



REPORT ON THE ECONOMIC SITUATION

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The German economy at the start of 2024

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At the end of 2023, it became increasingly evident that the sentiment in the German economy has hit a low point. It was a difficult economic year that ended with a shrinking gross domestic product and a relatively high inflation rate. Stagflation gave rise to dissatisfaction. The construction industry collapsed due to high interest rates, energy-intensive companies limited production, the automotive industry struggled with the structural transformation, and private consumption remained relatively weak. There were no new impulses from the international environment, and only the US supported the German export industry. And the German government also created uncertainty, not least by its response to the decision of the Federal Constitutional Court.

At the same time, 2023 was not a bad year for investors. Equity markets finished the year with significant gains, and the bond markets also offered new opportunities. Sentiment was sometimes worse than the actual situation. So how do things look at the beginning of 2024? Considering that the year started with farmer protests and the rail engineer strike, it does not appear that sentiment is improving. However, what trends are becoming apparent at this point?

Based on its fall forecast (which is still valid), the federal government expects the gross domestic product (GDP) to grow by 1.3 percent in 2024. But in the fall of 2023, several forecasters were much more cautious in this regard, and that was before the financial policy impact from the Federal Constitutional Court's decision of 15 November 2023 was taken into account. The Expert Panel for the Economy only expected 0.7 percent economic growth. Together with the now lower financial policy impulse, GDP growth is likely to be even less. Hence Germany continues to stagnate.

As per the federal government, the expected inflation rate for 2024 is 2.6 percent, which is in line with the forecasts of the economic research institutions and the ECB. But this seems optimistic, considering how entrenched inflation has become. The increase in indirect taxes due to the federal government's budget policy (higher CO₂ prices for transportation and buildings, reversal of the temporarily reduced VAT for gas and meals, higher air transportation taxes, the removal of tax subsidies such as agricultural diesel) leads to higher prices. Added to the above

is the fact that some base effects will not be as favourable as in the previous year, because in the coming months energy prices cannot decrease as quickly as compared to the previous year 2022, not to mention higher wages, which companies will attempt to pass on. The ifo Institut expects that wages in the year 2024 will rise by around 5 percent. Therefore it is not expected that interest rates will be reduced.

Positive signs include the robust labour market, although unemployment is gradually increasing as the economy weakens.

The financial position is comfortable, despite the media hype: The government debt ratio is moving towards the Maastricht limit of 60 percent; financial markets are rewarding Germany with top ratings. The federal government and all of the federal states and municipalities are on the way towards moderate consolidation, which is supportive of the monetary policies with its slightly restrictive impact. At the same time, this consolidation is creating political challenges for the federal government, particularly when it comes to reducing subsidies.

On a structural level, the German economy continues to fight high energy costs and relatively high unit labour costs, the highest corporate tax burden in the world and enormous regulatory costs. The relative disadvantage of high energy costs cannot really be addressed, not least because of the required increases in CO₂ pricing. Labour costs could decrease in some areas. But on a structural level, demographic trends are leading towards higher labour costs. Therefore economic and financial policies must improve the investment environment by improving the tax situation and reducing regulatory intensity. Corporate tax reform and a policy of deregulation are urgently required.

It is doubtful that the federal government will take this challenge on.

Sincerely yours

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