Coronavirus outbreak is delaying the recovery of the German economy

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– The German economy lost pace in the final quarter of 2019. Growth will probably sit just slightly above stagnation level in the first half of 2020 before quarterly growth rates pick up again from summer.

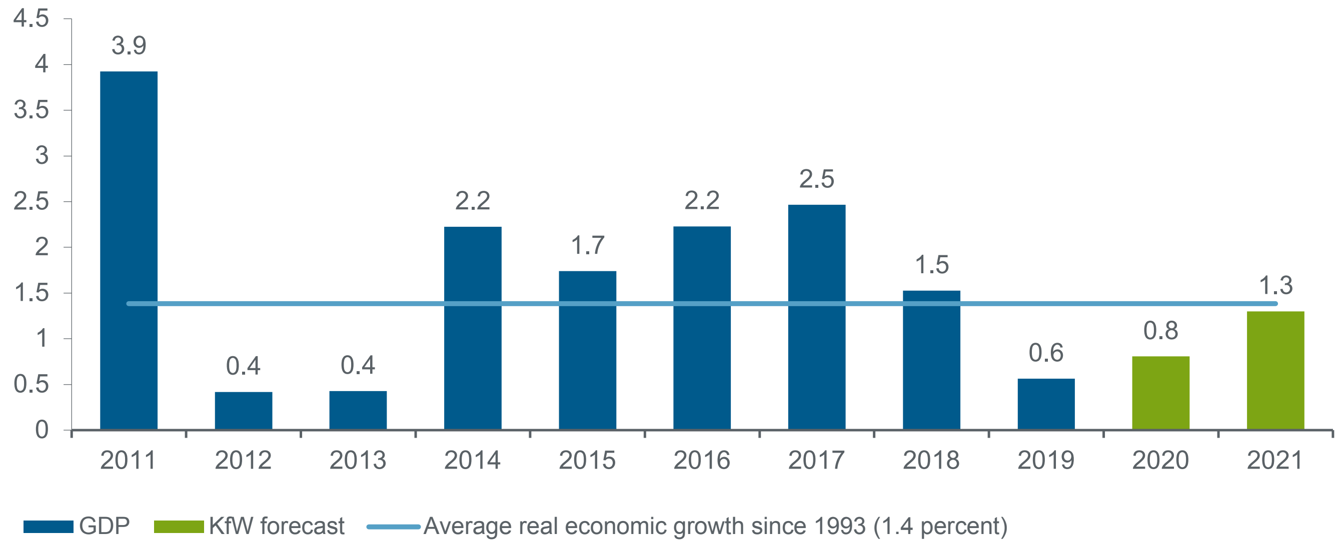
– The outbreak of the novel coronavirus is extending what has already been a record long German industrial recession into the year 2020. Industrial output is not likely to return to positive growth before the situation in China has normalised.

– We predict GDP growth in 2020 to be 0.8% (calendar-adjusted: +0.4%), 0.1 percentage points lower than previously forecast. In an initial forecast, KfW Research predicts growth to accelerate to 1.3% for 2021 (calendar-adjusted: +1.3%).

– Downward risks predominate. They include substantial disruptions in global value chains in the event of a protracted Covid-19 epidemic, as well as new trade tensions or a failure of negotiations between the EU and the United Kingdom.

Germany's gross domestic product

Variation on previous year in per cent, adjusted for prices



Source: KfW Research, Destatis

Quarterly stagnation ends weak year 2019

The German economy has lost pace as a result of difficult global conditions. Gross domestic product (GDP) adjusted for price, seasonal and calendar effects stagnated in the final quarter, and growth for all of 2019 was a meagre 0.6% (calendar-adjusted: +0.6%). That was the lowest rate since the euro crisis in 2012 and 2013, caused mainly by very weak export growth and the associated industrial recession which has now lasted for six consecutive quarters, the longest since unification. By contrast, domestic demand showed resilience and bolstered growth. Consumption grew quite strongly amid record high employment figures and tangible real wage growth, although signs of fatigue began to appear towards the end of the year. Private investment in residential construction also gained momentum in a continuing low interest rate environment. On the other hand, business investment lost a great deal of momentum, reflecting the continuing decline in industrial output and subdued export expectations.

Little more than stagnation in the first half of 2020

In the short term, a recovery is not in sight. It is true that the manufacturing business climate improved visibly in early 2020, which in itself gives reason to hope for a turnaround in industrial activity. However, the massive outbreak of the coronavirus SARS-CoV-2 in China has dashed these hopes yet again. The coronavirus is affecting the globally heavily integrated German economy along two channels: First, demand from China for German products is falling in the short term and second, the standstill in operations of Chinese suppliers can directly and indirectly disrupt transboundary value chains. Industrial output is therefore likely to continue contracting in the first quarter. On the other hand, construction investment and consumption will continue to prop up growth as employment expansion weakens while remaining positive overall. Declines in industrial employment will probably be more than offset by employment growth in the services industries. Overall, we expect renewed stagnation in the first quarter. GDP will likely grow only slowly in the second quarter as well, before growth picks up again after the middle of the year. We base this on the assumption that the coronavirus epidemic will remain confined mostly to China and will have passed its peak in several weeks' time. After that, life and economic activity in China should return to normal relatively quickly before any economically significant disruptions occur to value chains and global logistics networks.

Forecast for the year 2020 downgraded

Under these conditions, we expect average price-adjusted annual GDP growth of just 0.8% for 2020 (previous forecast: +0.9%). However, it must be taken into account that this growth forecast, which is customarily issued in Germany in terms of the original rate of growth, i.e. it is not adjusted for the variation in the number of working days, is being supported by an unusually strong calendar effect. As significantly more holidays will fall on a weekend in 2020, the year has nearly four more working days than 2019. The additional value added will contribute almost 0.4 percentage points total annual growth. GDP in 2020 – adjusted for calendar effects, that is, driven purely by economic activity – will therefore grow by just 0.4%, an even weaker pace than last year, when the calendar effect was negligible. Especially in the first half of the year, global demand for German export goods, such as cars and machinery in particular, will remain weak, which is why businesses will also hold back on their investment decisions for the time being.

Significant growth acceleration in 2021

Exports should recover next year in line with the anticipated gradual increase in global economic growth. German industry should then grow somewhat more strongly again as it will benefit from more favourable external demand. This will also stimulate business investment. At the same time, the partial abolition of the solidarity surcharge from 2021 will bolster private purchasing power. As consumption and private residential construction will presumably continue to increase, our initial forecast is for GDP growth of 1.3% in 2021. Next year will have practically the same number of working days as 2020. We therefore predict calendar-adjusted GDP growth of 1.3% as well, which constitutes a noticeable economic revival compared with this year's very modest calendar-adjusted growth.

Downward risks predominate

Given the weak fundamental economic trend, the German economy remains susceptible to negative surprises, so downward risks continue to predominate. Although key negative risks associated with trade policy have eased slightly, significant new uncertainties have arisen with the outbreak of the coronavirus. Our working hypothesis is that the outbreak will have a temporary and relatively limited regional impact. However, should the Covid-19 epidemic continue for longer and impact other regions of the world more heavily, it would raise the likelihood of serious consequences for international trade and value chains, to which German industry is particularly exposed. After the orderly departure of the United Kingdom from the EU at the end of January, the only clarity applies to the transitional period. The British side does not wish to extend this period beyond 2020 under any circumstances although the legal option to do this by consensus between both sides remains until the end of June of this year. Our forecast therefore presumes that a basic agreement will at least be concluded by the end of the year that allows trade between the EU and the United Kingdom to continue essentially unchanged. But given the very different concepts on both sides of the English Channel, this appears to be highly uncertain. If the negotiations were to fail, trade between the EU and the United Kingdom would fall under WTO regulations from the beginning of 2021, which would inevitably involve trade barriers such as tariffs and quotas. The very prospect of this is likely to weigh on economic sentiment. Even after the partial agreement entered into between the US and China, a high degree of uncertainty over US trade policy remains, particularly with a view to the EU. Germany could still be hit hard by the introduction of special US tariffs on European cars and parts, which have been threatened for some time now. Compared with the downward risks, the upward risks of our forecast are rather modest. Above all, there is a possibility that we may underestimate the recovery trend expected to set in from the second half of 2020 in the manufacturing sector, which was under particular pressure in the past one and a half years. Finally, fiscal scope is available in the national budget to at least partly cushion unexpected shocks.