"UPGRADED SUPPORT TOOL FOR INTEGRATION OF SMEs IN EUROPEAN AND GLOBAL VALUE CHAINS"

REPORT 6

MACROECONOMIC OVERVIEW OF GERMAN ECONOMY

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Construction industry

Germany - Macroeconomic overview

According to the economic report of the World Bank from 2023, Germany is the third largest economy in the world after the USA and China and the first largest economy in the European Union. With around 83 million people, Germany is the most populous country in the European Union and a significant investor in developing markets, especially in the economies of the Western Balkans. Unlike many countries in Europe that face a negative demographic trend, Germany does not have these problems, primarily due to a large number of migration processes that are in force not only from Europe but also from other parts of the world. If we look at the German economy through the prism of SWOT analysis, the following can be mentioned: stable public finances; strong industrial base; low structural unemployment; diversification of the export sector; political stability and low political risk and many others.

Table 1 Overview of basic macroeconomic indicators of Germany

The name of the indicator	2017	2018	2019	2020	2021	2022	2023	*2024p*	*2025p*	*2026p*
Real GDP growth, in %	2,7	1,0	1,1	-3,8	3,2	1,8	-0,3	*0,2*	*1,3*	*0,5*
GDP in current prices, in billions of EUR	3.265	3.370	3.473	3.408	3.628	3.891	4.127	4.251	4.419	4.576
Population, in millions	82,6	82,9	83,1	83,2	83,2	83,8	84,5	*84,6*	*84,6*	*84,5*
GDP per capita, in EUR	39.502	40.645	41.795	40.975	43.611	46.435	48.821	50.269	52.258	54.140
Output gap in % of potential GDP	1,0	0,8	0,4	-3,1	-1,1	0,8	-0,5	*-1,3*	*-0,9*	*-0,4*
Total investments, in % of GDP	21,0	21,9	21,9	22,0	23,2	25,0	23,6	*22,6*	*22,7*	*23,1*

Note: p – projections.
Source: IMF.

The annual growth of the German economy in the last few years clearly shows that the most attractive labor market in Europe clearly lags behind the most developed countries in the world, the USA and China, both in terms of economic development and in terms of technology. Germany leads the EU, which is increasingly losing the technological game with the more experienced USA and significantly more progressive China. The American business environment represents a much more attractive area for capital placement due to the policy of subsidies and high interest rates, while on the other hand, Chinese economies are taking over technological dominance in the global market, especially in the auto industry market, so now both view Germany as a "younger brother".

GDP per capita last year was around 49,000 Euros, which ranks Germany among high-income countries and one of the most attractive destinations for non-residents, with attractive living conditions. IMF analysts and economists expect this indicator to continue growing in the coming years and estimate that GDP per capita will exceed 50,000 Euros at the end of the current year. Total investments in this country are at a stable level in the observed time series and make up almost 25% of GDP each year. A positive trend in the German economy is that every observed year the gap in the ratio of production and GDP is at a minimal level, i.e. at the level of about 0.5%.

Table 2 Overview of basic macroeconomic indicators of Germany - Consumer prices and the labor market

	2017	2018	2019	2020	2021	2022	2023	*2024p*	*2025p*	*2026p*
Inflation in %	1,7	1,9	1,3	0,4	3,2	8,7	6,0	*2,4*	*2,0*	*2,0*
Inflation in %	1,6	1,8	1,3	-0,5	5,4	10,8	3,0	*2,2*	*2,0*	*2,0*
Reference interest rate	0,0	0,0	0,0	0,0	0,0	2,5	4,5	*3,4*	*2,7*	*…*
Unemployment rate	3,6	3,2	3,0	3,6	3,6	3,1	3,0	*3,3*	*3,1*	*3,0*
Employment	40,9	41,2	41,6	41,2	41,4	42,4	42,9	*42,8*	*42,8*	*…*
Gross national savings	28,8	29,9	30,0	29,0	30,9	29,4	30,4	*29,6*	*29,6*	*29,7*

Note: p – projections.
Source: IMF.

Inflation has created visible problems in the last few years and is the number one problem of the German economy. High inflationary pressures caused, first, by the COVID crisis in 2020, and then by the Ukrainian war, fueled the energy and food crisis throughout the world. Nevertheless, in recent months, inflation has been continuously decreasing towards the central value, but this calming is still not to the extent necessary for the ECB to make a decision to reduce the reference interest rate. The latest announcements indicate that there will almost certainly not be more than two reductions in the reference interest rate during the second half of the current year, which nevertheless indicates that the fight against persistent inflation is still ongoing.

Due to the aforementioned crises, many essential supply chains in the global market have been disrupted, leading to a mismatch between supply and demand. During 2023, the average inflation in Germany was still at a high level and amounted to 6.0%, but the restrictive monetary policy of the ECB still managed to stabilize it, so in 2024, the average inflation in this country is expected to be at the level of about 2.4%. Industrial production in the last three years has been negative with an increasing tendency to fall from year to year. After 0.6% in 2022, the decline in the manufacturing sector is even more pronounced and in 2023 it amounted to 1.7%. Bloomberg economists expect that production will continue to suffer during the current year and that the projections of the decline are not optimistic, and that this year the decline will be even more pronounced, at the level of around 2.0%.

The unemployment rate in Germany is around 3.0%, which, with minor annual fluctuations, represents a constant value, which is expected by the head of the IMF in the coming years. The average gross salary during 2023 was around 4,200 Euros.

Table 3 Overview of Germany's foreign trade exchange in the period 2017-2023

	2017	2018	2019	2020	2021	2022	2023
Export of goods	1.278	1.318	1.328	1.209	1.379	1.601	1.574
year-on-year change	6,2	3,1	0,8	-9,0	14,1	16,1	-1,7
Import of goods	1.030	1.088	1.104	1.027	1.202	1.512	1.359
year-on-year change	7,4	5,6	1,5	-7,0	17,0	25,8	-10,1
Foreign trade deficit	248	230	224	182	177	89	215
year-on-year change	-0,4	-7,3	-2,6	-18,7	-2,7	-49,7	141,6

Source: ITC trade map.

By analyzing Germany's foreign trade exchange with the world, 2022 can be seen as a year in which a big step forward was made when it comes to exports, which increased by 14% this year and exceeded 1,600 billion Euros. From 2017 to 2021, exports were at a constant level of around 1,300 billion Euros, so that the general increase in prices on the global market during 2022 would additionally "push" global exports, and therefore also German exports. On the other hand, a similar trend is recorded by imports, which in 2022 exceeded 1,500 billion Euros, and in the following year it would decrease by about 10%. This implies the conclusion that Germany achieves a surplus in foreign trade in goods in all observed years and that in 2023 this indicator amounts to 215 billion Euros. The share of exports in the GDP of the country is about 40%, while the indicator of the openness of the economy exceeded 70%.

If we look at the structure of Germany's exports, it can be seen that the largest export products are vehicles, nuclear reactors and electrical machines, that is, final products with a high level of added value that make up practically 50% of Germany's total exports in 2023. This country is also a major exporter of pharmaceutical products, an industry that is particularly important and developed in this country. On the import side, in addition to the products of the mechanical and electrical industry, we should also mention mineral fuels, plastic raw materials, iron, steel, etc. From this it can be clearly concluded that Germany procures raw materials and components from abroad, and that the production processes of the final products are carried out in the country.

The distribution of the most important trade partners is significantly fragmented, and the largest partners are the USA, China, and Great Britain, but also Euro zone countries such as the Netherlands, Poland and Italy. In exchange with the USA, Germany records a surplus of around 66 billion Euros in 2023, while in exchange with China the deficit amounts to 60 billion Euros. When it comes to trade in services, Germany's exports in 2023 reached 407 billion Euros, while imports amounted to 470 billion Euros.

Table 4 Fiscal indicators of the German

	2017	2018	2019	2020	2021	2022	2023	*2024p*	*2025p*	*2026p*
Fiscal revenues	45,5	46,3	46,5	46,1	47,4	47,0	46,1	*46,3*	*46,5*	*46,7*
Fiscal expenditures	44,2	44,3	45,0	50,5	50,9	49,5	48,3	*47,8*	*47,8*	*47,6*
Fiscal deficit	1,3	2,0	1,5	-4,4	-3,5	-2,5	-2,2	-1,5	-1,3	-0,9
Current account deficit of the balance of payments	7,8	8,0	8,2	7,1	7,7	4,4	6,8	*7,0*	*6,9*	*6,6*

Note: p – projections.
Source: IMF.

When it comes to fiscal indicators, Germany records a budget deficit of around 2.2% of GDP in 2023, with the IMF noting that in the coming years it is expected to gradually decrease to 0.9% of GDP in 2026. In the current account of the balance of payments, a deficit of 6.8% was realized, which is the second lowest value of this indicator since 2017, but this is not something that should cause concern. According to credit rating agencies, Germany is the most suitable place for investment and capital placement with a credit rating of "AAA" with stable prospects for further improvement.

After the recession in 2023, economists expect that economic activity in Germany will stagnate during the current year, but also that domestic demand will grow slowly in the current and next year, as real wage growth continues. However, it is estimated that investments will remain well below pre-pandemic levels, limited by persistently high financing costs, and that exports will slow down in 2024 and slowly recover over the next year. Buoyed by domestic demand, GDP growth is expected to increase moderately, fiscal consolidation continues with the government deficit and a gradual decline in the debt-to-GDP ratio.

In the second quarter of 2024, Germany recorded a drop in GDP of 0.1%, which after a growth of 0.3% in the first quarter is an indicator of oscillations and a state of anemia in which the German economy has been for a long period of time. From the third quarter of 2021, economic activity in Germany has slowed down significantly and this economic indicator varies in the interval from -1% to 1%, which means that the largest economy of the Euro zone is in a state of stagflation, which economists define as stagnation in conditions of high inflation. Quarterly growth around zero for an extended period of time indicates that the economy is struggling but unable to gain real momentum and move forward at more progressive rates of progress. The largest economy of the Euro zone in recent years represents the main brake on the faster economic recovery of the entire bloc, and the problems that the makers of economic policy in this country are facing are only piling up. Inflation accelerated again in July, which is one of the reasons why the ECB is cautious and is not yet deciding on an expansionary monetary policy.

Despite all the challenges of recent years, Germany is intensively fighting both recession and stagflation and is the only G7 economy that recorded a decline in economic activity during 2023, while in the current year it will record the slowest growth among the countries of this group. Some economists believe that this is a passing phase in development, while others claim that the economic growth model is broken and that the problems are now manifesting primarily because the growth was based on the import of cheap gas from the Russian Federation, which gave the impetus to German industry to achieve a large market share export competitive advantage. Of course, there are well-founded arguments for this conclusion, because the shutdown of Russian gas contributed to a sharp rise in inflation and significantly higher living costs.

The main risks for the German economy in the coming period: still high inflationary pressures; potential escalation of conflicts in the world; lack of qualified workforce, loss of technological competitiveness and market share; export dependence; the developmental dominance of the automotive sector compared to other industries; greater economic growth threatened by a drop in investment; imbalance of savings policy and incentive policy, etc.

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