DIW Weekly Report 10+11 2024

AT A GLANCE

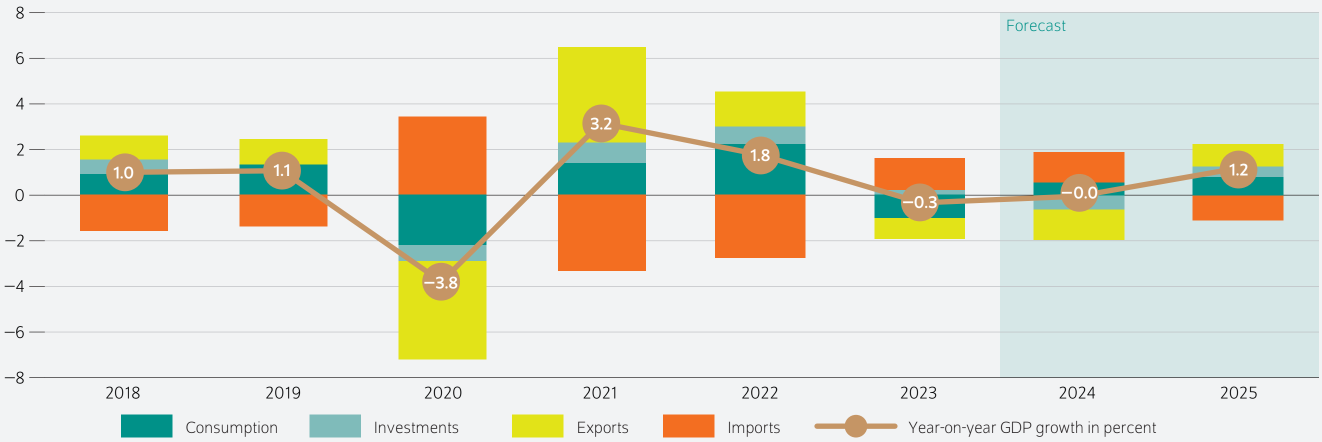
DIW Berlin Economic Outlook: Global economy experiencing robust growth; Germany's recovery is delayed further

By the DIW Berlin Economic Forecasting Team

- German economy experiencing a sluggish recovery: GDP growth projected to be zero in 2024
- Real wages and likely private consumption will increase as inflation declines further
- Companies are remaining cautious for now due to uncertainty about the economic policy framework
- Economic output is projected to grow by a solid 1.2 percent in 2025, supported by private consumption and equipment investment
- Global economy will expand by 3.5 percent in both 2024 and 2025; industrial production is likely to come out of its global slump

Consumption is slowly picking up speed in 2024, investments will follow in 2025

Individual components' contribution to overall GDP growth in percentage points



Source: DIW Berlin Economic Outlook Spring 2024.

FROM THE AUTHORS

"As inflation continues to fall, private consumption will become the main driver of the upswing beginning in the second quarter. Real wages are rising continuously and should compensate for the loss of purchasing power over the past years."

— Timm Bönke —

MEDIA

Audio Interview with Timm Bönke (in German)

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DIW Berlin Economic Outlook: Global economy experiencing robust growth; Germany's recovery is delayed further

By Timm Bönke, Guido Baldi, Hella Engerer, Pia Hüttl, Konstantin Kholodilin, Frederik Kurcz, Violetta Kuzmova-Anand, Theresa Neef, Laura Pagenhardt, Werner Roeger, Marie Rullière, Jan-Christopher Scherer, Teresa Schildmann, Ruben Staffa, and Kristin Trautmann

ABSTRACT

The German economy will likely contract in the first quarter of 2024 due to still heightened inflation and weak demand, which was already weighing on German economic output in 2023. Inflation, which is falling in both Germany and the euro area overall, is expected to return close to the European Central Bank's two-percent target, suggesting that a turnaround in interest rates can be expected in early summer. Better financing conditions and the slowdown in price momentum are likely to somewhat boost both private consumption as well as corporate investments over the course of 2024. Nevertheless, there is currently still a great deal of uncertainty, particular in regard to the future economic policy environment, which is causing households and companies to remain cautious in Germany. In addition, fiscal policy stimuli as well as foreign demand are lacking. German GDP will virtually stagnate and, carried by private consumption and public investments in equipment, increase more markedly by 1.2 percent in 2025. The global economy will continue to develop more robustly than Germany; it is projected to increase by 3.5 percent in both 2024 and 2025, which should gradually strengthen German exports.

Global economy: Industry fighting its way out of a slump, geopolitical risks are high

The global economy expanded by 3.9 percent in 2023 (Figure 1). Growth is subdued compared to historical standards, but nevertheless robust given the prevailing challenges. In many places, high energy prices, higher interest rates, a loss of purchasing power due to inflation, and geopolitical crises and uncertainties weighed on economic development. In most countries, this weakened the industrial sector in particular, while services fared somewhat better.

The advanced economies, especially the United States, did provide a boost to the global economy. The US economy experienced a surprisingly strong expansion of 2.5 percent (Table 1). Comprehensive fiscal policy stimuli from 2020 to 2022 continued to support private consumption and corporate investments. Of the emerging economies, China contributed significantly to global growth: The Chinese economy grew by 5.2 percent in 2023. Compared to the pre-pandemic years, however, this growth was considerably weaker. In 2023, the recovery following the zero COVID policy was overshadowed by lasting problems in the real estate sector in particular. The Mexican economy grew by 3.2 percent in 2023, although exports to the United States have not been as dynamic of late. The Brazilian economy grew by 3.1 percent, in part thanks to strong harvests and exports in the first half of 2023. The Indian economy expanded by a powerful 6.9 percent in 2023 due to solid domestic demand.

The European economy, in contrast, stagnated overall, stalled by the energy price crisis and restrictive monetary policy. With growth of only 0.5 percent, the euro area contributed little to global economic growth in 2023. The United Kingdom fell into a technical recession in the second half of 2023, meaning it experienced two back-to-back quarters of declining economic output (by 0.1 and 0.3 percent). The aftermath of the cost of living crisis weighed heavily on growth in the UK throughout 2023.[1] The Japanese economy expanded by

1 Cf. Arnab Bhattacharjee and Adrian Pabst, *Improving UK Living Standards* (National Institute of Economic and Social Research: 2024) (Accessed on February 28, 2024. This applies to all other online sources in this report unless stated otherwise).

DOI: https://doi.org/10.18723/diw_dwr:2024-10-1

1.9 percent in 2023, but fell into a technical recession in the second half of the year. High inflation there is also weighing on domestic demand in particular. Only the trade balance was positive because exports grew more strongly than imports due to the weak yen.

The global economy is likely to grow relatively robustly in the first quarter of 2024. The Purchasing Managers' Indices for manufacturing have recorded an upward trend in most advanced economies recently, despite the fact that the major euro area Member States and the UK are still below the expansion threshold. In the emerging economies, the Purchasing Managers' Index for China (Caixin) has been above the expansion threshold since November 2023 and in Brazil since December 2023. Industry, which has been weak globally, should thus gradually overcome this slump. However, manufacturing continues to be weak, especially in Japan and Germany. While this is due to the high costs for imports given the weak yen and subdued domestic demand in Japan, high energy prices and weak foreign demand are weighing on the development in Germany.

In the United States, growth is likely to slow somewhat to 0.5 percent (annualized 1.9 percent) in the first quarter of 2024. The South Korean economy is expanding at a similar rate, driven by strong semiconductor exports. The euro area as well as the UK are likely to gradually recover, with quarterly growth of 0.1 percent. Japan's economy is likely to only grow by 0.4 percent due to persistently high inflation.

In most emerging economies, in contrast, strong growth is expected in the first quarter of 2024 (Table 1). In China, consumers spent considerably more money around the Lunar New Year holiday as compared to before the pandemic; tourist traffic and tourism expanded as well. The Chinese economy is likely to expand by 1.0 percent in the first quarter of 2024. Economic output in the Central and Eastern European countries of the European Union will likely expand by 0.7 percent in the first quarter of 2024 due to falling inflation rates and stronger consumption, a slightly greater increase than recently.

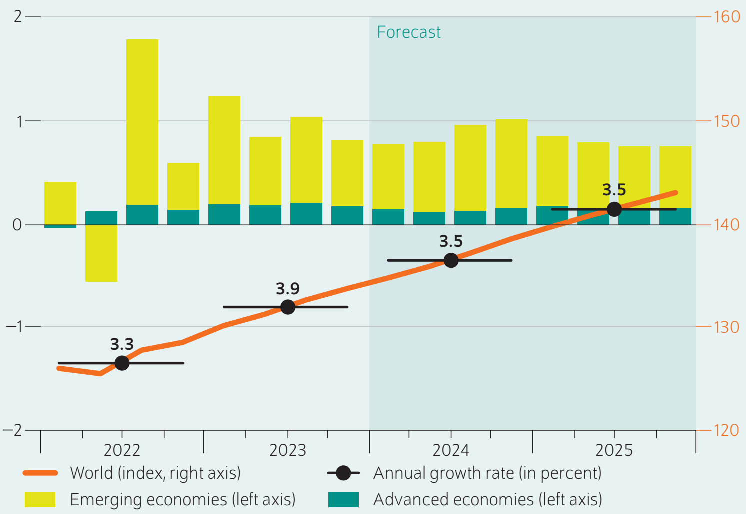
International trade will probably experience only moderate growth in 2024. Although the supply bottlenecks of recent years have eased, more expensive transportation costs cannot be ruled out due to the conflicts in the Red Sea and the drought in the Panama Canal. International trade declined by 1.9 percent in 2023.

Monetary policy in many advanced economies, except for Japan, will remain restrictive at the beginning of 2024. However, as inflations rates are falling in the euro area, the European Central Bank is expected to make its first key interest rate cut in early summer. Lending to households has also stabilized recently.[2] In the United States, inflation did not decline further in January 2024, primarily due to

Figure 1

Growth of real GDP

Quarter-on-quarter percentage growth (left axis); index 2015 Q1 = 100 (right axis)



Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2023.

The expected turnaround in interest rates should have a positive impact on global economic development from the second half of 2024.

higher living costs. Thus, an initial interest rate decrease in March, as widely expected by financial markets, is no longer likely. In many emerging economies, monetary policy has already been loosened: The Chinese central bank lowered the five-year key interest rate for mortgages, a further supportive measure for the country's struggling real estate sector. Weak domestic demand is also reflected by a deflationary trend in China, where prices fell by a further 0.8 percent in January 2024.

Fiscal policy will likely only provide moderate stimuli for the economy during the forecast period. In light of higher interest rates, many governments are holding back on additional spending, partly to comply with fiscal deficit and debt rules. However, the federal deficit remains high in the United States and will be considerably above five percent of economic output in 2024 and 2025. In the United Kingdom, further fiscal measures that appeal to voters are to be expected given the forthcoming British general election, most likely in the form of further tax relief for companies. Medium-term investment packages are likely to continue to support economic growth in the advanced economies.

Overall, the global economy is expected to grow by 3.5 percent in 2024; growth in the advanced economies is likely to be 1.5 percent. The upcoming turnaround in interest rates will probably have a positive impact on investment activity in many countries. In the euro area, continued increases in real wages will provide stronger momentum to private consumption. In the United States, household savings from the

2 Cf. Deutsche Bundesbank, "Geldpolitik und Geldmarktentwicklung," *Monatsbericht Februar* (2024) (in German; available online).

Table 1

Real GDP, consumer prices, and unemployment rates in the global economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Year-on-year percentage change											
	2022	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025
Europe												
European Union	3.5	0.5	0.9	1.9	9.2	6.4	3.0	2.4	6.1	6.0	6.2	6.0
Euro area	3.4	0.5	0.5	1.5	8.4	5.4	2.6	2.0	6.7	6.5	6.5	6.4
excluding Germany	3.9	1.1	1.0	1.5	8.0	5.0	2.6	2.1	8.5	8.2	8.2	8.1
France	2.5	0.9	0.8	1.4	5.9	5.7	2.5	1.9	7.3	7.3	7.4	7.3
Italy	3.9	0.7	0.6	1.0	8.7	5.9	2.3	2.2	8.1	7.6	7.7	7.7
Spain	5.8	2.5	1.8	2.1	8.3	3.4	3.2	2.1	12.9	12.1	11.5	11.1
Netherlands	4.4	0.1	0.9	1.9	11.6	4.1	2.7	2.1	3.5	3.6	3.9	3.8
United Kingdom	4.3	0.1	0.2	1.5	9.1	7.3	2.5	2.0	3.9	4.0	4.3	4.7
Switzerland	2.7	0.8	1.0	1.9	2.8	2.1	1.6	1.5	4.3	4.1	4.4	4.3
Central and Eastern Europe	4.7	0.3	2.4	3.3	13.4	11.6	4.3	3.6	3.5	3.6	3.4	3.1
Turkey	5.3	4.0	2.7	3.2	72.3	54.0	50.9	36.0	10.5	9.5	9.5	10.0
Russia[1]	−1.3	3.0	3.4	1.4	13.8	5.9	6.5	5.0	3.9	3.2	2.8	2.7
The Americas												
USA	1.9	2.5	2.2	1.5	8.0	4.1	2.6	1.9	3.6	3.6	3.9	4.0
Mexico	3.9	3.2	1.8	2.2	7.9	5.5	3.7	3.1	3.3	2.9	3.2	3.3
Brazil	3.1	3.1	1.6	2.1	9.3	4.6	3.4	2.9	9.5	8.3	10.6	14.8
Asia												
Japan	0.9	1.9	1.0	1.1	2.5	3.3	2.5	1.3	2.6	2.6	2.4	2.4
South Korea	2.6	1.3	2.2	2.3	5.1	3.6	2.4	1.9	2.9	2.7	3.1	3.1
China	3.0	5.2	4.7	4.5	2.0	0.2	1.0	1.8	5.6	5.2	5.0	5.0
India	6.6	6.9	6.3	6.3	6.7	5.8	5.1	3.9	7.6	7.6	7.2	7.4
Total												
Advanced economies	2.5	1.7	1.5	1.5	7.7	4.6	2.6	2.0	4.4	4.3	4.5	4.5
Emerging economies	3.8	5.3	4.7	4.6	8.4	6.8	7.9	7.5	6.3	6.0	5.9	6.3
Global economy	3.3	3.9	3.5	3.5	7.9	5.5	5.1	4.7	5.9	5.6	5.6	5.9
For reference:												
Export weighted[2]	*2.9*	*2.9*	*2.6*	*2.6*								
GDP weighted in USD[3]	*3.2*	*3.0*	*3.0*	*3.0*								

1 The data forecast for Russia are subject to major uncertainties. Russia has only minor weight in the overall forecast.
2 World weighted with shares of German exports from 2022.
3 World weighted with the GDP in USD from 2022 to 2025.

Notes: The black figures are finalized. The values of the groups of countries are a weighted average, with the respective GDP in purchasing power parities from the IMF World Economic Outlook for 2022 to 2025 used to weight GDP and consumer prices. The 2022 labor force (15–64 years old) figures of the respective countries are used to weigh the unemployment rate in the groups of countries. Central and Eastern Europe consist of Poland, Romania, Czechia, and Hungary in this forecast.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Spring 2024.

COVID relief measures are expected to continue dwindling and be depleted by mid-year. However, rising real wages are likely to support consumption even after the fiscal stimulus expires in the second half of 2024. In the emerging economies, economic output will likely increase by 4.7 percent in 2024. China's persistent problems in the real estate sector, weak domestic demand, and deflationary trends, as well as ongoing trade tensions with the United States, are likely to limit growth to below five percent. Russia is continuing to convert its economy to a war economy, as arms-related sectors are expanding strongly. Overall, Russia's economic output is likely to increase as a result.[3]

In 2025, the global economy is projected to expand by a further 3.5 percent when the economic growth in the advanced economies returns to its long-term trend in light of normalized inflation rates and falling interest rates. Then, the emerging economies will finally benefit from stronger global demand.

3 Cf. The Bank of Finland Institute for Emerging Economies, "Russia's GDP growth last year higher than expected; lower growth ahead," *BOFIT Weekly Review* no. 7 (2024) (available online).

German economy only slowly coming out of its slump

Weak domestic and foreign demand slowed the German economy in 2023 and continue to weigh on it in 2024. After economic output stagnated for three quarters in 2023, it fell in the final quarter, down by 0.3 percent quarter on quarter, and in the year as a whole by 0.3 percent as well. While foreign demand declined due to weak global industrial production, repeated interest rate hikes by the European Central Bank (ECB) and high inflation rates dampened domestic demand. Although consumer prices have had almost consistently lower growth rates since the beginning of 2023, in particular due to falling energy prices, the annual average inflation rate was still 5.9 percent.

Nevertheless, high wage agreements over the course of 2023 led to a slight increase in real wages. However, this increase could not compensate for consumers' previous loss of purchasing power. The development of incomes and prices led to lasting uncertainty, which dampened consumer sentiment and caused private consumption to fall markedly in 2023 as a whole. Rising nominal interest rates are also providing incentives to save, which has further increased the already high savings rate.

Financing costs also rose due to the interest rate hikes and dampened investment activity of private households and enterprises. Construction investments in particular declined considerably, especially due to weakening private residential construction. At the same time, investments in equipment likely benefited from the high order backlog, a result of the recovery following the coronavirus pandemic, and increased overall. In contrast, weak foreign demand weighed on exports. However, as imports declined even more sharply due to high energy prices and low demand for foreign intermediary goods from domestic industry, the trade balance was positive.

Despite the weak economic situation, employment reached an all-time high with an annual average of 45.9 million people in employment. Primarily migration made this employment growth possible. The additional jobs in healthcare, education, and public administration created by the federal, state, and local governments also played a role. Simultaneously, the number of registered unemployed increased and the unemployment rate grew from 5.3 percent in 2022 to 5.7 percent in 2023.

The gross value added, especially in manufacturing, was in decline over the second half of 2023. Energy-intensive sectors in particular suffered due to the permanently heightened energy prices.

Weak start to 2024

The same factors are still expected to weigh on the German economy in the first quarter of 2024, resulting in a 0.1-percent decline in economic output (Figure 2). Thus, the German economy will likely contract for the third quarter in a row (Table 2).[4]

Figure 2

Real GDP growth in Germany

In billions of euros (left axis) and quarter-on-quarter in percent (right axis)

Note: Forecast from the first quarter of 2024; adjusted for price, seasonal, and calendar effects.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2024.

After stagnating in 2024, the economy is projected to pick up again significantly in 2025.

Nominal wages and disposable income continue their strong upward trend and inflation rates are declining more and more, which results in higher purchasing power. Nevertheless, consumer sentiment among private households remains subdued and is characterized by uncertainty about economic developments.[5] This can be seen in, for example, the *GfK-Konsumklimaindex,* which is currently stagnating in the negatives. Retail sales also declined again in January 2024. Thus, private consumption is likely to experience only minimal growth and will be unable to prevent a decline in GDP in the first quarter of 2024 (Table 2).

In contrast, slight negative stimuli are expected from investments in the first quarter of 2024. While manufacturers of capital goods still have a large stock of existing orders, new orders are trending downward; only some bulk orders are interrupting this trend. The ifo Business Climate Index for Germany is also not suggesting the situation will improve in the short term. Thus, investments in equipment are likely to fall in the first quarter of 2024. In the area of construction

4 Economic performance already began declining in the third quarter of 2023, even if only marginally by 0.01 percent. Thus, the German economy has been in a technical recession since the fourth quarter of 2023.

5 For example, the Economic Policy Uncertainty Index for Germany has increased noticeably since May 2023 and has since remained markedly above the overall European index values.

Figure 3

GDP and important components

Seasonally, calendar, and price-adjusted development

Note: Forecast from the first quarter of 2024; adjusted for price, seasonal, and calendar effects.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2024.

Table 2

Quarterly data on the development of use and value-added components of real GDP in Germany
In percent (quarter-on-quarter, seasonally and calendar adjusted)

	2023				2024				2025			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	−0.6	0.2	−0.0	0.2	0.1	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Public consumption expenditure	−1.4	−0.2	1.1	0.3	−0.2	0.0	0.4	0.5	0.4	0.4	0.4	0.3
Gross facilities investment	1.0	−0.0	0.1	−1.9	−0.5	−0.2	0.2	0.5	0.7	0.8	0.9	0.9
Construction	1.5	−0.5	−0.8	−1.7	−0.8	−0.4	−0.0	0.2	0.4	0.6	0.6	0.7
Equipment	1.9	0.8	1.4	−3.5	−0.4	0.2	0.6	1.0	1.1	1.3	1.4	1.4
Other investment	−1.6	−0.0	0.3	0.7	0.1	0.1	0.2	0.2	0.5	0.5	0.7	0.7
Inventory changes[1]	−0.5	0.5	−0.6	−0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic consumption	−0.9	0.6	−0.4	−0.3	−0.1	0.1	0.3	0.4	0.4	0.4	0.4	0.3
Net exports	1.0	−0.5	0.3	0.0	0.0	−0.0	−0.0	−0.0	−0.0	−0.0	−0.1	−0.1
Exports	−0.2	−0.9	−0.7	−1.6	−1.1	−0.1	0.3	0.6	0.7	0.7	0.6	0.6
Imports	−2.2	0.1	−1.5	−1.7	−1.3	−0.1	0.4	0.7	0.8	0.8	0.8	0.8
GDP	0.1	0.0	−0.0	−0.3	−0.1	0.1	0.3	0.4	0.4	0.4	0.3	0.3
Gross value added	0.3	−0.0	−0.0	−0.4	−0.1	0.1	0.3	0.4	0.4	0.4	0.3	0.3
Manufacturing	0.1	0.3	−0.9	−1.4	−0.6	−0.3	0.2	0.5	0.6	0.5	0.4	0.4
Construction	5.0	−0.4	−0.1	−2.6	−0.6	−0.2	0.1	0.2	0.3	0.5	0.4	0.4
Trade, hospitality, transport	−0.7	0.1	0.9	−0.9	0.3	0.4	0.4	0.5	0.5	0.5	0.4	0.4
Professional services provider	−0.1	0.6	−0.0	0.2	−0.2	−0.1	0.2	0.4	0.4	0.4	0.4	0.4
Public services, education, health	1.0	−0.6	0.0	0.1	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.2

1 Contribution to growth in percentage points.

Note: Forecast from the first quarter of 2024; adjusted for price, seasonal, and calendar effects.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Spring 2024.

investment, residential construction in particular is likely to remain weak in the first quarter of 2024 due to persistently high interest rates. In light of a historically low number of incoming orders and building permits as well as a stagnation in new credit volume, a continued marked decline is expected here. Only non-residential construction (especially civil engineering) may have a supporting effect and somewhat cushion the renewed decline in construction investment.

As of the beginning of 2024, foreign trade is also not providing any growth stimuli; both imports as well as exports are likely to decline in the first quarter and not contribute to economic output overall. While a majority of the Purchasing Managers' Indices in other European countries are trending upward again, the values are often still in the negatives. A recovery in foreign industrial production, which could benefit German exports, is therefore unlikely to materialize in the first quarter, meaning that exports will probably continue to decline. Furthermore, leading indicators for the German manufacturing industry, such as capacity utilization and the German Purchasing Managers' Index, suggest that imports of intermediary goods may also decline again (Figure 3).

Consumption picking up speed, supported by investments

From the second quarter of 2024, factors weighing on domestic and foreign demand should begin to weaken. Following the decline in inflation rates in 2023, which was primarily due to falling energy prices, weakening price pressure on food and non-energy goods will likely have a greater effect on inflation in 2024. Overall, inflation in Germany and in the euro area is expected to reach the ECB's two-percent target within 2024. The European Central Bank is therefore expected to herald a turnaround in interest rates at the end of the second quarter. Falling interest rates are likely to decrease financing costs for companies and households and make saving more unattractive. Simultaneously, industry worldwide will slowly crawl out of its slump and stimulate foreign demand.

Private consumption is likely to be the main driver of the economic upswing for the remainder of the forecast period. The continuing slowdown in price momentum, which will strengthen consumer confidence, will probably make a key contribution to this. Real wages are expected to continue to rise, gradually over the forecast horizon, compensating for the loss of purchasing power in the past years. After wages rose in many cases due to one-off inflation adjustment premiums in 2023, sustainable wage increases according to pay scales are likely to increasingly come into effect in 2024. This is likely to positively influence households' income security and boost consumption. Falling nominal interest rates are also likely to lead to a decline in the savings rate and a significant increase in private households' propensity to consume in 2025.

Declining financing costs are likely to have only a delayed impact on residential construction, meaning that construction

Table 3

Key economic indicators for the German economy

	2023	2024	2025
GDP[1]	−0.3	−0.0	1.2
Employment[2] (1,000 persons)	45,933	46,067	46,109
Unemployed (1,000 persons)	2,609	2,721	2,565
Unemployment3 (BA concept, in percent)	5.7	5.9	5.5
Consumer prices[4]	5.9	2.3	2.0
Unit labor costs[5]	6.7	5.2	2.0
Gross labor income[2] per employee	6.1	4.5	3.2
Collective wage (monthly)	3.6	4.3	2.1
Government budget balance[6]			
in billions of euros	−87.4	−51.4	−29.7
in percent of nominal GDP	−2.1	−1.2	−0.7
Current account balance			
in billions of euros	248.4	302.9	306.4
in percent of nominal GDP	6.0	7.1	7.0

1 Price adjusted. Year-on-year change in percent.
2 Domestic concept.
3 Unemployed as a percentage of the civilian labor force (definition according to the Federal Employment Agency).
4 Year-on-year change.
5 Compensation of employees per employee hour worked in Germany as a percentage of real GDP per hour worked of the employed.
6 As defined in the national accounts (volkswirtschaftliche Gesamtrechnungen).

Note: Forecast from the first quarter of 2024.

Sources: Federal Statistical Office; Federal Employment Agency; DIW Berlin Economic Outlook Spring 2024.

investment will probably continue to decline for the time being; it is not expected to stabilize until the end of 2024 (Figure 3). The slight decline anticipated in construction prices from the record highs in recent years should then also boost demand somewhat. Non-residential construction will probably continue to benefit primarily from investments in civil engineering, above all in rail and road construction, and prevent an even greater slump in construction investment. Non-residential construction is expected to support momentum in construction investment in 2025 as well.

Investments in equipment over the course of the forecast period are expected to be significantly determined by public defense spending and should be supporting economic growth in 2025 in particular. These investments are likely to massively increase in the second half of 2024 and in 2025 in particular as a part of the *Bundeswehr*'s special fund. Meanwhile, lower growth in acquisition expenditure is expected from private investors. For example, according to DIHK surveys, corporate willingness to invest has recently fallen repeatedly. This is due to, among other things, uncertainties regarding long-term economic policy, for example in regards to climate and transition policy.

As the economies of key German trading partners continue to recover, German exports are likely to increase again from the second half of 2024. Imports are also expected to increase, supported by the recovery in the manufacturing industry and the related strong foreign demand for intermediary goods. This demand will also be significantly stronger in 2025 due to the expansion of public investments in military equipment and will then result in a slightly negative trade balance.

No clear stimuli are expected from fiscal policy measures in 2024. The reduced consumption taxes on natural gas and in the food service industry expired at the beginning of 2024 and the CO_2 surcharge was increased. Energy and electricity subsidies for private households will end in April. The largest expansionary stimulus will probably come from a considerable increase in defense spending in both 2024 and 2025. Overall, revenue is likely to increase more strongly than expenditure in 2024 and 2025. The public deficit will likely decline from 1.2 in 2024 to 0.7 percent of GDP in 2025. The debt-to-GDP ratio according to the Maastricht Criteria is likely to fall from 63.6 to 62.6 percent of GDP.

The manufacturing industry is likely to recover somewhat over the course of 2024 thanks to momentum in investments and increase more considerably in 2025. Personal services such as retail and hospitality will be able to escape the weak phase of the past years with the revival of private consumption. Gross value added as a whole is also likely to increase over the course of the year, but stagnate in annual terms. In 2025, it is likely to experience strong growth of 1.2 percent.

The development on the production side is also likely to be supported by an increase in the labor volume, which itself will be supported by the continuous increase in employment over 2024. The number of hours worked per employee is also likely to increase over the course of 2024, with a normalization of the still significantly higher sick rate being the primary contributing factor. In the context of a further increase in the number of hours worked in line with the pre-coronavirus trend, a significant increase in the labor volume is also expected in 2025. However, the shortage of labor and skilled workers, which is intensifying as a result of demographic change, is likely to have a limiting effect. In line with the economic development, unemployment is likely to rise moderately at first and then fall again from the second half of 2024 onwards, meaning that the unemployment rate should still be 5.9 percent in 2024 and then only 5.5 percent in 2025 (Table 3).

It can be assumed that the labor force potential will decline towards the end of the forecast horizon despite immigration and rising employment rates, thus limiting potential output. Potential output is likely to grow at a rate of 0.5 percent and 0.4 percent in 2024 and 2025, respectively. By the end of the 2020s, the rate should gradually fall to 0.3 percent. The expected output gap thus will initially increase further to 1.5 percent in 2024 before falling considerably to 0.7 percent in 2025.

Overall, real GDP will probably stagnate in 2024 despite the increasing momentum over the course of the year. A strong 1.2-percent increase is expected for 2025.

This forecast is subject to many uncertainty factors. For example, inflation rates in the euro area could increase again, either through stronger increases in nominal wages or intensifying geopolitical tensions that drive up commodity and, in particular, energy prices. Both could delay the expected interest rate turnaround.

Political polarization also poses a great risk. For example, right-wing nationalists could perform well in German regional elections this year, scaring off foreign skilled workers and investors. The presidential elections in the United States and the European Parliament elections could also strengthen forces that are seeking to move away from the rules-based international economic and security order. This could significantly slow down international trade. The weak domestic demand in China could also negatively impact global trade more than assumed if their domestic issues, such as the tensions in the real estate sector, increase. Both of these factors could negatively impact German foreign trade.

Timm Bönke is Co-Head of the Forecasting and Business Cycle Policy Group in the Macroeconomics Department at DIW Berlin | tboenke@diw.de

Guido Baldi is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the USA | gbaldi@diw.de

Hella Engerer is a Research Associate in the Energy, Transportation, Environment Department at DIW Berlin specializing in Central and Eastern Europe | hengerer@diw.de

Pia Hüttl is Head of the global economic forecast and a Research Associate in the Macroeconomics Department at DIW Berlin | phuettl@diw.de

Konstantin Kholodilin is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in estimating potential output and production | kkholodilin@diw.de

Frederik Kurcz is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area | fkurcz@diw.de

Violetta Kuzmova-Anand is a Research Associate in the Macroeconomics Department at DIW Berlin | vkuzmovaanand@diw.de

Theresa Neef is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in public finances | tneef@diw.de

Laura Pagenhardt is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in investments | lpagenhardt@diw.de

Werner Roeger is a Guest Researcher in the Macroeconomics Department at DIW Berlin specializing in estimating potential output and macroeconomics modeling | wroeger@diw.de

Marie Rullière is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area | mrulliere@diw.de

Jan-Christopher Scherer is Head of the German economic forecast and Research Associate in the Macroeconomics Department | jscherer@diw.de

Teresa Schildmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the German labor market | tschildmann@diw.de

Ruben Staffa is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the USA and German foreign trade | rstaffa@diw.de

Kristin Trautmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area and European monetary policy | ktrautmann@diw.de

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DIW BERLIN

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
www.diw.de
Phone: +49 30 897 89 – 0 Fax: – 200
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Publishers
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Layout
Roman Wilhelm; Stefanie Reeg; Eva Kretschmer, DIW Berlin

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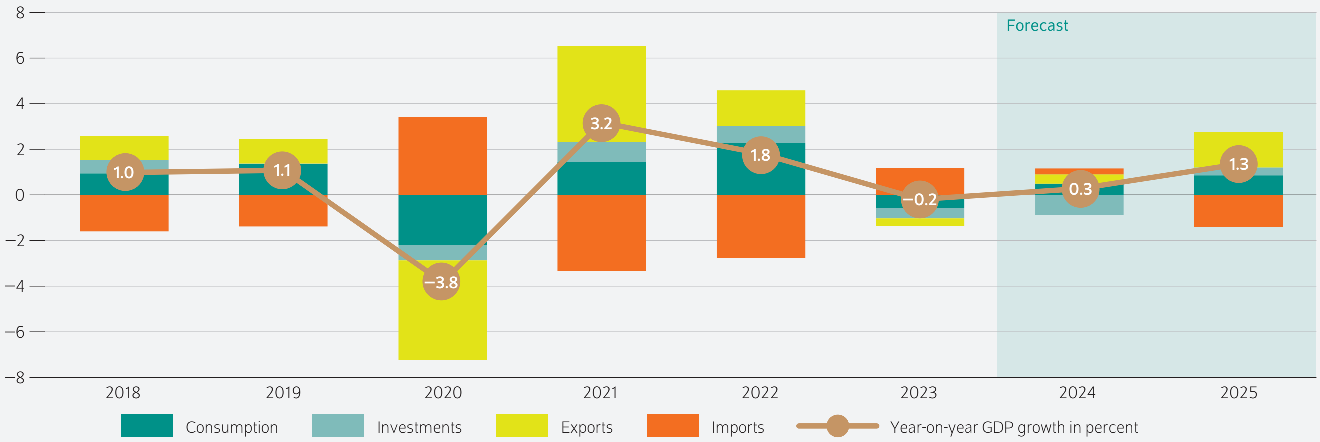
AT A GLANCE

DIW Economic Outlook: Global economy recovering swiftly; German economy gaining momentum

By DIW Berlin's Economic Forecasting Team

- German economy picked up at the beginning of 2024 and developed better than expected thanks to a strong expansion in construction investment and powerful goods exports
- Private consumption declined in the first quarter unexpectedly; consumer sentiment has since brightened, inflation remains under three percent, real wages are rising
- DIW Berlin is revising its forecast for the German economy upward to 0.3 percent, 2025 forecast now slightly more optimistic at plus 1.3 percent
- UEFA Euro 2024 will provide small stimuli for consumption; consequences of flooding in southern Germany are unlikely to have an economic impact
- Global economy also picking up speed and should expand by a good 3.5 percent in both 2024 and 2025

Consumer spending is supporting the German economy; investment will also contribute to growth in 2025
Individual GDP components' contribution to growth in percentage points



Source: DIW Berlin Economic Outlook Summer 2024.

FROM THE AUTHORS

"Consumer sentiment in Germany is brightening considerably: In many sectors, employees are now permanently earning more money thanks to the collective wage increases. In conjunction with inflation, which is now lower, real wages are rising. In addition to this is the turnaround in interest rates, which is making saving less attractive and loans more affordable." — ***Geraldine Dany-Knedlik*** —

MEDIA

Audio Interview with G. Dany-Knedlik (in German)
www.diw.de/mediathek

DIW Economic Outlook: Global economy recovering swiftly; German economy gaining momentum

By Geraldine Dany-Knedlik, Guido Baldi, Nina Maria Brehl, Hella Engerer, Angelina Hackmann, Pia Hüttl, Konstantin Kholodilin, Frederik Kurcz, Laura Pagenhardt, Marie Rullière, Jan-Christopher Scherer, Teresa Schildmann, Ruben Staffa, and Kristin Trautmann

EXECUTIVE SUMMARY

The German economy began recovering at the beginning of 2024 and has developed better than initially expected. A sharp rise in construction investment, albeit more of a flash in the pan as a result of mild winter weather, along with strong goods exports helped the economy onto its recovery path and masked the disappointing development of private consumption, which sank unexpectedly. However, consumer sentiment has since brightened considerably: Following the recent special payments, employees in many sectors are now earning more on a permanent basis due to pay raises, which increases income security. In conjunction with the inflation rate now being stable at below the three-percent threshold, real wages are rising significantly. Added to this is the turnaround in interest rates initiated by the European Central Bank, which is making saving less attractive and loans more affordable. The UEFA European Men's Football Championship, which is being held in Germany this year, is also likely to boost consumption, albeit slightly.

In addition to private consumption, foreign trade will prove to be the second mainstay of the German economy in the forecast period. On the one hand, imports are increasing as the domestic economy becomes stronger. On the other hand, the German export industry will also experience a significant boost, as industrial production is likely to pick up worldwide. Due to the high share of intermediate products and investment goods, exports "made in Germany" are particularly dependent on the global industry's economic situation. In Germany, too, industrial companies will begin investing more in their capacities from 2025 at the latest. Construction investment will then also rise again.

Overall, the outlook is somewhat more positive than it was in the spring: Instead of stagnating, DIW Berlin now expects the German economy to grow by 0.3 percent in 2024 and by 1.3 percent in 2025. One risk factor for the forecast is that the full extent of the damage from the flooding in southern Germany is still unclear. In some places, production capacities could remain impaired for longer than expected. At the same time, it is also conceivable that repair and reconstruction work could increase economic output. Overall, however, the effects in one way or the other are likely to remain manageable. In addition, the tug-of-war over the next federal budget could once again become a factor contributing to uncertainty, possibly even more so than was already to be expected after the results of the EU elections in Germany.

The global economy will also gain some momentum over the forecast period. The euro area is finally overcoming its weak phase for good and international trade is picking up speed. The interest rate turnaround in the major advanced economies will likely have a positive effect on residential construction and corporate investments from the second half of 2024. Overall, the global economy is expected to grow by 3.7 percent in 2024 and by 3.6 percent in 2025.

DOI: https://doi.org/10.18723/diw_dwr:2024-24-1

Global economy: Advanced economies once again picking up speed

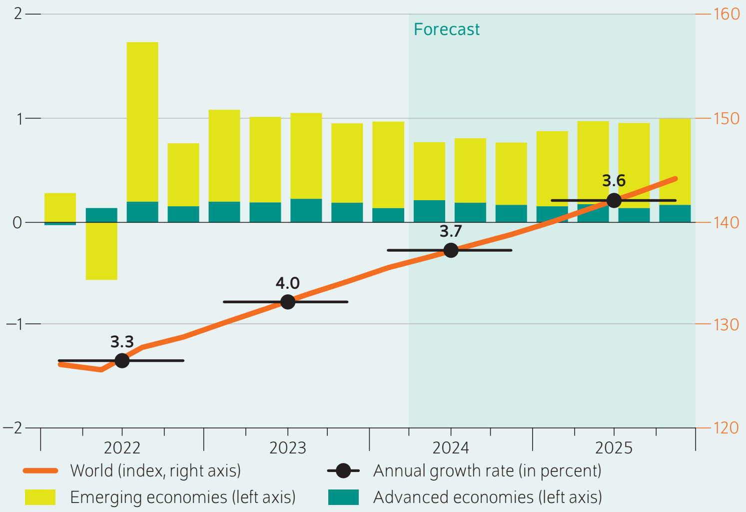
The global economy developed better than expected in the first quarter of 2024 in particular due to the recovery of domestic demand in most advanced economies. Among the emerging economies, China performed surprisingly well in terms of high exports and strong industrial output.

In Europe, real wage increases have finally arrived in the pockets of consumers and are boosting private consumption. Quarter-on-quarter the economy expanded by 0.3 and 0.6 percent in the euro area and the United Kingdom, respectively. Economic growth in the United States was at 0.3 percent and continues to be carried by consumer spending. In contrast, inflation is weighing strongly on domestic demand in Japan, where GDP shrunk by 0.5 percent in the first quarter of 2024. Of the emerging economies, the Indian and Chinese economies experienced the most growth. The Chinese economy expanded by 1.6 percent, more than in the previous quarter; this was driven primarily by industrial output and exports, while domestic demand continued to develop weakly. Overall, the global economy expanded by 1.0 percent in the first quarter of 2024, similar to the fourth quarter of 2023 (Figure 1).

Figure 1

Growth of real GDP

Quarter-on-quarter percentage growth (left axis); index 2015 Q1 = 100 (right axis)



Sources: National Statistical Offices; DIW Berlin Economic Outlook Summer 2024.

The advanced economies are contributing somewhat more to economic growth again.

The global economy should continue its recovery into the current second quarter of 2024. The upswing in the advanced economies will receive a bit more momentum, especially due to the euro area economy, where falling inflation rates combined with rising nominal wages are leading to rising real wages. This should boost the purchasing power of consumers as well as domestic demand. The upswing in the United Kingdom is also likely to continue; the favorable outlook for services points to a further increase in consumption. The US economy, in contrast, is expected to expand only moderately, as private households' remaining excess savings are running out, cooling private consumption. In Japan, high inflation is continuing to weigh on economic growth. The Manufacturing Purchasing Managers' Indices have been recovering in most advanced economies since the beginning of 2024. The May values for Japan, the United Kingdom, and the United States are consistently over the threshold expansion of 50. The value for the euro area remained under 50, but experienced a strong increase from 45.7 in April to 47.3 in May. Thus, industrial output is likely to gradually pick up speed.

The emerging economies are expected to cool down in the second quarter following a strong first quarter. While economic development in China and India continues to support growth, other countries such as Brazil and Mexico are experiencing weak growth due to dampened domestic demand. In contrast, there are signs of a recovery in economic momentum in China, mainly due to more expansive monetary and fiscal policies. Moreover, the recovery of the global economy is likely to boost Chinese exports. Continued dynamic growth is expected for the Indian economy in the second quarter thanks to solid domestic demand.

International trade recovered by 0.3 percent in the first quarter of 2024, following a decline of 1.9 percent in 2023. Weak demand from advanced economies and ongoing geopolitical turmoil weighed on international trade in 2023. Nevertheless, some trade barriers have partly been dissolved since the beginning of the year: For example, circumventing blockaded trade routes from Asia to Europe by means of an alternative African route is now factored into supply chains and production. This and the gradual recovery of the global economy are likely to lead to international trade picking up somewhat in 2024, albeit less strongly than before the pandemic. One important reason for this is that trade policy conflicts, especially between Western countries and China, will continue to have a dampening effect. The punitive tariffs imposed by the US government on Chinese electric vehicles and semiconductors in May 2024 emphasize the fact that the situation is not expected to ease anytime soon.

Monetary policy in many advanced economies remained restrictive at the beginning of 2024 and interest rates were still high. The first key interest rate cuts were made in spring

Box

Assumptions and framework conditions

The forecast is based on the following assumptions about the further development of key interest rates, exchange rates, and commodity prices (Table). These assumptions were made based on previous development, futures markets prices, and the closing prices on the date of this forecast (14. May 2024).

The European Central Bank (ECB) first decreased interest rates in June, as was assumed in the spring forecast. After a year of stable interest rates, it has now initiated a turnaround; further interest rate cuts will follow. We assume five subsequent cuts over the forecasting horizon. In detail, we assume a cut of 35 basis points at the September 2024 meeting, and subsequent cuts every quarter of respectively 25 basis points.[1] Taken together, this leads to a decline of 85 basis points in 2024 and of 75 basis points in 2025. The ECB has thus initiated an interest rate cut before the US Federal Reserve. The Fed and the Bank of England will presumably not lower interest rates until the third quarter of 2024.

Money market interest rates fell at the beginning of 2024 in anticipation of the interest rate turnaround. It is assumed that these, in line with key interest rates, will continue to fall over the forecast horizon. The refinancing costs for households and companies are likely to decline as key interest rates fall over the next years. The return on government bonds slightly increased again following a brief decline in winter 2023. It is assumed that capital market interest rates will remain largely unchanged over the forecast horizon at 2.6 percent for Germany and 3.1 percent for the euro area. The euro has recently depreciated against the US dollar due to the interest rate differential. For the forecast period, it is assumed that the exchange rate of EUR to USD will remain at 1,08 USD per EUR, the level reached at the end of the data period on June 6.

Uncertainties about the gas supply in the coming year resulted in slight increases in the wholesale price for gas (TTF) recently. However, well-filled gas storage facilities should prevent a severe supply shortage. According to futures, the average gas price should be around 30.90 and 35.50 euros per megawatt hours in 2024 and 2025, respectively. According to traded futures, the price for Brent oil should increase slightly in the coming months before declining again at the start of 2025 until the end of the forecast period. In 2024, the average price is likely to be 83 USD per barrel before it declines to an average of 78 USD per barrel in 2025.

This forecast is also based on political assumptions: We assume that no further escalations will occur, but also that none of the current geopolitical crises, such as the Israeli-Hamas war, the Russo-Ukrainian War, and conflict between China and Taiwan, will end.

1 Furthermore, the ECB is expected to reduce the corridor between the deposit facility rate and the main refinancing rate to 15 basis points from September 18, 2024.

Table

Forecast assumptions

		2022	2023	2024	2025
ECB key interest rate (year end)	Percent	2.5	4.5	3.7	2.9
Money market interest rate	Three-month EURIBOR in percent	0.3	3.4	3.6	2.9
Capital market interest	Yield on euro-area government bonds with a remaining term of ten years	2.3	3.2	3.0	3.1
Capital market interest	Yield on German government bonds with a remaining term of ten years	1.8	2.5	2.6	2.6
Exchange rate	USD/EUR	1.05	1.09	1.08	1.08
Crude oil price	USD per barrel	98.6	82.1	83.0	78.0
Gas price	EUR per megawatt hour	133.9	42.2	30.9	35.5

Note: Annual average unless indicated otherwise. Sources: European Central Bank; European Money Markets Institute (EMMI); Eurex Exchange; Deutsche Bundesbank; Federal Reserve; Energy Information Administration (EIA); Intercontinental Exchange (ICE); CME Group; DIW Berlin Economic Forecast Summer 2024.

2024 in light of lower inflation rates only in isolated cases, such as in Switzerland. It is expected that other central banks will begin lowering their interest rates in the summer (Box). In the euro area, this turnaround happened on June 6th, sooner than in the United States and the United Kingdom due to rapidly falling inflation rates. Commodity prices are also no longer likely to provide any price-driving impetus. Japan is a special case, as its inflation is still well above the Bank of Japan's two-percent target as of April 2024 at 2.5 percent, which is unusually high for the country.

Monetary policy has once again become somewhat less restrictive in many emerging economies. There have already been regular key interest rate cuts in Brazil since the end of 2023 due to declining inflation rates and low economic growth, while Mexico decreased its key interest rates in March 2024. In February 2024, the People's Bank of China also adopted a more expansive course by lowering its minimum reserves to support the struggling economy and combat deflationary trends. In India, the key interest rate will likely not be lowered until the third quarter because food

Table 1

Real GDP, consumer prices, and unemployment rates in the global economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Year-on-year percentage change											
	2022	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025
Europe												
European Union	3.5	0.6	1.1	1.9	9.2	6.4	2.8	2.5	6.2	6.0	6.1	5.9
Euro area	3.5	0.6	0.8	1.5	8.4	5.4	2.4	2.0	6.8	6.6	6.5	6.3
excluding Germany	4.0	1.2	1.2	1.5	8.0	5.0	2.3	2.1	8.6	8.3	8.1	7.8
France	2.5	0.9	0.9	1.4	5.9	5.7	2.4	1.9	7.3	7.3	7.4	7.3
Italy	4.1	1.0	0.9	1.0	8.7	5.9	1.6	2.1	8.1	7.7	7.3	7.2
Spain	5.8	2.5	2.3	1.9	8.3	3.4	3.1	2.2	13.0	12.2	11.7	11.1
Netherlands	4.4	0.2	0.6	1.9	11.6	4.1	2.6	2.1	3.5	3.6	3.7	3.7
United Kingdom	4.3	0.1	0.8	1.1	9.1	7.3	2.3	2.2	3.9	4.0	4.3	4.6
Switzerland	2.7	0.7	1.1	1.5	2.8	2.1	1.6	1.5	4.4	4.1	4.3	4.3
Central and Eastern Europe	4.8	0.4	2.4	3.4	13.4	11.6	4.3	3.9	3.5	3.6	3.6	3.4
Turkey	5.3	4.4	3.8	3.2	72.3	54.0	52.5	39.1	10.5	9.4	9.5	10.0
Russia[1]	−0.6	3.0	3.4	1.8	13.8	5.9	6.5	5.0	4.0	3.2	2.8	2.7
The Americas												
USA	1.9	2.5	2.4	1.6	8.0	4.1	3.2	2.3	3.6	3.6	3.9	4.1
Mexico	3.9	3.2	1.8	2.0	7.9	5.5	4.8	3.1	3.3	2.8	2.7	2.6
Brazil	3.1	2.9	1.8	2.2	9.3	4.6	3.3	3.0	9.5	8.0	7.8	7.6
Asia												
Japan	1.0	1.9	0.8	1.1	2.5	3.3	2.2	1.5	2.6	2.6	2.5	2.4
South Korea	2.6	1.3	2.2	2.3	5.1	3.6	2.4	1.9	2.9	2.7	3.1	3.1
China	3.0	5.2	4.8	4.6	1.0	−1.7	0.9	1.8	5.6	5.2	5.1	5.0
India	6.6	7.7	6.6	6.2	6.7	5.8	4.7	4.0	7.6	7.6	7.2	7.0
Total												
Advanced economies	2.5	1.7	1.7	1.5	7.7	4.6	3.0	2.3	4.4	4.3	4.5	4.5
Emerging economies	3.9	5.5	4.9	4.7	9.4	7.3	9.4	9.2	6.3	5.9	5.8	5.6
Global economy	3.3	4.0	3.7	3.6	8.2	5.5	5.6	5.3	5.9	5.6	5.5	5.4
For reference:												
Export weighted[2]	*2.9*	*2.9*	*2.8*	*2.6*								
GDP weighted in USD[3]	*3.2*	*3.0*	*3.1*	*3.1*								

1 The data forecast for Russia are subject to major uncertainties. Russia has only minor weight in the overall forecast.
2 World weighted with shares of German exports from 2022.
3 World weighted with the GDP in USD from 2022 to 2025.

Notes: The black figures are finalized. The values of the groups of countries are a weighted average, with the respective GDP in purchasing power parities from the IMF World Economic Outlook for 2022 to 2025 used to weight GDP and consumer prices. The 2022 labor force (15–64 years old) figures of the respective countries are used to weigh the unemployment rate in the groups of countries. Central and Eastern Europe consist of Poland, Romania, Czechia, and Hungary in this forecast.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Summer 2024.

prices, which are important in India, are currently still rising, although core inflation is already falling overall.

Fiscal policy during the forecast period is likely to be slightly restrictive in most economies. On the one hand, this is due to the fact that measures taken to combat the energy crisis are expiring. On the other hand, higher interest rates are putting governments under pressure to reduce expenditure, which is likely to be to the detriment of medium-term investment programs. In the EU, however, the NextGenerationEU recovery funding is stimulating investments in Member States, while the new European fiscal rules are creating leeway for investments that support growth.[1] China is again an exception here: The Chinese government announced several billion-euro measures to revive the debt-ridden real estate sector.

The global economy is likely to continue gaining momentum throughout the further course of the forecast. The interest rate turnaround in the major advanced economies will likely have a positive effect on residential construction and corporate investments from the second half of 2024 and primarily in 2025. Private consumption is also likely to support the upswing in the advanced economies, which is partly due to the continued good situation on the labor market and accordingly solid growth in labor income. The output gap in the United States is likely to close over the course of the forecast horizon, as is the currently negative output gap in the euro area. Chinese GDP is likely to continue its powerful development, but rates are likely to be lower than before the pandemic. Potential growth has declined markedly compared to

1 European Parliament, "New EU fiscal rules approved by MEPs," press release from April 23, 2024 (available online; accessed on May 30, 2024. This applies to all other online sources in this report unless stated otherwise).

past decades in light of demographic development and the provinces' high level of debt.

On average, the advanced economies should expand by 1.7 percent in 2024. Economic output will likely increase by 4.9 percent in the emerging economies. Overall, the global economy is expected to grow by 3.7 percent in 2024 (Table 1). As the development in the euro area as well as in China was better than expected in the first half of 2024, DIW Berlin is increasing its forecast for the entire year by 0.2 percentage points. In 2025, the global economy is likely to increase by 3.6 percent, unchanged from the spring forecast.

This forecast is based on several uncertainty factors. On the one hand, geopolitical risks remain quite high. The crises relating to the ongoing Israel-Hamas War could spread throughout the region; there is also no end to the Russo-Ukrainian War in sight. There are also simmering geopolitical conflicts in Asia concerning the Korean peninsula or Taiwan, for example. A possible intensification of these geopolitical conflicts harbors many risks for the global economy, from temporarily higher energy and resource prices to major trade distortions and real economic losses.

A further risk factor is public debt sustainability in light of higher interest rates. Long-term government bond yields continue to be high, for example in the US, and react sensitively to developments in inflation and monetary policy decisions. Local governments in China are also heavily over-indebted due to the ongoing real estate crisis. The fact that 2024 is a record election year could also lead to a further increase in debt ratios. Forty-nine percent of the world population will be going to the polls in 2024. Elections often entail fiscal stimuli and thus higher debt.[2] Together with higher interest rates, this could signal a somewhat more restrictive fiscal policy in the future.

In addition, the elections are creating a greater risk of political polarization in many countries. For example, uncertainties regarding the direction of US economic and security policy would increase if Donald Trump is re-elected in November. A further escalation of the trade conflict with China is also to be expected under a Trump administration. Moreover, it is not yet clear to what extent the nationalist forces in the EU Parliament, which made strong gains in the recent elections, will paralyze the EU's active role in shaping common economic and foreign policy.

2 Cf. International Monetary Fund, "Fiscal Policy in the Great Election Year," *Fiscal Monitor* (April 2024) (available online).

German economy: Private consumption becoming the driver of the upturn

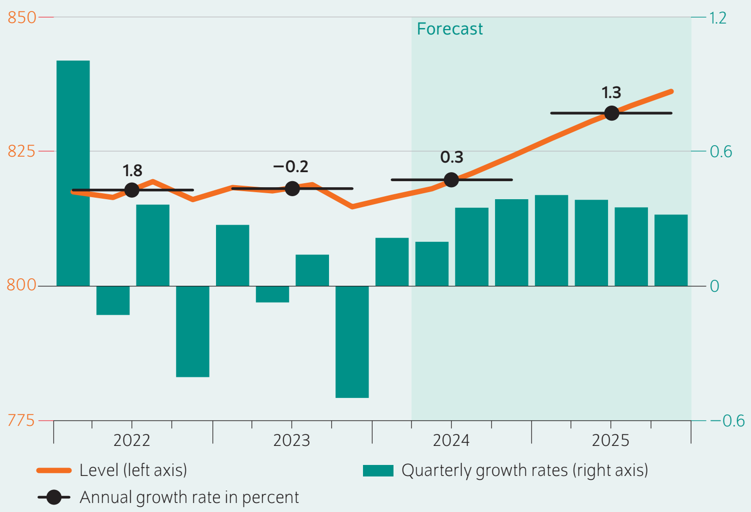
The German economy is slowly exiting its slump, starting out 2024 with momentum following weak performance in 2023.[3] Economic output increased by 0.2 percent in the first quarter of 2024, more than previously expected (Figure 2).[4] The robust growth rate in the first quarter was due in particular to a surprisingly strong increase in construction investment as a result of mild winter weather. In addition, goods exports rose unexpectedly sharply, resulting in a positive trade balance. Meanwhile, private consumption continued to decline despite falling inflation rates and rising disposable incomes.

High interest rates and the German government's political indecisiveness seemed to have dampened consumer sentiment at the beginning of 2024. Even strong growth in real wages seemingly could not boost consumer confidence enough at the beginning of the year to prevent a decline in private consumption. The signs for a recovery in private consumption were there at the beginning of 2024: Employment increased and nominal wages rose significantly, for example in the energy industry and in the public sector at the state level. Together with further declining consumer price inflation, which has been consistently below the three-percent threshold, real wages rose noticeably. The decline in inflation is primarily due to lower food inflation and lower energy goods prices. Meanwhile, core inflation, which excludes foodstuffs and energy, rose more strongly in the first quarter, which was likely largely due to rising prices for services.

Figure 2

Real GDP growth in Germany

In billions of euros (left axis) and quarter-on-quarter in percent (right axis)



Note: Forecast from the second quarter of 2024 onwards; price, seasonally, and calendar adjusted.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Summer 2024.

The German economy will grow again in both 2024 and 2025.

Goods exports increased markedly, especially the export of chemical and pharmaceutical products. Chemical products often serve as the intermediate inputs in further production processes. After their marked declined due to high energy prices, their recent increase might point to a gradual recovery of global industrial production. German goods imports also increased strongly. However, as imports grew less overall than exports, there was a positive trade balance in the first quarter. Private and public investments also supported economic output. The main reason for this was the mild weather, which boosted production in the construction industry and led to a significant increase in construction investment, particularly in residential construction. In contrast, equipment investment declined slightly.

Gross value added rose somewhat more strongly in the first quarter at 0.3 percent than GDP. Production in the manufacturing industry rose slightly. Energy-intensive sectors are showing signs of a slow recovery and were able to expand production again for the first time following the prolonged weak period caused by the sharp rise in energy prices. Nevertheless, they are not likely to recover all losses in the long term. At least some of the energy-intensive companies have relocated production abroad by now and cut jobs in Germany in light of the country's comparatively high energy costs. Together with the strong expansion in the construction industry, industrial production was also able to increase overall and contribute positively to gross value added with nearly 0.1 percentage points. However, the overall increase was primarily carried by services; both the consumer-related (around 0.1 percentage points) as well as public (around 0.2 percentage points) service sectors experienced a strong expansion.

In the current second quarter, the German economy is likely to increase again by 0.2 percent (Table 2). Private consumption in particular should improve on a sustained basis. Households are slowly gaining purchasing power due to continuously rising real wages. Following the one-time special payments that were paid to employees in many sectors in 2023, the collective wage increases are now in effect in many places, which results in employees permanently earning more money. This is likely to strengthen income security. The strong growth in real wages is a relief to low-income households in particular,

3 According to revised data from the Federal Statistical Office, the decline in economic output in the fourth quarter of 2023 was somewhat more pronounced than had been reported in the spring.

4 This forecast uses price-adjusted figures except for when describing price and wage developments, public finances, and public debt.

Table 2

Quarterly data on the development of use and value-added components of real GDP in Germany
In percent (quarter-on-quarter, seasonally and calendar adjusted)

	2023				2024				2025			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	−0.7	0.3	0.0	0.4	−0.4	0.3	0.4	0.4	0.4	0.3	0.3	0.2
Public consumption expenditure	−1.3	0.1	1.4	0.6	−0.4	0.3	0.1	0.2	0.2	0.4	0.4	0.3
Gross capital formation	1.0	−0.1	0.1	−2.1	1.2	−0.5	−0.1	0.2	0.6	0.7	0.8	0.8
Construction	1.5	−0.5	−0.7	−1.9	2.7	−0.9	−0.4	−0.1	0.4	0.6	0.6	0.7
Equipment	1.9	0.7	1.4	−4.0	−0.2	−0.2	0.4	0.7	0.9	1.0	1.1	1.1
Other investment	−1.6	0.0	0.3	0.7	−1.1	0.1	0.1	0.1	0.6	0.8	0.8	0.8
Change in inventories[1]	−0.1	0.2	−0.6	−0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic consumption	−0.5	0.4	−0.3	−0.8	0.0	0.1	0.2	0.3	0.4	0.4	0.4	0.4
Net exports	0.8	−0.4	0.4	0.3	0.3	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Exports	0.5	−0.7	−0.9	−0.9	1.1	0.6	1.0	1.0	0.9	0.7	0.7	0.7
Imports	−1.1	0.2	−1.8	−1.6	0.6	0.5	0.8	0.9	0.9	0.9	0.9	0.9
GDP	0.3	−0.1	0.1	−0.5	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.3
Gross value added	0.4	−0.1	0.1	−0.5	0.3	0.2	0.3	0.4	0.4	0.4	0.3	0.3
Manufacturing	0.7	0.0	−1.1	−1.7	0.2	0.1	0.4	0.5	0.5	0.5	0.4	0.4
Construction	3.2	0.1	0.0	−2.0	2.5	−0.8	−0.3	0.1	0.4	0.5	0.6	0.6
Trade, hospitality, transport	−0.8	0.0	1.3	−1.3	0.4	0.4	0.6	0.6	0.6	0.5	0.4	0.4
Professional services providers	−0.1	0.4	0.3	0.5	−0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.3
Public services, education, health	1.2	−0.5	0.1	0.2	1.1	0.3	0.3	0.2	0.2	0.2	0.2	0.2

1 Contribution to growth in percentage points.

Note: Forecast from the second quarter of 2024 onwards.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Summer 2024.

who are henceforth likely to support consumption. Household surveys also indicate a lower propensity to save and a greater willingness to consume. The UEFA European Men's Football Championship, which is taking place in Germany in early summer, will provide additional momentum for private consumption in the second and third quarters.

The global economy is boosting foreign demand. German foreign trade is likely to benefit in particular from the upturn experienced by important euro area trade partners. Imports are likely to increase at a similar rate to exports, meaning that the overall contribution of foreign trade to GDP in the second quarter will probably be lower than in the first quarter.

Following the strong start to the year, investments, however, are unlikely to provide any growth stimuli in the current second quarter. A negative countermove to the strong increase in the first quarter is expected in construction investment, mainly due to a decline in residential construction, where the situation remains extremely tense. Equipment investment is also likely to fall again slightly in light of the still fragile economic situation.

Industry is also likely to recover rather slowly. Companies are continuing to view their situation cautiously. The manufacturing industry has been recording fewer and fewer new orders since 2022 and business expectations are improving only slowly. The Global Composite Purchasing Managers' Index has climbed over the expansion threshold of 50 in the second quarter of 2024, the first time since summer 2023. However, this is primarily due to the services sector, where sentiment has recently brightened considerably; the recovery in private consumption and the positive momentum from the UEFA European Men's Football Championship should ensure a rapid upturn. In addition to the hospitality sector, further consumer-related service providers and consumer goods manufacturers are also likely to benefit and expand production. The flooding in southern Germany will however likely not significantly disrupt production.

The recovery of the German economy is projected to gain significant momentum over the further course of the forecast. Private consumption will be the main driver and remain supported by continued positive wage development, rising employment, and declining unemployment. As the economies of important trading partners are also likely to recover, foreign trade should also expand on a sustained basis from the second half of 2024. In addition to this is the expected upturn in global industrial production, which will benefit from the expected interest rate turnaround by the major central banks and should boost German exports. This should also somewhat revive the momentum of private equipment investment if companies expand their capacities again in view of rising demand, particularly in 2025. In addition, there are strong investment stimuli from the public sector. For example, more funds for military expenditure are likely to be drawn from the special fund for the German armed forces (*Bundeswehr*). Only construction investment will continue to stagnate in the second half of 2024 due to the ongoing weak performance of residential construction and will first contribute to economic growth again in 2025, driven primarily by investments in rail and energy networks. Reconstruction and repair work following the flooding in southern Germany should not substantially alter this picture.

In addition to monetary policy, which is only gradually becoming less restrictive, fiscal policy also displays a restrictive orientation: A large number of fiscal policy measures that were introduced in response to the energy price crisis (above all the electricity and gas price brakes, the stabilization of transmission grid fees, and aid for hospitals and care facilities) have already ended or will end in 2024. In 2025, restrictive stimuli such as the end of the tax-free inflation compensation premium are also likely to outweigh expansionary stimuli from the *Wachstumschancengesetz* (Growth Opportunities Act) and the special fund for the *Bundeswehr*. In line with this, government deficits are expected to decrease slightly, falling from 2.4 percent in relation to GDP in 2023 to 1.9 percent in 2024 and further to 1.3 percent in 2025.

All in all, price-adjusted GDP will likely rise slightly by 0.3 percent in 2024 (Table 3). Growth is projected to be 1.3 percent in 2025. Thus, DIW Berlin is increasing its forecast for 2024 by 0.3 percentage points and for 2025 by 0.1 percentage points. The main factors for the improved forecasts are the unexpectedly strong first quarter of 2024 as well as slightly stronger momentum over the course of the year, which should benefit from the fact that the global economy and, in particular, important trading partners will recover somewhat more quickly.

Potential GDP will likely develop weakly until the end of 2028, primarily due to the negative development of labor volume. In light of the moderate expansion in 2024, the output gap in 2024 is likely to grow somewhat larger and amount to an annual average of -1.6 percent of potential GDP. In 2025, the output gap is expected to fall to -0.6, and by 2028 it should close completely.

Following the significant rise of 5.9 percent in consumer prices last year, inflation is expected to average 2.3 percent in 2024 and 2.0 percent in 2025. Thus, DIW Berlin's inflation forecast remains unchanged compared to the spring. In light of the higher price increases for services, the core rate is likely to average 2.7 percent in 2024 and fall to 2.0 percent in 2025 as wage growth slows.

Table 3

Key economic indicators for the German economy

	2023	2024	2025
GDP[1]	−0.2	0.3	1.3
Employed[2] (1,000 persons)	45,932	46,072	46,153
Unemployed (1,000 persons)	2.609	2.731	2.608
Unemployment rate[3] (Federal Employment Agency concept, in percent)	5.7	5.9	5.6
Consumer prices[4]	5.9	2.3	2.0
Unit labor costs[5]	6.6	4.6	2.4
Government budget balance[6]			
in billions of euros	−99.1	−82.8	−56.5
in percent of nominal GDP	−2.4	−1.9	−1.3
Current account balance			
in billions of euros	243.1	321.9	351.9
in percent of nominal GDP	5.9	7.6	8.0

1 Price adjusted. Year-on-year change in percent.
2 Domestic concept.
3 Unemployed as a percentage of the civilian labor force (definition according to the Federal Employment Agency).
4 Year-on-year change.
5 Compensation of employees per hour worked in Germany as a percentage of real GDP per hour worked.
6 As defined in the national accounts (volkswirtschaftliche Gesamtrechnungen).

Note: Forecast from 2024 onwards.

Sources: Federal Statistical Office; Federal Employment Agency; DIW Berlin Economic Outlook Summer 2024.

In addition to the global risks, there are also domestic uncertainties for the German economy, such as the recent flooding in the southern part of the country and the associated damage. The consequences of the flooding in Bavaria and Baden-Württemberg could be much greater than assumed in this forecast. For example, it is possible that production capacity is disrupted more than initially expected, with the corresponding consequences for industrial output. This is a downside risk for the forecast. However, an upside risk is also conceivable: If damage to residential buildings and public infrastructure is greater than expected, the resulting reconstruction work could boost economic output, especially from 2025.

Another domestic risk for the German economy is the unclear economic policy framework, in particular the upcoming budget for 2025. If a budget agreement is significantly delayed, this could make private households and companies uneasy and thus lead to a reluctance to consume and invest.

Geraldine Dany-Knedlik is Head of the Forecasting and Business Cycle Policy Group in the Macroeconomics Department at DIW Berlin | gdanyknedlik@diw.de

Guido Baldi is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the USA | gbaldi@diw.de

Nina Maria Brehl is a Doctoral Student in the Macroeconomics Department at DIW Berlin | nbrehl@diw.de

Hella Engerer is a Research Associate in the Energy, Transportation, Environment Department at DIW Berlin specializing in Central and Eastern Europe | hengerer@diw.de

Angelina Hackmann is a Research Associate in the Macroeconomics Department at DIW Berlin | ahackmann@diw.de

Pia Hüttl is Head of the global economic forecast and a Research Associate in the Macroeconomics Department at DIW Berlin | phuettl@diw.de

Konstantin Kholodilin is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in estimating potential output and production | kkholodilin@diw.de

Frederik Kurcz is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area | fkurcz@diw.de

Laura Pagenhardt is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in investments | lpagenhardt@diw.de

Werner Roeger is a Guest Researcher in the Macroeconomics Department at DIW Berlin specializing in estimating potential output and macroeconomics modeling | wroeger@diw.de

Marie Rullière is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area | mrulliere@diw.de

Jan-Christopher Scherer is Head of the German economic forecast and Research Associate in the Macroeconomics Department | jscherer@diw.de

Teresa Schildmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the German labor market and German fiscal policy | tschildmann@diw.de

Ruben Staffa is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the USA, German fiscal policy, and German foreign trade | rstaffa@diw.de

Kristin Trautmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area and European monetary policy | ktrautmann@diw.de

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DIW BERLIN

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
www.diw.de
Phone: +49 30 897 89 –0 Fax: –200
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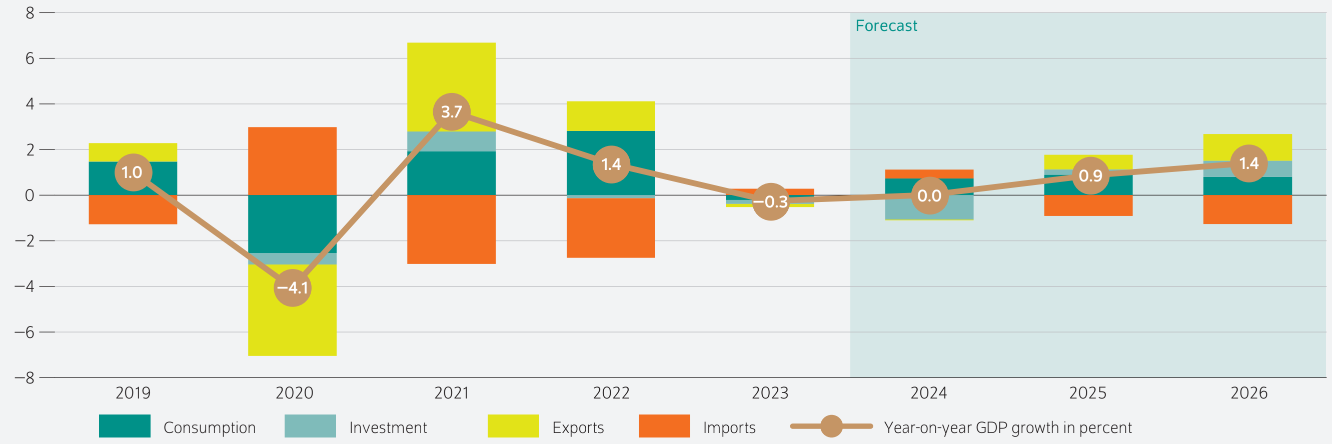
AT A GLANCE

DIW Berlin Economic Outlook: Industry sputtering globally while the German economy stagnates

By the DIW Berlin Economic Forecasting Team

- German economy continuing to tread water: it declined in the second quarter following a positive start to the year; earliest expected recovery not until the end of 2024
- Despite higher real wages and inflation in the two-percent range, people are saving their money; exports and investments are also floundering
- DIW Berlin forecasts stagnation for the German economy this year and growth of 0.9 and 1.4 percent in 2025 and 2026
- Private consumption, which will initially rise more slowly than expected, will be the main driver; falling interest rates worldwide are boosting foreign trade and investments
- Global economy continuing on its recovery path with growth of 3.8 percent projected for 2024, although it has weakened slightly recently; growth in China is faltering, the US is on the brink of a cooldown

Private consumption supporting the German economy in 2025 and 2026; no growth momentum from foreign trade
Individual components' contribution to overall GDP growth in percentage points



Source: DIW Berlin Economic Outlook Autumn 2024.

FROM THE AUTHORS

"Domestic and foreign demand for German industrial goods is still weak and the lack of orders is increasingly becoming a problem. However, there is hope that slowly increasing foreign investment activity will stimulate German industrial production, despite strong competition from China."
— Geraldine Dany-Knedlik —

MEDIA

Audio Interview with G. Dany-Knedlik (in German)
www.diw.de/mediathek

DIW Berlin Economic Outlook: Industry sputtering globally while the German economy stagnates

By Geraldine Dany-Knedlik, Nina Maria Brehl, Hella Engerer, Angelina Hackmann, Pia Hüttl, Konstantin Kholodilin, Frederik Kurcz, Laura Pagenhardt, Marie Rullière, Jan-Christopher Scherer, Teresa Schildmann, Ruben Staffa, and Kristin Trautmann

ABSTRACT

The German economy continues to stagnate. After it appeared to finally be growing at the start of 2024, it experienced a slight setback in the second quarter. Although incomes are rising and inflation is now near the two-percent target, people in Germany are saving their money. As investments and exports faltered due to the sluggish industrial sector, the upturn has been delayed for the time being. Overall economic output is likely to stagnate in 2024, but it will likely pick up at the end of the year; growth of 0.9 and 1.4 percent is expected in 2025 and 2026, respectively. Private consumption, which will increase more slowly than expected but still provide a stimulating effect, will primarily support this growth. As interest rates continue to fall worldwide, foreign trade and investments are also supporting growth. The global economy has returned to its recovery path, but expanded more weakly in the second quarter compared to the first. Growth in China in particular has stalled somewhat, and there are also signs of an upcoming economic slowdown in the United States. Following growth of 3.8 percent in 2024, the global economy is expected to expand by only 3.5 percent in 2025, but develop more dynamically again in 2026.

Global economy: recovery expected to continue, while the US economy cools off

The global economy weakened in the second quarter of 2024. Following a 1.0-percent increase in the first quarter, it only grew by 0.7 percent in the second (Figure 1). Growth stalled in the emerging economies in particular; this was due to the development in China, where domestic demand remained weak. In contrast, a bit more momentum came from the advanced economies, especially the United States and the euro area, where inflation rates continued to decline. This resulted in a first interest rate cut in the euro area in June.

Carried by consumption and exports, the advanced economies expanded by 0.6 percent in the second quarter. The euro area economy remained on its recovery path and grew again by 0.3 percent. Foreign trade in particular made a positive contribution to growth due to rising exports. Spain (0.8 percent) and the Netherlands (1.0 percent) provided particularly strong support for the economic recovery in the euro area. France and Italy also recorded positive quarterly growth in the second quarter, with 0.3 percent each. Germany was the only major euro area country to make a negative contribution to growth with -0.1 percent. In the United Kingdom, economic output continued to rise significantly by 0.6 percent, supported primarily by a strong increase in inventories.

The US economy also experienced strong growth of 0.7 percent in the second quarter, still driven by robust consumer spending and corporate investments. In contrast to its negative start to the year, Japan's GDP expanded by 0.8 percent. Tax relief and real wage growth as a result of larger wage increases have spurred private consumption.

Among the emerging economies, which expanded by 0.8 percent overall, only China performed poorly: The Chinese economy grew by merely 0.7 percent in the second quarter, compared to a strong 1,5 percent in the first. Negative factors, such as the still struggling real estate market, subdued domestic demand, and severe storms and flooding dampened growth, while fiscal and monetary policy measures only had a limited

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impact on the problems in the real estate market.[1] In contrast, strong foreign demand and government investments in the high-tech sector contributed positively to growth. The Indian economy continued to expand thanks to strong domestic economic activity. The Mexican and Brazilian economies continued to grow, although momentum is slowing somewhat. Restrictive monetary policy had an impact in these countries and the export sector felt the effects of the weaker global economy. Poland stands out among the Central and Southeastern European countries with impressive quarterly growth of 1.5 percent.

In the current third quarter, most advanced economies are expected to contribute a bit less to the recovery than previously. In particular, the US economy is likely to contract slightly as a result of less dynamic consumption and a deteriorating situation in the labor market. By contrast, the euro area economy without Germany is likely to continue its recovery path. Steady growth in real wages will probably strengthen domestic demand. No momentum is expected from the euro area industry: While the Manufacturing Purchasing Managers' Indices (PMI) of the individual euro area countries in the first half of 2024 still showed signs of recovery, they have been declining again since June. Companies are pessimistic in terms of political uncertainty (France), declining orders and rising prices for intermediary goods and labor costs (Spain, Netherlands, Italy). The outlook is also deteriorating in most Member States in the services sector, but the indices remain above the expansion threshold. The mood has improved in France due to the Olympic Games. The outlook for the third quarter for the United Kingdom is good: Both the upward trend in the PMIs in all economic sectors and the rise in consumer confidence point to a further recovery. Real wage increases are likely to continue boosting consumption. In Japan, the recovery in domestic demand is providing slight growth stimuli in the third quarter. At the same time, there are also only very weak signals for a recovery in the Japanese manufacturing industries; the PMI has been stuck below the expansion threshold of 50 for two months in a row.

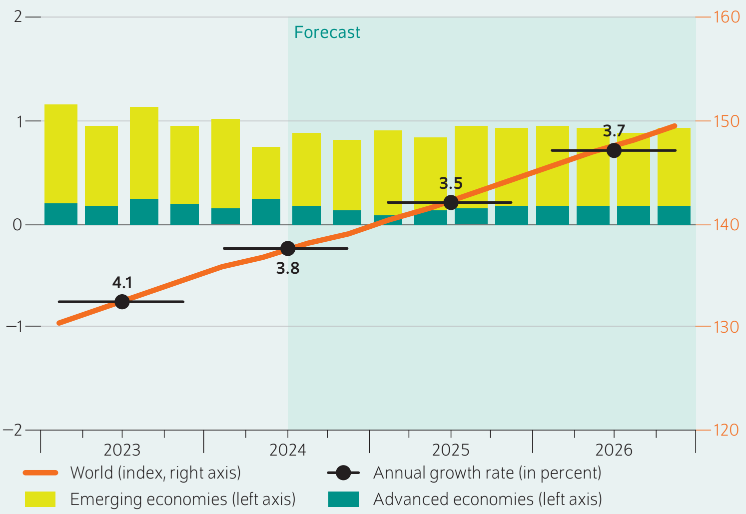
Growth is expected to be stronger in the emerging economies in the third quarter than in the second quarter. The Indian economy should continue to grow dynamically. The Chinese economy is likely to benefit from rising exports and investments in the high-tech sector. Despite all the stimulating monetary and fiscal policy measures, domestic demand is likely to continue to suffer from the problems on the real estate market, which puts into question the Chinese government's annual growth target of five percent for 2024.

Despite still pending or already initiated interest rate cuts, monetary policy in the advanced economies is likely to remain restrictive. The neutral rate of interest will probably be reached by the end of 2025 in many places. The European Central Bank announced an interest rate turnaround in June (Box 1) and the Bank of England followed in August. In the United States, a turnaround in interest rates is likely in mid-September in response to steadily falling inflation. In contrast, the Bank of Japan decided on a further interest rate hike in July due to high inflation and a weak yen. This is a sign that the years of ultra-expansive monetary policy are coming to an end, but have led to short-lived global stock market turbulence.

Figure 1

Real GDP growth

Quarter-on-quarter percentage growth (left axis); index 2015 Q1 = 100 (right axis)



Sources: National Statistical Offices; DIW Berlin Economic Outlook Autumn 2024.

The global economy is continuing on its recovery path, but will grow somewhat less dynamically in 2025.

Central banks in many emerging economies have been cutting key interest rates for some time now. Key interest rates have been declining regularly in Brazil due to falling inflation rates and weak economic growth. There were also interest rate cuts in Mexico in March and August, although they were more moderate due to persistent inflation. The People's Bank of China is following a more expansive course due to deflationary tendencies. There, the weak recovery following the coronavirus pandemic and debt problems, especially in the real estate sector, are dampening price pressure.

Interest rates, which remain high in most economies, limit fiscal policy. Fiscal policy will thus continue to be slightly restrictive during the forecast period, especially in the euro area. Governments remain under pressure to save due to interest rates declining only gradually, which is likely to result in reduced spending on medium-term investment programs. Existing programs such as the NextGenerationEU should, however, still have a positive impact on investments in Member States. The new European deficit rules

1 Cf. Timm Bönke, "DIW Konjunkturprognose Winter 2023: Aussichten reichen von heiter bis wolkig," *DIW Wochenbericht* no. 5, Box 2 (2023): 717 (in German; available online. Accessed on August 29, 2024. This applies to all other online sources in this report unless stated otherwise).

Box 1

Assumptions and framework conditions

This forecast is based on the following assumptions about the further development of key interest rates, exchange rates, and commodity prices (Table). These assumptions were made based on previous development, futures markets prices, and the closing prices on the date of this forecast (August 19, 2024). The European Central Bank (ECB) first decreased interest rates in June. After a year of stable interest rates, it has now initiated a turnaround. Six further interest rate cuts are assumed over the forecast horizon, which are likely to take place at every second ECB meeting. Specifically, it is assumed that the ECB will cut interest rates for the second time in September, again by 25 basis points. At the same time, the Central Bank will, as announced, decrease the interest rate corridor between the main refinancing rate and the deposit rate from 50 to 15 basis points. For some time now, the ECB has been steering the economy via the deposit rate and not the main refinancing rate. The deposit rate is thus the key indicator for interest rate changes. The subsequent interest rate cuts are assumed to be 25 basis points each, which results in a reduction of the deposit rate by 75 basis points in both 2024 and 2025.

Money market interest rates fell at the beginning of 2024 in anticipation of the interest rate turnaround. It is assumed that these, in line with key interest rates, will continue to fall over the forecast horizon. The refinancing costs for households and companies are likely to decline as key interest rates fall over the coming years. The return on government bonds increased again slightly following a brief decline at the beginning of 2024. It is assumed that capital market interest rates will remain largely unchanged over the forecast horizon at 2.4 percent for Germany and 3.1 percent for the euro area. The euro has recently depreciated against the US dollar due to the interest rate differential. For the forecast period, it is assumed that the exchange rate of EUR to USD will remain at 1.09 USD per EUR.

Uncertainties about the gas supply in the coming year resulted in slight increases in the wholesale price for gas (TTF) recently. However, well-filled gas storage facilities should prevent a severe supply shortage. According to futures, the average gas price should be around 34.50 (2024), 41.90 (2025), and 35.70 euros (2026) per megawatt hours. The price for Brent crude oil will decline slightly over the forecast horizon according to traded futures. In 2024, the average price is likely to be 84,60 USD per barrel before it declines to an average of 76,70 USD per barrel in 2025 and finally to 73,70 USD per barrel in 2026. This forecast is also based on political assumptions: We assume that no further escalations will occur, but also that none of the current geopolitical crises, such as the Israeli-Hamas War, the Russo-Ukrainian War, and the conflict between China and Taiwan, will end.

Table

Forecast assumptions

		2023	2024	2025	2026
ECB deposit rate[1] (year end)	Percent	4.0	3.25	2.5	2.5
Money market interest rate	Three-month EURIBOR in percent	3.4	3.5	2.4	2.2
Capital market interest	Yield on euro-area government bonds with a remaining term of ten years	3.3	3.1	3.1	3.1
Capital market interest	Yield on German government bonds with a remaining term of ten years	2.6	2.5	2.4	2.4
Exchange rate	USD/EUR	1.08	1.09	1.09	1.09
Crude oil price	USD per barrel	82.5	82.6	76.7	73.7
Gas price	EUR per megawatt hour	42.1	34.5	41.9	35.7

1 The ECB steers the economy via the deposit rate, not the key interest rate.

Note: Annual average unless indicated otherwise.

Sources: European Central Bank; European Money Markets Institute (EMMI); Eurex Exchange; Deutsche Bundesbank; Federal Reserve; Energy Information Administration (EIA); Intercontinental Exchange (ICE); CME Group; DIW Berlin Economic Forecast Autumn 2024.

are creating leeway for investments that support growth.[2] In Poland, a switch in governments made it possible for previously blocked EU funds to be disbursed in spring 2024; these funds will increase the country's fiscal leeway. In the United Kingdom, the Labor government is likely to provide new impetus in its autumn budget. However, it will have very limited fiscal leeway and will probably be unable to avoid tax increases; the government has already announced initial cost cutting measures. No new significant fiscal policy stimuli are expected in the United States, as in an election year, neither party has any incentive to curb the high deficits. Together with the Central Bank, the Chinese government presented a package of measures to support the real estate sector in May. However, according to recent figures, only a fraction of the funds was disbursed to bail out property developers.

International trade is recovering slowly; powerful growth rates are not expected in 2024 overall. The ongoing global industrial weakness in the advanced economies will likely still weigh on international trade in 2025. Falling interest rates, however, should revive corporate investment, and thus also international trade, from mid 2025.

Over the rest of the forecast period, global growth rates are expected to be muted in 2025 before becoming more dynamic in 2026 (Table 1). In winter 2024/2025, inflation rates in many places will reach the target corridor of the central banks. As interest rates fall, monetary policy in most economies will switch from a restrictive policy to a more neutral one by the end of 2025, thereby supporting economic

2 European Parliament, "New EU fiscal rules approved by MEPs," press release from April 23, 2024 (available online).

Table 1

Real GDP, consumer prices, and unemployment rate in the global economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Year-on-year percentage change											
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
Europe												
European Union	0.5	1.1	1.7	1.9	6.4	2.8	2.5	2.2	6.0	6.2	6.0	5.9
Euro area	0.5	0.8	1.3	1.4	5.4	2.5	2.1	2.0	6.6	6.5	6.4	6.2
excluding Germany	1.3	1.4	1.4	1.6	5.0	2.4	2.1	1.9	8.3	8.0	7.8	7.7
France	1.1	1.2	1.3	1.5	5.7	2.4	1.9	1.8	7.4	7.5	7.4	7.3
Italy	1.0	0.9	1.0	1.0	5.9	1.3	2.0	2.0	7.7	7.0	6.9	6.9
Spain	2.5	2.7	1.8	2.1	3.4	3.1	2.4	1.9	12.2	11.6	11.1	10.8
Netherlands	0.1	0.8	2.0	1.8	4.1	3.3	2.5	2.0	3.6	3.6	3.6	3.6
United Kingdom	0.1	1.1	1.4	1.2	7.3	2.5	2.2	2.1	4.0	4.4	4.6	4.3
Switzerland	0.7	1.5	1.7	1.8	2.1	1.7	1.5	1.3	4.1	4.2	4.3	4.1
Central and Southeastern Europe	0.5	2.3	3.1	3.4	11.6	4.1	3.6	3.0	3.6	3.7	3.5	3.4
Turkey	4.5	3.6	3.4	3.4	54.0	59.6	41.2	38.0	9.4	8.9	9.4	8.5
Russia[1]	3.2	3.5	1.8	1.4	5.9	7.7	5.0	4.1	3.2	2.7	2.7	2.7
The Americas												
USA	2.5	2.5	1.1	1.8	4.1	2.9	2.0	1.9	3.6	4.2	4.5	4.1
Mexico	3.2	1.4	2.3	2.4	5.5	4.4	3.0	3.0	2.8	2.7	2.6	2.6
Brazil	2.9	2.0	2.2	2.4	4.6	4.2	3.1	3.0	8.0	7.8	7.6	7.5
Asia												
Japan	1.7	0.3	1.0	0.9	3.3	2.4	1.8	1.6	2.6	2.6	2.4	2.3
South Korea	1.4	2.4	2.2	2.2	3.6	2.4	1.9	1.9	2.7	2.9	3.0	3.0
China	5.2	4.8	4.6	4.5	−1.7	0.6	1.6	1.8	5.2	5.0	5.1	4.9
India	7.8	6.9	6.4	6.5	5.7	4.1	4.2	3.9	8.1	7.8	7.5	7.3
Total												
Advanced economies	1.7	1.7	1.2	1.6	4.8	3.0	2.1	2.1	4.3	4.6	4.7	4.4
Emerging economies	5.5	4.9	4.7	4.8	4.5	5.7	5.6	6.0	6.1	5.9	5.8	5.6
Global economy	4.1	3.8	3.5	3.7	4.3	3.9	3.4	3.6	5.7	5.6	5.5	5.4
For reference:												
Export weighted[2]	*2.9*	*2.8*	*2.4*	*2.7*								
GDP weighted in USD[3]	*3.4*	*3.2*	*2.9*	*3.0*								

1 The data forecast for Russia are subject to major uncertainties. Russia has only minor weight in the overall forecast.
2 World weighted with shares of German exports from 2023.
3 World weighted with the GDP in USD from 2023 to 2026.

Notes: The black figures are finalized. The values of the groups of countries are a weighted average, with the respective GDP in purchasing power parities from the IMF World Economic Outlook for 2023 to 2026 used to weight GDP and consumer prices. The 2022 labor force (15–64 years old) figures of the respective countries are used to weigh the unemployment rate in the groups of countries. Central and Southeastern Europe consist of Poland, Romania, Czechia, and Hungary in this forecast.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Autumn 2024.

development, especially corporate investment and construction. In the advanced economies, the opposing trends between the United States and Europe are likely to converge. While the United States has left the euro area behind in terms of growth over the past years, the situation there now seems to be deteriorating, while signs in the euro area are pointing to growth again.

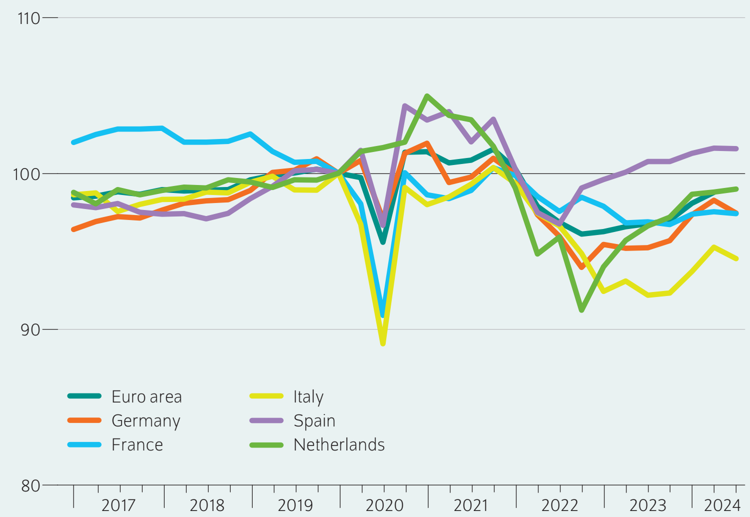
The gradual slowdown in economic momentum in the United States is primarily being driven by declining private consumption and the labor market. However, the labor market seems to be more robust than the unemployment rate, which has been higher since spring, would suggest. The unemployment rate is likely overstated due to the immigration boom. Even if some indicators point to an increased risk of a recession in the United States, a gradual slowdown in the pace of expansion seems more likely, especially as the US Federal Reserve has sufficient leeway to cut interest rates.

In the euro area, on the other hand, the purchasing power of private households is likely to increase further thanks to lower inflation and higher nominal wages, even if real wages in the euro area are still one percentage point below pre-pandemic levels and even further below pre-energy crisis levels (Figure 2). The positive situation on the labor market will likely continue to support the economy, although it has worsened slightly recently. Japanese GDP is likely to be above its potential growth in 2025 due to recovering domestic demand and growing exports.

The outlook for most emerging economies over the forecast period is favorable. Dynamic domestic demand and gradually

Figure 2

Real wages in the euro area
Index December 1, 2019 = 100



Sources: ECB; Eurostat; DIW Berlin Economic Outlook Autumn 2024.

Although there has been a strong increase in real wages, they have not yet reached pre-pandemic levels in most countries.

falling interest rates should support investments in countries such as Mexico and Brazil. Chinese GDP is likely to continue its powerful development, but growth rates are likely to be lower than before the pandemic. The previous investment-driven growth model seems to have reached its limits and has not been replaced by private consumption so far.

On an annual average, the advanced economies are expected to expand by only 1.7 percent in 2024, while economic output will likely increase by 4.9 percent in the emerging economies. Overall, the global economy is expected to grow by 3.8 percent in 2024, 0.1 percentage points more than forecast in summer. In 2025, global growth is likely to be somewhat weaker at 3.5 percent, due to the US economy cooling down, before growing more dynamically again by 3.7 percent in 2026. Thus, the forecast for 2025 is 0.1 percentage points less than expected in summer.

This forecast is subject to many uncertainty factors. For example, the inflation rates, especially in the United States and the euro area, could decline more slowly than expected, which would result in a longer phase of restrictive monetary policy and thus dampen economic growth. If inflation fell more quickly, in contrast, it could support consumption more and lead to more rapid interest rate cuts. Geopolitical risks remain quite high. The war in the Middle East could escalate further, which would likely lead to higher oil and natural gas prices. The war in Ukraine, the development of which is difficult to predict, is a further risk. Donald Trump's possible re-election in November could lead to major uncertainties regarding the direction of US economic and security policy. The trade conflict between China and the West could also escalate further and have a negative impact on international trade. Generally, the risk of political polarization is high in many places; extremist parties are gaining ground worldwide. In the long term, this populism harbors considerable risks for growth and prosperity prospects, especially if it ignores or undermines fundamental economic principles.

German economy caught in a slump

The German economy remains stuck in a phase of weak growth. Following a slight 0.2 percent increase in GDP at the beginning of the year, this positive development did not continue: Economic output contracted slightly by 0.1 percent in the second quarter (Figure 3[3]). A recovery failed to materialize. On the one hand, private household consumption was significantly lower than the increase in disposable income since the energy crisis had suggested. On the other hand, investments in equipment and in construction slumped and exports declined, probably primarily due to persistent low domestic and foreign demand for industrial goods.

Private consumption contracted somewhat in the second quarter: Private households seem to be unsettled, both due to the political and economic conditions as well as the low but steady rise in unemployment. This likely resulted in consumers consuming less in the second quarter than they did at the beginning of the year, despite strong increases in real wages. In line with this, private households are saving a bit more of their income: At 10.8 percent, the savings rate is currently slightly higher than in 2023.[4] Consumer sentiment is dampened, likely due to the high price level. While inflation has stabilized noticeably recently and consistently been under three percent since the beginning of 2024, core inflation and the price increases in the services sector in particular have remained elevated, likely having curbed consumption. As expected in early summer, the UEFA European Men's Football Championship did not noticeably boost private consumption in Germany.

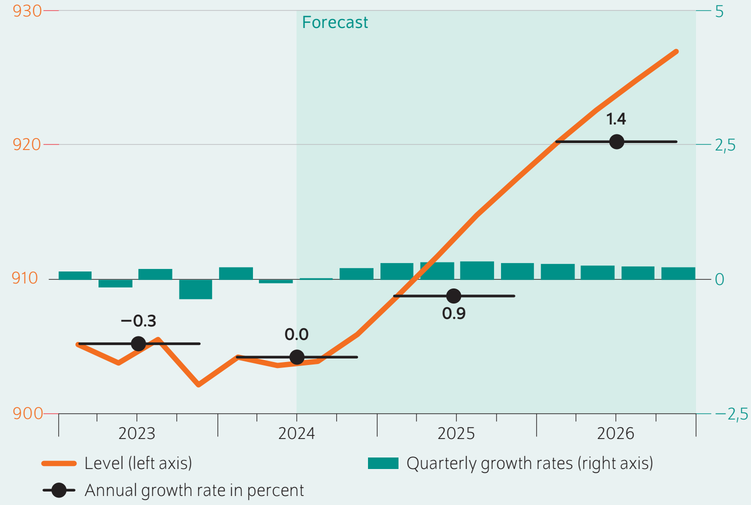
Foreign trade also did not provide any growth stimuli in the second quarter. While strong exports of intermediate goods, such as chemical and plastic products, had indicated a recovery in the global industry[5] and thus German trade at the beginning of the year, exports of these goods significantly declined again in the second quarter. Although travel boosted service exports, it was unable to prevent the decline in exports overall. Service imports also experienced strong growth, while goods imports fell slightly. Overall, imports stagnated, resulting in a slightly negative balance of exports and imports in the second quarter.

The decline in investments was even greater. Particularly private investment in equipment suffered a serious slump; in the second quarter, it was at its lowest level since the production restrictions during the coronavirus pandemic. In contrast, public equipment investment had a stimulating effect. The downward trend of recent years also continued in construction investment, which declined significantly, mainly in residential and public construction.

Figure 3

Growth of real GDP in Germany

In billions of euros (left axis) and quarter-on-quarter percentage growth (right axis)



Note: Forecast from the third quarter of 2024; price, seasonally, and calendar adjusted.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Autumn 2024.

The German economy will not grow again until the end of 2024.

The evolution of gross value added (GVA) in the second quarter shows that the gap between the services and manufacturing sectors is growing. Overall, GVA declined by 0.1 percent, the same rate as GDP. While production declined slightly in manufacturing, it plummeted in the construction industry. As a result, the manufacturing industry as a whole reduced GVA by 0.3 percent. Services increased slightly, supporting GVA by 0.1 percent. However, it was a mixed picture in the individual economic sectors. Value added in the consumer-related sectors decreased, while business-related services were able to expand their production. This development in value added is also reflected in the latest labor market figures: employment has continued to rise overall, albeit at a slightly slower rate than at the beginning of the year. Employment expanded in the services sector but declined in the ailing manufacturing industry as well as construction. Overall, however, the labor market has so far remained stable, even if unemployment is rising.

Stagnation expected in the third quarter for the German economy

The recovery of the German economy is likely to remain elusive in the current third quarter; GDP is not projected to increase (Table 2). Private consumption is still projected to expand, although less powerfully than was implied in spring (Figure 4). Consumer confidence indicators, which rose steadily during the first half of 2024, have recently experienced a slight downturn. Households' willingness to spend

3 Detailed figures on the forecast for the Germany economy can be found in the online appendix (in German).

4 The general revision of the VGR data results in the savings rate for Germany being revised downward significantly. Until recently, the data showed a significantly higher savings rate level than was the case before the coronavirus pandemic.

5 For more, see the section on the global economy in this Weekly Report.

Table 2

Quarterly data on the development of expenditure and production components of real GDP in Germany
In percent (quarter-on-quarter, seasonally and calendar adjusted)

	2023				2024				2025				2026			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	−0.4	0.8	0.0	0.0	0.3	−0.2	0.2	0.3	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.2
Public consumption expenditure	0.2	−0.2	1.2	0.7	−0.1	1.0	0.8	0.5	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.3
Gross fixed capital formation	0.6	−0.2	−0.3	−1.4	0.1	−2.2	−0.3	0.1	0.5	0.7	0.8	0.8	0.8	0.7	0.7	0.6
Construction	1.3	−0.7	−1.3	−1.9	0.8	−2.0	−0.5	−0.3	0.4	0.6	0.7	0.7	0.6	0.4	0.3	0.3
Machinery and equipment	−1.0	−0.2	0.5	−2.1	−1.6	−4.1	−0.2	0.8	0.5	0.5	0.6	0.8	1.1	1.2	1.3	1.3
Other investment	1.7	1.0	0.9	1.4	1.4	0.6	0.3	0.4	0.9	1.1	1.1	0.9	0.8	0.7	0.6	0.6
Inventory changes[1]	−0.3	−0.1	−0.2	−0.7	−0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic consumption	−0.3	0.2	−0.1	−0.9	0.0	0.0	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Trade balance	0.5	−0.4	0.3	0.5	0.2	−0.1	−0.2	−0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports	0.2	−0.4	−0.7	−0.9	1.3	−0.2	−0.1	0.4	0.5	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Imports	−1.0	0.5	−1.4	−2.0	0.8	0.0	0.4	0.6	0.7	0.8	0.8	0.7	0.7	0.7	0.7	0.7
GDP	0.1	−0.2	0.2	−0.4	0.2	−0.1	0.0	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Gross value added	0.5	−0.2	0.0	0.6	0.0	−0.1	0.0	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Manufacturing	1.1	−0.1	−1.0	0.0	−1.0	−0.2	−0.1	0.1	0.2	0.3	0.4	0.4	0.3	0.3	0.3	0.3
Construction	5.9	−0.6	−1.1	−1.9	1.9	−3.2	−0.7	−0.2	0.4	0.5	0.6	0.6	0.6	0.4	0.3	0.2
Trade, hospitality, transport	−1.1	−0.2	0.6	0.9	0.3	−0.6	0.1	0.4	0.4	0.5	0.5	0.4	0.4	0.3	0.3	0.3
Business services providers	−0.2	0.5	0.2	1.2	−0.3	0.9	0.2	0.3	0.3	0.4	0.4	0.3	0.3	0.3	0.2	0.2
Public services, education, health	0.4	0.1	0.7	0.2	0.5	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2

1 Contribution to growth in percentage points.

Note: Forecast from the third quarter of 2024.

Sources: Federal Statistical Office, DIW Berlin Economic Outlook Autumn 2024.

will likely remain dampened due to uncertainty about the economy and worries about job loss given the rising unemployment figures. At the same time, the strong real wage increases since mid-2023 have extensively compensated for the losses during the energy crisis and are expected to support consumption in the second half of 2024. Low-income households have likely continued to experience strong income growth recently, which should benefit private consumption, as these households have a higher propensity to consume. Income for higher income groups, in contrast, has increased somewhat less strongly than previously. As a result, labor income inequality should remain the same this year (Figure 5). Additionally, consumer price inflation is continually declining, and—especially thanks to decreasing energy prices—fell below the two-percent target for the first time since March 2021 in August 2024, bringing the annual average closer to the inflation target of the European Central Bank (ECB). Leading price indicators such as import and wholesale prices also suggest this. Although some of these indicators are rising again, the rates remain well below two percent. Stable price development should strengthen consumer confidence once more and stimulate private consumption. Robust employment expansion, which the services sector will likely continue to drive, should also support private consumption. Cyclical unemployment is expected to continue to rise slightly due to weak economic development (Table 3).

Investments are expected to make a negative contribution to economic growth again in the current quarter. Investment in equipment continues to suffer due to weak industrial production and a lack of demand; the stock of existing orders is shrinking while new orders are faltering. In construction, despite the initiated interest rate shift, the persistently high interest rates and the high and continuously rising construction costs remain the key obstacles and are likely to further slow down residential construction in the second half of the year. Although the volume of new residential construction loans has increased somewhat again recently, this is not yet reflected in the approval and order figures. Corporate capacity utilization in building construction recently declined to its lowest value since 2010. In contrast, civil engineering is expected to continue to support construction investment.

The demand from abroad for German intermediate and capital goods is also likely to remain weak in the current quarter. The ifo Export Expectations fell for the third time in a row in August; thus, another decline in goods exports is expected for the third quarter. Service exports, which make up a good 20 percent of German foreign trade, should expand further due to the growing importance of the domestic and foreign service sectors. The IT sector in particular as well as tourist traffic are carrying this development, although they are unlikely to be able to increase total exports. In light of weak exports and sluggish industrial output, imports are expected to continue to develop meekly, although goods imports are also expected to fall and services imports to increase in the current global and domestic economic environment. Overall, a negative trade balance is projected for the third quarter.

Figure 4

Gross domestic product and key components
Seasonally, calendar, and price-adjusted development

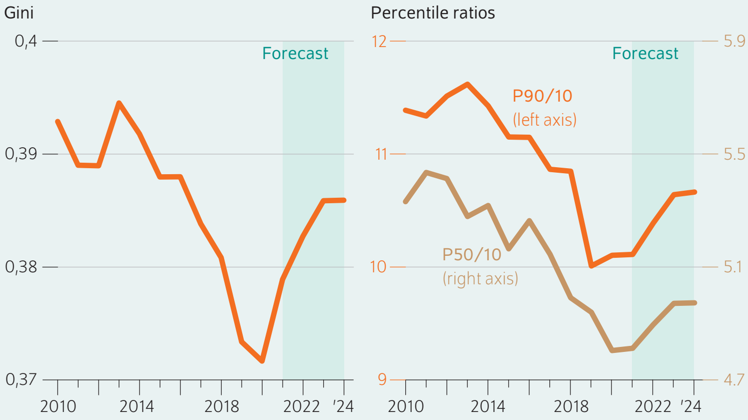
Note: Forecast from the third quarter of 2024; price, seasonally, and calendar adjusted.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2024.

Figure 5

Nowcast of labor income inequality: Gini coefficient and selected percentile ratios

Index points (left side), percent (right side)



Note: DIW Berlin developed a model that can be used to forecast the current state (nowcast) of labor income inequality. The nowcast combines annually available microeconomic data from the German Socio-Economic Panel (SOEP) with a number of higher-frequency macroeconomic and labor market indicators as well as the current results of the DIW Berlin economic forecast in a macroeconometric model to extrapolate the average labor income of different income groups. Based on the model results and certain distribution assumptions, a labor income distribution for the entire population can be created.

Sources: Socio-Economic Panel (SOEP); Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2024.

The increase in labor income inequality is expected to weaken considerably in 2024.

Table 3

Key economic indicators for the German economy

	2023	2024	2025	2026
GDP[1]	−0.3	0.0	0.9	1.4
Employment[2] (1,000 persons)	46,011	46,181	46,209	46,123
Unemployed (1,000 persons)	2,609	2,776	2,737	2,548
Unemployment rate[3] (BA concept, in percent)	5.7	6.0	5.9	5.5
Consumer prices[4]	5.9	2.2	2.0	2.0
Unit labor costs[4,5]	6.7	5.0	2.4	1.2
Government budget balance[6]				
in billions of euros	−107.5	−110.4	−102.6	−79.8
in percent of nominal GDP	−2.6	−2.6	−2.3	−1.7
Current account balance				
in billions of euros	257.7	288.9	296.7	304.6
in percent of nominal GDP	6.2	6.7	6.7	6.6

1 Price adjusted. Year-on-year change in percent.
2 Domestic concept.
3 Unemployed as a percentage of the civilian labor force (definition according to the Federal Employment Agency).
4 Year-on-year change.
5 Compensation of employees per hour worked in Germany as a percentage of real GDP per hour worked.
6 As defined in the national accounts (*volkswirtschaftliche Gesamtrechnungen*).

Note: Forecast from 2024.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2024.

The split evolution of the industrial and services sectors is expected to continue on the production side in the third quarter. Although sentiment in both sectors has recently deteriorated somewhat according to the Purchasing Manager Indices for Germany, sentiment remains more robust and above the expansion threshold of 50 points in the services sector, supported by growing demand. In the industrial sector, in contrast, the index is consistently below the expansion threshold. According to the ifo Business Climate Index survey in August, the business climate in the industrial sector has fallen for the third time in a row, with the respondents rating both the current situation and future business as critical. The lack of orders is increasingly becoming a problem and will likely impede production in the current quarter.

Gradual recovery over the course of the forecast

The German economy is expected to recover over the course of the forecast, although more sluggishly than the indicators suggested during the summer. In terms of the domestic economy, the positive real wage trend, which should be supported by low inflation rates and continue throughout the forecast period, is likely to have the greatest impact initially. While employees' bargaining power has weakened somewhat with the slight decline in the Labor Shortage Index, the collective wage negotiations planned for the end of 2024, such as in the public sector as well as the metalworking and electrical industry, are expected to result in further strong nominal wage increases. Unemployment will reach its peak at the beginning of 2025 and decline as the economy recovers and integration processes, particularly of Ukrainian refugees, progress. This development benefits private consumption, which is expected to support economic output at the turn of the year. Government consumption should continue to contribute positively to GDP. Expenditure on a moderate increase in employment in the public sector is likely to support growth in 2024 and 2025, while social benefits in kind, particularly in the areas of health and care services, will probably be expanded throughout the forecast period.

German foreign trade is not expected to noticeably increase again until 2025. Supported by falling interest rates worldwide and a gradual upturn in investment activity abroad, demand for German industrial goods should rekindle. However, German goods exports are unlikely to expand as dynamically as in the past due to strong competition from China. As a result, the share of services of total exports should increase further over the forecast horizon. Goods imports will likely benefit from the recovery of the export business and the improvement in German industrial production and pick up. As German exports of industrial and capital goods should be somewhat weaker, goods imports will probably exceed exports in relative terms. This results in a slightly negative trade balance for the German economy in both 2025 and 2026 (Table 4).

Rising foreign demand should boost private equipment investment again from the second half of 2025. Companies

Box 2

Impact of fiscal policy measures on private consumption and GDP

Fiscal policy measures in 2024 and 2025 will be restrictive overall and are expected to contract by 0.7 and 0.4 percent of GDP year-on-year. In 2026, fiscal policy will become neutral again. In accordance with fiscal policy assumptions, the majority of the Federal Government's growth initiative measures are not considered here.

The majority of fiscal measures affect private households. A DSGE model with two different household types (TANK model) is used to estimate the stimulating effect of private consumption and GDP while accounting for their distributional effects. To this end, a distinction is first made between the extent to which the measures affect the lowest-income 40 percent of households and how the remaining households benefit or are negatively affected.

The 40 percent with the lowest incomes earn around 20 percent of total disposable income and have a savings rate of zero, which is why they are referred to as liquidity-constrained (LC) households. In addition to private households, there are the measures that affect companies or the Federal Government. Fiscal policy measures are divided into six categories according to their impact on the two household types and other actors:

1. Measures that affect LC households only
2. Measures that affect all households per capita
3. Measures that affect all households proportionally to their income
4. Measures that affect high-income households only
5. Measures that affect companies (differentiated by effect on profits and subsidies)
6. Measures that affect the government

Since the two household types differ in their consumption behavior, the consumption effect will be highest for low-income households in particular and decline over the other three categories. Some of the measures that will relieve low-income households in particular are the basic income (*Bürgergeld*) and housing benefits (*Wohngeld*) reforms in 2024 and the introduction of the basic child benefit in 2025. Moreover, the change to the basic pension from 2024 should support low-income households. High-income households are likely to benefit from the *Inflationsausgleichgesetz* (Inflation Adjustment Act) and, in particular, from the corresponding income tax rate adjustments, especially in 2024, but also in 2025 and 2026.

The measures that burden both household types per capita include, above all, the expiry of the tax exemption for the inflation compensation premium, but also the expiry of the electricity and gas price brakes. Additional burdens proportional to private household income come from increasing the health and long-term care insurances. Higher-income households will be burdened by the expiry of the environmental bonus for electric vehicles and of the fourth Coronavirus Tax Relief Act, as well as by cuts to parental allowance (*Elterngeld*) for top earners. Companies will be subject to various kinds of sales tax cuts and the gas and electricity price brake will end.

Overall, fiscal policy measures will lower the income of private households by 0.04 percent in relation to GDP compared to the base year of 2022 in 2024 and by 0.01 in both 2025 and 2026 (Table). The measures will dampen private consumption by 0.3 in 2024 and by 0.4 in both 2025 and 2026, primarily due to the decline in consumption among low-income households. Investment will fall by 0.4 percent in 2024 and by 0.5 and by 0.6 percent in 2025 and 2026, respectively, as companies in particular are reducing their investment activity. Overall, restrictive fiscal stimuli will have a negative impact of 0.06 and 0.05 percent on GDP in 2025 and 2026.

Table

Stimuli from fiscal policy measures
In percent of GDP

	2024	2025	2026
Low-income households	0.03	0.08	0.08
High-income households	0.32	0.48	0.60
Per capita	−0.22	−0.45	−0.45
Proportionally	−0.65	−0.82	−0.95
Companies	−0.41	−0.59	−0.60
Government	0.18	0.08	0.14
Total	−0.75	−1.22	−1.18

Source: DIW Berlin Economic Outlook Autumn 2024.

will then likely increasingly invest in their production capacities to meet demand. However, considerable catch-up effects are not expected over the forecast period, as the recovery of the industrial sector will likely be slow. The public sector will continue to support equipment investment, in particular with the special fund for the German armed forces (*Sondervermögen Bundeswehr*), which should lead to a significant increase in public spending. Construction investments will not pick up until the second half of 2025, when construction costs will gradually stabilize. This is decisive for residential construction in particular, which should not pick up until 2026. In contrast, investment in non-residential construction is likely to expand continuously, with civil engineering in particular continuing to drive the positive trend.

Despite falling interest rates, monetary policy will initially remain restrictive and is not expected to reach the range of

Box 3

Fiscal policy measure assumptions

Expansive fiscal policy measures that were implemented during the energy crisis and are now expiring are being followed by less comprehensive new programs. Thus, there will be a considerable negative fiscal stimulus (Table) this year.

The expiry of the electricity and gas price brakes as well as the end of aid for hospitals and care facilities as a part of the energy crisis has the greatest impact. On the expenditure side, this is offset by additional expenditure from the Climate and Transformation Fund (*Klima- und Transformationsfonds,* KTF) (promoting energy efficiency in the building sector, subsidies for constructing refueling and charging infrastructure and the end of the EEG surcharge for consumers) as well as expenditure from the special fund for the *Bundeswehr* and support for Ukraine. These are significant in themselves, but quantitatively smaller than the spending cuts.

On the income side of the government, the increase in the carbon price and the truck toll as well as the increase in the air traffic tax will result in more revenue for local authorities. A restrictive effect also comes from the income side of social insurance. The increase in the contribution rate for statutory long-term care insurance on July 1, 2023, still has an impact this year. Moreover, it is assumed that the state health insurance providers will slightly increase their supplemental premium on average compared to 2023. As it is assumed that the tax-free inflation compensation premium will account for a smaller share of wage increases in 2024 compared to 2023, this will also have a restrictive effect on household labor income. Overall, fiscal policy is likely to have a dampening effect on economic activity this year with growth of 0.7 percent in relation to GDP.

Fiscal policy measures will be restrictive overall in 2025, too, as tax and duty increases will predominate on the income side and cuts will have a greater impact than spending increases on the expenditure side. Overall, the budget impact of fiscal policy measures is likely to amount to 0.4 percent of economic output in 2025.

The expiry of the inflation compensation premium, a further increase in the carbon price, and any increases in social security contribution rates result in higher revenue increases on the income side than adjustments to the income tax rate as part of the elimination of bracket creep and tax breaks from the Growth Opportunities Act (*Wachstumschancengesetz*) will reduce government revenue. On the expenditure side, the introduction of the basic child security, a further increase to the child benefit, the measures included in the Long-Term Care Support and Relief Act (*Pflegeunterstützungs- und Entlastungsgesetz*), and further additional expenditure on defense will likely provide stimulating effects. In contrast, cuts to support to Ukraine as well as to the KTF mean that overall expenditure will be lower than in 2024 and thus have a restrictive fiscal effect.

In 2026, fiscal policy measures will balance each other out, resulting in an effect of zero in relation to GDP. Primarily adjustments to the income tax rates, such as the elimination of bracket creep, will lead to a reduction in government revenue, which in turn increases the income of private households and thus has an expansionary effect. The collective depreciation reform as well as the extension of the degressive depreciation for assets also contribute to the expansive nature of the income side. Conversely, social security contributions are expected to be raised further and revenue from fuel emissions trading should continue to support the general government budget. On the expenditure side, investments within the scope of the special fund for the *Bundeswehr* in particular will have an impact. However, the effect will be dampened by further consolidation measures in the KTF.

the neutral rate of interest until mid-2025.[6] Initially, fiscal policy will be quite restrictive in the forecast period until expansive and restrictive measures balance each other out again in 2026. However, it is likely to have a negative effect on GDP in 2025 and 2026, with the greatest burden being placed on low-income households (Box 2). In 2024, this is primarily due to the expiry of measures that were initiated to mitigate the energy crisis, as well as consolidation measures, such as cuts to the Climate and Transformation Fund (*Klima- und Transformationsfonds*). There will be thus fewer expansive stimuli from the Growth Opportunities Act (*Wachstumschancengesetz*) as well as fewer adjustments to the income tax rate (Box 3). In 2025, restrictive measures, such as the end of the tax-free inflation compensation premium as well as further consolidation measures (such as those relating to agricultural diesel and support for Ukraine), are also likely to outweigh expansionary stimuli from the Growth Opportunities Act, the elimination of bracket creep, and the special fund for the *Bundeswehr*. In 2026, the restrictive fiscal measures (increasing emissions trading revenue, increasing social security contributions) are likely to be on par with the expansive fiscal policy effects, for example through further income tax cuts and the extension of degressive depreciation rules. Of the 49 measures from the German Federal Government's recently announced growth initiative, this forecast only includes the Tax Reform Act (*Steuerfortentwicklungsgesetz*), for which a cabinet decision has already been made. As it is expected that the measures will only gradually be implemented over the next two years, the growth effect is likely to be positive, but small.[7]

6 The rate of neutral interest can only be estimated, not observed. According to estimates by the European Central Bank, the nominal rate of neutral interest is between 1.25 and 2.7 percent if a two-percent inflation premium is added to the estimates of the real natural interest rate. Cf. Claus Brand, Noëmie Lisack, and Falk Mazelis, "Estimates of the natural interest rate for the euro area: an update," *ECB Economic Bulletin* no. 1 (2024): 66–69.

7 Cf. VFA – Die forschenden Pharmaunternehmen, "Impulse der Wachstumsinitiative: Welche Wirkungen dadurch möglich sind," *MacroScope Pharma* 8 (2024) (in German; available online); Bundesministerium für Wirtschaft und Klimaschutz, "Rohstoffstrategie der Bundesregierung. Schlaglichter der Wirtschaftspolitik," *Monatsbericht* 8 (2024) (in German; available online).

Table

Fiscal measures: General government budget burdens (−) and relief (+)
In billions of euros (compared to previous year)

	2024	2025	2026
Local government revenue			
Annual Tax Act 2022	0.2	1.0	−1.1
Inflation Adjustment Act (adjustment to the income tax rate)	−14.6	−2.8	−1.0
Continuation of the elimination of bracket creep	0.0	−5.4	−2.8
Increase in the exemption limit for the solidarity surcharge	0.0	−0.4	−0.3
Tax-exempt inflation compensation premium	2.5	5.1	0.0
End to preferential treatment of agricultural diesel	0.0	0.2	0.1
Increase in air traffic tax	0.4	0.2	0.0
Reduction in electricity tax	−3.3	0.0	3.3
Sales tax reduction on gas	4.5	1.0	0.0
Sales tax reduction in gastronomy	2.9	0.5	0.0
Revenue from fuel emissions trading (BEHG)	4.3	2.9	2.1
Elimination of tax capping for the electricity tax	1.7	0.0	0.0
Degressive depreciation for assets (AfA) (Second Coronavirus Tax Relief Act)	3.8	1.8	0.0
Fourth Coronavirus Tax Relief Act (extension of degressive AfA, work from home lump sum, etc.)	−1.2	2.1	3.1
Collective depreciation reform, extension of degressive AfA	0.0	−0.3	−4.0
Increase in the truck toll	7.5	0.0	0.0
Growth Opportunities Act	−0.7	−0.9	0.7
Increase in the tobacco tax	0.0	0.9	0.8
Financing for the Future Act	−0.6	−0.3	−0.1
Other tax measures	0.3	0.0	−0.2
Social insurance revenue			
Increase in average additional contribution to statutory health insurance	2.6	0.0	2.0
Increase in contribution rate for statutory long-term care insurance	3.5	2.1	0.0
Tax-exempt inflation compensation premium	3.5	7.1	0.0
Local government revenue			
Electricity and gas price brakes, stabilization of transmission grid fees	29.3	1.3	0.0
Aid for hospitals and care facilities (energy crisis)	6.0	0.0	0.0
One-time payments to pensioners and students	0.8	0.0	0.0
Subsidy for companies with high additional costs due to higher natural gas and electricity prices	2.0	0.0	0.0
Relief from the EEG surcharge	−3.9	2.1	0.0
Other KTF expenditure	−6.0	3.5	1.0
Introduction of basic income	−0.4	0.0	0.0
Cuts to basic income	0.3	0.1	0.0
Increase to child benefit	1.5	−0.7	−0.7
Basic child security allowance	0.0	−2.0	0.0
Housing benefits reform	−0.9	0.0	0.0
Additional financial support for social housing construction	−0.7	−0.4	−0.2
49 Euro Ticket	−0.6	0.0	0.0
Cuts to parental benefit for top earners	0.2	0.3	0.1
"Startchancen" program for schools	−0.4	−0.5	−0.3
Defense expenditure	−14.0	−2.2	−4.0
Support to Ukraine	−2.9	3.5	0.0
Federal consolidation measures	1.9	2.3	0.0
Social insurance revenue			
Adjustment to pensions in the east	−0.5	0.0	0.0
Basic pension	−0.1	−0.1	−0.2
Long-term Care Support and Relief Act	1.0	−3.0	−0.2
Total	30.0	19.0	−1.8
Compared to GDP in percent	0.7	0.4	0.0
Nominal GDP	4,319.2	4,439.7	4,586.4

Note: Without macroeconomic repercussions. Other tax measures include the Annual Tax Act 2020, the Corporate Income Tax Modernization Act, the increase in the child tax allowance in 2025 and 2026, and the expansion of the research allowance. Measures not taken into account are the Vocational Training and Continuing Education Act, expiring coronavirus measures (corporate aid), and the 29th BafôG Amendment Act.

Sources: German Federal Government (budget plan, draft laws, monthly reports from the Federal Ministry of Finance, financial reports from 2021 to 2024, tax policy data); DIW Berlin Economic Outlook Autumn 2024.

Table 4

Contributions to change in GDP in Germany

In percentage points (price-adjusted)

	Contribution to change[1]			
	2023	2024	2025	2026
Consumption	−0.2	0.7	0.9	0.8
Private households	−0.2	0.2	0.5	0.6
Government	0.0	0.5	0.4	0.2
Gross fixed capital formation	−0.3	−0.6	0.2	0.7
Construction	−0.4	−0.4	0.0	0.3
Machinery and equipment	−0.1	−0.4	0.0	0.3
Other investment	0.2	0.1	0.1	0.1
Change in inventories	0.1	−0.4	0.0	0.0
Domestic demand	−0.4	−0.4	1.1	1.5
Trade balance	0.1	0.4	−0.3	−0.1
Exports	−0.1	0.0	0.6	1.2
Imports	0.3	0.4	−0.9	−1.3
Gross domestic product[2]	**−0.3**	**0.0**	**0.9**	**1.4**

1 Expenditure components adjusted for import content.
2 Year-on-year change in percent; deviations in the totals are due to rounding.

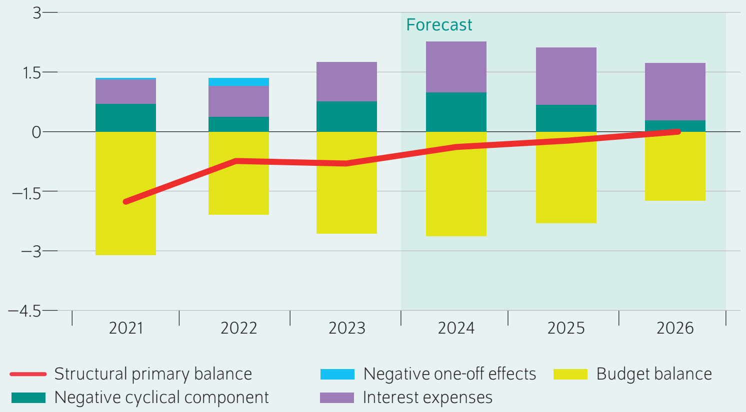
Note: Forecast from the year 2024 onward.

Sources: Federal Statistical Office; DIW Berlin calculations; DIW Berlin Economic Outlook Autumn 2024.

Figure 6

Structural primary balance

In percent (in relation to nominal production potential)



Note: The structural primary balance is the sum of the columns. Forecast from 2024 onward.

Sources: Federal Statistical Office, DIW Berlin Economic Forecast Autumn 2024.

Fiscal policy, which is restrictive overall, is reflected in a rising structural primary balance.

Overall, government deficits are expected to decrease slightly over the forecast period, falling from 2.6 percent in relation to GDP in 2024 to 2.3 percent in 2025 and further to 1.7 percent in 2026 (Figure 6).

All in all, price-adjusted GDP will likely stagnate in 2024. Economic output is expected to grow by 0.9 percent in 2025 and by 1.4 percent in 2026. Thus, DIW Berlin is lowering its forecast for 2024 by 0.3 percentage points and for 2025 by 0.4 percentage points compared to the summer forecast. The forecast was revised downward primarily due to a revision of the reported data and the significantly weaker indicators for the German and global economy over the summer.

Due to ongoing weak investment and declining labor force potential, potential GDP is likely to continue to develop sluggishly until the end of 2029. The labor volume in particular will decline as a result of the aging population. In light of the stagnation this year, the output gap is likely to grow and amount to -1.9 percent of potential GDP on average for 2024. With the recovery over the coming years, the output gap should then shrink to -0.6 percent at the end of the short term and close in 2029.

Average consumer price inflation should be 2.2 percent in 2024. In 2025 and 2026, it will likely level off at the ECB's two-percent inflation target. Thus, the inflation expectation for 2024 is slightly lower compared to summer, while it remains unchanged for 2025. The core rate, inflation excluding energy and food, is expected to average three percent in 2024 due to continuous strong price increases for services. It will also reach the two-percent target over the course of the forecast.

In addition to the global risks that are creating uncertainty for the outlook of the German economy, there are also domestic risk factors. Above all, this includes political uncertainty, which is currently close to its all-time high according to the Economic Policy Uncertainty Index. Although the German Federal Government was recently able to agree on a draft budget for 2025, there are still concerns that the coalition parties—which are pursuing different objectives in many areas—are to a certain extent unable to take action. This makes for an unclear economic policy framework, which could more negatively impact the domestic economy than assumed in this forecast.

The recent results of the state elections in Thuringia and Saxony and the rise of the populist forces there also pose an additional risk. These results could increase the skilled worker shortage and reduce Germany's attractiveness as an economic location.

In addition, right-wing and left-wing populist parties could perform well in the upcoming 2025 *Bundestag* elections and increase uncertainty with regard to the subsequent formation of a government.

Geraldine Dany-Knedlik is Head of the Forecasting and Business Cycle Policy Group in the Macroeconomics Department at DIW Berlin | gdanyknedlik@diw.de

Nina Maria Brehl is a Doctoral Student in the Macroeconomics Department at DIW Berlin | nbrehl@diw.de

Hella Engerer is a Research Associate in the Energy, Transportation, Environment Department at DIW Berlin specializing in Central and Eastern Europe | hengerer@diw.de

Angelina Hackmann is a Research Associate in the Macroeconomics Department specializing in the German labor market at DIW Berlin | ahackmann@diw.de

Pia Hüttl is Head of the global economic forecast and a Research Associate in the Macroeconomics Department at DIW Berlin | phuettl@diw.de

Konstantin Kholodilin is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in estimating potential output and production | kkholodilin@diw.de

Frederik Kurcz is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area | fkurcz@diw.de

Laura Pagenhardt is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in investments | lpagenhardt@diw.de

Marie Rullière is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area | mrulliere@diw.de

Jan-Christopher Scherer is Head of the German economic forecast and Research Associate in the Macroeconomics Department | jscherer@diw.de

Teresa Schildmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in German fiscal policy | tschildmann@diw.de

Ruben Staffa is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the USA, German fiscal policy, and German foreign trade | rstaffa@diw.de

Kristin Trautmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the United Kingdom and European monetary policy | ktrautmann@diw.de

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LEGAL AND EDITORIAL DETAILS

DIW BERLIN

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin

www.diw.de

Phone: +49 30 897 89–0 Fax: –200

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AT A GLANCE

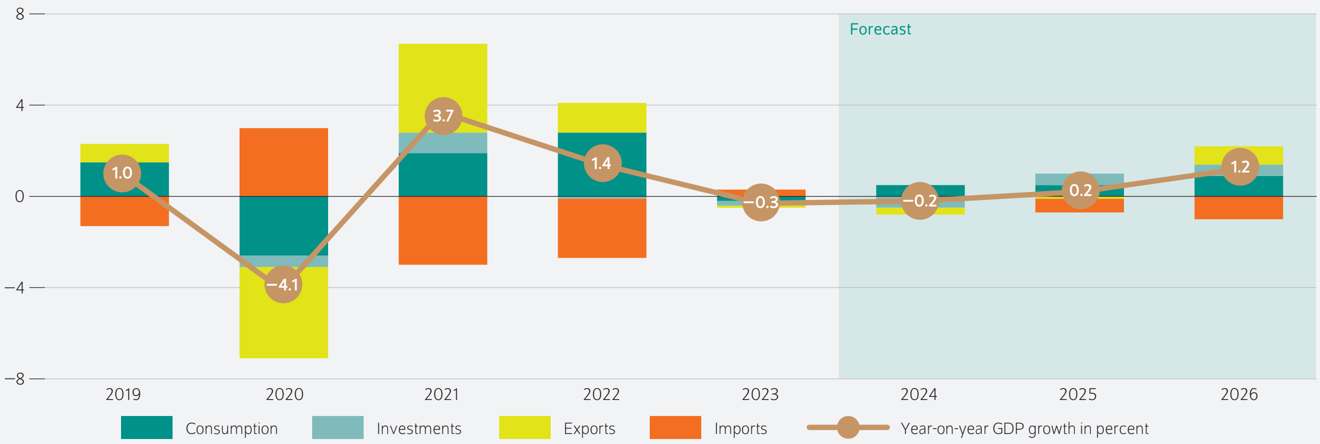
DIW Berlin Economic Outlook: German economy stuck in limbo while trade conflicts threaten the global economy

By the DIW Berlin Economic Forecasting Team

- German economy in a difficult position facing weak growth and structural change; GDP will decline in 2024 for the second year in a row
- German industry experiencing a serious crisis in particular, with increasing international competition, increasing protectionism, and unclear domestic economic policies having a negative impact
- Private consumption not picking up speed despite increasing real wages, partially due to worries about job layoffs
- DIW Berlin is revising its growth forecast for Germany for 2025 significantly downward to 0.2 percent; growth of 1.2 percent is expected in 2026
- Economic boom in the United States continues to drive the global economy, compensating for the sluggish recovery in other countries; global growth from 2024 to 2026 is expected to be 3.5 percent each year

German economy not picking up speed for the time being; private consumption and exports will not contribute more to growth until 2026

Individual components' contribution to overall GDP growth in percentage points



Source: DIW Berlin Economic Outlook Winter 2024.

FROM THE AUTHORS

"Private households' uncertainty should lessen over the course of 2025 somewhat. Industry will recover slowly once it is clear next year what government Germany will have and what the economic policy framework will look like. This knowledge brings security and the ability to plan ahead."

— Geraldine Dany-Knedlik —

MEDIA

Audio Interview with Geraldine Dany-Knedlik (in German)

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DIW Berlin Economic Outlook: German economy stuck in limbo while trade conflicts threaten the global economy

By Geraldine Dany-Knedlik, Guido Baldi, Nina Maria Brehl, Hella Engerer, Angelina Hackmann, Pia Hüttl, Konstantin Kholodilin, Frederik Kurcz, Laura Pagenhardt, Jan-Christopher Scherer, Teresa Schildmann, Hannah Magdalena Seidl, Ruben Staffa, and Kristin Trautmann

EXECUTIVE SUMMARY

The German economy is stuck in a difficult position as it faces both slow growth as well as structural change. The continuing lack of orders in manufacturing, increasing international competition, and sluggish development in industry-related services are now affecting the labor market and leading not only to short-time work but to layoffs too, despite the continuing skilled worker shortage. While GDP increased slightly by 0.1 percent in the third quarter of 2023, this growth was preceded by a stronger than initially recorded decline in economic output of 0.3 percent in the second quarter. Thus, the German economy cannot be said to be on a stable growth path. In contrast, leading indicators suggest that economic output will decline again in the fourth quarter, with overall growth for 2024 likely to be 0.2 percent. This means that the German economy will contract for the second year in a row.

German industry in particular is experiencing a serious crisis. Foreign trade may temporarily benefit, as many companies despite a lack of demand are expected to increase their exports to the United States in order to get ahead of the possible tariffs that US President-elect Donald Trump announced. However, impending protectionist measures are already having an impact and unsettling local companies, which are therefore postponing investments further.

In addition, the economic framework conditions in Germany are unclear and will remain unpredictable until at least the spring when there is a new federal government. All of these factors in conjunction with increasing concerns about their own jobs are unsettling households in Germany, resulting in private consumption failing to pick up speed despite rising real wages.

A gradual easing is not expected until mid-2025, when domestic and foreign economic uncertainties will successively lessen. Nevertheless, the German economy should expand by 0.2 percent in 2025. Thus, DIW Berlin is revising its fall forecast downward by 0.7 percentage points. Economic output is expected to increase by 1.2 percent in 2026, although this is partially due to non-recurring effects such as a relatively high number of work days.

In regard to the global economy, the boom in the United States will remain a key driver for now, compensating for the sluggish recovery in many other advanced economies as well as China. While the Chinese economy falters, a gradual upswing is continuing in the euro area due to rising purchasing power and falling inflation. In 2024, the global economy is expected to grow by 3.7 percent, while it should grow by 3.6 percent and 3.7 percent in 2025 and 2026, respectively.

 DOI: https://doi.org/10.18723/diw_dwr:2024-50-1

The rising shadow of protectionism is negatively affecting the global economy

The sustained boom in the United States is once again determining the expansion tempo of the global economy in 2024, compensating for the sluggish recovery in many other advanced economies and China. Thus, the gap in economic output between the United States and other important economies such as the euro area is growing. Purchasing power has recovered in the euro area and the United Kingdom and is supporting a gradual upturn there. The Chinese economy is faltering, meaning it will not reach its growth target of five percent for 2024. Lastly, the economic and trade policies of US President-elect Donald Trump are putting the global economic order to the test.

Global economic growth has picked up speed recently: The global economy expanded by 0.8 percent in the third quarter of 2024 after growth of 0.7 percent in the second quarter (Figure 1). In the fall, global growth in the advanced economies was primarily driven by a strong increase of 0.7 percent in the United States. Most other advanced economies are continuing to recover at a moderate pace; for example, the British and Japanese economies grew by only 0.1 and 0.2 percent, respectively. The euro area, in contrast, continued its recovery, recording an increase of 0.4 percent. Spain and the Netherlands grew the most by 0.8 percent each, followed by France by 0.4 percent. In contrast, Italy and Germany stagnated.

The economies of the Central and Southeastern EU countries suffered from weak demand from Germany. In these countries, economic output declined by 0.2 percent in the third quarter of 2024. The only exception was Czechia, where GDP increased by 0.3 percent.

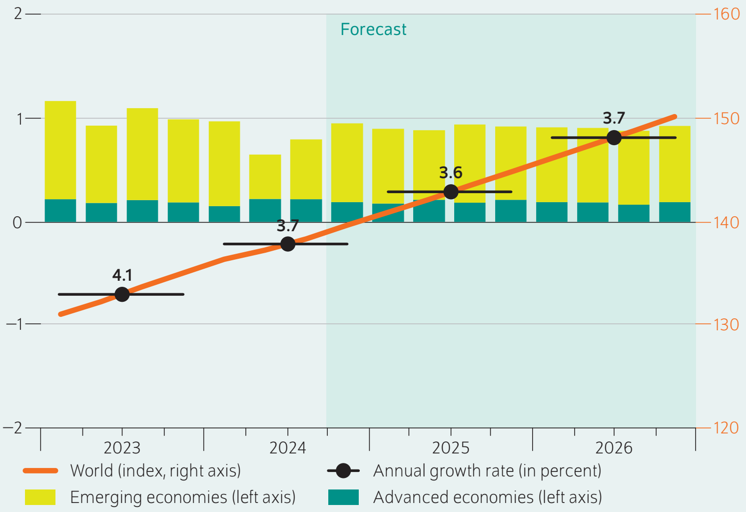
Following a weak second quarter, the situation was somewhat better for emerging economies. The Chinese economy picked up speed and recorded growth of 0.9 percent. The pace of expansion of the Indian economy has also been stronger recently, and Mexico's GDP increased by 1.1 percent in the third quarter. In contrast, growth of 0.9 percent in Brazil was weaker than in the previous quarter.

Despite the expected geopolitical and trade policy cutbacks, the global economy should expand slightly in the fourth quarter of 2024, in part thanks to China's increasingly strong economic growth. Most advanced economies are losing momentum slightly, and the leading indicators deteriorated in the fall months. The slump in global industrial production continues as well: The Purchasing Managers Indices for the United States and the euro area were tilted to the downside from May to September and recently moved sideways. The picture in the services sector appears to be mixed: While the United States experienced strong growth in November, the indices for the euro area fell below the expansion threshold.

Figure 1

Growth of real GDP

Quarter-on-quarter percentage growth (left axis); Index 2015 Q1 = 100 (right axis)



Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2024.

Tightened trade barriers are likely to slow the global economy down somewhat.

In October, the Purchasing Manager's Index for manufacturing in the United Kingdom dropped below 50, a trend that continued into November. The index for Japanese manufacturing is continuing its sideways movement slightly below the expansion threshold. In surveys, the newest political developments, such as Trump's re-election and the collapse of the German government coalition, were only partially reflected. However, these events are likely to have led to increased uncertainty among firms and private households alike about future economic policy frameworks. The biggest uncertainties concern the future trade policy of the United States. To hedge against this, companies will likely pull orders forward, meaning that exports to the United States should initially be somewhat stronger than expected. However, this will presumably not be reflected in the aggregated global economic output.

We expect growth in the United States in the fourth quarter of 2024 will continue to be strong, albeit somewhat weaker than in the third quarter, and supported by private consumption in particular. The recovery in the euro area will lose some momentum for the time being: For example, France is experiencing a weak fourth quarter following the one-off effects related to the Olympic Games. The Japanese and

Table 1

Real GDP, consumer prices, and unemployment rates in the global economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Year-on-year percentage change											
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
Europe												
European Union	0.5	0.9	1.5	1.9	6.4	2.6	2.4	2.2	6.1	6.0	5.9	5.7
Euro area	0.5	0.7	1.1	1.4	5.4	2.4	2.1	2.0	6.6	6.4	6.3	6.2
excluding Germany	1.2	1.3	1.4	1.6	5.0	2.2	2.0	1.9	8.3	7.9	7.7	7.5
France	1.1	1.1	0.9	1.5	5.7	2.4	1.9	1.8	7.3	7.5	7.4	7.3
Italy	0.8	0.4	0.8	1.0	5.9	1.1	1.9	2.0	7.7	6.7	6.5	6.4
Spain	2.7	3.1	2.3	2.2	3.4	2.8	2.3	1.9	12.2	11.5	11.1	10.8
Netherlands	0.1	1.0	2.2	1.8	4.1	3.1	2.5	2.0	3.6	3.7	3.6	3.6
United Kingdom	0.3	0.9	1.2	1.2	7.3	2.5	2.2	2.1	4.0	4.3	4.4	4.3
Switzerland	0.7	1.7	1.8	1.8	2.1	1.2	1.0	1.2	4.0	4.2	4.3	4.1
Central and Eastern Europe	0.5	1.7	2.7	3.4	11.6	4.0	3.4	3.0	3.6	3.7	3.5	3.4
Turkey	5.1	3.4	2.9	3.4	54.0	58.7	35.9	29.8	9.4	8.7	9.0	8.6
Russia[1]	3.3	3.5	1.7	1.5	5.9	8.2	6.5	4.6	3.2	2.5	2.4	2.4
The Americas												
USA	2.9	2.7	2.4	2.2	4.1	2.8	2.2	2.2	3.6	4.0	4.1	3.9
Mexico	3.2	1.3	1.4	1.8	5.5	4.6	3.2	2.9	2.8	2.7	2.6	2.6
Brazil	2.9	3.0	2.4	2.3	4.6	4.2	3.1	2.9	8.0	7.0	6.8	6.9
Asia												
Japan	1.7	−0.1	1.2	0.9	3.3	2.6	1.9	1.6	2.6	2.6	2.4	2.3
South Korea	1.4	2.2	2.0	2.2	3.6	2.4	1.9	1.9	2.7	2.8	3.0	3.0
China	5.2	4.7	4.5	4.3	−1.7	0.4	1.3	1.4	5.2	5.1	5.0	5.0
India	7.8	6.5	6.1	6.6	5.7	4.9	5.7	4.6	8.1	7.9	7.5	7.3
Total												
Advanced economies	1.9	1.8	1.8	1.8	4.8	3.0	2.3	2.3	4.4	4.5	4.5	4.3
Emerging economies	5.5	4.7	4.5	4.6	4.5	5.9	5.7	5.4	6.2	6.0	5.8	5.7
Global economy	4.1	3.7	3.6	3.7	4.3	3.9	3.5	3.4	5.8	5.7	5.5	5.4
For reference:												
Export weighted[2]	*3.1*	*2.8*	*2.8*	*2.8*								
GDP weighted in USD[3]	*3.4*	*3.1*	*3.1*	*3.1*								

1 The data forecast for Russia are subject to major uncertainties. Russia has only minor weight in the overall forecast.
2 World weighted with shares of German exports from 2023 using figures from Destatis.
3 World weighted with the GDP in USD from 2023 to 2026.

Notes: The black figures are finalized. The values of the groups of countries are a weighted average, with the respective GDP in purchasing power parities from the IMF World Economic Outlook for 2023 to 2026 used to weight GDP and consumer prices. The 2023 labor force (15–64 years old) figures of the respective countries are used to weigh the unemployment rate in the groups of countries. Central and Eastern Europe consist of Poland, Romania, Czechia, and Hungary in this forecast.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2024.

South Korean economies, in contrast, are projected to gain some momentum again. In China, the outlook has improved due to the recently announced monetary and fiscal policy measures, which has brightened economic sentiment.

We assume that a less restrictive monetary policy will support economic growth in the coming years. The central banks of many advanced economies will likely cut interest rates further in 2025. The inflation rate continues to be lower in many places, which is mainly due to falling energy prices. Inflation in the services sector remains high in many places. Emerging economies have initiated an interest rate turnaround earlier and may have reached the end of the interest rate cuts. For example, inflation in Mexico is proving to be more persistent than expected, and the Central Bank of Brazil recently raised interest rates again in response to higher core inflation. In contrast, the People's Bank of China is following a loose monetary policy due to deflationary tendencies.

Fiscal policy is slightly expansionary in most economies. In the United Kingdom, the Labour government passed its fall budget, ushering in an expansionary fiscal policy. Fiscal policy in the United States is also likely to be expansionary over the forecast horizon due to many of President-elect Trump's proposals. At the end of September, the Chinese government announced its largest stimulus package since the pandemic. Equaling around 1,300 billion euros, the package focuses on solving the debt problems of local governments. An exception to the expansionary fiscal policy is the euro area, where fiscal policy will likely remain slightly restrictive over the forecast period.

Box 1

Assumptions and framework conditions

Assumptions about interest rates, exchange rates, and energy prices

This forecast is based on the following assumptions about the further development of key interest rates, exchange rates, and commodity prices (Table). These assumptions were made based on previous developments, futures markets prices, and the closing prices on the date of this forecast (November 12, 2024). The European Central Bank (ECB) decreased interest rates once again in October, thus continuing the path of normalization. For the winter forecast, four further interest rate cuts of 25 basis points each are assumed for the deposit rate until spring 2025. The money market interest rates also fell in line with key interest rates. We expect that key interest rates will continue to fall until mid-2025 and then remain at that level. The transmission of interest rate cuts into the real economy is also beginning to show. For example, the refinancing costs for households and firms began to decline in the second quarter of 2024, and this decline is likely to continue in line with key interest rates. The yield on government bonds increased again slightly in the fourth quarter of 2024. We assume that capital market interest rates will remain largely unchanged over the forecast horizon at 2.3 percent for Germany and 2.9 percent for the euro area. The euro has recently appreciated slightly against the US dollar. For the forecast period, it is assumed that the exchange rate of EUR to USD will remain at 1.07 USD per EUR, the level reached at the end of the data period. According to futures, the price for Brent oil should increase slightly in the coming months before declining again at the start of 2025 until the end of the forecast period. In 2024, the average price should be 81 USD per barrel before declining to an average of 73 USD per barrel in 2025 and finally to 71 USD per barrel in 2026. The wholesale price for gas (TTF) rose over the course of 2024 and should be 34 euros per megawatt hour on average. Over the forecast horizon, we assume that the prices will increase to 40 euros in 2025 before falling to 34 euros per megawatt hour in 2026.

Geopolitical and trade policy assumptions

Additionally, the forecast assumes that there will be no further escalation in the war in Ukraine. In the Middle East, an easing of tensions is becoming increasingly less likely. The fall of former Syrian President Bashar al-Assad is causing uncertainty and could lead to higher oil and gas prices. In addition, this forecast assumes that US President-elect Trump will implement some of the trade tariffs he has announced. It is assumed that the American government will increase tariff rates by 10 percentage points for all goods imported from China in the first quarter of 2025. As a result, the average tariff rate on Chinese goods, which is currently around 20 percent, would increase again by half to around 30 percent (including automotive tariffs and 100-percent tariffs on e-cars). The tariffs on European Union aluminum and steel, which had been suspended, will be implemented again (10 percent for aluminum and 25 percent for steel). Furthermore, trade partners will presumably forego broad countermeasures and only react with retaliatory tariffs on specific groups of goods.

Table

Forecast assumptions

		2023	2024	2025	2026
ECB deposit rate[1] (year end)	Percent	4.0	3.0	2.25	2.25
Money market interest rate	Three-month EURIBOR in percent	3.4	3.5	2.0	2.0
Capital market interest	Yield on euro-area government bonds with a remaining term of 10 years	3.3	3.0	2.9	2.9
Capital market interest	Yield on German government bonds with a remaining term of 10 years	2.6	2.4	2.3	2.3
Exchange rate	USD/EUR	1.08	1.08	1.06	1.06
Crude oil price	USD per barrel	82.5	80.3	72.9	70.9
Gas price	EUR per megawatt hour	42.1	34.1	40.4	34.2

1 The ECB is currently steering the economy via the deposit facility, not the main refinancing rate (key interest rate).

Note: Annual average values; ECB deposit facility values at the end of the year.

Sources: European Central Bank; European Money Markets Institute (EMMI); Eurex Exchange; Deutsche Bundesbank; Federal Reserve; Energy Information Administration (EIA); Intercontinental Exchange (ICE); CME Group; DIW Berlin Economic Forecast Winter 2024.

The booming American economy and the gradual recovery in many other advanced economies have somewhat stimulated international trade in the third quarter. Assuming that global trade barriers are tightened from 2025 onwards, international trade is likely to be stronger in the fourth quarter of 2024, due to anticipated purchases . Therefore, overall growth of 1.2 percent is expected for 2024. Only a moderate upswing is expected for 2025 and 2026 due to likely tighter trade barriers. Furthermore, industry's ongoing weak growth should continue to weigh on international trade before falling interest rates boost corporate investment somewhat at the end of 2025 and support international trade.

In the coming years, the expected increase in trade barriers is likely to slow global economic growth. This forecast assumes that the US government will increase tariff rates on Chinese goods imports by 10 percentage points, resulting in an average rate on Chinese exports of around 30 percent. At the same time, the forecast also assumes that the aluminum and steel tariffs on the European Union, which had been suspended by the Biden administration, will be reintroduced. In reaction to the increase in US tariffs, it is assumed that the economies affected will take targeted countermeasures, but avoid an escalation. Due to tariff asymmetries, regions may be affected differently.

Box 2

Trump reloaded: Expected American trade policy

Majority of tariff announcements likely to function as bargaining chips

An increase in protectionist measures in the United States is expected over the forecast horizon. President-elect Donald Trump has made contradictory and sometimes extreme announcements about tariff increases. It is likely that Trump will continue the trade policy of his first term and that the threat of additional import tariffs will primarily serve as a means of exerting pressure in bilateral negotiations, with tariffs likely to be implemented only partially.

Concretely, this forecast assumes that following Trump's inauguration, tariffs on Chinese goods will increase by 10 percent[1] and the tariffs on European Union aluminum and steel, which were suspended by the Biden administration (10 percent for aluminum and 25 percent for steel), will be reimplemented. Furthermore, the United States' trade partners will presumably avoid broad countermeasures and only react with retaliatory tariffs on specific groups of goods.

Although Trump announced further drastic measures such as universal import tariffs of 10 or 20 percent during his election campaign, these would have considerable economic and political implications if implemented. On the one hand, tariffs of this magnitude would considerably increase the prices of imported goods and thus create strong inflation, potentially accompanied by supply chain disruptions and a supply shortage in the United States.[2] This is likely to be met with considerable resistance from the public as well as from industry. For example, a study has shown that high inflation rates considerably decrease approval of the reigning government.[3] In addition, a sharp increase in import tariffs could destabilize the stock markets, as indicated by the recent drop in shares of the car manufacturers General Motors and Ford following Trump's announcements of tariffs on Mexican imports. Finally, there are legal hurdles which, despite the US President's far-reaching powers, are likely to make an escalation in trade spolicy more difficult.

If all tariffs actually are implemented, they will cause significant real economic distortions

Nevertheless, there is great uncertainty regarding these assumptions and it seems possible that considerably comprehensive protectionist measures will be implemented. Drastic import tariffs are not only justified as a means of obtaining concessions from trade partners, but also as a means of generating public revenue as well as maintaining domestic industry and related jobs. Although these justifications are not empirically sound, they could point to the actual implementation of more far-reaching tariffs.

For example, Trump has repeatedly announced universal import tariffs of 10 percent and tariffs on Chinese imports of 60 percent. This would be a drastic break from previous American trade policy; for example, the average effective tariff rate in 2023 was only 3.8 percent. Such a massive tightening of trade policy would also have very negative economic consequences for the United States. For example, model calculations[4] show that implementing universal import tariffs of 10 percent without trade policy reactions would reduce US production by 0.4 percentage points by the end of the forecast horizon. In the year of the tariff increase, inflation would be 0.6 percentage points higher.

The Federal Reserve would likely respond to this strong price pressure with a restrictive course, which would dampen domestic economic activity. In the long term, comprehensive tariffs are also likely to weaken the competitiveness of the US economy due to higher production costs and the shifting of resources to less productive sectors.[5] The United States' trade partners could respond with broad retaliatory tariffs, which could trigger a trade war and further destabilize international trade relations. Positive effects of the import tariffs on the US economy will likely be limited. For example, a study[6] shows that the tariffs during Trump's first term did not create any jobs in tariffed sectors. On the contrary, the resulting counter tariffs imposed by China were economically costly for the United States[7] and negatively affected employment levels.[8] At the same time, the tariffs would not reduce the trade deficit,[9] partly due to an expected appreciation of the US dollar, which makes exports more expensive and imports cheaper.

The global economy would also be hit hard by such a comprehensive increase in US tariffs. For example, exports will decline and production will fall in the rest of the world, while at the same time goods imported from the United States will become more expensive due to a likely appreciation of the US dollar. The negative consequences for individual countries will likely depend on the tariff amount and the country's dependency on the United States as a trade partner. The table (Table) shows the share of total volume

1 Cf. Vivek Mishra and Kevin Yao, "Trump to Unleash Nearly 40 Tariffs on China in Early 2025, Hitting Growth: Reuters Poll," *Reuters*, November 20, 2024 (available online).

2 Cf. Warwick J. McKibbin, Megan Hogan, and Marcus Noland, "International Economic Implications of a Second Trump Presidency," Working Papers 24-20 (2024: Peterson Institute for International Economics) (available online).

3 Cf. David Steinberg, Daniel McDowell, and Erdem Aytac, "The Impact of Inflation on Support for Kamala Harris in the 2024 Presidential Election," (2024) (available online).

4 Cf. McKibbin, Hogan, and Noland, "International Economic Implications of a Second Trump Presidency."

5 Cf. Davide Furceri, Swarnali A. Hannan, Jonathan D. Ostry, and Andrew K. Rose, "Macroeconomic consequences of tariffs," National Bureau of Economic Research Working Paper, no. 25402 (2018) (available online).

6 Vgl. David Autor, Anne Beck, David Dorn, and Gordon H. Hanson, "Help for the Heartland? The employment and electoral effects of the Trump tariffs in the United States," National Bureau of Economic Research Working Paper no. 32082 (2024) (available online).

7 Cf. Sung Eun Kim and Yotam Margalit, "Tariffs as Electoral Weapons: The Political Geography of the US–China Trade War," International Organization 75, no. 1 (2021): 1–25 (available online).

8 Cf. Autor, Beck, Dorn, and Hanson, "Help for the Heartland?"

9 Cf. McKibbin, Hogan, and Noland, "International Economic Implications of a Second Trump Presidency."

of goods exports to the United States and its relative importance compared to other trade partners for selected economies.

It is clear that the share of all exports to the United States of total exports is rather low for large EU Member States. The economic consequences of the tariffs may thus be rather limited overall, but there are significant regional differences. A study[10] investigated possible consequences of a universal import tariff of 10 percent, 60 percent on Chinese imports, and 100 percent on all imported cars. According to the model calculations in the study, the EU's GDP is expected to decline by around 0.11 percent.[11]

Germany's economy, in contrast, would be hit even harder; imposing import tariffs on cars would severely affect German industry.[12] In addition, the United States is the most important individual sales market for German pharmaceutical companies. If US gas exports to the EU are used as a means of political pressure, there is also the risk that energy prices will rise again. This would likely further burden the beleaguered manufacturing industry in Germany in particular. However, Germany could benefit from tariff asymmetries and trade diversification, which may somewhat compensate for the negative effects; an escalation of the trade conflict between the United States and China that entails significantly higher tariffs on both trade partners would make German products relatively more affordable. At the same time, the tariff policy may lead to more diversification of trade relationships with other countries,[13] which could further increase demand for German products.

With a share of around 15 percent of total export volume in 2023, the United States is China's most important trade partner. An increase in tariffs on all imported Chinese goods to 60 percent would hit the Chinese economy hard and lead to distortions in international trade. At the same time, China may, as in 2018, take countermeasures, which would likely strengthen the effect. During the first Trump administration, the counter tariffs were around the amount of the American tariffs, which avoided an escalation.

Tariffs on Mexican and Canadian goods could result in significant economic losses for both countries. In Canada, the crude oil sector[14] would be affected, while in Mexcio, the automobile industry, the country's most important industrial sector, would be affected in particular.

Table

Significant of the United States as an export partner and share of exports to the United States

Country	Rank	Share of total volume of goods exports (in percent)
Germany	1	10
France	5	7
Italy	2	10.7
Spain	6	4.7
Netherlands	5	5
United Kingdom	1	13.8
Switzerland	1	15
Hungary	4	5
Polan	8	2.9
Czechia	11	2.3
Romania	14	2.3
Turkey	2	5.8
Russia	11	2.8
Mexico	1	79.6
Brazil	2	11
Japan	1	20.2
South Korea	2	18.4
China	1	14.8
India	1	17.6

Source: UNCTAD Database, end of 2023.

For emerging economies, the expected appreciation of the US dollar due to the sharp increase in import tariffs would be associated with considerable disadvantages, as their debts are denominated in dollars. An International Monetary Fund study[15] suggests that a 10 percent increase in the dollar would decrease economic output in emerging economies by 1.9 percent after six months. These effects will last for up to two and a half years.

10 Cf. Aurélien Saussay, *The economic impacts of Trump's tariff proposals on Europe* (Policy Publication, London School of Economics: 2024) (available online).

11 The United Kingdom's GDP is also projected to experience only a moderate decline of 0.14 percent.

12 Cf. Saussay, *The economic impacts of Trump's tariff proposals on Europe.*

13 Cf. Pablo Fajgelbaum, Pinelopi Goldberg, Patrick Kennedy, Amit Khandelwal, and Daria Taglioni, "The US-China trade war and global reallocations," *American Economic Review: Insights* 6, no. 2 (2024): 295–312 (available online).

14 Ninety-seven percent of Canadian crude oil exports are sent to the United States, which accounts for 16 percent of Canada's total export revenue.

15 Vgl. International Monetary Fund, *External Sector Report 2023, Chapter 2* (2023) (available online).

We expect that the strong expansion in the United States will last until 2026 before gradually slowing down. While a protectionist trade policy and restrictive immigration policy will lead to price pressure, falling energy prices will likely dampen this pressure in the forecast period. Continued strong consumption should contribute to growth, supported by households' good financial situation, a solid labor market, and planned tax relief for private households under the new government. Corporate investments will likely support growth as well, driven by better financing conditions, the recovery of the real estate sector, and an expected decrease in the corporate income tax.

The euro area economy should expand further in 2025 and 2026 due to strong domestic demand as a result of rising real wages (Figure 2). The effects of US tariffs as assumed in this forecast should only marginally hamper growth. While the United States is an important trade partner for European economies, its market share for exports from the large EU Member States is in the single digits on average and therefore relatively small compared to that of the Member States' trade partners within the EU (Box 2).

The outlook for the emerging economies remains favorable, but the new US government is likely to increase trade policy uncertainty. In addition to China, Mexico may be the country most affected by import tariffs. In China, the most recent stimulus package is generating growth, although the American import tariffs on Chinese products will weigh heavily on goods exports.

In 2024, advanced economies are projected to expand by 1.8 percent and emerging economies by 4.7 percent. A growth rate of 3.7 percent is expected for the global economy in 2024, while growth of 3.6 and 3.7 percent is expected for 2025 and 2026, respectively. The forecast for 2025 has been adjusted downward by 0.1 percentage points. This moderate downward correction results from the fact that the assumed trade barriers are offset by more dynamic growth in the United States (Table 1).

Downward risks for the global economy have increased considerably since the fall. Geopolitical risks remain quite high. Further escalation in the Middle East could increase oil and gas prices even more. The war in Ukraine remains incalculable, especially following Trump's re-election, which has increased economic and security policy risks overall. This forecast makes assumptions about future US trade and fiscal policy after Trump's inauguration in January 2025 (Box 1). However, if there are considerably higher trade barriers than assumed in this forecast, there are likely to be greater global economic fallouts (Box 2). A further risk factor is public debt sustainability. In France, government bond yields have risen, as the resignation of French Prime Minister Michel Barnier has increased doubts about a reduction in the debt burden.

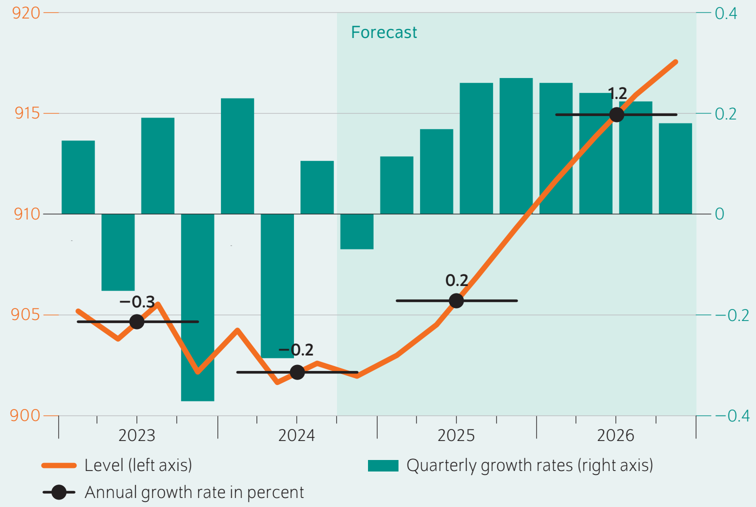
German economy still struggling to make headway

The German economy continues to experience weak growth. In addition to the ongoing global industrial slump, the economic structural change in Germany is having a noticeable impact: Structural adaptation in the manufacturing industry, for example to stronger international competition, has now reached industry-related sectors such as business-related services and are affecting the labor market. Companies in industry as well as those in industry-related sectors are responding to the lack of orders not only by expanding short-time work, but also by laying off some of their staff despite the ongoing skilled worker shortage. Accordingly, unemployment has increased again recently. While economic output increased slightly (by 0.1 percent) in the third quarter of 2024, this growth was preceded by a strong decline (by 0.3 percent) in the second quarter (Figure 2).

Figure 2

Growth of real GDP in Germany

In billions of euros (left axis) and quarter-on-quarter in percent (right axis)



Note: Forecast from the fourth quarter of 2024; adjusted for price, seasonal, and calendar effects.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2024.

The German economy will experience steady growth once again from 2025.

Exports and investments in particular have declined again, likely also due to structural reasons. Persistently weak foreign demand for local manufacturing products was also evident in the third quarter: Exports dropped significantly, goods exports experienced a considerable slump. This in combination with slightly positive imports resulted in a negative trade balance. Thus, foreign trade depressed economic growth in Germany. Investments in equipment and construction were also on the decline again.

Nonetheless, GDP increased slightly in the third quarter, which can be attributed to a moderate expansion of private consumption on the one hand. However, as this growth followed a steep decline in the previous quarter, this cannot be considered a recovery. Taking into account stable inflation rates and sustained wage increases, which were once again strong in the third quarter, the expansion of private consumption seems rather restrained. In light of the impending layoffs at major industrial companies, many private households are likely to be more concerned about their own jobs. It seems that they are saving more money again out of caution: The savings rate increased for the fourth quarter in a row. On the other hand, inventories were expanded significantly and supported economic development: Companies produced more than was consumed, resulting in GDP being higher than the sum of its components.

Examining individual economic sectors makes it clear that the crisis in German industry is worsening and noticeably impacting other sectors. The gross value added of manufacturing as well as the construction sector have recently declined. It declined by 1.4 percent for manufacturing, considerably more than expected in the fall. The gross value added of some services, such as professional services firms, financial services and insurance providers, and information and communication services, declined. Strong growth in public services and other service providers are keeping overall gross value added from dipping into the red.

The re-election of Donald Trump and the collapse of the German government coalition at the beginning of November created further uncertainty about the economic policy framework of the coming years, especially among companies. The outlook for foreign trade has worsened, as the Trump administration will likely increase trade barriers significantly starting in 2025. This forecast assumes that after Trump takes office, he will reimpose 10-percent tariffs on steel and 25-percent tariffs on aluminum that had previously been repealed by current US President Joe Biden. Moreover, it assumes that the tariff rate for Chinese exports to the United States will increase by 10 percentage points. The average tariff rate on goods imports from China to the United States will likely be 30 percent instead of around 20 percent (Box 1).

Domestically, there is still no federal budget for 2025 due to the collapse of the government coalition and the snap election. Provisional budget management applies following the collapse, under which expenditure may only be incurred

Table 2

Quarterly data on the development of use and value-added components of real GDP in Germany
In percent (quarter-on-quarter, seasonally and calendar adjusted)

	2023				2024				2025				2026			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	−0.4	0.8	0.0	0.0	0.1	−0.5	0.3	0.1	0.1	0.2	0.3	0.4	0.3	0.3	0.2	0.2
Public consumption expenditure	0.2	−0.2	1.2	0.7	−0.3	1.6	0.4	0.0	0.1	0.3	0.4	0.2	0.2	0.2	0.3	0.2
Gross facilities investment	0.6	−0.2	−0.3	−1.4	0.2	−2.1	−0.1	−0.4	0.2	0.3	0.5	0.5	0.5	0.5	0.6	0.6
Construction	1.3	−0.7	−1.3	−1.9	0.7	−2.2	−0.3	−0.6	0.1	0.2	0.3	0.3	0.3	0.3	0.4	0.4
Equipment	−1.0	−0.2	0.5	−2.1	−1.3	−3.4	−0.2	−0.3	0.1	0.3	0.7	0.8	0.8	0.8	0.9	0.9
Other investment	1.7	1.0	0.9	1.4	1.4	0.6	0.6	0.0	0.6	0.7	0.7	0.7	0.7	0.6	0.6	0.5
Inventory changes[1]	−0.3	−0.1	−0.2	−0.7	0.0	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic consumption	−0.3	0.2	−0.1	−0.9	0.1	0.1	1.0	0.0	0.1	0.2	0.4	0.4	0.3	0.3	0.3	0.3
Net exports	0.5	−0.4	0.3	0.5	0.2	−0.4	−0.9	−0.1	0.0	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1
Exports	0.2	−0.4	−0.7	−0.9	1.4	0.2	−1.9	0.2	0.3	0.1	0.2	0.3	0.4	0.4	0.3	0.3
Imports	−1.0	0.5	−1.4	−2.0	1.0	1.2	0.2	0.4	0.4	0.3	0.5	0.6	0.6	0.6	0.6	0.5
GDP	0.1	−0.2	0.2	−0.4	0.2	−0.3	0.1	−0.1	0.1	0.2	0.3	0.3	0.3	0.2	0.2	0.2
Gross value added	0.5	−0.2	0.0	0.5	−0.1	−0.5	−0.2	−0.1	0.1	0.2	0.3	0.3	0.3	0.2	0.2	0.2
Manufacturing	1.1	−0.1	−1.0	0.0	−1.0	−0.8	−1.4	−0.6	−0.2	0.0	0.2	0.4	0.4	0.3	0.3	0.2
Construction	5.8	−0.6	−0.9	−2.1	1.8	−3.4	−1.2	−0.5	0.0	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Trade, hospitality, transport	−1.2	−0.2	0.6	0.8	−0.5	−0.8	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.3
Professional services provider	−0.2	0.5	0.5	1.0	−0.7	0.3	−0.3	−0.1	0.0	0.1	0.3	0.3	0.3	0.3	0.2	0.2
Public services, education, health	0.4	0.1	0.7	0.2	0.4	0.2	1.3	0.2	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1

1 Contribution to growth in percentage points.

Note: Forecast from the fourth quarter of 2024; adjusted for price, seasonal, and calendar effects.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2024.

to “maintain existing institutions, legal obligations of the federal government,”[1] and for measures that have already been adopted. In addition, some fiscal policy support that had already passed the Federal Cabinet but had not yet been approved by the *Bundestag* will no longer find a majority under the current minority government. This support includes measures aimed at stimulating investment, such as the extension of degressive depreciation rules, which were introduced as part of the growth initiative announced in late summer. Planned adjustments to the income tax rate to eliminate bracket creep and the increase in the child allowance and child benefit are also unlikely to happen for the time being. This forecast assumes that a government will be formed and a budget resolution agreed upon in early summer 2025, which will support the financial situation of the federal ministries and agencies and thus government consumption. However, as new government plans and fiscal policy measures cannot yet be known, fiscal policy will remain restrictive for the time being. Due to uncertainties about a new government’s economic policy orientation, companies located in Germany in particular are likely to act carefully. Thus, investment decisions are likely to be delayed to 2025.

The increased uncertainty is hitting the German economy in an already extremely difficult situation between cyclical weakness and structural change. Thus, another decline in economic output is expected in the current fourth quarter (Table 2). Leading indicators from the beginning of the current quarter, i.e., before the US presidential election and the collapse of the German government coalition caused additional uncertainty, suggest that the industrial slump would have continued regardless of the additional negative factors and that a recovery would have been delayed again. The Global Composite Purchasing Managers’ Index remained below the expansion threshold of 50 index points in October. In November, the index declined again. While the index for industry stagnated below the expansion threshold of 50, the index for services fell below this threshold for the first time since February. It should be noted that only some of the surveys took place following Trump’s re-election and the collapse of the German government coalition. The extent to which these political developments have further depressed sentiment will probably only become fully apparent in the December survey. Meanwhile, the order situation remains weak for both services as well as manufacturing. For example, gross value added in the current fourth quarter is likely to decline slightly overall, yet slight increases in the service sectors will compensate for further declines in industrial production.

The uncertainties due to foreign and domestic political developments should result in companies acting more reserved in

1 The legal basis for provisional budget management is Article 111 of the Basic Law. The term “institutions” includes constitutional bodies, federal agencies, institutions, and construction facilities, for example. Maintaining existing institutions includes ongoing personnel costs, costs related to filling new positions, and replacement equipment costs. “Legal obligations” include, among other things, benefit claims from Social Code II (SGB II) such as the citizen’s benefit (*Bürgergeld*), housing allowance (*Wohngeld*), parental allowance (*Elterngeld*), and expenditure obligations from international agreements.

the current quarter, resulting in a noticeable decline in private equipment investment. The deteriorating external economic environment is also having an dampening impact on foreign trade as well as the willingness to invest. On the flip side, exports to the United States are expected to be pulled forward to the current and upcoming quarters, as the risk of steep tariff increases goes well beyond the reintroduction of aluminum and steel tariffs assumed in this forecast. The temporary rise in exports should in turn boost imports of intermediary goods. Overall, foreign trade is expected to once again make a negative contribution to GDP in this quarter.

Private consumption should continue to develop weakly, barely supporting economic development in the fourth quarter. Job worries in particular are dampening private households' willingness to spend. This is reflected in the savings rate, which has been rising for four quarters. In addition, the price level, which has become permanently higher, is slowing consumption despite rising real disposable income. Construction investments in which residential construction largely driven by private households plays a key role are likely to decline again.

We expect that the economic situation will relax very gradually over the further course of the forecast. From mid-2025, with a new federal government and clearer external economic conditions, more and more uncertainties will dissipate and make households and companies more confident again. The stabilization of employment over the course of 2025, which should even grow somewhat in 2026 should also contribute to this. Accordingly, unemployment will gradually decline. As a result, we expect that more of the higher disposable incomes and at least some of the household savings will be spent again. Construction and equipment investments should then stabilize, with the latter likely also being supported by government expenditure in 2025 in particular as a part of the *Bundeswehr*'s special fund. Companies will likely increasingly invest in their production capacities beginning in 2026. As European industry increasingly recovers, foreign demand will rise and the European Central Bank (ECB), as assumed, will cut interest rates further and German exports will likely pick up speed again.

While monetary policy will become increasingly less restrictive due to further interest rate cuts over the course of the forecast period, fiscal policy will likely remain restrictive. On the one hand, this is due to the expiry of expansionary measures in response to the energy crisis, the end of tax breaks, and tax increases. On the other hand, we assume that the collapse of the coalition will mean that revenue-reducing legislation will no longer be implemented, thus decreasing expansionary stimuli. Due to the snap elections for the German *Bundestag*, the overall direction of fiscal policy during the forecast period is subject to a high degree of uncertainty.

All in all, price-adjusted GDP will likely contract by 0.2 percent in 2024 for the second year in a row (Table 3). In 2025, global economic output should expand by 0.2 percent, considerably less than was expected in the fall. Growth will be

Table 3

Key economic indicators for the German economy

	2023	2024	2025	2026
GDP[1]	−0.3	−0.2	0.2	1.2
Employment[2] (1,000 persons)	46,011	46,106	46,071	46,120
Unemployed (1,000 persons)	2,609	2,787	2,854	2,707
Unemployment[3] (BA concept, in percent)	5.7	6.0	6.1	5.8
Consumer prices[4]	5.9	2.2	2.0	2.0
Unit labor costs[5]	6.7	5.4	3.1	1.8
Government budget balance[6]				
in billions of euros	−107.5	−108.6	−92.8	−82.7
in percent of nominal GDP	−2.6	−2.5	−2.1	−1.8
Current account balance				
in billions of euros	248.7	254.3	223.4	209.5
in percent of nominal GDP	5.9	5.9	5.1	4.6

1 Price adjusted. Year-on-year change in percent.
2 Domestic concept.
3 Unemployed as a percentage of the civilian labor force (definition according to the Federal Employment Agency).
4 Year-on-year change.
5 Compensation of employees per employee hour worked in Germany as a percentage of real GDP per hour worked of the employed.
6 As defined in the national accounts (Volkswirtschaftliche Gesamtrechnungen).

Note: Forecast from the year 2024.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Winter 2024.

stronger in 2026 at 1.2 percent. However, this will be in part due to non-recurring effects such as a comparatively high number of work days. Thus, DIW Berlin is lowering its forecast for 2024 by 0.5 percentage points and for 2025 and 2026 by 0.7 and 0.2 percentage points, respectively. The significant downward revision in some cases is primarily due to the enormous additional burdens on the German economy due to the many uncertainties, both for companies as well as private households. With this forecast, DIW Berlin is revising potential GDP downward again. In 2029, potential growth of the German economy should still be 0.3 percent. Overall, the output gap for 2024 and 2025 is likely to be a bit larger than expected in fall. The gap will be –1.0 percent for 2024 and –0.9 percent for 2025. Over the course of the recovery, the gap is expected to nearly close at –0.2 percent in 2026.

Following the strong growth of previous years, average consumer price inflation should be 2.2 percent, primarily due to falling energy prices. This is close to the ECB's two-percent target In the coming years, the inflation rate is expected to level off at two percent. Thus, DIW Berlin's inflation forecast remains unchanged compared to the fall. The core rate (inflation excluding energy and food) should also decline further and come closer to the inflation target, but more slowly than the overall rate of inflation.

The downside risks for the German economy grew significantly larger in the fall. In particular, domestic and foreign economic policy uncertainties pose a risk of real economic distortions that could be significantly greater than assumed in this forecast. There could be delays in forming a government and, accordingly, in the budget process, which would keep economic conditions in Germany in limbo for longer than assumed here. The new US government could impose high tariffs on German car exports to the United States, which would hit the already struggling manufacturing industry in Germany even harder. In addition, it is unclear to what extent the German economy's weak growth is shaped by structural adaptation and to what extent by cyclical factors. Global economic risks are also affecting Germany.[2] For example, there is no easing in sight for many geopolitical flashpoints, such as the war in Ukraine.

2 For more, see the section on the global economy in this Weekly Report.

Geraldine Dany-Knedlik is Head of the Forecasting Department in the Macroeconomics Department at DIW Berlin | gdanyknedlik@diw.de

Guido Baldi is a Guest Researcher in the Macroeconomics Department at DIW Berlin | gbaldi@diw.de

Nina Maria Brehl is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area and consumer prices in Germany | nbrehl@diw.de

Hella Engerer is a Research Associate in the Energy, Transportation, Environment Department at DIW Berlin specializing in Central and Eastern Europe | hengerer@diw.de

Angelina Hackmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the German labor market | ahackmann@diw.de

Pia Hüttl is the Coordinator of the global economic forecast and a Research Associate in the Macroeconomics Department | phuettl@diw.de

Konstantin Kholodilin is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in estimating potential output at DIW Berlin | kholodilin@diw.de

Frederik Kurcz is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the euro area | fkurcz@diw.de

Laura Pagenhardt is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in investments | lpagenhardt@diw.de

Jan-Christopher Scherer is the Coordinator of the German economic forecast and Research Associate in the Macroeconomics Department at DIW Berlin | jscherer@diw.de

Teresa Schildmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in German fiscal policy | tschildmann@diw.de

Hannah Magdalena Seidl is a Research Associate in the Macroeconomics Department at DIW Berlin | hseidl@diw.de

Ruben Staffa is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the USA, German fiscal policy, and German foreign trade | rstaffa@diw.de

Kristin Trautmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the United Kingdom and European Monetary Policy | ktrautmann@diw.de

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DIW BERLIN

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
www.diw.de
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