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Economic forecast 2008/2009

1. The global economic situation and prospects

In spring 2008 the world economy and international financial markets are under the aura of the US real estate crisis and its consequences. It is becoming increasingly obvious that the US economy is on the verge of a recession. However, the effects of the US downturn on global economic development have so far been limited. The emerging markets report continued dynamic growth. The economic picture in Europe is mixed, but the growth drivers dominate overall. The key question is which forces will win the day in view of the financial market crisis – those of the upswing or those of the downturn? Further increases in commodity and food prices are a strain in this respect.

What began as a real estate crisis in the subprime segment in 2007 has turned into a global financial crisis. The negative repercussions from the lending markets on banks and the economy harbor the danger of a self-fueling downward spiral. With the equity markets also caught up in the maelstrom since the beginning of the year, this is all the more true. Economic policymakers are stepping up their efforts to combat the looming downward spiral, with US monetary policy playing a particular role. In our view, the measures being deployed – liquidity injections, interest rate cuts, tax relief for private households, tax-related investment incentives and special measures aimed at stabilizing the US real estate market – are appropriate given the current situation and will help stabilize the economy. The scope for action by policymakers has certainly not been exhausted yet. But that's a good thing. As we know from our observations to date – the financial market crisis is unpredictable. This makes it difficult to estimate its effect on the economy. For this reason the economic and monetary assumptions underlying an economic forecast should be all the more transparent.

We have assumed the following global conditions for our economic forecast:

- The turbulence on the financial markets will persist for several months more, although there will not be a drastic escalation such as a systemic bank crisis. The markets will gradually calm down in the second half of 2008.
- Monetary policy remains expansive. The Fed will cut rates from 5.25 % to 1.75 %; the ECB from 4 % to 3.5 %.
- The latest surge in commodity prices will not continue during the rest of the year. The gradual recovery on the financial markets will cause commodities exposures to lose their safe haven function, and the price of crude oil will move more in line with fundamental data again. It will fall well below the USD 100-per-barrel mark at some point during the year.
- The US dollar will continue to slide for the time being. EUR/USD 1.60 may be exceeded temporarily. The US dollar will stabilize in the course of the year, closing well above its historic lows.

We expect the following developments for the key economies and regions outside of Europe:

Growth rates in main economic regions

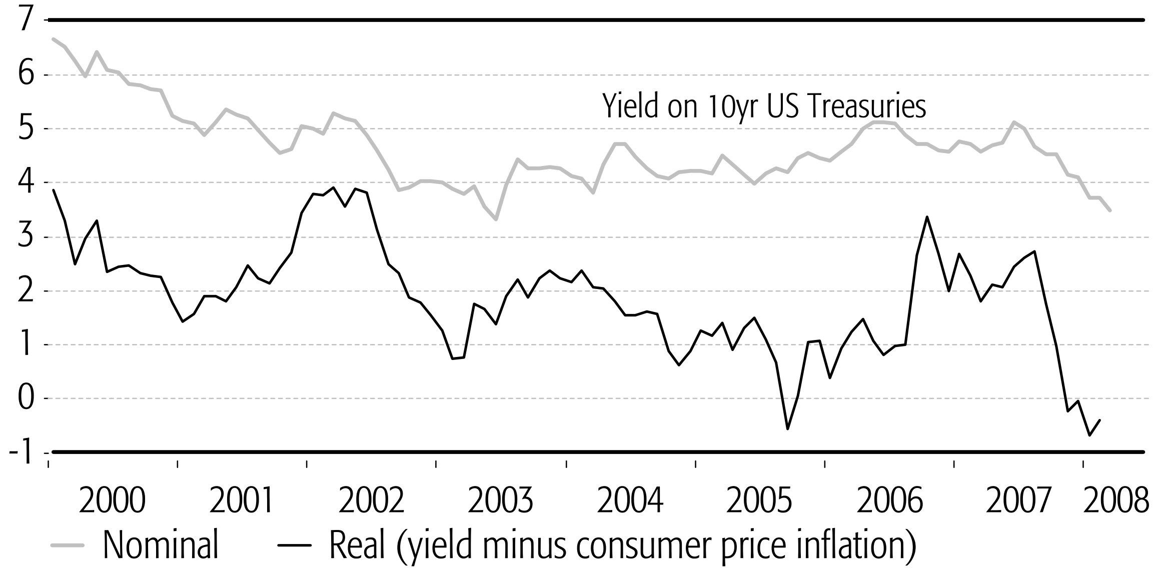
- GDP, real % change over previous year -

	2004	2005	2006	2007	2008[1)]	2009[1)]
Industrialized countries	**2.9**	**2.3**	**2.8**	**2.4**	**1.7**	**2.2**
European Union	2.4	1.7	3.1	2.9	2.0	2.2
Euro area	1.9	1.4	2.8	2.6	1.8	2.0
Germany	1.1	0.8	2.9	2.5	1.8	2.2
USA	3.6	3.1	2.9	2.2	1.5	2.4
Japan	2.7	1.9	2.4	2.0	1.5	2.0
Emerging markets	**7.0**	**6.4**	**7.1**	**7.2**	**6.4**	**6.3**
Asia	7.8	7.8	8.5	8.7	7.9	7.8
Latin America	6.0	4.1	5.2	5.4	4.1	4.5
Central and Eastern Europe	6.5	5.3	6.4	6.7	6.2	5.3
World	**3.8**	**3.3**	**3.8**	**3.6**	**2.9**	**3.3**

1) forecast.

- Growth in the US will come to a standstill in the first half of 2008. Indeed, a slight contraction is not out of the question. There will be no growth in consumer demand in the first half of the year – for the first time in a long time. However, the stimulus package will have an impact from May when tax relief payments to households commence. However, the bulk of the USD 100bn in tax rebates will not be paid out until the third quarter. Based on previous experience, we expect households to spend a considerable portion of the tax rebate. As a result, consumer demand is likely to recover in the second half of 2008. Exports will provide an economic bolster throughout the year. Thanks to the fiscal impetus and the gradual effects of the interest rate cuts, the second half of the year is likely to see an economic recovery which will continue into 2009. This assumes a gradual bottoming out of the real estate market. After 1½ % this year, the US economy is expected to get stronger again in 2009 and at 2 ½ %, grow more in line with its medium-term trend again.
- The Japanese economy will remain on a moderate growth path. Neither an economic stagnation nor a sustained recovery can be expected. We expect growth of 1½ % this year, and 2 % next year.
- Growth momentum in the emerging markets remains steadfast. The downturn in the US will dampen their export opportunities, but the capital flows now evading the US are likely to increasingly benefit the emerging markets. With around 6½ % growth this year and next, the emerging markets will match the high growth rates seen from 2004 to 2007 almost exactly.
- All in all, the global economy will probably grow slightly slower in 2008 than in the past four years, at just under 3 %, but in view of the difficult situation for the US economy, this would be a respectable result. We expect global growth of over 3 % again in 2009. This should translate into a 5-6 % increase in world trade in 2008 and 6-7 % in 2009.

Real interest rates at a low



The massive monetary easing will have positive effects on the economy, but is a risk in terms of the longer-term inflation outlook. The global trend towards rising inflation in 2007 is unlikely to continue any further in 2008 in view of the economic cool-down; however, inflation may rise again in 2009. The limited availability of commodities, the burgeoning demand in many emerging markets and the improved situation on the labor markets in many industrial nations could drive up costs and prices.

The financial markets will factor in the increasing inflationary pressure. Government bond yields are under considerable pressure due to the current flight to quality, and are actually negative in real terms, which means yields on the market will rise considerably as business activity revives. This is likely to happen as soon as the second half of this year. However, long-term yields for 2008 and 2009 are unlikely to exceed 4½ to 5 % in either the US or Europe.

In addition to our base scenario of sustained moderate global economic growth, the risk of much more negative developments in view of the financial market crisis must be taken into consideration. We find it unlikely, although it cannot be completely ruled out, that the US economy will slide into a severe recession, causing the financial market crisis to escalate. This would send stock markets reeling, and would pose the threat of a full-blooded credit crunch for companies. The economic damage in Europe would be substantial, and growth would probably come to a standstill in the euro area. Monetary policy would be even more expansive than in our base scenario; the US administration would implement substantial government countermeasures, and concerted international action would be on the cards. This means economic policy would retain its ability to act even in this risk scenario. In this case the economy would not recover until sometime during 2009.

2. Economy and policy environment in the euro area

The oil price has climbed above USD 100 a barrel, the euro has shot up towards 1.60 USD/EUR, the financial market crisis is proving more serious and protracted than initially assumed – and nonetheless the latest figures do not suggest any substantial slowdown in the EMU economy. But can this really continue?

Economic growth in the euro area already lost appreciable momentum in the fourth quarter of last year. We expect this weaker pace of expansion to continue in the first half of 2008 but not slow down further. For the near term one of the encouraging signs is that the most recent business sentiment surveys have produced remarkably robust results. In our view the European economy can escape relatively unscathed over the rest of the year and indeed regain some momentum if the negative factors gradually lose intensity in accordance with our assumptions. We expect EMU gross domestic product to rise by 1.8 % in 2008 after 2.6 % last year. In 2009 economic growth is likely to pick up slightly to 2 %, bringing it more or less into line with the potential rate.

Euro area: Economic indicators and forecasts*

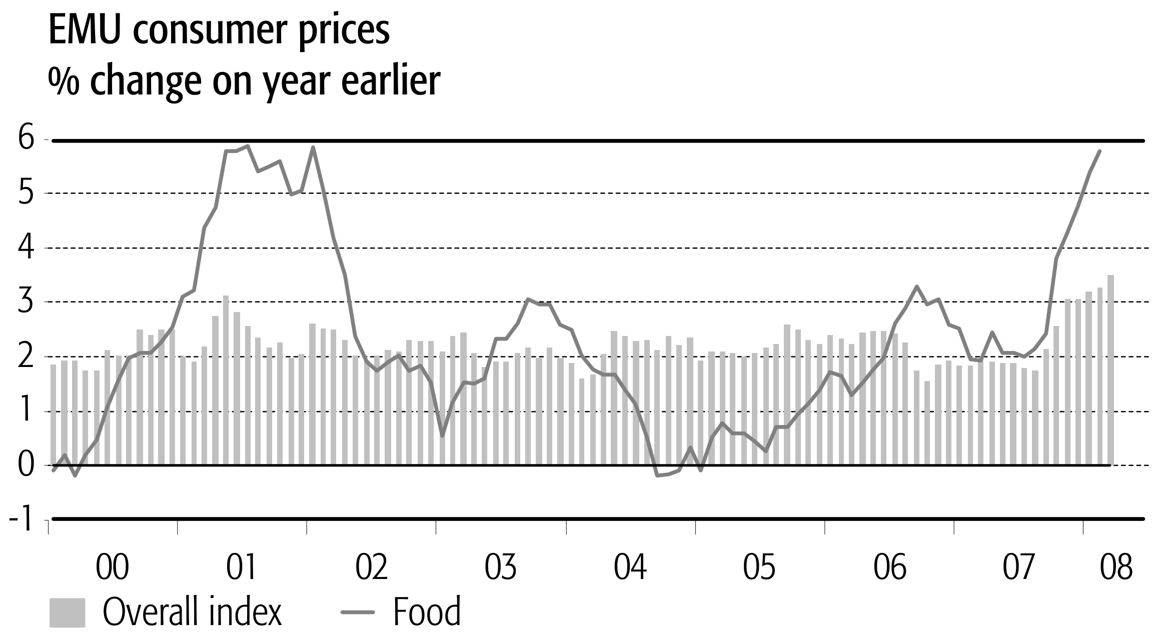
		2006				2007				2008						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2006	2007f	2008f
GDP real		0.9	1.0	0.6	0.8	0.8	0.3	0.7	0.4	0.4	0.4	0.5	0.5	2.8	2.6	1.8
Private consumption		0.7	0.4	0.5	0.4	0.0	0.5	0.6	0.5	0.5	0.4	0.5	0.4	1.9	1.6	1.9
Government spending		1.1	0.2	0.6	0.4	0.8	0.1	0.4	0.3	0.5	0.4	0.3	0.3	2.0	1.8	1.5
Investment		0.7	2.7	0.8	1.7	1.9	-0.2	1.1	0.8	0.5	0.9	0.9	1.0	5.4	5.0	3.1
Exports		3.0	1.6	1.1	3.1	0.8	0.8	1.2	1.0	1.2	1.1	1.1	1.2	8.1	5.6	4.6
Imports		2.1	1.3	1.9	1.7	1.0	0.5	1.8	1.5	1.1	1.2	1.3	1.2	7.7	5.2	5.3
Unemployment rate	%	8.7	8.4	8.2	8.0	7.7	7.5	7.4	7.2	7.1	7.0	7.0	6.9	8.3	7.5	7.0
Consumer prices	y-o-y, nsa	2.3	2.5	2.1	1.8	1.9	1.9	1.9	2.7	2.6	2.1	2.2	1.7	2.2	2.1	2.2

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

The assorted trends in the big member states should not be overlooked. Whereas, up to and including 2005, Germany's GDP growth had significantly trailed the EMU average for years, the two have been approximately on a par since then. This is also likely to be the case in 2008, and in 2009 Germany could see slightly above-average expansion. Having ranked among the euro area laggards in the past two years, France looks set to almost match the EMU average this year and next with ongoing solid growth rates of 1.7 % and 1.9 % respectively. Italy, by contrast, is likely to remain one of the slowcoaches, trailing average euro area growth by around ¾ of a percentage point. In Spain we expect to see a marked slowdown given its housing market problems. Following an increase of almost 4 % in Spanish GDP last year, we have penciled in growth of only around 2 % in both 2008 and 2009. The days of well above average performance are thus over, with Spain's economic growth moving more into line with the EMU average.

In the euro area as a whole investment activity is unlikely to be as brisk as in the past two years – on the one hand given a degree of reticence in view of the extremely uncertain global outlook and the resulting shadow on sales prospects, on the other also on the financing side: lending to non-financial corporations has been rising strongly at double-digit rates (most recently 14.8 %) since 2006. At the same time indebtedness has risen from 65 % of GDP in early 2000 to 78 % now, pushing companies' net interest burden up with it. Moreover, although we are not expecting the financial crisis to trigger a credit crunch, borrowers could well face more stringent terms and higher costs.

So, while domestic demand is likely to receive less support from investment than hitherto, a stronger underlying boost from private consumption is on the cards. We see the positive trend on the labor market contributing to this, even if the improvement is now proceeding at a slower pace. Following employment growth of 1.7 % last year, the increase in 2008 is likely to be around half a percentage point lower. The unemployment rate will probably drop below its current low of 7.1 %. With the labor market getting tighter, wages and salaries are likely to rise more strongly. However, we do not see the increase in wages at very much above 3 % (2007: 2.7 %). In addition, a further slight fall in the savings rate, which has dipped to 13.8 % from its peak of 14.1 % in the first quarter of 2007, could also buoy consumption. However, of key importance for a pickup in real private consumption is what happens to purchasing power, in other words we need some positive news on the inflation front.

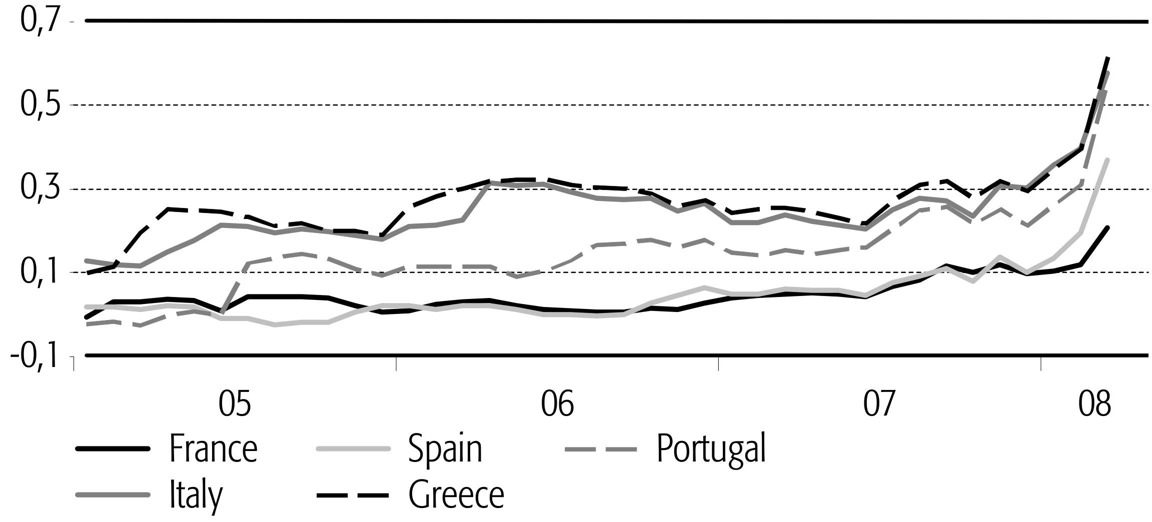


The EMU inflation rate rose further in March to 3.5 %. This is likely to be the peak, with year-on-year increases then set to decline gradually. Alongside the energy component, the rise in food prices is currently playing a considerable role. Stripping out energy and food, inflation stood at 1.8 % in February. The rise in food prices contributed around one percentage point to year-on-year inflation, with around half of this coming from the product groups milk, cheese and eggs as well as bread and wheat products. Although structural reasons such as the increased demand from emerging markets or the growing use of biofuels tend to point to steeper food price rises, we believe that the spike seen since September 2007 is to some extent an exception. Nonetheless, although momentum is set to ease, the average rise in food prices in 2008 is likely to top that seen in 2001 when it rose exceptionally strongly to 5 % following the introduction of euro notes and coins. We estimate that overall euro area inflation will come in at 3 % this year. The ECB's comfort threshold of 2 % is unlikely to come back within closer reach until 2009.

In this price environment the European Central Bank is reluctant to cut interest rates. But ultimately, given the economic risks, fueled also by the rise in the euro caused among other things by the key rate differential between the USA and EMU, the ECB will be obliged to relax monetary policy. However, in its communication, the ECB is unlikely to prepare the ground for a rate cut until the topical economic data confirm a substantial slowdown compared with 2007 and hence reduced inflationary pressure going forward. We therefore expect it to delay a cut until the third quarter. We have penciled in a key interest rate of 3.5 % at the end of 2008. However, once the EMU economy has picked up speed again the ECB is likely to be keen to get interest rates back up to their present 4 % level as quickly as possible next year.

The ECB has frequently stressed that it differentiates between its interest-rate and its liquidity policy. On the latter front it recently implemented a new measure aimed at countering the renewed tensions on the money market: via a tender banks were offered liquidity for a six-month period compared with the three-month period used in longer-term refinancing operations to date. With three-month money rates at 4.7 % again some 50 basis points higher than the usual level given the present key interest rate, the yield curve as measured by the gap between 3m-EURIBOR and the 10-year benchmark yield is clearly inverse. By contrast, the yield curve as measured by the spread between two-year and ten-year German government bonds is flat or slightly upward-sloping. As we expect the tensions on the money market to gradually unwind and given the expected shift in monetary policy, three-month money rates are likely to drop below 4 % by the end of the year. At the same time the flight to the safe haven of government paper should ease and the yield on ten-year Bunds climb towards 4.5 %.

Yield differential against Germany
10yr government bonds (percentage points)



The recent widening of yield spreads between German government paper and bonds of other EMU countries, evident in the chart above, is linked to the financial market turmoil, more exactly the flight into as liquid as possible bonds. As the crisis wanes we are likely to see spreads narrow again. Among other things, the development in public sector budgets will then resume a greater role in determining spreads. Last year none of the EMU countries is likely to have been at odds with the 3 % Maastricht deficit criterion. However, France, Greece, Italy and Portugal have failed to build up an adequate safety cushion and risk slipping back into an excessive deficit relatively swiftly if the economic going now gets tougher than in the past two years. In the euro area as a whole consolidation of public sector finances will mark time: having fallen to an estimated 0.9 % last year from 1.6 % the previous year, the deficit ratio is like to remain practically unchanged in 2008 and 2009. The current hallmark of European fiscal policy is a tendency to lower taxes and social levies, funded by deploying additional revenue or in some cases by increasing indirect taxes. With the economy ticking over nicely, the genuine will to rein in spending appears to have gone by the wayside.

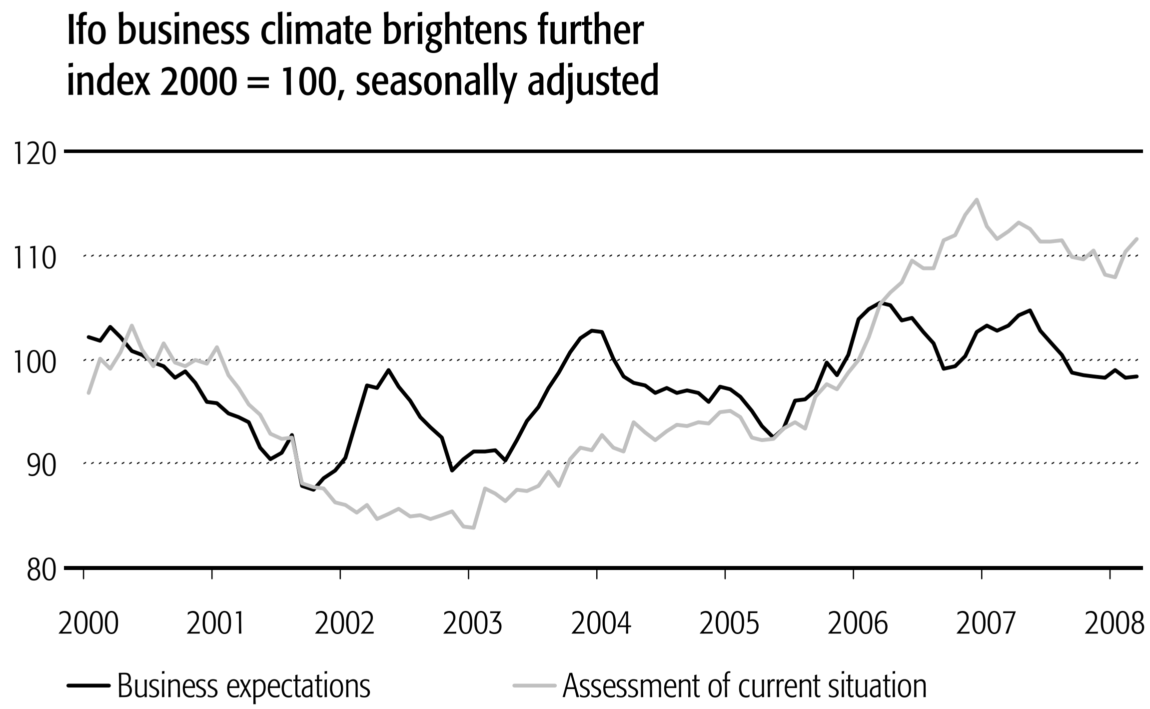
3. Economic situation and outlook in Germany

3.1 Current economic situation

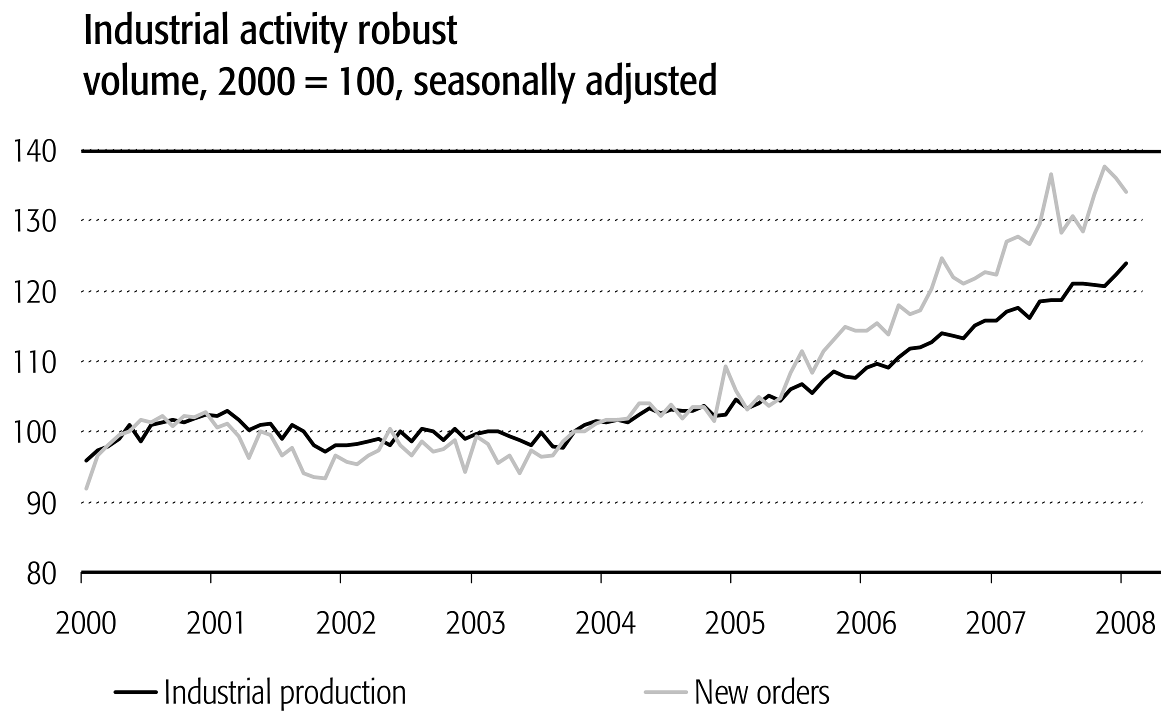
The upswing in Germany continued last year, although economic development was subject to much stronger fluctuations than in 2006. The first and third quarters each reported strong growth, whereas growth in the second and fourth quarters was noticeably weaker. Real GDP increased by an annual average of 2.5 %. The working-day adjusted figure was 2.6 %.

Growth was buoyed in particular by investment and foreign trade. The investment boom continued almost unabated – companies again stepped up their investment in equipment and machinery substantially. In contrast, development in private consumption was disappointing. The VAT hike at the beginning of 2007 prompted a downright slump in consumption in the first quarter. It was unable to recover by the end of the year. On the other hand, development on the German labor market was extremely positive once again – the average jobless total fell by over 700,000 to approximately 3.8 million. At the same time, employment growth continued in 2007 with a dynamic increase of 1.7 %, following 0.6 % in 2006.

Dark clouds started to move into German economic skies in the summer of 2007, and since then there has been a distinct increase in the downside factors for the economy. In addition to the turbulent situation on the international financial markets which was sparked by the US real estate crisis, the sharp rise in the price of oil and the strength of the euro were particular factors casting a shadow over the German economy. Economic expansion already started to slow down noticeably in the fourth quarter of 2007.



And how successful has the German economy's start to 2008 been? A look at the economic indicators available so far suggests that the first quarter is likely to have been much better than was initially presumed. This is particularly true for German industry: in the period January to February output rose 1.8 % on the end of 2007 in seasonally adjusted terms. With overall orders still looking healthy, industrial activity looks set to remain dynamic until well into the second quarter at least. Various sentiment indicators, such as the purchasing managers' index for the manufacturing sector and the Ifo business climate index, also paint a positive picture. The latter rose in March for the third month running. The companies surveyed were significantly more upbeat about their current business situation than they had been in the January and February surveys. At the same time their expectations for future business have stabilized at a level which signals a moderate continuation of the upswing. And, last but not least, the improvement on the labor market proceeded in strides in the first quarter of 2008. The seasonally adjusted jobless total fell by 219,000 to 3.285 million. Admittedly, the latest retail sales figures were once again disappointing. Nonetheless, given the ongoing growth in employment and the steeper rise in wages than hitherto, we are optimistic that private consumption will make a substantial contribution towards economic growth this year.



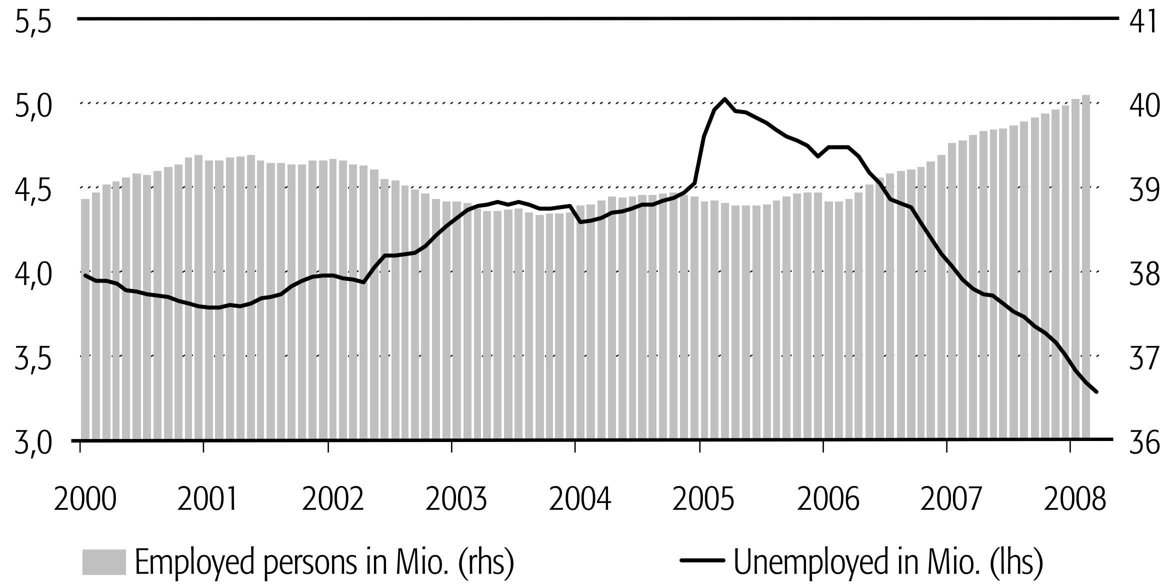
3.2 Positive economic picture rests on robust domestic demand

At the beginning of last year it was essentially uncertainty over the consequences of the VAT increase that complicated economic forecasting. In 2008, a whole assortment of negative factors has conspired to muddy the waters as we seek to assess further economic development this year and next. Foremost among these are the crisis into which the subprime debacle has plunged the financial markets and uncertainty over the further course of the US economy, obstinately high energy prices and the pronounced strength of the euro. We can expect turmoil on the international financial markets to hold us in its sway for a while yet. Nor is the economic situation in the US likely to achieve any sort of durable stabilization until the second half of 2008. We must also reconcile ourselves to the fact that for the time being the euro will lose little of its strength versus the US dollar. With regard to the development in oil prices, we see some easing by the second half of the year at the latest owing to the more cloudy world economic environment and the improved supply picture on the crude oil markets.

What does all this mean for economic trends this year? After getting off to what looks set to be a very strong opening quarter, business activity in Germany will probably already start to come off the boil significantly during the current three months as the impetus to growth from external trade is clearly checked by the strong euro and less dynamic global economic activity. As from Q3, external trade is even likely to generate negative growth impetus on balance. We do not see any notably sustained revival in overall economic activity until the fourth quarter – and then most probably driven exclusively by domestic demand.

Domestic demand does indeed play a key role in our economic forecast. And private consumption in particular. Having languished for years, in 2008 it is poised to take over as the new economic engine. Far from being motivated by calculated optimism, this assessment is based on realistic assumptions on future labor market and wage trends. We expect unemployment to fall below 3.3 million on average for 2008, marking a drop of 500,000 on the previous year and fully 1.2 million down on 2006. Our forecast is further based on the assumption of a slight pickup in the pace of wage growth with actual earnings per employee increasing by 2.8 % in 2008, as against roughly 1.5 % last year. Disposable household incomes should therefore rise considerably faster than in 2007. Given still-high capacity utilization, machinery and equipment investment this year should also build up positive growth momentum, although certainly not on the previous year's scale. All in all, we see real economic growth in 2008 hitting 1.8 %. On a working day-adjusted basis that would represent a plus of 1.6 %. Then for 2009 we expect economic expansion to accelerate to 2.2 %. Once again, the economy will presumably be bolstered mainly by private consumption, accounting for around half of GDP growth. Net exports, on the other hand, are unlikely to provide any positive impetus. On average for the year, shipments will probably expand by barely more than 3 %, while imports – driven by buoyant domestic demand – are predicted to jump 4.6 %.

Pickup on labor market continues
seasonally adjusted



Inflation in 2008 will probably be marginally higher than last year, climbing by 2.4 %. The value added tax hike at the beginning of 2007 will drop out of the equation, but sharply higher energy prices and still moderately rising food prices are likely to wipe out this effect entirely. But then in 2009 inflation should slow again to just below the 2 % mark.

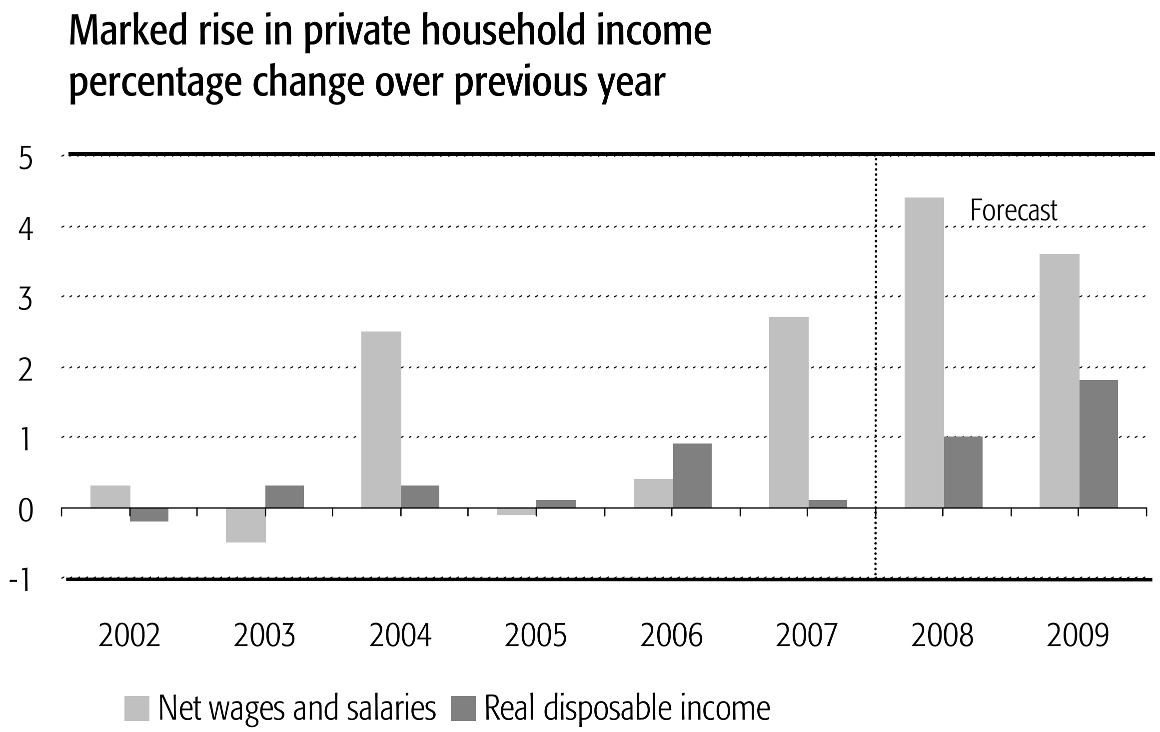
Germany: Economic indicators and forecast*																
		2007				2008				2009						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2007	2008f	2009f
GDP real		0.6	0.2	0.7	0.3	*0.5*	*0.2*	*0.3*	*0.6*	*0.5*	*0.7*	*0.6*	*0.5*	2.5	*1.8*	*2.2*
Private consumption		-1.8	0.8	0.3	-0.8	*0.5*	*0.3*	*0.5*	*0.7*	*0.5*	*0.7*	*0.2*	*0.5*	-0.4	*1.2*	*2.1*
Government spending		1.7	0.1	0.5	-0.5	*1.0*	*0.0*	*0.8*	*0.3*	*1.0*	*0.5*	*1.0*	*0.0*	2.1	*1.4*	*2.5*
Investment in machinery/equipment		3.7	0.9	0.4	3.4	*-1.5*	*0.7*	*1.0*	*2.0*	*1.5*	*2.0*	*1.0*	*0.5*	8.2	*3.8*	*5.9*
Construction		1.3	-3.9	0.5	-1.1	*0.7*	*0.5*	*1.0*	*0.5*	*-1.5*	*1.5*	*1.0*	*0.5*	2.3	*0.8*	*1.2*
Domestic demand		1.7	-1.1	0.8	-0.5	*0.4*	*0.2*	*0.5*	*0.8*	*0.5*	*0.9*	*0.6*	*0.6*	0.9	*1.1*	*2.5*
Exports		-0.3	0.8	2.5	1.3	*1.8*	*1.0*	*0.5*	*0.7*	*1.0*	*0.5*	*1.0*	*0.8*	7.8	*6.3*	*3.1*
Imports		2.0	-2.0	3.2	-0.2	*2.0*	*1.2*	*1.2*	*1.5*	*1.0*	*1.0*	*1.0*	*1.0*	4.8	*5.6*	*4.6*
Industrial production (excl. construction)		1.8	0.9	2.1	0.9	*1.0*	*0.8*	*0.5*	*0.5*	*1.3*	*1.5*	*1.0*	*0.8*	5.9	*4.1*	*4.0*
Unemployment rate (EU def.)	%	8.7	8.5	8.3	8.0	*7.4*	*7.2*	*7.2*	*7.0*	*6.9*	*6.8*	*6.7*	*6.6*	8.4	*7.2*	*6.7*
Unemployment rate (nat. def.)	%	9.4	9.2	8.9	8.5	8.0	*7.7*	*7.7*	*7.5*	*7.4*	*7.3*	*7.2*	*7.1*	9.0	*7.7*	*7.2*
Employed persons (national def.)														1.7	*1.1*	*0.6*
Consumer prices	y-o-y	1.8	2.0	2.3	3.1	2.9	*2.7*	*2.4*	*1.6*	*1.5*	*1.6*	*2.0*	*2.4*	2.3	*2.4*	*1.9*
Consumer prices (HICP)	y-o-y	1.9	2.0	2.2	3.1	3.0	*2.8*	*2.5*	*1.7*	*1.6*	*1.7*	*2.1*	*2.5*	2.3	*2.5*	*2.0*
Producer prices	y-o-y	2.8	1.7	1.2	2.2	3.7	*3.2*	*3.3*	*2.5*	*1.8*	*2.3*	*2.5*	*3.0*	2.0	*3.2*	*2.4*
Current account balance	EUR bn	32.0	43.2	42.7	45.9	*39.0*	*40.0*	*37.0*	*35.0*	*40.0*	*37.0*	*39.0*	*38.0*	163.8	*151.0*	*154.0*
	% of GDP													6.8	*6.0*	*5.9*
Budget balance	EUR bn													0.2	*-2.0*	*1.0*
(Maastricht-definition)	% of GDP													0.0	*-0.1*	*0.0*
3-month money market rate **	%	3.9	4.2	4.8	4.7	4.7	*4.4*	*4.0*	*3.7*	*3.7*	*4.0*	*4.2*	*4.2*	4.3	*4.3*	*4.0*
10-year gov.bond yield **)	%	4.1	4.6	4.3	4.3	3.8	*4.0*	*4.3*	*4.4*	*4.5*	*4.6*	*4.6*	*4.6*	4.2	*4.1*	*4.5*
Exchange rate **)	USD per EUR	1.33	1.35	1.42	1.47	1.58	*1.53*	*1.50*	*1.45*	*1.45*	*1.43*	*1.42*	*1.40*	1.37	*1.50*	*1.43*

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

3.3 The wait for consumer spending is over

It was due chiefly to the VAT increase and the marked pickup in consumer prices in the second half of 2007 that high-street spending in Germany last year worked out lower on balance than in the previous twelve months. In real terms, consumption contracted by 0.4 %.

In the absence of last year's fiscally motivated drain on purchasing power, there is a good chance this year that the long-awaited revival in private consumption will actually materialize. Employment gains should continue, although not as dynamically as in 2007: we are looking for an increase of 1.1 %, against 1.7 % last year. In absolute terms this means 476,000 more people in work on average for the year than in 2007. Pay increases are also likely to accelerate, with contractual wages rising considerably faster than in previous years – a trend already emerging in the current round of pay negotiations. Economy-wide we see negotiated wages per employee climbing by 2.5 % (against 1.2 % in 2007), while the jump in actual earnings could hit as much as 2.8 %. That would make this year the second in succession to register a steeper run-up in actual earnings than negotiated wages. In the main this is a reflection of the positive economic situation and increasing labor market tightness. All in all, both the gross and net payroll thus look set to climb by a good 4 %. On the assumption of a slight drop in transfer incomes and a marginally slower increase in property and entrepreneurial income, households' disposable income will therefore grow by almost 3 %. In real terms, that would still represent a plus of nearly 1 % and compare positively with last year's stagnation in real incomes. Turning to the savings ratio, we predict a downtick from 10.9 to 10.7 %, chiefly as a counter-movement to last year's sharp increase in the wake of the VAT hike. All in all, private consumption is thus heading for expansion of 1.2 %, in which case it would contribute almost one-third towards this year's 1.8 % GDP growth.



We are even more upbeat on the development in consumption next year. The build-up in employment should continue at a moderate pace of plus 0.6 %, with actual earnings per employee performing slightly better than this year to expand by 3 %. As a result nominal disposable incomes should be ratcheted up even more substantially than 2008, by over 3 %. Assuming the savings rate is slightly lower, real private consumer spending should advance by 2.1 %. Accounting for more than half the forecast GDP growth, private consumption would then finally have emerged as Germany's new economic locomotive.

Box 1: Development in negotiated wages in 2007

Despite some high collectively negotiated pay settlements last year (e.g. in the metal and chemical industries), economy-wide wage trend statistics have not been affected significantly so far. In the fourth quarter of 2007 hourly agreed wages were a mere 1.1 % higher year-on-year. The figure for actual earnings per employee was not much higher, at 1.3 %. What statistical aspects play a part here?

Data from the Federal Statistics Office shows agreed monthly salaries climbing 2.0 % on average for 2007, their highest increase since 2004. And with a rise of 2.5 % agreed hourly wages even enjoyed their steepest growth since 2003. But the Bundesbank's negotiated wage statistics paint an entirely different picture, with agreed wages on an hourly and monthly basis each ticking up by only 1.4 %. The surprising factor is the size of the gap between the rates, which widened in the second half of 2007 and was more pronounced than in the previous years. Part of the difference can be explained by discrepancies in the universal set. For example, holiday pay and Christmas bonuses, as well as one-off payments under negotiated pay settlements and lump-sum payments covering the months between the expiry of an old collective agreement and the entry into force of a new contract, are counted towards basic negotiated compensation in the Bundesbank's reckoning but disregarded by the Federal Statistics Office. Moreover, the Statistics Office only takes into account the negotiated agreements covering the highest numbers of employees, with mandatory inclusion of at least 75 % of the employees in each reporting sector.

One of the main reasons for this presumably lies in the different underlying weighting systems, since the changes in wages and salaries under the various collective agreements enter the respective index of agreed wages and salaries as weights determined by the ratio of the employees in a certain sector to the total number of workers from all sectors covered.
The Federal Statistics Office’s index of agreed wages and salaries (the Bundesbank’s index of negotiated wages) is calculated using the Laspeyres price index formula with a fixed base year. The index values refer to the employment structures in the base year currently applied. Allowance is not made for changes in the sectoral employment structure until the index is recalculated for a new base year. The present base year is 1995.
In contrast, the Bundesbank’s index of negotiated wages is calculated using the following weighting formula:

$$M_t = \frac{\sum_{i=1}^{n} B_{it} \times M_{it}}{\sum_{i=1}^{n} B_{it}}$$

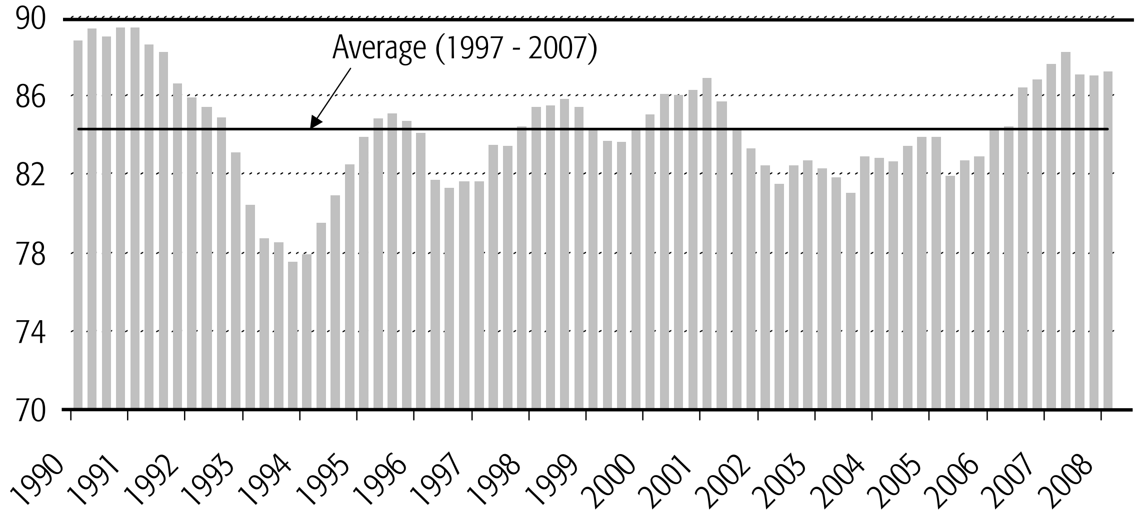
M_{it} stands for the monthly salary and B_{it} for employment in the collectively negotiated sector i for the month t; n designates the number of sectors covered in the negotiated earnings statistics. Unlike the Statistics Office’s agreed wage index, which is calculated with constant weights, the Bundesbank’s index of negotiated wages therefore also reflects shifts in the employment structure.
For example, the share of persons employed in financial, real estate, renting and business activities jumped from 11.8 % of the total workforce in 1995 to 17.3 % in 2007 while that in the production industries fell from 23.9 % to 19.9 %. Last year in particular was hallmarked by very strong growth in employment in the services sector. The Statistics Office’s index of agreed wages and salaries could therefore be distorted. On the other hand, the rise in the Bundesbank’s index of negotiated wages does seem surprisingly moderate given the very high new pay settlements in 2007.
Source: Federal Statistics Office, Deutsche Bundesbank.

3.4 Investment less buoyant

Last year the boom in machinery and equipment investment continued unchecked. Up 8.2 %, spending matched the previous year’s momentum. Driven by pull-forward effects related to the alterations in tax legislation coming into effect at the end of the year, capital expenditure was stepped up very sharply in the fourth quarter of 2007: For one, immediate write-off allowances for so-called low-value assets were restricted; and for another, at the end of 2007 the tax-beneficial degressive depreciation facility on machinery and equipment was phased out. The investment brought forward to the final quarter of 2007 will be missing in Q1 2008, which is why we expect the year to get off to a very slow start.

However, we see investment in machinery and equipment gradually gathering momentum again in the course of the year. The projected slump in the first quarter will be nothing more than a temporary blip and not a trend reversal. On the whole, the backdrop for capital expenditure remains quite good, even if financing costs have risen in the past few months. The Bundesbank reports first-quarter capacity utilization in manufacturing at 87.2 %, still well above the long-term average of 84.3 % (1997-2007), and sales prospects remain positive. Very importantly, the corporate tax reform that came into force this year has made Germany more attractive in international competition for inward investment. All told, we see real growth of 3.8 % in machinery and equipment investment this year. For the coming year we have penciled in a 5.9 % rise, with significantly higher average annual growth resulting essentially from the better start to early 2009.

Industrial capacity utilization still high
seasonally adjusted, in %

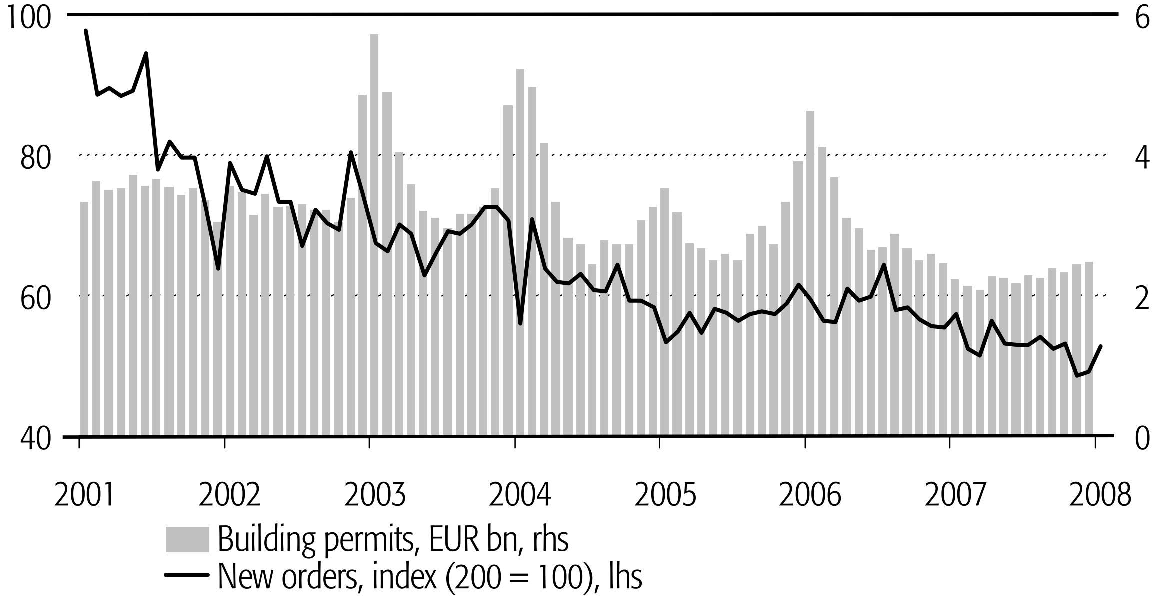


Construction spending cooled perceptibly last year, notching up real expansion of just 2.3 % against a plus of 4.3 % in 2006. Practically all this slowdown was due to the development in housing construction, which accounts for roughly half of total construction investment. It turned in average growth of a mere 0.6 % across the whole of 2007, and in the course of the year expenditure on house building even declined. Essentially, this trend represents the flipside of the pull-forward effects triggered by the expiry of homeowner subsidies at the end of 2005 and the value added tax hike at the beginning of 2007. Recent data on building permits and new orders do not point to the likelihood of a rebound in the foreseeable future, which is why we predict falling housing investment both this year and next. However, the outlook for work on existing properties is far brighter than for new-build housing. Ever-more stringent climate protection measures, the increase in inheritances, the trend to smaller household sizes, the improved income situation for dependent employees and persistently low interest rates are stimulating demand here.

Public-sector and commercial construction continue to perform very well. Last year they expanded by 6.7 % and 3.7 % respectively. We expect both sectors to continue growing over the entire forecast period. The public sector's considerably improved fiscal situation should leave it in a position to continue working off the backlog of investment that accumulated in the tight budget years. However, the pace of investment is likely to slow a little as federal and local authority workers take home higher salaries in 2008 for the first time in years. The escalation in personnel costs will presumably narrow the scope for capital expenditure.

Commercial construction will benefit as the still-good earnings situation keeps the corporate sector very much in the mood for investment. What is more, eastward enlargement of the EU has elevated Germany to a central transport hub in the heart of Europe with numerous trade, warehousing and distribution facilities. All in all this year, we project growth of 0.8 % in aggregate construction spending. Next year we see this figure climbing to 1.2 %.

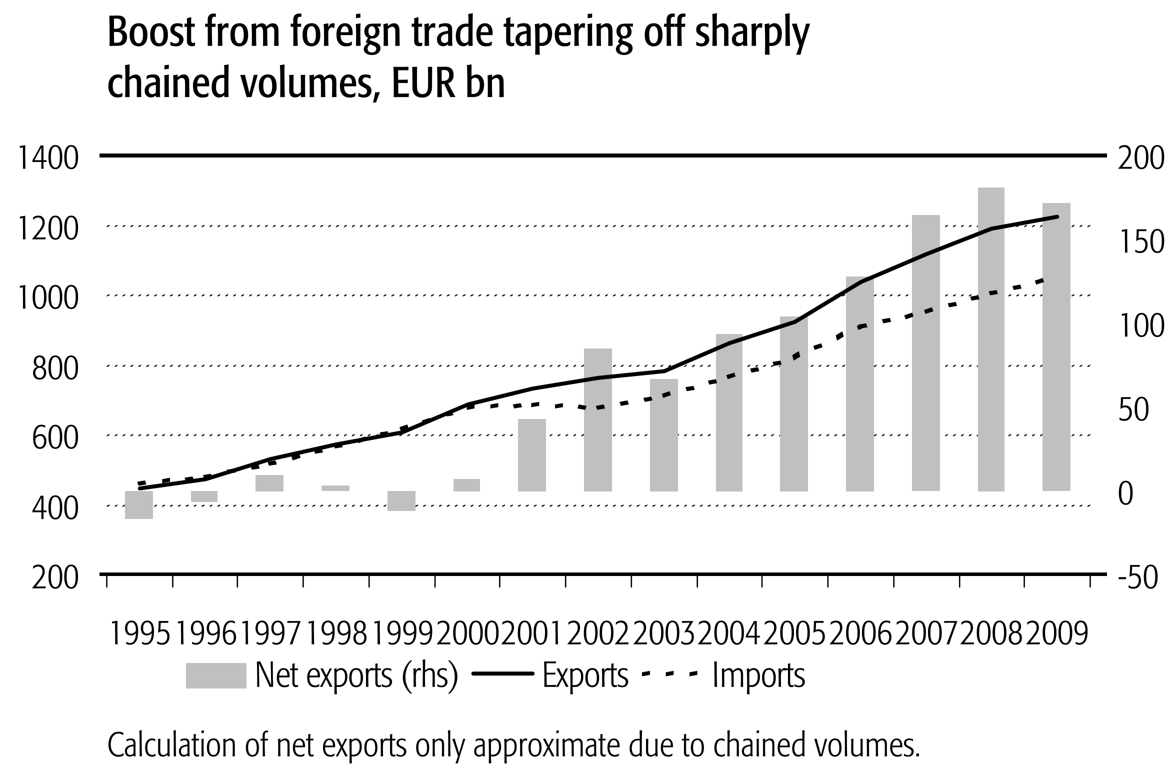
Residential construction
seasonally adjusted



3.5 External trade bows out as economic locomotive

Last year German exports surged by a hefty 7.8 %. Even so, they failed to match the strong momentum of 2006, when expansion hit a remarkable 12.5 %. Growth will likely slow a little further in 2008 to 6.3 %. The foreign trade figures already available for the beginning of the year and manufacturing industry's still comfortably filled foreign order books indicate that shipments in the first six months will continue to increase briskly, but we expect export momentum to lose considerable steam in the second half-year. The main reason for this, besides more muted world economic expansion, is the dogged strength of the euro, which is increasingly crimping the competitiveness of German exports in countries outside the euro area. The indicator of price competitiveness published by the Bundesbank shows that in 2007 German business surrendered almost 5 % of its price competitiveness to rivals from non-EMU countries. Given the euro's substantial appreciation in the first quarter of 2008 – particularly relative to the US dollar – this trend will presumably have persisted in the opening months of this year.

We expect imports in 2008 to develop more dynamically than last year, with growth accelerating from 4.8 % to 5.6 %. Although the slower pace of capital investment will check import demand from that side, this should be more than compensated by the stronger import pull of markedly resurgent private consumer spending. Having contributed more than half of last year's real 2.5 % GDP growth, external trade will probably account for barely one-third this year. And in 2009 its share of growth is likely to border on the negligible as imports – driven by buoyant domestic demand – expand more strongly than exports for the first time in six years.



For years the regional structure of German exports has mirrored what we have also been observing in a global context – the rising importance of the emerging markets. The so-called BRIC countries – Brazil, Russia, India and China – are a good illustration of this. In 2000 they absorbed a mere 3.8 % of Germany's total foreign shipments. But by 2007 the figure had reached 7.5 %, almost doubling in the space of just seven years. Indeed, Russia almost trebled its share over the same period. It is also interesting to see how the relative shares of individual non-European industrial countries have developed. The US is the most prominent example: In 2000 more than 10 % of all German exports still headed for America, but last year's figure of 7.6 % was not much higher than the tally for the BRIC countries as a whole. Japan has likewise become considerably less important to the German export industry in latter years: between 2000 and 2007 its share almost halved. In comparison, the proportion of German imports absorbed by the euro area can almost be described as stable, contracting "only" from just under 45 % to around 43 %.

Growing regional diversification of German exports
% share of total German exports

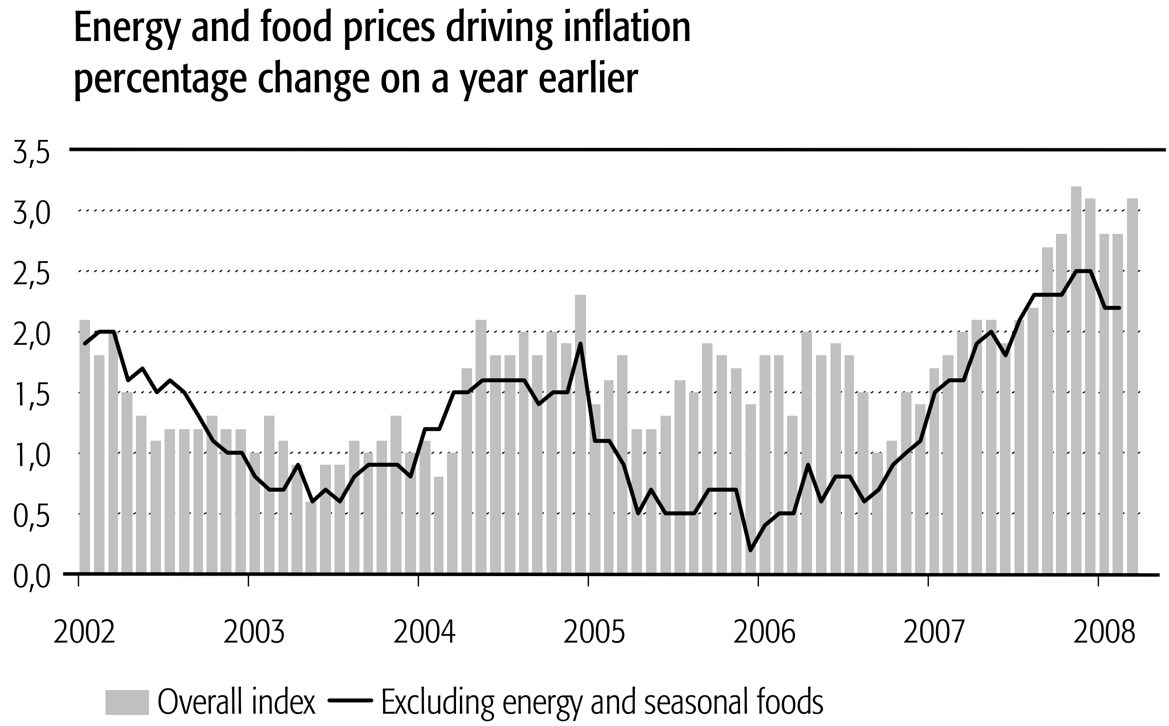
	2000	2006	2007
France	11.3	9.6	9.7
United Kingdom	8.3	7.3	7.3
Italy	7.5	6.7	6.7
Netherlands	6.5	6.3	6.4
Poland	2.4	3.2	3.7
Czech Republic	2.1	2.5	2.7
Hungary	1.7	1.8	1.8
EMU countries	44.7	42.5	42.8
EU27 countries	64.7	63.6	64.8
USA	10.3	8.7	7.6
Japan	2.2	1.6	1.3
Brazil	0.8	0.7	0.7
Russia	1.1	2.6	2.9
India	0.3	0.7	0.8
China	1.6	3.1	3.1

To summarize, we can say that while the other EMU member states' importance to the German export industry is, as a whole, receding only gradually, for some years massive shifts in country weightings have been taking place in the non-EMU members. The rise in the emerging markets is quite clearly occurring at the expense of the big industrial countries. In the process, Germany's export industry is becoming more regionally diversified, making it less dependent on economic trends in one single country. For example, the 5.9 % slide in exports to the US last year, which taken alone would have represented a distinct dent, was more than made up for by strong rates of increase in deliveries to other countries and regions. As a result, even though the world's largest economy floundered last year German exports still registered a hefty nominal increase of 8.5 %.

3.6 Inflation well down in the course of 2008

Last year, consumer prices in Germany jumped sharply by 2.3 %, fueled by no fewer than three factors: the VAT increase at the beginning of the year, soaring energy prices and distinctly higher prices for food. On average for the year, food was 3.9 % more expensive, but with massive variations in the rate of increase depending on the type of produce. Dairy products, for instance, climbed almost 6 % on average for the year, and in December milk products were a whopping 20 % dearer than a year previously.

For this year we expect inflation to average 2.4 %, a whisker above the previous year's level. Last year's increase resulting from the VAT hike will no longer have any effect, bringing considerable relief; but this is likely to be wiped out almost entirely by two other developments. First, we expect upward pressure on food prices to persist, although not at such a dynamic rate as last year. And second, still-high energy prices will have a clearly negative impact. On average for 2008 we are pricing in benchmark grade Brent oil at USD 90/barrel, which would represent a more than 23 % gain on 2007. With base effects related to the 2007 VAT hike petering out and oil prices geared more closely again to fundamentals – in other words, slower growth in demand accompanied by an expansion in real supply – the annual inflation rate should dip well below the 2 % mark again in the course of the year. On average for the fourth quarter we see it easing to just 1.6 %.



For 2009 we have penciled inflation of 1.9 % into our forecast. This is based partly on expectations that average energy prices for the year will hold stable versus 2008 and on the assumption that the upward trend in food costs will at least not accelerate appreciably.

3.7 Budget slightly in the red again

Last year, the positive economic situation and, not least, the sharp value added tax increase had tax revenues flowing abundantly, presenting the German government with its first budget surplus since 1989 (setting aside the year 2000, when the government raked in billions from the one-off auction of UMTS licenses). The small plus amounted to around EUR 0.2bn or 0.01 % of GDP. Only a year previously the deficit had equaled 1.6 %, and in 2005 no less than 3.4 %.

We expect this year's budget to slip slightly into the red again as revenue growth loses some of its momentum amid weaker economic development. Expenditure also looks set to nudge considerably higher, due at least partly to government's laxer spending discipline. Here are just a few selected examples:

- Pension increase: Going by the pension adjustment formula, the adjustment in old-age pensions due in July 2008 should be only in the region of 0.5 %. But federal labor minister Olaf Scholz now plans to suspend the graduation mechanism in the formula that has the effect of keeping rises in check. This would make the adjustment in pensions 0.6 percentage points higher, leading to an increase of altogether 1.1 %. Given a pension volume of roughly EUR 200bn, this steeper 0.6 percentage-point rise will cost the pension fund about an extra EUR 1.2 billion in 2008.

- Unemployment benefit I: With retroactive effect from January 1, 2008 older unemployed are entitled to draw unemployment benefit I for longer.
- Public-sector workers: Wages and salaries for the 1.3 million public service employees are to be raised substantially in 2008 for the first time in years. Backdated to January 1, 2008 pay for all wage groups is to be raised by EUR 50. Building on this, pay will then be increased by 3.1 %. In total this corresponds to an increase of 5.1 %. A further 2.8 % hike together with a one-off payment of EUR 225 has been agreed for January 1, 2009.
- Financial crisis: The federal and regional governments are spending considerable funds to shore up individual public sector banks that have realized heavy losses or have had to assume liability for losses by other banks in the wake of the US subprime meltdown.

All in all, we are reckoning with a budget deficit this year of EUR 2bn or 0.1 % of GDP. For 2009 we expect to see the budget return to slightly positive territory as the economy performs more dynamically again – and despite the elections to the Bundestag which will be held that autumn.

3.8 German industry well prepared for economic slowdown

German industrial companies can meanwhile look back on four straight years of growth, the longest phase of industrial upswing since Germany's reunification. In the years 2004 to 2007 the manufacturing sector accounted for nearly one third of nominal aggregate growth although its weight in the economy is not even one quarter. In 2007, industrial output actually leapt by nearly 7 % in price-adjusted terms, the first such surge since reunification. Industry thus contributed some 1.2 percentage-points growth to the economy.

The economic indicators at the beginning of 2008 are also signaling a marked rise in output in the producing sector for the first quarter. Even if part of the growth can be attributed to special effects, such as working off orders for capital goods which had been brought forward and the mild winter, industrial expansion is latching on for the moment to the strong momentum of the previous year and is once again the main force powering aggregate growth. As the year continues, however, a host of negative factors from the international environment will have a growing influence on industrial activity. Exporters of capital and intermediate goods, which account for nearly three quarters of German merchandise exports, will be unable to maintain the high growth pace of previous years and will only record average growth rates. Domestic orders of capital and intermediate goods will also lose momentum.

The full negative effects of the international financial market crisis and the growth dent in the USA will probably only filter through to German industry in the winter months of 2008. However, German companies are well-equipped to cope with the subdued economic development this year thanks to their solid earnings and financial backing. This applies not only to large-scale industrial companies but also to medium-sized industrial companies supplying exporters or directly exporting themselves. Next year, the cyclical momentum in German industry will gather steam again. The deterioration in price competitiveness in relation to other countries as a result of the euro appreciation will then gradually ease up, thereby fueling stimulus from abroad. Domestic orders should gain a sizeable boost not only from the rising investment activity but also from private consumption.

As, however, the contribution of consumer goods producers to German industrial production of nearly one fifth is relatively low, and given that foreign producers will primarily profit from the consumption recovery expected in the forecast period, the slower pace of the capital and intermediate goods industry will feed through to industrial production in 2008 and 2009. Nonetheless, German industrial activity remains in good shape. Starting out from a high level, real production will rise by an average of around 3 ¾ % this year followed by growth of some 4 % next year which in turn will be based on renewed stronger sequential growth. In spite of growth being halved compared to the boom year of 2007, the intermediate and capital goods producers will manage in the forecasting period to expand their production as strongly - by some 4 % a year - as they had in the long-term trend since the middle of the nineties. In 2008 and 2009, the production increase for consumer goods of in each case some 2 % should way exceed the long-term trend of nearly 1 %.

German industrial production 2007 to 2009[1)]
% change on previous year

As of: April 2008

Sector	2007	2008 [2)]	2009 [2)]
Producing sector (excl. construction)	6,1	3,7	4,0
Manufacturing sector	6,9	3,8	4,2
Food industry	3,4	3,0	3,0
Wood industry	-0,7	0,0	3,0
Paper industry	8,5	3,0	3,0
Publishing, printing	-1,2	2,0	3,0
Chemical industry	4,7	3,0	4,0
Rubber goods	5,8	2,0	2,0
Plastic goods	6,8	4,0	6,0
Production of crude iron and steel	2,8	0,0	2,0
Metal products	8,3	3,0	4,0
Mechanical engineering	9,7	5,0	3,0
Electrical engineering	11,5	5,0	6,0
Electricity generation and distribution instruments	7,2	4,0	5,0
Radio, TV, telecommunications	17,0	10,0	8,0
Medical and orthopaedic technology	4,0	4,0	5,0
Measurement, control and navigation technology	6,2	5,0	6,0
Motor vehicles and components	7,5	4,0	4,0
Furniture industry	3,2	2,0	4,0
Energy supply	-3,5	4,0	2,0
Construction	2,7	1,0	0,5

Source of outturn figures: Federal Statistical Office
1) All figures are working-day adjusted
2) Forecast; figures for individual sectors rounded to half or full point

The table below provides a survey of the most important sectors of the manufacturing industry in Germany:

Automobile construction

Following the relatively strong production growth of over 7 % in the previous year, the German automobile industry will lose cyclical pace somewhat both this year and next at growth rates of in each case 4 %. Exports, which meanwhile account for 75 % of vehicles produced in Germany, will remain the main driving force in 2008. Although demand in the important sales markets such as the USA and western Europe will develop relatively weakly, the domestic carmakers will manage to compensate this by gaining market shares – with the German automobile industry extremely competitive particularly in the premium segment – and above all by boosting exports to eastern Europe and Asia. However, clearly negative repercussions for exports could no longer be ruled out were the euro to continue appreciating further.

The German automobile market is lagging behind the export development, even if car registration figures are likely to have picked up again moderately following last year's slump. The discussion over climate changes and the high petrol prices have unnerved domestic car drivers. Nonetheless, the expected improvement in private consumption could stimulate sales particularly as a great need for replacements must have built up in the meantime. In 2009 we therefore expect the domestic market to develop somewhat more dynamically, powered by a further recovery in private consumption. By then the uncertainty over climate policy regulations should have waned. In return, the export trade should ease up somewhat.

Mechanical engineering:
Mechanical engineering is currently undergoing an unusually stable and long-term growth phase worldwide. In 2007 global engineering sales climbed by approximately 5 % in real terms. Of the major machine producing countries, the greatest contribution came from China with a sales increase of 26 % followed by Germany with 11 %. In contrast, Japan registered a relatively moderate increase of 3 % in real terms while in the USA sales even stagnated. With new orders having mainly risen in the developing and commodity-extracting countries in recent years, decisive stimulus also derived recently from western Europe. In 2008 engineering should continue to expand globally, albeit at a slower pace due to the further weakening economic trend in the USA. No stimulus will derive from Japanese engineering either. In China demand for foreign machines is likely to grow less strongly than in the past owing to the fact that the country's own production is increasingly able to meet the unchanged high demand. This year overall machine sales are therefore likely to record global growth of an estimated 3 % real.

German engineering, as the world's largest exporter and the third most important producer worldwide, is profiting noticeably from the distinct rise in international demand for capital goods in recent years. Recently, however, domestic orders also made a significant contribution to growth. In 2007, production in Germany gained by nearly 10 %. German engineering can thus boast of the longest growth phase in decades. Most recently, capacity utilization in engineering stood at 92 %, a utilization ratio way above the average of the last five years and also above the approx. 87 % considered to be optimum from a business management viewpoint. A number of engineering companies are therefore meanwhile complaining of capacity restraints.

Their high competitiveness signals solid export growth for German engineering companies, even in weaker global economic conditions. So far practically no signs of deceleration can be noticed in the development of foreign orders. The slackening demand from the USA is being largely compensated by the still positive demand from the emerging and developing companies. However, the risks have been compounded as a result of the US real estate crisis, uncertainty over global financial markets, the unrelenting surge in commodity prices and the continuous plunge in the US dollar exchange rate.

New domestic orders have lost momentum of late. This suggests that at many companies the lost ground has meanwhile been recovered, with orders already revealing the effects of the new tax regulations governing writedowns which had been tightened at year end. However, order volumes still extend way into the year 2008, with a generally lower order momentum not likely to feed through to production until the autumn. Overall we expect German engineering to record a production increase of 5 % this year and 3 % in 2009. In spite of the slackening momentum, this would be the fifth and sixth straight year of production growth – a fairly untypical situation for this cyclical sector.

Electrical engineering

According to the Federal Statistical Office, German electrical engineering has recorded expansion in 2007 for the fifth straight time. At 11 ½ %, production growth was not only in the double-digit region but was also once again well above the 8 % average growth seen in the last four years. However, the sector growth is overstated by the fact that technical progress and quality improvements (e.g. greater processor capacity and faster processing speeds) have resulted automatically in price increases for the produced goods. It comes as no surprise to learn therefore that the strongest growth stimulus has stemmed once again from the divisions IT Technology (a good +40 %) and Electronic Components (above +30 %). On the other hand, the insolvency of BenQ as a special effect in the TC technology sector has resulted in a massive collapse in production (-17 %) in this segment.

Sales recorded an appreciably more subdued development than output, gaining only 2 % in 2007. If the BenQ insolvency is excluded from the calculations, the sales increase pans out at some 6 % according to the ZVEI. The rate is more likely to underestimate somewhat the actual sector development compared to the production development, as major sections of electrical engineering are subject to a steady drop in prices due to the rapid technological progress. In 2007 the main stimulus for sales derived this time from the domestic business, while foreign revenues – unlike previous years – rose only fractionally.

In spite of the evident slowdown in the growth momentum in recent months, the prospects for German electrical engineering are still favorable, as also underscored by the positive ifo Business Climate Index. Overall, production is expected to climb by some 5 % in 2008, with a further rise expected in 2009 of approx. 6 %. With the exception of the IT and TC technology segments which, as a result of hedonistic price formation, are again registering above-average growth, all segments of this sector will contribute almost equally to the sector growth. The upswing thus remains on a broad base. This particularly applies also to energy technology which, with a share of a good 45 %, represents the main emphasis of electrical engineering in Germany and which for years has proved to be a reliable source of stimulus. This segment is profiting especially from the favorable investment climate: according to the latest investment survey by the ifo Institute, west German industry will continue to expand its investment activities in 2008 and 2009 in spite of the harsher regulations governing tax depreciation law, including in particular engineering, the automobile industry and chemicals as important customers. For exports, however, a subdued development is being signaled due to the negative repercussions for the sectors from the steep slide in the US dollar. However, the still buoyant investment in energy and traffic infrastructure projects in developing countries such as China, India and the OPEC countries of the Middle East will prevent exports from falling.

Chemical industry

Chemical industry companies in Germany will have to adapt to a slower growth pace in 2008 following four years of dynamic upswing in which production soared by some 20 % overall. First, aggregate economic activity will weaken up noticeably in Germany and, second, more signs are emerging of a global economic slowdown. All told we therefore expect growth in chemical production of some 3 % on average for 2008 following a good 4½ % last year. This relatively optimistic forecast is based on the progress achieved by the sector in recent years to restructure its activities. Above all overcapacities have been reduced and costs lowered. What is more, most companies have upgraded their equity bases. All these measures are now starting to bear fruit and are enabling German companies from the chemical industry to look confidently into the future – in spite of cost pressure stemming from the high energy and commodity costs and the slackening internal and external economic stimulus.

It should be pointed out, however, that the risks facing the chemical sector have increased: the euro is strong, oil prices have hit new highs and the financial market upheavals sparked off by the US real estate crisis have still not been overcome. While a strong euro can cushion to some extent the higher oil expenses for the chemical industry, it is nonetheless increasingly eroding the price competitiveness of European producers. The consequences would be rising import pressure combined with subdued export growth. However, in keeping with the expected more favorable economic prospects for 2009 we forecast a slight improvement in the growth momentum for the chemical industry which should translate into a production gain in 2009 of 4 %.

Box 2: Productivity development in 2007

While gross output at current prices brushed 4 % in 2007 to register its strongest rise for many years and also notched up another steep increase of around 3 % in real terms, productivity development failed to match this dynamic pace. The increase in gross value added at current prices per person employed and hours worked nudged up by just 2.7 %, falling short of the previous year's performance. In real terms labor productivity per employee progressed hardly at all, by a negligible 0.8 %.

This low overall growth rate can be explained by marked sectoral differences: The quite positive trend in manufacturing contrasted with poor performance in the services sector. Whereas gross output per person employed (at current prices) in manufacturing, excluding construction, expanded by 5.0 % on average for 2007 (up 4.0 % in real terms), productivity growth in trade, hotels/restaurants and transport lagged way behind at 1.4 % (0.8 % in real terms). In financial, real estate, renting and business services, the sector making up the lion's share of gross value added, at almost 30 % (against 26 % in manufacturing excluding construction), labor productivity per employee dropped by 0.7 % (-0.8 % in real terms) and by as much as 1.2 % (-1.3 % in real terms) per hour worked.

The reasons for this can probably be traced to the structural differences in employment. One reason may be the higher share of part-time workers in the services sector. And it is in exactly the services sector where there are also many jobs for low-skilled and accordingly less productive workers, with hotels/restaurants (service staff) and business-related services (security watches, cleaning staff) springing to mind here. The high level of outsourcing in industry in recent years will presumably also have been a contributing factor.