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DIW Economic Outlook Summer 2025

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LEGAL AND EDITORIAL DETAILS

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
www.diw.de
Phone: +49 30 897 89–0 Fax: –200
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Publishers
Prof. Anna Bindler, Ph.D.; Prof. Dr. Tomaso Duso; Sabine Fiedler; Prof. Marcel Fratzscher, Ph.D.; Prof. Dr. Peter Haan; Prof. Dr. Claudia Kemfert; Prof. Dr. Alexander S. Kritikos; Prof. Dr. Alexander Kriwoluzky; Prof. Karsten Neuhoff, Ph.D.; Prof. Dr. Sabine Zinn

Editors-in-chief
Prof. Dr. Pio Baake; Claudia Cohnen-Beck; Sebastian Kollmann; Kristina van Deuverden

Reviewer
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Editorial staff
Rebecca Buhner; Dr. Hella Engerer; Petra Jasper; Adam Mark Lederer; Frederik Schulz-Greve; Sandra Tubik

Layout
Roman Wilhelm; Stefanie Reeg; Eva Kretschmer, DIW Berlin

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AT A GLANCE

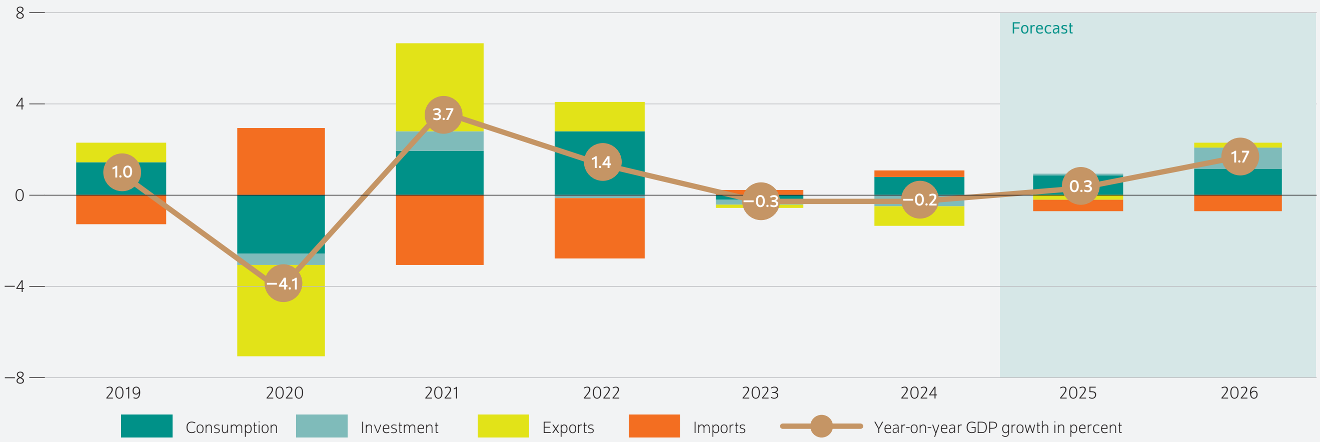
Tariff chaos overshadowing the global economy; fiscal package bolstering the German economy

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

- German economy is on the brink of recovery; growth of 0.3 percent and of 1.7 percent expected for 2025 and 2026; DIW Berlin is increasing its forecast
- Federal investment package to provide stimuli; effects in 2025 will be minimal due to planning delays, but a noticeable flow of funds is expected in 2026
- Consumption and front-loaded exports to the US due to expected tariffs supported the economy in the first quarter of 2025, but the economy will likely cool down in the second half of the year
- Labor market situation remains tense, unemployment will rise for the time being; inflation stagnating at 2.1 percent in 2025 and will increase to 2.2 percent in 2026
- Geopolitical tensions and protectionist policies are weighing on the global economy: Growth of 3.3 percent in 2025 and of 3.4 percent in 2026 is expected

German economy returning to growth path

Individual components' contribution to overall GDP growth in percentage points



Source: DIW Berlin Economic Outlook Summer 2025.

FROM THE AUTHORS

"The German economy started off the new year with some momentum. However, this does not change the structural issues such as declining competitiveness and the shortage of skilled workers. One ray of hope is the investment package for infrastructure which should have noticeable effects in 2026."

— Geraldine Dany-Knedlik —

MEDIA

Audio Interview with Name (in German)

www.diw.de/mediathek

Tariff chaos overshadowing the global economy; fiscal package bolstering the German economy

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

EXECUTIVE SUMMARY

Despite a strong start to 2025, the German economy will experience middling growth for the time being before beginning a long-awaited upturn at the end of the year. DIW Berlin's forecast indicates growth of 0.3 percent for 2025 and of 1.7 percent for 2026; thus, DIW Berlin is increasing its forecast significantly.

Expansionary fiscal policy is counteracting the effects of higher tariffs. From 2026 onwards, the multi-billion euro fiscal package is expected to provide considerable funds to boost consumption and investment. The new fiscal leeway will hardly have any impact this year, as the public budget for 2025 is not expected to be passed until the fall, which will delay planning, approval, and procurement procedures. Even for 2026, the funds provided are likely to fall short of the average annual 40 billion euros that would be invested in infrastructure if the funds were distributed evenly over the intended 12-year period. Nevertheless, the positive effects will be noticeable and counteract the dampening effects of the structural weakness of industrial production and of foreign trade, which has been hit by high US tariffs. However, risks to economic development remain: ongoing geopolitical tensions and a possible escalation of the trade conflict between the United States and the EU. The German economy had a strong start to the year primarily due to the front-loading of goods exports to the United States due to the threats of tariffs by the Trump administration. However, private consumption also grew, while the seasonally adjusted savings rate experienced an exceptional decline. Glimmers of hope emerged for the manufacturing industry, but sentiment among service providers dampened somewhat recently. In the second quarter, only slight front-loading is expected for exports, although not as strongly as in the first three months of the year. Private consumption should continue to increase, albeit at a slower pace. The situation on the labor market remains tense, as the unemployment rate is rising and people are worried about job losses. During the second half of 2025, the economy should cool down slightly before speeding up at the end of the year as the fiscal policy measures gradually begin to have an impact. At 2.1 percent in 2025, inflation will remain stable before rising slightly to 2.2 percent in 2026. Some EU Member States, and thus the entire euro area, should benefit from the overall positive development in Germany. On balance, though, the global economy remains clouded by US tariff policy. However, this tariff policy will probably affect the United States itself the most; its economy is expected to grow by only 1.4 percent in 2025 and by 1.6 percent in 2026. For the global economy, growth of 3.3 percent in 2025 and of 3.4 percent in 2026 is expected.

DOI: https://doi.org/10.18723/diw_dwr:2025-22-1

German economy: Fiscal package providing hope for stronger domestic economy

The German economy got off to a strong start in 2025: With 0.4 percent quarter-on-quarter growth, economic output expanded powerfully in the first three months (Figure 1). This growth was driven in part by strong exports to the United States, which, however, were probably front-loaded due to the expectation of further increases in US tariffs. US trade policy and the uncertainty stemming from it continue to weigh on the German economy. Furthermore, the German economy is in the middle of structural change: It is grappling with weakened competitiveness, a shortage of skilled workers, and decarbonization. One ray of hope for long-term growth expectations comes in the form of the new German Federal Government's planned public investments, which should support the German economy noticeably, especially from 2026 onward.

Overall, exports increased by 3.2 percent at the beginning of the year (Table 1) after shrinking by over 2.5 percent in the last two quarters each. In particular, goods exports to the United States increased markedly, whereas goods exports to other important trade partners rose only slightly. Although exports are characterized by a high import intensity, meaning many intermediary goods for the production process are purchased from abroad, imports developed less dynamically. This could indicate that the front-loaded deliveries to the United States were partially supplied from existing inventories, thereby contributing to an unusually strong negative growth contribution from inventories to GDP in the first quarter.

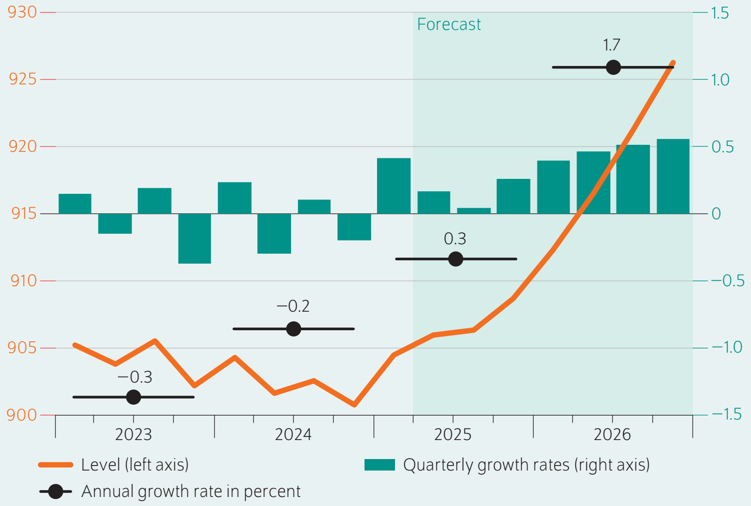
In addition to rising exports, strong growth in private consumption also supported economic performance at the beginning of the year. Although real disposable income declined slightly overall, the private households that are able to save from their current income put aside noticeably less in the first quarter: The seasonally-adjusted savings rate fell unusually sharply from 11.3 to 10.4 percent.

Besides the strong growth in private consumption, investments in equipment, construction, and other facilities also saw strong growth of 0.9 percent in the first quarter, supporting the German domestic economy. Businesses' strong start to the year was reflected in gross value added. The manufacturing industry recorded growth of one percent following six consecutive quarters of decline, and the services sector also experienced growth of one percent in gross value added. Overall, gross value added expanded by 0.6 percent. Despite this, the industrial sector in particular is still experiencing difficulties, which is reflected in the labor market. Overall, employment stagnated, while it declined in the manufacturing industry once more. Furthermore, unemployment continued to rise.

Figure 1

Growth of real GDP in Germany

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



Note: Forecast from the second quarter of 2025; adjusted for price, seasonal, and calendar effects..

Sources: National Statistical Offices; DIW Berlin Economic Outlook Summer 2025.

The German economy will grow significantly from the end of the year.

Trade conflict also shaping the second quarter

Since "Liberation Day" on April 2, the United States has significantly increased tariffs on over one hundred countries, including the EU. Since then, the United States has been switching between threats, announcements, and temporary suspensions to the tariffs. This caused stock markets to slide at times and increased uncertainty. For example, tariffs on EU exports of aluminum and steel products currently stand at 50 percent, while 25 percent tariffs continue to apply to vehicles and vehicle parts. In addition, there is a base tariff rate of ten percent (Box 1). Due to the uncertain development of the trade conflict and the risk of escalation, slight front-loading effects in foreign trade can also be expected for this quarter.

Corporate sentiment will likely remain reserved in the current quarter for these reasons as well. According to the Purchasing Managers' Index, the assessment of the business situation in the industry remains tense and is stagnating slightly below the expansion threshold. At the same time, according to ifo Institut surveys, the first signs of a stabilization are present: The business climate has improved in both the manufacturing industries as well as the services

Table 1

Quarterly data on the development of expenditure and gross value-added components of real GDP in Germany

In percent (quarter-on-quarter, seasonally and calendar adjusted)

	2024				2025				2026			
	1	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption expenditure	−0.1	0.1	0.3	0.2	0.5	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Public consumption expenditure	0.5	1.5	1.2	0.4	−0.3	0.2	0.9	0.7	0.3	0.5	0.6	0.6
Gross fixed capital formation	0.2	−1.8	−0.4	0.5	0.9	−0.2	0.3	0.8	1.1	1.4	1.6	1.8
Construction	0.5	−1.8	−0.3	0.8	0.5	−0.4	0.1	0.4	0.7	0.8	1.2	1.4
Machinery and equipment	−0.9	−3.2	−1.1	0.2	0.7	−0.5	0.4	1.1	1.4	2.0	2.3	2.5
Other investment	1.0	0.5	0.7	0.2	2.0	0.7	0.8	1.2	1.5	1.7	1.7	1.9
Inventory changes[1]	0.0	0.0	0.9	0.5	−0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic use	0.2	0.0	1.3	0.9	−0.5	0.1	0.4	0.5	0.5	0.6	0.7	0.7
Net exports[1]	0.1	−0.3	−1.1	−1.1	0.9	0.1	−0.3	−0.2	−0.1	−0.1	−0.1	−0.1
Exports	0.1	1.8	−2.6	−3.1	3.2	0.5	−1.0	−0.2	0.2	0.2	0.2	0.2
Imports	−0.3	2.8	−0.1	−0.7	1.1	0.4	−0.2	0.3	0.3	0.5	0.6	0.6
GDP	0.2	−0.3	0.1	−0.2	0.4	0.1	0.0	0.3	0.4	0.5	0.5	0.6
Gross value added	−0.5	−0.3	−0.4	−0.3	0.6	0.1	0.0	0.3	0.4	0.5	0.5	0.6
Manufacturing	−0.7	−0.6	−1.3	−0.3	1.0	0.1	−0.2	0.2	0.3	0.4	0.4	0.4
Construction	0.6	−2.8	−1.0	−0.1	0.9	−0.4	0.1	0.5	0.8	1.1	1.3	1.6
Trade, hospitality, transport	0.4	−0.7	−0.1	0.6	1.1	0.1	0.1	0.2	0.3	0.5	0.5	0.5
Professional services provider	−0.2	0.2	−0.7	−0.3	0.0	0.0	0.0	0.2	0.3	0.4	0.5	0.6
Public services, education, health	0.7	0.3	1.5	0.0	−0.2	0.3	0.2	0.3	0.4	0.5	0.5	0.5

1 Contribution to growth in percentage points.

Note: Forecast from the second quarter of 2025; adjusted for price, seasonal, and calendar effects.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Summer 2025.

sector; in particular, corporate expectations have increased noticeably since the beginning of the year. However, it is a mixed picture. Uncertainty remains high, particularly in business-related services. The Purchasing Managers' Index for the services sector has fallen noticeably since January and was clearly below the growth threshold of 50 index points in May. The ongoing weakness in the industry continues to weigh on the order situation in sectors such as engineering and IT services: According to ifo surveys, the share of companies in these sectors whose business was being negatively affected by a lack of demand has in part tripled since 2023. The situation looks somewhat better in the consumer-related service sectors, even if the upswing hoped for still seems to be delayed. According to GfK, consumer sentiment is slowly improving, but retail sales fell again in April compared to the first quarter.

Overall, the German economy is likely to expand by 0.1 percent in the second quarter compared to the first. The industrial sector will probably continue to stagnate: Although manufacturing should experience a slight expansion, falling production in the construction industry is expected to prevent stronger growth. Public service sectors are expected to support production. Consumer-related and business-related services, in contrast, should contribute little to growth due to the tense economic situation.

Private consumption is likely to increase, although not as strongly as in the first quarter. It is supported by continually rising wages and lower-than-expected energy prices (Box 2). Ongoing job worries given the rising unemployment may on the other hand dampen households' willingness to spend. Following a decline in the first quarter, government consumption will probably only expand marginally for now due to the ongoing provisional budget. Investment activity is likely to slow down temporarily after the strong start to the year: For now, the unclear tariff policy and the still uncertain design of fiscal policy are making it difficult to plan investment projects. There should be some slight growth from foreign trade: Front-loaded exports to the United States will probably boost exports a little overall, while imports should only increase moderately due to weak domestic economic development.

Fiscal policy gradually stemming the tide against tariffs

Tariffs will continue to weigh on foreign trade and thus slow down economic activity over the course of the forecast. Following a brief ramp-up period, the comprehensive fiscal package should mainly boost the domestic economy. Overall, the economy is therefore expected to cool down somewhat at first before picking up speed again by the end of the year.

Box 1

Tariff assumptions

Trade barriers have increased once again since the beginning of the second quarter of 2025. On April 2, so-called "Liberation Day," US President Trump announced country-specific tariffs on goods for over one hundred trade partners that came into immediate effect. The tariffs were described as reciprocal, but their calculations do not correspond with the calculation method used for reciprocal tariff adjustments. Instead of aligning US tariffs with other countries' tariffs on US exports, the new tariffs are based on calculations of "implied tariffs." In this calculation, the United States' trade balance deficit with a country is divided by that country's exports to the United States. These "reciprocal" tariffs are country-specific base tariff rates that are generally half as high as the implied tariffs calculated. In any case, the United States levies a base tariff of ten percent on every country listed. Overall, the process seems to be arbitrary and not based on scientific results. For example, the base tariff for goods from China and the EU were set at 125 and 20 percent, respectively.

The April 2 tariffs initially resulted in turbulence on the stock markets. For example, the Dow Jones and DAX fell by four and three percent, respectively, on April 3. Between April 1 and 8, they fell by 11 and nine. In addition, because of an increased risk premium, yields on ten-year US government bonds rose by almost 0.5 percentage points. These distortions probably led to the US government temporarily suspending many of the very high tariffs on April 9. For example, the base tariff rate for imports from the EU was reduced from 20 to ten percent for 90 days. By the end of May, the stock markets had recovered and returned to their previous growth paths. Even if the US tariffs from April 2 speed up trade agreements between the United States and other countries, the resulting trade relationships with the United States will probably have much higher average tariffs than under the previous administration.

This forecast assumes that current trade agreements will remain in place, such as the tariff rates between the United States and China, Mexico, or the United Kingdom (Table). It further assumes that a trade agreement between the EU and United States will be reached with a base tariff rate of ten percent. It is also assumed that there will be a concession on aluminum and steel tariffs, so that these products, vehicles, and vehicle parts will only be subject to tariffs of 25 percent in the future. In return, the EU is likely to take countermeasures based on the list of goods published by the EU Commission for future counter tariffs, which will affect US industrial and agricultural imports in the amount of 95 billion euros.[1] Imposing a 35 percent tariff on this list of goods would roughly represent proportional retaliation. However, as in the past, the EU is likely to respond more cautiously in order to protect companies based in the EU. Therefore, it is instead assumed that the EU will introduce 25-percent tariffs on goods worth around 21 billion euros and adopt the US tariff rate of ten percent for the remaining goods on the list. Although these measures are milder, they take into account the fact that the EU was already imposing higher average tariffs on US imports than vice versa before the escalation under the Trump administration.

Table

Trade policy assumptions

Tariff-issuing country	Trade partner	Product category	Tariff rate/notes
United States	World	General	Base tariff rate of 10 percent
United States	China	General	40 percent
United States	Mexico	General	25 percent with the exception of trade compliant with USMCA
United States	Canada	General	25 percent, 10 percent on energy and potash with the exception of trade compliant with USMCA
United States	World	Steel and aluminum	25 percent
United States	World	Vehicles and vehicle parts	25 percent
Retaliatory tariffs			
China	United States	General	10 percent
Canada	United States	Selected products	25 percent on imports over 29.8 billion Canadian dollars
Countries exporting vehicles	United States	Selected products	Amount according to the effect of US vehicle tariffs
EU	United States	Selected products	Targeted and more moderate than US tariffs from July

Source: DIW Berlin Economic Outlook Summer 2025.

1 Cf. European Commission, "Reaktion auf US-Zölle: Kommission startet Konsultation und bereitet WTO-Verfahren vor," press release from May 9, 2025 (in German; available online).

In particular, a counter effect in foreign trade is likely to emerge in the second half of the year when the front-loaded demand from the United States drops off. Furthermore, Germany's continued weak competitiveness as a business location and its consistently declining exports to China are weighing on exports. Accordingly, it is expected that employment in the manufacturing industry will continue to decline at first while businesses adjust to these structural changes.

Total unemployment will probably rise somewhat over the course of 2025 and exacerbate the job concerns of private households. At the same time, real disposable income should continue to grow, primarily driven by growth in the middle to upper labor income groups (Box 3), as was the case in 2024. Private households in these income groups may, due to job concerns, decide to save a larger share of their income. Thus, it can be expected that the savings rate will remain above its long-term level for a while longer. In contrast, persistently stable prices are improving households' willingness

Box 2

Assumptions and framework conditions

This forecast is based on assumptions on the development of key interest rates, exchange rates, and raw material prices (Table). These assumptions were made based on previous developments, futures markets prices, and the closing prices on the date of this forecast (May 12, 2025).

The decline in euro area inflation, as expected by the ECB, continues. Against this outlook the ECB decreased key interest rates again in April and June by 25 base points each. With a deposit rate of 2.0 percent, monetary policy should now be neutral.[1] This forecast assumes that the ECB will keep interest rates at the level achieved by the end of the forecast horizon. Thus, the monetary policy assumptions in this forecast remain unchanged compared to DIW Berlin's spring forecast.

In line with central bank interest rates, money market interest rates also declined steadily and, linked to central bank interest rates, may now remain around less than two percent. Falling refinancing costs for companies and falling borrowing costs for households reflect this normalization. This forecast assumes that these credit rates will continue to fall once the ECB's monetary easing will have come to an end. While yields on ten-year government bonds skyrocketed at the beginning of March as a part of announcements of investment packages for infrastructure and more financing possibilities for military expenditure in Germany as well as at an EU level, they had normalized again by the beginning of the second quarter. Similarly to the spring forecast of the DIW Berlin, this forecast assumes that capital market interest rates will remain largely unchanged over the forecast horizon at 2.5 percent for Germany and 3.1 percent for the euro area.

The euro has recently appreciated against the US dollar. The forecast assumes that the exchange rate of EUR to USD will remain at 1.11 USD per EUR, the level reached at the end of the data period, slightly higher than was assumed in spring. The price of Brent crude oil recently declined considerably due to an increase in supply due to disagreements within OPEC+. Based on futures prices, it is assumed that the price of crude oil will only decline slightly, remaining at an average of around 65 USD per barrel in 2025 and around 62 USD per barrel in 2026. Thus, this forecast is expecting a crude oil price that is around 13 and 12 percent lower year-on-year, respectively. The wholesale price for gas (TTF) has recently slightly decreased as well. Price expectations, which were still slightly elevated in the spring, have fallen considerably over the past months. In 2025, the wholesale price is likely to average 37.60 euros per megawatt hour before falling to around 32.50 euros per megawatt hour in 2026. Therefore, gas price assumptions for the two forecast years have been lowered by 26 and 20 percent, respectively, compared to the spring forecast. This forecast is also based on trade policy assumptions (Box 1).

1 Cf. European Central Bank, Economic Bulletin Issue 1 (2024) (available online; accessed on June 2, 2025).

Table

Forecast assumptions

		2023	2024	2025	2026
ECB deposit facility[1] (year end)	Percent	4.0	3.0	2.0	2.0
ECB key interest rate (year end)	Percent	4.5	3.15	2.15	2.15
Money market interest rate	Three-month EURIBOR in percent	3.4	3.6	2.0	1.8
Capital market interest	Yield on euro-area government bonds with a remaining term of ten years	3.3	3.0	3.1	3.1
Capital market interest	Yield on German government bonds with a remaining term of ten years	2.6	2.4	2.6	2.5
Exchange rate	USD/EUR	1.08	1.08	1.10	1.11
Crude oil price	USD per barrel	82.0	79.7	65.0	62.4
Gas price	EUR per megawatt hour	42.1	34.5	37.6	32.5

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

Note: Annual averages; year-end ECB deposit facility values.

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 2025.

to spend. While services prices are continuing to increase somewhat more strongly than two percent on average, this growth is partially evened out by declining energy prices. As the economy recovers and labor demand rises accordingly in 2026, working hours will probably increase again and unemployment will fall. Fewer job concerns and an improved bargaining position for employees may speed up wage growth and strengthen private consumption. However, heightened pressure on consumer prices from rising wages is not expected for now.

This forecast assumes that no further interest rate cuts will follow the most recent cut by the European Central Bank (ECB) (Box 2). After a strong increase in March related to the German fiscal package and the increased financing possibilities for defense expenditure in Europe, yields on ten-year government bonds have returned to their pre-announcement level. With this return, financing conditions for investments have improved significantly in a year-on-year comparison. This should support a noticeable expansion in investment activity from the second half of the year and especially in 2026.

There will be noticeable investment and consumption stimuli from fiscal policy, especially from 2026 onward. In March, the German Federal Government loosened the debt brake for defense-related spending and announced a special 500-billion-euro fund for infrastructure spanning a period of

Box 3

Labor income inequality nowcast

DIW Berlin has developed a model that can forecast current labor income inequality (known as a nowcast). The nowcast combines annual microeconomic data from the Socio-Economic Panel (SOEP) with a number of high frequency macroeconomic and labor market indicators as well as the current results of the DIW Berlin Economic Outlook in a single macroeconomic model in order to extrapolate the average labor income of various income groups. Based on the model results and under certain distributional assumptions, a labor income distribution for the entire population can be generated.

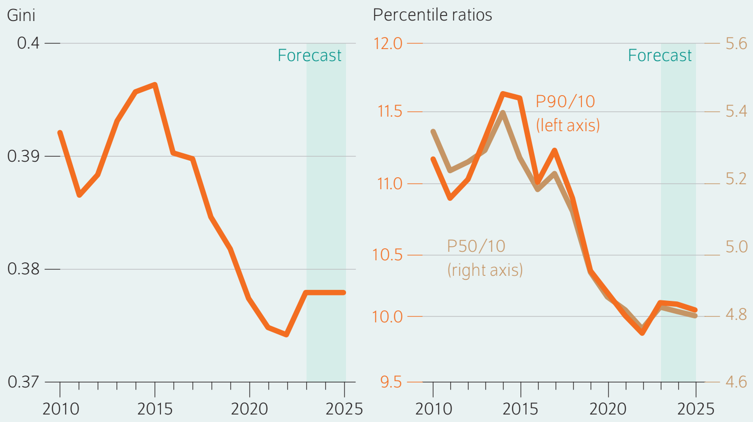
The most recent SOEP data is from 2022 (wave v39). Thus, the model is used to estimate the development of inequality for the years 2023, 2024, and 2025. The estimates for 2023 and 2024 used macroeconomic data from public statistics, while the nowcast for 2025 also uses the DIW Berlin Economic Outlook.

The model results show that, following a period of decline in inequality, particularly during the coronavirus crisis and the energy crisis, labor income has once again become somewhat more unequally distributed across the employed population (Figure). The Gini index increased from 0.374 in 2022 to 0.378 in 2023 and has been stagnating at this level ever since. The growth in inequality, especially in 2023, is likely primarily due to the fact that middle to top-earning households have benefited from wage negotiations and the correspondingly strong real wage increases following the energy crisis. This also suggests that the direction of fiscal policy in Germany could not prevent an increase in labor income inequality. This can also be seen by the increase in the income ratio between the top and low earners (P90/10) as well as between the middle and bottom end of the distribution (P50/10) in 2023. Thanks to somewhat stronger growth at the bottom end of the distribution, the income ratio is currently slightly declining.

Figure

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

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



Sources: Socio-Economic Panel (SOEP); Federal Statistical Office; DIW Berlin Economic Forecast Summer 2025.

Labor income has once again become more unequally distributed since 2023.

12 years. However, the 2025 federal budget is projected to be passed only after the summer break. In addition, many projects must first be planned, put out to tender, and awarded, meaning that only around three billion euros from the special fund via the Climate and Transformation Fund (KTF) is expected to come into effect for 2025. In contrast, a noticeably stronger fiscal stimulus of around 25.7 billion euros in nominal terms is expected in 2026. Of this amount, around 14.5 billion euros are attributable to the special fund for infrastructure and around 11 billion to defense spending. For the special infrastructure fund, funds are therefore significantly lower than the 41.7 billion euros that would result if the total amount were spread evenly over twelve years. There are already project plans at a federal, state, and municipal level that are currently stuck in limbo due to a lack of financing. Some of these could be implemented swiftly. Nevertheless, only limited funds are expected to flow in 2026 due to bureaucratic requirements and personnel bottlenecks in planning. The implementation of short-term incentives for corporate investments, such as the announced special depreciation allowance, are also likely to accelerate the outflow of funds to a limited extent only. Overall, following a slightly restrictive stance in 2025, fiscal policy will be considerably more expansionary in 2026. Government deficits are expected to improve marginally at –2.6 percent relative to economic output in 2025 compared to the previous year (–2.7 percent). In 2026, they will grow significantly to –3.3 percent. Adjusted for cyclic components and interest payments, there will be a structural primary deficit of –0.7 percent in 2025 and of –1.8 in 2026 relative to potential GDP, following a deficit of –0.9 percent in 2024.

Scientific studies on the effects of these additional fiscal policy stimuli on private investments and private consumption (fiscal multiplicators) reveal quite a broad spectrum overall. The effect of an additional euro spent by the government on GDP depends on the type of expense, the structural characteristics of the economy (such as employment structure and degree of openness), the state of the business cycle, and the duration of the stimuli.[1] The forecast results suggest that the fiscal policy stimuli from the additional 25 billion euros will increase GDP by 0.8 percentage points overall in 2026. Fiscal resources will boost investment activity

1 Cf. Valerie A. Ramey, "Ten years after the financial crisis: What have we learned from the renaissance in fiscal research?" *Journal of Economic Perspectives* 33.2 (2019): 89-114.

and consumption noticeably in 2026 while only resulting in moderate price increases. Consistent with the literature, the prospect of long-term additional public spending in anticipation of future contracts is likely to stimulate investments and job creation. Private investment activity is already benefiting in the short term from higher depreciation allowances as a part of the immediate investment program. A large share of state funds will likely flow into defense-related projects and infrastructure and thus primarily into the construction industry. With a current capacity utilization of slightly below 70 percent, there are short-term reserves to increase construction activity. The services sector, as planning and consulting services, should also be stimulated early on through government consumption in the form of advance payments for public projects. However, the situation is different for defense spending: Here, short-term production bottlenecks will probably limit the growth-stimulating effect. Domestic capacities for providing modern defense equipment and services must be expanded first, which is why more imports are expected in the short term.

Excluding major growth stimuli from the public sector in the form of infrastructure and defense orders, the structural changes resulting from intensified international competition, higher domestic production costs, and demographic changes are likely to further weigh on the recovery of the German economy over the course of the forecast. Exports, in particular, are likely to stagnate. Although German exports are expected to stabilize and benefit from the gradual upturn in corporate investment—especially in other European countries—rampant protectionism and the continued decline in the competitiveness of German companies, particularly compared to Chinese producers in the manufacturing industry, render it unlikely that the domestic export industry will regain its former strength.

Overall, price-adjusted GDP in Germany will expand by 0.3 percent in 2025 due to the strong start to the year. In 2026, much stronger growth of 1.7 percent is projected. This is primarily a result of the fiscal stimuli, but partially also due to a higher number of work days than in 2025 and a statistical overhang.[2] Accordingly, the DIW Berlin is raising its forecast for 2025 by 0.3 percentage points and for 2026 by 0.6 percentage points.

Potential GDP will develop until 2029 at an average rate of 0.4 percent. Labor volume should continue to decline due to the demographic changes. Given the only moderate economic upturn in 2025, the output gap is likely to narrow only marginally, amounting to an average of –1.0 percent of potential GDP for 2025. With the recovery expected over the forecast period, the production gap will close almost entirely by the end of 2026 and become noticeably positive in the medium term.

Consumer price inflation should rise slightly over the course of the forecast. Following 2.2 percent inflation in 2024, falling energy prices are dampening inflation, while moderate price increases due to expansionary fiscal policy are expected in 2026. Overall, the DIW Berlin is maintaining its inflation forecast of an annual average rate of 2.1 percent for 2025. At 2.2 percent, inflation should be slightly higher in 2026 than expected in spring.

The results of this forecast are subject to considerable risks. The uncertain nature of current US trade policy continues to weigh on the German economy and poses a downside risk for both the German and global economies. Should tariffs on European and German goods turn out to be higher than expected, this would have negative consequences on the export economy and the manufacturing industry in Germany. In turn, this could have negative effects on the labor market, private investments, and consumption.

The fiscal package effects estimated are also subject to considerable uncertainty. On the one hand, due to incomplete budget planning, it is still unclear how exactly these funds will be used and thus when which fund outflows are expected. On the other hand, the macroeconomic effect is uncertain. For example, the effect could be smaller due to capacity bottlenecks in sectors particularly affected, such as civil engineering or defense, and result only in noticeable price increases. On the other hand, the fiscal policy measures could be implemented more quickly and efficiently if bureaucratic processes and approval procedures were simplified.

A further upside risk is posed by the upcoming increase of the minimum wage. If the current practice of aligning it with past collective wage developments continues, the minimum wage is likely to rise in 2026 due to noticeable wage growth in 2024. If the minimum wage commission were also to align its decision with the 60-percent threshold of the median wage, as is anchored in the Directive on Adequate Minimum Wages, the increase would likely be even more significant and further drive up effective earnings. This could have a positive impact on disposable income and private consumption and lead to a stronger upturn than assumed in this forecast.

2 When adjusted for calender effects, the increase in economic output will only be 1.4 percent in 2026. The statistical overhang should be 0.3 percentage points for 2026.

Global economy: Effects of Trump's tariff policy becoming visible, especially in the United States

Following a phase of solid economic development, global growth weakened noticeably in the first quarter of 2025: Global GDP increased by only 0.8 percent quarter-on-quarter, compared to 1.1 percent in the fourth quarter of 2024 (Figure 2). Advanced economies as well as emerging economies experienced lower growth at the start of 2025 compared to the end of 2024. Due to heightened trade barriers, a strong upturn is not expected in the coming quarters.

The weaker start to the year was mainly due to US politics: Higher US tariffs and the resulting countermeasures led to increased trade barriers worldwide. Additionally, constant changes to tariffs that had already been announced and enacted further fueled uncertainty. With this trade policy in place, many regions are experiencing economic pressure.

Short-term effects of the tariff policy have been affecting economies in many countries around the world since the start of the year. Due to concerns about upcoming higher import taxes or price increases, many companies based in the United States front-loaded deliveries from abroad. As a result, imports to the United States in particular rose sharply in the first quarter, simultaneously boosting exports in closely interlinked economies. Due to these anticipatory effects, macroeconomic activity in the United States cooled down with an abrupt decline of 0.1 percent quarter-on-quarter. However, this underestimates the previously robust domestic economic development in the United States, which is reflected in the ongoing stability of the labor market, among other things.

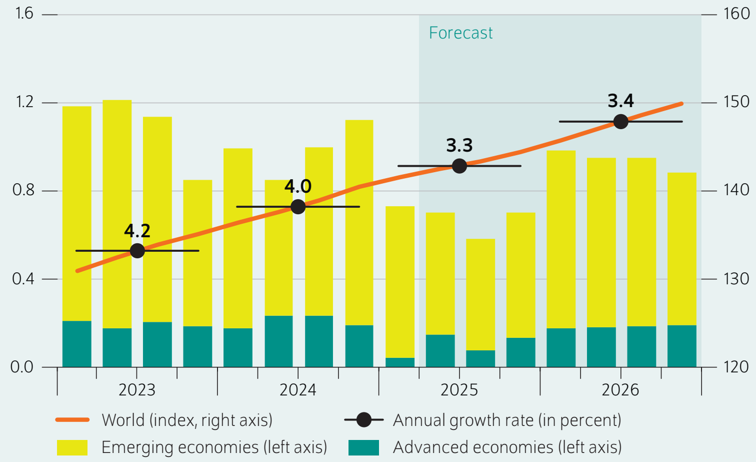
In the short term, the correspondingly higher exports to the United States supported economic development in many countries with close ties to the United States. In China, these high exports continued to contribute to growth noticeably, as was the case in the final quarter of 2024. Chinese companies have probably front-loaded deliveries to the United States, primarily delivering via southeast Asia. In contrast, Chinese domestic demand continued to slow due to the persistently weak real estate sector: Overall, growth declined from 1.6 percent at the end of 2024 to 1.2 percent in the first quarter. Mexico experienced a similar pattern, where an otherwise weak first quarter was temporarily stabilized by external economic impulses.

Front-loaded US purchases have also left their mark on several European economies. In the United Kingdom, consumption, investments, and front-loading of exports drove strong growth of 0.7 percent. In the euro area, front-loaded exports to the United States stimulated growth, especially in Germany and Ireland. Overall, the European Union experienced strong growth of 0.6 percent in the first quarter, supported by robust consumption and vigorous investment activity in many places.

Figure 2

Real GDP growth

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



Sources: National Statistical Offices; DIW Berlin Economic Outlook Summer 2025.

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Heightened trade barriers are weighing on advanced as well as emerging economies.

In some Asian countries, front-loaded deliveries to the United States played a subordinated role. For example, robust domestic demand was the primary contributor to strong, sustained economic activity in India. In Japan and South Korea, countries with domestic economies already struggling and no front-loading of exports, economic activity fell by 0.2 percent respectively in the first quarter.

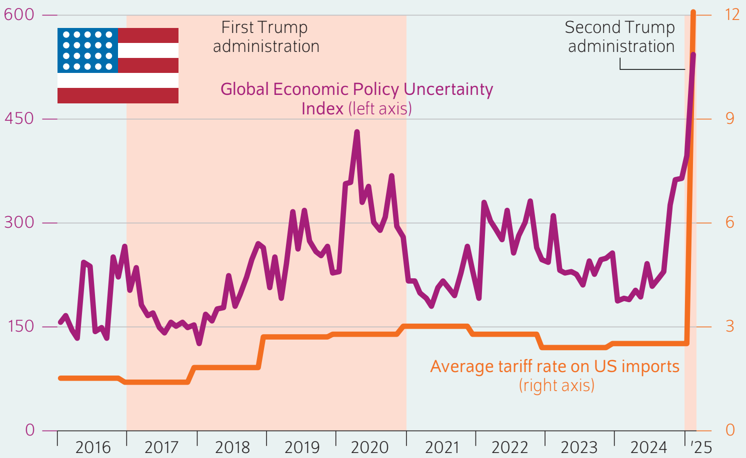
As a result of front-loaded exports to the United States, global trade picked up considerably: Quarterly growth increased from 0.5 percent in the final quarter of 2024 to 2.0 percent in the first quarter of 2025. However, this temporary boost is likely to fade gradually as the year progresses, which is why the consequences of the increased trade barriers on global trade will materialize.

Tariff chaos dragging down global economy

Trade policy tensions worsened in the second quarter and should continue to weigh on the global economy in the second and third quarters. On so-called "Liberation Day" on April 2, the Trump administration announced a number of new import tariffs on nearly all countries, which resulted in major uncertainty for companies and increased volatility on the financial markets (Figure 3). Numerous trade partners

Figure 3

Global economic policy uncertainty and US tariffs
Index in points (left axis) and average tariff rates in percent (right axis)



Note: As of May 31, 2025.

Sources: Tax Foundation; Economic Policy Uncertainty; authors' depiction.

Uncertainty due to US tariff policy has skyrocketed worldwide.

enacted countermeasures, which further increased global trade barriers. While most of the newly announced reciprocal tariffs were suspended shortly after, a baseline tariff rate of ten percent remains. Thus, a trade regime has emerged that is significantly weighing on global goods traffic and companies' ability to plan.

The tariff increases on April 2 also led to a noticeable downturn in global economic sentiment; key early indicators responded by plummeting. The global Purchasing Managers' Index for services temporarily declined by 1.8 points between March and April before climbing back up to 52 points in May, thereby remaining above the expansion threshold. Business-related service providers in particular suffered due to the heightened uncertainty as a result of the exacerbated trade conflicts. In April, the global Purchasing Managers' Index for the manufacturing sector fell below the 50-point threshold and continued to fall in May. While the index stabilized in May in the euro area and the United States, it declined significantly in China.

Overall, the leading indicators are signaling that the weak economic development will continue on into the second quarter. This forecast assumes that the US tariff structure currently in place will apply over the entire forecast period (Box 1). This includes universal ten-percent import tariffs, 40-percent tariffs on China, and 25-percent tariffs on certain groups of products such as vehicles, vehicle parts, steel, and aluminum.[3] Despite already having been decided and announced, further punitive tariffs are currently suspended. This forecast assumes that these tariffs will remain permanently suspended, as implementing them subsequently is not considered politically realistic. Retaliatory ten-percent tariffs from China on all US imports as well as the countermeasures of other vehicle-exporting countries have already been enacted and are included in the baseline scenario. It is assumed that from July 2025, the European Commission will also take countermeasures, which are expected to be targeted and moderate and, thus have limited effects on the domestic economy.[4]

Overall, global economic development should be weak in the second quarter. Earlier-than-planned purchases from the United States are still expected, but to a lesser extent than in the first quarter of the year. Global GDP is projected to increase by only 0.7 percent quarter-on-quarter, primarily due to a cooling in emerging economies.

Weaker growth is expected in most advanced economies too, with the exception of the United States, where an increase of 0.4 percent in economic output is expected. This increase is likely due to private consumer spending occurring earlier than expected, triggered by concerns about higher US tariffs and related price increases. The euro area economy should only stagnate in the second quarter. Spain is likely to remain one of the main drivers of growth, supported by robust consumption, with an expected growth rate of 0.5 percent, while France will probably continue to show little progress.

Fiscal policy to support economy in 2026

Over the further course of the forecast, it is expected that the global economy will continue to lose momentum during the year before recovering gradually in 2026. Primarily trade barriers and related uncertainty will weigh on economic activity in 2025.

Fiscal policy, which is expansionary in many places, should counteract this somewhat, supporting overall economic demand. In the euro area, fiscal policy is considerably more expansionary than it was at the beginning of the year. The comprehensive German investment packages as well as increases to defense expenditure—made possible by relaxed fiscal regulations—contributed to this significantly. The investment packages and defense expenditure increases are due to the new security policy landscape that has emerged as a result of the Russian attack on Ukraine as well as growing uncertainty about the role of the United States as a reliable security partner for Europe. While these fiscal policy measures will probably stimulate the economy to a considerable extent, the economic effect should take some time to become noticeable. At the same time, high debt levels

3 There are currently 50-percent import tariffs on aluminum and steel. This forecast assumes a tariff concession will be made and the tariffs will be lowered to 25 percent.

4 Cf. European Commission, "Reaktion auf US-Zölle: Kommission startet Konsultation," press release from May 9, 2025 (in German; available online).

Table 2

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	0.6	1.0	1.5	1.8	6.4	2.6	2.5	2.3	6.1	6.0	5.8	5.8
Euro area	0.6	0.8	1.3	1.3	5.4	2.4	2.2	2.0	6.6	6.4	6.2	6.2
excluding Germany	1.2	1.4	1.2	1.3	5.0	2.2	2.0	1.9	8.3	7.8	7.5	7.5
France	1.1	1.1	0.6	1.2	5.7	2.3	1.7	1.8	7.3	7.4	7.4	7.5
Italy	0.8	0.5	0.7	0.9	5.9	1.1	1.8	1.9	7.7	6.6	6.3	6.3
Spain	2.7	3.2	2.4	2.1	3.4	2.9	2.3	1.9	12.2	11.4	10.5	10.2
Netherlands	0.1	1.0	1.4	1.1	4.1	3.2	3.0	2.0	3.6	3.7	3.7	3.6
United Kingdom	0.4	1.1	1.3	1.4	7.3	2.5	3.2	2.4	4.1	4.3	4.4	4.3
Switzerland	0.7	1.3	1.1	1.2	2.1	1.1	0.3	0.9	4.0	4.3	4.6	4.3
Central and Southeastern Europe	0.6	1.9	2.5	3.3	11.5	4.0	3.9	3.3	3.6	3.7	3.6	3.5
Turkey	5.1	3.2	2.8	3.1	54.0	58.5	36.9	29.8	9.4	8.7	8.4	8.5
Russia[1]	3.9	4.4	1.5	1.0	5.9	8.5	9.8	7.9	3.2	2.5	2.4	2.4
The Americas												
USA	2.9	2.8	1.4	1.6	4.1	3.0	2.8	2.5	3.6	4.0	4.3	4.5
Mexico	3.4	1.2	−0.4	0.9	5.5	4.7	3.8	3.1	2.8	2.7	3.4	3.8
Brazil	3.2	2.9	1.8	1.9	4.6	4.4	5.3	3.8	8.0	6.9	6.9	7.0
Asia												
Japan	1.4	0.2	0.7	0.6	3.3	2.7	2.7	1.7	2.6	2.5	2.4	2.3
South Korea	1.4	2.1	0.9	2.2	3.6	2.3	2.5	1.9	2.7	2.8	2.9	3.0
China	5.4	5.0	4.3	3.9	−1.7	0.0	0.1	1.1	5.2	5.1	5.2	5.1
India	8.8	6.9	6.3	6.5	5.7	4.9	4.1	4.4	8.1	8.0	7.9	7.7
Total												
Advanced economies	1.8	1.9	1.3	1.5	4.6	3.3	3.0	2.5	4.4	4.5	4.5	4.6
Emerging economies	5.8	5.1	4.4	4.3	4.2	5.7	5.4	5.4	6.2	6.0	6.0	5.9
Global economy	4.2	4.0	3.3	3.4	4.2	3.9	3.8	3.6	5.8	5.7	5.7	5.7
For reference:												
Export weighted[2]	*3.1*	*2.9*	*2.4*	*2.5*								
GDP weighted in USD[3]	*3.4*	*3.1*	*2.7*	*2.7*								

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 2024.
3 World weighted with the GDP in USD from 2023 to 2026.

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

Sources: National Statistical Offices; DIW Berlin Economic Outlook Summer 2025.

in countries such as France and Italy are forcing governments to consolidate further, dampening overall European growth. In the United States, the United Kingdom, Japan, and China, fiscal policy is likely to be expansionary and support the global economy.

In addition, monetary policy should stimulate the economy: Due to an easing of monetary policy, financing conditions have improved worldwide and are thus supporting investment activity. The deposit rate, which was gradually lowered by the European Central Bank (ECB) to 2.0 percent in spring 2025, can now be considered neutral. Further decreases are not expected. In contrast, the Bank of England and Central Bank of India are expected to continue lowering interest rates. In China, monetary policy should remain expansionary so as to counteract deflationary tendencies and the weak domestic economy. US monetary policy, in turn, is expected to remain restrictive despite inflation recently falling to 2.3 percent, as tariff increases have an inflationary effect in the short term. As a consequence, inflation in the United States is expected to be 2.8 percent in 2025, while it should fall to 2.2 percent on average for the euro area, primarily supported by considerably lower energy prices. Since the beginning of the year, both oil and wholesale prices for gas have fallen noticeably. Global food prices are expected to continue on a downward growth trend.

Despite the economic slowdown, labor markets have remained solid and should contribute significantly to robust consumption together with falling energy prices. In contrast, however, heightened foreign economic uncertainties may negatively affect investment activity.

The US economy in particular will probably be affected, where comparatively weak growth of 1.4 percent (Table 2) is expected in 2025. Only a slight increase to 1.6 percent is expected in 2026. In the euro area, growth of 1.3 percent is expected in both 2025 and 2026. Private consumption and investments should support growth in 2025, while fiscal stimuli from Germany should support growth in 2026.

The situation remains varied throughout the emerging economies. Growth momentum in China is expected to continue to decline due to persistently weak domestic demand and trade barriers with the United States. The Mexican economy is also likely to be negatively affected by the higher tariffs. In contrast, growth should remain strong in India, in part because India, as an alternative production location to China, may benefit from global location shifts. Robust growth should continue in central and southeastern European countries.

Overall, advanced economies are projected to grow by 1.3 percent and emerging economies by 4.4 percent in 2025. The global economic growth rate is expected to be 3.3 percent in 2025, while 3.4 percent is expected for 2026 (Table 2). Thus, the forecast is 0.2 percentage points weaker for both 2025 and 2026 each compared to the spring forecast, primarily due to the increase in trade barriers and the related uncertainties.

The global economic outlook remains subject to significant risks. The largest downside risk is from US trade policy; further measures that have been announced, such as a 50-percent tariff on all EU imports, could exacerbate trade barriers. This would negatively affect the economic development of countries with close economic ties to the United States, such as Germany, Italy, and the Netherlands.

A further risk is posed by high national debt, especially in the United States. There, the government is planning to extend existing tax cuts and introduce new ones, despite a debt level of over 120 percent of GDP. These measures are partially mitigated by savings in other areas, for example through cuts to climate-friendly investment programs and additional revenue from the tariff increases. The Congressional Budget Office, however, estimates that the United States' national debt will continue to rise. Rising debt leads to growing doubts about fiscal sustainability. These doubts have already recently been reflected on the bond markets, which have responded with increased risk premia: Thirty-year government bonds temporarily traded above five percent in May. Due to the role of US government bonds as a global secure investment, a further loss of confidence in the United States as a reliable debtor could lead to turmoil on the worldwide financial markets.

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

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

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

Hella Engerer is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in Central and Southeastern Europe | hengerer@diw.de

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

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

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

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

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

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

Hannah Magdalena Seidl is Head of the global economic forecast and a Research Associate in the Macroeconomics Department at DIW Berlin | hseidl@diw.de

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

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

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