

ECONOMICS: EUROPEAN PERSPECTIVES

IS THE GERMAN CONSUMER FINALLY WAKING UP?

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German consumer spending ended 2014 on a strong note. Supported by rising real incomes and high consumer confidence, we expect this trend to continue. This won't cure all the euro area's ills, but it does suggest that consensus growth estimates—for Germany and the region as a whole—are too low and that they're likely to move higher in coming months.

Details released this week confirmed that the German economy grew by a surprisingly robust 0.7% in the fourth quarter of 2014. Perhaps more impressively, the data showed that the consumer ended last year on a strong footing. Household spending rose by 0.8% during the fourth quarter, taking the annualized gain in the second half of the year to 3.0%.

In truth, signs of life from the German consumer are long overdue. As we have noted in the past, the German household sector isn't over-leveraged, doesn't face rising fiscal pressure and should be benefiting from hugely accommodative monetary and financial conditions.

Record Low Unemployment

A strong labor market should also support consumption. At 4.5%, the unemployment rate is now at its lowest since reunification in the early 1990s (**Display 1**). And, after a period in the doldrums, negotiated wages grew by 3.0% last year, the biggest rise since the mid-1990s. As a result, real disposable income rose by 2.8% in the final quarter of last year, the fastest growth rate since 2001. This, in turn, provided the fuel for the pickup in consumption at the end of last year (**Display 2**).

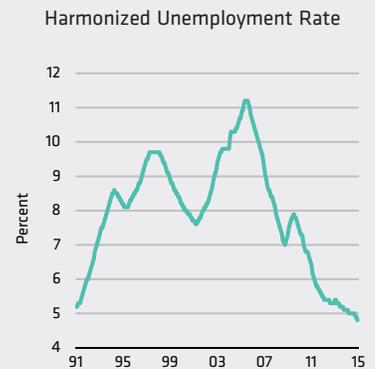
Real income growth should provide an even bigger boost to consumption in the coming year. There are two reasons for this. First, inflation is likely to be lower this year: in January, the annual rate of inflation stood at -0.4% compared with 0.5% in the fourth quarter of last year and 0.9% for 2014 as a whole. Second, even though inflation has fallen, wage settlements look set to at least keep pace with last year.

That's certainly the message from the metalworking sector (which, traditionally, sets the tone for the German wage round). Under an agreement reached this week, the influential IG Metall union secured a 3.4% wage increase for its members. Once adjusted for one-off payments, this amounts to an effective increase of 3.7% compared with 3.2% in 2014. In real terms, this is the biggest increase since 1999 (when, incidentally, German consumption rose by 2.9%).

Growing Confidence

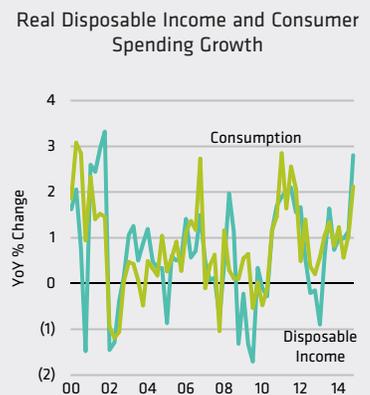
The recent decline in inflation is, of course, primarily due to oil prices and likely to prove temporary. Much will therefore depend on the extent to which consumers decide to spend or save the windfall gain. We're optimistic, especially with consumer

Display 1
Record Low Jobless Rate



As of December 31, 2014
Source: Haver Analytics

Display 2
Income Drives Consumption



As of December 31, 2014
Source: Haver Analytics

confidence either at, or approaching, record highs.

Germany has two main consumer sentiment surveys*. The domestic version is available from 2002 and currently stands at a record high. The harmonized measure, compiled by the European Commission (EC), has a much longer history, running back to 1985. It, too, is at elevated levels (though not record highs).

One component of the EC survey is, however, particularly striking at present. That's the question asking consumers if this is a good time to make major purchases. Except for a brief period in 2006, just before the standard rate of value-added tax was raised by three percentage points, this reading is currently higher than at any point in the last 30 years (**Display 3**).

Motoring Ahead

Of course, what people say they're going to do and what they actually do are sometimes different. Recent hard data suggest that's not the case at present. This is particularly evident in car registrations, which rose by 4.4% in January following increases of 2.3% and 1.6% respectively in the third and fourth quarters of last year. As **Display 4** shows, car registrations are on a strong upward trend.

Once Bitten

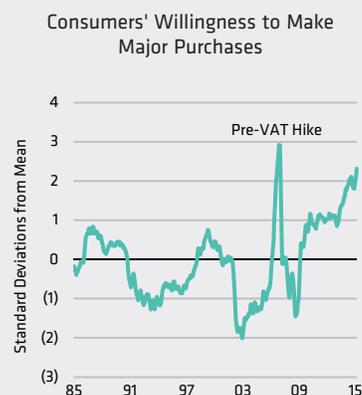
On a couple of occasions in recent years, we have turned more upbeat on German consumption only for our optimism to be overtaken by events. The same could, of course, happen again. But we shouldn't let this possibility bias our analysis today.

The facts today are as follows: the German household sector is fundamentally sound and is benefitting from highly supportive money and credit conditions as well as the fastest real income growth for many years. Perhaps not surprisingly, consumers are becoming more optimistic and this is now being reflected in the hard data: strong consumption at the end of last year and the upward trend in car registrations.

In light of this, we think it's right to adopt a constructive stance on German consumption. While this won't cure all of the euro area's ills, it will surely help. At the very least, it suggests that consensus growth estimates—for Germany and the region as a whole—are too low and that they're likely to move higher in coming months. ■

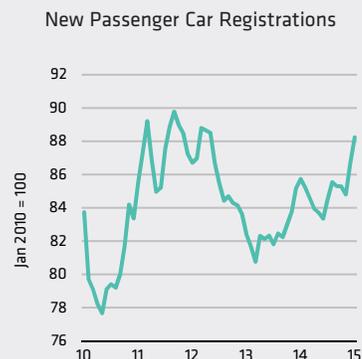
*In both cases, the source data are provided by GfK. However, the methodologies used are different.

Display 3
Ready to Loosen the Purse Strings?



As of February 26, 2015
Three-month rolling average
Source: Haver Analytics

Display 4
Motoring Ahead



As of January 31, 2015
Three-month rolling average
Source: Haver Analytics

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