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The German economy is struggling to get any wind in its sails

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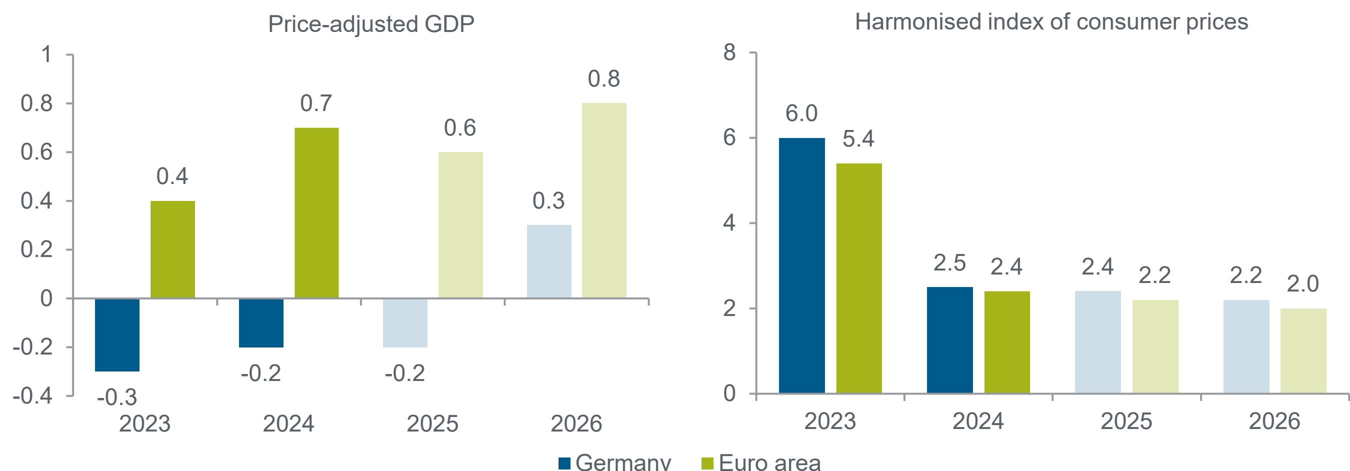
- Positive and negative quarterly German GDP growth rates have regularly alternated in a sawtooth-shaped pattern for three years now. On balance, economic output at the end of last year only roughly matched the level of the fourth quarter of 2019, before the outbreak of the COVID-19 pandemic.
- Monetary easing and higher real wages are currently providing some lift. Still, consumption remains subdued and investment continues to be weak in light of significant capacity underutilisation. The threat of tariffs from the US is dampening the outlook for exports.
- We expect the sawtooth-shaped business cycle to continue for the time being. For 2025, we expect GDP to fall again by 0.2% (previous forecast: +0.5%), real growth is likely to pick up slightly to 0.3% in 2026 (initial forecast). We regard the forecast risks as balanced.
- In the euro area, many uncertainties are weighing on business and consumer sentiment. We predict GDP growth of 0.6% in 2025 (previous forecast: +0.8%) and 0.8% in 2026 (initial forecast). NGEU funds will provide impetus particularly in Spain and Italy.
- Given the persistent services inflation, we now expect inflation (HICP) of 2.2% in the euro area and 2.4% in Germany in 2025 (previous forecasts: +2.0 and +2.1%). Inflation should fall to 2.0% in the euro area and 2.2% in Germany in 2026 (initial forecasts).

Economic growth and inflation

Per cent year-over-year change



Sources: KfW Research, Destatis, Eurostat

Price-adjusted GDP growth in the euro area

Per cent year-over-year change

	DE	FR	IT	ES	EA
2023	-0.3	0.9	0.7	2.7	0.4
2024	-0.2	1.1	0.5	3.2	0.7
2025	-0.2	0.5	0.3	2.2	0.6
2026	0.3	0.7	0.6	1.8	0.8

Source: Destatis, Eurostat, KfW Research

Germany: return to moderate growth not before 2026

German gross domestic product (GDP) is stuck in a deep stagnation. Positive and negative quarterly growth rates have regularly alternated in a sawtooth-shaped pattern for three years now. On balance, GDP at the end of last year only roughly matched the level of the fourth quarter of 2019, before the outbreak of the COVID-19 pandemic. The initiated easing of ECB monetary policy and the noticeable increases in real wages last year are currently providing some impetus. Still, household consumption can be factored out at least as a strong driver, since real wage momentum already appears to be waning again and the household saving rate, which rose considerably in 2024, can be expected to decline only minimally as a result of rising unemployment risks. At the same time, investment will remain anaemic at least in 2025 given the very dim business expectations of enterprises, high trade and geopolitical uncertainty and significant capacity underutilisation. The outlook for exports is also unfavourable, especially because of the threat of US tariffs which we expect to be implemented in the second quarter in the form of moderately higher US tariffs on the EU. Finally, the national and EU rules are in opposition to significantly expansionary fiscal policy and it is likely to take some time for a new German government to get to work after the parliamentary election. Some impetus could then come from more cost-effective fiscal measures, such as a reduction in bureaucracy, but probably not before next year. All in all, we expect the sawtooth-shaped business cycle to continue for the time being. We now forecast GDP to fall again slightly by 0.2% this year (previous forecast: +0.5%), and real growth is likely to pick up moderately to 0.3% in 2026 (initial forecast). We view the upside and downside risks to the forecast as relatively balanced. If new US tariffs on the EU can be fully averted, for example, or if Germany succeeds in reforming its fiscal rules in a way that strengthens investment, growth during the forecast period may also turn out higher.

Euro area: improvement will depend on more clarity

Economic growth in the euro area weakened at the end of 2024. GDP grew by only 0.1% in the final quarter, after achieving slightly higher growth in the three preceding quarters. Cyclical and trade uncertainties are weighing on business as well as consumer sentiment. We therefore expect GDP growth of only 0.6% in 2025 (previous forecast: +0.8%). The moderate increase of tariffs on all exports from the EU to the US, which we assume the US administration will impose in the second quarter of 2025, is likely to prevent stronger growth. The effects will be felt primarily in the already ailing industrial sector, especially in mechanical engineering, automotive engineering and the chemicals industry. In 2023, the exports of these three sectors to the US contributed 2.2% to euro area GDP. At the same time, consumer restraint will likely ease only gradually. Nevertheless, private consumption is likely to grow moderately on a year-on-year basis and bolster growth as a result of further increases in real incomes. Monetary policy-driven investment incentives are increasing as a result of falling interest rates. The most difficult stretch on the road to the recovery of investment now appears to have been successfully navigated. Still, enterprises remain reluctant to invest for lack of planning certainty, so that a return to moderate growth in investment is unlikely until later in the year 2025. Among the four large euro area countries, NGEU funds will provide fiscal impetus particularly in Spain and Italy. On balance, we expect euro area growth to pick up moderately in real terms to 0.8% in 2026 (initial forecast). US protectionism is likely to exert its strongest braking effect next year. However, higher investment and consumption expenditure will favourably offset the dampening effects of US tariff increases on GDP. If a global trade war can be averted, global inflation rates continue to fall and trade uncertainty eases, external demand from the rest of the world is then likely to recover somewhat on a low level as well. Spain will presumably achieve the highest real growth of the four large countries during the forecast period.

Consumer price inflation: still on target

Consumer prices have lately increased at a slightly higher rate. In January 2025, the euro area inflation rate as measured by the Harmonised Index of Consumer Prices (HICP) stood at 2.5%, after temporarily dropping to its low of 1.7% in September last year. At the same time, inflation in Germany rose from 1.8 to 2.8%. The faster pace of annual inflation, however, is mainly a result of energy prices, in which base effects were predictably a negative factor. At the same time, however, services inflation – for which wages play an important role – remained on a higher level in January as well (euro area: +3.9%; Germany: +5.1%) and service providers' sales price expectations, in fact, recently picked up again slightly. Even if it will therefore likely take some time for domestic price pressure to ease noticeably, we expect the inflation rate to approach its target level of 2% in the course of 2025. Catch-up price increases are likely to come to an end and wage increases should ease gradually. According to the ECB wage tracker, which is based on collective bargaining agreements that are already in place, negotiated wage growth will slow to 1.5% up to the final quarter of 2025, after 5.4% in the fourth quarter of last year. In light of the persistently high services inflation, we have nonetheless revised our inflation forecasts slightly upward. We now predict an inflation rate of 2.2% for the euro area (previous forecast: +2.0%) and 2.4% for Germany (previous forecast +2.1%) for this year. On average for the coming year, inflation is likely to drop to 2.0% in the euro area and 2.2% in Germany (initial forecasts). Risks to European price stability could arise from US tariff policy. We expect the trade conflict to remain limited and to hardly influence the inflation rate. But a significant euro depreciation would pose a relevant risk to this assessment.