The German economy in choppy international waters

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1 Introduction

Ladies and gentlemen,

We find ourselves in very turbulent times: for Germany, for our European neighbours, and for the world, of which the United States of America is probably still the leading nation. All of us, you and I, are constantly trying to process the stream of news that we consider relevant.

If you have ever read the diaries of Thomas Mann, you will probably find a completely different mindset. On 15 January 1954, he wrote: "Mid-month already. Terrible." Today, in mid-February 2025, I find myself in wholehearted agreement with the author Thomas Mann, who was born 150 years ago.

I will try to embody both mindsets: the mindset of an author, who is presumably thinking about advancing his own plans, whilst also processing the stream of news to pick up on longer-term trends that are relevant to relations between Germany and the rest of the world. I hope that this fits with the international outlook that you very rightly put at the focus of the Union International Club.

I would like to discuss three topics today: the development of trade, the economic situation in Germany, and the possible impact of additional tariffs. I will then revisit Thomas Mann and his mindset as I conclude.

2 Development of trade

I would like to begin by looking back to the past. Specifically, to 1970, when global integration and, as a result, global trade were picking up pace. This pace remained unusually high for almost 40 years. During this time, the volume of global trade, measured in terms of global economic output, grew from 25 per cent to 61 per cent.[1] Key drivers were lower transport costs, diminishing government trade barriers such as tariffs and quotas, and new possibilities for information and communication.

Since the financial crisis, the degree of interconnectedness in the global economy has not risen any further.[2] It remains high, however, amounting to 58 per cent in 2023. Nevertheless, the trade policy climate has been deteriorating noticeably for some years now. This began in 2018 with the escalation of the bilateral trade conflict between the United States and China. It was then further intensified by the coronavirus pandemic, which caused the number of trade restrictions to surge in 2020. Of course, health considerations also played an important role here at first, too.

Since then, around 6,000 new trade-restricting measures have been adopted worldwide each year. More recently, additional contributing factors have been Russia's war of aggression against Ukraine as well as rising geopolitical tensions. Alongside trade restrictions in the stricter sense, subsidies also played a major role. Protectionist measures have been implemented in many G20 (Group of 20) countries.

Particularly noteworthy in this regard is China, which subsidises – in some cases, significantly – the production of industrial goods and thus undermines the level playing field. This was one factor that resulted in record exports: in 2024, China exported over US (United States)$3.6 trillion worth of goods – more than any country in history – representing an increase of almost 6 per cent over the previous year.

This was not without consequence: more than one-third of the current anti-dumping measures and compensatory tariffs that have been introduced around the world since 2009 are aimed at China.[3] These are intended to restore a fair competitive environment in the affected markets.

For the German economy, developments in China's economy have significant repercussions. Alongside technological advances, subsidies may have contributed to Chinese companies taking market share away from their competitors in certain sectors – both in China and abroad – and particularly in sectors in which German companies had been especially successful until now: for example, in machinery and the automotive industry.

In the automotive industry, in particular, the figures speak clearly for China's growing strength. Between 2020 and 2024, China increased its net exports of motor vehicles from just under 1 million to almost 6 million.[4] The German automotive industry bears substantial responsibility for the poor overall performance of German exports to China in recent times.

However, China is not the only reason why German exporters have lost considerable market share since 2019.[5] Since the start of the 2020s, the growth in Germany's exports has lagged behind the growth in Germany's sales markets by around 8 percentage points. According to the German Council of Economic Experts, were global GDP (gross domestic product) to rise by 1 per cent, the increase in Germany's exports would now be only 0.6 per cent. Fourteen years ago, this figure was 1.4 per cent.[6]

This weakened position in the world has significant repercussions for the German economy. If Germany's exports had kept pace with the expansion of its international sales markets, the growth in the German economy between the beginning of 2021 and mid-2024 would have been more than 2 percentage points higher in real terms.

If we look at the changing flows of trade, then there are additional driving forces alongside the obvious protectionism and the associated, far-reaching subsidies. In the wake of the coronavirus pandemic and Russia's war of aggression against Ukraine, we have had to learn hard lessons on the importance of robust supply chains.

Since then, policymakers and businesses have understandably stepped up their efforts to ensure that we in Europe can obtain necessary goods and services at all times. Companies are examining the certainty of their deliveries from their suppliers in the event of a crisis. Furthermore, the European Commission's Open Strategic Autonomy initiative aims, amongst other things, to reduce trade political and geoeconomic dependencies.

The extent of this dependency, particularly with regard to critical imports from China, was revealed by a representative survey of German firms conducted by the Bundesbank last year.[7] This showed that there are considerable risks from supply chain disruptions. However, individual sectors would be affected very differently.

According to the survey, nearly one out of every two firms in the manufacturing sector directly or indirectly sourced essential intermediate inputs from China. In addition, more than 80 per cent of these firms stated that it would be at least difficult to substitute these critical intermediate inputs.

However, subsequent Bundesbank surveys show that firms are taking appropriate steps.[8] Nevertheless, changes in supply chains are associated with certain increases in costs, which could reduce productivity. These changes should not be allowed to lead to new concentration risks building up elsewhere.

Another factor contributing to the weakness in Germany's exports is the higher costs of production, particularly the costs of energy.[9] According to figures from the International Energy Agency (IEA (International Energy Agency)), between 2013 and 2023, electricity and gas prices for German industry rose by 30 per cent and 55 per cent, respectively. By way of comparison, electricity prices in the United States rose by just 18 per cent over the same period, and the price of gas actually saw a minimal decline.

3 Current economic situation in Germany

So as you can see, Germany's export industry is not in particularly good shape at the moment. What is the economic situation like in Germany overall? I will now turn to this topic in the second half of my speech.

Partly owing to the weak performance of Germany's export industry, German economic output declined for the second year in a row in 2024 – something that has not happened since 2003. After price and calendar adjustment, the German economy contracted by 0.2 per cent in 2024.

And the outlook for this year is not much better, either. In the Bundesbank's December Forecast for Germany, the experts are much more sceptical than last summer; we are expecting only a small amount of growth in 2025. And things are unlikely to improve noticeably until at least 2026.

This is due mainly to the extended period of weakness in industry. No wonder investment remains low. But private consumption, too, is less dynamic. It is not driving the expected recovery.

As a central banker, I can at least confirm that inflation has now fallen significantly. And, despite all the uncertainty, the chances of returning to a rate of 2 per cent soon are good.

I have already mentioned that Germany will benefit less from the growing global markets than in previous years because of the deteriorating competitive position. How things will proceed is far from certain. The change of government in the United States has not done anything to ease this uncertainty. And this brings me to the third and final topic of my speech – the potential impact of US (United States) tariffs.

4 Potential impact of US (United States) tariffs

"Tariff," according to the new US (United States) President, "is the most beautiful word in the dictionary." Hardly a day goes by without him using it, thus fuelling new speculation on the subject.

Germany would be particularly strongly affected by a new period of protectionism in the United States. This is because we maintain close trade relations with the US (United States). In absolute terms, we were by far the largest European exporter to the United States in 2023. And we export a larger share of our total exports to the United States than most other EU (European Union) Member States.

The Bundesbank's December 2024 forecast, which I mentioned a moment ago, does not yet take into account potential protectionist measures by the new US (United States) administration. That is because it is still unclear exactly what form they might take. Of course, this does not mean we have been twiddling our thumbs and are rushing blindly towards potential tariff increases. Quite the opposite: to accompany the December forecast, we analysed one possible scenario.[10] I would like to outline this briefly for you now.

What exactly did we investigate? Our assumptions regarding tariffs were based on Trump's announcements from his election campaign; tariffs on imports from China would rise to 60 per cent, while products from Germany and other countries would be slapped with a 10 per cent tariff rate.

As things stand today, the US (United States) government has already imposed additional tariffs of 10 per cent on Chinese goods. Tariffs of 25 per cent on aluminium and steel have been announced for March, while tariffs of the same amount have been proposed against the country's close trading partners Mexico and Canada.

In addition to US (United States) tariff increases, we factored in other announced measures, including tax relief and the consequences of a mass deportation of immigrants from the United States. We also assumed that the trading partners of the United States would introduce retaliatory tariffs and that macroeconomic uncertainty would increase in an environment such as this.

We used two different models to estimate the macroeconomic impact of this scenario for Germany. The first model comprehensively captures global trade relations. Meanwhile, the second model provides a detailed look at the German economy. What were the results of our scenario calculations?

The German economy would suffer considerably from such a policy shift. Both models agree on this. Our heavy reliance on exports makes us particularly vulnerable to dwindling foreign demand. Higher uncertainty presents an additional impediment. A depreciating euro could improve price competitiveness. But that would not be enough to compensate for the negative effects. All in all, economic output in 2027 would be almost 1.5 percentage points lower than projected.

By contrast, the effects of inflation differ significantly in the models. While the model tailored to Germany shows only minor effects, the model that more closely captures the global economy points to markedly higher inflation rates. These differences mainly stem from the fact that the depreciation of the euro and the retaliatory tariffs are passed through more quickly and more comprehensively to consumer prices in the model that better captures the global economy.

In the United States, too, protectionist measures are likely to have a marked dampening effect on economic activity. Losses in purchasing power and increased costs for intermediate inputs outweigh any gains in competitiveness for US (United States) industry. Inflation would rise sharply and could be even higher still in the absence of any significant monetary policy tightening. Contrary to what the administration has announced, the tariffs would therefore have negative repercussions for the United States.

What can we take away from this? A drastic policy shift in the United States would entail considerable risks to economic growth in Germany. It could also fuel inflation, although it is very hard to say to what extent. However, we should bear in mind that we are still talking about a hypothetical scenario at present. Let us hope that it remains hypothetical and that trade policy uncertainty will soon recede again.

5 Conclusion

Ladies and gentlemen,

At the start of my speech, I mentioned the 150-year-old “birthday boy” Thomas Mann. Of course, the author is not famous for his discourse on protectionism. But his writing contains repeated hints that international cooperation and cultural exchange are important ways of fostering peace and progress.

So if I could leave you with just one message today, it would be that protectionism leads to welfare losses in all the countries concerned. There are no winners. And it will be particularly damaging to the German economy, which is strongly export-oriented. I will therefore continue to advocate for an open and rules-based trading system.

The recently negotiated free trade agreement between the EU (European Union) and the Mercosur countries shows that it still possible to take steps in the right direction, even in turbulent times. Further agreements are intended to follow – and will hopefully not take 25 years to negotiate.

Trade is an important building block for prosperity. Wise economic policy is another. Germany is currently facing a large number of structural challenges. We are all responsible for tackling and overcoming them. This includes the next Federal Government.

Mid-month already? Terrible? Let's roll up our sleeves. Then Germany's listless economy will also be reinvigorated. But first I look forward to our discussion. Thank you very much for your attention.

Foot notes:

1. These figures are calculated as the sum of exports and imports of goods and services in relation to gross domestic product based on data from the World Bank and the OECD (Organisation for Economic Co-operation and Development).
2. See IRC (incremental risk charge) Trade Task Force (2016), Understanding the weakness in global trade: What is the new normal?, Occasional Paper Series, No 178, ECB (European Central Bank), September 2016.
3. WTO (World Trade Organization), Trade Remedies Portal
4. Tordoir, S. and B. Setser (2025), How German industry can survive the second China shock, Centre for European Reform, p. 1.
5. Deutsche Bundesbank (2024), The German economy, Monthly Report, November 2024.
6. German Council of Economic Experts (2024), Addressing shortfalls, modernising resolutely: Annual Report 2024/25 *[https://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/gutachten/jg202425/JG202425_Chapter_1.pdf]* , p. 41.
7. Deutsche Bundesbank (2024), Risks facing Germany as a result of its economic ties with China, Monthly Report, January 2024.
8. Deutsche Bundesbank (2023), German enterprises' profitability and financing during the 2022 energy crisis, Monthly Report, December 2023.

9. German Council of Economic Experts (2024), Addressing shortfalls, modernising resolutely: Annual Report 2024/25 *[https://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/gutachten/jg202425/JG202425_Chapter_1.pdf]*, p. 3.
10. See Deutsche Bundesbank (2024), Forecast for Germany: Significantly gloomier growth outlook – inflation decreases to 2 %, Monthly Report, December 2024, supplementary information: The possible impact on the German economy of measures announced by the incoming US (United States) administration.