

Press Release 14/2022

Halle (Saale), June 21, 2022

War drives up energy prices – High inflation weighs on economy

While the lifting of nationwide coronavirus regulations boosts many service sectors such as the hospitality industry, supply bottlenecks are likely to weigh on the manufacturing sector throughout the summer and high inflation will dampen private consumption. Gross domestic product (GDP) in Germany is expected to decline slightly in the second quarter of 2022. The situation in the manufacturing sector is expected to ease towards the end of the year. The Halle Institute for Economic Research (IWH) forecasts that GDP will increase by 1.5% in 2022, following an increase by 2.9% in 2021. In East Germany, GDP will increase by 1%.

Press embargo:
June 21, 2022,
1:00 p.m. CEST

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Keywords
business cycle, corona, economic development in Germany, financial policy, forecast, Germany, global economy, labour market, monetary policy, production, Russia, Ukraine

Table

Forecast for Germany: Key Economic Indicators^a for Germany, 2020–2023

	2020	2021	2022	2023
percentage change over previous year (price adjusted)				
Germany	–4.6	2.9	1.5	2.0
East Germany ^a	–3.8	2.3	1.0	1.6
percentage change over previous year in %				
hours worked	–4.9	1.7	0.8	1.0
hourly union wages	2.2	1.3	2.8	3.1
hourly actual wages	3.3	2.1	5.2	3.8
unit labour costs ^b	3.4	0.9	4.1	3.0
consumer price index	0.5	3.1	7.2	4.3
1,000 persons				
employment (domestic)	44,898	44,918	45,530	45,687
unemployment ^c	2,695	2,613	2,287	2,246
in %				
unemployment rate ^d	5.9	5.7	5.0	4.9
East Germany ^a	7.3	7.1	6.6	6.4
in % of nominal GDP				
general government overall balance	–4.3	–3.7	–1.8	–0.6
current account balance	7.1	7.4	5.1	5.7

^a East Germany including Berlin. – ^b Per hour (IWH calculations). – ^c Federal Employment Agency (BA) concept. – ^d Unemployment in % of civilian labour force (Federal Employment Agency (BA) concept).

Sources: Federal Statistical Office; 2022–2023: IWH forecast (as of June 20, 2022).

The global economic recovery was already subdued at the beginning of the year. Over the course of the summer, the global economy remains exposed to various pressures that will cause prices to rise strongly. Further production shutdowns in the wake of China's zero-covid strategy are likely to temporarily exacerbate shortages of industrial goods and thus fuel inflation worldwide. Additionally, the war in Ukraine gave rise to

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concerns about the supply of raw materials driving prices higher. The surge in commodity prices leads to a loss of real income and weighs on the demand for goods.

"The economic outlook in Germany is considerably burdened by the war in Ukraine, associated price increases as well as interrupted supply chains," says Oliver Holtemöller, head of the Macroeconomics Department and vice president of the IWH. "These factors diminish the chances of a swift recovery." The summer is expected to prove challenging for the German economy. While the scrapping of nationwide Corona regulations in March provides momentum for some service sectors such as the hospitality industry, consumer sentiment has plummeted with the start of the war in Ukraine, and the inflation rate reached a record pace of 7.9% year-on-year in May 2022. This is likely to dampen private consumption. Conversely, consumption will be supported by the sharp increase in the minimum wage. Fixed capital formation will be adversely affected by the high level of uncertainty due to the war. Government orders accompanying the energy turnaround are likely to have a supportive effect. The limited capacity in the construction industry will continue to be a drag to fixed capital formation. Exports are also likely to weaken in 2022 since new orders have fallen sharply since the start of the year. Unemployment continues to fall, but at a slower pace than before due to the sizable minimum wage increases. "If there are restrictions on economic activity in the winter, the economic recovery is likely to be further delayed," Holtemöller says. The fiscal deficit is expected to decrease in the current year because general government revenues will likely outpace spending. Although public investment is increasing noticeably, subsidies and capital transfers provided are declining as the Corona-related support measures expire.

The long version of the forecast contains two boxes (both in German):

[Box 1: Assumptions for the forecast](#)

[Box 2: Estimation of potential output](#)

Publication:

Drygalla, Andrej; Exß, Franziska; Heinisch, Katja; Holtemöller, Oliver; Kämpfe, Martina; Kozyrev, Boris; Lindner, Axel; Müller, Isabella; Sardone, Alessandro; Scherer, Jan-Christopher; Schultz, Birgit; Staffa, Ruben; Zeddies, Götz: Krieg treibt Energiepreise – Hohe Inflation belastet Konjunktur. IWH, [Konjunktur aktuell](#), Jg. 10 (2), 2022. Halle (Saale) 2022.

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