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Focus Germany

Structural downshift in global trade burdens growth outlook

December 2, 2014

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Meagre Q3 GDP expansion: Harbinger of weak winter half. Underlying growth of the German economy has slowed in Q3. After average quarterly growth rates of over 0.3% qoq in the last 1 ½ years, GDP expanded just 0.1% in Q3. The growth composition was one sided and not encouraging for Q4 growth. While consumption remained the major growth contributor in Q3 thanks to the robust labour market, investment in machinery & equipment slumped as moderate capacity utilization, concerns over global growth prospects and geopolitical risks are taking their toll. Inventories were a major drag. Net exports were slightly positive. Due to upward revisions to H1 GDP we see 2014 GDP at 1.4% now. We expect about stagnation in the next two quarters with a risk of a negative print as sentiment has weakened further in October/November. The growth composition is likely to be tilted towards private consumption with exports and investment being a drag. This will provide a weak starting base for 2015 GDP growth.

Sluggish German exports – cyclical or structural? After world trade slumped in 2009 during the global financial crisis, it rebounded strongly in 2010 and 2011. Since 2012, however, global trade growth has been anaemic and has in contrast to past decades been even lower than GDP growth. Weaker global trade growth is already leaving its imprint in Germany's muted export performance. For Germany the questions are therefore as follows: Is the relative slowdown in German exports due to temporary cyclical factors or lasting structural changes? Can exports fulfil their usual role as a motor of growth in the next few years?

The little momentum generated since 2012 points towards structural changes. The establishment of global value chains has probably reached a plateau for the time being; the Chinese economy's stronger domestic focus will provide little stimulus for world trade; and the negotiations about new major trade agreements are becoming increasingly difficult. In addition, the G20 nations have adopted new restrictive measures which dampen trade. Comparing the actual development of German exports with the estimate provided by our trade model indicates that the lower elasticity with regard to global growth is structural in nature and that probably a level shift occurred. We forecast average real German export growth at the lower end of a range of 4%-6% between 2014 and 2019, which should be buttressed by a depreciation of the euro.

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2014F	2015F	2016F	2014F	2015F	2016F	2014F	2015F	2016F	2014F	2015F	2016F
Euroland	0.7	0.8	1.2	0.5	0.8	1.4	2.2	2.5	2.4	-2.6	-2.5	-2.4
Germany	1.4	0.8	1.2	1.0	1.2	1.5	7.2	6.4	6.2	0.1	-0.5	-0.7
France	0.4	0.7	1.4	0.6	0.8	1.3	-1.8	-1.8	-1.5	-4.4	-4.2	-3.9
Italy	-0.4	0.3	0.8	0.2	0.6	1.1	1.6	1.3	1.2	-3.0	-2.9	-2.7
Spain	1.2	1.7	1.7	-0.1	0.7	1.4	0.5	0.7	1.1	-5.6	-4.6	-4.0
Netherlands	0.7	1.7	1.1	0.4	0.8	1.4	10.9	11.4	11.5	-2.5	-2.0	-1.9
Belgium	0.9	0.7	1.3	0.6	1.0	1.5	1.0	0.7	0.4	-2.8	-2.9	-2.7
Austria	0.7	0.7	1.3	1.5	1.5	1.7	1.5	1.8	2.4	-3.0	-1.9	-1.2
Finland	-0.4	0.4	1.1	1.3	1.3	1.5	-1.9	-1.7	-1.3	-2.9	-2.9	-2.3
Greece	0.4	2.5	2.9	-1.1	0.0	1.0	0.0	0.5	1.0	-1.6	0.2	1.6
Portugal	1.0	1.0	1.5	-0.1	0.8	1.3	0.5	0.8	1.0	-4.7	-3.7	-3.4
Ireland	3.7	2.7	3.0	0.3	0.8	1.6	5.5	5.5	5.0	-3.8	-3.1	-2.9
UK	3.1	2.5	2.3	1.7	1.9	2.0	-4.0	-3.2	-3.0	-4.6	-3.5	-2.1
Denmark	1.0	2.0	1.8	1.0	1.5	2.0	6.7	6.4	6.0	0.0	-1.0	-2.0
Norway	2.4	2.5	2.5	1.8	2.2	2.0	11.0	10.5	10.0	7.0	6.7	6.5
Sweden	2.2	2.6	2.5	0.2	1.5	2.0	6.0	5.5	5.0	-1.5	-1.0	-0.5
Switzerland	1.3	1.8	2.0	0.0	0.3	0.6	12.0	11.0	10.5	0.0	0.2	0.5
Czech Republic	2.2	2.4	2.8	0.5	1.8	2.0	-1.4	-1.2	-1.5	-2.1	-2.3	-2.4
Hungary	3.2	2.3	3.0	0.0	2.1	3.3	1.9	2.0	1.5	-2.9	-2.5	-2.8
Poland	3.0	3.2	3.8	0.2	1.1	2.3	-1.7	-1.8	-2.2	4.5	-2.9	-2.8
United States	2.3	3.5	3.1	1.7	1.3	2.4	-2.5	-2.4	-2.5	-2.9	-2.5	-2.9
Japan	0.5	1.4	1.6	2.9	1.4	1.0	0.4	1.9	2.4	-7.2	-6.4	-5.4
China	7.3	7.0	6.7	2.2	2.6	3.0	3.1	3.4	3.3	-2.1	-2.5	-3.0
World	3.1	3.6	3.7	3.5	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

						2014				2015			
	2012	2013	2014F	2015F	2016F	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	0.4	0.1	1.4	0.8	1.2	0.8	-0.1	0.1	0.0	0.1	0.2	0.3	0.4
Private consumption	0.7	0.8	1.1	1.1	0.9	0.5	0.1	0.7	0.3	0.2	0.2	0.2	0.3
Gov't expenditure	1.2	0.7	1.2	0.9	0.3	0.2	0.4	0.6	0.2	0.1	0.2	0.1	0.2
Fixed investment	-0.7	-0.6	3.0	1.6	2.4	2.8	-1.8	-0.9	0.3	0.3	0.6	1.0	0.7
Investment in M&E	-3.1	-2.4	2.9	0.9	4.2	1.7	0.4	-2.3	-1.0	0.0	0.7	2.0	1.0
Construction	0.6	-0.1	3.4	2.3	2.3	4.2	-3.9	-0.3	1.0	0.7	0.7	0.7	0.7
Inventories, pp	-1.4	0.2	-0.3	-0.3	-0.2	-0.1	0.1	-0.5	0.0	0.0	-0.1	0.0	0.0
Exports	2.8	1.6	3.9	4.7	5.2	-0.2	1.2	1.9	0.5	0.7	1.0	1.2	1.5
Imports	0.0	3.1	3.7	5.5	5.4	-0.1	1.1	1.7	1.2	1.0	1.2	1.5	1.5
Net exports, pp	1.3	-0.5	0.3	0.0	0.3	-0.1	0.1	0.2	-0.2	-0.1	0.0	0.0	0.1
Consumer prices*	2.0	1.5	1.0	1.2	1.5	1.2	1.1	0.8	0.8	1.2	1.2	1.2	1.3
Unemployment rate, %	6.8	6.9	6.7	6.8	7.1	6.8	6.7	6.7	6.7	6.7	6.7	6.8	6.9
Industrial production	-0.4	0.1	1.8	1.0	0.0								
Budget balance, % GDP	0.1	0.0	0.1	-0.5	-0.7								
Public debt, % GDP	81.0	78.4	74.0	72.4	70.6								
Balance on current account, % GDP	7.1	6.7	7.2	6.4	6.2								
Balance on current account, EUR bn	196	192	207	190	189								

*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

Meagre Q3 GDP expansion: Harbinger of weak winter half

— The underlying growth of the German economy has slowed in Germany in Q3. After average quarterly growth rates of over 0.3% qoq in the last 1 ½ years, GDP expanded just 0.1% in Q3.

— The growth composition was one sided and not encouraging for Q4 growth. While consumption remained the major growth contributor in Q3 thanks to the robust labour market, investment in machinery & equipment slumped as concerns over global growth prospects, geopolitical risks and moderate capacity utilization levels took their toll. Inventories were a major drag.Net exports were slightly positive. Due to upward revisions to H1 GDP we see 2014 GDP at 1.4% now.

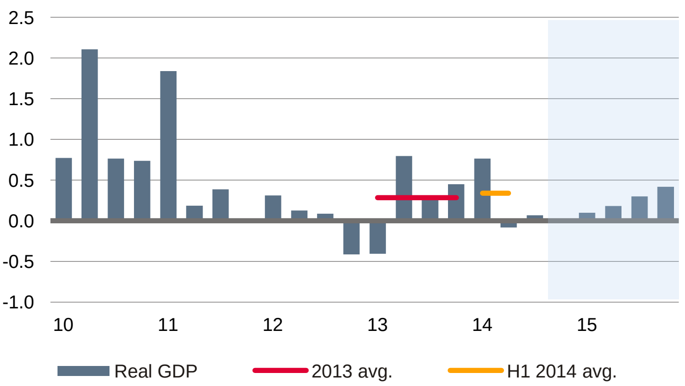
— We expect about stagnation in the next two quarters with a risk of a negative print as sentiment has weakened further in October/November. The growth composition is likely to be tilted towards private consumption with exports and investment being a drag. This will provide a weak starting base for 2015 GDP growth. Our 0.8% forecast marks the lower end of the November's Consensus economics edition.

Underlying growth momentum has slowed in Q3

Detailed GDP numbers confirmed the 0.1% qoq expansion in Q3. The economy did not contract again in Q2. But Q2's -0.1% was a pay-back to the abnormally mild weather conditions which propped Q1 growth to 0.8% qoq. Taken together growth averaged a good 0.3% qoq in H1, the same pace observed over the course of 2013.

Growth has slowed in Q3 1

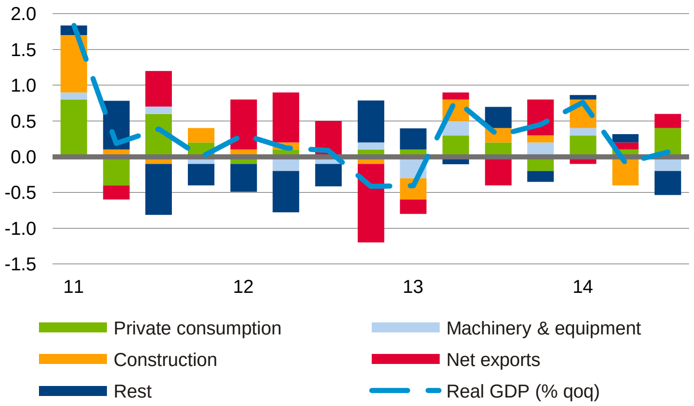
Real GDP, % qoq



Sources: Federal Statistical Office, Deutsche Bank Research

Investment weighed on Q3 growth 2

Contribution to real GDP growth, qoq, %-points



Sources: Federal Statistical Office, Deutsche Bank Research

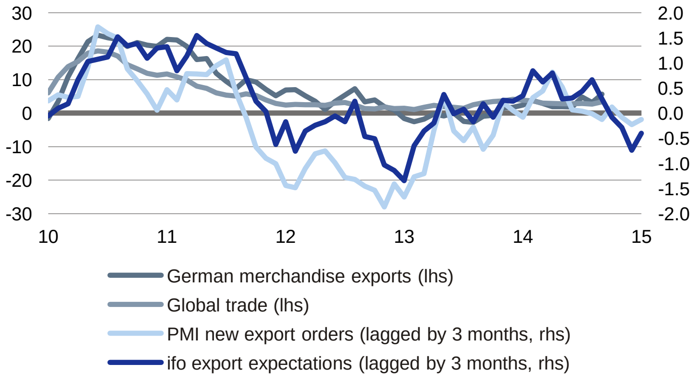
Geopolitics and growth concerns curbed investment

The main source of weakness in Q3 was the decline of investment in machinery & equipment (-2.3% vs. +0.4% prev.). This was a 0.2%-point drag on overall growth and a reaction to worsening export expectations, geopolitical risks and low capacity utilization. Ifo export expectations dropped by over 6 points from May to September and only recovered somewhat in October/November. While the drop looks a bit strong given the until recently more resilient PMI export orders and actual export growth in Q3 it is at least a sign of the uncertainty companies are facing. Chart 4 below shows the search intensity of the German word “Krise” (crisis) in Germany on Google, which has surprisingly high correlation with investment spending underlining this reasoning. But probably even without this uncertainty, the gradual drop in capacity utilisation towards its long-term average suggests that activity is not strong enough to encourage investment.

Concerns over the demand development could also have played a role in the decrease of inventories, which was a substantial 0.5% drag on Q3 GDP. However, this GDP component is only a residual in Germany and not based on actual data making it difficult to interpret. It fits with the greater fall of intermediate goods production (-0.9%) relative to total industrial production (-0.3%), as well as companies’ assessment of their inventory levels, though.

Coming weakness likely overstated (as in 2013) 3

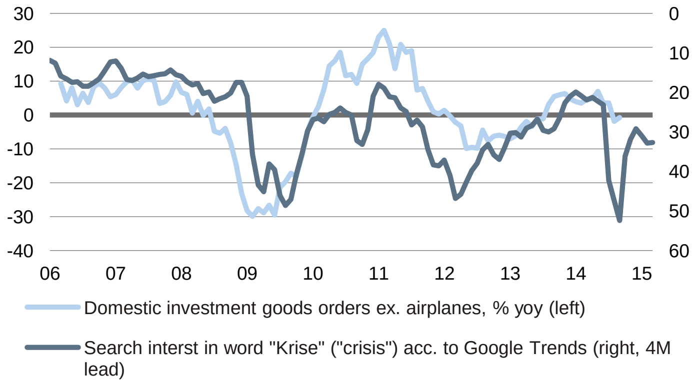
% 3M mov avg yoy (lhs), Standardized values (rhs)



Sources: Deutsche Bundesbank, ifo, Markit, CPB, Deutsche Bank Research

Crisis (fears) and investment goods orders 4

Germany, 3M moving averages



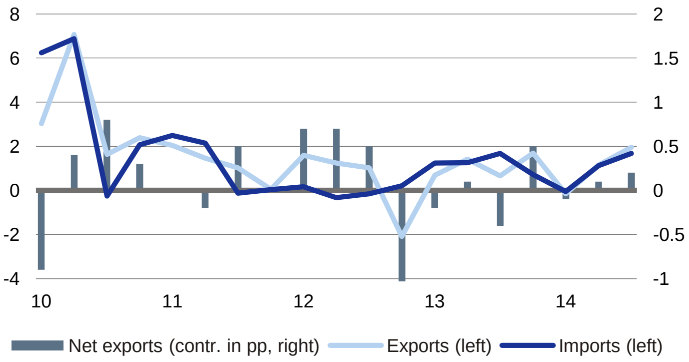
Sources: Federal Statistical Office, Deutsche Bank Research, Google

Net exports slightly positive

In contrast to the drop in export sentiment, net exports actually provided still a small positive for Q3 growth adding 0.2%-points as real exports grew by 1.9% (vs. 1.5%), while imports were up 1.7% (vs. 1.1%). The ifo export expectations point to a steel fall in exports over the coming months; like during 2013 this is likely to be only partly reflected in actual exports. Except for Russia there is no clear single drag on exports. Exports to Russia were down around 18% yoy in Q3, which equals about a 0.5%-point drag on total nominal export growth. Other major export destinations have broadly been supportive of German export growth in 2014. Especially exports to the US (+13%) and Asia (+10%) were much higher than last year, but in general there is a lack of underlying momentum in line with weak global trade.

Robust ex- & imports in Q3 5

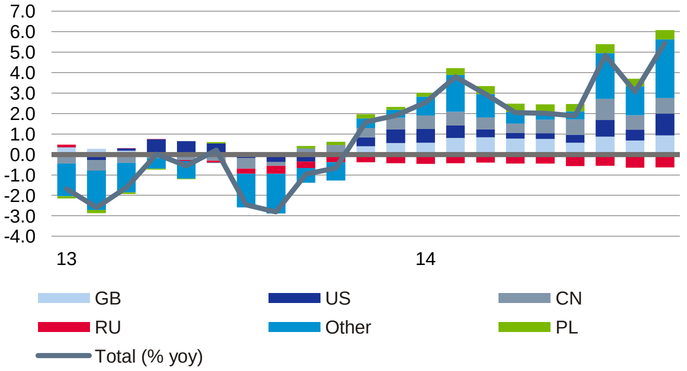
Real, sa, % qoq



Source: Federal Statistical Office

Russia continues to weigh on exports 6

Growth contribution, %-points, 3M mov. avg.



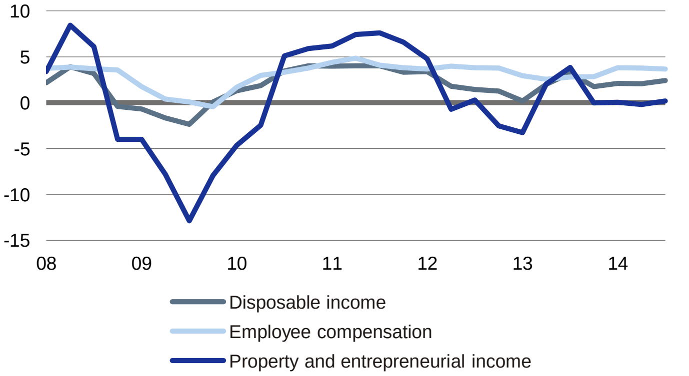
Sources: Federal Statistical Office, Deutsche Bank Research

Labour market supports income and consumption growth

One positive of Q3 GDP was the vigour shown by real private consumption. It expanded by 0.7% qoq (vs. 0.2% prev.) and, thus, contributed 0.4%-points to overall growth. Disposable income has remained on a steady expansion path rising by 2.4% yoy in nominal terms, which is slightly faster than over the last couple of quarters. Income growth is strongly tilted towards wage income (+3.7% yoy), though. This was due to the ongoing strength in employment growth (+83k qoq after +130k in Q2) and robust wage increases (negotiated wages: +2.8% yoy in Q3). The labour market continued to receive impetus from high net immigration flows. In contrast, property and entrepreneurial income remained weak (0.2%) due to companies' low overall utilization and rising wage costs that could be passed on to the consumer only in part. The savings rate stood at 9.3% in Q3 – slightly higher than the average over the last 8 quarters.

Incomes growth at different speeds 7

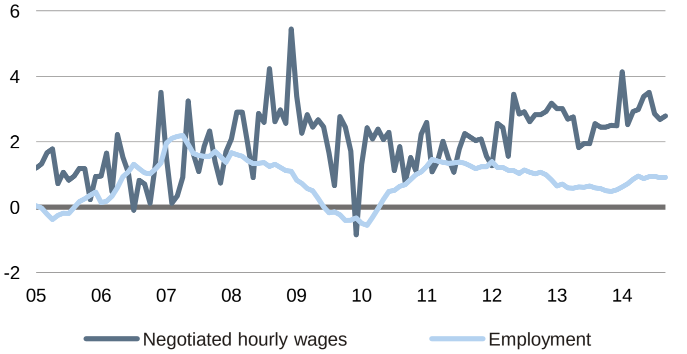
% yoy, nominal



Source: Federal Statistical Office

High wage and robust employment growth 8

% yoy

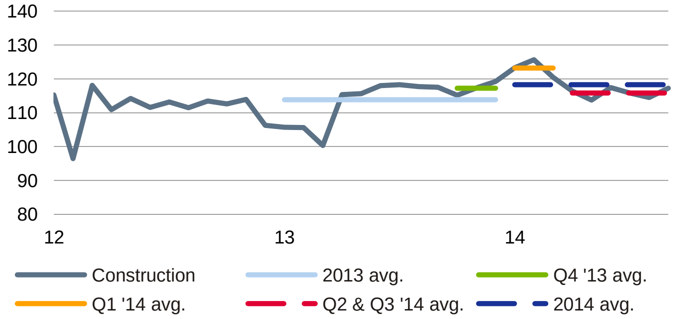


Sources: Federal Statistical Office, Deutsche Bundesbank

Construction was unexpectedly weak in Q3 (-0.3% qoq), after the weather driven yo-yo movement in H1 (Q1:+4.2%; Q2: -3.9%), given e.g. the rise of the construction PMI and the uptrend of residential permits along with the overall supportive environment (low interest rates, rising disposable income, immigration). Thanks to the strong Q1 construction is still up 3.6% year-to-date, though.

Construction output normalising | 9

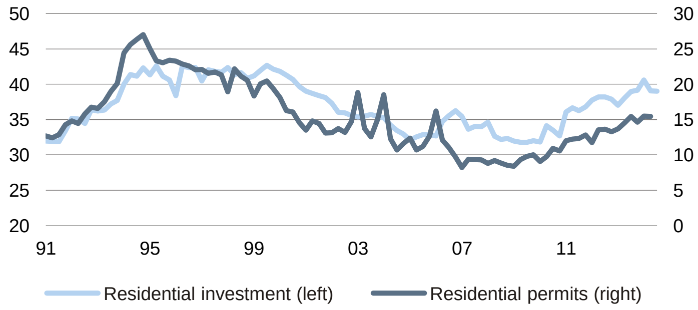
Construction index, 2010=100



Sources: Federal Statistical Office, Deutsche Bank Research

Residential construction remains on an upward trend | 10

Real, 2005=100, sa (l.); bn EUR, sa (r.)



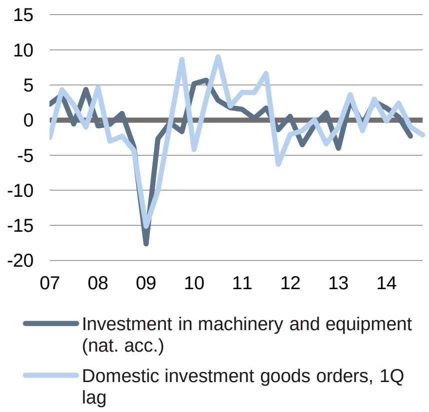
Sources: Federal Statistical Office, Deutsche Bundesbank

Sentiment and investment goods orders point to weak winter-half

Available hard and soft data suggest that German economy is probably stagnating in Q4. We forecast stagnation. While forecasts based on ifo & PMI data suggest moderate growth of 0.2-0.3% qoq, these models generated too optimistic growth prospects in the last two quarters. There is even a risk of a negative quarter in the winter half. On the other hand, the improvement in the ifo index in November could at least suggest that the downtrend is coming to an end. The weak near-term outlook is also corroborated by the further declines of domestic investment goods orders, which have a good correlation with machinery & equipment investment and lead them by about a quarter. Ifo export expectations and PMI new export orders suggest that exports could weaken further, while leading indicators of consumption and employment still look supportive of solid consumption growth.

Investment goods orders point to another decline of investment in M&E | 11

Real, % qoq



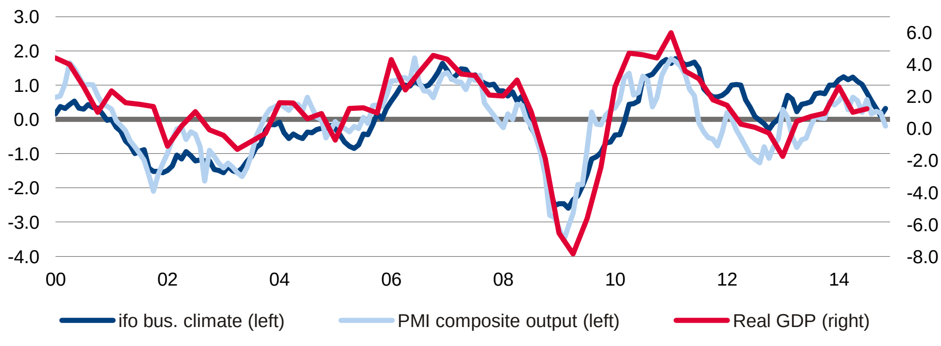
Source: Federal Statistical Office

2014 GDP now 1.4% due to revisions, but 2015 stays at 0.8%

Due to the Statistical Office's moderate upward revisions to H1 2014 our GDP forecast for 2014 has risen to 1.4% from 1.3%. More importantly, our low forecast for 2015 (0.8%) remains untouched. This forecast assumes growth to re-accelerate towards potential in the second half of 2015.

Weakening sentiment points to weak Q4 2014 | 12

Germany; standardized values (left); % yoy (right)



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

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Sluggish German exports – cyclical or structural?

- After world trade slumped in 2009 during the global financial crisis, it rebounded relatively strongly in 2010 and 2011. Since 2012, however, the growth in global trade has been anaemic and in contrast to the development during the past decades has been even lower than GDP growth. Structural changes suggest that global trade performance will also be relatively weak in the coming years.
- This weaker growth is also reflected in less dynamic German export performance. For Germany the questions are therefore as follows: Is the relative slowdown in German exports due to temporary cyclical factors or lasting structural changes? Can exports fulfil their usual role as a motor of growth in the next few years?
- Germany was a clear beneficiary of the increase in international trade links in past decades. The main drivers behind the robust growth in global trade were the integration of emerging markets into the global economy and technological advances, which triggered fundamental changes in work organisation and production methods that enable global value chains to be established and reduced trade costs considerably.
- The little momentum generated since 2012 points towards structural changes. The establishment of global value chains has probably reached a plateau for the time being; the Chinese economy's stronger domestic focus will provide little stimulus for world trade; and the negotiations about new major trade agreements are becoming increasingly difficult. In addition, the G20 nations have adopted new restrictive measures which dampen trade.
- German export growth is also likely to be less dynamic in the coming years. Comparing the actual development with the estimate provided by our trade model indicates that the lower elasticity with regard to global growth is structural in nature and that a level shift probably occurred. We forecast average real German export growth at the lower end of a range of 4%-6% between 2014 and 2019, which should be buttressed by a depreciation of the euro.

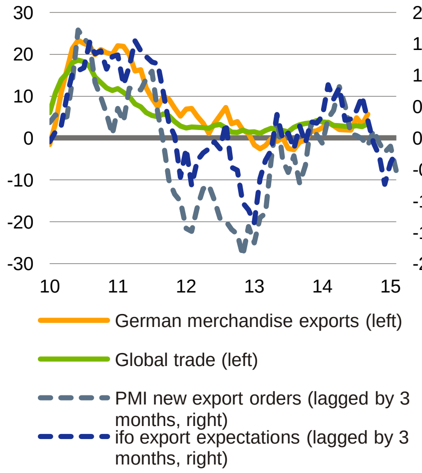
After global trade slumped in 2009 during the global financial crisis, it rebounded relatively strongly in 2010 and 2011. Since 2012 the development of global trade has been anaemic and even fallen short of GDP growth. This was in clear contrast to the development during the past decades and has been one major reason for the generally disappointing performance of the global economy over the last three years. Structural changes suggest that global trade is likely to remain relatively weak in the coming years and post only negligibly faster average growth than global GDP (of more than 3 ½%) until 2019.[1]

This is likely to have far-reaching repercussions for Germany's open economy, whose exports have grown roughly in line with global trade in the past decades. Germany was a clear beneficiary of the increase in international trade links. German firms have been outperformers in setting up global value chains. The weaker growth in global trade relative to global GDP growth has already been reflected in less dynamic German export growth since 2012. Germany thus faces the following questions: Is the relative slowdown in German exports due to temporary cyclical factors or lasting structural changes? Can exports fulfil their usual role as a motor of growth in the next few years?

[1] Peters, H.; Schneider, S. (2014). Sluggish global trade – cyclical or structural? Global Economic Perspectives. Deutsche Bank Research. 26 November 2014.

Weak development and outlook for German exports 2

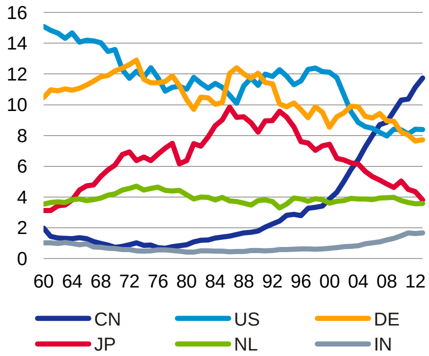
% 3M mov. avg. yoy (left), Standardised values (right)



Sources: Deutsche Bundesbank, ifo, Markit, CPB, Deutsche Bank Research

China's remarkable rise to the world's largest goods trading nation 3

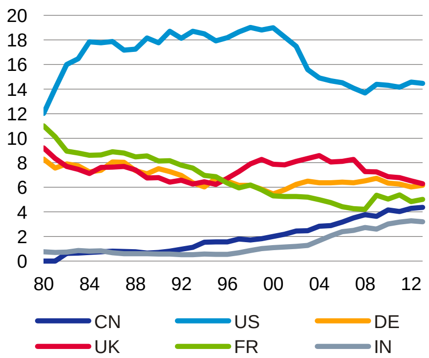
% of global goods trade



Source: UNCTADstat

US continues to dominate global services trade 4

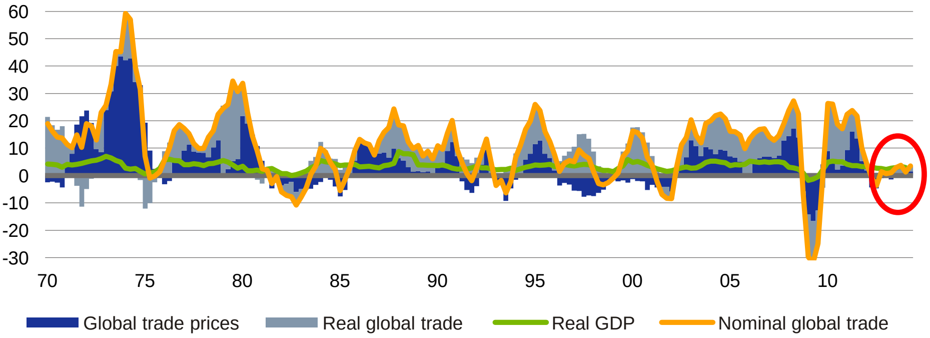
% of global services trade



Source: UNCTADstat

Weakness of real global trade and trade prices in recent years 1

% yoy



Sources: IMF - IFS, Deutsche Bank Research

Boom in German exports in recent decades thanks to combination of several favourable factors

Over recent decades German exports have grown at roughly the same pace as global trade. This enabled Germany to impressively defend its position as one of the world's biggest exporters – despite the rise of the emerging markets and in contrast to the other major advanced economies. Germany thus benefited much more than other countries from the increase in globalisation, which ensured that in the past decades global trade grew much faster than global GDP (1970-2013: 5.6% vs 3.6%), especially in the 1990s when global trade grew more than twice as fast as the global economy. Global trade openness – defined as the ratio of trade to GDP – increased from about 15% at the beginning of the 1990s to currently 25%. The gains from intensified globalisation significantly boosted global welfare and supported the catching-up process especially in the emerging markets.

The main drivers behind the outperformance of global trade were:

— The integration of emerging markets into the global economy following political reforms or even revolutions which, facilitated by far-reaching trade agreements, fostered a massive catching-up.

— Technological advances, which triggered fundamental changes in work organisation and production methods and reduced trade costs considerably.

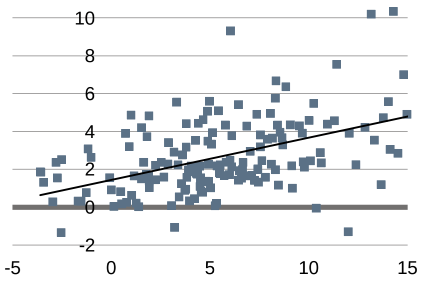
Global trade and German exports outperformed global growth in previous decades 5

	Global GDP growth % yoy	Global trade growth % yoy	German trade growth % yoy
70-13	3.6	5.6	5.3
70-79	4.0	6.4	5.4
80-89	3.2	3.7	4.8
90-99	3.1	6.6	5.6
00-09	3.8	5.1	4.6
10-13	4.0	6.8	6.9

Sources: IMF, Deutsche Bank Research

Real GDP per capita growth stronger in countries with higher export growth 6

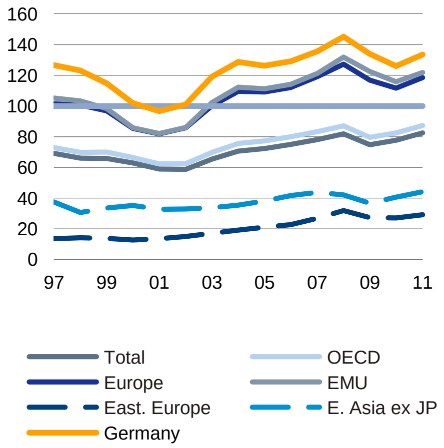
x-axis: real export growth; y-axis: real GDP per capita growth
(median 90-13; % yoy)



Sources: IMF, Deutsche Bank Research

Hourly compensation the lowest in Eastern Europe and East Asia ex JP 7

Hourly compensation costs in manufacturing
(Index, US=100)



Source: BLS

The opening-up of emerging market economies

The trade and financial liberalisation of the large emerging markets caused serious disruptions to historically established international trade relations and intensified global competition markedly. The global trade share of emerging markets increased strongly from 28% in 1978 to almost 50% in 2013. The main beneficiaries of the marked increase in demand for capital goods were German manufacturing companies that are often world market leaders.

In particular, the integration of the two most populous countries, China and India with their population of 2.6 billion or almost 40% of the world's total, into the world economy had a massive impact providing strong cost pressure for companies in high-wage advanced economies. In addition, there were massive political and economic upheavals in Eastern Europe. Following the collapse of Comecon the Eastern European countries implemented far-reaching structural changes and the modernisation and expansion of their production facilities in order to become integrated in the global economy.

In China the process started at the end of the 1970s with Deng's "reform and opening up" focusing on the industrial sector. Since 2009 China has been the world's largest goods exporter. By contrast, India began its liberalization about 10 years later and focused on the services sector. However, until now India has remained a relatively closed economy compared to China.

While both countries started by specialising in mass production of simple products, such as textiles, clothing and footwear, utilising their comparative advantage in labour costs, they have constantly moved up the value chain into the fast growing sectors related to information and communications technology (ICT), for example electronic goods in China and ICT services in India. Thus, they have relocated production factors more and more to sectors with higher productivity.[2]

Intensified competition from low-wage countries with their abundant supply of labour put downward pressure on global wages, weighing on inflation and thus also on long-term real interest rates.[3] German companies had to increase their efficiency and innovate in order to safeguard their market shares and their technological leadership. Thus, labour demand shifted away from lower-skilled workers in Germany due to higher imports from emerging markets resulting in outsourcing and offshoring.

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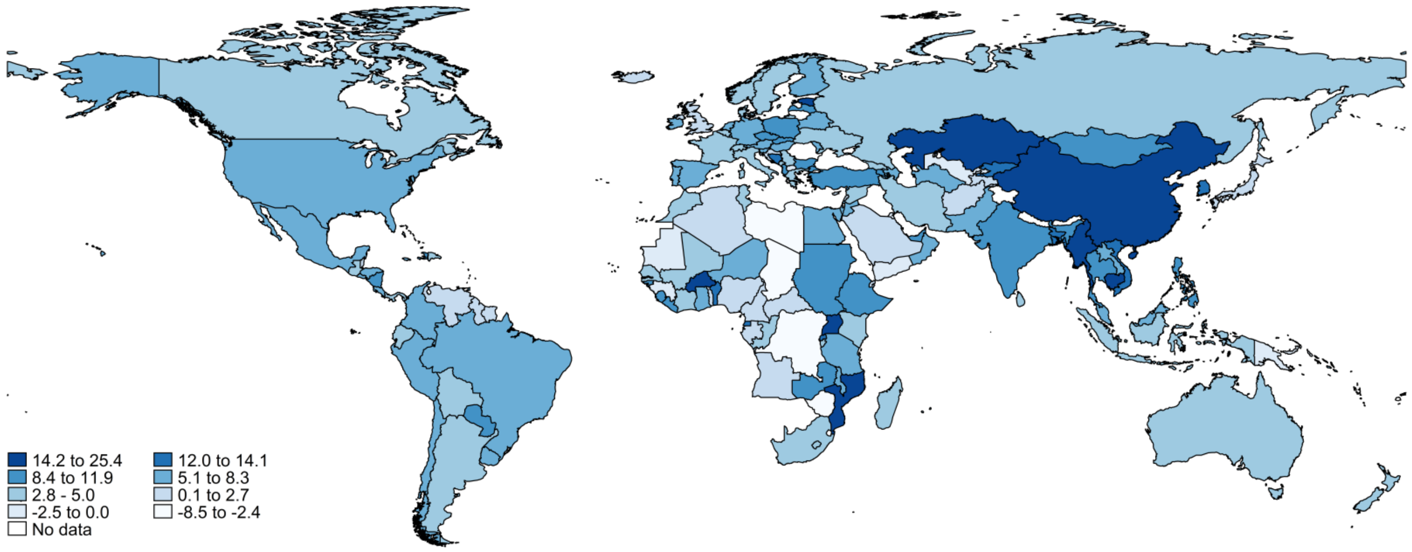
[2] Bensidoun, I. et al. (2009). The integration of China and India into the world economy: a comparison. The European Journal of Comparative Economics, 6(1), pp. 131-155.
[3] Folkerts-Landau, D. et al. (2014). The Revived Bretton Woods System's First Decade. Deutsche Bank Research. Special Report. 16 August 2014.

Strongest growth of exports in Asian countries 8

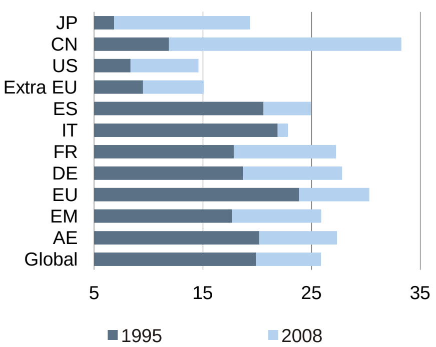
Export growth (real terms, median 1990-2013, % yoy)



Sources: IMF, Deutsche Bank Research

Foreign value added content of exports has risen markedly since the mid-1990s 9

% of total gross exports



Sources: OECD/WTO TIVA, Deutsche Bank Research

Global value chains deepened the international division of labour

Technological advances in ICT since the 1990s further increased the pressure on lower-skilled workers doing routine tasks in part via automation and partly via the new possibility for companies to divide up their production into different stages across a number of countries.[4] Firms could significantly boost their competitiveness by dividing up their value chains and shifting parts of the value chain to other countries, either by establishing subsidiaries, acquiring stakes in foreign companies (offshoring) or by purchasing from external suppliers (outsourcing).[5] Multinational firms – but above all global consumers – profited from lower prices as a consequence of more intense competition between the producers of intermediates, from a broader range of intermediates and from more efficient production. Since production for example is contracted out to specialised manufacturers, multinational groups can gain access to international expertise that they do not have in-house. In addition, manufacturing locally eases access to foreign markets considerably. The conditions for the smooth functioning of global value chains are far reaching trade agreements, legal certainty, the presence of specialist service providers, trade financing and ICT.

The changes from purely national to global value creation have boosted the share of imported intermediates in a country's exports (bazaar economy[6]). Germany benefited particularly handsomely from the opening-up of Eastern European countries on account of its geographical proximity. The German economy extensively exploited the new opportunities to outsource parts of the value chain – thanks to the much lower wage costs – and not only to eastern Europe, but especially also to Asia. This also changed the composition of Germany's trade in goods towards the trade in intermediate goods. The share of

[4] Michaels, G. et al. (2014). Has ICT Polarized Skill Demand? Evidence from Eleven Countries over Twenty-Five Years. The Review of Economics and Statistics, 96(1), pp. 60-77. Baldwin, R. (2009). Integration of the North American economy and new-paradigm globalisation. CEPR Discussion Papers 7523.

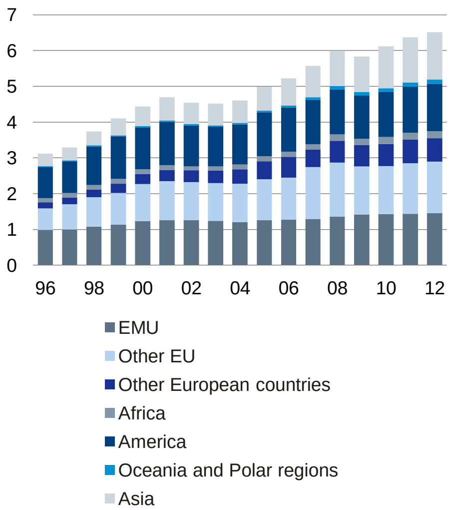
[5] Grossman, G., Rossi-Hansberg, E. (2008). Trading Tasks: A Simple Theory of Offshoring. American Economic Review, 98 (5), pp. 1978-1997; Cadot, O. et al. (2011). Trade Diversification: Drivers and Impacts, in Jansen M., Peters, R., Salazar-Xirinachs, J.M., Trade and Employment: from Myths to facts. ILO.

[6] Sinn, H.-W. (2005). Die Basar-Ökonomie: Deutschland: Exportweltmeister oder Schlusslicht? Econ, 2nd edition. Aichele, R., Felbermayr, G. and Heiland, I. (2013). Neues aus der Basar-ökonomie. ifo Schnelldienst 6/2013.

imported intermediates in German exports increased from 19% in 1995 to 28% in 2008.

Employment in foreign subsidiaries of German companies 10

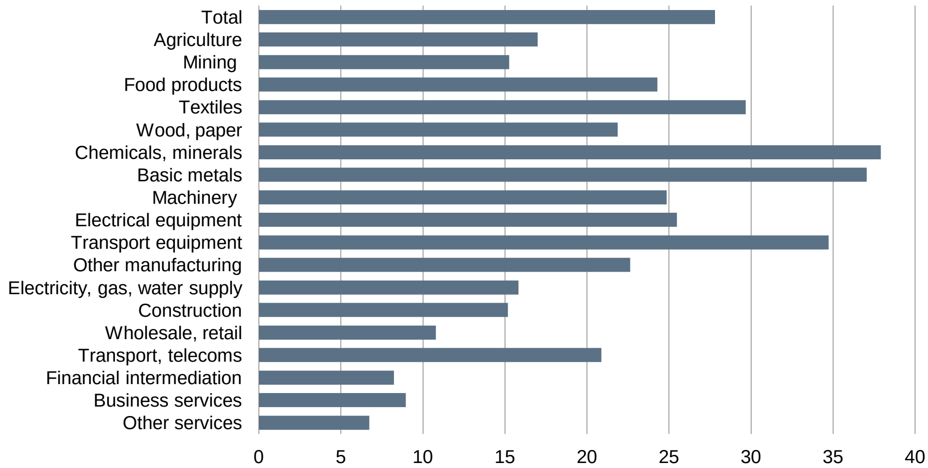
No of people (million)



Source: Deutsche Bundesbank

Foreign value added content of exports the highest in manufacturing 11

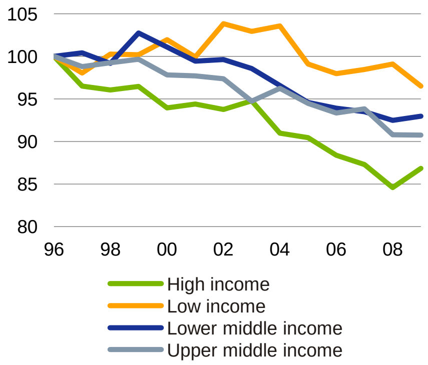
% of total gross exports



Sources: OECD/WTO TIVA, Deutsche Bank Research

Trade costs fell especially for high income countries 12

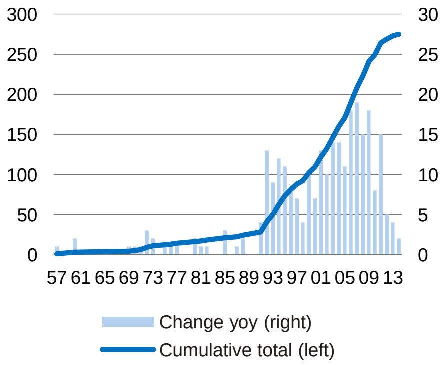
1996=100, average trade costs for manufactured goods



Source: Arvis, J.-F. et al. (2013)

Failure to reach multilateral agreements pushed up number of Regional Trade Agreements since the mid-1990s 13

Cumulative total of RTAs in force (left), new RTAs per year (right)



Sources: WTO - Regional Trade Agreements Information System, Deutsche Bank Research

Trade costs fell markedly due to trade agreements and technological advancements and automation

This integration was made possible by extensive trade liberalisation measures – reduction in tariffs, dismantling of non-tariff trade barriers – declining transport cost thanks to technological advances and increased automation in the logistics sector. Trade costs fell significantly across all regions in recent decades, with high-income countries enjoying the strongest declines.[7] However, in some emerging markets the costs of trade are still burdened significantly by legal uncertainty, corruption and partly non-functioning administrations.

Only after prolonged efforts have been made on multilateral agreements to further liberalise global trade, for example the Doha round negotiations have been dragging on since 2001. While in the past it was relatively easy to agree multilaterally on the reduction of tariffs, the subsequent reduction in non-tariff barriers and reaching agreement on international standards have proved a great deal more difficult to achieve. Further liberalisation has thus increasingly taken place via regional trade agreements (RTAs).The number of RTAs worldwide has increased almost tenfold since the beginning of the 1990s. However, RTAs are only second best, since they are typically disadvantageous for non-member countries due to the trade diversion effect. For Germany it was primarily the European integration process that brought about far-reaching changes that culminated in the founding of EMU.

[7] Arvis, J.-F. et al. (2013). Trade Costs in the Developing World: 1995-2010. World Bank. Policy Research Working Paper 6309.

German export growth will probably continue to disappoint like global trade

German export growth slowed after the rebound in 2010/11 and has failed to gain lasting momentum this year. Exports should grow by about 4% in 2014, a slightly higher rate than global trade – so Germany can even slightly enhance its international performance. However, especially weak global investment spending – the result of global overcapacities, weak commodity prices, elevated geopolitical risks and heightened uncertainty regarding the global outlook (EMU, China) – dampens global trade to a disproportionately large extent due to the higher trade intensity of investment spending compared to other demand components of GDP.

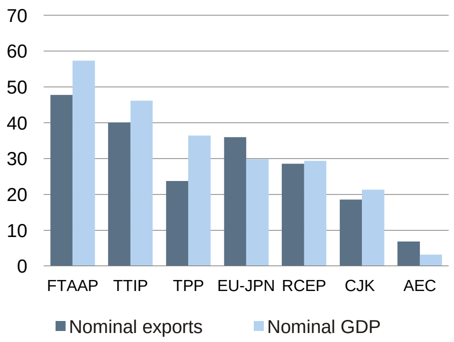
German exports are being hit particularly hard by the disappointing performance of the eurozone, Germany's most important export market by far. This is likely to remain the case over the next few years as EMU growth will be dampened by the considerable deleveraging still required in the private and public sector. By contrast, emerging Asia is still providing support. Thanks to the expected US-driven recovery of the world economy (2015F: 3.6%, 2016F: 3.7%) the cyclical weakness of investments and also exports is expected to vanish slowly.

However, the rebalancing of the Chinese economy away from being the "workbench" of the world to a services-oriented, consumption-driven economy is likely to weigh on demand for capital goods over the medium term, which will probably have a negative impact, especially on the German plant and machinery sector.

The pace of trade liberalisation has slowed

Economic significance of future RTAs 14

As % of global exports and GDP



Sources: WTO, UNCTAD, IMF, Deutsche Bank Research

Since tariffs were already lowered markedly in previous decades, German exports could only be boosted significantly by agreements on a further reduction of non-tariff barriers. But to reach agreement in for example areas of government procurement, foreign investments, services, intellectual property, labour and environmental standards as well as agriculture is quite difficult. At the end of 2013 the declaration of intent to implement the Trade Facilitation Agreement (TFA) in Bali – to sign by mid-2014 and to come into effect in mid-2015 – provided a glimmer of hope. In mid-2014, however, agreement failed to be reached due to opposition from India, Cuba, Venezuela and Bolivia. Recently, however, all the countries agreed to the TFA after all. Ratification and actual implementation will probably take several years, however, and the positive effects are likely to be limited since most of the Bali agreement has already been implemented unilaterally.[8]

Looking at the RTAs currently being negotiated, if the US – the third biggest destination for German exports – and the EU reach agreement on Transatlantic Trade and Investment Partnership (TTIP) it could give a major boost to German exports. However, negotiations have stalled recently and reaching an agreement will probably take years at best.

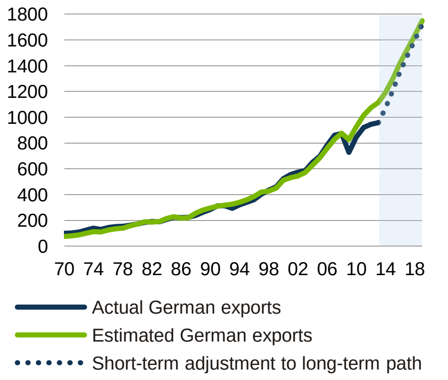
If agreement should be reached at the negotiations currently being conducted on other RTAs (Trans Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP)) in which the European nations are not involved, this would tend to have a negative impact on German external trade, because of the likely trade diversion effect. Also, there is a risk that existing German value chains with Asian countries could be less attractive and could be broken apart.

[8] Evenett, S.; Jara, A. (2013). Building on Bali: A Work Programme for the WTO. A VoxEU.org eBook. CEPR.

In addition, new restrictive trade measures by G20 nations continue to increase and they dampen global trade.

Long-term correlation between German trade, Terms of Trade and global GDP 15

Index 1970 = 100



Sources: IMF, Deutsche Bank Research

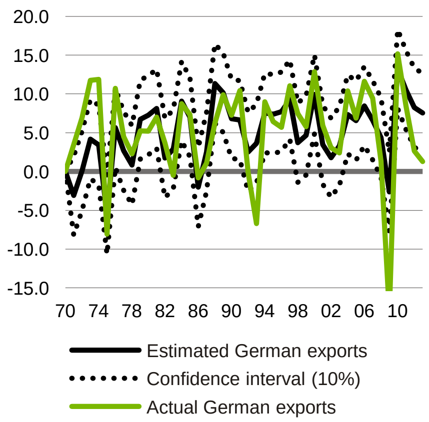
Weak German exports since 2012 probably a consequence of structurally lower trade elasticity of global economic growth

To check more formally for a structural break in the relationship between global GDP growth and German exports since 2012, we compare the actual development in German exports since 2012 with our estimated development in German exports provided by our trade model. We formulate an Error Correction Model of German exports, Terms of Trade and global GDP over the observation period extending from 1977 to 2008.[9] There is a historical long-term relationship between these three variables, as the cointegration of the variables shows. The short-term equation of the model describes the actual development in German exports relatively well until the year 2011.

For 2012 and 2013 the model solution of the error correction model delivered German export growth figures that were much higher than those actually observed. However, the actual development is even outside the 10%-confidence interval of the model estimations. The model has thus been unable to predict the actual development since 2012, which is probably an indication of a structural break.

German trade development markedly below model prediction in 2012/13 16

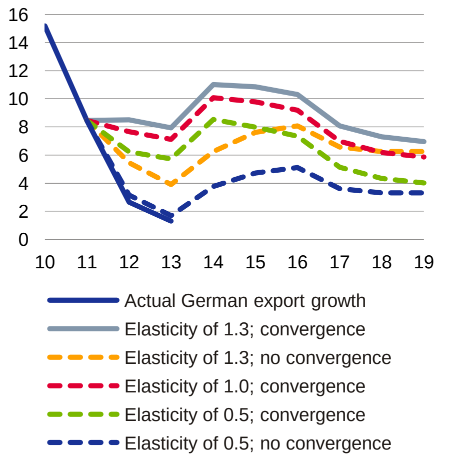
% yoy



Sources: IMF, Deutsche Bank Research

Deviation of actual from ECM trade model prediction points to lower elasticity and no convergence 17

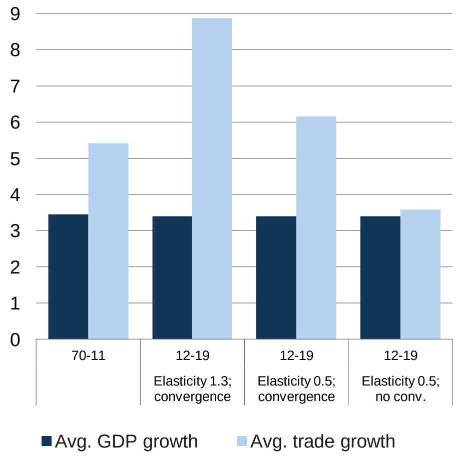
% yoy



Sources: IMF, Deutsche Bank Research

Export growth probably weaker than in the past given global GDP growth 18

Avg. % yoy



Sources: IMF, Deutsche Bank Research

This tallies with the cyclical and structural factors discussed above, which point towards a lower elasticity of global trade to global GDP growth and/or a level shift. We calculate different scenarios assuming different elasticities and level shifts. The scenario that best fits the actual development in German exports in 2012 and 2013 has a lower elasticity and probably a permanent downward level shift. This would mean that there was no convergence to the long-term equilibrium.

The scenario thus suggests that the impressive export performance during the last three decades was indeed the result of the confluence of favourable factors, of which at least some seem to have run their course. Therefore, the trade dynamics of coming years will probably be weaker than suggested by the

[9] See table 19 with the estimation results of the Error Correction Model.

historical correlation. German exports are, however, likely to be buttressed in the coming years by the depreciation of the euro, which is likely to result in a deterioration of the terms of trade. We forecast average real German export growth at the lower end of a range of 4%-6% between 2014 and 2019.

Error correction-model (Engle Granger two step estimation) 19

Long-term relationship

Endogenous variable: ln (real German exports)

Observation period: 1977-2008

	Coef.	Std. Err.	t	P>t	[95% Conf. Interval]	
ln (real global GDP)	1.86	0.04	41.37	0.00	1.76	1.95
ln (terms of trade)	-0.81	0.16	-5.10	0.00	-1.14	-0.49
Constant	-0.48	0.57	-0.85	0.41	-1.64	0.68

Null hypothesis that the residual of the long-term relationship estimation contains a unit root can be rejected (Dickey-Fuller test: p-value of 0.04).

Short-term relationship

Endogenous variable: German trade growth, % yoy

Global GDP growth	1.30	0.44	2.96	0.01	0.40	2.20
Change of Terms of trade	-0.60	0.15	-4.08	0.00	-0.90	-0.30
Error correction term	-0.32	0.12	-2.75	0.01	-0.55	-0.08
Constant	0.01	0.02	0.91	0.37	-0.02	0.05
Adj. R-squared	0.49					

Sources: IMF, Deutsche Bank Research

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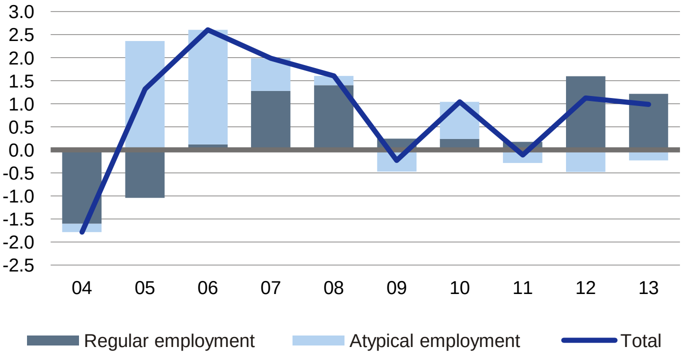
Stefan Schneider (+49 69 910-31790, stefan-b.schneider@db.com)

Chart of the month

Since 2011 employment boom solely due to standard employment relationships

% yoy, pp



Sources: Federal Statistical Office, Deutsche Bank Research

Almost all types of atypical employment have declined since 2011

% yoy, pp

Growth contributions do not sum up due to the fact that one employee coud be in several atypical employment types at the same time, eg. marginal part-time temporary workers.

Sources: Federal Statistical Office, Deutsche Bank Research

Declining importance of atypical types of employment

Given the good development of the German labour market, employment rose beyond the 43 million mark in November 2014 for the very first time. What is more, the importance of atypical types of employment declined in the last few years, which is also a testament to the quality of the jobs created.

Since 2011, the marked increase in employment has been solely attributable to an expansion of regular employment, i.e. permanent full-time jobs with social insurance obligations. Atypical employment declined in 2013 for the third year in a row. This is w due – thanks to the high demand for labour – to a decrease in jobs with fixed-term contracts. Marginal part-time employment (less than 20 hours per week) has continued to edge up since 2011, a trend likely attributable to a further increase in the female labour participation rate. Women account for some 86% of total marginal part-time employment, as many of them, for example, stay at home to look after their children (or there is a dearth of child care facilities).

The share of workers in regular employment rose to 67.5% in 2013 – the highest reading since labour market reforms were implemented in the mid-2000s. Since its low in 2006 the share increased by 2 pp. Even though economic activity has weakened in the course of 2014, the jobs trend probably continued. One indication is that in a year-on-year comparison the number of employees required to pay social security contributions increased faster than total employment activity. In addition, demand for labour is still relatively high. At 515,000, the number of job vacancies – 95% employment with social insurance obligations and roughly 80% permanent jobs – is up 12% on the year.

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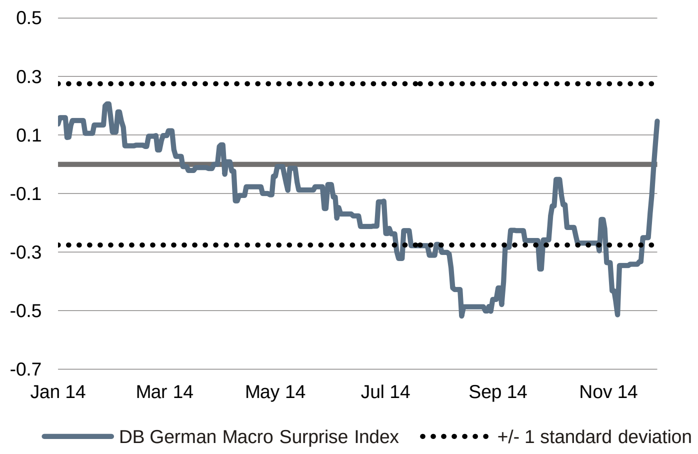
DB German Macro Surprise Index

The DB German Macro Surprise Index compares published economic data with market forecasts and thus provides clues as to the direction of future forecast revisions.[10]

DB German Macro Surprise Index

Average of last 20 z-scores of data surprises

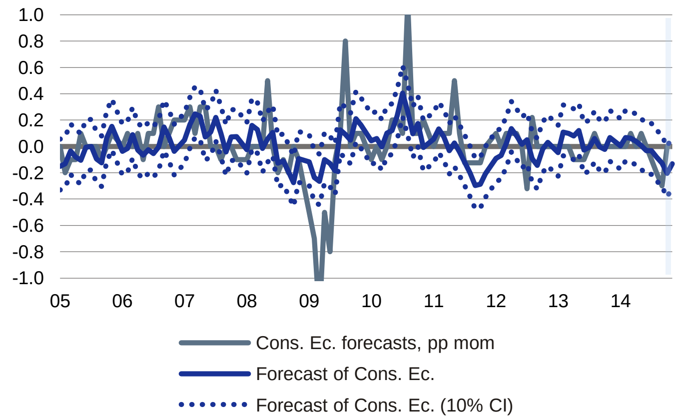


Values above (below) 0 indicate the data came in better (worse) than expected

Sources: Bloomberg Finance LP, Deutsche Bank Research

DB German Macro Surprise Index and GDP forecasts

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



CI: 10% Confidence Intervall

Sources: Consensus Economics Inc., Deutsche Bank Research

Last 20 published economic data for Germany

Bloomberg Tickers	Indicator	Reporting month	Publication date	Current value	Bloomberg consensus	Surprise	Standardised surprise	Quantile rank
GRIFPBUS Index	IFO Business Climate	10 2014	27.10.14	103.2	104.5	-1.3	-1.1	0.1
GRIMP95Y Index	Import Price Index (% yoy)	9 2014	28.10.14	-1.6	-1.9	0.3	0.6	0.8
GRUECHNG Index	Unemployment Change (000's mom)	10 2014	30.10.14	-23.0	4.0	27.0	0.8	0.8
GRFRIAMM Index	Retail Sales (% mom)	9 2014	31.10.14	-2.8	-0.9	-1.9	-1.2	0.1
MPMIDEMA Index	Markit Manufacturing PMI	10 2014	03.11.14	51.4	51.8	-0.4	-0.4	0.2
MPMIDESA Index	Markit Services PMI	10 2014	05.11.14	54.4	54.8	-0.4	-0.4	0.3
GRIORTMM Index	Factory Orders (% mom)	9 2014	06.11.14	0.8	2.3	-1.5	-0.7	0.2
GRCAEU Index	Current Account Balance (EUR bn)	9 2014	07.11.14	22.3	18.0	4.3	1.0	0.8
GRIPIMOM Index	Industrial production (% mom)	9 2014	07.11.14	1.4	2.0	-0.6	-0.5	0.3
GRCP20YY Index	CPI (% yoy)	10 2014	13.11.14	0.8	0.8	0.0	0.3	0.4
GRZECURR Index	ZEW Survey Current Situation	11 2014	18.11.14	3.3	1.7	1.6	0.2	0.6
GRZEWI Index	ZEW Survey Expectations	11 2014	18.11.14	11.5	0.5	11.0	1.3	0.9
MPMIDESA Index	Markit Services PMI	11 2014	20.11.14	52.1	51.7	0.4	0.5	0.7
MPMIDEMA Index	Markit Manufacturing PMI	11 2014	20.11.14	50.0	50.0	0.0	0.0	0.5
GRIFPBUS Index	IFO Business Climate	11 2014	24.11.14	104.7	103.0	1.7	1.1	0.9
GRGDPPGQ Index	GDP (% qoq)	9 2014	25.11.14	0.1	0.1	0.0	-0.1	0.3
GRIMP95Y Index	Import Price Index (% yoy)	10 2014	26.11.14	-1.2	-1.5	0.3	0.6	0.8
GRUECHNG Index	Unemployment Change (000's mom)	11 2014	27.11.14	-14.0	-0.5	13.5	0.3	0.6
GRCP20YY Index	CPI (% yoy)	11 2014	27.11.14	0.6	0.6	0.0	0.3	0.4
GRFRIAMM Index	Retail Sales (% mom)	10 2014	28.11.14	1.9	1.5	0.4	0.6	0.7

Sources: Bloomberg Finance LP, Deutsche Bank Research

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

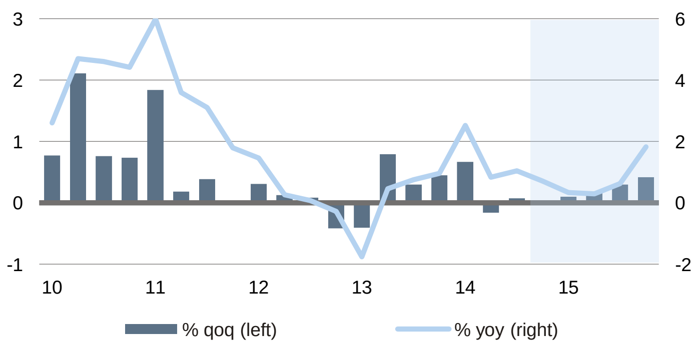
Chartbook – Total economy

— In Q3 the German economy barely avoided falling into a technical recession. GDP grew by 0.1% qoq after a 0.1% decline in the previous quarter. Underlying growth has slowed after it had averaged 0.3% qoq over the last 6 quarters. The strongest negative impetus came from investment in machinery & equipment (-2.3% qoq vs +0.4% qoq in Q2). Companies reacted to the only moderate capacity utilization, concerns regarding the global economy and geopolitical risks. Net exports contributed positively to GDP, but export growth remains moderate – just like global trade. Construction (-0.3%) failed to rebound after the weather induced volatility in H1. The most important growth pillar was private consumption (+0.7% vs +0.1%), which benefitted from ongoing solid increase in disposable income. This is driven by the robust labour market. In contrast, entrepreneurial and property income continued to languish given the low interest rate environment and companies' moderate capacity utilization levels.

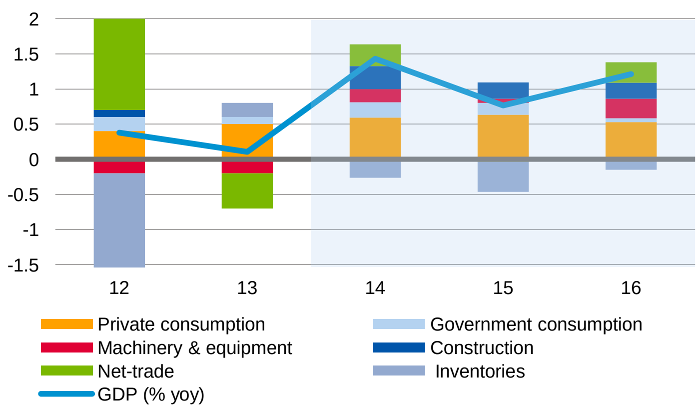
— Sentiment indicators were lower in Oct/Nov compared to their Q3 averages, which supports our expectation that Q4 is set to remain weak. We forecast that the German economy will stagnate in Q4 and Q1 on average. Sentiment is being weighed down by ongoing geopolitical risks and questions marks over the global economy. Disappointing momentum in France (9% of German exports) and Italy (5%) as well as the slump of German exports to Russia (-18% yoy; 3% of German exports) dampen export growth. In this uncertain environment companies are likely to be cautious and put their investment plans on hold. On a positive note, the ifo index's increase in November back to its low September value could at least point to a stabilization of growth prospects – a necessary condition for our growth forecasts.

— On account of these factors and the lowered global growth forecasts for 2015 and 2016, we have scaled back our growth forecasts lately. We now expect the German economy to expand by 1.4% this year and by 0.8% in 2015, which is partly due to the low starting base provided by the weak winter half (2016: 1.2%).

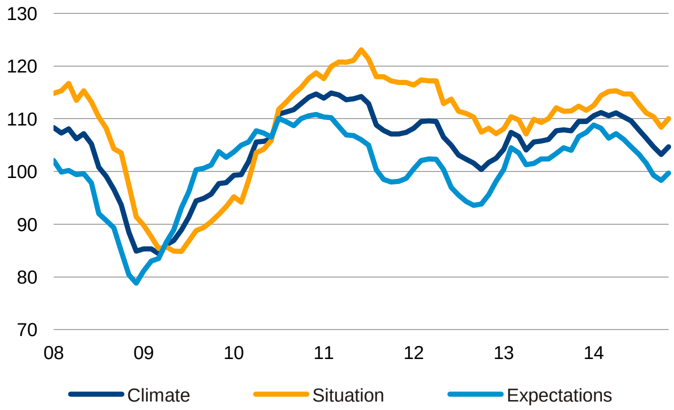
Real GDP growth



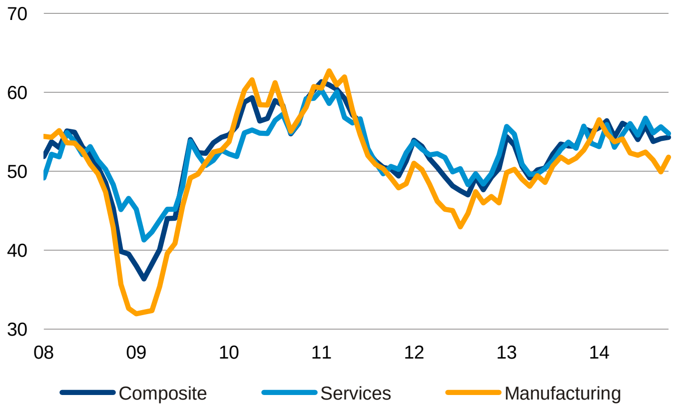
Contribution to real GDP growth (%-points)



ifo index - total economy (2005=100)



Purchasing manager index



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

Chartbook – Foreign trade

— As expected foreign trade recovered in September. Exports rose 6.1% mom and, thus, mostly made up for the 6.7% decline in August, which was heavily impacted by special factors. The yoy-comparison (+5.7%) paints a more positive picture, but it is also strongly affected by the monthly volatility observed in Q3. In general, German export growth remains moderate – in line with global trade. Imports, too, recovered (+7.1% mom vs +4.6%). The trade balance surplus rose slightly to EUR 19.4 bn, which is well above the H1 average of around EUR 18 bn.

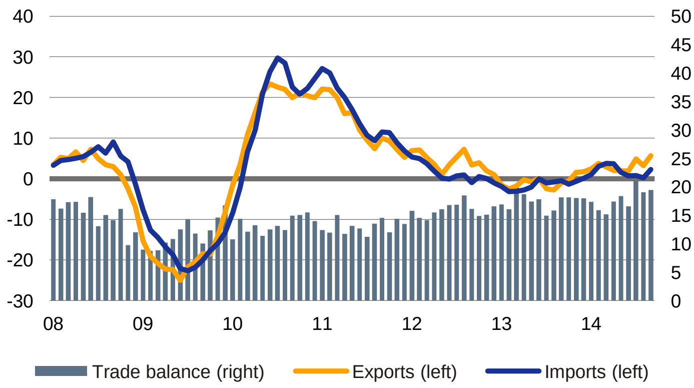
— Demand from the US and Asia remained high and exports to these destinations are up around 10% yoy, although this increase is also influenced by the latest volatility. Exports to EMU dampen (+3.6%).

— It was foremost automobile exports (July +10.1%; Aug +2.6%; Sep +3.6%) that produced the volatility (negative one-offs: holiday effect, re-tooling of production lines for new models). The other German export engine, mechanical engineering, was stuttering. Foreign demand in the metal industry remained weak.

— Leading export indicators were mixed in November, but are on a low level and are all in all pointing to a continued weak export development. The unresolved Ukraine-Russia crisis and the clouded growth outlook for some major German trading partners – esp. China, France, Italy – will probably continue to be a drag. Thanks to the moderate recovery of the world economy next year – driven by solid US growth – and the weaker EUR, we expect a gradual recovery of exports with risks to the downside. Imports will probably grow relatively strong thanks to robust domestic demand.

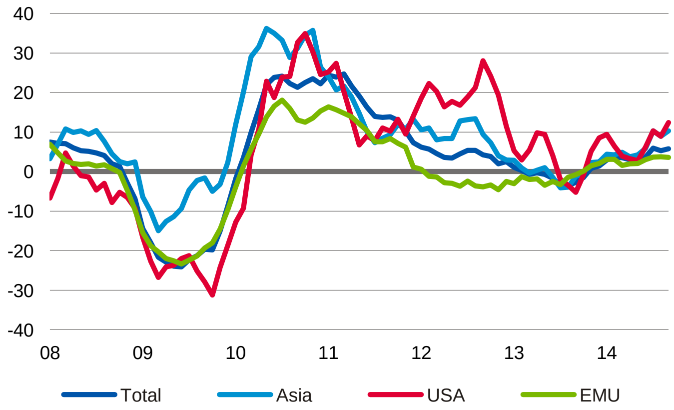
Merchandise trade

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



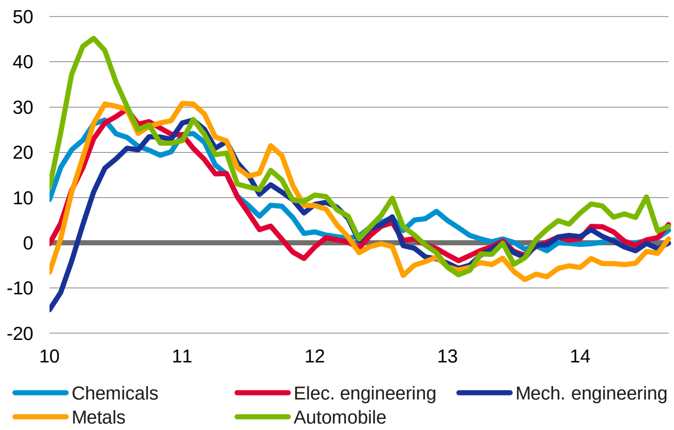
German exports by region

% yoy, 3M mov. avg.



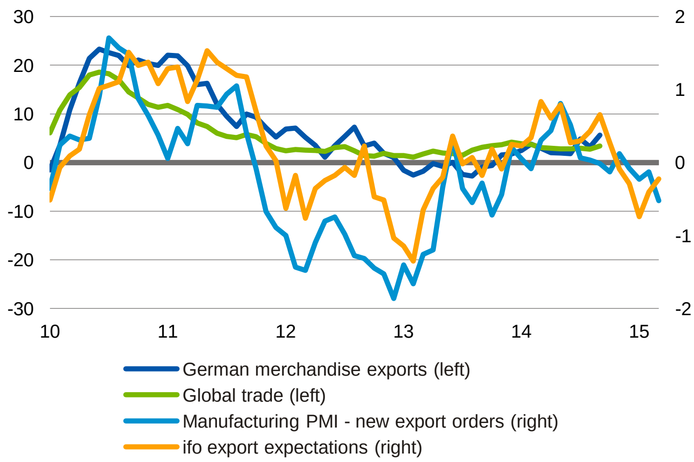
Exports by sector

% 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

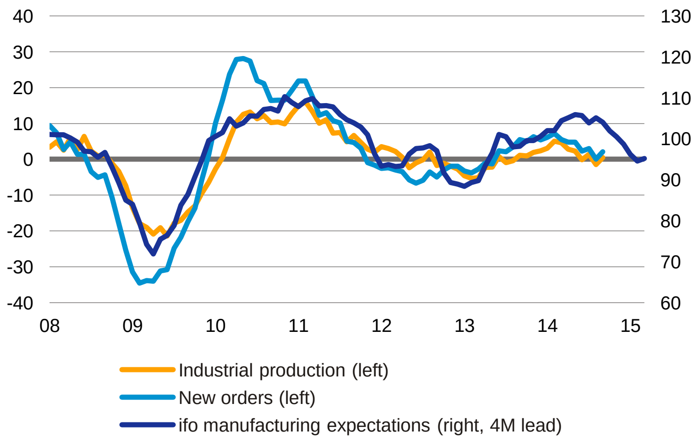
— September industrial production – just like exports – showed the expected partial counter movement to the strong declines observed in August (+1.4% mom vs -3.1%). Compared to last year production was up only 0.5% (3M mov. avg.).

— The ifo index for the manufacturing industry rose in November after six consecutive declines. By contrast the PMI (which fell) more than reversed its gain from October. On current levels both suggest that industrial growth should remain weak in Q4, though.

— Following weak performance in winter half-year 2014/15 industrial production in Germany is likely to return to a moderate uptrend in the course of 2015, resulting in expansion of roughly 1.5% in real terms in 2014 and about ¾% in 2015. We expect both the automotive industry and mechanical engineering to increase their output by roughly 1% in 2015. While mechanical engineering should thus slightly improve its performance over 2014 (stagnation), the auto industry should see its growth cool noticeably (2014: +4%). Electrical engineering is poised for stagnation in 2015 – following a 1.5% increase in 2014. Production in the metals industry is expected to decline slightly in 2015 after a moderate increase in the current year. Chemicals production is likely to add 2.5% in 2015; however, this would "only" neutralise the setbacks in 2014. Production in the food industry could increase by 0.5% in 2015.

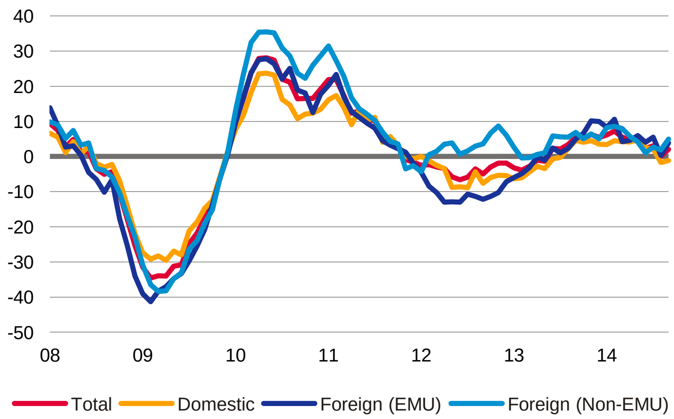
Industrial production, new orders & ifo expectations

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

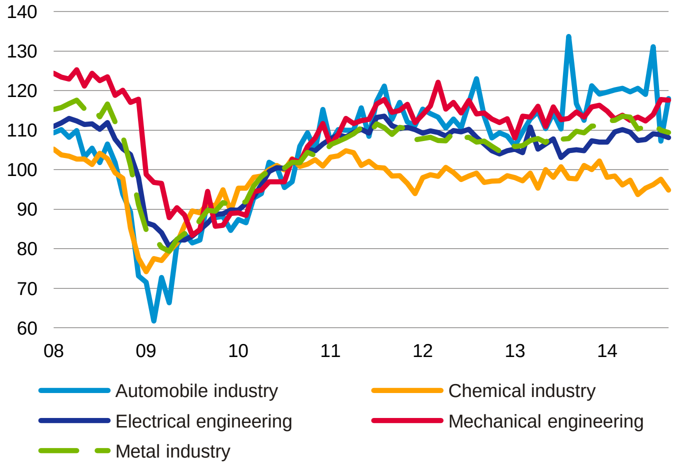


New manufacturing orders by region

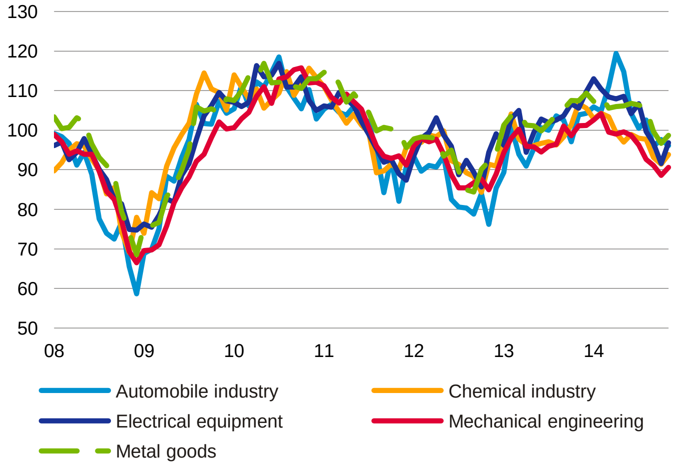
% yoy, 3M mov. avg.



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 German labour market remained in good shape in November. Unemployment fell strongly for the second month (-14k mom). Employment growth continued to be mainly driven by the integration of immigrants into the German labour market which highlights mismatch problems of the domestic labour force. The outperformance of employment relative to unemployment continues due to almost 350,000 additional persons that entered the German labour market this year mainly thanks to high net migration. Early indicators suggest a modestly positive development over the next few months. The unemployment rate should fall to 6.7% in 2014 (2013: 6.9%). In 2015 we expect the unemployment rate to increase slightly to 6.8% due to the weaker economic situation and the negative impact from the minimum wage.

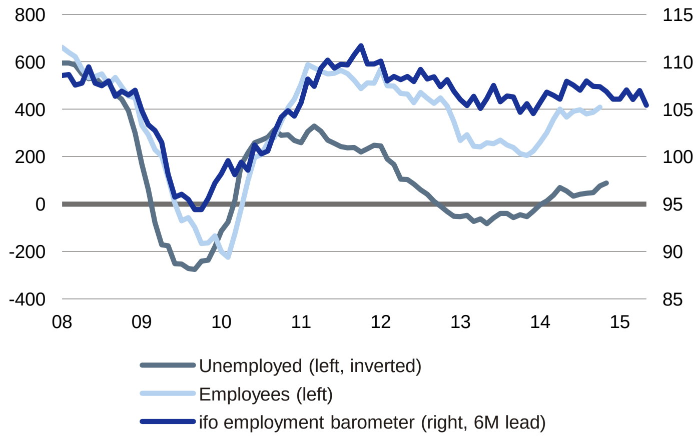
— As expected real retail sales recovered in October (+1.9% mom) after collapsing in September (-2.8%). Compared to last year sales are up around 1% (3M mov. avg.), not bad given retail sales' usual under-performance relative to private consumption. The rebound took place due to the typical purchases of autumn fashion, which had suffered from warm weather in September. In particular, the sales volumes for textiles, clothing, footwear and leather goods recovered in October.

— After weakness in 2013 investment in M&E and construction spending should moderately contribute to growth again this year. Still, domestic investment goods orders and capacity utilization currently point to a continued weakness in the remainder of 2014. Given the weak starting base investment in M&E should rise by only about 1% in 2015 after a good 3% in 2014 (2013: -2.7%).

— The construction sector benefits from high net immigration and rising disposable income propelling housing demand. Construction spending could grow by about 3% in real terms in 2014 and 2 ½% in 2015 (2013: -0.1%).

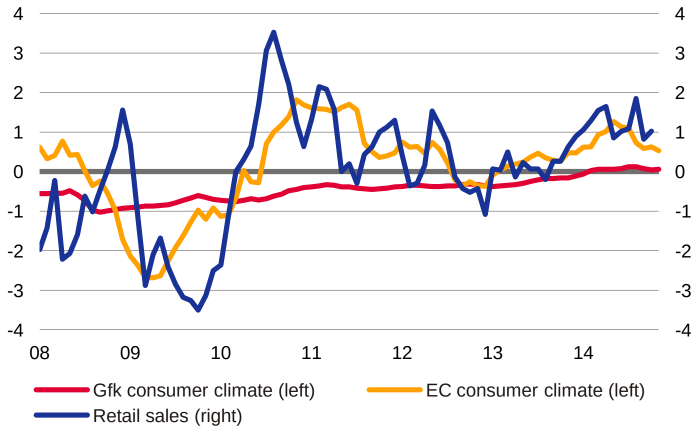
Unemployment barometer, employment and unemployment

'000 yoy (left); index (right)



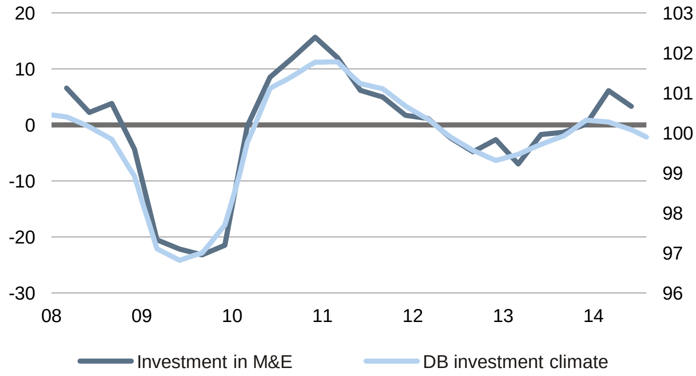
Retail sales and consumer confidence

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



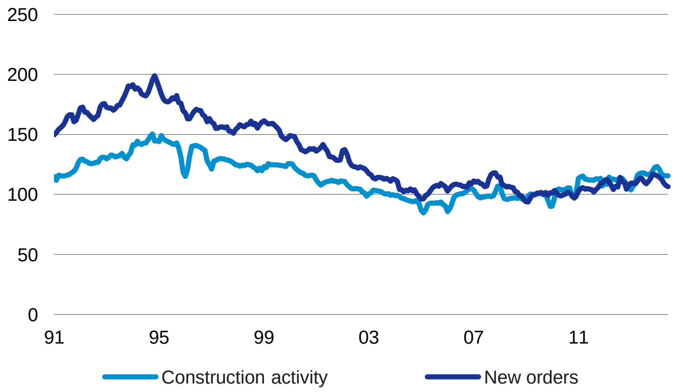
Investment in machinery & equipment and DB investment climate

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



Construction activity and new orders

2010=100, 3M mov. avg.

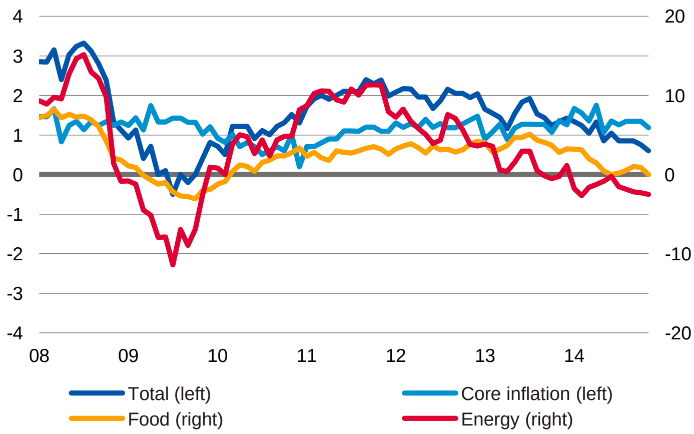


Sources: Federal Statistical Office, Deutsche Bank Research, Gfk, EU Commission, ifo

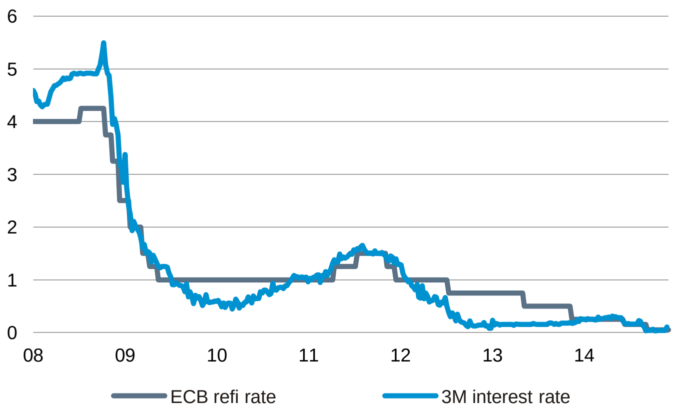
Chartbook – Financial markets

- According to the preliminary data for November inflation stood at 0.6% yoy after hovering at 0.8% in the previous four months. The fall in the oil price continued to weigh on energy prices (-2.5% yoy vs prev. -2.3% yoy). Food prices stagnated (+0.0% yoy vs 0.7% yoy). Core inflation fell, too (probably 1.2% after 1.3%), but this could have been due to the volatile prices for package holidays. While the downtrend in oil prices is set to dampen energy inflation, the food producers' price expectations suggest that food inflation could pick up (temporarily) in the coming months. Also, the expected weakness of the Euro and the introduction of the minimum wage will push up prices. Our inflation forecast is 1.0% for 2014 and 1.2% for 2015.
- Fearing a negative feedback loop between declining current inflation, a disanchoring of inflation expectations and still weak banking system restricting the supply of credit, the ECB has become more expansionary in recent. It started the covered bond purchase programme (CBPP3) recently and will begin purchasing non-financial private sector assets under an ABS purchase programme (ABSPP) later in Q4. Objectives are credit easing and weakening the EUR by expanding the balance sheet to early 2012 levels. However, we expect these measures to reach about half of the targeted of EUR 1 trillion. Therefore, we expect the ECB to initiate "broad-based asset purchases", which will include government bonds, within the next six months.
- Given diverging interest rate and growth expectations for EMU and the US, the yield spread between 10Y US treasuries and German Bunds has widened further to over 150 pp as of late.

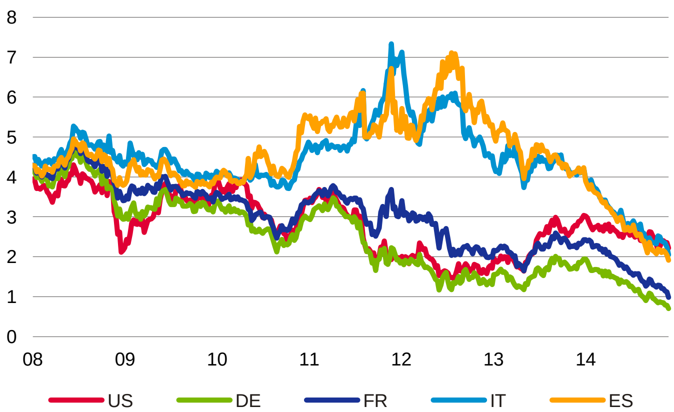
Consumer prices (% yoy)



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

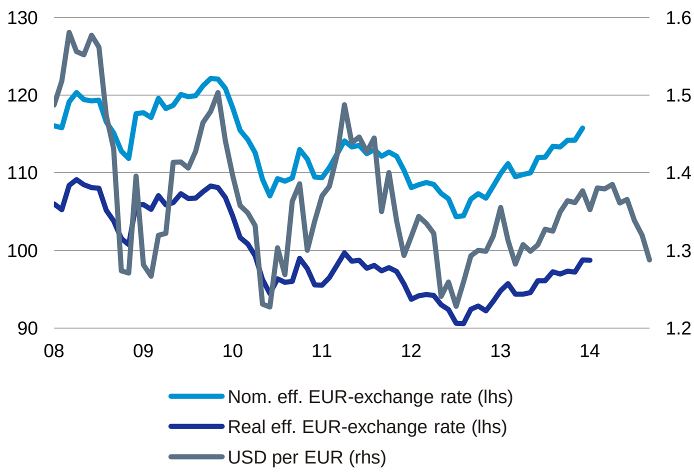


10Y government bond yields (%)



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

— During 2014, shrinking processes for credit to corporates have become somewhat less pronounced in the euro area. With -2.4% yoy, October records the smallest reduction since the start of the year (for comparison: January -3.4%, mid-2013: -5.9%). While still shrinking, the trend suggests bottoming-out coming closer. Household deleveraging in the euro area continues in October (-0.6% yoy).

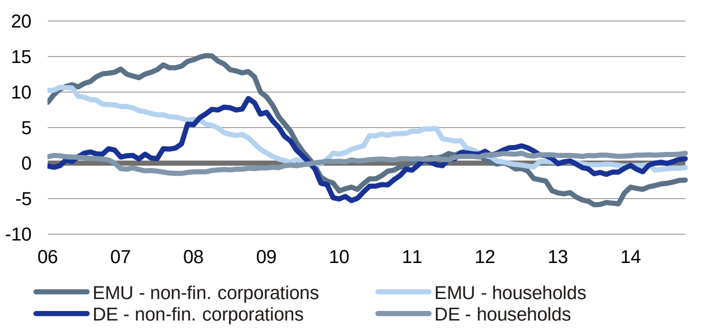
— Credit conditions for German corporates continue to be very favourable. Interest rates for corporate credit remained at 2.8% (September). Only 18.3% of companies from industry and trade (October 17.7%) and some 21.2% of construction companies (October: 21%) report restrictive access to credit in November. Nevertheless, corporate borrowing has remained restrained throughout the year. Only most recently Q3 records slight growth and October saw an increase of +0.6% yoy. Despite easy access to credit and the low rate environment, German corporates have shown reluctant demand for credit and investment.

— Alternative financing options of enterprises such as issuing corporate bonds have continued to dampen corporate loan demand.

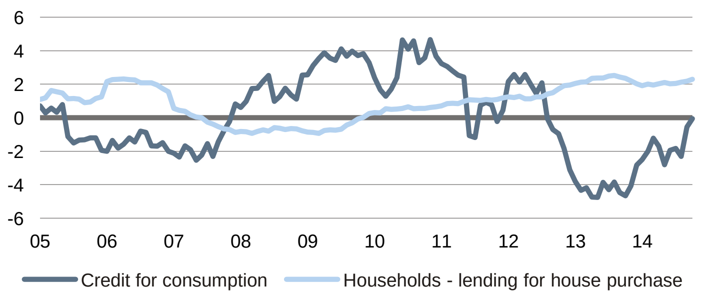
— Lending to households in Germany continues to rise modestly (October: +1.4% yoy). Growth in mortgage credit (+2.3% yoy) continues to drive total increases. For the first time in almost two years, consumer credit remains almost stable, only recording a minimal drop in October (-0.1%).

— Mortgage credit growth in Germany has remained around 2% this year, in line with developments in 2013. Given the very low interest rates – September reached a new low at 2.3% – credit growth remains rather moderate. This partly reflects portfolio shifts by households and local supply shortages as well as rather cautious attitudes with regards to lending. Rising real incomes reduce the need to finance consumption via credit for many households translating into restrained credit demand despite the low interest rates.

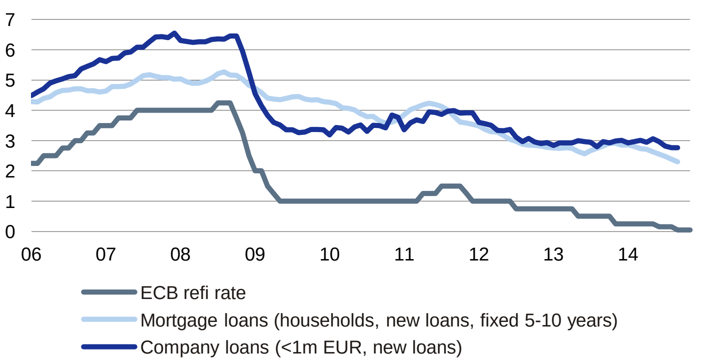
Lending to the private sector (% yoy)



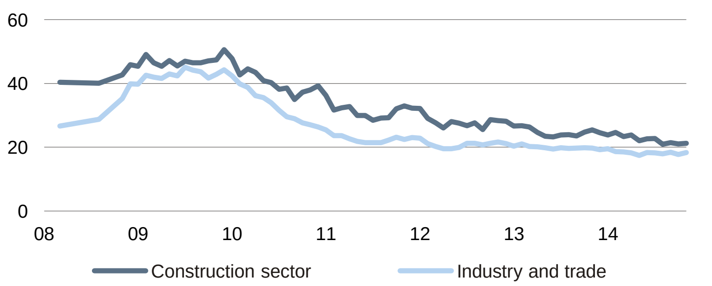
Loans to households (% yoy)



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

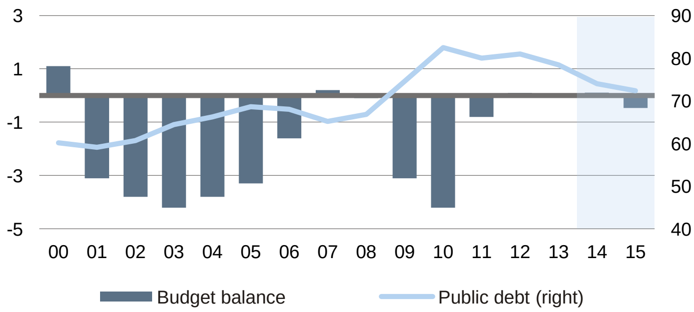
Chartbook – Public finances/Politics

— In 2013 the general budget only edged into the black thanks to the surpluses generated by the municipalities and the social-security scheme. The general budget for 2014 is projected to close to balance. But in 2015 the budget situation is set to deteriorate due to now weaker than hitherto expected economic growth and slightly higher unemployment, caused among other things by the introduction of a minimum wage. As a result the general government budget will report a deficit of round about 0.5%. The German public debt ratio stood at 75.4% of GDP at the end of Q2 2014 (Q4 2013: 76.9%). The still relatively positive development reflects the small surplus in 2013 due to continuously rising revenues. In addition, refinancing costs continue to remain low. General government debt in Germany is set to decline further during the next few years, despite weaker growth dynamics. The fact that the bad banks continue to run down their portfolios will alone cut debt by 0.5% of GDP p.a.

— In October, total tax revenues climbed by 3.1% yoy. From January until October, total tax revenues were about 3% higher than a year earlier and thus currently only slightly below the forecast for the whole year (3.4%). The target for the whole year will probably slightly be missed. Hence the solid growth of tax revenues continues this year. Income tax is a major contributor to this development. On a cumulative basis it is now almost 5% higher than in the same period last year. However, the components of income tax develop differently. The final withholding tax on interest income and the non-assessed tax on earnings (which largely corresponds to the withholding tax on dividends) are still lower on a cumulative basis than in the corresponding pre-year period, despite a large individual case in the latter case which resulted in a sharp increase of the October reading. Regarding the final withholding tax the low interest rate environment has a negative impact on the revenues. On the other hand the revenues of the highly profit-dependent corporation tax are still (on accumulated basis) above the pre-year period. Due to the still favourable situation on the labour market and strong wage gains the revenues of the wage tax, the most important component of the income tax, are 6% (cumulated until October) over the pre-year period and therefore the main driver for the positive revenue development. The VAT still grows robustly with a rate of 3% (yoy as well as on a cumulated basis), whereby recently the import VAT was the main driver rather than the domestic VAT.

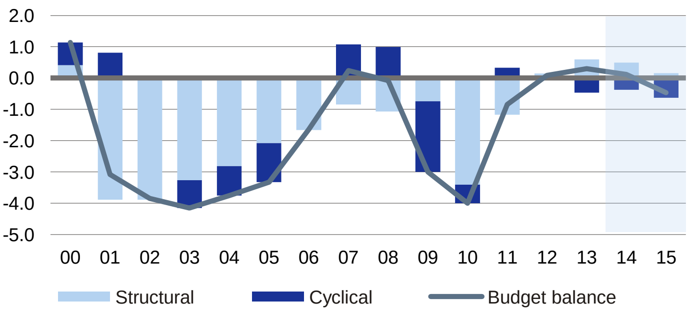
Public debt and budget balance

General government, as % of GDP,



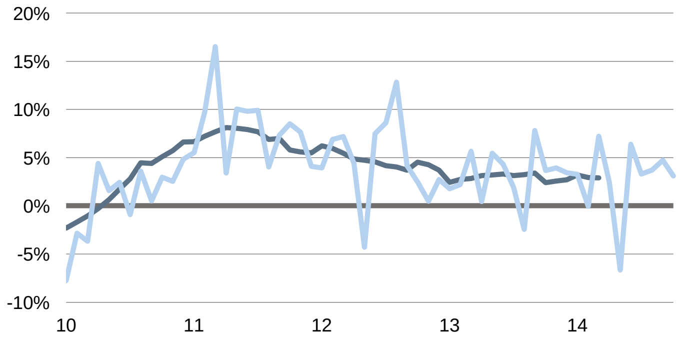
Budget balance

General government, % of GDP



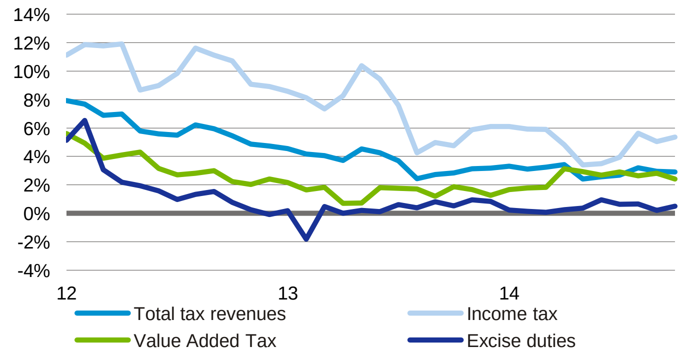
Tax revenues

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
4 Dec	ECB Governing Council meeting, press conference	Review of the monetary policy stance.
8 Dec	End of adjustment programme in Greece	Greece will leave its second macroeconomic adjustment programme and will be further backed by a flexible credit line from ESM.
11 Dec	2nd TLTRO	The ECB is due to allot the second round of its targeted long-term refinancing operations. A total of EUR 83 bn was taken up under the first operation in September, a disappointment relative to our projection for around EUR 100 bn take up and even higher market expectations.
18/19 Dec	European Council	The two focal points are likely to be the status of a Greek programme and the EUR 315 bn euro area-wide “stimulus” package.
1 Jan	Lithuania due to join the euro area	Lithuania will adopt the euro in 2015 (on 23 July the European Council approved Lithuania’s requires to join the euro area at of 1 January 2015 at a conversion rate of EUR 1=LTL 3.45280).
14 Jan	ECJ Advocate General to deliver his opinion on the ECB's OMT	Following the oral hearing on the German complaints against OMT on Oct 14, the Advocate General announced to give his assessment by mid-January, again in open court. The GCC will then take its own decision in the light of the preliminary ruling of the ECJ.

Source: Deutsche Bank Research

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Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
5 Dec 2014	8:00	New orders manufacturing (Index, sa), pch mom	October	-1.5	0.8
8 Dec 2014	8:00	Industrial production (Index, sa), pch mom	October	-0.3	1.4
9 Dec 2014	8:00	Trade balance (EUR bn, sa)	October	18.6	19.4
9 Dec 2014	8:00	Merchandise exports (EUR bn, sa), pch mom (yoy)	October	-0.5 (5.1)	6.1 (6.2)
9 Dec 2014	8:00	Merchandise imports (EUR bn, sa), pch mom (yoy)	October	0.6 (5.8)	7.1 (6.0)
16 Dec 2014	9:30	Manufacturing PMI (Flash)	December	50.5	50.0
16 Dec 2014	9:30	Services PMI (Flash)	December	52.5	52.1
18 Dec 2014	10:30	ifo business climate (Index, sa)	December	105.0	104.7
30 Dec 2014	8:00	Import prices (Index, sa) pch mom (yoy)	November	-0.7 (-2.0)	-0.3 (-1.2)
5 Jan 2015	14:00	Consumer prices preliminary (Index, sa), pch mom (yoy)	December	0.2 (0.4)	0.0 (0.6)
7 Jan 2015	10:00	Unemployment rate (%, sa)	December	6.6	6.6
8 Jan 2015	8:00	Retail sales (Index, sa), pch mom	November	0.5	1.9
15 Jan 2015	8:00	Real GDP (Index, sa), % qoq	2014	1.4	0.1

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	0.05	0.50	0.00	0.00	0.20	1.50	2.00	2.10	0.05
Dec 14	0.125	0.10	0.05	0.50	0.00	0.00	0.20	1.50	2.00	2.10	0.05
Mar 15	0.125	0.10	0.05	0.75	0.00	0.00	0.20	1.50	2.00	2.10	0.05
Sep 15	1.000	0.10	0.05	1.00	0.00	0.00	0.20	1.50	2.00	2.10	0.05
3M interest rates, %											
Current	0.23	0.20	0.08	0.55							
Dec 14	0.35	0.15	0.10	0.55							
Mar 15	0.35	0.15	0.10	0.80							
Sep 15	1.30	0.15	0.10	1.05							
10Y government bonds yields, %											
Current	2.07	0.60	0.70	1.93	0.43	1.00	0.93	1.89			
Dec 14	2.35	0.50	0.90	2.50	0.70	1.75	1.50	2.75			
Mar 15	2.50	0.55	1.20	2.70	0.80	1.90	1.60	2.93			
Sep 15	2.70	0.60	1.40	3.10	1.00	2.20	1.80	3.32			
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	1.25	117.53	0.79	0.64	1.20	9.24	7.44	8.60	4.18	307.14	27.61
Dec 14	1.25	117.00	0.77	1.62	1.22	8.95	7.46	8.00	4.15	310.00	27.50
Mar 15	1.22	119.00	0.76	1.61	1.23	8.90	7.46	7.95	4.13	313.00	27.50
Sep 15	1.18	123.00	0.74	1.59	1.25	8.80	7.46	7.85	4.08	319.00	27.50

Sources: Bloomberg, Deutsche Bank

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German data monitor

	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Jun 2014	Jul 2014	Aug 2014	Sep 2014	Oct 2014	Nov 2014
Business surveys and output											
Aggregate											
Ifo business climate	108.9	110.8	110.3	106.3		109.6	107.9	106.3	104.7	103.2	104.7
Ifo business expectations	106.0	107.8	106.0	101.4		104.7	103.3	101.6	99.3	98.3	99.7
PMI composite	54.5	55.4	55.2	54.5		54.0	55.7	53.7	54.1	53.9	52.1
Industry											
Ifo manufacturing	104.6	106.8	106.5	102.1		105.2	103.6	102.2	100.6	98.4	99.5
PMI manufacturing	52.9	55.0	52.8	51.3		52.0	52.4	51.4	49.9	51.4	50.0
Headline IP (% pop)	0.5	1.1	-1.1	-0.3		0.4	1.6	-3.1	1.4		
Orders (% pop)	2.0	0.0	-0.2	0.1		-2.4	4.8	-4.2	0.8		
Capacity Utilisation	83.3	83.5	84.3	84.0	83.7						
Construction											
Output (% pop)	-0.5	5.1	-6.0	0.0		3.3	-1.4	-1.1	2.4		
Orders (% pop)	2.5	1.6	-5.0	-2.9		-6.4	5.9	-2.2	-2.7		
Ifo construction	121.3	122.6	120.5	119.1		120.5	119.3	119.5	118.4	118.3	119.1
Services											
PMI services	54.1	54.0	55.1	55.7		54.6	56.7	54.9	55.7	54.4	52.1
Consumer demand											
EC consumer survey	-2.8	0.3	4.3	1.0		4.3	3.9	0.3	-1.1	-0.7	-1.6
Retail sales (% pop)	0.1	1.5	-0.3	-0.4		1.0	-0.9	1.3	-2.8	1.9	
New car reg. (% yoy)	1.6	2.8	-0.3	4.1		-1.9	6.8	-0.4	5.2	3.7	
Foreign sector											
Foreign orders (% pop)	3.7	-1.3	0.2	1.7		-3.2	7.6	-6.5	3.7		
Exports (% pop)	1.8	1.1	0.5	2.3		0.9	4.8	-6.7	6.1		
Imports (% pop)	-0.2	3.9	-1.1	-0.7		3.6	-1.4	-4.6	7.1		
Net trade (sa EUR bn)	54.2	48.4	52.4	60.6		16.6	22.1	19.1	19.4		
Labour market											
Unemployment rate (%)	6.9	6.8	6.7	6.7		6.7	6.7	6.7	6.7	6.6	6.6
Change in unemployment (k)	15.3	-43.0	-19.7	2.7		6.0	-13.0	1.0	9.0	-23.0	-14.0
Employment (% yoy)	0.5	0.7	0.9	0.9		0.9	0.9	0.9	0.9	1.0	
Ifo employment barometer	107.2	107.5	106.8	106.4		106.0	106.0	107.0	106.0	106.9	105.4
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.3	1.0	0.9	0.8		1.0	0.8	0.8	0.8	0.7	0.5
Core HICP (% yoy)	1.1	1.1	1.1	1.2		1.1	1.2	1.2	1.2	1.1	
Harmonised PPI (% yoy)	-0.7	-1.0	-0.8	-0.8		-0.7	-0.8	-0.8	-1.0	-1.0	
Commodities, ex. Energy (% yoy)	-10.4	-11.1	-4.9	-1.8		-3.5	-3.0	-1.3	-1.1	0.9	
Oil price (USD)	109.3	108.2	109.7	102.0		111.8	106.9	101.6	97.4	87.3	
Inflation expectations											
EC household survey	25.5	22.0	16.9	13.4		14.6	15.3	14.8	10.0	11.1	8.5
EC industrial survey	6.1	5.6	2.3	4.2		2.6	3.3	4.1	5.2	4.7	3.2
Unit labour cost (% yoy)											
Unit labour cost	1.4	0.8	2.1	2.0							
Compensation	2.0	2.8	2.6	2.5							
Hourly labour costs	2.2	0.8	2.5	2.3							
Money (% yoy)											
M3	2.7	3.5	4.2	4.8		4.2	4.4	5.0	4.8	4.0	
M3 trend (3m cma)						4.3	4.5	4.7	4.6		
Credit - private	-3.1	-3.6	-3.5	1.4		-3.5	-2.8	1.0	1.4		
Credit - public	-17.1	-1.5	9.7	5.9		9.7	11.4	5.1	5.9		

% pop = % change this period over previous period.

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

Focus Germany

Focus Germany is part of the Current Issues series and deals with macroeconomic and economic policy issues in Germany. Each issue also contains a timetable of financial and economic policy events as well as a detailed data monitor of German economic indicators. Focus Germany is a monthly publication.

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Available faster by E-mail:
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Printed by: HST Offsetdruck Schadt & Tetzlaff GbR, Dieburg

Print: ISSN 1612-314X / Internet/E-mail: ISSN 1612-3158