

Grömling, Michael

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Michael Grömling

The Current Economic Situation in Germany in the Context of Previous Crises

This article places the current economic stagnation in Germany in the context of previous crises since 1991. In terms of depth, the current macroeconomic crisis, resulting from the pandemic and geopolitical upheavals, has already exceeded the level of all three previous crises, in some cases considerably. In order to return to the growth path experienced in the last three decades, annual economic growth of 2.5% for the next six years is necessary. There are serious doubts about whether the German economy will return to its previous path of prosperity.

Germany's economy stagnated in 2024, and its economic output has remained more or less at the level of 2019, i.e. the level before the major economic burdens associated with the COVID-19 pandemic and the Russian invasion of Ukraine. The outlook for 2025 signals continued stagnation. This means that Germany is experiencing its longest period of economic inactivity in the last seven decades. In 2023 and 2024, significant declines were recorded in the manufacturing and construction industries (Figure 1).

The construction industry is suffering from high financing and construction costs as well as weak investment activity overall. The high construction costs reflect the material and energy problems, as well as high regulatory costs. In addition, in the wake of the war-related energy price shock and associated high inflation, interest rates rose significantly.

The manufacturing crisis can be attributed to several partly mutually reinforcing causes (Grömling, 2024a):

Weak global economy. The geopolitical conflicts are having a direct negative impact on international investment activity. The high inflation rates resulting from energy price shocks caused by the war have also weakened consumption worldwide. This global slump is dampening foreign demand for German industrial goods and exports.

In the major industrial sectors in Germany, foreign sales account for around two-thirds of business.

Weak domestic demand. In addition to weak external demand, there is a macroeconomic investment crisis in Germany. The construction recession has led to a significant drop in demand for industrial intermediate goods and construction-specific capital goods. In addition, the notable rise in financing costs is dampening general investment activity and thus an important part of the German industrial spectrum.

Uncertainties. The geopolitical upheavals are having a direct impact not only on global investment activity. Rather, the political uncertainties are also creating a business environment characterised by economic imponderables. In addition, uncertainties in the context of climate policy and the conditions for transformation and, above all, the unclear economic policy course in Germany are causing caution and restraint among companies and consumers. The end of the German government coalition in November 2024 and the anticipated outcome of the election in early 2025 are contributing to economic policy uncertainty.

Loss of competitiveness. Last but not least, the competitive position of internationally oriented companies has deteriorated, which in turn is curbing demand for industrial goods via the foreign trade channel and the propensity to invest domestically. As a result of the multiple cost shocks caused by the sharp rise in energy prices, higher raw material prices and higher production costs due to global logistical problems and higher labour costs, German industry has lost price competitiveness. Added to this is the appreciation of the effective exchange rate of the euro against a number of international competitors.

Figure 1 shows that the services sector has so far provided an economic counterbalance. In the first half of

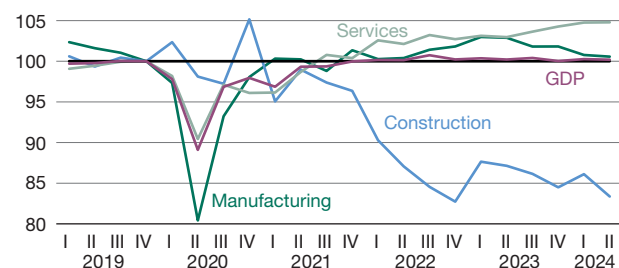
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Michael Grömling, German Economic Institute (IW), Cologne; and IU International University of Applied Sciences, Cologne, Germany.

Figure 1
Sectoral breakdown of economic development in Germany

Seasonally, price- and working day-adjusted gross value added; index: 4th quarter 2019 = 100



Sources: Statistisches Bundesamt; author's own calculations.

2024, the price-adjusted gross value added in this sector, which accounts for around 70% of total economic activity in Germany, was 1.6% higher than in the previous year. There was growth across the entire spectrum of the service economy – in business services and consumer-related services as well as in the public and social sectors. The positive income trend resulting from wage increases and normalising inflation rates as well as expansive government activity are currently benefiting the German service sector. Nevertheless, this trend is at best sufficient to compensate for the declines in manufacturing and the construction industry.

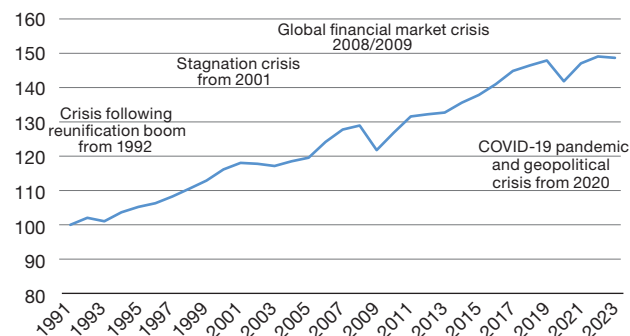
Cyclical and structural explanations

The arguments cited for the current manufacturing crisis extend beyond the poor cyclical situation, as cyclical factors partly overlap with long-term structural shocks. The pandemic and the current geopolitical upheavals show that economic shocks can also trigger changes in the sectoral structure of an economy (Grömling, 2021). Conceptually, the business cycle refers to fluctuations in the utilisation of a given production potential. The production potential describes the overall economic production possibilities of an economy with a normal utilisation of its production factors. Capacity utilisation is measured by gross domestic product (GDP), i.e. the actual volume of goods and services produced. Structural shocks (in addition to neutral technical progress and factor accumulation) have a direct influence on the level and composition of the production potential.

From a structural point of view, geopolitical changes and adjustment burdens have been causing an economic re-orientation and triggered a new discussion about the risk of deindustrialisation (Grömling et al., 2023). This dis-

Figure 2
Long-term economic development in Germany

Seasonally, price- and working day-adjusted GDP; index: 1991 = 100



Source: Federal Office of Statistics; author's own calculations.

cussion relates to the medium- to long-term significance of previously familiar sales markets, the reliability of international supply chains and logistics systems, the supply of raw materials and energy and, last but not least, the international transfer of knowledge. The restrictions experienced as a result of the pandemic (see Grömling, 2021) are being exacerbated by new tensions and uncertainties due to the changing geopolitical climate.

It remains to be seen what long-term adjustment burdens the new US administration will impose on the global economy and Germany. Added to this are the direct adaptation burdens for companies resulting from climate change and political transformation goals. The acute deterioration in competitiveness must also be seen in a long-term context. The quality of a business location is influenced by a variety of conditions – such as the availability of skilled workers, energy supply, the various infrastructures – and by the fundamental economic policy orientation.

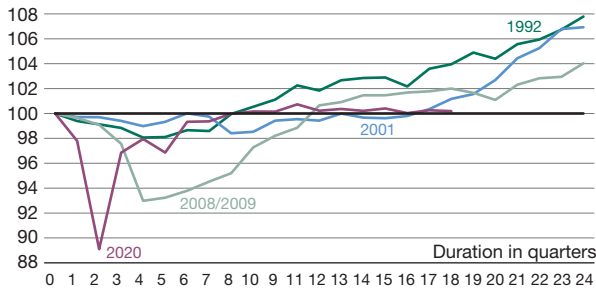
Current crisis in the context of former business cycles

This article places the current economic situation in the context of previous crises in Germany since 1991 (Grömling, 2024a). Figure 2 shows the development of price-adjusted GDP on the basis of annual values with the four crises: the crisis following the reunification boom from 1992, the stagnation crisis from 2001, the global financial market crisis of 2008/2009, the COVID-19 pandemic and geopolitical crisis from 2020. The aim and subject of this article is to provide a simplified method for assessing the current economic situation against the background of the economic crises that have occurred in Germany in the last three decades. The duration and depth of these crises can be seen in Figure 3.

Figure 3

Duration and depth of economic crises in Germany

Seasonally, price- and working day-adjusted GDP; index: quarter with the last peak = 100



Notes: The development of seasonally, price- and working day-adjusted GDP is shown on the basis of quarterly figures from the national accounts. The time series are indexed to the quarter before the start of a recession. The first quarter of 2020 thus marks the start of the macroeconomic recession and, accordingly, the time series begins with the fourth quarter of 2019.

Sources: Federal Office of Statistics; author's own calculations.

In terms of the overall economy and quarterly figures, the slump in the wake of the coronavirus pandemic was the sharpest to date, followed by the decline during the global financial market crisis in 2009. The pre-crisis level was nearly reached relatively quickly during the COVID-19 crisis in the eighth quarter. Figure 1 has already shown that there has been no economic movement since then, however. In contrast, the overall economic recovery to pre-crisis levels took a much longer time during the financial market crisis and the stagnation crisis, after which a sustained upturn set in.

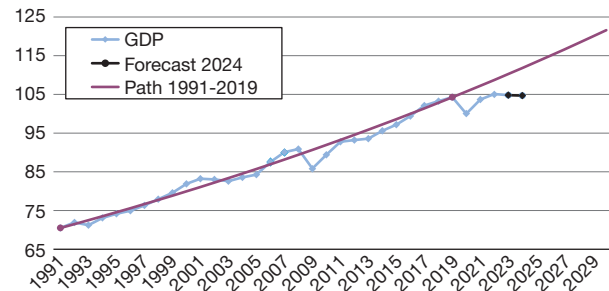
Comparison with a reference path

When assessing a recession based on the production volume before the outbreak of the crisis, it is assumed that a return to pre-crisis levels is considered normal or a matter of course. On the other hand, it is not taken into account that economic life would have continued to develop without the crisis and would probably not have remained at the level of the quarter before the crisis. For this reason, a counterfactual economic development is compared with the actual economic development to estimate the value added losses associated with the coronavirus pandemic (Grömling, 2024b). For the purpose of this analysis, an economic environment was assumed in which the pandemic and the war in Ukraine, the Middle East crisis and the associated geo-economic adjustment burdens do not exist. To derive such a counterfactual course, for example, economic development can be extrapolated at a pace that is based on the economic momentum of the past. Long-term forecasts can also be used that were made before the crises occurred.

Figure 4

Growth path and actual economic development in Germany

Actual development of seasonally, price- and working day-adjusted GDP (index: annual average, 2020 = 100) and growth path



Note: The reference growth path is based on average growth of the overall economy in the period from 1991 to 2019 with extrapolation to 2030.

Sources: Federal Office of Statistics; author's own calculations.

Figure 4 shows the actual development of seasonally, price- and working day-adjusted GDP for the period 1991-2023. In addition to the data shown in Figure 2, this time series was updated with a forecast for the year 2024 (Bardt et al., 2024). Secondly, Figure 4 shows a growth path, which can be interpreted as a reference path for trouble-free development – even though past crises also influence the overall dynamics of this growth path. The reference path in Figure 4 is based on average growth for the overall economy for the period 1991-2019. The current crisis period from 2020 onwards is not taken into account here, otherwise the average growth would be reduced by 0.15 percentage points. Figure 4 shows that the actual development has always returned to this reference path after the three previous crises in Germany.

A trend line could also be used as an alternative to this linear path analysis. With a linear trend, the economic reference is measured on the basis of equal annual changes in absolute terms, with correspondingly lower rates of change in the trend path over time. The approach chosen here, on the other hand, is based on a development path with constant percentage changes, which comes close to an exponential trend. A trend with a Hodrick-Prescott filter (Hodrick & Prescott, 1997; van Ruth, 2010), in which a very high smoothing parameter is used, also comes closer to this approach. The smoothing parameter “penalises” the extent to which the trend deviates from the original time series. The smaller the smoothing parameter is selected for the HP filter, the closer the trend approximates the original series and the more the trend takes crisis effects and cyclicity into account. This should explicitly not be

the case with the approach chosen here; instead, an overall undisturbed counterfactual development is chosen as a reference – from which, in turn, a deliberately chosen steady progress in prosperity can be derived.

Underwater periods in Germany

By comparing the actual development and the reference growth path, the economic “underwater” periods can be seen and measured for the economy as a whole. The comparison makes clear how long and how deeply economic development has dipped below the growth path defined here. This also reveals an output gap with the corresponding implications for macroeconomic income generation. This approach allows conclusions to be drawn about the intensity of economic crises.

Table 1 documents the length of time (in years) it took to return to the growth path. The speed of recovery after reaching the pre-crisis level is also relevant. The extent of the crises is the sum of the annual percentage deviations of the actual values from the growth path and shown as a percentage (rounded values to full percentages). When assessing the current crisis, it is important to bear in mind that this crisis is not yet over and that it is therefore not yet possible to determine the final outcome. The data for the path analysis includes the complete year 2024 based on a forecast (Bardt et al., 2024). In general, it should be noted that the assumed linear development as a counterfactual reference always poses a greater challenge compared to other forward-looking trend methods.

In terms of the depth and the associated deviation of the economy as a whole from the growth path that has been in place since 1991, the current situation has already exceeded the level of all three previous crises, in some cases considerably. As far as the duration and final impact on the economy as a whole is concerned, it remains to be seen how long the current crisis will last and thus how far the gap to the linear trend will widen. The financial market crisis follows at a distance. In terms of both duration and depth, the reunification crisis and the stagnation crisis were much less of a burden on the German economy.

Pace of recovery

In order to classify the economic crises, this path analysis can also be used to determine the pace of recovery required to return to the usual growth path from the current crisis and to overcome the underwater period (Grömling, 2024a). The path based on the growth average from 1991 to 2019 was extrapolated to 2030 in

Table 1
Economic crises in Germany: Duration, depth and recovery

	Crisis after reunification boom from 1992	Stagnation crisis from 2001	Global financial market crisis 2008/2009	Pandemic and geopolitical crisis from 2020
Duration in years ¹	5	3	8	5
Depth of the crisis ²	-4	-4	-16	-23
Pace of recovery ³	1.8	1.7	2.1	2.5

Note: Comparison with the level of the growth path. Growth path based on the actual annual average change in the overall economy in the period from 1991 to 2019. ¹ Duration in years until the growth path is reached again. ² Sum of the annual percentage deviations of the actual values of GDP from the growth path. ³ Average annual growth in real GDP (in percent) required to return to the growth path after the respective crisis.

Source: Author's own calculations.

Figure 4. It should be noted that the recovery phases in the past were occasionally interrupted, prompting the beginning of a new recovery. At a macroeconomic level, an average growth rate of 1.7% to 2.1% per year was required in the previous crises in order to close the gap to the path (Table 1). An above-average pace was necessary, particularly to resolve the financial market crisis.

In terms of the economy as a whole, a permanent annual economic growth rate of 2.5% for the next six years is necessary to return to the growth path. This appears to be a target that is almost impossible to achieve. The growth potential of the German economy is likely to be severely curbed by demographic trends and a lack of qualified employees in the coming years. Added to this are the adjustment burdens resulting from the geopolitically necessary restructurings and decarbonisation. There are therefore serious doubts that the German economy will return to the path of prosperity experienced between 1991 and 2019 in the near future.

Decisive changes are needed if the German economy is to turn around and embark on a path of recovery and growth at all. A real deescalation of geopolitical tensions including the wars in Ukraine and the Middle East and latent conflicts, i.e. growing nationalism in the European Union, territorial conflicts in the Indo-Pacific, the impact of the new US administration on the world economy, is an essential geoeconomic game changer. The reliability of well-established markets would be strengthened; the international division of labour would be stabilised through trustworthy supply chains and effective raw

material and energy supplies; and the risk of paralysing production and cost shocks would be reduced. Current uncertainties in the business environment would also be diminished. This chain of effects would increase the chances of a self-sustaining global investment and transformation cycle – which is good for the global community both economically and ecologically. In addition, reliable economic policy in Germany must seriously address and promote the quality of the business location. Internationally oriented taxes, regulations and innovation conditions as well as effective government investment is necessary to strengthen competitiveness. Uncertainties for companies due to climate change itself, but above all due to unclear conditions for the transformation, are a brake that must be removed.

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