IWH
Halle Institute for Economic Research
Member of the Leibniz Association

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A turning point for the German economy?

The international political environment has fundamentally changed with looming trade wars and a deteriorating security situation in Europe. The leading parties in Germany are setting the stage for debt-financed additional defence tasks with far-reaching changes to the debt brake. This entails major risks for the German economy, but also opportunities. Meanwhile, the economy continues to be in a downturn. According to the spring forecast of the Halle Institute for Economic Research (IWH), gross domestic product (GDP) in 2025 is likely to be roughly the same as in the previous year, and it will not increase significantly until 2026, partly because uncertainty about German economic policy is likely to decrease after the new government is established, meaning that the savings rate of private households will fall again somewhat and the debt-financed additional government spending will gradually have an impact on demand. The IWH economists are forecasting an increase in GDP of 0.1% for 2025. In December, they were still forecasting growth of 0.4% for 2025. The outlook is similar for East Germany, where production is likely to have increased slightly in 2024, unlike in Germany as a whole.

The announcements and decisions made by the new US administration, particularly regarding its position in the Russia-Ukraine conflict and its tariff policy, have led to high uncertainty worldwide and recently caused US share prices to fall significantly. Meanwhile, the global economy is likely to have continued expanding moderately during winter. The economy remained robust in the US, but weak in the euro area. In the US, the negative effects of economic policy uncertainty and higher tariffs are likely to roughly balance out the short-term positive effects of deregulation. In China, the property crisis is continuing for the time being, while the success of the DeepSeek chatbot app has improved the outlook for the Chinese tech sector. In the euro area, the economy will remain weak in 2025.

In Germany, CDU/CSU and SPD have agreed to de facto suspend the debt brake in order to finance rearmament and additional public infrastructure investments. “The additional public spending should gradually have a stimulating effect on the economy,” says Oliver Holtemöller, head of the Macroeconomics Department and Vice President at the IWH. “The policy shift comes against the backdrop of an economy in crisis, with a loss of international competitiveness and weak investment.” The decline in production in the fourth quarter of 2024 was primarily due to lower exports, and investment in equipment has fallen further. The unemployment rate continues to rise slowly, and employment growth has recently come to a standstill. Private households are adapting to the economic crisis by being more cautious with their spending: their savings rate is at present significantly higher than the long-term average. In this forecast, we assume that the

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The IWH Forecasting Dashboard (ForDas)

The IWH-ForDas is an interactive platform for comparing macroeconomic forecasts from various institutes on the German economy.

Keywords
business cycle, debt brake, defence investments, economic growth, East Germany, euro area, export, fiscal policy, forecast, Germany, global economy, gross domestic product, production, Russia, tariff policy, tariffs, Ukraine, USA

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infrastructure fund will indeed be set up and that military spending will be significantly higher. However, all this will hardly have any real economic impact in the current year, but only in later years. In addition, the sharp rise in social security contributions has a negative impact on disposable income. "All in all, gross domestic product in Germany is likely to stagnate in 2025, as will the number of employed persons," says Oliver Holtemöller. The general government budget deficit is likely to amount to 2.7% in 2025 and rise to 3.2% in 2026.

Table

Forecast for Germany: Key Economic Indicators[a] for Germany, 2023–2026

	2023	2024	2025	2026
	percentage change over previous year (price adjusted)			
Germany	–0.3	–0.2	0.1	1.3
East Germany[a]	0.7	0.2	0.1	1.1
	percentage change over previous year in %			
hours worked	0.4	–0.1	–0.5	0.3
hourly union wages	3.6	4.7	2.2	2.5
hourly actual wages	6.6	5.4	3.4	2.1
unit labour costs[b]	6.7	5.5	3.1	1.3
consumer price index	5.9	2.3	2.3	2.1
	1,000 persons			
employment (domestic)	46 011	46 082	46 066	46 108
unemployment[c]	2 609	2 787	2 865	2 788
	in %			
unemployment rate[d]	5.7	6.0	6.1	6.0
East Germany[a]	6.7	7.5	7.6	7.5
	in % of nominal GDP			
general government overall balance	–2.5	–2.8	–2.7	–3.2
current account balance	5.8	5.7	4.5	4.4

[a] East Germany including Berlin. – [b] Per hour (IWH calculations). – [c] Federal Employment Agency (BA) concept. – [d] Unemployment in % of civilian labour force (Federal Employment Agency (BA) concept).

Sources: Federal Statistical Office; 2025/2026: IWH forecast (as of March 11, 2025).

Risks for the German economy arise primarily from the uncertain political environment. The uncertainty surrounding US trade policy is having a particularly strong impact on the German economy, as the US is by far the country to which most German exports are shipped. Furthermore, deficit-financed expansion of government spending in Germany and Europe entails its own considerable risks. A loss of investor confidence could quickly put euro area countries with high levels of debt into financial difficulties, which the European Central Bank (ECB) according to the IWH economists would probably counter with purchases of the affected government bonds. In such a case, European monetary policy, dominated by fiscal considerations, would risk losing its focus on price stability.

The extended version of this forecast contains three boxes (all in German):

Box 1: On the estimation of potential output

Box 2: Effects of CO_2 pricing on consumer prices in Germany

Box 3: Short-time work on the rise again — focus shifts to the manufacturing sector

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The Halle Institute for Economic Research (IWH) – Member of the Leibniz Association was founded in 1992. With its four research departments – Financial Markets; Laws, Regulations and Factor Markets; Macroeconomics; Structural Change and Productivity –, IWH conducts economic research and provides economic policy recommendations, which are founded on evidence-based research. With the IWH's guiding theme "From Transition to European Integration", the institute's research concentrates on the determinants of economic growth processes with a focus on efficient capital allocation in a national and European context. Particular areas of interest for the institute are macroeconomic dynamics and stability, microeconomic innovation processes, productivity and labour markets, the dynamics of structural adjustment processes, financial stability and growth and the role of financial markets for the real economy.

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