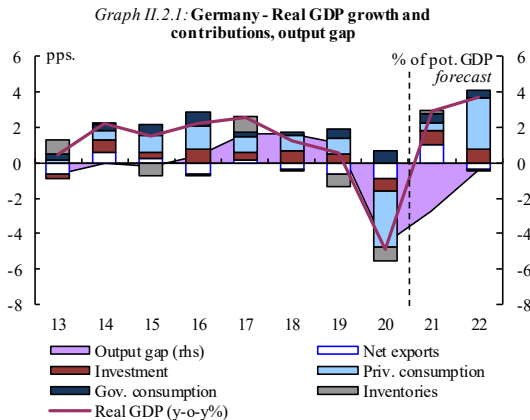


2. GERMANY

Lockdown measures have been depressing private consumption since December 2020 but a marked recovery in consumer spending and overall activity is expected from the second half of this year, as vaccination progresses and contact-intensive services reopen. Exports have been recovering since mid-2020 and are expected to continue supporting growth. Inflation is forecast to spike later this year due to temporary factors, but should ease again in 2022. Sizable fiscal measures to support the recovery remain in place throughout the year and should mitigate job losses and insolvencies. The fiscal deficit is set to increase in 2021 but to narrow in 2022.

Lockdowns halt the recovery in early 2021

Germany's economy grew by 0.5% in the fourth quarter of last year after a strong rebound in Q3. Overall, the decline in GDP for 2020 was 4.8%. The economy contracted by 1.7% in Q1 2021. Even if exports keep increasing, the stringent containment measures in place since last December have further depressed activity in the hospitality and leisure services as well as non-food retail. Although rebounding in March, industrial production was weakened by a shortage of semiconductor components early in the year. Construction was hampered by harsh weather.



An upswing expected in summer should continue in 2022

A pick-up in economic activity in the second half of the year is expected to be driven by the lifting of restrictions and the ongoing strength of exports. In April, private consumption remained constrained by suspended contact-intensive services. As vaccination progresses, however, restrictions should be gradually lifted, allowing a marked recovery in household spending. Largely unaffected by the restrictions, exports have been recovering since the second half of 2020. New orders in manufacturing are currently above pre-

pandemic levels. Business expectations point towards a continuation of these trends, which should spur a recovery in business investment. Housing investment is foreseen to regain strength in view of the high construction volumes authorised by permits. Economic activity is forecast to recover to its pre-crisis level in late 2021.

Overall, GDP is projected to rebound by around 3½% in 2021. In 2022, the level of activity is forecast to be around 4% higher than the year before, as private consumption regains pre-pandemic levels and investment growth continues.

Sizable policy support cushions labour market impact

Unemployment has stayed stable at 4½% since mid-2020 with job losses contained at 1.1% in 2020. The number of employees on short-time work has been picking up again since November last year, but remains – at 3.3 million in February – just over half of the peak reached in April 2020. Employment and wage growth are expected to start recovering over the coming quarters.

With aggregate household disposable income remaining relatively stable and consumption limited by restrictions, the gross household saving rate increased to 23½% in 2020 and is expected to remain similarly high in 2021. Accumulated savings are expected to fuel a rebound in spending in tandem with the lifting of restrictions. The saving rate is expected to come down but not go below its pre-pandemic level of 18½% due to the limited deferability of the spending affected by the restrictions and the concentration of savings in higher income households.

Altogether, sound balance sheets and public support to non financial corporations should help to avoid a massive wave of insolvencies. The restrictions on activity, however, have affected

many small businesses and have fuelled a decline in self-employment.

Germany's current account surplus is set to climb to nearly 8% of GDP in 2021, reflecting buoyant export growth and imports dragged down by depressed consumption and investment in the first half of the year. In 2022, the surplus is expected to decline again as foreign travel resumes and recovering domestic demand spurs imports.

Inflation to soar temporarily

HICP inflation fell from 1.4% in 2019 to 0.4% in 2020 amid weak demand, cheaper energy and reduced VAT rates. In 2021, the reinstatement of regular VAT rates, increased carbon taxes and rising commodity prices, reinforced by a rebound in spending are forecast to push inflation to 2.4% in 2021. As base effects dissipate and lower energy prices exert a disinflationary effect, inflation is expected to ease to 1.4% in 2022.

Fiscal measures continue to support the recovery in 2021

The government balance deteriorated by 5.7 pps. to a deficit of 4.2% of GDP in 2020, due to the size of public support measures related to the COVID-

19 pandemic. Still, the deficit turned out smaller than expected, due to delays in the pay-out of support measures of 1% to 2% of GDP, which will only materialise in 2021.

Thus, together with the revised set of pandemic support measures amounting to a little more than 6% of GDP, the deficit is projected to reach around 7½% of GDP in 2021. The revised measures comprise subsidies to companies and increased spending on COVID-19 testing and vaccination. If pay-outs from these measures turn out smaller than budgeted, the deficit could be lower. In 2022, the deficit is forecast to decrease to around 2½% of GDP. These projections include fiscal measures to be financed by the RRF of around 0.3% of GDP in 2021 and 0.1% in 2022.

Public debt increased by around 10 pps. of GDP in 2020 to almost 70% of GDP and is projected to increase further to around 73% in 2021, before falling to around 72% in 2022. The increase in public debt is driven by the fiscal measures to fight the pandemic and the functioning of automatic stabilisers, but also includes equity injections in companies in the transport and travel sector.

Table II.2.1:

Main features of country forecast - GERMANY

	2019		01-16	Annual percentage change						
	bn EUR	Curr. prices		% GDP	2017	2018	2019	2020	2021	2022
GDP	3449.1	100.0	1.2	2.6	1.3	0.6	-4.9	3.4	4.1	
Private Consumption	1806.9	52.4	0.8	1.5	1.5	1.6	-6.1	0.1	7.3	
Public Consumption	704.5	20.4	1.6	1.6	1.2	2.7	3.3	3.6	1.0	
Gross fixed capital formation	748.0	21.7	0.7	2.5	3.5	2.5	-3.1	3.2	3.9	
of which: equipment	240.1	7.0	1.4	4.2	4.4	0.5	-12.1	9.0	6.0	
Exports (goods and services)	1617.4	46.9	4.7	4.7	2.3	1.0	-9.4	10.4	4.8	
Imports (goods and services)	1417.4	41.1	3.9	5.3	3.6	2.6	-8.5	7.9	7.2	
GNI (GDP deflator)	3542.8	102.7	1.4	2.5	1.6	0.6	-4.8	3.3	4.0	
Contribution to GDP growth:										
Domestic demand			0.9	1.6	1.8	1.9	-3.2	1.5	4.8	
Inventories			-0.1	0.8	-0.1	-0.7	-0.8	0.4	0.0	
Net exports			0.5	0.1	-0.4	-0.6	-0.9	1.5	-0.6	
Employment			0.6	1.4	1.4	0.9	-1.1	-0.2	0.9	
Unemployment rate (a)			7.5	3.8	3.4	3.1	3.8	4.1	3.4	
Compensation of employees / head			1.8	2.6	2.9	3.0	0.5	2.8	2.9	
Unit labour costs whole economy			1.1	1.4	3.0	3.3	4.5	-0.8	-0.2	
Real unit labour cost			-0.2	0.0	1.3	1.1	2.9	-2.4	-1.7	
Saving rate of households (b)			17.0	17.9	18.3	18.4	23.5	24.4	18.9	
GDP deflator			1.3	1.4	1.7	2.2	1.6	1.6	1.5	
Harmonised index of consumer prices			1.5	1.7	1.9	1.4	0.4	2.4	1.4	
Terms of trade goods			0.5	-1.6	-1.0	1.1	2.9	-2.2	0.1	
Trade balance (goods) (c)			6.8	7.7	6.7	6.4	5.8	6.4	6.0	
Current-account balance (c)			5.5	8.0	7.6	7.3	7.2	7.8	6.9	
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			5.4	7.7	7.4	7.1	6.9	7.4	6.6	
General government balance (c)			-1.5	1.4	1.8	1.5	-4.2	-7.5	-2.5	
Cyclically-adjusted budget balance (d)			-1.4	0.6	1.1	1.0	-1.8	-6.2	-2.5	
Structural budget balance (d)			1.0	0.8	1.2	1.0	-1.8	-6.2	-2.5	
General government gross debt (c)			70.1	65.1	61.8	59.7	69.8	73.1	72.2	

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