Flash Economics

N° 17
August 27th, 2024

The causes of Germany's economic difficulties

Germany continues to experience negative GDP growth in the second quarter of 2024, while the entire eurozone has recorded positive growth (+0.3%).

We are questioning the causes of Germany's difficulties, which stem from:

- Weak exports, particularly exports to other EU countries and China, which may result from Germany's productive specialization;
- Weak business investment, partly due to declining profitability;
- Weak household consumption, with an increase in their savings rate;
- Restrictive fiscal policy, with the implementation of the "debt brake."

The recovery of Germany's growth will be difficult, as it will require an improvement in productive specialization (with an upgrade), an increase in business profitability, a return of household confidence, and a greater flexibility in fiscal policy rules.

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Germany's growth is weak compared to that of the eurozone.

Germany's growth has been significantly weaker than that of the entire eurozone since the beginning of 2021(**Charts 1A/B/C).**

This is true for overall growth as well as for the growth of manufacturing output (**Chart 1D**).

Chart 1A
Real GDP (Y/Y as%)



Chart 1B
Real GDP (Y/Y as%)

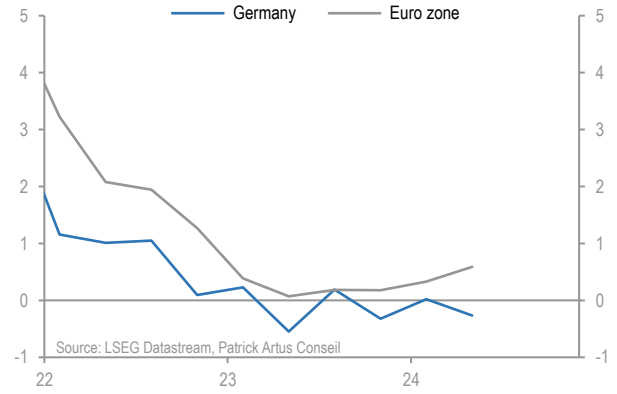


Chart 1C
Real GDP (Q/Q as%)

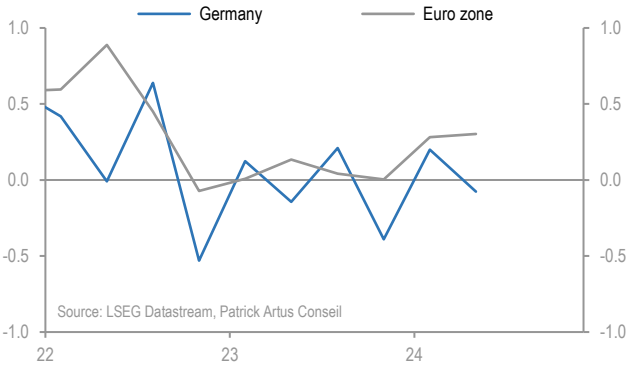
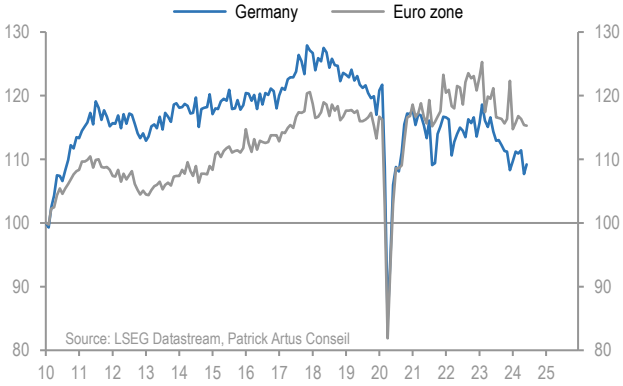


Chart 1D
Manufacturing production (01.01.2010 = 100)



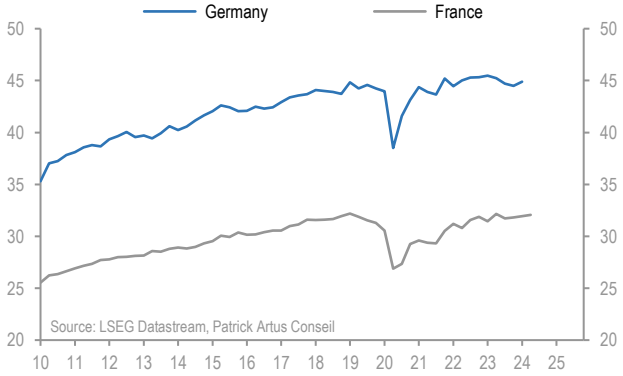
We are questioning the **origin of this weakness in Germany's growth**.

Possible explanations for the weakness in Germany's growth

1- Weakness and high weight of exports

The weight of exports in Germany's GDP is significantly higher than that of other eurozone countries. **(Chart 2)**.

Chart 2
Exports of goods and services
(in volume terms, as % of real GDP)



Germany has been suffering from stagnant exports since 2018 (Charts 3A/B), particularly with a decline in its exports to other EU countries and China (Chart 4).

Chart 3A
Germany: Exports of goods and services



Chart 3B
Germany: Exports of goods (EUR bn, annualized)

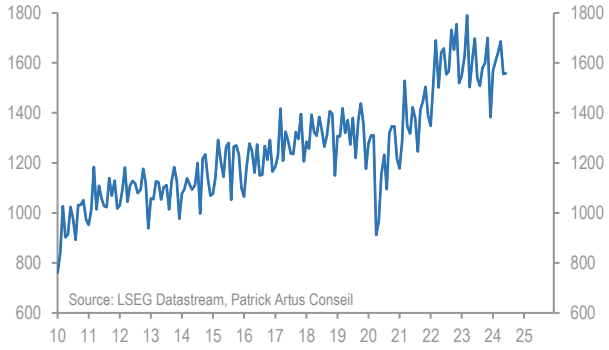
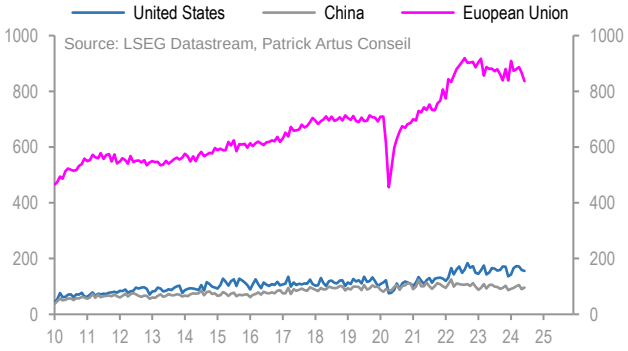
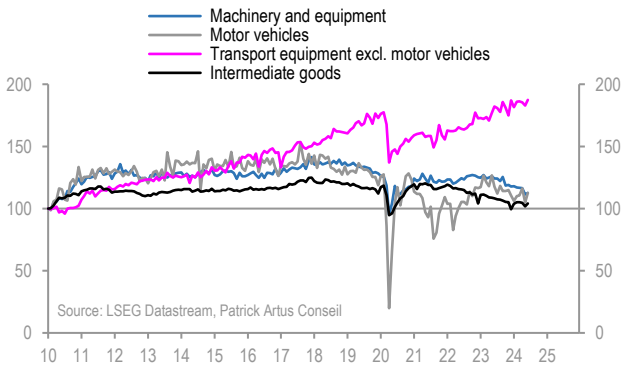


Chart 4
Germany: Exports to the United States, China and European Union (EUR bn, annualized)



This weakness in Germany's exports since 2018 can be linked to **Germany's disadvantageous productive specialization**. Its industrial production is concentrated in automobiles, capital goods, and intermediate goods **(Chart 5)**, and less in higher-end sectors (such as electronics) or sectors less affected by competition from the Chinese industry.

Chart 5
Germany: Manufacturing production (01.01.2010 = 100)



2- Weakness in Business Investment

The poor positioning in terms of product range and the decline in business profitability **(Chart 6)** have resulted in weak business investment **(Chart 7).** This means that not only is short-term growth weak, but **potential growth is also low**. However, since 2019, this weakness in business investment is not more noticeable in Germany than in other eurozone countries.

Chart 6
Ratio between GDP deflator and unit labour cost (100: 2002.Q1)

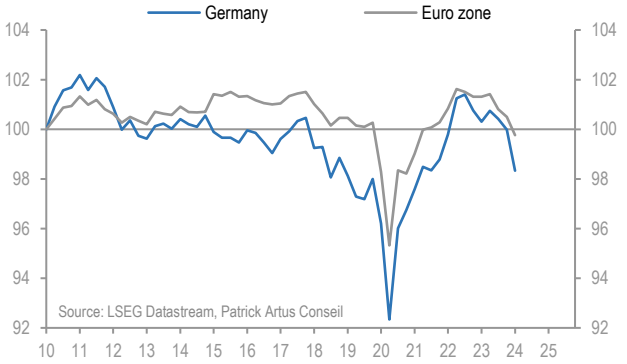
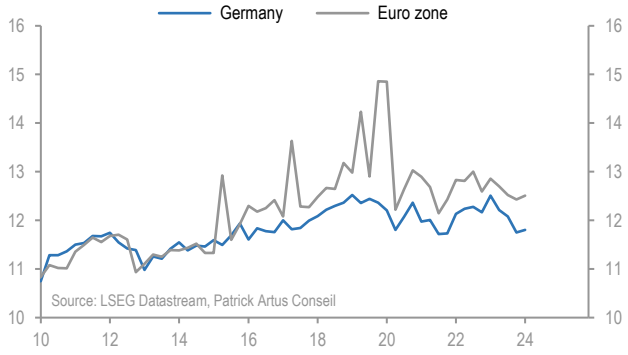


Chart 7
Corporate investment (in value terms, as % of nominal GDP)



3- Weakness in household consumption

The weakness in **German household consumption (Chart 8)**, particularly since 2022, is notably due to **the increasing trend in their savings rate** (**Chart 9)**, as wages have been rising rapidly in Germany since 2021 **(Chart 10)**.

Chart 8
Household consumption in volume terms (Y/Y as %)

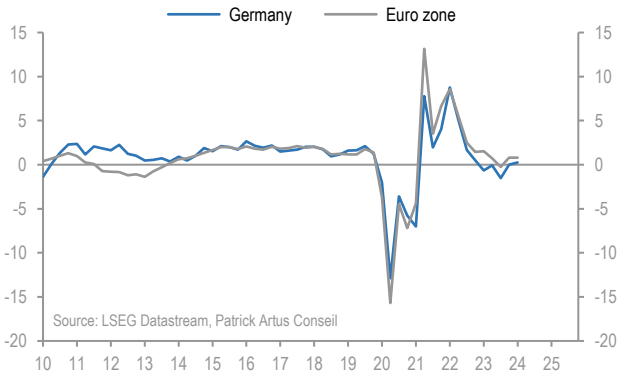


Chart 9
Gross household savings rate (as %)

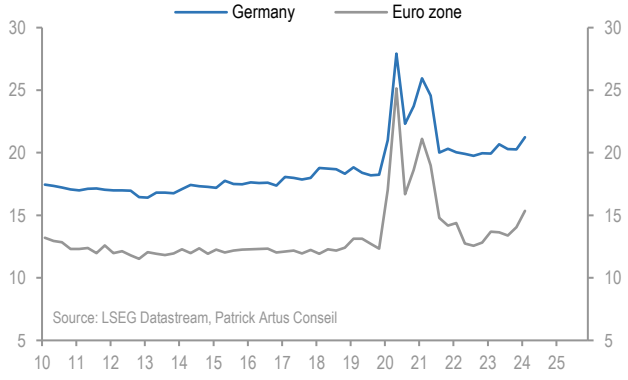
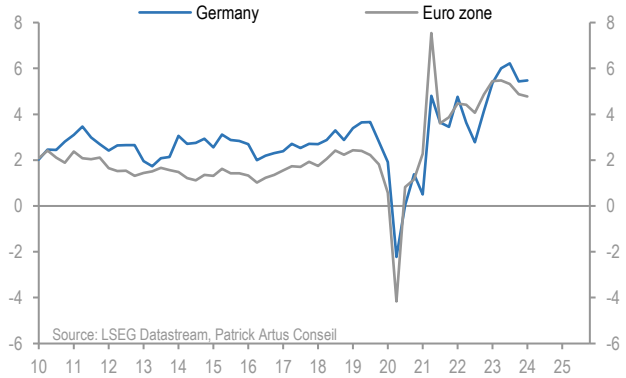


Chart 10
Nominal compensation per employee (Y/Y as %)



4- Restrictive Fiscal Policy

Germany maintains the « **debt brake** » (Schuldenbremse), which requires it to return to a near-zero public deficit **(Chart 11)** and prevents necessary public investments and expenditures (infrastructure, business investment aids) from being carried out **(Chart 12)**.

Chart 11
Fiscal deficit (as % of nominal GDP)

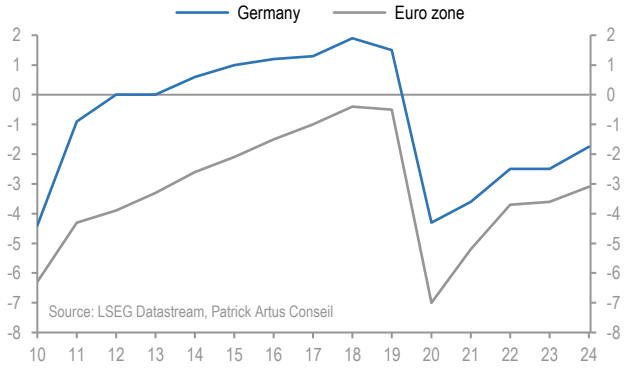
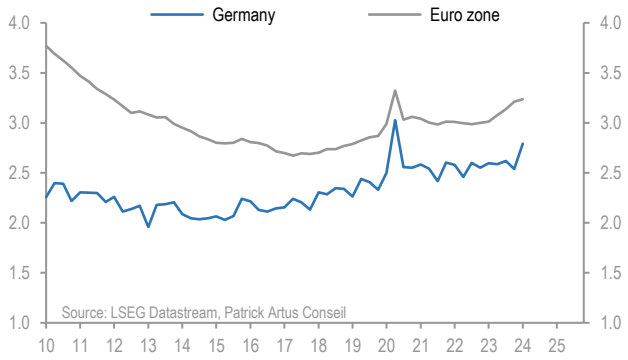


Chart 12
Public investment
(as % of nominal GDP)



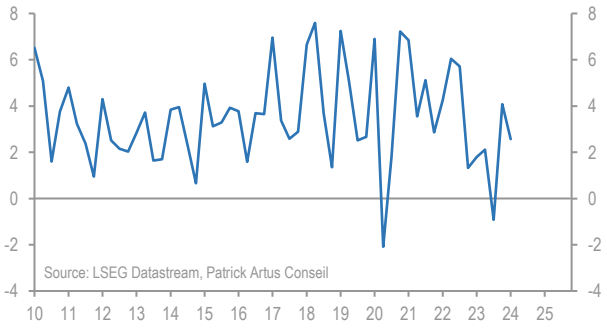
Summary: The recovery of Germany's growth will be difficult.

Germany has been suffering, especially since 2018, from:

- Its mercantilist strategy (growth based on exports) while its mid-range productive specialization exposes it to competition from other countries (China, United States);
- The weakness of the business investment rate, linked to low profitability and unfavorable productive specialization;
- The weakness of household confidence, which explains the increase in their savings rate;
- Fiscal rules that are not adapted to the needs for public investments.

As long as German companies prefer to invest abroad **(Chart 13)**, it is unlikely that Germany's situation will improve.

Chart 13
Germany: Direct investment outflows*
(as % of nominal GDP)



(*) Direct investment outflows are capital outflows leading to an increase in assets (in this case for Germany), and are therefore given a positive sign.

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