



# German economy: It is party time

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The economy continues to steam ahead, with quarterly GDP growth of 0.5% qoq in the winter half. A tight labour market and swelling order books are boosting the unions' bargaining power so they are pushing hard for higher wages, although increases might fall short of expectations among workers and the ECB tower. Meanwhile, in Berlin, Groko hopefuls are spending Germany's fiscal surpluses, seemingly unconcerned with demographic challenges and the fact that record-low interest rates and above-potential growth will not last. This party will probably go on for some time – maybe even a few years. However, the situation feels increasingly reminiscent of carnival revellers' popular song "*Am Aschermittwoch ist alles vorbei*" (It's all over on Ash Wednesday).

**Germany enjoys a solid start to 2018.** Recording growth of 2.2% in 2017 (2016: 1.9%), the German economy expanded for the eighth consecutive year. Private consumption was supported by strong income and employment growth. Moreover, the recovery of global trade provided a lift to export demand. This resulted in rising capacity utilisation and hence higher investment in machinery and equipment. For the fourth quarter of 2017, we expect GDP growth of 0.5%. Whilst retail sales were flat on the previous quarter, industrial production was up sharply despite a negative "bridge day" effect in October. Thanks to the solid underlying dynamics, Germany has enjoyed a good start to 2018. This is reflected in industrial order intake, the robust labour market and consumer and business sentiment indicators.

**German wage round – approaching its first peak.** IGM has started "24h-token strikes" to increase pressure ahead of the 6<sup>th</sup> round of talks. The crunch point remains IGM's insistence on a partial subsidy in case employees want to temporarily reduce their weekly working hours to 28. Despite the intensification of the dispute, there still seems to be willingness on both sides to avoid a collapse; both have signalled their intention to return to the negotiating table after Friday, when the current wave of strikes ends. Improved offers by metal employers and VW support our long-held view that pay increases could be clearly north of 3%.

**Groko formation on the home stretch: Concerns over SPD members' verdict.** After surprisingly fast negotiations in the past few days, the CDU, the CSU and the SPD appear to be on the verge of agreeing on a draft coalition treaty. But SPD leader Schulz will have to go extra miles to enlist his party members' support in the imminent membership ballot. Despite mixed public sentiment and the critical SPD youth organisation's No campaign, the most likely scenario seems to be a positive result, as in the negotiations the CDU/CSU has accommodated some of the SPD members' key requests. Angela Merkel's re-election could be carried out by early March – i.e. in time for the next official European Council meeting. Should the members' ballot fail, Germany seems very likely to go for new elections.



## German economy: It is party time

### 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	2.3	2.3	1.7	1.5	1.4	1.5	3.3	2.7	2.1	-1.1	-0.9	-1.0
Germany	2.2	2.3	1.8	1.8	1.6	1.8	7.2	6.5	6.5	1.2	0.8	0.5
France	1.8	2.0	1.6	1.2	1.3	1.4	-0.8	-0.6	-0.6	-2.9	-2.7	-2.9
Italy	1.6	1.4	1.0	1.3	1.0	1.5	2.9	2.8	2.6	-2.1	-1.9	-1.8
Spain	3.1	2.9	2.3	2.0	1.5	1.6	1.8	1.7	1.6	-3.1	-2.2	-1.6
Netherlands	3.0	2.5	2.4	1.3	1.6	1.9	10.2	10.2	10.1	1.1	0.5	0.4
Belgium	1.8	2.2	1.7	2.2	1.6	1.7	-1.0	-0.7	-1.0	-1.8	-1.5	-1.5
Austria	2.8	2.5	2.3	2.2	2.0	1.7	2.2	2.5	2.8	-0.9	-0.7	-0.5
Finland	2.9	2.6	2.1	0.9	1.2	1.6	-1.0	0.0	0.5	-1.2	-1.0	-0.8
Greece	1.2	3.0	2.2	1.2	0.7	1.1	-1.0	-0.5	0.0	-1.6	0.0	1.0
Portugal	2.6	2.0	1.5	1.6	1.2	1.5	0.2	0.0	0.0	-1.4	-1.2	-1.2
Ireland	4.1	4.0	3.2	0.3	1.0	1.2	3.8	3.5	3.0	0.1	0.1	-0.4
UK	1.8	1.0	1.4	2.7	2.5	2.3	-4.5	-4.0	-3.5	-2.5	-2.1	-1.4
Denmark	2.1	2.0	1.9	1.1	1.6	1.6	7.5	7.5	7.0	-1.0	-0.5	-0.5
Norway	1.8	2.2	2.0	1.9	1.9	1.8	6.0	6.0	5.5	3.5	4.0	5.0
Sweden	3.0	2.7	2.5	1.8	2.0	2.2	5.0	4.5	4.0	1.0	1.0	0.5
Switzerland	0.9	2.1	1.8	0.5	0.3	0.7	10.5	10.6	11.0	0.3	0.3	0.2
Czech Republic	4.4	3.4	3.0	2.5	2.4	2.2	0.6	0.4	1.0	1.0	0.8	1.1
Hungary	3.9	3.5	3.1	2.3	2.5	2.9	4.2	3.4	2.9	-2.0	-2.4	-2.3
Poland	4.5	3.8	3.5	2.0	2.2	2.9	-1.3	-1.4	-1.2	-2.1	-2.4	-2.8
United States	2.3	2.7	2.3	2.1	2.1	2.1	-2.9	-3.2	-3.5	-3.6	-2.8	-3.2
Japan	1.8	1.2	0.8	0.5	0.4	0.8	4.1	4.6	4.5	-3.7	-3.2	-2.8
China	6.9	6.3	6.3	1.6	2.7	2.4	1.2	0.8	0.6	-3.7	-4.0	-4.0
World	3.8	3.9	3.8	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

	2016				2017F				2018F				2019F			
	2016	2017F	2018F	2019F	2016	2017F	2018F	2019F	2016	2017F	2018F	2019F	2016	2017F	2018F	2019F
Real GDP	1.9	2.2	2.3	1.8	0.5	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Private consumption	2.1	2.0	1.8	1.5	0.4	0.6	0.5	0.5	0.3	0.4	0.3	0.2	0.3	0.4	0.3	0.2
Gov't expenditure	3.7	1.4	1.0	1.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Fixed investment	3.1	3.0	3.7	3.6	1.0	1.0	1.0	0.8	1.0	0.9	0.9	0.8	1.0	0.9	0.9	0.8
Investment in M&E	2.2	3.5	5.1	3.1	1.0	1.0	1.0	0.5	1.0	0.7	0.7	0.5	1.0	0.7	0.7	0.5
Construction	2.7	2.6	4.0	4.9	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Inventories, pp	-0.2	0.1	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports	2.6	4.7	4.8	4.5	1.2	1.2	1.2	1.2	1.1	1.0	1.0	1.2	1.1	1.0	1.0	1.2
Imports	3.9	5.2	5.2	5.1	1.3	1.4	1.4	1.4	1.2	1.2	1.1	1.2	1.2	1.2	1.1	1.2
Net exports, pp	-0.3	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	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	5.3												
Industrial production	1.4	3.0	1.8	1.5												
Budget balance, % GDP	0.8	1.2	0.8	0.5												
Public debt, % GDP	68.1	64.4	60.9	58.1												
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												

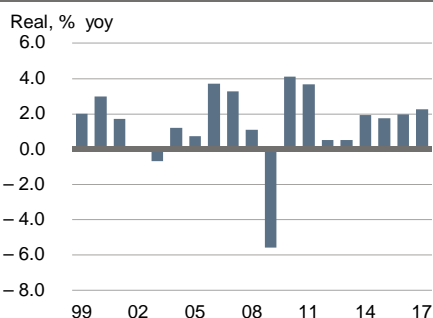
\*Inflation data for Germany based on national definition. This can lead to discrepancies to other DB publications.  
Sources: Federal Statistical Office, German Bundesbank, Federal Employment Agency, Deutsche Bank Research



## German economy: It is party time

### Strong GDP growth for fourth year in a row

1

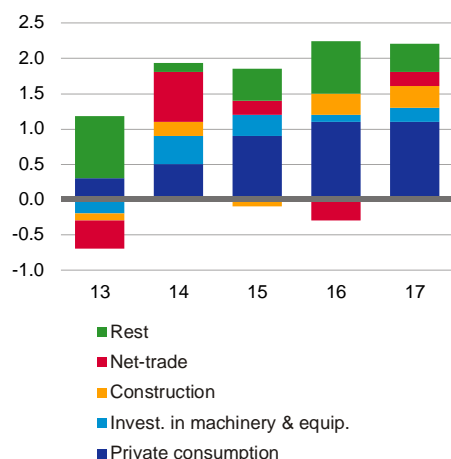


Source: Federal Statistical Office

### Private consumption contributing half of GDP growth in 2017

2

Growth contributions to yoy real GDP growth, pp



Sources: Federal Statistical Office, Deutsche Bank Research

### Germany: Economic forecast

3

(% yoy, unless stated)	2016	2017F	2018F
Real GDP	1.9	2.2	2.3
Private consumption	2.1	2.0	1.8
Gov't expenditure	3.7	1.4	1.0
Fixed investment	3.1	3.0	3.7
Investment in M&E	2.2	3.5	5.1
Construction	2.7	2.6	4.0
Inventories, pp	-0.2	0.1	0.3
Exports	2.6	4.7	4.8
Imports	3.9	5.2	5.2
Net exports, pp	-0.3	0.2	0.2
HICP	0.4	1.7	1.6
Public debt, % GDP	68.3	64.9	61.3
Unemployment rate, %	6.1	5.7	5.4
Budget balance, % GDP	0.8	1.2	0.8
Balance on current account, % GDP	8.4	7.2	6.5

Sources: Federal Statistical Office, Deutsche Bank Research

## Germany enjoys a solid start to 2018

- Recording growth of 2.2% in 2017 (2016: 1.9%), the German economy expanded for the eighth consecutive year. In calendar-adjusted terms, growth was up by as much as 2.5%, as there were three fewer working days than in 2016.
- Robust and broad-based domestic demand remained the key driver. Private consumption was supported by strong income and employment growth. Moreover, the recovery of global trade provided a lift to export demand. This resulted in rising capacity utilisation and hence higher investment in machinery and equipment.
- For the fourth quarter of 2017, we expect GDP growth of 0.5%. Whilst retail sales were flat on the previous quarter, industrial production was up sharply despite a negative “bridge day” effect in October.
- Thanks to the solid underlying dynamics, Germany enjoyed a good start to 2018. This is reflected in industrial order intake, the robust labour market and in consumer and business sentiment indicators.

### GDP growth in 2017 broad-based

According to initial calculations of the Federal Statistical Office, the German economy expanded by 2.2% in 2017. In calendar-adjusted terms, growth was even up by as much as 2.5%. The expansion was broad-based, with all major GDP components recording positive results. Private consumption (+2.0%) and gross fixed investment (+3.0%), in particular, contributed to GDP growth. At 2.6%, construction investment rose more or less by the same rate as in the previous year, whereas investment in machinery and equipment picked up visibly to 3.5%. Due to the lower number of refugees, government spending decelerated, up only 1.4%. On balance, domestic demand edged up by 2.1%. Net exports contributed 0.2 %-points to GDP growth.

### Employment and income

Thanks to the flourishing labour market, nominal disposable income rose by 3.9%. In real terms, it increased by 2.1%, given consumer inflation of 1.8%. Gross wages in 2017 were up by 4.4%, driven by a 2.7% increase in gross wages per employee to EUR 2,861 a month and 1.7% employment growth.

Productivity per hour worked inched up by 1% in 2017. Average compensation, per employee and per hour worked, rose by 2.5%, well above productivity growth. As a consequence, unit labour cost advanced by 1.5% (per hours) resp. 1.8% (per persons), which weighed on the profitability of the business sector. The gradual narrowing of the gap versus the other larger EMU countries, which started after the crisis, has therefore continued. But when 2000 is taken as a base year, Germany still enjoys a substantially more modest ULC rise than most EMU peripherals.

### Q4 2017 likely expanded by 0.5%

When publishing initial German GDP results for 2017, the Federal Statistical Office provided neither growth rates nor details for the fourth quarter. Final-quarter data and the revisions to the initial results for 2017 are due to be released on 14 February, followed by details on 23 February. Monthly economic data and sentiment indicators suggest that the German economy expanded at a

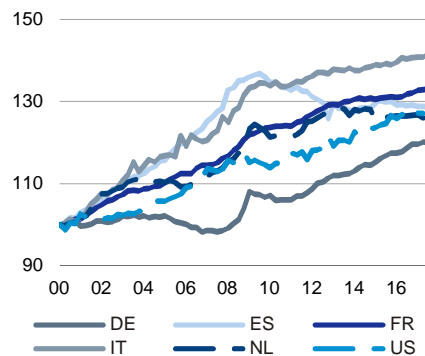


## German economy: It is party time

Unit labour costs

4

2000=100



Source: OECD

robust rate of 0.5% in the final quarter of 2017, which would mark a slight slowdown following the particularly strong expansion in Q3 (0.8%). But we believe risks are slightly tilted to the upside, as indicated by our survey-based GDP models.

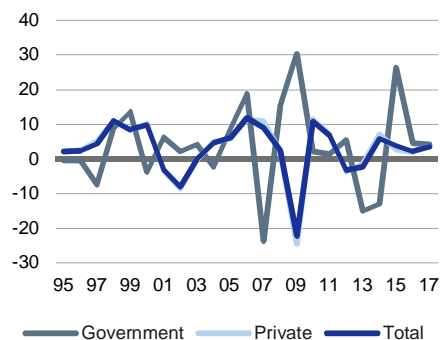
Industrial production in October declined slightly, also due to two nationwide “bridge days”. Manufacturing output on such a day is, on average, around one-third lower than on a normal working day. But, as experience shows, the effect is smaller in months with two “bridge days”, because only one of the days is usually used for a long weekend.<sup>1</sup> After slipping slightly in October, industrial production gathered steam in November, recording a strong month-over-month increase of 4.3%. The PMIs point to further production gains in December. The Manufacturing PMI, for instance, marked an all-time high of 63.3 and, at 58.8, the Composite PMI was close to its 80-month high of 58.9.

Incoming orders paint a similar picture, with average order intake in October and November up by around 2.7% on the third quarter. Robust growth was driven by domestic orders, but also by rising demand from the euro area and the non-EMU countries.

Private sector investment in equipment is catching up

5

Machinery & equipment investment, % yoy



Source: Federal Statistical Office

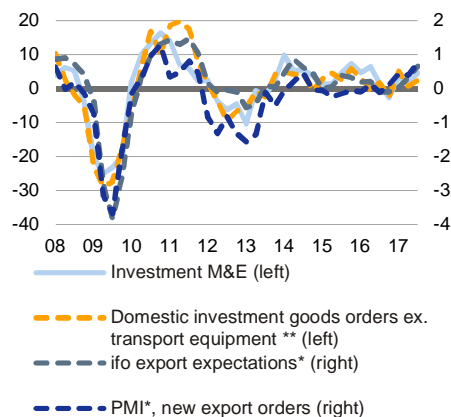
Moreover, upbeat business sentiment was supported by favourable weather conditions. According to the recent release of the IAB Institute for Employment Research, there were no negative weather impacts on employment in Q4.

On the demand side, private consumption looks set to have risen slightly in the final quarter, following a minimal dip in Q3. Domestic capital goods orders and business surveys at all-time highs suggest that investment activity will remain dynamic. At the same time, German export activity is supported by the ongoing recovery in the euro area and the upturn of global trade, which helps to mitigate the adverse effects of the recent euro appreciation. This is also reflected in the December survey on ifo export expectations. Though falling slightly to 19.9 (Nov: 21) balance points, they remain at elevated levels. Overall, German industry expects export growth to continue, albeit at a slower pace.

Increase in equipment investment expected

6

% yoy (left), standardised values (right)



\*Lead of \*2Q \*\*1Q

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

On balance, recent sentiment indicators suggest that strong growth momentum was maintained in the first weeks of the year. Recovering its moderate December losses in January, the ifo business climate was back at its all-time high of November. The PMI indices underscore this picture. At the beginning of the year, the Composite PMI is only 0.1 point below its December 80-month high of 58.9. The final readings of the January PMI indices underline this picture. For Q1 2018, we therefore also reckon with GDP growth of around 0.5%.

From the German perspective, the first quarter of 2018 will be dominated by the formation of the new government and the wage negotiations in metal and electrical engineering industry (in progress), the public sector and construction industry (both start this month). Both events should at least not have a growth-dampening effect in the short term and could even further strengthen the cycle. In the current grand coalition negotiations, however, Germany’s competitiveness is, at best, being treated indirectly, for instance in infrastructure investment plans. More directly, companies in Germany will be burdened by the adverse effects of rising health insurance contributions and further labour market regulation, whilst, at the same time, massive corporate tax cuts on the other side of the Atlantic are luring foreign direct investment.

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<sup>1</sup> See. Deutsche Bundesbank, Calendar effects on economic activity, monthly report, December 2012, pp. 53 -63.





## German wage round – approaching its first peaks

- IGM has started “24h-token strikes” to increase pressure ahead of the 6<sup>th</sup> round of talks. The crunch point remains IGM’s insistence on a partial subsidy in case employees want to temporarily reduce their weekly working hours to 28.
- Despite the intensification of the dispute, there still seems to be a willingness on both sides to avoid a collapse; both have signaled their intention to return to the negotiating table after Friday, when the current wave of strikes ends.
- Improved offers by metal employers and VW support our long-held view that pay increases could be clearly north of 3%.

## Unions enjoy higher bargaining power compared to previous years

The decentralized nature of the wage talks makes it hard to keep track. In principle there are still parallel talks in seven different regions, covering the whole of Germany, but it seems clear that both sides are trying to find a solution in Baden-Württemberg (South-West), which could then be adopted by the other regions.

We have argued that this wage round could turn out to be quite difficult given the tight labour market in general and the excellent demand situation in the metal industry in particular. This suggests relatively high settlements compared to the sector’s old contract, which expired at the turn of the year (it had a duration of 21 months with a 2.8% increase in the first period followed by another 2% increase in April 2017). Altogether the annual increases amounted to 2.14% for 2016 and 2.67% in 2017. Collective wage increases in the overall economy were 2.1% in 2017 (on a monthly basis).

## IGM’s request for an individual option to cut working hours to 28 increases complexity

Matters have been complicated further by IGM (the metal sector union) demanding an option to reduce individual weekly hours to 28 for up to two years, with a EUR 200 monthly subsidy from employers if hours are reduced to take care of a child or a close relative. The employers’ association has flatly rejected this request on the basis of surging demand with production already impaired by the lack of qualified labour. Moreover, the association has commissioned legal expertise, which argues that such a subsidy would be illegal given the resulting preferential treatment of employees who get reduced hours under such a contract compared to those who are already working reduced hours and are not entitled to the EUR 200 monthly subsidy.

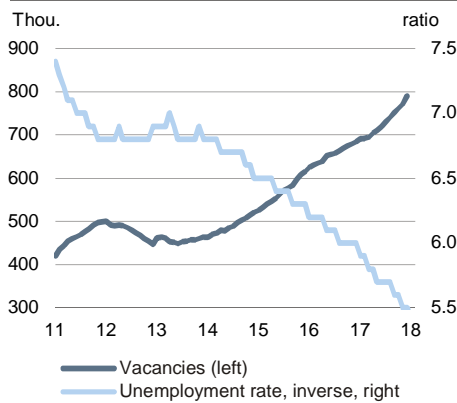
Although it is unclear whether this assessment would hold up in court, the impression is that IGM may be having second thoughts about its own demand – especially since the work forces in some SMEs do apparently consider such a measure detrimental to their company under current circumstances.

## Watch negotiations in the south-west

We still do not expect that employers will agree to subsidise lower working hours. But we expect them to improve their wage offer further in exchange for more symmetric working-time flexibility. During the 5<sup>th</sup> round of talks, they improved on their initial wage offer (2% plus a lump-sum payment) offering a

Labour market: Approaching full-employment

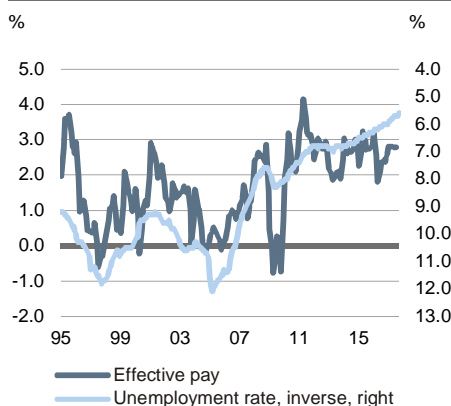
1



Source: Deutsche Bundesbank

German Phillips curve: Shaping up?

2



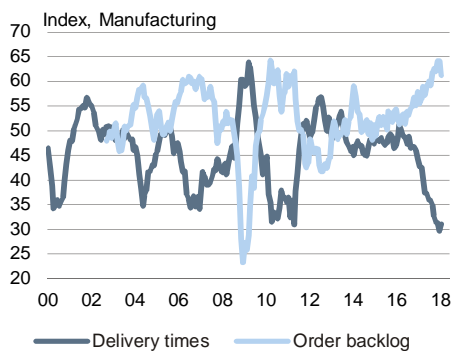
Sources: Deutsche Bundesbank, Deutsche Bank Research



## German economy: It is party time

Signs of capacity constraints

3



Source: IHS Markit

6.8% pay rise spread over 27 months. In a similar vein, VW – which traditionally has company-specific wage settlements – has beefed up its offer (3.5% starting in May, plus 2% in May 2019, with the whole contract running for 30 months, translating into annual increases of roughly 3% in 2018 and 2.5% in 2019). We still believe that the final deal for the metal sector could be much shorter; perhaps close to 4% and running slightly more than 12 months so that employers could argue that the actual (annual) increase remains clearly below the 4% threshold. Employers could alternatively offer a relatively high one-off payment, which would have the additional appeal of not lifting the basis for future wages.

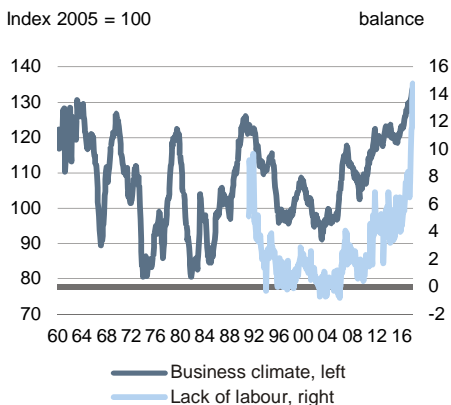
Such an agreement might be reached in February, as works council elections loom. IGM officials might be keen to have a settlement by then, which could add to their election chances.

### And if not?

Wage talks tend to develop their own internal dynamics and may – despite the first positive signs of a solution – still hit a wall: That would mean that talks are declared failed by the unions. This would likely be followed by a strike vote among union members, which – if successful – could lead to fully fledged strikes. The last time such a scenario unfolded was in 2003. However, given the overall very cooperative stance of industrial partners in Germany, we see the likelihood of such a scenario as clearly below even.

Construction sector: Booming

4



Source: ifo

### Other sectors? Watch construction!

In 2018 wage contracts for close to 10m employees are up for renewal, i.e. about 1/4 of all employed persons in the country. Besides the metal sector (3.9m), there are two other heavyweights – the public sector (2.7m) and the construction sector (0.7m) – where contracts expire by the end of February. The construction sector is running quite hot at the moment. There are reports that orders for renovations are no longer being taken by some companies, given the high demand for more lucrative new developments. There is anecdotal evidence that companies have started to offer iPads or even company cars to young people to win them for an apprenticeship. Against this backdrop, the union's initial claim of a 6% pay increase and a fully fledged 13<sup>th</sup> month salary looks almost modest. However, such an increase (13<sup>th</sup> month salary) would add about another 4pp to the claim in the west. In the east it could add more than 8% in extreme cases, where so far not even partial payments for a 13<sup>th</sup> month's salary exist. IG Bau, the construction sector union, is also requesting that daily commute time to construction sites is counted as working hours. This could in extreme cases add almost 10% to the wage bill. The current basic agreement includes some (modest) compensation for commuting costs. Since the basic wage agreement (Manteltarifvertrag) can only be terminated by the end of the year, it seems unlikely that this issue will be dealt with in the upcoming pay round.

In contrast to the metal sector's regional approach, the construction sector has only one centralized bargaining process, which negotiates one joint contract for the construction industry and the building craft for the whole of Germany. The first round of talks will take place on February 7<sup>th</sup> in Wiesbaden. A second round has been tentatively set for the end of February. The last wage round in 2016 kicked off with an initial claim of 5.9% and ultimately yielded pay increases (2016/2017) of 2.4% / 2.3% in the west and 2.9% / 2.4% in the east. The pay gap that still exists between east and west – currently 7% in comparisons between pay groups (but closer to 20% when the different grouping of workers in the east and the west is taken into account) – could be another crunch point,

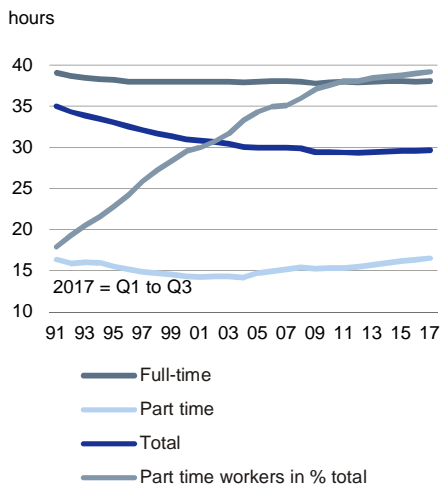


## German economy: It is party time

given the agreed aim to equalize pay by 2021, which would require that pay increases in the east be distinctively higher. While considerations of competitive position in world markets and likely the worry that employers shift production out of Germany in case of excessive settlements help to keep a lid on workers' expectations in the metal sector, such considerations hardly matter in the construction sector. Hence workers' expectations are probably running quite hot, too. Thus, we believe the risk that things reach a point such that even arbitration will not work is clearly higher in the construction sector than in the metal sector. In such a scenario, fully fledged strikes could probably start by the end of March.

Average weekly working hours

5



Source: IAB

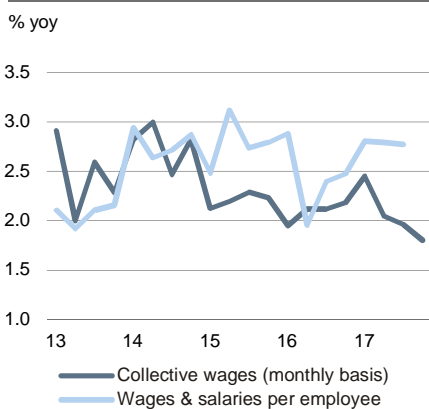
### Public sector – Focus should be on pay

Talks in the public sector (for employees at the federal level and in municipalities) will start on February 26<sup>th</sup> (rounds 2 and 3 are planned for mid-February and mid-April). The public sector union ver.di will decide upon its wage claim on February 8<sup>th</sup>. First discussions in the union's committees point to demands of a 6% pay rise, as in the private sector. Of course, the current high fiscal surpluses are grist to ver.di's mill, although the situation is quite heterogeneous across individual cities and municipalities. The final stage of the expiring two-year contract saw a 2.35% pay rise in February 2017. Public employees at the Länder level – who have separate wage negotiations – got a 2.35% pay raise at the beginning of the year, part of a deal struck back in February 2017.

It seems that in the public sector, the discussion will focus mainly on a pay increase. But the debate about temporary employment – one of the last contentious issues for the formation of a Groko – revealed that temporary employment is actually more common in the public (7.4% of all contracts) than in the private sector (6.7%), which might bring this topic onto the agenda of the upcoming wage talks.

Germany: Wage drift

6



Source: Deutsche Bundesbank

### What about overall wage growth?

One likely explanation for the still rather modest pay demands (in the context of the current macro backdrop) of 6% – besides the above-discussed issues of the 28h option in metal or the 13<sup>th</sup> month salary in construction – is that many companies are already paying above the collectively agreed wage level to retain qualified workers. Aside from strong anecdotal evidence, this can be seen in the increasing wage drift (the gap between collective wage increases and the wages and salaries that employees are actually receiving). In Q3 2017 the gap stood at 0.8 pp. Based on the wage increases for 2018 in contracts already agreed last year, and assuming that in the service sector (with lower productivity growth) settlements will probably end up more modest than in the booming metal industry, the overall increase in collective wages will probably remain slightly below 3% in 2018. By contrast, effective wages (wages and salaries per employee), which determine companies' cost basis as well as consumers' income levels, could increase by around 4%. Given that Germany accounts for 29.1% of EMU GDP (and that wages are gradually rising in the rest of EMU too) this supports our view that EMU core inflation will gradually increase and allow the ECB to exit QE by the end of the year, despite Bundesbank research showing that the pass-through of higher wages to prices is less than 50% in Germany.

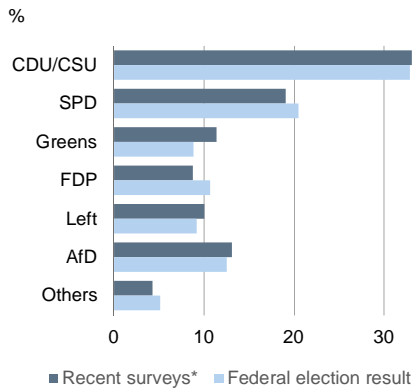
Stefan Schneider (+49 69 910-31790, stefan-b.schneider@db.com)



German economy: It is party time

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

1



\* Average of major recent surveys (Allensbach, Emnid, Forsa, Forschungsgruppe Wahlen, Infratest dimap, INSA)  
Source: Wahlrecht.de

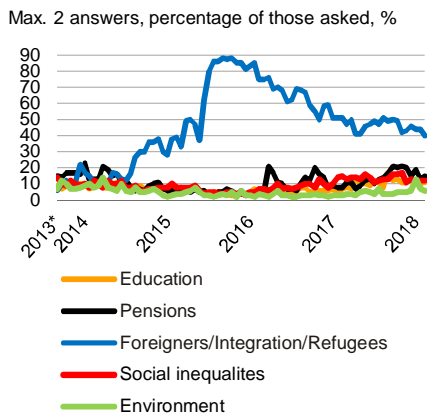
## Groko formation on the home stretch: Concerns over SPD members' verdict

Following about a week of intense meetings, coalition negotiations among the CDU, the CSU and the SPD have already reached their final state. The negotiations should end on February 6, the start of the carnival peak season, at the latest. The three parties will then present the draft of their joint coalition treaty. But that is only a stage victory. They will have to wait for the outcome of the SPD membership ballot, which will decide on the treaty and thus on the formation of a renewed Groko. This postal ballot will take two or three weeks. Thus, in a reasonable timeline, Angela Merkel's re-election as Chancellor could be scheduled for early March – i.e. before the next meeting of the European Council on March 22 to 23.

The past days' speedy negotiations are surprising. Only a fortnight ago, the debates at the SPD party convention hinted at lengthy proceedings. There, the delegates criticised the result of the previous exploratory talks, i.e. the basis for the present negotiations and they called for corrections especially in the fields of asylum, labour market, and health policy. Finally, with these reservations only a relatively thin majority (56%) of the delegates voted for their party's participation in official negotiations with the CDU/CSU.

Most important problems in Germany

2

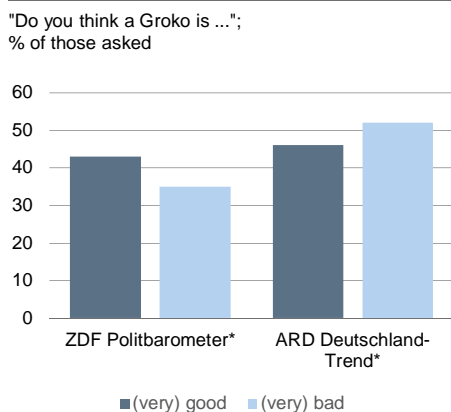


\* From the federal election (September 22) onwards  
Source: Forschungsgruppe Wahlen: ZDF Politbarometer

These additional requests have complicated matters. While some SPD grandees have requested substantial corrections, CDU and CSU representatives have rejected modifications of the basic agreement altogether. However, options for a compromise emerged soon. A case in point was the CDU/CSU's increased willingness to accommodate requests important to SPD members, e.g. enhanced benefits from the statutory health insurance scheme (reduced appointment waiting times for scheme members). On the other hand, the SPD no longer insisted on major corrections of the original compromise on asylum policy which provided for a limit of refugee immigration (max. 220,000 per year) and restrictive rules for family reunification (max. 1,000 per month plus hardship cases). When the media reported last Tuesday that the SPD has widely accepted this key CSU project, it was clear that the negotiators had achieved a breakthrough.

The German's attitude with regard to a Groko

3



\* Published February 2  
Sources: Infratest dimap, Forschungsgruppe Wahlen

So far, little detail is known beyond the principal points stipulated in the exploratory talks and the outline of the compromises on the SPD's additional requests. Notwithstanding these modifications and (possibly) further clarifications, especially with regard to European policy issues, the final treaty will most likely primarily reflect the political projects and priorities already known. This means a forthcoming Groko is likely to widely use the current fiscal headroom to finance a further rise of social expenditures, to promote infrastructure investment (esp. on digitalisation, education and transportation) and to provide tax relief for low- and middle-income earners. We expect that these measures will over time lead to a gradual decline in the (general government) fiscal surplus.

The distribution of cabinet posts amongst the three parties is still open. This issue, too, will be part of the coalition agreement. However, the SPD will formally nominate its cabinet members, i.e. the persons who will take the respective offices, only upon completion of the membership survey. According to press reports (Spiegel online, Jan 26) party leader Schulz will join the cabinet as Foreign Minister or as Finance Minister.

In the days after the presentation of the new coalition treaty, Schulz and his leadership team will have to go extra miles to enlist their party members' support for the treaty and thus to clear the final hurdle on the way to a renewed Groko. A difficult task to undertake, given the widespread reservation among Germans



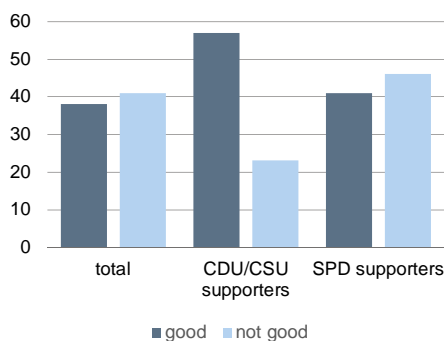


## German economy: It is party time

The German's rating of the Groko exploratory talks results

4

"Do you think the results of the exploratory talks among the CDU, CSU and SPD are ..."; %



Source: Forschungsgruppe Wahlen: ZDF Politbarometer (Jan 19)

and SPD supporters. Public sentiment is mixed. Some surveys show a (small) majority for the Groko proponents over the sceptics, others indicate the opposite. The assessments of the exploratory talk results is similarly ambiguous. According to the January ZDF-Politbarometer (Forschungsgruppe Wahlen), 38% of all respondents think that the results are good, while 41% stated they are not. A similar picture has emerged among SPD supporters (41% vs 47%). Solely among CDU/CSU supporters do the proponents dominate the scene (57% vs. 23%).

The SPD's youth wing, strongly opposing a renewed Groko, has invited people to (temporarily) become SPD members to participate in the members' ballot and to vote No. According to press reports (FAZ, WDR), the SPD has registered several thousand new members in the past few days. The relevant registration deadline is February 6, though. Arithmetically the campaign's impact should be limited, as the SPD has 443,000 members (as of end-2017). In autumn 2013, in a similar survey on the past Groko's coalition treaty, the participation rate was nearly 78%. Only in a close call might the newcomers tip the balance. Should the membership ballot fail, Germany seems likely to go for new elections.

However, a positive member ballot result still seems the most likely scenario. Given public sentiment and the critics' campaign, though, the approval rate should hardly be as convincing as in autumn 2013 when 76% of the participants greenlighted the CDU/CSU-SPD coalition.

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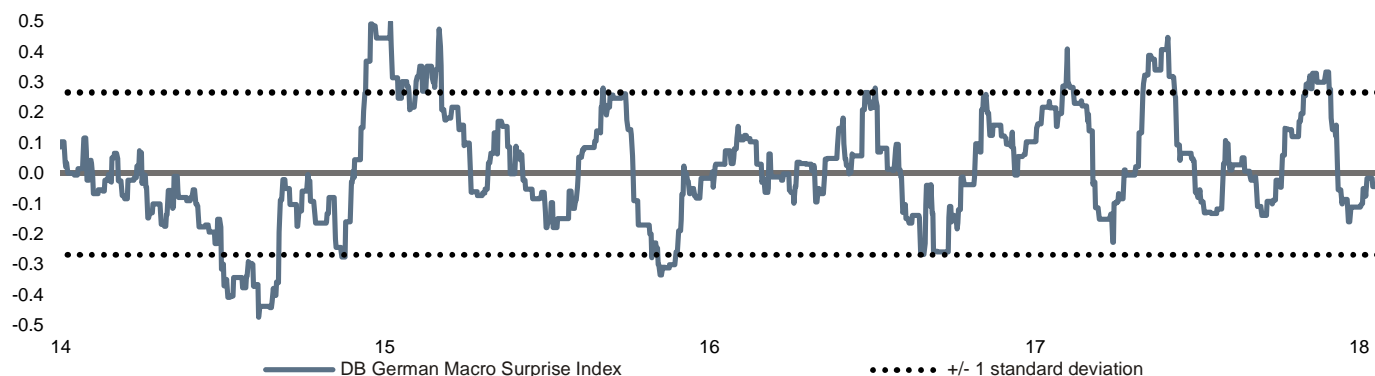
## German economy: It is party time

### 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
GRCP20YY Index	CPI (% yoy)	11 2017	13/12/2017	1.8	1.8	0.0	0.2	0.3
GRIFPBUS Index	IFO Business Climate	12 2017	19/12/2017	117.2	117.5	-0.3	-0.4	0.3
GRIMP95Y Index	Import Price Index (% yoy)	11 2017	22/12/2017	2.7	2.6	0.1	0.4	0.7
MPMIDEMA Index	Markit Manufacturing PMI	12 2017	02/01/2018	63.3	63.3	0.0	0.0	0.4
GRUECHNG Index	Unemployment Change (000's mom)	12 2017	03/01/2018	-30.0	-13.0	17.0	0.5	0.7
MPMIDESA Index	Markit Services PMI	12 2017	04/01/2018	55.8	55.8	0.0	0.0	0.5
GRFRIAMM Index	Retail Sales (% mom)	11 2017	05/01/2018	1.9	1.0	0.9	1.0	0.9
GRIORTMM Index	Factory Orders (% mom)	11 2017	08/01/2018	-0.4	0.0	-0.4	-0.2	0.4
GRIPIMOM Index	Industrial production (% mom)	11 2017	09/01/2018	3.4	1.8	1.6	1.4	0.9
GRCAEU Index	Current Account Balance (EUR bn)	11 2017	09/01/2018	25.4	25.3	0.1	-0.3	0.4
GRCP20YY Index	CPI (% yoy)	12 2017	16/01/2018	1.7	1.7	0.0	0.2	0.3
GRZECURR Index	ZEW Survey Current Situation	1 2018	23/01/2018	95.2	89.6	5.6	0.7	0.8
GRZEWI Index	ZEW Survey Expectations	1 2018	23/01/2018	20.4	17.7	2.7	0.4	0.7
MPMIDESA Index	Markit Services PMI	1 2018	24/01/2018	57.0	55.5	1.5	1.7	0.9
GRIFPBUS Index	IFO Business Climate	1 2018	25/01/2018	117.6	117.0	0.6	0.3	0.6
GRIMP95Y Index	Import Price Index (% yoy)	12 2017	29/01/2018	1.1	1.1	0.0	0.3	0.6
GRCP20YY Index	CPI (% yoy)	1 2018	30/01/2018	1.6	1.7	-0.1	-0.4	0.2
GRUECHNG Index	Unemployment Change (000's mom)	1 2018	31/01/2018	-25.0	-17.0	8.0	0.1	0.6
GRFRIAMM Index	Retail Sales (% mom)	12 2017	31/01/2018	-1.9	-0.4	-1.5	-0.9	0.2
MPMIDEMA Index	Markit Manufacturing PMI	1 2018	01/02/2018	61.1	61.2	-0.1	-0.2	0.3

Sources: Bloomberg Finance LP, Deutsche Bank Research

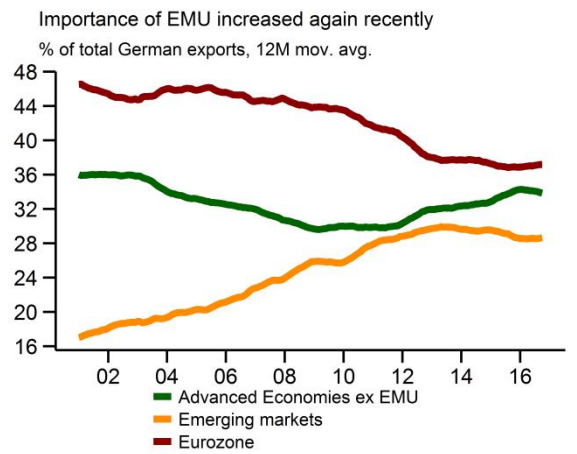
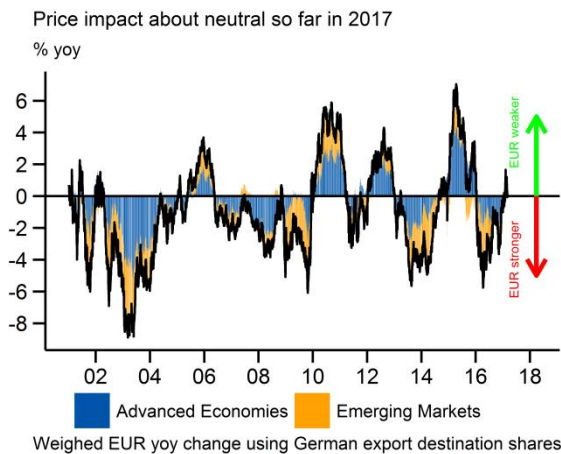
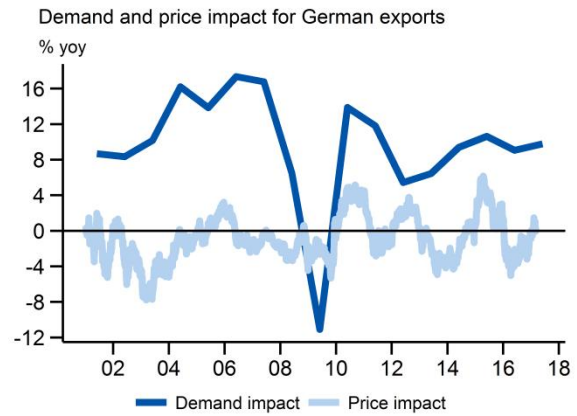
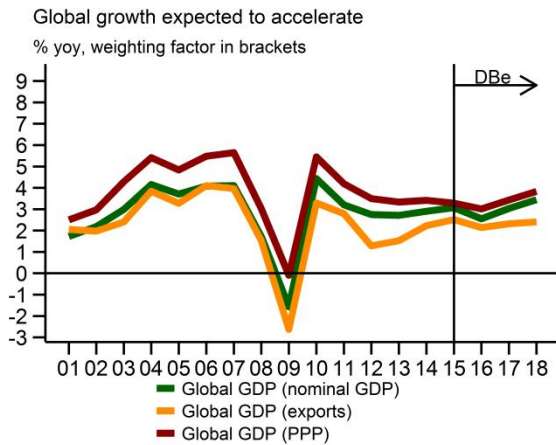
Updated by Sebastian Becker and Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)  
Source: Heiko Peters (2014). DB German Macro Surprise Index. Focus Germany, 4 August 2014.



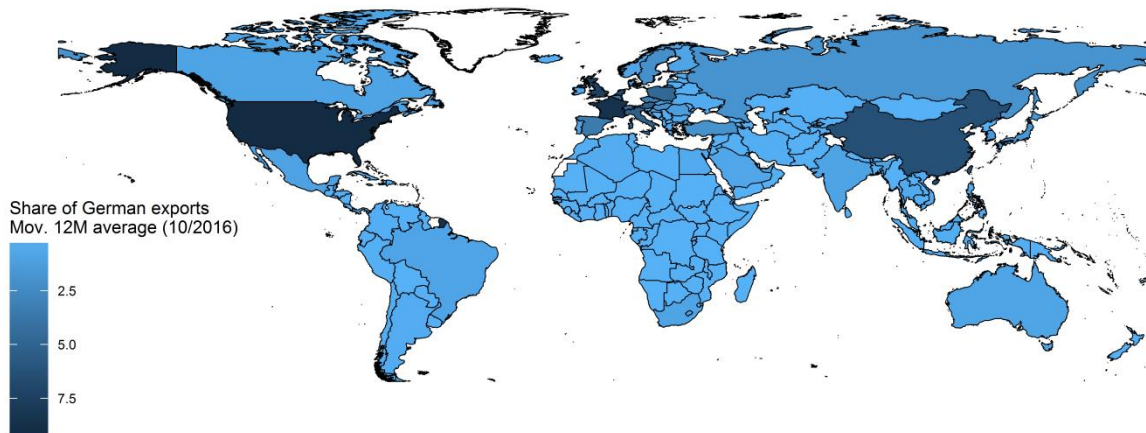
## German economy: It is party time

### 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).<sup>2</sup>



German exports focus on Europe, the USA and China



Sources: Eurostat - Comext, Deutsche Bank Research

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<sup>2</sup> See for details Focus Germany, March 3, 2016.



## German economy: It is party time

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

Date	Event	Remarks
Since early Jan	Metal wage round	The IGM union has started the wage talks with the demand for a 6% wage hike plus an option to reduce individual weekly hours to 28 (with employer subsidies).
5 or 6 Feb	(Probably) End of the coalition negotiations, Berlin	Finalizing the negotiations the CDU, CSU and SPD will present their joint draft coalition treaty. Major projects will be European policy, intensified investment on digitalisation and education as well as increased social spending.
15 Feb	Start of the construction sector wage round	The IG Bau union demands a 6% pay increase and a fully-fledged 13th month salary. We believe the talks will be very difficult and might include strikes.
19-20 Feb	Eurogroup and ECOFIN meeting, Brussels	Situation in the euro area, (poss.) thematic discussion on growth and jobs – investment in human capital, Ireland – Post Programme Surveillance – 8th review.
End Feb	(Probably) End of SPD membership ballot	The SPD carries out a postal ballot. This will take 2 to 3 weeks. We expect a thin majority for the Groko proponents.
26 Feb	Start of the public sector wage round (federal and municipal level)	The union Ver.di will decide upon its wage claim on Feb 8. Public employees at the Länder level got - in a separate wage round (in 2017) - a 2.35% pay raise at the beginning of this year.
Early March	(Prob.) Election of the Federal Chancellor, Bundestag Berlin	Provided that the SPD members will agree on the treaty, Angela Merkel will be re-elected as the chancellor of a renewed Groko. This will be her 4th term.
4 March	General election in Italy	It is open whether the new parliament can establish a stable government. Anyway, government formation will likely be difficult.
8 March	ECB Governing Council meeting, press conference	Review of the monetary policy stance. The QE programme - reduced to EUR 30 bn per month since January – continues until September 2018. Given the robust economy, we expect the end of net asset purchases by year-end.
12-13 March	Eurogroup and ECOFIN meeting, Brussels	(Possibly) Greece – state of play, annual ex-ante reporting on debt issuance plans, (possibly) preparation of international meetings: inflation and exchange rate developments.
22-23 March	European Council	Debates on the future of the EU, foreign affairs and international relations.

Source: Deutsche Bank Research

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### Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
6 Feb 2018	8:00	New orders manufacturing (% mom, sa)	December	0.4	-0.4
7 Feb 2018	8:00	Industrial production (% mom, sa)	December	-0.4	3.4
9 Feb 2018	8:00	Trade balance (EUR bn, sa)	December	20.4	22.3
9 Feb 2018	8:00	Merchandise exports (% mom, sa)	December	-1.8	4.1
9 Feb 2018	8:00	Merchandise imports (% mom, sa)	December	-0.2	2.2
14 Feb 2018	8:00	Real GDP (% qoq)	Q4 2017	0.5	0.8
23 Feb 2018	8:00	Real GDP (% qoq) - Details	Q4 2017	0.5	0.8
21 Feb 2018	9:30	Manufacturing PMI (Flash)	February	61.5	61.1
21 Feb 2018	9:30	Services PMI (Flash)	February	56.5	57.0
22 Feb 2018	10:30	ifo business climate (Index, sa)	February	117.0	117.6
27 Feb 2018	14:00	Consumer prices preliminary (% yoy, nsa)	February	1.5	1.6
2 Mar 2018	8:00	Retail sales (% mom, sa)*	January	1.2	-1.9
28 Feb 2018	09:55	Unemployment rate (% sa)	February	5.4	5.4

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

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





## German economy: It is party time

### Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
<b>Key interest rate, %</b>											
Current	1.375	-0.10	0.00	0.50	-0.75	-0.50	0.05	0.50	1.50	0.02	0.50
Mar 18	1.625	-0.10	0.00	0.50	-0.75	-0.50	0.05	0.50	1.50	0.03	0.75
Jun 18	1.875	-0.10	0.00	0.50	-0.75	-0.50	0.05	0.50	1.50	0.05	1.00
Sep 18	2.125	-0.10	0.00	0.50	-0.75	-0.50	0.05	0.50	1.50	0.05	1.00

### 3M interest rates, %

Current	1.77	0.07	-0.33	0.52
Mar 18	1.83	0.05	-0.30	0.55
Jun 18	2.08	0.05	-0.30	0.55
Sep 18	2.33	0.05	-0.30	0.75

### 10Y government bonds yields, %

Current	2.75	0.10	0.70	1.49
Mar 18	2.60	0.00	0.55	1.50
Jun 18	2.75	0.00	0.55	1.60
Sep 18	2.75	0.00	0.70	1.70

### Exchange rates

	EUR/USD	USD/JPY	EUR/GBP	GBP/USD	EUR/CHF	EUR/SEK	EUR/DKK	EUR/NOK	EUR/PLN	EUR/HUF	EUR/CZK
Current	1.24	109.18	0.88	1.42	1.16	9.77	7.44	9.56	4.15	310.65	25.28
Mar 18	1.22	115.00	0.91	1.34	1.19	9.60		9.30	4.12	313.57	25.39
Jun 18	1.24	117.00	0.92	1.35	1.22	9.40		9.20	4.07	317.00	25.26
Sep 18	1.26	119.00	0.93	1.35	1.24	9.15		9.00	4.07	316.00	25.13

Sources: Bloomberg Finance LP, Deutsche Bank Research



## German economy: It is party time

### German data monitor

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Aug 2017	Sep 2017	Oct 2017	Nov 2017	Dec 2017	Jan 2018
<b>Business surveys and output</b>											
<b>Aggregate</b>											
Ifo business climate	111.2	114.5	115.9	117.2		116.1	115.4	116.9	117.6	117.2	117.6
Ifo business expectations	104.3	106.2	107.6	109.9		107.9	107.5	109.3	111.0	109.4	108.4
<b>Industry</b>											
Ifo manufacturing	106.2	109.7	112.0	113.3		112.3	111.5	112.9	113.8	113.2	113.9
Headline IP (% pop)	1.2	1.9	1.1			2.7	-1.1	-1.2	3.4		
Orders (% pop)	-1.1	0.8	3.7			4.1	1.3	0.7	-0.4		
Capacity Utilisation	85.8	86.0	86.7	87.3	87.9						
<b>Construction</b>											
Output (% pop)	4.4	5.1	-0.8			0.0	0.1	-2.6	3.8		
Orders (% pop)	0.1	-2.8	-2.1			-2.2	0.4	0.6	9.0		
Ifo construction	128.5	130.5	133.0	134.1		133.4	134.0	135.1	133.2	133.9	133.6
<b>Consumer demand</b>											
EC consumer survey	-0.6	3.6	4.1	5.5		3.3	3.9	5.2	5.3	6.1	7.4
Retail sales (% pop)	0.0	1.4	0.4	-0.1		-0.3	1.2	-1.3	1.9	-1.9	
New car reg. (% yoy)	6.7	0.0	0.3	4.2		3.5	-3.3	3.9	9.4	-1.0	
<b>Foreign sector</b>											
Foreign orders (% pop)	-0.6	1.0	4.1			4.7	2.0	1.1	-0.5		
Exports (% pop)	2.8	1.6	0.7			2.4	-0.4	-0.3	4.1		
Imports (% pop)	3.3	3.7	1.4			-4.4	2.3	1.1			
Net trade (sa EUR bn)	59.4	60.7	62.5			21.3	21.9	19.9	22.3		
<b>Labour market</b>											
Unemployment rate (%)	5.9	5.7	5.7	5.5		5.7	5.6	5.6	5.5	5.5	5.4
Change in unemployment (k)	-52.3	-41.7	-25.0	-55.7		-8.0	-24.0	-13.0	-21.0	-30.0	-24.0
Employment (% yoy)	1.5	1.5	1.5	1.5		1.5	1.5	1.5	1.5	1.5	
Ifo employment barometer	110.3	111.1	111.9	112.9		111.2	112.3	112.1	113.2	113.6	113.8
<b>Prices, wages and costs</b>											
<b>Prices</b>											
Harmonised CPI (% yoy)	1.9	1.6	1.7	1.6		1.8	1.8	1.5	1.8	1.6	1.4
Core HICP (% yoy)	1.0	1.4	1.5	1.3		1.5	1.5	1.1	1.3	1.4	1.3
Harmonised PPI (% yoy)	2.8	2.8	2.7	2.5		2.6	3.1	2.7	2.5	2.3	
Commodities, ex. Energy (% yoy)	32.7	8.9	4.2	-5.6		4.8	5.3	0.7	-6.2	-10.5	-11.1
Crude oil, Brent (USD/bbl)	54.5	50.8	52.2	61.5		51.9	55.5	57.6	62.7	64.4	69.2
<b>Inflation expectations</b>											
EC household survey	18.9	17.6	16.3	16.0		15.8	18.1	16.0	17.2	14.8	16.6
EC industrial survey	13.0	12.2	11.7	14.2		10.4	12.8	12.3	13.4	16.9	15.1
<b>Unit labour cost (% yoy)</b>											
Unit labour cost	0.9	2.5	1.7								
Compensation	2.6	2.7	2.6								
Hourly labour costs	0.9	4.0	2.8								
<b>Money (% yoy)</b>											
M3	5.9	5.6	4.7	4.3		4.7	4.7	4.9	4.5	4.3	
M3 trend (3m cma)	5.6	5.3	5.0	4.7		5.0	4.7	4.8	4.7		
Credit - private	3.3	3.8	3.9	4.2		3.8	3.9	3.9	4.0	0.0	
Credit - public	21.0	4.1	5.5	-2.9		-7.5	5.5	-0.6	-4.4	-2.9	

% pop = % change this period over previous period.

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



## German economy: It is party time

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## Focus Germany

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