The economic situation in Germany remains difficult

Exclusive report for ACATIS Investment: Prof. Dr. Dr. h.c. Lars P. Feld, University Freiburg and Walter Eucken Institute

These days, economic observers are doing their best to extract some good news out of the monthly industrial production numbers, the volume of incoming orders or sentiment indicators. But a sober look beyond any one month reveals that there is no sign of an upward trend.

This finding is supported by a series of economic indicators beginning with the sentiment indices. Empirically speaking, the ifo business climate index and the ifo business expectation index have a fairly good forecasting ability with regard to economic performance. These indices are early indicators of economic developments. The same is true in the case of the Purchasing Managers' Index. Even though these expectation indicators reveal slight improvements, there are no signs of a real upturn. The Purchasing Managers' Index is stuck under the threshold value of 50 that indicates the beginning of an upward trend. While the ifo indicators have improved since January 2025, they are still below the relevant threshold values.

As the sentiment improves, economic researchers expect that more orders will be placed. The data series for incoming orders have a lot of volatility month to month and are often dominated by large orders (or lack thereof). At times, such large orders can skew incoming order numbers, so that the public is left with the impression that things are going well. But when we examine this data series since the beginning of the year, there is no sign of a significant increase in incoming orders in Germany. Therefore it is not surprising that the third indicator that is more closely related to economic performance, namely industrial production, continues to trend downward.

The continued decline in industrial production also conveys a message, and the news is not good. Industrial production has been declining since the beginning of 2018. The COVID-19 crisis and subsequent recovery were not able to break this trend. Since then, the industrial sector has lost 250,000 workplaces - a trend that actually accelerated this year. This development is not fully reflected in a higher unemployment rate (yet), as social plans or transfer companies are glossing over the actual unemployment situation. At the same time, those affected still lost good-paying jobs with salaries that cannot always be maintained when they find new employment. This structural weakness, together with a great sense of uncertainty due to the general economic situation, also puts pressure on private consumption.

Things are not much better in the European Union. Germany is no longer the economic engine that drives Europe. Moreover, Germany's structural weakness also puts pressure on other European economies. Having said that, they themselves do not provide any support for the German economy either. The same can be said for the US and China. Exports to the US are hindered by Trump's tariff policy and do not provide any economic stimulus. Exports to China are also declining. This is due to a mixture of certain indices pointing to weakness in China and the increased competitiveness of Chinese companies in the former German industrial strongholds of automotive, machine building and chemicals. As a result, foreign trade represents more of a problem for the German economy, rather than a positive stimulus.

That leaves investments as a possible driving force. But in view of the structural problems in the Germany industrial sector, it is not surprising that private investment activity remains weak. Only public investments and government consumption (specifically, increased government spending financed with debt) deliver economic stimulus. For the coming year, the International Monetary Fund expects Germany's GDP to grow by 0.9%. Two-thirds of that number, i.e. 0.6%, are due to increased (and debt-financed) government expenditures, while a third is due to calendar effects, i.e. because holidays fall on weekends and Germans have to work more. Economic growth that is the result of dynamic private investment looks very different.

In essence, the structural problems of Germany's industrial sector are home-made. Companies rarely invest in Germany anymore; they invest abroad, hence they see demand for their products abroad, and they want to service that demand from abroad. In Germany, investors are scared off by excessive costs. Energy costs, labor costs and regulatory intensity are too high. Moreover, companies still pay relatively high taxes for dilapidated infrastructure. To date, the federal government has not made any decisions that would lead to a significant improvement in this situation. Too often, the government actually does the opposite of what is needed.

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