DIW Weekly Report 37 2021

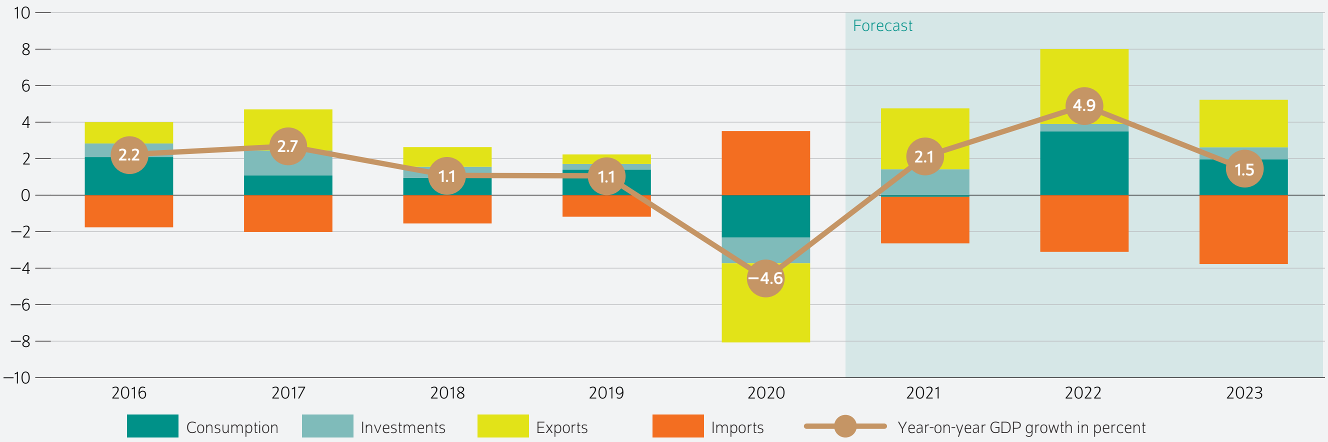
AT A GLANCE

German economy only slowly emerging from the pandemic

By Marius Clemens, Simon Junker, and Laura Pagenhardt

- German economy not growing as quickly as expected – DIW forecasting experts expect 2.1 percent growth in 2021
- Global economy is booming; but in Germany, industry is slowing down despite booming demand: production is stalled due to global supply bottlenecks and exports are temporarily stagnating
- Service providers are recovering slowly and are likely to experience new setbacks in the winter – private consumption still not at its pre-crisis level
- If supply bottlenecks are solved and the pandemic is overcome in 2022, growth of 4.9 percent is expected
- Inflation boosted mainly by special effects such as the VAT cut expiry and higher energy prices – moderate inflation expected again in 2022

German economy: Substantial recovery only in 2022 – consumption boosts back to normal levels
Individual GDP components' contribution to growth in percentage points



Sources: DIW Berlin Economic Outlook Autumn 2021.

FROM THE AUTHORS

"The vaccination and testing strategy has been effective, but private consumption is far from its pre-crisis level and will be dampened again in winter as case numbers rise again. However, supply bottlenecks will at least slowly dissolve and domestic industry will pick up speed again. We are expecting recovery on all levels from spring 2022."
— Simon Junker —

MEDIA

Audio Interview with Simon Junker (in German)
www.diw.de/mediathek

German economy only slowly emerging from the pandemic

By Marius Clemens, Simon Junker, and Laura Pagenhardt

ABSTRACT

The German economy is taking longer than expected to overcome the pandemic: It is likely to increase by only 2.1 percent in 2021 and capacities remain markedly underutilized. In addition, global supply bottlenecks are affecting German industry, resulting in stalled domestic production despite high demand. Following a profitable summer due to low case numbers and progress in the vaccination campaign, the personal services sector is weakening again as infection rates rise once more. If the supply bottlenecks are solved in 2022, industry should take off and the German economy should record powerful growth of 4.9 percent. Although inflation remains moderate in the underlying trend, higher oil prices and the return to the normal value-added tax are driving the rate up to 3.0 percent in 2021. These effects will no longer apply in 2022. Nevertheless, inflation remains somewhat elevated at around 2.0 percent, as rising production costs due to a shortage of intermediary goods are partly passed on.

The recurring waves of the coronavirus have stalled service providers' recovery repeatedly, and as a result, a strong recovery has so far failed to materialize. Although there will be a marked upswing in the third quarter of 2021, the approaching fourth wave will set service providers back over the coming months. It is assumed that policymakers will react to the likely increase in case numbers with less strict measures compared to winter 2020/21, but regional flare-ups will result in restrictions and cautious consumer behavior. Thus, personal services in particular will be affected by a fourth coronavirus wave in winter 2021/22, but to a lesser extent than previously. From spring 2022 onward, it is assumed that the pandemic will be largely contained so that service providers can then ramp up operations again on a sustainable basis (Table 1).

The global economy is booming[1] and the mood in the export-dependent industry is accordingly euphoric. However, global supply bottlenecks will continue to weigh on production for a while. Only when—as assumed by winter 2021/22 onward—the global shortages are gradually eliminated will industry be able to pick up speed and expand strongly in 2022 (Figure 1).

Overall, the German economy is likely to grow at a sluggish pace to an annual average of 2.1 percent (Table 2) and there will be little reduction in underutilization in 2021 (Figure 2). However, GDP is expected to grow by 4.9 percent in 2022, a noticeable recovery, and overall economic capacity utilization will then return to more or less normal levels. In 2023, growth is likely to be 1.5 percent, slightly above the potential rate. Capacity utilization is likely to be slightly elevated, but not excessive, as continuing strong foreign demand is supporting industrial activity.

Recently, exports have lost momentum noticeably, primarily due to disruptions in international trade (Figure 3). As industrial production increases, exports will expand significantly again, especially in 2022. In 2023, foreign demand will lose momentum somewhat but will remain dynamic.

1 Cf. the first report in this Weekly Report: Guido Baldi et al., "Global economy returning to its recovery course after summer setbacks," *DIW Weekly Report* no. 37 (2021): 270–274.

DOI: https://doi.org/10.18723/diw_dwr:2021-37-2

The labor market is noticeably picking up pace since summer 2021 and with the exception of a setback in winter, this will likely continue throughout the forecast period. The number of short-time workers has decreased by half since spring 2021 (Figure 4). Employment growth will be strong in the third quarter of 2021; in addition to public service providers, other service providers, such as in the retail sector, are also likely to have hired more staff. Industry is also likely to hire to a great extent again over the further course. Overall, after a lean first half of 2021, the number of employed persons is likely to remain at around the 2020 level for 2021 before rising by almost 350,000 in 2022 and by just under 300,000 in 2023. The pre-crisis level will be achieved by the final quarter of 2022.

Registered unemployment is likely to decline by 50,000 people in 2021. As the labor force will likely recover from its losses over the further course, the number of unemployed will not decrease at the same high rate as employment is increasing. However, it will decrease by 150,000 people in both 2022 and 2023; the unemployment rate will drop from 5.8 percent in 2021 to 5.0 percent in 2023. Hourly wages will rise only moderately in 2021 but will accelerate as 2021 progresses, as the increase in employment will be driven by employment subject to social insurance contributions, even more strongly in sectors with comparably high wages.

When observing the recent high inflation rates (3.9 percent in August 2021), it should be considered that around one percentage point is due to the VAT cut expiry and more than another percentage point stems from the recovery in energy prices. Neither of these will be a factor in 2022, which is why inflation, after an outlier of 3.0 percent in 2021, will be moderate again thereafter at 2.0 percent and 1.7 percent, respectively, in 2022 and 2023.

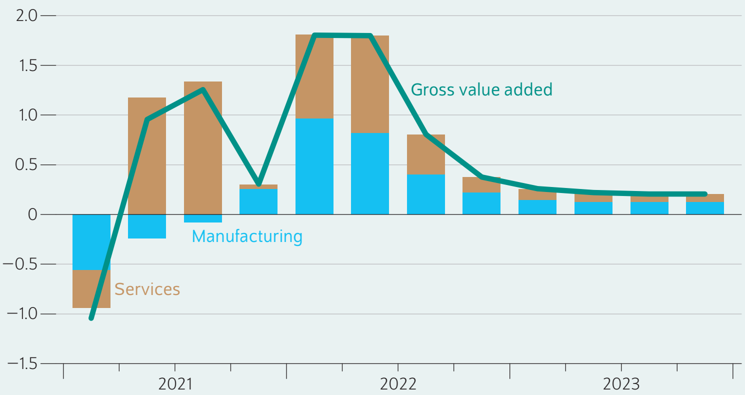
Private consumption is likely to have jumped sharply in the third quarter of 2021 while the state of the pandemic was comparably calm; however, it is likely to decrease slightly in winter 2021/22 in light of a fourth wave of the coronavirus before recovering strongly in spring 2022. Labor income is noticeably rising as wages and employment are increasing at an accelerated rate, with the reduction in short-time work contributing significantly to this. On the other hand, short-time allowances are increasingly being discontinued, which is another reason social benefits are increasing at a comparatively modest pace. The partial abolition of the solidarity surcharge at the beginning of 2021 and various measures under the Second Family Tax Burden Reduction Act will also have a relieving effect. Overall, disposable income has remained remarkably stable, in part thanks to economic stimulus programs. In the third quarter of 2021, the savings rate is likely to have decreased significantly, but will probably increase somewhat in winter 2021/22 in light of the poor outlook for services consumption, before quickly returning to its pre-crisis level over the further course of the forecast.

Investment in equipment and machinery has been weak recently, presumably due to continuing material shortages. However, in view of an increasingly positive order situation,

Figure 1

Total gross value added and components

In percent (components in percentage points)



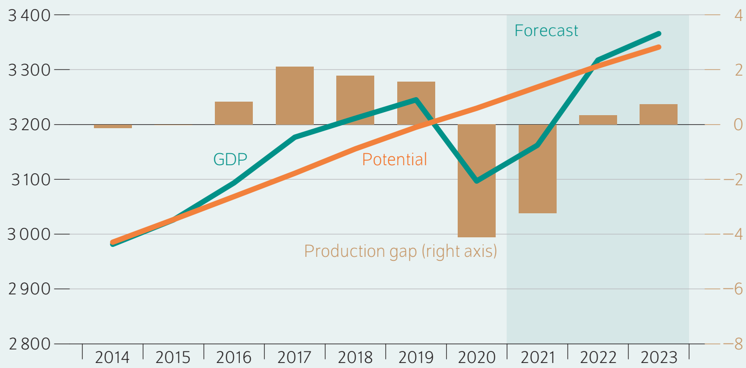
Source: DIW Berlin Economic Outlook Autumn 2021.

Industry will not make a noticeable contribution to gross value added until 2022. Service providers will experience another setback due to the pandemic in winter 2021/2022.

Figure 2

Gross domestic product, potential output, and gap

In billion euro, gap in relation to potential



Sources: Federal Statistical Office; EU Commission; DIW Berlin Economic Outlook Autumn 2021.

The German economy will close the output gap in 2022.

Figure 3

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

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2021, forecasts from 2021 Q3 onward.

Table 1

Use of gross domestic product, quarter-on-quarter growth rates

Price, seasonally and working-day adjusted, in percent

	2021				2022				2023			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	−5.2	3.2	2.8	−0.5	−0.2	4.8	1.9	0.9	0.6	0.4	0.3	0.3
Public consumption	−0.7	1.8	0.7	0.5	0.2	0.0	−0.2	0.0	0.2	0.3	0.3	0.3
Gross fixed capital formation	−0.7	0.5	0.7	1.2	1.2	1.2	0.9	0.7	0.8	0.8	0.8	0.8
Investment in machinery and equipment	−0.2	0.3	−0.3	0.2	0.8	1.1	0.9	0.8	0.7	0.7	0.7	0.7
Construction investment	−0.4	0.3	1.9	2.7	2.0	1.7	0.9	0.6	1.0	1.0	1.0	1.0
Other investment	−2.6	1.3	1.2	1.2	1.1	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Change in inventories[1]	1.9	0.1	−1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic uses	−1.1	2.4	0.7	0.1	0.3	2.8	1.1	0.6	0.5	0.5	0.4	0.4
Net exports[1]	−0.9	−0.6	0.6	0.2	1.5	−0.8	−0.3	−0.2	−0.2	−0.3	−0.2	−0.2
Exports	1.4	0.5	−0.3	0.3	4.1	3.7	2.6	1.3	1.1	1.0	0.9	0.9
Imports	4.2	2.1	−1.9	0.0	0.9	6.3	3.6	1.9	1.7	1.6	1.5	1.5
Gross domestic product	**−2.0**	**1.6**	**1.3**	**0.3**	**1.8**	**1.8**	**0.8**	**0.4**	**0.3**	**0.2**	**0.2**	**0.2**
Gross value added	**−1.0**	**1.0**	**1.3**	**0.3**	**1.8**	**1.8**	**0.8**	**0.4**	**0.3**	**0.2**	**0.2**	**0.2**
Manufacturing	−0.8	−1.3	0.0	1.0	4.2	3.4	1.6	0.8	0.5	0.4	0.4	0.4
Construction	−5.2	0.1	−0.3	0.2	0.8	1.1	0.9	0.7	0.6	0.6	0.6	0.6
Trade, accommodation, transport	−2.7	1.1	5.1	−1.4	2.0	2.6	1.3	0.5	0.3	0.3	0.2	0.2
Business and production services	0.2	1.3	1.3	1.7	2.2	2.0	0.7	0.2	0.1	0.1	0.1	0.1
Public admin., community and social serv.	−0.1	3.8	−0.6	1.0	0.7	0.6	0.2	0.1	0.1	0.1	0.1	0.1

1 Contribution to GDP growth in percentage points

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2021, forecast from 2021 Q3 onward.

Table 2

Key economic indicators for the German economy

	2018	2019	2020	2021	2022	2023
Real GDP[1] (percent change over previous year)	1.1	1.1	−4.6	2.1	4.9	1.5
Domestic employment (1,000 persons)	44,858	45,268	44,898	44,885	45,228	45,517
Unemployed (ILO concept)	1,468	1,373	1,664	1,581	1,486	1,374
Unemployed (BA concept)	2,340	2,267	2,695	2,649	2,490	2,320
Unemployment rate[2] (ILO concept)	3.4	3.2	3.8	3.7	3.4	3.2
Unemployment rate[2] (BA concept)	5.2	5.0	5.9	5.8	5.4	5.0
Consumer prices	1.8	1.4	0.5	3.0	2.0	1.7
Unit labor costs[3]	3.0	3.1	3.4	0.9	0.3	2.7
Government budget balance[4]						
in billion EUR	64.4	51.1	−145.2	−161.4	−77.5	−42.6
in percent of GDP	1.9	1.5	−4.3	−4.6	−2.1	−1.1
Current account balance, in percent of GDP	7.8	7.4	6.9	6.8	7.3	6.0

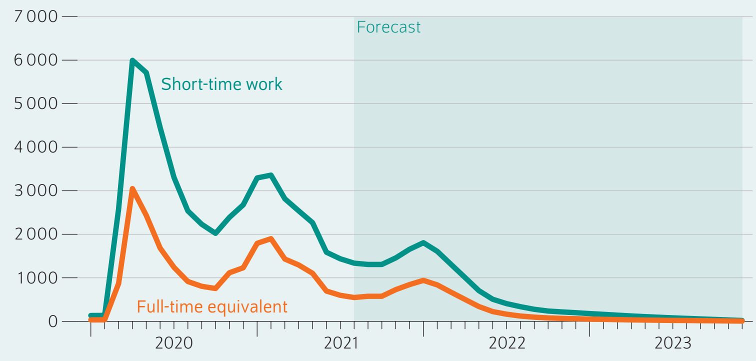
1 Price-adjusted, chain-linked
2 As a share of domestic labor force (ILO), resp. civilian labor force (BA)
3 Compensation of employees (national concept) per hour worked over real GDP
4 According to ESA 2010

Sources: National and international institutions; DIW Berlin Economic Outlook Autumn 2021, forecast from 2021 Q3 onward.

especially among machinery manufacturers, a much more dynamic trend will emerge towards the end of 2021 and, increasingly, in 2022. As part of the economic stimulus program, significant government stimulus is being provided by the federal, state, and local governments. The tension between a good economic situation and a material shortage is also evident in the construction sector. Construction investments were subdued in all sectors in the second quarter of 2021. The continued sharp rise in raw material prices resulted in enormous price increases in construction, which are expected to continue in the third quarter of 2021. Nevertheless, demand remains high, particularly in residential construction, and is supporting the positive underlying momentum. In public construction, the discontinuation of the trade tax equalization scheme, which was introduced because of the pandemic, is straining municipal

Figure 4

Short-time work and full-time equivalent
In 1,000 persons



Sources: Federal Employment Agency; DIW Berlin Economic Outlook Autumn 2021, forecast starting 07/2021.

Short-time work continues on its downward trend after a break in winter 2020/2021.

coffers. In the further course, however, considerable funds will be available from the *Zukunftspaket* and the reconstruction funds for flood relief.

Imports stumbled for the first time in July 2021. Due to global supply bottlenecks, sluggish consumption in winter 2021/22, and temporarily weaker exports, they will not start to grow strongly again until spring 2022. Moreover, as domestic production potential increasingly lags behind stable domestic demand as time passes, the latter will increasingly be met by imports, and the trade surplus will shrink significantly.

The coronavirus containment measures will lead to a substantial general government deficit of just over 160 billion euros in 2021. Among other things, this deficit reflects expenditures for advance services and personnel for the national vaccination and testing strategy and emergency aid measures. Sales tax revenue is likely to be much stronger than in 2021, as the VAT rate has been raised again and consumption is gradually recovering. The rebounding economy will boost revenues from taxes and social security contributions over the course of 2021. A large part of the investment grants agreed in the *Zukunftspaket* of the economic stimulus program, amounting to around 15 billion euros, is expected to run out over 2022–2023. In principle, the momentum of government gross capital formation is likely to be quite high, not least because of the *Zukunftspaket*, although this will be held back for the time being by supply bottlenecks and the skilled labor shortage. Significant deficits of 78 and 43 billion euros are expected in 2022 and 2023. The gross debt ratio of the federal government to nominal GDP was a good 69 percent in 2020. In 2021, assuming additional loans and equity investments of 20 billion euros, it is expected to rise to around 72 percent and to fall again to 67 percent in 2022.

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