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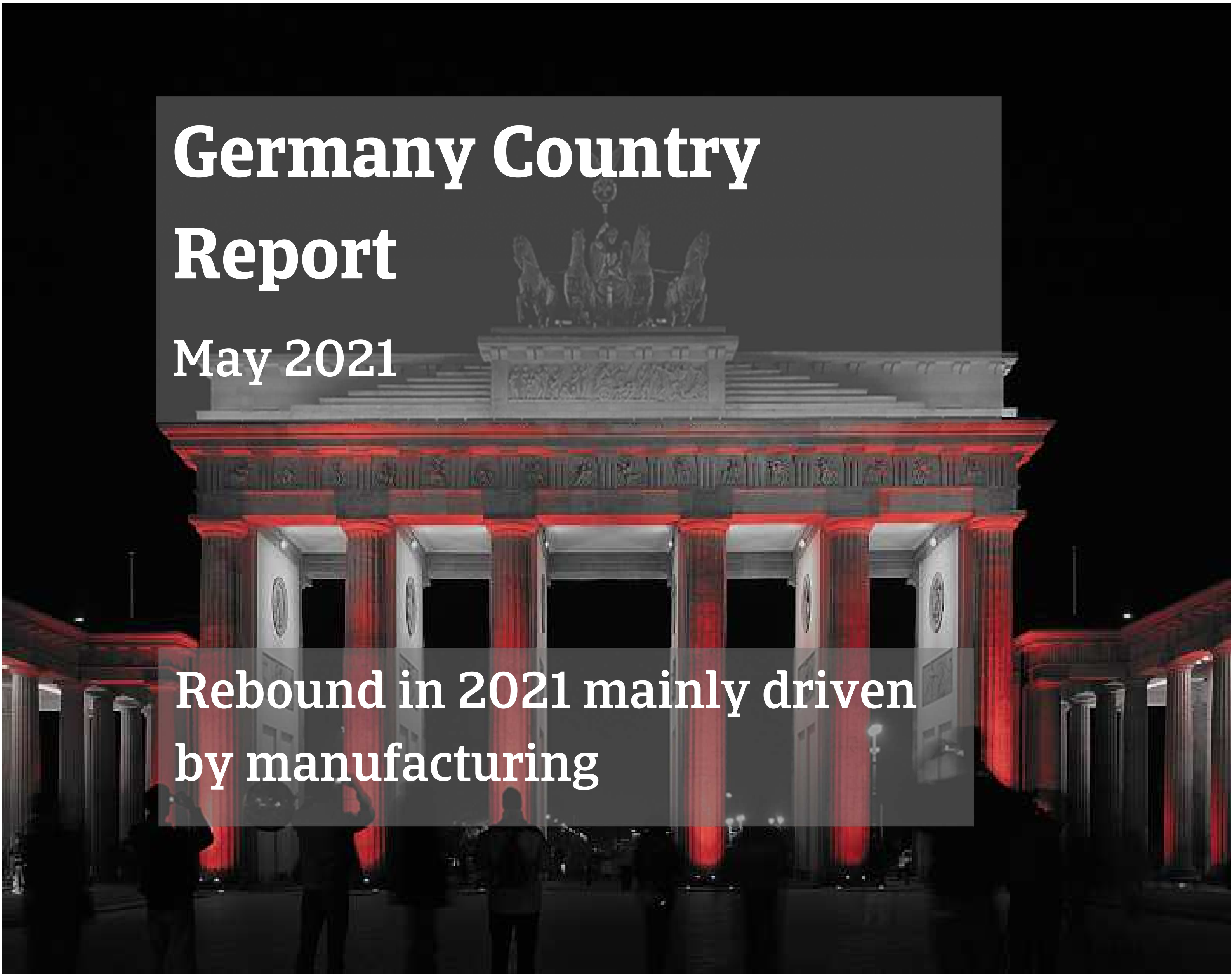
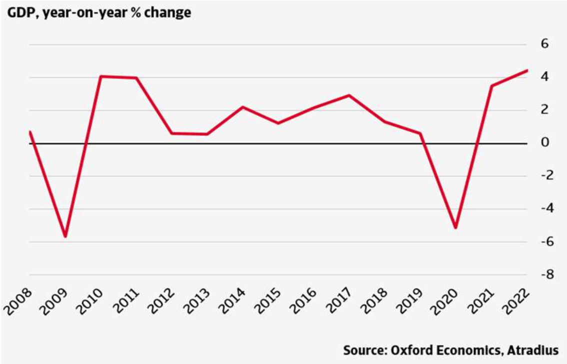


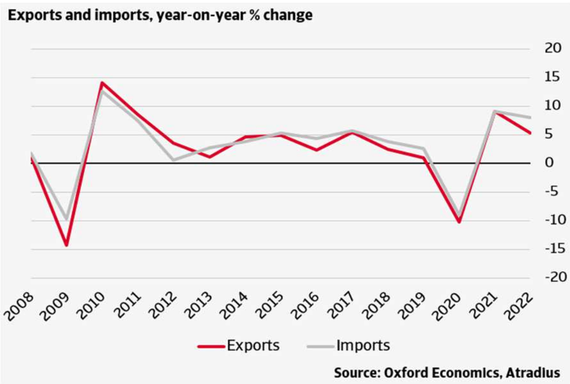
Germany Country Report

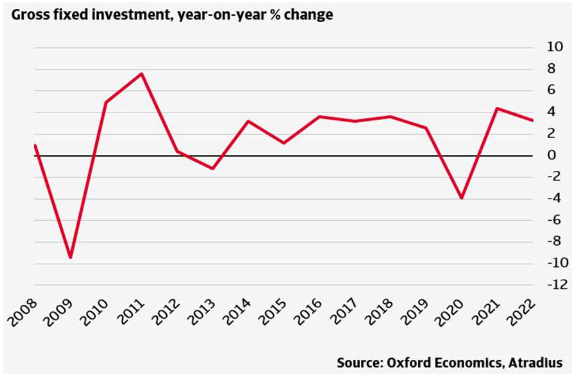
May 2021

Rebound in 2021 mainly driven by manufacturing

Economic Situation







A 3.5% GDP rebound expected in 2021

The economic rebound seen in H2 of 2020 did not last in early 2021, as GDP contracted 1.8% quarter-on-quarter in Q1 of 2021. Another spike of coronavirus cases and subsequent lockdown measures mainly hit private consumption. Additionally, household spending has been affected by the expiry of a temporary VAT reduction end of December 2020, which was part of pandemic-related stimulus measures.

That said, exports continued to sustain the economic performance, benefitting from global rebound, particularly robust demand from China (German exports to China increased 25.7% year-on-year in February and 37.9% in March).

Currently, it is expected that economic activity will accelerate as of Q2, due to the ongoing vaccination rollout and easing of restrictions, and it will return to its pre-pandemic level in late 2021. According to Oxford Economics, GDP is forecast to rebound 3.5% this year, after a 5.1% contraction in 2020. Manufacturing and construction are the main driver of the recovery, expected to grow 8.2% and 3.3% respectively, while the services sector will increase by just 1.7%, after a 4.5% contraction in 2020.

Industrial production and exports are forecast to increase 9.7% and 9.0% respectively. Exports will benefit from ongoing demand from China, and additionally take advantage of the robust US economic recovery (fuelled by massive stimulus packages). That said, private consumption growth remains subdued, rising 1.7% in 2021 after a 6.3% slump in 2020. As a result of mainly higher prices for energy and fuels, consumer prices have been rising since the beginning of the year, and inflation will increase above 2% in 2021.

GDP growth is expected to accelerate to about 4.5% in 2022, as household consumption is forecast to see a catch-up growth rate of more than 8% in 2022, while export and investment growth rates will remain solid.

Debt brake rule increasingly in focus

In 2009 Germany enshrined a debt brake rule in its constitution, stopping regions from running budget deficits and limiting the federal government's structural deficit to 0.35% of GDP.

Due to the pandemic, the debt brake rule has been temporarily suspended, and large stimulus measures have led to annual deficits of more than 4% in 2020 and 2021. Public debt increased from 55% of GDP in 2019 to 65% of GDP in 2021, expected to rise to 67% in 2021.

While the rule is due to be restored in 2022, a debate over whether it remains appropriate and should be re-imposed in its current form is underway. Three political parties (centre-left or left) are in favour of modifying or even abolishing the debt brake, and it is expected that this topic will be a key issue in the run-up to the federal election in September. While a fundamental change of Germany's fiscal policy is rather unlikely, a more flexible approach taken by the next government is in the cards, given the need to tackle the challenges of climate change (tighter regulations) and digitalisation with higher public investments.

Performance of key manufacturing industries and construction

Automotive: German motor vehicles and related parts output are forecast to grow by about 17% in 2021, after a 25% slump in 2020. However, temporary production disruptions caused by semiconductor shortages could slow down the pace of recovery. The credit risk of many automotive suppliers remains elevated. While government support and loans had a positive impact on businesses' liquidity, these loans are usually short-term and require linear repayment, which means that businesses have to hold available liquidity at short notice.

Chemicals: Production has rebounded in Q4 of 2020, and, despite a pullback in Q1, it is forecast to increase 4% in 2021, with turnover growing 5%. Most businesses remain financially resilient, and the credit risk situation remains benign.

Construction: The industry has remained relatively unaffected by the worst impacts of the pandemic, and output is forecast to grow by more than 3% in 2021 after a 1.8% increase in 2020. Residential construction activity will remain the main driver of growth. However, the performance of the industrial/commercial construction segment remains muted, due to lower business investment in commercial, retail and office building. Additionally, construction businesses are currently impacted by a scarcity of building materials (e.g. reinforcing steel, insulation materials, wood), with difficulties in passing on higher purchase prices for those items to end-customers. Due to the material shortage, the risk of project delays has increased.

Machines/Engineering: After a 12% sales and 14% production contraction in 2020, the industry association VDMA expects mechanical engineering production to rebound 7% in 2021. However, despite the ongoing recovery, businesses still face liquidity and profitability issues, and the outlook for subsectors like printing machines and machine tools for automotive remains subdued.

Metals and Steel: Both industries have seen a rebound in orders and sales since Q3 of 2020, and the liquidity situation of most businesses is either stable or good. Steel producers currently benefit from higher sales prices due to increasing demand and shortages of steel supply.

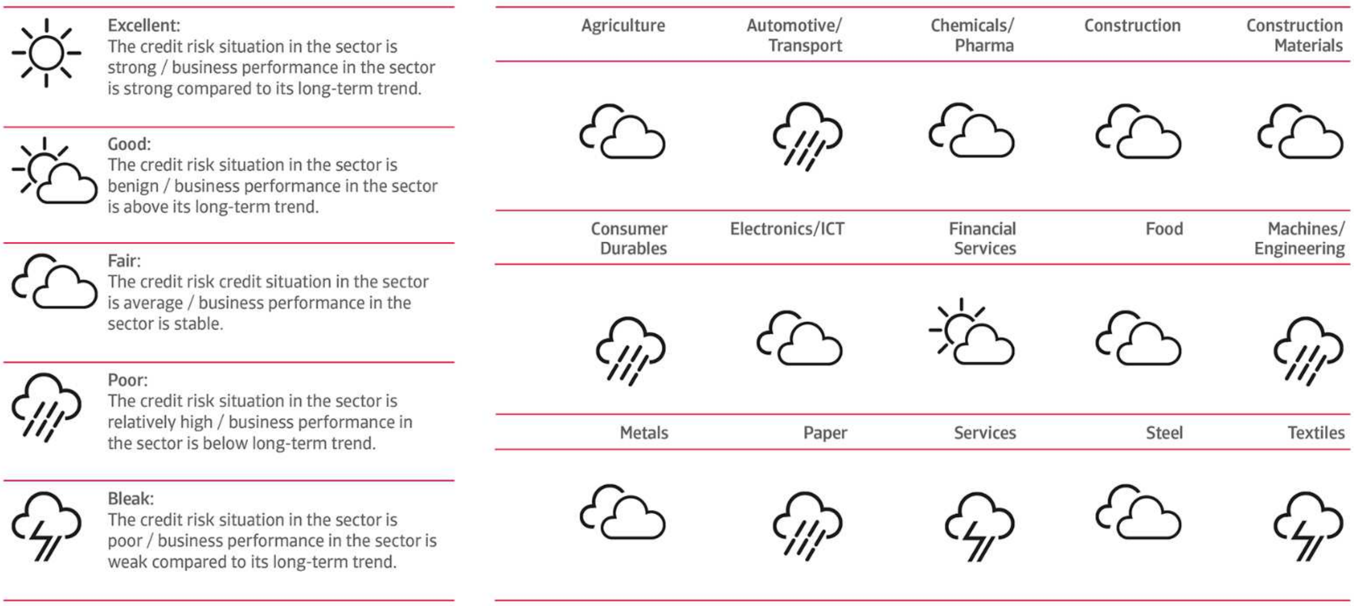
Therefore, the business performance/credit risk situation forecast of metals and steel has been recently upgraded from "Poor" to "Fair" (see chart below). However, businesses in the pipe-manufacturing subsector, along with smaller automotive suppliers that do not benefit from the current car demand surge in the Chinese and US markets, still face elevated credit risks.

Rising insolvencies expected as of H2 of 2021

Despite the economic contraction in 2020, German business insolvencies decreased 15.5% year-on-year, to 15,800 cases, and continued to decline in the first two months of 2021. The decrease was mainly due to a temporary bankruptcy moratorium and extensive fiscal support. However, with the expiry of temporary adjustments to the insolvency law, and with the phasing out of fiscal support, it is expected that business failures will increase again in H2 of 2021. Looking at the cumulative insolvency growth between 2019 and 2021, German business failures are forecast to level off, after annual decreases since 2010.

Germany industries performance forecast

May 2021



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