Outlook 2021 – Contingent on the COVID cycle

- **The COVID cycle and vaccination progress will drive the economy in 2021.** We expect that infection rates will not come down decisively before Q2. By summer vaccination numbers should reach critical mass. A strong recovery starting in Q2 should yield an annual GDP increase of 4.5% after a 5.4% drop in 2020.

- **Global trade and exports.** The recovery in global trade and exports is taking a breather during the winter half. Exports are expected to rise about 10% in 2021.

- **A double dip for private consumption during winter 2020/21.** In Q4, the recovery of private consumption is likely to pause due to the 'lockdown lite'. A rebound should begin in the summer half of 2021, yielding an annual growth rate of 4.7%.

- **German labour market – resilient thanks to massive fiscal support.** Employment is not expected to reach pre-crisis levels before mid-2022. The unemployment rate should rise to 6.3% on average in 2021 (2020: 5.9%).

- **Equipment investment.** Damaged corporate balance sheets will remain a burden for investment. Although equipment spending is projected to pick up significantly, pre-corona levels will likely only be reached in 2022.

- **Housing market: The boom is not over.** The impact of the COVID-19 crisis on the residential sector should remain fairly limited due to the severe housing shortage. The construction sector is very solid and should grow in 2020 and 2021.

- **Public finance caught in a downward spiral due to coronavirus.** We estimate that the general government deficit should remain above 4% of GDP in 2021. The debt ratio should reach its provisional high point late 2021, at approximately 71.7%.

- **Inflation: Return to normal in 2021.** We expect the inflation rate to rise to 1.4% in 2021 and 1.6% in 2022.

- **German industry: Losses only partly offset in 2021.** We expect domestic manufacturing production to increase by roughly 8%.

- **All attention on the super election year 2021.** Germany is facing federal elections and multiple state elections. Our baseline scenario is a conservative-green government, but coalition talks will significantly test the willingness to compromise on both sides.

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### Key Economic Forecasts

#### Figure 1: Economic Forecasts

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

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</table>

*Inflation data for Germany based on national definition. This can lead to discrepancies to other DB publications. **Manufacturing (NACE C)

Source: Federal Statistical Office, Deutsche Bank Research

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**Source:** National Authorities, Deutsche Bank
Contingent on the COVID cycle

When starting to think about the outlook for the upcoming year, it should be standard practice for all serious forecasters to look back and check what was said and written 12 months ago and benchmark that against what has actually happened during these 12 months. As so often is the case, this is a sobering exercise. Our outlook for 2020 was titled “Fragile – handle with care”. However, our major concern was that the expected recovery in global trade, which had fallen into the red during 2019, could turn out more lackluster than widely expected, posing obvious risks for German industry and investment spending.

Well, four months into 2020, world trade had collapsed by 16% yoy, German industry’s foreign order intake had plunged by about 30% yoy as major parts of the world had moved into their first-ever lockdown to fight the ravaging COVID-19 pandemic. As Scott Sagan wrote in “Limits to Safety”, things that have never happened before happen all the time!

Still, to conclude that macro forecasts are fools’ gold given the – unfortunately not so rare – appearance of black swans would be naïve. The uncertainties that individuals and societies have gone through during the ongoing pandemic have clearly demonstrated that we need structure to function as societies as well as individuals. Since societies are dynamic systems, structure implies expectations about the future to guide activities and policies. Hence, our lesson is to handle forecasting and forecasts with even more care and to point out that they are contingent on a set of explicit assumptions and even more importantly on the big implicit assumption that nothing else major goes wrong.

Infection rates to be squeezed by higher temperatures and speedy vaccination

Of course, as in 2020, the economic profile in 2021 will remain a derivative of the pandemic development. The quarterly profile in H1 in particular will be shaped by the interplay of two COVID-related factors:

1. The rate of new infections and hospitalisations
2. The number of vaccinations per week in the race to herd immunity

Given the uncertainty related to both factors, we have to rely on assumptions as we are not in a position to forecast them. Despite ongoing restrictions to increase social distancing, infection rates are not assumed to fall strongly for the better part of Q1 due to adverse seasonal factors. On the contrary, the planned modest easing during the Christmas holidays/vacations could result in a further increase – if not being upended on short notice for exactly this reason. Moreover, there is an increasing risk that restrictions could be tightened further, as already happened in Bavaria. In Saxony, a comprehensive lockdown will start next Monday. A short but tighter lockdown similar to the one in April is becoming very likely for the time between Christmas and January 10 (including longer school holidays). The resulting bigger dent in economy might, however, be offset by a quicker relaxation possible thereafter.

In our baseline, we assume that daily infection rates of 15,000 to 20,000 people will require a further extension of most measures from lockdown lite beyond Jan 10th. On the other hand, such a range would probably not provide a sufficiently strong argument to ratchet measures up in early 2021, despite several examples from
neighboring countries showing that harder measures for a shorter period of time can be a successful strategy. With regard to the speed of vaccinations, we have become cautiously more optimistic in recent weeks. Following recent guarded comments by Merkel,1 the head of the STIKO commission (Standing Committee on Vaccination), Mertens,2 and other epidemiologists, it seems to us that something close to herd immunity will not be reached before midyear at the very earliest, with some hiccups likely in the first few weeks/months (see "Ramping up vaccination" following this article). While vaccinations will immediately reduce the infection risk for the person concerned, their slowing effect on the pandemic will only build up over time. Hence, a more substantial reduction in restrictions is, at least for the early part of Q2, no done deal.

**GDP profile depends on how the pandemic pans out**

The uncertainties deliberated above make it crystal clear that quarterly GDP forecasts are largely dominated by the pandemic. The good start into Q4 (industrial production +3.2% mom and retail sales +2.6%) could mean that the decline in Q4 GDP might be even smaller than the 1 ½% qoq drop that we expect (consensus - 0.5%). As there is – for the time being – little chance that the current lockdown will be eased quickly enough to give growth a jolt in Q1 already, we think our forecast of GDP stagnation in Q1 is valid, in particular as the risks of a Brexit without even a mini-agreement are increasing by the day. The further we move into the year, the more ‘animal spirits’ should be lifted by the hope that vaccines will bring about a clear improvement for business and life in general, even though that might only very gradually show up in actual infection rates. Still, with additional support from seasonal factors, the pandemic outlook should brighten from spring onwards and growth should pick up. All in all, a rebound in GDP by about 4 ½% after a drop of 5 ½% seems a realistic scenario in which the pre-COVID output level would be exceeded by Q3. In 2022 growth could expand by another 4%, clearly exceeding potential.

**Complex systems are emergent**

One key feature of highly complex systems such as society or the economy is emergent, meaning that its own behavior and the behavior of its major elements (parties, people, interest groups) constantly change the system’s structure. Admittedly, we have seen all too often that dramatic events (such as 9/11 or the Global Financial Crisis in 2008/9) were at the time expected to deliver lasting changes to societies and economies, but with hindsight actually not that much changed. Currently we are reflecting and debating about how we want to live, consume and spend our holidays in future, how and where we will work. Individuals and societies are debating whether they should become less self-centered and more caring about others. With the massive support provided by the government to citizens and – on an unprecedented scale – to companies of all shapes and sizes, the balance between the market economy and the state has been massively shifted in the direction of the state. Quite a few seem to be convinced that this is the way to go further, given the huge challenges our society is confronted with, such as global warming, digitization and population ageing. Some even expect COVID-19 might be the catalyst for greater (fiscal) unity within the EU. They see the EU’s Recovery and Resilience Facility as a clear indication and hope that it will generate a stronger political mandate for the EU. On the other hand, groups that have been rather critical about the political direction of Germany during the last decade or two

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1 Spiegel Online, 7.12.2020
2 Deutschlandfunk 7.12.2020
have exploited COVID-19 and the authorities' struggle to get this under control for their general criticism of the government. For some smaller groups, it has even provided the linchpin for their rejection of our whole political system. Their protests have become more radical, in part even violent. But more abrasive, less-tolerant debate can be observed in many parts of the society.

Election year unlikely to calm tempers
The expected economic upswing is unlikely to end this. In particular, as the debate about who will foot the bill for the government’s COVID-19 induced spending binge has just started. In the run-up to the federal election in September, we could therefore experience much wider and more heated public debate. After 16 years of Merkel chancellorship and altogether 12 Groko years, both the CDU and the SPD are still trying to determine their future positions. In a similar vein, the Greens, expecting an important role and say in the next government, will have to get more realistic regarding the implementation of their highly ambitious and very expensive plans for a social and economic transformation.

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Ramping up vaccination
Germany has started to set up vaccination centres all over the country. Vaccination in such centres makes sense since logistics surrounding the process are quite sophisticated (cooling of vaccines) and because economies of scale can be achieved if all necessary personnel and equipment is concentrated. According to media reports, more than 400 of these centres will be implemented. Federal states are responsible for building up the vaccination centres. The approaches may differ in detail depending on population and settlement density or the size of single vaccination centres. However, every federal state aims to ramp up enough capacity to vaccinate a large portion of the local population as soon as possible.

Vaccination is expected to start in early 2021. Not every vaccination centre will be ready to work at full capacity from the very beginning. However, physical infrastructure will probably not become a significant bottleneck in the vaccination process. Availability of vaccines is likely to be the decisive limiting factor in the first weeks of 2021. This is why the German national COVID-19 vaccination strategy contains a highly targeted and highly prioritised vaccination plan based on ethical and epidemiological consultations. Certain risk groups will be vaccinated first. This includes staff in hospitals and elderly care homes, older people or persons with preexisting conditions, since these groups are especially vulnerable or have a higher risk of exposure.

As soon as more vaccines are available, medical and service personnel in vaccination centres might become a bottleneck. This holds true especially for physicians since every person who wants to be vaccinated needs a medical consultation by a doctor first. To avoid a bottleneck, retired physicians are currently being asked to support these consultations in vaccination centres.

More than 12 million vaccinations per month possible
Assuming that every vaccination centre will be able to perform 1,000 vaccinations per day (planned capacity is higher at many centres) and that every centre is in
operation for seven days a week, more than 12 million vaccinations could be conducted in Germany per month. This number will probably not yet be reached in January or February. However, additional vaccinations in medical practices or by mobile vaccination teams will become important as soon as vaccines are available that are easier to handle (e.g. no cooling necessary). At the end of the day, there appears to be a realistic chance to get a sufficiently high share of the population immunised as soon as summer 2021 (even taking into account that some vaccines must be administered twice). Herd immunity can be reached if roughly 60% of the population is vaccinated. Such prospects were not thought possible only a few weeks ago.

To reach this target it is of course necessary that vaccines prove to be effective in real life (especially for risk groups) and that people’s willingness to be vaccinated is sufficiently high. Different polls show that more than 50% of the population is willing to be vaccinated. We expect the number to increase as soon as it (hopefully) becomes clear that negative side effects of vaccination are harmless or minor. It is also clear that setbacks in terms of vaccine production and delivery, logistics or time to immunisation cannot be ruled out. That would prolong the path towards herd immunity.

Everything back to normal soon? Not so fast! Medical experts expect a significant time lag between ramping up vaccination and a positive impact on the numbers of new infections. Thus, politics will probably remain cautious for some time. A comprehensive easing of corona restrictions – such as social distancing, the requirement to wear masks in certain surroundings or hygiene measures – is not likely before new infections have come down significantly. Remember that the requirement to wear masks remained in place last summer when the 7-day incidence in Germany was below 10. Easing the measures will probably be a smooth transition over several weeks and months, and not a fast reopening of all sectors that are currently shut down. Warmer weather in Q2 could become an ally of vaccines that helps bring down the number of new infections.

*Eric Heymann (+49 69 910-31730, eric.heymann@db.com)*
Global trade and exports over the winter

- Emerging markets are growing more important to the export industry.
- Global trade and exports take a breather during the winter half.
- Many arguments in favour of expanding continental value chains at the expense of global ones.

The historic economic collapse this past spring caused value chains to break down. Large swaths of European automotive manufacturing ground to a halt. There were also supply issues with everyday products and medications. Real global trade during the period from January through May 2020 fell by around 19% compared to the end of 2019. The massive collapse was followed by a bounce back that was almost as sharp, putting global trade now just 2% below the level seen at the end of 2019. As new lockdowns are brought in over the winter in the northern hemisphere, the recovery will probably be less robust than a number of leading indicators have hinted at lately. Averaged over the year, however, the drop should “only” be roughly 6% as compared to 2019. That is a positive development compared to the low seen in the spring. It also represents a smaller decrease than was noted during the financial crisis, when global trade slid by more than 12% on average over the course of the year. Despite the lockdowns in the West, we expect global trade to shed only 2% from October to March, for two reasons. First, infections are relatively low in Asia and in the southern hemisphere. Second, the global value chains are currently quite robust. We expect a strong economic recovery starting in April. Averaged over the year, our forecast is for more than 7% growth in global trade in 2021.

…down again, followed by a strong recovery

In 2020, German goods exports saw an even sharper downturn than global trade (see figure 4). In both nominal and real terms, goods exports were down by more than 30% from January to April. Subsequently and in line with global trade, goods exports recovered very strongly. As a consequence, we expect the annual average for 2020 to show a decrease of just over 10% (with export prices down by about 1% due to the collapse in the price of oil). This forecast takes into account a new contraction in nominal exports from October to March by nearly 4%. The countries that were hit especially hard by the second wave of the coronavirus pandemic are responsible for a larger share of this decrease. The expected dynamic recovery starting in the second quarter of 2021 should boost nominal and real exports by about 10% on average over the year, bringing activity to nearly pre-crisis levels by the end of 2021. An even stronger recovery will also be hampered by the expected appreciation of the euro. We expect to see the euro trading at 1.25 against the US dollar and 0.95 against the pound sterling at the end of 2021 (assuming a trade agreement is reached between the EU and the UK; otherwise, the pound could see an even steeper devaluation). Averaged over the year, the euro is expected to rise by about 6% against both currencies. Our models show export elasticity at 2/3, causing exports to the United States and the United Kingdom to increase by about 4% less than would be the case without the devaluation. With the global economic outlook relatively positive and China in particular expected to see GDP grow by nearly double digits, export growth should top import growth in 2021. As a result, we expect net exports to contribute 1.8 percentage points to GDP in 2021, following a negative GDP growth contribution of -1.1 percentage points in 2020.
Market share: Demand from emerging markets remains relatively high

The COVID-19 crisis is amplifying a trend seen in recent years, as emerging markets grow more important. That is true in Asia, especially in China and South Korea, and in Europe – particularly for Germany’s neighbouring countries of Poland and the Czech Republic, with the lines between emerging markets and developed economies increasingly blurred. The ranking of the most important sales markets therefore includes a number of shifts. Still, the United States remains the most important market in 2020, with a market share of 8.5% (down from almost 9% in 2019). This figure is expected to rise sharply to over 9% in 2021, buoyed not just by the relatively robust U.S. economy, but also by the new administration, which is expected to usher in improved transatlantic relations and greater support for the WTO. Particularly with an eye to settling disputes between trading partners, this could reduce the great political and economic uncertainty that has been felt around the world. China has become more important in 2020 and is now the second most important sales market, ahead of France. It is expected to further expand on this position. The Netherlands’ export share increased to more than 7% in 2020. Exports to the UK are down for the fifth year in a row, from nearly EUR 90 billion in 2015 to about EUR 65 billion in 2020. This has lowered Britain’s market share from 7.5% in 2015 to 5.4%. Even in the case of a “soft” Brexit – meaning without WTO rules being introduced, which would drive tariffs up sharply – the UK could continue to slide down the rankings in 2021. Even Switzerland, ranking ninth with its export share of 4.8% in 2020, could become more important to the German export industry in 2021 than the UK. Poland rose two places in 2020, to rank sixth, placing it ahead of Italy and Austria for the first time, which came in seventh and eighth respectively. Belgium remains in tenth place. The Czech Republic is in eleventh place, having overtaken Spain in 2020. Comparing different regions also shows clear shifts in favour of emerging markets. The Visegrad Four together account for more exports in 2020 than all of the Americas (North and South), the first time this has been the case. Exports to the Visegrad countries had already surpassed those to Southern Europe before the COVID-19 crisis struck. Asian markets have seen their market shares continuing to rise year amid the coronavirus pandemic, driven especially by China and South Korea, while the share of exports to the Americas has been flat for years. The signing this November of the Regional Comprehensive Economic Partnership (RCEP) among 15 countries in the Pacific probably implies further positive impetus for exports to Asia.

Figure 6: 2019-2021 Ranking of export shares as % of total exports of goods

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
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<th>2021</th>
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<td>3.6</td>
<td>3.5</td>
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</table>

Source: Federal Statistical Office, Deutsche Bank Research

Figure 7: 2019-2021: Exports of goods (growth in % yoy)

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Source: Federal Statistical Office, Deutsche Bank Research

Figure 8: Export shares

<table>
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<th>in % of total exports</th>
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Source: Deutsche Bank Research, Federal Statistical Office

Figure 9: Export shares

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</table>

Source: Deutsche Bank Research, Federal Statistical Office
Possible outlook: Continental value chains replace global ones
Germany’s export industry is deeply embedded in global value chains. With national labour costs, business taxes, and electricity prices relatively high and owing in part to Germany’s ambitious climate goals, companies turned to the outsourcing of production to cut costs in the past. The COVID-19 crisis has once again highlighted the risks that accompany this global approach to production, with its focus on efficiency. We believe continental value chains will partially replace global production in the long run. Policymakers are likely to create further incentives in the future to ensure crisis-proof basic supply levels. The coronavirus fiscal stimulus package already provided funding to restore production of key medications and pharmaceutical products in the domestic market. The new German supply chain law, which was agreed in the coalition agreement but is disputed due to the economic crisis, could be adopted in 2021. The new legislation would force companies to monitor production of intermediate goods with an eye on labour conditions and environmental standards. A strict obligation of control based on the new supply chain law would probably be easier to enforce in European linguistic, legal and cultural spheres than in Asian markets, for example. As a result, this law could make continental value chains more attractive than global ones. In this context, tougher climate targets and the introduction of a new tax known as a “carbon border adjustment” by the EU, as Chancellor Merkel and President Macron urged in the summer of 2020, could bring production sites back to Europe. These considerations are underpinned by geopolitical factors, especially the ongoing struggle between the U.S. and China for primacy in the Pacific region, which is expected to continue under a Biden administration. Alongside this political perspective, private-sector incentives also argue in favour of continental value chains. The COVID-19 crisis has laid bare the need to sound out production processes for potential shortfalls. If, as the Intergovernmental Panel on Climate Change expects, the number of natural disasters rises, then having multiple continental production chains will lower the entrepreneurial risk. If continental value chains do in fact become more important, Eastern European locations within the EU and potential candidates for joining the EU should benefit in particular. Exports to these countries would then rise disproportionately. Although such trends will tend to take shape more in the long term, the new supply chain law and the Bundestag election in 2021 will be important inflection points.

Current account surplus under 6% of GDP in just a few years
The current account surplus is expected to fall to about 6.6% of GDP in 2020. This is the fifth annual decrease in a row (with the largest dip having been in 2015, at 8.6%). We expect 2021 to bring a continuation of this trend and a decrease to 6.2%. This means that among the major countries, Germany will continue to contribute in special measure to global imbalances, although this is the product of decisions by millions of individual economic actors in Germany and other countries rather than the outcome of a specific industrial policy strategy. Surpluses are expected to decrease in the years after that as well. We expect the figure to fall further, to 5.9%, in 2022. That would put Germany under the 6% threshold that indicates an economic imbalance according to the EU’s macroeconomic rules for the first time since 2010. Demographic change is likely to bring further decreases in the years to come as well, which should cause this topic to become less and less relevant. Still, fully drawing down the surpluses is likely to take many years owing in part to the lack of competitiveness of some European trading partners that typically account for more than half of the surplus.

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The corona pandemic, and in particular the first lockdown in April, led to a historic slump in private consumption in Q2 of -11.1% qoq. In contrast to the GFC in 2009 this expenditure component could not provide an anchor of stability. Tight restrictions on brick-and-mortar retail shops and consumer-related services as well as the general precaution of many citizens’ compressed expenditures, thereby pushing the savings rate to a record high of 21.1% although household incomes were supported by a massive expansion of government support measures. These include, in particular, easier access to short-time work and assistance for the self-employed. The easing of hygiene measures unleashed a rapid recovery in private consumption (Q3: 10.8% qoq) during summer. With the unwinding of the expenditure backlog, the savings rate fell to 16.2% in Q3, still substantially above its long term average of 10.5%.

Nevertheless, consumer sentiment remains sensitive to the renewed rise in the number of infections and is clearly subdued towards the end of the year. As the assessment of economic developments becomes increasingly critical, income expectations also fall. Worries about job security are putting a lid on the propensity to buy.

In the final quarter of 2020, the recovery is likely to pause due to the lockdown lite implemented in November and its further tightening at the start of December. Although the discount campaigns in online retail in particular could boost private consumption in the run-up to Christmas, the stricter spacing rules in stationary
retailing are likely to dampen the buying mood. In addition, purchases of durable consumer goods may have been brought forward into preceding months. According to a GfK survey, increased purchases of freezers (2. to 21. Mar: +185%) and food preparation equipment (23. Mar - 26. Apr: +28%) were already made during the first lockdown. Retail sales of electrical household appliances grew 4% yoy in Q2 and a strong 11% in Q3. The massive expansion of remote working in H1 resulted in purchases of the necessary equipment. Given the reduction in VAT (in place until year’s end) there is evidence for only a minor boost in household demand. According to a survey by the ifas Institute, only 11% of people replied that they intended to bring forward purchases planned for 2021. Against this rather mixed backdrop, we expect private consumer spending to decline by -3.5% qoq in Q4. Restrictions in the restaurant and hotel industry as well as in the cultural sector also support this expectation. For 2020 as a whole, we expect private consumption to decline by -6.2%.

Given the ongoing confrontation with the corona pandemic, consumer behaviour could also change in the longer term. Many previously sceptical consumers may now have learned to shop online. In a survey conducted by Deutsche Bank, 17% of those surveyed stated that they now increasingly shop online. 30% said they now spend less on clothes and 49% reduced their travel expenses. On the other hand, spending on medicine, food, balcony and garden – “my home is my castle” – increased.

In view of the recent positive news from vaccine research and the preparations already underway for the vaccination campaigns, we consider broad availability by Q2 2021 to be realistic. If the expectations for the vaccines are fulfilled, infection rates are likely to decline with the level of immunisation, making comprehensive containment measures less pressing.

Private consumption outlook 2021

Until then, however, private consumption spending can be expected to be impaired by ongoing restrictions to increase social distancing that may be necessary to fight COVID-19. A further slight quarterly decline in Q1 consumption is therefore expected, all the more since the end of the temporary VAT reduction is also likely to have a dampening effect at least with respect to purchases of big-ticket items. With the insolvency moratorium ending, initial evidence of increasing company bankruptcies could also have an impact on income expectations and thus on consumer sentiment.

With the availability of vaccination coverage, a further strong recovery in private consumption should then begin in the summer half, leading to growth of 4.7% for the year 2021 as a whole. The pre-crisis consumption level could then be reached again in early 2022. In addition to the ongoing fiscal support measures, the abolition of the solidarity surcharge for low and medium incomes should provide a positive stimulus. The further normalisation of the savings ratio could also boost private consumption. Purchasing power should benefit from the strength of the euro, which we expect, although energy prices are likely to rise in the event of a sustained global recovery due to increased demand. Collective wage increases will be of limited importance for household income in 2021. Since the influential negotiations are taking place primarily in crisis-ridden sectors (retail, metal and electrical industries), collective wages are likely to increase by only 1.5%, after an estimated 2% in 2020.

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German labour market - resilient thanks to massive fiscal support

- The COVID-19 recession has left its mark on the German labour market. Overall, employment fell significantly in 2020 and is not expected to reach pre-crisis levels before mid-2022.
- The unemployment rate should rise to 5.9% on average in 2020 (2019: 5%). Without the tried and tested Kurzarbeit, the increase in unemployment would certainly have been far greater.
- Collective wage agreements for 2021 should lead to an average increase of around 1.5%. With the corona crisis still present and in view of more far-reaching structural changes, job security is likely to be given high priority.

The COVID-19 recession has left its mark on the German labour market. Employment declined noticeably in Q2 and unemployment figures soared. As the year progressed, the labour market appeared to regain its footing at first glance. Nevertheless, this was primarily due to the ongoing extensive government support measures, above all easier access to short-time work (Kurzarbeit). This enabled companies to realise the lion’s share of the adjustment to underutilisation via working hours.

Without this tried and tested measure, the rise in unemployment would certainly have been far greater. It helped to limit the increase to an annual peak of just under 3 million (August, rate: 6.4%) and to bring it down since then. The unemployment rate should rise to 5.9% on average in 2020 (2019: 5%). The massive use of short-time work culminated in April with almost 6 million employees subject to social security contributions on reduced hours. This corresponds to an employment equivalent of 2.9 million people and gives an impression of how much underutilisation was compensated. During the GFC 2009 Kurzarbeit had peaked at 1.44 million. In autumn 2020, the number of short-time workers was still significantly higher (Sep: 2.2 million).

Despite the economic recovery in Q3 and the decline in short-time work, effective earnings (per capita) are likely to fall by a good 1% over the year as a whole, with the wage drift thus reaching a good -3%.
However, despite short-time work, the number of employees subject to social security contributions in Q2 fell a significant -0.9% qoq, followed by an initial recovery. The sectors mainly affected were the metal, electrical and steel industries, temporary work and the hotel and restaurant industry. According to the latest data, employment subject to social security contributions in Q3 is still expected to be 0.3% below the previous year’s level. From this perspective, Q4 is likely to be weak again, as employment at the end of 2019 was at a record level of 33.9 million.

Employment in general recorded an even stronger Q2 decline (-1.4% qoq or -628k) than employment subject to social security contributions. This was mainly due to the fall in the number of persons employed on low wages only. This group cannot make use of short-time work, so that the crisis had its full impact here. With the economic recovery during the summer, this group also bottomed. However, since a large number of these jobs are in consumer-related services, the recovery is likely to come to a standstill at year’s end as a result of lockdown lite. In 2020 as a whole, employment is expected to fall by 430k or 1%.

Labour market with mixed outlook for 2021

The main factor for the labour market development in 2021 will of course be the availability of vaccines. With the expected easing of hygiene measures, economic activity should return to normal by H2 2021. This will be particularly beneficial for the services sector, where many companies rely on personal interaction with their customers. However, a large number of companies may not have survived the mandatory closures despite government aid, and may therefore cease to be employers. This could already become apparent with the expiry of the moratorium to file for insolvency.

If the pandemic can also be contained globally, the continued recovery of world trade could ultimately benefit industrial workers. Here, however, the recovery is likely to be slowed by sector-specific structural changes. This applies in particular to the car industry and its suppliers, the aviation industry, but also to the mechanical engineering and metal and electrical industries in general. Although short-time work has made it possible to retain experienced staff for the time being, it remains to be seen to what extent the business models are still viable after a year of crisis. Once short-time work is reduced in many cases, companies are likely to hold back on hiring new staff. This is particularly true when restructuring requires existing staff to be reallocated as a matter of priority.

At present, leading indicators (IAB and ifo barometers as well as PMI sub-components) for the German labour market point to a sideways employment trend, although uncertainty is currently high. Against the backdrop of our economic forecast for 2021 (GDP: +4.5%) and the special constellation on the German labour market, we expect the average number of people employed to increase by around 80,000 (+0.2%) over the year 2021 (2020: -1%). The pre-crisis level should then be reached again in H2 2022. Despite the expected economic recovery, short-time work is likely to continue to play a role in 2021 and is unlikely to fall below 1 million on annual average. In 2022, the number should then fall to an annual average of just over 200,000.

Due to a combination of restrained new hiring, a meltdown of short-time work and structural headwinds, the reduction of unemployment is likely to be very slow in the coming year. As a result of the base effect from 2020, the unemployment rate should therefore rise to 6.3% on average in 2021 (2020: 5.9%). In 2022, it should then fall to just under 6% on annual average.
Collective bargaining round in 2021

During the collective bargaining round 2021, negotiations are scheduled for around 12 million employees covered by collective agreements, just under 36% of the last 33.5 million employees subject to social security contributions. The focus is likely to be on negotiations starting in mid-December 2020 in the metal and electrical industry (3.8 m) and then, from Q1 onwards retail trade (regional March to June: 2.36 m). In addition, new collective agreements will be negotiated from June in the construction industry (0.6 m) and from September in the public sector of the federal states (0.9 m).

With the corona crisis still present and in view of more far-reaching structural changes, job security is likely to be given high priority, especially in the metal and electrical industries but also in retail trade. This could include both an adjustment of working time models (4-day week) and further training measures. The initial demands for collective wage increases, which have in recent years hovered at around 6%, are currently slightly lower (IG Metall: 4%). In the main construction industry and in the public sector of the Länder, the conditions are a bit different. As the construction industry continues to perform well and the public sector has already reached an agreement on the federal level and municipalities, more progressive demands can certainly be expected here. Overall, the collective wage agreements for 2021 should lead to an average increase of around 1.5% (2020: 2%). In combination with a clear reduction of short-time work (in line with the economic recovery), this should lead to a strong increase in effective earnings of a good 3%.

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Equipment and other investments

- The COVID-19 pandemic has had a deep negative impact on equipment investment. Although strongly bouncing back in Q3 2020, equipment investment has been still around 8 ½% lower compared to its pre-corona level.

- Over the outlook period 2021-22, investment activity will remain highly contingent on the COVID cycle. While positive news on the vaccination front should eventually improve consumer and business sentiment, the overall economic damage that has been caused to corporate balance sheets will remain a burden for investment in the foreseeable future. Both supply-side (financial) issues and demand-side issues are likely to be major constraints for a rapid catch-up.

- First of all, absorbing the economic shock will take some time – notwithstanding ultra-expansive fiscal and monetary policies. Secondly, many structural impediments – that have hampered investment – might continue (e.g. rising protectionism, high political risks or the adverse effects from Brexit).

- In 2020, we expect equipment investment to contract by 12.6%, while other investments are set to decline only moderately by 0.7%. In 2021, growth in equipment and other investment is projected to pick up significantly, posting rates of around 10.7% and 4.2%, respectively. However, the strong pick-up in the growth rate for equipment investment should not be misinterpreted. Overall, we expect equipment investment not to exceed its pre-corona levels before 2022.
Equipment investments are put in a stranglehold by the pandemic

The COVID-19 pandemic has had a deep negative impact on domestic investment in machinery, equipment and vehicles (in what follows labeled as “equipment investment” only). Following a contraction of roughly 2 ½% in the second half of 2019 (based on seasonally-/calendar and price-adjusted national accounts data), equipment investment collapsed by almost 15% in the first half of this year. Although strongly bouncing back in Q3 2020 (+16% qoq) amid the short-lived summer recovery, the total economy’s equipment investment has been still around 8 ½% lower compared to the pre-corona level (as of Q4 2019) (see fig. 18). The decline in equipment investment over the first six months of 2020 was exclusively the result of collapsing private-sector activity (-18%), whereas briskly expanding public-sector equipment investment (+27%) helped to soften the overall decline (see fig. 19 and 20). In comparison to equipment investment, the decline in other investments (comprising, for instance, investment in research and development as well as in software or databases) was much less severe. That said, other investment in the total economy contracted “only” by 3.3% in H1 2020, though was caused by declines in both the private-sector (-3 ½%) as well as public-sector (-2 ½%). Overall, the corona-related drop in private equipment investment was slightly more pronounced than during the global crisis (see fig. 19).

Expect a slow recovery despite some (industrial) silver linings

Over the 2021-22 outlook period, investment activity will remain highly contingent on the COVID cycle. While good news on the vaccination front should eventually improve consumer and business sentiment – and hence become a positive for investment by reducing uncertainty – the overall economic damage that has been caused so far to corporate balance sheets will remain a burden for investment in the foreseeable future. Broadly speaking, both supply-side (financial) issues (falling/negative profits, lower financial reserves) and demand-side issues are likely to be major constraints for a quick and rapid recovery in equipment investment. In this context, it is worth noting that the profit ratio of the private sector has fallen considerably for almost a decade now. The profit ratio – as measured by the operating surplus (plus income by self-employed persons) as a percentage of gross value added – reached a post-reunification low of 23.2% already in 2019 (see the
autumn 2020 Joint Economic Forecast report. The economic institutes expect this ratio to remain weak over the outlook period – barely moving higher than 22%.

Given the current suspension of a corporate’s duty to file for insolvency (in the case of over-indebtedness), the official trend in corporate insolvencies is highly distorted at this point in time. Actually it is very misleading as corporate insolvencies have actually fallen during the corona crisis so far. Although Creditreform forecasts corporate insolvencies to fall to 16,300 cases in 2020 (down 13.4% compared to the 18,830 numbers reported in 2019), it also stresses that insolvency developments have decoupled from economic reality (see FAZ as of 9th December 2020). In particular, smaller firms have been kept financially alive due to the government’s financial aid. However, starting in 2021 – the suspension is set to end 1st of January – corporate bankruptcies will likely rise considerably. In the most affected sectors, numbers may go up strongly (including the restaurant, hotel and stationary retail industries). Overall, Creditreform forecasts the cases of corporate insolvencies to spike by 50% in 2021, rising to 24,000 cases.

But also solvent firms may only cautiously raise investment given the still-high level of economic uncertainty and a more difficult / less attractive environment to raise the necessary external funds investing (equity issues, bank loans). The service sector – which had been a key driver of growth in equipment investment in the past (see figure 22), accounting for around two-thirds of total equipment investment in 2019 (see figure 21) – is likely to become a particular drag. For other investments, which are predominantly conducted by the manufacturing sector, the outlook is generally much brighter. The need for companies to further invest into the digitalization of their production/working processes should buoy investment needs and actual investment in other investment, such as software, databases or research and development.

Downside risks to investment still stem from the rise in protectionism (and the associated risks of damaging beggar-thy-neighbor policies) as well as from hard Brexit. But there are also some positives. The strong recovery of the Chinese economy will certainly help stimulating economic growth and hence investment
activity in Europe and Germany (China is the largest trading partner for Germany). In addition, Germany’s 130 bn fiscal package will help to at least partially mitigate the adverse effects of corona. Both the improved loss carry-back and the temporary reintroduction of the declining allowance for depreciation (on mobile fixed assets) for the years 2020/21 are in that sense probably the most relevant for investment. Finally, there are some points of silver lining from the relatively solid industrial recovery (see figure 24). After a deep fall in March/April of up to nearly 30%, production in the manufacturing sector has already risen for six months in a row now – thus sharply reducing the “corona hole” in output. In October, manufacturing production was “only” 6% lower than back in February. Further good news is coming from October manufacturing orders which were even (slightly) higher than in February – an impressive rebound after a severe drop of roughly 37% over March/April. Finally, yearly growth in domestic investment goods orders (our preferred leading indicator for equipment investment) has clearly returned to expansion mode, posting +2.8% in October (see figure 26).

Outlook for 2020-22: Long road to (full) recovery on stony ground

Despite the silver lining(s) in Germany’s industrial sector, the road to recovery is very long and on stony ground, at least for equipment investment. Fully absorbing and overcoming the economic shock will require some time – notwithstanding the continuation of ultra-expansive fiscal and monetary policies. The recent economic survey by the Association of German Chambers of Industry and Commerce (DIHK) (from autumn 2020) seems to confirm our view. While around one-third of the companies surveyed are planning to reduce their investment budgets over the next 12 months, only 19% of firms intend to raise investment. Across sectors, investment budgets are to be cut heavily in the hospitality, travel, leisure, trade fair and exhibition industries, i.e. in those sectors that were hit the hardest by the pandemic. But firms in the industrial sector are also seemingly reluctant to raise investment given existing uncertainties with regard to foreign demand. According to the DIHK survey, investment plans will be particularly downsized in the area of capital goods producers, boding ill for future equipment investment. In 2021, growth in equipment and other investment is projected to pick up significantly, posting growth of around 10.7% and 4.2%, respectively. However, in our view the strong pick-up in equipment investment should not be misinterpreted. Instead it has to be seen in light of the deep decline in 2020. That said, equipment investment is not expected to exceed pre-corona levels before 2022.

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Housing market: The boom is not over

- The impact of the COVID-19 crisis on the residential sector should remain fairly limited due to the severe housing shortage.
- We expect a gradual increase and no structural break in the use of work from home post-COVID.
- The construction sector is very solid and should grow in 2020 and 2021.

Even the COVID-19 crisis has not ushered in an end to the boom in the German housing market. In particular, institutional investors’ demand for real estate is likely to have been further boosted by the crisis. The flight to safety and the low interest rate environment probably explain much of the substantial rise in prices in the German housing market in 2020. Moreover, the fundamental situation continues to be shaped by a marked shortage of supply. That is why we expect housing prices to rise in 2021 and for several years to come. Often, debate has centred on COVID-related shifts in demand (fig. 27). Due to the scarcity of residential space, however, such shifts are associated with massive rent and price hikes. As a result, the pandemic is likely to have only a limited effect on the subsegments of the housing market.

Since 2009, rents have risen at roughly half the rate of prices in the housing market. The future relationship between price and rent growth could be even weaker. In addition to the many regulatory interventions, which tend to push down rents or slow their growth, the pandemic should temporarily have a stronger negative impact on housing demand than on housing supply. Income development has slowed significantly due to very low wage increases in all sectors, a temporary rise in unemployment and lower employment rates. Consequently, rent growth in 2020 and 2021 is only likely to roughly match inflation. For nationwide housing purchase prices, however, we expect a clear rise of more than 6% year on year in both 2020 and 2021. As a result, rental returns should continue to decline.

The established fundamental problem in the housing market has been exacerbated by the coronavirus crisis, at least temporarily. The expansion of the housing supply, especially in urban centres, has been slow. According to our estimates, the number of completed residential units should once again stagnate at the previous year’s level of 293,000 units in 2020 (data will not be available until May 2021). Even in 2021, the number of completed residential units is unlikely to exceed 300,000, placing it only slightly above the level seen in years prior. On the demand side, the economic recovery from the second quarter of 2021 onward should have a positive impact on demand for living space, with increases in demand once again being fuelled by migration. We expect net immigration to return to the pre-crisis level of roughly 300,000 persons. Germany may have become even more attractive as a destination for immigrants on account of its good healthcare system and its solid political leadership in comparison to other countries.

Policy and regulation: Stricter and more numerous rules, greater demands for affordable housing with limited success

The debate surrounding further regulatory tightening is likely to continue generating many headlines in 2021. All eyes will be focused on parliamentary elections in Germany, with most parties once again looking to promote affordable housing (as if anyone were arguing in favour of unaffordable housing) and striving to outdo each other with campaign promises. Even conservatives are likely to repeat their demands from the most recent parliamentary election to build 1.5
million residential units in the 2017 to 2021 legislative period. By contrast, the fact that Germany has fallen significantly short of this goal in the current legislative period – probably by well over 200,000 residential units – will likely go virtually unnoticed, as some parties are deaf to this market-based argument from the start. As it stands, the child benefits for homes (Baukindergeld) is set to expire on March 31, 2021, which could have a slightly dampening effect on prices in the low- and mid-price segments of the housing market. The special accelerated depreciation allowance for investments in rental properties will end on December 31, 2021, which might increase the shortage of supply in the future. However, an extension could still materialise. A decision as to whether the Berlin rent cap is constitutional is also pending and may have far-reaching consequences for an approach to housing policy that is increasingly inspired by socialism. Any ruling that the rent cap is constitutional will likely trigger the imminent exacerbation of the shortage of supply on the Berlin housing market. On the other hand, 2021 could usher in an end to the socialistic trend in housing policy if the rent cap is found to be at least partially unconstitutional. Regardless of the decision, the ever-stricter regulatory framework and the many well-meaning programmes, including the government’s housing initiative, should at best cushion the impact of the underlying issue caused by a shortage of residential space and fail to remedy it. At worst, they will exacerbate the problem.

Commercial real estate: COVID-19 crisis accelerates existing trends

Without a doubt, many segments in the commercial real estate market face major upheavals. Logistics real estate has benefited from the COVID-related boost in online retail sales. Particularly during the months under lockdown, the sector posted year-on-year gains of more than 30%. Bricks-and-mortar retail is at the losing end of this development – with the exception of the food retail sector. In this segment, retailers with an online presence have not succeeded in massively expanding their market share, even in the face of the pandemic. The general consensus is that these trends will continue well beyond 2020. The hotel market has also been hard hit by the lockdowns. Here too, we expect to see a substantially lower number of business trips and overnight stays even after the coronavirus crisis. Web and video conferencing are often a feasible and beneficial replacement for face-to-face meetings, at least for established business relationships. Moreover, there was anecdotal evidence that the supply of hotels had already exceeded demand in some cities even before 2020. As a result, market consolidation appears imminent in 2021, at least on a regional basis.

The greatest uncertainty exists in the largest commercial segment, the office market. In Germany, almost 15 million people work in offices. At the start of the pandemic, the media was keen to report on the supposed end of the traditional office. Today the debate is more nuanced. The great unknown in the post-COVID world remains the productivity of teams that work from home – an issue that also remains unresolved in the academic literature. Productivity was surprisingly high in March and April 2020, yet we are sceptical as to whether this success in the short term will continue to hold up in the long term. In particular, the onboarding of new employees, as well as the building and development of team and corporate culture, could reduce productivity. The shortage of housing is another obstacle that works against any structural change. What is more, policymakers are now backtracking on their initial promises to introduce a right to work from home. We therefore expect merely a gradual expansion in telecommuting rather than a structural upheaval. Furthermore, we believe that the flexible use of various office spaces (short-term leasing of empty spaces on the outskirts of a city, co-working, hotels, etc.) is suitable only for a small number of companies and that these considerations are
hyped too much in the media. Lost revenue due to productivity losses is likely to quickly exceed the savings resulting from less expensive office space. Because traditional offices remain an important cornerstone, in our opinion, we expect two very different six-month periods in 2021. At first, the negative developments seen in 2020 are likely to continue due to the coronavirus pandemic. With a low number of new contracts, new spaces that remain unlet will consequently lead to marginally higher vacancy rates while rents and prices stagnate. Falling rents and prices can also be expected in some cities. In the second half of the year, however, the post-COVID world will start to emerge, and a first set of companies will return to a more restrictive approach to telecommuting. Accordingly, the number of transactions will increase again, vacancy rates should begin to stagnate and, at least in cities with very low vacancy rates, rents and prices should start to rise again.

Figure 33: 2005-2020 New orders

Figure 34: 2018-2021: Real construction investments

Construction investment: Commercial sector likely to decline

The construction sector has been very solid throughout the pandemic. While the ifo index for the construction industry may have fallen considerably, the construction industry has tended since 2009 to underestimate the actual business situation throughout the economic cycle. Order backlog and capacity utilisation have changed only minimally year on year, according to the ifo survey. Moreover, order intake and construction output have fallen only slightly and had largely recovered by September after bottoming in spring. In particular, order intake in residential construction is currently up on the peaks prior to the COVID-19 crisis. By contrast, commercial and public-sector construction saw significant declines in 2020, and a marked recovery has yet to materialise. The negative developments in retail and the hotel sector, as well as the high degree of uncertainty in the office market, should continue to weigh on commercial construction well into 2021 – and beyond in some cases. On the other hand, the comprehensive fiscal package is likely to help public-sector construction get back on its feet. Following a 2.2% increase in real construction investment in 2020, we expect growth of 1.8% in 2021. Once again, residential and public-sector construction will probably be the pillars of growth, whereas investment in commercial construction is likely to decline.

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Public finance caught in a downward spiral due to coronavirus

- The coronavirus pandemic has brought the high budget surpluses Germany had enjoyed since 2014 to a screeching halt. The coronavirus will continue to dominate public finance until 2022. We estimate that the general government deficit (Maastricht deficit) should come to just under 6.5% of GDP this year. The debt ratio is not expected to reach its provisional high point until late 2021, at approximately 71.7%.

- The new federal government will face major challenges and weighty decisions. After all, it will ultimately have to manage to put the public finances back on solid ground without overly squeezing the economy with even more burdensome taxes and contributions. Long-term consolidation of government finances will probably be much harder this time around than in the wake of the Global Financial Crisis, when a booming labour market, an exceptionally buoyant economy and huge interest savings made for a golden period in fiscal policy.

- Following the Bundestag elections next fall, a major reckoning looks inevitable. The future direction in fiscal policy – especially with an eye to long-overdue reforms on pensions, health, and long-term care – will be one of the themes of the upcoming Bundestag elections.

COVID-19 pandemic throws public finance off balance
The coronavirus pandemic has brought the high budget surpluses Germany had enjoyed since 2014 to a screeching halt. Although government interest spending will be modest in the years to come thanks to low and negative interest, the coronavirus pandemic has hit the general government budget hard – both directly, in the form of discretionary spending, and indirectly, through lower revenue and higher expenditures relating to the economy at large. According to estimates by the German Federal Ministry of Finance (BMF) from early spring, the full range of measures taken in relation to COVID-19 – including the 130-billion-euro stimulus package (see also “Focus Germany: Sounding out the Q2 GDP slump”) and other priority measures taken by the German federal government and social insurers – are expected to weigh on the budget by nearly EUR 230 billion over the next two years alone (for more information on additional spending spurred by the crisis, see “Focus Germany: Coronavirus interim aid scheme: A ripple or a mighty wave?”). But it is already apparent from the extraordinary economic aid provided due to the lockdown (November/December aid) that the tab for the direct rescue costs will be much higher (see also “Germany Blog: German federal budget 2021: Will the credit high be followed by a debt hangover?”).

Even with growth expected to pick back up to a significant degree next year, the lower tax revenue due to economic performance amid the coronavirus is likely to remain a major burden for the financial planning period running until 2024. General government tax revenue is expected to shrink by almost 9% this year alone. According to the working group tasked with estimating taxes at the Federal Ministry of Finance, the cumulative tax shortfall due to the pandemic is expected to amount to roughly EUR 330 billion from 2020 to 2024 (based on a comparison of current estimates for November against estimated tax results in the pre-coronavirus era from October 2019). This year alone, tax revenue is expected to be around EUR 88 billion lower than was forecast before the pandemic hit. Even in 2024, the expected tax shortfall could still be EUR 56 billion. At the German federal level alone, there will be a hole of more than EUR 42.5 billion to fill between 2022 and 2024, according to the financial plan.
Outlook for 2020-2022: Coronavirus crisis still dominant

With all these factors in play, it is no surprise that the outlook for the overall government budget and public debt will continue to be dominated by the coronavirus crisis throughout the forecast period. We estimate that the general government deficit (Maastricht deficit) should work out to just under 6.5% of GDP this year (for comparison, the government posted a surplus of 1.5% in 2019). Although the recovery of the wider economy should have an increasingly positive effect on government finances next year – as we see from the fact that the deficit due to overall economic conditions is expected to decrease to “only” about 1% of GDP in 2021, from slightly over 2.5% in 2020 – the budget deficit will still probably amount to more than 4% of GDP due to the discretionary measures taken to combat the crisis. We also expect the structural deficit – that is, after adjustment for economic and one-time and special effects – to decline only slightly, sliding from an estimated 3.8% of GDP this year to approximately 3.1% next year (see figure 35). The further course of fiscal policy in 2022 and beyond will depend in large measure on the outcome of the Bundestag election and the next federal government’s budgetary policy priorities. While a giant question mark hangs over the idea of a return to compliance with the “debt brake” at the federal level starting in 2022 (see figure 36), we do expect the coming years to bring gradual consolidation, and thus lower government deficits.

As a result of the budget deficits (numerator) that increase the debt and the steep fall in GDP (denominator), the debt ratio is expected to rise this year from just under 60% at the end of 2019 to slightly above 70% (see figure 37). The debt ratio will likely rise slightly again next year to stand at approximately 71.7% of GDP at the end of 2021. Although the debt ratio could fall slightly starting in 2022, there are signs that considerable consolidation will be needed in the medium term, both because the sharply reduced spending on interest will gradually have less and less effect in terms of relieving budgetary pressure and because it will not be long before the state really starts to feel the financial burdens brought by demographic change – even as the labour force shrinks and growth potential significantly declines.
From credit high to debt hangover: Major reckoning looms after Bundestag elections

Although the Maastricht debt ratio will probably not reach the record 82.3% of GDP set in 2010 even with the coronavirus pandemic, the sharp increase in public debt represents a major financial policy burden. According to think tank Stiftung Marktwirtschaft, the publicly announced debt is just the tip of the iceberg. When the implicit or “hidden” public debt is included, what is known as the sustainability gap (all explicit and implicit debts together) is expected to shoot up to over 400% of GDP in the wake of the second lockdown. Under these circumstances, it is probably only a matter of time before policymakers ask taxpayers to dig deeper into their wallets. The contribution guarantee of no more than 40% (for the time being only) promised up to the end of 2021 (“social guarantee 2021”) is looking quite shaky indeed as a result. Already next year the total contribution rate is set to rise to 39.95% for employees with children and hence will get very close the 40%-threshold (see figure 38). However, for employees without children, the total contribution rate will already rise above 40% in 2021 because of the additional contribution rate which they have to pay for long-term care insurance. The idea of a so-called “healthcare solidarity payment” to finance healthcare spending has been floated, as have proposals for a one-time wealth tax, in both cases aimed at a one-sided increase in government revenue. Whether even higher taxes and social contributions are the right medicine for the post-coronavirus period seems highly doubtful with an eye to the high tax and contribution burdens already shouldered by companies and workers alike. Even raising the top tax rate, a common demand, would not just affect high-income private households, but also – and especially – the partnerships that have been hit hard by the crisis.

The new federal government will face major challenges and weighty decisions in fiscal and economic policy. After all, it will ultimately have to manage to put the public finances back onto solid ground without overly squeezing the economy with even more burdensome taxes and contributions. Long-term consolidation of government finances will probably be much harder this time around than in the

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wake of the Global Financial Crisis, when a booming labour market thanks to the positive effects from Gerhard Schröder’s Agenda 2010, an exceptionally buoyant economy (quite a bit less likely in the future with protectionism on the rise) and huge interest savings made for a golden period in fiscal policy.

Following the Bundestag elections next fall, a major reckoning looks inevitable. The future direction in financial policy – especially with an eye to reforms on pensions, health and long-term care – will be one of the themes of the upcoming Bundestag elections. Healing Germany’s public finances will probably be possible only through true structural reform (chiefly limiting the growth of expenditures to a sustainable level, including with an eye to generational equity). The reintroduction of the catch-up factor in the statutory pension insurance system would certainly be a start.

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Inflation: Return to normal in 2021

- The COVID-19 pandemic has dampened consumer price inflation considerably. Even though the pandemic is driving prices up for some goods and services, the price-dampening factors (still) clearly dominate. The currently negative inflation rate is, however, also largely the result of a considerable decline in energy prices. A significant discrepancy is now evident in the development of prices for goods and services.
- With financial burden on public budgets, it does not seem unreasonable that prices for some state-administered goods and services could soon rise significantly, as has been the case in the past.
- In 2021, however, slightly higher energy prices and the withdrawal of the value-added tax cuts on 1 January are likely to give a noticeable boost to inflation. After dropping to 0.5% in 2020, we expect the inflation rate to rise to 1.4% in 2021 and 1.6% in 2022. This is based on the expectation that core inflation will be higher again in 2021/22 at 1.4% and 1.2%, respectively, compared to just around 1% in 2020.

The COVID-19 crisis, oil price slide and temporary value-added tax cuts have dampened the inflation rate considerably

The COVID-19 pandemic has not only triggered a record decline in the global economy, but also dampened consumer price inflation. The pandemic has driven up prices for some goods and services due to factors such as supply chain disruptions or companies having to spend more on hygiene and distancing measures. Nevertheless, the price-dampening factors (still) clearly dominate. As in September, the nationally measured inflation rate (CPI annual rate of change) was -0.2% in October, with core inflation (excluding energy and food) still positive at +0.5%. Relative to the harmonised index of consumer prices (HICP), annual inflation in October was as low as -0.5% (core inflation: +0.2%). The current negative inflation rate is, however, largely the result of the considerable decline in energy prices (down 6.8% yoy). Furthermore, there is currently a significant discrepancy in the price development of goods and services (CPI value in October: -1.5%, or +1.0% yoy) (see figure 39).
In addition to the oil price slide from approximately USD 64 a barrel in January to less than USD 20 in April, the temporary value-added tax (VAT) cut (due to expire at the end of 2020) is another one-off factor that weighs on inflation in 2020. The VAT cut applies for the period from 1 July until 31 December 2020 and was included in the federal government’s fiscal package. The regular VAT rate was lowered from 19% to 16% during this period, with the reduced rate falling from 7% to 5% (see figure 40). About 70% of the goods and services in the German CPI basket are subject to either the reduced or regular VAT rate; the remaining approximately 30% are exempt from VAT. For example, no VAT is levied on net rents.

According to the Federal Statistical Office (Destatis), the reduction in VAT leads to a price drop of about 1.6% in purely mathematical terms in the case of complete and direct price transmission. As such, the VAT cut could reduce the annual inflation rate for 2020 by a maximum of approximately one percentage point, though the actual effect is likely to be lower. However, if the tax cut were to be passed on by half, which does not seem like an unrealistic scenario, the annual inflation rate would be dampened by at least 0.6 percentage points in 2020.

Empty public purses could soon trigger a surge in state-administered prices
With the financial burdens being placed on public budgets becoming ever more apparent, it does not seem unreasonable that prices for some state-administered goods and services could soon rise noticeably (for more information see our inflation article in Focus Germany: “November lockdown = Q4 GDP knockdown”). According to Eurostat, the share of state-administered prices at present (2020) is approximately 12.4% of the total HICP basket. This share is derived from the weighting for direct (6.7%) and partly administered prices (5.7%). The former include price developments for water supply/disposal, waste collection, administration/nursery fees, passenger transport or hospital services, for example, while the latter include those for museum or zoo visits, dental services or pharmaceutical products. A look back highlights that there have indeed been some sharp increases in administered prices in trying financial times (see figure 41). Even if these prices increase noticeably, the overall effect on the rate of inflation should remain limited, given that price increases have as yet not been too sharp. However, should administered prices demonstrate drastically higher annual inflation rates – such as most recently in 2004, with +5.8% – a significant upward effect of around 0.7 percentage points on the German inflation could be the result (see figure 42).
Higher energy prices and withdrawal of VAT cut to accelerate inflation in 2021

This year, the CPI inflation rate is expected to be dampened mainly by low energy prices and the temporary VAT cut. We estimate that the energy component is likely to decrease by 4 ¾% on average over the year (2019: +1.3%), thereby reducing the inflation rate by about half a percentage point in 2020 (see figure 44). This should clearly outweigh the inflationary impact of just over two-tenths of a percentage point triggered by higher food prices. Finally, core inflation is also likely to fall significantly (from 1 ½% in 2019 to just around 1% this year), with the trend then set to reverse in 2021. On the one hand, the withdrawal of the VAT cut on 1 January 2021 (estimated effect: +0.8 pp. or +0.4 pp. if passed on in full or in half) is likely to increase inflation. On the other hand, rising energy prices are likely to accelerate inflation, though the expected appreciation of the euro (to USD/EUR 1.30 by the end of 2021) should, in turn, somewhat mitigate the inflationary impact (see figure 43).

All told, energy prices are expected to increase by roughly 1%, raising inflation by around one-tenth. In addition, the climate change package adopted last year is expected to have price-increasing effects, with the price increases resulting from the planned CO₂ pricing (in the transport/building sectors) likely to outweigh the price reduction effects (lower electricity prices) resulting from the reduction of the renewable energy surcharge. The Deutsche Bundesbank expects a net price-increasing effect of approximately 0.3 and 0.2 percentage points overall in 2021 and 2022 respectively.

Inflation is still expected to be fairly moderate in the coming year given the structural factors dampening price developments (recession, negative output gap, wage restraint and cautious consumers). We therefore expect a decline in the CPI inflation rate to around 0.5% in 2020 to be followed by increases to 1.4% and 1.6% in 2021 and 2022 respectively (see figure 44). This estimate is based, among other things, on the assumption that core inflation will be higher again in 2021 and 2022 at 1.4% and 1.2%, respectively, compared to just around 1% in 2020. The main factor behind the expected increase in CPI inflation in 2022 is the likelihood of a significant rise in energy prices. New price risks could emerge in the medium to long term, meaning the period after 2023. For example, declining competitive and price pressures due to a possible increase in market concentration (i.e. a potential wave of bankruptcies) could have a price-increasing effect. An abrupt discharge of
current pent-up demand could also lead to strong price increases in some areas, at least temporarily. The ultra-expansive monetary and fiscal policy also entails a tendency towards higher price risks.

**Figure 43: HICP: Energy component is set to rise again due to higher oil prices**

![Graph showing the energy component of HICP and oil price (Brent Blend) over time.](image)

*Source: Eurostat, WEFA, Deutsche Bank Research*

**Figure 44: Consumer price inflation outlook for 2020-21**

![Graph showing the annual (average) inflation rate in % yoy and contributions to inflation.](image)

*Source: Federal Statistical Office, Deutsche Bank Research*

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German industry: Corona losses will only be partly offset in 2021

- German manufacturing output should drop by 11% in real terms in 2020. International demand for capital goods should provide stimulus for industrial companies in Germany in 2021. We expect domestic production in the manufacturing industry to increase by roughly 8% next year.

- In 2021, the automotive industry should recover from its deep recession. Domestic production is expected to increase by 30% after a drop by 25% in 2020.

German manufacturing output is expected to drop by 11% in real terms in 2020. This is the second decline in a row and the biggest since 2009 when the global economic and financial crisis hit German export industries very hard. The trough in the current “corona cycle” was reached in Q2 2020 as companies from key industrial sectors such as the automotive industry (voluntarily) shut down their factories due to collapsing demand, supply chain disruptions and concerns about contagion.

Output and order intake have steadily increased recently. Demand from China has been an important factor. German exports to China have already exceeded their previous-year level during the last few months. However, regulatory lockdown measures in Germany and other European countries in November and December 2020 (and probably also in early 2021) will dampen the recovery process in the German manufacturing industry even though the sector is not directly affected by lockdown lite. The willingness to invest will remain subdued in major German export markets such as the EU and the US as long as these countries register a high number of new COVID-19 infections and as long as politics imposes restrictions to contain the corona crisis. Economic momentum in the winter half year 2020/21 will therefore be curbed.

This mixed picture is supported by recent developments in business, export and output expectations in the German manufacturing sector. All three indicators improved strongly directly after the corona shock and returned back to positive territory already in June/July 2020. However, expectations have come down of late given the renewed rise in COVID-19 infections and stricter policy measures. Indeed, export expectations are now slightly negative again.
Even though new orders have developed quite satisfactorily since Q2 2020 and order backlog in the manufacturing sector has reached the highest level since April 2019, companies may decide to process recent orders over a longer period to avoid high volatility in capacity utilisation and inventory pileup.

**Vaccination likely to unleash investment activity**

As soon as it becomes clear that a further exponential spread of the coronavirus can be avoided and that the crisis is gradually being brought under control due to vaccination in large economies and higher temperatures in the northern hemisphere, trust in a self-sustaining upswing will be strengthened. This will finally unleash ‘animal spirits’ in companies – a development that stock markets are already anticipating. This should lead to higher growth rates in global investment spending, starting in Q2 2021 at the latest. A certain backlog demand after many quarters of sluggish economic activity could provide additional stimulus.

The German manufacturing industry will benefit from increasing global demand for capital goods. The recent positive development of German exports to China is an example for how external demand should support output growth in Germany as soon as the corona crisis is under control in important export markets. The generous short labour work regime in Germany will help to ramp up employment once demand growth stabilises since companies are able to retain a large share of their core staff. We expect manufacturing employment in Germany to decline by only 2-3% in 2020. This will become an advantage over European competitors once demand kicks in.

We expect production in the manufacturing industry in Germany to increase by roughly 8% in 2021. The output level should remain roughly 10% below the peak of 2018, though. In 2021, manufacturing will thus not completely be able to offset the corona losses of 2020. German production might increase by another 6% in 2022.

**Auto industry: High volatility – huge structural challenges more relevant**

We expect output in the automotive sector (including suppliers) to decline by roughly 25% in real terms in 2020. This would be the third decline in a row (after -1.7% in 2018 and -11.3% in 2019) and the strongest since German reunification. In 2021, a significant upswing is likely. Output may increase by about 30% yoy on average based on increasing global car demand.
A huge statistical overhang at the end of 2020 plays a part as well. In fact, an increase of 30% would not even require considerable momentum during 2021. But even if this growth rate materialises, car output would still be down by more than 10% compared to 2017.

Structural challenges remain more important for the automotive industry than the short-term development of global car demand. Stricter CO\(_2\) limits for new passenger cars in the EU are an example. By 2021 at the latest, the CO\(_2\) emissions of all new passenger cars in the EU are to be reduced to 95 g/km on average. This limit has to be reached for the major part of new registrations already in 2020. If the auto industry fails to reach this goal, it will have to pay fines. Ironically, the corona crisis helps to reach the CO\(_2\) targets in 2020 since demand for petrol and diesel driven cars deteriorated at the beginning while electric vehicles benefit from (even higher) governmental support. It is an open question, however, when the average customer will be convinced of the appeal of an electric car without calling for subsidies. A further threat for the internal combustion engine is a tightening of emission standards (Euro 7), which is currently being discussed and might be introduced in 2025. The future of trade agreements between the EU and the US or China and the trade regime with the UK after Brexit are further areas that give cause for concern. We find that the German auto industry is better prepared for these challenges than Germany as an industrial location for automotive production.

**Figure 51: Chinese car market turned to positive growth rates again**

![Chinese car market turned to positive growth rates again](image1)

* Source: ACEA, BEA, CAAM

**Figure 52: Metal production still weak**

![Metal production still weak](image2)

* Source: Federal Statistical Office

**Mechanical and electrical engineering: Rising demand for capital goods to lead to output growth in 2021**

The corona crisis has hit mechanical and electrical engineering to a different extent. Even during the peak of the first wave, production remained quite stable in some subsectors of electrical engineering, such as medical technology. In addition, electrical engineering had gotten off to a good start into 2020 (before the pandemic), whereas mechanical engineering output tended to move sideways at the beginning of the year.

We expect mechanical engineering output to decline 14% in real terms this year (2019: -3.1%). Domestic electrical engineering output looks set to decrease c. 8% (2019: -2.4%). Both should benefit from stronger demand for capital goods at both the domestic and the international level. In 2021, we expect output to rise 7% in mechanical and c.5% in electrical engineering.
The firm euro may cause German companies to lose orders to foreign competitors, although the Chinese yuan has appreciated as well. However, German producers’ ability to provide tailor-made mechanical and electrical equipment will protect them to some extent against an exchange-rate appreciation.

Metals industry: Limited recovery in 2021
With production in key customer industries declining in 2020, it is no surprise that the metals industry is in for major output losses, too. The sector as a whole looks set to experience an output decline of 13% in real terms (2019: -4.3). Losses will be slightly bigger in metals production compared to metal product manufacturing. In 2021, growth of 6% appears possible. From a structural vantage point, the outlook for metals production seems more clouded than for metal product manufacturing. Metals production is suffering from global overcapacities and uncertainties about climate and energy policy in Germany and the EU. The sector’s capital stock in Germany has been declining for years. Metal product manufacturers are less dependent on energy policy, as their production is considerably less energy-intensive than metals production. Instead, their output will depend on the extent to which customers from the capital goods industry keep producing in Germany.

Chemical industry: Structural problems set limits
The chemical industry sector suffered relatively moderate losses during the peak of the corona crisis, at least compared to other industrial sectors. In 2020 as a whole, chemicals output in Germany is expected to decline by 2% in real terms. However, it will rise only by 3% in 2021, according to our forecast. Overall, the chemical industry in Germany looks set to remain structurally weak in the coming years, which means that domestic production is likely to trend downwards or stagnate at best. Similar to the metals sector, the capital stock in the chemical industry has been deteriorating for years for the very same reasons. Uncertainties about long-term climate and energy policy decisions make managers reluctant to invest, particularly since the plants are usually operated for decades.

Pharmaceuticals output even slightly up in 2020 – further increase in 2021
Foreign demand for German pharmaceutical products has supported domestic production during the corona crisis; in the first three quarters of 2020, German pharmaceuticals exports were up close to 7% yoy in nominal terms. We expect pharmaceutical production to increase by 1% in 2020 and 5% in 2021, respectively (both in real terms). Vaccines against COVID-19 will partly be produced in Germany. However, demand for certain pharmaceutical products such as cold/flu medication might suffer if outbreaks of the common cold are curtailed by social distancing over the coming months. The pharmaceutical industry will remain the most dynamic sector in terms of domestic production.

Food industry: Continued stable development
The impact of the corona crisis on domestic production in the food industry was limited to the months of April and May. Companies reduced output to implement new hygiene standards at their facilities or protect their employees from infection at the peak of the crisis. Meanwhile, output in the food industry has recovered significantly. We now even expect production index to increase by 1% in 2020 and by 2% in 2021. The market power of food retailers and their ability to exercise price pressure remain the sector’s biggest challenges.

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All attention on the super election year 2021

- Germany is facing not only the federal elections but multiple state elections that will capture political resources. Managing the pandemic will be put to the test.

- The conservatives lead in the polls but their leadership battle is still unresolved. Our baseline scenario is a conservative-green government but coalition talks will significantly test the willingness to compromise on both sides.

- The protests against corona measures – partly also anti-establishment moves – will likely continue in 2021. Although they reflect a certain polarisation, the resilience of society and the political system remains high.

Governing during the pandemic has strengthened above all the CDU/CSU. The internal fights for Chancellor Merkel’s succession have not prevented the conservatives from assuming a comfortable lead in the polls over both their coalition partner SPD and the Green party (see Figure 53). The CDU/CSU was able to leverage the well-acknowledged crisis management by Chancellor Merkel almost to the 40% threshold in polling (currently still close to 36%). The same government, back at the beginning of 2019, was perceived as feeble and divided, resulting in record low polls close to the 25% mark for the CDU/CSU. The SPD, though, despite its governmental role and the nomination of the popular FM Scholz as chancellor candidate, has seen just a minor uptick in voter support and continues to hover around the 15% mark in the polls. One reason for the poor performance might also be that the party lacks an appealing political agenda to win back its traditional core voters. Thus, it is hard to see that the SPD will be able to bridge the gap between the weak polling of the party and the high popularity of its chancellor candidate and improve substantially until the elections.

The Greens relegated the SPD to the third place and are likely to play a pivotal role in forming the next government. After their survey peak of 26% in summer 2019, the Greens maintained good scores well above the 20% mark until the beginning of 2020. The party’s hope for a Green chancellor might have been a bit overambitious, though, as the Greens fell behind in polls during the pandemic – at times close to the 15% mark – and have since been trailing the CDU/CSU. Currently the Greens are close to 20% in polls. In addition, most voters (64%) are not confident that the Greens are able to lead the federal government and appoint the chancellor (Politbarometer, Nov 27). Nevertheless, the Greens have turned into a party that is increasingly appealing to a broader voter base. With the adoption of a new party programme at their convention in November, the Greens further underpinned their claim to leadership. However, the discussion at the convention showed that the party base, in contrast to the party leadership, still has not lost sight of a more radical, leftish policy course in terms of both climate change and social policy – on the latter, the Greens’ position is more in line with those of the SPD or even the Left party. In case of coalition negotiations with the CDU/CSU after the federal elections, this might force party leadership to walk a fine line in striking compromises to keep its base on board.
Current polls point to a conservative-green coalition. Based on the recent poll of polls, there are only two alternatives for majority government: (i) Another remake of the grand coalition – but this has been ruled out many times by the SPD leadership, which seeks a more leftish policy course; (ii) a conservative-green coalition – this option is favoured by a relative majority of the electorate (Politbarometer, Nov 27). Even though coalition talks will be challenging for either side, we consider the latter option as our baseline. Still, uncertainty might be higher this time for two reasons: First, the good scoring of the CDU/CSU is closely linked to the popularity of Chancellor Merkel (see Figure 54). It thus remains to be seen how the CDU scores after the party has nominated its new party leader and – at a later stage – its chancellor candidate with its Bavarian counterpart, the CSU. Second, in the perception of the public, Merkel’s government has rather successfully steered Germany through the pandemic so far. But public support for crisis management is weakening and the political and public debate is becoming more controversial (see Figure 55). A significant rise in corporate insolvencies, bad news from the labour market or a growing feeling that the vast amount of money spent did not prevent social hardships, might change the perception. Subsequently, the CDU/CSU’s bonus could fade over the course of the election year.

Polarisation partly fuelled by corona crisis. A certain dissatisfaction with corona measures has already led to loud and partly violent protests in Germany. While at the start (understandable) concerns over the economic impact of restrictions and curtailment of citizens’ rights had been the focus, other groups with different agendas have captured the protest movements in the meantime. These protest are likely to continue not only because the pandemic (and with it the restrictions) will last well into 2021 but also because some anti-establishment forces see that as a welcome way to question the system of representative democracy as a whole. In search of a mobilizing election topic the right-wing populist AfD got engaged in the anti-establishment protests. So far, however, the AfD has not been successful in leveraging political capital from it and seems to be stuck at the 10% mark in the polls. We find this rather surprising, given when the governing coalition was perceived as weak, the AfD rose to 15% and more in the polls. Then, at the beginning of the pandemic, the government showed itself capable of action, and the AfD was not successful in blaming it for the crisis (as was the case back in 2015 with the refugee crisis). Also in eastern Germany, where a large part of the AfD electorate comes from, the party seems to be losing support – the party’s core issue,
migration, is currently not on the forefront of voters’ minds, and the party does not seem to have found a convincing response yet to the predominant problem of the pandemic. In addition, the AfD’s party convention revealed a strong split between the moderate and the extreme right wing of the party, which might hold the party back from returning to its previous strength. Still, if the AfD succeeds in creating a more general anti-government sentiment, the current situation might change. But while the protests capture large media attention, 86% of Germans reject them (see Figure 56) and the trust in democratic institutions remains high, at least in a European comparison (Eurobarometer). There is little doubt that the corona crisis has been perceived by and has impacted different groups differently, thereby increasing political and societal polarisation. Still, the German welfare state has responded with massive financial transfers – far more generous than in most other countries – for those hit hardest. Also, the federal structure of Germany’s political system is a potent element of bringing politics close to the people and providing flexible solutions to local and regional problems despite its time-consuming processes. Therefore, we consider the political and societal resilience of Germany to be quite strong.

**Election campaign more controversial this time.** Apart from COVID-19 crisis management and broader economic policy, party positioning will likely focus on public finances including the role of the state and climate change. The huge fiscal support has increased budget deficits and public debt (see “Public finance caught in a downward spiral due to coronavirus” on page 21). The debate over who has to bear the costs for the pandemic has already started. The proposals range from moderate fiscal tightening, compliance with national debt rules to increasing tax rates, a COVID-soli, some sort of a wealth levy or the abolition of the debt brake altogether. The expected discussion of the fiscal framework on EU level will add another layer to this sometimes emotional debate.

The other topic, climate change, ranked high in polls on the pre-COVID-19 priorities of the electorate (see Figure 57) and has fuelled the popularity of the Greens. Still, even in Germany green politics are unlikely to be a fast-selling item. Germany’s climate goals will require a major shift away from established consumption patterns and production processes unless new technologies are developed and broadly used. In this process, regulations and standards – often set at the European level (e.g. emission standards) – will play a key role. This also implies that there will be losers among both households and corporations. Conflicts about distribution and compensation might well increase and fuel polarisation in the political landscape. In case of coalition talks between the conservatives and the Greens, painful and costly compromises might be necessary from both sides.

Another topic of interest for foreign investors and Germany’s EU partners alike is European policy. However, there is no evidence from past elections that it has a significant impact on voters’ decisions. The most important issue in this context will be the EU Recovery Fund. Once operational, the fund is a big achievement for the EU and the German Council presidency at the time of negotiations – but for Germany it is a principal change of course in European policy. Feelings about the fund are therefore mixed (see Figure 58) – especially the conservatives prefer the loan over the grant part and stress the limited duration of the Fund and its financing pattern. The Greens, in contrast, are in favour of attributing more fiscal policy competences to the EU, in particular the competence to raise own resources and the possibility to finance the EU budget with loans as part of an own anti-cyclical economic policy. A voter survey just after the closing of the deal showed that the fund was quite broadly supported with 66% of Germans agreeing to it.
(Politbarometer, July 31). A more recent ECFR survey reveals rather mixed feelings among German voters about the fund – while one-third has positive feelings, another one-third has negative feelings about the deal. Moreover, among the voters with a negative response, there is widespread concern that in some cases the money from the fund may not be used efficiently. Thus, critical voices might get louder should there be no reliable evidence that the transfers improve productivity and structural transformation in the receiving countries.

**Election law slightly changed.** Earlier this year, the coalition parties approved an amended electoral law in the Bundestag and Bundesrat against fierce critiques from the opposition. While all agreed that the electoral law needs to be adapted to prevent another oversized parliament (today, the Bundestag has 709 mandates instead of the 598 mandates provided for in the law; see FG, July 9), the amended law now provides for the non-compensation of up to three overhang mandates in the case that the newly elected Bundestag exceeds the norm size of 598 seats. This will benefit all the CDU and CSU, which, due to their strength, are most likely to win overhang mandates. Apart from that, an increase in the number of postal voters is to be expected for the Bundestag elections – continuing the trend of the last elections, this time reinforced by the experience of the pandemic (see FG, Nov 13). Both the new electoral law and the expected increase in postal voters tend to make the election process and projections more complex. Still, we expect a smooth electoral process and timely result as usual.

**Signposts to watch in the short term.** The next date to watch on the path to the federal elections is January 16 when the CDU will elect its new party leader. It is an open race between the three candidates running: The polls are currently led by the conservative Friedrich Merz, whom 27% of the electorate and 39% of CDU supporters would like to see as the next CDU leader. He is followed by the MP Norbert Röttgen (22%) who recently surpassed the centrist North Rhine-Westphalian PM Armin Laschet (see Figure 59). However, popularity is just one side of the coin. The other is the political dynamic that takes place among the 1,001 CDU delegates who in fact are electing their party leader in a so-far-not-detailed virtual format. Delegates are not bound by electoral recommendations of their party groups and the election is held in secret. So far, the CDU’s youth organisation as well as the CDU’s business wing have openly declared their support for Merz – two important groups that account for about 400 delegates. Laschet, in turn, heads the largest state party, the CDU NRW, which has the most delegates of all states (in 2018, there were 298 delegates from NRW) and is running with the popular Health Minister Jens Spahn. The latter is himself mooted as a possible party leader and chancellor candidate – however, both Laschet and Spahn repeatedly stress that they want to stick to the chosen team solution. This constellation essentially turns predictions of who will win into ‘reading tea leaves’ – except that it will need a runoff after the first round. More importantly beyond the election of the CDU chair: While in the past, the party leader was at a later stage traditionally nominated chancellor candidate, that is not at all a given this time. In this context, the CDU’s sister party CSU will play an important role, and its leader, Bavarian PM Söder, is seen by many as a possible chancellor candidate. The CDU/CSU has already twice run with a CSU chancellor candidate (in 1979 with Franz Josef Strauß instead of Helmut Kohl and in 2002 with Edmund Stoiber instead of Angela Merkel) – both times in vain. This could be different this time, but only if Söder is prepared to give up ‘his place in
Bavaria’ – as he likes to say (SZ, Sep 16, 2020). He indicated that the joint decision of CDU and CSU could be taken towards the end of March.

Other signposts will be four regional elections ahead of the federal elections (see Figure 60): One of big importance will be the election on March 14 in the large, automotive-dominated state of Baden-Württemberg, i.e. a state where the regional economy and with it the job situation face a significant structural challenge. The state is currently governed by a Green-conservative government under Green PM Kretschmann, who is running again. While regional issues will of course play a role, the outcome of the elections will still receive broad attention beyond Germany’s borders as it is the first chance in 2021 to gauge voters’ sentiment for parties and potential coalitions with regard to the federal level.

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_We thank Ursula Walther for her valuable contribution._
### Key events – Outlook 2021

**Figure 61: 2021 Calendar of the year**

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1</td>
<td>Portugal takes over EU Council Presidency from Germany</td>
</tr>
<tr>
<td>First half of 2021*</td>
<td>Judgement on the complaint of review of the norms for the Berlin rent cap</td>
</tr>
<tr>
<td>January 20</td>
<td>Collective bargaining rounds 2021 in the metal and electrical industries: Usually two to three rounds of negotiations in following two months</td>
</tr>
<tr>
<td>January 29</td>
<td>Gross domestic product Q4 2020, flash reading without details</td>
</tr>
<tr>
<td>February 24</td>
<td>Gross domestic product Q4 2020, 2nd reading with details</td>
</tr>
<tr>
<td>March/April</td>
<td>Start collective bargaining rounds 2021 in the wholesale and foreign trade: Usually two to three rounds of negotiations in following two months</td>
</tr>
<tr>
<td>March/April/May/June</td>
<td>Start collective bargaining rounds 2021 in retail sales sector: Usually two to three rounds of negotiations in following two months</td>
</tr>
<tr>
<td>March 14</td>
<td>State parliament elections in Baden-Württemberg and Rhineland-Palatinate</td>
</tr>
<tr>
<td>April 25</td>
<td>State parliament elections in Thuringia</td>
</tr>
<tr>
<td>April 30</td>
<td>Gross domestic product Q1 2021, flash reading without details</td>
</tr>
<tr>
<td>May 25</td>
<td>Gross domestic product Q1 2021, 2nd reading with details</td>
</tr>
<tr>
<td>Mid-May</td>
<td>Working party on tax estimates will publish tax revenue projections</td>
</tr>
<tr>
<td>End-May/early June</td>
<td>Publication of completions in the residential sector for 2020, Federal Statistical Office</td>
</tr>
<tr>
<td>May/June*</td>
<td>Financial Stability Committee (AFS): Report to the German Bundestag on financial stability. Possible proposals/interventions in mortgage lending with effects on the real estate market</td>
</tr>
<tr>
<td>June 6</td>
<td>State parliament elections in Saxony-Anhalt</td>
</tr>
<tr>
<td>Mid 2021*</td>
<td>The Eurosystem will decide whether to start a digital euro project with the possible launch of an investigation phase aimed at developing a minimum viable product</td>
</tr>
<tr>
<td>July 30</td>
<td>Gross domestic product Q2 2021, flash reading without details</td>
</tr>
<tr>
<td>August 24</td>
<td>Gross domestic product Q2 2021, 2nd reading with details</td>
</tr>
<tr>
<td>September</td>
<td>Collective bargaining rounds 2021 in the public sector (federal states): Usually two to three rounds of negotiations in following two months</td>
</tr>
<tr>
<td>September 26</td>
<td>Federal election</td>
</tr>
<tr>
<td>September 26</td>
<td>State parliament elections in Mecklenburg-Vorpommern and Berlin</td>
</tr>
<tr>
<td>October 29</td>
<td>Gross domestic product Q3 2021, flash reading without details</td>
</tr>
<tr>
<td>November 23</td>
<td>Gross domestic product Q3 2021, 2nd reading with details</td>
</tr>
<tr>
<td>Early November</td>
<td>Working party on tax estimates will publish tax revenue projections</td>
</tr>
</tbody>
</table>

*presumably

Source: Deutsche Bank Research
Appendix 1

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