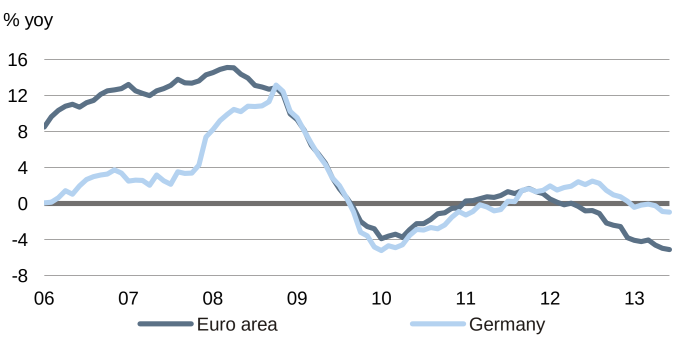
— However, the “implicit inflation expectation” may be biased. On the one hand the current real interest rates close to zero earned on an inflation protected bond are hard to reconcile with economic considerations. On the other hand nominal bond yields are depressed by massive purchases of several major central banks and still persistent flight to quality.

— After peaking at 1.37 in February EUR/USD has moved in a narrow 1.28-1.34 range during Q2. Recently, the partly contradictory comments by the Fed led to a relative volatile sideways movement.

— The USD should strengthen in H2 2013 due to the higher growth rate of the US economy of around 3% and Fed tapering later this year. According to our FX strategists the USD will probably appreciate to EUR/USD 1.20 end-Q4 (1.26 end-Q3). They see the emerging strength of the USD as the beginning of a multiyear uptrend and forecast that the USD will reach parity to the EUR by 2017.

Chartbook: Financial markets (4)

Loans to companies



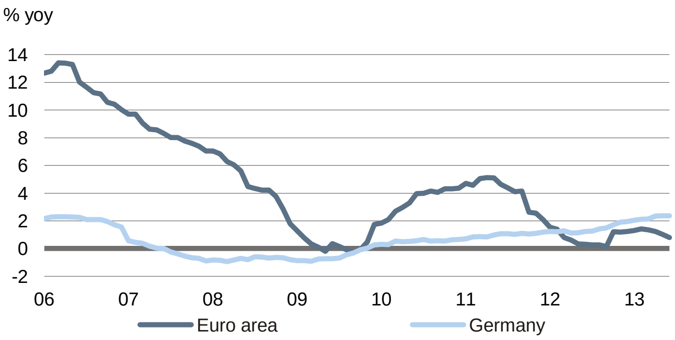
Sources: ECB, DB Research

— Growth in lending to German corporates has remained restrained in June (-0.9% yoy, EUR -8.6 bn).

— While the rate of reduction remains clearly below the euro area average, the slowdown in investment activity until Q1 2013 is reflected in lending volumes. In addition, borrowings are partly substituted by corporate bond issuance.

— Contraction of a corporate lending in the euro area continues at accelerated pace (-5.1% yoy in June, May: -5%) – mainly reflecting the bleak macroeconomic situation and ongoing deleveraging in countries strongly affected by the crisis.

Mortgage volumes



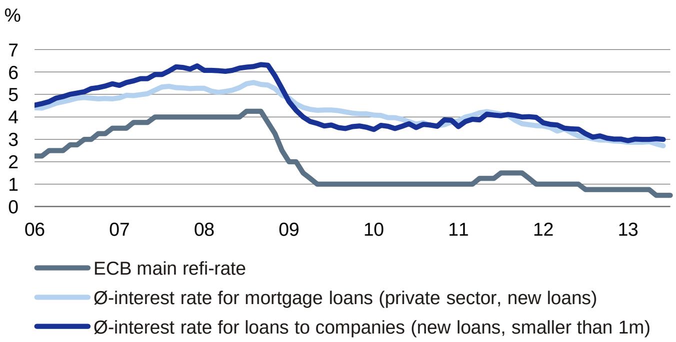
Sources: ECB, DB Research

— June showed again solid growth in mortgage lending for Germany (+2.4% yoy, EUR +23.3 bn). Increases throughout Q2 were consistently at pre-crisis levels but did not show further pronounced acceleration.

— Low interest rates coupled with stable income and labour market conditions bolster property demand by house-holds.

— German mortgage growth is clearly above the euro area average (0.8% yoy in June).

Interest rates

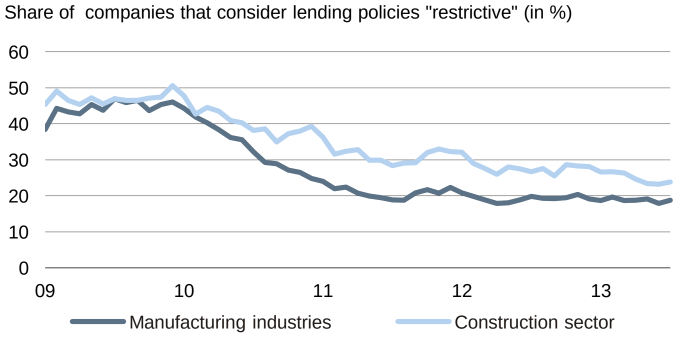


Sources: ECB, Bundesbank

— Interest rates for mortgages and loans to corporates have remained at historic lows. Interest rates for loans to companies continued to stand at 3% in June. Mortgage rates decreased again slightly (-0.1 pp compared to the previous month) and stood at 2.7%.

— The generally low interest rate environment has allowed banks to refinance themselves at relatively low cost, which they pass on to clients.

Lending standards



Source: ifo

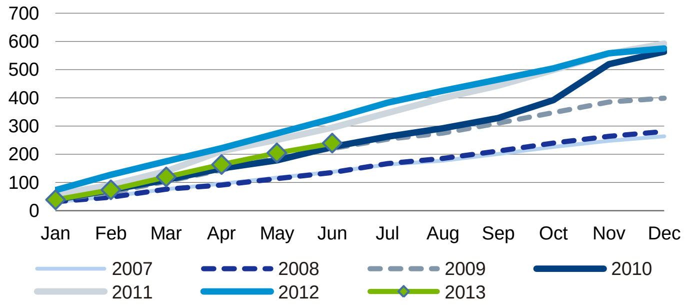
— Corporates on average saw no problem with credit supply.

— Despite a small increase (+0.9 pp compared to the previous month) the share of corporates from manufacturing industries that consider lending policies restrictive remained at very low levels in July. Similarly, the share of construction companies taking a sceptical view on lending policies slightly rose (+0.6 pp) but is still remaining at very low levels.

Chartbook: Financial markets (5)

Gross issuance of public debt securities

Cumulative issuance volume, EUR bn

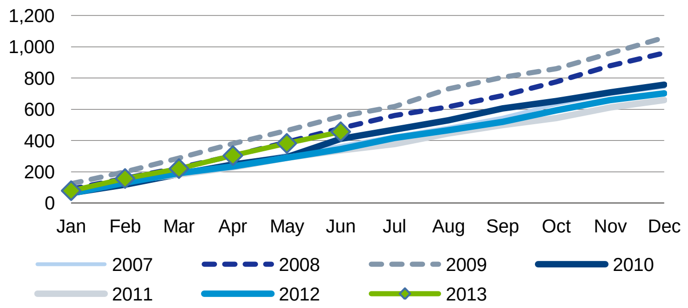


Sources: Bundesbank, DB Research

- Debt security issuance of German public sector has lost momentum. Germany's Länder and the federal government issued around EUR 35 bn in June 2013.
- The figures lagged behind the volume of the last two years, amounting only to EUR 239 bn in the first half of 2013.
- With interest rates and global markets slowly normalising, German public sector bonds seem to benefit less from safe-haven effects which propelled markets during the previous years.

Gross bank debt issuance

Cumulative issuance volume, EUR bn

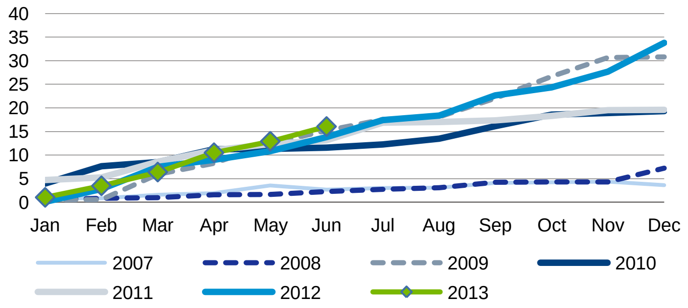


Sources: Bundesbank, DB Research

- Banks' bond issuance activity in June remained in line with monthly averages for 2013 and stands at around EUR 75 bn.
- German banks have raised EUR 457 bn on bond markets in the first half of 2013, the highest year-to-date volume since 2009. Tighter financial bond spreads and the fact that banks have improved their balance sheets seem to have helped banks to raise funding on the debt capital markets.
- Bond issuance in the rest of Europe shows decreasing tendencies, though.

Gross non-bank corporate debt issuance

Cumulative issuance volume, EUR bn

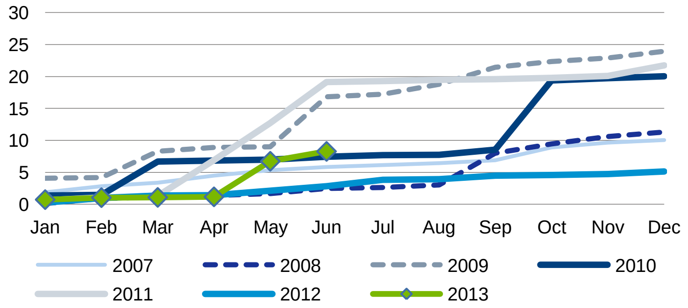


Sources: Bundesbank, DB Research

- Corporations tapped the bond markets with EUR 3.1 bn issuance volume in June, the second highest issuance volume in 2013 and the highest in a given June since 2007.
- Cumulative issuance activity in 2013 stood at around EUR 16 bn marking the highest issuance observed year-to-date.
- Corporate bond issuance seems to further gain as an alternative financing channel for corporations.

Gross equity issuance

Cumulative issuance volume, EUR bn



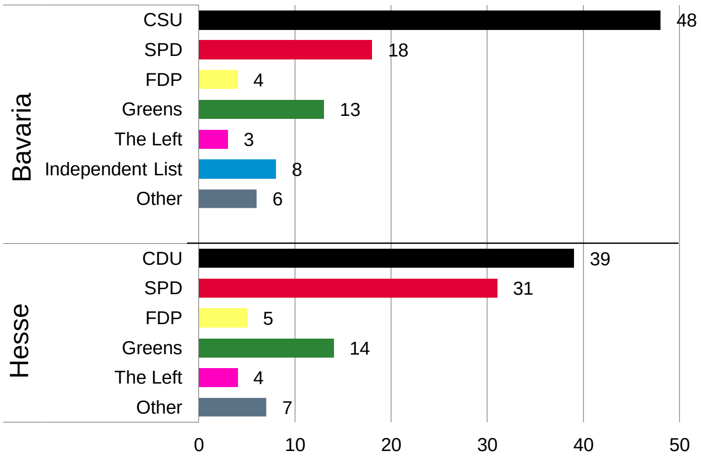
Sources: Bundesbank, DB Research

- Equity issuance cooled somewhat in June. German companies raised EUR 1.5 bn from the equity markets, which still topped monthly averages Jan.-Jun. but clearly stood below values reached in May (EUR 5.6 bn).
- Due to the strong increase in May, the issuance activity in the first half of 2013 stands close to averages for the first six months of the year (2007-2013) at around EUR 8.3 bn.
- Companies seem to take advantage of rising stock prices which have triggered higher demand from investors.

Chartbook: Economic policy

Polls for state elections in Bavaria and Hesse

as % of, elections in Bavaria on 15/09/2013, elections in Hesse on 22/09/2013

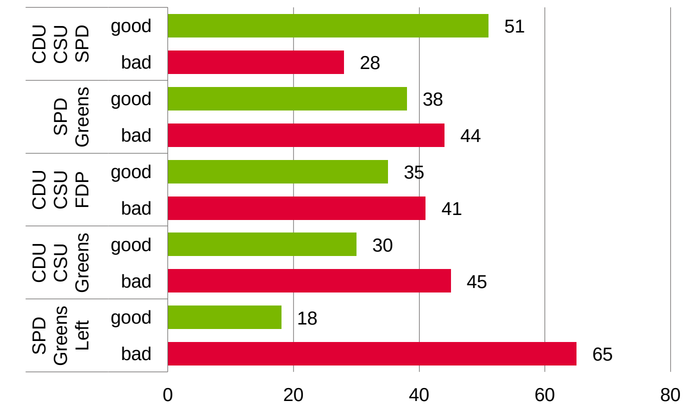


Sources: Infratest dimap, Emnid and Wahlrecht.de

- State elections will be held in Bavaria one week before the federal elections. In Hesse state elections are conducted parallel to federal elections. Both “Länder” are currently governed by a CDU- or CSU-FDP coalition – as in Berlin. Both states together hold 11 votes in the Bundesrat (upper house).
- In Bavaria the CSU currently looks set to win the absolute majority of votes. This could strengthen the position of the CDU/CSU at the federal level. Many commentators will be tempted to draw conclusions from the results in Bavaria for the federal election.
- In Hesse the state elections will be more exciting than previously thought as the CDU-FDP camp has in recent polls narrowed the gap to the SPD-Greens in the polls.

Assessment of possible coalition goverments

as % of

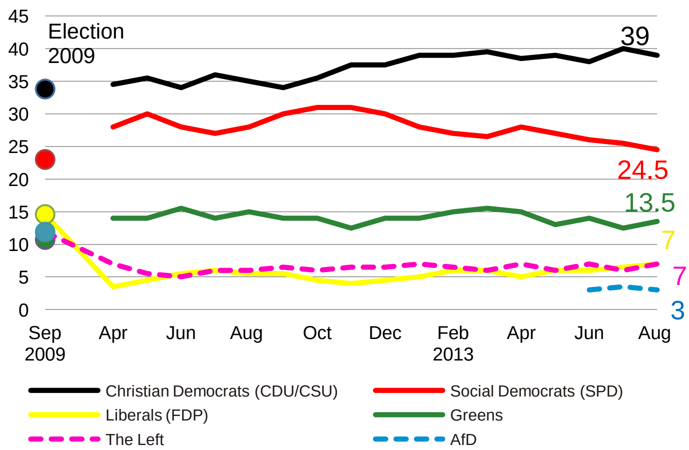


Sources: Politbarometer, Forschungsgruppe Wahlen and ZDF

- When asked for an assessment of possible coalition governments a majority of respondents welcomed a “grand” coalition of CDU/CSU and SPD. All other coalition governments were rejected.
- Remarkably, there is no big difference in the assessment of a possible SPD/Greens coalition or a coalition of CDU/CSU and FDP. A coalition between SPD/The Left/Greens is rejected by a vast majority of respondents.

Deutscher Bundestag, if elections were held tomorrow

2009 election results, from 2011 onwards survey results, %



Source: IFD Allensbach

- According to the average of recent polls, the governing CDU/FDP coalition would currently receive around 46% of the votes, which might suffice for an absolute majority in the Bundestag. Currently, the FDP and The Left are able to pass the 5% hurdle.
- The CDU remains far ahead of the Social Democrats. Chancellor Angela Merkel is still clearly more popular than her SPD challenger Peer Steinbrück.
- The AfD, which was founded in March and whose main topic is the reorganisation of the eurozone, remains below the 5% hurdle. But pollsters are unsure to what extent people reveal their real voting intentions regarding the AfD.

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Germany: Events of economic-, fiscal- and euro-politics

Date	Event	Remarks
3 Sep	1st reading of the draft 2014 federal budget in the Bundestag	The draft 2014 budget envisages expenditures totalling EUR 295.4 bn. (2013: EUR 310 bn including EUR 8 bn allocated to the Flood Relief Fund). New borrowing in 2014 will fall to EUR 6.2 bn (2013: EUR 25.1 bn).
5 Sep	Meeting of the ECB Council, press conference	Review of the monetary policy stance.
5/6 Sep	G20 summit Saint Petersburg	Priorities of Russia's presidency: growth and job creation through investment and effective regulation among others. This includes public debt sustainability and financial market regulation.
13/14 Sep	Informal ECOFIN meeting in Lithuania	
15 Sep	State election in Bavaria	Horst Seehofer will most likely remain prime minister. According to recent surveys the CSU might even reach a majority on its own in the state parliament.
22 Sep	State election in Hesse	Even a possible change of the state government (CDU/FDP) would not have a major impact on the majority in the Bundesrat (upper house).
22 Sep	Federal election	See chart 'Deutscher Bundestag …' in the chartbook 'Economic policy' for results of recent surveys.
2 Oct	Meeting of the ECB Council and press conference in Paris	Review of the monetary policy stance.
11-13 Oct	Annual meetings of the World Bank and the IMF	Discussion on the outlook for the global economy and developments in financial markets.
14/15 Oct	Eurogroup/ECOFIN meeting	Review of reform progress; preparation of the European Council.
24/25 Oct	European Council in Brussels	EU leaders' summit on social policies. Furthermore, debates on competitiveness, employment and growth in the EU.
7 Nov	Meeting of the ECB Council, press conference	Review of the monetary policy stance.

Source: DB Research

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Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
5 Sep 2013	12:00	New orders manufacturing (Index, sa), pch mom	July	-3.0	3.8
6 Sep 2013	12:00	Industrial production (Index, sa), pch mom	July	0.5	2.4
6 Sep 2013	8:00	Trade balance (EUR bn, sa)	July	17.0	15.9
6 Sep 2013	8:00	Merchandise exports (EUR bn, sa), pch mom (yoy)	July	3.5 (2.0)	0.6
6 Sep 2013	8:00	Merchandise imports (EUR bn, sa), pch mom (yoy)	July	2.8 (1.5)	-1.0 (-1.0)
-	9:30	Manufacturing PMI (Flash)	September	51.5	52.0
-	9:30	Services PMI (Flash)	September	52.0	52.4
24 Sep 2013	10:30	ifo business climate (Index, sa)	September	107.3	107.5
27 Sep 2013	14:00	Consumer prices preliminary (Index, sa), pch mom (yoy)	September	0.1 (1.5)	0.0 (1.5)
30 Sep 2013	8:00	Retail sales (Index, sa), pch mom	August	0.5	-1.4
1 Oct 2013	10:00	Unemployment rate (%, sa)	September	6.8	6.8
15 Oct 2013	8:00	Import prices (Index, sa) pch mom (yoy)	August	0.1 (-3.8)	0.3 (-2.6)
14 Nov 2013	8:00	Real GDP (Index, sa), % qoq	Q3 2013	0.3	0.7

Sources: DB Research, Federal Statistical Office, Federal Employment Agency, ifo, Markit

Financial forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	0.100	0.10	0.50	0.50	0.00	1.00	0.20	1.50	2.50	3.80	0.05
Sep 13	0.100	0.08	0.50	0.51	0.00	1.00	0.10	1.50	2.50	3.50	0.05
Dec 13	0.100	0.08	0.50	0.51	0.00	1.00	0.10	1.50	2.50	3.50	0.05
Jun 14	0.100	0.08	0.50	0.60	0.00	1.00	0.10	1.50	2.50	3.50	0.05
3M interest rates, %											
Current	0.26	0.23	0.22	0.52							
Sep 13	0.35	0.30	0.50	0.51							
Dec 13	0.35	0.30	0.50	0.51							
Jun 14	0.35	0.30	0.50	0.60							
10J government bonds yields											
	Yields, %				Spreads vs. EMU, pp						
Current	2.76	0.73	1.85	2.60	-0.76	0.59	0.21	1.15			
Sep 13	2.50	0.90	1.55	2.25	-0.70	0.25	0.25	0.65			
Dec 13	2.50	1.00	1.75	2.50	-0.65	0.20	0.30	0.70			
Jun 14	3.00	0.80	2.00	2.80	-0.65	0.20	0.30	0.75			

Exchange rates	EUR/USD	USD/JPY	EUR/GBP	GBP/USD	EUR/CHF	EUR/SEK	EUR/DKK	EUR/NOK	EUR/PLN	EUR/HUF	EUR/CZK
Current	1.32	98.33	0.85	1.55	1.23	8.73	7.46	8.09	4.26	300.78	25.74
Sep 13	1.26	102.00	0.86	1.47	1.25	8.25	7.46	7.35	4.13	284.90	25.80
Dec 13	1.20	110.00	0.85	1.41	1.25	8.05	7.46	7.25	4.00	279.30	25.60
Jun 14	1.18	112.00	0.84	1.40	1.24	8.00	7.46	7.15	4.00	275.10	25.30

Sources: Bloomberg, Deutsche Bank

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German data monitor

	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Mar 2013	Apr 2013	May 2013	Jun 2013	Jul 2013	Aug 2013
Business surveys and output											
Aggregate											
Ifo business climate	102.3	101.4	106.1	105.3		106.7	104.4	105.7	105.9	106.2	107.5
Ifo business expectations	94.3	95.6	103.0	101.9		103.6	101.6	101.6	102.5	102.4	103.3
PMI composite	47.9	49.1	52.8	49.9		50.6	49.2	50.2	50.4	52.1	53.4
Industry											
Ifo manufacturing	96.4	95.1	101.1	100.5		101.9	99.3	100.7	101.5	101.5	103.1
PMI manufacturing	45.0	46.3	49.7	48.7		49.0	48.1	49.4	48.6	50.7	52.0
Headline IP (% pop)	0.3	-2.5	0.0	2.8		0.9	1.7	-0.8	2.4		
Orders (% pop)	-1.9	0.9	0.4	1.2		2.2	-1.9	-0.5	3.8		
Capacity Utilisation	83.6	82.1	83.2	82.7	83.6						
Construction											
Output (% pop)	0.5	-2.3	-6.6	12.1		-5.8	15.7	-1.0	5.1		
Orders (% pop)	-1.2	2.2	2.4	0.3		-5.4	0.7	0.5	5.1		
Ifo construction	118.1	117.7	125.7	123.8		127.2	124.5	123.5	123.4	121.9	120.2
Services											
PMI services	49.4	50.0	53.8	49.9		50.9	49.6	49.7	50.4	51.3	52.4
Consumer demand											
EC consumer survey	-7.9	-10.0	-6.5	-4.2		-5.4	-4.9	-4.5	-3.2	-2.3	
Retail sales (% pop)	-0.6	-0.7	1.6	0.0		-0.3	0.2	0.8	-0.8	-1.4	
New car reg. (% yoy)	-7.0	-6.2	-10.5	-3.7		-17.1	3.8	-9.9	-4.7	2.1	
Foreign sector											
Foreign orders (% pop)	-1.4	2.2	-1.0	3.0		2.7	-1.1	0.5	4.2		
Exports (% pop)	1.1	-2.0	0.4	0.1		0.5	1.4	-2.0	0.6		
Imports (% pop)	0.3	-0.9	-1.0	1.3		1.0	1.2	1.4	-1.0		
Net trade (sa EUR bn)	50.6	47.1	50.5	48.0		17.1	17.5	14.6	15.9		
Labour market											
Unemployment rate (%)	6.8	6.9	6.9	6.8		6.9	6.9	6.8	6.8	6.8	6.8
Change in unemployment (k)	25.7	28.7	-8.0	19.7		12.0	4.0	18.0	-13.0	-7.0	7.0
Employment (% yoy)	1.1	0.9	0.6	0.6		0.6	0.6	0.6	0.6	0.5	
Ifo employment barometer	105.9	106.3	106.2	104.9		106.4	104.7	105.5	104.4	105.6	106.8
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	2.1	2.0	1.8	1.5		1.8	1.1	1.6	1.9	1.9	1.6
Core HICP (% yoy)	1.2	1.3	1.4	1.0		1.8	0.6	1.1	1.2	1.2	
Harmonised PPI (% yoy)	1.4	1.5	1.1	0.3		0.4	0.1	0.2	0.6	0.5	
Commodities, ex. energy (% yoy)	-4.5	0.7	-3.5	-7.0		-3.7	-6.2	-6.7	-8.2	-13.7	
Oil price (USD)	109.7	110.1	112.6	102.5		108.4	102.0	102.6	103.0	107.9	
Inflation expectations											
EC household survey	27.0	31.2	26.6	22.5		25.6	25.4	21.6	20.6	23.5	
EC industrial survey	0.8	2.9	3.7	-0.6		2.5	-0.4	-1.8	0.5	1.3	
Unit labour cost (% yoy)											
Unit labour cost	3.3	3.1	4.0	1.4							
Compensation	2.7	2.9	2.2	1.6							
Hourly labour costs	3.7	3.7	4.2	1.1							
Money (% yoy)											
M3	6.9	6.0	5.3	4.2		5.3	5.7	4.6	4.2	2.2	
M3 trend (3m cma)						5.6	5.2	4.8	3.7		
Credit - private	0.6	-0.4	-0.2			-0.2	-0.2	-0.1	1.3		
Credit - public	10.4	13.5	-18.7			-18.7	-13.2	-23.1	-22.4		

% pop = % change this period over previous period.
Sources: Deutsche Bundesbank, European Commission, Eurostat, Federal Employment Agency, German Federal Statistical Office, HWWI, ifo, Markit

Deutsche Bank
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Focus Germany

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