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Strong economy supports Merkel's re-election chances

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German GDP: Further upside risks. After Q1's sturdy 0.6% qoq GDP growth, soft indicators do not signal any moderation of the growth momentum. Employment in 2017 so far, has been expanding at similar clip as in 2016, making our 1% consumption forecast for 2017 quite conservative. Exports have rebounded in the winter half – in line with global trade. The growth momentum of global trade seems to have peaked; therefore, we remain cautious, predicting 3.6% German export growth in 2017 after 2.7% last year. In combination with lingering geo-political uncertainty this will weigh on investment spending, where a utilization rate of 2pp above its long-term average suggests a still limited necessity to invest. Following Q1 GDP growth of 0.6% we have revised our 2017 GDP forecast to 1.3% (1.1%). Latest confidence surveys, however, hint at further upside potential and increasing risks of over-heating for 2018.

German industrial output: forecast for 2017 lifted to +1.5%. We have raised our forecast for German manufacturing output growth in 2017 as a whole from +0.5% to 1.5% (both in real terms. Manufacturing producer prices have risen quite steadily over the last few months, not least due to the uptrend in oil prices. Among the main capital goods sectors, electrical engineering did best at the beginning of 2017. We expect output in this sector to rise by 3% in 2017 as a whole. In contrast, we are more cautious about mechanical engineering (+1.5%) and the automotive industry (+1%). Within the metals sector, the processing industry (metal products) continues to grow more strongly than the producing industry. Output in the chemical sector looks set to stagnate in 2017, whereas the pharmaceutical industry might register the strongest output growth of all sectors, at 4% in real terms.

Corporate funding in Q1 – lending: There is a limit to everything; a breather in the bond business. Solid lending to German companies in Q1 – driven by the construction sector and retail & wholesale trade, held back by real estate-related industries. Cooperative banks and savings banks once again grow most. Bond issuance takes a breather after a record-breaking year in 2016.

The view from Berlin. Smaller parties: fighting for public attention. While the political debate in Germany is dominated by the SPD's ups and downs in the polls and the CDU's reverse showing the polls also indicate interesting swings in the smaller parties' popularity ratings. Given the overlaps in both parties' ideas in tax and labour market policy the question is not why the Greens lost in popularity while the SPD gained during the Schulz hype earlier this year but why it did not work the other way round recently. The FDP which scholars have labelled as a "protest party light" is in an upswing. According to a recent survey the AfD seems to become a party for a small, isolated minority, only. Compared to the other smaller parties the Left's approval rating has been more stable in the past few years.

Strong economy supports Merkel's re-election chances

Economic forecasts

	Real GDP (% growth)			Consumer Prices* (% growth)			Current Account (% of GDP)			Fiscal Balance (% of GDP)		
	2016	2017F	2018F	2016	2017F	2018F	2016	2017F	2018F	2016	2017F	2018F
Euroland	1.7	1.8	1.6	0.2	1.6	1.5	3.3	3.1	2.9	-1.5	-1.4	-1.3
Germany	1.9	1.3	1.5	0.5	1.6	1.6	8.4	8.0	7.8	0.8	0.5	0.2
France	1.1	1.4	1.6	0.3	1.3	1.3	-0.9	-0.6	-0.5	-3.4	-3.1	-2.8
Italy	0.9	1.0	1.0	-0.1	1.4	1.3	2.6	2.7	2.3	-2.4	-2.3	-2.3
Spain	3.2	2.7	2.1	-0.3	2.0	1.8	2.0	1.9	1.8	-4.5	-3.3	-2.8
Netherlands	2.2	2.1	1.5	0.1	1.1	1.4	8.4	10.2	10.2	0.4	0.6	0.0
Belgium	1.2	1.6	1.6	1.8	2.3	1.9	-0.4	1.0	1.0	-2.6	-2.1	-2.1
Austria	1.6	1.8	1.6	1.0	1.9	1.6	1.7	2.8	3.1	-1.6	-0.9	-0.8
Finland	1.5	1.2	1.5	0.4	1.0	1.4	-1.1	-1.0	-0.7	-1.9	-2.1	-1.6
Greece	-0.1	0.9	2.0	0.0	1.1	1.0	-0.6	1.0	1.0	0.7	-1.3	0.6
Portugal	1.4	1.7	1.3	0.6	1.2	1.5	1.0	0.7	0.7	-2.0	-2.0	-2.0
Ireland	5.2	4.0	3.2	-0.2	0.2	1.3	4.7	10.0	8.0	-0.6	-0.7	-0.5
UK	1.8	1.6	1.2	0.6	2.7	2.8	-4.4	-4.0	-4.0	-2.9	-2.9	-2.5
Denmark	1.3	1.7	1.8	0.3	1.1	1.4	6.5	6.5	6.5	-2.1	-2.5	-1.9
Norway	0.7	1.6	1.8	3.6	2.7	2.5	4.4	6.2	7.0	3.7	3.9	4.2
Sweden	2.9	3.0	2.4	1.0	1.5	1.5	4.7	4.9	5.1	2.0	0.0	0.3
Switzerland	1.3	1.5	1.7	-0.3	0.5	0.7	9.5	9.3	9.0	-0.1	-0.1	-0.1
Czech Republic	2.3	2.1	2.8	0.7	2.3	2.0	1.1	1.1	1.0	0.6	-0.6	-0.6
Hungary	2.0	3.3	3.1	0.4	2.6	3.0	4.9	3.4	3.1	-1.9	-2.5	-2.3
Poland	2.7	2.7	3.4	-0.6	1.9	2.1	-0.3	-1.1	-1.3	-2.5	-3.0	-2.9
United States	1.6	2.4	2.6	1.3	2.3	2.1	-2.6	-2.9	-3.2	-3.1	-2.9	-2.9
Japan	1.0	1.4	0.8	-0.1	0.4	0.5	3.7	4.0	4.1	-3.5	-3.5	-3.2
China	6.7	6.7	6.3	2.0	1.7	2.7	1.6	1.3	1.1	-3.8	-4.0	-4.0
World	3.1	3.6	3.8	4.2	5.1	4.3						

*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			
	2014	2015	2016	2017F	2018F	Q1	Q2	Q3	Q4	Q1F	Q2F	Q3F	Q4F
Real GDP	1.6	1.7	1.9	1.3	1.5	0.7	0.5	0.2	0.4	0.6	0.4	0.4	0.5
Private consumption	0.9	2.0	2.1	1.0	1.4	0.7	0.4	0.5	0.2	0.3	0.3	0.4	0.4
Gov't expenditure	1.2	2.8	4.0	1.2	1.0	1.6	0.7	0.1	0.3	0.4	0.2	0.3	0.3
Fixed investment	3.4	1.7	2.2	1.9	2.9	1.5	-1.3	-0.1	0.4	1.7	0.4	0.9	1.0
Investment in M&E	5.5	3.7	1.1	0.8	3.4	0.9	-2.3	-0.5	-0.1	1.2	0.5	1.0	1.0
Construction	1.9	0.3	2.8	3.1	3.3	2.1	-1.4	0.0	0.8	2.3	0.5	1.0	1.2
Inventories, pp	-0.3	-0.5	-0.2	0.2	0.0	-0.4	0.0	0.3	0.4	-0.4	0.2	0.0	0.0
Exports	4.1	5.2	2.7	3.6	3.9	1.6	1.1	-0.3	1.7	1.3	0.8	1.2	1.0
Imports	4.0	5.5	3.8	4.1	4.6	1.5	0.2	0.6	2.5	0.4	1.1	1.5	1.1
Net exports, pp	0.4	0.3	-0.4	0.0	0.0	0.1	0.4	-0.4	-0.2	0.5	-0.1	-0.1	0.0
Consumer prices*	0.9	0.2	0.5	1.6	1.6	0.3	0.1	0.5	1.1	1.8	1.6	1.5	1.4
Unemployment rate, %	6.7	6.4	6.1	5.7	5.9	6.2	6.1	6.1	6.0	5.9	5.7	5.7	5.7
Industrial production**	1.5	1.1	1.4	1.5	1.0								
Budget balance, % GDP	0.3	0.7	0.8	0.5	0.2								
Public debt, % GDP	74.9	71.2	68.3	65.9	63.4								
Balance on current account, % GDP	7.3	8.3	8.4	8.0	7.8								
Balance on current account, EUR bn	213	253	263	259	260								

*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 GDP: Further upside risks

— After Q1's sturdy 0.6% qoq GDP growth, soft indicators (ifo, PMI) do not signal any moderation of the growth momentum.

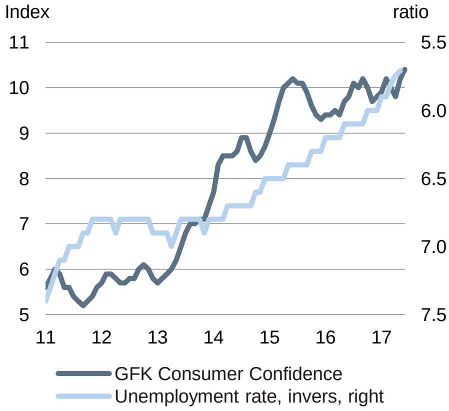
— Employment in 2017 so far, has been expanding at similar clip (50k per month) as in 2016, supporting private consumption growth, despite the oil price-induced pick-up in inflation. As a result our 1% consumption forecast for 2017 looks quite conservative.

— Exports have rebounded in the winter half – in line with global trade. The growth momentum of global trade seems to have peaked; therefore, we remain cautious, predicting 3.6% German export growth in 2017 after 2.7% last year.

— In combination with lingering geo-political uncertainty moderate export growth will weigh on investment spending, where a utilization rate of 2pp above its long-term average suggests a still limited necessity to invest.

— Following Q1 GDP growth of 0.6% we have revised our 2017 GDP forecast to 1.3% (1.1%). Latest confidence surveys, however, hint at further upside potential and increasing risks of over-heating risk for 2018.

Consumer confidence & unemployment 1

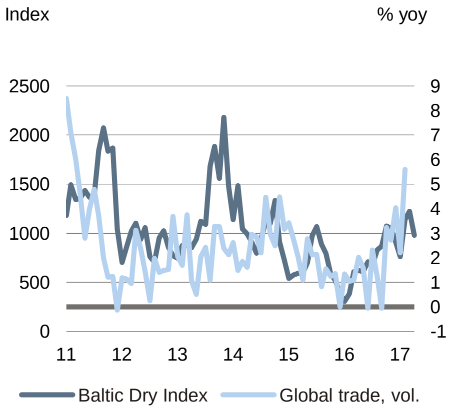


Sources: GFK, Deutsche Bundesbank

Full employment supports consumption growth despite higher inflation. Strong demand and the shortage especially of qualified workers continue to leave their mark on the labour market. Unemployment and the unemployment rate (5.7%) have dropped to historic lows in April, despite an increasing number of immigrants entering the market. Employment growth has kept last year's brisk pace and is up by 1.5% yoy. Nominal wage growth has picked up somewhat, due to higher settlements in the public sector kicking in. But for 2017 there is little risk of further acceleration given the almost completed wage round. Real wage growth has actually slowed in early 2017 given the oil-induced pick-up in inflation. As a result private consumption has shifted into slightly lower gear, after growing at an average 0.5% qoq between Q4 2014 and Q3 2016 when the price of oil (in EUR) almost halved. Given the expected normalisation in inflation, private consumption growth will slow to around 1% (vs. 2% in 2016), with the strong labour market and a renewed rise in consumer sentiment signalling upside risks to our forecast. Owing to fading influx of refugees government consumption should slow sharply after last year's 4% rise.

Construction finally pushing GDP growth

Baltic Dry Index & global trade 2

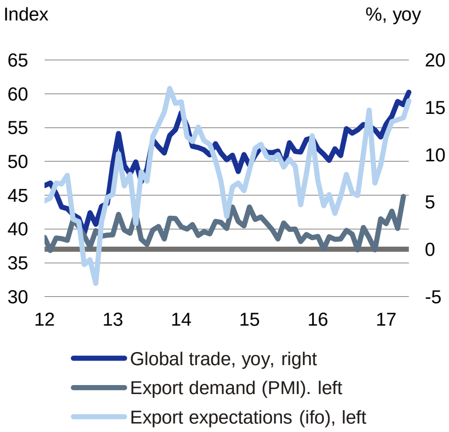


Sources: Reuters, CPB

The construction sector's lacklustre output growth seemed always at odds with the strong demand and price dynamics in the sector, in particular in the residential sector. Recently the Statistical Office published new output numbers based on an updated company sample. This has brought production more in line with buoyant demand and is also reflected in the 2.3% jump in Q1 construction output, with favourable weather also being supportive. Construction investment hence added 0.2pp to Q1 GDP growth although accounting for only 10% of total GDP. Still, even if the new construction statistics yields not only a higher output level but also brings somewhat stronger dynamics going forward the shortage in the housing market will prevail for some years as the housing market will continue to be hampered by a shortage of building land which is very inelastic due to multiple bureaucratic and ecological hurdles. Hence, we have lifted our forecast for this sector only marginally to slightly above 3%, making the housing market the only segment of the German economy where strong growth and ECB's policies have so far resulted in an overheating with respect to prices.

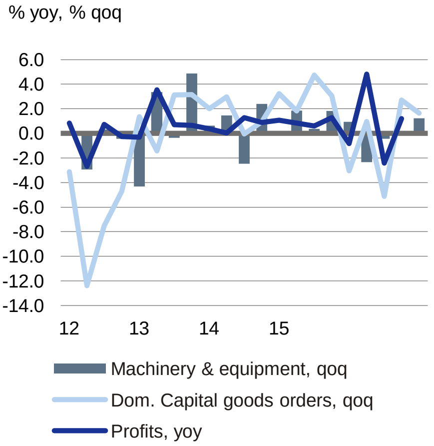
Exports & investment: Some improvement but no all-clear: During the winter half, global trade has overcome its partly oil price-induced slowdown in 2016. A

Export outlook has improved – for the time being 3



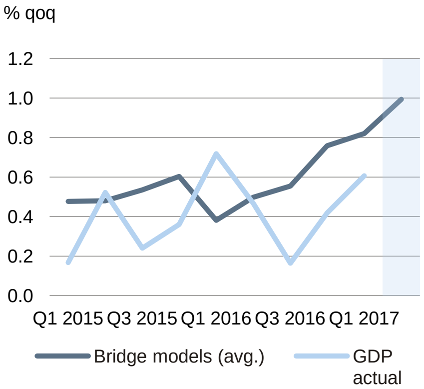
Sources: IFO, Markit, CPB

M&E spending: No all-clear 4



Source: Federal Statistical Office

Bridge models: Overstating growth, but by how much? 5



Sources: Deutsche Bundesbank, Markit, ifo, Deutsche Bank Research

somewhat stronger European economy has also been supportive. On the back of this, German trade and investment have strengthened somewhat. In Q1 equipment investment and net exports contributed to growth and we expect a further expansion throughout 2017. In May ifo export expectations reached their highest levels since late 2013, the assessment of export demand in the PMI was even the highest since 2010. However, there are signs, for example the drop in the Baltic Dry Index, suggesting that the global trade momentum might have peaked. In addition, the recent strengthening of the EUR should curtail export demand. Despite the EMU-related 4.8% mom jump in March foreign orders, external demand has essentially remained flat in Q1 compared to Q4 2016, providing further support for our cautious export outlook. The still unclear trend in external demand combined with ongoing geo-political uncertainty (US criticism of Germany's exports, Brexit, Italian elections, etc.) will likely prevent any surge in investment spending, despite the very strong readings of business climate surveys. During the last 6 months domestic capital goods orders have essentially moved sideways (Q1 0.7% yoy).

Federal elections with limited impact on 2017/18 growth: Based on current polls the elections (Sep. 24) are unlikely to yield substantially different policies. With ongoing fiscal surpluses the next government will embark on tax cuts in the range of at least ½% of GDP. Together with more infrastructure investments and more labour market regulation, overheating risks are on the rise for 2018.

Upside risk to our GDP forecast for Q2 and 2017: Since Q3 2016 bridge models based on soft data (ifo, PMI) have over-predicted actual qoq GDP growth by 0.3pp on average in each quarter. Still, they have correctly predicted the direction and even the acceleration of GDP growth! The unexpectedly strong surge in the May readings of the ifo and the PMI index have pushed these model forecast to around 1% for Q2. Even adjusting for their recent over-prediction would, according to these models, yield 0.7% GDP growth in Q2. This would push Germany's annual GDP growth to 1 ½%. So what are we waiting for? Except for April retail sales, which showed a 0.2% mom drop, we do not have any hard data for the second quarter. Furthermore April data – not only retail sales, but also output and order data should be treated with caution given the late location of Eastern in 2017.

Overheating risks for 2018: At any rate, no matter whether the economy will grow by 1.3% (DBe) or indeed 1.5% (upside risk) growth momentum will be at least as strong as last year when adjusted for calendar variations (which are reducing this year's growth rate by about 0.3pp). German GDP growth will thus have exceeded potential GDP growth (estimated at 1.2% by the Bundesbank[1]) by almost 1/2pp per year for the fourth consecutive year. Notwithstanding, that these kind of estimates and calculations have quite substantial error margins, 2017's GDP should exceed potential GDP by between 1 ½pp to 2pp in 2017. This positive output gap should widen further in 2018. Especially, if fiscal policy becomes even looser in 2018 and the ECB tightens very, very gradually. So far personal and institutional characteristics of the Germans and the German economy (low time preference, risk aversion, prudent borrowing/lending behavior, system collective wage setting, etc.) have – with the above mentioned exception of the housing market – prevented the economy from overheating. In 2018 the risks are clearly rising, especially, if the gradual reversal of monetary policy would prompt potential private and corporate borrowers to act swiftly.

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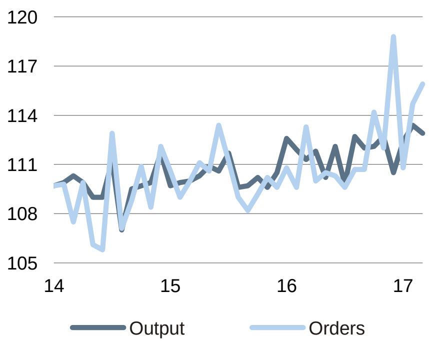
[1] Deutsche Bundesbank, Demographic change, immigration and the potential output of the German economy, Monthly Report April 2017

Start of the year showed quite good results 1

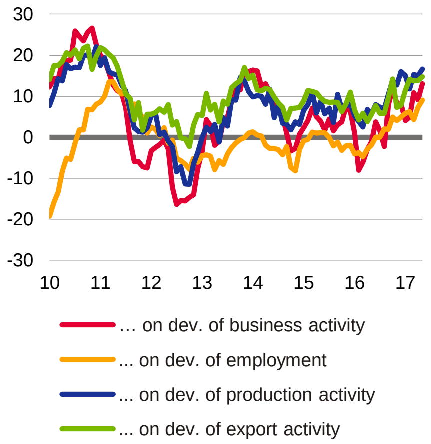
Start of the year showed quite good results



Source: Federal Statistical Office

Sentiment indicators in the German industry in positive territory 2

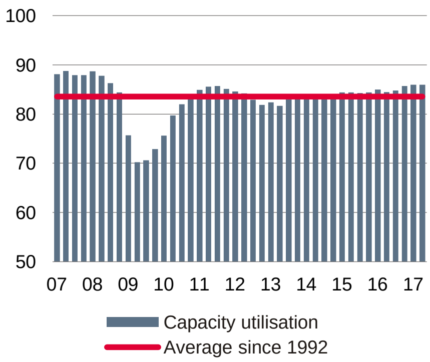
Company expectations, balance of positive and negative company reports



Source: ifo Institute

Capacity utilisation above long-term average 3

Capacity utilisation in the manufacturing industry in Germany, %



Source: ifo Institute

German industrial output: forecast for 2017 lifted to +1.5%

— We have raised our forecast for German manufacturing output growth in 2017 as a whole from +0.5% to 1.5% (both in real terms). In 2018, manufacturing output will probably increase by 1%. Manufacturing producer prices have risen quite steadily over the last few months, not least due to the uptrend in oil prices.

— Among the main capital goods sectors, electrical engineering did best at the beginning of 2017. We expect output in this sector to rise by 3% in 2017 as a whole. In contrast, we are more cautious about mechanical engineering (+1.5%) and the automotive industry (+1%). Within the metals sector, the processing industry (metal products) continues to grow more strongly than the producing industry. Output in the chemical sector looks set to stagnate in 2017, whereas the pharmaceutical industry might register the strongest output growth of all sectors, at 4% in real terms.

In Q1 2017, German manufacturing output rose 1% qoq in real terms. This was the third quarter-on-quarter increase in a row, and growth accelerated considerably in comparison to the two preceding quarters (+0.1% and +0.2% qoq, respectively). However, the month-on-month growth rates still fluctuate strongly. Order intake was down 1% qoq in real terms in Q1 2017, but this should be taken with a grain of salt, as the increase in Q4 was exceptionally strong, at more than 4% qoq. Month-on-month order intake figures are currently quite volatile, too.

The latest ifo indices for the manufacturing sector suggest that domestic production will continue to rise in the coming months. Business expectations as well as output and export expectations are clearly above the expansion threshold. In fact, companies are more confident about their current business situation than at any time since mid-2011. Moreover, capacity utilisation reached its highest level since autumn 2008 at the beginning of Q2 2017.

Sentiment was probably boosted by the considerable rise in demand from abroad. In Q1 2017, German goods exports were up 8.5% year-on-year (in nominal terms) after having risen by only about 1% in 2016 as a whole. Still, the year-on-year comparison is a bit distorted by the fact that Easter fell in Q1 in 2016, but in Q2 in 2017, which means that Q1 2017 had more working days than Q1 2016. Nevertheless, world trade was slightly more dynamic than we had expected at the beginning of the year. Domestic investment activity remains subdued. We expect investment in machinery and equipment to rise only marginally in 2017 as a whole. We are more optimistic about construction investment, which is supported by residential construction.

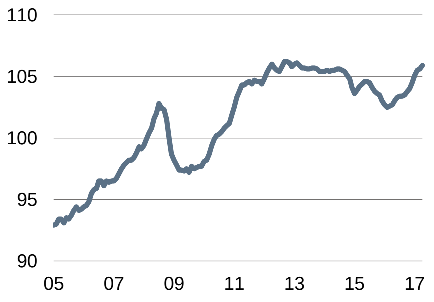
Overall, the favourable influences predominate. We have therefore raised our forecast for German manufacturing output growth in 2017 as a whole from +0.5% to 1.5% (both in real terms). In 2018, manufacturing output will probably increase by 1%. Manufacturing producer prices have risen quite steadily over the last few months, not least due to the uptrend in oil prices. Producer prices in the industrial sector tended to move sideways in the years before.

Different momentum in the individual capital goods sectors

Among the major capital goods sectors, electrical engineering is currently doing best. Domestic output was up 2.2% qoq in real terms in Q1 2017. This was the strongest increase since Q3 2011 and the sixth quarter-on-quarter rise in a row. Order intake rose at the beginning of the year, too, namely by 2.3% qoq in real terms in Q1. Exports of electronic/electrical goods are an important pillar of

Recovery of producer prices continues 4

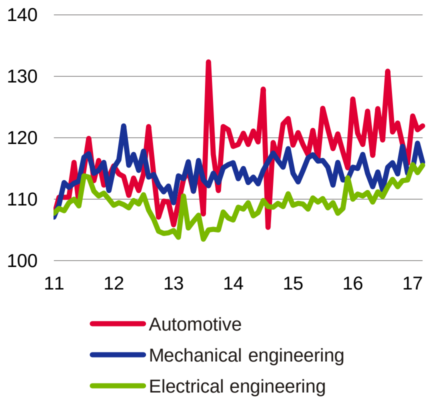
Producer prices in the manufacturing sector
DE, 2010=100



Source: Federal Statistical Office

Electrical engineering on the rise 5

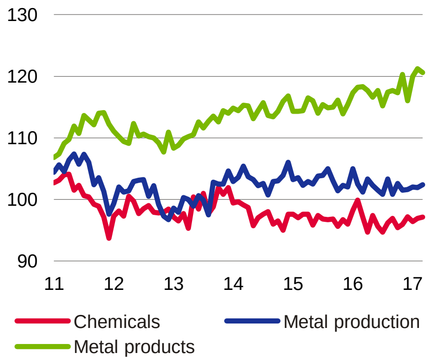
Production in selected sectors in DE, 2010=100



Source: Federal Statistical Office

Chemical industry has stopped downward trend 6

Production in selected sectors in DE, 2010=100



Source: Federal Statistical Office

output growth. In the first three months of the year, nominal exports were up by almost 11% yoy. In particular, exports to China and the US have risen considerably so far this year. Business expectations in electrical engineering have been trending upwards for some months now and are clearly in positive territory. And this is even truer of the current situation. Construction-related sub-sectors of electrical engineering are benefiting from the expansion in residential construction. Overall, we have raised our output growth forecast for electrical engineering from +1% to +3% for 2017 as a whole.

Output in the German automotive industry rose 2.7% qoq in real terms in Q1 2017, i.e. even more strongly than that of electrical engineering. However, the increase in Q1 was not sufficient to offset the major decline registered in Q4 2016 (-3.8% qoq). In addition, order intake in the auto sector has been trending downwards for a few months now. Business expectations have recently even become negative, even though the current situation is still mostly regarded as favourable. In addition, capacity utilisation declined considerably at the beginning of Q2 2017. However, there is also some positive news. Car sales have continued to recover in Germany and most other European countries at the beginning of 2017. Germany, as a production location, is benefiting from this development. Moreover, the sector increased its exports to the world's two largest car markets, China and the US, in year-on-year terms during the first three months of 2017 even though the overall momentum in these markets slowed. In contrast, exports to the UK declined by almost 10% yoy in nominal terms; however, the year-on-year figure is dragged down by the depreciation of the British pound versus the euro. Overall, we have raised our cautious forecast for auto output in Germany from +0.5% to +1% for 2017 as a whole.

In mechanical engineering, both domestic production and total order intake were up 0.9% qoq in real terms in Q1 2017. Both series rose for the third quarter in a row. At the same time, output figures fluctuate considerably from month to month, whereas order intake trended firmly upwards in the last few months. In addition, capacity utilisation in mechanical engineering has risen for three quarters in a row and business expectations are optimistic. So far this year, the considerable increase in nominal mechanical engineering exports to China and Russia boosted the sector. German exports of machinery and equipment to Russia declined from 2013 to 2016, even considerably in some years, but now a turnaround seems to be on the cards. We have revised our output forecast for mechanical engineering, too, from +0.5% to +1.5% in 2017 as a whole.

Chemical industry still relatively weak, plastics and metal products doing better

The chemical industry (excluding pharmaceuticals) has been the problem child of the major German industries in the last few years. Between 2011 and 2016, domestic output dropped in four out of six years. At the beginning of the year, the signals from the sector were mixed. While output was up 0.7% qoq in price-adjusted terms in Q1 2017, order intake was down 0.5% qoq in the same period. At the same time, German chemical companies are optimistic about the business outlook for the coming six months. Capacity utilisation also rose to its highest level since the beginning of 2008 at the beginning of Q2 2017. Producer prices have trended upwards during the last few months, not least due to higher oil prices. Overall, we expect output in the chemicals sector to stagnate in 2017. Before, we had forecast a decline by 1%.

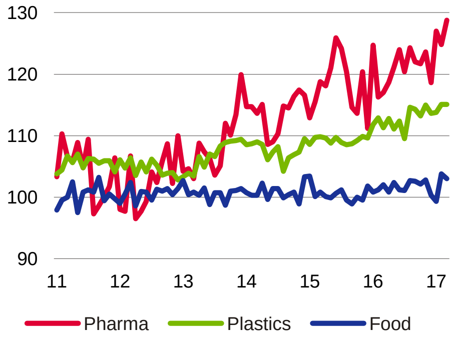
The German plastics industry continued on the favourable growth path of the past two years. While domestic output was up "only" 0.6% qoq in real terms in Q1 2017, this was the sixth quarter-on-quarter increase in a row. The uptrend is obviously intact. The sector benefits from consumer-related demand and high residential construction activity. We expect output to rise 2.5% in real terms in 2017 as a whole.

Metal processing companies (metal products) saw their output rise 2.3% yoy in real terms during Q1. The sector benefited from demand by industrial customers, households and residential construction. We have lifted our output forecast for the metal processing industry from +0.5% to +2.5% for 2017. We are more cautious about metal production itself and expect domestic output to stagnate in 2017. In any case, producer prices in the metals sector have been trending upwards in the last few months – a good sign for corporate earnings in this sector.

Pharmaceuticals will probably register the strongest growth rate in 2017; slight growth in the food processing industry

Pharma and plastics industry show an upward trend 7

Output in selected sectors in DE, 2010=100



Source: Federal Statistical Office

Output in the pharmaceuticals sector is still fluctuating considerably from month to month. This makes it more difficult to calculate an accurate forecast. Output was up 4.6% qoq in real terms in Q1 2017, and order intake even increased by more than 5% qoq, with a jump in export orders in March 2017 driving the figure up. We believe that the pharmaceuticals industry will be unable to maintain the very strong output momentum seen in the last few months over the whole of 2017. That is why we forecast output growth of "only" 4% for 2017 as a whole; nevertheless, this would make the pharmaceuticals sector the growth leader among German industrial sectors. At the moment, our estimates even tend to be too cautious. In early 2017, pharmaceutical exports to the US or Switzerland are booming (and those to the UK declining), and the sector is benefiting from migration to Germany, even though this effect will be less pronounced in 2017 than in 2016.

Food processing is one of the industrial sectors with the highest turnover in Germany and well-known for its low cyclical volatility. It started relatively calmly into the year. Output rose 0.3% qoq in Q1 2017, and we forecast output growth of 1% for 2017 as a whole. Producer prices have risen palpably since mid-2016. However, price pressures remain strong due to the market power of food retailers.

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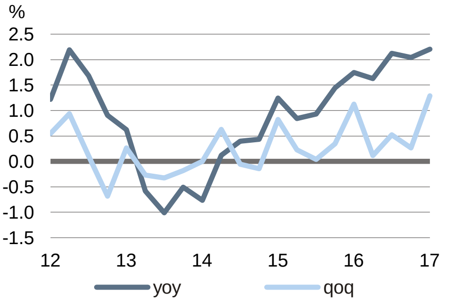
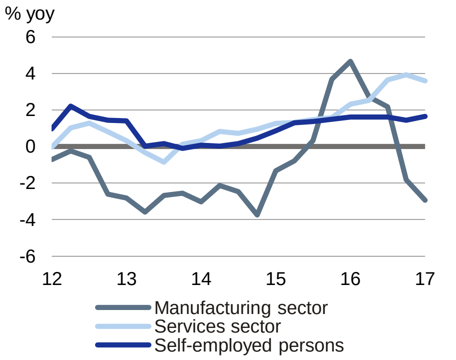
Loans to domestic companies and self-employed persons* 1



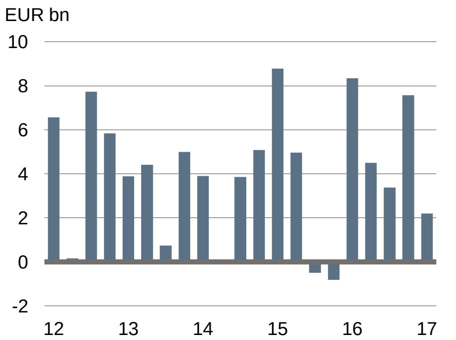
* excl. other financial institutions
Sources: Bundesbank, Deutsche Bank Research

... by industry 2



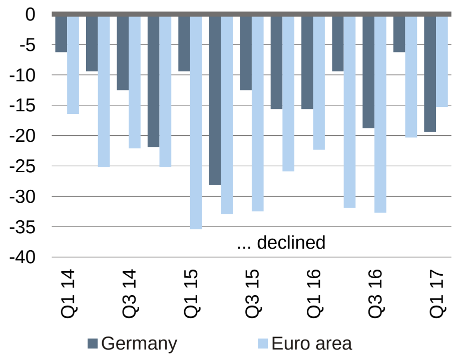
Sources: Bundesbank, Deutsche Bank Research

Net bond issuance by domestic non-financial companies 3



Sources: Bundesbank, Deutsche Bank Research

Bank lending survey: margins for average corporate loans 4



Sources: Bundesbank, ECB

Corporate funding in Q1 – lending: There is a limit to everything; a breather in the bond business

— Solid lending to German companies in Q1 – driven by the construction sector and retail & wholesale trade, held back by real estate-related industries.

— Cooperative banks and savings banks once again grow most.

— Bond issuance takes a breather after a record-breaking year in 2016.

Lending to German companies and self-employed persons was once again solid in the first quarter of 2017. The lending volume rose by EUR 15.6 bn, and thus was up 2.2% year-on-year. However, the increase was driven by a small number of industries, while momentum in key sectors declined. Lending to the manufacturing sector recovered slightly in the first three months; however, year on year the volume declined by 2.9% on the back of a very strong first quarter of last year and the subsequent slump. Lending to the largest individual manufacturing industry, mechanical engineering/automotives, declined by 8.4%, outstanding loans to the metals industry are down 2.5% and those to the electrical engineering industry by 3%. Momentum in the services sector also fell slightly (growth rate 3.6% yoy) following the boom seen in recent quarters. The real estate-related industries, in particular, reported a slowdown, while lending to investment companies rose sharply. The tourism, telecom/consulting/advertising and healthcare industries all recorded robust growth. Among the other sectors, lending to construction companies and retail & wholesale trade made strong gains between December and March, by EUR 4.7 bn and EUR 3.3 bn, respectively. In fact, the rise in the construction industry was the greatest ever seen in a quarter since German reunification, and that in retail & wholesale trade was the greatest in five and a half years.

Long tenors (maturities > 5 years) continued to develop positively; the current 3.5% yoy increase is the highest level seen since the New Economy bubble. Short tenors (maturities < 1 year), on the other hand, continued on their downward trend, declining by 4.8%. Among the different banking groups, cooperative banks as well as savings banks recovered from their minor setbacks in Q4, with both recording growth in lending to companies and self-employed persons of about 5% yoy. Domestic commercial banks, on the other hand, are performing significantly poorer; although they got off to a decent start to the year, yoy growth only amounted to 1.7%.

Among the alternative sources of financing, bond issuance by non-financial companies calmed down slightly at the start of the year following a record-breaking year in 2016. Net new issues here only amounted to EUR 2.2 bn. With a net issuance of EUR 4.9 bn, commercial papers, on the other hand, had the best quarterly result since 2011, while leasing posted its best-ever Q1 volume of new contracts concluded at EUR 12.6 bn. Competitive pressure for bank loans therefore remains high, which was also reported in the Bank lending survey (BLS): the banks once again confirmed that they have eased the actual credit conditions (more for larger companies than for smaller ones) and that margins for average loans have shrunk from quarter to quarter for the past three years now. Such a persistent decline is unprecedented since the introduction of the BLS almost a decade and a half ago. At the same time, a net 13% of the surveyed banks reported that demand for loans rose once more in Q1.

More information (in German only)

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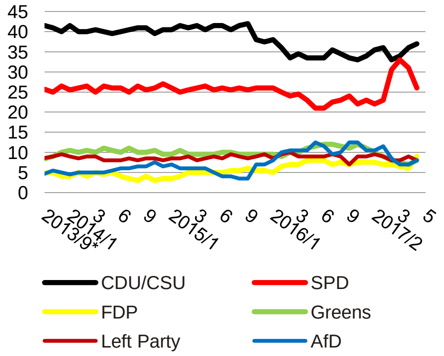
The view from Berlin

German parties' popularity 1

Results of the Allensbach survey, %

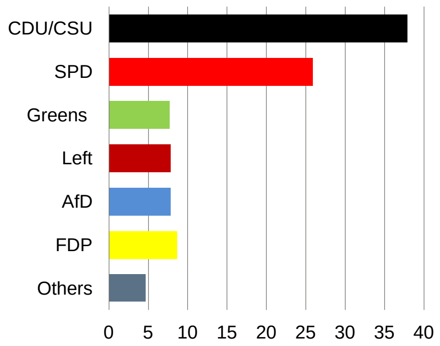


* Result of the federal election on September 22

Source: IfD Allensbach

Major political parties' popularity on the federal level* 2

Surveys published from mid- to end-May 2017, %

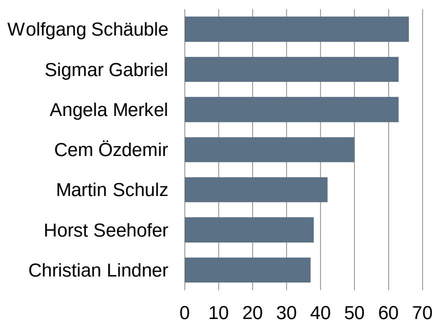


* Average of major surveys (Allensbach, Infratest Dimap, Forsa, Forschungsgruppe Wahlen, TNS Emnid)

Source: Wahlrecht.de

The German's assessment of major politicians' performance 3

Q: "Are you (very) satisfied with the respective politicians' work?"*, percentage of those asked



* Politicians selected from Infratest dimap's more comprehensive list

Source: Infratest dimap: ARD-Deutschland Trend (May 2017)

Smaller parties: fighting for public attention

Political observers in Germany have recently been focusing on the SPD's ups and downs in the polls and the CDU's reverse showing. In fact, the surge in the SPD's approval rating by more than 10pps in the first two months after Martin Schulz' nomination as frontrunner in the federal election campaign was unprecedented in Germany's opinion polling. And the recent plunge in the polls following the SPD's defeat in the Saarland state election on March 26 has hardly been less spectacular. In contrast, Chancellor Merkel's CDU seems to enjoy a continued boost – for now. Likely fuelled by the victories in the state elections in Schleswig-Holstein (SH) and in North-Rhine Westphalia (NRW) on May 7 and 14, respectively, the CDU surpassed the SPD by 12pps in the most recent polls. Thus, its lead is nearly as large as it was prior to the SPD's surprising personnel decision.

As many eyes are still on the two major parties, the smaller ones have attracted much less attention. But here, the polls indicate interesting swings in the public sentiment, too: (i) The Greens' popularity rating has fallen below the 10-percent mark. (ii) The FDP has re-established itself clearly above the 5% threshold. (iii) The AfD's heydays seem to have passed only the Left party's ratings have remained relatively stable.

The Greens' public support – at present at about 7.5% – has declined by about one third over the past seven months. In the important NRW state election the Greens even lost nearly 40% of the eligible votes compared to the election in 2012 albeit the general turnout increased by 5.6pps. They just reached 6.4% vs. 11.4% in 2012. Those were the Greens' good times when they were expected to become the third big party besides the CDU and the SPD.

Partially, the Greens' declining popularity in Q1 2017 can be explained by the SPD's upswing at that time, given the overlaps in both parties' political positioning. In the party's draft election platform and even more in papers agreed at a party convention in autumn 2016 the Greens presented tax and labour market policy proposals suggesting a relatively leftish approach based on the idea of social justice. Among others, the Greens stressed the necessity of a wealth tax which promises high revenues. These, however, are the SPD's traditional positions, too, and Mr. Schulz has even more strongly promoted „social justice". So the question is not why the Greens lost while the SPD gained, but why it did not work the other way round in the past few months.

The media have repeatedly reported on differences between the Greens' dogmatic, more leftish wing and the pragmatic wing. Commenting on the defeat in NRW, the most prominent representative of the latter group, Baden-Wuertemberg's state MP Kretschmann blamed the Greens in NRW for an "excessive-idealistic dogmatism" [„idealistischer Überschuss"] (FAZ, May 22). The Greens' two frontrunners in the federal election campaign, Katrin Göring-Eckhard and Cem Özdemir, are longstanding, pragmatic party figures. So a more leftish version of the election platform, which is to be finalized and agreed at a party convention mid-June, would be a déja vue for Mrs. Göring-Eckhard, who was one of the top candidates in the last federal election, too. In 2013 the Greens gained 8.4% and thus failed to meet higher expectations.

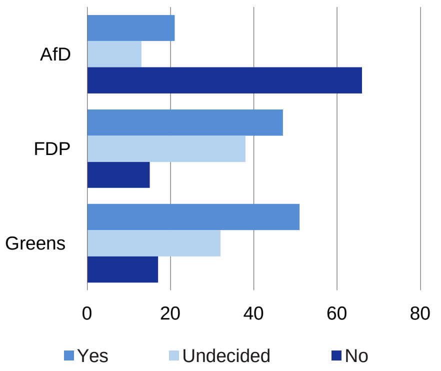
Against this background, the Greens currently published a short position paper with '10 essentials for green politics'. Prominent representatives from both wings have signed it. The paper is clearly focused on ecological issues while much debated issues such as the introduction of a wealth tax are missing. It remains to be seen, however, whether the final election platform will be alleviated in this way, too. Of course, it would be easier for the pragmatic frontrunners to promote such a platform, which also would fit better as basis for possible coalition talks with the CDU/CSDU (and the FDP) after the September election. From the present point of view (polls) such a Jamaica coalition is the sole arithmetically feasible alternative to a renewed grand coalition.

In contrast to the Greens, the FDP seems to be in an upswing. The Liberal's popularity rating is at 8% in most polls and in the latest state elections in SH and NRW, the party came in at double digit figures. In both states the FDP was able to field popular top candidates. Party-leader Lindner, who run successfully in NRW, is also the frontrunner in the federal election campaign. Lindner has positioned the FDP as an alternative to the SPD as well as to the CDU. He has criticized the SPD as "backward-looking" and Chancellor Merkel clinging merely to the status-quo (FAZ net 28.04.). He also presents himself as a personnel alternative to the two bigger parties' top candidates. He is only 38, i.e. much younger than Merkel and Schulz. He appears more dynamic and, e.g., uses the social media intensively.

The FDP seems to build on a twofold strategy. Lindner pushes the classic liberal topics such as massive cuts in taxes in the amount of EUR 30 bn to 40 bn and the reduction of red tape to enhance flexibility especially on the labour market. But he also extended his party's message on issues that are not purely economic like education and migration. Academics have labelled the FDP as "protest party light" for the middle class.[2] However, such a strategy has also its shortcomings. The more the FDP tries to stand aloof from the two big parties the higher is the risk to lose credibility in case it gets the option to join one of them to establish a coalition government after September 24.

Germans' attitude towards smaller parties' parliamentary representation 4

Q: "Do you think it is good if the party will hold seats in the next Bundestag?", % of those asked

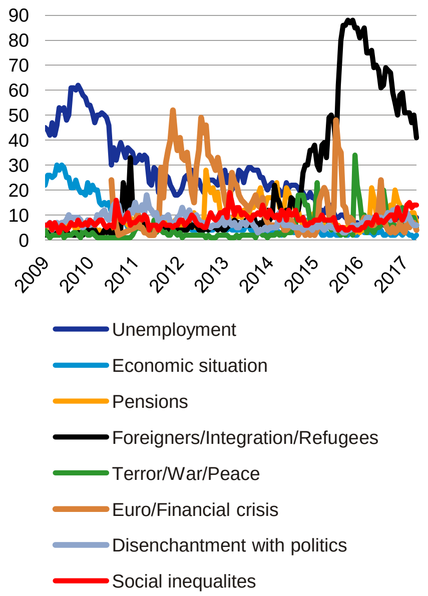


Sources: IfD Allensbach, FAZ

So far, the Germans have primarily associated the AfD with the idea of a protest party. But according to a recent survey (Allensbach Institute) the AfD seems to become a party for a small isolated minority only.[3] Recently 74% of those asked have stated that the AfD is not a normal democratic party. In 2015 only 62% thought so. And at present only 15% are in principle prepared to vote for the AfD in any election. 21% would applaud if the populist party managed to clear the 5% threshold and thus to hold seats in the Bundestag. The FDP and the Greens have much higher approval ratings here, namely, 47% and 51%, respectively.

Most important problems in Germany 5

max 2 answers



Source: Forschungsgruppe Wahlen: Politbarometer (19.05.2017)

At present the Germans citizens primarily see the AfD as a party that wants to strictly limit the influx of refugees. Given the decline in the number of refugees and the federal government's more restrictive asylum policy, this issue has lost its former explosive force. Nevertheless, the Germans still worry. In the latest survey (Forschungsgruppe Wahlen) 41% (but autumn 2015 more than 80%) of those asked stated that immigration/refugees is Germany's most important problem while social inequality ranked 2nd with 14% only. The AfD's results in the recent state elections as well as the party's popularity ratings on the federal level are in line with these various findings. In all three state elections the AfD managed to clear the 5% threshold but remained markedly below double digit figures. According to recent polls, the federal election could end with a similar result.

Compared to the other smaller parties the Left's approval rating has been more stable in the past four years since the 2013 election. In the Allensbach Institute poll the rating has hovered between 8% and 10%, albeit at the lower end of this range recently. This reflects the party's relatively strong position in East Germany. There, the party is represented in all state parliaments and there it got double digit results in the latest state elections in 2016. The performance in this year's state elections in West Germany was mixed, however. While the Left succeeded

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2 Butzlaff, Felix and Micheal Freckmann (2016). Wahlanalyse: FDP als Protestpartei light. Göttinger Institut für Demokratieforschung. http://www.demokratie-goettingen.de/blog/fdp-landtagswahlen2016

3 See Thomas Petersen (2017). Am Rand. FAZ No. 121, May 26, p8.

in the Saarland (12.8%), it missed the 5% threshold in SH as well as in NRW. In all the three states, i.e. including the Saarland, the voters clearly rejected the idea of red-red-green coalition, however. As mentioned above, according to all recent polls an alliance among the SPD, the Greens and the Left is also no arithmetically feasible option for a future coalition government on the federal level.

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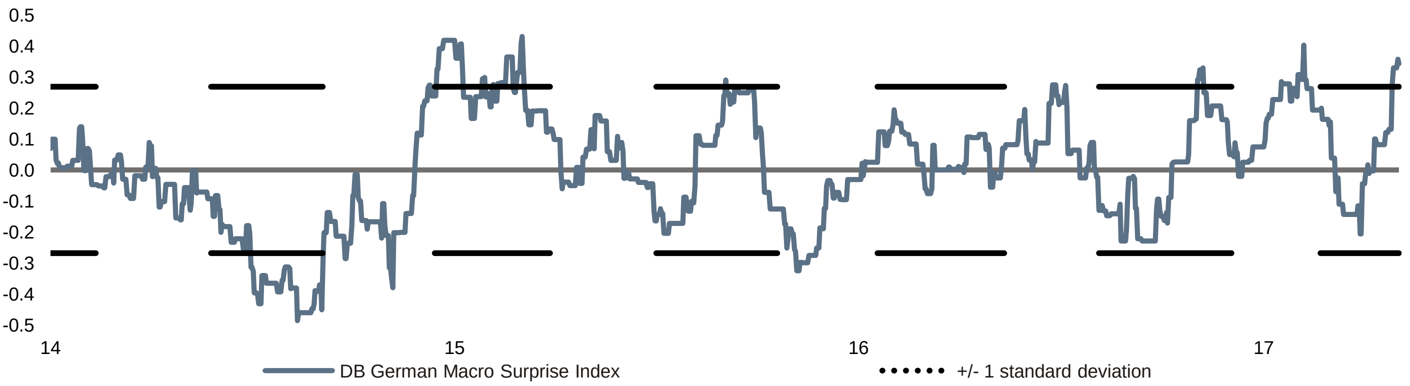
DB German Macro Surprise Index

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	4 2017	24/04/2017	113.0	112.4	0.6	0.3	0.6
GRFRIAMM Index	Retail Sales (% mom)	3 2017	28/04/2017	0.2	0.0	0.2	0.4	0.7
GRIMP95Y Index	Import Price Index (% yoy)	3 2017	28/04/2017	6.1	6.5	-0.4	0.0	0.4
MPMIDEMA Index	Markit Manufacturing PMI	4 2017	02/05/2017	58.2	58.2	0.0	0.0	0.5
GRUECHNG Index	Unemployment Change (000's mom)	4 2017	03/05/2017	-15.0	-11.0	4.0	-0.1	0.5
MPMIDESA Index	Markit Services PMI	4 2017	04/05/2017	55.4	54.7	0.7	0.8	0.8
GRIORTMM Index	Factory Orders (% mom)	3 2017	08/05/2017	1.0	0.7	0.3	0.1	0.6
GRIPIMOM Index	Industrial production (% mom)	3 2017	09/05/2017	-0.4	-0.7	0.3	0.3	0.6
GRCAEU Index	Current Account Balance (EUR bn)	3 2017	09/05/2017	30.2	26.5	3.7	0.8	0.8
GRCP20YY Index	CPI (% yoy)	4 2017	12/05/2017	2.0	2.0	0.0	0.2	0.3
GRZECURR Index	ZEW Survey Current Situation	5 2017	16/05/2017	83.9	82.0	1.9	0.2	0.6
GRZEWI Index	ZEW Survey Expectations	5 2017	16/05/2017	20.6	22.0	-1.4	-0.2	0.5
GRGDPPGQ Index	GDP (% qoq)	3 2017	23/05/2017	0.6	0.6	0.0	-0.1	0.3
GRIFPBUS Index	IFO Business Climate	5 2017	23/05/2017	114.6	113.1	1.5	1.0	0.8
MPMIDESA Index	Markit Services PMI	5 2017	23/05/2017	55.2	55.5	-0.3	-0.3	0.4
GRIMP95Y Index	Import Price Index (% yoy)	4 2017	30/05/2017	6.1	6.3	-0.2	0.2	0.5
GRCP20YY Index	CPI (% yoy)	5 2017	30/05/2017	1.5	1.6	-0.1	-0.4	0.2
GRUECHNG Index	Unemployment Change (000's mom)	5 2017	31/05/2017	-9.0	-15.0	-6.0	-0.4	0.3
GRFRIAMM Index	Retail Sales (% mom)	4 2017	31/05/2017	-0.2	0.3	-0.5	-0.1	0.4
MPMIDEMA Index	Markit Manufacturing PMI	5 2017	01/06/2017	59.5	59.4	0.1	0.1	0.5

Sources: Bloomberg Finance LP, Deutsche Bank Research

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.

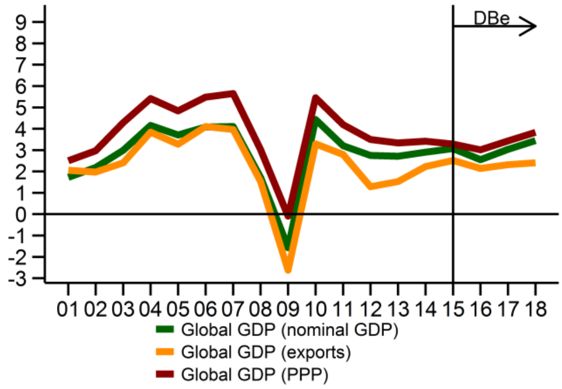
Updated by Marc Schattenberg and Jochen Möbert (+49 69 910-31727, jochen.moebert@db.com)
Source: Heiko Peters (2014). DB German Macro Surprise Index. Focus Germany, 4 August 2014.

German Export Indicator

The Export Indicator identifies the effects on German exports of changes in global demand on the one hand, and currency movements on the other (price impact).[4]

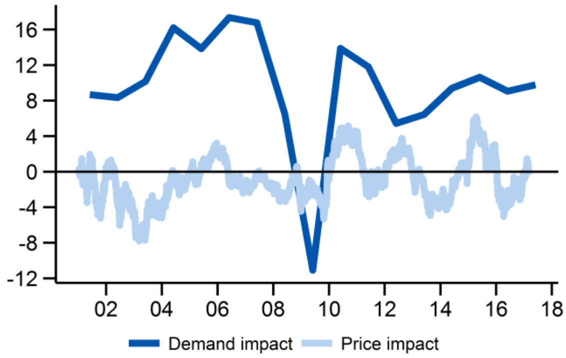
Global growth expected to accelerate

% yoy, weighting factor in brackets



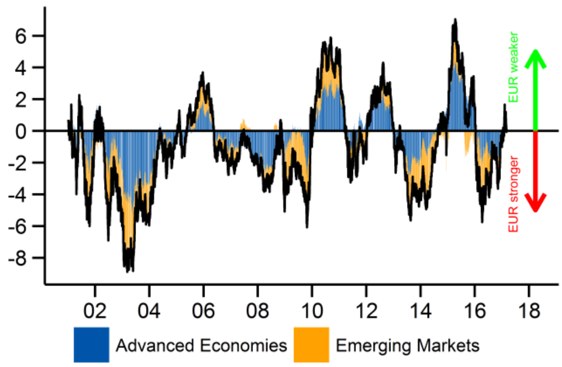
Demand and price impact for German exports

% yoy



Price impact about neutral so far in 2017

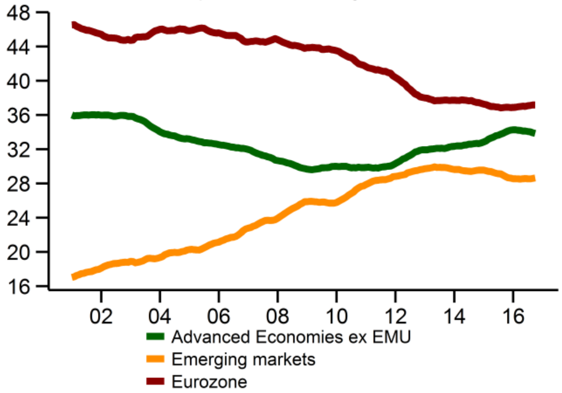
% yoy



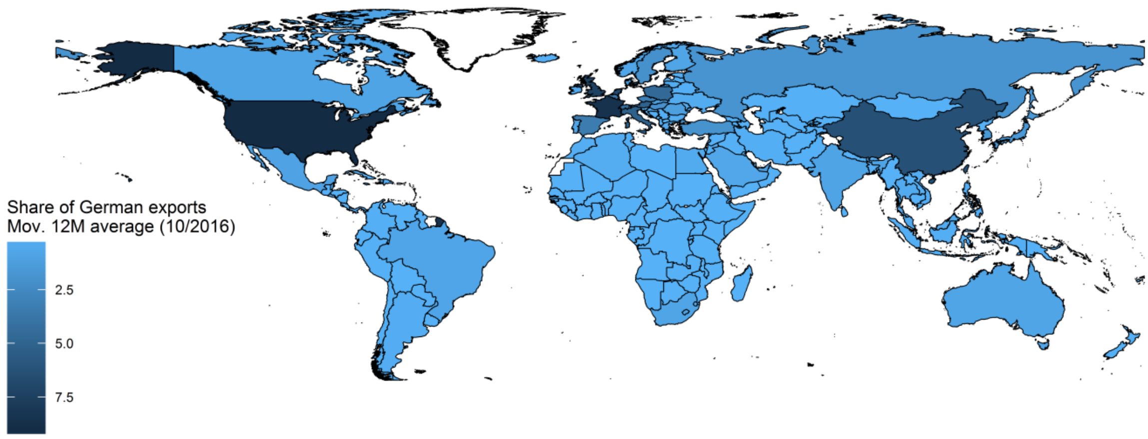
Weighed EUR yoy change using German export destination shares

Importance of EMU increased again recently

% of total German exports, 12M mov. avg.



German exports focus on Europe, the USA and China



Sources: Eurostat - Comext, Deutsche Bank Research

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[4] See for details Focus Germany, March 3, 2016.

Strong economy supports Merkel's re-election chances

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

Date	Event	Remarks
8 June	ECB Governing Council meeting, press conference, Tallinn	We expect forward guidance to be adjusted in June, tapering to be pre-announced in September and a one-off deposit rate hike in December. The risks are that the change to forward guidance could be delayed beyond June.
15-16 June	Eurogroup and ECOFIN, Brussels	(Poss.) Implications of the spring forecast for EDPs/EIPs for euro area countries, thematic discussion on growth and jobs – quality of public finances, Greece – state of play, Banking Union, preparation of the June European Council among others.
16-18 June	The Greens party convention, Berlin	Final debates on the party's election platform and launch of the programme.
22-23 June	European Council, Brussels	Debates on the future of the EU and (poss.) on the Brexit negotiations.
25 June	SPD, special party convention, Dortmund	Adoption of the party's election programme which is very likely to focus on "social justice".
early July	CDU/CSU (t.b.c.)	Final debates on the sister parties' joint election platform and launch of the programme which is likely to include an Agenda 2025 for the creation and preservation of jobs (exact date still open).
7-8 July	G20 Summit, Hamburg	Debates on international economic, fiscal policy and trade policy issues, among others. The G20 summit will attract special attention as it is the first such event that US President Trump will visit.
10-11 July	Eurogroup and ECOFIN, Brussels	Agenda not yet published. Possibly Greece, Banking Union, among others.
20 July	ECB Governing Council meeting, press conference	Review of monetary policy stance (see above June 8).

Source: Deutsche Bank Research

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Germany: Data calendar

Date	Time	Data	Reporting period	DB forecast	Last value
7 Jun 2017	8:00	New orders manufacturing (% mom, sa)	April	0.4	1.0
8 Jun 2017	8:00	Industrial production (% mom, sa)	April	1.0	-0.4
9 Jun 2017	8:00	Trade balance (EUR bn, sa)	April	19.1	19.5
9 Jun 2017	8:00	Merchandise exports (% mom, sa)	April	0.4	0.4
9 Jun 2017	8:00	Merchandise imports (% mom, sa)	April	1.0	2.5
23 Jun 2017	9:30	Manufacturing PMI (Flash)	June	58.8	59.5
23 Jun 2017	9:30	Services PMI (Flash)	June	55.6	55.2
26 Jun 2017	10:30	ifo business climate (Index, sa)	June	113.5	114.6
29 Jun 2017	14:00	Consumer prices preliminary (% yoy, nsa)	June	1.4	1.5
30 Jun 2017	8:00	Retail sales (% mom, sa)*	May	0.5	-0.2
30 Jun 2017	10:00	Unemployment rate (%, sa)	June	5.7	5.7

*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

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Strong economy supports Merkel's re-election chances

German data monitor

	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Dec 2016	Jan 2017	Feb 2017	Mar 2017	Apr 2017	May 2017
Business surveys and output											
Aggregate											
Ifo business climate	107.8	108.3	110.6	111.1		111.0	109.9	111.1	112.2	113.0	114.6
Ifo business expectations	101.8	102.5	105.5	104.2		105.3	103.1	104.0	105.4	105.2	106.5
Industry											
Ifo manufacturing	101.8	102.7	105.3	106.0		105.1	104.5	105.8	107.7	107.9	110.3
Headline IP (% pop)	-0.5	0.3	0.0	1.3		-1.8	1.3	1.8	-0.4		
Orders (% pop)	-0.8	0.1	4.2			6.1	-6.8	3.4			
Capacity utilisation	84.5	84.8	85.7	86.0	86.0						
Construction											
Output (% pop)	-1.0	1.7	-1.4	4.8		-0.2	-6.6	17.0	2.9		
Orders (% pop)	-0.3	-4.2	7.9	0.9		0.4	-0.3	2.0	-0.5		
Ifo construction	124.8	126.9	129.6	128.4		130.6	129.1	127.5	128.5	129.8	130.5
Consumer demand											
EC consumer survey	-3.2	-2.5	-1.5	-0.6		-0.7	0.2	-2.1	0.2	2.8	3.1
Retail sales (% pop)	-0.1	0.5	0.9	-0.1		0.5	-1.0	1.1	0.2	-0.2	
New car reg. (% yoy)	9.4	4.2	-0.3	6.7		3.7	10.5	-2.7	11.4	-8.0	
Foreign sector											
Foreign orders (% pop)	-2.1	1.8	3.1	-0.4		4.6	-4.5	0.4	4.8		
Exports (% pop)	0.4	-0.2	2.4	2.8		-2.1	2.5	0.9	0.4		
Imports (% pop)	-1.2	1.4	3.7	3.7		0.1	2.7	-1.6	2.5		
Net trade (sa EUR bn)	65.6	61.8	60.1	59.6		18.6	18.9	21.2	19.5		
Labour market											
Unemployment rate (%)	6.1	6.1	6.0	5.9		6.0	5.9	5.9	5.8	5.8	5.7
Change in unemployment (k)	-26.3	-26.0	-32.7	-61.0		-20.0	-25.0	-16.0	-28.0	-15.0	-9.0
Employment (% yoy)	1.2	1.2	1.3	1.5		1.4	1.5	1.5	1.5	1.5	
Ifo employment barometer	108.2	109.0	111.2	110.3		111.9	110.7	110.7	109.4	111.4	110.8
Prices, wages and costs											
Prices											
Harmonised CPI (% yoy)	0.0	0.4	1.0	1.9		1.7	1.9	2.2	1.5	2.0	1.4
Core HICP (% yoy)	1.0	1.1	1.2	1.0		1.4	1.1	1.1	0.9	1.6	
Harmonised PPI (% yoy)	-2.6	-1.7	0.2	2.8		1.0	2.4	3.1	3.1	3.4	
Commodities, ex. Energy (% yoy)	-6.5	2.9	19.2	32.7		29.5	34.5	37.7	26.3	16.5	8.3
Crude oil, Brent (USD/bbl)	45.6	46.6	51.1	54.5		54.9	55.4	56.0	52.6	53.8	51.4
Inflation expectations											
EC household survey	3.6	6.2	10.0	18.9		10.8	17.3	18.9	20.6	17.4	17.5
EC industrial survey	1.7	3.0	6.2	13.0		6.3	11.4	13.8	13.8	11.7	13.4
Unit labour cost (% yoy)											
Unit labour cost	0.4	1.8	2.3	1.1							
Compensation	2.0	2.3	2.3	2.3							
Hourly labour costs	0.6	2.4	3.4	0.8							
Money (% yoy)											
M3	7.2	6.6	5.7	6.0		5.7	5.7	5.6	6.0	5.1	
M3 trend (3m cma)	7.1	7.0	5.4	5.7		5.4	5.5	5.6	5.7	5.5	
Credit - private	2.7	2.6	2.9	3.3		2.9	3.1	3.0	3.3	3.1	
Credit - public	9.7	-0.1	8.9	21.0		8.9	15.5	18.4	21.0	11.5	

% pop = % change this period over previous period.
Sources: Deutsche Bundesbank, European Commission, Eurostat, Federal Employment Agency, German Federal Statistical Office, HWWI, ifo, Markit

Strong economy supports Merkel's re-election chances

Financial forecasts

	US	JP	EMU	GB	CH	SE	DK	NO	PL	HU	CZ
Key interest rate, %											
Current	0.875	-0.10	0.00	0.25	-0.75	-0.50	0.05	0.50	1.50	0.90	0.05
Jun 17	1.125	-0.10	0.00	0.25	-0.75	-0.50	0.05	0.50	1.50	0.90	0.05
Sep 17	1.125	-0.10	0.00	0.25	-0.75	-0.50	0.05	0.50	1.50	0.90	0.15
Dec 17	1.375	-0.10	0.00	0.25	-0.75	-0.50	0.05	0.50	1.50	0.90	0.25
3M interest rates, %											
Current	1.21	0.06	-0.33	0.29							
Jun 17	1.48	0.05	-0.30	0.35							
Sep 17	1.73	0.05	-0.30	0.40							
Dec 17	1.73	0.05	-0.30	0.40							
10J government bonds yields, %											
Current	2.18	0.05	0.28	1.03							
Jun 17	2.25	0.05	0.40	1.15							
Sep 17	2.50	0.03	0.55	1.40							
Dec 17	2.75	0.00	0.70	1.55							
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	1.12	111.00	0.87	1.28	1.09	9.78	7.44	9.44	4.19	307.20	26.42
Jun 17	1.10	113.00	0.85	1.30	1.07	9.60	7.46	9.50	4.26	311.66	26.00
Sep 17	1.06	116.00	0.85	1.24	1.05	9.43	7.46	9.25	4.35	311.83	26.30
Dec 17	1.02	118.00	0.85	1.20	1.00	9.25	7.46	9.00	4.40	312.00	25.50

Sources: Bloomberg Finance LP, Deutsche Bank Research

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