



Only a technical recession? It is all about risks!

August 19, 2019

Authors

Josef Auer
+49 69 910-31878
josef.auer@db.com

Barbara Böttcher
+49 69 910-31787
barbara.boettcher@db.com

Dieter Bräuninger
+49 69 910-31708
dieter.braeuninger@db.com

Eric Heymann
+49 69 910-31730
eric.heymann@db.com

Kevin Körner
+49 69 910-31732
kevin.koerner@db.com

Jochen Möbert
+49 69 910-31727
jochen.moebert@db.com

Jan Schildbach
+49 69 910-31717
jan.schildbach@db.com

Editor

Stefan Schneider

Deutsche Bank AG
Deutsche Bank Research
Frankfurt am Main
Germany
E-mail: marketing.dbr@db.com
Fax: +49 69 910-31877

www.dbresearch.com

DB Research Management

Stefan Schneider

Content

Page

Forecast tables.....	2
Only a technical recession?	3
German automotive industry	6
Chemical industry: End to growth	10
House prices and rents still rising strongly	13
Corporate lending in Germany	15
The view from Berlin: Decisive weeks ahead for the Groko	17
Digital politics: AI, big data, and the future of democracy.....	23
DB German Macro Surprise Index.....	24
Data calendar.....	25
Financial forecasts	26
Data monitor.....	27

Only a technical recession? We see Germany in a technical recession, as we expect another ¼% GDP drop in Q3. Our forecast for 2019 is now 0.3%. Given no indication for a rebound, we lowered our 2020 forecast to 0.7%. We acknowledge this revision does not properly account for the recent accumulation of risks. Given the increasingly fragile state of the global economy, the realization of one or more risks could easily push the economy into a completely different scenario, where growth revisions of a few tenths of a percentage point will not be sufficient.

Taking the pulse of the German automotive industry: Downturn continues.

Sentiment indicators in the German automotive industry remain weak. Global car demand will probably not pick up before Q4 2019. Domestic production and exports will decline significantly in 2019 as a whole.

Chemical industry: End to growth in Germany. We expect chemical production to shrink by 2.5% in 2019 and 1% in 2020. Apart from the current cyclical weakness, the chemical sector has also been struggling with structural problems, such as German energy and environmental policies since the beginning of the decade.

House prices and rents still rising strongly. An end to the property boom is not in sight as housing prices rose 7% yoy during H1 2019. The uptrend is particularly pronounced in metropolitan areas, although strong differences exist. While rent yields are declining, they are still quite attractive in comparison with Bunds.

Corporate lending in Germany continued to expand vigorously in the second quarter. Outstanding volumes climbed by 5.6% yoy. The credit boom is the strongest since 2000 and broad-based, even though a surge in short-term loans is a warning signal.

The view from Berlin: Decisive weeks ahead for the Groko. Surveys indicate heavy defeats for the CDU and the SPD in the important state elections in Saxony and Brandenburg. But the fog over the Groko's future is unlikely to lift before the end of October when the SPD will present the result of the membership ballot on its new leader(s). We think Merkel's government will become even more fragile.

Digital politics: AI, big data, and the future of democracy. The digital transformation has enriched the societal discourse through new forms of multilateral communication. But it has also amplified the spread of misinformation, echo chambers, and propaganda and has offered authoritarian states new means of surveillance and control. How democracies approach this challenge will be a key factor for their performance in the intensifying competition of political systems.



Only a technical recession? It is all about risks!

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2018	2019F	2020F	2018	2019F	2020F	2018	2019F	2020F	2018	2019F	2020F
Euroland	1.9	1.1	1.0	1.8	1.2	1.4	2.9	2.4	2.1	-0.5	-1.0	-1.0
Germany	1.4	0.3	0.7	1.9	1.7	1.4	7.4	6.5	6.1	1.7	0.7	0.3
France	1.7	1.3	1.2	2.1	1.4	1.5	-0.6	-0.3	-0.2	-2.5	-3.3	-2.5
Italy	0.7	0.3	0.7	1.2	1.0	1.3	2.5	2.6	2.5	-2.1	-2.4	-2.6
Spain	2.6	2.2	1.9	1.7	1.4	1.9	0.9	0.6	0.5	-2.5	-2.1	-1.9
Netherlands	2.6	1.8	1.9	1.6	2.7	2.0	10.9	9.9	9.7	1.5	0.8	0.4
Belgium	1.4	1.2	1.2	2.3	1.7	1.6	-1.3	-0.5	0.0	-0.7	-1.4	-1.5
Austria	2.8	1.6	1.8	2.1	1.6	1.8	2.3	2.2	2.3	0.1	0.2	0.3
Finland	1.7	1.7	1.6	1.2	1.4	1.5	-1.6	-1.5	-1.0	-0.7	-0.5	-0.6
Greece	1.9	1.6	1.7	0.8	0.9	1.1	-2.9	-2.0	-1.5	1.1	0.9	0.8
Portugal	2.1	1.7	1.5	1.2	0.8	1.5	-0.4	-0.9	-1.1	-0.5	-0.3	-0.3
Ireland	6.8	3.1	3.0	0.7	1.4	1.2	9.1	8.5	8.0	0.0	-0.3	-0.6
UK	1.4	1.2	1.3	2.5	1.8	1.9	-3.9	-3.7	-3.5	-1.1	-1.9	-1.5
Denmark	1.5	1.8	1.7	0.7	1.2	1.5	5.7	6.5	6.4	-0.3	0.4	-0.1
Norway	1.8	2.4	1.9	2.8	2.3	1.8	8.1	7.0	6.5	7.3	7.5	7.2
Sweden	2.5	1.5	1.7	2.0	1.7	1.8	1.7	3.6	3.8	1.7	0.6	0.4
Switzerland	2.5	1.1	1.6	0.9	0.3	0.7	10.2	10.2	10.4	0.9	0.5	0.4
Czech Republic	2.9	2.7	2.4	2.1	2.7	2.1	0.3	0.5	0.6	0.9	0.7	0.6
Hungary	4.9	4.0	3.1	2.9	3.4	3.0	0.5	0.4	0.6	-2.2	-1.7	-1.6
Poland	5.1	4.1	3.5	1.8	2.3	2.9	-0.6	-1.4	-1.4	-0.3	-1.7	-2.3
United States	2.9	2.4	1.8	2.4	1.5	2.0	-2.4	-3.5	-3.5	-3.8	-4.2	-4.0
Japan	0.8	0.5	-0.1	1.0	0.4	0.5	3.5	3.2	3.6	-2.3	-2.1	-2.1
China	6.6	6.2	5.8	2.1	2.4	2.7	0.4	0.2	-0.1	-4.2	-5.0	-5.0
World	3.8	3.2	3.3	3.3	3.0	3.0						

*Consumer price data for European countries based on harmonized price indices except for Germany. This can lead to discrepancies compared to other DB publications.
Sources: National Authorities, Deutsche Bank

Forecasts: German GDP growth by components, % qoq, annual data % yoy

	2017				2018				2019F				2020F			
	Q1	Q2	Q3F	Q4F	Q1	Q2	Q3F	Q4F	Q1	Q2	Q3F	Q4F	Q1	Q2	Q3F	Q4F
Real GDP	2.2	1.4	0.3	0.7	0.4	-0.1	-0.3	0.1	0.2	0.2	0.2	0.2				
Private consumption	1.8	1.1			1.2											
Gov't expenditure	1.6	1.0			-0.3											
Fixed investment	2.9	2.6			1.1											
Investment in M&E	3.7	4.2			1.2											
Construction	2.9	2.4			1.9											
Inventories, pp	0.1	0.5			-0.6											
Exports	4.6	2.0			1.0											
Imports	4.8	3.3			0.7											
Net exports, pp	0.2	-0.4			0.2											
Consumer prices*	1.7	1.9	1.7	1.4												
Unemployment rate, %	5.7	5.2	5.0	4.9												
Industrial production	2.9	1.1	-1.5	1.5												
Budget balance, % GDP	1.0	1.7	0.7	0.3												
Public debt, % GDP	65.2	61.7	59.3	57.5												
Balance on current account, % GDP	8.1	7.3	6.5	6.1												
Balance on current account, EUR bn	261.9	245	219	212												

*Inflation data for Germany based on national definition. This can lead to discrepancies to other DB publications.
The actual figures for Germany's Q2 GDP subcomponents have not yet been published. Therefore, we only provide our quarterly growth forecasts for real GDP.

Sources: Federal Statistical Office, German Bundesbank, Federal Employment Agency, Deutsche Bank Research



Only a technical recession? It is all about risks!

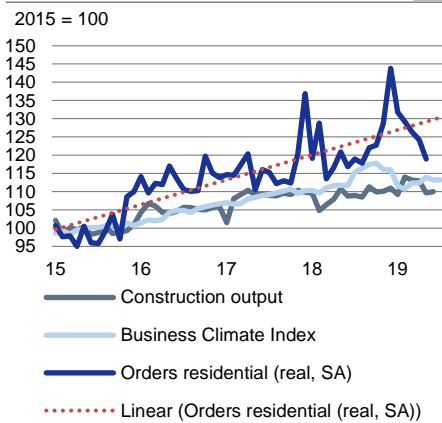
Only a “technical recession”? It is all about risks!

- We see the German economy in a technical recession, as we expect the economy to shrink by ¼% in Q3. Our forecast for 2019 has been cut to 0.3%.
- Given no indication for a rebound in the next few quarters we lowered our 2020 forecast to 0.7% (0.3% if the strongly positive working day effect is excluded).
- We acknowledge these reductions do not properly heed the accumulation of risks we have been facing over the last few quarters. Given the increasingly fragile state of the global economy, the realization of one or more risks could easily push the economy into a completely different scenario, where growth revisions of a few tenths of a percentage point will not be sufficient.

As expected, the German economy shrank by 0.1% in Q2. The consensus seems to drift towards anticipating a “technical recession” for the summer half, as business surveys (ifo, PMI, ZEW) have continued to deteriorate in July and August (ZEW). According to the statistical offices’ commentary, the drag on German Q2 GDP came mainly from net-exports, while domestic demand components, such as private and government consumption and machinery and equipment investment, were stabilizing growth. Construction investment apparently shrank, but that was probably more a negative payback following the weather-related surge activity in Q1, rather than the sign that Germany’s construction boom is coming to an end.

Construction: Seasonal volatility but upward trend intact

1



External headwinds have strengthened

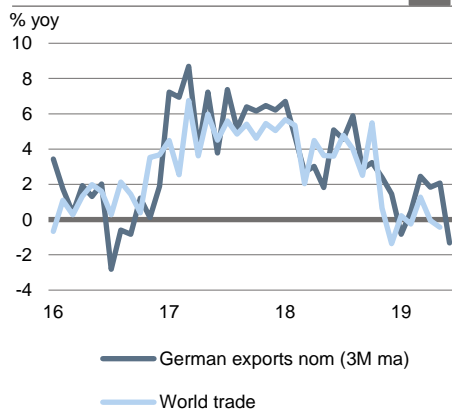
Indeed, global trade has continued to flatline in the second quarter, new export orders (global PMI) fell further below the expansion threshold of 50 (Q2 48.7). Therefore, we expect net exports to continue to subtract from growth. Together with the long list of uncertainties, net exports will also weigh on domestic investment spending, which in H1 was still supported by commercial vehicle purchases catching up after three quarters slump in 2018.

Consumption and construction with positive contributions

We still expect the consumer to hang in. Even in the battered manufacturing sector, employment was still up by 1.1% yoy by mid-year, an even stronger increase than in the whole economy (0.9%). The number of vacancies has been falling since April but stood at 780k in July, only 25k below its all-time high. Wage growth should remain slightly above 2 1/2% in 2019 and still around 2% in 2020. Consumer confidence (GfK) has inched lower since spring (August: 9.7 versus 10.7 in Q1) but remains at a high level. Consumers’ income perspectives (50.8) are just two points below their average of 2017/18. All in all, there is little evidence so far that consumers are retrenching. Similarly, construction output should remain a mainstay of growth, as indicated by the massive and still rising demand overhang. In both demand components, consumption, and construction, expansionary fiscal policy is making itself felt. Social transfers to private households expanded by 4.4% yoy in Q1. On July 1st pensions of Germany’s 21 million retirees were lifted by 3.18% (West) and 3.91% (East). Public construction, accounting for about 10% of total construction spending, has been expanding by an average of 6.8% (yoy, real) during the last four quarters.

German exports march in step with world trade

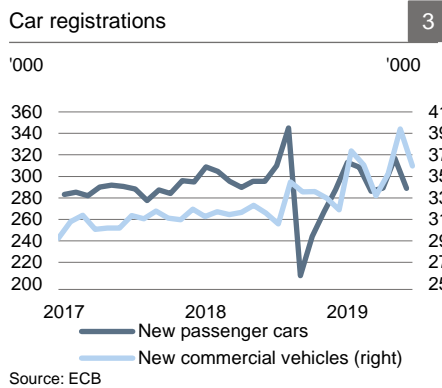
2





Only a technical recession? It is all about risks!

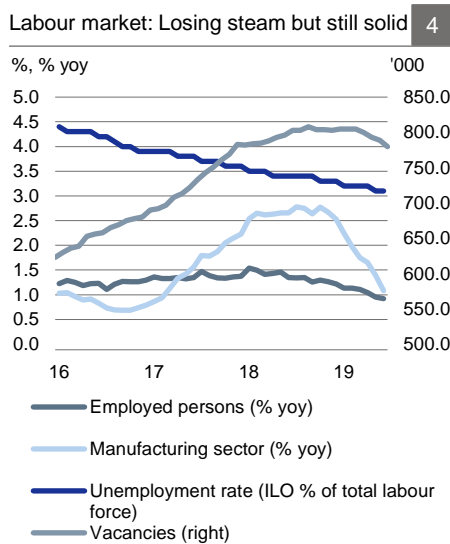
Technical recession expected



Still, given the trend in hard data, particularly the continuing weakness in order intake – June’s unexpected 2.5% jump was largely the result of surging non-EMU big ticket orders – and the 1.5% drop in June output, the industrial sector’s recession will most likely deepen in Q3. Therefore, we expect Q3 GDP to drop by another ¼% pushing Germany in a “technical recession”, a scenario we had already discussed back in February.

What next?

According to Bloomberg, the consensus still expects GDP to grow again by 0.2% qoq in the final quarter of the year, which might in part be due to slow forecast updates. For 2020 the consensus expects quarterly rates at 0.3%, which would be even slightly above trend growth. Given the massive deceleration in growth over the last four quarters, one can’t help asking where such a rebound should come from? On the contrary, currently we are witnessing a self-reinforcing interaction of various negative trends typical for a recession, such as profit warnings, announcements of job cuts and increasing volatility in financial markets. Pundits are discussing the likelihood of a US recession given the inversion of the US yield curve. In China, Germany’s most-important export market, monetary and real economic data showed a further weakening of economic activity in July. Our colleagues expect a policy easing, but they think these measures will only slow but not reverse the downward trend.

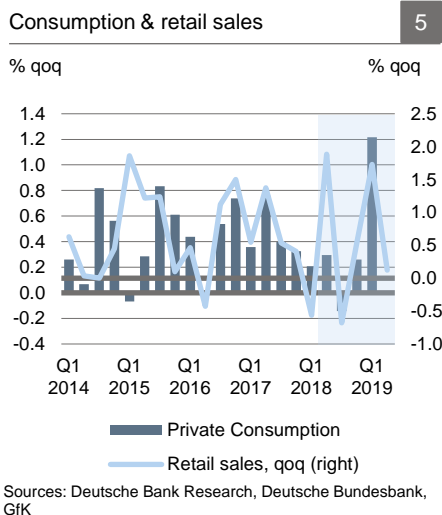


Nonlinearities and perception biases

These reinforcing negative dynamics are highly nonlinear and one important reason why economists tend to underestimate the depth of recessions by a wide margin. The disregard for these nonlinearities, causing a false belief of understanding and control, might explain the recent optimism bias among economic forecasters.

Massive uncertainties regarding assumptions ...

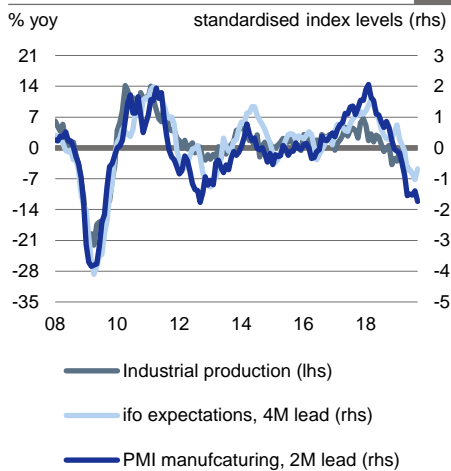
At the current crossroads, this optimism bias as well, as the status quo bias, might entail a much-bigger forecast error via too benign political assumptions. The most obvious pitfalls are obviously the US-Chinese trade conflict and Brexit. It is probably fair to say that with respect to both events the market consensus has been much too optimistic and failed to see the permanent deteriorations in both during the last few quarters. Given the waywardness of key players’ forecasters have finally accepted that these events are de facto unpredictable. This applies not only to the political developments but also to the economic implications following from them. Of course, we can probably be certain about the direction, i.e., that a hard Brexit will be negative for the economy. Even the best attempts trying to assess the actual size of the impact need to be taken with a large grain of salt, given they rely on partial analysis, and we cannot be sure at all about the stability of the structure and coefficients of the applied models. It is virtually impossible to provide a probability distribution with regard to the entry and the impact – we are faced with fundamental uncertainty. And of course the list of such events is much longer with US recession, a China hard landing, Italy, Hong Kong, and Iran being the most prominent ones.





Only a technical recession? It is all about risks!

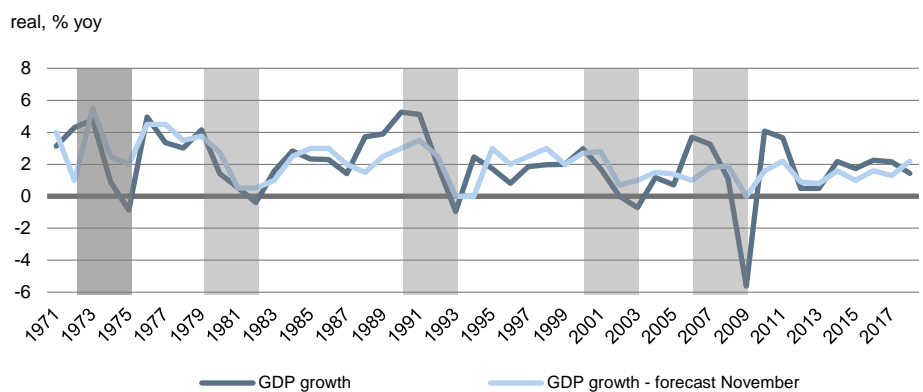
German Industry - no upturn in sight! 6



Sources: IHS Markit, ifo, Federal Statistical Office

Of course, none of these will become a baseline assumption in economic forecasts before it is all but unavoidable. Economists tend to shy away from expressing such extreme views. However, merely putting them into the risk section also implies an extreme view, i.e., that the likelihood is below 50%, which might “feel” less risky given our status quo bias, although it is questionable. So our German GDP forecast for 2020, which we have cut to a meager 0.7% (or 0.3% corrected for the strongly positive working day effect) does not assume that the US will levy higher tariffs on European car imports or a hard Brexit causing serious and longer-lasting disruptions.

Forecasters systematically underestimate the recession depth 7



Sources: World Bank, German Council of Economic Experts

... imply potentially massive forecast errors

Bottom line: we should not place too much trust into current forecasts, even if they get reduced somewhat as a result of recent negative trends. The probability that one or more of these key assumptions might turn out differently, i.e., worse than assumed, is unusually high, in our view. In such a case, another reduction by a few tenth of a percentage point might not be sufficient, as we might find ourselves in a completely different scenario. Given the already extremely stretched position of monetary policy at least in Europe and Japan, the onus would fall on a coordinated fiscal push, and, of course, Germany would be a part of such an exercise.

Stefan Schneider (+49 69 910-31790, stefan-b.schneider@db.com)



Only a technical recession? It is all about risks!

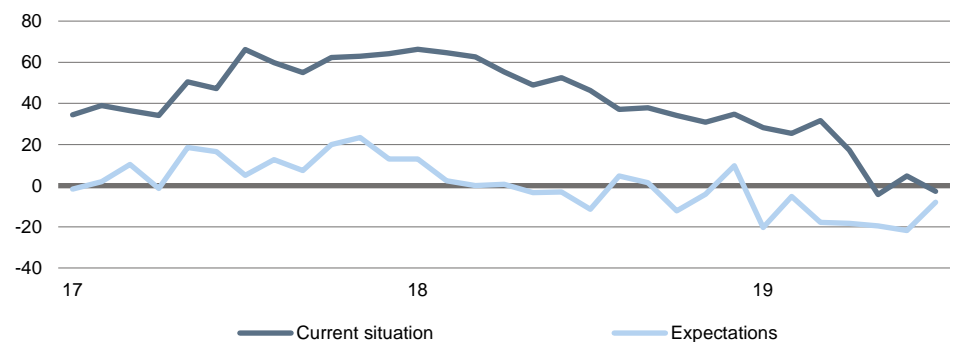
Taking the pulse of the German automotive industry: Downturn continues

The automotive industry is the largest industrial sector in Germany, measured by revenue. Its performance will decide when the German manufacturing industry will overcome the recession that has started in Q3 2018. Domestic production has been declining in H1 2019 since global car demand remains weak. The hangover of the shift to WLTP in H2 2018 is abating, though. Sentiment indicators in the sector have mostly been falling during the last few months. Order intake declined again at the latest reading. It would be a massive setback for the German automotive industry if the US government were to introduce higher tariffs on automotive imports from the EU, as has been threatened several times. A decision in this trade issue can probably be expected by mid-November 2019.

ifo business climate

1

Automotive industry in Germany, balance of positive and negative company reports (%)



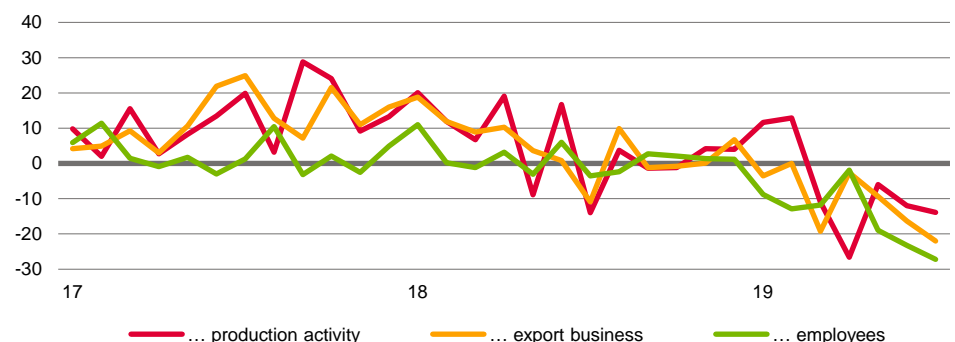
Source: ifo

Chart 1: Despite the increase in July, business expectations in the German automotive industry have been negative since the beginning of the year, not least due to weaker global demand for cars. Companies were also pessimistic about the current situation of late. However, order backlog in the sector is still on a high level – albeit declining.

ifo expectations with regard to...

2

Automotive industry in Germany, balance of positive and negative company reports (%)



Source: ifo

Chart 2: The pessimistic expectations of the sector are reflected in the subcom-



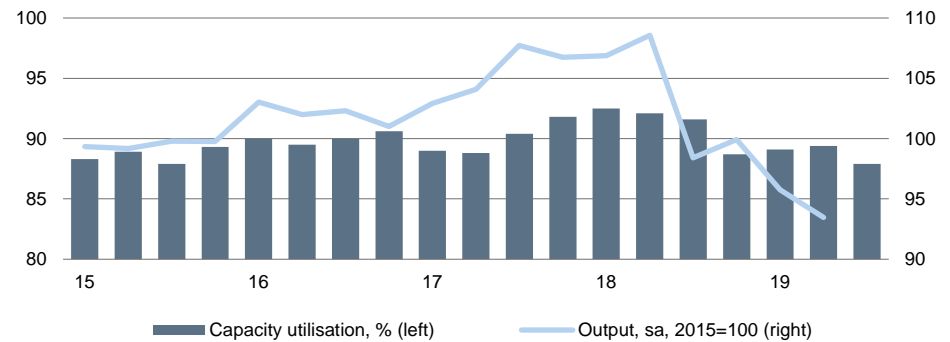
Only a technical recession? It is all about risks!

ponents of the ifo survey. Production and export expectations declined significantly again in July. Continued weak global car demand and the difficult environment for world trade (Brexit, threat of US tariffs) can explain this. The renewed decline in employment expectations indicates a decrease in employment in the sector in 2019.

Output and capacity utilisation

3

Automotive industry in Germany



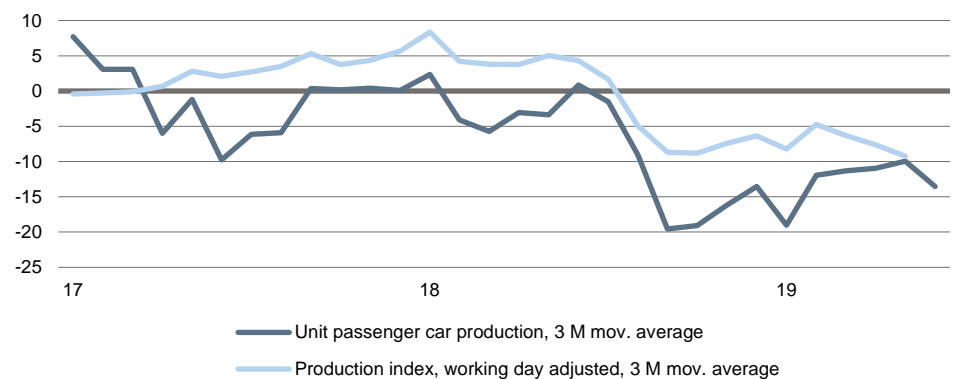
Sources: Federal Statistical Office, ifo

Chart 3: At the beginning of Q3 2019, capacity utilisation in the German auto industry was considerably below the value of 2018 but still above the long-term average. The renewed slight decrease in capacity utilisation at the beginning of Q3 2019 suggests domestic production activity has probably not yet reached the trough yet.

Automotive production

4

Automotive industry in Germany, % yoy



Sources: Federal Statistical Office, VDA

Chart 4: German car production (in unit terms) was considerably down in year-on-year terms in the first months of 2019. In July, a decrease in production by 5% yoy “only”. However, there was one working day less compared with July 2019. The decline in the output index, which also includes qualitative criteria (such as better equipment of cars), is smaller, despite the recent downward revision (see chart 7). According to the Federal Statistical Office, the output index decreased by 2.4% qoq in Q2 2019. The year-on-year growth rate looks set to turn positive again in H2 2019, as the WLTP effect pushed down the basis for comparison during H2 2018. However, domestic production will decline significantly in 2019 as a whole.



Only a technical recession? It is all about risks!

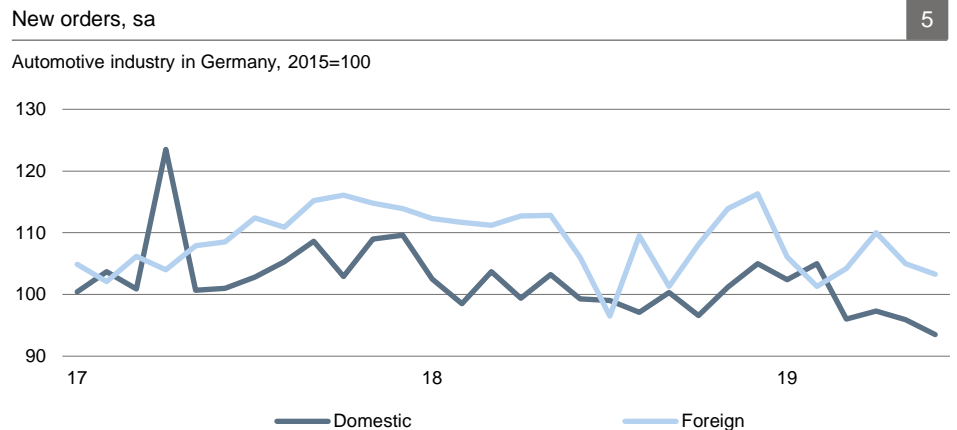


Chart 5: Domestic as well as foreign order intake decreased in June (-2.5% and -1.6% mom respectively). Orders thus have not yet stabilised during the last few months. German new passenger car registrations trended sideways at a high level in the first seven months of 2019. Export orders will probably not pick up again before Q4 2019.



Chart 6: Weak demand in important German export markets towards the end of 2018 and in the first months of 2019 weighed on auto exports. On average, exports will decline in 2019.

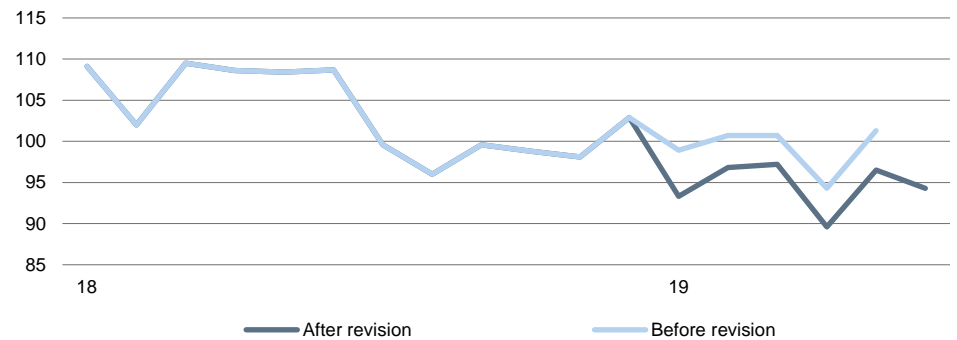


Only a technical recession? It is all about risks!

Revision of production index

7

Automotive industry in Germany, sa, 2015=100



Source: Federal Statistical Office

Chart 7: Together with the recent publication of output data for June, the Federal Statistical Office revised the monthly production numbers since the beginning of 2019. The downward revision amounted to 4.5 pp on average. Thus, the difference between the production index's decrease and the decline in unit car production shrank.

Eric Heymann (+49 69 910-31730, eric.heyman@db.com)



Only a technical recession? It is all about risks!

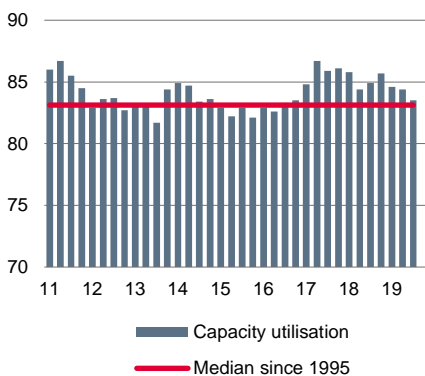
Chemical industry: End to growth in Germany

- In the face of continuing major international conflicts, activity in the chemical sector is unlikely to stabilise before year-end. We expect chemical production to shrink by 2.5% in 2019 (2018: -2.1%) and only 1% in 2020 (partly as a result of a statistical underhang). Chemical industry is, as a consequence, lagging behind the manufacturing sector.
- Given its strong international exposure and its role as a supplier of intermediate input to many downstream industrial sectors and production chains in Germany and abroad, the chemical industry is immediately dragged lower as global growth weakens.
- Apart from the current cyclical weakness, the chemical sector has also been struggling with structural problems since the beginning of the decade. German energy and environmental policies, for instance, have left deep marks on medium-sized companies, as many of them are not eligible for exemptions under the Renewable Energy Sources Act (EEG). Given the combination of cyclical weakness and structural challenges, activity in the chemical sector has been clearly underperforming compared with other major industries since 2011.

Falling capacity utilisation

1

Capacity utilisation in German chemical industry, %

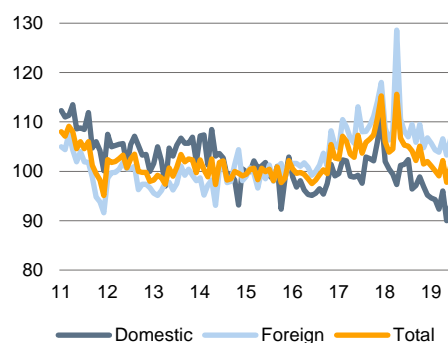


Source: ifo Institute

Order intake in Germany's chemical sector remains on the decline

2

Real, seasonally-adjusted, 2015=100



Source: Federal Statistical Office

In 2018, growth in the chemical sector disappointed for the eighth consecutive year. Despite a 2017 production overhang, production in the German chemical sector slipped by 2.1% in price-adjusted terms. Following a peak in May 2018, the trend has been to the downside and looks unlikely to stabilise at low levels before year-end. This also reflects capacity utilisation in the sector. Falling from 85.9% at the start of 2018 to only 83.5% at the beginning of July 2019, utilisation is now down to the median since 1995.

The chemical industry, Germany's fifth-largest industry by GDP, started 2019 with a negative production overhang of 2.8%. In the first quarter of 2019, real order intake plummeted by 2.7% compared with the final quarter of 2018, but stabilised in the second quarter (+0.2% qoq). Chemical production, on the other hand, shrank by 1.3% qoq in the second quarter. Unfilled orders have been on a downtrend over the past months.

Of the broad product range supplied by chemical industry, only the segment of fine and specialty chemicals recorded a small increase in production in 2018, whereas production of petrochemicals and consumption chemicals, basic inorganic chemicals as well as plastics and foams declined.

According to the ifo Institute, the current assessment of chemical companies has turned increasingly pessimistic since the start of 2018 and even became slightly negative at the beginning of July 2019. Marking negative territory for most of the period since November 2018, business expectations have declined in recent months. Alongside production, real sales are also on a downtrend. In our view, both sentiment indicators and order intake suggest that a stabilisation of chemical activity is not to be expected before year-end 2019, at the earliest, provided the international trade conflicts do not escalate and the Brexit does not leave deep marks on the European economy.

No special effects to be expected from low water levels in 2019

For the chemical industry, the Rhine is the key inland waterway. In 2018, many German chemical companies along the river and its tributaries had to trim back production for a six-week period due to low water levels. With production stalling along the Rhine, other chemical sites -- locally and abroad -- had to step into the breach. Inland water transport accounts for around 10% of chemical products in total tonnage terms. As the hot summer months are coming to an end, negative

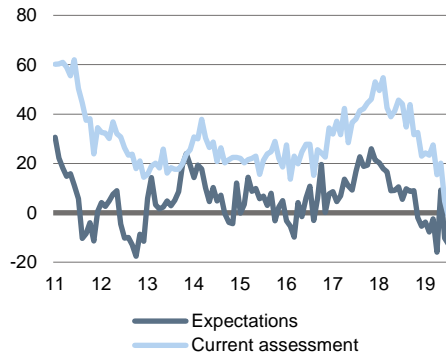


Only a technical recession? It is all about risks!

Sentiment deteriorated sharply

3

Chemical industry in Germany, balance of positive and negative responses



Source: ifo Institute

shocks from low water levels are unlikely to weigh on chemical industry in 2019. The eight-point action plan addressing low water levels on the Rhine, which was prepared by the VCI (chemical industry association), other associations and the Federal Ministry for Economic Affairs in July 2019, is a pledge for future structural improvements surrounding forecasts, infrastructure, transport, and logistics.

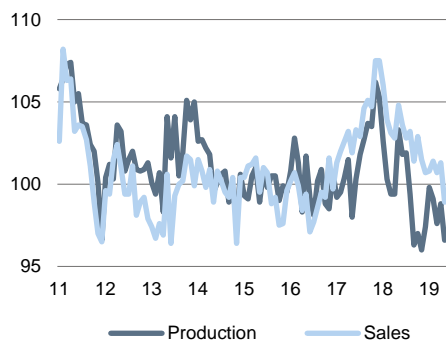
Weak chemical activity can actually be traced to several factors. Given its strong dependence on exports (61%, compared with an average of 50% for all industrial sectors), the chemical industry is hit by faltering global growth on a number of fronts. The persistent trade conflict between the US (export share of the German chemical sector: 6%) and China (export share: 5%) is weighing on international trade flows and propensity to invest. Europe, the key export market (export share: 68%), is a constant source of new concern. Currently, European activity is hampered by tensions and uncertainties surrounding the Brexit and political problems in Italy. Only sound growth of the construction sector is presently working in domestic activity's favour, whereas demand for chemical supplies from the sector's traditional industrial customers such as vehicle construction has declined with the latter trimming back production.

Increasing international competition in basic chemicals

Production and sales in German chemical industry on the decline

4

Real, seasonally-adjusted, 2015=100



Source: Federal Statistical Office

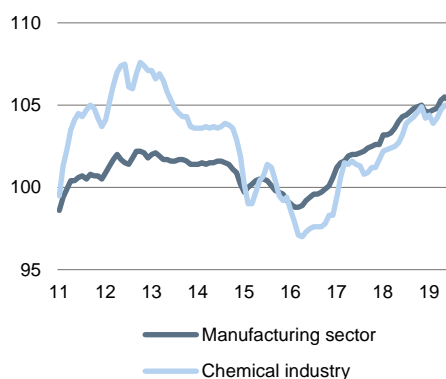
In Germany, specialty chemicals, which are predominantly an SME industry, are still dominated by industrial chemicals with their basic segments. Due to the decline in crude oil prices – the key basic raw material for petrochemicals – the cost burden was alleviated somewhat in 2019. On the other hand, oil price inflation weighs on naphtha prices, the major chemical raw material. Moreover, with primary chemicals now being traded in monthly contracts, lower procurement costs incurred by chemicals enterprises have to be passed on to their consumers in a relatively swift fashion.

In addition, German producers are at a structural disadvantage compared with their counterparts in the US, given the latter's twofold benefit of lower oil prices and lower taxation of oil. Furthermore, competition in the segment is increasing as oil nations, such as Saudi Arabia and Russia, are also investing in petrochemicals. Petrochemicals are likely to play an increasingly smaller role in Germany, also due to ambitious local energy policies. Future environmental policy decisions harbour additional risks.

Producer prices point to the upside

5

Producer prices in Germany, 2015=100



Source: Federal Statistical Office

“Energiewende” weighs on chemical sector – chemical sector calls for “Energiewende”

Located at the beginning of many value chains in Germany, the chemical sector is a particularly energy-intensive industry. However, the lead over total manufacturing production in Germany is (meanwhile) insignificant in statistical terms, due to structural factors such as German companies' multi-year reluctance to invest.

Production of basic chemicals, in particular, comes with high energy consumption. Despite various exemptions (e.g. under the EEG), the sector is negatively impacted by German energy policy, the more so as it is uncertain for how much longer these exemptions will be granted. The envisaged transition of electricity generation to renewables is an additional challenge for chemical industry. Many chemical production facilities are running 24 hours a day. Stable base load supply is therefore a sine qua non. However, cost-effective industrial-scale storage technologies that would ensure ongoing and dependable energy supply from renewables are not in sight. Another pressing challenge is the setup and expansion of distribution networks to transmit electricity to where it is needed.

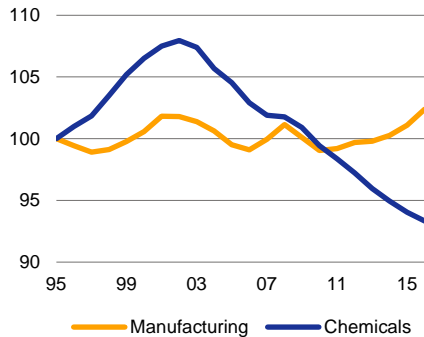


Only a technical recession? It is all about risks!

Real net fixed assets decline visibly in chemical industry

6

Real net fixed assets in Germany, 1995=100



Source: Federal Statistical Office

If policymakers and society fail to create a chemical-friendly energy infrastructure with internationally competitive electricity prices and a regulatory energy framework that is reliable on a long-term basis, chemical companies will be reluctant to invest and may move production to less cost-intensive countries. In recent years, the German chemical sector has already invested billions of euros in non-eurozone countries, not least in the US. In parallel, the real capital stock of chemical industry in Germany has been on the decline over the past years, which is one of the reasons why production in the sector continues to be weak. Without fundamental changes in the regulatory framework, this trend is likely to continue, which would put an end to growth in Germany's chemical sector.

Josef Auer (+49 69 910-31878, josef.auer@db.com)

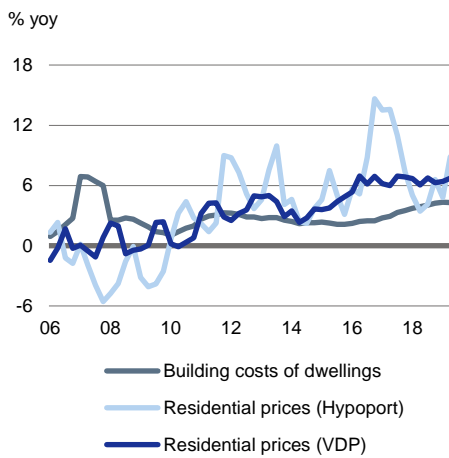


Only a technical recession? It is all about risks!

House prices and rents still rising strongly

Housing prices vs. building costs

1



Sources: Deutsche Bank Research, Federal Statistical Office, Hypoport

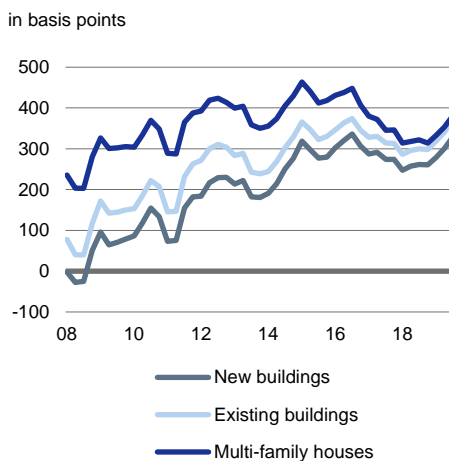
- An end to the boom is not in sight. According to Hypoport and the Association of German Pfandbrief Banks (Verband deutscher Pfandbriefbanken, vdp), house prices rose 7% yoy during H1 2019.
- The uptrend is particularly pronounced in metropolitan areas. While rent yields are declining, they are still quite attractive in comparison to Bunds.
- There are major differences between the metropolitan areas; prices in Berlin are rising at an above-average clip. In contrast, price trends for existing homes in Düsseldorf were subdued.

On average, German house prices rose 7% yoy during H1

After having declined in some areas during the winter months, house prices once again rose quickly in year-on-year terms during H1 2019. According to Hypoport, prices were up by almost 7% in H1 2019. The vdp price indices showed a similar increase. We therefore stick to our forecast of +7.4% yoy for 2019 as a whole. Despite the continued, strong uptrend in prices, investment activities are likely to remain sluggish. Construction costs will probably increase, not least due to additional legal restrictions for landlords. In fact, construction costs rose by 4.3% yoy in Q2 2019, which is the strongest rate since the beginning of the current cycle in 2009.

Rental yields: Spreads against Bunds

2



Sources: Bloomberg Finance LP, Deutsche Bank Research, riwis

Uptrend in prices and rents in metropolitan areas continues

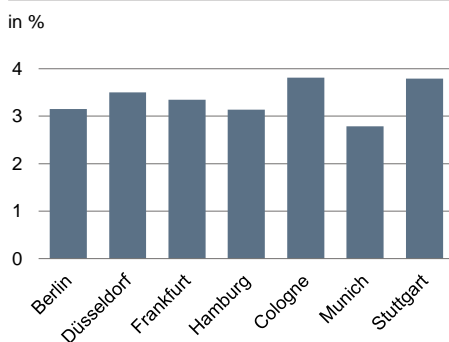
According to bulwiengesa, apartment prices and rents rose during the first half of 2019, with both newly completed and existing properties being affected by the uptrend. Across all metropolitan areas, prices for existing and new apartments jumped by c. 9% yoy on average during Q2 2019. As before in the current cycle, the uptrend in rents was considerably slower, at c. 3 ¾%. Initial rent yields (defined as the ratio between rents and purchase prices, excluding transaction costs, borrowing and tax aspects) average c. 3% across all metropolitan areas. They are slightly below the average for new properties, but amount to almost 3 ½% for existing properties and multi-family homes. Investing in concrete remains quite attractive, at least in comparison to Bund yields.

Significant divergence between rent yields across metropolitan areas

According to bulwiengesa, rent yields differ considerably between metropolitan areas. In fact, initial rent yields for multi-family homes have dropped to 2.6% in Munich, whereas they still amount to c. 4% in Cologne. Initial rent yields for existing apartments range between 2.8% and 3.8%. The range for new properties is significantly tighter, at 2.7% – 3.2%. Rent yields are lowest in Munich and higher in Düsseldorf or Cologne.

Rental yields: Apartment, existing

3



Sources: Deutsche Bank Research, riwis

Berlin: Prices for existing apartments rise by 14% yoy

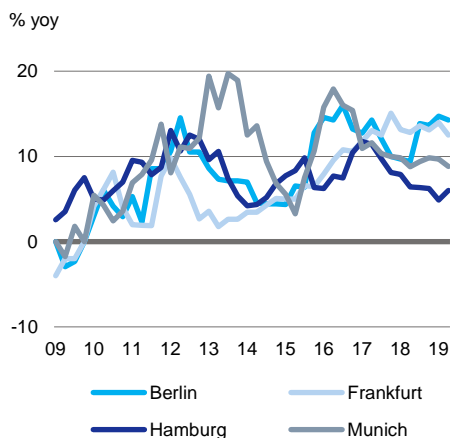
While some metropolitan areas registered significant price increases, the uptrend slowed palpably in others. Despite frantic political action, Berlin is still the city where the uptrend is strongest. In Q2 2019, prices for existing and new apartments jumped by 14% and almost 12% yoy, respectively. By now, existing apartments are about 10% more expensive in Berlin than in Düsseldorf or Cologne. During the same period, rents for new properties rose by more than



Only a technical recession? It is all about risks!

Key metropolises: Residential prices of existing dwellings

4



Sources: riwis, Deutsche Bank Research

9%. In contrast, rent growth for existing properties was only slightly above the average, at 4% versus 3.8% across all metropolitan areas.

Frankfurt: apartment prices rising at a two-digit rate

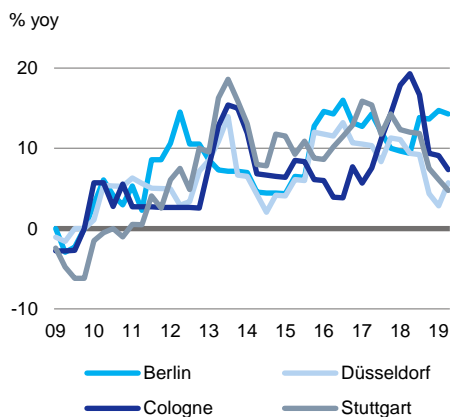
In Frankfurt, prices for both existing and new apartments rose by c. 12% yoy in Q2 2019. It seems they are still affected by a “Brexit effect”, and the British government’s latest statements suggest this impact will continue to make itself felt in the coming months. Rent growth is not keeping up with the price uptrend; at 4.5% for existing properties, it is currently somewhat above the average for all metropolitan areas. Rents for newly let homes were up by 2 ½%, i.e., slightly above the rate of inflation.

Düsseldorf: rents almost unchanged

Rent growth was particularly slow in Düsseldorf, at less than 1% yoy in Q2 2019 for both existing and new tenancy contracts. In contrast, prices for existing and new homes were up by almost 6% and by more than 11%, respectively. To some extent, the significant price jump for new properties is probably quality-related.

Key metropolises: Residential prices of existing dwellings

5



Sources: riwis, Deutsche Bank Research

Outlook: No reason to review nationwide price forecasts

Recent trends on the residential property market are in line with our forecasts for the year as a whole. We therefore do not see any reason to review our forecasts.

Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)

Germany Residential Real Estate Market

Residential property prices (126 cities)*

Prices and rents (126 cities)...

...for existing properties

Single-family house

Terraced house

Apartments

Re-letting

Yields

...for new properties

Apartments

Terraced house

Rents

Yields

Data sources Source of forecast Unit

2016 2017 2018 2019

8,7 9,3 8,6 7,4

5,2 5,3 7,3 5,0

6,7 6,5 8,5 7,0

10,4 10,7 9,1 8,0

5,5 6,9 3,3 3,3

4,5 4,4 4,1 4,0

8,5 10,0 7,7 7,0

8,0 7,9 9,4 7,0

5,6 6,0 5,0 4,5

3,6 3,4 3,4 3,3

*total, based on Bundesbank weighting scheme
Abbreviations: bg = bulwiengesa, DB = Deutsche Bank

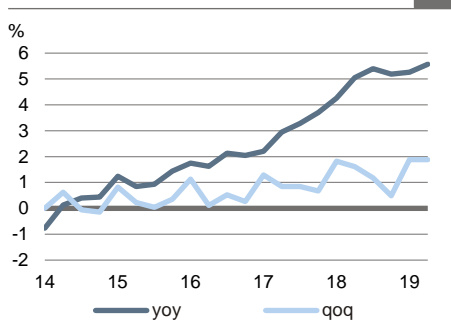
Source: Deutsche Bank Research



Only a technical recession? It is all about risks!

Corporate lending in Germany in Q2 19: Robust growth but spike in short-term lending

Loans to domestic companies and self-employed persons*



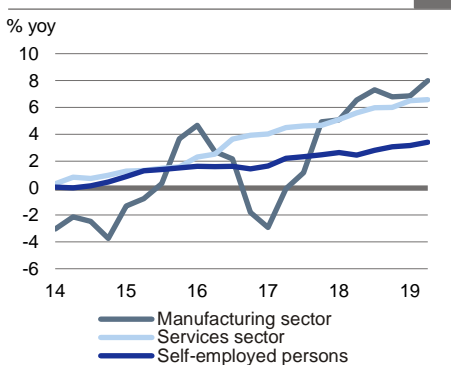
* excl. other financial institutions
Sources: Deutsche Bundesbank, Deutsche Bank Research

Loans to non-financial companies and self-employed persons in Germany continued to expand vigorously in the second quarter. Outstanding volumes climbed EUR 25.5 bn qoq and were up 5.6% yoy. The credit boom is the strongest since 2000, and it is broad-based, with loans increasing by a hefty EUR 5.9 bn in manufacturing and EUR 15.6 bn in services.

Among the individual industries which stood out are the core mechanical engineering and automotive industry (EUR +2.6 bn) and the chemical industry (EUR +1.5 bn) as well as construction (EUR +2.1 bn) and utilities (EUR +1.7 bn). Among services, housing enterprises (EUR +4.5 bn) and commercial real estate firms (EUR +1.8 bn) performed well, despite a slightly lower rise than a year ago. Telecom/consulting/advertising (EUR +3.4 bn) and the health sector (EUR +1 bn) each recorded one of their best results since the introduction of the euro. The only industry which had to concede a – seasonally typical – contraction was retail & wholesale trade (EUR -0.5 bn).

Recession in industry triggers jump in short-term lending

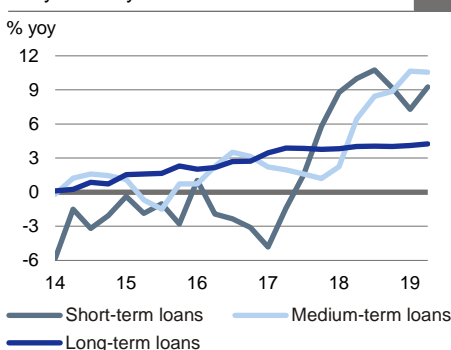
... by industry



Sources: Deutsche Bundesbank, Deutsche Bank Research

Despite the robust growth overall, there are signs of firms becoming more cautious in light of the increasingly deteriorating economic environment, shaped by the trade war and Brexit uncertainty. Short-term loans with maturities below one year saw the biggest jump in a Q2 in two decades (EUR +8.2 bn), pushing up the yoy growth rate to more than 9%. This was most evident in sectors which are particularly sensitive to shifts in the business cycle (and to a potential surge in tariffs): mechanical engineering and automotive industry, chemical industry, and also utilities. This suggests some companies already face weakening cash flows and revert to higher borrowing to compensate. Thus, the dichotomy seen in the real economy between i) the export-oriented manufacturing sector, which is in recession, and ii) the domestic services-oriented economy, which so far has shrugged off the downturn, is also somewhat visible in lending statistics. Still, growth in long-term loans with maturities above 5 years edged up a bit, too, to +4.3% yoy.

... by maturity*



* excl. other financial institutions
Sources: Deutsche Bundesbank, Deutsche Bank Research

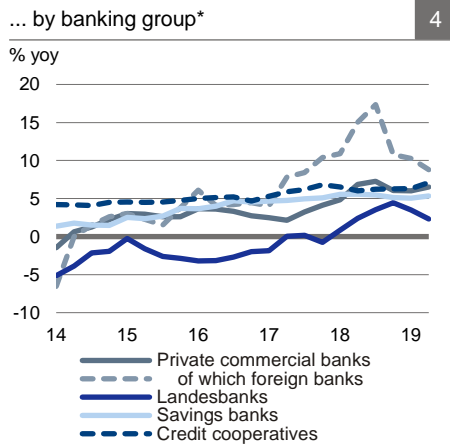
With regard to the performance of the different banking groups, there were no substantial changes in Q2. Foreign banks (+9% yoy) and cooperative banks (+7%) posted the strongest growth rates. Domestic commercial banks, savings banks as well as public development banks all ranked in the middle (+5% each), while Landesbanks (+2%) were the only major laggard. Overall, there has been much convergence between banking groups recently, with foreign banks' credit expansion slowing down considerably from 17% yoy last autumn, whereas domestic commercial banks and development banks caught up with the rest of the pack in the past few quarters.

Corporates pay negative deposit rates while enjoying record-low borrowing rates

On the other side of banks' balance sheets, growth in deposits from companies and self-employed persons was stable at 2% yoy (EUR +7.2 bn qoq). Inflows into sight deposits and outflows from time deposits continued unabatedly. Thus, like in the past year, growth was far weaker in deposits than in loans, which is also due to negative deposit rates. Companies had to pay 3 bp on average for their sight deposits in June, and 7 bp for time deposits. At the same time, lending rates fell across the board in Q2, in some buckets hitting new record lows:



Only a technical recession? It is all about risks!



* excl. other financial institutions

Sources: Deutsche Bundesbank, Deutsche Bank Research

banks charged only 1.4% p.a. for loans to non-financial corporations with a rate fixation period of more than 5 years, and only 1.9% for loans to non-corporate businesses and self-employed persons. In this respect, the ECB's policy to urge firms to borrow more seems to be working. However, given the cooling economy (which might already be in recession) and the pending major political risks, it is doubtful whether this trend can be sustained much longer – corporate loan growth in Germany is set to slow.

Jan Schildbach (+49 69 910-31717, jan.schildbach@db.com)



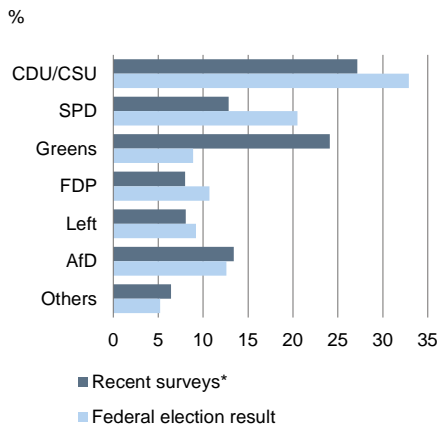
Only a technical recession? It is all about risks!

The view from Berlin

Decisive weeks ahead for the Groko

Major political parties' popularity & result of the last federal election

1



* Average of major recent surveys (Allensbach, Emnid, Forsa, Forschungsgruppe Wahlen, Infratest dimap, INSA)

Source: Wahlrecht.de, mid-August, 2019

About two weeks ahead of important state elections in Saxony and Brandenburg and a further election later on in Thuringia, the Groko parties are on high alert. Surveys indicate heavy defeats for the CDU and the SPD, due to the AfD's continuing strength in East Germany. But the fog over the Groko's future is unlikely to lift before the end of October. On October 26 the SPD will declare the result of the membership ballot on its new leader(s). We think Merkel's government will become even more fragile following the three elections. The Groko's fate, however, will also depend on its ability to master the big issues on its agenda for the coming weeks, namely to agree on a basic pension and a climate package. A constantly deteriorating economic environment will make compromises even harder.

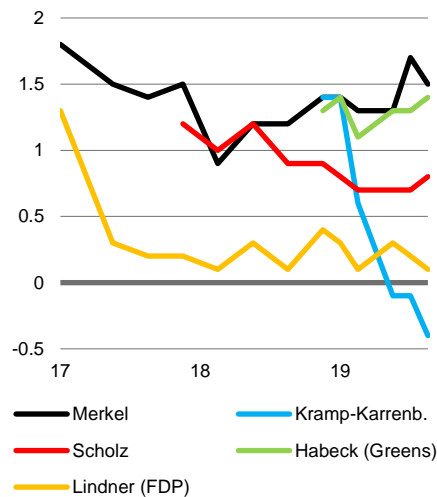
AKK has underpinned her claim to succeed Merkel

The CDU can focus on campaigning in East Germany and on the political issues as major personnel decisions have been made before the summer recess. The party leader Annegret Kramp-Karrenbauer (AKK) surprisingly entered Merkel's cabinet as the new Defence Minister. She replaces Ursula von der Leyen, who – also unexpectedly – became the President-elect of the European Commission in July. Thus, AKK has underpinned her claim to succeed Merkel as chancellor, too, whenever the need might arise. Possible other candidates like Armin Laschet, the PM in North-Rhine Westphalia, are still in the race but markedly behind AKK, for the time being. Chancellor Merkel seems to have managed to hone a potential successor – an effort on which all her predecessors failed. However, AKK's decision to join the cabinet is hardly an indication of the Groko's stability. Some commentators argued AKK would not have joined the cabinet if she expected it to fail soon. But her decision could also be interpreted as a bold move to strengthen her position in that case. So far, AKK has failed to enhance her popularity, given not least that 65% of the Germans criticised her move as a "no good appointment" (Infratest dimap).

Major politicians' approval ratings

2

Approval rating of the respective politician on a scale from -5 to 5



Source: Forschungsgruppe Wahlen, ZDF-Politbarometer, August 9

Dearth of high profile candidates for new leadership reflects the Groko's low popularity among the SPD

While the CDU/CSU seems to have resolved its leadership issue for the time being, the SPD leadership contest is at its early stage. The registration list is open until September 1, so far 13 candidates have signed up. German Finance Minister Olaf Scholz last week declared his willingness to run for the party chair, giving up his earlier refusal to bid for the position. He still has to name a female co-candidate to comply with the decision of the party's executive for mixed tandems. Before Scholz's announcement, none of the party's important officials has thrown a hat in the ring, neither one of the SPD members in the federal government nor one of the SPD state PMs. The same is true for outspoken Groko supporters among the party's MPs in the Bundestag. According to the polls, in case of snap elections, the SPD would most likely lose a substantial number of seats in the Bundestag. Therefore, many MPs should hardly be interested in a premature end of the Groko. In line with this reasoning, the leader of SPD Bundestag parliamentary group, Mützenich, repeatedly argued in favour of the coalition.

The cabinet members' hesitation to come forward might be a strategy to avoid the risk of being discredited in a longer nomination procedure. But it also points to the Groko's low popularity among the SPD and the general public. The party



Only a technical recession? It is all about risks!

establishment seems to favour a leadership duo for gender reasons and as an opportunity to better balance the different wings within the party (probably eyeing the positive experience of the Green party with such a tandem solution). Given his seniority and decent popularity with the electorate, Scholz might be the frontrunner for the position, even though resistance from the left wing of the SPD can be expected.

The true contest will be held from early September to mid-October. During these six weeks the registered candidates (candidate duos) will present their ideas about the SPD's future to the party members in more than 20 regional conferences all over Germany. If Olaf Scholz (or a split ticket including him) made the race, this should contribute to a stabilization of the Groko. Scholz not only belongs to the current cabinet but is also a declared advocate of the government coalition. If, however, a Groko critic or a Groko-sceptic duo succeeded in the membership ballot, which will be held from October 14 to 25, the prospect for Merkel's government would be bleak. This holds true, although, officially, the Groko's fate will be subject to the SPD mid-term review on the government's performance. Over the weekend, the SPD/ CDU/ CSU coalition committee decided to present the government's mid-term review of the Groko by mid-October. On August 19, the SPD's current executive committee will decide on the details of this review, i.e., the relevant issues and performance criteria. According to press reports, the evaluation of the review will take place at a party convention on December 6 to 8, i.e., the SPD will abstain from another membership ballot for cost reasons. While it is open who will finally win the contest, it seems obvious a lengthy procedure and the related uncertainty and lack of clear leadership do not help to improve the parties' meagre popularity ratings.

The outcome of both, the leadership contest and the mid-term review will very much depend on the SPD's performance in the imminent elections and the Groko's ability to master its ambitious political agenda in the coming months.

Groko might not survive the outcomes of the upcoming state elections

The upcoming state elections in Brandenburg and Saxony on September 1, respectively, and in Thuringia on October 27 will attract much attention, although only one out of nine Germans will be called to cast a ballot in the three states in total. But the elections could further undermine the Groko's stability or even trigger a premature end of Merkel's coalition. The latter scenario could become relevant if the CDU and/or the SPD suffered devastating defeats, going beyond the already massive losses indicated by recent polls. What will count in this respect is not only the number or share of votes these parties will lose primarily to the AfD but also to the Greens. Even more important would be possible upheavals in the state's political landscape regarding government coalition formation that could result from such losses. Groko risks would also surge if the SPD no longer appointed the PM in Brandenburg or the CDU failed to do so in Saxony.

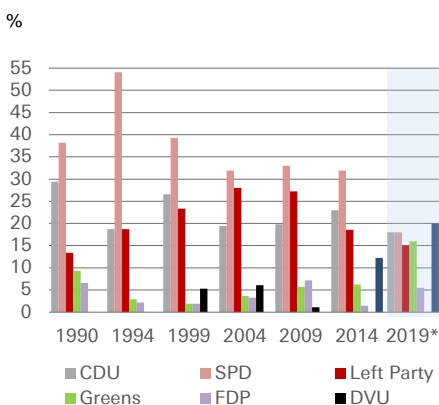
Exceptional political picture in Brandenburg at present

In Brandenburg much is at stake, especially for the SPD. In the past 29 years since unification the SPD has always been the strongest party there. The SPD has led all state governments, mostly as the major partner in a coalition, at present with the Left. In the past election in 2014 this alliance got a clear majority (SPD 31.9%, Left Party 18.6%).

But now the picture is quite different. In fact, it is exceptional and unique for Germany, since in Brandenburg all major parties, the CDU, the SPD, the Left, the Greens and the AfD – except the FDP – show similar popularity ratings in

Election results in Brandenburg

3



* Average of latest Forsa and INSA surveys

Source: Wahlrecht.de



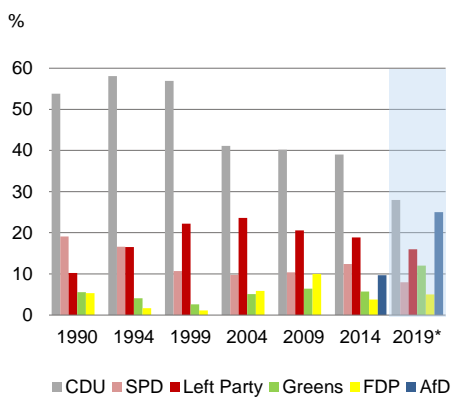
Only a technical recession? It is all about risks!

the range of about 15% to 20%, according to the polls. This reflects a remarkable increase in popularity not only for the AfD (2014: 12.2%) but even more for the Greens (2014: 6.2% only). Therefore, the present coalition will most likely be kicked out of office, due to the SPD's weakness (about 18% in recent polls, i.e. about 13pps lower than 2014). What is more, the AfD and the CDU could defeat the SPD so that the latter could come in second or third, only. Even in such a scenario, however, the SPD has the prospect of leading the next government again, namely in a likely coalition with the Left and the Greens. This prospect would vanish if the Left Party and/or the Greens, too, defeated the SPD. But this scenario is relatively unlikely, according to the polls (Left Party 15%, Greens 16%). It is also very unlikely that the CDU would team up with the AfD.

Government formation in Saxony could pose a dilemma for the CDU

Election results in Saxony

4



* INSA survey

Source: Wahlrecht.de

In Saxony the CDU is in a similar situation like the SPD in Brandenburg. Saxony used to be the CDU's stronghold in East Germany. In the 1990s the party even managed to win absolute majorities in three consecutive elections. At present the CDU leads a coalition with the SPD. But this alliance, too, is very unlikely to survive. According to the polls, both parties could lose about one third of their shares in total votes compared with the past election in 2014 (CDU 39%, SPD 12.4%). The AfD is expected not only to scoop up voters on the right but also to attract huge numbers of former CDU and SPD voters. In the polls the CDU is only slightly ahead of the AfD (27% vs. 25%).

Due to the likely sea change coalition formation could become difficult in Saxony. Since the CDU has repeatedly stated neither to cooperate with the AfD nor with the Left, its position in Saxony could be much more uncomfortable than the SPD's in Brandenburg. Given the CDU's positioning, three scenarios could emerge, according to the polls:

A CDU-Greens-SPD coalition. Under present circumstances this seems to be the outcome favoured by the parties' grandees in Berlin. Thus, such an outcome would be slightly positive for the Groko's stability. However, politicians in Saxony could be less pleased. A smooth formation and operation of such a coalition is not granted as the CDU in Saxony is said to be relatively conservative while the regional Greens take up a relatively leftish stance.

A CDU-Greens-SPD-FDP coalition. Such an alliance could become an option if the before mentioned three party alliance fell short of the majority of seats. Of course, it presupposes the FDP will manage to pass the 5% threshold in the election. This is still open, although the polls indicate the FDP will perform slightly better than in 2014 (3.8%) when it missed the threshold. However, such a four-party alliance could only be a stopgap solution. It could provide politics only with a very small common denominator among parties with very different political views.

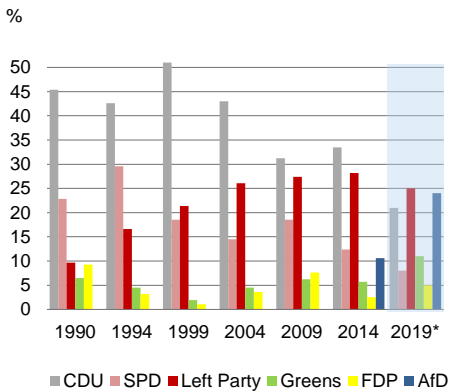
Against this background, regional CDU politicians have ventilated the idea of a CDU minority government. This proposal appears doubtful, as such a government would have to search separate majorities for all its projects. This would at least implicitly open the door for the AfD to decide on the state's policies, in contrast to AKK's cooperation ban. According to commentators, a landslide CDU defeat in Saxony could strengthen the party's conservative wing there (and elsewhere) so that they might dare this kind of rebellion against AKK. This scenario would become more likely if the present PM Michael Kretschmer, a proponent of the CDU's centrist wing, flopped in his electoral district.



Only a technical recession? It is all about risks!

Election results in Thuringia

5



* Infratest dimap survey

Source: Wahlrecht.de

State election in Thuringia of minor relevance for federal policy

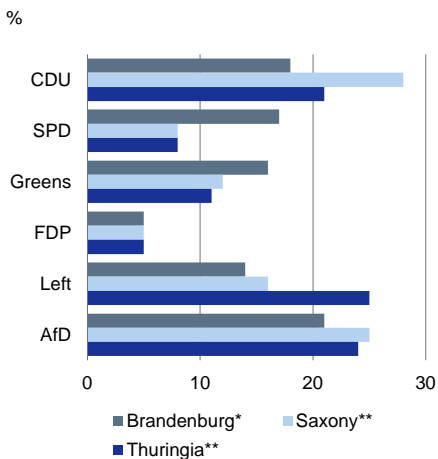
Regarding the election in Thuringia (on October 27th) the situation seems contradictory. This election is likely to enter the limelight, although – most likely – it will hardly be relevant for the federal government’s stance and stability. The media are likely to pay special attention to the AfD as their frontrunner is a representative of the populists’ far right wing. According to the polls, the AfD is neck to neck with the Left – both parties could get about a quarter of all votes, respectively – and clearly ahead of the CDU (21 to 22%). Obviously, an AfD victory would not be conducive for Thuringia’s reputation.

Nevertheless, several factors suggest the election in Thuringia will be of minor relevance for federal policy. (I) In Berlin the critical period of major events and decisions will already have ended by October 27, the election date. (II) Thuringia is a relatively small state with only 2.15 m inhabitants (2.8% of all German citizens of voting age, Brandenburg: 3.3%, Saxony 5.4%). (III) The political situation has already been special since the past election in 2014. Albeit at that election as always in the past three decades the CDU came in as the strongest party (2014: 33.5%), it was excluded from state government formation. Instead, the Left Party (28.2%) forged an alliance with the SPD (12.2%) and the Greens (5.7). Thus, Bodo Ramelow became the first and only state PM from the Left.

Whether Ramelow will remain PM is still open, however. Much will depend on the Greens’ and the FDP’s result. If the Greens managed to ride the wave of popularity until the election day and the FDP failed again to pass the 5% threshold then the PM’s prospect to stay in office would seem quite good despite losses expected (indicated by the polls) for his party and especially the SPD. Otherwise the situation could become difficult or even chaotic. Given the AfD’s high popularity rate, only minority governments seem to be politically feasible in this scenario, namely a Left-Greens-SPD government again but this time without a majority or a CDU-Greens-SPD minority government. Even if the FDP passed the 5% threshold a four-party coalition could fail the majority of parliament seats, not to mention the political obstacles to form an alliance among four parties with substantially divergent views.

Upcoming elections in East Germany – results of the latest surveys

6



* Forsa, ** INSA, *** Infratest dimap

Source: Wahlrecht.de

Landslide CDU and SPD losses could precipitate the Groko’s premature end

Heavy CDU defeats in Brandenburg and especially in Saxony would send shock waves to Berlin. The authority and standing of Chancellor Merkel and party leader AKK would suffer markedly, if the AfD came in ahead of the CDU in both states. This would put a damper on AKK’s ambitions to succeed Merkel. As AKK is actively campaigning in both states, critics could point to a series of CDU defeats in state elections and the EP election since AKK has joined the party leadership team in February 2018. In case Merkel stepped down because of such an event, the CDU might face a renewed leadership debate.

A defeat of the SPD in Brandenburg would provide further tailwind for the numerous Groko critics within the party. Especially a victory of the Left or the Greens there which would deprive the SPD of the PM post, i.e., the lead in the government, would most likely also strengthen the position of Groko-sceptical candidates in the SPD leadership contest.

At least formally, however, the SPD will decide on the Groko’s future only at its early-December convention. The delegates verdict will not only depend on the result of the imminent state elections but also on the federal government’s ability to master the big issues on its agenda for the coming weeks, namely to agree on a basic pension and a climate package.



Only a technical recession? It is all about risks!

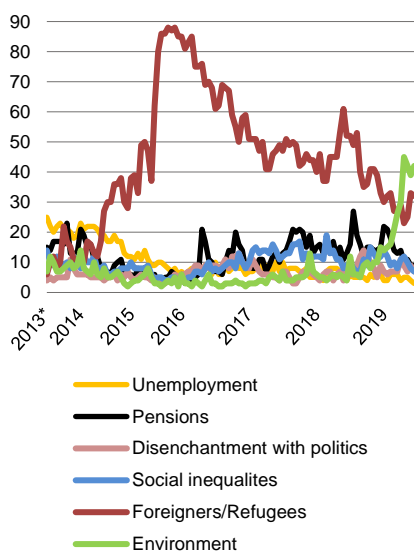
Compromise on basic pension to please East German voters

Regarding the basic pension project the coalition in Berlin is still divided on the eligibility conditions. The CDU insists on a scheme with a means test as agreed in the coalition treaty in order to limit the number of potential beneficiaries and thus the government outlay. The SPD rejects such a means test. But the CDU's left-wingers have proposed a compromise, a modified means test neglecting private wealth, especially owner-occupied property, but not spouses' income and personal capital income. Over the weekend, the Groko decided to present a cross-party paper within the next two weeks and then have a working group finalise a compromise on the issue. Proponents estimate 0.5 m pensioners would benefit from such a modified basic pension (compared to about 3 m and 0.15 m according to the SPD and the original CDU proposal, respectively). The compromise will cost EUR 0.5 bn to 0.8 bn p.a. In the medium and longer term pensioners in East Germany are likely to benefit disproportionately from a basic pension.

Most important problems in Germany

7

Max. 2 answers, percentage of those asked, %



* From the federal election (September 22) onwards

Source: Forschungsgruppe Wahlen: ZDF Politbarometer, August 9

Climate policy package to contain the Green's ascent

In September, climate policy will dominate the agenda. On September 20 Merkel's cabinet will decide on a comprehensive package to enhance climate protection. As a major element, the package shall include a price on CO₂ for industries that are currently not subject to the European system for trading emission certificates (EU-ETS), i.e., primarily for the transport and building sectors. Debates revolve around two issues here: on the one hand, with regard to the strategy for implementing this price and, on the other hand, measures to tackle the unwanted distributional impact of such a price. Regarding the first issue, the debated alternatives are a carbon tax or an emission trading scheme. The SPD favours the first, the CDU/CSU the latter solution. The implementation of a CO₂ tax would take less time but would not provide a calculable emission reduction, while an additional emission-certificates trading scheme would be more efficient from an economic as well as an ecological point of view.

Both camps agree the government should pass back the revenues generated by a CO₂ price to the citizens. While major parts of the SPD argue for a flat rate bonus for households with low income, the CDU and the CSU advocate financial relief for those affected most, namely commuters, as in Germany the petrol price is already inflated by an ecological tax. This latter proposal would reduce the burden in rural areas, which are often the CDU's and the CSU's home turf. However, it would also partially thwart the intended ecological effects of the CO₂ price. In September the government will also present a concerted draft law on the exit of the coal-based power generation. Besides a time frame for the exit, the draft law will provide for public funds to facilitate the structural change in the regions affected.

With this timetable the Groko postpones major climate-policy decisions to dates after the elections in Brandenburg and Saxony. Anyway, in East Germany the Groko parties would find it hard to gain much with the promotion of climate protection. In both states, particularly in Brandenburg, many jobs still depend on the lignite industries (surface mining as well as power generation).

Debates on "schwarze Null" will not (yet) result in a fiscal package

In the context of the climate-package debate, some politicians, including AKK, called for a major restructuring of the German climate policy. AKK argued for a reduction of the variety of German ecological taxes, such as the renewable-energy charge or the gasoline tax, in favour of a more comprehensive emission-certificates trading system. In addition, she proposed subsidies for owners of



Only a technical recession? It is all about risks!

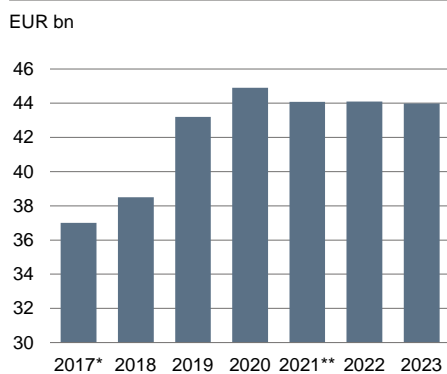
long-standing homes with oil-fired heating to incentivize the substitution of these heaters by modern devices with lower CO₂ emission.

Prior to AKK, SPD politicians had called for a substantial increase in public spending on infrastructure and climate protection projects. According to these voices, the volume of the necessary measures should not be limited by restrictions resulting from the principle of having (structurally) balanced budgets at federal and Länder level (so-called “schwarze Null”) which is anchored in the Basic Law. Even representatives of the German business community joined the chorus of criticism. One of these critics stated this principle was inflexible and would block necessary public infrastructure investment. He pointed to the negative yields even of 30-year bonds from which the German government could benefit by intensified spending.

However, CDU grandees harshly rejected the idea of abandoning the “schwarze Null” since this would enable the government to squander money without the need to prioritize and would also be the wrong signal to partner countries. This past Monday, Chancellor Merkel and FM Scholz (SPD) also backed the principle as they have done repeatedly. Given the government’s top representatives’ positions, debates on a marked German fiscal stimulus provided by a major public infrastructure-investment package are rather speculative for now. We think it would require a significant deterioration of the labour market to trigger bold fiscal action, which hard data does not support. Nonetheless, the SPD labour minister has already announced a targeted package to protect the labour market from the prospect of a recession. Apart from the domestic situation, the government might want to keep a steady hand to allow fiscal support both on national and European level in case of an increasingly likely hard Brexit end-October or a further escalation of the trade disputes.

Defence spending: A key issue for AKK but hardly for the Groko

Defence spending in Germany only flat in the medium term



* 2017 to 2019 value specified in the budget (Sollwert),
** From 2021 onwards according to the medium-term budget plan

Sources: Federal Ministry of Defence, Deutscher Bundestag (Federal Parliament)

Following AKK’s promotion, defence policy has attracted much media attention. In fact, AKK has repeatedly called for a substantial increase in defence spending. She wants these expenses to rise from 1.37% (expected) of GDP in 2019 to 1.5% in 2024 to be more in line with the NATO’s medium-term goal of 2%. The SPD, however, has rejected this demand. According to the medium-term financial planning of FM Scholz (SPD), the respective quota shall even fall back to about 1.2% in 2023. Given AKK’s promotion, this debate has become even more politically charged in recent weeks. Against this background and the continuing tensions at the Persian Gulf the share of the Germans calling for compliance with the 2.0% goal has markedly increased by 7 pp to 50%, recently. Nevertheless, it seems unlikely an issue as debated as military spending will derail the Groko.

Groko’s fate primarily in the hands of East German voters

To sum up: If the CDU and the SPD get off cheaply in the next few weeks, a break-up of the Groko will not be a foregone conclusion. But this scenario has at least two essential preconditions: (i) in the imminent elections in Brandenburg and Saxony the SPD and the CDU, respectively, will become strong enough to lead a stable coalition government; (ii) the Groko will manage to agree on this autumn’s key projects. Otherwise the Groko is very unlikely to survive through year-end. In this scenario the decisive event will be the SPD convention on December 6 to 8 when the party delegates will officially appoint the new SPD leader or leaders’ duo and also pass their verdict on the Groko mid-term review.

Barbara Böttcher (+49 69 910-31787, barbara.boettcher@db.com)
Dieter Bräuninger (+49 69 910-31708, dieter.braeuninger@db.com)



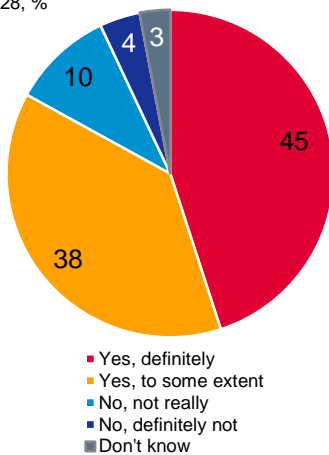
Only a technical recession? It is all about risks!

Digital politics: AI, big data and the future of democracy¹

EU survey: Fake news and democracy

1

EU28, %



Survey: "In your opinion, is the existence of news or information that misrepresent reality or is even false a problem for democracy in general?" (EU28, %)

Source: Flash Eurobarometer 464 (April 2018)

For billions of people, the digital transformation has brought enormous benefits and convenience. But policymakers and market participants will be able to understand the full economic and political implications only in hindsight. This is a major challenge when it comes to addressing risks and opportunities of technology for democratic institutions and processes.

Digital technology can be used both in the service of liberal or authoritarian societies, strengthen both government accountability and repressive capabilities. It has led both to unprecedented access and exchange of information as well as amplified the spread of misinformation, echo chambers, and propaganda and thereby might have contributed to rising populism and polarization of democratic societies.

Users around the globe enjoy "free" services in the data economy. But the underlying business models and concentration of influence and wealth have raised pressing questions regarding privacy, data ownership and targeted manipulation – not only for economic but also for political purposes.

Authoritarian states quickly learned to use surveillance technology, artificial intelligence, and mass data to their advantage, both for domestic control as well as for erosion of democratic societies abroad.

For democracies, whose cohesion is based on the sovereignty and consent of their citizens, this represents an unprecedented challenge. How democracies approach this challenge will be a key factor for their performance in the intensifying competition of political systems.

Governments need to update regulation, competition rules, and supervision to account for the transformed requirements of the global digital economy. Companies need to make sure their business models and products are compatible with users' constitutional rights and the integrity of democratic institutions and processes. Citizens need to become "digitally literate" in better understanding the algorithms and designs behind their apps and devices as well as the underlying mechanics of the data economy.

Democracies need an informed dialogue on data and technology ownership, on how to share the benefits of AI and automation and on how to prevent increasing asymmetries in wealth and power from destabilizing their foundations. Competitiveness in key technologies is crucial to maintain economic prosperity and public support for the democratic order.

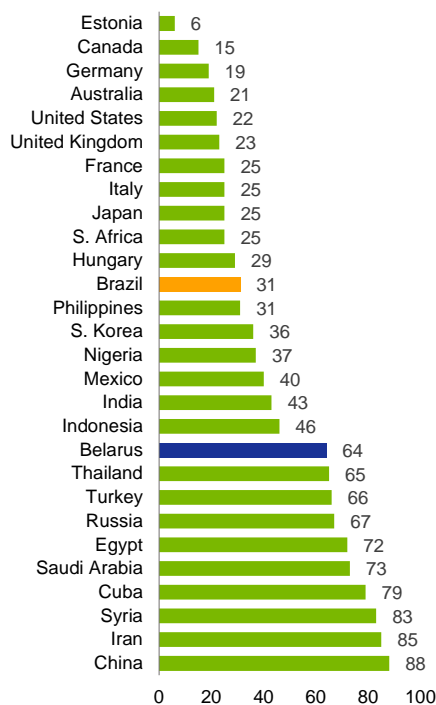
The EU has taken a front seat in addressing the challenges posed by the digital transformation to citizens and society as a whole. It has become a global role model in fighting disinformation and setting legal and ethical standards for data protection and AI development.

Kevin Körner (+49 69 910-31718, kevin.koerner@db.com)

Freedom of internet users

2

Freedom on the net index (2018)



Source: Freedom House

¹ This is an excerpt of a forthcoming publication.



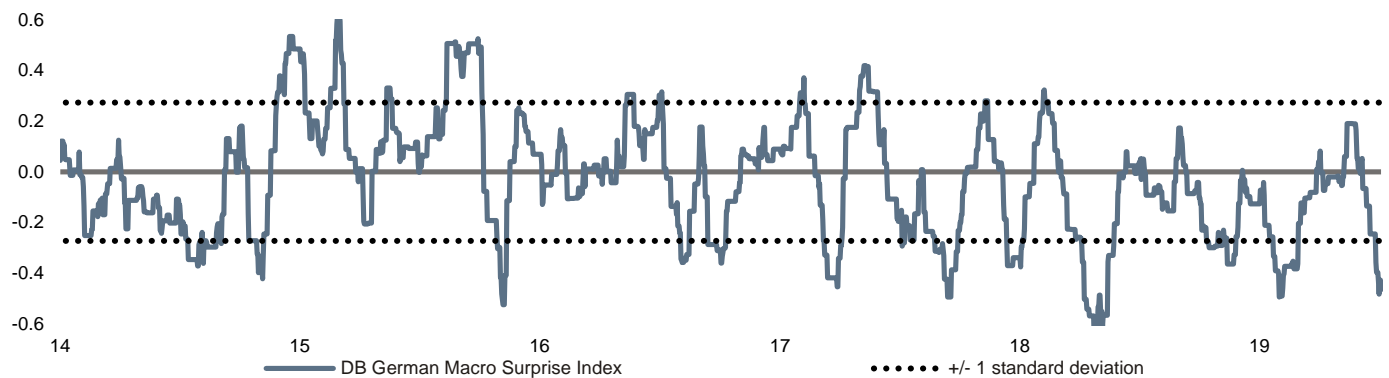
Only a technical recession? It is all about risks!

DB German Macro Surprise Index

The DB German Macro Surprise Index compares published economic data with market forecasts and thus provides clues as to the direction of future forecast revisions.

DB German Macro Surprise Index

Average of last 20 z-scores of data surprises



Values above (below) 0 indicate the data came in better (worse) than expected

Sources: Bloomberg Finance LP, Deutsche Bank Research

Last 20 published economic data for Germany

Bloomberg Tickers	Indicator	Reporting month	Publication date	Current value	Bloom-berg consensus	Sur-prise	Standar-dised surprise	Quantile rank
GRTBALE Index	Trade Balance (EUR bn)	5 2019	08/07/2019	20.6	17.0	3.6	0.0	0.9
GRBTEXMM Index	Exports (% mom)	5 2019	08/07/2019	1.3	0.9	0.4	0.2	0.6
GRCP20YY Index	CPI (% yoy)	6 2019	11/07/2019	1.6	1.6	0.0	0.2	0.4
GRZECURR Index	ZEW Survey Current Situation	7 2019	16/07/2019	-1.1	5.0	-6.1	-1.0	0.1
GRZEWI Index	ZEW Survey Expectations	7 2019	16/07/2019	-24.5	-22.0	-2.5	-0.3	0.4
GRIMP95Y Index	Import Price Index (% yoy)	6 2019	26/07/2019	-2.0	-1.3	-0.7	-0.2	0.2
GRFRIAMM Index	Retail Sales (% mom)	6 2019	31/07/2019	3.5	0.5	3.0	2.6	1.0
GRUECHNG Index	Unemployment Change (000's mom)	7 2019	31/07/2019	1.0	2.0	1.0	-0.2	0.4
MPMIDEMA Index	Markit Manufacturing PMI	7 2019	01/08/2019	43.2	43.1	0.1	0.1	0.6
MPMIDESA Index	Markit Services PMI	7 2019	05/08/2019	54.5	55.4	-0.9	-1.0	0.1
GRIORTMM Index	Factory Orders (% mom)	6 2019	06/08/2019	2.5	0.5	2.0	0.9	0.8
GRIPIMOM Index	Industrial production (% mom)	6 2019	07/08/2019	-1.5	-0.5	-1.0	-0.8	0.2
GRCAEU Index	Current Account Balance (EUR bn)	6 2019	09/08/2019	20.6	21.7	-1.1	-0.6	0.2
GRTBALE Index	Trade Balance (EUR bn)	6 2019	09/08/2019	16.8	19.5	-2.7	-1.2	0.1
GRBTIMMM Index	Imports (% mom)	6 2019	09/08/2019	0.5	0.3	0.2	0.1	0.5
GRBTEXMM Index	Exports (% mom)	6 2019	09/08/2019	-0.1	0.0	-0.1	-0.1	0.5
GRZECURR Index	ZEW Survey Current Situation	8 2019	13/08/2019	-13.5	-6.3	-7.2	-1.2	0.1
GRZEWI Index	ZEW Survey Expectations	8 2019	13/08/2019	-44.1	-28.0	-16.1	-2.0	0.0
GRCP20YY Index	CPI (% yoy)	7 2019	13/08/2019	1.7	1.7	0.0	0.2	0.4
GRGDPPGQ Index	GDP (% qoq)	6 2019	14/08/2019	-0.1	-0.1	0.0	-0.3	0.3

Sources: Bloomberg Finance LP, Deutsche Bank Research

Updated by Marc Schattenberg (+49 69 910-31875, marc.schattenberg@db.com)

Source: Heiko Peters (2014). DB German Macro Surprise Index. Focus Germany, 4 August 2014.



Only a technical recession? It is all about risks!

Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
22 Aug 2019	9:30	Manufacturing PMI (Flash)	August	43.0	43.2
22 Aug 2019	9:30	Services PMI (Flash)	August	53.0	54.5
26 Aug 2019	10:30	ifo business climate (Index, sa)	August	95.0	95.7
27 Aug 2019	8:00	Real GDP (% qoq) - Details	Q2 2019	-0.1	-0.1
29 Aug 2019	14:00	Consumer prices preliminary (% yoy, nsa)	August	1.7	1.7
29 Aug 2019	9:55	Unemployment rate (% , sa)	August	5.0	5.0
30 Aug 2019	8:00	Retail sales (% mom, sa)*	June	0.5	3.1
5 Sep 2019	8:00	New orders manufacturing (% mom, sa)	July	-0.5	2.5
6 Sep 2019	8:00	Industrial production (% mom, sa)	July	0.7	-2.5
9 Sep 2019	8:00	Trade balance (EUR bn, sa)	July	17.0	18.1
9 Sep 2019	8:00	Merchandise exports (% mom, sa)	July	-0.3	-0.1
9 Sep 2019	8:00	Merchandise imports (% mom, sa)	July	0.8	0.5

*An earlier data release may be possible due to the Federal Statistical Office.

Sources: Deutsche Bank Research, Federal Statistical Office, Federal Employment Agency, ifo, IHS Markit

Marc Schattenberg, Sebastian Becker & Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)



Only a technical recession? It is all about risks!

Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	2.125	-0.10	0.00	0.75	-0.75	-0.25	0.00	1.25	1.50	0.26	2.00
Sep 19	1.875	-0.10	0.00	0.75	-0.75	-0.25	0.00	1.50	1.50	0.25	2.00
Dec 19	1.625	-0.10	0.00	0.75	-0.50	-0.25	0.00	1.50	1.50	0.25	2.00
Mar 20	1.625	-0.10	0.00	0.75	0.00	-0.50	0.00	1.50	1.50	0.25	2.00

3M interest rates, %

Current	2.12	0.05	-0.40	0.77
Sep 19	2.00	0.05	-0.36	0.79
Dec 19	1.90	0.05	-0.36	0.85
Mar 20	1.75	0.05	-0.36	0.85

10Y government bonds yields, %

Current	1.53	-0.23	-0.72	0.41
Sep 19	2.05	-0.10	-0.35	1.03
Dec 19	2.15	-0.10	-0.30	1.12
Mar 20	2.20	-0.10	-0.23	1.13

Exchange rates

	EUR/USD	USD/JPY	EUR/GBP	GBP/USD	EUR/CHF	EUR/SEK	EUR/DKK	EUR/NOK	EUR/PLN	EUR/HUF	EUR/CZK
Current	1.11	106.15	0.92	1.21	1.08	10.72	7.46	10.01	4.35	326.20	25.88
Sep 19	1.10	107.50	0.93	1.18	1.14	10.70		9.65	4.35	323.00	25.65
Dec 19	1.13	105.00	0.93	1.22	1.15	10.80	7.46	9.60	4.35	325.00	25.60
Mar 20	1.16	103.75	0.93	1.25	1.16	10.73		9.55	4.40	320.00	25.50

Sources: Bloomberg Finance LP, Deutsche Bank Research



Only a technical recession? It is all about risks!

German data monitor

	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Mar 2019	Apr 2019	May 2019	Jun 2019	Jul 2019	Aug 2019
Business surveys and output											
Aggregate											
Ifo business climate	103.4	102.2	99.4	98.3		99.8	99.2	98.2	97.5	95.7	
Ifo business expectations	100.0	98.4	94.9	94.8		95.5	95.1	95.3	94.0	92.2	
Industry											
Ifo manufacturing	104.6	101.6	97.9	95.1		96.9	95.4	95.6	94.2	91.5	
Headline IP (% pop)	-1.4	-1.2	-0.7	-1.8		0.6	-2.2	0.8	-1.8		
Orders (% pop)	-1.1	0.4	-4.2	-1.0		0.5	0.5	-2.0	2.5		
Capacity Utilisation	87.8	87.1	86.3	85.3	83.9						
Construction											
Output (% pop)	0.5	0.1	3.9	0.4		-0.5	-1.6	-2.2	3.3		
Orders (% pop)	1.2	10.1	-2.0			-2.2	-1.7	-4.2			
Ifo construction	116.4	116.6	111.6	113.2		112.4	112.4	114.0	113.2	113.3	
Consumer demand											
EC consumer survey	0.4	0.4	-0.2	-1.7		-0.1	-0.7	-1.4	-3.1	-2.9	
Retail sales (% pop)	-0.6	0.6	1.7	0.3		0.2	-0.3	-1.2	3.1		
New car reg. (% yoy)	1.2	-8.1	0.2	0.9		-0.5	-1.1	9.1	-4.7	4.7	
Foreign sector											
Foreign orders (% pop)	-2.4	0.9	-5.2	1.3		4.4	1.4	-3.9	5.0		
Exports (% pop)	-0.2	0.9	0.7	-1.8		1.5	-3.2	1.3	-0.1		
Imports (% pop)	2.3	-0.1	0.6	-1.1		0.5	-1.0	-0.3	0.5		
Net trade (sa EUR bn)	52.7	56.1	56.7	53.8		19.7	17.0	18.7	18.1		
Labour market											
Unemployment rate (%)	5.1	5.0	5.0	5.0		4.9	4.9	5.0	5.0	5.0	
Change in unemployment (k)	-40.3	-45.3	-31.0	19.0		-7.0	-11.0	61.0	0.0	0.0	
Employment (% yoy)	1.3	1.2	1.1	0.9		1.1	1.0	0.9	0.9		
Ifo employment barometer	104.8	104.2	102.4	100.6		101.5	101.5	100.3	100.0	99.6	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	2.2	2.2	1.6	1.6		1.4	2.1	1.3	1.5	1.1	
Core HICP (% yoy)	1.4	1.4	1.5	1.5		1.0	2.0	0.9	1.5	0.9	
Harmonised PPI (% yoy)											
Commodities, ex. Energy (% yoy)	-0.5	-0.3	1.5	0.2		3.7	4.1	-3.4	0.1	10.0	
Crude oil, Brent (USD/bbl)	75.1	68.0	63.1	69.0		66.1	71.2	71.2	64.3	63.9	58.8
Inflation expectations											
EC household survey	34.2	34.3	31.7	33.8		30.4	32.7	35.4	33.4	34.0	
EC industrial survey	15.8	17.6	14.4	7.1		11.4	6.7	8.4	6.2	2.6	
Unit labour cost (% yoy)											
Unit labour cost	3.3	2.8	3.8								
Compensation	3.5	2.9	3.2								
Hourly labour costs	3.0	2.0	2.9								
Money (% yoy)											
M3	4.1	4.5	5.1	4.8		5.1	5.5	4.7	4.8		
M3 trend (3m cma)						4.5	5.0	5.1	5.0		
Credit - private	4.3	3.9	4.1	4.6		4.1	4.1	4.4	4.6		
Credit - public	-2.7	-6.3	14.1	5.6		14.1	6.2	6.3	5.6		

% pop = % change this period over previous period.

Source: Deutsche Bundesbank, European Commission, Eurostat, Federal Employment Agency, German Federal Statistical Office, HWWI, ifo, IHS Markit



Focus Germany

Our publications can be accessed, free of charge, on our website www.dbresearch.com. You can also register there to receive our publications regularly by E-mail.

Ordering address for the print version:
Deutsche Bank Research
Marketing
60262 Frankfurt am Main
Fax: +49 69 910-31877
E-mail: marketing.dbr@db.com

Available faster by E-mail:
marketing.dbr@db.com

- ▶ Only a technical recession?
It is all about risks! August 19, 2019
- ▶ A looming black-green coalition:
Painful compromises needed July 8, 2019
- ▶ Not out of the woods, politics of no help May 20, 2019
- ▶ Exports and autos weigh heavily
on the German economy in 2019 April 9, 2019
- ▶ The German economy's Achilles heel March 4, 2019
- ▶ The R-question February 5, 2019
- ▶ Outlook 2019:
Slowing growth, but no hard landing December 14, 2018

© Copyright 2019. Deutsche Bank AG, Deutsche Bank Research, 60262 Frankfurt am Main, Germany. All rights reserved. When quoting please cite "Deutsche Bank Research".

The above information does not constitute the provision of investment, legal or tax advice. Any views expressed reflect the current views of the author, which do not necessarily correspond to the opinions of Deutsche Bank AG or its affiliates. Opinions expressed may change without notice. Opinions expressed may differ from views set out in other documents, including research, published by Deutsche Bank. The above information is provided for informational purposes only and without any obligation, whether contractual or otherwise. No warranty or representation is made as to the correctness, completeness and accuracy of the information given or the assessments made.

In Germany this information is approved and/or communicated by Deutsche Bank AG Frankfurt, licensed to carry on banking business and to provide financial services under the supervision of the European Central Bank (ECB) and the German Federal Financial Supervisory Authority (BaFin). In the United Kingdom this information is approved and/or communicated by Deutsche Bank AG, London Branch, a member of the London Stock Exchange, authorized by UK's Prudential Regulation Authority (PRA) and subject to limited regulation by the UK's Financial Conduct Authority (FCA) (under number 150018) and by the PRA. This information is distributed in Hong Kong by Deutsche Bank AG, Hong Kong Branch, in Korea by Deutsche Securities Korea Co. and in Singapore by Deutsche Bank AG, Singapore Branch. In Japan this information is approved and/or distributed by Deutsche Securities Inc. In Australia, retail clients should obtain a copy of a Product Disclosure Statement (PDS) relating to any financial product referred to in this report and consider the PDS before making any decision about whether to acquire the product.

Printed by: HST Offsetdruck Schadt & Tetzlaff GbR, Dieburg

ISSN (Print) 2510-5248 / ISSN (Online) 2512-0824