The German economy: navigating cyclical fluctuations and boosting long-term growth

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1 Introduction

Thank you, Governor Müller, for your kind introduction and for the invitation. It is a great pleasure and honour for me to speak here today. I truly appreciate the warm hospitality of Eesti Pank. Since my arrival, I have spent an exciting weekend enjoying several concerts, a trip to the Estonian wilderness, and a walking tour of your beautiful Old Town.

Ladies and gentlemen, Estonia and Germany are connected in surprising ways. For example, the esteemed Estonian economist Ragnar Nurkse, in whose honour this lecture series is being held, attended Tallinna Toomkool. The school was also formerly known as the Domschule zu Reval, and its lessons were held in German.

Estonia and Germany have also shared a similar economic fate in recent years: Both countries' economies have largely stagnated since the outbreak of the COVID (coronavirus disease)-19 pandemic.

Today, I want to share my thoughts on how the German economy reached its current state and how it could recover. I will structure my remarks around three key questions.

First, what is the current state of the German economy, and what are the main drivers shaping the economic outlook?

Second, what national structural reforms could help put the German economy back on a growth trajectory?

And third, how can we work together to improve the European policy framework to better support growth and security across the European Union?

2 German economy: current state and outlook

2.1 Current state of the economy

Let’s begin by examining the current state of the German economy. In 2024, Germany’s annual real GDP (gross domestic product) was only 0.4 % higher than in 2019. Similarly, Estonia’s economy remained largely stagnant at its 2019 level. There are several reasons for this sobering growth experience in Germany. For one thing, the economy has been significantly impacted by recent crises.

As one of the most globally interconnected economies, Germany experienced supply chain disruptions during the COVID (coronavirus disease)-19 pandemic more acutely than many other nations. Moreover, Germany’s heavy reliance on Russian natural gas made it particularly vulnerable to the sharp rise in energy prices.

Simultaneously, German industry has been experiencing a gradual loss in competitiveness in international markets. This decline is partly due to the increasing strength of global competitors, especially from China. It had already taken root well before the onset of the pandemic.

In addition to these external challenges, there are also various, persistent internal obstacles to growth, which I will discuss in more detail shortly. Overall, potential output growth stands at a modest 0.4 %, and without significant policy changes, it is likely to remain at this low level.

2.2 Economic outlook

Against the background of these structural challenges, what are the short-term prospects of the German economy?

In the first quarter of this year, the German economy grew by 0.4 %, rebounding from a slight contraction at the end of last year. This growth was stronger than anticipated, partly because concerns about rising tariffs resulted in shipments being frontloaded. However, the underlying economic momentum remains weak.

The Bundesbank's June 2025 forecast indicates that the German economy is expected to more or less stagnate this year. Factoring in the stronger-than-expected first-quarter growth figures, a slight annual increase appears possible. However, this would still represent three consecutive years of minimal growth.

Our forecast aligns with recent predictions from the IMF (International Monetary Fund) and the European Commission, both of which project zero growth for 2025. The OECD (Organisation for Economic Co-operation and Development) is slightly more optimistic, projecting a growth rate of 0.4 %. Looking ahead, we see promising signs of recovery.

In 2026, the Bundesbank projects that the German economy will grow by 0.7 %. And in 2027, growth could reach 1.2 %. Compared to last December's forecast, the outlook for 2025 has thus been revised downward, while the forecast for 2027 has improved. The forecast is influenced by two opposing factors.

On one hand, the tariff hikes and heightened uncertainty are estimated to reduce the German economy's growth by approximately three-quarters of a percentage point. This impact is primarily expected to affect growth in 2025 and 2026.

The baseline forecast assumes that the additional tariffs of at least 10 % imposed on all US (United States) trading partners since April will remain in place. Additionally, it accounts for the tariffs on steel and aluminium as well as on cars and car parts. Finally, the forecast factors in a significant increase in uncertainty, in particular with regard to trade policy.

On the other hand, from 2026 onwards, the growth-dampening effects of tariffs are counterbalanced by positive growth impulses from German fiscal policy.

Significant leeway for increased debt has been established, and deficits are expected to rise. Amongst other things, this leeway will be used to finance additional defence and infrastructure spending. Our experts estimate that this extra spending could boost economic growth by a total of three-quarters of a percentage point by 2027.

In our baseline forecast, the two opposing forces in effect broadly cancel each other out. However, our projections are accompanied by considerable uncertainty. Trade disputes, geopolitical tensions, and specifics of German economic and fiscal policy all present risks.

For instance, an escalation of the trade conflict could increase GDP (gross domestic product) losses to one-and-a-half percentage points by 2027. In this risk scenario, the US (United States) tariff hikes announced in early April, some of which are currently suspended, would take full effect. This would be followed by renewed strong financial market reactions and ongoing high uncertainty regarding US (United States) economic policy. It is also assumed that the EU (European Union) would retaliate with tariffs on a similar scale.

The situation remains fluid, with both escalation and resolution of these tensions being possible at any moment. Just to mention, in two days, on July 9th, the 90-day pause on US (United States) reciprocal tariffs will conclude. We will see what happens.

In summary, the German economy faces significant headwinds in the short term. Nevertheless, there are grounds for cautious optimism as we look to the future.

Before discussing policy measures to boost growth in Germany, let me take a moment to digress. In observing the public debate in Germany, it appears that the war in Ukraine still feels far removed for many people.

This contrasts sharply with the situation in Estonia, where a direct neighbour has become an immediate threat. Considering Estonia's history and recurrent struggle for independence, one could say: "once more".

My impression is that the new German government understands the gravity of the situation. And I am confident that it will take the necessary steps to enhance European security.

3 National policy measures to boost growth

Ladies and gentlemen, A politically strong Europe must be built on a solid economic foundation. And as we have seen, Germany has significant room for improvement in this regard. So, how can Germany enhance its growth potential?

A few months ago, I presented a comprehensive set of measures during a speech in Berlin.[1] Let me summarise the key takeaways for you. I see three key areas where policymakers can enhance Germany's growth potential.

3.1 Increasing labour supply

The first area that needs to be addressed urgently is labour supply. As the baby boomers from the 1960s retire, the number of working individuals is declining, which diminishes our growth potential. Accordingly, policymakers must explore every avenue to increase labour supply in Germany.

One crucial option lies in increasing the working hours of part-time employees, especially women. While the employment rate of women in Germany is slightly above the European average, their weekly working hours are significantly lower.

This discrepancy partly stems from disincentives in the tax and social security systems that discourage longer working hours. Moreover, the lack of an adequate supply of childcare and elderly care facilities limits part-time workers' ability to increase their hours. Improving these facilities can pave the way for longer working hours, thereby boosting our national labour supply.

Another key component is labour market-oriented migration. Currently, bureaucratic hurdles and slow visa processes are hindering the effective integration of workers from non-EU (European Union) countries. This represents one of several areas where Germany's backlog in digitalising public services is hampering growth. Simplifying recognition procedures for academic qualifications and creating a centralised, digital point of contact for immigrants and their families can facilitate smoother transitions.

It is also vital to ensure that skilled workers remain in Germany over the long term. Currently, within two years of entering the labour market, more than 30 % of immigrants from other EU (European Union) countries leave again.[2] Enhancing language courses and granting residency rights for workers' family members can provide greater stability and integration.

Additionally, we need to improve work incentives for recipients of the civic allowance. Research shows that the recent abolition of sanctions has significantly decreased the transition of recipients into the labour market.[3] Reinstating previous rules on grace periods, protected assets, and reporting obligations can help these individuals in their transition back to regular employment.

Finally, we must harness the substantial potential of older individuals for additional, often highly qualified labour.[4] Germany faces a unique challenge, as the ratio of retirees to working-age individuals is expected to worsen significantly over the next 15 years compared to the OECD (Organisation for Economic Co-operation and Development) average.

To mitigate the increasing ratio of working to retirement years, it seems advisable to link the earliest possible retirement age, and subsequently the retirement age after 2031, to life expectancy. The year 2031 is significant, as by that time, the regular retirement age will have been increased to 67.

Estonia serves as a role model in this context, as it will start linking retirement age to average life expectancy in 2027.[5] Germany would be wise to follow Estonia's example.

Furthermore, it is time to reconsider the rule that permits early retirement without deductions for individuals who have worked for 45 years.

These measures would not only alleviate labour shortages and support economic growth, but also ease the financial pressure on pension systems.

3.2 Efficiently transforming the energy sector

The second area that needs to be addressed is the transformation of the energy sector. Germany aims to achieve carbon neutrality by 2045. As a member of the European Union, Estonia, too, is expected to achieve carbon neutrality by 2050 under the European Climate Law.

This monumental task will necessitate significant investments in several key sectors. To ensure the energy transition is as efficient as possible, Germany needs to adopt a comprehensive and cohesive strategy.

A key element of this strategy is implementing an effective carbon pricing system across all sectors and regions. Currently, carbon prices differ across sectors. However, only a standardised carbon price will ensure that savings are made in the most cost-effective areas. Therefore, it is crucial for Germany to advocate for consistent carbon pricing within the EU (European Union) and other economic regions.

Simultaneously, it is highly advisable to abolish climate-damaging subsidies. These subsidies undermine the economic incentives of carbon pricing by promoting fossil fuel consumption.

Another essential component is establishing a reliable and coherent framework for the energy transition. Given the long planning horizons and substantial investments needed, a clear policy direction is essential. The government needs to clarify how domestic renewable energy sources and energy imports will interact, considering potential supply bottlenecks, particularly during the winter months.

Moreover, policymakers should create economic incentives to better align electricity supply and demand within Germany. Flexible electricity tariffs and innovative approaches such as bidirectional charging for electric vehicles can help achieve this.

3.3 Reviving business dynamism

The third area in which Germany has significant room for improvement is business dynamism. Specifically, improved conditions for start-ups and business investment are critical for guiding the German economy back onto a stronger growth path.

What needs to be done?

To begin with, Germany should reduce excessive bureaucratic burdens. Entrepreneurs often express frustration with increasing bureaucracy and regulation.[6] The National Regulatory Control Council (*Normenkontrollrat*) has identified several promising avenues in this context. Moreover, implementing EU (European Union) rules as sparingly and efficiently as possible can significantly reduce compliance burdens. We should avoid “gold plating”, which refers to adding extra layers of regulation at the national level.

Rather, the focus should be on facilitating start-ups and enhancing innovative capacity. Over one-half of company founders in Germany view bureaucratic hurdles and delays as problematic.[7] Creating a “one-stop shop” for aspiring entrepreneurs to manage all typical tasks related to starting a business can unleash greater business dynamism. Innovative start-ups should be embraced, benefiting from a large domestic market and suitable funding opportunities.

Lastly, simplifying and expediting administrative processes is essential for reviving business dynamism. Faster planning and approval procedures can help modernise infrastructure more quickly. Moreover, digitalisation, automation, and standardisation can all streamline administrative processes.

In this context, Estonia and Germany differ significantly. According to the World Bank, Estonia ranks among the most conducive countries for starting businesses in the EU (European Union) – namely on position 14, while Germany ranks much lower – namely on position 125.[8]

The 2025 Spring Report from the German Council of Economic Experts provides a detailed comparison of what it takes to start a company in both countries.[9] The differences are striking.

Estonia’s approach to founding a company exemplifies efficiency, featuring a fully digital, centralised system that enables entrepreneurs to complete the process quickly and with minimal bureaucracy.

The entire procedure can be completed online through a one-stop shop for administrative services known as the “e-Business Register”. It employs a standardised template and allows users to apply for a VAT (value added tax) number at the same time. The costs of starting a company in Estonia are relatively low. Moreover, authorities process applications within five working days, or within one day if the expedited option is selected.

This efficient, fully digital system positions Estonia as a leader in facilitating entrepreneurship.

By contrast, Germany’s process is more fragmented, necessitating interaction with multiple authorities and requiring significantly more time and effort.

Founders must consult several institutions, including notaries, the local court, the trade office, the tax office, and the Federal Employment Agency if they plan to hire employees. Additionally, the costs of starting a company in Germany are considerably higher. Moreover, it takes an average of 35 days, which is considerably longer.

This is certainly another area where I believe Germany should follow Estonia’s lead.

4 The European dimension

Implementing rigorous structural reforms at the national level is essential for boosting Germany’s growth potential. However, for certain issues, we need to find solutions and make progress at the European level.

4.1 Addressing geoeconomic and geopolitical challenges

One aspect of this is developing a unified European response to the geoeconomic and geopolitical threats we face today. Europe is currently being confronted with an erratic and confrontational US (United States) trade policy.

So far, the European Commission has made every effort to de-escalate the situation. Simultaneously, however, the Commission is prepared to retaliate. I believe this is a reasonable approach.

Overall, Europe should remain committed to a rule-based international trade order and pursue free trade agreements with like-minded countries and regions. Commission President Ursula von der Leyen's recent proposal to enhance cooperation between the EU (European Union) and members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership)) represents a welcome and appropriate step in that direction.

Regarding geopolitics, Europe must assume greater responsibility for its own defence. In this context, it is crucial to enhance European coordination, including with non-EU (European Union) countries such as Norway and the United Kingdom, in military strategy, deployment, personnel build-up, procurement, and production capacities. This coordination will incur minimal fiscal costs and may even save money through increased synergies.

The EU (European Union) Commission's "Readiness 2030" initiative aims to create space for additional national defence spending within the Stability and Growth Pact. I consider such temporary additional leeway for defence expenditure to be reasonable. It will enable European countries to act swiftly and adapt gradually to permanently higher defence spending.

Lastly, Europe should enhance its autonomy in the payments sector. Currently, Europe remains largely dependent on non-European payment providers. We still lack a digital payment solution that functions across the entire euro area and operates on European infrastructure.

Introducing a digital euro in both retail and wholesale variants could be a cornerstone for true autonomy in payments. I would encourage legislators to push forward with the digital euro project accordingly.

4.2 Boosting European integration

The second dimension we must focus on is fostering European integration.

The European Single Market has been a cornerstone of prosperity to date, allowing goods to flow freely across borders while fostering competition, innovation, and economic growth. However, significant barriers still exist when it comes to services. Cross-border trade in services is still far less developed than in goods, partly due to national regulations that restrict professional services such as legal advice, architecture, and engineering. While some regulations are justified, many are not, resulting in inefficiencies and lost opportunities.

The digital revolution presents a unique opportunity to overcome these obstacles. Digital platforms, virtual collaboration, and online services are revolutionising how businesses operate and interact. To fully harness this potential, we need to simplify regulations, reduce administrative burdens, and establish a truly unified digital marketplace. For example, the centralised EU (European Union) digital portal for public services established by the European Commission is a welcome step towards facilitating cross-border employment for professionals. This serves as a mechanism to give citizens easier access to services in other Member States.

By eliminating unjustified obstacles, we can unlock the full potential of the Single Market, enhance competitiveness, and ensure that Europe remains a global leader in innovation.

Energy is another area where deeper European integration can yield significant benefits. Europe’s energy markets are still fragmented, with infrastructure bottlenecks and national boundaries restricting the efficient flow of electricity.

A more integrated European electricity market would enable us to better align supply and demand across borders, reduce reliance on costly reserve power plants, and accelerate the transition to renewable energy. To achieve this, we need to invest in cross-border infrastructure, modernise our grids, and eliminate regulatory obstacles that impede energy trade. By collaborating, we can not only achieve our climate goals but also enhance Europe’s energy security and competitiveness in a rapidly evolving global landscape.

Last but not least, we must deepen the integration of European financial markets. The European Savings and Investments Union can help mobilise the necessary financing for additional investments, such as, for instance, for the green transition and the enhancement of defence capabilities.

Three key elements are at play here.

First, the European Savings and Investments Union can help diversify funding sources. Enhancing access to equity, market-based debt financing and venture capital will enable the financing of a broader range of investments.

Second, the European Savings and Investments Union will facilitate cross-border investments by harmonising regulations and breaking down barriers. This would ease the formation of pan-European companies, enabling them to harness cost-lowering economies of scale.

This point echoes Ragnar Nurske's "balanced growth theory". Tailored to the situation of high-income economies, one could paraphrase him in the following way: The limited size of the domestic market can constitute an obstacle to the application of capital by firms or industries, thus posing an obstacle to economic growth generally.[10]

Third, the European Savings and Investments Union will make Europe more appealing to external investors. This would increase both the quantity of available financing and reduce its cost.

Recent policy actions by the US (United States) administration have led international investors to start questioning the US (United States) dollar's safe haven status and to reassess the relative attractiveness of Europe as an investment location compared to the US (United States). Boosting growth in the EU (European Union) and making it an attractive investment destination presents an opportunity for Europe.

5 Concluding remarks

Ladies and gentlemen, Allow me to briefly summarise and share a few concluding thoughts.

I began my speech by noting that economic growth has been weak in both Germany and Estonia over the past few years. In Germany's case, the economy is currently navigating a combination of cyclical fluctuations and structural challenges.

This is a pivotal moment – a time for reflection, decisive action, and bold leadership. I am optimistic that the new German government will address the structural issues with determination and help its economy to become one of Europe's growth engines.

In light of today's geopolitical and geoeconomic uncertainties, Europe's role is more crucial than ever. Let us seize this opportunity to deepen European integration and emerge stronger together.

If we take the right actions, I am confident that our two economies will soon share two key outcomes once again: vibrant economic growth and enduring security.

For now, I eagerly anticipate our discussion here and my ongoing conversations with Governor Müller. I look forward to exchanging ideas and the opportunity to learn from each other. Thank you for your attention.

Foot notes:

1. Nagel, J. (2025), Economic policy measures to boost growth in Germany, speech held at the Berlin School of Economics, Humboldt University of Berlin.
2. See Hammer, L. and M. Hertweck (2022), EU (European Union) enlargement and (temporary) migration: Effects on labour market outcomes in Germany, Deutsche Bundesbank Discussion Paper No 02/2022.
3. See Weber, E. (2024), The Dovish Turnaround: Germany's Social Benefit Reform and Job Findings, IAB (Institute for Employment Research)-Discussion Paper 07/2024.
4. For a comprehensive analysis of retirement timing in Germany, see Deutsche Bundesbank (2025), Early, standard, late: when insurees retire and how pension benefit reductions and increases could be determined, June Monthly Report.
5. See Republic of Estonia Social Insurance Board (2025), Retirement age | Sotsiaalkindlustusamet *[https://sotsiaalkindlustusamet.ee/en/pension-and-benefits/applying-pension/retirement-age]*
6. See Metzger, G. (2024), Start-up activity lacks macro-economic impetus – self-employed people are becoming more important as multipliers, KfW (Kreditanstalt für Wiederaufbau) Entrepreneurship Monitor 2024, KfW (Kreditanstalt für Wiederaufbau) Research.

7. See World Bank Group (2025), Rankings *[https://archive.doingbusiness.org/en/rankings]*.
8. See German Council of Economic Experts (2025), Between hope and fear: Economic weakness and opportunities of the fiscal package, bureaucratic obstacles and structural change, Spring Report 2025, Chapter 3, Section 10.
9. See Nurkse, R. (1961), Problems of Capital Formation in Underdeveloped Countries, New York: Oxford University Press, p. 163. The original citation is: “The limited size of the domestic market in a low income country can thus constitute an obstacle to the application of capital by any individual firm or industry working for the market. In this sense the small domestic market is an obstacle to development generally”.