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# THE GERMAN ECONOMY: FROM WUNDERKIND TO PROBLEM CHILD?



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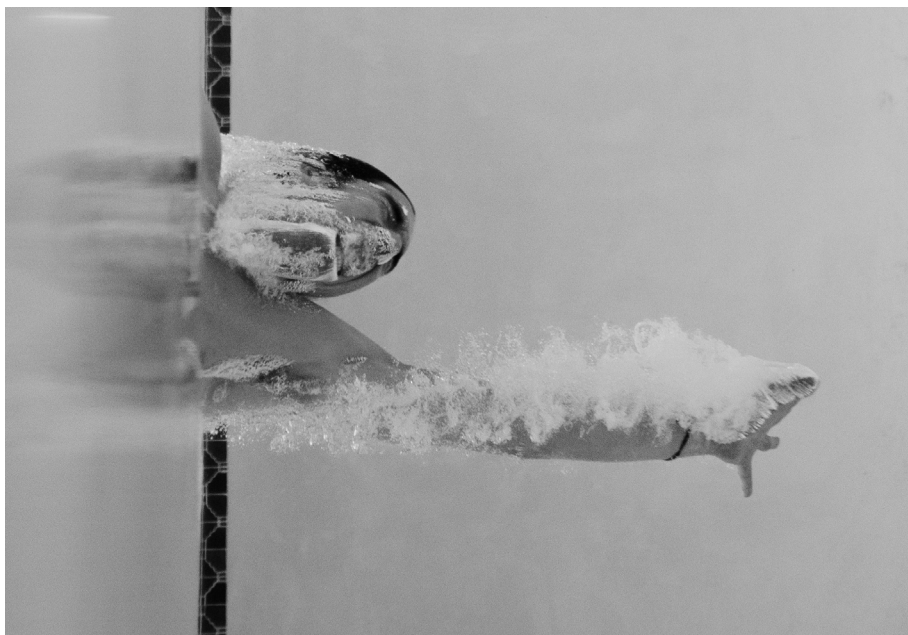
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# HOW STRONG WILL GERMANY EMERGE FROM THE COVID-19 CRISIS?



An apology for regulatory issues in the pandemic from Angela Merkel, which made history, vaccination chaos and economic aid packages worth billions, and yet: Due to its good economic and financial substance and its stable political structures, **Germany has so far made it through the COVID-19 crisis without any serious upheavals.** However, since the beginning of March this year, the public mood is shifting. The crisis has shown that Germany has structural weaknesses, especially due to a weak digital infrastructure and the backwardness of the bureaucracy, which will become significant for the time after the crisis. **Since federal elections will take place in autumn and Chancellor Angela Merkel is not running again, there could be a change of political power.** Looking at the current public opinion and pre-election votes, it seems likely that the Green Party will enter the new government at least as a coalition partner. This would bring climate policy stronger than before onto the priority list of the political tableau. In any case: With a foreseeable end to the 16-year „Merkel Era“, Germany is already undergoing a slow but significant change.



### GERMAN POPULATION INCREASINGLY DISAPPOINTED OF PUBLIC MANAGEMENT IN THE PANDEMIC

The number of deaths in the pandemic was about half of what Italy, France and Spain notified. **In terms of population, Germany's health system was not overstressed at any time (so far), and citizens complied with the restrictions in a largely disciplined manner.** Demonstrations against the lockdown rules and in some cases even against the mask requirement that took place in the summer and autumn of 2020 were only supported by a small minority of Corona deniers, conspiracy theorists and right-wing extremists. The vast majority of the population, on the contrary, supported the government's course. Since the beginning of March 2021, however, this has changed. **Resentment about the crisis management is increasing, as new corona infections continue to be at a high level.** Therefore, the German Bundestag has decided on a nationwide emergency brake from an incidence value of 100 to tackle infection rates, because some experts predict an overstrain of the health system. At the same time, approval rates for the governing parties are declining rapidly. Reasons are a corruption affair of the Christian Democrats around the mask supply industry, as well as the slow vaccination campaign. So far only about forty-one percent of the German population has received the first vaccination and about fifteen percent the full vaccination while lockdown regulations have been extended again and again. Hotels, shops, cultural institutions, gyms, restaurants and many other providers have de facto been closed for half a year now and their owners are increasingly desperate.

# GERMAN ECONOMY HAS COPED RELATIVELY WELL WITH THE CRISIS. SO FAR.



## GERMAN ECONOMIC OUTPUT (FINANCIAL CRISIS/CORONA CRISIS)



After a first deep slump of minus 10% in the first quarter of 2020, the German economy experienced a quick recovery in the following summer and autumn period. Overall, the economic output fell by 4.9 % in 2020, less than after the financial crisis in 2009 (when it was minus 5.7%), strongly due to the fact that the industrial production remained intact. Also German supply chains functioned well throughout all of this time apart from some individual, minor problems. Due to the rapid recovery in China, exports did not decline as much as initially expected at the beginning of the crisis. An increase of economic growth of around 3% is expected until the end of 2021.

### MOST VULNERABLE BRANCHES SUSTAINED BY MASSIVE FINANCIAL AIDS

The acute challenges of the German economy were bridged with a lot of money. **Already in spring 2020, an aid package of 750 billion € was decided and got expanded over winter – amounting to a total of 1.2 trillion € available for economic aid packages.** Most of the aid is provided in loans, guarantees and temporary state participation in companies (such as Lufthansa), but there is also a lot of direct aid. Small businesses and the self-employed workforce receive support via payments that mostly cover fixed costs and since the second wave of corona in autumn, also the loss of sales. Critics however argue that the aids are often distributed in an exhausting bureaucratic process.



### SHORT-TIME WORK HELPS BUFFER DRASTIC SOCIAL CONSEQUENCES

Since the outbreak of the pandemic, unemployment rates rose only slightly, from 5.3% up to 6.3% thanks to the German system of short-time work, which was developed by the federal government during the financial crisis in 2009. It has since been copied by many other countries. The short-time work system does not leave workers and employees laid off but allows them a bridging allowance of up to 80% of their regular income per month for the duration of their unemployment - for up to 24 months. Additionally, socially vulnerable groups may be granted one-off extra payments.

**As another crisis measure, German legislators reduced VAT rates for most products and services temporarily from 19% to 16%.** As a result, Corona has so far not caused any acute impoverishment.

Quite the opposite is the case: since people were able to spend less on travel, for example, **private savings have increased enormously. In 2020, Germans put aside an unprecedented rate of around 16% of their annual income (average rate: 10%).**

However, these figures mask the fact that there are sectors, including culture, gastronomy, trade fairs and hotels, which are performing comparatively bad and will have difficulty to recover from the crisis. A subsequent wave of bankruptcies in retail and small service businesses is foreseeable. Post-crisis effects are also likely to change the face of German city centres and commercial property markets. And there is, as in all countries around the globe, an entire generation of young people who have been thwarted in starting their studies or careers.

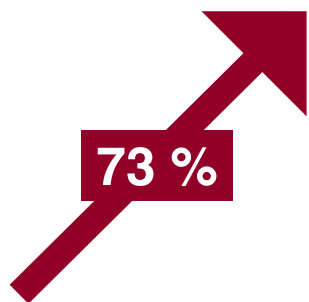


### BLACK ZERO: “BALANCED BUDGET” DOCTRINE LIKELY TO BE QUESTIONED, FACING COVID DEBTS

Since 2014, the German federal level has been able to proudly announce that it had reached „black zero“, i.e. that it had taken out no more loans. Especially the governing Christian Democrats (CDU) made this their political trademark. In some years there were even surpluses. At the same time, the federal government was able to meet many spending requests and increase programmes for public investment in infrastructure, science and education. All the federal states also managed to achieve the „black zero“ target or were close to it up until Corona arrived. **In 2010, Germany’s debt level was still 82% of the gross domestic product. By 2020, it had fallen to 59.6%.**

It was therefore no problem at all for Chancellor Merkel and Finance Minister Olaf Scholz (SPD) to bring out the „bazooka“ right at the beginning of the crisis as Scholz said, alluding to a phrase by former ECB chief Mario Draghi. The federal budget for 2020 provided for an extraordinary new debt of 218 billion €, of which, however, only 130 billion were claimed in real terms. Germany’s debt ratio thus rose again to 73%. Nonetheless, this is still low in European and global comparison and absolutely bearable - provided the economy picks up after the crisis quickly. For the period of 2021 and 2022, further borrowing of around 300 billion € is planned. How far this money will actually be needed remains an open question.

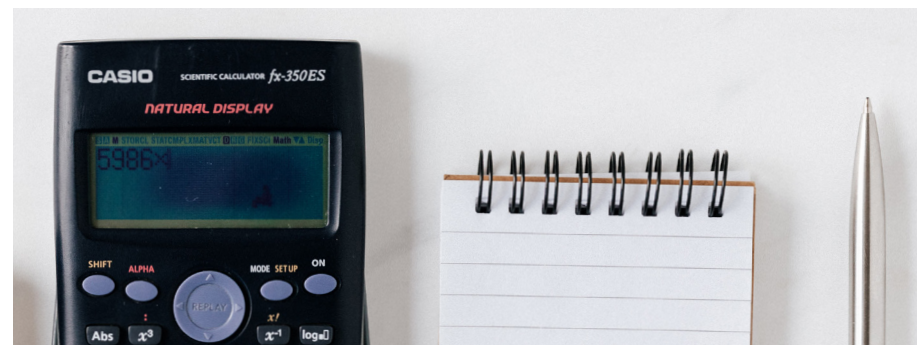
### GERMANY’S DEBT RATIO 2021



According to current financial plans, future federal governments will have to make considerable savings in the coming years between 2026 to 2042 in order to repay the new debt, which is prescribed by the mechanism of the debt brake. At the same time, the funds borrowed by the EU for its Corona programme must also be serviced by Germany. The financial leeway of future governments will thus be considerably smaller.

### “DEBT BRAKE” AND “BLACK ZERO” COULD SHAPE PRE-ELECTION DEBATES

In view of this prospect, a fundamental debate on the debt brake has begun. The Social Democrats and the Greens want to either abolish or best least relax the rules. But the two-thirds majority required to amend the Basic Law in the German Bundestag is very difficult to achieve. At the same time, there is a debate about increasing taxes, especially for the rich. **Left parties for instance are calling for a wealth levy; some politicians are also proposing a one-time crisis levy on the super-rich, while tax increases are strictly rejected by the conservative parties.** This issue is likely to play a role in the upcoming federal election campaign.



# WHERE IS THE GERMAN PROSPERITY MACHINE SPUTTERING?



Industry is globally competitive, as is science. The success of the research company Biontech in Mainz, which was the first to develop a vaccine against Covid-19, but also that of Curavec in Tübingen have shown this trend. **And there are still many „hidden champions“ from Germany in a number of sectors, especially in mechanical engineering.**

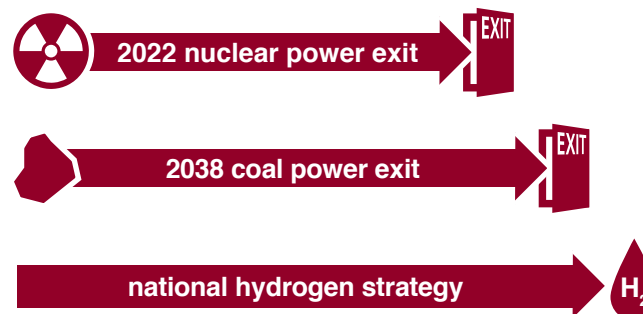
### THE AUTOMOTIVE INDUSTRY: FROM “WUNDERKIND” TO PROBLEM CHILD?

A structural core problem for Germany is the country's strong dependence on the car industry, which is currently fighting for its position on the world markets. For a long time, the business model of Volkswagen, BMW, Daimler and Porsche worked well: Large, heavy cars in the middle and upper classes, which were and still are very much in demand in the emerging markets. However, with the scandal about manipulated and dirty diesel engines that shook up car industry business models and caused sales problems in the domestic markets the picture has changed. Above all, it is not compatible with the climate policy to which Germany and the EU in accordance to UN climate goals have committed themselves. **Above all, e-mobility was largely slept through.** The fact that Tesla is now building a so-called “Gigafactory” near Berlin - of all places, virtually on Merkel's doorstep -, which is to start production this summer, has not only woke up the German carmakers, but also the politicians. In the meantime, massive efforts are being made to expand the charging infrastructure; **the purchase of an electric car is subsidised at a very high rate**, so that sales have recently risen sharply. While the German government is investing large sums in the development of national battery production, and carmakers into new e-car models to achieve climate change targets, it remains questionable whether Germany can still catch up with Asian and American e-mobility manufacturers.

### ENERGY TRANSITION GOT STUCK IN EXPENSIVE BOTTLENECKS

**With nuclear power finally expiring in 2022, and coal-fired power plants planned to be off the grid by latest 2038, Germany is facing problems for its energy sector.** While the expansion of offshore wind power is making good progress, onshore wind power is faltering, partly due to resistance from local citizens' initiatives and conservationists. To tackle this backdrop, **the government has adopted a national hydrogen strategy, which is intended to open up another energy alternative to prevent for an energy gap.** Among other things, these concerns explain Germany's unconditional adherence to the Nordstream II Baltic Sea pipeline for Russian gas.

#### GERMANY IN THE ENERGY TRANSITION:





### DIGITAL INFRASTRUCTURE: GERMANY'S MOST CRUCIAL BACKDROP

Germany's digital weakness has become particularly apparent during the unfolding of the Corona crisis. When home offices and home-schooling had to be switched to, it became apparent that many people had no or only a slow network at home. **Although broadband expansion was planned many times, progress was overslept by politics.** There are still areas where there is practically no internet reception for mobile phones.



**In 2019, a 5 billion € programme to digitise schools was decided upon, but had hardly been implemented so far.** In turn, schools are in particular were poorly digitally equipped during corona lockdowns. For home-schooling, there were initially no tablets or e-learning programmes in place, nor were teachers familiar with digital learning.

The German Corona app has drawn attention to another special problem: **German data protection laws are particularly strict.** Germans seem very suspicious when private individuals or the state want their details. Accordingly, the app is only allowed to show anonymously whether one has approached someone infected with Corona within the last few hours. A positive test may be reported to the app voluntarily (and anonymously), which by no means all of the infected did. As a consequence, the app is considered largely useless in the fight of the pandemic.

**The pandemic has also shown once again that the public administration in Germany is lacking modern technology, flexibility, and suitable ready personnel.** Concerning the urgency of the crisis however, this will remain a reform issue for the post-corona period. The acceleration of administrative procedures has long been discussed in Germany. **Many investors complain that permits of all kinds take a very long time. This will also be a topic in the election campaign.** However, Germany's bureaucracy, which is characterized by professional civil service and strong staff council seems resistant to so far reform approaches as procedures only grip very slowly.

# OUTLOOK ON THE NEXT EDITIONS

## **2 SUMMER BRIEFING: WHO SUCCEEDS MERKEL?**

We will report on this question in the next briefing and **add national and international consequences of the Bundestag elections taking place in September (including the area of trade policy)**. But one thing can already be said: the German political system is very stable; it resembles a tanker. No matter who takes command on the bridge, the tanker will only change course very slowly, if at all.

## **3 AUTUMN BRIEFING: WHAT ARE THE MEGATRENDS IN GERMANY?**

**The mega colour on the political landscape is green. The mega word is eco.**

And people's goal in life is no longer just prosperity at any price, but a good work-life balance and the compatibility of family and career. All this will also become a political topic during and after the federal elections. You will find more about this in our autumn Briefing.



**SABINE CLAUSECKER**

Managing Partner Kreab Germany  
sabine.clausecker@kreab.com  
+49 30 81884 132

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RELEVANT COMPETENCIES AND AGILE PROCESSES.  
THEREBY WE CREATE REMARKABLE, EFFECTIVE COMMUNICATION  
AND EVENTS FOR AND WITH OUR CLIENTS.“**

**Sabine Clausecker**  
Managing Partner, Kreab Germany



**CARSTEN HOLTkamp**

Senior Partner Kreab Germany  
carsten.holtkamp@kreab.com  
+49 30 81884 181



**PAUL SCHOTTHÖFER**

Director Kreab Germany  
paul.schotthoefner@kreab.com  
+49 30 81884 141