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Focus Germany

Heightened risks

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GDP forecast for 2015 scaled back to 1 ½%. The recent positive surprises – due in part to one-off items – provided by real economic indicators have for now banished concerns that Germany might slide into recession in Q3. We expect growth of 0.4% qoq. The ongoing geopolitical risks (above all the Ukraine-Russia crisis) and the question marks hanging over the expected cyclical upturn will probably lead to weaker growth in exports and company investment. That is why we have scaled back our growth forecast for the winter half-year 2014/2015. Thus, we have lowered our forecast from 1.8% to 1.5%.

Germany's fiscal position – too good to last? Germany's Minister of Finance Schäuble has announced a balanced budget for 2015 and the following years up to 2018. This is a clear indication that he is not prepared to boost German infrastructure investment further as requested not only in Germany but also by some other EMU countries and most recently ECB President Mario Draghi. Still, a somewhat more clouded economic outlook, the Grand coalition's pension giveaways and the restructuring of the federal government-Länder finances as well as of the fiscal equalisation scheme provide clear risks for the budget.

Russia using threat of halting gas supplies as leverage in conflict with Ukraine? In the context of escalating economic sanctions between Russia and the EU, a complete halt to gas supplies would be Russia's "weapon of last resort". In light of the significance of gas revenues for the Russian public purse and the reliability of deliveries in the past, our baseline scenario does not foresee any permanent suspension of deliveries. In case of a suspension of deliveries to Ukraine or even a halt to deliveries to Europe as a whole, there are unlikely to be any dramatic bottlenecks given large gas reserves in Germany and western Europe, provided the disruptions last no longer than 6 months and there is no exceptionally severe winter. Nonetheless, prices are likely to rise considerably for gas and – not quite as strongly – for gas substitutes, reducing real income and dampening growth. If gas supplies were to be disrupted completely, it would be virtually impossible for Germany to prevent the economy sliding into recession.

Household investment behaviour: Still playing it safe. At first glance, households seem to have become more risk-tolerant. For instance, the share of direct stock holdings has recently risen to just under 6%. However, a deeper analysis shows that the increase is only attributable to share price gains. Households even have reduced their stock positions in 2012 and 2013. When it comes to their financial assets, households continue to play it safe.

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	1.0	1.4	0.5	1.1	1.5	2.5	2.1	1.6	-2.6	-2.5	-2.1
Germany	1.5	1.5	1.4	0.9	1.5	1.8	7.2	6.7	6.6	0.2	-0.1	-0.2
France	0.4	0.9	1.5	0.6	0.9	1.5	-1.8	-1.8	-1.5	-4.4	-4.3	-3.8
Italy	-0.4	0.4	0.7	0.2	0.8	1.2	1.6	1.6	1.5	-3.0	-2.9	-2.7
Spain	1.2	1.9	1.8	-0.1	0.8	1.4	0.4	0.5	0.7	-5.6	-4.6	-3.3
Netherlands	0.7	1.7	1.1	0.5	1.1	1.5	10.9	11.4	11.5	-2.5	-2.0	-1.9
Belgium	1.0	1.0	1.6	0.7	1.3	1.5	-1.0	-0.8	-0.5	-2.5	-2.3	-2.2
Austria	0.8	1.3	1.8	1.5	1.7	1.7	2.7	2.9	3.1	-3.0	-1.8	-1.2
Finland	-0.4	0.6	1.6	1.1	1.2	1.4	-2.0	-1.7	-1.3	-2.4	-1.8	-1.1
Greece	-0.2	2.1	2.7	-1.0	0.4	0.9	1.0	1.5	1.5	-1.8	-0.6	0.1
Portugal	1.0	1.1	1.7	-0.1	0.9	1.3	1.0	1.0	1.0	-4.2	-3.3	-2.7
Ireland	3.7	2.5	3.7	0.4	1.1	1.6	6.5	7.0	7.0	-4.0	-2.7	-2.5
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	2.4	2.6	2.8	0.4	1.8	2.0	-1.5	-1.4	-1.5	-2.6	-2.5	-2.4
Hungary	3.4	2.7	3.0	0.3	2.7	3.3	1.8	1.8	1.5	-2.9	-2.7	-2.8
Poland	3.1	3.5	3.8	0.4	1.5	2.3	-1.8	-2.0	-2.2	4.3	-2.9	-2.8
United States	2.3	3.4	3.1	1.8	2.2	2.4	-2.6	-2.7	-2.9	-2.9	-2.5	-2.9
Japan	1.1	1.2	1.4	2.8	1.6	1.8	0.4	1.3	2.1	-7.0	-5.9	-4.6
World	3.2	3.9	4.0	3.5	3.7	3.7						

*Consumer price data for European countries based on harmonized price indices except for Germany. This can lead to discrepancies compared to other DB publications.
Sources: National Authorities, Deutsche Bank

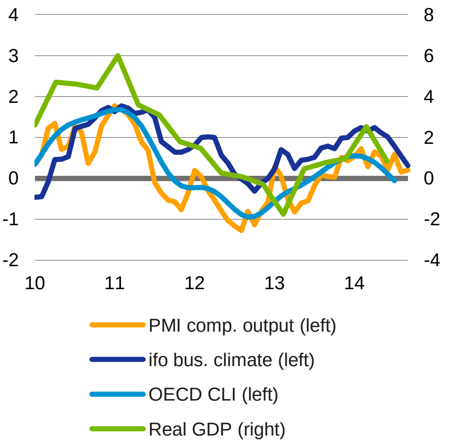
Forecasts: German GDP growth by components, % qoq, annual data % yoy

						2013				2014			
	2012	2013	2014F	2015F	2016F	Q1	Q2	Q3	Q4	Q1	Q2	Q3F	Q4F
Real GDP	0.4	0.1	1.5	1.5	1.4	-0.4	0.8	0.3	0.4	0.7	-0.2	0.4	0.2
Private consumption	0.7	0.8	1.0	1.5	1.0	0.2	0.6	0.7	-0.8	0.8	0.1	0.5	0.4
Gov't expenditure	1.2	0.7	0.8	0.5	0.3	0.0	0.0	0.6	-0.1	0.4	0.1	0.2	0.2
Fixed investment	-0.7	-0.7	3.5	2.4	2.1	-2.5	2.2	0.8	1.1	2.9	-2.3	0.7	0.5
Investment in M&E	-2.9	-2.7	3.9	3.1	3.1	-3.7	2.3	-0.5	2.1	2.1	-0.4	0.5	0.0
Construction	0.6	-0.1	3.6	2.8	2.3	-2.8	3.0	1.8	0.7	4.1	-4.2	0.5	1.0
Inventories, pp	-1.4	0.2	0.3	0.2	-0.1	0.2	-0.1	0.0	0.2	-0.2	0.4	0.1	0.0
Exports	2.8	1.6	3.6	6.0	6.6	0.7	1.4	0.7	1.7	0.0	0.9	1.1	1.2
Imports	0.0	3.1	4.7	7.1	6.5	1.2	1.3	1.7	0.7	0.5	1.6	1.4	1.8
Net exports, pp	1.3	-0.5	-0.2	-0.1	0.5	-0.2	0.2	-0.4	0.5	-0.2	-0.2	-0.1	-0.2
Consumer prices*	2.0	1.5	0.8	1.4	1.8	1.5	1.5	1.6	1.3	1.2	1.1	0.7	0.7
Unemployment rate, %	6.8	6.9	6.7	6.8	7.0	6.9	6.9	6.8	6.9	6.8	6.7	6.7	6.6
Industrial production	-0.4	0.1	2.7	3.0	0.0								
Budget balance, % GDP	0.1	0.0	0.2	-0.1	-0.2								
Public debt, % GDP	81.0	78.4	73.5	71.0	68.7								
Balance on current account, % GDP	7.1	6.8	7.2	6.7	6.6								
Balance on current account, EUR bn	196	192	209	198	204								

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

German GDP growth and leading indicators 1

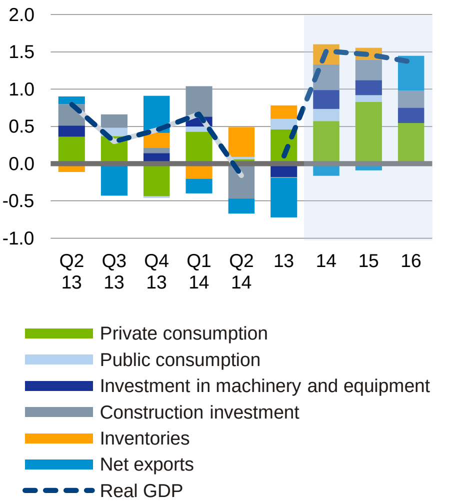
Standardised values (left); % yoy (right)



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

Domestic economy the main growth driver 2

Contributions to real GDP growth, qoq, pp



Sources: Federal Statistical Office, Deutsche Bank Research

GDP forecast for 2015 scaled back to 1 ½%

— The recent positive surprises – due in part to one-off items – provided by real economic indicators have for now banished concerns that Germany might slide into recession in Q3. We expect growth of 0.4% qoq.

— The ongoing geopolitical risks (above all the Ukraine-Russia crisis) and the question marks hanging over the expected cyclical upturn have led to a deterioration in sentiment in industry and among consumers.

— This uncertain environment will probably lead to weaker growth in exports and company investment. That is why we have scaled back our growth forecast for the winter half-year 2014/2015. This does not, however, alter our GDP forecast for the full-year 2014; it remains at 1.5%. For 2015, however, we have lowered our forecast from 1.8% to 1.5%, and for 2016 we expect growth of 1.4%. With these forecasts, however, it is the downside risks that dominate.

— In addition, both of the grand coalition's major reform projects – the introduction of the minimum wage of EUR 8.50 per hour and the pensions package are likely to generate first reactions by Germany's business sector.

Return to growth in Q3

Following the decline in economic activity in Q2 we will probably see a rise in German GDP in Q3. This is being bolstered by the positive surprises – due in part to one-off items – provided by real economic indicators at the start of Q3.[1] The sharp rise in new orders in July was largely due to the surge in the volatile elements of the heavy transport equipment segment. Around 50% of the increase in industrial output was due to the shortening/shifting of the holiday shutdown period at the major automakers' factories, which means that a negative rebound is likely in August. The pronounced surge in exports is unlikely to be repeated given the marked decline in the leading indicators for exports and the still tentative upturn in world trade.

Sentiment indicators have trended downwards in recent months. The ifo business climate index was down for the fifth month in a row, but remained above its long-term average. The PMI manufacturing fell – for the second consecutive month – and at its current level is only slightly above the expansion threshold. By contrast, the PMI services rose once again and points to a robust development of domestic demand. At the current level, however, sentiment indicators point towards growth of about ½% qoq in Q3.

Geopolitical risk and the fragile recovery in the eurozone are likely to lead to a weak winter half-year

Sentiment is coming under increasing pressure from the ongoing geopolitical risks (above all the Ukraine-Russia crisis) and the question marks hanging over the expected cyclical upturn, especially given the sluggish pace of reform in several eurozone countries. Disappointing economic performance in France (9% of Germany's total exports in H1 2014) and Italy (5% of exports) as well as the slump in exports to Russia (3% of exports)[2] are weighing more and more heavily on German exports. In this uncertain environment companies are likely to focus on the near term and postpone some of their planned investments, which means that investment in machinery and equipment will probably turn out

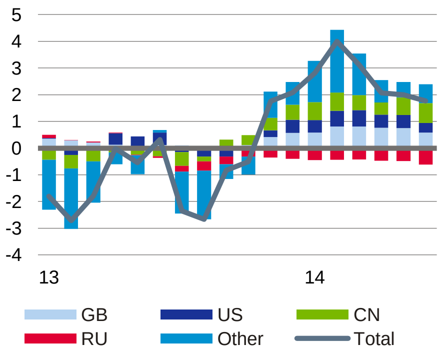
[1] See also DB German Macro Surprise Index on p. 20.
[2] See also Chart of the month "Ukraine-Russia crisis hits east German exports harder" on p. 19.

lower than hitherto expected. On account of these factors we have scaled back our growth forecast for the winter half-year 2014/2015 to an average of 0.2% qoq. This does not, however, alter our GDP forecast for the full-year 2014; it remains at 1.5%.

Negative impact of reforms in the coming years and continuing heightened uncertainty

Russia weakens German export performance 3

Growth contributions (pp), % yoy



Sources: Federal Statistical Office, Deutsche Bank Research

As a consequence of the expectation of slightly tempered growth in the winter half-year 2014/15 our forecast for 2015 has been cut from 1.8% previously to 1.5% now. For 2016, we project economic growth of 1.4%. The main growth driver during the forecast period is likely to be the domestic economy. The labour market will probably continue to perform relatively well for the time being and the ongoing increased volume of immigration should generate additional demand. This combined with historically low borrowing rates (2.48%, fixed for 5-10 years) and the low yields in alternative investment classes is likely to boost demand for housing. With the US economy expected to boost global growth from 3.3% in 2014 to about 4% in 2015/16 we should see German exports pick up and net exports again contribute to growth in 2016, which should prompt investment in machinery and equipment to surge once again following a weak winter half-year 2014/15. With this forecast it is the downside risks that still dominate. The forecast is based on the global economy picking up strongly, the reforms in the eurozone being advanced slowly, the ECB remaining ready to act and the Ukraine-Russia conflict slowly being defused.

Both of the grand coalition's major reform projects – the introduction of the minimum wage of EUR 8.50 per hour and the pensions package are likely to generate first reactions by Germany's business sector. The introduction of the minimum wage is likely to generate significant considerable negative employment effects, make it much more difficult for problem groups in particular to (re)enter the labour market and increase structural unemployment with considerable negative fiscal effects. Reducing the inequality of gross pay distribution will be achieved at the cost of squeezing out workers who are the least productive. The growth in employment is likely to be halted in 2015 by the introduction of the minimum wage despite a further rise in net immigration. The impact of the pensions package, especially "early" retirement at 63, is also decidedly negative and counterproductive in light of the huge demographic challenges. The pensions package with its reintroduction of early retirement is a gift to older people and a burden on the young that will have serious negative consequences for the public purse. Further likely outcomes are a worsening of the skill shortage and a significant loss of company-specific human capital.

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Germany's fiscal position – too good to last?

— Germany's Minister of Finance Wolfgang Schäuble has announced a balanced budget for 2015 and the following years up to 2018. This is a clear indication that he is not prepared to heed the calls to significantly boost German infrastructure investment that have been issued not only in Germany but also by some other EMU countries and most recently ECB President Mario Draghi.

— This achievement owes a lot to the structural reforms of the past and the ultra-low interest rate level. Still, a somewhat more clouded economic outlook provides clear risk for the budget, although the still high volume of social security contributions provide a cushion in this respect.

— Above all, the grand coalition's pension giveaways will result in a deterioration of Germany's fiscal situation over the medium term.

— The upcoming negotiations for a restructuring of the federal government-Länder finances as well as of the fiscal equalisation scheme could harbour additional burdens in the medium term, which are currently difficult to quantify, however.

At a time when there are increasing voices demanding a more flexible interpretation of the Maastricht deficit rules, German Minister of Finance Wolfgang Schäuble has presented his budget, which does without any new federal debt between 2015 and 2018. This should come much to the chagrin of France, where his counterpart Michel Sapin has been forced to admit that this year's deficit will be at least 4.3% of GDP and that meeting the 3% target needs to be postponed for the third time until 2017 at the earliest.

Germany: Federal budget proposal 2015-2018 1

EUR bn

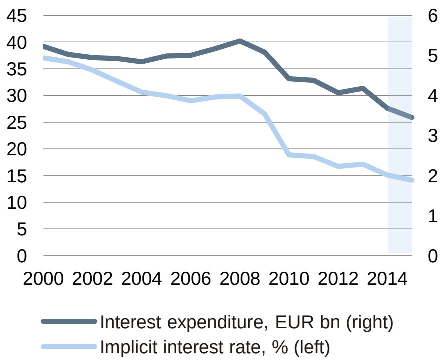
	Budget projection	Government proposal	Financial plan		
	2014	2015	2016	2017	2018
Spending	296.5	299.5	310.6	319.9	329.3
% yoy		1.00%	3.70%	3.00%	2.90%
Revenues	296.5	299.5	310.6	319.9	329.3
Tax revenues	268.2	278.5	292.9	300.7	311.8
Budget deficit	6.5	0	0	0	0
Structural deficit, % of GDP	-0.05%	-0.01%	-0.03%	-0.01%	-0.02%
Investment spending (excl. ESM in 2014)	25.5	26.1	27.2	27.9	27.2

Source: Federal Ministry of Finance

The budget presentation in the German parliament was accompanied by a tweet from Schäuble's Ministry saying: "Fiscal policy focused on stability makes a necessary contribution to building global confidence in Europe", thus firmly rejecting calls to shift towards a more expansionary (i.e. credit financed) fiscal policy in Germany. According to the budget, the federal government could do without new debt for the first time since 1969. Given similarly good developments at the Länder and local authority level[3] and favourable revenue developments in the social security system, courtesy of the healthy labour market, the general government budget could even enjoy a small surplus again.

[3] This refers to Länder and local authorities as a whole. Within the respective groups, the financial situation is very heterogeneous, however.

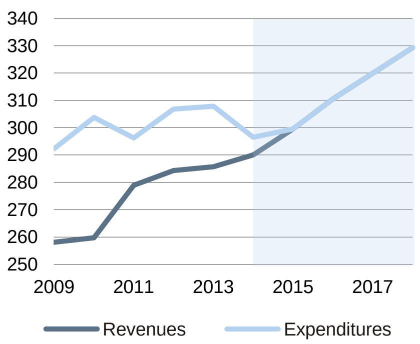
Federal interest expenditures 2



Sources: Federal Ministry of Finance, Deutsche Bank Research

Balanced Federal budget 3

EUR bn



Source: Federal Ministry of Finance

How much of an achievement?

Germany has virtually no output gap. A balanced budget is therefore exactly what the Stability and Growth Pact demands – nothing more. Moreover, the surplus in the 2017 budget still indicated in the 2013 Stability Programme update has been dropped, as a result of the pension giveaways implemented by the grand coalition. What is more, judging from the cyclical position of the German economy the interest rate level is between 2 and 3 percentage points too low, thanks to the ECB. Even taking into account that this gap has only gradually opened up since 2011, it should still save Mr. Schäuble close to EUR 10 bn (0.4% of GDP) in interest expenditures in 2015, which he estimates at around EUR 27 bn (about 1% of GDP) in his budget.

Will it work?

Assumptions are crucial. Since forecast accuracy drops dramatically going beyond the next one or maybe two years, the assumption of an average growth rate of 1.4% between 2016 and 2018 – marginally above trend growth – is a realistic one. Still, although recent economic gyrations have little to do with normal cyclical ups and downs, one cannot dismiss the risk of a cyclical downswing over a five-year period. At any rate, the macro assumptions for 2015 are probably facing bigger risks. Given the still sluggish global economy and increasing burden of the Ukraine/Russia conflict, which has resulted in slumping German exports to Russia and is increasingly weighing on business sentiment and investment spending, the government's 2% GDP growth forecast for 2015 looks very ambitious. Similarly the inflation forecast of 1.9% looks on the high side. All in all, nominal growth could in our view fall short of the government's assumption by between ½ and ¾ of a percentage point.

There are also legal risks related to the nuclear fuel tax, which generates revenues of EUR 1.3 bn p.a. but where a Hamburg financial court has doubts whether the tax law is unconstitutional and therefore referred to the Constitutional Court for review. In addition, the regular constitutional review of the minimum subsistence is due in autumn, as a consequence of which child benefit/child allowance as well as the basic tax-free allowance will probably be raised from 2015. Furthermore, the negotiations currently underway between the federal government and the Länder about their financial relations – as a result of numerous demands of the federal states (e.g. old debt funding and solidarity surcharge) – make further burdens on the federal budget more likely in the medium term.[4]

Finally, the uncertain short-term effects of the introduction of the minimum wage imply risks, albeit to both sides, depending on its impact. If the negative employment consequences[5] materialise only with time lags, this might provide a small boost to income tax revenues, although the effect on social security contributions would be stronger. If, however, against the backdrop of a more clouded macro-environment, employers respond more quickly with staff redundancies, both income categories could be negatively affected.

[4] See next chapter for more detail.
[5] See „Minimum wage at EUR 8.50: The wrong policy choice". Deutsche Bank Research. Standpunkt Deutschland. November 4, 2013.

Restructuring the finances of the federal government and the Länder – the great unknown

The expiry of the solidarity pact II and the Länder fiscal equalisation scheme at the end of 2019 as well as the increasingly harder to justify solidarity surcharge leave much scope for the resulting required restructuring of financial relations between the federal and Länder governments. Since the summer of this year, joint negotiation rounds between the federal governments and the Länder governments have taken place, discussing both the vertical and the horizontal distribution of revenues and expenditure.

In principle, all – politicians and academics – agree that in Germany a reform of financial relations and allocation of tasks is required to generate the advantages of a federal state and make the total government act more effectively again.[6] To achieve this, the web of financial links would have to be reduced und the autonomy of local bodies and federal states would have to be strengthened. For the more the Länder budgets benefit from the “fruits of their labours” – e.g. the strengthening of economic power – the greater their incentive to exert themselves.[7] In the current system of fiscal equalisation, too much of the extra revenues are still skimmed off, so there is insufficient incentive to make one’s own efforts.[8]

Paradoxically, the debt brake in force from 2020 for the Länder under current conditions leads to increased (financial) pressure from Länder on the federal government.[9] As the Länder have relatively little autonomy on both the revenue side and the expenditure side[10] and the debt brake will remove the remaining autonomy in accessing credit from 2020, it is currently easier due to a lack of alternatives to demand financial concessions from the federal government.

In the negotiations between the federal government and the Länder various points are currently being discussed. These include among other things the right to impose surcharges on income and corporation tax; a different allocation of the debt framework[11] in accordance with the national and European fiscal rules; increased joint borrowing by the federal government and the Länder, the integration of the solidarity surcharge in income tax in connection with an old debt fund for highly indebted Länder; more sanction and influence possibilities for the stability council and, last but not least, of course different approaches for changes in the tax allocation and the fiscal equalisation scheme between the Länder.

The target is to present specific suggestions by the end of the year. This does not mean, however, that a decision will have been made by then. The negotiation process may take a long time – until well into next year. The interests of the participants are too different, and the funds at stake are too high. The federal government is faced with the Länder, but the financially weak Länder are also faced with the financially strong Länder. The discussion on the solidarity surcharge, whose revenue of currently around EUR 15 bn accrues to the federal government alone, illustrates that quite a lot is at stake for the federal budget.[12]

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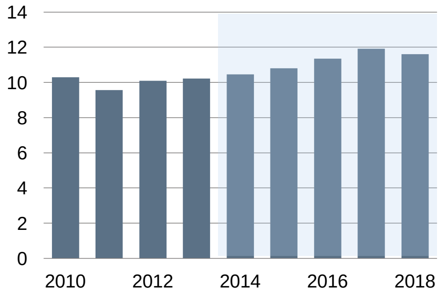
6 Without a certain degree of autonomy, this raises the question of whether the federal structure and the budget autonomy of the Länder still make sense.
7 This also entails that the principle of fiscal equivalence is reflected more strongly as a connection between the provision of public goods and services should be related to tax and spending levels.
8 This incentive problem could also be solved on the income side without major reform by adjusting potential additional revenues (for example from autonomously levied surcharges on other taxes) for differing tax rates when determining the financial strength – in a similar way to the procedure worth the real property transfer tax.
9 Finance Minister Schäuble has recently put the demands of the Länder at currently EUR 40 bn.
10 For instance by Germany-wide social security benefits.
11 Without wanting to change the existing national upper limits, though.
12 If the solidarity surcharge were currently fully integrated into income tax, the federal government (without additional changes) would on the basis of the current distribution rates have to forgo

Federal expenditures: Traffic & transport 4

EUR bn



Source: Federal Ministry of Finance

Should (future) taxpayers be thankful?

Mr. Schäuble’s barely disguised glee about the balance budget has reignited the debate about the “crumbling German infrastructure”, culminating in the accusation that he is saving at the expense of future generations. While we find a modest gap in German infrastructure spending, which would require some EUR 4-7bn (between 0.1% and 0.3% of GDP) of additional infrastructure investment per year (in large part from local authorities)[13], we do not see the benefit of a large-scale, debt-financed infrastructure programme. Admittedly, real financing costs are zero, but the invested sum still needs to be generated via additional growth. In addition, given the structural change driven by globalisation, demography and digitalisation there might be some virtue in maintaining more fiscal leeway for future expenditures. In addition, with a much too loose monetary policy and a depreciating exchange rate it would be imprudent – and in fact repeating the past mistakes made by the peripheral countries – if fiscal policy also became expansionary. While the wish to stick to a balanced budget should prevent larger spending desires from being fulfilled, German policy still remains reserved with regard to the greater “fiscal-policy flexibility” desired in other countries. The joint plans of Finance Minister Schäuble and his French opposite number Sapin for better financing possibilities for infrastructure projects show a certain willingness to compromise in view of the problems in the neighbouring countries.

Should EMU partners be angry?

Implicitly Mr. Schäuble’s budget gives a deafening “No” to requests from other EMU countries, the IMF and the ECB president Draghi that Germany should increase investment to generate positive spillover effects for its ailing neighbouring economies. Infrastructure investments in Germany are running at around EUR 35 bn p.a. Even if it was technically possible to lift them by 10% or even 20% p.a. within a year or so this would amount to a meagre 0.05% to 0.1% of EMU GDP, meaning that spillover effects would be virtually nil, given that the import content of construction investment is quite low.

So all-clear for German public finances?

Unfortunately not! The current government is surfing a wave generated by past reform efforts and exceptionally low interest rates. The grand coalition’s own flagship projects – the temporary possibility to retire at 63 years (without a reduced pension) and the pension increases for mothers having given birth to kids before 1991 and people with reduced earnings capacity – will cause a significant deterioration in government finances. Mr. Schäuble has managed to disguise this during the current government’s term by taking recourse to the still buoyant revenues of the social security system (cutting transfers and choosing not to reduce contribution rates, which would otherwise have become mandatory). The next government has to find more sustainable sources of financing, otherwise the period of balanced budgets will only be a short-term intermezzo.

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almost 60% of revenues, i.e. roughly EUR 9 bn. This amount would thus exceed net borrowing in the federal budget of EUR 6.5 bn planned for the current year.

[13] See Investment gap in Germany – Likely only in the public sector. Deutsche Bank Research. Focus Germany. September 2, 2014.

Russia using threat of halting gas supplies as leverage in conflict with Ukraine?

— In the context of escalating economic sanctions between Russia and the EU, a complete halt to gas supplies would be Russia's "weapon of last resort". Supply bottlenecks and profound uncertainty surrounding gas deliveries could throttle Euroland's fragile economic recovery.

— In light of the significance of gas revenues for the Russian public purse and the reliability of deliveries in the past, our baseline scenario does not foresee any permanent suspension of deliveries. However, the recent temporary loss of pressure in European gas pipelines is unlikely to have been an accident or technical hitch.

— If worse came to worst, Russia's actions would probably display great finesse – as has so far been the case in the Ukraine conflict. In the following, we only present two broad scenarios which differ solely in terms of the immediate geographical fallout and the volume of disruption: a) a stop to gas supplies for Ukraine, and b) a halt to deliveries to Europe as a whole.

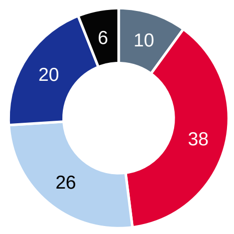
— In both scenarios there are unlikely to be any dramatic bottlenecks given large gas reserves in Germany and western Europe, provided the disruptions last no longer than 6 months and there is no exceptionally severe winter[14]. Nonetheless, prices are likely to rise considerably for gas and – not quite as strongly – for gas substitutes. Should gas reserves be largely used up during the winter of 2014/15, this would lead to a situation where they could not be sufficiently replenished by the following winter, creating a much more critical supply situation.

— Even if, at the end of the day, Russia were to issue threats only but take no action – as assumed in our baseline scenario – the development witnessed over the last few months would trigger a rethink on the part of the gas importing countries in Europe, which would weaken Russia's economic position over the medium term.

Gas market undergoing change from gas glut to supply stop?

Russia is Germany's main gas supplier 1

Share of DE gas volume, %, 2013



Sources: AG Energiebilanzen, BDEW

Thanks to its reliable deliveries even during the Cold War era, Russia has since been considered a trustworthy partner in the natural gas business. Volatility was usually triggered elsewhere. The shale gas revolution in the US, for instance, gave rise to hopes for a more benign long-term development of gas prices also on the part of European customers by creating the prospect of a globally integ-rated gas market. Before the outbreak of the Ukraine conflict, large-scale dis-ruptions of deliveries from Russia resulting in supply bottlenecks were, at best, a wildcard scenario.

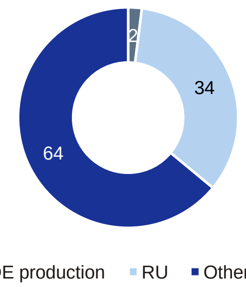
Germany's "vulnerability" is considerable. In 2013 Russia was Germany's main supplier of natural gas, petroleum and coal. Of the three fossil energy sources, however, gas has a peculiarity which is becoming increasingly important in the current context. While there are alternative sources for oil and coal available globally, there is no genuine "world market" for gas, even though shipments of liquefied natural gas (LNG) mean that regional markets for gas are better connected now than a decade ago.

[14] An Embargo of Russian Gas and Security of Supply in Europe, Institute of Energy Economics at the University of Cologne (EWI).

Can Russian gas supplies be replaced quickly?

Russia also Germany's main oil supplier 2

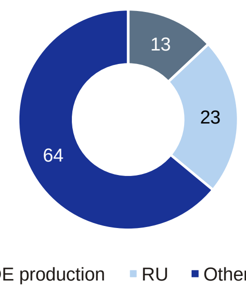
Share of DE petroleum volume, %, 2013



Source: AG Energiebilanzen

Russia also Germany's main coal supplier 3

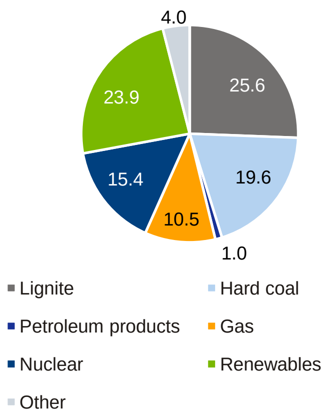
Share of DE hard coal volume, %, 2013



Source: AG Energiebilanzen

Gas contribution of 10.5% to German electricity generation last year 4

Share of gross electricity generation, %, 2013



Source: AG Energiebilanzen

In the event of supply disruptions from Russia, gas could alternatively be delivered by the Netherlands or Norway. However, both these countries would then have to substantially boost production volumes and use existing pipelines to Germany. In the case of the Netherlands, the required production capacities do not yet seem to be available.

Another potential alternative is liquefied gas (LNG), but there is no terminal as yet in Germany for converting it into natural gas and feeding it into the German grid. The unused capacities for this in the Netherlands and Belgium could be utilised more extensively than so far.

Last year, LNG imports in the Netherlands, Belgium, the UK, Italy and France, i.e. the five countries which could potentially replace Russian deliveries (unlike Spain and Portugal as the latter are not connected to the central European system of gas pipelines) amounted to 28 bn cbm. In Europe as a whole, LNG imports came to 52 bn cbm in 2013. Both figures are considerably lower than back in 2011. At that time, Europe's LNG imports amounted to 90 bn cbm, and those of the five relevant "compensation countries" to 56 bn cbm. The gap between existing LNG import capacities of those five countries (approx. 110 bn cbm) and their current LNG imports has therefore widened noticeably. While unused capacities in 2011 amounted to "only" just over 50 bn cbm, the figure exceeded 80 bn cbm in 2013.

Against this backdrop, approx. 45 bn cbm could probably be supplied to Europe via LNG terminals in Rotterdam and Belgium in order to cover a supply shortfall over a period of five months. However, this would curtail supplies to Asia and lead to soaring LNG prices. At present, gas prices are roughly twice as high in southeast Asia as in Europe. Despite constructive signals from US President Obama it will probably take a number of years for the US to be able to export significant volumes of LNG.

An average of about 10% of gas imports is used for electricity generation. A stop to deliveries from Russia could easily be compensated for by existing excess capacities at the coal plants as well as by (nuclear) power from abroad. As regards power generation, gas would continue to lose in importance compared with coal which has already registered a growing share.

In the heating segment, many households with gas heaters would be hard hit as they would not be able to switch to alternative sources quickly. However, households would be likely to react to higher gas prices and potentially also to supply problems, depending on their duration, by changing habits, e.g. lowering heating temperatures or restricting heating times.

At the end of the day, Europe's gas inventories will be the decisive factor. Overall inventory capacities are roughly 100 bn cbm. Thanks to the exceptionally mild winter of 2013/14 depots are almost completely full at present. Russian deliveries to Europe amounted to 162.7 bn cbm in 2013, or approx. 25% of annual gas demand or 32% of import volumes. Germany has gas depots holding approx. 23 bn cbm and in 2013 imported 38% of its annual consumption from Russia. This means that even taking into consideration seasonally higher demand in the winter half-year – which gas depots are actually meant to offset – Germany would be able to absorb a 5-month supply disruption from Russia by using up its stocks.

Technical problems with supply?

Another cause for concern could be our gas infrastructure. Generally speaking, European markets for natural gas and electricity remain insufficiently integrated which makes it more difficult to compensate for shortfalls in national grids. Against this backdrop our calculations regarding the scale of European gas inventories could be overly optimistic. Germany's network of pipelines is geared to supply from Russia. Large volumes of gas are delivered via the new "Nord-Stream" pipeline to northern Germany and the Ukraine pipeline to Bavaria. Large-scale supply disruptions from Russia would change flow conditions. Therefore, even with larger volumes being delivered from Holland and/or Norway there could be a loss of pressure in Bavaria, which would cause problems in supplying end users there.

Various price adjustment mechanisms play a part

As regards pricing, supply disruptions will not hit all market participants equally hard as their contractual arrangements vary quite considerably at present.

— Among the potentially hardest hit are gas importers, but the terms of their individual import contracts with Russia are confidential. As a rule, they have already sold on the expected volume of gas supplies to public utilities or industrial companies. If Russia halts deliveries, they will have to turn to other suppliers (e.g. Norway) or the commodities exchange – at higher costs – but as a vendor are bound to the prices already agreed with their customers. They would be affected to a lesser degree if their contracts included a Force Majeure clause.

— Month-ahead contracts are the rule at major industrial enterprises. TTF (Holland) market prices are usually used for continental Europe. This means that large customers would face price increases quite soon.

— Germany's small and medium-sized enterprises (SMEs) typically negotiate fixed prices for one or two years. This shields SMEs from price risks that are independent of their core business. Hence they would be protected from rapidly rising gas prices for some time.

— However, many industrial enterprises would see the cost of their (gas-based) own electricity supply rise.

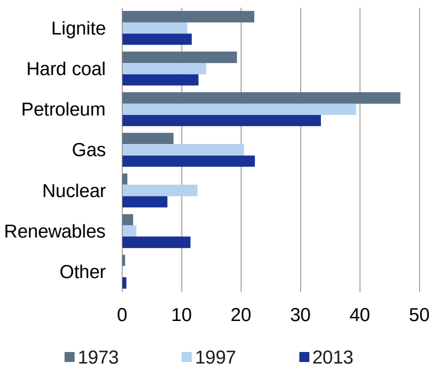
— Differentiation is required for households: for those who typically change suppliers (i.e. very cost-aware consumers) contracts with fixed annual prices are the rule. This implies they would be protected from quickly rising gas prices for some time, depending on individual contractual conditions. The situation is different for households which do not regularly change suppliers. They usually have flexible price arrangements with at least six weeks' notice. However, end users (also including those not regularly switching suppliers) are able to terminate their contracts in case of price increases. Hence, there is the risk for suppliers – in the case of households these would frequently be municipal utilities – that their customers will look for alternatives and if necessary switch suppliers.

— A critical issue for Russia is the fact that new price revisions are in the offing, for instance for October 1. Gazprom's long-term export contracts are based on specially calculated prices for a whole range of oil products. For this reason price developments for these products have an immediate impact on the price of gas. Basically, Russia wants to maintain this oil price indexation. But what if – also triggered by its supply disruptions – higher prices would be possible?

Scenario 1: Complete termination of gas deliveries to Ukraine – Germany as collateral damage

Gas has become increasingly important for Germany 5

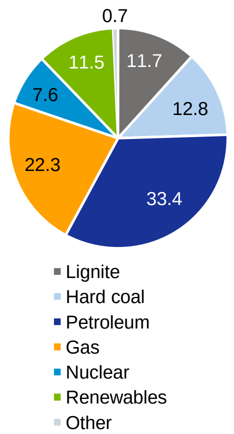
Share of primary energy consumption, %



Source: AG Energiebilanzen

German energy consumption based recently on 22% gas share 6

Share of primary energy consumption, %, 2013



Source: AG Energiebilanzen

In the past, a complete stop to gas supplies to Ukraine harboured greater risks for western Europe than it does today. This is due to the fact that – as a gas transit country – Ukraine has become much less important for Russia. While Russia still delivered 93% of its overall gas exports to Europe via Ukraine in the 1990s, the figure will be no more than 50% in 2014 – mostly thanks to the opening of the Nord-Stream pipeline. As it is technically impossible to differentiate between deliveries to and transit via Ukraine, suspension of supply to Ukraine would de facto lead to Russian gas exports to Europe dropping by 50%.

It is virtually impossible to gauge the price effects of supply disruptions from Russia of this order. This is due, for one thing, to the possibilities of substitution, whose technical and price parameters (LNG terminals, CO_2 certificates) have changed markedly in the past years. For another, gas storage facilities – at least in Germany – are largely in the hands of private companies, making forecasts of potential delivery profiles more difficult.

As a result of a 50% reduction in gas supplies to Germany, prices could rise by about 25%. This would push the gas price in Europe closer to Asian levels, making a redirection of supply to Europe more attractive.

Of course, such a massive price increase would be likely to depress demand – at least in areas where substitution is possible. However, households could also restrict consumption to some extent, for instance, by reducing average room temperatures during the heating season.

Substitution would probably push up prices for coal and oil, though. Coal prices are currently at very low levels globally and oil prices, too, have come down approx. 10% from pre-year levels. Prices for both commodities look set to rise, albeit within a tight range, as – for one thing – substitution of gas by oil or coal is limited (especially in the short run) and – for another – weaker economic activity in Europe, which in our scenario is mostly caused by a loss of confidence, and the resultant drag on the global economy will have a dampening effect on prices.

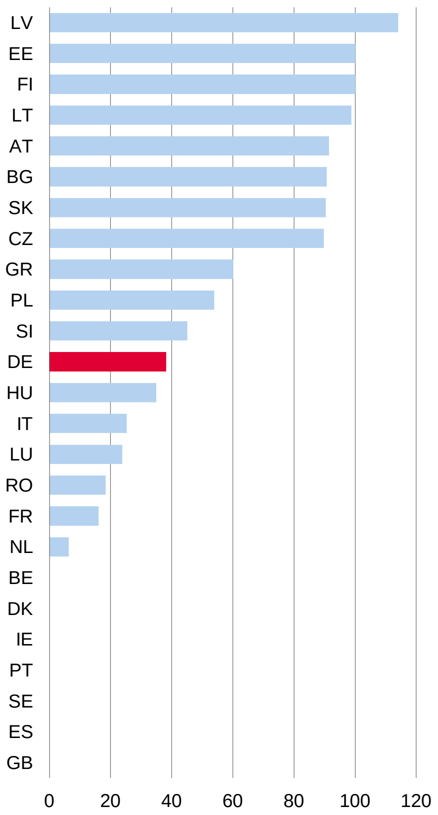
In this scenario we assume a 25% rise in natural gas prices which, including the effects on other sources of energy, would push energy prices as a whole up by 10-15% in Germany. This would raise inflation by 1 to 1 1/2 percentage points and dampen real incomes correspondingly. In light of rising uncertainty it is unlikely that households would offset this effect by lowering their savings ratio. Growth losses triggered directly by soaring gas prices would be manageable for the German economy but could increase in case of an even steeper slump in confidence. In this scenario, losses are expected to be most severe for the large gas utilities.

Scenario 2: Supply disruptions in the direction of Europe hit both Germany and Russia

For Russia a complete halt of deliveries to Europe would be tantamount to a complete end to global gas exports. Of Russia's total gas exports, 24% go to eastern Europe and 76% to western Europe. With a share of 24%, Germany absorbs the largest volume. From a different perspective, Russia in 2013 provided 38% of Germany's overall gas consumption, i.e. more than the Netherlands, Norway and the UK. Germany's dependence on gas imports (88% of consumption) is stronger than that of the EU (65%). In Europe, the import

Russia's import share of respective national gas consumption in 2012 | 7

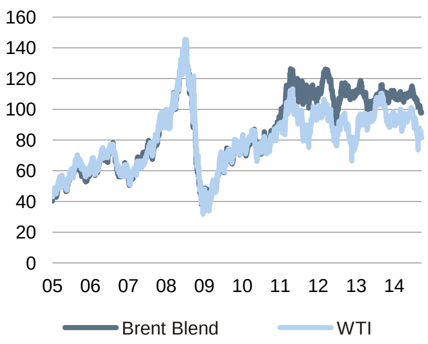
%



Sources: IEA/OECD/DIW

Oil price | 8

USD/bbl



Source: Global Insight

ratio has risen over the past ten years, due among other things to declining production in Europe itself.

In this extreme Scenario 2, Russia would be hit hardest (as is already the case) – and not only during the observation period. If Russia actually were to use "gas as a weapon", i.e. pursue this kind of politically motivated energy policy, it would most certainly lose its reputation as a reliable partner for years or maybe even decades to come. And all this in addition to the fact that the Russian economy would hurt itself to a considerable degree with its "new energy policy". After all, trade in energy products accounts for one-quarter of Russia's GDP, half of total government revenues and two-thirds of exports.

According to model simulations for the gas market conducted by the Institute of Energy Economics at the University of Cologne (EWI) which assumes supply disruptions from November 2014, Germany's gas supply would be secured for five months.[15] This means that "only" after April 2015 would Germany be threatened by supply bottlenecks. This result is based on three important assumptions, all of which seem quite plausible: 1. Gas depots are expected to be full at the beginning of November 2014 (seems realistic as inventory levels are already high) and reduced topping-up is expected in 2015. 2. Europe imports 45 bn cbm more LNG in 2014 than in 2013 (despite much scepticism – also on the part of EWI – this could materialise as the LNG market has recently seen a slight easing). 3. Weather conditions in winter are expected to be normal (this assumption harbours both risks and opportunities).

Uncertainties are much higher when assessing the price effects of a complete halt to supplies than of a mere reduction in deliveries, as described in Scenario 1, as in the second scenario processes and reactions would hardly follow a linear path. We have therefore assumed, in Scenario 2, that gas prices will soar by 75% and similarly pronounced increases would be registered for other sources of energy. Overall the scenario is based on a 50% upturn in energy prices which, in Germany, would lead to an inflationary push of approximately 5 percentage points, with a corresponding drag on real incomes. Initial price effects would probably weaken again because of the resulting slump in demand but it would be virtually impossible to prevent the country sliding into recession.

If supply disruptions materialise, what other risks would have to be expected?

The greatest risk in our view would certainly be severe winter weather in the first quarter of 2015 which lasts longer than just a few days. In that case, supply would be threatened in many countries of Europe. In Germany, too, gas reserves would quickly be depleted. Another risk is a prolonged crisis, stretching over 9 months, a full year or even longer. We cannot rule out extreme cases due to more than one risk materialising at the same time, as for instance an extremely cold winter and, on top, a very long phase of supply disruptions. Germany – as well as the rest of Europe – would then be hit even harder and required to take action. And not least, there are urgent questions of allocation: how should the shortfall be distributed? Will households actually be given priority? Or will companies and/or gas-fired power plants be favoured – e.g. for macroeconomic reasons and assuming some degree of flexibility on the part of politicians? Nor should the allocation of supply in Europe be left solely to market forces. So will Germany be able to decouple from the economically weaker countries and regions of Europe (in the east and the south) thanks to its relatively strong purchasing power? Or will there be a price to pay for solidarity within Europe, for instance if western and eastern Europe seek to achieve a "fair

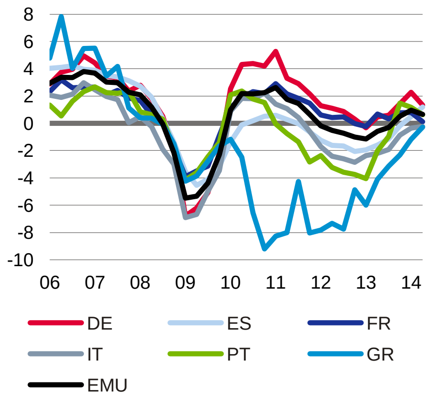
[15] For details see Institute of Energy Economics (2014). An Embargo of Russian Gas and Security of Supply in Europe. Cologne. September 8.

distribution" of supply volumes and thus also risks (provided this is technically possible within the existing gas infrastructure). There are many more questions regarding liability for risks. Not least, it is not clear to German gas importers who will be liable (and to what extent) for not honouring the long-term contracts typically agreed for German gas imports from Russia. Also affected, albeit on a completely different level, will be private consumers in Germany: in the event of (partial or total) non-fulfilment of their contracts with local gas suppliers, who will be liable?

Burden hits Euroland economy in still fragile phase

EMU: Economic growth 9

Real GDP, % yoy



Source: Eurostat

Supply disruptions with resulting price effects would hit the Euroland economy in a still fragile phase. True, the euro area has overcome the latest recession but growth momentum remains very weak and by no means stable in view of the structural problems (such as overindebtedness). In our scenario of a disruption to Russian gas supplies to Ukraine, it would be virtually impossible to prevent the euro area from sliding back into recession and Germany would be highly likely to register stagnation.

If Russia were to completely halt supplies to Europe, the eurozone economy would face a deep slump. In that case, recession would also have to be expected for Germany. A renewed recession in the euro area would also have noticeable dampening effects on the global economy via trade and particularly the confidence channel. In our baseline scenario, which foresees no supply disruptions but growing geopolitical risks with an adverse effect on confidence, we expect the euro area to register economic growth of roughly 3/4% this year, which will pick up to 1% next year. For Germany, our baseline scenario put real GDP growth in 2014 and 2015 at 1 1/2% each.

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Household investment behaviour: Still playing it safe

— The financial assets of households rose by close to EUR 200 bn last year and increased by another EUR 55 bn to EUR 5,200 bn or 295% of disposable income by the end of March 2014. Nearly one quarter of the increase in financial assets is attributable to share price gains, the remainder is due to new investments from current savings.

— At first glance, households seem to have become more risk-tolerant. For instance, the share of direct stock holdings has recently risen to just under 6%.

— However, a deeper analysis shows that the increase is only attributable to share price gains. Households even sold stocks worth almost EUR 6 bn last year after they had already reduced their stock positions by EUR 3.5 bn in 2012.

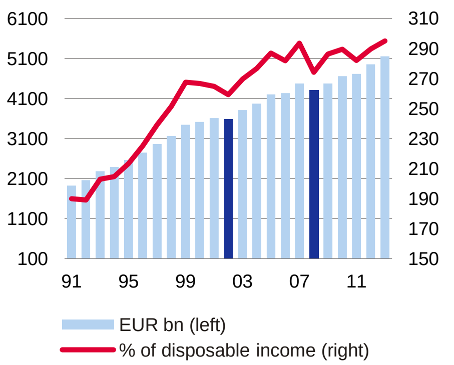
— When it comes to their financial assets, households continue to play it safe.

— Looking at the current stock market development, stock price gains on last year's scale are unlikely. Correspondingly, private financial assets should rise by only roughly EUR 150 bn to EUR 5,300 bn in our view. Thus, the relation to disposable incomes remains almost unchanged at 295%.

Financial assets: Almost continuous rise to EUR 5,200 bn

Private households' financial assets 1

EUR bn (left), % of disposable income (right)



Source: Deutsche Bundesbank

The financial assets of households increased by close to EUR 200 bn last year and continued to rise by almost EUR 55 bn in Q1 2014. Thus, households have financial assets totalling EUR 5,207 bn at their disposal, which equals almost three times their disposable incomes. Following unification, financial assets came to only EUR 1,900 bn or 190% of disposable incomes, respectively. The sharp rise of financial assets since the start of 2013 was mainly due to new investments to the tune of close to EUR 200 bn and share price gains of EUR 50 bn.

The almost continuous increase in private financial assets does not come as a surprise given the savings ratio of households, which had averaged nearly 11% since 1991 and is currently roughly 10%. Last year, households saved EUR 174 bn, obtained asset transfers of a good EUR 2 bn and took out loans of EUR 12 bn. Thus, funds of EUR 188 bn were available to households for the purchase of tangible and financial assets. Households bought tangible assets, including real estate and durable goods, in the amount of a good EUR 40 bn, EUR 148 bn flowed into the formation of financial assets.

Acquisition of assets & financing 2

	2013 EUR bn
Savings	174.2
Transfers of assets	2.3
Net borrowing	11.8
Total funds	188.3
Use of funds	
Acquisition of tangible assets*	40.6
Acquisition of financial assets	147.7

*) Tangible assets = real estate, land for building, durable goods etc.

Source: Deutsche Bundesbank

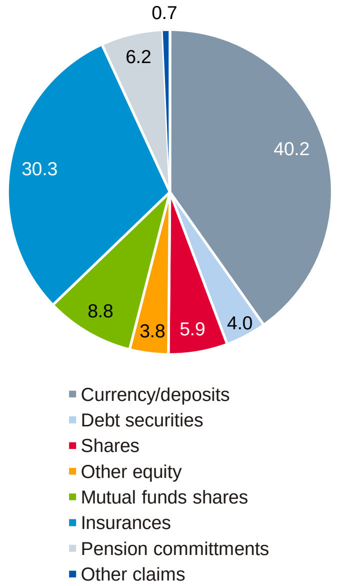
Only in two years, in 2002 and 2008, did private financial assets decline, as the new formation of financial assets from savings was unable to offset the losses on equities and mutual funds. In 2002, after the bursting of the New Economy bubble, and in 2008, in the wake of the financial crisis, stock prices fell dramatically and reduced the worth of private stock and mutual funds holdings by a total of EUR 155 bn (2002) and close to EUR 250 bn (2008), while new formations of financial assets amounted to only EUR 117 bn and EUR 122 bn, respectively.

Financial assets: Concentrated on cash, deposits and insurance

Households hold 40% of their financial assets in the form of cash and risk-free asset classes or types of assets with a very low risk such as deposits at financial

Private households' financial assets by instruments **3**

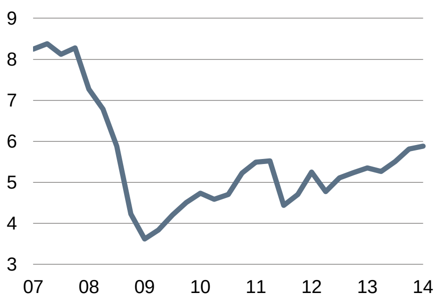
Q1 2014, % of total financial assets



Source: Deutsche Bundesbank

Private households' financial assets: Shares **4**

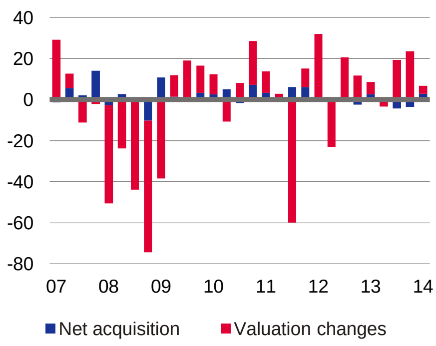
% of total financial assets



Source: Deutsche Bundesbank

Private households' financial assets: Shares **5**

Contribution to changes qoq, EUR bn



Sources: Deutsche Bundesbank, Deutsche Bank Research

institutions. More than half of them are accounted for by savings deposits, savings certificates and term deposits. In addition, 30% of financial assets are invested in insurance; insurance companies therefore continue to be the Germans' favourite investment. By contrast, risk-bearing individual assets (fixed-income securities, stocks, other shares and investment certificates) have a share of only 22.6%.

Are households greater risk-takers again?

At first glance the development of the structure of financial assets shows a surprising picture. For instance, the share of directly held equity assets has – also recently – continued to rise to close to 6% and thus offset almost half the decline that resulted from the financial and euro crisis. German households therefore seem to have become more risk-tolerant again, which would be in contrast to the results of our forecast roughly one year ago, when we noticed a rising risk aversion of households in Germany.[16]

No, directly held stocks were reduced

However, on closer examination the statement above does not hold true. The higher share ratio is only due to an increase in value as a result of the good stock price performance. From the end of 2011 until the end of March 2014, the DAX rose by a good 66% by itself. Private households even sold stocks to the extent of almost EUR 6 bn net last year after they already reduced their stock positions by EUR 3.5 bn in 2012. This reflects the continuing high risk aversion of households despite the favourable labour market and income development as well as potential profit-taking in view of limited expectations of further stock price gains.

Have investors perhaps switched to equity funds?

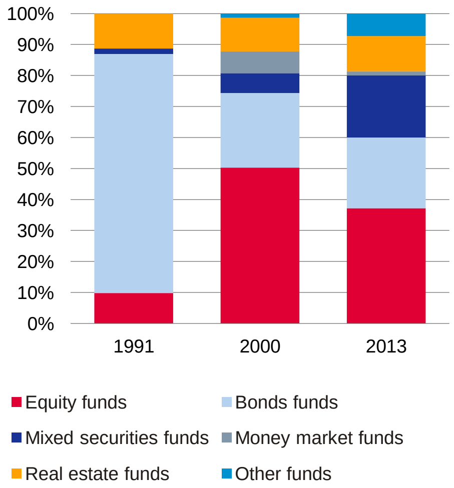
Granted, the Bundesbank's figures we used only illustrate direct equity holdings of households. For instance, households may have invested indirectly in equities via equity funds. In fact, households invested over EUR 20 bn in mutual funds shares (where equity funds belong to) in 2013. After 2005 (EUR 17.7 bn) and 2010 (EUR 10 bn), this was the first substantial inflow into this category since the mid-2000s, while in the other years high outflows reaching almost EUR 100 bn prevailed. However, the Bundesbank does not break down this asset class in its subcomponents. The financial and capital accounts only show the holdings and new investments in investment certificates, the new investments in equity funds are not apparent from these statistics.

Alternative data from the fund statistics of the BVI (German Investment Funds Association) and the Bundesbank statistics on investment companies refer to total funds managed by the German investment sector and the funds consisting of domestic investment management companies and investment stock corporations. Thus, they do not only comprise the fund assets of domestic private households but also of companies and foreign investors. However, the developments described in the statistics should permit valid conclusions on the investment behaviour of German households, for despite the different absolute levels, total sums of the funds invested in mutual funds and investment certificates show very similar developments according to the three sources.

16 See Gräf, B., O. Rakau (2013). Investment behaviour of German households: Markedly higher risk aversion in the course of financial crisis. Deutsche Bank Research. Current Issues. Focus Germany. September 2, 2013

Public funds 6

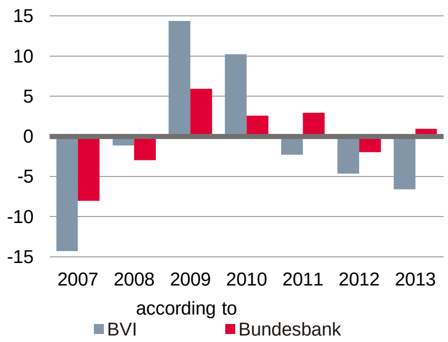
Share



Source: BVI

Acquisition of equity funds 7

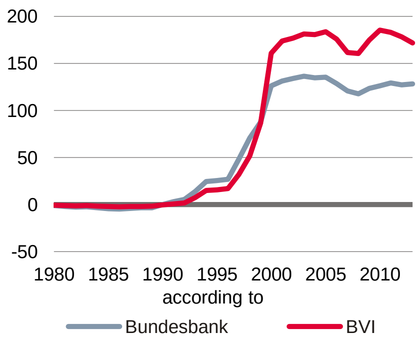
EUR bn



Sources: Deutsche Bundesbank, BVI, Deutsche Bank Research

Acquisition of equity funds 8

Cumulated, EUR bn



Sources: Deutsche Bundesbank, BVI, Deutsche Bank Research

A good one-third of fund assets is invested in equity funds

While in the early 1990s bond funds accounting for 80% of fund assets were dominant, equity funds currently prevail. According to the BVI statistics, 37% of the managed fund assets are held in equity funds. In 2000, at the peak of the dotcom bubble, the share was even as high as 50%. Since about the start of the 2000s, the traditional bond funds have a share of roughly 25%, and open-ended real-estate funds also have a relatively stable share of around 10% in fund assets. By contrast, the share of funds held in money market funds (just below 1.5%) is extremely low, which does not come as a surprise in view of negative short-term rates. From the introduction of money market funds in the mid-1990s until the onset of the financial crisis, their share in fund assets at a real rate of return of just below 2% on average ranged between 10% and 15%.

Investors also avoided equity funds!

Both the BVI and the Bundesbank data do not suggest increased interest in equity funds from German private investors. According to the Bundesbank, a meagre EUR 925 m net flowed into equity funds in 2013; according to the BVI, there were outflows of even as much as EUR 6.6 bn from the equity funds managed from Germany. The picture was similar in the preceding years: for the last three years, the BVI statistics registered cumulative outflows of over EUR 13 bn, whereas the Bundesbank statistics show a cumulative inflow of less than EUR 2 bn.

Going one step further and summing up all net inflows into equity funds, both sources show that German private investors after the dotcom bubble of the early 2000s lost interest in stock investments in the form of funds. During this time – i.e. over almost 15 years – the sum invested stagnated more or less.

Households continue to play it safe

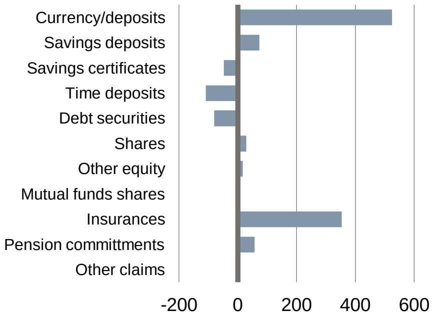
When it comes to investing their savings, households are still playing it safe. Their investment behaviour continues to be marked by a very high risk aversion by international standards. While in the last two years German households reduced financial assets in the form of directly held stocks by a total of close above EUR 9 bn, Spanish households invested a good EUR 30 bn net in equities despite the recession and a catastrophic labour market with an unemployment rate of roughly 25%. Since 2008, Spanish households have invested a total of EUR 50 bn, and thus nearly twice as much in equities as German households, although their disposable income is only a good one-third of that of their German counterparts. Furthermore, the share of directly held stocks in financial assets of Spanish households, at almost 23%, is almost four times as high as in Germany.

However, not only the low fund inflows into stocks do illustrate the strong risk aversion of German households, all other risk-bearing investment instruments were avoided, too. From the onset of the financial crisis to the end of March 2014, households invested a total of close to EUR 820 bn. Of this amount, EUR 525 bn or 64% went into cash and sight deposits at financial institutions and a good EUR 350 bn into insurance products, which in part was also financed by disinvesting from other asset classes.

Since the onset of the financial crisis, households have withdrawn savings bonds totalling EUR 47 bn and term deposits of almost as much as EUR 110 bn. Evidently, households no longer felt sufficiently compensated for giving up instant availability due to the dramatic decline in interest rates and have reduced

Private households: Net aquisition of financial assets 9

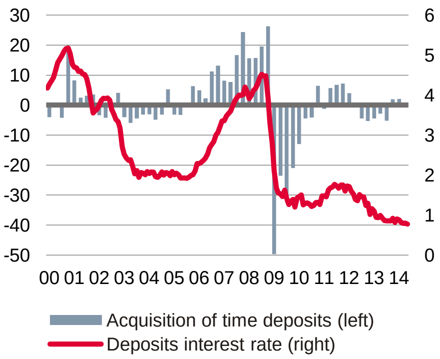
Q3 2008 - Q1 2014, EUR bn
Total: almost EUR 820 bn



Source: Deutsche Bundesbank

Private households' time deposits & deposit s interest rate 10

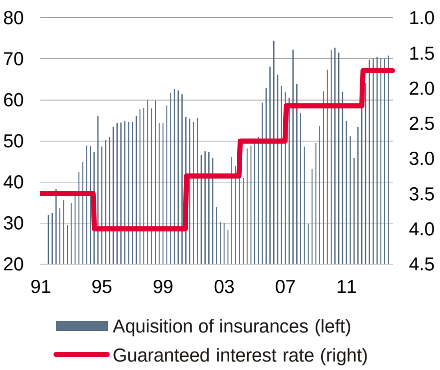
EUR bn (left), % (right)



Sources: Deutsche Bundesbank, ECB

Insurances & guaranteed interest rate 11

bn EUR (4Q mov.sum, left),
% (right, inverted scale)



Sources: Federal Statistical Office, Bafin

these investment forms in favour of cash and sight deposits at financial institutions.

Increase in financial assets expected to flatten

On the basis of our forecast of an increase in disposable incomes of a good 2 ½% households will – with an unchanged savings ratio of 10% – have savings of EUR 178 bn for asset formation as a whole (real and financial assets) at their disposal. Taking into account borrowing and the acquisition of non-financial assets, around EUR 150 bn should flow into financial asset creation in 2014, which roughly corresponds to the order of the previous year. As far as the allocation of funds is concerned, in view of the cut in the guaranteed interest rate from currently 1.75% to 1.25% decided as of the beginning of 2015, above all insurance companies are likely to benefit from pull-forward effects as observed in the event of the cuts in guaranteed interest rates from 4% in 2000 to 2.25% in 2007.

A look at the stock market performance gives no reason for optimism. The DAX is currently slightly down on its year-end level of 2013, so that the value of equity assets of private households should decline slightly. All in all, we expect a further increase in private financial assets in the current year, but it should be flatter than last year. Towards the end of 2014, financial assets will probably thus come to roughly EUR 5,300 bn, which in relation to disposable incomes should hover around 295%.

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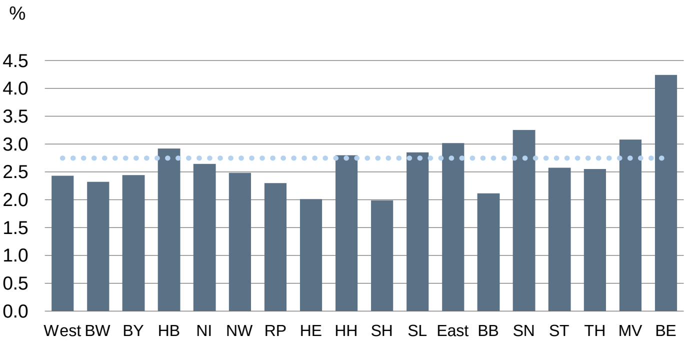
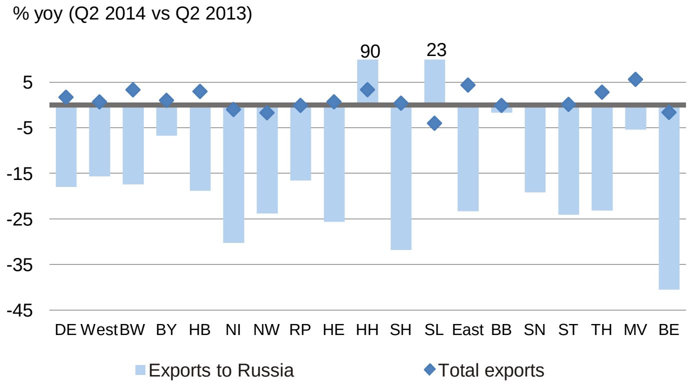
Chart of the month

Share of exports to Russia slightly higher in east Germany



Sources: Federal Statistical Office, Deutsche Bank Research

Ukraine-Russia crisis hits east German exports harder



Sources: Federal Statistical Office, Deutsche Bank Research

Ukraine-Russia crisis hits east German exports harder

The conflict between Russia and Ukraine is becoming an increasing drag on German economic growth, with the latest ramping-up of sanctions against Russian financial, armaments and energy firms suggesting there will be no easing of tensions soon. In the middle of this year total German exports to Russia were down some 20% on the pre-year level. This was also due to the fact that even before the Ukraine conflict Russian economic growth had been slowing down steeply since 2012. It is especially the demand for German cars and machinery that has nosedived. In addition, the increased geopolitical uncertainty combined with the question marks hanging over economic recovery in the eurozone have led some companies to postpone their planned investments. Weak German investment in machinery and equipment in Q2 could be the first indication of this.

With exports to Russia making up around 3% of all Germany's exports the ongoing conflict could cost Germany roughly ¼ of a percentage point of growth, which we forecast will come in at 1 ½% for the current year. Breaking down the declines by region, it is striking that while all the Länder – with the exception of Hamburg and Saarland[17] – have seen some exports dip sharply, it is the east German Länder that have been hit somewhat harder. Although east German exports to Russia have contracted more sharply than those from west Germany and their share of total exports is somewhat higher the negative growth effect in both regions of Germany is probably roughly the same because the east German Länder are less open[18], i.e. foreign trade is less important for the economy.

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Marcel Engelhardt

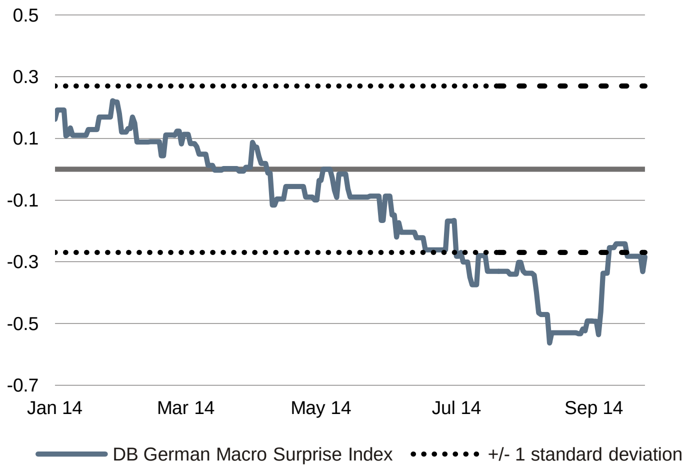
[17] The positive growth figures are according to the goods classification system due to an above-average increase in exports of metals (SL) and other vehicles (HH). All other goods categories were also contracting or recorded only minimal increases.
[18] This was only 21% in west Germany compared with 34% in east Germany.

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.[19]

DB German Macro Surprise Index

Average of last 20 z-scores of data surprises

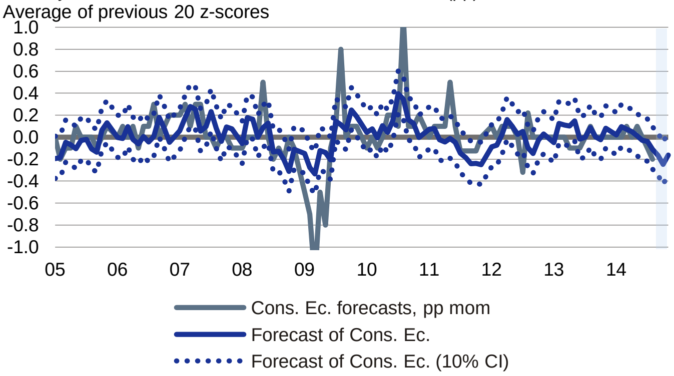


Values above (below) 0 indicate the data came in better (worse) than expected

Sources: Bloomberg Finance LP, Deutsche Bank Research

DB German Macro Surprise Index: Downside-risks for 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
GRCAEU Index	Current Account Balance (EUR bn)	6 2014	08.08.14	17.2	18.5	-1.3	-0.8	0.2
GRZEWI Index	ZEW Survey Expectations	8 2014	12.08.14	8.6	17.0	-8.4	-1.0	0.1
GRZECURR Index	ZEW Survey Current Situation	8 2014	12.08.14	44.3	54.0	-9.7	-1.5	0.0
GRCP20YY Index	CPI (% yoy)	7 2014	13.08.14	0.8	0.8	0.0	0.3	0.4
GRIFPBUS Index	IFO Business Climate	8 2014	25.08.14	106.3	107.0	-0.7	-0.7	0.2
GRIMP95Y Index	Import Price Index (% yoy)	7 2014	27.08.14	-1.7	-1.4	-0.3	0.1	0.5
GRUECHNG Index	Unemployment Change (000's mom)	8 2014	28.08.14	2.0	-5.0	-7.0	-0.5	0.3
GRFRIAMM Index	Retail Sales (% mom)	7 2014	29.08.14	-1.1	0.1	-1.2	-0.7	0.2
MPMIDEMA Index	Markit Manufacturing PMI	8 2014	01.09.14	51.4	52.0	-0.6	-0.9	0.1
GRGDPPGQ Index	GDP (% qoq)	6 2014	01.09.14	-0.2	-0.2	0.0	-0.1	0.4
MPMIDESA Index	Markit Services PMI	8 2014	03.09.14	54.9	56.4	-1.5	-1.5	0.0
GRIORTMM Index	Factory Orders (% mom)	7 2014	04.09.14	4.6	1.5	3.1	1.3	0.9
GRIPIMOM Index	Industrial production (% mom)	7 2014	05.09.14	1.9	0.4	1.5	1.3	0.9
GRCAEU Index	Current Account Balance (EUR bn)	7 2014	08.09.14	21.7	14.0	7.7	2.0	1.0
GRCP20YY Index	CPI (% yoy)	8 2014	11.09.14	0.8	0.8	0.0	0.3	0.4
GRZEWI Index	ZEW Survey Expectations	9 2014	16.09.14	6.9	5.0	1.9	0.2	0.7
GRZECURR Index	ZEW Survey Current Situation	9 2014	16.09.14	25.4	40.0	-14.6	-2.1	0.0
MPMIDEMA Index	Markit Manufacturing PMI	9 2014	23.09.14	50.3	51.2	-0.9	-1.4	0.1
MPMIDESA Index	Markit Services PMI	9 2014	23.09.14	55.4	54.6	0.8	0.9	0.8
GRIFPBUS Index	IFO Business Climate	9 2014	24.09.14	104.7	105.8	-1.1	-1.0	0.1

Sources: Bloomberg Finance LP, Deutsche Bank Research

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

Chartbook – Total economy

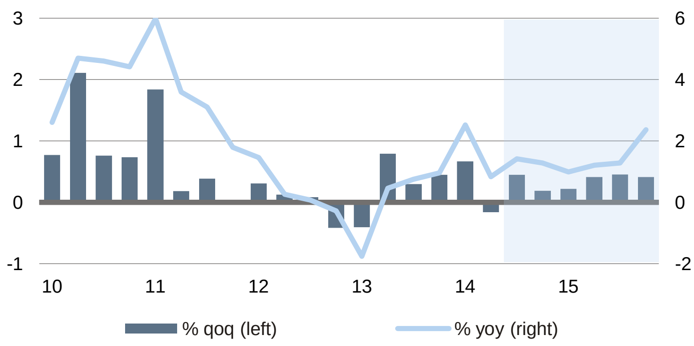
— The 0.2% qoq Q2 2014 GDP decline showed a much bigger payback for the strong Q1 (+0.7%) than expected. This distinctive quarterly profile is – mostly but not only – due to the mild winter that boosted Q1 construction (+4.1%). With the usual spring acceleration not materialising the seasonal adjustment caused a big decline in Q2 (-4.2%). Private consumption corrected after its Q1 surge (+0.1% qoq vs +0.8%), which was probably in part due to a lump-sum payment in the large retail sector in January. In H1 domestic demand was the only contributor to growth. In contrast, net exports were a drag in Q1 and Q2 (each -0.2 pp).

— We will probably see a rise in German GDP in Q3. This is being bolstered by the positive surprises provided by real economic indicators at the start of Q3. However, this is in part due to one-off items, e.g. shortening/shifting of the holiday shutdown period at the major automakers' factories. Sentiment indicators have trended downwards in recent months. At the current level, however, sentiment indicators point towards growth of about ½% qoq in Q3.

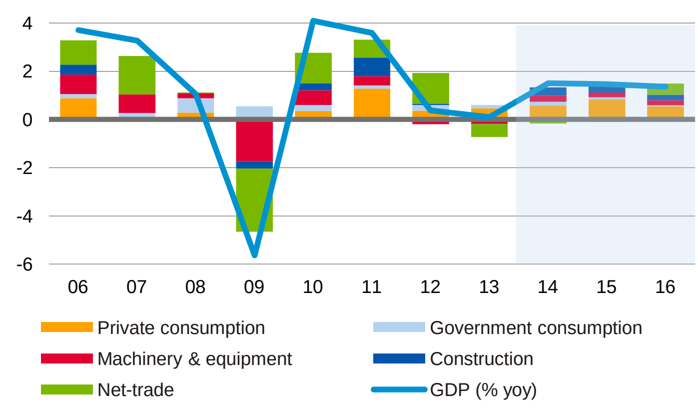
— Sentiment is coming under increasing pressure from the ongoing geopolitical risks (above all the Ukraine-Russia crisis) and the question marks hanging over the expected cyclical upturn, especially given the sluggish pace of reform in several eurozone countries. Disappointing economic performance in France (9% of Germany's total exports in H1 2014) and Italy (5% of exports) as well as the slump in exports to Russia (3% of exports) are weighing more and more heavily on German exports. In this uncertain environment companies are likely to focus on the near term and postpone some of their planned investments, which means that investment in machinery and equipment will probably turn out lower than hitherto expected.

— On account of these factors we have scaled back our growth forecast for the winter half-year 2014/2015 to an average of 0.2% qoq. This does not, however, alter our GDP forecast for the full-year 2014; it remains at 1.5%. Our forecast for 2015 is scaled back from 1.8% to 1 ½%.

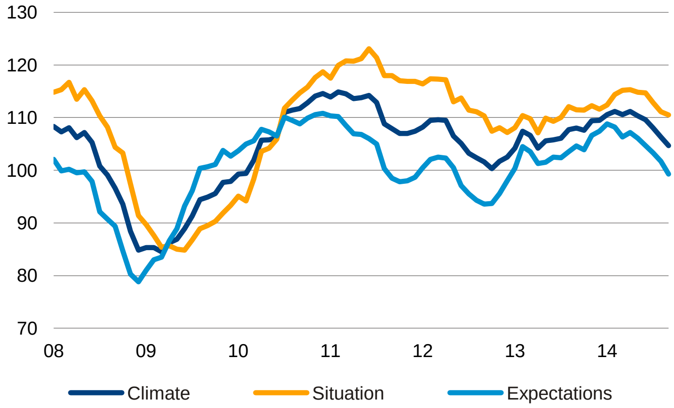
Real GDP growth



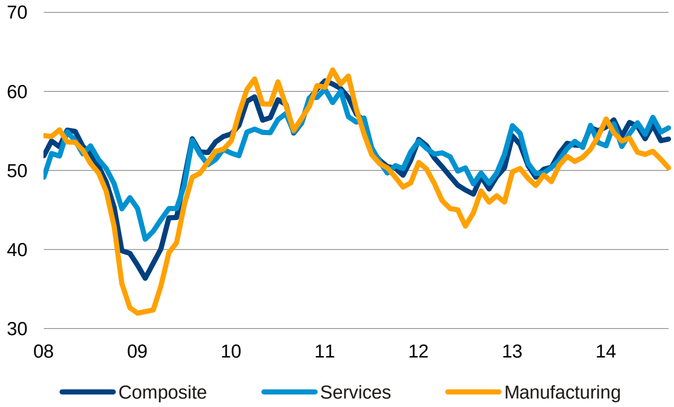
Contribution to real GDP growth (%-points)



ifo index - total economy (2005=100)



Purchasing managers' index



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

Chartbook – Foreign trade

— Foreign trade surprised strongly to the upside recently and is a clear sign for the rebound of German growth in Q3. Exports jumped 4.8% yoy in July (all 3M mov. avg.). Imports developed unimpressively, which was probably partly due to weak commodity prices (+0.9%). Therefore, the trade surplus reached a new all-time-high of EUR 22 bn in July.

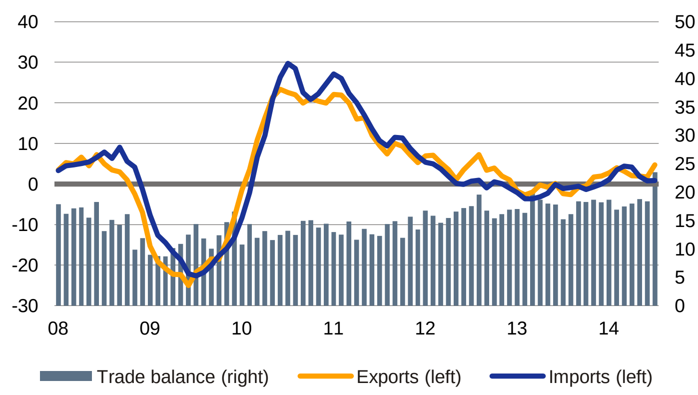
— Demand for German goods increased across all major regions, but especially strong from Asia (+10.1% yoy) and the US (+9.8% yoy). Exports to EMU were up 3.7% yoy.

— It was foremost the recovery in automobile exports (July: +9.4% yoy) – boosted by the shortening/shifting of the holiday shutdown period at the major automakers' factories – that drove the increase in exports. By contrast, the other German export engine, mechanical engineering, was stuttering (-1.0% yoy). Foreign demand in the metal industry (-2.6% yoy) remained weak.

— Leading external trade indicators trended down recently. Ifo export expectations dropped to the lowest level since the beginning of 2013 and PMI new export orders fell to 50.8 in September. The unresolved Ukraine-Russia crisis will probably continue to dampen German exports during the rest of the year. However, the expected acceleration of global trade, thanks to a pick-up of global growth in H2 driven mainly by strong US growth and a moderate acceleration of growth in China, should overcompensate that. Additionally, exports should gradually benefit from the weaker EUR. We expect a moderate recovery of exports during the rest of the year with risks to the downside. Imports will probably grow relatively strong thanks to solid domestic demand. Therefore, net exports will probably dampen GDP growth in 2014 (1.5% in 2014F; net exports growth contribution: -0.2 pp).

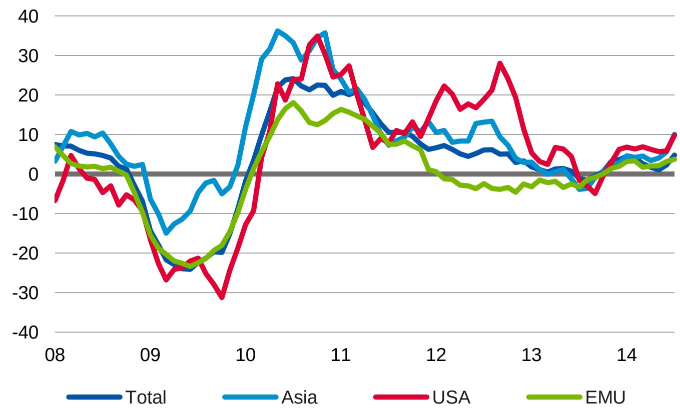
Merchandise trade

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



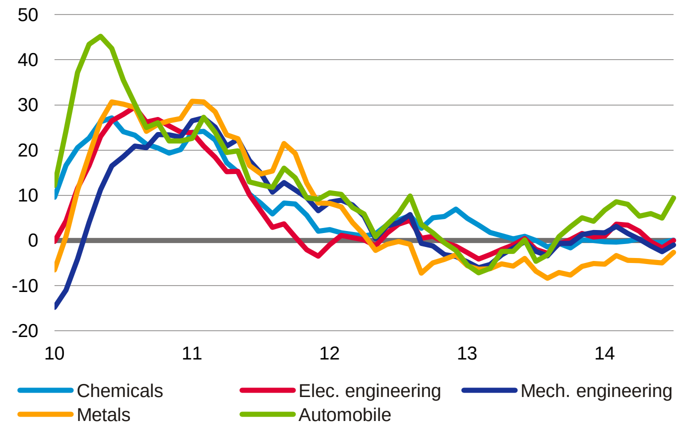
German exports by region

% yoy, 3M mov. avg.



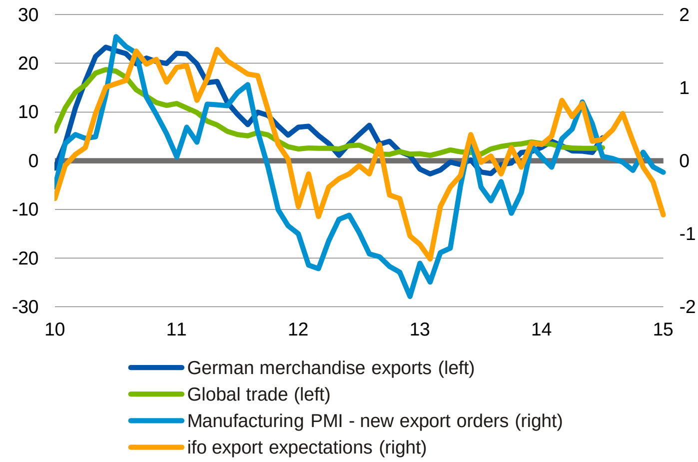
Exports by sector

% 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

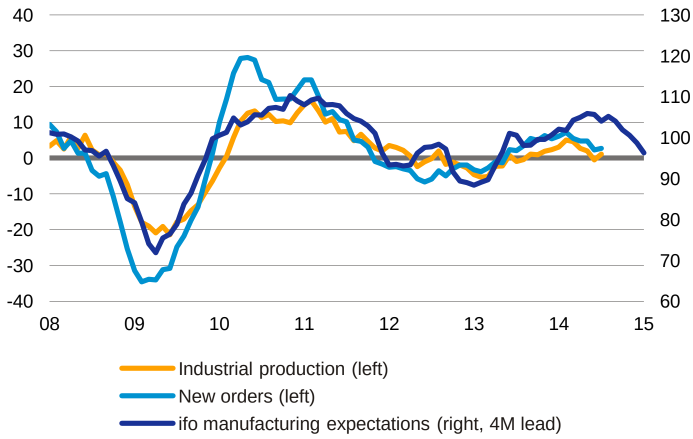
— As exports, industrial production growth surprised to the upside in July (July: +1.1% yoy; 3M mov. avg.). However, this brings the production level only back to where it was early-2014 and underlying production momentum is overstated as about half of the production increase came from a near 12% mom surge of auto production in July. This is a result of the large German car producers postponing/cancelling their usual July/August factory vacations. This had further knock-on effects on the auto sector's suppliers, which also saw strong increases. With the VDA having already reported that August car production was down 30% yoy substantial payback for industrial production is to be expected in August.

— The ifo index and the PMIs for the manufacturing sector have fallen further in the last few months and suggest that industrial growth should be weak in H2 with some downside risks.

— We still expect industrial production – with significant downside risks – to increase by 2.5% yoy in 2014. The large industrial sectors are characterised by a heterogeneous development. The automobile industry should achieve the highest growth rate in 2014. We still expect an increase of 5% in real terms thanks to a strong H1, but risks are clearly to the downside given the geopolitical crises. Production in the mechanical engineering industry is likely to stagnate at best. More than others, the sector feels the consequences of the Ukraine crisis. The crisis has also dampened business sentiment in Germany which negatively affects propensity to invest. Domestic production in the electrical engineering industry and the metal industry could grow 3%. The chemical sector, however, could see domestic production decline by 2% after disappointing results in the first half of 2014. The food industry – a very stable sector as it is – could see production stagnating in 2014. In 2015, manufacturing output in Germany should expand by about 2% in real terms.

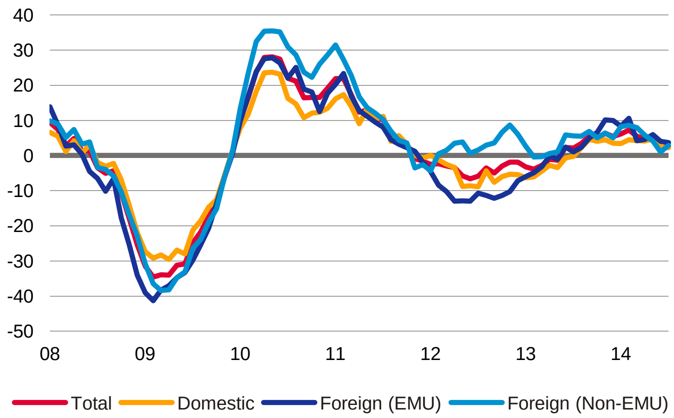
Industrial production, new orders & ifo expectations

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

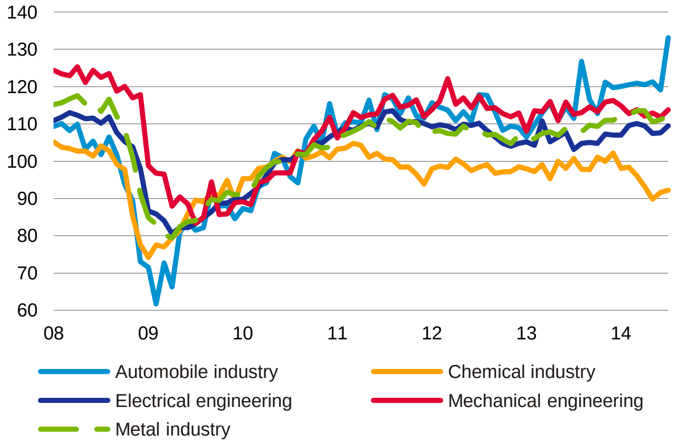


New manufacturing orders by region

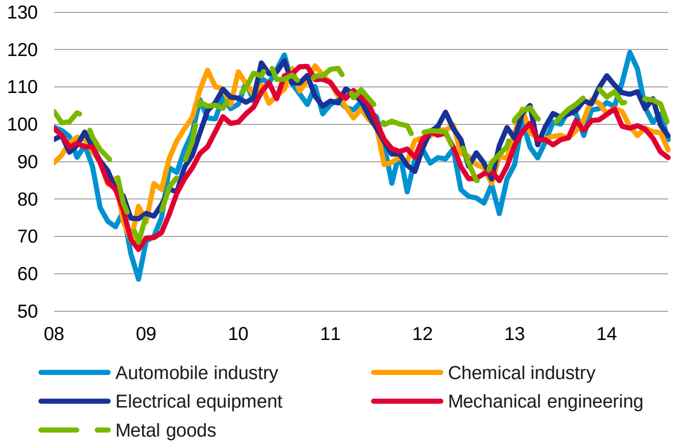
% yoy, 3M mov. avg.



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



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



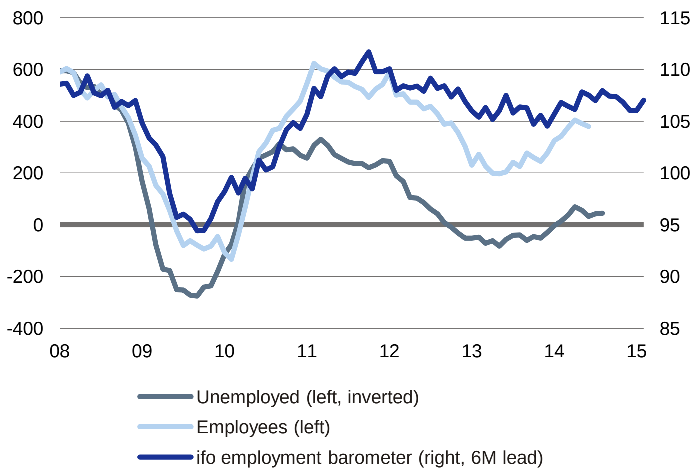
Sources: Federal Statistical Office, ifo

Chartbook – Domestic economy

- In August unemployment rose by 2k mom after it had fallen by 12k in July. The increase of unemployment by a total of 30k in the two months before that, thus, really seems to have been due to lack of a spring recovery a result of the mild winter. In the first 8 months of the year unemployment fell by 7k on average. Thanks to strong immigration flows and rising participation employment rose by a much stronger 37k on average. 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%).
- Retail sales were up 1.0% yoy in July (3M mov. avg.). Sales growth weakened somewhat over the last few months. The assessment of the business cycle in the consumer climate markedly weakened recently. This is probably the result of the geopolitical risks but it might overstate short term risk to consumption growth, given positive income dynamics.
- After weakness in 2013 investment in M&E and construction spending should moderately contribute to growth again this year. Domestic investment goods orders and capacity utilization currently do not point to a further acceleration in the remainder of 2014. Investment in M&E should still rise by almost 4% (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 ½% in real terms in 2014 (2013: -0.1%).

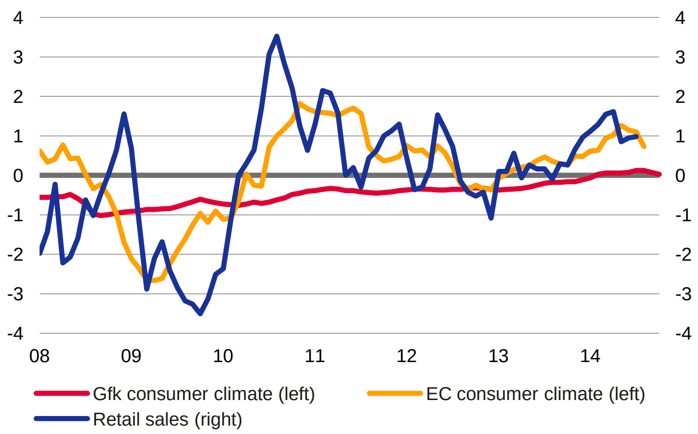
Unemployment barometer, employment and unemployment

'000 yoy (left); index (right)



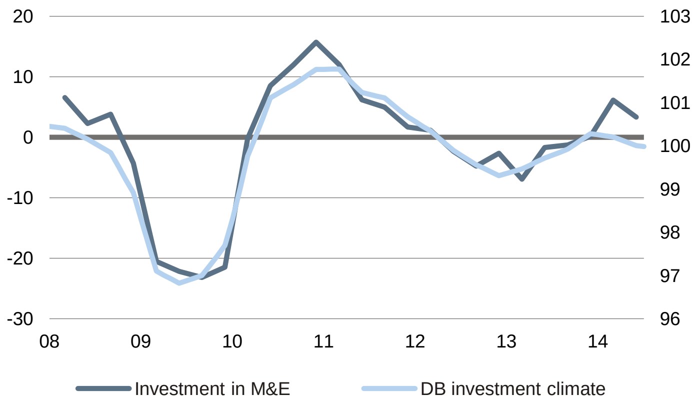
Retail sales and consumer confidence

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



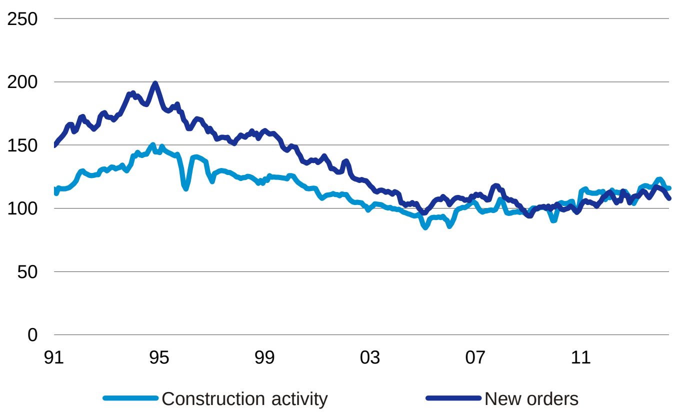
Investment in machinery & equipment & DB investment climate index

% 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

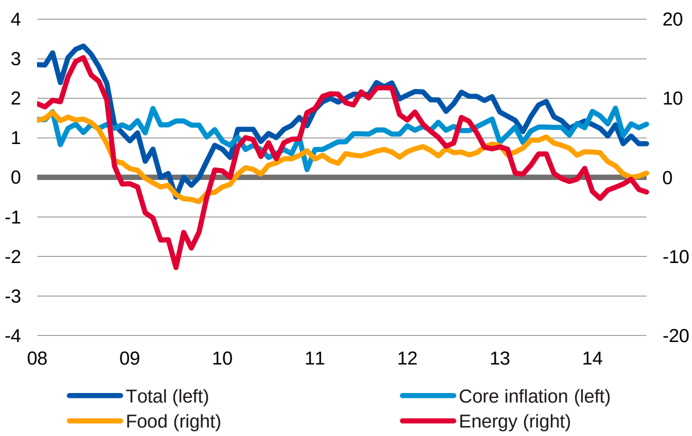
Chartbook – Financial markets

— According to the preliminary data for September inflation stood at 0.8% yoy. A small increase in food prices (September: +0.9% yoy, +0.3% prev.) has partly compensated for the stronger fall in energy prices (-2.2% yoy vs. -1.9% prev.). Core inflation amounted to 1.2% yoy in September after some volatility earlier in the year. While the downtrend in oil prices is set to dampen energy inflation, the food producers' price expectations suggest that food inflation could pick up further in the coming months.

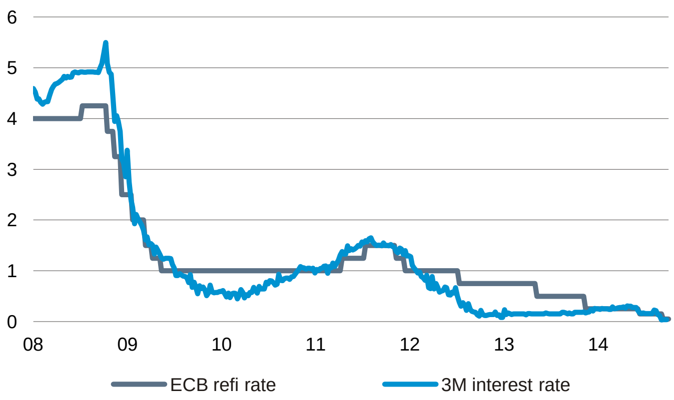
— After announcing a package of measures – e.g. rate cut, cheap term funding for banks (TLTRO) – in June, the ECB became more expansionary again in September. Fearing a negative feedback loop between declining current inflation, a disanchoring of inflation expectations and still weak banking system restricting the supply of credit, the ECB decided to start purchasing non-financial private sector assets under an ABS purchase programme (ABSPP) and under a new covered bond purchase programme (CBPP3). Additionally, the refi rate was lowered to 0.05% and the deposit rate to -0.2. 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 balance sheet target of EUR 1 trillion. Therefore we expect the ECB to initiate "broad-based asset purchases", which should include government bonds, within the next six months.

— Given diverging interest rates and growth expectations for EMU and the US, the yield spread between 10Y US treasuries and German Bunds has widened further to over 150pp as of late.

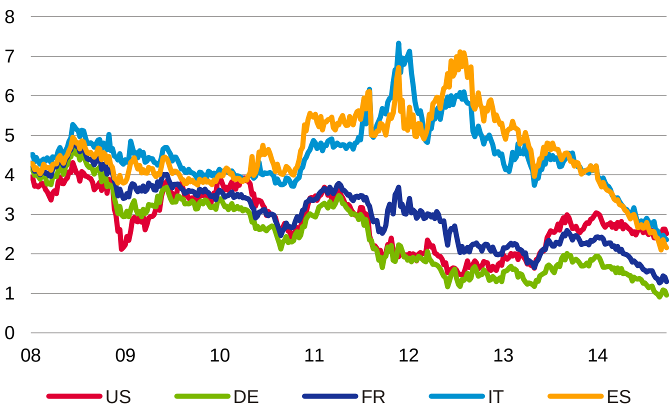
Consumer prices (% yoy)



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

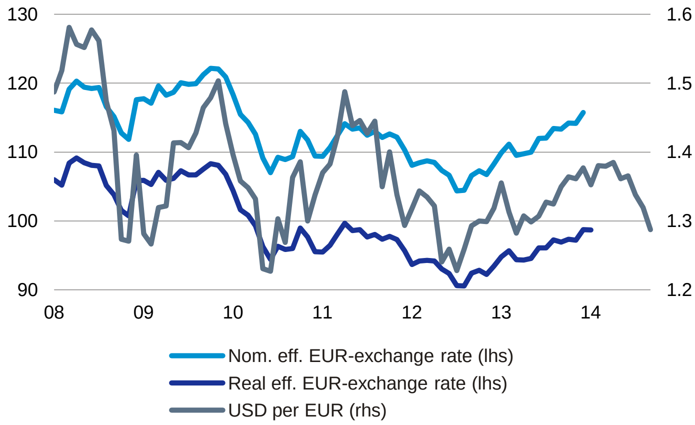


10Y government bond yields (%)



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

— Lending to corporates remained weak in 2013 with the declines being more pronounced in the eurozone than in Germany. While reductions in Germany reflect a mix of modest investment activity and firms' use of alternative means of financing, the drop in the eurozone is to a large extent the result of ongoing deleveraging processes. During 2014, shrinking processes have become somewhat less pronounced in the eurozone. With -2.6% yoy, August records the smallest reduction since the start of the year. Also, recent Bank Lending Survey results for the eurozone show increasing net demand for corporate credit and the first net easing of credit conditions since Q2 2007. Credit to corporates in Germany shows signs of stabilization in Q2 with mustering marginal yoy increase (August: +0.2% yoy).

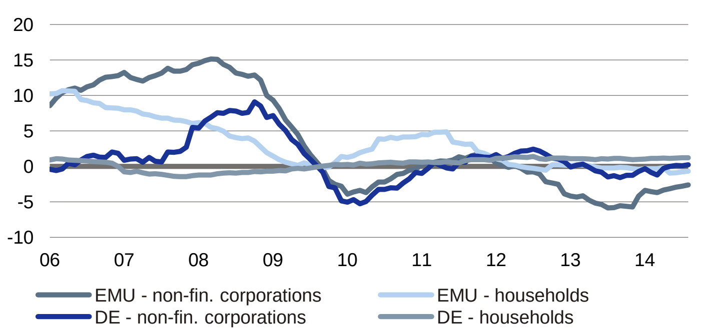
— Household deleveraging in the eurozone continues weighing on new borrowing (August: -0.7% yoy). By contrast, lending to households in Germany continues to rise (August: +1.2%).

— The moderate credit growth in Germany is solely driven by mortgage lending. July +2% yoy and is in line with developments in the first half of the year. Given the low level for mortgage rates (further drop in July to 2.5%), credit growth remains rather modest, which partly reflects portfolio shifts by households and local supply shortages. Consumer credit remained restrained (July: -1.8% yoy) also reflecting rising incomes reducing the need to finance consumption via credit for many households.

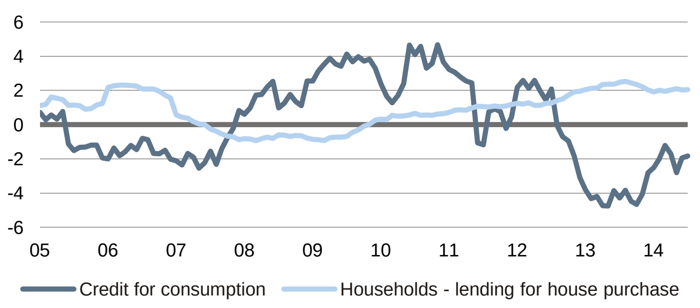
— Interest rates for corporate credit decreased by 15 bps to about 2.8% in July. With key official rates at new historic lows (further decrease to 0.05% in September), favourable interest rates for German companies persist.

— Credit conditions for German corporates continues to be very favourable, even further improving in August: only 20.9% of construction companies (down from 22.7% in July) and some 17.8% of companies from industry and trade (down from 18.2% in July) report restrictive access to credit. On balance, alternative financing options of enterprises continued to dampen corporate loan demand though to a lower extent most recently.

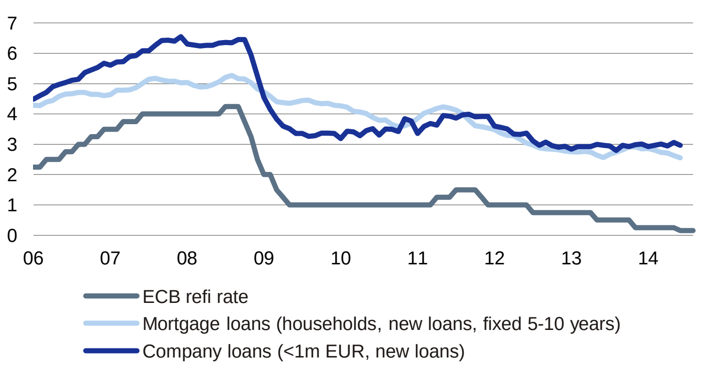
Lending to the private sector (% yoy)



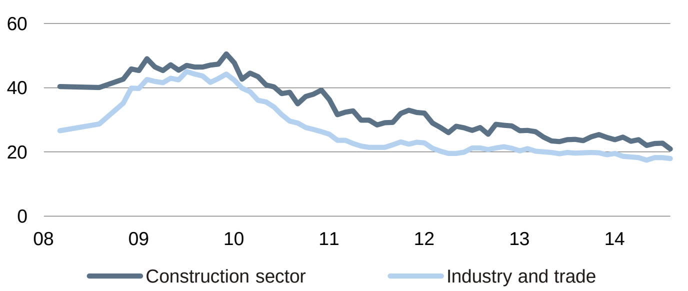
Loans to households (% yoy)



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

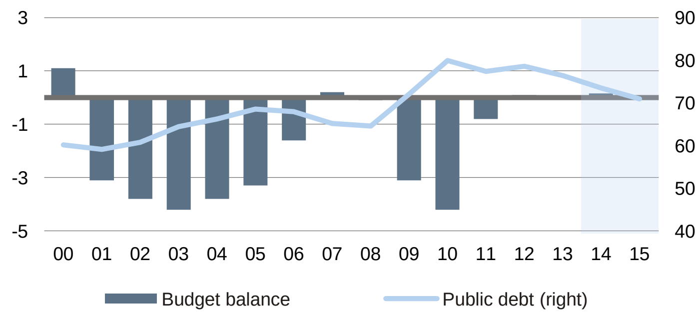
— In 2013 the general budget only edged into the black thanks to the surpluses generated by the municipalities and the social-security scheme. The general budget for 2014 is also projected to close with a small surplus. But in 2015 the budget situation is set to deteriorate due to now weaker than expected 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 small deficit. The German public debt ratio stood at 77.3% of GDP at the end of Q1 2014 (Q4 2013: 78.4%). In addition, refinancing costs continue to remain low. Public 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 August, total tax revenues climbed by 3.7% yoy. From January until August, total tax revenues were about 2.7% higher than in the same period a year earlier (and thus currently still below the forecast for the whole year [3.4%]). Hence the solid growth of tax revenues continues. Income tax is a major contributor to this development. On a cumulative basis it is over 4% higher than in the same period last year. However, the components of income tax develop differently. The highly profit-dependent taxes like corporation tax, the final withholding tax on interest income and the non-assessed tax on earnings are lower on a cumulative basis. By contrast, wage tax, the most important component, is much higher.

— The government formation process has not yet been completed in Saxony (SN), Brandenburg (BB) and Thuringia (TH). At the moment there is much to suggest that in SN and TH there will by a grand coalition made up of the CDU and the SPD (as at the federal level) and that in BB another SPD/Left government will be formed. If these details remain the same, then the grand coalition will still be without a majority in the Bundesrat. If a CDU/SPD government would be formed in BB then it could have a majority of one vote. All the same, such a majority given the different government combinations and the diverging interests of the federal and Länder governments would provide anything but a guarantee for Chancellor Merkel to govern as she pleases. The eurocritical party Alternative für Deutschland (AfD) is entering all three regional parliaments – in each case with a comfortable share of the votes of around 10%. In the latest polls it is now also attracting this degree of support at the federal level, which is, however, not exceptional immediately after achieving electoral success. Next year only the two city-states will be holding elections. As such, the influence of the AfD on federal politics will remain limited – for now.

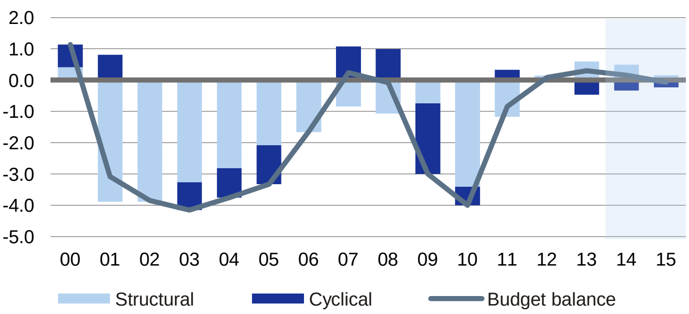
Public debt and budget balacnce

General government, as % of GDP



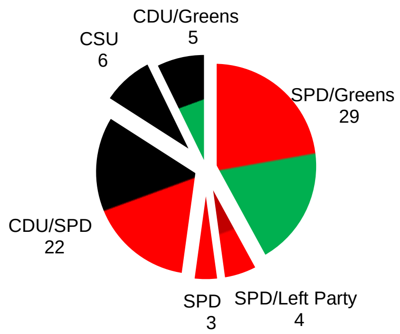
Budget balance

General government, % of GDP



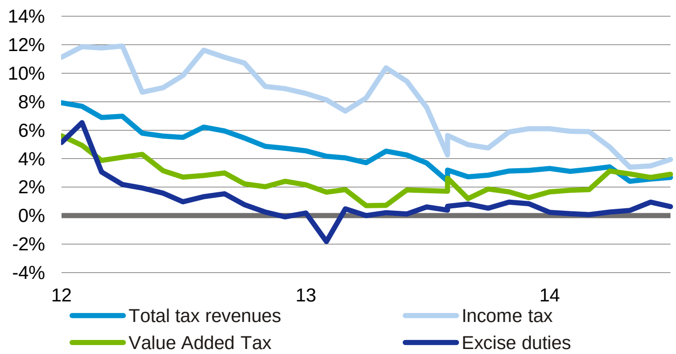
Distribution of seats in the Bundesrat

69 seats in all, assumption: CDU/SPD in SN und TH, SPD/Left in BB



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
2 Oct	Meeting of the ECB Council in Rome, press conference	Review of the monetary policy stance. The ECB is due to announce the technical modalities of its planned ABS and covered bond purchase programmes after the press conference.
13/14 Oct	Eurogroup and ECOFIN, Luxembourg	Discussion and review of the fiscal stance of euro area countries against the need for public investment.
23/24 Oct	European Council	EU leaders meet in Brussels – official agenda tbd.
October (second half)	ECB comprehensive bank assessment results	ECB due to publish the results of the comprehensive assessment of around 128 largest euro area banks, comprising an asset quality review and stress test. Banks facing a shortfall will be requested to submit capital plans within two weeks, which will then be evaluated by the SSM.
4 Nov	ECB assumes Single Supervisor role	Following the publication of the results of comprehensive assessment exercise and 12 months after the SSM regulation came into force the ECB will assume its full supervisory tasks over the largest 128 Euro area banks.

Source: Deutsche Bank Research

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Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast		Last value	
6 Oct 2014	8:00	New orders manufacturing (Index, sa), pch mom	August	-5.2		4.6	
7 Oct 2014	8:00	Industrial production (Index, sa), pch mom	August	-2.0		1.9	
9 Oct 2014	8:00	Trade balance (EUR bn, sa)	August	18.6		23.5	
9 Oct 2014	8:00	Merchandise exports (EUR bn, sa), pch mom (yoy)	August	-3.1 (4.0)		5.3 (8.8)	
9 Oct 2014	8:00	Merchandise imports (EUR bn, sa), pch mom (yoy)	August	2.4 (1.5)		-0.4 (-0.6)	
23 Oct 2014	9:30	Manufacturing PMI (Flash)	October	50.0		50.3	
23 Oct 2014	9:30	Services PMI (Flash)	October	55.5		55.4	0.0
27 Oct 2014	10:30	ifo business climate (Index, sa)	October	104.0	0.0	104.7	0.0
14 Nov 2014	8:00	Real GDP (Index, sa), % qoq	Q3 2014	0.4	0.0	-0.2	0.0

Sources: Deutsche Bank 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	0.125	0.10	0.05	0.50	0.00	0.25	0.20	1.50	2.50	2.10	0.05
Dec 14	0.125	0.10	0.05	0.50	0.00	0.25	0.20	1.50	2.00	2.10	0.05
Mar 15	0.250	0.10	0.05	0.75	0.00	0.25	0.20	1.50	2.00	2.10	0.05
Sep 15	1.000	0.10	0.05	1.00	0.00	0.25	0.20	1.50	2.25	2.60	0.05
3M interest rates, %											
Current	0.23	0.21	0.08	0.56							
Dec 14	0.35	0.20	0.10	0.55							
Mar 15	0.35	0.20	0.10	0.75							
Sep 15	1.30	0.20	0.10	1.00							
10Y government bonds yields, %											
Current	2.54	0.52	0.92	2.46	0.56	1.48	1.23	2.30			
Dec 14	2.80	0.60	1.30	3.00	0.70	1.75	1.50	2.75			
Mar 15	2.90	0.65	1.40	3.10	0.80	1.90	1.60	2.93			
Sep 15	3.15	0.80	1.60	3.30	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	1.27	108.53	0.78	1.63	1.21	9.18	7.44	8.17	4.17	311.51	27.53
Dec 14	1.30	112.00	0.78	1.67	1.27	8.70	7.46	7.90	4.15	325.00	27.00
Mar 15	1.25	114.00	0.77	1.62	1.27	8.64	7.46	7.80	4.08	324.50	27.00
Sep 15	1.19	118.00	0.76	1.56	1.27	8.52	7.46	7.60	4.03	323.50	27.00

Sources: Bloomberg, Deutsche Bank

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German Data monitor

	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Apr 2014	May 2014	Jun 2014	Jul 2014	Aug 2014	Sep 2014
Business surveys and output											
Aggregate											
Ifo business climate	107.3	108.8	110.8	110.4	106.3	111.2	110.3	109.6	108.0	106.3	104.7
Ifo business expectations	103.5	106.0	107.8	106.0	101.4	107.2	106.1	104.7	103.3	101.7	99.3
PMI composite	52.9	54.5	55.4	55.2	54.5	56.1	55.6	54.0	55.7	53.7	54.0
Industry											
Ifo manufacturing	102.8	104.5	106.8	106.5	102.2	107.4	106.8	105.2	103.6	102.2	100.7
PMI manufacturing	51.2	52.9	55.0	52.8	51.4	54.1	52.3	52.0	52.4	51.4	50.3
Headline IP (% pop)	0.7	0.5	1.1	-1.5		-0.2	-1.6	0.4	1.9		
Orders (% pop)	1.6	2.2	0.1	-0.4		3.2	-1.7	-2.7	4.6		
Capacity Utilisation	83.2	83.2	83.4	84.3	84.0						
Construction											
Output (% pop)	1.3	-0.5	5.1	-6.0		-3.4	-2.3	3.3	-0.6		
Orders (% pop)	-1.3	3.4	1.6	-4.8		3.9	-4.9	-7.7	7.4		
Ifo construction	120.5	121.2	122.6	120.5	119.1	120.6	120.3	120.5	119.4	119.5	118.4
Services											
PMI services	52.6	54.1	54.0	55.1	55.7	54.7	56.0	54.6	56.7	54.9	55.4
Consumer demand											
EC consumer survey	-3.2	-2.8	0.3	4.3		3.1	5.5	4.3	3.9	0.3	
Retail sales (% pop)	-0.3	0.1	1.5	-0.4		-0.5	-0.3	1.1	-1.1		
New car reg. (% yoy)	-1.4	1.6	2.8	-0.3		-3.6	5.2	-1.9	6.8	-0.4	
Foreign sector											
Foreign orders (% pop)	0.7	3.9	-1.3	0.0		4.9	-1.2	-3.4	6.9		
Exports (% pop)	0.3	1.8	-0.1	0.3		2.6	-0.3	0.2	5.3		
Imports (% pop)	2.5	-0.2	0.8	-0.5		2.5	-1.5	0.8	-0.4		
Net trade (sa EUR bn)	49.8	55.1	53.0	55.1		18.0	18.8	18.4	23.5		
Labour market											
Unemployment rate (%)	6.8	6.9	6.8	6.7		6.7	6.7	6.7	6.7	6.7	
Change in unemployment (k)	-0.3	12.3	-46.3	-18.7		-26.0	24.0	7.0	-11.0	1.0	
Employment (% yoy)	0.6	0.5	0.7	0.8		0.8	0.8	0.8	0.8		
Ifo employment barometer	106.3	107.2	107.5	106.8		107.4	106.9	106.1	106.0	107.0	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.7	1.3	1.0	0.9		1.1	0.6	1.0	0.8	0.8	
Core HICP (% yoy)	1.2	1.1	1.1	1.1		1.4	0.7	1.1	1.2	1.2	
Harmonised PPI (% yoy)	-0.3	-0.7	-1.0	-0.8		-0.9	-0.8	-0.7	-0.8	-0.8	
Commodities, ex. Energy (% yoy)	-12.2	-10.4	-11.1	-4.9		-5.8	-5.4	-3.5	-3.0	-1.3	
Oil price (USD)	110.4	109.3	108.2	109.7		107.7	109.6	111.8	106.9	101.6	
Inflation expectations											
EC household survey	26.2	25.5	22.0	16.9		18.0	18.1	14.6	15.3	14.8	
EC industrial survey	2.8	6.1	5.6	2.3		2.5	1.9	2.6	3.3	4.1	
Unit labour cost (% yoy)											
Unit labour cost	1.5	1.4	0.9	2.1							
Compensation	1.9	2.0	2.8	2.5							
Hourly labour costs	1.4	2.2	1.0	2.4							
Money (% yoy)											
M3	2.5	2.7	3.5	4.2		3.7	4.4	4.2	4.4	5.0	
M3 trend (3m cma)						3.8	4.1	4.3	4.5		
Credit - private	-4.0	-3.1	-3.6	-3.5		-3.4	-3.2	-3.5	-2.8		
Credit - public	-17.7	-17.1	-1.5	9.7		-8.4	-2.3	9.7	11.4		

% 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

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