

Snap | 22 August 2025

GERMANY

# Germany's economic slump worsened in the second quarter

A full reversal of previous US front-loading effects has pushed the German economy back into recessionary territory, and it looks increasingly unlikely that any substantial recovery will materialise before 2026



Today's data could support the case against more ECB rate cuts

Return to the danger zone. As feared, the second estimate of Germany's second-quarter GDP data saw the eurozone's largest economy falling back into an even worse contraction.

After a surge of 0.3% quarter-on-quarter in the first quarter, the German economy shrank by 0.3% in the second (the initial estimate showed a drop of 0.1% QoQ). On the year, the economy was up by 0.2%, seasonally and calendar-adjusted. While investments, the construction sector and net exports were significant drags on economic activity, private and public consumption, as well as inventories, supported activity. A bit overlooked in the first release was the fact that the statistical agency had significantly revised downwards the official GDP numbers for 2023 and 2024. As a result, the size of the German economy is currently still slightly below its 2019 level, probably the best and most painful illustration of stagnation.

### Optimism alone doesn't bring back growth

Today's GDP release shows the recent wave of optimism that had caught the German economy in the first months of the year is not yet showing in the data. In fact, after the surge in economic activity resulting from the US front-loading of German exports in the first quarter, the economy experienced a reversal of the front-loading effect, and the first full-blown impact of US tariffs (implemented in the second quarter) took effect.

Still, as illustrated by yesterday's PMI data, at least business optimism seems to be almost unbreakable. It is still unclear where this optimism is exactly coming from. Is it due to fiscal stimulus, a less benign take on US tariffs, or signs that the turning of the inventory cycle that we saw at the start of the year will pick up steam again? Possible, but definitely not a done deal. The narrative of a turning inventory cycle saw a setback recently with disappointing industrial data.

### Waiting for a substantial recovery continues

Looking ahead, the path for the German economy and industry will be particularly affected by trade, the exchange rate, and fiscal stimulus. In the near term, recent corporate results were already a painful reminder that US tariffs, but also structural transitions, were in full swing in the second quarter, weighing on company results. This is a trend that won't change too much in the third quarter, with US tariffs of 15% on most European goods and uncertainty over whether (and when) the 27.5% tariffs on automotives will be brought back to 15%. With 10% of total German exports going to the US, the new tariffs will weigh on economic growth.

While financial markets seem to have grown numb to tariff announcements, let's not forget that their adverse effects on economies will gradually unfold over time. The German Mittelstand could become a victim of US tariffs, as these hidden champions will have more trouble relocating production than big corporates. Add to that the stronger euro exchange rate – not only against the US dollar, but many other currencies – and it is hard to see how the export-dependent German economy will be able to get out of seemingly never-ending stagnation in the second half of the year.

All of this dampens hopes for fiscal stimulus, corporate investments and innovation bringing back growth. In this regard, the current political debate in Germany on possible austerity measures could undermine the – at least psychological - impact of the announced fiscal stimulus for infrastructure and defence. As much as we subscribe to the need for sustainable public finances and structural reforms for the economy and the budget, it is a debate that would benefit from swift decisions. The longer a debate on potential austerity measures lasts, the higher the risk that households and companies will hold back spending and investment decisions – a risk factor that financial markets seem to have missed so far.

All in all, the German economy has made itself too comfortable in stagnation, and it could take

until next year before a more substantial recovery starts to unfold.

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