REPORT ON THE ECONOMIC SITUATION

9/2024

The economic situation ahead of the 2025 Bundestag elections

Exclusive report for ACATIS Investment: Prof. Dr. Dr. h.c. Lars P. Feld, University Freiburg and Walter Eucken Institute

More bad news. Meyer-Werft, Thyssen-Krupp, BASF, VW, several automotive suppliers (including ZF) are dominating the headlines because of their financial and economic difficulties. Established mid-size sector firms prefer to invest abroad. One notable example is Stihl, a Waibling-based company that is expanding in Switzerland. Others include Miele, which is relocating some of its production from Gütersloh to Poland. Trumpf is starting reduced working hours (with the corresponding reductions in salary) at its main Ditzingen location, while investing tens of millions in Austria. It seems that the de-industrialisation process in Germany is gaining momentum.

Economically speaking, there are no signs of an upward trend. The leading German economic research institutes – IfW Kiel, ifo Munich, RWI Essen and DIW Berlin – have recently downgraded their economic growth forecasts for the current and the next year. The German economy continues to stagnate in the second half of 2024; and while forecasters expect that increased private consumption will create some stimulus in the coming year, those same expectations have already been disappointed so far this year. Despite the calm on the price front, there are many who say that inflation has not been conquered yet. The ECB expects average inflation rates of over 2 percent for 2024 and 2025. And it thinks it will take until the end of next year to get a better sense of whether inflation is under control. The labour market, a long-time bright spot, is increasingly showing signs of weakening economic performance. Unemployment is rising, and only the public sector is adding employees.

International observers increasingly wonder what is going on in Germany. It is not enough to simply point to special factors, such as the impact of the energy crisis on industry, China's relative economic weakness, or the effect on higher interest rates on the construction industry. The German economy is in its third year of stagflation. But even more importantly: On top of the economic developments, there are also structural problems that are becoming more pronounced. The German economy faces a toxic mix of high costs. Labour and energy costs, the tax burden and regulatory costs are among the highest in the world. And there is no improvement in sight.

If you have read these and similar assessments before: It is not because there are no other ideas. Because: This assessment has remained virtually unchanged. Only the growth of inflation has abated and interest rates are also starting to come down.

A multitude of indicators also points to considerable uncertainty with regard to German economic policy. The term "German Angst" is often used to describe the typically sceptical attitude exhibited by Germans. However, the current economic uncertainty is much stronger here than in the rest of the world, so there must be other factors at play. Mostly this has to do with the policies of the federal government, the repeated disagreements and disputes. But at the core, there is a much bigger problem, namely the fundamental incompatibility of two economic policy paradigms, which are expressed not just in the lack of consensus within the federal government, but also in the political ideas of the German population.

The first paradigm is based on administrative law, subsidies and industrial policy (in short: controlled investments), in order to manage the big challenges of our time, such as climate protection or new geo-strategic situations. The second paradigm relies on the market economy environment and incentives, and on the price system, so solutions for these challenges can be developed from inside the market and its knowledge-generating pricing mechanisms. For sure, both paradigms can be pragmatically reduced to their intersectional components to achieve a compromise, but that does not make them congruent. If that sounds a lot like muddling through, that is exactly what it is. And even worse: According to the latest surveys for the 2025 federal elections, this will not change in the next legislative period.

What is the solution? Social market economy and regulatory policy. The government should provide a general framework for the economy, but it should not intervene in the market; in other words, it should create incentives for CO2 savings and climate-protecting innovations through e.g. CO2 pricing, instead of trying to control investments through the prohibition of combustion engines or subsidies for electromobility and an energy-intensive economy. If we cannot return to this form of a social market economy, the economic decline will continue, definitely in the coming year.

Sincerely yours

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