Clouds on the horizon for Goldilocks

September 4, 2018

Authors
Dieter Bräuninger
+49 69 910-31708
dieter.braeuninger@db.com

Eric Heymann
+49 69 910-31730
eric.heymann@db.com

Jochen Möbert
+49 69 910-31727
jochen.moebert@db.com

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

Editor
Stefan Schneider

Deutsche Bank AG
Deutsche Bank Research
Frankfurt am Main
Germany
E-mail: marketing.dbr@db.com
Fax: +49 69 910-31877

www.dbresearch.com

DB Research Management
Stefan Schneider

Content Page

German economy in H2: Still Goldilocks despite external headwinds. Domestic demand will remain the major growth pillar in H2, with impulses coming from the service sector and the booming construction sector, as household incomes are boosted by wage increases and ongoing employment growth. We maintain our forecast of around 0.5% quarterly GDP growth in both Q3 and Q4, following average growth of 0.4% in H1. The H1 growth composition, however, marginally lowers the annual average to 1.9% (2.0%) and risks remain more skewed to the downside.

German manufacturing industry: Further slowdown. We expect manufacturing output to increase by 2.5% in real terms in 2018 (2017: +2.9%). While this rise in production appears quite healthy in comparison to the downtrend in orders, it is largely due to the considerable statistical overhang around the turn of the year. We expect industrial production to pick up somewhat in the course of 2019 and grow by about 1% in real terms in 2019 as a whole.

Anyone out there for construction work? The construction sector is suffering from a shortage of qualified workers in the current cycle. Moreover, the cyclical shortage will be overlapped by a structural shortage when the baby boomers retire. It seems reasonable to expect that construction quality, which has already fallen according to anecdotal evidence, will continue to decline in coming years.

Corporate taxes: Growing need for action. High tax rates in contrast to the international trend, relatively restrictive depreciation allowances, a lack of broad-based, systematic R&D tax incentives and the complexity of tax law indicate the need for thorough corporate-tax reform. Given the criticism of Germany's current account surpluses, a reduction in corporate taxes would also be a strong signal.

Groko's social policy package – much for ageing voters, but little for the future. The Groko has agreed on an expensive social policy package, albeit medium- and long-term financing of the package is unsecured. Still, Finance Minister Scholz came up with an even more costly idea for extended pension benefits. Ahead of the state elections in Bavaria and Hesse on October 14 and 28, it seems the SPD wants to promote an issue that will differentiate itself. A silver lining could be if the Groko manages to launch a law on labour migration.

Clouds on the horizon for Goldilocks

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2017	2018F	2019F	2017	2018F	2019F	2017	2018F	2019F	2017	2018F	2019F
Euroland	2.5	2.1	1.7	1.5	1.8	1.8	3.5	3.3	2.7	-0.9	-0.6	-0.6
Germany	2.2	1.9	1.7	1.8	1.6	1.8	7.9	7.3	6.4	1.0	1.2	1.2
France	2.3	1.8	1.6	1.2	1.9	1.5	-0.6	-0.4	-0.4	-2.6	-2.1	-2.8
Italy	1.6	1.3	1.0	1.3	1.2	1.5	2.9	3.1	3.2	-2.3	-1.7	-1.2
Spain	3.0	2.8	2.5	2.0	1.5	1.7	1.9	1.6	1.4	-3.1	-2.1	-1.3
Netherlands	2.9	2.5	2.5	1.3	1.3	1.8	10.5	10.2	10.1	1.1	0.5	0.4
Belgium	1.7	1.9	1.8	2.2	1.9	1.7	-0.2	-0.7	-1.0	-1.0	-1.0	-1.0
Austria	3.1	3.0	2.3	2.2	2.1	1.8	1.9	2.4	2.7	-0.7	-0.6	-0.3
Finland	2.8	2.3	2.1	0.8	1.2	1.4	0.7	0.5	0.5	-0.6	-0.3	-0.3
Greece	1.3	2.3	2.2	1.1	0.6	1.0	-0.8	-0.5	0.0	0.8	1.5	2.0
Portugal	2.7	2.2	1.7	1.6	1.0	1.5	0.7	0.4	0.2	-3.0	-1.0	-1.0
Ireland	7.2	5.4	3.3	0.3	1.0	1.3	8.5	6.0	3.0	-0.3	0.1	-0.4
UK	1.7	1.3	1.6	2.7	2.4	2.0	-3.9	-3.8	-3.5	-1.4	-1.9	-1.4
Denmark	2.3	2.0	1.9	1.1	1.5	1.6	7.6	7.5	7.0	0.9	-0.5	-0.5
Norway	2.4	2.2	2.0	1.9	1.9	1.8	5.5	6.0	5.5	4.4	4.0	5.0
Sweden	2.5	2.7	2.4	1.8	1.9	2.0	3.3	4.0	4.0	1.3	1.0	0.5
Switzerland	1.1	2.2	1.8	0.5	0.5	0.6	9.8	11.2	11.4	0.6	0.2	0.2
Czech Republic	4.5	3.7	3.2	2.5	2.2	2.3	1.0	0.6	1.1	1.6	0.8	0.6
Hungary	4.0	3.8	3.2	2.3	2.8	3.2	3.1	1.9	1.5	-2.0	-2.2	-2.3
Poland	4.6	4.2	3.4	1.9	1.9	2.7	0.2	-0.8	-1.0	-1.6	-2.0	-2.3
United States	2.2	2.9	2.7	2.1	2.5	2.2	-2.3	-3.0	-3.5	-3.4	-3.9	-4.6
Japan	1.7	0.8	0.6	0.5	0.8	0.6	4.0	3.8	4.2	-2.8	-2.6	-2.3
China	6.9	6.6	6.3	1.6	2.0	2.4	1.3	0.6	0.3	-3.7	-3.5	-3.5
World	3.8	3.9	3.8	2.9	3.3	3.3						

*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	2017	2018F	2019F	2018 Q1	2018 Q2	2018 Q3F	2018 Q4F	2019 Q1F	2019 Q2F	2019 Q3F	2019 Q4F
Real GDP	2.2	2.2	1.9	1.7	0.4	0.5	0.4	0.5	0.5	0.4	0.4	0.4
Private consumption	2.1	1.8	1.6	1.4	0.5	0.3	0.4	0.4	0.4	0.4	0.3	0.2
Gov't expenditure	4.0	1.6	1.2	1.4	-0.3	0.6	0.8	0.4	0.3	0.3	0.3	0.3
Fixed investment	3.5	2.9	3.1	2.9	1.4	0.5	0.9	0.8	0.9	0.8	0.8	0.7
Investment in M&E	2.3	3.7	4.5	2.6	2.3	0.3	0.5	0.5	1.0	0.7	0.7	0.5
Construction	3.8	2.9	3.5	4.1	1.6	0.6	1.2	1.2	1.0	1.0	1.0	1.0
Inventories, pp	0.2	0.1	0.2	0.0	-0.1	0.4	-0.1	0.0	0.0	0.0	0.0	0.0
Exports	2.3	4.6	3.1	4.2	-0.3	0.7	1.0	1.2	1.1	1.0	1.0	1.2
Imports	4.1	4.8	3.8	5.0	-0.2	1.7	1.2	1.3	1.2	1.2	1.1	1.2
Net exports, pp	-0.5	0.2	-0.1	-0.1	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.1
Consumer prices*	0.5	1.8	1.6	1.8								
Unemployment rate, %	6.1	5.7	5.2	4.9								
Industrial production**	1.4	3.0	1.8	1.5								
Budget balance, % GDP	0.9	1.0	1.2	1.2								
Public debt, % GDP	67.9	63.9	60.1	56.5								
Balance on current account, % GDP	8.5	7.9	7.3	6.4								
Balance on current account, EUR bn	268.8	257.7	250	225								

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

German economy in H2: Still Goldilocks despite external headwinds

— Domestic demand will remain the major growth pillar in H2, with impulses coming from the service sector and the booming construction sector, as household incomes are boosted by wage increases and ongoing employment growth.

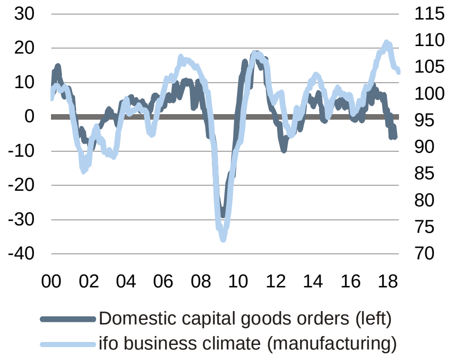
— The Donald Trump/Jean-Claude Juncker meeting on July 26th and recent progress regarding an US-Mexican trade agreement have temporarily calmed concerns about a further escalation of the US/EU trade dispute. Still, the external environment remains – in our view – the major source of risk for the German economy.

— We maintain our forecast of around 0.5% quarterly GDP growth in both Q3 and Q4, following average growth of 0.4% in H1. The H1 growth composition, however, marginally lowers the annual average to 1.9% (2.0%) and risks remain more skewed to the downside.

— Despite stronger wage growth, headline and core inflation will vacillate around 2% and 1 ½%, respectively.

Germany: Investment cycle 1

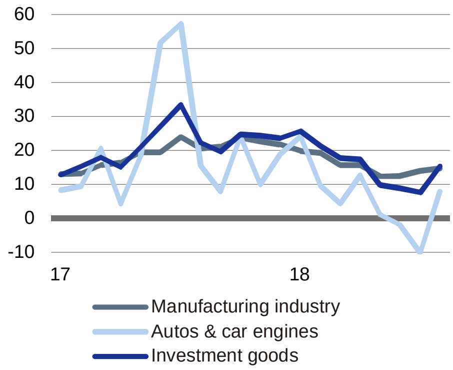
% yoy, 3Mav, volume
2015=100



Sources: Deutsche Bundesbank, ifo Institute

ifo: Export expectations 2

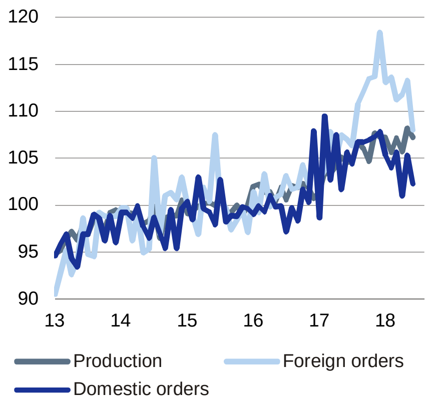
Balance



Source: ifo Institute

Manufacturing: Monthly indicators 3

2015 = 100



Sources: Deutsche Bundesbank, Federal Statistical Office

Q2 GDP details disappointed

While GDP growth accelerated slightly to 0.5% qoq after 0.4% in Q1, the composition revealed a less robust picture. Inventories contributed 0.4pp to growth, while net exports subtracted the same amount. Private consumption slowed to 0.3% qoq (Q1 0.5%), real disposable income eked out a meagre 0.1% qoq increase, after surging 1.2% in Q1, although the quarterly profile might have been strongly influenced by calendar effects. The savings rate even continued to increase to 10.2% in Q2. Investment in machinery & equipment hardly grew (+0.3% qoq) as hinted by the slumping domestic capital goods orders (Q2/Q1 -3.2% and Q1/Q4 -2.7%), however the Q1 increase was revised up to 2.3% qoq.

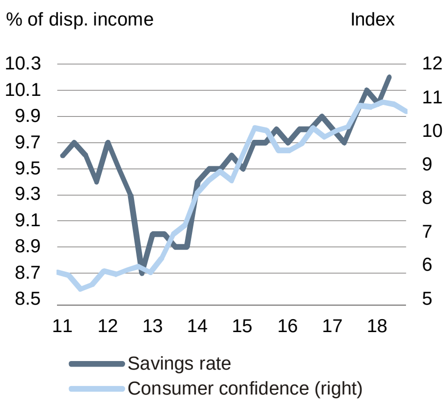
Sentiment stabilising

Due to strong August readings the ifo index and the PMIs have recovered somewhat in Q3 compared to Q2, although sentiment in manufacturing continued to weaken a bit in both surveys. While export demand softened again in August after picking up slightly in July, according to the PMI survey, export expectations for the next 3 months jumped in the August ifo survey. The rebound was particularly evident in the car industry (from 7.9 after -10.1 in July), where the truce in the US/EU trade dispute agreed between Donal Trump and Jean-Claude Juncker in late July raised hopes that the tariff increase to 20% as mentioned by Trump will be avoided – at least for the next 3 months, the time horizon ifo asks about in its export expectations questions. Production expectations provided a mixed picture, increasing 0.7 points in the PMI survey but falling 0.9 points in ifo (manufacturing, Jul/Aug v. Q2).

Hard data has yet to stabilise

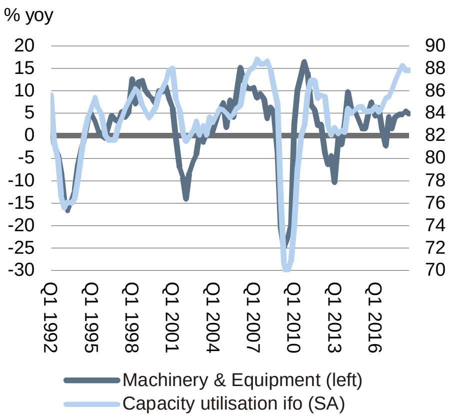
The latest order data (June) do not suggest any pickup in output soon. The quarterly comparison shows declines in Q2 (and Q1) of -2.0% (-2.2%) for domestic and -1.4% (-2.2%) for foreign order intake, following bumper orders in Q4 last year.

Savings rate & consumer confidence 4



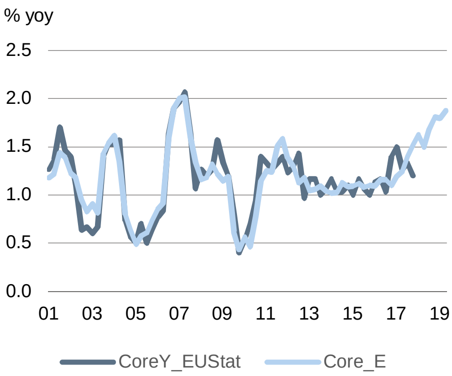
Source: Deutsche Bundesbank

Investment & capacity utilisation 5



Sources: ifo Institute, Deutsche Bundesbank

German core inflation 7



Sources: Deutsche Bundesbank, Deutsche Bank Research, IHS Markit

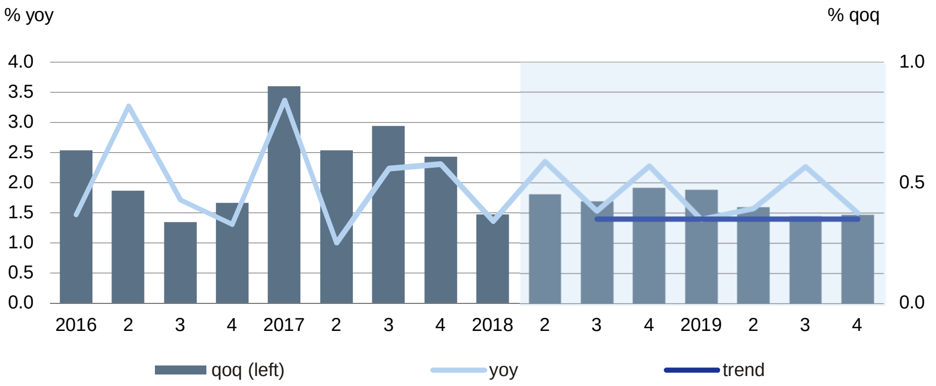
EH2 export outlook will be key for investment and GDP growth

Households' disposable income growth (nominal) slowed sharply in Q2 to 0.4% following a 1.6% jump in Q1. There might be some issues regarding the booking of the wage increases (construction, mechanical engineering, public sector) and a negative calendar effect seems to have impacted Q2. Still, employment growth has hardly slowed and the recent increase in the savings rate (10.2%) in Q2 might not continue in H2, although consumer confidence has come off its recent highs a bit. Therefore, household consumption should remain solid in H2, growing at around 0.4% on a quarterly basis, notwithstanding the slightly disappointing July retail sales (-0.4% mom, real).

Investment spending will be key for the overall growth. Despite the poor order intake we do expect at least some pickup in Q3, although none of the uncertainties surrounding the business outlook (trade, Italy, Turkey, Brexit) looks likely to be solved over the next months. Still, with the output gap already strongly positive and continuing to widen – as actual growth remains above potential – capacity utilisation just 1 point shy of its all-time high and the unemployment rate poised to fall below 5%, there should be at least some incentive to expand capacities, despite the more uncertain outlook.

Quarterly growth should therefore remain close to 0.5% in H2. Given H1's more disadvantageous growth composition, the annual average, however, will inch down by 0.1pp to 1.9%. Assuming that a further substantial escalation in the tariff rift (especially higher auto tariffs) can be avoided, Brexit will indeed be soft and further clashes within the EU (Italian budget, refugees, etc.) can be circumvented; the German economy should continue to expand slightly above trend in 2019. Average quarterly growth rates of 0.4% could yield an annual increase of 1.7%.

GDP momentum slowing to (slighty above) trend 6



Sources: Deutsche Bank Research, Federal Statistical Office

Inflation hovering around 2%

Headline inflation has eased marginally to 2.0% yoy in July and August (flash estimate, May 2.2%), as core inflation (1.4% yoy) came off its May-high of 1.6% (nat. definition), despite accelerating in energy prices. Based on DB's oil price and USD/EUR forecasts, energy prices should have peaked in August at 6.9% and fall towards 2.5% by year-end. Food price inflation is still decelerating (August 2.5%). This year's drought-induced crop failures are unlikely to reverse this trend in the remainder of 2018. This year's higher wage settlements will feed through into core inflation mainly during 2019. In the rest of this year, core should hover at around 1 ½% and headline inflation should remain at around 2%. Next year some relief from lower oil prices and a strengthening EUR should be counterbalanced by core inflation finally drifting towards 2%.

Groko politics – a domestic risk factor

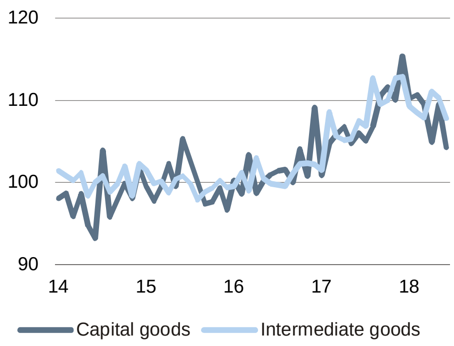
Taking a step back, however, shows the German economic cycle is still in good shape. Growth above potential, unemployment falling below 5% and inflation not really moving beyond 2% – not to forget budget surpluses still north of 1% and debt levels south of 60% – it really does sound like a fairy tale. However, as indicated by the latest pension / unemployment contributions compromise, there are increasing indications political dynamics in the grand coalition might create the opportunity for pork-barrel politics (fiscal / social spending, re-winding past reforms), which could ultimately curtail the economy's potential at a time when the supply side will be severely challenged by adverse demographics.

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

German manufacturing activity: Further slowdown

Orders tending downwards 1

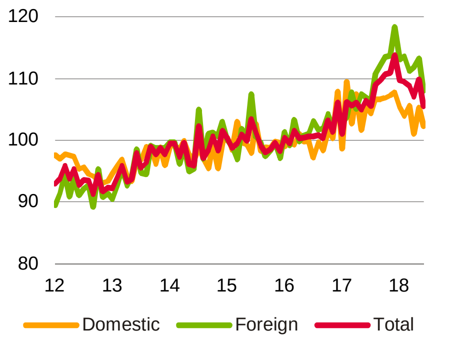
Manufacturing industry in DE, orders, 2015=100



Source: Federal Statistical Office

Industrial orders decrease 2

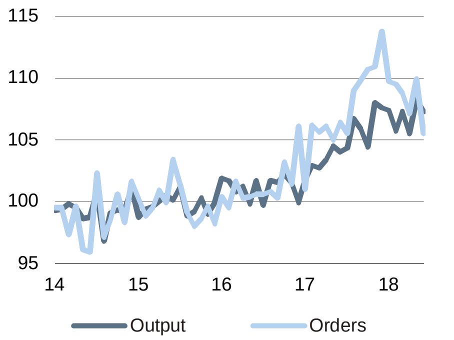
Manufacturing industry in DE, orders, 2015=100



Source: Federal Statistical Office

Beyond cyclical peak 3

Manufacturing industry in DE, output, 2015=100



Source: Federal Statistical Office

— In quarter-on-quarter terms, order intake in the German manufacturing sector declined in both Q1 and Q2 2018 (Q1: -2.2% in real terms; Q2: -1.7%). Both domestic and export orders trended downwards, and capital goods orders slipped disproportionately (Q1: -2% qoq; Q2: -3.5%). This development appears to be due to both the advanced stage of the global economic cycle and, increasingly, the intensifying trade policy conflicts.

— We stick to our forecast and expect manufacturing output to increase by 2.5% in real terms in 2018 as a whole (2017: +2.9%). While this rise in production appears quite healthy in comparison to the downtrend in orders, it is largely due to the considerable statistical overhang around the turn of the year. We expect industrial production to pick up somewhat in the course of 2019 and grow by about 1% in real terms in 2019 as a whole. Employment might continue to increase until the beginning of 2019, if at a somewhat slower pace than until now. Industrial producer prices look set to rise by just above 2% in both 2018 and 2019.

German industrial activity is continuing to slow down. This is particularly evident from order intake, which was down in seasonally adjusted terms in each of the first two quarters of 2018 (Q1: -2.2% in real terms; Q1: -1.7%). Both domestic and export orders trended downwards, and capital goods orders slipped disproportionately (Q1: -2% qoq; Q2: -3.5%). This development appears to be due to both the advanced stage of the global economic cycle and, increasingly, the intensifying trade policy conflicts. It is quite understandable that buyers of capital goods in particular become more cautious in such an environment. After all, companies which invest in new machinery and equipment towards the end of an economic cycle may soon be faced with overcapacity. Numerous managers will still remember the recession years 2008/2009, when excess capacity drove expenses up.

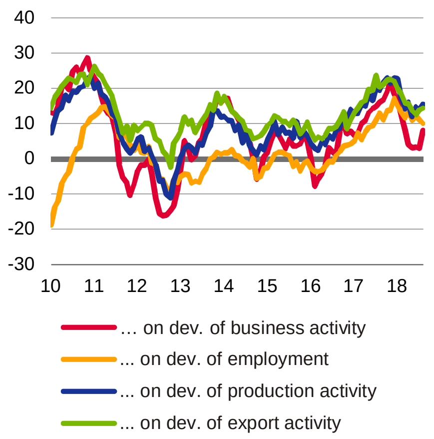
Still, an abrupt downturn in German manufacturing appears improbable. The order backlog continued to increase until recently, even though the pace of growth slowed considerably in 2018 in comparison to 2017. The ifo sentiment index suggests that industrial companies are still optimistic overall. While the expectations component has declined markedly since autumn 2017, it is still in expansionary territory and has even recovered recently. This applies also to companies' export expectations, which are still clearly in positive territory, despite a recent decline. At first sight, the optimistic export expectations may appear surprising against the background of the latest trade-policy conflicts (just think of US threats to impose tariffs on EU imports). However, German exports have actually done quite well so far this year. In H1 2018, goods exports were up 4% in nominal terms year-on-year (2017: +6.2%). Moreover, the meeting between US President Trump and EC President Juncker helped to calm the waters somewhat, at least for now. Still, the trade conflict is not yet resolved, and last month's uptick in ifo expectations might prove too optimistic in the end.

Flat output in 2018 and 2019

German manufacturing output rose only marginally in price-adjusted terms in the first two quarters of 2018 (+0.1% and 0.2% qoq, respectively, in seasonally adjusted terms), down from a quarterly average of +1.3% in 2017. We expect industrial output to move largely sideways during the second half of 2018. Geopolitical tensions should continue to dampen demand for capital goods and prevent any significant growth in this segment. In addition to global trade conflicts centering around the US, Brexit and economic sanctions, for example against Russia, are important issues in this context. If capital goods orders

Majority of German manufacturing companies still has pos. expectations 4

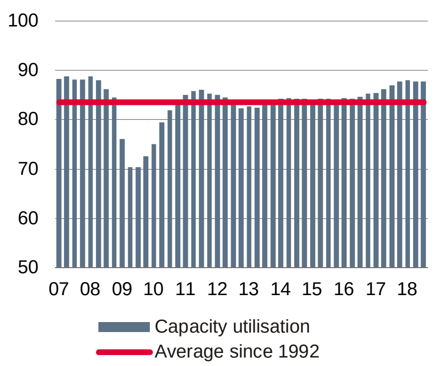
Company expectations, balance of positive and negative company reports



Source: ifo Institute

Capacity utilisation stagnates, albeit at a high level 5

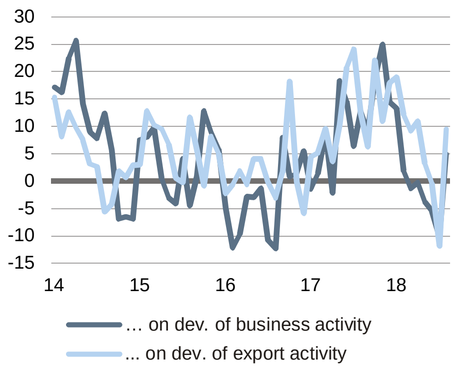
Capacity utilisation in the manufacturing industry in Germany, %



Source: ifo Institute

Expectations in the automotive industry drop significantly 6

Expectations in the German autom. industry..., balance of pos. and neg. company reports



Source: ifo Institute

decline, producers of intermediate goods will suffer, too. The fact that capacity utilisation in manufacturing "only" stagnated at the beginning of Q3, if at a high level, also suggests that output will remain relatively stable.

In addition, a lack of skilled industrial workers will prevent stronger output growth from the supply side. Employment in the manufacturing sector has steadily increased since mid-2010 and climbed to new record highs almost every month. At the same time, according to the regular surveys conducted by the Association of German Chambers of Commerce and Industry (DIHK), companies already have been saying since autumn 2016 that a potential lack of skilled workers was the most important business risk and weighed on investment activity. The bottlenecks on the German labour market will make it difficult to resolve this problem any time soon.

During the second half of the year, German industrial output might suffer from the fact that the car industry will temporarily interrupt the production of several models. The certification of new models according to the Worldwide Harmonized Light Vehicles Test Procedure (WLTP) is being delayed. Moreover, the automotive industry has passed its cyclical peak in important foreign markets for German producers. That is one reason why business and export expectations in the sector recently dropped into negative territory, followed by a recovery after the Donald Trump/Jean-Claude Juncker meeting. Since the auto industry makes up a large share of overall industrial value creation in Germany (c. 20%), output declines in this sector will affect the outcome for manufacturing as a whole.

The relatively weak euro exchange rate versus the dollar should support exports, as it will improve German companies' price competitiveness in many countries outside the euro area. In addition, consumer goods producers continue to benefit from still very stable domestic growth in Germany, which is supported by the favourable labour market situation and comparatively strong wage increases.

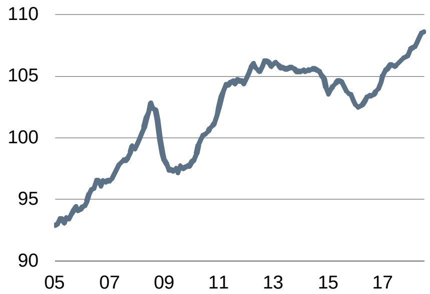
German industrial output to rise by 2.5% in 2018 and 1% in 2019, respectively

Despite subdued quarter-on-quarter output growth during the first half of 2018 and our forecast of flat development during the remainder of 2018, we continue to expect manufacturing output to increase by 2.5% in real terms in 2018 as a whole (2017: +2.9%). Much of this increase is due to the considerable statistical overhang around the turn of the year 2017/2018. We expect industrial output to pick up slightly in the course of 2019, with the statistical overhang around the turn of the year 2018/2019 being almost zero. Industrial output looks set to grow by about 1% in real terms in 2019 as a whole. Employment might continue to increase until the beginning of 2019, if at a somewhat slower pace than until now. At the moment, employment expectations in the industrial sector, as measured by the ifo index, are still in positive territory. However, as the end of the cycle approaches, companies will become more cautious about taking on new employees, particularly if the order backlog does not increase further. From our vantage point, the trade policy conflict between the US and the EU is the biggest source of uncertainty for our output forecast.

Producer prices recently driven up by energy

Manufacturing producer prices were up by more than 2% yoy in each of the last few months. However, this is partly due to the energy component. Overall, producer price inflation looks set to be somewhat slower in 2018 and 2019 than in 2017 (+2.6%). Nevertheless, a slower uptrend would still be a clear improvement for companies in comparison to the period from 2011 until 2016, Producer prices continue to rise 7

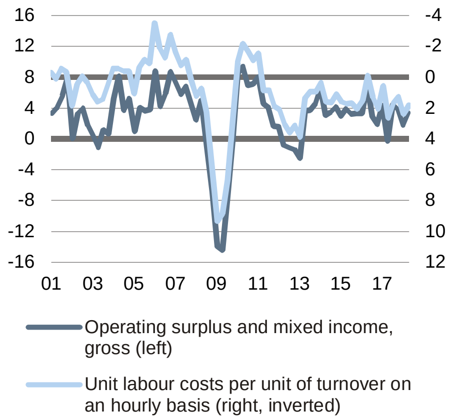
Producer prices in the manufacturing industry
DE, 2010=100



Source: Federal Statistical Office

Operating surplus and unit labour costs highly correlated 8

Germany, whole economy, % yoy



Sources: Deutsche Bundesbank, Eurostat, Deutsche Bank Research

when prices fell. As a rule, rising producer prices have a favourable effect on corporate profits. This might be offset, to some extent, by higher wage expenses due to the comparatively strong wage increases, which will, everything else being equal, result in higher unit labour costs. Overall labour productivity in Germany has already declined during the past few quarters. Higher unit labour costs and lower labour productivity will weigh on companies' operating surpluses, which have, until recently, grown at a rate of 1% per quarter. Moreover, as the economic cycle approaches its end, price competition is set to become fiercer in some sectors. And finally, exchange rates will have an impact on corporate profits, even though this effect will depend on the sales and output structure of the individual companies.

Eric Heymann (+49 69 910-31730, eric.heymann@db.com)

Anyone out there for construction work?

— The construction sector is suffering from a shortage of qualified workers in the current cycle. Companies have taken numerous measures to compensate for the lack of skilled labour.

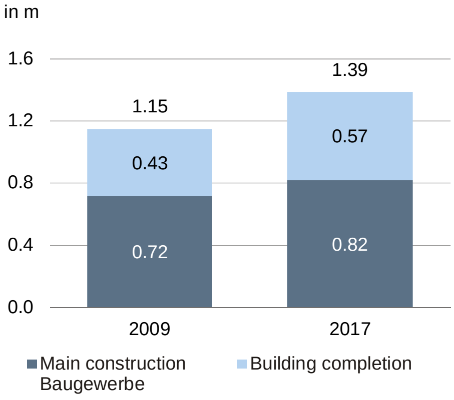
— In particular, they extended working hours, took on non-skilled workers, increasingly employed foreign workers in jobs subject to social security contributions and tried – with relatively moderate success – to recruit more apprentices.

— Because construction activity has picked up – and probably also because there is a shortage of skilled workers – the utilisation rate of construction machinery and equipment reached a new high. In addition, investment in construction machinery and equipment has risen considerably in the last few years. Recent surveys point to a further increase in investment activity in 2018.

— With the baby-boomer generation due to retire over the coming years, the shortage of skilled workers will probably become a structural factor. In order to compensate for the negative effects of the labour bottlenecks, companies will probably rely more and more on the measures mentioned above.

— Even today, it may take up to six months to fill vacancies in positions of responsibility, for example master craftsmen who can supervise construction work. According to anecdotal evidence, construction quality standards have declined over the cycle. Persistent bottlenecks will considerably increase the risk of low-quality construction.

Employees in construction 1

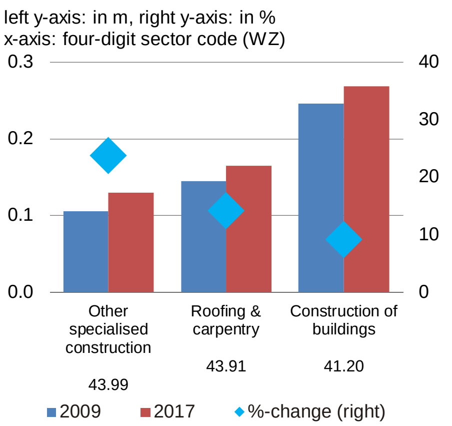


Sources: Deutsche Bank Research, Federal Statistical Office

Construction labour market 2

Sources: Deutsche Bank Research, Federal Employment Agency

Main construction: Employees in very large subsectors 3



Sources: Deutsche Bank Research, Federal Statistical Office

Construction sector chasing new records

The construction sector is booming. Order intake and industrial output have grown by c. 40% since 2009, and the order backlog has reached a 20-year high. According to the ifo institute, the unusually good order intake has resulted in four months of order coverage. The ifo business sentiment index therefore rose to an all-time high in August. Since the framework conditions – scarce supply and rising demand – have not changed, activity in the construction sector is likely to remain strong far beyond 2018.

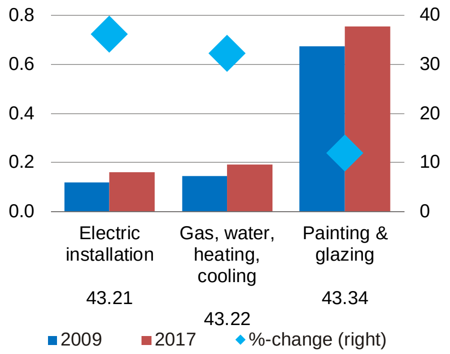
Residential construction supply not growing dynamically

Low supply elasticity is the main reason for the boom in house prices and rents during the current house price cycle, i.e. from 2009. Construction activity remained sluggish during the cycle due to a lack of available construction plots, complex rules and regulations, staff shortages at building authorities, high and rising public participation and (as a consequence) low incentives for local policymakers to plan large-scale projects. In addition, the energy transition has considerably increased construction costs, and a misdirected federal residential construction policy, which aimed not to boost new construction until 2018, but to tighten regulation, prevented dynamic growth. And last, but not least, a shortage of skilled construction workers was identified as a major problem early on. This issue is what we will focus on in this report.

The construction labour market since 2009

Building construction: Employees in very large subsectors 4

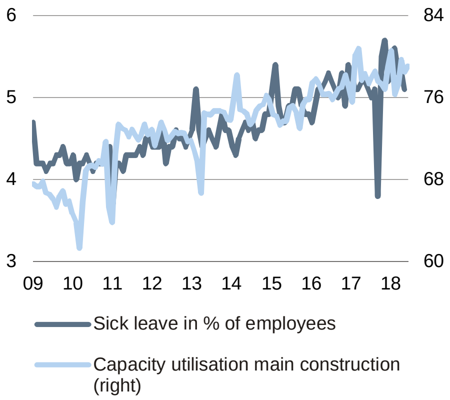
left y-axis: in m, right y-axis: in %
x-axis: four-digit sector code (WZ)



Sources: Deutsche Bank Research, Federal Statistical Office

ifo: Sick leave 5

both y-axes: in %



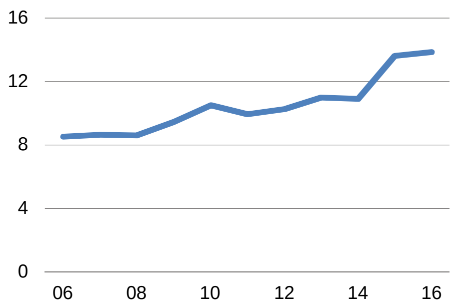
Sources: ifo Institute, Deutsche Bank Research

The number of workers in the construction sector rose by 20% between 2009 and 2017, from 1.15 million to almost 1.4 million. This increase considerably exceeded that in German employment as a whole (+9%). Due to the boom in residential construction, the number of employees in finishing construction sectors rose particularly strongly, by 30%. In contrast, employment in the main construction sector was up “only” 10%, with sectors which are close to residential construction registering stronger increases in several instances. Building construction saw the smallest increase in employment (Figure 4). As a result, the number of registered vacancies in the main construction sector has risen by 50% since 2012, and the number of unemployed construction workers and craftsmen has roughly halved. On average, only 50,000 construction workers were registered as unemployed so far this year. At the same time, the number of vacancies has increased by c. 50%. The ratio between unemployed workers and vacancies has dropped to near or even below one in a number of construction-related professions. Potential labour is becoming scarce, and construction companies are competing fiercely for workers. Consequently, construction workers were able to secure considerable wage increases during the wage negotiations this spring. Wages will rise by c. 5% in 2018 and even further in 2019.

Skilled labour shortage to intensify during 2018

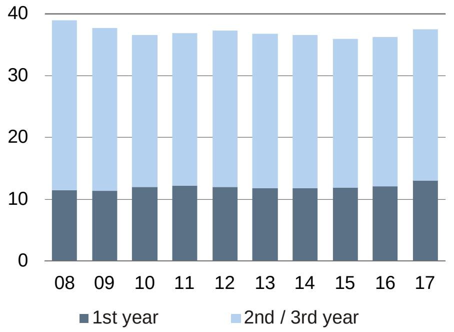
A survey conducted by the Association of German Chambers of Commerce and Industry (DIHK) at the beginning of 2018 found that 80% of construction companies regard the shortage of skilled workers as a key risk for their business. The ifo data, too, point to a shortage of skilled workers in all construction sectors. In 2018, a record number of construction companies claimed that they were urgently looking for skilled workers, in residential construction as well as in commercial or public-sector construction. In addition, the shortage of skilled workers in commercial construction might have a negative impact on residential construction. Since commercial buildings offer higher returns and economies of scale in comparison to residential buildings, commercial construction companies may offer better working conditions than their competitors in the residential construction sector. This might, in turn, lure workers away from residential construction. The labour shortage in construction has significantly intensified during the cycle. In fact, the Federal Employment Agency’s analysis of bottlenecks on the labour market already found back in 2012 that there was a lack of skilled workers in finishing construction sectors, in particular in plumbing and heating engineering. This bottleneck became even more pronounced during the following years. Jobs remained vacant for longer, not only in plumbing and heating engineering, but across all construction sectors. In 2018, the lack of skilled labour reached a new dimension; now, construction companies are looking for master craftsmen who can take on supervisory functions. Unemployment among these specialists is around 1%, and, according to the Federal Employment Agency, it usually takes half a year to fill a vacancy. With both master craftsmen and skilled workers lacking, it may be difficult to boost construction.

Potential occupational disease 6



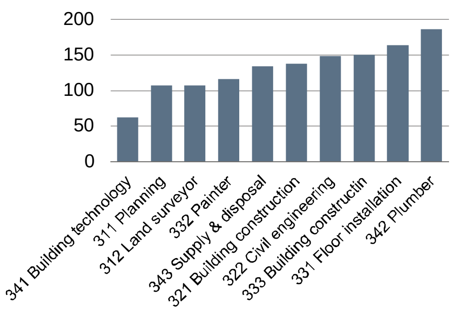
Source: Employers' liability insurance association

Apprentices in construction 7



Source: Main construction industry association

2018 Construction labour market: Shortage analysis 8



Source: Arbeitsagentur

Skilled labour shortage likely to become even more serious

Several characteristics of the construction jobs which are subject to social security contributions also point to a significant labour shortage. The share of unskilled workers has risen, whereas the share of skilled workers has declined. This is particularly true for traditional building construction. Several other factors also illustrate the bottlenecks. The share of those aged above 55 has risen in the last few years and now almost amounts to 20% of the total number of construction workers. In contrast, the share of those aged below 25 is only about 11% and has been declining slightly in the last few years. In addition, the ratio between apprentices in their first year of training and workers who retired was negative during the whole cycle, i.e. since 2009. This trend will become even more pronounced, as the baby boomers are approaching the retirement age. Moreover, construction workers tend to become unable to work much earlier than their colleagues in other sectors and try to retire early. According to the employers' liability insurance association, the number of suspected instances of occupational disabilities has risen by 50% between 2009 and 2016. This is one factor which, besides buoyant business activity, might explain the increase in the sickness rate from c. 4% of all employees in 2009 to currently more than 5%. Due to the domestic labour market bottlenecks, companies have increasingly taken on foreign workers in jobs which are subject to social security contributions. Their number has roughly doubled over the cycle, with their share currently amounting to c. 15%. However, recruiting foreign workers may soon run into a limit, too. The number of workers transferred to Germany has stagnated at slightly above 100,000 since 2015. In particular, the number of workers from Eastern Europe, which makes up about 70% of all transferees in the construction sector, has been declining.

Analysis and outlook: How do labour and capital intensity, productivity and other factors affect new construction?

By now, there is broad consensus about the fact that new construction should be boosted in order to increase supply and reduce the pressure on rents and house prices. Our analysis has shown, however, that the lack of skilled labour will intensify. New housing might therefore remain scarce for structural reasons. In principle, there are several options for boosting new construction: (i) employ more workers, (ii) increase working hours per employee, (iii) increase capital intensity and (iv) build smaller apartments, increase productivity and/or reduce construction quality. Before giving an outlook, we will first analyse how these factors have developed between 2009 and 2017.

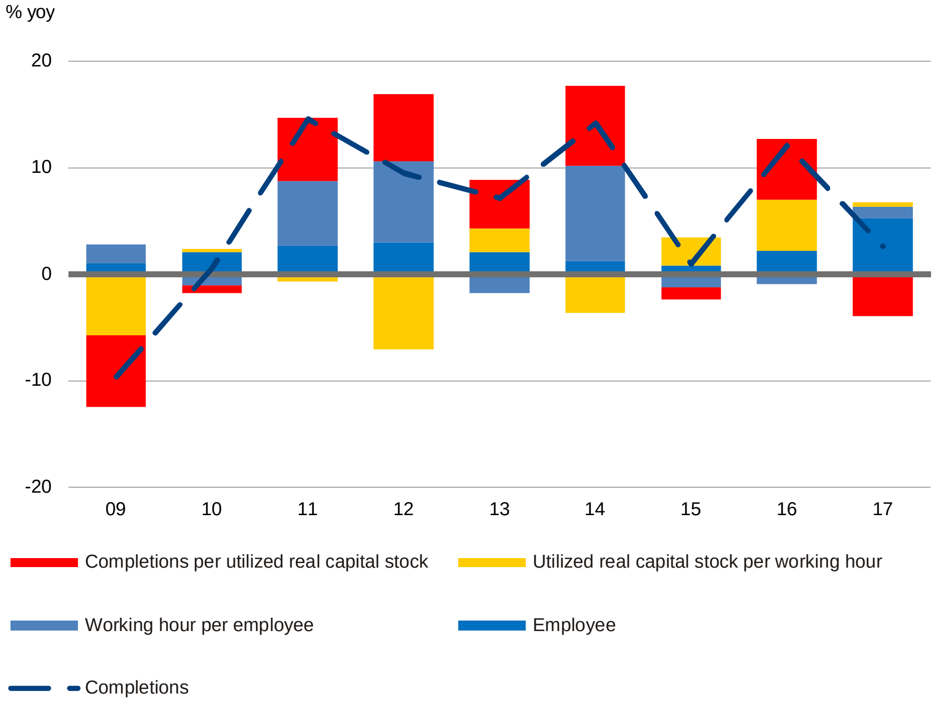
Strong employment increase of more than 5% in 2017

As mentioned above, the number of employees rose by c. 20% during the cycle as a whole. The increase in employment remained subdued until 2016, but accelerated to c. 5% in 2017. The labour-market bottlenecks described above suggest that construction companies and craftsmen initially tried to employ mainly qualified workers and took on only a few new workers, as there was simply no staff available. With the order intake unusually strong, they may have decided to try and employ unskilled workers as well by now.

Increase in working hours exceeds rise in number of employees during the cycle

According to our calculations, the number of working hours per employee also rose strongly, from less than 1,800 per year in 2009 to more than 2,100 per year in 2017 (or from 7.2 to 8.4 hours per day). While the number of employees was up only by c. 20%, working hours increased by more than 40%. Most of the increase took place until 2014. In subsequent years, working hours grew at roughly the same clip as employment. Together with anecdotal evidence from companies, this suggests that per-capita working hours cannot be increased much more, both for reasons of labour law and due to natural capacity limits. Another significant increase in working hours per employee is therefore unlikely.

New construction of dwellings and factors of production 9



Sources: Deutsche Bank Research, Eurostat, Federal Statistical Office, ifo Institute

Capacity utilisation and capital stock

Higher capital intensity is another way to boost construction. We calculate the capital stock on the basis of the fully utilised, real capital stock (mostly machinery and equipment and vehicles) plus the leased capital stock. We then compare the capital stock to the number of working hours.[1] Capital stock utilisation (according to ifo) has risen by 12 pp, from 66% at the beginning of the cycle to 78% in 2017, and construction companies have also increased their investment significantly during this period. Investment in construction machinery and equipment has jumped by c. 60% in real terms during the cycle, to about EUR 5,000 bn per year. According to our calculations, the capital stock increased only by c. 20% due to high depreciations during the cycle; capital stock utilisation was up by c. 40%. This means that capital stock utilisation grew somewhat less than working hours (+44%). Capital intensity, as measured by real capital stock utilisation per working hour, has thus declined slightly. Interestingly, both the capital stock and the capital intensity grew more strongly on average in each of the years between 2015 and 2017 than in the preceding years. This may be due to the fact that, up until 2014, companies invested mainly in machinery and equipment in order to adequately equip workers for

[1] We approximate the real capital stock in the construction sector by using annual investment in machinery and equipment plus the leasing rates as reported by the Association of the Construction Industry from the 1990s until today and assuming an annual depreciation rate of 12%. The depreciation rate is chosen so that the growth rate of real capital stock is in line with the capital stock calculated in the literature.

longer working hours, particularly as new employment remained low. From 2015, the labour bottlenecks intensified, and companies seem to have invested more in capital stock in order to substitute workers. This interpretation appears probable because the increase in the utilisation of the machinery and equipment slowed from 2015. The historical average utilisation rate is c. 66%, and even during the boom years from 1991 until 1995, it never exceeded 70%. At almost 80%, utilisation is probably approaching technical and logistical limits at the moment. Higher utilisation rates, as in manufacturing, where they are sometimes above 90%, are probably impossible in the long run as production batches are smaller, machinery and equipment must be moved regularly and machinery and equipment is subject to significant weather-related wear and tear, which requires more maintenance work.

Other factors driving new construction during the cycle

Several other factors have helped to boost new construction. First, the number of completed apartments has risen over the cycle because the average apartment size has declined. In 2009, new apartments offered almost 120 m2 of living space, but this number fell to less than 105 m2 in 2017. Had apartments not become smaller, 30,000 fewer apartments would have been built in 2017 (assuming that the overall newly constructed residential space remained the same), and during the cycle as a whole, 110,000 fewer apartments would have been built. This development is probably due to the fact that residential construction was stronger in large cities than in smaller cities and rural areas and to the fact that more multifamily homes were built. This automatically reduced the available living space, as prices and rents rose particularly strongly for such apartments. Second, larger construction orders and full order books permit synergies which will increase productivity. Still, the increase in productivity, as evidenced by official statistics, appears to be very limited. Third, there is considerable anecdotal evidence which points to a clear deterioration in construction quality. While this effect is and will remain difficult to quantify, it would not be surprising if quality standards increasingly fell by the wayside due to significant supply bottlenecks and the considerable lack of skilled labour.

Conclusion and outlook

All available data suggest that the shortage of skilled labour will intensify over the coming years. In addition to the cyclical bottleneck, we might be in for a structural shortage, as the baby boomer generation reaches retirement age. Based on recent developments, we make the following forecasts. Construction companies are likely...

1. ...to employ more unqualified labour, as they have already done for the last few years. This might reduce construction quality, particularly if master craftsmen who can work as supervisors become even scarcer than today. Moreover, there is a risk of a higher number of workplace accidents. According to the employers' liability insurance association, the number of workplace accidents rose slightly in 2016 (latest available data), in contrast to the trend of the preceding years.
2. ...to try and invest more in machinery and equipment and vehicles in order to increase productivity. However, there are limits to this substitution, as modern equipment often can only be used by qualified staff. Massive capital substitution, for example in the framework of a digitalisation strategy, may take place only in the medium term or even later.

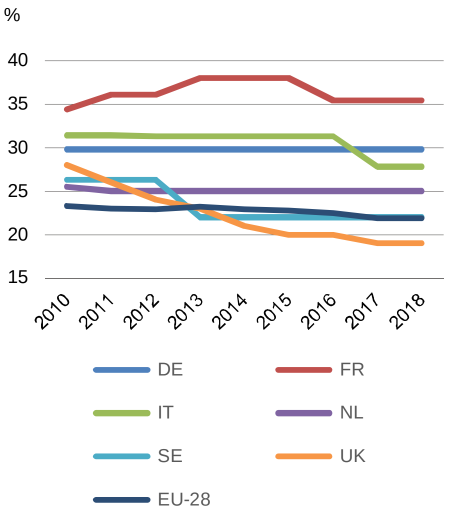
3. ...to be willing to pay higher wages to qualified workers. The wage increase by more than 5% in 2018 may be a sign of what is to come.

As existing shortages on the construction labour market are likely to intensify, the government's goal of building 1.5 million new apartments during the legislative period from 2017 to 2021 is less and less likely to be achieved. We therefore stick to our forecast that price pressures will remain until 2022 at least.

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

Corporate taxes: Growing need for action[2]

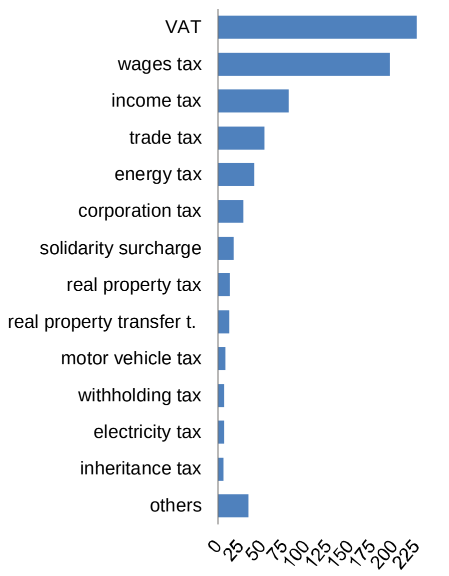
Top statutory tax rates on corporate income 1



Source: European Commission

Government receipts from selected taxes in Germany 2

2017, EUR bn



Source: Federal Ministry of Finance

Since the last corporate tax overhaul in 2008, the need for reform has been continuously building in Germany. High tax rates, relatively restrictive depreciation allowances, a lack of broad-based, systematic R&D tax incentives, the increasing complexity of tax law, for instance, are weighing on the investment climate in an unduly manner. The federal government appears to take insufficient account of this.

Given the ongoing criticism of Germany's current account surpluses, a reduction in corporate taxes would indeed be a strong signal to provide new impulses to the sluggish domestic investment activity, thereby addressing a key issue of the current account discussion.

Moreover, the international trend towards lower tax rates also needs to be addressed, if Germany is to retain its competitiveness as a site for investment, innovation and jobs. By 2020, taxes for corporate entities in major neighbouring countries will undershoot the German level of 30% by up to 13 %-points. Recently, Germany has lost ground vis-à-vis the US. Measures there included a reduction in the federal corporate tax rate from 35% to 21% and immediate expensing.

In the face of technological competition with the USA and China in the areas of AI and robotics, Germany needs enhanced incentives to promote R&D activities, if it does not want to run the risk of falling (further) behind. The introduction of an income tax credit to the tune of 10% of R&D staff expenditure, as proposed by the BDI (Federation of German Industries), could provide such incentives without overstretching public coffers. When securing the attractiveness of Germany as an innovation site, patent box regimes such as many countries have established in recent years could also play a major role.

As regards the implementation of international measures against unwanted tax base reductions and profit shifting of multinational companies (under the OECD BEPS action plan and respective EU initiatives), Germany is one of the frontrunners. But this is problematic, if other countries are hesitant to take the cue or fail to follow suit in a decisive fashion. International efforts to create a level playing field for the calculation of taxable earnings, can then backfire – at the expense of German companies. Therefore, appropriate implementation of international and EU standards is fundamental.

Another noteworthy factor is that corporate income tax and the double taxation of equity capital (at the company and the (share)holders) has led to distortions in investment decisions and between equity funding and external financing. With so-called allowance for corporate equity schemes (ACE), i.e. the adjustment of (taxable) equity capital corresponding to the interest rate development, academic research provides interesting remedies, which meanwhile have been taken up (in a modified form) by the EU Commission.

The necessary reforms have to be addressed swiftly. The respective plans have been on the table for some time now. With state coffers filled to the brim, the short-term costs of the overhaul, i.e. tax shortfalls, should be manageable. In the medium to long term, a growth-oriented policy will help to boost income and employment, hence retaining sources of tax revenue.

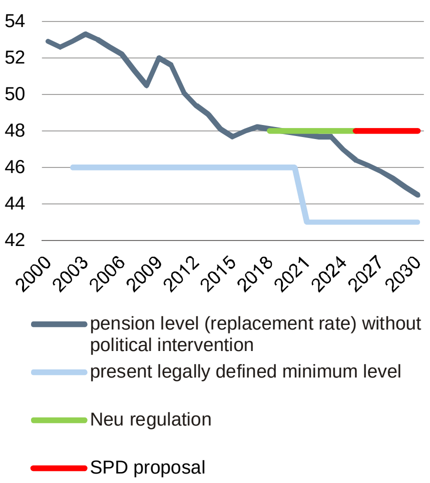
Dieter Bräuninger (+49 69 910-31708, dieter.braeuninger@db.com)

[2] Executive summary of the Deutsche Bank Research Germany Monitor: Corporate taxes: Growing need for action, forthcoming.

Groko's social policy package – much for ageing voters, but little for the future

Falling replacement rate for public pensions 1

Pensions before taxes & after deduction of social contribution as % of the resp. income *, %



*Pension entitlement of average earner after 45 years of contribution

Sources: BMAS, SPD

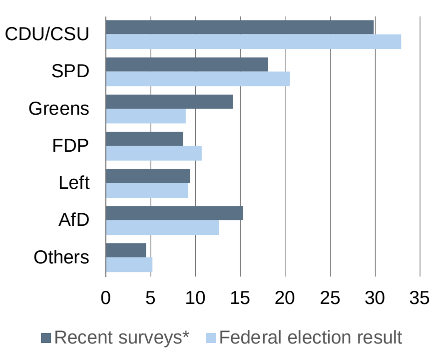
In the end, it all happened quite quickly. Following a few days of heated debate, on Tuesday evening, representatives of Chancellor Merkel's Groko agreed on a social policy package which the Bundestag is to pass in the autumn. The package largely sticks to the guidelines stipulated in the coalition treaty from mid-March. Then, the three parties announced additional pension benefits, ignoring strong criticism from well-known academics and German industry. In the short term, the package's most expensive element is an increase of the pensions for nearly 7 m mothers with children born before 1992, which will cost about EUR 3.8 bn p.a. initially. This benefit is based on a CDU/CSU request, which would have entailed similar costs, albeit the conservatives demanded higher pension increases for a subgroup of the respective mothers only, namely those with 3 or more children. The SPD enforced its demand for securing the status quo in the public pension scheme, by a so-called double stop line. The government will ensure the scheme's replacement rate will remain above the present level of 48% (of the average net wage/salary income) up to 2025, while the contribution rate (at present 18.6%) will not pass 20% (of the income earned subject to contributions). Politicians from both camps successfully insisted on increased pension benefits for persons with reduced earning capacity and for low-wage earners with a longer working career.

According to the protagonists, Germany can afford the additional expenses. But this would require ongoing robust economic growth, as well as full employment. However, such a Goldilocks scenario is not a certainty in the medium, let alone the longer term; given that supply-side policies are not high on the Groko's agenda. It is unclear how the additional benefits will be financed in the long term. The Groko's generosity threatens to overburden the pension scheme's active members and other taxpayers, when the baby boomers retire from 2025. A commission of experts, installed in May, will propose measures to stabilise the pension scheme and present its result in spring 2020.

Nevertheless, Finance Minister Scholz fueled recent debate with a new, even more costly, proposal. He argued for a stabilisation of the replacement rate at 48% up to 2040. According to Professor Börsch-Supan, a member of the commission, this would entail enormous costs of about EUR 50 bn p.a. by 2040 and more than twice that amount if a long-term stop line for the contribution rate was established too. But Mr. Scholz admitted that he had not calculated his proposal's costs.

Major political parties' popularity & result of the past federal election 2

%



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

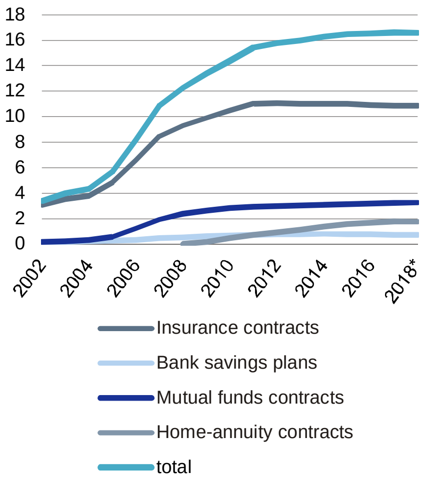
Source: Wahlrecht.de

The Minister's intervention with new pledges for additional pension benefits suggests two interpretations, at least. (i) A few weeks up to the important state elections in Bavaria and Hesse on October 14 and 28, respectively, the SPD wants to promote an issue that could differentiate itself from the CDU and the CSU and to attract its traditional voters. Such an endeavour is natural, given the party's ongoing poor showing in the surveys – markedly below 20% on the federal level. In the Bavarian elections, the SPD could come in third, behind the Greens and the AfD, according to recent polls. (ii) The SPD is still at odds with the reforms Chancellor Schröder launched in the early-2000s. The then established mechanism to limit benefits, especially the reduction of the replacement rate in accordance with the number of pensioners and inversely of employees, has hit middle-income white and blue collar workers too. But they are the SPD's traditional voters, at least that is the party's perception. In the past legislative term, the SPD managed to establish a privilege for this group, namely the pension at 63. Now, the protection against further decreases in the pension level is on the agenda.

Leading SPD politicians' have requested the government retain the 5.5% income tax surcharge for individuals with higher income, which speaks volumes. This would target those who provide about 50% of income-tax receipts, while additional taxes would be levied on the "very rich" and those with substantial wealth. Here, a new dispute with the CDU/CSU, who advocate a rapid and consistent abolishment of the surcharge for all taxpayers, is in the offing.

Stagnating Riester pension 3

Number of Riester pension contracts, m



* as of end-March 2018

Source: BMAS

Nevertheless, the Finance Minister has a point. Beside step-wise reductions in the replacement rate, the Schröder reforms included initiatives to promote company pension schemes and the individual old-age provision, especially the Riester pension. The latter, however, has missed expectations. Since 2015, the number of Riester contracts has stagnated at about 16½ m, and the coverage ratio has remained below 50%. Therefore, many Germans are confronted with the risk of an increasing pension gap.

However, closing the gaps via a u-turn in public pension benefits, which would make them high enough to return pensioners' to their former standard of living, ignores economists' views on the risks for growth resulting from costly, overburdened pay-as-you-go pension schemes. The appropriate alternative is strengthening private old-age provision with less restrictive rules for the Riester pension market. Above all, the legislator should abolish financial providers' obligation to guarantee a minimum payout in the amount of all contributions paid during the accrual phase. Due to this obligation, Riester pension providers have to invest substantial parts of the contribution in government bonds with small yields in the present low interest rate environment.

The government has also presented guidelines for the planned immigration law, a sensible project with regard to the public pension scheme's future. The government intends to further liberalise the rules for the migration of (qualified) third-country nationals (from outside the EU) and subsume the regulations transparently under one comprehensive law. Among the new rules are: (i) in principle, qualified migrants will no longer need a job offer to be accepted, i.e. they will be allowed to come to Germany to search for a job, too. (ii) The whole labour market will be open rather than only those segments where the authorities have officially noted a shortage of qualified labour. However, besides qualification (professional training); a job offer, German language skills, age and sufficient means to support oneself will be criteria for preferred acceptance. But it is still open as to how these criteria will be evaluated.

Another open issue is the status of working refugees. The SPD has demanded that refugees and asylum applicants whose application was refused should be granted the right to stay in Germany, in cases where they have a job (subject to social security contributions). But major parts of the CDU/CSU are opposed to this request. They are afraid that such a right would attract additional refugees. Therefore, experts have proposed a cutoff date. But actually stipulating such a date would cause new problems. If the authorities chose a current date (e.g. Sep. 1), they would draw an arbitrary line between those who already have a job and those less lucky. A deadline in the future would solve this problem but it could become a pull factor for migration. Nevertheless, it should be possible to reach a compromise here, as recent experience has shown that it is not impossible to manage migration, at least not in the short term.

Given the ageing population, a migration policy aimed at the needs of the labour market could markedly strengthen growth potential and alleviate public pension financing. At present, about 12% of all employees (including mini jobs) are foreigners, 47% of which stem from outside the EU. Without these workers the German economy would not have reached the impressive growth of past years. However, unrealistic demands regarding the public pension scheme's future benefits would remain illusory even under intensified labour migration.

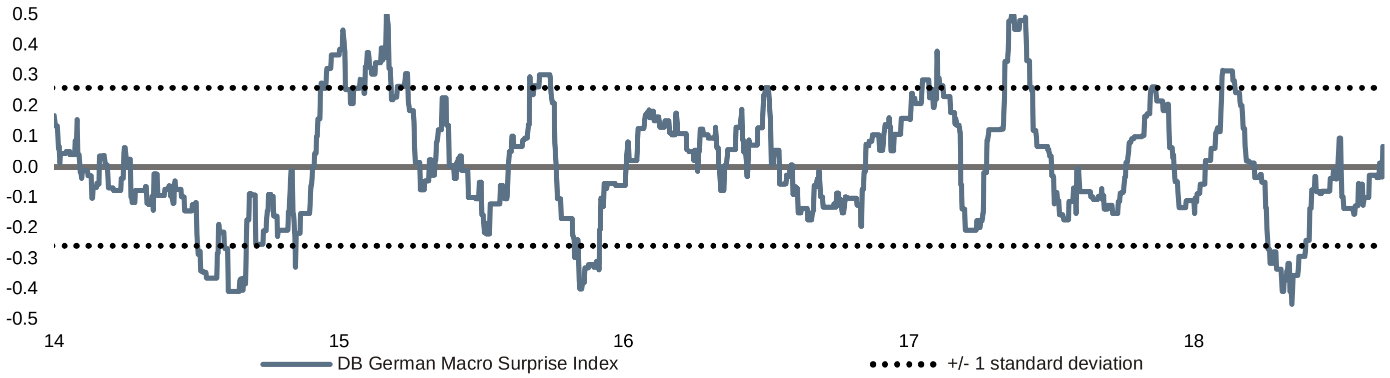
Dieter Bräuninger (+49 69 910-31708, dieter.braeuninger@db.com)

DB German Macro Surprise Index

The DB German Macro Surprise Index compares published economic data with market forecasts and thus provides clues as to the direction of future forecast revisions.

DB German Macro Surprise Index

Average of last 20 z-scores of data surprises



Values above (below) 0 indicate the data came in better (worse) than expected

Sources: Bloomberg Finance LP, Deutsche Bank Research

Last 20 published economic data for Germany

Bloomberg Tickers	Indicator	Reporting month	Publication date	Current value	Bloomberg consensus	Surprise	Standardised surprise	Quantile rank
GRIFPBUS Index	IFO Business Climate	7 2018	25/07/2018	101.7	101.5	0.2	0.0	0.5
GRIMP95Y Index	Import Price Index (% yoy)	6 2018	27/07/2018	4.8	4.5	0.3	0.6	0.8
GRFRIAMM Index	Retail Sales (% mom)	6 2018	31/07/2018	0.9	1.0	-0.1	0.2	0.6
GRUECHNG Index	Unemployment Change (000's mom)	7 2018	31/07/2018	-6.0	-10.0	-4.0	-0.4	0.3
MPMIDEMA Index	Markit Manufacturing PMI	7 2018	01/08/2018	56.9	57.3	-0.4	-0.5	0.2
MPMIDESA Index	Markit Services PMI	7 2018	03/08/2018	54.1	54.4	-0.3	-0.3	0.4
GRIORTMM Index	Factory Orders (% mom)	6 2018	06/08/2018	-4.0	-0.5	-3.5	-1.7	0.0
GRIPIMOM Index	Industrial production (% mom)	6 2018	07/08/2018	-0.9	-0.5	-0.4	-0.3	0.4
GRCAEU Index	Current Account Balance (EUR bn)	6 2018	07/08/2018	26.2	21.0	5.2	1.2	0.9
GRZECURR Index	ZEW Survey Current Situation	8 2018	14/08/2018	72.6	72.1	0.5	0.0	0.5
GRCP20YY Index	CPI (% yoy)	7 2018	14/08/2018	2.0	2.0	0.0	0.2	0.3
GRZEWI Index	ZEW Survey Expectations	8 2018	14/08/2018	-13.7	-21.3	7.6	1.0	0.8
MPMIDEMA Index	Markit Manufacturing PMI	8 2018	23/08/2018	56.1	56.1	0.0	0.0	0.4
MPMIDESA Index	Markit Services PMI	8 2018	23/08/2018	55.2	55.2	0.0	0.0	0.5
GRGDPPGQ Index	GDP (% qoq)	6 2018	24/08/2018	0.5	0.5	0.0	-0.2	0.3
GRIFPBUS Index	IFO Business Climate	8 2018	27/08/2018	103.8	101.8	2.0	2.8	1.0
GRIMP95Y Index	Import Price Index (% yoy)	7 2018	30/08/2018	5.0	5.2	-0.2	0.2	0.5
GRUECHNG Index	Unemployment Change (000's mom)	8 2018	30/08/2018	-8.0	-8.0	0.0	-0.2	0.4
GRCP20YY Index	CPI (% yoy)	8 2018	30/08/2018	2.0	2.0	0.0	0.2	0.3
GRFRIAMM Index	Retail Sales (% mom)	7 2018	31/08/2018	-0.4	-0.2	-0.2	0.1	0.5

Sources: Bloomberg Finance LP, Deutsche Bank Research

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

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

Date	Event	Remarks
7 Sep	Eurogroup and informal ECOFIN meeting, Vienna	Thematic discussion on growth and jobs: allocative efficiency in labour and product markets; exchange of views with the Chair of the ECON Committee of the European Parliament; Portugal - Post Programme Surveillance.
13 Sep	ECB Governing Council meeting, press conference	The ECB will decide whether or not to follow through on the decision to phase out and conclude QE in Q4. What was said in the minutes of the June meeting was that only a “major deviation” from the expected path of inflation would warrant a reconsideration of the QE exit decision.
19-20 Sep	Informal meeting of the EU heads of states and government, Salzburg	According to the Austrian Presidency the meeting will focus on EU asylum policy issues. Other likely/possible topics include the state of the Brexit negotiations, securing prosperity and competitiveness through digitalisation, international trade, the EU’s initiatives on the taxation of the digital economy and on a common corporate tax base, and the EU’s relationships with the Western Balkan/South Eastern European countries.
1 Oct	Eurogroup and ECOFIN meeting, Brussels	Thematic discussion on growth and jobs – national automatic stabilisers; preparation of international meetings including exchange rate developments and of the October European Council.
14 Oct	State election in Bavaria	According to recent surveys the CSU is likely to lose the majority of seats in the Bavarian parliament. The formation of a new state government might prove to be very difficult. The Greens or the SPD could become coalition partners.
18 Oct	European council meeting, Brussels	The topics are likely to be more or less the same as at the September meeting.
25 Oct	ECB Governing Council meeting, press conference	The ECB is right to set the monetary policy stance to offset potential downside risks to growth. We expect there will be sufficient trust in the outlook for inflation for the ECB to follow through on its decision to phase out QE in Q4. We expect a 20bp deposit rate hike and simultaneous 25bp refi hike in Sep 2019, followed by the same again in March 2020.
28 Oct	State election in Hesse	Recent surveys indicate that the present coalition among the CDU and the Greens will lose its majority. From the present point of view a Jamaica coalition among the CDU, the Greens and the FDP or a grand coalition seems possible. If the CDU, as well as the CSU perform poorly, growing unrest in both parties is likely, which could further weaken Chancellor Merkel's position as CDU leader.
5 Nov	Eurogroup and ECOFIN meeting, Brussels	Thematic discussion on growth and jobs – financial stability in the EMU; Banking Union – euro area aspects, (poss.) Debrief of the G7 meeting; (poss.) Greece – post programme framework.

Source: Deutsche Bank Research

Dieter Bräuninger (+49 69 910-31708, dieter.braeuninger@db.com)
Marc Schattenberg (+49 69 910-31875, marc.schattenberg@db.com)

Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
6 Sep 2018	8:00	New orders manufacturing (% mom, sa)	July	1.8	-4.0
7 Sep 2018	8:00	Industrial production (% mom, sa)	July	0.3	-0.9
7 Sep 2018	8:00	Trade balance (EUR bn, sa)	July	19.4	19.3
7 Sep 2018	8:00	Merchandise exports (% mom, sa)	July	-0.3	0.1
7 Sep 2018	8:00	Merchandise imports (% mom, sa)	July	-0.5	1.3
21 Sep 2018	9:30	Manufacturing PMI (Flash)	September	56.5	56.1
21 Sep 2018	9:30	Services PMI (Flash)	September	55.8	55.2
24 Sep 2018	10:00	ifo business climate (Index, sa)	September	104.3	103.8
27 Sep 2018	14:00	Consumer prices preliminary (% yoy, nsa)	September	2.0	2.0
28 Sep 2018	9:55	Unemployment rate (%, sa)	September	5.1	5.2
1 Oct 2018	8:00	Retail sales (% mom, sa)*	August	0.5	-0.4

*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

Clouds on the horizon for Goldilocks

Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	1.875	-0.10	0.00	0.75	-0.75	-0.50	0.05	0.50	1.50	0.17	1.25
Sep 18	2.125	-0.10	0.00	0.75	-0.75	-0.50	0.05	0.75	1.50	0.50	1.25
Dec 18	2.375	-0.10	0.00	0.75	-0.75	-0.25	0.05	0.75	1.50	0.75	1.50
Mar 19	2.625	-0.10	0.00	0.75	-0.75	-0.25	0.05	0.75	1.50	0.80	1.50
3M interest rates, %											
Current	2.32	0.09	-0.32	0.80							
Sep 18	2.43	0.05	-0.30	0.80							
Dec 18	2.73	0.05	-0.30	0.80							
Mar 19	2.93	0.05	-0.30	0.80							
10Y government bonds yields, %											
Current	2.86	0.11	0.34	1.39							
Sep 18	3.25	0.08	0.45	1.40							
Dec 18	3.50	0.10	0.90	1.70							
Mar 19	3.60	0.10	0.95	1.75							
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	1.16	111.00	0.90	1.30	1.13	10.67	7.46	9.72	4.29	326.32	25.75
Sep 18	1.16	111.00	0.90	1.29	1.14	10.56		9.69	4.35	324.30	25.70
Dec 18	1.17	108.00	0.85	1.38	1.12	10.70	7.46	9.40	4.30	320.00	25.40
Mar 19	1.21	105.50	0.86	1.41	1.14	10.50		9.30	4.29	325.00	25.20

Sources: Bloomberg Finance LP, Deutsche Bank Research

German data monitor

	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Mar 2018	Apr 2018	May 2018	Jun 2018	Jul 2018	Aug 2018
Business surveys and output											
Aggregate											
Ifo business climate	104.0	105.1	104.3	102.2		103.5	102.4	102.4	101.9	101.7	103.8
Ifo business expectations	102.1	103.0	100.6	98.6		100.1	98.7	98.6	98.6	98.2	101.2
Industry											
Ifo manufacturing	107.9	109.0	107.9	104.9		106.5	105.0	104.9	104.8	104.1	104.9
Headline IP (% pop)	1.6	1.0	0.1	0.2		1.5	-1.7	2.7	-0.9		
Orders (% pop)	2.1	3.4	-2.2	-1.7		-0.6	-1.6	2.6	-4.0		
Capacity Utilisation	86.9	87.7	88.2	87.8	87.8						
Construction											
Output (% pop)	-0.4	-1.0									
Orders (% pop)	-1.7	10.2	-1.7	-3.9		-15.1	2.6	4.6	-4.3		
Ifo construction	109.9	110.7	110.1	111.5		110.8	111.4	111.8	111.3	115.4	116.7
Consumer demand											
EC consumer survey	4.1	5.5	6.7	5.5		6.1	6.1	5.9	4.6	4.5	4.4
Retail sales (% pop)	0.7	0.5	-0.6	0.9		0.3	1.4	-1.3	0.9	-0.4	
New car reg. (% yoy)	0.3	4.2	4.0	1.9		-3.4	8.0	-5.8	4.2	12.3	
Foreign sector											
Foreign orders (% pop)	3.5	4.9									
Exports (% pop)	0.7	2.5	-0.2	1.2		1.4	-0.1	1.6	0.1		
Imports (% pop)	0.2	2.8	0.0	2.8		-0.4	2.5	0.7	1.3		
Net trade (sa EUR bn)	62.4	63.2	62.5	59.0		21.6	19.3	20.4	19.3		
Labour market											
Unemployment rate (%)	5.7	5.5	5.4	5.2		5.3	5.3	5.2	5.2	5.2	5.2
Change in unemployment (k)	-26.7	-55.3	-68.3	-39.0		-17.0	-8.0	-12.0	-14.0	-6.0	-8.0
Employment (% yoy)	1.4	1.3	1.4	1.3		1.4	1.4	1.3	1.3	1.3	
Ifo employment barometer	103.3	104.0	104.8	103.8		103.9	103.3	104.2	104.1	104.1	
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.7	1.6	1.4	1.9		1.5	1.4	2.2	2.1	2.1	1.9
Core HICP (% yoy)	1.5	1.3	1.3	1.2		1.3	1.0	1.5	1.1	1.2	1.1
Harmonised PPI (% yoy)	2.7	2.5	2.0	2.6		1.9	2.0	2.7	3.0	3.0	
Commodities, ex. Energy (% yoy)	4.2	-5.6	-12.4	2.6		-12.6	-6.3	5.9	9.2	0.9	
Crude oil, Brent (USD/bbl)	52.2	61.5	66.9	74.5		66.0	72.0	76.9	74.4	74.3	72.4
Inflation expectations											
EC household survey	16.3	16.0	16.4	17.3		14.4	15.1	16.8	19.9	20.7	21.9
EC industrial survey	10.2	14.2	15.0	13.8		14.2	14.6	12.1	14.6	15.1	15.9
Unit labour cost (% yoy)											
Unit labour cost	1.7	1.2	2.5	1.8							
Compensation	2.6	2.5	2.8	3.0							
Hourly labour costs	2.5	2.6	3.5	1.4							
Money (% yoy)											
M3	4.7	4.3	3.3	3.6		3.3	3.5	4.2	3.6	3.8	
M3 trend (3m cma)						3.4	3.3	3.7	3.8		
Credit - private	3.9	4.2	4.3	4.3		4.3	4.3	4.1	4.3		
Credit - public	5.5	-2.9	-20.0	-7.0		-20.0	-8.7	-8.8	-7.0		

% pop = % change this period over previous period.

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

Deutsche Bank
Research

Focus Germany

Our publications can be accessed, free of charge, on our website www.dbresearch.com You can also register there to receive our publications regularly by E-mail.

Ordering address for the print version:
Deutsche Bank Research
Marketing
60262 Frankfurt am Main
Fax: +49 69 910-31877
E-mail: marketing.dbr@db.com

Available faster by E-mail:
marketing.dbr@db.com

Printed by: HST Offsetdruck Schadt & Tetzlaff GbR, Dieburg

ISSN (Print) 2510-5248 / ISSN (Online) 2512-0824