GERMANY
2021-2022 SCENARIO

POSITIVE JOLT FOLLOWED BY ACCELERATED GROWTH

20 July 2021

Philippe Vilas Boas

WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

CONTENTS

SUMMARY

POSITIVE JOLT FOLLOWED BY ACCELERATED GROWTH

Germany did not escape a downturn in Q1 when GDP contracted 1.8% quarter-on-quarter as pandemic containment measures dented consumption. With non-essential shops and businesses closed, consumption lost out as households saved more (10% higher than the pre-Covid savings rate). But with almost 56% of the population vaccinated by early July, the vaccination campaign bore fruit during the period bringing the incidence rate down to a very low level. The success in reducing infection rates allowed Berlin to lift most restrictions at the end of May, with better prospects for a return to a growth path. By our estimates, growth should rebound 2.2% in the second quarter, fuelled by the consumer spending that had only just begun to take off at the start of June, and the expected increased investment to cope with the long period of pent-up demand. Net exports will also make a positive – although smaller contribution – to growth in Q2, due in the main to rising imports rather than flagging exports. For full-year 2021, we forecast 4% growth in GDP buoyed by the sharp uptick in private-sector consumption that kicked off in Q2 and gained momentum in Q3, and higher productive investment and construction investment to meet resolutely robust demand. The vigour of the demand for German exports, especially for industrial goods, should also keep the fire burning under the country's recovery. In 2022, we expect to see growth pick up 4.7%, mainly due to the end-of-year carry over effect, although intrinsic activity will begin to normalise after several months of overheating.

Private-sector consumption should jump 3.4% in Q2, and rise even further in Q3 when practically all measures to contain the spread of Covid-19 are lifted and people return to shops and restaurants. The surplus savings built up should spill out into spending on services like accommodation, restaurants and leisure during the summer period. This uptick should be reflected quasi-automatically in lower numbers in short-time work, which were still at a high 2.3 million at the end of May. The majority of supports for businesses and households will stay until the end of the year to cushion the impacts of the pandemic and push out the risk of bankruptcy and higher jobless numbers to next year. The German government will stick to expansionary fiscal policy, which will raise the deficit to 8.9% of GDP in 2021, before narrowing to 3% in 2022. Nonetheless, the fiscal discipline during the years before Covid-19 hit will ensure the country's debt is contained at 75% of GDP for our forecast horizon.

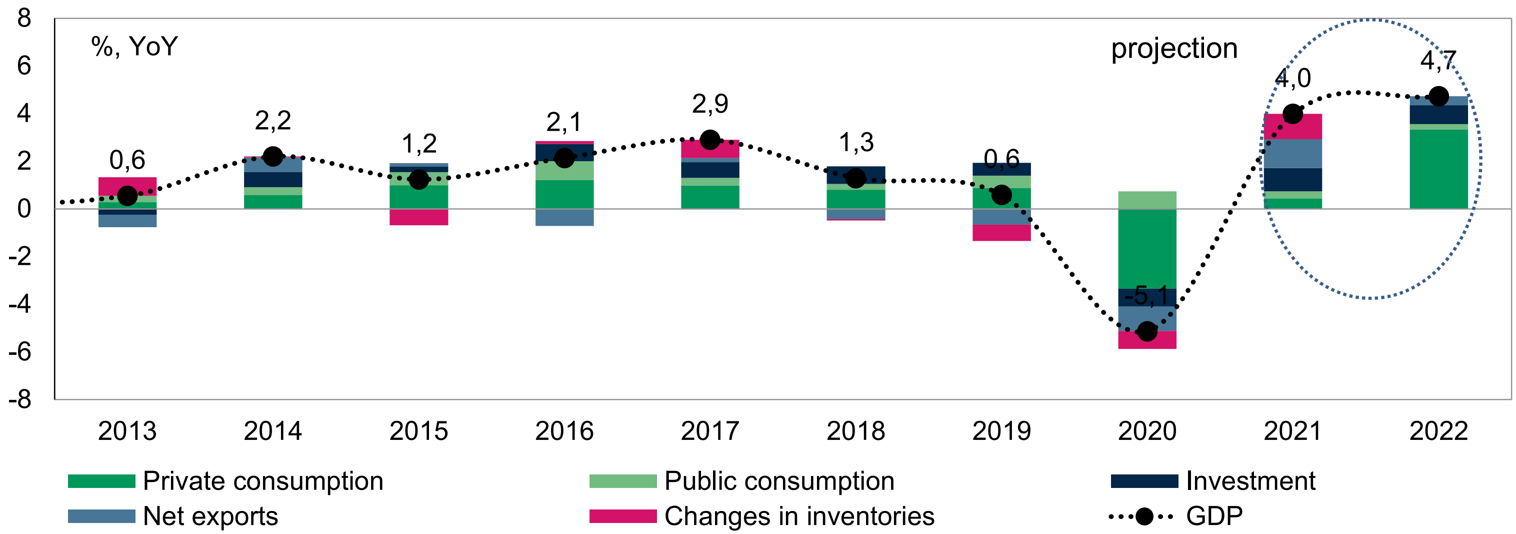
Total investment is expected to increase 1.5% in Q2 and continue to expand slightly on strong order books and the strong recovery in company margins. The productive capacity utilisation rate stands above its long-term average, which confirms the pressure on supply as it struggles to meet growing demand. Pending investment projects could be implemented based on this optimistic outlook. Investment in construction will also make a – smaller – contribution to growth. For 2021 as a whole, we see investment bouncing back 4.5%. The rate of investment growth will slow to 3.7% next year as economic and social life returns to normal.

As US, Chinese and European demand for exports rebounds to meet the needs of a strong economic recovery, the trade balance should once again contribute positively (1.2%) to GDP in 2021. But momentum will flag in 2022: net exports will make a slightly more modest contribution as global trade slows.

SUMMARY

POSITIVE JOLT FOLLOWED BY ACCELERATED GROWTH

Contributions to annual growth



	Yearly average (YoY, %)				Quaterly growth (QoQ, %)											
Germany	2018	2019	2020	2021	2019				2020				2021			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	**0,6**	**-5,1**	**4,0**	**4,7**	**-2,0**	**-9,7**	**8,7**	**0,5**	**-1,8**	**2,2**	**3,6**	**1,3**	**0,6**	**0,6**	**0,5**	**0,5**
private consumption	1,6	-6,2	0,8	6,4	-2,2	-11,5	11,2	-2,3	-5,4	3,4	5,9	1,6	0,6	0,6	0,5	0,4
investment	2,6	-3,5	4,5	3,7	-0,4	-6,7	3,7	2,5	0,3	1,5	1,7	1,4	0,6	0,6	0,6	0,6
change in inventories *	-0,7	-0,7	1,1	0,0	0,2	0,1	-2,3	0,5	1,7	0,0	0,0	0,0	0,0	0,0	0,0	0,0
net exports *	-0,7	-1,0	1,2	0,4	-1,1	-2,4	4,0	0,7	-0,8	0,1	0,2	0,1	0,1	0,1	0,1	0,1
unemployment rate	3,1	4,2	4,5	4,7	3,6	4,2	4,5	4,6	4,5	4,5	4,5	4,5	4,6	4,6	4,7	4,7
Inflation	1,4	0,4	2,6	1,7	1,6	0,7	-0,2	-0,6	1,7	2,1	2,9	3,9	2,1	1,7	1,6	1,6
Government net lending	1,5	-4,2	-8,9	-2,9												

** Contributions to GDP growth*

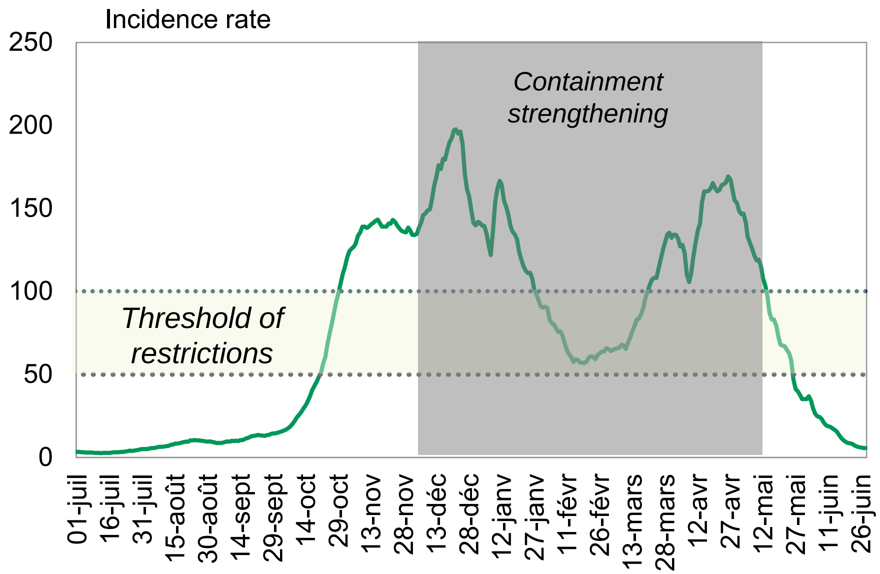
Sources: Crédit Agricole SA / ECO, forecasts

CONTENTS

RECENT ECONOMIC TRENDS

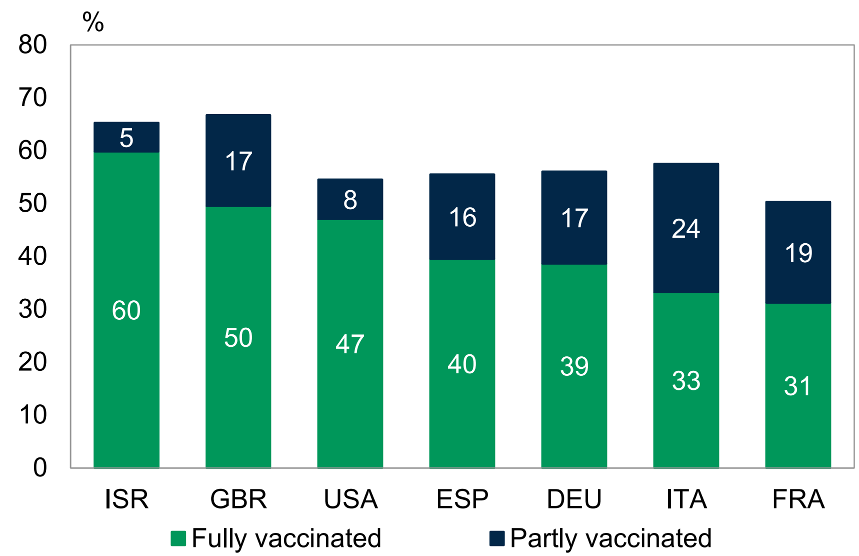
VACCINATIONS HELPING TO CURB THE EPIDEMIC

Sharp fall in infection rates



Sources: DIVI, RKI, Crédit Agricole SA / ECO

Percentage of the population vaccinated

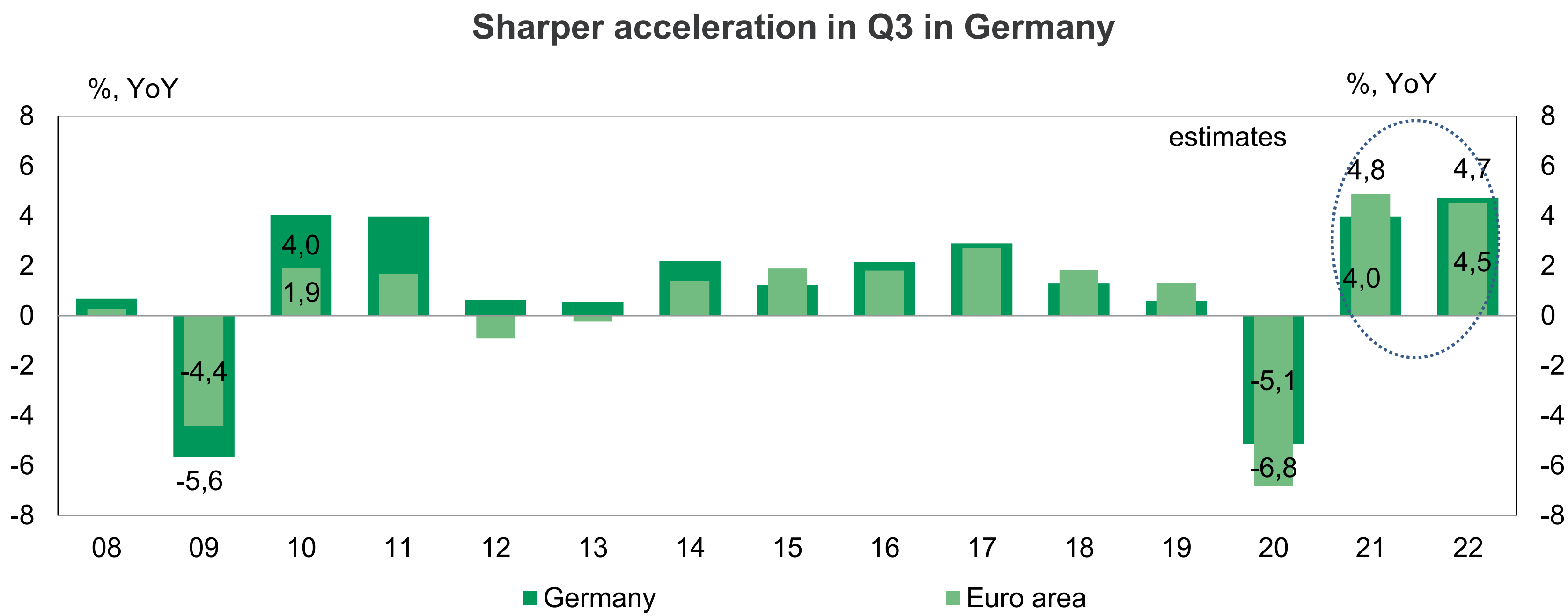


Sources: DIVI, RKI, Crédit Agricole SA / ECO

The public health situation improved markedly in mid-May. The incidence rate fell below 100, which allowed the government to loosen the restrictions it had imposed in mid-December. The rate dropped below 50 per 100,000 inhabitants at the start of June (improving in all German *Länder*) giving the green light to lift almost all pandemic restrictions. Progress with vaccines is helping to contain the pandemic. And the vaccination campaign was stepped up considerably during the second quarter with close to 58 million jabs administered in the space of three months. The success of the vaccination drive puts Germany ahead of some of its partners: 17% of Germans have now received a first dose of vaccine, while more than 39% are fully vaccinated (56% have received one or two jabs). But the spread of the “Delta” variant could put renewed pressure on hospitals if vaccination numbers falter during the summer months. “Delta” now accounts for 59% of new cases. Our growth scenario sees the economy expanding at a slower pace in Q2 as restrictions will only be lifted later in the quarter, before jumping off in Q3 when businesses open again. Growth should return to a more moderate pace at the end of the year.

RECENT ECONOMIC TRENDS

HETEROGENEOUS GROWTH RATES



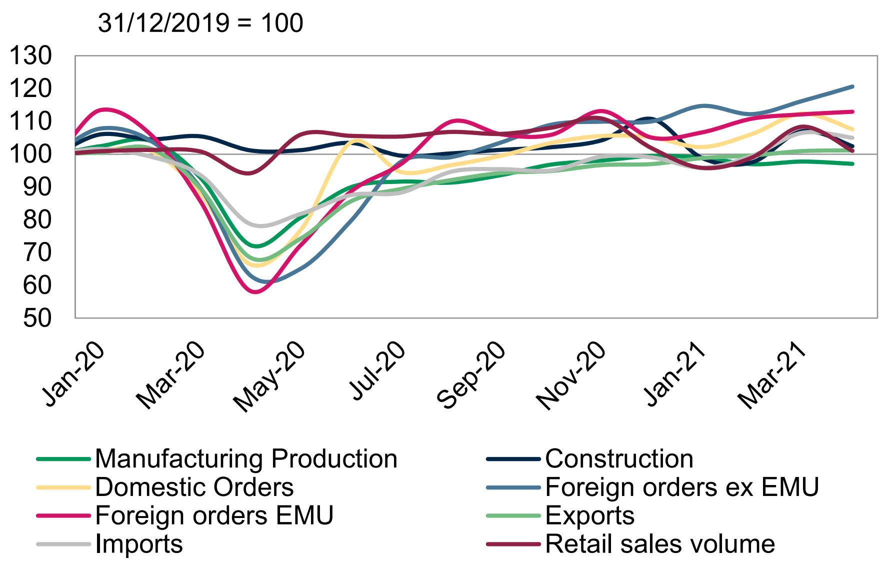
Sources: Eurostat, Crédit Agricole SA / ECO

Pandemic restrictions continued to weigh on Eurozone growth in the first quarter. Private-sector consumption declined sharply while other components of growth proved more or less resilient in the period. Vaccination campaigns ramped up during Q2 as massive supplies came on stream. Vaccinated people means less pressure on hospitals and a gradual easing of public health measures as cafés, restaurants, cultural and leisure venues start to open their doors once again. The Eurozone economy is set to bounce back fuelled by both domestic demand - primarily private-sector consumption – and investment. Yet, the recovery will not be the same across all countries in the area. We think growth could be as high as 4.8% in Eurozone this year, as the pandemic is brought under control by mass vaccinations. The pace will slow slightly to 4.5% in 2022, but will still outstrip pre-crisis performance by 3% at the end of the period. Our forecasts see German GDP, which was spared some of the hit from the pandemic by brisker industrial demand, revive faster but at a lower rate than its European partners. Domestic demand will be strong, as consumer spending and investment revive. Germany will also see the benefit of powerful export demand fuelled by the economic recovery in China, America and Europe. The lifting of restrictions should trigger a partial rebound in Q2 when the consumer spending tap is turned on. The recovery is expected to intensify in Q3 and normalise in Q4. For full-year 2021, we are projecting 4% growth, ticking up to 4.7% in 2022, primarily due to the growth overhang from Q4 2021.

RECENT ECONOMIC TRENDS

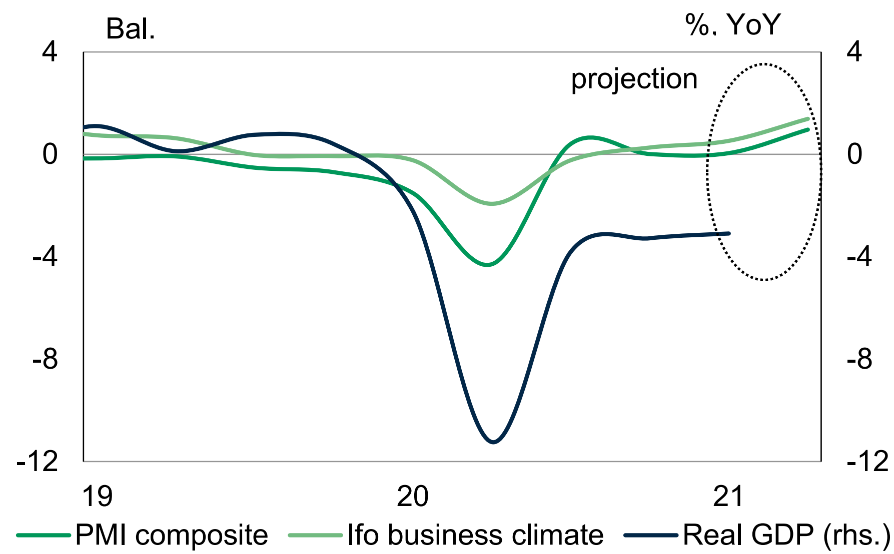
DEMAND FINALLY RELEASED

Trends of the main indicators



Sources: FSO, DB, Crédit Agricole SA / ECO

Business surveys and real growth



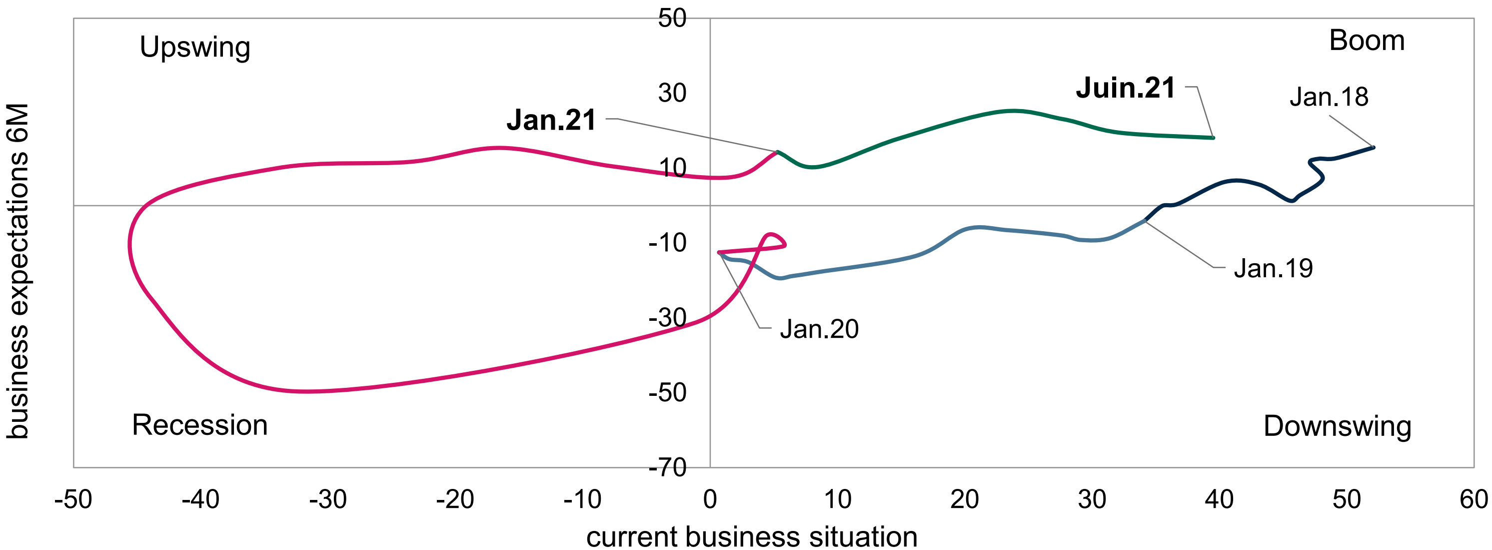
Sources: IFO, Crédit Agricole SA / ECO

Hard economic data continued to recover in Q2 2021 across most sectors. Domestic and international orders were resilient. Retail sales contracted early in the quarter only to bounce back strongly when non-essential retail outlets opened their doors in May. Although construction has slowed, activity is still well above pre-pandemic levels. Industrial output is still 3% below where it was before Covid hit, despite very healthy order books. The industrial sector is essentially struggling with problems securing supplies of raw materials and intermediate goods, which puts a damper on production, despite increasing demand.

Survey data confirm the steady revival in economic activity in Q2 in both industry and services. The PMI composite (purchasing managers index) recorded its biggest hike in more than 10 years in June, buoyed by industrial activity and a rebound in services with accommodation, food service and leisure activities reopening for business after months of restrictions. The Ifo index shared this optimistic view of an economy in full flight with the six-month forecast at a record high. Activity is set to resume in the second quarter and accelerate strongly after that.

STRONGER DEMAND FOR INDUSTRIAL GOODS AND SERVICES

Industrial cycle trend (IFO index)



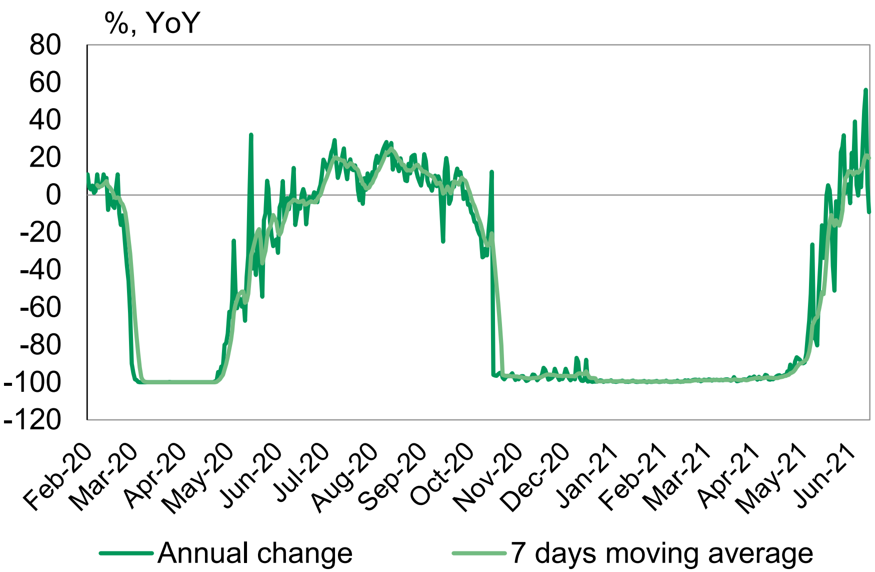
Sources: IFO, Crédit Agricole SA / ECO

The Ifo business climate index improved significantly in Q2 as industry recovered throughout the quarter while the services sector also picked up in May and June. Optimism about the coming six months dimmed slightly in industry, but expectations in services improved in Q2. Looking at the breakdown of the index by sector, expectations strengthened in automotive, machinery and equipment and manufacturing of metallurgical products, while IT equipment contracted significantly. Services jumped sharply from mid-May when non-essential shops and businesses reopened. Our forecast is for growth to pick up by only 2.2% in Q2 since it was late in the quarter when restrictions were eased. We think it will be Q3 before we see more positive impacts of the loosening of measures to contain the spread of coronavirus on economic activity in general and on consumer spending in particular, which was badly hit by lockdowns in Q4 and Q1.

RECENT ECONOMIC TRENDS

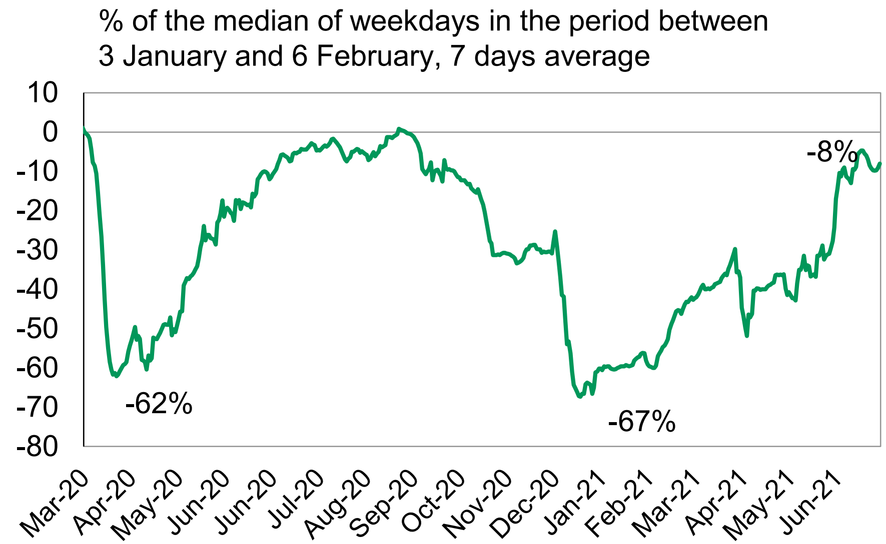
HIGH-FREQUENCY INDICATORS (CONSUMPTION)

Number of diners in restaurants



Sources: Opentable, Crédit Agricole SA / ECO

Customer footfall in retail outlets



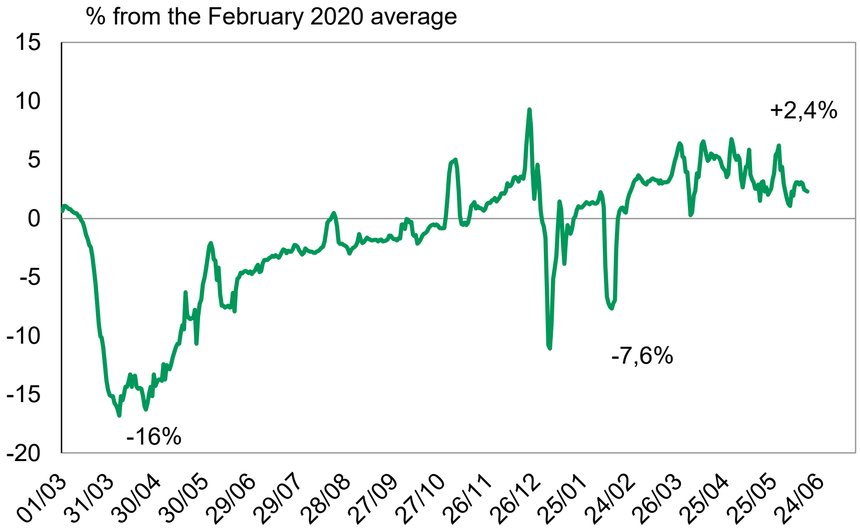
Sources: Google mobility report, Crédit Agricole SA / ECO

Consumption declined by 5.4% in Q1 (quarterly change), on the heels of a 2.3% fall in Q4 driven down by prolonged tight restrictions that forced non-essential shops and businesses to remain closed. Measures were eased when the incidence rate fell below 100 per 100,000 inhabitants at the end of May in most of the country's *Länder*. Restaurants reservations picked up well from then. People had yet to return to retail outlets. Footfall in the second quarter was 40% lower than pre-Covid levels, but rebounded well in June. However, it was still 8% off pre-pandemic traffic. But this positive trend suggests a firm recovery in consumer spending from the second quarter and an even bigger hike in Q3, driven by demand that has been pent up for far too long and an extended period of freedom from restrictions.

RECENT ECONOMIC TRENDS

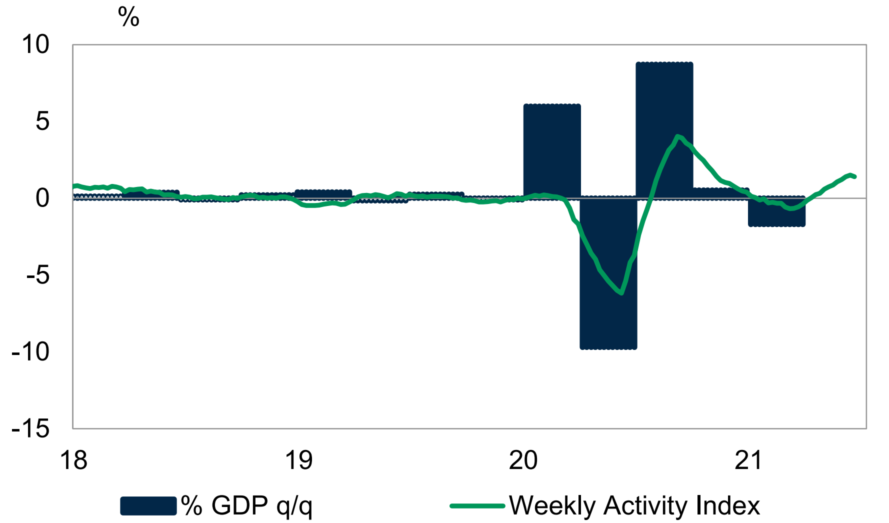
HIGH-FREQUENCY INDICATORS (TRAVEL AND ACTIVITY)

Truck traffic since February 2020



Sources: Destatis, Crédit Agricole SA / ECO

Weekly activity index and GDP growth



Sources: Apple mobility, Crédit Agricole SA / ECO

The Truck toll mileage index is a good indicator of where industrial output and trade are headed in the country. After dropping in early February, the index shows a steady and brisk flow of trucks since March, with the level at the end of June 2.4% higher than before the pandemic. This very favourable development reflects the fast-paced growth in industrial activity as well as robust demand for supplies from businesses as they re-opened.

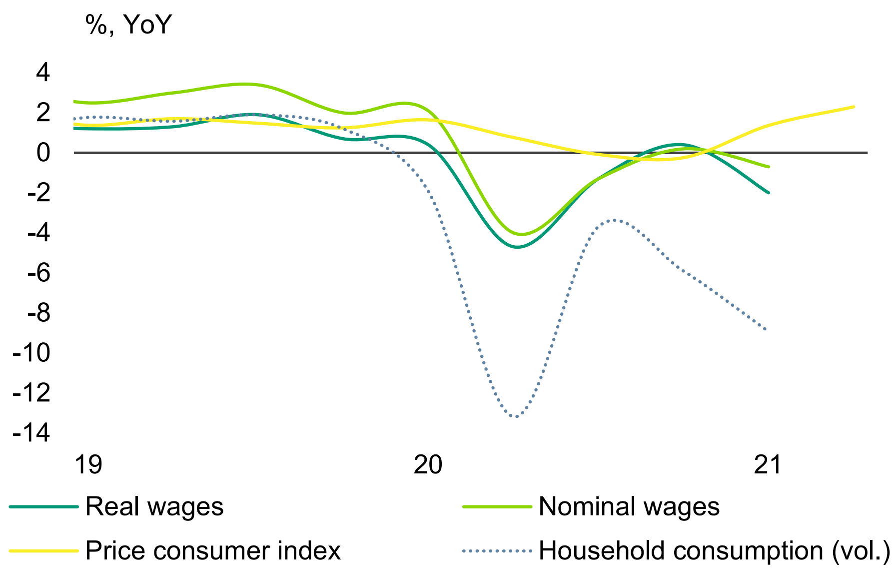
Based on a number of different indicators, the Bundesbank's weekly activity index (WAI) is designed to measure economic activity in real time. For the week of 21 to 27 June, the index was up 1.4% over the previous 13 weeks (edging back slightly from +1.5% the week before). The WAI-implied GDP growth rate was +2.9% throughout the whole of the second quarter, a slightly more optimistic outcome than our forecast for 2.2% growth.

CONTENTS

OUTLINE OF OUR SCENARIO

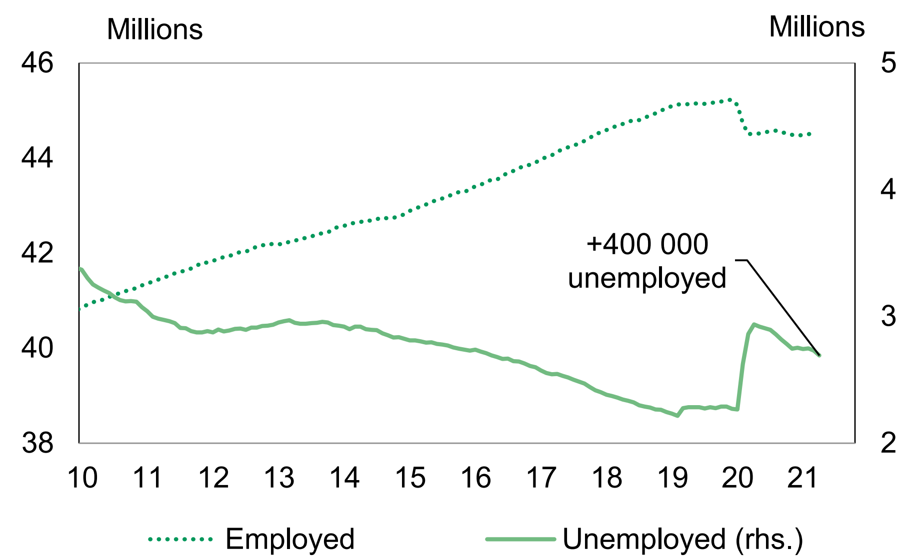
JOBS, WAGES AND CONSUMPTION

Wages, inflation and consumption



Sources: FSO, Crédit Agricole SA / ECO

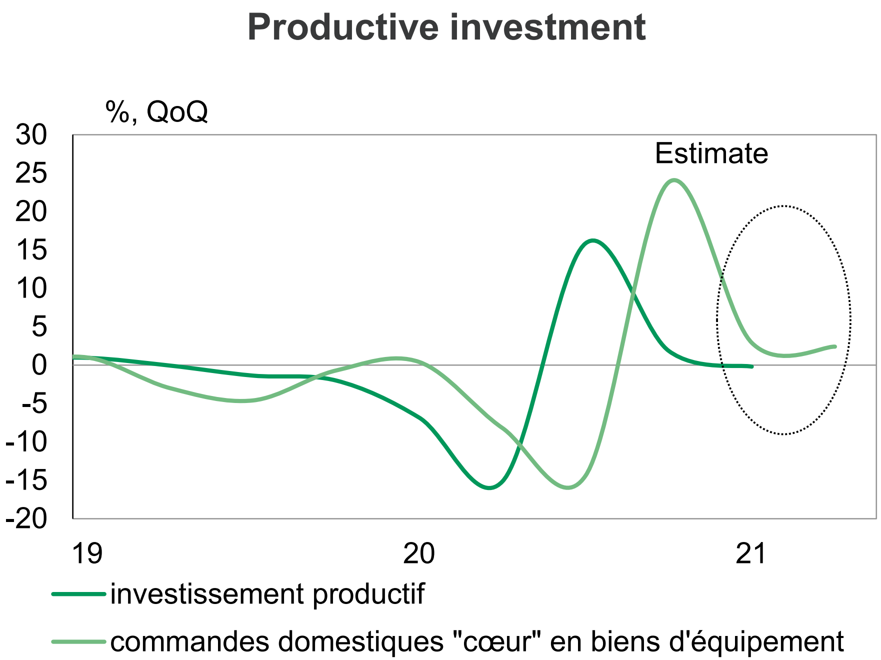
Number employed and unemployed



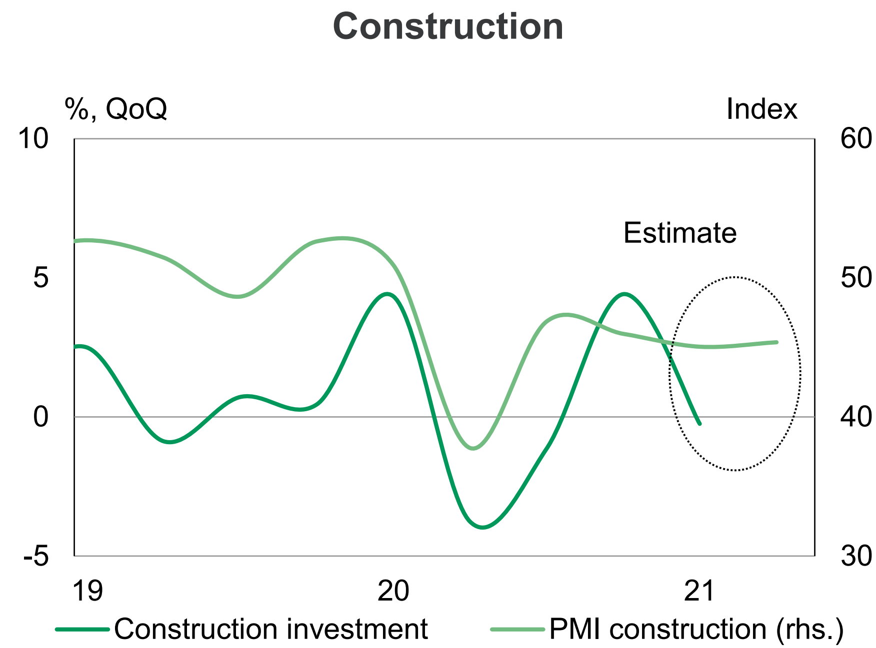
Sources: Agentur für Arbeit, Crédit Agricole SA / ECO

The main factor behind the 2% fall in real wages was inflation (1.4%). Nominal wages fell a slight 0.7%. This relative resilience in wages was down to fewer people on short-time work schemes (2.3 million in May) from a peak of 6 million in 2020. Shuttered shops and businesses were the main damper on consumer spending in Q1. When restrictions are lifted in May, consumption should surge – at least partially – in Q2. The challenging economic environment means that the prospects for wage increases are likely to be very limited this year (less than 2%) (for example, in pilot talks with IG Metall in the metal industry, the union negotiated the equivalent of a 2.3% increase in the form of bonuses). For now, unemployment has edged up only 0.9% relative to numbers before Covid-19 (400,000 more people out of work). Yet, most of the losses are jobs where pay is below the threshold to pay social security contributions – in other words, the most vulnerable are hardest hit. As government aids are phased out post-pandemic, the jobless rate may tick up next year. With restrictions still in place during the period, household savings rose further in Q1, up 10 points on December 2019 (+6 points in Q4). Our scenario shows consumer spending powering ahead 3.4% in Q2 and picking up even more steam in Q3 to give an annual increase of 0.8% for full-year 2021. A significant overhang will help push consumption up 6.4% in 2022, despite household spending patterns returning to normal.

INVESTMENT: SHORT-TERM OUTLOOK



Sources: FSO, Crédit Agricole SA / ECO

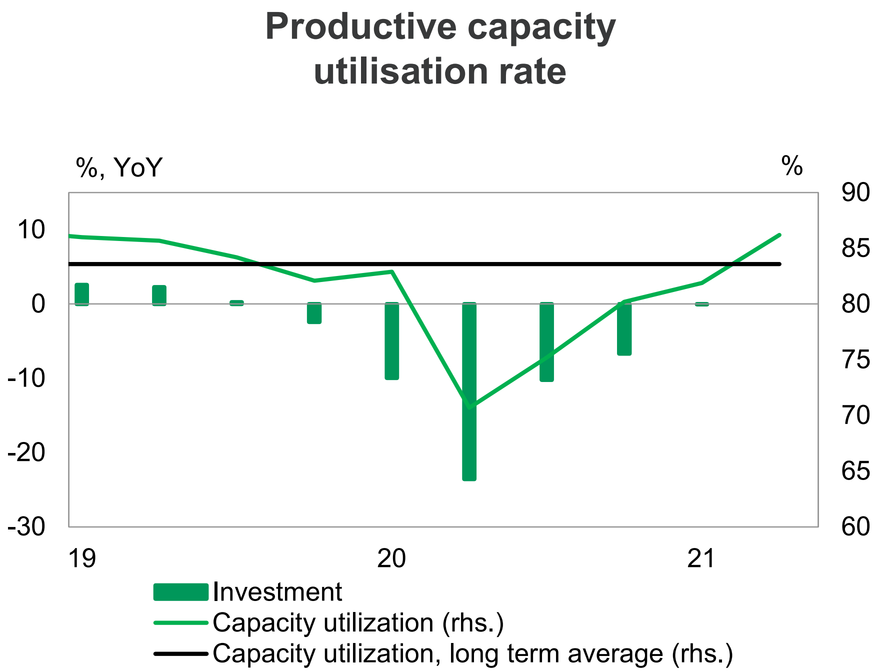


Sources: FSO, Markit, Crédit Agricole SA / ECO

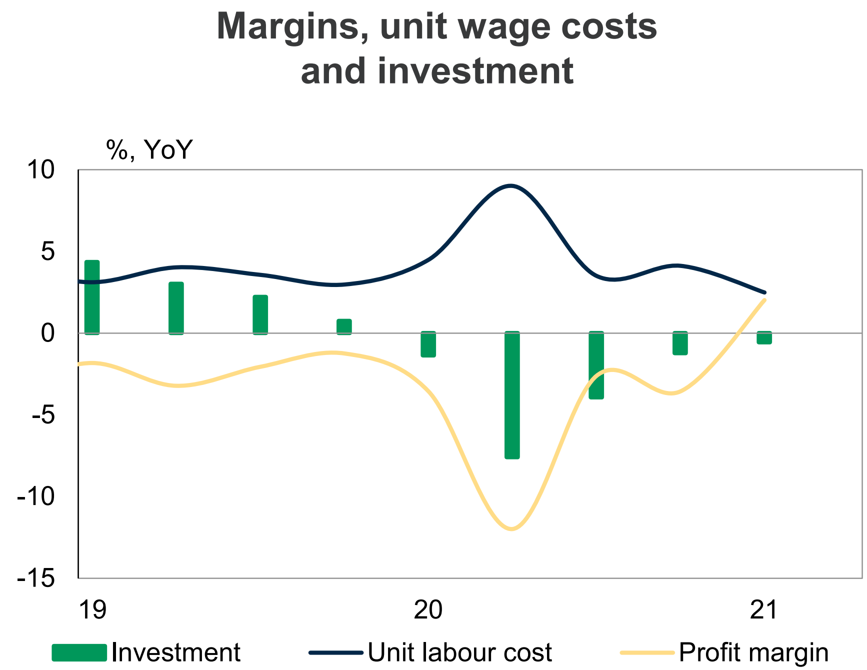
Productive investment slipped back 0.2% in Q1 compared with a 1.9% surge in Q4. The impact of strict lockdown measures was particularly pronounced in Q1, before the mass vaccination campaign hit its stride. As vaccines promise to put an end to the current pandemic, we think investment plans will be back on the table. Rising domestic orders for capital goods suggest a short-term bounce in productive investment. What is more, foreign industrial orders hit a record high in April indicating a surge in activity in Q2, which should prompt more investment if the trend continues in the coming months. Construction investment slowed to 1.2% in Q1, after +3.7% in Q4, but remains high and has outstripped the 3.4% we saw before coronavirus. The PMI for the sector seems to point to a slight increase in construction investment figures in Q2. Total investment is expected to rise 1.5% in Q2 and to step up – but at a slower pace – in Q3 as the global economy makes a strong comeback. These developments should be supportive of investments to increase productivity.

OUTLINE OF OUR SCENARIO

INVESTMENT: UNDERLYING TRENDS



Sources: Destatis, Crédit Agricole SA / ECO



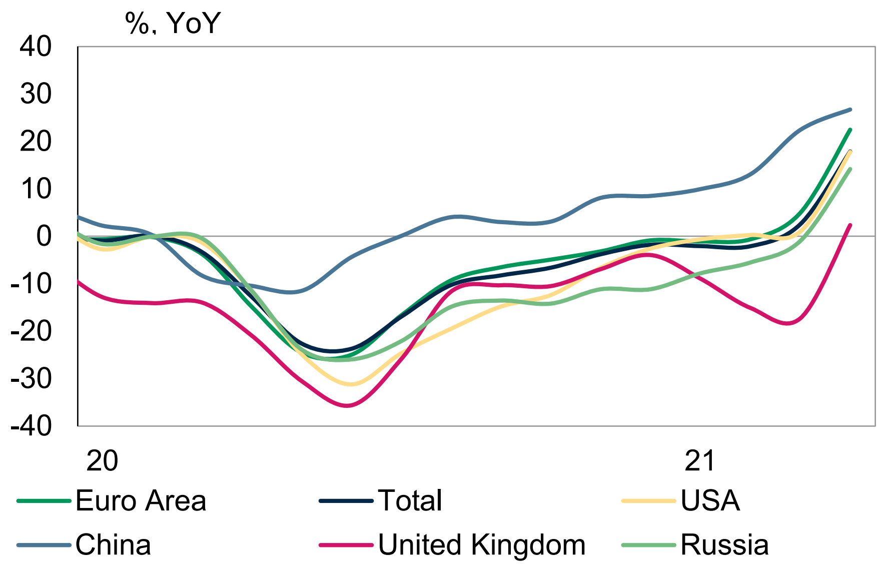
Sources: Destatis, Crédit Agricole SA / ECO

The production capacity utilisation rate put in a strong recovery in June and rose 1.2 points above the long-term average of 85%. The main driver behind this rapid improvement in production capacity is very vigorous demand from industry, in turn fuelled by demand from American and Chinese manufacturers, and more recently, from European partners. The upturn should translate into rapid growth in company margins in Q1 and into Q2 as the economy opens up completely. Our forecast is for total investment to rebound a robust 4.5% this year, mainly due to the surge in activity which will prompt initiatives to increase productivity to meet this excess demand. As production scales back to a more normal level next year, investment growth should slow to 3.7% in 2022. This level of investment increase is still solid and in line with the goals of Germany's recovery plan which aims to grow investment in technology to create the conditions for the country's industrial and energy transformation.

OUTLINE OF OUR SCENARIO

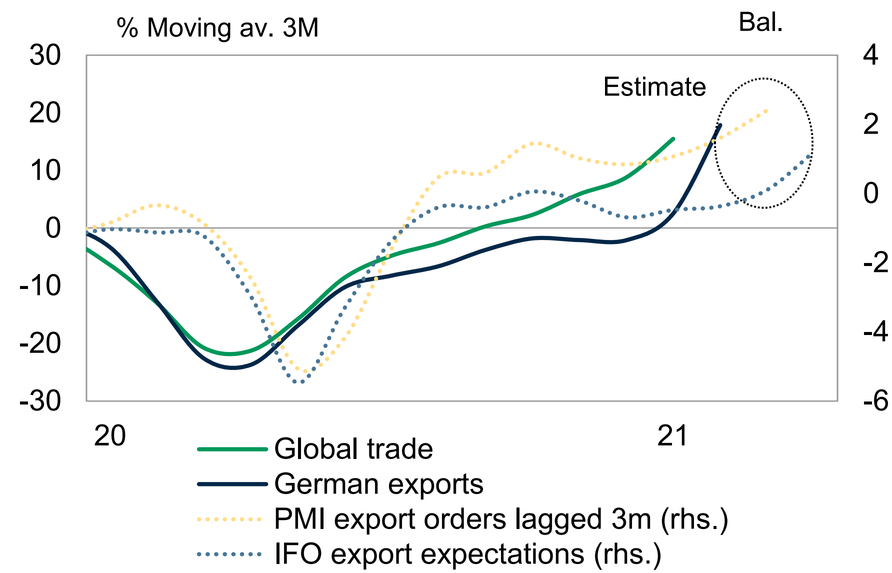
FOREIGN TRADE

Exports by main partners



Sources: Bundesbank, Crédit Agricole SA / ECO

Export outlook



Sources: Destatis, Crédit Agricole SA / ECO

German exports put in a healthy recovery in April and are now 14% above pre-pandemic levels. The improvements were mainly concentrated in exports to the main trading partners in the Eurozone, China and America. Only exports to the UK – which has left the EU – are trailing. The PMI indicator for export orders and the Ifo Institute's export expectations both point to an upward trajectory for foreign trade in the coming quarter. Strong domestic demand will increase imports, which will mitigate the positive effects of this rebound on the balance of trade in the short term. Under our forecast, net exports will make a positive contribution to growth of 0.1 points of GDP in Q2 and a little higher than this in the following quarter, as demand continues strong. For full-year 2021, we estimate that net exports will add 1.2% to growth, offsetting the losses sustained in the previous year. Our outlook is for this contribution to slow to 0.4 points next year as pent-up demand as run down during 2022.

OUTLINE OF OUR SCENARIO

RISKS TO OUR SCENARIO

Risk matrix associated with our scenario

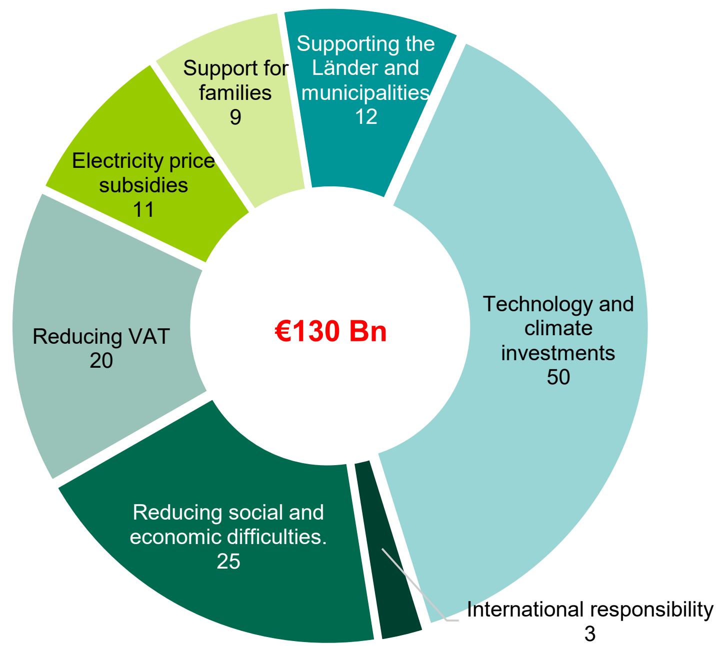
		Probability	Impact
↓	Persistent supply problems	High	High
	Low vaccine effectiveness in the context of a new variant	Medium	High
↑	Accelerated global growth	Medium	High
	Declining savings rate supporting consumption	High	High

CONTENTS

FOCUS: RECOVERY PLAN

KICKSTARTING LONG-TERM GROWTH

Stimulating growth, employment and productivity



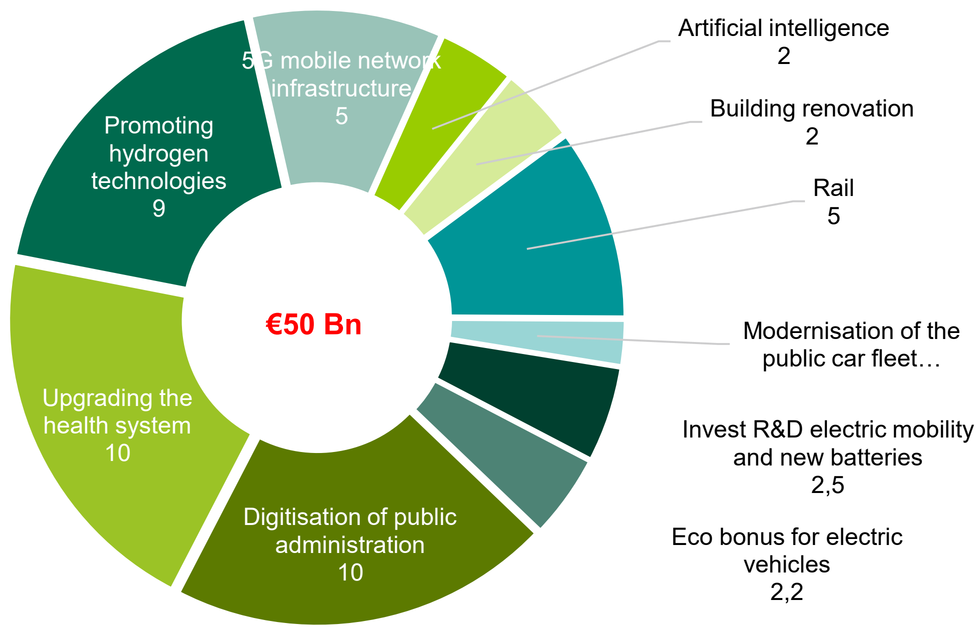
Sources: Ministry of Finance, Crédit Agricole SA / ECO

The German economic recovery plan is worth €130 billion or 4% of GDP to reboot the economy, invest in new technologies and combat climate change. The aim of the plan is to establish the conditions for lasting productivity gains. The measures in the plan break down into three top priorities. First (50% of spending): boost demand by temporary reductions in VAT, lower electricity bills and provide aid to families with a bonus benefit payment of €300 per child. The German government is also providing subsidies to companies to help cover fixed costs and some of the revenue lost to the pandemic. The second priority (10% of spending under the package) gives the *Länder* and local authorities a tax relief to offset shortfalls in trade tax and facilitate infrastructure investment. Third, the plan includes major investments to modernise the country and meet climate targets (40% of spending). These measures are strategically planned to lay the groundwork for new export technologies. This huge plan is complemented by grants from the New Generation European Recovery Plan (NGEU) for €23.6 billion by 2026, or 3% of the NGEU allocation. The EU funding alone will generate growth worth 0.6 points of GDP and 220,000 extra jobs in the economy by 2026.

FOCUS: RECOVERY PLAN

INVESTMENT IN NEW TECHNOLOGIES AND TO TACKLE CLIMATE CHALLENGES

Overhaul the industrial base



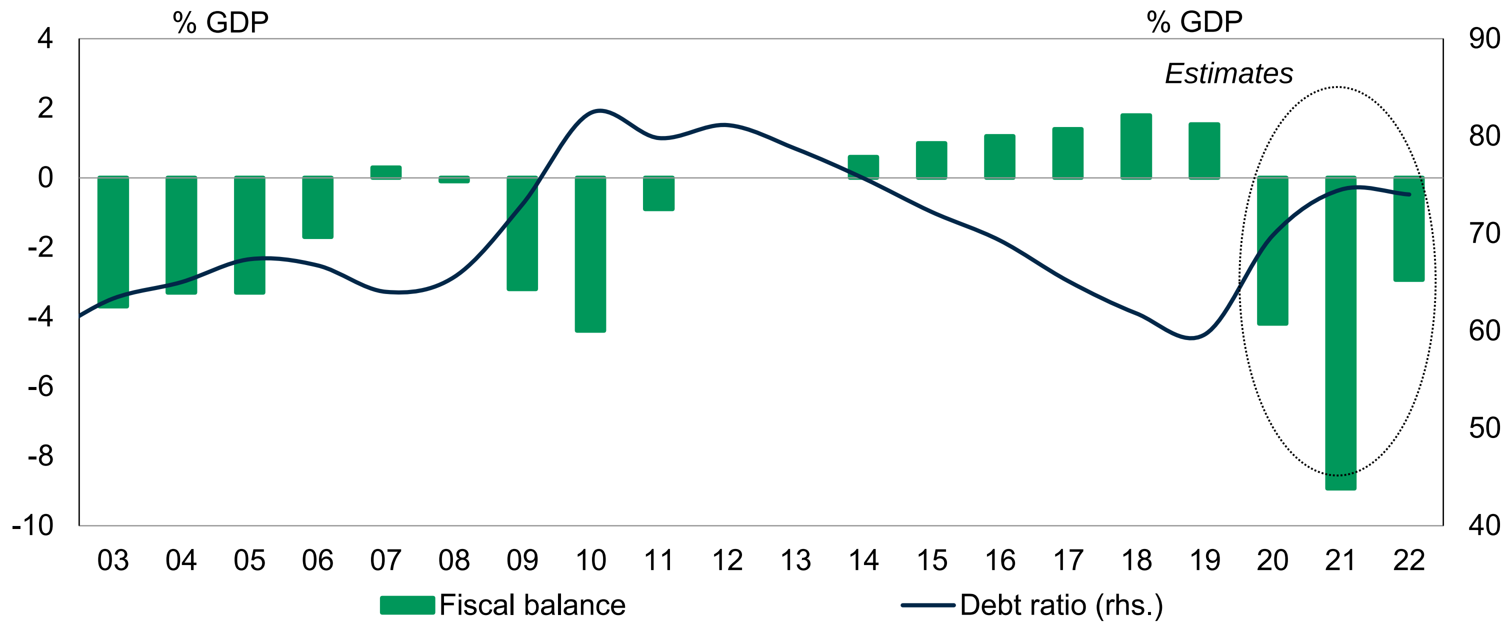
Sources: Ministry of Finance, Crédit Agricole SA / ECO

Investments in the technologies of the future and to counter climate change alone account for 40% of the recovery plan – a total of €50 billion. The aim is to modernise the country and lay the groundwork for the ambitious transformation of the industrial base. The strategy gives priority to decarbonising its industry through massive investments in green hydrogen technologies (through large-scale electrolysis, expanding industrial use, and European fuel cell production for electric vehicles). A public building renovation programme is also part of the plan to accelerate the energy transition. Turning to sustainable mobility, financing charging infrastructure, tax incentives to buy clean vehicles, modernising public urban fleets and renovating rail infrastructure are key parts of the drive to future-proof the country. Lastly, a digital innovation package includes investments in 5G infrastructure and AI. In addition, public services will be automated and online, digital networks in schools and colleges will be boosted and technological capacity in hospitals upgraded. The plan opens the way for numerous investment projects that will generate impetus for the future.

FOCUS: RECOVERY PLAN

THE COST IS HIGH BUT ACCEPTABLE FOR GERMANY'S PUBLIC FINANCES

Stimulus plan will temporarily widen the public deficit



Sources: Ministry of Finance, Crédit Agricole SA / ECO

The cost of responding to the health and economic crisis has severely dented Germany's public finances. In addition to the €130 billion deficit recorded last year (4% of GDP), Berlin is getting ready to push up the deficit substantially this year to €300 billion (8.9% of GDP). The majority of stimulus spending under the recovery plan is included in the target, such as support for businesses and households, short-time working benefits and provisions for taking equity stakes where necessary. Investment spending is spread out further over time. In 2022, the government plans to pursue this expansionist budget policy and has temporarily suspended the debt brake, setting the deficit on course to hit €100 billion. All in all, the cost of the coronavirus crisis adds up to €530 billion over the three years, equating to (15.9% of GDP). The spending will push the debt ratio up to 75% of GDP this year and then narrow back to 74% in 2022 – well below the 81% it reached during the 2009 financial crisis. The pandemic has pushed Berlin to abandon austerity and opt instead for policies to drive the transformation of its industrial model through long-term investment in green technologies and the digitisation of the economy.

CONSULT OUR LAST PUBLICATIONS

Date	Title	Theme
16/07/2021	United Kingdom – 2021-2022 Outlook: back to reality	United Kingdom
16/07/2021	Spain 2021-2022 Scenario – An uncertain summer	Spain
15/07/2021	The ECB's missed opportunity: gearing up for the next war… or the last one?	Eurozone
13/07/2021	France – Scenario 2021-2022: A recovery well underway	France
06/07/2021	Middle East – Political risk is not improving	Emerging countries
02/07/2021	World – Macroeconomic Scenario for 2021-2022: painfully divergent trajectories	World
02/07/2021	World – 2021-2022 Macroeconomic Scenario: economic and financial forecasts	World
01/07/2021	Covid-19 in sub-Saharan Africa: the dangers of the third wave	Emerging countries
25/06/2021	Henry, Milan and the rest	World
10/06/2021	Asia: vaccination delays a worry	Asia
03/06/2001	Seaweed: towards a greener future	Agrifood

VILAS BOAS Philippe

Philippe.vilasboas@credit-agricole-sa.fr

Completed on 13 July 2021

THANKS FOR YOUR ATTENTION

YOU CAN SUBSCRIBE TO OUR PUBLICATIONS ON OUR WEBSITE :
http://economic-research.credit-agricole.com/

Access and subscribe to our free online publications:
application available in App Store and in Google Play

Crédit Agricole S.A. — Group Economic Research
12 place des Etats-Unis – 92127 Montrouge Cedex

Publication Manager: Isabelle Job-Bazille - **Chief Editor:** Armelle Sarda
Information centre: Dominique Petit - **Statistics:** Robin Mourier, Alexis Mayer
Editor: Fabienne Pesty
Contact: *publication.eco@credit-agricole-sa.fr*