Focus Germany

January 28, 2013

Gradual improvement in 2013

Author
Bernhard Gräf
+49 69 910-31738
bernhard.graef@db.com

Editor
Stefan Schneider

Deutsche Bank AG
DB Research
Frankfurt am Main
Germany
E-mail: marketing.dbr@db.com
Fax: +49 69 910-31877

www.dbresearch.com

DB Research Management
Ralf Hoffmann | Bernhard Speyer

The German economy coped well with the difficult environment in 2012. Despite the deep recession in the southern peripheral countries of the euro area, the noticeable slowdown in economic growth in the emerging markets and the uncertainty surrounding the sovereign debt crisis, Germany's economy expanded by 0.7% last year. However, growth dynamics weakened substantially in the course of 2012 and economic output presumably even shrank by 0.5% in Q4, which shows that Germany was unable to fully decouple from the developments in its neighbouring countries.

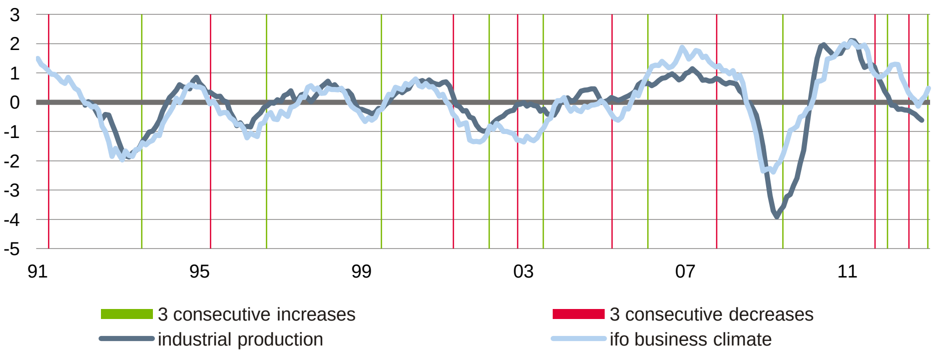
We expect a recovery to set in approximately in spring this year on the back of a stabilising euro area and more buoyant emerging markets. The third consecutive rise in the ifo index in January signalling somewhat more positive sentiment in Germany is in line with that. Owing to the low starting point, however, annual average growth will probably come to no more than ¼% in 2013. Nonetheless, the labour market is expected to remain relatively stable. With oil prices forecast to stabilise, consumer prices will probably rise less strongly this year.

Public-sector budgets look set to deteriorate for cyclical reasons in 2013. However, with a deficit of only about ½% of GDP, Germany would still be in an excellent position by international standards.

Content | Page

Third increase in ifo index suggests cyclical turning point

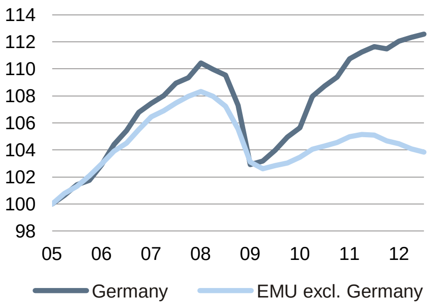
All normalised values: workday adjusted industrial production, % yoy; ifo business climate, 2005=100



Sources: ifo, Federal Statistical Office, DB Research

Real GDP 1

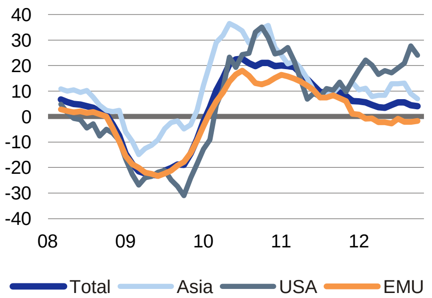
Q1 2005 = 100



Sources: OECD, DB Research

German exports 2

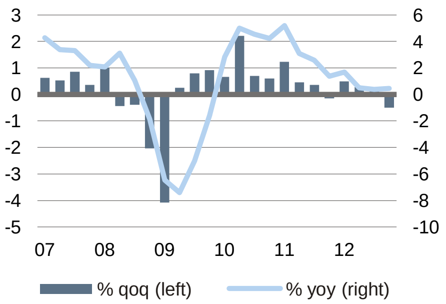
3M mov.avg, % yoy



Source: Deutsche Bundesbank

Germany: Economic growth 3

Real GDP



Sources: Federal Statistical Office, DB Research

German economy successful in difficult environment ...

The German economy is well positioned and highly competitive, and its export sector is geared to the right products and countries to benefit strongly from global growth impulses. Moreover, household, corporate and public-sector finances are in good shape. This explains why Germany has boasted considerably stronger growth than its neighbours since the outbreak of the sovereign debt crisis and has already more than offset the slump of 2009. Between 2010 and 2012, Germany's economy expanded by more than 2 ½% per annum, and output already exceeds pre-crisis levels by a good 2%. By contrast, the economies of the other members of the European Monetary Union (EMU) virtually stagnated during the same period, and their real gross domestic product (GDP) is more than 4% lower on average than prior to the crisis.

... but not immune to recession in EMU countries

True, the German economy has managed to hold its own in an increasingly adverse environment. But it is not immune to the deep recession in the southern peripheral countries of EMU or the stagnation in France, its most important sales market which still absorbs almost 10% of its exports. All in all, almost 40% of German exports go to the euro-area member states. Order intake from these countries has been declining since the end of 2011, most recently at double-digit rates. Correspondingly, German exports to EMU have been shrinking for several months now. As this was offset only in part by stronger exports to Asia and especially the US, German export growth decelerated in the course of 2012.

Markedly weaker growth dynamics in 2012

Investment, which was already weighed down by growing uncertainty surrounding the sovereign debt crisis, took an additional beating from weaker exports. Investment in plant and equipment, for instance, had been declining since Q4 2011 and was down considerably from its pre-year level at the end of 2012. Even though private consumption rose moderately and compensated weaker investment, it could not also outweigh the negative impulse from slowing exports. As a result, growth dynamics weakened noticeably in the course of 2012, and real GDP even shrank by 0.5% in last year's final quarter. Thanks to strong H1 growth, however, German economic output nonetheless grew by 0.7% on an annual average in 2012.

Global environment somewhat brighter in 2013

Although it is hardly reflected in annual average growth rates we nonetheless forecast an appreciable economic recovery during the current year. We expect the global economy to grow only slightly faster, at 3.2%, than in 2012, the US economy even somewhat more slowly at 2% (following 2.3% in 2012) and the euro-area economy to shrink even further, by -0.3%, this year (after -0.5% last year). We therefore assume that most euro-area countries will reach their cyclical low in Q1 2013 and swing onto a moderate growth path afterwards. In the US as well as the emerging markets, growth looks set to pick up in the course of the year.

The above is based on the assumption that after largely evening out the fiscal cliff Republicans and Democrats will also solve the debt ceiling problem at the beginning of the year. That should remove uncertainties over the economic

Economic growth 4

Real GDP, % yoy	2011	2012	2013	2014
USA	1.8	2.3	2.0	2.9
Japan	-0.5	2.0	0.6	0.6
Euroland	1.4	-0.5	-0.3	1.1
Germany	3.0	0.7	0.3	1.5
France	1.7	0.1	-0.3	1.0
Italy	0.6	-2.1	-0.9	0.5
Spain	0.4	-1.3	-1.1	0.6
Netherlands	1.0	-1.0	-0.1	1.7
Greece	-7.1	-6.5	-4.2	0.9
Portugal	-1.6	-2.9	-1.2	0.8
Ireland	1.4	0.2	0.8	1.9
UK	0.8	-0.1	0.9	1.8
Asia (ex Japan)	7.6	6.0	6.7	7.5
China	9.3	7.8	8.2	8.9
India	7.9	4.6	6.8	7.1
Eastern Europe	4.7	3.0	3.5	3.9
Latin America	3.9	2.7	3.5	3.9
World	3.8	2.9	3.2	4.0

Sources: IMF, DB Research

Budget balance 5

Total public sector, % GDP	2011	2012	2013	2014
Eurozone	-4.1	-3.3	-2.7	-2.3
Germany	-0.8	0.1	-0.4	-0.2
France	-5.2	-4.6	-3.6	-2.8
Italy	-3.9	-2.9	-2.3	-2.5
Spain	-9.4	-7.9	-6.1	-5.1
Netherlands	-4.5	-4.0	-3.2	-2.0
Greece	-9.4	-7.0	-6.1	-5.0
Portugal	-4.4	-5.3	-4.8	-3.4
Ireland	-13.4	-8.3	-8.0	-6.2

Sources: Eurostat, DB Research

Public debt 6

Total public sector, % GDP	2011	2012	2013	2014
Eurozone	88.1	93.2	95.4	95.1
Germany	80.5	81.7	80.7	78.5
France	86.0	91.5	95.4	95.8
Italy	120.7	128.8	129.8	129.6
Spain	69.3	85.3	91.0	93.0
Netherlands	65.5	71.7	73.2	74.3
Greece	170.6	170.8	184.8	188.2
Portugal	108.1	115.8	119.0	120.2
Ireland	106.4	113.9	117.9	118.7

Sources: Eurostat, DB Research

outlook for the US economy and thus the investment backlog in the US will disappear. The term "fiscal cliff" describes the expiry of tax cuts introduced under former President Bush, of temporary tax relief granted by President Obama by end-2012 as well as automatic spending cuts resulting from the failed consolidation negotiations of 2011, which would have plunge the economy into deep recession in H1 2013. However, the US congress found a compromise at the turn of the year that postponed the automatic spending cuts by two months and completely avoided tax rate hikes except for households in high income brackets. We assume that the Democrats and Republicans – after long and hard negotiations – will also find a compromise concerning the debt ceiling.

Moreover, economic growth looks set to pick up in the emerging markets, too. The Chinese economy, for instance, probably has left its trough behind already in Q4 2012 as growth picked up to 7.9% from 7.4% (Q3). In 2013 China should grow by over 8% again. Correspondingly, world trade – whose expansion rate probably halved to less than 3% in 2012 – is expected to show somewhat stronger growth in 2013.

Also, the dampening effects of fiscal consolidation in the euro area look set to be smaller this year than last. According to our estimates, the adverse effects on economic growth will add up to almost 1% of GDP in 2013 due to consolidation measures compared with 1 ½% in 2012. All in all, this means the global environment for the German economy will brighten, and we also expect fewer disruptions from the euro crisis.

Peripheral countries' budgets on the right track

A look at public-sector budget balances shows that the consolidation process in the euro area is successful. To be sure, the countries of the southern periphery (except Italy) as well as France this year all look set to exceed the 3% deficit limit prescribed by the Stability and Growth Pact. With the exception of the smaller countries of Greece, Portugal and Ireland, however, all other euro-area members could remain below the threshold in 2014. We put the eurozone's public-sector deficit as a whole at 2.7% of GDP in 2013, after 3.3% in 2012. Given the weak growth rate, however, the debt ratio – i.e. total public-sector debt in relation to GDP – will continue to rise in nearly all euro-area countries and come to 95% at the end of 2014.

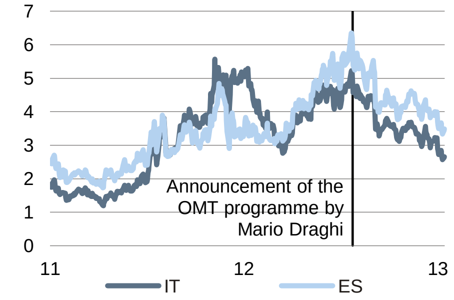
ECB calmed markets ...

Considerable uncertainties remain for the euro area as regards the implementation of the reform and consolidation programme in Greece, the large-scale problems besetting the Spanish banks as well as the discussion surrounding structural challenges for the Italian and French economies. With the announcement by ECB President Mario Draghi at end-July 2012 that the European Central Bank will do whatever it takes to preserve the euro, and with the bond purchase programme decided by the ECB in September 2012, the risks have become substantially smaller in our view.

The bond purchase programme (OMT – Outright Monetary Transactions) allows unlimited purchases of a country's government bonds, particularly regarding maturities of one to three years, by the ECB if the country applies for support from the euro bailout fund and accepts its conditionality. According to the ECB, the reason for the programme was unjustified risk premia for exchange-rate risk which must not exist within the euro area. Previously, yield spreads of Spanish and Italian government bonds versus German Bunds had widened to more than 6 and 5 percentage points, respectively. At times, this meant that yields for 10Y government bonds stood at 7 ½% in Spain and at 6 ½% in Italy, which over the

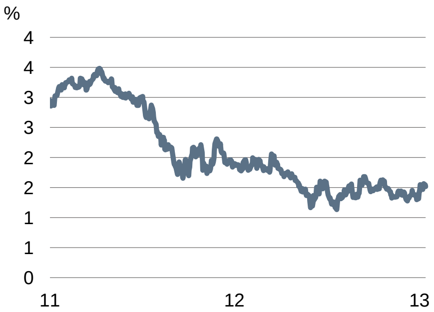
Yield spreads to Germany 7

Spread to German 10Y bunds, pp



Sources: Global Insight, DB Research

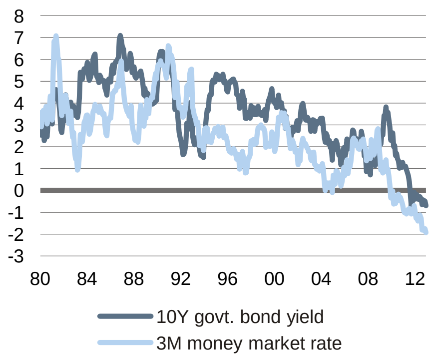
10Y bund yields 8



Source: DB Research

Germany: Real interest rates 9

Nominal interest rate - inflation, %



Sources: Federal Statistical Office, Global Insight

longer term would have pushed the countries into a debt spiral given their weak growth rates. Financial markets reacted euphorically to the announcement of the programme, yield premia dropped and share prices rose. However, there is also stark criticism of the OMT programme, particularly from the Bundesbank which rejects the programme because of its similarities to government financing and potential inflationary dangers.

... and completes its strategy to solve the euro crisis

The programme seems to complete the ECB's strategy to solve the government debt crisis. While national governments "are doing their homework", i.e. consolidating public finances and strengthening the competitiveness of their economies, and the European community together with the International Monetary Fund (IMF) supports this multi-year adjustment process under strict conditionality through low-interest financing, the ECB will provide the necessary calm in the financial markets during the adjustment period and will fight speculation that might hamper the adjustment process.

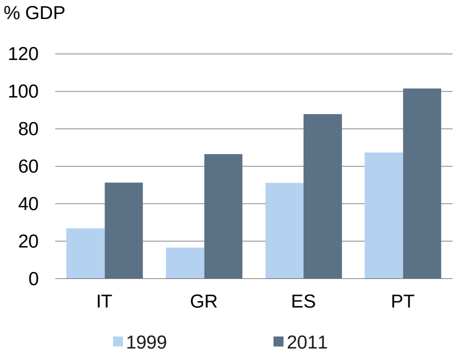
Although this strategy seems clear and logical, its implementation still harbours risks. The solution of the crisis for instance calls for perfect cooperation of all those involved at both the national and the European level which is not necessarily guaranteed, however, given political imponderables, time inconsistencies resulting from national elections as well as potential moral hazard problems. The reform and consolidation efforts of a country could slow down if it can improve its short-term situation thanks to low interest rates and pass on the costs to others via the ECB. Correspondingly, disruptions to the resolution process are possible at any time. Also, the conditionality, i.e. purchases of government bonds linked to the condition of far-reaching adjustment programmes, does not seem to be a credible threat in an extreme scenario, as the ECB has explicitly ruled out the reversibility of the euro, and a withdrawal by the ECB would probably lead to large-scale losses and chaos in the markets, making such a scenario seem even more probable.

Low-interest rate phase continues ...

In light of the ECB's role as supporting pillar in the resolution of the euro crisis we expect it to keep interest rates low for the foreseeable future in order not to jeopardise the stability of the financial system and the economic stabilisation. Although the ECB's measures have contributed to a stabilisation in the financial system the bank is likely to keep the key interest rate at its current low level of 0.75% into 2014 due to the weak economy.

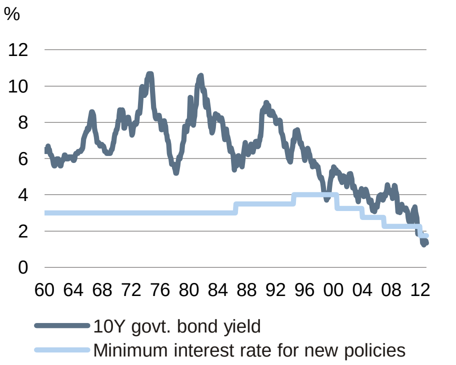
In the course of the worsening euro crisis yields of Bunds with a 10-year maturity have halved to 1 ½% and hovered around this level approximately since the spring/summer of 2012. At an inflation rate of 2% this would mean a negative yield of approx. ½%. We expect yield levels to normalise in the course of the current year. The strength of this return to normal will depend on the degree of calm in the euro area and thus the decline of Germany's safe-haven status. A yield level of around 2 to 2 ½% looks possible around year-end. In real terms, yields would then turn positive again (approx. ½%) but would still be extremely low in a historical comparison. Real yields of long-term Bunds, for instance, still averaged 4.4% between 1980 and 2000 and a remarkable 2.6% between 2000 and 2009.

Private households: Liabilities 10



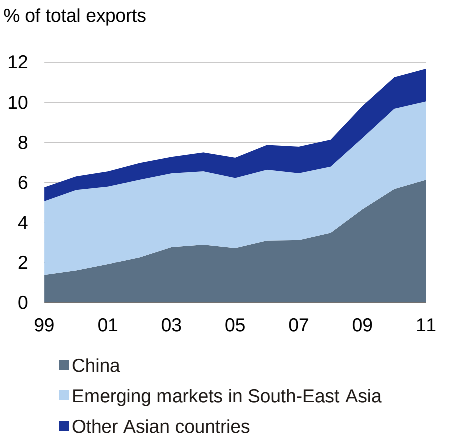
Source: Eurostat

10Y bond yields & minimum interest rate for new insurance policies 11



Sources: BaFin, Global Insight

German exports to Asia 12



Source: Deutsche Bundesbank

... with considerable risks and side-effects

To be sure, low interest rates provide advantages for public-sector finances and investment. They also create incentives for household borrowing. However, they also harbour considerable risks especially over a longer-term horizon. Particularly over the last few years it has become apparent that an excessively long low-interest period has led to a dramatic increase in public and private indebtedness as well as to asset price bubbles, for instance in the property sector. The kind of excesses low interest rates can cause is reflected in the household debt situation. In Italy, for example, household debt has doubled in relation to GDP since 1999, and in Greece even quadrupled. Moreover, low interest rates could reduce consolidation pressures on public-sector budgets and bank balance sheets and raise the propensity of household and institutional investors to take risks.

The low-interest phase causes problems above all for corporate pension funds and insurance companies. German insurance companies' stock of capital investments amounts to approx. EUR 1,300 bn, of which roughly 80% is invested in fixed-income securities. At present, insurance companies can meet the legal requirement of 1.75% minimum interest for new policies written since the start of 2012 relatively easily, as their portfolios still include bonds with long maturities and high coupons. Once these bonds fall due, however, this will change, so the guaranteed rate of interest might have to be lowered once again and the problem of low interest rates will thus be passed on to those taking out insurance policies, i.e. households. Moreover, household savings will have to rise or the period of saving to be prolonged to be able to make the necessary private provisions in light of expected cuts to government pensions caused by demographic change. The following example shows the extent of the compound interest effect. With interest rates down by 1 percentage point, nearly one-quarter more must be saved or savings must be prolonged by 4.5 years in order to achieve the same pension from private old-age provision, which foresees a 20-year savings phase and a pay-out phase of 24 years.

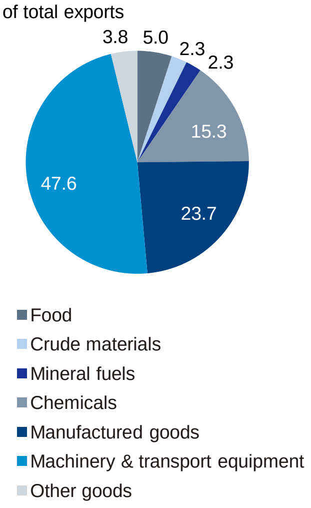
Our forecast for Germany in detail:
Net exports negative in 2013

The German economy has successfully geared its operations especially to demand from the dynamically growing emerging markets. The share of exports to Asian EMs, for instance, has doubled to 10% since 2000, with China's share in that period growing four and a half times to more than 6% and turning the country into Germany's fifth most important sales market. Nearly half of Germany's exports are machinery and transport equipment, i.e. capital goods. This group of goods even accounts for more than 72% of Germany's exports to China. This has its advantages and provides growth impetus in global upswing phases but also has its disadvantages in downturn phases, especially if investment is scaled down strongly, as shown by recent developments. Investment in plant and equipment, for instance, decreased markedly in the southern peripheral countries in 2012, with Spain recording a decline of nearly 7%, Italy and Portugal over 10% and Greece 14%.

German exports therefore look set to remain weak at least throughout the first quarter of the year. With the recession petering out in the eurozone peripherals, the second half of the year will likely see demand from these countries pick up somewhat. Together with continued lively demand from the emerging markets, and particularly China, this will probably boost dynamics in the export sector. In light of the weak starting point at the beginning of the year, though, we expect real exports to grow somewhat less strongly than last year, by 3 ½% on average in 2013.

German exports by main categories 13

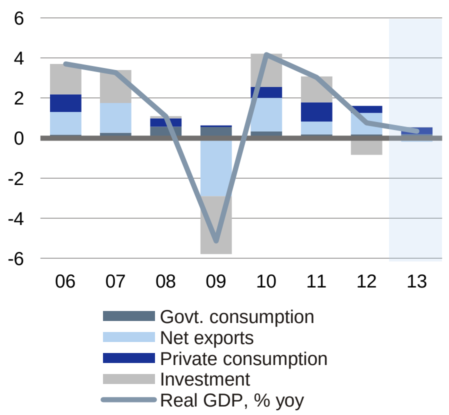
2011, % of total exports



Source: OECD

Germany: Growth contribution 14

pp



Sources: Federal Statistical Office, DB Research

Given the growth of domestic demand, real imports in 2013 look set to expand somewhat faster – at a good 4% – than exports. Correspondingly, net exports will shave off roughly one-quarter of a percentage point of growth. In 2012 net exports had still contributed just over 1 percentage point to economic growth. As a result, Germany's current account surplus will shrink to approx. EUR 155 bn or 5 ¾% of GDP in 2013, following approx. EUR 170 bn or just under 6 ½% of GDP last year.

Only moderate recovery of investment in plant and equipment

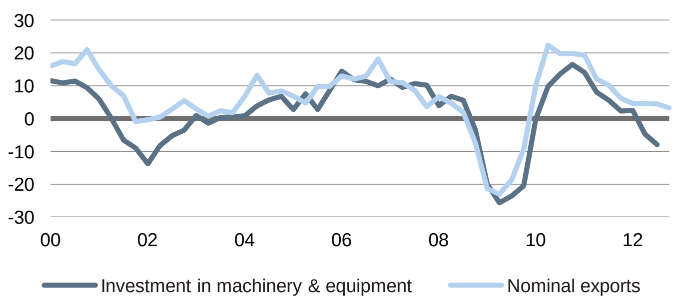
Poor export dynamics, falling profits and uncertainties surrounding the sovereign debt crisis probably were the main reasons behind the 4.4% decline in investment in machinery and transport equipment in 2012. A look at the investment ratio, i.e. the relation between investment in plant and equipment and GDP, reveals that it is higher in Germany than in other European countries. However, this does not constitute overinvestment which – when reduced – would hamper corporate investment activity over a longer period of time. A capital-intensive manufacturing economy such as Germany needs higher investments than other countries where production is more labour-intensive. Also, Germany's industrial sector contributes almost one-quarter to total gross value added and thus ranks second in a European comparison, after Ireland. Against this backdrop, a higher investment ratio in Germany therefore not only appears logical but even absolutely essential. Hence, the current weakness of investment is a cyclical phenomenon which will probably reach its lowest point soon.

Nonetheless, the recovery in investment in plant and equipment we expect will probably remain moderate despite the low interest environment. We assume that profit expectations will improve only gradually. This is suggested by persisting uncertainty regarding the sovereign debt crisis as well as weak growth in the eurozone due to an ongoing consolidation of public-sector finances, despite our forecast of an economic recovery in the emerging markets. In addition, capacity utilisation in Germany's industrial sector took another hefty blow in Q4 2012 and came in 2.5 percentage points below the long-term average.

All in all, average quarterly growth of investment in plant and equipment in 2013 will probably come to just under 1%, which is less than half the 2004-2007 figure when investment in plant and equipment had risen by 2 ¼% per quarter. Due to the large growth underhang at the beginning of this year (over 3%) this will result in another decline in investment in plant and equipment of 1 ¼% on an annual average.

Exports & investment 15

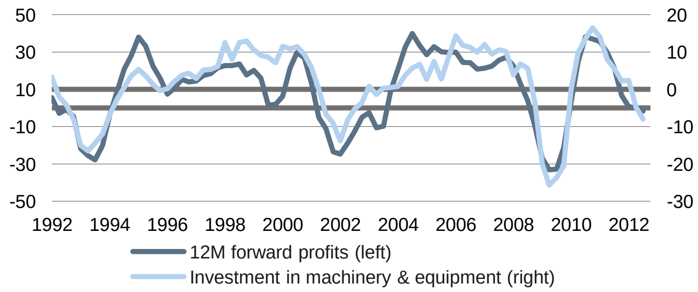
% yoy



Source: Federal Statistical Office

Germany: Profits & investment 16

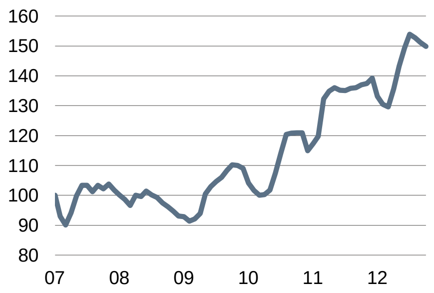
% yoy



Sources: Federal Statistical Office, IBES Thomson Reuters

Germany: Housing permits 17

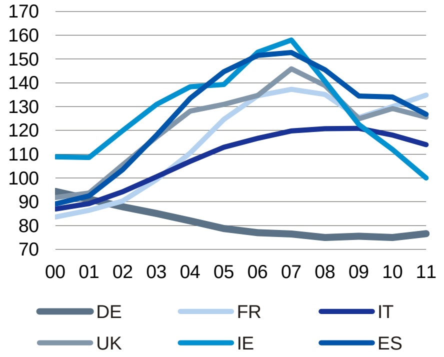
Q1 2007 = 100, 3M mov.avg.



Source: Federal Statistical Office

House prices 18

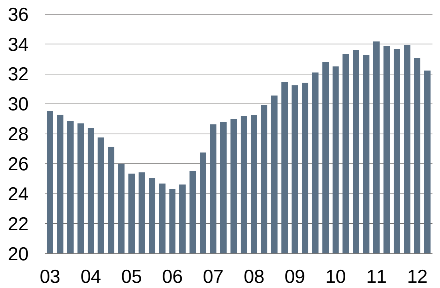
Price-to-income ratio, long-term average = 100



Source: OECD

Germany: Public construction investment 19

EUR bn. 4Q mov. sum



Source: Federal Statistical Office

Construction investment: Upswing to continue

Following a weak first half of the year, which also reflects an ongoing return to normal of public investment activity after the economic stimulation programmes had expired, construction investment recovered in the second half of 2012. Nonetheless, it fell by 1.1% on an annual average. Construction investment also showed strongly diverging developments in 2012 as regards the residential construction sector and commercial and public construction. While investment in residential construction probably rose by a good 2%, commercial construction investment was down slightly (-1%) and public-sector construction investment took a sharp plunge (-13%). This divergence looks set to continue this year, albeit to a somewhat less pronounced degree. The economic environment continues to be conducive to investment in residential construction. Besides low financing costs, extremely low investment yields which will probably continue to drive portfolio restructuring and thus the flight into real assets, the relatively stable labour market, favourable income prospects and high net immigration all suggest strong demand for residential properties for some time to come. The ongoing increase in building permits in the residential sector also points to an increase in residential construction investment this year by roughly 3% compared with 2012.

No real estate bubble

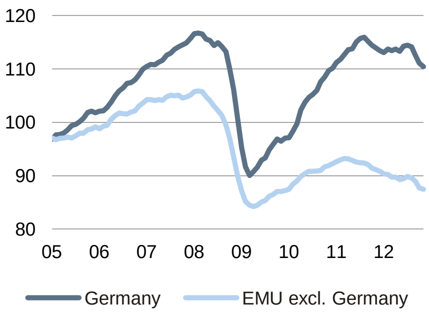
It is true that property prices rose by roughly 8% in Germany's conurbations and by around 5% in Germany as a whole in 2011 as well as in 2012, driven by stronger demand. Nonetheless, Germany is nowhere near a real estate bubble. Property prices were up by a noticeable degree in 2010 for the first time since 1995. Also, measured in terms of affordability, i.e. property prices in relation to disposable income, the German market is still undervalued by roughly 20% at present, according to OECD calculations. What is more, property prices and disposable incomes have been rising in tandem lately.

Very little impetus from commercial and public construction

By contrast, very little or no impetus at all is expected from commercial and public construction investment in the current year. Investment in commercial construction, especially in office buildings and retail outlets, is suffering from weak business activity and persisting uncertainties. The strong increase in commercial construction in 2011 (+8%) and the recent slump in capacity utilisation in manufacturing also do little to raise hopes of an improvement. We therefore forecast a slight decline in commercial construction investment this year, too. Even though public construction investment looks set to rise slightly in 2013 in the areas of road construction and civil engineering, the structural underfunding of many municipalities remains a major obstacle in light of the strong regional divergence of tax revenues. Overall, construction investment is likely to rise by 2% in 2013, after having fallen by 1% last year.

Industrial production 20

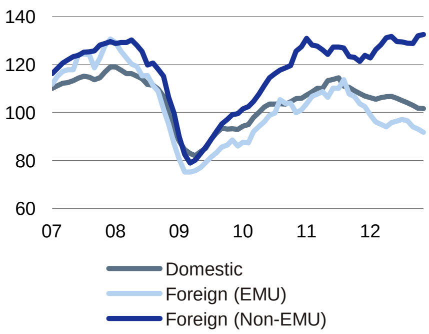
2005=100, 3M mov.avg.



Sources: Eurostat, Federal Statistical Office, DB Research

Germany: New orders 21

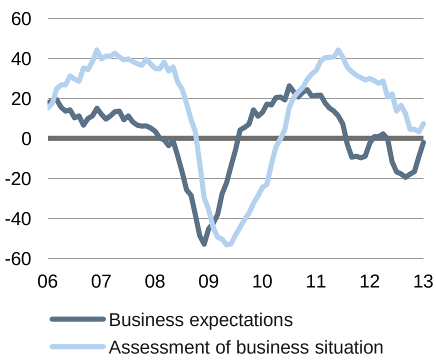
2005=100, 3M mov.avg.



Source: Federal Statistical Office

Germany: ifo business climate 22

Manufacturing, %-balance



Source: ifo

Industrial production is set to stagnate in 2013

Germany's industrial sector staged an impressive recovery from the deep recession of 2008/09 and was able to slightly exceed the production record of 2008 on an annual average in 2011. In this respect German industrial companies made a major contribution to the economic upswings of 2010/11.

Since the second half of 2011, however, the pronounced economic cooling in Germany and major export markets has begun to make itself felt. Domestic production has since trended downward slightly. In 2012, industrial output probably fell by an inflation-adjusted 1%. This result is still quite satisfactory considering that the economy in western European countries performed poorly again. The strong position of German industrial firms in North America or Asia for instance prevented a stronger decline in domestic industrial output. However, the recent cooling of the economy in many important non-European markets became most apparent in Q4 2012 when industrial output in Germany dipped sharply by a good 2%. Above all, the major export-intensive business sectors such as the automotive industry, mechanical engineering and electrical engineering reined in production significantly towards the end of last year, especially as they, too, didn’t receive any stimulus from domestic demand.

On account of this production decline in Q4 2012 industry started the new year with a statistical underhang. This underhang of roughly 2.5% is also the main reason why we recently lowered our forecast for German industrial production in 2013; instead of 1.5% growth we now expect stagnation. Our forecast is based on the expectation that output will trend up in the course of 2013, which will compensate for the weak start and result in a flat performance of output for the year as a whole.

The reasons for the cautious optimism lie among other things in the development of manufacturing sector’s business expectations. They have improved for the fourth time in succession recently, even though they have still not emerged from the negative zone. New order intake has also stabilised of late.

Comparing the output forecasts for individual industrial segments it is striking that we expect only minor fluctuations downwards or upwards. Last year already saw the variance in growth rates in the individual sectors narrow significantly compared with the period 2009 to 2011. This is to be interpreted as return to normal following the extraordinarily deep crisis of 2008/09 and the equally extraordinarily rapid recovery in 2010/11. As such, the trend towards a return to somewhat calmer waters for the German manufacturing sector will probably continue in 2013.

Of the major sectors the early-cycle chemicals industry should post the best performance this year with an increase in output of 1.5%. The industry appears to have already emerged from its cyclical slump. We expect electrical engineering to achieve a marginal increase in output and mechanical engineering output to move sideways in 2013. In both sectors the most important drivers will probably remain the non-EU countries. In the automotive industry, by contrast, we believe that output will probably decline in 2013 by around 2% in real terms – albeit from a high starting base. There is certainly potential for a positive surprise. It could turn out that the dips in production in Q4 2012 were so pronounced primarily because by taking a prudent approach and seeking to avoid an inventory build-up the sector applied the brakes more forcefully than would have been necessary. The food business is likely to grow again by about 1% this year after experiencing one of its extremely rare declines in production (2012: -0.5%).

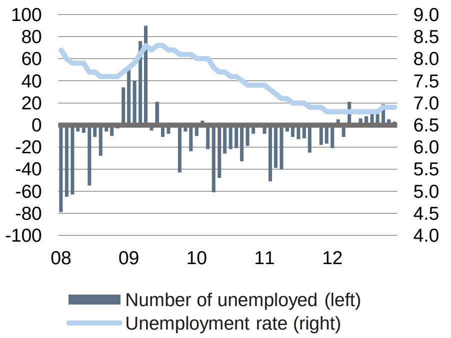
Germany – industrial production | 23

% yoy	2011	2012	2013
Food	1.1	-0.5	1.0
Beverages	3.7	0.5	1.0
Textiles	1.3	-7.0	-1.0
Clothing	0.2	-8.0	-8.0
Paper	0.5	-1.5	1.0
Chemicals	1.3	-3.0	1.5
Pharmaceuticals	4.7	-2.5	0.5
Plastics	5.8	-0.5	0.0
Building materials	8.2	-4.0	-1.0
Metal manufacturing	4.8	-3.0	0.5
Metal products	11.7	-1.0	1.5
Electrical engineering	14.3	-2.0	0.5
Mechanical engineering	13.3	1.5	0.0
Automobile	13.3	0.0	-2.0
Manufacturing	8.7	-1.0	0.0

Sources: Federal Statistical Office, DB Research

Germany: Unemployment | 24

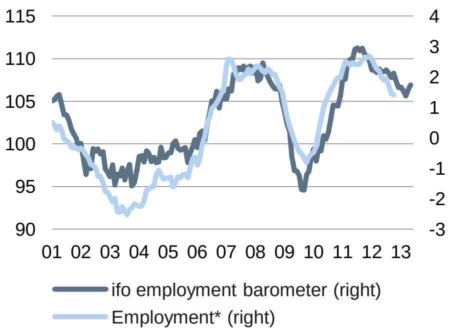
Change mom, 1,000 (left), % (right)



Source: Deutsche Bundesbank

ifo employment barometer & employment | 25

2005 = 100 (left), % yoy (right)



*) Shifted forward 6 months

Sources: ifo, Deutsche Bundesbank

Private consumption most important driver of growth in 2013

Private consumption has developed quite satisfactorily over the past few years. After more or less stagnating between 2000 and 2008, private consumption became an important pillar of growth in 2011 and 2012. In 2013, it will probably even be the most important driver of growth. We expect consumption expenditure this year to grow by over ½% in real terms and thus only slightly slower than the 0.8% in last year, supported by solid wage growth, lower pension contributions and a relatively stable labour market. Nominal disposable income looks set to rise by roughly 2 ¼% in 2013, inflation to average 1 ¾% and the savings ratio to remain at 10.3%.

Labour market remains relatively stable

The global weakening of growth has already made itself felt in the labour market. The jobless total, for instance, has risen slightly since the middle of 2012 and the growth rate of workers obliged to make social security contributions has slowed from 2 ¾% at the beginning of 2012 to approx. 1 ½% recently. This diverging development of employment and unemployment is largely attributable to relatively high immigration numbers. 2012 saw 340,000 persons (net) migrating to Germany, after 279,000 in the full year 2011. Immigration from EU countries, especially the peripheral countries, was up strongly as jobs were scarce there due to the deep recession and the desolate labour market situation.

The results of company surveys about staffing plans for the next few months show that staff numbers are being revised down and job cuts are looming. Also, leading indicators for labour market developments, such as the ifo employment barometer, the Federal Employment Agency's indicator for labour demand (the BA-X), the number of vacant jobs and of temporary workers have been declining since the second half of 2011, but are still at a relatively high level. In addition, the ifo employment index picked up again at the turn of the year which should be felt on the labour market sometime mid-2013. Employment growth, however, still looks set to slow on an annual average, and the jobless total will probably rise but remain below the 3 million mark on an annual average this year. Correspondingly, the unemployment rate is expected to rise somewhat to 7.0%, up from 6.8% in 2012. Hence, the situation in the German labour market can still be considered relatively stable by international standards, and particularly positive in a European comparison.

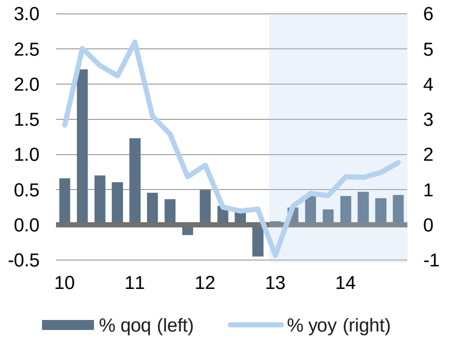
2013 likely to see no more than ¼% growth

After a weak start to the year, we now expect business activity in Germany to pick up in the summer half. Given the low starting point, however, economic growth will come to no more than ¼% on average in 2013, compared with 0.7% last year. Growth is supported mostly by private consumption spending, while net exports are making a negative contribution. If the euro area continues to stabilise and the global economy picks up as we expect – we think global economic growth in 2014 of 4% is conceivable – the upswing in Germany will probably continue as well, leading to real GDP growth of 1 ½% next year.

There are, naturally, considerable risks to the forecast of an economic turning point, which we expect for spring 2013. It would be wrong, however, to see the recent improvement in business confidence indicators as a first sign that the economy will recover more strongly and our growth forecast will be exceeded. Rather, the fact that sentiment indicators have turned out somewhat better is a

Germany: Economic growth 26

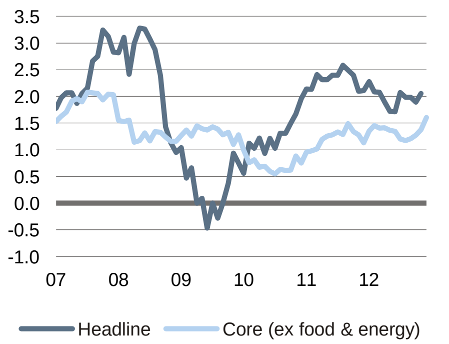
Real GDP



Sources: Federal Statistical Office, DB Research

Germany: Inflation 27

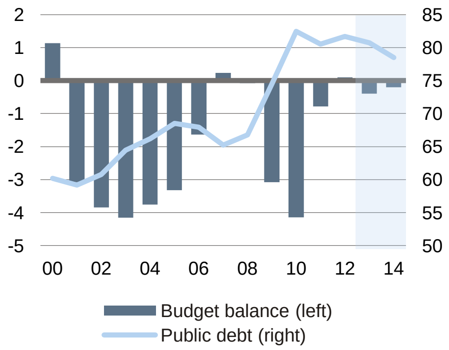
% yoy



Source: Federal Statistical Office

Germany: Public finances 28

Total public sector, % GDP



Sources: Deutsche Bundesbank, DB Research

necessary prerequisite for our growth forecast, which assumes that the cyclical trough has already been passed at the start of 2013.

Inflation down somewhat

The increase in consumer prices amounted to approximately 2% both at the end of 2012 and as an annual average. This rise has been mainly driven by higher prices for food and energy (up 3.2% and just under 5.7%, respectively). Excluding food and energy, the so-called core inflation rate only came to 1.3%.

Domestic price pressure is not in sight given the increasing underutilisation of production capacities in the course of slightly below-potential growth rates. We therefore expect the core inflation rate to continue to move in a narrow band between 1 and 1 ½%. As we assume oil prices to be virtually unchanged and the euro to weaken only slightly – we look for USD 1.20 per EUR at year-end 2013 – the increase in energy prices this year should remain below that registered last year despite markedly higher electricity prices. Correspondingly, inflation looks set to slow somewhat in the course of the year and should come to a halt at approx. 1 ¾% on an annual average.

Longer-term inflation risks have risen, as the ECB's monetary policy is too expansionary for Germany and its OMT programme may harbour negative consequences. However, these risks will initially make themselves felt more strongly in asset prices rather than consumer prices.

Public finances in good shape

Germany's public-sector finances are in good shape. Public budgets registered a surplus of 0.1% of GDP in 2012. This was achieved mainly by soaring tax revenues thanks to strong business activity, by lower interest payments on public-sector debt due to lower yield levels as well as by the expiry of economic stimulus packages.

However, weaker economic growth and cuts to pension contributions by 0.7%-points to 18.9% will mean that the budget balance will be slightly negative again in 2013. Therefore, stricter austerity efforts to consolidate the budget not only on the revenue side, as has been the case so far, but also on the expenditure side do make sense. However, Germany's fiscal policy course looks justifiable in light of weakening growth and the fact that the 2013 shortfall will probably come to no more than ½% of GDP, keeping Germany in an excellent position internationally. With growth picking up again, the deficit looks set to narrow further in 2014. Germany is thus well positioned to meet the debt rule anchored in its Basic Law, which limits the structural budget deficit to 0.35% of GDP from 2016. Moreover, it is probably the only eurozone country to achieve a lower (and falling) debt ratio already this year. Risks to this scenario lie in potential burdens stemming from the euro crisis.

2013 federal elections: New government in the offing?

According to a survey conducted in January 2013, the current CDU/FDP coalition with 44% – more than over the last two years – is slightly ahead of the possible SPD/Greens coalition with 42%. The federal elections presumably in September 2013 could still bring about a change in government, especially if the Liberal Democrats (FDP) – currently at 5% – fail to clear the 5% hurdle which would mean a bitter loss of around 10 percentage points compared with the last federal election in September 2009 (14.6%). If the elections were held today, the Christian Democrats (CDU/CSU) would garner 39% of the vote (2009

Germany – economic forecast				29
% yoy	2011	2012	2013	2014
Real GDP	3.0	0.7	0.3	1.5
Private consumption	1.7	0.6	0.6	1.0
Gov't expenditure	1.0	1.0	1.0	0.7
Fixed investment	6.2	-2.1	1.1	2.8
Investment in M&E	7.0	-4.4	-1.2	4.4
Construction	5.8	-1.1	1.9	1.5
Inventories *, pp	0.2	-0.5	-0.2	0.0
Exports	7.8	4.1	3.2	4.9
Imports	7.4	2.3	4.2	5.0
Net exports *, pp	0.6	1.1	-0.2	0.3
Consumer prices	2.3	2.0	1.7	1.6
Budget balance, % GDP	-0.8	0.1	-0.4	-0.2
Unemployment rate, %	7.1	6.8	6.9	6.8
Balance on current account, % GDP	5.7	6.4	5.7	5.5

* Growth contribution
Sources: Federal Statistical Office, DB Research

election: 33.8%), the Social Democrats (SPD) 28% (23.0%), the Greens approx. 14% (10.7%) and the Left approx. 7% (11.9%). Potential alternative government coalitions imply the risk that successful reforms could be unwound, even though they will become even more necessary in future.

Bernhard Gräf (+49 69 910-31738, bernhard.graef@db.com)
Eric Heymann (+49 69 910-31730, eric.heymann@db.com)
Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)
Heiko Peters (+49 69 910-21548, heiko.peters@db.com)
Oliver Rakau (+49 69 910-31875, oliver.rakau@db.com)
Stefan Schneider (+49 69 910-31790, stefan-b.schneider@db.com)

Economic forecasts

	Real GDP (% growth)			Consumer Prices (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2012F	2013F	2014F	2012F	2013F	2014F	2012F	2013F	2014F	2012F	2013F	2014F
Euroland	-0.5	-0.3	1.1	2.5	1.6	1.6	0.9	1.3	1.6	-3.3	-2.7	-2.3
Germany	0.7	0.3	1.5	2.0	1.7	1.6	6.4	5.7	5.5	0.0	-0.5	-0.3
France	0.1	-0.3	1.0	2.2	1.5	1.6	-2.1	-2.0	-2.3	-4.6	-3.6	-2.8
Italy	-2.1	-0.9	0.5	3.3	1.8	1.5	-1.0	-0.3	-0.2	-2.9	-2.3	-2.5
Spain	-1.3	-1.1	0.6	2.5	2.2	1.3	-1.8	0.0	-0.2	-7.9	-6.1	-5.1
Netherlands	-1.0	-0.1	1.7	2.8	2.3	1.8	9.0	9.0	9.5	-4.0	-3.2	-2.0
Belgium	-0.2	0.0	1.0	2.6	1.8	1.7	0.0	0.5	1.0	-3.4	-3.3	-2.6
Austria	0.5	0.9	1.3	2.5	2.0	1.9	1.2	1.8	2.1	-3.1	-2.8	-2.5
Finland	-0.1	0.0	1.2	3.1	2.5	2.2	-1.5	-1.0	-0.5	-0.8	-0.8	-0.5
Greece	-6.5	-4.2	0.9	1.1	0.1	-0.2	-6.0	-4.0	-3.0	-7.0	-6.1	-5.0
Portugal	-2.9	-1.2	0.8	2.8	1.0	1.2	-1.5	0.0	1.0	-5.3	-4.8	-3.4
Ireland	0.2	0.8	1.9	2.0	1.4	1.5	2.0	2.5	3.0	-8.3	-8.0	-6.2
UK	-0.1	0.9	1.8	2.8	2.5	2.2	-4.7	-4.4	-3.5	-5.3	-6.7	-5.9
Denmark	-0.5	1.5	1.5	2.5	1.8	1.8	5.5	4.5	4.5	-4.5	-2.0	-2.0
Norway	3.2	2.5	2.5	0.7	2.0	2.0	15.0	13.0	13.0	12.5	11.5	11.5
Sweden	1.2	1.9	1.9	0.9	2.0	2.0	7.5	6.0	6.0	-0.5	0.0	0.0
Switzerland	1.0	1.5	1.7	-0.6	0.4	0.8	11.0	10.5	10.0	0.0	0.2	0.5
Czech Republic	-0.8	1.0	3.4	3.3	2.5	2.1	-1.8	-1.6	-1.7	-3.5	-3.2	-2.7
Hungary	-1.3	0.0	1.6	5.7	4.1	3.5	0.9	1.5	0.9	-3.0	-2.9	-2.8
Poland	2.2	1.6	2.3	3.8	2.6	2.3	-3.4	-3.0	-3.7	-3.6	-3.5	-2.9
United States	2.3	2.0	2.9	2.1	2.3	2.5	-3.1	-3.3	-3.4	-7.1	-6.3	-5.3
Japan	2.0	0.6	0.6	-0.1	-0.6	1.6	1.2	1.4	1.9	-10.0	-9.9	-8.2
World	2.9	3.2	4.0	3.3	3.2	3.5						

Sources: National Authorities, Deutsche Bank

Forecasts: German GDP growth by components, % qoq, annual data % yoy

						2012*				2013			
	2010	2011	2012	2013F	2014F	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	4.2	3.0	0.7	0.3	1.5	0.5	0.3	0.2	-0.3	0.0	0.2	0.4	0.2
Private consumption	0.9	1.7	0.8	0.6	1.0	0.0	0.1	0.3	0.1	0.0	0.2	0.4	0.3
Gov't expenditure	1.7	1.0	1.0	1.0	0.7	0.4	-0.2	0.4	0.0	0.4	0.5	0.1	0.1
Fixed investment	5.9	6.2	-2.1	1.1	2.8	-0.8	-2.1	0.2	-0.1	0.4	0.6	0.6	0.6
Investment in M&E	10.3	7.0	-4.4	-1.2	4.4	-0.9	-4.0	-2.0	-1.5	0.5	0.9	1.0	1.0
Construction	3.2	5.8	-1.1	1.9	1.5	-0.7	-1.1	1.5	1.0	0.3	0.3	0.1	0.1
Inventories, pp	0.6	0.2	-0.5	-0.2	0.0	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Exports	13.7	7.8	4.1	3.2	4.9	0.7	3.3	1.4	-0.5	0.5	1.0	1.3	1.0
Imports	11.1	7.4	2.3	4.2	5.0	-0.7	2.2	1.0	0.2	1.0	1.3	1.3	1.3
Net exports, pp	1.7	0.6	1.1	-0.2	0.3	0.7	0.7	0.3	-0.4	-0.2	-0.1	0.1	-0.1
Consumer prices	1.1	2.3	2.0	1.7	1.6	2.2	1.9	1.9	1.9	1.8	1.6	1.7	1.5
Unemployment rate, %	7.7	7.1	6.8	7.0	6.8	6.8	6.8	6.8	6.9	7.0	7.0	7.0	7.0
Budget balance, % GDP	-4.1	-0.8	0.1	-0.5	-0.3								
Balance on current account, % GDP	6.0	5.7	6.4	5.7	5.5								

*Forecasts based on data including Q3 2012, as Federal Statistical Office has so far only published full-year data for 2012.
Sources: Federal Statistical Office, DB Research

Chart of the month

ABCD-Category

A-Cities: major cities in Germany, large property markets

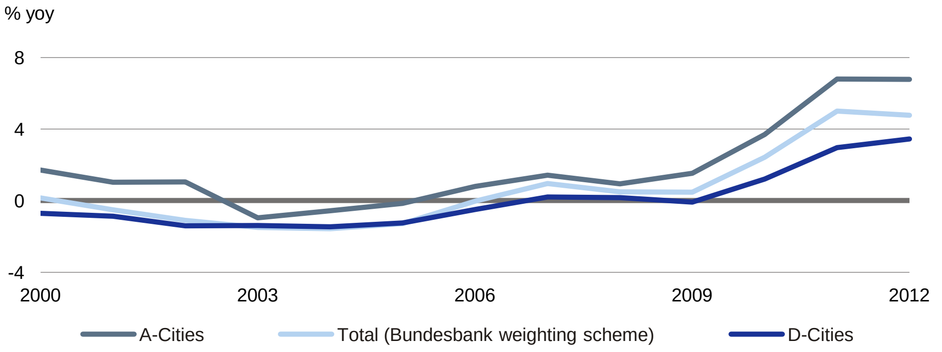
B-Cities: bigger cities of national and regional importance

C-Cities: larger cities, of limited national importance, but with broad regional influence

D-Cities: smaller cities, with regional or local focus, central functions for direct hinterland.

Source: BulwienGesa

2012 Residential property prices



Sources: BulwienGesa, DB Research

German residential property prices – review and outlook

Review: Residential property prices continued to rise

The positive price development on the German residential property market continued in 2012. According to recent data from BulwienGesa, prices rose by roughly 5%, thus to the same extent as in 2011. At an increase of 5 ½%, apartment prices went up particularly strongly. In the largest towns (A cities), they even rose by close to 8%. The prices of single-family homes and terraced housing rose by roughly 3%. Given an inflation rate of 2%, the price increase of houses in real terms thus still came to 1%. The real-estate boom continues to be particularly strong in large towns with a powerful economy. In some towns, even double-digit price increases were registered. At almost 7%, price increases were strongest in A-towns, while residential property prices in B-cities rose by 4.7%, in C-cities by 3.9% and in D-cities by 3.5% (see chart). In structurally weak cities prices stagnated or even fell, in some cases by up to 5%.

Outlook: Upswing to continue

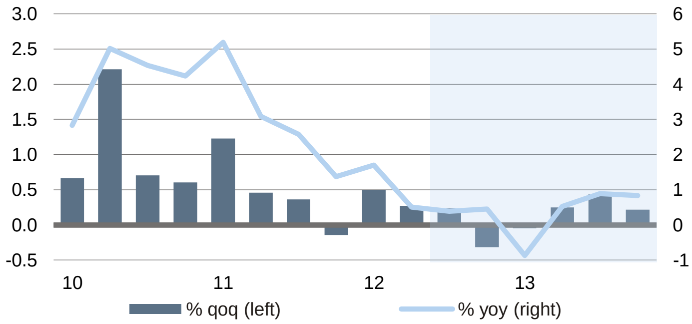
For 2013, we expect a similar macroeconomic situation to that in 2012: weak overall economic growth with quite stable rates of unemployment and a slight increase in employment figures. Real incomes should also rise slightly. For 2013, we expect wage increases to exceed the productivity increase. In view of the ECB's abundant liquidity supply and the falling yields on South European government bonds, Germany's residential real estate with rental yields of typically over 4% continues to be very attractive. For this reason portfolio switching from financial assets to the real-estate market remains an interesting investment opportunity for both German private and institutional investors. Due to the massive unemployment in the South European countries, net immigration (2012: +340,000) and capital inflows could continue to bring positive momentum for the German residential real estate market and stimulate demand.

In view of globalisation, urbanisation and demographic effects, the divergence between residential property prices is likely to increase further. Competitive cities will attract employees, while the number of inhabitants of towns with fewer competitive companies will tend to stagnate or decline. The corresponding differences in housing demand should continue to be reflected in prices.

Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)

Chartbook: Business cycle (1)

Real GDP growth



Sources: Federal Statistical Office, DB Research

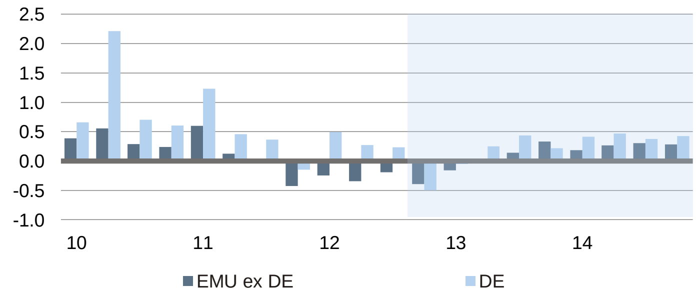
— At +0.7% GDP growth was much lower in 2012 compared to 2011 (+3.0%). In addition, growth slowed strongly during the year from +0.5% qoq in Q1 2012 to presumably -0.5% qoq in the last quarter.

— Strong exports especially in the first half of the year and to a lesser extend consumption contributed positively to overall growth. Investment in machinery & equipment as well as construction were a drag on growth.

— First signs – increases in the ifo index and somewhat higher growth in China – point towards a stabilisation/ recovery in Germany in spring. Due to the weak winter half our forecast for 2013 GDP growth is ¼%.

GDP growth: DE vs EMU

% qoq



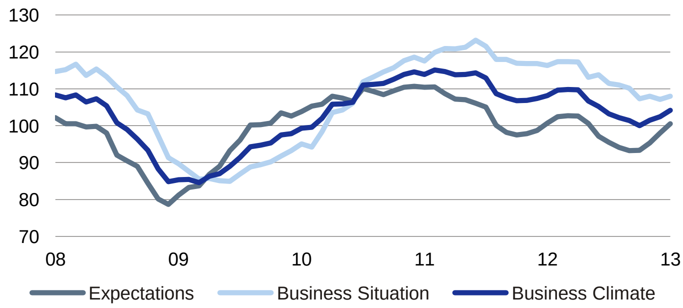
Source: Eurostat

— Compared to the rest of EMU the slowdown in Germany is still moderate. Admittedly, German GDP shrank in two out of the last five quarters (Q4 2011 and Q4 2012). However, it shrank in all five quarters in the rest of EMU.

— Considering the remaining adjustment needs in several EMU countries the EMU economy should remain in recession until early 2013 and set out on a very low growth trajectory thereafter. On average EMU GDP should decline by 0.5% in 2012 and 0.3% in 2013.

Ifo index - total economy

2005=100



Source: ifo

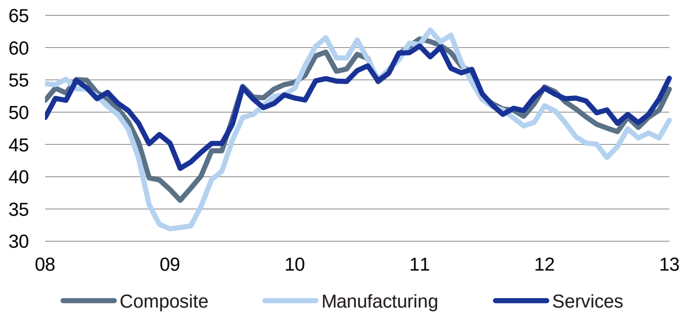
— The ifo index at 104.2 (prev. 102.4) surprised strongly to the upside in January. Historically, three consecutive rises in the ifo suggest a cyclical turning point, which supports our expectation of only one negative quarter for GDP growth (Q4). However, we still expect weak Q1 13.

— The increase of the ifo was again mostly driven by the expectation component, up for the fourth consecutive time in January. The situation component on the other hand has more or less stagnated over the last 4 months.

— A warning: This is reminiscent of early 2012, when better sentiment did not show up in yoy growth rates of industrial production and was later reversed.

Purchasing manager index

PMI, index



Source: Markit

— The manufacturing PMI now seems to be on track towards 50 as it increased strongly from its Q4 average of 46.3 to 48.8 in January. New orders fell at the slowest rate since June 2011 and manufacturing output was in expansionary territory for the first time since March 2012.

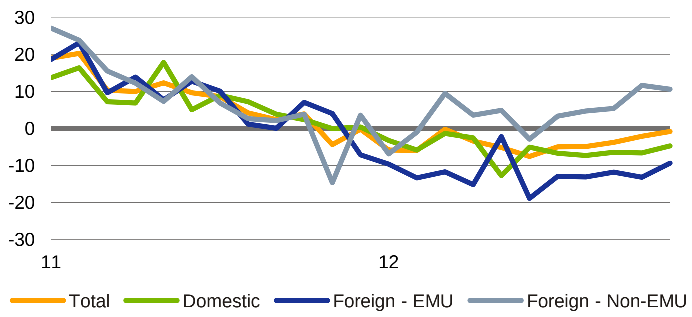
— The services PMIs went up to 55.3 in January (Dec.: 52.0; Nov.: 49.7). New business and business expectations both above 53.0 point to a solid expansion of output.

— Further modest increases in the ifo and PMI would be consistent with muted industrial production in the near term and a recovery in spring.

Chartbook: Business cycle (2)

New manufacturing orders

% yoy



Source: Federal Statistical Office

— Falling by 1.8% month-on-month in Nov. new orders reversed most of the 3.8% increase in Oct. as the effect from big ticket orders was reversed.

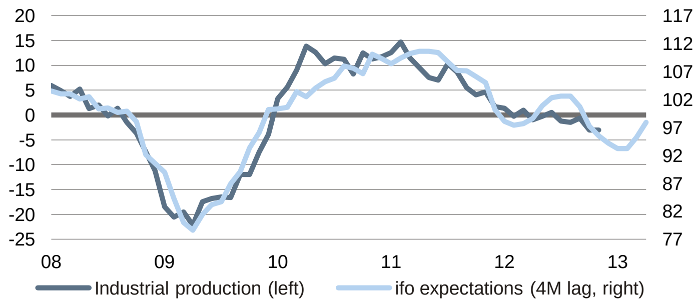
— Demand for German industrial goods seems to stabilise. Core orders (ex. airplanes, ships, trains) have improved slightly in Oct./Nov. after heavy declines in Q3.

— Compared to the previous year the order level is still down by 1.7% (two months average) especially due to significant declines in orders from EMU countries.

— Somewhat improved sentiment and slightly faster growth in China suggests that orders could improve gradually.

Industrial production and ifo expectations

% yoy (left), 2005=100 (right)



Sources: ifo, Federal Statistical Office

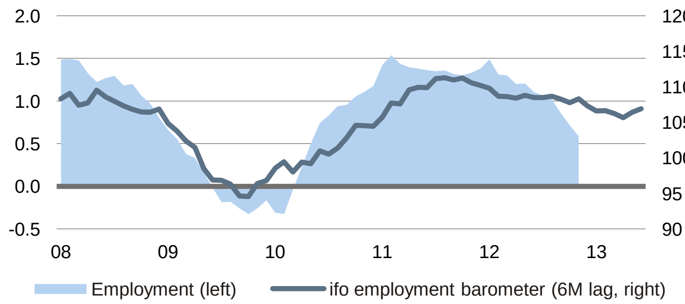
— Industrial production slumped towards the end of 2012. After falling by 1.2% mom in Sep. and 2.0% in Oct. production improved only slightly by 0.2% in Nov.

— In Q4 production is likely to have fallen by more than 2% as output of investment goods and the auto sector experienced heavy declines.

— Sentiment as well as new orders point to subdued output trend going into Q1 with only small monthly gains.

Employment and ifo employment baromter

% yoy (lef), 2005=100 (right)



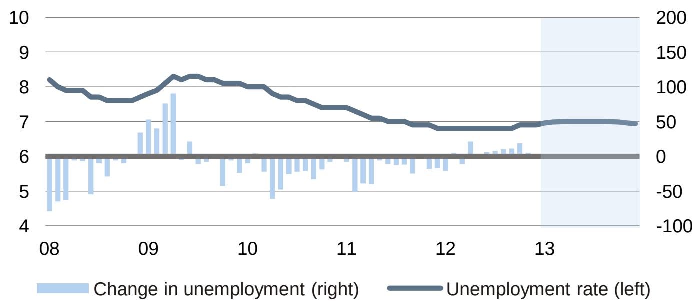
Sources: ifo, Federal Employment Agency

— The number of employed persons is still 0.6% higher than a year ago and with 41.6 m it hovers near a historic high. The level of employees subject to social security payments is up 1.4% yoy.

— Employment growth is tapering off. While employment grew by 30,000 per month on average in H1, there was only an increase of 6,000 in Q3. In November employment fell by 1,000 after much stronger declines in September (-19,000) and October (-10,000).

Unemployment

% of total civilan labour force (left); mom, '000 (right)



Sources: Federal Employment Agency, DB Research

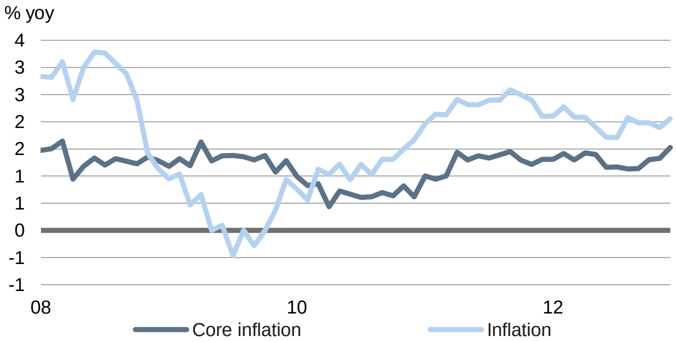
— In December unemployment rose for the ninth time in a row. The increase of 3,000 to around 2.9 m was lower than in the two preceding months (Oct. +19,000; Sep. +10,000). The unemployment rate is at 6.9%.

— Early indicators – ifo, PMI, BA-X – point to a further weakening of the labour market until mid-2013.The marked improvement of the ifo employment barometer in Nov. and Dec. is evidence pointing to an improvement from mid-2013 on.

— The unemployment rate should average 6.9% in 2013, only slightly higher than in 2012 (6.8%).

Chartbook: Business cycle (3)

Inflation rate and core inflation rate

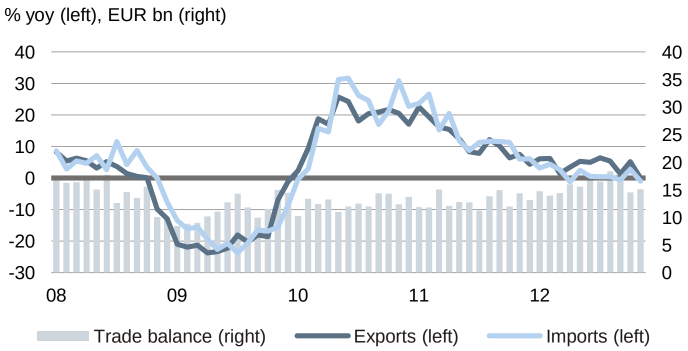


Sources: Federal Statistical Office, DB Research

— Inflation in 2012 averaged 2.0% somewhat lower than in 2011 (2.3%). Energy price inflation slowed markedly (to 5.7% from 10.0%), while food prices accelerated slightly (2.9% to 3.2%). Core inflation came in at 1.3%, the same as in the year before.

— We expect inflation to slow further this year to 1.7% on the back of an only modest oil price increase. Core inflation should remain muted due to the weakening labour market. The rise in core inflation at the end of 2012 was largely driven by one-off effects. Food prices pose limited upside risks to our forecast.

Merchandise trade



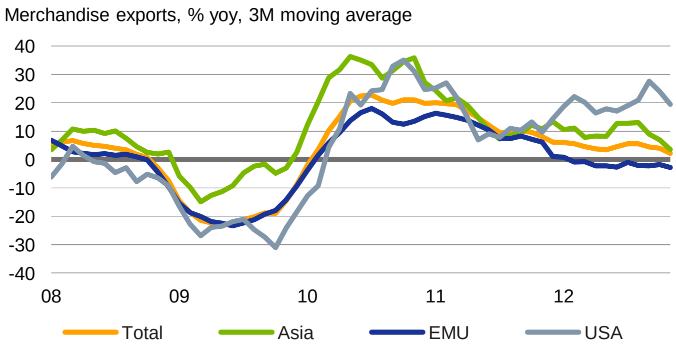
Source: Deutsche Bundesbank

— World trade decelerated in the last few months and was up only 2% on average over the last three months which has increasingly dampened German exports over the course of the year.

— In November exports (-3.4% mom) and imports (-1.0% mom) fell. The trade balance narrowed further to EUR 14.6 bn from EUR 14.8 bn in October. This is a marked drop from the EUR 18.4 bn recorded in August.

— Year-on-year exports were virtually unchanged in November which shows the clear slowdown from the beginning of 2012. Imports were down 1.1% yoy in November.

German merchandise exports by destination



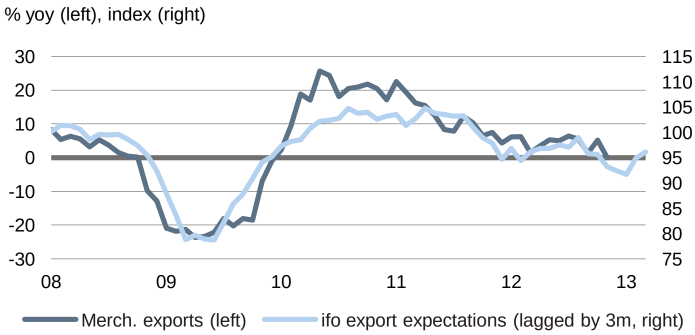
Source: Deutsche Bundesbank

— Since the onset of the euro crisis EMU's share in German exports has dropped by almost 10 percentage points to around 38% (Asia 17% and the US 8%).

— In the wake of the euro crisis and the recession in several EMU countries exports to EMU have fallen below their pre-year level.

— So far, exports to Asia and the US have managed to compensate for the declines in exports to EMU, which was mainly due to automobile exports.

Exports & ifo export expectations



Sources: Deutsche Bundesbank, ifo

— Exports should slow further in 2013 according to ifo export expectations which fell to a 40-months low in October and remained below their historic average despite a 4-point increase in Nov./Dec.

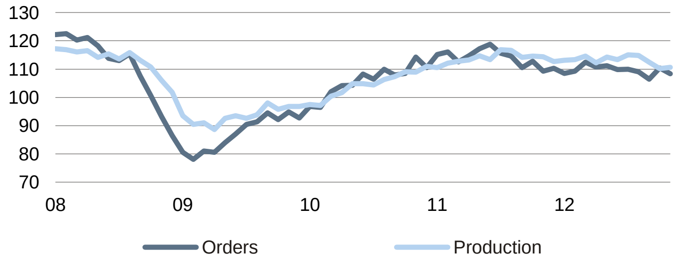
— Imports should remain comparably stable, by comparison, due to the high level of employment and moderate increases in real income.

— The growth contribution from net exports should become negative in the winter half.

Chartbook: Sectors

Manufacturing: Output and order intake

2005=100, sa



Source: Federal Statistical Office

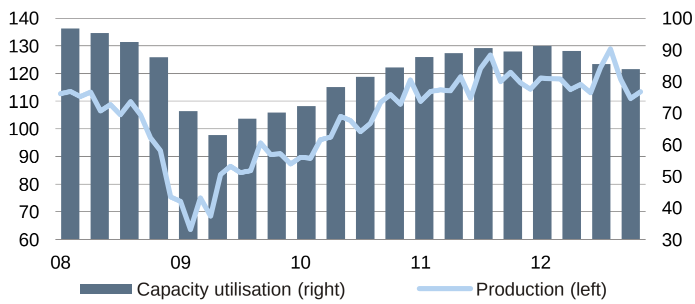
— Industrial output has trended downwards over the last few months, especially in Q4 2012. Output probably declined by 1% in real terms in 2012. We believe that industrial output is likely to stagnate in 2013.

— Order intake is below last year's level at present. Orders from other European countries, in particular, have declined markedly, while orders from outside Europe are still supportive.

— Risks to manufacturing activity stem from a continuing economic downturn in major export markets.

Car industry: Output and capacity utilisation

2005=100, sa (left), capacity utilisation % (right)



Sources: Federai Statistical Office, ifo

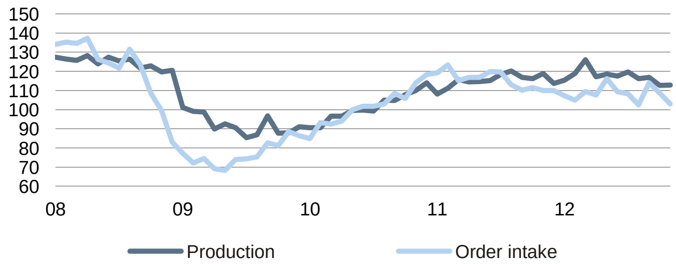
— In the last two months production level in the automotive industry was well below the average of 2012. Output probably stagnated last year.

— Business expectations have deteriorated considerably in the last few months, however, showing an improvement at the latest reading. Capacity utilisation in the automotive industry has fallen strongly over the past few months.

— Also on account of the statistical underhang we expect output in the automotive industry to fall by 2% in real terms in 2013.

Mechanical engineering: Order intake and output

2005=100, sa



Source: Federal Statistical Office

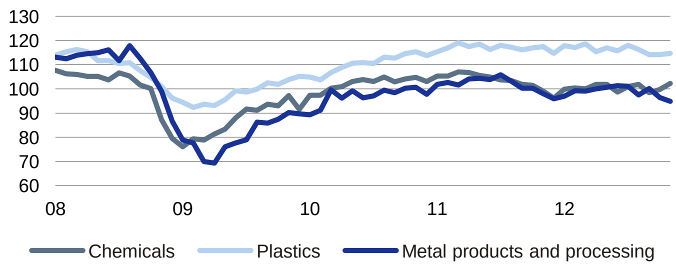
— With the ongoing depletion of order-books in the course of 2012, production momentum in mechanical engineering has slowed. Still, full-year output should have risen by 1.5%.

— Order intakes in the mechanical engineering industry have sent mixed signals during the last few months. A gradual stabilisation of the euro area could support foreign demand in 2013.

— For 2013 as a whole we expect mechanical engineering output to be flat, with output trending upwards in the course of the year as the sector will start 2013 with an underhang.

Production: Early cycle sectors

2005=100, sa



Source: Federal Statistical Office

— The early-cycle sectors currently show little signs of a major growth rebound in 2013.

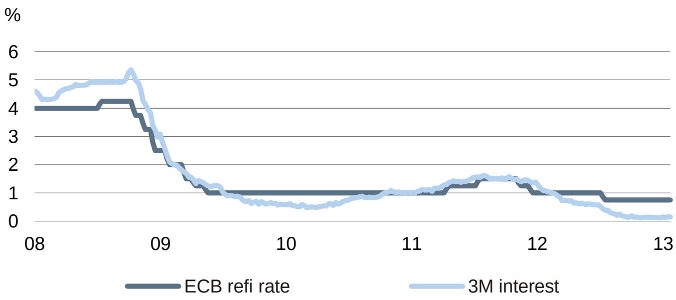
— Over the last few months production in the chemical industry has stabilised. In 2013 production should increase by 1.5%.

— Plastics production had been trending downwards recently, but business expectations have improved again of late.

— Output in metal production probably contracted by 3% in 2012, but it could post a marginal increase in 2013.

Chartbook: Financial markets (1)

EMU: Refi rate & 3M Interest



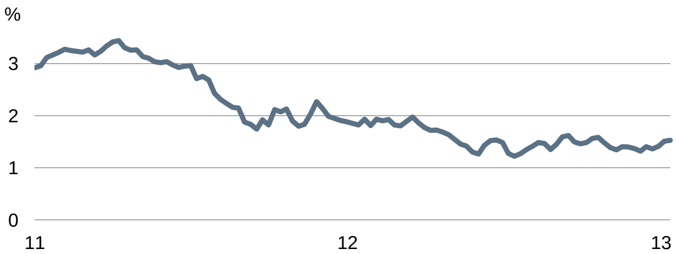
Sources: ECB, Global Insight

— We do no longer expect the ECB to cut the refi rate again in Q1 due to easing of the situation on the financial markets and first signs of economic recovery. The balance sheet reduction of about EUR 160bn since its peak could be seen as a first sign for the beginning of the exit from unconventional policy. Repayment of LTRO liquidity will reduce the balance sheet further.

— Although it has become less likely recently that a country will apply for an ESM-program, the ECB will be ready to start the program of purchasing bonds under strict conditionality (Outright Monetary Transactions, OMT).

— The costs of secured interbank refinancing are at a record low of around 0.15% p.a. (-0.9 pp yoy).

German government bonds: 10Y yields



Source: Global Insight

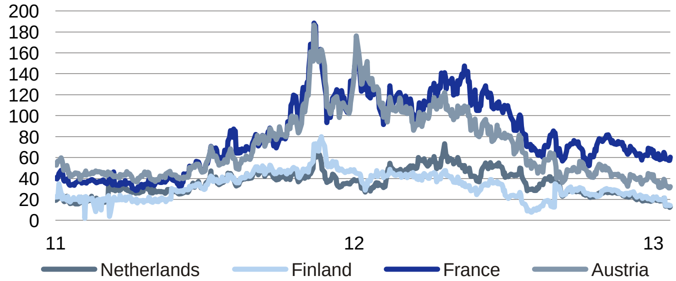
— Indications that the Fed might get second thoughts about its open-ended asset purchase program have resulted in a “mini sell off” of US treasury bonds at the start of the year.

— Bunds showed a similar development. The yield increased from 1.32 % at the beginning of the year to 1.58 % recently.

— Despite partly negative real interest rates many investors favour the “safe haven” of Germany – one of the few countries with an AAA-rating in Europe.

EMU: Bond yield spreads

Versus German govt. bond yield, basis points



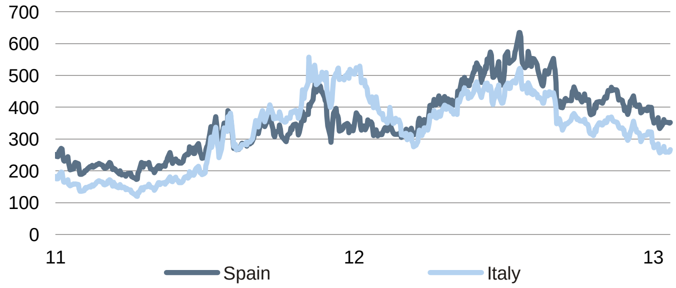
Source: Global Insight

— Intra-EMU bond yield spreads have declined markedly since the announcement by ECB president Draghi that the ECB is ready to do whatever it takes to preserve the euro (26 July 2012).

— Draghi highlighted on the January ECB press conference that financial market confidence improved significantly and that fragmentation has diminished.

EMU: Bond yield spreads

Versus German govt. bond yield, basis points



Source: Global Insight

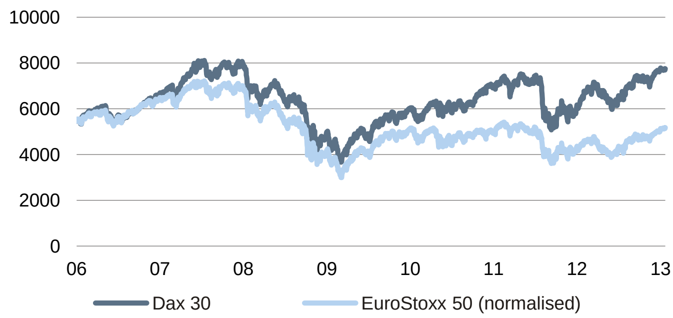
— The yield spreads of Italian and Spanish government bonds were the most sensitive to the prospect of ECB interventions (OMT).

— Since the beginning of September they fell by about 200 and around 190 for Spain and Italy, respectively.

— At the short end (3Y) – the focus of the bond purchasing programme – yield spreads fell by around 40% in Spain and roughly halved in Italy.

Chartbook: Financial markets (2)

Equity indices

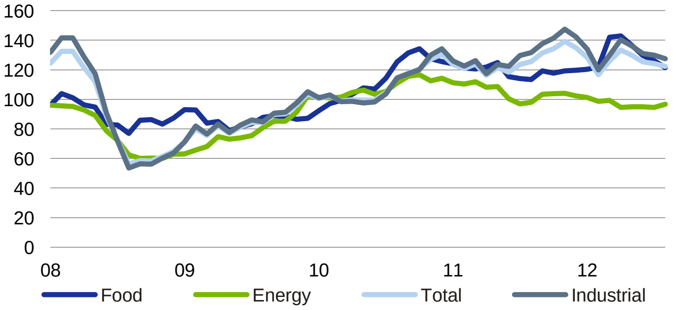


Sources: Global Insight, DB Research

- Currently, the DAX stands at around 7,700 points. The more optimistic assessment of the euro debt crisis sent the DAX rising further, not least because of a lack of investment alternatives in the German bond market due to negative real interest rates. The difference between dividend and bond yields is currently at a 35-year high.
- Since the beginning of the debt crisis the DAX has performed considerably better than European equities. Earnings downgrades for 2013/14 have tapered off recently. However, DAX 2013 earnings are still expected to fall yoy, because of a one-off-factor resulting from a balance sheet effect of a big car producer. Our equity strategists have a 2013 year-end target of 8000 for the DAX and 315 for the Stoxx600.

Raw material prices

HWWI index, 2010=100, based on EUR

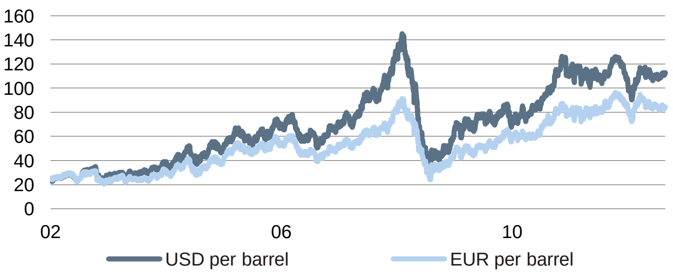


Source: HWWI

- Raw material price, in particular industrial and energy raw material price, will probably increase modestly due to a stronger growth in China – the largest importer of raw materials – and a sluggish economic recovery in the industrial countries.
- The expansionary monetary policy stance of the major central banks should keep upward pressure on prices.
- Food prices increased markedly in Q3 2012 due to droughts (in the US and Eastern Europe for example) and fell markedly again, recently, but are still up by about 7 % yoy.

Oil price

Brent Blend, USD or EUR per barrel

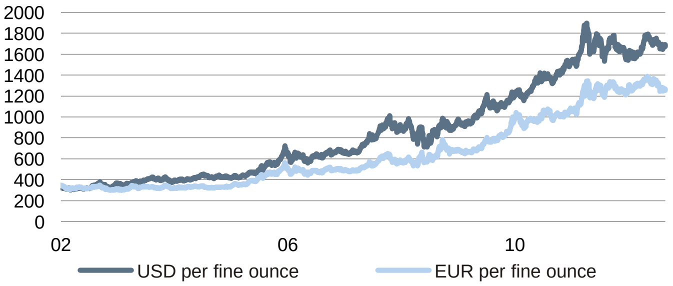


Sources: Global Insight, Reuters, DB Research

- Following a weak winter half year, oil demand should increase markedly in H2 2013 thanks to the recovery of the global economy. Additionally, supply-side factors (e.g. geopolitical risks, Iran) provide some upside risks.
- We expect an oil price of USD 115 per barrel Brent at the end of the year. At the moment the oil price amounts to slightly over USD 110 per barrel Brent.

Gold price

USD or EUR per fine ounce



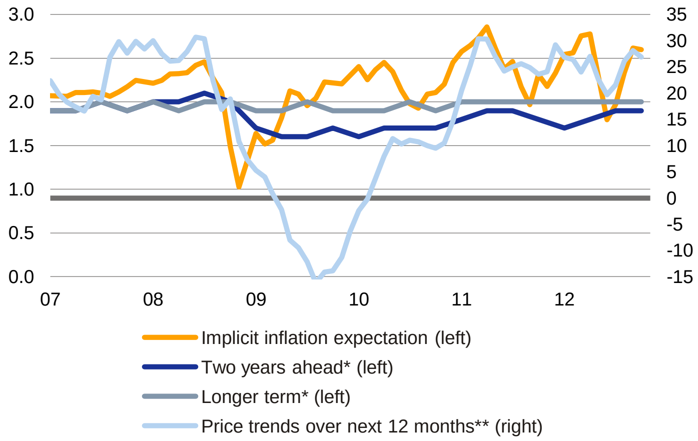
Sources: Global Insight, Reuters, DB Research

- The gold price should increase in the course of 2013 thanks to negative real interest rates, a weaker USD in H1 2013 and gold purchases of central banks diversifying their currency reserves.
- Our commodities analysts expect a gold price of USD 2,000 per fine ounce at the end of the year. Currently, the gold price stands at around USD 1,690 per fine ounce.

Chartbook: Financial markets (3)

Inflation expectations euro area

% yoy (left), balance of pos. u. neg. responses (right)

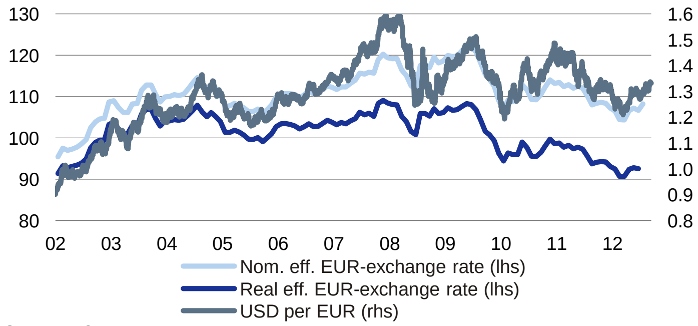


* ECB Survey of Professional Forecasters, ** EC Consumer Survey

Sources: ECB, EU Commission, Bloomberg

Exchange rate development for the EUR

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



Sources: ECB, Reuters

— Contrary to lingering inflation concerns in the general public the private forecasters of the ECB survey expect no increase of the EMU inflation rate in 2 years (1.9%) and neither in 5 years (2.0%).

— The implied inflation rate for the next 10 years – calculated as the difference between the yield of 10-year German government bonds and the yield of inflation-protected bonds – hovers between 2 and 2 ½% since the beginning of 2011.

— However, the “implicit inflation expectation” may be biased. On the one hand the current negative real interest rate of -1% earned on an inflation protected bond is hard to reconcile with economic considerations. On the other hand nominal bond yields are depressed by massive purchases of several major central banks and still persistent flight to quality.

— Since the end of July 2012 the EUR appreciated against the USD by 10% and now stands at EUR/USD 1.33. This comes as a result of a markedly lower tail risk of an EMU break-up which reduced the capital flight from EMU, improvement of the EMU current account balance, more expansive monetary policy of the Fed relative to the ECB and the uncertainty in the USA about the solution to reduce the fiscal deficits (fiscal cliff, debt ceiling).

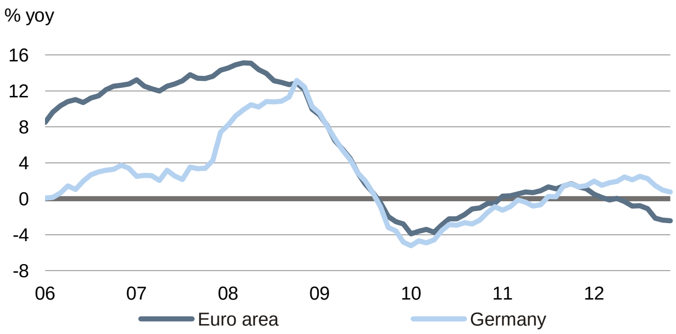
— Contrary to the Fed, the ECB is already shrinking its balance sheet. The repayment of LTRO liquidity will speed up the balance sheet reduction resulting in upward pressure on the EUR

— Our FX strategists expect a EUR/USD exchange rate of 1.35 in 3 months.

— The USD should strength in H2 2013 due to the higher growth rate of the US economy of around 3%. According to our FX strategists the USD will probably appreciate to EUR/USD 1.30 in 6 month. Additionally the evolving shale gas revolution might have a mitigating effect on the US current account deficit in the medium term.

Chartbook: Financial markets (4)

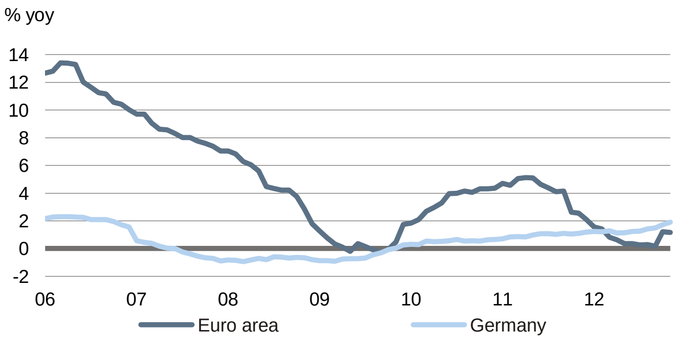
Loans to companies



Sources: ECB, DB Research

- The pace of growth in lending to German corporates lost further momentum in November (latest data available).
- While corporate lending in Germany (0.8% yoy) is still more expansive than in the euro area as a whole (-2.5% yoy), the slowdown in the economy clearly takes its toll on lending volumes.
- Contraction of corporate lending in the euro area shows a further acceleration – mainly reflecting the bleak macroeconomic situation and ongoing deleveraging process in countries strongly affected by the crisis.

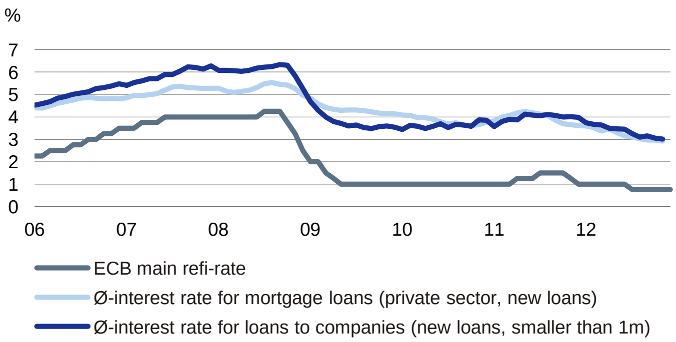
Mortgage volumes



Sources: ECB, DB Research

- The second half of 2012 saw a slight increase in mortgage lending growth in Germany (November: 1.9% yoy).
- Low interest rate levels and a partly buoyant housing market have so far had a limited effect on credit demand in Germany as demand is in part financed through a reallocation of existing capital. Mortgage growth has been moderate and has remained slightly below pre-crisis levels of 2007.
- Still, German mortgage growth is above the euro area average; the latest spike in the euro area yoy-rate is mainly due to a drop in the pre-year period.

Interest rates

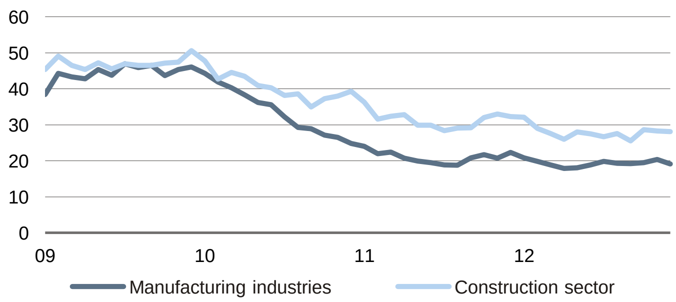


Sources: ECB, Bundesbank

- In November, interest rates for mortgages and loans to corporates fell to record lows since the introduction of the interest rate statistics.
- Since November 2011, lending rates in Germany have continuously fallen, in line with the lowering of the ECB's refinancing rate.
- Low yields for German bunds have allowed banks to refinance themselves at relatively low cost, which they partly passed on to clients.

Lending standards

Share of companies that consider lending policies "restrictive" (in %)

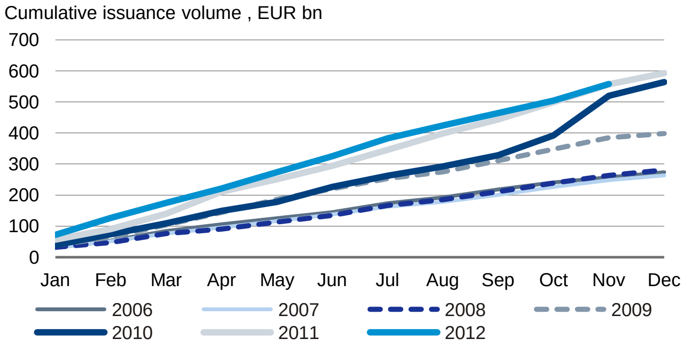


Source: ifo

- In December, corporates on average see no problem with credit supply.
- Slight decrease in the share of corporates that consider lending policies "restrictive": manufacturing industries -1.3 ppt compared to previous month; construction sector -0.2 ppt.
- In historical comparison, rather accommodating lending standards for the construction sector as well as for the manufacturing industries. Somewhat tighter standards for construction companies, albeit positive prospects of this sector.

Chartbook: Financial markets (5)

Issuance of public debt securities



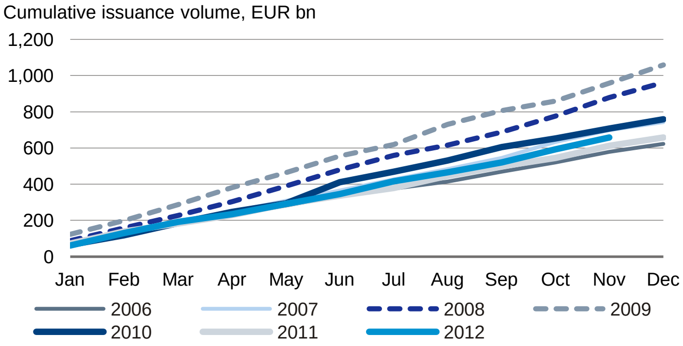
Sources: Bundesbank, DB Research

— Until November 2012, cumulated issuance of debt securities by the public sector in Germany has nearly reached pre-year levels (EUR 585 bn). Up to now, strong demand mainly by international investors.

— In 2012, overall shift in issuance volume: Germany's Länder in total have issued more, whereas the federal government has issued less compared to the previous year.

— Overall debt servicing costs relative to GDP decreased as a result of quite favourable interest rates for the German sovereign.

Bank debt issuance



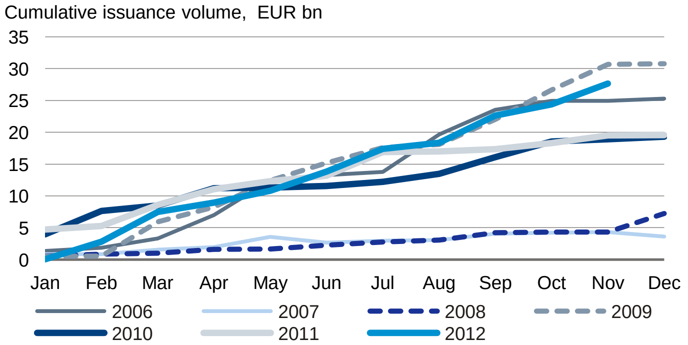
Sources: Bundesbank, DB Research

— Issuance volume of debt securities by banks in Germany has reached EUR 658 bn by the end of November, 7.5% above pre-year value.

— Rather stable refinancing conditions of German banks compared to other euro area countries; no dependence on ECB credit.

— Over several years, issuance volume of German covered bonds (Pfandbriefe) and traditional bank bonds declined in relative terms; overall volume growth, however, was driven almost entirely by issuance of public sector development banks.

Non-bank corporate debt issuance



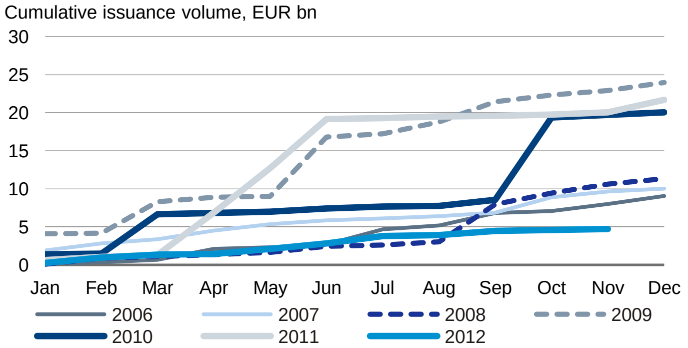
Sources: Bundesbank, DB Research

— By the end of November, debt issuance by non-bank corporates reached EUR 27.7 bn, about 40% above comparable period last year; relatively strong issuance activity in November (EUR 3.3 bn).

— Continuously positive environment for corporate bond issuance: low interest rate levels, low risk premia and a search for yield by investors.

— Currently, the market for corporate bonds grows faster than that for corporate lending.

Equity issuance



Sources: Bundesbank, DB Research

— Equity issuance in Germany until November with EUR 4.7 bn rather weak compared to pre-year value of EUR 20 bn.

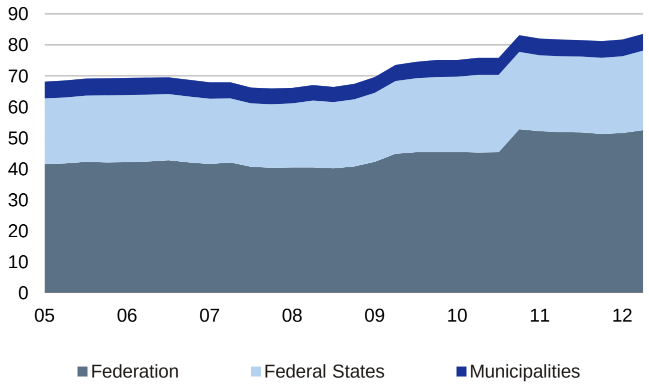
— The quite buoyant development of German equity markets in 2012 has not been able to stimulate IPOs or secondary market offerings on a broad basis.

— Yet, the statistics provides a somewhat negatively distorted picture, since going public of Talanx and Telefonica Germany is not reflected in the data (no fresh issuance of shares).

Chartbook: Economic policy

General government debt

% of GDP, Maastricht-Figures, end of quarter



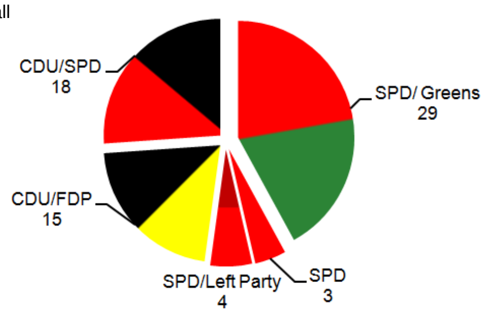
Sources: Deutsche Bundesbank, DB Research

— By the end of 2010, Germany´s overall debt-to-GDP-ratio had jumped to nearly 83% of GDP. Almost 13% of the increase can be explained by the assistance measures for financial institutions and the Euro area.

— Thanks to steadily growing GDP and redemption/sales of (financial) assets the debt-to-GDP-ratio fell back to just above 81% by the end of Q1 2012. Given the redemption/sales of assets and (at least temporarily) new assets in context of the Erste Abwicklungsanstalt (former WestLB bad bank) first estimates show that the debt-to-GDP-ratio raised to round about 82% by the end of 2012. Therefore increased debt-to-GDP ratio is primarily because of growing Länder debt (especially in North-Rhine Westphalia).

Distribution of seats in the Bundesrat

60 seats in all

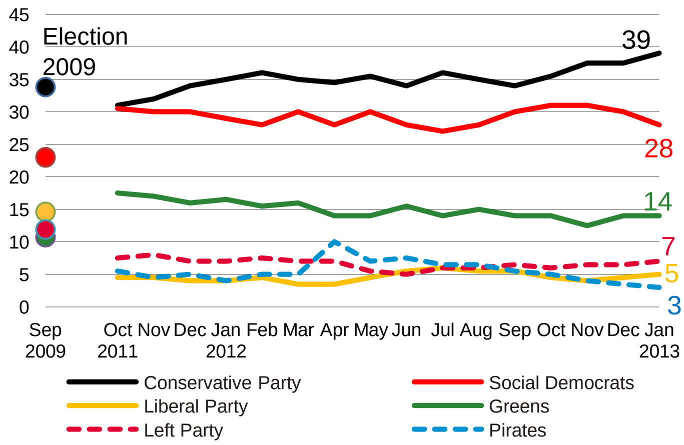


Source: Bundesrat

— The razor-thin victory for SPD and the Greens in Lower Saxony will change voting majorities in the Bundesrat (the second chamber represents the Länder [federal states]). The legislative process requires for numerous important bills (e.g. tax policy) to pass through Bundestag and Bundesrat. Together with the Left Party (coalition of SPD/Left Party in Brandenburg) the SPD and the Greens can now count on a majority (36) in the Bundesrat. De facto there will be no major changes in the legislative process before next federal elections in autumn this year. The current coalition of CDU and FDP had already previously no majority in the Bundesrat due to several CDU/SPD coalition Länder governments. But if it comes to a change of government after federal elections SPD and Greens could count on comfortable majorities in both chambers allowing them to pass bills easily (assuming – according to current polls – that elections in Hesse will also change government, SPD and Greens would even need no longer support by the Left Party).

Deutscher Bundestag, if there were elections tomorrow

2009 election results, 2011 onwards survey results, %



Source: IFD Allensbach

— Allensbach survey on political sentiment in Germany (‘Sonntagsfrage’) delivered continuously improving rates for the CDU/CSU parties, and the FDP is also able to surpass the 5% threshold. With a total of 44% of the votes (which is more than in the past two years) they are ahead of SPD and Greens. The latter is a result of deteriorating survey results of the SPD and the bad start of the candidate for chancellor Peer Steinbrück. Even the elections in Lower Saxony won´t change much about this development at the federal level.

Contact persons for our chartbooks:

Business cycle and financial markets:
Heiko Peters (+49 69 910-21548, heiko.peters@db.com)
Oliver Rakau (+49 69 910-31875, oliver.rakau@db.com)
Jan Schildbach (+49 69 910-31717, jan.schildbach@db.com)

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

Economic policy:
Dieter Bräuninger (+49 69 910-31708, dieter.braeuninger@db.com)
Frank Zipfel (+49 69 910-31890, frank.zipfel@db.com)

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

Date	Event	Remarks
7 Feb	Meeting of the ECB Council, press conference	Review of the monetary policy stance. We do not expect any changes to the main refinancing rate.
7/8 Feb	European Council in Brussels	Debate/agreement on the EU long-term financial framework 2014-2020. Debate on trade relations and on foreign relations especially with the countries of the Southern neighbourhood.
11/12 Feb	ECOFIN and Eurogroup in Brussels	Financial and macroeconomic stability developments in the euro area, including monitoring of individual Member States, Economic situation in the euro area – broad outline of the Commission winter forecast.
15/16 Feb	G20 finance ministers and central bank governors in Moscow	Debates on regulation of financial markets and shadow banking.
4/5 Mar	ECOFIN and Eurogroup in Brussels	Second review of Greece adjustment programme; second review of Spanish financial sector programme; EDP implications of the Commission winter forecast.
7 Mar	Meeting of the ECB Council, press conference	Review of the monetary policy stance. We do not expect any changes to the main refinancing rate.
14/15 Mar	European Council in Brussels	EU leaders agree on common economic policy principles and reform goals for 2013
4 Apr	Meeting of the ECB Council, press conference	Review of the monetary policy stance. We do not expect any changes to the main refinancing rate.
11/12 Apr	ECOFIN and Eurogroup in Ireland	Seventh review of Portuguese adjustment programme; ninth review of Irish adjustment programme; stability and growth pact implementation for euro area countries
18/19 Apr	G20 finance ministers and central bank governors in Washington	Debate on the situation of international financial system.
19/20 Apr	Spring meetings of IMF and World Bank in Washington	

Source: DB Research

Dieter Bräuninger (+49 69 910-31708, dieter.braeuninger@db.com)
Nicolaus Heinen (+49 69 910-31713, nicolaus.heinen@db.com)

Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
31 Jan 2013	08:00	Import prices (Index, sa) pch mom (yoy)	Dec	0.4 (1.3)	0.0 (1.1)
31 Jan 2013	14:00	Consumer prices preliminary (Index, sa), pch mom (yoy)	Jan	-0.3 (2.1)	0.9 (2.1)
31 Jan 2012	10:00	Unemployment rate (%, sa)	Jan	6.9	6.9
31 Jan 2013	08:00	Retail sales (Index, sa), pch mom	Dec	0.5	0.9
8 Feb 2013	08:00	Trade balance (EUR bn, sa)	Dec	15.7	15.1
8 Feb 2013	08:00	Merchandise exports (EUR bn, sa), pch mom (yoy)	Dec	1.1 (5.2)	-2.5 (0.0)
8 Feb 2013	08:00	Merchandise imports (EUR bn, sa), pch mom (yoy)	Dec	0.7 (2.7)	-3.7 (-1.0)
6 Feb 2013	12:00	New orders manufacturing (Index, sa), pch mom	Dec	-0.5	-1.8
7 Feb 2013	12:00	Industrial production (Index, sa), pch mom	Dec	0.0	0.2
14 Feb 2013	08:00	Real GDP (Index, sa), % qoq	Q4 2012	-0.5	0.2
21 Feb 2013	09:30	Manufacturing PMI (Flash)	Feb	49.5	48.8
21 Feb 2013	09:30	Services PMI (Flash)	Feb	55.5	55.3
22 Feb 2013	10:30	ifo business climate (Index, sa)	Feb	105.0	104.2

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

Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	0 - 0.25	0 - 0.1	0.75	0.50	0.00	1.00	0.20	1.50	4.00	5.75	0.05
3M	0 - 0.25	0 - 0.1	0.75	0.50	0.00	1.00	0.20	1.50	3.50	5.25	0.05
6M	0 - 0.25	0 - 0.1	0.75	0.50	0.00	1.00	0.25	1.75	3.50	4.75	0.05
12M	0 - 0.25	0 - 0.1	0.75	0.50	0.00	1.00	0.30	2.00	3.25	4.50	0.05
3M interest rates, %											
Current	0.31	0.30	0.22	0.51							
3M	0.35	0.30	0.20	0.55							
6M	0.35	0.30	0.20	0.60							
12M	0.35	0.30	0.30	0.70							
10J government bonds yields											
	Yields, %				Spreads vs. EMU, pp						
Current	1.99	0.76	1.68	2.11	-0.94	0.22	0.07	0.87			
3M	2.50	0.80	1.70	2.20	-0.95	0.05	-0.30	0.85			
6M	2.50	0.80	1.90	2.50	-0.90	0.20	-0.25	0.90			
12M	2.50	0.90	2.25	3.10	-0.85	0.30	-0.20	1.00			
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	91.05	0.85	1.57	1.25	8.70	7.46	7.44	4.18	298.40	25.70
3M	1.35	91.00	0.85	1.61	1.25	8.50	7.46	7.25	4.05	280.00	25.00
6M	1.30	92.00	0.85	1.56	1.25	8.20	7.46	7.10	3.98	280.00	24.50
12M	1.20	95.00	0.83	1.49	1.25	8.00	7.46	6.95	3.84	280.00	23.80

Sources: Bloomberg, Deutsche Bank

Heiko Peters (+49 69 910-21548, heiko.peters@db.com)
Oliver Rakau (+49 69 910-31875, oliver.rakau@db.com)

German Data monitor

	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Aug 2012	Sep 2012	Oct 2012	Nov 2012	Dec 2012	Jan 2013
Business surveys and output											
Aggregate											
Ifo business climate	107.0	109.2	107.2	102.3	101.3	102.2	101.4	100.0	101.5	102.4	104.2
Ifo business expectations	98.0	101.9	100.1	94.3	95.5	94.1	93.2	93.3	95.3	98.0	100.5
PMI composite	50.3	52.9	49.3	47.9	49.1	47.0	49.2	47.7	49.2	50.3	53.6
Industry											
Ifo manufacturing	102.4	104.4	102.5	96.4	95.0	97.0	95.6	94.2	94.6	96.3	99.0
PMI manufacturing	48.5	49.9	45.5	45.0	46.3	44.7	47.4	46.0	46.8	46.0	48.8
Headline IP (% pop)	-1.6	-0.4	0.0	0.9		-0.4	-1.2	-2.0	0.2		
Orders (% pop)	-2.4	-0.7	0.5	-2.0		-0.8	-2.4	3.8	-1.8		
Capacity utilisation	85.6	85.1	85.0	83.7	82.1						
Construction											
Output (% pop)	0.4	-3.7	3.3	1.0		-2.2	2.5	-1.6	1.0		
Orders (% pop)	0.6	9.2	-5.6	-1.7		5.6	-7.8	22.8	-20.5		
Ifo construction	117.2	123.1	120.0	118.0	117.6	118.6	116.7	115.7	118.3	118.7	122.6
Services											
PMI services	51.1	52.9	51.3	49.4	50.0	48.3	49.7	48.4	49.7	52.0	55.3
Consumer demand											
EC consumer survey	-2.8	-0.3	-1.1	-7.9	-10.0	-8.8	-10.3	-9.3	-10.2	-10.4	
Retail sales (% pop)	0.1	-0.4	0.1	-0.8		-0.5	0.0	-0.6	0.9		
New car reg. (% yoy)	3.0	1.3	0.2	-7.0	-6.2	-4.7	-10.9	0.5	-3.5	-16.4	
Foreign sector											
Foreign orders (% pop)	-1.7	-0.7	1.1	-1.3		0.0	-2.9	6.6	-4.1		
Exports (% pop)	-1.2	2.4	1.8	1.4		2.2	-2.5	0.1	-2.5		
Imports (% pop)	-1.2	1.3	-0.2	0.3		0.3	-0.9	2.9	-3.7		
Net trade (sa EUR bn)	39.5	43.2	48.4	51.5		18.4	16.6	14.6	15.1		
Labour market											
Unemployment rate (%)	6.9	6.8	6.8	6.8	6.9	6.8	6.8	6.9	6.9	6.9	
Change in unemployment (k)	-39.3	-38.7	18.0	22.7	34.0	10.0	11.0	19.0	5.0	3.0	
Employment (% yoy)	1.4	1.4	1.2	1.0		1.0	0.9	0.7	0.6		
Ifo employment barometer	108.5	108.5	107.8	106.5	106.3	106.6	106.3	105.6	106.4	106.9	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	2.6	2.4	2.1	2.1	2.0	2.2	2.1	2.1	1.9	2.1	
Core HICP (% yoy)	1.3	1.3	1.4	1.2	1.3	1.2	1.2	1.2	1.2	1.5	
Harmonised PPI (% yoy)	4.8	3.3	2.0	1.4	1.5	1.6	1.7	1.5	1.4	1.5	
Commodities, ex. Energy (% yoy)	-5.8	-9.6	-7.8	-4.5	0.7	-4.2	-6.2	-0.3	1.5	1.1	
Oil price (USD)	109.4	118.4	108.2	109.7	110.1	113.5	113.1	111.8	109.2	109.4	
Inflation expectations											
EC household survey	30.3	28.3	25.0	27.0	31.2	26.8	29.3	31.2	31.2	31.2	
EC industrial survey	9.0	10.0	6.4	0.8	2.9	1.0	1.1	2.1	2.1	4.6	
Unit labour cost (% yoy)											
Unit labour cost	2.4	2.0	2.8	3.2							
Compensation	2.7	2.2	2.4	2.5							
Hourly labour costs	3.8	1.7	2.7	4.1							
Money (% yoy)											
M3	5.9	7.0	7.1	6.4		7.6	6.4	9.6	8.3	8.3	
M3 trend (3m cma)						7.6	7.9	8.1	8.8	8.3	
Credit - private	1.9	2.1	0.7	0.6		1.0	0.6	-0.2	-0.6		
Credit - public	-21.3	13.5	22.0	10.4		26.8	10.4	12.1	4.3		

% pop = % change this period over previous period.
Sources: Deutsche Bundesbank, European Commission, Eurostat, Federal Employment Agency, German Federal Statistical Office, HWWI, ifo, Markit

Current Issues

Our publications can be accessed, free of charge, on our website www.dbresearch.com You can also register there to receive our publications regularly by E-mail.

Ordering address for the print version:
Deutsche Bank Research
Marketing
60262 Frankfurt am Main
Fax: +49 69 910-31877
E-Mail: marketing.dbr@db.com

Available faster by E-mail:
marketing.dbr@db.com

Printed by: HST Offsetdruck Schadt & Tetzlaff GbR, Dieburg

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