



## Highlights and Key Issues

- The German economy is clearly slowing in the face of the latest phase of the Eurozone crisis. We expect the impact of the crisis on business investment and exports to cause the economy to contract in Q2 before recovering slowly in H2. As a result, GDP growth is now forecast to slow to 0.7% in 2012 overall from 3.1% last year, before accelerating to 1.4% in 2013.
- Despite favourable financing conditions, investment in machinery and equipment has lost steam as nervous companies delay investment projects. Business investment fell by 1% in Q1 after growing at an average pace of 1.3% in the previous four quarters. We expect further falls in business investment in Q2 and Q3.
- Forward-looking labour market indicators suggest that labour market conditions have deteriorated a little. Reflecting a weakening economy and high business uncertainty, we expect the unemployment rate to rise slightly in H2 this year, to 7% from the current 6.7%, before starting to fall again in 2013 as growth accelerates and uncertainty dissipates somewhat.
- As energy prices moderate, we expect consumer price inflation to slow to 2% this year and then to 1.8% in 2013. But in contrast, other components of the CPI will be accelerating due to faster and broad-based wage growth. This in turn is likely to cause inflation excluding energy to rise, to 1.6% this year and then to 1.7% in 2013.

<b>Forecast for Germany</b>						
(Annual percentage changes unless specified)						
	2011	2012	2013	2014	2015	2016
<b>Domestic Demand</b>	2.5	-0.1	1.0	2.1	1.9	1.8
Private Consumption	1.4	0.9	1.3	1.4	1.5	1.5
Fixed Investment	6.6	-0.4	2.2	4.7	4.4	3.7
Stockbuilding (% of GDP)	0.8	0.1	-0.1	0.1	0.1	0.1
Government Consumption	1.1	1.0	0.5	0.7	0.7	0.7
<b>Exports of Goods and Services</b>	8.4	3.0	3.8	5.8	6.0	5.3
<b>Imports of Goods and Services</b>	7.9	1.7	3.4	6.5	6.3	5.5
<b>GDP</b>	3.1	0.7	1.4	2.1	2.0	2.0
<b>Industrial Production</b>	8.0	-0.5	2.1	4.2	3.5	2.5
<b>Consumer Prices</b>	2.3	2.0	1.8	1.9	2.0	2.0
<b>Current Balance (% of GDP)</b>	5.7	6.4	6.7	6.2	6.0	5.9
<b>Government Budget (% of GDP)</b>	-1.0	-1.2	-1.0	-0.9	-0.6	-0.1
<b>Short-Term Interest Rates (%)</b>	1.39	0.69	0.50	0.86	1.99	2.99
<b>Long-Term Interest Rates (%)</b>	2.67	1.59	1.95	2.44	2.92	3.70
<b>Exchange Rate (US\$ per Euro)</b>	1.39	1.27	1.28	1.27	1.24	1.24
<b>Exchange Rate (£ per Euro)</b>	0.87	0.81	0.82	0.81	0.79	0.79

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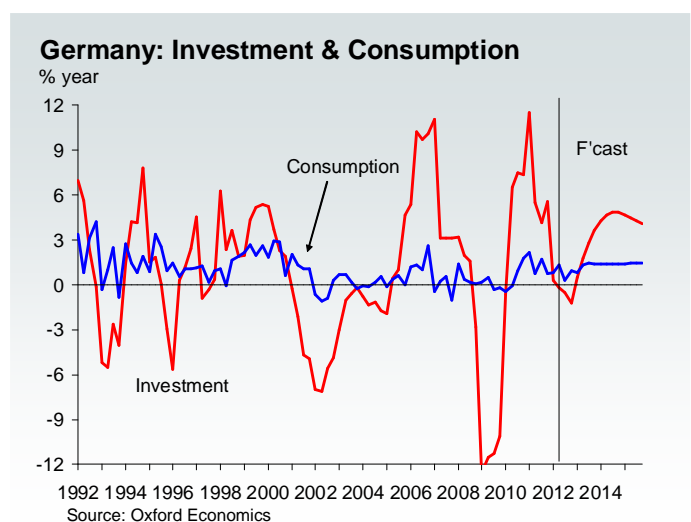
## Overview

### Eurozone crisis is taking its toll...

- Despite stronger than expected growth in Q1, the German economy is clearly slowing in the face of the latest phase of the Eurozone crisis. Over the past six months, the economy has grown at an annualised pace of just 0.7% compared with growth of 3.1% in 2011. Activity surveys have also deteriorated, with the expectations component of the Ifo business survey slipping back noticeably in May. We expect the negative impact of the latest bout of the Eurozone crisis on business investment and exports to cause the economy to contract in Q2 and to recover only slowly in H2. Consequently, growth is now expected to slow to 0.7% in 2012 before accelerating to 1.4% in 2013 as the Eurozone crisis eases.
- The impact of the latest bout of the Eurozone crisis on the German economy can clearly be seen in the manufacturing orders data. Although domestic orders have risen 3.1% since the start of the year, foreign orders have fallen 1.5%, reflecting a 9.8% decline in investment goods orders from the Eurozone.

### ...with investment already hit...

- Germany is benefiting from the Eurozone's very expansionary monetary policy. In addition, safe-haven flows into government bonds have driven down interest rates to historically low levels for both public and private sector borrowers. Despite these exceedingly favourable financing conditions, investment in machinery and equipment slowed in the last two quarters as nervous companies delayed expansion projects. Business investment rose just 0.4% in Q4 and fell 1% in Q1 after growing at an average pace of 1.3% in the previous four quarters.
- We expect further falls in business investment in Q2 and Q3. But provided the sovereign debt crisis does not escalate further, companies should gradually become more confident as 2012 progresses and re-launch postponed projects, enabling investment growth to turn positive by Q4. For 2012 as whole, we expect business investment to slow to just 0.6% from 7.2% in 2011, before accelerating to 2.5% in 2013.
- Economic uncertainty will probably cause some of Q1's 0.4% rise in consumption to be reversed in Q2, but after that consumer spending should start to rise



thanks to low unemployment, rising income growth and strong household balance sheets. As a result, we expect consumer spending growth to slow from 1.4% in 2011 to 0.9% this year, before picking up to 1.3% in 2013.

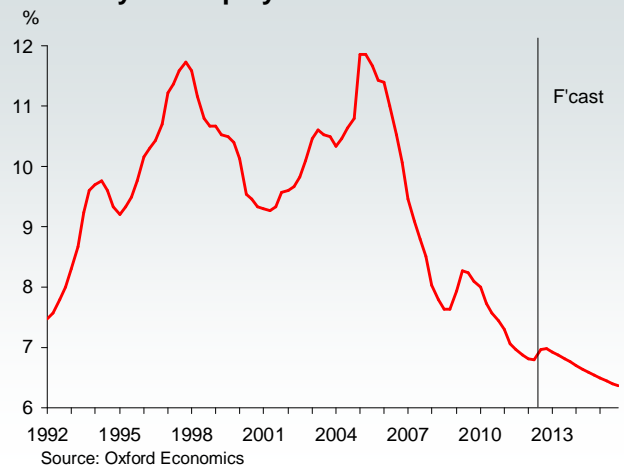
## Labour market impact yet to come

- Unemployment fell to 6.8% at end 2011, from 7.4% at the start of the year, but since then it has been broadly unchanged. Forward-looking labour market indicators such as the Ifo employment barometer suggest that labour market conditions have deteriorated a little, albeit from a very strong starting point. Reflecting a weakening economy and business uncertainty, we expect the unemployment rate to rise slightly in H2 this year, to about 7% from its current 6.7%, before again starting to fall gradually in 2013 as uncertainty dissipates somewhat and growth starts to accelerate.
- The combination of low unemployment and healthy corporate profits is causing trade unions to make higher wage demands, and more of their demands than usual have been met. This is particularly true of the metal working industry, where basic pay will be increased by 4.3% for a period of 13 months, but above-inflation pay deals have also been awarded across the public sector and service sector.
- Consumer price inflation slowed to 1.9% in May, and we expect it to average about 2% this year, and then 1.8% in 2013, as energy prices moderate. In contrast, other components of the CPI are expected to accelerate due to broad-based wage growth. This is expected to cause inflation ex energy to rise from 1.4% in 2011 to 1.6% this year and then to 1.7% in 2013.

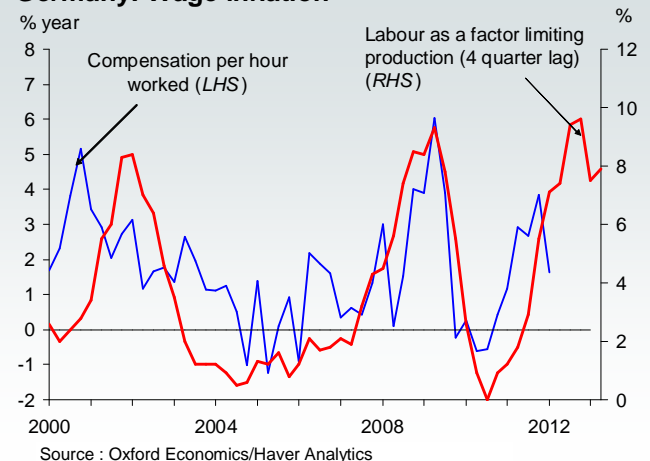
## Crisis escalation is key risk

- The main risk facing the German economy is a further intensification of the Eurozone crisis, which would impact directly through trade and financial channels, and indirectly by depressing business and consumer confidence. The German banking system remains vulnerable to external shocks due to its high leverage ratios, the low quality of bank capital, significant cross-border exposures and its reliance on wholesale funding. But even if these downside risks materialise, Germany is in the enviable position of being able to ease fiscal policy in response.

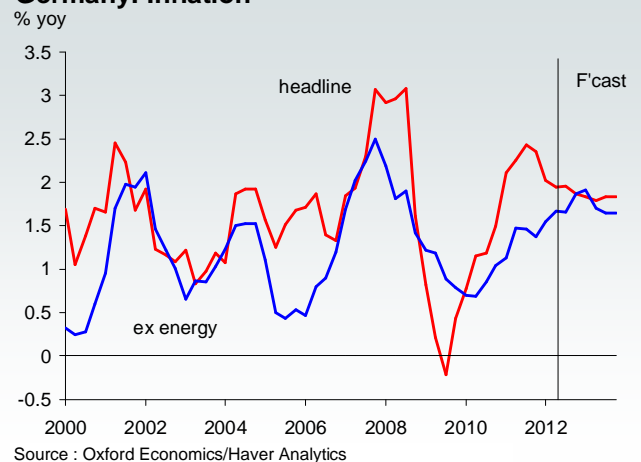
### Germany: Unemployment



### Germany: Wage inflation



### Germany: Inflation



**Key Indicators: Germany**

Percentage changes on a year earlier unless otherwise stated

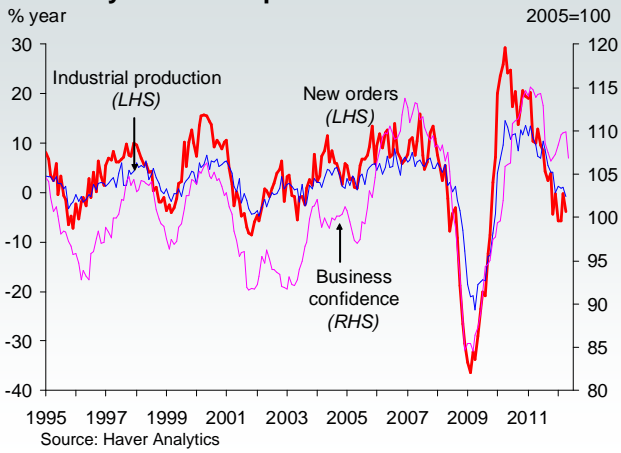
	Industrial production	Unemploy- ment	CPI	IFO Index 2005=100	Consumer confidence % balance	Exports	Imports	Trade balance (€ bn)
<b>May</b>	7.3	7.0	2.3	114.0	9.0	12.1	11.8	12.4
<b>Jun</b>	7.1	7.0	2.3	114.3	9.8	8.4	9.3	12.1
<b>Jul</b>	10.4	7.0	2.4	112.9	8.4	8.0	11.7	10.8
<b>Aug</b>	8.6	7.0	2.4	108.6	0.2	12.1	11.7	13.7
<b>Sep</b>	5.5	6.9	2.6	107.5	-1.9	10.3	11.9	15.2
<b>Oct</b>	4.2	6.9	2.5	106.5	-3.3	6.6	11.0	12.2
<b>Nov</b>	4.7	6.9	2.4	106.8	-2.9	8.3	7.1	14.8
<b>Dec</b>	1.6	6.8	2.1	107.3	-2.2	4.6	5.7	13.9
<b>2012</b>								
<b>Jan</b>	1.6	6.8	2.1	108.4	0.5	7.0	4.5	14.7
<b>Feb</b>	0.0	6.8	2.3	109.6	-0.8	6.8	4.8	13.9
<b>Mar</b>	1.3	6.8	2.1	109.8	-0.6	2.0	3.2	13.9
<b>Apr</b>	-0.7	6.8	2.1	109.9	-2.3	3.8	-0.8	16.1
<b>May</b>	-	6.7	1.9	106.9	0.4	-	-	-

**Financial Indicators: Germany**

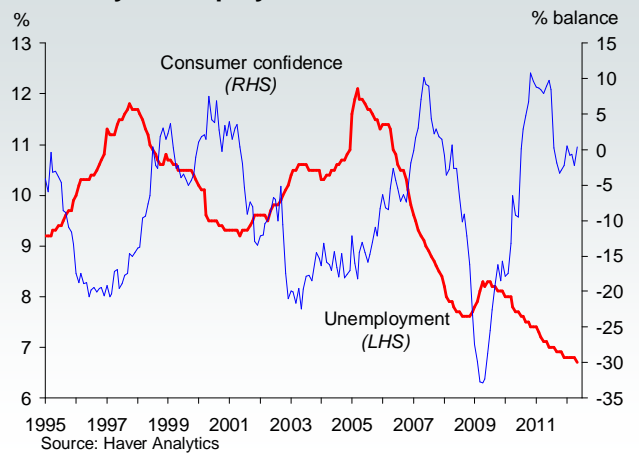
Percentage changes on a year earlier unless otherwise stated

	Short rate %	Long rate %	Money Supply (M3)	Nominal effective 2005=100	Real effective 1999Q1=100	Share price XETRDAX	Reserves US\$ bn
<b>May</b>	1.4	3.1	4.3	102.2	92.1	7331	162.9
<b>Jun</b>	1.4	3.0	4.3	102.3	92.2	7159	159.7
<b>Jul</b>	1.6	2.8	4.4	101.7	91.7	7293	170.6
<b>Aug</b>	1.5	2.2	4.8	101.9	91.9	5924	184.7
<b>Sep</b>	1.5	1.9	5.9	101.2	91.5	5402	181.4
<b>Oct</b>	1.5	2.0	5.9	101.4	91.8	5872	181.9
<b>Nov</b>	1.4	1.9	5.5	101.0	91.6	5826	188.0
<b>Dec</b>	1.4	2.0	5.9	100.1	90.5	5868	184.6
<b>2012</b>							
<b>Jan</b>	1.2	1.9	6.0	98.9	89.4	6278	195.1
<b>Feb</b>	1.0	1.9	6.7	99.3	89.7	6790	195.7
<b>Mar</b>	0.8	1.9	7.0	99.4	89.6	6967	186.6
<b>Apr</b>	0.7	1.7	6.3	-	89.5	6732	-
<b>May</b>	0.6	1.5	-	-	88.9	6425	-

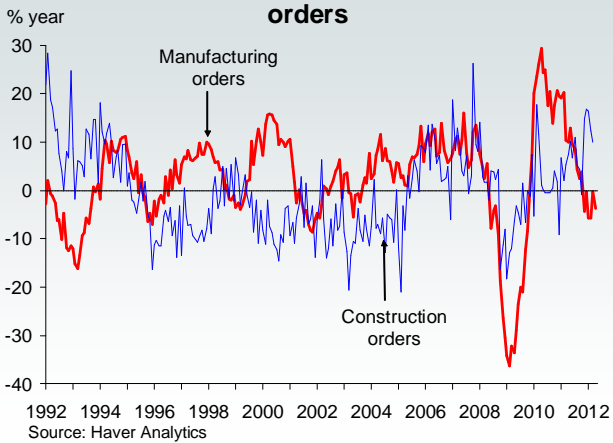
## Germany: Industrial performance



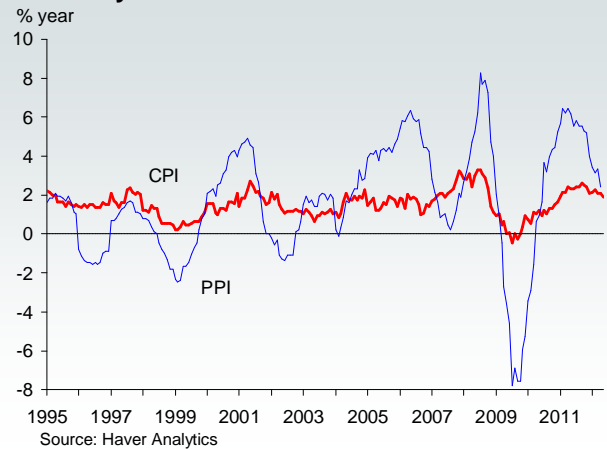
## Germany: Unemployment



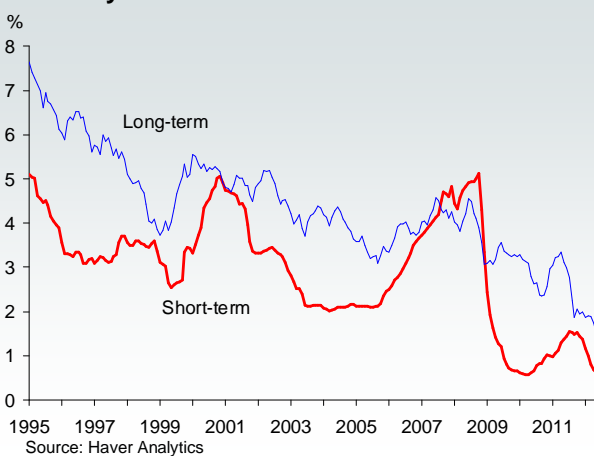
## Germany: Manufacturing and construction orders



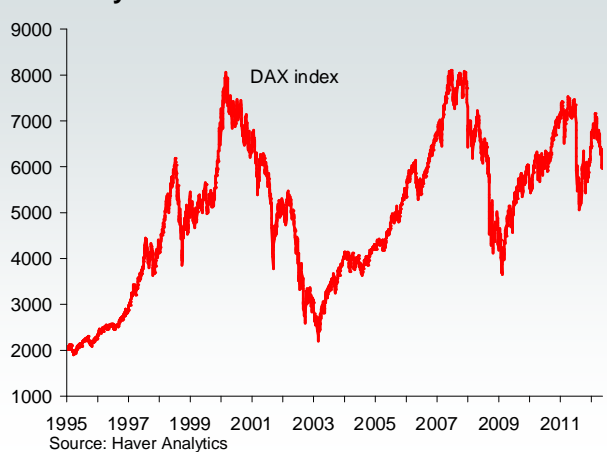
## Germany: Inflation



## Germany: Interest rates



## Germany: Stockmarket



## GERMANY

TABLE 1 SUMMARY ITEMS

Annual Percentage Changes, Unless Otherwise Specified

	CONSUMERS EXPENDITURE	REAL PERS. DISPOSABLE INCOME	SAVING RATIO (%)	REAL GDP	INDUSTRIAL PRODUCTION	UNEMPLOYMENT RATE (%)	AVERAGE EARNINGS	WHOLE ECONOMY PRODUCTIVITY (GDP/ET)	COMPETITIVENESS (2008=100)	PRODUCER PRICES	CONSUMER PRICES
	(C)	(PEDY)	(PESR)	(GDP)	(IP)	(UP)	(ER)	(GDP/ET)	(WCR)	(FPI)	(CFI)
<b>YEARS BEGINNING Q1</b>											
2011	1.4	1.0	11.0	3.1	8.0	7.1	3.3	1.7	96.8	5.6	2.3
2012	0.9	1.6	11.7	0.7	-0.5	6.9	3.1	-0.3	92.8	3.2	2.0
2013	1.3	1.1	11.6	1.4	2.1	6.8	3.5	1.2	92.9	3.3	1.8
2014	1.4	1.6	11.7	2.1	4.2	6.6	2.9	1.9	91.0	3.0	1.9
2015	1.5	1.4	11.7	2.0	3.5	6.4	3.0	2.0	88.3	2.7	2.0
2016	1.5	1.2	11.4	2.0	2.5	6.3	3.0	2.0	86.7	2.5	2.0
<b>2011</b>											
I	2.2	1.2	10.7	4.6	12.9	7.3	3.3	3.2	96.7	6.1	2.1
II	0.7	1.0	11.3	2.9	8.0	7.1	3.9	1.6	97.3	6.0	2.3
III	1.7	1.3	10.9	2.7	8.1	7.0	3.1	1.4	96.6	5.6	2.4
IV	0.8	0.7	11.1	2.0	3.5	6.9	2.8	0.7	96.6	4.8	2.4
<b>2012</b>											
I	0.8	1.8	11.6	1.2	1.0	6.8	2.5	-0.3	93.3	3.3	2.2
II	1.4	1.9	11.8	0.7	-0.9	6.8	2.2	-0.5	93.5	2.9	1.9
III	0.3	1.3	11.7	0.2	-2.2	7.0	3.5	-0.6	92.0	3.1	2.0
IV	0.9	1.5	11.6	0.7	0.1	7.0	4.1	0.1	92.5	3.5	1.9
<b>2013</b>											
I	0.9	0.8	11.6	0.6	0.6	6.9	3.6	0.4	92.8	3.4	1.6
II	1.3	1.0	11.5	1.3	2.1	6.9	3.8	1.2	93.1	3.3	1.8
III	1.5	1.3	11.5	1.7	2.7	6.8	3.5	1.4	93.0	3.2	1.8
IV	1.4	1.4	11.6	2.0	3.2	6.8	3.2	1.7	92.7	3.1	1.8
<b>2014</b>											
I	1.4	1.5	11.6	2.1	3.7	6.7	3.0	1.8	92.3	3.1	1.8
II	1.4	1.6	11.7	2.1	4.2	6.6	2.9	1.9	91.5	3.0	1.9
III	1.4	1.6	11.7	2.1	4.4	6.6	2.9	1.9	90.5	2.9	1.9
IV	1.4	1.6	11.8	2.1	4.4	6.5	2.9	2.0	89.6	2.9	1.9
<b>2015</b>											
I	1.4	1.5	11.7	2.1	4.1	6.5	3.0	2.0	88.9	2.8	2.0
II	1.4	1.5	11.7	2.1	3.7	6.4	3.0	2.0	88.6	2.8	2.0
III	1.5	1.4	11.6	2.0	3.3	6.4	3.0	2.0	88.2	2.7	2.0
IV	1.5	1.3	11.6	2.0	3.0	6.4	3.0	2.0	87.6	2.6	2.0
<b>2016</b>											
I	1.5	1.2	11.5	2.0	2.8	6.3	3.0	2.0	87.2	2.6	2.0
II	1.5	1.2	11.5	2.0	2.6	6.3	3.0	2.0	86.9	2.5	2.0
III	1.5	1.2	11.4	2.0	2.3	6.3	3.0	2.0	86.6	2.4	2.0
IV	1.5	1.2	11.3	1.9	2.1	6.2	3.0	2.0	86.1	2.4	2.0

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## GERMANY

TABLE 2 SUMMARY ITEMS

	TRADE BALANCE (EURO BN)	CURRENT ACCO UNT (EURO BN)	CURRENT ACCO UNT (% OF GDP)	GOV. FIN BALANCE (MAAS.DEF) (EURO BN)	GOV. FIN BALANCE (MAAS.DEF) (% OF GDP)	SHORT-TERM INTEREST RATE	LONG-TERM INTEREST RATE	REAL SHORT-TERM INTEREST RATE	REAL LONG-TERM INTEREST RATE	DM PER US DOLLAR	EFFECTIVE EXCHANGE RATE (1990=100)
	(BVI)	(BCU)	(BCU/100/GDP)	(GBM)	(GBM/100/GDP)	(RSH)	(RLG)	(Nob 1)	(Nob 1)	(RXD)	(RX)
<b>YEARS BEGINNING Q1</b>											
2011	155.5	147.3	5.7	-25.7	-1.0	1.39	2.67	-0.89	0.39	1.41	101.37
2012	187.1	168.6	6.4	-30.2	-1.2	0.69	1.59	-1.32	-0.41	1.54	98.94
2013	202.1	179.6	6.7	-28.1	-1.0	0.50	1.95	-1.28	0.18	1.53	100.22
2014	201.6	174.5	6.2	-24.1	-0.9	0.86	2.44	-1.01	0.57	1.54	100.68
2015	206.4	175.6	6.0	-16.7	-0.6	1.99	2.93	-0.01	0.93	1.58	100.33
2016	214.0	179.8	5.9	-4.5	-0.1	2.99	3.70	0.97	1.69	1.58	100.49
<b>2011</b>											
I	38.3	38.8	6.1	-6.4	-1.0	1.10	3.13	-1.01	1.03	1.43	101.05
II	36.6	31.4	4.9	-6.4	-1.0	1.42	3.13	-0.84	0.88	1.36	102.55
III	39.7	38.8	6.0	-6.5	-1.0	1.56	2.33	-0.84	-0.07	1.38	101.40
IV	41.0	38.2	5.9	-6.5	-1.0	1.50	2.07	-0.86	-0.29	1.45	100.48
<b>2012</b>											
I	42.6	39.1	6.0	-8.6	-1.3	1.04	1.97	-1.17	-0.25	1.49	99.61
II	44.8	42.9	6.6	-7.6	-1.2	0.70	1.40	-1.25	-0.55	1.53	99.06
III	50.4	44.1	6.7	-6.6	-1.0	0.50	1.40	-1.49	-0.59	1.59	98.23
IV	49.3	42.5	6.4	-7.5	-1.1	0.50	1.60	-1.37	-0.27	1.57	98.86
<b>2013</b>											
I	48.6	43.3	6.5	-7.3	-1.1	0.50	1.80	-1.14	0.16	1.54	99.57
II	48.4	46.0	6.9	-7.1	-1.1	0.50	1.90	-1.29	0.11	1.53	100.07
III	52.7	45.8	6.8	-6.9	-1.0	0.50	2.00	-1.34	0.16	1.52	100.46
IV	52.3	44.5	6.5	-6.7	-1.0	0.50	2.10	-1.33	0.27	1.52	100.78
<b>2014</b>											
I	50.7	44.3	6.4	-6.5	-0.9	0.50	2.25	-1.34	0.42	1.52	100.99
II	47.5	43.8	6.3	-6.2	-0.9	0.53	2.40	-1.32	0.55	1.54	100.78
III	51.4	43.3	6.2	-5.9	-0.8	1.07	2.50	-0.81	0.62	1.56	100.54
IV	52.0	43.2	6.1	-5.6	-0.8	1.36	2.60	-0.56	0.68	1.56	100.41
<b>2015</b>											
I	50.9	43.4	6.1	-5.2	-0.7	1.61	2.70	-0.35	0.74	1.57	100.31
II	48.4	43.7	6.0	-4.5	-0.6	1.86	2.80	-0.13	0.81	1.58	100.31
III	53.1	44.0	6.0	-3.8	-0.5	2.11	3.00	0.11	0.99	1.58	100.33
IV	54.1	44.4	6.0	-3.2	-0.4	2.36	3.20	0.35	1.19	1.58	100.38
<b>2016</b>											
I	53.0	44.7	6.0	-2.5	-0.3	2.61	3.40	0.60	1.39	1.58	100.42
II	50.5	44.9	6.0	-1.9	-0.2	2.86	3.60	0.85	1.59	1.58	100.47
III	55.0	45.1	5.9	-0.7	-0.1	3.11	3.80	1.10	1.79	1.58	100.50
IV	55.6	45.2	5.9	0.6	0.1	3.36	4.00	1.35	1.99	1.58	100.56

Note 1: REAL INTEREST RATES = Nominal interest rate (RSH or RLG) - % change in CPI

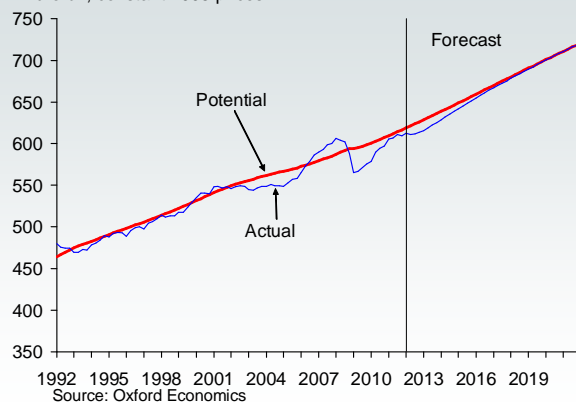
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## Potential output growth 1.5%pa

- Potential output is projected to rise by 1.5%pa over the next 10 years, a slightly higher rate than in the previous decade. GDP is set to expand by 0.7% in 2012, having grown by 3.1% in 2011 and to be slightly below potential growth at 1.4% in 2013. As a result, the small output gap of 0.8% in 2011 will expand in 2012 to 1.7% and increase in 2013 to 1.9%, and it is not forecast to close fully until 2020.
- The main contribution to growth in potential output over the coming decade comes from expanding total factor productivity.
- The 0.0%pt contribution from expanding labour usage reflects the 0.4%pa fall in the working population over the next ten years and an increase in the participation rate which combine to reduce the labour supply by 0.1%pa. For the capital stock's contribution of 0.6%pt, the main factor is significantly higher investment growth (at 2.6%pa) than in the previous decade. Finally, total factor productivity growth's slightly higher contribution of 0.9%pt reflects the better contribution to potential growth from factors influencing production other than labour and capital over the coming decade.

### Germany: Actual & potential output

Euro bn, constant 2005 prices



### Potential GDP and Its Components Average Percentage Growth

	2002-2011	2012-2021
Potential GDP*	1.2	1.5
Employment at NAIRU	0.2	0.0
Capital Stock	1.3	1.8
Total Factor Productivity	0.6	0.9

\* $\ln(\text{Potential GDP}) = 0.65 \cdot \ln(\text{Employment at NAIRU}) + 0.35 \cdot \ln(\text{Capital Stock}) + \ln(\text{Total Factor Productivity})$

## Long-Term Forecast for Germany

(Average annual percentage change unless otherwise stated)

	2002-2006	2007-2011	2012-2016	2017-2021
<b>GDP</b>	1.0	1.1	1.6	1.6
<b>Consumption</b>	0.3	0.5	1.3	1.4
<b>Investment</b>	0.1	1.1	2.9	2.3
<b>Government Consumption</b>	0.4	2.1	0.7	1.1
<b>Exports of Goods and Services</b>	7.5	3.3	4.8	3.3
<b>Imports of Goods and Services</b>	6.0	3.5	4.7	3.5
<b>Unemployment (%)</b>	10.7	7.9	6.6	5.9
<b>Consumer Prices</b>	1.4	1.7	1.9	2.0
<b>Current Balance (% of GDP)</b>	3.9	6.3	6.3	5.5
<b>Exchange Rate (per \$)</b>	1.2	1.4	1.3	1.3
<b>General Government Balance (% of GDP)</b>	-3.4	-1.7	-0.8	0.3
<b>Short-term Interest Rates (%)</b>	2.6	2.5	1.4	4.1
<b>Long-term Interest Rates (%)</b>	4.0	3.4	2.5	4.4
<b>Working Population</b>	-0.4	-0.3	-0.3	-0.6
<b>Labour Supply</b>	0.2	0.2	0.1	-0.4
<b>Participation Ratio</b>	78.7	80.9	82.7	83.7
<b>Labour Productivity</b>	1.2	0.1	1.4	1.9

### Long-Term Forecast for Germany

Annual percentage changes unless otherwise specified

	2002-2011	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2021
<b>GDP</b>	1.0	0.8	-5.1	3.6	3.1	0.7	1.4	2.1	2.0	2.0	1.8	1.7	1.6	1.6	1.5	1.6
<b>Consumption</b>	0.4	0.5	0.0	0.6	1.4	0.9	1.3	1.4	1.5	1.5	1.5	1.4	1.3	1.2	1.4	1.3
<b>Investment</b>	0.6	1.0	-11.4	5.2	6.6	-0.4	2.2	4.7	4.4	3.7	3.1	2.7	2.3	1.8	1.5	2.6
<b>Government Consumption</b>	1.3	3.1	3.3	1.7	1.1	1.0	0.5	0.7	0.7	0.7	0.8	0.9	1.1	1.2	1.4	0.9
<b>Exports of Goods and Services</b>	5.4	2.1	-13.6	13.4	8.4	3.0	3.8	5.8	6.0	5.3	4.5	3.7	3.1	2.7	2.5	4.0
<b>Imports of Goods and Services</b>	4.7	3.0	-9.2	11.5	7.9	1.7	3.4	6.5	6.3	5.5	4.9	4.0	3.3	2.7	2.5	4.1
<b>Unemployment (%)</b>	9.3	7.8	8.1	7.7	7.1	6.9	6.8	6.6	6.4	6.3	6.1	6.0	5.9	5.8	5.7	6.3
<b>Consumer Prices</b>	1.6	2.6	0.3	1.2	2.3	2.0	1.8	1.9	2.0	2.0	2.0	2.0	2.0	2.0	1.9	2.0
<b>Current Balance (% of GDP)</b>	5.1	6.2	5.9	6.0	5.7	6.4	6.7	6.2	6.0	5.9	5.8	5.6	5.5	5.4	5.4	5.9
<b>Exchange Rate (per \$)</b>	1.3	1.5	1.4	1.3	1.4	1.3	1.3	1.3	1.2	1.2	1.2	1.2	1.3	1.3	1.3	1.3
<b>General Government Balance (% of GDP)</b>	-2.5	-0.1	-3.2	-4.3	-1.0	-1.2	-1.0	-0.9	-0.6	-0.1	0.3	0.4	0.3	0.2	0.0	-0.3
<b>Short-term Interest Rates (%)</b>	2.5	4.6	1.2	0.8	1.4	0.7	0.5	0.9	2.0	3.0	3.9	4.1	4.1	4.1	4.1	2.7
<b>Long-term Interest Rates (%)</b>	3.7	4.1	3.3	2.8	2.7	1.6	2.0	2.4	2.9	3.7	4.3	4.4	4.5	4.5	4.5	3.5
<b>Working Population</b>	-0.3	-0.4	-0.5	-0.1	0.1	0.0	-0.2	-0.3	-0.4	-0.4	-0.5	-0.5	-0.6	-0.6	-0.7	-0.4
<b>Labour Supply</b>	0.2	0.0	0.4	0.0	0.6	0.8	0.1	-0.1	-0.2	-0.2	-0.3	-0.3	-0.3	-0.4	-0.6	-0.1
<b>Participation Ratio (%)</b>	79.8	80.4	81.1	81.2	81.6	82.3	82.5	82.7	82.9	83.1	83.3	83.5	83.7	83.9	84.0	83.2
<b>Labour productivity</b>	0.6	-0.4	-5.1	3.1	1.7	-0.3	1.2	1.9	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.6
<b>Employment</b>	0.4	1.2	0.0	0.5	1.3	1.0	0.2	0.2	0.0	-0.1	-0.1	-0.2	-0.3	-0.3	-0.4	0.0
<b>Output gap (% of potential GDP)</b>	-1.2	1.6	-4.5	-2.3	-0.8	-1.7	-1.9	-1.4	-1.0	-0.6	-0.4	-0.2	-0.1	0.0	0.0	-0.7



## Background

- Until the global crisis, Germany's economic performance had been categorised by surging exports that had left it as the world's leading exporter and boosted investment, but had only slowly filtered into the labour market and private consumption. Exports are more important to the German economy than other major European economies, accounting for some 40% of GDP. Main exports are engineering products, both mechanical and electrical, and main markets include other EU countries and Russia. The importance of exports in GDP had been the main factor behind Germany's emergence from several years of stagnation. In the early part of the 2000s, corporate Germany rationalised production, scaling back on capacity – limiting investment and shedding employees – as well as forcing through wage restraint. These measures were successful, as witnessed by Germany's export success, but unemployment rose steadily between 2001 and 2005 and real incomes barely grew.
- In 2008 and 2009, however, reliance on exports proved a mixed blessing. With a collapse in world trade, Germany was hit harder than most countries. This surprised many analysts since the economy did not participate in the housing and finance boom of the preceding years. In Germany, there have been calls to change the economic model, but such changes do not happen overnight – they would require an overhaul of the tax system and probably reforms of the finance sector to unleash consumption.
- Then, in 2010 and early 2011, German growth rebounded quickly as the country was able to reap the benefits of past reforms and business investment quickly increased to meet demand from abroad. But the onset of the Eurozone sovereign debt crisis and a general slowdown in Europe saw growth start to slow again in 2011H2.
- The elections at the end of September 2009 put a coalition of the centre-right CDU/CSU and the liberal FDP into power, with Angel Merkel remaining as Chancellor for a second term. This type of coalition has dominated German governments in the post-war period. Among the ministries the Liberals have received are the foreign ministry and the economics ministry.
- In the previous government, the appetite for reform had diminished, partly due to difficulties in reaching agreement within the "Grand Coalition" and partly due to the perceptions that the electorate would oppose further reforms. Thus some of the reforms of the Schröder government were diluted, in particular on labour markets ('Agenda 2010'). The current coalition campaigned on a reform agenda, notably a reform of income tax. But electoral defeat in North Rhine-Westphalia, the most populous state, means that the coalition has lost its majority in the upper house of parliament. This, together with the tight budget constraints following the crisis, means that reforms have slid back down the list of priorities.
- Over the medium term, fiscal policy is driven by the goal to achieve fiscal balance as stipulated in the constitution. The law sets a limit for public deficits at 0.35% of GDP by 2016. The deficit has already been reduced significantly, to 1% of GDP in 2011, and this objective is easily achievable. There is even room for the government to relax its fiscal stance to help bolster growth but, so far at least, such suggestions have met with stark rejection by the finance ministry. After the 9 December 2011 European summit, fiscal rules are expected to be implemented throughout the Eurozone, giving more support to Germany's approach to fiscal policy.
- The leadership of Chancellor Merkel has been weakened by a series of defeats and mistakes, ranging from significant disagreement within the coalition over the nature and extent of deficit reduction measures to defeats in regional election and to the resignation of a key minister, defence minister zu Guttenberg, and that of President Koehler and the narrow win for Merkel's candidate for the presidency, Christian Wulff, later marred by personal scandal. In addition, Merkel's leadership has been further undermined by domestic opposition to the bailout packages for weaker countries in the Eurozone.
- As the Eurozone crisis has spread to more countries, Germany is now seen as the only country with the financial means to support any solution. This has given it more power externally.

## Key Facts

### Politics

Head of state: President Joachim GAUCK  
 Head of government: Chancellor Angela MERKEL  
 Political system: Federal Republic  
 Date of next presidential election: 2015  
 Date of next legislative election: September 2013  
 Currency: Euro

### Long-term economic & social development

	1980	1990	2000	2011*
GDP per capita (US\$)	11744.2	21584	23114	43730
Inflation (%)	5.5	2.7	1.5	2.3
Population (mn)	78.3	79.1	82.2	81.7
Urban population (% of total)	72.8	73.1	73.1	73.8
Life expectancy (years)	72.6	75.2	77.9	80.1

Source : Oxford Economics & World Bank

### Structure of GDP by output

	2009
Agriculture	0.8%
Industry	26.5%
Services	72.7%

Source : World Bank

\* 2011 or latest available year

### Long-term sovereign credit ratings & outlook

	Foreign currency	Local currency
Fitch	AAA (Stable)	AAA (Stable)
Moody's	Aaa (Stable)	Aaa (Stable)
S&P	AAA (Stable)	AAA (Stable)

### Structural economic indicators

	1990	1995	2000	2011*
Current account (US\$ billion)	21	-28	-34	205
Trade balance (US\$ billion)	22	58	55	216
FDI (US\$ billion)	-21	-27	150	-35
Govt budget (% of GDP)	-2.1	-9.5	1.1	-1.0
Govt debt (% of GDP)	42.1	54.9	59.7	80.2
Long-term interest rate	8.7	6.9	5.3	2.7
Oil production (000 bpd)	0.0	58.5	63.8	54.9
Oil consumption (000 bpd)	2682	2882	2767	2414

Source : Oxford Economics / World Bank / EIA

### Destination of goods' exports (2010)

European Union (27)	60.3%
United States	6.8%
China	5.6%
Switzerland	4.4%
Russian Federation	2.7%

Source : WTO



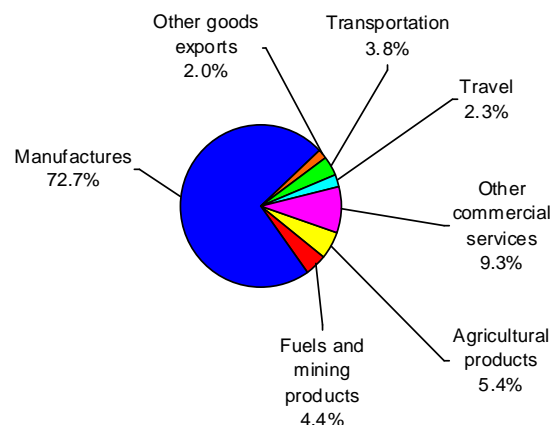
Source : CIA Factbook  
 Central Europe, bordering the Baltic Sea and the North Sea, between Netherlands & Poland, south of Denmark (CIA Factbook)

### Corruption perceptions index 2011

	Score
Developed economies (average)	7.70
Emerging economies (average)	3.44
<b>Germany</b>	<b>8.05</b>

Source: Transparency International  
 Scoring system 10 = highly clean, 0 = highly corrupt

### Composition of goods & services exports, 2010



Source : WTO