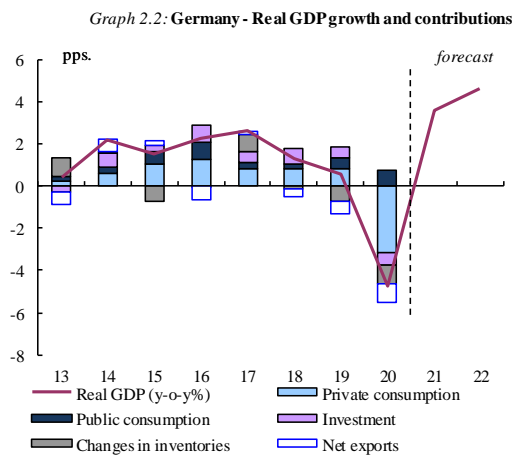


2.2. GERMANY

After declining by 1.8% q-o-q in the first quarter of this year and in line with the gradual relaxation of containment measures, real GDP is expected to bounce back by 1.7% in the second quarter and by 3.6% in the third. On an annual basis, real GDP is expected to increase by 3.6% in 2021 and 4.6% in 2022. This is somewhat higher than projected in spring, largely due to the faster improvement in the health situation and more favourable trends in business confidence.

Since the spring forecast, the accelerating pace in the administration of vaccines and declining infection rates have prompted a gradual relaxation of the restrictions throughout May and June, although with significant regional variation. Business sentiment in hard-hit service sectors has been improving since March. Despite some supply bottlenecks, strong order inflows should fuel an expansion in manufacturing and construction over the coming months. All in all, after a mild rebound in the second quarter, growth is expected to strengthen significantly in the third. Increasing household incomes, benefitting from continued policy support, and the unwinding of accumulated savings are expected to fuel a vigorous recovery in private consumption. Private and public investment are expected to strengthen on the back of a favourable outlook for domestic and external demand and the implementation of the Recovery and Resilience Plans across the EU, which should benefit Germany both directly and indirectly.



Rising energy prices, spurred by the phasing-in of carbon pricing, explain part of the rise in HICP inflation since January. Increasing inflation observed for services and non-energy industrial goods also signal strong demand and rising supply costs. The reversal of the VAT rebate implemented in the second half of last year is set to trigger a temporary jump in inflation in the third and fourth quarters of 2021. However, continued slack in the labour market, reflected in the depressed level of hours worked, should keep a lid on temporary price pressures. After picking up to 2.8% in 2021, inflation is expected to decline to 1.6% in 2022.