

Who wants to be a trillionaire?

The rich are getting richer in the States; total household assets jumped by an astonishing \$12.6tn last year. We look at what it could mean for the global recovery and inflation. As for higher prices and bond yields in the eurozone, the ECB seems split on what to do next. And what about the \$600bn of treasuries that US banks might need to offload? Answers here

In this bundle



United States

US: Wealth surges even in a pandemic

US household net worth increased \$12.6tn last year as unprecedented fiscal and monetary support first stabilised the economy before fuelling a recovery in...

By James Knightley



ECB: Looking through inflation (and platitudes)

A front-loading of asset purchases and a very nebulous reaction function. This is not only the European Central Bank's answer to higher bond yields...

By Carsten Brzeski



Listen: ECB steps up stimulus but is it enough?

The European Central Bank is stepping up the pace of asset purchases in response to rising bonds yields, which have threatened to undermine the...

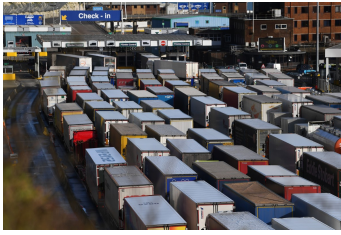
By Rebecca Byrne



US banks hold their breath ahead of Fed leeway expiration

The stakes are high as we head to 31st March. By then, the positive leeway the Fed gave to US banks on how to treat Treasuries and reserves comes to an...

By Padhraic Garvey, CFA



United Kingdom

Brexit: Five charts show the impact on the UK economy this year

Expect a 3-4% hit to UK manufacturing output in January, though the jury's out on how much was solely down to Brexit-related disruption. The pandemic,...

By James Smith



Germany

Germany: Super election year set to start

Sunday's regional state elections mark the start of a 'super election year', leading to the national elections in September. The two elections...

By Carsten Brzeski

US: Wealth surges even in a pandemic

US household net worth increased \$12.6tn last year as unprecedented fiscal and monetary support first stabilised the economy before fuelling a recovery in risk appetite. While the rich are undoubtedly getting richer, there is evidence that less well-off households have seen some improvement, which will provide a strong platform for growth in 2021



Assets roar back

The Federal Reserve [Flow of Funds data](#) for 4Q20 shows some astonishing figures. Despite the pandemic and the resulting lockdowns, business closures and, at its worst point, the loss of more than 20 million jobs, the US household balance sheet improved massively through 2020.

Total assets jumped by \$12.6tn – not quite as good as the \$13.2tn gain in 2019, but remarkable given what was endured last year. Meanwhile, household liabilities increased by only \$657bn to leave net worth up \$11.9tn – a gain equivalent to 57% of 2020 GDP!

US household assets, liabilities and net worth

USD tn	2019	2020		2019	2020
total asset	134.6	147.2	total liabilities	16.4	17.1
Non-financial assets	39.9	42.6	Residential mortgages	10.5	10.9
cash, deposits & money markets	13.7	16.5	Consumer credit	4.2	4.2
Debt securities	5.8	5.1	other loans	1.1	1.3
Corporate equities & mutual funds	30.9	36.0	Trade payables & other	0.6	0.6
Pension & life insurance	29.5	31.3			
Equity in non-corp business	12.4	13.0			
other	2.5	2.6	Net Worth	118.2	130.2

Source: Federal Reserve, ING

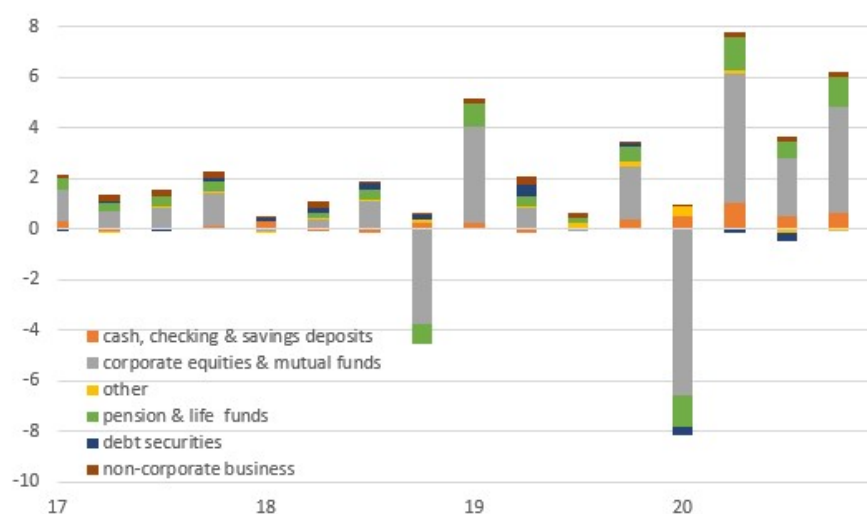
Unprecedented stimulus drives market gains

Looking at the quarterly profile the performance is even more remarkable. Households experienced a \$6.7tn plunge in the value of their assets in 1Q in response to the economic pain and uncertainty created by the pandemic. However, it rebounded by \$19.3tn between the start of 2Q20 and the end of the year to stand at \$147.2tn or 664% of GDP. Real estate contributed “just” \$1.86tn of this with financial assets making up the bulk of the gains by adding \$17tn. The remainder came from equipment and other physical assets.

Corporate equities and mutual funds were the biggest contributor as households benefited from surging equity markets in the wake of unprecedented monetary and fiscal stimulus, while pension and insurance funds improved for the same reasons. However, we also see a notable increase in cash, checking and savings deposits – a gain equivalent to more than 10% of GDP!

Liabilities increased, but at a far more modest rate – up \$583.6bn to \$16.4tn. The stock of outstanding mortgage debt increased by \$391.9bn to \$10.9tn while consumer credit rose just \$41.8bn to \$4.178tn.

Quarterly change in the value of household financial assets 2017-2020 (USD tn)



Source: Federal Reserve

The wealthy are getting wealthier, but...

The overwhelming majority of the increases in wealth is going to have been concentrated in higher income and already wealthy households. The obvious narrative is that higher income and wealthier households spend more on services and “experiences” such as travel, eating out, theatre, cinema – things that Covid containment measures have prevented. Consequently, we are likely to have seen a significant increase in unplanned saving with the money instead put into various financial and physical assets.

In any case, these households are likely to have more of their wealth in equities, pensions and real estate in the first place so will have benefited from surging stock and real estate prices in the wake of massive stimulus efforts from the Federal Reserve and Federal Government.

However, we think that there are interesting nuances that sets the US apart from elsewhere. We suspect that the way the US government reacted to the crisis has broadened out the range of households who have seen an improvement in their financial position. While not necessarily making a huge dent in the wealth inequality within the US, there is evidence of a tangible increase in net financial worth spread over more of the income spectrum. This could have a significant impact on path of the recovery.

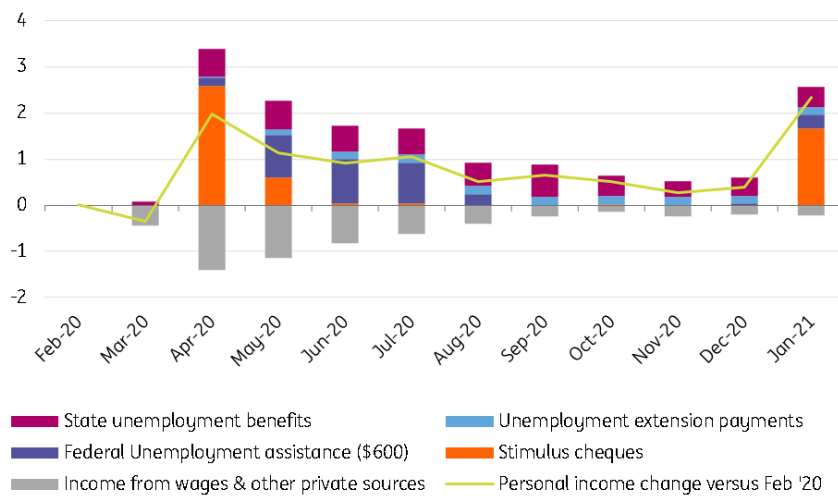
US government policy boosted incomes of poorer households

The US and Europe took very different approaches in dealing with the pandemic's effects on the jobs market. The European furlough schemes were designed to preserve jobs with the government subsidizing the private sector to keep workers on payrolls. This wasn't a full subsidy as there were limits in terms of both percentage of salaries and caps for monthly payments so those on the schemes ended up with lower incomes.

The US government took the decision to avoid interfering directly in the labour market. Instead, they chose to strengthen the financial safety net for those who lost their jobs by extending the duration of unemployment benefits, expanding the number of people who could receive them and then initiating a new \$600 weekly Federal unemployment benefit to boost incomes. In consequence, the University of Chicago calculated that 69% of unemployment benefit recipients actually earned more money being unemployed than [when they were working](#). The median recipient received 134% of their previous after-tax compensation.

When combined with \$1200 CARES Act stimulus payments and the fact that half the jobs lost during the pandemic have been recovered, we see that US incomes have increased substantially versus pre-pandemic levels. This has not been the case in Europe.

Annualised US household income changes versus February 2020 (USD tn)

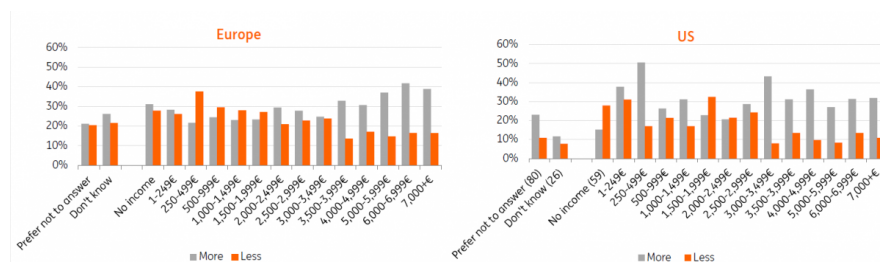


Source: Macrobond, ING

Lower income households have improved their financial position

With opportunities for spending being limited due to Covid containment measures it is likely that not all of these income gains have been spent. Indeed, monthly data suggests outstanding credit card balances have been paid down and are currently at four-year lows. ING's own survey of savings also suggests that there has been more saving right across the income spectrum, whereas in Europe higher savings has been a story seen mainly in higher income households.

US savings have increased across the income spectrum



Source: ING International Survey

Recent data has shown that the improved financial position of a broader range of US households means that when presented with a windfall payment, such as the latest \$600 stimulus cheque, consumers have the confidence to spend it. This contributed to a 5% month-on-month jump in retail sales in January with daily credit and debit card transaction data from www.tracktherecovery.org indicating that the bulk of the additional spending came from lower income households.

Household spending on debit and credit cards since January 2020



A better platform for recovery

This is an encouraging precedent for the outlook for consumer spending. Another \$1400 cheque is soon on its way and this too should boost consumer spending, particularly with the vaccine program going well and a broad re-opening anticipated as we progress through the second quarter. This means there will be a broader range of options to spend money on this time around.

We expect job opportunities to improve further – note that the NFIB small business survey suggest that 40% of small firms already have job openings they cannot fill – an all-time high. Consumer sentiment surveys already suggest that households expect jobs to become more plentiful and this should heighten the chances that households use some of their accrued savings for spending over coming months – especially with more options such as travel and leisure being made available.

Significantly, with the extended Federal unemployment benefits continuing as part of the \$1.9tn stimulus, the unemployed also have the guarantee of robust financial support in addition to state benefits to fall back on should they fail to find work.

This should cement the US' position as the fastest growing developed market economy and potentially allow it even grow as fast as China this year – ING are forecasting 6.5% GDP growth for the US in 2021 and 7% for China.

Huge wealth inequality persists

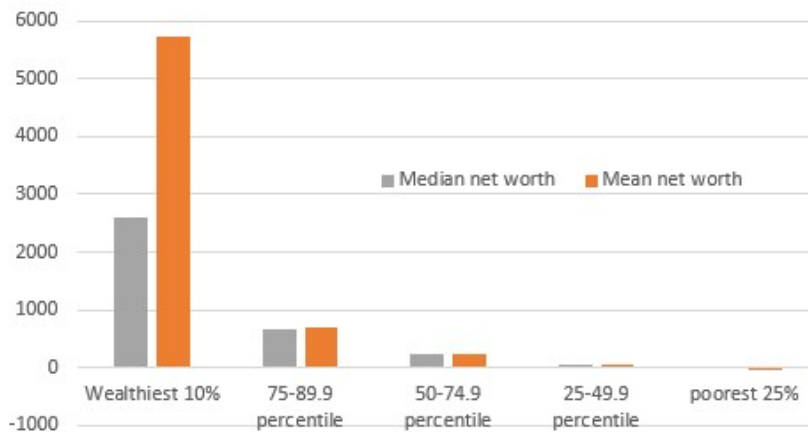
While we suggest there have been increases in wealth across the income spectrum in the US relative to Europe, that is not to say there has been a narrowing in wealth inequality. As another Federal Reserve survey from last year shows – [Changes in U.S. Family Finances from 2016 to 2019](#) – there are huge divergences and those are still likely to have increased

That report shows that the median net worth (gross physical and financial assets less liabilities) of US households in 2019 was 121,700, but the wealthiest 10% of households had a median net worth of \$2.6mn while for the poorest 25% of US households it was just \$300. When looking at the mean the numbers are \$5.7mn and a net debt of \$13,500 respectively.

Much has been made of the gains in equity markets and the “democratization” provided by

commission free trading apps, but the Fed's survey of family finances shows just 15% of respondents directly owned stocks in 2019 while 9% had a pooled investment fund and 50% had a retirement account. Given what we have seen in the asset performance number – this reinforces the view that the wealthy continue to accelerate away from everyone else.

Family median and mean net worth



Source: Federal Reserve, ING

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Snap | 15 March 2021

ECB: Looking through inflation (and platitudes)

A front-loading of asset purchases and a very nebulous reaction function. This is not only the European Central Bank's answer to higher bond yields but probably also the outcome of a controversial discussion at the ECB's Governing Council



How will the ECB react to the recent increase in inflation and bond yields? This was the main question ahead of today's ECB meeting. The announced decision to front-load asset purchases in the coming months and the press conference with ECB President Christine Lagarde suggest that the ECB is split on how to continue.

Fresh round of macro projections

In its broader general macro assessment, the ECB has not really changed its mind. Despite delays in the vaccination rollout and longer-than-expected lockdowns, the ECB's GDP growth forecasts remained almost unchanged from December, with the ECB now expecting GDP growth to come in at 4% in 2021, 4.1% in 2022 and 2.1% in 2023. The ECB remains optimistic that fiscal policy support and the reopening of economies will lead to a significant pick-up in the course of this year. Remarkably, the ECB changed its risk assessment from 'tilted to the downside but less pronounced'

to 'more balanced'.

As regards inflation, the ECB seems to have updated its oil price assumption and actual inflation data for January and February but is not expecting an uncontrollable acceleration in inflation. At 1.5% for 2021, 1.2% in 2022 and 1.4% in 2023, the ECB sees just temporary and one-off factors driving inflation. According to Lagarde's comments during the press conference, the ECB will look through any temporary acceleration in prices. She also stressed the high level of slack in the eurozone economy which would prevent any wage pressures from emerging.

Explaining the ECB's reaction function

With the latest increase in bond yields, financial market participants had expected the ECB to better clarify its current reaction function. The decision to front-load its asset purchases over the next quarter took away some of the pressure, indicating that the ECB was willing to put a cap on yields. The comments during the press conference, however, were more confusing rather than providing any clarity.

What is clear is that the ECB will continue focusing on 'preserving favourable financing conditions'; no yield curve control as Lagarde stated during the press conference. According to the ECB, 'financing conditions are defined by a "holistic" and "multifaceted" set of indicators, spanning the entire transmission chain of monetary policy from risk-free interest rates and sovereign yields to corporate bond yields and bank credit conditions. The comments during the press conference, however, added confusion and no additional clarity. Holistic, multifaceted, upstream, downstream, anchor and compass. A series of platitudes my editor would not allow me to use; at least not this prolifically.

Three key takeaways

What to make of this festival of platitudes? Let's take a step back, forget the platitudes and just look at the facts. There are, in our view, three main takeaways from today's ECB meeting: i) the ECB will look through any temporary acceleration of inflation and expects inflation to slow down again next year; ii) the ECB will front-load asset purchases in the coming months to underline its willingness to look through higher inflation and limit further bond yield increases; iii) the change of the balance of risk for the economic outlook suggests that any increase in the total size of the asset purchases is still far out and unlikely. Instead, today's decision looks like a compromise of a split Governing Council.

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Podcast | 12 March 2021

Listen: ECB steps up stimulus but is it enough?

The European Central Bank is stepping up the pace of asset purchases in response to rising bonds yields, which have threatened to undermine the eurozone's economic recovery. But has it done enough to placate investors? In this podcast, ING's Antoine Bouvet discusses the bank's next move and the outlook for eurozone bond markets in the months ahead



German bund yields rose to the highest level in a year last month while French 10-year bond yields climbed above zero for the first time since June. Eurozone bond markets have been tracking a rise in US Treasury yields on worries about higher inflation. But the ECB's actions on Thursday prompted a rally in bonds, pushing yields lower. So has the bank done enough? [In this podcast](#), ING's Senior Rates Strategist Antoine Bouvet shares his thoughts with Senior Editor Rebecca Byrne.

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Opinion | 11 March 2021

US banks hold their breath ahead of Fed leeway expiration

The stakes are high as we head to 31st March. By then, the positive leeway the Fed gave to US banks on how to treat Treasuries and reserves comes to an end, unless the Fed decides to extend it. We think they will, but not with conviction. If they don't, there are \$600bn of Treasuries that banks may feel obligated to off-load. Not a small number by any stretch



Source: Shutterstock

Around a year ago, when Covid-19 was really hammering the US system and economy, the Federal Reserve decided to allow banks to buy Treasuries and hold deposits without regulatory restriction.

The Fed was in a systemic-panic-containment mode a year ago, as it rolled out a series of measures aimed at keeping the system afloat, while at the same time providing various life-lines to the wider economy

At that time, the Treasury market needed support, as deteriorating liquidity and elevated bid/offer spread became an issue. The market was stressed and the system had been under some pressure.

The ease of restriction on US banks lasts until the end of the month – 31 March. In all probability, the Fed will extend it by at least six months. To understand why, and what the nuances are, we dig a little deeper. But this deep dive also helps to understand why the Fed might decide against extending, which would have far more consequences.

Why was allowing banks to buy more Treasuries and hold more reserves even important?

As a starting point, banks take deposits. At its simplest level, those deposits are used to either provide loans to consumers and businesses, or they can be invested in ultra-safe securities, like Treasuries. Both of these avenues generate a return for the bank – a traditional savings and loan model. And some of those excess deposits end up as reserves held at the central bank.

But this cannot be done without limit, and there are various regulatory requirements that banks need to abide by to ensure their activities are underpinned by a suitable amount of capital. However, the one at issue here is the supplementary leverage ratio – it requires a minimum capital of 3% relative to total leverage exposure, and that leverage exposure includes holdings of Treasuries and reserves at the Fed.

An important side objective of course was not just to allow banks to buy more Treasuries, and get more involved in that market, but also to facilitate the extension of credit to the economy.

Consequently, the extent to which banks can build their balance sheet is limited by underlying capital. The Fed overlay to this was to take holdings of Treasuries and reserves at the Fed out of the denominator. Consequently, banks could up their holdings of Treasuries, and by extension, there was no implied limit on the ability to take in deposits from consumers and businesses.

An important side objective of course was not just to allow banks to buy more Treasuries, and get more involved in that market, but also to facilitate the extension of credit to the economy. The source of funds for that could be through the funding markets, but a better source is through vanilla deposits (just like banks are supposed to do).

Should the Fed unwind policy? Some argue yes. We, narrowly, feel they'll keep it in place

Some argue that US banks are getting special treatment here, as the supplemental leverage ratio is applied to banks globally with more than \$250bn in consolidated assets. Moreover, they argue that the Treasury market and the financial system is no longer in jeopardy and that credit conditions are super easy.

So, the argument goes, the Fed should revert to the pre-Covid state. But there are two issues with this.

It could look a tad off colour if the Fed were to then pull one of their own emergency policies, even if it has morphed more into an insurance back stop

First, it could be viewed as a first sign that the Fed is reversing course on the exceptionally easy policy that it has in place. The Federal Reserve vehemently objected to the US Treasury taking back the numerous facilities supported by Treasury capital injection at the end of 2020, even though many of these facilities had not been used much through the latter months. Surely they could not then pull one of their own, at least not just yet.

Second, the US Treasury market is in the midst of a bear market right now, and ideally, one that the Fed would prefer not to get out of control. Choosing to require banks to include Treasuries in their leverage ratios would not necessarily require banks to sell Treasuries. Still, the pressure would certainly be in that direction for any given level of capital.

If the Fed were to tighten, it risks adding to the bear market for bonds

So how much are we talking about?

US banks as a whole hold about \$4trn of US Treasuries, most of which would be relatively short in maturity. As the economy expands over time, so too do commercial bank holdings of Treasuries. In recent years, US banks' natural increase in Treasuries' holdings has been between \$100bn to \$250bn per annum. In 2020, that increase was an outsized \$735bn, and it has gone up by another \$100bn in January 2021 alone.

Commercial bank holdings of Treasuries are running at about \$600bn above trend. In other words there is a net \$600bn liquidation risk for Treasuries should the Fed choose to end the break on the leverage ratio.

That is not a small number, representing some 15% of all commercial bank holding of Treasuries. Or it equates to a little over 2% of outstanding US Treasuries held by all players. But remember, it is relatively short in duration, as the concentration of banks holdings tends to be biased towards shorter-dated. And so, risk-adjusted, the potential effect is less dramatic than the absolute flow number suggests.

It is also possible that the central bank chooses to remove the green card for Treasuries, while simultaneously allowing banks to continue to exclude reserves at the Fed from the leverage ratio calculation. That would soften a potentially negative blow, but would still leave the bond market exposed to the selling of US Treasuries.

How big a deal is all of this?

If the Fed extends the leverage ratio leeway for US banks, there is no drama and we get on with our lives. If the Fed ends the leeway, then expect net selling of Treasuries from US banks. As they are short in duration, the impact will be muted but it could well be enough to do some crowding out, and push the 10-year back up to 1.6%, and likely break above.

If the Fed ends the leeway, the impact will be muted but could be enough to do some crowding out, and push the 10-year back up to 1.6%

Difficult to disentangle this from the ongoing reflation bear market, but it would push in the same direction, augmenting its effect. The Fed could decide to go halfway and keep the leeway in place for reserves. This would to an extent ease some talk of banks refusing to take deposits (likely overstated), but would not really abate the risk for Treasuries.

A decision, either way, is due.

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Brexit: Five charts show the impact on the UK economy this year

Expect a 3-4% hit to UK manufacturing output in January, though the jury's out on how much was solely down to Brexit-related disruption. The pandemic, stockpiling, and December's Covid-related port chaos will also have played their part. Still, data suggests the new trade frictions are still weighing on exporters and that's unlikely to change fast



GDP data will give a more concrete sense of Brexit-related strains

Friday's UK GDP data is unlikely to be pretty. The imposition of a new strict nationwide lockdown at the start of January will inevitably see a sharp fall in monthly output as a range of consumer services sectors were shuttered. Meanwhile, higher Covid-19 prevalence and school closures meant staff shortages became more of an issue for businesses. All in, we think we're looking at a 5% fall in January GDP.

None of that, admittedly, will come as much of a surprise. But Friday's data is arguably still relevant because it will give us the first, concrete sense of the damage from the switch to new EU-UK trade terms at the start of the year. Despite a deluge of news reports detailing the difficulties

faced by businesses, the data we've had so far has sent mixed signals on how bad it's been on aggregate.

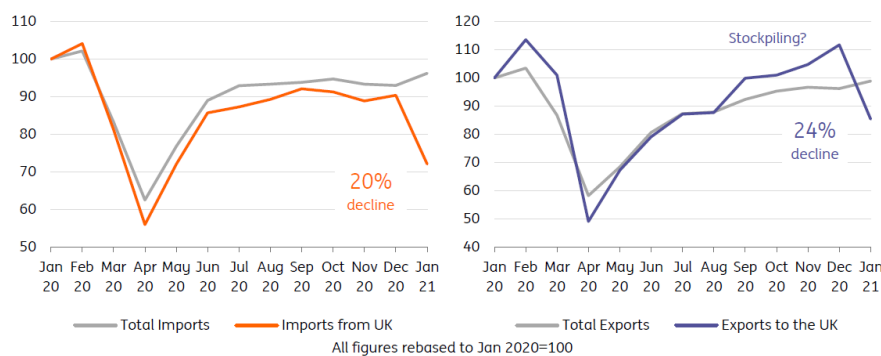
Here's a brief look at what we know so far...

Traffic between the UK and EU was noticeably lower

Firstly, we know that the number of shipments moving across the UK-EU border fell sharply in January. That's evident in lorry traffic data from Dover, [obtained by the BBC](#), which shows it was considerably lower than normal through the first few weeks of the year. Anecdotal evidence also suggests many lorries heading back to the continent were empty (worth remembering here that around 85% of hauliers on the Dover-Calais route are EU-based).

All of this tallies with trade data that has begun to emerge from Europe. French data shows a 20% decline in imports from the UK in January as trade frictions were introduced, while imports from the rest of the world increased. Data from the [German](#) and [Italian](#) statistics agencies suggest similarly dramatic falls.

French trade data shows a clear 'Brexit effect' in January



Manufacturing data shows less of an impact

However, the picture appears slightly less dramatic when looking at UK manufacturing indicators, which alongside agriculture, is arguably where much of the initial sector-specific impact would likely show.

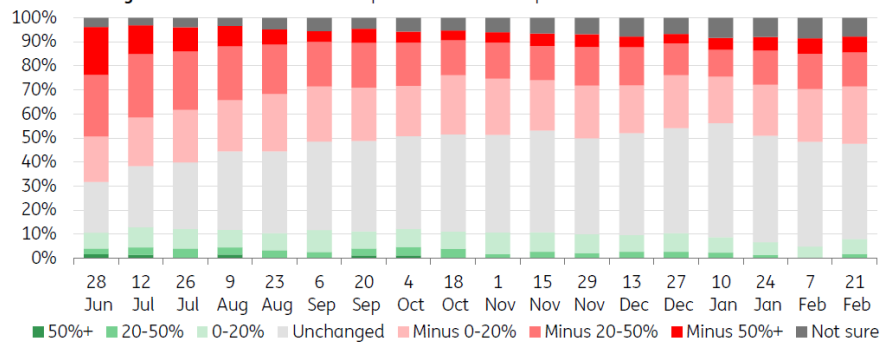
The only real 'hard' data we've had so far is car production, which fell on a year-on-year basis, albeit perhaps not as sharply as might have been expected. When we seasonally-adjust monthly data from the [Society of Motor Manufacturers and Traders \(SMMT\)](#), we see around an 8% fall in car production from December to January. In the context of what is a fairly volatile dataset, this isn't massive.

That sentiment is also reflected in the purchasing managers indices (PMIs) in both January and February. Both pointed to a sharp rise in supplier delivery times, but the impact on output was more limited. Indeed new orders have been fairly stable, all things considered.

Recent [ONS business surveys](#) also show no discernible deterioration in turnover in the manufacturing sector since the start of the year.

No discernible hit to manufacturing revenues in January

Manufacturing: How does turnover from the past two weeks compare to normal?



Source: ONS Business Impact Survey

Results collated from waves 7-24 of the Business insights and impact on the UK economy survey

Brexit wasn't the only story affecting UK trade in January

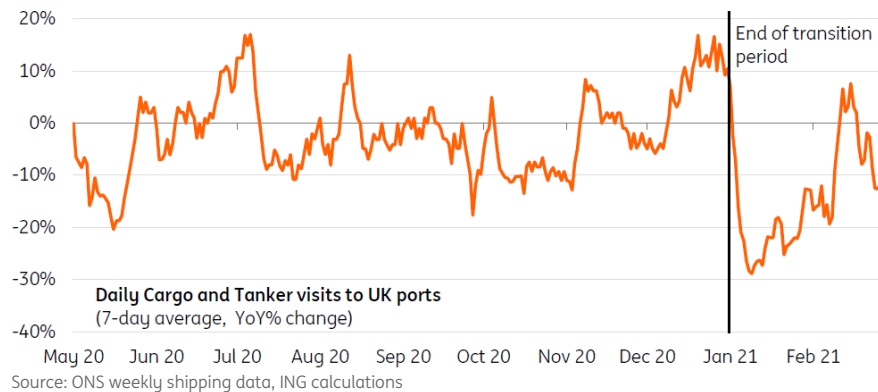
Wrapping all of that together, what should we conclude?

Firstly, we think this implies we could see a 3-4% fall in January's UK manufacturing output, though in practice this may prove to be an overestimate. Unfortunately we won't be able to gauge the impact on exports so clearly; the way the ONS measures these will change, [which it says](#) means the pre-2021 figures won't be fully comparable with January's data.

Secondly, all of the above emphasises that there was a lot going on besides Brexit in January. Data on French exports to the UK displays very clear signs of stockpiling during the latter months of 2020. That probably also explains the noticeable fall in cargo ship visits to UK ports, which came too early in January to be a reaction to disruption, and instead is probably indicative of firms taking a 'wait and see' approach given the long-telegraphed risk of border disruption.

Thirdly, the disruption at Dover/Calais ports in December, when French authorities effectively closed the border due to fears of the new Covid-19 variant, probably also had ripple effects into January. Car manufacturers were forced to pause production in mid-late December and that may be a relevant factor behind the January fall in production. Vehicle production is heavily reliant on 'just in time' deliveries across the channel.

Cargo/tanker visits to UK ports sank at the start of January compared to usual levels



Firms were less prepared than they'd have hoped

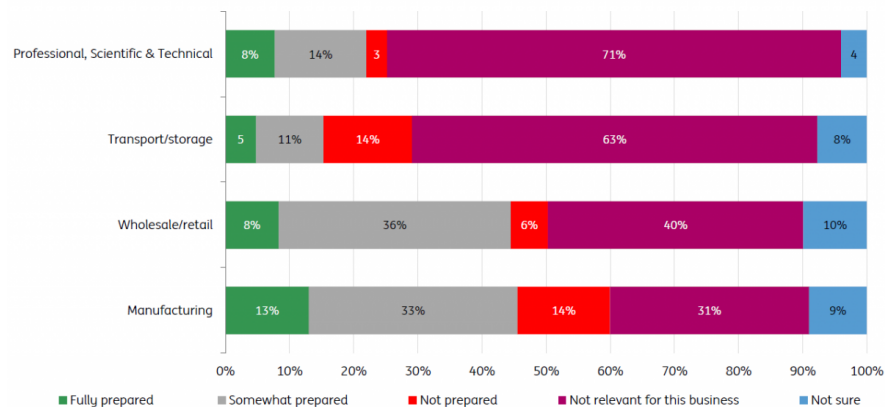
Nevertheless, there clearly was a 'Brexit effect', and the question is how much of this is temporary teething issues, and how much is going to prove longer lasting?

In practice, a bit of both. Firms were undoubtedly less prepared than they'd have wanted to be, not helped of course by the pandemic. Only around 1 in 10 manufacturers thought they were fully prepared back in mid-December, according to the ONS bi-weekly business survey.

Meanwhile, 31% of manufacturers and 40% of wholesalers/retailers said the changes weren't relevant for their business. Partly this is because not all firms export/import, but we suspect this figure also includes firms who weren't fully aware of the forthcoming challenges.

Retailers in particular may have been caught out by new rules of origin requirements, which govern whether a good has sufficient domestically-produced content to be eligible for tariff-free entry. Elsewhere, the problems were more acute for agriculture, where new veterinary hurdles and barriers to entry for certain produce caused significant issues.

1 in 10 manufacturers said they were prepared for the end of the transition period



Source: ONS Business Impact Survey, wave 20

Question: Overall, how prepared is your business for the end of the EU transition period? Percentage of businesses currently trading, broken down by industry, weighted by count, UK, 14 December to 23 December 2020

Since early January though, some of the early sticking points appear to have been worked through. For instance, major hauliers have resumed UK-EU deliveries, having in some cases paused services in response to a significant percentage of consignments arriving without the correct paperwork.

That said, it's striking that roughly 10-20% of 'exporting manufacturers' have still been consistently reporting that they haven't been able to export, according to the ONS (see chart below). That suggests that 'teething issues' only tell part of the story, and many firms are still grappling with the new (permanent) changes that have arisen as a result of the Trade and Cooperation Agreement (TCA).

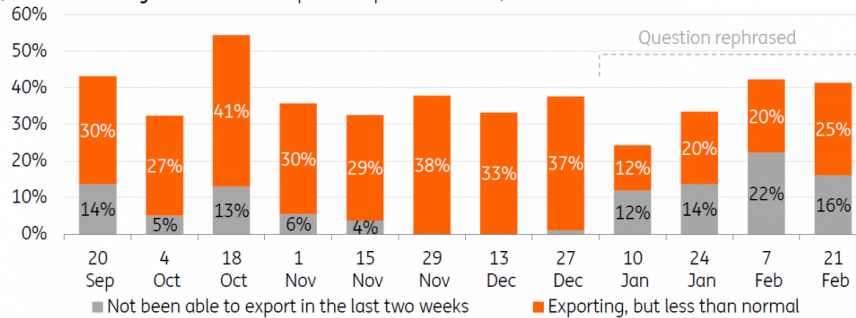
In the short-term, things are, if anything, likely to get trickier. The UK will shortly begin phasing in full customs processes between April and July, potentially posing some additional challenges for UK imports. Meanwhile the political situation between the UK and EU remains fairly febrile. The UK's unilateral decision to extend a grace period on export health certificates on goods destined for Northern Ireland has further eroded trust between governments.

While it's not yet clear where the disagreement over the Northern Ireland protocol will take us, it's a reminder that UK-EU relations are likely to remain tense, and in turn there's a residual risk of parts of the TCA being suspended (eg via tariffs). If nothing else, it's hard to see the UK and EU agreeing to steps that would reduce some of the bureaucratic burden on firms in the longer-term.

10-20% of 'exporting manufacturers' haven't been able to export

How have exports been affected in the last two weeks?*

(% **manufacturing** firms that have exported in past 12 months)



Source: ONS Business Impact Survey

Question: How does your business's exporting in the last two weeks compare with normal expectations for this time of year? (Note that before 2021, the question was specifically linked to the impact of coronavirus on exports)

Manufacturing should gradually recover through 2021, helped by new tax incentives

All of this will put pressure on the UK economy during the post-Covid recovery, and some firms will be forced to reorganise parts of their businesses to adapt to new changes. For some that will mean setting up European operations (eg warehousing), while others may be forced to make cuts to hiring and investment in response to higher costs (both the ONS and PMI surveys show a clear rise in input costs since the start of the year).

That said, we suspect manufacturing production will gradually recover through the next few months, helped along by new tax incentives. The government included a so-called 'superdeduction' in the [latest budget](#), which allows businesses to offset 130% of the cost of new machinery/equipment against their tax bill. This offers a pretty big incentive to bring forward investment.

While the recovery in overall CapEx will still be fairly gradual, this measure should help inject a bit of life into investment after a very lacklustre period since the 2016 referendum.

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Germany: Super election year set to start

Sunday's regional state elections mark the start of a 'super election year', leading to the national elections in September. The two elections on Sunday will give a first taste of the country's appetite for political change



On Sunday, the so-called super election year in Germany will kick off. Ahead of the national elections in September, six regional states will be voting on a new government. Up first, the states of Baden-Württemberg and Rhineland-Palatinate. Local elections on county and city councils in the regional state of Hesse also take place on Sunday.

Regional state elections in Germany are always a strange beast. Sometimes they are heavily influenced by regional developments, sometimes they offer a chance to voice support or discontent with national politics and politicians. Even more interesting, regional state elections in the spring of a national election year have often heralded the country's appetite for change. With this in mind, keep a close eye on Sunday's results.

What to watch

There are about 3.1 million eligible voters in Rhineland-Palatinate and around 7.7 million in Baden-Württemberg, roughly one fifth of all eligible voters in the country. The current government in Rhineland-Palatinate comprises a coalition known as the 'traffic light coalition' because of the colour of the parties. These include the Social Democratic Party (SDP), the Free Democratic Party

(FDP), and the Greens. Baden-Württemberg is the only German state led by a Green minister-president, in a coalition with the CDU. The two parties will be the main rivals for the most votes. In both states, latest polls point to a small majority for the current coalitions. For the national elections in September, however, there are three major aspects to watch on Sunday:

- In Rhineland-Palatinate, the SPD had one of its best election outcomes in 2016, defying the national trend of gradually diminishing electorate support. Back then, the party received 36% of the vote. Anything close to the 2016 result could give finance minister Olaf Scholz a tailwind for his campaign in the national elections. Any significant loss, however, could dent supporters' enthusiasm in the months ahead.
- The Greens have their only minister-president, Winfried Kretschmann, in Baden-Wuerttemberg. The party has enjoyed a lot of electorate support over the last few years and is currently the second largest party in national polls, looking for a potential government coalition with the CDU at the national level after September. Another victory for Winfried Kretschmann would support the Green's ambitions at the national level.
- The CDU still has to decide on its candidate for the national elections. The choice will be between newly-elected party chairman Armin Laschet and Bavarian minister-president Markus Söder. The party's performance in Sunday's two elections will weigh in on this decision. A better-than-expected performance should, in our view, increase Laschet's chances, a worse-than-expected performance would support calls to opt for a more popular candidate, read Söder.

The result of Sunday's elections will probably be a mix of regional and national factors. Particularly for the CDU, it will be a popularity vote on the recent handling of the coronavirus crisis. Never-ending lockdowns, delays and chaos with vaccinations and rapid tests, and now recently also the scandal over two CDU MPs resigning over alleged kickback payments for state purchases of respiratory masks, have led to significant losses in opinion polls. For the CDU and other parties, too, Sunday's elections will be the first real test case to measure the country's support of the latest crisis management.

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