German economy: uncertainty remains despite rebound

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ABSTRACT

Following prolonged coronavirus-related lockdowns, the German economy is slowly beginning to experience growth again. Due to an increasing number of vaccinated people and declining infection rates, many branches are hoping for a return to normal business operations, especially service providers in sectors hit hard by the pandemic, such as the cultural, event, and travel sectors. German industry, which fared better over the past few months than during the first lockdown in 2020, is being held back by worsening raw material shortages. Nevertheless, at 3.2 percent for 2021 and 4.3 percent for 2022, the growth of economic output in Germany is expected to be somewhat higher compared to spring 2021. However, the forecast remains subject to considerable uncertainty. Another flare-up of new infections could lead to setbacks as well as to a large wave of insolvencies. However, the situation could develop better if the infection rate remains low and private consumption picks up more quickly and sustainably than expected.

The German economy is on a recovery course following the flattening of the third wave of the coronavirus. The sectors affected by the lockdowns are restarting operations and a strong global economy is leading to a brisk demand for products "Made in Germany." German industry was able to maintain its production and a powerful recovery will begin for many service sectors in summer 2021 as infection rates sink and the vaccination campaign continues. GDP will increase at a strong rate over the further course of 2021 (Figure). However, despite growth of 3.2 percent in 2021 (Table), capacities remain underutilized. With an average annual increase of 4.3 percent, normal utilization will be reached in 2022. A failure to invest, a lack of innovation and start-ups, distortions on the labor market and in vocational training and education, and business closures have damaged potential.

In the present forecast, it is assumed that the incidence can be kept permanently low enough for all sectors to return to regular operations only from late summer 2021 onward. With the number of unvaccinated people still high, increases in infection rates are expected; at least regionally, re-openings will have to be reversed over the next weeks. Thus, recovery in the service sector is progressing but taking longer than in summer 2020.

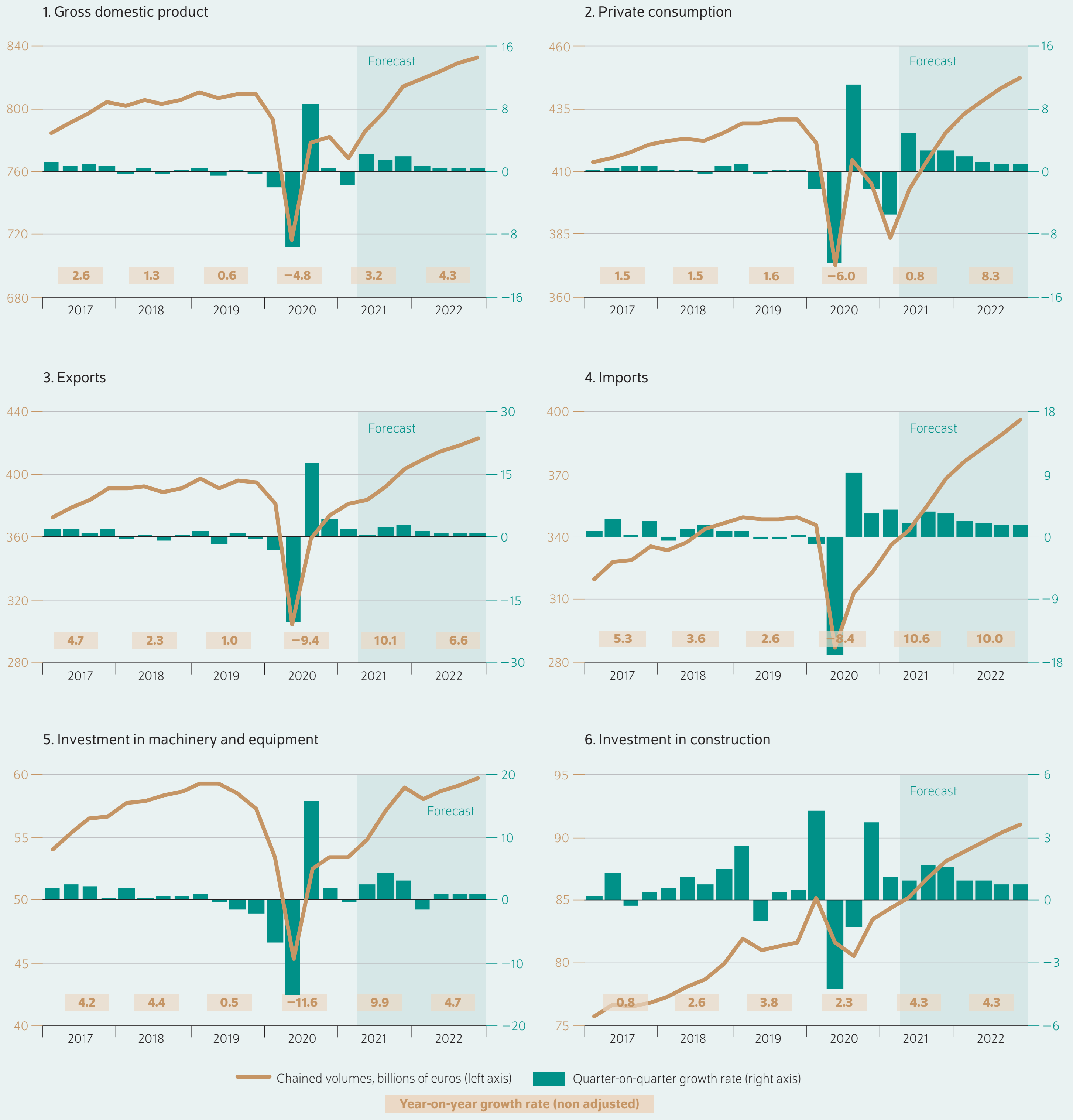
The upswing in industry, however, is progressing under difficult conditions. Foreign demand in particular is booming in the wake of international economic recovery programs. However, production was initially somewhat stunted by massive bottlenecks in advance payments, but presumably only until late summer 2021. **Exports** reflect these delays, as they will not return to full speed until later in the year.

The coronavirus pandemic has noticeably weighed on the **labor market** over the course of the lockdown. As in spring 2020, companies combated restricted business activity primarily through massively implementing **short-time work**. Short-time work will be noticeably reduced over the course of the recovery and thus contribute significantly to labor input, which is necessary for a noticeable increase in value added in the remaining quarters of 2021. However, the number of employed persons is likely to expand more strongly with an end to the pandemic in sight.

DOI: https://doi.org/10.18723/diw_dwr:2021-23-3

Figure

Gross domestic product and use of GDP
Seasonally and working day adjusted



Sources: Federal Statistical Office; DIW Berlin Economic Outlook Summer 2021. Forecast from 2021 Q2 onward.

Table 1

Key economic indicators for the German economy

	2017	2018	2019	2020	2021	2022
Real GDP[1] (percent change over previous year)	2.6	1.3	0.6	−4.8	3.2	4.3
Domestic employment (1 000 persons)	44 262	44 868	45 269	44 818	44 741	45 084
Unemployed (ILO concept)	1 621	1 468	1 373	1 846	1 901	1 631
Unemployed (BA concept)	2 533	2 340	2 267	2 695	2 666	2 327
Unemployment rate[2] (ILO concept)	3.8	3.4	3.2	4.2	4.3	3.7
Unemployment rate[2] (BA concept)	5.7	5.2	5.0	5.9	5.8	5.1
Consumer prices	1.5	1.8	1.4	0.5	2.7	1.8
Unit labor costs[3]	1.1	2.8	3.2	4.2	0.2	0.0
Government budget balance[4]						
in billion EUR	44.4	61.6	52.5	−149.2	−160.7	−79.4
in percent of GDP	1.4	1.8	1.5	−4.5	−4.5	−2.1
Current account balance, in percent of GDP	7.8	7.9	7.5	7.0	6.6	5.4

1 Price-adjusted, chain-linked
2 As a share of domestic labor force (ILO), resp. Civilian labor force (BA)
3 Compensation of employees (national concept) per hour worked over real GDP
4 According to ESA 2010

Sources: Data from national and international institutions; DIW Berlin Economic Outlook Summer 2021; forecast from 2021 onward.

Table 2

Use of GDP, quarter-on-quarter growth rates

Price, seasonally and working-day adjusted, in percent

	2020				2021				2022			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	−2.2	−11.5	11.2	−2.3	−5.4	5.0	2.8	2.7	1.9	1.2	1.0	1.0
Public consumption	1.1	1.3	1.0	0.1	0.2	0.3	0.5	0.3	0.2	0.2	0.1	0.1
Gross fixed capital formation	−0.4	−6.7	3.7	2.5	0.3	1.4	2.3	1.9	0.2	0.9	0.8	0.8
Investment in machinery and equipment	4.3	−4.3	−1.3	3.7	1.1	0.9	1.7	1.6	0.9	0.9	0.8	0.7
Construction investment	−6.8	−15.1	15.9	1.9	−0.2	2.6	4.3	3.2	−1.4	1.1	0.9	0.9
Other investment	−2.5	0.2	0.9	0.1	−1.6	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Change in inventories[1]	0.1	−0.1	−1.9	0.5	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic uses	−1.0	−7.6	5.1	−0.2	−1.3	3.0	2.2	2.0	1.1	0.9	0.8	0.8
Net exports[1]	−1.1	−2.4	3.8	0.7	−0.6	−0.5	−0.4	0.0	−0.3	−0.2	−0.2	−0.2
Exports	−3.3	−20.4	17.9	4.4	1.8	0.6	2.2	3.1	1.4	1.2	1.1	1.1
Imports	−1.1	−16.9	9.2	3.3	3.8	1.9	3.7	3.4	2.3	1.9	1.7	1.7
GDP	**−2.0**	**−9.7**	**8.7**	**0.5**	**−1.8**	**2.3**	**1.6**	**1.9**	**0.7**	**0.6**	**0.5**	**0.5**
Gross value added	**−1.6**	**−10.3**	**8.3**	**0.5**	**−0.8**	**2.3**	**1.6**	**1.9**	**0.7**	**0.6**	**0.5**	**0.5**
Manufacturing	−3.6	−18.6	14.4	6.6	0.4	−0.5	2.0	3.1	1.3	0.9	0.8	0.8
Construction	4.1	−3.0	−3.0	9.1	−4.9	1.6	1.7	1.5	0.9	0.8	0.8	0.8
Trade, accomodation, transport	−1.1	−14.0	13.7	−2.3	−3.2	5.3	2.8	3.0	0.7	0.7	0.4	0.4
Business and production services	−1.8	−11.1	4.6	1.4	0.0	1.1	1.5	2.2	0.7	0.7	0.5	0.5
Public admin, community and social services	−1.4	−7.6	9.7	−3.9	−0.3	3.9	1.0	0.8	0.4	0.4	0.4	0.4

1 Contribution to GDP growth in percentage points

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Summer 2021, forecast from Q2 2021 onward.

Due to the declines in the 2020 winter half-year, there will be 76,000 fewer employed people compared to 2020 in 2021 on average. Thanks to dynamic growth over the further course of 2021, it will increase by 340,000 people in 2022. In 2021, **unemployment** will decrease accordingly little to 5.8 percent. However, over the course of 2022, it will reduce markedly more on average to 5.1 percent. Until recently, **wage growth** came close to matching the solid increases seen before the crisis. In 2021, hourly wages should increase noticeably, by over 2.5 percent, and by almost two percent in 2022.

Inflation will remain moderate over the entire forecast period. However, at 2.7 percent, it is decidedly higher in 2021. In addition to the end of the VAT reduction and rapidly increasing oil prices, a further factor has been driving inflation over the past weeks: global bottlenecks in many important raw materials and advance payments have led to massive price increases for these goods. This is likely to continue for the time being but will presumably subside from late summer 2021 onward. Altogether, inflation will temporarily exceed three, partially 3.5 percent, and it will be 2.7 percent for 2021 as a whole. Inflation will decrease to 1.8 percent in 2022, as most non-recurring effects will no longer apply. Thereby, the increase by two-tenths of a percentage point due to the renewed carbon tax increase is included.

Lockdown restrictions primarily curtailed **private consumption**. Diversionary effects could also not prevent consumption from collapsing. However, unspent funds were saved and cash reserves in particular skyrocketed. As was the case in 2020, repealing lockdown measures is associated with a rapid increase in consumption. Wage incomes will increase by five percent in both 2021 and 2022, with an even greater net increase in 2021. Despite a restrained increase in income from self-employment and assets—a stronger increase is expected in 2022—available income will grow noticeably in 2021 and 2022. Moreover, households are likely to return to normal saving behavior. After the savings rate ballooned to 20.1 percent at the beginning of 2021, which is almost equal to the record level of the second quarter of 2020, it should sink markedly over the course of the year and achieve the pre-crisis level of almost 11 percent in 2022. Nominally, consumer spending will increase powerfully, in real terms it will be damped by higher inflation in 2021.

Equipment investment is developing robustly, particularly against the backdrop of the rapidly improving global economy, but also due to the progress made in combating the pandemic. Together with high capacity utilization in industry, private investments are likely to increase strongly. **Public investment in equipment** is also providing impetus, in particular due to the projects in the German government's climate and future packages. **Building investments** were off to a better start in 2021 than expected at the beginning of the year, when it experienced a primarily weather-related production collapse. High demand for living space remains unaffected: building permits for new construction achieved its highest number in 15 years. However, the global shortage of important building materials, such as lumber and steel, is temporarily stunting growth.

Imports will continue a noticeable upward trend over the course of increasing domestic growth and the sustained powerful global economic growth; however, it will be temporarily dampened by strong price increases. Travel is expected to pick up as the pandemic is contained, as it had already spiked temporarily in recent months. The **current account balance** will decrease to 5.4 percent by 2022 in relation to economic output.

Restrictions on economic activity during the lockdown also affected **public finances**. At almost 161 billion euros, the deficit is expected to be around ten billion euros higher in 2021 than in 2020. On the one hand, the rebounding economy is driving revenue from taxes and social contributions. Moreover, the renewed increase in the VAT rate and, primarily, rising private consumption are boosting sales tax revenues. On the other hand, expenditures are rising: The vaccination and testing strategy is noticeably increasing government purchases and the emergency measures account for around 25 billion euros in the first quarter of 2021. Ten and five billion euros, respectively, are expected to flow out as investment grants from the future package contained in the economic stimulus program, which is also boosting public investment. A noticeable deficit of 79 billion euros is also expected for 2022. Previously at 70 percent in 2020, the **debt-to-GDP-ratio** is likely to be 72 percent in 2021 and 69 percent in 2022.

As long as the pandemic is not contained, this forecast is subject to considerably more uncertainty than usual. A further wave of infections could occur, especially in late fall 2021, due to the colder weather, new virus mutations, stalled vaccination progress, or a decrease in vaccination protection. Such factors would lead to a setback in economic activity. However, it is also possible case numbers can be sustained at the current low level. In that case, a more rapid recovery will take place, especially for the service sector. A more drastic number of insolvencies than assumed here would slow growth, especially over the further course, as fewer capacities would be available and indirect income effects will dampen consumer spending. The current shortage in important materials and supplies could last longer; this would stunt industrial growth primarily but also increasingly result in higher consumer prices and thus weigh on consumer spending. By contrast, consumption may receive a much stronger boost if the savings accumulated during the crisis were to be spent to a much greater extent.

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JEL: E32, E66, F01

Keywords: Business cycle forecast, economic outlook

LEGAL AND EDITORIAL DETAILS

DIW BERLIN

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
www.diw.de
Phone: +49 30 897 89–0 Fax: –200
Volume 11 June 18, 2021

Sale and distribution
DIW Berlin Leserservice, Postfach 74, 77649 Offenburg
leserservice@diw.de
Phone: +49 1806 14 00 50 25 (20 cents per phone call)

Layout
Roman Wilhelm, Stefanie Reeg, DIW Berlin

Cover design
© imageBROKER / Steffen Diemer

Composition
Satz-Rechen-Zentrum Hartmann + Heenemann GmbH & Co. KG, Berlin

ISSN 2568-7697