GERMANY
2023-2024 SCENARIO

THE WINDING PATH OF THE RECOVERY

April 2023

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WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

GROUP ECONOMIC RESEARCH

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SUMMARY

THE WINDING PATH OF THE RECOVERY

The German economy wobbled in Q4 2022, down 0.4% on Q3. Private consumption and investment dropped sharply, economic activity being propped up by net exports thanks to a decline in imports. The slump resulted from double-digit inflation, peaking in October at 11.6%. Inflationary pressures faded somewhat but did not completely disappear, continuing to impact consumption and investment in Q1 2023. Energy prices and producer prices have decreased, but their impacts have yet to be fully felt, and second-round effects stemming from union wage negotiations cannot be ruled out. More persistent inflation could jeopardise the country's ability to rebound.

The various economic indicators at our disposal suggest a further, albeit limited, decline in Q1, with high inflation continuing to impact consumption. The economy is expected to post a moderate recovery starting in Q2 as inflation gradually ebbs. Subsidies for capping the price of gas, electricity and urban heating will not be paid out before March, with a delayed effect on the loss of household purchasing power. Rising interest rates will also put the brakes on economic activity, particularly in the real estate sector, under pressure from higher financing costs and more restrictive access to credit. The country's loss of competitiveness due to rising energy prices remains a major issue in the longer term. At the same time, the roll-out of projects related to the country's industrial transformation towards a low-carbon economy will be a key source of growth. **We have revised our GDP growth forecast down slightly to 0.1% for 2023** owing to negative overhang from Q4 2022 and because Q1 continues to be hampered by the recessionary effects of inflation on household consumption and by sluggish investment. The expected recovery will begin in Q2 as price pressures recede, but the pace of the recovery will be slowed by uncertainties over global economic activity. As such, we expect **modest growth of 1% in 2024 as competitiveness is impeded by the sustained rise in energy costs**.

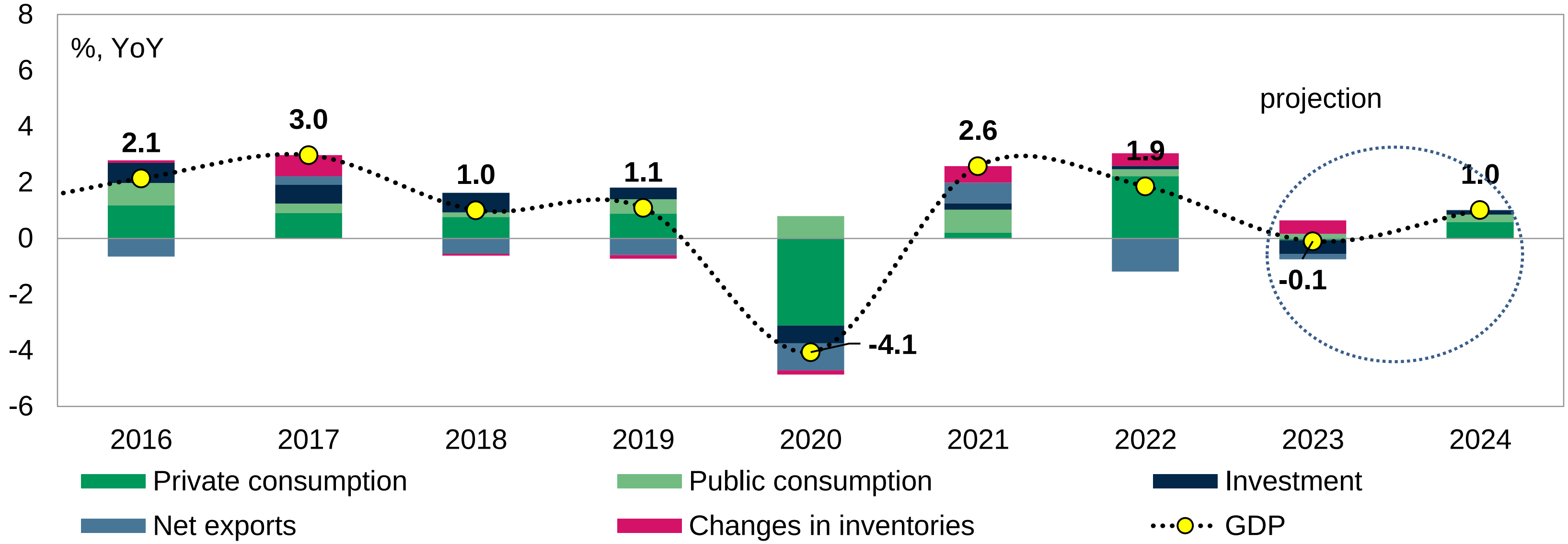
Private consumption was undermined by high inflation at the end of 2022, the effects of which continued in Q1 2023, underscored by the precipitous decline in retail sales. The government was slow to introduce measures to support purchasing power and ease the pressure on households and businesses. In another negative development, the definitive shutdown of the last remaining nuclear power plants in April could drive electricity prices upwards. Meanwhile, **unions are calling for higher wages than usual owing to the inflationary environment and persistent tensions on skilled jobs.** Their demands could lead to higher wage growth than initially expected. Business investment will suffer from weak demand and the erosion of margins stemming from production costs, as well as higher project financing costs and scant visibility on the direction of the ecological transition. Investment in construction will also remain heavily impacted by the rise in interest rates, which is keeping a lid on home loans. Net exports will continue to weigh on growth due to the slowdown in the US economy, Germany's largest export partner. In the longer term, the country will have **to rethink its trade policy with the US and China in favour of an industrial policy more focused on its European partners.**

Fiscal policy will remain expansionist in 2023 (with an expected deficit of 3.1% of GDP) but much less accommodative thereafter, the government having announced that it will once again comply with the debt brake rule as of 2024 (with an estimated deficit of 2.2% of GDP). The three successive packages of support measures for households and businesses to limit the negative effects of inflation will have cost €95 billion, i.e. 2.5 points of GDP. The "defensive shield" capping gas, electricity and urban heating prices through April 2024 is currently estimated at €83 billion (2.1 points of GDP) with an upside risk depending on the cost of energy generation. Public debt is therefore expected to rise slightly to 67.5% of GDP in 2023, before returning to a downward trajectory guided by fiscal prudence and the hoped-for return of fiscal balance in the coming years.

SUMMARY

THE WINDING PATH OF THE RECOVERY

Contributions to annual growth



Germany	Yearly average (YoY, %) 2021	2022	2023	2024	Quaterly growth (QoQ, %) 2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2	2024 Q3	2024 Q4
GDP	**2,6**	**1,9**	**-0,1**	**1,0**	**0,8**	**0,1**	**0,5**	**-0,4**	**-0,3**	**0,1**	**0,2**	**0,3**	**0,3**	**0,3**	**0,3**	**0,3**
private consumption	0,4	4,4	-0,1	1,1	0,7	0,6	0,7	-1,0	-0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,4
investment	1,0	0,6	-2,4	0,7	2,3	-1,2	1,3	-2,5	-0,8	-0,2	0,1	0,2	0,2	0,2	0,3	0,3
change in inventories *	0,6	0,5	0,5	0,0	-0,3	0,7	0,1	0,3	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
net exports *	0,7	-1,2	-0,2	0,0	0,1	-0,7	0,0	0,1	-0,1	-0,1	0,0	0,0	0,0	0,0	0,0	0,0
unemployment rate	3,6	3,1	3,2	3,3	3,1	3,0	3,1	3,0	3,2	3,2	3,2	3,2	3,3	3,3	3,3	3,3
Inflation	3,2	8,7	6,2	3,0	6,1	8,3	9,4	10,8	8,6	6,8	6,2	3,5	3,2	3,2	2,9	2,7
Government net lending	-3,7	-3,3	-3,1	-2,2												

** Contributions to GDP growth*

Sources: Crédit Agricole S.A./ECO, forecasts

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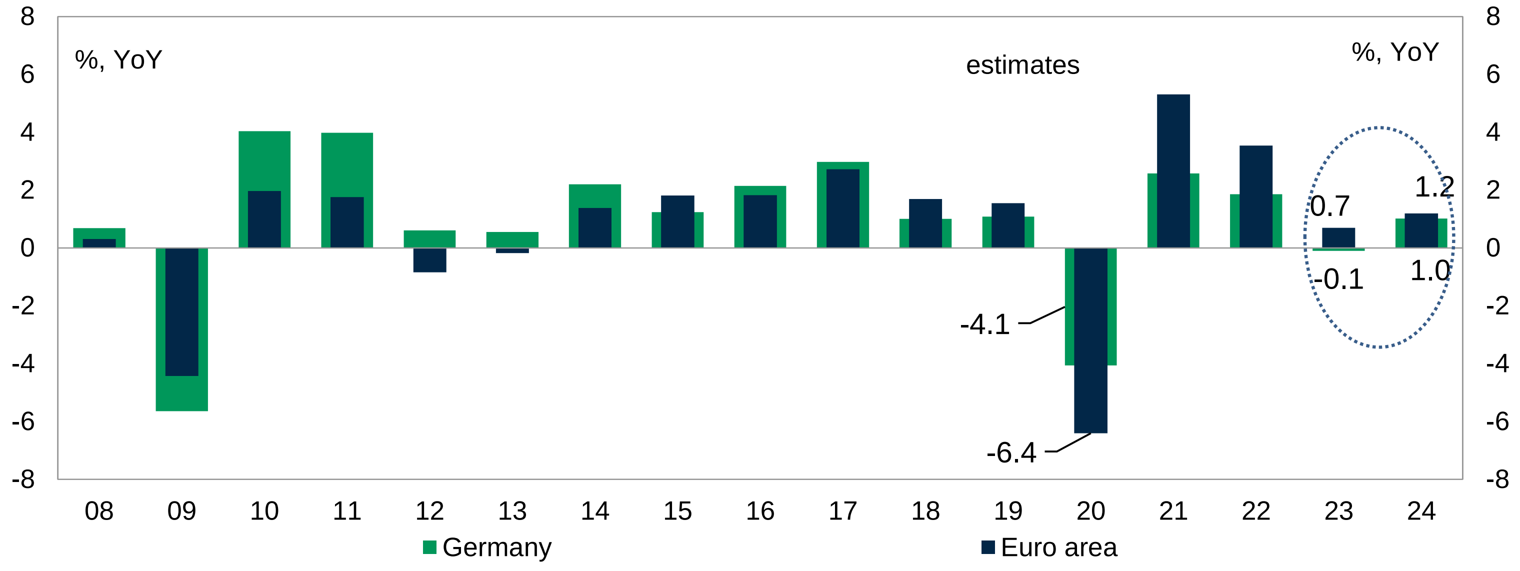
INFLATION EBBS BUT LEAVES ITS MARK

Consumption still hampered at the start of the year



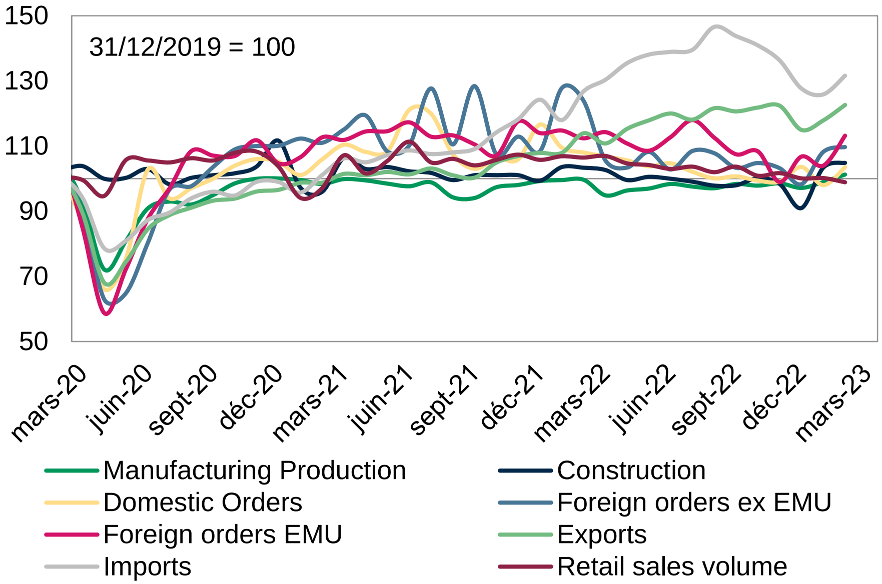
Sources: Eurostat, Crédit Agricole S.A./ECO

German activity was particularly affected by the acceleration in inflation, which reached 10.8% in Q4, leading to a 0.4 qoq decline in GDP. Private consumption and investment were significantly impacted, while net exports benefited from a stronger contraction in imports than exports. The GDP gap relative to its pre-crisis level widened again with a substantial lag in consumption and investment. Inflation is expected to continue impacting economic activity in Q1 despite an easing in price pressures. Inflation will continue to trend downwards but also continue to undermine the expenditure of the most vulnerable households in Q1. Subsidies linked to the cap on electricity prices will not be paid before March, with a delayed impact on household purchasing power gains. Our growth forecast includes a slight 0.1% drop in GDP in 2023 owing to the negative overhang from Q4 and a further contraction in activity expected in Q1 as inflation continues to throttle consumption. But this technical recession should give way to a moderate recovery in growth starting in the second half of the year, leading to a limited rebound of 1% in 2024 owing to the recessionary effect of the increase in interest rates, which will weigh on construction. In the longer term, rising energy bills will continue to hinder Germany's competitiveness and growth potential.

RECENT ECONOMIC TRENDS

TOWARDS A STRONGER INDUSTRIAL REBOUND?

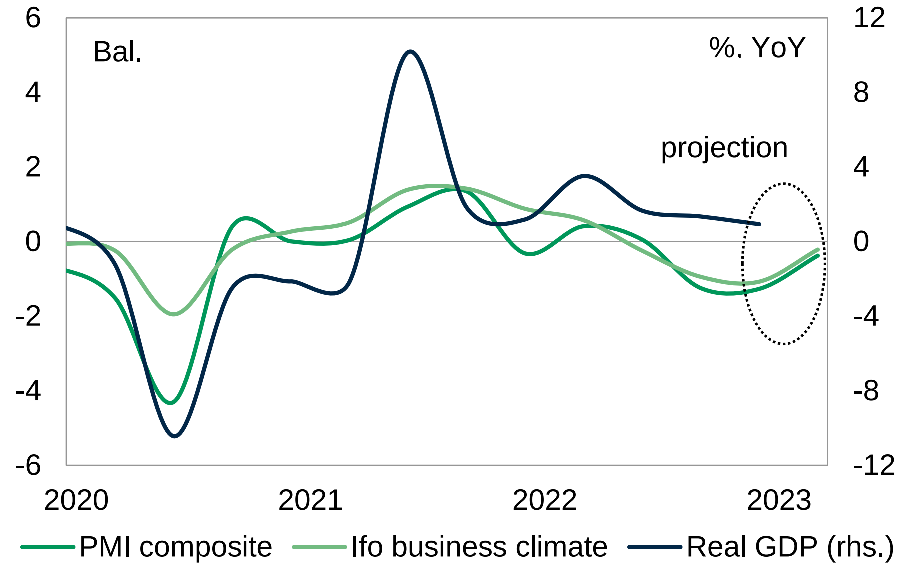
Trends in the main indicators



Sources: FSO, DB, Crédit Agricole S.A./ECO

Industrial activity picked up surprisingly at the beginning of the year, driven by the automotive industry, which recovered sharply as supply improved and enabled carmakers to catch up on orders. Domestic and foreign demand is improving, suggesting stronger recovery momentum providing that energy prices do not pick up again and negatively impact energy-reliant industries. The Q1 growth overhang was 2.8% after growth of 0.2% in Q4. On the downside, retail sales reflect significant pessimism as inflation continues to seriously undermine household consumption.

Business surveys and real growth



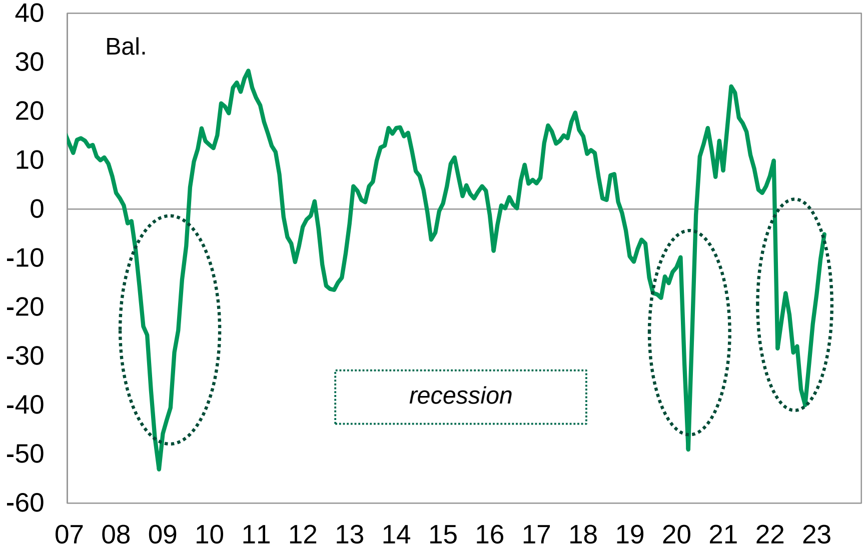
Sources: IFO, Crédit Agricole S.A./ECO

The composite PMI for purchasing managers points to a recovery in activity in Q1 as services activities begin to expand again. Industrial activity continues to contract, though the situation improved in Q1. The Ifo business climate index also points to an improvement in activity in Q1, both in industry and services. Six-month activity expectations are also looking brighter, with fewer intermediate product shortages, more contained energy prices and lower production costs for companies.

RECENT ECONOMIC TRENDS

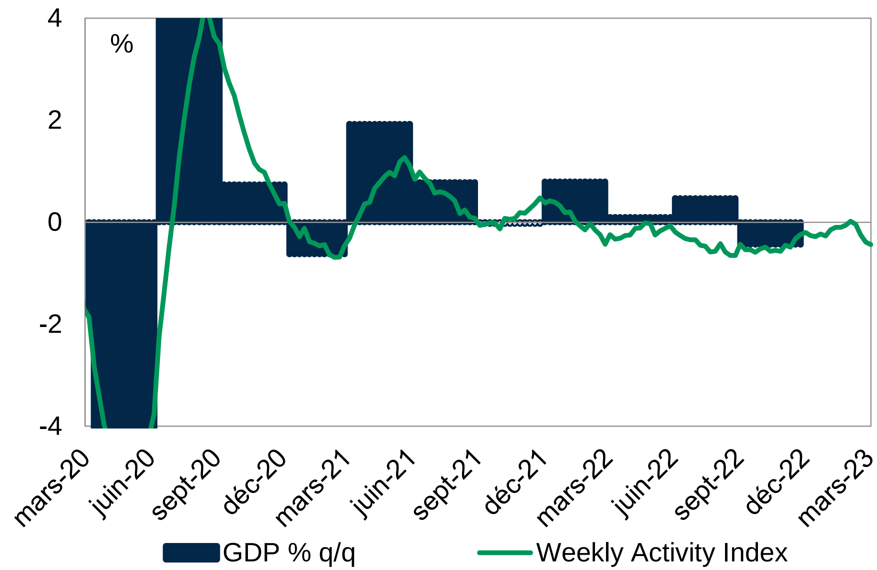
ECONOMIC INDICATORS BRIGHTEN BUT REMAIN HIGHLY UNCERTAIN

Industrial production activity forecast



Sources: Ifo, Crédit Agricole S.A./ECO

Weekly activity index and GDP growth



Sources: Bundesbank, Crédit Agricole S.A./ECO

Expectations for industrial activity are recovering, pointing to a more sustained recovery in the pace of activity in the coming months. However, an assessment of the situation in the first quarter does not make it possible to rule out a technical recession. The road traffic index, a tangible indicator of industrial activity, also rebounded, suggesting an end to the shortage of intermediate products and a more dynamic recovery. However, catch-up in the production of durable goods may not suffice to offset the negative and persistent effects of inflation on consumption as a whole.

The Bundesbank's weekly activity index suggests a contraction in Q1, with an implicit GDP growth rate of -0.3% at the end of March compared with the last three months. This is in line with our estimate of a 0.3% GDP contraction over the period. While the recovery is under way, it remains fragile and vulnerable to any exogenous inflationary pressures. Furthermore, the interest-rate hike implemented to curb inflation could have a delayed impact on economic activity resulting in relatively weak growth over the rest of the year.

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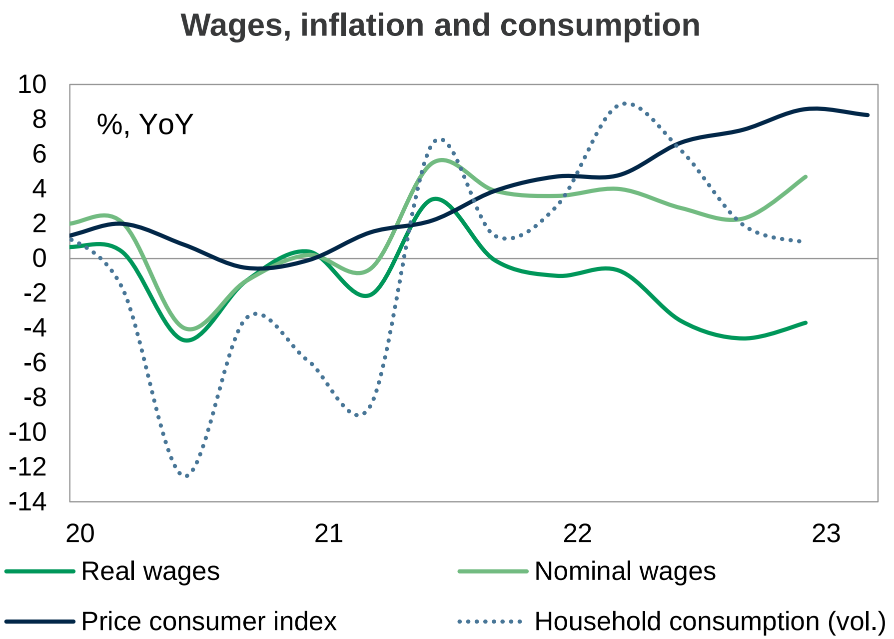
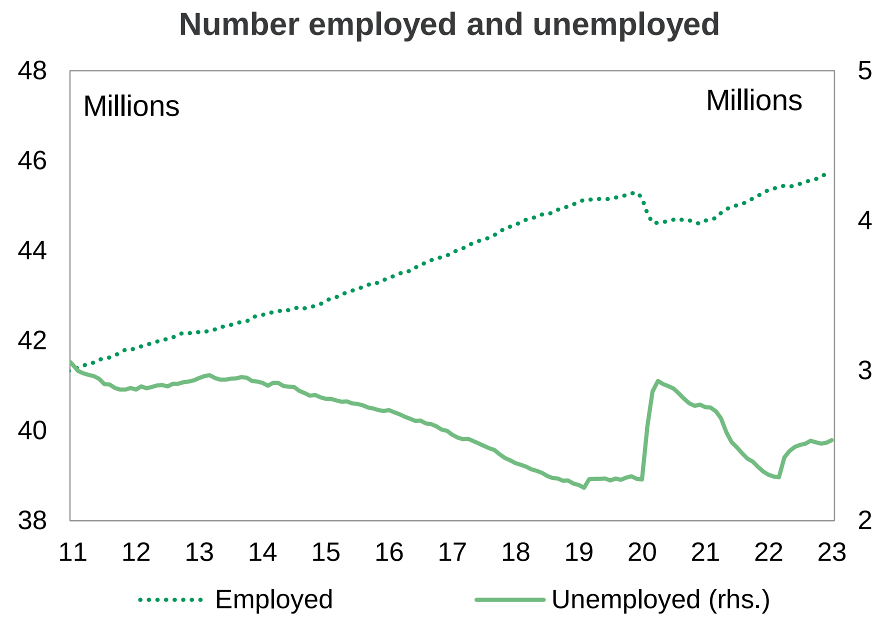
OUTLINE OF OUR SCENARIO

JOBS, WAGES AND CONSUMPTION



Sources: FSO, Crédit Agricole S.A./ECO



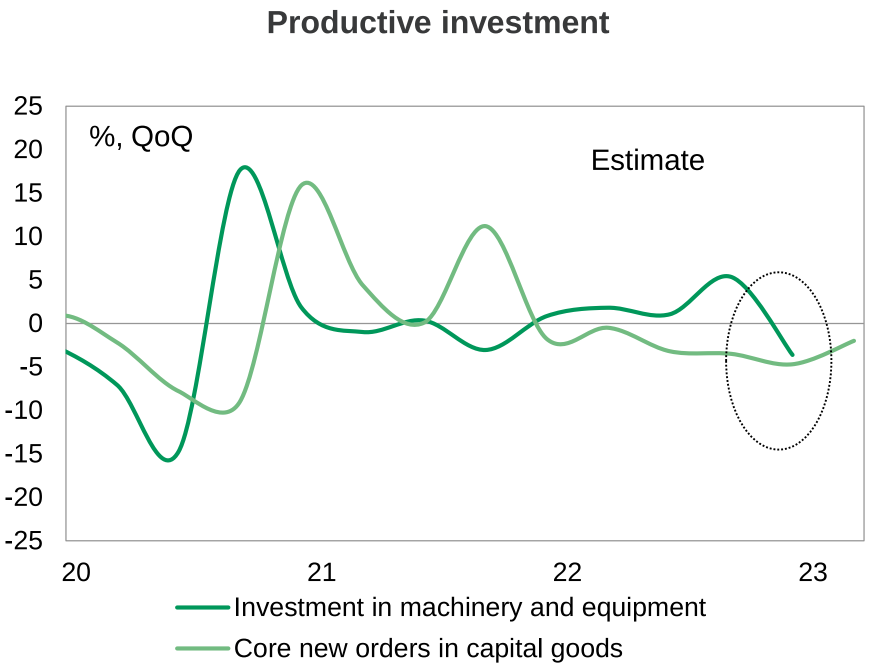
Sources: Agentur für Arbeit, Crédit Agricole S.A./ECO

Nominal per-capita wages rose 5.6% year-on-year in Q4 2022, while the consumer price index rose nearly 11%, eroding purchasing power and significantly affecting consumption. The decline in inflation in the coming months will be supported by a favourable base effect and a lull in energy prices, but wage pressures are expected to increase. The increase in Germany's minimum hourly wage to €12 in October for 6.2 million people will continue to drive salaries upwards in 2023. In addition, unions are calling for substantial wage increases. Public-sector workers are demanding a 10.5% increase, the postal service 15%, the national rail operator 12%, and the textile industry 10.5%.

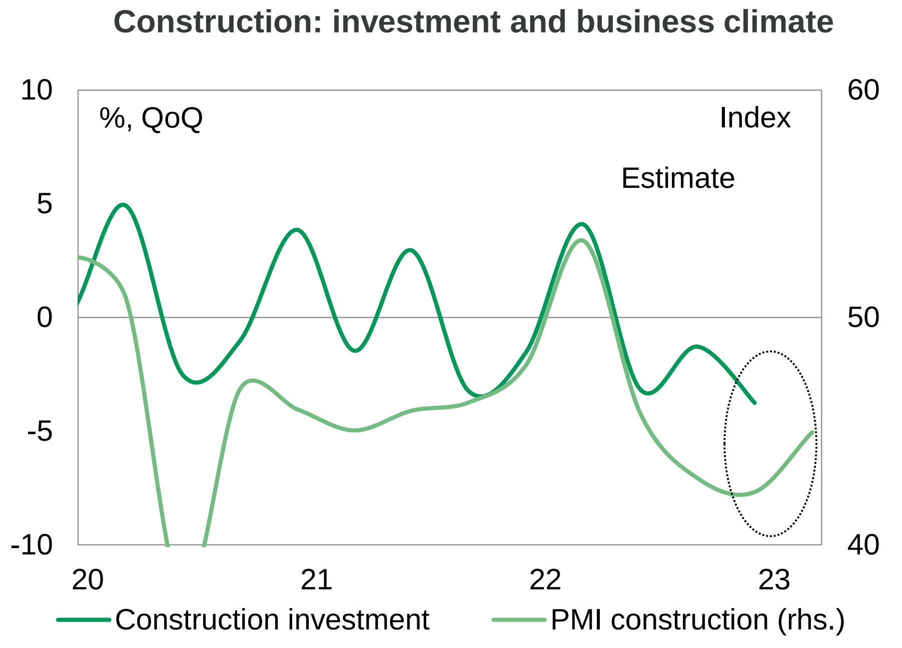
Nearly 11 million employees would be concerned by these increases overall. High inflation and persistent job shortages are driving wage demands higher than in previous years. Overall wages could increase between 4.8% and 5.2% this year, outstripping our most recent estimates. Job creation continues and the unemployment rate has stabilised at 5.5%. The savings rate remains at around 11.4%,more or less the same as before the crisis. We expect consumption to decline slightly in Q1, by around 0.3% qoq, after -1% in Q4, as it will continue to be impacted by inflation before strengthening as the latter eases.

OUTLINE OF OUR SCENARIO

INVESTMENT: SHORT-TERM OUTLOOK



Sources: FSO, Crédit Agricole S.A./ECO



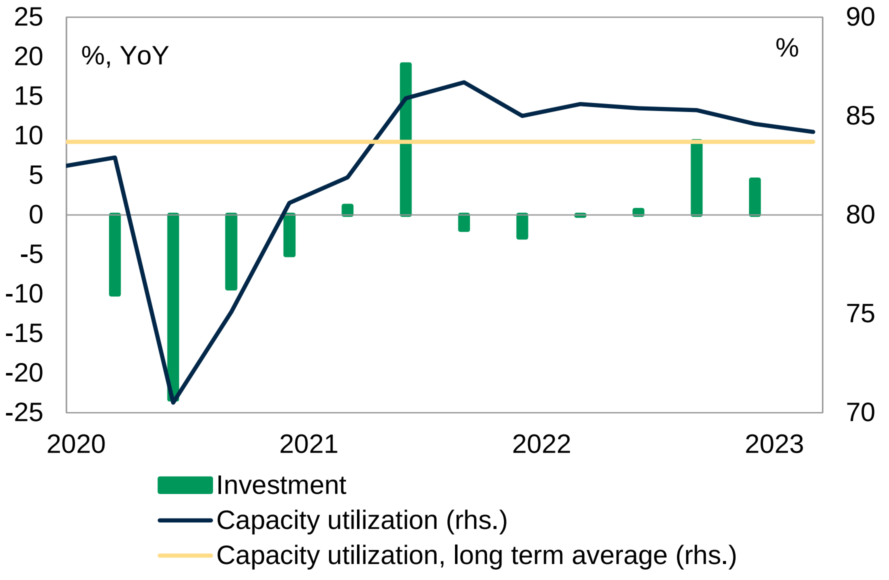
Sources: FSO, Markit, Crédit Agricole S.A/ECO

Productive investment fell 3.6% quarter-on-quarter in Q4 and was 3.7% lower than before the health crisis. The improvement in domestic orders for capital goods suggests a potential but fairly limited recovery in Q1. Higher production costs and lower competitiveness are likely to dissuade companies from embarking on new investments. Construction investment fell 2.9% qoq in Q4 for three consecutive quarters of decline. The rapid rise in interest rates to a relatively high level has ultimately weighed on real estate purchases owing to higher financing costs. Rising temporarily in February before falling again in March, the construction PMI contracted for the twelfth consecutive month. We expect a dip in total investment throughout the first half of the year ahead of a slight recovery mid-year as part of the necessary transformation of the energy-intensive and fossil fuel-dependent industrial production system.

OUTLINE OF OUR SCENARIO

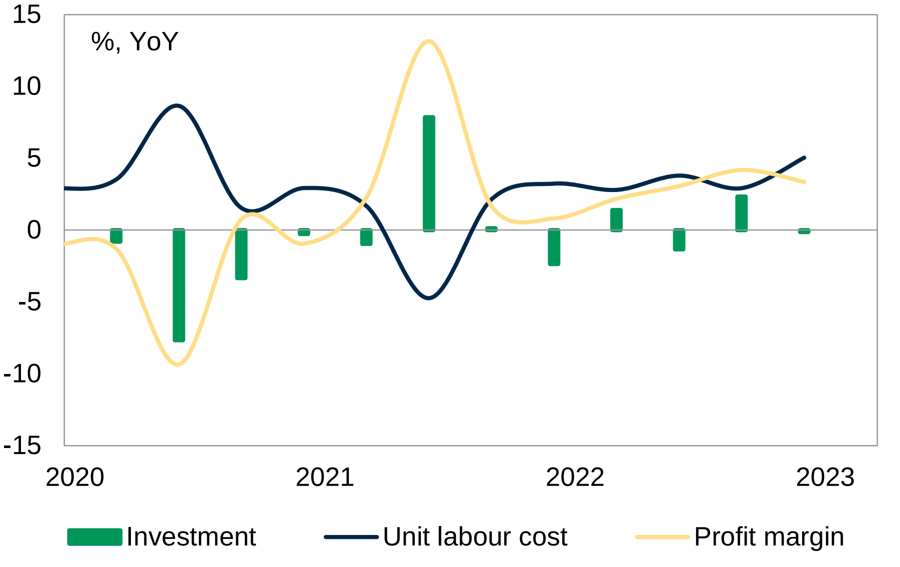
INVESTMENT: UNDERLYING TRENDS

Productive capacity utilisation rate



Sources: Destatis, Crédit Agricole S.A./ECO

Margins, unit wage costs and investment

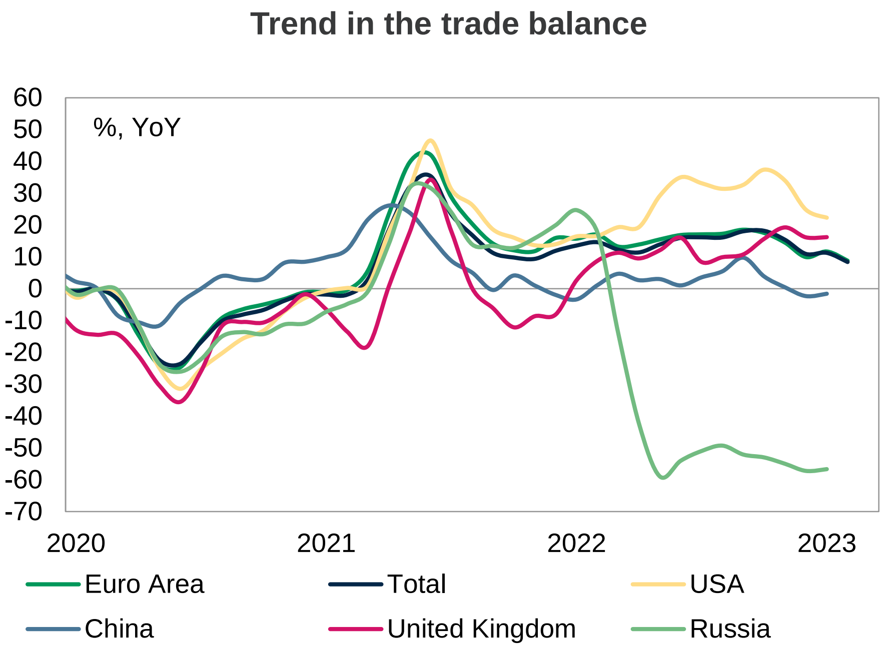


Sources: Destatis, Crédit Agricole S.A./ECO

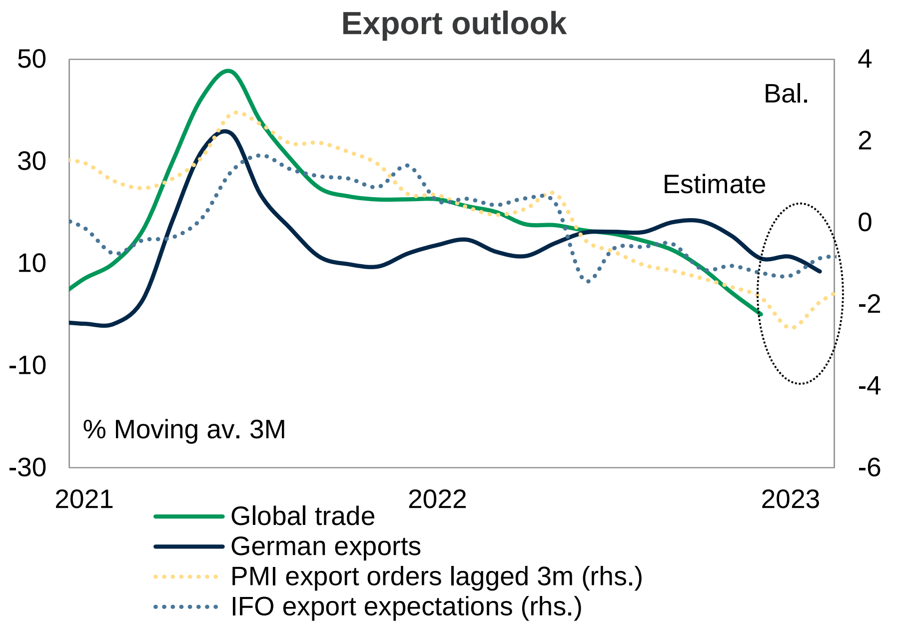
The capacity utilisation rate continued to decline in Q1 but remains above its long-term trend. Supply bottlenecks and order delays have decreased significantly, especially in the automotive sector, and industrial orders appeared to firm up in February. The margin rate eroded with the rise in unit labour costs, leading to a decline in investment in Q4. Commodity prices appear to be less of a source of concern for companies at the start of the year, while wage negotiations are likely to generate higher unit labour costs and reduce corporate margins. As such, we expect overall investment to contract by 2.4% in 2023 on rising wage costs and a sharp drop in construction investment. We also expect the need to step up the ecological transition to generate a recovery in productive investment at the end of the year and an acceleration in 2024.

OUTLINE OF OUR SCENARIO

FOREIGN TRADE



Sources: Bundesbank, Crédit Agricole S.A./ECO



Sources: Destatis, Crédit Agricole S.A./ECO

German exports appear to have slowed in Q1 but remain more dynamic than imports, suggesting an improvement in the trade balance in the short term. The percentage of goods blocked in ports awaiting loading dropped to 7.4% of goods, compared with 10% a year earlier and 12% at the height of the health crisis. Both the PMI for export orders and the Ifo's export forecasts point to a recovery in trade in the coming months. However, while exports to China may increase as the country reopens, the US growth outlook will be more pessimistic, with a technical recession expected in the second half of the year that will inevitably impact the country's demand. For these reasons, we expect trade to make a negative contribution to growth, at -0.2 points of GDP in 2023 compared with -1.2 points in 2022. For 2024, we see a zero contribution from exports due to the loss of industrial competitiveness resulting from persistently higher energy prices and the increased risk of a tightening of Chinese and US trade policies that would be detrimental to Germany.

RISKS TO OUR SCENARIO

Risk matrix associated with our scenario

		Probability	Impact
↓	Price-wage spiral	Low	High
	Sustained high inflation	High	High
↑	Additional support measures for households and businesses	Medium	Medium
	Acceleration of industrial orders linked to sustained external demand	Medium	High

Source: Crédit Agricole S.A./ECO

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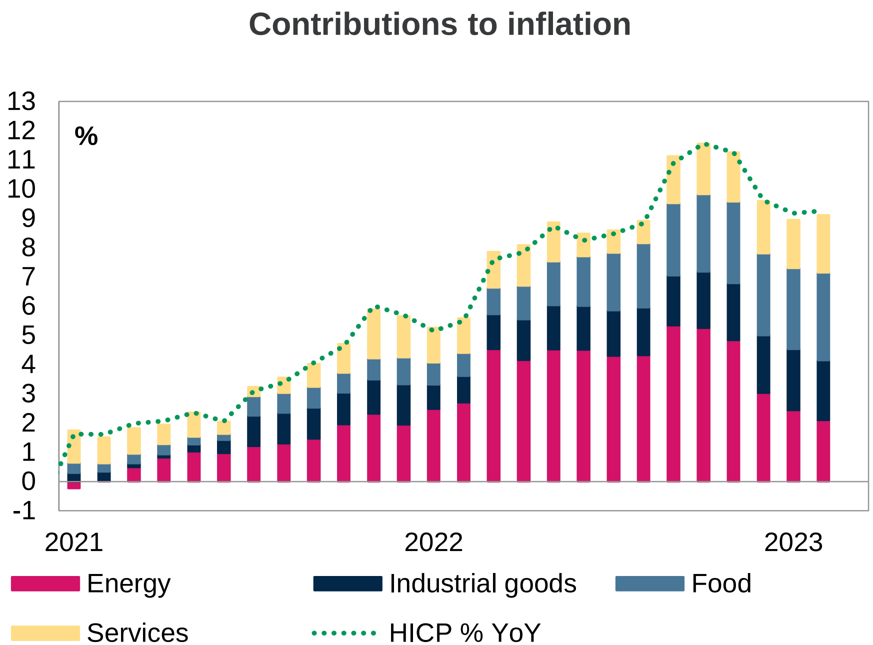
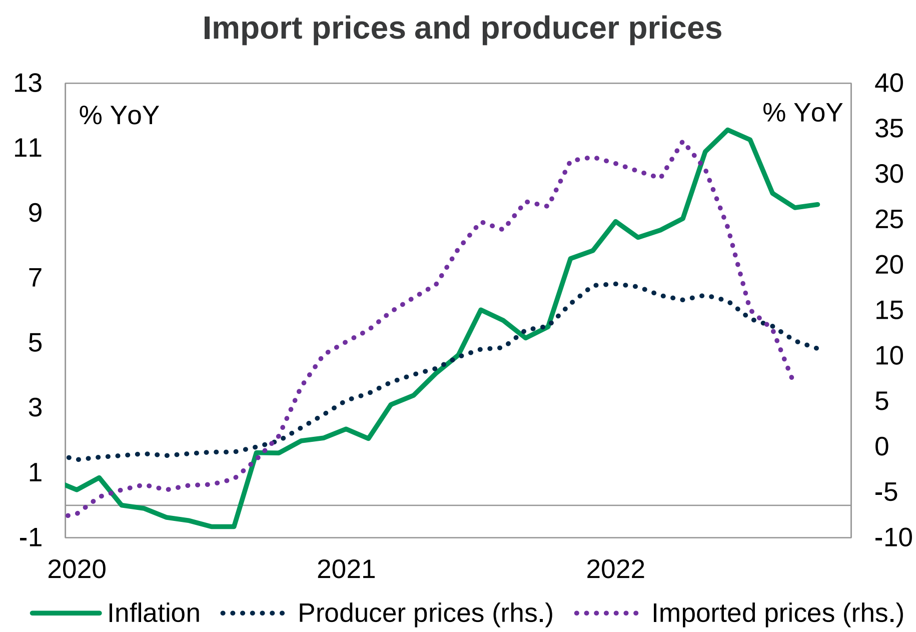
DECLINE EXPECTED TO GATHER IN PACE IN THE COMING MONTHS



Sources: Eurostat, Crédit Agricole S.A.



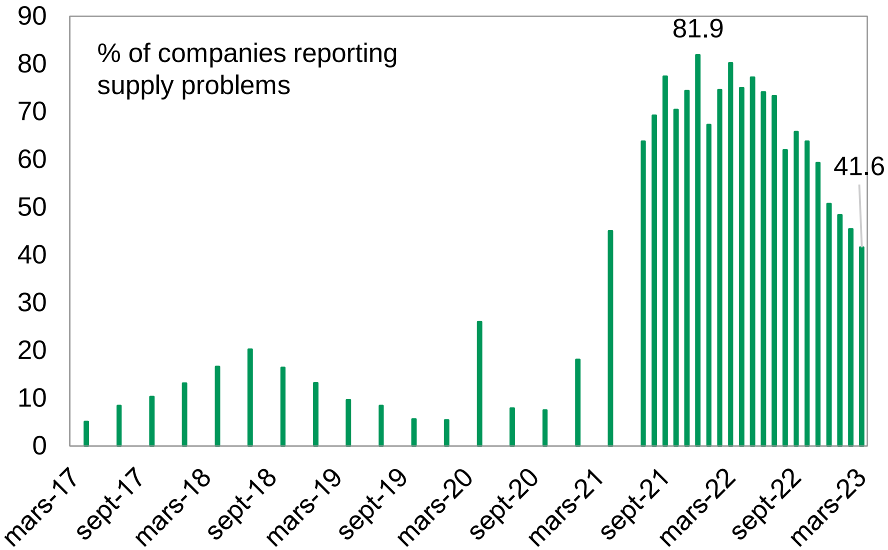
Sources: Eurostat, Crédit Agricole S.A.

German inflation rose to 9.3% in February after 9.1% in January and a peak of 11.6% in October. While energy inflation seems to be more contained, its impact on other components such as food and services may nevertheless generate some erratic upward movements. However, the fall in import prices that began last summer has continued unabated, translating into a decrease in producer prices, which also appears to be continuing. Rebuilding liquefied gas inventories before next winter has now become less crucial, with reserves high and floating terminals fully operational. Lastly, the disappearance of the base effect linked to the war in Ukraine is expected to fade automatically over the course of the year. But ongoing collective bargaining may drive domestic inflation upwards. We expect inflation to fall more swiftly in Q1 and reach 3.5% at the end of the year and 2.7% at the end of 2024, i.e. above the ECB's recommended 2% target.

FOCUS: DISINFLATION INITIATED, BUT AT WHAT PACE?

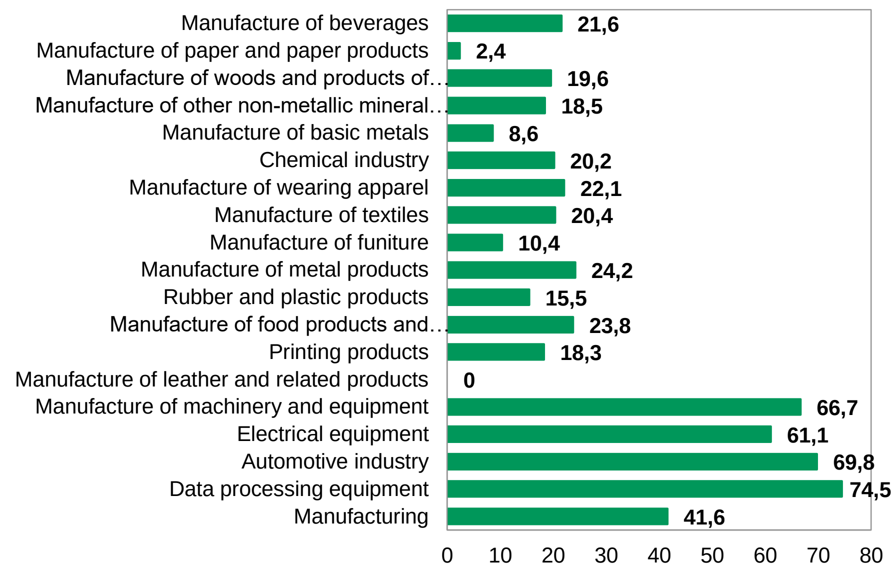
A CLEAR SUPPLY-SIDE IMPROVEMENT

Indicator of industry shortages



Sources: Ifo, Crédit Agricole S.A.

Main sectors facing supply difficulties



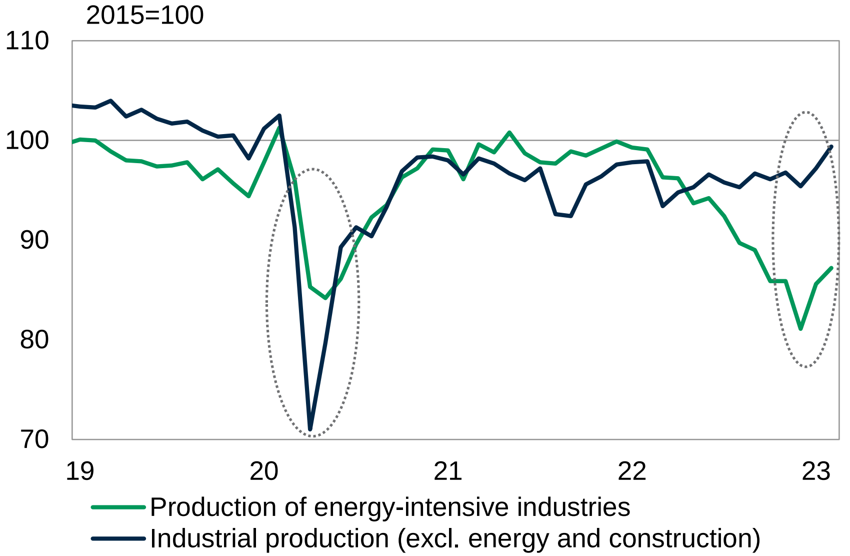
Sources: Ifo, Crédit Agricole S.A.

Global supply-chain bottlenecks have eased substantially since China dropped its zero-COVID policy. According to the Ifo indicator on shortages in the manufacturing sector, 41.6% of surveyed companies continue to report difficulties sourcing intermediate products necessary for production, compared with 82% at the height of the crisis in December 2021. Most sectors now consider that the situation has almost returned to normal. But some sectors – including automotive, data processing equipment, electrical equipment, and machinery and equipment – continue to report serious supply issues. The Kiel indicator on the percentage of world goods blocked in ports continues to fall significantly (7.4% in March). This suggests that the return to normal is continuing, with a swift recovery in store for manufacturers if demand holds up.

FOCUS: DISINFLATION INITIATED, BUT AT WHAT PACE?

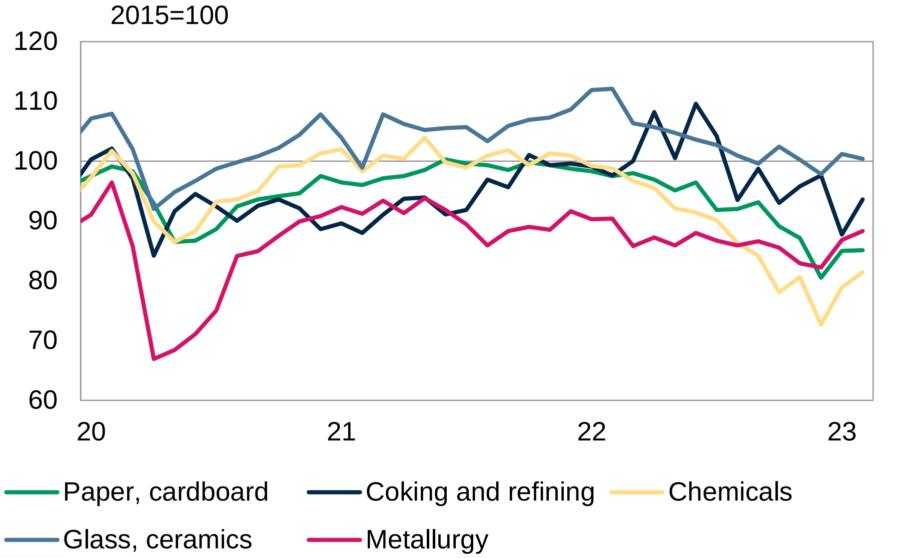
TEMPORARY RELIEF FOR INDUSTRY

Change in production in energy-intensive industries



Sources: Destatis, Crédit Agricole S.A.

Production indicator for energy-intensive industries



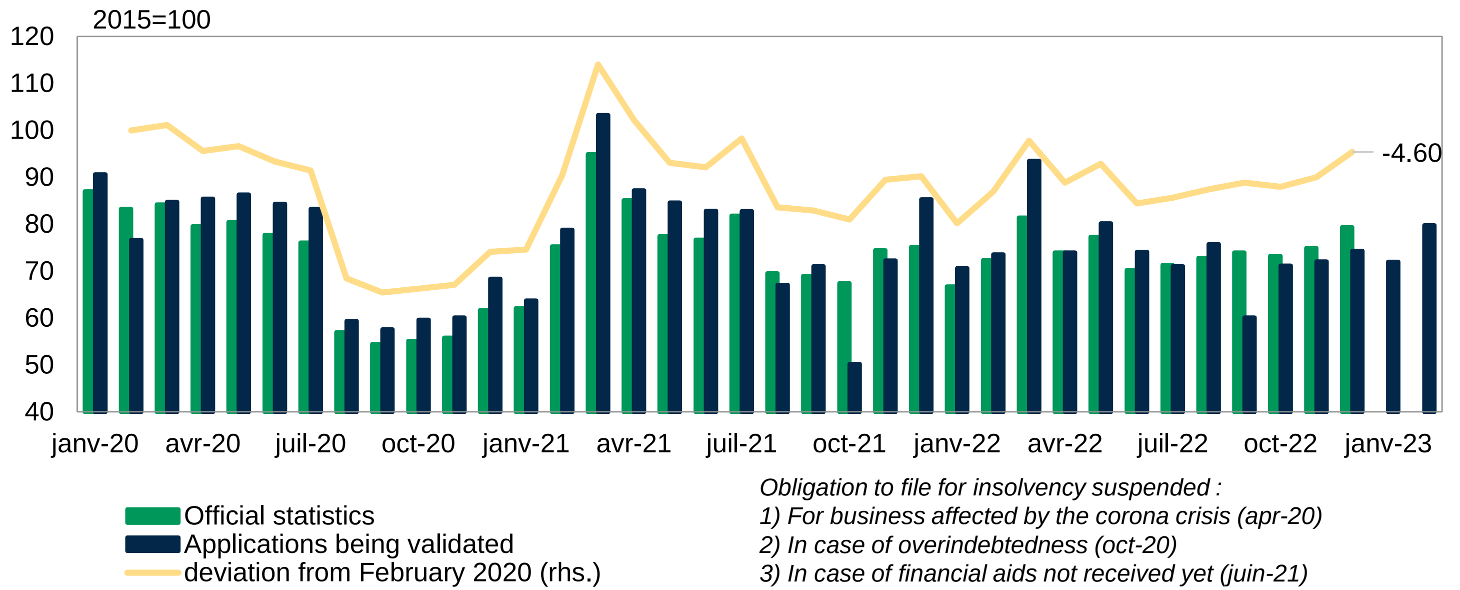
Sources: Destatis, Crédit Agricole S.A.

The production index of the most energy-intensive industries has recovered alongside that of traditional industries. However, in February 2023 the index exceeded its level of the previous year before Russia invaded Ukraine (+1.5%), while the index of energy-intensive industries remains 12% below its pre-war level. Replacing gas with other energies remains difficult if not impossible for some industries. Rising fossil fuel prices could have a more lasting impact on these sectors and make them less competitive in the future. But the easing of commodity prices together with federal subsidies to cap gas and electricity prices are helping to cushion the shock. That said, the situation remains difficult for the chemicals, cardboard and metallurgy industries. Although the latter represent just 21% of industrial added value, they are curbing the development of industry as a whole and negatively impacting business activity in general.

FOCUS: DISINFLATION INITIATED, BUT AT WHAT PACE?

DEFAULTS STILL FEW AND FAR BETWEEN

Corporate insolvency claims



Sources: Destatis, Crédit Agricole S.A.

The health crisis and the war in Ukraine had significant repercussions on GDP growth, but the support measures provided to businesses limited the impact on activity and employment. Since May 2021, companies have once again been required to declare insolvency. But there has been no sharp increase in the number of companies declaring bankruptcy. Official figures show considerable resilience, with the number of bankruptcies still 4.6% lower than before the crisis.

Companies appear to have perceived these exogenous shocks as purely transitory and have generally held up fairly well owing to continued demand. Large-scale government financial support has proved decisive in overcoming these shocks. Continued entrepreneurial resilience should be further bolstered in the second half of the year by a recovery in activity.

FOCUS: DISINFLATION INITIATED, BUT AT WHAT PACE?

COSTLY AND TEMPORARY BUT NECESSARY SUPPORT

Measures to support households and businesses to limit the effects of inflation.	Support plan n°1	Support plan n°2	Support plan n°3	Total	GDP points
Policies to support purchasing power :	14,25	9	39,3	62,6	1,6
200 increase in the flat-rate income tax allowance (to €1,200)	4,2			4,2	0,1
Increase of the first income tax bracket to €10,347	6,75			6,75	0,2
Increase in family allowances	1,5	0,75		2,25	0,1
Extend eligibility for housing benefit from 2 million to 700k people			3	3	0,1
One-off payment of €200 for students			3	3	0,1
300 one-off payment for pensioners			6	6	0,2
Continuation of the €9 ticket system for transport			1,5	1,5	0,0
Extension of short-time working allowance			1,5	1,5	0,0
Monthly reduction to €9/month for public transport		3		3	0,1
General increase of the tax-free income ceiling for "midi-jobs" from €1300 to €1600			1,3	1,3	0,0
Flat rate energy grant of €100 for unemployed people	0,75			0,75	0,0
135 flat rate energy grant for students and vulnerable people	1,05			1,05	0,0
Flat rate energy grant of €300 for employees		5,25		5,25	0,1
Transformation of Hartz IV into a €500 citizen's income			3	3	0,1
Increase of the monthly child allowance by EUR 18/month per child			2	2	0,1
Deduction of pension contributions			5	5	0,1
Widening of income tax brackets			12	12	0,3
Fund for global food security			1	1	0,0
Business support policies and state aid :			9,7	9,7	0,3
Exemption from tax contributions for companies paying exceptional salaries			1	1	0,0
Subsidies to energy-consuming companies			1,7	1,7	0,0
Extension of reduced VAT to 7% in restaurants and hotels			4	4	0,1
Postponement by one year of the planned €5/tonne increase in the price of CO2 on 1 January			3	3	0,1
KFW support programmes to ensure liquidity in the gas markets					0,0
Policies to limit price increases:	0,75	6	16	22,8	0,6
Reduction of VAT on fuels to 7% vs. 19			6	6	0,2
Reduction of 30 € cents/litre on petrol and 14 € cents/litre on diesel for 3 months		6		6	0,2
Reduction of VAT on natural gas to 7% instead of 19			10	10	0,3
Abolition of the renewable energy tax	0,75			0,75	0,0
Total	15	15	65	95	2,5
Defensive Shield				Total	
Gas price cap for households - gas price at 12 cents €/KWh for 80% of consumption in September 2022				20	0,5
Gas price cap for businesses - gas price at 7 cents €/KWh for 70% of consumption in 2021				10	0,3
Price cap for electricity - 40 cents €/KWh				45	1,2
Price cap for district heating - 9.5 cents €/KWh				8	0,2
Total				83	2,1

The German government has rolled out three support plans for a total of €95bn (or 2.5 points of GDP) to help households and businesses cope with these exogenous inflationary tensions. The aid is focused primarily on households, notably in the form of tax breaks and subsidies, with more modest backing for companies. The government has also implemented a "defensive shield" of nearly €83bn (2.1 points of GDP) capping gas, electricity and district heating prices, the main measures of which will apply through April 2024. This costly support is a source of vital relief for households and businesses as it serves to halt or limit the decline in their purchasing power and competitiveness.

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