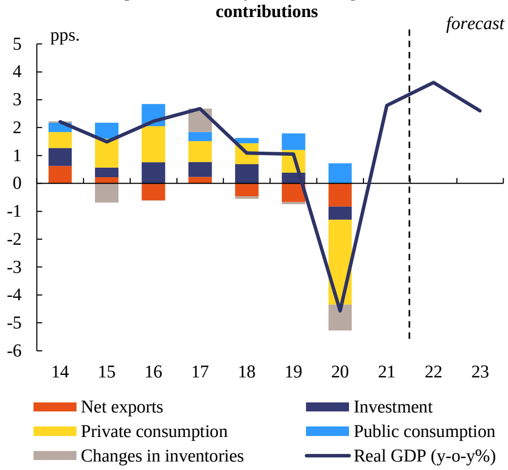
2.2. GERMANY

After contracting by 4.6% in 2020, the German economy rebounded by 2.8% in 2021. In the second and third quarters of the year, the economy benefited from the easing of the pandemic-related restrictions and a rise in private consumption, growing by 2.2% and 1.7%, respectively. Exports and investment were a drag on growth in the third quarter, as supply bottlenecks held back production activity, notably in the automotive sector, and depressed business sentiment. In the fourth quarter, GDP declined by 0.7%. Investment dropped further, while the recovery in private consumption was halted by the new infection wave and elevated consumer price inflation, including soaring energy prices.

Employment remained below its pre-crisis peak throughout 2021. However, the labour market has been improving steadily since the second quarter of last year, supported by the extension of regulations on short-time work and by recovering labour demand. Wages increased by 3.2% after stagnating the previous year. The net saving rate of households eased to 15.0%, from 16.1% in the previous year, but remained significantly above its pre-crisis level of 10.8% due to the re-emergence of factors restraining consumption.

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



With infection rates still rising, private consumption is expected to remain subdued in early 2022, particularly for services. In addition, exports are set to continue suffering from supply chain disruptions. Activity is also likely to be slowed down by sickness-related absenteeism. As a result, the economy is expected to stagnate in the first quarter of this year.

The expansion of the economy is set to resume in the second quarter, favoured by assumed subsiding infection rates and supply bottlenecks. Moreover, record-high manufacturing order books, in particular in the investment goods industries, suggest that exports and domestic sales of equipment and vehicles are likely to grow again especially as sentiment in industry has improved at the turn of the year. Accumulated savings should spur a resumption in the recovery in consumer spending, even if rising consumer prices somewhat dent purchasing power.

Overall, real GDP is forecast to expand by 3.6% in 2022, implying a return to its pre-crisis level in the course of the year. In 2023, GDP is expected to continue growing by 2.6% as restraints on pent-up consumer and investment demand dissipate.

HICP inflation soared to 6.0% in November and 5.3% in December, raising the annual rate in 2021 to 3.2%, from just 0.4% a year before. This was mainly driven by the reinstatement of regular VAT rates, increased carbon taxes and rising commodity prices, reinforced by strong pent-up demand. Lingering supply bottlenecks, higher energy prices and waning labour market slack are expected to lead to even higher inflation in 2022. A series of minimum wage increases, in particular 6.4% in July and 14.8% in October 2022 are expected to give a boost to wage growth in consumer services and overall in both 2022 and 2023. In 2023, inflation is expected to moderate. Still, robust aggregate demand, and the tight labour market are expected to keep it above 2% in 2023.