

Rising momentum of exports stabilising upturn



The world economy continues to point upwards. German exports are increasing on the back of expanding world trade. The leading emerging countries of Asia and Latin America are contributing significantly to these developments. The economic upturn in these countries is increasingly self-sustaining, as economic stimu-

lus packages combine with rising investment and higher private consumption to fuel growth. Despite the recession-induced weak domestic demand in Germany, GDP growth of between 1.5 and 2 % is still within reach. After the harsh winter, construction should pick up again this spring and manufacturers' order books have continued to fill up since the start of the year.

However, the return to pre-recession levels is a long, hard road strewn with risks: though unlikely, setbacks on the job market cannot be ruled out. Prices for key commodities are rising steadily. Access to finance remains difficult and

threatens to further complicate the recovery, while public budgets are having to shoulder increasing burdens.

Despite these latent risks, the prospects for economic growth in Germany are good. There have not, so far, been any major setbacks on the financial markets and the first steps to reform the global financial system have been initiated. Top priority for economic policy must be a strategy to consolidate public budgets and unleash the drivers of growth. The goal of this dual strategy must be to lead Germany onto a path of sustainable higher growth.

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German Economy



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Foreign Economic Report



Export remains main pillar of German growth

Result of quality products and competitive companies

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World Economy

Recovery trend continues

The upturn in the world economy has continued during the spring of 2010. Both the OECD and the IMF predict a dynamic upward trend. The South-East Asian countries are showing the strongest growth. Though initially prompted by national economic stimulus programmes, the upturn here is increasingly self-sustaining with higher consumption and investments, developments which are serving to fuel global growth.

The **US** remains the unchallenged global engine of economic growth. Key indicators here also point to an upturn, buoyed by monetary and fiscal initiatives. Though unemployment at 9.7 % is still high, it is on the decrease. Private consumption, the main pillar of the US economy, is rising and consumer confidence showed an unexpected surge in March 2010. In view of the large production gap, inflation risks and US interest rates look set to stay on a low level for the time being.

Japan is also sending out positive signals. Stimulus packages have fuelled private consumption and net exports are rising. For the first time in almost two years, private investments also increased. GDP grew 1.1 % in the fourth quarter. Japan's close links to the economies of China and South-East Asia make a sustainable recovery increasingly likely.

The **Eurozone** is also feeling the upwind, though at a below-average rate. In Q4 2009, GDP was up 0.1 % (Q3 2009: 0.4 %). But the risks are still there. While the upturn is stabilising in Germany, France and Italy, Ireland and Spain are still suffering from the direct consequences of the financial crisis. At 19 %, Spain has the highest rate of unemployment in the entire Eurozone. On top of that, with macroeconomic problems intensifying in Greece, Spain and Ireland, these countries are again heading for negative growth in GDP this year.

Photo: BDI/photocase (bIO-540)

German Economy

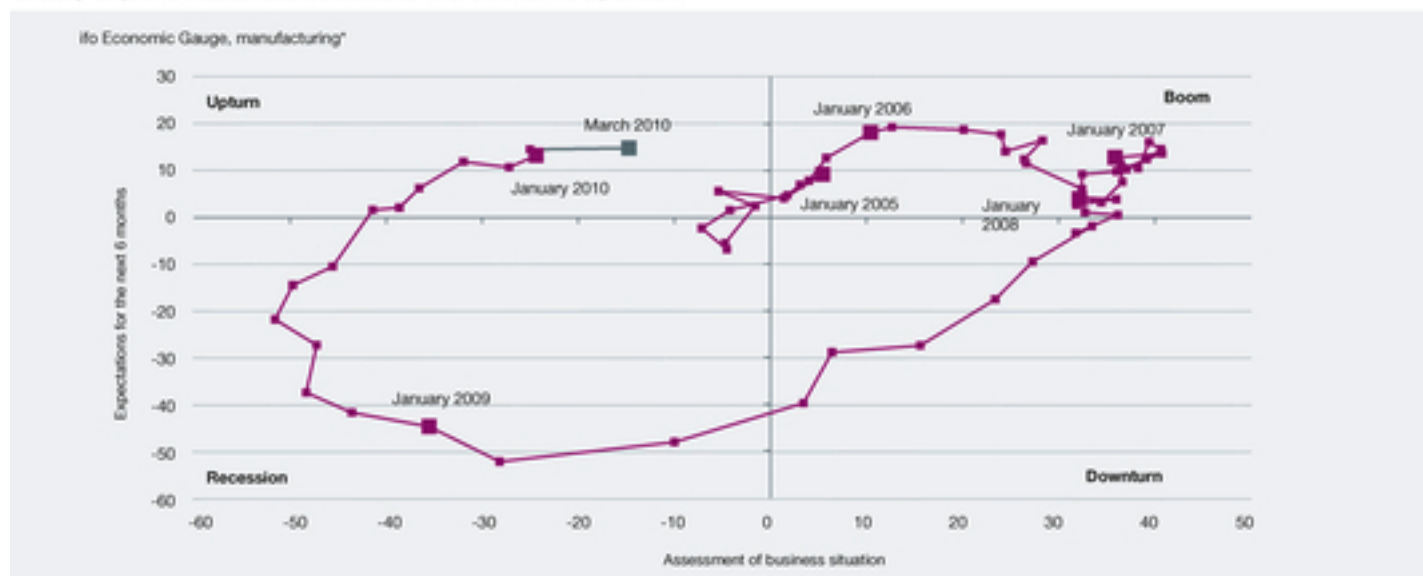
Foreign trade gathering momentum, consumption and investments weaker

In Q4 2009 the pace of the upturn weakened slightly with GDP stagnating at the previous quarter's level. While exports increased 3 %, imports decreased 1.8 %. Net exports were balanced out in full by declining public and private spending (-0.6 % and -1.0 %), lower construction and capital equipment expenditure (-0.5 % and -1.5 %) and reduced inventories (-1.2 %).

In a three-month comparison, German exports increased for the second time in a row. In February 2010 exports grew 5.1 %

compared with the previous quarter, while imports nudged up a mere 0.2 %. Factors behind this development are the global inventory cycles and the economic stimulus packages implemented around the world, which are also boosting the German economy as it is so extensively integrated in world trade. Germany is benefiting in particular from the positive economic development in South-East Asia and China as well as from higher economic activity in the US and the Gulf. Declining private spending and diminishing demand for foreign intermediates kept imports down in Q4 2009. As a result foreign trade contributed to growth, and continued to turn global growth to domestic advantage.

Greatly improved business conditions fuel economic optimism



* Balances, seasonally adjusted
Source: Ifo Institute

2010: 2 percent economic growth within reach



deral Employment Agency, which measures the human resources demand of enterprises, increased in March. In addition, more trainee positions were registered between October 2009 and February 2010 compared to the same period the previous year. The euro inflation rate is still low (March 2010: +1.3 % compared with March 2009) despite recent increases in energy and oil prices. The relatively stable job market and moderate inflation makes only a slight decline in consumer spending likely.

Investment activity has bottomed out but is still muted due to high overcapacities. Investments actually shrank 0.7 % in Q4 2009, with capital equipment spending going down 1.5 %. In the first two months of 2010, however, capital goods manufacturers recorded sales increases of 5.6 % and 0.8 % respectively. In February 2010, sales increased year-on-year for the first time since October 2008. Construction investment delivered a mixed performance (Q4 2009: -0.5 % quarter-on-quarter). 2009 overall showed an increase of 4 % in residential construction, an increase of around 30 % in public building construction spending, with commercial construction diminishing by 22.4 %. The harsh winter paralysed construction work in the early months of the year, but the impact of this should diminish over the course of the year.

Public spending decreased slightly in the last quarter of 2009, but is set to expand once again and will be the only sector of domestic demand making any notable contribution to growth. The upturn is largely dependent on the development of foreign trade.

Photo: BDI/fotolia (Mixage)

The car-buying incentive programme, which has since expired, squeezed private spending in Q4 2009, a major reason for the 1.0 % drop. Retail sales tended downwards. Year-on-year, the change in retail sales was continuously negative between May 2009 and February 2010. Nonetheless, calendar and seasonally adjusted, sales are comparably stable, which is also a reflection of the surprisingly robust job market. March 2010 already showed a slight spring upswing. The number of unemployed decreased year-on-year by 18,000 and in comparison with previous month figures fell by a further 75,000, bringing the total number of unemployed down to 3.568 million. The unemployment rate dropped 0.2 % to 8.5 %. The job index of the Fe-

Incoming Orders/Industrial Production

Incoming orders: Trend still pointing up

New orders continue to rise, production hesitantly following suit



*) Manufacturing. **) Manufacturing and industry, seasonally adjusted, volume index 2005=100, two-month average. Source: Federal Statistical Office

Demand for industrial goods has continued to gather pace since the start of 2010. Following a solid rise of incoming orders in January over the previous month (+5.1 %), the order volume stagnated in February 2010 at the previous month's level. This was no backlash however, as the underlying trend in incoming orders is still pointing up. Foreign demand is looking particularly robust, recording a 1.8 % increase in February 2010 (non-Eurozone: +2.8 %), a sure indicator of the impact the global recovery has on the German economy (domestic orders: -1.9 %). The upward trend is even more evident in the statistically more significant two-month comparison January/February 2010 compared to November/December 2009, which showed an increase of 3.7 %. Domestic demand (+4.5 %) and foreign orders (+3.3 %) contributed equally to the solid increase in orders.

Among the main manufacturing groups, the positive trend continued for intermediate goods, with new orders having risen steadily since April 2009 (apart from December 2009), and the latest figures showing a rise of 2.1 % in February 2010. Orders are on the up in Germany, in the Eurozone and the non-Eurozone. Non-Eurozone orders were the strongest, going up 5.0 %. The two-month comparison, which shows a rise of 4.9 %, highlights the momentum in intermediates.

Following solid growth in January 2010 (+5.1 %) manufacturers of capital goods experienced a slight drop in demand in February 2010 (-0.6 %). While domestic orders contracted by 4.3 %, foreign orders continued the upward trend, rising by another 2.1 %. The main factor causing the decline in domestic orders was a backlash following an unusually high increase in orders in January 2010 (+9.1 %). The two-month comparison reveals a clearer picture with an increase of 3.9 %.

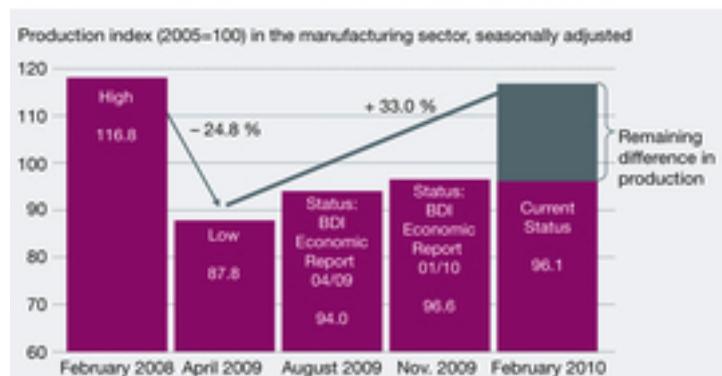
The development of consumer goods was muted with 5.6 % less consumer goods ordered in February 2010 than the previous month. Domestic orders suffered the biggest drop (-6.4 %) with Eurozone orders going down least (-0.8 %). The two-month comparison also records a decline (-2.2 %), clearly showing the reduced propensity of private households to consume.

Production: Increase still hesitant but not to be stopped

Rising orders have not yet had a full knock-on effect on production levels. In February 2010 output in manufacturing and industry remained at the previous month's level, following a minimal increase of 0.1 % in January 2010 (two-month comparison January/February 2010 vs. November/December 2010: -0.4 %).

Industrial output grew marginally by 0.2 % (two-month comparison: -0.1 %). Among the main industrial groups, manufacturers of capital goods increased their production the most (+1.5 %), but recorded a decrease of 0.9 % in the two-month comparison. The production of consumer goods declined by 2.3 % in February 2010 (two-month comparison January/February 2010: -0.6 %), while the production of intermediates remained steady (-0.1 %; two-month comparison January/February 2010: 1.2 %).

Production: Expectations based on spring recovery



After the weather-induced drop in the main construction industry in January 2010 (-14.2 %) the sector grew slightly in February 2010 (+1 %), also reflected in the two-month comparison. The harsh winter caused a decrease of 14.6 %. In contrast, the weather conditions caused energy production to rise by six % in January/February 2010 compared to November/December 2009.

The trend in incoming orders and – more muted – in production, is a reflection of current and expected economic development: The global upward forces are reaching Germany through the demand and production of industrial goods. The impetus coming from abroad is much greater than the increase in domestic demand. As expected, Q1 2010 was weak but Q2 2010 will see a clear improvement, indications that are supported by the ifo business climate index for manufacturers: In March 2010 business expectations went up slightly, an improvement on the already high level, with business conditions rated as clearly better than in the previous month.

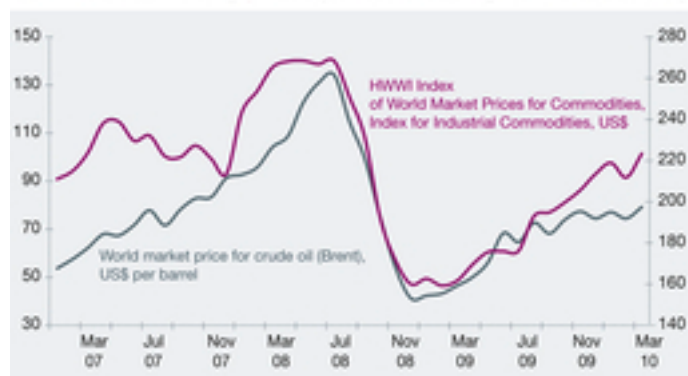
Photo: BDI/fotolia (Jake Hellbach)

Outlook

Upward trend continues but risks remain

Following the drastic slump of the world economy and the serious consequences for Germany, the road back to pre-recession levels is still a long one, notwithstanding the current positive signs. There are still factors that could jeopardize further economic recovery. The prices for commodities have climbed substantially in the past year, especially for crude oil and iron ores, a result of both increasing demand and speculative transactions. The job market is surprisingly stable and is even showing signs of easing. Though unlikely, setbacks on the job market with a domino effect on private consumption and public budgets cannot yet be ruled out. Access to financing for manufacturers is still restricted, and the problems that could ensue are not merely the looming credit crunch – a whole row of financing channels remain difficult to access. Private equity and securitizations are only two examples. The economic recovery is actually intensifying the situation: While access to financing remains difficult, the need for financing is increasing. The tense fiscal situation of various countries around the world is adding to the load. The budgetary situation of Greece is a dramatic illustration of a situation when large-scale new debt coupled with a high level of existing debt and a relatively weak real economic outlook can quickly become a huge macroeconomic crisis. And Greece may be the beginning of a whole trend.

Commodities: Rising prices pose increasing risk for economy



Source: HWI



*Oil-stage: The prices for oil have climbed substantially.
Photo: BDI/fotolia (Ian Holland)*

Despite these latent risks, the prospects for economic growth in Germany are good. There have not, so far, been any major setbacks on the financial markets and the first steps to reform the global financial system have been initiated. The recent surge in incoming orders and the expected increase in construction work following the harsh winter should boost economic performance in the further course of the year. Exports will play the lead role here. Germany is already benefiting more than other countries from the increased economic momentum in the emerging countries of Asia and Latin America. The upturn there is only partly due to economic stimulus packages, and is becoming increasingly self-sustaining. Economic growth in Germany of between 1.5 and 2 % this year is still within reach.

The strength of German exports is therefore the most important basis for a return to higher growth. Competitiveness in price, and especially in quality, is the trademark of German companies and products. The latest critiques of German export performance are misdirected – the successful reforms of both economic and company policy should rather be taken as an inspiration and incentive for other economies.

Further information can be found [here](#):

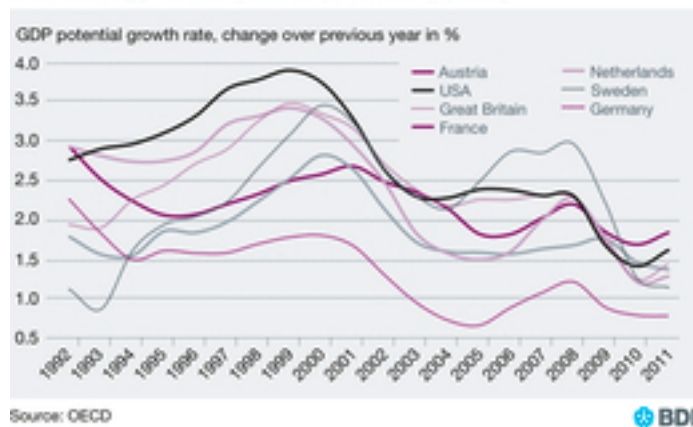
Photo: BDI/fotolia (Aintschie)

Policy Agenda

Start consolidation, strengthen drivers of growth

Germany's integration into the world economy puts the country in an excellent position to benefit from rising world trade. Conversely, the slump in global demand caused by the recession also revealed how vulnerable Germany is to external jolts.

Exit strategy needs growth-promoting policy



This makes it all the more important to strengthen the domestic economy to stand alongside the main pillar of the German economy, which is exports. The main priorities here are to improve investment terms and deregulate the service sector. A strategy to tackle these points must be embedded in an extensive reform concept. First, the slight upward trend increases the necessity to move out of crisis management and to start "tidying up". Second, neither the recession, nor the first signs of upturn should veil the fact that Germany still faces structural problems which confine it to a path of growth that is simply too flat.

The biggest economic policy challenge for the governing Coalition is to achieve the balancing act of consolidating the budget while also investing in the future and offering tax relief and thus stimulate higher growth.

In consolidating the budget, priority must be given to the actual factors driving costs. Federal spending has increased by 35 % in the last ten years alone. Social security spending has risen most, climbing by 75 % in the last ten years (i.e. over €75 billion). Back in 2001, €102 billion – equivalent to 42 % of the federal budget – was spent on labour and social expenditure; this year, spending here is set to reach €178 billion, i.e. 54 % of the federal budget. Combined with the cost of servicing its debt, this already accounts for two thirds of the federal budget.

The consolidation process must be based on quantity and most particularly on quality. Investment expenditures are needed to promote additional economic growth, which is vital to attain the consolidation target. In terms of public investments (in relation to GDP), Italy is the only European country to spend less than Germany, leaving a backlog of necessary investments especially in infrastructure and education.

To take Germany onto a higher growth path, effective reforms are needed in three areas.

Growth driver education, innovation, information technology

- Strengthen education as the foundation of growth
- Promote growth with research and development in enterprises
- Enhance growth potential of the knowledge society
- Secure low-price energy for Germany as an industrial country.

Growth driver resource efficiency, sustainable mobility, health

- Mobilise climate change and resource efficiency as a driver of growth
- Attain leading position in future-oriented mobility
- Mobilise health as an engine of growth.

Growth driver competitive parameters

- Make Germany more attractive for investments
- Create incentives to boost performance with tax reliefs
- Release the brakes on growth in competition regulations.

Successful consolidation and higher growth will create more leeway for the necessary tax reliefs. Germany will thus be propelled onto a path of higher growth, which will also strengthen domestic demand.

Photo: BDI/fotolia (Dima)