Falling inflation, but not yet time to sound the all-clear – outlook for the German economy up to 2026

The German economy will recover in the coming years, albeit with a time lag. At present, the main factors still slowing growth are weak foreign demand in industry, hesitant private consumption, and higher financing costs for investment brought about by monetary policy tightening. As from the beginning of 2024, though, the German economy is likely to return to an expansion path and gradually pick up speed. Exports will increase on the back of expanding foreign sales markets, and households will increase their consumption expenditure as their real incomes rise significantly thanks to a stable labour market, strong wage growth and falling inflation. On the other hand, private investment will initially continue to decline, not providing moderate stimulus again until 2026.

The current projection assumes that calendar-adjusted real gross domestic product (GDP) will increase by 0.4% in 2024 following a slight contraction of 0.1% this year. In 2025 and 2026, the economy will grow by 1.2% and 1.3%, respectively. Compared with the June projection, the GDP rate has been lowered significantly for 2024 and slightly for 2025. Key factors are weaker foreign demand, slower growth in consumption and tighter financing conditions.

Inflation in Germany is on the decline, but it is still too early to sound the general all-clear. As measured by the Harmonised Index of Consumer Prices (HICP), inflation is likely to come down to an annual average of 6.1% this year before dropping to 2.7%, less than one-half of the current figure, in 2024. Energy price inflation will decline sharply and food price inflation will also go down considerably. It is only this year that core inflation (excluding energy and food) will peak at 5.1%. It, too, will fall significantly to 3.0% next year. Supply bottlenecks will then no longer be such a major problem and profit margins will normalise. Monetary policy tightening is increasingly taking effect. From 2025 onwards, the strong wage growth will decline more markedly, although it will remain high. This will see the core rate gradually continue to fall to 2.3% in 2026. The headline rate will diminish to 2.2%, which is nonetheless still high. Compared with the June projection, the inflation rate was revised downwards noticeably for 2024 and slightly for 2025.

Public finances will benefit from temporary support measures gradually expiring. This will have a greater impact than rising expenditure in areas such as defence and pensions. The deficit ratio will therefore fall to 2% in 2023 and 1.3% in 2024. It will remain unchanged in the subsequent years. The debt ratio will decline, approaching 60% again in 2026. Following the Federal Constitutional Court's ruling on the debt brake, the fiscal policy stance and its impact on the economy are still uncertain, especially from 2025 onwards.

Beyond this, there are other risks owing, in particular, to geopolitical conflicts. Tighter monetary policy has reduced, but not yet eliminated, the risk of a more persistent inflation process. Overall, risks to economic growth currently remain tilted to the downside, and those to inflation to the upside.

Economic outlook[1]

German economy not yet on recovery path in Q2 and Q3 2023

After rising slightly in the second quarter, seasonally adjusted real GDP fell again by the same amount in the third quarter.[2] The German economy thus merely stagnated in the 2023 summer half-year. By contrast, the June projection had anticipated a continuous expansion that would gradually intensify.[3] One reason why the recovery initially failed to materialise was the unexpectedly weak foreign demand in industry, which dampened production and exports. Moreover, households were more hesitant than expected when it came to discretionary spending. Although their real disposable income actually rose somewhat more strongly in the summer half-year than assumed in June, they merely kept their consumption stable. This increased their saving ratio. Enterprises, meanwhile, expanded their investment moderately in line with the June projection. Housing investment declined, albeit less sharply than predicted. The construction sector performed surprisingly well overall. Order books were still fairly well filled; this probably bolstered production more strongly than expected.

December 2023 projection

Year-on-year percentage change

Item	2023	2024	2025	2026
Real GDP, calendar adjusted	– 0.1	0.4	1.2	1.3
Real GDP, unadjusted	– 0.3	0.3	1.1	1.6
Harmonised Index of Consumer Prices	6.1	2.7	2.5	2.2
Excluding energy and food	5.1	3.0	2.6	2.3

Source: Federal Statistical Office (up to Q3 2023). Annual figures for 2023 to 2026 are Bundesbank projections.
Deutsche Bundesbank

Business situation and expectations in the economy as a whole

Balances, seasonally and calendar adjusted

Source: ifo Institute.
Deutsche Bundesbank

Economic output likely to fall slightly in current quarter

Economic output is likely to fall again slightly in the current quarter, as suggested by the depressed survey indicators. According to the ifo Institute, enterprises' assessment of their business situation was somewhat more negative averaged over October and November than in the third quarter. The S&P Global Purchasing Managers' Index was in contractionary territory. The industrial sector, in particular, will probably scale back its production further. It continues to suffer from subdued demand and high energy costs. Both these factors are also a drag on exports. Furthermore, weak industrial activity is clouding the outlook for business investment, which is additionally being dampened by higher financing costs and possibly also by increased uncertainty surrounding government subsidies in the area of transition and climate change mitigation measures. Higher interest rates are having an even stronger impact on housing construction. The construction industry will probably have to continue adjusting its output to the depressed level of new orders. At all events, households are benefiting from further gains in purchasing power and a stable labour market. They will probably step up their consumption again slightly.

1 This projection for Germany was finalised on 30 November 2023. It was incorporated into the projections for the euro area published by the European Central Bank (ECB) on 14 December 2023.
2 Seasonal adjustment here and in the remainder of this text also includes adjustment for calendar variations, provided they can be verified and quantified.
3 See Deutsche Bundesbank (2023a).

First signs of tentative improvement from Q1 2024

At the beginning of 2024, the German economy is likely to return to an expansion path given that there are initial signs of a slight improvement. Business expectations as surveyed by the ifo Institute brightened somewhat in October and November. Sentiment in trade and manufacturing, in particular, was less pessimistic. In the industrial sector, foreign demand may have bottomed out. Export expectations have risen of late. Moreover, households' income situation should continue to improve. The labour market remains robust, wages are rising sharply and inflation is easing slightly. Private consumption is therefore likely to pick up somewhat more strongly in the first quarter.

Growth will pick up over 2024, continuing to accelerate slightly until 2026

The projection sees growth gradually picking up over the course of 2024. It will continue at a slightly accelerated pace over the following two years. The economic recovery is based on two key pillars. First, exports are rising on the back of burgeoning demand in German exporters' sales markets. Second, households are expanding their consumption expenditure as real incomes rise. Moreover, the saving ratio is gradually receding, which is providing consumption with an additional boost. By contrast, housing and business investment will decline in 2024 and will not provide any stimulus in 2025, either. It is not until 2026 that they will increase moderately again.

Compared with the June projection, GDP rate for 2024 revised downwards, in particular

On the whole, the German economy is therefore slowly emerging from the bout of weakness since the outbreak of the Russian war of aggression against Ukraine. Calendar-adjusted real GDP will increase by 0.4% in 2024 following a slight contraction of 0.1% this year. In 2025 and 2026, German economic output will then expand more sharply, at rates of 1.2% and 1.3%, respectively.[4] The recovery will thus take place roughly three quarters later than anticipated in the June projection. Nevertheless, the GDP rate for 2023 will turn out to be slightly higher since the results for the fourth quarter of 2022 and the first quarter of 2023 have been revised upward. This more than compensates for the weaker second half of 2023. However, the delayed recovery has been reflected in a significant downward revision of the GDP rate for 2024. The rate for 2025 has also been lowered slightly. The deterioration in the economic outlook compared with the June projection is due to weaker external demand,

Technical components of the GDP growth projection

% or percentage points

Item	2023	2024	2025	2026
Statistical carry-over at the end of the previous year[1]	– 0.2	– 0.1	0.4	0.5
Fourth-quarter rate[2]	– 0.1	0.9	1.3	1.3
Average annual GDP growth rate, calendar adjusted	– 0.1	0.4	1.2	1.3
Calendar effect[3]	– 0.2	0.0	– 0.1	0.3
Average annual GDP growth rate[4]	– 0.3	0.3	1.1	1.6

Source: Federal Statistical Office (up to Q3 2023). Annual figures for 2023 to 2026 are Bundesbank projections. **1** Seasonally and calendar-adjusted index level in the fourth quarter of the previous year in relation to the calendar-adjusted quarterly average of the previous year. **2** Annual rate of change in the fourth quarter, seasonally and calendar adjusted. **3** As a percentage of GDP. **4** Discrepancies in the totals are due to rounding.

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Revisions since the June 2023 projection

Year-on-year percentage change

Item	2023	2024	2025
GDP (real, calendar adjusted)			
December 2023 projection	– 0.1	0.4	1.2
June 2023 projection	– 0.3	1.2	1.3
Difference (in percentage points)	0.2	– 0.8	– 0.1
Harmonised Index of Consumer Prices			
December 2023 projection	6.1	2.7	2.5
June 2023 projection	6.0	3.1	2.7
Difference (in percentage points)	0.1	– 0.4	– 0.2

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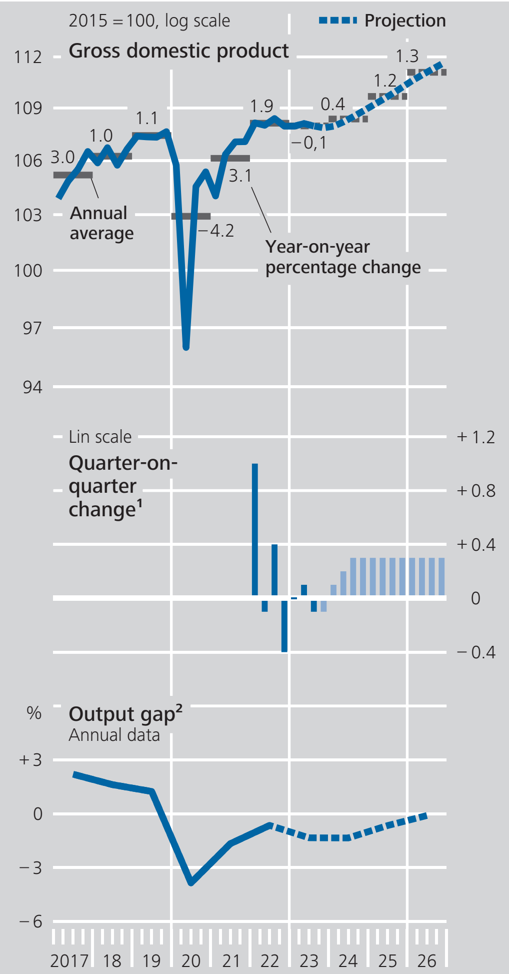
4 In unadjusted terms, the growth profile is even more pronounced, with unadjusted GDP dropping by 0.3% because of the relatively small number of working days in 2023. Next year, the unadjusted rate will be slightly lower, coming in at +0.3% when rounded to one decimal place. 2025 will have somewhat fewer working days compared to the previous year, but then 2026 will have considerably more working days than 2025. At +1.1% and +1.6%, the unadjusted GDP rates will therefore be first slightly lower and then noticeably higher than the calendar-adjusted figures (see the upper table on this page).

Aggregate output and output gap

Price, seasonally and calendar adjusted



Sources: Federal Statistical Office and Bundesbank calculations. Annual figures from 2023 to 2026 are Bundesbank projections. **1** Rounded to one decimal place. Shown beginning in Q1 2022. **2** Deviation of GDP from estimated potential output based on the annually estimated output gap.
Deutsche Bundesbank

slower growth in private consumption owing to the current consumer restraint, and lower investment. The latter is affected by the further tightening of financing conditions as a result of tighter monetary policy. Another factor is that government support for private investment in the areas of climate change and transformation is now expected to be lower.[5]

German economy will not reach potential output until 2026

The German economy will not come close to its potential output again until 2026. Potential growth rates are expected to be subdued compared with the pre-pandemic period. After +0.6% in 2023, +0.4% in 2024 and +0.5% in 2025, a potential rate of +0.7% is estimated for 2026.[6] These low rates are mainly due to the impact of the persistently higher energy costs caused by Russia's attack on Ukraine.[7] In addition, demographics are having a dampening effect. However, in the current high inflation environment, the fact that economic output will remain below its potential for such a long time is not an indication of a widespread absence of aggregate demand. Instead, the spate of recent supply disruptions has weighed even more heavily on economic activity than on potential output for some time now.[8]

Economic activity in detail

Exports back on recovery path from Q1 2024

Exports are likely to decline again in the current quarter. This is indicated by ifo export expectations, which improved in October and November but remained predominantly pessimistic. In addition, industrial new orders from abroad continued to decline in the third quarter, even though the underlying trend, at least, is showing signs of bottoming out.[9] Persistently weak external demand is weighing on the export-driven industrial sector. This sector is also having to hold its own in a challenging international competitive environment, not least because of the considerable rise in energy costs in Germany in the wake of the Ukraine war. Nonetheless, surveys by the ifo Institute suggest that supply bottlenecks have eased significantly. From the first quarter of 2024 onwards, exports are expected to slowly return to a recovery path as the global economic recov-

5 The background to this is the Federal Constitutional Court's ruling on the debt brake. See pp. 21 f. for more on how the fiscal repercussions of the ruling have been factored into the projection.
6 The estimate for potential output is thus virtually unchanged from the June projection. In chronological context: the estimated potential rate for Germany for the period from 2015 to 2019 averaged 1.6%.
7 See Deutsche Bundesbank (2022a).
8 This is because the Bundesbank's concept of potential output is based on sustainable economic performance on the supply side. It is therefore only dampened by the permanent consequences of the supply shocks rather than the temporary effects which do, however, dampen GDP itself. See Deutsche Bundesbank (2023a), pp. 15 ff.
9 See Deutsche Bundesbank (2023e).

Underlying conditions for macroeconomic projections

The projection is based on assumptions by Eurosystem experts about the global economy, exchange rates, commodity prices and interest rates. These assumptions are based on information that was available on 23 November 2023. The projection incorporates fiscal policy measures as soon as they are sufficiently specified and their implementation is considered likely.

Restrained global economic growth

Global economic activity expanded somewhat more materially in the second and third quarters of the current year than expected in the June projection. This was associated with, in particular, robust domestic activity in the United States. In the final quarter of this year, however, momentum is likely to weaken visibly. Global economic growth will therefore be slightly lower than in the summer half-year.[1] The central banks' tighter monetary policy is contributing to the declining inflation rates in numerous countries. At the same time, the higher financing costs are a negative factor for the global economy. In contrast, robust labour market developments and prospects of further real income growth are underpinning demand. The consequences of China's structural challenges, such as the problems on its property market, are also having a ripple effect on the global economy. Overall, global economic activity is expected to be similarly subdued over the projection horizon as in the June projection. Following 3.3% growth in the current year, the global economy excluding the euro area will grow at a slightly lower rate of 3.1% in the coming year. Growth rates of 3.2% are expected for both 2025 and 2026.

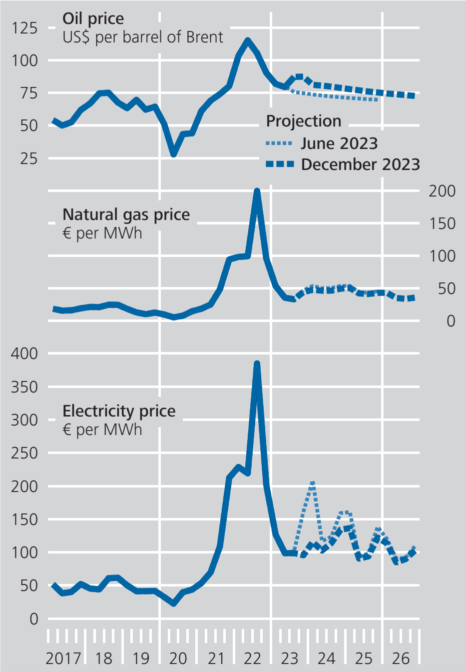
Economic development figures in the other euro area countries on which the projection is based are derived from the forecasts of the national central banks, which were incorporated into the projection for the euro area published by the ECB on 14 December 2023.[2] Economic growth for the euro area excluding Germany is therefore expected to be slightly weaker than in the June projection, with rates of 0.8% in 2023 and 1.0% in 2024. Following 1.7% growth in 2025, largely in line with the June projection, economic activity is expected to rise by 1.6% in 2026.

As some advanced economies posted lower-than-expected imports in the 2023 summer half-year, the outlook for international trade is slightly below the June projection. Import demand from the emerging economies was also estimated to be lower. The average growth rate of 1.1% for global trade (excluding the euro area) in the current year is also being dampened by the decline in the 2022-23 winter half-year. A growth rate of 3.0% is estimated for each of the years 2024 and 2025. At a rate of 3.2%, slightly higher momentum is expected in 2026. The sales markets of German exporters are likely to expand even more slowly than global trade in the coming year. This is because import growth of trading partners within the euro area and some other advanced economies, which account for a large proportion of German export markets, is lagging somewhat behind the momentum of global trade as a whole. Somewhat higher export market growth is expected in 2025 and 2026, which will then turn out to be similar to growth of global trade.

1 See Deutsche Bundesbank (2023b).
2 See European Central Bank (2023).

Oil, natural gas and electricity prices

Quarterly averages



Sources: Bloomberg, European Energy Exchange and ECB staff. Projections derived from forward quotations.
Deutsche Bundesbank

Technical assumptions of the projection

Energy commodity prices rose again over the summer. Production cuts by Saudi Arabia and Russia, in particular, led to higher prices in the crude oil markets. Whereas forward quotations suggest that prices will fall over the next three years, the crude oil price assumptions remain above those of the June projection. Thanks to well-filled gas storage facilities, the expected rise in wholesale gas prices in Europe for the colder months of the year has so far been slightly lower than estimated in June.[3] Forward quotations suggest a gradual decline in European gas prices after the winter of 2024-25. Over the next two years, they will remain slightly below the trajectory assumed for the June projection. European electricity prices, which are closely linked to gas prices, also rose far less considerably in the second half of this year than expected in June and have even declined recently. For the European electricity markets, futures indicate higher prices for the winter months up to the end of the projection period, although the increases will be lower than assumed in the June projection.

In view of the weaker economic outlook, other commodity prices have fallen more sharply in recent months than expected in June. It is assumed that prices will rise again slightly on average in 2025 and 2026. Agricultural producer prices in the euro area have fallen more persistently in recent months than estimated in the June projection. The more stable trend in gas prices, which has an impact inter alia on fertiliser prices, is also likely to have contributed to this development. Forward quotations suggest that producer prices for food will remain largely unchanged until 2026.

According to the June projection and the ECB's September projection, inflation in the euro area will remain too high for too long. At each of its monetary policy meetings in June, July and September, the ECB Governing Council therefore decided to raise key interest rates by a further 25 basis points in order to bring inflation back to its medium-term target without delay. In addition, principal payments from maturing securities under the asset purchase programme (APP) have no longer been reinvested since July 2023. In October, the ECB Governing Council left its key interest rates unchanged. The Governing Council's decisions on the appropriate level of the key interest rate will remain data-driven. Against the backdrop of the additional tightening of monetary policy, money market rates have continued to rise in recent months. For the next two years, however, the EURIBOR futures rates will be on a downward trend before indicating a largely steady level for 2026. The

3 For more on the driving forces behind European gas prices, see Deutsche Bundesbank (2023c).

EURIBOR will therefore be slightly higher next year than assumed in the June projection and then marginally lower in 2025. After the June projection was finalised, 10-year German government bond yields also initially continued to rise, but then fell again in November. Forward quotations indicate a largely constant yield for the next two years, which will rise again slightly in 2026. The yield level will therefore be above the June projection in the next two years. Financing costs for bank loans are also expected to be higher than in the June projection.

Changing expectations among market participants regarding the US Federal Reserve's monetary policy stance as well as incoming US and euro area economic data caused the external value of the euro to rise initially in the summer and then fall again. In the period relevant for deriving exchange rate assumptions, the euro was trading at US$1.08, largely unchanged from the June assumption. However, gains by the euro against some central European currencies, the yen and the renminbi contributed to a 1.6% appreciation of the euro against 41 currencies of importance to German foreign trade.

Major assumptions of the projection

Item	2023	2024	2025	2026
Exchange rates of the euro				
US dollar/euro	1.08	1.08	1.08	1.08
Effective[1]	121.9	123.5	123.5	123.5
Interest rates				
Three-month EURIBOR	3.4	3.6	2.8	2.7
Yield on government bonds outstanding[2]	2.5	2.6	2.6	2.7
Prices				
Crude oil[3]	84.0	80.1	76.5	73.6
Natural gas[4]	41.5	47.4	44.2	36.9
Electricity[4,5]	105.0	116.5	110.8	97.7
Other commodities[6,7]	− 13.2	− 2.3	2.4	1.7
Food[7,8]	− 2.4	− 3.6	0.2	− 0.3
German exporters' sales markets[7,9]	0.4	2.4	3.1	3.1

1 Compared with 42 currencies of major trading partners of the euro area (EER-42 group of currencies); Q1 1999 = 100. 2 Yield on German government bonds with a residual maturity of over nine and up to ten years. 3 US dollars per barrel of Brent crude oil. 4 Euro per MWh. 5 Wholesale prices in the euro area based on data from the European Central Bank. 6 In US dollars. 7 Year-on-year percentage change. 8 Producer prices for food in the euro area based on data from the European Commission. In euro. 9 Calendar adjusted.

Deutsche Bundesbank

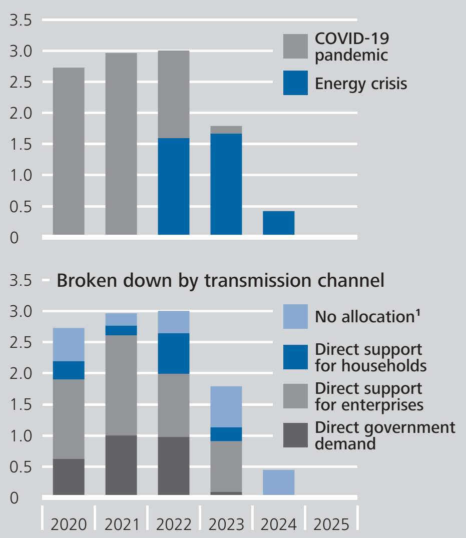
Fiscal projection for Germany: schematic adjustment to the ruling on the debt brake

The Federal Government and some Federal states are currently revising their financial plans in order to align them with the ruling handed down by the Federal Constitutional Court on the debt brake.[4] Consultations in this context were still under way when the projection was finalised (see p. 20 on the latest agreements concerning central government finances for 2024). For 2023, the projection takes into account the information in the draft supplementary budget for 2023. For 2024, it no longer contains any measures that the Economic Stabilisation Fund for Energy Assistance (ESF-E) should finance. In particular, the energy price brakes will expire at the end of 2023 and central government will no longer stabilise the grid fees in 2024. In addition, €60 billion of the reserve for the Climate and Transformation Fund (Climate Fund) will be immediately cancelled as a result of the ruling. This will be taken into account by schematically lowering the projected expenses prior to the ruling. Only those grants with which the Federal Government offsets the renewable energy levy on the electricity price are not affected. This is because a legislative amendment would be necessary to implement a reduction. As a result, the Climate Fund will only run annual deficits of less than €10 billion in the projection from 2024 to 2026.

4 For more about the ruling, see Deutsche Bundesbank (2023d).

Temporary fiscal measures affecting the deficit that are directly linked to the COVID-19 pandemic and the energy crisis*

As a percentage of GDP



* Bundesbank estimate. This definition does not include longer-term fiscal projects, such as those for climate change mitigation. **1** VAT rate and energy tax rate cuts, revenue shortfalls due to employers' one-off payments being exempt from income tax and social contributions, and reduction in fares for local public transport (€9 ticket).

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Lapsing of crisis measures easing pressure on the general government budget

Temporary crisis-related measures will weigh heavily on public finances for the last time in 2023, with the share of these measures in gross domestic product falling from 1¾% in the current year to ½% in the coming year. By 2025, these burdens will have lapsed altogether (see chart above). Among the energy price support measures, the transfers in the course of the electricity and gas price brakes are particularly significant. Moreover, the ESF-E pays supplementary aid to hospitals and care facilities in particular. Substantial government revenue shortfalls will result from the fact that remuneration components will be exempt from tax as inflation compensation premiums up to and including 2024. In addition, VAT on natural gas and district heating will remain reduced until the end of February 2024. In 2024, the crisis measures will mainly affect the promotion of inflation compensation premiums.

Other measures will have a net negative impact on the general government budget

In addition to short-term crisis support, the projection includes a number of other fiscal policy measures. In terms of revenue, the income tax rate in particular will shift in 2023 and 2024 to compensate for the previous year's bracket creep.[5] It is assumed that legislators will continue this practice. The Growth Opportunities Act *(Wachstumschancengesetz)* and a lower electricity tax for companies in the manufacturing sector in 2024 and 2025 are also included – both are planned but have not yet been adopted. Social security contribution rates will increase significantly up until 2026. Above all, health insurance institutions are raising their supplementary contribution rates in order to close funding gaps. The truck toll will also generate significant additional revenue as of 2024 due to higher toll rates and an expanded toll obligation.

5 Various measures are also taken into account regarding expenditure. However, the projected expenditure by central, regional and local authorities as well as social security organisations generally cannot be allocated to individual measures. They are addressed in the description of the projection where they are relevant for the respective development.

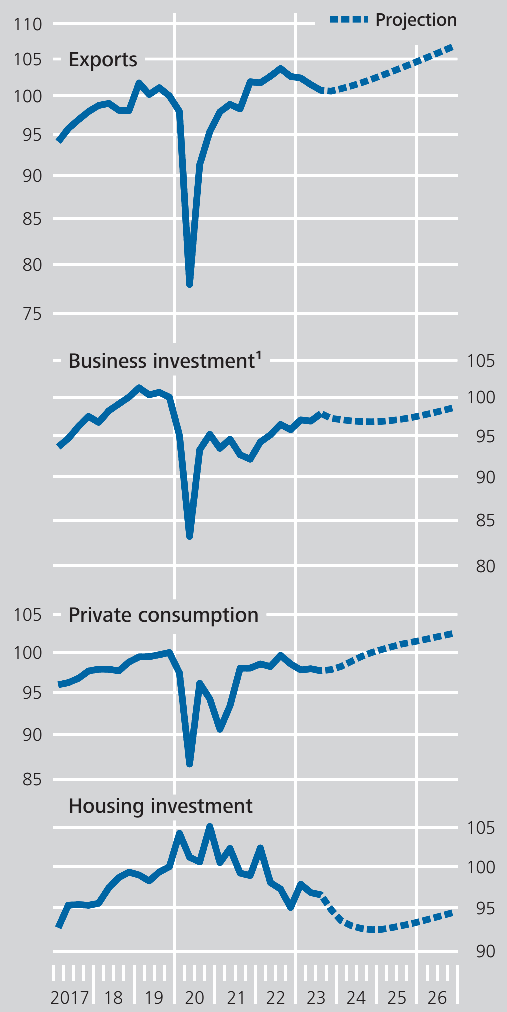
ery causes sales markets to grow.[10] Over the course of next year, exports will then pick up momentum, keeping a roughly constant pace over the remainder of the projection horizon. They will grow more slowly overall than the sales markets, since the comparatively sharp rise in labour costs in Germany is eroding the price competitiveness of German exporters. They will therefore be forced to sustain losses in market share, especially in trade with euro area partner countries.

Weak industrial activity and monetary policy tightening weigh on business investment

Despite adverse underlying conditions, business investment has so far been robust.[11] However, enterprises' spending on capital goods will probably already begin to fall during the current quarter. As a result of monetary policy tightening and the slowdown in economic activity, interest rates on loans to enterprises rose significantly, and commercial banks tightened their lending policies appreciably. In this setting, banks' net lending to enterprises fell into negative territory, meaning that the annual growth rate in October of this year was negative for the first time in more than eight years. This was also reflected in domestic demand for capital goods, which plummeted in the third quarter. According to the ifo Institute, sentiment among capital goods producers also deteriorated significantly. Heightened uncertainty surrounding future government support for investment in the areas of climate change mitigation and the transition to a low-carbon economy is likely to further dampen propensity to invest. A stronger slump is being prevented by what is still a considerable order backlog. The tightening of monetary policy, in particular, will probably curb investment activity for some time to come. Moreover, weak export dynamics are providing only a small boost to investment. All in all, the projection expects business investment to decline next year. Over the remainder of the projection horizon, however, the continuous improvement in foreign demand, in particular, will increasingly provide momentum. On an annual average, business investment will grow only marginally in 2025, but will then expand more significantly again in 2026.

Expenditure components

Q4 2019 = 100, log scale,
price, seasonally and calendar adjusted



Sources: Federal Statistical Office and Bundesbank projections.
1 Private non-residential fixed capital formation.
Deutsche Bundesbank

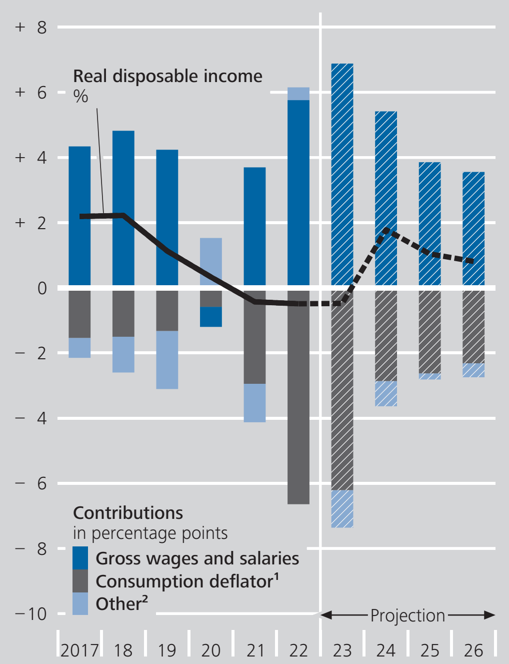
Private consumption recovering markedly thanks to rising real disposable income

The underlying conditions for private consumption will improve markedly over the projection horizon. This is because households' real disposable income is rising significantly thanks to a stable labour market, steep wage increases and subsiding inflation. The greatest improvement is expected to take place in 2024. After

10 For more information on the assumptions regarding the international environment, see pp. 19 ff.
11 In 2023 so far, spending on machinery and equipment, commercial buildings and other investment, which mainly includes expenditure on research and development, has gone up markedly. Supporting factors are likely to have been the potential for catching up after the slump during the COVID-19 crisis as well as the significant improvement in the availability of some capital goods.

Households' real disposable income

Year-on-year change



Sources: Federal Statistical Office and Bundesbank calculations. **1** With a negative sign in the chart: an increase in prices lowers the increase in real disposable income. **2** Disposable income excluding gross wages and salaries (including, inter alia, government transfers, mixed income and investment income).
Deutsche Bundesbank

this, income growth will tail off slightly. Private consumption will probably already edge up again in the current quarter, as indicated by new private car registrations according to data from the German Association of the Automotive Industry (VDA) and real retail sales, which exceeded the previous quarter's level in October. However, according to the GfK survey, consumer sentiment remained weak of late, although it had at least stabilised. According to GfK, precautionary motives are playing a major role in the subdued propensity to consume.[12] Besides this, the latest increase in the saving ratio is also likely to have been driven by back-payments for electricity and heating for 2022.[13] Higher interest rates on savings deposits could also play a part. Against this backdrop, households are unlikely to fully channel the increase in their real income into higher consumer spending at first. The saving ratio will rise a little further until the first quarter of 2024. However, it will then gradually recede over the remainder of the projection horizon. This is because the special factors associated with energy back-payments will expire, and precautionary motives will subside. From the middle of next year, private consumption will therefore increase slightly more strongly than real disposable income for some time. Towards the end of the projection horizon, both metrics will grow at a similar rate, with the saving ratio reaching more or less its long-term average.

Given subdued demand, housing investment will drop significantly at first, but will then go back up

Real income losses for households, soaring construction costs, higher financing costs and more restrictive lending policies have now pushed down demand for housing sharply. Net lending for housing practically came to a standstill. In the third quarter, both building permits and new orders for housing construction were significantly lower than their levels at the beginning of 2022. Large order backlogs in the construction sector have so far cushioned the drop in demand somewhat. According to surveys by the ifo Institute, the range of orders in housing construction was still above the long-term average in November. However, it has declined significantly compared to its peak. The share of firms with a shortage of orders actually rose to almost 50%. It should therefore be assumed that weaker demand will increasingly affect construction activity. Housing investment is already likely to fall significantly in the current quarter. According to the projection, it will continue to decline in the course of 2024, albeit at lower rates. It will not bottom out until the beginning of 2025. After this, a moderate recovery will set in. This is due to several factors. For example, the fundamental demand for housing remains intact and is being amplified by the high level of immigration. Furthermore, it is assumed that financing costs will not continue to rise, and real household income will recover significantly. Renovations to increase the energy efficiency of the existing housing

12 These motives are attributed to general uncertainty among consumers owing to the (geo)political and economic situation; see GfK (2023).
13 Since energy back-payments are used in 2023 to pay for consumption expenditure for 2022, these appear in the national accounts in the form of higher household savings.

stock will probably provide support over the entire projection horizon. These will become more important in the light of higher heating costs and the heating transition as part of climate policy.

Government demand set to rise steeply from 2024 onwards

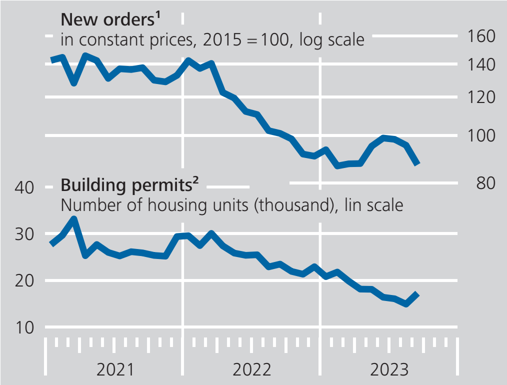
Real government consumption will fall significantly this year, owing to the fact that pandemic-related health spending has expired.[14] Higher spending on asylum seekers and the military, for example, will dampen the decline somewhat. From 2024 onwards, real government consumption will go back up steeply. This is mainly due to a significant increase in intermediate consumption and social transfers in kind. Real government investment will grow sharply over the entire projection horizon, with a particularly steep rise in investment in military machinery and equipment. By contrast, it is assumed that government investment in construction will edge up more slowly in the coming years than in the current year. This is because local government finances are coming under increasing strain.

Stronger growth in imports than in exports; current account balance initially set to rise sharply before declining slightly

As domestic demand recovers, imports will grow more strongly than exports, which are being held back by diminishing competitiveness. This will put downward pressure on the trade surplus and the current account surplus over the entire projection horizon. Nevertheless, these surpluses will initially rise sharply this year – probably to 6.7% of GDP in the current account. In the previous year, the current account balance totalled only 4.4% owing to the deterioration in the terms of trade on the back of a sharp rise in energy prices. The rebound this year is mainly due to the improved terms of trade as a result of lower prices for imported commodities (especially natural gas and other energy imports). This is likely to continue over the remainder of the projection horizon, albeit to a noticeably lesser degree. Although some commodity prices will presumably actually go back up, a gradual decline is likely, in particular for crude oil prices. Overall, import prices will therefore increase at only a comparatively moderate pace. By contrast, export prices will

Demand indicators for housing construction

Seasonally and calendar adjusted



Source: Federal Statistical Office. **1** Main construction sector (housing construction). **2** Residential construction.
Deutsche Bundesbank

rise quite steeply in the coming years, mainly as a result of strong domestic wage pressures. All in all, the trade balance will decline slightly between 2024 and 2026 and the current account surplus will be slightly lower, too.

Labour market

Labour market, despite weakening in current economic setting, remains remarkably stable overall

Despite the economy being mired in a downturn for over one and a half years now, the labour market has remained remarkably stable. Only in the third quarter of 2023 did the previously significant increase in employment come to a virtual halt. There is still a pronounced shortage of skilled workers in large parts of the economy. Although the number of job vacancies declined somewhat, it continues to be very high, with the time taken to fill vacancies still lengthy. Hours worked per worker recovered only slowly from the depressed levels of 2022. While at least high levels of sick leave eased somewhat, the economic slowdown was re-

14 As of the second quarter of 2023, the national accounts no longer record local public transport in the corporate sector but in the government sector. However, this statistical reclassification does not play a role in the real path of government consumption described here. It only affects the deflator of government consumption. (Real) transport services remain part of private consumption. The deflator of government consumption will therefore show exceptionally strong growth this year, but this also reflects wage increases and the general upward pressure on prices.

Key figures of the macroeconomic projection

Year-on-year percentage change, calendar adjusted[1]

Item	2023	2024	2025	2026
GDP (real)	– 0.1	0.4	1.2	1.3
GDP (real, unadjusted)	– 0.3	0.3	1.1	1.6
Components of real GDP				
Private consumption	– 0.9	1.4	1.8	1.1
Memo item: Saving ratio	11.5	11.9	11.3	11.0
Government consumption	– 2.4	0.8	2.0	2.1
Gross fixed capital formation	0.9	– 0.8	0.8	1.8
Business investment[2]	1.9	– 0.4	0.2	1.0
Private housing construction investment	– 1.7	– 3.8	– 0.1	1.2
Exports	– 1.3	0.2	1.9	2.2
Imports	– 2.4	1.3	2.9	2.6
Memo item: Current account balance[3]	6.7	6.6	6.4	6.4
Contributions to GDP growth[4]				
Domestic final demand	– 0.8	0.7	1.5	1.4
Changes in inventories	0.1	0.1	0.0	0.0
Exports	– 0.7	0.1	0.9	1.0
Imports	1.2	– 0.6	– 1.2	– 1.1
Labour market				
Total number of hours worked[5]	0.9	0.3	0.6	0.1
Employed persons[5]	0.8	0.1	0.2	0.0
Unemployed persons[6]	2.6	2.7	2.5	2.4
Unemployment rate[7]	5.7	5.8	5.5	5.3
Memo item: ILO unemployment rate[8]	3.0	3.2	3.1	3.0
Wages and wage costs				
Negotiated wages[9]	4.0	5.0	3.0	3.1
Gross wages and salaries per employee	5.9	5.3	3.6	3.5
Compensation per employee	5.7	5.3	3.8	3.6
Real GDP per employed person	– 0.9	0.2	1.0	1.3
Unit labour costs[10]	6.7	5.0	2.8	2.2
Memo item: GDP deflator	6.2	2.9	2.6	2.1
Consumer prices[11]	6.1	2.7	2.5	2.2
Excluding energy	6.4	2.9	2.7	2.4
Energy component	5.2	1.3	0.8	0.2
Excluding energy and food	5.1	3.0	2.6	2.3
Food component	11.7	2.4	3.0	3.0

Sources: Federal Statistical Office (up to Q3 2023); Federal Employment Agency; Eurostat. Annual figures for 2023 to 2026 are Bundesbank projections. **1** If calendar effects present. **2** Private non-residential fixed capital formation. **3** As a percentage of nominal GDP. **4** In arithmetical terms, in percentage points. Discrepancies in the totals are due to rounding. **5** Domestic concept. **6** In millions of persons (Federal Employment Agency definition). **7** As a percentage of the civilian labour force. **8** Internationally standardised as per ILO definition, Eurostat differentiation. **9** Unadjusted figures, monthly basis. Pursuant to the Bundesbank's negotiated wage index. **10** Ratio of domestic compensation per employee to real GDP per employed person. **11** Harmonised Index of Consumer Prices (HICP), unadjusted figures.

Deutsche Bundesbank

flected in relatively low overtime worked and the reduction of balances on working time accounts. Short-time work continues to be less relevant at the current time. By contrast, the weak economy left more significant but still limited traces in the form of a gradual rise in registered unemployment, but this is only partly related to cyclical weakness. A somewhat greater part of the increase since June 2022 is due to the gradual inclusion of immigrants, with the proportion of refugees being high.

Short-term indicators do not suggest major deterioration in labour market

Given the only lagged and slow economic recovery, no increase in total employment is to be expected in the current quarter or the first quarter of 2024. However, all leading indicators are suggesting that the high level of employment achieved can be maintained. According to the ifo Institute, recruitment plans of trade and industry, a sector that is particularly exposed to economic stress at present, tend to be in negative territory. However, extrapolated to the aggregate economy, the outlook is neutral. The risk of dismissal is very low by historical standards. The number of newly registered job seekers at the Federal Employment Agency (BA) soon to lose their jobs is still high at present. However, the probability of hiring unemployed persons is likewise relatively low at the current time. Unemployment is therefore likely to rise somewhat in the coming months, especially among job seekers who have completed language and integration courses.[15]

Labour market to pick up over course of 2024 as economic recovery takes hold

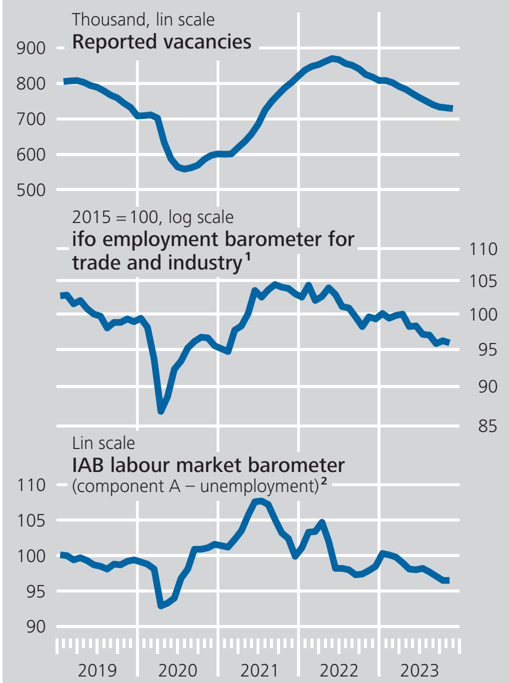
In the course of 2024, hours worked per worker will rise initially as the economic recovery takes hold. Employment will also shift back onto an upward path, with a slight time lag, but will grow only to a relatively small degree. Employment is already at a very high level and the shortage of skilled workers will increase again as soon as there is a significant rise in demand for labour. Despite the negative demographic impact, the labour force will expand

15 This group of persons is not counted as unemployed while participating in the measures due to their unavailability.

again markedly in 2024. The process of integrating the many immigrants who came in 2022 and 2023 is making itself felt here. However, integration into employment is particularly challenging for refugees, as they did not migrate for the purpose of work and the skills they bring with them often do not match labour demand, for example. This is another reason why registered unemployment is still expected to be slightly higher on average in 2024 than in the current year. On the other hand, unemployment will start to decline again in the second half of 2024 as the economic recovery accelerates.

Leading indicators for the labour market

Seasonally adjusted



Sources: Federal Employment Agency, ifo Institute and Institute for Employment Research (IAB). **1** Qualitative employment plans of 9,000 surveyed enterprises for the next three months. **2** Values below 100 correspond to rising unemployment.
Deutsche Bundesbank

Labour supply is constraining factor for labour market in medium term

Owing to demographic developments, labour supply will increasingly be the constraining factor for the labour market in the coming years. The rising labour force participation rate of the population and the high level of immigration in recent years have so far more than made up for the dampening impact of demographics. However, the labour force participation rate will stop rising in the medium term owing to the unfavourable age structure in Germany, although the individual propensity to work is likely to continue to increase. This is mainly due to the fact that "baby boomers" are leaving the prime-age bracket, where participation rates are highest. With regard to immigration, this projection assumes a balance of 300,000 persons per year in the medium term.[16] The massive influx of immigrants over the past 12 years has improved the demographic structure of the population, as it was mainly young people, including many children, who came to Germany. This development will also dampen the burdens of demographic change in Germany in the future. The majority of these people need to be successfully integrated into the labour market, however. Given the assumptions made here, the labour supply will not increase significantly overall in 2025 and will decline slightly in 2026.

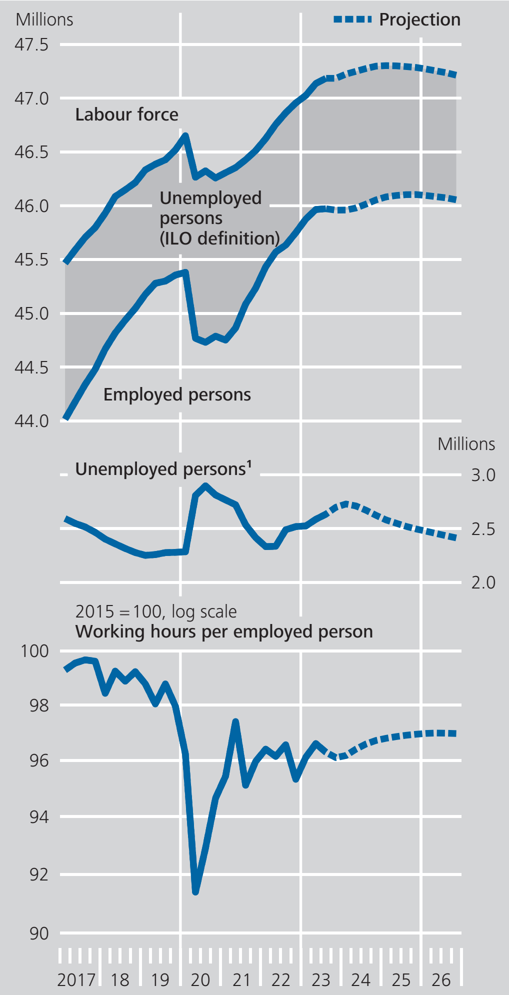
Tight labour market and recovering labour productivity in 2025-26

In 2025, employment will continue to grow somewhat while the economy continues to recover, with unemployment declining at the same time. Furthermore, hours worked per worker will also go up slightly via an increase in the number of overtime hours. However, there is not much upward headroom here either as, taking a longer-term perspective, hours worked will tend to decline due to the rise in the share of women and older persons, who are more often in part-time employment. The labour market will continue to become tighter overall. In 2026, both the increase in employment and the number of hours worked will largely come to a halt as a result of the shortage of labour supply. At the same time, unemployment will fall again slightly. As immigrants gain more work experience and enterprises boost their capacity utilisation, the economic recovery towards the end of the projection horizon will

16 With regard to the Ukrainian refugees, this is due neither to large new inflows nor to a substantial emigration back to their home country. Significantly higher net immigration of 600,000 persons is expected for 2023, one-third more than in the June projection. A slight increase in immigration is also assumed for the coming year (400,000 persons in net terms).

Labour market

Seasonally and calendar adjusted, quarterly data



Sources: Federal Statistical Office, Federal Employment Agency and Bundesbank projections. **1** Unemployment according to national definition (in accordance with Section 16 of the Third Book of the German Social Security Code (*Sozialgesetzbuch*)).
Deutsche Bundesbank

mainly be supported by the recovery in previously subdued labour productivity.

Labour costs and prices

Substantial wage agreements and delays in wage negotiations this year

The wage agreements concluded so far this year were once again higher than the already strong results for 2022. The compensation of previous real wage losses continued to play a key role, a widespread combination being significant tax-free and social contribution-exempt inflation compensation bonuses and high permanent wage increases. The wage increases agreed after the June projection were well above expectations, in particular in the smaller sectors. At the same time, negotiations in some major sectors proved to be very heavy going. As a case in point, negotiations in the retail sector as well as in wholesale and foreign trade that have been ongoing since April have still not been concluded. The expected pay rises in the retail sector will thus be shifted into 2024, as compared with the assumptions of the June projection. It was no longer possible to include the pay settlement in the public sector of the Federal states reached on 8 December 2023.[17] It is assumed that higher negotiated wages for the retail sector and public sector of the Federal states will no longer be disbursed this year. These postponements will affect around six million employees and lead to a somewhat smaller increase in overall negotiated rates of pay (4.0%) in 2023 than anticipated in the June projection.[18]

Negotiated wages to rise sharply in 2024, then to ease off but still climb steeply

At the same time, the projection for 2024 was revised upwards substantially to 5.0%. The stronger than expected and, in some cases, delayed rise in wages in this year's pay round will outweigh the significantly lower assumptions for wage settlements in 2024 in view of the weaker economic outlook compared to the June projection. These will be considerably lower than in previous years but remain comparatively high. This is due to the fact that losses in purchasing power suffered in previous years have not yet been fully compensated for, while inflation is falling but still above-average and the labour market is robust overall. However, the decelerating wage growth will not be clearly visible in the projection of negotiated wages until 2025. In addition, no more inflation compensation bonuses will be awarded from that time. Overall, growth in negotiated

17 The settlement was accurately predicted in the projection in relation to composition and the time frame. However, it exceeded expectations in terms of volume.
18 All past pay agreements included in the Bundesbank's negotiated wage statistics (around 500 collective wage agreements and provisions governing civil servant pay) are factored into the projections of negotiated wage increases. They are extrapolated beyond their contractual terms, taking into account the overall economic situation and industry-specific idiosyncrasies.

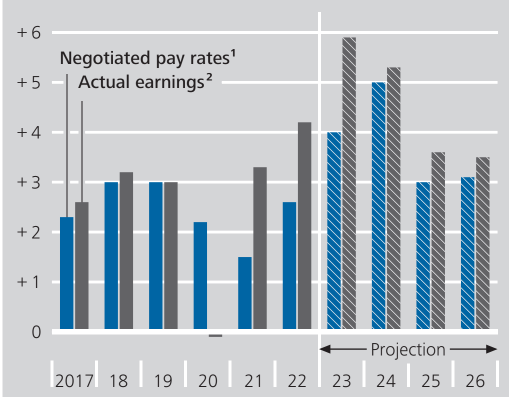
wages will fall to rates of around 3% for both 2025 and 2026, which still roughly corresponds to the level of 2018 and 2019, years characterised by a strong economy.

Growth of actual earnings consistently outpaces that of negotiated wages

Growth of actual earnings will consistently outpace that of negotiated wages over the projection horizon. Compensation for high inflation, staff shortages, longer working hours, higher performance bonuses and the strong wage increases among low earners triggered by the rise in the minimum wage in October 2022 are contributing factors this year.[19] At just under 6% in 2023, actual earnings will rise at their fastest rate in more than 30 years. In contrast to negotiated wages, their growth will already tail off somewhat in the coming year. The minimum wage increase from January 2024 will provide little stimulus. More importantly, there are the effects of the still subdued economic activity and the associated lower performance bonuses. Wage growth will then decline more significantly in 2025 and 2026. However, at rates of around 3½%, it will remain higher than the historical average since reunification. This is due to a combination of a high level of labour market tightness and pent-up demand from the period of high inflation. Compensation per employee will increase at a similar pace to actual earnings, possibly even somewhat more strongly in 2025 and 2026 when employers' social contributions rise.

Negotiated wages and actual earnings

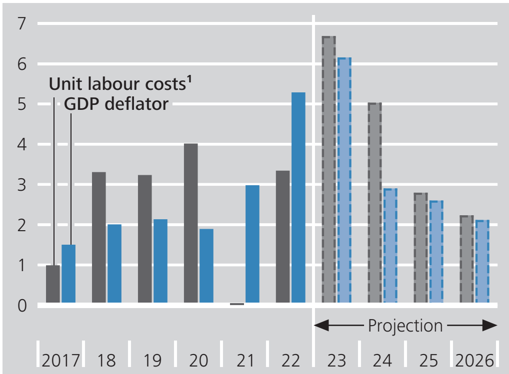
Year-on-year percentage change, monthly basis



Sources: Federal Statistical Office and Bundesbank projections. **1** According to the Bundesbank's negotiated wage index. **2** Gross wages and salaries per employee.
Deutsche Bundesbank

Unit labour costs and GDP deflator

Year-on-year percentage change, seasonally and calendar adjusted



Sources: Federal Statistical Office, Bundesbank calculations and Bundesbank projections. **1** Ratio of domestic compensation per employee to real GDP per employed person.
Deutsche Bundesbank

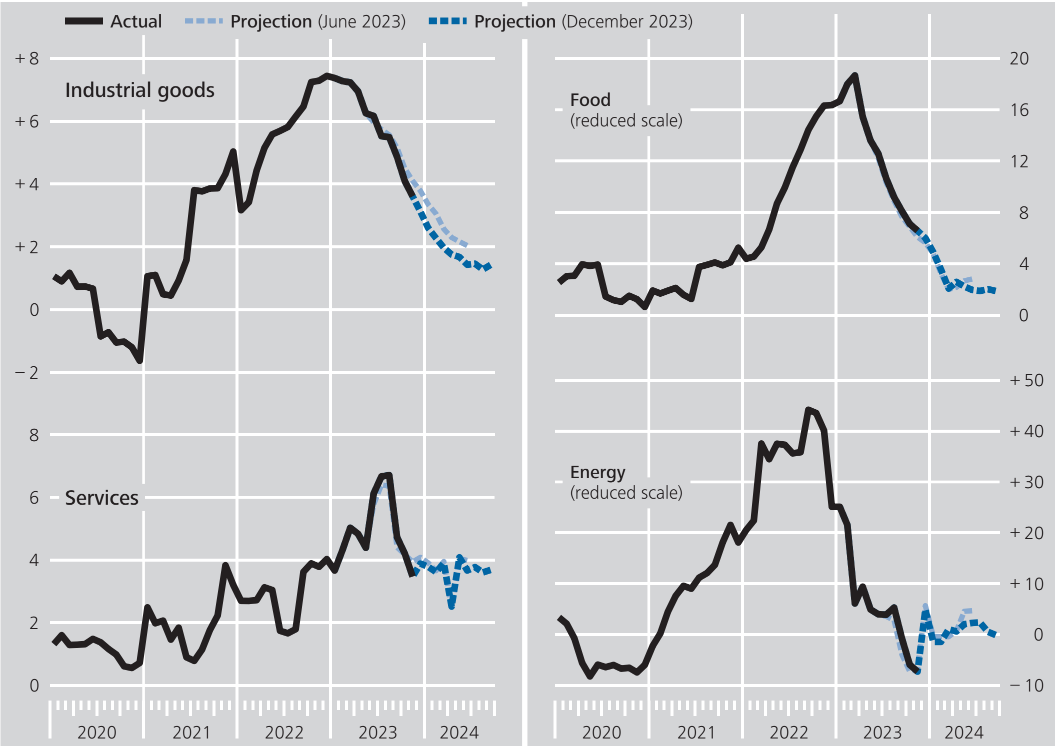
High level of domestic inflation declines as profit margins normalise

Combined with declining economic activity and a stable labour market, unit labour costs will rise extremely sharply this year, with their growth a major factor in the high level of domestic inflation. In addition, enterprises will be able to expand their profit margins slightly on average this year. In previous years, margins had already risen steeply in an environment of strong and, in some cases, pent-up demand (in the form of higher order backlogs, for example), supply-side bottlenecks and high inflation rates. Recently, however, they have already eased off to a point. Unit labour costs will continue to exert very significant pressure next year, as the economy is set to recover only gradually, with robust employment but very high wage growth. Enterprises are likely to absorb this development through their profits, however. This is due to the fact that they enjoy a very satisfactory earnings situation, the supply bottlenecks will have largely dissipated in 2024 and pent-up demand is receding – also as a result of the tightening of monetary policy. Aggregate profit margins will therefore fall steeply in 2024 and return roughly to pre-

19 The advance payments already made by some larger employers as a result of the long-overdue wage agreements in the retail sector will also increase wage drift in 2023. The delayed wage agreements will then have a counter-effect on wage drift in 2024.

Latest revisions to projections for selected HICP components in Germany

Year-on-year percentage change



Sources: Federal Statistical Office and Bundesbank projections.
Deutsche Bundesbank

pandemic levels in 2025. From 2025 onwards, in addition to weaker wage growth, the recovery in labour productivity will contribute to unit labour costs rising at a markedly slower pace. Against this backdrop, domestic inflation as measured by the GDP deflator will fall markedly in 2024, from 6.2% this year to 2.9%, and over the remainder of the projection horizon will gradually decline to 2.1% in 2026.

Headline rate declines in 2023, while core inflation is just reaching its peak

After reaching an all-time high of 8.7% (as measured by the HICP) last year, inflation declined markedly during the course of this year. It is expected to reach 6.1% on average in 2023. The main reason for the easing of price pressures is the deceleration in energy price increases – which were initially dampened by government relief measures and lastly by lower fuel prices. By contrast, food inflation is likely to remain in double digits overall on average for 2023, even though it has already fallen steeply over the course of the year and some products have even seen prices slashed significantly. Only this year will core inflation (excluding energy and food) reach its peak at 5.1%. It is particularly in services where it is up once again from the previous year. Continued pent-up demand for services that were not available during the pandemic has initially been a factor, allowing an increase in profit margins in some sectors. This is compounded by the steep hike in wages, lagged adjustments to the sharp increase in the general statutory minimum wage in October 2022 and repercussions following the considerable rise in energy prices last year. In the case of non-energy industrial goods, price inflation is again well above average for 2023. Supply chain disruptions initially still had an impact here, although they eased over the course of the year, causing consumer price inflation to drop in the second half of the year.

The June projection had assumed a steep decline in the inflation rate for the second half of 2023, partly because the sharp price rises in the same period last year were increasingly exempt

Inflation rate declined sharply until November, but will rise again significantly in coming months

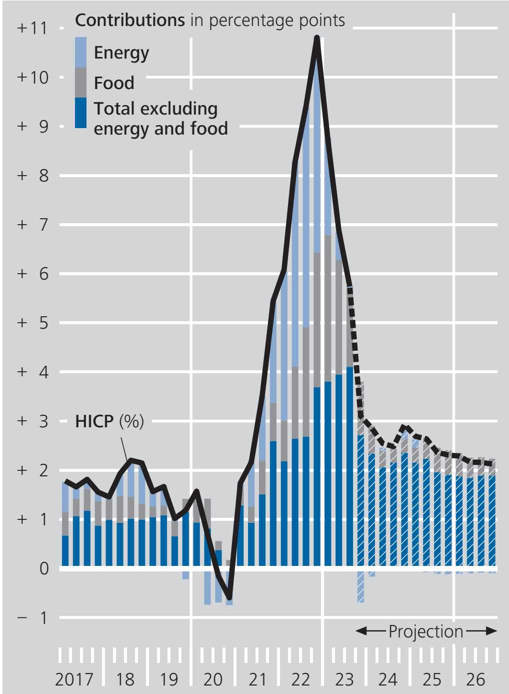
from the calculation. Actual developments were even slightly more pronounced. At 2.3%, headline HICP inflation was 0.4 percentage point lower than expected in November and the core rate was even down by 0.5 percentage point. The fact that non-energy industrial goods price inflation weakened more rapidly than assumed in the wake of price developments at the upstream stages also played a role. However, this also largely reflected unexpectedly sharp price slumps for some services with fluctuating price patterns, such as air travel, which are unlikely to be permanent. The comparatively low rates should therefore not detract from the fact that underlying price pressures are still strong. The core rate was still 3.5% in November. Moreover, the headline rate will be significantly higher again in the coming months. A considerable surge is to be expected in December, in particular, as the government covering advance payments for gas and district heating bills a year ago had temporarily depressed price levels significantly.

Headline and core rates set to fall markedly next year …

Next year, narrowing profit margins are likely to take the pressure out of core inflation. Particularly in the case of non-energy industrial goods, inflation will then fall to a sizeable extent. It will remain above average, however, as price pressures caused by rising labour costs will still be very high. As wages have a greater impact on services prices than on other price components, services price inflation will decline less significantly. For food prices, by contrast, the inflation rate will drop considerably despite the rise in wages, as agricultural producer prices in the euro area are assumed to be lower. Falling prices are also expected for energy commodities. However, the impact on energy price inflation will be softened somewhat by the expiry of government measures to dampen the rise in energy prices. This concerns, for example, the temporary cut in the VAT rate on gas and district heating and the price brakes on electricity and gas tariffs.[20] Second, the annual increase in the CO_2 price on fossil fuels, which was suspended in 2023, will be resumed. This will make a marked contribution to energy price inflation over the next three years.[21] Overall, the inflation rate in 2024 is likely to decline by more than one-half to 2.7%. Core inflation is expected to fall to 3.0%.

Contributions to headline HICP inflation by component

Year-on-year change



Sources: Federal Statistical Office, Bundesbank calculations and Bundesbank projections.
Deutsche Bundesbank

… and continue declining slowly in both 2025 and 2026, while remaining above average

According to the projection, energy prices will remain fairly stable in 2025 and 2026 and will thus hardly contribute to headline inflation any more.[22] This is in contrast to food prices, which will continue to rise sharply owing to persistent wage pressures, as agricultural producer prices will no longer offer relief. Although monetary policy tightening will continue to yield results, core inflation will fall only slowly, as it, too, will be maintained at a high level, above all, by the

20 The projection assumes that the price brakes will expire at the end of this year. While the average retail tariffs for electricity may then have already fallen below the brake value, the retail tariffs for gas may still be somewhat above the brake value when the brake expires.
21 For more information on the impact of the rising CO_2 price on inflation, see p. 20.
22 The increases in the carbon price roughly offset the assumed further decline in futures prices for energy commodities.

strong wage dynamics. For a while, the sharp rise in unit labour costs in 2023 and 2024 will continue to have an impact. And further wage growth will remain above average, though it will no longer be as strong as in previous years. All in all, by 2026, headline inflation will be down to 2.2% and core inflation down to 2.3%. Both rates will thus remain above average over the longer term.

Public finances

Lower deficit ratio in 2023 due to reduced coronavirus measures

According to this projection, the general government deficit ratio will fall from 2.5% in 2022 to 2.0% this year. Temporary crisis measures have been much less substantial in 2023, thus reducing the burden on budgets compared with the previous year (see p. 22). Other developments are weighing on public finances. Inflation, for example, is pushing up expenditure considerably. In particular, intermediate consumption and interest expenditure on inflation-indexed securities are significantly higher. Aside from this, expenditure on defence and climate action is increasing. Economic activity is also weighing on the budget somewhat. In addition, developments in profit-related taxes are significantly weaker than would be expected on the basis of the macroeconomic reference variables – unlike in 2022, when they saw a significantly stronger rise than the reference variables would have suggested.

Temporary burdens from crisis measures will be phased out by end-2024

According to the projection, the deficit ratio will fall significantly to 1.3% in 2024 and remain virtually unchanged in the years that follow (for information on how the Federal Constitutional Court's ruling on the debt brake will be taken into account, see pp. 21 f.). The temporary crisis assistance will have been phased out largely in 2024, and entirely in 2025. Taken in isolation, the deficit will fall sharply, above all next year. The weak economy will still have an impact at first. It is not until 2026 that its dampening effect will recede and then become deficit-neutral.

Worsening structural balance due to significant growth in expenditure, primarily on the military and pensions

Without the temporary effects of the crisis measures and economic activity, i.e. in structural terms, the balance will gradually deteriorate. Expenditure on the military, in particular, will increase significantly from 2024 onwards. In addition, grants to finance the renewable energy (EEG) levy will rise sharply in 2024. This is because the sale of electricity from renewable energy plants will not cover the promised proceeds, and the reserves from the EEG levy will then be used up. Wage growth in the public sector will be strong, mainly as a result of high wage adjustments.[23] Moreover, pension expenditure will rise dynamically. This is mainly a lagged reflection of the high wage increases at the macroeconomic level. Demographic developments will also play a role, however: more and more people will be reaching retirement age. Growth in expenditure on health and long-term care will also outpace that of the reference variables for social security contributions. Nonetheless, this gap will largely be offset by the assumption of higher contribution rates. For interest expenditure, the burdens associated with inflation-indexed debt instruments will decrease from 2024 onwards but this will be outweighed by rising refinancing costs.

Debt ratio will fall towards 60%

The debt ratio is still trending downwards and, according to this projection, will stand at 60.7% at the end of 2026 (2022: 66.1%). This decline is mainly due to the strong growth in nominal GDP (denominator effect). Moreover, the Federal Government is paring back debt related to coronavirus assistance loans and to bad bank portfolios stemming from the financial crisis. If the generational capital fund announced by the Federal Government were to be implemented, this in itself would increase the debt ratio, as the required capital is to be funded primarily from loans.[24] The repayments

23 The state government collective wage agreement reached after this projection was finalised exceeds the wage increases for state government assumed in the projection. The impact on the projected general government deficit is small.
24 See Deutsche Bundesbank (2023f).

that Germany has committed to under the Next Generation EU programme are not included in the Maastricht debt ratio reported here. These are expected to rise to 2.3% of GDP by 2026. In economic analyses, they should be counted towards the German debt ratio.[25]

Risk assessment

Downside risks to economic growth, upside risks to inflation

The macroeconomic projections presented here are subject to several uncertainties. All in all, risks to economic growth are tilted to the downside, and risks to inflation to the upside, at present.

Some fiscal policy decisions still pending

The fiscal policy stance and its impact on the economy are still not completely certain following the Federal Constitutional Court's ruling on the debt brake. After this projection was finalised, German fiscal policymakers responded to the ruling, particularly with regard to central government finances in 2024. This means that there is no need for significant revisions to the projection (see the box on p. 34). However, the details of some parts of the agreements still need to be fleshed out, and responses by the state governments are also still pending in some cases. Furthermore, it remains uncertain how the future climate and transformation policy stance from 2025 onwards is to be structured and financed in concrete terms. This goes hand in hand with uncertainty about important underlying conditions for the German economy.

Risks arising from geopolitical tensions and regarding energy supply

In addition, there are geopolitical risks, especially with regard to the wars in Ukraine and the Middle East. An intensification of geopolitical conflicts would probably lead to tensions on the international energy and commodity markets and could trigger renewed supply chain disruptions. If the war in the Middle East were to escalate and spread to (crude oil-exporting) neighbouring countries, the price of crude oil could rise rather than fall as projected. This would weigh on the German economy and, at the same time, fuel inflation. There could be similar consequences if the supply situation for natural gas in Germany were to worsen again. The gas storage facilities are currently much better filled than is usual for this time of year. The Federal Network Agency therefore considers the risk of a gas shortage to be low at present.[26] However, residual risks persist. They are associated, for example, with a colder-than-average winter or a halt in Russian gas supplies to southern Europe. In the former case, the demand for gas in Germany would be higher. In the latter, less gas would be available because Germany would export more to southern Europe.[27]

Risk of more persistent inflation due to higher rises in wages or profit margins declining less steeply

The risk that the inflation process will prove more stubborn than assumed in the projection has been reduced, but not yet eliminated, by the tighter monetary policy stance. For example, the combination of prior real wage losses and a tightening labour market could lead to even stronger wage growth. This would probably result in correspondingly higher second-round effects on consumer prices. Inflation could also remain elevated for longer if firms absorb the pressure from unit labour costs via reduced profit margins to a lesser extent than assumed in the projection. This could occur, say, given less intense competition or a more favourable demand situation. In an even longer-lasting high-inflation environment, the risk of economic agents adapting to elevated inflation and adjusting their long-term inflation expectations upwards would ultimately increase. Inflation could then become further entrenched.

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25 See Deutsche Bundesbank (2022b).
26 See Federal Network Agency (2023).
27 Since the projection was finalised, futures prices for energy commodities have decreased, especially for the short term. Further technical assumptions underlying the projection have also changed since then. For example, market expectations for the Euribor and the yield on long-term government bonds in the euro area have declined. In addition, the euro has depreciated. Viewed in isolation, these changes in the underlying conditions would have a slight positive impact on GDP growth over the projection horizon. They would dampen inflation somewhat next year, but increase it slightly in 2025 and 2026.

What do the latest announcements on central government finances for 2024 mean for the projection?

The projection is based on assumptions as to how fiscal policy will react to the ruling by the Federal Constitutional Court (see pp. 21 f.). After the projection was finalised, leading Federal Government policymakers adopted new resolutions on central government finances for 2024. Only a few details were known as this report went to press. Overall, however, there is no significant need to revise the projection at present – with neither the fiscal nor the macroeconomic outlook requiring any revision as things currently stand.

The announcements indicate that indirect levies are likely to increase slightly more sharply than projected. This applies to the price of national CO_2 certificates in 2024 and 2025 and other indirect levies (in particular, a new levy on plastic products). Planned expenditure is apparently also somewhat higher than assumed in our projection. The information available on this is patchier, however. Overall, the forecast deficit ratio of 1.3% for the years 2024 to 2026 still appears plausible. The Federal Minister of Finance has projected a deficit ratio of 1.5% for 2024, which is only slightly higher.

Most of the macroeconomic variables in the projection will therefore not require any major revision. However, the higher CO_2 price will have a direct impact on consumer prices. In the baseline of the projection, it was still assumed that the fixed price per tonne of CO_2 would be raised from currently €30 to €40 in January 2024 and to €50 in January 2025. The maximum price of €65 was assumed for 2026. In total, these increases would have raised the rate of the Harmonised Index of Consumer Prices (HICP) in 2024 and 2025 by approximately 0.15 percentage point for each year and in 2026 by just over 0.2 percentage point.[1] According to the latest announcements, the increase in the carbon price in the coming year to €45 will initially turn out to be more substantial, boosting the effect on the HICP rate by 0.1 percentage point. By 2025, the new carbon price should then amount to €55. The increase will therefore remain at €10, which means that the inflationary effect will not change. The maximum price of €65 is still assumed for the last projection year, yet the jump to this price now turns out to be smaller than before. Compared to the baseline, the contribution to the HICP rate is therefore reduced by close to 0.1 percentage point. Other measures planned, such as imposing a levy on plastic products or a kerosene tax on domestic flights, are still too unspecific to permit a precise assessment of their inflationary effect. While the measures are likely to have a trend inflationary effect, it will probably be limited. Domestic flights, for instance, account for less than 0.5% of the HICP basket of goods and services.

1 For the method to calculate the impacts based on the price path at the end of 2019, cf.: Deutsche Bundesbank (2019).

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