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Current Issues
Business cycle

Focus Germany

Weaker recovery in H2

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Content Page

German business cycle losing its shine. Economic growth probably suffered a worse setback in Q2 than initially presumed. We only expect stagnation now, but would no longer rule out a minimal decline. All in all, global economic conditions do not point to dynamic growth in H2. In particular, the tougher sanctions on Russia and the risk of further escalation of the conflict are set to weigh on business sentiment and investment activity in spite of Russia's low share in German exports. The debate triggered by ECB and Bundesbank comments about higher wage increases in Germany is likely to have a similar impact, even though the substance of the statements is less spectacular, on closer inspection, than the media hype. As uncertainties abound we have decided to refrain for now from making a downward revision to our full-year forecast of 1.8% GDP growth.

DB German Macro Surprise Index: latest economic data largely disappoint. The DB German Macro Surprise Index is calculated by comparing the published economic data with market expectations. The index provides information on future forecast adjustments and has, on average, a 3-month lead over adjustments to the German GDP Consensus Economics forecast figures. The DB German Macro Surprise Index has been in negative territory since mid-May. This disappointment is partly related to one-off effects, but downside risks for German GDP forecasts should nonetheless be considered. Based on historical correlation, the average German GDP estimates for 2014 should fall by 0.3%-point in the next 3 months, from their current level of 2% (July – Consensus Economics), which would be slightly below our current GDP projection of 1.8%.

Revision of 2014 national accounts: Expect roughly 3% higher GDP. A “major” revision of the national accounts will be carried out in September. Three changes will be particularly important in quantitative terms: the more precise definition of sectors, especially of the government sector, as well as the classification of military expenditure and expenditure on research and development as capital formation. Overall, the revision could mean that the level of GDP could be boosted by approximately 3%. However, growth revisions will likely be limited as these are mostly level effects. A positive side-effect of the revision: per-capita GDP will rise by more than EUR 1,000 and the investment ratio by over 2 percentage points of GDP, while Germany's government debt ratio will fall by 2.5 percentage points.

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F	2013	2014F	2015F
Euroland	-0.4	1.1	1.5	1.4	0.7	1.2	2.4	2.4	2.3	-3.1	-2.5	-2.1
Germany	0.4	1.8	2.0	1.5	1.1	1.6	7.0	7.1	6.8	0.0	0.2	0.1
France	0.4	0.7	1.3	1.0	0.9	1.0	-1.3	-1.1	-1.1	-4.3	-3.9	-3.6
Italy	-1.9	0.3	1.3	1.3	0.5	1.1	1.0	1.6	2.0	-3.0	-2.9	-2.5
Spain	-1.2	1.0	1.8	1.5	0.2	1.0	0.8	0.5	0.5	-7.1	-5.7	-4.9
Netherlands	-0.8	0.3	1.7	2.6	0.5	1.1	10.4	11.1	10.9	-2.5	-2.9	-2.2
Belgium	0.2	1.4	1.5	1.2	0.8	1.3	-1.6	-1.0	-0.5	-2.6	-2.5	-2.4
Austria	0.3	1.4	1.8	2.1	1.6	1.6	2.7	3.4	3.6	-1.5	-2.7	-1.4
Finland	-1.3	-0.4	0.8	2.2	1.2	1.3	-1.1	-0.8	-0.5	-2.1	-2.5	-1.8
Greece	-3.9	0.5	2.2	-0.9	-1.0	0.2	0.8	1.0	1.5	-12.7	-1.5	-0.2
Portugal	-1.4	0.9	1.5	0.4	0.0	0.9	0.6	1.0	1.0	-4.9	-4.1	-3.0
Ireland	0.2	1.8	2.3	0.5	0.4	1.1	6.6	6.5	7.0	-7.2	-4.7	-2.6
UK	1.7	3.1	2.5	2.6	1.6	1.8	-4.4	-3.7	-3.0	-5.8	-4.6	-3.4
Denmark	0.4	1.4	1.8	0.8	0.8	1.8	7.2	6.5	6.5	0.0	-1.5	-2.5
Norway	2.0	2.1	2.4	2.1	1.8	2.2	11.1	11.5	11.0	7.6	9.5	9.0
Sweden	1.6	2.4	2.8	0.0	0.1	1.6	6.5	6.3	6.0	-3.6	-1.5	-1.0
Switzerland	2.0	1.8	2.0	-0.2	0.0	0.4	16.0	12.5	12.0	0.2	0.0	0.2
Czech Republic	-0.9	2.3	2.6	1.4	0.6	1.8	-1.4	-1.5	-1.4	-1.4	-2.6	-2.5
Hungary	1.1	2.7	2.5	1.7	0.2	2.6	-0.8	1.8	1.8	-2.4	-2.9	-2.7
Poland	1.6	3.3	3.7	0.9	0.4	1.5	-1.3	-1.8	-2.0	-4.4	4.3	-3.1
United States	2.2	1.9	3.5	1.5	2.0	2.3	-2.4	-2.7	-2.8	-4.0	-2.8	-2.5
Japan	1.5	1.2	1.5	0.4	2.7	1.7	0.7	0.5	1.8	-9.1	-6.8	-5.7
World	3.0	3.3	4.1	3.3	3.5	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

						2013				2014			
	2011	2012	2013	2014F	2015F	Q1	Q2	Q3	Q4	Q1	Q2F	Q3F	Q4F
Real GDP	3.3	0.7	0.4	1.8	2.0	0.0	0.7	0.3	0.4	0.8	0.0	0.5	0.4
Private consumption	2.3	0.8	0.9	1.3	1.6	0.3	0.7	0.3	-0.3	0.7	0.4	0.4	0.4
Gov't expenditure	1.0	1.0	0.4	0.8	0.5	0.0	-0.2	0.7	-0.3	0.4	0.2	0.2	0.2
Fixed investment	6.9	-2.1	-0.8	5.5	3.8	-1.4	1.2	1.3	0.7	3.2	0.4	1.0	0.9
Investment in M&E	5.8	-4.0	-2.4	7.0	5.1	-1.4	0.5	0.1	1.4	3.3	1.5	1.5	1.5
Construction	7.8	-1.4	-0.2	5.4	3.2	-1.5	1.7	2.1	0.2	3.6	-0.5	0.5	0.5
Inventories, pp	-0.1	-0.5	0.1	0.5	0.0	0.5	-0.4	0.2	-0.2	0.7	-0.2	0.1	0.0
Exports	8.0	3.2	0.9	4.7	6.8	-0.7	2.5	-0.1	2.5	0.2	1.4	1.2	1.5
Imports	7.4	1.4	1.5	6.5	7.2	0.2	1.5	0.8	1.3	2.2	1.5	1.5	1.8
Net exports, pp	0.7	0.9	-0.2	-0.5	0.3	-0.5	0.6	-0.5	0.7	-0.9	0.0	-0.1	-0.1
Consumer prices*	2.1	2.0	1.5	1.1	1.6	1.5	1.5	1.6	1.3	1.2	1.1	1.1	1.2
Unemployment rate, %	7.1	6.8	6.9	6.7	6.7	6.9	6.9	6.8	6.9	6.8	6.7	6.7	6.6
Industrial production	7.3	-0.4	0.1	4.2	3.0								
Budget balance, % GDP	-0.8	0.1	0.0	0.2	0.1								
Public debt, % GDP	80.0	81.0	78.4	75.2	72.0								
Balance on current account, % GDP	6.3	7.4	7.0	7.1	6.8								
Balance on current account, EUR bn	164	196	192	201	198								

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

German business cycle losing its shine

— Economic growth probably suffered a worse setback in Q2 than initially presumed. We only expect stagnation now, but would no longer rule out a minimal decline.

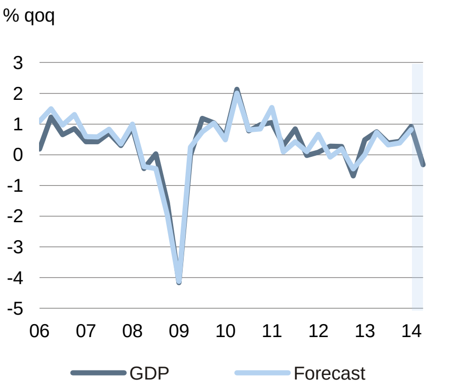
— All in all, global economic conditions do not point to dynamic growth in H2. In particular, the tougher sanctions on Russia and the risk of further escalation of the conflict are set to weigh on business sentiment and investment activity in spite of Russia's low share in German exports.

— The debate triggered by ECB and Bundesbank comments about higher wage increases in Germany is likely to have a similar impact, even though the substance of the statements is less spectacular, on closer inspection, than the media hype.

— As uncertainties abound we have decided to refrain for now from making a downward revision to our full-year forecast of 1.8% GDP growth.

Some three weeks ago Germany won football's World Cup in Brazil and thereby satisfied its long-held yearning to add a fourth star to the national team shirt. Sport and football in particular are highly emotional endeavours. All the same it is surprising that there have been so many ex-post analyses by experts and armchair managers of the national side which have impressively explained why Germany was bound to win the World Cup. Having said that, football is probably what Daniel Kahnemann would call a “low-validity environment”, i.e. a field where there are simply too few meaningful correlations to yield forecasts with an acceptable probability of materialising. That is why we should be all the more wary of regarding the pleasing and no doubt deserved success of the German national side as tantamount to proof of the currently superior competitiveness and economic success of the country as a whole.

Bridge model forecasts decline in GDP 1



Sources: Deutsche Bundesbank, Deutsche Bank Research

Confidence indicators weaker 2

Source: Thomson Reuters

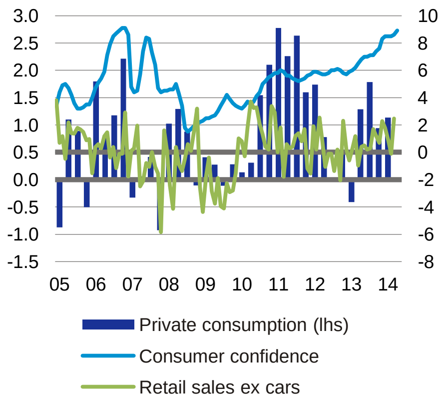
Probably only stagnation in Q2

Admittedly, everyone knew that the 0.8% rise in GDP in Q1 2014 was bolstered by a weather-related impact of around 0.3 of a percentage point, and that the flipside of this would be felt in Q2. This now appears to have turned out to be unexpectedly pronounced, though. The Bundesbank now considers a stagnation in economic output to be likely. Monthly indicators for the real economy are indeed unexpectedly poor, as shown impressively by our new Surprise Index (see article below). Besides the spring recovery which partly occurred in the first quarter already another contributory factor was probably also the month of May which encouraged a particularly large number of people to take extended holiday weekends. But even if we factor into our simple GDP-bridge-model that industrial output in June staged a strong recovery to the Q1 average level (+ 2 1/2% mom), a precise calculation would even arrive at a small decline in GDP. (However, as a result of the extended holiday weekends there could be a considerable amount of late reporting and the corresponding uncertainty concerning revisions to May's output figures). By contrast, models based on confidence indicators (ifo, PMI) still forecast growth rates of ½% and higher. They have, however, overestimated growth of late. We have therefore reduced our GDP forecast for Q2 “only” from 0.2% qoq to 0%.

Since around 0.3 of a percentage point of the slowdown in Q2 was due to a rebound from the Q1 weather effect, the Q2 growth rate adjusted for this effect could be roughly 0.3%, which would still be quite decent as a basis for the performance in H2.

Robust consumption 3

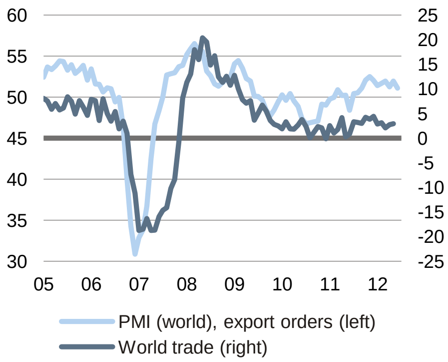
% yoy (left), % yoy, index (right)



Sources: Statistisches Bundesamt, GfK, ECB

World trade – virtually sideways 4

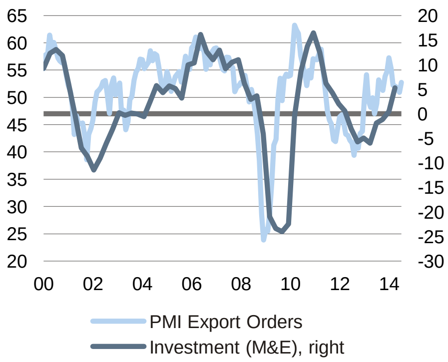
Index (left), % yoy (right)



Sources: CPB, Markit

Investment and export demand 5

Index (left), % yoy (right)



Source: Thomson Reuters

Outlook for H2 bleak

In the last few months, however, besides the surprisingly sharp deterioration in the monthly economic indicators there has also been an increase in the risks for H2. Only private consumption has remained unimpressed thanks to continued growth in employment and rising real wages, although given the 0.3% qoq decline in retail sales in Q2, the growth in Q2 is likely to be far more modest than the 0.7% in Q1. Construction investments, which are hit hardest by the weather effect, after increasing by 3.6% in Q1, will probably even drop appreciably in Q2. Over the year as a whole construction investment is likely to make a significant contribution to growth. The less favourable outlook is likely to be felt especially in corporate investment activity, i.e. the actual driver of the economy.

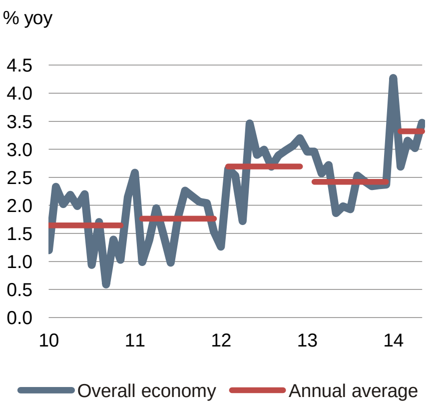
Investment climate: External burdens …

Although the US and Chinese economies recovered in Q2 – albeit in the case of the US partly due to the weather – world trade has been virtually flat until recently and was up 2.9% yoy in real terms in May. The index of new export orders in the global PMI fell in Q2 compared with Q1 and at 51.1 in June was at its lowest level for ten months. Hopes of clear global stimuli for German exports are thus unlikely to be fulfilled for the time being. The latest ramping-up of sanctions against Russia is having the same effect. Between January and May German exports to Russia had already slumped by 15% yoy. The European Commission expects that sanctions in the EU could result in a decline of EUR 40 bn (0.3% of GDP) this year. Although this calculation also includes the effects of Russian retaliatory measures the figures appear to be quite high for the current year. If one, however, factors in a 20-25% decline in German exports for the year, this would reduce German export growth by between 0.5 and 0.7 percentage points. Due to imported intermediates the impact on net exports would be somewhat smaller, so that the decline in GDP could – actually – be close to ¼ of a percentage point. With relatively robust domestic demand the outcome would not necessarily have to be an appreciable burden on the German investment climate. It would, however, be surprising if the sanctions spiral were soon to come to a standstill. In particular, Russia is likely to stoke western European concerns about gas supplies. Since Russia cannot sell its gas elsewhere at short notice on account of a lack of network infrastructure, it would suffer considerable lost revenues which would constitute an additional burden for the public purse given the country's already anaemic economy. On the other hand, however, the EU has few substitution options it can access at short notice. Even if Russia should fulfil its long-term supply contracts and not – as threatened – demand higher prices, the uncertainty in this area is more likely to increase in the near term and thus weigh on the investment climate.

… and homemade uncertainties

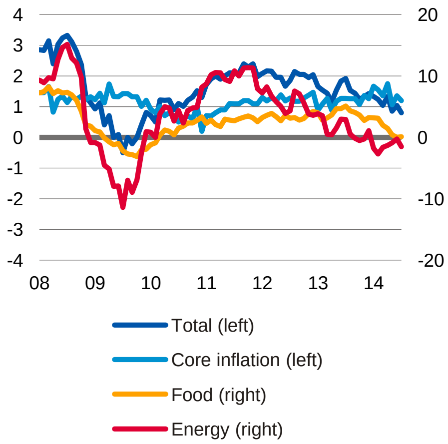
The policy decisions made by the grand coalition and the resulting increase in labour and energy costs, especially the foreseeable medium-term rise in social security contributions, are likely to dampen the propensity to invest in any case. On top of this, the debate about wages triggered by comments from the Bundesbank and the ECB gives the impression that we are in a land of confusion. The chief economist of the ECB, Peter Praet, said that in countries where labour market developments are positive, such as Germany, higher pay increases (compared to those in the EU crisis countries) would be appropriate. The Bundesbank was more concrete, calculating a “higher pay increase” of around 3%, as this exploits the medium-term distribution-neutral scope provided

Collectively agreed hourly wage rates rise (as "recommended") 6



Source: Bundesbank

Consumer prices (% yoy) 7



Source: Federal Statistical Office

by productivity and the inflation trend, which is allegedly adequate in view of the labour market situation. Keynesians cheered, stability-oriented economists by contrast saw this as – another – capitulation by the Bundesbank, and financial journalists even suspected there was a strategy behind this of preventing potential ABS purchases by the ECB. What everyone overlooked in all this excitement is that pay increases in Germany have already picked up compared with 2013 (2.5%) and at 3.2% (collective hourly wages in the economy as a whole) were even slightly higher than the 3% recommended by the Bundesbank and thus slightly exceed the distribution-neutral scope. Conversely, what was more interesting was the Bundesbank's suggestion for deriving the distribution-neutral scope to use the medium-term "inflation target" of close to 2% instead of the current inflation rate for this year of probably around 1%. This could prevent a temporarily lower inflation rate from becoming entrenched. In times of low inflation this would, however, exceed the distribution-neutral scope – as at present – and thus pay would increase at the expense of corporate earnings. Companies should be able to absorb this at present, but in the event of a "normal" downturn in which wages react to a worsened economic and earnings environment with a time-lag in any case, such a strategy could have a pro-cyclical effect and place an additional burden on investment activity. This is especially the case if it remains unclear whether an inflation rate that possibly climbs above 2% later on in the cycle would then also be disregarded when wages are being negotiated. It would therefore come as no surprise to find that the current "wage debate" – although it is actually nothing more than a storm in a teacup – is being followed by companies with mixed feelings.

Question marks growing over GDP forecast of 1.8% for 2014

Calculated precisely, i.e. with 0% GDP growth in Q2 and the risk that the growth pattern in H2 on account of the factors discussed above could be somewhat lower than our expectations (Q3 0.4%, Q4 0.5%), we would actually have to make another downward revision to our GDP forecast of 1.8% for 2014. Given the major uncertainties (weather and calendar effects in Q2, geopolitics) we shall first wait and see and hope that the economic weakness in the eurozone remains a temporary Q2 phenomenon.

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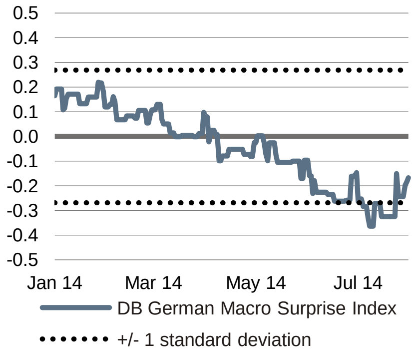
DB German Macro Surprise Index since May in negative territory 1

Average of last 20 z-scores of data surprises

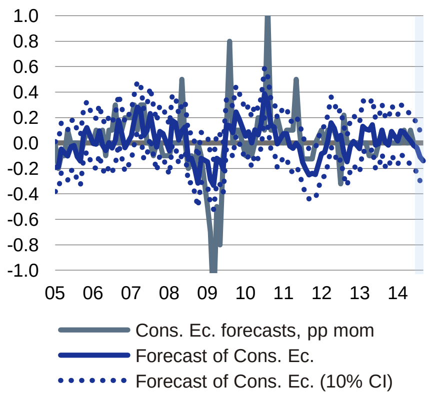


Values above (below) 0 indicate the data came in better (worse) than expected

Sources: Bloomberg Finance LP, Deutsche Bank Research

DB German Macro Surprise Index: Downside-risks for GDP forecasts 2

Monthly revisions of Consensus Economic Forecasts (pp); Average of previous 20 z-scores

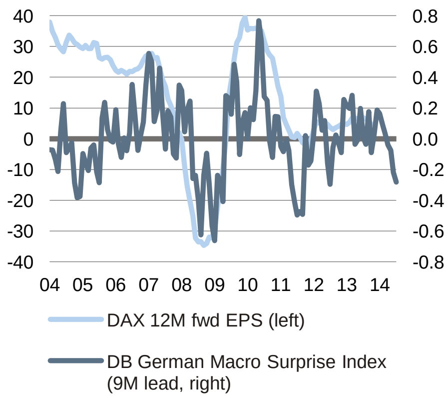


CI: 10% Confidence Intervall

Sources: Consensus Economics Inc., Deutsche Bank Research

DB German Macro Surprise Index points to downside risks for DAX 12M fwd EPS 3

% yoy (left); average of 20 z-scores of data surprises (right)



Sources: IBES, Deutsche Bank Research

DB German Macro Surprise Index: Latest economic data largely disappoint

— The DB German Macro Surprise Index is calculated by comparing the published economic data with market expectations.

— The index provides information on future forecast adjustments and has, on average, a 3-month lead over adjustments to the German GDP Consensus Economics forecast figures.

— The DB German Macro Surprise Index has been in negative territory since mid-May. This disappointment is partly related to one-off effects, but downside risks for German GDP forecasts should nonetheless be considered. Based on historical correlation, the average German GDP estimates for 2014 should fall by 0.3 pp in the next 3 months, from their current level of 2% (July – Consensus Economics), which would be slightly below our current GDP projection of 1.8%.

DB German Macro Surprise Index: Timely new information on upside and downside risks

For a timely assessment of German economic performance relative to market expectations (Bloomberg Finance LP Consensus), we have calculated the DB German Macro Surprise Index.[1] It is based on sentiment and real economic indicators, prices and developments in the labour market and international environment.[2] The index measures whether the consensus survey participants perceived the current economic situation too pessimistically (positive area) or too optimistically (negative area).

With strong or long-term divergence between published economic figures and market expectations, it is to be anticipated that forecasters and market participants will adjust their estimates and forecasts.

However, the forecast adjustments are often delayed, as, for example, the forecasters initially stick to their views and attribute ongoing deviations to volatility, that is, to noise and one-off effects, which will later be offset. It could also be that they have set fixed dates for updating their projections. Expectations thereby react with some delay to past forecast errors. This said, too frequent modification of estimates following the latest changes in data would, in many cases, significantly reduce their usefulness for the audience (e.g. corporate planners).

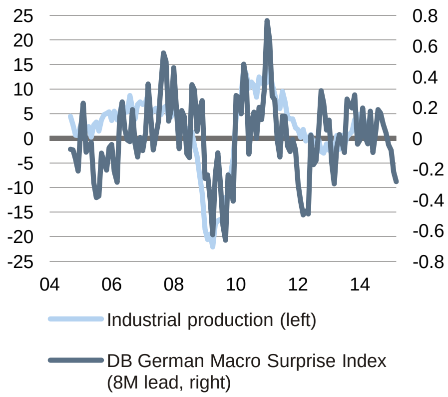
Downside risks to GDP forecasts due to largely disappointing recent data

The DB Macro Surprise Index[3] has a 3-month lead over changes in the GDP forecasts of Consensus Economics. The index has trended downwards since the end of January and has been lying in negative territory since mid-May. However, this is partly due to one-off effects such as the negative impact of extended holiday weekends on industrial production.[4] Nonetheless, the disappointing data, given the historical correlation, suggest that the Consensus

[1] With the DB Macro Pulse Index, Daniel Brehon and Bilal Hafeez (FX strategists) have already been calculating for some time a surprise index for the large currency areas. See http://gm.db.com/FXProduct.
[2] Information on the indexes and calculations can be found in the appendix.
[3] The surprise index is stationary.
[4] See chart of the month.

Downside risks for economic activity 4

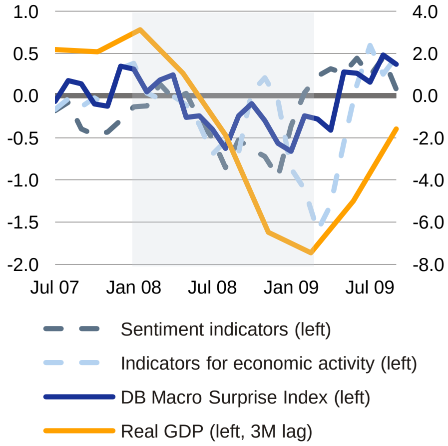
% yoy (left); average of 20 z-scores of data surprises (right)



Sources: Federal Statistical Office, Deutsche Bank

Data surprises in the course of the economic crisis 2008/2009 6

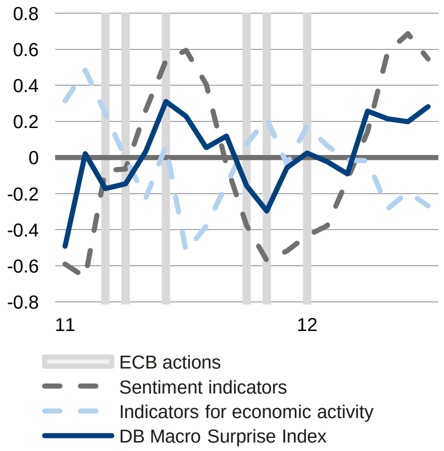
Standardised values (mov. 3M avg., left), % yoy (right)



Source: Deutsche Bank Research

High volatility of sentiment indicators over the downswing 2011/13 due to ECB actions 7

Standardised values (mov. 3M avg.)



Source Deutsche Bank Research

forecasts for the year 2014 will, in the coming months, be revised downwards by 0.3 pp from the current 2% (July), slightly below the consensus forecast at the start of the year and our current estimate (although the confidence interval is rather large).

Regression results 5

	Cons. Eco. mean GDP forecast, mom (pp)	Industrial production % yoy	12M DAX fwd earnings % yoy
DB German Macro Surprise Index			
(t-3)	0.50***		
(t-8)		15.53***	
(t-9)			31.37***
Constant	0.00	1.82**	12.77***
R^2	0.27	0.30	0.18
N. of cases	114	117	117

* p<0,05, ** p<0,01, *** p<0,001

Sources: Consensus Economics Inc., IBES, Federal Statistical Office, Deutsche Bank Research

In addition, the surprise index has a lead time over the 12M DAX-earnings expectations (% yoy – 9-month lead) and developments in industrial production (% yoy – 8-month lead). The surprise index therefore provides early information on whether upward or downward risks to current forecasts exist, and on which direction the real economy is heading in.

Detection of risks for a downturn more difficult due to ECB policies

The extent to which the surprise index can provide information on the beginning of a recession could, so far, only be verified twice, due to limited availability of data on all indicators (since 2004).

In the first downturn of the deep global financial crisis, which lasted from the first quarter of 2008 to the second of 2009, the negative data surprises provided an early indication of a setback in economic activity. The sentiment and real economic indicators started to disappoint more or less at the same time. This said, due to their lead feature, the sentiment indicators began, as expected, to positively surprise before real economic indicators did. The end of the recession phase was also relatively well detected by the surprise index, with a lead of about a quarter.

Over the course of the second downturn, which lasted from third quarter of 2011 to first quarter of 2013, the surprise index provided less precise indication. However, this was mainly due to the extreme loose monetary policy of the ECB at the height of the crisis, which ensured higher data surprise volatility in sentiment indicators (ifo, PMI, ZEW), which significantly influenced the development of the DB Surprise Index. The ECB reduced the key interest rates in the course of the downward phase, from 1.5% to 0.75%; it pumped massive liquidity into the banking system, with two 3-year LTROs; Draghi said in his mid-2012 speech that “the ECB is ready to do whatever it takes to preserve the Euro. And believe me, it will be enough” and shortly thereafter the OMT-programme was announced.

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William Vickery

Focus Germany

Last 20 published economic data for Germany 8

Bloomberg Tickers	Indicator	Reporting month	Publication date	Current value	Bloomberg consensus	Surprise	Standardised surprise	Quantile rank
GRZECURR Index	ZEW Survey Current Situation	6 2014	17.06.14	67.7	62.1	5.6	0.7	0.8
GRIFPBUS Index	IFO Business Climate	6 2014	24.06.14	109.7	110.3	-0.6	-0.6	0.2
GRIMP95Y Index	Import Price Index (% yoy)	5 2014	27.06.14	-2.1	-2.2	0.1	0.4	0.7
GRFRIAMM Index	Retail Sales (%	5 2014	30.06.14	-0.2	0.8	-1.0	-0.5	0.2
GRUECHNG Index	Unemployment Change (000's mom)	6 2014	01.07.14	7.0	-10.0	-17.0	-0.8	0.2
MPMIDEMA Index	Markit Manufacturing PMI	6 2014	01.07.14	52.0	52.4	-0.4	-0.7	0.2
MPMIDESA Index	Markit Services PMI	6 2014	03.07.14	54.6	54.8	-0.2	-0.2	0.4
GRIORTMM Index	Factory Orders (% mom)	5 2014	04.07.14	-1.7	-1.1	-0.6	-0.3	0.3
GRIPIMOM Index	Industrial production (% mom)	5 2014	07.07.14	-1.8	0.0	-1.8	-1.5	0.1
GRCAEU Index	Current Account Balance (EUR bn)	5 2014	08.07.14	13.2	14.5	-1.3	-0.8	0.2
GRCP20YY Index	CPI (% yoy)	6 2014	11.07.14	1.0	1.0	0.0	0.3	0.4
GRZECURR Index	ZEW Survey Current Situation	7 2014	15.07.14	61.8	67.4	-5.6	-0.9	0.1
GRZEWI Index	ZEW Survey Expectations	7 2014	15.07.14	27.1	28.2	-1.1	-0.1	0.5
MPMIDESA Index	Markit Services PMI	7 2014	24.07.14	56.6	54.5	2.1	2.2	1.0
MPMIDEMA Index	Markit Manufacturing PMI	7 2014	24.07.14	52.9	52.9	0.0	0.0	0.4
GRIFPBUS Index	IFO Business Climate	7 2014	25.07.14	108.0	109.4	-1.4	-1.2	0.1
GRIMP95Y Index	Import Price Index (% yoy)	6 2014	29.07.14	-1.2	-1.2	0.0	0.4	0.7
GRCP20YY Index	CPI (% yoy)	7 2014	30.07.14	0.8	0.8	0.0	0.3	0.4
GRUECHNG Index	Unemployment Change (000's mom)	7 2014	31.07.14	-12.0	-5.0	7.0	0.1	0.5
GRFRIAMM Index	Retail Sales (%	6 2014	31.07.14	1.3	1.0	0.3	0.5	0.7

Sources: Bloomberg Finance LP, Deutsche Bank Research

Appendix: Construction of the DB Macro Surprise Index

The DB German Macro Surprise Index is calculated as follows:

i. For the individual economic indicators, we calculated the deviation of the published values from the Bloomberg forecast consensus values. A positive (negative) value is then a positive (negative) surprise. We use 13 German economic indicators: sentiment indicators (assessment of the purchasing managers, ifo business climate, ZEW-economic indexes), indicators of trends in the real economy (GDP, factory orders, industrial production, retail sales), in prices (CPI, import prices), in the labour market (change in unemployment) and in the external environment (current account balance). The starting period varies – depending on the earliest available Bloomberg consensus data (from 1996 to 2004). The number of survey participants ranges from 6 to 40 (see chart 9).

ii. The data surprises of the respective indicators are then standardised by subtracting their mean, calculated over the period of observation, and dividing the resulting value by their standard deviation.

iii. The DB Macro Surprise index is then the average of the z-values from the last 20 published economic data, to which we give the same weight. An index that lies in positive (negative) territory then means that the published data was above (below) market expectation and that the latter was therefore too pessimistic (optimistic).

Economic indicators used for the calculation of the DB Macro Surprise Index 9

Bloomberg Tickers	Indicator	Start date	Number of poll participants
Sentiment Indicators			
GRIFPBUS Index	IFO Business Climate	29.02.2004	40
MPMIDEMA Index	Markit/BME Germany Manufacturing PMI	31.04.2004	22
MPMIDESA Index	Markit Germany Services PMI	31.04.2004	19
GRZECURR Index	ZEW Survey Current Situation	29.02.2004	22
GRZEWI Index	ZEW Survey Expectations	31.03.2002	35
Indicators for economic activity			
GRGDPPGQ Index	GDP SA QoQ	31.12.1996	29
GRIORTMM Index	Factory Orders MoM	31.10.1998	30
GRIPIMOM Index	Industrial production	28.02.1997	35
GRFRIAMM Index	Retail Sales	01.02.1997	20
External economic environment			
GRCAEU Index	Current Account Balance	31.12.2001	7
Labour market			
GRUECHNG Index	Unemployment Change (000's)	31.08.1998	24
Prices			
GRIMP95Y Index	Import Price Index YoY	31.01.1999	6
GRCP20YY Index	CPI YoY	31.01.2003	27

Sources: Bloomberg Finance LP, Deutsche Bank Research

Revision of 2014 national accounts: Expect roughly 3% higher GDP

— A "major" revision of the national accounts will be carried out in September.

— Besides a large number of methodological details and other revisions, the most important changes in quantitative terms are: a more precise delimitation of sectors, especially of the government sector, as well as a reclassification of both military and research & development expenditures as capital formation.

— Overall, the revision could mean that the level of GDP could be boosted by approximately 3%.

— However, growth revisions will likely be limited as these are mostly level effects.

— Positive side effects of the revision: per-capita GDP will rise by more than EUR 1,000 and the investment ratio by over 2 percentage points of GDP, while Germany's government debt ratio will fall by 2.5 percentage points.

"Major" revision of national accounts in the offing

At the beginning of September, the Federal Statistical Office will announce the changes resulting from the "major" revision of the national accounts – together with the release of the German national accounting data for the second quarter of 2014.

Besides the usual regular updates of provisional quarterly results based on newly available data as well as the annual main calculation of the national accounting data, which includes a comprehensive review of the last four reporting years, a "major" revision is carried out roughly every 5 years. This revision includes a fundamental methodological enhancement of national accounts. The last major revision was carried out in 2005[5] and included the changeover of the ESA from a fixed-year to a previous year basis, chain-linking, the introduction of new deflation methods such as hedonics, the newly adjusted calculation of banking services (FISIM) as well as the integration of the services statistics, and in 2011[6] the adjustment of the statistics to new classifications of sectors and goods.

In light of changing economic conditions such revisions are necessary in order for the official statistics to paint as realistic a picture of the economy as possible at all times.[7] The upcoming revision of the national accounts takes place in the framework of the Europe-wide introduction of the new European System of National and Regional Accounts 2010 (ESA 2010), the implementation of which is compulsory for all EU Member States.

National accounts: A comprehensive description of an economy

National accounts provide a comprehensive quantitative picture of economic activity within a country. They provide the information on which many important business decisions are based and serve as a point of orientation for the political

[5] See Gräf, B. (2005). Statistisches Bundesamt revidiert VGR: Vergleiche mit den USA werden aussagekräftiger. Deutsche Bank Research. Aktuelle Themen Nr. 314. February 2005.
[6] See Räth, N. (2011).Revision der Volkswirtschaftlichen Gesamtrechnungen 2011 für den Zeitraum 1991 bis 2010. Federal Statistical Office. Wirtschaft und Statistik. September 2011.
[7] Federal Statistical Office (2007). Volkswirtschaftliche Gesamtrechnungen. Revisionsbedarf des Bruttoinlandsprodukts.

National Accounts	1
	2013 EUR bn
Origin of GDP	
Agriculture, forestry and fishing	19
Manufacturing	625
Construction	116
Trade, transport & hotels/restaurants	356
Information and communication	97
Financial and insurance services	99
Real estate	299
Business services	281
Public services, education, health care	451
Other services	112
= Gross value added	2,454
+ Taxes on products minus subsidies	284
= Gross domestic product	2,738
Use of GDP	
+ Private consumption	1,572
+ Government consumption	533
+ Gross fixed capital formation	472
+ Changes in inventories	-14
+ Exports	1,385
- Imports	1,212
= Gross domestic product	2,738
Distribution of GDP	
+ Compensation of employees	1,416
+ Entrepreneurial and investment income	703
= National income	2,119
+ Production-related and import duties minus subsidies	277
+ Depreciation	409
= Gross National income	2,805
- Primary income balance from rest of world	67
= Gross domestic product	2,738

Source: Federal Statistical Office

community in economic policy, for trade unions and employers in collective wage negotiations, for investors in the structuring of their portfolios, for businesses in their planning processes and for the European Central Bank in setting its monetary policy course. In addition, they also fulfil Europe-specific tasks in that they form the basis for the calculation of the Member States' contributions to the EU budget, for the distribution of money from the EU's structural and regional funds among the Member States as well as for monitoring compliance with the Stability and Growth Pact.

The central measure of the national accounts is gross domestic product (GDP). It is a statistical indicator of an economy's output and measures the value of all goods and services produced domestically within a certain period of time, i.e. basically the value created by the economy during that time. GDP is calculated on the basis of internationally harmonised concepts. It serves to identify economic growth and thus plays an important part in the comparison of countries. The most important segments of the national accounts are the calculation of GDP by origin and use as well as its distribution, as depicted in the adjacent table. It shows the extent to which individual sectors contribute to overall economic output (e.g. manufacturing, construction or distributive trade), how the income created is used (e.g. for consumption and capital formation) and how income is distributed among the production factors: labour (employee remuneration) and capital (corporate and investment income). Other sections of the national accounts include input-output statistics, tables on individual sectors as well as financial and capital accounts. While the former depict flows between individual sectors such as households, companies, government and foreign countries, i.e. relations between these sectors within a certain period of time, the financial and capital accounts register the stock of e.g. assets and liabilities of these sectors at a certain point in time.

Major changes

The upcoming ESA 2010 revision comprises a large number of changes.[8] For instance, new rules will be introduced on the calculation of value creation by insurance companies, the treatment of government guarantees will be laid down in greater detail, supplementary tables will be created i.e. on pension entitlements by households calculated according to actuarial principles[9], and illegal proceedings, such as the purchase and sale of drugs or stolen goods, will be factored into the calculations. However, most of these changes will hardly be of interest to many users and will probably have a limited impact on the final figures. The changes primarily represent methodological clarifications.[10]

Much more important – especially in terms of clarifying which segments are being aggregated in one sector, and above all its quantitative significance – are the following three changes:

— a more precise definition of sectors, especially the government sector

— the classification of military expenditure and

— the classification of R&D expenditure

8 See Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union. Official Journal of the European Union.

9 The supplementary table will provide an overview of all accrued-to-date pension entitlements by households in private and state old-age pension systems and is thus of particular interest regarding implicit government debt.

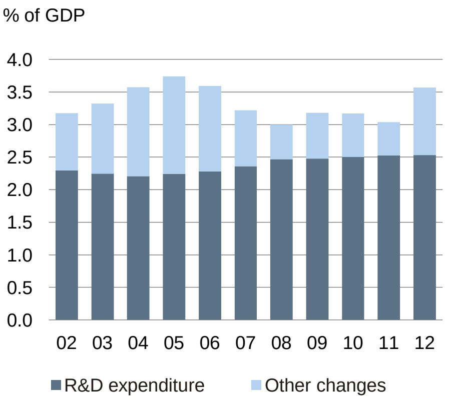
10 A systematic description would exceed the scope of this paper. The EU regulation on ESA 2010 mentioned above consists of more than 700 pages.

What makes up the "government sector"?

Against the backdrop of the European sovereign debt crisis, European budget control and the Excessive Deficit Procedure, a clear definition of the "government sector" is of particular importance. Therefore, an entire chapter has been dedicated to this sector in the ESA revision. It was explicitly laid down under what circumstances an institutional entity is to be defined as belonging to the government sector. An institutional unit which is controlled by the state and is a non-market producer (i.e. the goods and services produced by this unit are being passed on without charge or at economically insignificant prices) now forms part of the government sector.

Furthermore, the so-called 50% criterion - which establishes that state-controlled entities, for which less than 50% of production costs are covered by sales proceeds, form part of the government sector – still applies. However, this criterion has been further tightened. Hence, the definition of costs comprises not only intermediate consumption, wages and salaries, depreciation and other production-related duties, as has been the case so far, but also net interest payments. In principle, this means the number of entities included in the government sector will be on the rise[11]. These will include, for example, municipal construction facilities and urban development corporations. However, the effects of these changes will probably be relatively minor in Germany by international standards, as the rules of definition had already been interpreted in a strict and sometimes considerably more stringent manner under the current ESA 95 standard.

USA: Effects of 2013 national accounts revision on GDP 2

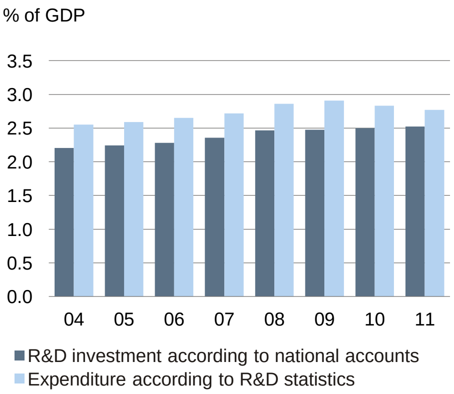


Source: BEA

Military weapon systems = capital formation

Under the ESA 1995, military facilities which can also be used for civilian purposes such as airports, barracks and military hospitals, were recorded as fixed capital formation by the state, while all other military goods and, correspondingly, military weapon systems, too, were classified as intermediate consumption and hence as general government consumption. In the future, these military goods will also be recorded as capital formation because military weapon systems are continuously used to provide security services and are therefore classified as fixed assets[12]. This change will trigger an increase in gross value creation by the state, which is calculated via costs, and thus also an increase in GDP.[13]

USA: R&D expenditure 3



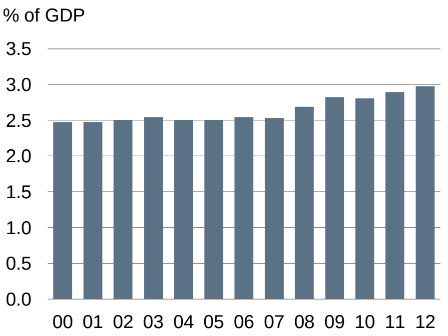
Sources: BEA, OECD

R&D expenditure = capital formation

Probably the most significant change in quantitative terms is the future treatment of expenditure on research and development (R&D), which has so far been booked mainly as intermediate consumption and thus "disappeared" in the production process.[14] R&D spending is expenditure on systematic, creative work to enhance knowledge in view of finding new applications. They can include private and public spending on basic research as well as on targeted, application-oriented research, either within a company, or externally e.g. by outsourcing research to other companies, research institutes or universities.

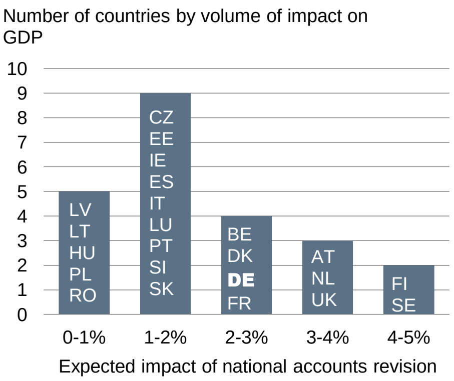
[11] See Braakmann, A. (2013). Revidierte Konzepte für Volkswirtschaftliche Gesamtrechnungen. Federal Statistical Office. Wirtschaft und Statistik. August 2013.
[12] See Federal Statistical Office (2014). Methodological enhancement of national accounts - the 2014 revision. January 2014.
[13] See Braakmann, A. (2013). Revidierte Konzepte für Volkswirtschaftliche Gesamtrechnungen. Federal Statistical Office. Wirtschaft und Statistik. August 2013.
[14] See Federal Statistical Office (2014). Methodological enhancement of national accounts - the 2014 revision. January 2014.

Germany: R&D expenditure 4



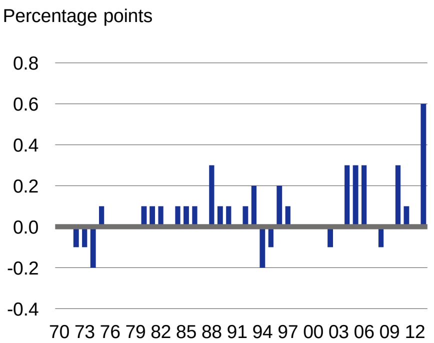
Source: Federal Statistical Office

Volume of expected impact of national accounts revision 5



Source: European Commission

USA: GDP growth revision* 6



*Revision of rate of change of real GDP caused by 2013 national accounts revision

Source: BEA

R&D expenditure comprises compensation-related costs, e.g. for engineers, and non-compensation-related costs such as spending on material and equipment, energy costs, technical literature, laboratory equipment/materials, overhead costs (office services, telecommunications) as well as rents and user fees.

The current changes are a reflection of the widespread opinion, which has been voiced for a long time, that R&D expenditure is to be recognised as capital formation. This will lead to a noticeable increase in the level of GDP. The extent of this increase can be estimated by means of the data available on R&D expenditure and with the help of the outcome of the national accounts revision in the US. There, the revision – which also included the reclassification of R&D expenditure as capital formation – was carried out as early as the end of July 2013 and led to a 3.3% to 3.6% higher GDP between 2002 and 2006. Up to 75% of this increase was attributable to the reclassification of R&D expenditure alone.[15] According to OECD data, expenditure on research and development in the US amounted to approximately 2 3/4% of GDP. The figure is similar in Germany, where R&D spending came to roughly 2.5% of GDP between 2000 and 2006 and has, since then, risen to 3% of GDP. As a result of adjusting the methodology, gross fixed formation among corporations will rise to the extent of the capitalised R&D expenditure, as will gross value creation due to lower intermediate consumption.

Effect of the national accounts revision: GDP to come in 3% higher

According to rough estimates, the level of GDP could be boosted by 3% owing to the national accounts revision, with the reclassification of R&D spending as capital formation likely to have the most pronounced effect.[16]

The impact on GDP will probably be similar in Belgium, Denmark and France, too. The European Commission expects the statistical changes to have even stronger effects in Austria, the Netherlands and the UK as well as in Finland and Sweden, where GDP could rise by as much as 4 to 5%.[17]

Growth effects of revision only minor

Even though the effects of the upcoming revision on GDP in absolute terms will be considerable, the impact on economic performance, i.e. current growth rates, will likely be limited. This was the case for the national accounts revision in the US last year, where methodological changes comparable to those now underway in Germany were introduced. This revision of annual US economic growth rates, which covered the years 1929 to 2013, has led to shifts that lay – in 59 of the 83 years – within a narrow band of -0.1 to +0.1 of a percentage point, with only 6 years seeing growth revisions of more than 0.3 pp.

Per-capita GDP and investment ratio on the rise, debt ratio on the decline

Positive side effects of the ESA revision: per-capita GDP for 2013 will rise by more than EUR 1,000 to EUR 35,000 and the investment ratio by over 2 percentage points of GDP, coming in at almost 19.5% for 2013 instead of

[15] See McCulla, S., Holdren, A.E., Smith, S. (2013). Improved Estimates of the National Income and Product Accounts. Results of the 2013 Comprehensive Revision. Bureau of Economic Analysis Survey of Current Business 93. September 2013.

[16] See Federal Statistical Office (2014). Methodological enhancement of national accounts - the 2014 revision. January 2014.

[17] See: European Commission (2014). Questions and Answers: European System of Accounts 2010. Memo 14/21. January 16, 2014.

17.3%. In addition, Germany's government debt ratio will fall by approx. 2 1/2% of GDP as the divisor (GDP) rises. Instead of 78.4% of GDP, public-sector debt will then amount to only about 76% at the end of 2013. Debt ratios will fall in Europe's periphery as well. As the effects of the revision on GDP in these countries are estimated to be smaller than in Germany, however, the gap to Germany's government debt ratio will widen.

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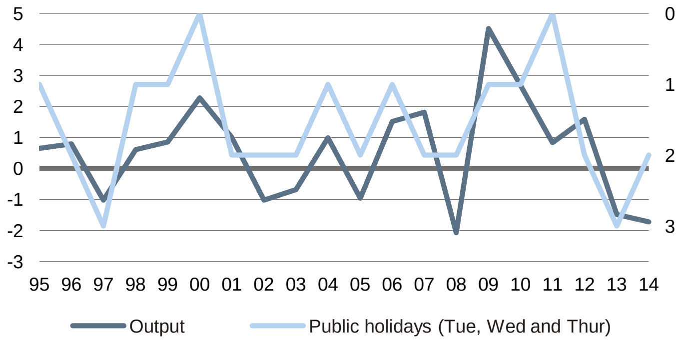
Chart of the month

Extended holiday weekends lead to output fluctuations in May

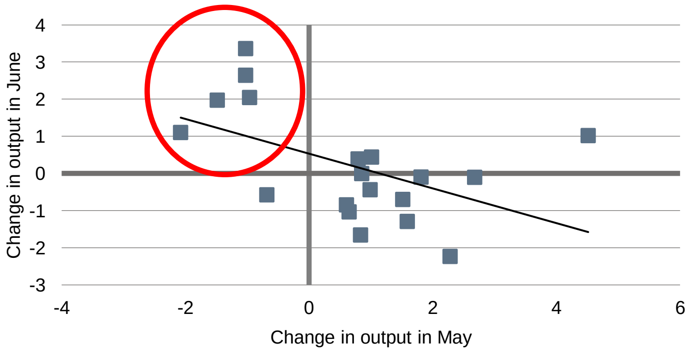
Manufacturing output in May, % mom, seasonally adjusted and calendar adjusted (left); number of public holidays on Tue & Wed & Thur in May (right)



Sources: Federal Statistical Office, Deutsche Bank Research

Weak May usually followed by strong June

Output in May and June, manufacturing, % mom, seasonally adjusted and calendar adjusted, data for 1995-2013



Sources: Federal Statistical Office, Deutsche Bank Research

Extended holiday weekends a major factor in May's drop in output

The first item in this issue of Focus Germany has revealed that German economic data has been disappointing of late. The sharp drop in industrial output in May (-1.8% mom) was the biggest disappointment with regards to Q2 GDP growth. Even if one only looks at manufacturing output (down by 1.7%) and thus disregards the partly expected return to normal in the construction sector (down by 4.9%) the decline was still unexpected and significant. Above all, the days on which public holidays fell in May 2014, which were accompanied by workers taking an above-average amount of additional holidays, suggest however that the sharp deterioration exaggerated the decline and that it will have been followed by a swing in the opposite direction in June.

The month of May has the highest density of public holidays on average. If these holidays fall on a Tuesday, Wednesday or Thursday, workers have the appealing option of needing to take just a few days of annual leave in order to enjoy a large number of days off in one go. The resulting lost production days are only inadequately offset (or not at all) by the seasonal adjustment process, as the number of extended holiday weekends can fluctuate markedly from year to year and can differ from one Land to the next. Chart 1 shows that the number of public holidays and the swings in output in May are not insignificantly correlated (nearly 60%).

Output data is also generally susceptible to fluctuation (due for example to annual leave tacked onto public holidays, holiday shutdowns, weather conditions, the scheduling of school holidays). By historical standards the decline in May 2014 was unexceptional; it was slightly larger than one standard deviation. Furthermore, since 1995 more than 60% of the months following a decline in output have witnessed an increase or vice-versa. The change in output has thus swung in the majority of cases from month to month and a weak May has mostly been followed by a strong June (chart 2).

Several factors suggest, however, that there is no strong counter-trend and thus indicate there are certain downside risks to our Q2 GDP forecast. By historical standards the two public holidays in May 2014 that encouraged workers to take additional leave were expected to generate a smaller decrease in output. Furthermore, orders (down by 3%), on which such additional holidays should have little influence, were weak – as were exports, too. Moreover, the sentiment indicators trended downward and the VDA (Germany's Industry Association) reported quite weak auto output data for June.

Interestingly, the decline in May was concentrated in a few segments of manufacturing (e.g. beverages -12%; chemicals -4%; pharmaceuticals -6%; coking and petroleum refining -7%). These are segments that have technically dominated ongoing processes (low level of labour intensity), which tends to weaken the case for public holidays and the associated additional leave taken by employees having a major impact on output. Note the contrast with, for example, tobacco (+5%), engineering (+2%) and automakers (+1%).

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Chartbook – Total economy

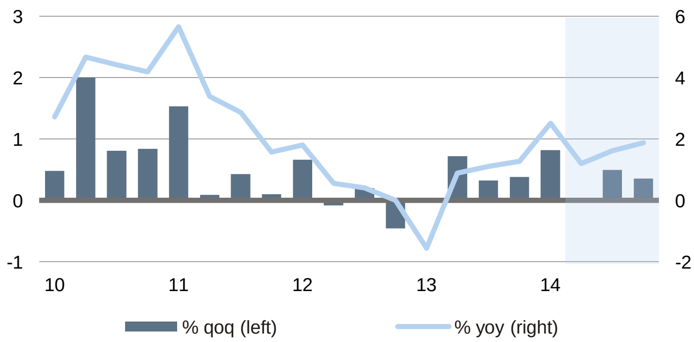
— The German economy started strongly into 2014. At 0.8% qoq GDP growth was the highest since Q1 2011. Due to the mild winter that benefitted construction investment (+3.6% qoq) the rate overstated the underlying momentum which should be about 0.4% qoq – the average of the last five quarters. Strong growth is partly related to high net immigration to Germany from Eastern Europe and increasingly from peripheral countries.

— Only the domestic economy (+1.7%-p.) contributed to Q1 GDP growth, especially private consumption and construction (each 0.4%-p.). In contrast, net exports were a drag on growth (-0.9%-p.) due to weak exports. This is the opposite growth composition of the preceding quarter when only exports supported growth. Over the last five quarters, however, the current strength of domestic demand is obvious. It contributed on average 0.5%-p. while net exports were a small drag on average (-0.1%-p.).

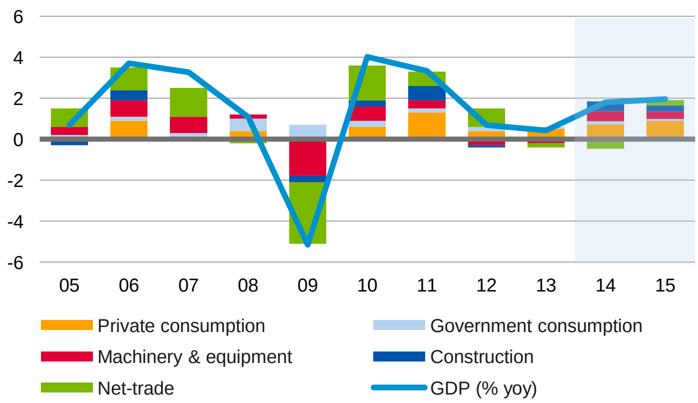
— In Q2 there should be some payback for GDP growth (+0.0% qoq) as construction investment normalises. This was already heralded by the strong decline of construction spending (April/May). Sentiment indicators provided a mixed bag, but their levels still suggest robust (domestically driven) growth. In July the fall of the ifo index was broad based. It was the third consecutive decline. In contrast, esp. the services PMI surprised positively in July and increased to the highest level since mid-2011. However, the details (surveyed separately) were relatively weak. The manufacturing PMI also surprised positively, but remained lower than the services index.

— Thanks to average quarterly growth rates of 0.4% qoq, GDP should expand by 1.8% in 2014. Domestic demand should be the major growth pillar, just like in 2013. Private consumption (+1.3% yoy) should provide impetus thanks to the positive labour market dynamic. Construction spending and investment in machinery & equipment should grow at a healthy pace, in part thanks to strong Q1 rates. Net exports are set to be a drag on overall growth as strongly rising imports more than offset the modest improvement in exports.

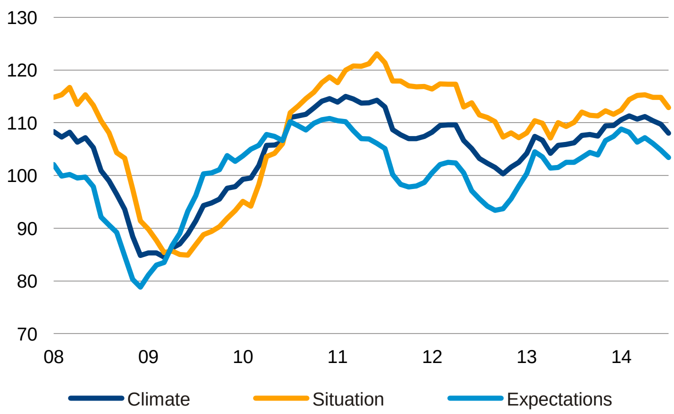
Real GDP growth



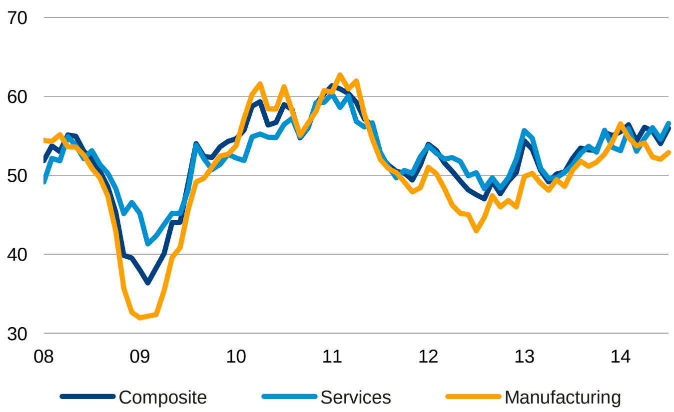
Contribution to real GDP growth (%-points)



ifo index - total economy (2005=100)



Purchasing manager index



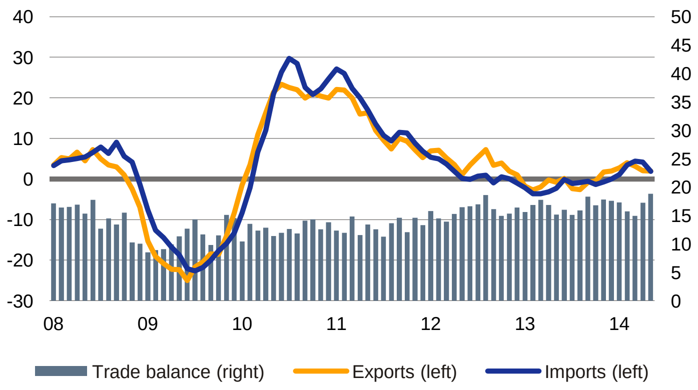
Sources: Federal Statistical Office, Markit, ifo, Deutsche Bank Research

Chartbook – Foreign trade

- Foreign trade was weak in 2013. Goods exports stagnated and imports by a good 1%. Around mid-2013 the trough was reached and a moderate recovery started. Due to the still lacklustre world trade (May +2.9% yoy) German foreign trade did not gain momentum. In May German exports were up 1.7% yoy (3M mov. avg.). The trade balance increased to the historical peak of EUR 18.8 bn in May due to even weaker imports (esp. volatile other transport equipment, oil and gas, coke and refined petroleum products). Thanks to strong domestic demand we expect imports to increase again in the coming months.
- The loss in momentum is especially obvious in German exports to EMU (Jan +3.2% yoy, May +2.2% yoy, 3M mov. avg.) with their share of nearly 40%. Exports to Asia (Jan +4.6%; May +4.1%) and the US (5.7% vs. 6.8% in January) have slowed, too.
- It is foremost the recovery in automobile exports (May: +5.3% yoy) that drives the moderate increase in exports. Especially as the European car market is experiencing pent-up demand after years of restraint domestic demand. By contrast, the other German export engine, mechanical engineering, was stuttering (-2.5% yoy). Foreign demand in the metal industry (-6.0% yoy) remained weak.
- Leading indicators paint a mixed picture for exports. Ifo export expectations and PMI new export orders currently point to muted export demand growth at best. Still, we expect an accelerating global economy over the course of the year thanks to a rebound of the US economy, gradually accelerating Chinese growth and a continuation of the weak and fragile EMU recovery.

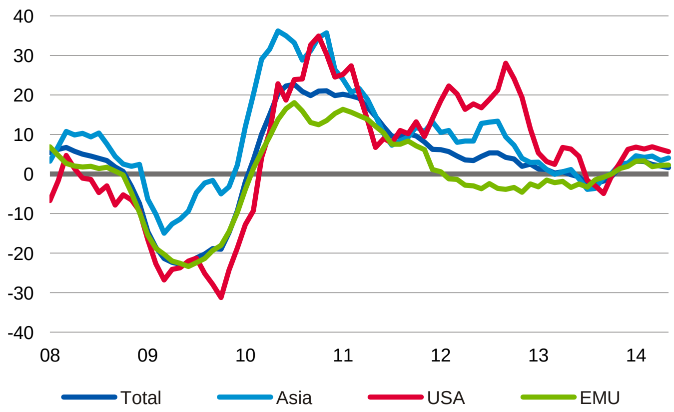
Merchandise trade

% yoy, 3M mov. avg. (left); EUR, bn (right)



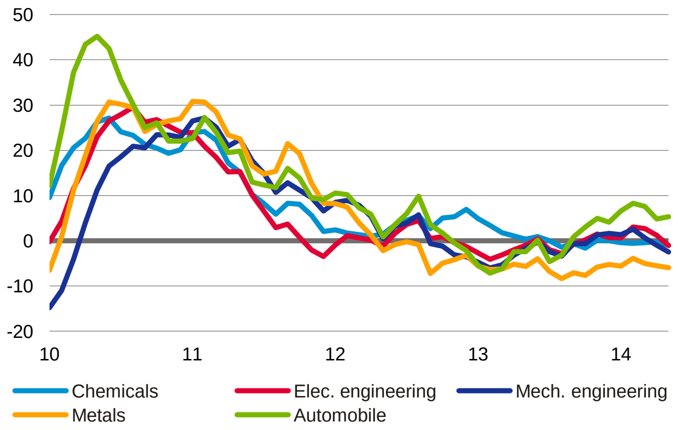
German exports by region

% yoy, 3M mov. avg.



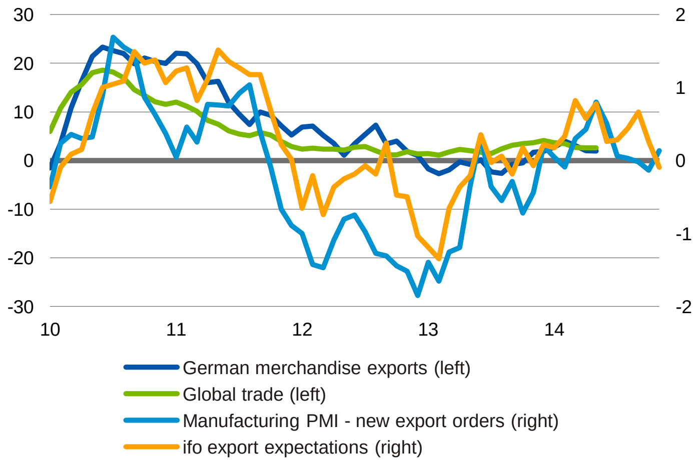
Exports by sector

% yoy, 3M mov. avg.



Exports and early indicators

% yoy, 3M mov. avg. (left); Standardized values (right, 4M lead)



Sources: Federal Statistical Office, Markit, ifo, Deutsche Bank Research, CPB

Chartbook – Industry

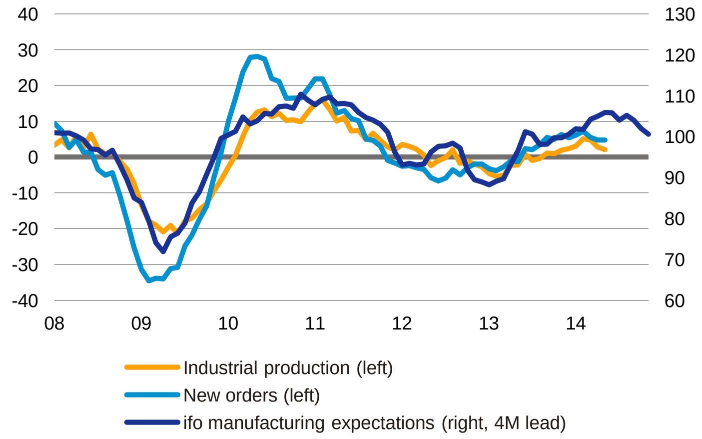
— The German industry benefitted from the recovery of the global economy over the course of 2013. However, like exports the industrial sector slowed lately. But, industrial production and new orders were still up by 2.1% yoy and 4.8% yoy (3M moving average) in May. Production was dampened by the normalizing construction output (that had benefitted from the mild winter in Q1) and a bridge day effect.

— The ifo index and the PMIs for the manufacturing sector point to a further slowdown in German industry towards the end of 2014.

— Of the largest industrial sectors the automobile industry should achieve the highest growth rate in 2014. We expect an increase of 5% in real terms. The essential driver behind this is the recovering car demand in Western Europe, where German manufactures have a market share of about 50%. In mechanical engineering, we see a production increase of 2%. The sector should benefit from foreign demand and the increasing inclination of domestic companies to invest. However, Q1 2014 was quite weak. Domestic production in the electrical engineering industry could grow 3%. For the metal industry we even expect a 4% increase. The chemical sector could see growth of 1% despite disappointing results in the first months of 2014. Thus, a downward revision in d the chemical industry has become more likely. The food industry – a very stable sector as it is – could see production stagnating in 2014. All told, the manufacturing output in Germany should expand by about 4% in real terms in 2014 (after -0.1% in 2013).

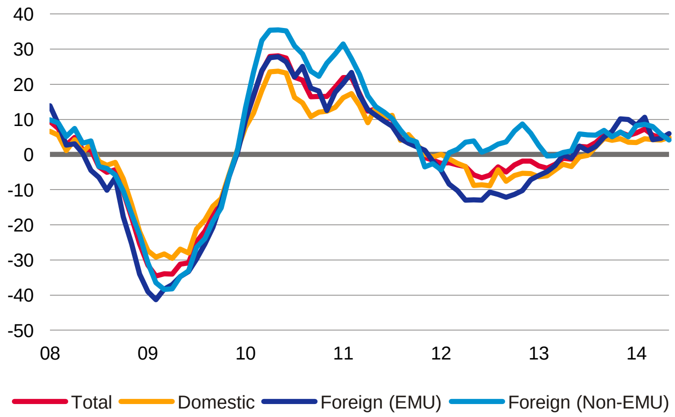
Industrial production, new orders & ifo expectations

% yoy, 3M mov. avg. (left); index (right)

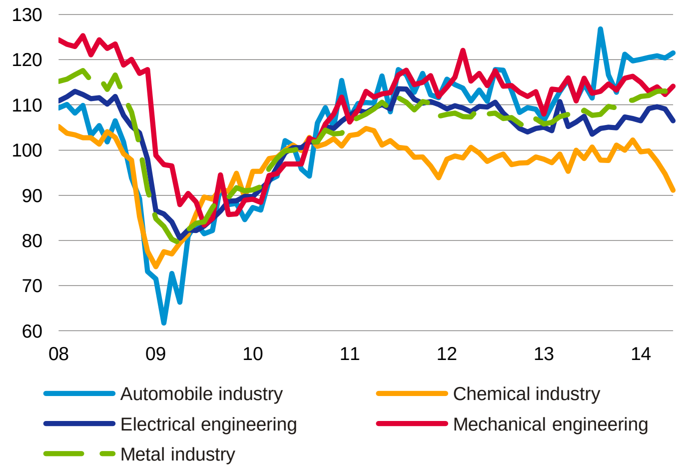


New manufacturing orders by region

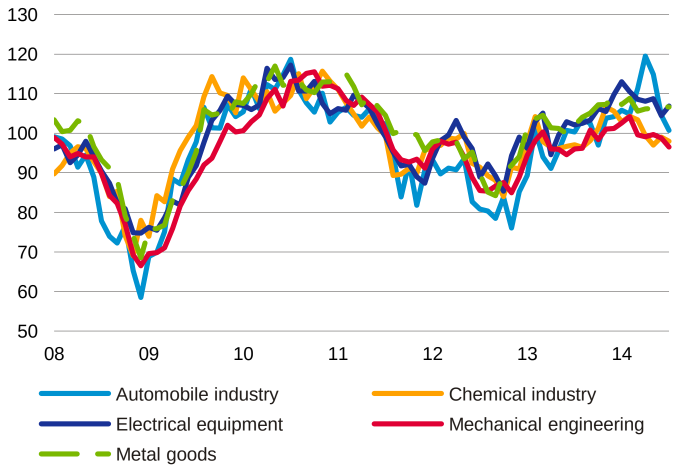
% yoy, 3M mov. avg.



Production of largest industrial sectors (2010=100, sa)



ifo business expectations of the largest industrial sectors (2005=100)



Sources: Federal Statistical Office, ifo

Chartbook – Domestic economy

— The cyclical recovery since spring 2013 has translated into upward momentum on the labour market towards the end of 2013. In July 2014 the labour market showed renewed strength, after disappointing in the previous two month – payback for the earlier than usual spring recovery. The number of unemployed persons fell by 12,000 which was stronger than expected. Unemployment stands below its previous year's level (-43,000 yoy). Mainly due to immigration employment gains exceed unemployment decreases by about 350,000 persons. Leading indicators suggest that the positive trend should continue in the next few months. The unemployment rate should fall to 6.7% in 2014 after 6.9% in 2013.

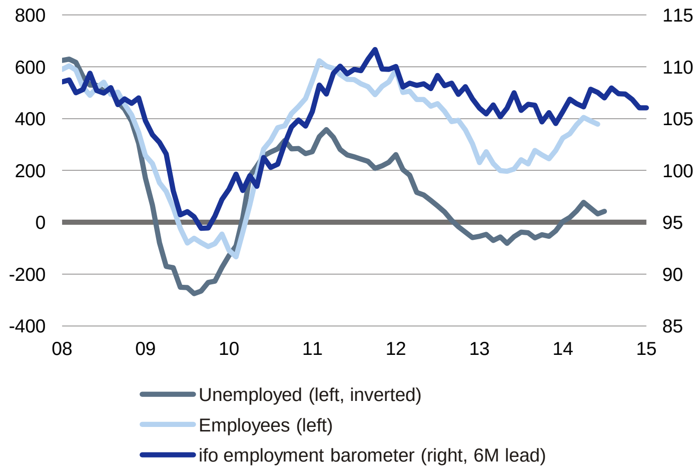
— Retail sales were up by 2.1% yoy (3M mov. avg.) in June – mostly due to the strong April (+3.2% yoy). Thus, the growth rate is likely to moderate in July. The record level of e.g. the Gfk consumer climate (highest since December 2006) and the positive labour market suggest a continued robust growth of retail sales.

— After weakness in 2013 investment in M&E and construction spending should pick up again this year. Investment in M&E was strong in Q1. However, domestic investment goods orders and capacity utilization currently do not point to a further strong acceleration in the remainder of 2014.

— The construction sector benefits from high net immigration and rising disposable income propelling housing demand. Construction activity (Apr.: +4.5% yoy, 3M mov. avg.) and orders (+12.7%) are markedly higher than last year despite weakening in April. Construction spending could grow by a good 5% in real terms in 2014 (2013: -0.2%).

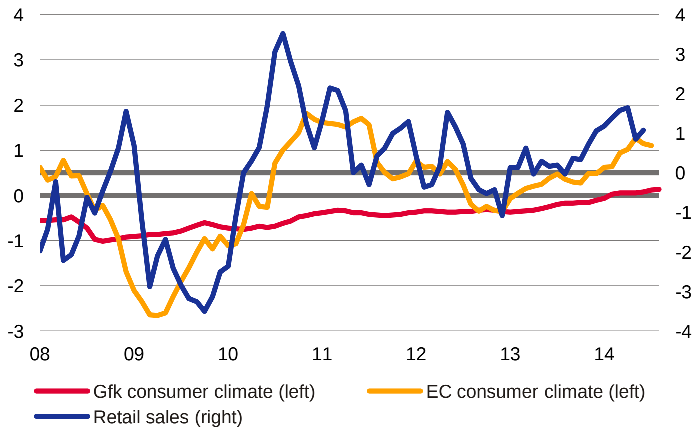
Unemployment barometer, employment and unemployment

'000 yoy (left); index (right)



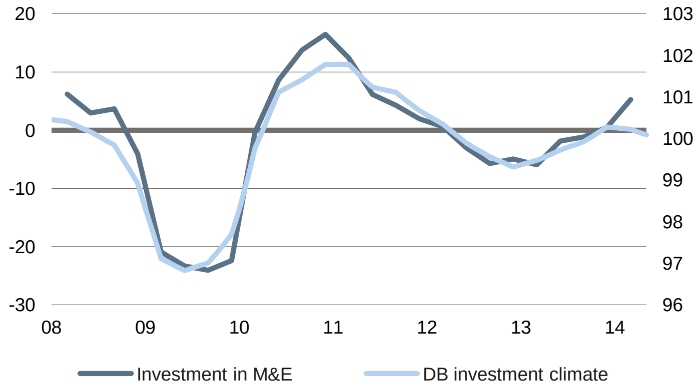
Retail sales and consumer confidence

Normalized data (left), % yoy, 3M mov. avg. (right)



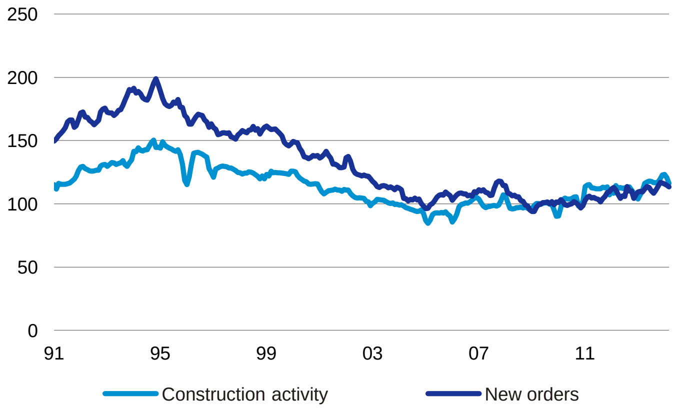
Investment in machinery & equipment and DB investment climate

% yoy (left); index normalized to 100 (right)



Construction activity and new orders

2010=100, 3M mov. avg.

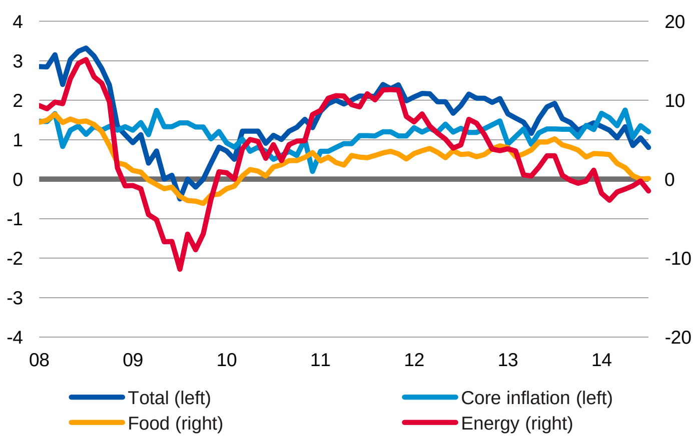


Sources: Federal Statistical Office, Deutsche Bank Research, Gfk, EU Commission, ifo

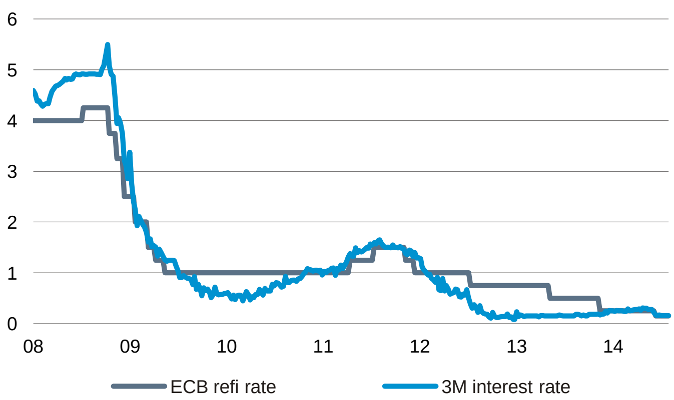
Chartbook – Financial markets

- Inflation fell to its lowest level since early 2010 (0.8% vs. 1.0% prev.). This reflects primarily a – in our view temporary – oil price related decline in energy prices (-1.5% vs. -0.3%). Food prices were nearly unchanged (+0.1% vs. +0% prev.). World food prices and price expectations of food producers suggest an upward movement in the coming months. Core inflation moderated to 1.2% (1.4% prev.) largely due to a fall of package holidays prices that have fluctuated lately.
- The ECB introduced a broad based package of easing measures. The refi rate was lowered to 0.15% and the deposit rate to -0.1% – the first negative rate ever. In addition, the full allotment was prolonged, the sterilisation of the SMP program stopped, preparations for a private bond purchase program (ABS) intensified and a targeted LTRO announced. This is supposed to secure banks' access to liquidity for the foreseeable future, keep short-term interest rates low and stimulate lending. While the package is big, we do not believe that it will provide a decisive boost. Thus, a private asset purchase program is expected in H1 2015.
- Since the start of 2014 10Y US treasury yields fell from 3% to 2.5% recently. This was caused by uncertainty about the strength of the US recovery, the dampened inflation environment and dovish Fed-comments. Despite some signs of rising inflation Fed chief Yellen remained cautious with remarks on the Fed's first rate hike. Given diverging interest rates and growth expectations for EMU and the US, the yield spread between 10Y US treasuries and German Bunds has widened further to above 1pp as of late. In contrast, an improved economic outlook and continued policy accommodation have lowered the peripheral's spread vs. Germany to below 1.5% (mid-2013: around 3pp).
- The EUR depreciated against the USD due to the divergent economic development and monetary policy stance of the US and Eurozone.

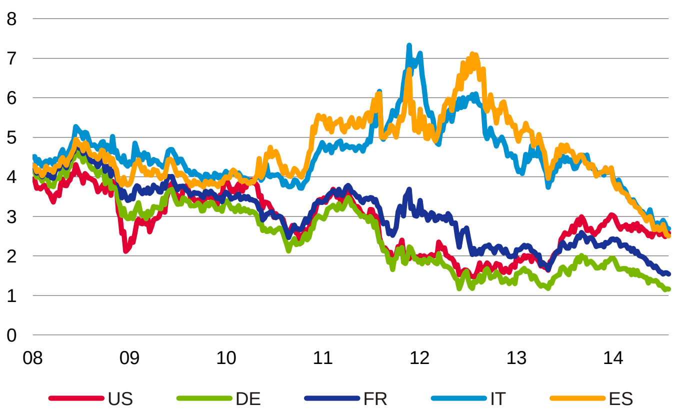
Consumer prices (% yoy)



EMU: Refi rate & 3M interest rate (%)

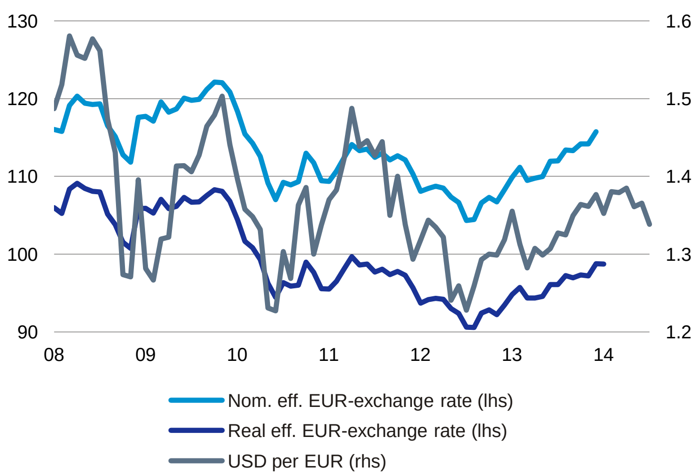


10Y government bond yields (%)



Exchange rate development for the EUR

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

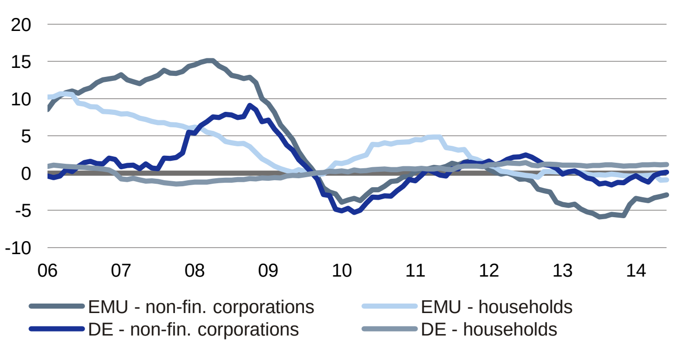


Sources: Federal Statistical Office, ECB, EU Commission, Global Insight, Reuters, Deutsche Bank Research

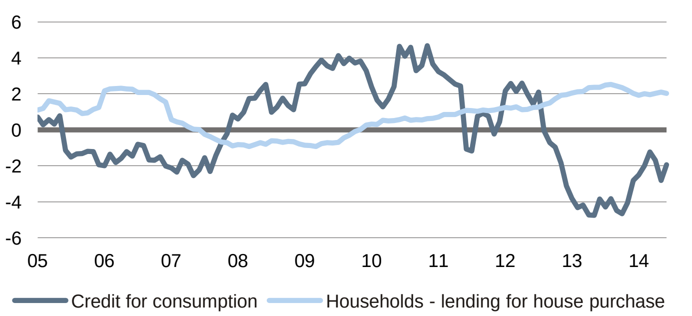
Chartbook – Lending

- Lending to corporates remained weak in 2013 with the declines being more pronounced in the Eurozone than in Germany. While reductions in Germany reflect a mix of modest investment activity and firms' use of alternative means of financing, the drop in the Eurozone is to a large extent the result of ongoing deleveraging processes. In 2014, shrinking processes have become somewhat less pronounced in the Eurozone. With -2.9% yoy, June records the smallest reduction since the start of the year. Also, recent Bank Lending Survey results for the Eurozone show increasing net demand for corporate credit and the first net easing of credit conditions since Q2 2007. Credits to corporates in Germany shows signs of stabilization in Q2 with June even showing slight growth (+0.1% yoy) for the first time since March 2013.
- Households in the Eurozone also continue deleveraging weighing on new borrowing (June: -0.9% yoy). By contrast, lending to households in Germany continues to rise (June: +1.2%), which is rather modest given the backdrop of strong consumer confidence and record low interest rates.
- The moderate credit growth in Germany is solely driven by mortgage lending. June (+2% yoy) is in line with developments in the first half of the year. Given the low level for mortgage rates (May 2.6%), credit growth remains rather modest, which partly reflects portfolio shifts by households and local supply shortages. Consumer credit remained restrained (June: -2% yoy) also reflecting rising income situation for many households reducing the need to finance consumption via credit.
- With benchmark rates remaining historically low, favourable interest rates for German companies persist. Interest rates for corporate credit increased by 11 bps to 3.1% in May.
- Credit constraints remain favourable in June, only 18.3% of companies from industry and trade and 22.6% of construction companies see credit constraints. Most recent results from the ECB's bank lending survey suggest that credit standards for loans to enterprises have remained unchanged in Q2. Net loan demand of enterprises on the other hand increased somewhat with 3%. On balance, alternative financing options of enterprises continued to contribute negatively to corporate loan demand though with a lower extent. Looking forward, for the third quarter of 2014 German banks expect significant net easing of credit conditions to enterprises.

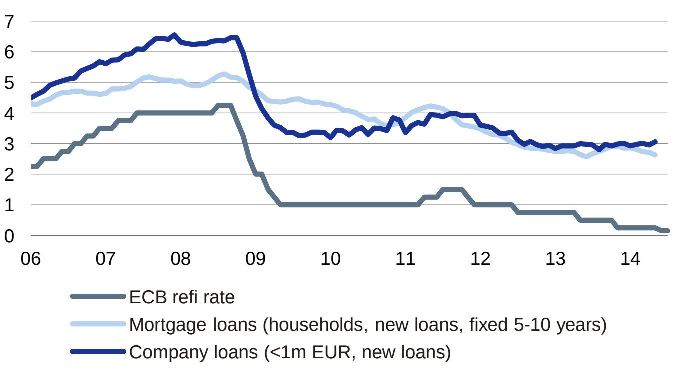
Lending to the private sector (% yoy)



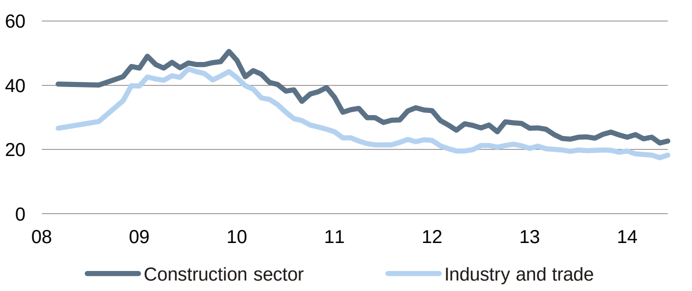
Loans to households (% yoy)



Interest rates (%)



Companies' view on access to credit



Credit constraints: Percentage of companies reporting restrictive access to credit. Higher values indicate more restrictive access to credit from companies' perspective.

Sources: ECB, ifo, Deutsche Bank Research

Chartbook – Public finances

— In 2013, Germany was the only eurozone country – apart from Luxembourg – without a budget deficit. But the federal and Länder governments (in total) still report deficits. The general budget only edged into the black thanks to the municipalities and social-security surpluses. Budgets for 2014 and 2015 are also projected to close with small surpluses.

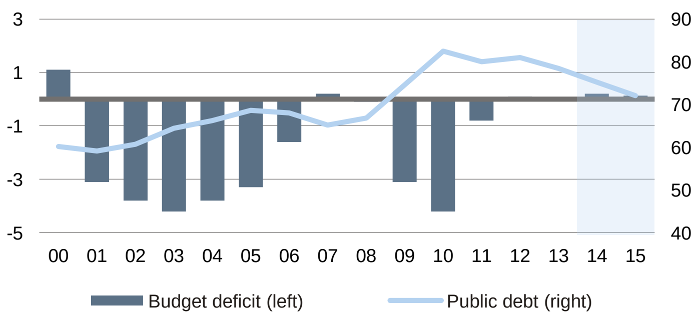
— The German public debt ratio stood at 77.3% of GDP at the end of Q1 2014 (Q4 2013: 78.4%). The positive development was partly attributable to growing revenues, but also to the fact that the bad banks continue to run down their portfolios. By contrast, the debt-to-GDP ratio in the eurozone climbed from 92.7% to 93.9%.

— General government debt in Germany is set to decline further during the next few years. The reduction of the bad bank portfolios alone will cut the debt by 0.5% of GDP p.a.; moderate growth outstripping economic potential will also help lower the debt-to-GDP ratio.

— As expected after the sharp decrease in May total tax revenues climbed again in June compared to the same period last year – indeed very boldly by round about 6% yoy. The special effects in connection with the final withholding tax on dividends and the motor vehicle tax were compensated in June. In H1, total tax revenues were again about 2.5% higher than in the year-earlier period (+1.4% in May). On the basis of a 12 months moving average the increase was even 2.6%. The wage tax (as the main component of income tax) and the VAT are still growing at a solid pace. However, on a cumulative basis, the other components of income tax – especially the highly profit-dependent taxes like the corporation tax, the final withholding tax on interest income and the non-assessed tax on earnings (which largely equals the withholding tax on dividends) – lie clearly below the same period last year.

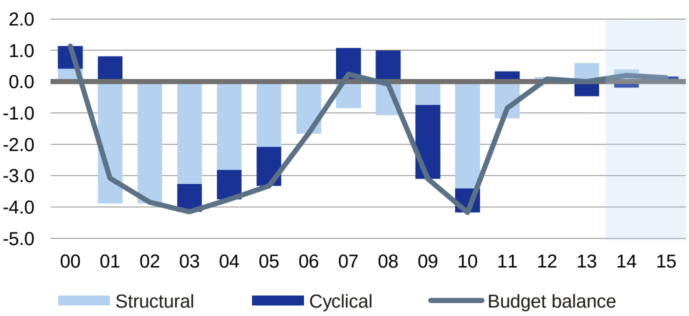
Public debt and public deficit

as % of GDP



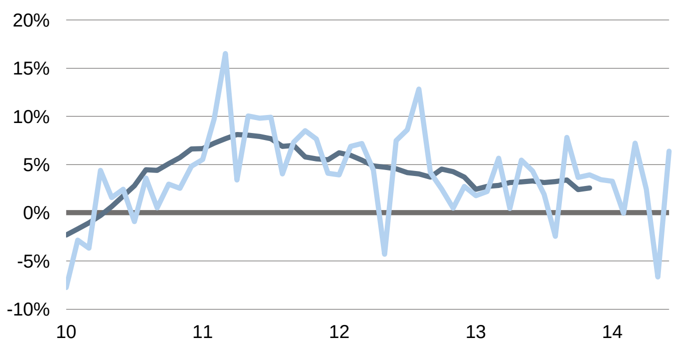
Budget balance

General Government, % of GDP



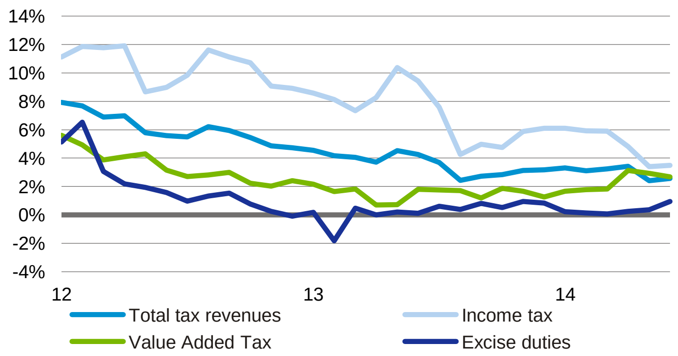
Tax revenues

Monthly data, yoy and yoy 12 months moving average



Development of important taxes

Change yoy, 12 months moving average



Sources: Deutsche Bank Research, European Commission, Bundesbank

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

Date	Event	Remarks
7 Aug.	Meeting of the ECB Council, press conference	Review of the monetary policy stance.
30 Aug.	European Council, special meeting in Brussels	Decisions on appointments for the next institutional cycle.
31 Aug.	State election in Saxony	The CDU will again become the strongest party by far in the state parliament. Most likely, however, it will again need a coalition partner to remain in power. Probably the CDU will have the opportunity to choose between the SPD, the Greens and the AfD.
4 Sep.	Meeting of the ECB Council, press conference	Review of the monetary policy stance.
11/12 Sep.	Meeting of the ASEM Finance Ministers, Milan	Finance Ministers from 52 European and Asian states will debate on economic relations and prepare the ASEM summit on 16/17 Oct.
12/13 Sep.	Eurogroup and informal ECOFIN, Milan	Stability developments in the euro area; economic outlook for 2014-2015; Greece and Cyprus adjustment programmes - 5th review; Banking Union.
14 Sep.	State elections in Brandenburg and Thuringia	In Thuringia a renewed CDU/SPD coalition is likely. However, the SPD has not yet ruled out a coalition with the Left party. In Brandenburg we expect a renewed coalition between the SPD and the Left party.
20/21 Sep.	Meeting of the G20 Finance Ministers and Central Bank Governors, Cairns/Australia	Debates on fiscal and monetary policy (measures to boost investment, trade and employment), on financial regulation (e.g. shadow banking), and tax (tax avoidance and tax transparency).

Source: Deutsche Bank Research

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Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
6 Aug 2014	8:00	New orders manufacturing (Index, sa), pch mom	June	0.5	-1.7
7 Aug 2014	8:00	Industrial production (Index, sa), pch mom	June	1.2	-1.8
8 Aug 2014	8:00	Trade balance (EUR bn, sa)	June	17.8	18.8
8 Aug 2014	8:00	Merchandise exports (EUR bn, sa), pch mom (yoy)	June	1.2 (3.2)	-1.1 (2.4)
8 Aug 2014	8:00	Merchandise imports (EUR bn, sa), pch mom (yoy)	June	2.8 (1.5)	-3.4 (-1.9)
14 Aug 2014	8:00	Real GDP (Index, sa), % qoq	Q2 2014	0.0	0.8
21 Aug 2014	9:30	Manufacturing PMI (Flash)	August	52.5	52.9
21 Aug 2014	9:30	Services PMI (Flash)	August	55.5	56.6
25 Aug 2014	10:30	ifo business climate (Index, sa)	August	107.5	108.0
28 Aug 2014	10:00	Unemployment rate (%, sa)	August	6.6	6.7
28 Aug 2014	14:00	Consumer prices preliminary (Index, sa), pch mom (yoy)	August	0.1 (0.9)	0.3 (0.8)
29 Aug 2014	8:00	Import prices (Index, sa) pch mom (yoy)	July	-0.7 (-2.0)	0.2 (-1.2)
29 Aug 2014	8:00	Retail sales (Index, sa), pch mom	July	-0.5	1.3

Sources: Deutsche Bank Research, Federal Statistical Office, Federal Employment Agency, ifo, Markit

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Financial forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	0.125	0.10	0.15	0.50	0.00	0.25	0.20	1.50	2.50	2.10	0.05
Sep 14	0.125	0.10	0.15	0.50	0.00	0.25	0.20	1.50	2.50	2.20	0.05
Dec 14	0.125	0.10	0.15	0.75	0.00	0.25	0.20	1.50	2.50	2.20	0.05
Jun 15	0.500	0.10	0.15	1.00	0.00	0.25	0.20	1.50	2.50	2.50	0.05
3M interest rates, %											
Current	0.24	0.21	0.21	0.56							
Sep 14	0.35	0.20	0.20	0.55							
Dec 14	0.35	0.20	0.20	0.80							
Jun 15	0.75	0.20	0.25	1.10							
10J government bonds yields, %											
Current	2.54	0.54	1.16	2.59	0.62	1.65	1.54	2.35			
Sep 14	2.65	0.70	1.50	2.90	0.85	1.90	1.85	2.65			
Dec 14	2.80	0.70	1.75	3.00	1.15	2.10	2.05	2.80			
Jun 15	3.00	0.80	1.90	3.20	1.35	2.20	2.10	3.15			
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	1.34	102.78	0.79	1.69	1.22	9.22	7.46	8.40	4.15	312.96	27.50
Sep 14	1.33	107.00	0.79	1.68	1.26	9.00	7.46	8.00	4.13	314.00	27.00
Dec 14	1.30	112.00	0.78	1.67	1.27	8.70	7.46	7.90	4.05	320.00	27.00
Jun 15	1.22	116.00	0.77	1.58	1.27	8.58	7.46	7.70	4.00	319.00	27.00

Sources: Bloomberg, Deutsche Bank

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German data monitor

	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Feb 2014	Mar 2014	Apr 2014	May 2014	Jun 2014	Jul 2014
Business surveys and output											
Aggregate											
Ifo business climate	105.3	107.2	108.8	110.9	110.4	111.3	110.7	111.2	110.4	109.7	108.0
Ifo business expectations	101.8	103.4	106.0	107.8	106.0	108.2	106.3	107.2	106.1	104.8	103.4
PMI composite	49.9	52.9	54.5	55.4	55.2	56.4	54.3	56.1	55.6	54.0	55.9
Industry											
Ifo manufacturing	100.4	102.7	104.5	106.8	106.6	107.3	106.9	107.5	106.9	105.3	103.7
PMI manufacturing	48.7	51.2	52.9	55.0	52.8	54.8	53.7	54.1	52.3	52.0	52.9
Headline IP (% pop)	1.6	0.7	0.6	1.3		0.5	-0.8	-0.3	-1.8		
Orders (% pop)	1.0	1.5	2.3	0.1		0.9	-2.8	3.4	-1.7		
Capacity Utilisation	82.1	83.2	83.2	83.4	84.3						
Construction											
Output (% pop)	11.8	1.4	-0.5	5.1		1.9	-4.1	-3.6	-3.6		
Orders (% pop)	1.9	-1.3	3.4	1.6		-3.8	-2.3	3.9	-4.9		
Ifo construction	123.7	120.5	121.2	122.6	120.5	123.1	120.6	120.6	120.3	120.5	119.4
Services											
PMI services	49.9	52.6	54.1	54.0	55.1	55.9	53.0	54.7	56.0	54.6	56.6
Consumer demand											
EC consumer survey	-4.2	-3.2	-2.8	0.3	4.3	-0.7	2.3	3.1	5.5	4.3	3.9
Retail sales (% pop)	0.2	-0.2	0.2	1.5	-0.3	0.6	-0.5	-0.5	-0.2	1.3	
New car reg. (% yoy)	-3.7	-1.4	1.6	2.8	-0.3	4.3	5.4	-3.6	5.2	-1.9	
Foreign sector											
Foreign orders (% pop)	2.8	0.6	3.9	-1.3		0.7	-4.5	5.0	-1.2		
Exports (% pop)	0.4	0.2	1.6	0.3		-1.3	-1.8	2.6	-1.1		
Imports (% pop)	1.4	-0.3	0.6	2.2		0.4	-1.1	0.2	-3.4		
Net trade (sa EUR bn)	48.1	49.3	52.2	48.0		15.8	14.9	17.2	18.8		
Labour market											
Unemployment rate (%)	6.9	6.8	6.9	6.8	6.7	6.8	6.7	6.7	6.7	6.7	6.7
Change in unemployment (k)	17.0	0.0	13.3	-47.0	-19.3	-13.0	-10.0	-26.0	23.0	7.0	-12.0
Employment (% yoy)	0.5	0.6	0.6	0.8	0.9	0.8	0.9	1.0	0.9	0.9	
Ifo employment barometer	104.9	106.3	107.2	107.5	106.8	108.0	107.4	107.4	106.8	106.0	106.0
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.5	1.7	1.3	1.0	0.9	1.0	0.9	1.1	0.6	1.0	0.8
Core HICP (% yoy)	1.0	1.2	1.1	1.1	1.1	1.2	0.9	1.4	0.7	1.1	
Harmonised PPI (% yoy)	-0.1	-0.3	-0.7	-1.0	-0.8	-0.9	-0.9	-0.9	-0.8	-0.7	
Commodities, ex. Energy (% yoy)	-7.0	-12.2	-10.4	-11.1	-4.9	-11.0	-11.3	-5.8	-5.4	-3.5	
Oil price (USD)	102.5	110.4	109.3	108.2	109.7	108.9	107.5	107.7	109.6	111.8	
Inflation expectations											
EC household survey	22.5	26.2	25.5	22.0	16.9	22.0	19.9	18.0	18.1	14.6	15.3
EC industrial survey	-0.6	2.8	6.1	5.6	2.3	4.8	4.1	2.5	1.9	2.6	3.3
Unit labour cost (% yoy)											
Unit labour cost	1.4	1.2	1.2	0.5							
Compensation	1.7	2.0	2.0	2.5							
Hourly labour costs	1.1	1.2	1.9	0.3							
Money (% yoy)											
M3	3.8	2.5	2.7	3.5	4.2	3.9	3.5	3.7	4.4	4.2	
M3 trend (3m cma)						3.5	3.7	3.8	4.1		
Credit - private	1.3	-4.0	-3.1	-3.6		-3.9	-3.6	-3.4	-3.2		
Credit - public	-22.4	-17.7	-17.1	-1.5		-5.8	-1.5	-8.4	-2.3		

% 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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