# 2. GERMANY

*In early 2020, German manufacturing had shown signs of recovery, but the COVID-19 pandemic and the confinement measures in March ended this. The economy is now set for the deepest recession since WWII. Activity is expected to recover in the second half of the year and thereafter, but to remain below normal for some time due to lingering limitations on social life and travel and impaired foreign trade. The swift and sizeable fiscal measures are expected to help avert a deeper recession. They will come with a significant fiscal cost and the budget balance is set to switch to an unprecedentedly large deficit.*

## A turn for the better ended too soon

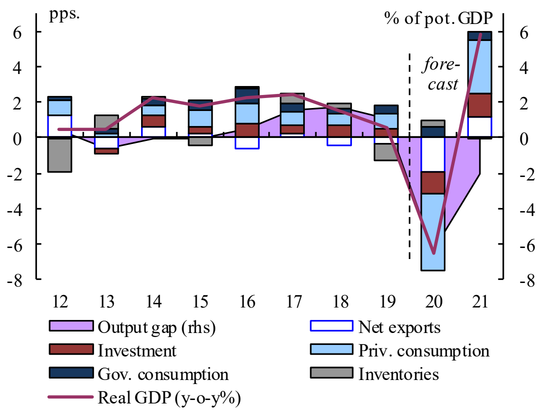
In January and February industrial production, exports and factory orders were recovering, retail sales were rising, and construction was at an historical high. Businesses and consumers were regaining confidence and employment was further increasing. Growth seemed to be reviving after a year of near-stagnation. In March, however, the factory shutdowns in China started to affect manufacturing in Germany. Sanitary measures to contain the COVID-19 outbreak imposed severe limitations on mobility, social and leisure activities and most of retail trade. These developments squeezed domestic demand and the services sector, which were largely keeping the economy afloat in past contractions, and are likely to have caused GDP to decline already in the first quarter of the year.

## Heading towards a recession

The first weeks of the second quarter have been marked by complete outages in various service activities due to the containment measures. Manufacturing is not subject to restrictions, but major factories have been shut due to the disappearance of demand and the disruption of supply chains as a result of the global spread of COVID-19. Demand for leisure-related services is constrained both by sanitary measures as well as by consumer uncertainty. Thus, Q2 will likely see an unprecedented decline in activity that will drag the economy in 2020 into its deepest recession in the history of the Federal Republic.

In the coming months, many activities, in particular services, will need to adapt to limitations on the use of their capacity. Manufacturing may continue to struggle as a result of impaired supply chains and weak global trade as markets and suppliers around the world continue to suffer from the impact of COVID-19 and related restrictions. This will inevitably affect business investment adversely. Germany was among the first set of EU Member States to announce a gradual relaxation of confinement measures. Assuming that the measures to mitigate the public health risks and contain the economic fall-out are effective, activity is expected to recover thereafter and to reach its pre-crisis level in late 2021. Overall, GDP is expected to decline by around 6 ½ % in 2020 and grow by around 6% in 2021.

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




## Determined support by policy

Despite its strength at the start of the year, the labour market seems unlikely to escape the economic fallout of the COVID-19 pandemic. To cushion the impact, the government has enhanced access to subsidised short-time work programmes. Combined with running down overtime balances, this scheme, which proved successful in the financial crisis, is expected to again help companies to keep their employees on the payroll so that skilled labour remains available once activity recovers. This measure is aimed at containing job cuts and protecting household incomes, but cannot totally fend off an increase in unemployment. Moreover, in light of uncertainty concerning the crisis and constraints on consumption, the household saving rate is likely to increase.

The very large volume of measures to support businesses consist of tax deferrals, liquidity support for SME's and credit guarantees, which are expected to enable companies to stay liquid and avoid excessive cutbacks to investment.

### External surplus to fall markedly

Exports are expected to suffer a large decline before foreign markets recover. The decline in imports is expected to remain more contained as the import-rich components of private consumption are not as adversely affected. Thus, the current account surplus, which declined to 7.1 % of GDP in 2019, is expected to come down further to around 6% in 2020, a level last seen 7 years ago, before rebounding in 2021.

### Inflation to slow

Consumer prices are expected to be affected by dichotomous trends, as services and energy prices slow down or fall while food and non-energy consumer goods prices increase due to possible supply bottlenecks. Nevertheless, inflation is expected to be subdued in 2020 (0.3%) and 2021 (1.4%).

### A temporary large budget deficit

The government reacted swiftly to the COVID-19 outbreak with measures of historic size to stabilise the economy. These provide liquidity support to companies and transfers to avoid lay-offs and bankruptcies. At the end of March 2020, ample guarantees and an extra budget of EUR 156 bn (4.8% of GDP), almost half the size of the federal budget, were adopted to finance the measures. Together with the expected decrease in tax revenues due to the drop in activity, the general government deficit is projected to jump to around 7% of GDP after a surplus of 1.4% in 2019. Based on unchanged policies and assuming that the measures prove effective in supporting a quick recovery, the budget is projected to be closer to balance again in 2021.

Government debt fell below 60% in 2019 for the first time since 2002 but is expected to rise to around 76% in 2020 due to the measures adopted to support the economy. In 2021, the government debt is projected to return to its downward trend to reach around 72% of GDP.

*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 | **0.6** | **-6.5** | **5.9** |
| Private Consumption | | 1743.7 | 52.1 | 0.7 | 2.3 | 1.3 | 1.3 | **1.6** | **-8.3** | **6.0** |
| Public Consumption | | 665.6 | 19.9 | 1.5 | 4.1 | 2.4 | 1.4 | **2.6** | **2.8** | **2.1** |
| Gross fixed capital formation | | 707.7 | 21.2 | 0.6 | 3.8 | 2.4 | 3.5 | **2.6** | **-5.8** | **5.9** |
| of which: equipment | | 235.3 | 7.0 | 1.8 | 3.0 | 4.0 | 4.4 | **0.6** | **-17.0** | **12.7** |
| Exports (goods and services) | | 1585.8 | 47.4 | 5.4 | 2.4 | 4.9 | 2.1 | **0.9** | **-12.1** | **10.3** |
| Imports (goods and services) | | 1379.7 | 41.3 | 4.3 | 4.3 | 5.2 | 3.6 | **1.9** | **-9.2** | **8.6** |
| GNI (GDP deflator) | | 3437.9 | 102.8 | 1.4 | 2.4 | 2.6 | 1.8 | **0.7** | **-7.1** | **6.4** |
| Contribution to GDP growth: | Domestic demand | | | 0.8 | 2.8 | 1.7 | 1.7 | **1.9** | **-5.0** | **4.8** |
| | Inventories | | | -0.1 | 0.1 | 0.5 | 0.3 | **-0.9** | **0.5** | **-0.1** |
| | Net exports | | | 0.6 | -0.6 | 0.2 | -0.4 | **-0.4** | **-1.9** | **1.2** |
| Employment | | | | 0.6 | 1.2 | 1.4 | 1.4 | **0.9** | **-0.9** | **0.6** |
| Unemployment rate (a) | | | | 7.8 | 4.1 | 3.8 | 3.4 | **3.2** | **4.0** | **3.5** |
| Compensation of employees / head | | | | 1.7 | 2.3 | 2.6 | 2.9 | **3.2** | **-0.6** | **3.2** |
| Unit labour costs whole economy | | | | 1.1 | 1.3 | 1.5 | 2.7 | **3.5** | **5.3** | **-1.9** |
| Real unit labour cost | | | | -0.1 | 0.1 | 0.4 | 1.2 | **1.3** | **3.1** | **-3.5** |
| Saving rate of households (b) | | | | 16.9 | 17.6 | 17.9 | 18.5 | **18.7** | **24.8** | **20.7** |
| GDP deflator | | | | 1.2 | 1.2 | 1.0 | 1.5 | **2.2** | **2.1** | **1.6** |
| Harmonised index of consumer prices | | | | 1.6 | 0.4 | 1.7 | 1.9 | **1.4** | **0.3** | **1.4** |
| Terms of trade goods | | | | 0.1 | 2.3 | -1.6 | -1.1 | **1.2** | **3.2** | **0.0** |
| Trade balance (goods) (c) | | | | 6.5 | 8.1 | 7.8 | 6.8 | **6.7** | **5.5** | **6.3** |
| Current-account balance (c) | | | | 4.8 | 8.6 | 8.3 | 7.6 | **7.6** | **6.1** | **7.4** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | | 4.7 | 8.6 | 8.0 | 7.5 | **7.4** | **5.9** | **7.2** |
| General government balance (c) | | | | -1.7 | 1.2 | 1.2 | 1.9 | **1.4** | **-7.0** | **-1.5** |
| Cyclically-adjusted budget balance (d) | | | | -1.6 | 1.0 | 0.5 | 1.0 | **0.9** | **-3.8** | **-0.5** |
| Structural budget balance (d) | | | | - | 0.9 | 0.7 | 1.2 | **0.9** | **-3.8** | **-0.5** |
| General government gross debt (c) | | | | 69.5 | 69.2 | 65.3 | 61.9 | **59.8** | **75.6** | **71.8** |

(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.