DIW Weekly Report

A policy bulletin from the German Institute for Economic Research

35–39 2024

Economy. Policy. Science.

DIW BERLIN

DIW Economic Outlook Autum 2024

223 Report by the DIW Berlin Economic Forecasting Team

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

LEGAL AND EDITORIAL DETAILS

DIW BERLIN

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Volume 14 September 12, 2024

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Cover design
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Composition
Satz-Rechen-Zentrum Hartmann + Heenemann GmbH & Co. KG, Berlin

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ISSN 2568-7697

DIW Weekly Report 35—39 2024

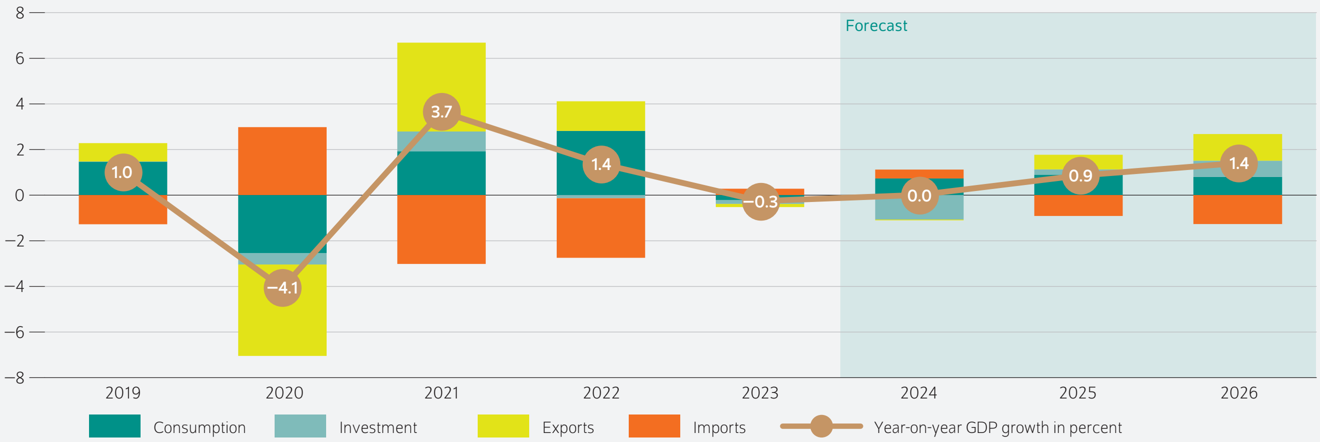
AT A GLANCE

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

 DOI: https://doi.org/10.18723/diw_dwr:2024-35-1

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.

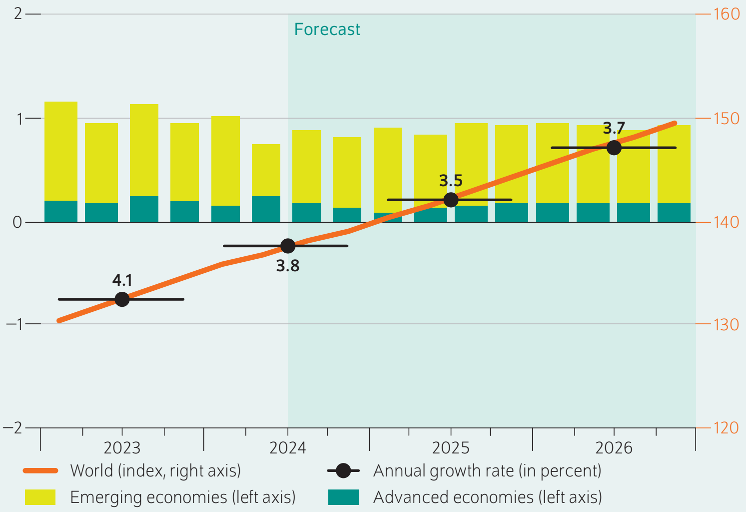
Growth is expected to be stronger in the emerging economies in the third quarter than in the second quarter. The Indian economy should continue to grow dynamically. The Chinese economy is likely to benefit from rising exports and investments in the high-tech sector. Despite all the stimulating monetary 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.

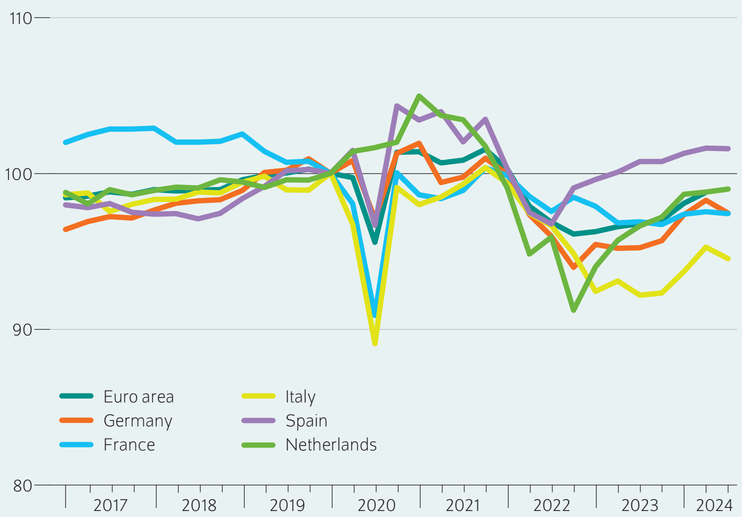
The gradual slowdown in economic momentum in the United States is primarily being driven by declining private consumption and the labor market. However, the labor market seems to be more robust than the unemployment rate, which has been higher since spring, would suggest. The unemployment rate is likely 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.

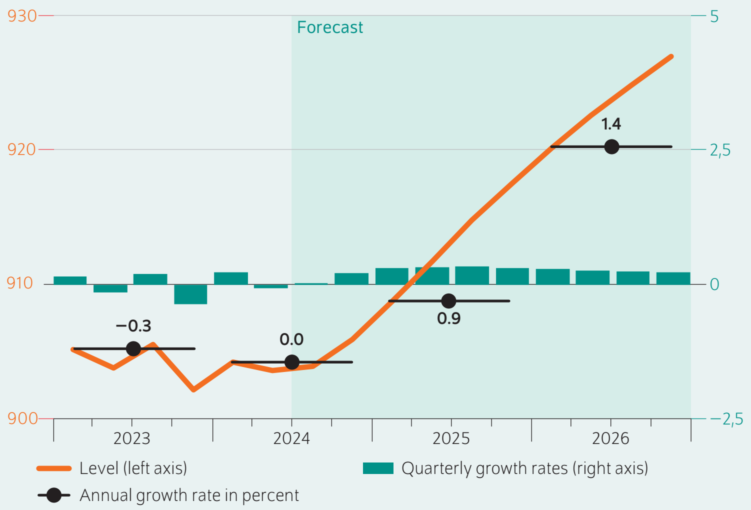
Foreign trade also did not provide any growth stimuli in the second quarter. While strong exports of intermediate goods, such as chemical and plastic products, had indicated a recovery in the global industry[5] and thus German trade at the beginning of the year, exports of these goods significantly declined 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.

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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

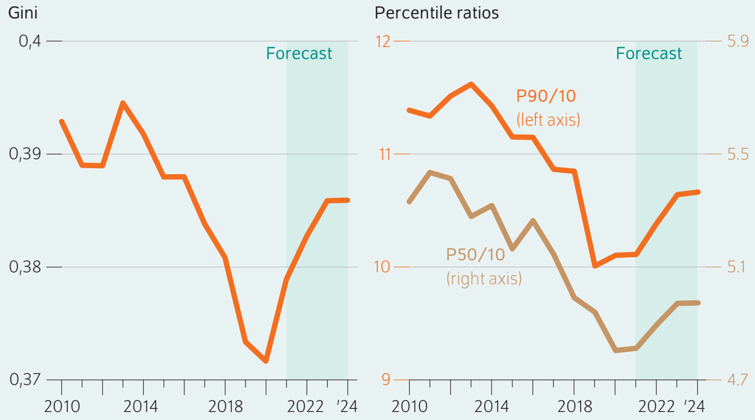
Note: Forecast from the third quarter of 2024; price, seasonally, and calendar adjusted.

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 BaföG 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**

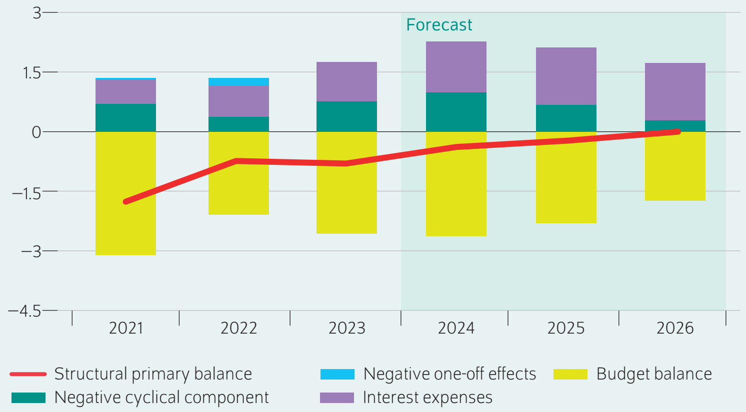
1 Expenditure components adjusted for import content.
2 Year-on-year change in percent; deviations in the totals are due to rounding.

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.

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JEL: E32, E66, F01

Keywords: Business cycle forecast, economic outlook