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European economy on a pandemic rollercoaster

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The German economy is in partial lockdown during the second wave of the pandemic. True, this lockdown is lighter than the first one back in the spring; nevertheless, losses are still to be feared in many sectors. All the same, the situation in Germany is still much more favourable than in many of our European partner countries.

The degree of disagreement about the impact on fourth-quarter GDP is substantial. On the other hand, the fourth quarter only now plays a comparatively insignificant role with respect to the full-year growth rate. The negative growth rate in aggregate economic output for 2020 as a whole is likely to work out at between minus 5 and minus 6 percent.

The current lockdown will have a greater arithmetical impact on the 2021 growth rate, effectively wiping out the statistical growth overhang for the new year. 2021 will get off to a very subdued start. Subsequently, it is hoped, not least because of the progress being made regarding the development of vaccines, the recovery could accelerate sharply.

In the heavy fog of the current predicament, economic policy-makers have to act with care and consideration. The ECB has announced a "recalibration" of all its instruments for December. In our opinion, this must include an increase in the tiering multiplier.

European economy on a pandemic rollercoaster

The effect of the new partial lockdown

The autumn has brought another significant surge in the number of coronavirus infections - the feared second wave. Against this backdrop, most European countries have felt compelled to impose stricter measures to contain the Covid-19 virus. Unlike in the spring, though, governments are striving to avoid a complete shutdown of the economy. Industrial production is, for the most part, continuing to tick over. Freight transport does not have to face border closures this time either; supply chains remain largely intact. All economic agents involved have now been on a learning curve and are better prepared. Curtailment of activities is now more gradually and carefully targeted than in the first wave. “Partial lockdown” is an apt description of the situation on the ground.

Production losses are concentrated in some sectors

However, some sectors are particularly badly affected. Once again, a particular toll is being taken on the hotel and catering industry, events, travel, large swathes of the leisure sector and the cultural sector. These sectors are now to be compensated with targeted support measures. Nevertheless, there is reason to worry that many livelihoods are at risk in these sectors. And also with regard to the economy as a whole, greater damage is to be feared than just the direct repercussions in the businesses affected by the closures. Negative sentiment has negative spillover effects. Consumption opportunities and the propensity to consume are crimped on a broader basis. Consumer behaviour inevitably changes in an environment threatened by high infection rates. In some cases, however, this would have been the case regardless of whether or not government measures had been imposed.

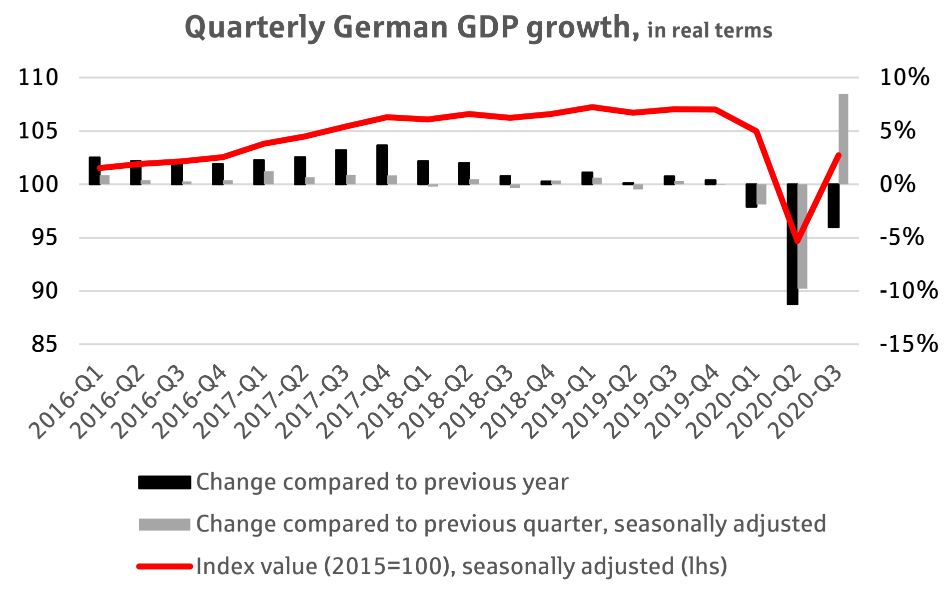
November has already elapsed under a partial-closure regime. This “lockdown light” scenario may well be extended. Thus, there is a risk of setbacks for GDP in the fourth quarter as a whole. And the renewed slowdown in cyclical activity could also have consequences right through into the first quarter of 2021.

The interim recovery proved very strong

This is rather frustrating because the recovery during summer, between the two waves, was markedly successful. The rebound in economic activity turned out to be very pronounced. In the retail sector, sales quickly returned to pre-crisis levels. In that domain, we indeed saw a textbook V-shaped recovery. A significant part of the slump was similarly retraced in manufacturing industry.

Third quarter GDP growth with strong recovery of 8.5 percent

Overall, a very strong seasonally-adjusted quarter-on-quarter growth rate of 8.5 percent was reported for Germany in the third quarter. According to most recent official numbers (24th November, including decomposition of GDP use) this corresponds to a marginally higher growth rate compared to a flash estimate from end of October (was +8.2 percent). This made up for a large part of the decline of 9.8 percent sustained in the second quarter, following the -1.9 percent contraction in the quarter which witnessed the onset of the pandemic. All things considered, then, German GDP was still 4.0 (3.9) percent below the level in the corresponding quarter of the previous year, after adjustment for calendar effects (non-seasonally adjusted), in the quarter stretching from July to September.



Source: Destatis

Germany has got off relatively lightly by comparison with the rest of Europe

GDP seasonally-adjusted, qoq	2020 Q1	2020 Q2	2020 Q3
Euro area	-3.7	-11.8	+12.6
Germany	-1.9	-9.8	+8.5
France	-5.9	-13.7	+18.2
Italy	-5.5	-13.0	+16.1
Spain	-5.2	-17.8	+16.7

Source: Eurostat

The alternation between slump and recovery has, on the whole, been similar in our European partner countries as well as in the euro area. In most countries, the magnitude of fluctuations was somewhat higher still than in Germany. By way of illustration, the euro zone as a whole recorded a growth rate of no less than 12.6 percent in the third quarter. This even more than offset the 11.8 percent decline suffered in the second quarter. However, the initial decline in the first quarter must be taken into account when looking at the trajectory of GDP, the reason being that the epidemic was already rolling violently through Southern Europe in February and March, even before the first wave reached Germany.

One example here is Italy, which already lost more than 5 percent of its GDP in the first quarter. In Spain, the slump was particularly severe in the second quarter, but the recovery in the third quarter was likewise above-average. Nonetheless, Spain was the large euro-zone member country which, in net terms, sustained the largest negative level effect on a cumulative three-quarter basis. This is mainly due to the preeminent importance of the tourism sector in this Iberian country. And this structural exposure will undoubtedly make things particularly difficult for Spain during the current second wave and beyond.

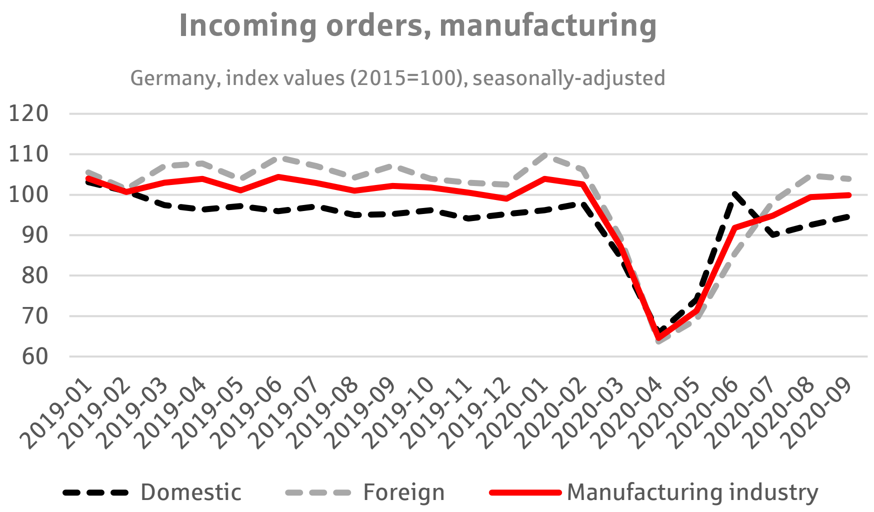
Another country currently being severely affected by the virus is France. The rollercoaster ride between the quarters was particularly pronounced there. The recovery in the third quarter, at over 18 percent, was extremely impressive - but that is, of course, a diagnosis with a look in the proverbial rear-view mirror. This is because France was forced to impose a particularly determined lockdown in November in the face of exploding new infection figures. For the most part, France is currently having to endure blanket restrictions on mobility – sadly, the situation on the left side of the River Rhine fully deserves the term “lockdown.” Austria has followed a similarly strict course from mid-November onwards.

Despite all the lamentations about the pandemic measures that have been implemented in Germany, and despite all the pain emanating from the sectors primarily affected by the pandemic, we should bear in mind how comparatively light the restrictions are on an international comparison: there have been no hard curfews in this country.

With the virus into the autumn

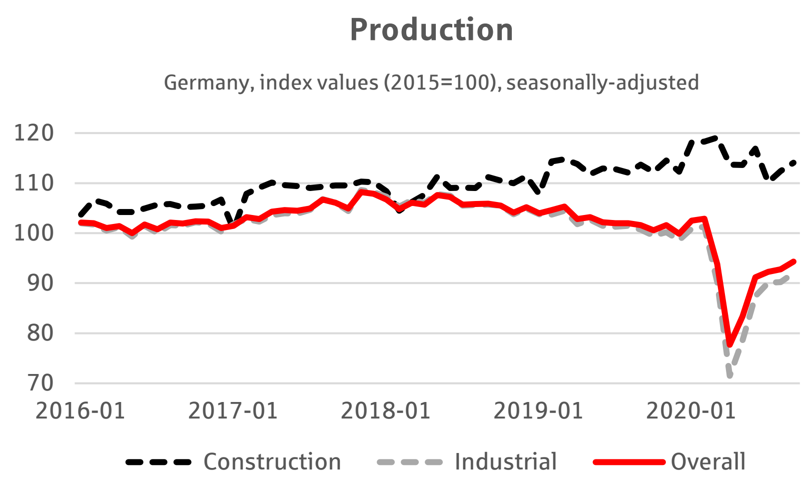
The fact remains that the second wave of the pandemic is bound to leave a clear mark on Germany's economic performance as well.

Let us first take a look at the initial situation - how the German economy was positioned at the end of the third quarter and how far the recovery had progressed by that point. The incoming-orders and production data for the months up to and including September are already available.



Source: Destatis

Incoming orders displayed an almost completely closed V-shaped pattern, especially those from abroad. This reflects, for example, China's almost complete recovery from the toll of the pandemic.



Source: Destatis

On the production front, the recovery has proved somewhat more subdued, except for construction activity, which has hardly been affected by the coronavirus epidemic in any case. The latter has tended to consolidate somewhat since the beginning of the summer - but not because of the summer, this being a seasonally-adjusted time series - albeit still at a very high level. Industry, which claims a bigger share in GDP, provided a locus classicus of the much-quoted “partial recovery.” It is being hoped that industry can, for the most part, keep producing over the course of the new partial lockdown.

If - and this is a “big if,” by no means a guaranteed prerequisite - demand remains sufficiently dynamic. It remains to be seen how cautious and reserved consumers and investors will prove to be in and after the new pandemic wave, although the latest reports about progress on the vaccine-development front could soon improve sentiment. In the services sector, the second lockdown will certainly, in the first instance, generate more markedly negative knock-on effects.

Uncertainty over the fourth quarter will only now have a limited impact on the annual growth rate for 2020

Estimates for overall fourth-quarter GDP continue to diverge markedly. In its annual report presented in mid-November, the German Council of Economic Experts (Sachverständigenrat) estimated a quarter-on-quarter rate of change, adjusted for seasonal and calendar effects, of just below zero. That would imply a growth rate of minus 5.1 percent for full-year 2020 GDP.

Key data oft he Council of Experts‘ forecast for Germany (%)	2020	2021
GDP	-5.5	+3.7
Private consumption	-6.8	+3.4
Gross fixed capital formation	-3.6	+4.1
Consumer price inflation	+0.5	+1.7
Unemployment rate	4.1	4.2
Current account balance (% of GDP)	+6.8	+7.1

Source: German Council of Economic Experts (Sachverständigenrat)

It is scarcely possible any longer to find forecasts that project a positive growth rate for the fourth quarter. Most expert predictions are either slightly or significantly below those made by the German Council of Economic Experts. In an ad hoc survey of the Chief Economists of the Savings Banks Finance Group (Sparkassen-Finanzgruppe) and in the Group's publications, the range for the final quarter of 2020 is quite wide, stretching from -1 to -6 percent. This reveals the extent of the prevailing uncertainty about the impact of the current (partial) lockdown.

It should again be emphasised, though, that the fourth quarter now only has a limited bearing on, and a limited significance for, the annual rate of expansion, which, this year, is going to turn out to be a pronounced “rate of contraction.” If it is assumed that there will be no more major revisions for the first three quarters already reported by the Federal Statistical Office, the historical dimension of the annual negative growth rate can already be measured fairly precisely: very likely, German aggregate economic output is set to shrink by between -5 and -6 percent.

The statistical interdependencies are shown in the following table. This chart illustrates which current rates of change for the final quarter are associated with which annual rate. First of all, the seasonally-adjusted quarter-on-quarter figures are used to compile the calendar-adjusted annual result. Then working-day effects between 2019 and 2020 have to be factored into the equation in order to arrive at the reported headline annual growth rate. This is because the seasonally-adjusted quarter-on-quarter figures invariably need to be adjusted for the number of working days. This adjustment must logically then be taken into account when aggregating to annual GDP, if an assessment of measured unadjusted GDP is the goal.

Working-day effects questionable in this special year

One can, of course, have magnificent arguments about how great the working-day effect is in a modern economy, in view of the options provided by online retailing, and so on. This effect will certainly be of diminished importance in this exceptional year of 2020, in which lockdowns, home office etc. have bulked so large. Nevertheless, the Federal Statistical Office officially calculates a disparity of 0.4 percentage points of GDP for the three or four more working days, depending on the federal state, which have been available in 2020 in contrast to 2019 due to the timing of public holidays at weekends. This disparity is taken into account in the following table.

Table: Relationship between Q4 quarter-on-quarter growth rate, annual rate and statistical overhang
(assumption: no revisions for the first three quarters already officially reported in 2020)

German gross domestic product, inflation-adjusted, changes in %			
Hypothetical, seasonally-adjusted growth rate Q4 / 2020	Implied calendar-adjusted annual rate 2020	Headline annual rate 2020	Statistical overhang for 2021
-6.0	-6.8	-6.4	-3.2
-5.0	-6.5	-6.1	-2.4
-4.0	-6.3	-5.9	-1.6
-3.0	-6.1	-5.7	-0.9
-2.0	-5.8	-5.4	-0.1
-1.0	-5.6	-5.2	+0.7
0.0	-5.3	-4.9	+1.4

However great the uncertainty about the current situation, the official headline figure for German GDP growth in 2020, a year overshadowed by Corona, will most likely have minus five before the decimal point. The corollary is that Germany's GDP looks set to contract by a similar magnitude to the situation in the financial crisis (2009: -5.7 percent). This will be the case despite all the differences that can otherwise be observed between the two crises - the cause, the size of the sectors affected, the extent of the exogenous setbacks, the position of the crisis-ridden quarters in the annual calendar, etc.

Q4 2020 is going to prove more important for 2021 than for 2020

Statistical overhang carries the effect of the current lockdown into 2021

The above table also reveals that the final quarter of 2020, which has been partially in thrall to the second partial lockdown, is of particularly importance for the macroeconomic performance in 2021. This is because the production level at the end of the year determines the so-called "statistical overhang", i.e. the statistical growth dowry with which the new year sets out. In an environment of steady growth, the growth overhang is regularly positive in "normal" years. The trend from the previous year accordingly contributes to annual average growth in the next year by anchoring the starting point at a higher level.

At present, however, it is completely unclear whether the level in the final quarter of 2020 will be above-average by comparison with the very volatile trajectory over the course of the present year. The only probable certainty so far is that production will hold up better during the second lockdown than at the low point of the first lockdown in the second quarter.

The other side of this coin, though, is that it is not even clear yet whether the previous year’s dowry for the next year will be positive (an overhang) or negative (an underhang). Statistically speaking, the "break-even" fourth-quarter quarter-on-quarter growth rate translating into a zero overhang is -1.9 percent, i.e. a quite realistic projection right in the middle of the forecast range.

Catch-up potential for 2021 - Economic policymakers need to drive by sight

The narrative in most forecasts for 2021 remains one of ongoing recovery, especially now with recently vindicated hopes regarding the development of various vaccines. That the figures for forecast annual growth in the new year have drifted downwards to some extent in recent weeks is not due to a change in the projected outlook for the course of 2021, but rather to the lower baseline resulting from the current lockdown. In this respect, the invariably positive outlook for 2021 reflected in the already-mentioned ad hoc survey of the Chief Economists of the Savings Banks Finance Group - German GDP growth in the 2.4 to 5.0 percent range - symmetrically encapsulates the projection arrived at by the German Council of Experts (3.7 percent).

Current dent in GDP is inevitable

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Economic policy must rather support recovery thereafter

When spring arrives, the question of what economic-policy measures will then be needed to support the upswing will perhaps arise again. Currently, however, in the acute phase of the second lockdown, the tried-and-tested transitory instruments should be drawn on. The short-time working arrangements in operation at present are warranted, although they cannot be extended forever, and support measures precisely targeted at the sectors most affected were and are the right thing to be using. By contrast, the temporary reduction in VAT should be allowed to expire at the end of the year, as planned. The cut in VAT was appropriate as an important (not least psychological) signal in the summer during the first recovery phase between the waves of the pandemic, helping to build confidence and revive consumption. However, its effect on the real economy will mainly come through “anticipatory effects,” as economic agents scramble to bring forward purchases ahead of the reversion to the former VAT rate, and thus ultimately through the announcement of the renewed tax hike. This effective “cliff” should not therefore be called into question. Being a very expensive and far too “broad brush” instrument, a reduction in VAT is not to be recommended in the long term.

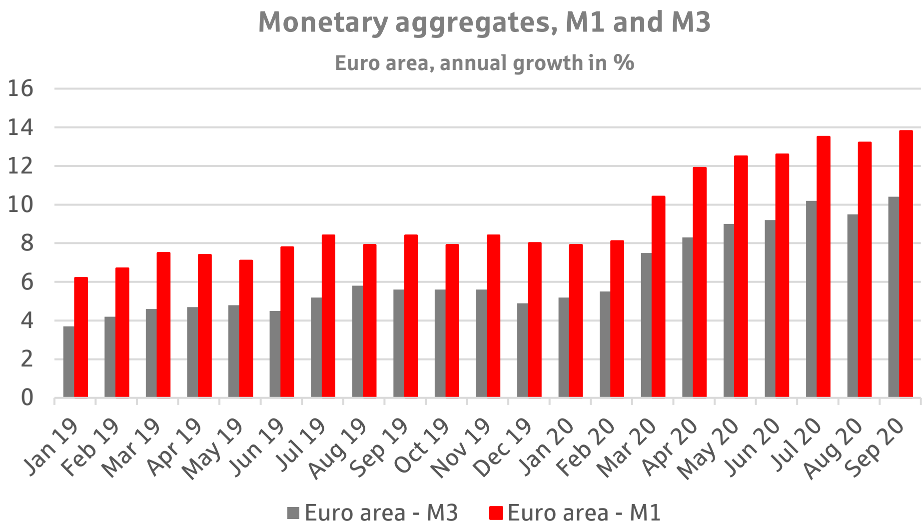
In any case, the current growth dent taking its toll on GDP in the current lockdown cannot be forcibly ironed out in full. What is more important is how the economy is positioned for the phase after we emerge from lockdown.

Catch-up effects in consumption to be smoothed by abundant savings

And here there are certainly grounds for cautious optimism: despite the initial (purely statistical) burdening effect of the low or even negative growth overhang for 2021, it can be argued that the more draconian the present lockdown, the greater the catch-up potential. For a catch-up effect is quite conceivable on account of foregone consumption opportunities and pent-up consumer demand. The dramatic surge in the domestic savings ratio, the brimming-over current-account balances of customers which we at Germany’s savings banks are observing, and the strong pace of money-supply growth are all arguments in favour of this. There is no across-the-board shortage of money.

Monetary policy at full throttle

The growth rates of the monetary aggregates, which had certainly not been low before in any case, have accelerated further and further over the course of 2020. In an economic area sharing the same currency, such monetary developments are best illustrated by the aggregates for the whole currency zone, i.e. in this case for the euro area. However, these “macro” trends are definitely also typical of the development in Germany. Germany’s sub-aggregates are shaping up in a very similar manner to the overall figures.



Source: ECB

This spurt in money-supply growth is no accident: it is something which monetary policymakers have been wishing for. What is more, the transmission mechanism has more tailwind at its back than in recent years. The disbursement of bridging loans and the rise in national debt at all levels are likewise contributing their mighty mite to money creation. To that extent, it is also important to keep an eye on the inflationary risks which may rear their heads in the medium term. Over the long years marked by low inflation and low rates of price increases, economic agents have largely reduced their inflationary expectations, maybe even forgetting them completely for a longer period of time.

Subdued inflation potentially waiting for a spark

So far, warnings about inflation letting rip - warnings which were already voiced earlier in the low-interest phase - have not proved warranted. There have repeatedly been effects putting downside pressure on inflation dynamics, whether the cost reductions and enhanced efficiency conferred by globalisation, the sharp increase in savings over the last decades or, most recently, the brakes slammed on sharply by the coronavirus crisis. The fact remains that such strong monetary growth cannot remain without consequences forever. This can be gauged, for example, from a sideways glance at Turkey, which is currently saddled with a currency crisis because the room for monetary-policy manoeuvre threatens to be overstrained in the long run by excessively low interest rates and by - to put it mildly - very "unconventional views" concerning the impact of monetary policy.

In the euro area, which enjoys a high degree of credibility and institutional independence, things do, of course, look different. There is no danger of an abrupt loss of confidence or of currency depreciation. Now, still in the acute phase of the crisis, the ECB has both the scope and the will to increase the degree of monetary stimulus. In view of currently weak inflation dynamics and of the risks looming in the trough of the second lockdown - a trough which is pronounced in some countries - this is quite understandable. The ECB has already, in effect, announced a broad package of measures for its next Governing Council meeting on 10 December. According to the statements at the previous meeting of the euro area's top monetary custodians and at the subsequent press conference, a "recalibration of all instruments" is on the agenda.

A recalibration of all the ECB's instruments is in the offing

The ECB's various purchase programmes will certainly be adjusted at the December meeting. These are scheduled to continue in 2021 anyway, and there are, in fact, still sufficient free volumes left. However, the ECB wishes to send a signal to the financial markets by extending the time frame and/or increasing the pace of purchases. This may also be necessary because the mobilisation of the €750 billion EU Reconstruction Fund is faltering - in a not entirely unpredictable way - for institutional reasons and as a result of political wrangling.

By contrast, it is to be hoped that the ECB will not change its key interest rates. Quite justifiably, there has been considerable reluctance this year among the eurozone's monetary authorities, as at other major central banks, to lower interest rates so as not to overtax monetary policy in a damaging fashion. One can be more open-minded about providing favourable conditions under the TLTRO programme for a longer period of time. Longer-term LLTRO tenders can maintain incentives for lending while at the same time taking pressure off banking systems.

Modification of Tiering multiplier should be part of recalibrations

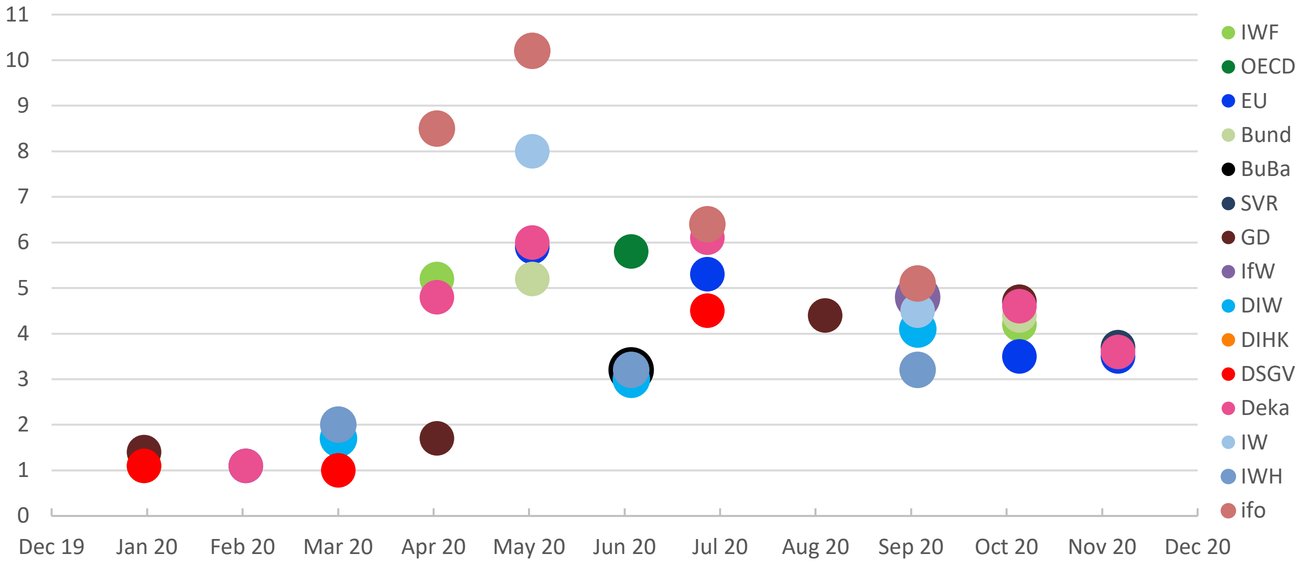
For the latter objective to be attained, though, an increase in the ECB's tiering multiplier would also be necessary. The "tiering" instrument introduced just over a year ago was expressly designed to have a variable multiplier, initially set at six times an institution's minimum reserve requirements, governing the volume of reserve holdings exempt from the central bank's (negative) deposit facility rate. The multiplier set for the initial maintenance period has not been changed, and an upward adjustment at this point would be fully in line with the announced "recalibration" of ECB instruments. In view of the fact that the amount of excess liquidity sloshing about within the European banking system has increased further in the interim, and even more so if the purchase programmes are going to continue to exert pressure here, an increase in the tiering multiplier to ten or twelve would be called for.

A. Growth of world economic regions, percentage change in year-on-year terms

	2018	2019	2020*	2021*
World trade volume	3.7%	1.0%	-10.4%	8.3%
GDP - World	3.4%	2.8%	-4.4%	5.2%
USA	2.9%	2.2%	-4.3%	3.1%
Japan	0.3%	0.7%	-5.3%	2.3%
China	6.7%	6.1%	1.8%	8.0%
Euro area	1.9%	1.3%	-8.3%	5.2%
Germany	1.5%	0.6%	-6.0%	4.2%

* International Monetary Fund October 2020

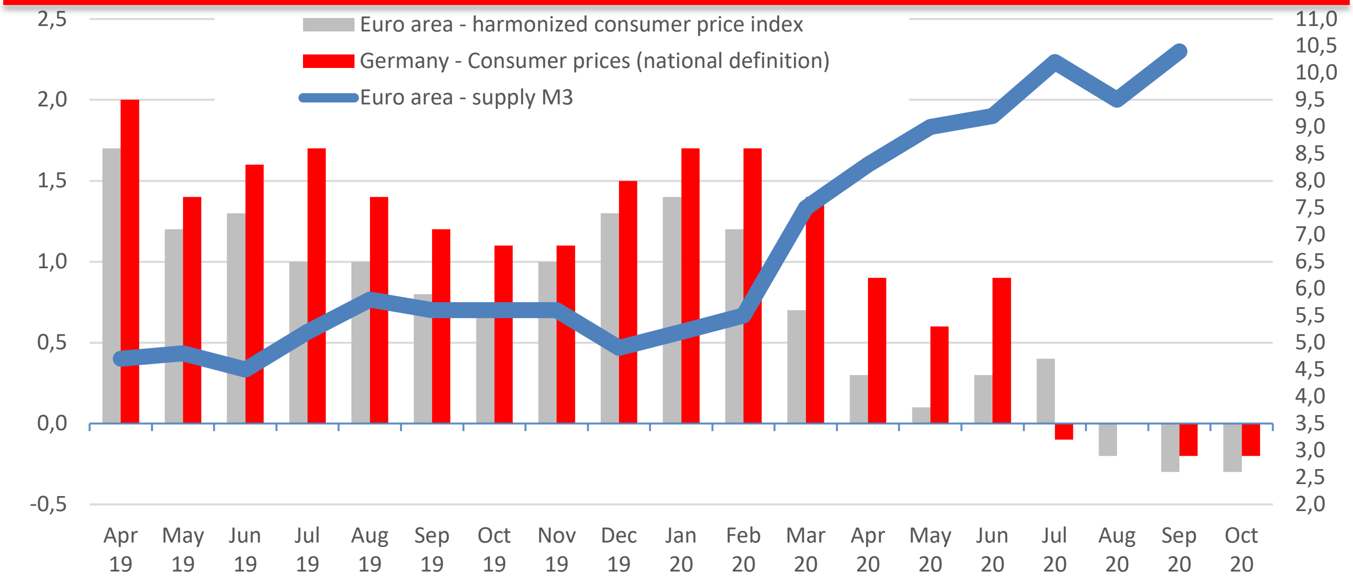
B. Forecasts for economic growth in Germany for 2021, in %



C. GDP in the euro area and Germany

	year 2019	Q IV - 2019	Q I - 2020	Q II - 2020	Q III - 2020
	real, yoy	real rate of change, yoy and seasonally-adjusted growth rate, qoq			
Euro area GDP	+1.5%	+0.9% 0.0%	-3.3% -3.7%	-14.8% -11.8%	-4.4% +12.6%
Germany GDP	+0.6%	+0.2% +0.0%	-1.7% -1.9%	-11.3% -9.8%	-3.9% +8.5%
Private consumption	+1.6%	+1.0% +0.1%	-1.4% -2.3%	-13.0% -11.1%	-3.7% +10.8%
Gross fixed capital formation	+2.6%	+0.4% -0.2%	-0.2% -0.4%	-7.0% -6.6%	-3.4% +3.6%
Exports	+0.9%	+0.8% -0.3%	-3.2% -3.3%	-22.4% -20.5%	-9.1% +18.1%
		level, not rate of change; quarterly figures, seasonally-adjusted			
Savings ratio	10.9%	11.1%	12.2%	21.1%	16.2%

D. Consumer prices (lhs) **and M3 money supply** (rhs), annual rates of change in %



E. Monthly economic indicators Germany

	Jul 20	Aug 20	Sept 20	Oct 20	Nov 20
Prices (national definition)	Change compared to same month of previous year				
Consumer prices	-0.1%	0.0%	-0.2%	-0.2%	-
- Excluding food and energy (core inflation)	+0.7%	+0.7%	+0.5%	+0.5%	-
Producer prices for commercial products	-1.7%	-1.2%	-1.0%	-	-
Import prices	-4.6%	-4.0%	-4.3%	-	-
Sentiment indicators					
Ifo Business Climate Index	90.2	92.4	93.2	92.5	90.7
ZEW Economic expectations	59.3	71.5	77.4	56.1	39.0
Order intake	Change compared to same month of previous year				
Manufacturing industry	-6.8%	-3.8%	+1.1%	-	-
- domestic	-7.1%	-5.2%	+1.8%	-	-
- foreign	-6.6%	-2.9%	+0.7%	-	-
Capital goods producers	-7.3%	-2.1%	-1.9%	-	-
Production	Working-day-adjusted change compared to same month of previous year				
Producing sector as a whole	-9.5%	-8.7%	-7.3%	-	-
thereof construction	-2.2%	0.0%	+0.3%	-	-
thereof industry	-11.2%	-10.8%	-8.8%	-	-
Foreign trade	Change compared to same month of previous year				
Exports	-11.0%	-10.2%	-3.8%	-	-
Imports	-11.3%	-6.8%	-4.0%	-	-
Labour market	Level of the quota or change compared to the same month of the previous year in 1000				
Unemployment rate	6.3%	6.4%	6.2%	6.0%	-
Jobless total	+635	+636	+613	+556	-
Employed persons (place of work in Germany)	-660	-653	-649	-	-
Employees subject to social security contrib.	-105	-104	-	-	-

F. Commodity, foreign exchange and financial markets

	Jul 20	Aug 20	Sep 20	Oct 20	26th Nov.
Brent oil price in US $	43.24	44.74	40.91	40.19	46.54 (24.)
Exchange rates					
US- Dollar / EUR	1.1463	1.1828	1.1792	1.1775	1.1900
Japanese Yen / EUR	122.38	125.4	124.5	123.89	124,04
Stock markets					
German share index DAX, end of month	12,313.36	12,945.38	12,760.73	11,556.48	13,287
Change compared to same month of previous year	5.13%	-1.43%	-9.44%	13.15%	-
Money and capital market interest rates					
Overnight money (EONIA)	-0.46%	-0.46%	-0.47%	-0.47%	-0.47% (25.)
1-month money (EURIBOR)	-0.51%	-0.52%	-0.52%	-0.54%	-0.53% (25.)
3-month money (EURIBOR)	-0.44%	-0.48%	-0.49%	-0.51%	-0.53% (25.)
Current yield on German government bonds with a residual maturity of ten years	-0.50%	-0.57%	-0.40%	-0.58%	-0.59%
Interest payable by credit institutions, on new business					
Overnight deposits of households, DEU	0.00%	0.00%	0.00%	-	-
for comparison: across the euro area	0.02%	0.02%	0.02%	-	-
Deposits of households up to 1 year, DEU	0.15%	0.16%	0.10%	-	-
for comparison: across the euro area	0.20%	0.17%	0.17%	-	-
Corp. loans up to € 1 million over 5 years, DEU	1.66%	1.51%	1.55%	-	-
for comparison: across the euro area	1.52%	1.51%	1.55%	-	-

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