Bundesverband der Deutschen Industrie e.V.

QUARTERLY REPORT GERMANY

Robust recovery despite global uncertainty

Quarter III / 2015

- **Real growth of nearly 2 percent is still attainable.** The outlook for the German economy remains robust this year, with healthy economic activity driven by strong private consumption. Low oil prices and exchange rates are having just as positive an impact on the economy as the recovery in the euro area.
- **Global economy gets off to a weaker start to the year than expected.** The US economy's false start can be attributed to one-off factors, and improvements are expected to be seen as the year progresses. China has bounced back from the dip in growth experienced in the first quarter with a solid second quarter. The situation in Japan is surprisingly positive. India remains the star performer in terms of growth. Russia and Brazil, on the other hand, are mired in deep recessions.
- **Over the course of the year, investment activity in many segments is expected to pick up slightly.** Most indicators point towards higher levels of economic activity as the year progresses. It remains to be seen how companies will adjust to the uncertainties over Greece and the new opportunities in Iran.

Content

Global economy falters at year's start

Global economic growth slowed somewhat in the first few months of the year. Industrial production fell sharply in the newly industrialised countries. Momentum also tapered off in the industrialised countries. Macroeconomic reports were very mixed, prompting international organisations to moderately downgrade their growth forecasts. The IMF recently announced that the global economy would not recover but move sideways this year (3.3 per-cent in 2015 following 3.4 percent in 2014). In June, the OECD also dropped its forecast by more than half a percentage point (0.6 percentage points) to 3.1 percent. Both the IMF and the OECD still expect the global economy to pick up considerably in 2016. The volume of world trade, however, will expand only gradually this year, with the OECD anticipating a rise of 3.9 percent and the IMF a rise of 4.1 percent, following a 3.2 percent increase last year.

Forecast summary: Growth in real GDP 2015/16

	2014	2015			2016		
	IST	IWF[1]	OECD[2]	EU-KOM[3]	IWF	OECD	EU-KOM
World	3.4	3.3	3.1[4]	3.6	3.8	3.8[4]	4.0
USA	2.4	2.5	2.0	3.5	3.0	2.8	3.2
China	7.4	6.8	6.8	7.1	6.3	6.7	6.9
Japan	-0.1	0.8	0.7	1.3	1.2	1.4	1.3
EU	1.4			1.7			2.1
Euro area	0.8	1.5	1.4	1.3	1.7	2.1	1.9
Germany	1.6	1.6	1.6	1.5	1.7	2.3	2.0
France	0.2	1.2	1.1	1.0	1.5	1.7	1.8
Italy	-0.4	0.7	0.6	0.6	1.2	1.5	1.3
Spain	1.4	3.1	2.9	2.3	2.5	2.8	2.5
UK	2.9	2.4	2.4	2.6	2.2	2.3	2.4
India	7.3	7.5[5]	6.9	6.6	7.5[5]	7.6	7.1
Brazil	0.1	-1.5	-0.8	0.7	0.7	1.1	1.8
Russia	0.6	-3.4	-3.1	-3.5	0.2	0.8	0.2

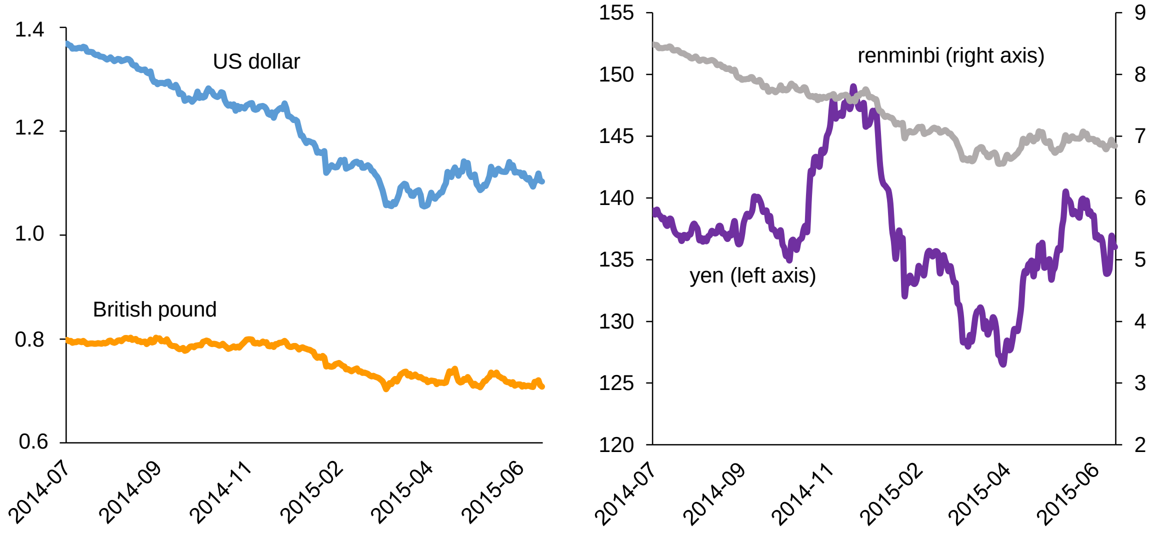
1: IMF (July 2015)
2: OECD (2015)
3: European Commission (May 2015)
4: Forecast on the basis of 70 percent world GDP (PPP of 2013)
5: Information on India for the fiscal year and in current prices

Global economic growth, year-on-year in percent

Source: IMF 2015

The most volatile markets in the last few months – currencies and oil prices – have calmed down. Crude oil prices have recovered slightly from their low point and are in line with market expectations. The big realignment of the euro-dollar exchange rate has been overcome, with the euro exchange rate stabilising slightly in the last few weeks. The turbulences surrounding Greece seem to have barely impacted the euro exchange rate.

Euro`s exchange rate to the US dollar, British pound, Japanese yen and Chinese renminbi



Source: Eurostat

The outlook for inflation remains unchanged, with very weak performance in the large economies and gradually increasing core rates. The extreme swings on the bond markets have also been corrected somewhat.

The latest national developments have prompted contradictory market corrections. While the forecasts for the United States, Mexico and Brazil have dropped considerably and those for Japan moderately, the prospects for the euro area and China are stable and those for Russia and Spain have been increased. None of these developments have been triggered primarily by monetary or fiscal policy changes. The monetary policy of most countries remains expansive, while the fiscal policy of most countries is largely neutral. It is rather a series of specific temporary factors that are playing a significant role.

After weak start, US should improve as the year progresses

The US economy caused the biggest disappointment in the first quarter. According to the most recent estimates of the Bureau of Economic Analysis (2015), however, it declined in real terms by only 0.2 percent (on an annual basis) and not by 0.7 percent (as in the mid scenario), following 2.2 percent growth in the fourth quarter. Thus, the US economy did not follow the expansion path that had been largely anticipated. The start of the year was marked with dampening influences: falling exports combined with rising imports pulled down growth by half a percentage point; weaker capital expenditure on equipment caused negative growth of 0.2 percentage points (Ifo 2015); and lower public spending by the individual states and municipal governments acted as a further drag on economic activity. The positive contributions made by private consumption, inventories and residential construction were not enough to keep growth above the zero line.

One-off factors behind dismal performance

The reasons for the early year slide are clear enough. Net exports fell by 10 percent on an annual basis on account of the considerable appreciation of the trade-weighted dollar. The lower exports also hit corporate profits. Industrial production declined slightly. There are indications that the new exchange rate situation will stabilise and will not have a stronger impact over the course of the year. Capital expenditure on equipment will remain weak in the first six months of the year as they will be affected by the extraordinary effects in the shale gas sector. Many companies are cutting back their investments considerably in response to the lower oil price on the global market. Economic output was curbed until March by the harsh weather (by a quarter of a percentage point) and labour disputes at ports on the West Coast.

Fundamental factors still robust

All these factors are likely to be temporary. The labour market is still very dynamic, but is not yet providing all people with jobs so there is upward potential. The financing conditions for the business sector are still very favourable. The scope for private households to consume more should be put to better use in the further course of the year, although early in the year consumers showed a considerably higher savings quota following savings in heating and petrol. Car sales in the last two months have been very robust and consumer spending increased in May by a sturdy 0.9 percent compared with the previous month. The housing market is picking up speed across the country. Wages have not risen much, which is surprising in view of the very low unemployment rate of 5.3 percent, according to the latest available figures.

Solid growth and increase in interest rates likely

Despite the mixed news for the US economy, the upward trend should remain intact (DIW 2015, Ifo 2015). Real growth of up to 2.5 percent looks realistic for this year. Key indicators of investment and consumption point towards a revival in the second quarter and in the rest of the year. Those states that have yet to completely overcome the long-term effects of the property crisis are slowly beginning to grow again (Economist 2015). This should also help to contain the weak phases that Mexico and Canada have been going through of late. The US Federal Reserve is likely to stick to its road map for a hike in interest rates in the second half of the year if the trends on the labour market persist and the dollar stabilises, according to the Fed Chair's most recent half-year report to Congress on July 15 (Yellen 2015).

Following a sluggish winter, China's economy stabilises in the second quarter

The IMF and OECD both assess China's growth target of 7 percent for this year as mostly realistic (both institutes forecast growth at 6.8 percent). As a response to the acute weak period for industry early in the year, China's monetary and economic policy is targeted towards stabilising output and this has taken effect in the second quarter. The Central Bank has cut interest rates four times since November. The key interest rate is currently at 5.1 percent, which is 1.5 percentage points lower than it was in November. According to press reports, the Central Bank is intervening on a broad scale on the foreign exchange markets to support a strong exchange rate and bolster confidence. The renminbi appreciated by a good 14 percent on an annual basis, in real terms and trade-weighted, practically soaring in unison with the US dollar. Furthermore, Chinese banks also stepped up lending. The Central Bank is trying to put the brakes on lending to the property sector while going easy on the corporate sector. On the whole, it seems to be succeeding in enduring the correction on the property market despite the knock-on effects on industry, and in drastically cutting back the financing of shadow banks while also getting a handle on the massive risks for financial stability. The property market is meanwhile close to bottoming out. The government has also started a public investment scheme to set incentives while the lower local authorities are having to cope with declining tax revenue from real estate. In addition, the Chinese Government and monitoring authorities have succeeded in bringing the financing of the private sector back to normal bank structures last year and contain the shadow bank financing that had threatened since 2013 to spiral out of control.

Solid second quarter instead of a steady descent

According to the government estimates, the first half of 2015 performed as follows. Growth in the first quarter was a meagre 1.4 percent (on a real, seasonally adjusted basis) higher than the previous quarter and, in non-adjusted terms, 7 percent higher than the first quarter of 2014 (NBSC 2015a, b). This was the weakest quarter China has seen for a long time. At 1.7 percent over the first quarter and again 7 percent above the same quarter in 2014, the economy is clearly regaining strength. The booming financial services sector has definitely played a role in these months. Capital expenditure on equipment rose by more than 12 percent in real terms in the first six months, year on year, with consumer spending up more than 10 percent. Despite the considerable real appreciation of the renminbi, exports increased slightly while imports dropped by more than 15 percent. Net exports contributed to growth. Industry gross value added increased in the first two quarters by 6.2 percent and 6.3 percent respectively. Viewed on a monthly basis, the weak phase in the first quarter with a low in March was clearly overcome in the second quarter. Although these increases are low by Chinese standards, they are certainly in line with the targeted restructuring of the Chinese economy. If the services sector is to grow faster than overall growth, industry will have to remain below the overall average growth of the economy. In view of the continuing correction on the property market, the building materials and steel production sectors are especially hit by surplus capacities and weak output although this surplus in supplies is in part also exported. Car manufacturing is also posting below average growth rates with production volumes decreasing since last summer (NBSC 2015c). The sharp rises in share prices in the last few months have most recently been corrected somewhat. Potential effects on the real economy will be very limited, however, although it might affect the propensity of the more well-off Chinese to spend.

China's economic restructuring proceeding at a fast pace

China's programme of "rebalancing" external and internal growth factors is racing ahead at a torrid pace. Real value creation in the services sector is currently at 49.5 percent, which is not only 2.1 percentage points higher than a year earlier but now also outperforms the industrial sector by 5.8 percentage points. Consumer spending meanwhile accounts for 60 percent of domestic demand, up 5.7 percentage points over the same period last year (NBSC 2015b).

Japan resumes recovery

Japan's impressive return to growth in the first quarter (up to 1 percent quarter-on-quarter) made clear that the Japanese economy has overcome the shock effect of the 2014 tax increase. We forecast real growth of 1 to 1.5 percent for both this year and next (Deutsch and Keichel 2015). The government's consolidation course for the state budget was directed into a less ambitious path in June, but fiscal policy continues to have a slowing effect. Monetary policy on the other hand is still favouring inflation and providing economic stimulus. While the Bank of Japan did slightly lower its average growth forecast for 2015 recently by 0.3 percentage points to 1.7 percent, (1.9 percent for 2016) and its 2015 inflation forecast to 0.7 percent (1.9 percent for 2016), there has not been any strategic change in monetary policy (Deutsche Bank Research, 2015).

Performance indicators for the domestic economy will likely show solid improvement, as capital equipment spending and inventories rose significantly in the first quarter. Lower corporate tax rates will provide additional impetus. Consumer spending is up slightly as well on rising employment and incomes. Net exports are improving gradually despite the substantial decline of the yen, but remain a burden. Implementation of some of the many specific reforms called for under the "third arrow" of Abenomics promise medium-term effects. Following corporate governance reform, the partial privatisation of Japan Post is now on the agenda, slated for autumn 2015.

European economic engine humming

Coming off years of modest growth, the 28 EU countries are now experiencing again a significant increase in economic output. The European Commission is forecasting growth of 1.8 percent for 2015 and 2.1 percent for 2016. Projections for the euro area are somewhat lower at 1.5 percent and 1.9 percent respectively, yet still quite respectable. The OECD, IMF and ECB vary in their estimates within a narrow corridor around the Commission's figures. There are considerable differences in the EU from country to country; 2015 growth in the major economies will, according to Commission data, come in at 2.8 percent for Spain, 2.6 percent for the United Kingdom, 1.1 percent for France and only 0.6 percent for Italy. In its April forecast, the IMF published similar numbers before revising these upward in July for certain EU countries. It now projects 3.1 percent growth for Spain, for example. These developments are still driven by the ECB's expansionary monetary policy, the weak euro and low oil prices.

High unemployment remains a concern

Current growth is sufficient for labour markets to consolidate, with job numbers rising and unemployment falling. The European Commission reckons that the unemployment rate for the 28 EU countries was 10.2 percent in 2014 and projects 9.6 percent for 2015 as well as a decline to 9.2 percent in 2016. Despite the clear downward trend, Europe is thus still well above the average for the pre-crisis years. In 2008 the EU28 unemployment rate was 7 percent, with the average for the years 2000–08 at 8.5 percent (Eurostat). It is still a long way back to that level. The data for the euro area look similar, with the OECD, IMF and ECB estimating a 2014 unemployment rate of 11.6 percent, declining to around 10.5 percent in 2016. Greece and Spain are the problem children of the euro area, having current unemployment rates of around 25 percent.

Low investment is hindering growth

Low investment since the crisis erupted is one reason for the harsh labour market situation. The level of investment activity in the EU is currently 15 percent off the 2007 peak. The situation of research and development (R&D) expenditures is even more dramatic; here the EU lags far behind international benchmarks. The EU was already overtaken by China in relative R&D spending in 2012.The last two years of underinvestment caused many European businesses to lose competitiveness and partially caused the present labour market situation. The expansionary monetary policy of the European Central Bank (ECB) and the investment plan for Europe (the Juncker plan) are attempts to make progress on backlogged investment. Over the next few years the European Fund for Strategic Investment (EFSI) will mobilise 315 billion euros for investments. This measure is flanked by the Capital Markets Union, an attempt to facilitate the capital market access for enterprises which typically rely on debt financing (Eichert 2015).

ECB is unbending in its course

In January 2015, the ECB decided to purchase 60 billion euros in securities and government bonds monthly until at least September 2016. This measure is aimed at getting euro area inflation back up to the target mark of just below 2 percent from the current low level of 0.4 percent. The ECB projects core inflation to be 0.3 percent in 2015, 1.5 percent in 2016 and 1.8 percent in 2017. Since the start of 2015 the euro has depreciated against the currencies of major trading partners. The nominal exchange rate versus the US dollar fell from 1.21 in January to around 1.10 in July 2015, where it has stabilised. The OECD’s exchange rate forecast is 1.12 (as of May 2015).

Europe’s big question mark

The situation in Greece remains unclear. Following the "No" vote in the referendum of 5 July 2015, negotiations between creditors and the Greek government went back to square one. The second assistance programme expired, and now a third has been applied for with the Eurogroup. Conditions have deteriorated, however, and it will take a fair amount of time for any decision to be made. It is impossible to say whether the Greek government is now more open to reforms after the resignation of Finance Minister Yanis Varoufakis. Greece ranks 38th on the list of Germany’s most important trading partners, and any direct impact has been minimal. There have been indirect consequences, however, in the form of market uncertainties.

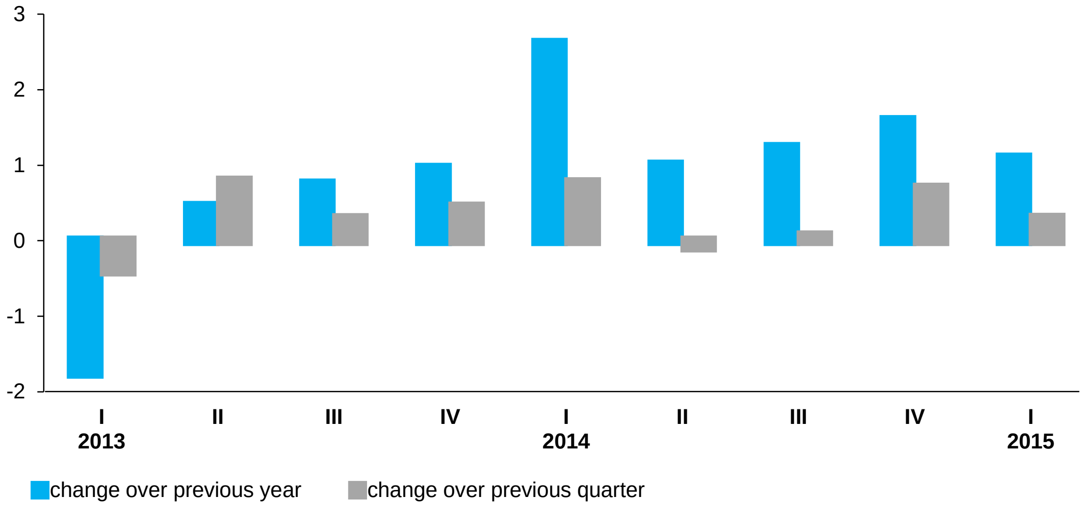
The German economy

Germany off to a solid start in 2015

The German economy came out of the starting blocks quite well this year. After achieving robust GDP growth of 0.7 percent in the final quarter of last year, Germany saw its economic output rise 0.3 percent on an inflation, calendar and seasonally adjusted basis in the first quarter of 2015 versus the previous quarter. This represents a 1.1 percent increase in year-on-year terms. According to preliminary data, the number of employed people who generated the first quarter’s economic output was 42.4 million (up 0.7 percent over the same period last year).

Looking at the **supply side** of gross domestic product, price-adjusted value creation was higher than one year ago across nearly all economic sectors. The biggest growth rates were in trade, transport and the hospitality industry (up 2.3 percent) and among corporate service providers (up 1.8 percent). An increase of 0.6 percent was recorded for manufacturing. Construction output declined 3.1 percent, reflecting the strong economic performance recorded for the same quarter last year. Domestic factors were again the sole driver of demand in the first quarter.

Growth in real GDP, quarterly basis in percent



Source: Federal Statistical Office

Growth boosted by domestic demand, trade balance a drag

In quarter-on-quarter terms after inflation, calendar and seasonal adjustments, **consumer spending** increased 0.7 percent while **government spending** was up 0.6 percent. Consumer spending contributed 0.5 percentage points to the growth figure. Domestic factors were supported by **capital expenditure**, with equipment spending up 1.5 percent, construction investment up 1.7 percent and investment in other assets (patents, software, etc.) up 0.7 percent on a quarterly comparison. The major decline in inventories early in the year, a 0.3 percentage point drop, resulted in domestic demand only contributing 0.5 percentage points to the growth figure. Net exports – the difference between exports and imports – also had a drag effect. Exports rose only 0.8 percent versus the same quarter last year, which may seem surprising at first given the substantial decline in the euro. In terms of volume, however, global imports were down quarter-on-quarter in the first quarter, mainly due to very low Chinese import activity. Additionally, Germany imported 1.5 percent more goods and services in the first quarter, which took 0.2 percentage points off the net exports figure.

Weak euro providing significant stimulus for German exports

In the first quarter of 2015, German exports of goods rose by 15 billion euros, a 5.4 percent increase over the first quarter of last year (country-specific, adjusted figures for the previous-year quarter were not available). Fuelled by the exchange rate, the largest gains in **exports** were to the United States (up 20.6 percent, a gain of 4.65 billion euros), the United Kingdom (up 7 percent, a gain of 1.49 billion euros) and Poland (up 9.5 percent, a gain of 1.08 billion). The economic recovery in the euro area also led to an increase in exports of goods to France (up 3.5 percent, a gain of 914 million euros), Spain (up 9.4 percent, a gain of 827 million euros) and Italy (up 3.4 percent, a gain of 470 million euros). Exports to Switzerland and Turkey declined substantially. Exports to Russia plunged 33.9 percent, by 2.56 billion euros, due to EU sanctions and the country's slumping economy.

Significantly fewer goods were supplied to Ukraine (down 30.7 percent, a decrease of 470 million euros) and Belarus (down 33.4 percent, a decrease of 146 million euros)

Export surpluses and deficits in selected countries

Q1 2015 versus the same quarter last year

Increase (+) or decrease (-) in exports			Increase (+) or decrease (-) in imports		
	in million euros	in %		in million euros	in %
USA	+ 4 658	+ 20.6	**China**	+ 4 154	+ 21.8
UK	+ 1 488	+ 7.0	**USA**	+ 2 304	+ 18.8
Poland	+ 1 081	+ 9.5	**Poland**	+ 1 262	+ 13.2
France	+ 914	+ 3.5	**Ireland**	+ 497	+ 22.4
Spain	+ 827	+ 9.4	**Czech Republic**	+ 493	+ 5.5
Switzerland	+ 793	+ 6.8	**Hungary**	+ 371	+ 6.9
Turkey	+ 661	+ 13.8			
Netherlands	+ 488	+ 2.6	**Kazakhstan**	- 401	- 33.0
Italy	+ 470	+ 3.4	**Belgium**	- 457	- 4.7
			France	- 535	**- 3.0**
Belarus	- 146	- 33.4	**Nigeria**	- 587	- 49.3
Ukraine	- 293	- 30.7	**Netherlands**	- 813	- 3.6
Russian Federation	- 2 562	- 33.9	**Russian Federation**	- 3 140	- 29.6
Total	**+ 15 025**	**+ 5.4**	**Total**	**+ 4 212**	**+ 1.8**

Source: Federal Statistical Office

Imports only rise slightly

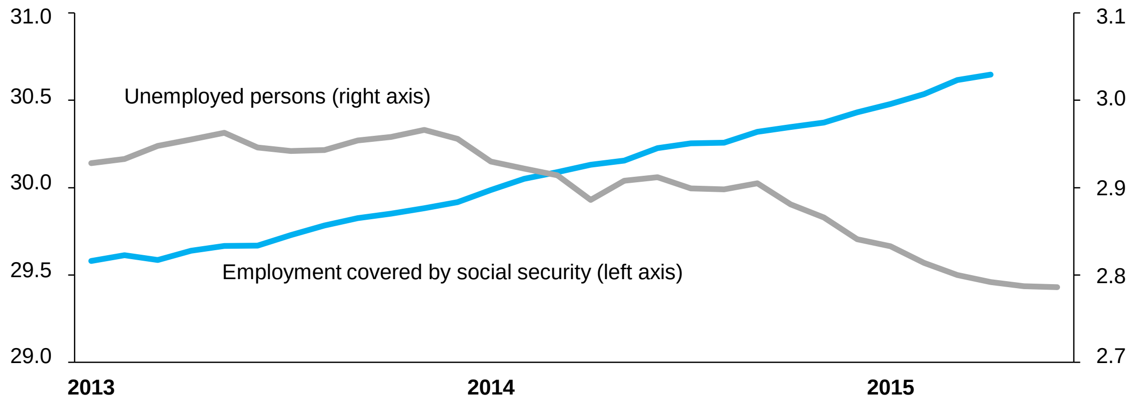
German **imports** were up only 1.8 percent versus the same period last year, with China accounting for bulk of his increase (up 21.8 percent, a gain of 4.15 billion euros). Imports of goods and services from the United States rose 18.8 percent (up 2.30 billion euros), from Poland 13.2 percent (up 1.26 billion euros) and Ireland 22.4 percent (up 497 million euros) versus a year ago. Imports from Hungary, the Czech Republic and Croatia rose substantially as well. Imports of raw materials were much lower from such supplier countries as Nigeria (down 49.3 percent), Kazakhstan (down 33 percent) and the Russian Federation (down 29.9 percent). Goods imports declined as well from our western neighbours the Netherlands (down 3.6 percent, a decrease of 813 million euros), France (down 3 percent, a decrease of 535 million euros) and Belgium (down 4.7 percent, a decrease of 457 million euros).

German exports are expected to gain further momentum in the second quarter. The foreign trade data for May 2015 indicate that aggregate exports rose by 5.7 percent in the first five months of the year versus the same period last year. Aggregate exports to EU countries increased by 4.9 percent (euro area was up 3.4 percent, non-euro area 7.5 percent). Goods exports to non-EU countries increased 6.8 percent in year-on-year terms, presumably boosted by exchange rates. German imports increased at a slower pace, up 2.1 percent from EU countries, while the figure for goods bought from outside the EU was somewhat more vigorous at 2.8 percent.

Job growth losing momentum

The number of **employed** in Germany rose to 42.8 million in May according to preliminary data from the Federal Statistical Office. This represents a 0.5 percent increase versus May of last year, an increase of 213,000 employed people. While the number of employed continues to grow, the rate of job creation has fallen by nearly half in year-on-year terms. According to the latest projections from the Federal Employment Agency, in April 2015 (latest available data) 30.88 million employees were paying into the **social security system**. This represents an increase of 1.7 percent, or 521,000 employees, versus a year ago. The number of jobs rose year-on-year across nearly all industries. On an absolute basis, the most hiring was seen in skilled corporate services (up 4.2 percent, or 89,000 employees), nursing and social work (up 3.4 percent, or 69,000 employees), other business services (up 4.8 percent, or 61,000 employees) and trade (up 1.4 percent, or 59,000 employees). The only noteworthy declines were in the public sector (down 0.9 percent, or 16,000 employees) and in the areas of mining, energy and water supply, and waste management (down 1.6 percent, or 9,000 employees).

German labour market*



*seasonally adjusted, in million

Source: Federal Employment Agency

Unemployment down significantly

The Federal Employment Agency recorded 2.711 million unemployed in June 2015. This represents a 4.3 percent decrease, or 121,600 fewer unemployed people, in year-on-year terms. According to the German calculation method, the unemployment rate for June was 6.4 percent. The corresponding figure according to the ILO method is 4.7 percent – the lowest in the European Union. While the number of employees paying into the social security system rose in the first of quarter of 2015 over same period last year, there were declines in other employment categories. According to the Federal Statistical Office, the number of self-employed (including contributing family workers) declined 1.8 percent. The number of workers exclusively employed in officially low-paid jobs decreased 3.7 percent in April, according to Federal Employment Agency data, reflecting in part the introduction of a national minimum wage. Hiring numbers continue to rise, with the levels up year-on-year according to both nationwide job data and officially reported job figures. Despite the recent surge in jobs subject to social security contribution, unemployment has not fallen accordingly. Increasing employment chiefly reflects the hiring of individuals not recorded as unemployed and growth of the labour pool due to immigration and an increased inclination to work.

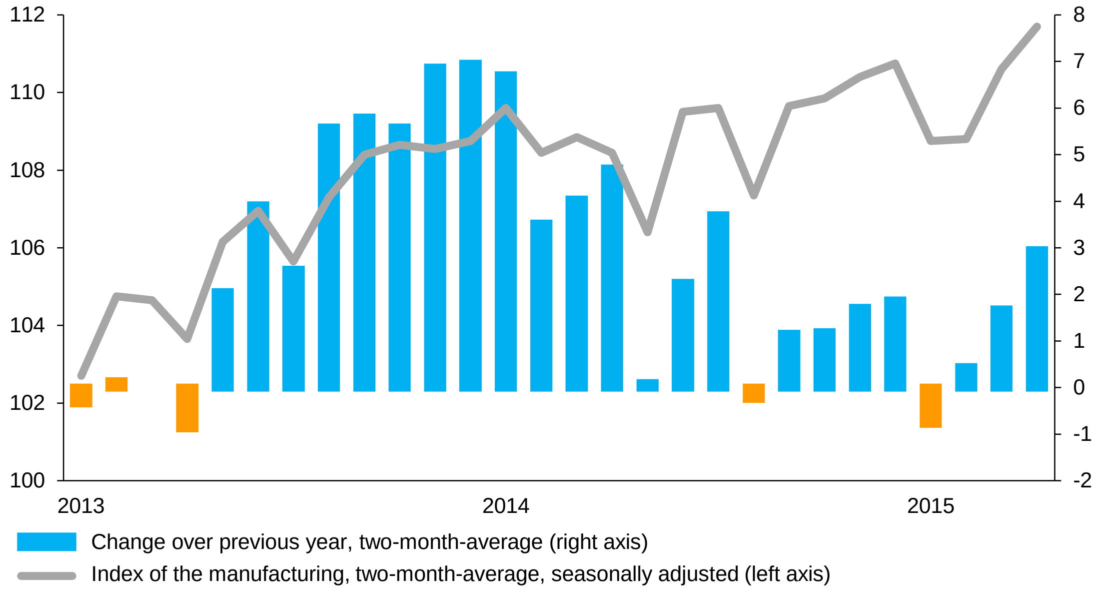
Incoming orders and manufacturing

New orders down slightly

A 0.2 percent month-on-month decline in manufacturing **orders** occurred in May 2015 according to preliminary data (after inflation, calendar and seasonal adjustments). The April figure, however, was corrected upwards by 0.9 index points on subsequent data. Orders were up 2.2 percent in April 2015, large order volume being relatively light in April and well below average in May.

The adjusted **two-month comparison** between February/March 2015 and April/May 2015 shows a significant 2.7 percent increase in new orders. While domestic demand declined by a slight 0.4 percent in the two-month comparison, international orders rose by a solid 5 percent versus same period last year, driven by a 7.7 percent gain in orders from the euro area. Orders from non-EU countries increased 3.4 percent. Industrial activity picked up across up the board in the second quarter, part of a clear upward trend in manufacturing orders since the year began. Although orders levelled off in June, they will likely rise by 2 percent or more in the second quarter versus both the previous quarter and year over year.

New orders, manufacturing



Source: Federal Statistical Office

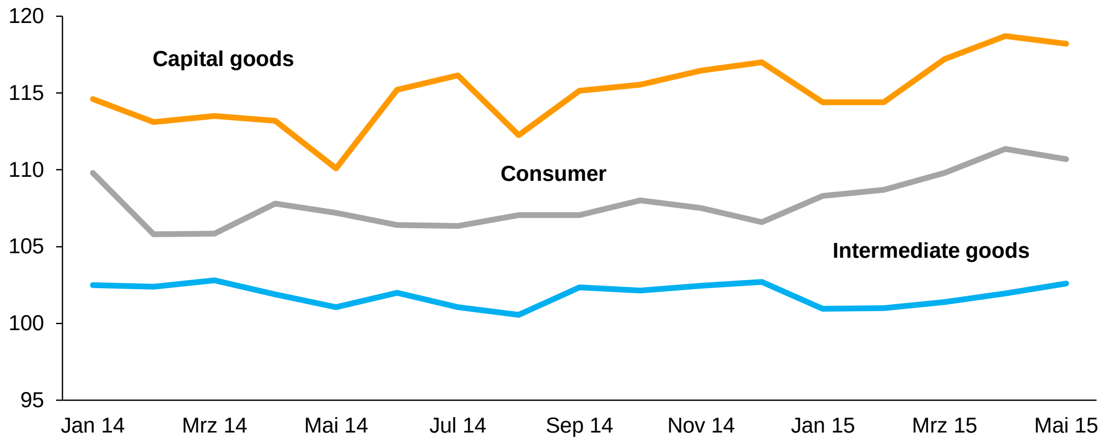
Rising demand for intermediate goods

In May, among the main manufacturing sectors, only producers of intermediate goods recorded an increase in new orders (up 1.3 percent). Both domestic and international demand for intermediate goods rose from April to May. In a two-month comparison between February/March and April/May the increase was 0.9 percent. Demand for domestic intermediate goods increased 0.8 percent while international demand rose for the first time in five months (up 1.0 percent).

Demand for capital goods stable

Capital goods manufacturers reported a 0.8 percent decline in new orders in May 2015, after two straight months of increases. Domestic demand was down 2.9 percent month-on-month, while international demand for capital goods rose again slightly (up 0.3 percent). The two-month comparison, which smooths out volatility, shows a 3.8 percent rise versus the earlier period. The recent jump in international demand for capital goods (up 7.2 percent) more than offset declining domestic demand (down 1.9 percent). Despite the latest negative blip, capital goods demand has in general been quite stable. Also, apart from a small decline at the start of this year, two-month comparisons have consistently shown demand for capital goods exceeding the previous-year level since September 2014.

Incoming orders within the main manufacturing sectors*



* two-month average, seasonally adjusted

Source: Federal Statistical Office

Consumer goods still in demand

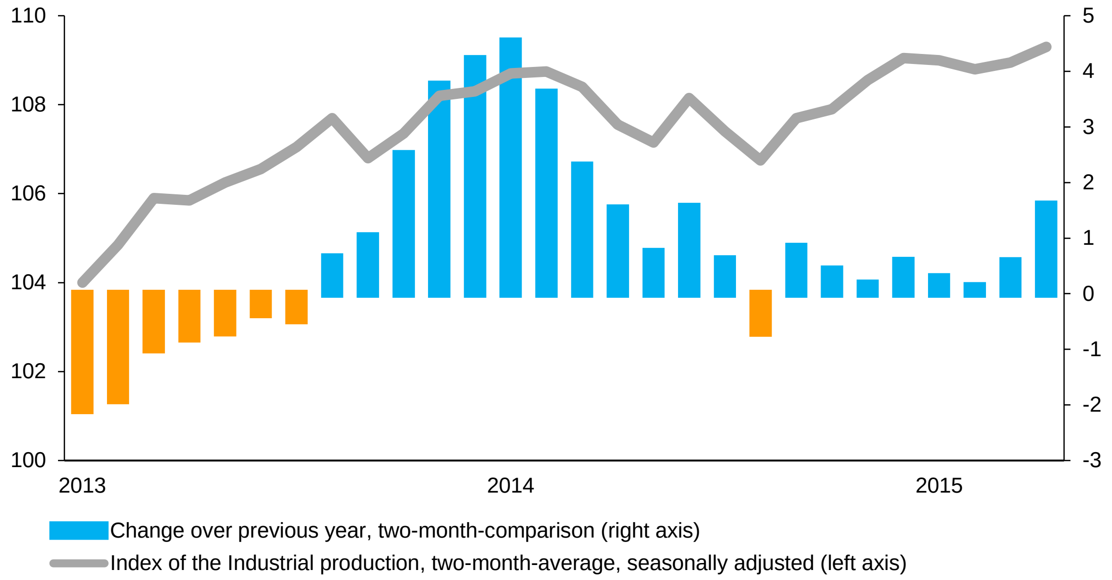
Makers of consumer goods recorded a 1.2 percent month-on-month decline in new orders in May, after a 4.1 percent rise in April. Domestic demand increased 2 percent, while international demand fell markedly by 3.4 percent. In the two-month comparison between February/March and April/May, demand for consumer goods rose 2.4 percent. Domestic demand increased 1.8 percent and international demand 2.8 percent in that period, the fourth rise in a row in the latter category. Demand for consumer goods retreated slightly around the start of the year due to weak foreign demand. Since spring, however, both domestic and foreign demand have risen well above their previous-year levels.

Temporary decline in industrial production

Output in industrial production was unchanged month-to-month in May 2015 according to initial data (on an inflation, calendar and seasonally adjusted basis). After a downward revision of 0.3 percentage points, a 0.6 percent production increase versus March was recorded. There were considerable differences within the production sector, with energy output down 3.1 percent and construction output 0.5 percent lower than in April. **Industrial production** increased by 0.4 percent in May versus the previous month. Within the **main manufacturing sectors**, production of intermediate goods decreased by 0.2 percent. Capital goods production on the other hand increased by 0.4 percent in May, while consumer goods production rose by 1.3 percent.

In the **two-month comparison**, industrial production as a whole increased by 0.5 percent. After declines in the two previous months, a comparison between February/March and April/May indicates **industrial production** likewise rose 0.5 percent – up 1.4 percent year-on-year according to the most recent data. Within the **main manufacturing sectors**, producers of **intermediate goods** recorded a decline of 0.1 percent for their third straight decrease. However, output exceeded the previous-year level for the first time in three months. **Capital Makers of capital goods** recorded a 1.2 percent production increase in the most recent two-month comparison.

Industrial production



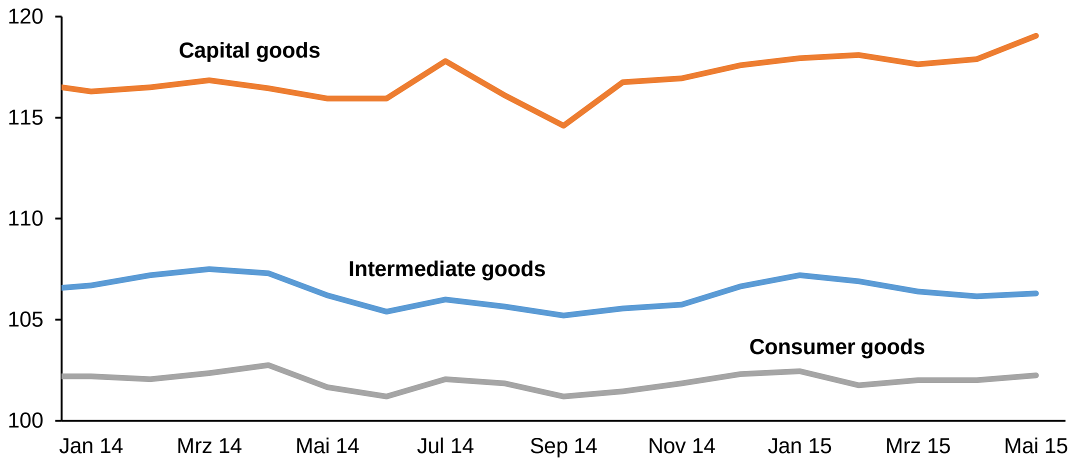
Source: Federal Statistical Office

In fact, production exceeds the previous year's figure by a substantial 2.7 percent. **Consumer goods** production has risen by 0.2 percent most recently, and is up slightly year-on-year, by 0.4 percent. For almost a year now though, production of consumer goods has churned sideways within a narrow range of +/– 0.8 percent.

Industrial activity stable in the spring

In the spring industrial production continued its slow march upward. A decline in construction affected the overall result somewhat; however, it is not unusual for the springtime surge in the construction industry to flatten out if a mild winter disrupts production only minimally. **Industrial activity** appears to have further stabilised during the spring. Even if industrial output stagnates in June, which is improbable in view of order flow, production in the industrial sector is set to increase 0.5 percent quarter-on-quarter. A similar figure will likely be achieved in the manufacturing sector, where the previous year's production level is set to be exceeded again in the second quarter of this year.

Production within the main manufacturing sectors*



* two-month average, seasonally adjusted

Source: Federal Statistical Office

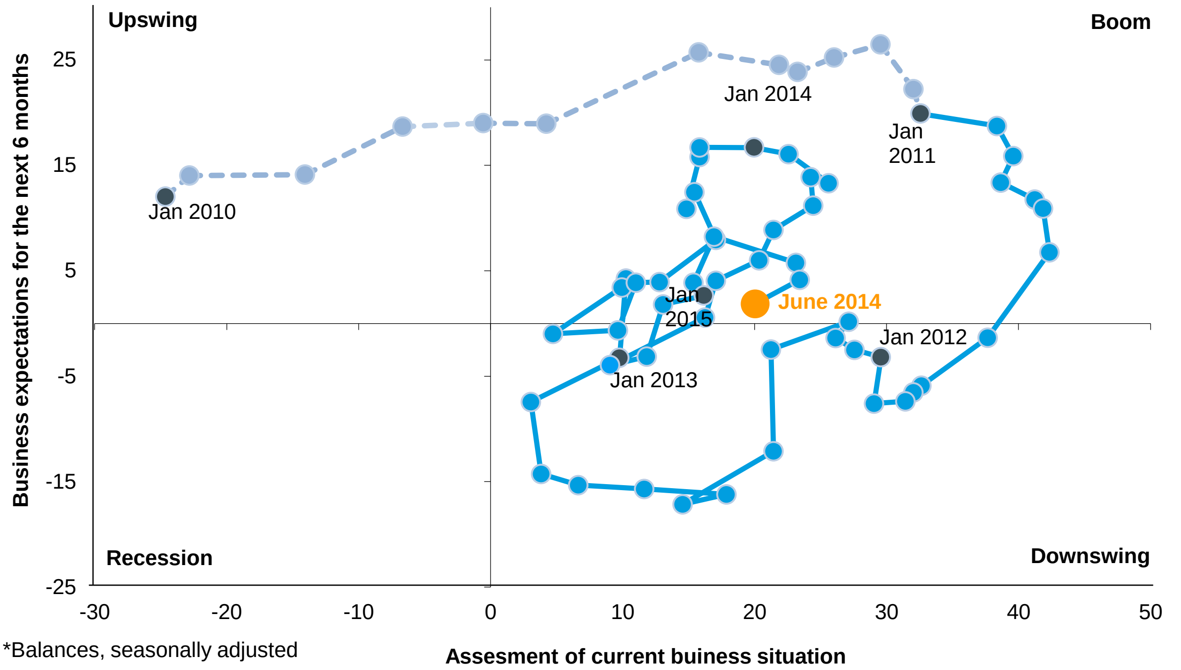
Capacity utilisation remains high

The production increase observed in recent months led to another slight rise in **capacity utilisation** among industrial enterprises (excluding food and beverage production and tobacco processing). In the second quarter capacity utilisation rose to 85.1 percent, its fourth increase in a row. Capacity utilisation is therefore now at a three-year high. A majority of companies believe their capacities are still more than sufficient to meet demand over the next twelve months. Orders in hand in manufacturing remain stable. Companies have an order backlog of 2.8 months on average since early 2013.

Business climate index lower, though still on a high level

The **Ifo Business Climate Index** for industry and trade fell significantly in June 2015 after a minor decline in May. The expectations component had been the factor negatively influencing the climate index, but now since June the current business situation of the companies surveyed has deteriorated. The **industrial mood** has also caused a noticeable decline in the Business Climate Indicator, with recent highly positive assessments having been retracted to a significant extent. Expectations for the six months ahead have fallen for the third consecutive time. Despite the rather substantial deterioration in business climate, the pointer on the **Ifo Business Cycle Clock** remains in the “boom quadrant”. Although the mood has deteriorated, industrial firms believe international business will remain good. Production plans were somewhat less expansionary in view of ebbing demand. According to the Ifo Employment Barometer, industrial firms are planning to hire additional staff.

ifo Business-Cycle Clock
Germany, manufacturing*



*Balances, seasonally adjusted

Source: ifo Institute

Outlook

GDP growth of 2 percent still possible

The German economy is currently on a stable upward trajectory and, as it seems, nearly immune to current geopolitical uncertainties, whether it is the Ukraine conflict, unrest in the Middle East and Gulf region, or the Greek crisis. Concerns are outweighed by such positive factors as lower oil prices than last year, which boosts consumer purchasing power, and a low euro exchange rate, which is a boon to exports.

Consumer spending strong, in line with expectations

The German economy has picked up substantial momentum after a steady start to the year. Domestic factors are again the main driver, particularly consumer spending, which is buoyed by a steady employment trend. The number of employed rose to approximately 42.8 million, influenced by immigration and slightly decreasing unemployment. The most growth was in jobs subject to social security contributions. Private consumption received a further boost from increased consumer purchasing power, which was partly due to a considerable year-on-year fall in energy prices. Wage increases at a rate that significantly outstrips inflation also helped to strengthen real consumer purchasing power. While consumer confidence, as gauged monthly by the consumer research firm GfK, has deteriorated somewhat in July due to the Greek crisis, it remains at a very high level. Consumers' economic expectations are slightly less positive, but income expectations have hit a new high. This was reflected in the performance of retail sales, which were markedly higher in April and May.

Slight increase in CAPEX possible

Capital expenditures may well provide a tailwind for the domestic economy. ECB monetary policy continues to create an extremely favourable lending environment, and corporate financing problems are therefore not likely. The economy is not yet in danger of overheating. Industrial capacity utilisation has steadily risen in recent quarters, albeit only slightly. While not enough to spur investment in expansion, it is increasingly fuelling investment in replacement equipment. The low interest rate environment, rising incomes and a good labour market situation have created favourable conditions for private housing construction. And housing demand continues to rise due to immigration, which bodes well for construction.

Foreign trade picking up

Following a tepid start to the summer half of the year, German exports should accelerate somewhat due, among other factors, to the nascent recovery of the global economy. After a weak first quarter, the US economy appears to be on the move again, even as some countries in the euro area are staging a much stronger recovery than could have been expected early in the year. In addition, German exports continue to enjoy a bit of tailwind from the weak euro. Imports should continue to benefit from a vibrant domestic economy and also stand to gain significantly. With commodity prices low and terms of trade consequently more favourable, the trade balance will for the time being reflect rising net exports, so foreign trade should provide a positive impetus to growth. When the oil price effect wears off towards the end of the year, this driver of GDP growth will likely go into reverse.

Over the remainder of this year, the German economy can be anticipated to gain further steam, building on its robust start. Consumer spending and the gradually increasing level of capital expenditure will be the principal pillars supporting growth. Foreign trade will not be a drag on growth in the rest of this year, so GDP expansion of up to 2 percent is still quite attainable for 2015.

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This Quarterly Report is a translation based on „Quartalsbericht Deutschland III / 2015" as of 23 July 2015.

Basic data for national accounts

GDP (price, seasoanlly and calendar adjusted)
Change over previous period in percent

			Year 2014				2015
	2013	2014	Q1	Q2	Q3	Q4	Q1
Consumption	0.8	1.2	0.6	0.2	0.7	0.6	0.6
Private Consumption	0.8	1.2	0.8	0.0	0.7	0.7	0.6
Public Consumption	0.7	1.1	0.0	0.7	0.6	0.3	0.7
Investment	-0.6	3.4	3.0	-1.7	-1.2	0.8	1.5
Machinery and Equipment	-2.4	4.3	2.0	0.6	-1.4	0.4	1.5
Construction	-0.1	3.6	4.5	-3.7	-1.5	1.3	1.7
Other	1.3	1.2	0.8	0.1	0.2	0.2	0.7
Domestic Demand	0.7	1.3	0.9	-0.3	-0.3	1.1	0.5
Exports	1.6	3.9	0.1	1.0	1.5	1.0	0.8
Imports	3.1	3.4	0.2	0.7	0.8	1.9	1.5
Contributions to growth (in percentage points)							
Consumption	0.6	0.9	0.4	0.2	0.5	0.5	0.5
Private Consumption	0.5	0.7	0.4	0.0	0.4	0.4	0.3
Public Consumption	0.1	0.2	0.0	0.1	0.1	0.1	0.1
Investment	-0.1	0.7	0.6	-0.4	-0.2	0.2	0.3
Machinery and Equipment	-0.2	0.3	0.1	0.0	-0.1	0.0	0.1
Construction	0.0	0.4	0.5	-0.4	-0.2	0.1	0.2
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic Demand	0.6	1.2	0.8	-0.2	-0.3	1.0	0.5
Net Exports	-0.5	0.4	-0.1	0.2	0.4	-0.3	-0.2

Source: Destatis

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