

German economy makes headlines again for all the wrong reasons

The German economy contracted at the end of 2024, and there's a high likelihood this downturn will lead to a winter recession



Now it's official. The German economy ended 2024 in contraction, shrinking by -0.2% quarter-on-quarter. On the year, the economy also contracted by 0.2%. Fun fact: this was the third year in a row that the German economy ended the year with a negative quarter.

GDP details will only be released next month but available monthly data as well as the statistical office's press release suggest that exports dragged the economy into contraction. At the same time, today's data confirms that the German economy shrank by 0.2% year-on-year in 2024, from -0.3% YoY in 2023. Adjusted for working days, the German economy shrank by 0.2% YoY in 2024 and 0.1% YoY in 2023. It's the first time since the early 2000s that the German economy contracted for two consecutive years.

2024 was the year when cyclical and structural headwinds became a storm

Looking at the broader picture, the German economy has now been stuck between cyclical and structural headwinds for several years, and 2024 was finally the year that many politicians

realised that the old macro business model of cheap energy and easily accessible large export markets was no longer working.

Ten years of underinvesting, deteriorating competitiveness and China's shift from an export destination to a fierce industrial competitor have taken – and will continue to take – their toll on the German economy. Contrary to the early 2000s when Germany's economic "sickness" or problem was high unemployment and a rigid labour market, the current problems are much more diverse and hence even more difficult to solve than they were 20 years ago. Let's also not forget that the external environment in the early 2000s was far more favourable for Germany, with China's entry into the World Trade Organization and the EU's enlargement. This contrasts sharply with today's geopolitical tensions, a nearby war, and the rise of protectionism.

For now, Germany's problems seem mainly concentrated in industry, particularly in automotive. Five years after the onset of the Covid-19 pandemic, German industrial production remains about 10% below its pre-pandemic levels. Manufacturing capacity utilisation is at lows comparable only to those seen during the financial crisis and the initial lockdowns. This paints a rather unflattering picture of a nation known as an industrial powerhouse. However, given the importance of industry for the entire economy, spillovers to other sectors – be it via sentiment or real economic channels – are already happening.

Near term outlook doesn't promise any substantial change

Looking ahead, besides some rather technical rebounds, a substantial recovery of German industry is not in sight just yet. Inventories have continued to increase instead of turning around, and have now been at elevated levels for more than a year. At the same time, order books have not started to recover and the important turning of the inventory cycle has still not started.

Add to this looming tariffs and the expected modern version of 'beggar-thy-neighbour' policies by the incoming new US administration, and the outlook for German industry remains anything but rosy. Not just because of the potential impact on German exports, but more so the effect on German investments if companies were to move production to the US.

At the same time, the increase in bankruptcies since mid-2023 is likely to enhance the already gradual turning of the labour market, potentially denting hopes of a private consumption rebound.

Election campaign shifts focus from economy to immigration

Needless to say, the upcoming elections will be key for Germany's economic outlook in 2025 and beyond. While the election campaign had started with almost all focus on the economy, the latest developments have turned the campaign away from the economy to immigration and how to deal with the right-wing AfD. Yesterday, the German parliament voted for a plan by CDU leader Friedrich Merz for tougher migration measures; with votes from the AfD and against the votes of the current minority government parties, SPD and Greens. This vote won't have any impact on actual measures, for now, but has unleashed a heated debate in Germany on whether or not the CDU broke the informal agreement of Germany's mainstream parties not to cooperate with the far right. The counterargument used by the CDU is that there hasn't been any cooperation but that it would simply do what it thinks is right, no matter whether the 'wrong' parties would support it.

No matter where anyone stands in this debate, the shift from economics to immigration, the strong polling of the AfD, as well as the discussion on how to deal with the AfD, will give the next

three weeks new momentum. Together with the hardening of the red lines between centre-left and centre-right political parties, this is likely to make coalition negotiations after the elections even more complicated. There is an increasing risk that the shift of the election debate towards immigration will eventually lead to a muddling-through stance on economic reforms and investments.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.