

Talking point

German manufacturing suffering slump in business with Russia

March 12, 2015

In 2014, Germany exported goods worth EUR 1.1 tr (+3.7%), which represented a new record high. Conversely, German exports to Russia fell by 18% because of the latter's economic and political problems, with the declines in certain sectors even exceeding 30%. True, the share of total German exports going to Russia has decreased to only 2.6% (2013: 3.3%; 2012: 3.5%), but certain sectors and companies are nevertheless being hit hard by the decline. We expect exports to Russia to drop significantly in 2015, too. Out of Germany's major manufacturing sectors it is probably engineering that is suffering the most as Russia is still one of its biggest foreign markets.

Germany achieved record-high exports in 2014 worth more than EUR 1.1 tr (+3.7%). Exports to Russia, by contrast, tumbled 18%. The depreciation of the rouble, patently weak investment, considerable capital outflows and trade sanctions due to the crisis in eastern Ukraine dampened Russian demand for German manufactured goods. In the second half of 2014 came the slump in the oil price, too, as the Russian economy is still highly dependent on energy commodities. The strong decline in exports to Russia resulted in the country's share of German exports falling to 2.6%; in 2012 the share was still 3.5%. As a result, Russia slipped two places in the league table of Germany's biggest export markets to 13th place.

Declines vary from one sector to the next

A look at individual sectors shows that weak Russian demand has had a very mixed impact on them. Out of the major German manufacturing sectors it is the food industry that has suffered the heaviest slump in Russian sales; its exports have fallen by nearly 34% in value terms. The sector as a whole can cope with this, however. Its export ratio of 22.5% means that it is not particularly export intensive. In addition, Russia has become less important as a market for German foods over recent years. In 2014 the country absorbed just 1.8% of all German food exports (2010: 3.9%).

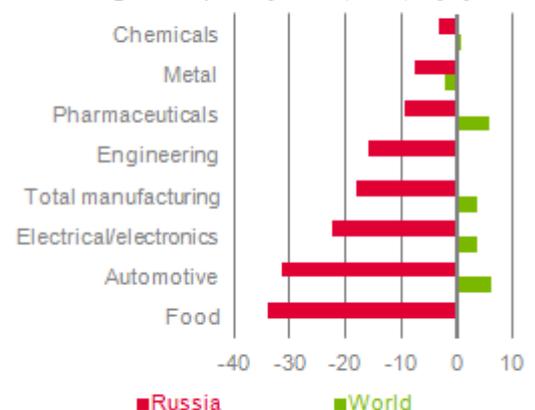
Auto industry exports to Russia also nosedived in 2014, dropping by a nominal 31.5%. This was already the second sharp decline in succession (2013: -14%), with the result that Russia's share of all German auto industry exports has shrunk to a mere 2.5% (2012: 4.6%). In the space of one year Russia has slipped in the rankings of the most important foreign markets for the German automotive industry from 5th place (2013) to 10th (2014). True, the auto industry did manage to offset the decrease in Russian sales in 2014 by boosting the value of exports to China, the US and Western Europe (especially the UK and Spain). The sector's total exports rose by 6.5% in 2014. Nevertheless, the latest softening of exports to Russia is a bitter disappointment to the sector since many market observers thought Russia was already in the process of becoming the biggest car market in Europe.

Admittedly, engineering exports to Russia did fall by "only" 15.8% in 2014 (2013: -4.6%). However, this decline hit the sector comparatively hard. Russia was after all – despite the declines – still the sixth biggest export market for German engineering in 2014 (share: 4.1%; 2012: 5.1%). On top of this, engineering is one of the most export-intensive sectors overall (export ratio 2014: 65.4%). In absolute terms engineering is the sector that generates the highest revenues from exports to Russia (2014: EUR 6.8 bn).

In both the chemicals and pharma industries exports to Russia were comparatively robust in value terms in 2014. Chemicals industry exports fell by only 3.2% in value terms in 2014. Russia's share of total chemicals exports

Exports to Russia falling at differing rates

German goods exports by sector, 2014, % yoy



Sources: Federal Statistical Office, Deutsche Bank Research



from Germany, however, amounted to only 2.8%. In the pharma industry the value of exports to Russia declined by 9.2% in 2014. However, it should be noted that chemicals exports to Russia had more than doubled between 2009 and 2013.

Engineering also hit harder than average in 2015

The economic outlook for Russia has become more gloomy in recent weeks. We expect GDP to contract by 5% in real terms in 2015. Continuing capital outflows, a low oil price, the depreciation of the rouble and ongoing trade and financial sanctions as a result of the still unsolved conflict in eastern Ukraine would remain negative factors in 2015 as well. In this environment German exports to Russia are set to decrease this year, too.

Generally the sectors hit hardest by this will be those with a high export ratio overall and in which Russia also absorbs an above-average share of total exports. For example, this applies to German engineering, which is likely to book far fewer orders from Russia in 2015 because capital expenditure there will decrease. In the pharma industry, too, both criteria are fulfilled, but demand for pharmaceutical products is relatively income inelastic. One fascinating question is whether the German chemicals industry will again succeed in getting off lightly in its Russian business operations in 2015. In the auto industry the Russian share of total exports is no longer particularly high. A further decline in automotive demand in Russia would hurt all the same. In the auto industry, what is more serious overall is that for the time being the companies can derive only little benefit from the investments they made in Russia over recent years. This also applies to other competitors from other countries of course.

Overall, German exports to Russia will continue to decrease in 2015. Thus, the market that was once regarded as a beacon of hope will continue (for now) to become less important for the German export business. None of the major manufacturing sectors will be able to escape the downturn. For individual companies with particularly extensive activities in Russia the fallout from the decline in Russian business may be a great deal larger. However, it is also the case that the overall German export outlook has improved over the last few months. The most important German export markets are benefiting from the lower oil price. In addition, the weaker euro is boosting the price competitiveness of products from Germany. All in all, the expected decline in German exports to Russia in 2015 is clouding the otherwise relatively positive German export outlook; in the full year 2015 German exports should grow by about 5% in real terms.

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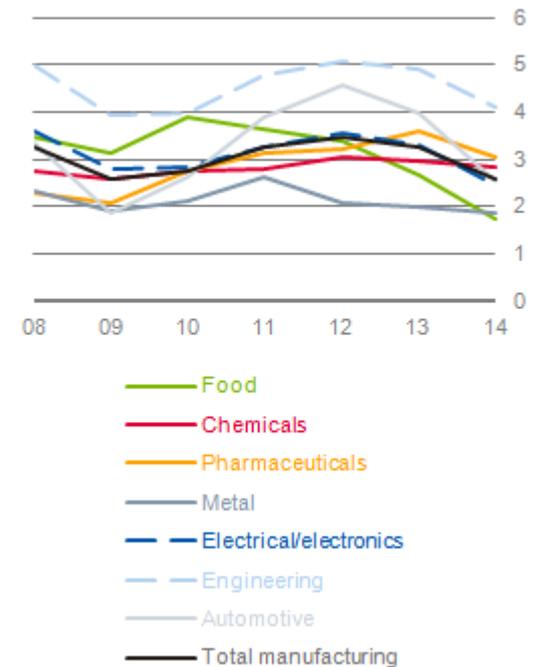
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Russian export share fell across all sectors in 2014

Russian share of German exports by sector, %



Sources: Federal Statistical Office, Deutsche Bank Research

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