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A looming black-green coalition: Painful compromises needed

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The view from Berlin: CDU and SPD try to avoid the Groko's breakdown and their decline. The Groko parties are labouring to come out of their rut. The CDU tries to dissipate doubts about its party leader's standing and to cope with controversial climate policy issues. The SPD struggles to overcome its leadership crisis. Both partners have removed obstacles for a Groko continuation. However, the bumpy process of the nomination of the EU COM-President has caused new irritations. The result of the upcoming state elections in East Germany could decide on the Groko's fate.

A black-green coalition: Painful compromises would be necessary. In case of a snap election in Germany, a CDU/CSU-Greens coalition could be an option. Given both camps' radically different political positions in many areas, such a coalition would require both to make significant compromises. A black-green government would need to direct its focus and its available financial resources to climate protection and the energy transition. Corporates and consumers would have to bear considerable costs. This also spells a dilemma for fiscal policy. A larger share of government spending would necessarily have to be allocated to providing subsidies and mitigating the social impact of a quicker energy transition. Citizens and corporates cannot hope for major tax relief.

German goods exports: Political uncertainties weighing on outlook. We estimate structural bilateral export equations for key markets: the euro area, the US, the UK, and China. Our models include GDP growth and changes in FX rates. Other factors, such as the realignment of US trade policy and Brexit, are factored in, via these macro variables.

German industry. We now expect manufacturing output to shrink by 1.5% in 2019 (previously 0%), due to the persistent weakness of sentiment indicators, which reflect the general economic slowdown and the dampening effects of the trade conflicts or the Brexit. The loss in industrial production may be recouped in 2020.

Labour market still robust, but external downturn is leaving its mark. A review of the placement status of persons entitled to ALG II provided a sharp boost to s.a. unemployment. The special effect is also likely to drive up unemployment in July. Later this year, after the effect tapered off, we do not expect unemployment to decline again, as supported by the leading labour market indicators and given the slowdown in the German economy.

German automotive business cycle. Sentiment indicators in the German automotive industry declined again of late since global car demand remains weak. We expect a recovery in domestic automotive production in yoy terms in H2 2019, as the WLTP effect pushed down the basis for comparison during H2 2018.

A looming black-green coalition: Painful compromises needed

Economic forecasts

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

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

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

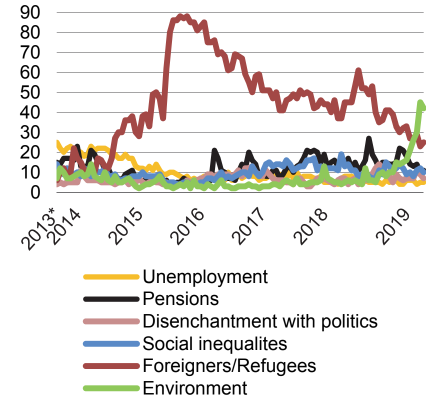
					2019				2020			
	2017	2018	2019F	2020F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	2.2	1.4	0.7	1.2	0.4	0.0	0.1	0.3	0.2	0.3	0.2	0.3
Private consumption	1.8	1.1	1.7	1.0	1.2	0.0	0.2	0.2	0.3	0.3	0.3	0.3
Gov't expenditure	1.6	1.0	1.3	1.4	-0.3	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Fixed investment	2.9	2.6	2.6	2.6	1.1	0.2	0.5	0.6	0.6	0.3	0.4	0.4
Investment in M&E	3.7	4.2	1.9	1.8	1.2	0.0	0.0	0.5	0.3	0.0	0.0	0.3
Construction	2.9	2.4	4.7	3.6	1.9	0.5	0.8	0.8	0.8	0.7	0.7	0.7
Inventories, pp	0.1	0.5	-0.7	-0.1	-0.6	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0
Exports	4.6	2.0	2.1	2.0	1.0	0.5	0.5	0.6	0.2	0.2	0.2	0.2
Imports	4.8	3.3	3.3	2.4	0.7	0.7	0.7	0.7	0.3	0.3	0.3	0.3
Net exports, pp	0.2	-0.4	-0.4	0.0	0.2	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Consumer prices*	1.7	1.9	1.7	1.4								
Unemployment rate, %	5.7	5.2	5.0	4.9								
Industrial production**	2.9	1.1	-1.5	1.5								
Budget balance, % GDP	1.0	1.7	0.8	0.5								
Public debt, % GDP	64.5	60.9	58.3	56.0								
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 view from Berlin

Most important problems in Germany 1

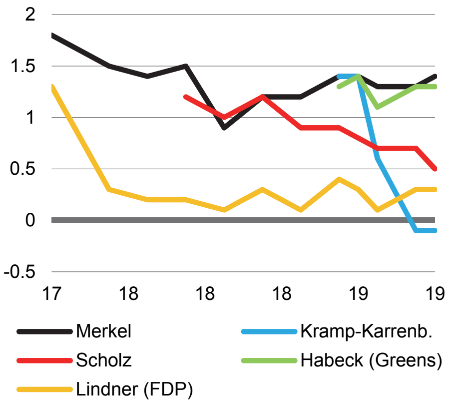
Max. 2 answers, percentage of those asked, %



* From the federal election (September 22) onwards
Source: Forschungsgruppe Wahlen: ZDF Politbarometer

Major politicians' approval ratings 2

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



Source: Forschungsgruppe Wahlen, ZDF-Politbarometer, June 22

CDU and SPD try to avoid the Groko's breakdown and their decline

Following their poor results in EP elections in late May and the turbulences afterwards, especially in the SPD where party leader Nahles resigned, the Groko parties are labouring to come out of their rut. The CDU tries to dissipate doubts about party leader Annegret Kramp-Karrenbauer's (AKK) authority and standing within the party and beyond and to cope with controversial issues, especially with regard to climate policy. Interacting with media promotion, successful grass-root initiatives (Fridays for Future) and the Greens' recent ascent, the latter topic has taken centre stage and become the most-important political issue for the Germans, according to recent surveys (Forschungsgruppe Wahlen). The SPD's interim leadership trio tries to lick the party's wounds by demonstrating unanimity and to overcome the crisis that resulted from the series of state-election defeats and the lack of stable leadership structures (14 different leaders over the past 30 years). Above all, the trio has to organise the membership ballot on the next party leader or leaders' duo. In addition, the ministers from Merkel's government, the party whips, and other leading MPs from the SPD as well as the CDU and the CSU seek to enhance the Groko's public image.

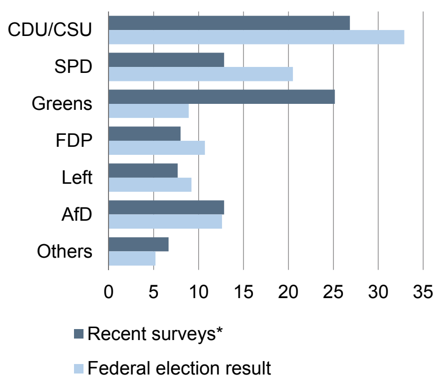
Nevertheless, uncertainty and nervousness are likely to dominate the political scene in Germany in the next few months, given the three state elections in East Germany on September 1 and October 27 and the prospect of further defeats for the CDU and above all the SPD. Commentators rightly deem these elections as a stress test for the Groko. Very poor SPD results, in particular, would substantially increase the risk of a breakup of Merkel's government before year-end, as these results would obviously enhance the chances for outspoken Groko opponents to win the membership ballot and thus to be elected as new party leader(s) by the delegates at the party convention on December 6 to 7. Such a new party leadership would most likely use the revision clause in the coalition treaty to push for the SPD's exit of the government. In this scenario, we expect snap elections in spring 2020. Albeit the polls for the respective states indicate such a scenario, it is not a foregone conclusion, given the CDU and SPD grandees' recent endeavour to stabilise the Groko.

At present, however, there a few signs for a change in public sentiment. In the polls the CDU is still markedly below 30%, the Greens rank 2nd at about 25 to 26% and the SPD seems to be stuck at historically low levels (about 13%) neck and neck to the AfD (about 13%, too). While Robert Habeck (Greens) has managed to become the most-popular politician besides Angela Merkel, AKK has been faced with low popularity ratings in recent weeks. According to polls, only a minority of the Germans think she is the right person to become the next chancellor. Therefore, the media speculated whether she would be an appropriate CDU/CSU frontrunner for a future election campaign. CDU grandees have rejected such reasoning as irrelevant stating the present government's term ends in autumn 2021, only. Thus, the grandees also backed Chancellor Merkel, who has repeatedly stated to stay in office until this date.

Merkel continues to focus on Germany's international relations as well as on European issues. On the sidelines of the recent Osaka G20 summit Merkel together with European Council President Donald Tusk as well as the French president and the Spanish PM tried to arrange outlines for the personnel decision at the recent EU leaders' summit in Brussels. However, the plan to nominate the Dutch Commissioner Frans Timmermans for President of the

Major political parties' popularity & result of the last federal election 3

%

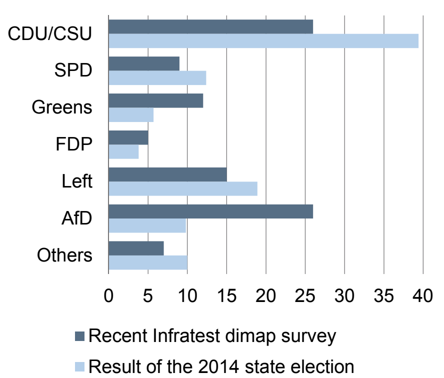


* Average of major recent surveys (Allensbach, Emnid, Forsa, Forschungsgruppe Wahlen, Infratest dimap, INSA)

Source: Wahlrecht.de, July 3,2019

Saxony: political parties' popularity & result of the last state election 4

%



Source: Infratest dimap, July 1, 2019

European Commission – a proposal the SPD appreciated very much – failed. Instead the Council nominated the German defence Minister Ursula von der Leyen (CDU). Merkel herself had to abstain from voting for her confidante. This was due to the fact that the SPD did not accept von der Leyen as the German government's official candidate. The argument was that she failed the SPD's criteria according to which the new EC President should be elected among the recent EP election campaign's top candidates. In turn AKK and the Bavarian PM Söder (CSU) harshly criticized the SPD for discrediting Germany's interests and international standing. So Merkel could not present a solution to the complex personnel issues in Brussels appreciated by all parties involved – at home and in Brussels.

Besides Merkel and AKK, Ralph Brinkhaus, the party whip in the Bundestag, has emerged as another power centre within the CDU. A few weeks ago he demonstrated his independence when he surprisingly refrained from the CDU's demand for a complete abolishment of the income-tax surcharge with AKK and others being forced to follow suit. Previously, this request seemed to be a key issue for the conservatives. But it also was a no-go for the SPD and therefore a stumbling block for a Groko continuation.

The Groko's fate rests with the SPD. Recently, the Social Democrats, too, signalled more leeway for compromise regarding their pet project, namely, to grant low-wage earners (after a working career of at least 35 years) a basic pension without a means test, although such a test is stipulated in the coalition treaty and still strongly requested by the CDU/CSU. Over the last weekend, Hubertus Heil (SPD), the Minister for Labour and Social Affairs, stated the eligibility conditions for the planned basic pension are open to discussions within the government coalition. This past week FM Scholz presented his draft budget for 2020 and the medium-term budget plan. The latter, especially, could hardly please the CDU. Despite subdued prospects for German economic growth, the plan is based on a balanced budget in line with the CDU/CSU's wishes, but it provides for intensified social spending partially at the cost of the defence spending, which will not be increased sustainably contrary to the CDU/CSU's request and promises Germany made to its allies in the NATO. The SPD also insists on a climate protection act which shall stipulate greenhouse gas-emission reductions for individual industries such as agriculture, manufacturing, or transportation. In addition, the SPD advocates a carbon tax. Such a tax as well as some of the SPD's proposals for intensified climate protection measures are debated among the CDU/CSU. For example, CDU-grandees criticised the Bavarian PM Söder when he proposed to end Germany's coal-based power generation by 2030 already, ignoring a governmental commission's recent compromise on 2038 as the appropriate date. However, the climate policy, which has not been among the Groko parties' pet projects, so far, will hardly derail Merkel's government.

The major risk for the Groko are severe defeats in the upcoming state elections. Such defeats would intensify the anti-Groko stance among the SPD just in a sensible period when the contest for the new party leadership is running. The candidates and teams (duos) who will participate in the contest will have to submit their application by September 1. Afterwards, they will present themselves to the party members all over Germany at several regional conferences scheduled from early September to mid-October. The membership ballot will then be held from October 14 to 25. On October 26, i.e., on the eve of the state election in Thuringia (on Oct. 27), the ballot results will be revealed. (If no candidate or team gets more than 50% of the votes, a run-off will be held.) If the members then vote for an outspoken left-wing new leadership, this will most likely also prejudice the SPD's planned Groko mid-term review. (At present it is still open how this review will be organised, i.e., who will participate and finally decide.) Therefore, poor SPD results in the upcoming East German elections could in the end trigger a collapse of Merkel’s government coalition, notwithstanding the SPD MPs’ and ministers’ conflicting interests.

We stick to our view that snap elections are the most-likely scenario in case of a Groko breakup. According to recent polls a coalition among the CDU/CSU and the Greens would be a feasible outcome of such an election. Together, the three parties would get the necessary majority of seats in the Bundestag, while from the present point of view the most-debated alternative, namely a red-red-green (i.e., SPD-Left Party-Greens) alliance, would miss the majority. However, the formation of a CDU/CSU-Greens coalition would be difficult, given both camps' different stances with regard to major political issues (see article “A black-green coalition: Painful compromises would be necessary” in this issue).

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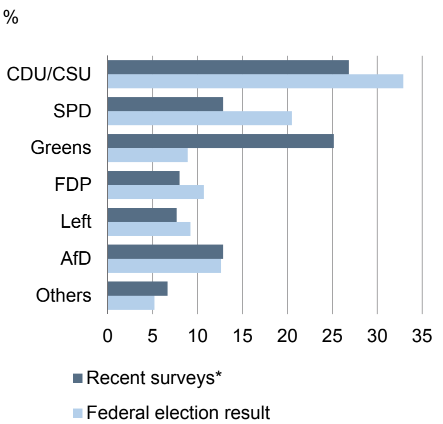
A black-green coalition: Painful compromises would be necessary

— In case of a snap election in Germany, a “black-green” coalition consisting of the CDU/CSU and the Greens could be an option at the federal level. Even though some observers believe the two parties pursue rather similar goals in some important areas of policy, such a coalition would require both sides to make significant compromises. In fact, their political positions are radically different in many areas, such as tax and social policy, European policy, climate and energy policy, defence policy, and migration policy.

— Our observations go to show just how strongly a black-green government would need to direct its focus and its available financial resources to climate protection and the energy transition if these issues are to get top priority. Corporates and consumers would have to bear considerable costs. This applies particularly if energy and climate protection policy relies heavily on state intervention instead of market-based instruments. In this case, business and consumers would probably see their options limited, too – a development that might have an impact on growth forces as well. The introduction of basic benefits would raise costs, too.

— This spells a dilemma for fiscal policy. Tax and contributions revenues are unlikely to keep up with the high additional financial needs. A larger share of government spending would necessarily have to be allocated to providing subsidies and mitigating the social impact of a quicker energy transition on the one hand and to the significant revamp of the social security system on the other. It might be difficult to find a cross-party compromise for a reliable funding of these expenses. If the coalition partners also intend to spend more money on education and training, citizens and corporates cannot hope for major tax relief.

Major political parties' popularity & result of the last federal election 1



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

Source: Wahlrecht.de, July 3,2019

Since Andrea Nahles’ decision to step down as party and parliamentary group leader of the SPD, observers have speculated about snap elections in Germany. While both the CDU/CSU and the SPD have repeatedly said they were willing to continue with the grand coalition, their alliance has become more fragile. Both parties wish to sharpen their political profiles, and that desire will only increase after their significant losses at the European elections and in view of weak poll results. As a result, inter-coalition conflicts are likely to continue.

At the same time, the Greens have become quite popular among the electorate. The figures suggest that a “black-green” coalition consisting of the CDU/CSU and the Greens might be an option after new elections. In fact, according to the latest polls, it is not even sure which of the two would gain a majority of the vote, so a “green-black” coalition seems possible, too. Even though some observers believe the two parties pursue rather similar goals in some important areas of policy, such a coalition would require both sides to make significant compromises. In fact, their political positions are radically different in many areas, such as tax and social policy, European policy, climate and energy policy, defence policy, and migration policy.

While we believe the two parties might be able to agree on common principles and positions in these areas of policy, too, the necessary willingness to find a compromise may alienate or at least irritate some of their voters.

While state-level coalitions between the CDU and the Greens are working quite smoothly and successfully, numerous areas of policy, which are key for the country’s economic development and where the potential for conflicts is particularly large, are the responsibility of the federal government. A black-green coalition at the federal level would be something completely new. For this reason, any forecasts about the effects of such an alliance on the economy are subject to particular uncertainties.

This article will focus on potential compromises in the areas of tax and social policy, European policy and climate and energy policy and try to explain how these agreements might change the economic framework conditions and structures. We will also discuss areas where the positions of the two parties are so far apart that compromises appear difficult.

Tax and social policy: Moving in fundamentally different directions

The CDU/CSU and the Greens support clearly different concepts in the fields of tax and social policy, from suggestions for individual measures to core goals of political action. The Greens aim to use both policy areas to realise their idea of how society should function. “Justice” is a key word in their tax-policy proposals (“for a more-just distribution of prosperity”), and they attach top priority to family and social policy goals. Economic policy considerations, such as better incentives for investment beyond projects with an immediate ecological thrust, are largely absent from the Green agenda.

The CDU/CSU’s position is quite different. In contrast to what was said ahead of the latest Bundestag elections, leading CDU/CSU politicians are now clearly calling for corporate tax rate cuts, not least in response to the recent bout of international competition for investment and jobs, which was triggered by the US tax reform that entered into force at the end of 2017. This is in line with the demand for a complete abolition of the solidarity surcharge on income and corporate taxes (a demand which recently the CDU has suspended to stabilize the Groko, but which is still among the party’s objectives). After all, income tax is equivalent to corporate tax for a large number of business partnerships in Germany.

From the Greens’ vantage point, international tax competition is not necessarily a reason to reduce domestic corporate tax rates. Instead, they aim to crack down on options which allow to avoid or circumvent taxes. With this in mind, they support better cooperation at the international and European level and better resources for the German tax authorities. In addition, the Greens demand a “revenue-based tax on digital companies”. This is an idea which the CDU/CSU rejects.

Recently, the Greens have presented the idea of a climate fund, whose set-up would be a particular fiscal challenge. According to the plans, the fund is to have a size of EUR 100 bn (almost 3% of GDP). This amount is to be financed by a mix of cuts to subsidies (for agriculture, diesel and kerosene etc), not providing tax relief (keeping the solidarity surcharge) and taking on new debt. Many aspects of these proposals obviously run counter to the CDU/CSU’s current policies. In the spirit of compromise, the size of the fund might be reduced, and a large part of it might be financed by higher taxes on energy and/or carbon emissions (see below).

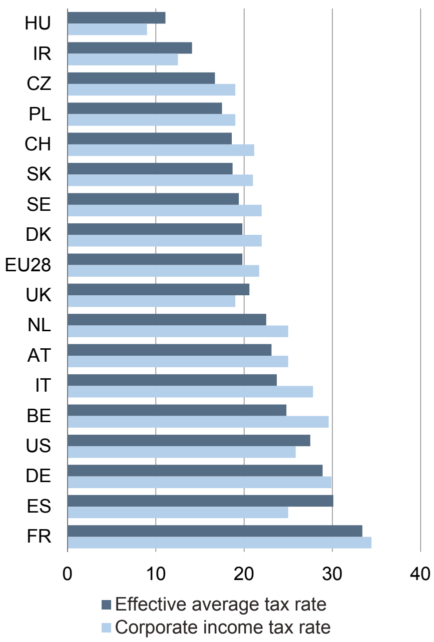
There are fundamental differences in social policy, too. The Greens have proposed a “guaranteed income”, which is similar to a basic income but will depend on people’s wealth and needs. This is a major step away from the traditional German social-security system. In contrast, the CDU, and particularly its leader Annegret Kramp-Karrenbauer believe reciprocity, as manifested by the principle of equivalence in the social security system, is a core element of social policy.

Still, these fundamental differences do not mean that the two parties cannot find common ground in other areas or on individual issues. Both parties emphasise (just like all other parties) that education will become ever more important as a means to provide equal opportunities, ensure social mobility and secure overall prosperity. In the area of education policy, the parties might disagree on how to take into account the fact that education is one of the responsibilities of the federal states. The Greens are sceptical about this division of competences.

Sufficient corporate tax relief seems unlikely

Corporate tax rates 2

2018, %



Sources: OECD, ZEW Mannheim

In the area of taxation, the two parties should be able to agree on (further) relief for small and medium incomes and for families. In fact, larger corrections to the income-tax system, especially the tax scale, should be sufficient to reach these targets, and in particular the CDU/CSU's goal of abolishing the solidarity surcharge. However, it might be quite difficult to find a compromise if the CDU/CSU continues to reject the Greens' call for tax hikes for higher income earners and if the Greens want to keep the solidarity surcharge. In addition, the Greens are calling for abolishing tax breaks for childless (married) couples. This might be a difficult issue, too. Right now, it is unclear whether a black-green government could agree on cutting corporate tax rates beyond measures to promote research and development or innovation (above all in ecological and climate-friendly technologies). The Greens' current focus is on the taxation of digital business models. As part of a black-green federal government, the party would probably call for quicker action and finding solutions at the international or – at least – the European level.

The CDU, and in particular the CSU, is unlikely to give way to recent Green demands to increase taxes on "wealth", which would probably lead to changes to the inheritance tax (recently, there have not been any calls for a wealth tax). However, the CDU/CSU might consider the Greens' plans to abolish the withholding tax on dividend payments and equity sales gains, even though there are good reasons for keeping the current regime. From our vantage point, the withholding tax is easy to administer and handle and prevents the excessive taxation of dividends

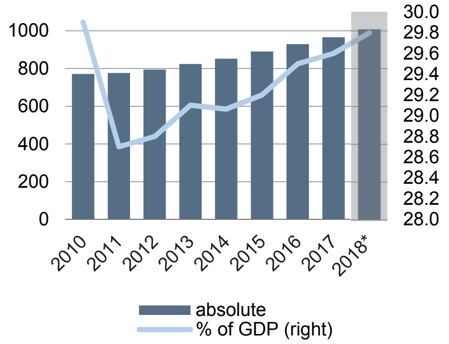
Greens are calling for a radical change to the social-security system, which CDU/CSU rejects

The Greens are calling for several major changes to the social-security system, which the CDU/CSU will find difficult to stomach. Within the grand coalition, the CDU/CSU has rejected similar demands by the SPD and even refused to consider introducing new systems. This is true for the idea of a guaranteed (minimum) pension for long-term contributors to the system (regardless of their actual financial situation), for a basic guaranteed income for children and for a uniform ("citizens") healthcare insurance system. Whether the CDU/CSU could continue to refuse such ideas would mainly depend on the balance of power in a new coalition, i.e., the share of the vote the Greens gain in the elections. Even though discussions about far-reaching reforms might take longer, it may be possible to make necessary adjustments to the system, for example in the area of social benefit payments (in the Hartz IV scheme long-term unemployed with children have insufficient incentives to seek a job).

A looming black-green coalition: Painful compromises needed

Increasing welfare spending 3

EUR bn (left-hand scale), % of GDP (right-hand)

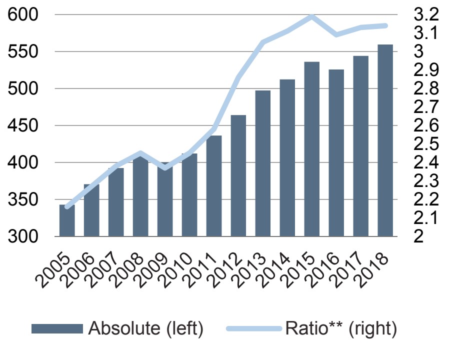


* estimate

Sources: BMAS, Federal Statistical Office, Deutsche Bank Research

Welfare recipients among older people* 4

Absolute number of recipients in '000 (left scale), percentage share among all 65+* (right scale)

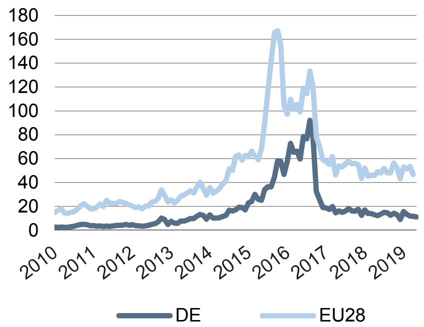


* People at retirementment age (2019: 65.66 years) and older
** From 2012 onwards rough calculations only, from 2015 onwards bias due to massive immigration

Sources: Federal Statistical Office, Deutsche Bank

DE and the EU: numbers of asylum applicants at relatively low levels now 5

First time applicants*, monthly data, '000



* Especially the German figures for 2015 to 2017 reflect the immigration of refugees only with delay,

Source: Eurostat

Still, a more sustainable pension system seems likely

In contrast to the grand coalition, however, a black-green coalition may introduce more sustainability to the pension system. It would be unlikely to continue the grand coalition's mistake of hacking away at the pension reforms adopted at the beginning of this century, which aimed to make the pension system sustainable in the long run. Instead, it might make the transition from work to retirement (even) more flexible. In addition, it could strengthen funded pension schemes. For example, the black-green government in Hesse has prepared a proposal for a supplementary, private-sector-based pension system, which might, in a modified version (i.e., without a state fund as standard provider), give a necessary additional boost to capital market based old-age provision.

CDU/CSU and Greens – almost antipodes in their EU approach

While the CDU/CSU and the Greens share a clearly positive stance towards the EU and the EMU, both camps differ on their ideas how the process of European integration shall be stabilised and subsequently promoted against the background of major challenges within Europe and abroad. In its campaign for the recent European elections the CDU/CSU has frequently stressed its strong commitment to the EU and its institutions. But this commitment appeared to be rather defensive and status quo oriented with slogans such as "For Germany's future. Our Europe" and it displayed a lack of appetite to push for changes despite the unresolved current debates over euro-area stability, defence capacities, or migration. The reluctance to discuss a vision for future European reforms can also be read from CDU leader Kramp-Karrenbauer's response earlier this year to French President Macron's agenda for Europe. While Macron has repeatedly stressed the need to defend Western/European values against populist anti-EU forces, the CDU leader suggested the elections should be about "getting Europe right" and adapt to the contest of systems with China and the US.

In contrast the Greens advocate a strong integrationist approach to the EU. They propose a deepening of the economic, monetary, and social union and demand more action on climate change and European foreign policy. The Greens back (in Germany) highly controversial issues such as EDIS, a euro-area budget reaching 1% of EU GDP over the medium-term, a common fiscal policy with a double hat for the EU Commissioner for Economy and Finance and the Eurogroup chair and an EU-wide unemployment reinsurance system. With these positions the Greens are closer to Macron's ideas than to Germany's traditional alleys, the Netherlands and some Nordic countries. They are rather restrictive on business-related topics such as the plea for a harmonized corporate tax, enforcement on climate targets or minimum wages.

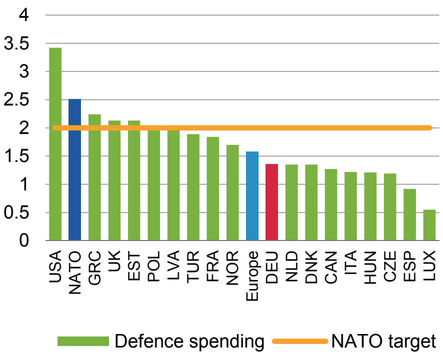
Migration, integration, and refugees: Virtually worlds apart

A liberal immigration and asylum policy stance is part of the Greens' DNA. The party has supported Chancellor Merkel's original asylum policy and emphatically criticised her government's policy shift towards a more-restrictive approach. In the Bundesrat (upper house) the Greens have repeatedly blocked the Federal Government's initiative to declare the Maghreb countries as safe countries of origin and thus to make it easier to send people from there back home. In addition, the Greens call for non-bureaucratic opportunities for family reunification, and they refuse the monthly contingent of 1,000 persons established by the Groko. Further differences exist regarding the citizenship law, among others. The Greens want to make the procedures for naturalisation easier and faster, and they want to give a German passport to all children born in Germany. In contrast, the CDU/CSU argues for a more-restrictive handling of the dual-citizenship regulations. All in all, the CDU/CSU seems to be eager not to become vulnerable for AfD attacks. However, as long as the number of asylum seekers in Germany remains at the past months' relatively low level, all these differences will hardly be a stumbling block for a CDU/CSU-Greens alliance. This might also be deduced from the Greens' recent behaviour in the Bundesrat, when they agreed on the Groko's immigration act for skilled personnel, although they had repeatedly demanded a more-comprehensive immigration law based on a point system.

Defence policy: Not an issue to make or break a coalition

Most EU countries continue to miss NATO defence spending target 6

Defence spending (2019 est.), % of GDP



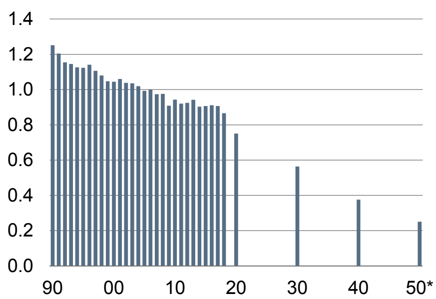
Source: NATO

In contrast to the CDU/CSU, the Greens clearly reject the goal of raising defence expenditure to 2% of GDP in the medium term (from expected 1.36% in 2019). But also the medium-term financial planning of the current government coalition of CDU/CSU and SPD might fail reaching the already downscaled objective of 1.5% of GDP by 2024. Based on the planning, defence expenditures could even fall back to just above 1.2% until 2023. Both Greens and CDU/CSU support European efforts for stronger cooperation on security and defence in the framework of the Permanent Structured Cooperation (PESCO), while the Greens focus stronger on opportunities for cost saving and strengthening capabilities for civilian security cooperation. They reject shifting funds in the next EU multi-year budget from civilian budget lines to defence spending and have a critical view of the European Defence Fund. In addition, they take a much more-restrictive stance on military exports than the CDU/CSU. Nevertheless, defence policy is certainly not an issue to make or break a coalition.

Climate and energy policy: A minefield

Ambitious climate targets 7

Greenhouse gas emissions in Germany, CO_2 equivalent (billion tonnes)



* Federal government target for reduction of greenhouse gas emissions by 2050: at least -80% relative to 1990

Sources: Federal Environment Agency, Deutsche Bank Research

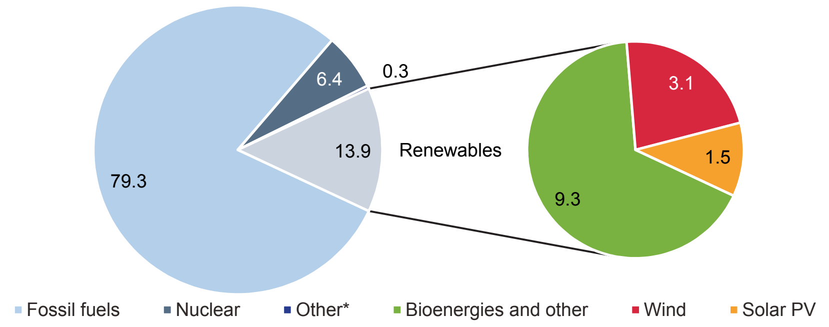
In principle, both the CDU/CSU and the Greens have committed themselves to the German climate policy targets and the Paris Climate Agreement. Germany officially aims to reduce its greenhouse gas emissions by 80-95% compared to 1990 by 2050. In order to enable our readers to fully understand the climate debate, we would like to explain just how ambitious this goal is. Between 1990 and 2018 (i.e., including the German unification effects), German greenhouse gas emissions declined by an average 1.3% per year. In order to achieve a reduction by "only" 80% by 2050, emissions will have to be slashed by an average 3.8% per year.

These figures show that high-performance, reliable, and cost-effective carbon-free sources of energy are required for heating, mobility, and electricity production. Policymakers prefer and support mainly wind power and photovoltaics so far. However, these sources of energy do not meet the criteria listed above – at least not up to now. In 2018, their share in Germany's total primary energy consumption was less than 5%. The public discussion focuses on the electricity sector, where the share of renewables already amounted to 35% of gross electricity generation in 2018. However, this is only a small piece of the overall picture; progress in terms of energy transition (not only electricity) is much slower. Electricity's share in total final energy consumption in Germany amounts only to c. 20%.

Unless new technologies are developed and broadly used, Germany's long-term climate goals will require a major shift away from established consumption patterns and production processes. This will lead to higher prices for energy and considerable restrictions to households' and corporates' options, ownership rights and standard of living. A discussion about sacrifices would be inevitable. So far, however, there have been only vague hints about this issue.

Fossil fuels prevail – bioenergy is the mainstay of renewables 8

Share of energy sources in total primary energy demand in Germany, 2018, %



* Minus electricity exchange balance

Source: AG Energiebilanzen

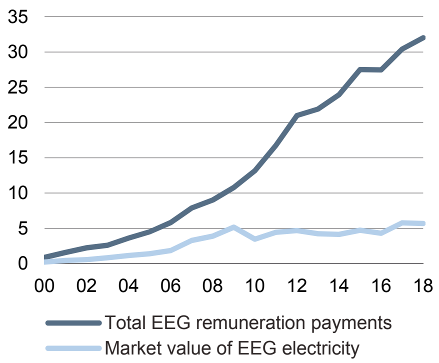
These preliminary remarks are necessary because the German public climate debate sometimes gives the impression that climate protection goals are almost within reach and that only minor "finishing touches" are necessary, which will not have a significant impact on either households or corporates. This is not the case.

The energy transition goals are numerous, and even though Germany looks to miss more and more of them, the goals as such have not come under discussion as of yet. Back in 2016, we already stated in our report on the German energy transition that Germany had taken on too much in too short a time.[1] This assessment has not changed.

Climate protection policy: Different challenges for government and opposition parties

The gap is widening 9

Total EEG remuneration payments and market value of EEG electricity in Germany, EUR bn



Source: BMWi

Climate protection policy currently presents different challenges for the CDU/CSU and the Greens. Being in government, the CDU/CSU has to face several facts: climate protection always comes at a cost, has implications for social and competition policy, and often meets with resistance (such as citizens' initiatives against wind-power plants or against the expansion of the electricity grid). These facts slow down progress, and there are no easy solutions. From an economic vantage point, the federal government certainly does not pay enough attention to the efficiency of its climate protection tools. Of course, some instruments, such as the Renewable Energy Act, are a legacy of its predecessors.

Opposition parties, such as the Greens, are in a better position. They can call for more climate protection without having to go into detail about the financial burden on citizens and companies, about actual regulatory measures or about the funding of climate protection measures. However, the Greens are providing more and more details about their concept. Since climate change is an important (and sales-generating) topic in the German media and since numerous citizens are getting more and more concerned about the negative impact of climate change, the opposition can successfully challenge the

[1] See Heymann, Eric (2016). German Energiewende: Many targets out of sight. Deutsche Bank Research. Germany Monitor. Frankfurt am Main.

government on this issue, as the latest election results and polls have confirmed.

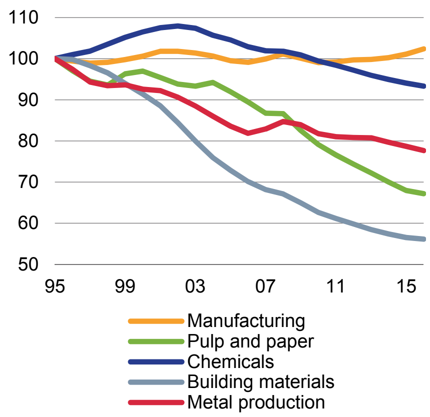
Black-green climate protection policy: Several different scenarios possible

Several different scenarios for a black-green climate protection policy and its consequences for households and corporates are imaginable. From our vantage point, there are two major influencing factors: first, the type of climate policy instruments that are used, and second, the goals themselves.

The actual scenarios depend on the details of the influencing factors. For example, a black-green federal government might rely on (a small number of) market-based instruments, such as a carbon tax or emissions trading. Or it might use command and control legislation (i.e. define certain requirements, bans or quotas) and offer technology-specific subsidies. Turning to climate protection goals, a black-green government might stick to the existing goals and adapt them to the actual development; in this case, the German goals would be embedded in EU climate policy. Or Germany (governed, for example, by a Green chancellor) might even step up the national climate protection goals.

Real net fixed assets decline in energy-intensive sectors 10

Real net fixed assets in individual German industrial sectors, 1995=100



Source: Federal Statistical Office

Depending on the actual characteristics of the influencing factors, we have developed four scenarios. The individual effects are not easy to quantify, and it is not possible to distinguish clearly between the scenarios. A scenario which relies mainly on regulatory tools and uses more ambitious climate protection goals would result in the biggest burdens for households and companies. Compared to market-based instruments, command-and-control legislation has the disadvantage that it becomes unnecessarily expensive to reach the goals.[2] In order to take an international lead, Germany would have to intensify its efforts in comparison to other EU countries. In all probability, energy-intensive sectors would be affected most. The real capital stock in these sectors has been declining for years now. Sectors with high transport expenses would have to shoulder higher burdens, too, as would households. At the same time, there would be subsidies for sectors and climate-friendly technologies that, in policymakers' opinion, should receive support. Excluding compensation payments, low-income households would have to bear a larger burden than high-income households. While the latter consume more energy in absolute terms, energy and mobility expenses take up a smaller share of their total incomes, and their willingness and ability to pay is higher.

From our vantage point, the most-probable scenario is that a black-green federal government sticks to the current climate protection goals (which are ambitious anyway) and uses regulatory tools and subsidies to reach them. A more market-based mix seems improbable because, for example, an extension of the EU emissions-trading scheme to other sectors would require a decision at the EU level – and such a development is not in sight. Focussing on regulatory law and subsidies would continue to make German climate protection policies unnecessarily expensive.

Room for a black-green agreement

In principle, we believe the CDU/CSU and the Greens may agree on some symbolic issues. For example, a black-green coalition might decide on abandoning coal as a source of energy more quickly. The Greens demanded an exit from coal by 2030 in their election programme for the Bundestag elections in 2017. While the compromise on abandoning coal as a source of energy by 2038 is quite recent and was reached after difficult negotiations, it would be

2 See Heymann, Eric (2019). Carbon tax: Better than the status quo, but not the optimal solution. Deutsche Bank Research. Talking Point. Frankfurt am Main.

possible to engineer the transition some years earlier. In all probability, the affected regions would need to receive more compensation than agreed so far. As wind power and photovoltaics are not reliable sources of electricity and cheap, high-performance storage technology for the industry is not available yet, Germany would probably need more gas-power plants as a replacement for the coal plants. However, investors in gas-power plants would have to shoulder considerable risks, as the plants' utilisation and profitability will come under pressure when wind power and photovoltaics are increasingly used.[3]

A black-green coalition might also agree on a national carbon tax. While the CDU/CSU have not yet formulated a uniform position on this issue, the Greens have proposed a carbon tax of EUR 40/ton. Assuming an average of ten tons of greenhouse gas emissions per capita (carbon equivalents), this would – on average – amount to additional taxes of EUR 400 for every person living in Germany (before potential compensation). While rebates would reduce the burden, they would also increase administrative expenses and reduce the steering effect of the tax, as private households would be free to use the money for carbon-intensive activities (such as mobility). Moreover, this idea of simply shifting money around is based on a concept of government which will meet with some resistance from the conservative-liberal wing of the CDU/CSU at least. If a black-green federal government introduced a carbon tax, social-policy and economic considerations would probably keep the tax rate below the EUR 40 per ton demanded by the Greens, at least at the beginning.

How detailed will the programmes for the next elections be?

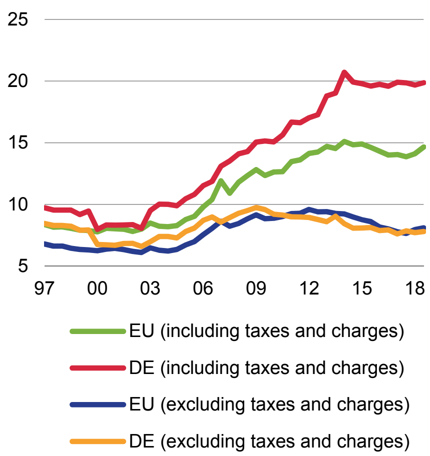
It is unclear whether the CDU/CSU's and the Greens' programmes for the next Bundestag elections will contain concrete climate and energy-policy proposals, and it is even less clear just how many details would make it into a coalition agreement. Moreover, Green government participation will not change anything about the fact that carbon emissions cannot be reduced without putting a burden on households and corporates in some way. There are simply no easy answers to a number of practical climate policy challenges. It is therefore quite uncertain just what a black-green compromise on any of these issues might look like. Here are a few examples:

— Germany has formulated numerous concrete ecological goals in the framework of the energy transition. Economic goals, however, are quite vague or non-existent. Policymakers typically state that energy has to remain "affordable" but remain quite vague about just what they mean by that term. It remains to be seen whether a black-green federal government would pay more attention to the economic aspects of climate protection or the energy transition. It might, for example, introduce a cap on subsidies for low-carbon technologies or set a maximum limit on the percentage of the electricity price which consists of taxes and fees. Of course, the actual limits would be a topic for negotiation.

— So far, there are no satisfactory solutions to the problem of rising systemic costs in the electricity sector. While, encouragingly, production costs for renewable energy and, in turn, subsidy needs per kilowatt hour are declining, overcapacities in the electricity sector are steadily increasing and driving costs up. Moreover, there are additional expenses for expanding and monitoring the grid and for more-frequent periods in which excessive power is produced which cannot be consumed. Will these costs remain borne by a surcharge on electricity prices? Or would a black-green government include the expenses of the energy transition in the federal budget and discuss

Taxes and charges are the main drivers of electricty prices in Germany 11

Electricity price for industrial customers*, cents per kilowatt hour



* Annual electriicity consumption. between 500 and 2.000 MWh

Source: Eurostat

3 See Auer, Josef and Eric Heymann (2019). Steady decline in capacity utilisation in the German electricity sector. Deutsche Bank Research. Talking Point. Frankfurt am Main.

every year in parliament whether the money should be spent on these or other budget items?

— It is unclear how a black-green federal government would deal with local resistance to the grid expansion or the installation of new wind-power plants. Should approval procedures be changed in a way that resistance can be more easily crushed?

— As renewables play a larger role in the overall power mix, the question of how surplus energy is to be stored gains importance. As we have explained above, there are no cheap, high-performance storage technologies for the industry in sight. Will a new subsidy regime emerge?

— One of the biggest challenges in the area of climate protection policy is making the existing buildings largely climate-neutral by 2050. Which instruments should be used to drive energetic refurbishment or a transition to renewable energies in heating? Subsidies? That would be quite expensive. Command-and-control law, i.e., strict energy requirements or bans? That might result in political difficulties and disproportionate expenses for many homeowners. Moreover, with qualified construction labour lacking, it might simply be impossible to fulfil this Herculean task.

— Looking at the transport sector, it is unclear which climate policy instruments should be used. Would a black-green government hike fuel taxes, and if so, by how much? What about commuters who need their car to get to work? Would subsidies for e-mobility be raised once again even though electric cars are by no means emission-free? And what would happen if most people continued to buy traditional cars? Would a black-green government be content with fines for carmakers if the latter do not meet the EU's average carbon limits for new cars? Or would it take additional measures?

— Which tools would be used in the area of heavy road transport? Would the government extend and increase the road toll for lorries? Would it subsidise alternative technologies or raise fuel and vehicle taxes? Or would it take regulatory measures to reduce road transports (for example temporary driving bans)? How would a black-green government deal with the emissions of construction machinery, which run mainly on diesel?

— How is the steady increase in air traffic to be dealt with? Would a black-green government introduce a kerosene tax or raise air travel taxes? Would it introduce caps on air travel? Or would it be content to stick to internationally agreed instruments to allow a carbon-neutral increase in air traffic?

— How would a black-green federal government deal with competition aspects of climate protection policy? Would it continue to provide exemptions to energy-intensive industries, for example under the Renewable Energy Act, to reduce carbon and investment leakage? Or would these exemptions be abolished or reduced? How should process-related carbon emissions be treated which are a by-product of the production of certain outputs, such as cement or other construction materials?

— Which measures would a black-green government take to reduce agricultural greenhouse gas emissions? Would it introduce a tax on meat or animal farming? How would it treat the emissions of agricultural machinery?

And this list of open questions is far from complete. Still, it shows just how difficult it might be for the CDU/CSU and the Greens to find political compromises and reduce German carbon emissions to the planned extent. Moreover, it underlines that the implementation of the ambitious climate protection goals will lead to major changes in all areas of life and companies' value creation chains as well as redistributions.

It is highly unclear which expenses and changes to consumption and production patterns households and corporates would be willing to accept for the purpose of reducing greenhouse gas emissions. Sacrifices are inevitable, at least for as long as no new technologies are developed. People's willingness to make sacrifices and bear costs will depend to a large extent on what happens in other countries.

It seems likely the Green electorate of urban, high-income households and younger voters, who have not yet amassed much personal property, is more willing to make sacrifices. However, this is not necessarily clear. In contrast, the CDU/CSU's traditional electorate consists of rural medium- and low-income earners who would suffer considerably if, for example, mobility became more expensive (commuters). This means that the CDU/CSU stands to lose more voters by agreeing to black-green compromises in the area of climate protection policy.

Conclusion and outlook

Our observations go to show just how strongly a black-green government would need to direct its focus and its available financial resources to climate protection and the energy transition if these issues are to get top priority and to be implemented with the smallest possible compromises, in line with the demands of the Greens and other protagonists in the field. Corporates and consumers would be highly affected as well and have to bear considerable costs. This applies particularly if energy and climate protection policy relies heavily on state intervention instead of market-based instruments. In this case, business and consumers would probably see their options limited, too – a development which might have an impact on growth forces as well. In fact, this scenario implies that Germany goes it alone and that domestic companies lose part of their international competitiveness, at least in the beginning. Only part of the related slowdown in growth momentum will be offset by a better outlook for suppliers of climate and environmentally friendly technologies. The introduction of basic benefits (Greens: guaranteed income and basic income for children) would raise costs, too.

This spells a dilemma for fiscal policy. Tax and contributions revenues are unlikely to keep up with the high additional financial needs. A larger share of government spending would necessarily have to be allocated to providing subsidies and mitigating the social impact of a quicker energy transition on the one hand and to the significant revamp of the social security system on the other. It might be difficult to find a cross-party compromise for a reliable funding of these expenses. If the coalition partners also intend to spend more money on education and training, citizens and corporates cannot hope for major tax relief – not even if a black-green government was willing to give up the goal of a balanced budget, which has been quite important so far. While the EU partners should tend to welcome a more-expansionary German fiscal policy, major changes to European policy are unlikely.

Whether the scenario developed in this article materialises will depend considerably on the strength of the Greens in a potential black-green coalition. The European elections and the polls of the last few weeks suggest the CDU/CSU's lead would be relatively small, at least in terms of seats in parliament. As the Bundestag elections of 2013 have shown, it is improbable the Greens benefit from a left-wing tax programme in the elections. If there were no black-green majority, the alternative to the current grand coalition would be "Jamaica 2.0" – quite a difficult endeavour.

Overall, there is a large number of potential breaking points for a black-green coalition. Some of these relate to the cores of the political "brands" of the potential partners and cannot be resolved by rhetorical compromises or clever timing. Depending on the actual results, however, both parties would probably face the facts and take responsibility for the state as a whole, particularly since both have proved willing to undergo the experiment in times of an increasing fragmentation of the political landscape, which makes finding a compromise more difficult. Still, looking at political concepts, purely “left-wing” coalitions (red-red-green) appear easier, as recent developments in Bremen have shown. Whether such a coalition emerges after the next Bundestag elections or only after a potentially dissonant black-green experiment is unclear.

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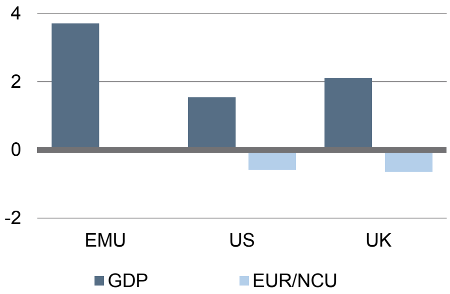
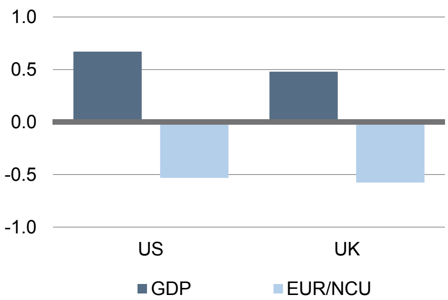
Bilateral export elasticities relative to GDP and exchange rate 1



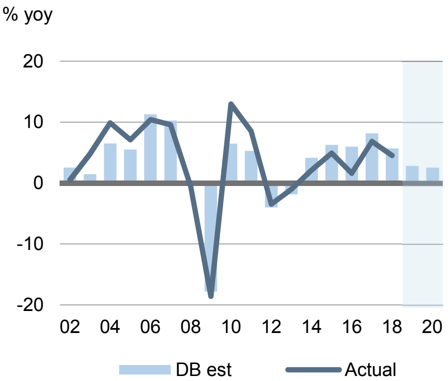
Source: Deutsche Bank Research

Bilateral standardized export elasticities relative to GDP and exchange rate 2



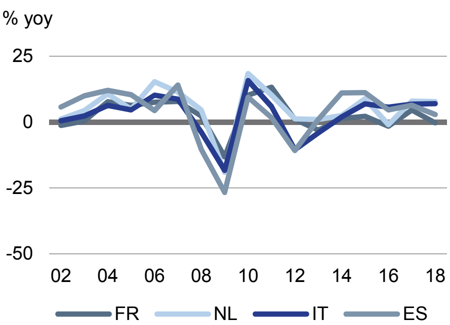
Source: Deutsche Bank Research

Euro area 3



Source: Deutsche Bank Research

High parallelism of EMU exports 4



Source: Deutsche Bank Research

German goods exports: Political uncertainties weighing on outlook

— We expect German exports to inch up by roughly 2% in 2019 and 2020, somewhat less sharply than the structural export models presented in this article suggest. In the face of heightened global uncertainties, however, these estimates (4% in 2019 and 2.5% in 2020) may to some extent exaggerate the actual expansion.

— We estimate structural bilateral export equations for the key export markets: the euro area, the US, the UK and China. Our models include GDP growth and changes in FX rates. Other factors such as the realignment of US trade policy, but also Brexit, are only indirectly factored in, via moves in the above macro variables.

— The regressions outlined in this article are based on annual data of the past 20 years. Including variables such as global trade growth, crude oil inflation, but also idiosyncratic economic variables, does not improve the accuracy of the estimates. In our view, the beneficial effect of quarterly data and error correction models is only marginal (for further details see appendix).

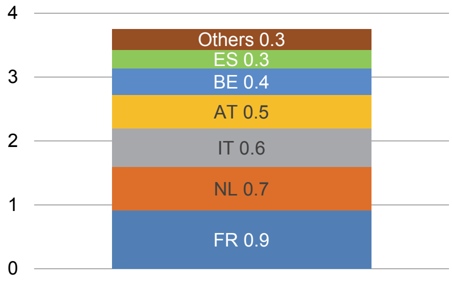
— Bilateral nominal exports in the euro area are modelled exclusively on the basis of euro-area GDP growth, with a 1 pp rise in EMU GDP implying an increase of over 3 pp in German exports (elasticity).

— When estimating German exports to the US and the UK, we also factor in changes in FX rates, alongside GDP growth. For the US dollar and the pound sterling, the elasticities are approximately -0.6. A rise in the euro by 1 pp, as a consequence, shaves 0.6 pp off export growth to the US or the UK. These elasticities are extraordinarily robust.

— At around 2, the elasticity of UK GDP is equally robust. For the US, on the other hand, GDP elasticity is highly volatile, depending on which specification is selected. Elasticities are particularly high when using simple linear regressions, whereas quantile regressions and ridge regressions used in AI research imply much-lower values. Given the realignment of US trade policy, we prefer the lower elasticities of around 1 ½.

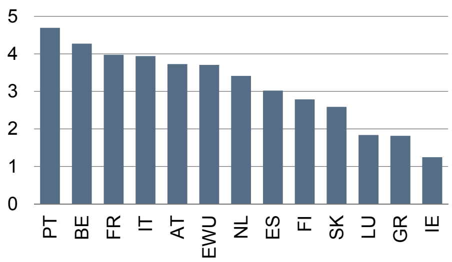
— The standard approach of using GDP growth and FX to model German goods exports to China does not work. We, for instance, do not find any significant correlation with Chinese GDP growth, and moves in the renminbi also seem to play only a subordinate role. In our view, the best proxy model is based on Korean GDP growth and Chinese rail freight transport. When we apply the identical regression to exports from the euro area ex Germany to China, the signs and values of the coefficients are very similar.

Export elasticity relative to GDP to the euro area 5



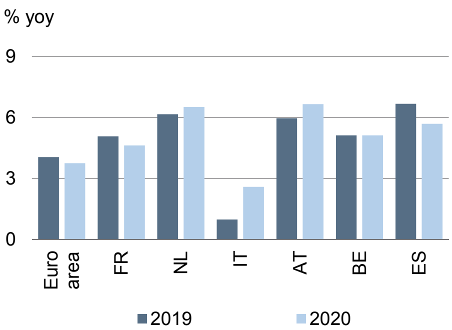
Source: Deutsche Bank Research

German exports to european countries: Bilateral elasticities relative to GDP 6



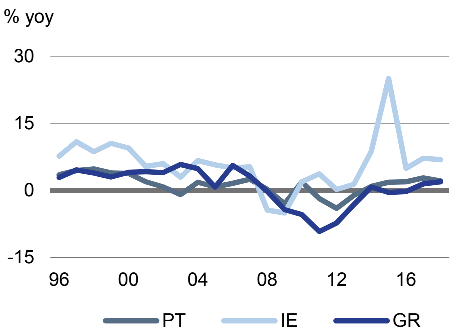
Source: Deutsche Bank Research

Germany: Exports to EMU 7



Source: Deutsche Bank Research

Germany: exports to... 8



Sources: Deutsche Bank Research, Federal Statistical Office

German goods in high demand around the world – high global diversification

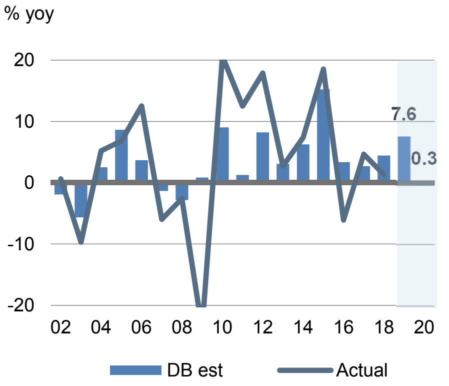
In this article, we analyse key drivers of German nominal goods exports and forecast export growth for 2019 and 2020. German goods are in high demand in many countries, with global diversification likely to rise further, particularly due to stronger demand from the emerging markets. For instance, goods exports to the US, the major destination of German exports (excluding the euro area as a whole), account for less than 10% of total goods exports, and this share has been declining further of late. At only 37%, the combined weight of the top 5 German export markets was more or less unchanged for two decades in 2018. When explaining FX, the standard approach in the literature refers to demand and price effects. The key determinant of German exports is economic activity in the importing countries, usually measured by means of GDP growth. For China, however, we used a proxy model, as the standard approach is lacking statistical significance. From a statistical perspective, the demand component is partially better reflected by other indicators. The price component is captured by nominal changes in FX rates. Following the Brexit vote, for instance, aggregated annual German exports to the UK slipped by about 8% between 2015 and 2018, which can largely be traced to the sterling's depreciation of up to 20% since June 2016.

Euro-area exports: High GDP elasticity, but heterogeneous trend in the individual euro countries

To explain exports to the euro area, we regress annual growth of nominal German exports to the euro area in the period from 2001 to 2018 on real GDP growth in the euro area. According to this regression, a 1 pp increase in EMU GDP growth adds 3.7% to German exports. This elasticity is relatively robust. The export elasticity is more or less unchanged, if euro-area GDP is adjusted for Germany and, when using different estimation methods resp. periods, the effect is also marginal. Moreover, estimates based on quarterly data also confirm the elasticity of over 3. In addition, we ran a search for the euro-area countries that helps to explain Germany's exports to the euro area in the best possible manner. In statistical terms, French GDP growth – unsurprisingly – dominates German exports to the euro area as a whole. Accordingly, the bivariate regression of German export growth on French GDP growth has similar economic and statistical properties (coefficient, t-value, R^2, no autoregression[4]) to the regression on aggregate GDP growth in the euro area. In the past, at least, Germany and France were wielding the baton in the euro area, in political, but also in economic terms. What is surprising, however, is the lack of relative importance of other euro countries for German export growth in a multivariate context, which points to a high degree of cyclical synchronisation across the euro area. However, this correlation is not reflected in export growth, nor is it mirrored in export elasticities by countries. Relative to GDP growth of the euro countries, the elasticities vary strongly, particularly for the small countries, where export elasticities are both at the lower and the upper end. GDP growth in Ireland, for example, boosts export growth to these countries by a factor of under 2, compared with an export elasticity of nearly 5 for Portugal, the key reason probably being the less-dynamic restructuring of the economy during the crisis years. In Ireland, on the other hand, the transformation process proceeded at a much-faster pace, sharply pushing up GDP growth. Low Irish export elasticities hence had a high relative effect.

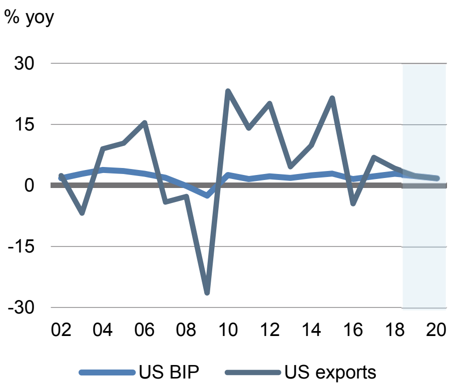
[4] Based on Durbin Watson statistic.

Exports to US 9



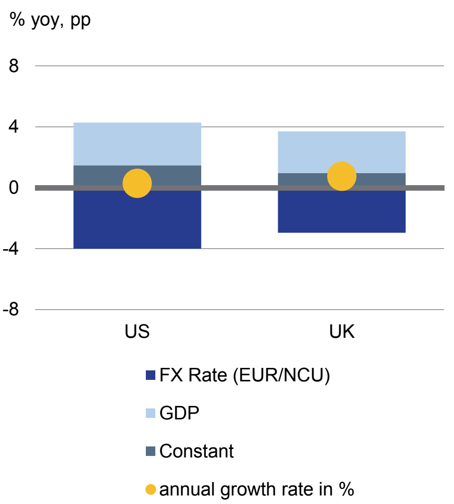
Source: Deutsche Bank Research

German exports to US vs. US GDP growth 10



Source: Deutsche Bank Research

2020 Germany: Bilateral exports to US and UK 11



Source: Deutsche Bank Research

Six countries account for 90% of aggregate German exports to EMU, including the neighbouring countries Austria, Belgium, and the Netherlands, along with the large economies France, Italy, and Spain. Based on our export elasticity estimates and our GDP forecasts, German exports to Spain, Austria, and the Netherlands would edge up by roughly 6% p.a. in 2019 and 2020. At just 5%, exports to France and Belgium look set to rise somewhat less dynamically in the same period, followed by Italy, with only around 1% growth for 2019 and roughly 3% for 2020. In the past decade, Germany has been particularly hard hit by the slowdown in Italy. Already, Italy has fallen behind in the ranking of Germany's key export markets and is now taking 6th rank. If the Italian economy had grown at the same rate as the euro area as a whole in the past ten years, it would now be Germany's third-largest export market, after the US and France. Assuming the malaise continues, Italy could also be overtaken by Austria and Poland (currently rank 7 and 8) within the next five years.

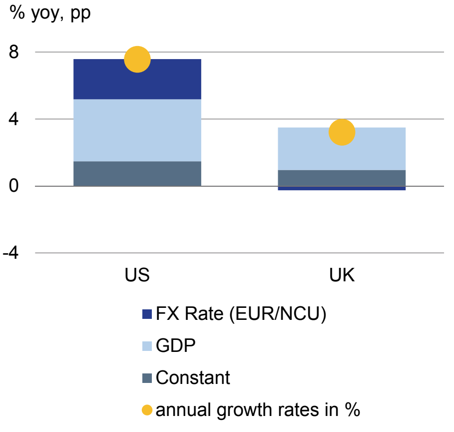
Based on the export elasticities for the euro area as a whole, we also compute export growth by means of our current GDP forecasts. For 2019 and 2020, we expect exports to the euro to rise by just under 3% p.a., which would be roughly in line with average growth since 2012.

Goods exports to the US: Euro appreciation in 2020 posing a risk

Exports to the US are primarily driven by US dynamics and the EUR/USD exchange rate. Given FX elasticity of around -0.6, every 1 pp appreciation of the EUR would reduce US demand for German products by 0.6 pp. While this elasticity is very robust across different specifications and models, the elasticity of GDP growth is a different story. At around 5, values are particularly high in simple linear regressions (OLS). Quantile regressions, which give less weight to outliers than simple regressions, point to values of 3 ½, and ridge regressions used in AI research, which reduce overfitting effects, imply an elasticity of roughly 1 ½. Even though structural elasticity could be around 3 in the ultra-long term, it is likely to be lower at present, given the realignment of US trade policy – at least, if the new policy approach is regarded as a non-temporary phenomenon. We therefore assume an elasticity of around 1 ½ for the upcoming years. A 1 pp increase in US growth would hence add roughly 1.5 pp to German exports to the US. Pointing to an increase of 4.4% – compared with an actual expansion of 1.3% – this model overstated actual growth of German goods exports to the US by approximately 3 pp in 2018. In the past five years, however, annual goods exports were on average understated by around 1 pp. Based on this model and the forecasts of our US colleagues, German exports to the US would soar by 7.6% in 2019. For 2020, their expectation of a year-over-year rise in the EUR/USD exchange rate of nearly 7% points to quasi-stagnation, which means that German exports to the US would inch up by just 0.3%. When assuming a stable EUR/USD exchange rate, our estimates imply an increase of 4.3% for 2020.

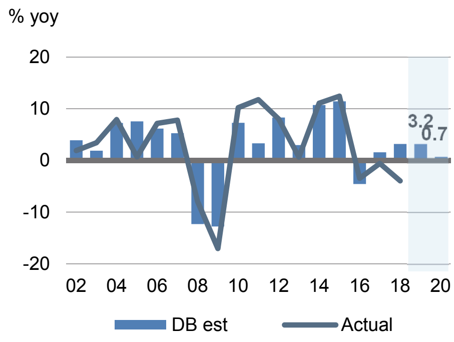
Sterling appreciation in 2019 could stimulate goods exports to the UK

The elasticity of export growth is around 2 with respect to British GDP growth, and -0.6 with respect to the EUR/GBP exchange rate. The inclusion of a Brexit variable of 1 following June 2016 and 0 previously, is – as expected – slightly negative, but insignificant. On balance, our estimate on the basis of GDP and FX is relatively robust. Hence, the decline in exports to the UK can be fully explained by the slowdown in UK growth and, in particular, the depreciation of sterling. For 2019, we reckon with GDP growth of 1.2% for the UK and a slight move lower in GBP of roughly 0.4% versus EUR. If our assumptions are correct, 2019 Germany: Bilateral exports to US and UK 12



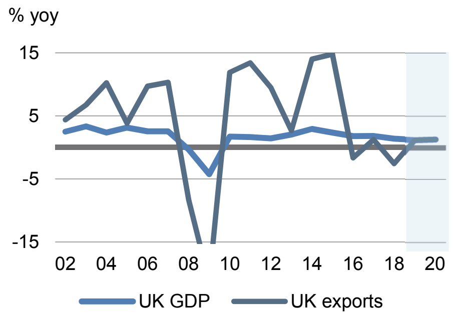
Source: Deutsche Bank Research

Exports to UK 13



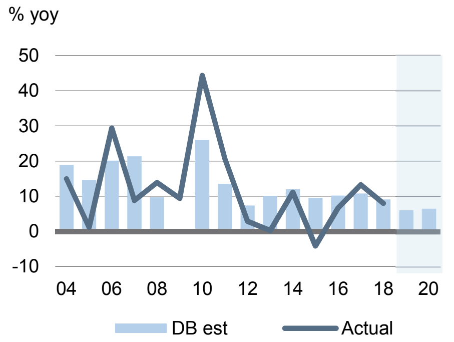
Source: Deutsche Bank Research

German exports to UK vs. UK GDP growth 14



Source: Deutsche Bank Research

Exports to China 15



Source: Deutsche Bank Research

our model implies export growth of roughly 3%. For 2020, our expectation of 1.3% GDP growth and a further depreciation in sterling of almost 5% on annual average argues for an increase of only around ¾% in German goods exports to the UK. Assuming our forecasts are correct, which implicitly rules out Brexit chaos, nominal exports to the UK in 2020 would undershoot nominal exports in 2016. This would be unusual, as strong declines in exports are often followed by even stronger counter-movements in the subsequent years. However, if – contrary to our current expectations – a positive Brexit surprise emerges, sterling is likely to appreciate sharply. Assuming a 10% year-over-year rise in sterling in 2020, for example, our models imply export growth of over 9%, which would roughly compensate losses in the period from 2016 to 2019.

Goods exports to China can be statistically captured by means of Korean GDP

The relative importance of GDP growth for the expansion of German exports to China has been limited in the past twenty years. Although the elasticity of GDP growth is positive, the variable is insignificant. Its extraordinarily low volatility alone, which is not in line with other economic indicators, implies GDP growth can hardly explain the strong divergence in annual German growth to China, with figures ranging from -4% to +44%. Moreover, we believe exports to China are not exclusively driven by factors pertaining to China. Global trends probably also play a role. From the statistical perspective, however, neither global trade growth nor different FX nor idiosyncratic economic variables – as, for instance, Chinese purchasing managers' indices – help to model exports to China. In purely statistical terms, growth of Chinese rail-freight transport and Korean GDP growth produce the best estimates. These variables can be interpreted as a proxy for Chinese demand for domestic and foreign products. Until 2014, Chinese rail-freight transport was closely correlated with Chinese GDP. In the following years, however, the volatility of GDP declined sharply and rail freight traffic turned highly volatile, with the latter probably being a better reflection of the cyclical trend. The statistical significance of Korean GDP could reflect the similarities between German and Korean industry with respect to their competitiveness and their product range. Demand for German goods could hence run parallel to demand for Korean products. In our model, the export elasticity of Korean GDP growth is 3.5. A 1 pp increase in South Korean GDP growth therefore translates into a 3.5 pp rise in exports to China. The elasticity of Chinese rail-freight transport is below 1. Even though the inclusion of the renminbi versus the euro in the estimation equation has the expected negative sign, it is insignificant. The economic relevance of the above correlation is corroborated when the estimate is applied to euro-area exports ex Germany to China. The resulting elasticities and statistical properties are similar. As Chinese rail-freight transport is not part of our forecast horizon, we have left it out, or else we would not have been able to present a forecast for exports to China. According to our bivariate regression, which is exclusively based on Korean GDP growth, German exports to China ought to rise by just over 6% p.a. in 2019 and in 2020.

Modelled goods exports a good indicator for total exports

In the past two decades, growth rates of German goods exports to the markets covered by our model (share of aggregate German exports around 60%) have been similar to those of the remaining German goods exports. Barring the years of the financial and euro crisis, services exports have also been growing at a comparable rate. In this respect, our structural models are indicative for total nominal exports. If the growth rates are weighted with the respective export shares (2018: EMU 37.4%, US 8.6%, China 7.1% and UK 6.2%), the aggregate growth rate for 2019 is 4%, followed by 2.5% in 2020.

Our models ought to overstate the trend in 2019

Given current high political uncertainties such as the Brexit chaos, the dissent regarding future European policy and, in particular, the uncertain realignment of US trade policy, our structural models ought to overstate the sales potential of German exporters in 2019. We therefore continue to expect muted nominal export growth of just over 2% in 2019. Export prices are closely correlated with crude oil inflation. As we expect no further price increases for the remainder of 2019, export prices are likely to rise only marginally, up by 0.5%, which argues for an increase of just 1.6% in real exports in 2019.

In line with our models, slight improvement expected for 2020

As outlined above, our models point to a 2.5% increase in nominal German goods exports in 2020. With our DB forecast assuming crude oil prices will move more or less sideways in 2020, export prices in 2020 would rise at the same rate as in 2019, up by 0.5%. Real exports, as a consequence, look set to rise by only 2%.

Net exports in 2019 and 2020 still negative

Led by robust domestic demand and, in particular, sound employment, real imports in 2019 und 2020 are likely to rise at a faster rate than real exports. For 2019, we forecast an increase of 2%, followed by 2.4% in 2020. Contributions of net exports to GDP growth will, as a consequence, be negative, at -0.4 pp in 2019 and -0.04 pp in 2020. Against this backdrop, our 2019 GDP forecast of just 0.7% can above all be traced to the currently challenging environment for export industry. With net exports likely to improve in 2020, GDP growth looks set to accelerate to 1.2%, which would be roughly in line with the long-term average of the past ten years.

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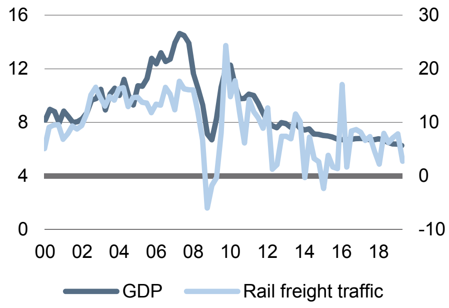
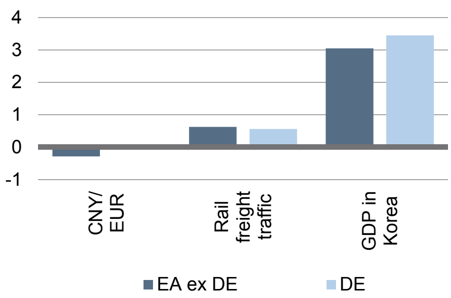
China: GDP vs. Rail freight traffic 16

both y-axes: % yoy



Sources: www.stats.gov.cn, Deutsche Bank Research

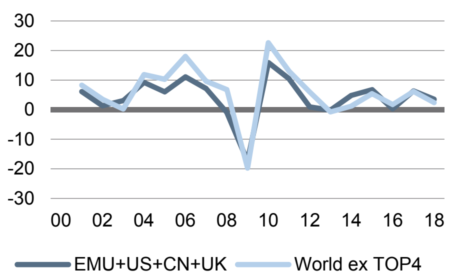
Elasticities for exports to China 17



Sources: Deutsche Bank Research, Eurostat, Federal Statistical Office

Germany: Export growth 18

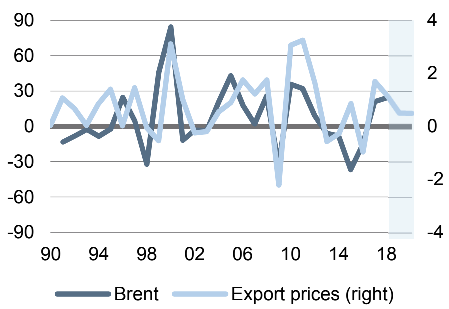
% yoy



Source: Deutsche Bank Research

Germany: Export prices 19

both y-axes: % yoy

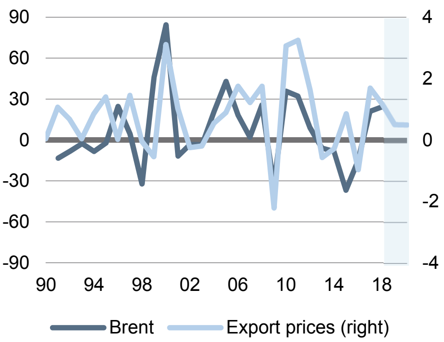


Sources: Deutsche Bank Research, Haver Analytics, Federal Statistical Office

Appendix

Germany: Export prices 20

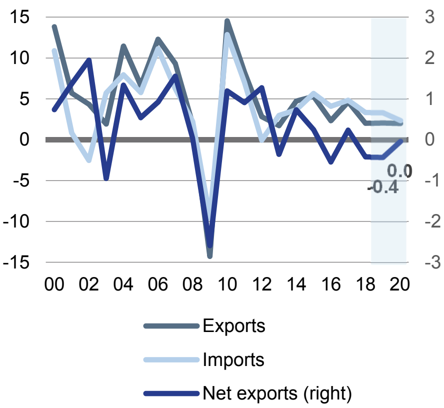
both y-axes: % yoy



Sources: Deutsche Bank Research, Haver Analytics, Federal Statistical Office

Real exports and imports plus growth contribution of netto exports to GDP 21

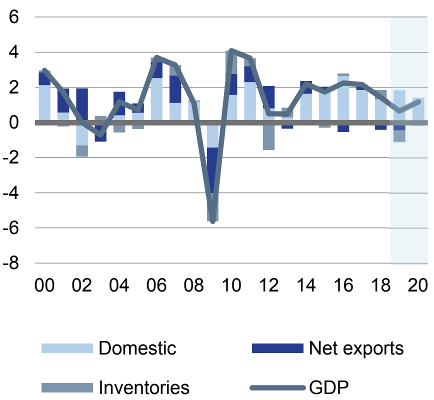
left y-axis: % yoy
right y-axis: pp



Source: Deutsche Bank Research

GDP growth 22

% yoy, pp



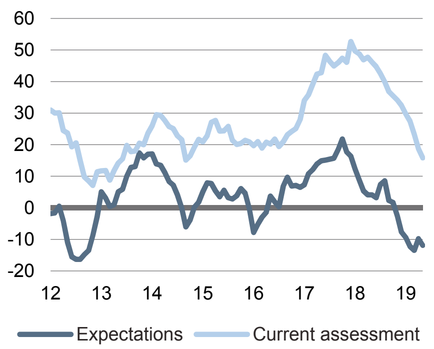
Sources: Deutsche Bank Research, Federal Statistical Office

The regressions outlined above are primarily based on simple linear models with desirable economic (correct sign) and statistical properties (significant t-value, R^2, low/no autoregression). The accuracy of the estimates is not improved by the inclusion of variables such as world trade growth, crude-oil inflation, or idiosyncratic economic variables. Furthermore, the beneficial effect of more-complex estimation methods, which capture error correction terms, and quantile regressions on the modelling of bilateral goods exports is, from our perspective, very limited. When using quarterly data, the coefficients of error correction terms – i.e., the estimation error of the preceding quarter or quarters – regularly have the expected negative sign and, sometimes, statistical significance. The elasticities, however, are more or less unchanged. The problem of seasonal effects – some quarterly variables are not seasonally adjusted – would have to be tackled by means of quarterly indicators, which would add to the models' complexity. As a result, our quarterly forecasts for GDP growth and FX would have to be combined with the quarterly indicators, in order to derive annual forecasts for Germany's bilateral goods exports. Using annual data in our models keeps them much more simple and interpretable. We therefore believe the simple linear models are the best choice, both from an economical viewpoint and in statistical terms. Exceptions have been discussed above.

German industry: Production to drop by 1.5% in 2019 – outlook for 2020 extremely uncertain given trade dispute and Brexit

ifo business climate: Gloomy mood 1

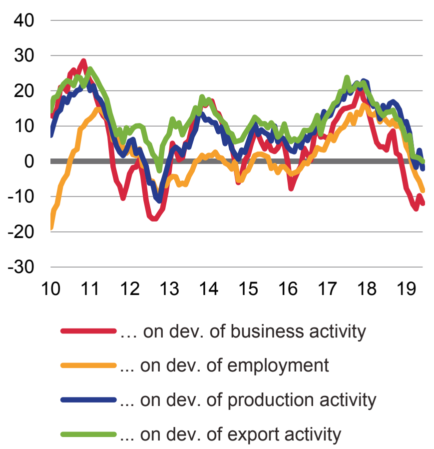
Manufacturing industry in DE, balance of positive and negative company reports



Source: ifo Institute

Negative expectations in the German industry 2

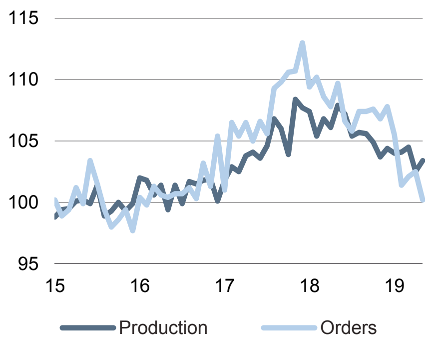
Company expectations, balance of positive and negative company reports



Source: ifo Institute

Hardly any stabilisation 3

Manufacturing industry in DE, 2015=100



Source: Federal Statistical Office

— We now expect manufacturing output to shrink by 1.5% in 2019 (previously 0%), due to the persistent weakness of sentiment indicators, which reflect the general economic slowdown and the dampening effects of the trade conflicts or Brexit. Whilst hard data (output, orders) also fell short of expectations at the start of the year, unfilled orders in German industry are still at relatively high levels. This helps to stabilise industrial production.

— The loss in industrial production may be recouped in 2020, provided the trade disputes do not escalate (further) and a hard Brexit pulling economic growth in Europe lower over several quarters is averted.

Industrial sentiment in Germany has deteriorated steadily over the past months, even though the majority of companies remain optimistic about their current business situation. Particularly disappointing news, however, came from expectations. Following signs of a rebound in May, business, export and production expectations in the German manufacturing sector resumed their downtrend in June.

The smouldering and acute trade conflicts (especially between the US and China), the stalemate surrounding Brexit or the US threats of import tariffs on European cars are hurting export-intensive German industry. All these factors are hardly new. Over the past quarters, however, these uncertainties have left their mark in reality, sharply slowing growth in Europe as well as in the US. With growth primarily driven by private consumption (sound labour markets) rather than investment, no impulses are provided to German capital goods manufacturers. As regards their rhetoric, central banks in the euro area and the US have already reacted to the slowdown in economic growth, signalling their readiness to loosen monetary policy (even further).

Production and orders pointing to the downside – industrial output likely to decline by 1.5% in 2019

Not only sentiment indicators in German manufacturing are on the decline of late. For over a year now, output and order intake in industry have also been on a relatively steady downtrend. In the first four months of 2019, production shrank by 2.4% compared with the same period a year earlier. At -6.2% yoy, orders plunged even more sharply (in the first five months of 2019).

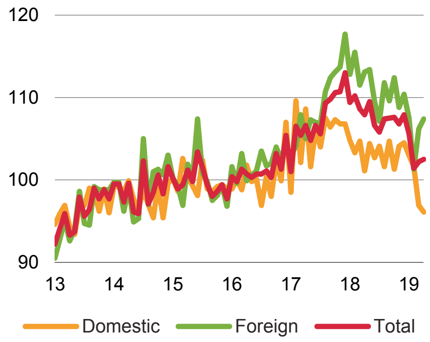
At the beginning of Q2 2019, capacity utilisation in manufacturing contracted for the fifth quarter in a row. On balance, however, the decline is not dramatic. Running 2 pp above the long-term average, utilisation is still comfortable for industry, partly due to the high level of unfilled manufacturing orders. Whilst the latter have declined somewhat since the start of 2019, their absolute level is still high.

We expect German manufacturing production to be more or less flat through the next few months, with production expanding only marginally at year-end. A sharp contraction as in 2008/2009, however, is unlikely in our view, courtesy of the high level of unfilled orders. We forecast a real annual decline of 1.5%. This would mark the first drop in production since 2011.

Despite contracting manufacturing output, industrial producer prices continue to rise, although at a slower pace. In the first four months of 2019, they rose by only 1.5% yoy, compared with 2.1% in 2018. As a consequence, average returns in the German industrial sector are likely to come under pressure – the

Domestic order intake disappointing 4

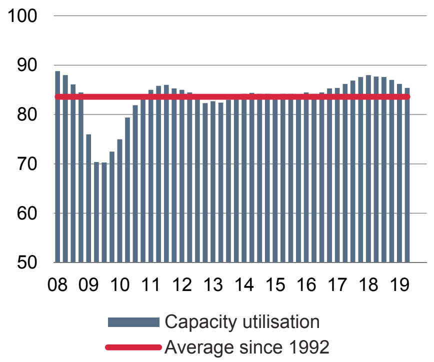
Manufacturing industry in DE, orders, 2015=100



Source: Federal Statistical Office

Capacity utilisation is falling steadily 5

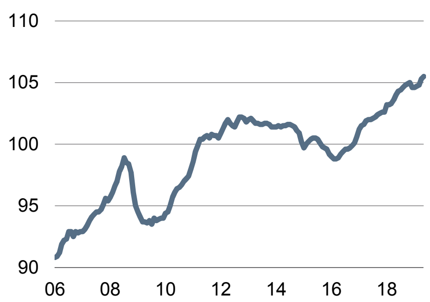
Capacity utilisation in the manufacturing industry in Germany, %



Source: ifo Institute

Producer prices still on the rise 6

Producer prices in the manufacturing industry DE, 2015=100



Source: Federal Statistical Office

more so, as wages in 2018 were up significantly. Lower margins are of course a common phenomenon in phases of slowing growth.

Production to edge up by 1.5% in 2020, if …

In 2020, the loss of 1.5% in real industrial production in Germany could be recouped, provided (further) escalation of the trade disputes is averted and Brexit – in whatever form it eventually takes place – does not pull down economic growth in Europe over several quarters. The key assumption in this scenario is that the US do not follow through on their threat to impose tariffs of 25% on European auto imports. If, however, punitive duties are levied by year-end, German auto exports to the US look set to collapse by nearly 50% in the long term, according to the ifo Institute. Including second-round effects, these tariffs could shave roughly 0.25-0.5 pp off German GDP growth in 2020. In this case, manufacturing production in Germany would probably contract for the second consecutive year.

Capital goods sectors to suffer declines in 2019 – rebound in 2020?

On balance, domestic production in the three key capital goods sectors in Germany – automotive industry, mechanical, and electrical engineering – ought to shrink by 1 to 1.5% in 2019. For the automotive sector, this would mark the second drop in a row, as demand for passenger cars in China, the US and Western Europe is either contracting or rising only marginally in 2019 (see additional article in this issue). In mechanical and electrical engineering, weak investment in Germany itself and in major export markets is leaving its mark. Still, nominal exports of these sectors to some key markets such as the US edged up at the beginning of 2019, possibly due to higher US tariffs on Chinese imports, which may prompt US customers to increasingly shift to German products. The euro's depreciation versus the US dollar at the beginning of the year should have played a role, too.

In 2019, production also looks set to shrink in the chemical, metal, and plastics sector, though only moderately. The building-materials industry, which benefits from the construction boom, is likely to expand production, along with the food sector.

What holds for manufacturing as a whole is probably equally true for the key industrial sectors: Production gains are possible in 2020, if the trade conflicts do not escalate or if positive surprises materialise on this front. For automotive industry, the potential US tariffs on auto imports from the EU are an exceptional sword of Damocles.

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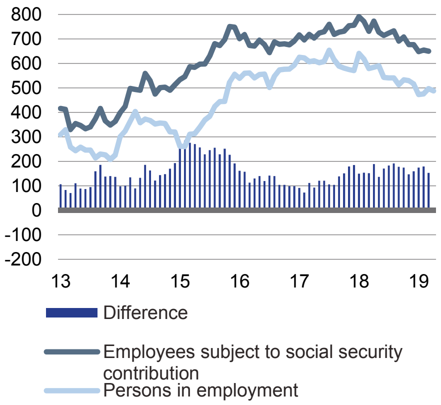
Labour market still robust, but external downturn is leaving its mark

- In May, a review of the placement status of persons entitled to ALG II provided a sharp boost to seasonally adjusted unemployment. This special effect will continue to take its toll, likely pushing up jobless figures through the summer. Later this year, after the effect tapered off, we do not expect unemployment to decline again, given the sharp slowdown in the German economy.
- During the economic turmoils of the past twelve months, the sound German labour market was an anchor for stability. Even though the employment trend is still pointing upwards, the seasonally adjusted unemployment figure and underemployment (excluding short-time work) signal first labour market effects of the whole economic slowdown.
- The common leading labour market indicators (ifo, IAB barometer, and the PMI subcomponents) have been on a steady decline in the past 3 to 6 months, which argues for a further uptick in seasonally adjusted unemployment and slowing employment growth.

German labour market in good shape - so far

Ongoing but slowing employment growth 1

Change yoy, '000 persons



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

The German labour market continues to stand out. In April, the number of employed rose to an all-time high of 45.2 million, up by 1.1% on the same month a year earlier. The positive trend is mainly due to the growth in the number of employees subject to social security contributions, which rose to around 33.4 million (March 2019). This translates into an increase of 650k compared with the previous year. At the same time, the number of self-employed and persons in marginal employment continued to decline.

When taking a look at the year-over-year comparison, however, the key message is that employment dynamics have been slowing, especially in the past 6 months. Surely, this observation can largely be explained by the fact that employers are struggling to fill jobs, as indicated by the recent rise in the average vacancy period to 119 days (June). Alongside a general lack of candidates, qualification-related shortfalls are the major obstacle to filling job openings. Tensions are predominant in the construction industry, to some technical occupations and in the health and care sector, which is largely immune to cyclical fluctuations.

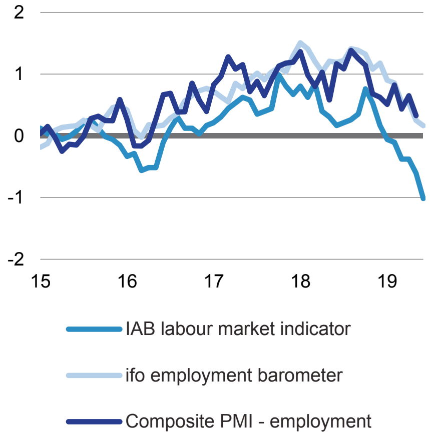
Problems to fill vacancies are only one side of the coin

Employers struggling to fill jobs are only one side of the coin, though. The other is the weak underlying dynamics leaving their negative imprint. German industry is stuck in recession since mid-2018. The chain of negative factors ranges from the problems of automotive industry surrounding WLTP certification to slowing external demand to the continued trade uncertainties between China and the US resp. the EU and the US to the uncertain outcome of Brexit.

For up to 6 months now, the usual leading labour market indicators (IAB, ifo barometer, employment component of the purchasing managers' indices) are suggesting the German labour market will likely be dragged lower by the soft patch in the German economy.

Labour market indicators: No fundamentally different message 2

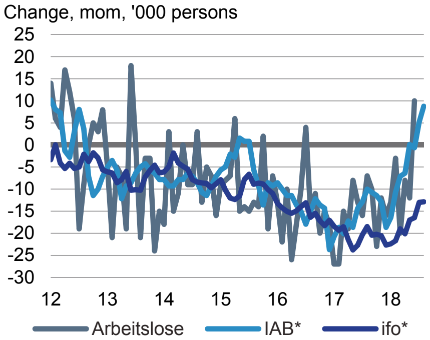
Standardised values



Sources: ifo, IAB, IHS Markit, Federal Employment Agency

Forecasts: IAB and ifo barometer pointing to higher unemployment (sa) 3

Change, mom, '000 persons



* Simple linear regression of unemployment change on the basis of leading labour market indicators (lagged by 1 resp. 2 months). For May 2019 , we assumed that seasonally-adjusted unemployment would have risen by 15,000, excluding the one-off effect from the special review of the placement status of ALG II recipients.

Sources: ifo, IAB, Federal Employment Agency

The unemployment component of the IAB barometer has been stuck below the neutral level of 100 since March 2019, signalling higher unemployment figures in the months ahead. Furthermore, with the employment component of the purchasing managers' index (PMI) also in contractive territory of below 50 since March, signs also point to job losses in this sector. Last, but not least, the ifo employment barometer has been sending the same signals for six months now.

At present, the German economy is a mixed bag, with the recession-stricken industry on the one hand and robust services and booming construction on the other hand. Employment signals from the latter sectors are still positive, accordingly as suggested by the respective PMI employment components and the ifo employment barometer.

Labour market revival in the spring – not at all!

Even though weather conditions were extremely favourable, the monthly decline in the number of unemployed (adjusted for May's special effect) slowed from 13.5 k in H2 2018 to roughly 5 k in H1 2019. Due to the review of the status of persons entitled to ALG II, seasonally adjusted unemployment in May was pushed up by around 30 to 40 k, which translated into a total increase of 61 k compared with the previous month. From May to June, these reviews had no upward effect on the data. However, according to the Federal Ministry of Labour, another – albeit far more moderate – one-off effect is likely to emerge in July.

The economic slowdown is also reflected in underemployment (excluding short-time work). From April to June (adjusted for May's special effect) it rose by an average of more than 5k persons. As a result, it fell by only 2.5 k per month in H1 2019, while in H2 2018 it fell by an average of 14.5 k. Underemployment (excluding short-time work) also includes people who participate in active labour policy measures and thus relieve the unemployment rate. The expansion of these measures, hence, masked the slowing unemployment decline that had already set in at the beginning of the year.

To date, the labour market – as a typical lagging cyclical indicator – has been a beneficiary of the high level of unfilled orders and above-average capacity utilisation. The previously mentioned surveys suggest this phase is coming to an end. Moreover, structural adjustments seemingly looming in some sectors (automotive suppliers) are also likely to leave their mark on the labour market.

Led by the ALG II reviews and the cyclical slowdown, seasonally adjusted unemployment in July looks set to rise by 10-15 k compared with the previous month. Given weak growth, a resumption of the downtrend is an unlikely scenario in the following months. We have raised our forecast for the unemployment rate to 5% for 2019 (4.9%) and 4.9% for 2020 (4.7%). These revisions are based on our GDP forecast (2019: 0.7%, 2020: 1.2%), which expects only stagnating or declining growth in Q2, followed by a very moderate recovery in the second half of the year.

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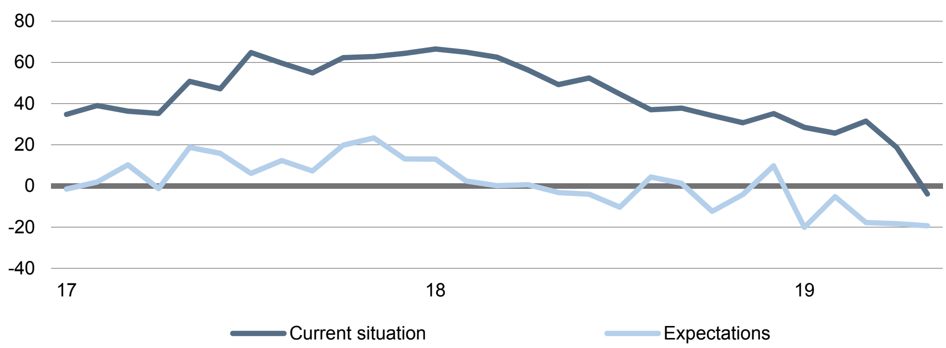
German automotive business cycle

The automotive industry is the largest industrial sector in Germany, measured by revenue. Its performance will decide if the German industrial sector successfully comes out of the recession that has started in Q3 2018. The sector is still working towards overcoming the WLTP induced dip of H2 2018. At the same time global demand has slowed significantly. It is thus not surprising that sentiment indicators in the sector have been falling during the last few months. Order intake has not yet stabilised of late. It would be a massive setback for the German automotive industry if the US government were to introduce higher tariffs on automotive imports from the EU, as has been threatened several times. A decision in this trade issue can probably be expected by November 2019.

ifo business climate 1

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

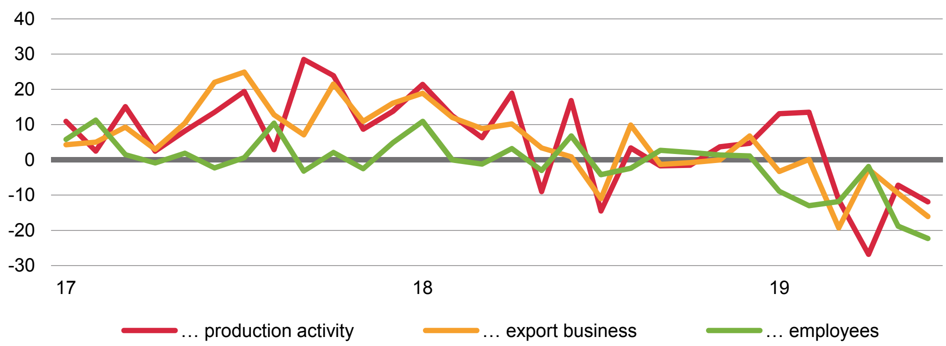


Source: ifo

Chart 1: Business expectations in the German automotive industry have been negative since the beginning of the year, not least due to weaker global demand for cars. At the latest reading, companies were also pessimistic about the current situation. However, order backlog in the sector is still on a high level of late.

ifo expectations with regard to... 2

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

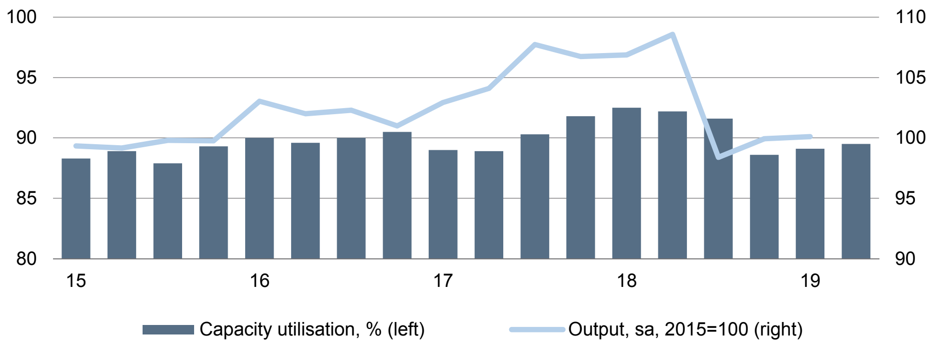


Source: ifo

Chart 2: The pessimistic expectations of the sector are reflected in the subcomponents of the ifo survey. Production and export expectations declined significantly in June. Continued weak global car demand and the difficult environment for world trade (Brexit, threat of US tariffs) can explain this. The renewed decline in employment expectations indicates a decrease in employment in the sector in 2019.

Output and capacity utilisation 3

Automotive industry in Germany

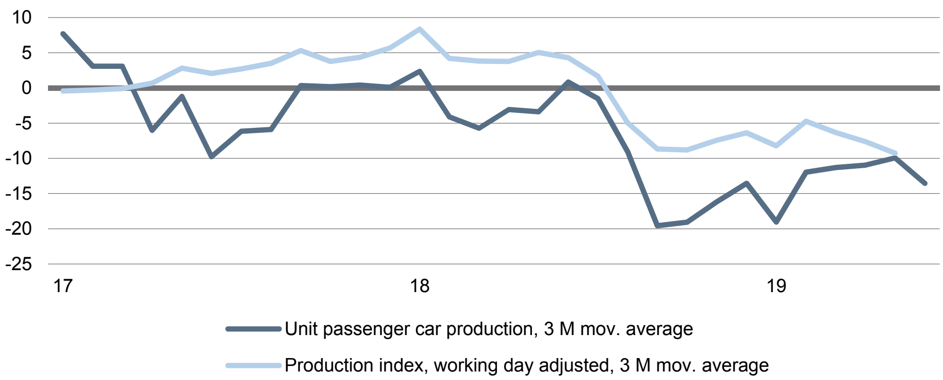


Sources: Federal Statistical Office, ifo

Chart 3: At the beginning of 2019, capacity utilisation in the German auto industry was considerably lower than in the first three quarters of 2018, but still above the long-term average. The renewed slight increase in capacity utilisation at the beginning of Q2 2019 suggests domestic production activity might pass the trough in H1 2019.

Automotive production 4

Automotive industry in Germany, % yoy

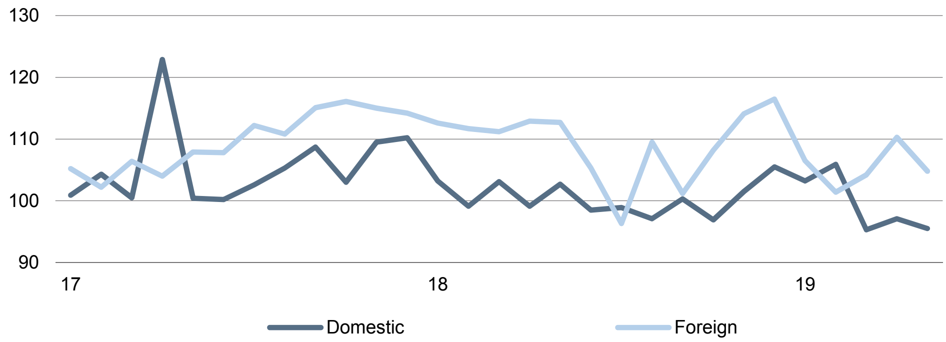


Sources: Federal Statistical Office, VDA

Chart 4: German car production (in unit terms) was considerably down in year-on-year terms in H1 2019. In June, a decrease in production by 24% yoy was registered not least due to less working days compared to June 2018. The decline in the output index, which also includes qualitative criteria (such as better equipment of cars), is smaller. According to the Federal Statistical Office, output index increased by 0.3% qoq in Q1 2019. The year-on-year growth rate looks set to turn positive again in H2 2019, as the WLTP effect pushed down the basis for comparison during H2 2018.

New orders, sa 5

Automotive industry in Germany, 2015=100

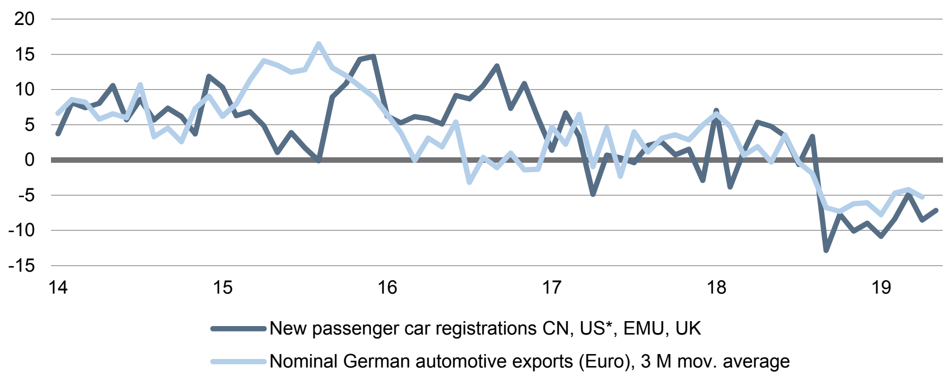


Source: Federal Statistical Office

Chart 5: Domestic as well as foreign order intake decreased in May (-1.6% and -5% mom respectively) after an increase in April. Orders thus have not yet stabilised during the last few months. German new passenger-car registrations trended sideways at a high level in the first six months of 2019. Export orders look set to pick up again from H2.

Global car demand and German automotive exports 6

% yoy



* Light vehicles

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

Chart 6: Weak demand in important German export markets towards the end of 2018 and at the beginning of 2019 weighed on auto exports. On average, exports are likely to decline in year-on-year terms during H1 2019.

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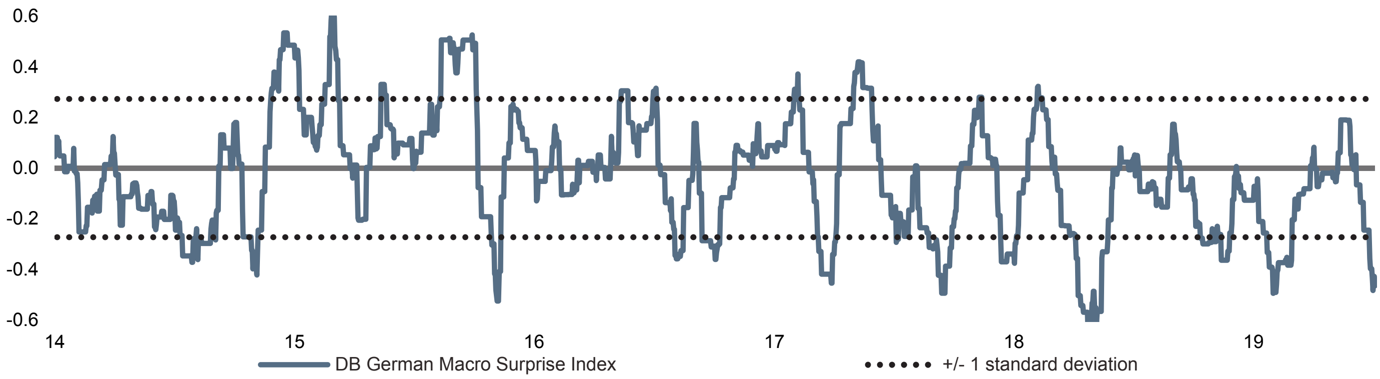
DB German Macro Surprise Index

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 Tickers	Indicator	Reporting month	Publication date	Current value	Bloomberg consensus	Surprise	Standardised surprise	Quantile rank
GRIMP95Y Index	Import Price Index (% yoy)	4 2019	28/05/2019	1.4	1.6	-0.2	0.0	0.6
GRUECHNG Index	Unemployment Change (000's mom)	5 2019	29/05/2019	61.0	-7.5	-68.5	-3.0	0.0
GRFRIAMM Index	Retail Sales (% mom)	4 2019	31/05/2019	-1.0	0.1	-1.1	-0.6	0.2
MPMIDEMA Index	Markit Manufacturing PMI	5 2019	03/06/2019	44.3	44.3	0.0	0.0	0.5
MPMIDESA Index	Markit Services PMI	5 2019	05/06/2019	55.4	55.0	0.4	0.5	0.8
GRIORTMM Index	Factory Orders (% mom)	4 2019	06/06/2019	0.4	0.0	0.4	0.2	0.6
GRBTIMMM Index	Imports (% mom)	4 2019	07/06/2019	-0.9	-0.2	-0.7	-0.3	0.4
GRBTEXMM Index	Exports (% mom)	4 2019	07/06/2019	-3.4	-0.9	-2.5	-1.4	0.1
GRIPIMOM Index	Industrial production (% mom)	4 2019	07/06/2019	-1.9	-0.5	-1.4	-1.1	0.1
GRTBALE Index	Trade Balance (EUR bn)	4 2019	07/06/2019	17.9	19.5	-1.6	-0.8	0.2
GRCP20YY Index	CPI (% yoy)	5 2019	13/06/2019	1.4	1.4	0.0	0.2	0.4
GRZECURR Index	ZEW Survey Current Situation	6 2019	18/06/2019	7.8	6.1	1.7	0.2	0.6
GRZEWI Index	ZEW Survey Expectations	6 2019	18/06/2019	-21.1	-5.6	-15.5	-1.9	0.0
GRCP20YY Index	CPI (% yoy)	6 2019	27/06/2019	1.6	1.6	0.0	0.2	0.4
GRIMP95Y Index	Import Price Index (% yoy)	5 2019	28/06/2019	-0.2	-0.2	0.0	0.3	0.7
MPMIDEMA Index	Markit Manufacturing PMI	6 2019	01/07/2019	45.0	45.4	-0.4	-0.5	0.2
GRUECHNG Index	Unemployment Change (000's mom)	6 2019	01/07/2019	-1.0	0.0	1.0	-0.2	0.4
GRFRIAMM Index	Retail Sales (% mom)	5 2019	02/07/2019	-0.6	0.5	-1.1	-0.6	0.2
MPMIDESA Index	Markit Services PMI	6 2019	03/07/2019	55.8	55.6	0.2	0.3	0.7
GRIORTMM Index	Factory Orders (% mom)	5 2019	05/07/2019	-2.2	-0.2	-2.0	-1.0	0.1

Sources: Bloomberg Finance LP, Deutsche Bank Research

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

A looming black-green coalition: Painful compromises needed

Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
8 Jul 2019	8:00	Industrial production (% mom, sa)	May	0.5	-2.5
8 Jul 2019	8:00	Trade balance (EUR bn, sa)	May	16.0	17.0
8 Jul 2019	8:00	Merchandise exports (% mom, sa)	May	-0.5	-3.4
8 Jul 2019	8:00	Merchandise imports (% mom, sa)	May	0.9	-0.9
24 Jul 2019	9:30	Manufacturing PMI (Flash)	July	46.0	45.0
24 Jul 2019	9:30	Services PMI (Flash)	July	55.5	55.8
25 Jul 2019	10:00	ifo business climate (Index, sa)	July	98.0	97.4
30 Jul 2019	14:00	Consumer prices preliminary (% yoy, nsa)	July	1.4	1.4
31 Jul 2019	8:00	Retail sales (% mom, sa)*	June	0.5	-0.6
31 Jul 2019	9:55	Unemployment rate (%, sa)	July	5.0	5.0
6 Aug 2019	8:00	New orders manufacturing (% mom, sa)	June	0.7	-2.2

*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

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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	0.00	1.25	1.50	0.25	2.00
Sep 19	1.875	-0.10	0.00	0.75	-0.75	-0.25	0.00	1.50	1.50	0.15	2.00
Dec 19	1.625	-0.10	0.00	0.75	-0.50	-0.25	0.00	1.50	1.50	0.25	2.00
Mar 20	1.625	-0.10	0.00	0.75	0.00	-0.50	0.00	1.50	1.50	0.25	2.00
3M interest rates, %											
Current	2.31	0.05	-0.36	0.76							
Sep 19	2.00	0.05	-0.36	0.79							
Dec 19	1.90	0.05	-0.36	0.85							
Mar 20	1.75	0.05	-0.36	0.85							
10Y government bonds yields, %											
Current	2.02	-0.16	-0.37	0.75							
Sep 19	2.05	0.00	-0.35	1.03							
Dec 19	2.15	0.00	-0.30	1.12							
Mar 20	2.20	0.00	-0.23	1.13							
Exchange rates											
	EUR/USD	USD/JPY	EUR/GBP	GBP/USD	EUR/CHF	EUR/SEK	EUR/DKK	EUR/NOK	EUR/PLN	EUR/HUF	EUR/CZK
Current	1.12	107.86	0.90	1.25	1.11	10.53	7.46	9.63	4.24	323.41	25.44
Sep 19	1.10	107.50	0.93	1.18	1.14	10.70		9.65	4.35	323.00	25.65
Dec 19	1.13	105.00	0.93	1.22	1.15	10.80	7.46	9.60	4.35	323.00	25.60
Mar 20	1.16	103.75	0.93	1.25	1.16	10.73		9.55	4.40	320.00	25.50

Sources: Bloomberg Finance LP, Deutsche Bank Research

German data monitor

	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Jan 2019	Feb 2019	Mar 2019	Apr 2019	May 2019	Jun 2019
Business surveys and output											
Aggregate											
Ifo business climate	102.3	103.4	102.1	99.4	98.2	99.6	98.8	99.7	99.3	97.9	97.4
Ifo business expectations	99.0	99.9	98.4	94.8	94.9	94.8	94.0	95.6	95.3	95.2	94.2
Industry											
Ifo manufacturing	105.1	104.6	101.6	97.8	95.0	98.9	97.9	96.7	95.5	95.4	94.2
Headline IP (% pop)	0.5	-1.4	-1.2	-0.1		-0.4	0.1	0.4	-1.9	0.9	
Orders (% pop)	-1.2	-1.1	0.5	-4.1		-2.1	-3.9	0.7	0.4	-2.2	
Capacity Utilisation	87.8	87.8	87.1	86.3	85.3						
Construction											
Output (% pop)	5.1	0.5	0.1	3.9		-1.4	8.8	-0.5	-1.6	-2.2	
Orders (% pop)	-5.2	0.7	11.3								
Ifo construction	111.8	116.5	116.6	111.5	113.1	111.5	110.7	112.4	112.5	113.8	113.1
Consumer demand											
EC consumer survey	0.9	0.4	0.4	-0.2	-1.7	-0.4	-0.2	-0.1	-0.7	-1.4	-3.1
Retail sales (% pop)	1.9	-0.7	0.6	1.7		2.7	0.7	0.1	-1.0	-0.6	
New car reg. (% yoy)	1.9	1.2	-8.1	0.2	0.9	-1.4	2.7	-0.5	-1.1	9.1	-4.7
Foreign sector											
Foreign orders (% pop)	-1.1	-2.3	1.0	-5.1		-2.7	-5.7	4.7	1.1	-4.3	
Exports (% pop)	1.0	-0.2	0.9	0.8		0.1	-1.2	1.6	-3.4	1.1	
Imports (% pop)	2.1	2.3	-0.1	0.6		1.4	-1.4	0.4	-0.9	-0.5	
Net trade (sa EUR bn)	59.6	52.7	56.1	57.0		18.6	18.5	19.9	17.0	18.7	
Labour market											
Unemployment rate (%)	5.2	5.1	5.0	5.0	5.0	5.0	5.0	4.9	4.9	5.0	5.0
Change in unemployment (k)	-39.7	-36.3	-45.7	-32.7		-16.0	-13.0	-3.0	-20.0	-7.0	-12.0
Employment (% yoy)	1.3	1.2	1.2	1.1		1.1	1.1	1.1	1.1	1.0	
Ifo employment barometer	104.0	104.8	104.2	102.4	100.6	103.0	102.8	101.5	101.5	100.3	100.0
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	2.0	2.2	2.2	1.6	1.6	1.7	1.7	1.4	2.1	1.3	1.3
Core HICP (% yoy)	1.3	1.4	1.4	1.5	1.4	1.8	1.6	1.0	2.0	0.9	1.3
Harmonised PPI (% yoy)	2.6										
Commodities, ex. Energy (% yoy)	2.6	-0.5	-0.3	1.5	0.2	-2.3	2.9	3.7	4.1	-3.4	0.1
Crude oil, Brent (USD/bbl)	74.5	75.1	68.0	63.1		59.4	64.0	66.1	71.2	71.2	64.3
Inflation expectations											
EC household survey	30.1	34.2	34.3	31.7	33.8	32.8	31.8	30.4	32.7	35.4	33.4
EC industrial survey	13.8	15.8	17.6	14.4	7.1	18.9	13.0	11.4	6.7	8.4	6.2
Unit labour cost (% yoy)											
Unit labour cost	1.7	3.3	2.8	3.8							
Compensation	2.8	3.5	2.9	3.2							
Hourly labour costs	1.7	3.0	2.0	2.9							
Money (% yoy)											
M3	3.6	4.1	4.5	5.1		4.0	4.4	5.1	5.5	4.7	
M3 trend (3m cma)						4.3	4.3	4.5	5.0	5.1	
Credit - private	4.3	4.3	3.9	4.1		3.7	3.9	4.1	4.1	0.0	
Credit - public	-7.0	-2.7	-6.3	14.1		-9.0	-1.4	14.1	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

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