

think:act CONTENT

Fresh thinking for decision makers

"Three times three
percent" | Our

SCENARIO UPDATE 2011

optimistic scenario
for Germany | Recovery
is well underway | Just
like we said | And it will
continue until 2012 |
If not longer!

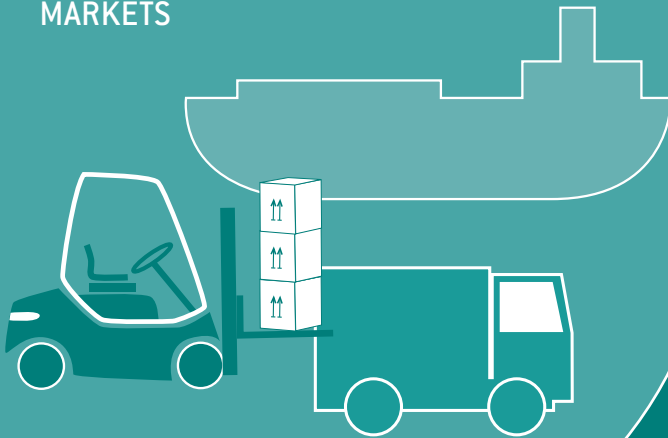
WHAT WAS
2010

WHAT IS
2011

HERE COMES...
2012...

THE SOURCES OF SUSTAINABLE
GROWTH IN GERMANY:

GROWTH IN GERMAN EXPORT
MARKETS



GROWTH IN THE GERMAN DOMESTIC
MARKET



GROWTH FORECASTS
FOR GERMANY: 3-2-1 PERCENT!

WE FORECAST 3x3 PERCENT!

3-3-3
2010 2011 2012

"3x3" – AN OPTIMISTIC SCENARIO FOR GROWTH IN GERMANY

OUR SCENARIO: 3% GDP GROWTH FOR 3 YEARS

Where is the German economy headed? Not even the economic pundits know the answer. Whether in times of boom or bust, their complex forecasting models, based on quantitative data, have proved inadequate. They were simply not up to predicting the future.

Companies need reliable forecasts in order to make long-term decisions. At Roland Berger Strategy Consultants, our specific expertise marks us out from run-of-the-mill pundits. Together with our clients, we think in terms of scenarios. We look at fundamental economic trends, industrial structures and the underlying strengths and weaknesses of market players. This is where our international presence comes in handy. We work with companies all over the world. We know the situation in Germany's main export markets intimately. We can also draw on our experience working with clients. We start with the figures and build reliable scenarios based on our business instincts.

What did we predict for 2010? In our economic scenarios we forecast a V-shaped recession early on. In other words, a quick recovery in the world economy in 2010 (see think:act CONTENT Scenario Update 2010). And that's exactly what happened. At the time, we were much more optimistic than many other observers. We aim to keep up this positive attitude and continue to base our forecasts on fundamental strengths and weaknesses over the next few years.

Current statements by German economic research institutes are cautious. In 2010, Germany experienced a 3.6% rise in gross domestic product (GDP). Predictions are for slower growth in 2011, around 2% to 3%. In 2012 the recovery is expected to slow down even further, with growth of 1% or so. In other words, a 3-2-1 prediction.

Our outlook is rather more sunny. We foresee a 3x3 scenario: following 3.6% growth in 2010, we expect at least 3% for 2011 and the same again in 2012.

Let's look first at the gloomy 3-2-1 prediction by German economic research institutes. Why exactly should the German economy's upturn slow down so much? The prediction assumes that exports will slow and that domestic growth is not strong enough to make up for it. It sees the key drivers of growth in 2010 as one-off effects – making up for deferred investments and rebuilding stocks depleted by the crisis, for example. It assumes that the German economy can no longer count on this type of driver in 2011. That is true, but not all data can be written off as catch-up effects. The 3-2-1 forecast also assumes that the crisis in the eurozone will put a damper on Germany's economy. That may happen. But there are other factors that could make up for it.



ECONOMIC SCENARIOS BY ROLAND BERGER STRATEGY CONSULTANTS

We forecast a V-shaped recession and recovery early on



3.6%
GDP growth in Germany in 2010

THE V-SHAPE

A sharp drop in 2009 followed by fast recovery in 2010



GDP GROWTH IN GERMANY:

3 times past the 3% hurdle

Now let's turn to our more optimistic prediction. We believe that a sustainable, dynamic recovery will take place. Just look back ten years. Germany has proven time and again that a 3x3 scenario is feasible: in 2000, in 2006, and again in 2010. The restructuring of the German economy in the period up to 2005, accompanied by wage restraint and major structural reforms, was a major boost to Germany's long-term competitiveness. The German business model – a strong focus on key value-adding, system-head functions – is a roadmap that many other countries follow. Our industrial competence is an international yardstick.

Our upbeat predictions for 2011 and 2012 are not just plucked out of the air. They have a solid basis in fact. Below, we analyze the factors guaranteeing sustainable growth in Germany: our key export markets and the domestic market. At the same time, we explore which factors could reverse the scenario. Finally, we highlight the action that the government can take to create the right conditions for strong growth in 2011 and beyond.

GROWTH REGIONS DETERMINE INTERNATIONAL DEMAND

As early as 2010, the BRIC countries were boosting demand for German goods and services. This more than made up for the decrease in orders from the United States and Europe. In 2011 the situation in Europe and the US will improve and enable further growth in Germany.

CHINA

In 2009 many feared that growth in the Chinese economy would fall below the 5% threshold. We preferred to accentuate the positive – Expo 2010 in Shanghai, for example. Work on Expo 2010 went ahead despite the crisis. This gave us cause for optimism. We worked with Chinese companies and institutions, helping them to modernize, restructure and innovate. We saw all the projects that they initiated during the crisis. Ultimately, Chinese growth ended up at 9.1% in 2009 and 10.3% in 2010. For 2011, the International Monetary Fund (IMF) is predicting growth of 9.6%. German exports to China rose by 40% in the first eleven months of 2010.

These trends are key to our scenario. By the end of 2011, China could already be the largest non-European export market for Germany. As long as the Chinese economy grows at a rate of over 9%, Germany's exports will not be substantially affected. China's five-year plan focuses on investment, innovation and green tech. It is solid and sure to be implemented. We assume that the Chinese government will handle the risk of inflation sensibly. The increase in minimum reserves and refinancing interest rates has been balanced since late 2010 and has not restricted growth to date.

INDIA

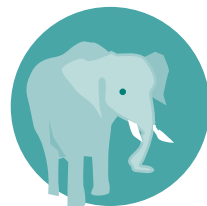
Everyone is talking about China. But what about India? Its economy is also growing rapidly, but has been rather neglected by the economic pundits. In 2010, it expanded by 9.4% and in 2011 it will grow at least 8.4%. India has an emerging middle class: by 2015 around 60 million households will enjoy an annual income of over USD 3,000. This new stratum of society will create growing demand for consumer products from home and abroad.

But let's put the figures to one side for a moment. Here are two vivid examples of what India means to the German economy. First, the Indian airline IndiGO ordered 180 planes from the Franco-German aircraft maker Airbus in January, one of the largest single orders in aviation history. Second, 2011 is set to be a special year for Indo-German relations, with the two countries aiming to foster closer business ties. The slogan is "Germany and India – infinite opportunities." This harbors new opportunities for our export industries.



GROWTH REGION: CHINA

By the end of 2011, China could already be the biggest German export market outside Europe



GROWTH REGION: INDIA

An emerging middle class is driving consumption



GROWTH REGION: USA

Gradually regaining its former strength

UNITED STATES

In our V-shaped scenario, we assumed that the US would recover quickly. That didn't happen in 2010, but now all the positive signs are there. The IMF has just raised its growth forecast from 2.3% to 3% for 2011. Ben Bernanke, Chairman of the United States Federal Reserve, considers 3-4% feasible. Optimistic forecasters put US growth at as much as 5%.

Extending tax cuts beyond 2011 and other actions will free up some USD 150 billion in 2011. This may help revive consumption in the US. President Barack Obama also wants to invest USD 60 billion in the country's infrastructure and in so doing bolster the real economy.

The Purchasing Managers Index and monthly production data are creating an upbeat mood in the manufacturing industry. In services – an important sector in the US – prospects have also improved since the end of 2010. True, the disappointing labor market figures are a cause for concern, but they should not be given undue weight in forecasts. To quote Blackstone's Vice Chairman Byron Wien, "Market players are focusing on the 10% of the US workforce who are unemployed. But much more important is what the other 90% are doing for the economy. And this 90% feel much more secure in their jobs and are willing to spend more money again." To illustrate, at the North American International Auto Show in Detroit in January 2011, large American pickups were once again the public's favorites. That looks more like business as usual. Whether a return to long-established ways – in terms of fiscal policies, for example – is a good idea in the long term, is another matter. But in the short term it adds weight to our 3x3 scenario.



GROWTH REGION: RUSSIA

Modernizing infrastructure could bring significant benefits

RUSSIA

The Russian economy was hit hard by the recession, shrinking by 8%. Growth was still comparatively weak last year, at just 3.4%. The current forecast for 2011 is 4%. Prior to the crisis, however, Russia was growing nearly 8% on average. If higher oil and gas prices bring additional money into the country and this flows into the long-planned modernization of infrastructure and equipment, there should be significant benefits – particularly for the German economy.

Two illustrations: With his "Russia Forward" initiative, President Dmitri Medvedev has sparked a debate among Russia's elite on how the technology of the future can be better supported and dependency on oil reduced. This may be the first step toward encouraging economic policy reforms.

Or look at the ambitious new EUR 11.1 billion tourism project in the North Caucasus. If enough private investors – foreigners included – can be found, then by 2020 a cluster of five large ski resorts and 90,000 hotel beds could be up and running, catering to up to five million holidaymakers a year.

EUROPE

Growth forecasts for 2010 are cautiously optimistic. The European Commission predicts that all member states will return to growth in 2012 and it has almost doubled its forecast for 2011 to just under 2%. Of course, the unexpectedly positive trend in Germany is partly responsible for this. So we should not be too optimistic as far as German exports are concerned. The action currently being taken to cut public and private sector debt in the UK and Spain is stifling demand from these countries. This will inevitably result in less momentum in the German economy.

Northern and Central Europe show considerable growth potential in terms of their fundamental economic data. In these countries, manufacturing accounts for 20% of GDP versus just 14% in the United States.

Europe remains highly competitive despite the lukewarm economic situation. According to the World Economic Forum's Global Competitiveness Report 2010-2011, the top 10 countries in categories such as the "nature of competitive advantage", "capacity for innovation", "local supplier quality" and "production process sophistication" are almost exclusively European.



GROWTH REGION: EUROPE

Uniquely competitive

Ranking in Global Competitiveness Report 2010-2011

Rank	Nature of competitive advantage	Capacity for innovation	Local supplier quality	Production process sophistication
1	Japan	Germany	Austria	Japan
2	Switzerland	Japan	Switzerland	Germany
3	Germany	Sweden	Germany	Switzerland
4	Finland	Switzerland	Japan	Sweden
5	Sweden	Finland	Sweden	Finland
6	Denmark	USA	Belgium	Netherlands
7	Israel	Israel	Canada	Austria
8	Netherlands	France	Netherlands	Qatar
9	UK	Denmark	Qatar	Belgium
10	Belgium	Netherlands	France	Norway

Source: WEF

European companies will also benefit from their specific strengths in corporate management and culture. The financial markets' trust in the euro is already returning. Stability will return if economic policy can be better coordinated in the eurozone (see "What needs to be done with a view to 2012?"). There is also a new initiative that will help revive the European domestic market. If Europe succeeds in leveraging all of these strengths then it has a real chance of sustainable growth, from which Germany will also benefit.

DOMESTIC DEMAND IS PICKING UP

In the first half of 2010, the recovery in Germany was driven largely by exports. In 2011 there will be even more reasons for hope: companies, consumers and the government now have more money at their disposal – and enough confidence in the recovery to actually spend it on the domestic market.

German companies are busy investing again. In January 2011, the Ifo Business Climate Index rose for the fourth time in a row, reaching the highest level since German reunification. The corporate profit forecasts for 2011 say earnings are up 8% or more. Order books are strong, and finding financing has become a lot easier. All this is supported by realistic wage agreements. It is not much of a surprise therefore that many companies have stepped up their investment plans for 2011.

German companies' cautious HR policies during the crisis, supported by government-sponsored short-time work, are now paying off. The current positive development on the labor market may be more than a short-lived rebound. Companies are hiring because they need people to deal with the expected growth. In late 2010, unemployment stood at 7.7%. We think it is realistic to forecast 7% for the end of 2011. Secure jobs give people confidence and make them feel more like spending money. Look at the GfK Consumer Climate Index: except for a small dip in December, it began a steep ascent in the second half of 2010 and is still rising. Prospects for 2011 are glowing.

The government is also awash with cash. Tax revenues are rising a lot faster than expected: in 2011 and 2012, federal, regional and local governments look set to rake in almost EUR 60 billion more than they originally thought, according to the official tax estimate published in November 2010. This money can be used to push growth even further, for instance by investing in education, research and infrastructure.

Overall, domestic and international demand is developing fast. Optimism is certainly justified. If everything goes as we expect, this fresh dynamism will help us past the 3% growth threshold in 2011.

Good news, then. But no cause to rest on our laurels. Building scenarios means looking at alternative developments and thinking them through. Below we look at some of the factors that might put a damper on our enthusiasm and call our 3% growth prediction into question.



CONSUMPTION IN 2011:

Rising employment and income levels in Germany

WHAT NEEDS TO BE DONE WITH A VIEW TO 2012?

Once again, the question is how domestic and export markets will fare. Remember that in the long run, exports on their own cannot provide a sufficient basis for sustainable growth. Companies and industries with firm roots in local markets will have a clear edge on those that don't. So for Germany to be able to generate more than 3% growth after 2011, we need to make Europe strong both economically and politically. That means taking action in three areas: reducing debt, securing raw materials and energy supplies, and developing new business models.

REDUCING DEBT WITH THE HELP OF SOVEREIGN INSOLVENCY PROCEDURES

With a 2.5% budget deficit this year, Germany will once again meet the 3% limit under the EU stability pact. Germany's self-imposed constitutional "debt brake" works, but going it alone doesn't. Certain countries must take the blame for ruining the capital markets' confidence with their misguided government financial and economic policies (Greece) or private sector excesses (Portugal, Ireland and Spain).

Within in a very short space of time, the European Union has taken massive action to shore up confidence. We have gone a long way toward instituting European procedures which could help distressed countries become functional again. The first step was a success. Bonds issued by the European Financial Stability Facility (EFSF) were several times oversubscribed. Investors rushed to get their hands on the bonds and help finance the bailout package for Ireland. What's more, a trade-off is emerging that would allow a soft bailout for distressed countries: the EFSF would provide cheap loans that bankruptcy candidates could use to buy back some of their bonds and so reduce their debts.

Starting in 2013, the European Stability Mechanism (ESM) will continue these initiatives and help bridge temporary sovereign illiquidity. The ESM is designed to persuade private creditors to hold on to their receivables. But if countries are permanently unable to pay their debts, they must agree on a restructuring plan with their private-sector creditors – with a little help from the ESM, if need be.

As part of the follow-up strategy to the Lisbon Agenda ("Europe 2020"), the EU has agreed to launch what has become known as the "European Semester" in March 2011. This is a new six-month cycle of economic policy coordination involving all EU countries. The idea is to spot macroeconomic imbalances early on with the help of indicators and take counter-action if predefined targets are missed or limits exceeded. The "competitiveness pact" established by Chancellor Angela Merkel in early February will also help the eurozone coordinate its economic policies more closely without having to negotiate changes to EU treaties.



CONFIDENCE BRINGS STABILITY

Bonds in the European financial rescue fund



SECURING RAW MATERIALS AND ENERGY SUPPLIES

The financial markets are important, but what about energy and raw materials? Energy prices played a major role in driving inflation in the eurozone up to 2.4% in January 2011. And industry needs an affordable and secure supply of raw materials, especially oil.

We are optimistic here, too – despite the fact that demand from emerging markets continues to rise. We do not believe that the oil price will pass the USD 143 per barrel mark (its peak value from July 2008) in the next 12 months, which push energy prices and lead to higher inflation in Germany. Current forecasts predict about USD 90 per barrel at the end of 2011. Looking any further beyond that point in time is tricky. For the future, we are relying on OPEC to exert its influence. So far, OPEC has kept a close eye on the risks to the recovery of the global economy that a higher oil price would entail.

Since our own natural resources are limited, naturally we have less influence over the price of raw materials. For this reason, Europe urgently needs to agree on a coordinated raw materials strategy to mitigate the consequences of future bottlenecks, particularly those in the supply of rare earth elements and special metals.

We also need to start using our existing raw materials in a more intelligent and efficient way. Progress needs to be made on a European energy plan. Concerted action is required. For example, European countries should further liberalize markets, build up sufficient transmission capacity and promote energy-saving products.

NEW BUSINESS MODELS FOR SUSTAINABLE GROWTH

Over the medium term, traditional industries will profit from initiatives relating to raw materials and energy efficiency. Europe needs to build up its green tech sector. Green tech is based on the intelligent combination of engineered products, electrical engineering and high-value services – areas where Europe excels. In our opinion, Germany is best positioned in Europe to take on a leading global role in environmentally friendly technologies.

To share in the growth potential of green tech over the long term, we need to improve the general framework. Up until now, Europe's green tech companies have been too small and not internationally minded enough. We recommend a policy that promotes larger structures and ensures export financing. This policy should focus more on particularly promising or geographically appropriate regions and company clusters. By supporting our industrial core, we will automatically attract intelligent, business-related services. This means better integration of the industry and service sectors. We currently lack a proper qualification structure – career profiles, degree programs, etc. – for these industries. Effective action in all these areas will allow us to take our industrial competence to the next level.

As Europeans, German entrepreneurs and managers are well-equipped for the future. They look at business strategically, with an eye to the long haul. They are committed to seeing their strategies through. And they combine a long-term and a short-term perspective.

Europeans prioritize differentiation in their businesses. We think in terms of products and technologies rather than focusing solely on the interests of the capital markets. We have learned to see the world in all its variety and diversity. Americans are often seen as wheeler-dealers, looking to make short-term gains and a quick buck. Europe, on the other hand, represents a craftsman culture, one which strives toward the permanent. These are the values that will count. And they substantiate our 3x3 scenario.

On balance, there is every reason to believe that our 3x3 scenario will prove correct, as long as we continue acting with optimism and self-confidence in 2011. Johann Wolfgang von Goethe once wrote: "In these unsettled times, the man whose mind is unsettled only increases the evil." That still holds true today. And, as they say, "the future is when you regret not doing what you could have done today."

IF YOU HAVE ANY FURTHER QUESTIONS,
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