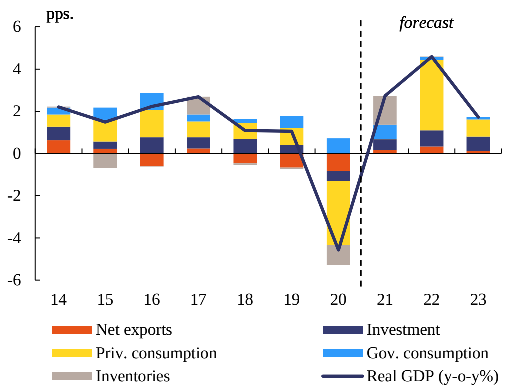
2. GERMANY

Easing of containment measures has spurred spending on services in recent months; however, supply bottlenecks are slowing down manufacturing and putting a lid on the rebound of exports and investment. Shortage of materials is also likely to add to inflation pressures over upcoming months, together with base effects and higher energy prices. Still, the economy and the labour market are well set to recover. The fiscal deficit is projected to narrow in 2022 and 2023, as policy support is withdrawn and the economy moves from recovery into expansion.

A mild rebound as restrictions ease

After declining by 2% quarter-on-quarter in Q1-2021, real GDP bounced back by 1.6% in Q2-2021. With the gradual relaxation of containment measures, private consumption partly recouped the losses of the winter months. Investment and export growth were, however, restrained by shortages of raw materials and intermediate goods, in particular semiconductors for auto- and equipment builders, lumber for the construction sector.

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



Lingering bottlenecks delay recovery

In Q3-2021, growth in services is expected to have benefited from rising vaccination rates and further easing of restrictions. Improvements in the accessibility of contact-intensive services are assumed to continue driving the recovery in consumption. On the other hand, despite strong demand, manufacturing and construction are still struggling with supply shortages, and exports and investment are likely to remain depressed for a few more months. Surveys suggest that supply bottlenecks in manufacturing could persist, while those in construction seem to be easing. Both sectors have significant order backlogs and their unwinding - subject to the easing of bottlenecks - is expected to translate to brisk export, investment and consumption growth in the course of 2022. Investment will also be supported by the implementation of the Recovery and Resilience Plan.

Overall, real GDP is projected to rebound by 2.7% in 2021. In 2022, the level of activity is forecast to be 4.6% higher than the year before, as all final demand components regain pre-crisis levels. In 2023, GDP is expected to grow by 1.7%, assuming a normalisation of supply and demand dynamics.

Employment on the mend

At 44.8 million in Q1-2021, employment was still 1.2% below the level of Q4-2019. After peaking at 4.1% in late 2020, the unemployment rate declined to 3.6% by August 2021. The number of employees on short-time work is estimated to have dropped to 610,000 in September, after having risen to 3.3 million in February 2021 (just over half of the peak reached in April 2020). Hiring expectations and the percentage of businesses reporting labour shortages are currently close to or higher than the pre-crisis level. This sets the stage for a resumption of employment and wage growth. While recent wage settlements in industry and construction have proved moderate so far, actual wages will also be driven by the return to normal work intensity as activity across sectors recovers.

With aggregate household disposable income remaining relatively stable and consumption limited by restrictions, the gross household saving rate increased to just above 23% in 2020 and is expected to remain there in 2021. On top of growing earnings, accumulated savings are expected to support the recovery in spending as supply shortages dissipate even if inflation runs higher than the subdued rate observed since 2013 (1.1% on average). The saving rate is expected to come down but not go below its pre-pandemic level of 18.4% as the spending affected by the restrictions can only be made up for to a limited extent.

Germany's current account surplus is set to narrow this year (to below 7% of GDP), due to the soft patch in exports in the second half, the resumption of foreign travel and more expensive imports. Over 2022-23, the surplus is expected to edge up again as pent-up export demand unravels, before resuming its trend of a gradual decline.

Inflation to increase temporarily

In 2021, the reinstatement of regular VAT rates, increased carbon taxes and rising commodity and energy prices, reinforced by strong demand are forecast to push inflation to 3.1% from just 0.3% a year before. Lingering supply bottlenecks and elevated energy prices are expected to keep inflation above 2% in 2022. Even if tightening, the labour market is not expected to generate significant additional price pressures. In 2023 inflation is then expected to slow to below 2%.

Deficit reaching a peak in 2021

With the bulk of the public support measures to counter the COVID-19 pandemic being paid out this year the government headline deficit is expected to peak at 6.5% of GDP. The phasing out of measures towards the end of this year is set to noticeably reduce the deficit thereafter to 2.5% in 2022 and 0.5% in 2023.

The extension of pandemic support measures comprises mostly subsidies to companies, prolongation of the short-time work scheme and increased healthcare spending for vaccination and testing. The reduction in government tax revenues due to the partial abolishment of the solidarity levy and increase in child allowances and other tax reliefs is to some extent compensated by the phasing in of a levy on CO2 emissions that will gradually increase over the coming years.

The bulk of COVID-19 measures of this year will only lead to a slight increase of the debt ratio to a peak above 71% of GDP in 2021. In line with the decreasing deficit in 2022 and 2023, the debt ratio is set to decline to 69% and 68% of GDP respectively. With the ending of the pandemic support measures at the end of this year, Germany can be expected to return to the debt reduction path seen before the outbreak of the pandemic.

Table II.2.1:

Main features of country forecast - GERMANY

		2020			Annual percentage change					
	bn EUR	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		3367.6	100.0	1.3	1.1	1.1	-4.6	**2.7**	**4.6**	**1.7**
Private Consumption		1708.0	50.7	0.8	1.4	1.6	-5.9	**0.0**	**6.7**	**1.6**
Public Consumption		754.6	22.4	1.7	1.0	3.0	3.5	**3.0**	**0.7**	**0.5**
Gross fixed capital formation		735.9	21.9	1.1	3.4	1.8	-2.2	**2.4**	**3.5**	**3.1**
of which: equipment		216.9	6.4	1.8	4.4	1.0	-11.2	**5.4**	**5.6**	**4.7**
Exports (goods and services)		1462.1	43.4	4.6	2.3	1.1	-9.3	**7.8**	**7.9**	**5.4**
Imports (goods and services)		1269.3	37.7	4.2	3.9	2.9	-8.6	**8.6**	**8.1**	**5.8**
GNI (GDP deflator)		3461.3	102.8	1.5	1.9	1.1	-5.0	**2.9**	**4.5**	**1.7**
Contribution to GDP growth:		Domestic demand		1.0	1.6	1.8	-2.8	**1.2**	**4.3**	**1.6**
		Inventories		-0.1	-0.1	-0.1	-0.9	**1.4**	**0.0**	**0.0**
		Net exports		0.4	-0.5	-0.7	-0.8	**0.2**	**0.3**	**0.1**
Employment				0.7	1.4	0.9	-0.8	**0.0**	**0.9**	**0.4**
Unemployment rate (a)				7.3	3.4	3.1	3.8	**3.6**	**3.4**	**3.2**
Compensation of employees / head				1.8	2.9	3.4	0.4	**3.1**	**3.3**	**2.9**
Unit labour costs whole economy				1.2	3.2	3.2	4.3	**0.4**	**-0.3**	**1.6**
Real unit labour cost				-0.1	1.2	1.2	2.7	**-2.2**	**-2.7**	**-0.2**
Saving rate of households (b)				17.1	18.7	18.4	23.3	**23.4**	**19.3**	**18.8**
GDP deflator				1.3	2.0	2.1	1.6	**2.6**	**2.4**	**1.8**
Harmonised index of consumer prices				1.5	1.9	1.4	0.4	**3.1**	**2.2**	**1.7**
Terms of trade goods				0.4	-1.0	1.1	2.9	**-3.2**	**-0.7**	**0.2**
Trade balance (goods) (c)				7.0	6.7	6.2	5.6	**5.1**	**5.3**	**5.6**
Current-account balance (c)				6.0	8.1	7.6	7.1	**6.7**	**6.8**	**6.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				5.9	7.9	7.5	6.7	**6.3**	**6.4**	**6.5**
General government balance (c)				-1.3	1.9	1.5	-4.3	**-6.5**	**-2.5**	**-0.5**
Cyclically-adjusted budget balance (d)				-1.1	1.3	0.9	-2.1	**-5.0**	**-2.6**	**-0.8**
Structural budget balance (d)				1.0	1.4	0.9	-2.1	**-5.0**	**-2.6**	**-0.8**
General government gross debt (c)				70.5	61.3	58.9	68.7	**71.4**	**69.2**	**68.1**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.