GERMAN COUNCIL
of Economic Experts

UPDATED ECONOMIC OUTLOOK 2023 AND 2024

22 March 2023 – EXECUTIVE SUMMARY

This is a translated version of the original German-language text "Aktualisierte Konjunkturprognose 2023 und 2024“, which is the sole authoritative text. Please cite the original German-language text if any reference is made to this text.

KEY MESSAGES

↘ The **global economic outlook** has improved **slightly** compared to the forecast in the GCEE Annual Report 2022. Decreasing wholesale energy prices and China's exit from its zero-Covid policy mitigate the expected decline in economic growth in Germany and the Euro area for 2023. However, **high inflation will dampen growth** until 2024. The German economy will continue to suffer from high energy prices, but has proven to be fairly resilient to the energy crisis during the current winter. Accordingly, **German economic output** is expected to **grow moderately** in 2023 and 2024, **at 0.2 %** and **1.3 % respectively**. In the euro area, expected growth is 0.9 % and 1.5 % (calendar-adjusted), respectively. At the global level, the GCEE expects GDP to increase by 2.2 % this year and by 2.7 % next year.

↘ **Inflation** has been **declining since autumn** 2022, especially in advanced economies, following a sharp rise over the past two years. **However**, the decline has been **slow and uneven**. Consumer prices for energy have recently fallen somewhat in the euro area. However, price inflation of other goods and services is likely to subside only gradually. In **Germany**, the GCEE expects consumer prices (**CPI**) to **increase by 6.6 %** and **3.0 %** in 2023 and 2024, respectively. In the euro area, the inflation rate (HICP) is expected to stay well above the ECB's inflation target of 2 %, at 5.9 % in 2023 and 2.9 % in 2024. Globally, the GCEE expects consumer prices to rise by 5.3 % and 3.5 %, respectively.

↘ **Various downside risks remain**. While Europe has avoided a **gas shortage** in the winter of 2022/23, energy supply in the winter of 2023/24 remains uncertain. If inflation were to decline more slowly than expected, more pronounced monetary tightening might become necessary. This would dampen private demand more strongly. At the same time, the recent rise in financial market risks has made it more difficult for central banks to fight inflation. If the monetary policy response were to weaken due to these trade-offs, inflation could remain high for longer than expected or even pick up again. In addition, an increase in **geopolitical tensions** between the US and China could put a significant strain on global trade in goods and international supply chains.

I. EXECUTIVE SUMMARY

1. The **outlook for the German economy** has improved slightly compared to the GCEE's economic forecast of November 2022. The GCEE expects gross domestic product (GDP) to grow by **0.2 % in 2023**. ↘ ITEM 25 ↘ CHART 2 The short-term downside risks to economic growth have declined. Most notably, uncertainty about energy supplies has receded for the time being, leading to a decline in wholesale energy prices. For example, the average price of natural gas in Europe (EGIX THE) in the first half of March 2023 was around €46 per MWh, around 80 % lower than at its peak in August 2022. ↘ ITEM 8

   Inflation – as measured by the German consumer price index (CPI) – fell from 8.8 % year-on-year to 8.1 % in December 2022. It climbed back to 8.7 % in January and February 2023. Core inflation has continued to rise year-on-year in January and February 2023 and amounted to 5.6 % and 5.7 %, respectively. This suggests that inflation will decline only gradually and remain elevated throughout the forecast horizon. ↘ ITEMS 28 F. The resulting loss of purchasing power is weighing on private consumption expenditure. As monetary policy continues to tighten, rising interest rates exacerbate this development and, in conjunction with sustained high economic uncertainty, dampen business investment. Against this background, the GCEE expects the **economy to grow by 1.3 % in 2024**. The GCEE forecasts **6.6 % and 3.0 % inflation** this year and next year, respectively.

2. **Although the energy supply situation has eased for the time being, the energy crisis is not over**. In the winter of 2022/23, Germany averted a gas shortage with state-ordered rationing. ↘ CHART 1 Russian supplies of natural gas were partly replaced by additional imports from other European countries. In addition, exports to neighbouring countries were reduced. At the same time, natural gas consumption decreased by 14 % in 2022, relative to the average consumption in the past four years (Federal Network Agency, 2023a). The decrease reflected both savings of private households and industry, and relatively mild winter temperatures. In the energy-intensive industry sectors, a seasonally and calendar adjusted decrease in production of 12.8 % between January 2022 and January 2023 contributed to these savings. Since wholesale energy prices are expected to stay permanently above their level in the period between 2010 and 2019 according to futures prices (JG 2022 item 302), a full recovery of output in energy-intensive industries is not anticipated. Besides, there remains a downside risk of a gas shortage for the German economy in the winter of 2023/24. ↘ ITEM 30

3. **Consumer price inflation has probably peaked** in Germany and many other advanced economies. Last year, consumer energy prices increased particularly strongly, but are now likely to be dampened by falling wholesale energy prices. ↘ ITEMS 9 AND 16 **However, prices of many goods and services are** continuing to **rise by more than 2 %**, which is the medium-term inflation target of many central banks. ↘ CHART 1 Further increases are expected since the costs of downstream producers continue to rise. For example, German producer prices for domestic consumer goods rose by 1.8 % in January 2023 compared to the previous month. Effective wages are expected to rise by 5.9 % and 4.5 % in 2023 and

↘ CHART 1

Determining factors for the German forecast

Despite improved outlook, energy crisis and inflation-related loss of purchasing power dampen economy

	Current situation	Assumptions for the outlook	Risks
Energy crisis	**Gas shortage avoided**; tight energy supplies, and energy prices remain elevated	**Gas shortage avoided** also in 2023/24; energy intensive industries remain depressed	**Natural gas imports** or **energy savings** lower than expected; **gas shortage**
High inflation	**Core inflation** becomes main driver of inflation; decisive **monetary tightening**	Monetary policy has lagged effects; **inflation decreases slowly**; purchasing power starts to recover	**Inflation more persistent** than expected; risk of **credit crunch** due to monetary tightening; financial markets risks; **deter** sufficient monetary policy **measures against inflation**
Global economy	China's exit from zero-Covid policy **improves outlook for 2023 slightly**; inflation depresses global growth in forecast period	**Easing** of **supply bottlenecks**; **US** monetary policy depresses demand; growth in **China** strengthens global economy	**Chinese demand** increases global inflation; rise in **geopolitical tensions**

Source: own representation

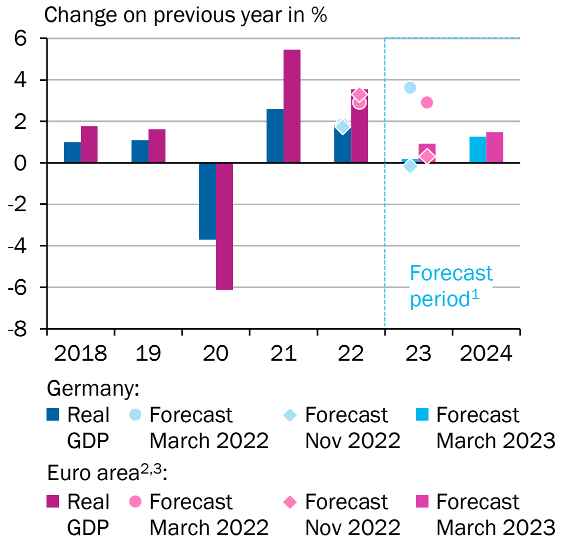
2024, respectively. Higher labour costs, in turn, are expected to result in rising consumer prices, especially for services. ↘ ITEM 28

4. The inflation outlook suggests that central banks will continue to raise interest rates in the US and the euro area in the upcoming months. ↘ ITEM 10 ↘ BOX 2 In the euro area in particular, monetary **policy tightening is** thus **stronger than financial markets expected in autumn 2022** and than forecast(ed) in the GCEE Annual Report 2022. ↘ CHART 1 The first real economic effects of rising key policy rates became apparent in the sharp decline in new home construction loans to private households. Their volume in January 2023 was 38.1 % lower than in the previous year. The **monetary** tightening is likely to broadly **affect consumer prices only in the upcoming months**, but probably before the end of the year. Compared to the US, where indicators for consumption and the labour market continue to rise and necessitate a strong reduction in demand, ↘ BOX 1 a smaller reduction will likely suffice in the euro area to reduce inflation (Koester et al., 2023).

Persistent inflation remains a risk for the economic outlook in the euro area. ↘ ITEM 12 If the expected increases in key interest rates fail to bring consumer price inflation back onto a path towards the ECB's medium-term target of 2 %, an even stronger monetary policy response may become necessary. This could lead to a decline in bank lending, for instance due to increased loan loss provisions or rising loan defaults. In addition, business investment could fall as a result of higher

↘ CHART 2
Updated Economic Outlook for the years 2023 and 2024 at a glance

GDP in Germany and the euro area



Key economic indicators (in %)

	2022	2023[1]	2024[1]
Germany			
Gross domestic product[4,5]	1.8	0.2	1.3
Consumer prices[5]	6.9	6.6	3.0
Unemployment rate[6]	5.3	5.4	5.2
Effective wages[5,7]	4.7	5.9	4.5
Budget balance[8]	– 2.6	– 1.6	– 0.4
Euro area			
Gross domestic product[2,4,5]	3.5	0.9	1.5
Consumer prices[5,9]	8.4	5.9	2.9
Global economy			
Gross domestic product[2,4,5]	2.9	2.2	2.7
Consumer prices[5]	7.4	5.3	3.5

1 – Forecast by the GCEE. 2 – Values are based on seasonal and calendar-adjusted quarterly figures. 3 – March 2022 and November 2022 forecasts without Croatia. 4 – Constant prices. 5 – Change on previous year. 6 – Registered unemployed in relation to civil labour force. 7 – Gross wages and salaries (domestic concept) per employees hour worked. 8 – In relation to nominal GDP; regional authorities and social security according to national accounts. 9 – Harmonised Index of Consumer Prices.

Sources: Eurostat, Federal Statistical Office, national statistical offices, own calculations

interest rates. This could further depress economic activity in 2024. At the same time, the financial market risks that have emerged in recent weeks make it more difficult for the central bank to fight inflation. This could lead to an insufficient monetary policy response. ↘ ITEM 10

5. In the short term, the **inflation-induced loss of purchasing power** remains the **main burden** for the economy in Germany and most other euro area member states. ↘ CHART 1 Catch-up effects after pandemic restrictions were lifted have boosted consumption until autumn 2022, especially in contact-intensive services. ↘ ITEM 31 These catch-up effects are now likely to fade. Since the winter of 2022/23, the negative effects of real income losses have become visible, for example in the decline in hotel and restaurant sales by 16.4 % between October and December 2022 (adjusted for price, seasonal and calendar effects). In contrast, rising employment, a declining household savings rates and extensive fiscal policy measures support demand. **Real disposable income** is expected to increase only in 2024 when wages increases will exceed the decreasing inflation rates, allowing for higher consumption expenditure. ↘ ITEM 31

6. The **global economic outlook** has improved slightly compared to autumn 2022. ↘ CHART 1 ↘ ITEM 11 In particular, **China's exit from its zero-Covid policy** should increasingly foster global economic growth. ↘ BOX 1 Therefore, the GCEE is revising its forecast for global GDP growth in 2023 upwards by 0.3 percentage points to 2.2 %. Next year, growth is expected to increase to 2.7 %. In addition, bottlenecks in intermediate goods are expected to continue to ease. ↘ BOX 2

German exports of goods should therefore gain more momentum in 2023 than expected in autumn 2022. ↘ ITEM 36 However, there are several risks for the global economy. If the US economy cools down more than expected, for example due to increased monetary tightening, this would affect economies in other world regions. In particular, this could slow down the Chinese industry, which is just recovering and is important for the global economy. Conversely, higher production in China could increase prices via rising demand for commodities such as metals or energy sources. ↘ ITEM 13 There is also a risk that geopolitical tensions between the US and China could have an impact on the global economy - especially if sanctions or higher tariffs are imposed on some commodities and products. ↘ ITEM 22