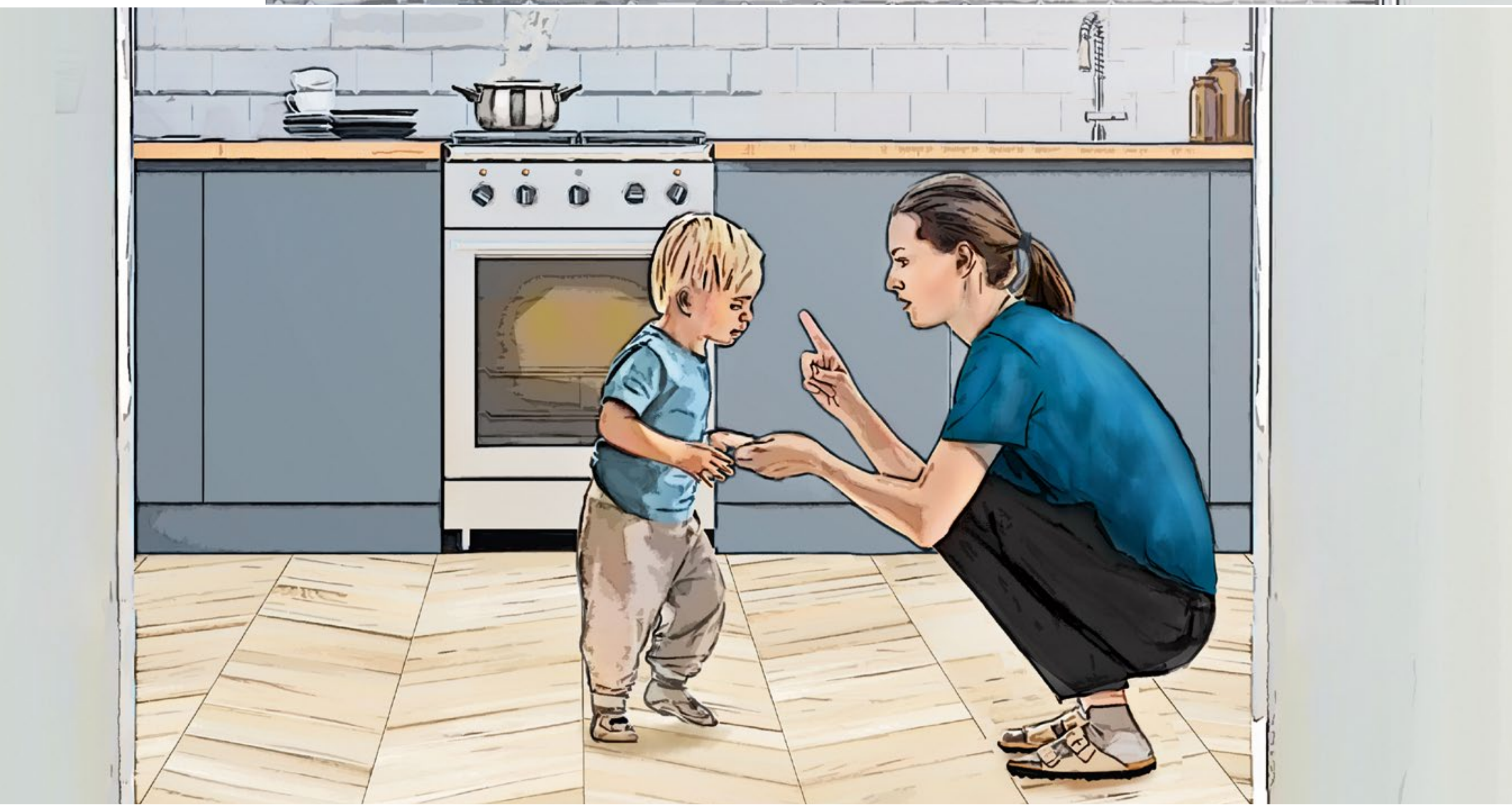
Research

Helaba

Markets and Trends 2021

A helping hand from Nanny



Values with impact.

Dr. Gertrud R. Traud

Chief Economist / Head of Research

Editorial

It is precisely in uncertain times like these that the question of “who is going to lead us into the future?” takes on a special significance. The fact that so many things are unclear is not only reflected in economic indicators.

In 2020, “lost” was chosen as the German youth word of the year – in the sense of not only being unaware but rather of no longer understanding what is going on.

Do you feel the same way as young people do? The current situation is arguably one of the most difficult we have ever faced. We have not yet overcome this crisis and we simply do not know how long it will take.

Dear Readers,

Although we do not know what the future will look like, what we can do is design scenarios and assign probabilities to them. For 2021, we have asked a question that is simple and sophisticated at the same time: Who is going to lead us into the future? Will it be a nanny, a poltergeist or an avatar?

The Covid-19 pandemic has transformed the world we live in. Measures to **protect** public health have been enacted that hardly anybody would have previously imagined were possible: curfews, mandatory face masks, restrictions on social contacts, bans on alcohol, accommodation and assembly and much more – in other words, measures that **encroach on our individual rights and freedoms**.

> *"The greatest enemy of knowledge is not ignorance; it is the illusion of knowledge."*
> Stephen Hawking (1942–2018)

To stabilise the economy, however, governments have also implemented a raft of **supportive measures** to help companies and employees, including extending furlough schemes, tax cuts and tax relief, emergency aid, bridging loans and guarantees. The unprecedented interventionist policies of governments and central banks have steadied demand and the financial markets, but have not been able to prevent a deep recession.

Yawning gulf between countries

The choice of measures varies greatly from one country to another. Some have opted to impose extreme restrictions and controls on public life for a longer period of time, while others favour shorter and more targeted lockdowns but have made more frequent use of this instrument. Sweden has taken an approach of enacting less severe restrictions and making recommendations, with a focus on individual responsibility. Only those who are most at risk from the virus are being explicitly protected. Every country is providing generous financial and monetary policy support.

Nanny wanted

In other words, countries want to direct the behaviour of their citizens while simultaneously helping them with supportive measures. This strategy is typically described as educating the populace.

There are different areas of life in which **educational work** is carried out by a variety of persons or institutions with the respective authority. It starts at home with a child's parents, continues with educational establishments, pastoral care, social work and much more. Then there is the **nanny** or governess – someone many families would have been delighted to have during the strict lockdowns. Nannies are well qualified and have made it their mission to prepare a child for a self-determined life with the utmost care and attention.

In the world of musicals, this subject achieved great success with "Mary Poppins", although she employed unique educational methods. Her magical powers and constructive attitude enabled her to find solutions, even in seemingly hopeless situations.

A nanny would also seem like the right person to guide the adult world through the current crisis. But what are the right measures to take and when should they be taken?

> *"When the world turns upside down, the best thing to do is turn right along with it."*
> Mary Poppins

Different educational approaches

In the academic world, there is no single method of education. The various approaches differ according to the underlying objectives and norms. However, the crucial factor in determining the success of an educational approach is the **attitude of the educator**. Yet, cultures also have an impact on education, with the result that it may vary from one country to another and change over time.

The components of education can be classified according to numerous characteristics, ranging from welfare, to support, restriction, control and overprotection. The latter is just as dangerous as neglect by those charged with providing care. The same also applies to economies: There are consequences to both a laissez-faire attitude as well as a policy of overreaching **state paternalism**, although the second approach has been steadily gaining in popularity for some time.

The risks of overprotection

In the short term, it may be appropriate for the state to considerably expand its intervention in the economy. However, it harbours medium to long-term risks, not only for the freedom of the individual but also for economic dynamism.

In view of changing demographics, it is essential for a country to have a large and modern capital stock as well as a high labour productivity, not least in Germany. That is why voters should pay close attention to the positions each party adopts in the next German federal election campaign in 2021. Who is prepared to put the long-term wellbeing of the country and its people ahead of short-term political gain?

> *The basic principles of a good education should be to prepare a child for a self-determined life.*

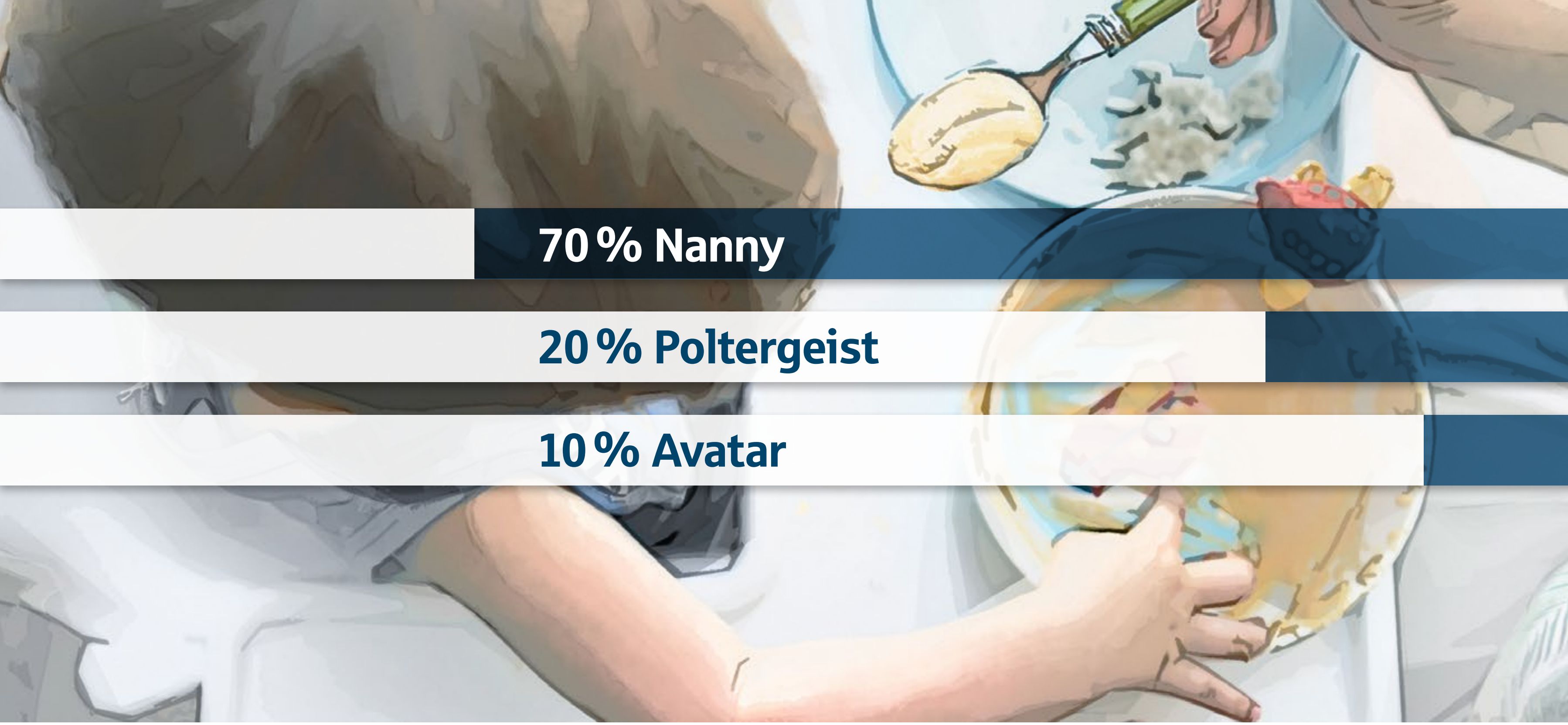
In terms of trade and competition policy, it currently appears that, in many places, the governess is increasingly taking on a Chinese complexion. In **China**, the successful response to the pandemic to date is interpreted as further proof of the superiority of its own system. Criticism from abroad is increasingly seen as the envy of those who do not benefit from the wise leadership of the Communist Party. Even in the West, more and more politicians are inclined to approve of the Chinese style of education.

To ensure that a child can stand on its own two feet at some point requires a well-balanced combination of care and support on the one hand and control, bans and restrictions on the other. Fortunately, at least some economic stimulus packages contain all of these features.

Negative scenario: Poltergeist

In our negative alternative scenario, uncertainty becomes even greater. The things we fear most are precisely those that we cannot see – a phenomenon embodied by the poltergeist. Though amorphous, it torments houses and their inhabitants.

In the same way, the world economy continues to be plagued by an almost invisible virus, should no vaccine be found. In addition, other sources of trouble could heighten people's insecurity, such as protectionism and nationalism. The **fear** of these malevolent forces alone may plunge the global economy back into recession.



Positive scenario: Avatar

Not all change these days is bad. The **digital revolution** is unlocking new opportunities that still seem inconceivable to many people. The new – and from today's perspective artificial – world has the potential to not only facilitate medical progress and ease the burden of many types of work, but also to enable sustainable and productive economic activity.

The avatar symbolises a successful structural transformation, the emergence of innovative ideas and their practical application. In this scenario, the global economy recovers very quickly from the crisis. Innovations give a significant boost to progress and growth as well as equity markets.

> *We may not know a lot, but we can learn something new every day – if we allow ourselves to.*

With this in mind, I wish you a healthy and successful 2021.

Yours

Chief Economist / Head of Research

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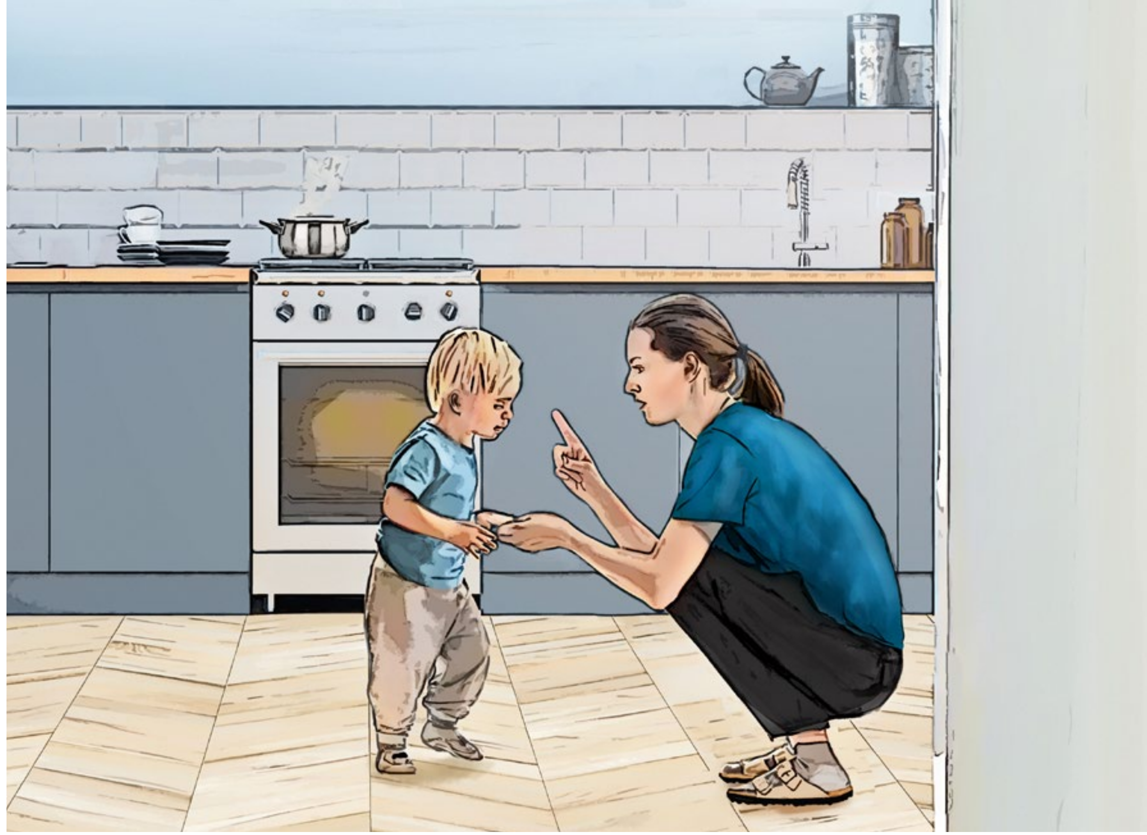
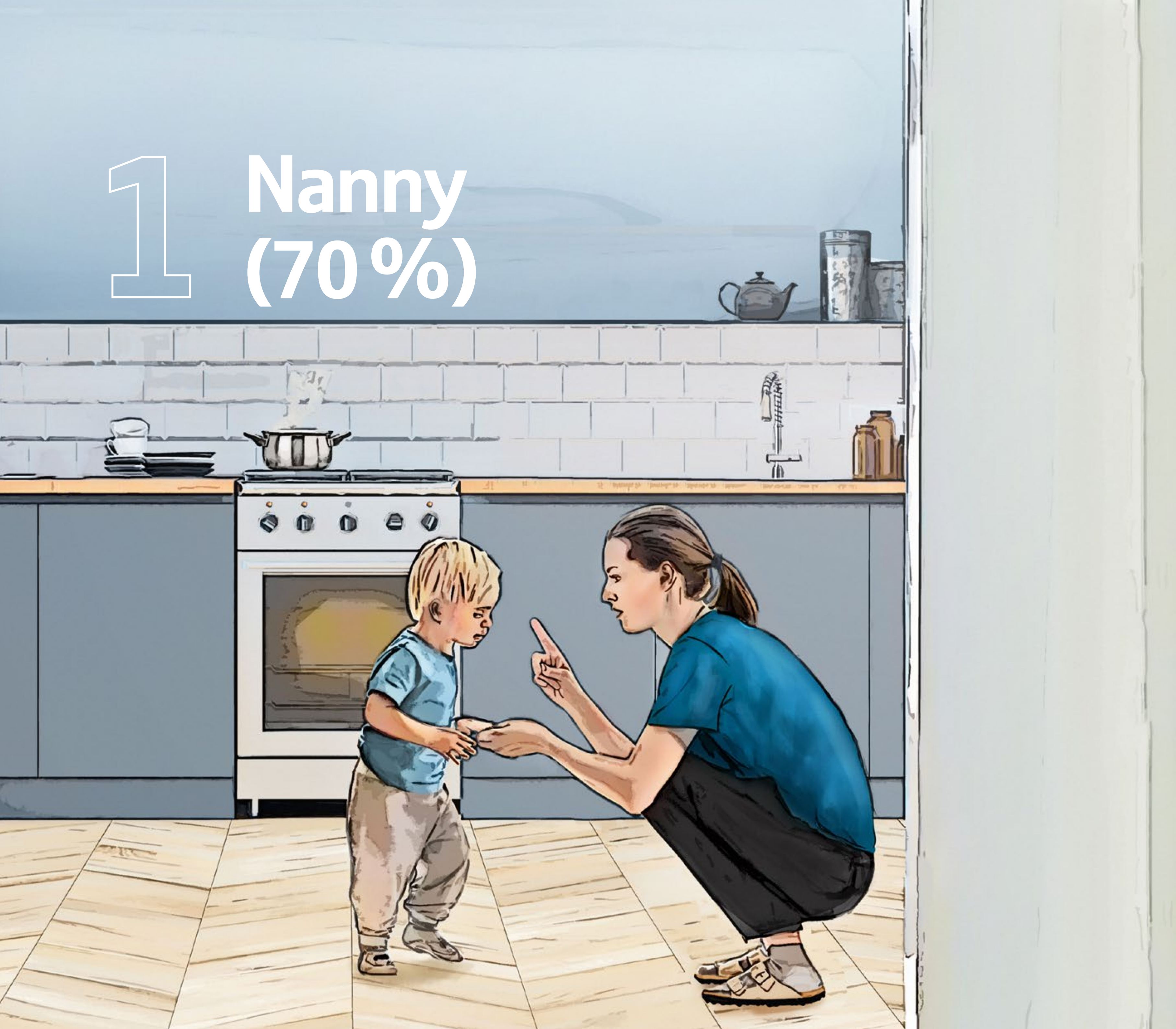
Content



Editorial date: 5 November 2020

1 Nanny (70 %)



Baseline scenario

A helping hand from Nanny (70 %)

As the Covid-19 pandemic has unfolded, governments the world over have used a variety of measures in an attempt to influence the behaviour of their people and, at the same time, to support them. This is what we commonly understand by education – the carrot and the stick. The nanny state will still be active in 2021. We assign a probability of 70 % to this scenario.

Just as the global economy began to recover from the escalating trade dispute of 2018 and 2019, the Covid-19 pandemic broke out. As a result of this massive shock, in 2020 the global economy has shrunk more than at any time since the end of World War II. Despite a second wave, whose impact is different from region to region, a **global economic recovery** has taken hold. It should lead to output growing sharply in 2021. At 5 %, Germany will probably record its highest rate of growth since the early 1990s. However, as in most countries, average performance over the period 2020/2021 is likely to be rather sluggish.

Amid a very brief but steep contraction, governments and central banks stabilised the financial markets and demand by i**ntervening on a historic scale**. Since then, uncertainty has diminished to some extent. Monetary and fiscal policy will help to mitigate the consequences of the shock, such as corporate bankruptcies and unemployment, even as the recovery gains momentum in 2020/2021.

In this baseline scenario, we assume that there will be no repeat of the nationwide, week-long and complete lockdowns and that a vaccine will be developed by the first half of 2021. As in 2020, the quality of healthcare systems and, more generally, the way the pandemic is handled by policymakers and society at large will determine which economies perform worse – and which perform better.

The rise of the nanny

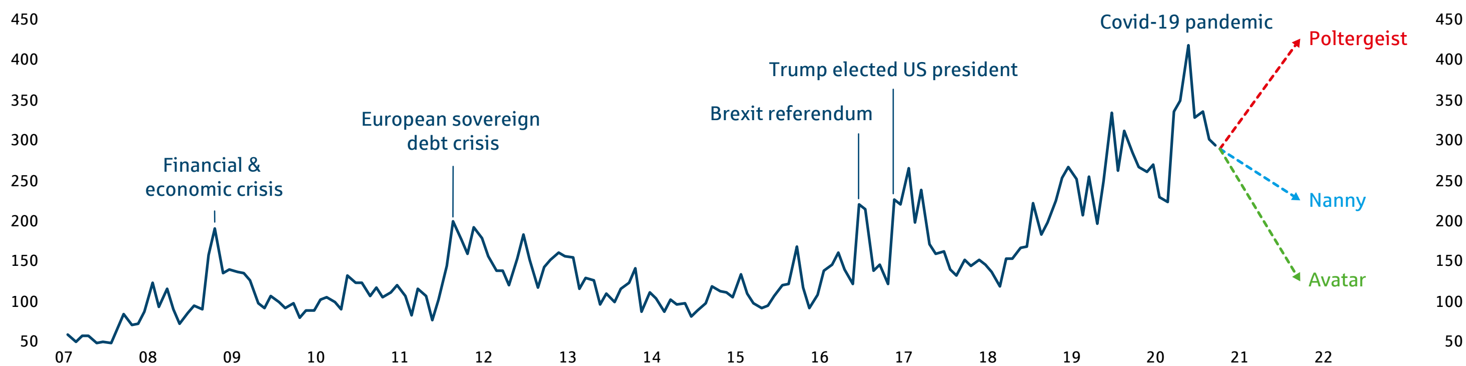
Up to now, Germany has fared better during the crisis than many of its neighbours. As an export-oriented country, however, it is dependent on how the **principles of the international division of labour** and the **free market** will develop in the future. Both are currently **under threat**, most notably from state intervention. The United Kingdom would be hit harder by tariff barriers after Brexit than the rest of the European Union, but they would also pose a threat to Germany's export industry.

Of greater importance is what happens next to the global trade order, dealing with rising levels of debt (including in the private sector), climate change or the digital transformation. In each case, the state has the power to play a positive or negative role. In trade and competition policy, the governess is taking on an increasingly Chinese complexion in many places. Some politicians seem to believe that we need to become more like China in this respect – which is not necessarily a good sign.

The share of the economic "cake" claimed by the state has grown significantly during the crisis – partly because the size of the whole cake has shrunk. For governments to sustain this situation in the long run would necessitate tax increases. In the medium term, we can expect a reduction in ballooning deficits to more "normal" levels. There is a risk that we could see a ratchet effect: Just as

Uncertainty recedes

Global Economic Policy Uncertainty (GEPU) Index*



* Global Economic Policy Uncertainty Index, based on PPP-adjusted GDP weightings. Newspapers reports, among other sources, are included in the calculation.

Sources: Datastream, Helaba Research

public spending ratios in G7 countries did not return to their pre-2008 levels after the global financial crisis, they may move up yet another notch in the "new normal" post-Covid world – perhaps even significantly so.

Finger-wagging (not only) from the Eurotower

Central banks display a particularly marked tendency when it comes to enlarging their own spheres of influence. Unelected technocrats have expanded their power by following the slogan of "we know best!". In a process that is best described as "mission creep", central bankers unilaterally claim authority over new areas of responsibility such as social or environmental policy. Meanwhile, the core task of monetary policy – maintaining price stability – is increasingly relegated to the sidelines. 2021 will provide a good example of this phenomenon: despite a noticeable rise in inflation rates, central banks will not unwind their expansionary stance and, in some cases, will go even further.

In addition, monetary policymakers seem to be handing governments a **carte blanche to implement additional debt-financed measures** with their zero or negative interest rate policy. Everywhere you look at the moment, money is being spent as if it grew on trees, adorned with euphemisms such as "Recovery and Resilience Facility". "Redistribution Fund" just doesn't have the same ring to it.

Safety versus dynamic growth

In the short term, it may be appropriate for the state to considerably expand its intervention in the economy. But it harbours **medium to long-term risks**, not only for the freedom of the individual but also for economic dynamism. In view of changing demographics, it is essential for a country to have a large and modern capital stock as well as high labour productivity, not least in Germany.

A rising burden of regulation, more bureaucracy, increasing tax and public spending ratios – these are not recipes for a dynamic and productive economy. If governments are too generous in mitigating economic disruption, e.g. by extending all of their support measures until the end of 2021, they risk cementing existing structures and this could lead to the rise of “**zombie companies**”.

> *“Intelligence is the ability to adapt to change.”*
> Stephen Hawking (1942–2018)

Many structural elements are in danger of becoming obsolete at an unusually rapid pace anyway, for example as a result of attempts to contain global warming or behavioural shifts triggered by the pandemic – especially in respect of digitisation. This would replicate a mistake made by Japan in the 1990s and by the EU after the 2008/2009 financial crisis. At that time, **inevitable structural change** was either **blocked or delayed** out of concern for short-term costs (e.g. in the form of job cuts). This is precisely the direction that a zero interest-rate environment and an extension of government support schemes would take the economy now. They prevent resources from being diverted from yesterday’s industries to those of tomorrow. A strict but good nanny, on the other hand, recognises the need for her charges to shed some tears now and again

Selected forecasts 2021

Euro area

GDP growth, %	6.3			
Inflation, %	1.4			
Q1–Q4				
Repo rate, %	–0.5	–0.5	–0.5	–0.5
US dollar/euro	1.20	1.20	1.25	1.25
EURO STOXX 50, index value	3,420	3,470	3,520	3,550

Germany

GDP growth, %	5.0			
Inflation, %	1.9			
Q1–Q4				
3M Euribor, %	–0.50	–0.45	–0.45	–0.40
10y Bunds, %	–0.40	–0.30	–0.20	–0.20
DAX, index value	13,300	13,600	13,800	14,000

USA

GDP growth, %	3.8			
Inflation, %	3.3			
Q1–Q4				
Federal Funds Rate (mid-point), %	0.13	0.13	0.13	0.13
10y Treasuries, %	0.75	1.00	1.00	1.20
S&P 500, index value	3,600	3,650	3,700	3,750

in the short term – after all, it is in their own long-term interest!

Overview of forecasts in the baseline scenario

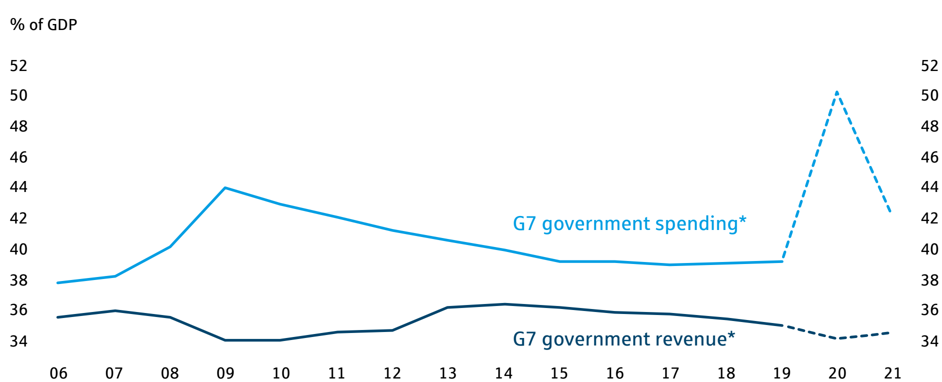
In a rebound following the deep recession of 2020, **economic growth** in Germany and the euro area in 2021 will be very strong at 5 % and more than 6 %, respectively. The US economy is set to expand by almost 4 %. Inflation will pick up, not least as a consequence of a sharp rise in oil prices over the course of the year. However, euro area **inflation** will remain below the ECB's target of 1.4 %. In Germany, consumer prices will climb by around 2 %, while in the United States inflation is likely to exceed 3 % on average over the year.

Under normal circumstances, **bonds** would be a risky investment in this environment. An economic recovery, rising commodity prices, higher inflation rates and a considerably higher volume of bonds on the market due to skyrocketing government debt will combine to form a toxic cocktail. However, central banks – unlike virologists – already appear to have an antidote to this threat. As a result of their purchase programmes, they control yield levels, yield curves and risk premiums. It is hard to imagine that the ECB would expect the euro area's debt-stricken countries to be able to cope with more than a modest rise in yields. At – 0.2 % by the end of 2021, 10-year German government bonds will not emerge from negative yield territory next year.

The economic recovery will alleviate the pressure on corporate credit profiles in 2021. **Corporate bond** issuance will return to normal. As corporate credit ratings stabilise, this will have a positive effect on the quality of **banks'** balance sheets. **Covered bonds** will be underpinned by their quality and demand will remain buoyant. The low level of risk premiums will persist, driven by demand from central banks.

Equity investors have endured a rollercoaster year of extreme volatility in the wake of the 2020 Covid-19 pandemic. In 2021, **equities** will continue to be caught between high valuations and a lack of investment alternatives. Stocks will benefit from their status as tangible assets. After all, the global volume of negative-yielding government bonds has reached its previous all-time high of August 2019 again. However, until effective vaccines become available, equities will remain dependent on support from monetary and fiscal policy. Nevertheless, in view of anticipated

Nanny provides strong support

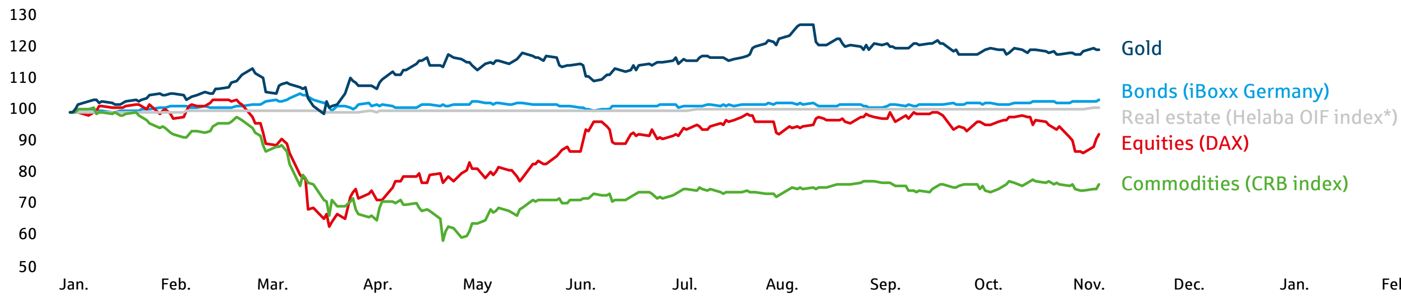


* 2020 and 2021: IMF forecasts

Sources: Macrobond, Helaba Research

Gold only asset class with significant gains in 2020

Indexed, 31 December 2019 = 100, total return in EUR



*Helaba index for German open-ended real estate funds

Sources: Datastream, Helaba Research

medical advances and an associated strong economic rebound, among the traditional asset classes equities hold out the best prospects for 2021. Towards the end of the year, the DAX is likely to be trading at around 14,000 points.

As an asset class, **real estate** will continue to benefit from extremely low interest rates. However, the recession of 2020 will not leave the real estate market unscathed. In commercial segments, especially retail, rents and purchase prices will decline in 2021. In contrast, the German housing market will resume its upward trend, albeit at a slightly more moderate pace, thanks to ongoing robust demand and a continuing shortage of available properties.

2020 was a record-breaking year for **gold**. With the outbreak of Covid-19, the traditional safe-haven was propelled to unprecedented highs. Even after the pandemic has subsided, we do not expect any turnaround in 2021. After all, gold always stands to gain when the world's reserve currency, the US dollar, weakens. This is compounded by an ongoing situation of real negative yields and astronomical levels of government debt. Overall, with political support, the gold price will be trading at 2,000 US dollar or 1,600 euro per troy ounce by the end of the year.

The attractiveness of the **US dollar** has waned. Its yield advantage against the euro will remain low as loose monetary policy is here to stay for some time to come. Without a cyclical tailwind, it is at risk of being adversely affected by structural problems. Caution is warranted due to a high budget deficit combined with a chronic current account deficit in the United States, especially since the greenback is regarded as overvalued. The euro-dollar exchange rate is likely to be trading at around 1.25 by the end of the year.

Patrick Franke

Interest rates and bonds

The power on the River Main

Despite a cyclical revival, higher inflation and rising national debt, yields on 10-year German government bonds will remain negative throughout 2021. This is attributable to the ECB and its ballooning balance sheet, which will exert downward pressure on bond market yields.

The European Central Bank, which has now been under the leadership of Christine Lagarde for a year, is the guardian of the euro bond market. Since the euro area sovereign debt crisis, the central bankers have intervened in bond markets on an enormous scale by launching purchase programmes, the main goal of which is to avert the danger of a significant rise in risk premiums. These mammoth **liquidity injections** and changes to the **regulatory framework** during the Covid-19 pandemic should prop up banks and companies; more importantly, though, they are designed to stabilise the capital markets.

And the ECB's efforts have paid off. Even without cutting key interest rates, which have already reached record lows, it was rapidly able to contain bond prices of crisis-torn countries. In conjunction with extensive EU rescue packages, the yield on 10-year Italian government bonds even fell to a new all-time low of 0.6 %. While the **ECB's balance sheet total** already stood at as much as 2 trillion euros in 2014, since March it has risen from 4.7 trillion to a most recent level of 6.7 trillion euro. In 2020, the central bank's total assets are expected to soar to around 60 % of euro area nominal GDP. This is part of a global trend, with Japan leading the way with a ratio of more than 120 %.

Yields set to rise – but the ECB will keep a lid on them

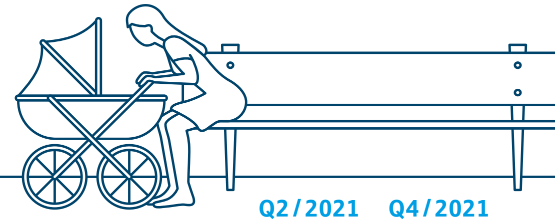
The yield on 10-year German government bonds also registered a new low of – 0.8 % in March. By the end of 2021, it is likely to rise to – 0.2 %. The trend towards rising yields will be fuelled by a **cyclical recovery, inflation** gathering pace and a massive increase in **government debt**. Now, even the European Union is to join the ranks of major issuers on the bond market. In the past, the significantly higher supply and the extremely negative real yield would have entailed considerable price risks.

> *"In the face of what I call the market failures, it is a question that we have to ask ourselves as to whether market neutrality should be the actual principle that drives our monetary policy portfolio management."*
> Christine Lagarde, ECB President

But with the ECB acting as a backstop, many investors will presumably be reassured. They are counting on the central bank simply expanding its purchase programmes if the worst comes to the worst. The most likely option is to extend the **Pandemic Emergency Purchase Programme (PEPP)** beyond the previously envisaged exit date of mid-2021. In addition, investors can rely on the fact that key interest rates will stay negative for a long time to come. The ECB's announcement in the middle of the year of a **strategy review** should underpin this expectation. There are strong indications that the ECB will follow the US Fed's lead in seeking higher inflation in future as well as tolerating a longer period of inflation target overshoot.

As regards to risks and side-effects …

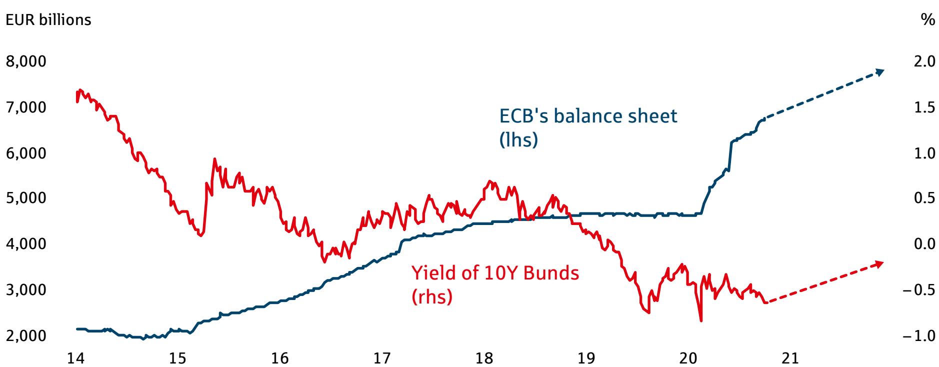
However, the link between monetary and fiscal policy, which have become increasingly intertwined during the Covid-19 crisis, could prove to be a serious problem in the long term. The rising share of outstanding government bonds that are held by the ECB threatens its capacity to act and exposes it to **growing political influence**. If inflation rises significantly, will it still be possible to tighten monetary policy without jeopardising the ability for euro area countries to refinance themselves? Perhaps this is more of a rhetorical question. Alternatively, is the ECB itself becoming a socio-political protagonist and playing a role that goes far beyond its remit of controlling inflation – for example, by contributing to the fight against climate change? At the same time, there is a risk that necessary reforms, in Italy for instance, will be put on the back burner due to the extensive monetary policy support the ECB has provided. Christine Lagarde's suggestion that the EU's economic stimulus packages should be retained as permanent support mechanisms would only add to this risk.



Forecast, end of period …	Q2/2021	Q4/2021
3M Euribor	–0.45	–0.40
10y Bunds	–0.30	–0.20
10y US Treasuries	1.00	1.20

for more interest rate forecasts see page 54
Source: Helaba Research

Purchase programmes ensure yields remain in negative territory



Sources: Datastream, Helaba Research

In turn, this could result in populist tendencies, especially in northern EU countries, flaring up again. Ultimately, **incentives for sound economic management will diminish** – not only in struggling countries.

US government bonds are also affected by tensions between mounting government debt and ultra-loose monetary policy. Here, too, rising yields can be expected as a reaction to a transformed economic environment. While the yield on 10-year US Treasuries has been around 0.7 % since the beginning of the crisis, it is likely to reach 1.2 % by the end of 2021 – although this is still relatively low by historical standards. If inflation expectations and US key interest rates were to be used in old regression models, it would result in a yield of around 2.5 %.

Ulf Krauss

Covered Bonds

Quality matters

Covered bonds have proven their resilience to crises in 2020 and will remain in demand in 2021, too. Meanwhile, the market continues to evolve: EU minimum standards are expected to be implemented by the middle of 2021 and the sustainability segment is growing.

The impact of the Covid-19 pandemic on covered bonds was less severe than on many other asset classes. Spreads reached their pre-crisis levels at an early stage, mainly thanks to generous support by the ECB. For 2021, we expect **credit qualities to remain largely stable**. Any major real estate risks should be limited to the retail and hotel segments.

Owing to the fact that many loans are prefunded and that there are attractive refinancing alternatives available through the Eurosystem, maturing debt of around 134 billion euro will be matched by new issues with a total estimated volume of only around 105 billion euro. As demand is expected to remain strong, especially from central banks, **risk premiums should stay low**.

Monetary policy boosts relative appeal

While the persistence of negative yields may act as a deterrent to certain investors, at the same time **yields on alternative bonds** – such as those from German Länder, development banks or the new major issuer the European Union – are **even more negative in many cases**. In addition, banks have to pay high penalty rates for excess reserves.

> *Market remains receptive.*

The number of investors seeking sustainability-linked assets is increasing and this trend is supporting the still small but rapidly growing segment of **green and social covered bonds**.

Furthermore, to ensure the quality of covered bonds, EU-wide minimum standards designed to harmonise covered bonds are set to be transposed into national law by mid-2021. For some covered bond markets, such as Spain or the Czech Republic, the new requirements are likely to mean an increase in quality. However, issuers will not have to apply the new requirements until the middle of 2022.

Sabrina Miehs

Credits

The new normal

The need to refinance maturing debt and fund structural investment programmes will be the primary motives for corporates to issue bonds in 2021. Banks' activities on the primary markets will be determined by the ECB's liquidity operations and regulatory requirements.

The wide-ranging measures launched to raise liquidity in the wake of the Covid-19 crisis mean that the primary market for **euro corporate bonds** will reach a new record volume of more than 450 billion euro in 2020. Purchases by the ECB to support the market will be a key factor in ensuring that demand for corporate bonds remains high in 2021 and **refinancing costs** stay **at a low level**.

In addition, the economic recovery will tend to reduce risk premiums for companies. Although default rates for corporates are likely to rise in some cases as a delayed consequence of the pandemic, pressure on credit profiles should ease for the majority of companies.

> *Primary market appears unlikely to set a new record in 2021.*

As the crisis subsides, the need for many issuers to further increase their liquidity will decrease. Instead, the capital market operations of corporates will once again focus on **replacing maturing issues** and **financing structural investment programmes**, for example in the automotive industry (e-mobility) or in the telecommunications sector (expanding networks). Overall, we estimate that **issuance activity in 2021** will be **significantly lower**. We anticipate a primary market volume of 300 to 350 billion euro.

Banks benefit from support by monetary policy and regulators

Stabilising corporate credit qualities will also have a positive effect on the quality of banks' assets. However, banks have so far taken very different approaches to setting aside **provisions for credit risks** in line with economic expectations. The extent to which these provisions are adequate will only become apparent once moratoria and fiscal policy support programmes have expired.

The **issue of sustainability** is becoming increasingly important for every segment. The pandemic is also boosting the trend towards **digitisation**. Cost-cutting initiatives will remain on the agenda as a result of high capital expenditure costs and dwindling earnings. On a positive note, at least most banks have built up substantial capital buffers. Having been forced to abstain from paying out dividends to their shareholders, they want to return to their previous distribution policies as soon as possible.

Due to their large-scale participation in the ECB's TLTRO programme, many institutions have slashed the number and volume of issues they had planned for 2020 as a whole. In 2021, issuance will again be strongly influenced by ECB policy. The ECB's **liquidity operations** and the challenging business environment both weigh on the outlook for primary market activities. On the other hand, there will be a renewed increase in maturities. In addition, the volume of regulatory-driven **non-preferred issues** will continue to grow so that there will be further use of favourable capital market windows.

Dr. Susanne E. Knips, Ulrich Kirschner, CFA

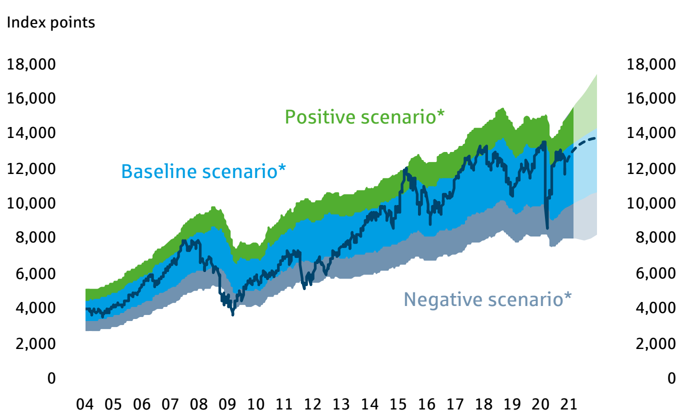
Equities

Dependent on support

Equity investors have endured an unusually turbulent year amid the unfolding crisis of the Covid-19 pandemic: a crash in the first quarter was followed by a record-breaking rally whereupon many indices succeeded in recouping most of their losses. Although fresh lockdowns have once again reduced investors' appetite for risk, equities are still likely to be the best performers among traditional asset classes in 2021.

Despite mounting an impressive overall comeback, there have been **considerable geographic variations in how equities have rebounded**. Among economic heavyweights, China has so far weathered the crisis most successfully in terms of equity market performance. As of 4 November, Chinese stocks (Shanghai Shenzhen CSI 300) were trading 18 % up on their 2019 year-end level. US equities (S&P 500) had posted a 7 % gain, while in Europe (EURO STOXX 50) they were still 16 % lower.

DAX has upside potential



*Bands: fair value based on earnings, dividends, cash flow and book value

Sources: Datastream, Helaba Research

Since reaching a peak in March, investors' **risk aversion** has **declined** sharply as the year has progressed. The implied volatility of the leading international indices – an indicator of market participants' perceived uncertainty – has moved largely within normal parameters, even since the resumption of lockdowns.

Why are market players handling the crisis with such surprising calm? The main reason is probably a combination of **highly expansionary fiscal policies** by governments around the world and the **ultra-loose monetary policy** of central banks. In view of this, investors have clearly extended their investment horizons and are already anticipating a post-Covid era. In some cases, this has resulted in surging equity valuations.

In 2021, it is likely that equities will continue to be **caught between high valuations and a lack of investment alternatives**. In this regard, stocks will benefit from their status as tangible assets. After all, the global volume of negative-yielding government bonds has reached its previous all-time high of August

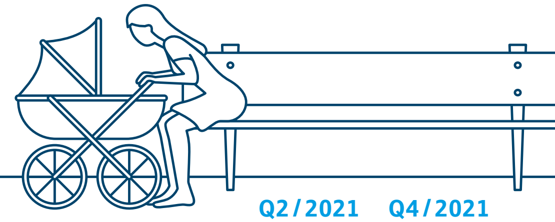
2019 again. However, until effective vaccines become available, equities will remain dependent on support from monetary and fiscal policy.

Moreover, a crucial factor will be to ensure that measures to combat the pandemic are administered adequately so that the economic damage can be contained. However, it is not a foregone conclusion that this will always succeed at the first attempt. In light of this, so-called risky assets may suffer temporary setbacks. Nevertheless, in view of anticipated medical advances and an associated strong economic rebound, among the traditional asset classes equities hold out the best prospects for 2021.

> This is what investors feel equities are best placed to deliver:
>
> *“Success is not final, failure is not fatal, it is the courage to continue that counts.”*
>
> Winston Churchill (1874–1965)

Valuation of US equities particularly high

The primary beneficiaries on the US market in 2020 have included IT, telecoms and e-commerce stocks. These are exactly the equities with strong weightings in the S&P 500. Consequently, they account for around 50 % of the market capitalisation of the S&P 500 index – almost as high as at the peak of the new economy boom in



Forecast, end of period …	Q2 / 2021	Q4 / 2021
DAX	13,600	14,000
EURO STOXX 50	3,470	3,550
S&P 500	3,650	3,750

for more equity forecasts see page 54
Source: Helaba Research

the late 1990s. This has also contributed to the fact that the valuation of the S&P 500 – in terms of its price-earnings ratio – has come close to **all-time highs seen in the spring of 2000**.

Even if interest rates remain low, there is little scope for permanently higher valuations, especially since other sectors of the US market are already expensive. As a result, equity prices are likely to rise only to the extent that the outlook for corporate earnings improves. We expect the S&P 500 to close 2021 at 3,750 points.

DAX relatively attractive

In contrast, European and especially German stocks are **valued significantly lower than their US counterparts**. The DAX, for example, is currently within its fair long-term valuation range. As the economy recovers dynamically, in line with our assumptions, expectations for corporate earnings will rise noticeably. At the same time, there is room for a modest uptick in valuations and thus potential for price gains.

In our baseline scenario, the DAX will be trading for the most part in the upper half of a fair valuation range of 11,000 to 14,500 points in 2021. Towards the end of the year, we expect the leading German index to reach 14,000 points.

Markus Reinwand, CFA

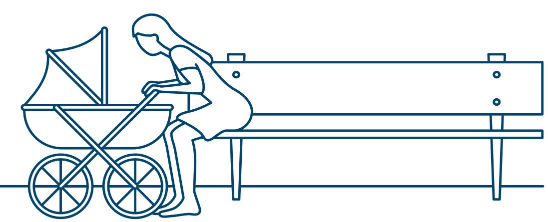
Gold

Politically protected

2020 was a record-breaking year for gold. With the outbreak of Covid-19, the traditional safe-haven was propelled to unprecedented highs. In 2021, political support for the precious metal will continue so that, even when the pandemic is over, there will be no turnaround in the trend.

The precious metal has surged from one high to another, breaking through the psychologically significant mark of 2,000 US dollar per troy ounce in August before reaching a new all-time high of 2,075 US dollar. In euro terms, its growth was even more pronounced, culminating in a record of almost 1,750 per troy ounce. Subsequently, a period of consolidation set in, although the precious metal should soon breach the 2,000 US dollar threshold once again and rise, at least temporarily, to 2,300 US dollar per troy ounce in 2021.

In this respect, gold has lived up to its reputation as a **safe haven currency**, attracting investors due to the current high level of uncertainty on the markets. As the pandemic subsides in the course of 2021, we do not expect to see any more comparable spikes in the price of gold. At the same time, though, there is unlikely to be a significant downward correction either, as is usually the case after similar record years. Three investment-related issues will contribute to this in 2021 and should ensure demand for gold remains stable: monetary policy, fiscal policy and the weakness of the dollar.



Forecast, end of period ...	Q2/2021	Q4/2021
Gold USD/ounce	2,000	2,000
Gold Euro/ounce	1,667	1,600

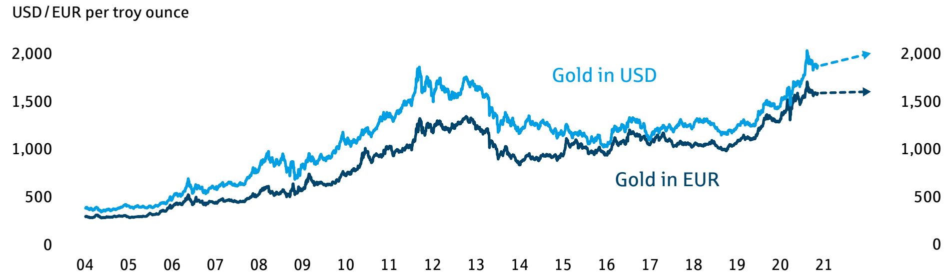
Source: Helaba Research

Negative real interest rates

The Fed, the ECB and a number of other central banks have fixed their key interest rates at zero or lower as part of their efforts to combat the crisis. This **zero-rate policy** is not expected to be abandoned any time soon; on the contrary, monetary policymakers are signalling that they will keep their interest rates at this low level for a very long time to come. This has not only pushed down nominal interest rates in both the United States and Germany, but has also led to **negative real interest rates** in both currency areas. The result is that, compared to alternative safe investments, holding gold no longer entails any **opportunity costs** and even offers advantages by avoiding negative interest rates. In 2021 this will not change in real terms.

> *"You have to choose between trusting to the natural stability of gold and the natural stability of the honesty and intelligence of the members of the Government. And, with due respect for these gentlemen, I advise you, …, to vote for gold."*
>
> George Bernard Shaw (1856–1950)

Gold: setting its sights on another record high



Sources: Macrobond, Helaba Research

Lasting mountains of debt

In their response to the crisis, countries throughout the world have seen their national debt rise sharply. Although economies are now recovering from the downturn, it will take some time before they reach pre-crisis levels again. There is no prospect of any rapid decline in **government debt**; in fact, policymakers seem to be pursuing a strategy of "growing" out of their debts. However, this is in turn fuelling expectations that governments will seek to stoke **inflation** in the long term in order to devalue their debt. If this approach were to gain traction among investors and savers, the role of paper currencies would be undermined as a means of storing value and, in return, gold's appeal as an **alternative currency** would increase.

Weak dollar = strong gold

Gold always benefits when the global reserve currency, the US dollar, weakens. This was the case in 2020 as a result of the Fed's monetary policy and US President Trump's (mis)management of the Covid-19 pandemic.

In 2021, the greenback will not regain its former strength, even under a new president. Overall, the precious metal will fluctuate around the **2,000-dollar mark** with **political** support, in a range of between 1,800 and 2,300 US dollar per troy ounce.

Claudia Windt

Real estate

Not completely immune

Real estate will continue to reap the benefits of a protracted low interest rate environment in 2021. However, the deep recession in the previous year will have a delayed impact – with market segments affected in quite different ways.

Experience has shown that real estate markets are closely correlated with, but lag behind, macroeconomic trends. For this reason, to a certain extent the severe recession in Germany is not expected to have an impact on rents and property values until 2021. The consequences of the pandemic will vary considerably by property type.

Apart from the hospitality sector, **retail properties** were hit hardest by large-scale closures during the spring lockdown. Food retailing is an exception to this. However, many bricks-and-mortar retailers are the main casualties of the crisis, with consumers increasingly turning to online retailers. A swathe of retail outlets will not survive the Covid-19 crisis and this could result in lost rental income and rising vacancy rates, especially in less desirable locations. The decline in prices, which was already underway before the onset of the pandemic, will continue in 2021.

The boom on the German **office market** is also likely to have run its course for the time being. Many companies are postponing new leases and reviewing their office space requirements. Although rental income will recover in 2021, the long-term impact on demand for office space of a shift to remote working arrangements may gradually become more noticeable. The likely outcome will be rising vacancy rates in certain locations and a modest decline in office rents. However, more generous distancing regulations and cautious project developers, as well as a rebound in employment, should limit negative market reactions.

Robust German housing market

The pandemic has not yet had any negative repercussions for the German housing market. The crisis of recent months has probably even reinforced the trend towards a flight into residential property, in a similar way as during the financial crisis. The latest data point to a **sustained upward trend**, although the average rise in residential property prices is likely to slow down somewhat in 2021. Ultimately, with more people working from home, demand may tend to migrate from central inner-city locations to the outskirts of metropolitan areas.

> *The German housing market will remain in the political spotlight. Will the political parties try to outdo each other in proposing interventionist measures during the election campaign? This would not result in any more living space being built.*

The fundamentals of the housing market will remain largely intact: low interest rates and people relocating to conurbations will ensure buoyant demand. With construction firms' order books bursting at the seams, this will limit residential construction activity; consequently, the **gap between supply and demand will remain wide**. Finally, housing policy is having anything but a constructive effect. Some measures are not helping to overcome the housing shortage and could even discourage investors. It will be interesting to see what the party manifestos for the 2021 German federal elections have to say about this issue.

Weaker real estate funds due to the crisis

The average year-on-year performance of German open-ended mutual property funds fell below the 2 % mark for the first time since 2011 due to the crisis-induced decline in prices. Given the customary time lag associated with property appraisals, further depreciations of properties are likely in 2021, especially in retail and hospitality sectors. This will **lower** the average annual **performance** to between 1 % and 1.5 %, before a turnaround can be expected in the second half of the year. At the end of 2021, average yields on the major funds are likely to remain below 2 %.

In view of the significantly weaker performance compared with previous years, **capital inflows will decline**. However, thanks to the introduction of notice and minimum holding periods several years ago, even funds experiencing temporarily negative returns are unlikely to see any substantial outflows.

Dr. Stefan Mitropoulos

Currencies

Dollar slide to continue

On currency markets, it is often a question of who is one-eyed and who is blind. For many years, the euro was considered the greater source of concern. This view seems to be changing: In the wake of Covid-19, political and economic difficulties are coming to the fore in the United States. Prospects for the US currency therefore remain gloomy.

In periods of uncertainty, the US dollar is often a much sought-after **safe-haven currency**. Indeed, the greenback initially benefitted from the coronavirus pandemic – but it didn't last long. In the meantime, there are signs that the US currency will close out 2020 in the red. This is despite the fact that the US economy has taken less of a battering than the euro area. However, the US Federal Reserve reacted more aggressively to the crisis than the ECB. Yields on US bonds are only slightly higher than those in Europe, eroding one of the US dollar's main advantages over the euro.

Despite the economic recovery in 2021, monetary policy in the US and the euro area will not see any fundamental change. Interest rate hikes are still a long way off. The only area in which the Fed is likely to shift down a notch ahead of the ECB is quantitative easing. However, the US yield advantage will not increase significantly. In any case, the US Federal Reserve took the lead, which the **stronger monetary growth** serves to underline. The United States is not expected to enjoy a growth advantage in 2021, so there is unlikely to be any cyclical tailwind for the US dollar. Other factors have counselled caution for some time already.

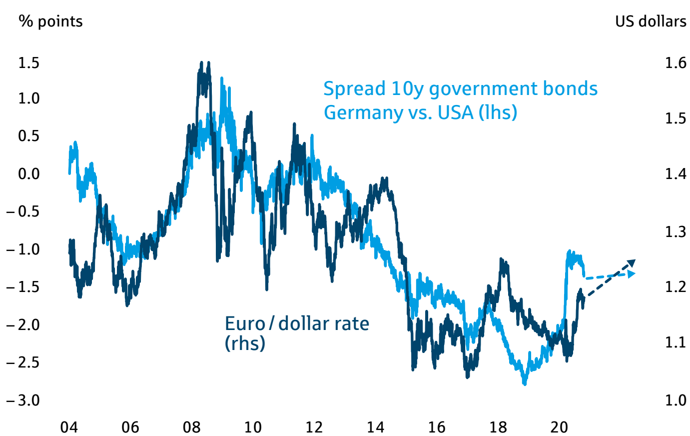
Dollar faces structural problems

Budget deficits have been rising everywhere during the crisis. In the United States, though, the deficit has been rising particularly steeply, not least it is financed by the Fed. Apart from some one-off effects that are set to expire, deficits remain high. Regardless of the election outcome, there are no signs of fiscal consolidation in US politics. Since the United States is also dependent on financing its spending from overseas due to its chronic current account deficit, this is of relevance for the dollar. The record-high "**twin deficit**" arouses suspicion among foreign creditors, especially as some are not amused by the way the US currency is being used as a tool to impose international sanctions, e. g. on Russia or Iran. In any case, the US dollar is still considered overvalued in terms of purchasing power parity – especially against the euro. Given their increasingly protectionist stance, even US policymakers might show a growing interest in a weaker currency.

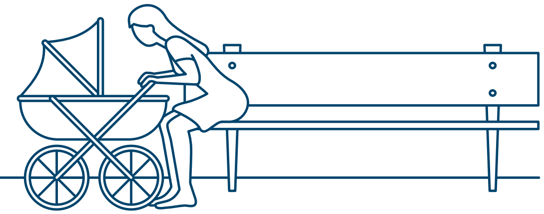
> *“The US dollar slide has entered the early stages of what looks to be a sharp descent.”*
> Stephen Roach, US economist

Structural problems and a lack of cyclical tailwind – does that foreshadow a major dollar collapse? The danger of a dramatic devaluation is still minimal and it is unlikely that the greenback will lose its status as the world’s reserve currency any time soon due to a lack of alternatives. After all, even the euro is one-eyed at best. The EU’s recovery funds will help to alleviate certain difficulties, but financial and political concerns will not be banished forever. In any case, a monetary policy turnaround by the ECB is still a long way off. For this reason, the trend towards a **modest depreciation of the dollar** will presumably continue in 2021. The euro-dollar exchange rate is likely to close the year at 1.25.

Low interest rate spread makes US dollar unattractive



Sources: Macrobond, Helaba Research



Forecast, end of period* ...	Q2 / 2021	Q4 / 2021
US dollar	1.20	1.25
Japanese yen	125	128
British pound	0.85	0.85
Swiss franc	1.10	1.12

* vs. euro

for more currency forecasts see page 54
Source: Helaba Research

Pound sterling, Swiss franc and Japanese yen

Sterling has been plagued by a “Brexit discount” for years. An end to the political uncertainty should give the British currency a boost, even if the new reality outside the EU will be anything but rosy. Hopes are also high for a more robust economic recovery once the devastating effects of the pandemic have subsided. The fact that the Swiss franc, as a safe haven for investment, has not been a major beneficiary of Covid-19 can be explained in no small part by the SNB’s aggressive intervention. In the wake of a generally more favourable economic environment, **demand for the Swiss currency will decline** and the euro-franc exchange rate should rise to 1.12.

The **Japanese yen** has been able to benefit from the weaker US dollar but has lost ground somewhat against the euro. This trend is expected to continue in 2021. In terms of its external position, Japan is in considerably better shape than the United States but is posting slower growth than the euro area.

Christian Apelt, CFA

2 Countries in the baseline scenario

European Union

The next generation

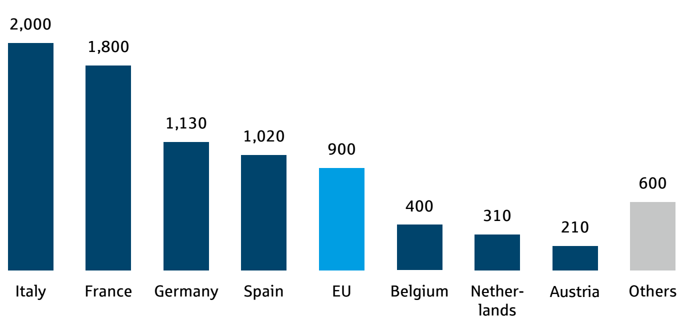
The year to date has brought about changes that will have a lasting transformative impact on the European Union. 2021 marks the beginning of a new era.

The withdrawal of the United Kingdom from the EU in the spring as well as decisions taken in July on a European recovery plan and the EU's multiannual financial framework are the defining events of 2020.

> *"The COVID-19 crisis presents Europe with a challenge of historic proportions."*
> European Council

EU to rank fifth as debtor in future

Outstanding volume, EUR billions



* EU member states: as of 2019; EU: total estimated volume over next few years

Sources: EU, Bloomberg, Helaba Research

An unprecedented economic slump, millions of job losses and health systems that are stretched to the limit represent challenges that have been driving a trend towards **closer collaboration among the 27 remaining EU states**. As part of the "NextGenerationEU" (NGEU) recovery plan, a decision was made that member states can apply for financial aid worth 390 billion euro from the EU budget. This package represents an unparalleled level of support and will be supplemented by loans, bringing the total NGEU volume to 750 billion euro.

"Recovery & Resilience Facility" a central element of the EU budget

In July, the NGEU recovery plan was adopted as part of the EU's Multiannual Financial Framework for the period of 2021 to 2027, which amounts to a total of 1.8 trillion euro. This shows that NGEU is crucial for the expansion of the EU budget in the coming years, especially in view of the years 2021 to 2023, when the bulk of payments will be made.

Outstanding bonds with a volume of EUR 900 billion possible

The EU Commission will fund these measures by tapping the capital markets. Together with smaller issuance programmes (e. g. the EU short-time work scheme, SURE) and EFSM activities, the volume of outstanding EU bonds will amount to around 900 billion euro within a few years. This will make the EU **fifth-largest borrower** in Europe in the future. While in the United Kingdom, national political concerns have gained the upper hand due to Brexit, with these measures the EU is taking a giant leap towards communitisation. This does not represent the introduction of Eurobonds – not yet at least – but EU bonds will play an important role in the primary market for years to come.

Ralf Umlauf

Germany

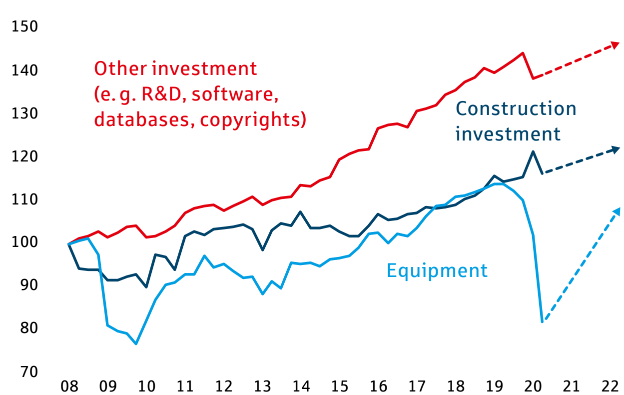
Emerging stronger from the crisis

The Covid-19 crisis is not over yet in Germany. However, with a decline of 5.4 % in calendar-adjusted terms in 2020, the economy is not expected to shrink as fast as the euro area as a whole. A process of recovery is already underway. Measures by the government to stabilise the economy have mitigated the damage, with a stimulus package of around 130 billion euro providing an additional boost.

Following the slump in economic output in the spring and a strong rebound in the third quarter, growth will largely come to a standstill in the final quarter of 2020 due to stricter measures to combat the pandemic. Ultimately, Germany is likely to see a calendar-adjusted fall in GDP of 5.4 % by the end of the year. Nevertheless, leading indicators point to a continuation in the recovery. For 2021, we expect that the economy will grow by an estimated 5 % and that it should return to its pre-crisis level by as early as next autumn.

Investments in R&D and software to rapidly exceed pre-crisis levels

Real gross fixed capital formation in Germany, Index Q1 / 2008 = 100



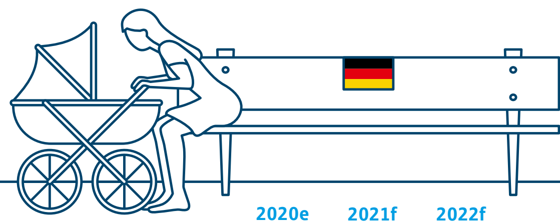
Sources: Macrobond, Helaba Research

> *The coronavirus pandemic has widened the gap in per capita income between Germany and the euro area.*

In contrast to France or Italy, **public consumption expenditure** rose in the spring of 2020. After all, they account for one fifth of gross domestic product and are forecast to have grown by 3.5 % in 2020. In 2021, thanks to generous government spending, a further rise of 3 % is expected. Social benefits, in particular, were increased in 2020. Social security systems have partially offset people's loss of income due to short-time work and increased unemployment.

The number of partially unemployed workers, which recently stood at around 3.3 million, is likely to fall further in 2021 and the unemployment rate should also decline. People will gradually return to regular **employment**, but this will take time. Unemployment in 2021 is expected to average 2.8 million, some 530,000 more than in 2019.

Consumer spending is likely to rise by 5 % in real terms in 2021. However, due to ongoing pressure as a result of the Covid-19 pandemic, consumer will still be limited in their financial scope, especially with regard to services. The retail sector has benefitted, although not in all segments, having already exceeded its pre-crisis level of sales. Online retailers are the biggest winners, but the situation of bricks-and-mortar retailers has also improved.



	2020e	2021f	2022f
GDP real, % yoy	–5.0	5.0	1.9
GDP real, % yoy, working day adjusted	–5.4	5.0	2.0
Private consumption, % yoy	–7.0	5.0	2.0
Government spending, % yoy	3.5	3.0	2.0
Gross fixed capital formation, % yoy	–5.6	5.0	2.0
Investment in equipment, % yoy	–18.0	12.0	4.0
Construction, % yoy	1.0	2.0	1.0
Exports, % yoy	–12.0	8.0	4.0
Imports, % yoy	–10.0	6.5	4.0
Consumer prices, % yoy	0.5	1.9	2.0
Unemployment rate, %	6.0	6.1	5.5
Unemployed, million	2,750	2,800	2,500
General government balance, % of GDP	–6.5	–3.5	–2.5
Current account balance, % of GDP	6.7	6.7	6.6

e = estimate, f = forecast

Source: Helaba Research

The growth in consumption will coincide with an increase in disposable income of only about 4 %. However, **savings rate** will return to a normal level. It is likely to fall by three percentage points following a sharp rise in 2020 to 16 %. Real growth in consumption in 2021 will be hampered by a somewhat higher deflator. At the beginning of the year, value-added tax is set to revert to its original level and higher energy prices will have an inflationary effect.

Capital expenditure to determine competitiveness

It will be a while before a recovery in global investments in equipment sets in. Capacities in manufacturing industry remain underutilised so that, for the time being, expansion is not an urgent priority. In addition, the severe recession has led to a deterioration in corporate earnings. **Protectionist tendencies** and the consequences of Brexit have long had a negative impact. Currently, this is acutely felt by German industry, which is heavily geared towards supplying capital goods.

Exports in 2021 are expected to grow by 8 %, only partially compensating for this year's slump to date (2020: –12 %). As a result, the **handbrake has also been applied to equipment spending** in Germany, which will also rise at a more moderate pace. Having plummeted by an estimated 18 % in 2020, it will probably take several years to return to pre-crisis levels. Starting from this low baseline, investments in vehicles and machinery are likely to increase by 12 % in 2021.

The German government's **economic stimulus measures will help to improve the country's international competitiveness**, e. g. the reduction in the EEG (renewable energy) surcharge, the reintroduction of degressive depreciation, improvements to research funding, the expansion of tax loss carry-back rules as well as the capping of social security contributions to 40 % by 2021. In addition, financial support from the government will make it easier for German companies active in fields such as e-mobility, hydrogen technology, artificial intelligence (AI) and quantum technology to bolster their position.

Apart from government consumption expenditure, **construction investment** is the only other item that has risen, growing by around 1 % in 2020. Building sites have been able to continue working almost without interruption. New orders, however, continued to decline well into the summer months, although here, too, the situation can be expected to improve.

Demand for housing and renovation work remains high. As the labour market returns to normal, existing uncertainty should abate and financing conditions remain attractive for buyers. Public sector construction will continue to benefit from the spending policies of local authorities. The situation in the commercial construction sector is more difficult, however. Overall, investments in construction are expected to show somewhat more robust growth of 2 % in 2021.

While companies dramatically reduced their investments in machinery and vehicles in 2020, reductions in spending on research and development as well as software were significantly lower. They are the principal component of investments in "other investments", whose share of total investments has now risen to almost 19 %. In order to enhance their competitiveness with the help of new processes and products and by digitising workflows, companies are also likely to invest more heavily in these areas over the years ahead. Here, **German industry continues to play a leading international role**.

The social market economy must not be allowed to turn into a nanny state.

Given the exceptional pandemic situation, government protection policies and economic stimulus packages are the right response to the difficulties that arose. The German economy is gaining momentum again. For this reason, the government should gradually start considering **phasing out interventionist measures in the economy**. The German model of a social market economy must not be allowed to turn into a nanny state. This would have a detrimental effect on productivity and, by extension, on Germany's competitiveness.

In 2020, the government deficit has jumped to an estimated 6.5 % of gross domestic product, significantly more than during the financial crisis (2009: –3.2 %). The **national debt** is likely to rise by more than 10 percentage points to more than 70 % of GDP. The financial tour de force that the government undertook was readily managed because years of prudent fiscal policy had preceded the crisis. The next government that Germans elect in October 2021 should quickly consolidate this approach in order to be able to cope with possible future crises.

Dr. Stefan Mütze

Hesse, Thuringia, North Rhine-Westphalia and Brandenburg: keep your cool!

Germany is a country with a distinctly federal character. So, it comes as little surprise that the federal states have favoured different approaches in the Covid-19 crisis. In this situation, the important thing is for politicians and citizens alike to keep their cool as there is a lot of uncertainty how to tackle the pandemic. It might even be worthwhile experimenting with different strategies to combat the disease. When the going gets really tough, Germany's federal system has proven that it is able to achieve workable compromises – as the decision on the most recent lockdown in November shows.

The following selection of German federal states is focused on Helaba's core regions.

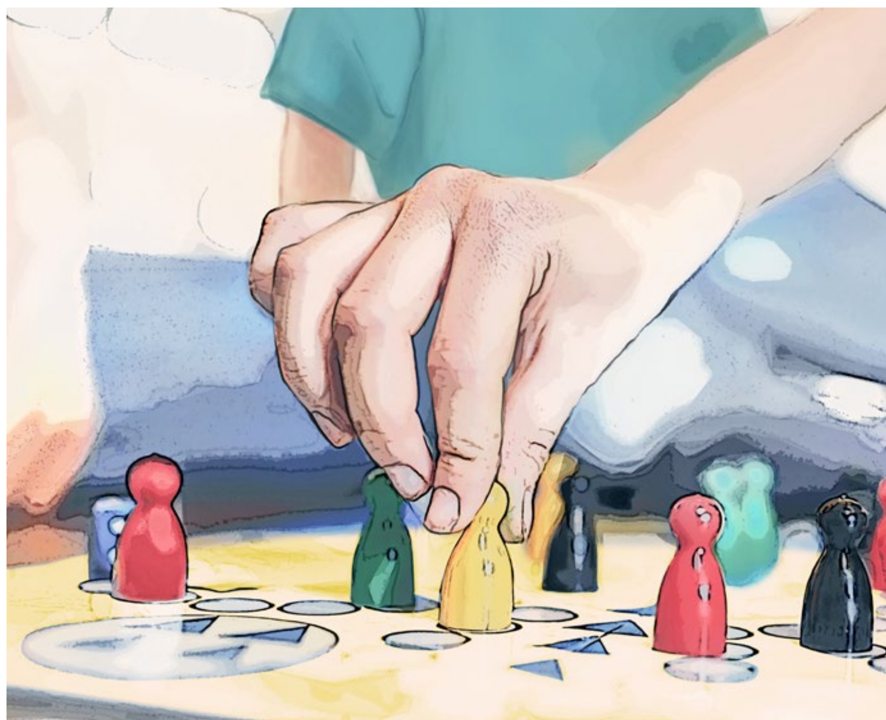
Hesse more effected by Covid-19

Covid-19 has hit the State of Hesse with particular severity. In October 2020, the number of unemployed rose by 47,500 compared to the same month last year. This was 7.5 times higher than during the financial crisis. The reason for this drastic increase can be found in service sectors. For example, the volume of passengers passing through Frankfurt Airport in the period up to October 2020 was around 75 % lower than the same period in 2019. The Hessian hospitality industry suffered a –43 % slump in turnover in the first seven months of 2020.

Although the industrial sector in Hesse recorded declining sales, a recovery has already set in and should mean that revenues in 2020 will fall by less than 10 % overall. The retail sector, which includes online sales, even posted a 2.5 % increase in sales in real terms and the construction sector also registered growth. Overall, Hesse's GDP is likely to fall by around 6 % in 2020, with an average contraction in Germany as a whole of –5 %. With growth of 5 % in 2021, the economic recovery in Hesse could be just as strong as that of Germany.

Thuringia to make up lost ground

Industrial companies in the German state of Thuringia have so far weathered the Covid-19 pandemic somewhat more successfully and their revenues in 2020 are likely to see a decline of considerably under 10 %. Food manufacturers were responsible for this more positive performance. Demand for their products was not only high during the lockdown, as evidenced by a 16 % increase in sales in the first eight months of 2020 compared to 2.6 % in Germany as a whole. Other industrial segments, such as the auto-



motive industry and producers of metal products, felt the full force of the coronavirus pandemic. Unemployment rose by 18 % in Thuringia in October 2020, which was below the national average of 25 %. Thuringia's economic growth should be strong enough to achieve stagnation over 2020 and 2021.

Smaller impact on North Rhine-Westphalia

At the beginning of 2020, all the signs were pointing to an economic recovery in North Rhine-Westphalia (NRW) as well. But then everything changed. The industrial sector experienced major losses. Meanwhile, the worst is behind it but a contraction of around 10 % will be unavoidable for 2020 as a whole. The tourist industry has been operating, to a greater or lesser extent, in a strict lockdown. A 35 % loss of income has meant a struggle for survival for many hotels and restaurants.

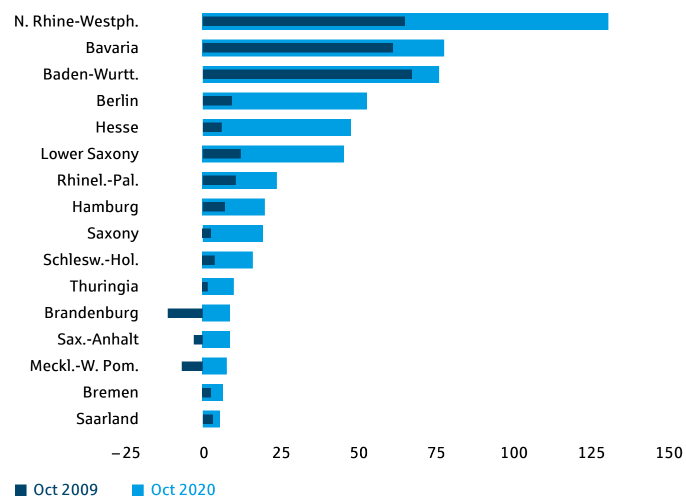
NRW's retail sector, on the other hand, has recorded a 2.5 % growth in sales in real terms this year, which is even on a par with the particularly strong performance it achieved in 2019. The biggest winners are e-commerce businesses, supermarkets, consumer electronics stores and DIY stores as well as pharmacies and sports retailers. Other retailers, however, are struggling to survive. The overall contraction in NRW's economy is expected to be below 5 % in 2020 which, as in the financial crisis, will be slightly lower than the national German average. Provided that there are no strict lockdowns lasting weeks in the new year, growth in NRW could reach around 5 %.

Brandenburg to emerge relatively unscathed

The structure of Brandenburg's economy has its own unique features. The industrial sector has a share of only 13 % (Germany: 22 %). On the other hand, service industries and the public sector

Labour market: impact of Covid-19 bigger than financial crisis

Number of unemployed: absolute change compared to same month the year before (thousands)



Sources: German Federal Employment Agency, Helaba Research

account for an above-average proportion of overall output. At the time of the financial crisis, this structure helped to mitigate the downturn and resulted in a contraction of only 2.8 % in Brandenburg back then. A similar development is likely to occur in 2020 – albeit to a lesser extent, since this time a large number of services are affected by the crisis. At around 4 %, GDP is likely to fall by one percentage point less than the German average. In 2021, we can expect to see a rebound of at least 5 % as tourist traffic picks up once the pandemic dies down and the recently opened Berlin-Brandenburg airport fills with activity.

Barbara Bahadori

France

Uncertainty abounds

The second wave of the Covid-19 pandemic is ravaging France. Gross domestic product is expected to fall towards the end of the year, but it will be followed by a recovery in 2021 after this enforced hiatus.

In France, an estimated 8.7 % contraction in GDP in 2020 is likely to slightly exceed that of the euro area as a whole. The reason for this was the prolonged and severe lockdown in the spring. Consumption has traditionally been a more important factor for our Gallic neighbour's economy than Germany's, for example. When public spending is included, it accounts for almost 77 % of GDP, which is four percentage points higher than the equivalent German figure. The rapid uptick in new Covid-19 cases is weighing on consumer confidence. The government's decision to reimpose curfews in an effort to contain the virus will **dent the recovery in consumer spending** that was already underway.

	2020e	2021f	2022f
GDP real, % yoy	–8.7	8.0	2.3
Consumer prices, % yoy	0.5	1.3	1.7
Unemployment rate, %	7.6	8.3	7.6

e = estimate, f = forecast

Source: Helaba Research

Spending by private households is likely to plunge by 7 % in 2020 as a whole. It is expected to rebound in 2021 with a similarly strong increase of 7 %.

The sharper drop in economic activity can also be explained by the fact that public sector consumption expenditure in France fell significantly in the first half of 2020, whereas it increased in Germany. However, this segment has also turned the corner and this trend is expected to continue in 2021. In addition, the French government is attempting to stimulate economic growth with a **stimulus package in the order of 100 billion euro**. It includes EUR 20 billion in cuts to business taxes not linked to profits. On top of that, the government has announced steps to boost digitisation and the transition to a green economy with additional investment in the railway network, renewable energy and the thermal insulation of buildings. These measures will lead to more investment in equipment and buildings from 2021 onwards.

Imports are likely to grow only a little bit slower than exports in 2021, especially as domestic demand will be stimulated and the stronger euro will suppress demand from overseas. This means that net exports will once again be a factor limiting economic growth. Overall, though, the French economy should expand by 8 %.

The **downside of the Covid-19 stimulus measures** is the state of **public finances**, despite the almost 40 billion euro that France can expect to receive from the EU's recovery plan. It is not only that the country's budget deficit will skyrocket from 3 % to an estimated 11 % of GDP in 2020. National debt, which had already reached 98 % in 2019, is also set to soar – to a level of around 120 % of GDP. This will not change significantly in 2021, either. If there were ever any serious attempt to reduce these levels, this would then mean abandoning stimulus spending.

Dr. Stefan Mütze

Italy

Help from Brussels

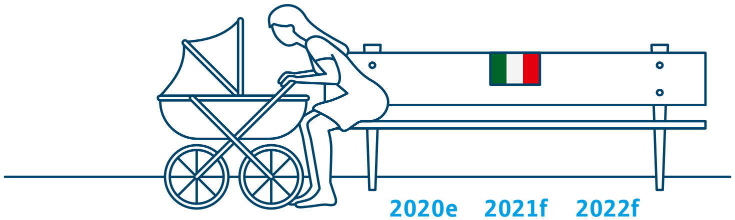
Italy, which is beset by weak growth, will receive substantial funds from the EU's recovery programme. This should help the country to weather the deep recession. It remains to be seen if the Italian government will use the funds to tackle underlying structural problems as well.

Italy has a long-term growth problem. In the ten years up to 2019, price-adjusted GDP grew by an average of only 0.3 % per annum. This is partly due to **structural problems** that have never been solved. Then the coronavirus hit and, with it, a slump in GDP of 8.3 % as the country suffered a long and hard lockdown in the spring.

Recently, Italy has again resorted to tougher measures in an effort to tackle the second wave of the pandemic. **Growth** should reach **6 %** in 2021, supported by anticipated payments from the EU's recovery programme. Despite this, overall economic output is not expected to return to its pre-crisis level until 2023.

Unemployment, which was under-reported in the spring due to statistical errors, is likely to rise further in the coming months. This will put a damper on consumer spending, especially as there will be almost no increases in collective bargaining wages. The service sector continues to be hit hard, notably the tourist industry.

In view of a deterioration in the capital base of many Italian companies – especially SMEs – as a result of the coronavirus



	2020e	2021f	2022f
GDP real, % yoy	– 8.3	6.0	1.7
Consumer prices, % yoy	– 0.2	0.8	1.1
Unemployment rate, %	9.3	10.3	9.6

e = estimate, f = forecast

Source: Helaba Research

pandemic, a recovery in capital expenditure is only likely to proceed at a very gradual pace. However, the **EU is expected to start handing out funds** in 2021. Italy is likely to focus on the roughly 65 billion euro that it will receive as non-repayable grants first. Including the loans, the total funding provided will amount to as much as 205 billion euro. The government has announced plans to invest in infrastructure projects and in the key areas of digitisation, transitioning to a green economy and education, among others.

Italy will see stronger growth up to 2026, even if the implementation of projects may be delayed. The **additional growth** is likely to reach a maximum of half a percentage point. Even before the decision on EU financial support was made, two decrees were issued that laid the groundwork for measures to protect the economy and provide economic stimulus packages. Reforms in the country's administrative and judicial systems would be necessary in order to increase the effectiveness of the financial aid packages and accelerate their implementation. This would enhance the country's competitiveness.

Dr. Stefan Mütze

Spain

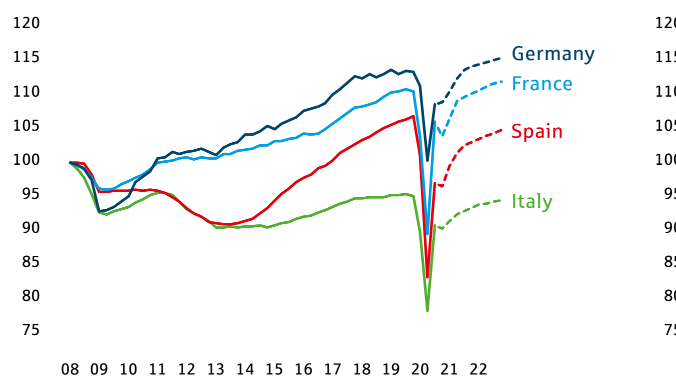
No common strategy

Along with Italy, Spain is one of the big beneficiaries of EU financial assistance. Nevertheless, the economic recovery remains fragile. Politicians are unable to find common ground in combatting the crisis. The all-important tourist industry is causing major headaches.

In the second quarter of 2020, Spain suffered the most pronounced economic downturn among the euro area's "big four" and the subsequent recovery is on shaky ground. After contracting by 11 %, gross domestic product should grow by 7.5 % in 2021. Government debt is expected to rise by 25 percentage points to around 120 % of GDP in 2020 as a result of the Covid-19 crisis.

Italy and Spain below pre-crisis levels for a long time

Real gross domestic product, index Q1 / 2008 = 100



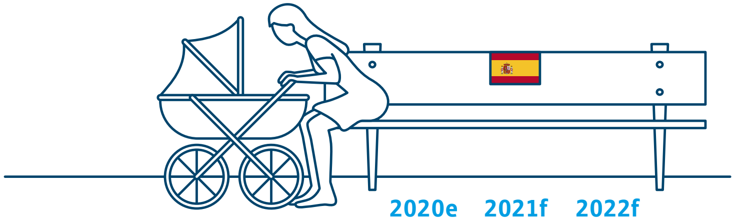
Sources: Macrobond, Helaba Research

Spain

The job market has already seen an initial stabilisation, although the number of **unemployed** has risen by 700,000 to over 3.8 million since the beginning of the Covid-19 crisis. This is aggravated by the enormous significance of **tourism** for Spain. This sector, which around 12 % of the workforce depends on, is currently on its knees. There are no signs that European travel restrictions for Spain will be lifted any time soon.

In light of this, it comes as no surprise that Spanish consumers feel particularly downbeat compared to other European countries at the moment. Following an above-average decline in **consumer spending** of around 13 %, only around half of this shortfall is expected to be recouped in 2021. As exports are likely to grow more rapidly than imports, Spanish **foreign trade** will make a positive contribution to growth.

Overall, **capital expenditure** is likely to show only moderate growth. Given the difficult economic situation for many households, the positive impact of housebuilding activity will remain subdued. Due to underutilised capacities, expansion is not an issue for many companies. However, Spain is one of the major beneficiaries of the **EU's recovery programme**. Financial assistance for Madrid will amount to approximately 140 billion euro. Of this, 72 billion euro are non-repayable grants that will be used first. Among other things, the parliament planning includes projects to boost digitisation and measures to promote the transition to a green economy. These programmes should help to raise the productivity of the Spanish economy.



	2020e	2021f	2022f
GDP real, % yoy	–11.0	7.5	2.5
Consumer prices, % yoy	–0.4	0.6	1.1
Unemployment rate, %	15.7	16.5	15.5

e = estimate, f = forecast

Source: Helaba Research

It is uncertain, however, whether the minority government will really succeed in bolstering the country's competitiveness. Even in major crises, Spain's **political parties are scarcely able to reach agreement**. The previous conservative government's budget, which has already been extended twice, is still in effect and a budget for 2021 has yet to be passed. The Spanish government's **reforming zeal** has also **run out of steam**. For example, in order to contain spiralling costs, the government urgently needs to make changes to the pension system.

Dr. Stefan Mütze

Sweden

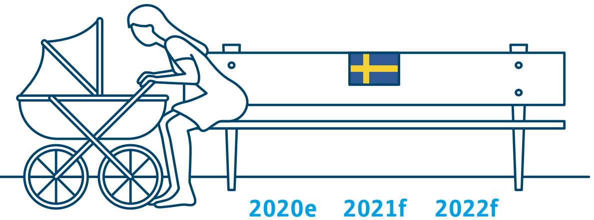
Going it alone

So far, Sweden has been pursuing its own strategy in tackling the Covid-19 pandemic. This will also define how the economy performs in 2021.

Sweden's minority government, made up of Social Democrats and Greens, has adhered to recommendations by its chief epidemiologist in imposing **neither a lockdown nor mandatory face masks**. Shops and cafés have remained open. Moreover, since it started the year with higher economic growth than the EU average, the 2020 recession is forecast to be relatively mild with a contraction of –4.1 % (EU: –6.8 %). However, the "Swedish way" has also been the subject of harsh criticism at home and abroad due to the disproportionately high number of deaths.

Consequently, the economy will have less catching up to do in 2021 than other countries. The public's fear of Covid-19 infection will continue to hamper the **domestic economy and tourism** until a vaccine is available. The momentum of the recovery among its trading partners will also play an important role, given that exports of goods account for about one third of GDP. Overall, a growth rate of 3.2 % can be expected. However, GDP is unlikely to reach its pre-crisis level before 2022.

Sweden



	2020e	2021f	2022f
GDP real, % yoy	– 4.1	3.2	2.8
Consumer prices, % yoy	0.5	1.4	2.0
Unemployment rate, %	8.5	8.5	8.0

e = estimate, f = forecast

Source: Helaba Research

Generous support

Support is coming from a wide variety of sources: despite not lowering the repo rate again, the **Riksbank** did reduce the overnight lending rate to an all-time low of 0.1 %. Monetary policy is strongly accommodative, with bond purchases of up to 10 % of GDP and additional lending facilities for companies and banks. The central bank has already indicated that they intend to remain on this path. Further easing is expected in 2021, should the central bank consider Sweden's competitiveness at risk due to exchange rate movements, for example.

The government has also provided **generous fiscal relief** in 2020 by making subsidies, liquidity support and guarantees available. If fully utilised, they will amount to as much as 17 % of GDP. For the following two years, the government has announced economic stimulus packages of around 2 % of GDP in each case.

Marion Dezenter

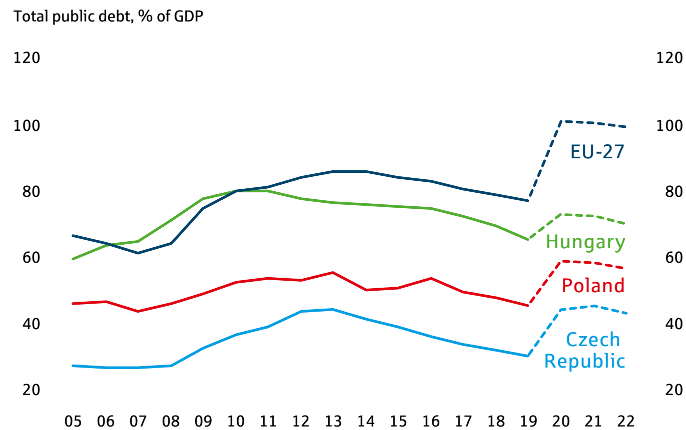
Poland, the Czech Republic, Hungary

Regulations – no thanks!

The strength of the recovery in these countries will be determined by the different structures of their economies. What they have in common is a trend towards (economic) policy independence.

With its **large domestic economy**, Poland is better placed than some other countries to weather the crisis. After the recession in 2020, the economy should expand by 3.5 % in 2021. The Czech Republic, where the **automotive industry** dominates the economy and exports account for 80 % of GDP, has been hit hard by the interruption of supply chains and the closure of manufacturing sites. Although economic activity in important trading partners such as Germany is characterised by significant catch-up effects, the slowdown triggered by the second wave of the pandemic in the Czech Republic is having a drastic impact on its economy. Economic growth is likely to reach just above 3 % in 2021.

Central Europe: comparatively modest debt levels



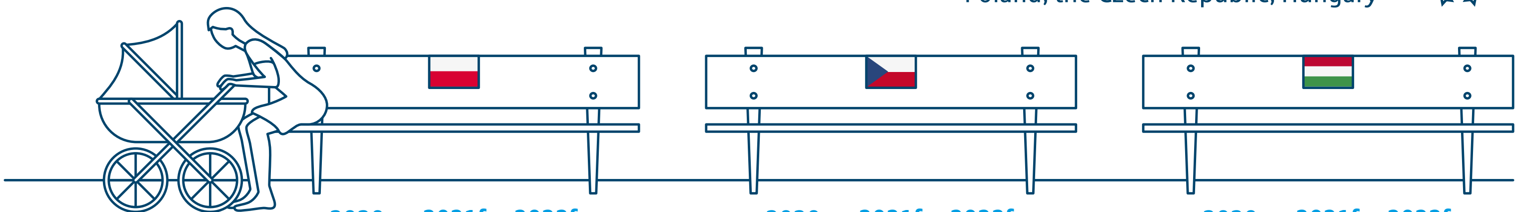
Sources: Eurostat, Helaba Research

Hungary is similarly dependent on manufacturing. In addition, losses in the key **tourism segment** are an additional burden and their effects will probably still be felt in 2021. Cross-border travel can be expected to remain subdued in the medium term as well. As a result, economic growth is unlikely to exceed much more than 3.7 % in 2021.

Sanctions by “EU nanny state” unwelcome

The pandemic has reinforced a trend towards **policy independence**, particularly in Poland and Hungary. Here, the right-wing populist governments have been pursuing generous as well as patronising policies for years by distributing benefits to anyone who fits into their preferred world view.

Poland, the Czech Republic, Hungary



	Poland 2020e	Poland 2021f	Poland 2022f	Czech Republic 2020e	Czech Republic 2021f	Czech Republic 2022f	Hungary 2020e	Hungary 2021f	Hungary 2022f
GDP real, % yoy	–4.1	3.5	3.5	–7.4	3.3	3.4	–6.9	3.7	3.3
Consumer prices, % yoy	3.5	2.1	2.4	3.2	2.0	2.3	3.5	3.2	3.3
Unemployment rate, %	6.0	5.9	5.7	3.6	3.6	3.0	4.3	4.3	3.8

e = estimate, f = forecast

Source: Helaba Research

At the same time, the EU's interference in issues concerning the **rule of law** is perceived as an assault on their independence. Attempts to link subsidy payments from the EU's recovery plan to rule of law criteria is likely to remain a tricky task.

> *The pandemic has reinforced a trend towards policy independence.*

Autonomy also shapes **monetary policy** in all three countries: key interest rates have been cut to (or close to) all-time lows and reserve requirements have been weakened. Central banks in Poland and Hungary have relaxed monetary policy by making large-scale bond purchases.

Giving up this autonomy would be difficult, with the result that an accession to the euro area in the near future is even less likely than it was anyway. All three currencies have depreciated against the euro. **Exchange rates** are significantly above their previous average levels, leading to inflationary pressure. There is little prospect of any sustained appreciation before the exceptional pandemic situation has subsided.

Rising debt burden not without risks

Substantial government assistance for companies, loan guarantees, tax breaks and other support programmes will **leave their mark on public deficits and debt ratios** beyond 2020. Parliamentary elections in the Czech Republic in October 2021 and in Hungary in April 2022 will push the issue of reducing government debt further into the background.

Government debt levels in all three countries remain well below those of other EU member states. At around 45 %, the Czech Republic's national debt is even comfortably within the Maastricht limit of 60 % of GDP. However, there is a caveat to this situation. It may well be easy to increase public borrowing in the current phase of low interest rates. Should rates rise, though, a nightmare scenario beckons: the need to service a high level of debt would then severely restrict the scope for fiscal action. The EU's helping hand in the form of grants and loans from the **Recovery and Resilience Facility**, from which the countries are expected to receive payments of between 2 and 4 % of their GDP by the end of 2022, will reduce the strain on national finances and is therefore a welcome boost – autonomy or not.

Marion Dezenter

United Kingdom

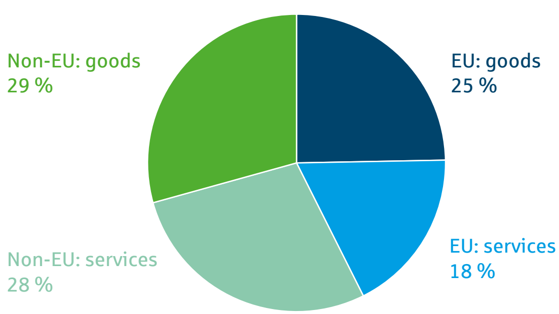
Liberated from the EU nanny

Free at last – that's what will be on the minds of Brexit hardliners as the transition period expires at the end of 2020. Will it herald the dawn of a brighter future? At the moment, due to the dire impact of the Covid-19 pandemic, things can hardly get much worse for the UK. Despite all of this, the British economy will grow strongly in 2021. However, Brexit will still have negative consequences.

After years of torturous negotiations, a final decision is due on the **future relationship** between Britain and the EU – the official withdrawal took place on 31 January 2020. Even if there are still hurdles to overcome, there is a realistic prospect of an agreement. From 2021 onwards, exporters and importers will have to adapt to the new reality that will include the imposition of customs formalities. It is inevitable that there will be some difficulties to overcome at the border at the beginning of the year. There may be adjustments to standards in trading goods. Trade in services is set to become more difficult. The difference to a "hard" Brexit no longer seems to be that big, at least in the long term. In that case, however, tariffs would be imposed on WTO terms and there would be legal uncertainty and a much longer period of chaos at the border – which would significantly reduce British growth in 2021.

EU most important export destination

Goods and services exported from UK in 2019, share in %



Sources: Macrobond, Helaba Research

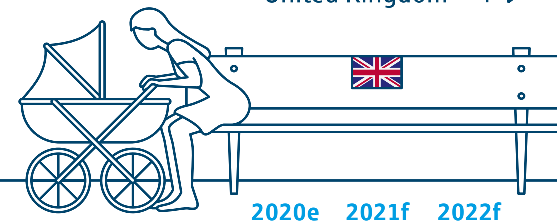
Brexit burdens predominate

The advantages of Brexit are …? Well, perhaps the vague chance of free trade agreements with other countries on more favourable terms. Although the British will be able to regulate more things themselves, this will not apply to areas in which they want to do business with the EU. The notion of Britain becoming a kind of lightly regulated "Singapore-on-Thames" is scarcely something that would be politically acceptable in the UK, either.

> *"Brexit means Britain can no longer blame the EU for nanny state nonsense."*
> Baylen J. Linnekin, expert on food policy

Even the Conservative government is planning additional state intervention. A more complicated border will make the country less attractive as a manufacturing location. There are hardly any other advanced economies for whom exports of services are so important. The EU is not the primary destination here, unlike for goods. But British companies are likely to lose some of their business or profits. This would have a tendency to **hamper growth**. After all, freedom has its price.

United Kingdom



	2020e	2021f	2022f
GDP real, % yoy	– 10.7	5.7	2.5
Consumer prices, % yoy	1.0	2.4	2.3
Unemployment rate, %	5.0	6.2	5.2

e = estimate, f = forecast

Source: Helaba Research

Economy to recover from slump

The Covid-19 pandemic, which has hit the country particularly hard, means the UK economy is facing an even greater challenge in the short term than Brexit. There will be no repeat of the 10.7 % contraction in 2020 and a recovery has already gathered momentum. Consumers are eager to spend again. Government support is providing some relief from loss of income. However, unemployment is expected to rise. In addition, since a number of Covid-19 restrictions will remain in place, and even tightened for limited periods, consumer spending will stay below pre-crisis levels. Even before the coronavirus hit, capital expenditures had been already running in low gear. The rebound after the downturn will continue to be tempered by uncertainties. In the course of 2021, however, investment is likely to pick up noticeably, as there will be **more clarity** about both the pandemic and Brexit.

The UK government has shown itself to be very big spender. But, in view of enormous budget deficits, it will not be able to churn out one new stimulus package after another. Collapsing imports have led to a distinct improvement in the trade balance in 2020. Next year, the balance will deteriorate as country's final exit from the EU takes its toll. Despite all the problems and even with further Covid-19 restrictions or a chaotic end to the Brexit transition period, the British economy will grow in 2021. As long as these burdens can be kept within limits, **GDP** is expected to grow by **5.7 %**.

Despite higher Inflation – Bank of England stays on course

Inflation will jump from **1 % to 2.4 %** in 2021. Higher energy prices, the abolition of temporary stimulus measures such as specific VAT cuts, a general recovery in demand and a likely increase in Brexit-induced import costs will drive up inflation. Since recent talk coming out of the Bank of England seems to be more focused on negative rates, the bank rate of 0.1 % will hardly be raised. However, after the recent increase the bank is expected to terminate its current asset purchase programme at the end of 2021.

Christian Apelt, CFA

United States

Uncle Sam will take care of it

The US government, Congress and the Federal Reserve have reacted to the pandemic and the economic damage caused by the lockdown with fiscal and monetary policy interventions on an unprecedented scale. The record stimulus has very quickly and decisively helped to put the US economy back on a growth trajectory.

Against this backdrop, we expect growth close to 4 % in 2021, which would broadly restore US output to its pre-crisis level by the end of the year. On balance, however, given a trend growth rate of just under 2 % a year, stagnation over 24 months is a poor outcome. The unemployment rate at the end of 2021 is forecast to still be around two percentage points higher than in February 2020.

The IMF estimates that the fiscal stimulus in 2020 will amount to more than eight percentage points of GDP, compared with just over two percentage points in the 2009 financial crisis. Thanks to Uncle Sam, many households even had more money in their pockets in the spring of 2020 than before the crisis.

Government stimulus measures for the US economy have probably reached or are already past their peak. The likely next president, the Democrat Joe Biden, has announced substantial spending plans during the election. However, without a majority in Congress it could be hard for him to follow through on all of his promises. For the time being, dealing with the pandemic will be the first priority, anyway.

Future room for manoeuvre in **fiscal policy will be limited**. According to the non-partisan Congressional Budget Office (CBO), by 2020 federal debt had already almost reached its previous record level of shortly after World War II (around 106 % of GDP) as a result of the emergency pandemic measures. Based on assumptions in the CBO's baseline projection (in particular, no changes to tax and spending laws), this figure would increase further in the coming years. In particular, demographic shifts threaten to accelerate this upward trend which, if nothing is done to stabilise it, would lead to US federal debt rising to almost 150 % of GDP by 2040.

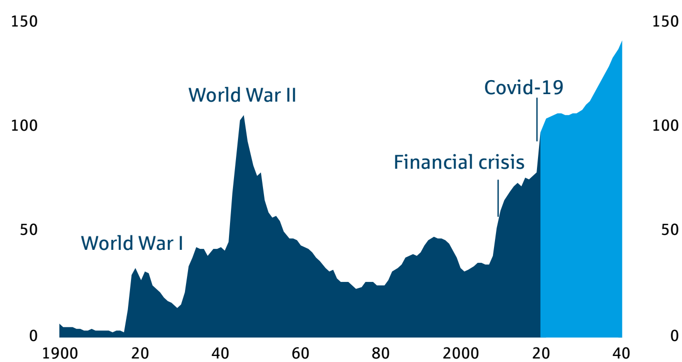
No sovereign default "Made in USA"

It is unlikely that things will ever get that bad. But these figures underscore the fact that, even without additional tax cuts or spending programmes, government finances will continue to deteriorate. A **further stimulus package** is expected in 2021. In contrast to the EU, the fiscal measures in the US are still mainly short-term in nature. Nevertheless, fiscal policy should evolve from a cyclical tailwind to a headwind in 2021. However, in this highly unusual cycle, the momentum of the recovery is likely to be strong enough to withstand this fiscal tightening.

> *"Ask not what your country can do for you, ask what you can do for your country."*
> John. F. Kennedy (1917 – 1963)

USA: Federal debt goes through the roof

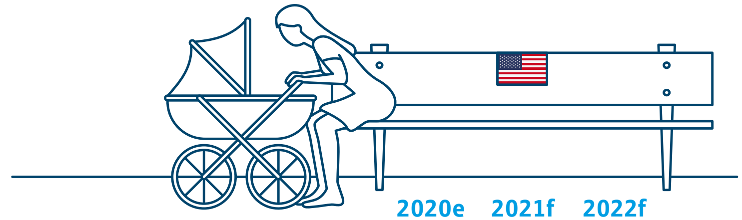
Federal debt, % of GDP*



* "marketable debt held by the public", from 2020: CBO's baseline projection

Sources: Congressional Budget Office, Helaba Research

United States



	2020e	2021f	2022f
GDP real, % yoy	– 3.6	3.8	2.5
Consumer prices, % yoy	1.3	3.3	2.5
Unemployment rate, %	8.0	5.8	5.0

e = estimate, f = forecast

Source: Helaba Research

The **Federal Reserve** stabilised the financial markets and lending activities during the crisis and, in our view, even went beyond what was reasonably warranted. However, given the uncertainty about the further course of the pandemic and the persistently very high rate of unemployment, any change of course in the near future is unlikely.

Inflation probably will not become a headache for the Fed in the short term. We anticipate that headline inflation will rise to above 3 % in 2021. However, the assumed increase in the price of crude oil, of just over 50 % by the end of 2021, will be an important driver. The core rate, which excludes energy and food, is also set to rise. Yet, it will probably stay in a range that the Fed is comfortable with – especially since, as part of its strategic review, it now seems to give less weight to price stability than to the goal of full employment. Given the expected economic recovery and the fact that key interest rates will probably remain close to zero for the foreseeable future, the sustainability of US government debt should not be a major issue in 2021. The Fed is therefore likely to phase out its emergency measures over the course of the year.

Patrick Franke

Japan

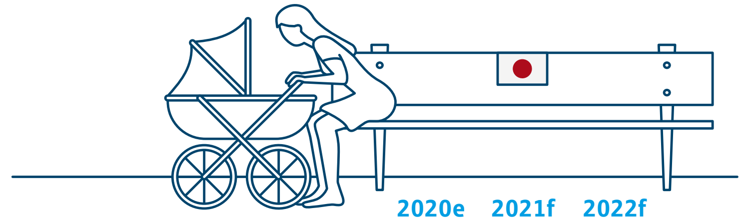
Ballooning national debt

Following a deep recession, modest growth is expected in 2021. Support from economic policy will play a very important role here.

September ushered in a change at the helm of the world's third-largest economy. For the time being, the **new government** of Prime Minister Yoshihide Suga is likely to pursue economic policies that are essentially similar to those of Shinzo Abe. During the so-called "Abenomics" era, the country experienced a long phase of expansion with monetary and fiscal policy closely aligned.

> *The new government will likely retain the core elements of "Abenomics" for the time being.*

In order to stimulate the Japanese economy by weakening the yen and to avert deflationary tendencies by providing abundant liquidity, the **Bank of Japan** has adopted an ultra-loose stance and is extremely active in buying government bonds. The central



	2020e	2021f	2022f
GDP real, % yoy	– 6.2	2.2	1.2
Consumer prices, % yoy	0.0	0.3	0.5
Unemployment rate, %	3.0	3.3	3.2

e = estimate, f = forecast

Source: Helaba Research

bank now holds almost half of outstanding JGBs. The zero or negative interest rate policy that Japan has been pursuing for around 20 years now makes servicing public debt easier.

Major Covid-19 stimulus package

Even before the pandemic erupted, Japan was already the most heavily indebted country among the major industrialised nations, with total borrowing accounting for almost 240 % of GDP. Covid-related stimulus measures amount to a total volume of 234 trillion yen (around 2 trillion euro or 40 % of GDP). These measures include the provision of substantial emergency financial aid or interest-free corporate loans. Some of these funds are also expected to be used to improve the health care system.

Despite this, a severe recession in Japan was inevitable and had already set in during the final quarter of 2019 when the government raised the consumption tax. The Covid-19 lockdown in the spring of 2020 only served to aggravate the situation. Overall, the Japanese economy is expected to **grow by 2.2 % in 2021** following a contraction of approximately –6 % in 2020. A return to pre-crisis levels will likely take some time, especially as Japan continues to grapple with the problem of an ageing population and is heavily impacted by global trade disputes.

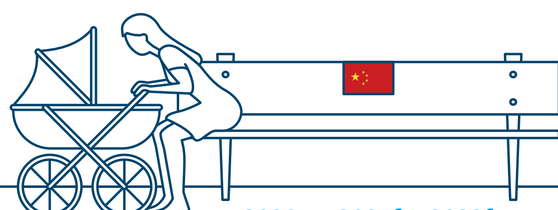
Ulrike Bischoff

China

Profiteer from the crisis

Origin of the pandemic, key player in the trade conflict and increasingly both an enemy and role model for many economic policymakers in industrialised countries – China has rarely been as pivotal as it is today. Contrary to most expectations in the spring of 2020, it currently appears as if the country could prove to be a **profiteer from the Covid-19 crisis**.

China suffered a sharp drop in economic activity as a result of imposing a strict lockdown. However, economic growth picked up strongly immediately after this was lifted. As early as the second half of 2020, the country appears to have **nearly returned to pre-crisis trend**. With the help of additional fiscal and monetary stimuli, output is likely to rise by over 9 % in 2021 – the sharpest rise since 2011. Over the entire 2020/2021 period, the deviation from the pre-crisis trend should be smaller than in many other countries, not least the United States. As such, the pandemic and its consequences have expedited the pace at which the Chinese economy has been closing the gap to industrialised countries.



	2020e	2021f	2022f
GDP real, % yoy	1.8	9.3	5.5
Consumer prices, % yoy	2.8	2.8	2.5
Unemployment rate, %	3.9	3.9	3.7

e = estimate, f = forecast

Source: Helaba Research

Regardless of the outcome of the US presidential election, a return to the "good old days" on **trade issues** is not in the cards. There is no end in sight to the race for dominance in high-tech industries. In addition, China's government has focused on supporting domestic production during the crisis. By contrast, most industrialised countries are primarily stimulating demand. Thus, stimulus measures both by China and by its trading partners will tend to bolster the growth of Chinese exports – creating additional potential for conflict.

> *"Crises and opportunities always exist side by side. Once overcome, a crisis is an opportunity."*
> Xi Jinping

In China, the hitherto successful management of the pandemic is interpreted as further proof of its system's superiority. Criticism from abroad is treated as the envy of those who are not able to benefit from the wisdom and leadership of the Chinese Communist Party.

Patrick Franke

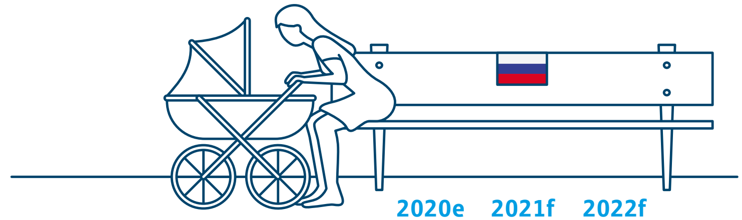
Russia

Development projects postponed

While the Covid-19 lockdown, which was mild by European standards, resulted in high infection rates, the country's recession in 2020 is expected to be less severe with GDP contracting by 3.8 %. In 2021, Russia will benefit from an increase in the oil price up to 60 US dollar per barrel. The oil and gas industry accounts for a third of GDP and almost two thirds of export revenues.

In addition to **dependence on commodities**, numerous other structural weaknesses limit potential growth, including poor institutional governance, low productivity growth and a gloomy business environment. That is why we only anticipate a weak recovery of 3 % in 2021, meaning that pre-crisis levels will probably not be reached.

Although Russia can boast fundamentally sound public finances and its total debt has risen by seven percentage points to a mere 20 % of GDP due to Covid-19, the country suffers from a **low revenue base** of only 16 % of GDP. Consequently, no major impetus for growth can be expected from fiscal policy, since 2020 saw revenues decline by 35 billion US dollar, primarily due to the low price of oil.



	2020e	2021f	2022f
GDP real, % yoy	–3.8	3.0	2.0
Consumer prices, % yoy	3.8	4.0	3.7
Unemployment rate, %	6.0	5.6	4.4

e = estimate, f = forecast

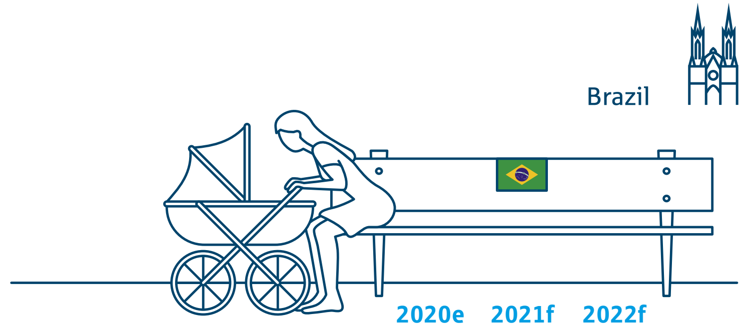
Source: Helaba Research

Diversification of the economy still a long time coming.

Due to the need to reduce spending, the completion of the "13 national projects", an important prestige initiative by Putin, has now also been postponed by six years to 2030. These projects comprise a total investment of 360 billion US dollar.

The decision to push back the projects does not bode well for already **weak investment growth** and will also delay the diversification of the economy. Russians will also have to wait six years longer before the government is able to deliver on its promises of halving poverty and increasing life expectancy. Following an amendment to the constitution in 2020, President Putin could even still be in office then.

Patrick Heinisch



	2020e	2021f	2022f
GDP real, % yoy	–4.5	4.8	2.7
Consumer prices, % yoy	2.3	2.6	3.6
Unemployment rate, %	16.7	12.6	9.4

e = estimate, f = forecast

Source: Helaba Research

Brazil

Pre-election goodies expected

Although an economic recovery took hold in the second half of 2020, the **shock of the pandemic is still reverberating**. As a result, considerably fewer new jobs are likely to be created in 2021 than were lost in the previous year. Although unemployment will fall, it will still be two percentage points higher than before Covid-19 at around 13 %. This is disastrous for Brazil because, unlike many other South American countries, the economy has traditionally been more dependent on consumer spending (64 % of GDP) than on exports (about one third of GDP). An economic slump of –4.5 % in 2020 will be followed by a modest recovery of 4.8 % in 2021.

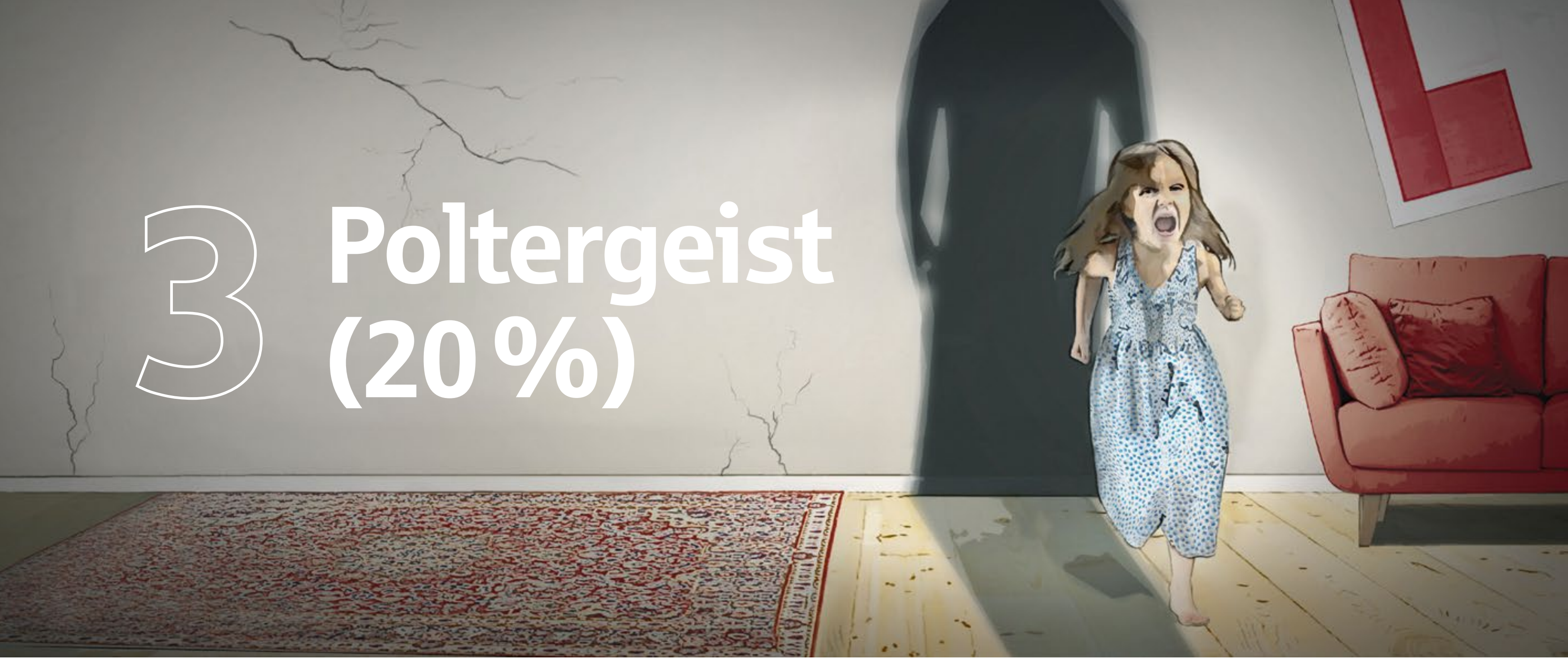
President Bolsonaro is already looking ahead to his **re-election in October 2022**. Despite the coronavirus pandemic, he has succeeded in boosting his approval rating by handing out benefits to poorer sections of the population. The president is also likely to continue to style himself as a charitable patriarch and leave the necessary lockdown measures to the governors.

2020 was a year of wasted opportunities for economic reforms. Bolsonaro and his Minister of the Economy, Guedes, were still being celebrated by the business community when they took office. But apart from a pension reform at the end of 2019, they have so far failed to enact any significant measures. We also expect little progress in 2021, as the president will avoid unpopular projects just before an election year. Nevertheless, we anticipate some minor efficiency improvements in the public sector, simplifications to the tax regime and privatisations.

> *Budget consolidation and reforms must wait until pandemic ends.*

The **consolidation of public finances** will shift back into focus in 2021. Due to the budget deficit of 16 % of GDP, Brazil's national debt is set to approach 100 % in 2020. The high level of debt was already an issue before the pandemic. Although the pension reform is helping to reduce expenditure, additional efforts are now needed. It is unlikely that the primary budget will be almost balanced, as it was in 2019, until after the elections.

Patrick Heinisch



Negative scenario

Poltergeist (20 %)

No sooner had the haunting by populists and protectionists seemed to have faded somewhat that the pandemic brought back an object of dread from the dark days of human history. Because they are invisible to the naked eye, some people believe just as little in the existence of the virus as they do in that of poltergeists. But this scepticism does nothing to change the threat they pose – and banishing them is anything but a simple matter. We assign a probability of 20 % to this scenario.

It has rarely been easier to justify a negative scenario for the economy and for financial markets than it is today. Without a vaccine, a return to normality is almost inconceivable for the foreseeable future. Prolonged restrictions on economic and social activities and consumer uncertainty could turn this recession into a "**double dip**": a rare phenomenon in which, after a temporary recovery, the economy goes downhill again.

Complete and repeated national lockdowns stop growth cold. In this difficult environment, the German economy shrinks again in 2021 – a disaster coming on the heels of the 2020 contraction. The global economy also suffers another year of recession. The absence of a sustained recovery would exacerbate the **second-round effects of the crisis**, which had previously been muted in their severity: business failures, job losses, over-indebtedness, struggling households. Entire industries could be decimated.

A haunting from the past

In addition, a protracted slump would fan the flames of the more unsavoury political tendencies of recent years. At least since 2016, with Brexit and the election of Donald Trump, we have witnessed political turmoil of a magnitude that could hardly have been imagined before. A sustained and pronounced drift towards isolationism, whether for nationalistic reasons ("Buy American!") or to promote regional economies ("Buy regional!"), would be toxic for the global economy. The consequence could be **downward spirals of protectionism and devaluation**, last seen in the 1930s, if governments seek to "secure" a larger share of demand for their domestic producers. Today, however, economies are significantly more intertwined than back then and the costs of de-globalisation would be colossal.

> *"They're here."*
> From the film "Poltergeist" (ranked 69th out of the "100 best film quotes", American Film Institute)

At the same time, other trends are busy playing out in the shadows that will inevitably entail costs and hardships and in which policy errors may prove very expensive, especially in a period of economic weakness: regulations to combat climate change, the race for technological dominance, the ongoing debate on raising taxes on (digital) companies or **saddling businesses with excessive red tape**. One example is the German Supply Chain Act, which continues to be advanced – despite the economic crisis – as if it were on autopilot.

There are obvious dangers in this respect, not least of all on the level of the EU. Regional parliaments have the power to block international trade agreements for around 450 million EU citizens. With the departure of the United Kingdom, a proponent of the free market with relatively liberal economic policies is leaving the Union. The debate in Brussels is increasingly turning towards an **industrial policy of "national champions"** and, in an environment of rising unemployment, the notion of competition is fast becoming unfashionable. At the same time, vociferous calls for a far-reaching **communitisation of national debt** or measures to tackle so-called "tax dumping" may lead to divisions in the Union.

In the classic 1982 movie, houses had been built on the site of an old cemetery, causing the apperance of the poltergeists. The sins of the past come back to haunt the protagonists. A hitherto nonchalant approach to protectionist tendencies (chlorinated chickens!) makes it harder to firmly confront them now. On top of that, **debts** in the public and private sectors, which had already reached high levels in most countries in 2008 and, in most cases, **have continued to accumulate** since the financial crisis, take their revenge. Mounting private debt leads to a reluctance to invest, while public debt significantly restricts governments' room for manoeuvre and the effectiveness of fiscal policy.

> *"Whoever fights monsters should see to it that in the process he does not become a monster."*
> Friedrich Nietzsche (1844–1900)

In this scenario, **central banks are under additional pressure** to keep interest rates low or cut them even further in order to mobilise the last modicum of stimulus and to stabilise escalating debt ratios. It is conceivable that they would pursue novel strategies, such as extreme versions of "forward guidance", yield curve control or even helicopter money.

Overview of forecasts in the negative scenario

The economic recovery that got underway in the third quarter of 2020 is interrupted. Although it is resumed after a delay in the course of 2021, annual average **gross domestic product** in Germany and the euro area declines again. The US economy is likely to virtually stagnate. The economic setback puts a damper on price increases, but **inflation rates** remain in positive territory.

However, **bonds** benefit from a tailwind. The ECB lowers the deposit rate and launches another expansion of its purchase programmes. Due to the persistently high level of uncertainty, safe investment havens such as US Treasuries and German government bonds are in demand. The yield on 10-year German government bonds ends the year in deeply negative territory at – 0.8 %. The yield curve is temporarily inverted.

The poor state of the economy piles further pressure on the financial profiles of **corporates**. A renewed rise in risk premiums is likely. This is reflected in another phase of rising impairments on loans and financial assets at **banks**. For the most part, **covered bonds** remain resilient and in strong demand, but growing fundamental risks lead to greater differentiation among bonds with low risk premiums.

On balance, the outlook for corporate earnings does not recover in 2021 from its previous collapse. Despite the widespread deployment of monetary policy and a lack of investment alternatives, investors' risk aversion rises significantly. This results in considerable valuation discounts on **equities**. The DAX falls into a range around the 10,000-point mark.

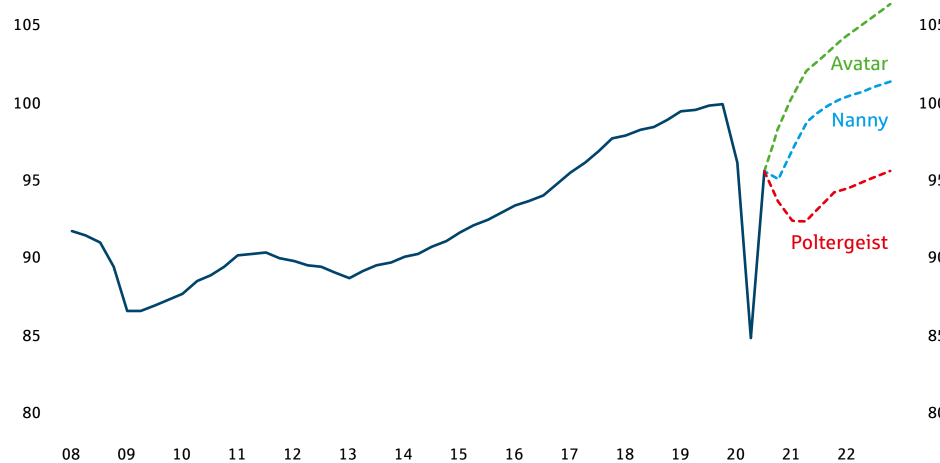
Real estate prices and rents see across-the-board falls in the commercial segment. Significant declines in prices not only hit retail properties but affect office buildings as well. The housing market remains comparatively stable, but further price increases are not expected in this fragile environment.

As a safe haven currency, **gold** reaches new record highs. Since monetary and fiscal policy advances into even more unorthodox areas, the precious metal has its sights on the 3,000 US dollar per troy ounce mark.

Once again, the **US dollar** benefits from a challenging environment, even if economic problems in the United States are hardly less severe. However, the euro is additionally impacted by increasing political conflicts within the monetary union and is the "winner" in a global devaluation contest. The euro-dollar exchange rate falls to parity.

Poltergeist disturbs the recovery

Euro area GDP, Index Q4 / 2019 = 100



Sources: Macrobond, Helaba Research

Patrick Franke

4 Avatar (10 %)

Positive scenario

Avatar (10 %)

Among our three scenarios, it is the positive one that changes least from year to year. This is not due to a lack of imagination, but to the notion of an optimistic but plausible economic outlook that only gradually evolves. In computer games, avatars are often idealised versions of the players that sometimes possess superhuman qualities. In this sense, we always project our hopes into the positive scenario, to which we assign a probability of 10 % this time.

A necessary condition for such a scenario to come to pass in 2021 is for the **virus to be defeated**, the sooner the better. Whether this is achieved with a vaccine or through restrictions on social interaction, as in China or South Korea, is not of primary importance in this respect.

Yet, although in itself a catastrophically negative shock, the pandemic could also trigger lasting and positive processes. After such a severe downturn, it does not take a genius to realise that there is potential for a strong rebound in 2021. But a slump as extreme as this may also act as a **catalyst** for developments that were previously impeded by the forces of inertia or by other factors. The sudden flexibility in the workplace or the use of digital technology, which many former sceptics now find appealing due to the need for social distancing and remote working arrangements, are just a few examples that immediately spring to mind.

Digitisation – the next “boss fight”

Studies have shown that the outward appearance of an avatar in games often influences a player’s actions – the so-called **Proteus effect**: A noble appearance encourages noble deeds. This psychological tendency can readily be transferred to an economic scenario. In a positive environment, those in charge act better. Or, as economists like to say, it makes a universally better equilibrium possible.

In Germany, room for improvement is particularly evident in the **high-tech segment**. Instead of attacking the so-called “internet giants” for their potentially anti-competitive practices, would it not be better to ask: Why were almost all of these companies started in the United States? What can or must other countries do in order to achieve a similar level of success in these areas?

> *“Good science is good observation.”*
> From the movie “Avatar”

Germany lags behind global leaders in this field. In this regard, the conversation is too often limited to the issue of inadequate public investment. But companies, especially in increasingly key service sectors, also have a poor record compared to other parts of the world.

According to figures from the OECD, the share of high-tech as a proportion of total investment in Germany has been declining since its peak in the year 2000. The most recent data suggest that it was below the OECD average and was considerably higher in France, for instance. However, this indicates that there is a **potential for catch-up** which, if tapped, should considerably drive future growth.

> *The future will one day be the present and will seem as unimportant as the present does now.*
> William Somerset Maugham (1874 – 1965)

Even prevailing global imbalances, rather than sparking trade disputes, may give rise to constructive **reforms** in deficit and surplus countries. Germany, for example, could improve conditions for domestic investment and thereby reduce the incentives to export capital.

In circumstances like these, even higher growth rates than in our baseline scenario could be achieved in 2021. Although this would be associated with significant additional inflationary pressure, investment that increases productivity would have a disinflationary effect over the medium term. Given the extreme starting points, neither fiscal nor monetary policy could be quickly returned to normal and would have a **pro-cyclical** impact for a longer period of time. Rising tax revenues as a result of strong growth would rapidly bring government deficits back down. Interest rate hikes would not be postponed ad infinitum any more.

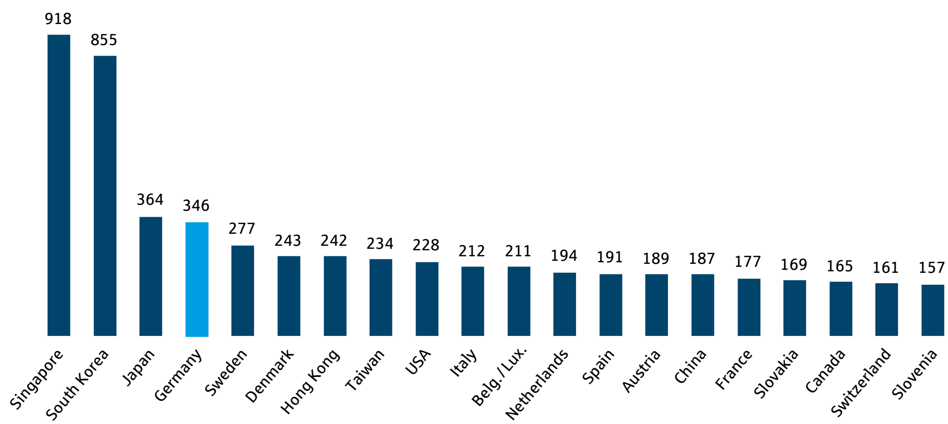
Overview of forecasts in the positive scenario

The economic recovery that started in 2020 picks up steam overthe course of 2021. Germany and the euro area achieve record **economic growth**. The United States also expands much more strongly than in the baseline scenario. In the wake of this dynamic rebound, **consumer prices** could rise by more than 2 % in the euro area, by over 3 % in Germany and by around 4 % in the United States.

Despite a changed environment, the ECB keeps its key interest rates stable, resulting in a steep yield curve for German **bonds**. Purchase programmes on both sides of the Atlantic are suspended.

Automation as an opportunity

Robot density, number of robots per 10,000 workers in manufacturing industry 2019



Sources: International Federation of Robotics, Helaba Research

The yield on 10-year German government bonds breaks out of negative territory due to a sharp rise in inflation expectations and climbs to 0.75 % by the end of 2021.

Favourable economic conditions provide **corporates** with noticeably more breathing space. Having recognised extensive write-downs on their loan books during the Covid-19 crisis, **banks** are even in a position to reverse loan loss provisions.

Despite the fact that unsecured bank bonds become more attractive in some cases, **covered bonds** remain well supported thanks to supply being under maturity levels and reinvestment by the Eurosystem.

Strong economic expansion leads to significant increases in sales and fully utilised capacities. Companies take advantage of scope for price increases to boost profit margins. As a result, their net profits see above-average growth. In view of investors' increasing appetite for risk, valuations expand and the **DAX** shoots past 16,000 points.

The rapid recovery from the crisis reduces pressure on the **real estate market**. While the impact on the office market remains very limited, retail properties continue to suffer from the onward march of e-commerce, despite an improved economic environment. The longstanding boom on the German residential property market goes into extra time with house prices seeing sharp rises.

Gold loses its aura as a safe haven currency as its attractiveness relative to equities and bonds declines once the crisis is over. Despite extremely high levels of national debt and rising inflation, the precious metal is likely to dip below 1,500 US dollar per troy ounce.

The thriving economy is particularly supportive to the euro, especially since Europe also lays the structural groundwork for further growth. In addition, with imbalances within the monetary union receding, confidence in the single currency improves. The **euro-dollar exchange rate** rises to 1.35.

Patrick Franke

Financial markets forecasts

	Change since 31.12.2019	Current*	Forecast horizon at end … Q1/2021	Q2/2021	Q3/2021	Q4/2021
	basis points	interest rate, %				
ECB deposit facitlity rate	0	−0.50	−0.50	−0.50	−0.50	−0.50
Overnight rate €STR**	−3	−0.56	−0.50	−0.50	−0.50	−0.50
3M Euribor	−13	−0.52	−0.50	−0.45	−0.45	−0.40
2y Bunds	−19	−0.79	−0.70	−0.70	−0.65	−0.60
5y Bunds	−34	−0.82	−0.65	−0.55	−0.40	−0.40
10y Bunds	−45	−0.64	−0.40	−0.30	−0.20	−0.20
30y Bunds	−58	−0.23	0.00	0.15	0.25	0.30
10y swap rate	−48	−0.27	−0.05	0.05	0.15	0.20
Federal funds rate***	−150	0.13	0.13	0.13	0.13	0.13
10y Treasuries	−115	0.76	0.75	1.00	1.00	1.20
	in local currency, %	index				
DAX	−7.0	12,324	13,300	13,600	13,800	14,000
EURO STOXX 50	−15.6	3,161	3,420	3,470	3,520	3,550
S&P 500	6.6	3,443	3,600	3,650	3,700	3,750
Nikkei 225	0.2	23,695	25,500	26,000	26,500	27,000
	%	price				
Brent crude $/bbl	−37.5	41	53	60	63	64
Gold $/oz	25.4	1,903	1,800	2,000	1,800	2,000
Gold €/oz	19.9	1,623	1,500	1,667	1,440	1,600
	vs. Euro, %	exchange rate				
US dollar	−4.4	1.17	1.20	1.20	1.25	1.25
Japanese yen	−0.6	123	125	125	128	128
British pound	−6.3	0.90	0.88	0.85	0.85	0.85
Swiss franc	1.5	1.07	1.10	1.10	1.12	1.12
Swedish krona	1.9	10.30	10.30	10.20	10.10	10.00
Chinese yuan	0.3	7.79	7.92	7.92	8.13	8.13

* 4.11.2020 ** Eonia = €STR + 8,5 bp *** mid-point of target range Sources: Bloomberg, Helaba Research

Gross domestic product, inflation, budget balance

	Gross domestic product Real change, % yoy				Consumer prices Change, % yoy				Budget balance % of GDP			
	2019	2020e	2021f	2022f	2019	2020e	2021f	2022f	2019	2020e	2021f	2022f
Euro area	**1.3**	**−6.8**	**6.3**	**2.1**	**1.2**	**0.3**	**1.4**	**1.6**	**−0.6**	**−8.9**	**−5.0**	**−3.0**
Germany	0.6	−5.4	5.0	2.0	1.4	0.5	1.9	2.0	1.5	−6.5	−3.5	−2.5
France	1.5	−8.7	8.0	2.3	1.3	0.5	1.3	1.7	−3.0	−11.0	−7.0	−5.0
Italy	0.3	−8.3	6.0	1.7	0.6	−0.2	0.8	1.1	−1.6	−12.0	−6.0	−4.0
Spain	2.0	−11.0	7.5	2.5	0.8	−0.4	0.6	1.1	−2.9	−13.0	−7.0	−5.0
Netherlands	1.6	−5.0	4.0	2.5	2.7	0.7	1.1	1.5	1.7	−5.5	−2.2	−0.5
Austria	1.4	−7.1	3.9	3.2	1.5	1.4	1.5	1.7	0.7	−10.0	−5.5	−2.7
Ireland	5.9	−2.0	4.0	3.5	0.9	−0.4	0.9	1.5	0.4	−6.0	−4.0	−1.0
Portugal	2.2	−8.0	5.5	2.4	0.3	−0.2	0.9	1.5	0.2	−6.7	−3.8	−1.0
Greece	1.9	−7.5	5.0	2.8	0.5	−0.3	1.0	1.2	1.5	−6.8	−4.0	−3.0
Sweden	**1.3**	**−4.1**	**3.2**	**2.8**	**1.8**	**0.5**	**1.4**	**2.0**	**0.3**	**−5.5**	**−3.5**	**−1.5**
Norway	**1.2**	**−3.3**	**3.0**	**2.4**	**2.2**	**1.4**	**2.3**	**1.8**	**6.5**	**−6.0**	**0.0**	**2.8**
Poland	**4.6**	**−4.1**	**3.5**	**3.5**	**2.3**	**3.5**	**2.1**	**2.4**	**−0.7**	**−10.0**	**−3.8**	**−3.5**
Czech Republic	**2.3**	**−7.4**	**3.3**	**3.4**	**2.8**	**3.2**	**2.0**	**2.3**	**0.3**	**−7.8**	**−4.0**	**−2.5**
Hungary	**4.6**	**−6.9**	**3.7**	**3.3**	**3.3**	**3.5**	**3.2**	**3.3**	**−2.1**	**−6.7**	**−4.2**	**−3.0**
United Kingdom	**1.3**	**−10.7**	**5.7**	**2.5**	**1.8**	**1.0**	**2.4**	**2.3**	**−2.1**	**−15.0**	**−9.0**	**−6.0**
Switzerland	**1.1**	**−3.7**	**3.5**	**2.2**	**0.4**	**−0.5**	**1.0**	**1.3**	**1.5**	**−4.2**	**−1.4**	**−0.6**
United States	**2.2**	**−3.6**	**3.8**	**2.5**	**1.8**	**1.3**	**3.3**	**2.5**	**−6.3**	**−20.0**	**−10.0**	**−6.0**
Japan	**0.7**	**−6.2**	**2.2**	**1.2**	**0.5**	**0.0**	**0.3**	**0.5**	**−3.3**	**−14.0**	**−8.0**	**−6.0**
Asia ex Japan	**4.7**	**−1.0**	**7.7**	**5.0**	**2.9**	**2.6**	**2.5**	**3.3**	**−3.8**	**−10.0**	**−9.4**	**−8.4**
China	5.8	1.8	9.3	5.5	2.9	2.8	2.8	2.5	−6.3	−12.0	−12.0	−11.0
India	4.2	−9.6	10.1	6.2	3.7	5.7	3.8	4.2	−4.6	−7.0	−6.5	−5.4
Russia	**1.3**	**−3.8**	**3.0**	**2.0**	**4.8**	**3.8**	**4.0**	**3.7**	**2.1**	**−4.0**	**−1.8**	**−1.0**
Turkey	**0.9**	**−4.0**	**4.6**	**3.7**	**15.6**	**10.7**	**10.0**	**8.5**	**−2.9**	**−5.2**	**−4.2**	**−3.8**
Latin America	**1.4**	**−7.3**	**4.6**	**3.0**	**8.3**	**6.5**	**7.2**	**6.4**	**−3.7**	**−10.4**	**−5.6**	**−3.8**
Brazil	1.1	−4.5	4.8	2.7	3.8	2.3	2.6	3.6	−5.9	−16.3	−6.8	−4.8
World	**3.0**	**−3.6**	**5.9**	**3.6**	**2.9**	**2.2**	**2.9**	**3.0**	**–**	**–**	**–**	**–**

GDP growth working day adjusted if available; e=estimate, f=forecast

Sources: EIU, Macrobond, Datastream, Helaba Research

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Imprint

Helaba
Landesbank Hessen-Thüringen
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Concepts and design

La Mina GmbH, Darmstadt, Germany

Translation

Christopher Hanna

Printed by

Druckerei Braun & Sohn, Maintal, Germany

Photo credits

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iStock: Cover (U1), p. 6, p. 8, Toa55, kieferpix, Gladiathor; p. 5, TARIK KIZILKAYA; p. 7, 48, Cherry-Merry, melkerw, KatarzynaBialasiewicz, archideaphoto; p. 7, 51, mysticenergy; p. 14, KurKestutis; p. 16, tomazl; p. 20, PhotoInc; p. 23, AsiaVision; p. 24, encrier; p. 26, Image Source, mbaysan, Vimvertigo, t_trifonoff, akova, Six_Characters; p. 28, jacoblund; p. 31, skynesher; p. 33, FamVeld; p. 35, Martinan; p. 36, fizkes; p. 41, gbrundin; p. 42, serts, FatCamera; p. 44, ake1150sb; p. 45, lovleah, djedzura, kool99; p. 46, esolla; p. 47, G&J Fey; Cover (U3), ljubaphoto

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