

Current economic policy challenges in Germany and Europe

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1 Introduction

Ladies and gentlemen, it is a great pleasure for me to speak to you today. Germany and the Republic of Korea are far apart on the map, but our economies have much in common.

For example, both are export-driven, with large manufacturing bases. Manufacturing made up about 18 per cent of GDP (gross domestic product) in Germany, and a striking 24 per cent in the Republic of Korea in 2023 – far more than the 13 per cent across the OECD (Organisation for Economic Co-operation and Development).^[1] As a result, both economies are deeply embedded in global value chains. This means that they are exposed to trade policy changes and geopolitical risks, especially involving the United States and China.

Furthermore, both countries depend heavily on imported energy, making them vulnerable to global energy price shocks. In 2023, Germany met around 70 per cent of its energy needs through net imports. In the Republic of Korea, the share was even higher at 85 per cent.^[2]

Finally, both Germany and the Republic of Korea have a rapidly ageing population and low birth rates. The fertility rate was about 1.4 in Germany and 0.7 in the Republic of Korea in 2023.^[3] Both rates are below 2.1, which is the level required to keep the population stable. This demographic shift will weigh on labour supply and public finances.

In this speech, I will set out how we can address these challenges and seize the opportunities that come along with them. As you would expect, my focus is on Germany and Europe. Yet some of the lessons might be relevant to the Republic of Korea as well. I will organise my speech around three questions:

First, what is the current economic situation in Germany and what is the medium-term outlook?

Second, what policy measures could Germany enact at the national level to address the challenges ahead?

Third, what needs to be done at the European level to complement these national reforms?

I will close with a discussion on the outlook for euro area monetary policy.

2 Current economic situation in Germany

Let me start with Germany's economic backdrop. In the 2010s, Germany enjoyed solid growth, powered by earlier structural reforms and strong global demand. As late as 2017, Germany was still growing faster than the euro area as a whole. But towards the end of the twenty-tens, the German growth engine began to stutter.

One key reason was a loss of competitiveness for German firms in several international markets. According to recent Bundesbank estimates, this loss of competitiveness accounts for around three-quarters of the decline in export market shares observed in recent years. ^[4]

Furthermore, many German firms specialise in products that have been affected by subdued global demand, such as cars. As a consequence, Germany's export goods mix – which, for decades, was a recipe for success – has also contributed to recent market share losses.

On top of these structural headwinds, a series of shocks has dampened economic growth. Germany's deep integration within global supply chains meant that the pandemic hit hard. Logistics bottlenecks and shortages of intermediate inputs affected more firms than in many other countries.

Furthermore, Germany's heavy reliance on Russian gas amplified the energy price surge after Russia's invasion of Ukraine. That shock is still felt across energy-intensive industries.

Against this backdrop, what is the outlook for the German economy? The latest Bundesbank forecast from June sees two opposing forces shaping 2025 and the following two years:

On the one hand, US (United States) tariffs and policy uncertainty will weigh on growth this year and next. ^[5] Recent US (United States) trade measures have pushed up average US (United States)-tariffs on EU (European Union) goods from around 1.5 per cent to about 15 per cent.

On the other hand, expansionary fiscal policy will help to drive a recovery from next year onwards. Higher defence and infrastructure spending will boost demand. This could support GDP (gross domestic product) growth by roughly three-quarters of a percentage point in cumulative terms over the next two years.

However, on its own, higher public spending will not change our long-term growth path. Our internal Bundesbank simulations show that the extra fiscal spending would only modestly raise potential output. To exploit the full potential of the fiscal package, it must be complemented by structural reforms.

3 Structural challenges for Germany

What might those reforms look like? I will focus on three main areas that could boost our growth potential: a better business environment, a more efficient energy system and higher labour supply.

3.1 Business environment

The first area that has to improve in Germany is the business environment.

To regain market shares in a turbulent global trading environment, firms need scope to invest and innovate. Bureaucracy is the most-cited investment constraint in recent surveys.^[6] Compliance costs have risen – especially for manufacturing firms. Let me illustrate this using two numbers.

According to the ifo (economic research institution) Institute, excessive bureaucracy costs nearly €150 billion in output each year – more than 3 per cent of GDP (gross domestic product).^[7] The Institute for Employment Research found that firms hired around 325,000 extra staff in recent years just to comply with new rules.^[8] That is scarce labour tied up in non-productive tasks.

But bureaucracy not only costs money and ties up scarce labour. It also stifles start-ups: bureaucratic hurdles and delays were the most frequently-cited barriers to starting a business.^[9] Accordingly, Germany should urgently cut unnecessary red tape.

3.2 Energy markets

The second area in need of reforms is the energy sector.

High energy prices have hit German industry hard. At the same time, Germany has legally committed itself to achieving carbon neutrality by 2045. This transition will require substantial investment.

According to estimates in a recent study, Germany has to invest around €390 billion annually from 2021 to 2030, or 11 percent of its GDP (gross domestic product).^[10] However, in many cases, these investments are typical replacement investments, as fossil-fuel-based technologies are simply being phased out in favour of climate-neutral alternatives. The additional net financing needs are thus much lower, amounting to around €120 billion or some three per cent of GDP (gross domestic product).

Our goal should be to deliver the transition at the lowest possible cost. A single, standard carbon price across sectors is the most efficient way to cut emissions. This directs efforts to areas where cuts are most cost-effective and spurs innovation in green technologies. To avoid distorting price signals, subsidies for activities that are harmful to the climate should be phased out.

Policy must also provide reliability, because the transition needs long-term investment. In addition, we must accelerate digitalisation in the energy system. By rapidly rolling out smart meters, smart grids and enabling bidirectional charging, we could make more efficient use of renewables. This could significantly reduce the costs of the green transition.

All in all, I am convinced that keeping up the pace of renewables deployment will ultimately pay off. This is our best route to cutting our dependence on imports and staying on the path to climate neutrality.

3.3 Labour supply

The third area in need of reforms is labour supply.

The demographic trend is the main headwind. As baby boomers retire, the number of workers will fall – and potential growth with it. Accordingly, we must make work easier and more rewarding.

One lever is to help part-time workers increase their hours if they wish – especially women. Annual hours per worker in Germany are low based on standards in the advanced economies. One reason stems from disincentives relating to taxes and social security contributions. Childcare and eldercare provision is another major constraint. Better care provision, longer opening hours and more flexibility could increase labour supply.

Germany also needs labour market-oriented migration. The reformed Skilled Immigration Act creates opportunities in this area. But red tape is an issue here as well – procedures remain too slow and too complex. A “work and stay” approach – involving faster digital processing, simpler recognition of qualifications and better integration – would help. Language training and residency rights for family members could improve worker retention. In the current setting, many intra-EU (European Union) migrants leave the country within two years.

Furthermore, Germany should tap the potential of older workers. It makes sense to link the earliest retirement age – and then the statutory retirement age after 2031 – to life expectancy. Ending the option to retire early without deductions after 45 years of contributions would reduce the incentive to leave the workforce early.

Together, these steps would ease labour shortages, support growth and strengthen pension financing.

4 Need for European reforms

National reforms are vital to meet Germany’s challenges. But many decisive issues will be determined at the European level.

One example is trade. Germany – like the Republic of Korea – thrives in an open, rules-based global trading system. Rising protectionism makes that harder. In the face of this, Europe must stay committed to a rules-based global trade order.

As long as worldwide trade reform is not feasible, striking free trade agreements with like-minded partners is a promising way forward. Deepening ties with the members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership)) is one avenue. Strengthening trade and investment links between the EU (European Union) and Korea is another.

At the same time, Europe needs deeper integration and greater resilience.

4.1 Deepening European integration

Greater integration is necessary on three fronts: economics, finance and energy.

4.1.1 Economic integration

Let us start with economic integration.

The free movement of goods, services, capital and people is a cornerstone of the European Union. For goods and people, integration has advanced substantially.

^[11] But fragmented national rules are still hampering trade in services to a significantly larger extent.

Removing barriers could boost competition and productivity. The digital revolution might help here. For example, a unified digital single market would allow professionals to work and firms to sell services across borders with ease.

Another solution would be an optional “28th regime”. The idea here is to establish an EU (European Union)-wide legal framework that companies can opt into instead of navigating 27 national rulebooks. This would make cross-border operations easier.

4.1.2 Financial integration

The second area in which Europe needs deeper integration is finance.

The European Union aims to build a Savings and Investments Union. In short, the idea of this concept is to channel more of Europe’s significant household savings into domestic investment. At present, households predominantly channel their savings into safe products like deposits. At the same time, start-ups have difficulty raising funds, while some larger firms leave Europe in order to scale up.

The key is to diversify firms' funding towards more equity, market-based debt and venture capital. What should be done here?

First, firms need better access to equity. For small, innovative start-ups, that means better access to venture capital. For established firms looking to expand, that means deeper, more liquid capital markets.

Second, a deeper securitisation market would help banks to transfer risk from their balance sheets to financial markets. In turn, that would free up banks' additional lending capacity.

Finally, households and institutional investors need encouragement to buy more of these assets. For households, better financial literacy would empower them to make informed decisions and seize opportunities in the capital markets. For institutional investors, we should review whether some regulatory hurdles to capital markets investments could be eased.

Once completed, the Savings and Investments Union will help to mobilise capital for green projects, defence and innovation. It would also make Europe more attractive to global investors at a time when relative attractiveness is being reassessed.

4.1.3 Energy system integration

Finally, integrating European energy markets should be another priority.

The European Union aims to achieve carbon neutrality by 2050. The European Commission estimates that EU (European Union) countries will have to invest over €1.2 trillion annually from 2021 to 2030.^[12]

Today, Europe's power systems are still mainly national. Better cross-border grids and market coupling would align supply and demand more efficiently. That would cut reliance on costly reserve capacity and speed up the rollout of renewables. In effect, energy integration would lower energy prices and further strengthen both climate policy and energy security.

4.2 Fostering European resilience

Alongside integration, Europe must increase its resilience.

4.2.1 Defence

First and foremost, Europe needs closer defence coordination on strategy, personnel, procurement and production. We should also work with partners beyond the EU (European Union), such as the UK (United Kingdom) and Norway.

The European Commission's Readiness 2030 strategy is a step in the right direction. Amongst other things, it aims to create a single market for defence goods. This would deliver scale, lower unit costs and save billions each year.^[13]

Even so, defence spending will be structurally higher for years to come. That, inevitably, raises the question of financing. In the European Union, debt financing is limited by fiscal rules. They safeguard sound, sustainable public finances – a precondition for monetary policy to deliver on its price stability mandate.

Given the urgency, temporary exceptions can help to mobilise resources quickly. But permanently higher outlays must be aligned with the European framework for sound public finances.

4.2.2 Payments

Payments is another area in which Europe has to build resilience. Europe currently relies heavily on non-European payment providers.

At present, about two-thirds of all card payments in the euro area are processed by non-European providers such as Visa and Mastercard – and often on servers outside Europe. That creates dependencies and leaves us vulnerable to geopolitical risks. And if US (United States) dollar stablecoins were to become widespread in Europe, our reliance on American providers could become even greater.

A central bank digital currency (CBDC (central bank digital currency)) in the euro area would secure control over critical infrastructure and make us less dependent on non-European providers. Where do we stand here?

In terms of the retail variant – the digital euro – the Eurosystem has just concluded its preparation phase.^[14] It will now start to build the necessary technical capacity ahead of a possible decision to issue the currency. What we still need is a legal basis for the digital euro. It is now up to the European Parliament and the Council to give the green light. I really hope that we will see swift progress here.

For wholesale CBDC (central bank digital currency), the Eurosystem has recently tested three different solutions involving market participants. I am proud to say that the Bundesbank, through the Trigger Solution developed by our Payment and Settlement experts, has played a decisive role in this endeavour. Demand was strong and market participants showed clear interest in moving beyond the trials. Just recently, the Eurosystem started working on the Pontes project – a distributed ledger technology (DLT (distributed ledger technology)) solution that links market DLT (distributed ledger technology) platforms and TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer System)

Services to settle transactions in central bank money.^[15]

Taken together, strengthening our defence capabilities and bringing the euro into the digital age would increase Europe's resilience.

5 Euro area monetary policy

Ladies and gentlemen, so far, I have spoken about broader economic policy issues. They matter for central bankers because they shape the medium-term outlook for inflation as well as growth. Let me close my speech by explaining how we conduct monetary policy in the euro area and discussing the current monetary policy outlook.

Unlike the Bank of Korea, the Deutsche Bundesbank does not set monetary policy on its own. Rather, Germany is part of a monetary union with 19 other European countries – the euro area. Together, the 20 national central banks and the European Central Bank (ECB (European Central Bank)) form the Eurosystem. As an aside, as of January there will be 21 member states, with Bulgaria set to join the Eurosystem.

Monetary policy decisions in the Eurosystem are taken by the ECB (European Central Bank)'s Governing Council. It includes the 20 national central bank governors and the ECB (European Central Bank)'s Executive Board, led by President Christine Lagarde. The Governing Council meets eight times per year to set monetary policy.

At every other policy meeting, Eurosystem or ECB (European Central Bank) staff present projections for inflation, growth and other key variables. These forecasts provide vital input to our monetary policy decisions. They are published four times a year – in March, June, September and December. So much for the institutional set-up.

Over the last couple of years, interest rates in the euro area have been on a rollercoaster ride. After a long period of negative interest rates, the Eurosystem reacted forcefully to the inflation surge that began in 2021 and reached its peak in 2022. Between July 2022 and September 2023, interest rates were hiked ten times, by a total of 450 basis points.

In June 2024, the Eurosystem began to lower rates again. By June this year, they had fallen by 200 basis points. At its July, September and October meetings, the ECB (European Central Bank)'s Governing Council left interest rates unchanged.

The Eurosystem currently uses the deposit facility rate to implement its desired policy stance, since liquidity remains ample. At present, this rate stands at 2 per cent. So where does that leave us?

One way to judge whether rates are in the right place is the natural rate of interest. This is defined as the interest rate that is consistent with growth at potential and stable prices. As we cannot observe it directly, we have to estimate it.

Our latest Bundesbank estimates for the third quarter of 2025, drawing on a broad range of models, point to values between 1.7 and 2.6 per cent in nominal terms. Eurosystem model-based calculations in spring 2025 put the nominal natural rate between 1.75 and 2.25 per cent.^[16] Accordingly, the current rate of 2 per cent sits more or less in the middle of those ranges.

This suggests that Eurosystem monetary policy is broadly neutral right now. However, this assessment should be taken with a grain of salt, because estimates of the neutral rate are inherently uncertain.

Our inflation projections are a better guide for interest rate decisions.^[17] In the latest projections from September 2025, ECB (European Central Bank) staff expected inflation to average around 2 per cent over the next three years, including a slight dip in 2026.^[18] Euro area growth over the same period should average about 1.2 per cent. That is very close to the European Commission's estimate of potential growth of 1.1 per cent for 2026.^[19]

Moreover, the projections have been quite stable for some time now. Taken together, our projections also suggest that interest rates are currently in a good place.

Right now, Eurosystem staff are finalising projections to be published in conjunction with the ECB (European Central Bank) Governing Council's December meeting. They will include an initial projection for 2028. Based on these forecasts, we will be able to determine whether we are still on track to meet our medium-term inflation target.

6 Concluding remarks

Ladies and gentlemen, let me conclude.

Germany and the Republic of Korea face similar challenges. I hope my remarks have given you a clear view of how Germany and Europe could tackle these challenges.

To increase its potential growth, Germany has to cut red tape, reduce energy costs and expand its labour supply. At the European level, we need to deepen the Single Market, finalise the Savings and Investments Union, integrate energy markets and boost Europe's resilience in defence and payments.

I truly appreciate being here in the Republic of Korea and learning from your experiences. By deepening ties between our two countries, we can learn from each other and make faster progress.

For now, I look forward to our discussion.

Thank you for your attention.

Footnotes:

1. See Manufacturing, value added (% of GDP) – OECD members, Korea, Rep., Germany | Data
[https://data.worldbank.org/indicator/NV.IND.MANF.ZS?locations=OE-KR-DE&most_recent_year_desc=true]
2. See Energy imports, net (% of energy use) – Germany, Korea, Rep. | Data
[<https://data.worldbank.org/indicator/EG.IMP.CON.S.ZS?locations=DE-KR>]
3. See Fertility rate, total (births per woman) – Germany, Korea, Rep. | Data
[<https://data.worldbank.org/indicator/SP.DYN.TFRT.IN?locations=DE-KR>]
4. See Deutsche Bundesbank (2025), What's behind the sustained decline in German export market shares?, Monthly Report, July 2025.
5. See Deutsche Bundesbank (2025), Forecast for Germany: US (United States) tariffs initially weigh on economic growth; fiscal policy provides impetus with a delay, Monthly Report, June 2025.
6. See Deutsche Bundesbank (2025), Challenges Faced by Firms, Deutsche Bundesbank Survey of firms (BOP (Bundesbank Online-Panel)-F), 30 October 2025.
7. See ifo (Institut für Wirtschaftsforschung) Institute (2024), Bureaucracy in Germany Costs 146 Billion Euros a Year in Lost Economic Output, Press release, 14 November 2024.
8. See Institute for Employment Research (2025), 325.000 Arbeitskräfte waren laut Betrieben in den letzten drei Jahren zusätzlich nötig, um die gewachsene Bürokratie zu bewältigen, Press release, 20 November 2025. The press release is only available in German.
9. See KfW (Kreditanstalt für Wiederaufbau) (2024), Start-up activity lacks macro-economic impetus – self-employed people are becoming more important as multipliers, KfW (Kreditanstalt für Wiederaufbau) Entrepreneurship Monitor 2024.
10. See Kemmler et al. (2024), Klimaschutzinvestitionen für die Transformation des Energiesystems, Prognose. This study is only available in German.
11. See Nagengast, A., F. Rios-Avila and Y. Yotov (2025), The European single market and intra-EU (European Union) trade: An assessment with heterogeneity-robust difference-in-differences methods, Bundesbank discussion paper 26/2025.
12. See European Commission (2023), Investment needs assessment and funding availabilities to strengthen EU (European Union)'s Net-Zero technology manufacturing capacity, SWD (2023) 68 final.

13. See Centrone, M. and M. Fernandes (2024), Improving the quality of European defence spending – cost of non-Europe report, European Parliamentary Research Service.
14. See Eurosystem (2025), Progress on the preparation phase of a digital euro – Closing progress report.
15. See Brand, C., N. Lisack and F. Mazelis (2025), Natural rate estimates for the euro area: insights, uncertainties and shortcomings, ECB (European Central Bank) Economic Bulletin, 1/2025.
16. See Nagel J. (2024), Dot plots for the Eurosystem? Speech at Harvard University, 22.10.2024, Cambridge.
17. See ECB (European Central Bank) (2025), Eurosystem staff macroeconomic projections for the euro area, September.
18. See European Commission (2025), European Economic Forecast, Institutional Paper No. 318, May.