Why Germany’s Economy Is Stagnating and the Reforms Needed for Recovery

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Germany Economic Stagnation Latest News

- Germany, the world’s third-largest economy with a $5 trillion GDP, is experiencing near-zero growth this year, with output expected to rise only **0.2%**.
- This stagnation follows **two consecutive years of recession**, marking a prolonged period of weak economic performance.
- These findings come from the annual report of the **German Council of Economic Experts**, an independent body established in 1963 to assess the country’s macroeconomic trends.

Germany’s Return as the “Sick Man of Europe”

- Germany is again being labelled the “sick man of Europe,” with chronic stagnation requiring long-term structural reforms.

- The economy has grown only **0.1% since 2019**, far below the US and euro area. Forecasts remain bleak, with potential growth expected at just **0.4% per year**.

New Economic Challenges: From Worker Shortages to Rising Labor Costs

- Unlike the early 2000s, Germany now faces **worker shortages**, not job scarcity.
    - **20 million workers** will retire in the next decade, while only **12.5 million** will enter the labor force.
    - Aging populations mean fewer hours worked and higher labor costs.
    - Unit labor costs have risen due to **sluggish productivity** and higher wages.
- Employment stability measures like **short-time work** hinder structural change by discouraging worker mobility into more productive sectors.

Manufacturing Decline and High Energy Costs

- Germany's manufacturing sector—once the engine of growth—has been declining since 2018.
- Key factors:
    - Loss of competitiveness
    - Weak foreign demand
    - Rising trade fragmentation
    - Threat of US tariffs
    - Competition from China
- Energy-intensive industries have suffered from persistently high energy costs, making Germany less attractive for emerging sectors like AI and data centers.

Dependence on Legacy Industries and Weak Capital Markets

- Germany's strength in automotive, chemicals, and mechanical engineering has created over-reliance on legacy "mid-tech" sectors.
- This limits diversification into high-tech fields like IT and biotechnology.
- Capital markets remain shallow:
    - Heavy dependence on banks
    - Insufficient venture capital, especially for scale-ups
    - Lack of large institutional investors willing to back European funds
- This pushes promising start-ups to relocate to the US.

Germany's Economy Falling Behind Europe and the World

- Germany is no longer leading the euro area; instead, it is lagging behind both European and global growth averages.
- The German Council of Economic Experts attributes the slowdown to a combination of **cyclical weaknesses, structural challenges, and major geopolitical shifts** that have disrupted the traditional German export-driven model.

Geopolitical Shifts Undermining Germany’s Economic Model

- A key disruption has been the change in US leadership and America’s reduced willingness to provide economic and security guarantees to allies like Germany.
- This has forced Berlin and other European countries to reconsider their security frameworks and allocate more resources to defence and trade resilience.
- **Fragmentation within the European Single Market** has also prevented EU nations from crafting strong collective responses to global challenges, weakening competitiveness.

Domestic Challenges Intensifying the Slowdown

- Germany faces internal pressures as well:
    - Declining industrial competitiveness
    - Rapid demographic ageing
    - Weak implementation of Chancellor Friedrich Merz’s fiscal package despite ambitious promises for infrastructure and defence investments

Policy Recommendations to Boost Growth

- The German Council of Experts suggests four key steps:
    - **Better targeted fiscal spending** to increase productive investment.
    - **Stronger European economic integration**, removing barriers to a true single market for goods and services.
    - **Corporate tax cuts** to incentivise business investment.
    - **Reducing wealth inequality**, including a state-subsidised long-term investment account to improve financial security, especially for older citizens.
- If Germany fails to revive growth soon, India — with a GDP nearing **$4 trillion** — may surpass it to become the **world’s third-largest economy.**

Source: IE | IMF
