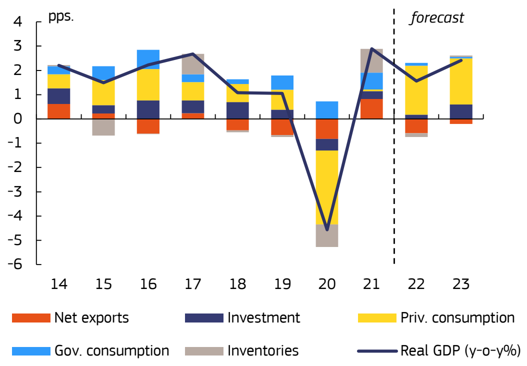
2. GERMANY

High energy and raw material costs and supply bottlenecks are holding back the rebound of exports and investment. This is, however, offset by recovering spending on services, a solid labour market and the use of accumulated savings, which are expected to drive private consumption growth despite the surge in inflation (6.5% in 2022 and 3.1% in 2023). GDP is forecast to grow by 1.6% in 2022 and 2.4% in 2023. The general government deficit is expected to continue decreasing (2.5% in 2022 and 1% in 2023) as additional public spending on defence, the green transition and in reaction to heightened energy prices is compensated by solid tax revenues.

Another interrupted rebound

Following subdued growth in 2022-Q1, at 0.2%, the relaxation of COVID-19 containment measures in early 2022 supported the consumption of contact-intensive services. In January and February industrial and construction activity was up relative to late 2021. However, in March, the fallout of the Russian invasion of Ukraine and the imposition of COVID-19-related lockdowns in some of China's industrial hubs resulted in renewed supply bottlenecks, soaring energy and material costs and a further uptick in already high consumer price inflation.

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



A host of headwinds

These developments are expected to be a drag on growth in the upcoming quarters, with manufacturing and exports set to continue to be slowed by trade disruptions caused by the war in Ukraine and the lockdowns in China. Germany is intensifying the steps to reduce its dependency on Russian energy by diversifying suppliers and speeding up the take-up of renewables, among other measures. However, in the short-to-medium term, still high energy prices are expected to depress production in key sectors in early stages of the value chain (such as metals and chemicals).

Uncertainty about the outcome of the war in Ukraine is projected to have a negative impact on investment. At the same time, the unwinding of significant industry and construction order backlogs should benefit growth later this year and in 2023, as some of the supply bottlenecks ease. Household consumption is set to be impaired by elevated prices, although in the coming quarters this is expected to be partly offset by the ongoing recovery in the spending that had been constrained by the pandemic.

Overall, real GDP is projected to fall in Q2-2022. Growth is set to remain muted at 1.6% in 2022 and to strengthen somewhat to 2.4% in 2023 as the economy adapts to trade disruptions. The possibility of a sudden stop of gas delivery from Russia entails a significant downside risk to the outlook.

Employment continues to improve

After peaking at 4.1% in late 2020, unemployment declined to a historically low 2.9% in March 2022. Although the easier conditions for access to the short-time work scheme have been extended until mid-2022, its take-up has been very low in recent months. In 2022-Q1, employment recovered to the pre-pandemic level. Hiring expectations are altogether close to pre-crisis levels and reported labour shortages continue increasing.

Wages grew by 3.5% in 2021, partly through a recovery in hours worked. Wage growth is set to continue in 2022 and 2023, supported by an increase in the minimum wage and a tightening labour market. However, the inflation compensation in the wage negotiations later this year (notably in the engineering and chemical sectors and civil service) is expected to be partial and staggered. With consumption still limited by restrictions, the household saving rate remained high at 22.6% in 2021. For 2022 and 2023 it is expected to decline to offset higher prices as spending picks up.

Germany's current account surplus is set to decline in 2022 (to just above 6% of GDP), due to trade disruptions, the resumption of foreign travel and more expensive energy imports. In 2023, the surplus is expected to edge up again as export growth picks up.

Inflation to stay elevated

In April 2022 HICP inflation soared to 7.8% and is expected to reach 6.5% for the year on average, driven by the surge in energy prices and rising input costs amid strong demand. Lingering pass-through of higher costs into prices, and a boost to service sector wages, due to an increase in the minimum wage in late 2022, are expected to maintain inflation above 3% in 2023.

Deficit and debt level decreasing

In 2021, the deficit decreased to 3.7% of GDP, turning out lower than initially expected, mostly due to a smaller take-up of the measures to alleviate the impact of the pandemic.

In 2022, the deficit is projected to decrease to 2.5% of GDP. While pandemic-related support measures are phased out, measures in response to the war in Ukraine like additional spending for defence and humanitarian aid increase government expenditure, as does green investment by the Energy- and Climate Fund. Furthermore, in reaction to the rising energy prices, the government has adopted a series of targeted one-time payments to households that weigh on the budget in 2022. At the same time, robust tax revenues are set to lead to an overall improvement of the headline balance.

In 2023, the government plans to increase its spending in defence, while tax revenues are projected to continue rising. Consequently, the deficit is expected to decrease to 1.0% of GDP.

Government debt peaked in 2021 at 69.3% of GDP and is projected to decrease to 66% in 2022 and 64% in 2023. This declining debt ratio is partly driven by the impact elevated inflation has on growth of nominal GDP, as well as the reduction in the portfolio of bad banks and the use of cash reserves accumulated during the height of the pandemic. Germany is returning to a path of debt reduction similar to that seen before the pandemic.

Table II.2.1:

Main features of country forecast - GERMANY

		2021			Annual percentage change						
	bn EUR	**Curr. prices**	**% GDP**	**02-17**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
GDP		3570.6	100.0	1.3	1.1	1.1	-4.6	**2.9**	**1.6**	**2.4**
Private Consumption		1763.0	49.4	0.8	1.4	1.6	-5.9	**0.1**	**4.1**	**3.7**
Public Consumption		801.3	22.4	1.7	1.0	3.0	3.5	**3.1**	**0.5**	**0.2**
Gross fixed capital formation		783.9	22.0	1.1	3.4	1.8	-2.2	**1.5**	**0.8**	**2.7**
Exports (goods and services)		1694.6	47.5	4.6	2.3	1.1	-9.3	**9.9**	**2.4**	**4.2**
Imports (goods and services)		1497.0	41.9	4.2	3.9	2.9	-8.6	**9.3**	**4.1**	**5.1**
GNI (GDP deflator)		3678.5	103.0	1.5	1.9	1.1	-5.0	**3.1**	**1.3**	**2.4**
Contribution to GDP growth:		Domestic demand		1.0	1.6	1.8	-2.8	**1.1**	**2.3**	**2.6**
		Inventories		-0.1	-0.1	-0.1	-0.9	**1.0**	**-0.2**	**0.1**
		Net exports		0.4	-0.5	-0.7	-0.8	**0.8**	**-0.6**	**-0.2**
Employment				0.7	1.4	0.9	-0.8	**0.0**	**0.8**	**0.5**
Unemployment rate (a)				6.8	3.2	3.0	3.7	**3.6**	**3.3**	**3.2**
Compensation of employees / head				1.8	2.9	3.4	0.4	**3.4**	**3.4**	**4.0**
Unit labour costs whole economy				1.2	3.2	3.2	4.3	**0.5**	**2.6**	**2.1**
Saving rate of households (b)				17.1	18.7	18.4	23.3	**22.6**	**18.2**	**15.8**
GDP deflator				1.3	2.0	2.1	1.6	**3.0**	**5.4**	**3.6**
Harmonised index of consumer prices				1.5	1.9	1.4	0.4	**3.2**	**6.5**	**3.1**
Terms of trade goods				0.4	-1.0	1.1	2.9	**-4.2**	**-1.8**	**1.8**
Trade balance (goods) (c)				7.0	6.7	6.2	5.6	**5.1**	**4.7**	**5.2**
Current-account balance (c)				6.0	8.1	7.6	7.1	**7.2**	**6.1**	**6.5**
General government balance (c)				-1.3	1.9	1.5	-4.3	**-3.7**	**-2.5**	**-1.0**
Structural budget balance (d)				0.9	1.3	0.7	-2.4	**-2.6**	**-1.8**	**-1.0**
General government gross debt (c)				70.5	61.2	58.9	68.7	**69.3**	**66.4**	**64.5**

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