



Focus Germany

GDP forecast: Uptick in Q1, slippage in Q2

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Content	Page
Forecast tables	2
GDP forecast: Uptick in Q1, slippage in Q2.....	3
Mirror, mirror, on the wall – which EMU member is the richest of all?	5
Convergence in pay between east and west Germany at a standstill since the early 2000s	9
German industry: Waiting for the upswing	16
Chart of the month	20
Chartbook: Business cycle.....	23
Chartbook: Sectors	26
Chartbook: Financial markets	27
Chartbook: Economic policy.....	32
Event calendar.....	33
Data calendar	34
Financial forecasts.....	34
Data monitor	35

GDP forecast: Uptick in Q1, slippage in Q2. Over the past few days sentiment has brightened considerably in Germany, and there are even signs of euphoria in some places – Munich and Dortmund in particular. But unlike Germany's two Champions League semi-finalists the economic releases of late have been a sobering disappointment following the encouraging data at the start of the year. For this reason we have slightly lifted our forecast for German Q1 GDP growth from 0.1% qoq to 0.3%. At the same time, though, we cut our expectations for Q2 from 0.4% to 0.2%. On balance this leaves the annual average unchanged at 0.3%.

Mirror, mirror, on the wall – which EMU member is the richest of all? Are households in crisis-stricken southern Europe really richer than those in Germany? While such comparisons are admittedly complicated, the reality is much more complex than a caricature of rich northern Europeans and poor southerners prevailing until then. Nevertheless, it would not seem at all inappropriate to consider having the wealthiest households play a bigger part in the bailout of their national economies.

Convergence in pay between east and west Germany at a standstill since the early 2000s. The continuing pay differentials between east Germany and west Germany underscore that even after 20 years it has not been possible to create highly productive well-paid jobs throughout east Germany to date despite huge volumes of transfers and the diffusion of technology. Moreover, the exodus of younger and higher-skilled people has ensured that the wage differential for the youngest birth cohort has started to widen again. While private-sector wages in east Germany have been roughly 30% below the west German level since the 2000s, wages in the public sector have continued to converge. By 2011, they were only about 10% shy of the level in west Germany.

German industry: Waiting for the upswing. German industry still has to work its way out of the trough this year. After sending promising signals at the start of the year surveys have turned south again eroding hope for a strong upswing in H1. Still, faint indications of a recovery in several early-cycle sectors and slightly improved prospects for key export markets outside EMU suggest that industrial growth might recover during the course of the year. Still, we expect annual average manufacturing output to be flat in real terms.



Focus Germany

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2012F	2013F	2014F	2012F	2013F	2014F	2012F	2013F	2014F	2012F	2013F	2014F
Euroland	-0.6	-0.6	1.0	2.5	1.6	1.6	1.2	1.7	1.6	-3.2	-3.0	-2.6
Germany	0.7	0.3	1.5	2.0	1.6	1.6	7.0	6.3	6.1	0.2	-0.4	-0.2
France	0.0	-0.6	1.1	2.2	1.4	1.5	-2.3	-2.2	-1.9	-4.6	-3.8	-3.2
Italy	-2.4	-1.8	0.9	3.3	1.8	1.6	-0.6	0.0	0.4	-3.0	-3.0	-2.4
Spain	-1.4	-1.6	0.5	2.4	1.9	1.3	-1.1	0.5	0.3	-10.0	-6.2	-5.3
Netherlands	-1.0	-0.5	0.8	2.8	2.6	1.7	9.9	8.2	8.0	-4.0	-3.8	-3.0
Belgium	-0.2	-0.3	1.0	2.6	1.4	1.6	-1.4	0.5	1.0	-3.0	-3.2	-3.0
Austria	0.8	0.8	1.6	2.6	2.3	2.0	1.8	2.2	2.4	-3.0	-2.7	-2.4
Finland	-0.2	-0.3	1.0	3.2	2.3	2.2	-1.8	-0.8	-1.0	-1.9	-1.6	-1.4
Greece	-6.4	-4.5	0.5	1.0	-0.3	-0.1	-3.0	-2.0	-1.0	-6.8	-5.2	-4.1
Portugal	-3.2	-2.2	0.8	2.8	0.5	1.2	-1.8	1.0	1.5	-4.9	-5.0	-3.8
Ireland	0.9	0.5	1.7	1.9	1.2	1.4	4.9	3.5	4.0	-7.8	-7.9	-6.4
UK	0.3	0.5	1.8	2.8	3.0	2.6	-3.7	-3.1	-2.5	-7.8	-7.1	-6.4
Denmark	-0.5	0.3	1.5	2.4	2.0	2.0	5.6	5.0	4.5	-4.4	-2.5	-2.0
Norway	3.0	2.2	2.6	0.7	1.8	2.0	14.1	14.0	13.0	10.1	10.5	10.0
Sweden	1.2	1.3	2.3	0.9	1.0	1.5	7.2	6.5	6.0	-0.7	-0.5	0.0
Switzerland	1.0	1.0	1.5	-0.7	0.2	0.6	13.6	10.5	10.0	0.3	0.5	0.5
Czech Republic	-1.2	0.7	2.8	3.3	2.0	2.0	-2.4	-2.3	-2.4	-4.4	-3.2	-2.7
Hungary	-1.7	-0.2	1.6	5.7	2.6	3.1	1.6	1.2	0.5	-2.1	-2.7	-2.6
Poland	2.1	1.4	2.3	3.7	1.8	2.5	-3.5	-2.3	-3.0	-3.6	-3.5	-2.9
United States	2.2	2.3	3.3	2.1	2.3	2.6	-3.1	-3.1	-3.3	-6.8	-6.3	-5.3
Japan	2.0	1.4	0.6	0.0	0.0	2.0	1.0	1.2	2.3	-9.6	-9.4	-7.4
World	2.9	3.2	4.0	3.3	3.3	3.6						

*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

	2010					2011					2012					2013				
	2010	2011	2012	2013F	2014F	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F			
Real GDP	4.2	3.0	0.7	0.3	1.5	0.5	0.3	0.2	-0.6	0.3	0.2	0.4	0.3	0.3	0.2	0.4	0.3			
Private consumption	0.9	1.7	0.6	0.7	1.0	0.2	0.2	0.0	0.1	0.3	0.1	0.4	0.3	0.3	0.1	0.4	0.3			
Gov't expenditure	1.7	1.0	1.4	1.1	0.6	0.6	-0.3	0.7	0.4	0.3	0.1	0.1	0.1	0.3	0.1	0.1	0.1			
Fixed investment	5.9	6.2	-2.5	0.2	3.1	-1.0	-1.9	-0.4	-0.7	0.7	1.0	0.6	0.6	0.7	1.0	0.6	0.6			
Investment in M&E	10.3	7.0	-4.8	-1.4	4.4	-1.1	-3.0	-2.2	-2.0	0.5	0.9	1.0	1.0	0.5	0.9	1.0	1.0			
Construction	3.2	5.8	-1.5	1.9	1.9	-0.8	-1.4	0.7	-0.1	0.9	1.0	0.3	0.3	0.9	1.0	0.3	0.3			
Inventories, pp	0.6	0.2	-0.5	0.0	0.0	-0.2	-0.1	-0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Exports	13.7	7.8	3.7	3.1	5.4	0.7	3.3	1.5	-2.0	1.0	1.4	1.6	1.3	1.0	1.4	1.6	1.3			
Imports	11.1	7.4	1.8	4.2	5.5	-0.7	2.3	0.6	-0.6	1.4	1.6	1.7	1.6	1.4	1.6	1.7	1.6			
Net exports, pp	1.7	0.6	1.0	-0.3	0.3	0.7	0.7	0.5	-0.8	-0.1	0.0	0.1	0.0	-0.1	0.0	0.1	0.0			
Consumer prices*	1.1	2.1	2.1	1.6	1.6	2.1	2.0	1.8	2.0	1.6	1.6	1.6	1.5	1.6	1.6	1.6	1.5			
Unemployment rate, %	7.7	7.1	6.8	6.9	6.7	6.8	6.8	6.8	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9	6.9			
Budget balance, % GDP	-4.1	-0.8	0.2	-0.4	-0.2															
Balance on current account, % GDP	6.2	6.2	7.0	6.3	6.1															

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

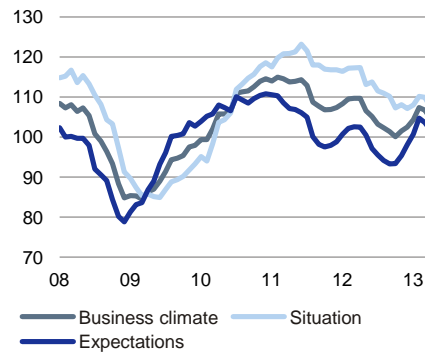


GDP forecast: Uptick in Q1, slippage in Q2

ifo Index with marked decline in March and April

1

2005=100, sa

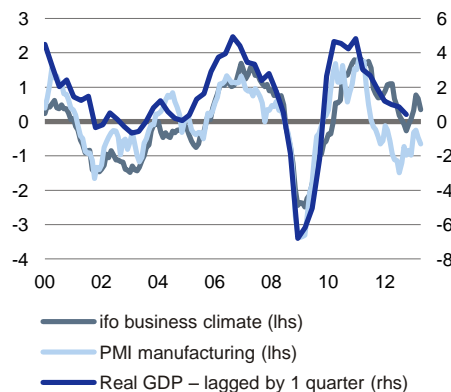


Source: ifo

ifo more positive than PMIs

2

Germany; standardized values (lhs); % yoy (rhs)

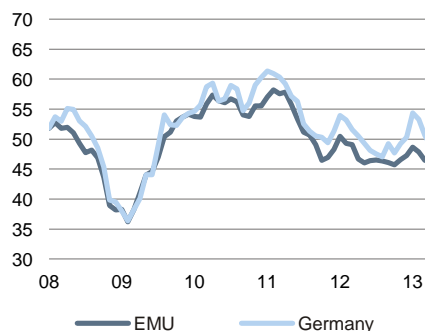


Sources: Federal Statistical Office, Markit, ifo, DB Research

German purchasing manager only little more optimistic than in EMU

3

PMI composite



Source: Markit

Over the past few days sentiment has brightened considerably in Germany, and there are even signs of euphoria in some places – Munich and Dortmund in particular. But unlike Germany's two Champions League semi-finalists the economic releases of late have been a sobering disappointment following the encouraging data at the start of the year. For this reason we have slightly lifted our forecast for German Q1 GDP growth from 0.1% qoq to 0.3%. At the same time, though, we cut our expectations for Q2 from 0.4% to 0.2%. On balance this leaves the annual average unchanged at 0.3%.

The second consecutive, more noticeable decline in Germany's ifo Index in April following a significant recovery in the preceding months moved us to tweak our current growth profile, even though the extent of the changes still ranges within the margin of error. The ifo Index advanced by 4.7 points on average in Q1 but recently lost 3 points against its high in February. Other national and international indicators also suggest that a more significant recovery as the year progresses, which many people have been hoping for, is going to be delayed again – at least for now – and that the GDP forecasts published recently are probably too optimistic. Germany's four major economic research institutes say in their spring forecast that they look for a tangible growth spurt of 0.7% in Q2, and a full-year increase of 0.8%. However, the German government remained somewhat more conservative than the research institutes in its appraisal, raising its forecast for 2013 only minimally (to 0.5%, up from 0.4%). This might have been partly due to the weak ifo figures.

Not only the ifo Index but also the German Purchasing Managers' Indices (PMIs) fell again noticeably in April – the third straight decline for the overall index. While the assessments of the PMI manufacturing respondents were still slightly higher than their weak average in Q4, those of the PMI services sector were in fact even slightly lower. Moreover, the index levels have fallen below the critical expansion/contraction threshold of 50. Thus, in contrast to the ifo Index, they even point to a decline in economic performance in the second quarter, should they persist at the current level. A similar discrepancy emerged between the two indicators in early 2012, too. At the time, the "more optimistic" ifo Index provided a better description of real economic performance, as illustrated in the accompanying chart.

At the international level, economic data proved disappointing, too. True, the PMI for the eurozone slipped only a bit in April, since the decline in Germany was partly offset by a perceptible improvement in France (albeit from a low basis). However, the data are at odds with our forecast that after a 0.3% decline in Q1 (-0.6% in Q4) the eurozone economy will start to stabilise no later than Q2. Since the ECB will probably also review its expectation of a near-term recovery and at the same time determine that eurozone inflation is on a significant downtrend (March: 1.7% yoy), it will probably cut its refinancing rate by 25 bp at the beginning of May. It is no doubt well aware that such a homeopathic reduction when key interest rates are already at an extremely low level will do little to combat the fragmentation of national lending rates, and is likely to even worsen the malaise in the core countries – even though growth is also faltering there – just as Chancellor Merkel's recent, rather unusual statement on interest rate policy shows.

All in all, the political tensions in the eurozone seem to have started increasing again palpably, since some representatives of, in most cases, southern European countries have seized on the academic brouhaha surrounding the famous Rogoff/Reinhart report – and their core assertion that debt levels exceeding 90% of GDP will severely weaken growth – to question the wisdom of Germany's demands for "austerity policy". Now it is no doubt possible to discuss



at length – strictly academically – whether or not there would be a better time for fiscal consolidation. Practically, though, this question does not arise, since the European sovereign debt crisis erupted precisely because the markets were no longer prepared to finance rising deficits and debt levels. The flare-up in the debate is thus either evidence – to put it cautiously – of a lack of understanding of market practices, or else it implicitly suggests that other facilities in Europe are being tapped to fund the deficits. A concept that, so shortly before the general elections in Germany and considering the initial success of the anti-euro AfD party, is little likely to find much sympathy with the German government.

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Mirror, mirror, on the wall – which EMU member is the richest of all?

The ECB published the initial findings from the “Household Finance and Consumption Survey” (HFCS) in April. For this a standardised survey design was used to collect information about the income, debt and assets of households in the eurozone. According to the survey, median net wealth (i.e. the level of wealth that marks the dividing line between the richer half and the poorer half) in Luxembourg is EUR 397,800, followed by Cyprus at EUR 266,900. Germany and Austria bring up the rear, with median net wealth of just EUR 51,400 and EUR 76,400 respectively. One explosive political issue is that households in the crisis-stricken southern European countries are wealthier than households in those states shouldering most of the financial risks arising from the euro bailout.

But are the Germans really poorer than the southern Europeans? The answer to this “simple” question is far more complex than some contributors to the public debate would have us believe. These pronouncements often ignore the issue of which questions such a household survey can answer sensibly and which ones it cannot. It does not provide justification for calling into question the principle of European solidarity in efforts to deal with the crisis. However, attempts to put a positive spin on the low level of private wealth in some countries make just as little sense. Instead, the survey underlines that the income and wealth data in the eurozone do not correspond with the caricature of rich northern Europeans and poor southerners prevailing until then.

Net wealth and income of households in the eurozone

1

	Net wealth (in EUR 1,000)		Household income (in EUR 1,000)	
	Median*	Mean	Median*	Mean
LU	397.8	710.1	64.8	83.7
CY	266.9	670.9	32.3	43.3
MT	215.9	366.0	21.6	26.4
BE	206.2	338.6	33.7	49.5
ES	182.7	291.4	24.8	31.3
IT	173.5	275.2	26.3	34.3
FR	115.8	233.4	29.2	36.9
NL	103.6	170.2	40.6	45.8
GR	101.9	147.8	22.0	27.7
SI	100.7	148.7	18.0	22.3
FI	85.8	161.5	36.3	45.1
AT	76.4	265.0	32.3	43.9
PT	75.2	152.9	14.6	20.3
SK	61.2	79.7	11.2	13.5
DE	51.4	195.2	32.5	43.5

*The median is the value which separates the richer 50% of households from the poorer 50%

Source: ECB Eurosystem Household Finance and Consumption Survey

Does the data enable a meaningful international comparison to be made?

The aim of the HFCS was to collect comparable wealth data for all EMU countries with the aid of a harmonised survey design. Households provided their own information on how much they earn and the size of their assets and their debts.¹ Of course many households do not have precise knowledge of exactly

¹ The only exception is Finland, where administrative income and wealth data could be drawn upon.



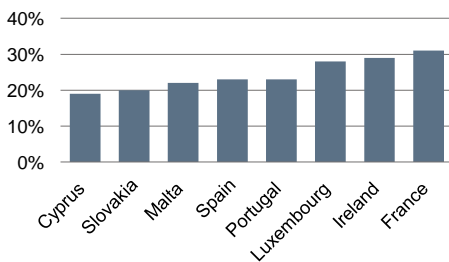
how wealthy they are or they may not wish to provide truthful information about this. However, this only becomes a problem for international comparability if the respondents in some countries provide more precise or more honest information about their wealth than respondents in other countries. What is more problematic is that in most cases there are usually no “true” current market prices available for real estate, which is the largest single asset owned by many households. Especially in countries where real estate prices changed considerably in the years preceding the survey and some real estate was massively overvalued there are probably very few households in a position to accurately estimate the value of their property.

The quality of the data can be examined in some cases by comparing it with alternative data sources. The ECB itself compares the wealth data provided by respondents with the wealth statistics contained in the national economic accounts. According to this data, most countries are somewhat wealthier, but their rankings barely change as a result. There are, however, several smaller countries missing from this data set (e.g. Luxembourg and Cyprus) that do not publish comparable data, but which own the greatest wealth, according to the HFCS. Bearing in mind the usual caveats that apply to a household survey, the quality of the HFCS data, however, appears to be relatively unproblematic.

Nevertheless, the wealth data determined by the HFCS is only partially comparable between the EMU states. This already starts with the fact that average household size varies considerably in some cases. In Germany it is the lowest at 2.04 persons, whereas the highest levels are found in Slovakia (2.83) and Malta (2.85). Such differences are still the easiest to strip out and do not make a major difference overall. More complications arise from the differences between the social security systems, for example. Pension claims represent a key element of a household's illiquid assets in all countries, but there are significant differences between the level of provision in some cases. The biggest problem, however, is the timing of the collection of data. On the one hand, it has not been possible to agree on a common base year (the data for Spain comes from 2008, the data for Greece, Finland and the Netherlands from 2009 and for the remaining countries from 2010). And on the other, in the midst of the most serious economic crisis for decades these figures are already out of date for many countries. For instance, unemployment rates in Spain and Greece have doubled to more than 25% since the data was collected, which is bound to have an impact on wealth creation. Furthermore, in 2008 the real estate bubble in Spain was at its largest. The HFCS does not reflect the current situation, but rather provides a lagging image of wealth in the eurozone.

Tax burden of households (2009) 2

Income tax and social security contributions
(% of income)



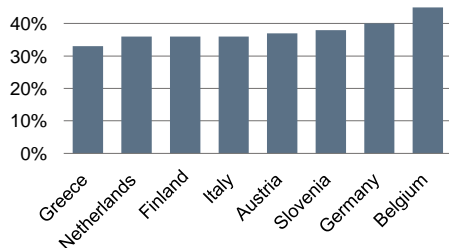
Source: PwC Personal Tax in the European Union

Income and assets: Two sides of the same coin?

Germany and Austria are among the richest countries in the eurozone in terms of GDP per capita and also their average household incomes of EUR 43,500 and EUR 43,900 respectively (HFCS figures) are much higher than those of Spanish, Italian and Greek households. At the same time, both countries report lower levels of private wealth than most southern European countries. Does this necessarily mean there is a contradiction?

Tax burden of households (2009) 3

Income tax and social security contributions
(% of income)



Source: PwC Personal Tax in the European Union

Wealth creation is a process that extends over decades and which is equally dependent on general institutional conditions and individual preferences. One key institutional factor in European countries is firstly the tax and social security burden, as it determines the level of disposable income that can be put towards private wealth creation in the first place. In recent years the effective tax rates within the eurozone have converged significantly, but in Germany of all places the tax burden was higher than in most other countries for a long time.

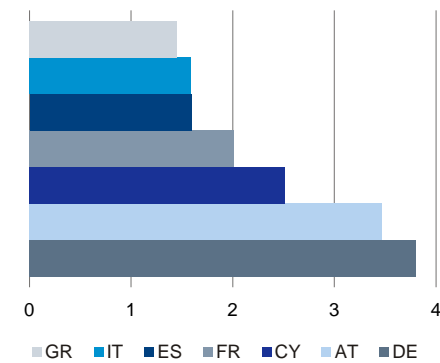


Focus Germany

Wealth inequality

6

Mean/median of net wealth



Sources: ECB, DB Research

Differences in consumption and investment behaviour can influence wealth accumulation, though, too. When there are differences in consumption preferences and people in some countries spend a larger share of their income on immediate consumption, this has a negative impact on wealth creation. Households' investment behaviour is, at least, every bit as important. By international standards, Germans tend to be risk averse and hold much of their wealth in safe asset classes; the share of equity investment in German portfolios was relatively low (according to Deutsches Aktieninstitut, only 5.6% of the population even owned equities in 2010, and only 11.2% held equity funds). However, low-risk types of investment also generate lower returns on portfolios which, on an investment horizon of several decades, may cause substantial differences in long-term wealth creation that are amplified even more by the compound interest effect.

Households' wealth = national wealth?

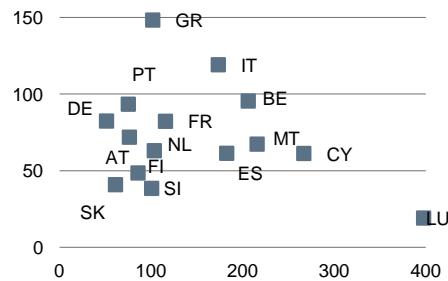
The total wealth of a national economy comprises not only the wealth of the households but also that of businesses and the public sector. The size of these individual components of wealth in relation to one another is, to a certain degree, a matter of intra-national distribution.

Measured in terms of capital stock, for instance, companies from Germany, Austria and the Netherlands are worth more than those from the countries of southern Europe. Since many of these enterprises are public limited companies whose shares are widely held internationally, resident nationals are only part-owners of these assets. This applies in particular to countries with a low share of equity holdings, such as Germany. The asset position of the public sector also plays a part. Countries with a low level of government debt can collect lower taxes or afford better infrastructure in the long run. A combination of soaring public debt and concurrently very sizeable personal assets suggests, by contrast, that such countries had either set tax rates that were too low for a long time, or there was a lack of tax compliance along with inefficiencies in tax administration.

Household net wealth and public debt

4

X-axis: Median net wealth in EUR '000
Y-axis: Public debt as % of GDP (2010)



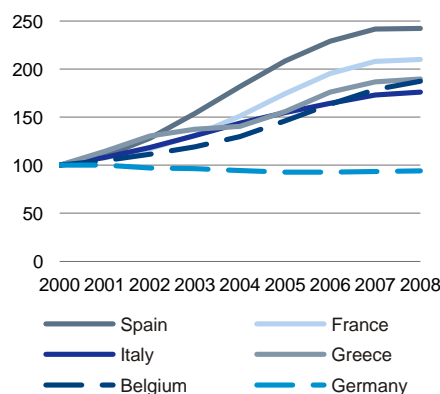
Sources: HFCS, Eurostat

So a contradiction does not necessarily exist if an obviously wealthy country reports relatively low levels of personal assets at the same time. This is one reason why the HFCS does not measure a country's overall wealth – there are more suitable yardsticks to do that, such as GDP, for instance – but instead the personal wealth of its households.

House prices 2000-2008

5

Index 2000=100



Sources: OECD, DB Research

Does home ownership really have such a big influence?

Yes, definitely. There has been a pronounced jump in property prices in most countries especially since the introduction of the euro. Between 1985 and 2008 in fact, house prices more than doubled in real terms in France, while they nearly trebled in Belgium and the Netherlands, and quadrupled in Spain. Thanks to the high rates of home ownership (e.g. 82.7% in Spain and 69.6% in Belgium, compared with only 44.2% in Germany and 47.7% in Austria), many households were able to participate in the huge increases in value. By contrast, real estate prices in Germany and Austria actually fell in real terms during the same period, so property ownership was unable to contribute to an increase in household wealth there. So this actually does explain part of the difference in wealth readings in the HFCS between Germany and countries such as Spain, Italy, France and Belgium. However, real estate was significantly overvalued in some countries, as illustrated by the extreme case of Spain in particular. Since 2008 (the year of the survey in Spain), property prices there have declined by 30%.



The growth of real estate prices may also partially explain why wealth seems to be distributed more inequitably in Germany and Austria than in other euro countries. At least this is a conclusion that may be drawn if one calculates the ratio of mean household wealth to the median. In Germany and Austria, the mean is nearly four times higher than the median, which suggests relatively pronounced inequality. But since all the other countries have a larger share of home ownership, a large proportion of households hold substantial wealth in an asset class which strongly increased in value. This has significantly boosted the median wealth in those countries.

Are Luxembourg and Cyprus households really so much richer than the rest of the eurozone?

One of the most striking findings of the ECB survey is the sizeable wealth of households in Luxembourg, Cyprus and Malta, which is certainly not to be explained only by differences in the development of property values.

The fact that Luxembourg households' wealth is particularly high is not very surprising. After all, the stated income of Luxembourg households is more than twice as high as the eurozone average. Thus, the amount of income available for wealth creation is also considerably larger. However, the situation differs in the case of Malta and Cyprus. The median household income in Malta was slightly lower than the eurozone average in 2010, and in Cyprus only slightly higher. The variation in wealth accumulation is probably mainly attributable to the much smaller tax and social security burden over the long term. The effective tax burden on a household in Malta or Cyprus is about 10-15 percentage points lower than in Germany, France or Italy.² In combination with higher returns on investments, in particular, these differences could explain the significantly greater accumulation of wealth by those households.

Conclusion

Household wealth levels in the eurozone involve too many different variables to be able to sum them in one single figure. Even in a country such as Germany, which is one of the strongest economies in the eurozone in GDP terms with one of the lowest unemployment rates, a substantial percentage of the population is not able to accumulate enough wealth. By contrast, there are many households in the crisis-stricken countries of southern Europe that have considerable wealth at their disposal. So it is indeed remarkable that a household in Germany with net wealth of over EUR 1.16 m is among the richest 10% of the nation, while in Cyprus, for example, assets worth over EUR 4.16 m would be required for membership of this cohort. Against this backdrop it would not seem at all inappropriate to consider having the wealthiest households play a bigger part in the bailout of their national economies.

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² KPMG's Individual Income Tax and Social Security Rate Survey 2012
<http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/individual-income-tax.pdf>



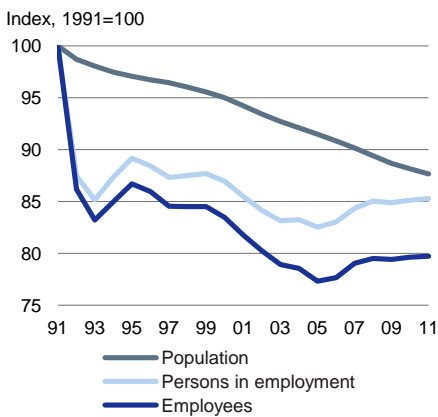
Convergence in pay between east and west Germany at a standstill since the early 2000s

- Following the reunification shock the catching-up process for the east German economy has been stuttering since the mid-1990s.
- The convergence in pay came to a standstill in the early 2000s. In 2011, east German wages were 25% lower than those in west Germany.
- The continuing difference between pay levels in east and west Germany shows that even after 20 years it has not been possible to create highly productive well-paid jobs throughout eastern Germany. With the outward migration of mainly younger and more highly qualified people the wage gap for the youngest birth cohort of persons born since 1970 has widened again and is in fact larger than that of the preceding cohorts.
- Public-sector pay levels have converged much faster than those in the competitive private sector, which means that public-sector workers in east Germany are probably better off than their west German counterparts when one takes into account their contrasting price levels.

Decades of operating under a command economy meant that east German firms were unaccustomed to facing up to international competition – quite unlike their west German neighbours. With the 1:1 conversion³ of pay introduced with the start of economic, monetary and social union on July 1, 1990 east German firms lost their competitiveness overnight and a large proportion of companies were no longer even able to cover their variable costs when selling their goods at world market prices. In addition, demand shifted from east German products to those from west Germany and foreign countries. As a result industrial production and employment nosedived and by the end of 1990 were just some 46% and 67% of their respective 1989 levels. With the far-reaching employment adjustments in east German companies labour productivity rose markedly immediately following unification. To alleviate the situation transitional short-time working was implemented on a large scale and employees were parked in hive-off vehicles. Some 20% of employees were on short-time working at the end of 1990.⁴

Declining employment in east Germany

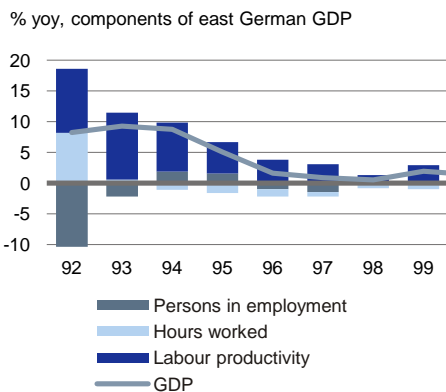
1



Sources: VGRdL, DB Research

Marked increase in productivity due to employment adjustments

2



Sources: IAB, VGRdL

Huge labour stockpiling due to transitional short-time working in east Germany

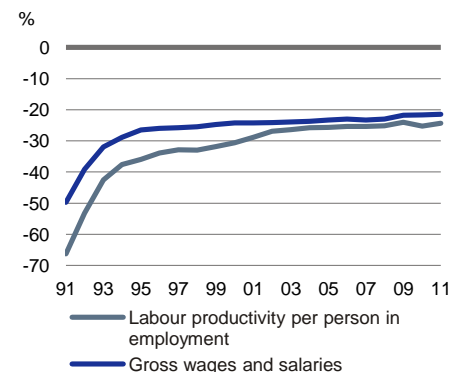
3



Source: Federal Employment Agency

Pay and productivity gap between east and west Germany

4



Sources: VGRdL, DB Research

³ For tradable goods there was a virtual exchange rate of DM 1 to DDR-Mark 4.40 (slope value). See Wagener, H.-J. (2010). Der deutsche Sonderweg der Transformation, in: IWH, 20 Jahre Deutsche Einheit – Von der Transformation zur Integration. Tagungsband. IWH-Sonderheft 3/2010.

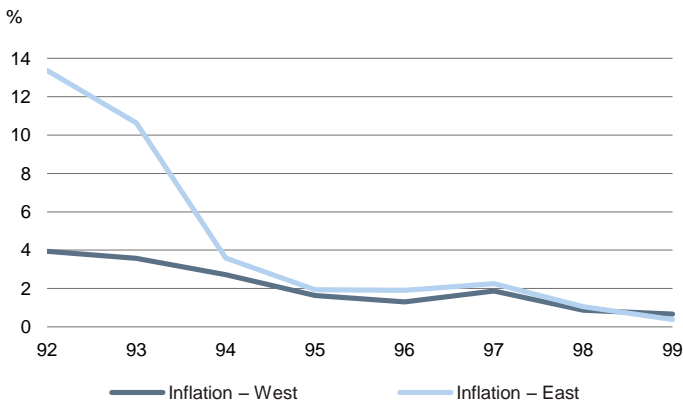
⁴ Akerlof et al. (1991) East Germany in from the Cold: The Economic Aftermath of Currency Union. Brookings Papers on Economic Activity 1991 (1).



To improve the bleak employment situation wages and salaries should have fallen in order to re-establish competitiveness. In fact, however, huge pay increases were implemented. Politicians declared that the objective should be to bring east German pay up to west German levels as quickly as possible. In addition, the unions secured hefty pay increases in east Germany for fear that otherwise mass migration from east to west Germany would exert downward pressure on wages. Moreover, west German companies did not want the value of their production facilities to be reduced by cheap competition from east Germany. The result was another major blow to competitiveness. Due to their higher wage costs companies raised prices – where possible – with the result that the inflation rate in east Germany was much higher than in west Germany.⁵ In addition, companies tried to evade the sharp rise in wage costs by making greater use of machinery in production processes instead of labour inputs. The diffusion of technologically more advanced west German production processes to east Germany also boosted productivity. As a result employment contracted further.

Excessive pay rises in the east one reason for high inflation rates

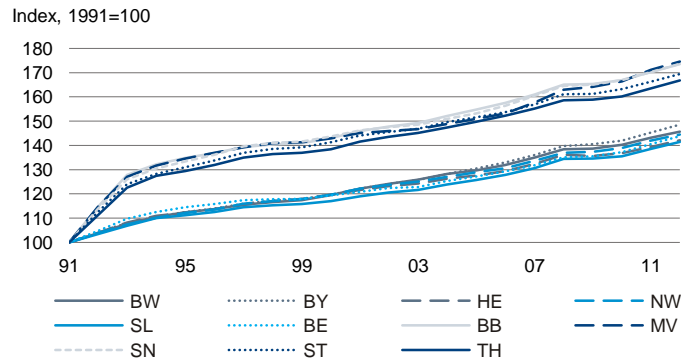
5



Source: VGRdL

Prices in the individual federal states

6

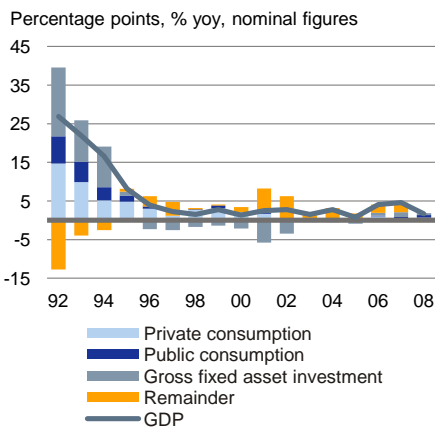


No data available for HB, HH or SH and data for NI and RP only available from 1995

Sources: Statistical Offices of the Länder, DB Research

Consumption and investment the growth drivers in east Germany in the early 1990s

7



Source: VGRdL

Following the reunification shock came the beginning of east Germany's catching-up process

Following this reunification shock the far-reaching restructuring process began in the east German economy. This was supported by large transfers from west to east Germany, subsidies and tax breaks.⁶ Driven by an unsustainable boom in construction that was stoked by huge public funding – the construction industry's real gross value added increased by some 80% between 1991 and 1995 – and relatively stronger consumption growth the east German economy expanded much faster than its west German counterpart in the early 1990s. Moreover, the new additional range of products from west Germany was gladly snapped up, which resulted in a large “external trade deficit” opening up. Growth rates returned to normal relatively quickly and fell below those in west Germany in 1997. Also, the trade deficit began to narrow from the mid-1990s and thus delivered moderately positive contributions to GDP growth.

⁵ Separate consumer price indices for east Germany and west Germany have not been calculated by the Federal Statistical Office since the year 2000.

⁶ East Germany's reliance on transfers was about 34% of nominal GDP in the early 1990s. This fell to 21% in 2010, but thereby remained at a relatively high level (Lehmann, R., Ragnitz, J. (2012). Die Transferleistungen zugunsten der ostdeutschen Bundesländer – Status quo und Ausblick. ifo Schnelldienst 65 (03). 2012. pp. 25-30.

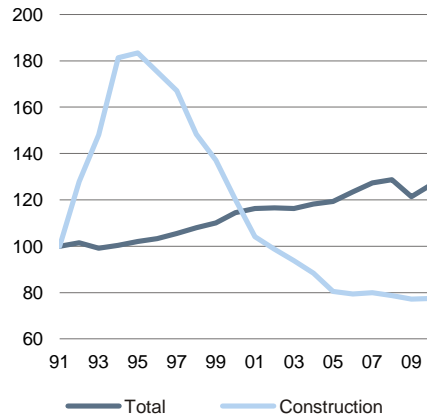


Focus Germany

Construction boom in east Germany until mid-1990s

8

Real gross value added, index, 1990=100

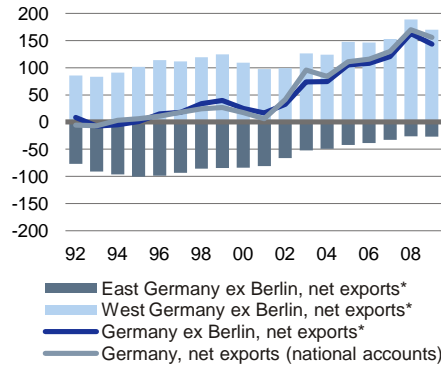


Sources: VGRdL, DB Research

Stubbornly negative net exports by east Germany

9

EUR bn, nominal figures



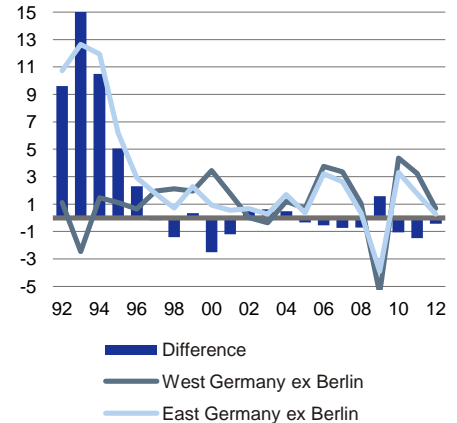
* Net exports are not recorded in the national account statistics collected by the Statistical Offices of the Länder. They have therefore been calculated approximately: GDP-fixed asset investment-consumption data.

Sources: VGRdL, Federal Statistical Office, DB Research

Rapid catching-up process for east Germany in early 1990s

10

GDP, % yoy



Sources: VGRdL, DB Research

Downturn in the east German labour market

The relatively large differences in pay and the rapid decline in employment led to an initial wave of migration from east to west Germany especially by younger and higher skilled people. With the relatively high growth rates and the initially large pay increases the tide of migrants has receded in the meantime. The restructuring of the economy, the bursting of the east German property bubble and the excessive pay rises then prompted a deterioration in the labour market. The unemployment rate climbed sharply from 10.4% in 1991 to 19.2% in 1997. Those hit particularly hard were the unskilled. Their unemployment rate rose over the same period from 31% to 55%. With the lack of prospects migration from east to west Germany increased again at the end of the 1990s. In the second wave of migration the share of younger and better trained people was even higher than during the first wave.⁷

The catastrophic situation in the labour market and the exodus exerted increasing pressure on the unions, which led to a decline in their influence. They had to give up their strategy of trying to achieve pay convergence as quickly as possible.⁸ Wages were no longer raised by as much as before and thus the inflation rates between the east and the west gradually converged again. In the first half of the 2000s east German gross monthly pay rose by an average of just 1.3% per year.

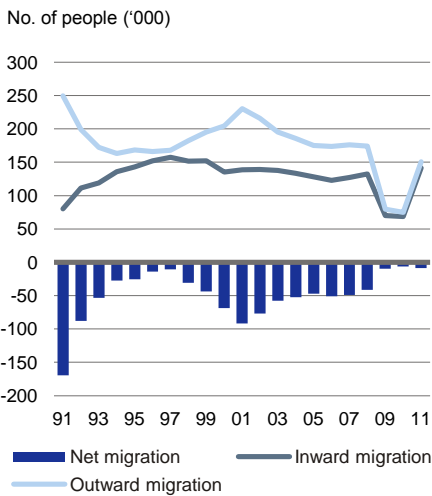
⁷ See Brücker, H., P. Trübswetter (2007). Do the best go west? An analysis of the self-selection of employed East-West migrants in Germany. *Empirica*, 34 (4), pp. 371-395; Fuchs-Schündeln, N., M. Schündeln (2009). Who Stays, Who Goes, Who Returns? East-West Migration within Germany since Reunification. *Economics of Transition*, 17 (4), pp. 703-738; Heiland, F. (2004). Trends in East-West German Migration from 1989 to 2002. *Demographic Research* 11 (7), pp. 173-194.

⁸ See Smolny, W., M. Kirbach (2011). Wage differentials between East and West Germany: are they related to the location or to the people? *Applied Economics Letters*, 18(9), pp. 873-879.; Kohaut, S., C. Schnabel (1999). Der Flächentarif verliert an Boden. *iwd* 19/1999, pp. 4-5.



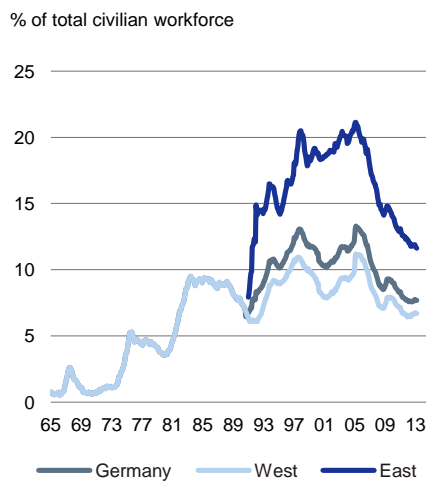
Focus Germany

Migration from east to west Germany 11



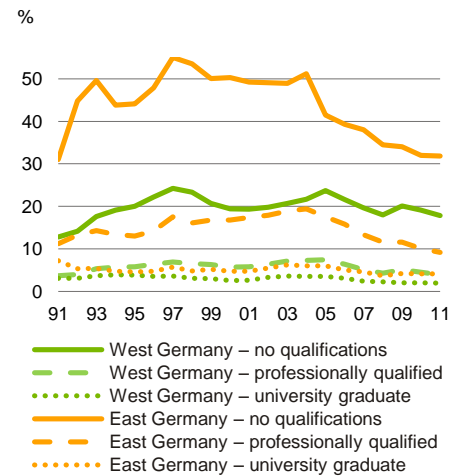
Source: Federal Statistical Office

Marked rise in unemployment until mid-2000s 12



Sources: Federal Employment Agency, DB Research

Qualification-specific unemployment 13



Change in statistics in 2005

Source: IAB

Pay convergence came to a standstill in the early 2000s

The following analysis of employee wage growth draws on data from the German Socio-Economic Panel Study (SOEP) up to the year 2011.⁹ This is an annual representative household survey of an identical group of persons and families on, among other things, wage growth, personal characteristics and job-specific features. Because of attribution problems, Berlin is excluded from the analysis.¹⁰

The rapid economic convergence process stopped at the end of the 1990s and the structural weaknesses of the east German economy reappeared. The reduction of overemployment in businesses went hand in hand with a decline in potential productivity because of redundancies. The employee share – the ratio of employees to the total population – stabilised at a low level.

As there had initially been excessive wage hikes in east Germany the monthly gross wage differential had plummeted by around 20 percentage points (pp) by the mid-1990s, from 44% in 1992.¹¹ Pay convergence slowed considerably in the subsequent years and came to a standstill at a negative wage gap of just over 20% in the early 2000s. Thanks to the higher average monthly working time in east Germany – mainly because of the smaller share of part-time work – the gap in hourly wages was even larger in 1992, at 49%.

The deep economic slump in 2009, which particularly hit west German companies with a strong export bias owing to the collapse of global trade, led to a temporary adjustment of the wage gap. However, it returned to below the 20% mark in 2011 as exports staged a strong recovery.

⁹ Whether Berlin is regarded as being part of east Germany or west Germany has no bearing on the quality of the statements.

¹⁰ See Wagner, G., J. R. Frick, J. Schupp (2007). The German Socio-Economic Panel Study (GSOEP) – Evolution, Scope and Enhancements. Schmollers Jahrbuch, 127 (1), pp. 139-169.; Haisken-DeNew, J. P., and J. R. Frick (2005). Desktop Companion to the German Socio-Economic Panel Study (GSOEP). Version 8.0 – Update to wave 21. Berlin: DIW.

¹¹ If wages are deflated with the consumer price indices of the Statistical Office of the respective federal state, the wage differential in 1992 narrows from -44% to -39%. Hence, the uniform deflator using the overall German consumer price index overstates pay convergence in the early 1990s. This deflator approach is not used in the following analysis, though, because no consumer price indices are available for the Länder of Bremen, Hamburg and Schleswig-Holstein, and the data for Lower Saxony and Rhineland-Palatinate are only available from 1995.

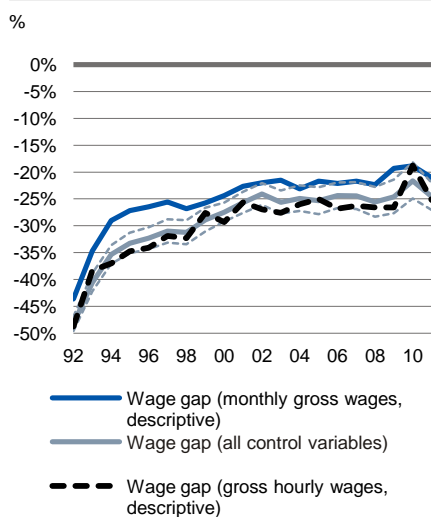


	East-West Germany wage gap				t-test on the equality of means*			
	92-96	97-01	02-06	07-11	92-96	97-01	02-06	07-11
Nom. monthly gross wage	-32%	-25%	-22%	-21%	***	***	***	***
Nom. monthly net wage	-29%	-23%	-20%	-18%	***	***	***	***
Real monthly gross wage	-32%	-25%	-22%	-21%	***	***	***	***
Real hourly gross wage	-38%	-29%	-26%	-25%	***	***	***	***
Real monthly gross wage, CPI Bula	-32%	-27%	-24%	-22%	***	***	***	***
Working time (hours per month)	13%	11%	9%	9%	***	***	***	***
Nom. gross wages and salaries (National accounts)	-30%	-25%	-24%	-22%				

*Notes: *** significant at 1 per cent.

Sources: Federal Statistical Office, Statistical Offices of the Länder, SOEP, DB Research

Pay convergence stopped in the early 2000s



Dotted lines: upper and lower 95% confidence interval

Sources: SOEP, DB Research

Wage levels are determined not only by regions though, but also by numerous other factors such as the personal characteristics of the employee, the structure of the economy, the features of the workplace and other non-observable properties¹². Using simple wage regressions with the log of real monthly gross wages¹³ as an endogenous variable it is then possible when controlling for these numerous other factors – job-specific variables and personal characteristics¹⁴ – to ascertain with a dummy variable for east Germany just how large the wage differential between east Germany and west Germany is that emerges from the geographical difference alone.¹⁵ This conditional wage gap, i.e. as determined by the regression, is about 5% lower than the descriptive monthly gross wage gap on average. The curve of the conditional wage gap does not differ significantly though from that of hourly gross wages. It is not possible to determine which factors are responsible for this conditional wage gap using our approach. Substantial importance may probably be attached to deep-seated structural problems, such as the absence of appropriate jobs in the high-wage segment, and non-observable factors.

In the following, the conditional wage differentials for various random samples are compared with one another. Significant differences are to be found in the degree of convergence between the public sector and the private sector and according to birth cohorts.

Pay convergence much smaller in the private sector than the public sector

Wages in the public sector, which are protected from competition, have continued to converge from a negative wage differential, fully in keeping with the will of politicians and trade unions. In 1992, wages in east Germany were 46% lower than the level in west Germany; in 2011 the gap had narrowed to only about 10%.¹⁶ However, what is disregarded here is that there was a marked

¹² A table of descriptive statistics is to be found in the appendix (figure 19).

¹³ Gross wages were deflated uniformly in the regressions using the consumer price index for Germany as a whole. Germany's Federal Statistical Office stopped calculating separate series for east Germany and west Germany as of 2000. In the early 1990s, though, this practice resulted in pay convergence being overstated.

¹⁴ *Job-specific variables*: working time, period of employment and the square of the period of employment, sector dummies, company size, dummy for public sector or private sector; *personal characteristics of the employee*: highest professional qualification, sex, family status, number of children and disability.

¹⁵ By using interaction terms of the region dummies with year dummies and, in addition, year dummies, the annual wage gap between east Germany and west Germany is determined while controlling for the other factors.

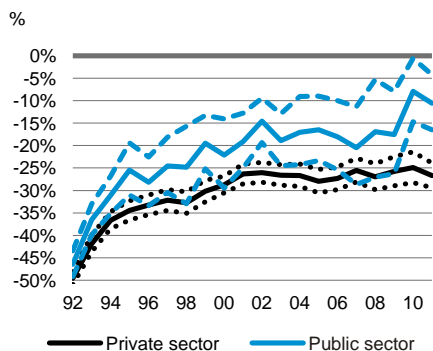
¹⁶ One argument for the greater degree of pay convergence in the public sector is that the requisite qualifications and related workflows do not differ as much between east Germany and west Germany as they do in the private sector.



Focus Germany

Wage gap: Public sector vs private sector

16



Dotted lines: upper and lower 95% confidence interval

Sources: SOEP, DB Research

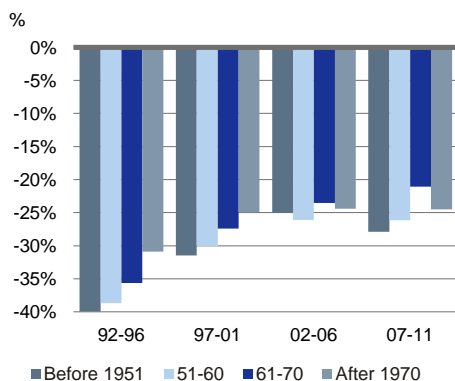
contrast between the costs of living in east and west Germany. For example, east German rents were roughly 30% below those in west Germany in 2012, the purchase price of semi-detached houses nearly 50% and the price of apartments about 35% – so purchasing power was probably higher for public-sector employees in east Germany than in west Germany and this is likely to be a reason to have doubts about such a policy.

By contrast, private-sector wages converged at a much slower pace. The conditional negative wage gap was around 50% in 1992, narrowing by about 20 pp by the early 2000s and hovering since then at a level of just under 30%. There is extremely limited scope for wage hikes in east Germany at companies operating in a competitive environment. After over 20 years it has still not been possible to create competitive jobs whose high productivity would enable payment at the west German level in the high-wage segment.

Exodus of younger and high-skilled workers boosts the wage differential

Conditional wage gap by birth cohort

17



Sources: SOEP, DB Research

Owing to the radical changes in economic structure, organisation of production and workflows, workers in east Germany had to write off part of the human capital they had acquired in the German Democratic Republic during the era of central planning.¹⁷ In terms of birth cohorts this means that the conditional wage gap increases with the age of the birth cohort.

At the beginning of the 1990s the wage gap for the oldest birth cohort of all persons born before 1951 is indeed the biggest, at 40%. For those of the youngest birth cohort analysed, of persons born after 1970, the wage gap is nearly 10 pp smaller. Up until the early 2000s, the wage gap declines to roughly the same extent for all cohorts. The exodus of younger and higher-skilled persons – especially in the second wave of migration – is ensuring, however, that the wage gap of the youngest birth cohort rises again and outstrips that of the preceding cohorts.

Conclusion

Pay convergence between east Germany and west Germany came to a standstill in the early 2000s. Since then, the only exception was in the 2009 crisis year. The temporary slump in global trade triggered a collapse especially in demand for products of west German companies with a strong export bias. The recovery of world trade in 2010 and 2011 returned the wage gap to roughly the pre-crisis level of about -25% in 2011.

The continuing pay differentials between east Germany and west Germany underscore that even after 20 years it has not been possible to create highly productive well-paid jobs throughout east Germany to date despite huge volumes of transfers and the diffusion of technology. Moreover, the exodus of younger and higher-skilled people has ensured that the wage differential for the youngest birth cohort has started to widen again.

While private-sector wages in east Germany have been roughly 30% below the west German level since the 2000s, wages in the public sector have continued to converge. By 2011, they were only about 10% shy of the level in west Germany.

¹⁷ Franz, W., S. Steiner (2000). Wages in the East German Transition Process – Facts and Explanations. *German Economic Review*, 1 (3), pp. 241-269; Krüger, A. B., J.-S. Pischke (1995). A Comparative Analysis of East and West German Labor Markets: Before and After Unification, in: Freeman, R. B., L. F. Katz. *Differences and Changes in Wage Structures*. University of Chicago Press, pp. 405-446.



Taking the differences in the cost of living into account, this more significant pay convergence is probably one reason why public-sector employees in east Germany are better off than their counterparts in the west. This is probably difficult to justify, though. For example, rents in east Germany, which constitute 21% of the consumer price index, are about 30% lower than in west Germany. There are no representative data available on the differences in the cost of living between west Germany and east Germany.

The clear improvement in the labour market situation over the past few years noticeably reduced the unemployment rate also in east Germany. However, it still far exceeds the west German reading, and the over 30% rate for unskilled workers remains very high.

Appendix

German federal states

18

Descriptive statistics

19

		East Germany ex Berlin				West Germany ex Berlin			
		92-96	97-01	02-06	07-11	92-96	97-01	02-06	07-11
BW	Baden-Wuerttemberg								
BY	Bavaria								
BE	Berlin								
BB	Brandenburg								
HB	Bremen								
HH	Hamburg								
HE	Hesse								
MV	Mecklenburg-Western Pomerania								
NI	Lower Saxony								
NW	North Rhine-Westphalia								
RP	Rhineland-Palatinate								
SL	Saarland								
SN	Saxony								
ST	Saxony-Anhalt								
SH	Schleswig-Holstein								
TH	Thuringia								
	Nom. monthly gross wage (EUR)	1,395	1,696	1,889	2,020	2,048	2,262	2,425	2,545
	Nom. monthly net wage (EUR)	968	1,116	1,233	1,340	1,362	1,450	1,537	1,643
	Real monthly gross wage (EUR)	1,635	1,845	1,917	1,876	2,407	2,462	2,461	2,372
	Real hourly gross wage (EUR)	9.1	10.5	11.0	10.8	14.7	14.9	15.0	14.4
	Real monthly gross wage, CPI Bula (EUR)	1,660	1,832	1,916	1,880	2,446	2,513	2,512	2,418
	Working time (hours per month)	187	183	177	176	166	165	161	163
	Firm with over 2000 employees	16%	14%	15%	18%	27%	24%	21%	24%
	Public sector	11%	11%	9%	9%	10%	9%	8%	8%
	Period of employment	8.8	8.3	9.6	10.5	10.8	10.9	11.0	11.3
	Part time work	17%	23%	26%	27%	25%	29%	32%	33%
	Standard employment relationship	86%	83%	82%	79%	83%	80%	77%	75%
	Without professional qualifications	3%	5%	6%	5%	20%	17%	15%	13%
	Professional qualification, not university	69%	67%	68%	71%	66%	66%	67%	66%
	University degree	28%	27%	26%	24%	15%	17%	18%	21%
	Women	43%	45%	48%	49%	41%	43%	46%	48%
	Children	50%	43%	35%	30%	39%	41%	40%	35%
	Disability	3%	4%	4%	5%	6%	6%	6%	6%
	Birth cohort < 1951	37%	27%	17%	5%	40%	28%	17%	7%
	Birth cohort 1951-1960	29%	29%	31%	31%	27%	28%	27%	24%
	Birth cohort 1961-1970	29%	30%	29%	29%	28%	30%	32%	33%
	Birth cohort > 1970	6%	15%	24%	35%	6%	14%	24%	36%

Source: DB Research

Sources: Federal Statistical Office, Statistical Offices of the Länder, SOEP, DB Research

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German industry: Waiting for the upswing

Expectations still positive

1

ifo business expectations, manufacturing, index, left, manufacturing output, % yoy, right



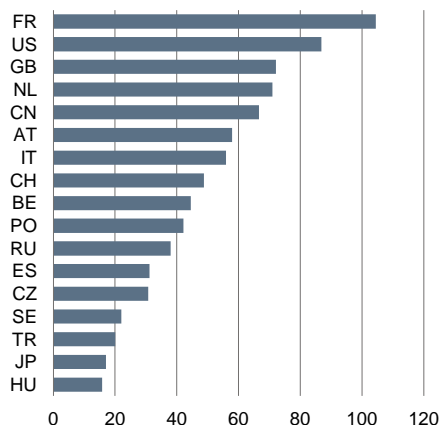
* 4 months shifted forward

Sources: ifo, Federal Statistical Office

17 trading partners = 75% of exports

2

German exports by trading partner, EUR bn, 2012

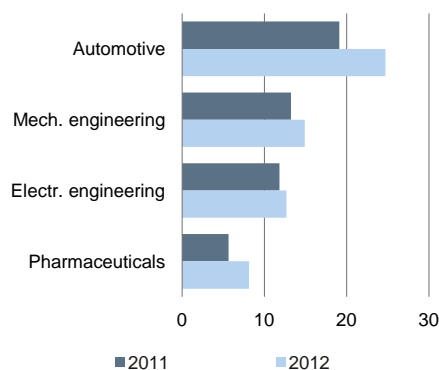


Source: Federal Statistical Office

German exports to the US increased in 2012

3

EUR bn



Source: Federal Statistical Office

After recovering for five consecutive months the expectation component of the ifo Index (manufacturing industry) corrected somewhat in March and April. Similarly, the manufacturing PMI has dropped below 50 again in March/April (April 47.9), suggesting that a recovery in manufacturing output will not materialize before H2. However, as can be seen from chart 1, the ups and downs of the sentiment indicators have not really been followed by actual output, which has been on a stable modest downward trend for the last one and half years. This desynchronisation might be attributed to the gyrations of the euro crisis, having an exaggerated impact on sentiment. Therefore, our analysis focuses on whether there are already signs of a recovery above and beyond the sentiment indicators. In this context, the level of economic activity abroad is of particular significance to German industry, which is driven strongly by exports.

German industry has tapped new markets

After two boom years (2010: +12%; 2011: +7,8%), in which industrial output was able to regain the territory lost in the slump of 2008/09, manufacturing had to digest a slight setback in 2012. Real output fell by 1% altogether in 2012. Q4 performance was particularly weak, so production started into 2013 with a statistical underhang of 1.7%. Recently, the sluggishness affecting key export markets outside EMU also began to make itself felt.

The economic crisis in Europe has weighed on German exporters' sales. GDP in Germany's most important export market, France, stagnated in 2012 and will probably decline by 0.6% in 2013. Italy, which absorbed 5.1% of German exports last year, saw its economy contract by 2.4% in 2012, and it is unlikely to find its way out of the red in 2013 (-1.8%). Correspondingly, there was a decline in German exports of goods and services to EMU countries in 2012, and their share of total exports went down to only 37.5%. In 2000, the share still came in at 45.5% on the basis of the same country group. In relative terms, especially Spain and Italy, but also Belgium, offered German companies poorer sales opportunities.

Conversely, the significance of exports to non-EMU countries has generally increased, offsetting the declines seen in many sectors to most countries of continental Europe. Among Germany's eight most important trading partners, which accounted for more than 50% of its total exports in 2012, the United States ranked second again. During the economic crisis, the share of exports to the US remained nearly unchanged at close to 8% p.a. over the past five years. Companies from certain sectors managed to make further inroads in the US as a key market for their products. One striking aspect is the robust growth of automotive exports to the US, which absorbed 13% of the sector's total exports in 2012 (up from 10.3% in 2011). This represents an increase of nearly 30% yoy. Germany's automakers benefited in particular from their attractive range of models and the good image of German car brands.¹⁸ German pharmaceutical makers' exports to the US, the key market in the sector, accounted for 15% of their total exports in 2012 (+44% yoy). Germany's mechanical engineers also strongly boosted their sales to the US in 2012 (+12.6% yoy), so the US further consolidated its position as the second most important export market for this sector. Stimuli came from the local auto industry in particular, as carmakers modernised their plants. However, the recent sluggishness in the US domestic market has had an impact on German exporters over the past few months – despite the positive results for the year as a whole. This had already been the

¹⁸ See Heymann, Eric (2011). US car market: Returning to its previous size. Deutsche Bank Research. Current Issues.

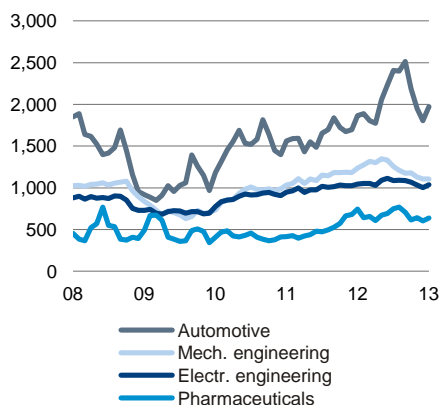


Focus Germany

German auto exports to the US slumped in Q4

4

German exports to the US, EUR m



Source: Federal Statistical Office

case in the mechanical engineering sector since mid-2012; Germany's carmakers felt the effects in Q4 (see chart 4).

While exports to the United Kingdom (3rd place) increased at a double-digit pace in the past three years, Britain's significance as a destination for German exports has still not regained the level seen in 2007. By contrast, shipments to Switzerland, which absorbs close to 4 ½% of Germany's total exports in fact, also regained significance in comparison with 2007.

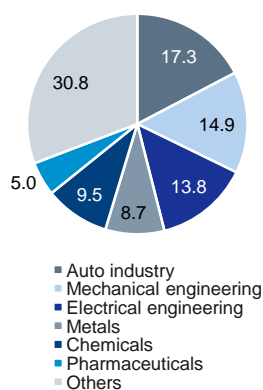
German export structure strongly concentrated

German industry has always had a strong bias towards export trade. Companies from the automotive, mechanical engineering and pharmaceuticals sectors have generated over 60% of their revenues abroad of late. The chemicals industry and electrical engineering were not far behind, also reporting foreign revenues of well over 50% and thus also outstripping the manufacturing industry average. On balance, merely a few product groups dominate Germany's export structure. Four sectors account for over 50% of the total, these being automotives, mechanical engineering, electrical engineering (goods and equipment), and metals and metal products (see chart 5). The sizeable 44% share in the capital goods segment and the further 31% in intermediate goods underscore the strong degree of specialisation and the focus on investment activity abroad.

Exports: Focus on a few sectors

5

Share in total exports, DE, 2012, %



Source: Federal Statistical Office

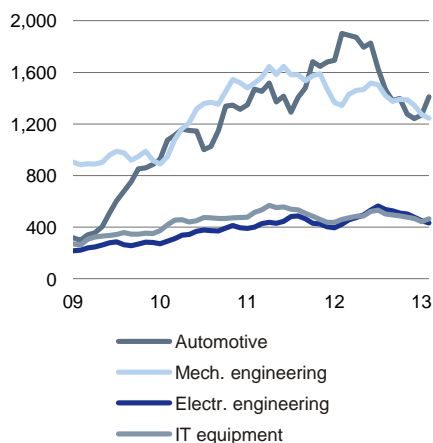
Among the export destinations outside EMU, China is particularly prominent as a growth market: China's share in German exports increased from 3.1% in 2000 to 6.1% in 2011 and 2012.¹⁹ This means that China has now advanced to 5th place (2012) in the ranking of chief export countries (see chart 2). Given the economic crisis in neighbouring European countries, German companies have sought over the past few years to tap the sizeable potential offered by the Chinese market. Both the US and China play a particularly important role as export markets for the automotive, mechanical engineering and electrical engineering industries. China was the biggest market for Germany's mechanical engineers (10.3% of sector exports) and for producers of electrical equipment (8.8%) in 2012; for auto makers, China ranks second in terms of sector exports (10.2%).

This market's major significance for German companies also entails sales risks, though, if – as in 2012 – China's GDP expands at a slower pace. All in all, the growth of German goods exports to China cooled considerably in 2012 compared to one year earlier (+2.7% yoy vs +20.6% yoy in 2011). In addition, exports to China picked up at an only below-average pace in relation to the total exports of German companies. The impact of the slowdown in Chinese growth was particularly noticeable in the mechanical engineering sector, with exports there falling by 10% yoy in 2012. While the automotive industry managed to boost exports to China for the year as a whole, these had already started to trend downward back in Q2 2012. However, most recent data signal that auto exports to China could have reached bottom (see chart 6).

Exports poised for renewed growth

6

German exports to China, EUR m



Source: Federal Statistical Office

Moderate outlook for the export markets

At present, German exporters in certain industries are being confronted with falling sales in various markets. As 2013 progresses, these exporters are likely to benefit from a return to increased dynamics in key markets. However, in the EMU this is probably going to be pretty small, as we expect the eurozone to post a decline in GDP of 0.6% for 2013 as a whole. While we believe the fiscal drag on the economy will weaken in the course of the year and growth will slightly recover starting in the third quarter, this will probably provide German industry

¹⁹ For more, see Stobbe, Antje (2013). German industry: China market growing moderately. Research Briefing. Deutsche Bank Research.

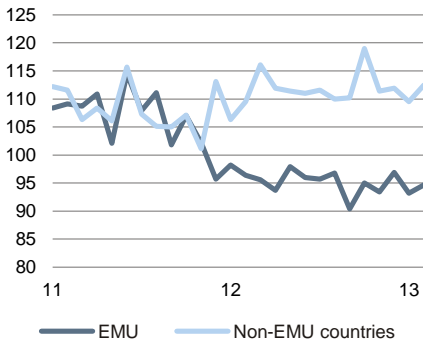


Focus Germany

EMU orders have bottomed out

7

Foreign orders, 2010=100, sa



Source: Federal Statistical Office

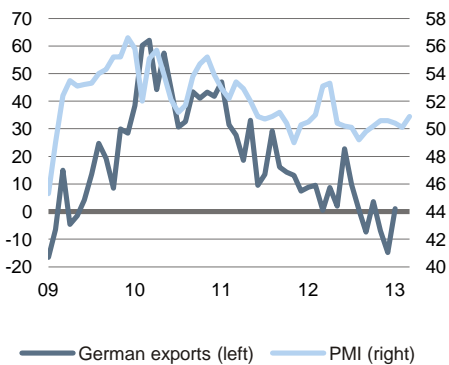
with only weak stimuli. Order intake from other EMU countries is still trending downward in a year-on-year comparison. Nonetheless, orders have stabilised since Q4 at a low level (see chart 7).

The budding recovery in German industry's other major export markets is likely to pave the way to further growth opportunities in the course of 2013. We reckon that China will see a slight acceleration of its GDP growth, from 7.7% in 2012 to 8.2% in 2013; its more expansionary economic policy lends support to growth. The China Purchasing Managers' Index, a good leading indicator of industrial output, has stabilised over the past few months (see chart 8). Car sales also picked up again in China in Q4 2012 and Q1 2013. Demand remains subdued in the mechanical engineering sector, though.²⁰ Investment activity is likely to increase in 2013 (+8.5%), with Chinese imports picking up in particular (+12.5%). The prospects for German exporters are hence also set to improve. It holds for all sectors, though, that German exporters are currently still swaying from the decline in exports over the past few months. Therefore, it is imperative that they manage in future to participate in the economic upswing.

German exports lost steam recently

8

German exports to China, % yoy, PMI China



Sources: Federal Statistical Office, IHS

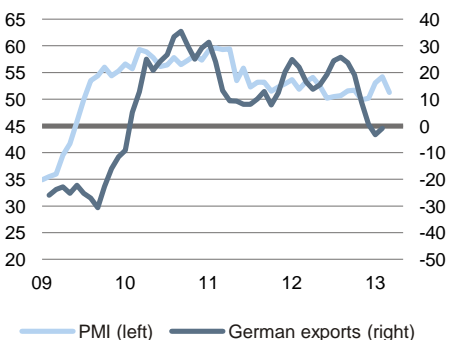
The US economy is also likely to pick up again slightly in the current year; one sign of this, for example, is the moderate improvement in the US PMI at present. We look for GDP growth of 2.3% and higher industrial output of 5.2% yoy in the US in 2013 (up from 3.6% in 2012). This could benefit several German sectors again in 2013, one of them being pharmaceuticals. However, Germany's auto exporters will initially have to digest the deep slump that has affected them since Q4, so they will probably fail to match the high growth rates of 2012, especially since German companies are increasingly serving the US market from local plants.

Flat industrial output in 2013

US sentiment improved slightly

9

US PMI, German exports to the US, % yoy, 3M movavg



Sources: Federal Statistical Office, FRB

Currently, there are still few "hard facts" pointing to an imminent upswing in German industry, such as how this could be triggered by foreign markets, for instance. The signals on incoming orders have been mixed for quite some time. All in all they increased by 2.3% mom in February, after having decreased by 1.6% in January, so the more informative two-month comparison showed an only feeble 0.1% increase in January/February vis-à-vis November/December 2012. It is positive to note, though, that domestic orders displayed 1.4% growth vis-à-vis the previous period in the same two-month interval. What this suggests is that German industry might have emerged from the trough in Q4 2012. This is backed, moreover, by the fact that capacity utilisation in the manufacturing sector as a whole increased again slightly in H1 2013, to 82.2%, after having fallen steadily for 1 1/2 years.

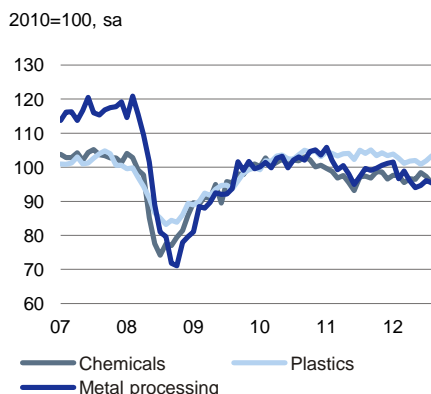
In the early-cycle sectors there are only weak indications of an economic recovery this year. The strong brightening of sentiment in the plastics processing industry over the past few months is especially striking; the expectations component has risen by over 30 points from its low in August 2012, reaching +12 at last reading. Production also picked up again in the first two months of the year in comparison with November/December 2012 (+1.2% versus preceding period). This can also be seen in metals production (+1.5% on the period) and slightly weaker performance from the producers of metal products (+0.5%). However, metals production was hit by a sizeable drop in output in the second half of last year, so the sector started this year with a substantial statistical underhang (-3.8%). The chemicals industry had seen real output stabilise in H2 2012, yet it declined again by 1.1% on the preceding

²⁰ See Germany Trade & Invest (2013). Branche kompakt - Maschinenbau und Anlagenbau - VR China. 2013. February 19, 2013. <https://www.gtai.de/GTAI/Navigation/DE/Trade/maerkte.did=763774.html>



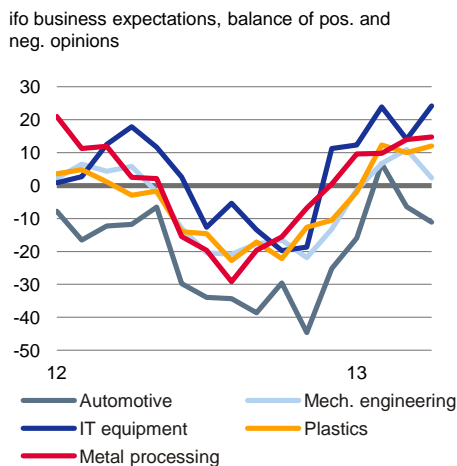
Focus Germany

Production: Early-cycle sectors 10



Source: Federal Statistical Office

German industry: Expectations mostly positive 11



Source: ifo

Industrial production Germany 12

Manufacturing sector	2010	2011	2012	2013F
Food	1.8	-0.6	0.0	2.0
Beverages	1.4	3.1	-0.5	2.0
Textiles	11.9	0.1	-7.3	-1.0
Clothing	-0.3	-1.5	-9.3	-6.0
Chemicals	17.6	-0.3	-2.6	1.0
Pharmaceuticals	0.6	4.3	-2.4	0.5
Plastics	12.7	4.2	-1.1	-0.5
Metal processing	21.0	2.1	-3.8	0.5
Metal products	14.5	10.9	-1.4	1.5
Electrical engineering	16.9	11.5	-2.6	0.5
Mechanical engineering	10.7	13.1	1.3	-1.0
Automotive	25.3	12.7	-0.4	-2.0
Manufacturing	12.0	7.8	-1.0	0.0

Sources: Federal Statistical Office, DB Research

period in the first two months of 2013. Incoming orders also slipped – especially because of the weaker demand from abroad; by contrast, domestic orders were up a tad. All things considered, there are only few signs materialising in a few early-cycle sectors – apart from an improvement in sentiment – of a sluggish upswing in industry.

In the other major sectors of industry that typically pick up later in the cycle these signs are not yet visible, though. German automakers are having to contend not only with the weak demand from the eurozone in particular, but also with the downtrend in domestic orders since Q2 2012. Correspondingly, production has trended downward over the past few months and performance was also weak at the start of 2013 (-1.2% Jan/Feb vs Nov/Dec). While we expect domestic auto production to gather momentum again in the course of 2013, real output is probably going to decline by about 2% overall, not least because of the large statistical underhang (-3.8%). There are still no signs of a budding recovery in the mechanical engineering sector, either. This is not surprising, since mechanical engineering activity usually does not pick up until somewhat later in the cycle. Following a downturn in production at the beginning of the year a reversal was to be seen in February; nonetheless, in the first two months real output fell 0.8% short of the reading for the prior period. All in all, we look for mechanical engineers to report a 1% decline in production in 2013. Electrical engineering, by contrast, is showing tentative signs of a recovery: for one thing, the balance of positive and negative business expectations in the IT equipment segment has soared, recently achieving a pretty high level of +24.2. For another, incoming orders increased in the first two months of the year (+1.8%), driven by orders from both the home market and abroad. We therefore forecast that electrical engineering will post moderate expansion in the current year, at 0,5%.

To wrap up: German industry still has to work its way out of the trough this year. While recent data has been disappointing there still signs that this will happen during the year. Not only the improvement in expectations, but also faint indications of a recovery in several early-cycle sectors argue in this vein. But there has not been any breakthrough, yet. The slightly improved prospects for key export markets outside EMU – based on the forecasts of DB’s regional economists – suggest that industrial growth will enter a modest recovery phase. The first signs of support from domestic growth, which is likely to enjoy greater significance in 2013, are another plus factor. At the end of the day, however, we expect manufacturing output to be flat in real terms, as it is being dragged down by the large underhang. Potential risks to our forecast, which are pretty much skewed to the downside, are harboured particularly in a worsening of the EMU economic crisis, which would unleash negative repercussions for the world economy as a whole. However, a significant flattening of the growth curve in China or a renewed slump in demand for cars could also compel us to correct our forecast.

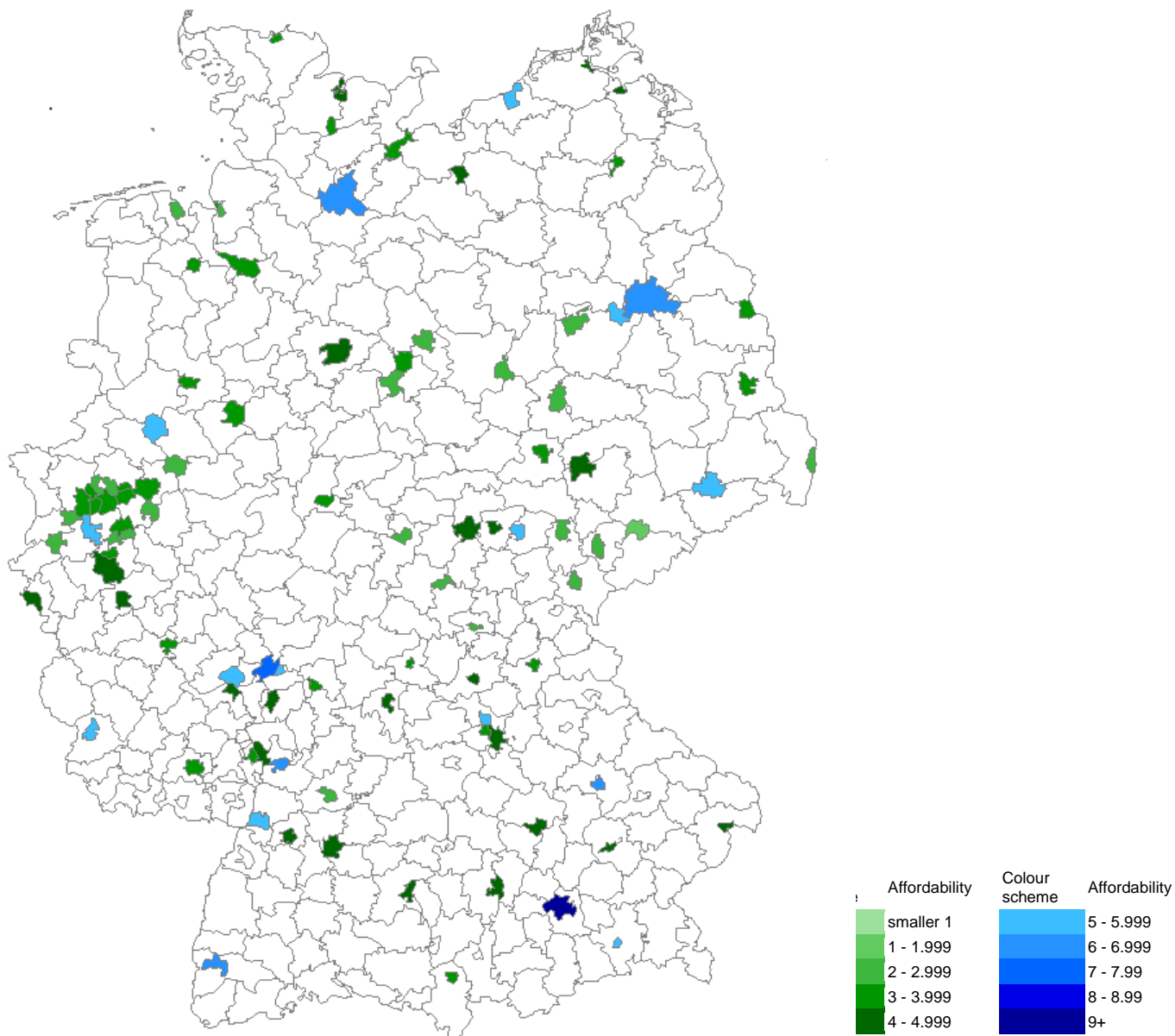
Antje Stobbe (+49 69 910-31847, antje.stobbe@db.com)



Chart of the month

Germany: 2012 affordability indices of existing apartments in cities

Definition: Affordability is the price of existing apartments with an area of 100 sqm relative to disposable income of a household



Sources: BulwienGesa, DB Research

Real estate prices: Bubbles in cities?

Prices on the German residential real estate market have risen strongly in the last few years. According to the Bundesbank, prices went up by over 5% yoy in 2012. Thus, they rose more strongly than disposable incomes once again. Prices of Germany's resident real estate are favourable both historically and by international standards. Furthermore, the German economy has been quite crisis-resistant so far. Correspondingly, we interpret the price increases of the last few years as a normalisation.



Price developments in cities

The price development in Germany varies strongly from region to region. While nominal prices of existing apartments from 2008 to 2012 rose by roughly 10% on average and by as much as 40% in Hamburg, they fell by double-digit rates in structurally weak cities. This raises the question whether existing apartments in some cities are too expensive.

Affordability indices of existing apartments in cities

Affordability indices are defined as real estate prices relative to disposable household income. They answer the question how many net annual incomes private households have to spend on the purchase of real estate. Currently, a household has to spend 4 ½ annual incomes on average to buy an existing apartment with an area of 100 sqm. The map of Germany shows the varying affordability of the individual cities.

Number of inhabitants driving force behind affordability

The number of inhabitants in particular seems to have a major impact on affordability. A flourishing economy attracts inhabitants, and the demand for limited living space meets a rather inelastic supply. For this reason existing apartments in larger cities – despite higher incomes – are in most cases "less affordable". According to a rule of thumb, in large cities the average multiple paid for an apartment is 6 times annual income, in Munich no less than 9 times annual income, in medium-sized cities with 150,000 to 500,000 inhabitants 4 ½ and in small cities an average of 3 ½ times annual income. There are price differences between west and east Germany as well, which, however, are caused by the large cities. With the exception of the large cities, both in west and in east Germany, 4 times annual income has to be paid on average. Thanks to higher incomes German resident real estate is currently more affordable than in 2000, for at that time 5 times annual income had to be paid for an existing apartment across the country.

Change in affordability indices

From 2008 to 2012, the affordability index rose by 0.4 times annual income across Germany. This is mainly due to price increases in large and medium-sized cities. At present, home buyers in medium-sized cities have to pay roughly 0.25 times annual income and in large cities almost 1 times annual income more than in 2008. In small cities with fewer than 150,000 inhabitants, real estate prices are currently as affordable as 2008, i.e. prices of apartments have risen at the same pace as incomes.

Development of households and population growth

The development in the number of households and the number of inhabitants is just as varied as that of prices. Large and medium-size cities grow and in cities with fewer than 150,000 inhabitants the number of households and the population usually stagnates or declines. It is hardly surprising that an increase in the number of inhabitants and a rise in the affordability index go hand in hand. In simple econometric estimates, the population development can largely explain the change in affordability.



Conclusion: Valuations are fair in general

Existing apartments in cities have a fair valuation. The affordability indices are high there and have risen where it seems to make economic sense, that is particularly in cities where the number of households and inhabitants is increasing.

Outlook: Globalisation favours large and medium-sized cities

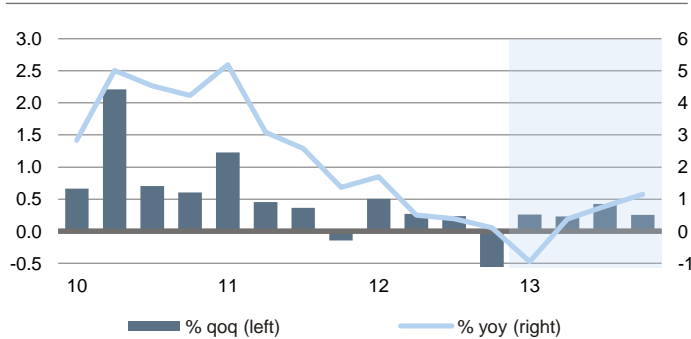
Households live close to their jobs, and jobs are created mainly in the cities which benefit from globalisation most, i.e. the large and medium-sized cities. For this reason the number of inhabitants there should rise further, thus the current demand overhang should persist and the affordability indices should tend to rise even more – apartments will therefore become less affordable. In the smaller cities, however, affordability should change only slightly – as in the last few years.

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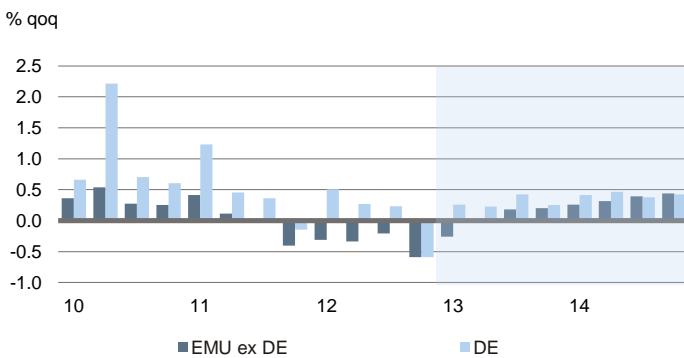
Chartbook: Business cycle (1)

Real GDP growth

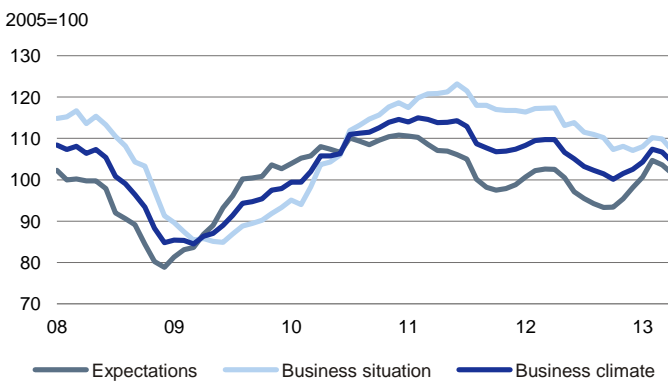


Sources: Federal Statistical Office, DB Research

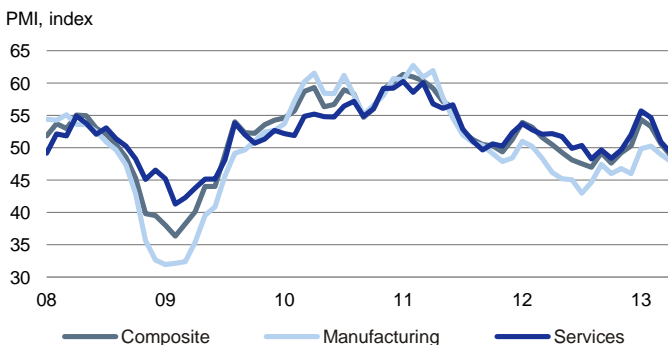
GDP growth: DE vs EMU



Ifo Index - total economy



Purchasing Manager Index



Source: Markit

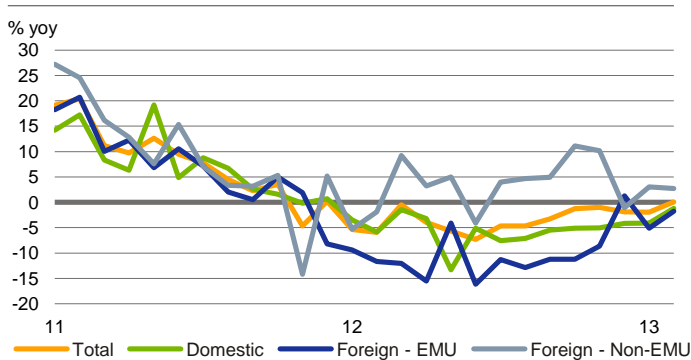
- At +0.7% GDP growth was much lower in 2012 compared to 2011 (+3.0%). We assume that Q4 2012 (-0.6% qoq) marked the trough and expect a small GDP increase in Q1 2013 followed by a gradual acceleration.
- The ifo and PMIs fell noticeable in March/April. The ifo Index, however, remained above its long term average. *At this level it supports our cautions forecast for H1 GDP growth (Q2: +0.2% qoq; Q1: +0.3% qoq).*
- Economic growth of 0.3% in 2013 is likely to be supported by consumption while net exports weigh on growth. Investment in machinery & equipment will remain negative too in 2013.
- Despite weakening GDP growth during 2012 the German economy fared fairly well compared to other EMU countries which experienced stagnation or even recession.
- Considering the remaining adjustment needs in several EMU countries the EMU economy should remain in recession in H1 2013 and set out on a very low growth trajectory thereafter. Despite the recovery in H2 EMU GDP should decline by 0.6% in 2013 – the same rate as last year – while marked downside risks persist.
- After rising markedly for four consecutive times the ifo Index fell in March and April. Expectations as well as current situation fell appreciably. However, the index level remained above its long term average. At its current level it points to moderate growth in Q2.
- The political uncertainty in Italy and Cyprus as well as somewhat dissapointing economic data from the US and China are likely to have played a role.
- The sentiment declined in all surveyed business sectors in April. However, the export expectations in the manufacturing sector regained some of the moderate losses sustained in March.
- European and German Purchasing Manager Indices (PMI) fell in March and April losing most of the gains realized late 2012. They currently stand below the growth/contraction threshold of 50. The German manufacturing PMI remained somewhat above its Q4 levels, while the services index fell slightly below it.
- For Germany the PMIs point to a loss of growth momentum, which is a much more pessimistic picture than conveyed by the ifo Index. In spring 2012 a similar gap appeared between the two indicators. At that time the ifo Index was more accurately forecasting the actual development of GDP growth and industrial production.



Focus Germany

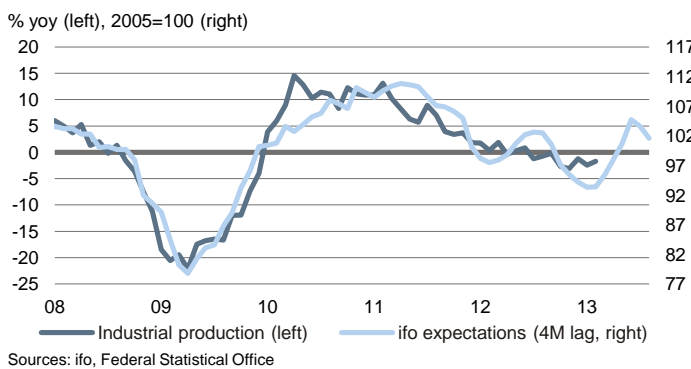
Chartbook: Business cycle (2)

New manufacturing orders



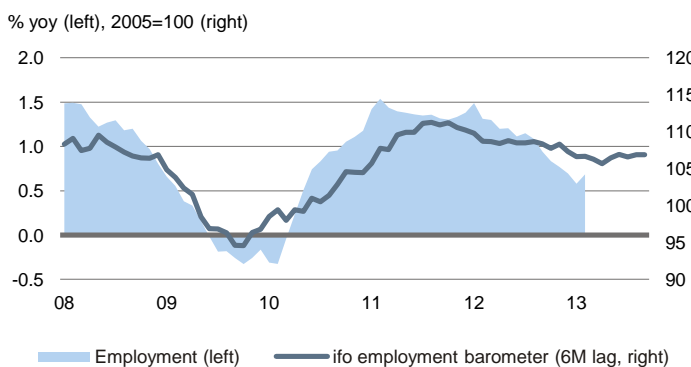
- Growing by 2.3% mom in February new orders made up for the weakness in January (-1.6%). Orders were strongly influenced by orders of airplanes. Even excluding these big-ticket items order were up 1.2% (-2.0% prev.).
- On back of positive demand from abroad (+2.7% yoy) new orders are now unchanged on a year ago.
- Business surveys (ifo, PMI) point to further increases of foreign demand. However, the PMI decline in March suggests that this trend should remain muted.

Industrial production and ifo expectations



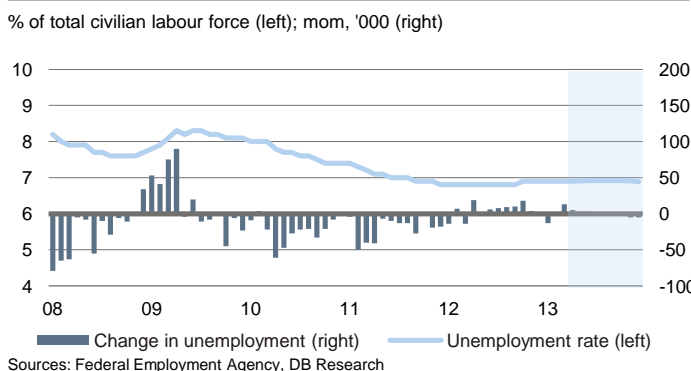
- Industrial production rose by 0.5% in February. However, due to the fall in January output remained 0.3% below its Q4 level, which supports our cautions forecast for Q1 GDP growth (0.1% qoq).
- On back of a marked increase in investment goods production (+2.4%) manufacturing output rose by 0.4%. Construction (-2.7%) and energy production (+3.9%) were strongly influenced by weather effects.
- Despite the monthly increase output was still 1.8% below its previous year's level in Feb. While production should accelerate in the next months according to the ifo the pace is unlikely to be as marked as the chart suggests.

Employment and ifo employment barometer



- The number of employed persons is still 0.7% higher than a year ago in Feb. and with 41.7 m it hovers near a historic high. The level of employees subject to social security payments is up 1.4% yoy.
- Employment growth tapered off in 2012. While employment grew by 1.4% yoy in Jan 2012, there was only an increase of 0.6% in Jan 2013. In Feb the yoy employment growth rate picked up to 0.7%.
- In Q1 employment growth seems to have picked up modestly. In Jan./Feb. it averaged +37k mom. In Q4 that number was 20k.

Unemployment

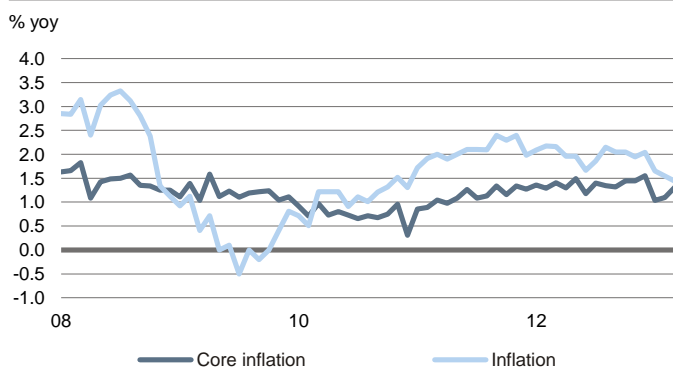


- The labour market had a good start into 2013. The number of unemployed persons remained roughly constant in Q1 2013, after rising in H2 2012 (on average by 8,000 per month). The unemployment stayed unchanged at 6.9% in March.
- Early indicators – ifo, PMI, BA-X – point to a robust labour market in the coming months. Starting in mid-2013 the labour market should improve again.
- The unemployment rate should increase slightly to 6.9% in 2013 after 6.8% in 2012 due to the temporary weakness in the winter half year.



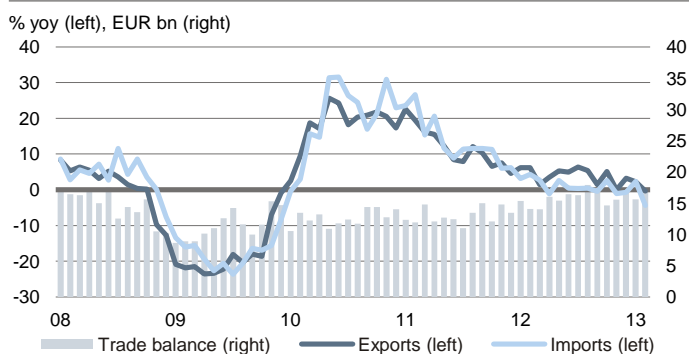
Chartbook: Business cycle (3)

Inflation rate and core inflation rate



- Inflation has slowed appreciably at the start of 2012. After averaging 2.0% in 2012 the inflation rate dropped to 1.4% in March (Jan. 1.7%; Feb. 1.5%).
- Especially the slowdown of energy prices to only +0.5% yoy weighed on headline inflation. It was still 4% at the end of 2012. Core inflation increased to 1.3% from 1.1%. This was due to (temporary) effects from higher prices for package holidays.
- Given the muted oil, import and producer price inflation consumer price inflation should remain subdued over the next months. We expect it to average 1.6% in 2013.

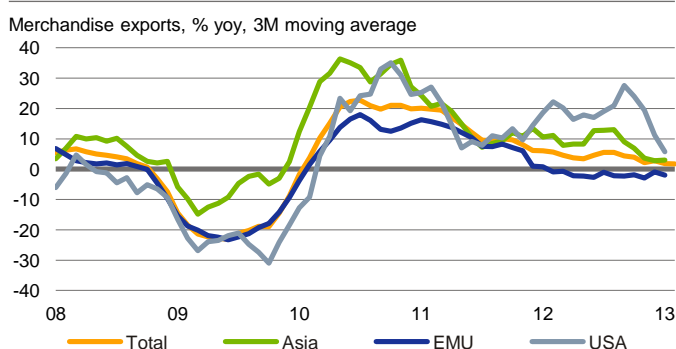
Merchandise trade



Source: Deutsche Bundesbank

- In February the trade balance rose markedly to EUR 17.1 bn after EUR 15.6 bn before. Therefore, net exports could be less of a drag on Q1 GDP growth than we currently expect.
- The higher balance was due to imports (-3.8% mom; +3.3% prev.) falling even more than exports (-1.5%; +1.3% prev.)
- The weakness in imports is likely to be in part due to a drawdown of inventory levels (intermediate as well as finished goods). That is suggested by details from the PMI survey.

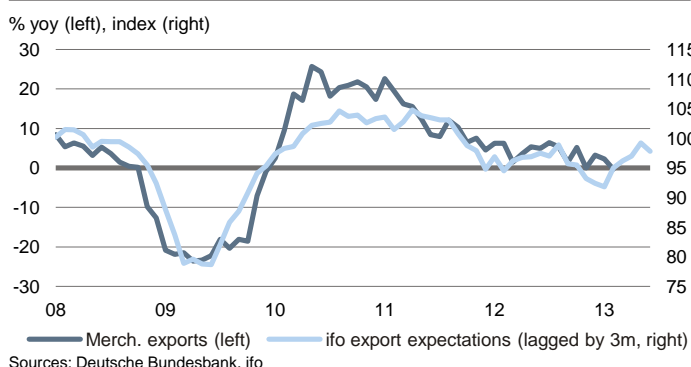
German merchandise exports by destination



Source: Deutsche Bundesbank

- Since the onset of the euro crisis EMU's share in German exports has dropped by almost 10 percentage points to around 38% (Asia 17% and the US 8%).
- In the wake of the euro crisis and the recession in several EMU countries exports to EMU have fallen below their pre-year level, which was a drag on German trade balance surplus with these countries.
- So far, exports to Asia and the US – automobiles in particular – have managed to compensate for the declines in exports to EMU. However, especially US exports have slowed down strongly lately.

Exports & ifo export expectations



Sources: Deutsche Bundesbank, ifo

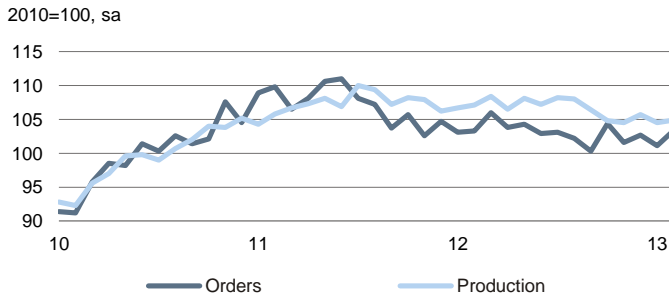
- Exports should remain weak at the start of 2013. Ifo export expectations had recovered from their lows at the end of 2012 and in the first two months of 2013. Although there was a setback in March the expectation level remained slightly above its long-term average.
- Imports should remain comparably stable, by comparison, due to the high level of employment and moderate increases in real income.
- The growth contribution from net exports should remain negative in Q1. In Q4 2012 it removed 0.8 pp from the quarterly growth rate.



Focus Germany

Chartbook: Sectors

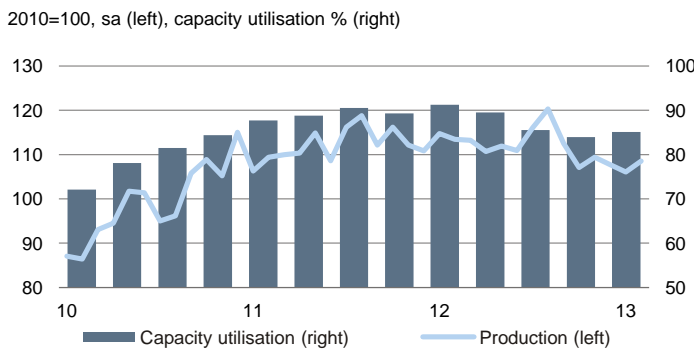
Manufacturing: Output and order intake



Source: Federal Statistical Office

- Industrial production in Germany declined by 1.1% in 2012. Output was well below the average of 2012 especially in Q4 2012. We believe that industrial output is likely to stagnate in 2013.
- Order intake in 2012 was 6% below the level of 2011. Orders from other European countries, in particular, have declined markedly, while orders from outside Europe are still supportive.
- Risks to manufacturing activity stem from a continuing economic downturn in major export markets.

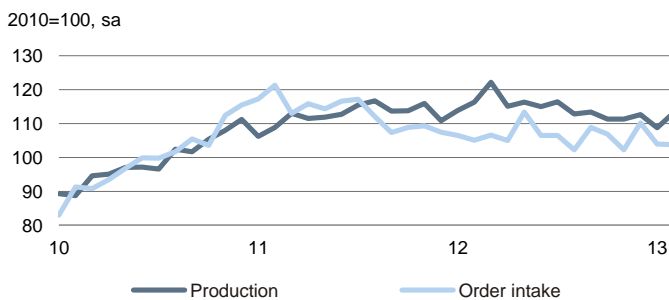
Car industry: Output and capacity utilisation



Sources: Federal Statistical Office, ifo

- In Q4 2012 production level in the automotive industry was well below the average of 2012. Output declined marginally last year.
- Business expectations declined significantly in March and April after having improved for three months in a row. Capacity utilisation in the automotive industry has stabilised in Q1 2013.
- Also on account of the statistical underhang we expect output in the automotive industry to fall by 2% in real terms in 2013.

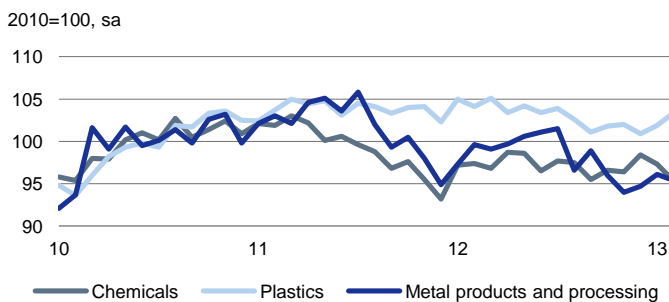
Mechanical engineering: Order intake and output



Source: Federal Statistical Office

- With the decrease of new orders in 2012, production momentum in mechanical engineering has slowed. Still, full-year output rose by 1.4%.
- Order intakes in the mechanical engineering industry have sent mixed signals over the last few months. A gradual stabilisation of the euro area and accelerating growth in Asia could support foreign demand in 2013.
- For 2013 as a whole we expect mechanical engineering output to decline by roughly 1%, with output trending upwards in the course of the year as the sector will start 2013 with an underhang.

Production: Early cycle sectors



Source: Federal Statistical Office

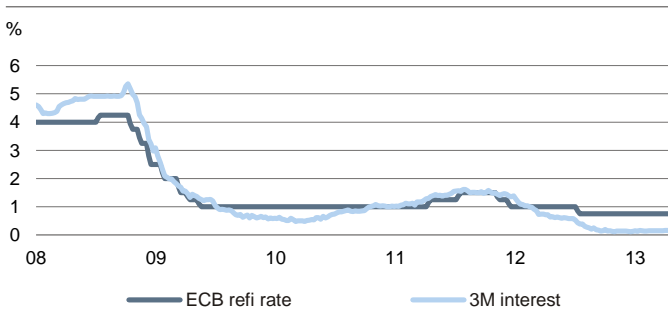
- The early-cycle sectors currently show no strong signs of a major growth rebound in 2013.
- Production in the chemical industry has declined slightly in the last two months. In 2012 as a whole production fell by -2.8%. In 2013 production should increase by 1.5%.
- Plastics production has increased slightly in the beginning of 2013 and business expectations have turned positive of late.
- Output in metal production contracted by 3.6% in 2012, but it could post a marginal increase in 2013.



Focus Germany

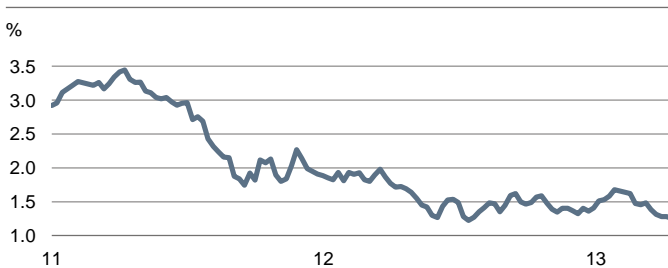
Chartbook: Financial Markets (1)

EMU: Refi rate & 3M Interest



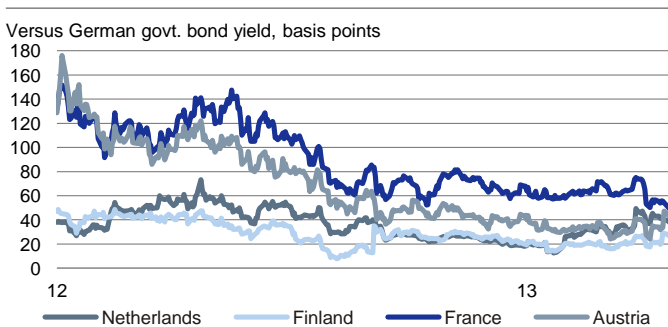
Sources: ECB, Global Insight

German government bonds: 10Y yields



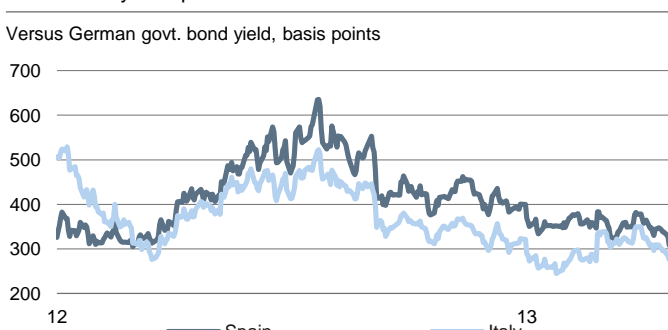
Source: Global Insight

EMU: Bond yield spreads



Source: Global Insight

EMU: Bond yield spreads



Source: Global Insight

- The balance sheet reduction of about EUR 470 bn since its peak (29 June 2012) partly due to LTRO repayments could be seen as a first sign for the beginning of the exit from unconventional policy. *We expect the ECB to cut its refi rate by 25 bp to 0.50% on May, 2 due to the disappointing PMIs in April.*
- The ECB will be ready to start the OMT under strict conditionality and contributed – despite Italy, Cyprus and Portugal – to the reassurance of the markets.
- The costs of secured interbank refinancing are at a record low of around 0.15% p.a. (-60 bp yoy).

- The yields of Bunds increased from 1.32% at the beginning of the year to 1.70% at the end of January.
- Due to uncertainties regarding Italy and Cyprus the yields of Bunds fell again to currently 1.22%.
- Despite real interest rates close to zero many investors favour the “safe haven” of Germany – one of the few countries with an AAA-rating in Europe.

- Intra-EMU bond yield spreads have declined markedly since the announcement by ECB president Draghi that the ECB is ready to do whatever it takes to preserve the euro (26 July) and the clear political commitment – especially by the German government – to hold the Eurozone together.
- In addition, Draghi highlighted the stabilisation of bank deposits in peripheral regions, private capital inflows from abroad, and the reduction of Target2 imbalances as further signs for defragmentation.

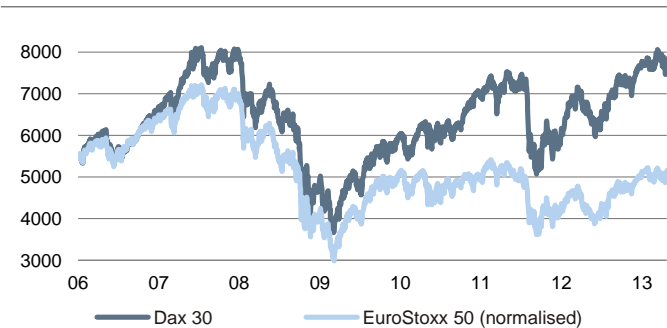
- The yield spreads of Italian and Spanish government bonds were the most sensitive to the prospect of ECB interventions (OMT).
- Since the beginning of September they fell by about 215 bp and around 150 bp for Spain and Italy, respectively.
- At the short end (3Y) – the focus of the OMT – yield spreads almost halved in Spain and in Italy.



Focus Germany

Chartbook: Financial Markets (2)

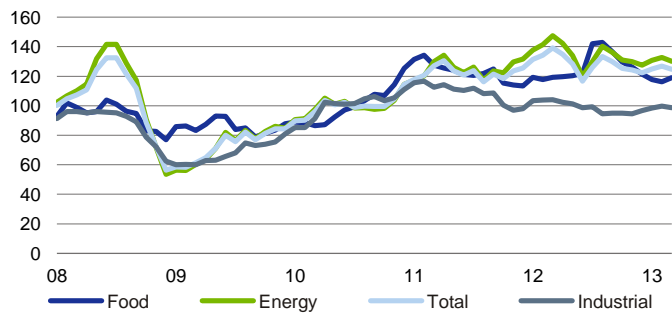
Equity indices



Sources: Global Insight, DB Research

Raw material prices

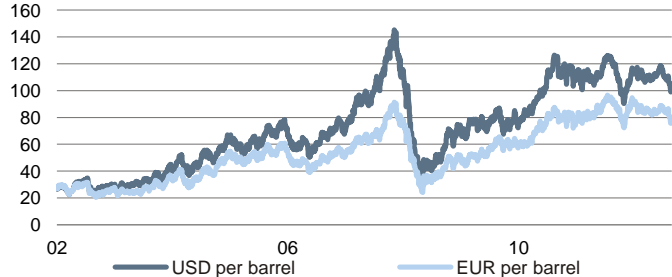
HWWI index, 2010=100, based on EUR



Source: HWWI

Oil price

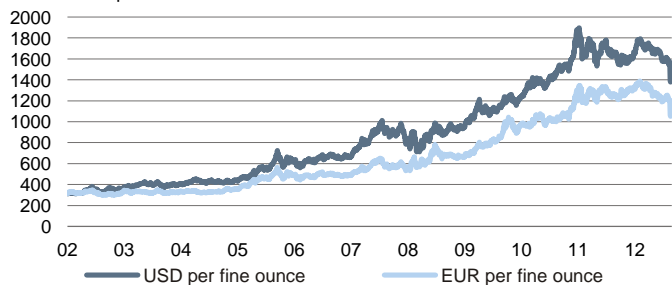
Brent Blend, USD or EUR per barrel



Sources: Global Insight, Reuters, DB Research

Gold price

USD or EUR per fine ounce



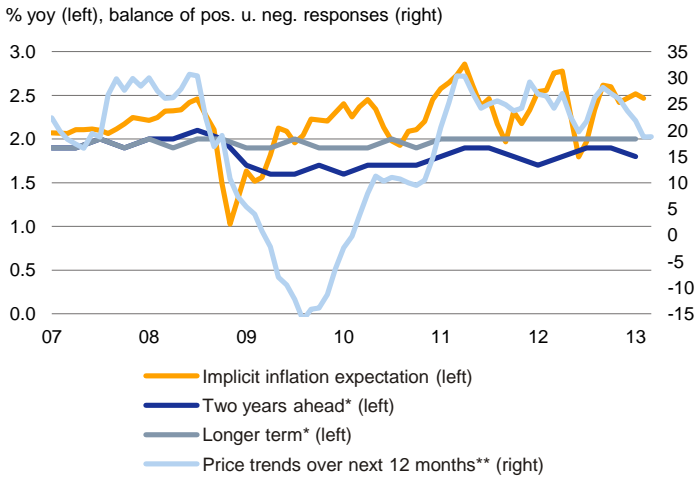
Sources: Global Insight, Reuters, DB Research

- Currently, the DAX stands at around 7,800 points. The DAX is holding up well lately, not least because of a lack of investment alternatives in the German bond market due to partly negative real interest rates. The difference between dividend and bond yields is currently at a high level. Recently, there were ups and downs especially after the election in Italy and the difficult negotiations of the Cyprus rescue package.
- Since the beginning of the debt crisis the DAX has performed considerably better than European equities. Our equity strategists have a 2013 year-end target of 8000 for the DAX and 315 for the Stoxx600.
- Raw material prices – in particular industrial and energy raw material prices – will probably increase modestly due to a stronger growth in China – the largest importer of raw materials – and a sluggish economic recovery in the industrial countries.
- Food prices increased markedly in Q3 2012 due to droughts (in the US and Eastern Europe for example) and fell markedly again, recently. In March prices are 17% below the last year's peak.
- Following a weak winter half year, oil demand should increase in H2 2013 thanks to the recovery of the global economy. Additionally, supply-side factors (e.g. geopolitical risks, Iran) provide some upside risks.
- Overall, oil prices should hover around its actual level. Our commodities analysts expect an oil price of USD 115 per barrel Brent at the end of 2013.
- Currently, the gold price stands at around USD 1,400 per fine ounce or more than 20% below the peak value of 2012 (Oct, 4, 2012).
- *Our commodities analysts cut their gold price forecast from USD 2,000 per fine ounce at the end of the year to USD 1,700 per fine ounce. Thus, the gold price is expected to increase yoy by the slowest pace since 2001.*
- The subdued development is being triggered by a rise in US real interest rates, a declining equity risk premium and increasing signs that a long term uptrend in the USD is underway.



Chartbook: Financial Markets (3)

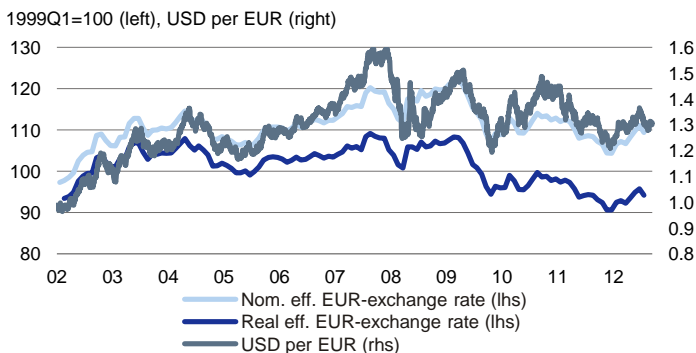
Inflation expectations Eurozone



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

Sources: ECB, EU Commission, Bloomberg

Exchange rate development for the EUR



Sources: ECB, Reuters

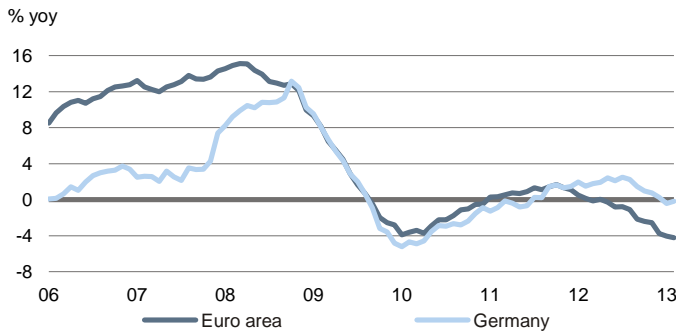
- Contrary to lingering inflation concerns in the general public the private forecasters of the ECB survey expect no increase of the EMU inflation rate. Recently, the expectation for the inflation rate in 2 years fell slightly to 1.8% and remained stable at 2.0% for the inflation rate in 5 years.
- The 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 is 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.
- Since the lowest level of 2012 the EUR appreciated against the USD by 13% to EUR/USD 1.37 at the beginning of February. This comes as a result of a markedly lower tail risk of an EMU break-up which reduced the capital flight from EMU, improvement of the EMU current account balance, more expansive monetary policy of the Fed relative to the ECB and the uncertainty in the USA about the solution to reduce the fiscal deficits.
- Due to uncertainties regarding Italy and Cyprus and relatively weak EMU economic data the EUR depreciated by 4% and stands currently at EUR/USD 1.30.
- Our FX strategists expect a EUR/USD exchange rate of 1.26 in 3 months.
- The USD should strengthen in H2 2013 due to the higher growth rate of the US economy of around 3%. According to our FX strategists the USD will probably appreciate to EUR/USD 1.23 in 6 month. They see the current strength of the USD as the beginning of a multiyear uptrend.



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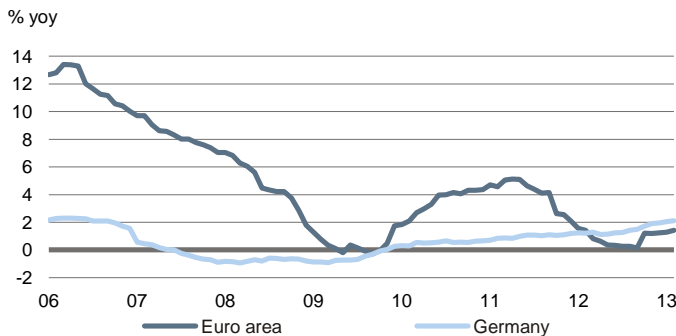
Chartbook: Financial Markets (4)

Loans to companies



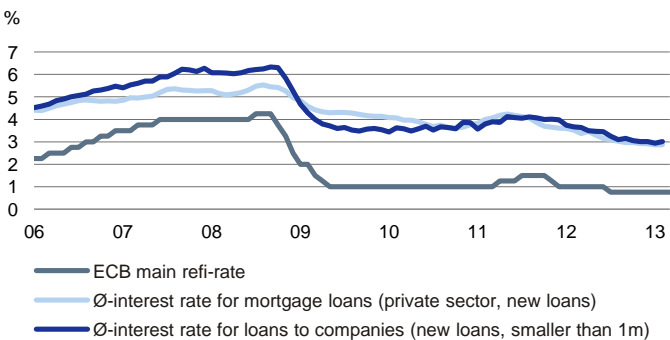
Sources: ECB, DB Research

Mortgage volumes



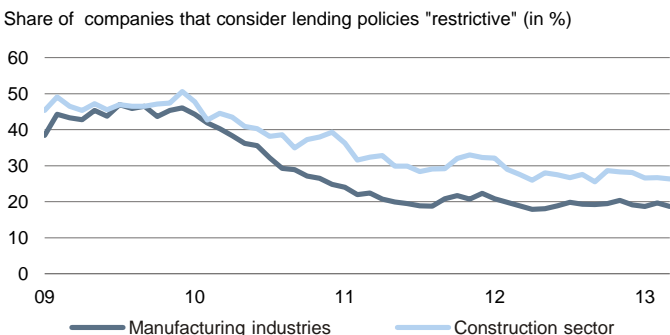
Sources: ECB, DB Research

Interest rates



Sources: ECB, Bundesbank

Lending standards



Source: ifo

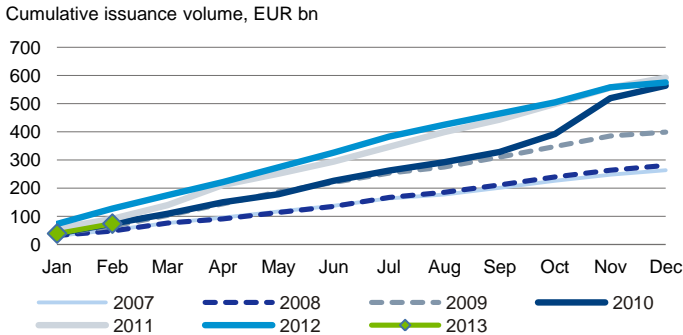
- Restrained growth in lending to German corporates during the first months of 2013: Feb -0.2% (yoy).
- While Germany's growth remains above the euro area average, the slowdown in investment activity clearly takes its toll on lending volumes. In addition, borrowings are partly substituted by corporate bond issuance.
- Contraction of corporate lending in the euro area continues unabatedly (-4.2% yoy in Feb) – mainly reflecting the bleak macroeconomic situation and ongoing deleveraging process in countries strongly affected by the crisis.
- The second half of 2012 saw a slight increase in mortgage lending growth in Germany which is continuing in 2013: mortgage growth at 2.1% yoy in February reached almost pre-crisis period.
- Low interest rate levels and a partly buoyant housing market have so far had a limited effect on credit demand in Germany as real estate purchases are in part financed through a reallocation of existing capital.
- Still, German mortgage growth is above the euro area average (1.4% yoy in Feb).
- The generally low interest rate environment has allowed banks to refinance themselves at relatively low cost, which they partly pass on to clients.
- Interest rates for mortgages and loans to corporates remained at historic low: 2.9% for mortgage loans in February and 3% for loans to companies.
- Corporates on average saw no problem with credit supply.
- Slight decrease in the share of corporates that consider lending policies "restrictive" in March. For manufacturing industries -1 ppt and construction sector -0.4 ppt compared to previous month.
- In historical comparison, rather accommodating lending standards for the construction sector as well as for the manufacturing industries.



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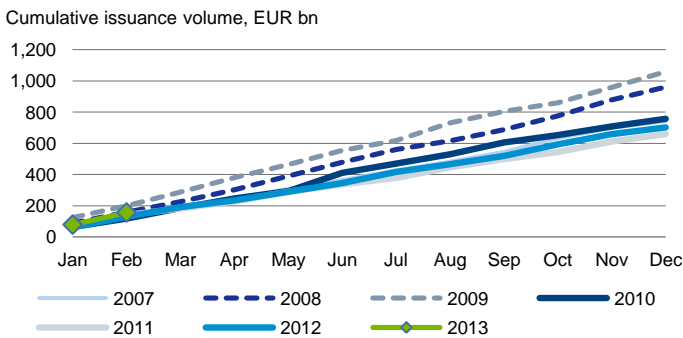
Chartbook: Financial Markets (5)

Issuance of public debt securities



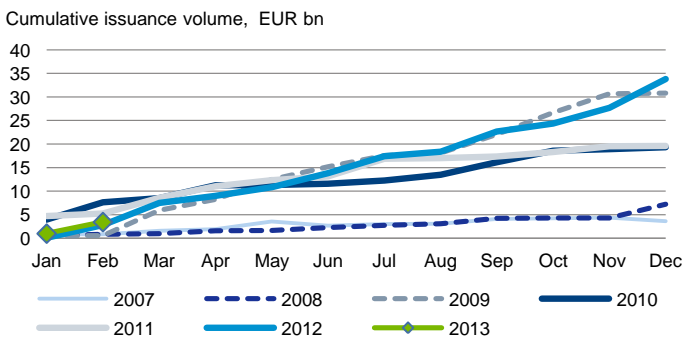
Sources: Bundesbank, DB Research

Bank debt issuance



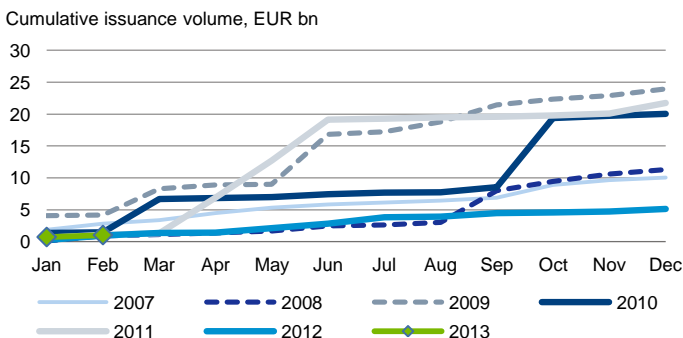
Sources: Bundesbank, DB Research

Non-bank corporate debt issuance



Sources: Bundesbank, DB Research

Equity issuance



Sources: Bundesbank, DB Research

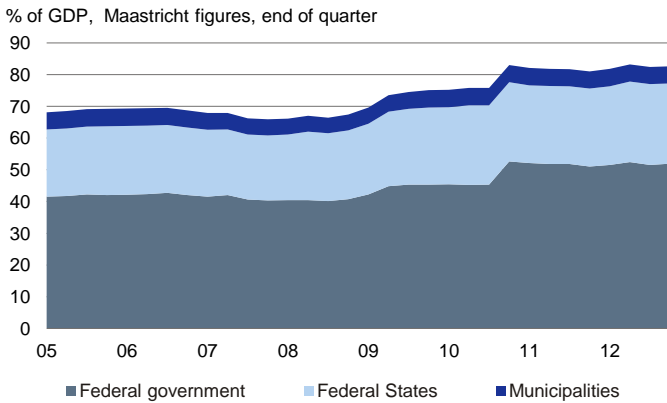
- As in the previous month, rather weak issuance activity by the German public sector compared to previous year. Germany's Länder and the federal government issued EUR 35 bn in February 2013.
- A favourable cash flow situation and this year's relatively small planned budget deficit have dampened financial demand of the German public sector so far.
- EMU-wide regulation came into force in January this year. Bonds issued by the German federal government with a maturity of one year or more are now subject to collective action clauses (CAC).
- Issuance of bank debt securities continued to grow slightly above long-term averages, with a gross issuance of EUR 78 bn in February 2013.
- Bank refinancing conditions in the euro area generally improved during the past few months.
- Over several years, issuance volume of German covered bonds (Pfandbriefe) and traditional bank bonds declined in relative terms; overall volume growth was driven almost entirely by issuance of public sector promotional banks.
- In February, corporate bond issuance picked-up slightly (EUR 24 bn). Still, corporate demand for debt financing remains rather subdued compared to the previous year.
- However, continuously positive environment for corporate bond issuance: low interest rate levels, low risk premia and a search for yield by investors.
- The market for corporate bonds still grows faster than that for corporate lending.
- Issuance activity still below long-term averages, despite the quite buoyant development of German equity market (Feb EUR 0.3 bn after EUR 0.7 in Jan).
- Corporates prefer using internal funds to raise capital or have a generally low demand for equity capital.



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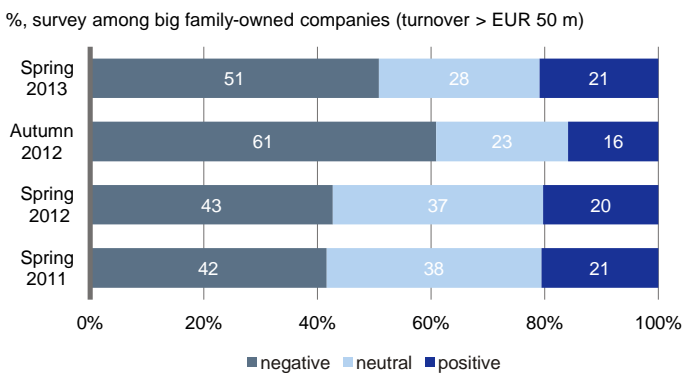
Chartbook: Economic policy

General government debt



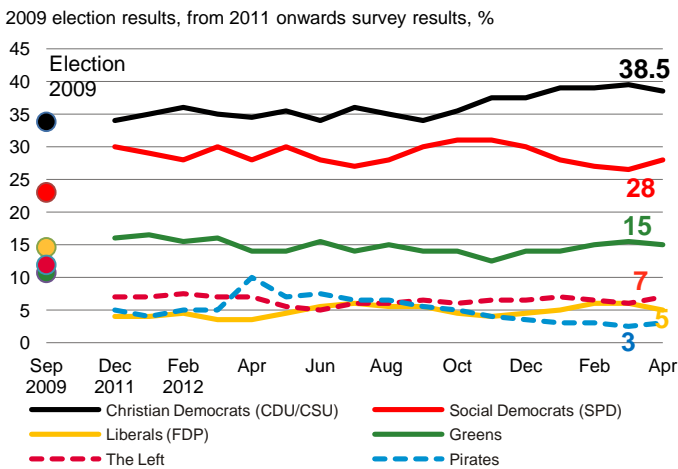
Sources: Deutsche Bundesbank, DB Research

Impact of the euro crisis on corporate activity 2011-2013



Sources: IfM Bonn, DB Research

Deutscher Bundestag, if elections were held tomorrow



Source: IFD Allensbach

- By the end of 2012, Germany's overall debt-to-GDP-ratio had risen to 81.9% of GDP. This is slightly below the highest level to date (82.4% in 2010). Despite a small general government budget surplus of EUR 4 bn German debt increased by 1.5 pp of GDP or EUR 81 bn compared to 2011.
- EUR 45 bn of the increase stems from support measures in the framework of the sovereign debt crisis (ESM: EUR 9 bn, EFSF: 36 bn). They are not relevant for the Maastricht deficit but count towards overall debt. The rest is due to increasing debt of the federal government and some Länder and municipalities. In 2012 debt-relevant effects of measures for financial institutions (bad banks) were roughly neutral in sum. Since 2008 the cumulative effect of all stabilisation measures (financial institutions and sovereigns) amounts to 13.5% of GDP (EUR 350 bn).
- The euro crisis has a significant negative influence on the activities of big family-owned companies in Germany. Main drivers are uncertainties surrounding investment decisions and problems concerning sales of goods and services in euro crisis countries.
- The climax to date was in summer/autumn of last year – just before the European Central Bank confirmed its willingness to intervene in the financial markets.
- As market conditions improved at the beginning of 2013 the share of companies which see a negative impact due to the euro crisis has declined recently. However, more than 50% of the companies say the euro crisis is adversely affecting their business.
- Most recently the SPD was able to regain lost ground. But the range of poll results is particularly wide for the SPD. While the CDU results hover around the level of 40%, the SPD is fluctuating in a range of 22% to 28%. In most polling institutes' surveys the ruling coalition parties, CDU and FDP, are slightly ahead of the SPD and the Greens.
- The eurosceptic party Alternative für Deutschland (AfD) was founded only recently. Hence only a few polling institutes have included the AfD in their regular surveys. First results show that the AfD was able to score 3% – a remarkable result at this early stage. This is the first time that protest against current European policies has been channelled into a new party in Germany. Moreover first polls show that the AfD may gain votes from all of the established parties in Germany as well as from non-voters. Therefore, the AfD may have a substantial impact on the result of the federal election in autumn this year.



Focus Germany

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

Date	Event	Remarks
2 May	Meeting of the ECB Council in Bratislava	We now expect that the refi rate will be cut by 25 bp.
3 May	European Commission	GDP spring 2013 forecast.
4/5 May	FDP extra ordinary party convention	Presentation of the election manifesto.
6-8 May	Spring meeting of the Working Group on Tax Revenue Forecasting	We expect a slight reduction of the revenue forecast for 2013 (so far +3%) and 2014/15.
10/11 May	Meeting of G7 Finance Ministers and Central Bank Governors in Buckinghamshire/London	Debate on the ongoing crisis and international economic challenges.
13/14 May	ECOFIN and Eurogroup in Brussels	Economic situation as well as financial and macroeconomic stability developments in the euro area, the Commission's spring forecasts, macro-imbances procedures - in depth reviews of euro area countries.
22/23 May	European Council - EU leaders' summit.	Informal Summit.
End of May	Meeting of the German Stability Council	Tasks of the Council: coordination of public budgets; domestic implementation of the National Stability Pact; monitoring and analysis of the Länder finances.
6 June	Meeting of the ECB Council, press conference	Review of the monetary policy stance.
11/12 June	Hearing at the German Constitutional Court on the constitutional complaints against the ECB's secondary market programmes and Germany's participation in ESM.	The judgment will be held later in summer. It will most likely be in line with the constructive approach of former judgments that provided that (1) the Court will not comment on the ECB's monetary policy and (2) any major decision taken by intergovernmental mechanisms such as EFSF and ESM needs to be legitimized by the German legislative.
17/18 June	G8 leader summit in the UK (Northern Ireland)	The UK G8 will focus on global economic growth, on open economies, open governments and open societies to support free trade, and on measures to tackle tax evasion.
20/21 June	ECOFIN and Eurogroup in Luxembourg	Agenda is likely to include: tenth review of Irish adjustment programme; eighth review of Portuguese adjustment programme; third review of Spanish financial sector programme; third review of Greek adjustment programme; (poss.) euro area enlargement.
27/28 June	European Council - EU leaders' summit in Brussels	Country-Specific recommendations on economic policy.
4 July	Meeting of the ECB Council, press conference	Review of the monetary policy stance.
19/20 July	Meeting of the G20 Finance Ministers and Central Bank Governors in Moscow	

Source: DB Research

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Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
7 May 2013	12:00	New orders manufacturing (Index, sa), pch mom	March	0.5	2.3
8 May 2013	12:00	Industrial production (Index, sa), pch mom	March	0.0	0.5
10 May 2013	8:00	Trade balance (EUR bn, sa)	March	16.4	17.2
10 May 2013	8:00	Merchandise exports (EUR bn, sa), pch mom (yoy)	March	2.7 (2.0)	-1.5 (-0.4)
10 May 2013	8:00	Merchandise imports (EUR bn, sa), pch mom (yoy)	March	4.3 (-0.8)	-3.9 (-4.4)
15 May 2013	8:00	Real GDP (Index, sa), % qoq	Q1 2013	0.3	-0.6
23 May 2013	9:30	Manufacturing PMI (Flash)	May	47.3	47.9
23 May 2013	9:30	Services PMI (Flash)	May	49.5	49.2
24 May 2013	10:30	ifo business climate (Index, sa)	May	103.5	104.4
31 May 2013	8:00	Import prices (Index, sa) pch mom (yoy)	April	-0.4 (-2.2)	-0.1 (-2.3)

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	0.13	0.10	0.75	0.50	0.00	1.00	0.30	1.50	3.25	4.75	0.05
Jun 13	0.13	0.10	0.50	0.50	0.00	1.00	0.30	1.50	3.25	4.25	0.05
Sep 13	0.13	0.10	0.25	0.50	0.00	1.00	0.40	1.50	3.25	3.50	0.05
Mar 14	0.13	0.10	0.25	0.50	0.00	1.25	0.50	1.75	3.25	3.50	0.05

3M interest rates, %

Current	0.28	0.23	0.21	0.50
Jun 13	0.35	0.30	0.25	0.51
Sep 13	0.35	0.30	0.25	0.52
Mar 14	0.35	0.30	0.30	0.60

10Y government bonds yields

	Yields, %				Spreads vs. EMU, pp			
Current	1.68	0.59	1.21	1.72	-0.61	0.32	0.14	0.85
Jun 13	2.00	0.70	1.40	2.25	-0.70	0.25	0.25	0.65
Sep 13	2.50	0.80	1.55	2.45	-0.65	0.20	0.30	0.70
Mar 14	3.00	0.90	1.85	2.90	-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	1.30	99.54	0.85	1.54	1.23	8.63	7.46	7.65	4.16	301.24	25.90
Jun 13	1.26	103.00	0.87	1.61	1.25	8.20	7.46	7.30	4.06	288.00	25.20
Sep 13	1.23	106.00	0.86	1.56	1.25	8.00	7.46	7.20	3.96	280.00	25.20
Mar 14	1.20	110.00	0.85	1.49	1.25	7.80	7.46	7.10	3.80	280.00	25.03

Sources: Bloomberg, Deutsche Bank

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German Data Monitor

	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Nov 2012	Dec 2012	Jan 2013	Feb 2013	Mar 2013	Apr 2013
Business surveys and output											
Aggregate											
Ifo business climate	109.2	107.1	102.3	101.4	106.1	101.5	102.5	104.3	107.4	106.7	104.4
Ifo business expectations	101.8	100.0	94.3	95.6	103.0	95.4	98.1	100.7	104.7	103.6	101.6
PMI composite	52.9	49.3	47.9	49.1	52.8	49.2	50.3	54.4	53.3	50.6	48.8
Industry											
Ifo manufacturing	104.3	102.5	96.4	95.1	101.1	94.6	96.3	99.1	102.3	101.9	99.3
PMI manufacturing	49.9	45.5	45.0	46.3	49.7	46.8	46.0	49.8	50.3	49.0	47.9
Headline IP (% pop)	0.1	0.0	0.2	-2.6		-0.4	0.2	-0.6	0.5		
Orders (% pop)	-0.2	-0.4	-1.7	1.0		-2.7	1.1	-1.6	2.3		
Capacity Utilisation	85.1	84.9	83.7	82.1	83.2						
Construction											
Output (% pop)	-2.9	2.6	0.5	-2.3		1.1	-6.5	-0.5	-0.5		
Orders (% pop)	8.6	-5.2	-1.3	2.1		-20.2	0.8	9.5	4.4		
Ifo construction	123.0	119.9	118.0	117.6	125.6	118.3	118.8	122.7	127.0	127.2	124.5
Services											
PMI services	52.9	51.3	49.4	50.0	53.8	49.7	52.0	55.7	54.7	50.9	49.2
Consumer demand											
EC consumer survey	-0.3	-1.1	-7.9	-10.0	-6.5	-10.2	-10.4	-7.6	-6.4	-5.4	
Retail sales (% pop)	-0.9	1.0	-0.9	-0.5	1.7	1.0	-2.0	2.9	-0.3		
New car reg. (% yoy)	1.3	0.2	-7.0	-6.2	-10.5	-3.5	-16.4	0.0	-10.5	-17.1	
Foreign sector											
Foreign orders (% pop)	0.1	0.1	-1.0	2.2		-4.7	1.6	-2.7	2.3		
Exports (% pop)	2.1	1.5	1.3	-2.0		-2.2	0.2	1.3	-1.5		
Imports (% pop)	1.1	-0.2	0.2	-0.8		-3.8	-1.5	3.3	-3.9		
Net trade (sa EUR bn)	43.5	47.9	50.8	47.1		15.6	16.9	15.6	17.2		
Labour market											
Unemployment rate (%)	6.8	6.8	6.8	6.9	6.9	6.9	6.9	6.9	6.9	6.9	
Change in unemployment (k)	-32.3	14.7	21.7	30.3	-7.3	4.0	0.0	-13.0	0.0	13.0	
Employment (% yoy)	1.4	1.2	1.1	0.8		0.8	0.7	0.6	0.7		
Ifo employment barometer	108.5	107.8	106.5	106.3	106.8	106.5	106.9	106.6	106.9	106.9	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	2.4	2.1	2.1	2.0	1.8	1.9	2.0	1.9	1.8	1.8	
Core HICP (% yoy)	1.3	1.4	1.2	1.3	1.4	1.2	1.5	1.1	1.3	1.8	
Harmonised PPI (% yoy)	3.3	2.0	1.4	1.5	1.1	1.4	1.5	1.7	1.2	0.4	
Commodities, ex. Energy (% yoy)	-9.6	-7.8	-4.5	0.7	-3.5	1.5	1.1	-3.7	-3.2	-3.7	
Oil price (USD)	118.4	108.2	109.7	110.1	112.6	109.2	109.4	113.1	116.3	108.4	
Inflation expectations											
EC household survey	28.3	25.0	27.0	31.2	26.6	31.2	31.2	27.6	26.5	25.6	
EC industrial survey	10.0	6.4	0.8	2.9	3.7	2.1	4.6	5.4	3.2	2.5	
Unit labour cost (% yoy)											
Unit labour cost	2.1	2.9	3.3	3.0							
Compensation	2.3	2.4	2.5	2.7							
Hourly labour costs	1.8	3.2	3.5	4.0							
Money (% yoy)											
M3	6.9	7.0	6.8	6.0		8.2	6.0	6.1	5.8		
M3 trend (3m cma)						7.8	6.8	6.0			
Credit - private	2.1	0.7	0.6	-0.4		-0.6	-0.4	-0.3	-0.2		
Credit - public	13.5	22.0	10.4	13.5		4.3	13.5	-5.4	-13.0		

% pop = % change this period over previous period.

Sources: Deutsche Bundesbank, European Commission, Eurostat, Federal Employment Agency, German Federal Statistical Office, HWWI, ifo, Markit



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