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How strong a Q3 rebound?

- **How strong a Q3 rebound?** Monthly data point to a strong pickup in economic momentum during the course of Q2, in part due to catch-up effects. Still, after the unprecedented 10.1% GDP contraction in Q2 we expect a 5% increase in Q3 followed by a 2% rise in Q4 (consensus: 5.2% and 2.4%). The increase in COVID-19 infection rates in Germany and elsewhere is a concern, although not yet alarming. For seasonal reasons we expect elevated rates until spring 2021. We assume that a vaccine will be widely available by mid-2021, generating a confidence boost for the back part of that year. We now expect German GDP to contract by 6.4% (compared with -9% predicted in early May) followed by a 4% increase in 2021. Still, the pre-COVID output level will not be reached before mid-2022. The current exceptional volatility in monthly data and the further development of the global pandemic imply that the error margins remain exceptionally high.

- **Merkel's strength might become a burden for her potential successors**. Chancellor Merkel leveraged her strong standing and Germany's economic and political weight to help broker a deal on the EU budget and the Recovery Fund. She will remain busy steering European affairs during the German EU presidency until the end of December. At home, contenders within the conservative camp are stepping up their campaigns for CDU leadership and succeeding Merkel as the CDU/CSU's chancellor candidate ahead of the party convention on Dec. 3-5. The odds seem to have shifted between the candidates based on their performance during the pandemic. A key question will be whether the CDU and its potential new leaders will try to emancipate themselves from Merkel's legacy. If opportune at all, this has become more difficult now given Merkel's popularity, which has pushed up polls for the conservatives during the pandemic, too. The perception of a weakened CDU candidate field has fueled speculation that Bavarian PM Söder may eventually become the chancellor candidate of the CDU/CSU. But the decision on this position is unlikely to be taken before next year.

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Table of Content

Key Economic Forecasts

Figure 1: Economic Forecasts

	Real GDP (% growth)			Consumer Prices (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2019	2020F	2021F	2019	2020F	2021F	2019	2020F	2021F	2019	2020F	2021F
Euroland	1.3	-8.6	4.6	1.2	0.3	0.8						
Germany	0.6	-6.4	4.0	1.4	0.4	1.1						
France												
Italy												
Spain												
Netherlands												
Belgium												
Austria												
Finland												
Greece												
Portugal												
Ireland												
UK	1.5	-11.5	3.7	1.8	0.6	1.6				-2.5	-18.6	-7.8
Sweden												
Denmark												
Norway												
Switzerland												
Poland												
Hungary												
Czech Republic												
United States	2.2	-5.2	3.1	1.8	1.0	1.3	-2.3	-3.1	-3.5	-4.6	-23.2	-11.5
Japan	0.7	-6.4	1.6	0.5	0.1	0.6	3.6	2.2	1.7	-4.1	-15.0	-10.2
China	6.1	1.6	8.8	0.8	3.0	2.3						
World	3.0	-4.5	5.4	2.5	2.6	2.6						

Source : National Authorities, Deutsche Bank

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

	2018	2019	2020F	2021F	Q1	Q2	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	1.5	0.6	-6.4	4.0	-2.0	-10.1	5.0	2.0	1.0	0.7	1.6	1.6
Private consumption	1.3	1.6			-3.2							
Gov't expenditure	1.4	2.7			0.2							
Fixed investment	3.5	2.6			-0.2							
Investment in M&E	4.4	0.6			-6.9							
Construction	2.5	3.8			4.1							
Inventories, pp	0.3	-0.8			-0.1							
Exports	2.1	1.0			-3.1							
Imports	3.6	2.5			-1.6							
Net exports, pp	-0.4	-0.6			-0.5							
Consumer prices*	1.7	1.4	0.4	1.1								
Unemployment rate, %	5.2	5.0	6.2	6.6								
Industrial production**	1.1	-4.2										
Budget balance, % GDP	1.9	1.5										
Public debt, % GDP	61.9	59.8										
Balance on current account, % GDP	7.4	7.8										
Balance on current account, EUR bn	241.4	267.1										

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

Source : Federal Statistical Office, Deutsche Bank Research

How strong a Q3 rebound?

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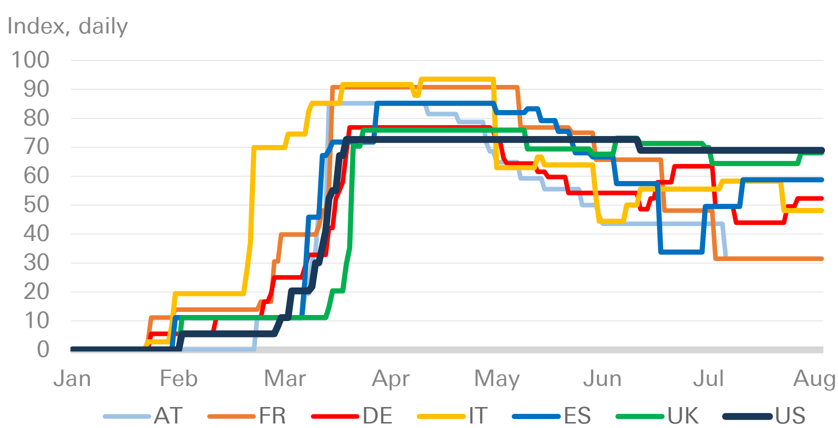
- The increase in COVID-19 infection rates in Germany and elsewhere is a concern, although not yet alarming. For seasonal reasons we expect elevated rates until spring 2021. We assume that a vaccine will be widely available by mid-2021, generating a confidence boost for the back part of that year.
- We now expect German GDP to contract by 6.4% (compared with -9% predicted in early May) followed by a 4% increase in 2021. Still, the pre-COVID output level will not be reached before mid-2022. The current exceptional volatility in monthly data and the further development of the global pandemic imply that the error margins remain exceptionally high.

Economic moment surged during the course of Q2, despite a record GDP contraction

The 10.1% slump in Q2 GDP was historic, albeit not as dramatic as feared back in early May. May/June retail sales and industrial data showed that the end of most lockdown restrictions in May unleashed a stronger-than-expected rebound. We do not expect this momentum to be maintained during Q3. First, monthly data were driven by catch-up effects causing some likely overshooting. This has been particularly evident in retail sales. Here we expect some negative payback, notwithstanding the 3pp VAT reduction from July 1st. Secondly, the pandemic is far from over. Chances are high that for seasonal reasons and due to less vigilant individual behavior in parts of the society, infection rates will remain elevated in H2. Still, Q3 GDP is expected to expand by 5% qoq. Maybe more, if these two caveats turn out to be less of a factor.

Figure 3: COVID-19: Government Response Tracker (100 = Strictest response)

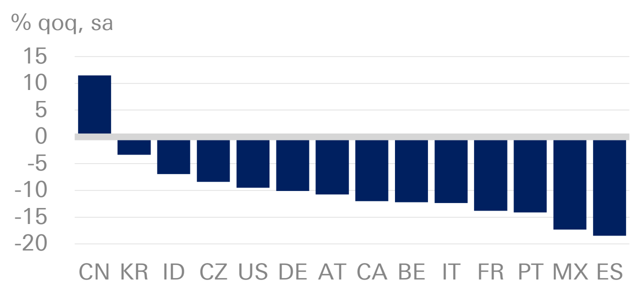


Source : Oxford COVID-19 Government Response Tracker

Global environment improving slightly faster than expected

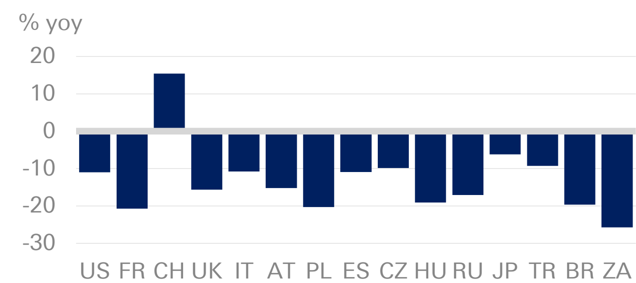
In Q2 almost all major countries suffered quarterly GDP declines of an unprecedented scale. Ranging from -18.5% in Spain to -9.5% in the US. China provided the big exception growing by 11.5%. Korea and Taiwan, which managed the pandemic very well, could limit their GDP decline to 3.3% and 2.3%, respectively. In July the global composite (50.8) and manufacturing PMI (50.3) managed to surpass the 50 boom/bust-threshold after falling to all-time lows of 26.2 and 39.6 back in April. The index for new export orders (46.9) is recovering more gradually, albeit positive surprises provided by Chinese exports – see for example the further 7.2%, jump in July. This has to a lesser extent been mirrored by most other Asean countries. Overall, global trade – which was down by 17.7% yoy in May according to CPB – will recover more gradually due to the uneven regional impact of COVID-19 but probably also due to the recent flare-up of the US-Chinese conflict and the increasing risk that Brexit will cause further frictions, although we still expect that a no-deal Brexit will be avoided.

Figure 4: Q2 GDP growth rates of selected countries



Source : OECD, 6 August 2020

Figure 5: Germany's major export destinations (June 2020)



Source : Federal Statistical Office

Given that in most countries the Q2 GDP slump has turned out slightly less severe than we expected back in early May we have marked up our forecasts for 2020 growth in many regions of the world. Global growth is now seen at -4 1/2% this year, about 1 1/2% pts stronger than we projected three months ago. The quicker recovery this year takes some steam out of our projection for growth in the first half of 2021, as does the surprisingly persistent spread of the virus in the US and increasing prospects for some resurgence more globally over the winter. But our expectation for widespread vaccination by the middle of next year should give the second half of the year a lift and leaves global growth for the year about in line with our earlier projection in the vicinity of 5-1/2%. Beyond next year, we see world growth gradually slowing at above-trend rates as unemployment gradually returns to pre-virus norms by 2024-25. We expect trend or potential growth rates in out years to be somewhat below pre-virus rates due to a combination of demographic forces (aging populations slowing labor-force growth), lingering disruptions from COVID-19, fiscal drag, and supply-chain realignments in the presence of persistent global trade tensions. The longer-term slowdown would be greater were it not for an overdue innovation boom that should be giving productivity growth a lift.

Pandemic situation and assumptions – vaccine available by mid-2021

Worldwide, the number of COVID-19 infections is still rising by about 250k per day. Total confirmed cases stand at 19.1 million, deaths related to the virus have exceeded 700k. While the number of new daily infections seems to have reached a plateau or flattened in recent hotspots such as the US, Brazil, India, and Russia, it has picked up again in some European countries such as Poland, Spain, the Netherlands, Belgium, and Romania. In some countries (Israel, Australia) a "second wave" seems to have started. These recent COVID-19 setbacks indicate that significant challenges remain in the near term, especially over the winter to come before widespread vaccination occurs.

In Germany the rate of new infections has risen to around 750 per day (7 day moving average), following the low of about 350 recorded mid-July. This compares with around 5500 at the peak of the pandemic in early April. Part of the acceleration can be traced to more testing. New infections are reported from specific settings (agri. plants, nursing homes, and refugee facilities), but there is also a more-diffuse pick-up, related to people returning from vacations abroad and less social distancing (parties, religious events). The number of counties reporting zero new infections during the last week has fallen to 65 compared to almost 150 at the beginning of June.

With tests now required for people returning from most non-EU countries the number of new infections is expected to rise further. We expect these rates to remain alleviated in autumn and winter. Research suggests that the virus can survive better within colder environments and can spread more easily once people stay more indoors and their resistance levels are lower for seasonal reasons. The impact of children returning to school after summer holidays will be closely watched, although research seems to suggest that this should not lead to an increase in infection rates. If we get a more-normal flu season people with unclear symptoms are likely to self-quarantine in rather large numbers. In our baseline we expect a reimplementation of restrictions only at a local level and temporarily. But voluntary social distancing is likely to increase in response to higher infection rates.

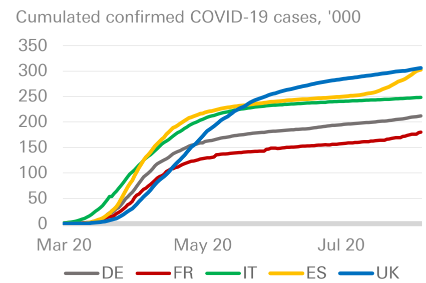
That said, news on the vaccine development front has been generally favorable. In early May we assumed implicitly that effective vaccination would not occur on a global scale until late next year. With several candidates now well into stage-3 testing and production under way, that schedule may well have advanced by as much as six months. We now assume effective vaccination will be widely available by mid-2021 if not sooner. We see risks on both sides of this schedule.

Q2 GDP: Historic slumps, albeit not as bad as feared

With -10.1% qoq the Q2 slump was by far the biggest decline since the start of quarterly GDP statistics in 1970, although it was not as bad as we had expected in our forecast from early May (-14%). In our assessment at the end of June we had clearly highlighted the "upside risks", by stating that our 14% call looked somewhat too pessimistic, given the information provided by high-frequency trackers.[1] According to the Statistical Office's explanations provided with the flash estimate, all demand components except government consumption suffered massive declines. GDP fell by 11.7% yoy exceeding the -7.9% contraction in Q2 2009 by a wide margin. The Stat. Office will publish more-detailed results on August 25. It has warned that the massive uncertainties triggered by the COVID-19 pandemic could result in bigger-then-usual revisions. Given the June production and export numbers, which came more or less in line with expectations, the risks are relatively limited, though.

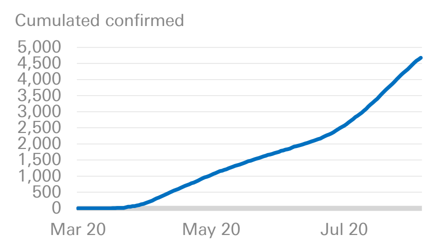
The better-than-expected Q2 result is to a large extent due to an unexpectedly large catch-up effect in private consumption. After falling by a cumulated 8.6% in March and April, retail sales surged by 12.7% mom in May. Despite a modest 1.6% mom decline in June the index level was still almost 5% above the 2019 average. Potential postponements of big-ticket purchases, given the 3pp VAT cut becoming effective in July, were not visible in the sales data (sales of groceries, beverages and tobacco falling by -5.9% mom recorded the biggest drop). Similarly, June manufacturing

Figure 6: Continental Europe: Renewed acceleration in infection rates



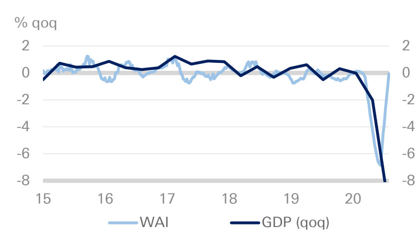
Source : WHO

Figure 7: Continued growth of new infections in the US



Source : WHO

Figure 8: GDP & Weekly Activity Indicator

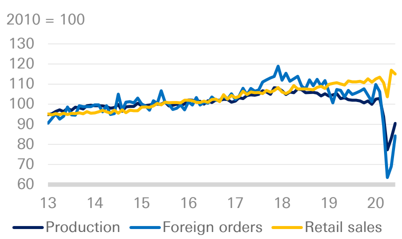


Source : Deutsche Bundesbank

1 See Focus Germany: "Sounding out the Q2 GDP slump", June 26, 2020.

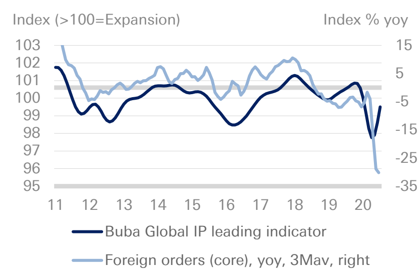
data was boosted by a normalization in the auto sector, where output jumped 54.7% mom, with car incentive programs in important markets probably playing a role, too. While new orders surged by 66.5% in June, we therefore still expect more-modest production increase in coming months.

Figure 9: Monthly indicators



Source : Deutsche Bundesbank, Federal Statistical Office

Figure 10: Foreign orders & global IP (LEI)

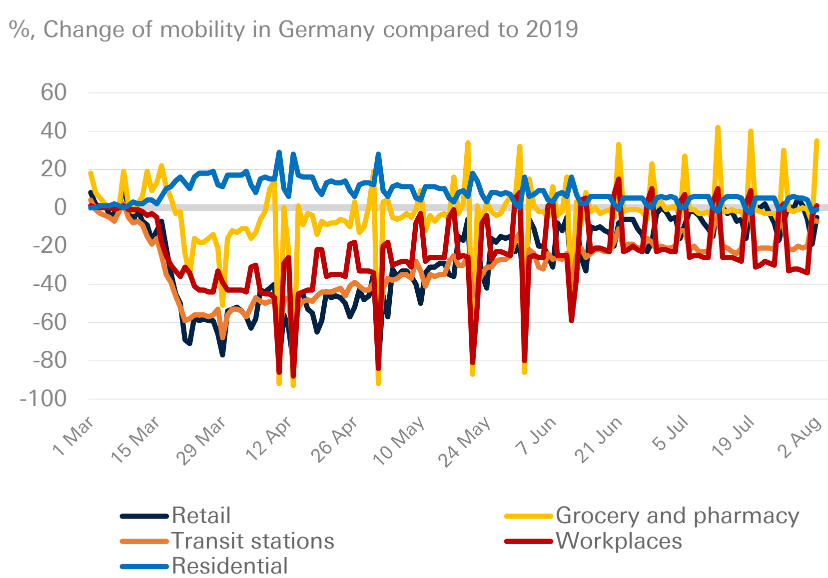


Source : Deutsche Bundesbank

Q3 GDP: 5% increase – risks probably skewed to the upside

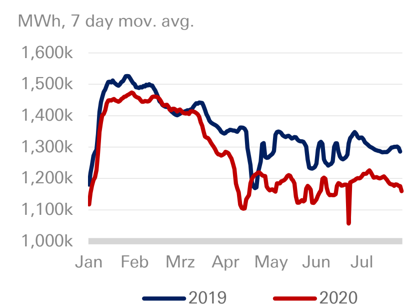
High-frequency activity trackers have largely normalized at the beginning of August. Since July truck-traffic data has been trailing its pre-COVID levels by less than 5%. Individual mobility data is more or less back to its pre-COVID level. However, electricity consumption is still almost 10% lower than a year ago. Given that industrial output has accelerated from May onwards (May and June saw increases of on average 8%), Q3 industrial production should enjoy a substantial rebound after Q2's 16.2 slump. Given the extremely alleviated retail sales levels in May and June resulting in a marginal 0.3% qoq decline in Q2, the Q3 will almost certainly see a decline in retail sales.

Figure 13: Google mobility index



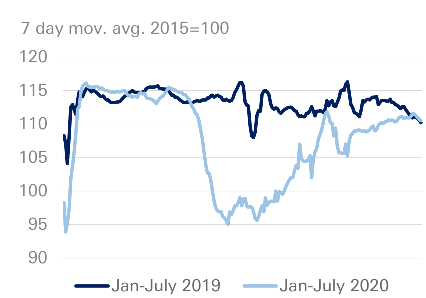
Source : Apple mobility reports

Figure 11: Germany: Actual electricity demand



Source : Bundesnetzagentur, Deutsche Bank Research

Figure 12: German truck-traffic index: The gap has closed



Source : Federal Statistical Office

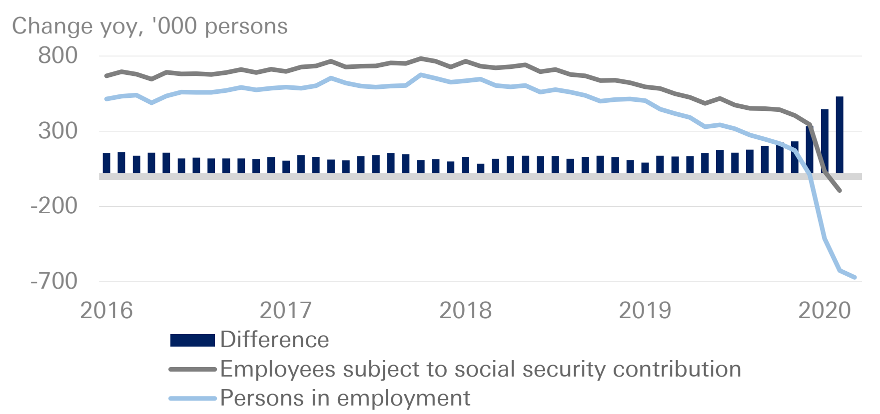
Risks for winter half – limited 2021 GDP increase to about 4%

The strong momentum in the capital goods sector – even ex cars domestic orders surged by 64.4% mom in June resulting in a 21.4% yoy increase – suggests that the sentiment in the corporate sector is – so far – recovering more quickly than we had expected earlier this year. Still, we expect that increasing infection rates will put a lid on animal spirits in the coming months. Furthermore, the end of the moratorium on corporate insolvencies at the end of September will likely result in a strong increase in insolvencies of smaller companies. Due to the moratorium corporate insolvencies were down by an amazing 13.3% yoy in April. This reality check should also leave its imprint in the Q4 unemployment numbers. With the impulses from pent-up demand tapering off, quarterly GDP growth rates will slow in the winter half. If our expectation of a vaccine being widely available by mid-2021 materializes, this should provide a renewed jolt to activity in Germany and globally, so that German GDP should increase by about 4% following a 6.4% decline in 2020.

Unemployment to rise into 2021

The massive GDP slump in Q2 also left its mark on the German labour market. The seasonally adjusted number of unemployed climbed to 2.8m (+548k) in the second quarter, but fell by 18k in July. The unemployment rate rose to 6.2%, after 5% in Q1. Based on the unadjusted monthly figures, the Federal Employment Agency (BA) calculates the COVID-19 effect on July unemployment at +635k persons compared to the previous year – an increase of around 28%. This increase is due in roughly equal parts to increased inflows from employment and self-employment, lower outflows, less relief from underemployment as a result of the COVID-19-related restrictions for labour market policy measures, and a residual figure of "other reasons". Nevertheless, this development would certainly have been even more dramatic without the massive use of short-time work. According to preliminary projections by the BA, short-time work benefits were paid to around 6.7m employees in May (April: 6.1m), hence almost 20% of all German employees subject to social-security contributions were actually on short-time work in May. The number of notifications of short-time work peaked at 8.02m (April). In July (up to and including 26th) new applications for only 190k employees were received. Just under 30% of these latest notifications were in the mechanical engineering, metalworking and automotive industries.

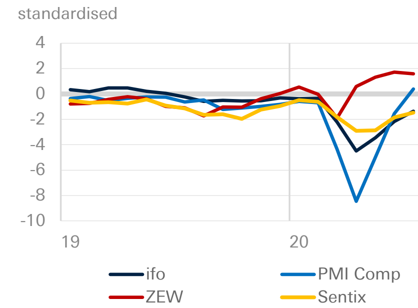
Figure 16: COVID-19 puts an end to German employment growth



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

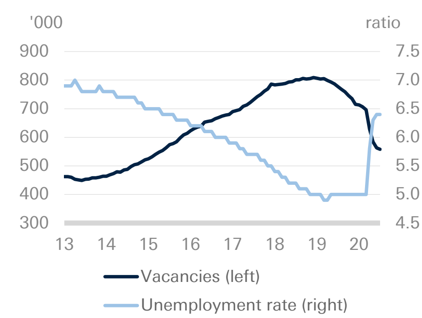
The fact that the economic trough is now behind us is reflected in leading labour market indicators (IAB labour market barometer and ifo employment barometer).

Figure 14: German confidence indicators up strongly



Source : Bloomberg Finance LP, ifo, IHS Markit

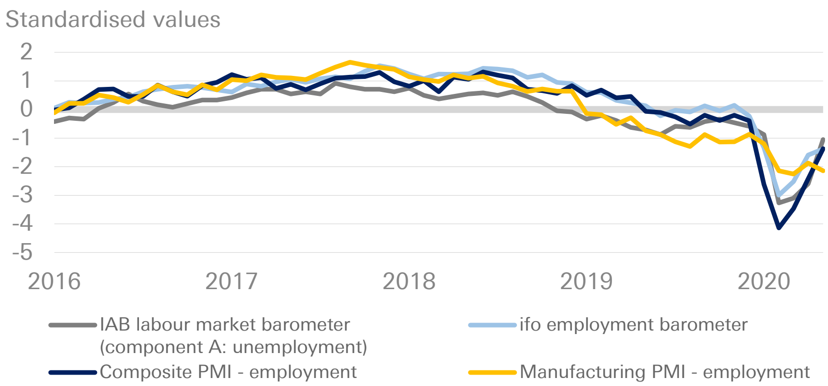
Figure 15: German labour market: Signs of stabilisation after the severe COVID-19 shock



Source : Federal Employment Agency

Nevertheless, the signs here are currently pointing more to stabilization than expansion. Industry, in particular, is expecting further redundancies.

Figure 17: Labour market indicators: General stabilization but still negative outlook for manufacturing



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

Nevertheless, in H1 the rise in unemployment was lower than forecast, as economic developments were not quite as bad as we had expected. Based on the upward revision of our 2020 GDP forecast and the development of the labour market to date, we now expect an unemployment rate of 6.2% for the current year (previously: 6.6%). In 2021 we expect this ratio to rise to 6.6% (previously 6.4%). The COVID-19 shock is likely to have more long-term and thus structural consequences than previously assumed, companies are likely be forced to make redundancies despite the possibility of short-time working. This could, for example, affect temporary workers who are currently still on short-time working. There are already numerous corporate statements pointing into this direction, e.g. from the automotive industry or the aviation sector. In addition, many job starters will probably have difficulties finding a job and therefore register as unemployed. On the other hand, we expect only a comparatively modest reduction in unemployment in 2021, as companies will likely be reluctant to increase their workforce due to the ongoing uncertainties in the environment. A major upside risk would, of course, be the availability of an effective corona vaccine. In this case, labour-market policy measures could again be applied on a larger scale. People who then participate in further training or retraining measures of the regional employment agencies would no longer be recorded as unemployed. From today's perspective, this has the potential to reduce the number of unemployed by a good 250,000 persons.

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Merkel's strength might become a burden for her potential successors

- Chancellor Merkel leveraged her strong standing and Germany's economic and political weight to help broker a deal on the EU budget and the Recovery Fund. She will remain busy steering European affairs during the German EU presidency until the end of December.
- At home, contenders within the conservative camp are stepping up their campaigns for CDU-leadership and succeeding Merkel as the CDU/CSU's chancellor candidate ahead of the party convention on Dec. 3-5. The odds seem to have shifted between the candidates based on their performance during the pandemic.
- A key question will be whether the CDU and its potential new leaders will try to emancipate themselves from Merkel's legacy. If opportune at all, this has become more difficult now given Merkel's popularity which has pushed up polls for the conservatives during the pandemic, too.
- The perception of a weakened CDU candidate field has fueled speculation that Bavarian PM Söder might eventually become the chancellor candidate of the CDU/CSU. But the decision on this position is unlikely to be taken before next year.

As broadly expected, on the last meters of her chancellorship Merkel is investing political capital on topics beyond domestic politics. In particular, she has leveraged – and is likely to continue doing so – her high domestic popularity for European (and international) matters. Together with French President Macron she was the decisive figure to foster a compromise on the multiannual EU budget and the Recovery Fund for which the German-French initiative from May paved the ground. Germans have somehow mixed feelings about the agreed package – which allows the EU for the first time to take up significant debt to finance grants to crisis-affected EU members. Still, Merkel's personal approval ratings which have soared to over 70% (Deutschlandtrend) in recent months largely thanks to the handling of the corona crisis, remain high. In the recent "elite-panel" (Allensbach, FAZ July 27), 91% of business and political executives surveyed consider Merkel's political work a success (see Figure 1). The broader popularity ranking for the most important politicians (see Figure 2) clearly sets Merkel apart from senior CDU politicians, including those running for CDU leadership. Only the Bavarian PM Markus Söder (CSU) enjoys a comparably good approval rating. The Germans' new "love affair" with their chancellor makes life for Merkel's successor more difficult. It also leaves the question of who will be leading Germany from autumn next year basically open.

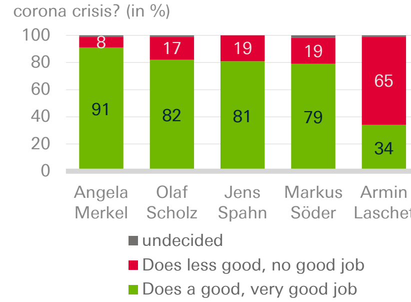
Reshuffling the field of candidates?

The pandemic and the management of the crisis has left their imprint on the election of a new CDU leader both in terms of process as well as most promising frontrunners.

Just to recall the pre-COVID-19 developments: Merkel stepped down from the CDU chair in the middle of 2018 and reemphazised that she would stand down after the current term. The move was supposed to allow her party a sort of restart against the background of a severe dispute with the CSU over Merkel's refugee policy, weak regional election in CDU strongholds and a general public perception of Merkel as a lame duck. The same year Annegret Kramp-Karrenbauer (AKK) become CDU chair, a close win against Friedrich Merz but a more-comfortable margin over the third contender, Jens Spahn, health minister in Merkel's cabinet. But the election

Figure 18: Leaders attest most top politicians good performance during corona crisis

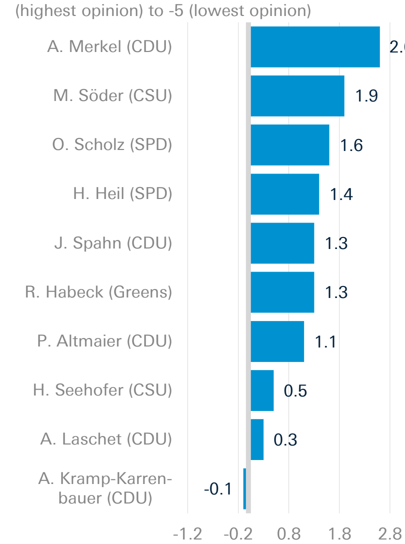
How do you rate the work of political leaders in the corona crisis? (in %)



Source : FAZ, July 27, 2020, survey of 523 executives from business, politics and administration

Figure 19: Popularity ranking of important German politicians

"What do you think about...", scale from +5 (highest opinion) to -5 (lowest opinion)



Source : Forschungsgruppe Wahlen Politbarometer July 2020 of AKK, a close Merkel ally, as new CDU party leader did not prevent further defeats in (eastern) state elections thus adding to increasing criticism of AKK. In February this year, AKK relinquished ambitions for chancellorship and announced to step down from the party chair. The election of the next party leader and potential chancellor candidate envisaged for April was postponed several times and will now take place at the ordinary annual party convention on December 3-5.

The field of candidates slightly changed compared with 2018. Jens Spahn pulled himself out of the game by now running in tandem with Armin Laschet, the PM of North Rhine-Westphalia. Norbert Röttgen (MP) has thrown his hat in the ring, while Friedrich Merz will again run on his own. While Laschet and Spahn had to prove themselves in (regional) crisis management, Merz (without executive function) and Röttgen have kept a low profile over the recent months. Now, as the immediate threat of the COVID-19 crisis is gradually pushed to the back, political competition and posturing have returned. The boasting between state PMs on the most successful policy response and crisis management also has a strategic dimension with a view to the leadership contest.

But to a certain extent, the crisis generally seems to have weakened the candidate field. Laschet, the previous forerunner seems to be stumbling. Laschet is a moderate, Merkel-like voice within the CDU, prime minister of Germany's most-populous state and has a reputation as dedicated European (he refrained from closing the border to Belgium and the Netherlands during the pandemic). But his response to the pandemic as PM of North Rhine-Westphalia has raised questions about his judgement by some observers. Media have turned rather critical towards him, with possible repercussions in public perception. Also the popularity of both his fellow candidates Röttgen and Merz was damaged during the pandemic. The situation looks different for Jens Spahn, Laschet's running mate. His track record in managing the crisis as Federal Minister of Health has pushed the 40-year old to eye level with Laschet. The still-influential Wolfgang Schäuble, former finance minister and currently president of the Bundestag, regards him as "an outstanding talent in the CDU" (Zeit, July 16). Other senior CDU politicians suggest Spahn should give up his reservation to run for chancellor and party leadership independently but Spahn's response so far has been that "Laschet and himself have decided to make the bid to the party in tandem" (Spiegel, July 26).

Decoupling the posts of CDU chair and CDU/CSU candidate for chancellorship?

Usually, the CDU's leadership contest is de facto also a predecision regarding the CDU/CSU chancellor candidate. The perceived weakness of the CDU candidate field, though, has fueled speculations in media and politics of a different approach: To decouple the posts of CDU leadership and chancellor candidate of the Union. Center of these speculations is Markus Söder, the PM of Bavaria and leader of the CDU's sister party, the CSU. Söder's popularity has surged amid his handling of the crisis, and his popularity ratings are second only to Chancellor Merkel's. His appearance during the pandemic and the more-rigid measures that he implemented for Bavaria were rewarded with broad public support also on the federal level. In various polls a (relative) majority regards him as the best option for a CDU/CSU chancellor candidate. Söder himself has so far been rather vague on whether he would accept a potential offer; but his denials have become less categorical recently. At the CSU party convention on December 12 (a week after the CDU convention), however, he would likely have to take a position on this. Merkel has kept quiet about her preference for a successor (after the positioning of AKK did not work out as hoped for), but she allowed Söder to host her for an official visit in

Bavaria which produced favorable images for him, likely frustrating his rivals.

However, politics is not only about popularity. First, while the CDU and CSU form a joint parliamentary group, the CSU accounts for just a fifth of the MPs. CDU MPs might find it difficult to accept a candidate from the smaller sister party. In addition, historical experience with a Union's candidate from the CSU has not been encouraging. Against the background of the CDU questioning its own leader's prospect, it decided to run with CSU candidates in 1979 (Franz Josef Strauß instead of Helmut Kohl) and in 2002 (Edmund Stoiber instead of Angela Merkel) but lost both elections. Second, it is unclear that whoever will be elected as CDU leader would be willing to step aside for Söder. In particular, for Merz and Laschet the major reason to pursue the party's top job is probably the chance to go for Germany's top job. In this situation some have started to encourage Minister of Health Spahn to run for party leader on his own and not in tandem with Laschet (see above). In fact, he would then run against Laschet if the latter does not withdraw his candidacy. This could create the opportunity to form an alternative team of Spahn and Söder , a combination that according to recent surveys (RTL Trendbarometer, Forsa) 49% of the Germans and 66% of the CDU/CSU electorate would consider a good one. We would see this as a possible but rather unlikely option as of now.

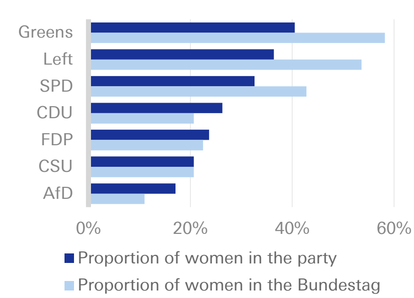
Lack of hot topics for the CDU candidates' campaigning

Before the COVID-19 pandemic, the election of the new CDU party leader had been regarded as a principle decision between a more-conservative and a moderate "Merkelian"- centric policy path both in social as well as economic terms. At least with regard to the latter this might not be such a hot topic for the time being. The government's crisis measures built a huge fiscal rescue and stimulus package, largely debt-financed. The preparedness to let the state assume a stronger role in the economy – even including equity stakes in larger and smaller companies – makes it difficult for any candidate to distance themselves from this approach or to criticise a slippery slope into state capitalism.

On climate change and European policy, differences between candidates can be found in details on the implementation but less so on the broad outline, at least until very recently. Merz is putting more emphasis on market forces and technological progress for meeting the environmental targets. With regard to European policy, Laschet has proven, as mentioned, to incorporate European aspects into his policy decisions. He welcomed the results of the recent EU summit and stressed that the agreement on the bonds issued by the EU Commission prove that Europe can stand together in a time of crisis (WELT, July 21). Merz, though, regards the decision to allow the EU to take on debt as overstretching the EU treaty (n-tv, July 22).

A soft (but emotional) topic that will be up for decision at the party convention is a binding quota for women in the party's bodies and on the election lists. Candidates have voiced different views on this question. The proposal foresees a gradual implementation of a 30% quota as of January 2021, 40% as of January 2023 and 50% from 2025 onwards. This comes against the background that among the MPs within the CDU parliamentary group just 21% are female – only the AfD has a lower share (see Figure 3). The Greens, the SPD and the Left have implemented quotas since decades.

Figure 20: Parties have different proportions of women



Source : Bundestag and Niedermayer, Oskar (2019). Parteimitglieder Deutschland, Version 2019.

Friedrich Merz has voiced some reservation against this proposal and announced to present an alternative. Röttgen has put his weight behind the proposal as it stands whereas Laschet has kept quiet on the initiative. It is difficult to assess whether such a move will help the CDU to win more voters. In a survey (RTL Trendbarometer) an overwhelming majority of 89% of the respondents said that gender does not influence their voting decision. Already now, the CDU is relatively more attractive for female than for male voters (see Figure 4), but if this will hold after Merkel's departure remains to be seen. In any case, Merkel's CDU has been moving along strongly with the German Zeitgeist, which makes it likely that a binding quota will be approved at the party convention.

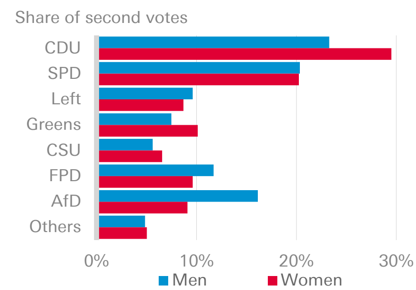
Autumn will see other parties reposition themselves, too

The leadership debate is not limited to the CDU/CSU.

While the SPD has formally elected the parties' co-leaders Saskia Esken and Norbert Walter-Borjans at the end of last year, their more-leftish approach has not paid off in terms of sharpening the party's profile and by that its popularity. The party leaders' interventions on a wealth tax or the design of the support package for the auto industry in the context of the stimulus packages have been met with criticism even from their own camp, the unions. Despite the constructive and important roles finance minister Olaf Scholz and labour minister Hubertus Heil have played in the government's crisis management, the SPD continues to hover around 15% in the polls. To a certain extent, the nomination of a more-conservative CDU leader and/or chancellor candidate might help the SPD to better distinguish itself in the current political landscape. And the leadership debate in the SPD is far from being resolved, too. Finance minister Scholz is the second-most-popular politician in Merkel's cabinet and 48% of Germans (Politbarometer) consider him a good choice for chancellor, probably also because he seems to represent continuity beyond the Merkel years. But it is exactly this image of "continuity" that caused the party base not to go for Scholz as party leader at the end of last year. But on the other hand, with Scholz as SPD chancellor candidate, both another grand coalition with the CDU and a coalition with the Left and Greens would be possible – even though the chances for the latter are small in the first place. Thus, the SPD faces once again the challenge of bridging its party-internal tensions between the base demanding a leftish policy course and a much more-centrist chancellor candidate. In addition, there might be trouble ahead for Scholz given the open questions around the insolvency of Wirecard. Right now it remains open when the SPD will decide on the nomination of its chancellor candidate, and even the date for the next party convention in early 2021 is not yet fixed.

The Greens seem to be the only German party that has got things straightened out with itself. Its leadership has just presented a 58-page draft for the new party manifest. Now, the members are invited to comment on the final manifest (the fourth in the history of the Greens) to be adopted at the Green delegates' conference in autumn. The paper calls for a strong state without fully putting the benefits of economic efficiency and competition into question. Still, the Federation of German Industries (BDI) has taken a critical stance towards major proposals in the draft claiming that too much emphasis is put on regulations that undermine the freedom and flexibility of business. More generally speaking, the draft underpins the leadership ambitions of the Greens by providing positions on a broad range of policy issue beyond climate change.

Figure 21: CDU/CSU and Greens won more female than male votes in 2017



Source: The Federal Returning Officer

Figure 22: Upcoming party conventions

Party	Date	Place
FDP	Sep 19, 2020	Berlin
Left	Oct 30 - Nov 1, 2020	Erfurt
Greens	Nov 20-21, 2020	Karlsruhe
CDU	Dec 3-5, 2020	Stuttgart
CSU	Dec 12, 2020	Nuremberg
SPD	Spring 2021	

Source : Websites and information from the political parties.

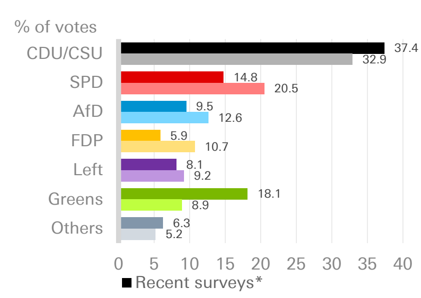
At the same time the wording of the positions is sufficiently vague to allow coalition building with different political partners – which, in the case of the CDU/CSU would require painful compromises, though. In terms of nomination of a chancellor candidate, the fact that the Green party is led by the leadership tandem Annalena Baerbock and Robert Habeck makes it more challenging to single out the right chancellor candidate. In polls, roughly a third of the Germans consider Habeck as qualified for chancellor. However, contrasting the CDU/CSU and the SPD with a female candidate for chancellorship might also be an interesting strategic consideration. In any case, for the first time since WWII the election year 2021 could see three serious contenders for chancellorship to compete against each other (otherwise it used to be two, except for the short episode with FDP leader Westerwelle).

The FDP is struggling to meet the 5% threshold in the current polls. It is still suffering from its role in the state elections in Thuringia last year and the perceptions that the local FDP has an unclear approach towards the far-right AfD. Also, the party's political program to a certain extent runs against the societal trends in Germany. During the current pandemic, a strong state with strong leaders seem to be more important for the electorate than a focus on citizens' own responsibility and individual rights. In order to address the crisis and calm concerns about their own and the collective economic future, voters seems to be willing to accept high budget deficits and rising public debt. It might be too early for calls to return to the principles of the social market economy and considerations about the fiscal burden for future generations given the repercussions of the pandemic crisis, let alone its unforeseeable end.

The far-right AfD has played no significant role in dealing with the pandemic not least as it is nowhere in an executive position – though represented in all regional parliaments. In addition, there is a lot of infighting over the future path of the party and a gamble for power between the extreme right wing and the more-moderate party members. Still, even despite the internal party quarrels and their lack in constructive policy cooperation its polling has peaked last summer, since then hovering at around 10%. And it cannot be ruled out that the trend will be reversed in the aftermath of the crisis should it be followed by a long recession – which is not our base line, though.

The Left is not represented in six important regional parliaments but is part of the governments in Bremen and Berlin. It still has its specific strength in the eastern German states, above all in Thuringia where a PM from the Left party heads a minority government. The next elections in Thuringia will take place in mid-April 2021. They have the potential for another political uproar as tensions between the parties are significant in Thuringia where the far-right AfD is the second strongest party.

Figure 23: Major political parties' popularity & result of the last federal election



* Average of major recent surveys (Forsa, Kantar, INSA, FG Wahlen)

Source : Wahlrecht.de, August 5, 2020

One year until the federal elections – an eternity in political terms

Current party polls (see Figure 6) show the CDU/CSU in a very comfortable position at 37%. This indicates that right now a government without the conservatives would be rather impossible in arithmetic terms: SPD, the Greens and the Left will hardly combine 45% of the votes given that the SPD is still hovering around 15% and the Greens are back to just below 20% after their peak in summer 2019. With its current strength, more options for coalition building have been opening up for the CDU/CSU. In principle, another "grand coalition" would be possible. So would a conservative-green government. A fifth of the voters currently support one of these options (Politbarometer July 2020). To the dismay of the CDU's conservative wing, the alternatives to the chancellor's centrist course seem to be rather limited (not least as the center-right FDP might struggle to cross the 5% hurdle to return to the Bundestag).

However, this is a snapshot in a volatile environment. The CDU/CSU currently benefits from the high approval rates for the government's crisis management as well as the "chancellor bonus". The crucial question will be whether this can be sustained until the federal elections in September 2021. Apart from the choice of the CDU leader and the chancellor candidate it hinges on a number of developments such as

- Further course of the pandemic – will Germany manage a possible second wave of COVID-19 infections without another (partial) lockdown and prove its resilience to the crisis as it did since early spring?
- Success of the (financial) crisis measures – the government's ambition that with the EUR billions provided in liquidity and guarantees no previously healthy business should become insolvent due to the pandemic might be challenged with a time lag in the course of 2021.
- Recovery of the economy – economic forecasts are right now more uncertain than ever but in our baseline, 2021 should see a return to growth (DB GDP forecast: a 4% rebound in 2021 after -6.4% in 2020). Still, unemployment might remain higher than most have experienced over the recent past, fueling concerns of further job losses and decline in consumer confidence.

Major signposts for voters' sentiment in early spring 2021

The first important signpost for voters' sentiment will be the regional elections in Baden-Wuerttemberg (and Rhineland-Palatinate) on March 14 (see Figure 7). The elections there are an important rehearsal for the federal elections later in 2021 for several reasons: BW is one of the biggest and most populous German states; it is the only state governed by a Green-CDU coalition; and its corporate landscape is dominated by the car industry and its suppliers as well as mechanical engineering, both sectors that are either in a restructuring process or heavily depending on export demand. The state elections there will be the final kickoff for a fierce federal election campaign which will likely capture attention beyond Germany's borders.

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Figure 24: Super election year 2021

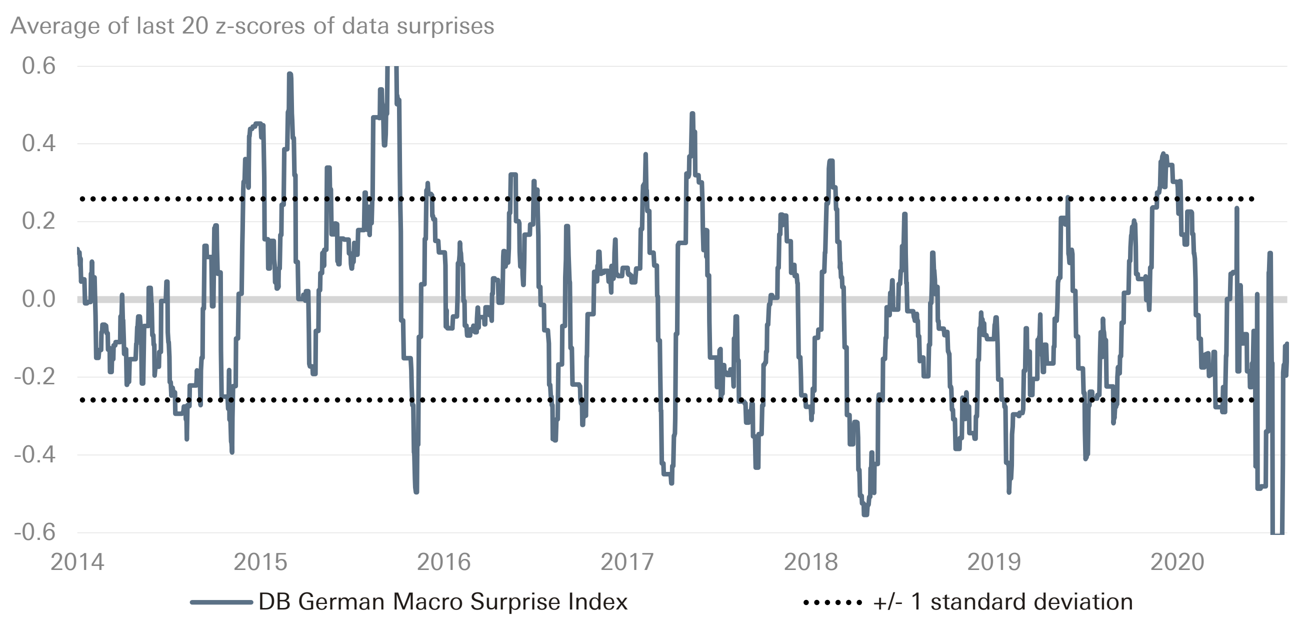
Date	Land	Elections
13-Sep-20	North Rhine-Westphalia	Local elections
14-Mar-21	Hesse	Local elections
14-Mar-21	Baden-Württemberg	Landtag
14-Mar-21	Rhineland-Palatinate	Landtag
25-Apr-21	Thuringia	Landtag
6-Jun-21	Saxony-Anhalt	Landtag
Autumn-21	Lower Saxony	Local elections
Autumn-21	Mecklenburg-Vorpommern	Landtag
Autumn-21	Berlin	Abgeordnetenhaus
Autumn-21	**all Länder**	**Bundestag**

Source : Wahlrecht.de

Deutsche Bank German Macro Surprise Index

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

Figure 25: DB Macro Surprise Index



Values above (below) 0 indicate the data came in better (worse) than expected
Source : Bloomberg Finance LP, Deutsche Bank Research

Last 20 published economic data for Germany

Bloomberg Tickers	Indicator	Reporting month	Publication date	Current value	Bloomberg consensus	Surprise	Standardised surprise	Quantile rank
GRBTEXMM Index	Exports (% mom)	5 2020	09/07/2020	8.9	14.0	-5.1	0.0	0.0
GRBTIMMM Index	Imports (% mom)	5 2020	09/07/2020	3.6	12.4	-8.8	-3.7	0.0
GRTBALE Index	Trade Balance (EUR bn)	5 2020	09/07/2020	7.0	7.0	0.0	-0.1	0.4
GRCAEU Index	Current Account Balance (EUR bn)	5 2020	09/07/2020	7.0	10.0	-3.0	-1.2	0.1
GRZECURR Index	ZEW Survey Current Situation	7 2020	14/07/2020	-80.9	-65.0	-15.9	-2.4	0.0
GRZEWI Index	ZEW Survey Expectations	7 2020	14/07/2020	59.3	60.0	-0.7	-0.1	0.5
GRCP20YY Index	CPI (% yoy)	6 2020	14/07/2020	0.9	0.9	0.0	0.2	0.4
GRIMP95Y Index	Import Price Index (% yoy)	6 2020	29/07/2020	-5.1	-5.1	0.0	0.4	0.7
GRCP20YY Index	CPI (% yoy)	7 2020	30/07/2020	-0.1	-0.1	0.0	0.2	0.4
GRUECHNG Index	Unemployment Change (000's mom)	7 2020	30/07/2020	-18.0	41.0	59.0	1.8	1.0
GRGDPPGQ Index	GDP (% qoq)	6 2020	30/07/2020	-10.1	-9.0	-1.1	-2.7	0.0
GRFRIAMM Index	Retail Sales (% mom)	6 2020	31/07/2020	-1.6	-3.0	1.4	1.1	0.9
MPMIDEMA Index	Markit Manufacturing PMI	7 2020	03/08/2020	51.0	50.0	1.0	1.1	0.9
MPMIDESA Index	Markit Services PMI	7 2020	05/08/2020	55.6	56.7	-1.1	-1.3	0.1
GRIORTMM Index	Factory Orders (% mom)	6 2020	06/08/2020	27.9	10.1	17.8	7.3	1.0
GRTBALE Index	Trade Balance (EUR bn)	6 2020	07/08/2020	15.6	11.3	4.3	1.6	1.0
GRCAEU Index	Current Account Balance (EUR bn)	6 2020	07/08/2020	22.4	15.0	7.4	1.9	1.0
GRBTIMMM Index	Imports (% mom)	6 2020	07/08/2020	7.0	10.6	-3.6	-1.5	0.0
GRIPIMOM Index	Industrial production (% mom)	6 2020	07/08/2020	8.9	8.2	0.7	0.7	0.8
GRBTEXMM Index	Exports (% mom)	6 2020	07/08/2020	14.9	14.4	0.5	0.2	0.6

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

Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
21 Aug 2020	9:30	Manufacturing PMI (Flash)	August	52.5	51.0
21 Aug 2020	9:30	Services PMI (Flash)	August	56.5	55.6
25 Aug 2020	8:00	Real GDP (% qoq) - Details	Q2 2020	-10.1	-2.0
25 Aug 2020	10:30	ifo business climate (Index, sa)	August	91.0	90.5
31 Aug 2020	14:00	Consumer prices preliminary (% yoy, nsa)	August	0.9	-0.1
1 Sep 2020	9:55	Unemployment rate (%, sa)	August	6.5	6.4
2 Sep 2020	8:00	Retail sales (% mom, sa)*	July	5.5	-1.6
4 Sep 2020	8:00	New orders manufacturing (% mom, sa)	July	3.0	27.9
7 Sep 2020	8:00	Industrial production (% mom, sa)	July	3.0	11.1
8 Sep 2020	8:00	Trade balance (EUR bn, sa)	July	16.0	14.5
8 Sep 2020	8:00	Merchandise exports (% mom, sa)	July	4.8	14.9
8 Sep 2020	8:00	Merchandise imports (% mom, sa)	July	3.7	7.0

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

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

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Financial Forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	0.125	-0.10	0.00	0.10	-0.75	0.00	-0.60	0.00	0.10	0.60	0.25
Sep 20	0.125	-0.10	0.00	0.10	-0.75	0.00	-0.75	1.50	0.10	0.60	0.25
Dec 20	0.125	-0.10	0.00	0.10	-0.75	0.00	-0.75	1.50	0.10	0.50	0.25
Mar 21	0.125	-0.10	0.00	0.10					0.10	0.50	0.25
3M interest rates, %											
Current	0.24	-0.07	-0.47								
Sep 20	0.40	0.03	-0.40								
Dec 20	0.50	0.03	-0.40								
Mar 21	0.40	0.03									
10Y government bonds yields, %											
Current	0.53	0.01	-0.53	0.11							
Sep 20	0.60	0.00	-0.28	0.23							
Dec 20	0.70	0.10	-0.20	0.45							
Mar 21	0.85	0.10	-0.10	0.53							

Exchange rates

	EUR/USD	USD/JPY	EUR/GBP	GBP/USD	EUR/CHF	EUR/SEK	EUR/DKK	EUR/NOK	EUR/PLN	EUR/HUF	EUR/CZK
Current	1.19	105.72	0.90	1.31	1.08	10.31	7.45	10.64	4.41	345.90	26.27
Sep 20	1.15	100.00	0.94	1.22	1.07	10.25		10.25	4.50	365.00	27.00
Dec 20	1.20	100.00	0.96	1.25	1.05	10.50	7.46	10.25	4.45	365.00	26.50
Mar 21	1.21	97.50	0.95	1.27	1.04	10.50		10.19	4.40	360.00	25.75

Source : Bloomberg Finance LP, Deutsche Bank Research

Germany – Data monitor

	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Feb 2020	Mar 2020	Apr 2020	May 2020	Jun 2020	Jul 2020
Business surveys and output											
Aggregate											
Ifo business climate	95.2	95.1	92.5	80.1		95.8	86.1	74.3	79.7	86.3	90.5
Ifo business expectations	91.9	92.2	88.3	80.6		92.9	79.8	69.6	80.5	91.6	97.0
Industry											
Ifo manufacturing	91.1	90.8	90.0	77.5		92.6	85.0	72.8	76.7	82.9	88.0
Headline IP (% pop)	-0.8	-1.7	-1.9	-19.2		0.4	-11.0	-21.2	10.0	11.1	
Orders (% pop)	-0.2	-1.1	-2.5	-22.8		-1.2	-15.0	-26.1	10.4	27.9	
Capacity Utilisation	83.9	82.6	82.9	71.4	74.4						
Construction											
Output (% pop)	0.4	0.8	4.6	-1.8		-1.3	-2.0	-0.7	1.1	-0.2	
Orders (% pop)	0.3	7.2	-4.2			-6.5	-10.5	2.7	-5.7		
Ifo construction	112.7	111.2	106.7	95.0		108.2	103.9	92.4	95.1	97.6	100.3
Consumer demand											
EC consumer survey	-3.1	-3.3	-4.6	-14.0		-2.6	-7.6	-16.3	-14.8	-10.8	-10.3
Retail sales (% pop)	0.7	0.2	0.7	-0.3		0.8	-2.4	-6.3	12.7	-1.6	
New car reg. (% yoy)	6.8	13.7	-20.3	-47.4		-10.8	-37.7	-61.1	-49.5	-32.3	-5.4
Foreign sector											
Foreign orders (% pop)	-0.2	-1.1	-2.6	-29.0		-3.3	-15.9	-28.9	8.7	22.0	
Exports (% pop)	0.6	0.6	-3.5	-21.8		1.2	-11.8	-23.9	8.9	14.9	
Imports (% pop)	-0.6	0.8	-2.3	-16.1		-1.2	-5.3	-16.6	3.6	7.0	
Net trade (sa EUR bn)	57.7	57.7	52.3	25.3		21.1	12.6	3.3	7.5	14.5	
Labour market											
Unemployment rate (%)	5.0	5.0	5.0	6.2		5.0	5.0	5.8	6.3	6.4	6.4
Change in unemployment (k)	22.7	-6.3	-11.0	548.3		-9.0	-1.0	371.0	237.0	69.0	-18.0
Employment (% yoy)	0.8	0.6	0.3	-1.1		0.4	0.0	-0.9	-1.3	-1.3	
Ifo employment barometer	98.8	99.0	97.0	89.0		98.1	93.4	86.4	88.4	92.3	93.2
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	1.0	1.2	1.5	0.7		1.7	1.3	0.8	0.5	0.8	0.0
Core HICP (% yoy)	0.9	1.5	1.3	1.1		1.4	1.3	1.0	1.1	1.1	0.7
Harmonised PPI (% yoy)											
Commodities, ex. Energy (% yoy)	6.3	5.3	2.1	-5.5		0.2	-2.5	-7.3	-4.8	-4.2	-5.7
Crude oil, Brent (USD/bbl)	62.1	62.5	50.7	33.1		55.8	33.9	26.9	32.6	40.5	43.2
Inflation expectations											
EC household survey	33.7	31.6	34.3	38.9		34.4	33.3	42.3	44.0	30.4	24.2
EC industrial survey	2.2	2.7	2.2	-4.9		3.4	0.0	-4.6	-6.0	-4.0	-0.5
Unit labour cost (% yoy)											
Unit labour cost	2.9	3.0	4.1								
Compensation	3.6	2.7	1.8								
Hourly labour costs	3.0	3.5	3.5								
Money (% yoy)											
M3	5.1	4.6	6.7	7.0		4.7	6.7	6.3	7.2	7.0	
M3 trend (3m cma)											
Credit - private	4.5	4.9	5.3	4.7		4.9	5.3	5.3	5.4	0.0	
Credit - public	3.1	-5.9	5.0	3.1		3.6	5.0	2.5	-0.4	3.1	

% pop = % change this period over previous period.

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

Appendix 1

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