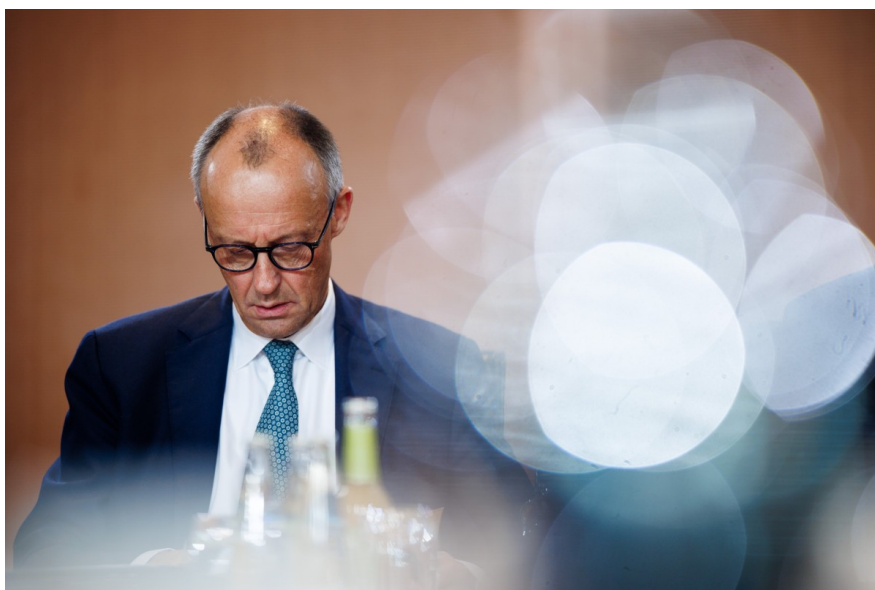


Germany: Searching for a higher gear

Optimism in Germany took a hit over the summer as political developments and decisions undermined the full positive impact of the fiscal stimulus announced in the spring



German Chancellor
Friedrich Merz

A rude awakening

After the excitement and enthusiasm sparked by Germany's fiscal policy U-turn and its decision to invest significantly in infrastructure and defence this spring, the summer has brought a rude awakening. The mood in Germany has once again soured. Optimism has ground to a halt – and not just because of US tariffs or a stronger euro, both of which complicate matters for the export industry. Domestic politics have also played a role. The hope that a new government and fiscal stimulus would finally lift the economy out of its prolonged stagnation seems to have faded.

Over the summer, two developments in the political debate have cast a shadow:

1. A discussion around possible austerity measures, which could undermine the psychological impact of the announced fiscal stimulus.
2. The government's decision to shift previously planned investments from the annual budget to special investment funds, bringing with it the whiff of creative accounting in German fiscal policy.

These developments not only revive unpleasant memories of coalition infighting from the previous

government but also risk dampening household and corporate spending and investment decisions.

Let's be clear: the scale of Germany's announced fiscal stimulus – €500bn for infrastructure and a 'whatever it takes' stance on defence – remains significant. This money will eventually reach the economy. However, recent fiscal manoeuvres have increased the risk that the stimulus will be less impactful and slower to materialise than initially hoped. Add to this the well-known supply-side constraints – from a shortage of skilled labour and high material costs to bureaucratic hurdles – and it seems likely that infrastructure investments will boost the economy more in 2027 than in 2026. Defence spending, on the other hand, could still deliver a positive growth surprise.

Beyond the diluted impact of fiscal stimulus, the government is also struggling to agree on the far-reaching reforms needed to structurally enhance Germany's competitiveness. Chancellor Friedrich Merz has promised a 'Fall of Reforms'. So far, the government has not only failed to deliver but also appears stuck in a macroeconomic model rooted in the 20th century, lacking a clear plan to propel the German economy into the 21st century. That said, autumn isn't over yet, and recent weeks have seen new initiatives aimed at reducing bureaucracy and boosting digitalisation. And yes, it takes time for investments and reforms to translate into growth. But given the disappointments of recent weeks, the need for a traditional short-term stimulus – or at least a stabilisation package – seems to grow by the day.

All in all, the German economy is heading for a third consecutive year of stagnation, and hopes for an imminent turnaround have clearly taken a hit over the summer. Both the government and private sector will need to find a higher gear soon to avoid a fourth year of stagnation.

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