ECONOMIC RESEARCH & CORPORATE DEVELOPMENT

Forecast Update

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} MACROECONOMICS } FINANCIAL MARKETS } ECONOMIC POLICY } SECTORS

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USA, Euro area, Germany

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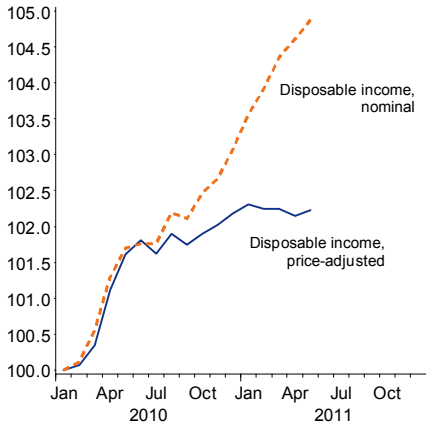
Forecast Update

USA

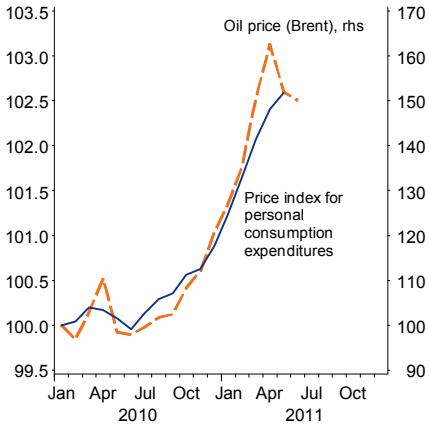
- Economic momentum remained moderate in Q2
- Key negative factors starting to fade
- Dark clouds of uncertainty still hover over fiscal policy

Compared with the final quarter of 2010, the US economy slowed noticeably in the first six months of 2011. In the first three months of this year, real gross domestic product rose by only 1.9% (annualized rate) on the previous quarter as a result of slower consumption momentum, dwindling private construction spending and an accelerated decline in government spending. To some extent, the disappointing growth figures can be attributed to one-off factors, such as inclement weather conditions and a marked drop in volatile defense spending.

Disposable personal income
Indices, Jan. 2010=100



Oil price and consumer prices
Indices, Jan. 2010=100



Source: EcoWin.

Nevertheless, economic momentum in the second quarter of the year is also expected to lag well behind the high expectations being touted by many observers only a few months ago. Based on the economic indicators that are available at the moment, GDP growth is once again expected to come in at only around 2%. Although the sustained recovery in equipment investment and exports is being accompanied by a moderate increase in private construction investment, the disruption to the global value chains sparked by the catastrophe in Japan is still weighing down on economic growth. Bottlenecks affecting the supply of parts and components by Japanese suppliers are certainly leaving their mark, causing a dip in automotive production in particular and, as a result, reduced expansion in industrial production. In particular, however, real consumer spending is, yet again, down considerably quarter-on-quarter. Private consumption is still being shaped to a considerable degree by the impact of the substantial oil price hike in the period leading up to early May. On balance, the associated increase in gasoline prices has caused the real incomes of private households to stagnate.

However, there are growing signs that these negative factors are beginning to fade. As a result, there is a chance that the US economy will be able to get back into its stride in the second half of the year. First, the distinct upturn in Japanese export volumes in May suggests that the Japanese industrial sector will be able to offset the production losses incurred. Given these normalization trends, it comes as no surprise that the production plans of the US automotive industry for June and July point clearly upwards. If these plans are put into practice, US automotive production could see double-digit growth in the third quarter and make a growth contribution of just shy of one percentage point (annualized rate). Second, the conditions for the stabilization of consumer spending have improved. The recent reversal in oil prices means that gasoline prices are now already back to more than 10% below the peak reached in May. This should help to keep consumer prices more or less stable in June and July at least.

The US economy is, however, treading a fine line. Above all, it can be expected to remain fragile for as long as job creation – which slowed of late – does not start to pick up speed again. What is more, the ongoing consolidation efforts at federal state and municipal level will translate into sustained downward pressure on government spending. Overall, therefore, the potential for recovery looks limited. All in all, we predict average annual growth to the tune of 2.5% in 2011.

One of the risks hanging over future economic development continues to lie in the ongoing uncertainty surrounding future fiscal policy. The government and Congress have still to reach an agreement on lifting the government debt ceiling. According to updated calculations by the US Treasury Department, a decision will have to be made by the beginning of August at the latest. Otherwise, the existing budget gap, which corresponds to almost 10% of GDP, would have to be closed immediately, a move that would doubtlessly plunge the US economy back into recession. The potential volatily on the financial markets stemming from continued uncertainty about fiscal policy alone could be enough to have a marked negative impact on the economy.

USA: Economic indicators and forecasts*

		2010				2011				2012						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2010	2011f	2012f
GDP real		3.7	1.7	2.6	3.1	1.9	2.2	3.1	2.5	2.1	2.7	2.6	2.7	2.9	2.5	2.5
Private consumption		1.9	2.2	2.4	4.0	2.2	1.2	2.4	1.9	2.0	2.4	2.5	2.4	1.7	2.4	2.2
Fixed investment		3.4	18.9	1.5	6.8	1.3	7.8	9.1	9.5	5.7	4.3	4.7	4.9	3.9	6.1	6.5
Inventory change	USD bn	44	69	121	16	56	50	56	56	36	41	41	45	62.6	54.4	40.8
Government spending		-1.6	3.9	3.9	-1.7	-5.8	0.2	-1.0	-0.6	-1.0	-0.8	-0.8	-0.8	1.0	-1.2	-0.8
Gross domestic demand		3.9	5.2	4.1	0.1	1.7	1.7	2.8	2.4	1.4	2.2	2.2	2.3	3.2	2.1	2.1
Exports		11.4	9.1	6.7	8.6	7.7	7.6	8.0	6.2	8.7	7.8	7.4	7.4	11.7	7.8	7.7
Imports		11.2	33.5	16.8	-12.6	5.1	3.0	4.7	4.7	3.0	4.1	4.1	4.1	12.6	3.9	3.9
Net exports	USD bn	-338.4	-449.0	-505.0	-397.7	-392.4	-376.1	-366.2	-363.7	-341.6	-328.1	-316.1	-303.6	-422.5	-374.6	-322.4
Industrial production		8.1	7.1	6.7	3.1	4.2	1.7	3.7	3.0	3.7	3.2	3.5	3.5	5.3	3.9	3.3
Unemployment rate	%	9.7	9.6	9.6	9.6	8.9	8.9	8.8	8.7	8.7	8.6	8.5	8.5	9.6	8.8	8.6
		0.0	0.0	0.0	0.0											
Consumer prices		1.3	-0.5	1.4	2.6	5.2	4.3	1.4	1.8	2.0	2.0	2.1	2.4	1.6	3.0	2.1
Producer prices		7.4	0.3	1.1	6.5	12.9	7.8	1.4	1.8	2.0	2.0	2.1	2.4	4.2	6.3	2.3
		0.0	0.0	0.0	0.0											
Current account balance	USD bn	-118.3	-120.3	-120.1	-112	-119	-134	-132	-133	-127	-124	-122	-119	-471	-518	-492
	% of GDP	-3.3	-3.3	-3.3	-3.0	-3.2	-3.5	-3.4	-3.4	-3.3	-3.1	-3.1	-3.0	-3.2	-3.4	-3.1
Federal budget	FY, USD bn													-1294	-1425	-1150
	% of GDP													-8.9	-9.4	-7.3
3-month money market rate **)	%	0.3	0.5	0.3	0.3	0.3	0.3	0.3	0.6	0.9	1.2	1.5	1.6	0.3	0.4	1.3
10-year treasury yield **)	%	3.8	2.9	2.5	3.3	3.5	3.1	3.4	3.6	3.8	3.9	4.0	4.0	3.2	3.4	3.9
Exchange rate **)	USD per EUR	1.35	1.23	1.36	1.34	1.42	1.45	1.45	1.45	1.45	1.45	1.45	1.45	1.33	1.43	1.45

*) Percent change over previous period, seasonally adjusted annual rates, except where noted; **) End of quarter, yearly average.

f = forecast.

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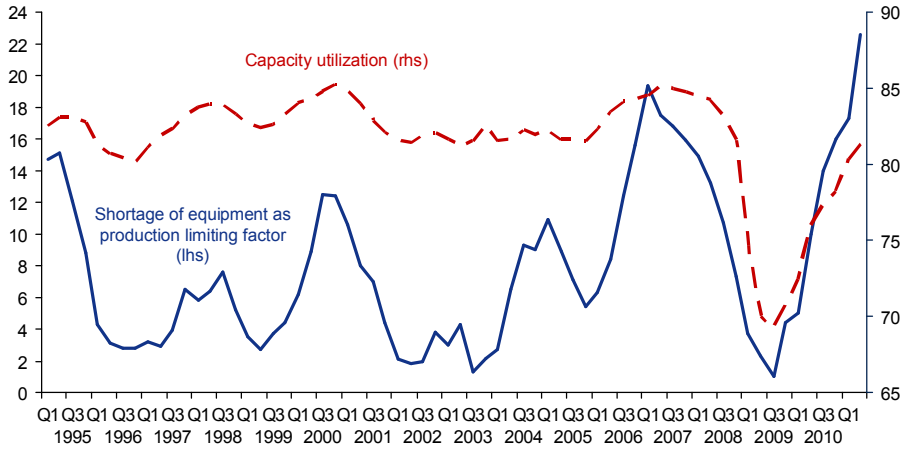
EUROZONE

- Strong growth in real GDP in the first quarter
- Economic recovery continues at a slower pace
- Continuation of the interest rate turnaround

The eurozone economy moved up a gear in the first quarter of this year. Bolstered by positive development in domestic demand and, in particular, in equipment investmens, with a growth rate of 2.3% (q-o-q), real gross domestic product rose by 0.8% on the previous quarter. At the same time, performance within the single currency area continued to vary. Whereas economic output was particularly strong in Germany (+1.5% on the previous quarter) and showed relatively robust growth in France, gross domestic product virtually stagnated in Italy (+0.1%) and Spain (+0.3%), and fell in Portugal, for the second time running, by 0.6%. Even though Greek GDP expanded marginally at a rate of 0.2% in the first three months of the year, this must be viewed against the backdrop of the steep 2.8% slump in economic activity in Q4 2010. Thanks to solid export performance, Irish GDP delivered a positive surprise, with quarter-on-quarter growth of 1.3%.

Manufacturing: Capacity utilization and shortage of equipment



Sources: EcoWin, DG ECFIN.

We expect the recovery in economic activity to continue as the year progresses, not least thanks to the fact that the European Central Bank's monetary policy is still accommodative. Leading indicators, however, such as the purchasing managers' index (PMI), suggest that the pace of economic recovery in the euro area will ease in the course of the year. Compared with May, the survey results for June slid from 54.6 to 52 points for the manufacturing industry and from 56 to 54.2 for the service sector. The fact, however, that some of the factors that are currently weighing on economic growth – such as the inflation fueled by commodity prices, which is having a negative impact on real disposable incomes and, as a result, on private consumer spending – are likely to start to fade during the forecast period suggests that the recovery should continue at a moderate pace. Sustained foreign trade impetus, improved capacity utilization and more relaxed financing conditions suggest that private investment demand will remain lively. At the same time, the increasingly restrictive fiscal policy could put the brakes on the pace of expansion.

All in all, we expect to see real GDP growth in the euro area to the tune of 2.0% this year and 1.7% next year.

At its last meeting, the ECB Council left the main refinancing rate at its current level of 1.25%, as expected. Banks finding it difficult to access the interbank market are still being propped up by the policy of unlimited liquidity. The Governing Council announced that it would be sticking by its policy of offering a generous supply of central bank funds to commercial banks and maintaining the full allotment both for weekly main refinancing operations and for special refinancing operations for as long as proves to be necessary, but at the very least until October of this year.

The increase in commodity prices has meant that inflation rates in the eurozone have been relatively high in recent months, with the annual rate of inflation (HICP) coming in at 2.7% in May after touching 2.8% in April. In a monthly comparison, however, inflation in the single currency area remained moderate. The annual core rate of inflation (which leaves energy and foodstuffs out of the equation), which was still sitting at only 1.1% at the end of 2010, stood at 1.7% in May. From the ECB's perspective, it is of considerable importance that the increase in the rate of inflation does not trigger second-round effects for prices and wages, ushering in widespread inflationary pressure.

Against this backdrop, Jean-Claude Trichet used his speech to draw attention to the upward price risks and the need for strong vigilance – suggesting that the interest rate turnaround that has already been initiated will be continued. The ECB also announced that it had raised its forecasts for inflation and economic growth: the Central Bank's economists expect this year to bring average annual inflation of 2.6% (March projection: 2.3%) and average economic growth of 1.9% (March projection: 1.7%). Arguing against any further tightening of monetary policy are the risk of the European debt crisis coming to a dramatic head or a severe economic slump in the euro area. We, however, are of the view that the marked political commitment to solving the sovereign debt crisis, coupled with steady economic development, should be enough to nudge the ECB in the direction of a further interest rate hike.

These considerations suggest that moderate interest rate increases will be the most realistic compromise, meaning that any radical move to break ties with the expansionary monetary policy or to abandon the interest rate turnaround can be ruled out. We predict a moderate increase in the main refinancing rate to 1.5% at the coming Council meeting on July 7. Assuming that this is the case, the ECB is likely to gradually lift the key interest rate to 2.0% next year and move away from its policy of the unlimited allotment of central bank liquidity at a fixed interest rate.

Euro area: Economic indicators and forecasts*

		2009				2010				2011				2012							
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011f	2012f
GDP real		-2.6	-0.2	0.4	0.3	0.3	0.9	0.4	0.3	*0.8*	*0.3*	*0.3*	*0.4*	*0.4*	*0.5*	*0.5*	0.5	-4.1	1.7	*2.0*	*1.7*
Private consumption		-0.1	0.0	-0.2	0.2	0.4	0.2	0.2	0.3	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*	*0.4*	*0.4*	-0.7	0.8	*1.2*	*1.3*
Government spending		0.9	0.8	0.4	0.4	-0.3	0.3	0.1	-0.1	*0.6*	*-0.2*	*-0.1*	*0.1*	*0.1*	*0.2*	*0.2*	*0.2*	2.8	0.6	*0.5*	*0.4*
Investment		-5.2	-2.2	-1.2	-0.7	-0.7	2.2	-0.2	-0.3	*2.0*	*0.8*	*0.7*	*0.7*	*0.7*	*0.7*	*0.8*	*0.8*	-11.1	-0.9	*3.4*	*3.0*
Exports		-7.7	-1.1	2.6	2.3	3.4	4.3	1.6	*1.6*	*2.2*	*1.5*	*1.4*	*1.4*	*1.5*	*1.5*	*1.5*	*1.5*	-12.2	10.9	*7.6*	*6.0*
Imports		-6.0	-2.7	1.8	1.2	3.8	4.1	1.3	*1.1*	*1.7*	*1.2*	*1.3*	*1.3*	*1.3*	*1.3*	*1.4*	*1.4*	-10.8	9.2	*6.1*	*5.3*
Industrial production (excl. construction)		-9.3	-1.5	2.9	1.1	2.5	2.4	1.1	1.8	*1.2*	*0.9*	*0.9*	*0.9*	*0.8*	*0.7*	*0.9*	*1.0*	-14.7	7.4	*5.1*	*3.4*
Unemployment rate	%	8.9	9.4	9.8	10.0	10.1	10.2	10.1	10.1	*9.9*	*9.9*	*9.9*	*9.8*	*9.8*	*9.7*	*9.6*	*9.6*	9.5	10.1	*9.9*	*9.7*
Consumer prices	y-o-y	1.0	0.2	-0.4	0.4	1.2	1.6	1.7	2.0	*2.5*	*2.7*	*2.5*	*2.1*	*1.7*	*1.8*	*1.8*	*1.8*	0.3	1.6	*2.5*	*1.8*
Producer prices	y-o-y	-2.0	-5.8	-7.9	-4.6	-0.1	3.0	4.0	4.8	*6.5*	*6.5*	*6.2*	*5.4*	*3.2*	*2.3*	*2.7*	*3.2*	-5.1	2.9	*6.1*	*2.8*
Current account balance	EUR bn, nsa	-19.1	-7.6	-1.4	-2.8	-1.2	-11.2	-8.2	-16.0	*-15.1*	*-6.0*	*1.3*	*2.5*	*2.8*	*3.0*	*3.3*	*3.5*	-30.9	-36.6	*-17.3*	*12.5*
	% of GDP																	-0.3	-0.4	*-0.2*	*0.1*
Budget balance	% of GDP																	-6.3	-6.0	*-4.6*	*-3.8*
3m money market rate**)	%	1.5	1.1	0.8	0.7	0.6	0.8	0.9	1.0	*1.2*	*1.5*	*1.5*	*1.6*	*1.7*	*1.8*	*1.9*	*2.1*	1.2	0.8	*1.5*	*1.9*
10yr gov. bond yield***)	%	3.0	3.4	3.2	3.4	3.1	2.6	2.3	3.0	*3.4*	*3.0*	*3.2*	*3.5*	*3.6*	*3.7*	*3.8*	*3.9*	3.3	2.8	*3.3*	*3.8*
Exchange rate**)	USD per EUR	1.33	1.41	1.46	1.44	1.35	1.23	1.36	1.34	*1.42*	*1.45*	*1.45*	*1.45*	*1.45*	*1.45*	*1.45*	*1.45*	1.39	1.33	*1.43*	*1.45*

*) quarterly values: percentage change over previous period, seasonally adjusted, except where noted; annual GDP not adjusted; foreign trade incl. intra-trade.
) end of quarter, yearly average. *) Germany as benchmark; end of quarter, yearly average.

f = forecast.

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GERMANY

- Slower growth momentum in the second quarter of 2011
- Buoyant consumption
- Ongoing investment backlog

The German economy, which got off to a flying start in 2011 with q-o-q growth of 1.5%, lost some of its momentum in the second quarter of this year. GDP is expected to have edged up by around ½ percent compared with the first quarter – which nevertheless constitutes respectable growth of more than 3% on a year earlier.

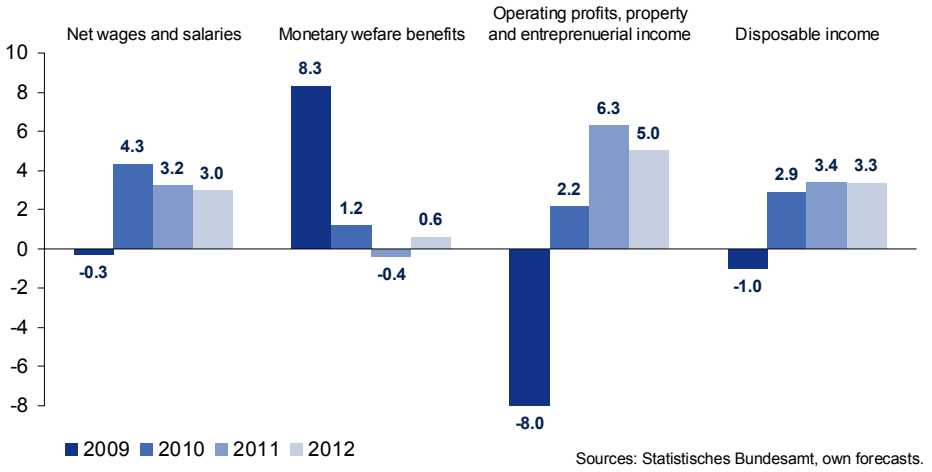
Several reasons have contributed to the somewhat weaker economic momentum in the spring. First of all, the natural and reactor catastrophe in Japan has disrupted global production chains. Second, the late Easter break this year is likely to have put the production rhythm out of sync and third, the dramatic increase in the price of commodities has resulted in substantial real income losses for the corporate sector and private households alike. Finally, the escalation of the debt crisis is likely to have put at least a slight damper on economic expectations. Considering all of the above, the fact that growth is no longer quite as high as it was should not be seen as a disappointment.

The labor market is still sending out positive signals, even if the drop in unemployment (on a seasonally-adjusted basis) has slowed slightly over the past few months. In May, the number of people out of work inGermany fell below the three-million mark for the first time this year and is expected to remain below this threshold for the remainder of the year. The figures most recently available show that around 500,000 more people were in work than in the same period of the previous year. The fact that the number of people in full-time posts that are subject to social security contributions has risen by 440,000, or 2.0%, is particularly encouraging.

This employment boost generates income which, in turn, will bolster the upward trend in domestic demand. The gross monthly earnings of full-time employees in Q1 2011 were up by 4.1% year-on-year, particularly due to longer working hours. The total of gross wages and salaries of all employees was up by 4.4% in a year-on-year comparison in the first three months of 2011. Even if the overall tax burden on incomes in 2011 has risen further, net labor income is set to rise by more than 3% this year. Given that less use is being made of the shorter working hours model and the fact that unemployment figures are on a downward trend, monetary social benefits in 2011, on the other hand, will fall slightly. Corporate budgets and the self-employed can expect to see their income increase substantially this year. All in all, the disposable income of private households is likely to increase by just under 3½%. Stripping out likely inflation of 2.3%, this will leave real income gains to the tune of around 1%. With hopes of rosy economic prospects evidently high, the propensity to consume among private households in 2011 to date has been higher than in recent years. Real private consumption is expected to increase by 1½ - 2% in 2011, the sort of increase last seen back in 2001.

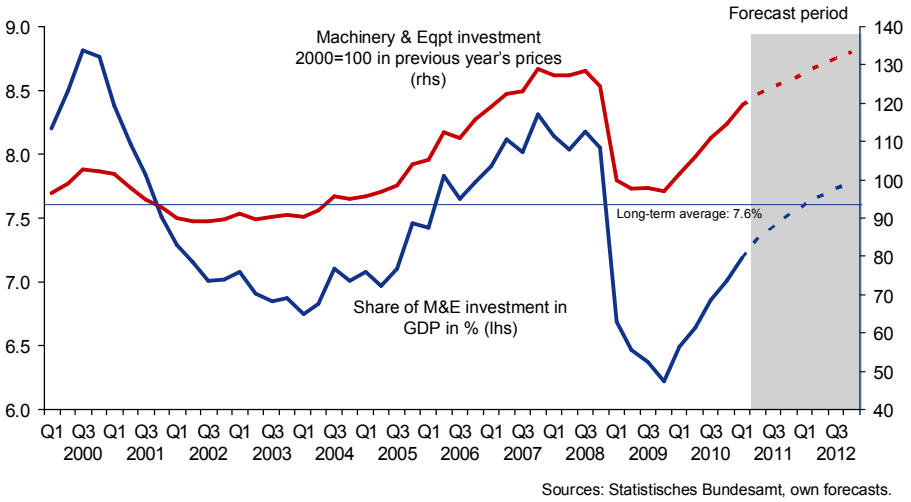
Private household disposable income

% change on year earlier



One aspect of economic activity that is currently flourishing is investment. Given the low investment levels in the wake of the economic crisis and the marked rise in capacity utilization of late, this is an absolute must if we want to lay the foundation for a continued upswing. In the first quarter of 2011, around 18% more was invested in equipment than in the first quarter of 2010. Equipment investment expressed as a proportion of gross domestic product, however, are still languishing below the long-term average. Solid corporate earnings and low interest rates suggest that investment demand in Germany will continue to rise in the course of the year, even if the global economy slows down. Looking at 2011 on average, we expect to see equipment investment rise by around 13½%.

Investment volume and investment ratio



Thanks to the buoyant start to the year the German economy is likely to record average annual growth of 3.2% in 2011.

Germany: Economic indicators and forecasts*

		2009				2010				2011				2012							
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2009	2010	2011f	2012f
GDP real		-3.7	0.5	0.8	0.5	0.5	2.1	0.8	0.4	*1.5*	*0.4*	*0.3*	*0.2*	*0.5*	*0.6*	*0.6*	*0.6*	-4.7	3.6	*3.2*	*1.7*
Private consumption		0.2	0.5	-1.1	-0.2	0.1	0.7	0.3	0.6	*0.4*	*0.4*	*0.2*	*0.2*	*0.4*	*0.4*	*0.4*	*0.4*	-0.2	0.5	*1.7*	*1.2*
Government spending		0.8	1.0	0.5	0.0	1.5	-0.6	0.8	-0.2	*1.3*	*0.0*	*0.0*	*0.0*	*0.2*	*0.3*	*0.2*	*0.2*	2.9	1.9	*1.4*	*0.6*
Investment in machinery/equipment		-19.6	-2.4	0.4	-1.0	4.6	4.6	4.5	3.2	*4.2*	*2.5*	*1.5*	*1.5*	*1.5*	*1.5*	*1.3*	*1.3*	-22.6	10.9	*13.4*	*5.4*
Construction		-0.2	-0.4	0.9	0.5	-2.2	6.7	-0.5	-2.6	*6.2*	*-1.0*	*0.0*	*1.0*	*1.0*	*1.0*	*1.0*	*0.8*	-1.5	2.8	*4.9*	*2.2*
Domestic demand		-1.4	-0.7	1.3	-1.5	1.4	2.0	0.5	-0.2	*1.1*	*0.1*	*0.2*	*0.3*	*0.5*	*0.5*	*0.6*	*0.6*	-1.9	2.4	*1.9*	*1.3*
Exports		-10.1	-1.6	2.8	3.3	4.0	6.8	1.4	1.8	*2.3*	*2.5*	*1.5*	*1.0*	*1.5*	*1.8*	*1.5*	*1.5*	-14.3	14.7	*9.1*	*5.4*
Imports		-5.5	-4.7	4.3	-1.5	6.7	7.1	0.8	0.8	*1.5*	*2.0*	*1.2*	*1.2*	*1.5*	*1.8*	*1.5*	*1.5*	-9.4	13.0	*6.7*	*5.4*
Industrial production (excl. construction)**		-12.6	-0.3	3.7	1.2	2.3	5.1	1.8	3.0	*2.0*	*1.4*	*1.2*	*1.0*	*1.1*	*0.9*	*0.7*	*0.7*	-16.2	10.9	*8.8*	*4.2*
Unemployment rate (EU def.)	%	7.6	7.8	7.9	7.7	7.5	7.2	6.9	6.7	*6.3*	*6.0*	*5.9*	*5.8*	*5.7*	*5.7*	*5.5*	*5.5*	7.7	7.1	*6.0*	*5.6*
Unemployment rate (nat. def.)	%	7.9	8.3	8.2	8.1	8.0	7.7	7.6	7.4	*7.3*	*7.0*	*6.9*	*6.8*	*6.7*	*6.6*	*6.4*	*6.4*	8.1	7.7	*7.0*	*6.5*
Employed persons (national def.)	y-o-y	0.4	0.0	-0.2	-0.3	-0.2	0.5	0.8	1.1	*1.4*	*1.2*	*1.0*	*0.9*	*0.7*	*0.6*	*0.5*	*0.5*	0.0	0.5	*1.1*	*0.6*
Consumer prices	y-o-y	0.8	0.3	-0.2	0.4	0.8	1.1	1.2	1.5	*2.1*	*2.3*	*2.4*	*2.1*	*1.8*	*1.7*	*1.9*	*2.1*	0.4	1.1	*2.2*	*1.9*
Consumer prices (HICP)	y-o-y	0.8	0.2	-0.4	0.3	0.8	1.0	1.2	1.6	*2.2*	*2.5*	*2.5*	*2.2*	*1.9*	*1.6*	*1.9*	*2.1*	0.2	1.2	*2.4*	*1.9*
Producer prices	y-o-y	0.9	-3.6	-7.4	-6.3	-2.6	1.1	3.6	4.7	*5.7*	*4.7*	*4.3*	*3.7*	*2.3*	*2.4*	*2.4*	*2.4*	-4.1	1.7	*4.6*	*2.4*
Current account balance	EUR bn	24.2	29.3	38.3	43.0	33.4	30.2	37.6	38.3	*35.0*	*31.0*	*29.0*	*31.0*	*32.0*	*32.0*	*33.0*	*33.0*	133.7	141.4	*126.0*	*130.0*
	% of GDP																	5.6	5.6	*4.9*	*4.9*
Budget balance	EUR bn																	-72.7	-82.0	*-50.0*	*-27.0*
(Maastricht-definition)	% of GDP																	-3.0	*-3.3*	*-1.9*	*-1.0*

*) quarterly figures: percentage change over previous period, seasonally and working day adjusted, except where noted, yearly figures: percentage change, not working day adjusted; **) yearly average working day adjusted.

f = forecast.

These assessments are, as always, subject to the disclaimer provided below.

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In 2010 151,000 employees in 70 countries achieved total revenue of 106.5 billion Euros and an operating profit of 8.2 billion Euros. Benefits for our customers reached 91.4 billion Euros.
This business success with insurance, asset management and assistance services is based increasingly on customer demand for crisis-proof financial solutions for an ageing society and the challenges of climate change. Transparency and integrity are key components of sustainable corporate governance at Allianz SE.

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