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DIW Economic Outlook Summer 2024

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DIW Weekly Report 24+25+26 2023

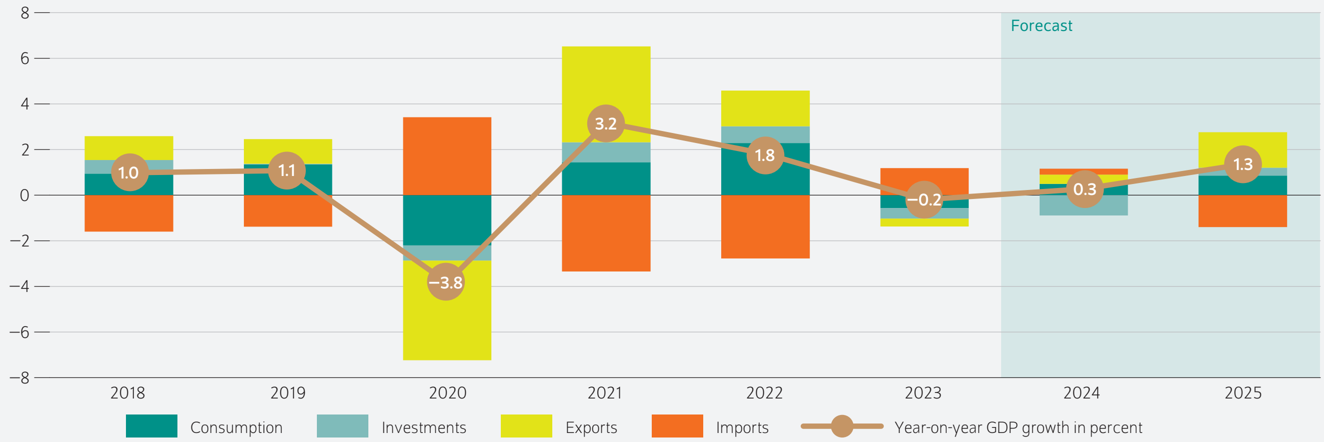
AT A GLANCE

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

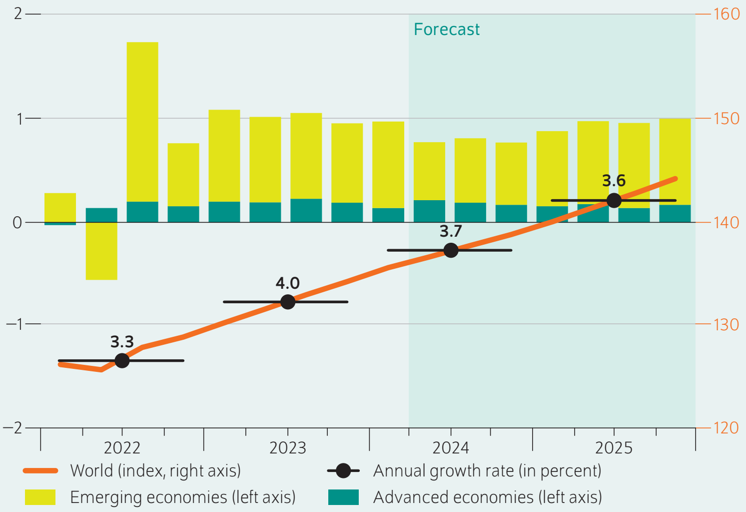
The global economy developed better than expected in the first quarter of 2024 in particular due to the recovery of domestic demand in most advanced economies. Among the emerging economies, China performed surprisingly well in terms of high exports and strong industrial output.

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 overindebted 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

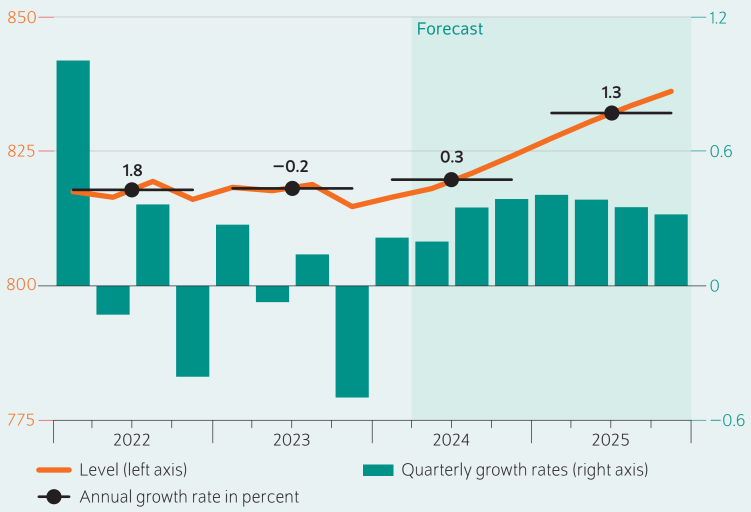
The German economy is slowly exiting its slump, starting out 2024 with momentum following weak performance in 2023.[3] Economic output increased by 0.2 percent in the first quarter of 2024, more than previously expected (Figure 2).[4] The robust growth rate in the first quarter was due in particular 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.

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