DIW Weekly Report 50–52 2024

AT A GLANCE

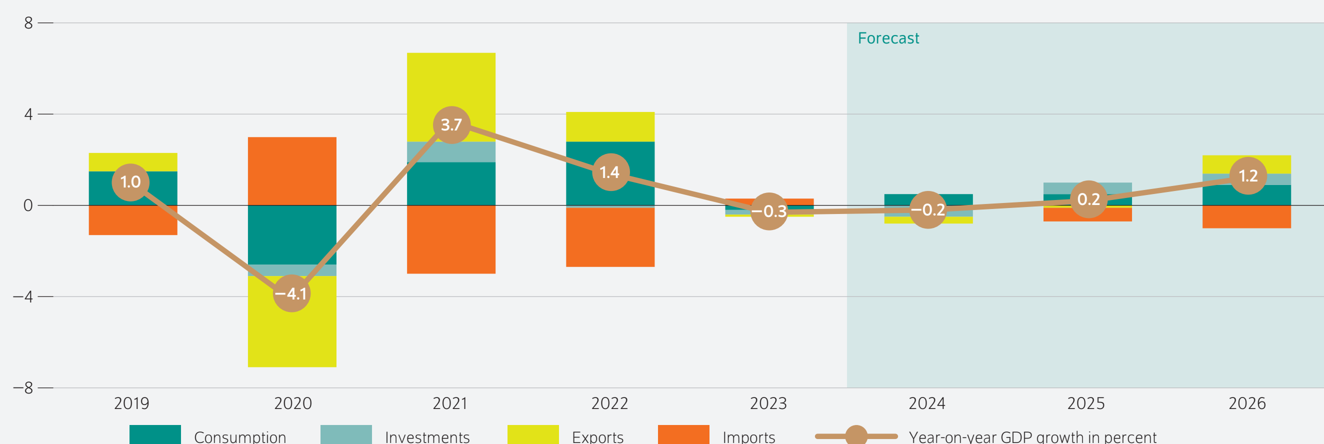
DIW Berlin Economic Outlook: German economy stuck in limbo while trade conflicts threaten the global economy

By the DIW Berlin Economic Forecasting Team

- German economy in a difficult position facing weak growth and structural change; GDP will decline in 2024 for the second year in a row
- German industry experiencing a serious crisis in particular, with increasing international competition, increasing protectionism, and unclear domestic economic policies having a negative impact
- Private consumption not picking up speed despite increasing real wages, partially due to worries about job layoffs
- DIW Berlin is revising its growth forecast for Germany for 2025 significantly downward to 0.2 percent; growth of 1.2 percent is expected in 2026
- Economic boom in the United States continues to drive the global economy, compensating for the sluggish recovery in other countries; global growth from 2024 to 2026 is expected to be 3.5 percent each year

German economy not picking up speed for the time being; private consumption and exports will not contribute more to growth until 2026

Individual components' contribution to overall GDP growth in percentage points



Source: DIW Berlin Economic Outlook Winter 2024.

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FROM THE AUTHORS

"Private households' uncertainty should lessen over the course of 2025 somewhat. Industry will recover slowly once it is clear next year what government Germany will have and what the economic policy framework will look like. This knowledge brings security and the ability to plan ahead."

— Geraldine Dany-Knedlik —

MEDIA

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

DIW Berlin Economic Outlook: German economy stuck in limbo while trade conflicts threaten the global economy

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

EXECUTIVE SUMMARY

The German economy is stuck in a difficult position as it faces both slow growth as well as structural change. The continuing lack of orders in manufacturing, increasing international competition, and sluggish development in industry-related services are now affecting the labor market and leading not only to short-time work but to layoffs too, despite the continuing skilled worker shortage. While GDP increased slightly by 0.1 percent in the third quarter of 2023, this growth was preceded by a stronger than initially recorded decline in economic output of 0.3 percent in the second quarter. Thus, the German economy cannot be said to be on a stable growth path. In contrast, leading indicators suggest that economic output will decline again in the fourth quarter, with overall growth for 2024 likely to be 0.2 percent. This means that the German economy will contract for the second year in a row.

German industry in particular is experiencing a serious crisis. Foreign trade may temporarily benefit, as many companies despite a lack of demand are expected to increase their exports to the United States in order to get ahead of the possible tariffs that US President-elect Donald Trump announced. However, impending protectionist measures are already having an impact and unsettling local companies, which are therefore postponing investments further.

In addition, the economic framework conditions in Germany are unclear and will remain unpredictable until at least the spring when there is a new federal government. All of these factors in conjunction with increasing concerns about their own jobs are unsettling households in Germany, resulting in private consumption failing to pick up speed despite rising real wages.

A gradual easing is not expected until mid-2025, when domestic and foreign economic uncertainties will successively lessen. Nevertheless, the German economy should expand by 0.2 percent in 2025. Thus, DIW Berlin is revising its fall forecast downward by 0.7 percentage points. Economic output is expected to increase by 1.2 percent in 2026, although this is partially due to non-recurring effects such as a relatively high number of work days.

In regard to the global economy, the boom in the United States will remain a key driver for now, compensating for the sluggish recovery in many other advanced economies as well as China. While the Chinese economy falters, a gradual upswing is continuing in the euro area due to rising purchasing power and falling inflation. In 2024, the global economy is expected to grow by 3.7 percent, while it should grow by 3.6 percent and 3.7 percent in 2025 and 2026, respectively.

 DOI: https://doi.org/10.18723/diw_dwr:2024-50-1

The rising shadow of protectionism is negatively affecting the global economy

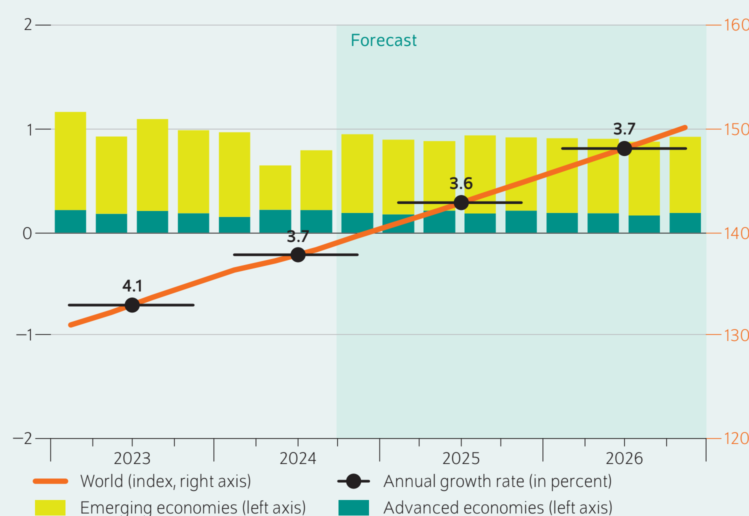
The sustained boom in the United States is once again determining the expansion tempo of the global economy in 2024, compensating for the sluggish recovery in many other advanced economies and China. Thus, the gap in economic output between the United States and other important economies such as the euro area is growing. Purchasing power has recovered in the euro area and the United Kingdom and is supporting a gradual upturn there. The Chinese economy is faltering, meaning it will not reach its growth target of five percent for 2024. Lastly, the economic and trade policies of US President-elect Donald Trump are putting the global economic order to the test.

Global economic growth has picked up speed recently: The global economy expanded by 0.8 percent in the third quarter of 2024 after growth of 0.7 percent in the second quarter (Figure 1). In the fall, global growth in the advanced economies was primarily driven by a strong increase of 0.7 percent in the United States. Most other advanced economies are continuing to recover at a moderate pace; for example, the British and Japanese economies grew by only 0.1 and 0.2 percent, respectively. The euro area, in contrast, continued its recovery, recording an increase of 0.4 percent. Spain and the Netherlands grew the most by 0.8 percent each, followed by France by 0.4 percent. In contrast, Italy and Germany stagnated.

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 Winter 2024.

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Tightened trade barriers are likely to slow the global economy down somewhat.

The economies of the Central and Southeastern EU countries suffered from weak demand from Germany. In these countries, economic output declined by 0.2 percent in the third quarter of 2024. The only exception was Czechia, where GDP increased by 0.3 percent.

Following a weak second quarter, the situation was somewhat better for emerging economies. The Chinese economy picked up speed and recorded growth of 0.9 percent. The pace of expansion of the Indian economy has also been stronger recently, and Mexico's GDP increased by 1.1 percent in the third quarter. In contrast, growth of 0.9 percent in Brazil was weaker than in the previous quarter.

Despite the expected geopolitical and trade policy cutbacks, the global economy should expand slightly in the fourth quarter of 2024, in part thanks to China's increasingly strong economic growth. Most advanced economies are losing momentum slightly, and the leading indicators deteriorated in the fall months. The slump in global industrial production continues as well: The Purchasing Managers Indices for the United States and the euro area were tilted to the downside from May to September and recently moved sideways. The picture in the services sector appears to be mixed: While the United States experienced strong growth in November, the indices for the euro area fell below the expansion threshold. In October, the Purchasing Manager's Index for manufacturing in the United Kingdom dropped below 50, a trend that continued into November. The index for Japanese manufacturing is continuing its sideways movement slightly below the expansion threshold. In surveys, the newest political developments, such as Trump's re-election and the collapse of the German government coalition, were only partially reflected. However, these events are likely to have led to increased uncertainty among firms and private households alike about future economic policy frameworks. The biggest uncertainties concern the future trade policy of the United States. To hedge against this, companies will likely pull orders forward, meaning that exports to the United States should initially be somewhat stronger than expected. However, this will presumably not be reflected in the aggregated global economic output.

We expect growth in the United States in the fourth quarter of 2024 will continue to be strong, albeit somewhat weaker than in the third quarter, and supported by private consumption in particular. The recovery in the euro area will lose some momentum for the time being: For example, France is experiencing a weak fourth quarter following the one-off effects related to the Olympic Games. The Japanese and

Table 1

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

	GDP				Consumer prices				Unemployment rate in percent			
	Year-on-year percentage change											
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
Europe												
European Union	0.5	0.9	1.5	1.9	6.4	2.6	2.4	2.2	6.1	6.0	5.9	5.7
Euro area	0.5	0.7	1.1	1.4	5.4	2.4	2.1	2.0	6.6	6.4	6.3	6.2
excluding Germany	1.2	1.3	1.4	1.6	5.0	2.2	2.0	1.9	8.3	7.9	7.7	7.5
France	1.1	1.1	0.9	1.5	5.7	2.4	1.9	1.8	7.3	7.5	7.4	7.3
Italy	0.8	0.4	0.8	1.0	5.9	1.1	1.9	2.0	7.7	6.7	6.5	6.4
Spain	2.7	3.1	2.3	2.2	3.4	2.8	2.3	1.9	12.2	11.5	11.1	10.8
Netherlands	0.1	1.0	2.2	1.8	4.1	3.1	2.5	2.0	3.6	3.7	3.6	3.6
United Kingdom	0.3	0.9	1.2	1.2	7.3	2.5	2.2	2.1	4.0	4.3	4.4	4.3
Switzerland	0.7	1.7	1.8	1.8	2.1	1.2	1.0	1.2	4.0	4.2	4.3	4.1
Central and Eastern Europe	0.5	1.7	2.7	3.4	11.6	4.0	3.4	3.0	3.6	3.7	3.5	3.4
Turkey	5.1	3.4	2.9	3.4	54.0	58.7	35.9	29.8	9.4	8.7	9.0	8.6
Russia[1]	3.3	3.5	1.7	1.5	5.9	8.2	6.5	4.6	3.2	2.5	2.4	2.4
The Americas												
USA	2.9	2.7	2.4	2.2	4.1	2.8	2.2	2.2	3.6	4.0	4.1	3.9
Mexico	3.2	1.3	1.4	1.8	5.5	4.6	3.2	2.9	2.8	2.7	2.6	2.6
Brazil	2.9	3.0	2.4	2.3	4.6	4.2	3.1	2.9	8.0	7.0	6.8	6.9
Asia												
Japan	1.7	−0.1	1.2	0.9	3.3	2.6	1.9	1.6	2.6	2.6	2.4	2.3
South Korea	1.4	2.2	2.0	2.2	3.6	2.4	1.9	1.9	2.7	2.8	3.0	3.0
China	5.2	4.7	4.5	4.3	−1.7	0.4	1.3	1.4	5.2	5.1	5.0	5.0
India	7.8	6.5	6.1	6.6	5.7	4.9	5.7	4.6	8.1	7.9	7.5	7.3
Total												
Advanced economies	1.9	1.8	1.8	1.8	4.8	3.0	2.3	2.3	4.4	4.5	4.5	4.3
Emerging economies	5.5	4.7	4.5	4.6	4.5	5.9	5.7	5.4	6.2	6.0	5.8	5.7
Global economy	4.1	3.7	3.6	3.7	4.3	3.9	3.5	3.4	5.8	5.7	5.5	5.4
For reference:												
Export weighted[2]	*3.1*	*2.8*	*2.8*	*2.8*								
GDP weighted in USD[3]	*3.4*	*3.1*	*3.1*	*3.1*								

1 The data forecast for Russia are subject to major uncertainties. Russia has only minor weight in the overall forecast.
2 World weighted with shares of German exports from 2023 using figures from Destatis.
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 Eastern Europe consist of Poland, Romania, Czechia, and Hungary in this forecast.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2024.

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South Korean economies, in contrast, are projected to gain some momentum again. In China, the outlook has improved due to the recently announced monetary and fiscal policy measures, which has brightened economic sentiment.

We assume that a less restrictive monetary policy will support economic growth in the coming years. The central banks of many advanced economies will likely cut interest rates further in 2025. The inflation rate continues to be lower in many places, which is mainly due to falling energy prices. Inflation in the services sector remains high in many places. Emerging economies have initiated an interest rate turnaround earlier and may have reached the end of the interest rate cuts. For example, inflation in Mexico is proving to be more persistent than expected, and the Central Bank of Brazil recently raised interest rates again in response to higher core inflation. In contrast, the People's Bank of China is following a loose monetary policy due to deflationary tendencies.

Fiscal policy is slightly expansionary in most economies. In the United Kingdom, the Labour government passed its fall budget, ushering in an expansionary fiscal policy. Fiscal policy in the United States is also likely to be expansionary over the forecast horizon due to many of President-elect Trump's proposals. At the end of September, the Chinese government announced its largest stimulus package since the pandemic. Equaling around 1,300 billion euros, the package focuses on solving the debt problems of local governments. An exception to the expansionary fiscal policy is the euro area, where fiscal policy will likely remain slightly restrictive over the forecast period.

Box 1

Assumptions and framework conditions

Assumptions about interest rates, exchange rates, and energy prices

This forecast is based on the following assumptions about the further development of key interest rates, exchange rates, and commodity prices (Table). These assumptions were made based on previous developments, futures markets prices, and the closing prices on the date of this forecast (November 12, 2024). The European Central Bank (ECB) decreased interest rates once again in October, thus continuing the path of normalization. For the winter forecast, four further interest rate cuts of 25 basis points each are assumed for the deposit rate until spring 2025. The money market interest rates also fell in line with key interest rates. We expect that key interest rates will continue to fall until mid-2025 and then remain at that level. The transmission of interest rate cuts into the real economy is also beginning to show. For example, the refinancing costs for households and firms began to decline in the second quarter of 2024, and this decline is likely to continue in line with key interest rates. The yield on government bonds increased again slightly in the fourth quarter of 2024. We assume that capital market interest rates will remain largely unchanged over the forecast horizon at 2.3 percent for Germany and 2.9 percent for the euro area. The euro has recently appreciated slightly against the US dollar. For the forecast period, it is assumed that the exchange rate of EUR to USD will remain at 1.07 USD per EUR, the level reached at the end of the data period. According to futures, the price for Brent oil should increase slightly in the coming months before declining again at the start of 2025 until the end of the forecast period. In 2024, the average price should be 81 USD per barrel before declining to an average of 73 USD per barrel in 2025 and finally to 71 USD per barrel in 2026. The wholesale price for gas (TTF) rose over the course of 2024 and should be 34 euros per megawatt hour on average. Over the forecast horizon, we assume that the prices will increase to 40 euros in 2025 before falling to 34 euros per megawatt hour in 2026.

Geopolitical and trade policy assumptions

Additionally, the forecast assumes that there will be no further escalation in the war in Ukraine. In the Middle East, an easing of tensions is becoming increasingly less likely. The fall of former Syrian President Bashar al-Assad is causing uncertainty and could lead to higher oil and gas prices. In addition, this forecast assumes that US President-elect Trump will implement some of the trade tariffs he has announced. It is assumed that the American government will increase tariff rates by 10 percentage points for all goods imported from China in the first quarter of 2025. As a result, the average tariff rate on Chinese goods, which is currently around 20 percent, would increase again by half to around 30 percent (including automotive tariffs and 100-percent tariffs on e-cars). The tariffs on European Union aluminum and steel, which had been suspended, will be implemented again (10 percent for aluminum and 25 percent for steel). Furthermore, trade partners will presumably forego broad countermeasures and only react with retaliatory tariffs on specific groups of goods.

Table

Forecast assumptions

		2023	2024	2025	2026
ECB deposit rate[1] (year end)	Percent	4.0	3.0	2.25	2.25
Money market interest rate	Three-month EURIBOR in percent	3.4	3.5	2.0	2.0
Capital market interest	Yield on euro-area government bonds with a remaining term of 10 years	3.3	3.0	2.9	2.9
Capital market interest	Yield on German government bonds with a remaining term of 10 years	2.6	2.4	2.3	2.3
Exchange rate	USD/EUR	1.08	1.08	1.06	1.06
Crude oil price	USD per barrel	82.5	80.3	72.9	70.9
Gas price	EUR per megawatt hour	42.1	34.1	40.4	34.2

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

Note: Annual average values; ECB deposit facility values at the end of the year.

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 Winter 2024.

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The booming American economy and the gradual recovery in many other advanced economies have somewhat stimulated international trade in the third quarter. Assuming that global trade barriers are tightened from 2025 onwards, international trade is likely to be stronger in the fourth quarter of 2024, due to anticipated purchases . Therefore, overall growth of 1.2 percent is expected for 2024. Only a moderate upswing is expected for 2025 and 2026 due to likely tighter trade barriers. Furthermore, industry's ongoing weak growth should continue to weigh on international trade before falling interest rates boost corporate investment somewhat at the end of 2025 and support international trade.

In the coming years, the expected increase in trade barriers is likely to slow global economic growth. This forecast assumes that the US government will increase tariff rates on Chinese goods imports by 10 percentage points, resulting in an average rate on Chinese exports of around 30 percent. At the same time, the forecast also assumes that the aluminum and steel tariffs on the European Union, which had been suspended by the Biden administration, will be reintroduced. In reaction to the increase in US tariffs, it is assumed that the economies affected will take targeted countermeasures, but avoid an escalation. Due to tariff asymmetries, regions may be affected differently.

Box 2

Trump reloaded: Expected American trade policy

Majority of tariff announcements likely to function as bargaining chips

An increase in protectionist measures in the United States is expected over the forecast horizon. President-elect Donald Trump has made contradictory and sometimes extreme announcements about tariff increases. It is likely that Trump will continue the trade policy of his first term and that the threat of additional import tariffs will primarily serve as a means of exerting pressure in bilateral negotiations, with tariffs likely to be implemented only partially.

Concretely, this forecast assumes that following Trump's inauguration, tariffs on Chinese goods will increase by 10 percent[1] and the tariffs on European Union aluminum and steel, which were suspended by the Biden administration (10 percent for aluminum and 25 percent for steel), will be reimplemented. Furthermore, the United States' trade partners will presumably avoid broad countermeasures and only react with retaliatory tariffs on specific groups of goods.

Although Trump announced further drastic measures such as universal import tariffs of 10 or 20 percent during his election campaign, these would have considerable economic and political implications if implemented. On the one hand, tariffs of this magnitude would considerably increase the prices of imported goods and thus create strong inflation, potentially accompanied by supply chain disruptions and a supply shortage in the United States.[2] This is likely to be met with considerable resistance from the public as well as from industry. For example, a study has shown that high inflation rates considerably decrease approval of the reigning government.[3] In addition, a sharp increase in import tariffs could destabilize the stock markets, as indicated by the recent drop in shares of the car manufacturers General Motors and Ford following Trump's announcements of tariffs on Mexican imports. Finally, there are legal hurdles which, despite the US President's far-reaching powers, are likely to make an escalation in trade spolicy more difficult.

If all tariffs actually are implemented, they will cause significant real economic distortions

Nevertheless, there is great uncertainty regarding these assumptions and it seems possible that considerably comprehensive protectionist measures will be implemented. Drastic import tariffs are not only justified as a means of obtaining concessions from trade partners, but also as a means of generating public revenue as well as maintaining domestic industry and related jobs. Although these justifications are not empirically sound, they could point to the actual implementation of more far-reaching tariffs.

For example, Trump has repeatedly announced universal import tariffs of 10 percent and tariffs on Chinese imports of 60 percent. This would be a drastic break from previous American trade policy; for example, the average effective tariff rate in 2023 was only 3.8 percent. Such a massive tightening of trade policy would also have very negative economic consequences for the United States. For example, model calculations[4] show that implementing universal import tariffs of 10 percent without trade policy reactions would reduce US production by 0.4 percentage points by the end of the forecast horizon. In the year of the tariff increase, inflation would be 0.6 percentage points higher.

The Federal Reserve would likely respond to this strong price pressure with a restrictive course, which would dampen domestic economic activity. In the long term, comprehensive tariffs are also likely to weaken the competitiveness of the US economy due to higher production costs and the shifting of resources to less productive sectors.[5] The United States' trade partners could respond with broad retaliatory tariffs, which could trigger a trade war and further destabilize international trade relations. Positive effects of the import tariffs on the US economy will likely be limited. For example, a study[6] shows that the tariffs during Trump's first term did not create any jobs in tariffed sectors. On the contrary, the resulting counter tariffs imposed by China were economically costly for the United States[7] and negatively affected employment levels.[8] At the same time, the tariffs would not reduce the trade deficit,[9] partly due to an expected appreciation of the US dollar, which makes exports more expensive and imports cheaper.

The global economy would also be hit hard by such a comprehensive increase in US tariffs. For example, exports will decline and production will fall in the rest of the world, while at the same time goods imported from the United States will become more expensive due to a likely appreciation of the US dollar. The negative consequences for individual countries will likely depend on the tariff amount and the country's dependency on the United States as a trade partner. The table (Table) shows the share of total volume

1 Cf. Vivek Mishra and Kevin Yao, "Trump to Unleash Nearly 40 Tariffs on China in Early 2025, Hitting Growth: Reuters Poll," *Reuters*, November 20, 2024 (available online).

2 Cf. Warwick J. McKibbin, Megan Hogan, and Marcus Noland, "International Economic Implications of a Second Trump Presidency," Working Papers 24-20 (2024: Peterson Institute for International Economics) (available online).

3 Cf. David Steinberg, Daniel McDowell, and Erdem Aytac, "The Impact of Inflation on Support for Kamala Harris in the 2024 Presidential Election," (2024) (available online).

4 Cf. McKibbin, Hogan, and Noland, "International Economic Implications of a Second Trump Presidency."

5 Cf. Davide Furceri, Swarnali A. Hannan, Jonathan D. Ostry, and Andrew K. Rose, "Macroeconomic consequences of tariffs," National Bureau of Economic Research Working Paper, no. 25402 (2018) (available online).

6 Vgl. David Autor, Anne Beck, David Dorn, and Gordon H. Hanson, "Help for the Heartland? The employment and electoral effects of the Trump tariffs in the United States," National Bureau of Economic Research Working Paper no. 32082 (2024) (available online).

7 Cf. Sung Eun Kim and Yotam Margalit, "Tariffs as Electoral Weapons: The Political Geography of the US–China Trade War," International Organization 75, no. 1 (2021): 1–25 (available online).

8 Cf. Autor, Beck, Dorn, and Hanson, "Help for the Heartland?"

9 Cf. McKibbin, Hogan, and Noland, "International Economic Implications of a Second Trump Presidency."

of goods exports to the United States and its relative importance compared to other trade partners for selected economies.

It is clear that the share of all exports to the United States of total exports is rather low for large EU Member States. The economic consequences of the tariffs may thus be rather limited overall, but there are significant regional differences. A study[10] investigated possible consequences of a universal import tariff of 10 percent, 60 percent on Chinese imports, and 100 percent on all imported cars. According to the model calculations in the study, the EU's GDP is expected to decline by around 0.11 percent.[11]

Germany's economy, in contrast, would be hit even harder; imposing import tariffs on cars would severely affect German industry.[12] In addition, the United States is the most important individual sales market for German pharmaceutical companies. If US gas exports to the EU are used as a means of political pressure, there is also the risk that energy prices will rise again. This would likely further burden the beleaguered manufacturing industry in Germany in particular. However, Germany could benefit from tariff asymmetries and trade diversification, which may somewhat compensate for the negative effects; an escalation of the trade conflict between the United States and China that entails significantly higher tariffs on both trade partners would make German products relatively more affordable. At the same time, the tariff policy may lead to more diversification of trade relationships with other countries,[13] which could further increase demand for German products.

With a share of around 15 percent of total export volume in 2023, the United States is China's most important trade partner. An increase in tariffs on all imported Chinese goods to 60 percent would hit the Chinese economy hard and lead to distortions in international trade. At the same time, China may, as in 2018, take countermeasures, which would likely strengthen the effect. During the first Trump administration, the counter tariffs were around the amount of the American tariffs, which avoided an escalation.

Tariffs on Mexican and Canadian goods could result in significant economic losses for both countries. In Canada, the crude oil sector[14] would be affected, while in Mexcio, the automobile industry, the country's most important industrial sector, would be affected in particular.

Table

Significant of the United States as an export partner and share of exports to the United States

Country	Rank	Share of total volume of goods exports (in percent)
Germany	1	10
France	5	7
Italy	2	10.7
Spain	6	4.7
Netherlands	5	5
United Kingdom	1	13.8
Switzerland	1	15
Hungary	4	5
Polan	8	2.9
Czechia	11	2.3
Romania	14	2.3
Turkey	2	5.8
Russia	11	2.8
Mexico	1	79.6
Brazil	2	11
Japan	1	20.2
South Korea	2	18.4
China	1	14.8
India	1	17.6

Source: UNCTAD Database, end of 2023.

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For emerging economies, the expected appreciation of the US dollar due to the sharp increase in import tariffs would be associated with considerable disadvantages, as their debts are denominated in dollars. An International Monetary Fund study[15] suggests that a 10 percent increase in the dollar would decrease economic output in emerging economies by 1.9 percent after six months. These effects will last for up to two and a half years.

10 Cf. Aurélien Saussay, *The economic impacts of Trump's tariff proposals on Europe* (Policy Publication, London School of Economics: 2024) (available online).

11 The United Kingdom's GDP is also projected to experience only a moderate decline of 0.14 percent.

12 Cf. Saussay, *The economic impacts of Trump's tariff proposals on Europe.*

13 Cf. Pablo Fajgelbaum, Pinelopi Goldberg, Patrick Kennedy, Amit Khandelwal, and Daria Taglioni, "The US-China trade war and global reallocations," *American Economic Review: Insights* 6, no. 2 (2024): 295–312 (available online).

14 Ninety-seven percent of Canadian crude oil exports are sent to the United States, which accounts for 16 percent of Canada's total export revenue.

15 Vgl. International Monetary Fund, *External Sector Report 2023, Chapter 2* (2023) (available online).

We expect that the strong expansion in the United States will last until 2026 before gradually slowing down. While a protectionist trade policy and restrictive immigration policy will lead to price pressure, falling energy prices will likely dampen this pressure in the forecast period. Continued strong consumption should contribute to growth, supported by households' good financial situation, a solid labor market, and planned tax relief for private households under the new government. Corporate investments will likely support growth as well, driven by better financing conditions, the recovery of the real estate sector, and an expected decrease in the corporate income tax.

The euro area economy should expand further in 2025 and 2026 due to strong domestic demand as a result of rising real wages (Figure 2). The effects of US tariffs as assumed in this forecast should only marginally hamper growth. While the United States is an important trade partner for European economies, its market share for exports from the large EU Member States is in the single digits on average and therefore relatively small compared to that of the Member States' trade partners within the EU (Box 2).

The outlook for the emerging economies remains favorable, but the new US government is likely to increase trade policy uncertainty. In addition to China, Mexico may be the country most affected by import tariffs. In China, the most recent stimulus package is generating growth, although the American import tariffs on Chinese products will weigh heavily on goods exports.

In 2024, advanced economies are projected to expand by 1.8 percent and emerging economies by 4.7 percent. A growth rate of 3.7 percent is expected for the global economy in 2024, while growth of 3.6 and 3.7 percent is expected for 2025 and 2026, respectively. The forecast for 2025 has been adjusted downward by 0.1 percentage points. This moderate downward correction results from the fact that the assumed trade barriers are offset by more dynamic growth in the United States (Table 1).

Downward risks for the global economy have increased considerably since the fall. Geopolitical risks remain quite high. Further escalation in the Middle East could increase oil and gas prices even more. The war in Ukraine remains incalculable, especially following Trump's re-election, which has increased economic and security policy risks overall. This forecast makes assumptions about future US trade and fiscal policy after Trump's inauguration in January 2025 (Box 1). However, if there are considerably higher trade barriers than assumed in this forecast, there are likely to be greater global economic fallouts (Box 2). A further risk factor is public debt sustainability. In France, government bond yields have risen, as the resignation of French Prime Minister Michel Barnier has increased doubts about a reduction in the debt burden.

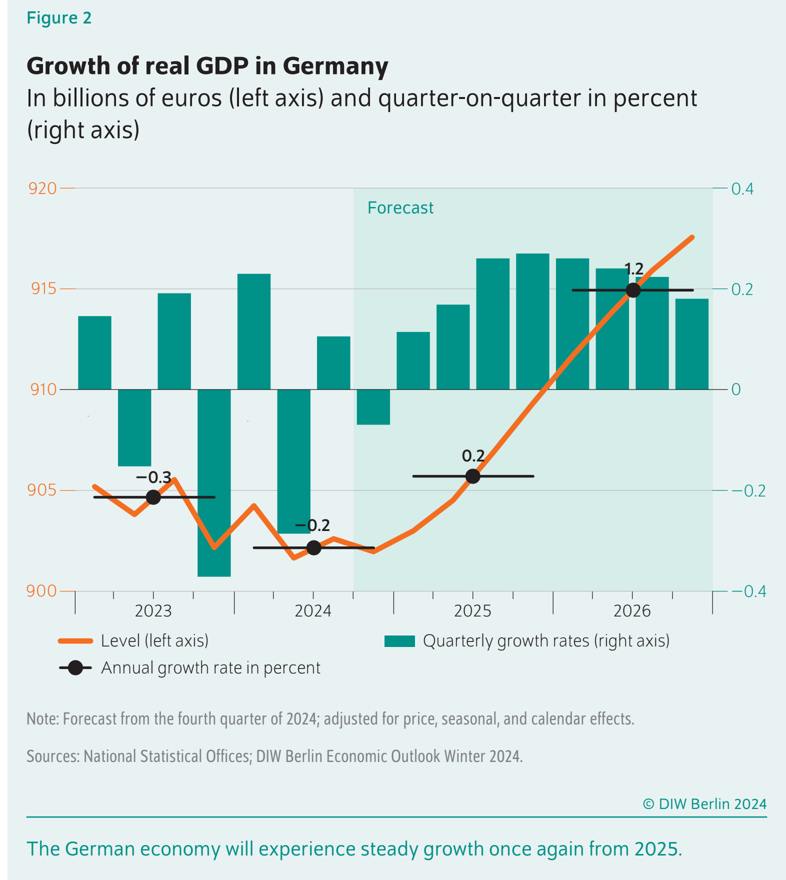
German economy still struggling to make headway

The German economy continues to experience weak growth. In addition to the ongoing global industrial slump, the economic structural change in Germany is having a noticeable impact: Structural adaptation in the manufacturing industry, for example to stronger international competition, has now reached industry-related sectors such as business-related services and are affecting the labor market. Companies in industry as well as those in industry-related sectors are responding to the lack of orders not only by expanding short-time work, but also by laying off some of their staff despite the ongoing skilled worker shortage. Accordingly, unemployment has increased again recently. While economic output increased slightly (by 0.1 percent) in the third quarter of 2024, this growth was preceded by a strong decline (by 0.3 percent) in the second quarter (Figure 2).

Figure 2

Growth of real GDP in Germany

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



Note: Forecast from the fourth quarter of 2024; adjusted for price, seasonal, and calendar effects.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2024.

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The German economy will experience steady growth once again from 2025.

Exports and investments in particular have declined again, likely also due to structural reasons. Persistently weak foreign demand for local manufacturing products was also evident in the third quarter: Exports dropped significantly, goods exports experienced a considerable slump. This in combination with slightly positive imports resulted in a negative trade balance. Thus, foreign trade depressed economic growth in Germany. Investments in equipment and construction were also on the decline again.

Nonetheless, GDP increased slightly in the third quarter, which can be attributed to a moderate expansion of private consumption on the one hand. However, as this growth followed a steep decline in the previous quarter, this cannot be considered a recovery. Taking into account stable inflation rates and sustained wage increases, which were once again strong in the third quarter, the expansion of private consumption seems rather restrained. In light of the impending layoffs at major industrial companies, many private households are likely to be more concerned about their own jobs. It seems that they are saving more money again out of caution: The savings rate increased for the fourth quarter in a row. On the other hand, inventories were expanded significantly and supported economic development: Companies produced more than was consumed, resulting in GDP being higher than the sum of its components.

Examining individual economic sectors makes it clear that the crisis in German industry is worsening and noticeably impacting other sectors. The gross value added of manufacturing as well as the construction sector have recently declined. It declined by 1.4 percent for manufacturing, considerably more than expected in the fall. The gross value added of some services, such as professional services firms, financial services and insurance providers, and information and communication services, declined. Strong growth in public services and other service providers are keeping overall gross value added from dipping into the red.

The re-election of Donald Trump and the collapse of the German government coalition at the beginning of November created further uncertainty about the economic policy framework of the coming years, especially among companies. The outlook for foreign trade has worsened, as the Trump administration will likely increase trade barriers significantly starting in 2025. This forecast assumes that after Trump takes office, he will reimpose 10-percent tariffs on steel and 25-percent tariffs on aluminum that had previously been repealed by current US President Joe Biden. Moreover, it assumes that the tariff rate for Chinese exports to the United States will increase by 10 percentage points. The average tariff rate on goods imports from China to the United States will likely be 30 percent instead of around 20 percent (Box 1).

Domestically, there is still no federal budget for 2025 due to the collapse of the government coalition and the snap election. Provisional budget management applies following the collapse, under which expenditure may only be incurred

Table 2

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

	2023				2024				2025				2026			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
Private consumption	−0.4	0.8	0.0	0.0	0.1	−0.5	0.3	0.1	0.1	0.2	0.3	0.4	0.3	0.3	0.2	0.2
Public consumption expenditure	0.2	−0.2	1.2	0.7	−0.3	1.6	0.4	0.0	0.1	0.3	0.4	0.2	0.2	0.2	0.3	0.2
Gross facilities investment	0.6	−0.2	−0.3	−1.4	0.2	−2.1	−0.1	−0.4	0.2	0.3	0.5	0.5	0.5	0.5	0.6	0.6
Construction	1.3	−0.7	−1.3	−1.9	0.7	−2.2	−0.3	−0.6	0.1	0.2	0.3	0.3	0.3	0.3	0.4	0.4
Equipment	−1.0	−0.2	0.5	−2.1	−1.3	−3.4	−0.2	−0.3	0.1	0.3	0.7	0.8	0.8	0.8	0.9	0.9
Other investment	1.7	1.0	0.9	1.4	1.4	0.6	0.6	0.0	0.6	0.7	0.7	0.7	0.7	0.6	0.6	0.5
Inventory changes[1]	−0.3	−0.1	−0.2	−0.7	0.0	0.4	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic consumption	−0.3	0.2	−0.1	−0.9	0.1	0.1	1.0	0.0	0.1	0.2	0.4	0.4	0.3	0.3	0.3	0.3
Net exports	0.5	−0.4	0.3	0.5	0.2	−0.4	−0.9	−0.1	0.0	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1	−0.1
Exports	0.2	−0.4	−0.7	−0.9	1.4	0.2	−1.9	0.2	0.3	0.1	0.2	0.3	0.4	0.4	0.3	0.3
Imports	−1.0	0.5	−1.4	−2.0	1.0	1.2	0.2	0.4	0.4	0.3	0.5	0.6	0.6	0.6	0.6	0.5
GDP	0.1	−0.2	0.2	−0.4	0.2	−0.3	0.1	−0.1	0.1	0.2	0.3	0.3	0.3	0.2	0.2	0.2
Gross value added	0.5	−0.2	0.0	0.5	−0.1	−0.5	−0.2	−0.1	0.1	0.2	0.3	0.3	0.3	0.2	0.2	0.2
Manufacturing	1.1	−0.1	−1.0	0.0	−1.0	−0.8	−1.4	−0.6	−0.2	0.0	0.2	0.4	0.4	0.3	0.3	0.2
Construction	5.8	−0.6	−0.9	−2.1	1.8	−3.4	−1.2	−0.5	0.0	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Trade, hospitality, transport	−1.2	−0.2	0.6	0.8	−0.5	−0.8	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.3	0.3	0.3
Professional services provider	−0.2	0.5	0.5	1.0	−0.7	0.3	−0.3	−0.1	0.0	0.1	0.3	0.3	0.3	0.3	0.2	0.2
Public services, education, health	0.4	0.1	0.7	0.2	0.4	0.2	1.3	0.2	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1

1 Contribution to growth in percentage points.

Note: Forecast from the fourth quarter of 2024; adjusted for price, seasonal, and calendar effects.

Sources: National Statistical Offices; DIW Berlin Economic Outlook Winter 2024.

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to "maintain existing institutions, legal obligations of the federal government,"[1] and for measures that have already been adopted. In addition, some fiscal policy support that had already passed the Federal Cabinet but had not yet been approved by the *Bundestag* will no longer find a majority under the current minority government. This support includes measures aimed at stimulating investment, such as the extension of degressive depreciation rules, which were introduced as part of the growth initiative announced in late summer. Planned adjustments to the income tax rate to eliminate bracket creep and the increase in the child allowance and child benefit are also unlikely to happen for the time being. This forecast assumes that a government will be formed and a budget resolution agreed upon in early summer 2025, which will support the financial situation of the federal ministries and agencies and thus government consumption. However, as new government plans and fiscal policy measures cannot yet be known, fiscal policy will remain restrictive for the time being. Due to uncertainties about a new government's economic policy orientation, companies located in Germany in particular are likely to act carefully. Thus, investment decisions are likely to be delayed to 2025.

The increased uncertainty is hitting the German economy in an already extremely difficult situation between cyclical weakness and structural change. Thus, another decline in economic output is expected in the current fourth quarter (Table 2). Leading indicators from the beginning of the current quarter, i.e., before the US presidential election and the collapse of the German government coalition caused additional uncertainty, suggest that the industrial slump would have continued regardless of the additional negative factors and that a recovery would have been delayed again. The Global Composite Purchasing Managers' Index remained below the expansion threshold of 50 index points in October. In November, the index declined again. While the index for industry stagnated below the expansion threshold of 50, the index for services fell below this threshold for the first time since February. It should be noted that only some of the surveys took place following Trump's re-election and the collapse of the German government coalition. The extent to which these political developments have further depressed sentiment will probably only become fully apparent in the December survey. Meanwhile, the order situation remains weak for both services as well as manufacturing. For example, gross value added in the current fourth quarter is likely to decline slightly overall, yet slight increases in the service sectors will compensate for further declines in industrial production.

The uncertainties due to foreign and domestic political developments should result in companies acting more reserved in

1 The legal basis for provisional budget management is Article 111 of the Basic Law. The term "institutions" includes constitutional bodies, federal agencies, institutions, and construction facilities, for example. Maintaining existing institutions includes ongoing personnel costs, costs related to filling new positions, and replacement equipment costs. "Legal obligations" include, among other things, benefit claims from Social Code II (SGB II) such as the citizen's benefit (*Bürgergeld*), housing allowance (*Wohngeld*), parental allowance (*Elterngeld*), and expenditure obligations from international agreements.

the current quarter, resulting in a noticeable decline in private equipment investment. The deteriorating external economic environment is also having an dampening impact on foreign trade as well as the willingness to invest. On the flip side, exports to the United States are expected to be pulled forward to the current and upcoming quarters, as the risk of steep tariff increases goes well beyond the reintroduction of aluminum and steel tariffs assumed in this forecast. The temporary rise in exports should in turn boost imports of intermediary goods. Overall, foreign trade is expected to once again make a negative contribution to GDP in this quarter.

Private consumption should continue to develop weakly, barely supporting economic development in the fourth quarter. Job worries in particular are dampening private households' willingness to spend. This is reflected in the savings rate, which has been rising for four quarters. In addition, the price level, which has become permanently higher, is slowing consumption despite rising real disposable income. Construction investments in which residential construction largely driven by private households plays a key role are likely to decline again.

We expect that the economic situation will relax very gradually over the further course of the forecast. From mid-2025, with a new federal government and clearer external economic conditions, more and more uncertainties will dissipate and make households and companies more confident again. The stabilization of employment over the course of 2025, which should even grow somewhat in 2026 should also contribute to this. Accordingly, unemployment will gradually decline. As a result, we expect that more of the higher disposable incomes and at least some of the household savings will be spent again. Construction and equipment investments should then stabilize, with the latter likely also being supported by government expenditure in 2025 in particular as a part of the *Bundeswehr*'s special fund. Companies will likely increasingly invest in their production capacities beginning in 2026. As European industry increasingly recovers, foreign demand will rise and the European Central Bank (ECB), as assumed, will cut interest rates further and German exports will likely pick up speed again.

While monetary policy will become increasingly less restrictive due to further interest rate cuts over the course of the forecast period, fiscal policy will likely remain restrictive. On the one hand, this is due to the expiry of expansionary measures in response to the energy crisis, the end of tax breaks, and tax increases. On the other hand, we assume that the collapse of the coalition will mean that revenue-reducing legislation will no longer be implemented, thus decreasing expansionary stimuli. Due to the snap elections for the German *Bundestag*, the overall direction of fiscal policy during the forecast period is subject to a high degree of uncertainty.

All in all, price-adjusted GDP will likely contract by 0.2 percent in 2024 for the second year in a row (Table 3). In 2025, global economic output should expand by 0.2 percent, considerably less than was expected in the fall. Growth will be stronger in 2026 at 1.2 percent. However, this will be in part due to non-recurring effects such as a comparatively high number of work days. Thus, DIW Berlin is lowering its forecast for 2024 by 0.5 percentage points and for 2025 and 2026 by 0.7 and 0.2 percentage points, respectively. The significant downward revision in some cases is primarily due to the enormous additional burdens on the German economy due to the many uncertainties, both for companies as well as private households. With this forecast, DIW Berlin is revising potential GDP downward again. In 2029, potential growth of the German economy should still be 0.3 percent. Overall, the output gap for 2024 and 2025 is likely to be a bit larger than expected in fall. The gap will be –1.0 percent for 2024 and –0.9 percent for 2025. Over the course of the recovery, the gap is expected to nearly close at –0.2 percent in 2026.

Following the strong growth of previous years, average consumer price inflation should be 2.2 percent, primarily due to falling energy prices. This is close to the ECB's two-percent target In the coming years, the inflation rate is expected to level off at two percent. Thus, DIW Berlin's inflation forecast remains unchanged compared to the fall. The core rate (inflation excluding energy and food) should also decline further and come closer to the inflation target, but more slowly than the overall rate of inflation.

The downside risks for the German economy grew significantly larger in the fall. In particular, domestic and foreign economic policy uncertainties pose a risk of real economic distortions that could be significantly greater than assumed in this forecast. There could be delays in forming a government and, accordingly, in the budget process, which would

Table 3

Key economic indicators for the German economy

	2023	2024	2025	2026
GDP[1]	−0.3	−0.2	0.2	1.2
Employment[2] (1,000 persons)	46,011	46,106	46,071	46,120
Unemployed (1,000 persons)	2,609	2,787	2,854	2,707
Unemployment[3] (BA concept, in percent)	5.7	6.0	6.1	5.8
Consumer prices[4]	5.9	2.2	2.0	2.0
Unit labor costs[5]	6.7	5.4	3.1	1.8
Government budget balance[6]				
in billions of euros	−107.5	−108.6	−92.8	−82.7
in percent of nominal GDP	−2.6	−2.5	−2.1	−1.8
Current account balance				
in billions of euros	248.7	254.3	223.4	209.5
in percent of nominal GDP	5.9	5.9	5.1	4.6

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

Note: Forecast from the year 2024.

Sources: Federal Statistical Office; DIW Berlin Economic Outlook Winter 2024.

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keep economic conditions in Germany in limbo for longer than assumed here. The new US government could impose high tariffs on German car exports to the United States, which would hit the already struggling manufacturing industry in Germany even harder. In addition, it is unclear to what extent the German economy's weak growth is shaped by structural adaptation and to what extent by cyclical factors. Global economic risks are also affecting Germany.[2] For example, there is no easing in sight for many geopolitical flashpoints, such as the war in Ukraine.

2 For more, see the section on the global economy in this Weekly Report.

Geraldine Dany-Knedlik is Head of the Forecasting Department 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 Energy, Transportation, Environment Department at DIW Berlin specializing in Central and Eastern 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

Pia Hüttl is the Coordinator of the global economic forecast and a Research Associate in the Macroeconomics Department | phuettl@diw.de

Konstantin Kholodilin is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in estimating potential output at DIW Berlin | kholodilin@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 Macroeconomics Department at DIW Berlin specializing in investments | lpagenhardt@diw.de

Jan-Christopher Scherer is the Coordinator of the German economic forecast and 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 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 USA, German fiscal policy, and German foreign trade | rstaffa@diw.de

Kristin Trautmann is a Research Associate in the Macroeconomics Department at DIW Berlin specializing in the United Kingdom and European Monetary Policy | ktrautmann@diw.de

JEL: E32, E66, F01

Keywords: Business cycle forecast, economic outlook

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
Volume 14 <Month> <#>, 2024

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

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ISSN 2568-7697

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