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No deep recession despite energy crisis and rise in interest rates

High energy prices and deteriorating financial conditions are weighing on the German economy. However, the period of weakness over the winter is likely to be moderate, partly because the energy price brakes are supporting private incomes. The Halle Institute for Economic Research (IWH) forecasts that due to the recovery from the pandemic in the first three quarters, gross domestic product (GDP) is estimated to have increased by 1.8% in 2022. Due to high energy prices, however, GDP will slightly decline in the winter months and stagnate on average in 2023. Inflation will fall from 7.8% in 2022 to 6.5% in 2023.

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Table
Forecast for Germany: Key Economic Indicators^a for Germany, 2022–2024

	2021	2022	2023	2024
percentage change over previous year (price adjusted)				
Germany	2.6	1.8	0.0	1.9
East Germany ^a	2.3	1.8	0.2	1.7
percentage change over previous year in %				
hours worked	1.7	1.6	0.0	0.6
hourly union wages	1.3	2.1	3.2	3.6
hourly actual wages	1.8	3.8	4.1	3.8
unit labour costs ^b	0.7	3.2	4.2	2.6
consumer price index	3.1	7.8	6.5	3.5
1,000 persons				
employment (domestic)	44 980	45 533	45 645	45 707
unemployment ^c	2 613	2 421	2 572	2 561
in %				
unemployment rate ^d	5.7	5.3	5.6	5.5
East Germany ^a	7.1	6.7	7.0	6.9
in % of nominal GDP				
general government overall balance	-3.7	-2.0	-2.8	-1.0
current account balance	7.4	3.4	2.5	3.5

^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 December 20, 2022).

The outlook for the international economy in 2023 is shadowed: It is uncertain whether Europe will have sufficient energy supplies this winter and next, but it is certain that key interest rates will continue to rise in 2023. In addition, the pandemic outbreak in China will lead to production losses. However, the tension in supply chains and international price dynamics appear to be easing somewhat. The price of natural gas in Europe is significantly lower than in late summer, as are world market prices for crude oil, microchips and freight rates for sea transport. Inflation in the USA has

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also fallen somewhat recently. As a result, interest rate expectations for the USA have fallen a bit and international stock prices have somewhat risen again. These are signals for a global economic downturn in 2023 instead of a global recession.

At the turn of the year, the German economy is facing difficult times: The terms of trade have deteriorated significantly, the rise in energy prices is increasing the cost of living, and financing conditions also have deteriorated due to more cautious lending by banks. "However, the German economy has so far proved quite robust, and production expanded into the fall as it recovered from the pandemic," says Oliver Holtemöller, head of the Macroeconomics Department and vice president at the IWH. Real incomes will fall significantly in the winter, when energy price rises reach their maximum, but the subsidisation of energy through the gas and electricity price brakes will dampen the decline in real incomes and private consumption. Beginning in spring, a further easing of international supply chains and a revival of the global economy should support the economy. Some stimulus will come from the high pressure on the German economy to modernise. This relates, for example, to investment in equipment that saves energy as an adjustment to changed cost structures. A limiting factor in many cases is likely to be high rates of capacity utilisation.

As an export-oriented economy, Germany is particularly affected by global economic risks. One such risk factor is the current pandemic outbreak in China. What consequences the relaxation of containment measures will have for global supply chains will depend largely on how China's healthcare system can cope with a nationwide spread of the pandemic. However, according to Holtemöller, there is also a risk for which German policy-makers are responsible. "While the gas and electricity price brakes are likely to cushion the fall in output in winter, it also increases the risk that the inflation rate will be further fueled by the high debt-financed government transfers", says the economic expert.

The extended version of the forecast contains three boxes (all in German):

[Box 1: On the estimation of potential output](#)

[Box 2: On the estimation of the effects of electricity and gas price brakes on inflation, private incomes and government budgets](#)

[Box 3: On the development of important components of government consumption](#)

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