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The German economy’s Achilles heel

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The German economy’s Achilles heel. The recession in German industry can be traced to the massive slowdown in global trade in 2018. Will the German service sector withstand the recession in industry, as some recent survey data seems to suggest? We doubt it. In previous downswings in the manufacturing sector services were pulled lower, too. Indeed, the two sectors' output trends during 2018 did already follow this pattern.

Economic Minister Altmaier's National Industrial Strategy 2030: Correct diagnosis, unconvincing medication. The call for national champions and the proposal that the government should acquire company stakes under certain circumstances have triggered a heated debate. In our view, such strategies imply substantial risks.

Federal Budget: "Sudden" funding gaps. According to press reports, the federal government is expected to register an accumulated deficit of EUR 24.7 bn over the next five years. Unless the government abandons the “black zero”, major conflicts over the future budget structure appear inevitable, as the CDU/CSU backs lower taxes while the SPD aims for new social security programmes.

Lower total and rental inflation thanks to new basket**.** Due to methodological changes, in particular the setup of a new sample to measure rents, the CPI (national definition) for 2017 and 2018 was revised slightly lower. The new rental sample could slow rental inflation in the future. This will also affect the harmonised index (HICP) and hence index linkers.

Corporate lending in Germany: Past the peak. Lending to companies and self-employed persons in Germany grew rapidly in 2018 (c. +5% yoy, or EUR 65 bn – the highest figure for a full year since the introduction of the euro). This year, both banks and businesses are likely to take a more cautious approach to credit in light of the slowdown in the economy.

Groko parties' image building exercises yield limited success. The SPD tries to attract attention with a leftish social policy stance. The CDU and its new leader Kramp-Karrenbauer want to enhance their performance with a stronger conservative profile. The imminent bickering is likely to spoil the political climate in Berlin further, although little of these controversial ideas will be implemented in the current term.

The German economy's Achilles heel

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	1.8	0.9	1.3	1.7	1.3	1.5	2.7	2.3	2.0	-0.8	-1.0	-1.0
Germany	1.4	0.5	1.4	1.9	1.7	1.4	7.4	6.5	6.1	1.7	0.8	0.8
France	1.5	1.3	1.3	2.1	1.5	1.7	-0.7	-0.3	-0.2	-2.5	-3.2	-2.0
Italy	0.8	0.3	0.7	1.2	1.2	1.4	2.5	2.2	2.2	-2.1	-2.4	-2.2
Spain	2.5	2.1	2.0	1.7	1.3	2.0	1.4	1.2	1.0	-2.7	-2.2	-1.8
Netherlands	2.6	1.9	1.8	1.6	2.3	2.0	10.2	9.9	9.7	0.8	0.6	0.4
Belgium	1.4	1.4	1.4	2.3	1.8	1.6	0.3	0.4	0.5	-1.1	-1.3	-1.4
Austria	2.8	1.9	1.8	2.1	1.6	1.8	2.2	2.3	2.5	-0.2	0.1	0.3
Finland	2.2	1.9	1.8	1.2	1.3	1.5	-1.6	0.0	0.5	-0.7	-0.7	-0.6
Greece	2.0	1.9	1.8	0.8	1.0	2.7	-1.0	-0.6	-0.3	0.6	1.1	1.3
Portugal	2.2	1.7	1.5	1.2	0.7	1.6	-0.4	0.0	0.0	-0.8	-0.7	-0.6
Ireland	6.4	3.4	3.3	0.7	1.0	1.1	11.0	10.0	9.0	0.0	0.0	0.3
UK	1.4	1.5	1.3	2.5	1.9	2.2	-3.5	-3.3	-3.0	-1.1	-1.4	-1.4
Denmark	1.2	1.9	1.7	0.7	1.5	1.8	6.0	6.2	6.1	-0.3	-0.2	0.2
Norway	1.7	2.1	2.0	2.8	2.1	2.0	6.2	6.0	6.1	7.2	5.3	5.2
Sweden	2.4	2.0	1.9	2.0	1.9	1.9	2.8	3.1	3.1	1.7	0.9	0.6
Switzerland	2.5	1.4	1.6	0.9	0.8	1.1	10.3	10.3	10.7	0.4	0.5	0.4
Czech Republic	2.9	2.7	2.8	2.1	1.9	1.9	0.5	0.3	0.3	1.4	1.0	0.9
Hungary	4.8	3.3	3.0	2.9	2.9	3.0	1.6	1.0	1.2	-2.1	-2.0	-1.8
Poland	5.1	3.6	3.2	1.8	2.0	2.7	-0.5	-0.9	-0.7	-0.9	-1.6	-1.9
United States	2.9	2.5	2.1	2.4	1.6	2.3	-2.5	-3.5	-3.5	-3.8	-4.2	-4.1
Japan	0.7	0.4	0.2	1.0	0.6	0.7	3.4	3.8	4.2	-2.3	-2.0	-1.9
China	6.6	6.1	6.0	2.1	2.4	2.6	0.4	-0.2	-0.4	-3.5	-4.5	-4.0
World	3.8	3.4	3.5	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

					2019				2020			
	2017	2018	2019F	2020F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	2.2	1.4	0.5	1.4	-0.1	0.3	0.4	0.3	0.2	0.2	0.2	0.3
Private consumption	1.8	1.0	0.8	1.3	0.1	0.4	0.4	0.3	0.2	0.3	0.3	0.3
Gov't expenditure	1.6	1.0	2.0	1.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Fixed investment	2.9	2.6	2.5	2.8	0.5	0.6	0.7	0.6	0.5	0.4	0.4	0.5
Investment in M&E	3.7	4.2	2.1	2.4	0.5	0.7	0.7	0.5	0.3	0.0	0.0	0.3
Construction	2.9	2.4	3.5	3.8	0.7	0.7	0.8	0.8	0.7	0.7	0.7	0.7
Inventories, pp	0.1	0.5	-0.2	-0.1	-0.2	-0.1	0.0	0.0	-0.1	0.0	0.0	0.0
Exports	4.6	2.0	1.6	3.2	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Imports	4.8	3.3	3.5	3.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Net exports, pp	0.2	-0.4	-0.8	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Consumer prices*	1.7	1.9	1.7	1.4								
Unemployment rate, %	5.7	5.2	4.9	4.8								
Industrial production**	2.9	1.5	0.0	1.0								
Budget balance, % GDP	1.0	1.7	0.8	0.8								
Public debt, % GDP	63.9	60.1	57.7	55.1								
Balance on current account, % GDP	8.0	7.4	6.5	6.1								
Balance on current account, EUR bn	261.2	249.1	226	220								

*Inflation data for Germany based on national definition. This can lead to discrepancies to other DB publications. **Manufacturing (NACE C)
Sources: Federal Statistical Office, Deutsche Bundesbank, Federal Employment Agency, Deutsche Bank Research

The German economy's Achilles heel

— The recession in German industry can be traced to the massive slowdown of global trade which has even gone into reverse in the final months of 2018. Of course this deceleration can to some extent be linked to Brexit, US–Chinese trade tensions and the slowdown in the Chinese economy.

— Two factors might explain the strong effect on the German economy: First, the slowdown in global trade reflects in part a weakening in global car demand, which makes Germany with its strong reliance on car exports particularly vulnerable. Second, the increasing importance of the Chinese economy for corporate Germany. Although strong demand for capital goods imports resulting from the "Made in China 2025" strategy have sheltered German exports from the Chinese cyclical slowdown. Which might explain why the overall response of the German economy is not unusual if compared to previous episodes of slowing global trade or the performance of other large exporters.

— Will the German service sector withstand the recession in industry, as some recent survey data seems to suggest? We doubt it. In previous downswings in the manufacturing sector services were pulled lower, too. Indeed, the two sectors' output trends during 2018 did already follow this pattern.

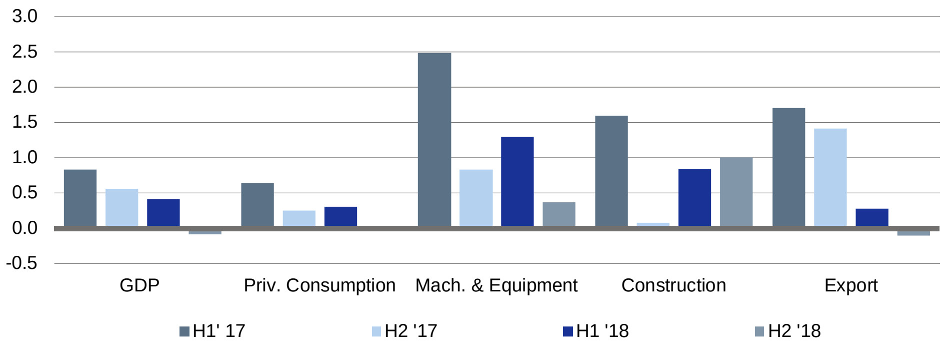
— This does not mean that the service sector will follow industry into recession. There are good reasons to expect that the domestic economy – albeit being pulled lower – will continue its expansion. But this will probably not be enough to reverse the trend in the industrial sector, despite some temporary factors tapering off. A clear recovery requires a rebound in global growth which does not seem to be on the cards for the next few months.

Economy stagnated in Q4

Contrary to the Statistical Offices' initial verbal indications, the German economy did not eke out a positive growth number in Q4 following the WLTP-induced 0.2% drop in Q3. However, final domestic sales (GDP minus net-export and inventory investment) expanded by a solid 0.6% qoq after stagnating in Q3, as inventories were reduced by 0.6pp of GDP (after surging by 0.8pp in Q3 due to the WLTP problems) while net-exports were growth-neutral.

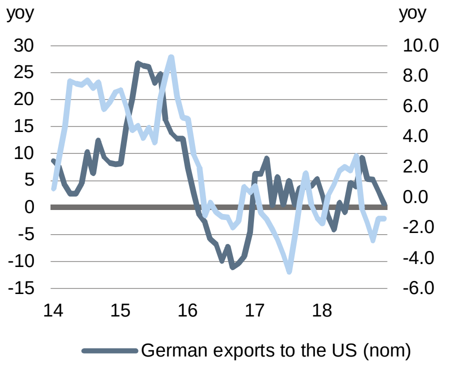
GDP & components 1

Average qoq rates



Sources: Federal Statistical Office, CPB

US domestic Car sales & German exports to the US 2



Sources: Federal Statistical Office, Bloomberg Finance LP

Domestic part of the economy weakening but still solid

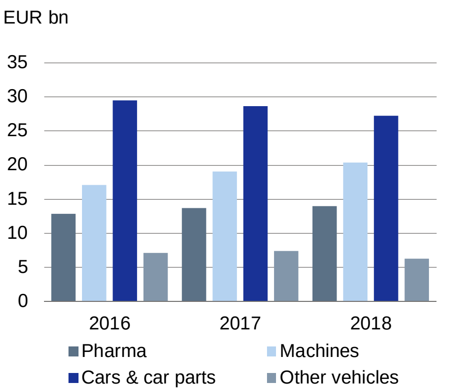
Throughout the year, the domestic side has been providing the growth impulse for the economy, although its momentum clearly slowed in H2. Private consumption has benefitted from robust albeit slowing employment growth and last year's strong wage increases resulting in 1.3% real increase in households' disposable income which financed a private consumption rise of 1.0%, as the savings rate increased from 9.9% to 10.3.

Capex expanded by 4.5% and construction output was pushed 3.0% higher by strong demand, low interest rates and higher public infrastructure investments. While corporate capex investment is expected to slow due to weaker external demand and increased economic policy uncertainty, there is no obvious reason why the other parts of domestic demand – private consumption and construction investment – should add to the economy's slowdown.

But what about trade war, Brexit and the slowing Chinese economy?

This leads to the question whether the German economic slowdown might be just the result of an unfortunate coalescence of negative external factors. The obvious candidates are Brexit, the US–Chinese trade conflict – with its possible extension to the EU – and the slowdown of the Chinese economy, given that the US (8.6%), China (7.1%) and the UK (6.2%) ranked number one, three and five among Germany's largest export destinations in 2018. German goods exports (nominal, current account definition) expanded by 3% in 2018 (2017: 6.2%), real exports of goods and services (SNA = system of national accounts) by just 2% with growth rates falling to 0.4% yoy (SNA) and 1.5% (current account) in the final quarter.

German exports to the US 3

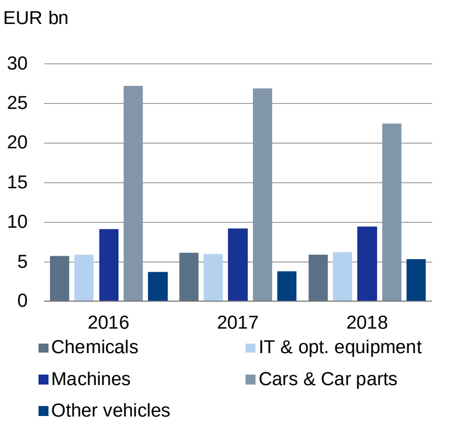


Source: Federal Statistical Office

Exports to the US underperformed in 2018

Nominal goods exports to the US rose only 1.5% in 2018, but this was largely due to the saturated US car market rather than the result of the flaring up trade conflict. Exports to the US have been slowing in recent months, largely because of car exports (24% of German exports to the US) as US light vehicle sales have been shrinking in the latter part of 2018 (-2.5% yoy in Sep./Dec.). Actually, German brands were able to gain market share, in part of course sourced by local US production. The impact of the steel & aluminum tariffs introduced June 1st, should have been rather limited. German annual aluminum exports to the US amounted to EUR 0.58 bn (2017) steel exports to around EUR 1bn whereas Germany's total export to the US stood at EUR 111.8 bn (2018).

German exports to the UK 4



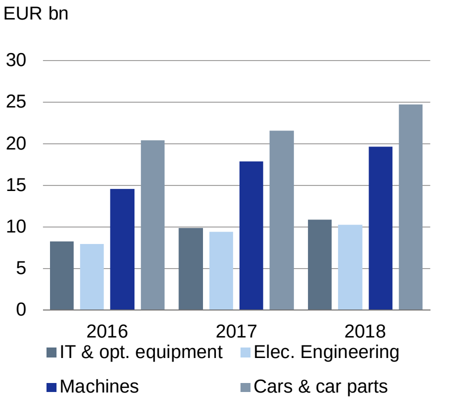
Source: Federal Statistical Office

Exports to the UK falling since 2016

Exports to the UK fell by 4.0% in 2018. This was almost exclusively the result of a 16.3% slump in car and car parts exports, which still accounted for 27.4% of all German deliveries to the UK. In 2018 other important product groups such as machines (11.5%) or IT and optical equipment (7.5%) still reported export increases of 4.2% and 5.1%, respectively. By contrast, pharmaceuticals has been a major casualty of Brexit-related uncertainties. German pharmaceutical exports virtually collapsed in 2018 (-32.5%) pushing the sectors weight in total exports down to 5%. Given the increased Brexit-related uncertainties in recent weeks, we doubt that there will be an improvement anytime soon.

“Made in China 2025” shelters German exports from slowdown

German exports to China 5



Source: Federal Statistical Office

Exports to China were actually pretty strong expanding by 8.1% in 2018. Despite the Chinese cyclical slowdown German capital goods exporters benefitted from Chinese investments related to “Made in China 2025”, as this initiative aims for import substitution by expanding the domestic capital stock. Although China’s car registrations slumped by -11% in H2, in part because consumers have been waiting for fiscal incentives for purchases of cars, the value of German car exports to China (26.5% of all German exports to China) still expanded by 14.6% in 2018, which can in part be traced to the reduction of Chinese import duties on foreign cars and car parts which became effective in July 2018.

Given that the US, China and the UK account for 27.5% of all global imports (first three quarters of 2018, USD) the specific issues in these three countries are certainly a major factor behind the slowdown in global trade in 2018, especially if their role in regional value creation clusters is taken into account as well. Still, the widespread slowdown in global trade, also visible in regions less impacted by Brexit, trade wars or China, leads to the question whether Germany’s slowdown is the result of a more general deceleration in global trade given the traditionally close correlation of Germany’s economic performance with global trade.

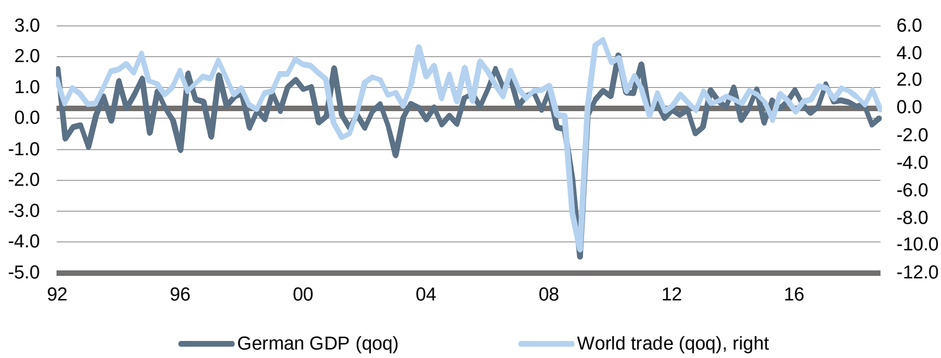
German GDP: High correlation with world trade

German exports: Little idiosyncrasy 6

Sources: Federal Statistical Office, Deutsche Bank Research

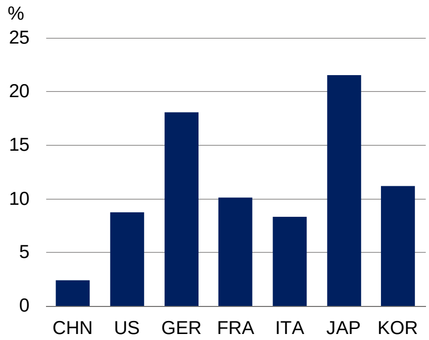
Global trade has been in reverse in H2, yoy growth rates of more than 5% at the start of the year have become negative in the final months of 2018. In January 2018 the IMF wrote about a strong acceleration in global trade and predicted the annual growth rate (goods & services) of 4.6%. The drop in the goods component suggests an actual rate of clearly below 4%. As Charts 6 and 7 show there is strong correlation between world trade and German exports and GDP growth, with the concurrent correlation running at 0.7 based on yoy-rates and 0.6 using qoq-rates. The chart clearly shows that the German economy is facing a high risk of falling into a recession whenever global trade growth turns negative. However, when comparing the current slowdown in German exports with the trends of other major exporters there seems also little in terms of a “special German factor”.

World trade and German GDP 7



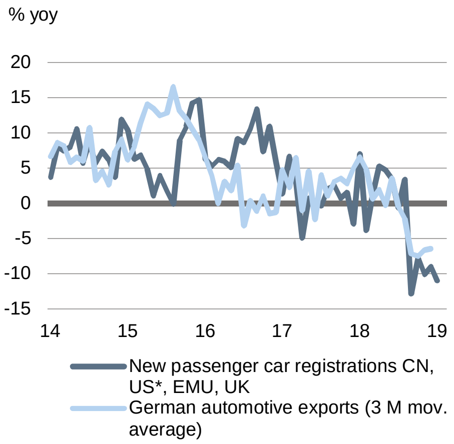
Sources: Federal Statistical Office, CPB

Car exports as % of total goods exports 8



Sources: WTO, Deutsche Bank Research

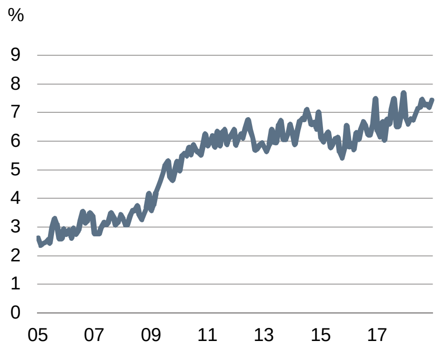
Weak global car demand affects German automotive exports 9



* Light vehicles

Sources: ACEA, Bureau of Economic Analysis, China Information, Federal Statistical Office

China share in German goods exports 10



Source: Federal Statistical Office

High dependence on car exports

Two aspects might still make Germany more vulnerable. First, its strong focus on the automotive sector, which clearly shows up in its export structure. In 2017 only Japan had a slightly higher share of automotive exports in its total exports. The German VDA expects global car registration to have dropped by 1% in 2018 after expanding by 2% in 2017. It might therefore not be a total coincidence that our Japanese colleagues have cut their GDP forecast for 2019 to 0.4%.

Strong China link

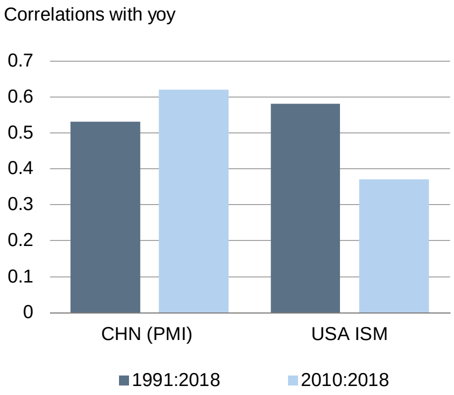
Second, Germany is particularly exposed to China. Back in 2015, the Bundesbank presented model simulations of the effect of a severe weakening of real domestic demand in China on the output of other countries and found that among the major economies Germany is hardest hit, with the exception of China's Asian neighbors such as Japan and South Korea. At the time, the Bundesbank itself suggested that the simulation might well underestimate the actual impact given that it did not include confidence, financial markets or profit channels.[1] In a more recent simulation, the Bundesbank improved its approach by modeling a slowdown in Chinese domestic demand in more detail, namely taking into account that a slowdown affects investment spending more strongly than private consumption, especially if the slowdown is triggered by problems in the financial sector. The relevance for growth spill overs, i.e. the German economy, is heightened by the fact that the import elasticity of Chinese investment spending is much higher than the one of its private consumption. The Bundesbank's simulation assumed a shock pushing Chinese GDP growth down to 2% for two years. In the second year, this leads to a 25% decline in Chinese imports (relative to baseline). In year two German GDP is 0.8pp lower than in the baseline scenario. But again even this might be too benign as the model simulation only runs through the trade channel.[2] This effect is currently probably even working in Germany's favour, due to the investments related to the "Made in China 2025" strategy. The clear increase in the correlation between the two economies in recent years does also suggest that Germany has probably become more dependent on the Chinese economy than is apparent from the strengthening trade link. The correlation between German quarterly GDP growth (yoy) lagged by one quarter and Chinese PMI has risen to 0.62 since 2010, while that with the US ISM has fallen to 0.37 (starting in 2004 the correlation with the ISM was 0.58, slightly higher than that with Chinese PMI 0.53). Our equity research colleagues estimated that back in 2015 China contributed between 22% and 62% to German car OEM's profits.

Will industry drag down the service sector? Survey data of limited help

The substantial slowdown of the German economy has been caused by the manufacturing sector. Although the output of the production sector (ex-construction) was already stagnant in H1 with average quarterly rates of -0.1%, it nose-dived in H2 when its output shrank by 0.9% qoq in Q3 and 1% in Q4. The question to what extent the recession in the manufacturing sector has been the result of temporary factors (WLTP, low Rhine water levels, and massive swings in the pharmaceutical sector's output) is still hotly debated. We interpret the fact that ifo and manufacturing PMI continued to fall in January and

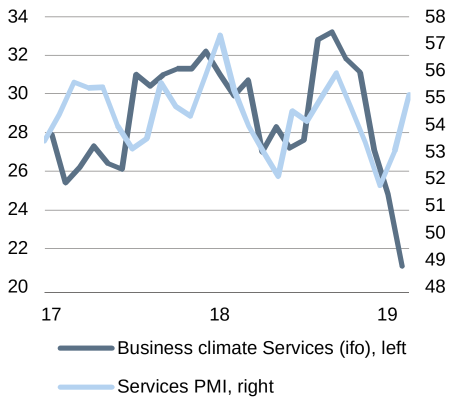
[1] Bundesbank Monthly Report, July 2015
[2] Bundesbank Monthly Report, July 2018

German GDP: China more important 11



Sources: Stabu, Haver Analytics, Deutsche Bank Research

Services: ifo and PMI point into different directions 12



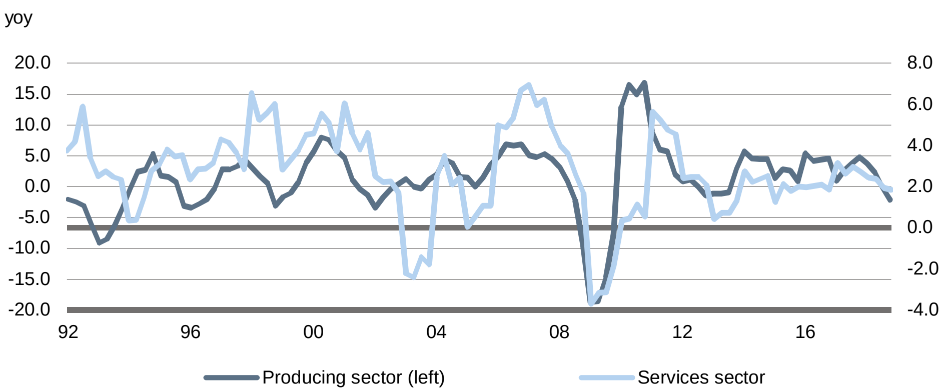
Sources: ifo, IHS Markit

February – in particular their more forward looking components – as a corroboration of our view that these factors had probably a more limited impact.

The key question for the short-term economic outlook is rather whether the domestic part of the economy, especially services which account for 61% of GDP[3] (producing sector 23% and construction 5%) will be able to keep the economy on track. While the service sector's output has been slowing in H2 (avg. qoq rates of 0.3% compared to 0.5% over the whole expansion) it is still up 1.9% on the year in contrast to the producing sector's output which is down by 2.1%.

Unfortunately, there is no reliable real-time data for the service sector. The monthly survey data provided by the new ifo business climate index or the services PMI have limited correlation with the service sector's gross value added, at least when looking at quarterly changes. While since 2005 services PMI did rather well (correlation 0.58 with services output) compared to ifo services business climate (0.38), the correlation has completely disappeared after 2013 (-0.02%) while the correlation with ifo services dropped to a meagre 0.18. With regard to yoy-changes in the service sector's GVA (since 2013) the surveys do a better job, with ifo (correlation 0.54) outperforming the PMI (0.44). Both measures have been trending down since August 2018 but have diverged in Jan./Feb. While the ifo services index's downward momentum even accelerated, the services PMI has mustered an impressive rebound, lifting it less than 1 point shy of its August high.

GVA: Producing & services sector 13



Source: Federal Statistical Office, Deutsche Bank Research

Hard data suggests that the service sector follows the industrial sector

If manufacturing is driving services, it should show up in the lagged correlation of the sectors' PMIs or business climates. However, the correlations between lagged ifo manufacturing and ifo services climate are only marginally higher than the other way round. Given that the services business climate has little correlation with the actual value added of the sector, as described above, it might be better to check the GVA's of the manufacturing and the service sector for causality. Visual inspection suggests that at least the more substantial downswings in the producing sector are followed by decreases in the services

[3] We include the following sectors in services (weight in brackets): retail trade (24%), information & communication (7%), property & financial (21%), business related (21%) and public services (27%).

sector's output (1992, 1995, 1997, 2000, 2006 and 2010) (see Chart 13). (In the period 2003 to 2005 the correlation broke down, which can probably be traced to the liberalization of telecommunication services.) In the table, we present bi-directional correlations. In the two samples (1991-2018, 2006-2018) the producing sectors' GVA has a strong lead over the services sectors GVA reaching its maximum after 2 to 3 quarters. This pattern has started to show up again during the course of 2018. It does not necessarily indicate that the services sector will fall into recession too, but it clearly suggests that the weak producing sector will pull services lower.

Lagged correlations between services and producing sector's GVA 14

	1991-2018		2006-2016	
lag	Services lagged Prod	Prod lagged Services	Services lagged Prod	Prod lagged Services
1	0.48	0.18	0.66	0.32
2	0.48	-0.07	0.66	0.03
3	0.46	-0.29	0.62	-0.26
4	0.4	-0.46	0.55	-0.52
5	0.24	-0.5	0.34	-0.6
6	0.07	-0.46	0.11	-0.62

Sources: Federal Statistical Office, Deutsche Bank Research

External environment and its impact on service sectors does not suggest a strong rebound in H1

The analysis above shows that the German economy's grinding to a halt can be traced to the strong deceleration of global trade, which has to some extent been driven by Brexit, trade tensions and the Chinese economy's slowdown. For Germany, this effect is heightened by the slowdown in global car demand and the car sectors' dominance in German exports. But the German economy's response does not seem exceptionally strong compared to previous downswings in global trade or compared to the trade performance of other important export nations.

The key question is to what extent the services sector will be pulled lower by the producing sector's recession. This seems to be the typical chain of events and has already started to materialise in 2018. There are good arguments such as the strong labour market, solid wage increases or the structural demand overhang in the housing market combined with still extremely low interest rates, suggesting that the domestic part of the economy will continue to expand. Still, with a clear rebound in world trade unlikely to materialise during the next few months, we expect very weak German GDP growth in H1 and recessionary tendencies in parts of the economy.

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Economic Minister Altmaier's National Industrial Strategy 2030: Correct diagnosis, unconvincing medication

— The Federal Ministry for Economic Affairs and Energy has released its "National Industrial Strategy 2030". This step is a clear signal of appreciation for the German manufacturing industry. The paper correctly outlines the challenges for Germany as an industrial location and for the export-oriented German industry (such as increasing protectionism, state-supported industrial policy in China, the risk of falling behind in the area of digital technology). However, we do not think that it makes sense to set a specific target for the share of manufacturing in total GDP.

— A number of the problems and challenges described in the National Industrial Strategy do not stem from unfair international competition, protectionism or rising state influence abroad, but from domestic political framework conditions. Take closed value chains, for example, which the paper quite rightly judges to be highly important. However, the capital stock in energy-intensive industries is declining, not least due to national climate and energy policies.

— Two aspects of the National Industrial Strategy in particular have triggered heated debates. One is the call for national champions, the other the statement that the government itself should acquire company stakes under certain circumstances. We agree that doing so would result in considerable risks, particularly for competition. In addition, we doubt whether government influence increases the chances of a company's success.

At the beginning of February, German Economics Minister Peter Altmaier revealed his "National Industrial Strategy 2030", which contains "strategic guidelines for a German and European industrial policy". What do we think of this strategy, which the Federal Ministry explicitly calls a "first step" and which "does not claim to be complete or to enjoy undivided endorsement"?

First of all, we welcome policymakers' clear appreciation for the German manufacturing sector. After all, we wrote only at the end of January that support for the German industry was sometimes lacking and that recent industrial policy discussions had not been sufficiently based on facts.[4] Moreover, the ministry's strategy gives a correct (if incomplete) overview of international challenges for Germany as an industrial location and for the export-oriented German industry:

— There is a trend towards protectionism around the world. The US in particular have announced plans to raise import tariffs and tighten trade restrictions over the last few months under President Trump's "America First" policy. Tariffs on some industrial products (such as steel or aluminium) have already been increased.

— China pursues an active industrial policy and provides targeted support to a wide range of key technologies ("Made in China 2025"). State-owned enterprises play a major role and try to take over companies around the world. And private-sector companies, too, are often thought to be subject to significant state influence. This distorts competition in market-oriented economies and increasingly triggers criticism. China is well aware of its growing importance as an economic power, as a sales market and as an investment destination and relies on a strategic mix of state-directed and market economy elements. These include "local content" provisions, which say that a certain percentage of the overall value creation must take place in

[4] See Heymann, Eric (2019). German industry: growth in investment spending driven by only a few factors. Deutsche Bank Research. Germany Monitor. Frankfurt am Main.

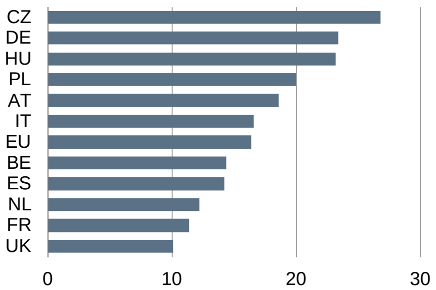
China if a company wants to sell its products on the Chinese market. In addition, rules for cooperations between domestic and foreign companies force the foreign partners to transfer know-how to their Chinese partners.

— Germany does not belong to the international top players in the area of new key technologies (digital platform economies, artificial intelligence), particularly not when it comes to specific applications. In fact, it currently seems to be falling further behind its competitors from the US or China. Integrating digital technologies into traditional industrial products is one of the major challenges for the German industry.

Specific target for contribution of industry to total GDP does not make sense

Industry is important in Germany 1

Share of manufacturing industry in total gross value added, 2017, %



Source: Eurostat

While the National Industrial Strategy correctly analyses the economic and political challenges, it also includes a number of statements which give rise to criticism, starting with its goals. A concrete target for the share of manufacturing in overall GDP does not make sense on either the German or the EU level. Creating favourable economic framework conditions for companies from all sectors, i.e. including services and construction, is more important. The final contribution of the industry to aggregate GDP should be a market result. Moreover, economic structures differ from country to country. They have grown over time and reflect the countries' relative competitive advantages at the international level. This means that raising the share of manufacturing in total GDP is not necessarily the optimal solution for all EU countries, particularly since the emerging markets are likely to become more important competitors for numerous industrial products.

The National Industrial Strategy explicitly says that the contribution of manufacturing to total German gross value added (GVA) is to be increased from just above 23% in 2018 to 25% by 2030. However, it does not clarify why this percentage (and no other) is thought to increase overall prosperity. The goal for the EU as a whole is even more ambitious, seeing that the share of the industry in EU GVA is to rise from 16.4% in 2017 to 20% in 2030. In order to achieve this goal, value added in the industry would need to grow above the average rate for the economy as a whole for years to come. Just take a look at our sample calculation: if nominal value added in all sectors excluding manufacturing rose by 1% p.a. between 2018 and 2030, value added in the industry would need to expand by 3% p.a. to reach the target share of 20% by 2030. Such a discrepancy in growth rates is unrealistic, not least due to the structural slowdown in world trade.

Politically motivated, overambitious targets are nothing new. In fact, the EU already decided back in 2012 to increase the share of manufacturing in gross value added to 20% by 2020 – and failed. And we already voiced our doubts about specific targets back then.[5]

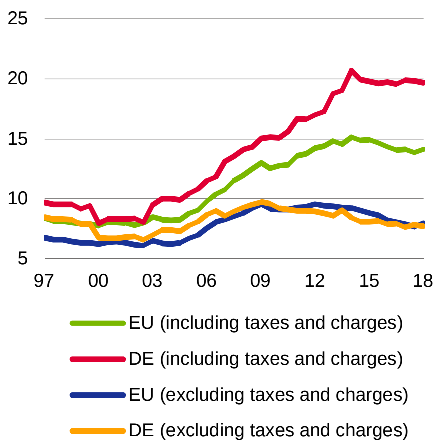
Some of the identified challenges are home-made

The ministry's National Industrial Strategy lists a number of concrete challenges, some of which, however, do not stem from unfair international competition, protectionism or growing state intervention abroad, but at least to some extent from domestic political framework conditions. For example, the paper criticises that "innovative carbon fibre materials are largely produced outside of Germany". One major reason for this is that carbon fibre materials production

[5] See Heymann, Eric and Stefan Vetter (2013). Europe's re-industrialisation: The gulf between aspiration and reality. Deutsche Bank Research. EU Monitor Frankfurt am Main.

Taxes and charges are the main drivers of electricty prices in Germany 2

Electricity price for industrial customers*, cents per kilowatt hour



* Annual electricity consumption. between 500 and 2.000 MWh

Source: Eurostat

requires a lot of electricity. Since electricity is quite expensive in Germany and the future energy and climate-policy course is uncertain, Germany is not the first location which comes to mind when choosing the best place for a carbon fibre factory.

The situation is similar with regard to the "risk of Europe failing to catch up with international developments in new biotechnologies or losing touch with them again if they do catch up", which is also mentioned explicitly. This statement is somewhat surprising, seeing that the framework conditions for basic research in "green biotechnology" – not to mention for the development of final products – are not particularly favourable in Germany (just remember the ban on planting genetically modified crops).

Ground-breaking innovations as a game changer: Policymakers' knowledge is limited

The National Industrial Strategy claims that "digitalisation and in particular the rapid dissemination of artificial Intelligence applications" is "the most important ground-breaking innovation today". Digital technologies will certainly spread to more and more areas of the economy and of everyday life. The German industry is currently working on making traditional industrial products fit for the digital age ("industry 4.0").[6] However, it is uncertain whether the blanket statement quoted above really is true. After all, policymakers cannot know whether we will soon see the development of new technologies, which are just as ground-breaking. Moreover, the digital transformation is only one of numerous global existential challenges, which include, for example, providing a sufficient supply of food or clean drinking water for a global population that is growing by 80 million each year or developing low-carbon, high-performance reliable energy sources.

While Germany is clearly lagging behind in many digital technologies, it is not readily obvious why "a large economy [...] must participate properly in the value added by the platform economy" if it is "to be successful on a sustainable basis". At the very least, it is unclear what "participate properly" means.

The global data market will certainly continue to grow. However, cooperations will allow German companies to participate (for example in the traffic sector) even if they do not run global digital platforms themselves. If, for example, German companies put a particular focus on data security, they may enjoy higher customer loyalty. As a rule, network effects tend to lead to a concentration of digital platforms, which is why the number of truly global providers is likely to remain limited.

Ultimately, it is impossible for policymakers to know what the ground-breaking technologies of the future will be. They should therefore endeavour to make the environment for research as supportive as possible (top universities, tax support for research expenses).

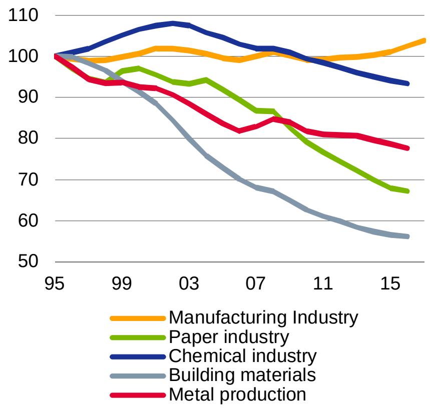
Points of reference for a national industrial policy are vague and contradictory

The first paragraph of the chapter on "Points of reference for a national industrial policy" already includes a statement which is worth some debate. It says: "Our economy must be able to withstand global competition in all main areas also in the future, particularly where key technologies and ground-breaking innovations are concerned." However, no country is in the top group in

6 See Auer, Josef (2018). Industry 4.0 – Digitalisation to mitigate demographic pressure. Deutsche Bank Research. Germany Monitor. Frankfurt am Main.

Real net fixed assets decline in energy-intensive sectors 3

Real net fixed assets in Germany, 1995=100



Source: Federal Statistical Office

all areas, and moreover, this is unnecessary in a world which is characterised by the division of labour.

In addition, the ministry's paper claims that "maintaining closed value added chains is highly important". Germany does indeed have vertically integrated industrial supply chains, and this is an advantage over other industrial countries. However, parts of these industrial supply chains are currently being weakened by domestic policy measures. For example, the capital stock in energy-intensive industries (such as metals production or the chemical industry) has been declining for years now, not least due to uncertainties about future energy and climate policies.[7] Once again, domestic policy can do much more for the continued existence of closed value chains. Still, the National Industrial Strategy states later on that Germany's competitive position has deteriorated due to climate and energy policy measures and that action on electricity and energy prices is necessary. It remains to be seen whether the necessary measures are really taken.

A National Industrial Strategy must of course include the statement that small and medium-sized enterprises are one of Germany's special strengths. The ministry's paper says that digitalisation is a "huge challenge" for these companies, which is why they "need customised offers and support". However, it does not explain what form this support should take. One thing is certain: policymakers could have been much quicker about providing a reliable broadband network.[8] Interestingly, the Mechanical Engineering Industry Association (VDMA), which represents mainly small and medium-sized enterprises, is not particularly interested in "customised offers". Rather, its comment on the National Industrial Strategy calls for good economic framework conditions, such as contract and legal certainty, the protection of ownership rights, competitive regulation which prevents monopolies or cartels and tax support for research expenses.[9]

National champions and state stakes in companies: Risks are predominant

Two aspects of the National Industrial Strategy in particular have triggered heated debates after the paper's release. The first is the call for or positive assessment of "National and European champions", i.e. large companies. The second is the statement that the state should be able to acquire stakes in companies "in very important cases" "for a restricted period of time" and that a national participation facility might be created for this purpose.

At first sight, the ministry's arguments for the establishment of national champions appear convincing. There are indeed sectors and technologies where critical mass (for example sufficient capital) is helpful because it enables companies to enter tenders for large-scale orders or raise funds for research. In addition, there are size-related market entry barriers. In terms of competition policy, the definition of the relevant market is particularly important. The ministry argues that mergers in Germany and Europe may fail because competition law defines the relevant market too narrowly. In some cases, the relevant market is not Germany or Europe, but the world market.

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[7] See Heymann, Eric (2019). German industry: growth in investment spending driven by only a few factors. Deutsche Bank Research. Germany Monitor. Frankfurt am Main.

[8] See Heymann, Eric and Kevin Körner (2018). Digital infrastructure: Bottlenecks hamper Europe's progress. Deutsche Bank Research. EU Monitor. Frankfurt am Main.

[9] See Welcker, Carl Martin (2019). Small and medium-sized businesses do not need a state master plan. Guest article in: Frankfurter Allgemeine Zeitung. 11 February 2019. Frankfurt am Main. Carl Martin Welcker is the current VDMA president.

This argument does hold water. Still, the purpose of competition law is not to create national champions, but to promote competition and prevent misallocations by forbidding the formation of cartels, overseeing mergers and monitoring any misuse of a dominant market position. Justus Haucap, a specialist in competition economics, called the National Industrial Strategy "counterproductive". In a recent article, he quotes numerous studies which show that corporate mergers reduce competitive pressure, which helps to lift profit margins in the short term, but is detrimental for customers in the medium term. In addition, large-scale mergers lead to reduced spending on research and development, which, in turn, weighs on innovation. Taking the failed merger of the railway divisions of Siemens and Alstom as an example (the plans were rejected by the European Commission), Haucap explains that even after the merger the company would not automatically have got access to China, the largest railway market world-wide. In addition, he points out that only 29 out of a total of 7,000 filed merger plans have been rejected by the European Commission since 1990.[10]

At the same time, a redefinition of the relevant market raises other problems, which the European Commission has already mentioned. For example, it may be difficult, particularly in the case of tech companies, to evaluate a company's position on a given regional market. If we take the global market as the relevant market, Facebook has only a market share of 20%. Over the coming weeks, the pros and cons of amendments to national and European competition law will be discussed intensively. For any amendments to the latter, unanimity among the EU-27 is required.

Ministry tries to avoid impression of state interventionism

Economics Minister Altmaier says in his foreword to the National Industrial Strategy that the strategy "defines those cases in which state activity is justified by way of exception or may even be necessary to avoid serious disadvantages for the country's economy and for the prosperity of the nation as a whole". The ministry paper lists criteria ("new economic principle of proportionality") which need to be reviewed before the government actively intervenes in the economy (by buying stakes in companies). The government is obviously thinking of undesirable takeovers of German companies by foreign competitors. Still, the criteria are very vague. They say that "risks to national security" and to "critical infrastructures" should be averted. In addition, the economic significance of the process should be considerable.

It is unclear what this is supposed to mean. And this is probably where the biggest problem with a state participation facility is. How can the government decide which companies should be protected against foreign takeovers without intervening massively in market competition? In addition, there is the problem of how the government should decide whether direct state investments in a particular technology are necessary and justified to achieve certain goals. The National Industrial Strategy gives the examples of platform economies, artificial intelligence or autonomous driving. But why were these technologies selected and not any other ones? Why should the research-intensive German car industry need state participation to develop technologies for autonomous driving? The recently announced cooperation between BMW and Daimler in this field shows that the sector is not reliant upon the state. Or will artificially created "me-too" digital platforms really have a chance of success against well-established providers? Will state participation actually ensure economic success? It is quite impossible to give a satisfactory answer to these questions,

[10] See Haucap, Justus (2019). Je größer desto besser? Guest article in: Frankfurter Allgemeine Zeitung. 18 February 2019. Frankfurt am Main.

which is why we are against state participations. They are “sweet poison” and might eventually induce companies to rely too much on the state. The VDMA President succinctly states in his guest article referenced above that the association is against a state participation fund.

With regard to its statements on public participation in private-sector companies, it is interesting that the National Industrial Strategy in general argues in favour of market economy principles. The foreword already says that “we need more, not less, market economy if we are to maintain the future viability of our economic sector”. Later on, the paper states that “state activity can only come into question as an exception, temporarily, and only in cases of fundamental importance”. With regard to principles of regulatory policy, the National Industrial Strategy says that the state “may never encroach upon business decisions of individual companies” and should “not intervene arbitrarily in the competition between individual companies”. In addition, Germany “is committed to the principle of free and open international markets”. It seems as if the ministry somehow is afraid of its own courage in considering state participation as a last resort – or as if the commitment to market economy principles was to serve as a regulatory fig leaf.

Ministry’s concerns are justified, but the focus should be on economic framework conditions and on a consequent defence of open markets

Regardless of our criticism of the National Industrial Strategy, there is one highly welcome aspect: the government has thought about the global challenges for the German industry and emphasised the sector’s importance for the German economy. The paper will certainly fuel debates about industrial policy in the coming months. In addition, it is a step towards our neighbour and partner France, which has always held different convictions in the area of industrial policy. The recent, joint paper by the French and German ministries of economics focuses on the role of competition policy as a potential defence against unfair practices by foreign companies.

The industrial policy debate should be expanded to take into account additional aspects, such as the lack of qualified labour and the trend towards a smaller workforce, which the National Industrial Strategy does not address yet. And finally, it is remarkable that large parts of the German corporate sector are quite critical about the state’s taking a more active role in the form of state participations. This shows that German industrial companies are less concerned about sufficient protection by the state and more about good economic framework conditions in Germany (and in the Europe). The German industry evidently is confident enough that it can address the challenges of the future.

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Federal budget: “Sudden” funding gaps

— The aggregate general government budget balance is likely to remain in the black in 2019 and 2020, as the overall fiscal situation of the federal states, the local governments and the social security system is still favourable.

— According to press reports, the federal government is expected to face a large accumulated funding gap of EUR 24.7 bn (c. 0.7% of the GDP forecast for 2019) in the five-year period from 2019 to 2023.

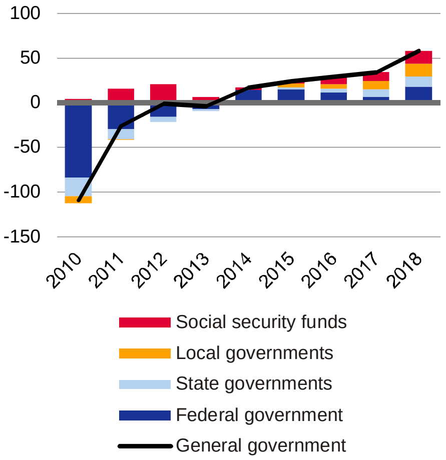
— In view of the cyclical fiscal deterioration, it is clearly a good thing that the refugee provision was once again increased by EUR 11.2 bn in 2018 thanks to the considerably higher surplus. This enables the federal government to enter the downturn with a larger financial buffer than initially assumed.

— Unless the federal government abandons its goal of a “black zero”, major coalition conflicts over the future budget structure appear inevitable, seeing that the CDU/CSU tends to back tax relief programmes and the SPD aims at creating new social security programmes.

— Europe should put to rest any hopes that Germany might prop up euro-area growth by a major investment initiative in the near future. All this does not bode well for the structural growth outlook for Germany and the euro area as a whole.

General government balance in surplus for the fifth year in a row 1

General government balance (national accounts), EUR bn



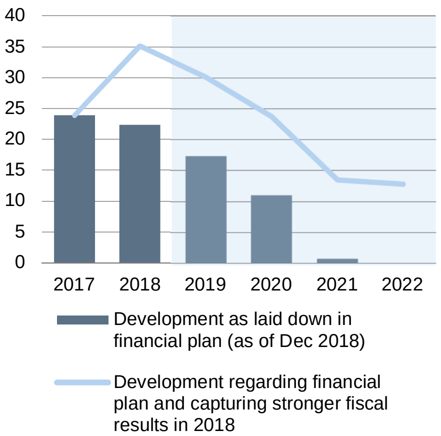
Sources: WEFA, Destatis, Deutsche Bank Research

In 2018, the federal government budget contributed most (nearly EUR 18 bn) to the record aggregate surplus of EUR 58 bn

According to the updated calculations of the Federal Statistical Office (national accounts), Germany achieved its highest aggregate budget surplus since the German unification in 2018. The total includes the balances of the federal, state and local budgets, the social security system and any special budgets. The federal government made the largest contribution to the surplus (EUR 17.9 bn), followed by the social security system (EUR 14.9 bn), the local governments (EUR 14.0 bn) and the states (EUR 11.1 bn). This fifth annual surplus in a row probably helped to reduce the overall debt ratio (according to the Maastricht definition) further in 2018, to 60.1% of GDP (2017: 63.9%). The aggregate budget balance is likely to remain in the black in 2019 and 2020, as the overall fiscal situation of the federal states, the local governments and the social security system is still favourable. However, as the expansion slows (we forecast a growth rate of 0.5% for 2019) and the federal government is set to register fiscal deficits, the surpluses are likely to decline. We believe that the surplus will decline considerably in 2019, to only 0.8% of GDP (initial forecast: 1.0%), and that the debt ratio will decrease only to 57.7%, i.e. less than initially expected (initial forecast: 57.2%). Even though Germany’s budget figures are excellent in an international comparison, policymakers and economists are currently discussing how Germany, and in particular the federal government, should respond to the growth slowdown. Some of them support additional borrowing, as the debt ratio is relatively low and interest rates are low, others are warning against higher debt and pointing to rising demographic burdens from mid-2020.

Development of the reserve fund for refugees 2

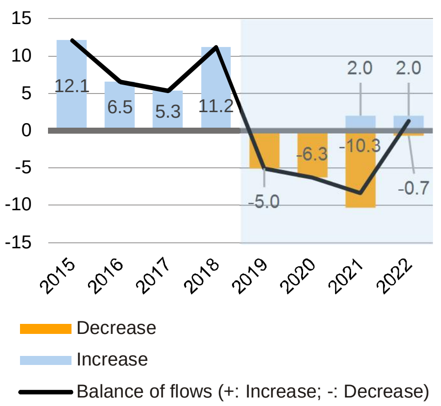
EUR bn



Sources: Federal Ministry of Finance, Deutsche Bank Research

Balance of flows of the federal government's reserve fund 3

EUR bn

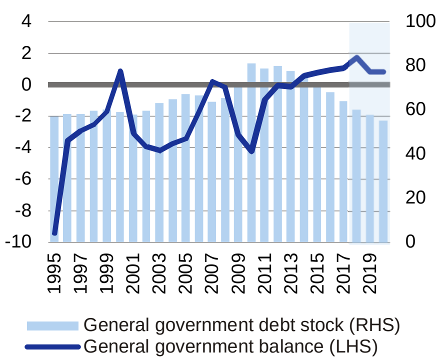


The government plans to pay annual installments of EUR 2 bn in each year in 2021 and 2022 into a reserve fund for demographic challenges.

Sources: Federal Ministry of Finance, Deutsche Bank Research

General government surplus is set to decline significantly in 2019 due to economic slowdown 4

% of GDP (general government level) (NA)



Sources: WEFA, Destatis, Eurostat, DB Research

The main concern: Weaker growth might lead to an aggregate funding gap of EUR 25 bn over the coming five years

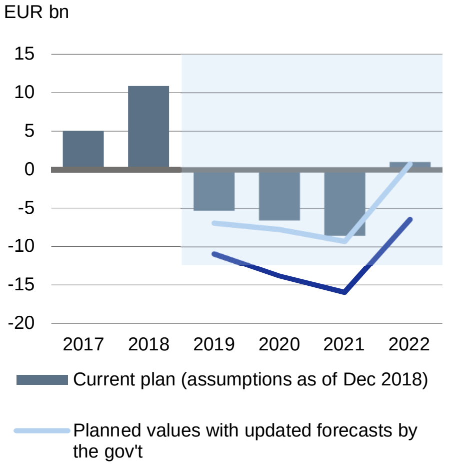
According to press reports (see, for example, Frankfurter Allgemeine Zeitung of 4 February 2019), the federal government is expected to face a funding gap of EUR 24.7 bn (c. 0.7% of the GDP forecast for 2019) in the five-year period from 2019 to 2023. This is what Minister of Finance Olaf Scholz allegedly told his colleagues at the beginning of February, thus calling on them to cut their spending in the future. The necessary austerity efforts for 2020 alone were recently put at EUR 6 bn. If it is not possible to close the funding gap by reducing spending, the government will probably miss its goal of a “black zero” (no new debt) soon. The downward risks we have often mentioned appear to be materialising, and it remains to be seen how policymakers will respond. They might try to close the funding gap by cutting expenditure and/or increasing revenues (this seems to be what the government is aiming at) in order to avoid higher debt.

Or they might use additional (limited) borrowing up to the ceiling set out in the “national debt brake”. Ultimately, the government will have to decide whether the “black zero” is carved in stone and, if it is, which type of spending is to be reduced and by how much. Remember that the “black zero” is a goal the government has set itself; it is not legally binding. During downturns, the “black zero” is more restrictive than the constitutional, legally binding provisions on debt. The latter limit structural net borrowing (i.e. borrowing adjusted for cyclical influences and financial transactions) to 0.35% of GDP of the year which precedes the budget preparation. In contrast to the “black zero”, the “debt brake” provides the government with more financial leeway during hard times than during expansions. While federal structural borrowing, at c. EUR 8 ½ bn, would be quite near the constitutional ceiling of EUR 11 ½ bn this year (see our Focus Germany of February 2019), the cyclical slowdown should not endanger the debt ceiling as such.

Government included deficits in its fiscal planning during the boom, ...

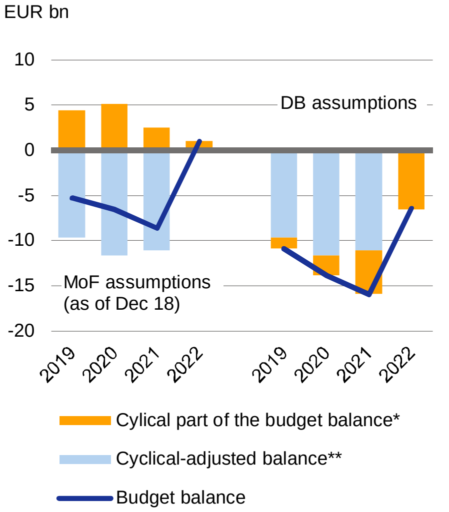
High tax revenues and a significant decline in interest expenditure (or, in other words, the favourable effects of strong growth, a labour market boom and low interest rates) have made it easy for the federal government to comply with the national debt provisions and do without additional debt over the past five years, even though spending for a number of purposes was increased considerably. However, the finance minister’s task may become more difficult due to the cyclical downturn. We will now try to analyse the “Scholz funding gap” of almost EUR 25 bn against the background of former budget and fiscal plans. Initially, the fiscal planning assumed a growth rate of 1.8% for 2018. This forecast was revised downwards to 1.0% in the latest annual report by the government. Even under the initial growth assumptions, the government expected deficits of EUR 5.3 bn for 2019, EUR 6.6 bn for 2020 and EUR 8.6 bn for 2021, respectively. A small surplus of EUR 1 bn was not expected until 2022. In order to achieve the grand coalition’s fiscal target of a “black zero”, these deficits were to be covered by annual dips into the refugee provision built up during the surplus years (EUR 5.0 bn in 2019; EUR 6.3 bn in 2020; EUR 10.3 bn in 2021; and EUR 0.7 bn in 2022) (see Chart 3). In view of the cyclical fiscal deterioration, it is clearly a good thing that the refugee provision was once again increased by EUR 11.2 bn in 2018 thanks to the considerably higher surplus, to currently EUR 35.2 bn (0.7%

Development of the federal government's budget balance 5



Sources: Federal Ministry of Finance, Deutsche Bank Research

Decomposition of the federal government's budget balance 6



* Based on the output gap estimation by the Ministry of Finance. ** Budget balance minus cyclical part of the balance.

Sources: Federal Ministry of Finance (MoF), Deutsche Bank Research

of GDP). This enables the government to enter the downturn with a larger financial buffer than initially assumed (see Chart 2)[11]

... and the deficits are likely to widen considerably due to the downturn

Based on the current, still valid financial planning,[12] the refugee provision will decline by c. EUR 22.3 bn, to roughly EUR 12.8 bn, by 2022.[13] This sum would theoretically be available for future years, such as the fiscal year 2023. However, with a cyclical fiscal deterioration on the cards, the funding deficits will probably be much higher in the coming years than expected so far. Our growth forecasts (only 0.5% for 2019) suggest that the economic slowdown alone might cause the deficit to widen by almost EUR 25 bn between 2019 and 2022 in comparison to the current plans. Even taking into account the better starting situation for the federal budget (and the additional increase in the refugee provision[14], the actual funding gap might still amount to more than EUR 20 bn. Based on this simple back-of-the-envelope calculation, which we approximate using the output gap estimate of the ministry of finance and semi-budget elasticity,[15] a relatively large funding gap is likely for the coming five years. This would require average austerity efforts of c. EUR 5 bn per year if the government wants to stick to the “black zero”, as agreed in the coalition agreement.

The “black zero” and social security expenditure seem to be more important than future-oriented investments

It seems that the federal government missed its chance of establishing a sustainable, growth-promoting, future-oriented fiscal policy during the fat years. During the boom, it used its fiscal leeway to expand social security spending, which is already quite high anyway (particularly for pensions). Unless the federal government abandons its goal of a “black zero”, major coalition conflicts over the future budget structure appear inevitable, seeing that the CDU/CSU tends to back tax relief programmes and the SPD aims at creating new social security programmes.

As there are currently no signs of measures to rein in social security spending (in fact, the SPD is calling for even more social security expenditure, for example in the form of pension hikes for low-income earners (“respect pensions”)), it is likely that, as always, other growth-promoting spending is cut, which would be elementary to secure Germany’s position as an economic hub.

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11 Initially, a drawdown of EUR 1.6 bn was planned for 2018. However, this was not necessary after all. The refugee provision allows the federal government to take out debt up to the amount to which debt allowances for former fiscal years have not been used. This means that any funding taken from this “reserve” will not count towards net borrowing pursuant to the “debt brake” definition. In other words: as long as future deficits can be covered by this provision, any new borrowing by the federal government will not be regarded as new debt under fiscal law, even though effective government debt and the overall debt ratio under the Maastricht definition will increase.

12 The federal government plans to present its key parameters for the budget 2020 and the reviewed financial planning on 20 March 2019. The planning horizon will be extended by another fiscal year (2023).

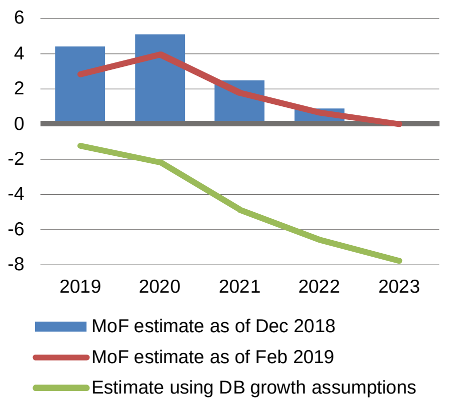
13 According to the current plans (i.e. excluding the better outcome for 2018), the provision would have been fully used by the end of 2022.

14 Lower interest expenditure than planned might create an additional financial buffer. In 2018, interest expenditure was EUR 1.5 bn lower than assumed (EUR 16.5 bn vs EUR 18.1 bn). If interest rates stay low, interest expenditure may remain below the budgeted figures in the coming fiscal years and thus relieve the fiscal strains.

15 This is 0.203 for the federal budget, meaning that a deterioration of the output gap by EUR 1 bn will lead to an additional fiscal burden of c. EUR 200 m.

Development of the cyclical part* of the federal government's budget balance 7

EUR bn



* The cyclical part of budget balance quantifies the impact of the business cycle on the budget position. A positive value implies that the budget balance is supported from the economy (due to a positive output gap), whereas a negative value implies that the budget position is burdened from the state of the business cycle (due to a negative output gap). The cyclical part is calculated as the product of the semi-elasticity of the budget (0.203) and the estimated output gap.

Sources: Federal Ministry of Finance, Deutsche Bank Research

At least that is what comments from the ministry of finance suggest, which says "No further use of tax money to fund expenses for digital infrastructure (broadband access, the digital pact for schools or other projects)". Taxpayers and high-performing sectors will also have to wait for tax relief, which is urgently needed, not least for structural reasons. It remains to be seen whether the government will indeed reduce the solidarity surcharge from 2021, as planned. In the current situation, it seems utopian to hope for more than the partial abolishment for 90% of all taxpayers, which the coalition agreement foresees. In addition, Europe should put to rest any hopes that Germany might prop up euro-area growth by a major investment initiative in the near future. All this does not bode well for the structural growth outlook for Germany and the euro area as a whole.

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Lower total and rental inflation thanks to new basket

— The Federal Statistical Office (FSO) changes its basket of goods to measure inflation (CPI = national definition) usually every five years. Due to extensive changes in the survey methodology, in particular the setup of a new sample to measure rents, the adjustment for the 2015 goods basket started later than previously scheduled. In February 2019, the FSO implemented and presented the changes to the public.

— Due to these methodological changes, the CPI for 2017 and 2018 was slightly revised downwards relative to previous years. Rental inflation was also slightly lowered for 2016 and 2017.

— The new rental sample, which takes greater account of private landlords than before and which gives less weight to net cold rents in the goods basket, could tend to slow rental inflation somewhat. This statement applies both to the CPI and to the harmonised index which is relevant for monetary policy, the HICP. Inflation-indexed government bonds could therefore also tend to price in lower inflation rates.

— The new sample for package holidays should lead to greater seasonal fluctuations than hitherto due to a better distinction between winter and summer holidays.

The current German inflation rate remains well below the ECB's target of "close but below 2%". Preliminary overall inflation in February was 1.6% compared to the previous year, after 1.4% in January and 1.6% in December. As a result of the current slowdown in growth and declining energy prices, we expect annual inflation to decline to 1.7% in 2019 (1.9% in 2018). Due to the structural shortfall of meeting the target – the average inflation rate over the past 20 years was 1.5% – the adjustments to the CPI basket, which usually take place every five years, are particularly noteworthy. Moreover, some of these changes have an impact on Germany's harmonised inflation rate (HICP) and thus also affect the HICP inflation rate for the euro area average.

At a press conference, the FSO explained these changes in more detail. The new goods basket and the adjustment to the weighting scheme of the CPI are necessary to account for changes in consumers' behaviour. For example, over time consumers tend to substitute cheaper goods and services for more expensive ones. At the same time, the FSO introduced some methodological changes and corrections. These mainly concern the measurement of rents and the price measurement of package holidays, which are now included in the basket of goods and services with a weight of 19.6% (previously: 21%) and 2.7% (unchanged) respectively.

Weighting Scheme of selected ´ items in % 1

Goods & services	2010	2015
Housing costs (rents, energy, etc.)	31.7	32.5
Transport	13.5	12.9
Leisure	11.5	11.3
Food & beverages	10.3	9.7
Restaurants & hotels	4.5	4.7
Health	4.4	4.6
Clothing	4.5	4.5

Sources Federal Statistical Office, Deutsche Bank Research

Methodological changes and revisions have altogether a dampening effect on headline inflation in 2017 and 2018. As a result of the above mentioned adjustments, Germany's headline CPI inflation rate was revised downward for the past two years, to 1.8% in 2018 (from 1.9%) and to 1.5% (from 1.8%) in 2017. The particularly strong downward adjustment for 2017 was to a significant extent driven by new lower rental inflation. That said, the methodological changes had no effect on Germany's CPI inflation rate in 2016, which was confirmed at 0.5%. In a nutshell, the inflation dampening effect in 2017 and 2018 could be primarily attributed to the new weighting scheme.

While rental inflation remained unchanged at 1.6% in 2018 under the new methodology, it was revised downward to 1.4% (from 1.6) in 2017 and 1.1% (1.2%) in 2016. Given widespread reports about strong rent increases this result looks surprising, at first glance. The downward revisions for 2016 and 2017

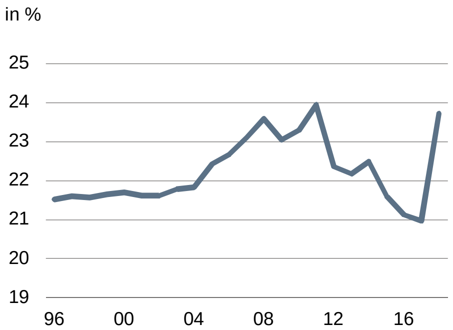
Product weights in % in new and former weighting scheme 2

new	HICP	CPI
Rent	9.5	19.6
Housing	23.7	32.5
Previously	**HICP**	**CPI**
Rent	10.1	21.0
Housing	21.0	31.7

Note: The HICP-weights are adjusted annually while the CPI-weights are adjusted generally every five years.

Sources: Federal Statistical Office, Deutsche Bank Research

Housing costs (rents, energy, ancillary costs) 3



Sources: Federal Statistical Office, Deutsche Bank Research

were related to a new larger rental sample (see our Focus Germany, April 2018), which now gives higher weight to rents for housing provided by individual private landlords (66%). The new weights for rents on housing provided by large private renters as well as residential building cooperatives & public renters – which present the bulk of the old sample – are now 11% and 22%, respectively. As small private landlords often have a more long-term oriented perspective and are reluctant to regularly demand higher rents, it is not surprising that rental inflation was revised lower for the past three years overall.

At the press conference, a new time series was introduced to track the development of rental inflation in metropolises. In the last years, rental inflation in metropolitan areas (Berlin, Düsseldorf, Frankfurt, Hamburg, Cologne, Munich and Stuttgart) was only slightly higher than the country average. This is plausible as many renters are still benefitting from the very low rental level for existing contracts which were signed many years or even decades ago. The FSO only provides a nationwide but no regional weighting schemes. So in the future this could potentially result in an underestimation of actual price developments. In the past, we have hinted at a potential underestimation in particular for Berlin. This is because consumer spending on rents might account for a larger share of income in Berlin than in other German regions and cities.

There are two key differences between the HICP and the CPI: First, the weighting scheme of the HICP is adjusted annually. Second, imputed or estimated rentals for owner-occupied housing are within the scope of the CPI and out of the scope of the HICP, as the harmonized index only refers to monetary transactions. As a consequence, the weight of net cold rents is only 9.5% in 2018 (CPI: 19.6%). However, the development of both indices was similar as the previous weight was 10.4% (CPI: 21%).

The impact on inflation-indexed bonds should be rather small, at least for now. In the future, if the higher market rents potentially increase the future rental inflation, then the new weighting scheme will dampen the measured rental inflation due to the lower weights. For total housing costs (rents plus energy and ancillary costs), the HICP weights increased from 21.6% in 2015 to 23.7% in 2018. The higher weight is particularly caused by ancillary costs whereas the rebound of the energy prices in 2018 played a minor role. All in all, the new weighting schemes changed quite similarly for the CPI and the harmonized European index (HICP).

The sample and methodology to measure the price development of package holidays was also adjusted. First, the sample was increased to roughly 400 package tours (previously: below 300). Second, a more targeted coverage of winter and summer package holidays has resulted in a more pronounced seasonal pattern in the respective price index (i.e. in a wider seasonal price fluctuation) with higher amplitudes in winter/summer months. As a result of the new sample, package holiday inflation was revised higher for 2017 (to 2.4% from 2.2%) and 2018 (to 3.2% from 2.8%) but at the same time lower for 2016 (to -1.6% from -0.8%). The FSO did not provide detailed information on the underlying reasons for the above price revisions (Note: the change in the seasonal pattern should not have an effect on the average rate). Overall, these methodological changes are expected to result in an even stronger seasonal impact on monthly package holidays and also headline inflation (given the relatively large weight of 2.7%). The new inflation data also revealed that the FSO does not measure important inflation differences between prices in stationary and online trade.

Here is our impression of the press conference on Feb 21: Besides our difficulty in fully grasping the impact of revisions on inflation for package holidays, the FSO answered, in our view, not all of our questions, in particular regarding rental inflation. For example, we asked for more granular data on the rental sample, i.e. the regional information for cities and towns included in the new sample is non-public. On a separate note, the FSO was also not aware of the fact that, in the old sample, Mecklenburg-Vorpommern, a rather rural and low-income Bundesland, had the highest rental inflation rate of all Länder in Germany with 2.4% in 2017 (Berlin 1.9%, Germany 1.3%).

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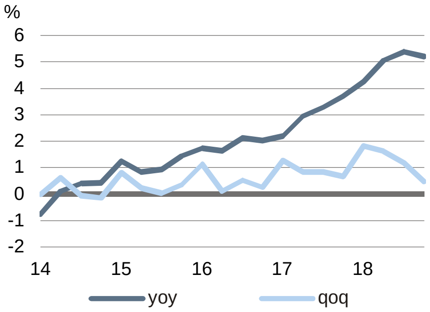
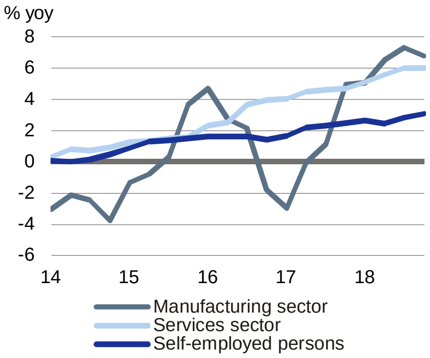
Loans to domestic companies and self-employed persons* 1



* excl. other financial institutions

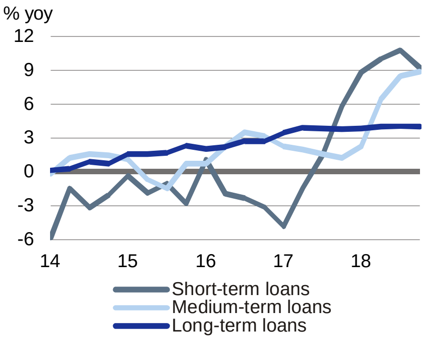
Sources: Deutsche Bundesbank, Deutsche Bank Research

... by industry 2



Sources: Deutsche Bundesbank, Deutsche Bank Research

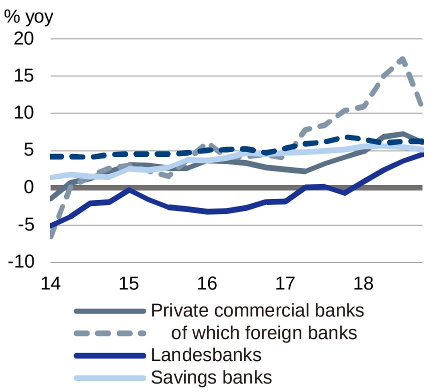
... by maturity* 3



* excl. other financial institutions

Sources: Deutsche Bundesbank, Deutsche Bank Research

... by banking group* 4



* excl. other financial institutions

Sources: Deutsche Bundesbank, Deutsche Bank Research

Corporate lending in Germany: Past the peak

Lending to non-financial companies and self-employed persons in Germany grew rapidly in 2018. Outstanding volumes were up 5.2% yoy, or EUR 65 bn – the highest figure for a full year since the introduction of the euro. At the same time, the credit boom appears to have already peaked. Growth slowed somewhat in Q4, and both banks and businesses are likely to take a more cautious approach to credit in light of the significant slowdown in the economy expected for this year.

The upturn in borrowing was fuelled by a number of industries. Lending to the manufacturing sector grew by 6.8%, with the services sector seeing a 6% rise and self-employed persons a 3.1% increase (there is some overlap). For the latter two sectors, this was the sharpest rise since 1999. Among individual industries, chemicals (+21%), investment companies (+12%) and housing enterprises (+8%) stood out. Only wood/paper/furniture and transport saw a slight decline. At +5½%, the core mechanical engineering and automotive industry was in the middle of the range.

The lion's share of growth came from short- and medium-term lending, each of which saw an increase of 9%. Long-term loans, on the other hand, posted a relatively solid yet unexciting rise of 4%. This indicates that some businesses are focusing more on short-term liquidity, whereas others have already started to feel a slowdown in their business and are looking to compensate for lower profitability by increased borrowing. The factors behind the decline in sentiment included a significant slowdown in the German economy (due not least to a weaker global economy) as well as the intensification of global trade conflicts and the increasing concerns about a potentially chaotic Brexit.

Foreign banks were the banking group with the most dynamic lending in 2018, posting an 11% yoy increase. However, signs of overheating have started to emerge, and loan books even shrank in Q4. Cooperative banks saw a more or less stable increase of 6%, with savings banks reporting a 5% rise. At +4½%, Landesbanks recorded their best result since the financial crisis and a massive improvement compared to 2017. Domestic commercial banks and development banks, including DZ Bank, reported underwhelming performance. Despite a rise in their growth rates, they continued losing market share, with an increase of 3½% and 2% respectively. The biggest question for 2019 is probably whether foreign banks and Landesbanks will be able and willing to keep up their rapid pace of expansion. Certain parallels to the situation seen just over a decade ago are obvious. At the time, these two banking groups recorded particularly high lending growth rates towards the end of the credit cycle only to aggressively back out and scale back in the wake of the financial crisis.

With regard to deposits, inflows from companies and self-employed persons remained rather lacklustre in 2018, despite a slight increase over the course of the year. Outstanding volumes rose 1.6% yoy, or EUR 20 bn. Sight deposits increased by EUR 50 bn, whereas time deposits decreased by EUR 30 bn, indicating a continuing significant substitution effect. Given the high level of corporate deposits, the sluggish momentum was more a healthy normalisation though and also due to the negative interest rates that companies still have to pay to banks. Rates on sight deposits and time deposits, e.g. were negative all year, most recently standing at -3 and -2 bp respectively. On the other hand, lending rates overall fell slightly once again. Most recently, corporations were paying just 2.1% for new small loans with a volume of less than EUR 1 m and 1.2% for larger loans. Non-corporate businesses and self-employed persons paid less than 2% – a new record low. Thanks to such attractive conditions, lending growth is set to slow in 2019, but should remain robust.

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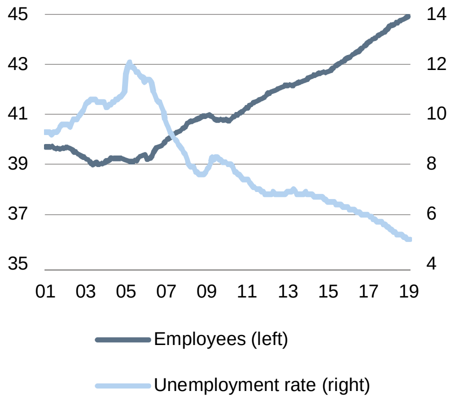
The view from Berlin

German labour market: Ongoing upswing 1

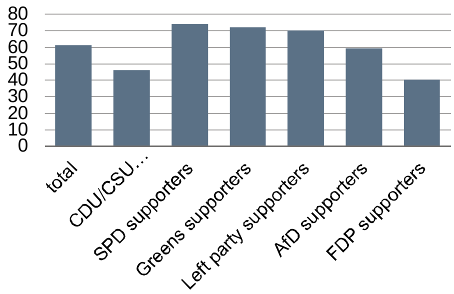
right y-axis: in m
left y-axis: in %



Sources: Federal Employment Agency, Federal Statistical Office

Majority among the Germans in favour of the SPD's basic pension plan 2

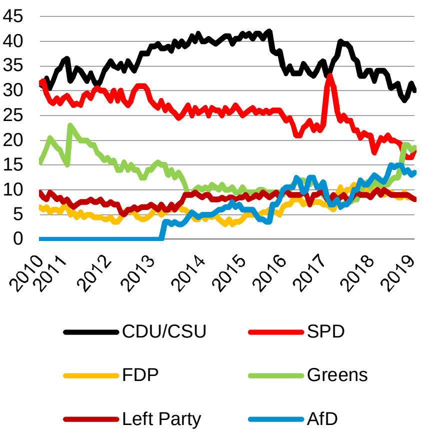
% of those surveyed



Source: Forschungsgruppe Wahlen: ZDF-Politbarometer February I (Feb. 08)

German parties popularity 3

Result of the Allensbach survey, %



Source: IfD Allensbach

Groko parties' image building exercises yield limited success

Given the European election at the end of May and important state elections later on in the year, German parties have started to sharpen their profile. Especially the Groko parties seem to feel the need to dissociate themselves from each other. The SPD tries to attract attention with a strongly leftish social policy stance. The CDU and its new leader Kramp-Karrenbauer want to enhance their standing with a stronger conservative profile including a more restrictive asylum policy. While it is open whether this muscle flexing will leave a lasting imprint on the electorate, the imminent bickering among the parties is likely to spoil the political climate in Berlin further. Nevertheless, it is unlikely that one of the parties will succeed in enforcing its proposals to any extent.

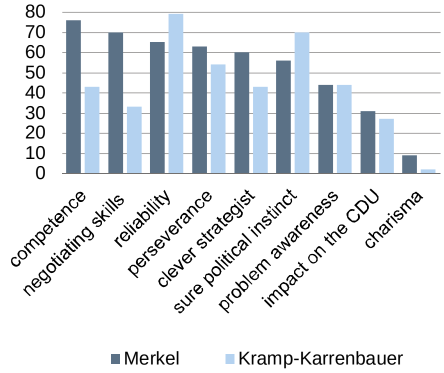
The SPD is eager to turn its back on the reforms of its former Chancellor Schröder. Key elements of its backward somersault are (i) the prolongation of the period for which unemployment benefits are paid from a maximum two to three years (for those aged 58 and above), (ii) the de facto abolishment of the Hartz IV welfare scheme, (iii) a basic pension, and (iv) a marked minimum wage increase (from EUR 9.19 to EUR 12). Regarding the Hartz IV scheme, above all the SPD advocates the abolishment of sanctions, i.e. of cuts in benefits for beneficiaries who (repeatedly) refuse a job offered by the labour agency, albeit this proposal would undermine the scheme's logic (promotion and sanctions). In addition, the SPD will provide (temporary) housing benefits to unemployed largely without a prior means test. The new basic pension shall be granted without such a test, too. Instead, the SPD intends to augment the pensions of all (former) low-wage earners with a working career of 35 years or more so that their pensions shall be markedly above the level of the basic welfare. The SPD has given top priority to its basic pension project, as it would benefit many elder voters especially in eastern Germany where three state elections will be held after the summer recess.

With its U-turn in social policy the SPD seems to ignore the impressive upward trend on the German labour market, i.e. the reduction of the number of unemployed by more than a half since January 2005. According to experts, this is due in no small part to the Hartz IV reform. In contrast the SPD's proposals would reduce incentives to work and perform in the official economy and entail high costs. The basic pensions alone would cost about EUR 5 bn p.a. even in the first years, i.e. without foreseeable side effects like an increase in early retirement.

Despite these shortcomings the SPD's new stance seems to be popular. In a survey from early February 61% of those asked supported the party's concept of a basic pension (see chart). Recently even 71% have welcomed the SPD's intention to strengthen the role of social policy and to spend more on the respective projects (Forschungsgruppe Wahlen: ZDF-Politbarometer Feb. 28). Furthermore, 53% think that in future elections the SPD will benefit from its new stance. Actually, the party's popularity rating has increased by about 2ppt to 17% in the past few weeks. Thus, the SPD has re-approached the Greens' level who have slightly lost to 18%. However, the SPD has still some way to go only to come close to its result of the past federal election in autumn 2017, i.e. to 20.5%, not to speak of its performance in the Schröder area. With its re-orientation the SPD also runs a risk. While the party might be able to regain votes from the Left and the Greens, even more centre voters could turn away leaving things on balance unchanged.

German elites' attitude regarding Merkel's and AKK's competences & strengths 4

% of those surveyed*

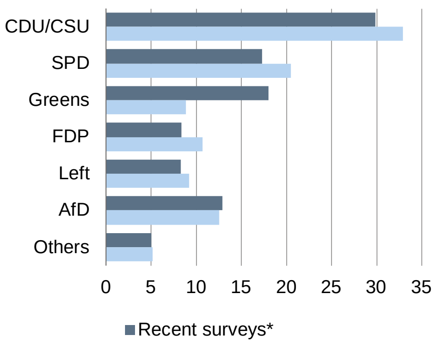


* survey conducted among business leaders, politicians and managers of public authorities

Sources: F.A.Z.-Capital-Elite-Panel, IfD Allensbach

Major political parties' popularity & result of the last federal election 5

%



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

Source: Wahlrecht.de (February 27)

The Greens, following their marked success in the state elections in Hesse and Bavaria last autumn, enjoyed an upswing in the polls on the federal level, too. Besides the popularity of their relatively young new party leaders Annalena Baerbock and Robert Habeck this might reflect a self-enhancing process triggered by these regional successes. In addition, already in the past terms the Greens benefited from a mid-term effect, i.e. the usual weakness of the governing parties at this stage of the term. Notwithstanding their relatively good showing at present, the Greens still lack the profile of a broadly based party. While 70% of their supporters think that the party cares about environmental issues, only minorities associate the Greens with other political goals and competences (IfD Allensbach). According to the Allensbach Institute a remarkably strong media focus on the Greens has also contributed to the party's present strength. Therefore, it seems doubtful whether the Greens would really get about 18% of the votes if elections were held today.

The CDU has promoted different issues recently. The most prominent calls are those (i) for tax relief, especially for corporate Germany, which contrast the SPD's demand for intensified social spending (cf. article on the federal budget), (ii) for a national industry strategy (cf. article above on this subject), and (iii) for a more restrictive asylum policy. Annegret Kramp-Karrenbauer has taken ownership primarily of the latter. She argues for a combination of humanity on the one hand and rigor, regarding deportations e.g., on the other hand. Thus, the new CDU leader tries to attract conservative voters without damaging Chancellor Merkel's reputation. Surveys indicate that AKK acts quite successfully. Together with Angela Merkel and Robert Habeck she ranks second behind Wolfgang Schäuble among Germany's most important politicians (ZDF-Politbarometer Feb. 28). Germany's elites regard her as a competent and highly reliable person (see chart). However, while the CDU's popularity rating has increased in the past months, it has not passed the 30% threshold lastingly.

Therefore, the Groko still misses a majority in the Bundestag, if elections were held today (see chart). But that would be the case for a black-green alliance between the CDU/CSU and the Greens as well. Based on the results of recent polls, only a four party alliance including the FDP would assume a majority to establish a new coalition government. This prospect might help to stabilize the Groko, despite its inherent policy divergence.

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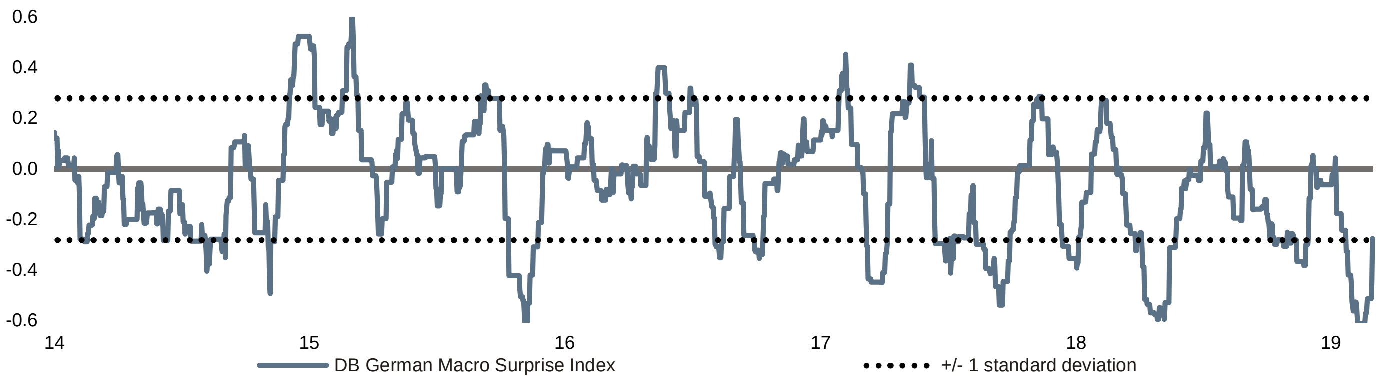
DB German Macro Surprise Index

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 Ticker	Indikator	Berichts-monat	Veröffentlich-ungsdatum	Aktueller Wert	Bloomberg Konsensus	Überra-schung	Standardisierte Überraschung	Quantils-rang
GRFRIAMM Index	Einzelhandelsumsätze (% gg. Vm.)	12 2018	31.01.2019	-3.1	-0.6	-2.5	0.0	0.1
GRUECHNG Index	Veränderung Arbeitslose (Tsd. gg. Vm.)	1 2019	31.01.2019	-2.0	-10.0	-8.0	-0.5	0.2
MPMIDEMA Index	PMI Verarbeitendes Gewerbe	1 2019	01.02.2019	49.7	49.9	-0.2	-0.2	0.3
MPMIDESA Index	PMI Dienstleistungssektor	1 2019	05.02.2019	53.0	53.1	-0.1	-0.1	0.4
GRIORTMM Index	Auftragseingänge (% gg. Vm.)	12 2018	06.02.2019	-1.6	0.3	-1.9	-0.9	0.1
GRIPIMOM Index	Industrieproduktion (% gg. Vm.)	12 2018	07.02.2019	-0.4	0.8	-1.2	-0.9	0.1
GRTBALE Index	Handelsbilanz (EUR Mrd.)	12 2018	08.02.2019	14.3	16.5	-2.2	-1.0	0.2
GRBTEXMM Index	Exporte (% gg. Vm.)	12 2018	08.02.2019	1.5	0.4	1.1	0.5	0.7
GRCAEU Index	Leistungsbilanzsaldo (EUR Mrd.)	12 2018	08.02.2019	21.0	23.3	-2.3	-1.0	0.1
GRBTIMMM Index	Importe (% gg. Vm.)	12 2018	08.02.2019	0.7	0.5	0.2	0.1	0.5
GRZEWI Index	ZEW - Konjunktur (Erwartungen)	2 2019	19.02.2019	-13.4	-13.6	0.2	0.1	0.5
GRZECURR Index	ZEW - Konjunktur (Situation)	2 2019	19.02.2019	15.0	20.0	-5.0	-0.8	0.1
GRCP20YY Index	VPI (% gg. Vj.)	1 2019	21.02.2019	1.4	1.4	0.0	0.4	0.4
MPMIDEMA Index	PMI Verarbeitendes Gewerbe	2 2019	21.02.2019	47.6	47.6	0.0	0.0	0.4
MPMIDESA Index	PMI Dienstleistungssektor	2 2019	21.02.2019	55.1	55.1	0.0	0.0	0.5
GRIFPBUS Index	ifo Geschäftsklimaindex	2 2019	22.02.2019	98.5	98.9	-0.4	-0.6	0.2
GRGDPPGQ Index	BIP (% gg. Vq.)	12 2018	22.02.2019	0.0	0.0	0.0	-0.2	0.3
GRIMP95Y Index	Importpreise (% gg. Vj.)	1 2019	28.02.2019	0.8	1.2	-0.4	-0.7	0.2
GRCP20YY Index	VPI (% gg. Vj.)	2 2019	28.02.2019	1.6	1.5	0.1	1.0	0.8
GRFRIAMM Index	Einzelhandelsumsätze (% gg. Vm.)	1 2019	01.03.2019	3.3	2.0	1.3	1.3	0.9

Quellen: Bloomberg Finance LP, Deutsche Bank Research

Updated by Sebastian Becker and Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)
Source: Heiko Peters (2014). DB German Macro Surprise Index. Focus Germany, 4 August 2014.

Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
8 Mar 2019	8:00	New orders manufacturing (% mom, sa)	January	0.7	-1.6
11 Mar 2019	8:00	Industrial production (% mom, sa)	January	0.5	0.2
11 Mar 2019	8:00	Trade balance (EUR bn, sa)	January	18.8	19.9
11 Mar 2019	8:00	Merchandise exports (% mom, sa)	January	-0.5	1.5
11 Mar 2019	8:00	Merchandise imports (% mom, sa)	January	0.0	0.7
22 Mar 2019	9:30	Manufacturing PMI (Flash)	March	49.0	47.6
22 Mar 2019	9:30	Services PMI (Flash)	March	54.0	55.1
25 Mar 2019	10:00	ifo business climate (Index, sa)	March	99.0	98.5
28 Mar 2019	14:00	Consumer prices preliminary (% yoy, nsa)	March	1.6	1.4
29 Mar 2019	8:00	Retail sales (% mom, sa)*	February	0.6	3.3
29 Mar 2019	9:55	Unemployment rate (%, sa)	March	5.0	5.0

*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

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

The German economy's Achilles heel

German data monitor

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Sep 2018	Oct 2018	Nov 2018	Dec 2018	Jan 2019	Feb 2019
Business surveys and output											
Aggregate											
Ifo business climate	104.2	102.6	103.3	102.1		103.9	103.0	102.2	101.1	99.3	98.5
Ifo business expectations	100.7	98.8	100.1	98.6		100.8	99.8	98.7	97.3	94.3	93.8
Industry											
Ifo manufacturing	107.9	105.1	104.6	101.6		104.7	102.6	101.8	100.5	98.8	97.8
Headline IP (% pop)	0.1	0.3	-1.6	-1.4		-0.1	-0.5	-1.5	0.2		
Orders (% pop)	-2.5	-1.4	-1.0	0.3		-0.1	0.3	-0.2	-1.6		
Capacity Utilisation	88.2	87.8	87.8	87.1	86.3						
Construction											
Output (% pop)	1.3	5.8	-0.1	-1.0		4.1	-2.0	-0.9	-1.3		
Orders (% pop)	0.7	-5.2	0.7	11.3		3.7	0.4	6.1	13.2		
Ifo construction	110.3	111.6	116.6	116.8		117.7	118.0	116.3	116.2	111.6	110.6
Consumer demand											
EC consumer survey	0.7	-1.1	-1.5	-1.5		-0.7	-1.1	-1.1	-2.3	-2.3	-2.2
Retail sales (% pop)	-0.3	1.2	-0.5	0.2		-0.2	0.4	1.6	-3.1	3.3	
New car reg. (% yoy)	4.0	1.9	1.2	-8.1		-30.5	-7.4	-9.9	-6.7	-1.4	
Foreign sector											
Foreign orders (% pop)	-2.6	-1.4	-2.3	1.3		-1.9	3.1	-2.3	-2.3		
Exports (% pop)	-0.4	1.0	-0.2	1.0		-0.4	0.9	-0.3	1.5		
Imports (% pop)	0.5	2.1	2.3	-0.2		0.7	0.8	-1.3	0.7		
Net trade (sa EUR bn)	61.9	59.6	52.7	56.6		17.6	17.9	18.9	19.9		
Labour market											
Unemployment rate (%)	5.4	5.2	5.2	5.0		5.1	5.1	5.0	5.0	5.0	5.0
Change in unemployment (k)	-68.7	-37.3	-36.3	-46.3		-23.0	-12.0	-16.0	-15.0	-4.0	-21.0
Employment (% yoy)	1.4	1.3	1.2	1.1		1.2	1.2	1.1	1.1	1.1	
Ifo employment barometer	104.9	103.9	104.8	104.2		105.0	104.8	103.7	104.2	103.0	102.9
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.5	2.0	2.2	2.2		2.2	2.6	2.2	1.7	1.7	
Core HICP (% yoy)	1.4	1.3	1.4	1.4		1.4	1.8	1.1	1.2	1.7	
Harmonised PPI (% yoy)	2.0	2.6									
Commodities, ex. Energy (% yoy)	-12.4	2.6	-0.5	-0.3		-2.1	1.5	-0.1	-2.2	-2.3	
Crude oil, Brent (USD/bbl)	66.9	74.5	75.1	68.0		78.9	81.0	64.7	56.5	59.4	64.1
Inflation expectations											
EC household survey	16.4	17.3	21.4	21.5		21.5	21.5	21.2	21.9	20.1	19.1
EC industrial survey	15.0	13.8	15.8	17.6		16.5	14.4	17.3	21.1	18.9	13.0
Unit labour cost (% yoy)											
Unit labour cost	2.5	1.7	3.4	2.7							
Compensation	2.8	2.9	3.5	2.8							
Hourly labour costs	3.5	1.6	3.0	2.0							
Money (% yoy)											
M3	3.4	3.6	4.1	4.5		4.1	4.5	4.4	4.5	4.0	
M3 trend (3m cma)						3.6	3.8	4.0	4.3	4.5	4.3
Credit - private	4.3	4.3	4.3	3.9		4.3	4.1	3.8	3.9		
Credit - public	-20.0	-7.0	-2.7	-6.2		-2.7	-6.7	-6.4	-6.2		

% pop = % change this period over previous period.
Source: Deutsche Bundesbank, European Commission, Eurostat, Federal Employment Agency, German Federal Statistical Office, HWWI, ifo, IHS Markit

The German economy's Achilles heel

Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	2.375	-0.10	0.00	0.75	-0.75	-0.25	0.05	0.75	1.50	0.15	1.75
Mar 19	2.375	-0.10	0.00	0.75	-0.75	-0.25	0.05	1.00	1.50	0.20	1.75
Jun 19	2.375	-0.10	0.00	0.75	-0.75	-0.25	0.05	1.00	1.50	0.35	2.00
Sep 19	2.625	-0.10	0.00	1.00	-0.75	-0.25	0.05	1.00	1.50	0.25	2.00
3M interest rates, %											
Current	2.63	0.03	-0.31	0.85							
Mar 19	2.93	0.05	-0.33	0.88							
Jun 19	3.18	0.05	-0.33	1.00							
Sep 19	3.43	0.05	-0.30	1.13							
10Y government bonds yields, %											
Current	2.72	-0.02	0.18	1.31							
Mar 19	2.90	0.00	0.13	1.55							
Jun 19	2.95	0.05	0.20	1.65							
Sep 19	2.95	0.05	0.35	1.70							
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	1.14	110.89	0.86	1.33	1.13	10.55	7.46	9.73	4.32	315.96	25.60
Mar 19	1.16	106.00	0.82	1.42	1.13	10.40		9.35	4.30	317.52	25.65
Jun 19	1.18	104.00	0.80	1.48	1.13	10.50		9.20	4.35	320.00	25.60
Sep 19	1.22	102.00	0.82	1.49	1.14	10.65		9.25	4.35	322.50	25.45

Sources: Bloomberg Finance LP, Deutsche Bank Research

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