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Growth rates have peaked – inflation should still recover

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Weaker recent data – too early to throw in the towel, but 2018 GDP forecast cut to 2%. Although German Q1 GDP growth now looks like reaching around ¼% qoq, we still expect some positive payback in Q2, as some temporary factors depressing activity should disappear. Corporate investment spending will be key for growth in the remainder of the year. Unfortunately, signals from proxy indicators have become somewhat mixed recently too. Notwithstanding a likely, albeit limited, Q2 rebound in activity, the strong drop in the expectations' component of the ifo business climate suggests that we have probably passed the peak in qoq growth rates in the current cycle. Due to the weaker Q1 we have lowered our GDP forecast for 2018 from 2.3% to 2.0%.

Inflation pressure curbed by slowing industrial dynamics and the strong euro. German inflation in 2018 will again remain below the 2% target rate, despite the fifth consecutive above potential rise in GDP, high capacity utilisation, labour shortages in many areas and strongly rising negotiated wages. At the beginning of the year, producer price inflation in manufacturing slowed compared with 2017, led by the breather in industrial activity. For the euro area, we expect an inflation rate of 1.6% in 2018. For the doves within the ECB, the weak uptick will provide strong arguments for the (announced) slow exit from expansionary monetary policy.

Labour migration: The boom is feeding the boom – so far. Since 2010 more people have migrated from EU-partner countries to Germany than from third countries outside the EU (up to August 2017 1.9 m vs 1.83 m). The doubling of the figure of foreign workers to 3.66 m (Q1 2010 vs. Jan/Feb 2018) has strengthened the growth forces and dampened wage rises. However, the number of recipients of social security benefits among foreigners has also increased markedly – recently reflecting the immigration of asylum seekers. The current mismatch between almost 1.2 million job vacancies in Q1 2018 on the one hand and 2.52 million unemployed, with almost 0.91 million of the latter touching social security benefits and a total of 4.26 million recipients registered as being able to work indicates just how big the task of bringing these people into work is.

The view from Berlin. Finance Minister Scholz: fiscal policy in Mr. Schäuble's tradition? Despite the Minister's recent announcement of a solid budget policy, the new government's first budget plans provide for a marked increase in public spending without any safeguard for a flattening in tax revenues. While social spending especially on pensions will be boosted the only slightly increasing trajectory of public investment and defence spending does not fit to the various challenges in these areas. On European and euro area matters Mr. Scholz has not signalled any major change in policy.

Growth rates have peaked – inflation should still recover

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2017F	2018F	2019F	2017F	2018F	2019F	2017F	2018F	2019F	2017F	2018F	2019F
Euroland	2.5	2.1	1.7	1.5	1.6	1.5	3.5	3.3	2.7	-0.9	-0.6	-0.6
Germany	2.2	2.0	1.8	1.8	1.6	1.8	7.2	6.5	6.5	1.1	1.1	0.9
France	2.0	1.8	1.6	1.2	1.9	1.5	-0.6	-0.4	-0.4	-2.6	-2.1	-2.8
Italy	1.5	1.3	1.0	1.3	1.2	1.5	2.9	3.1	3.2	-2.3	-1.7	-1.2
Spain	3.0	2.8	2.5	2.0	1.5	1.7	1.9	1.6	1.4	-3.1	-2.1	-1.3
Netherlands	3.2	2.5	2.5	1.3	1.3	1.8	10.2	10.2	10.1	1.1	0.5	0.4
Belgium	1.7	1.9	1.8	2.2	1.9	1.7	-0.2	-0.7	-1.0	-1.0	-1.0	-1.0
Austria	3.0	3.0	2.3	2.2	2.1	1.8	1.9	2.4	2.7	-0.9	-0.6	-0.3
Finland	2.7	2.3	2.1	0.8	1.2	1.4	0.7	0.5	0.5	-0.6	-0.3	-0.3
Greece	1.3	2.3	2.2	1.1	0.6	1.0	-0.8	-0.5	0.0	0.8	1.5	2.0
Portugal	2.7	2.2	1.7	1.6	1.0	1.5	0.6	0.4	0.2	-3.0	-1.0	-1.0
Ireland	7.8	5.4	3.3	0.3	1.0	1.3	12.5	6.0	3.0	-0.3	0.1	-0.4
UK	1.8	1.3	1.6	2.7	2.4	2.1	-4.1	-3.8	-3.5	-1.9	-1.9	-1.4
Denmark	2.2	2.0	1.9	1.1	1.5	1.6	7.5	7.5	7.0	-1.0	-0.5	-0.5
Norway	1.9	2.2	2.0	1.9	1.9	1.8	6.0	6.0	5.5	3.5	4.0	5.0
Sweden	2.7	2.7	2.4	1.8	1.9	2.0	5.0	4.0	4.0	1.3	1.0	0.5
Switzerland	1.0	2.2	1.8	0.6	0.5	0.6	9.3	11.2	11.4	0.2	0.2	0.2
Czech Republic	4.6	3.5	3.2	2.5	2.3	2.2	1.0	0.4	0.9	1.0	0.8	1.1
Hungary	4.0	3.8	3.2	2.3	2.5	3.0	2.9	1.9	1.5	-2.0	-2.2	-2.3
Poland	4.6	4.0	3.4	2.0	2.0	2.8	0.3	-0.4	-0.1	-1.9	-2.1	-2.5
United States	2.3	2.9	2.8	2.1	2.3	2.2	-2.9	-3.2	-3.5	-3.6	-3.7	-5.3
Japan	1.7	1.1	0.5	0.5	0.7	0.7	4.0	4.6	4.7	-2.7	-2.4	-2.2
China	6.9	6.6	6.3	1.6	2.7	2.4	1.3	0.6	0.3	-3.7	-3.5	-3.5
World	3.8	3.9	3.9	2.9	3.3	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

					2018				2019			
	2016	2017F	2018F	2019F	Q1F	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	1.9	2.2	2.0	1.8	0.3	0.6	0.5	0.5	0.4	0.4	0.4	0.4
Private consumption	2.1	1.9	1.3	1.5	0.3	0.7	0.5	0.5	0.3	0.4	0.3	0.2
Gov't expenditure	3.7	1.6	1.3	1.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Fixed investment	3.1	3.2	2.5	3.6	0.6	1.2	1.0	0.8	1.0	0.9	0.9	0.8
Investment in M&E	2.2	4.0	3.8	3.1	0.5	1.0	1.0	0.5	1.0	0.7	0.7	0.5
Construction	2.7	2.6	2.6	5.0	0.5	1.8	1.2	1.2	1.2	1.2	1.2	1.2
Inventories, pp	-0.2	0.1	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports	2.6	4.7	5.9	4.5	0.9	1.2	1.2	1.2	1.1	1.0	1.0	1.2
Imports	3.9	5.1	6.0	5.1	1.2	1.4	1.4	1.4	1.2	1.2	1.1	1.2
Net exports, pp	-0.3	0.1	0.4	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Consumer prices*	0.5	1.8	1.6	1.8								
Unemployment rate, %	6.1	5.7	5.3	4.8								
Industrial production**	1.4	3.0	1.8	1.5								
Budget balance, % GDP	0.8	1.1	1.1	0.9								
Public debt, % GDP	68.2	64.1	60.4	57.5								
Balance on current account, % GDP	8.4	7.2	6.5	6.5								
Balance on current account, EUR bn	262.6	232.0	212	214								

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

Weaker recent data – too early to throw in the towel, but 2018 GDP forecast cut to 2%

— Just as the ECB is getting serious about exiting QE economic data has started to surprise to the downside. In particular in Germany, the clear front-runner in the EMU economic cycle, hard and survey data have disappointed during the last few months.

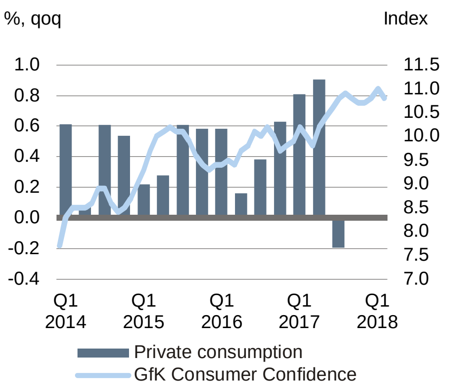
— Although German Q1 GDP growth now looks likely to have grown by about ¼% qoq, we still expect some positive payback in Q2, as some temporary factors depressing activity should disappear.

— Corporate investment spending will be key for growth in the remainder of the year. Unfortunately, signals from proxy indicators have become somewhat mixed recently too.

— Notwithstanding a likely albeit limited Q2 rebound in activity, the strong drop in the expectations component of the ifo business climate suggests that we have probably passed the peak in qoq growth rates in the current cycle.

— Due to the weaker Q1 we have lowered our GDP forecast for 2018 from 2.3% to 2.0%.

Consumption: Just pay back? 1



Sources: Deutsche Bundesbank, GfK, Deutsche Bank Research

Domestic demand stalled in H2

For starters, the growth composition of H2 2017 looked odd. Although each month 53k new jobs were created and real wages rose by about 1% – as in H1 – private consumption growth grinded to a halt. While business sentiment indicators marked new all-time highs and capacity utilization continued to rise, investment in machinery and equipment slowed to a meagre 0.7% (qoq) in Q4.

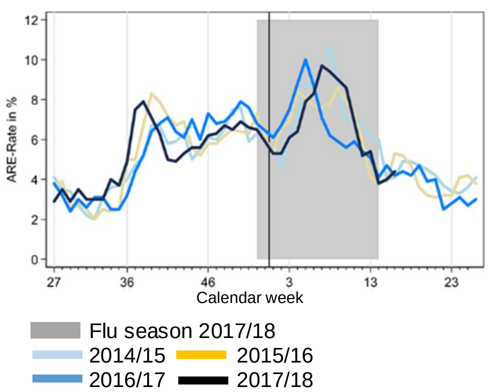
Of course there are possible explanations. Consumption might have taken a breather after H1's surge (0.85% qoq). Investment spending might have been hindered by capacity constraints as evident in rising delivery times and order backlog – maybe even the protracted government formation after the September election played a role – but it still looks odd.

Q1 hard data disappointed

Moreover, monthly hard data has been weak in Q1. This was not only the case in Germany. Economic surprise indices have turned south in Europe and softened in the US. German Q1 GDP will be clearly below earlier expectations of 0.6%.[1]

Comparing Q1 to Q4 averages gives a stagnation for industrial output (including construction), a 0.9% drop in retail sales. Orders fell by 2.1%, domestic capital goods orders even by 2.7%, while real exports should have shrunk by about 1%. Although in many cases the decline came on the back of very strong Q4 data real exports were down 1.1%. The Bundesbank suggests that strikes in the metal sector and the severe flu might have hampered output in February. Indeed output in the auto industry fell by 5.9% mom in February which is, however, well inside the usual monthly vola of these series. If output of specific companies shows unusual movements the Länder Stats Offices, which collect the data for the Federal Stats Office, usually check with the reporting company and take note of reasons such as strikes or shut-downs when transmitting the data to the Federal Stats Office: There were no such reports in February. But

Protracted flu season in 2018 2



Sources: GrippeWeb, Robert Koch-Institute

[1] See DB German Macro Surprise Index, p. 15

the 2.6% rise in capital goods output in March following a 2.7% decline in the preceding month suggest that strikes did play a role.

This year's flu season reached its climax in week 7 and it was certainly more severe than in previous years as the number of people on sick leave reached a ten year high in February, with the period people stayed off work also being exceptionally high. In February the manufacturing sector's delivery times reached an all-time high (PMI), which could in part be due to these impediments. On the other hand the order backlog shrank slightly (PMI) but continued to increase according to the ifo survey. These factors have certainly weighed on economic activity in February, but whether this explains all of the weakness remains questionable. Furthermore, the weather impact – also mentioned as a possible explanation – was actually rather modest in February (compared to Jan. and March). All in all, we should see some rebound in March activity data but even the GDP in Q1 is unlikely to increase by more than ¼% (flash estimate to be released on May 15th, March production on May 9th).

Confidence data: Normalisation or something more sinister?

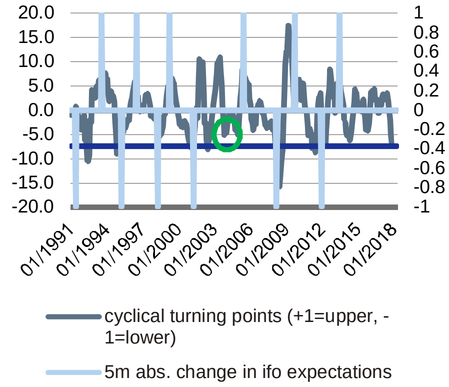
These transitory factors probably left their mark in the confidence surveys, too. In addition the heightened trade war rhetoric in early April might have had an impact, in particular in the ZEW-Index, as it is a survey among financial markets participants, more vulnerable to such political concerns. But ifo and PMI indices started inching lower at the turn of the year, when the above discussed transitory factors had not yet materialized. On the other hand, the decline in the ifo index or the manufacturing PMI happened after all-time highs had been reached. In addition both ifo and the PMI are diffusion indices meaning that if responses shift from "better" to "unchanged" this should not be necessarily interpreted as a deterioration, it might just mean that the economy is not improving as rapidly as in the preceding month. While the ifo index is based on a certain base year being 100, which actually was shifted from 2005 to 2015 with the release of the April survey, the PMI is calibrated to 50, meaning that as long as the index is above 50, the economy is still growing. The April composite PMI at 55.3 hence still signals robust growth given its long-term average of 53.3.

Reasons to remain upbeat

i. The levels of the confidence surveys are still very high. Bridge models based on the ifo index or the PMI yield qoq GDP growth rates of 1.1% for Q1. Even for Q2 (based on just the April readings) they hint at 0.9%. However, in Q4 2017 the residual of these models (i.e. the over-estimation of the actual GDP growth reached 0.7pp, while the average of the last 8 quarters was just 0.2pp).

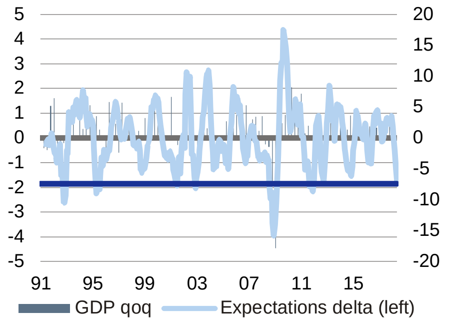
ii. There might be an element of circularity in these surveys. Corporate managers might – just like economists – have difficulties to decipher to what extent recent weakness in monthly statistics provides a reliable signal, but also whether their own companies' micro-data movements are noise or a proper indication of the cyclical movement.

iii. Of course, the macro environment externally (despite our downward revision of EMU growth from 2.4% to 2.1% following the weak Q1 GDP data, the global economy is still expected to expand at a solid 3.9% in 2018) and internally (solid employment and wage growth, expansionary fiscal policy stance [although rather back-loaded]) – does speak against an imminent weakening of the economy unless current trade disputes unexpectedly escalate. But these should also be known by the respondents ifo expectations (5m change) & cyclical turning points 3



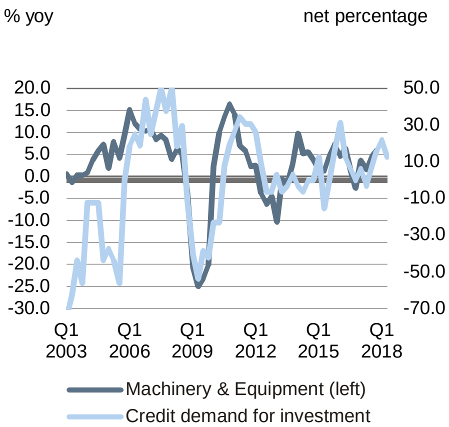
Sources: ifo, OECD, Deutsche Bank Research

ifo expectations (5m change) & GDP growth 4



Sources: ifo, OECD, Deutsche Bank Research

M&E investment & BLS responses 5



Sources: Deutsche Bundesbank, ECB

of the business survey. Why then have they marked down their expectations twice as much as their assessment of the current situation?

On the other hand …

The 7.4 points drop in the expectations' component of the ifo business climate over the last 5 months should not be dismissed lightly.

As chart 3 shows such a drop has in the past always been accompanied by an upper turning point of the economic cycle, the only exception was 2002, which still gives this signal an 80% accuracy (based on 5 observations). Moreover, in each of the six occasions when the expectations' component fell by 7.4pp or more over 5 months, quarterly GDP growth slowed noticeably.

Investment spending will hold the key

As mentioned above, the deceleration in H2 capex spending was a point of concern even before business confidence started drifting lower at the turn of the year and before the unexpected weakness of the Jan/Feb data. Following robust consumption, a sustained expansion in investment spending is necessary to keep the domestic cycle going

Unfortunately the outlook is somewhat mixed:

— Operating profits were up by 4 ¼% yoy in H2 2017, the strongest increase since 2013-Q4 and 2014-Q1. The current assessment in the ifo business climate – which peaked in January – is a good concurrent proxy for the development in profits and points towards some moderation.

— Capacity utilization in the manufacturing sector had risen strongly since mid-2016 to come less than 1pp shy of Q1 2008's all-time high of 88.8%, but fell marginally in Q2 2018.

— While economic policy uncertainty has receded substantially during the last 12 months, the DAX is down in yoy terms and its implied volatility (another proxy for economic uncertainty) has risen.

— In the Q2 bank lending survey the number of banks reporting fixed investment as a driver for loan demand fell slightly, after gaining in Q4 and Q1.

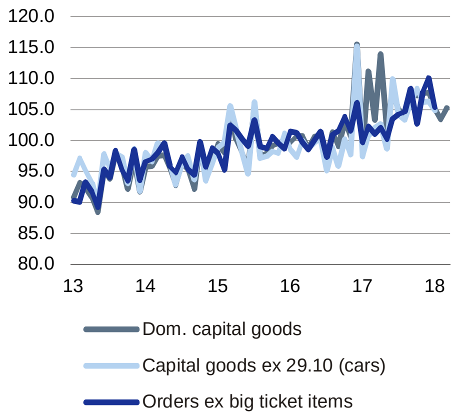
— Domestic capital goods orders have been very volatile over the last 12 months, in part due to big ticket orders. However, the overall trend was essentially sideways despite the modest recovery in March +1.8% after -1.6% in Feb. Possible flu and strike effects should be less of a factor with regard to orders.

— Domestic capital goods orders and investment spending itself are highly correlated with the ifo business climate in the manufacturing sector. Last year's increase in the business climate was only partially tracked by order and investment activity. But the turning point in the ifo business climate makes it less likely that recent weaker capital goods orders are just noise.

When looking at each of these factors individually, it is certainly too early to conclude that the investment cycle has peaked. Even taking them all together we are not yet prepared to draw this conclusion, but the one-sided recent data cannot be ignored.

Domestic capital goods orders 6

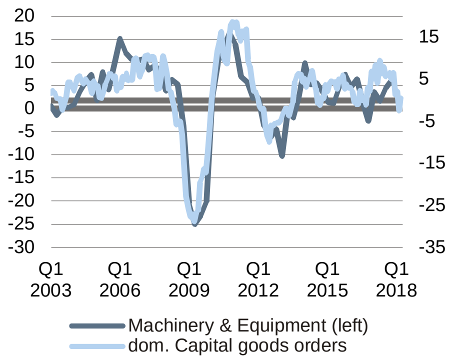
2015=100, volume



Sources: Deutsche Bundesbank, Federal Statistical Office

M&E investment & domestic capex orders 7

2015=100 % yoy, 3M ma, vol.



Sources: Deutsche Bundesbank. ECB

Growth should strengthen again in Q2, but momentum has probably peaked

Cyclical turning points hardly ever announce themselves: Every downswing ultimately starts with an innocent-looking first drop from a cyclical peak and the economy has looked just fine before it suddenly turned. Therefore, one should not draw too much comfort from the high-level argument with regard to the business surveys and maybe not even from the long list of explanations why current softness should turn out as a transitory phenomenon. The fact that the ifo index enjoyed several all-time highs until just a few months ago makes it rather unlikely that the index will reenter an upward trend in the next few quarters, based on its mean reversion properties. The weaker-than-expected labour market in April provides a further reason not to become too relaxed.

Annual GDP forecast cut to 2.0%

Even if last November was the peak in this cycle according to the ifo index (including services, base year 2015) it just suggests that growth will decelerate from last year's average qoq rate of 0.7% still with Q1 at around ¼% and the potential for catching up in Q2 limited by the still stretched capacity utilisation, our early growth forecast of 2.3% for 2018 is no longer feasible. Hence, we have cut the forecast to 2%, which assumes still healthy growth rates slightly above potential in H2.

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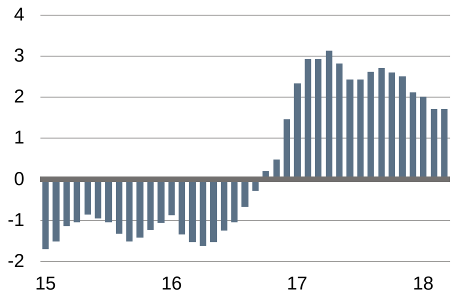
Producer prices continue to increase, albeit at a slower pace 1

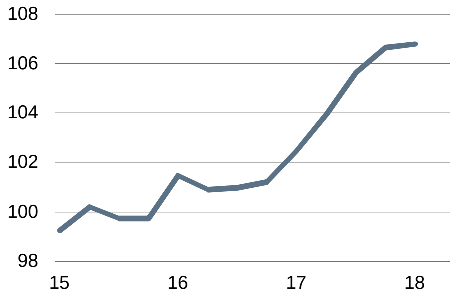
Producer prices in manufacturing industry in Germany, % yoy



Source: Federal Statistical Office

German industry is taking a breather at the beginning of 2018 2

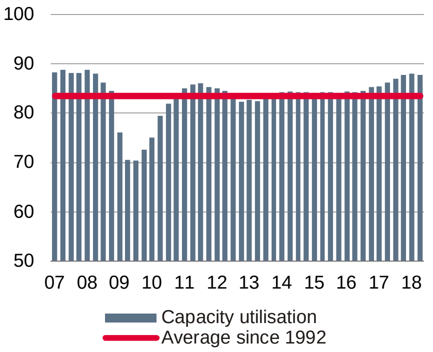
Output in manufacturing industry in Germany, quarterly values, sa, 2015=100



Source: Federal Statistical Office

Utilisation declines at a high level 3

Capacity utilisation in German manufacturing industry, %



Source: ifo

Inflation pressure curbed by slowing industrial dynamics and the strong euro

— German inflation in 2018 will again remain below the 2% target rate, despite the fifth consecutive above-potential rise in GDP, high capacity utilisation, labour shortages in many areas and strongly rising negotiated wages. At the beginning of the year, producer price inflation in manufacturing slowed compared with 2017, led by the breather in industrial activity. Furthermore, the stronger euro dampens German import prices, which look set to either slow sharply or even shrink relative to 2017.

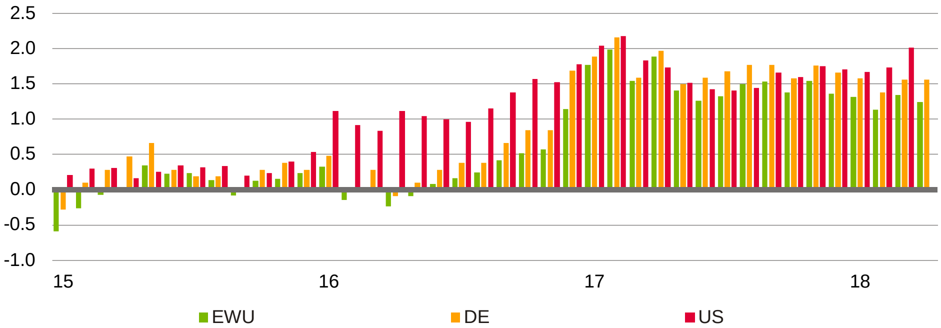
— For the euro area, we expect an inflation rate of 1.6% in 2018. For the doves within the ECB, the weak uptick will provide strong arguments for the (announced) slow exit from expansionary monetary policy.

The question as to when inflation will finally return has kept the international financial markets on their toes for many months now. Despite expansionary monetary policy and robust economic data, only inflation in the US meanwhile hit the target rate of roughly 2% (in March 2018, for the first time since January 2017). In the euro area, it is just under 1 ½% – in Japan, below 1%. In the US, signs are increasing that inflation and price pressure will build as the labour market tightens. In recent weeks, markets have hence priced in a higher probability of four or more Fed rate hikes this year. The ECB remains optimistic that inflation ought to pick up, led by relatively strong GDP growth, higher capacity utilisation and improving labour market data in many euro countries. At the recent press conference though, Mario Draghi struck a somewhat more cautious tone.

Over the past months, however, inflation was (well) below the 2% target in most countries. This also holds for Germany, although GDP in 2018 looks set to grow above potential for the fifth year in a row, whilst employment is at a record high and unemployment dropped to the lowest level since the reunification. In spite of these positive fundamentals, the inflation rate was only 1.7% in 2017 and just 1.5% year-over-year in the first four months of 2018 (2016: +0.4%).

Inflation rate in Europe still below 2% 4

Inflation rate*, % yoy



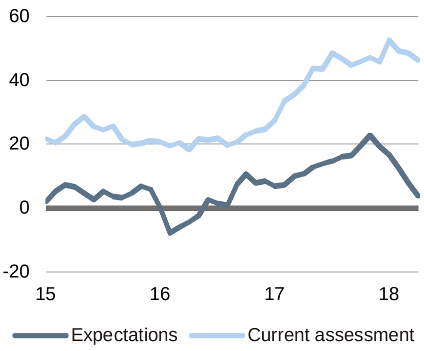
* For the US based Personal Consumption Expenditure Price Index

Sources: Bureau of Economic Analysis, Deutsche Bundesbank, Eurostat

Slowing German producer price dynamics

Manufacturing: Business expectations recede of late 5

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



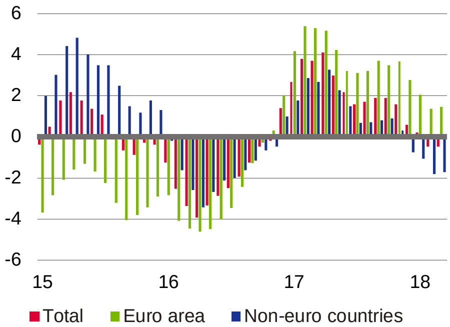
Source: ifo Institute

German manufacturing producer prices, at least, picked up by 2.6% in 2017. But dynamics have slowed visibly over the past months. In the first quarter of 2018, the increase came to only 1.8% compared with the previous year, which is somewhat surprising, not least because oil prices were up on the preceding year in the first months of 2018 (Q1 2018 vs. Q1 2017: +6.2% in euro terms; +23% in US-dollar terms). In 2017, producer price inflation in Germany was still largely driven by the commodity-related sectors (metals, chemicals).

The slowdown in inflation is possibly attributable to the fact that industrial activity took a breather in the first quarter of 2018. Seasonally adjusted output in the manufacturing industry increased only marginally on the previous quarter in Q1, after rising quite strongly during 2017. Moreover, industrial capacity utilisation also suggests that manufacturing has lost some steam of late. At the start of the second quarter of 2018, it slipped moderately, albeit from high levels. This is in line with business expectations of industry that declined for the fifth consecutive month in April 2018. However, they are still within positive territory, albeit only barely. Short-term, it seems unlikely from the current perspective that German manufacturing industry will slide into a severe economic crisis, and slowing growth momentum can – at least partly – be explained by high capacity utilisation and the tight labour market. As regards the targeted return of inflation towards levels that are below but close to 2%, however, the (temporary) soft patch in manufacturing comes at an unfortunate moment.

Strong euro dampens import prices 6

German import prices for products of the manufacturing industry, % yoy



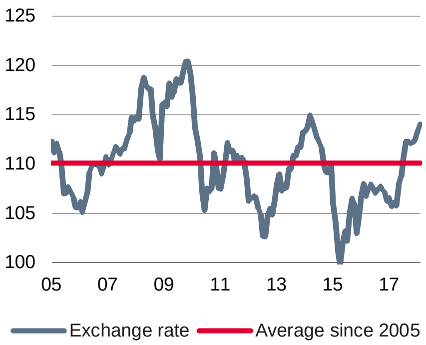
Source: Federal Statistical Office

Import prices from the non-euro countries turning negative

At the same time, the inflationary stimulus from German import prices is waning. Chart 12 illustrates the import prices for manufacturing products, for both imports from the euro area and from non-euro countries. Accordingly, year-over-year import prices from the non-euro area have turned negative in recent months, reflecting the relative strength of the euro vis-à-vis the currencies of major trading partners. In the first quarter of 2018, the nominal trade-weighted euro exchange rate for Germany was up by more than 7% on the same period a year earlier. In parallel, producer prices of manufactured goods in China – Germany's largest importer – have pointed to the downside in recent months.

Euro is trending up of late 7

Nominal (trade-weighted) effective exchange rate, Q1 1999=100



Source: ECB

Inflation rate in Germany and the euro area to remain below 2% in 2018

According to our current forecast, German inflation in 2018 is likely to come to around 1.6%. Drivers are the relatively high wage settlements as well as the further decline in the unemployment rate resp. payroll gains. Moreover, average annual oil prices in 2018 should come in higher than in 2017. At the same time, German imports become cheaper due to the strong euro. What is more, the economic cycle in Germany and major export markets is at an advanced stage.

For the euro area, we expect an inflation rate of 1.6% in 2018. For the doves within the ECB, the weak uptick will provide strong arguments for the (announced) slow exit from expansionary monetary policy

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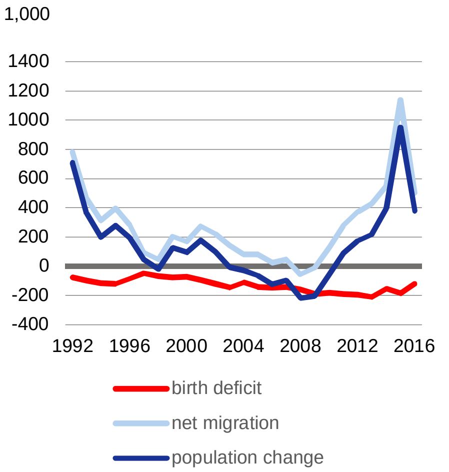
Labour migration: The boom is feeding the boom – so far

Migration markedly impacts changes in the population number | 1



Sources: Federal Statistical Office, Deutsche Bank Research

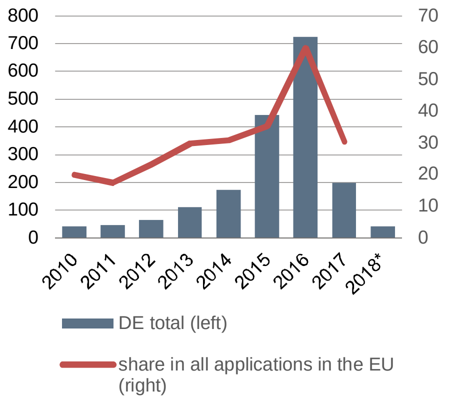
Migration pushes population figures up

Since the beginning of this decade, Germany has registered strong immigration. In fact, the numbers of immigrants are similar to those seen during the migration boom after the fall of the Iron Curtain. While there are several different aspects to current migration developments, the migration momentum seems to be slowing after about eight years, as it did back then. Between 2010 and 2017, roughly 3.83 million more people came to Germany than left the country (own calculations for the period from September 2017 until December 2017). This is equivalent to net immigration of c. 480,000 per year, compared to just above 96,000 per year during the past decade and 387,000 p.a. during the 1990s.

In contrast to what happened in most years of the past decade, immigration, in this decade, has more than offset the population decline stemming from the balance of births and deaths, which has been persistently negative since 1972. As a result, Germany's population has been growing since 2011. The Federal Statistical Office estimates that, by the end of 2017, c. 82.8 million people lived in Germany, i.e. roughly 2.5 million more than at the end of 2011 (the data for 2010 are not comparable).

Germany major EU destination for asylum applicants | 2

First time asylum applications, 1,000 left scale, % right scale



* Jan. to March

Sources: BAMF, Eurostat, Deutsche Bank Research

Refugee migration currently the predominant issue

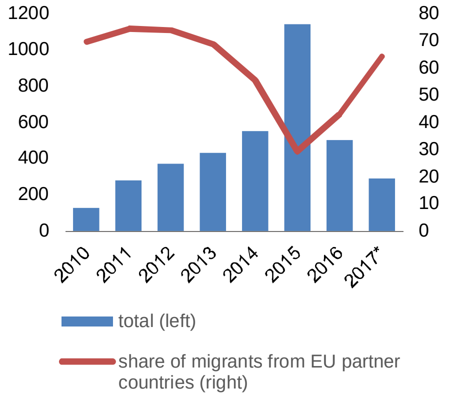
At the moment, the refugee crisis is the predominant issue in the German debate about migration. In 2015 and 2016, most immigrants were indeed refugees from the war-torn crisis areas of the Middle East and Africa[2]. The data of the Federal Statistical Office show that net immigration from these countries amounted to c. 550,000 in 2015 and just below 340,000 in 2016 (non-adjusted figures). This is equivalent to 48% and 46%, respectively, of the total net migration figures for each of these two years (figures for 2016 not adjusted). And these developments are one reason why Syrian nationals currently form the third-largest group of foreigners in Germany (almost 0.7 million), after Turkish (1.5 million) and Polish nationals (0.87 million) (figures for end-2017; total number of foreigners in Germany: 10.6 million).

Due to the closing-down of the "Balkan route", more restrictive German asylum policies and several measures at the EU level, in particular the agreement with Turkey concluded in March 2016, the number of asylum seekers has declined considerably from its peaks in autumn 2015 and spring 2016. The number of migrants from all third countries outside the EU has fallen. According to data collected by the Central Register of Foreigners (CRF), the net migration surplus of third-country nationals amounted to c. 850,000 in 2015, but dropped to c. 350,000 in 2016[3]. In H1 2017, the net migration surplus was equivalent to 117,000 – a decline by 40% from H1 2016 (figures from the CRF). These figures show that refugees currently make up the bulk of immigrants from third countries; as a matter of fact, there are only few (limited) other immigrations or residence options for third-country nationals. (One is a residence permit for work purposes, which was granted to c. 66,500 persons in 2016. About half of them entered Germany in that year.)

[2] This includes Afghanistan, Eritrea, Iraq, Iran, Nigeria, Pakistan, Somalia and Syria.
[3] The figures from the Central Register of Foreigners differ from those of the Federal Statistical Office because a registration only takes place if people reside in Germany for more than 90 days or if there is another reason for registration (such as an asylum application).

Net migration to Germany 3

1,000 left scale, % right scale

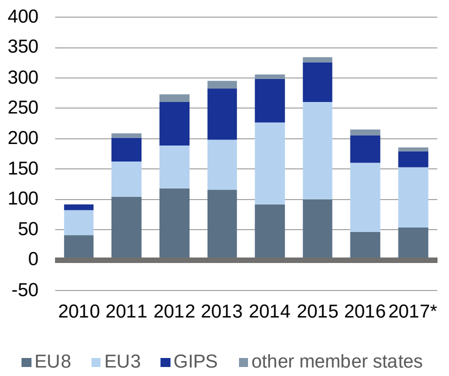


* Jan. to Aug.

Sources: Federal Statistical Office, Deutsche Bank Research

Net migration from EU partner countries 4

1,000



* Jan. to Aug.

Sources: Federal Statistical Office, Deutsche Bank Research

Since 2010, 1.9 million EU citizens have come to Germany

With the debate focusing on refugees, many commentators have overlooked the significant immigration figures from EU countries during the current decade. In fact, immigration from other EU countries has exceeded immigration from third countries since 2010. The net migration surplus (c. 1.9 million until August 2017) also exceeds the figure for third-country nationals (1.83 million), even though outward migration is higher among EU citizens (in particular including German nationals). All in all, almost 51% of this decade's migration surplus is the result of immigration from other EU countries. The share of EU immigrants only dropped below that of third-country nationals in 2015 and 2016, at 29% and 43%, respectively.

EU immigrants came almost exclusively (c. 97%) from two groups of countries. The first group includes the eight central European and the two south-eastern European states which joined the EU in May 2004 and at the beginning of 2007, respectively, but were not granted the right of free movement of labour until seven years later. This means that people from these countries were not allowed to enter Germany for work purposes (or in order to look for work) until May 2011 and January 2014, respectively. Since (net) incomes in these countries are relatively low in comparison to Germany (c. 30% of the German level in Poland or 18% in Romania) and people had been unable to move to most of the other EU countries for years, (net) immigration from these countries rose quickly and reached a total of 200,000 persons p.a. between 2012 and 2015. By now, the latter sub-group of countries (EU3) also includes Croatia, which was granted the right of free movement of labour by mid-2015 (it had joined the EU in mid-2013). Aggregate net immigration from these 11 EU countries sums up to 1.43 million people between the beginning of 2010 and August 2017, with most immigrants coming from Poland (414,000), Romania (434,000) and Bulgaria (201,000).

The second group consists of the four southern euro-area countries which underwent a crisis and years of high unemployment at the end of the past decade. In this decade the first group, the EU11, makes up almost three quarters of Germany's net migration surplus versus partner countries, and the share of the second group, the EU4 or GIPS (Greece, Italy, Portugal, Spain), is c. 22% (+410,000 for the period from 2010 until August 2017).

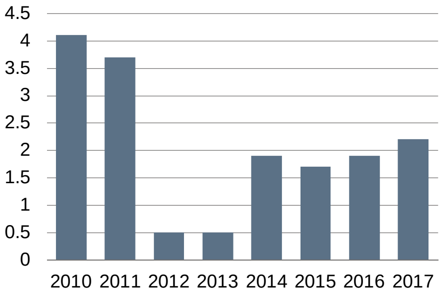
Migration momentum is slowing

Just like immigration from third countries, immigration from other EU countries declined in 2016. However, the Federal Statistical Office changed its data methodology in that year, which makes country-specific comparisons to 2015 difficult. The figures from the Central Register of Foreigners, which focus on migrants' nationality, point to a considerable decline (-25% in 2016 compared to 2015), which continued in 2017 (H1 2017 vs H1 2016: - 15%), even though recent figures from the Federal Statistical Office suggest otherwise. Still, the figures of the Federal Statistical Office show as well that immigration from the southern EU countries, in particular Spain and Portugal, has declined considerably so far this year. This fits in with the continued economic recovery in these countries.

Immigration from central and eastern Europe, in particular Poland, is likely to slow (further), too, seeing that demand for qualified labour is rising in these countries, too.

Germany on the growth path 5

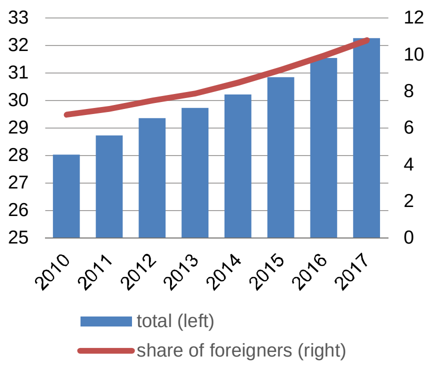
Real GDP, yoy change, %



Source: Federal Statistical Office

Labour market upturn supported by foreign labour 6

Gainfully employed persons*, m left scale, % right scale

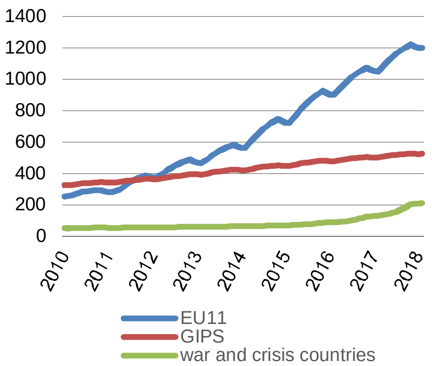


* only persons obliged to pay social security contributions

Sources: Federal Employment Agency, Deutsche Bank Research

Increase in the number of foreign workers by their nationality 7

Employed persons obliged to pay social security contributions, 3 m moving average, 1,000



Sources: Federal Employment Agency, Deutsche Bank Research

Migration props up growth and dampens wage rises

Migration has had a palpable effect on the German labour market in the last few years. In particular, immigration from other EU countries has boosted the supply of labour and thus helped the German economy stay on a remarkable path of growth even though domestic labour became scarce (average GDP growth since 2014: +1.9% p.a.; since 2010: +2.1% p.a.). Immigration has thus strengthened the expansion and, in turn, made Germany attractive for migrants who are looking for work.

A recent Bundesbank analysis finds that labour-related migration dampens wage growth[4], largely because many migrants, above all from the new EU member states, work in sectors where wages tend to be lower (and wage growth below the average), such as agriculture, temp work, restaurants or hotels, construction or transport and logistics.

Number of foreign workers has doubled since Q1 2010

Without foreign workers, the significant increase in the number of jobs which are subject to social security contributions by 15% or 4.23 million in total from 2010 until 2017 to a total of 32.26 million would have been almost impossible. 38% of all the new jobs created in that period are held by foreign workers. In fact, the number of foreign workers has doubled in the nine years since Q1 2010, to 3.66 million (in Jan/Feb 2018; yearly average 2017 to 2010: +85%, to 3.5 million). As a result, the share of jobs subject to social security contributions which are held by foreigners rose from 6.7% in 2010 to 10.8% in 2017 and even 11.3% in February 2018.

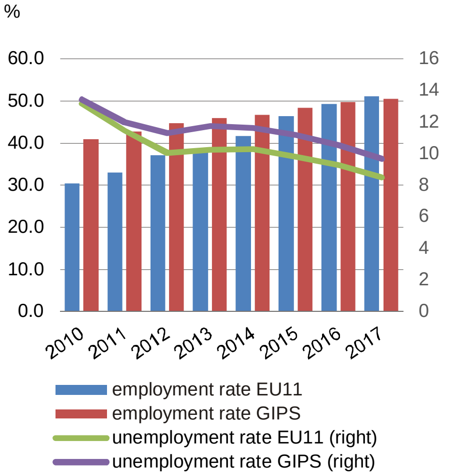
Workers from the new central and eastern European member states (EU11: +873,500, of which Poles: 286,000; Romanians: 251,000) and the GIPS countries (+180,000) played the most important role in this development. The number of workers from war and crisis countries rose by c. 140,000.

The significantly stronger rise in the numbers for the first two groups is probably due to the fact that most of these migrants came to Germany with the express purpose of looking for work, whereas refugees are looking for protection. Many immigrants from war and crisis countries are children and young people aged below 18. In addition, asylum seekers from these countries are not permitted to work during the first six months of their stay in Germany. Moreover, many refugees lack qualifications and, above all, do not speak the language sufficiently well to hold down a job. Getting the necessary qualifications and learning the language takes time.

Any interpretation of the employment statistics should bear in mind that the figures only focus on workers' nationality, regardless of whether people have recently come to Germany or been living here for some time already. To a (small) extent, the increases mentioned above might be due to a rising willingness to work among foreign nationals who were already resident in Germany before 2010. This seems to be the case in the Turkish community, seeing that the net migration surplus of Turkish nationals was only 30,000 since 2010, while the number of gainfully employed Turkish citizens has risen by c. 51,000 during the same period.

[4] Deutsche Bundesbank (2018): Lohnwachstum in Deutschland: Einschätzung der Einflussfaktoren der jüngeren Entwicklung. Monthly Report April 2018

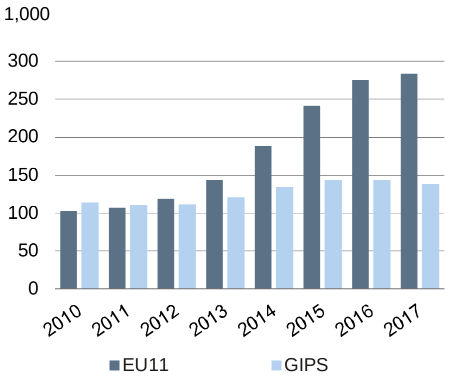
Employment* & unemployment** rates for citizens from EU partner countries 8



* employed obliged to pay social security contributions as percentage of the respective group of foreigners (according to the CRF), **rate with a shortened denominator

Sources: Federal Employment Agency, Deutsche Bank Research

Basic social security benefits recipients from EU partner countries 9



Sources: Federal Employment Agency, Deutsche Bank Research

Relatively high employment ratio among EU citizens

Based on the numbers of relevant nationals stored in the Central Register of Foreigners, the employment ratios for citizens of the GIPS and the EU11 are much higher (Feb. 2018: 49.7% and 50.4%, respectively) than for foreigners as a whole (41.1%; Germans: 61.2%; only jobs which are subject to social security contributions, excluding mini jobs and self-employed). The employment ratio drops to 19.4% for persons from war and crisis areas.

Unemployment numbers match these employment figures. Despite considerable immigration, fewer GIPS citizens were unemployed in Q1 2018 than nine years ago (61,100 vs. 66,500 in Q1 2010). In contrast, the number of unemployed citizens of central and south-eastern EU countries has roughly doubled during the same period, from c. 54,000 to 116,000 (April 2018: 107,000). The adjusted unemployment ratio (which is based on both jobs subject to social security contributions and mini jobs plus unemployed) amounted to 9.6% for GIPS nationals and 8.8% for EU11 nationals (but 16.8% for Bulgarians) in February – a result which reflects the rise in immigration.

Number of recipients of social security benefits considerably higher among foreigners

The extent to which people claim basic social security benefits under the respective German Social Code (SGB II) is one indicator for problems in the area of labour market integration. There are considerable differences between the individual groups of immigrants mentioned in this article. While the number of recipients from the GIPS countries rose by only about one-fifth between 2010 and 2017 (21.5% or by 24,400, to 138,000), the increase was substantially higher (175% or roughly 180,000) for EU11 nationals, to 283,000. In 2017, however, the rise for EU11 nationals was comparatively small (3%), and in January 2018, the number of recipients (281,000) was even down from the preceding year. A similar development has been in place among southern Europeans for some time now. In January 2018, 968,000 persons from war and crisis countries received basic social security benefits, with 652,000 of them registered as being able to work. This figure shows once again that integration is, indeed, a significant task.

Conclusion

The immigration boom has boosted the upswing in Germany and continues to support robust growth. By now, however, labour immigration from other EU countries looks set to have peaked. Insofar as there is still a demand overhang for qualified labour in the upcoming era of digitalisation, it makes sense to make Germany more attractive for qualified immigrants from third countries. Above all, however, the available supply of labour should be used effectively. There is currently a mismatch between almost 1.2 million job vacancies in Q1 2018 and 2.52 million unemployed, with almost 0.91 million of the latter touching social security benefits. At the same time, a total of 4.26 million recipients who are officially able to work (figures for January) indicates just how big the task of bringing these people into work is.

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The view from Berlin

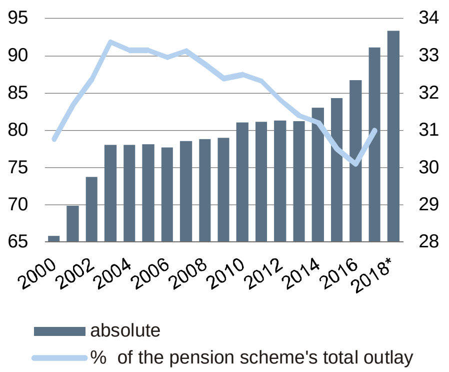
Finance Minister Scholz: fiscal policy in Mr. Schäuble's tradition?

Last Wednesday, Germany's new SPD Finance Minister Olaf Scholz attracted much public attention when he presented the CDU/CSU/SPD coalition government's budget plan for 2018 and its fiscal policy guidelines until 2022. Both plans hardly provided any surprises, given the Minister's limited leeway. He had to translate the projects stipulated in the coalition treaty into concrete budget plans with precise figures for the federal government's actual policy. Nevertheless, the Finance Minister's statement was met with criticism from different sides. Business representatives criticised the marked increase in social spending. Parts of his own party and the unions called for intensified public investment spending and blamed the Minister for an alleged and, in their view, misguided focus on the aim of a balanced budget.

At the press conference, the Minister emphasised that the government will perform a solid budget policy and refrain from any new net borrowing until the end of its term. Consequently, he also underlined his ambition of a further decline in Germany's debt-to-GDP ratio which according to the Minister will fall below the 60% threshold in 2019 under present conditions. All this is a reminder of his predecessor's policy approach, as we had expected. Confronted with such comparisons Scholz answered that Mr. Schäuble's policy was not "boring" and a solid budget presents a good trade mark.

Government funding for public retirement insurance rising 1

EUR bn (left scale), % (right scale)



* 2017/18 preliminary/planned figures according to the government budget

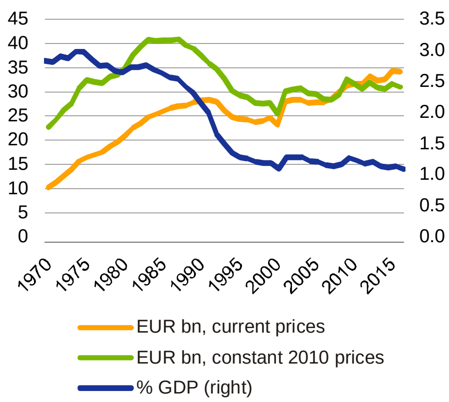
Sources: Bundesversicherungsamt, BMF, DRV

Safeguard for a flattening in tax revenues is missing

Criticism from different sides does not balance and mean that the budget is beyond doubts. We stick to our view that the government's aim to avoid new net borrowing despite strong increases in government spending especially on social security is very ambitious at least and does not provide any safeguard for a flattening in tax revenues. According to press reports (Deutschlandfunk) the federal government might benefit from even stronger increases in tax revenues than estimated so far. But the respective estimates from the Arbeitskreis Steuerschätzung (the working group for tax revenues estimates) which will be officially published on Wednesday are also based on a fair weather scenario. If such a scenario were to materialise, the need to provide sufficient relief for overloaded taxpayers would become even more pressing. The CDU's Secretary General Kramp- Karrenbauer on Monday morning already argued on TV (ZDF-Morgenmagazin) to use additional fiscal revenues for tax reduction for middle-income earners (beside stepping up spending for defence).

German defence spending down in real terms/share of GDP after cold war 2

Defence spending



Note: Break in GDP deflator/GDP series in 1991

Sources: Finance Ministry, Federal Statistical Office, Deutsche Bank Research

Anyway, those who argue against the budget's biased structure have a point, too. In 2018, e.g. the federal government will subsidise the public pension scheme with EUR 94 bn but spend EUR 37 bn on public investment only. From 2018 to 2022 the share of social spending in the federal budget will increase from 50.9% to 52.5% while at the same time the public investment's share will decline from 10.9% to 9.1%. Of course, the calculated decline in public investment (2022: EUR 33.5 bn only) primarily results from a revision of the investment financing (from 2021 onwards the Länder will shoulder a larger share and receive more subsidies in return). Nevertheless, this is hardly what a German government should signal, given the challenges from digitalisation, globalisation and increased geopolitical tensions.

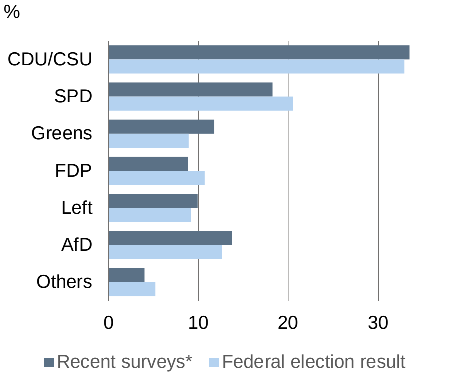
Intensified debates on defence spending

Against the background of the latter point and requests from Germany's allies, too, debates on defence spending have intensified recently. Despite an increase by EUR 1.5 bn to EUR 38.5 bn in 2018 and thus to 1.18% of GDP (2017) Germany will be still far away from the NATO 2% target. Therefore, Defence Minister von der Leyen put on record her reservation over the draft budget and formally called for additional funds for her budget. It came as no surprise that Andrea Nahles, the SPD leader and party whip, immediately rejected this request but there was also no outspoken support from the Chancellor who was just confronted with respective demands at her one-day trip to the US. Thus, the draft budget as well as the accompanying debates failed to signal a shift in Germany's willingness to assume more responsibility and closer cooperation with its partners.

More (fiscal) flexibility on the EU level?

Given the encouraging language on Europe in the German coalition treaty, expectations were running high among European partners that the social democratic FM Scholz would become more accommodative to EA reforms and plans than his predecessor and endorse quicker steps towards risk sharing – be it in the context of the transformation of the ESM into a European Monetary Fund or Banking Union. However, while endorsing Macron's call for a general overhaul of Europe and close cooperation between Germany and France, he cautioned that some of the proposals were not feasible – without going into details. Following media reports from the informal EcoFin meeting in Sofia at the end of April, Scholz also did not divert from previous government positions on Greece and debt relief when Greece will be exiting the bail-out programme in August. Finally, he took a balanced view on the upcoming talks on the EU's next medium-term budget. Acknowledging that Germany was willing to substantially increase its funding after Brexit, the Finance Minister reservedly commented on the European Commission's proposal from last week which calls for an even higher additional contribution by Germany (up to EUR 12bn p.a.). Scholz underlined that Germany would not cover the resulting gap of Brexit and the need for further spending on its own and that he lacks the phantasy to fulfil these wishes echoing comments from his predecessor. In any case, the additional contributions for the EU budget will not materialise before 2021, i.e. at the end of the current government's term.

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



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

Source: Wahlrecht.de

Approval of draft budget to be expected

Despite the reservations from various sides the coalition parties are likely to agree to the draft federal budget. But the Finance Minister will remain in the centre of the coalition's policy and will continue to play an important role in balancing the coalition partners' often divergent interests. As he is amongst the coalition's most popular politicians and enjoys Chancellor Merkel's as well as SPD leader Nahles' trust he should be in a good position to act as mediator if necessary. And even his predecessor was more flexible than his biased reputation suggests.

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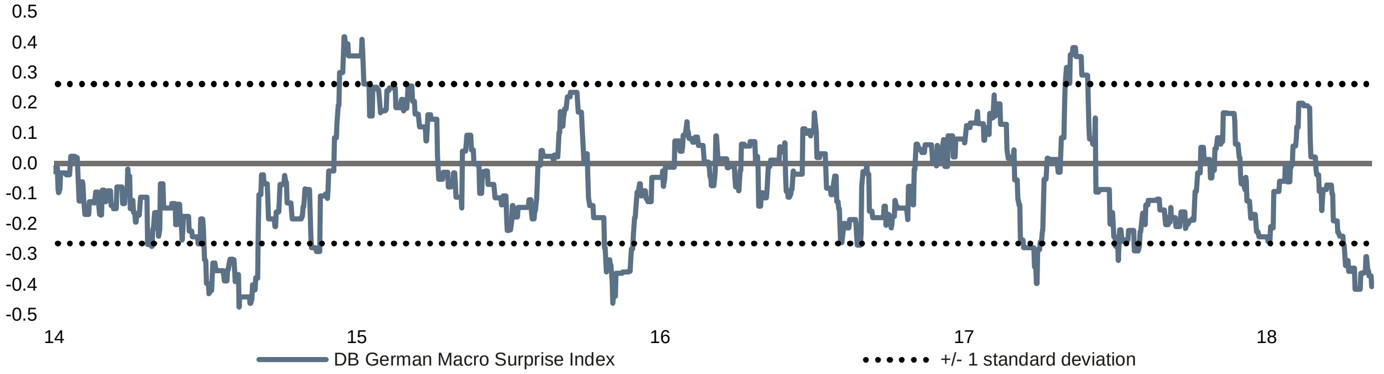
Growth rates have peaked – inflation should still recover

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
GRIFPBUS Index	IFO Business Climate	3 2018	22/03/2018	103.3	114.6	-11.3	-1.4	0.0
GRIMP95Y Index	Import Price Index (% yoy)	2 2018	27/03/2018	-0.6	-0.3	-0.3	0.1	0.5
GRUECHNG Index	Unemployment Change (000's mom)	3 2018	29/03/2018	-18.0	-15.0	3.0	-0.1	0.5
GRFRIAMM Index	Retail Sales (% mom)	2 2018	03/04/2018	-0.2	0.7	-0.9	-0.4	0.3
MPMIDEMA Index	Markit Manufacturing PMI	3 2018	03/04/2018	58.2	58.4	-0.2	-0.3	0.3
GRIORTMM Index	Factory Orders (% mom)	2 2018	05/04/2018	-0.2	1.5	-1.7	-0.9	0.2
MPMIDESA Index	Markit Services PMI	3 2018	05/04/2018	53.9	54.2	-0.3	-0.3	0.4
GRIPIMOM Index	Industrial production (% mom)	2 2018	06/04/2018	-1.6	0.2	-1.8	-1.5	0.1
GRCAEU Index	Current Account Balance (EUR bn)	2 2018	09/04/2018	20.7	22.9	-2.2	-1.0	0.1
GRCP20YY Index	CPI (% yoy)	3 2018	13/04/2018	1.6	1.6	0.0	0.2	0.3
GRZEWI Index	ZEW Survey Expectations	4 2018	17/04/2018	-8.2	-1.0	-7.2	-0.9	0.2
GRZECURR Index	ZEW Survey Current Situation	4 2018	17/04/2018	87.9	88.0	-0.1	-0.1	0.4
GRIFPBUS Index	IFO Business Climate	4 2018	24/04/2018	102.1	102.8	-0.7	0.7	0.6
GRUECHNG Index	Unemployment Change (000's mom)	4 2018	27/04/2018	-7.0	-15.0	-8.0	-0.5	0.3
GRIMP95Y Index	Import Price Index (% yoy)	3 2018	27/04/2018	-0.1	0.0	-0.1	0.2	0.6
GRCP20YY Index	CPI (% yoy)	4 2018	30/04/2018	1.6	1.5	0.1	0.9	0.8
GRFRIAMM Index	Retail Sales (% mom)	3 2018	30/04/2018	-0.6	0.8	-1.4	-0.8	0.2
MPMIDEMA Index	Markit Manufacturing PMI	4 2018	02/05/2018	58.1	58.1	0.0	0.0	0.4
MPMIDESA Index	Markit Services PMI	4 2018	04/05/2018	53.0	54.1	-1.1	-1.2	0.1
GRIORTMM Index	Factory Orders (% mom)	3 2018	07/05/2018	-0.9	0.5	-1.4	-0.7	0.2

Sources: Bloomberg Finance LP, Deutsche Bank Research

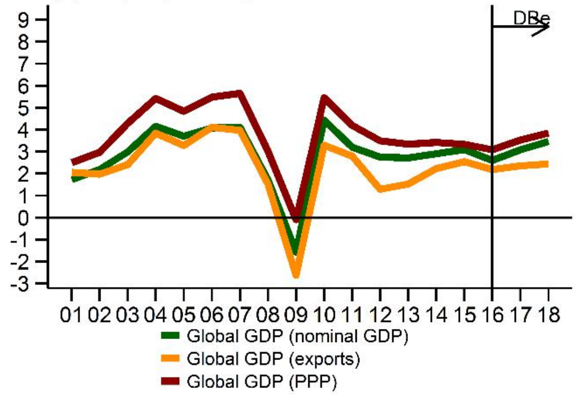
Updated by Sebastian Becker and Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)
Source: Heiko Peters (2014). DB German Macro Surprise Index. Focus Germany, 4 August 2014.

German Export Indicator

The Export Indicator identifies the effects on German exports of changes in global demand on the one hand, and currency movements on the other (price impact).[5]

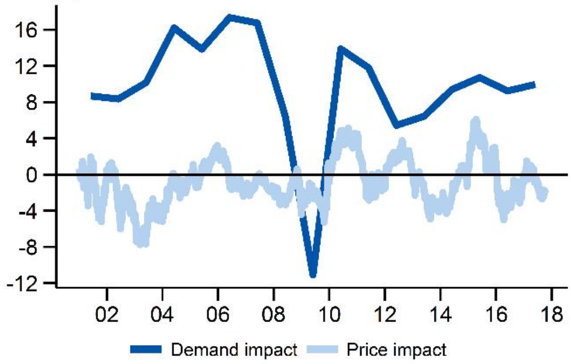
Global growth expected to accelerate

% yoy, weighting factor in parenthesis



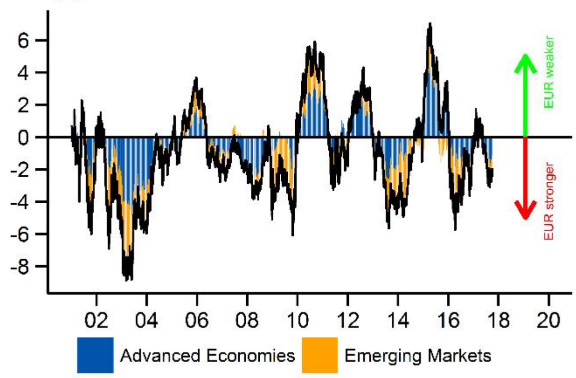
Demand and price impact for German exports

% yoy



Price impact slightly negative in 2017

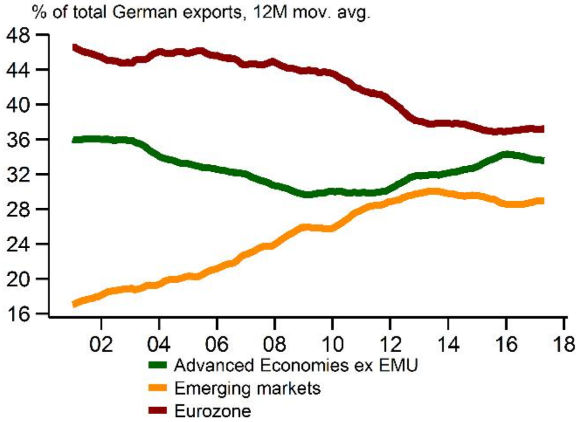
% yoy



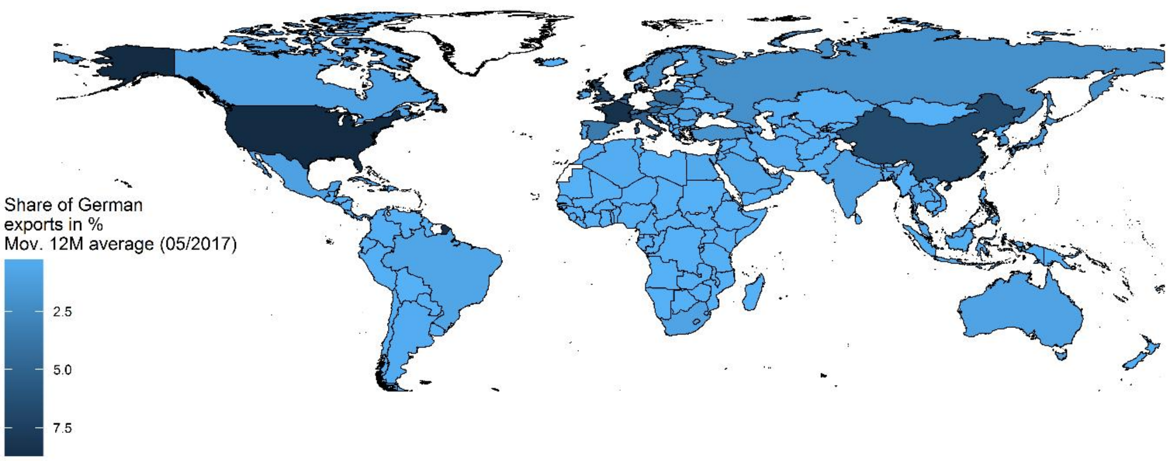
Weighed EUR yoy change using German export destination shares

Importance of EMU has moved sideways recently

% of total German exports, 12M mov. avg.



German exports focus on Europe, the USA and China



Sources: Eurostat - Comext, Deutsche Bank Research

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[5] See for details Focus Germany, March 3, 2016.

Growth rates have peaked – inflation should still recover

Germany: Events of economic-, fiscal- and euro-politics

Date	Event	Remarks
7 May	Start of the mediation process for collective bargaining in the construction sector	After the union IG Bauen-Agrar-Umwelt had declared the collective wage bargaining for the approximately 800,000 employees have failed after three rounds, a 14-day mediation process has begun on May 7. If no agreement is reached, the arbitration committee must make an award. The parties will then have to decide on its acceptance within two weeks. The mediator is the former Federal Minister for Economic Affairs Wolfgang Clement.
7-9 May	Working Party on Tax Revenue Estimates meeting, Mainz	At the meeting in November 2017 the Working Party forecasted an increase in total tax revenues by 4.1% for 2018 and 2019, respectively, to EUR 764.3 bn and EUR 795.4 bn. Given that the federal government and the relevant research institutes now expect stronger GDP and wage growth than expected in November, the working group is likely to increase its estimates - according to press reports by a total of up to EUR 60 bn for the period 2018 - 22.
24-25 May	Eurogroup and ECOFIN meeting, Brussels	Economic situation in the euro area – Commission spring forecast, thematic discussions on growth and jobs – spending reviews – follow-up, (poss.) Greece – state of play, Cyprus – Post Programme Surveillance.
14 Jun	ECB Governing Council meeting, press conference, (external meeting in Riga, Latvia)	Q1 weakness, the recent string of sluggish economic indicators and the ongoing potentially escalating trade dispute led us to assume that the ECB will remain in a wait-and-see mode, and that the end of QE is likely to be announced later.
21-22 Jun	Eurogroup and ECOFIN meeting, Brussels	Debates on (poss.) implications of the spring forecast for EDPs/EIPs for euro area countries, thematic discussions on growth and jobs: allocative efficiency in labour markets & pension sustainability, (poss.) IMF Article IV review of the euro area, (poss.) IMF FSAP – euro area aspects, (poss.) Greece – state of play, among others.
28-29 Jun	European Council meeting, Brussels	Debates on the future of the EU, foreign affairs and international relations, esp. trade relations, EU migration and asylum policy, political exchange on the EU budget, (poss.) state of the Brexit negotiations.
Mid-Jul - 7 Sep	Deutscher Bundestag Berlin	Parliamentary summer recess.
26 Jul	ECB Governing Council meeting, press conference	In the July council meeting the ECB may announce the QE exit. With the announcement the focus will directly shift to policy rates. We expect two 20bp deposit rate hikes and simultaneous 25bp refi hikes in Jun and Dec 2019. The soonest we could imagine a hike is June 2019.

Source: Deutsche Bank Research

Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
7 May 2018	8:00	New orders manufacturing (% mom, sa)	March	-0.9	-0.2
8 May 2018	8:00	Industrial production (% mom, sa)	March	1.1	-1.7
8 May 2018	8:00	Trade balance (EUR bn, sa)	March	22.0	19.2
8 May 2018	8:00	Merchandise exports (% mom, sa)	March	1.7	-3.1
8 May 2018	8:00	Merchandise imports (% mom, sa)	March	-0.9	-1.3
15 May 2018	8:00	Real GDP (% qoq)	Q1 2018	0.3	0.5
23 May 2018	9:30	Manufacturing PMI (Flash)	May	58.0	58.1
23 May 2018	9:30	Services PMI (Flash)	May	53.5	53.0
24 May 2018	8:00	Real GDP (% qoq) - Details	Q1 2018	0.3	0.5
25 May 2018	10:30	ifo business climate (Index, sa)	May	102.7	102.1
30 May 2018	09:55	Unemployment rate (%, sa)	May	5.3	5.3
30 May 2018	14:00	Consumer prices preliminary (% yoy, nsa)	May	1.5	1.6
30 May 2018	8:00	Retail sales (% mom, sa)*	April	1.5	-0.6

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

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Growth rates have peaked – inflation should still recover

Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	1.625	-0.10	0.00	0.50	-0.75	-0.50	0.05	0.50	1.50	0.05	0.75
Jun 18	1.875	-0.10	0.00	0.50	-0.75	-0.50	0.05	0.50	1.50	0.05	0.75
Sep 18	2.125	-0.10	0.00	0.75	-0.75	-0.50	0.05	0.75	1.50	0.05	0.75
Dec 18	2.375	-0.10	0.00	0.75	-0.75	-0.25	0.05	0.75	1.50	0.05	1.00
3M interest rates, %											
Current	2.30	0.07	-0.33	0.67							
Jun 18	2.34	0.05	-0.35	0.60							
Sep 18	2.52	0.05	-0.35	0.55							
Dec 18	2.76	0.05	-0.35	0.75							
10Y government bonds yields, %											
Current	2.95	0.05	0.54	1.46							
Jun 18	3.00	0.00	0.70	1.45							
Sep 18	2.95	0.00	0.90	1.60							
Dec 18	3.25	0.00	1.25	1.80							

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	1.19	108.94	0.88	1.36	1.19	10.56	7.45	9.64	4.28	313.87	25.51
Jun 18	1.24	102.00	0.91	1.37	1.20	9.60		9.25	4.16	317.00	25.44
Sep 18	1.26	105.00	0.93	1.35	1.22	9.40		9.10	4.17	316.00	25.05
Dec 18	1.28	105.00	0.93	1.38	1.25	9.20	7.46	9.00	4.19	315.00	24.75

Sources: Bloomberg Finance LP, Deutsche Bank Research

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Growth rates have peaked – inflation should still recover

German data monitor

	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Dec 2017	Jan 2018	Feb 2018	Mar 2018	Apr 2018	May 2018
Business surveys and output											
Aggregate											
Ifo business climate	105.7	107.1	108.0	106.9		107.8	108.2	106.8	105.7	104.5	
Ifo business expectations	103.1	104.4	106.4	102.8		105.9	104.6	102.9	101.0	99.8	
Industry											
Ifo manufacturing	106.0	107.9	109.0	107.8		108.6	109.4	107.6	106.3	104.8	
Headline IP (% pop)	1.5	1.6	1.0	0.1		-0.4	0.0	-1.7	1.1		
Orders (% pop)	1.2	2.3	3.5	-2.1		2.6	-3.5	-0.2	-0.9		
Capacity Utilisation	85.8	86.5	88.2	88.5	88.0						
Construction											
Output (% pop)	5.4	-0.4	-1.0			-3.3	5.9	-7.2			
Orders (% pop)	-2.0	-1.7	10.2			13.5	-12.8	9.9			
Ifo construction	108.1	109.9	110.7	110.1		110.7	110.2	109.3	110.7	111.5	
Consumer demand											
EC consumer survey	3.6	4.1	5.5	6.7		6.1	7.4	6.5	6.1	6.1	
Retail sales (% pop)	0.8	0.3	0.7	-0.9		-1.1	-0.4	-0.2	-0.6		
New car reg. (% yoy)	0.0	0.3	4.2	4.0		-1.0	11.6	7.4	-3.4	8.0	
Foreign sector											
Foreign orders (% pop)	1.5	3.5	4.9			4.4	-4.6				
Exports (% pop)	1.6	0.7	2.9	-0.7		0.0	-0.4	-3.1	1.7		
Imports (% pop)	1.4	0.2	2.8	-0.4		0.9	-0.3	-1.4	-0.9		
Net trade (sa EUR bn)	60.5	62.0	64.3	63.1		21.8	21.7	19.4	22.0		
Labour market											
Unemployment rate (%)	5.7	5.7	5.5	5.4		5.5	5.4	5.4	5.3	5.3	
Change in unemployment (k)	-45.0	-25.7	-54.7	-69.7		-29.0	-24.0	-21.0	-18.0	-7.0	
Employment (% yoy)	1.4	1.5	1.4	1.4		1.4	1.4	1.4	1.4		
Ifo employment barometer	102.7	103.3	104.0	104.8		104.7	105.5	105.0	103.9	103.3	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.6	1.7	1.6	1.4		1.6	1.4	1.2	1.5	1.4	
Core HICP (% yoy)	1.4	1.5	1.3	1.3		1.4	1.3	1.4	1.3	1.0	
Harmonised PPI (% yoy)	2.8	2.7	2.5	2.0		2.3	2.1	1.8	1.9		
Commodities, ex. Energy (% yoy)	8.9	4.2	-5.6	-12.4		-10.5	-11.1	-13.5	-12.6	-6.3	
Crude oil, Brent (USD/bbl)	50.8	52.2	61.5	66.9		64.4	69.1	65.3	66.0	72.0	74.2
Inflation expectations											
EC household survey	17.6	16.3	16.0	16.4		14.8	16.6	18.3	14.4	15.1	
EC industrial survey	11.6	10.1	14.1	14.3		17.7	15.6	14.0	13.4	15.0	
Unit labour cost (% yoy)											
Unit labour cost	2.6	1.9	1.1								
Compensation	2.7	2.7	2.5								
Hourly labour costs	4.1	2.8	2.8								
Money (% yoy)											
M3	5.6	4.7	4.3	3.4		4.3	3.6	3.2	3.4		
M3 trend (3m cma)						4.6	4.1	3.7	3.4		
Credit - private	3.8	3.9	4.2	4.3		4.2	4.3	4.3	4.3		
Credit - public	4.1	5.5	-2.9	-20.1		-2.9	-5.4	-12.9	-20.1		

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

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Focus Germany

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