



Trouble in the air

- **Another "COVID winter"**. GDP growth failed to accelerate further in Q3, as the supply shortages provided an increasing drag on industrial output. The supply chain issues will prevail throughout the winter half and only taper off very gradually during 2022. While private consumption was the growth engine in summer, the recent strong increase in the number of new COVID-19 infections will slow consumer spending during winter. But we expect consumers to become more perky by spring. Absent Q3 details we now expect GDP to stagnate in the winter half, but acknowledge the increasing risks of negative quarters. Given the upward revisions to H1 (published with the Q3 GDP flash) this would still result in an average growth rate of 2.5% yoy for 2021. Further upside surprises at all stages of inflation have, despite an increasing tightness in the labour market, not (yet) started a price-wage spiral. Although the energy price surge and base effects will drop out of the yoy rate, we expect further price pressure, given strongly rising (non-energy) import and producer prices combined with companies' strong expectations to be able to pass them on.
- **The next government is in the making**. The SPD, Greens and liberals are in the midst of their formal coalition negotiations. The three parties have started to dive into the details after having reached an agreement on the broad direction of travel two weeks ago. We attach a high likelihood to a traffic-light coalition government being formed within this year. At first glance, conclusions from pre-talks seem to bear the mark of the liberals (no new taxes and tax increases, no change of the debt brake). But the SPD (increased minimum wage, no pension cuts) and the Greens (earlier coal phaseout, more renewable energies) can also credibly claim to have successfully fought for their signature policies. Many details still need to be fleshed out, above all the financing of proposed public investments and social policies within the boundaries of the debt brake. The three parties aim to finalize the coalition agreement by the end of November, and then start internal party approval processes. The FDP and the SPD will hold a party convention. The Greens announced that their members will vote on the coalition agreement. Thus, the target of electing the new chancellor in parliament during the first week of December might prove to be relatively ambitious. Still, as things stand today, Germany will very likely be governed by a new traffic-light coalition before the end of the year.

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Key Economic Forecasts

Figure 1: Economic Forecasts

	Real GDP (% growth)			Consumer Prices (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2020	2021F	2022F	2020	2021F	2022F	2020	2021F	2022F	2020	2021F	2022F
Euroland	-6.5	4.9	4.0	0.3	2.5	2.5	2.0	2.3	2.6	-7.2	-7.7	-4.2
Germany	-4.6	2.5	4.5	0.4	3.1	2.6	7.0	6.2	5.9	-4.3	-6.3	-1.8
France	-8.0	6.3	3.5	0.5	1.9	2.0	-1.9	-1.5	-0.9	-9.1	-7.7	-5.2
Italy	-9.0	5.7	4.0	-0.1	1.7	2.0	3.6	3.4	2.7	-9.6	-11.5	-6.8
Spain	-10.8	4.8	6.4	-0.3	2.6	2.2	0.8	2.8	2.8	-11.0	-8.7	-4.8
Netherlands	-3.8	1.5	2.8	1.1	1.5	1.3	7.0	10.2	9.5	-4.2	-7.9	-6.2
Belgium	-5.7	4.2	3.9	0.4	1.7	1.2	0.8	-0.1	-0.7	-9.1	-7.0	-4.8
Austria	-7.0	2.9	5.1	1.4	1.4	0.5	1.9	2.6	2.8	-8.3	-7.2	-2.9
Finland	-2.9	2.2	3.0	0.4	1.9	0.9	-0.2	-0.5	-1.0	-8.0	-5.9	-4.1
Greece	-7.8	2.0	6.1	-1.3	-0.6	0.0	-7.4	-5.4	-4.2	-9.6	-7.2	-7.4
Portugal	-8.4	4.6	4.6	-0.1	1.2	0.9	-1.1	-0.5	-0.5	-5.8	-6.3	-6.8
Ireland	5.8	3.5	5.1	-0.5	1.3	0.2	-2.7	7.5	10.0	-4.9	-5.7	-2.8
UK	-9.7	7.1	3.6	0.9	2.4	3.8	-2.6	-2.3	-2.7	-14.9	7.4	3.7
Sweden	-2.9	3.3	3.0	0.7	1.2	1.4	5.7	4.2	4.0	-2.8	-2.5	-1.5
Denmark	-2.1	3.5	2.5	0.3	1.0	1.2	8.1	6.8	7.0	-0.2	-2.6	-1.9
Norway	-1.3	3.5	2.7	1.3	2.8	1.9	2.0	4.0	4.2	-3.0	2.0	4.1
Switzerland	-2.5	3.7	2.8	-0.7	0.1	0.4	1.2	8.9	9.6	-2.8	-1.7	-0.7
Poland	-2.5	4.7	5.0	3.4	4.9	5.9	2.9	3.0	1.9	-7.0	-5.8	-3.5
Hungary	-4.7	7.0	4.7	3.3	4.9	4.4	0.0	0.7	1.2	-8.0	-6.8	-6.1
Czech Republic	-5.6	3.0	3.5	3.2	3.6	3.6	3.6	1.8	0.9	-5.6	-9.2	-6.1
United States	-3.4	5.6	4.4	1.2	4.4	3.8	-3.1	-3.5	-3.8	-15.5	-13.1	-4.7
Japan	-4.7	2.1	2.7	0.0	-0.2	0.8	3.2	3.5	3.2	-13.0	-9.7	-5.4
China	2.3	7.9	5.1	2.5	0.8	1.6	1.9	2.5	2.0	-6.2	-5.0	-4.2
World	-3.1	5.7	4.2	2.6	3.7	3.7						

Source: National Authorities, Deutsche Bank

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

	2019	2020	2021F	2022F	2021				2022			
					Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
Real GDP	1.1	-4.6	2.5	4.5	-1.9	1.9	1.8	0.0	0.0	2.1	2.1	1.1
Private consumption	1.6	-5.9			-5.2	3.2						
Gov't expenditure	3.0	3.5			-0.7	1.8						
Fixed investment	1.8	-2.2			-0.7	0.5						
Investment in M&E	1.0	-11.2			-0.4	0.3						
Construction	1.1	2.5			-0.2	0.3						
Inventories, pp	-0.1	-0.9			1.9	0.1						
Exports	1.1	-9.3			1.4	0.5						
Imports	2.9	-8.6			4.2	2.1						
Net exports, pp	-0.7	-0.8			-1.0	-0.6						
Consumer prices*	1.4	0.5	3.0	2.5								
Unemployment rate, %	5.0	5.9	5.7	5.3								
Industrial production**	-4.2	-9.6	3.5	7.0								
Budget balance, % GDP	1.5	-4.3	-6.3	-1.8								
Public debt, % GDP	58.9	68.7	72.9	70.0								
Balance on current account, % GDP	7.5	7.0	6.2	5.9								
Balance on current account, EUR bn	267.1	220.6	215.0	212.0								

Source: Federal Statistical Office, Deutsche Bank Research



Another “COVID winter”

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- The supply chain issues will prevail throughout the winter half and only taper off very gradually during 2022.
- While private consumption was the growth engine in summer, the recent strong increase in the number of new COVID-19 infections will slow consumer spending during winter. But we expect consumers to become more perky by spring.
- Absent Q3 details we now expect GDP to stagnate in the winter half, but acknowledge the increasing risks of negative quarters. Given the upward revisions to H1 (published with the Q3 GDP flash) this still results in an average growth rate of 2.5% yoy for 2021.
- Further upside surprises at all stages of inflation have, despite an increasing tightness in the labour market, not (yet) started a price-wage spiral. Although the energy price surge and base effects will drop out of the yoy rate, we expect further price pressure, given strongly rising (non-energy) import and producer prices combined with companies’ strong expectations to be able to pass them on.

Growth did not accelerate further in Q3

German economic activity failed to pick up further momentum in Q3, as had been widely expected even a few months ago. GDP expanded by 1.8% qoq after increasing 1.9% in Q2. According to the Statistical Office’s commentary private consumption was – as in Q2 – the major growth driver, although retail sales rose a meagre 0.2% qoq. This points to a more solid contribution from services such as tourism, restaurants and personal services, given the widespread relaxation of COVID restrictions, which has been mirrored in high-frequency mobility data (see figure 9). By contrast, the modestly declining trend in the producing sector’s output in H1 worsened in Q3 with output declining by 2.4% qoq, largely due to increasing disturbances caused by supply bottlenecks. The manufacturing sector’s weakness should have spilled over into sluggish investment spending and shrinking exports (compared to Q2). Still, with imports even weaker – probably also due to the logistics problems – net-trade might have marginally contributed to Q3 GDP growth.

More clouded outlook for the winter half

The unabated decline in the ifo business climate until October (latest readings) and companies’ production and export expectations do not bode well for industry in the coming months.

Industrial output: Another qoq decline

German manufacturing continues to suffer from supply chain bottlenecks and rising prices for intermediate goods. Estimates derived from the PMI survey suggest that in all major economies the supply problems deteriorated further in October. While order books have recently reached a record high, production has remained subdued during the last few months. Capacity utilization decreased at the beginning of Q4 2021. The ifo Institute just calculated that shortages in supply will cause losses in gross value added of roughly EUR 40 bn in the German industrial sector. They have already left their imprint in the number of people working short shifts in manufacturing, which have risen by 20k (Oct.) according to ifo estimates.

Figure 3: Bundesbank Weekly Activity Index



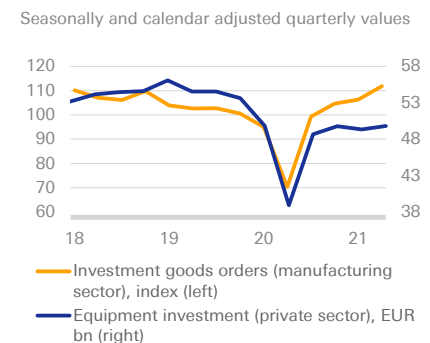
Source : Deutsche Bundesbank

Figure 4: Equipment investment vs. industrial goods orders



Source : Federal Statistical Office, Deutsche Bank Research

Figure 5: Equipment investment vs. investment goods orders



Source : Federal Statistical Office, Deutsche Bank Research



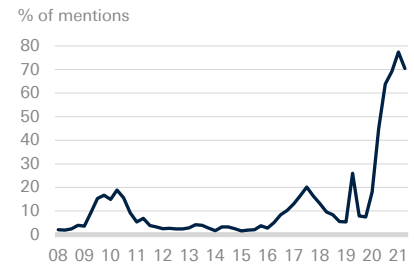
We expect the supply chain disruptions will only ease gradually during 2022, in some sectors maybe even later. This will be a drag on capacity expansions in the next few quarters. Some companies will hold back on expansion investments, given the more uncertain export outlook, especially, if they expect the demand surge to be only temporary. We revise our production forecast for the manufacturing sector down to +3.5% in 2021 (2020: -9.6%). This increase, however, is basically courtesy of the strong start into the year. We now expect production to rise by 7% in 2022. Thus, recovery is postponed and not rescinded.

Automotive production in Germany is specifically hampered by semiconductor shortages. A fast relief is not in sight. It becomes more and more likely that domestic automotive production will decline again in 2021 compared to the low level of the coronavirus year 2020. Structural (intra-group) shifts in production within Europe are also playing a part in this process, to the detriment of Germany. It is certainly noticeable that the shortage of semiconductors in most other EU countries leaves fewer marks in the production figures than in Germany.

Rising COVID infections to weigh on consumption

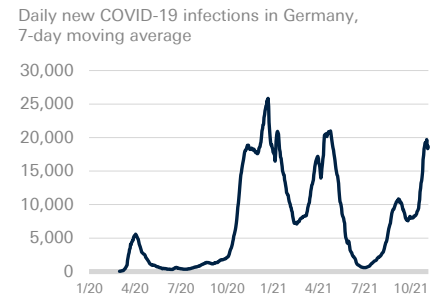
The number of new infections has increased during the last few weeks. 7 day incidence has reached levels at around 170 and is expected to remain high or even rise further for the weeks to come since more than 20% of the adult population in Germany is still not vaccinated and vaccines for children younger than 12 years have not yet been approved. The 7-day incidence is specifically high in younger age groups. However, hospitalization ratios are still correlated with age. Capacity utilization of intensive care units has increased in regions with high new infection numbers so that some hospitals are again postponing non-time-critical surgeries. The number of intensive care patients is rising but still lower than in former peak times.

Figure 6: ifo index: Shortage of materials in German manufacturing



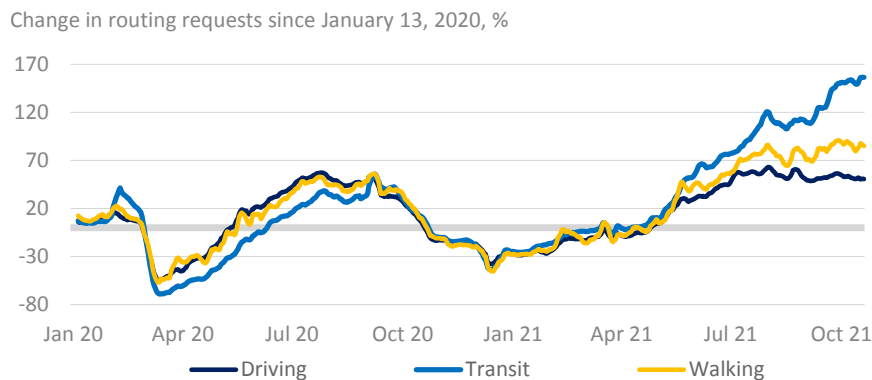
Source: ifo

Figure 7: New infections on the rise again



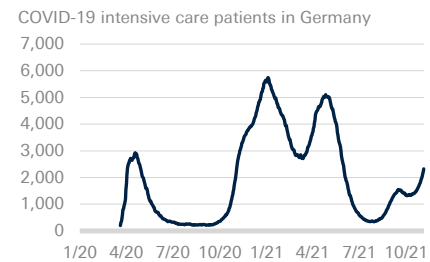
Source: RKI

Figure 9: Apple mobility index: Germany



Source: Apple Inc.

Figure 8: Number of intensive care patients currently below former peaks



Source: DVI

But no general lockdown expected

Even though virologists and politicians expect infection rates to remain high during the winter months, there are no signs or strong calls for a renewed comprehensive lockdown. We therefore expect the retail, hospitality and leisure sectors to stay open although capacity limitations might remain in place (or even increase) in some areas (e.g. for large sport events). Voluntary social distancing might reduce the speed and extent of economic recovery in those sectors, that have been affected by hygiene and distance rules. Current rules for the access to certain businesses and cultural institutions (vaccination certificate, proof of recovery or a current test



evidence, 3G) will most probably be more strictly controlled over the coming weeks. What is more, access for unvaccinated people to such facilities might be prohibited or impeded in case of rising infection or hospitalization rates (access for recovered and vaccinated people only, 2G). Saxony introduced such a 2G rule in early November. Other federal states are discussing similar regulations. That would also reduce consumption possibilities for unvaccinated people. Politicians want to keep schools open despite high incidences for school children. Thus, working parents will not be forced to stay at home due to a lack of childcare.

GDP stagnation during winter – further downside risk

We now expect GDP to more or less stagnate in the winter half. Given the modest upward revision to H1, this still allows for an annual average growth rate of 2.5%. The COVID-related news flow and more and more reports of supply problems do still provide downside risks to that view. We will address this question in more detail in early December on the basis of the Q3 details provided by the Statistical Office on 25. Nov. in our 2022 World Outlook.

Unemployment rate: Falling towards pre-COVID lows by 2022

The economic recovery in the summer half of 2021 is also reflected in a continued strong upward trend on the German labour market. From the end of Q2 to October, seasonally adjusted unemployment fell by around 215 thousand people. However, the leading indicators from ifo and IAB signal a weakening of the positive trend in the coming months. The industry and consumption outlook presented above will ultimately also dampen hiring plans – at least temporary. In the remaining two months of the year, unemployment is expected to fall by another 40 thousand or so. For 2021 as a whole, we now expect an unemployment rate of 5.7% (2020: 5.9%). In the coming year it should fall further to 5.3%.

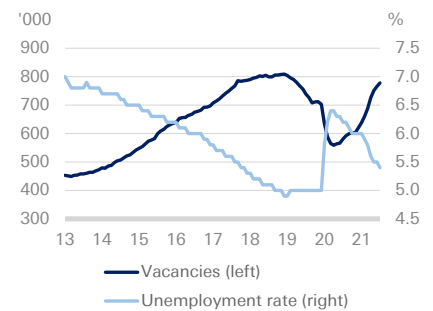
Short-time work continued to decline in Q3 and is likely to have fallen by around 1 million since mid-year to now around 500 thousand (Oct.) people. According to survey results from the ifo Institute, the figures for service providers and the hotel and restaurant sector fell sharply, as expected. By contrast, since the end of Q3 figures have slightly been rising again in various industrial sectors (automotive and suppliers, manufacturers of metal products) due to production shortfalls caused by supply bottlenecks. Nevertheless, the total number of short-time workers is expected to fall to around 400 thousand by the end of the year.

In 2021, the potential labour force probably shrank by a good 100k. According to the IAB research institute it should temporarily increase in 2022 as more people will reenter the labour market with the COVID crisis receding. In addition, migration is expected to recover. Still shortages of skilled and unskilled workers are becoming increasingly evident.

No price-wage spiral (so far)

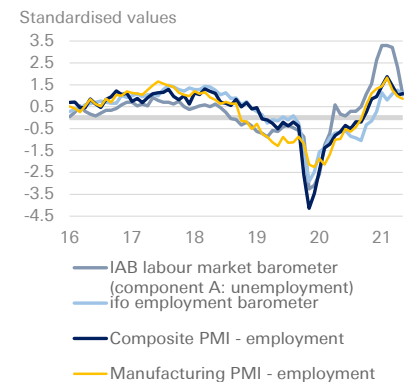
In view of the cyclical and structural factors, the latest wage settlements in the construction, retail, wholesale and foreign trade sectors have been surprisingly tame. Based on the respective terms, the average effective wage increases are roughly between 2.5% and 3.5% (construction, 33-months term). So far there are hardly any signs of a wage-price spiral setting in. The union demands of 5% wage increases (12 months) for public sector employees in the federal states (excluding Hesse) are also not unusually high. They are even 1pp below the demands of the 2019 round of negotiations. But the unions are already complaining that their initial demand is far too low given the unexpected surge in inflation. Although key 2022 wage settlements will not take place until later in the year, we still perceive that

Figure 10: German labour market with strong rebound during Summer



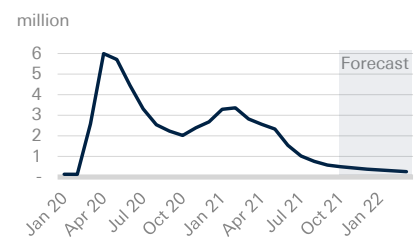
Source: Deutsche Bundesbank

Figure 11: Leading labour market indicators: Weakening of momentum



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

Figure 12: Number of short-time workers fell steadily during summer



Source: Federal Employment Agency, ifo Institute, Deutsche Bank Research



additional requests resulting in a positive wage drift is likely.

Inflation: Further upside surprises

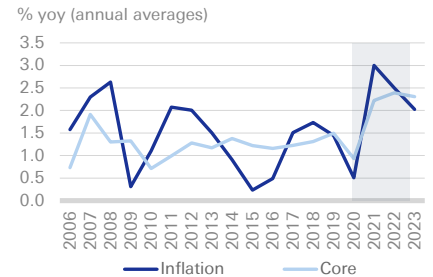
In October headline inflation (national definition) rose by a seasonally adjusted 0.5% mom (0.547% to be precise), propelling the yoy rate to 4.5%. The increase was largely the result of higher energy prices, which jumped by 4.0% mom (18.6% yoy). Core inflation increased by 0.2% on the month, the yoy rate inched up further to 2.9%. Prices for non-energy manufacturing goods rose a modest 0.1% mom, with the yoy rate falling marginally to 3.7%, of which about 1 ½ percentage points can be attributed to the temporary VAT reduction in H2 2020. With regard to the overall CPI the VAT effect and the introduction of CO₂ pricing has probably pushed the yoy up by about 1 ¼ percentage points. Although these base effects will drop out of the yoy comparison by January, we expect inflation to remain at around 2.5% in 2022 after averaging around 3% in 2021. The VAT effect does only play a role for consumer prices, but non-energy import prices are up by 10.1% yoy and non-energy producer prices are running at 8.6%, although mom rates slowed somewhat in September after rising rapidly during summer. Only a small part of these price increases has probably reached the consumer stage so far.

Output prices (PMI) and ifo selling price expectations all reached record highs in October

After receding marginally in August, PMI output prices reached a new all-time high in October, as did output prices in the service sector. Ifo selling price expectations in the manufacturing sector (for the next 3 months) reached a new all-time high as well. Obviously, corporates are highly confident that they will be able to pass their higher input prices on to their customers.

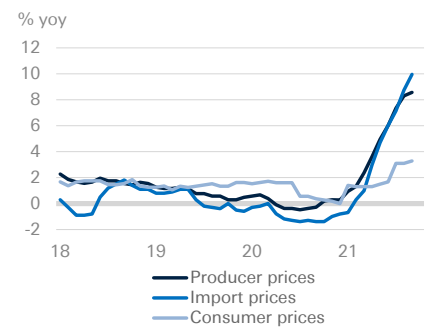
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Figure 13: Headline inflation to peak at 3% in 2021



Source : Federal Statistical Office, Deutsche Bank Research

Figure 14: German inflation ex energy at different stages



Source : Federal Statistical Office



The next government is in the making

- The SPD, Greens and liberals are in the midst of their formal coalition negotiations. The three parties have started to dive into the details after having reached an agreement on the broad direction of travel two weeks ago. We attach a high likelihood to a traffic-light coalition government being formed already this year.
- At first glance, conclusions from pre-talks seem to bear the mark of the liberals (no new taxes and tax increases, no change of the debt brake). But the SPD (increased minimum wage, no pension cuts) and the Greens (earlier coal phaseout, more renewable energies) can also credibly claim to have successfully fought for their signature policies. Many details still need to be fleshed out, above all the financing of proposed public investments and social policies within the boundaries of the debt brake.
- The three parties aim to finalize the coalition agreement by the end of November, and then start internal party approval processes. The FDP and the SPD will hold a party convention. The Greens announced that their members will vote on the coalition agreement. Thus, the target of electing the new chancellor in parliament during the first week of December might prove to be relatively ambitious. Still, as things stand today, Germany will very likely be governed by a new traffic-light coalition before the end of the year.

Traffic-light coalition: One step at a time

Two weeks ago, the SPD, Greens and liberals kicked off formal coalition negotiations. After reaching an agreement on the broad direction of travel ([see 12-page concluding paper](#)), the involved parties are now diving into the details in 22 thematic subgroups. So far, little of these talks has leaked. Unresolved issues are expected to be tackled in a cross-thematic second round of negotiations and the coalition agreement to be finalized by the end of the month (see figure 15). Given the subsequent party internal approval processes, the target of electing the new chancellor in the parliament during the first week of December might prove to be relatively ambitious. Still, we attach a high likelihood for the traffic-light coalition government to be formed within this year as:

- The **committed partners in spe** continue to emphasize their joint mission of modernizing the country, despite remaining programmatic differences. In particular the FDP stresses that “failure is not an option” ([NOZ, Oct 23](#)) – eager to not come up with another withdrawal like the one in 2017 from the Jamaica negotiations. The parties are determined not to repeat the 171-days record long government formation of 2017.
- **Highly popular amongst the electorate.** The traffic-light coalition is by far the most popular coalition option, preferred by 62% of voters (ZDF Politbarometer, Oct 15). This goes probably hand in hand with the high popularity of SPD frontrunner Scholz, who is favored by 75% as next chancellor. This view is not only shared by left-wing voters but also by 78% of FDP and 55% of CDU voters.
- **No viable alternative.** Despite being arithmetically possible, a CDU/CSU-led Jamaica coalition appears unlikely to be formed. The CDU is preoccupied by analyzing the reasons for its poor election result and by realigning itself behind a new (yet to be chosen) leadership. The entire federal leadership team will stand for reelection. The CDU chair will be determined by a member vote this time. The vote will have to be formally endorsed by a party convention taking place on January 21/22 next year

Figure 15: Timeline for the coalition negotiations

Date	Event
Thu, Oct 21	First negotiation round
Wed, Oct 27	Start of negotiations in 22 thematic groups including 4-6 members of each party
Wed, Nov 10	Planned end of negotiations in thematic groups, followed by negotiations rounds in core group
By end of Nov	Aim to have a coalition agreement
In the week of Dec 6	Election of the new chancellor and swearing in of the new cabinet

Source : Deutsche Bank Research based on media reports



which will then also elect the new federal leadership team.

And now for the tricky part ...

At first glance, the 12-page preproposal seems to bear the mark of the liberals (no new taxes and tax increases, no change of the debt brake), an impression also shared by voters (see figure 16). But that would have been too short-sighted for starting promising talks on a three-way coalition. SPD and Greens can also credibly claim to have successfully fought for their signature policies: minimum wage of EUR 12 in 2022, no pension cuts, no increases in the statutory retirement for the SPD – earlier coal phaseout, more renewable energies in the energy mix, end of the renewables surcharge for the Greens. The 22 working groups will now have to flesh out all the remaining details where the preproposal remained ambiguous or silent.

Fiscal policy – how to make ends meet?

One key point which the preproposal did not cover is how to “ensure the necessary investments...within the framework of the constitutional debt brake”. The maximum permissible net new borrowing under the debt brake, which is expected to average around EUR 12 billion per year in the budget years 2023 to 2025, will hardly be sufficient for this ([see latest Focus Germany on fiscal policy](#)). Still, the next government might explore all legal means and options to increase the borrowing margins allowed under the constitution: (i) off-budget special purpose vehicle (e.g. for investments in physical capital), (ii) change in the computational method of the cyclical component embedded in the debt brake¹ (iii) role of KfW, the federal public development bank which already plays a significant role in supporting the government’s climate policies. In addition, it is yet unclear whether the freeing up of “superfluous” spending and removing environmentally harmful subsidies² will contribute significant amounts to financing the needed investment.

Climate policy – more than the lowest common denominator

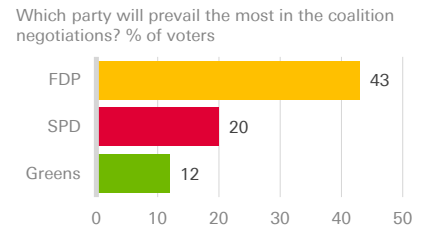
The adaptation of the German climate protection law towards cross-sectoral reduction targets (instead of sector-specific ones) and multi-annual review periods will increase the efficiency of climate protection. And it will bring about more flexibility with respect to transformational paths. Given the faster than planned coal phaseout, energy security issues might come to the fore again. This is addressed by the call for new modern gas-fired (H2-ready) power plants. Still, some of the key elements of the new climate policy are subject to financing – thus, new frictions could arise in the current round of negotiations, if fiscal constraints render key Green policy proposals impossible. With respect to EU climate policies, the three parties are fully supportive of the batch of legislative proposals the Commission presented in July (including the allowing new registrations exclusively for CO₂ neutral cars by 2035, i.e. de facto banning the combustion engine).

EU policy – vague not only on fiscal issues

“The stability and growth pact has proven its flexibility”. This statement can be interpreted in two ways. Either as reflecting the position of the liberals, who strongly advocate no legal change to the current rules and instead stress their flexibility. Or

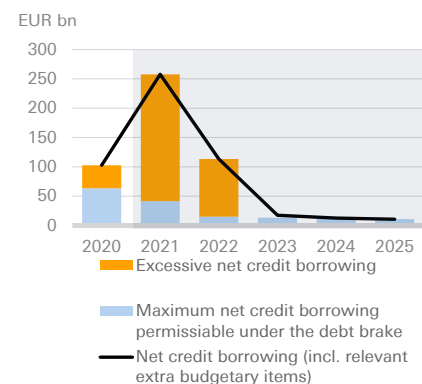
- 1 Setting the quantitative requirements for full utilization of capacity in the economy so high, that even an economic boom would still constitute underutilization of capacity and therefore a negative cyclical component.
- 2 Amounting to about EUR 65.4bn in 2018 according to [an estimate of the Federal Environment Office](#). In their “Klimaschutz-Sofortprogramm”, Greens proposed to eliminate EUR 10bn of these subsidies in a first step.

Figure 16: Many voters see the FDP in a strong position



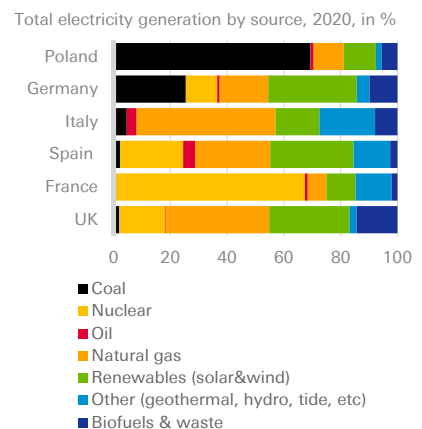
Source: Spiegel, Oct 27

Figure 17: Excessive net federal credit borrowing in the context of the debt brake



Source: Federal Ministry of Finance, Deutsche Bundesbank, Deutsche Bank Research

Figure 18: Germany – coal still a substantial part of the energy mix



Source: International Energy Agency



in the sense of the Greens, that the flexibility of the fiscal rules can be taken advantage of even further to allow for more climate and infrastructure investment by the respective member states. The debate at the EU level is unlikely to be settled by spring next year, thus using existing flexibilities of the fiscal framework that do not require legal changes seems to be the way forward for the time being, in our view ([see latest Focus Europe on the SGP reform](#)). The contentious topic of turning the Recovery and Resilience Fund (RRF) into a permanent fiscal capacity, which the Greens demand and the liberals forcefully reject is not mentioned in the consultation paper. It is unlikely that this will find its way into the final coalition treaty as the discussion on the EU level is just evolving without the need for a clear positioning any time soon. More generally speaking, in the past, the European chapters of the coalition agreements have remained somehow vague compared to domestic policy topics not least because they are subject to EU-level discussions and decisions. The sentence that the new government "...will define the German interests in the light of the European interests" underlines the strong pro-European policy approach of the next government including the liberals. Should the traffic-light coalition stick to its timeline, the next EU Council scheduled for Dec 16/17 2021 could already take place with the participation of the new government/chancellor.

Labor market and social policy – further discussions needed

With the agreement on an increase of the minimum wage and a stable pension level, important cornerstones have been set. In particular, the latter will tie up a significant portion of fiscal resources. Thus, it remains to be seen how much financial leeway will be left for other projects such as the "citizen money" (meant to replace Hartz IV) or a new child welfare model. The strengthening of private pensions and complementing the pay-as-you-go system with a funded second pillar (EUR 10 bn announced for 2022) can be regarded as steps towards future proofing the German pension system paying tribute to the large share of young voters of the Greens and the liberals. With regards to other necessary steps, the parties remain rather vague, proposing, for example, a simplified and more targeted process for the immigration of skilled workers.

Foreign policy – the presumably intended gaps

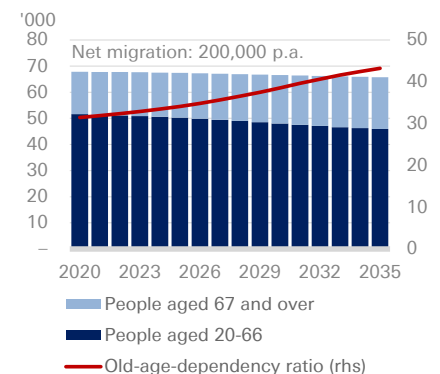
The future coalition parties announced a more strategically oriented foreign policy but remained rather vague beyond that. That is not unusual, in order to keep sufficient leeway to react to international developments. However, the three parties have yet to agree on a couple of sticking points, e.g. (i) defense spending, notably in view of the 2% NATO spending target and the future of the transatlantic relationship; (ii) the relationship with China and Russia, incl. Nord Stream 2; (iii) how to proceed with new and pending trade and investment deals. However, all these areas are strongly connected with an overarching EU foreign and security policy.

A new government by the end of the year? Signposts ahead

Once the coalition agreement has been finalized, there are still some procedural hurdles to be cleared on the way to forming the new government:

- **Intra-party consultations.** Late November, early December is probably crunch time for the three coalition partners to have the negotiated coalition agreement approved by the parties. The FDP and the SPD will hold a party convention. The Greens announced that their members will vote on the coalition agreement. What took the SPD about a month in 2017 could be sped up this time thanks to online procedures. So far, intra-party consultations have not blocked any coalition formation, but have boosted

Figure 19: Ageing puts German labor market and social systems under pressure



Source: Federal Statistical Office



their legitimization. This time, the Green vote could be the most critical as a few critical voices at the last party convention indicate ([e.g. FAZ, Oct 17](#)). The more ideological party base will pay close attention to whether the Greens will succeed in the negotiations of climate and social policy.

- The anticipated eventual **election of Chancellor Scholz**, envisaged for the first week of December, will be more of a formality. Taken together, coalition partners have a comfortable majority in the Bundestag (416 out of total 736 seats), way beyond the required absolute majority.

As things stand today, Germany will very likely be governed by a new traffic-light coalition before the end of the year. Until then, the Merkel-led cabinet will remain as caretaker government.

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We thank Ursula Walther for her valuable contribution.



Germany: Data Calendar

Date	Time	Data	Reporting period	DB forecast	Last value
23 Nov 2021	9:30	Manufacturing PMI (Flash)	November	56.8	57.8
23 Nov 2021	9:30	Services PMI (Flash)	November	50.5	52.4
24 Nov 2021	10:00	ifo business climate (Index, sa)	November	96.0	97.7
25 Nov 2021	8:00	Real GDP (% qoq) - Details	Q3 2021	1.8	1.9
29 Nov 2021	14:00	Consumer prices preliminary (% yoy, nsa)	November	4.8	4.5
30 Nov 2021	9:55	Unemployment rate (% , sa)	November	5.3	5.4
1 Dec 2021	8:00	Retail sales (% mom, sa)*	October	1.5	-2.5
6 Dec 2021	8:00	New orders manufacturing (% mom, sa)	October	1.0	1.3
7 Dec 2021	8:00	Industrial production (% mom, sa)	October	1.5	-1.5
9 Nov 2021	8:00	Trade balance (EUR bn, sa)	September	13.0	14.1
9 Nov 2021	8:00	Merchandise exports (% mom, sa)	September	-1.1	-1.1
9 Nov 2021	8:00	Merchandise imports (% mom, sa)	September	0.0	2.4

Source: Deutsche Bank Research, Federal Statistical Office, Federal Employment Agency, ifo, IHS Markit
Sebastian Becker, Marc Schattenberg, Jochen Möbert



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					1.25	2.06	2.75
Dec 21	0.125	-0.10	0.00	0.10					2.00	2.10	2.75
Mar 22	0.125	-0.10	0.00	0.25					2.75	2.55	3.00
Jun 22	0.125	-0.10	0.00	0.25					2.75	2.55	3.00
3M interest rates, %											
Current	0.14	-0.07									
Dec 21	0.25	-0.03									
Mar 22	0.20	-0.03									
Jun 22	0.20	-0.03									
10Y government bonds yields, %											
Current	1.54	0.07	-0.23	0.94							
Dec 21	1.80	0.10	-0.10	1.15							
Mar 22	2.15	0.15	0.05	1.28							
Jun 22	2.40	0.15	0.25	1.33							
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	113.87	0.86	1.35	1.06	9.93		9.89	4.60	360.17	25.34
Dec 21	1.16	110.00	0.88	1.32	1.05	10.25		10.00	4.80	365.00	26.50
Mar 22	1.18	111.00	0.87	1.36	1.05	10.13		9.88			
Jun 22	1.21	112.00	0.86	1.40	1.05	10.00		9.75			

Source : Bloomberg Finance LP, Deutsche Bank Research



Germany – Data monitor

	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	May 2021	Jun 2021	Jul 2021	Aug 2021	Sep 2021	Oct 2021
Business surveys and output											
Aggregate											
Ifo business climate	91.3	92.1	93.5	99.3	99.8	99.3	102.0	100.8	99.7	98.9	97.7
Ifo business expectations	95.9	93.5	95.7	101.8	98.8	102.8	104.0	101.1	97.8	97.4	95.4
Industry											
Ifo manufacturing	90.1	96.0	101.4	106.0	104.8	105.7	107.2	106.5	105.0	102.9	101.6
Headline IP (% pop)	13.9	6.4	0.0	-1.1	-2.4	-0.8	-0.5	1.5	-4.2	-1.5	
Orders (% pop)	32.1	7.6	2.5	3.3	1.0	-3.4	4.6	4.9	-8.8	1.3	
Capacity Utilisation	74.4	79.1	80.4	86.7	87.0						
Construction											
Output (% pop)	-0.2	0.4	-0.3	2.7	-1.1	-0.7	-0.1	-0.1	-3.3	4.5	
Orders (% pop)	3.4	5.6	-2.5	-3.8		-1.3	-3.6	2.6	7.3		
Ifo construction	101.4	101.0	100.6	103.0	105.8	103.2	103.7	104.7	105.6	107.1	108.0
Consumer demand											
EC consumer survey	-9.0	-10.5	-11.4	-4.5	-2.2	-4.3	-1.2	-2.0	-3.5	-1.1	-1.5
Retail sales (% pop)	4.2	0.7	-5.5	5.1	0.2	4.7	4.7	-4.1	1.2	-2.5	
New car reg. (% yoy)	-6.7	1.0	-6.4	44.2	-24.6	37.2	24.5	-24.9	-23.0	-25.7	-34.9
Foreign sector											
Foreign orders (% pop)	43.6	7.3	3.1	1.6	4.1	-6.2	0.9	10.4	-9.2	6.3	
Exports (% pop)	20.7	4.6	3.8	2.1		0.3	1.3	0.6	-1.1		
Imports (% pop)	12.3	5.4	2.9	7.0		3.4	0.6	-3.6	2.4		
Net trade (sa EUR bn)	49.7	50.1	54.3	41.8		12.6	13.5	17.7	14.1		
Labour market											
Unemployment rate (%)	6.3	6.2	6.0	5.9	5.5	5.9	5.8	5.6	5.5	5.5	5.4
Change in unemployment (k)	101.3	-79.3	-75.3	-32.7	-173.3	-22.0	-43.0	-91.0	-54.0	-31.0	-39.0
Employment (% yoy)	-1.1	-1.2	-1.5	0.0	0.5	0.1	0.3	0.5	0.5	0.5	
Ifo employment barometer	94.9	96.1	95.9	100.8	103.4	100.2	103.8	102.4	103.6	104.3	103.6
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	-0.2	-0.6	1.7	2.2	3.5	2.4	2.1	3.1	3.4	4.1	4.6
Core HICP (% yoy)	0.5	0.0	1.8	1.3	2.1	1.6	1.2	1.8	2.1	2.5	2.8
Harmonised PPI (% yoy)											
Commodities, ex. Energy (% yoy)	3.9	14.1	33.4	60.7	37.7	67.7	60.2	54.3	37.5	22.9	28.0
Crude oil, Brent (USD/bbl)	43.3	45.3	61.2	69.0	73.3	68.2	73.4	74.2	70.6	75.0	83.7
Inflation expectations											
EC household survey	25.4	28.6	33.4	38.3	44.1	35.1	44.8	43.6	45.1	43.6	48.4
EC industrial survey	0.1	3.3	14.9	37.1	47.7	36.0	44.6	44.7	49.0	49.5	52.6
Unit labour cost (% yoy)											
Unit labour cost	2.1	1.3	2.8	-4.1							
Compensation	0.3	1.5	0.9	4.7							
Hourly labour costs	2.3	3.5	3.7	-1.4							
Money (% yoy)											
M3	7.3	8.2	7.1	6.4	6.4	6.4	6.4	6.6	6.8	6.4	
M3 trend (3m cma)						7.7	6.9	6.6	6.5	6.6	6.6
Credit - private	4.3	4.1	4.2	3.8		3.6	3.8	4.0	4.1	0.0	
Credit - public	9.5	22.9	6.8	9.9		8.9	9.9	6.6	6.9	6.3	

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



Appendix 1

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