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Research

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Germany

Economics
Focus Germany

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Honey, we shrank our economy!

- **Honey, we shrank our economy!** Weaker-than-expected March hard data and shocking April survey data point to a lower trough in economic activity than assumed so far. We now see Q2 GDP falling by 14% qoq, with the risks still skewed to the downside. In the 2009 recession private consumption acted as a massive shock absorber. Given the lockdown, social distancing and a likely severe hit to income expectations, we expect private consumption to fall by 10% in 2020. The asynchronous global development of the COVID-19 pandemic and lasting impediments to global trade will make the recovery, which began in May and will become more evident in H2, less dynamic than hoped for earlier. As a result, we expect German GDP to decline by 9% this year and to expand by about 4% in 2021.
- **Public finance**: **Surging deficits will lead to ballooning public debt.** Germany's fiscal response has been quick, decisive and unprecedented in size and scope. It does not only involve a mixture of public subsidies, extra health spending and tax relief measures but is also based on sizeable government guarantees as well as loan and equity participation programs. In light of the deep recession, the government is expected to deplete the fiscal buffers it accumulated in past years as sharply higher fiscal deficits in 2020/21 will lead to ballooning debt. In our baseline scenario, gross debt is projected to spike to 82.2% of GDP by end-2021 (sharply up from 59.8% in 2019). However, should the economy move towards our protracted scenario, the public debt ratio could even get close to 100% by the end of next year.
- **Manufacturing**: **Output to decline by up to 15%.** We expect industrial production in Germany to fall by roughly 10% to 15% in real terms in 2020. It could increase by more than 10% in 2021. However, even with a rise this sharp, production would still fall short of the levels seen in 2018.
- **The view from Berlin: Lockstep in German politics comes to an end**. Federal states will decide over easing COVID-19 containment measures. Nationwide agreement on threshold for infections that triggers reimposition of lock-down measures. Increasing signs of a return to political normality with Groko parties debating amongst themselves over who will bear the costs of the corona crisis. The contest for CDU leadership and chancellor candidacy is heating up again but no clear front runner yet.

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Key Economic Forecasts

Figure 1: Economic Forecasts

	Real GDP (% growth)			Consumer Prices (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2019	2020F	2021F	2019	2020F	2021F	2019	2020F	2021F	2019	2020F	2021F
Euroland	1.2	-12.0	5.0	1.2	0.4	0.6	3.0	2.1	1.8	-0.6	-13.4	-11.4
Germany	0.6	-9.0	4.0	1.3	0.4	0.6	7.8	6.6	6.4	1.4	-8.7	-8.0
France	1.3	-14.0	6.0	1.3	0.3	0.8				-3.0	-16.2	-13.8
Italy	0.3	-14.0	5.5	0.6	-0.2	0.2				-1.6	-15.9	-12.7
Spain	2.0	-15.0	6.0	0.8	-0.2	1.2				-2.8	-16.3	-13.2
Netherlands												
Belgium												
Austria												
Finland												
Greece												
Portugal												
Ireland												
UK	1.4	-11.5	3.0	1.8	0.9	1.3				-2.2	-13.4	-5.7
Sweden												
Denmark												
Norway												
Switzerland												
Poland	4.1	-3.9	4.5	2.3	3.4	2.6	0.5	-2.6	-0.1	-1.0	-7.9	-3.3
Hungary	4.9	-2.0	4.7	3.4	3.5	3.0	-0.8	-2.8	-0.6	-2.0	-4.6	-3.2
Czech Republic	2.5	-6.3	5.5	2.8	3.2	2.1	-0.4	-2.3	0.5	0.3	-4.4	-2.4
United States	2.3	-7.1	2.6	1.8	0.3	1.3	-2.3	-3.5	-3.5	-4.6	-23.0	-12.0
Japan	0.7	-6.5	1.2	0.5	-0.1	0.5	3.6	3.8	4.2	-4.1	-10.5	-7.6
China	6.1	-1.1	9.5	2.9	3.5	2.4	1.0	0.7	1.1	-4.9	-4.0	-3.0
World												

Source : National Authorities, Deutsche Bank

Figure 2: Forecasts: German GDP growth by components, % qoq; annual data % yoy

	2018	2019	2020F	2021F
Real GDP	1.5	0.6	-9.0	4.0
Private consumption	1.3	1.6	-10.0	7.0
Gov't expenditure	1.4	2.6	6.8	0.4
Fixed investment	3.5	2.6	-9.3	6.0
Investment in M&E	4.4	0.6	-20.7	10.7
Construction	2.5	3.9	-3.2	3.7
Inventories, pp	0.3	-0.9	-0.3	-0.4
Exports	2.1	0.9	-14.0	6.0
Imports	3.6	1.9	-9.8	5.7
Net exports, pp	-0.4	-0.4	-2.6	0.3
Consumer prices*	2.0	1.3	0.4	0.6
Unemployment rate, %	5.2	5.0	7.00	6.0
Industrial production**	1.1	-4.2	-12.0	11.0
Budget balance, % GDP	1.9	1.4	-8.7	-8.0
Public debt, % GDP	61.9	59.8	75.6	82.2
Balance on current account, % GDP	7.4	7.8	6.6	6.4
Balance on current account, EUR bn	241.4	267.1	206.0	210.0

* HCPI This can lead to discrepancies to other DB publications. **Manufacturing (NACE C)

Source : Federal Statistical Office, Deutsche Bank Research

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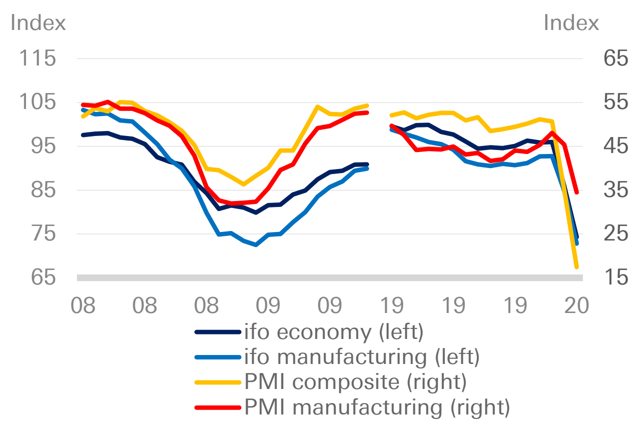
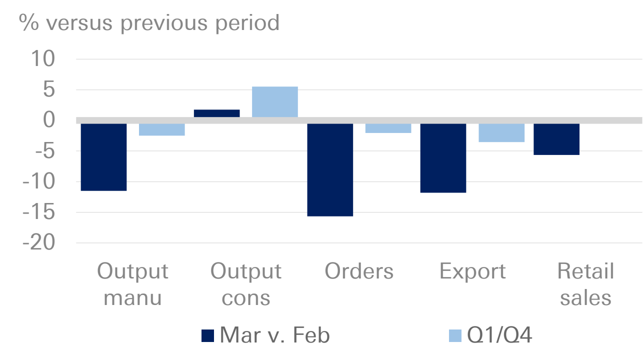
- Weaker-than-expected March hard data and shocking April survey data point to a lower trough in economic activity than assumed so far. We now see Q2 GDP falling by 14% qoq, with the risks still skewed to the downside.
- In the 2009 recession, private consumption acted as a massive shock absorber. Given the lockdown, social distancing and a likely severe hit to income expectations, we expect private consumption to fall by 10% in 2020.
- The asynchronous global development of the COVID-19 pandemic and lasting impediments to global trade, will make the recovery, which began in May and will become more evident in H2, less dynamic than hoped for earlier. As a result, we expect German GDP to decline by 9% this year and to expand by about 4% in 2021.

Figure 3: Sentiment indicators: Current vs. 2008/09



Source : ifo, IHS Markit

Figure 4: Cyclical indicators slump in March

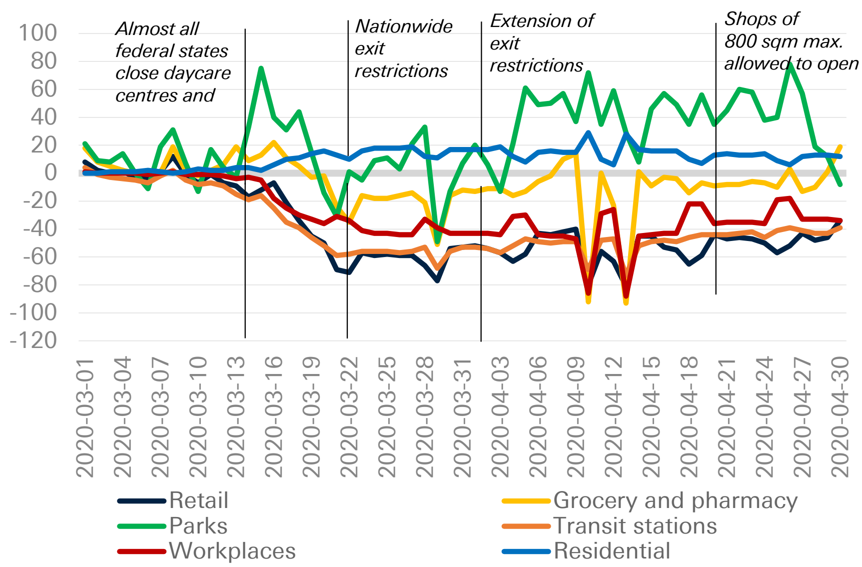


Source : Federal Statistical Office, Deutsche Bank Research

Survey data in April (ifo, PMI) collapsed marking all-time lows. Overall indices slumped off the charts while sentiment in the manufacturing sector remained only marginally above the lows seen in early 2009. Monthly industrial production (-9.2% mom), order numbers (-15.6%) and exports (-11.8%) provided a sobering picture for March. The 97% drop in April car production (March -37%) presents a further indication that orders and production will fall even more strongly in April. Applications received by job centers suggest that the number of Kurzarbeiter (workers on short time) might come close to 9m in April, a level which seemed inconceivable just a few weeks ago. Still, the darkest hour is just before dawn. While official economic data (the typical rear-view mirror approach) will continue to be unnerving, real time data such as daily mobility and traffic indices show that the easing of lock-down measures and the adjustment in consumer behavior is having an impact already. So, we continue to assume that Q2 will mark the trough in German economic activity. But, we have become more skeptical about the upward momentum in H2, in other words we no longer believe in a V-shaped recovery.

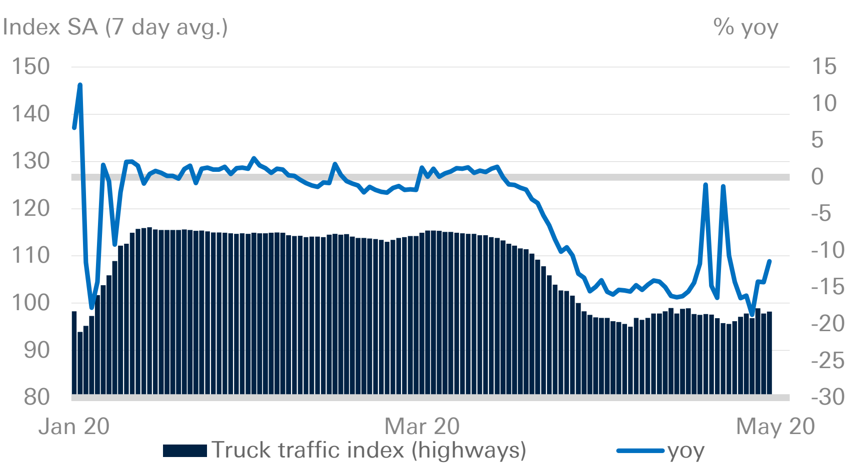
Figure 5: Mobility of German citizens still limited

%, Change of mobility in Germany compared to March 2019, based on mobile



*Comparison with the respective weekdays of a week from March 2019, transaction data of the mobile phone providers Deutsche Telekom and Telefónica
Source : Statista COVID-19 mobility project

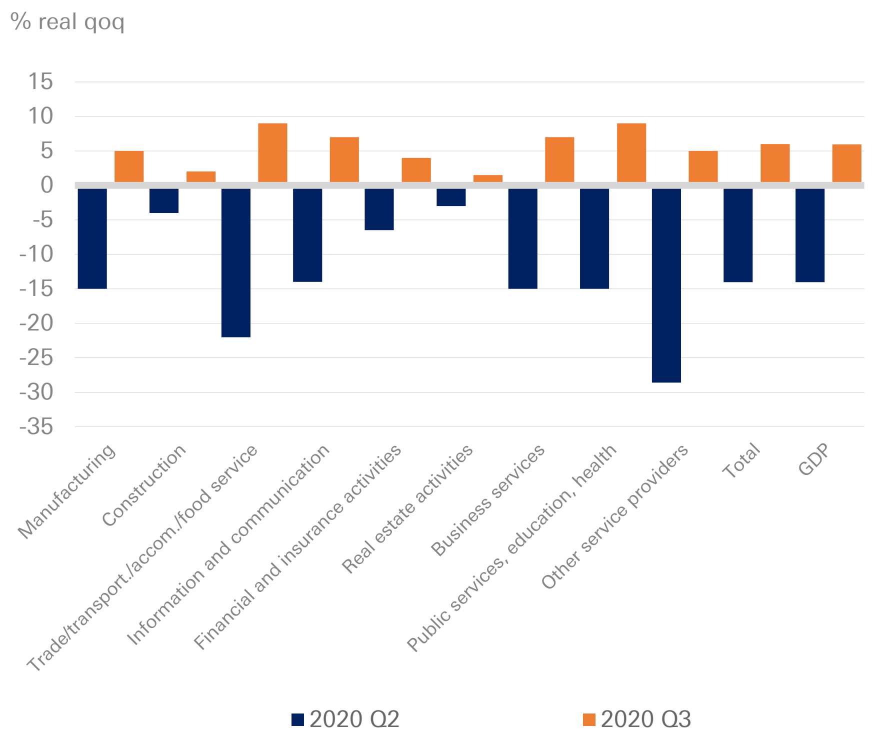
Figure 6: Truck traffic index (MAUT)



Source : Federal Statistical Office, Deutsche Bank Research

GDP forecasts rest on the assessment of the current situation and on a set of key assumptions. With regard to the key assumption – the further development of the COVID-19 pandemic – we feel encouraged by the fact that the Chinese epi curve has been horizontal since March and that new infections have clearly slowed in most industrial economies. The slope has not yet flattened in the US and the UK, neither in major emerging markets such as Brazil, India or Russia. This asynchronous pandemic developments are one factor hampering the recovery of world trade and hence the economic rebound in Germany. This will not only weigh on demand but will result in supply disruptions when companies restart production.

Figure 10: Gross value added by sector

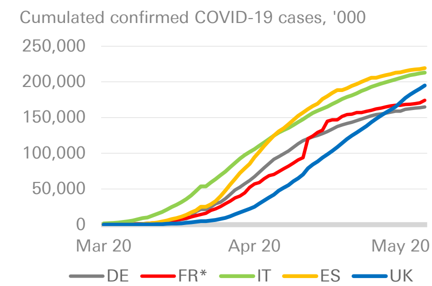


Source : Deutsche Bank Research

Baseline: GDP to fall by 14% in Q2, 2020 down by 9%

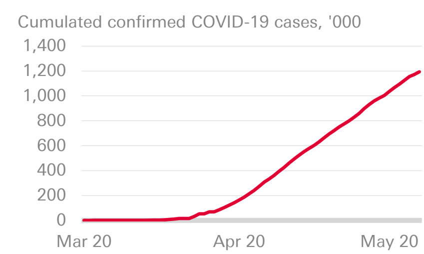
Usually, GDP forecasts focus on the economy's demand side. Based on external demand, households' income trends, capacity utilisation and profit expectations, major demand components such as exports, private consumption and investment are predicted. Given lock-down measures in response to COVID-19, forecasters currently are trying to assess how much output in the various sectors might have dropped (gross value added) in order to assess the depth of the slump. In Germany, this approach is probably less useful than in many other countries as major parts of the economy such as the manufacturing and the construction sectors were not directly impacted by lock-down measures, hence suffered only indirectly from slumping demand and sourcing difficulties. One has to be cautious not to become too confident regarding such an aggregated GDP forecast, since in essence the uncertainty is just transferred one level down into the estimates of the sub-components. However, it is probably reasonable to assume that the output loss in the services sector will be even more substantial than in industry (see chart). All in all, GDP in Q2 might fall by close to 15% versus Q1, but a 20% decline could also be "achieved".

Figure 7: Continental Europe managed to flatten better than UK



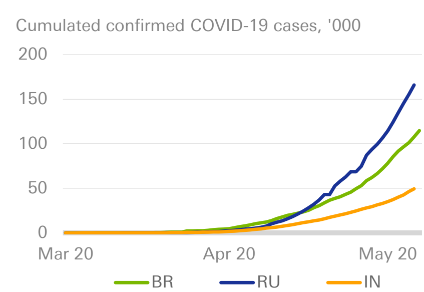
** Revision of statistical accounting in early April*
Source : WHO, Johns Hopkins University

Figure 8: Continued growth of new infections in the US



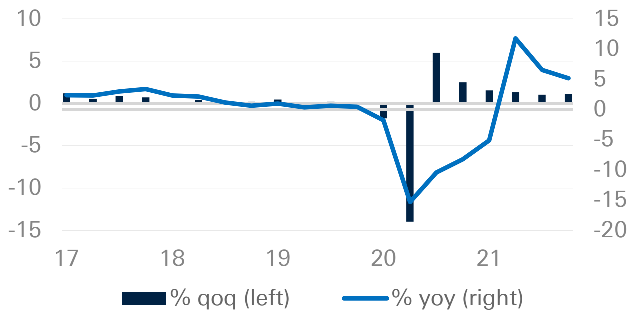
Source : WHO

Figure 9: Sharp increase in new infections in emerging markets



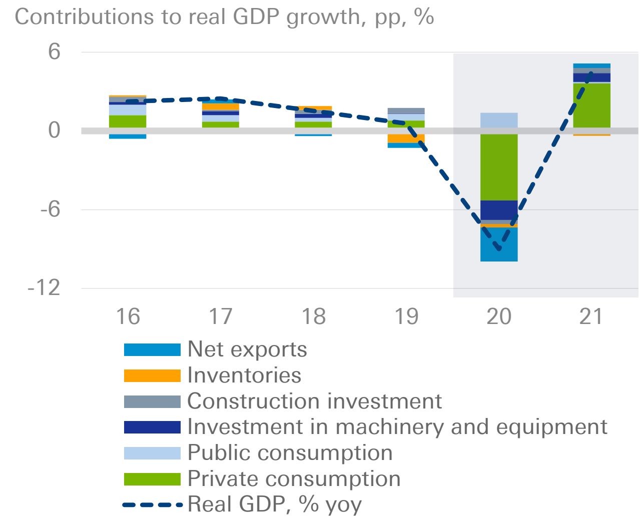
Source : WHO

Figure 11: Germany: Real GDP forecast (quarterly)



Source : Federal Statistical Office, Deutsche Bank Research

Figure 12: Germany: Real GDP growth and details

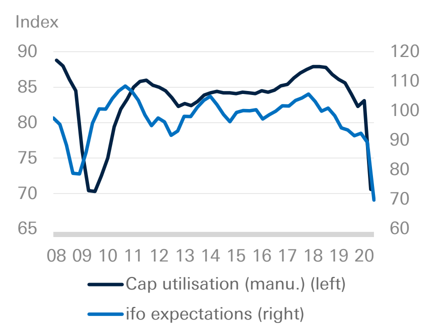


Source : Federal Statistical Office, Deutsche Bank Research

In May, the economy is exiting from lockdown

First small easing measures started on April 20th. With the decisions taken by the federal government and Länder PMs on May 6th[1] all shops are allowed to reopen, provided appropriate measures regarding hygiene and the control of customer flows are implemented. The exact time path and prerequisites are up to the Länder governments. The only kind of economic activity explicitly prohibited (up until at least the end of August) are large public events such as folk festivals or sports events with many spectators. This exit from lockdown and the reopening of auto plants (some 20% of manufacturing output) should allow for a very gradual pickup in economic activity in May, becoming more manifest during summer. The expected 6% rebound in Q3 GDP should make up about half of Q2's slump. For Q4, we forecast 2.5% GDP growth. As a result, GDP should fall by 9% on average in 2020. In 2021, we expect a small rebound of around 4%. By Q4 2021, GDP will still be about 4% lower than before the start of the COVID-19 crisis. In other words, there will be no V-shaped recovery. Social distancing will continue to limit the recovery from the supply side and weigh on demand as consumers are unlikely to revert to the status quo ante regarding their social activities. According to a consumer survey done by McKinsey between 30 to 40% of consumers in Germany are planning to limit the use of public transport, travel less and reduce visits of concerts, movies and theaters even after the pandemic has tapered off.[2]

Figure 13: Animal spirits having the blues



Source : ifo

Private consumption to fall by 10%

During previous shocks private consumption was an important stabiliser of economic activity. In 2009 private consumption fell by just 0.1% while the GDP tanked (-5.7%), even ex car purchases – which were boosted by a cash-for-clunkers program – private consumption fell only marginally. By contrast, private consumption will present by far the biggest drag on growth in Q2, falling by almost 20%. In the year as a whole, it will drop by around 10%, shaving some 5 percentage points off annual GDP. In March/April the slump was a combination of lacking

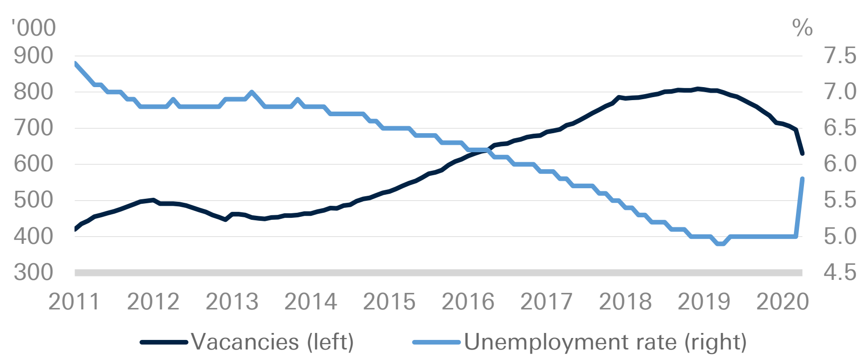
1 https://www.bundesregierung.de/breg-en/search/statement-nach-corona-kabinett-1751100
2 https://www.mckinsey.de/~/media/McKinsey/Locations/Europe%20and%20Middle%20East/Deutschland/News/Presse/2020/2020-05-07%20Consumer%20Sentiment%20Wave%205/200505_Consumer_Sentiment_Survey_Wave5_Germany.ashx

opportunities to spend, as most non-essential shops were closed, and consumers cocooning because of forced and voluntary social distancing. Household income will be supported by various government measures – with Kurzarbeitergeld the most important one. Still, household disposable income could fall by between 5% and 7% in 2020, given declining employment, falling effective wages (the result of a markedly negative wage drift), and a double-digit decline in profit income and income of self-employed (about 30% of disposable income). Following strong wage agreements in 2018 (2.9%) and 2019 (3%), the collective wage trend in 2020 and 2021 is likely to be a rather modest 1%. Moreover, we expect consumers to remain risk averse, hence adjusting their behavior only very gradually. Against this backdrop, GfK consumer confidence fell to a historic low of -23.4 pts (May). Higher job uncertainty should make Q2's jump in the household savings rate – in part the result of lacking opportunities to spend – a more permanent feature.

Labour market: Kurzarbeit is no panacea

During periods of economic weakness, the domestic economy has always been a supporting pillar of the German economy and thus also a counterweight to employment losses in export-oriented companies. At present, however, the domestically oriented and personnel-intensive service sector is not providing a similar buffer for employment, as the containment measures are having a particularly negative impact there.

Figure 15: Labour market: COVID-19 is beginning to leave its mark

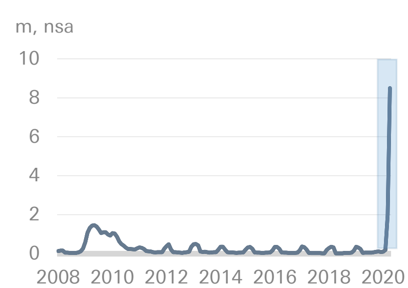


Source : Deutsche Bundesbank

Short-time workers approaching 9 m during the COVID-19 crisis

According to the latest evaluation by the Federal Employment Agency (BA), 751,000 companies had already registered short-time work by 26 April 2020. This means that in April employers had applied for short-time work benefits for 10.1 million people. (i.e 30% of all employees s.t. social insurance contributions). According to a survey, 1/3 of the companies (out of a total of 2.2 million companies) with at least one employee who is s.t. social insurance contributions have now applied for short-time work. Around one-fifth of the employees involved (2.2 million) come from the three sectors of retail, catering and motor vehicle manufacturing. However, it should be noted that short-time work might actually not be implemented for all the employees companies applied for. Because of the settlement procedure for short-time working compensation, the Federal Employment Agency (BA) only has figures on the workers affected with a delay of about three months.

Figure 14: Short-time workers



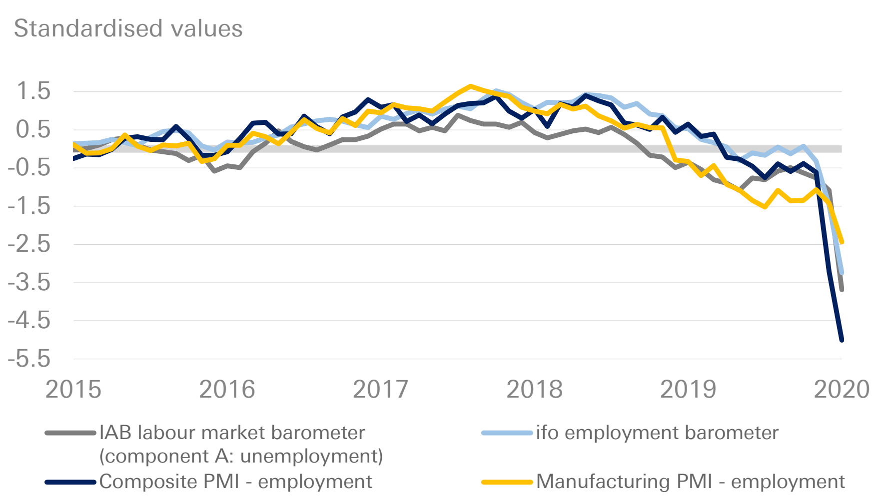
Source : Federal Employment Agency, Deutsche Bank Research

According to the weighted average of the figures from the Federal Statistical Office's business register (last status 2017), enterprises in the classes from 0 to 9 and 10 to 49 have an average of 7.6 employees. If the group of 50 to 249 are also included, the weighted average is 11.1 employees. According to the above-mentioned special evaluation and with regard to these groups of companies, the number of short-time workers expected in the near future would be between 6 million and a good 8 million. After April 26th, further notifications have certainly been received.

If that case materialises, the BA's reserve of EUR 26 billion will already be used up in 2020 and there would even be an additional financing requirement of EUR 4 to 5 billion from federal funds.

The latest results of an ifo company survey (5 May) also show that short-time working is now widespread in almost all sectors in Germany. The highest numbers are in restaurants and catering, with 99% of businesses making use of short-time work, as well as in hotels, with 97%. This is the result of surveys the ifo Institute conducted in April. The key sector of automotive engineering also reports particularly high figures, with 94% of companies implementing short-time work. The share in the retail trade now stands at 62% (ifo survey of 23 April: 55%). The average across all sectors is 50%.

Figure 16: Labour market indicators signal rising unemployment



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

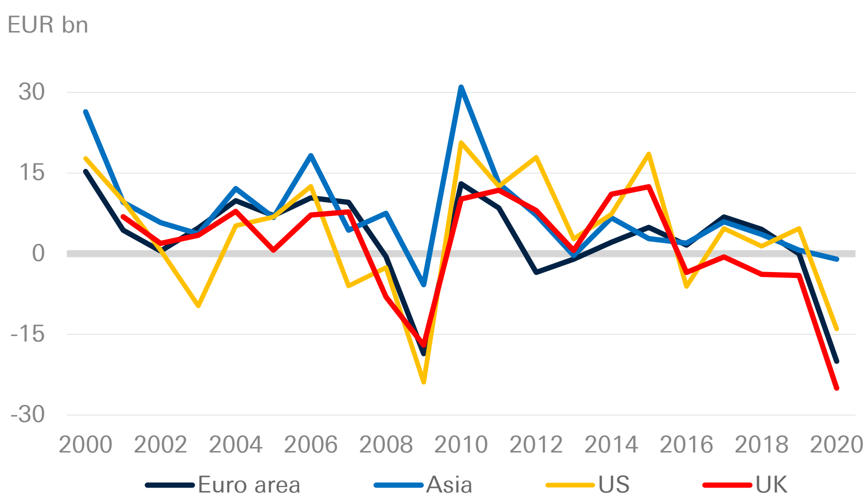
Monthly unemployment rate to peak above 8%

Despite the comprehensive measures to secure employment, unemployment is likely to rise in 2020. Our baseline scenario implies an increase in the 2020 unemployment rate to almost 7% (monthly peak: 8.5%) and only falling to 6% in 2021. Our protracted pandemic scenario implies an increase to around 9% (monthly peak: 13%) in 2020 and, due to a sluggish recovery and the lagged labour market response, an average of 8.5% in 2021. The number of people in employment is likely to fall by about 550,000 in 2020.

Investment spending slumping by 20%

Except for necessary expenditures to adhere to social distancing and hygiene there is hardly any reason for private businesses to increase investment. Profits are collapsing, profit expectations are likely to remain gloomy given the uncertainty related to the evolution of the pandemic and external demand, we expect global GDP to decline by more than 3% in 2020. Capacity utilisation has fallen substantially, so that any pickup in demand should be easily satisfied with the existing resources.

Figure 17: Bilateral exports to countries & regions



Source : Deutsche Bank Research, Federal Statistical Office

Exports falling by 14% - similar to 2009

The strong COVID-19 headwinds led to a collapse of global trade. We expect bilateral nominal goods exports to reflect the depth of the epidemiological crisis in the respective region. For instance, Asian countries are less affected and exports in the whole of 2020 might hardly fall against 2019. By contrast, goods exports to the euro area and the UK may be hard hit contracting by up to 25% as March exports have already collapsed by up to 20% yoy in several European countries. Exports to the US have only marginally contracted until March. Yet, the epidemiological crisis does not seem to have reached its peak. Therefore, we foresee exports to the US to fall by more than 10%. Nominal goods exports overall are expected to decline by 17% in 2020. Service exports should suffer a similar annual contraction. Real exports will contract less as export prices are set to shrink. Our structural model based on commodity prices implies an annual decline of only 1.2%. The model does not take into account the huge loss in aggregate demand. Therefore, we add the statistical error observed during the GFC in 2009. The result is a drop of 3% for 2020 which is an all-time low. Accordingly, real annual exports will shrink by 14%, close to the contraction during the GFC. As private consumption and investments are forecast to decline by around 10%, a similar contraction is expected for real imports in 2020. This results in a net export contribution to GDP growth of -2.6pp. The current account surplus will shrink to “only” 6.6% of GDP in 2020, still above the objective of 6% of the European Commission. We do not foresee a rapid economic normalisation. Social distancing will hamper both the global supply chains and aggregate demand for an extended period of time.

Protracted scenario: It will take longer and be more difficult to get COVID-19 under control

Given the uncertainties related to COVID-19, we stick with our scenario approach presented at the end of March.[3] In our updated "protracted" scenario, we assume a less benign pandemic development. In some countries, we might see a second or even third wave requiring renewed lockdowns. In other countries, more drastic measures are needed to keep infection rates at bay than assumed in our baseline scenario. In this scenario, we expect German GDP to decline by 15% in 2020 and to basically move sideways in 2021 (+1.0%)

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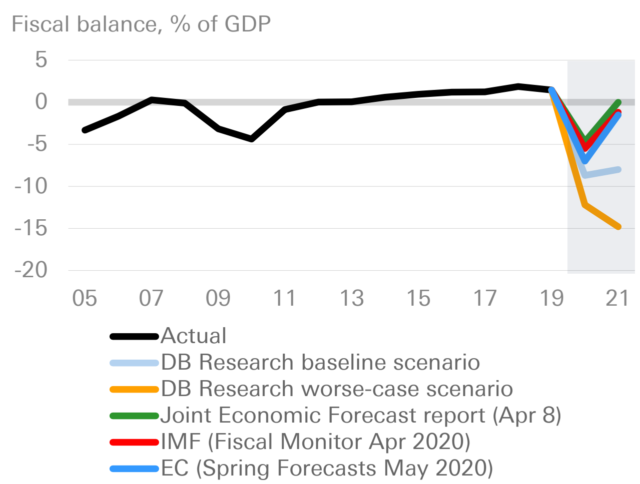
3 Deutsche Bank Research, Special Report, Impact of Covid-19 on the global economy: Beyond the abyss, March 30 2020

Public finance: Surging deficits will lead to ballooning public debt

Government has responded quickly and decisively to the crisis

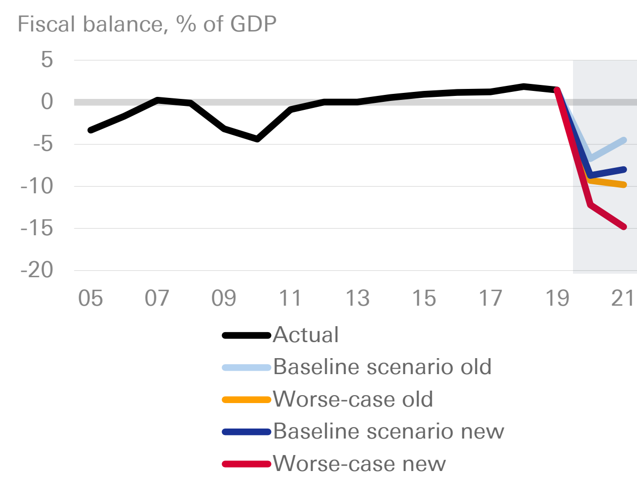
The German government(s) – both at the federal and state levels – have responded quickly and decisively to the economic fallout stemming from the Corona pandemic. Germany's fiscal response consists of a broad range of measures and instruments (both at the federal and state levels) that all aim to (a) secure the financing of the direct costs of the government in fighting the pandemic, (b) mitigate the economic strains on affected employers and employees and (c) protect the economy from a potential wave of corporate insolvencies and economic depression. The government's toolkit does not only involve a mixture of public subsidies, extra health spending and tax relief measures but is also based on sizeable government guarantees as well as loan and equity participation programs. While some of the measures will have an immediate direct effect on both the general government's fiscal balance and gross debt stock (e.g. subsidies paid to small firms and self-employed persons, spending for health equipment and protective clothing), other measures will solely affect the debt stock (and the budget only in case of realised losses) (e.g. financial transactions from loan and/or equity participation programs) or will affect the budget/debt stock only if they materialise (e.g. calls on government guarantees). For more details on Germany's fiscal response see Focus Germany: Quantifying the fiscal costs from corona virus (April 17, 2020).

Figure 18: Fiscal balance projections for 2020/21 in comparison



Source : Destatis, Deutsche Bank Research, IMF, EC, Joint Economic Forecast report

Figure 19: DB Research fiscal balance projections for 2020/21



Source : Destatis, Deutsche Bank Research

Government will deplete fiscal buffers it accumulated in past years

Thanks to the large fiscal surpluses over the last six years (2014-19) and a rapidly declining government-debt-to-GDP ratio to just 59.8% Germany's public finances remain very solid in an international comparison. Therefore, Germany has large fiscal buffers that it will now utilise. In this context, it is worth noting that Germany enters the corona crisis with a stronger public budget balance than ahead of the global financial crisis (+1.4% of GDP in 2019 vs. -0.1% in 2008) and a lower (gross) government debt ratio (59.8% of GDP in 2019 vs. 65.5% in 2008). Overall, Germany's fiscal costs from the crisis are a function of the (1) corona-related (discretionary) revenue/spending and off-budget measures, (2) the cyclically driven deterioration in public finances (from the operation of automatic stabilisers) as well as (3) occurring calls on government guarantees and/or fiscal losses related to the government's loan and participations programs.

Given both the breadth and depth of the economic crisis and the decisive discretionary response, we now project Germany's general government budget to post a deficit of 8.7% of GDP in 2020 and 8.0% in 2021. As a result of the large deficits and the sizeable credit market borrowing due to the government's loan and equity participation programs we project the general government's gross debt stock to climb to 75.6% of GDP in 2020 and 82.2% in 2021 (from just 59.8% in 2019). The above gross debt projections are explicitly based on the assumption that one half of the amount of EUR 250 bn – which is provided by the federal government and the states for loan/participation programs – will be borrowed in markets in 2020 and the other half later in 2021 (for more detail on these programs see Focus Germany from April 17, 2020). Moreover, the budget deficit and debt stock projections for 2021 explicitly capture fiscal costs from guarantee calls and loans/equity losses (estimated at EUR 75 bn) and are based on the presumption that the government will come up with a fiscal stimulus package worth around EUR 100 bn. In the protracted pandemic scenario, the fiscal deficit could reach even 12.2% of GDP in 2020 and 14.5% in 2021 (because of a larger cyclical deficit and higher fiscal costs from guarantee calls and loans/equity losses (estimated at EUR 125 bn). As a result, the debt ratio could rise to 83.2% of GDP by end-2020 and increase further to 97.8% by the end of 2021 in the protracted scenario.

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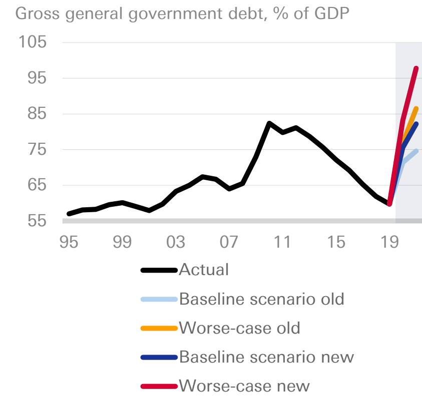
Figure 20: Public debt projections for 2020/21 in comparison

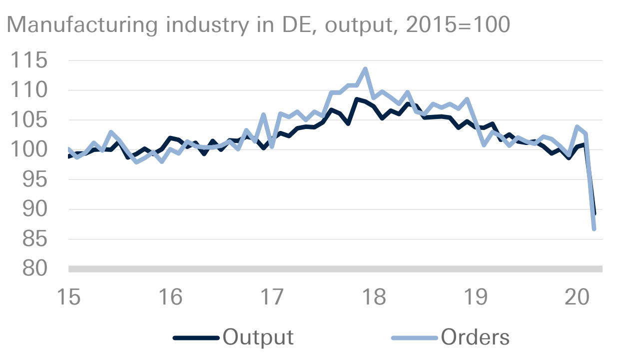


Source : Destatis, Deutsche Bank Research

Manufacturing: Output to decline by up to 15%

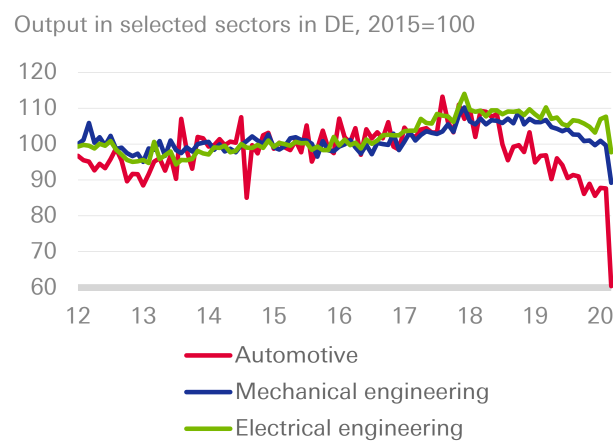
Production in the manufacturing sector in Germany decreased by 11.5% mom in March. This was the heaviest decline on a monthly basis since German reunification. However, we expect the decline in industrial production in Germany to be even more severe in April since almost all German carmakers closed down their factories during that month. We expect a recovery starting in May 2020. The recent restart of production in large parts of the German automotive industry speaks for such a recovery. The tremendous significance of the automotive industry as a customer for other branches of industry would also deliver impetus there. However, in the second quarter alone, production in the manufacturing sector could decline by 15% qoq.

Figure 21: Heavy decline in March



Source : Federal Statistical Office

Figure 22: Decline in output particularly strong in the automotive industry



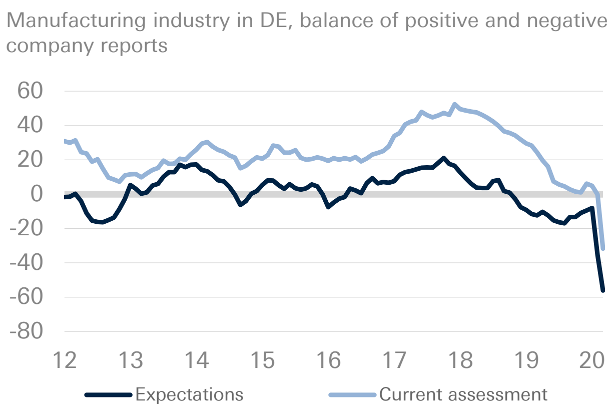
Source : Federal Statistical Office

The recovery will start at a low level and will not be terribly steep due to the extended nature of the COVID-19 crisis. Moreover, the negative economic consequences of the coronavirus pandemic have been so dramatic for many companies that global investment activity will remain restrained for the year as a whole. In the end, the protective measures that companies are taking at their factories (distancing and hygiene rules, capacity adjustments, etc.) are expected to impair productivity. It is therefore likely that production in the second half of 2020 will still fall short of the average level seen in 2019, which was already low.

In 2020, production in the manufacturing sector in Germany is expected to record its sharpest decline since the global economic and financial crisis of 2008/09. We expect industrial production in Germany to fall by roughly 10% to 15% in real terms in 2020.

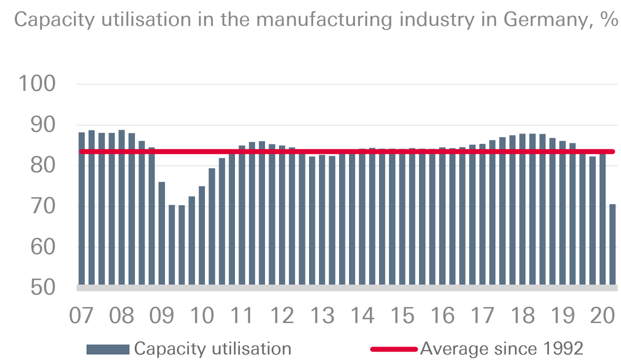
The decline could be limited to 10% if the negative economic impact of the crisis in all of Germany's main export markets (i.e. the United States) were to be confined to the second quarter, and if the recovery already under way in China were to continue. In this scenario, the national and international transport of goods would already be working well enough over the course of the second quarter to ensure supplies to customers. Interruptions in the supply chain would constitute an exception or would be manageable. Under these conditions, production in May would already be higher than in April (albeit at a very low level) and would generally rise rather constantly over the rest of the year.

Figure 23: Sharp decline in business expectations due to corona



Source : ifo Institute

Figure 24: Sharp decline in capacity utilisation in Q2



Source : ifo Institute

A 15% decline in production could occur if the efforts to contain or adapt to the coronavirus pandemic were to last into the second half of the year in key foreign sales markets and/or in Germany, and if there were to be further waves of infection leading to renewed restrictions on business and trading. Of course, it does not take much imagination to picture plausible scenarios in which domestic manufacturing could see a decline of even more than 15%.

Capital goods producers are more affected

We expect producers of capital goods to be affected more strongly than the food, chemical or pharmaceuticals industries. We therefore anticipate particularly pronounced declines in production in mechanical engineering, the automotive industry and the metals industry. The complete production shutdown in the automotive industry in late Q1 and early Q2 has left its mark on upstream industrial sectors as well. A large portion of the electrical engineering sector in Germany is also specialised in capital goods. However, certain branches – such as medical technology – appear better situated to be able to overcome the crisis.

Given the assumed production development for the manufacturing sector, with a gradual recovery over the course of the second half of the year, we would see a high statistical overhang at the end of 2020 and at the start of 2021. Industrial production has the potential to increase by more than 10% in real terms on average in 2021, even if growth were to slow during 2021 as compared to the second half of 2020. However, even with a rise this sharp, production would still fall short of the levels seen in 2018.

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The view from Berlin: Lockstep in German politics comes to an end

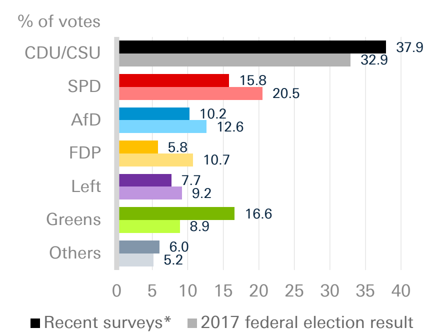
- Federal states will decide over easing COVID-19 containment measures. Nationwide agreement on threshold of infections that triggers reimposition of lockdown measures.
- Increasing signs of return to political normality with the Groko parties debating among and within themselves over who will bear the costs of the corona crisis.
- Contest for CDU leadership and chancellor candidacy is heating up again but no clear frontrunner yet.

Rollback of containment to be broadened and decentralised. On May 6th, Chancellor Merkel and the heads of the 16 regional states agreed to further lift corona-related restrictions. As of now, the regional states will individually decide on how to exactly proceed. Social distancing measures in general will remain in place until June 5th and the ban on large public events will continue until the end of summer. The only nationwide agreement is an "emergency clause" on the level of local infections beyond which a reintroduction of restrictions would be required. This reimposition can be limited in case of a localized outbreak which would pose the challenge of coordination should local outbreaks occur across the border of two states with different COVID-19 regimes in place.

German federalism passed the performance test. Throughout the management of the coronavirus crisis there have been debates about whether Germany's federal system with major competences, e.g. health care, anchored on state and municipal level will live up to this challenge. So far, the balance is a positive one. With the crisis leadership of Chancellor Merkel and Health Minister Spahn, the 16 states closed ranks and embarked on a coordinated coronavirus-fighting strategy. Lockdown measures were implemented accordingly and reviewed on a regular basis. When it became clearer, though, that Germany had so far avoided the worst, the discussions over speed and scope of exit measures intensified. Regional leaders were less willing to coordinate with the federal level and sometimes gave the impression of competition over easing the curbs. While differing concerns over the negative economic and societal impact played a role, diverging views are probably the result of significant variations of infection rates across states. A one-size-fits-all approach would be less appropriate than making use of the federalism's inherent flexibility. When (hopefully) passing the peak of the crisis, decision-making power thus has been passed back to the regional states where it belongs according to the constitution. It is now the responsibility of the states to prevent a second wave and to protect the health of their citizens, as Chancellor Merkel stressed in the press conference. She also indicated that she had preferred a more cautious exit strategy and said that "we have the very first phase of the pandemic behind us, …but we have a long struggle with the virus ahead of us".

Politics slowly returning to well-known pattern. To fight the coronavirus crisis, German politics entered into a truce with respect to other issues. Not only have key decision makers been rewarded with high approval ratings for their management but the coalition parties in general – the CDU/CSU to a much higher extent than the SPD, though. Merkel's performance as crisis manager was widely appreciated; but with the threat being perceived to be under control, fault lines among the coalition partners and within the respective parties slowly re-emerge. The liberal, business oriented wing of the CDU/CSU is concerned about the extent to which the state

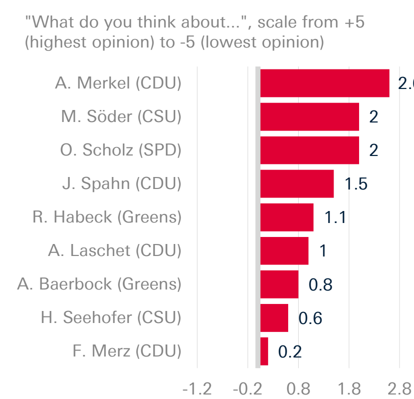
Figure 25: Major political parties' popularity & result of the last federal election



Average of major recent surveys (Forsa, Kantar, FG Wahlen, INSA, Allensbach)
Source : Wahlrecht.de, May 6, 2020

might intervene over a longer period in the economy and the corporate sector and calls for clear limits. The talks over financial support for Lufthansa and the rights of the government as shareholder are a good example in this regard. Within the CDU/ CSU's liberal wing, concerns are even stronger that the SPD could leverage the current crisis for a lasting pushback of market principles in favour of increasing state capitalism, a further expansion of the welfare state or new labour market regulations (e.g. a right for everyone to work from home). The debate on who will bear the bulk of the costs for the fiscal support packages and the question of proportionality and adequacy will dominate the debate in the near-term and will likely fuel a polarized election campaign in 2021. Calls from the SPD for some sort of wealth tax and a stronger burden for high income earners contrast with those from CDU/CSU (and the FDP) for tax incentives to support the economic recovery. How quickly (if at all) the expected steep rise in public debt will be countered partly hinges on party composition of the next government after the federal elections in September 2021. The currently strong scoring of the CDU/CSU would suggest the conservatives leading the next government again. Surveys (Politbarometer) show that the majority of the electorate still prefers a conservative-green coalition, and while the arithmetic still works, the substantial loss of voter support over the last weeks would now make them a clear junior partner in such a government. Still, whether the shift in polls will be maintained post-corona is open and it cannot be ruled out that the rise of the CDU/CSU will be reversed again to pre-crisis level (i.e. below 30%) should the overall (economic) exit strategy fail.

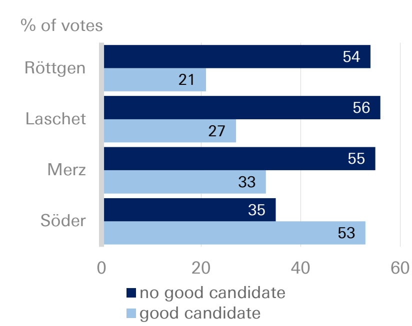
Figure 26: Popularity ranking of important German politicians



Source : Forschungsgruppe Wahlen Politbarometer April 2020

Race for CDU party chair and Merkel's succession will resume soon. In a world without the corona pandemic, the next CDU leader would have been elected two weeks ago. Now, the new CDU party leader and likely chancellor candidate will not be chosen until year-end, at the originally scheduled party convention on Dec 5/6. The corona crisis has somehow shaken up the field of contenders. Those in active political positions have been able to outperform while Friedrich Merz, supported by the CDU's business wing, almost disappeared from public view and might find it difficult to resume his pre-crisis standing. He might want to pick a fight over the role of the state in the economy, though, given the huge fiscal support packages, guarantees and even state participation in corporates which have been launched during the crisis. The second official candidate, Norbert Röttgen, who leads the Bundestag's foreign affairs committee, seems to have small chances already from the start.

Figure 27: View on CDU/CSU candidates for chancellor 2021



Source : Deutschlandtrend May 2020

State PMs to the frontline. Armin Laschet, the third man in the field and PM of NRW has been at the forefront of those pushing for accelerated easing of restrictions despite the fact that his state accounted for a high number of COVID-19 infections and deaths. He positioned himself as a caretaker for those hit particularly hard by the containment measures such as small businesses and families. Coronavirus crisis management has not pushed up his approval rates, though. His counterpart in handling the crisis in his respective state has been Markus Söder, the Bavarian PM who pursued a policy of strict measures and until recently warned against a rapid relaxation. Söder for now scores first in surveys about whom the electorate would see as a good CDU/CSU chancellor candidate. Already before the crisis he continuously reminded the public that the decision over the conservative chancellor candidate will be taken between the CDU and the CSU in 2021 and that there would be no automatism for the next CDU party leader to run for chancellor. His good performance has been feeding even more speculation that he could be the one. However, Bavarian politicians find it hard to strive beyond the state's borders and Söder continues to stress that he is not interested (this time). And then there is the unofficial candidate Jens Spahn, Germany's Health Minister, who has teamed up with Laschet. Spahn has become one of Germany's most popular politicians explaining the success of Germany's corona-fighting strategy in public. If Laschet wins the majority of the delegates' vote in December, Spahn would be his clear No 2. But one might also think of an alternative scenario with Laschet becoming CDU party leader and Spahn the party's candidate for chancellor. However, a second wave could reshuffle the (political) cards again given that some regional political leaders have become so tied to ending the lockdown that a return to more restrictive measures would hit their credibility. The only option we would clearly rule out is a fifth term for Merkel – despite growing media speculation around this.

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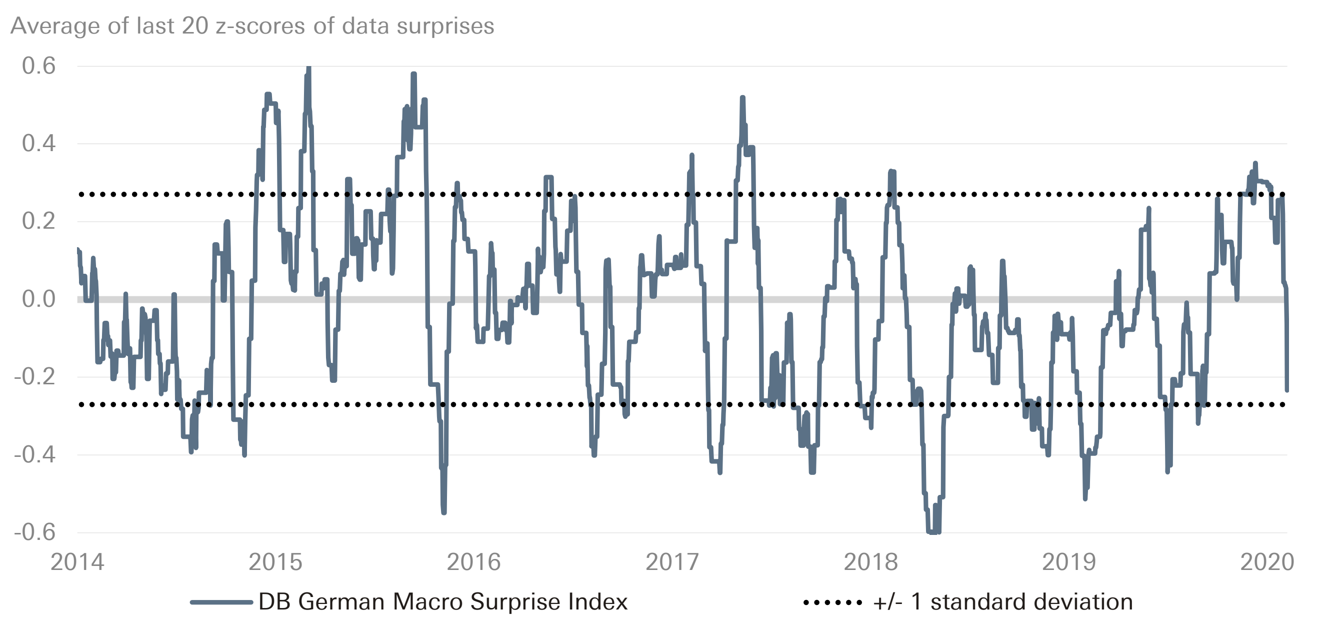
Deutsche Bank German Macro Surprise Index

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.

Figure 28: DB Macro Surprise Index



Values above (below) 0 indicate the data came in better (worse) than expected
Source : 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
GRIPIMOM Index	Industrial production (% mom)	2 2020	07/04/2020	0.3	-0.8	1.1	0.0	0.8
GRBTEXMM Index	Exports (% mom)	2 2020	09/04/2020	1.2	-1.0	2.2	1.1	0.9
GRTBALE Index	Trade Balance (EUR bn)	2 2020	09/04/2020	20.6	16.5	4.1	1.5	0.9
GRCAEU Index	Current Account Balance (EUR bn)	2 2020	09/04/2020	23.7	17.0	6.7	1.7	1.0
GRBTIMMM Index	Imports (% mom)	2 2020	09/04/2020	-1.5	-0.7	-0.8	-0.3	0.3
GRCP20YY Index	CPI (% yoy)	3 2020	16/04/2020	1.4	1.4	0.0	0.2	0.4
GRZEWI Index	ZEW Survey Expectations	4 2020	21/04/2020	28.2	-42.0	70.2	7.4	1.0
GRZECURR Index	ZEW Survey Current Situation	4 2020	21/04/2020	-91.5	-77.5	-14.0	-2.1	0.0
GRCP20YY Index	CPI (% yoy)	4 2020	29/04/2020	0.8	0.8	0.0	0.2	0.4
GRIMP95Y Index	Import Price Index (% yoy)	3 2020	29/04/2020	-5.5	-3.8	-1.7	-1.1	0.0
GRFRIAMM Index	Retail Sales (% mom)	3 2020	30/04/2020	-5.6	-8.0	2.4	2.2	1.0
GRUECHNG Index	Unemployment Change (000's mom)	4 2020	30/04/2020	373.0	74.5	-298.5	-9.8	0.0
MPMIDEMA Index	Markit Manufacturing PMI	4 2020	04/05/2020	34.5	34.4	0.1	0.1	0.6
GRIORTMM Index	Factory Orders (% mom)	3 2020	06/05/2020	-15.6	-10.0	-5.6	-2.7	0.0
MPMIDESA Index	Markit Services PMI	4 2020	06/05/2020	16.2	15.9	0.3	0.4	0.7
GRIPIMOM Index	Industrial production (% mom)	3 2020	07/05/2020	-9.2	-7.4	-1.8	-1.5	0.1
GRTBALE Index	Trade Balance (EUR bn)	3 2020	08/05/2020	17.4	18.8	-1.4	-0.7	0.2
GRBTIMMM Index	Imports (% mom)	3 2020	08/05/2020	-5.1	-4.0	-1.1	-0.5	0.3
GRBTEXMM Index	Exports (% mom)	3 2020	08/05/2020	-11.8	-5.0	-6.8	-3.5	0.0
GRCAEU Index	Current Account Balance (EUR bn)	3 2020	08/05/2020	24.4	20.7	3.7	0.8	0.8

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

Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	0.125	-0.10	0.00	0.10	-0.75	0.00	-0.60	0.00	0.50	1.08	1.00
Jun 20	0.125	-0.10	0.00	0.10	-0.75	0.00	-0.75	1.50	0.25	1.75	0.25
Sep 20	0.125	-0.10	0.00	0.10	-0.75	0.00	-0.75	1.50	0.25	1.25	0.25
Dec 20	0.125	-0.10	0.00	0.10	-0.75	0.00	-0.75	1.50	0.25	0.90	0.25
3M interest rates, %											
Current	0.43	-0.04	-0.26								
Jun 20	0.50	0.03	-0.40								
Sep 20	0.40	0.03	-0.40								
Dec 20	0.50	0.03	-0.40								
10Y government bonds yields, %											
Current	0.64	0.00	-0.55	0.24							
Jun 20	0.50	0.00	-0.40	0.63							
Sep 20	0.60	0.00	-0.28	0.60							
Dec 20	0.70	0.00	-0.20	0.70							

Exchange rates

	EUR/USD	USD/JPY	EUR/GBP	GBP/USD	EUR/CHF	EUR/SEK	EUR/DKK	EUR/NOK	EUR/PLN	EUR/HUF	EUR/CZK
Current	1.08	106.34	0.88	1.24	1.05	10.61	7.46	11.06	4.55	350.44	27.23
Jun 20	1.08	105.00	0.89	1.21	1.05	11.00		10.75	4.55	360.00	27.25
Sep 20	1.09	100.00	0.92	1.18	1.02	11.00		10.75	4.50	365.00	27.00
Dec 20	1.10	100.00	0.93	1.18	1.00	10.75	7.46	10.25	4.45	365.00	26.50

Source : Bloomberg Finance LP, Deutsche Bank Research

Germany – Data monitor

	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Dec 2019	Jan 2020	Feb 2020	Mar 2020	Apr 2020	May 2020
Business surveys and output											
Aggregate											
Ifo business climate	98.6	95.1	95.3	92.6		96.3	95.9	96.0	85.9	74.3	
Ifo business expectations	94.8	91.6	92.4	88.5		93.8	92.8	93.1	79.5	69.4	
Industry											
Ifo manufacturing	95.2	91.0	91.0	90.1		91.2	92.7	92.8	84.8	72.8	
Headline IP (% pop)	-2.0	-0.8	-1.7	-2.5		-1.5	1.9	0.4	-11.5		
Orders (% pop)	-1.1	-0.2	-1.0	-2.7		-1.5	4.8	-1.2	-15.6		
Capacity Utilisation	85.3	83.9	82.6	82.9	71.4						
Construction											
Output (% pop)	1.7	0.4	0.8	4.9		-1.8	6.8	-1.3	-1.1		
Orders (% pop)	-4.7	0.4	7.1			-2.9	2.5	-7.7			
Ifo construction	113.4	112.7	111.3	106.7		110.4	108.0	108.1	104.0	92.6	
Consumer demand											
EC consumer survey	-1.7	-3.1	-3.3	-4.6		-3.7	-3.6	-2.6	-7.6	-16.3	
Retail sales (% pop)	0.1	0.8	0.1	-0.4		-1.5	1.4	0.8	-5.6		
New car reg. (% yoy)	0.9	6.8	13.7	-20.3		19.5	-7.3	-10.8	-37.7	-61.1	
Foreign sector											
Foreign orders (% pop)	0.9	0.0	-1.0	-2.7		-3.1	8.3	-3.2	-16.1		
Exports (% pop)	-1.4	0.6	0.6			0.2	0.1	1.2			
Imports (% pop)	-1.0	-0.6	0.7			-0.5	0.6	-1.5			
Net trade (sa EUR bn)	54.1	57.7	57.7	52.9		19.1	18.7	21.4	12.8		
Labour market											
Unemployment rate (%)	5.0	5.0	5.0	5.0		5.0	5.0	5.0	5.0	5.8	
Change in unemployment (k)	20.7	20.3	-5.7	-9.3		8.0	-4.0	-8.0	0.0	373.0	
Employment (% yoy)	1.0	0.7	0.6	0.3		0.5	0.4	0.3	0.2		
Ifo employment barometer	100.6	98.8	99.0	97.0		98.8	99.6	98.1	93.4	86.3	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.6	1.0	1.2	1.5		1.5	1.6	1.7	1.3	0.8	
Core HICP (% yoy)	1.5	0.9	1.5	1.3		1.7	1.3	1.4	1.3	1.0	
Harmonised PPI (% yoy)											
Commodities, ex. Energy (% yoy)	0.2	6.3	5.3	2.1		9.2	9.1	0.2	-2.5	-7.3	
Crude oil, Brent (USD/bbl)	68.6	62.1	62.5	50.7		65.2	63.4	55.8	33.9	26.9	
Inflation expectations											
EC household survey	33.8	33.7	31.6	34.3		32.5	35.1	34.4	33.3	42.3	
EC industrial survey	7.1	2.2	2.7	2.2		2.7	3.2	3.4	0.0	-4.6	
Unit labour cost (% yoy)											
Unit labour cost	4.2	3.0	3.0								
Compensation	3.3	3.6	2.8								
Hourly labour costs	4.2	3.0	3.5								
Money (% yoy)											
M3	4.8	5.1	4.6	6.7		4.6	4.7	4.7	6.7		
M3 trend (3m cma)						4.8	4.6	4.7	5.4		
Credit - private	4.6	4.5	4.9	5.3		4.9	4.8	4.9	5.3		
Credit - public	5.7	3.1	-5.9			-5.9	7.1	3.6			

% pop = % change this period over previous period.

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

Appendix 1

Important Disclosures

*Other information available upon request

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