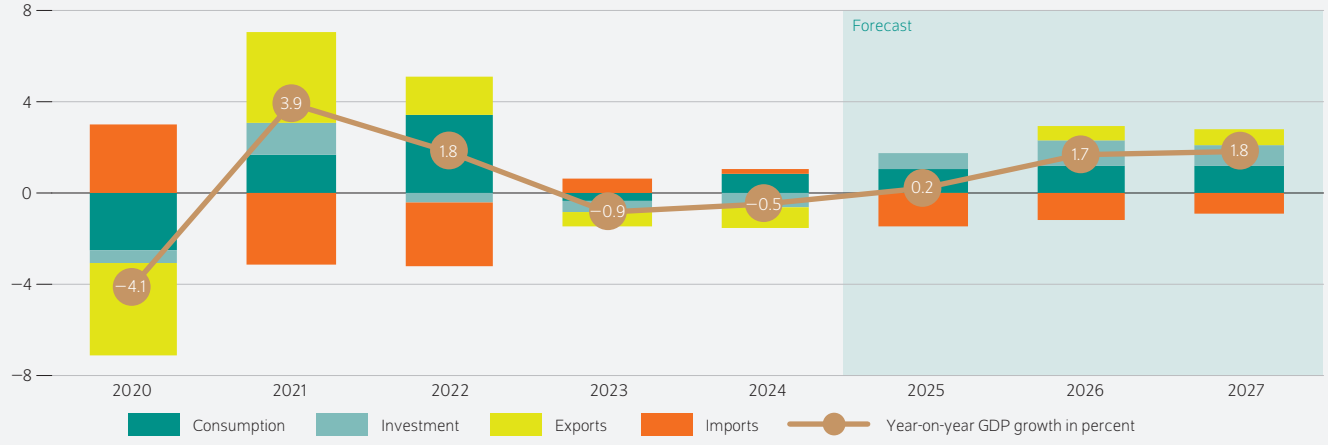
AT A GLANCE

German economy poised for upturn thanks to fiscal package; uncertainties in the global economy

By the DIW Berlin Economic Forecasting Team

- German economy emerging from economic slump; after a bumpy start to the year, things are slowly looking up; small growth of 0.2 percent expected this year
- Upturn imminent thanks to fiscal package for infrastructure and climate protection, higher defense spending and tax incentives for investment
- Economic output expected to rise by 1.7 percent in 2026 and 1.8 percent in 2027
- Growth mainly supported by domestic demand, with foreign trade losing importance; structural problems in the German economy remain
- International environment characterized by uncertainty, US tariffs weigh on many areas; global economy expected to grow by 3.7 percent in 2025, 3.3 percent in 2026, and 3.5 percent in 2027

Government consumption and investment providing major boost to the German economy
Individual components' contribution to overall GDP growth in percentage points



Source: DIW Economic Forecast Autumn 2025.

© DIW Berlin 2025

FROM THE AUTHORS

"The German economy is, unusually, not recovering from strong foreign trade, but rather from domestic activity, especially the expansion of the public sector. The positive effect of the massive public funds will mask the structural growth problems in Germany over the coming years."

— Geraldine Dany-Knedlik —

MEDIA

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

German economy poised for upturn thanks to fiscal package; uncertainties in the global 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, Kristin Trautmann, and Jana Wittich

EXECUTIVE SUMMARY

The German economy is slowly emerging from its trough. After a bumpy start to the year, which was marked by tariff-related special effects, growth in 2025 remains subdued at 0.2 percent. However, the economy is gradually picking up speed from the current third quarter onwards. Over the next two years, this will translate into noticeable economic growth of 1.7 and 1.8 percent annually, respectively.

The main drivers are the extensive fiscal package for infrastructure and climate protection, higher defense spending and tax incentives for corporate investment. These are primarily stimulating government consumption and investment, even if—as assumed in this forecast—the funds are disbursed at a slower rate than estimated in the federal government budget draft. However, as production capacities are currently underutilized, there is at least a chance that planned projects will be implemented quickly. Nevertheless, the expansionary fiscal policy only masks the structural weaknesses of the German economy. Industry is in crisis: High production costs, dwindling competitiveness, and demographic trends are slowing momentum. Traditionally strong foreign trade is losing importance, as growth is mainly supported by the domestic economy. Private consumption continues to grow, albeit at a subdued pace. While the persistently high level of unemployment and the associated job loss concerns have a dampening effect this year, a more favorable situation on the labor market should restore confidence from 2026 onwards. Rising real wages and lower inflation will also support consumption. Consumer price inflation is expected to be 2.1 percent in 2025. In 2026, it is likely to be in line with the European Central Bank's target of 2.0 percent before rising slightly to 2.2 percent in 2027 as a result of expansionary fiscal policy.

After exports to the United States were brought forward at the beginning of the year due to fears of tariffs threatened by US President Trump, a slump followed when the new trade barriers came into force. Although the provisional agreement between the EU and the US has stabilized the situation somewhat and reduced uncertainty, the ongoing trade barriers and the comparatively strong euro will continue to weigh on German exports. Robust demand from European partner countries provides some relief.

The international environment is still characterized by considerable uncertainty. The US government's tariff policy is weakening global trade and increasingly affecting the United States itself. In China, the real estate crisis and structural problems are weighing on growth. Emerging markets remain the engine of the global economy, while advanced economies are faltering. Overall, the global economy is expected to grow by 3.7 percent in 2025, 3.3 percent in 2026, and 3.5 percent in 2027.

DOI: https://doi.org/10.18723/diw_dwr:2025-36-1

Public spending concealing structural problems of German economy

The German economy is gradually emerging from its slump. Although the recession since the onset of the energy crisis has been more pronounced than initially anticipated,[1] the German economy does not have to write off recovery. Overshadowed by a volatile foreign trade due to tariff uncertainty, the domestic economy is showing signs of a moderate rebound in 2025, which is projected to gather considerable momentum in the years ahead. This upturn is driven by enormous fiscal packages for infrastructure and climate protection, defense spending, and incentives for private investment activity. However, these measures will not bring about the urgently needed structural transformation, as the competitiveness of German industry is likely to continue declining and foreign trade is expected to remain subdued.

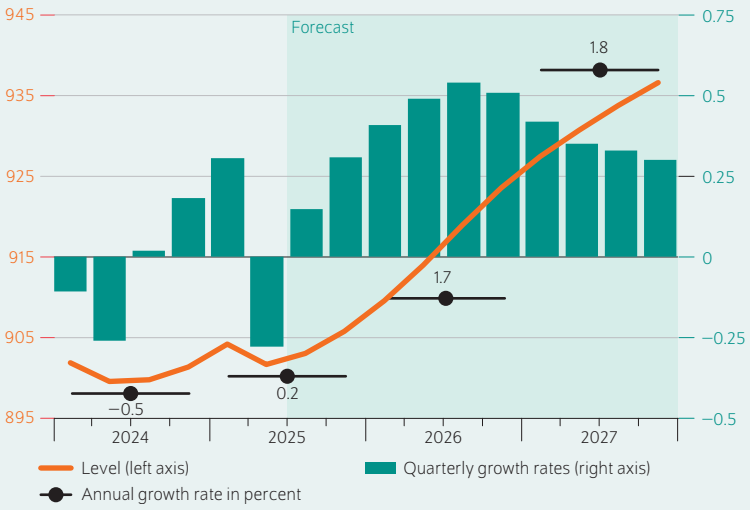
Tariff chaos exaggerates dynamics in first half of 2025

After noticeable growth at the start of the year, gross domestic product (GDP) declined by 0.3 percent in the second quarter (Figure 1).[2] However, this development is likely at least partially amplified by the effects of the US government's trade policy. The first quarter was dominated by US President Trump's threats to impose massive import tariffs on global trade with the United States, which triggered a surge in advance shipments to the US. German exports grew strongly as a result, with motor vehicles and pharmaceuticals in particular being exported to the US. In the second quarter, with the introduction of high tariff rates, a backlash followed: dominated by a collapse in exports to the US, exports of goods "Made in Germany" fell noticeably by 0.6 percent between April and June compared with the previous quarter. Exports of chemical products and machinery were most strongly reduced. A robust expansion in goods exports to other European countries, which account for two-thirds of total German exports, cushioned the decline. This was accompanied by robust growth in service exports, so that overall, German exports recorded only a slight drop in the second quarter (Table 1). Imports—particularly of goods—meanwhile expanded considerably, with both investment and consumer goods contributing to the strong momentum.

Figure 1

Real GDP in Germany

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



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

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2025.

© DIW Berlin 2025

After a noticeable increase at the beginning of the year, German economic output declined again in the second quarter.

Overall, this resulted in a negative net export contribution for the second quarter (Table 2).

The domestic economy also showed weaker performance in the second quarter than at the beginning of the year (Figure 2). While the sustained recovery in private consumption has been supporting the German economy for more than a year, it has recently slowed somewhat:[3] Rising job concerns due to persistently high unemployment and slowing wage growth appear to have dampened consumer sentiment in the past quarter (Table 3). As a result, private consumption spending increased only modestly. The savings rate, after having dropped sharply at the turn of the year, remained broadly stable at its long-term average of 10.2 percent.

While consumption—also supported by high public spending—bolstered GDP overall in the second quarter, investment activity declined markedly over the same period. Both equipment and construction investment recorded sharp declines. The former was driven by a double-digit contraction

1 According to the latest data from the German Federal Statistical Office, GDP has not declined only slightly over the past two years (by 0.3 and 0.2 percent, respectively), as previously estimated, but significantly (by 0.9 and 0.5 percent, respectively). The main reasons for the significant revisions were, on the one hand, the incorporation of new information from structural statistics, which contain detailed data from companies on turnover, investments, and cost structures, but are only available 18 months after the end of a reporting year. Secondly, the price adjustment was revised using new data from the input-output accounts, which resulted in a reassessment of companies' production values and intermediate consumption in particular. See Statistisches Bundesamt (2025): Sommerüberarbeitung 2025 der Volkswirtschaftlichen Gesamtrechnungen – Revisionen und Hintergründe (available online; accessed on 29 August 2025. This also applies to all other online sources in this report, unless otherwise noted).

2 Detailed figures on the forecast for the German economy can be found in the online appendix at www.diw.de/konjunkturzahlen.

3 The data revision by the Federal Statistical Office shows that private consumption, given the strong increases in real wages, grew more strongly in 2024 than initially estimated.

Table 1

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

	2024				2025				2026				2027			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	0.4	0.1	0.2	0.4	0.6	0.1	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Government consumption expenditure	0.0	1.8	1.0	0.5	−0.3	0.8	0.7	0.7	0.7	0.7	0.8	0.7	0.6	0.5	0.5	0.5
Gross fixed capital formation	−0.6	−1.6	−0.5	0.6	0.3	−1.4	0.9	1.0	1.2	1.4	1.5	1.3	1.0	0.8	0.7	0.7
Construction	0.5	−1.7	−0.7	0.7	0.2	−2.1	0.8	0.7	0.8	1.0	1.1	1.0	1.0	0.9	0.8	0.8
Equipment	−0.9	−3.1	−1.0	0.0	0.2	−1.9	1.1	1.5	1.8	1.9	2.1	1.7	1.0	0.6	0.3	0.3
Other fixed assets	−3.1	1.2	0.9	1.1	0.6	1.2	0.7	1.0	1.3	1.5	1.5	1.3	1.2	1.0	1.0	1.0
Inventory changes[1]	0.2	0.0	0.6	0.7	−0.4	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic demand	0.2	0.1	0.9	1.2	−0.1	0.4	0.4	0.5	0.5	0.6	0.6	0.6	0.5	0.4	0.4	0.4
Net exports	−0.3	−0.3	−0.8	−1.0	0.4	−0.7	−0.2	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1
Exports	−1.0	0.6	−1.7	−2.1	2.5	−0.1	−0.1	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Imports	−0.3	1.5	0.2	0.2	1.6	1.6	0.5	0.6	0.6	0.7	0.7	0.6	0.5	0.5	0.5	0.5
GDP	−0.1	−0.3	0.0	0.2	0.3	−0.3	0.1	0.3	0.4	0.5	0.5	0.5	0.4	0.4	0.3	0.3
Gross value added	−0.8	−0.2	−0.4	−0.3	0.6	−0.2	0.1	0.3	0.4	0.5	0.5	0.5	0.4	0.4	0.3	0.3
Manufacturing	−1.5	−0.8	−1.4	−0.9	1.6	−0.3	0.1	0.2	0.3	0.4	0.4	0.4	0.3	0.2	0.2	0.2
Construction	1.0	−2.0	−2.1	−1.3	1.3	−3.7	0.8	0.8	0.8	1.0	1.1	1.0	1.0	0.9	0.8	0.8
Trade, hospitality, transport	−0.7	−0.5	0.2	0.3	0.7	−0.6	0.1	0.2	0.3	0.5	0.5	0.5	0.4	0.4	0.3	0.3
Business services	0.1	0.5	−0.6	−0.6	−0.3	0.5	0.0	0.3	0.4	0.5	0.5	0.5	0.4	0.3	0.3	0.3
Public services, education, health	0.6	0.8	0.4	0.4	0.4	0.1	0.2	0.3	0.5	0.6	0.7	0.6	0.6	0.5	0.4	0.3

1 Contribution to growth in percentage points.

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

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2025.

© DIW Berlin 2025

in public investment in equipment, likely reflecting delays in the manufacture and delivery of military goods already ordered. Developments in the construction sector were marked by renewed steep declines in private investment in residential and commercial buildings. The persistently weak economic environment and the associated concerns about jobs and business locations have likely been decisive here. Uncertainties about the economic policy framework probably also played a role, deterring households from new construction projects and companies from expanding capacity. Only investments in other assets, which include expenditure on research and development, expanded, particularly in the public sector.

The development of the expenditure components was also reflected in the production figures for the second quarter: Value added in the industrial sector declined noticeably once again, with the construction industry recording a particularly deep slump. The decrease was more moderate in the manufacturing sector. In the service sector, the picture was mixed: While consumer-related service providers recorded negative rates, output from public service providers once again increased slightly, and output from business service providers grew surprisingly strongly.

Third quarter: strong state, meager private sector

The European Union (EU) and the Trump administration made significant progress in the tariff dispute during the summer months. Although the terms are disadvantageous for European countries in many respects compared to the US, the preliminary agreement is nonetheless expected to reduce uncertainty and stabilize foreign trade with the US. The German automotive industry in particular can look forward to significant relief compared to the tariff increase in the spring: Tariffs on automobile imports into the US will fall from 27.5 to 15 percent. The Trade Policy Uncertainty Index, a text-based uncertainty indicator derived from American daily newspapers, declined noticeably in August.[4] Although tariffs on typical German exports are lower on average than those of other export-oriented countries (Box 1), the German export industry is unlikely to benefit from this on the US market. Although tariffs are lower compared with Asian products, the weak exchange rate between the US dollar and the euro (Box 2) largely offsets the relative price advantage.

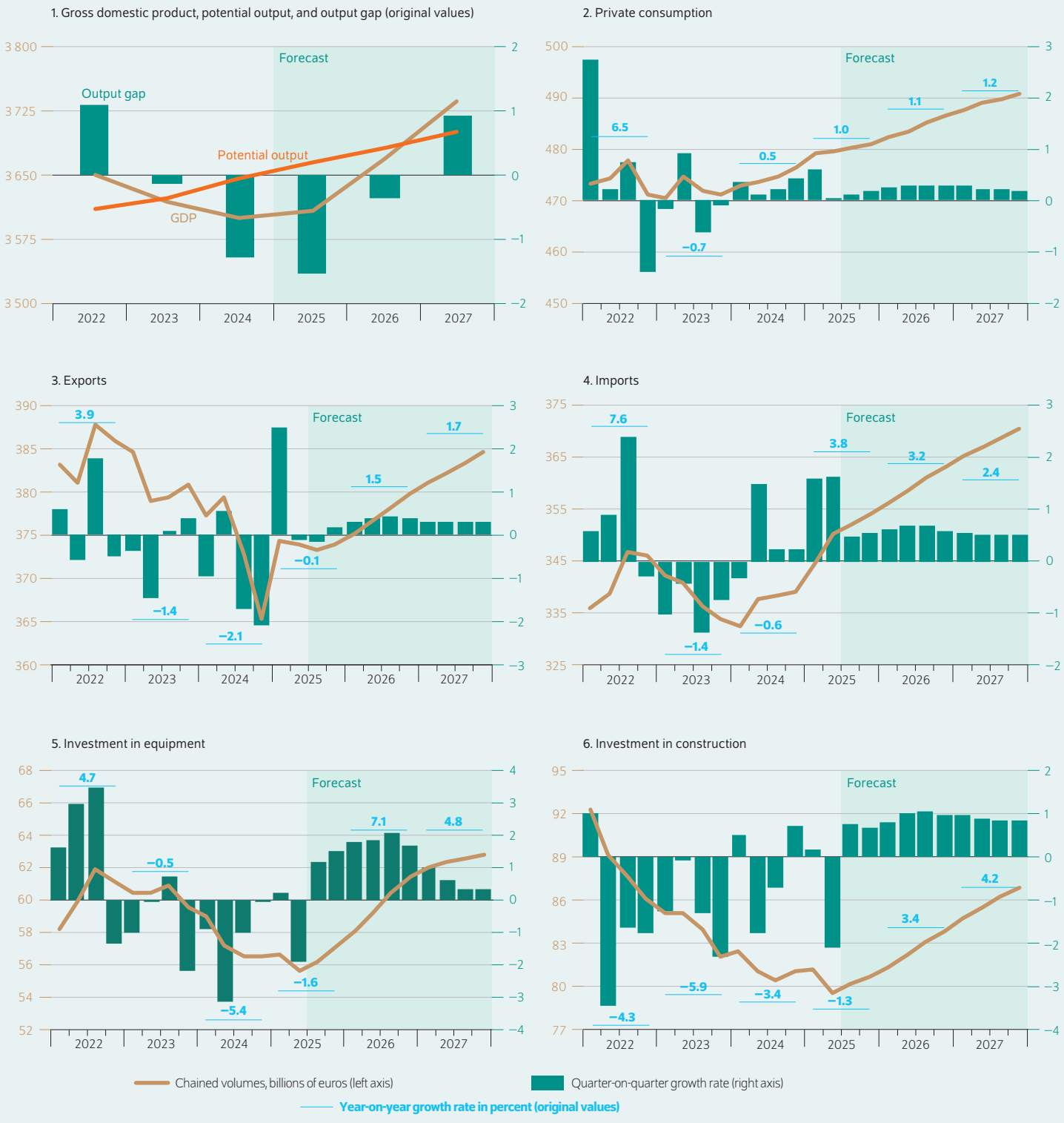
Meanwhile, the spending and incentive programs of the new federal government's fiscal stimulus package are becoming increasingly concrete. In the summer, the federal cabinet approved the federal budget for 2025 and 2026, with ambitious schedules for government investment and consumption spending. In addition, there are incentive programs

4 Economic Policy Uncertainty (2025): Trade Policy Uncertainty (available online).

Figure 2

GDP and important components

Seasonally, calendar, and price-adjusted development



Note: Forecast from the third quarter of 2025; adjusted for price, seasonal, and calendar effects (quarterly series) and price effects (annual series), respectively.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2025.

© DIW Berlin 2025

Table 2

Contributions to GDP growth in Germany

In percentage points (price-adjusted)

	Contributions to growth			
	2024	2025	2026	2027
Consumption expenditures	0.8	1.0	1.2	1.2
Private households	0.3	0.5	0.6	0.6
Government	0.6	0.5	0.6	0.6
Gross fixed capital formation	−0.7	−0.1	1.0	0.9
Construction	−0.4	−0.1	0.4	0.4
Equipment	−0.4	−0.1	0.4	0.3
Other fixed assets	0.0	0.1	0.2	0.2
Inventory changes	0.1	0.8	0.1	0.0
Domestic demand	0.2	1.7	2.3	2.1
Net exports	−0.7	−1.5	−0.6	−0.2
Exports	−0.9	0.0	0.6	0.7
Imports	−0.2	1.4	1.2	0.9
Gross domestic product[1]	**−0.5**	**0.2**	**1.7**	**1.8**

1 Year-on-year change in percent; any deviation in the totals is due to the rounding of the figures.

Note: Forecast from 2025 onward.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2025.

© DIW Berlin 2025

Table 3

Key economic indicators for the German economy

	2024	2025	2026	2027
GDP[1]	−0.5	0.2	1.7	1.8
Employment[2] (1,000 persons)	45,987	46,002	46,023	46,071
Unemployed (1,000 persons)	2,787	2,946	2,890	2,731
Unemployment rate[3] (BA concept, in percent)	6.0	6.3	6.2	5.8
Consumer prices[4]	2.3	2.1	2.0	2.2
Unit labor costs[5]	5.6	3.7	1.8	1.6
Government budget balance[6]				
in billions of euros	−115.3	−106.1	−149.5	−167.7
in percent of nominal GDP	−2.7	−2.4	−3.2	−3.5
Current account balance				
in billions of euros	243.8	219.1	204.7	192.1
in percent of nominal GDP	5.6	4.9	4.4	4.0

1 Price adjusted. Year-on-year percentage change.
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, ESVG).

Note: Forecast from 2025 onward.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2025.

© DIW Berlin 2025

Box 1

Assumptions on tariffs

Trade barriers have continued to increase since the beginning of the second quarter of 2025. On April 2, President Trump announced, on what he called "Liberation Day," country-specific and cross-product base tariffs for more than 100 trading partners, which took effect immediately. For example, base tariffs of 34 percent and 20 percent were imposed on goods from China and the EU, respectively. This move caused turbulence in the stock and bond markets, which likely contributed to the US government temporarily suspending many of the very high tariffs on April 9. For instance, the base tariff on imports from the EU was reduced from 20 to 10 percent for 90 days.

During the summer, the US reached initial preliminary agreements in trade policy with, among others, the EU, China, and Japan. At the same time, the US government put pressure on other countries such as Brazil and India with massive increases in import tariffs.

This forecast assumes that both the existing agreements and the currently applicable preliminary trade barriers will remain in place (Table). Compared to the trade barriers assumed in the summer forecast, the global tariff burden has increased. The universal US tariffs on imports from Europe, Canada, Japan, and South Korea have risen. In addition, US tariffs on aluminum and steel now also apply to more than 400 additional products containing aluminum and steel.

The progress and agreements in trade negotiations between the US and major economies such as China and the EU have significantly reduced uncertainty regarding trade policy conditions. Nevertheless, US trade policy remains unpredictable, also because no concrete binding agreements have been concluded yet.

The agreement has not reversed the sharp appreciation of the euro since the tariff announcements on Liberation Day; the expected economic slowdown in the US may also have contributed to this. The stock markets have recovered their losses around Liberation Day and are once again trading at record levels.

for corporate investment, such as tax relief and accelerated depreciation, some of which will take effect retroactively once the budget law for 2025 is passed by the *Bundestag* in mid-September, thus ending the provisional budget management (Box 3).

Thus, the stage is set for a recovery of the German economy. The cautiously positive sentiment among domestic companies is currently solidifying. The ifo Business Climate has risen for the fifth consecutive time in August. The current situation in particular is being assessed more positively than before. Optimism is especially evident among manufacturing

It can be assumed that the erratic US trade policy will continue to shape trade flows and global production in the second half of the year. Above all, the negative consequences of the tariff conflict are likely to become more pronounced and dampen world trade, as many strategies to avoid tariffs, such as front-loading deliveries, are no longer available.

Trade policy conditions for the EU and Germany

On July 27, 2025, the EU and the US agreed on key points for a future trade agreement. In the declaration announced by the EU, there are a number of specific immediate measures and some additional measures. However, the latter still lack concrete details and a legal basis, meaning they are not included in the assumptions of this forecast and only the immediate measures are considered.

The immediate measures include the introduction of a uniform tariff ceiling of 15 percent for almost all EU exports to the US. This represents relief for cars and auto parts, which were recently subject to tariffs of up to 27.5 percent. For German foreign trade in particular, which is strongly shaped by the automotive industry, this represents an easing. For other strategically important products such as aircraft or chemicals, tariffs are to return to their pre-January 2025 levels. In addition, the maximum rate of 15 percent is also to apply to tariffs on pharmaceuticals and semiconductors even if these were to fall under trade measures for reasons of national security.[1]

The further measures, which still need to be specified, include tariff-rate quotas that would allow imports of specified quantities of steel, aluminum, and copper into the US at a significantly lower tariff than the current 50 percent. At the EU level, market openings are also being considered, such as the complete abolition of existing EU tariffs on US industrial goods or the adjustment of tariff-rate quotas for US fishery and agricultural products.

Another measure to improve medium- to long-term trade prospects is the mutual reduction of non-tariff trade barriers, for example in the area of vehicle standards or cooperation on investment screening and export controls. In addition, the EU has offered energy imports from the US worth 750 billion US dollars (LNG, oil, nuclear energy), as well as the purchase of AI chips worth 40 billion US dollars and additional private investments in the U.S. totaling 600 billion US dollars by the end of 2028.

Table

Trade policy assumptions

Tariff-imposing Country	Trading Partner	Tariff Rate/Remark
USA	EU	Flat tariff rate of 15 percent; only steel, aluminum, copper, and their derivatives taxed at 50 percent
USA	China	Average tariff rate of 40 percent Suspension of tariffs above 100 percent until November 10, 2025
USA	Mexico	25 percent, except for USMCA-compliant trade
USA	Canada	35 percent; 10 percent on energy and potash, except for USMCA-compliant trade
USA	United Kingdom	Base tariff rate of 10 percent; first 100,000 cars taxed at 10 percent
USA	Other countries	India and Brazil: 50 percent, Japan and South Korea: 15 percent, Switzerland: 39 percent, base tariff rate: 10 percent
USA	World	50 percent on steel and aluminum (including derivatives) and copper; United Kingdom excluded
Retaliatory tariffs		
China	USA	Selected goods taxed at 10 or 15 percent Suspension of tariffs above 100 percent until November 10, 2025
Canada	USA	25 percent on cars, steel, and aluminum (originally about 29.8 billion Canadian dollars worth of goods affected, some measures now lifted)

Source: DIW Economic Forecast, Autumn 2025.

© DIW Berlin 2025

1 Section 232 is a provision in the U.S. Trade Expansion Act of 1962 that allows the President of the United States to take trade measures for reasons of national security—in particular, tariffs on imports if they are considered a threat to domestic industry or infrastructure. The US Department of Commerce conducts an investigation into whether certain imports endanger national security. If so, the President can impose tariffs or other trade restrictions—without the approval of Congress.

firms, while confidence in the service sector has subsided slightly. This trend is mirrored in the Purchasing Manager Index: The industrial index has been steadily approaching the 50-point expansion mark since the start of 2025 and is now just below it, while the service sector index has just fallen below the expansion threshold.

The German economy is projected to grow slightly by 0.1 percent in the third quarter of 2025, with manufacturing expanding modestly and construction more noticeably. Services are also likely to contribute positively to economic output (Table 1).

Modest growth in the third quarter is likely to be driven by public spending. Government consumption is expected to continue expanding strongly due to further employment growth in the public service sector and rising purchases of intermediate goods, including for defense. Following the decline in the second quarter, government investment is also set to pick up again, as defense equipment ordered under the *Bundeswehr* special fund is delivered and existing infrastructure projects, such as the expansion of the rail network, take shape.

Box 2

Assumptions and framework conditions

The forecast is based on assumptions regarding the development of key interest rates, exchange rates, and commodity prices (Table). These assumptions are derived from past developments, futures market prices, and closing levels as of the cut-off date for the forecast on August 14, 2025. Inflation in the euro area stands at two percent, thus matching the ECB's inflation target. Against this background, the ECB Governing Council left interest rates in the euro area unchanged in its latest decision, at 2.0 percent (deposit facility) and 2.15 percent (main refinancing rate). Monetary policy in Europe can therefore now be considered neutral.[1] In this forecast, it is assumed that interest rates will remain at their current levels until the end of the forecast horizon. Accordingly, the monetary policy assumptions are unchanged compared with DIW Berlin's summer economic forecast.

In line with the key interest rates, money market rates have steadily declined and, linked to the key interest rates, are now expected to remain at just below two percent. A similar tendency can be observed in falling refinancing costs for companies and borrowing costs for households. Due to the time lag of monetary policy effects, the forecast assumes that lending rates will continue to fall even after the end of monetary easing.

Similar to DIW Berlin's summer 2025 forecast, capital market interest rates are expected to remain largely unchanged over the forecast horizon at 2.7 percent for Germany and 3.2 percent for the euro area. The euro has recently appreciated against the dollar. It is assumed that the exchange rate will remain at the level reached at the data cut-off date—1.17 US dollars per euro—slightly higher than assumed in the summer.

The price of Brent crude oil surged in May due to the Israel–Iran conflict, but has since declined, particularly as a result of increased supply from OPEC+. Based on futures prices, it is assumed that the price of crude oil will only fall slightly and will average around 69 US dollars per barrel in the current year, and around 65 US dollars per barrel in each of the next two years. Compared with the summer, this means oil prices assumed for 2025 and 2026 are about six percent and five percent higher, respectively.

Wholesale gas prices (TTF) fell sharply in the first half of the year and have stabilized since the summer. Price expectations have not changed since the DIW Berlin summer forecast and average 38 euros per megawatt hour in 2025. In 2026 and 2027, they are expected to fall to around 33 euros and 30 euros per megawatt hour, respectively. This forecast is also based on assumptions regarding trade policy.[2]

Table

Forecast assumptions

		2024	2025	2026	2027
ECB deposit facility[1] (year end)	Percent	3.0	2.0	2.0	2.0
ECB key interest rate (year end)	Percent	3.2	2.15	2.15	2.15
Money market interest rate	Three-month EURIBOR in percent	3.6	2.1	1.9	2.1
Capital market interest	Yield on euro-area government bonds with a remaining term of ten years	3.0	3.1	3.2	3.2
Capital market interest	Yield on German government bonds with a remaining term of ten years	2.4	2.6	2.7	2.7
Exchange rate	USD/EUR	1.08	1.15	1.17	1.17
Crude oil price	USD per barrel	79.7	69.4	65.2	65.1
Gas price	EUR per megawatt hour	34.5	38.1	33.4	29.5

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 Autumn 2025.

© DIW Berlin 2025

1 Cf. European Central Bank (2024): Economic Bulletin Issue 1 (available online).

2 See also Box 1 in this report.

Private households and businesses are not expected to provide meaningful impetus for economic growth in the third quarter. Indicators of consumer sentiment continue to signal an increased propensity to save and a reduced willingness to spend among consumers. Due to the persistently difficult labor market situation, this reluctance is likely to persist and dampen private consumption. Business sentiment in the consumer-oriented retail sector and among consumer goods manufacturers has recently deteriorated slightly, pointing in the same direction. In addition, the labor income inequality nowcast suggests that households with medium to higher incomes have been the main beneficiaries of real wage gains in recent years (Box 4). However, these households respond to economic uncertainties with an increased propensity to save, likely limiting the positive effects on private consumption.

Although residential construction appears to have bottomed out, it is unlikely to make any great strides given the persistently low number of building permits and orders. On the corporate side, investment incentives are expected to take effect only gradually, implying that growth in commercial investment activity will remain modest in the current quarter.

The US government's restrictive trade policy will likely weigh more heavily on global trade in the third quarter, partly because short-term workaround strategies such as bringing forward deliveries have largely been exhausted.

This puts further pressure on German exports: According to ifo surveys, export expectations have recently deteriorated. In addition, the euro has appreciated consistently since the second quarter, reducing the competitiveness of German exporting companies. Meanwhile, the economic recovery in other European countries is projected to stabilize demand for German goods. Imports are likely to continue expanding robustly.

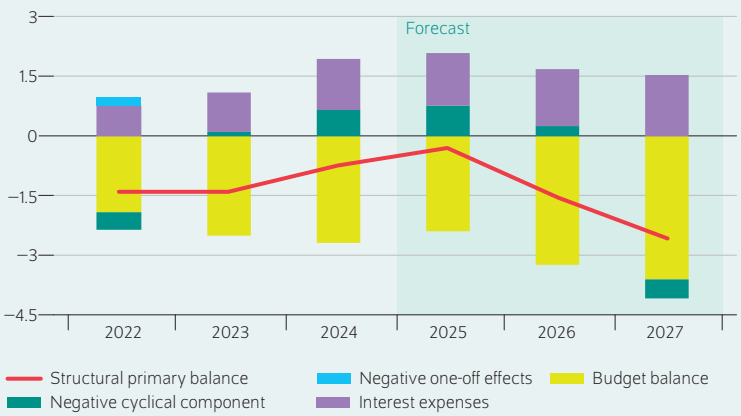
Recovery from 2026 owing to fiscal stimulus package

After a bumpy start to the long-awaited economic upturn, the German economy is expected to gain momentum over the forecast period. Although this forecast assumes lower outflows from special funds than envisaged in the federal budget,[5] rising expenditures in the coming years will still generate substantial growth in government consumption and investment. For 2026 and 2027, fiscal stimulus of around 33 billion and 21 billion euros is assumed, with around 22 billion and 13 billion euros coming from the special infrastructure fund and around 17 billion and 12 billion euros for additional defense spending. The difference from the total stimulus reflects small expiring expenditure measures and restrictive revenue-side effects, particularly higher social security contributions. Overall, fiscal policy will remain expansionary in the coming years, pushing the general government budget deficit from –2.4 percent of GDP in 2025 to –3.2 percent in 2026 and –3.5 percent in 2027. Adjusted for cyclical factors and interest payments, this results in a structural primary deficit relative to potential GDP of –0.4 percent in 2025, –1.5 percent in 2026, and –2.3 percent in 2027 (Figure 3).

In the upcoming quarters, the effects of expansionary fiscal policy will likely be primarily direct in nature. On the one hand, government consumption is expected to increase significantly, not only through new hires in the public sector in the areas of security and defense, but also through purchases of intermediate goods, for example for the planning and implementation of infrastructure and ecological transformation projects. In addition, investment in non-residential construction—particularly civil engineering, i.e., both analog and digital infrastructure—and equipment is also projected to increase. The rise in government demand for goods under the planned defense spending will mostly affect the relatively small German arms industry. Consequently, the impact on private equipment investment is likely to remain moderate, partly because arms manufacturers can repurpose at least some existing production facilities from other ailing industries.[6] On the other hand, the "investment booster" is

Figure 3

Structural primary balance
In percent (relative to nominal potential output)



Note: The structural primary balance is the sum of the columns. Forecast from 2025 onward.

Sources: Federal Statistical Office; DIW Berlin Economic Forecast Autumn 2025.

© DIW Berlin 2025

The structural primary deficit is growing over the forecast period.

expected to spur private purchases of machinery and equipment in the coming years. Financing costs are assumed to stay roughly at their current level, providing additional support for investment activity. Residential and commercial construction is also projected to pick up slightly.

Additional public spending is set to give a significant boost to the German economy from 2026 onwards. One factor is that the economy is currently operating well below capacity, leaving room for additional activity. This also applies to sectors that will be in particularly high demand, such as civil engineering. Over the forecast horizon, the economic upturn should stimulate the labor market, with unemployment projected to decline from the end of the year onwards. At the same time, real earnings and disposable income are likely to continue expanding robustly in the coming years, thereby boosting private consumption.[7]

The effects of fiscal stimulus measures merely mask the structural problems of the German economy, as these issues will persist throughout the forecast period. Rising international competition, high production costs, and demographic trends continue to restrain growth. The manufacturing sector and, by extension, foreign trade, are particularly affected and will likely lose further overall significance in the economy. While exports are expected to see a slight increase thanks to steady demand from European trading partners, their share of GDP is projected to continue declining. Imports, meanwhile, are likely to expand robustly, partly due to increased defense-related imports. Overall, foreign trade is projected

5 An examination of past special funds (such as the Energy and Climate Fund and the Digital Infrastructure Special Fund) indicates that at the start of new allocations, the amounts actually used are generally lower than the federal government's budget plans anticipate.

6 For example, at the beginning of 2025, the defense contractor KNDS took over a plant belonging to the train manufacturer Alstom in Görlitz, with plans to convert production there from train carriages to combat and armored personnel carriers by 2027. See Alstom press release dated February 5, 2025: Alstom and KNDS reach agreement: Bright future for Görlitz as an industrial location (available online).

7 The planned minimum wage increases to 13.90 euros per hour in January 2026 and 14.60 euros per hour in January 2027 are also likely to support real earnings.

Box 3

Assumptions on fiscal policy

Fiscal policy will remain expansionary throughout the forecast period (Table). This is mainly due to the use of expanded debt margins for infrastructure and defense. On the revenue side, however, slightly restrictive impulses are evident overall. While private households are relieved through income tax reductions and companies benefit from the investment acceleration program (*Investitionssofortprogamm*), rising social security expenditures exert significant pressure on contribution rates, meaning that companies, and, above all, households face considerable additional burdens.

On the revenue side, local authorities are generating additional income in 2025 from phasing out of pandemic- and energy price-related measures. The expiry of the inflation adjustment bonus will have a particularly noticeable effect here, at least to the extent that it is replaced by taxable wage components. Furthermore, the increase in the carbon tax in the heating and transport sectors at the end of 2026 will contribute to significant additional revenue. On January 1, 2027, it will be transferred to the corresponding European emissions trading system and its price will be determined by the market. To prevent excessive price increases, additional certificates are to be released if the price exceeds 45 euros. It is assumed that the carbon price will therefore rise moderately to around 70 euros per ton and generate robust additional revenue. The increase and expansion of the truck toll and tobacco tax implemented in 2024 will generate additional revenue, particularly in 2025. Moreover, at the initiative of the EU, a global minimum taxation and a plastic tax are being introduced, which will generate revenue for the first time in 2026.

In addition to adjustments to the income tax rate to offset bracket creep and increases in the basic and child allowances to exempt the minimum subsistence level from taxation, private households will also benefit from an increased commuter allowance in 2026. As part of the investment acceleration program, companies will benefit from the continuation and expansion of tax breaks for investments and research expenditure, as well as further tax relief, for example for the purchase of electric vehicles. In addition, agricultural businesses will be able to benefit from a reinstated agricultural diesel rebate in 2026 and—like companies in the manufacturing sector--from a permanent reduction in the electricity tax.

On the social security side, the elimination of the inflation compensation bonus will also result in significantly higher revenues in 2025. While this effect is considered temporary, rising social security contributions are sending restrictive signals across the entire forecast horizon. The average supplementary contribution to statutory health insurance in 2025 is 1.2 percentage points higher than in 2024 and is expected to increase by 0.3 percentage points in both 2026 and 2027. The contribution rate for statutory long-term care insurance has already been raised by 0.2 percentage points in 2025. Subsidies from the federal budget will stabilize it over the remainder of the year. A further increase in the contribution rate of 0.1 percentage points is assumed for both 2026 and 2027. Since the safeguard for the pension level has been extended until 2031 under the pension package, an increase in the contribution rate to statutory pension insurance is expected in 2027. Overall, fiscal policy on the revenue side is clearly restrictive in 2025 and will be neutral in 2026 and slightly restrictive in 2027.

On the other hand, the fiscal policy on the expenditure side of the government budget is clearly expansionary over the forecast horizon. Although the expiry of electricity and gas price caps in 2025 will continue to have a downward effect on expenditure, as will cuts in parental allowance, the *Startchancen* program and the continuation of the Germany-wide regional rail ticket (*Deutschlandticket*) will lead to additional expenditure, even though the latter is expected to see a price increase at the turn of 2026/27.

By far the greatest expansionary impulse comes from the increased scope for borrowing for infrastructure, climate protection, and defense. Among other things, the increased Climate and Transformation Fund (KTF) will be used to finance the gas storage levy in the 2025. Program expenditures are likely to remain stable in the coming years. Instead, expenditure from the special fund for infrastructure and climate protection, excluding the KTF top-up, will accelerate significantly, after being substantial this year but falling far short of a hypothetical equal distribution of the financial scope of 33 billion euros (400 billion euros without the KTF top-up, spread over twelve years). Considering how quickly or slowly funds from previous special funds have been disbursed, fund drawdowns are typically significantly lower in the first year in particular, as new projects first have to be initiated and approved. Withdrawals from the *Bundeswehr* special fund are also expected to increase over the forecast horizon as the equipment ordered is delivered gradually. In addition, this forecast assumes extra expenditure for all years under the expanded concept of defense. The goal is to reach the NATO target of 3.5 percent of economic output by 2029.

On the expenditure side of social security, the Care Support and Relief Act in particular is providing an expansive impetus in 2025. Measures such as the supplement to the reduced earning capacity pension, the Healthcare Strengthening Act, and hospital reform

Table

Fiscal policy measures: burdens (–) and relief (+) by the general government budget
In billion euros (compared to the previous year)

	2025	2026	2027
Revenues of local authorities			
Annual Tax Act 2022	1.0	–1.1	2.9
Inflation Compensation Act (adjustment of income tax rates)	–2.4	–1.0	–1.0
Adjustments to the tax exemption for the minimum subsistence level	–3.3	1.3	0.0
Increase in commuter allowance	0.0	–1.1	–0.2
Tax Law Development Act	–7.2	–6.3	–0.9
Tax exemption for inflation compensation bonus	6.0	0.0	0.0
Annual Tax Act 2024	–0.8	0.3	–0.1
Changes to agricultural diesel rebate	0.1	–0.4	0.0
Reduction in electricity tax	–2.6	2.5	–1.6
Temporary reduction in sales tax on gas	1.0	0.0	0.0
Temporary reduction in sales tax on gastronomy	0.5	0.0	0.0
Revenues from fuel emissions trading (BEHG)	3.2	3.0	3.6
Degressive depreciation (Second and Fourth Coronavirus Tax Assistance Acts)	5.0	3.8	1.5
Immediate investment programme (degressive depreciation, tax breaks for electric cars, expansion of research allowance)	–2.5	–5.6	–3.7
Increase in truck tolls	0.9	0.2	0.0
Growth Opportunities Act	–2.1	–0.7	0.1
Increase in tobacco tax	0.9	0.8	0.0
Financing for the Future Act	–0.2	–0.1	0.0
Global minimum taxation (Pillar 2)	0.0	1.0	–0.3
Plastic tax	0.0	1.4	0.0
Other tax measures[1]	0.2	0.2	–0.1

	2025	2026	2027
Social security revenues			
Increase in average additional contribution to statutory health insurance	13.5	4.0	4.0
Increase in contribution rate for statutory pension insurance	0.0	0.0	2.4
Increase in contribution rate for statutory nursing care insurance	2.6	1.3	1.3
Tax exemption for inflation adjustment bonus	8.1	0.0	0.0
Increase in insolvency allowance levy	1.1	0.0	0.0
Expenditure of local authorities			
Electricity and gas price brakes	1.3	0.0	0.0
Housing benefit reform	–0.4	0.4	0.0
Deutschlandticket (Germany-wide regional rail ticket)	–0.1	–0.2	–0.2
Cuts in parental allowance for top earners	0.3	0.1	0.0
Startchancen program for schools	–0.5	–0.5	–0.3
BAföG reform	–0.2	0.0	0.0
Pension package 2025	0.0	0.3	0.1
Benefits Law Adjustment Act	0.0	–0.1	0.0
KTF special fund	–7.7	3.6	–0.9
Additional expenditure on infrastructure and climate neutrality (excluding KTF)	–7.2	–21.8	–12.9
Additional expenditure on defense (including *Bundeswehr* special fund)	–10.5	–18.0	–14.3
Social security expenditure			
Basic pension	–0.1	–0.1	–0.1
Supplementary reduced earning capacity pension	–1.3	0.0	0.2
Hospital reform	–0.4	0.0	0.2
Care Support and Relief Act	–3.0	–0.2	–0.3
Healthcare Strengthening Act	–0.4	0.0	0.0
Extension of the period of entitlement to short-time working allowance	–0.3	0.3	0.0
Total	**–7.6**	**–32.6**	**–20.6**
As a percentage of GDP	**–0.2**	**–0.7**	**–0.4**

1 Other tax measures include the Annual Tax Act 2020, the Act to Modernize Corporation Tax Law, the increase in child allowances in 2025 and 2026, and the extension of the research allowance. Measures not taken into account are the Training and Further Education Act, expiring coronavirus measures (business support) and the 29th BAföG Amendment Act.

Note: Without macroeconomic repercussions.

Sources: Federal Government (budget, draft legislation, monthly reports of the Federal Ministry of Finance, financial reports for the years 2021 to 2024, tax policy data collection); DIW Berlin Economic Outlook Autumn 2025.

© DIW Berlin 2025

also involve additional expenditure. In the coming years, fiscal policy measures in this area are expected to be neutral.

All in all, the budgetary impact of the fiscal policy measures in 2025 amounts to 7.6 billion euros (–0.2 percent in relation to nominal GDP), to 32.6 billion euros (–0.7 percent) in 2026, and to 20.6 billion euros (–0.4 percent) in 2027.

The scope of fiscal policy measures for 2027 is subject to considerable uncertainty. If the measures do not—as assumed in this forecast—generate sufficient economic growth and thereby stabilize the government's structural net borrowing, consolidation measures may be required in 2027.

Box 4

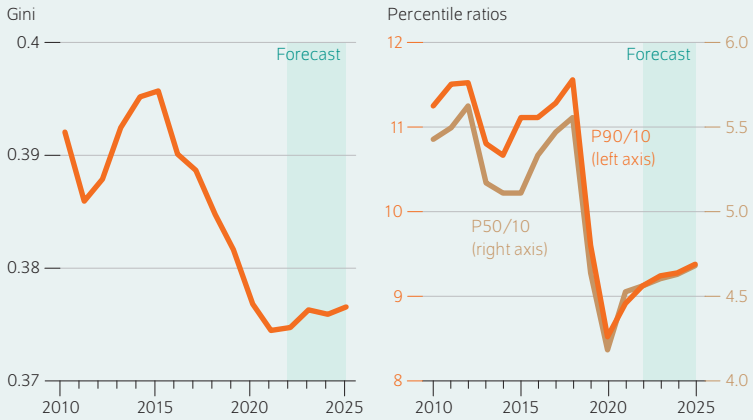
Labor income inequality nowcast

DIW Berlin has developed a model to nowcast labor income inequality. 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 most recent results of the DIW Berlin Economic Outlook in a single macroeconometric model. The aim is 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 evolution of inequality for the years 2023, 2024, and 2025. The estimates for 2023 and 2024 use macroeconomic data from public statistics, while the nowcast for 2025 also includes the DIW Berlin Economic Outlook. The model results show that, following a period of decline in inequality, particularly during the coronavirus pandemic and the energy crisis, labor income has again become somewhat more unequally distributed across the employed population (Figure). The Gini index increased from 0.375 in 2022 to 0.377 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. Therefore, the direction of fiscal policy in Germany could not prevent an increase in labor income inequality. This is also evident from the rising income ratios between the top and low earners (P90/10) as well as between the middle and bottom end of the distribution (P50/10) since 2023.

Figure

Nowcast of labor income inequality: Gini index and selected percentile ratios
Index points (left side), percentile ratios (right side)



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

© DIW Berlin 2025

Households with medium to high incomes have benefited most from the real wage increases in recent years.

to contribute negatively to economic growth in the coming years.

All in all, price-adjusted GDP in Germany is expected to grow by 0.2 percent in 2025. Significant increases in economic output of 1.7 and 1.8 percent, respectively, are projected for 2026 and 2027. This is mainly due to public spending on consumption and investment as well as investment subsidies within the framework of expanded fiscal leeway. For 2025, DIW Berlin therefore lowers its growth forecast by 0.1 percentage points due to the weak first half of the year. For 2026, the forecast remains unchanged compared to the summer forecast.

Potential growth in GDP averages around 0.4 percent in the medium term (Table 4). The volume of labor is likely to continue to decline due to demographic ageing. Given the only slight upturn in economic output in 2025, the output gap will widen and amount to an annual average of –1.4 percent of potential GDP. With the economic recovery, the output gap will close by the end of 2026. In 2027, the economy is likely to be operating at full capacity, with an output gap of 0.8 percent. Due to the expected increase in public spending, overcapacity is also to be expected in the medium term.

Consumer price inflation is projected to remain slightly above the European Central Bank's (ECB) two-percent target in 2025 due to higher rates at the beginning of the year. Further declines in energy prices and the easing of persistent price pressures in the service sector should support stable inflation going forward. DIW Berlin therefore maintains its inflation forecast for 2025, while lowering it by 0.2 percentage points for 2026. In 2027, consumer prices are expected to rise more significantly again, by 2.2 percent, driven by expansionary fiscal policy.

The risks associated with this forecast are considerable. It remains unclear how the trade agreement between the EU and the US will be structured in detail. In particular, questions regarding the agreed additional energy imports from the US and investments by European companies in the US have not been conclusively clarified. This uncertainty could

Table 4

Growth of real potential output
Annual average change in percent

	2020–2024	2024–2030
Potential output	0.5	0.4
Contributions to growth		
Labor input	0.7	–0.1
Capital input	0.3	0.3
Total factor productivity	0.2	0.2

Sources: Federal Statistical Office; European Commission; DIW Berlin Economic Outlook Autumn 2025.

© DIW Berlin 2025

hamper investment decisions, significantly affect trade flows in some cases, and dampen growth. If, for example, European companies were to actually invest an additional 600 billion US dollars in the US, the European economy would lack capital, with negative consequences for economic growth in Germany as well.

In addition, diversion effects are evident in imports from Asia: Goods that were previously delivered primarily to the US are increasingly being shipped to Europe. This could lead to the substitution of domestic products, reducing the competitiveness of European manufacturers and diminishing profits.

The share of imported goods in defense spending is also subject to uncertainty. It depends strongly on which goods are to be procured and whether defense equipment produced in this country is preferred for security policy reasons. A high import ratio would tend to dampen domestic growth, as value added would be generated abroad. A lower import ratio, i.e., stronger domestic production, would stimulate growth in the medium term, but would be associated with longer production and delivery times, thus also weakening short-term momentum.

The answer to the question of how quickly funds will be released from fiscal budgets and whether they are actually used as additional spending plays a key role in determining the economic impact. While this forecast assumes a slower outflow of funds than officially projected by the federal government, faster planning and approval procedures, for example, might allow funds to be drawn earlier and thus provide stronger growth impulses in the short term ("front-loading"). Conversely, delayed disbursement ("backloading") would shift the impact to later periods, temporarily dampening growth momentum.

LEGAL AND EDITORIAL DETAILS

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Anton-Wilhelm-Amo-Straße 58, 10117 Berlin
www.diw.de
Phone: +49 30 897 89–0 Fax: –200
Volume 15 September 10, 2025

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

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

Cover design
© imageBROKER / Steffen Diemer

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

Subscribe to our DIW and/or Weekly Report Newsletter at
www.diw.de/newsletter_en

ISSN 2568-7697
Reprint and further distribution—including excerpts—with complete reference and consignment of a specimen copy to DIW Berlin's Customer Service (kundenservice@diw.de) only.