

PRESS RELEASE

The need for resolute modernisation: Closing investment gaps, advancing digital innovation in the financial sector

- The German economy continues to stagnate: growth remains persistently weak, pointing at both cyclical and structural headwinds.
- German real GDP is expected to decrease by 0.1 % in 2024 and increase by 0.4 % in 2025. Inflation is declining significantly; the inflation rate is expected to be 2.2 % this year and 2.1 % next year.
- For years, public spending has failed to prioritise investment and other future-oriented expenditures. To ensure future-oriented spending, institutional provisions have to be enacted, such as a transport infrastructure fund and minimum quotas for education and defence spending.
- Germany is lagging behind in the area of digital finance and, as a result, is missing out on opportunities for innovation and efficiency gains. The digital euro can offer a cost-effective, secure alternative for digital payments that is independent of non-European payment service providers and increases competition.
- To remedy the lack of housing in urban areas and improve access to social housing, housing supply should be increased, the stock of existing housing should be utilised more efficiently, and social housing policy should become more targeted.

Wiesbaden, 13.11.2024 – Germany's real gross domestic product has grown by only 0.1 per cent over the past five years. Germany's economy thus continues to lag behind internationally. “The weakness of manufacturing and persistently weak economic growth suggest that the German economy is held back by both structural and cyclical headwinds,” explains Monika Schnitzer, chair of the German Council of Economic Experts (GCEE). “In Germany, there have been shortfalls in politics as well as in business in recent years and decades. Now is the moment to resolutely push ahead with the modernisation of our country.” In its Annual Report 2024/25, the GCEE discusses how to achieve this goal and, in particular, how to credibly commit public funding to future-oriented spending, how to advance the digitalisation of the financial sector, and how to overcome shortages in the housing market.

The GCEE expects the German economy to stagnate in 2024 and recover only slightly over the course of 2025. Both production and gross value added in the manufacturing sector have declined this year. Investments are also declining. Moreover, the recovery of the global economy is not having the same positive effect on exports as in the past. Despite significant real wage growth in 2023 and 2024, private consumption has not increased much. The GCEE therefore expects Germany's real gross domestic product (GDP) to fall by 0.1 per cent in 2024. In 2025, private consumption expenditures will continue to grow only slightly due to pessimistic expectations about economic developments and a slowdown in real wage increases. GDP is likely to grow only by 0.4 per cent next year. “German economic output in 2025 is expected to be at a similar level as before the COVID-19 crisis. Economic

development in Germany is significantly weaker than in other advanced economies,” explains council member Martin Werding. In the US, GDP is instead more than twelve per cent above the pre-COVID-19 level, and in the euro area it is more than four per cent higher.

Consumer price inflation fell significantly and is approaching the ECB's target. The inflation rate is expected to average 2.2 per cent in 2024 and 2.1 per cent in 2025.

Increase commitment to future-oriented public spending

The political process tends not to sufficiently prioritise investment and other future-oriented public spending, which has therefore been low in Germany for years. These failures are particularly evident in spending on transport infrastructure, defence and education, which are all areas of investment where benefits mainly accrue in the future. Politicians tend to postpone such future-oriented spending in favour of present-oriented spending that benefits the current electorate. Institutional provisions are necessary to ensure sufficient commitment for future-oriented spending. In its Annual Report, the GCEE systematically discusses possible instruments that credibly commit public funds towards future-oriented spending.

Institutional provisions must be tailored to the respective area of investment. “A suitable instrument to maintain, modernise and expand the federal road and rail network is a transport infrastructure fund with its own permanent sources of revenue - such as toll revenues - transferred from the federal budget,” says council member Achim Truger. The backlog of investments necessary for transport infrastructure could be funded via credit lines limited by a reformed debt brake. In the areas of defence and education spending, minimum spending quotas could be suitable instruments. The quota for defence could be NATO's two per cent target. The quota for education could be based on minimum spending per pupil. Education spending quotas should be defined at the level of the federal states, as they bear the costs of education.

Allowing digital change in the financial sector

The digitalisation of the German financial sector is also lagging behind. Within Europe, Germany is only in the lower midfield in this respect and is therefore wasting potential for innovation and efficiency improvements. “Digital innovation is primarily driven by new financial market players such as FinTechs and BigTechs,” explains council member Ulrike Malmendier. Digitalisation promises lower costs through more efficient services. Drivers include the automation of business processes, better utilisation of digital data and more intense competition, which reduces the market power of incumbents. At the same time, new products will improve the convenience of financial services.

“The central challenge for policy makers is to enable digital innovation in the financial sector without jeopardising financial stability,” adds Ulrike Malmendier. Regulatory sandboxes for new products and business models should be set up, for FinTechs in particular. To strengthen competition, the exchange of financial customer information between financial services firms at customer's request should be simplified. The planned digital euro could offer a cost-effective and secure alternative to credit cards and internet payment methods. This could promote cross-border payments in Europe and strengthen

independence from non-European providers. The ECB is particularly credible when it comes to data protection as it has no commercial interest in utilising payment data.

Eliminate shortages in the housing market, remove barriers to moving, facilitate access to housing

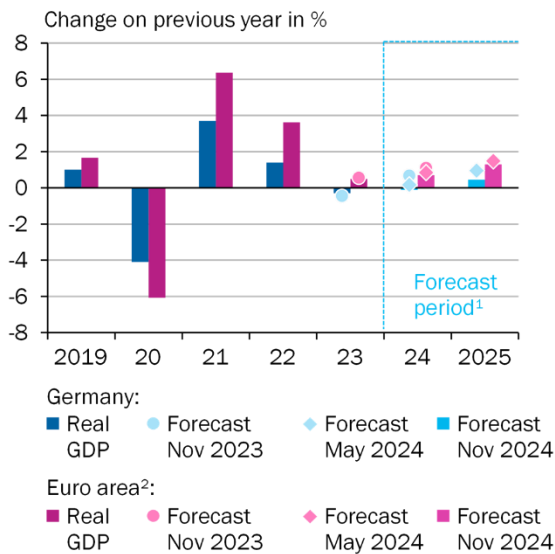
German house and rental prices have risen sharply over the past 15 years. Demand for housing has also risen sharply, particularly in urban areas and economically strong rural regions, but too few additional homes have been built in these areas. The shortage of housing is not only a social, but also an economic problem because it inhibits the influx of labour into productive regions. “To increase residential construction, we need to increase the availability of building plots, increase incentives for the construction of housing, and reduce construction costs by means of harmonising building regulations,” explains council member Veronika Grimm.

The gap between rents for new rental contracts and for existing rental contracts has widened significantly, and it is particularly large in urban areas. This reduces the financial incentives to move. Hence, caps on rent increases should no longer be set at lower levels in tight housing markets. In general, restrictive rent regulation should apply only temporarily and must be accompanied by measures to expand housing supply. In order to strengthen the incentives to increase the housing supply, the rent brake on new rents should not be extended beyond 2028.

Low-income households should be supported in gaining access to the housing market through policies tied to the beneficiary (subject-oriented policies) such as housing benefits. Furthermore, policies tied to housing and construction (object-oriented policies) such as social housing projects ensure that also those groups of people who are disadvantaged on the regular housing market regardless of their income situation gain better access to suitable housing. However, social housing subsidies should become more targeted and misallocations should be reduced through misoccupancy levies. This would allow subject- and object-oriented policies to complement each other.

Economic outlook for Germany and Europe

GDP in Germany and the euro area



Key economic indicators (in %)

	2023	2024 ¹	2025 ¹
Germany			
GDP growth ³	- 0.3	- 0.1	0.4
Inflation rate	5.9	2.2	2.1
Unemployment rate ⁴	5.7	6.0	6.1
Wage growth ⁵	6.6	5.2	3.5
Budget balance ⁶	- 2.6	- 2.1	- 1.9
Euro area			
GDP growth ^{2,3}	0.5	0.7	1.3
Inflation rate ⁷	5.4	2.4	2.1
Global economy			
GDP growth ^{2,3}	2.8	2.6	2.6
Inflation rate	5.3	4.6	3.0

1 – Forecast by the GCEE. 2 – Values are based on seasonal and calendar-adjusted quarterly figures. 3 – Constant prices. 4 – Registered unemployed in relation to civil labour force. 5 – Change of gross wages and salaries (domestic concept) per employees' hour worked. 6 – In relation to nominal GDP; territorial authorities and social security according to national accounts. 7 – Change of the Harmonised Index of Consumer Prices.

Sources: Eurostat, Federal Statistical Office, national statistical offices, own calculations

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The German Council of Economic Experts (GCEE) provides support to policymakers and the general public on questions and matters of economic policy. It was founded as an independent body in 1963 and currently consists of the council members: Professor Dr. Veronika Grimm, Prof. Dr. mult. Dr. h.c. Ulrike Malmendier, Professor Dr. Dr. h.c. Monika Schnitzer (chair), Professor Dr. Achim Truger, Professor Dr. Martin Werding. By publishing regular reports, the GCEE aims to help the general public and decision-makers in politics, business and society to form a reasoned opinion on economic policy developments in Germany.

Further information on the German Council of Economic Experts and its publications are available at <http://www.sachverstaendigenrat-wirtschaft.de/en>.

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