2.2. GERMANY

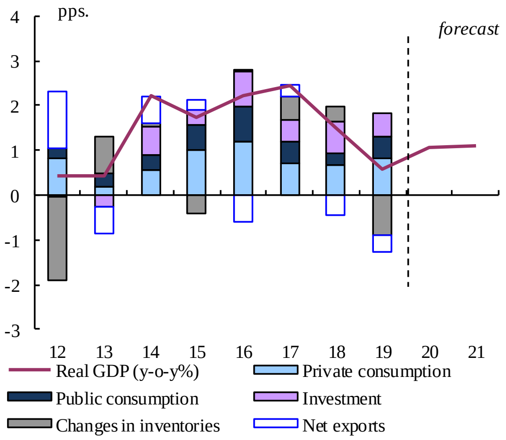
In 2019, GDP growth slowed to 0.6%, mainly as a result of weaker export growth and the continuing downturn in manufacturing.

Resilient domestic demand supported growth. Private consumption increased robustly amid record high employment and strong wage growth. Public consumption expenditure also rose markedly. Investment in construction gained further momentum. By contrast, equipment investment was almost stagnant, reflecting the protracted weakness in industrial production and depressed export expectations.

Exports are expected to start recovering gradually in line with the assumed modest recovery in world trade growth. However, demand for vehicles and investment goods, Germany's key exports, is likely to remain weak and to restrain new business investment in Germany. Indeed, recent high frequency short-term indicators do not yet point to a clear rebound in sentiment in the manufacturing sector. According to surveys, the assessment of order inflows, including for exports, has deteriorated and fallen to the lowest level since 2009. On the other hand, construction and private consumption should continue to sustain growth. Job growth in the service sector is expected to compensate the decline in manufacturing employment. Fiscal measures like the abolishment of the solidarity surcharge for the majority of households from 2021 on are also set to boost purchasing power.

Overall, real GDP growth is forecast to rebound somewhat to 1.1% in 2020, helped by a strong calendar effect (0.4 pps.). In 2021, the manufacturing sector is expected to return to growth and benefit from more favourable external demand. This should also spur business investment. With domestic demand increasing consistently, GDP growth should consolidate at 1.1% or above in 2021.

Graph 2.2: **Germany - Real GDP growth and contributions**



Downside risks relate to a prolonged impact of the coronavirus on foreign trade and supply chains to which the German industry is particularly exposed. They also relate to subdued business sentiment and continued investment restraint; lower-than-expected consumer confidence; and slower or weaker take-up of the planned fiscal stimulus. On the other hand, upward risks could stem from a more vigorous than expected recovery in the manufacturing sector that was particularly depressed last year.

Headline HICP inflation slowed from 1.9% in 2018 to 1.4% in 2019 driven by strong energy disinflation, whereas core inflation (all items excluding energy and unprocessed food) remained broadly unchanged at 1.4% from 1.5% a year earlier. Energy prices are not expected to fluctuate significantly this year and next. With services inflation responding somewhat more strongly to recent wage growth and robust domestic demand, inflation is expected to edge up slightly (1.5% in 2020, 1.6% in 2021) but remain moderate overall.