DIW Weekly Report 36+37 2023

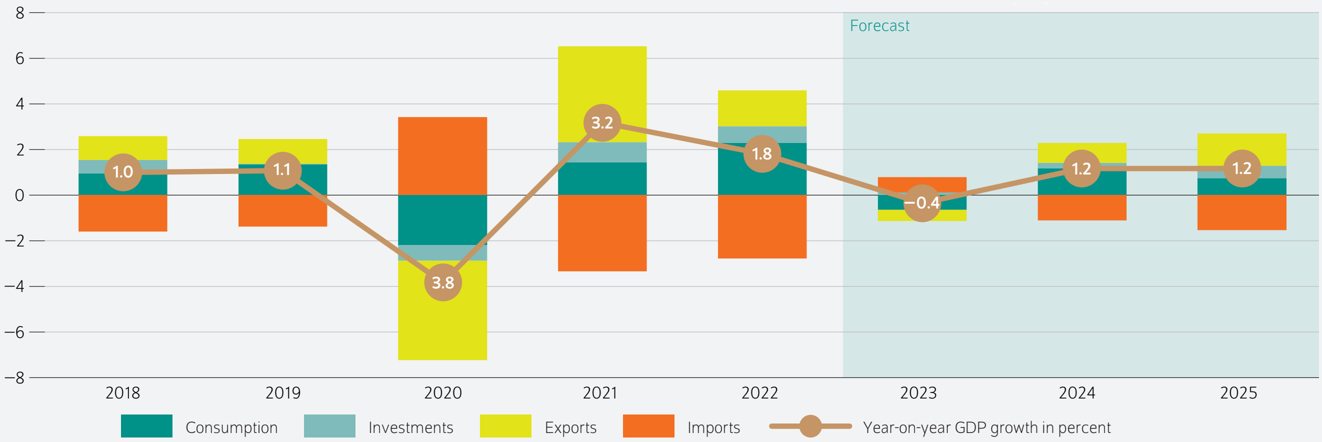
AT A GLANCE

German economy currently scarcely making headway

By DIW Berlin's Economic Forecasting Team

- German economy is recovering slowly; a 0.4-percent decline is expected in 2023 but solid growth of 1.2 percent is expected for both 2024 and 2025
- Private consumption is increasing slowly: Wage increases will take effect gradually and improve consumer spending; inflation will fall
- Foreign trade is also recovering gradually: German exports are rising slowly, subdued by the struggling domestic Chinese economy and sluggish euro area recovery
- Economy should regain momentum again in 2024 with strong consumption; exports likely to increase, inflation rates to fall
- Global economic growth expected to reach 3.9 percent in 2023 and 3.9 percent in 2024; USA with positive stimuli, while China falls behind

Private consumption and exports will carry the upswing in 2024 and 2025
Individual GDP components' contribution to growth in percentage points



Source: DIW Berlin Economic Outlook Autumn 2023.

FROM THE AUTHORS

"Stronger wage and salary increases are likely to significantly improve households' willingnses to buy and put the German economy on the road to recovery."
*— **Geraldine Dany-Knedlik** —*

*"Despite the improvement in the global economy, the export-oriented German economy is picking up speed slowly." — **Timm Bönke** —*

MEDIA

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

German economy currently scarcely making headway

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EXECUTIVE SUMMARY

Following the winter recession and stagnation in the second quarter of 2023, the economic upswing is proceeding at a sluggish pace, contrary to expectations over the summer. Weak foreign demand and ongoing inflation have proven to be slowing economic growth.

For the time being, private consumption is not driving the German economy and is likely to develop in the second half of 2023 only haltingly. Persistent inflation is deterring consumers, causing them to delay larger, and likely unnecessary, purchases. Collective wage agreements have recently been reached, causing nominal wages to rise by less than consumers had hoped; this is also putting a damper on consumer spending. Those who can afford it are keeping some of their money in bank accounts as interest rates rise or putting it aside as a precautionary measure, for example to pay off utility bills.

Exports are also proving to be a damper on the German economy. International demand is weakening, the domestic economy in China is struggling in particular, and German products are less in demand—apparently because Germany is relying more and more on domestic production of industrial goods.

In the third and fourth quarters of 2023, the German economy is expected to first grow by a moderate 0.1 percent and then by 0.2 percent. However, this cannot compensate for the weak growth in the first half of 2023. Ultimately, the German economy is likely to shrink by 0.4 percent on average in 2023. In its summer forecast, DIW Berlin had predicted a decline of only 0.2 percent.

Thanks to collective wage agreements that have already been agreed upon and those still outstanding, people in Germany will likely have noticeably more money in their pockets, especially from 2024. Together with markedly lower consumer price inflation, this strengthens households' purchasing power and stimulates private consumption. Foreign demand, too, is likely to gain momentum again, especially due to the European Union's economic recovery: The German economy is forecast to increase by 1.2 percent in 2024 as well as in 2025.

The global economy is likely to develop better than expected, although a major upswing will likely not happen. The United States and Japan recently recorded strong quarterly figures to much surprise. Falling inflation rates and expected interest rate turnarounds in the United States and euro area will spur on growth somewhat beginning in 2024. The emerging economies continue to drive a large share of global economic growth, although China is clearly weakening. The main cause for concern in China is the real estate sector and resulting sluggish domestic demand. Overall, the global economy is likely to grow by 3.9 percent in 2023 and in 2024 and by 4.1 percent in 2025.

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Global economy developing better than expected: USA providing stimulus, China slowing growth

The global economy grew by only 0.7 percent in the second quarter of 2023, slower than the 1.8-percent growth in the first quarter (Figure 1). Most advanced economies have experienced a moderate pick up in growth despite the rising interest rates in many places and the still high inflation rates. Emerging economies have clearly lost momentum, slowed by weak development in China, whose production remained significantly below expectations.

Japan had surprisingly strong growth rates in the first two quarters of 2023, carried by a positive trade balance. GDP growth in the United States also significantly exceeded expectations. This is partially due to the fiscal packages, which mainly support semiconductor production and renewable energy. Production dragged in the second quarter in Europe. In the euro area and the United Kingdom, the economy only grew slightly, although more than expected. Emerging economies, such as India, Brazil, and Mexico, grew dynamically. However, China's domestic demand recovered more disappointingly than expected after the end of its Zero COVID Policy, in part due to problems in the real estate sector.

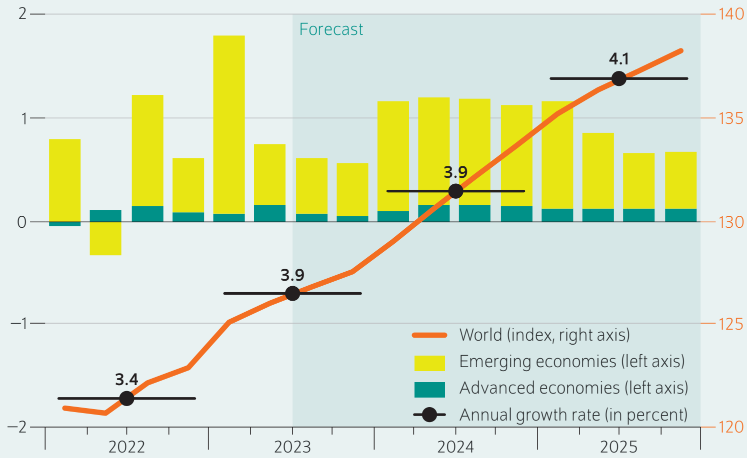
The global economy is likely to only grow moderately, by around 0.6 percent, in the third quarter. Limited growth stimuli are coming from the advanced economies (Table 1). In the beginning of the summer, industrial output and retail sales developed conservatively. However, the situation looks better in the United States, with likely growth of 0.5 percent, compared to the euro area and the United Kingdom, whose economies are likely to recover by only 0.15 percent. While the energy crisis in Europe did not lead to gas shortages or a deep recession as feared, its consequences are still reverberating and slowing down economic momentum in many places. The Purchasing Managers' Index, especially for industry, has remained significantly below the expansion threshold of 50 in many places. While the outlook for services is more favorable, it has also been getting worse since April. Consumer confidence has recovered somewhat in the past months but remains at a very low level.

Growth in the emerging economies will continue to be slowed down by China over the course of 2023. Due to its halting post-pandemic recovery, China is likely to only grow by 0.6 percent in the third quarter. A high level of debt, especially in the real estate sector, is weighing on domestic demand. A constant decline in real estate prices over the past quarters has made homeowners poorer, while potential buyers are holding back. There is a risk that homeowners will react to falling house prices by repaying their debts despite the low interest rates—a bad sign for further domestic economic development. In other emerging economies, in contrast, strong growth is expected (Table 1). For example, the Mexican economy is benefiting from the efforts of US American companies to shift production and the purchase of advance services away from China. This is expected to result in an increase of 0.3 percent in the third quarter. The Brazilian economy is likely to continue to be supported by strong exports of agricultural goods (+0.1 percent).

Figure 1

Growth of real GDP

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



Sources: National Statistical Offices; DIW Berlin Economic Outlook Autumn 2023

The emerging economies are contributing less to global economic growth due to the slump in the Chinese economy.

In 2023, monetary policy in many advanced economies, except for Japan, will remain restrictive. In a month-on-month comparison, inflation rates are gradually approaching the targets set by the central banks. Compared to 2022, however, core inflation in particular—inflation excluding energy and food prices—is still significantly higher in many economic areas. Central banks are unlikely to cut interest rates until they conclude that price increases will be reduced in the longer term. In the short term, the recent rise in oil prices is counteracting the slowdown in inflation. Natural gas prices, however, have remained low recently and are well below the 2022 level.

Although inflation rates in most advanced economies are falling, average inflation over 2023 will still be significantly above the target of the respective countries' central banks. In 2024, however, inflation will approach the targeted rates and reach or even fall below them by 2025 at the latest. Therefore, central banks' interest rate hikes will slowly come to an end.

Table 1

Real GDP, consumer prices, and unemployment rate in the global economy
In percent

	GDP				Consumer prices				Unemployment rate in percent			
	Year-on-year percentage change											
	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024
Europe												
European Union	3.5	0.8	1.6	1.8	9.2	6.7	3.4	2.4	6.1	6.0	6.0	5.9
Euro area	3.4	0.7	1.3	1.4	8.4	5.6	2.8	2.1	6.7	6.6	6.6	6.5
excluding Germany	3.8	1.2	1.2	1.5	8.0	5.3	3.0	2.1	8.0	7.8	7.9	7.8
France	2.5	0.9	1.3	1.4	5.9	5.5	2.7	2.0	7.3	7.2	7.3	7.2
Italy	3.8	0.9	0.9	1.0	8.7	6.7	3.4	2.4	8.1	7.6	7.7	7.8
Spain	5.5	2.3	1.7	2.2	8.3	3.0	2.5	1.8	12.9	12.3	12.3	12.0
Netherlands	4.4	0.4	1.0	1.7	11.6	5.3	3.4	2.4	3.5	3.6	3.9	3.8
United Kingdom	4.1	0.5	0.7	1.1	9.1	7.5	3.6	2.1	3.7	4.0	4.2	4.4
Switzerland	2.1	1.1	1.7	2.1	2.8	2.4	1.4	1.2	4.3	4.2	4.4	4.4
Central and Eastern Europe	4.6	1.6	3.3	3.5	13.5	12.5	6.1	3.8	3.5	3.5	3.4	3.3
Türkiye	5.4	2.6	3.3	3.2	72.3	50.6	43.3	39.0	10.5	9.7	10.0	10.0
Russia[1]	−1.4	0.2	1.0	1.4	13.8	5.9	5.4	4.6	3.9	3.5	3.5	3.5
The Americas												
USA	2.1	2.0	1.8	2.1	8.0	4.0	2.0	1.7	3.6	3.7	4.1	4.1
Mexico	3.0	3.1	1.9	2.3	7.9	5.4	3.3	2.8	3.3	3.1	3.4	3.6
Brazil	3.0	2.5	1.3	2.1	9.3	4.1	3.8	2.9	9.5	8.7	8.9	8.8
Asia												
Japan	1.0	1.8	1.3	1.1	2.5	3.1	1.7	1.3	2.6	2.6	2.6	2.6
South Korea	2.6	1.3	2.2	2.4	5.1	3.2	2.3	2.3	2.9	3.1	3.2	3.2
China	3.0	5.2	4.8	4.8	2.0	1.7	2.3	2.3	5.6	5.3	5.2	5.2
India	6.6	6.0	6.2	6.4	6.7	4.6	5.3	3.9	7.6	7.3	7.2	7.4
Total												
Advanced economies	2.4	1.3	1.4	1.6	7.3	4.4	2.0	1.7	4.6	4.6	4.7	4.7
Emerging economies	3.8	4.8	4.7	4.8	9.2	3.3	4.0	4.1	6.3	6.0	5.9	6.0
Global economy	3.4	3.9	3.9	4.1	9.2	4.2	4.3	4.2	5.9	5.6	5.7	5.7
For reference:												
Export weighted[2]	*2.6*	*1.9*	*1.9*	*2.2*								
GDP weighted in USD[3]	*3.6*	*3.2*	*3.4*	*3.7*								

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 2022 from deStatis.
3 World weighted with the GDP in USD from 2022 to 2025.

Notes: Forecast from the year 2023. The values of the groups of countries are a weighted average, with the resepctive GDP in purchasing power paraties from the IMF World Economic Outlook for 2022 to 2025 used to weight GDP and consumer prices. The 2022 labor force (15–64 years old) figures of the respective countries are used to weigh the unemployment rate in the groups of countries. Central and Eastern Europe consist of Poland, Romania, Czechia, and Hungary in this forecast.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Autumn 2023.

Beginning in 2024, interest rate cuts are expected in the USA and the euro area. Japan is an exception: The Bank of Japan is continuing to adhere to an ultra-loose monetary policy, although an inflation rate above the central bank's target could herald an end in the near future.

Monetary policy is currently restrictive in many emerging economies, but the inflation and interest rates are likely to have reached their peak in these countries. In Brazil, the interest rates were even lowered slightly at the beginning of August 2023. In India, however, inflation is expected to rise again temporarily due to poor harvests. In China, the situation is different: In July 2023, there was even a deflationary development, a decline in the general price level. This is a further sign of sluggish domestic demand.

Financial policy is only providing moderate stimuli for the economy during the forecast period. The measures combating the energy crisis in winter 2022/2023 and the support measures introduced during the coronavirus pandemic have largely expired. Stimulating effects on the economy are from longer-term investment packages, such as the NextGenerationEU in the EU and the Inflation Reduction Act in the United States. Due to the favorable economic development in emerging economies, no comprehensive fiscal packages are expected. The situation is different in China: In terms of fiscal policy, the government is countering weak economic development with targeted measures for the real estate sector. If these measures do not have the desired effect, a more comprehensive fiscal package can be expected.

International trade has declined by 2.5 percent compared to 2022. Weak development in the advanced economies and low growth in China are likely to hampen growth in trade. In contrast, the geopolitical and trade tensions surrounding China and the Western sanctions against Russia are becoming increasingly evident in trade flows. Chinese and Turkish trade with Russia is gaining in importance, while European trade with Russia has come to a standstill.

Global production will gradually and moderately increase in 2023. Slowly decreasing consumer price inflation, together with high interest rates, are dampening global economic growth. In addition, the low level of fiscal policy stimulus is unable to give the global economy a boost, whereas the robust labor market in many places is having a stabilizing effect.

While growth in the emerging economies is likely to be 4.8 percent, the advanced economies—also due to the sluggish recovery in the euro area and the United Kingdom — will only increase by 1.3 percent (Table 1). Overall, the global economy is expected to grow by 3.9 percent in 2023. Thus, the autumn forecast is 0.4 percentage points higher than the summer forecast (3.5 percent). On the one hand, first-quarter production figures for the euro area were revised upward; on the other, the economies in the United States and Japan, as well as India and Brazil, are developing more dynamically than thought.

While higher growth rates are expected from 2024, especially in the advanced economies, a powerful upswing is not in sight. As inflation decreases, the purchasing power of households will be stronger, which will support private consumption. Investment is likely to be stimulated primarily by longer-term financial measures, such as the investment packages adopted in advanced economies. In 2025, most economies will again be developing at similar rates as before the coronavirus pandemic and thus return to their respective potential growth. In 2024 and 2025, the global economy is likely to grow by 3.9 and 4.1 percent, respectively. DIW Berlin is slightly decreasing its forecast for 2024 by 0.2 percentage points.

This forecast is based on several uncertainty factors. There is a risk that inflation rates could remain at a high level, for example if the nominal wages in many places increase more significantly than forecast or the prices for oil and other raw materials increase more strongly than assumed. Central banks would then have to make their monetary policy more restrictive, which could lead to repercussions on the financial markets, jeopardizing the sustainability of private and public sector debt.

An additional risk factor is the real estate and financial crisis in China, which would impair the global economy mainly via international trade linkages. However, if the Chinese government introduces a comprehensive fiscal package, Chinese growth rates could be higher and give the global economy additional momentum.

Moreover, geopolitical conflicts, such as in the South China Sea or the war in Ukraine, could worsen, which would affect global trade and slow global economic growth.

Private consumption spurring on recovery of German economy

The economic recovery expected in Germany following the winter recession has failed to materialize. While GDP[1] stagnated in the second quarter (Figure 2), revised data show that the decline in growth from November 2022 to April 2023 was much milder than initially reported.[2] Nevertheless, the sideways movement of the German economy is disappointing, especially considering other advanced economies have regained their footing more quickly.

Overall, private households are restrained in their consumption as they were in the beginning of 2023, likely because the increases in nominal income could only partially compensate for the continued high price increases. Important collective wage agreements, such as those for federal and municipal public service employees and for parts of the manufacturing sector, as well as robust labor market developments suggested larger nominal wage increases in the second quarter. However, labor incomes are increasing more weakly than expected. First, employees received a part of the increases, in particular special payments, at the end of the second quarter. Although work hours increased, gross earnings per employee increased by 2.6 percent in the first quarter of 2023 and by only 0.3 percent in the second quarter compared to the previous quarter. The middle to upper income groups are likely to have benefited somewhat more from the increases in labor income. For example, the DIW Berlin nowcast on labor income distribution shows a slight increase in inequality in 2023.

Overall, the disposable income of private households decreased slightly. In addition, households, especially in the middle to upper income groups, have likely adopted a wait-and-see attitude: Recently, the savings rate increased by 1.2 percentage points,[3] while consumption of long-lasting commodities continued to decline.

Households' consumer spending is likely also to have been dampened due to the continually high consumer price inflation. At 6.1 percent in August, it remained almost unchanged from the level in May. Although energy and food prices are not rising as strongly, the inflation rate, especially in the service sector, remains high, likely due to the powerful nominal wage increases at the beginning of 2023.

In addition to weak private consumption, foreign trade has also slowed the economy recently. Exports fell sharply in the second quarter due to stagnating imports, resulting in net exports dipping into the red. Public and private investments did increase slightly at the same time by 0.4 percent. The fact that domestic demand was nevertheless positive overall is primarily attributable to strongly expanded inventories, which contributed 0.4 percentage points to the GDP in the second quarter.

Production also weakened in the second quarter. The manufacturing sector recorded slight growth of 0.1 percent and benefited from continued high existing orders, which were able to be processed as international supply chains normalized. Construction output also expanded slightly and increased by 0.2 percent.

In contrast, value added in the service sector decreased markedly. Consumer-related services in particular recorded a decline, likely also due to weak private consumption. For example, production in wholesale and retail trade, transport, and hotels and restaurants decreased by 1.4 percent.

Currently, sentiment is still subdued. Corporate sentiment about the future has been increasingly pessimistic since

1 In this forecast, price-adjusted figures are reported, except for the description of price and wage developments, public finances, and public debt.

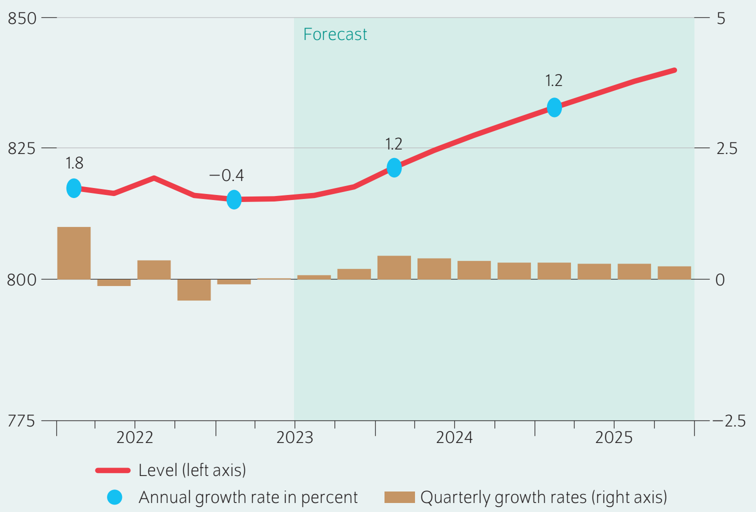
2 The fourth quarter of 2022 was revised upward by 0.1 percentage points, the first quarter of 2023 by 0.2 percentage points.

3 It should be noted that a large share of this increase is likely to be due to the special payment of 1,240 euros paid out at the end of June to around 2.4 million employees in the federal and municipal public service.

Figure 2

Growth of real GDP

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



Sources: National Statistical Offices; DIW Berlin Economic Outlook Autumn 2023

The emerging economies are contributing less to global economic growth due to the slump in the Chinese economy.

Table 2

Quarterly data on the development of use and origin components of real GDP in Germany
In percent (quarter-on-quarter, seasonally and calendar adjusted)

	2022				2023				2024				2025			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	0.6	0.2	0.7	−1.0	−0.3	0.0	0.2	0.4	0.7	0.6	0.6	0.5	0.4	0.4	0.3	0.3
Public consumption expenditure	1.4	−0.1	−1.1	−0.2	−1.9	0.1	0.5	0.0	0.5	0.2	−0.1	−0.2	0.0	0.0	−0.3	−0.3
Gross facilities investment	2.2	−1.6	1.0	−1.3	1.7	0.4	0.2	0.2	−0.3	−0.1	0.3	0.5	0.6	0.6	0.6	0.6
Construction	3.3	−3.9	−0.6	−2.0	2.7	0.2	−0.1	0.0	−0.5	−0.3	0.0	0.2	0.4	0.4	0.6	0.6
Equipment	1.9	1.6	4.2	−1.5	2.1	0.6	0.3	0.1	−0.3	−0.1	0.5	1.0	1.0	0.8	0.8	0.6
Other investment	−0.6	0.3	0.1	0.8	−1.6	0.4	0.8	0.8	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Inventory changes[1]	0.1	0.7	0.3	0.2	−0.8	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic consumption	1.2	0.5	0.7	−0.7	−1.0	0.6	0.3	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.2
Net exports[1]	−0.1	−0.6	−0.3	0.2	0.9	−0.5	−0.2	0.0	0.0	0.1	0.0	−0.1	−0.1	−0.1	0.0	0.0
Exports	−0.1	0.9	1.0	−1.1	0.4	−1.1	−0.2	0.3	0.8	1.0	0.8	0.7	0.7	0.7	0.8	0.8
Imports	0.1	2.4	1.8	−1.7	−1.5	0.0	0.2	0.4	0.9	0.9	0.9	0.9	0.9	0.9	0.8	0.8
GDP	1.0	−0.1	0.4	−0.4	−0.1	0.0	0.1	0.2	0.5	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Gross value added	0.6	0.3	0.6	−0.6	0.2	−0.5	0.1	0.2	0.5	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Manufacturing	−1.3	0.5	0.7	0.4	−0.1	0.1	0.0	0.0	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.3
Construction	0.7	−2.7	−2.1	−2.4	5.3	0.2	−1.0	−0.8	−0.4	−0.2	0.0	0.2	0.3	0.4	0.4	0.4
Trade, hospitality, transport	−0.3	0.1	1.2	−1.2	−0.5	−1.4	0.1	0.4	0.9	0.9	0.8	0.6	0.5	0.5	0.4	0.4
Professional services provider	1.8	−0.7	0.2	0.2	0.2	0.0	0.2	0.4	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Public services, education, health	1.9	0.7	1.4	−0.5	−0.3	−0.8	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2

1 Contribution to growth in percentage points.

Note: Forecast from the third quarter of 2023.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2023.

the summer: For example, the Purchasing Managers' Index has gone significantly below the threshold expansion of 50 index points. While the manufacturing index has been under this threshold for a while now, the service sector, which is far more important for the German economy, experienced a sharp decline and fell below the threshold expansion as well. The ifo Business Climate Index for Germany was also in decline for the fourth month in a row in August. The situation is similar here: The outlook has worsened not only in the manufacturing sector, but also in the service sector. The paltry level of new orders is likely to make companies in the manufacturing sector particularly pessimistic. The poor outlook in industry is also dampening sentiment in some important service sectors, such as transportation and logistics. However, sentiment in consumer-related service sectors, such as hotels and restaurants, was also somewhat dampened recently. In line with this, consumer confidence stagnated in August according to the *GFK-Konsumklima-Index*.

Thus, the current third quarter is likely to be weak. As the subdued sentiment and the leading indicators published so far suggest, the manufacturing sector is likely to stagnate. Although new orders increased by around 14 percent in June, they fell slightly when adjusted for volatile bulk orders.[4] In addition, foreign demand remains weak. The sluggish recovery of important trade partners in Europe, such as Spain, and the slump in the Chinese economy will probably dampen the export of German equipment in particular. The recently stable truck toll mileage index, which measures the mileage of trucks subject to tolls and thus allows conclusions to be drawn about output, does not indicate a decline in the current third quarter.

The construction sector will not generate noticeable stimuli for the economy. The number of planned and approved construction projects is still so high that the sector is likely to expand over the course of processing them in the third and fourth quarters. Considering the continually high interest rates and, above all, the sharp drop in construction orders, sustained declines in construction are to be expected from 2024 onward. In line with the subdued growth in industry, which includes manufacturing and construction, private investment is also likely to lose further momentum in the third quarter and expand only slightly. The service sector is likely to slightly increase overall, although some industry-related services such as transport and logistics will likely develop rather weakly in line with manufacturing. In contrast, consumer-related services are likely to record a strong increase.

Further powerful nominal wage increases and special payments are likely to boost private consumption in the third quarter. The wage negotiations in the retail sector and at

4 The increase was due to a rise in new orders from abroad. This is probably due to a major order from Airbus following an order from the Air India. Completion will likely take place over a longer period and have a correspondingly small impact on the development of manufacturing output overall.

Table 3

Key economic indicators for the German economy

	2022	2023	2024	2025
GDP[1]	1.8	−0.4	1.2	1.2
Employment[2] (1,000 persons)	45,596	45,918	46,133	46,108
Unemployed (1,000 persons)	2,418	2,592	2,578	2,458
Unemployment[3] (BA concept, in percent)	5.3	5.6	5.6	5.3
Consumer prices[4]	6.9	6.1	2.4	2.0
Unit labor costs[5]	3.2	7.7	4.3	4.3
Government budget balance[6]				
in percent of nominal GDP	−96.9	−72.1	−41.1	−26.3
Current account balance	−2.5	−1.7	−1.0	−0.6
in billions of euros				
in percent of nominal GDP	145.1	244.5	267.5	274.6
in percent of nominal GDP	3.7	5.9	6.2	6.2

1 Price adjusted. Year-on-year change in percent.
2 Domestic concept.
3 Unemployed as a percentage of the civilian labor force (definition according to the Federal Employment Agency).
4 Year-on-year change.
5 Compensation of employees per hour worked in Germany as a percentage of real GDP per hour worked.
6 As defined in the national accounts (*volkswirtschaftliche Gesamtrechnungen*).

Note: Forecast from 2023.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Autumn 2023.

Deutsche Bahn, for example, which are likely to end soon, herald significant increases in labor income. In addition, inflation rates are now likely to fall gradually. This is indicated by the expiry of base effects and the recent further sharp drop in producer and wholesale prices, which strengthens the purchasing power of private households.

Overall, consumption and investment will likely support the economic recovery. Negative stimuli, in contrast, are coming from foreign trade: There is a negative trade balance because exports are declining somewhat due to weak international demand, while imports—in line with private consumption—are increasing slightly. Overall, GDP will only slightly increase in the third quarter by 0.1 percent (Table 2).

The German economy should pick up speed again toward the end of 2023 but will probably not experience significant growth until 2024. The main driver of growth is likely to be revived private consumption (Table 2). First, wages and salaries will noticeably increase at the beginning of 2024 due to concluded wage increases. Second, in view of expiring collective wage agreements in many high-employment sectors, strong nominal wage increases are likely to be negotiated at the end of 2023, which would then take full effect from 2024. The continued robust development on the labor market should also be beneficial. Added to this is the gradually falling inflation as a result of continued restrictive monetary policy. This forecast assumes that the European Central Bank (ECB) will hike interest rates again in the fall and make the first interest rate cuts at the end of 2024, when expected inflation in the euro area will be close to the inflation target again. Energy and food prices have already risen more slowly over the summer. Nevertheless, the inflation rate is likely to decline slowly, as higher wages and the overall broad-based price pressure are clearly reflected in the core rate, which excludes energy and food prices. Therefore, the inflation rate will remain higher for longer and is not expected to reach 2.0 percent until the end of 2024.

Fiscal policy is characterized by expiring crisis measures and is likely to boost the economy only slightly. However, it will not provide the German economy with a major upswing. Private households are benefiting from most of the important measures, such as the *Inflationsausgleichgesetz*. Larger investment measures have not been passed to date. In addition, political uncertainties have arisen as the design of the energy transition is postponed. These are likely to curb the willingness of companies and households to make purchases. Moreover, the continued high interest rates are weighing on the willingness to invest. With the assumed interest rate turnaround in the second half of 2024 and global demand picking up, gross fixed capital formation should expand again. More dynamic global production in 2024 is likely to boost German exports and support foreign trade.

All in all, the price-adjusted GDP in 2023 will likely decline by 0.3 percent in 2023 due to the weak winter months and the reserved recovery in the second half of 2023. In 2024, it is likely to experience robust growth of 1.2 percent. In 2025, growth is expected to be 1.1 percent. Thus, DIW Berlin is lowering its forecast for GDP by 0.2 percentage points for 2023 and by 0.3 percentage points for 2024. On the one hand, this is due to the revised GDP figures and on the other, to weak second-quarter growth in 2023 in combination with the gloomy outlook for the third quarter. According to this forecast, the output gap in Germany at the end of 2023 is 0.5 percent and is expected to gradually close by the second half of 2025. Average consumer price inflation for the year is likely to be 6.1 percent in 2023 before it falls to 2.4 percent in 2024 and to 2.0 percent in 2025 (Table 3). Compared to the summer forecast, DIW Berlin is increasing its inflation forecast by 0.3 percentage points for 2023 and is decreasing it by 0.1 percentage points for 2024. The core rate is expected to be 5.5 percent on average in 2023 before falling to 3.1 percent in 2024 and to 2.0 percent in 2025. Compared to the summer, the current forecast is thus 0.4 percentage points lower (2023) or 0.3 percentage points higher (2024).

One risk to the German economy is a greater price increase due to a renewed rise in energy prices or a stronger transfer of the wage increases to the general price level. This could also have a significant negative impact on the German economy as the result of a possibly more restrictive monetary policy.

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