

Talking Points

German Exporters Amid the Global Recovery

By David Bartlett, RSM International and Christian Roller, RSM Germany

On July 8, Germany's Federal Statistics Office announced that German exports in May 2010 grew by 9.2 percent, their sharpest rise in 10 years. On seasonally adjusted balance, this result boosted German exports to €80.8 billion, just 5.4 percent below their pre-crisis peak.

The strong performance of German exporters boosted hopes that Europe's largest economy has rebounded from the recent global financial crisis, mitigating the springtime deluge of unfavourable news attending the Greek crisis.

Some analysts pointed to the depreciation of the Euro (which fell 20 percent against the U.S. dollar between December 2009 and May 2010) as the primary factor driving the surge in German exports. Others noted German companies' increasing use of offshoring (including business process outsourcing and IT service centers in India as well as "nearshoring" centers in Central and Eastern Europe) to reduce costs. Still others cited the success of German enterprise managers in securing union concessions, notably IG Metall's recent agreement with engineering employers in North Rhine-Westphalia to hold 2011 pay hikes to 2.7 percent. That agreement illustrated (1) the fact that many German workers value job security over wage increases

in the post-recession period, and (2) the mutual recognition by German labour and management of the need for greater labour market flexibility amid mounting competition from lower-cost emerging markets.

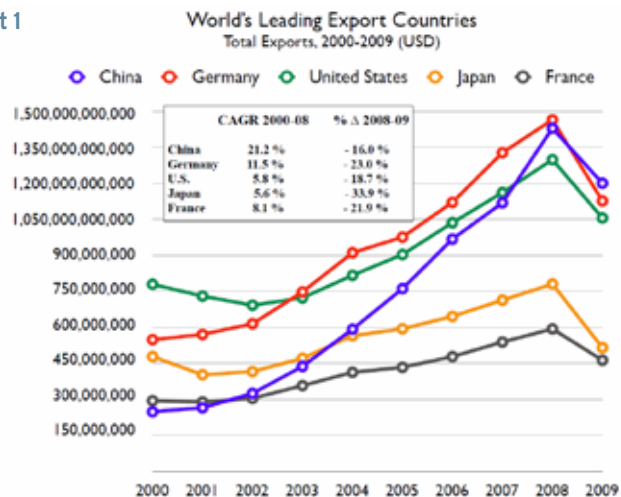
Euro depreciation has no doubt benefitted German exporters, and the combination of offshoring and wage moderation has clearly boosted the competitiveness of German exporters. But the key driver of Germany's export surge is the ability of German manufacturers to sell high value-added products for which demand is growing as the global economy recovers.

Rise of German Exporters

Germany surpassed the United States as the world's leading exporter in 2003, an impressive feat for an economy that is one-fifth the size of the USA's. Between 2000 and 2008, German exports grew by a Compound Annual Growth Rate (CAGR) of 11.5 percent, nearly double that of the United States. China, whose exports grew by 21.2 percent during this period, overtook Germany as the global export leader in 2008. China retained its leadership position in 2009, followed by Germany, U.S., Japan and France.

(See Exhibit 1)

Exhibit 1



All of these countries suffered large export falls under the impact of the global financial crisis. Between 2008-09, German exports contracted by 23 percent or US\$340 billion. Persistent anxieties over financial stability in the European Union (Germany's foremost export market) and uncertainties about world economic growth (projected by the International Monetary Fund to slow from 4.8 percent in 2010 to 4.3 percent in 2011) raise doubts about the sustainability of Germany's recent export surge.

But Germany's export sector possesses a number of competitive assets that bode favourably for long-term sustainable growth:

- Strong demand for German-engineered products in the BRIC countries (Brazil, Russia, India, China) and other emerging markets that comprise a rising share of Germany's export portfolio.
- The ability of German export manufacturers to command premium prices for specialised machinery, precision engineered equipment, and other high-end products that exhibit low price elasticities.
- The central role of the Mittelstand (family-owned middle enterprises) in Germany's export sector, some 500 of which qualify as export world champions (exportweltmeister) and which enjoy

greater financial/operational/strategic agility than many of the large, publicly listed companies that dominate the export sectors of other developed countries.

Composition of German Exports

The ability of German exporters to migrate up the international value chain provides important lessons to export manufacturers based in other high-cost countries struggling to achieve profitable growth in price-sensitive segments of the world economy.

Exhibit 2 shows the commodity composition of German exports. The top five product groups (machinery, motor vehicles, chemicals, computers/accessories, and electrical equipment) together represent nearly half of Germany's exports. Within these categories, German companies occupy leading positions in high-margin niches such as compounding systems, excavation equipment, industrial automation, laser/optical instruments, machine tools and power transmission. German manufacturers of solar energy products, which established a domestic foothold via Germany's feed-in tariff regime, are now exploiting export opportunities in that fast-growing global industry. Manufacturers of specialised automotive components are deeply integrated in the regional and global supply chains of German car manufacturers and tier-one suppliers.

Geographic Structure of German Exports

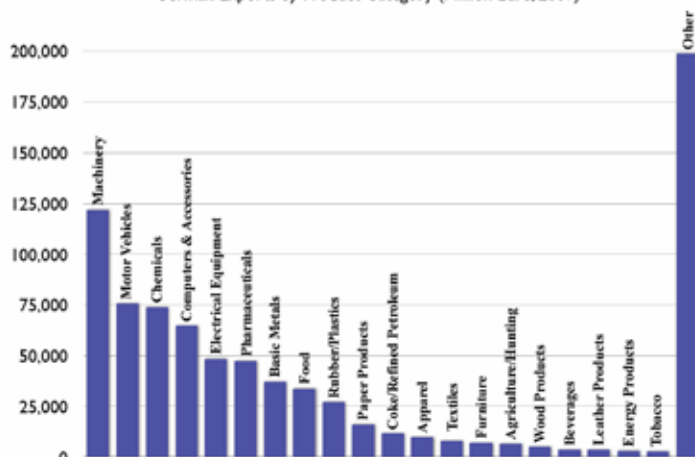
Like their counterparts in other European countries, German exporters conduct the bulk of their business within Europe. The Euro zone accounts for 48 percent of German exports, on which the recent depreciation of the Euro has no direct bearing. Non-Euro EU (a group that includes Denmark, Sweden and the United Kingdom along with eight accession countries of Central and Eastern Europe that have not yet adopted the Euro) represents 20 percent of German exports. Non-EU Europe (subsuming Iceland, Norway and Switzerland and the accession candidates of Southeastern Europe) accounts for another 7 percent, raising the intra-European share of German exports to 75 percent. Only two non-European countries (the United States and China) figure among the top ten destinations of German exports. (**See Exhibit 3 overleaf**)

But while intra-European transactions represent the largest share of German exports, emerging/developing economies outside the European Union constitute Germany's most rapidly growing export markets. The Russian Federation is Germany's fastest growing export market, posting a CAGR of over 25 percent since 2000. By contrast, exports to France (Germany's biggest foreign market) grew by 9.5 percent CAGR between 2000 and 2008.

German exports to the Russian Federation dropped nearly 40 percent in 2009 as Russian importers reeled under the impact of the recession and the decline in hydrocarbon prices. However, long-term demand for German manufactured products (particularly machine tools, transportation equipment and power systems) appears strong as Russian factories modernise their operations. The steady rise in foreign direct investment by German multinationals active in Russia (which reached US\$6.8 billion in 2009) serves to pull exports by Mittelstand companies and other suppliers. The anticipated growth of public expenditures in Russia (notably infrastructural investments attending the Sochi Winter Olympics in 2014) will create additional growth opportunities for German exporters in coming years.

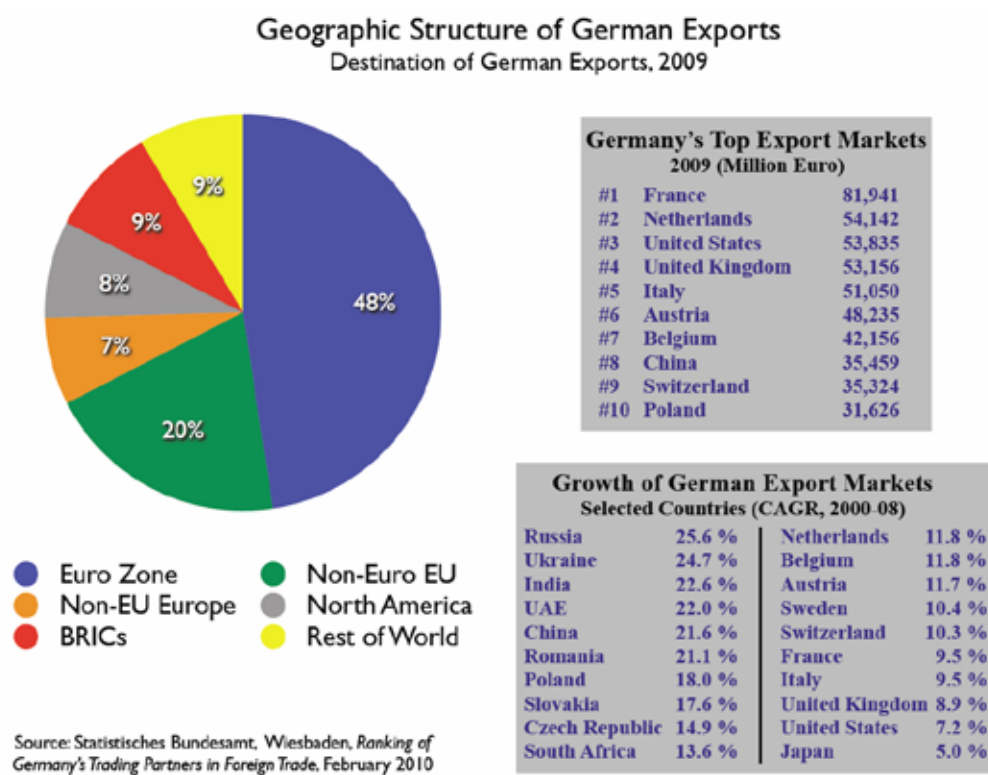
Exhibit 2

Commodity Composition of German Exports
German Exports by Product Category (Million Euro, 2009)



Source: Statistisches Bundesamt, Wiesbaden, Exports by

Exhibit 3



Other non-EU emerging markets (China, India, Ukraine, United Arab Emirates) similarly display German export growth rates well surpassing levels of Germany's foremost markets in developed Europe. The competitive advantage of German exporters in these countries resides in their ability to deliver advanced manufactured products essential for industrial modernisation in developing/emerging economies where local suppliers cannot yet attain German engineering standards.

Within the European Union, the new member states of Central and Eastern Europe (notably Romania, Poland, Slovakia, and the Czech Republic) show higher German export growth levels than Germany's leading export markets in the EU-15 (France, Netherlands, United Kingdom, Italy, Austria, Belgium), underscoring the pivotal role of emerging markets in the growth trajectory of German exporters.

Conclusion

Notwithstanding recent cost-cutting measures and moderate wage agreements, Germany remains a high-cost economy with a comparatively rigid labour market and an ageing work force. While German exporters still hold a competitive advantage as premier manufacturers of advanced manufactured products, these companies will inevitably confront emerging market rivals that enjoy unassailable cost advantages and that are steadily moving up the international value chain. To meet this long-term competitive threat, German manufacturers must boost their investments in productivity, technology, and new product development.

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