



## Recent floods to have limited impact on growth outlook and election outcome

### July floods: Among the most severe natural disasters in the recent past

The recent flooding caused by heavy rain was among the most severe natural disasters hitting Germany since reunification. More than 170 people lost their lives and many private homes and public buildings, roads and municipal infrastructure were destroyed. Several villages were cut off from the outside world and could only be reached after a few days. This was not the first flood of historic proportions in the recent past, although the death toll was by far higher than during the 2002 and 2013 floods (25 and 45, respectively). Overall, the current crisis appears to be much more disastrous than those two previous events. The epicenter of the disaster lies in predominantly rural areas in the highlands, mainly in the western part of Germany. Other rural areas in the south were also affected by heavy rain and floods.

### Limited impact on GDP growth for Germany as a whole

Since the flooding occurred in regions with low industrial density, the expected negative impact on overall economic activity in Germany, in particular on industrial production, should be relatively limited. Still, the regional impact on agricultural production (such as wine-growing) might be significant. Right now, it looks like the economic damage to the agricultural sector might amount to billions of EUR.

In contrast, the subsequent rescue and emergency aid – as well as reconstruction of destroyed infrastructure – could lead to small positive growth impulses in the short to medium term. In response to the floods, the federal government decided last week to provide federal emergency aid to affected households worth EUR 200 m. The federal states are supposed to add another EUR 200 m to lift these emergency payments to a total of EUR 400 bn (or 0.01% of GDP). These cash payments should be disbursed before the end of July to both insured and uninsured persons and might amount to up to EUR 3,500 per private household.

In addition, private donations and other support programs are expected to add to the overall financial support volume to the affected regions. These funds guarantee the procurement of goods essential for survival and reconstruction in the flooded areas. As the construction sector is working close to full capacity, the real GDP growth impulse from subsequent reconstruction works should be rather marginal in the short term. On a negative sidenote, the rescue and reconstruction operations increase the risk of a COVID-19 superspreader event as hygiene and distancing rules understandably could play a subordinate role in the affected areas. However, even if this adverse risk scenario materializes, the overall impact on the German

[Marc Schattenberg](#)

Senior Economist  
+49-69-910-31875

[Stefan Schneider](#)

Chief Economist  
+49-69-910-31790

[Barbara Boettcher](#)

Senior Economist  
+49-69-910-31787

[Marion Muehlberger](#)

Senior Economist  
+49-69-910-31815

[Jochen Moebert](#)

Senior Economist  
+49-69-910-31727

[Sebastian Becker](#)

Senior Economist  
+49-69-910-21548





macro economy should be low. As the upside and downside risks to economic activity cancel each other out, we stick to our current Q3 and Q4 2021 GDP forecasts of +4% and +1.5% quarter-on-quarter, which continue to back our (annual average) real GDP growth forecast of 4.0% for 2021.

### Reconstruction: High capacity utilization might limit any positive growth impulse in the short run

As the level of capacity utilization is close to an all-time high in the overall German construction sector (July: 78.5% vs annual all-time high 78.8%), it will be challenging to quickly rebuild the devastated areas (including public infrastructure, e.g. supply of fresh water, sewage systems, railroad tracks). In the worst case, the increased reconstruction activity in the affected regions could lead to a crowding out (of real resources), thus dampening real construction activity elsewhere. This is also a big difference to previous flood events of 2002 and 2013. Back then the utilization levels in the construction sector were much lower, at 59.6% (an all-time low) and 72.9%, respectively.

Despite a comparatively high capacity utilization ratio in civil engineering (76.1%), the construction industry association believes that there is sufficient capacity to tackle the repair of flood damage in a timely manner. The prerequisite, however, is a rapid award of contracts that takes into account the small to medium-sized structures in the regions. Despite the initial enthusiasm, the repair work is likely to be protracted as structural headwinds – such as material shortages and regional shortages of skilled labor – persist. Bureaucracy and (supply-side) bottlenecks in public administration might also slow the overall pace of reconstruction.

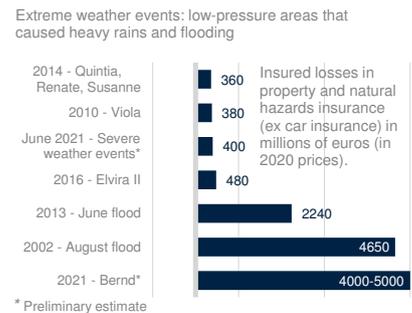
### High loss of insured and non-insured wealth

Due to the high death toll and massive economic damage, many experts reckon that the current flood-related loss of wealth is much higher than during past floods. One indication often used is the amount of insured losses. The German Insurance Association (GDV) estimates that insured losses could amount to EUR 4-5 bn (roughly 0.1% of GDP forecast for 2021). This estimate exceeds the overall losses incurred in 2002. In 2013, according to GDV data, total claims regarding property and natural hazards insurance amounted to EUR 2.24 bn (ca. 0.08% of 2013 GDP). In the current flood event, the effective duration of the flooding will be a key determinant of the ultimate outcome of property damage. The longer buildings remain under water, the higher the damage will be (in the worst case, there might be no way around tearing down heavily affected buildings).

As the recent disaster happened in areas that had been only mildly affected by similar events in the past, many homeowners and companies might lack appropriation insurance coverage for natural disasters. Therefore, the total uninsured loss could be a multiple of the estimated insured loss. By way of comparison, the total damage caused by the floods in 2002 was estimated at just under EUR 12 billion, equivalent to about 0.53% of nominal GDP in 2002. In our view, the total damage suffered this time is likely to be even higher and might well exceed the magnitude of the 2002 event.

The introduction of compulsory insurance for homeowners is currently being debated – especially since damage caused by heat waves and floods could increase in scale and frequency. In addition, recent events could lead to more public investments in disaster management. Many lives could have been saved if the communication from weather alerts to citizens had worked smoothly. Given

Figure 1: Insured losses caused by recent floods and heavy rain



Source: German Insurance Association (GDV), Deutsche Bank



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structural bottlenecks in public administration and the construction sector, these investments might also increase the structural price pressure.

#### Likely budgetary impact rather small

At this time, the total economic damage is still largely unknown. Hence, any flood-related fiscal costs (to be incurred at the federal, state and/or local government levels) can only be approximated by drawing on experience from past flood disasters. Generally, Germany's fiscal response comprises a) immediate financial aid to affected households/companies/farmers as well as b) the necessary public funds to finance the reconstruction works of destroyed public infrastructure (roads, bridges, cell towers, buildings, supply lines, railway tracks and stations).

As regards the first element, both the federal government and the federal states have promised to provide emergency aid of EUR 400 m in a timely and unbureaucratic way. As the state aims to disburse this money as quickly as possible, it will have to compromise on the thoroughness of its means-testing procedures (i.e. regarding the wealth/income situation of affected people). That being said, the federal government already hinted that it will abstain from any means testing to avoid unnecessary delays in disbursements. The emergency aid is meant to give basic support to affected private households and provide interim aid to companies and self-employed persons to cover for revenue losses.

As regards the second element, the government reckons that the overall costs of the reconstruction work might be as high as EUR 6 bn (almost 0.2% of GDP). Moreover, the federal government said it will pay the full amount of the reconstruction costs that are related to damaged federal infrastructure (i.e. federal roads, highways and railroads). In this context, Deutsche Bahn said that the damage might reach historic dimensions, stating that the costs of repairing the railroad system as well as destroyed railroad stations could reach EUR 1.3 bn. Finance Minister Olaf Scholz (SPD) and Minister of the Interior Horst Seehofer (CSU) already said that the volume of federal aid could still rise further if emergency and reconstruction needs turn out to be higher than currently approximated.

Although the overall fiscal impact is far from certain, experience from past floods – such as those in 2002 and 2013 – points to overall fiscal costs of around 0.2-0.3% of GDP. In the aftermath of the 2002 flood, the federal government established a special extra-budgetary fund of EUR 6.5 bn (roughly 0.2% of 2002 GDP). However, "only" EUR 5.3 bn (0.24% of 2002 GDP) was actually disbursed, while the remainder of EUR 1.2 bn was transferred back to the fiscal accounts of the federal government and the federal states. Following the 2013 flood, the federal government implemented another extra-budgetary vehicle, which totaled a somewhat higher EUR 8 bn (0.3% of 2013 GDP). Of these special funds, "only" EUR 5 bn (0.18% of 2013) has been actually spent so far. Another EUR 1.2 bn is still planned to be spent, which could bring the total cost to EUR 6.2 bn (2.2% of 2013 GDP). That said, another EUR 1.8 bn was already transferred back to the federal budget (see also FAZ article from 17<sup>th</sup> of July 2021).

Given the above (likely) fiscal dimensions, the budgetary impact should be comparatively small at the total government level, in particular when compared to the much larger fiscal impact from the COVID-19 pandemic. Just for the budget year 2021, the total of authorized net federal credit borrowing amounts to as much as EUR 240 bn (or around 6.8% of GDP forecast for 2021).



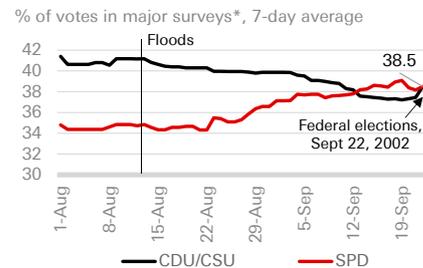
### Flood unlikely to be as decisive for election outcome as back in 2002

When thinking about possible effects of a flood on an upcoming federal election, the events of 2002 immediately come to mind. Back then, SPD Chancellor Gerhard Schröder was trailing in the polls with his reelection hanging in the balance. By effectively portraying himself as crisis manager during the flood, he eventually turned the tide. Still, 2002 does not lend itself to comparison for two reasons. First, the event was much closer to election day; second, the race was much tighter. In the end, the mere 3.7pps that the SPD gained in the aftermath of the flood vis-à-vis the CDU/CSU were sufficient to win the election. Currently, the CDU/CSU has a 10pp lead over the Greens, meaning a much larger shock would be required to fundamentally change the election outlook and by that our baseline of a black-green government.

**Limited impact on polls as expected.** Some of the most recent polls already fully capture post-flood views. As expected, there is no big shift in voter preferences. As the flood has again given rise to the awareness of extreme weather linked to climate change, it might have benefitted the Greens. But this does not seem to be the case (see [Figure 3](#)). In a recent survey (Spiegel, June 21), only one-third of voters state that climate change has become more decisive for their voting intentions. Thus, it is unlikely that the events will massively mobilize new green voters. Instead, they will likely confirm voters' previous choices. In addition, given the various climate-related legal packages at both the domestic and EU levels, the Greens' focus on climate no longer substantially differentiates them from other major parties. Still, polarization between those who think this is "only" weather and those who think climate change increases the likelihood of such events in Germany might increase further.

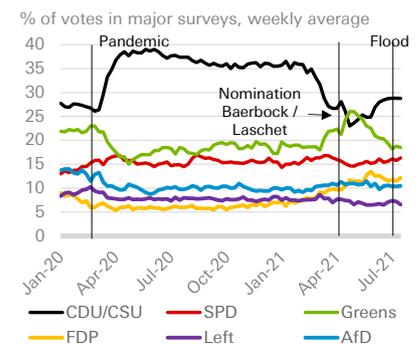
**Laschet's popularity takes a small hit.** If at all, it is the candidates' popularity that has (to a small extent) been impacted by the flood and the candidates' reaction to it. Laschet's small lead over Annalena Baerbock and Olaf Scholz seems to be gone (see [Figure 4](#)). While Baerbock remains on the sidelines calling for action but lacking any executive function, SPD candidate and Finance Minister Scholz is portraying himself as effective crisis manager providing emergency help. This has raised his standing, though not that of his party. Laschet's ability to manage a crisis is also being tested as he is PM of NRW, where large parts of the flooding occurred. Many in the public perceive his performance as reduced to an unfortunate few moments of chortling in the background during President Steinmeier's speech on July 18. This is also mirrored in our twitter sentiment analysis, which shows a net negative spike on that day (see [Figure 5](#)). Despite Laschet having apologized several times for this unbecoming appearance, it has again raised the question of whether he is the right leader to step into Merkel's footsteps. But Laschet's dip in popularity is likely to have only a limited impact on overall polls, possibly preventing the CDU from crossing the 30% approval rate, but not causing a significant decline.

Figure 2: Polling dynamics after the 2002 floods



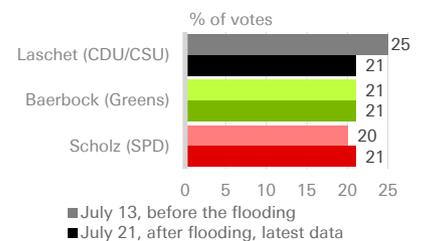
Note: \*major political surveys taken into account: Allensbach, Kantar, Forsa, FG Wahlen, Infratest, INSA.  
Source: Wahlrecht.de, Deutsche Bank

Figure 3: Flood has not (yet) left its imprint on polls



Source: Wahlrecht.de, Deutsche Bank

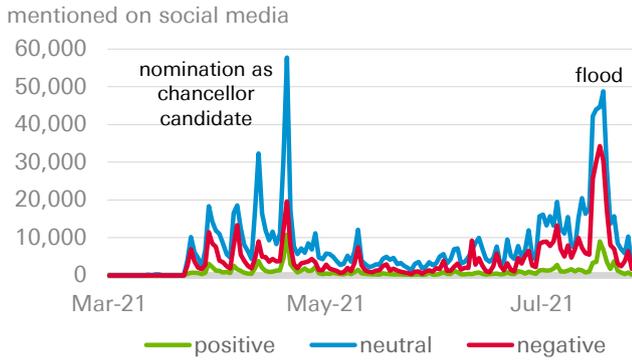
Figure 4: Popularity of chancellor candidates – Laschet loses the lead



Source: Spiegel, July 21

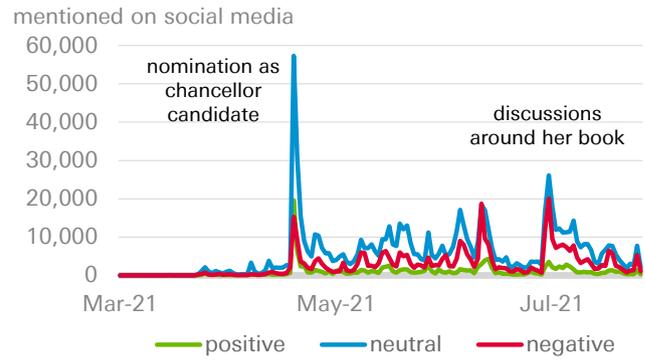


Figure 5: Social media sentiment: Flood leads to net negative spike for Laschet ...



Source : dbDIG

Figure 6: ... while Baerbock is spared this time



Source : dbDIG

**Fourth wave and fiscal policy: In the spotlight ahead of the election.** From today's point of view, these two topics will dominate the final weeks of the election campaign. Public discussion is currently focused more on why effective prevention failed (communication, sirens, etc.) than on how to reach ambitious CO<sub>2</sub> reduction goals. Both issues, though, raise pressing fiscal questions: (1) how to catch up on underinvestment in infrastructure during Merkel's era, and (2) how to fund the transformation to a net-zero economy. Facilitating higher fiscal spending in the absence of realistic options to change the debt brake is the key point here. Thus, it is important to monitor the candidates' statements over the next couple of weeks, which should provide better hints than election manifestos. Moreover, we expect the looming fourth wave (rising rate of infections combined with slowing pace of vaccination) to be the second key topic of the election campaign. The debate on mandatory vaccination vs civil freedom is likely to be in full swing by September. Not only inter-party but also intra-party views on that issue are diverging, as shown by statements by the Head of the Chancellery Braun (pro indirect obligation for vaccination) and Laschet (contra). As previously stated, we stick to our view that the electorate's perception of how well the pandemic is managed will continue to play a role in the election outcome. The next signpost to watch is the regular meeting between Chancellor Merkel and the state PMs scheduled for end-August but likely to be brought forward.



# Appendix 1

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## David Folkerts-Landau

Group Chief Economist and Global Head of Research

Pam Finelli  
Global Chief Operating  
Officer Research

Steve Pollard  
Global Head of Company  
Research and Sales

Anthony Klarman  
Global Head of  
Debt Research

Michael Spencer  
Head of APAC  
Research

Andreas Neubauer  
Head of Germany  
Research

Gerry Gallagher  
Head of European  
Company Research

Matthew Barnard  
Head of Americas  
Company Research

Tim Rokossa  
Head of German  
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Peter Hooper  
Global Head of  
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### International Production Locations

#### Deutsche Bank AG

Deutsche Bank Place  
Level 16  
Corner of Hunter & Phillip Streets  
Sydney, NSW 2000  
Australia  
Tel: (61) 2 8258 1234

#### Deutsche Bank AG

Equity Research  
Mainzer Landstrasse 11-17  
60329 Frankfurt am Main  
Germany  
Tel: (49) 69 910 00

#### Deutsche Bank AG

Filiale Hongkong  
International Commerce Centre,  
1 Austin Road West, Kowloon,  
Hong Kong  
Tel: (852) 2203 8888

#### Deutsche Securities Inc.

2-11-1 Nagatacho  
Sanno Park Tower  
Chiyoda-ku, Tokyo 100-6171  
Japan  
Tel: (81) 3 5156 6000

#### Deutsche Bank AG

1 Great Winchester Street  
London EC2N 2EQ  
United Kingdom  
Tel: (44) 20 7545 8000

#### Deutsche Bank Securities Inc.

60 Wall Street  
New York, NY 10005  
United States of America  
Tel: (1) 212 250 2500

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