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Price shock jeopardises recovery of German economy

Russia's war in Ukraine is hitting the German economy primarily via an energy price shock, but also by disrupting trade flows and causing general uncertainty. At the same time, however, the economy is receiving a strong boost from the lifting of many pandemic restrictions. The Halle Institute for Economic Research (IWH) forecasts that gross domestic product will increase by 3.1% in 2022. The consumer price index will be 4.8% higher than one year ago. The war affects the East German economy about as hard as the economy in Germany as a whole.

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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	3.1	1.5
East Germany ^a	-3.8	2.0	2.4	1.2
percentage change over previous year in %				
hours worked	-4.9	1.9	2.4	0.7
hourly union wages	2.2	1.3	2.8	3.3
hourly actual wages	3.3	1.8	2.2	3.2
unit labour costs ^b	3.4	0.8	1.3	2.8
consumer price index	0.5	3.1	4.8	3.2
1 000 persons				
employment (domestic)	44,898	44,920	45,377	45,528
unemployment ^c	2,695	2,613	2,299	2,249
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	-2.4	-1.5
current account balance	7.0	6.9	5.4	6.0

^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; 2020-2023: IWH forecast (as of March 16, 2022).

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

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Russia's attack on Ukraine has drastically worsened economic conditions in Europe. Prices for raw materials and energy, and here especially for natural gas, have risen sharply, the sanctions are bringing trade with Russia that goes beyond energy supplies to a virtual standstill, and European share prices have fallen significantly in value. In the event of a halt to Russian supplies, gas would have to be rationed in Germany, and a sharp recession, especially in the manufacturing sector, was to be expected. If, as assumed here, the gas flow continues, the main economic effect of the crisis will be the rise in energy prices, leading to real income losses for private households and a loss of competitiveness for firms, especially because natural gas is

particularly expensive in Europe. Value chains that led through Ukraine or Russia are also being torn apart. Inflationary pressures, which were already high in most regions of the world before the start of the war, will intensify further. In the US, monetary policy is turning less expansive which entails the risk of an economic downturn in the country itself, but also worldwide.

The war is hitting the German economy in a recovery phase, after the winter wave of the pandemic caused private consumption and economic activity to decline in the final quarter of 2021. "The pandemic is by no means over, but with the lifting of many restrictions imposed to combat the pandemic in March, the recovery is likely to gain momentum," says Oliver Holtemöller, head of the Department Macroeconomics and vice president at the IWH. This is because private households are likely to spend some of the savings they accumulated during the pandemic in the coming quarters, which will benefit service providers in particular. Production is therefore likely to expand quite strongly in the second quarter. However, consumers will have to use part of the money to meet the higher cost of living, as the Russian war will further increase the already strong price momentum in Germany. "Inflation, shortfalls in exports to Eastern Europe, and general uncertainty are channels through which the war is dampening the German economy, and consequently, rates of output growth will go down significantly in the second half of the year," Holtemöller says. The build-up in employment slows in the course of 2022, coming to a virtual standstill towards the end of the year due to the sharp increase in the minimum wage. High energy and raw material prices cause the German current account balance to fall sharply from 6.9% as a share of GDP in 2021 to 5.4% in 2022. The budget deficit is expected to decline significantly in the current year, as social security revenues are expected to expand at an accelerated pace as the economy picks up, while public spending is unlikely to rise much because the costs of the Corona pandemic will be declining.

The long version of the forecast contains four boxes (all in German):

[Box 1: The Russian economy is structurally weak](#)

[Box 2: Assumptions for the forecast](#)

[Box 3: Estimation of potential output](#)

[Box 4: Forecasting greenhouse gas emissions](#)

Publication

Drygalla, Andrej; Exß, Franziska; Heinisch, Katja; Holtemöller, Oliver; Kämpfe, Martina; Kozyrev, Boris; Lindner, Axel; Müller, Isabella; Sardone, Alessandro; Schultz, Birgit; Staffa, Ruben; Zeddies, Götz: Preisschock gefährdet Erholung der deutschen Wirtschaft. IWH, Konjunktur aktuell, Jg. 10 (1), 2022. Halle (Saale) 2022.

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