

2. GERMANY

Subdued growth following a sharp slowdown in 2019

After slipping into a technical recession in mid-2019, Germany's economy is expected to see muted growth over the forecast horizon. Foreign demand now looks likely to be weaker than previously expected and domestic demand is set to be dampened by weak investment. The labour market, by contrast, should remain supportive of private consumption, though likely less than in previous years. The current account surplus and domestic savings remain high while the fiscal stance is expected to be moderately expansionary over the forecast period, as budget surpluses diminish.

The manufacturing sector remains weak

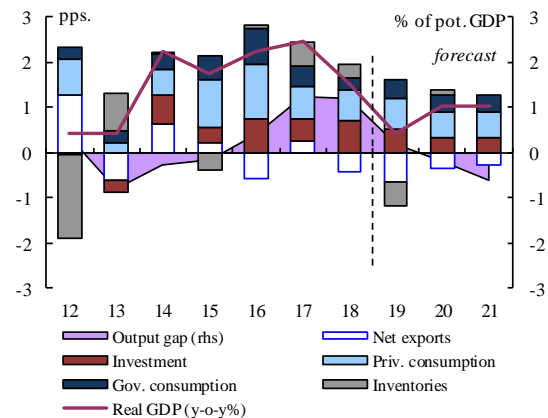
Germany's economy contracted by 0.1 % in the second quarter of 2019 as the souring external environment took its toll on exports. Manufacturing continued to decline for the fourth consecutive quarter. The car manufacturing sector, which has a high share of output and a complex value chain, is undergoing a structural transformation. The production of combustion engine vehicles is being scaled down and relocated abroad. At the same time, equipment manufacturers are suffering from the impact of trade conflicts on investment demand. The second quarter also showed declines in construction and key services. Whereas in construction this reflects a particularly strong first quarter, in services this may be signalling weaker demand from industries and consumers. Moreover, business confidence has been deteriorating over the last seven quarters and may have affected consumer sentiment. All this suggests that Germany could see another slight GDP contraction in the third quarter of this year, resulting in a technical recession.

Muted domestic demand to result in modest growth

Due to the continued weakness of global trade, export growth might recover only partially from its decline in the second and presumably the third quarter of 2019. At the same time, domestic demand could prove strong enough to generate growth. Consumption should continue benefitting from stable employment and ongoing wage increases. Even if constrained by capacity, construction activity is expected to continue expanding, while equipment investment should strengthen as export activity normalises as expected in a few quarters. These prospects are subject to downside risks, particularly as recent strong wage growth has boosted savings rather than consumption growth. Downside risks on investment relate to global trade uncertainty, sectoral structural issues (e.g. in the auto sector),

but not least also to the planning and implementation capacity of the public sector. All in all, after a nine year expansion, GDP is expected to increase by only ½ % this year, and by just 1 % in 2020 and 2021. This still suggests subdued underlying dynamics, as in both 2020 and 2021 there are positive calendar effects at play (0.4 % and 0.1 %).

Graph II.2.1: Germany - Real GDP growth and contributions, output gap



A supportive labour market

The labour market has so far remained robust with record high employment and increasing wages. Still, the number of overall hours worked stagnated in the first half of the year and the hiring appetite of firms has been subsiding. Private consumption growth was restrained in the second quarter, despite ongoing increases in disposable income and might disappoint further as consumer confidence continues declining. Nevertheless, job creation is expected to remain slightly positive on aggregate. Persistent labour shortages in some sectors are expected to sustain labour hoarding and wage growth. Job losses in the manufacturing sector are expected to be modest.

The external surplus remains high but declining

Export growth has slowed significantly since 2018 and is likely to recover only gradually in 2020. Meanwhile, resilient domestic demand is expected to lead to a further increase in the import-to-GDP ratio. Thus, the current account surplus, which declined to 7.6 % of GDP in 2018, is expected to come down further to around 6 ½ % in 2021.

Inflation to remain moderate

Consumer price inflation has been running below wage growth, which is supportive of purchasing power. Having been around 2 % for most of 2018, HICP inflation declined to just 1 % in the third quarter of 2019. Not taking into account volatile energy and unprocessed food prices, it hovered around 1.5 % between January and September 2019. Moderate domestic demand is not expected to exert strong inflationary pressure and core inflation is not expected to exceed 1.5 % before 2021.

Budget surpluses diminishing

The budget balance peaked at 1.9 % of GDP in 2018 and is expected to decline to around 1.2 %

in 2019, 0.6 % in 2020 and 0.2 % of GDP in 2021. This reduction of budget surpluses reflects the expected slowdown in growth as well as the planned implementation of fiscal measures.

On the revenue side, measures lowering the personal income tax burden and the abolition of the solidarity levy in 2021 for more than 90 % of taxpayers will dampen tax revenue. On the expenditure side, increased social transfers will provide additional support to household disposable income. Public investment is forecast to continue growing faster than GDP. The measures in the recent climate package should lead to additional spending of around 0.1 % of GDP per year. Government spending is set to increase noticeably over the forecast period, reducing the budget surplus. All measures together imply a modest fiscal expansion of around 1 pp. of potential GDP over the years 2019 to 2021.

The structural surplus peaked in 2018 at about 1½ % of GDP and is projected to decline by about 1 pp. over the forecast period. Government debt is projected at 59 % of GDP in 2019, falling below the 60 % Maastricht threshold, and to decline further to around 55 % of GDP in 2021.

Table II.2.1:

Main features of country forecast - GERMANY

	2018			Annual percentage change						
	bn EUR	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	3344.4	100.0		1.3	2.2	2.5	1.5	0.4	1.0	1.0
Private Consumption	1743.7	52.1		0.7	2.3	1.3	1.3	1.3	1.1	1.1
Public Consumption	665.6	19.9		1.5	4.1	2.4	1.4	2.1	2.0	1.9
Gross fixed capital formation	707.7	21.2		0.6	3.8	2.4	3.5	2.5	1.5	1.6
of which: equipment	235.3	7.0		1.8	3.0	4.0	4.4	0.6	0.4	1.7
Exports (goods and services)	1585.8	47.4		5.4	2.4	4.9	2.1	0.8	1.6	1.9
Imports (goods and services)	1379.7	41.3		4.3	4.3	5.2	3.6	2.5	2.7	2.8
GNI (GDP deflator)	3437.9	102.8		1.4	2.4	2.6	1.8	0.3	0.9	0.9
Contribution to GDP growth:										
Domestic demand				0.8	2.8	1.7	1.7	1.6	1.3	1.3
Inventories				-0.1	0.1	0.5	0.3	-0.5	0.1	0.0
Net exports				0.6	-0.6	0.2	-0.4	-0.6	-0.4	-0.3
Employment				0.6	1.2	1.4	1.4	0.8	0.1	0.2
Unemployment rate (a)				7.6	4.1	3.8	3.4	3.2	3.4	3.5
Compensation of employees / head				1.7	2.3	2.6	2.9	3.3	2.5	2.5
Unit labour costs whole economy				1.1	1.3	1.5	2.7	3.6	1.6	1.7
Real unit labour cost				-0.1	0.1	0.4	1.2	1.5	-0.4	-0.1
Saving rate of households (b)				16.9	17.6	17.9	18.5	19.3	19.6	19.7
GDP deflator				1.2	1.2	1.0	1.5	2.0	2.0	1.7
Harmonised index of consumer prices				1.6	0.4	1.7	1.9	1.3	1.2	1.4
Terms of trade goods				0.1	2.3	-1.6	-1.1	1.2	1.4	0.3
Trade balance (goods) (c)				6.5	8.1	7.8	6.8	6.4	6.2	5.9
Current-account balance (c)				4.8	8.6	8.3	7.6	7.0	6.8	6.4
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				4.7	8.6	8.0	7.5	6.9	6.7	6.3
General government balance (c)				-1.7	1.2	1.2	1.9	1.2	0.6	0.2
Cyclically-adjusted budget balance (d)				-1.5	1.0	0.6	1.3	1.1	0.7	0.5
Structural budget balance (d)				-	1.0	0.9	1.4	1.1	0.7	0.5
General government gross debt (c)				69.5	69.2	65.3	61.9	59.2	56.8	55.0

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.