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Research

Current Issues
Business cycle

Focus Germany

Outlook 2015: Recovery with risks attached

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After a surprisingly good start to 2014, the German economy cooled noticeably in the course of the year. This was mainly due to the slowing of growth in key export markets and higher uncertainties on the back of geopolitical crises.

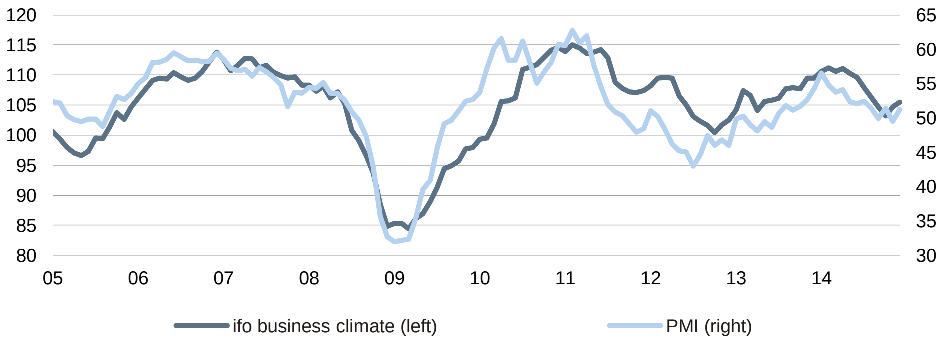
By contrast, the domestic economy, underpinned by a robust labour market, continued to post solid performance and was again by far the main driver of growth. Following a weak winter half in 2014/15 the economy looks likely to regain its footing as 2015 progresses. The ifo's rise in November and December points in this direction. However, sluggish performance at the turn of the year means growth will probably average only 1% in 2015 after 1.4% in 2014.

It is encouraging, however, that private consumption should remain a major pillar of growth, whereas net exports are likely to have a neutral impact. Nonetheless, signs are increasing that some – in our opinion misguided – economic policy moves (such as the introduction of a nationwide minimum wage as well as an enhanced pensions package) are weighing on the labour market and thus on consumption. Employment looks set to increase at a much slower pace than in 2014 and unemployment set to rise in the second half of the year.

While residential construction is still in good shape we expect little growth stimulus from investment in machinery and equipment. The chances of public budgets ending the year 2014 with a borderline surplus are fraught with risk. Given a weakening of cyclical activity and the costs of economic policy measures, we expect the general government budget to be slightly in deficit in 2015.

Confidence indicators

2000=100 (left), Index (right)



Sources: ifo, Markit

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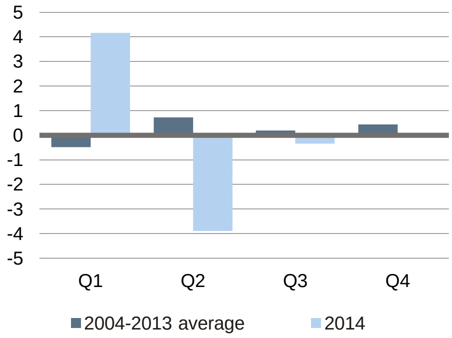
Economic performance 2014: Impacted by capricious weather, calendar effects and geopolitical developments

Germany: Construction investment 1

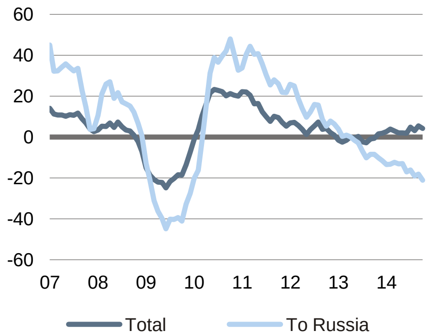
% qoq



Source: Federal Statistical Office

Germany: Exports 2

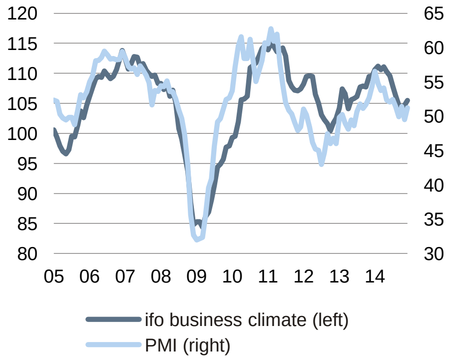
% yoy, 3M moving average



Source: Federal Statistical Office

Confidence indicators 3

2000=100 (left), Index (right)



Sources: ifo, Markit

The German economy boomed into 2014 with gross domestic product (GDP) notching up real growth of 0.8% (on the previous quarter) in Q1. Since then, however, this growth has weakened appreciably. While this sounds quite straightforward at first, it actually only poorly describes the growth dynamics of 2014 in the light of substantial weather-related distortions and special factors, such as calendar effects. Some 60% of the strong growth in the first quarter was attributable to the extreme jump in construction investment brought on by the mild weather. While investment in construction had fallen by 0.5% on average in the first quarter of each of the previous ten years, the reading for the first three months of 2014 was up 4.2%. As a consequence there was no revival of construction activity in spring as usual. The construction investment correction in Q2 (-3.9%) was one of the major reasons for the slight contraction of the German economy in that quarter.

Furthermore, the timing of the statutory holidays and school holidays as well as the shifting of factory shutdown periods (in the auto industry, for instance) during the summer half-year triggered further distortions that statistical adjustment methods were unable to strip out appropriately, so it was virtually impossible to shed satisfactory light on the actually underlying growth dynamics.

Besides these more technical factors economic activity was driven by two international developments in particular in 2014. One of these was the Russia-Ukraine conflict which led to the Western countries' imposition of heavy sanctions on Russia, a noticeable clouding of sentiment in industry and a severe downturn in German exports to Russia. The other was the increase in uncertainty over the economic recovery of the eurozone, which had started to weaken at about mid-year. This was a further blow to German investment activity, which had already been staggering under sluggish world trade. As an example, investment in machinery and equipment fell again from about mid-2014 after a tentative recovery at the start of the year.

Nonetheless, the German economy expanded by 1.4% in 2014 owing to the favourable starting position created by the robust growth in the first quarter. The latter was mainly due to a healthy increase in private consumption and construction investment, whereas the contribution of net exports to GDP growth was likely moderate. Germany thus again posted the highest GDP growth among the major euro countries.

Recovery expected on heels of sluggish 2014/15 winter half

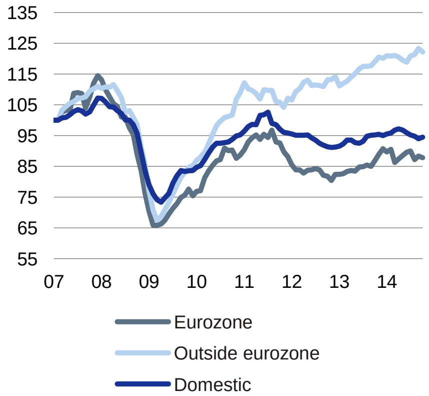
Given the months of continually clouded business sentiment, disappointing order intake (from the domestic side in particular) and the recent drop in industrial production to below the year-earlier level, we expect weak economic performance in the winter half. Even though we look for a subsequent recovery of growth – we forecast solid quarterly rates of 0.3% on average – GDP expansion looks set to remain below the year-earlier reading on average in 2015 at 1% on account of the unfavourable starting position. It follows that the German economy will not be able to exhaust its full growth potential of 1.2% until 2016.

German economy (still) in good form

The weaker performance in the current year is mainly of a cyclical nature. The German economy is actually still in pretty good shape, highly innovative and

Germany: Order intake 4

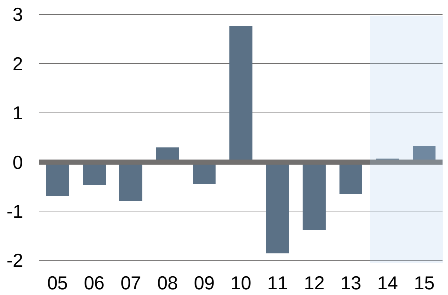
Manufacturing industry, Jan 2007 = 100,
3M moving average



Source: Federal Statistical Office

Germany: Fiscal impulse* 5

% GDP



*) Change in structural budget balance

Sources: European Commission, Deutsche Bank Research

competitive. Furthermore, there is no significant near-term need for budget consolidation in the public or private sector, and the unusually good labour market performance, by international standards, points to still relatively healthy structures. Even Germany's infrastructure – increasingly the subject of critical debate – continues to achieve top rankings in international comparisons. However, several positive policy reform moves that were implemented some ten years ago have already been rolled back or are in some cases at risk of being rolled back. Not least the steadily approaching demographic challenges point to the necessity of a reform agenda 2030.

Economic policy assumptions

Fiscal and monetary conditions look auspicious

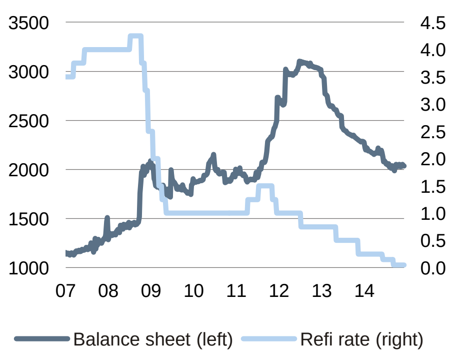
Our growth forecast is based on the assumption that there will be positive effects on German GDP growth from both the fiscal as well as the monetary policy angle in 2015. The structural budget surplus of the public sector as a whole, i.e. the budget balance excluding cyclical effects, looks set to deteriorate from about 0.5% of GDP to about 0.2% of GDP as a result of the policy measures. Germany's Council of Economic Experts estimates that the pensions package alone will trigger structural expansion of the annual transfer benefits by EUR 10 bn or 0.3% of GDP.

Interest rates to remain extremely low for the time being

We expect the ECB to keep its key rate at the current level of 0.05% for the time being – at least until 2016 in fact. Furthermore, as we expect quantitative easing to be expanded to include sovereign bond purchases, long-term yields are also likely to remain low. While rising yields in the US will probably induce European yields to trend upward in their wake on account of the international interest rate link, the increase should stay within narrow bounds. We see 10Y German Bunds yielding slightly over 1% at the end of 2015. Low interest rates harbour the risk of driving private investors on the search for higher yield into riskier types of investment. So far, however, households in Germany have continued to play it safe with their financial investments.[1]

ECB: Balance sheet & key rate 6

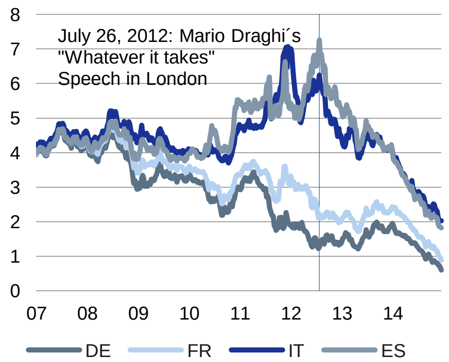
EUR bn (left), % (right)



Source: ECB

10Y government bond yields 7

%

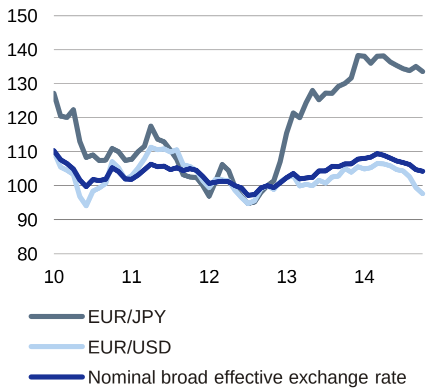


Source: Global Insight

[1] For more see Gräf, B., Rakau, O. (2014). Household investment behaviour: Still playing it safe. Deutsche Bank Research. Focus Germany. Sep 30, 2014.

EUR vs. USD, JPY and trade weighted 8

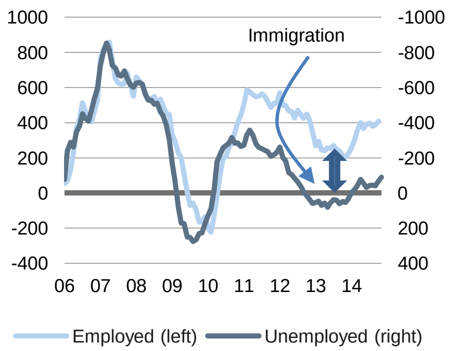
Oct 2012=100



Sources: ECB, Deutsche Bank Research

Germany: Employed & unemployed 9

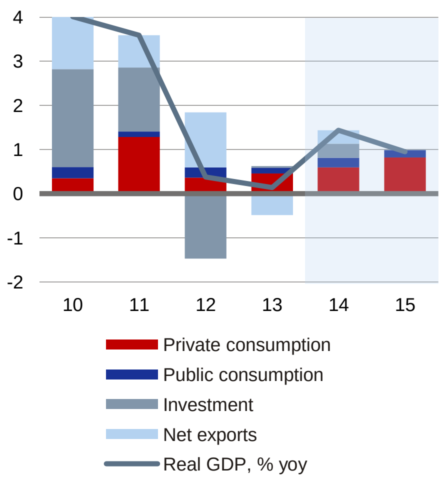
Change yoy, '000 (inverse scale, right)



Sources: Federal Employment Agency, Federal Statistical Office

Germany: Growth contribution 10

pp



Sources: Federal Statistical Office, Deutsche Bank Research

Euro exchange rate continuing to weaken

The euro has fallen by around 10% vis-à-vis the US dollar since its last high in spring 2014. The slide against the currencies of the 40 most important trading partners has been less pronounced at about 4.5%. The US's prospects of a significantly widening growth lead over the eurozone in 2015 and the diametrically opposed monetary policy on opposite sides of the Atlantic argue that the single currency will continue to soften. Accordingly, we suggest that an exchange rate of USD 1.15/EUR could be on the horizon – with further downside potential in the years ahead. A weaker exchange rate is probably also the ECB's primary objective in expanding its balance sheet. Besides stimulating GDP growth via net exports the ECB also hopes to come closer to achieving its target of lifting inflation in the eurozone towards close to but below 2% via higher import prices.

Our forecast for Germany in detail

Private consumption: The most important pillar of growth

Private consumption was already an important pillar of growth in 2014 in addition to investment – construction investment in particular. In 2015 it will probably become the most important pillar, in fact, with an increase of 1.5% even exceeding the solid year-earlier rate (likely 1%). However, the signs are increasing that some recent – in our opinion – misguided policy moves, such as the introduction of a nationwide minimum wage of EUR 8.50 per hour and the pensions package, are eroding the economy's fundamental pillar of private consumption. Employment is set to increase at a rate of slightly below ½% and thus only half as strongly as in 2014, and unemployment is set to pick up especially in the second half of 2015. All in all we expect the unemployment rate to come in at 6.9% at year-end, up from 6.7% in 2014. The higher employment coinciding with rising unemployment will be covered by immigration again in the current year, although this will be much less pronounced than in previous years. The introduction of the nationwide minimum wage and the restriction of temporary work will probably have a major negative impact in the medium term on the employment of problem groups in particular, seriously hamper (re)entry into the labour market and drive up structural unemployment with pronounced negative fiscal effects.[2]

On the income side, the surge in total gross wages triggered by the introduction of the nationwide minimum wage – roughly 4 ½ million employees whose income is a good 30% below the minimum will benefit from the wage floor – is set against no doubt significantly below-average growth of profit income flowing to households. All in all we believe that disposable income will increase by 2 ½%, which should enable real consumption expenditure to expand by 1.5% after deducting the low inflation rate of 1% and assuming a roughly unchanged savings rate.

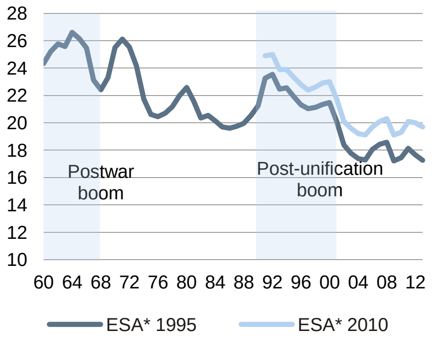
Is Germany facing an investment gap? In the public sector if at all

For the past few years Germany has been pilloried for its overly restrictive fiscal policy, wage moderation and high current account surpluses. Now, as of end-

[2] For more see Peters, H. (2014). Minimum wage of EUR 8.50 per hour: Grand Coalition on the wrong track. Deutsche Bank Research. Focus Germany. June 3, 2014. And: Gräf, B., Grewenig, E. (2014). Temporary work: Success story with an uncertain outcome. Deutsche Bank Research. Focus Germany. Feb 28, 2014.

Germany: Capital formation 11

% GDP

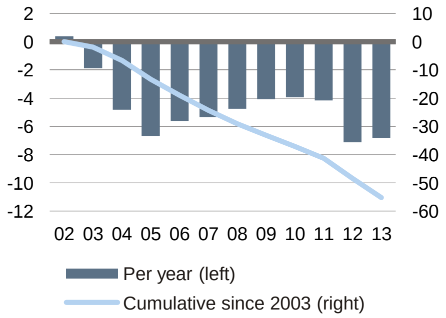


*Differing definitions of GDP. New standard includes R&D, for example, in capital formation

Sources: Eurostat, AMECO

Germany: Net public investment in infrastructure 12

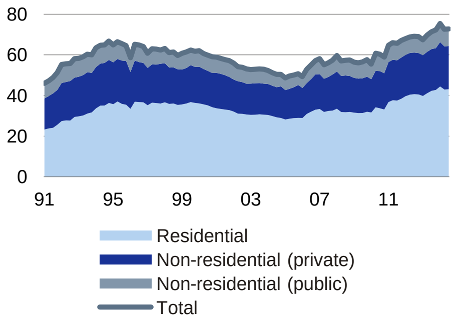
Investment in non-residential construction, EUR bn net



Source: Federal Statistical Office

Germany: Construction investment 13

EUR bn



Source: Federal Statistical Office

2014, critics have switched their focus, alleging that Germany has an excessively low level of investment – investment in public infrastructure in particular. They say that since the launch of the euro Germany has had an investment ratio that is too low not only by international standards but also relative to its own history. They claim that as a result a harmful investment gap has emerged since it curbs the country's growth potential. Moreover, Germany's European neighbours are supposedly being deprived of important demand stimuli. This criticism is inappropriate for many reasons: the calculation of a gap is predicated on the establishment of an optimum level of capital stock, and international comparisons are tainted because they have been distorted by overinvestment in many countries (e.g. real estate boom in Spain). Structural factors such as the respective demographic developments or differing production structures and resource endowments also play an important role. A comparison of today's investments with those of earlier decades paints a much too negative picture. This is partly due, for example, to post-World War II reconstruction or also the post-reunification construction boom.[3] Furthermore, the decline in the investment ratio has been at a standstill since roughly 2000.

The term "gap" seems to be especially misleading in the case of private investment. Private investments are made by profit-oriented firms that probably ought to know better than any politician (or economist) not only how much they want to invest, but also where and when. In our opinion, the currently sluggish state of private investment activity is partly to be explained by the disappointing and weak dynamics of global growth. German investments are partly also being curbed by structural factors such as the demographic challenge and the "Energiewende", Germany's transition to renewable sources of energy. The recent policy measures (e.g. pensions package and minimum wage) compound the burden. What is called for to support private investment is a better economic policy environment.

Public-sector investment in infrastructure probably was too low indeed over the past 10 years, as indicated by negative net investment. The extent of the extra investment required is a matter of dispute, however, and the frequently cited high totals are likely due in no small part to the interests of those responsible for the analysis. German infrastructure continues to score well in international comparisons. Despite widespread anecdotal evidence of deficiencies, an overly hasty, indiscriminate investment programme is to be rejected. We consider it plausible that the public sector will require extra investment focused on maintaining existing public infrastructure and totalling between EUR 5 bn and EUR 10 bn per year.

Residential and public-sector construction set for respectable increase

The capricious weather at the start of 2014 resulted in volatile construction investment performance on a quarterly basis. Thanks to the mild winter, the first quarter saw the highest quarterly increase for the sector in the past three years. Following a noticeable downturn in the second quarter, investment activity remained roughly stable in the second half of the year. In 2014 construction investment likely showed an overall increase of somewhat over 3% after flat performance in 2013. The growth was driven primarily by residential construction, which benefited significantly from the immigration flows to Germany, the robust increase in disposable income and the favourable funding conditions. All in all, residential construction was probably up by considerably

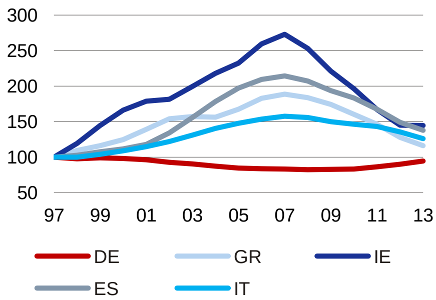
[3] For more see Rakau, O. (2014). Case for higher investment in infrastructure – despite questionable "gap analysis". Deutsche Bank Research. Standpunkt Germany. December 12, 2014 as well as Gräf, B., Rakau, O. (2014). Is Germany facing an investment gap? Likely only in the public sector! Deutsche Bank Research. Focus Germany. September 2, 2014.

more than 3%. There was also a palpable increase in investment in commercial construction. However, given the only moderate capacity utilisation in the economy as a whole and the investment reluctance in the second half induced by geopolitical risks and weak global trade, the increase of likely just over 2% still trailed investment in residential construction. Thanks to the better financial situation of many municipalities public construction also posted an increase in investment of over 2%.

In 2015 investment in construction will probably again be the most important pillar of growth apart from private consumption. Despite the continuing uptrend in order intake and the sizeable order backlog, the pace of expansion will, at around 2.5%, probably fall short of the year-earlier reading. Thanks to its large share of total investment, residential construction should remain the key growth driver again in 2015. The increase there will probably also total roughly 2.5%. The reluctance to invest in the commercial segment is likely to continue in early 2015 in view of the sluggish GDP growth and low capacity utilisation. This means that not more than 1.5% or so growth is in reach for the full year. Public construction should see the pace of investment pick up noticeably to 4%. The financial situation of the public budgets thus remains favourable, and at the federal level the funds earmarked for infrastructure investment have been moderately increased.

Real house prices 14

1997 = 100



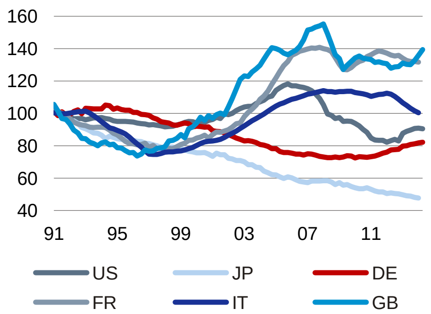
Source: OECD

Affordability defying rising prices

Real estate prices continued their strong upward climb also in 2014. While the increase has flattened out a bit, the macroeconomic environment suggests that prices will continue to rise. Monetary policy is accommodative, the labour market is in good shape and the number of immigrants high. Foreign and institutional investors are playing a part in driving up demand. At the same time, the supply will be inelastic in the short term, and political intervention such as the proposed cap on rents could curb investment. Demand is booming in the conurbations in particular, which is also reflected in the relatively stronger price hikes there. These came to over 7% in 2013 in comparison with below 5% in less sought-after areas. Despite these steep price increases German housing remains affordable by international and historical comparisons. In a historical comparison of rents and disposable incomes, real estate is still undervalued by 15% according to the OECD. This was partly attributable to the weak price development in the pre-crisis years and to recently robust income growth.

Housing affordability 15

Nominal real estate prices in relation to disposable income per capita, 1991=100



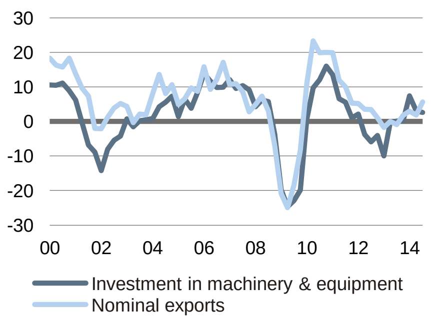
Source: OECD

Investment in machinery and equipment: Weighed down by uncertainties

Investment in machinery and equipment rose by about 3% in 2014. However, the growth was solely due to the strong performance at the outset of the year. This had nurtured hopes of a robust investment recovery following a roughly 3% decline in each of the previous two years. During 2014 the investment climate darkened again considerably though. Exports picked up only moderately, and as a result capacity utilisation in industry stabilised only roughly in line with its long-term average. Moreover, geopolitical tensions and the pronounced decline in demand prospects reflected in the ifo Business Climate Index probably played a part in damping investment. The still robust activity in the domestic economy was unable to make up for the external headwinds. As 2015 gets underway, investment in machinery and equipment will probably remain moderate for a while. As the year progresses, the geopolitical tensions should ease and the increasing stimuli from world trade should be reflected in a pick-up in investment activity. However, the outlook for the full year is an increase of only about 1%.

Germany: Exports & Investment 16

% gg.Vj.



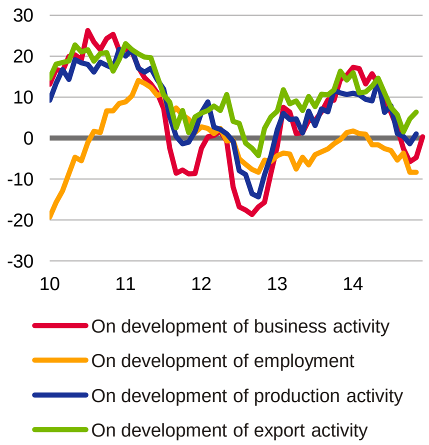
Source: Federal Statistical Office

Slower growth in Germany's industrial sector

Over the last few months, the generally weaker economic environment and heightened geopolitical risks have left their mark on Germany's manufacturing industry. Sentiment indicators trended downwards in almost all industrial sectors with some stabilization in late-2014. Moreover, starting in Q3, order intake and industrial output saw a reversal of the upward trend still visible at the beginning of 2014. For the full year 2014, industrial production will probably have risen by no more than 1.5% in real terms. This meant that the industrial sector was only able to offset the decline registered in the two preceding years.

Germany: Industrial sentiment 17

Company expectations, balance of positive and negative responses



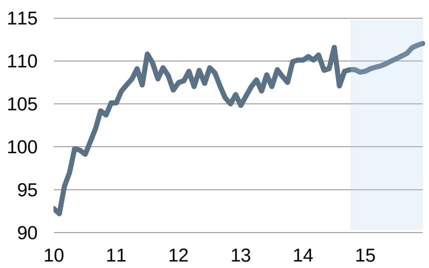
Source: ifo Institute

Especially in the first few months of 2015, the sector looks set to be hurt by weak economic activity in Germany and western Europe as a whole. This environment will continue to cloud the investment climate for some time, particularly as the political environment is worsening not only for industrial companies in Germany. On the bright side, though, demand from the US will provide some impetus. Exports to China are also likely to increase in 2015, even though we expect economic growth there to slow. Companies with a high share of value creation in Germany which also export many goods overseas, in particular, will see their price competitiveness benefit from the euro's weakness versus the US dollar. So it is mostly export-oriented industries such as automobiles, mechanical and electrical engineering that are feeling the effects of the mixed economic environment. More consumption-oriented sectors (e.g. the food industry, parts of the electronics, chemicals, plastics and paper industries) will likely benefit from robust private consumption in 2015. Still lively construction activity in Germany is supporting, inter alia, producers of building materials and other construction-related sectors such as metals, chemicals and plastics.

We expect industrial output in Germany to turn positive again, possibly from Q2 2015, following a weak winter half-year. But as 2015 is likely to get off to a slow start, the full year will probably only see production rise by an inflation-adjusted 3/4%, with some downside risks. This means the generally very muted dynamics of industrial activity in evidence since 2011 would continue in 2015. In such an environment it would already be an achievement if steady growth in employment level in German industry could be achieved. The number of employees in the industrial sector reached a new record high in 2014.

Germany: Industrial output & forecast 18

Manufacturing, real production index, 2010=100, seasonally adjusted



Sources: Statistisches Bundesamt, Deutsche Bank Research

We expect few outliers in the large industrial sectors next year. Both automobiles and mechanical engineering will probably see domestic production grow by approximately 1% in 2015. While mechanical engineering might improve its performance slightly compared with 2014 (stagnation), the auto industry should see its growth cool noticeably (2014: +4%). Electrical engineering looks poised for a round of stagnation in 2015 – following a 1.5% increase in 2014. Chemicals production is likely to add 2.5% in 2015; however, this would "only" neutralise the setbacks in 2014. The food industry looks set to continue on its slow but steady growth path. After stagnating in 2014, we expect the sector to register growth in the order of 0.5%.

Those sectors that rely heavily on petroleum as a raw material (e.g. chemicals and plastics) will benefit from falling oil prices. Of course, lower energy prices mean a general degree of relief on the cost side.

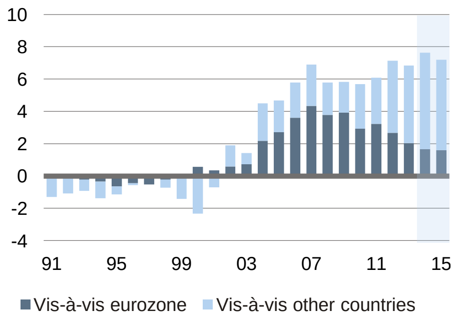
German exports & world trade 19

Real goods & services (% yoy)

Sources: IMF, Deutsche Bank Research

Germany: Balance on current account 20

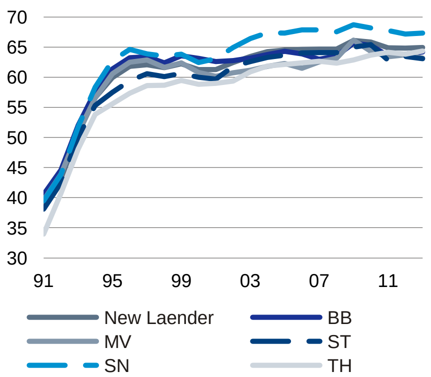
% GDP



Sources: Deutsche Bundesbank, Federal Statistical Office, Deutsche Bank Research

East Germany: Real GDP per capita 21

West Germany = 100



Source: Statistical Offices of the Länder

Only modest export growth

In light of modest economic momentum globally[4] and especially the stagnating Eurozone economy, German exports are unlikely to grow noticeably. Despite some tailwind from the weaker euro, we therefore expect an increase in exports of goods and services of only just under 4% this year (after slightly over 3% in 2014) which – like last year – is roughly in line with world trade growth and would not result in any substantial loss of market share for German exporters.

German current account surplus on the decline

As economic growth in Germany looks set to be driven exclusively by domestic demand, imports will probably rise more strongly than exports in real terms. Correspondingly, the current account surplus, which will probably come to around EUR 220 bn or 7.6% of GDP in 2014, could fall to approximately EUR 211 bn or just under 7.2% in 2015 and thus help Germany lower its high current account surpluses. Over the medium-term the surplus would then get closer to the European Commission's limit of 6% of GDP, introduced to keep macro-economic imbalances in check. According to the critics of Germany's high current account surpluses, Germany is flooding Europe's southern periphery in particular with its goods and savings and has thus massively contributed to these countries' debt problems, giving rise to calls for Germany to bring down its surplus to help stabilise the euro area. In our view, this is unjustified. For one thing, more than three-quarters of Germany's current account surplus stems from trade relations with countries outside the Eurozone, while the surplus vis-à-vis euro area countries has been more than halved since 2007, to considerably below 2% of GDP. For another, if one wants to "blame" one single party for the result of bilateral trade relations, China would be the more appropriate addressee. Since 2010, China has recorded higher surpluses than Germany in bilateral trade with the southern peripheral countries of the euro area, which have declined only slightly since 2010. Moreover, given the similarity of the product ranges, China is an almost overwhelming competitor in third markets and is increasingly also crowding out local producers.[5]

25 years after the fall of the Berlin Wall: "Blooming landscapes" only in part

The east German economy probably grew more strongly than the west German economy, as the weakness of exports and investments mainly hit west German companies. However, this snapshot of the current situation conceals the fact that the catch-up process in the east German real economy ground to a halt in the mid-2000s despite continued support.

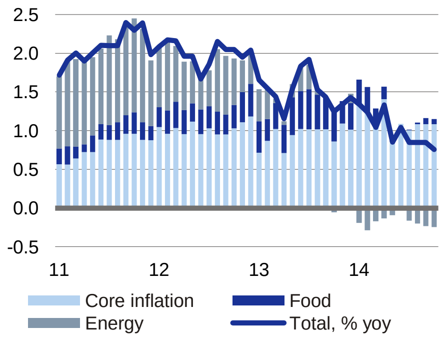
German reunification has probably cost just under EUR 2 tr so far and has been a driver of all-German debt. Nearly 60% of this cost was financed by transfers within the pay-as-you-go social security system, and the remaining 40% was made up of direct transfers. Since the start of the 1990s, east Germany's dependence on transfer payments has declined from around 35% to just above 20% but remains at a high level. Despite this support real per-capita GDP in the

[4] Peters, H. (2014). Structural downshift in global trade burdens growth outlook. Deutsche Bank Research. Focus Germany. December 2, 2014.

[5] See Peters, H., Schneider, S. (2013). Criticism of Germany's CA surpluses largely unfounded. Deutsche Bank Research. Standpunkt Deutschland. December 12, 2013, and Gräf, B., Iseringhausen, M. (2014). Spotlight on Germany's export surpluses: Who's the "bad guy" in Euroland? Deutsche Bank Research. Focus Germany. June 3, 2014.

Germany: Inflation 22

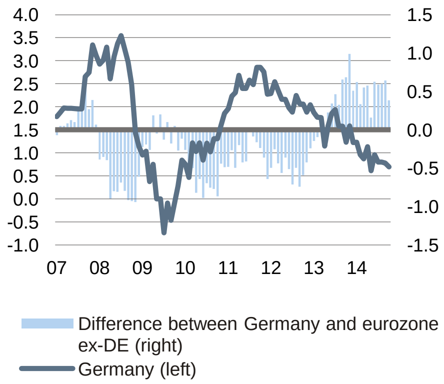
Components (contribution, pp)



Sources: Federal Statistical Office, Deutsche Bank Research

Germany: Inflation 23

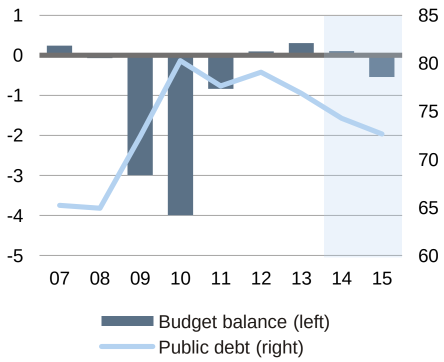
% yoy (left), pp (right)



Sources: Eurostat, Deutsche Bank Research

Germany: Public finances 24

Total public sector, % GDP



Sources: Deutsche Bundesbank, Deutsche Bank Research

east German Länder has lately stabilised at 65% of the western level, suggesting that structural differences persist.[6]

Moreover, the east German states will face another test this year. The introduction of the minimum wage will likely affect the east German economy particularly strongly, and drive up the already relatively high unemployment among unskilled workers. The biggest intrusion into the wage structure will be in Mecklenburg-Western Pomerania and Saxony where the minimum wage is roughly 70% of the median hourly wage for full-time employees, while this ratio stands at approximately 50% in the remainder of the country.

Inflation to remain above eurozone average

In Germany, too, inflation has recently slowed to around 0.5%%. This development has been driven by falling energy prices and a dramatically slower increase in food prices. While the latter had still risen by 5% yoy last summer, they recently stagnated. Core inflation, i.e. the increase in prices excluding energy and food prices, has moved in a narrow band slightly above the 1% mark over the last few years. Despite the general slowdown in inflation prices in Germany have risen approximately 0.5 of a percentage point faster than the average of the remaining euro area members since spring 2013, while they were lower by the same amount on average between 2008 and 2013. Inflation will probably stay at 1.0% in 2015. We expect oil prices to be nearly 30% lower on average this year, at just over USD 70 per barrel. But this will probably be partly offset by the weaker euro. The effects of the nationwide minimum wage and somewhat higher food prices look set to result in slight overall price increases. German inflation will thus remain higher than that of the larger euro-area members and the peripheral countries by around ½%.

Public finances: "Borderline" surplus to turn into "borderline" deficit

For the first time since 1969, Finance Minister Wolfgang Schäuble presented a balanced budget in 2014 and the government's medium-term fiscal planning foresees budgets up until 2018 that do not include new debt. Whether this should be celebrated as a big achievement is doubtful. The extremely low level of interest rates brought about by the ECB, for instance, which is two percentage points lower than warranted by the current economic situation in Germany, provides considerable relief for the finance minister. Even taking into account the fact that the savings resulting from the low interest rate level have been accumulating gradually since 2011, they will still mean savings for the finance ministry in the order of almost EUR 10 bn (0.4% of GDP) on interest expenditure, which come to a total of approx. EUR 27 bn (roughly 1% of GDP) in its budget planning. Also, the finance ministry had to say goodbye to the budget surplus planned for 2017 in the stability programme update. This was a consequence of the Grand Coalition's generous new benefits in the pension system. Besides the increase in the subsistence level of income, which as a result will probably lead to the children's allowance and the basic allowance being raised from 2015, risks to the budget lie primarily in the country's economic performance. True, the government has reduced its growth forecast for the current year from 2% to 1.3% of GDP. This still seems somewhat optimistic, though. We look for 1% growth.

At the general government level (including the subordinate levels of government and social security systems) we therefore expect a budget deficit of roughly

[6] See Peters, H., Rakau, O., Engelhardt, M. (2014). 25 years after the fall of the Berlin Wall: "Blooming landscapes" only in part. Deutsche Bank Research. Focus Germany. November 4, 2014.

1/2% of GDP for 2015, following a balanced budget in 2014. There are some question marks regarding medium-term budget developments due to the planned revision of the Länder financial equalisation system and energy policy. However, the good news is that public debt will continue to fall thanks to revenues from the disposal of assets held by state-owned bad banks. Public debt had already come down at the end of last year to over 74%, after peaking at 80.4% in GDP in 2010, and looks set to come in markedly below the 70% mark by 2017.

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Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2014F	2015F	2016F	2014F	2015F	2016F	2014F	2015F	2016F	2014F	2015F	2016F
Euroland	0.8	1.0	1.3	0.4	0.2	1.3	2.4	2.2	2.0	-2.6	-2.5	-2.3
Germany	1.4	1.0	1.2	1.0	1.0	1.5	7.6	7.2	7.0	0.1	-0.5	-0.7
France	0.4	0.9	1.4	0.6	0.5	1.2	-1.8	-1.8	-1.5	-4.4	-4.2	-3.9
Italy	-0.4	0.3	0.9	0.2	0.4	1.1	1.6	1.8	1.6	-3.0	-2.8	-2.7
Spain	1.3	1.9	1.8	-0.2	0.4	1.4	0.4	0.6	0.9	-5.6	-4.5	-3.8
Netherlands	0.7	1.7	1.1	0.3	0.6	1.3	10.9	11.4	11.5	-2.5	-2.0	-1.9
Belgium	1.0	1.0	1.4	0.6	0.8	1.4	1.0	1.5	1.0	-2.8	-2.8	-2.5
Austria	0.4	0.8	1.5	1.4	1.2	1.7	1.5	1.8	2.4	-3.0	-1.9	-1.2
Finland	0.0	0.8	1.3	1.2	1.1	1.4	-1.3	-1.0	-0.6	-2.7	-2.3	-1.7
Greece	1.2	2.7	3.1	-1.3	-0.7	1.0	0.5	1.5	2.0	-1.3	0.5	1.9
Portugal	0.9	1.2	1.6	-0.2	0.7	1.3	0.5	0.8	1.0	-4.7	-3.5	-3.3
Ireland	4.0	3.3	3.2	0.3	0.6	1.6	4.5	5.5	6.0	-3.6	-2.9	-2.8
UK	3.0	2.5	2.3	1.5	1.3	1.8	-5.0	-4.0	-3.5	-4.9	-3.9	-2.0
Denmark	0.9	1.7	1.8	0.6	1.0	1.5	6.8	6.5	6.0	-1.0	-2.5	-2.0
Norway	2.2	2.4	2.5	2.0	2.0	2.0	10.5	10.0	9.5	10.0	9.5	9.0
Sweden	1.9	2.3	2.8	-0.2	0.5	1.5	5.9	5.3	4.8	-2.0	-1.5	-1.0
Switzerland	1.7	1.8	2.0	0.1	0.4	0.8	11.0	10.8	10.5	0.0	0.4	0.8
Czech Republic	2.4	2.5	2.7	0.4	1.5	1.9	-1.0	-0.8	-0.6	-1.6	-2.1	-2.2
Hungary	3.4	2.4	2.3	-0.1	1.9	3.1	3.8	3.7	3.6	-2.9	-2.7	-2.4
Poland	3.3	3.3	3.5	0.1	0.9	1.7	-2.6	-2.9	-3.1	-3.4	-2.9	-2.7
United States	2.4	3.5	3.1	1.7	1.2	2.1	-2.5	-2.6	-2.9	-2.9	-2.5	-2.9
Japan	0.3	1.3	1.7	2.9	1.3	0.9	0.4	2.2	2.4	-7.1	-6.3	-5.4
China	7.3	7.0	6.7	2.2	2.6	3.0	3.1	3.4	3.3	-2.1	-2.5	-3.0
World	3.2	3.6	3.8	3.7	3.7	3.9						

*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

						2014				2015			
	2012	2013	2014F	2015F	2016F	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	0.4	0.1	1.4	1.0	1.2	0.8	-0.1	0.1	0.0	0.2	0.2	0.3	0.4
Private consumption	0.7	0.8	1.1	1.5	1.0	0.5	0.1	0.7	0.3	0.4	0.3	0.2	0.3
Gov't expenditure	1.2	0.7	1.2	0.9	0.3	0.2	0.4	0.6	0.2	0.1	0.2	0.1	0.2
Fixed investment	-0.7	-0.6	3.0	1.6	2.4	2.8	-1.8	-0.9	0.3	0.3	0.6	1.0	0.7
Investment in M&E	-3.1	-2.4	2.9	0.9	4.2	1.7	0.4	-2.3	-1.0	0.0	0.7	2.0	1.0
Construction	0.6	-0.1	3.4	2.3	2.3	4.2	-3.9	-0.3	1.0	0.7	0.7	0.7	0.7
Inventories, pp	-1.4	0.2	-0.3	-0.3	-0.2	-0.1	0.1	-0.5	0.0	0.0	-0.1	0.0	0.0
Exports	2.8	1.6	3.9	4.7	5.2	-0.2	1.2	1.9	0.5	0.7	1.0	1.2	1.5
Imports	0.0	3.1	3.7	5.5	5.4	-0.1	1.1	1.7	1.2	1.0	1.2	1.5	1.5
Net exports, pp	1.3	-0.5	0.3	0.0	0.3	-0.1	0.1	0.2	-0.2	-0.1	0.0	0.0	0.1
Consumer prices*	2.0	1.5	1.0	1.0	1.5	1.2	1.1	0.8	0.8	1.2	1.2	1.2	1.3
Unemployment rate, %	6.8	6.9	6.7	6.8	7.1	6.8	6.7	6.7	6.6	6.7	6.7	6.8	6.9
Industrial production	-0.4	0.1	1.8	1.0	2.0								
Budget balance, % GDP	0.1	0.0	0.1	-0.5	-0.7								
Public debt, % GDP	81.0	78.4	74.0	72.4	70.6								
Balance on current account, % GDP	7.1	6.7	7.6	7.2	7.0								
Balance on current account, EUR bn	196	189	220	211	212								

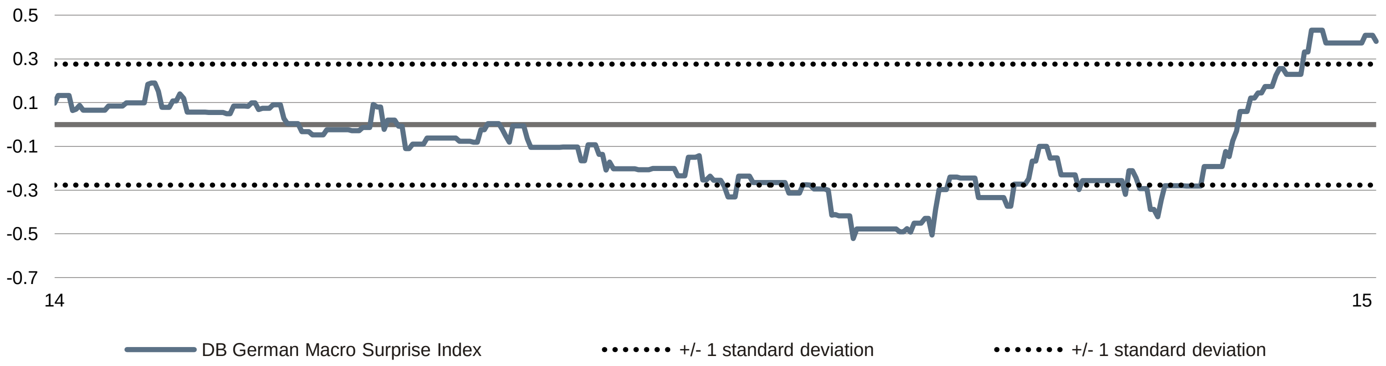
*Inflation data for Germany based on national definition. This can lead to discrepancies to other DB publications.
Sources: Federal Statistical Office, German Bundesbank, Federal Employment Agency, Deutsche Bank Research

DB German Macro Surprise Index

The DB German Macro Surprise Index compares published economic data with market forecasts and thus provides clues as to the direction of future forecast revisions.[7]

DB German Macro Surprise Index

Average of last 20 z-scores of data surprises



Values above (below) 0 indicate the data came in better (worse) than expected

Sources: Bloomberg Finance LP, Deutsche Bank Research

Last 20 published economic data for Germany

Bloomberg Tickers	Indicator	Reporting month	Publication date	Current value	Bloomberg consensus	Surprise	Standardised surprise	Quantile rank
GRZEWI Index	ZEW Survey Expectations	11 2014	18.11.14	11.5	0.5	11.0	1.3	0.9
GRZECURR Index	ZEW Survey Current Situation	11 2014	18.11.14	3.3	1.7	1.6	0.2	0.6
GRIFPBUS Index	IFO Business Climate	11 2014	24.11.14	104.7	103.0	1.7	1.1	0.9
GRGDPPGQ Index	GDP (% qoq)	9 2014	25.11.14	0.1	0.1	0.0	-0.1	0.3
GRIMP95Y Index	Import Price Index (% yoy)	10 2014	26.11.14	-1.2	-1.5	0.3	0.6	0.8
GRUECHNG Index	Unemployment Change (000's mom)	11 2014	27.11.14	-14.0	-0.5	13.5	0.3	0.6
GRFRIAMM Index	Retail Sales (% mom)	10 2014	28.11.14	1.6	1.5	0.1	0.4	0.6
MPMIDEMA Index	Markit Manufacturing PMI	11 2014	01.12.14	49.5	50.0	-0.5	-0.5	0.2
MPMIDESA Index	Markit Services PMI	11 2014	03.12.14	52.1	52.1	0.0	0.1	0.5
GRIORTMM Index	Factory Orders (% mom)	10 2014	05.12.14	2.5	0.5	2.0	0.9	0.8
GRIPIMOM Index	Industrial production (% mom)	10 2014	08.12.14	0.2	0.4	-0.2	-0.1	0.4
GRCAEU Index	Current Account Balance (EUR bn)	10 2014	09.12.14	23.1	18.0	5.1	1.2	0.9
GRCP20YY Index	CPI (% yoy)	11 2014	11.12.14	0.6	0.6	0.0	0.3	0.4
GRZECURR Index	ZEW Survey Current Situation	12 2014	16.12.14	10.0	5.0	5.0	0.6	0.7
MPMIDESA Index	Markit Services PMI	12 2014	16.12.14	51.4	51.4	0.0	0.1	0.5
GRZEWI Index	ZEW Survey Expectations	12 2014	16.12.14	34.9	20.0	14.9	1.7	0.9
GRIFPBUS Index	IFO Business Climate	12 2014	18.12.14	105.5	105.5	0.0	-0.2	0.4
GRIMP95Y Index	Import Price Index (% yoy)	11 2014	22.12.14	-2.1	-1.9	-0.2	0.2	0.6
MPMIDEMA Index	Markit Manufacturing PMI	12 2014	02.01.15	51.2	51.2	0.0	0.0	0.5
GRCP20YY Index	CPI (% yoy)	12 2014	05.01.15	0.2	0.3	-0.1	-0.3	0.2

Sources: Bloomberg Finance LP, Deutsche Bank Research

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[7] See for details Focus Germany. August 4, 2014.

Financial forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	0.125	0.10	0.05	0.50	-0.75	0.00	0.20	1.25	2.00	2.10	0.05
Mar 15	0.250	0.10	0.05	0.50	0.00	0.00	0.20	1.25	2.00	2.10	0.05
Jun 15	0.500	0.10	0.05	0.50	0.00	0.00	0.20	1.25	2.00	2.10	0.05
Dec 15	1.000	0.10	0.05	1.00	0.00	0.00	0.20	1.25	2.00	2.10	0.05
3M interest rates, %											
Current	0.35	0.20	0.08	0.56							
Mar 15	0.35	0.15	0.10	0.55							
Jun 15	0.75	0.15	0.05	0.68							
Dec 15	1.35	0.15	0.05	1.25							
10J government bonds yields, %											
Current	2.10	0.33	0.50	1.73	0.31	0.89	0.78	1.53			
Mar 15	1.85	0.40	0.70	2.10	0.00	0.00	0.00	0.00			
Jun 15	2.50	0.50	0.80	2.20	0.00	0.00	0.00	0.00			
Dec 15	2.65	0.60	1.10	2.50	0.00	0.00	0.00	0.00			
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	1.20	120.29	0.78	0.65	1.20	9.42	7.44	9.04	4.26	318.75	27.72
Mar 15	1.22	121.00	0.76	1.61	1.23	8.95	7.46	8.20	4.16	307.50	27.50
Jun 15	1.20	121.00	0.75	1.60	1.24	8.90	7.46	7.95	4.13	310.00	27.50
Dec 15	1.15	125.00	0.73	1.58	1.25	8.75	7.46	7.85	4.08	315.00	27.50

Sources: Bloomberg, Deutsche Bank

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German data monitor

	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Jul 2014	Aug 2014	Sep 2014	Oct 2014	Nov 2014	Dec 2014
Business surveys and output											
Aggregate											
Ifo business climate	108.9	110.8	110.3	106.3	104.5	107.9	106.3	104.7	103.2	104.7	105.5
Ifo business expectations	106.0	107.8	106.0	101.4	99.7	103.3	101.6	99.3	98.3	99.8	101.1
PMI composite	54.5	55.4	55.2	54.5	52.3	55.7	53.7	54.1	53.9	51.7	51.4
Industry											
Ifo manufacturing	104.6	106.8	106.5	102.1	99.6	103.6	102.2	100.6	98.4	99.5	100.8
PMI manufacturing	52.9	55.0	52.8	51.3	50.7	52.4	51.4	49.9	51.4	49.5	51.2
Headline IP (% pop)	0.6	1.1	-1.2	-0.3		1.0	-2.3	1.1	0.2		
Orders (% pop)	2.1	0.0	-0.2	0.2		4.8	-4.2	1.1	2.5		
Capacity Utilisation	83.3	83.5	84.3	84.0	83.7						
Construction											
Output (% pop)	-0.5	5.1	-6.0	-0.3		-1.4	-1.1	1.3	0.7		
Orders (% pop)	1.6	1.8	-4.9	-2.3		6.5	-3.5	-1.6	0.6		
Ifo construction	121.2	122.6	120.5	119.1	118.8	119.3	119.5	118.4	118.3	119.1	118.9
Services											
PMI services	54.1	54.0	55.1	55.7	52.6	56.7	54.9	55.7	54.4	52.1	51.4
Consumer demand											
EC consumer survey	-2.8	0.3	4.3	1.0		3.9	0.3	-1.1	-0.7	-1.6	
Retail sales (% pop)	0.1	1.5	-0.4	-0.3		-0.7	0.6	-1.8	1.6		
New car reg. (% yoy)	1.6	2.8	-0.3	4.1		6.8	-0.4	5.2	3.7	-1.8	
Foreign sector											
Foreign orders (% pop)	3.8	-1.4	0.2	1.8		7.6	-6.5	4.0	0.6		
Exports (% pop)	1.7	0.6	0.0	2.8		4.7	-5.5	5.5	0.9		
Imports (% pop)	-0.7	0.4	-0.1	0.7		0.5	-2.6	5.4	-3.0		
Net trade (sa EUR bn)	54.2	54.8	55.0	61.0		22.2	18.8	19.9	23.1		
Labour market											
Unemployment rate (%)	6.9	6.8	6.7	6.7		6.7	6.7	6.7	6.6	6.6	
Change in unemployment (k)	15.3	-43.0	-19.7	2.7		-13.0	1.0	9.0	-23.0	-14.0	
Employment (% yoy)	0.5	0.7	0.9	0.9		0.9	0.9	0.9	1.0		
Ifo employment barometer	107.2	107.5	106.8	106.4		106.0	107.0	106.0	106.9	105.4	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.3	1.0	0.9	0.8	0.4	0.8	0.8	0.8	0.7	0.5	0.1
Core HICP (% yoy)	1.1	1.1	1.1	1.2		1.2	1.2	1.2	1.1	0.9	
Harmonised PPI (% yoy)	-0.7	-1.0	-0.8	-0.8		-0.8	-0.8	-1.0	-1.0	-0.9	
Commodities, ex. Energy (% yoy)	-10.4	-11.1	-4.9	-1.8		-3.0	-1.3	-1.1	0.9	1.7	
Oil price (USD)	109.3	108.2	109.7	102.0		106.9	101.6	97.4	87.3	78.8	
Inflation expectations											
EC household survey	25.5	22.0	16.9	13.4		15.3	14.8	10.0	11.1	8.5	
EC industrial survey	6.1	5.6	2.3	4.2		3.3	4.1	5.2	4.7	3.2	
Unit labour cost (% yoy)											
Unit labour cost	1.4	0.8	2.1	2.0							
Compensation	2.0	2.8	2.6	2.5							
Hourly labour costs	2.2	0.8	2.5	2.3							
Money (% yoy)											
M3	2.7	3.5	4.2	4.8		4.4	5.0	4.8	4.0	5.2	
M3 trend (3m cma)						4.5	4.7	4.6	4.7		
Credit - private	-3.1	-3.6	-3.5	1.4		-2.8	1.0	1.4	1.2		
Credit - public	-17.1	-1.5	9.7	5.9		11.4	5.1	5.9	5.1		

% 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
Research

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