

GERMANY

10

A WEAKER RECOVERY, BUT ONE THAT IS STILL EXPECTED TO TAKE HOLD

After two years of recession, German growth began to recover in 2025. We expect it to strengthen in 2026, driven by the ramp-up of investment plans. We are, however, revising our forecasts downwards, as the German economy remains vulnerable to the current shock to energy prices (+0.8% in 2026 [-0.6pp] and +1.1% in 2027 [-0.4pp]). This will weigh on private consumption due to the impact of rising inflation (3.2% in 2026 [+1.6pp] et +3.5% in 2027 [+1.2pp]) on the purchasing power of wages. The fiscal trajectory, meanwhile, is expected to remain broadly unchanged. Public debt is set to continue rising towards 70% of GDP by 2030, which, in the current context, would maintain upward pressure on long-term interest rates.

GROWTH SET TO HOLD UP BETTER THAN IN 2022

After two years of contraction (-0.7% in 2023 and -0.5% in 2024), German growth returned to positive territory in 2025 (+0.4%), despite the US tariff shock. It was mainly driven by private consumption and public spending. Foreign trade weighed on economic activity, but for relatively favourable reasons: nearly two-thirds of the rise in imports came from capital goods, foreshadowing the ramp-up in public investment expected in 2026.

At the same time, investment made no contribution to growth in 2025, as the decline in the private sector was offset by the increase in the public sector. However, it has been rebounding since Q3 and is expected to accelerate further in 2026. It will be supported by public investment plans and tax incentives. The increase in new industrial orders observed at the end of 2025 serves as an additional indicator of an impending acceleration in investment (see our analysis). In our view, the conflict in the Middle East will not undermine this favourable momentum. The prolonged nature of public investment plans and their rapid implementation at the start of the year suggest ongoing support for growth: between January and February, investment spending (excluding SVIK¹) more than doubled compared with the same period last year (see Chart 2), defence spending rose by 38%, and SVIK disbursements have already reached 1/4 of the 2026 target.

Conversely, the situation for Germany's industrial sector, which is particularly energy-intensive, is more challenging, as this shock compounds the issues faced in 2022, the rise in US tariffs and growing Chinese competition. At this stage, business surveys suggest these risks should be put into perspective: although companies are reporting sharp rises in input costs, the deterioration observed remains less severe than in 2022.

Household consumption, on the other hand, will be significantly affected by the ongoing rise in energy prices. The expected resurgence in inflation will weigh on their spending intentions, even as wages have caught up with inflation in 2022-2023 to a lesser extent than elsewhere in Europe (see Chart 3). The risk is that this will lead, as it did previously, in a sharper rise in the savings rate than in France, Italy or Spain.

THE PROSPECT OF WAGE PRESSURES IS RECEDING

The German labour market remains historically strong. The unemployment rate increased from a low of 3% to 4% and stabilised at that level between December 2025 and March 2026, while remaining low compared with the eurozone average (6.2% in February across the eurozone). This rise in unemployment is due to job losses in the manufacturing sector, despite ongoing job creation in the services sector. Job losses are expected to continue in sectors that are already in difficulty, which are also the most exposed to the energy shock.

¹ Investment spending takes into account only spending from the main budget (excluding SVIK, the EUR 500 billion infrastructure fund).

Growth and inflation

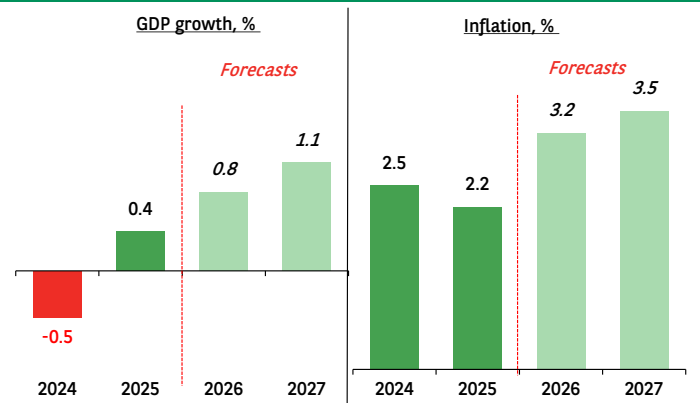


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

Investment spending (without SVIK) have more than doubled compared to the same period last year

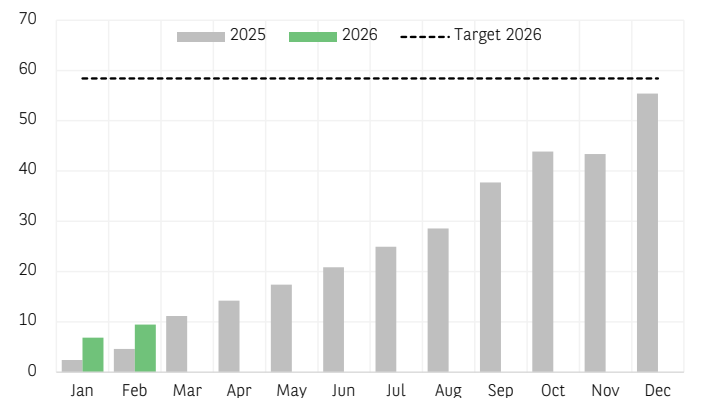


CHART 2

SOURCE: BUNDESFINANZMINISTERIUM, BNP PARIBAS

At the same time, the demand for labour has stabilised at a low level, and the tightness in the labour market continues to ease in both industry and services. Only construction remains an exception, although recruitment difficulties are easing there.

Against this backdrop, the gradual rise in employment linked to investment plans in defence and infrastructure is not expected to generate significant wage pressures. The redeployment of production capacity


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freed up by sectors in difficulty, and in particular their workforce, will in fact help to meet some of the needs of businesses. Furthermore, the prospect of wage growth once again falling short of inflation should mitigate the impact on profit margins of a likely rise in input costs.

INFLATION CONSISTENTLY ABOVE 2% COMPARED WITH THE REST OF THE EUROZONE

Inflation picked up again in March (+0.8 pp to 2.8% y/y), while the core component remained stable (2.5%). This rise is attributable to energy prices (+7.2% y/y). In the coming months, German inflation is expected to remain higher than that of the eurozone (2.5% y/y in March).

The high sensitivity of German electricity prices to fluctuations in gas prices suggests a sharper rise in inflation, which is likely to feed through to core inflation. Having accumulated nearly 5 percentage points of additional inflation compared with France and Italy since the onset of the inflationary crisis in 2022, this gap could widen further. This would pose a challenge to German competitiveness, which has already been in decline for nearly 10 years ([see our analysis](#)). Consequently, inflation is expected to remain above 2% at least until the end of 2027, a level below which it has not fallen since 2021.

In Germany, more than in other countries, this inflationary trend has significantly impacted real wages, which remain around 11 percentage points below their levels prior to the post-Covid inflationary crisis. The minimum wage increases planned for 2026 and 2027 (+8% and then +5%, to EUR14.60/hour) will have a direct impact on low-wage earners. However, their influence across the entire wage spectrum is likely to be limited. This situation is adversely affecting household confidence and consumption.

A FISCAL TRAJECTORY LARGELY UNCHANGED AT THIS STAGE

The current context does not call into question our assessment of a controlled increase in public spending. This is based on the budgetary reform initiated by the government in 2025, which includes a multi-year plan that derogates from the debt brake to finance investments in infrastructure and defence, while maintaining a constrained federal budget outside these sectors. Consequently, an initial rise in the public debt ratio was observed in 2025, to 63.5% of GDP (up from 62.2% in 2024).

At this stage, the budgetary cost of the measures adopted by the government in response to rising energy prices remains moderate (EUR 1.6 billion). These measures are centred on capping fuel prices and reducing the tax on petrol by EUR 0,17 / litre for a period of two months. In addition, a one-off, tax-free support payment of EUR 1,000 may be paid to employees. Further measures could be introduced if the conflict drags on and energy prices remain high. However, the scale of these measures is expected to be smaller than that seen in 2022, as there is less fiscal room for manoeuvre. Any additional measures or any deterioration in the deficit linked to a slowdown in growth will need to be offset in order to comply with the debt brake rule. Consequently, our public debt scenario remains broadly unchanged from our autumn forecast ([see our analysis](#)).

At the same time, financing requirements linked to extra-budgetary funds are likely to continue to exert upward pressure on sovereign yields. The yield on the 10-year Bund crossed the 3% threshold at the end of March, amid inflationary pressures and expectations of increased fiscal support. However, the effective interest rate on debt remains low (due to the prolonged period of negative long-term rates) and the debt burden (1.1% of GDP in 2025) is expected to increase only gradually, reaching 1.7% in 2030.

German wages have recovered less than in other countries to their pre-Covid inflationary crisis levels

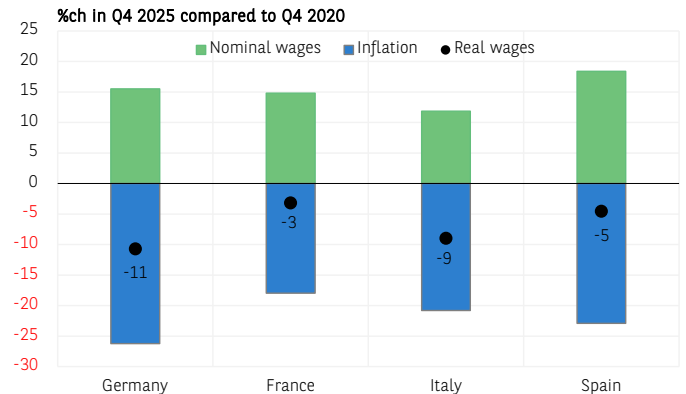


CHART 3

SOURCE: EUROSTAT, NATIONAL STATISTICS, BNP PARIBAS

Furthermore, structural reforms are ongoing, particularly those aimed at bolstering business investment, reforming tax and social protection systems, and expanding the labour supply. Fiscal measures are already in place (accelerated depreciation of business investment until 2027, to be followed by a reduction in corporation tax from 2028), supplemented by administrative simplifications for businesses, which will lead to an overhaul of the tax system effective from 1 January 2027. Finally, proposals for social security reform (pensions) have been put forward and will be finalised by the end of 2026.

A REBALANCING OF FOREIGN TRADE IS UNDERWAY

Exports continue to account for a significant share of the German economy (41% of GDP in 2025), significantly higher than the levels seen in the rest of the eurozone (nearly 30% in France, Italy and Spain). Although exports have not contributed to growth since 2023, they stabilised in 2025. This stabilisation is due to a geographical shift in trade patterns, with exports to the eurozone increasing (+4.1% y/y in 2025), compensating for the decline in markets outside Europe (notably China and the United States).

Beyond this geographical reallocation, a rebalancing of intra-European trade is underway. This shift is prompted by a reversal in competitiveness trends, characterised by a faster rise in labour costs in Germany than in other European countries over the past decade, in contrast to the previous period. As a result, Germany's trade surpluses with other European countries are gradually diminishing, as these countries increasingly benefit from German demand. This trend is reinforced by German investment plans and the intention to establish a European supply base as part of rearmament policies. It is evident in the rise of German imports and a reduction in bilateral surpluses, particularly with France. Therefore, German demand is fostering growth in other European countries, a recent development that is set to continue.

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