GERMANY

CREW CHANGE DURING TURBULENCE

After strong growth in Q2 and Q3, the business climate deteriorated due to supply problems, the increase in prices and the surge in Covid-19 infections. Output is likely to stagnate around the turn of the year. The new government will put the emphasis on social and environmental policies, while fully respecting the fiscal framework, important for Germany. Private consumption will be the major engine for growth in 2022.

Following the lifting of the lockdown restrictions, GDP rebounded strongly in Q2 and Q3, taking activity close to the pre-crisis level. Business cycle indicators point to a further slowdown or even stagnation in Q4. In November, the ifo climate indicator declined for the fifth consecutive month, as supply problems continued to weigh on activity in manufacturing. In services, business sentiment has been affected by the fourth wave of the coronavirus pandemic. Moreover, rising inflation has been weighing on purchasing power. Harmonised inflation reached 6% in November, largely because of hikes in energy and food prices. Against this backdrop, it is not surprising that consumer confidence is crumbling and the propensity to buy fell in November to a nine-month low. The government has taken action to limit the spreading of the virus. By blocking access for the unvaccinated to the non-essential shops, the government hopes to speed up the vaccination uptake, which is relatively low compared with neighbouring countries.

GROWTH AND INFLATION

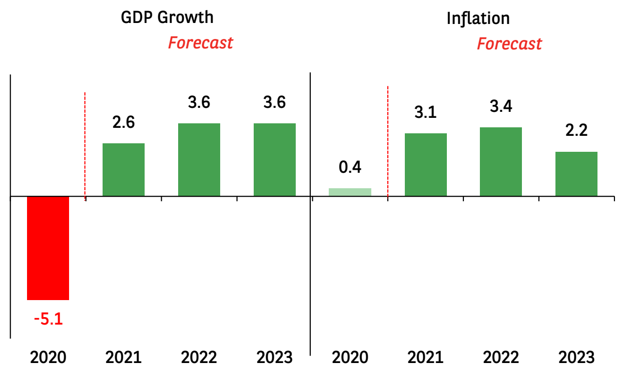

CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

AMBITIONS WATERED DOWN BY NEED FOR COMPROMISE

After two months of intense negotiations following the general election end September, the SPD (social democrats), the Greens and the FDP (liberals) reached agreement on forming the next government headed by Olaf Scholz (SPD). Even though the coalition programme emphasises the need for audacious progress, the economic proposals should not be viewed as a radical break, but rather as a correction of the policies of the Merkel years. It is a carefully crafted compromise that reflects the different sensibilities of coalition partners. All parties agreed on boosting investment in infrastructure to accelerate the energy transition and digitalisation, partly funded by the Next Generation EU programme. However, in particular for the FDP, the European programme should be limited in time and size. The SPD has obtained that the minimum hourly wage will be raised from EUR 9.60 to EUR 12.00. For the Greens, the priority is meeting the climate targets of the Paris agreement through an early exit from coal-powered energy plants and the closure of coal mines, if possible, by 2030. The new finance minister, Christian Lindner (FDP), is expected to uphold the budgetary rules in Germany and at the European level. However, the first challenge for the incoming government is to deal with the fourth wave of corona infections. The fiscal stance is likely to become less accommodative in 2022, as the government withdraws progressively the special support measures.

OUTPUT REBOUNDS AS SHORTAGES DIMINISH

The pandemic is likely to depress growth in early 2022, but as the vaccination process advances, its effect on the economy is likely to diminish, allowing a strong rebound in activity. This will initially be led by private consumption, as lockdown restrictions are lifted and the purchasing power losses associated with the rise in energy prices is softened by a rapid expansion of employment. Moreover, consumption is also supported by households reducing their savings accumulated during the crisis. Exports of manufacturing goods are likely to pick up in the course of 2022 as shortages of parts and semiconductors are diminishing. The improving outlook for the manufacturing sector should stimulate business investment, which is also supported by government policies to step up the energy transition and digitalisation of the economy. Headline inflation will remain at rather elevated levels in particular in the first half of 2022, mainly because of a hike in energy prices. In the coming years, the decarbonisation of the economy will add further to the rate of inflation. Against the backdrop of a tightening labour market, a major risk is that this would trigger a wage-price spiral.

Raymond Van der Putten
raymond.vanderputten@bnpparibas.com