

27 May 2008

# Economic news

## GROWTH IN GERMANY

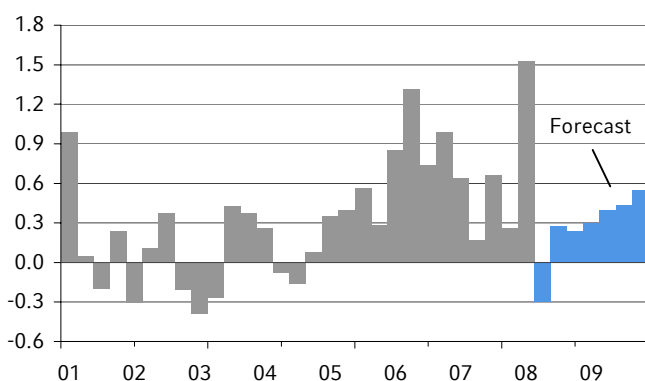
### Investment drives GDP growth in Q1

Buoyed by a sharp upsurge in investment, GDP grew by a strong 1.5% q/q in the first quarter of this year, marking a 12-year high. Private consumption also expanded, albeit moderately. Despite the rise in inflation, we remain upbeat on the consumption outlook. However, growth is likely to lose momentum later this year owing to the large number of negative factors. Nevertheless, we expect average annual GDP growth of 2.2% for 2008.

- GDP grew 1.5% q/q in the first quarter of this year, in line with the flash estimate published by the German Federal Statistics Office on May 15. Investment activity provided the main impetus to growth. Investment in machinery and equipment was up 4.0% q/q, while construction spending even rose 4.5% q/q. Also positive was the strong build-up in inventories, contributing 0.7 percentage points to GDP growth. In addition, public consumption picked up sharply.
- Despite the upturn in inflation, private consumption gained 0.3% after having contracted at the end of last year. Although exports likewise improved, net foreign trade dampened growth as imports saw a significant increase of 3.5%. On the one hand, this was probably attributable to the rise in domestic demand, with a particularly high share of imported capital goods. On the other hand, companies are likely to have built up their inventories in anticipation of higher commodity and intermediate goods prices.
- Private consumption recorded moderate growth, as disposable incomes rose significantly owing to the rapid increase in wages. Although the stronger price rise absorbed some of the additional income, there was scope for higher consumer spending as private households did not increase their savings.

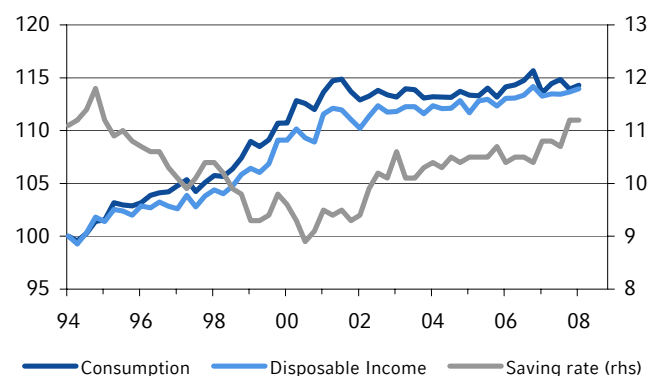
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**GDP**  
(% y/y)



Source EcoWin, WestLB Research

**Income and application of income**  
(1994 = 100 and %)



Source EcoWin, WestLB Research

- Today's data are encouraging for the consumption trend going forward. Expansion in disposable incomes will continue to accelerate given the strong revival on the labour market and high collective wage agreements. The sharp drop in unemployment has evidently contributed to the fact that consumers have become less sceptical about the future and are not increasing their savings any further. Finally, the increase in prices from purchases actually made by consumers has again proven to be weaker than the increase in consumer prices (CPI) stemming from fixed consumption behaviour – a trend that is crucial with regard to the recent surge in prices. Private households often react to higher prices for individual goods by limiting their spending accordingly; for example, volume sales of fuels tend to drop when petrol prices soar. In this setting, we still expect a revival in private consumption over the coming quarters.
- The sharp rise in construction investment in the first quarter is probably linked to the mild weather during the winter months. A countermovement is therefore likely in the current quarter. We also expect a countermovement in inventory spending. Whether this will be fully offset by private consumption and exports is questionable. We therefore project a slight decline in GDP in the second quarter. All in all, however, growth would still be substantial in the first half-year.
- We expect economic momentum to soften later in the year in response to high crude oil and commodity prices, a continued firm euro, decreasing global growth stimulus and tougher financing conditions. Nonetheless, growth should average 2.2% in 2008, which is certainly respectable given the difficult environment.

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