

## Germany: All good things eventually come to an end

Despite the messy and chaotic vaccination programme, Germany's economy is holding up relatively well, benefiting from better vaccination rollouts than in other parts of the world. Expect the German economy to grow by around 4% this year and in 2022



The Germany  
Chancellor, Angela  
Merkel

Germany and Germans are well-known for being organised, well structured and solid. These characteristics helped to get the country and the economy through the first phase of the pandemic relatively smoothly. The impressive U-turn on fiscal policy prepared the ground for what was supposed to be a stronger and swifter recovery than most other countries.

However, the second phase of the crisis has shown the other side of the Germany economy - the one that lacks flexibility and digitalisation - both of which are holding back the vaccination programme.

If you're wondering what happened to the good old German characteristics? Well, all good things eventually come to an end.

## Strong manufacturing

At the end of 2020, industrial production, exports and the construction sector prevented the entire economy from falling into contraction. The often-criticised growth drivers - industry and exports, benefited significantly from strong demand from Asia and China.

As the service industry continued to suffer from lockdowns and social distancing measures, the manufacturing sector was hardly hit by the second lockdown, and this divergence started last summer.

The nature of 'smart lockdowns' is clearly one important driver. While many parts of the German manufacturing sector voluntarily closed down during the first lockdown, also driven by severe supply chain disruptions, factories remained open during the second lockdown. Also, don't forget the German manufacturing sector seems to have benefited a lot from the strong and continuing recovery of the Chinese economy, however, there is a distinction between cyclical and structural rebound. In our view, the strong industrial performance since the summer is cyclical and not so much a structural rebound.

Looking ahead, it looks unlikely that the cyclical swings in industrial production, construction and exports will save the entire economy from falling into contraction again in the first quarter, even if the current picture is mixed. With production expectations in the manufacturing sector surging and order books still improving, the prospects of industrial production remain positive. On the other hand, with the sharp fall in January and the winter weather in February, the construction sector will hardly be a growth driver in the first quarter.

## The not-so-perfect vaccination rollout

The outlook for services and consumption is obviously closely linked to social distancing and lockdown measures.

In this regard, the extension of the current lockdown measures until the end of March does not bode well. Even if some easing of the measures has been announced, the slow and chaotic vaccination rollout will leave its mark on the economy. In fact, while the supply of vaccinations will gain momentum in the coming weeks, bureaucracy and inflexibility are hampering the rollout, so much so that the expected 20 million vaccines by the end of March, some 8 million, could end up somewhere in the fridge, unused.

The problems with the vaccination rollout illustrate the German economy's problems and challenges after the pandemic, which in all honesty are similar to those of the previous crisis - namely, a lack of digitalisation, structural reforms and the need for more investment. However, these issues will only gain more momentum after the elections.

Until then, the course of the economy will mainly be determined by lockdown measures and their easing, as well as whether the government's announced support measures finally reach the corporate world. One of the current problems is the fact that only a fraction of the announced support has actually made its way to the real economy.

## Private consumption with only mild rebound

While private consumption had a weak start to the new year, the low level of unemployment

should argue in favour of a consumption pick-up over the course of the year.

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However, the high number of people working part-time, the fear of potential job losses on the back of a bankruptcy wave and the drop in purchasing power as a result of higher inflation argue against too much optimism.

As a result of all of the above and assuming that the announced fiscal stimulus will eventually hit the real economy with full force, we expect the economy to grow by around 4% this year and in 2022. In this scenario, the German economy would return to its pre-crisis level at the turn of 2021/2022.

### All good things come to an end

Since the summer of 2018, when the decline of the manufacturing sector started, the need for a digital transformation, structural changes and more investment have been on top of every political and economic agenda. The pandemic might have diverted attention but it hasn't reduced the urgency to act.

After the strong and highly respected management of the first phase of the pandemic, the second phase has become challenging. But it also serves as a reminder that the economic work won't be over once the pandemic ends. Banking on good old German strengths like industrial production and exports might be too short-sighted.

After all, it wouldn't be the first time good things came to an end.

### The German economy in a nutshell (% YoY)

	2020	2021F	2022F	2023F
GDP	-5.0	4.0	3.8	1.5
Private consumption	-5.0	3.9	3.8	1.2
Investment	-4.0	3.1	3.1	2.0
Government consumption	3.8	3.1	2.9	1.8
Net trade contribution	-2.1	0.4	0.5	0.1
Headline CPI	0.4	2.5	1.3	1.6
Unemployment rate	3.8	4.4	4.4	4.0
Budget balance as % of GDP	-4.3	-3.5	-1.5	-0.5
Government debt as % of GDP	72.0	72.0	65.0	63.0

Source: Refinitiv Datastream, all forecasts ING estimates

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