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GERMANY: THE CALM BEFORE THE LABOR MARKET STORM

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In March, the German labor market appeared initially unaffected by the Covid-19 induced economic crisis, with unemployment posting a small decline compared to the previous month. But don't be fooled by the latest figure, which looks like "the calm before the storm": The German labor market miracle is about to come to an abrupt end.

With the cut-off date for the latest labor market statistics being March 12, they do not yet reflect the increasingly aggressive containment measures introduced over the course of March. A sharp rise in German unemployment in April and May is hence more than certain. The real extent of the economic disruption, however, will be visible above all in the number of workers on *Kurzarbeit*, i.e. shorter working hours, which in the coming months should far outpace anything observed during the great financial crisis. Already in the second quarter of 2020, not only the mid-2009 peak of 1.5 million but also the recent government estimate of 2.35 million workers on *Kurzarbeit* could be surpassed. In fact, we estimate that the sharp economic setback in H1 2020 could put up to 12 million jobs at risk in Germany.

The extent of labor market deterioration is closely tied to the length of the lockdown period.

In order to slow down the spread of the Covid-19 virus, German economic activity has largely been put on pause. A sharp - but comparatively more temporary - recession à la 2008/09 will be unavoidable, but the length of the lockdown will determine the setback for economic growth as well as the labor market. Drawing on the experience of China, in our baseline scenario, we modeled the economic shock with a one-month as well as a two-month full lockdown and, assuming containment measures are successful, a partial, u-shaped recovery thereafter. After all, while some catch-up effects are certain, economic actors are likely at first to consume and invest with an extra degree of caution, while some supply chains may need to be repaired. We also took into account the mitigating effects of policy bazookas.

Table 1: German unemployment under different economic scenarios

	Baseline scenario				Protracted crisis	
	1-month confinement followed by a U-shaped recovery in H2		*2-month confinement followed by a U-shaped recovery in H2*		*Downside risks materialize triggering deeper downturn allowing only for a L-shaped recovery*	
	2020	**2021**	**2020**	**2021**	**2020**	**2021**
GDP	-1.8%	2.2%	-5.0%	2.2%	-7.7%	-1.7%
Unemployment	5.5%	5.2%	6.0%	5.8%	7.0%	7.5%

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Sources: Refinitiv, Allianz Research

In this baseline scenario, the German economy is likely to shrink by -1.8% in 2020 if there is a one-month pause and by a full -5% if the standstill lasts for two months (see table 1). Even in the case of such a relatively brief pause, the unemployment rate looks set to record the first pronounced increase since the early 2000s, rising at least temporarily above the 6%-mark. This puts an end to the German labor market's remarkable run over the past 15 years, which saw the unemployment rate more than halve since 2006 – from 10.8% to 5% in 2019 – and barely budge neither during the great financial crisis nor the Eurozone sovereign debt crisis. Despite the increase in unemployment in 2020 – with losses above all centered on the trade as well as the services sector – employment should remain largely stable in our baseline scenario.

Prolonged crisis could leave deeper scars in German labor market

Downside risks to our baseline scenario continue to loom large. A more prolonged health crisis with possible reinfections cannot be ruled out. It would also mean borders stay closed and intermittent domestic confinement prevail. The longer the economy is on pause, the more difficult it will be to restart the growth engine and the probability of downside risks materializing is rising sharply. In such a scenario, we estimate German GDP to contract by -7% and the unemployment rate to rise above 7% in 2020 with the number of unemployed reaching more than 3 million.

These assessments are, as always, subject to the disclaimer provided below.