German economy: a recession is not automatically a crisis

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ABSTRACT

The slowdown in the global economy and the uncertainties caused by Brexit have affected the export-oriented German economy, which is expected to grow by only 0.5 percent this year. However, the German economy has not slid into a crisis due to marked fiscal policy stimuli and favorable developments on the labor market. Private consumption remains a mainstay of the economy; in addition, there is moderate inflation, which will barely dampen purchasing power over the next two years. Together with slightly stronger foreign demand, these factors will ensure that the German economy recovers somewhat over next year and the year thereafter. The economy is likely to grow by 1.4 percent in 2020 and 2021 as long as the serious political risks do not materialize. A no-deal Brexit, for example, would reduce growth in Germany by 0.4 percent in 2020.

The German economy is currently experiencing a period of weakness. After the export-driven booms in 2016 and 2017, a noticeable slowdown began in 2018, which initially seemed to be triggered by temporary factors in the automotive sector. However, it is now clear that the industry is facing bigger problems. Global demand for capital goods is weak, negatively affecting the export-oriented German economy in particular (see Figure). Industrial production has been declining for a year now, causing Germany to slide into a recession in the second half of the year.

Despite a strong start to the year, GDP will only grow by 0.5 percent[1] in 2019 and be roughly equal to its production potential. The phase of high capacity utilization will end. Over the next two years, the economy should be operating at roughly normal capacity. Companies are less confident across the board. The industrial downturn is now also affecting the service sector, as it is reducing demand for business-related services and, through weaker employment growth, is putting pressure on consumer-related sectors.

The global economic slowdown and uncertainties relating to Brexit and trade conflicts are the primary reasons the German economy has weakened. Demand for German exports is likely to remain below average over the forecast period (Table 1). Employment growth will also continue, albeit at a slower pace. Following last year's increase in employment of over 600,000 persons, this year's increase will slow to just under 400,000; over the next two years it will be around 200,000 each year. Weaker economic development as well as shortages in the labor market are leading to lower employment growth and preventing stronger growth. The unemployment rate this year is expected to be five percent and will sink to 4.9 percent and 4.7 percent, respectively, over the next two years while wages will continue to rise strongly.

1 The 68-percent confidence interval resulting from the forecast errors of the previous five years is between 0.0 and 0.9 percent for this year and between 0.9 and 1.8 percent for next year.

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Table 1

Use of GDP, quarter-on-quarter growth rates

Price, seasonally and working-day adjusted, in percent

	2019				2020				2021			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	0.8	0.1	0.3	0.2	0.7	0.4	0.3	0.3	0.7	0.5	0.3	0.3
Public consumption	0.8	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4
Gross fixed capital formation	1.6	−0.1	0.2	0.5	0.9	0.8	0.6	0.6	0.9	0.7	0.5	0.5
Investment in machinery and equipment	2.5	−1.0	0.6	0.8	0.8	0.8	0.5	0.5	0.8	0.8	0.3	0.4
Construction investment	1.4	0.6	−0.9	0.0	0.8	0.6	0.6	0.6	0.9	0.6	0.6	0.6
Other investment	−0.6	1.0	0.9	0.8	1.1	0.9	0.8	0.8	1.1	0.8	0.8	0.8
Change in inventories[1]	−1.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic uses	−0.1	0.5	0.3	0.3	0.7	0.5	0.4	0.4	0.7	0.5	0.4	0.3
Net Exports[1]	0.5	−0.5	−0.4	−0.1	−0.2	−0.1	−0.1	0.0	−0.2	−0.2	−0.1	0.0
Exports	1.8	−1.3	−0.4	0.6	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Imports	0.9	−0.3	0.5	0.8	1.2	0.9	0.6	0.5	1.0	0.8	0.6	0.5
Gross domestic product	**0.4**	**−0.1**	**−0.2**	**0.2**	**0.4**	**0.3**	**0.3**	**0.3**	**0.5**	**0.4**	**0.3**	**0.3**
Gross value added	**0.4**	**−0.3**	**−0.1**	**0.2**	**0.4**	**0.3**	**0.3**	**0.3**	**0.5**	**0.3**	**0.3**	**0.3**
Manufacturing	−1.0	−1.4	−1.0	0.2	0.5	0.5	0.5	0.5	0.6	0.5	0.5	0.5
Construction	1.1	−0.5	0.5	0.8	0.8	0.8	0.5	0.5	0.7	0.7	0.4	0.4
Trade, accomodation, transport	2.3	−0.6	0.5	0.2	0.7	0.5	0.4	0.4	1.0	0.6	0.4	0.4
Business and production services	0.7	0.0	−0.2	0.0	0.7	0.4	0.4	0.4	0.5	0.4	0.4	0.4
Public admin., community and social serv.	−0.2	0.4	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1

1 Contribution to GDP growth in percentage points.

Source: Federal Statistical Office; DIW Berlin, forecast from 2019 Q3 onward.

Table 2

Key economic indicators for the German economy

	2016	2017	2018	2019	2020	2021
Real GDP[1] (percent change over previous year)	2.2	2.5	1.5	0.5	1.4	1.4
Domestic employment (1 000 persons)	43,655	44,248	44,854	45,244	45,428	45,635
Unemployed (ILO concept)	1,775	1,621	1,469	1,359	1,313	1,206
Unemployed (BA concept)	2,691	2,533	2,340	2,271	2,269	2,165
Unemployment rate[2] (ILO concept)	4.1	3.8	3.4	3.1	3.0	2.7
Unemployment rate[2] (BA concept)	6.1	5.7	5.2	5.0	4.9	4.7
Consumer prices	0.5	1.5	1.8	1.4	1.6	1.6
Unit labor costs[3]	1.2	1.2	2.5	3.5	1.7	1.7
Government budget balance[4]						
in billion EUR	37.1	40.3	62.4	47.9	33.3	9.6
in percent of GDP	1.2	1.2	1.9	1.4	0.9	0.3
Current account balance, in percent of GDP	8.5	8.1	7.3	7.0	6.3	5.7

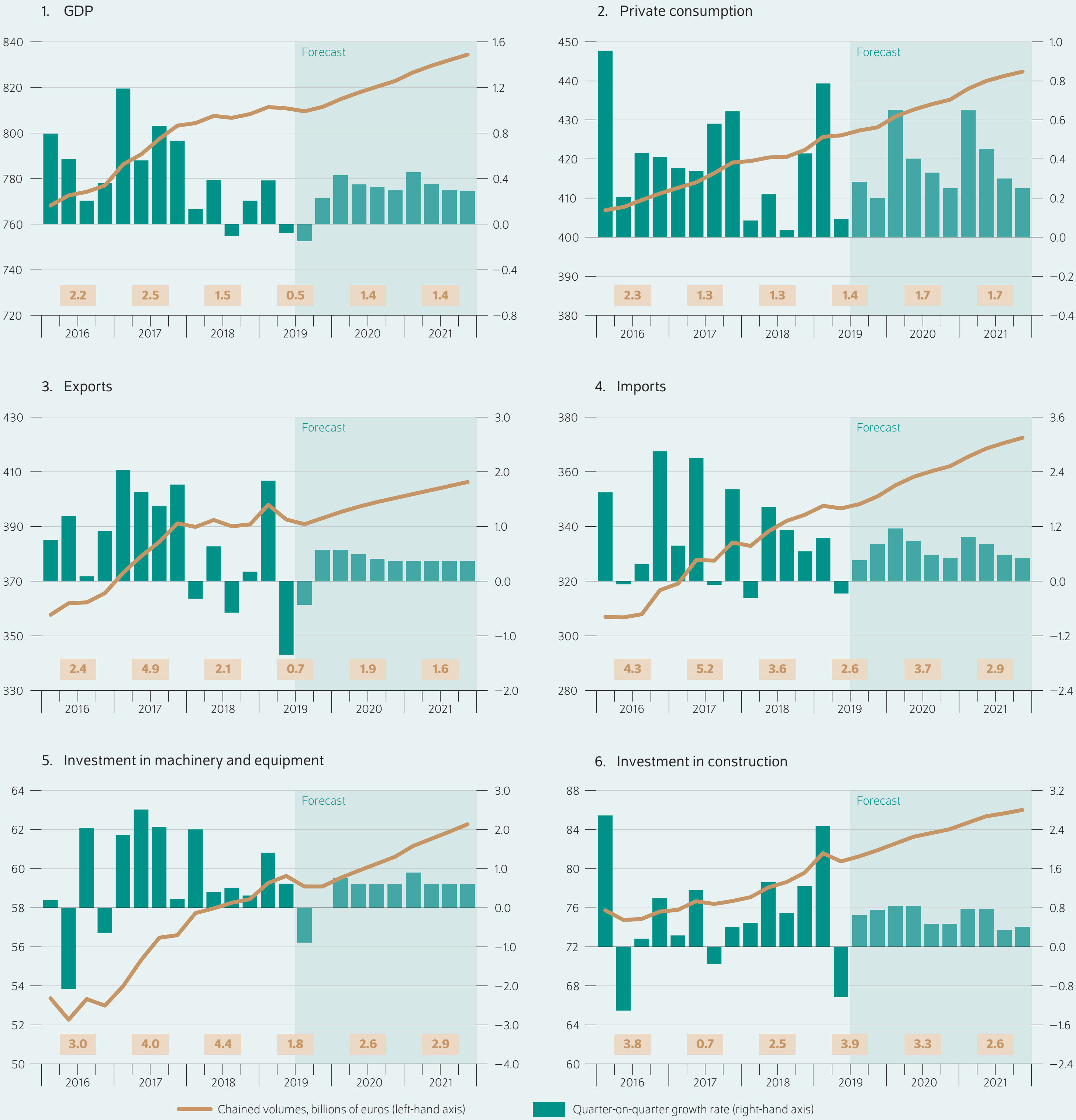
1 Price-adjusted, chain-linked.
2 As a share of domestic labor force (ILO), resp. Civilian labor force (BA).
3 Compensation of employees (national concept) per hour worked over real GDP.
4 According to ESA 2010.

Sources: National and international institutions; computations by DIW Berlin; 2018 to 2020: DIW forecast.

Figure

GDP and use of GDP

Seasonally and working-day adjusted



Sources: Federal Statistical Office; Computations by DIW Berlin 2019, forecasts as of 2019 Q3.

Overall, disposable income is growing solidly and supports private consumption, which is in turn supported largely by numerous fiscal policy measures implemented over the forecast period. At the beginning of 2019, reducing the bracket creep and reintroducing equally shared financing of statutory health insurance contributions had raised the net salaries of employees and contributed to a strong increase in private consumption. Further measures with tangible effects will be taken in the forecast period; in particular, the partial reduction of the solidarity tax in 2021 will increase income. The expected increase in consumption will make a noticeable contribution to domestic economic output as well, although a good portion will probably also be covered by imports. This increase is another reason why GDP growth in the coming two years will be higher than in 2019; at 1.4 percent each, it is likely to be slightly lower than potential growth. Due to the additional imports, net exports are declining significantly and the still high current account surplus is declining accordingly: from 7.0 percent this year to 6.3 percent in 2020 and 5.7 percent in 2021 (see Table 2).

Private investment in equipment and machinery continues to suffer from the high economic uncertainty and remains restrained initially due to lower capacity utilization. However, with foreign demand rising slightly and probably decreasing uncertainty, investment will likely begin to recover; government measures will also contribute to this.[2]

2 Marius Clemens, Marius Goerge, and Claus Michelsen, "Öffentliche Investitionen sind wichtige Voraussetzung für privatwirtschaftliche Aktivität," *DIW Wochenbericht* no. 31 (2019): 537–543 (in German; available online; accessed on September 6, 2019. This applies to all other online sources in this report unless stated otherwise.).

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