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German labour market's glamour (partly) gone

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- The COVID-19 pandemic and in particular the lock-down measures will push the German economy into its biggest slump since WW2. In our new baseline scenario, economic output in H1 2020 will shrink by 18% compared with the end of 2019. For the year as a whole, German GDP is expected to decline by around 9% in 2020 and then grow again by 4% in 2021. Should containment of the coronavirus prove more difficult, our protracted pandemic scenario assumes that GDP will fall by 15% in 2020, followed by only a meagre recovery of 1% in 2021.

- The COVID-19 pandemic hits the German labour market differently than the Global Financial Market Crisis of 2009. First, it is acting almost simultaneously as a supply shock and, as a result of the measures to restrict contact, as a demand shock. Second, is the speed and the might with which it has brought the economy to a standstill in many areas of Germany and around the world. Third, private consumption will suffer the biggest blow.

- Short-time workers are reaching up to 10 m during the COVID-19 crisis. The Federal Employment Agency (BA) only has figures with a delay of about three months. But, by April 26th, 751,000 companies had already registered for short-time work. This would imply an increase in the number of people actually on short-time work of up to 10 m. According to the BA, its financial reserve of EUR 26 billion will already be used up in 2020 making an additional transfer of EUR 4 to 5 billion from the federal government necessary.

- The number of persons unemployed will climb to 3 m. Despite the comprehensive measures to secure employment, which ultimately include support measures for companies, unemployment is likely to rise in 2020. Our baseline scenario implies an increase in the 2020 unemployment rate to 7% and only falling to 6% in 2021. Our protracted pandemic scenario implies an increase to almost 9% in 2020 and, due to a sluggish recovery and the lagged labour market response, an average of a good 8% in 2021.

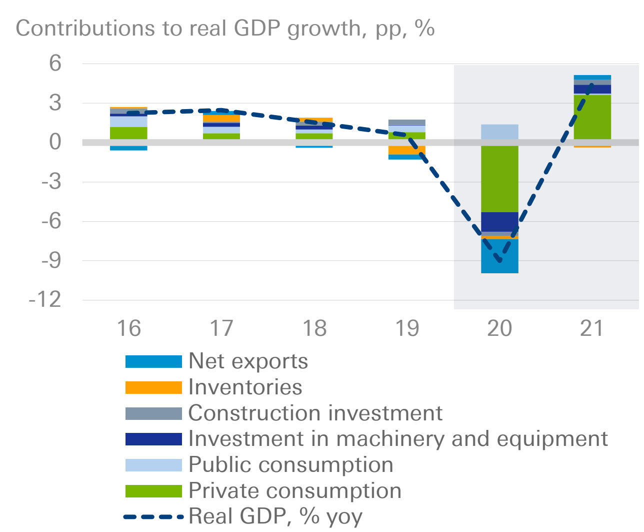
- Employment is likely to fall in 2020 by a good 1%. Not least due to the impact on the personnel-intensive services sector, the number of people in employment is likely to fall by about 550,000 (1.2%) in 2020. This trend is also indicated by the latest data on the number of job vacancies currently available. In April, the BA number of job vacancies fell by 9.5% mom to 630,000.

COVID-19 pandemic: Ultimate test for resilience of the German labour market

The COVID-19 pandemic and in particular the lock-down measures will push the German economy into its biggest slump since WW2. In our new baseline scenario,[1] economic output in H1 2020 will shrink by 18% compared with the end of 2019. For the year as a whole, German GDP is expected to decline by around 9% in 2020 according to our baseline scenario and then grow again by 4% in 2021. This scenario is based on the assumption that the wave of infection reaches its peak in Q2 of this year. The containment measures, which had a particularly strong impact on the services sector, have been gradually reduced, so that domestic economic momentum should pick up again. Nevertheless, hygiene measures and social distancing will almost certainly persist for some time to come, hampering the revival of the service sector to some extent. For the export-oriented German economy, a recovery of the global economy is a prerequisite. In contrast to our previous scenarios from March,[2] our current forecast takes even more account of the fact that the recovery among our global trading partners is phase-delayed.

In a more pessimistic scenario of a protracted pandemic the measures to contain COVID-19 remain in place into H2 or have to be tightened up again noticeably after an easing. In this scenario, an even sharper decline in German GDP (-15%) is expected in 2020, followed by only a meagre recovery (1%) in 2021.

Figure 1: Germany: Real GDP growth and details (baseline)



Source : Federal Statistical Office, Deutsche Bank Research

Figure 2: Germany: Patterns of GDP, employment and labour productivity

Source : Federal Statistical Office, Deutsche Bank Research

With regard to the labour market, our baseline scenario suggests that companies will facilitate the expected loss of working hours (volume in 2020: -4% yoy) mainly through working time balances and short-time work. In essence, they hoard labour,

1 Peter Hooper et al. (2020). World Outlook Update: Turning Gloomier. Deutsche Bank Research.
2 David Folkerts-Landau et al. (2020). Impact of Covid-19 on the global economy: Beyond the abyss. Deutsche Bank Research.

to be well positioned for the expected recovery in the second half of 2020. This applies in particular to highly qualified employees. German companies successfully used this strategy during the Global Financial Crisis (GFC) in 2009. Despite the measures to safeguard jobs, the unemployment rate is expected to rise to around 7% on average in 2020 according to our baseline scenario. If the economy recovers in H2 2020 and continues to do so next year, the unemployment rate should fall back to 6% in 2021.

COVID-19 pandemic hits German labour market differently than the Global Financial Market Crisis of 2009

From an economic perspective, several factors are exceptional in the current crisis. On the one hand, it is acting almost simultaneously as a supply shock and, as a result of the measures to restrict contact, as a demand shock. Second, is the speed with which the economy came to a standstill in many areas of Germany and around the world. Many classic growth engines in Asia, but also the USA, stuttered relatively quickly. Furthermore, it is the extent of the economic sectors affected. Third, private consumption will suffer the biggest blow. During previous periods of economic weakness, private consumption has always been a supporting pillar of the German economy and thus also provided a counterweight to employment losses in export-oriented companies. At present, however, the domestically oriented and personnel-intensive service sector is failing as a driver of employment, as the containment measures are having a particularly negative impact there. Therefore, the current situation is clearly different from the GFC of 2009 (German GDP -5.7% yoy). Nevertheless, the developments at that time and the economic policy countermeasures taken – especially those aimed at securing employment – provide important indications for the analysis of the current crisis. The starting position on the labour market at the beginning of 2020 was very solid after the record levels in the number of people in employment (2019 Q4: 45.3 million) overall, as well as in employees subject to social security contributions (2019 Q4: 33.7 million) and the lows (2019 Q1: 2.24 million) in the unemployment figures (2020 Q1: 2.27 million).

Adjustment channels in case of reduced labour demand by enterprises

Companies whose business activities are impaired can adjust the volume of work through various channels. These include the reduction of working time balances, short-time working, holiday arrangements, accepting lower labour productivity, possibly reducing the use of temporary work and finally shedding labour or not filling vacancies. The former channels are particularly suitable for short-term adjustment to a severe but relatively short-lived economic slump as expected from the COVID-19 pandemic. The economic policy measures are aimed at safeguarding jobs and support the companies primarily with financial support for short-time working, but also measures to support liquidity so that redundancies can be avoided and companies can keep their highly qualified and often very company-specific trained staff. Moreover, due to rather long notice periods and other company agreements, layoffs in Germany take time and are usually expensive.

Short-time working during the COVID-19 crisis and the use of working time accounts

In 2009 regulations on short-time working and the use of working time accounts demonstrated their effectiveness in safeguarding jobs. There was no sharp rise in unemployment. The seasonally-adjusted unemployment rate rose only from 7.6% in Q4 2008 to 8.3% in Q2 2009, only to fall steadily again in the following quarters.

Moreover, in the following recovery phase, companies' qualified, trained workforce was readily available. As a result, the German economic engine picked up speed comparatively quickly. Not least because of these positive experiences, the German government reacted to the economic slump in the wake of the COVID-19 pandemic by extending the regulations on short-time working.

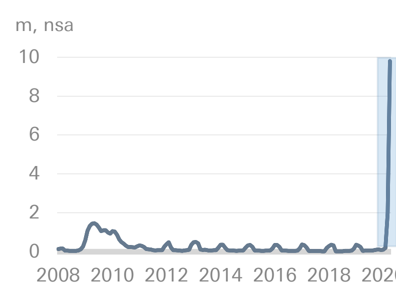
When the short-time measures were announced in mid-March 2020, the government was expecting around 2.15 million short-time workers, primarily as a result of the extension of "Kurzarbeiter"-regulation to the temporary employment sector. It should be noted that only employees subject to social security contributions (2019: around 33.5 million compared to 45.3 million employees) will be able to benefit from the short-time working arrangements. During the GFC, the number of short-time workers peaked at 1.45 million (May 2009). The climax with respect to the number of companies filing for short-time work was reached in February 2010 with almost 84,000.

Short-time workers reaching up to 10 m during the COVID-19 crisis

Because of the settlement procedure for short-time working compensation, the Federal Employment Agency (BA) only has figures on the workers affected with a delay of about three months. After notification of short-time work, the companies pay the employees not only the wages for the work performed but also the short-time work compensation in the corresponding month. A monthly payroll list with the reduced hours is then sent to the BA for reimbursement. By law, a company has up to three months to do this. Short-time work can also be limited to certain departments and can also be implemented to varying degrees. In addition, a number of companies are likely to have announced short-time working for the time being "as a precaution" in order to be able to implement it flexibly over the next 12 months.

According to the latest evaluation by the BA, 751,000 companies had already registered short-time work by 26 April 2020. This means that in March and April short-time work was announced for 10.1 million people, of which 2.6 million in March and 7.5 million in April. In other words, across all sectors, the proportion of people for whom short-time work was registered has jumped to 30% of all employees subject to social security contributions. However, it should be noted that short-time work is not likely to be implemented for all these employees. According to the survey, 1/3 of the companies (out of a total of 2.2 million companies) with at least one employee who is subject to social security contributions have now applied for short-time work. Around one-fifth of the people (2.2 million) for whom short-time work had been announced since March came from the three sectors of retail, catering and motor vehicle manufacturing.

Figure 3: Short-time workers



Source : Federal Employment Agency, Deutsche Bank Research

Measured by the number of employees, the majority of German companies are small and medium-sized. A glance at the different size categories therefore makes the expected extent of short-time work even more tangible. To estimate the number of short-time workers implied by the latest BA survey, the average number of employees per company is decisive. Most companies have up to 50 employees subject to social security contributions, a comparatively small share have 250 or more. For this reason, it makes sense to consider the lower size classes. In addition, smaller companies in particular suffer from the COVID-19 crisis. According to the weighted average of the figures from the Federal Statistical Office's business register (last status 2017), enterprises in the classes from 0 to 9 and 10 to 49 have an average of 7.6 employees. If the group of 50 to 249 are also included, the weighted average is 11.1 employees. According to the above-mentioned special evaluation and with regard to these groups of companies, the number of short-time workers expected in the near future would be between 7 million and up to 10 million. After April 26th, further notifications have certainly been received. As a result, the number of short-time workers at the peak should be even above the upper end of our range.

If this scenario were to materialise, according to the BA, its reserve of EUR 26 billion would already be used up in 2020 making an additional transfer of EUR 4 to 5 billion from federal government necessary.

The latest results of an ifo company survey (5 May) also show that short-time working is now widespread in almost all sectors in Germany. The highest numbers are in restaurants and catering, with 99% of businesses making use of short-time work, as well as in hotels, with 97%. This is the result of surveys the ifo Institute conducted in April. The key sector of automotive engineering also reports particularly high figures, with 94% of companies implementing short-time work. The share in the retail trade now stands at 62% (ifo survey of 23 April: 55%). The average across all sectors is 50%.

Support measures put into effect on an unprecedented scale

With retroactive effect from 1 March 2020, the German Federal Government, with its decisions of 23 March, has launched a comprehensive package of measures to support the German economy. In order to safeguard jobs, the regulations for short-time work (so far, short-time work compensation has generally amounted to 60% of the net remuneration lost, or 67% for parents.) were extended as follows:

- Notification of short-time work possible if at least 10% (previously 30%) of employees could be affected by a loss of working hours due to difficult economic developments.
- The build-up of negative working time balances ("minus hours") can be completely or partially dispensed with (negative working time balances have been mandatory up to now).
- Employees subject to social security contributions in the temporary work sector are now also entitled to short-time work.
- Social security contributions that employers have to pay for employees during short-time work are now paid in full by the BA.

The decisions of 23 April also adjusted the amount of compensations for the net loss remuneration. The measures, which are limited until the end of 2020, include.

- From the fourth month of reference, 70% (parents 77%) of the net loss of earnings will be covered.
- From the seventh reference month onwards, 80% (parents 87%) of the net loss of earnings is then covered.

In addition, the duration of unemployment benefit was extended by three months to 15 months. For unemployed persons over 50 years of age, the duration of entitlement will increase to 24 months. However, this is subject to prior employment subject to social security contributions for at least 24 or 48 months.

Overall, the Federal Government has put into effect the largest aid package to date (including the "Corona Shield for Germany") in the history of Germany with a volume of around EUR 1.9 trillion.

Short-time work serves as a bridging measure and should not be here to stay

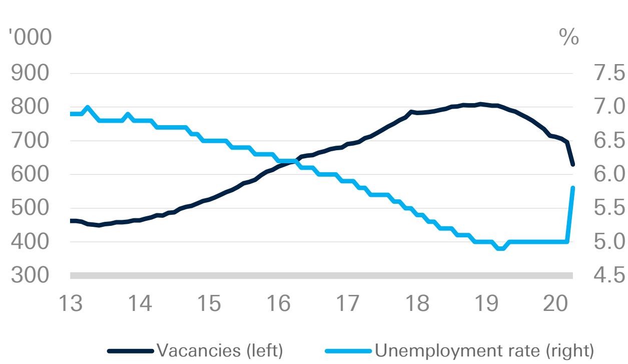
The regulations on short-time work allow for a subscription period of 12 months and can even be extended to 24 months in special cases. Nevertheless, this instrument primarily serves to bridge phases of economic weakness and cannot ensure the survival of structurally weak companies in the medium term. This would also provide employees with the illusion of having a safe job and reduce their incentive to look for other jobs. Short-time work must therefore not become a permanent solution, as this could lead to a real cut-off of employees from the labour market and ultimately restrict their mobility. A look at the labour market of the post-reunification period in eastern Germany underlines this. Even the increase to 80% (87% for parents) of the net loss of earnings that has now been decided should be reserved for those hardest hit and not be generalised. In addition, a discussion on the increase in unemployment benefits would be expected to follow.

Irrespective of this, there is also an economic incentive to use extended short-time working regulations beyond pure economic necessity given their financial relief effect. It should come as no surprise if this moral hazard played a role in the recent surge in notifications.

Unemployment and employment in the COVID-19 crisis

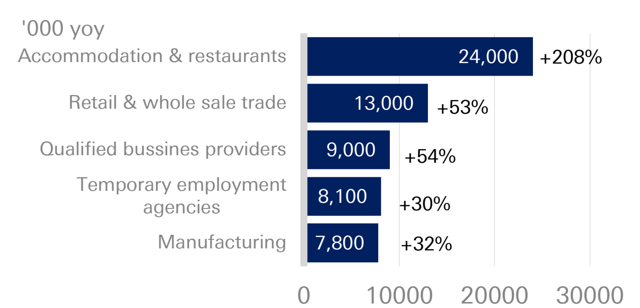
As a result of the extended measures to secure employment, many employees subject to social security contributions should not have to fear for their jobs in the short term. Nevertheless, a good 9 million workers are not protected by these measures. According to the data available for 2019, this includes some 4.15 million self-employed (including family members helping out) and 5.19 million marginally employed persons, i.e. persons in job opportunities (1-euro jobs), low wage or short-term employees. In particular, the gainful employment of marginal workers – often as a sideline in the service sector – is likely to suffer from the economic slump caused by the COVID-19 pandemic. Since these employment relationships are exempt from social security contributions, there are no claims to unemployment security benefits. The same applies to most self-employed persons, only a minority of whom make voluntary contributions to unemployment insurance. They would fall into the basic security by ALG II ("Hartz IV").

Figure 4: German labour market: COVID-19 with strong impact in April already



Source : Federal Employment Agency

Figure 5: COVID-19 and the increase in April unemployment (of previously employed persons)



Source : Federal Employment Agency

Rise in unemployment to 3 m

Despite the exceptionally comprehensive measures to secure employment, which ultimately include support services for companies (emergency aid, KfW programmes, tax liquidity support, guarantees), unemployment is likely to rise in 2020. Based on correlation between GDP growth and changes in the unemployment rate ("Okuns Law") in the 2000-19 period a GDP decline of around 9% (our baseline scenario) implies an increase in the unemployment rate to 7%. The 4% pick-up in GDP growth assumed for 2021 would then imply a decline of almost 1 percentage point. For 2020, however, this estimate is likely to overstate the actual trend. A noticeable rise in the unemployment rate can only be expected with a time lag in the middle of the second half of 2020. Based on the development in 2009, but exacerbated by the fact that the service sector has been affected, we expect the monthly unemployment rate to peak slightly north of 8% and the annual average to rise to almost 7%. The average number of unemployed will thus rise by around 850,000. The unemployment rate should fall to 6% in 2021 as a result of the economic recovery.

Should our more pessimistic scenario materialise, the unemployment rate is expected to rise to an annual average of around 9% in 2020 and, as a result of a sluggish economic recovery and the lagged labour market response, on average 8% in 2021.

However, the expected increases in unemployment in both scenarios are not only linked to redundancies. The labour market is fundamentally becoming weaker. As a result, significantly fewer workers who were made redundant in winter due to seasonal factors are being re-employed. In addition, fewer labour market policy measures were initiated due to the contact restrictions.

Employment is likely to fall in 2020 by a good 1%

Employment (2019: 45.3 million) and in particular the socio-economic situation of the population as a whole has been very positive in the recent past. Employment growth in the past year was mainly driven by service companies. In the manufacturing sector, on the other hand, it was already declining at the end of 2019. In contrast to the crisis in 2009, the domestically oriented service sector in particular is currently also being hit hard and can hardly be a counterweight to the weakness in employment in industry.

This is illustrated in particular by the latest PMIs. In April, these sentiment indicators plummeted to unprecedented lows of 15.9 points in services (a record low of 34.4 points also in industry). The ifo Business Climate for the services sector also marked a record low in April 2020, both in terms of the assessment of the situation and expectations. The overall index fell to a historic low of 74.3 in April (March 85.9). As a result of the expected sharp economic slump of 9% and the particular impact on the personnel-intensive services sector, the number of people in employment is likely to fall by about 550,000 or 1.2% in 2020.

This trend is also indicated by the latest data on the number of job vacancies currently available. In April, the BA number of job vacancies fell by 9.5% mom or 65,000 to 630,000.

Despite the extensive support measures for the German economy, corporate business models could be put at risk or, for example, individual self-employed persons with a thin financial base could be threatened with closure. In addition, those in marginal employment will be affected above all by the problems in the service sector. Even if the economic recovery we expect to see in 2021 with GDP growth of 4% materialises, companies are likely to be cautious about hiring new staff. In addition to layoffs, such caution could severely curb renewed employment growth. Given the pessimistic scenario described above, it is expected that the decline in employment could be even more severe in 2020 and that employment growth in the following year would be very weak.

Collective wage bargaining 2020 and 2021

Given the severely clouded employment outlook, we expect job security to be given high priority in the coming collective bargaining negotiations. Following strong wage agreements in 2018 (2.9%) and 2019 (3%), the collective wage trend in 2020 and 2021 is likely to be a rather modest 1%. Due to a markedly negative wage drift effective wages will shrink in 2020. If the economic recovery takes place as in our baseline scenario, short-time work in particular is likely to be reduced in the coming year, which will again support effective earnings.

Concluding Remarks

Before the outbreak of the COVID-19 pandemic, the employment boom of recent years had led to a general shortage of qualified workers and unemployment was reaching ever new lows. In view of the new economic conditions, these times are likely to be a thing of the past for the time being. Despite the sharp economic slump in 2020, however, it is plausible in our baseline scenario that companies will give priority to securing jobs wherever possible. This seems all the more likely given demographic change. In particular, the retirement of the baby boomers starting in the middle of the 2020s will noticeably reduce the number of workers.

Appendix 1

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