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The German Economic Crisis of 2024: A Country Study

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ABSTRACT

In 2024, the global landscape underwent significant geopolitical transformations that profoundly impacted economies worldwide. Central to these discussions is Germany, a key player in the European economy known for its substantial contributions to the global financial system. However, the recent geopolitical tensions, particularly the ongoing Russian-Ukraine conflict, have exacerbated existing challenges and introduced new complexities to Germany's economic landscape. This paper aims to analyze the current financial situation in Germany, focusing on the stagnation its once-robust manufacturing sector faces and the broader implications of both short-term shocks and long-term structural issues. Understanding the economic crisis in Germany is crucial, as it carries significant consequences for the global economy. By examining these challenges, this paper will also propose policy measures to revitalize Germany's economy and address the factors contributing to its recent downturn.

BACKGROUND OF THE STUDY

Germany has always been touted as a significant economic power over the years. After a decade of robust export growth, declining unemployment, and fiscal surpluses, we are now confronted with significant structural challenges brought on by the pandemic and energy crisis. However, these obstacles present clear opportunities for future improvements within the economy. Tracing back to the period just after World War II, contrary to many expectations, Germany achieved miraculous growth; it was technically termed The *Wirtschaftswunder*, which began with the replacement of the Reichsmark with the Deutsche mark in 1948 as legal tender. Rapid growth could be attributed to the

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government's ordoliberal policies. *Ordoliberalism* (a German variant of economic liberalism that emphasizes the need for government to ensure that the free market produces results close to its theoretical potential but does not advocate for a welfare state and neither advocate against one. Source: Wikipedia). Germany's economy capitalized on the skilled workforce and technological level they had to fuel their growth; even before the pandemic, the German economy was believed to occupy a strong position on the global front, but this pandemic and the Russia war exposed their vulnerabilities. These issues profoundly impacted the country; this reverberation of economic stagnancy is still the major issue Germany faces in 2024. This would be our topic of discussion throughout this paper.

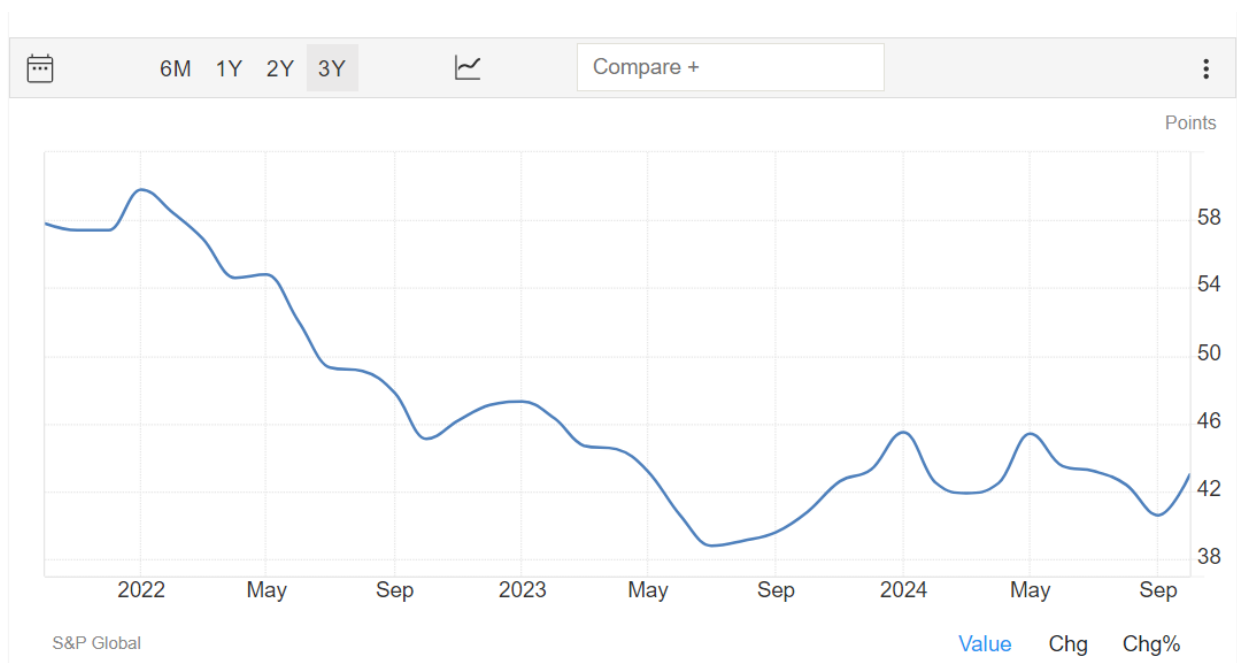
Growth rates, unless specified	2022	2023	2024
Gross domestic product	1.9	0.3	1.3
Private consumption	4.4	-0.2	1.4
Government consumption	1.2	0.3	0.4
Gross fixed capital formation	0.6	-1.8	1.3
Exports of goods and services	3.0	1.8	3.1
Imports of goods and services	6.1	1.4	2.9
Unemployment rate (% of labour force)	3.0	3.0	2.9
Harmonised index of consumer prices	8.7	6.6	3.0
Harmonised index of core inflation	3.9	5.7	3.4
Financial balance (% of GDP)	-2.7	-2.2	-1.0
Government debt (Maastricht, % of GDP)	66.5	65.8	65.6
Current account balance (% of GDP)	3.7	5.7	6.3

OECD calculations based on the Economic Outlook 112 database.

The above data exemplifies some of Germany's major economic indicators and how it has transitioned over the last few years.

Manufacturing Sector Challenges

The German manufacturing sector faces significant challenges, particularly its *Mittelstand* (small and medium-sized enterprises). Companies are demonstrating resilience despite soaring energy costs, inflation, and an ageing infrastructure. Leading manufacturers like Volkswagen are experiencing notable profit declines and the threat of plant closures as a result of decreased demand in key markets, particularly China. The ongoing economic downturn has intensified calls for reforms to boost competitiveness and productivity within this vital sector. Nonetheless, the industry's resilience continues to inspire a sense of optimism.

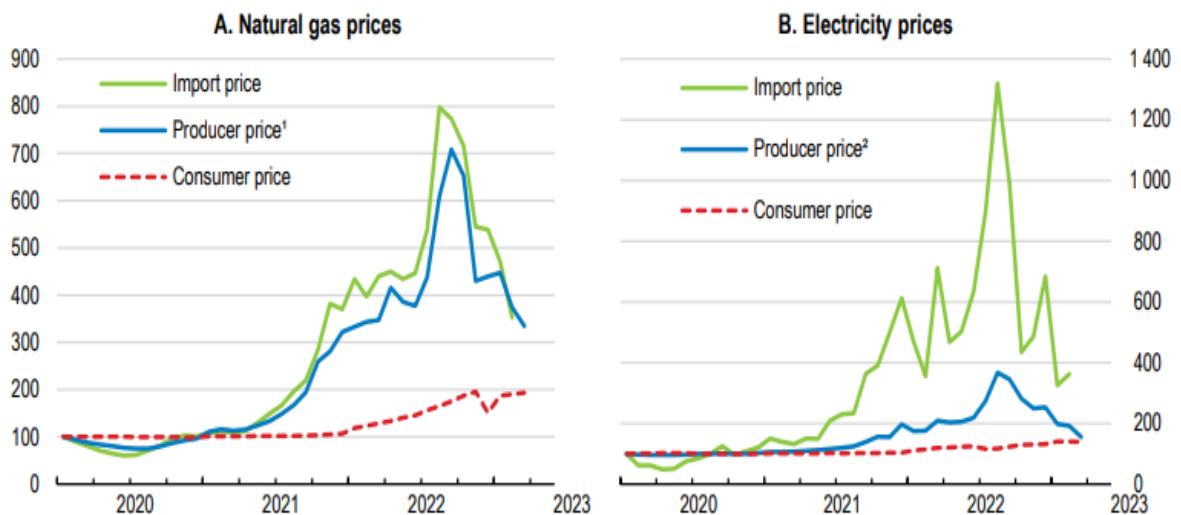


The HCOB Germany Manufacturing PMI was revised higher to 43 in October 2024 from a preliminary of 42.6 compared to a twelve-month low of 40.6 in September. The reading showed that the German manufacturing sector remained firmly in contraction, although rates of decline eased. Output, new orders, employment and stocks fell more slowly than in September, while business expectations were slightly less pessimistic. On the other hand, there was an accelerated decline in output prices across the goods-producing sector, as firms commented on intense competition for new work and came under pressure to pass on the cost savings from lower input prices. "The mood in German

industry remained glum in October. However, there are signs that an economic trough may have been reached. Although the headline PMI remained deep in the recessionary territory in October, it showed a slight improvement from a very low level."

However, through this paper, we also want to reflect on the fact that the German economic crisis at the surface level might have been caused by some immediate geopolitical reasons, including the Russia-Ukraine war. Still, the factors behind this weakened economy must be explored more. Due to Russia's Ukraine war, energy prices soared high, and Germany specialized in the production of heavy automobile industries as well as chemical power plants; both were severely affected after the war broke. Some economists even say that Germany's economic model is irreparably damaged. They argue that strong growth in previous decades was based on importing cheap Russian gas, which powered Germany's highly competitive export industries. Due to war, this cheap gas was no longer available, and German manufacturing faced a significant blow. However, this was the case immediately after the war situation in 2022, and this has indeed caused spiking inflation and cost of living pressures; however, the rise.

Gas prices have proven to be temporary. After soaring in 2022, wholesale gas prices have fallen back to 2018.



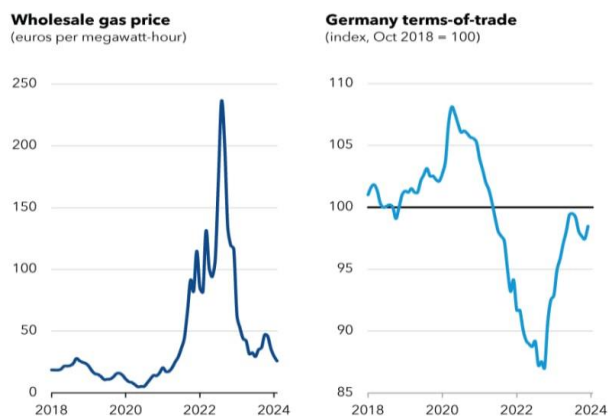
1. Producer price index of natural gas when supplied to industry.
 2. Producer price index of electricity when delivered to special contract customers.
 Source: Federal Statistical Office.

Statistik <https://statistik.lk/in3i>

A broader evaluation of Germany's international competitiveness paints a similar picture of substantial recovery; Germany's terms of trade had returned to the same level in 2024 as before the energy shock and Germany's trade surplus reached around 4.3 per cent of GDP last year, is A lower than the excessively high surpluses of the pre-pandemic years. Still, it is above the average of the previous two decades and will likely increase further this year.

Analyzing the manufacturing sector closer to the energy-intensive chemicals, metals and paper industries have contracted, there has been a significant green transition in Germany's automobile industry, where electric vehicles have been produced more significantly. This transition is not just a response to the current challenges but a crucial step towards a sustainable future, engaging all stakeholders in the process. Germany aims to reduce its greenhouse gas emissions by 65% by 2030, compared to 1990 levels, to achieve carbon neutrality by 2045. However, this green transition requires a proper labor reallocation strategy; workers displaced in the carbon-intensive sectors face more difficulty finding a new job because they tend to be older, working in a more specific occupation, and are geographically located.

Thus, even though the geopolitical tension has exposed Germany on the economic front, it's not the sole reason Germany still has a weak economy. Instead, Germany even has steps for the future involving green transitions, but at the same time, this future looks bleak due to some of the other factors we will analyze in the following sections.



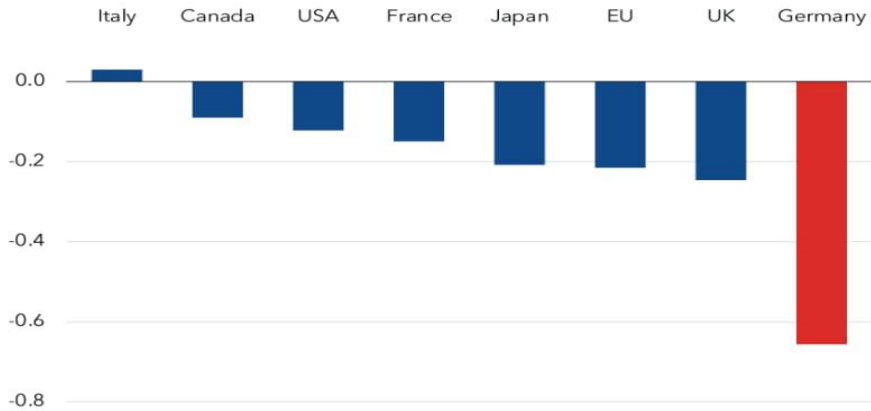
Source: Intercontinental Exchange, Deutsche Bundesbank, and IMF staff calculations. Notes: Gas price displayed is the Dutch Title Transfer Facility.



LABOUR AND UNEMPLOYMENT DYNAMICS IN THE GERMAN ECONOMY

One of the pressing structural reasons for the stagnant German economy is the ageing of the population. Germany's working-age population has been buoyed over the last decade by migrants escaping regional conflicts. However, as the migrant wave ends and baby boomers are retiring over the next five years, the growth of Germany's labor force will drop more than in any other G7 country. This imminent decline can cause downward pressure on GDP per person because fewer workers will be available for each retiree. The resulting combination of higher social security contributions, lower pensions, and the need to allocate a considerable share of healthcare services and pensions to a sizeable elderly population will deter the overall investment strategy. The situation demands immediate attention and action.

G7: Five-year projected change in working-age population growth rate
(percentage points)



Source: OECD and IMF staff calculations.
Note: The chart shows the difference between the average projected growth rate of the working-age population (age 15-64) during 2025-29 and the actual average growth rate of the working-age population during 2019-23.



The problem with Germany is not that they have a constantly spiraling down unemployment rate; still, their unemployment rate is low compared to many other

countries, but the actual problem is how this unemployment unfolds in the economy. In the case of Germany, the employment of the service sector has faced a surge while the manufacturing sector has hit a significant decline.



Germany is still adding many low-paid jobs, but the country's vital auto industry is scrambling to survive due to the lack of skilled workforce in the sector. With the evolution of electric vehicles in the auto industry, it's high time that German manufacturers must keep up the pace. Companies like Continental and Volkswagen have changed their layoff policies due to the situation. Even during the economic crisis, companies were forced to keep many people on the job because they feared the ageing German population. Thus, the manufacturing sector has to pay more to sustain production. Therefore, the present scenario reflects an ironic situation where jobs do not vanish drastically. Still, the jobs lost or vanished are the high-paid manufacturing jobs, which are pertinent to sustain the economy, whereas the low-paid service sector jobs are still adding up. Germany, thus, would have to rely on immigrants to maintain its economy. However, this pathway is adversely affected due to the slow visa processes, bureaucratic red tape delays, and lack of preferential treatment for skilled workers.

The German government must take some adequate action to rejuvenate its export-driven economy. The urgency and importance of these policy changes cannot be overstated. The updated skill immigration act of 2024 issued around 80000 visas, which was the first of many programs that the government needed to initiate.

The graphs below depict the situation in which the manufacturing sector was adversely affected by unemployment chaos.



SFB ANALYSIS

The SFB model, created by heterodox economist Wynne Godley, is based on fundamental double-entry accounting principles: each debit has a matching credit, and every financial asset has a corresponding financial liability. Unlike more complex, this macroeconomic model relies on basic accounting principles to ensure stock-flow consistency. In a three-sector economy consisting of the domestic private sector, government sector, and external sector (which includes both private and government sectors), the net financial asset accumulation across sectors must sum to zero. This means that the financial asset accumulation in any industry requires a corresponding accumulation of financial liabilities in at least one of the other sectors. The SFB 18 equation does not permit all sectors to accumulate net financial assets simultaneously.

Thus, the Equation is:

$$(S-I) + (T-G) + (M-X) = 0$$

Where S is private sector savings, I is private sector investment, G is government expenditure, T is tax receipts, X is exports, and M is imports. A current account deficit (CAD), where $X-M < M-X$ is less than zero, indicates an inflow of capital into the domestic economy, resulting in foreign investors accumulating assets domestically or the domestic sector accumulating liabilities to foreigners. This Equation holds whether the parameters are in absolute terms or as a percentage of GDP.

The equation can also be expressed as:

$$(S-I) = (G-T) + (X-M)$$

In the case of the domestic private sector, to accumulate net financial assets, the government must run a fiscal deficit, and the country must run a current account surplus (CAS), causing foreigners to accumulate net liabilities. The private sector, composed of households and firms, inherently desires to save and earn returns on those savings. Physical assets such as gold and property can be inconvenient and subject to theft, legal issues, and price fluctuations. Financial assets mitigate some of these problems but still carry risks. Therefore, the private sector prefers holding financial assets issued by the government, like treasury bills and bonds, which are considered safe because they are supported by the government's ability to issue sovereign currency. Negative asset accumulation or net financial liabilities by the domestic private sector, known as leveraging, can occur, especially during economic booms. However, this is unsustainable in the long term due to the need for debt repayments. Deleveraging, where the private sector reduces consumption and investment to save and reduce debt, can lead to a recession. Governments, however, can indefinitely accumulate net financial liabilities, which are the private domestic sector's and foreign entities' assets, enabling a country to run a CAD. In the following table, we have included the data required for SFB analysis from a German perspective. The data extends from 2020 to 2023, and we could infer some observations from the table (every value as per cent of GDP).

YEAR	X-M	G-T	S-I
2020	-1	-4.3	-5.3
2021	0.8	-3.9	-3.1
2022	-1.1	-2.7	-3.8
2023	0.2	-2.2	-2.0
2024	0.2	-1.0	-0.8

SOURCE: Data based on OECD calculations

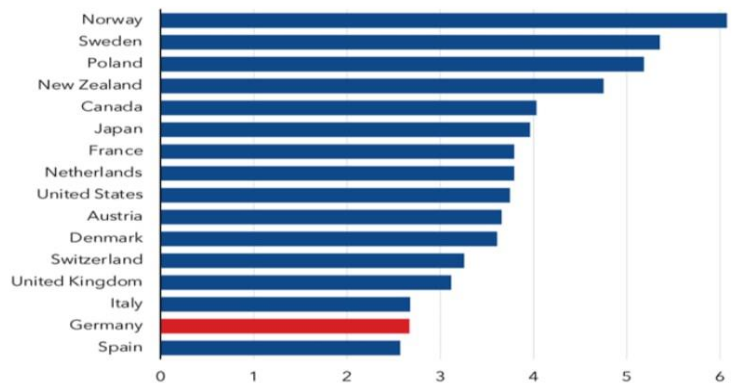
The table above shows us the interpretation of the German economy for the past 4 years. We can see that during the pandemic and Russia -Ukraine crisis in 2020 and 2022, the savings were drastically reduced due to the uncertainties in the economy while coming to the projected figures in 2024, the economy appears to be more balanced having a consensus between savings and investment, but does this reflect a healthy economy overall. We should always inspect these values in a much more pragmatic manner; throughout this paper, we are discussing how the weakness of the German economy was exposed, and even in this case, we should analyze how these investments take place. Based on the data collected, it has been evident that the lack of public investment is another reason for the stagnant nature of the German economy. The domestic savings accumulated is invested chiefly outside the country. The table below shows that Germany has been in the lower strata regarding public investment policies. Public investment declined in the 1990s; more is needed to offset depreciation. This puts Germany at the bottom of advanced economies in terms of public investment. Germany could expand municipalities' planning capacity to boost public investment through consulting services programs like *Partnerschaft Deutschland*.

Lack of public investment

Germany invests less in public infrastructure than other countries.

Gross public investment

(percent of GDP, 2018-22 average)



Source: OECD and IMF staff calculations.



YEAR	SAVINGS (in billion euros)
2020	327.1
2021	311.78
2022	248.19
2023	266.89

SOURCE: World Bank

YEAR	INVESTMENT (% of Nominal GDP)
2019	21.3
2020	21.5
2021	21.3
2022	22.1
2023	21.9

Source: World Bank

We have analyzed the separate individual savings and investment data of the private sector of Germany; we can see that the S-I, which was negative in the SFB analysis is mainly due to the falling savings; savings have been much higher during the pandemic due to the uncertainty in the economy and while during the Russia Ukraine crisis and accompanying energy crisis, inflation soared high and saving dropped significantly, while the investment from the private sector has been mostly remained the same and this itself shows that a stagnant nature of German economy.

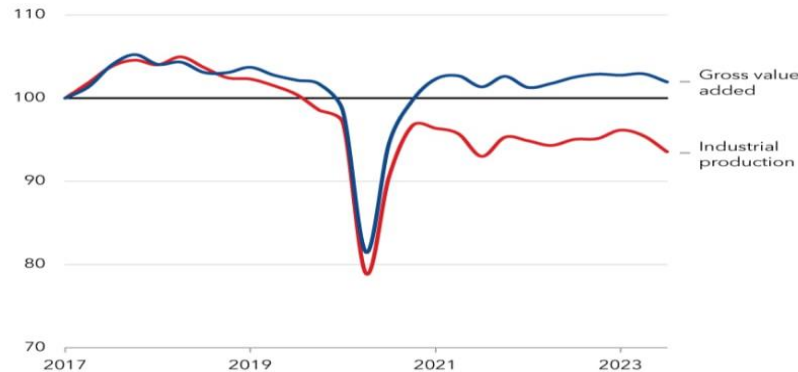
LACK OF DIVERSIFICATION AND DIGITALISATION

A significant failure of the stagnant German economy has been their overreliance on a few particular industries like automobile and chemical manufacturing; over the years, there has yet to be diversification in the German economy. Thus, when the energy crisis hit, both these industries were equally affected, causing Germany to fall into this economic trap. German manufacturers have not effectively used technology over the years, and their strategy to produce electric vehicles came too late in the global competitive scenario. The below graph shows the reality of the past few years, where manufacturers are adding more value even though they are producing less; this is because, in the past 2-3 years, significant production has not been for the manufacturing sector, but the German economy was not able to capitalize the output from other sectors because their export-driven economy was concentrated only to the manufacturing sector.

Doing more with less

Manufacturers are adding more value even as they produce less.

German manufacturing activity (index, 2017-Q1 = 100)



Source: Federal Statistical Office and IMF staff calculations.

IMF

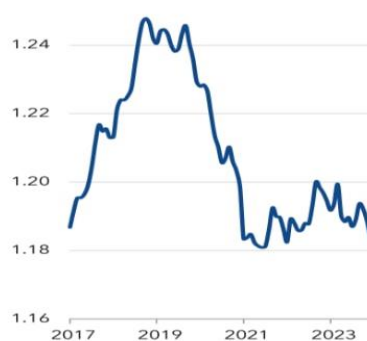
After the Energy crisis, energy industries have downsized, but other manufacturers have expanded, as given in the graph below; this did not transform into an economic boom because Germany was far behind many other countries in terms

of technological prowess in manufacturing, thus making their goods not compatible global scale. Thus, it depicts how vital diversification is to an economy.

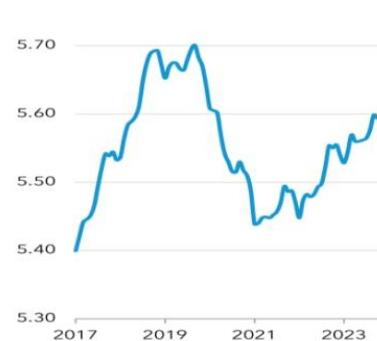
Diverging employment

Energy-intensive industries have downsized but other manufacturers have expanded.

Chemicals, metals, paper
(millions of workers)



Other manufacturing employment
(millions of workers)

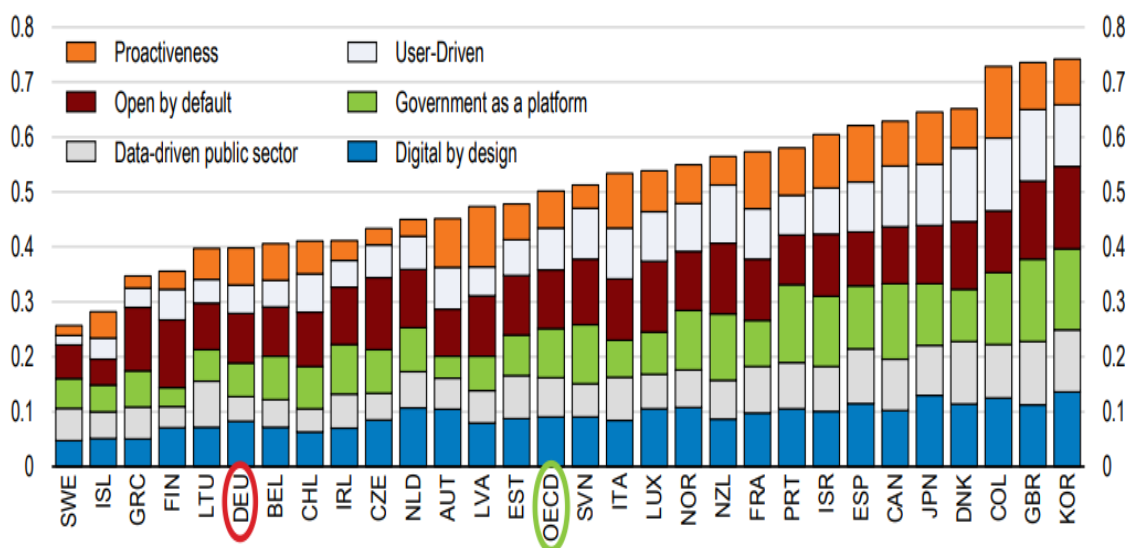


Source: Federal Statistical Office and IMF staff calculations.

IMF

The DIGITALISATION process has also been one of the significant fields in which Germany still needs to improve. Modernization and digitalization of public administration are considerable challenges, but they hold enormous potential to increase spending efficiency, growth, and welfare. The public sector is less data-driven than in other countries, as shown by the OECD Digital Government Index (Figure below). Improving data sharing and IT infrastructure, including independent researchers' access to linked microdata, would facilitate impact evaluation and targeting of policy programs and raise the quality of public spending. Digitalizing public services and administrative procedures and making them more user-friendly could significantly improve welfare and reduce administrative burdens for young and innovative firms, thereby raising business dynamism and productivity. It can also have positive spill-over effects on adopting digital technologies in the private sector. In addition, the digitalization of the public sector can help to address rising skilled labor shortages.

OECD Digital Government Index, 2019, score 0 to 1



Note: Data are not available for Australia, Hungary, Mexico, Poland, Slovakia, Switzerland, Türkiye and the United States. The OECD Digital Government Index (DGI) is based on the six dimensions of the OECD Digital Government Policy Framework (DGPF): digital by design, data-driven, government as a platform, open by default, user driven and proactiveness. It measures the capacity of the public sector to deliver a coherent and human-centric digital government transformation, as well as the strategic approaches, policy levers, implementation, and monitoring mechanisms in place to deliver the digital government strategy. Thus, it captures much more than just digitising analogue processes (OECD, 2020^[167]).

Source: OECD Survey on Digital Government 1.0.

German economic weakness can also be attributed to the growing competition with China, where China has excelled in using modern technologies to outstep Germany in manufacturing. Many automobile and chemical factories plan to shift their manufacturing base from Germany to China to avoid bureaucratic delays and labor shortages. Thus, Germany's manufacturing sector recovery is only possible with adequate technological prowess incorporated into their processes.

POWERLESS POWERHOUSE IN EUROPE

For an extended period, Germany was considered the engine of Europe. Even in the case of the European Union, Germany always wished to lead the Union as an

advanced nation. But this pandemic and crisis has exposed them very badly in front of their allies. Political instability has also unfolded in Germany, where Chancellor Olaf Scholz has lost his majority after firing his finance minister in the cabinet. Scholz now leads a minority government that will continue until the fresh elections are held. Still, even for the budget of 2025, Scholz now needs the approval of opposition parties, which creates a scenario of the continuing crisis in the country. Even after being one of the central arm exporters, Germany barely puts a significant share in its defense expenditure owing to its commitments to the EU and the USA. Thus, the stagnant nature of the economy, labor crisis, and loss of grip in their robust manufacturing sector have now placed Germany as a dependent nation on the EU since it has been evident that their recovery is not happening anytime soon.

CONCLUSION AND THE WAY FORWARD

Throughout this paper, our focus has been learning the current German economic crisis from a perspective where we tried to understand the actual realities on the ground rather than just interpreting the macroeconomic indicators, and we have learned that Germany, once a European powerhouse, now faces significant backlash after the energy crisis and post-pandemic situation. We have learned how the labor crisis; bureaucratic red tape and many other factors have contributed to this stagnant nature of economics. Governmental policy changes are required in Germany to foster a recovery for them; this can include:

Red tape-cutting could further be an incentive for enhancing productivity as both investment and new businesses find it as a hindrance. It takes almost five to six years to obtain permission to erect an onshore wind farm. Getting a business license requires 120 days, over twice the OECD average.

Germany can also increase labor supply by making it easier for women to extend their working hours. 2.3 million fewer women are working than men, and five times more women work part-time. Expanding reliable childcare access and reducing taxes on secondary earners in married couples may help bridge these gaps.

These are a few measures out of a lot which should be implemented in the economy; through this paper, I have tried to reflect on my understanding of the economic crisis in Germany, and it has been very evident that no matter in which sector of production we are strong, every country should update themselves technologically and digitally to maintain sustainable growth in the global economy.

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