



Talking point

□ Increase in capacity utilisation drives up producer prices

August 19, 2010

Germany's manufacturing industry was heavily burdened by the recession. The capacity utilisation rate declined by 17 pp within two years, the largest drop since this data has been collected. However, it recovered just as rapidly: within one year the capacity utilisation rate rose by 11 pp, an extraordinary development as well. As a result, producer prices will also rise considerably, at least temporarily.

The German economy has recovered considerably following the sharp decline in the past year. Both foreign and domestic orders in the manufacturing industry have grown by more than 20% within one year – albeit from a very low level. Production has been boosted and companies' capacity utilisation increased.

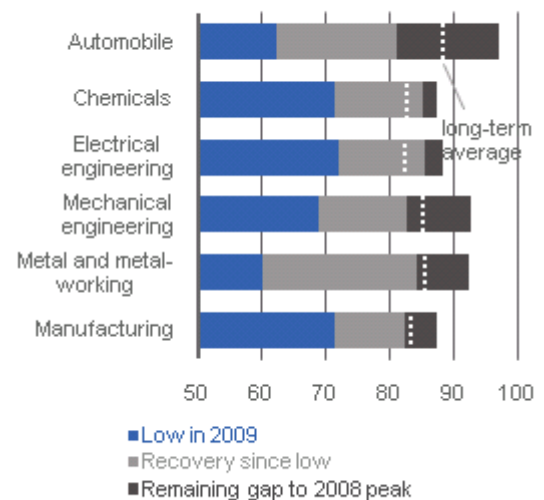
As recently as the second quarter of 2009, the capacity utilisation of German industry was down to merely 71%. This was the lowest level the Ifo Institute has ever recorded since it started collecting this data over 40 years ago. However, ever since this low the situation has been getting brighter: within four quarters industrial firms were able to increase their capacity utilisation by 11 pp. At 82%, the figure has now almost reached its long-term average. The chemicals and electrical engineering industries have even recorded a rate of 2 to 3 pp over the long-term average level.

This shows that the slump as well as the recovery in the manufacturing industry were very pronounced – much more pronounced than in earlier downswings. In the course of the dotcom crisis, for example, the capacity utilisation rate shrank by “only” 5 pp within three years, and it took three more years to compensate this decline. After the comparatively major recession in 1992/1993 it took two years for the rate to increase by 7 pp. Compared with this, the development of the past twelve months is unprecedented.

The huge increase in capacity utilisation is also likely to have an impact on the development of producer prices in the manufacturing industry. There is a close statistical correlation between the development of capacity utilisation and the producer price inflation. Growing demand results in better utilisation of capacity and prices adapt to a new equilibrium. The change in capacity utilisation, and not the absolute level, is decisive for the price boost. Empirically, producer price inflation follows the change in capacity utilisation in the manufacturing industry with a time lag of two quarters. This means that prices continue to decrease slightly when capacity is already increasing again. In addition, they keep rising slightly after the zenith of an upswing is reached. Technically, the change in the inflation rate is tightly linked with the change in capacity utilisation.

Increasing capacity utilisation

Capacity utilisation in Germany, %



Sources: Federal Statistical Office, DB Research

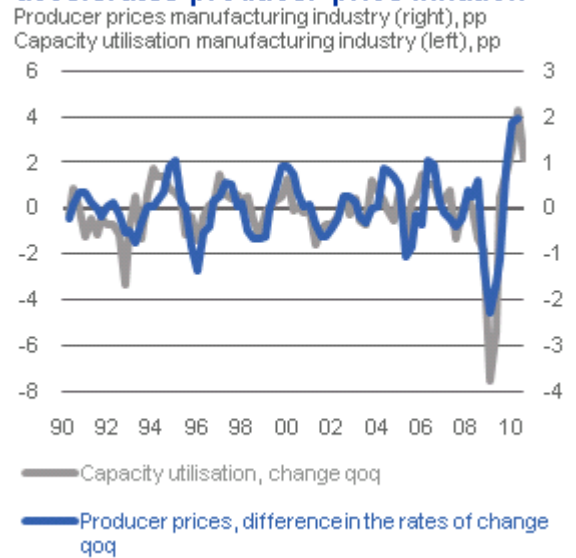


At the level of individual industries, however, the correlation between capacity development and producer prices varies substantially. On the one hand the correlation can be isolated quite easily for chemicals, metals and metal-working, and mechanical engineering, with slight differences in the time lag. On the other hand it is not so easy for the automobile industry and electrical engineering. For electrical engineering it is likely due to the very heterogeneous structure of the sector. Power engineering, semiconductors and domestic appliances do not follow a uniform cycle, neither in demand volume nor in price development. For the automobile industry, however, pricing at the end-user level is probably more important than producer prices at the intermediate stage.

This statistically confirmed correlation suggests that producer prices in the manufacturing industry can be expected to increase further at least in the next quarter. Producer prices are likely to rise temporarily by up to 3% yoy in the next one or two quarters. On the industry level we expect the strongest (transitory) price increase in mechanical engineering as well as in metals and metal-working. Since the growth of the capacity utilisation rate is already slowing down, the acceleration effect for prices is decreasing as well.

It has to be taken into account that demand deferred during the recession also has its share in the strong increase in capacity utilisation. By definition this catch-up effect is limited. In addition, many public funding programmes are coming to an end in the upcoming quarters and in important customer markets economic growth is losing momentum. According to our estimates, these cushioning effects will not endanger the overall upward trend of the manufacturing industry. However, in the next few quarters growth of manufacturing output is expected to be noticeably lower. In addition, this path may be linked with occasional setbacks. Therefore, the manufacturing industry is not expected to see a lasting elevated increase in producer prices. In 2011, producer price inflation will probably decelerate significantly to below 2%.

Increasing capacity utilisation accelerates producer price inflation



Sources: ifo Institute, Destatis, DB Research

Philipp Ehmer (+49) 69 910-31879

Tobias Just (+49) 69 910-31876

[...more information on Sector Research](#)

[Talking Point - Archive](#)

© Copyright 2009. Deutsche Bank AG, DB Research, D-60262 Frankfurt am Main, Germany. All rights reserved. When quoting please cite "Deutsche Bank Research".

The above information does not constitute the provision of investment, legal or tax advice. Any views expressed reflect the current views of the author, which do not necessarily correspond to the opinions of Deutsche Bank AG or its affiliates. Opinions expressed may change without notice. Opinions expressed may differ from views set out in other documents, including research, published by Deutsche Bank. The above information is provided for informational purposes only and without any obligation, whether contractual or otherwise. No warranty or representation is made as to the correctness, completeness and accuracy of the information given or the assessments made.

In Germany this information is approved and/or communicated by Deutsche Bank AG Frankfurt, authorised by Bundesanstalt für Finanzdienstleistungsaufsicht. In the United Kingdom this information is approved and/or communicated by Deutsche Bank AG London, a member of the London Stock Exchange regulated by the Financial Services Authority for the conduct of investment business in the UK. This information is distributed in Hong Kong by Deutsche Bank AG, Hong Kong Branch, in Korea by Deutsche Securities Korea Co. and in Singapore by Deutsche Bank AG, Singapore Branch. In Japan this information is approved and/or distributed by Deutsche Securities Limited, Tokyo Branch. In Australia, retail clients should obtain a copy of a Product Disclosure Statement (PDS) relating to any financial product referred to in this report and consider the PDS before making any decision about whether to acquire the product.