ECONOMIC RESEARCH & CORPORATE DEVELOPMENT

Working Paper 150

March 29, 2012

} MACROECONOMICS } FINANCIAL MARKETS } ECONOMIC POLICY } SECTORS

Claudia Broyer, Gregor Eder, Thomas Hofmann, Dr. Rolf Schneider

Economic Forecast 2012/2013: Upswing in Germany regaining momentum

Allianz

Working Paper

No. 150

Economic Forecast 2012/2013:

Upswing in Germany regaining momentum

AUTHORS:

CLAUDIA BROYER
Tel.: +49.69.2 63-57667
claudia.broyer@allianz.com

GREGOR EDER
Tel.: +49.69.2 63-5 33 58
gregor.eder@allianz.com

THOMAS HOFMANN
Tel.: +49.69.2 63-1 99 12
t.hofmann@allianz.com

DR. ROLF SCHNEIDER
Tel.: +49.69.2 63-5 77 90
rolf.schneider@allianz.com

1. Global economic situation and outlook

The global economy lost considerable momentum in 2011, with both global industrial production and world trade reporting growth rates that were only around half as high as in the previous year. There were manifold reasons for this development. First, the supply side was hit by an unusually large number of shocks. The steep rise in commodity prices in the first four months of the year pulled substantial purchasing power out of the net importing countries. In addition, the natural catastrophes in Japan and Thailand interrupted international production and supply chains in the spring and autumn.

Second, a change in economic policy strategies put a damper on development. The emerging markets were forced to tighten their monetary policy reins to combat racing inflation and signs of overheating in specific sectors. The industrialized nations started to focus on cutting their budget deficits, which had swollen considerably in the course of the recession. In the eurozone, the markets continued to up the consolidation pressure. The sovereign debt crisis reached a head in the second half of the year when contagion spread to Italy and banks encountered growing difficulties raising finance on the market. The considerable tension on the financial markets not only reflected the uncertainty surrounding further developments in the eurozone. Given the extent to which the world's foreign trade and financial systems are intertwined, the markets increasingly started to expect a marked slowdown in the global economy.

Although, in this less favorable overall environment, global economic output was still headed north at the end of 2011, growth in the real gross domestic product of the G20 states, which account for around 85% of global economic output, dropped - with considerable variation from region to region - to 0.7%, the lowest value seen since Q2 2009.

Over the past few months, European economic policy – and particularly the ECB with its resolute monetary policy easing – has been laying the foundation required to ensure that the forthcoming corrections to government budgets can be made while maintaining tolerable financing conditions for the private sector, too. Stress levels on the financial markets have fallen appreciably, fueling hopes that the spending plans that were shelved when uncertainty was at its peak can be revived again.

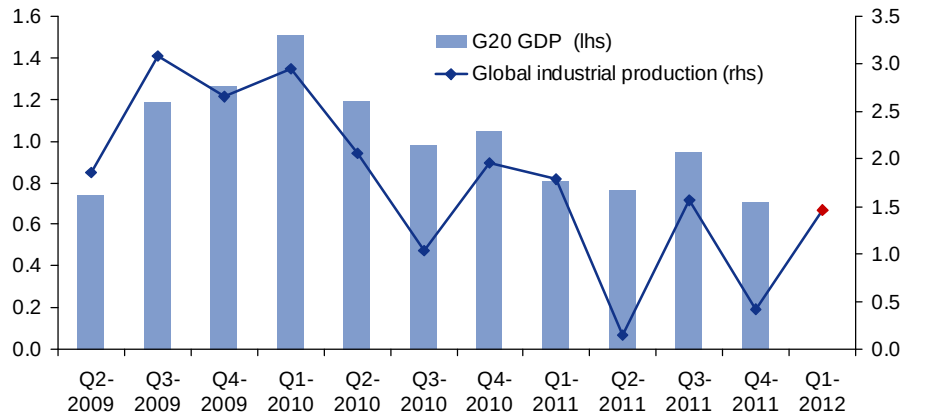
At the start of this year, key indicators are signaling that the slowdown in the global economy is not set to continue. Global industrial production, which had already rebounded in December 2011, rose again sharply in January, putting it almost 1.5 percent up on the overall disappointing level seen in the final quarter of 2011. Looking ahead, it is important to bear in mind the fact that many emerging markets have already eased their tighter monetary policy again. And signs of improved economic momentum recently emerged in the US, too.

One undesirable development, on the other hand, is the fact that oil prices are higher again, likely in response to the geopolitical tension in the Middle East. Another substantial increase in oil prices would clearly undermine the growth outlook. There is no doubt that the announcement made by Saudi Arabia that the country may take moves to considerably increase its oil supply reduces this risk considerably.

Chart 1

G20 GDP and global industrial production*

Change on preceding quarter in %



*) G20 GDP: Aggregation using purchasing power parity

Global industrial production: Q1 2012: January figure relative to Q42011 average

Sources: OECD, CPB Netherlands Bureau for Economic Policy Analysis.

All in all, there is much to suggest that the world economy will remain on the growth path. Nonetheless, 2012 won't be an easy year. Above all, the consolidation of public-sector budgets is likely to restrain economic momentum. This document sets out our assessment of the economic prospects for individual regions and countries:

USA

The US economy grew by only 1.7% in 2011, dragged down by falling government spending and lower inventory investment. The annual result mainly reflects the weak development in the first half of the year, because the US economy bucked the trend seen in many other countries by picking up speed as the year neared its close. This development owes itself to considerable moves to rebuild inventories which had previously fallen too low - in relation to end sales.

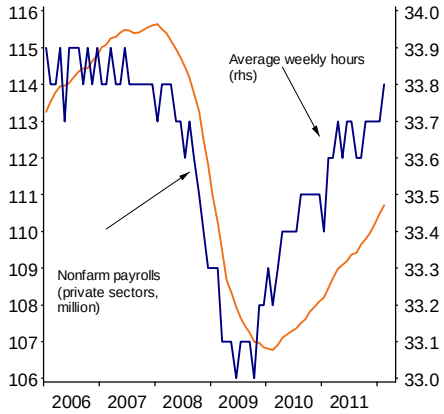
In the early months of this year, the labor market, in particular, paints an encouraging picture. Despite a further slide in public sector employment, 245,000 new jobs were created every month between December and February, and the downward trend in first-time jobless claims has continued of late. The demand for labor is now being helped along by the fact that the average weekly working hours of employees have already normalized again, returning to the level seen before the recession. This means that any additional work has to be increasingly covered by new hires.

The improved prospects of a job are likely to have a positive impact not only on general consumer sentiment, but also on the market for residential property. In particular, it should promote a further recovery in the number of new households formed, the most important quantitative determinant of the demand for residential space. In actual fact, a clear improvement in the estimates of residential construction companies as far as the sale of single-family houses is concerned and the upward trend for construction permits and construction starts over the past few months suggest that, after a long (since 2006) and very pronounced downturn, this year will bring a recovery in the residential construction sector. The large number of unsold houses, however, is likely to keep a lid on any upside potential for some time to come. In addition to this, access to mortgage loans is more difficult than it was in the past due to tighter lending standards. All in all, strong residential construction activity is likely to spur a sustained dynamic development in

overall private investment, which has recently been given a decisive boost by corporate equipment investment.

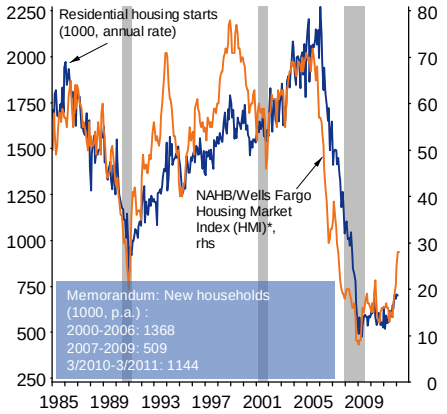
Chart 2

Working-time* already back to pre-crisis level



* Non-management employees.

Sentiment in residential sector has improved appreciably



*HMI derived from assessment by residential construction firms of current/expected sales of single-family houses and purchasers' interest..

Sources: EcoWin, US Census Bureau (Current Population Survey) .

The residential construction upswing could indirectly benefit private consumption, too, thanks to deferred demand for consumer durables. The momentum for real consumer spending is, however, expected to be limited again this year due to the loss of purchasing power as a result of higher energy prices.

Government spending is also likely to remain on a downward trajectory this year, with earlier stimulus programs expiring and defense spending also being cut. There is also considerable uncertainty surrounding next year's fiscal policy, which is expected to be highly restrictive (around 3% of GDP) based on the current legislation. The question as to whether or not and , if so, which changes will be made in this respect is unlikely to be resolved until after the presidential and congressional elections in November of this year.

All in all, we expect US economic growth to increase to 2.1% in 2012. Assuming that only half of the planned government budget cuts will be put into practice, we expect to see growth to the tune of 2.3% in 2013.

Euro area

Although the situation in Europe remains critical, substantial progress has been made in tackling the crisis. The central players are all playing a role: governments in the peripheral countries are knuckling down to austerity, European policymakers have taken an important step forward with the fiscal compact, and the European Central Bank has provided a sizeable rescue fund of its own – also due to the longer reaction time at the policy level, whereby the ECB measures are of a supportive, temporary nature.

The ECB is resolutely pursuing its role as the lender of last resort for banks and is doing everything possible to counter a credit crunch in the economy. At the end of last year, it lowered the key interest rate down a notch to 1% (the lowest level ever seen). What is more, the ECB has demonstrated flexibility in crisis situations by stepping up its unconventional measures – three-year refinancing transaction for banks with full allocation, lower requirements for the collateral that banks have to deposit with the ECB, halving of the minimum reserve ratio. The task in hand now is to let the measures take full effect. The next Bank Lending Surveys and lending data, for example, will provide an indicator of the extent to which the three-year tenders, in particular, which provided the banks with plentiful liquidity, have influenced the economy as a whole.

As far as further liquidity injections are concerned, increased caution would seem appropriate given that the risks that the medicine could have negative side effects are rising considerably. Conversely, it is unlikely that the ECB will swiftly pull the plug on its unconventional measures The key interest rate will remain unchanged at 1 percent until the end of the year. On the one hand, although the economy will remain vulnerable and jitters persist on the financial markets for the time being, on the other the recent signs of improvement in the economy are likely to continue, the turbulence surrounding the debt crisis gradually fade and the price stability benchmark of 2 percent be missed again, as last year.

Following negative GDP growth of -0.3% in the closing quarter of 2011, the EMU economy could contract again slightly in the first three months of this year. Unlike most forecasts, however, we are expecting the euro area economy to achieve (slight) positive growth in 2012 as a whole. The first signs of hope are starting to emerge: the comprehensive EMU economic sentiment index published by the European Commission improved in January for the first time in a long while, and climbed again in February. Capacity utilization in the eurozone also edged up slightly again at the start of the year. On the other hand, the EMU purchasing managers' indices dipped in March for both the service and the industrial sectors, falling to 48.7 and 47.7 points respectively. We believe that a marked economic recovery is unlikely to emerge before the second half of the year. As a result, we predict (meager) growth in gross domestic product in the euro area of 0.3% in 2012 as a whole, as against 1.5% last year. Looking ahead to 2013, we expect the economic upward trend to become more perceptible, with GDP likely to grow by 1.3%.

Euro area: Economic indicators and forecasts*

		2010				2011				2012				2013							
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2010	2011e	2012f	2013f
GDP real		0.4	0.9	0.4	0.3	0.8	0.1	0.1	-0.3	*-0.1*	*0.2*	*0.4*	*0.5*	*0.2*	*0.2*	*0.2*	*0.3*	1.8	1.5	*0.3*	*1.3*
Private consumption		0.2	0.1	0.3	0.4	0.2	-0.4	0.3	-0.4	*0.3*	*0.2*	*0.4*	*0.4*	*0.2*	*0.1*	*0.2*	*0.2*	0.8	0.3	*0.5*	*1.0*
Government spending		-0.4	0.2	0.1	0.0	0.2	0.1	-0.2	-0.2	*0.1*	*0.1*	*0.1*	*0.2*	*0.0*	*0.0*	*0.0*	*0.1*	0.5	0.2	*0.0*	*0.2*
Investment		-0.4	1.9	0.2	-0.3	1.8	-0.1	-0.3	-0.7	*0.8*	*0.5*	*0.7*	*0.9*	*0.7*	*0.7*	*0.5*	*0.6*	-0.6	1.8	*1.0*	*2.8*
Exports		3.1	4.6	2.1	1.5	1.6	1.2	1.4	-0.4	*0.3*	*0.5*	*1.0*	*1.5*	*0.8*	*0.9*	*1.0*	*0.8*	11.1	6.6	*2.3*	*4.0*
Imports		3.5	4.2	1.6	1.4	0.9	0.4	0.7	-1.2	*1.5*	*0.8*	*1.0*	*1.3*	*0.7*	*0.9*	*1.0*	*0.8*	9.4	4.2	*2.5*	*3.8*
Industrial production (excl. construction)		2.1	3.1	0.8	2.0	0.9	0.3	0.8	-1.9	*-0.1*	*0.8*	*0.7*	*0.7*	*0.3*	*0.4*	*0.4*	*0.4*	7.4	3.6	*0.0*	*2.0*
Unemployment rate	%	10.1	10.2	10.1	10.1	10.0	10.0	10.2	10.5	*10.8*	*11.0*	*11.0*	*11.0*	*11.0*	*11.0*	*10.9*	*10.8*	10.1	10.2	*11.0*	*10.9*
Consumer prices	y-o-y	1.1	1.6	1.7	2.0	2.5	2.8	2.7	2.9	*2.6*	*2.3*	*2.2*	*1.8*	*1.7*	*1.6*	*1.7*	*1.8*	1.6	2.7	*2.2*	*1.7*
Producer prices	y-o-y	-0.1	3.0	4.0	4.8	6.5	6.3	5.9	5.1	*3.1*	*2.2*	*2.7*	*3.2*	*2.7*	*2.5*	*2.1*	*1.8*	2.9	5.9	*2.8*	*2.3*
Current account balance	EUR bn, nsa	-3.0	-14.1	-7.6	-21.0	-10.2	-13.3	-1.7	-4.0	*-4.0*	*-6.0*	*-7.0*	*-8.0*	*-7.0*	*-7.0*	*-6.0*	*-5.0*	-45.7	-29.2	*-25.0*	*-25.0*
	% of GDP																	-0.5	-0.3	*-0.3*	*-0.3*
Budget balance	% of GDP																	-6.2	*-4.0*	*-3.0*	*-2.5*

*) quarterly values: percentage change over previous period, seasonally adjusted, except where noted; annual GDP not adjusted; foreign trade incl. intra-trade.

e = estimate; f = forecast.

The average EMU inflation rate for 2011 came in at 2.7% and was still sitting at this level in February. Two "special factors" have to be taken into account as price drivers in this

respect: energy and indirect taxes. The overall index, excluding energy, was recently up by only 1.9% on the prior-year level. What is more, Eurostat data for the Harmonized Index of Consumer Prices at constant tax rates (HICP-CT) shows that increases in indirect taxes contributed an average of up to 0.25 percentage points to EMU inflation in 2011. This year will once again see VAT increases in some member states leave their mark on inflation. We expect the average eurozone inflation rate for this year to ease to 2.2% at best. Next year, when, among other factors, tax effects will no longer come into play, it is expected to fall back to 1.7%.

The analysis and forecasts for the euro area as a whole must not, however, lead us to underestimate the current marked disparities between developments in individual countries. Employment in Germany and Austria, for example, was up by more than 1% on the prior year level in Q4 2011, while the figures for Spain and Portugal were down to the tune of around 3% (y-o-y). Some EMU countries are clearly in the throes of recession and there is a risk of a vicious circle emerging as countries try to balance consolidation efforts with weak economies. This is what makes it so important not to focus solely on austerity and, in the process, neglect pro-growth measures. This does not have to be a contradiction in terms, because for one, structural reforms do not necessarily cost money and for another, it can prove worthwhile to scrutinize government spending and loopholes on the revenue side.

Emerging markets

Following very buoyant growth in 2010, the economic momentum in the emerging economies of Asia, Latin America and eastern Europe dropped off considerably over the course of last year. There are manifold reasons behind this trend: first, the "normalization" of global trade following the pronounced rebound in 2010 resulted in less brisk export demand. Second, the Asian countries, in particular, had to cope with two massive supply shocks: one in the spring in the wake of the natural and nuclear catastrophe in Japan and one in the autumn as a result of the flooding in Thailand. In both cases, interruptions of international supply chains resulted in severe production losses. Third, the economic slowdown last year was also due, not least, to restrictive economic policies in many countries. Numerous central banks tightened the monetary reins in 2011 to get to grips with what was, at times, very rampant inflation. In countries like China, economic policy was also trying to combat signs of overheating in the real estate sector, for example.

In the course of this year, we expect growth in the emerging markets to accelerate slightly. Indeed, current economic indicators, such as those for Brazil, suggest that many of the emerging markets have already overcome the temporary weak patch. With many of them heavily reliant on external trade, they are likely to benefit inter alia from the expected recovery in world trade. At the same time, the substantial drop in inflationary pressure on the whole will give the central banks leeway to ease their monetary policy, which should in turn stimulate growth.

Both this year and next the Asian emerging markets are likely to grow by 7.2% in real terms, as against an increase of 7.4% last year. We do not expect the region to return to growth rates of between 8% and 10%, which were the order of the day before the crisis, in the medium term either. This assumption rests largely on the fact that we expect China to show slightly weaker growth in the long run. The world's second-largest economy is currently facing an economic slowdown. Admittedly, this development is only partly in line with the country's economic policy objectives. We do, however, expect that China will manage to achieve a "soft landing" as far as its economy is concerned and do not ex-

pect any abrupt slump in growth – not least given that the Chinese government has enough economic policy leeway to counter any unfavorable developments.

As far as the Latin American emerging markets are concerned, we expect to see economic growth of 3.4% in 2012, followed by a marked acceleration to 4.5% next year. Brazil, where we expect to see considerable economic momentum, not least given the massive investments ahead of the 2014 Soccer World Cup, is likely to remain the driving force behind this trend. Eastern Europe is expected to show only very subdued development this year, due primarily to the poor growth in the eurozone, the most important export market for these countries. Economic growth of only 2.6% this year is likely to be followed by 3.6% next year, an improvement that will be helped along by the expected economic stabilization in the euro area. All in all, we expect the emerging markets to grow by 5.2% in 2012 and by 5.8% in 2013, as against 6% last year. This means that the emerging markets will retain their status as a major source of impetus for the global economy throughout the entire forecast period.

Growth rates in main economic regions

GDP, real % change over previous year

	2006	2007	2008	2009	2010	2011[1)]	2012[1)]
Industrialized countries	**2.5**	**-0.2**	**-3.9**	**2.7**	**1.3**	**1.4**	**1.9**
European Union	3.2	0.3	-4.3	2.0	1.6	0.5	1.6
Euro area	3.0	0.3	-4.2	1.8	1.5	0.3	1.3
Germany	3.3	1.1	-5.1	3.7	3.0	1.0	2.0
USA	1.9	-0.3	-3.5	3.0	1.7	2.1	2.3
Japan	2.2	-1.0	-5.5	4.4	-0.7	2.1	1.8
Emerging markets	**8.3**	**5.5**	**1.4**	**7.4**	**6.0**	**5.2**	**5.8**
Asia	10.7	6.9	5.8	9.6	7.4	7.2	7.2
Latin America	5.9	4.3	-1.9	6.2	4.0	3.4	4.5
Central and Eastern Europe	7.5	4.4	-6.1	3.3	3.9	2.6	3.6
World	**4.2**	**1.5**	**-2.3**	**4.2**	**2.9**	**2.7**	**3.3**

1) forecast.

Sources: EcoWin, own forecasts.

All in all, global output will likely increase by 2¾% in 2012, roughly on a par with the pace of growth seen last year (2.9%) (country weighting based on current exchange rates). In 2013, the global economy looks set to expand by 3.3% as the euro area economy starts to improve and growth starts to pick up speed in the emerging markets of eastern Europe and Latin America.

The main overall framework on which our forecast is based is as follows:

- In historical terms world trade will record only subdued growth of 5-5½% this year. Momentum is not likely to re-attain medium-term average of a good 6% until next year.

- Crude oil prices (Brent) are expected to fluctuate between 110-130 USD/barrel during the forecast period. In February of this year, prices suddenly started to climb again, recently hitting the 125 USD/barrel mark, up by almost USD 15 on the average for 2011. In this environment, Saudi Arabia has already hinted that it is prepared to up its oil supply. This could effectively mean that the reduced oil deliveries from Iran as a result of the sanctions imposed could be compensated for, at least in part. The

prices for oil deliveries at the end of 2013 are also still well down on the current price level.

- Both the US Fed and the ECB are expected to stick to their ultra-loose monetary policy this year. The first corrections to the monetary policy focus could come at the end of the forecast period. Although the US Fed has signaled that it could leave key interest rates at a very low level until well into 2014, this assessment is based on the Fed's economic forecasts. The markets are likely to anticipate an earlier turnaround in key interest rates if the unemployment rate falls quickly.

- The euro is likely to be on weak side against the US dollar given the relatively firm US economy. We have penciled in an exchange rate of 1.25 USD/EUR at end-2012. However, the euro should gradually recover in course of 2013. The US dollar is likely to be hit not only by the ongoing need for consolidation in the US, but also by the progress we expect to see in the restructuring of EMU state finances. By the end of 2013, we forecast that the exchange rate will come in at 1.30 USD/EUR.

2. ECONOMIC SITUATION AND OUTLOOK IN GERMANY

2.1 Upswing regaining momentum

Despite high average growth in 2011, the German economy ended the year on a moderate note. A drop in exports (-0.8%), in particular, caused gross domestic product to contract in the fourth quarter. At the end of 2011, gross domestic product was only marginally up on the average for the year as a whole (0.2%). This small "annual overhang" considerably reduces the chances of good (average annual) growth in 2012. 2012 did not get off to too bright a start either – at least looking at the hard data that is available to date. Incoming orders in January of this year were down by more than 3% on the level seen in Q4 of last year, which was already moderate. In January, the retail industry reported a real drop in revenue as against Q4 to the tune of around 2%.

Nevertheless, the disheartening January figures are likely to be merely a snapshot that is of little real informational value. Corporate sector surveys are hinting at more positive prospects again, with the Ifo test, in particular, showing signs of stabilization over the past few months. According to the Ifo, since October 2011 the business climate in the industrial sector has now improved five months in a row. Business expectations have risen sharply.

The confidence in the corporate sector is also making itself felt on the labor market. Signs of an economic slump are nowhere to be seen if we look at the development in employment. Companies continued to hire considerable new staff during the autumn and winter months – setting aside the weaker development in February of this year due to poor weather conditions.

Domestic demand is likely to provide a source of positive impetus over the next few months. The construction sector has been witnessing the strongest expansion phase since German reunification in the early 1990s and consumer demand is also expected to pick up again. Although higher energy prices erode purchasing power, household disposable income is rising at a rate that is around one percentage point higher than the rate of inflation. The good consumer climate also suggests that households will be relatively keen to consume.

Germany: Economic indicators and forecasts*

		2010				2011				2012				2013							
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2010	2011e	2012f	2013f
GDP real		0.5	1.9	0.8	0.5	1.3	0.3	0.6	-0.2	0.2	0.6	*0.5*	*0.7*	*0.5*	*0.4*	*0.4*	*0.4*	3.7	3.0	*1.0*	*2.0*
Private consumption		0.0	0.8	0.3	0.7	0.6	-0.7	1.2	-0.2	0.3	0.5	*0.4*	*0.4*	*0.3*	*0.3*	*0.3*	*0.3*	0.6	1.5	*1.0*	*1.3*
Government spending		0.9	-0.6	0.8	0.1	0.1	0.8	0.6	0.1	0.2	0.3	*0.2*	*0.2*	*0.2*	*0.2*	*0.1*	*0.1*	1.7	1.4	*1.1*	*0.8*
Investment in machinery/equipment		4.1	5.2	4.9	2.6	0.7	0.5	1.9	0.0	0.8	1.5	*1.8*	*1.8*	*1.5*	*1.3*	*1.2*	*1.2*	10.5	7.6	*3.6*	*6.0*
Construction		-2.5	6.6	-0.8	-2.5	7.2	-0.5	-1.0	1.9	0.0	2.5	*1.0*	*0.8*	*0.7*	*0.5*	*0.3*	*0.3*	2.2	5.8	*2.6*	*2.9*
Domestic demand		1.3	1.3	0.2	0.6	1.1	0.2	0.5	0.1	0.3	0.4	*0.4*	*0.6*	*0.4*	*0.3*	*0.4*	*0.3*	2.4	2.3	*1.0*	*1.7*
Exports		3.4	7.0	2.0	1.0	1.6	2.7	2.6	-0.8	0.8	1.5	*1.5*	*1.5*	*1.5*	*1.4*	*1.2*	*1.3*	13.7	8.2	*3.6*	*5.7*
Imports		5.8	6.2	0.9	1.3	1.0	2.9	2.7	-0.3	1.0	1.3	*1.5*	*1.5*	*1.6*	*1.4*	*1.3*	*1.2*	11.7	7.4	*4.3*	*5.8*
Industrial production (excl. construction)**		2.1	5.1	1.6	3.2	1.7	1.4	1.6	-1.9	0.0	0.6	*0.6*	*0.6*	*0.6*	*0.6*	*0.6*	*0.6*	10.9	8.0	*0.9*	*2.6*
Unemployment rate (EU def.)	%	7.5	7.2	6.9	6.6	6.3	6.1	5.9	5.7	5.6	5.6	*5.5*	*5.4*	*5.4*	*5.3*	*5.2*	*5.1*	7.1	6.0	*5.5*	*5.2*
Unemployment rate (nat. def.)	%	8.0	7.7	7.6	7.4	7.3	7.0	7.0	6.9	6.8	6.7	*6.7*	*6.6*	*6.5*	*6.4*	*6.3*	*6.2*	7.7	7.1	*6.7*	*6.4*
Employed persons (national def.)	y-o-y	-0.3	0.4	0.8	1.0	1.4	1.3	1.3	1.4	1.4	1.1	*0.9*	*0.6*	*0.5*	*0.6*	*0.6*	*0.6*	0.5	1.3	*1.0*	*0.6*
Consumer prices	y-o-y	0.8	1.1	1.2	1.5	2.1	2.3	2.5	2.3	2.1	2.0	*2.0*	*2.0*	*1.8*	*1.8*	*1.9*	*1.9*	1.1	2.3	*2.0*	*1.9*
Consumer prices (HICP)	y-o-y	0.8	1.0	1.2	1.6	2.2	2.5	2.6	2.6	2.3	2.2	*2.1*	*2.0*	*1.8*	*1.8*	*1.9*	*1.9*	1.2	2.5	*2.1*	*1.9*
Producer prices	y-o-y	-2.6	1.1	3.6	4.7	6.1	6.0	5.6	4.8	3.1	2.2	*2.1*	*2.3*	*2.3*	*2.4*	*2.4*	*2.4*	1.7	5.6	*2.4*	*2.4*
Current account balance	EUR bn	32.5	32.6	38.9	43.9	38.2	31.6	39.0	38.6	36.0	36.0	*37.0*	*37.0*	*37.0*	*37.0*	*37.0*	*37.0*	150.7	147.7	*146.0*	*148.0*
	% of GDP																	6.1	5.7	*5.6*	*5.5*
Budget balance	EUR bn																	-106.0	-25.3	*-13.0*	*-5.0*
(Maastricht-definition)	% of GDP																	-4.3	*-1.0*	*-0.5*	*-0.2*

*) 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.

e = estimate, f = forecast.

Exports are also unlikely to become a source of concern for the German economy. The virtual stagnation of world trade in the second half of 2011 is unlikely to persist. The economic improvement in the US, the gradual easing of the European debt crisis and the impetus that is set to come from the emerging markets all suggest that global trade will experience a revival in 2012. The German economy is also expected to reap increasing benefits from the fact that the trade-weighted external value of the euro is lower than it has been in recent years. As a result, we expect demand from abroad to pick up in the course of 2012, and also in 2013.

Assuming there is no renewed escalation in the European sovereign debt crisis, the outlook for the German economy is very positive. We expect to see growth of around 2 percent in the course of both 2012 and 2013. Given the low 'growth overhang' from 2011, this gives average GDP growth of only 1 percent this year, but accelerating to 2 percent in 2013. Growth at this pace is sufficient to continue to bolster the upswing on the labor market.

2.2 Slight export revival this year

After the first three quarters of last year brought substantial growth for Germany's exports, they were down considerably by 0.8% in real, seasonally adjusted terms in a quarter-on-quarter comparison in the last three months of the year. A look at the regional structure of the country's exports soon reveals why: exports to the eurozone fell sharply. This means that the real economic impact of the sovereign debt crisis has left its mark on Germany's external trade. At the same time, however, exports benefited from the economic recovery in the US and Asia at the end of the year, with exports to these regions up considerably in some cases. All in all, however, this additional demand was not, of course, sufficient to make up for the slump in trade with the EMU countries.

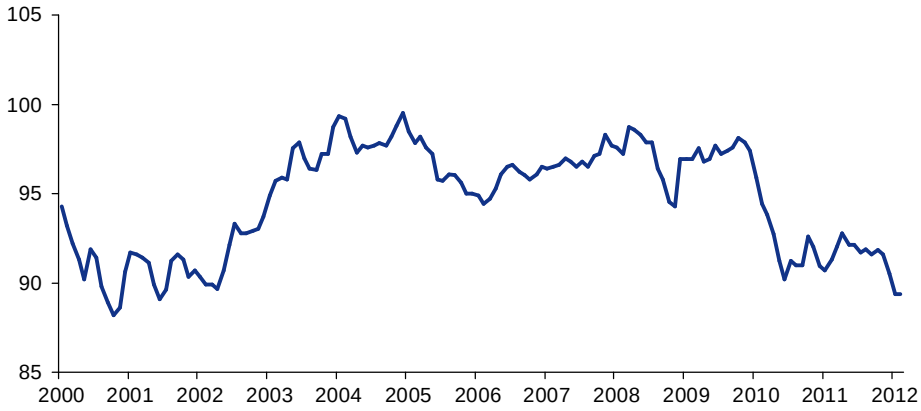
In Germany the backdrop for a modest rebound in export growth is fundamentally sound. The price competitiveness of the German economy has improved by almost 3% since October 2011 based on the German Bundesbank's indicator of the same name. In addition, various business surveys, such as the Ifo test, indicate that export expectations have at least stabilized again. And, not least, continued buoyant growth momentum in the emerging markets points to a further rise in demand for German exports from these countries. With its broad product range and focus on capital goods, the German econ-

omy can supply precisely those products which the rapidly growing economies urgently need to replenish and build up their capital stock.

Chart 3

Germany highly price competitive

Indicator* of price competitiveness of German economy, Index, 1999Q1=100



* against 56 trading partners, on basis of consumer price indices

Source: Deutsche Bundesbank.

Following a subdued start to this year, we expect the growth momentum for exports to start picking up again as of Q2. This is likely to be helped along by the expected stabilization of the eurozone economy and the continued slight revival in world trade. Real average export growth in 2012 is expected to come in at 3.6% following an increase of more than 8% last year. The growth momentum achieved in the course of this year should then remain on the scene for most of 2013, too. This would put average export growth for the year at 5.7%.

Imports also took a knock, albeit a slight one, in Q4 2011, hampered by stagnating domestic demand and weaker demand for export-induced imports. Given our economic forecast for Germany, import demand should start to bounce back a bit in as early as Q1 2012, after which it should continue to go from strength to strength as the year progresses. Looking at 2012 on average, we predict that exports will climb by 4.3%. Next year, imports are then expected to rival exports in terms of growth, rising by 5.8%. One thing that applies to the entire forecast period is that external trade will certainly not be the engine behind economic development. On average this year, net exports will not contribute to the expected economic growth of 1%. Next year, the contribution will be 0.3 percentage points of the forecast growth of 2%.

2.3 Consumer demand remains key mainstay

On the back of strong job creation and a simultaneous marked rise in effective earnings per employee, real private consumption, with an increase of 1.5 percent last year, recorded the steepest rise since 2006. On average over the last ten years private consumption grew by a paltry 0.4 percent.

Private consumption is set to remain a key mainstay of the economy this year as well. The latest surveys show that companies intend to step up recruitment further. The moderate pickup on the German labor market is therefore likely to continue. In 2012 as a whole we expect employment to rise by 1 percent. Actual earnings per employee will climb considerably again, even if this year's growth of an estimated 2.8% is likely to fall

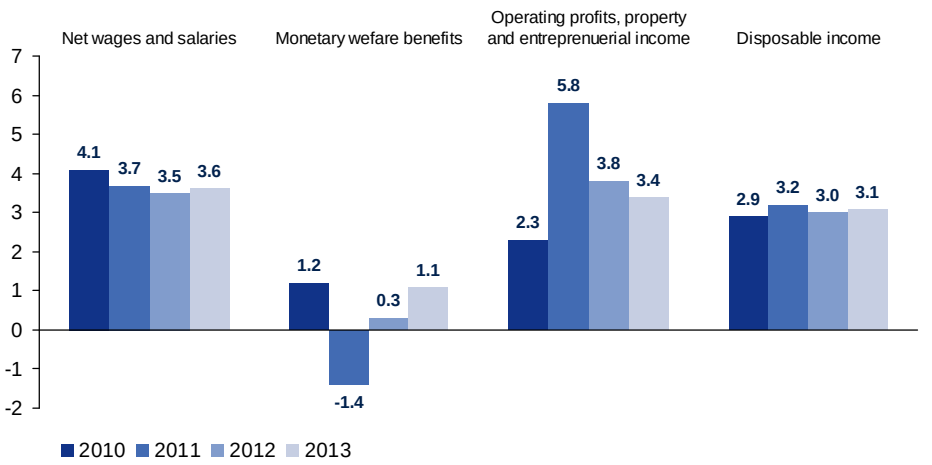
short of last year's figure, in particular due to the somewhat weaker development in the 2011/2012 winter half-year. “Cold progression” – the process by which taxpayers are shifted into higher tax brackets even when real incomes have not grown, will mean that net total wages will once again increase to a lesser degree than their gross counterparts. This effect will, however, be at least partially offset by the reduction in the statutory pension insurance contribution rate that came into force in early 2012. All in all, gross total wages are expected to grow by 3.8% and net total wages by 3.5%.

As far as monetary welfare benefits are concerned, we expect to see a slight increase overall. Although pensions will be given a boost of more than 2% with effect from July 1, benefits from unemployment insurance are expected to fall further in light of the positive labor market development. Operating profits, property and entrepreneurial income are expected to remain on a favorable trajectory. After an increase of almost 6% last year, 2012 is likely to bring an increase of almost 4%.

Chart 4

Private household income on stable path

% change on a year earlier



Sources: Statistisches Bundesamt, own forecasts.

All in all, private household disposable income will increase by 3 percent in 2012. Adjusted for expected inflation, this gives an increase in real earnings of around 1 percent. As we expect the savings rate to remain unchanged on a year earlier, real private consumption is also likely to rise by 1 percent. Next year the positive trend is likely to continue and private consumption increase by 1.3 percent. The following factors are behind the somewhat stronger development compared with this year: a marked increase in monetary welfare benefits thanks to another considerable increase in pensions (which, however, will not be largely canceled out by declining unemployment insurance benefits again due to weaker job creation), slightly lower inflation and a marginal increase in the propensity to consume compared with this year.

2.4 Investment still lagging

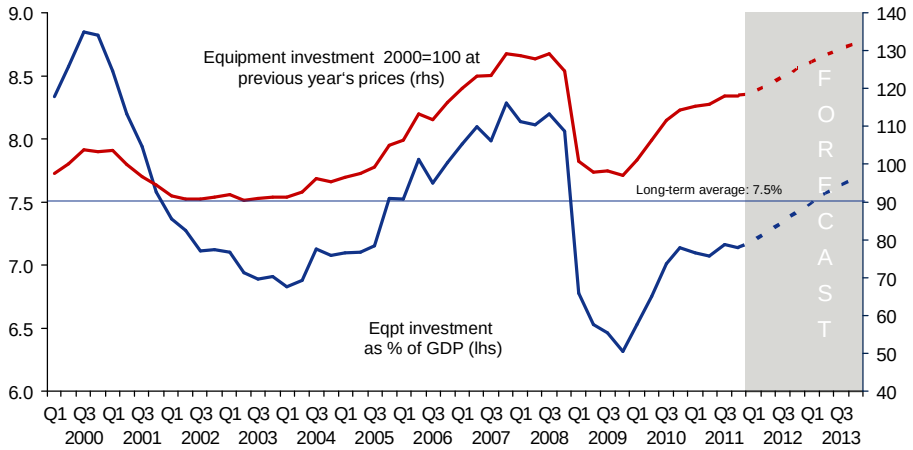
With real growth of 6.4%, fixed capital investment made a considerable contribution to domestic economic momentum last year. Construction investment was up by 5.8% - the strongest increase seen since 1994 - and equipment investment climbed by as much as 7.6%.

The strong growth rates should not, however, distract us from the fact that the level of equipment investment, in particular, remains anything but high. Equipment investment is the only component of gross domestic product that has yet to revert to the level seen before the economic crisis. Compared with early 2008, the backlog in the investment volume is vast – at around 8%.

This is compounded by the fact that the momentum of equipment investment slowed sharply in the course of 2011, with the investment volume actually stagnating in Q4 2011. The slowdown in investment demand at the end of 2011 does not, however, come as too much of a surprise. First of all, the menacing escalation of the debt crisis certainly fueled uncertainty among investors. Second, the capacity utilization rate in the industrial sector fell considerably at the end of the year. As a general rule, the capacity utilization rate leaves its mark on investment demand fairly quickly.

Chart 5

Investment ratio relatively low



Sources: Statistisches Bundesamt, own forecasts.

We are confident, however, that investment demand will start to pick up fairly swiftly. There are increasing signs that the furore surrounding the debt crisis is starting to die down and business expectations in the corporate sector are also brightening up again. What is more, financing conditions for the corporate sector are exceptionally favorable thanks to the very low interest rates. Moreover, there are no signs that Germany's financial institutions have clamped down on lending. We expect to see real equipment investment grow by 3.6% in 2012 and by as much as 6% in 2013. This would at least put the ratio of equipment investment to GDP back above the long-term average of 7.5% in 2013.

Construction activity picked up considerably last year, particularly in the commercial construction segment, which returned growth of 7.2%. Given the slump in equipment investment, growth rates for commercial construction are also expected to drop. In 2012, we expect commercial construction investment to grow by 2%, with a growth rate of 2.5% expected for 2013. Since the overall capacity utilization rate is likely to move up in 2012 and 2013, reaching a fairly high level in 2013, we can expect the demand for expansion investment to rise. The prospects for the commercial segment remain positive in the medium term.

As for the residential construction segment, which grew by 6.3% in 2011, the overall environment is more favorable than it has been in a long time. The interest rates on mortgage loans have hit historical lows and immigration means that the German population

is currently no longer shrinking. Household incomes are starting to climb more significantly again, with a return to modest growth even in real terms. The improved situation on the labor market makes it easier for households to plan, making them more keen to take out longer-term property loans. Furthermore, the financial crisis should have helped to promote investment in real assets.

Rising property prices are also helping to make a real estate investment more attractive. Given the above, we expect to see residential construction expand further, with real growth of 3½% predicted for both 2012 and 2013.

In the public sector, the prospects are not quite as favorable. Activity in this segment is expected to merely stagnate this year, although next year could see a return to growth of 1½%. The final discontinuation of the economic stimulus packages in 2011 is likely to trigger a temporary sag in public-sector construction. The improved financial situation of the municipalities, however, should soon help to combat this development. Since budgetary consolidation is progressing faster than expected, some room for maneuver for expanding public-sector investment should certainly emerge in the medium term.

Construction investment is likely to remain on an expansion path. We expect to see an increase of a respectable 2½% in 2012, followed by almost 3% in 2013.

2.5 Domestic inflationary impetus limited

The ups and downs on the commodity markets and, in particular, on the energy markets remain the dominant factor in determining consumer price developments. Last year, a sharp rise in energy prices led to mounting inflationary pressure in Germany well into the summer before tapering off considerably in Q4, in particular. In December 2011, consumer prices were up by 2.1% year-on-year, having stood 2.6% higher in September.

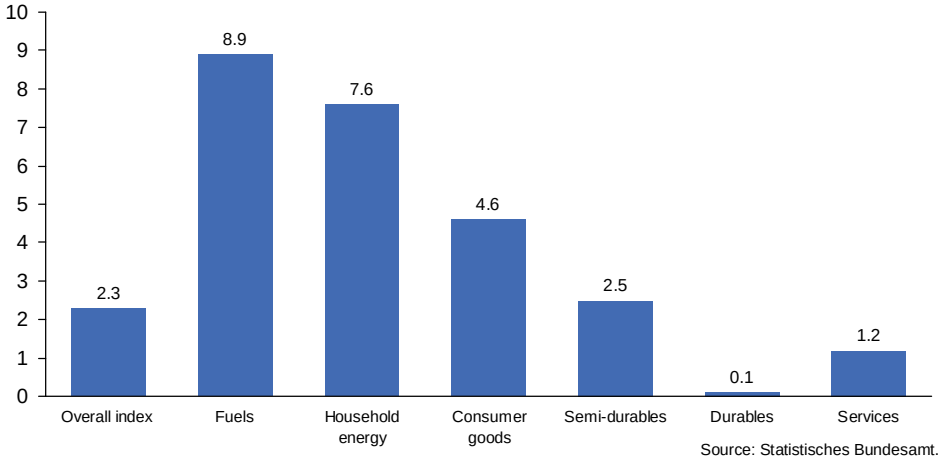
Energy prices have been shooting up again since the start of 2012, with Brent crude oil in March at times costing around 16% more than in late 2011. We do not expect the rise in oil prices to continue as the year continues. We believe that the most recent developments are owed less to an imbalance between supply and demand and more to political risks, such as the nuclear conflict with Iran. Assuming that these risks do not escalate, we expect prices to ease as the year progresses.

From a purely domestic demand perspective, inflation is expected to be low, despite the relatively high levels of capacity utilization and the sustained improvement on the labor market. In the fourth quarter of 2011, unit wage costs were up by only 0.6% on a year earlier in seasonally adjusted terms, having actually fallen by 0.4% in the third quarter. The average increase in unit wage costs in 2011 came in at 1%.

Chart 6

Energy prices up sharply

Consumer price index (2005=100), February 2012, % change on year earlier



Source: Statistisches Bundesamt.

All in all, we expect the rate of inflation to hover at between 1.9% and 2.1% for the rest of the year, following a temporary slight increase in the first three months of 2012. Looking at the average trend for 2012 as a whole, we predict that consumer prices will climb by 2%, with an increase of 1.9% expected for next year.

2.6 Labor market astonishingly resilient

Despite the dip in economic momentum, the strong job creation trend has continued to date. Since mid-2011 (in seasonally adjusted terms), more than 300,000 new jobs have been created in Germany, with the number of people out of work falling by some 100,000. The above-average increase in employment compared with the decline in unemployment is likely to have something to do with the general increase in labor force participation and increased immigration to Germany, as well as the abolition of restrictions on the freedom of movement for eastern European EU members and the recession in the debt-stricken EMU countries.

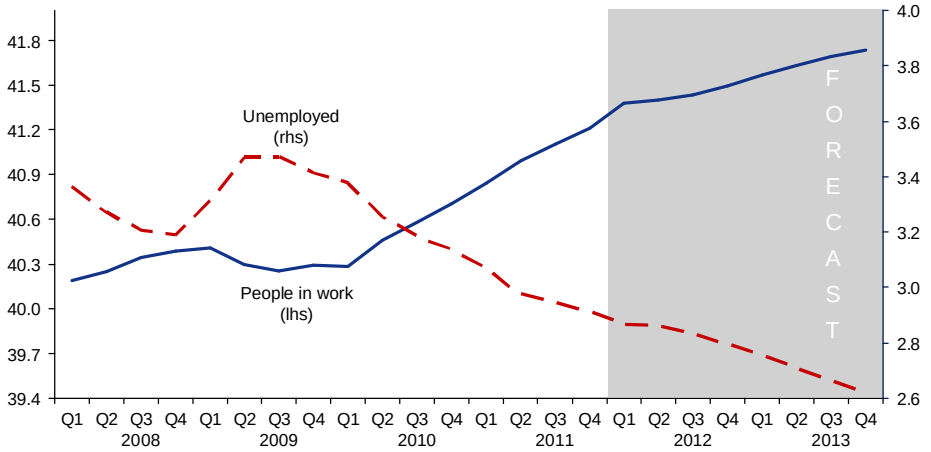
The growth in employment on a year earlier recently came in at 1.5% (more than 600,000), while the increase in employment that is subject to social security contributions stood at as much as 2.6% (more than 700,000). Among other developments, the number of people working exclusively in the low-wage sector declined.

The extreme willingness on the part of the corporate sector to recruit is testimony to the sector's marked confidence in the economic outlook, but possibly also to concerns that the number of skilled workers available on the labor market may prove insufficient in the future. This " labor hoarding ", however, is having an impact on costs and productivity. Unit wage costs rose by a far from insignificant 2½% in the course of 2011, despite only a slight increase in collectively agreed wages, after increasing by only 3% cumulatively in the previous ten years. Productivity (real gross domestic product per person in work) is actually expected to have fallen slightly in Q1 2012 compared with the previous year.

Chart 7

Improvement on labor market set to continue

millions



Sources: EcoWin, own forecasts.

Given these negative factors and an only moderate economic revival, we expect companies to become more hesitant in hiring additional staff both in the course of this year and in 2013. The number of people in work is still expected to rise by a sizeable 400,000 (+0.6%) in 2012 on average. We predict that the unemployment figures will slide by around 140,000 in 2012 and by around 150,000 in 2013. This would put the number of people out of work in Germany at only 2½ million by the end of 2013.

2.7 Further steps towards a balanced budget

In 2011 new borrowing was slashed to around ¼ of its 2010 level. At EUR 25.3bn it stood at only 1.0 percent of GDP. This illustrates how swiftly the deficit can be reined in given strong economic growth.

2012 and 2013 are not likely to see similarly large strides on the consolidation front. As a result of moderate economic growth, tax revenues are likely to rise by around 3½ % in 2012 after 7.1% last year. In 2013, we also expect to see growth of 3½%, with the effects of slightly higher economic growth and the planned reduction in income tax expected to cancel each other out. The revenue from social security contributions will also see weaker growth than in 2011 (+4.0%), coming in at 2½% and 3% for 2012 and 2013 respectively. This is because the pension insurance contribution rate will be cut in 2012 and presumably also in 2013. All in all, government revenue is expected to increase by around 3% in both 2012 and 2013.

Government spending, which fell by 1 percent in 2011, is likely to rise again moderately in 2012 and 2013. Although the favorable developments on the labor market will continue to put a damper on spending, additional expenses will be incurred among other things from the pension adjustment and the expected collective pay scale agreements in the public sector. On the whole, spending is likely to rise by 1.8% in 2012 and by 2.5% in 2013.

Given these trends in revenue and expenditure, new borrowing will fall to around EUR 13bn this year and EUR 5bn next year. The objective of a balanced budget will therefore be practically achieved as early as 2013.

Germany: Public-sector revenue and expenditure

in EUR bn	2009	2010	2011	2012	2013
Revenue	1066.0	1079.8	1148.2	1182.1	1219.4
of which:					
Taxes	546.3	548.9	587.8	608.4	629.7
Social contributions	409.8	418.7	435.3	446.2	459.5
Expenditure	1142.1	1185.8	1173.5	1195.0	1224.4
of which:					
Inputs	114.8	120.0	127.7	130.9	134.1
Employee compensation	189.7	194.5	199.8	204.8	209.9
Property income payable (interest)	63.8	61.9	67.7	66.3	67.6
Subsidies	27.1	27.2	26.1	26.1	26.3
Monetary welfare benefits	425.7	429.3	423.5	427.7	436.2
Welfare benefits-in-kind	196.0	203.0	207.4	213.7	220.1
Other current transfers	51.8	54.0	54.2	54.7	55.3
Gross investment	41.4	40.8	42.3	43.9	45.7
Financial balance	-76.1	-106.0	-25.3	-12.9	-5.0
memorandum (in %):					
State spending ratio[1)]	48.1	47.9	45.6	45.3	44.9
Financial balance[1)]	-3.2	-4.3	-1.0	-0.5	-0.2

[1)] in relation to gross domestic product in current prices.

Sources: Statistisches Bundesamt, own forecasts.

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

ABOUT ALLIANZ GROUP

Together with its customers and sales partners, Allianz is one of the strongest financial communities. More than 76 million private and corporate customers rely on Allianz's knowledge, global reach, capital strength and solidity to help them make the most of financial opportunities and to avoid and safeguard themselves against risks.
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.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained herein may include statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. In addition to statements which are forward-looking by reason of context, the words "may", "will", "should", "expects", "plans", "intends", "anticipates", "believes", "estimates", "predicts", "potential", or "continue" and similar expressions identify forward-looking statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (i) general economic conditions, including in particular economic conditions in the Allianz Group's core business and core markets, (ii) performance of financial markets, including emerging markets, and including market volatility, liquidity and credit events (iii) the frequency and severity of insured loss events, including from natural catastrophes and including the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the Euro/U.S. Dollar exchange rate, (ix) changing levels of competition, (x) changes in laws and regulations, including monetary convergence and the European Monetary Union, (xi) changes in the policies of central banks and/or foreign governments, (xii) the impact of acquisitions, including related integration issues, (xiii) reorganization measures, and (xiv) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences. The company assumes no obligation to update any forward-looking statement.

NO DUTY TO UPDATE

The company assumes no obligation to update any information contained herein.