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Services take off while industry flies on

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The situation in the various secors of the economy has remained largely unchanged during the current lockdown from December to the beginning of March: the services sector is being affected by direct closures in many areas, while manufacturing industry is largely able to continue producing unhindered. Were the tally of infections to recede, there would be hope of a broader and more uniform "fresh takeoff" for the German economy. Unfortunately, the incidence of Covid-19 infections has recently moved into a sideways trend.

If GDP is broken down into its components, private consumption and equipment investment continue to be depressed. Recoveries are underway in certain export domains. However, catch-up potential also continues to grow in the consumption sphere.

The inventory-investment equation proved to be very striking in Germany during 2020. There were considerable inventory drawdowns, which had a very strong impact on the trend in GDP. As can be seen below, various interpretations can be put forward for the depletion of inventories.

Money-supply growth in the euro area continues to accelerate. The inflation trend has turned positive, but has been temporarily overshadowed by special effects. However, the issue of inflation must be considered again in the medium term, especially since monetary policy is set to remain expansionary for a very long time.

Services take off while industry flies on

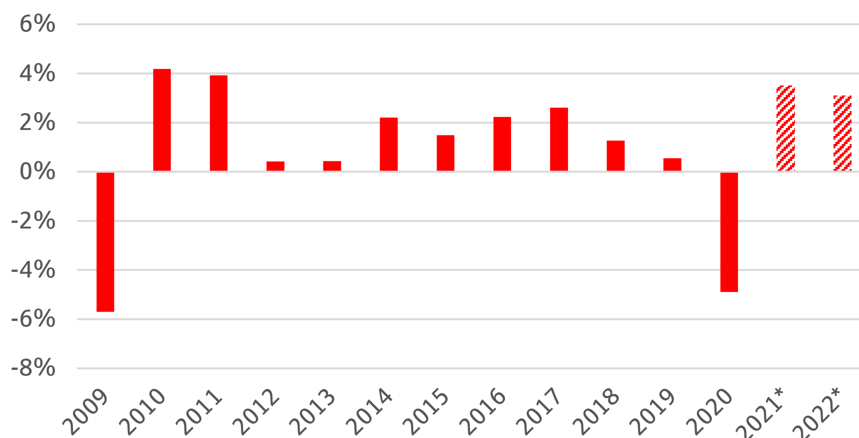
The sectoral set-up is still similar to the situation at the beginning of the (second) lockdown

During the second lockdown in Germany, industry has been able to continue producing largely undisturbed. This has become ever more clear in recent weeks. True, there have recently been discussions about how much the isolated border controls that have been introduced in the meantime might disrupt supply chains. But unlike last spring, this seems to be only a limited problem. Manufacturing industry can largely remain airborne or take off for fresh flights.

The situation is different for events, accommodation and catering, retail, culture, sports, travel and transportation. To retain the image of "take-off": aviation can at best hope for a future liftoff. The restrictions that have been in place for many sectors since November and which were then tightened further in mid-December are weighing heavily on large swathes of the services sector. Here there are only, as yet, isolated rays of hope and exceptions, such as the hairdressers who have just been allowed to open their doors for business again.

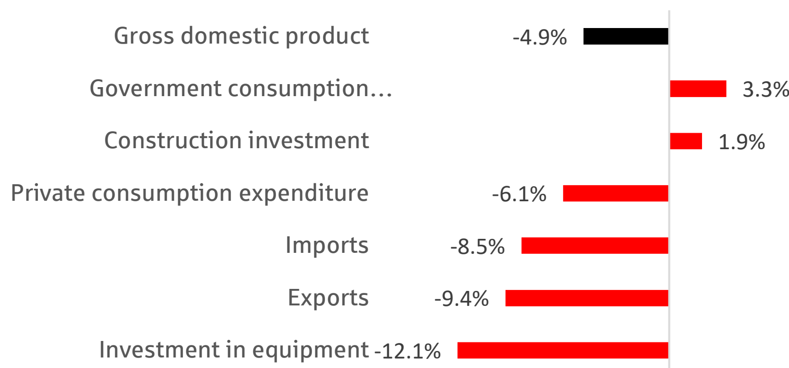
A dichotomy: Shuttered services firms vs. industrial outfits continuing to produce under full steam

As March begins, though, little has basically changed regarding the dichotomy between sectors that has existed since November of last year. Of course, everyone involved hopes that a decline in the tally of coronavirus infections will enable lockdown easings and reopenings in all sectors. Most macroeconomic forecasts are factoring in a broad-based resumption of social life, and of the economic life based on this, during the course of the spring. A seven-day incidence rate of 35, which is now being postulated as a prerequisite for this, came tantalizingly within reach as a result of the trend in the first half of February. Unfortunately, though, the tally of Covid infections has recently moved into a sideways trend in spite of the still ongoing lockdown. Further containment of the pandemic is therefore faltering. We can only hope that new mutatant strains will not prevent the resumption of social activities and that the vaccination programmes remain effective and can be rolled out more speedily going forward. In addition, an increased use of rapid tests could fulfil a bridging function for the next few months in order to allow more social contacts once again.



*Source: Destatis, * Joint forecast by the Chief Economists of the Savings Banks Finance Group from 26.1.2021*

Looking back at 2020, the structure of GDP has turned out in the way which was already to be expected since the first lockdown in the spring of last year: merchandise exports and investment in equipment were the items on the expenditure side of GDP which declined most sharply, contracting in real terms by 9.4 percent and 12.1 percent, respectively, in 2020 as a whole. In any case, these are the components that exhibit the greatest cyclical volatility in normal recessions, although not to the same extent as in the current coronavirus-induced cyclical downturn.



Source: Destatis

Consumption is continuing to generate catch-up potential

Private consumption, at -6.1 percent in 2020, was likewise a pendulum swinging with sharp fluctuations in the special situation prevailing. Private consumption expenditure indeed slumped even more than GDP as a whole, which contracted by -4.9 percent. On the GDP front, there has, however, been a small piece of positive news recently: the second estimate of the fourth-quarter growth rate has reported a small upward revision, which has accordingly filtered through to overall annual growth. The official figure for 2020 now has a four before the decimal point and no longer a five, as in the first estimate from January.

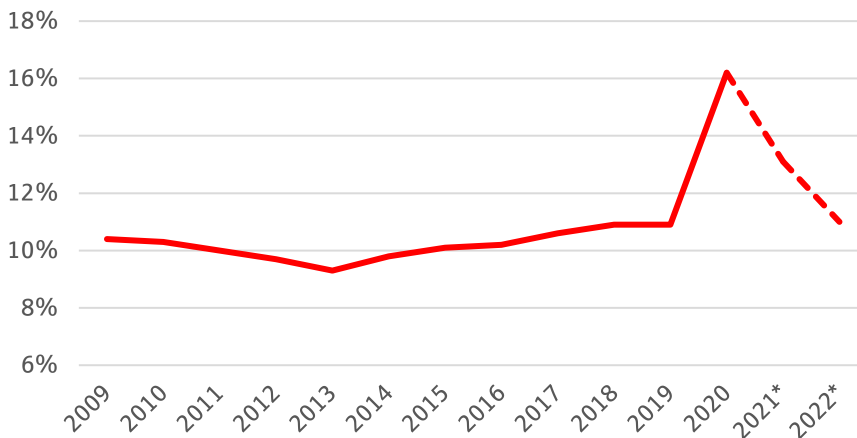
2020 annual GDP has been revised upwards slightly to a new figure of -4.9 percent

This more pronounced slump in consumption happened even though mass incomes were kept largely stable by state intervention. The national-income category “compensation of employees” indeed only fell by a total of 0.2 percent in nominal terms. The main reason for the disproportionate decline in private consumption was that many consumption activities were simply not possible over large parts of the year and still remain restricted in 2021.

In the case of durable consumer goods, it is relatively easy, in principle, to make up for postponed purchases. That is more difficult with many services. Events, and whole expanses of time, that have been cancelled cannot simply be “caught up on.” 2020 capacities at events, hotels, restaurants, etc., some of which have remained unused until today, have been effectively lost in the period in question and cannot be shifted from there into the future from a supply-side perspective. On the demand side, however, things look different. In many spheres, there is certainly a pent-up desire to consume that is waiting to be released. It remains to be seen how this will be reflected in prices when demand is unleashed. This demand will be met by, at best, unchanged and, at worst, diminished capacities at some suppliers who have not made it through the lean period.

On the supply side, “same-day” service offers cannot be made up for at a later date....

... but, on the demand side, pent-up consumption can definitely translate into actual demand subsequently



*Source: Destatis, * Joint forecast by the Chief Economists of the Savings Banks Finance Group from 26.1.2021*

At any rate, private households have built up the financial reserves needed to be able to afford a catch-up in consumption. The savings rate at private households reached a record level of 16.2 percent in 2020 - largely involuntarily, as implied above. If normalised consumption opportunities are once available again in the future, private consumption could well become a strong flywheel driving the recovery.

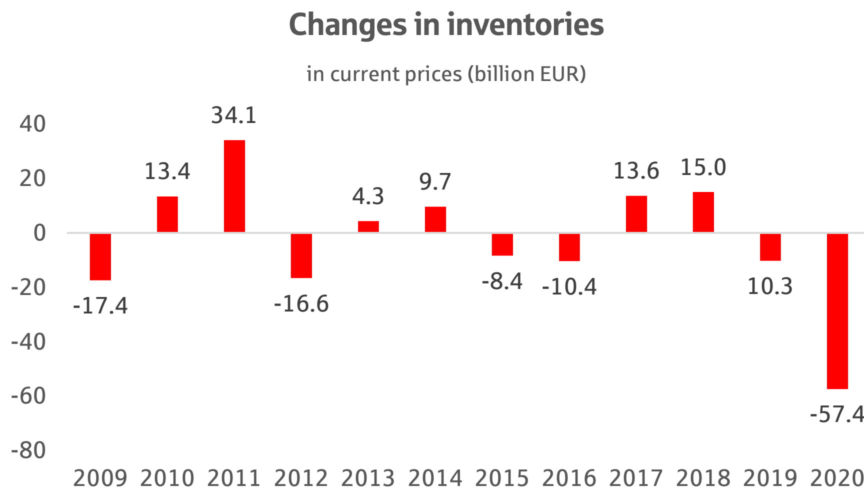
2020 witnessed a pronounced inventory drawdown

Another equally striking development in the 2020 national accounts - and one which has not yet been widely commented on - has taken place on the inventory-investment front. Inventory levels have decreased to a very pronounced extent across the economy as a whole.

Admittedly, the Federal Statistical Office does not publish any direct data for price-adjusted inventories. Only their contribution to growth is quantified within the framework of the real accounts. This means that only the changes in inventory balances can be gauged, i.e. “the change in the change” and thus the “second derivative” of inventories proper. Theoretically, then, a negative contribution to macroeconomic growth could also result from a level of inventory investment that was still positive but lower than in the previous year. The interpretation of these official inventory data should therefore be undertaken with caution, especially since inventories are often estimated as a kind of residual in statistical practice, being used as a buffer to keep calculations consistent overall.

As a residual item in the national accounts, inventory investment needs to be interpreted with caution

In 2020, however, the published data paint such an extreme picture that a marked inventory drawdown can indeed be inferred. In the nominal calculation of the expenditure side of GDP, information is provided on changes in inventories.



Source: Destatis

The “changes in inventories” figure for 2020 - no less than EUR 57.4 billion - is a pretty breathtaking figure. After all, this corresponds to a full 1.7 percent of German GDP. One could mentally contrast this figure with the overall GDP rates of change (-3.4 percent in nominal terms, -4.9 percent on a real basis). Thus, “final use” in Germany has not declined anything like as much as “production.” What has rather occurred is that a good part of “use of goods” has been catered for via warehouse depletion.

The inventory drawdown reported seems counterintuitive given all the unsold stock in the retail sector…

At first glance, this would appear counterintuitive. After all, one hears complaints from the retail sector that shop closures have left entire ranges of goods unsold and unsaleable on the shelves. This applies very plausibly and graphically, for example, to winter collections in the textile trade. This sounds more like an “involuntary inventory accumulation” scenario.

If these stocks are written down in value because of seasonal unsaleability, that would duly have a negative impact on the nominal value. This provides an explanatory contribution, but only a partial one. It does not reverse the underlying trend: even if the price of goods that have been “idly warming the shelves” is lowered or even reduced to zero, that would not explain the sharp decline in inventory levels compared to normal times.

However, various interpretations can be put forward as to why real stocks might actually have been used up in many goods categories during 2020:

… but explanations for declining stock levels can be put forward

- The disruption in supply chains in spring 2020;
- The surprisingly strong recovery observed in the third quarter;
- A trend which is the mirror image of the inventory-accumulation process in the United Kingdom prior to the turn of the year.

The supply bottlenecks during the first lockdown in the spring of 2020 certainly emptied many primary and intermediate product warehouses, which in many industries had been kept very lean for years anyway. Given that the further trajectory of the pandemic was not foreseeable, restocking did not immediately occur in all domains either. With so much uncertainty swirling around, a wait-and-see attitude took hold. Subsequently, in the third quarter, many players were taken by surprise by the strength and speed of the recovery. In some cases, inventory levels were simply not sufficiently prepared for such a rapid recovery. And it seems to be the case that the 2020 destocking process referred to was indeed focused on the third quarter.

After all, the next deadline in the Brexit endgame was approaching at the end of 2020, with the political exit of the United Kingdom at the end of 2019 scheduled to be followed by the UK's economic exit from the Single Market. The contours of the compromise agreement which was ultimately struck only became clear in the very last days of 2020. Prior to that, many British players had built up their stocks of EU goods in order to be on the safe side. This effect is perfectly evident in the British national-accounts statistics and has frequently been commented on in that context. But in Germany, too, these early deliveries could well have had mirror effects in the form of inventory reductions. These were not fully compensated for in the other direction because Germany mainly exports goods and imports services in its bilateral trade with the United Kingdom.

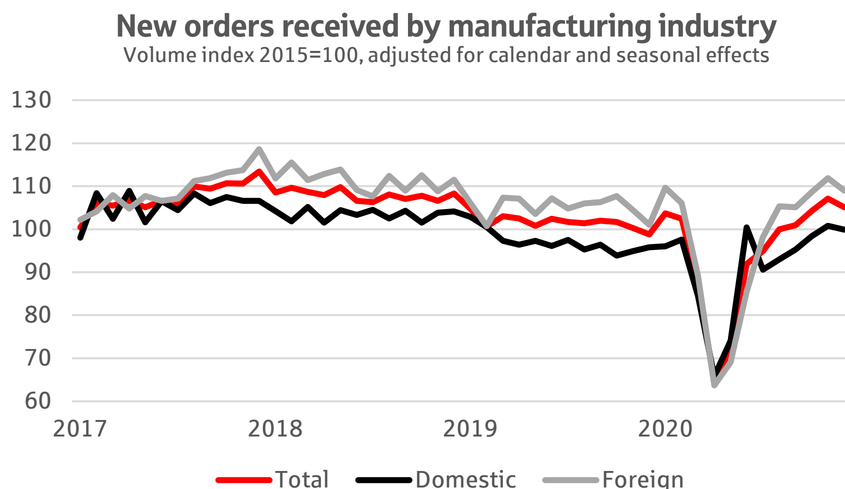
Inventory reaccumulation could turn out to be the flywheel propelling the recovery

These three "real economy" interpretations for the conspicuously negative inventory-investment national-accounts item in 2020 are good news for future prospects. This is because a fresh inventory buildup is on the cards going forward. Even if the rate of depletion were to continue at the extraordinary, unsustainable rate that has been witnessed, that would already have a positive mathematical effect on this item's growth contribution. More likely, however, is concrete rather than merely mathematical inventory accumulation as soon as belief in the post-coronavirus recovery solidifies. Materials requirements planners in manufacturing industry certainly do not want to be once again caught on the wrong foot by a strong upswing, as was the case in the third quarter of 2020 during the interim growth spurt at that time.

The current chip bottleneck at some German vehicle producers is a case in point of how a supply shortage for key components can lead to temporary production restrictions. In the crude-steel sector - bucking the long-term structural trend - there have also been some price-boosting bottlenecks recently.

Incoming orders have been back up above pre-crisis levels for some time

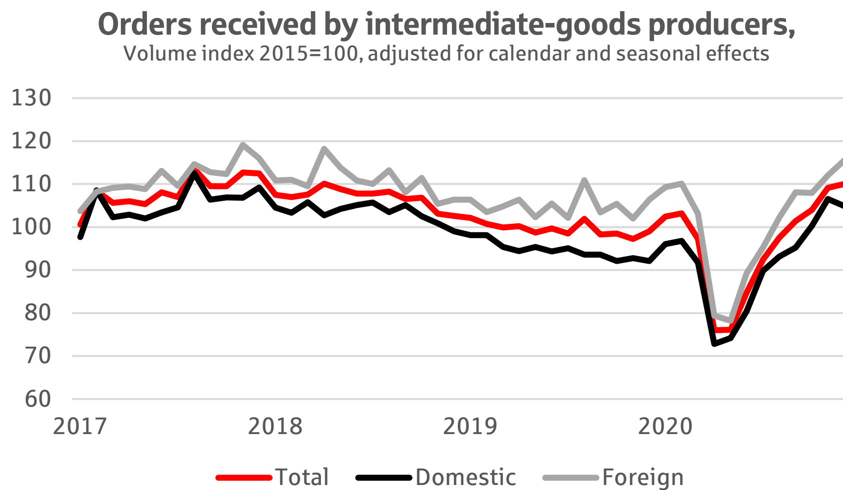
It is a fact that new orders already generated accelerated momentum during the last months of 2020, thus probably indicating that a replenishment of inventories is being targeted. Orders received by the German manufacturing sector as a whole are on an upward trend. True, there was a minor setback in December, but incoming orders at the end of the year were still as much as 6.4 percent higher than in the same month of the previous year.



Source: Destatis

More orders from Germany and even more from abroad are swelling the increased order intake. Driving orders from abroad is above all the China story, where the green shoots of growth have already been in full blossom again since the summer of last year.

On the other hand, some industries are also benefiting from particularly vigorous domestic orders. For example, Germany's Central Association of the Electrical Engineering and Electronics Industry (ZVEL) reported at the beginning of February that orders in December were up 13 percent overall, by 5.5 percent for orders from abroad and by as much as 23.7 percent for orders from within Germany compared to the same month of the previous year.

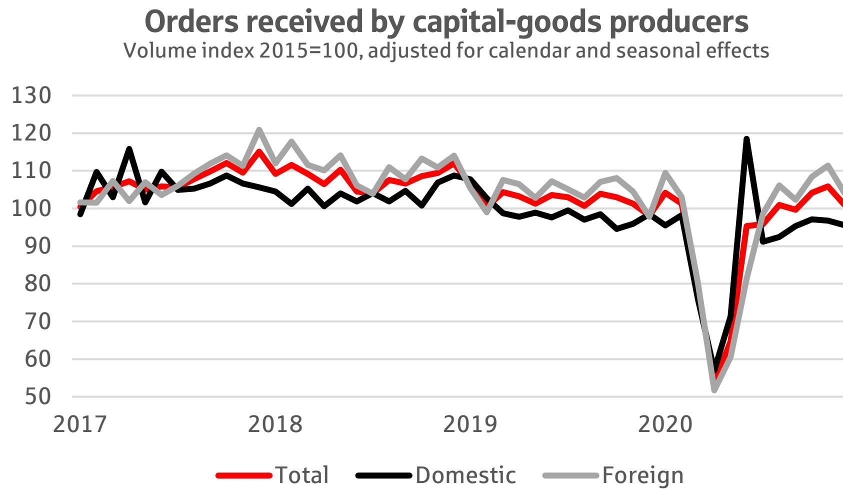


Source: Destatis

A similar picture emerges for the group of intermediate-goods producers, if one looks at the producer categories as classified by the Federal Statistical Office. There, intermediate products stand out on the orders side, demonstrating a particularly dynamic development. And among intermediate-goods producers, it is likewise primarily the strength of domestic orders that is contributing to the upside momentum. Domestic orders for intermediate goods weighed in 18.9 percent higher in December than in the same month of the previous year. This fits in with the thesis that inventories have started to be replenished. And this will provide further tailwind for production, as well as for overall GDP, in 2021.

Investment is still restrained

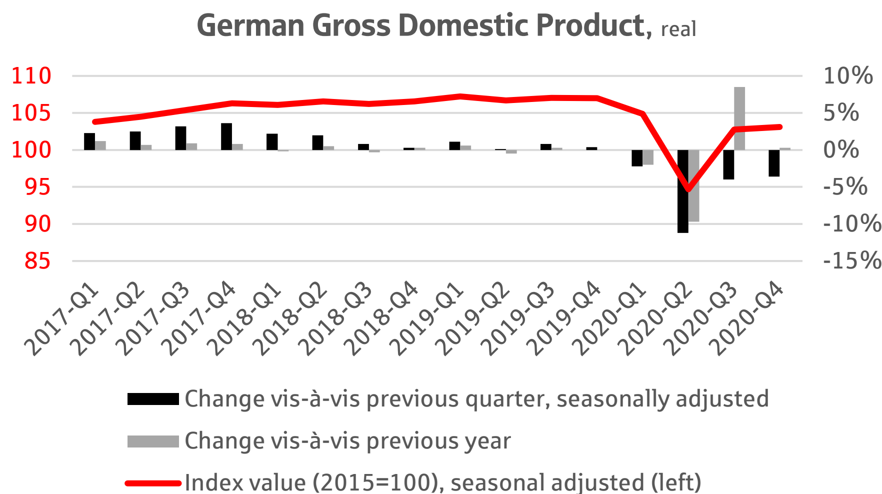
Among the categories used by the Federal Statistical Office, the order flow to capital-goods producers from the domestic market has been the most restrained so far. The prospects for genuine capacity-expanding investments are probably still too uncertain. However, this will be the category of goods by which the quality of the recovery will be measured in the medium term. A long and sustainable upswing will only prove feasible if there is more investment in state-of-the-art capacities for the post-coronavirus period, in the German business location as well.



Source: Destatis

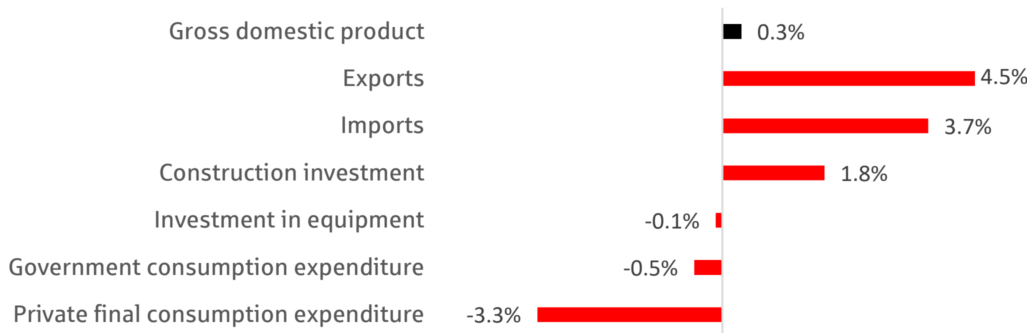
Growth in the final quarter of 2020 was still above the zero line, but the outset of 2021 will very likely undershoot this mark

The quarterly trend in GDP and its sub-components is, at the same time, encouraging and sobering. The fact that German GDP was able to just make it to above the zero line in the fourth quarter of 2020, registering growth of 0.3 percent compared to the previous quarter, is good news. The fact that a slightly higher level was attained at the end of the year following the strong recovery in the third quarter is a remarkable achievement in view of the recent lockdown. Germany also once again made a stronger showing in the final quarter of last year than many of its European partner countries.



Source: Destatis

But a look at the breakdown of GDP nonetheless remains sobering. Even in the fourth quarter, the underlying structure still resembles that already ascertainable for the year as a whole. Only favourable “construction investment” and “other investments” readings have lifted GDP above zero. The recovery in exports is encouraging, but so far this only amounts to a countermovement offsetting the previous losses. Private consumption is showing the toll taken by the renewed lockdown. And on the equipment-investment front, understandably, the already lamented lethargy is continuing to to prevail.



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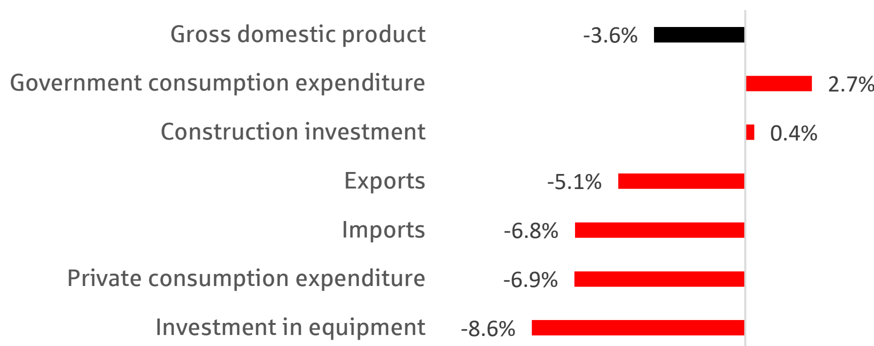
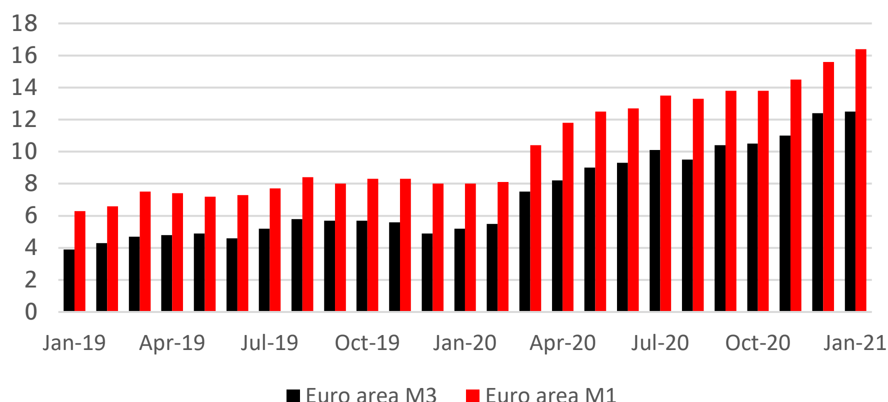


Source: Destatis

No real improvement is expected for the first quarter of 2021. In fact, given the lockdown that will have lasted for practically the entire quarter, it is highly likely that GDP will record a negative growth rate. Hopes are now pinned on a rapid recovery from the second quarter onwards.

Money-supply growth has accelerated further

Money-supply growth accelerated further at the turn of the year. Although lending to non-banks was no longer as big a driver of the development as back in the spring of 2020, central-bank purchasing programmes exerted a stronger direct impact. Overall, the twelve-month rate of M3 was running at 12.5 percent in January. The more narrowly defined monetary aggregate M1 even grew at a rate of 16.4 per cent. This reflects the exploding balances on retail current accounts.



Source: European Central Bank

Unlike the monetary expansion seen over the last few years, which mainly involved central-bank money being inflated in the internal monetary loop linking central banks and the banking sector, the glut of money has now also reached households and companies, and thus the real economy. Although the development is certainly being overstated by special trends under the sway of the pandemic and the lockdowns, clearly double-digit money-supply growth rates nevertheless arouse mixed feelings.

These will not have an inflationary effect in the short term, but a certain price effect is conceivable when the economy suddenly rebounds after the crisis is over.

The temporary reduction in VAT is going to give rise to base effects

The inflation trend at least turned positive again at the beginning of 2021: consumer prices in Germany rose by 1.0 percent in January compared to the same month last year; in December, CPI was still running at -0.3 percent. The main reason for the inflation turnaround in the Federal Republic was, of course, the expiry of the temporary reduction in VAT. Nevertheless, all price stimuli are now based on a rate that has returned to normal. In the coming months, base effects from energy prices, which were particularly depressed a year ago, will be added to the equation, followed in the second half of the year by the baseline effects deriving from last year's lowering of VAT. Other commodity prices are also currently driving up prices. One would be well advised to "look through" these temporarily higher inflation rates - they are not yet an immediate alarm signal, although we could see an initial discussion in the summer if rates overshoot in view of developments that require explanation. At the euro area level, the special effects are not quite as pronounced. So far, eurozone-wide rates are still clearly below the ECB's target - a target which could, admittedly, be revised in the second half of the year in response to the Eurosystem's strategy review, which will by then have been completed.

What is important on the inflation front is how medium-term trends will play out. With low interest rates, high debt, pent-up consumption pressure, depressed production capacities, high liquidity and very strong money-supply growth, all the ingredients for a surge in inflation would actually be in place. However, this scenario is counterbalanced by low inflation expectations and, so far, by well-anchored prices and wages. Inflation is therefore not a likely scenario, but certainly one to keep an eye on. At any rate, this scenario is being increasingly discussed again on the capital markets, not least in the USA.

In this situation, it is worrying that central banks have committed themselves to an expansionary course for such a long time to come. This is especially true in the case of the ECB. It is not only the central bank's forward guidance which stands in the way of a quick turnaround, should such a volte-face become necessary over the next few years. The instruments deployed have also developed a certain inertia. The central-bank purchase programmes cannot be quickly reversed without setting off dangerous repercussions for capital markets and government budgets. And the longer-term tenders (TLTROs), while now admittedly offering very generous terms and thereby stabilising lending and the financial sector, are set in stone for quite a long time because they have a three-year maturity.

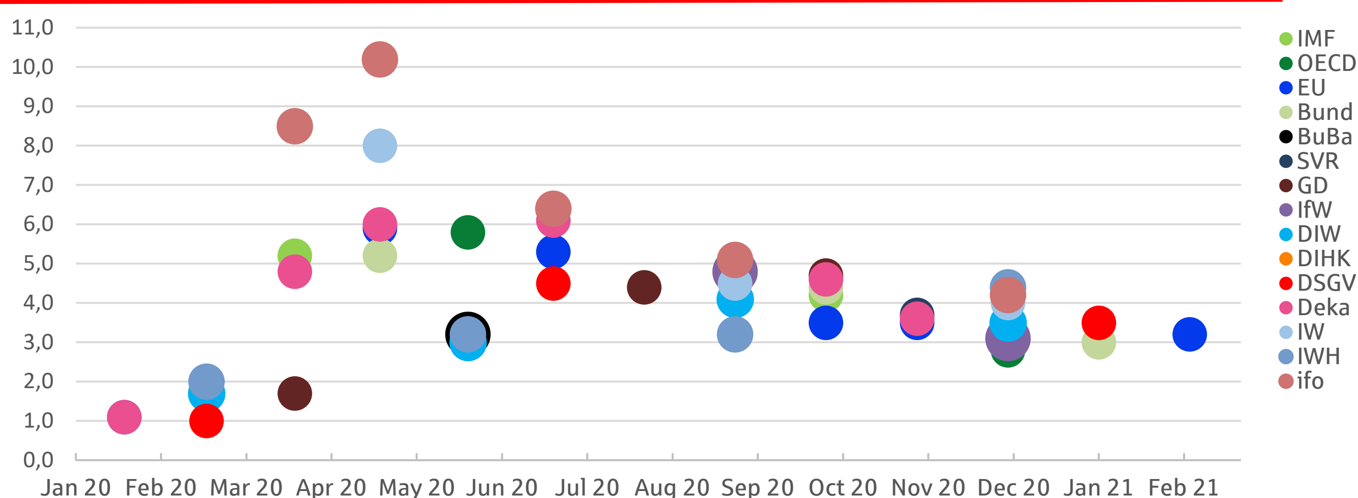
Monetary policy has been set for a very long time to come

A. Growth of world economic regions, change from previous year

	2019	2020	2021*	2022*
World trade volume	1.0%	-9.6%	8.1%	6.3%
GDP – World	2.8%	-3.5%	5.5%	4.2%
USA	2.2%	-3.4%	5.1%	2.5%
Japan	0.7%	-5.1%	3.1%	2.4%
China	6.1%	2.3%	8.1%	5.6%
Euro area	1.3%	-7.2%	4.2%	3.6%
Germany	0.6%	-4.9%	3.5%	3.1%

* International Monetary Fund projections from January 2021

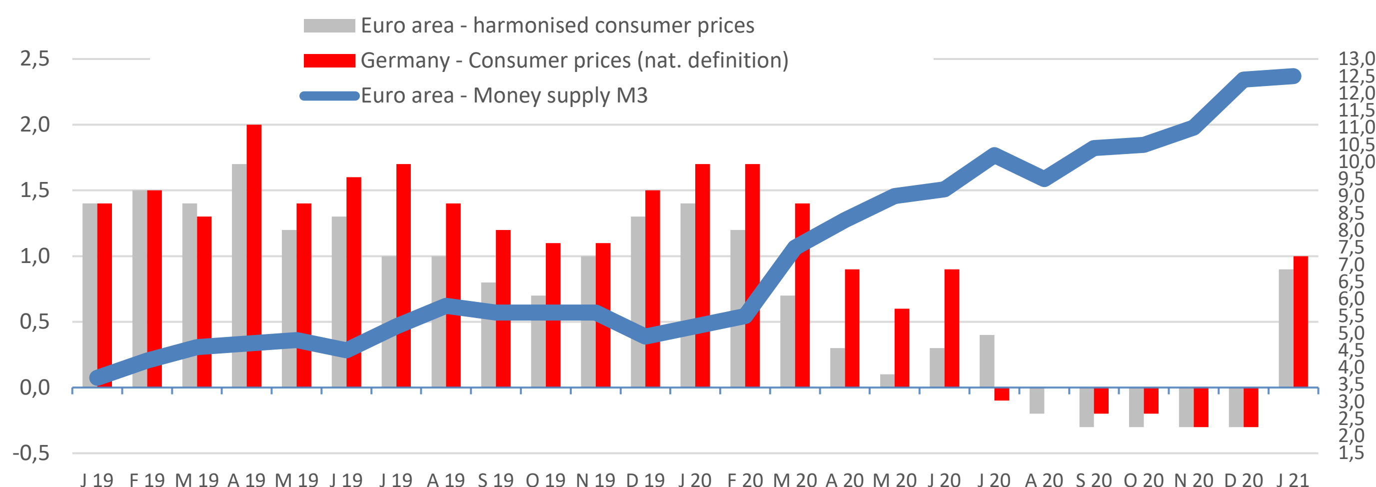
B. Economic growth forecasts for Germany for 2021, in %.



C. GDP in the euro area and in Germany

	2020 real change vs. previous year	Q I - 2020	Q II - 2020	Q III - 2020	Q IV - 2020
		Real change from the same quarter of the previous year and seasonally-adjusted real change from the previous quarter			
Euro area GDP	-7.2%	-3.2% -3.7%	-14.7% -11.7%	-4.3% +12.4%	-5.0% -0.6%
Germany GDP	-4.9%	-1.8% -2.0%	-11.3% -9.7%	-3.9% +8.5%	-2.7% +0.3%
Private consumption	-6.1%	-1.3% -2.3%	-12.8% -11.0%	-3.6% +10.8%	-6.5% -3.3%
Gross fixed capital formation	-3.1%	-0.6% -0.8%	-7.4% -6.6%	-3.5% +3.9%	-0.9% +1.0 %
Exports	-9.4%	-3.2% -3.3%	-22.3% -20.4%	-9.2% +18.0%	-2.9% +4.5%
		Level, not rate of change; quarterly figures, seasonally-adjusted			
Savings rate	16.2%	11.7%	20.3%	15.3%	17.7%

D. **Consumer prices** (left scale) **and money supply M3** (right scale), annual rates of change in %.



E. Monthly economic indicators Germany

	Oct 20	Nov 20	Dec 20	Jan 21	Feb 21
Prices (national definition)	Change compared to the same month of the previous year				
Consumer prices	-0.2%	-0.3%	-0.3%	1.0%	-
- Excluding food and energy (core inflation)	0.5%	0.5%	0.4%	1.4%	-
Producer prices of commercial goods	-0.7%	-0.5%	0.2%	0.9%	-
Import prices	-3.9%	-3.8%	-3.4%	-	-
Sentiment indicators					
ifo Business Climate Index	92.7	91.0	92.2	90.3	92.4
ZEW Economic Sentiment	56.1	39.0	55.0	61.8	71.2
Incoming orders	Change compared to the same month of the previous year				
Manufacturing industry	+2.9%	+8.9%	+10.2%	-	-
Thereof: domestic	+5.5%	+9.0%	+8.6%	-	-
Thereof: foreign	+1.3%	+9.0%	+11.3%	-	-
Capital-goods producers	+1.4%	+6.5%	+6.8%	-	-
Production	Working day adjusted change compared to the same month of the previous year				
Overall manufacturing	-3.1%	-2.5%	-1.0%	-	-
Thereof: construction	+3.2%	+3.8%	+2.2%	-	-
Thereof: industry	-4.6%	-3.7%	-1.5%	-	-
Foreign trade	Change compared to the same month of the previous year				
Exports	-6.4%	-1.2%	+3.0%	-	-
Imports	-5.8%	+0.5%	+3.5%	-	-
Labour market	Unemployment rate / change compared to the same month of the previous year in 1000				
Unemployment rate	6.0%	5.9%	5.9%	6.3%	-
Number of unemployed persons	+556	+519	+480	+475	-
Employed persons (place of work in Germany)	-717	-766	-756	-	-
Employees subject to social security	-108	-74	-	-	-

F. Commodity. foreign exchange and financial markets

	Oct 20	Nov 20	Dec 20	Jan 21	26th Feb 21
Brent **oil price** in US $	44.19	42.69	49.99	54.77	65.19 (24th)
Exchange rates					
US dollar / EUR	1.1827	1.838	1.217	1.2171	1.2121
Japanese yen / EUR	123.03	123.61	126.28	126.31	128.83
Stock markets					
German DAX share index, end of month	13,076	13,291	13,718	13,432	13,786
Change compared to the same month of the previous year	1.64%	3.21%	-2.08%	3.60%	-
Money and capital market interest rates					
Overnight money (€STR)	-0.554%	-0.556%	-0.557%	-0.563%	-0.564% (25th)
1-month money (EURIBOR)	-0.54%	-0.54%	-0.56%	-0.56%	-0.55% (25th)
3-month money (EURIBOR)	-0.51%	-0.52%	-0.54%	-0.55%	-0.54% (25th)
Current yield on German government bonds with a residual maturity of ten years	-0.63%	-0.59%	-0.57%	-0.54%	-0.27%
Interest rates of credit institutions for new business					
Daily deposits of private households, DEU	0.00%	0.00%	0.00%	-	-
for comparison: across the euro area	0.02%	0.02%	0.01%	-	-
Deposits of private households up to 1 year, DEU	0.10%	0.11%	-0.01%	-	-
for comparison: across the euro area	0.19%	0.19%	0.16%	-	-
Corporate loans up to € 1 million over 5y, DEU	1.49%	1.53%	1.56%	-	-
for comparison: across the euro area	1.54%	1.51%	1.48%	-	-

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