

GERMANY

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THE COUNTRY LAUNCHES ITS NEW GROWTH CYCLE

The German economy is undergoing a strategic transformation, with increased public spending poised to significantly change its economic model. This transformation has the potential to boost business investment and household spending, while also reducing the country's reliance on exports. The stability of GDP in Q3 2025 underscores this duality: the rise in public spending and private investment is offsetting the ongoing decline in exports. Following a growth rate of 0.3% in 2025, Germany's economic expansion is projected to gain considerable momentum in 2026 (1.4%) and 2027 (1.5%), with this growth gradually extending to the private sector. The rise in public debt is expected to remain manageable and temporary. However, several structural issues must be addressed to ensure that labour shortages and stagnant productivity do not impede the recovery. Social spending, which is currently bolstering growth, will have to be optimised to ensure fiscal sustainability, while managing inflation, which is still above the European average, is crucial to avoid a loss of competitiveness.

↗ A TWO-STAGE ACCELERATION IN GROWTH

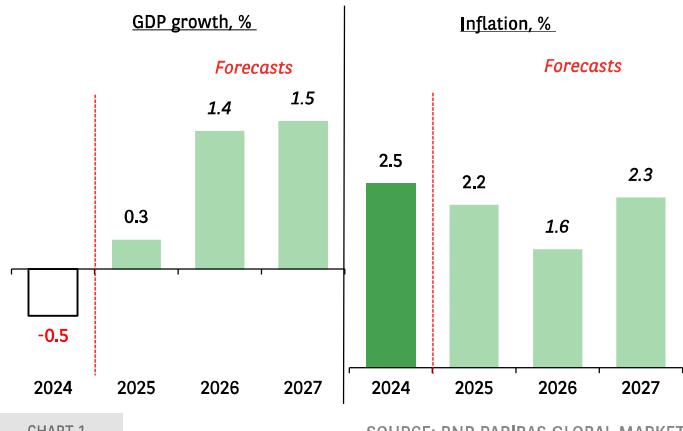
Germany's growth performance in 2025 was mixed. Its main driver was public spending, particularly public consumption, which increased mainly due to social spending and local government spending. In the first three quarters, public investment rose by +3.2% year-on-year, bolstered by a resurgence in spending on machinery and equipment (+13% year-on-year), albeit from a low starting point, resulting in its contribution to GDP growth being only 0.1 percentage points. In contrast, private consumption and exports remained subdued in 2025, with the latter particularly impacted by a decline in trade with the United States. The deterioration in export markets continued to exert pressure on the industrial sector, as evidenced by the persistently low capacity utilisation rate. Despite these challenges, GDP stopped contracting on a net basis, recording a growth of +0.3% in 2025 (following declines of -0.7% and -0.5% in 2023 and 2024 respectively).

Evidence of an improvement in the private sector has started to surface. According to the IFO survey, a growing number of industrial sectors are either rebounding or expanding (8 out of 21 in October, compared with just 2 at the end of 2024). Additionally, private investment in machinery and equipment grew in Q3 (+0.6% q/q, following a contraction of 11% over the past two years). This positive trend is expected to continue in 2026, due to lower interest rates and tax incentives, such as accelerated depreciation that reduces corporate tax for investing companies¹. Q4 2025 is expected to signal the onset of more significant growth, spurred on by the implementation of the 2025 budget approved last September, which will facilitate an increase in public investment. In 2026 and 2027, economic activity is projected to benefit from increased rearmament and infrastructure spending, alongside more favourable employment trends and improved household purchasing power (see our recent analysis), heralding a rebound in household consumption, which we estimate will rise by 1.6% in 2026. Consequently, GDP growth is expected to surpass 1% for the first time since 2018 (excluding the post-COVID rebound), with projections of 1.4% in 2026 and 1.5% in 2027.

⌚ LABOUR MARKET: A LEVER THAT RISKS RUNNING UP AGAINST FULL EMPLOYMENT

The unemployment rate has gradually increased from a low of 3% in 2023 to 3.8% in October 2025, according to Eurostat's definition. The country has therefore seen a moderate shift away from full employment due to job losses in industry (-320,000 compared to Q4 2019) and construction (-210,000), while job creation has remained concentrated in services (+310,000).

GROWTH AND INFLATION (YEARLY AVERAGE)



SOURCE: BNP PARIBAS GLOBAL MARKETS

The available workforce is estimated to be around 300,000 potential jobs, which should support non-inflationary growth at least until the end of 2026. It could support industrial restructuring for the advancement of military equipment production (which we have assessed as having significant potential, as outlined in our study). In the fourth quarter of 2025, only 8% of industrial companies reported labour shortages, down from 33% three years earlier, according to the European Commission.

However, this opportunity may be fleeting: the unemployment rate is projected to fall to 3.6% in 2026 and then to 3% in 2027, indicating a return to full employment levels. While the proportion of manufacturers facing labour shortages has fallen from 33% to 8% in three years, tensions persist in other sectors: 18% of service and construction companies—down 10 and 3 pp respectively—still report staff shortages. The relatively rapid return of these shortages therefore calls for prompt reforms, particularly aimed at improving the employment rate among people of working age, to mitigate their adverse effects.

⌚ DISINFLATION INCOMPLETE BUT EXPECTED TO PROGRESS

While Germany has recorded inflation around 5 percentage points higher than that of France and Italy since 2021, harmonised inflation reached 2.6% y/y in November (+0.7 pp compared to July, 0.5 pp above the eurozone average). After several months of decline, energy prices are stabilising, although inflation in services remains persistent.

¹ The implementation of the 'federal modernisation agenda', adopted in December 2025, which aims to reduce bureaucracy and related costs, should also contribute to this. The plan includes, among others, a reduction in the time required to register companies and obtain building permits, and the simplification of reporting requirements to facilitate access to finance.



As a result, inflation and wage growth curves are converging once again, with wages rising by 2.8% y/y in Q3 2025. The recovery in purchasing power has slowed significantly: in real terms, average wages are still around 12 points below their pre-inflation level, which may account for the ongoing weakness in household confidence and consumption. However, disinflation is expected to resume: inflation is projected to fall by 1 pp by May 2026, especially in the services sector (where the persistence of the y/y figure is mainly due to the dissipation of base effects). At the same time, wages should hold up better due to ongoing labour market pressures in certain services, public sector recruitment related to rearment, and the scheduled increase in the minimum wage in 2026 and 2027 (+8% in 2026, +5% in 2027 to reach EUR 14.60/hour).

However, the period of inflation below 2% is expected to come to an end in 2027 (forecast at 2.3%) due to wage pressures resulting from a return to full employment. Finally, a sustained anchoring of inflation at a lower level would require a correction in energy costs, which continue to exceed eurozone standards and have not fallen as sharply as in other regions recently.

⌚ TOWARDS A MANAGED INCREASE IN PUBLIC DEBT

The budgetary reform initiated by the government is based on two separate components. The first is a multi-year plan, extending over ten years, which derogates from the debt brake rule in order to finance investments in infrastructure and defence. The second is the federal budget, which remains fully subject to this rule and must therefore balance any new expenditures with savings. However, measures to promote the transition to low carbon (in particular, the reintroduction of a car bonus at a cost of around EUR 3 bn) and the pressures associated with demographic ageing (with an anticipated increase in pension and healthcare costs) will increase public spending. While tax revenues are expected to benefit from the projected economic recovery, several measures to bolster economic activity and industry (such as accelerated depreciation followed by a reduction in corporate tax, subsidies for electricity prices and a reduction in electricity taxes for industry) would constrain their growth. This combination is expected to widen the primary deficit (projected at -2.8% in 2025 according to our forecasts, -3.1% in 2026 and -2.7% in 2027, compared with -1.6% in 2024, [as outlined in our publication](#)), while additional budgetary financing through special funds (nearly EUR 230 billion between 2025 and 2027), will further increase debt levels, pushing up sovereign rates (2.8% on 5 December 2025, compared to an average of 2.3% in 2024) and therefore the interest burden (+0.3 pp by 2027 according to our estimates). All these factors are expected to contribute to a gradual increase in the public debt-to-GDP ratio, which is projected to reach 67.5% of GDP by 2027 (compared with 62.4% in Q2 2025).

While the budget deficit is expected to widen until 2027, fiscal consolidation is projected to facilitate a reduction thereafter. Still adhering to the debt brake rule, the government will likely seek to lower the public deficit to around 3% of GDP by the end of its term in 2029.

↳ DOMESTIC DEMAND IS PROJECTED TO COMPENSATE FOR THE DECLINE IN EXPORT OPPORTUNITIES

The German growth model has long relied on exports, which still accounted for 41% of GDP in 2024, a significantly higher percentage than in similarly sized countries (around one-third of GDP in Italy and France). While external markets are shrinking due to competition from China and the US tariff shock, domestic demand has yet to recover sufficiently (despite positive signs, such as an increase in new registrations

GERMANY: CHANGES IN GDP AND ITS COMPONENTS

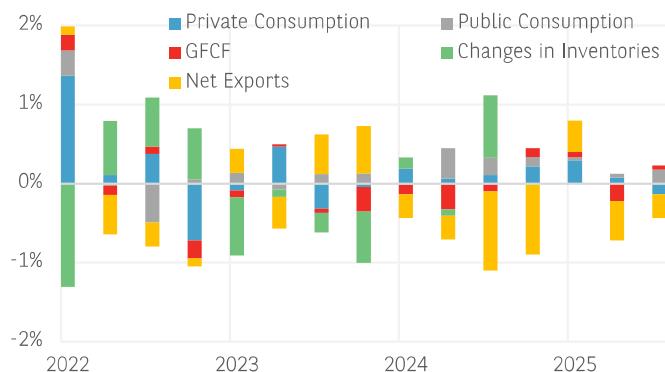


CHART 2

SOURCE: FEDERAL STATISTICAL OFFICE, BNP PARIBAS

GERMANY: CHANGES IN PUBLIC DEBT AND BUDGET BALANCE

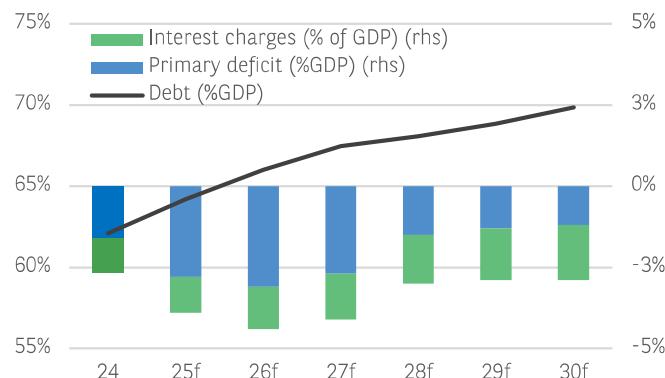


CHART 3

SOURCE: FEDERAL MINISTRY OF FINANCE, BNP PARIBAS FORECASTS

in 2025, particularly for electric vehicles). Meanwhile, exports of goods and services continue to decline (-0.7% q/q). The deficit with China is widening, while German exports are also being eroded in third markets. At the same time, the tariffs imposed by the Trump administration have intensified pressure on the automotive sector. Consequently, following a spike in Q1 associated with advance purchases in the US, the downturn in sales to the US in Q2 and Q3 was more pronounced, resulting in a negative net effect.

The EU may serve as a stabilising force in the coming quarters: increased internal trade within the region has already mitigated the decline. The expected rebound in growth in the eurozone, particularly from countries such as France and Italy, is expected to benefit German exporters. However, it is likely that the recovery in German growth will also lead to an increase in imports: consequently, the goods surplus and its counterpart, the current account surplus, are likely to continue to diminish, reaching around 4% of GDP by the end of 2027 (compared with 5.7% in 2024 and 7.9% in 2019).

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