DIW Weekly Report

10+11 2024

A policy bulletin from the German Institute for Economic Research

Economy. Policy. Science.

DIW BERLIN

DIW Economic Outlook Spring 2024

85 Report by the DIW Berlin Economic Forecasting Team

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

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
Volume 14 March 12, 2024

ISSN 2568-7697

DIW Weekly Report 10+11 2024

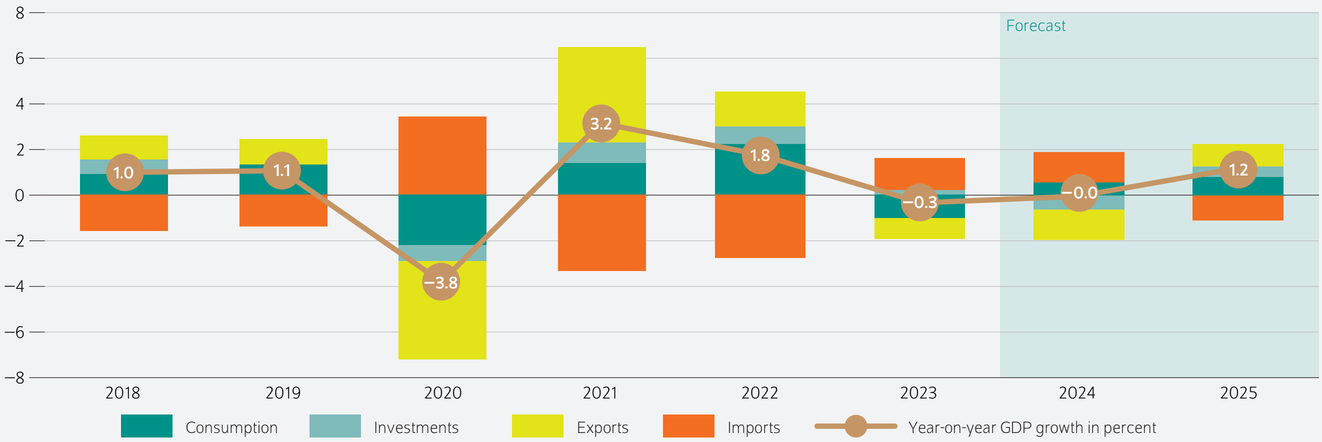
AT A GLANCE

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)
www.diw.de/mediathek

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.

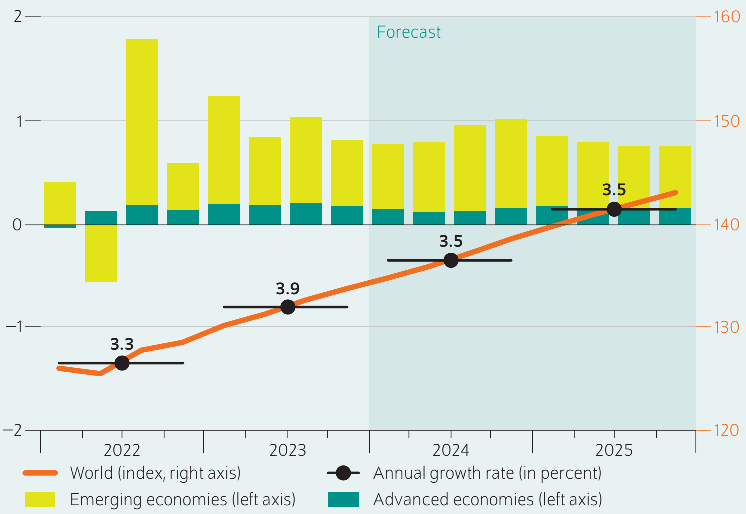
International trade will probably experience only moderate growth in 2024. Although the supply bottlenecks of recent years have eased, more expensive transportation costs cannot be ruled out due to the conflicts in the Red Sea and the drought in the Panama Canal. International trade declined by 1.9 percent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

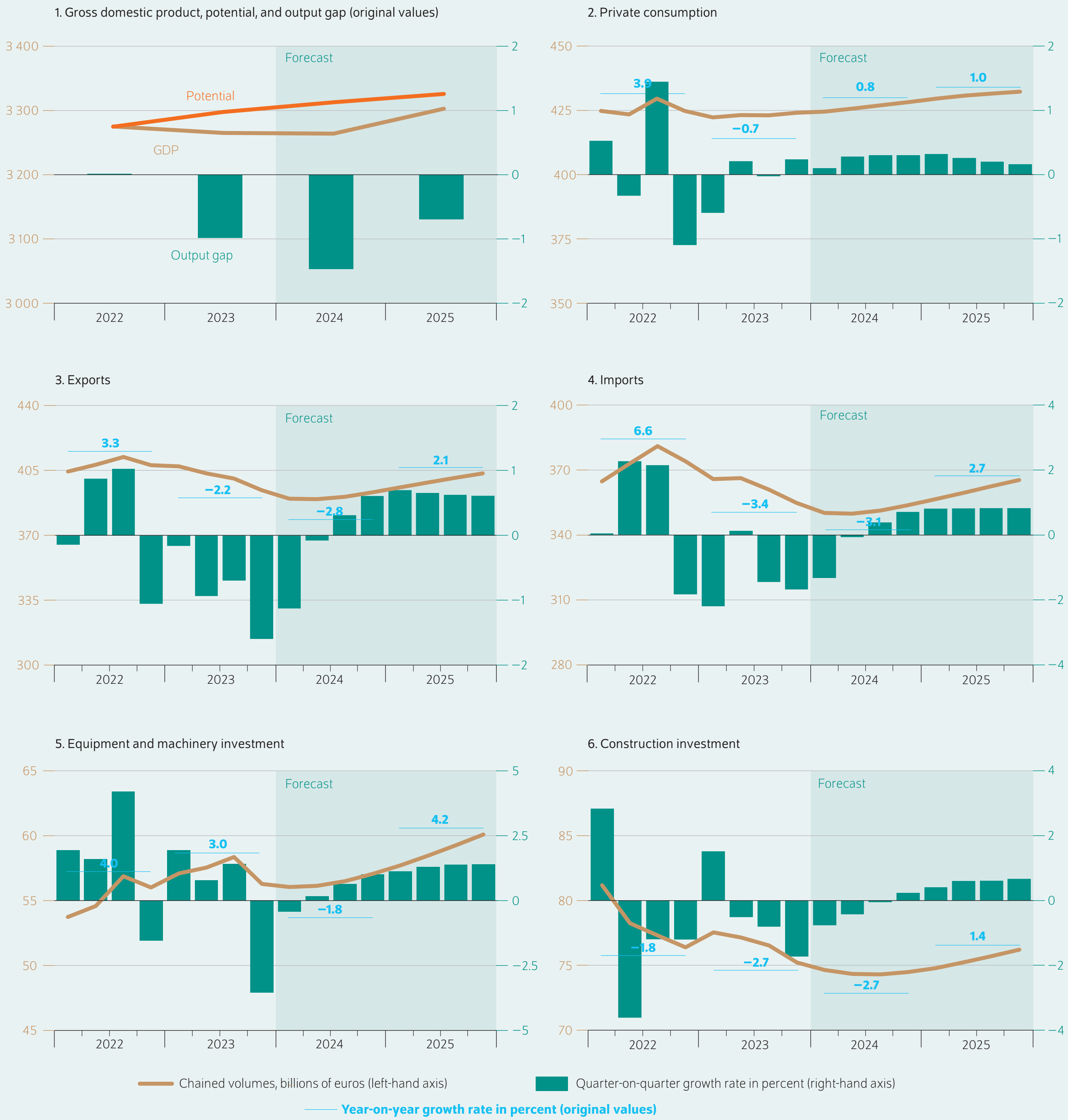
4 Economic performance already began declining in the third quarter of 2023, even if only marginally by 0.01 percent. Thus, the German economy has been in a technical recession since the fourth quarter of 2023.

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

JEL: E32, E66, F01

Keywords: Business cycle forecast, economic outlook