

- *Angela Merkel is now under huge pressure to take immediate steps to arrest the decline, but is it too late?*

Angela Merkel is not under that much pressure (at least not because of the current economic situation). Germany has enjoyed low unemployment for years and the beginning downturn has not yet had big effects on the well-being of the German population. While economists may be urging Merkel to act, there is only very little pressure from the public (or the politicians in her party).

- *She will step down in 2021, but should she quit as Chancellor now?*

No. Merkel quitting as Chancellor now would inevitably lead to new elections, as the SPD would not allow Annegret Kramp-Karrenbauer, who would be Merkel's successor, to gain an incumbency advantage for the next elections. A new election would stifle German politics for at least half a year. Furthermore, an election at this moment would likely lead to the democratic parties losing (in sum). Both large parties (CDU and SPD) are currently not in good shape. On one side, Annegret Kramp-Karrenbauer, who would be the candidate of the Christian Democrats, is currently not very popular. On the other side, the Social Democrats are currently in an interim period looking for new party leadership after Andrea Nahles stepped down. A new election now would thus probably lead to a lower vote share of these parties. While some of this vote share would lead to a higher vote shares of the other democratic parties, the right wing extremist party AfD would likely also gain considerably. For these reasons Merkel should not step down now.

- *Is Germany heading for recession? How bad is the current situation?*

Germany is heading for recession, but the current situation is not bad yet. The industrial sector is already in recession but the service sector not yet. German unemployment increased in May for the first time in five years but it is still close to record lows. Germany is only at the beginning of the recession, therefore the effects are not yet felt. When the situation worsens further in the industrial sector and when the service sector follows, the effects will be felt more clearly.

- *What could be the short and long-term impacts?*

The short-term impacts should no be different from recessions in general. Higher unemployment, lower production, downward pressure on inflation. The long-term impacts are more difficult to assess. There are some reasons to assume that recessions have negative long-term effects in general (e.g., because the human capital of the people who become unemployed depreciates, some of the newly unemployed might even never become employed again). At the very moment, there is also the danger that the downward pressure on inflation means that the euro zone will be stuck at the zero lower bound for a longer time than would otherwise be the case.

- *What can be done to arrest Germany's economic decline?*

Germany can hardly influence the factors leading to a decline of demand for its exports (the US-China trade war or Brexit, for example). However, Germany could do a lot to stimulate the economy at home. In fact, the moment seems optimal to do exactly this, with interest rates at a record low (nominal interest rates are negative even for 10- and 30-year Bunds, real interest rates are far in negative terrain, so that the German government would actually get paid to make debt). In addition, infrastructure spending in Germany was low in the last two decades so that there is a backlog in infrastructure investment, reaching from railways, roads, and bridges over digital infrastructure to childcare centers, public schools, and universities. Those investments would have largely positive returns (compared to negative financing costs) and would stimulate the economy to head off the coming recession. Unfortunately, the debt brake that entered the constitution does not allow for these debt-financed investments – however, this debt brake could be changed (which is what many economists have recently been demanding).

- *What are the potential impacts on Europe as a whole, considering Germany is the continent's biggest economy?*

The German recession will affect the whole of Europe (in particular the euro area) mainly for two reasons. First, there is the lower German demand for imports from the rest of Europe, leading to lower production in the other European countries. Second, the downward pressure on inflation in Germany will make it harder for countries with an overvalued real-exchange rate with respect to Germany (most other euro area countries) to gain competitiveness within the euro area. When prices grow significantly in Germany, the other countries can gain competitiveness by having prices grow less, but when prices hardly grow in Germany, the other countries can only gain competitiveness by deflation, which is a much more painful process with much higher unemployment.

- *Could terrible results in the upcoming regional elections spell the end of Merkel as Chancellor?*

This may happen, but I do not think that it is very likely. I believe that it is more likely that the SPD will prematurely end the grand coalition after a new party leadership has been elected, but also this probability should not be overestimated. The most likely option, in my opinion, is that the grand coalition with Merkel as Chancellor will last until 2021 when the next federal election for the Bundestag are scheduled.