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Cross-Asset- and Strategy-Research

Germany stuck in the slow lane

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From bad to worse – and the streak continues

The flood of grim news from the German economy, particularly the industrial sector, shows no signs of letting up. It feels like every week, well-known companies – especially in the automotive industry – announce that they need to “adjust” their workforce to reflect sluggish demand. In plain terms: tens of thousands of jobs in Germany are being cut. Insolvency figures have climbed back above pre-Covid levels, and the closely watched ifo Business Climate Index has dipped again in September after a brief period of mild improvements. Confidence is low across the board. The last time the ifo Expectations Index matched the average of the past two decades was at the beginning of 2022.

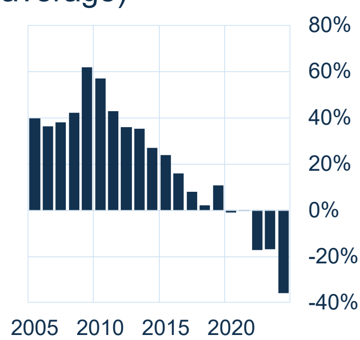
The economy remains mired in crisis

The malaise facing the German economy is more than just a cyclical downturn. It’s the result of a tangled web of problems and structural missteps. LBBW Research outlined these numerous structural obstacles in its stagnation study back in the fall of 2024. One year on, we are still in the same spot.

Waiting and hoping are not strategies

Adding insult to injury, external shocks are now piling on top of structural challenges. The overpowering protectionism of the Trump administration (well, let’s strike the word “administration” – Washington has essentially become a one-man show) is hitting Germany particularly hard. Few countries have been as reliant on export-driven growth over the past decades as Germany (see Fig. 1). Alas, the golden age of globalization is long gone. And now Trump is slamming on the accelerator in reverse.

Fig. 1: Contribution of net exports to German GDP-growth (10-year moving average)



Source: Destatis, LBBW Research. Data adjusted for price changes, chain-linked volume figures.

One of the unwelcome side effects of this is becoming increasingly clear: the U.S. is walling off its market from Chinese exports with particularly high tariffs. But China needs export success, as its domestic market struggles to regain momentum amid a shrinking workforce, a stubborn real estate crisis, and high debt levels. Struggling with overcapacity and U.S. protectionism, Chinese manufacturers are inundating other parts of the world with their often heavily subsidized products, including Europe. Germany finds itself squeezed from both sides: the rising tide of trade barriers make exporting more difficult, while heightened competition is putting pressure on the domestic market.

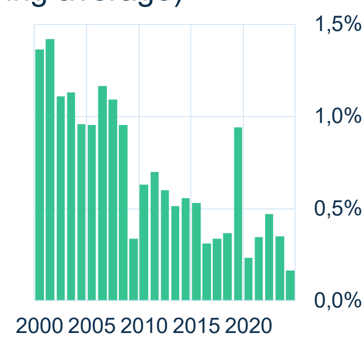
New challenge: China's exports to Europe

Time to seize the initiative

There are various ways to respond to these challenges. One approach might be summarized as "an eye for an eye, a tooth for a tooth." In fact, the Brussels grapevine suggests that the EU is preparing a package of tariffs on Chinese goods along with "Buy European" rules. This week, we got a preview of this approach, with the announcement of a 50% tariff on steel. Austria's Minister of Economic Affairs, Wolfgang Hattmannsdorfer, has even called for a "protection shield" for European industry: "We need to act more protectionist and patriotically European." Sounds a lot like "Make Europe Great Again." Some seem to succumb to the temptation to take a page out of Trump's isolationist playbook.

I do believe it's absolutely justifiable to impose countervailing duties on dumped goods from Asia. But protectionism, in and of itself, does not deliver prosperity. Incidentally, MAGA loyalists will come to realize this as well. After all, America has never been as "great" as it is now, following decades of free trade.

Fig. 2: Productivity growth per employee in Germany (10 year moving average)



Source: Federal Ministry of Finance, IMF, LBBW Research
NB: Productivity growth was negative in 2023 (-1.5%) and 2024 (-0.6%)!

Yet, the time Europe gains with China tariffs must be used wisely. The EU must double down on efforts to close the technological gap. If Europe instead clings nostalgically to an irretrievably bygone era of industrial dominance, the decline will only accelerate (see Fig. 2). Why Germany still identifies itself as an "industrialized nation" when 80% of its value creation now comes from outside the manufacturing sector? And when some German politicians these days talk about 'technological openness,' do they perhaps mean they want everything to stay as it was back when the country reigned supreme? Ignoring technological progress and structural change won't turn the tide. In my view, there's too much focus on the past and not enough on the future.

Just over a year ago, the Draghi report provided a blueprint for a competitive Europe. Yet, only about a tenth of its recommendations have been implemented so far. The much-needed €800 billion annual investment offensive is nowhere to be seen. Progress on completing the EU single market remains elusive. According to IMF estimates, the trade barriers within the EU are equivalent to an average tariff of 40% on goods – and even higher for services. Completing the internal European market is now more urgent than ever. It will require that each country will need to put its narrowly defined national interest on the back seat. How many more wake-up calls will it take for Europeans to understand that Europe's only chance lies in working together?

Complete the single market, invest in future technologies!

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