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The World Remains an Unpredictable Place

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The tariff issue remains a Damocles sword looming over the global economy. Even if some "deals" are reached, a lasting loss of confidence has already been inflicted. And at least some of the now increased "baseline" tariffs will continue to cause harm. The heavily export-oriented German economy will inevitably also suffer as a result.

A second major influence on the German economic trend over the next few years will be the implementation of the large-scale fiscal packages that have recently been put in place in the areas of security and infrastructure. Spending in these areas is urgently required. However, careful timing of the expenditure path is recommended so that the effect is not primarily a price surge due to tight production capacities.

In both these areas – tariffs and fiscal policy – there is still considerable uncertainty about the future. This makes any macroeconomic forecast particularly difficult at the moment. The analysis presented here therefore begins by systematising and qualitatively classifying the impact direction of these major policy issues on the level of production, prices and interest rates in the world's most important economic areas.

The world remains an unpredictable place

As yet, the trajectory of major trends can only, at most, be categorised qualitatively

The global economy is riddled with particularly great uncertainties in 2025. We were, of course, no strangers to such uncertainties earlier in the recent past: they were indeed decidedly rampant when we were hit by the pandemic, the war and the onset of the great inflation. Yet rampant uncertainty is rearing its head again, although the main topics on the agenda have now changed. This time round, it is the international framework for trade and the global industrial division of labour which have been shaken to the core. The main trigger for this has been the tariff disputes initiated by the new U.S. administration. The to and fro, involving announcements, threats, tariff enactments and temporary suspensions, has been spawning confusion and unpredictability.

A loss of trust has already occurred, wreaking permanent damage

Even if somewhat less onerous tariff burdens remain at the end of the day, maybe in the wake of certain "deals", the lion's share of the damage has already been done. Trust has been destroyed. Binding commitments and contractual security have given way to short-term arbitrariness or have been exposed to the pressure of power politics. In such a world, investment plans inevitably get put on hold and interactions which could otherwise have proved productive get shunned. This also applies to the Sparkassen and Landesbanken. The main transmission channels are customer companies from sectors that are particularly export-oriented, such as the metal, automotive and mechanical engineering industries. We at the DSGV have already provided corresponding sector analysis tools for our institutions within the Savings Banks Finance Group.

As yet, it is hardly possible to compute the extent of the negative effects for the economy as a whole. What we are experiencing is historically unique, meaning that no empirical evidence from the past is available. Many non-linear effects are conceivable. Yet, a new balance in the overriding framework is far from recognisable. All macroeconomic forecasts are currently being swamped by these difficulties. Admittedly, such forecasts always have to be made with qualifications and reservations in any case, but this is particularly true at the present. In principle, it is only possible at the moment to tentatively sketch potential scenarios: there is really no way that one can confidently paint a genuine main scenario which has a high probability of occurring.

Major topics covered:

- *The trade dispute*
- *Germany's new large-scale fiscal packages (for defence and infrastructure)*

Conversely, the analysis presented here seeks to shed light on at least the qualitative impact directions of the tectonic shifts we are currently witnessing. Not even these are really clear and unambiguous in all cases and amid the interplay of the many variables involved. The following schematic presentation attempts to classify the various threads.

We are focusing on the factors that are particularly significant from a German perspective, namely the trade dispute and the new large-scale fiscal packages.

The latter can definitely also be placed in an international causal chain. At least part of the higher defence spending being aimed at by Germany and Europe in general can be attributed to the USA's shift towards isolationism – not in terms of trade in this case, but in terms of security policy in the form of the partial de facto withdrawal of the U.S. military-defence umbrella.

On the other hand, the higher infrastructure spending now being planned for Germany is more a function of domestic demand, being attributable to years of public-sector investment being postponed in favour of consumer-related government spending.

These two major issues – the trade standoff and the radical paradigm shift in German fiscal policy – interact in manifold ways. They have a potential impact on macroeconomic growth, but also on prices and interest rates. In some cases, the effects move in opposing directions in the individual countries and economic areas. The table below attempts to categorise the positive and negative implications.

Single, double or even triple plus signs denoting a boosting influence on the variable in question, while equivalent single, double and triple minus signs point to a negative effect. Wherever the impact direction is theoretically open because it depends on possible trade-policy countermeasures or exchange-rate reactions, this is marked accordingly. In view of the uncertainty prevailing, this holds true in quite a number of fields. Those cases where the effects are negligible are also noted. Some important assessable combinations remain nonetheless.

Qualitative impact direction on various key countries in the global economy

Red: Effect of U.S. tariffs

Blue: Effect of higher German defence and infrastructure expenditure

	Effect on **GDP**	Effect on **prices**	Effect on the **interest-rate level**
USA	- - - +	+ + + ~	+ + ?
Euro area	- - +	? +	? +
Germany	- - + +	? +	? + +
China	- - ~	? ~	? ~
Third Countries	- ~	+ ~	+ ~

~ = negligible impact

? = The impact direction is theoretically open

With regard to the tariff barriers recently thrown up by the United States, it is helpful to realise from the outset that these are equivalent to a negative supply shock for the USA itself. For the USA's trading partners, on the other hand, they are tantamount to a negative demand shock. This will certainly prove to be the case if the countermeasures taken by the countries affected are more moderate in terms of height and breadth than the initial U.S. move, i.e. if there is no further mutual escalation leading to a complete trade blockade.[1]

Trump's tariffs amount to a supply shock for the USA itself, and a demand shock for other countries

The USA is, in a serious sense, cutting off its nose to spite its face

U.S. consumers will end up paying the bill

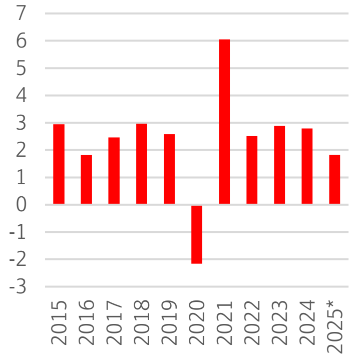
The implication for the USA is that the supply of goods available domestically for consumption and investment is reduced if fewer and/or more expensive imports enter the country. This will undoubtedly have the effect of boosting prices. In terms of the impact on U.S. national production, it is theoretically plausible that a domestic import-substitution industry could spring up behind the tariff wall and deliver more goods. This is Trump's declared goal. In reality, however, this is only likely to prove possible in a few sectors. In recent decades, after all, the USA has lost industrial capacity and expertise in many areas, often to China. It is presumably unlikely that these will be regained all that easily, especially if the

[1] In the case of the bilateral relationship between the USA and the People's Republic of China, it has looked at times as though a complete blockade would emerge. However, we assume that at least the absurd three-digit-percentage tariffs which these countries temporarily imposed on each other will be staved off via a negotiated solution.

United States spooks potential partners and investors with the looming spectre of legal uncertainty. It is also unlikely that the production factors required for an industrial revival will be successfully mobilised. The U.S. job market has been tight in recent years, marked by a high labour-utilisation rate. And it will grow even more inelastic in response to a more restrictive immigration policy.

What the USA has rather specialised on in recent decades is services and technology – certainly for its own benefit and in line with comparative advantage. But if the natural international division of labour is now suddenly thwarted, productivity and prosperity will suffer. This is the reason why trade wars have no winners, either in theory or in historical practice.

US GDP Growth,
Change to previous year, price-adjusted, in %



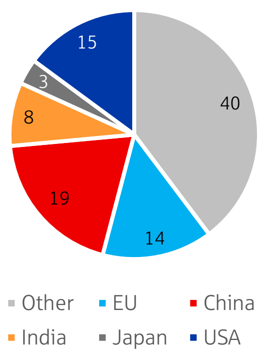
*Forecast 2025
Source: IMF

It is also the reason why we have postulated negative GDP effects for all countries/economic areas in the table above as a consequence of the “red” issue. The use of single, double or triple minus signs is intended to provide a rough estimate of the extent of the damage to macroeconomic growth. Such minus signs cannot aspire to providing quantitative assessments, but are merely intended to categorise the respective tendencies.

We expect the greatest negative effect to impact the USA itself.

It is true that foreign-trade theory argues that “large countries” can gain advantages through tariffs in certain situations. However, this only applies if the latter are used in a carefully-targeted manner on goods markets with a price-inelastic import supply and/or very elastic domestic demand. Yet the USA is not taking such a differentiated approach by pursuing Trump’s trade policy. Instead, it is taking a blunt broadsword to all goods and all supplier countries. On “Liberation Day” in early April, when Trump set free various tariff demons, practically every country in the world was on the list presented.

GDP based on purchasing power parities
percentage share in of 2024 global GDP



Source: IMF

If the USA, with its share of around 15 per cent[2] of global economic output, chooses to isolate itself from the rest of the global economy, i.e. from the other 85 per cent, then it is logically no longer such a big country. Insulating itself from international trade and knowledge flows is unlikely to do the country any favours. This is as true in the long term as it is in the short run. In the long term, noxious structural effects will materialise. And on an immediate short-run horizon, a disruptive effect will kick in if the USA indiscriminately cuts itself off from important preliminary products. This is the reason why we have entered a triple minus for the USA in terms of both production and prosperity.

Let us, in addition to the mainly qualitative analysis being pursued here, quickly slip in a quantitative order of magnitude: projections by the Kiel Institute for the World Economy put the loss for the USA stemming from the tariff measures discussed in May at around 1.5 per cent of GDP. Such a growth loss would

[2] Purchasing-power-parity-weighted shares of global production according to the methodology of the International Monetary Fund. At current market exchange rates, the USA's share would be somewhat higher.

naturally not amount to a complete collapse; but it would nevertheless mean the loss of at least half an annual GDP growth rate of the kind registered during the good years of the last decade. And if the non-linear structural damage caused by the loss of confidence were to materialise, then even more sizeable and durable scars could easily be imagined.

The vast "rest of the world" beyond the USA should unite by conducting extensive free trade

In order to minimise the damage to the rest of the world, the remaining 85 per cent of the global economy should focus all the more on free trade. Within the framework of the Franco-German Council of Economic Experts, the German Council of Economic Expert, together with their French counterparts, issued a statement to this effect in mid-May. They recommend that Europe should take a leading role in promoting the idea of free trade. In their view, the EU's agreement with Mercosur should be signed soon. We had already pointed out the opportunities which an EU-Mercosur free-trade agreement would unlock in the previous issue of "Economic Update" (12025). We hereby repeat this advice to policymakers to implement the Mercosur agreement as quickly as possible.

Also in the opinion of Germany's economic experts and their French colleagues, a negotiated solution should be sought with the USA, ideally in the form of complete mutual tariff exemption. In the event of negotiations with Washington not leading to a satisfactory result and of "reciprocal" tariffs being imposed by the USA, Europe must, in the experts' opinion, be prepared for a targeted trade-policy response.

We of the German Savings Banks Association, like the Chief Economists of the Savings Banks Financial Group, would largely agree with these trade-strategy recommendations. Now more than ever, working towards the 'target image of free trade' in a willing majority of the global economy is our concrete recommendation for action to German policymakers – and to the European level responsible for the internal market and thus all trade issues.

Countries like China and Germany will also be severely affected

Our core scenario is predicated on the assumption that Europe (Germany in particular) and China will also be severely affected. This would already be the case with 10 per cent U.S. "baseline" tariffs, and even more so if higher "reciprocal" tariff rates are imposed by Washington. We have accordingly entered a double minus for both Germany and China in the table above. The reason why the negative effect is that strong is that these two countries are very strongly integrated into the global economy and are particularly exposed to the USA as exporters of industrial goods and countries with current-account surpluses. The same applies to a somewhat lesser extent to the Euro Area as a whole.

The United Kingdom has struck a limited "deal"

The United Kingdom of Great Britain and Northern Ireland was the first country to forge a "deal" with the USA in the aftermath of the "Liberation Day" proclamations. The power of symbolism was on the front burner here: the aim of the exercise was to suitably ennoble a close traditional ally of the USA. However, such treatment of the United Kingdom stands in implausible contrast to the treatment meted out to Canada, another very close ally of the USA, which has been roughed up very aggressively at times during recent months. For the UK, which now, post-Brexit, is more vulnerable than it was previously under the protective cloak of the single market, it was certainly important to demonstrate that it is capable at all of reaching trade agreements on its own.

The UK is not primarily known as an aluminum exporter

However, if one takes a closer look at the small print of the US-UK agreement, the deal turns out to be by no means as favourable and free-trade-oriented as when marketed by both sides in the political shop window. All that has been negotiated, in fact, are a number of exemptions for certain goods, including steel and aluminium. What this Anglo-American scheme involves is a kind of reversal of the burden of proof: it is not individual goods that are to be subject to customs duties which are in the list, but rather the exemptions. The “Liberation Day” baseline tariff rate of ten per cent remains in force, it should be noted. And that is the decisive burden from the British perspective: after all, the UK is not primarily known as an exporter of aluminium.

The “Third Countries” group will be affected in individual ways – but as a group they are certainly going to be burdened rather than boosted

The degree to which the tariffs will take a toll on the other trading partners of the USA, the “Third Countries” in our taxonomy, can only be summarised to a limited extent. This will depend very much on the individual constellations involved. There may be special situations in which individual countries actually benefit. Some economies whose currencies are linked to the US dollar could also profit from dollar depreciation. On balance and in total, however, negative effects are likely to predominate. Given, however, that most countries do not, on average, have such strong export ties with the USA as China or Germany, for example, we have assigned just a single minus to the “Third Countries” group in the table on page 3.

Price effects are only clear for the USA, but uncertain for existing trade partners

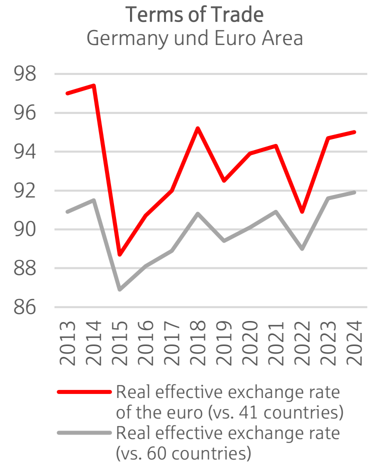
Let us turn now to the price effects liable to derive from the introduction of Trump’s tariffs. The impact direction of these is only really clear in the case of the USA itself. In the United States, they will clearly ramp up the price level. There will at least be a one-off upward level effect. The extent to which inflation is ratcheted higher on a long-term basis will also hinge on how other aspects of economic policy are handled. If, for example, U.S. monetary policymakers come under political pressure to cushion the situation with an excessively loose interest-rate policy, that could result in a lasting and recurrent inflationary stimulus. And it is a fact that we have been seeing signs of attempts by the Trump administration to exert political influence on the Federal Reserve.

Price effect for other countries will depend on the trade-policy response and on exchange-rate reactions

A long-term effect of the USA decoupling from global markets by imposing import tariffs will be a structural reduction in the international division of labour, with corresponding costs in the form of lower productivity. This too could have the effect of pushing, and holding, prices higher in the long term.

Regarding other countries, however, the impact on the general price level is very difficult to estimate, and the impact direction is indeed not even clear in the "qualitative" approach pursued here. The price effect will also depend on many other factors, particularly exchange-rate developments, but also on conceivable rerouting effects with respect to the flow of goods in world trade.

One concern currently doing the rounds in Europe is that Chinese goods now effectively locked out of the USA will end up, rerouted, on the European market. This is not unlikely given the high production capacities prevailing in many industries in China – high production capacities which must presumably now be categorised as overcapacities if sales potential has vanished on the U.S. market. Offered at marginal cost, such overcapacities could lead to certain distortions on European markets. From the Chinese point of view, however, this would certainly correspond to a calculated economic strategy, which it would be wrong to confuse with artificial subsidies – a reproach which is sometimes levelled against China's trade policy.



Source: Deutsche Bundesbank

Even though such an additional influx of Chinese goods would certainly not be to the benefit of European producers offering import competition, such a development would probably have to be tolerated in line with the "rest of the world" free-trade strategy recommended above to the Europeans. European consumers would certainly benefit in price terms. Europe's terms of trade would definitely improve further. Moreover, such a development would coincide with a terms-of-trade constellation that has already been benefiting from a positive tailwind in recent years. By virtue of the normalisation of energy prices, the terms of trade (i.e. real exchange ratios) for both Germany and the wider Euro Area have very largely recovered in 2023 and 2024 following the price shock provoked by the outbreak of the war in Ukraine.

Exchange-rate effects are unclear ex ante – yet empirical evidence would suggest a vote of no confidence in the US dollar

A significant portion of the price effect of tariffs on third markets also depends on exchange-rate reactions. In theory – viewed purely mechanistically and in isolation – a U.S. tariff leads to dollar appreciation. In the event of lower net import prices, which effectively flow to the supplier country concerned after customs duties have been skimmed off, due to the reduction in demand and (depending on the respective degree of elasticity) reduced delivery volumes, less foreign currency would be required to settle the import bill. At the same time, ceteris paribus, U.S. export revenues would be unaffected if the other countries involved did not launch retaliatory measures. The supply and demand relations on the foreign-exchange market, to the extent that they were derived from the trade flows concerned, would then cause the dollar to gain ground.

But there is a not unimportant marginal note here: once a new equilibrium had been attained, precisely such dollar appreciation would take the U.S. current-account balance back down to its old deficit level, assuming that capital flows did not change. In other words, President Trump's declared goal of balancing the U.S.

current account would therefore not be achieved – on the contrary – by applying such tariffs!

A weaker dollar is, to some extent, desired by the U.S. administration …

For this reason, U.S. president Trump may indeed have an interest in a weaker external value for the dollar. And it is a fact that we have recently witnessed a bout of dollar depreciation. The reason for this is, of course, the capital-account transactions which need to be included in the equation. For years now, capital-account volumes have been dominating the volumes traded on forex markets. The USA requires considerable capital inflows if it is to finance its persistent current-account deficit. These flows are decisively triggered by the USA's high fiscal budget deficit. It is not without reason that the interest-rate level in the USA is higher than in other advanced economies (classical examples here being Germany, Japan or Switzerland) as an incentive to lure such capital inflows. At the same time, Trump complains about the higher interest rates to be paid on U.S. Treasuries as being an "unfair" disadvantage for the United States, where the USA is, after all, making available important anchor assets for global financial markets in the form of the dollar and U.S. Treasury bonds.

It is true that these assets do play such a role. They can only continue to do so, however, if confidence in the U.S. dollar and the quality of the assets concerned is retained. And Trump's tariffs are doing a disservice on this front.

…but such dollar depreciation would be extremely dangerous,

even threatening to spark a global currency crisis

In the aftermath of Trump's early April "Liberation Day", it was not only equity markets – especially in the USA itself – which slumped. The dollar also lost significant traction on currency markets. Since the early spring, the dollar-euro currency pair has lost altitude from a level of 1.05 USD/EUR to as low as 1.15 USD/EUR. So Trump has achieved his desired devaluation, but at what cost! It is a dangerous game of brinkmanship, playing with fire on the brink of a currency crisis, which could easily widen into a global financial crisis. Even US investment banks are already talking about deglobalisation and de-dollarisation.

It is also a question of playing with fire because the USA's unsustainable public finances are a cause for concern in any case. It is more than unwise to decide on fresh tax cuts when the annual government budget deficit has ballooned to around 7 per cent of GDP. The question how sustainable US public finances are is becoming increasingly urgent. It was therefore appropriate that rating agency Moody's downgraded the USA's sovereign credit rating in mid-May, citing concerns about the nation's towering debt pile.

The markets were so far the most effective brake on Trump's agenda

It was probably on account of the vehement reaction by capital markets to his tariff tantrum that Trump decided to announce the 90-day moratorium on the implementation of his "reciprocal" tariffs. Financial markets subsequently calmed down to some extent. On the exchange-rate side, the pendulum has recently swung back to 1.12 USD/EUR. However, the final vote will be taken when the tariff-suspension period comes to an end. Will a sufficient number of sound negotiated solutions have been achieved by that time? The intermittent stabilisation on financial markets could in fact send the disastrous signal to the Trump administration that it is safe to embark on aggressive ventures as long as the president and his team are prepared to repeatedly row back in the event of strong market reactions.

Some question-marks are inevitable even at the level of qualitative impact assessment

As regards our overall qualitative impact assessment for prices, this means: we don't know! In particular, the unpredictability of exchange-rate trends has an impact on price levels in the “Third Countries” group. We have accordingly entered a few “question marks” denoting an open outcome for price levels in the table on page 3; this applies to Germany and the wider euro area, as well as to China. In the case of the other, smaller “Third ‘Countries”, on the other hand, the effect will probably involve a small plus, i.e. an upward effect on price trends. Most countries are not so strongly shielded by major currencies of their own (Switzerland and Japan are definite exceptions to this rule). Many emerging markets are either officially tied to the U.S. dollar, or else are strongly linked to it in de facto economic terms. These countries are likely to see their inflation rates moving higher in line with the USA, or else to suffer long-term structural damage, again in lockstep with the USA, as a result of the erosion in the international division of labour.

Due to their limited foreign exposure, the Savings Banks are not likely to be directly affected by the trade conflict in the first instance. Reduced global growth and any increased turbulence on the financial markets would of course also affect them. They are also affected by the impact on interest rates and other macroeconomic variables. However, it could even prove to be a relative advantage in the international competition between financial centres if interest rates in the Euro rea can remain significantly more stable and below the dollar level as a result of the structural shifts.

The interest-rate level will be affected both down on the ground in the real economy and via price effects

Multiple arguments imply a higher U.S. interest-rate level

The tariff measures are going to affect the interest-rate level via two channels: in the real economy via the change in capital flows and via capital shortages, and on the monetary-policy front via the price effects that will be triggered. On the latter front, we have already ascertained that the inflationary stimulus will tend to require higher U.S. interest rates. In the real economy, a tariff-related lockout of goods and, ultimately, of capital flows inevitably entails a shortage of capital. The interest-rate level in the USA should therefore prove to be higher in the “new tariff world” than in the era before trade barriers were thrown up. This effect is denoted by a double plus in our central table.

An interest-rate-increasing effect – in a somewhat more attenuated form (simple plus) – will presumably also apply to the majority of “Third Countries”, particularly those whose currencies are more or less firmly pegged to the dollar. In the case of the other major currency areas, China and the Euro Area, however, the interest-rate-effect is still unclear. It is indeed possible that more will be invested in the Euro Area at lower interest rates if capital outflows into the USA are prevented by the policy being operated there. Conversely, adverse interest-rate-increasing effects are also conceivable. What predominates will depend (as in the case of the price effect, and in the same conceptual context) on the way exchange rates move. Since the direction of the exchange-rate trend is theoretically open, as shown, a number of question-marks remain on this score as well.

In contrast, the effect of the newly launched German fiscal packages is clearly going to shift interest rates higher. The effects in the Federal Republic's fiscal policy are the second major topic on which we would like to shed light. In the table on page 3, the relevant entries here are the "blue-effect" signs.

Germany's fiscal programmes will primarily be effective domestically...

The additional expenditure now being envisaged by Berlin in the domains of security and infrastructure is of course primarily necessary, and warranted, for substantive reasons in these two essential government-policy areas. However, given the very large scale of the funds due to be mobilised, these programmes will also inevitably have a considerable effect on demand. This demand-side effect will certainly act as a stimulus for economic activity, but will, to some extent, have an upside impact on prices as well.

A slow investment roll-out is recommended due to currently limited production capacities

In view of the very low intensity of infrastructure and defence spending in Germany in recent years – in recent decades, to be more precise - the existing production capacities in the spheres in question are very limited. For this reason, it would make sense to roll out the new investment programmes slowly. The long duration planned for these programmes will help to provide industry with the long-term planning security it needs to build up the corresponding capacities. If, on the other hand, the spending programmes were to be rushed through and implemented at speed, that would only drive up prices to a disproportionate extent. The Savings Banks are of course ready to support SMEs, for example in the construction industry, in building up their capacity with appropriate financing.

The municipalities and districts belonging to Germany's layer of regional government will inevitably play an important role to ensure effective implementation of the new special funds. After all, the vast majority of German public-sector investment activity takes place at the municipal level. In recent years, the fiscal balances of most of the country's municipalities have deteriorated significantly due to the burden of compulsory consumption-related expenditure, which has squeezed their leeway to invest for the longer term. Our specific political recommendation is to enable structural improvements in the financial situation of the municipalities in the course of utilising the special funds.

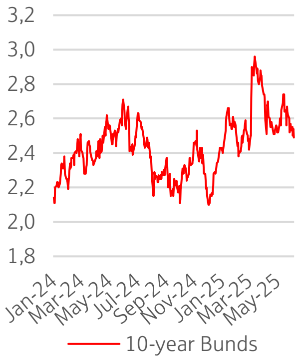
With regard to the time horizon, we are optimistic that policymakers are aware of the constrained capacity constellation, and that a spending path with a well-balanced timeline can be achieved over time. In the table on page 3, this is reflected in the blue double plus we have entered for the effect on German GDP, whereas there is only a single plus for the respective price effect.

By contrast, where a lasting effect of the increase in debt is to be expected in the long term is at the interest-rate level. This can be explained in terms of various transmission channels: higher inflation premiums, higher capital-market risk premiums and a greater shortage of capital in the real economy. In reality, all three of these factors are likely to interact, albeit over different temporal horizons and to varying degrees.

A certain 'crowding out' of private investment is also a likely consequence

An inflation premium could be expected as a temporary effect, especially in the event of the new funds being disbursed very quickly before production capacities have been expanded to a proportionate extent. The risk-premium argument would not seem to have very much traction due to Germany's very solid initial fiscal situation, which makes the surge in debt stemming from the new programmes appear sustainable for the time being. Nevertheless, spreads in the euro area could definitely tighten to some degree if Germany were to no longer live up to its role as a fiscal-policy benchmark and to enjoy quite such a big lead in the fiscal-soundness stakes. The biggest and most durable effect of the new, higher debt burden is likely to be an increased shortage of capital in the real economy. Such a shortfall is simply a function of the sheer scale of the new plans. A figure of one trillion euros cannot be raised without leaving any traces, even if spread over a period of ten years. Such a spending requirement must be offset by a combination of higher savings in other sectors, capital inflows from abroad and/or crowded-out investment by the private sector[3]. In order to minimise crowding out, the efforts of the Savings and Investment Union (SIU) in the EU could help. Helping to mobilise savings and direct them to the most profitable uses within this framework offers savings banks and Landesbanken new opportunities.

Current yield 10year German government bonds



Source: Deutsche Bundesbank

The most important market lever for the balancing of the changed capital contributions and utilisations is the interest rate. When the amendments to the German constitution ("Basic Law") regarding the debt brake and the establishment of the new special funds were passed recently, bond markets reacted immediately, bidding up the yield on ten-year German government bonds from around 2.5 per cent to almost 3.0 per cent. True, this yield updraft was retraced again in a downward direction in the weeks that followed. The downward movement in yields was largely due to the overriding influence of more downbeat economic expectations as a result of the tariff issue and of the resulting fall in energy prices. As a general rule, the "blue" theme of fiscal policy is liable to have an interest-rate-increasing effect in the long term, so we have entered this effect as a double plus in our qualitative table.

[3] At the same time, there are of course legitimate hopes that private-sector investment will be "crowded in," this means stimulated by the growth impetus from the new fiscal packages and from the necessary capacity-widening measures described above. That is indeed a decisive component of the hoped-for multiplier effect. At the same time, a certain counter-effect on other investments via the financing side / the interest-rate channel needs to be factored in.

...but will also have spillover effects on other countries

Germany's fresh fiscal-policy stimuli can be expected to have certain spillover effects on other countries. This applies in particular within the Euro Area. National interest rates are linked to the single currency anyway, meaning that an increase in interest rates can be expected for the currency area as a whole. In terms of monetary policy, the symmetry is complete. On the capital market, however, the "peg effect" is not perfect. On the contrary, as described above, certain convergences in terms of spreads and risk premiums are probably on the cards. We are taking account of this state of affairs by entering a simple plus for interest rates in our central table.

European partners will also benefit from a share of the demand stimulus

However, the Euro Area will also receive a portion of the real economic stimulus. Given Germany's high degree of economic openness and the high degree of interconnectedness within the EMU single market, part of the demand stimulus will undoubtedly work to the advantage of the Federal Republic's partner countries. This is also the reason why Germany's new fiscal schemes are being praised in these quarters. There are also going to be additional spending packages at a pan-European level, for example in the area of joint defence efforts, albeit not on the scale of Germany's epochal fiscal shift. We have therefore entered a single plus for the Euro Area in terms of the GDP effect as well as in terms of the price effect.

When it comes to spending on military equipment, U.S. products probably cannot be completely avoided

The surge in German government spending will probably also engender certain spillover effects benefiting the USA. Even if this is not particularly welcome in the current trade-policy predicament, and even if a certain degree of decoupling and greater independence from the United States is the necessary goal of the new ramp-up in defence spending, it will not be possible to avoid having recourse to American goods in all cases. Especially when it comes to acquiring certain defence competences, it will not be possible to completely avoid sourcing U.S. armaments. We have therefore entered a blue plus for U.S. GDP in the table on page 3.

As regards the rest of the world, including China, on the other hand, the new German spending stimuli will be largely dispersed and dissipated. Accordingly, the multiplier effects of these stimuli will only be felt to a negligible extent in more distant global regions.

The overall effect of the two major issues for Germany is going to be a favourably balanced one

If we draw an overall conclusion from the two major issues, tariffs and fiscal packages, as represented in the table above – plotting red against blue, as it were – the net result for Germany looks decidedly favourable. The negative demand shock from the foreign-trade channel and the positive demand stimulus deriving from additional government spending will counteract each other.

The structural match is not going to be perfect

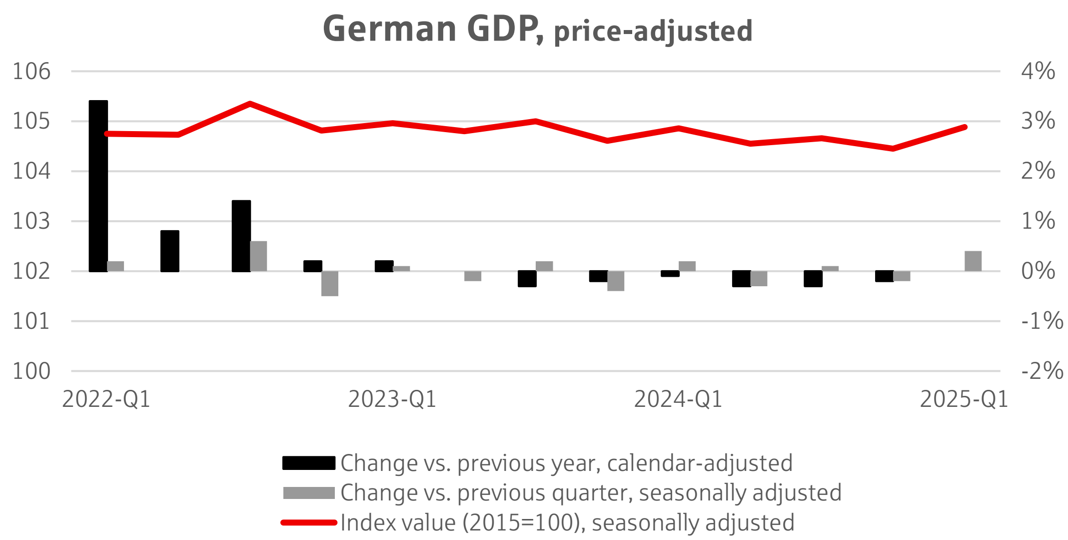
This does not, of course, mean that the countervailing stimuli are going to prove a perfect match in terms of the timeline, as well as in terms of goods structure and sectoral structure. A drastic illustration of this principle: cars and chemical products that can no longer be exported to the USA due to Trump's tariffs will not automatically and quickly transform themselves into defence goods or infrastructure in Germany.

Neither are we expecting a significant proportion of the additional expenditure to already become effective in 2025. Planning and ordering take time. It will take even longer for actual production to kick in and be reflected in the "value added" metric. This problem is going to be compounded by the fact that Germany's 2025 federal budget will probably only be able to be elaborated and approved retrospectively in the second half of this year due to the recent change of government.

Current GDP – Forecasts	2025	2026
German Council of Economic Experts (05/25)	0.0%	1.0%
EU Commission (05/25)	0.0%	1.1%
Spring Report (GD) (04/25)	0.1%	1.3%
IMF, World Economic Outlook (04/25)	0.0%	0.9%
OECD (03/25)	0.4%	1.1%

Most current forecasts therefore assume that a GDP growth rate of only around zero will be logged in 2025. That would see the Germany economy mired in stagnation for the third consecutive year.

The first quarter of 2025 got off to a good start. Germany's Gross Domestic Product rose by 0.4 per cent quarter-on-quarter in price-adjusted and seasonally-adjusted terms. This uptick in macroeconomic growth was crucially driven by a recovery in consumption and investment. Aggregate economic output was still below the level of the first quarter of the previous year if only adjusted for prices; if additionally adjusted for calendar effects, GDP did however claw its way back up to the previous-year level.



Source: Destatis

On the other hand, GDP benefited considerably in the first quarter from pull-forward effects before Trump could erect his tariff walls. Some U.S. importers were attempting to source German goods without the tariff surcharge. This can be gauged from the sharp 3.2 per cent increase in exports. Pharmaceutical products and vehicles, in particular, were delivered at an accelerated rate. Accordingly, such brought-forward demand may well no longer be available in the second quarter or – in the wake of the temporary 90-day tariff suspension – in the third quarter. That said, some of the brought-forward exports appear to be drawdowns from German inventories; in that case, they would merely be a transitory item for GDP which would need to be stripped out of the equation.

German GDP components in Q1/2025, percentage changes

Price-adjusted in %	Year-over-year	Quarter-over-quarter[1)]
Private consumption	+0.5	+0.5
Government consumption	+2.6	–0.3
Construction investment	–1.0	+0.5
Investment in machinery and equipment	–3.8	+0.7
Exports	–1.1	+3.2
Imports	+2.5	+1.1

[1)] Note: These figures have been adjusted for seasonal and calendar effects
Source: Destatis

A high-quality economic policy is definitely more important than just more money

The German economy is only expected to work up significantly more momentum in 2026, when the new rush of fiscal spending will come into play. According to most forecasts, positive GDP growth rates of one per cent or more will therefore be within the realms of possibility next year. The SME customers of the Sparkassen and Landesbanken would also benefit considerably from such growth momentum, at least to some extent.

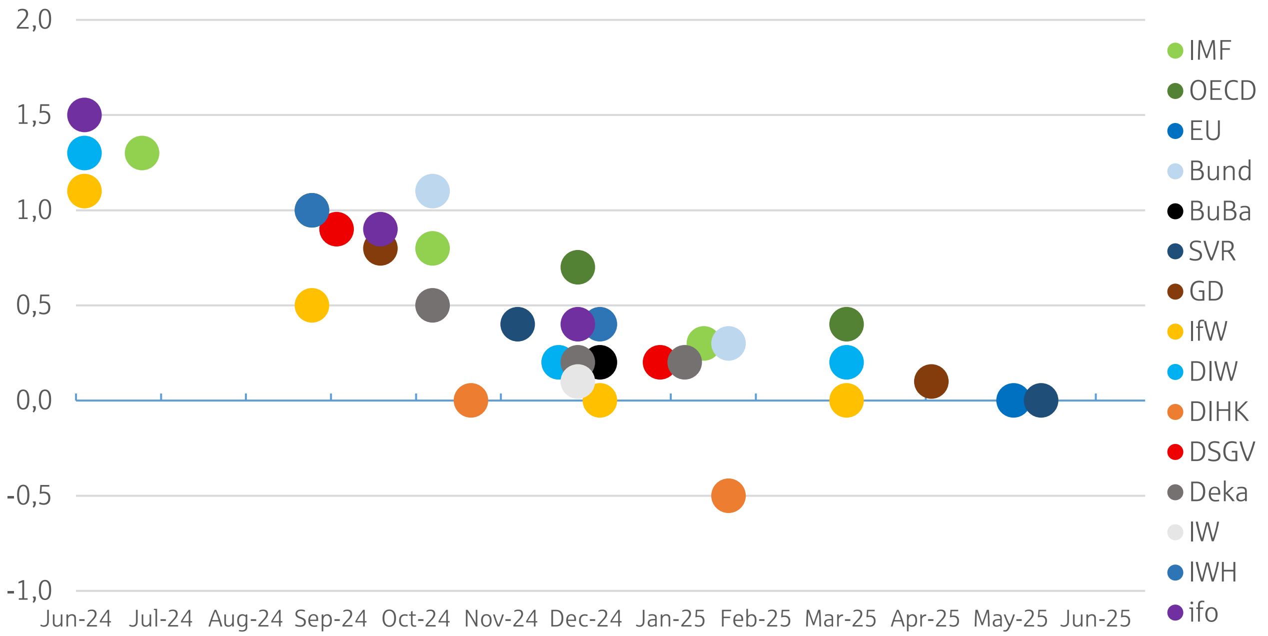
Hovering over such projections, however, is a Damocles sword, which will come crashing destructively down if the trade dispute escalates even further. And, of course, it is not enough for economic policymakers to focus solely on higher spending. Even more important in the new legislative period are growth-friendly structural reforms and the provision of planning security for investors. However, the fast-track measures announced by the new German government for the upcoming summer include some elements that are not clearly growth-friendly. This is our specific advice for German economic policy: to prioritise strengthening competitiveness even more clearly. In the medium term, this should also be achieved with major approaches such as a fundamental tax reform, further mobilisation of the labour market through deregulation and the ongoing task of reducing bureaucracy.

A. Growth of world economic regions, change on previous year

	2023	2024	2025*	2026*
World trade volume	0.7%	3.8%	1.6%	2.5%
GDP – world	3.3%	3.3%	2.8%	3.0%
USA	2.5%	2.8%	1.8%	1.7%
Japan	1.9%	0.1%	0.6%	0.6%
China	5.2%	5.0%	4.0%	4.0%
Euro area	0.4%	0.9%	0.8%	1.2%
Germany	–0.3%	–0.2%	0.0%	0.9%

* **April 2025 forecasts by the International Monetary Fund.**

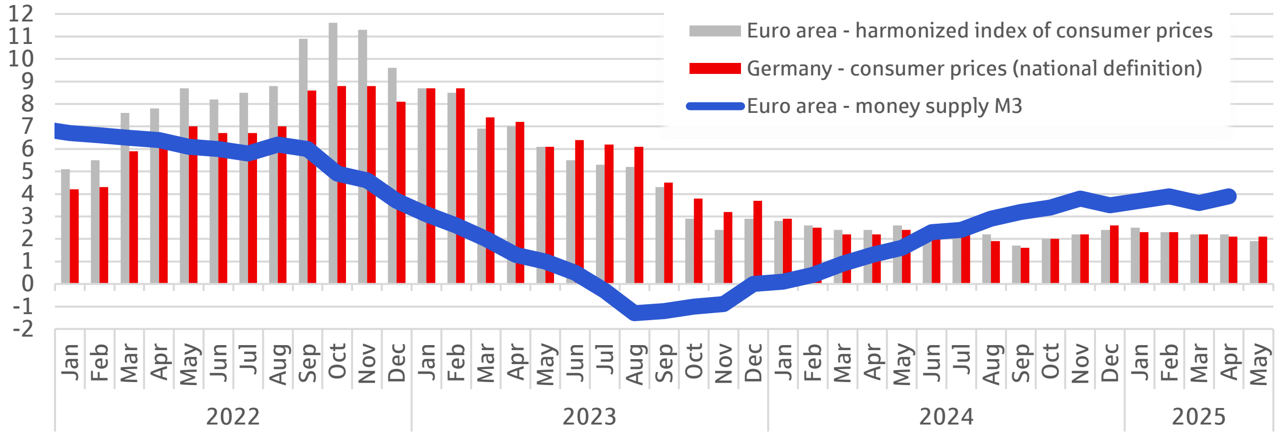
B. Economic growth forecasts for Germany for whole-year 2025, in %



C. GDP in Germany and the Euro Area

	2024 real year-on-year	Q II - 2024	Q III - 2024	Q IV - 2024	Q I - 2025
		real change compared to the same quarter of the previous year and seasonally-adjusted real change vs. the previous quarter			
Euro area GDP	+0.9%	+0.5% +0.2%	+1.0% +0.4%	+1.2% +0.2%	+1.2% +0.3%
Germany GDP	–0.2%	–0.3% –0.3%	–0.3% +0.1%	–0.2% –0.2%	+0.0% +0.4%
Private consumption	0.3%	–0.3% +0.1%	+0.2% +0.3%	+0.4% +0.2%	+0.5% +0.5%
Gross capital investment	–2.7%	–2.5% –1.8%	–2.4% –0.4%	–2.5% +0.5%	-1.0% +0.9%
Exports	–1.1%	+1.2% +1.8%	–0.7% –2.6%	–4.7% –3.1%	–1.1% +3.2%
		Level, not rate of change; quarterly figures, seasonally-adjusted			
Savings rate	11.6%	11.4%	11.7%	11.3%	10.4%

D. Consumer prices and money supply M3, annual rates of change in %



E. Monthly economic indicators Germany

	February	March	April	May	June
Prices (national definition)	Change compared to the same month of the previous year				
Consumer prices	2.3%	2.2%	2.1%	2.1%	–
– excluding food and energy (core inflation)	3.1%	2.8%	3.1%	2.7%	–
Producer prices for industrial products	0.7%	–0.2%	–0.9%	–	–
Import prices	3.6%	2.1%	–0.4%	–	–
Sentiment indicators					
ifo Business Climate Index	85.3	86.7	86.9	87.5	–
ZEW Economic Sentiment Survey	26.0	51.6	–14.0	25.2	–
Incoming orders	Change compared to the same month of the previous year				
Manufacturing industry	–2.2%	5.5%	–	–	–
from within Germany	–3.1%	5.7%	–	–	–
from abroad	–1.4%	5.5%	–	–	–
Capital-goods producers	–0.8%	6.6%	–	–	–
Production	Working-day-adjusted change compared to the same month of the previous year				
Overall manufacturing industry	–4.1%	–0.2%	–	–	–
thereof: construction	–7.3%	–2.9%	–	–	–
thereof: industry	–4.0%	0.3%	–	–	–
Foreign trade	Change compared to the same month of the previous year				
Exports	–1.6%	4.4%	–	–	–
Imports	3.0%	3.9%	–	–	–
Labour market	Unemployment rate, change in the jobless total compared to the same month of the previous year (1,000s)				
Unemployment rate (seasonally-adjusted)	6.4%	6.4%	6.3%	6.2%	–
Jobless total	+175	+198	+182	+197	–
Employed persons (with a place of work in Germany)	–57	–53	–61	–	–
Employees subject to social-security contributions	+67	+78	–	–	–

F. Commodity. foreign-exchange and financial markets

	February	March	April	May	June 3.
Brent oil price in USD	75.44	72.73	68.13	62.78	65.81
Exchange rates					
US dollar / EUR	1.0413	1.0807	1.1214	1.1339	1.1386
Japanese yen / EUR	158.09	161.17	161.67	162.96	163.00
Equity markets					
DAX German benchmark share index, end-of-month	22,551	22,163	22,497	23,997	24,091
Change compared to the same month of the previous year	+27.6%	+19.9%	+25.5%	+29.7%	+29.5%
Money-market and capital-market rates					
Call money (€STR)	2.691%	2.499%	2.341%	2.169%	2.172%
Current yield of German government bonds with a residual maturity					
- of one year	2.07%	2.01%	1.75%	1.78%	1.79%
- of ten years	2.42%	2.75%	2.52%	2.59%	2.56%
Interest rates of credit institutions, in new business					
Daily deposits of private households in D;	0.52%	0.52%	–	–	–
for comparison across the euro area as a whole	0.32%	0.31%	–	–	–
Deposits of private households up to 1 year in D;	2.20%	2.11%	–	–	–
for comparison across the euro area as a whole	2.19%	2.09%	–	–	–
Corporate loans of up to € 1 million over 5 years in D;	3.81%	3.81%	–	–	–
for comparison across the euro area as a whole	3.80%	3.77%	–	–	–

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