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Germany's brakes on growth: the full picture

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In Brief:

- Germany's economic weakness is the expression of fundamental structural changes.
- External influences such as deglobalization, but also a variety of homemade issues, impose a burden on the economy.
- While Germany can only mitigate exogenous factors, it must quickly tackle shortcomings such as excessive bureaucracy or the considerable investment backlog in infrastructure and education.
- Deglobalization is currently the biggest challenge for the German economy. Going forward, adverse demographics will increasingly undermine economic prospects.
- The race to catch up will be long and take more than the duration of one parliament.

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Introduction

"Is Germany the sick man of Europe again?" At the latest since this headline in the British Economist in August 2023, word has spread internationally that the German economic situation is not just a temporary phase of weakness. Rather, it is a fundamental problem that will not go away on its own. Some German economists have warned for years about these structural problems, but were largely ignored until the economic crisis worsened.

The fear that Germany is suffering from sustained economic weakness has solidified in the past quarters. The German economy has been hovering around the zero growth line for two years now. There is no shortage of hypotheses as for the reasons: There is a lot of talk about the urgent need to prune back excessive bureaucracy. About the fact that the era of seemingly effortless export growth is over. That the shortage of skilled workers due to the country's demographic decline is beginning to bite and that immigration urgently needs to compensate for the increasing decline in the domestic workforce. And everyone can relate experiences from their daily lives with the country's increasingly dilapidated infrastructure - be it from interrupted mobile phone connections or the perennially delayed trains or a frustrating visit to the residents' registration office. Not to mention the - extensive and costly – investment needs resulting from the transformation of the economy and the occurring disruptive changes.

But although all this is well known, Germany is apparently finding it difficult to escape its economic torpor. What are the reasons for this paralysis? How worrisome is the situation really? Are there battles that can be won quickly and that need to be tackled swiftly? And where do prevailing attitudes in German society perhaps stand in the way of progress? In this study we put the spotlight light on the topic of economic stagnation from various perspectives and put it also in an international comparative context. We aim to steer the public discussion towards a more rational and less political-emotional path, analyzing Germany's economic doldrums through the prism of the macroeconomic production function approach.

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The Growth Problem

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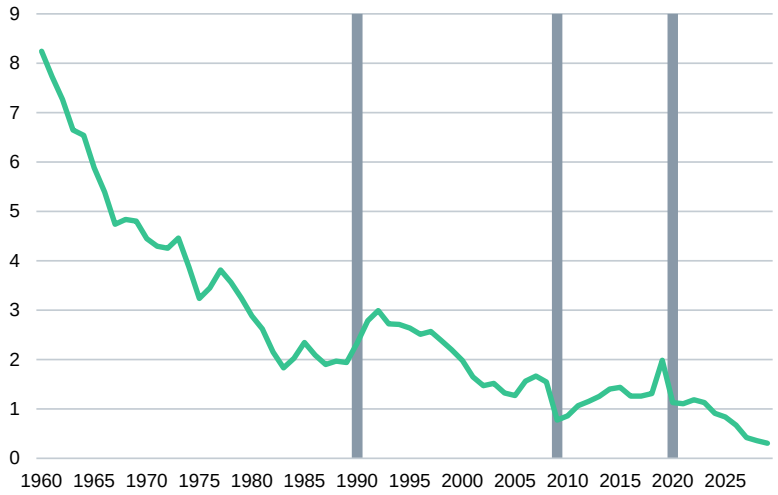
The growth trend hits bottom

The German economy made no headway for two years now. It swings from a quarter with minimal growth to a quarter with a small contraction and back to slight expansion. As a result, we can speak of stagnation at best. This is unusual, as a look at the **historical GDP growth rates** shows, but to a certain extent the flattening trend of recent years continues. German economic growth has lost momentum over the decades, as can be seen at Fig. 1. At the time of the post-war economic miracle, average GDP growth from 1951 to 1960 was still an impressive 8.2 %. Since then, ten-year average growth has gradually declined and most recently dipped below 1 %.

Fig. 1: Growth in gross domestic product Germany
Compared to the previous year (in %), 10-year moving averages



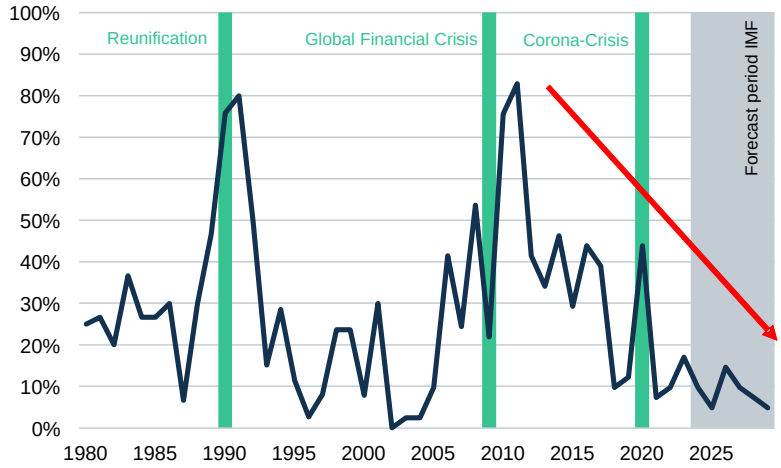
Source: Destatis, LBBW Research, 2024 to 2029 calculated on the basis of forecasts by LBBW Research

Growth comes to a screeching halt

However, the decline in growth rates alone is not enough evidence of a structural growth weakness in Germany. Gross domestic products in **developed economies** are generally no longer growing as strongly as in emerging economies. In addition, massive shocks such as the financial crisis and the pandemic have dampened growth since the turn of the millennium. The question is therefore: How does the German economy compare internationally? To this end, we have analyzed GDP growth rates since 1980. The highly developed economies are a suitable comparison group. The IMF currently classifies 41 countries in this group. Fig. 2 shows the percentage share of countries that perform worse than Germany in the GDP growth rate ranking.

The result shows that Germany's economic momentum is currently weak by international standards. In 2023, only about a fifth of the countries included had lower growth rates. In the past, Germany performed quite well after reunification, the financial crisis and - albeit to a lesser extent – during the Covid-19 pandemic. This shows that Germany has suitable financial resources and instruments - such as short-time working and budgetary leeway - to counter major crises. Still, **since 2011 Germany has been trending downwards in the rankings.** According to IMF forecasts, Germany will rank 39th out of all 41 countries in 2029. Only in Italy and Japan will growth be more sluggish.

Fig. 2: Germany's position in the ranking of GDP growth rates of highly developed economies
Proportion of countries (in %) that perform worse than Germany in the ranking

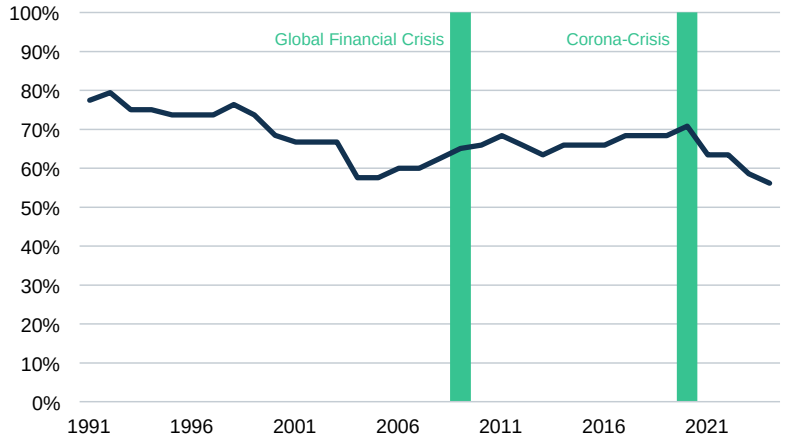


Source: IMF, LBBW Research

Growth falls behind advanced country peers

Even if the growth trend is pointing downwards, the prevailing view in Germany is that we are still one of the **richest countries in the world**. To classify this, we have analyzed the purchasing power-adjusted gross domestic product per capita in comparison to the highly developed economies according to the IMF definition. Fig. 3 shows the percentage of countries with a lower GDP per capita than Germany. It can be seen that Germany was still in the top third of the richest economies at the beginning of the 1990s. Today, however, Germany is only just in the top half of the highly developed economies. In an international comparison, Germany is therefore in a markedly worse position than it was 30 years ago. Since then Germany was surpassed in the rankings by other EU countries such as Ireland, the Netherlands and Sweden.

Fig. 3: Germany's position in the ranking of highly developed economies by GDP per capita (purchasing power parity)
Proportion of countries (in %) that perform worse than Germany in the ranking



Source: IMF, LBBW Research

Downward trend in the ranking

Before we analyze the causes of the current weak growth in Germany, let's take a look back to the past. First, we take a closer look at the **calculation of gross domestic product**. It can be calculated on both the origin and the use side. The economic performance of the individual economic sectors is the focus of the **origin side**. The great importance of the manufacturing industry in the German economy stands out. The share of industry in German GDP was 19 % in 2023 according to the World Bank. In the United Kingdom and France, for example, it

was only 9 % and 10 % respectively. Over the years, however, the importance of industry in Germany has declined. In 1991, their share of gross domestic product was still 25 %. By contrast, the service sector increased its share of gross domestic product from 56 % to 63 % between 1991 and 2023. The importance of the service sector therefore remains higher in other countries such as France (69 %) or the United Kingdom (73 %).

Manufacturing industry is still very important…

Germany's strong industrial base with its key sectors of automotive and mechanical engineering, electrical engineering and chemicals played a decisive role in Germany's economic emergence in the second half of the 20th century. The high-performing medium-sized companies, usually family-owned, made a significant contribution to this. Among them are a large number of hidden champions. A high level of innovation and a skilled workforce underpinned the success of German companies. According to the Federal Statistical Office, the manufacturing industry made positive contributions to economic growth each year from 1997 to 2007, with the exception of 2002, which in some cases even amounted to more than one percentage point. In recent years, however, the industry engine has stuttered. Manufacturing production in Germany has been declining since 2018.

…but has been in recession since 2018

German industry has traditionally been strongly export-oriented. High-quality products and brands "made in Germany" are in demand worldwide. This leads us to the so-called expenditure side of gross domestic product. Here gross domestic product is calculated as the sum of private and government consumption, investments and net exports (exports minus imports). Comparing the growth contributions of these individual components to GDP growth since 1992 exports of goods and services as an economic driver are a central driver of growth in Germany's economy. Exports often made the highest contribution to growth.

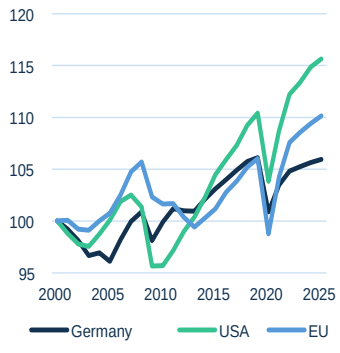
Exceptions are the period after reunification, the financial market crisis in 2009 and the coronavirus year 2020. But the past year also lines up to those periods. The fall in exports reduced economic growth by 0.1 percentage points in 2023. The export ratio - i.e. the share of exports of goods and services in gross domestic product - rose from 20 % in 1993 to 43 % in 2023: Increasing globalization after the end of the Cold War and the **opening of international markets** greatly benefited the open German economy. Germany's industry also benefited disproportionately from the **introduction of the euro**, which made it possible to gain global market share with a currency that was fundamentally undervalued for Germany's economy.

Germany was a big winner of globalization

In order to understand why Germany has lost growth momentum, we use the concept of the **production function**. According to it, economic growth is determined by the increase in the production factors of labor and capital input as well as by the increase in productivity. The factor **labor** refers to the human work performed as part of the production process. The size of this production factor can be influenced by population size or labor market conditions, for example. The factor **Capital** comprises the material resources used for production, such as machinery, buildings and infrastructure. Investments in a country's capital stock can increase production capacities and thus promote economic growth. The third factor is **productivity**. Higher productivity means that with the same amount of labor and capital the economy produces more. Productivity increases can be achieved, for example, through technological progress or better education and training of the workforce. So, if - as is foreseeable in Germany due to demographic trends - the working population shrinks, economic growth must come from an increase in capital and productivity.

Labor, capital and productivity determine growth

Fig. 4: Absolute annual number of working hours (indexed year 2000 = 100, from 2024 EU Commission forecasts)



The absolute number of hours worked for Germany, the U.S. and the EU is shown at Fig. 4, representing the labor factor. In order to assess the development since 2000, we have indexed the values to 100 in

2000. We have done the same with the net capital stock, the development of which is visualized at Fig. 5.

The net capital stock indicates the sum of the residual values of all fixed assets used in an economy and thus represents the production factor capital. The productivity factor is mapped in Fig. 6 using the total factor productivity, which is also referred to as multifactor productivity.

Total factor productivity does not relate output to a single factor (as in the case of labor or capital productivity), but to the combined use of the production factors labor and capital. It measures the efficiency of the use of these factors and is also used as a measure of technological development. The change in total factor productivity (see Fig. 6) is a purely arithmetical residual. Growth that cannot be explained by an increase in labor or capital must therefore have been achieved through an increase in productivity.

The charts show that Germany has fallen significantly behind the U.S. and the EU since 2000, particularly in terms of growth in the production factor **capital**. Germany has also been unable to keep up with the increases in the total working hours, which is measured within the production factor **labor**, particularly in recent years. At first glance, the **productivity increase** does not look so dramatic. However, if we only look at the period from 2015 onwards, the German economy has performed worse than the EU as a whole in terms of productivity growth - not to mention the U.S.

In the following, we highlight possible **causes of the weak growth** in Germany. In addition to exogenous factors such as protectionism, we take a closer look at German infrastructure. We will also look at the economic and regulatory framework set by the state and factors such as demographic trends and education. One chapter is also dedicated to relevant social developments and the fundamental attitude of Germans towards risks and innovation, for example. We evaluate the aspects examined in terms of their impact on the production factors of labor, capital and productivity, which in turn determine economic growth. At the end of each chapter we rate the aspects we consider in terms of their impact on the respective production factors on a scale from 0 (no impact) to 10 (extreme impact). At the end of each chapter, the classifications on the scale are shown graphically. These ratings reflect our subjective opinion and do not follow a clearly defined methodology.

Fig. 5: Net capital stock
(indexed year 2000 = 100, from 2024 EU Commission forecasts)

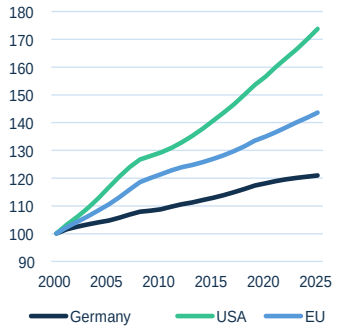
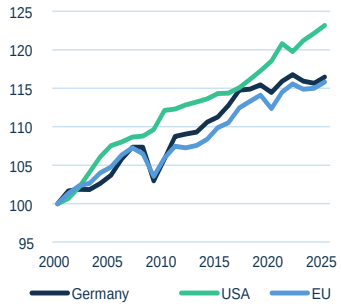


Fig. 6: Total factor productivity
(indexed year 2000 = 100, from 2024 EU Commission forecasts)



Source: LSEG, LBBW Research

03 |
External Factors

Germany has been one of the major winners of globalization in recent decades thanks to its strong industrial base. Since its peak in 2008, the share of global trade in global GDP has slumped from 25 % in the coronavirus era to 20 % and has since leveled off at around 23 % (see Fig. 7). This is one big **exogenous change** the German economy has been confronted with in the past few years. Increasing geopolitical tensions will fuel the deglobalization trend.

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Globalization on the retreat

The stagnation of globalization is mainly due to political reasons. In a world characterized by geopolitical tensions, asymmetries and an increase in hegemonial rivalry, aspects of supply chain security, perceptions of distributive justice and climate protection policies are replacing purely economic and rational decisions for an international division of labour. In recent years, many countries have attempted to protect their economies through **tariffs** and **non-tariff trade barriers**. While only 1% of globally traded goods were affected by import restrictions before the financial crisis, that rate had increased tenfold by 2023 (Fig. 8).

With an export ratio (goods & services) of 43% of GDP in 2023, Germany's prosperity is heavily dependent on foreign demand. Over the past 15 years, our export ratio to countries outside the EU has risen from 17 % to 22 % (see Fig. 9).

The U.S., on the other hand, has a low and falling export ratio, relies on its huge domestic market and is committed to protectionism. China moves away from exports as a growth driver and, like the U.S., is increasingly building on its potentially huge domestic market and striving for self-sufficiency in certain sectors. China now builds its own machines and vehicles; the erstwhile customer is becoming a competitor to Germany. Meanwhile, the U.S. and East Asia dominate computer and communications technologies as well as other future industrial sectors and the software sector.

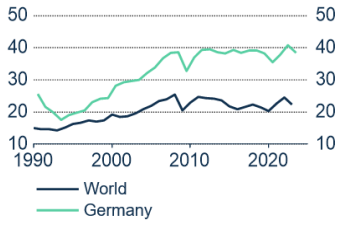
Open economies are suffering from the readjustment of trade relations. Germany is one of the main victims. With its export-oriented growth model it is coming under intense pressure . The increase in import barriers and sanctions is increasingly causing companies to relocate **production abroad**: "Produce where the sales markets are". In addition, politicians in the U.S. and China are using subsidies and tax incentives to encourage companies to relocate.

National policy usually has only limited influence on global trends. However, it would be helpful if the EU were to lend a helping hand to their companies, and therefore also the large German export industry, by concluding **free trade agreements** (FTA) in order to counter protectionism elsewhere. One example would be a trade agreement with Mercosur. FTAs with other resource-rich countries such as Australia and high-growth regions such as ASEAN should also be given top priority.

Competition for raw materials

As an industrialized nation, Germany is dependent on a stable supply of energy and raw materials. Given Germany's negligible own resource endowment, companies have to source a large proportion of this from abroad. For energy sources in particular, the proportion of imports for

Fig. 7: Export ratio goods (in % of GDP)

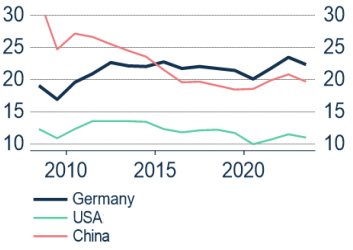


Source: LSEG, LBBW Research

Fig. 8: Goods affected by import restrictions (billion USD left / % of world trade right)

Source: WTO, LBBW Research

Fig. 9: Export ratio Germany (excl. exports to the EU) versus U.S. & China: (goods & services; % of GDP)



Source: LSEG, LBBW Research

Germany and the EU as a whole has recently increased, especially since 2015 (
Fig. 10). The increasing geopolitical tensions and global crises of recent years have uncovered the **vulnerability of global supply chains** and **high dependence** on a small number of supplier countries as an existential problem. A short-time sharp rise in energy prices and an endangered supply situation for critical raw materials are increasing concerns that could lead to hastened deindustrialization. In view of the need for greater climate protection and sustainability, the availability of energy and raw materials is becoming a key factor for future growth. According to surveys by the DIHK, more than 50 % of large industrial companies claim that they are considering cutting back production or relocating due to energy related worries.

In particular, the **energy-intensive industry**, which contributes around 17 % to industrial value creation in the country, has suffered from the price increases of the recent past (Fig. 11). The chemical industry is the industry most dependent on fossil fuels. Companies in the sector also use crude oil and natural gas as raw materials for the production of plastics, fertilizers and other chemicals. Production in the metal industry is also heavily dependent on the availability of energy. In comparison, the automotive industry, Germany's most important single economic sector, is less directly dependent on energy than the average of the various industrial sectors, but the industry requires a large number of mineral raw materials, including copper, lithium and rare earths (Fig. 12), in the manufacture of vehicles and their components. The risk of bottlenecks often exists not only with the raw material itself, but also with intermediate products containing raw materials, such as battery parts or transistors. In addition, a sufficient supply of energy sources and mineral raw materials is also necessary for the **development of important future industries** in the fields of artificial intelligence, robotics and quantum technology.

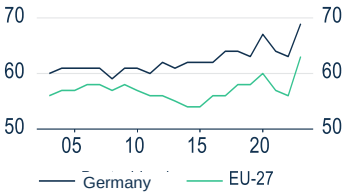
In view of increased geo-economic risks and a continuously rising demand for raw materials worldwide, Germany must further diversify its **supply chains and open up new raw materials markets** away from strategic rivals such as China and Russia. It should also coordinate its raw materials policy within the EU in order to secure access to critical primary products together with the most important partner countries and invest strategically in foreign production areas. Closer cooperation on exploration projects would be possible with Australia and the Mercosur countries for lithium, with Indonesia for cobalt and with India for rare earths. European mining opportunities (such as recently discovered rare earths in Sweden) should also be given greater consideration again.

At the same time, Germany must expand its recycling capacities and develop an effective circular economy. With better funding relevant research, the development of sustainable alternatives to hitherto hard-to-replace minerals, especially in the field of e-mobility, can succeed. Germany could then once again become a driver of innovation. In order to secure the electricity supply, the state must also secure and simplify the expansion of renewable energy and provide investment incentives for the energy infrastructure. In view of this need for investment, politicians must reconsider their strict adherence to the “Schuldenbremse” (debt brake) which precludes meaningful net public borrowing and massively reduce excessive regulation.

The pressure of transformation

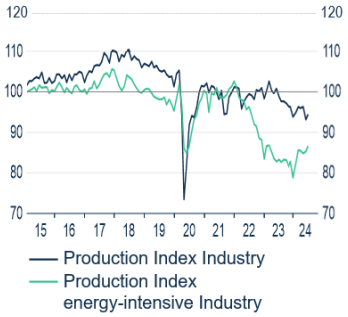
Germany aims to be climate-neutral by 2045. In order to achieve such an ambitious goal, a comprehensive energy transition towards an almost complete supply from renewable energies is necessary. This requires massive investment. However, this does not automatically increase production output. Initially, an old capital stock is essentially only

Fig. 10: Energy import dependence high and rising
(Share of net imports in primary energy consumption, %)



Source: Eurostat, LBBW Research

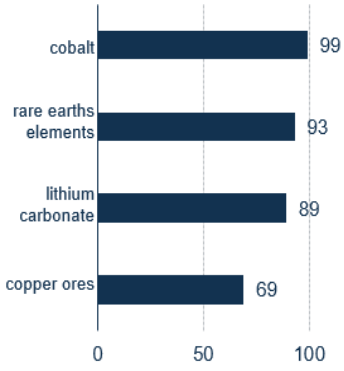
Fig. 11: Manufacturing in Germany in decline
(2015 = 100)



Source: Destatis, LBBW Research

High demand in industries of the future

Fig. 12: Share of imports - selected raw materials
(% of domestic consumption)



Source: GTAI, Deloitte, LBBW Research

Diversify, invest and deregulate

made redundant and replaced. This does not yet increase prosperity. The complex and far-reaching transformation process will shape at least the next decade. Practically all sectors of industry are affected, which has a much more significant impact on Germany than on countries whose economies are less industrialized. Especially the chemical, steel and automotive industries have a bull's eye on their back.

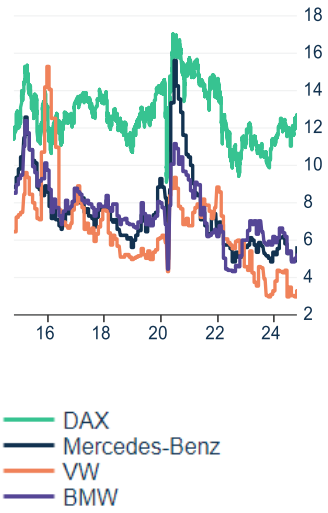
The **automotive sector**, including its suppliers, is Germany's most important industrial sector and exemplifies the consequences of the transformation for large parts of German industry. According to a study by the ifo Institute, every second job in the automotive industry is currently dependent on internal combustion technology. The national target is to depart from this fossil technology by 2035. That would have an outsized impact on employment and value creation in Germany. For one thing, the production depth of an electric car is significantly lower than that of a combustion engine. Car manufacturers Ford and Volkswagen estimate that 30 % fewer workers are needed to produce electric cars. In addition, the Chinese in particular have stormed ahead of the Germans in key technologies such as battery development. The U.S. is currently leading the way in the increasingly important use of IT in cars. All of this is reflected in the relatively low stock market P/E ratios of German automotive stocks (Fig. 13). On the other hand, the electrification of the car has not yet brought about a modification in the dominant transportation modes. In addition to the shift towards EVs, private transport and thus also car sales must be reduced in favor of public transport solutions and shared mobility. A certain **deindustrialization** as part of the necessary transformation appears inevitable.

Every second car job depends on the combustion engine

According to the ifo study, a total of around 215,000 jobs are likely to be affected by the transition to electric cars by 2030. The **reduction in employment** will be mitigated, but not completely offset, by age-related employment turnover: 147,000 employees in the automotive industry will retire by 2030. Recruitment in the automotive industry is taking place primarily in India, China, Eastern Europe and Central America, but also in Africa and North America. Southwest Europe and Germany are left out. The study sees Germany as the only country in which companies are planning to cut jobs over the next five years. The **subsidy race** that has already begun within Europe for new production sites for e-car factories is also likely to be challenging. For Germany it is critical that key research and development activities and high-tech production remain in the country. To secure that outcome, more needs to be done.

The bottom line is: Other economic sectors that benefit from the transformation to climate neutrality will have to compensate for the resulting **gap** in production and employment through growth. These are in particular the renewable energy sector, including wind, solar and hydropower, as well as companies that offer products and services to increase energy efficiency and the smarter use of energy in buildings or industrial plants. We also see good prospects for companies that specialize in the development of technologies for CO_2 capture, use and storage as well as more sustainable production processes and for sectors that focus on recycling and the development of circular economy business models to use resources more efficiently and reduce waste.

Fig. 13: P/E ratio DAX vs. German car manufacturers



Source: LSEG, LBBW Research

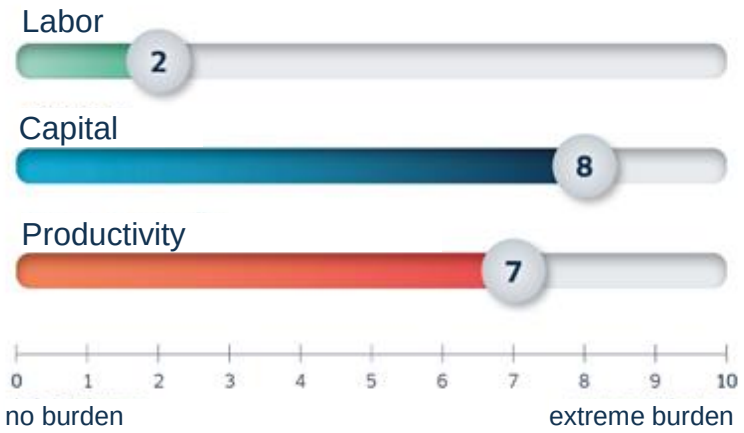
Conclusion

For an export-oriented country like Germany, exogenous factors are obviously important. Increasing protectionism and geopolitical influences are now prompting German companies to invest more abroad. As a result, jobs and production capacity that would otherwise have been located in Germany move abroad. Furthermore, the transformation of the economy towards climate neutrality will result in higher costs in the short term, as well as job losses in important key industries.

On the one hand, this could be a relief for the tight labor market as it frees up workers for use in other sectors. On the other hand, this also exacerbates shortages in some areas when particularly qualified personnel relocate abroad and thus withdraw from the German labor market altogether. Similarly, fewer foreign skilled workers are coming into the country. On balance, the burden on the **factor labor** resulting from external factors is likely to be rather weak.

The increased outflow of direct investment abroad reduces domestic investment and thus lowers the domestic capital stock. The energy transition requires massive investment in Germany. However, this does not automatically increase output. Initially, only an old capital stock is substituted. The exogenous influences weigh heavily on the **factor capital** in total.

As German companies compensate for the disadvantages of Germany as a business location by relocating investments, this could be viewed as reducing the pressure to compensate for these disadvantages by increasing productivity. Nevertheless, foreign markets and competition remain important. As the “easy” part of the export growth boom lies behind Germany and is replaced with a more challenging external environment the need to improve productivity looms larger than ever. Therefore, external influences also have a relatively strong impact on the **productivity factor**.



Source: LBBW Research

04 | Demographics

Honey, I shrunk the population!

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Germany is ageing. And it is ageing faster than most other developed economies. The Baby boomers, born in the 1960s, are gradually leaving the labor market. That would not be a problem in itself. However, the so-called boomer generation has brought too few children into the world itself. The **fertility rate**, i.e. the number of children an average woman will give birth to in her lifetime, has been below the level of most other developed economies for decades, and far below the level of 2.1. That rate is the number of children that would be required to keep the population constant (see Fig. 14). If the fertility rate remains below 1.5, as is currently the case, this means that each future generation will be over a quarter smaller than the one before it. In order to keep the population constant, the necessary **immigration** would therefore be a quarter of the existing population. Each generation. As this scenario is unlikely to unfold, the resident population will decline.

Accordingly, the working-age population between the ages of 20 and 64 is stagnating compared to other industrialized nations. This **demographic drag** on Germany's growth potential can no longer be offset without a high level of permanent immigration, which is politically implausible. And as the younger generation is also having fewer and fewer children, the negative trend will intensify (see Fig. 15).

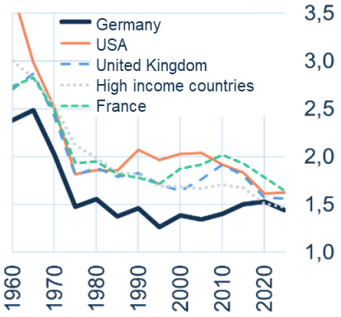
In the coming years, for example, we will lose almost half a million people on the labor market every year due to age: more elderly workers will retire than young people joining the labor market. This corresponds to around one percent of current employment in Germany. Each year! It would therefore take one percent growth in labor productivity per year to prevent the economy from shrinking. In the last decade, the actual productivity increase was rather lower.

Conclusion

The demographic trends in Germany have already reduced the growth potential and will become a **main brake** on economic development in the country. The growth-inhibiting effect manifests itself in particular through the declining supply of the **labor**. Even if the annual volume of work per person in employment remains constant (and current trends are towards less time at work), the available labor supply will shrink ever faster than in the past. An ageing workforce can also lead to a decline in **productivity** progress, as older people are less likely to be early adopters of new, productivity-boosting processes and technologies. Lower employment tends to be accompanied by lower complementary **investments**. However, this could be partially offset by labor-saving new investments; the net effect is ambiguous. The increasingly dramatic shortage of labor may stimulate labor-saving investments and the associated labor productivity, but from today's perspective it seems unlikely that the demographic pressure will be fully offset.

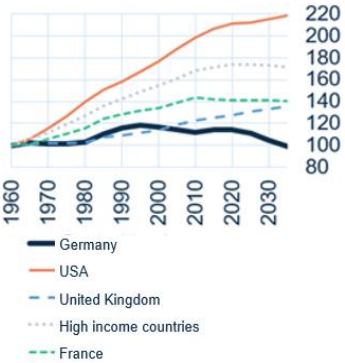
Germany: not a fertile ground

Fig. 14: Average number of children per woman

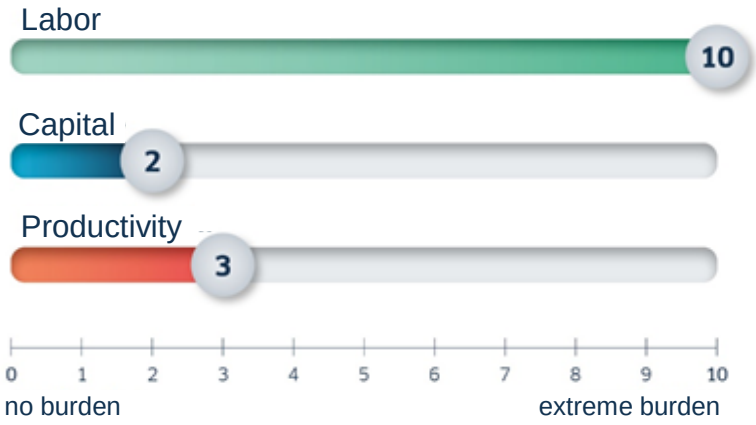


Source: United Nations, LBBW Research

Fig. 15: Working-Age Population



Source: United Nations, LBBW Research
Defined as age groups 20 to 64.



Source: LBBW Research

05 | Government Action

Labor costs and taxes

Anyone vying for the favor of skilled workers and companies in an internationally competitive environment must provide an incentivizing environment. One criterion companies and employees consider when choosing a location is the level of taxes. In addition to the level of net wages and payroll taxes, social security contributions can also be an important element of **non-wage labor costs**. In fact, Germany has the second-highest non-wage labor costs among OECD countries. With a rate of almost 50% for a single employee without children, Germany is well above the OECD average of 35%. The U.S., Australia and Korea are even below 30%. Overall, Germany therefore performs poorly. However, the gap to the average of comparable countries has actually shrunk in recent years (Fig. 16). In this respect, the gap to comparable countries has narrowed. Non-wage labor costs can therefore not provide a convincing explanation for Germany's recent underperformance.

The situation is similar for the overall **labor costs** - an issue that German industry often complains about. They are comparatively high in Germany. According to a study by the Institute for Macroeconomics and Business Cycle Research (IMK), Germany ranked fifth out of 27 countries in the eurozone in 2023. The main reason for this is the weight of manufacturing, where German labor costs are in fourth place.

Historically, wages in Germany have been closely aligned with productivity trends; it is difficult to ascertain a deterioration in the **competitive position** of German companies over time via unit labor costs. The still large trade surplus indicates that the problem is less competitiveness but innovation and productivity growth. Within the eurozone in particular, labor cost competitiveness has definitely not deteriorated over the years since 1999. In the immediate past few years, since the beginning of the coronavirus pandemic, there has been a shift in nominal terms, namely due to high wage increases. However, this been more than compensated for significant inflation in companies' sales prices, actually boosting margins. However, the future may look different as the demographically induced shortage of labor will hit Germany particularly hard. Wages could well rise disproportionately in the coming years - and thus also unit labor costs.

Internationally active companies pay particular attention to the expected **tax burden on profits** is. In Germany, a corporation tax rate of 15 % is supplemented by trade tax, which varies regionally, but averages 13.5 % nationwide. Other countries have lowered their rates in recent years. The reduction in corporate taxes in the U.S. from 35 % to 21 % after 2016 comes to mind. Under Emmanuel Macron, France reduced the corporate tax rate (plus surcharge) from 36.3 % to 28 % in 2017. As a result, Germany's competitive position when it comes to corporate taxation has eroded through inaction.

Excessive regulation

Wherever you meet entrepreneurs, it doesn't take long for them to start lamenting about "**excessive bureaucracy**". The extent to which different regional authorities, including the EU, are held responsible varies from case to case. However, there is broad consensus: Entrepreneurship hangs on a short bureaucratic leash.

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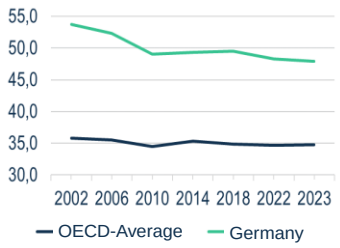
Fig. 16: Tax and contribution ratio Germany and OECD average



Source: OECD (Tax wedge), LBBW Research

Corporate taxes have been cut elsewhere, but not in Germany

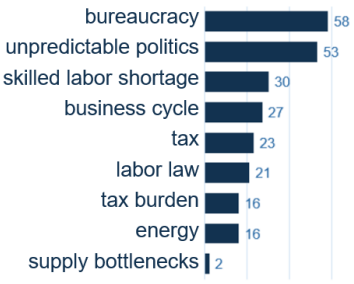
Small and medium-sized companies in particular feel overwhelmed. Large corporations don't enjoy bureaucracy either. However, as many of the **reporting obligations** - for example on supply chains or environmental aspects - have a fixed cost character, large companies can better digest the associated burdens. In smaller companies, on the other hand, paperwork can take up a disproportionate amount of time, which is then not available for the strategic development of the company. Surveys of German family businesses regularly reveal that bureaucracy is the biggest obstacle to investment, followed by economic policy, which is perceived as misguided (Fig. 17).

International comparisons repeatedly confirm that Germany is particularly and increasingly plagued by bureaucratic overkill. Fig. 18 documents Germany's gradual decline in international location comparisons for selected location factors. The green curve (regulation) is pointing sharply downwards, Germany has slipped to 15th place out of 17.

The German Regulatory Control Council (NKR) also regularly confirms the increase in compliance costs. In 2023, the burden on companies, authorities and the population resulting from federal law has almost tripled compared to the previous year - by EUR 9.3 billion per year to EUR 26.8 billion. The main driver was the Buildings Energy Act (GEG), whereas in previous years it was the Minimum Wage legislation and the All-Day School Act. In this years NKR report, the Council acknowledges that the federal government has slowed down the trend towards bureaucracy: The additional expenditure in 2024 amounted to EUR 400 million - with a relief of EUR 433 million for the economy (which is offset by an additional burden of EUR 821 million for the administration). These costs do not include the bureaucracy resulting from EU reporting obligations.

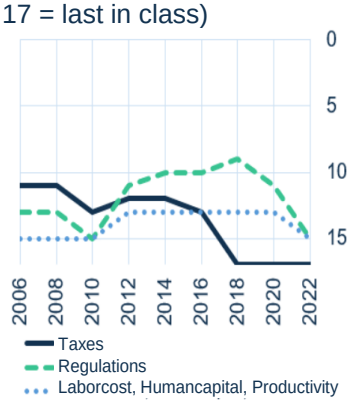
A necessary prerequisite for the success of the bureaucratic turnaround is to strengthen the **digital skills** of public administration. This is because Germany has slipped to the bottom half of the table in the EU over the last five years. The measures taken by the now defunct traffic light coalition remained piecemeal and were unable to trigger the psychological turnaround. A more consistent implementation of the "one in, one out" rule is not only necessary, but could be increased to two or three regulations to be dropped for each new one. Permits should be considered granted if not rejected within a given time frame. Such measures would be effective, highly visible. They would thus be effective in regaining the lost confidence of the business community and stimulate the willingness to invest

Fig. 17: What are the biggest obstacles to investment?
(Survey 1. Quarter 2024, up to three nominations possible)



Source: Die Familienunternehmer, LBBW Research

Fig. 18: Germany's ranking among 17 industrialized nations
(1 = best in class, 17 = last in class)



Source: Family Business Foundation, LBBW Research

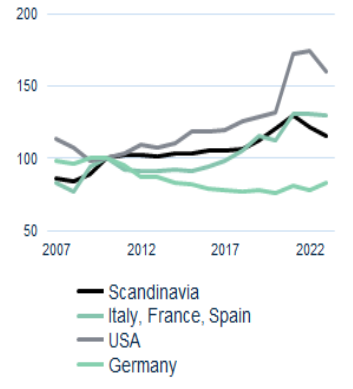
Start a company? Cumbersome!

A dynamic market economy thrives on **comings and goings**. Outdated business models are disappearing from the market. New and promising business ideas are emerging. Both are part of functioning markets. It should only be reasonably balanced.

But that balance is currently missing. The insolvency figures are rising. But there is a lack of start-ups in the German economy (see Fig. 19). Especially in a phase of rapidly accelerating structural and technological change, it is critical that young companies lead the way.

Founding a start-up must be simplified. In an international comparison, it is more convoluted to set up a company in Germany than it is elsewhere. According to a study by the World Bank, it took nine administrative processes to get a start-up up and running in Germany. There were only four steps in the UK and two in Canada. On a scale that ranks 190 countries according to the criterion of where it is easiest to get a company off the ground, Germany's regulatory frenzy puts it in 125th place. According to the survey, it is easiest to start a business in New Zealand, with the UK in 18th place and the U.S. in 55th place.

Fig. 19: Number of start-ups
(Indexed, 2010 = 100)



Source: OECD, LBBW Research

According to the KfW Start-up Monitor, the most common obstacle in the perception of founders is, you guessed it, bureaucracy. In 2023 bureaucratic hurdles and delays were a problem for 56 % of founders and thus ranked by far in first place among their concerns.

The task for the incoming government is crystal clear: When structural factors such as demographics and the labor market stand in the way of businesses, it is all the more urgent to throw bureaucratic obstacles overboard to make starting a business more attractive. This requires joint and coordinated action by the federal, state and local authorities. Otherwise Germany risks increasingly losing touch with the world's most economically dynamic regions.

Work incentives too weak

The provision of labor as a factor of production depends directly on the prevailing **social system**. The more generous the support for people capable of working outside of working life, the greater the incentives to rest in the proverbial “social hammock”. But how big is this issue really?

Overall, Germany is not particularly generous when it comes to social transfers. Compared with the 27 EU countries, the country is in the upper midfield. Particularly when it comes to monetary transfers such as unemployment benefit, social assistance, child benefit and pensions, Germany has slipped from a generous top position to mid-table in the last 25 years (Fig. 20).

The largest item in the social security system in all eurozone countries is pension payments. However, these only have a minor impact on the work incentives of the recipients, which have retired from the work force.

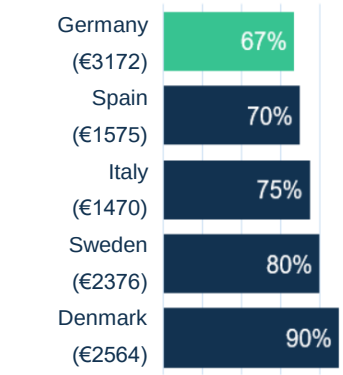
More relevant, however, is the **incentive structure** for people of working age. Generous unemployment insurance, for example, can reduce the willingness to seek employment. In an international comparison, support for the unemployed in Germany does not seem exceptionally generous at first glance: In the event of job loss, around two thirds of the lost salary are compensated, less than elsewhere (see Fig. 21). But: The maximum possible support is significantly higher in Germany than elsewhere (euro values in brackets). The eligibility period of up to 24 months is also at the upper end of international standards. The long-term unemployed are eligible for basic income support, which had recently increased significantly. With the fall in inflation, however, there will be no increase next year for the more than 5 million recipients. This should help to sharpen incentives to work and widen the gap between social transfers and earned income again.

Another much-discussed phenomenon in this context is the **shadow economy**. Anecdotally, many people will tell you about the cleaner who just doesn't want to be registered, or the craftsman who likes to see his bill paid under the table. However, the theory that a particularly large number of people in Germany prefer to live on benefits or a part-time job and supplement their income with undeclared work rather than pursuing official employment cannot be substantiated by numbers. The German shadow economy increased by 0.9 percentage points to 10.2 % of GDP in 2023. However, Germany's GDP share of the shadow economy ranks in the bottom third of industrialized countries and thus performs better than most other developed economies.

Fig. 20: Germany's ranking among 27 EU countries on social spending

Source: EU Commission AMECO database, LBBW Research

Fig. 21: Unemployment benefit in % of lost income (and maximum value in EUR)

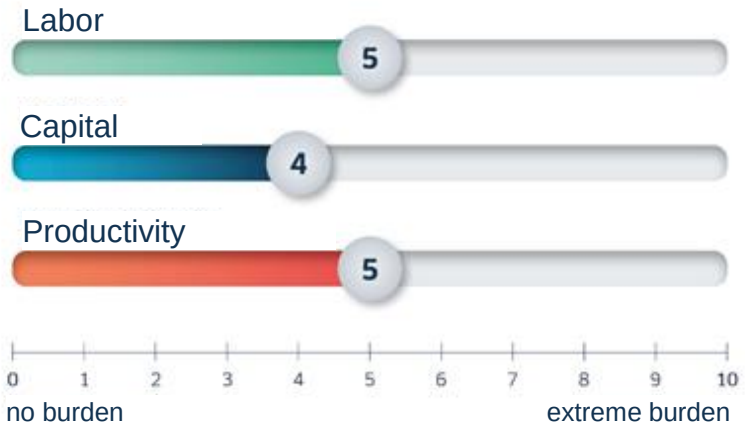


Source: Unedic, LBBW Research

Conclusion

Government regulation and intervention can lead to a reduction in work incentives and a corresponding shortage of available **labor**. However,

government intervention only plays a minor role compared to demographic trends. The bureaucracy that is routinely associated with the attribute "excessive" in Germany acts as a clear and dominant stumbling block to **capital** formation and thus reduces the otherwise possible dynamism in **productivity** development. Bureaucratic obstacles are slowing down start-ups and promising, innovative start-ups are moving abroad.



Source: LBBW Research

06| Infrastructure

Germany's investment backlog

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The International Institute for Management Development (IMD) publishes an annual ranking of 67 countries from all continents. The benchmark is its **quality as a business location**. The IMD examines the possibility of doing business, the efficiency of public administration or the extent of bureaucracy. Germany has been steadily dropping in this ranking - this year it fell two places to 24th overall. The decline in infrastructure was particularly rapid (by six places). In each sub-area of infrastructure that was examined, Germany was losing ground. While the country still looks respectable for research and healthcare infrastructure at fifth and eleventh place respectively, the country is found much further down the tables in the rankings for education and training (26th), basic infrastructure (35th) and technology infrastructure (37th).

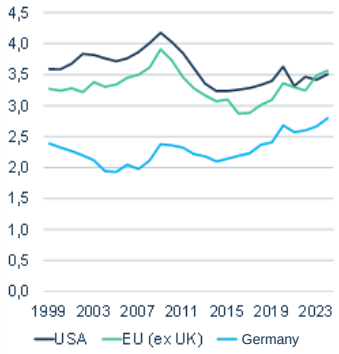
Germany falls further behind

These facts are underpinned by **anecdotal evidence**. The European Football Championship took place in Germany in 2024. Memories of the summer fairy tale of 2006 should come flooding back. While Germany presented itself to the world in many positive ways back then, there were some disappointments in 2024. Deutsche Bahn became a laughing stock of fans. Delays and train cancellations have long been part of everyday life for domestic passengers. Now foreign citizens know it too. Surveys on the country's mobile network coverage are also widely known. Depending on the source and survey period, the German mobile network ranks between 24th and 70th in an international comparison. The situation does not look much better for the expansion with fiber optics in the stationary network. However, the mobile network and fiber optic network are operated privately. Government action is reflected here in efforts to create the legal framework for broadband expansion.

UEFA European Championship a wake-up call

If we restrict ourselves to **public investment**, Germany performs well below average. Compared to the U.S. or the EU average, public investment is vastly insufficient for decades (Fig. 22).

Fig. 22: Public Investment, % of GDP



Source: LSEG, LBBW Research

The current backlog of public investment in Germany is estimated to be in the mid three-digit billion-euro range. A study published in May 2024 by the Institute for Macroeconomics and Economic Research lists 200 billion EUR for municipal investments alone (primarily in public transport), plus 40 billion EUR for schools and universities and 100 billion EUR for the expansion of trunk roads (40 billion EUR) and the rail network (60 billion EUR). In addition, a lump sum of EUR 200 billion has been earmarked for climate change adaptation measures. All in all, according to the Hans Böckler Foundation Institute, there is a shortfall of EUR 540 billion. To finance the expenditure, the authors propose relaxing the existing debt brake and expanding the possibilities for credit-financed investment expenditure in EU law.

A study in 2022 comes to a similar conclusion. It states: "Germany invests considerably less in its public infrastructure than all other EU countries. At an average of 2.1% of GDP in the period from 2000 to 2020, German public investment was significantly below the European average of around 3.7%." Neither the interest rate level nor the political orientation of the respective government or the legal framework of fiscal policy can fully explain the weakness of investment here compared to other countries. The study identifies other factors that act as obstacles: complex planning procedures, an excess of regulations to be

Infrastructure: considerable backlog

complied with and inadequate staffing of the responsible offices and authorities in relation to the requirements, which cause the backlog in public investment.

The problem of underinvestment is thus twofold. On the one hand there is a lack of money, on the other hand there is a lack of implementation. If **tax increases** are to be ruled out, as seems likely, the funds would have to be raised through a reform of the **debt brake**. The debt brake was passed by the Bundestag and Bundesrat with a two-thirds majority in 2009 – the intention was to put a stop to excessive debt accumulation. The brake performed its function well. At around 63 % of GDP (2024), Germany's debt ratio is significantly lower than that of the eurozone as a whole (90 %) or the other major countries (United Kingdom 102 %, France 112 %, and U.S. 121 %).

Bureaucracy and staff shortages as further causes

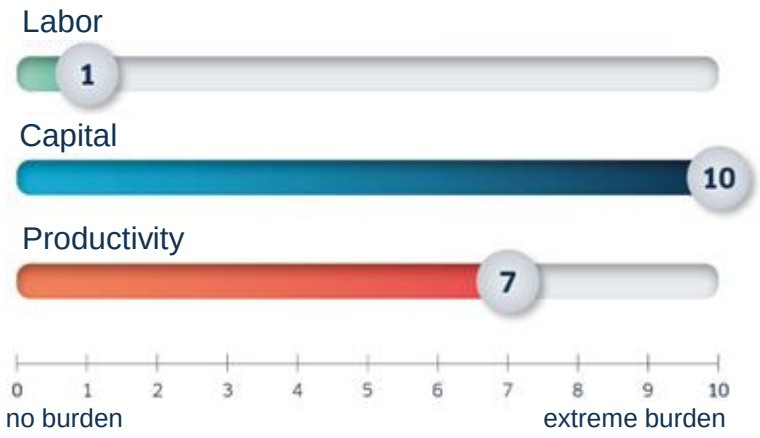
The task of keeping Germany's debt in check should remain guaranteed. A **reform of the debt brake** should not be a license for everyone and everything in the future either. Instead, policymakers must closely align the permissible debt **with the necessary investments**. The public sector can be ambitious in this respect. Almost a year ago, LBBW Research submitted a proposal: "If the debt brake were to be modified by 2030 in such a way that a deficit of 2 % is permitted, which must be invested in investment projects, the debt ratio would climb moderately to 70 % of GDP by 2030."(Klartext 12/08/23)

Debt and investment to go hand in hand

This approach should be flanked by a reduction in bureaucracy and a correspondingly swift implementation of the planned investments. The higher debt would then be offset by permanently higher real growth thanks to the improved infrastructure.

Conclusion

The importance of infrastructure for a country's economic performance is obvious. It is particularly serious for the factor **Capital**. Who would invest if supply, distribution, customer communication or coordination between production sites were insurmountable hurdles? For similar reasons, a functioning infrastructure is also likely to be of great importance for **productivity**, although there are other influential factors too. For the factor **labor**, on the other hand, the infrastructure seems less relevant to us; there are much more important factors here.



Source: LBBW Research

07 | Education & Integration

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An ‘F’-grade for education

Germany’s youths are increasingly unprepared for working, or even academic life. This becomes clear in various places. The notoriously poor performance of German children in the international **PISA comparative tests** is well known. In the most recent round, the results of which were published at the end of last year, Germany slumped again after an upward trend in the past decade (see Fig. 23). That happened in all three tested disciplines: Reading, math and science. The drop below the OECD average in mathematics is particularly worrying.

Almost 50,000 young people leave the German education system every year without any secondary school leaving certificate, equivalent to 6% each cohort. Often (curable) language deficits are the cause. However, the rate is also 4.6% for native German-speaking children. The difference between children with and without a migration background is nonetheless stark and can be observed in the PISA results (see Fig. 24): In particular, students who have immigrated to Germany (“first generation”) rank significantly below the OECD average. Those born in Germany without immigrant background are better positioned.

But it actually has to start much earlier. A decisive course is already set in early childhood education. There is no good news here either: there is a nationwide shortage of more than 300,000 daycare places and 125,000 preschool teachers, and the trend is rising rapidly. We are letting our children down. And we are undermining our country's economic prospects with this short-sightedness.

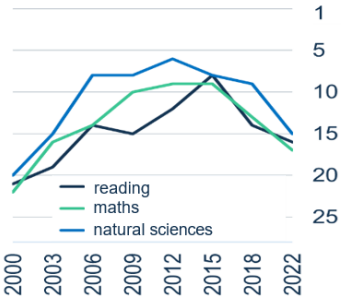
Germany is a country poor in raw materials. However, we have always compensated for this locational disadvantage with knowledge and ingenuity. This has brought us the prosperity we enjoy today. However, prosperity must be regained in every generation. And good education is an indispensable prerequisite for this. An international comparison makes it clear that successive governments in Germany have been too stingy with education expenditure (see Fig. 25). This cannot be allowed to continue. Our prosperity is based on the power of our minds.

Poor integration

The integration of immigrants into the German labor market is a highly controversial political issue. Of the Ukrainian refugees of working age between 18 and 64, for example, only just over 25% were working in Germany in 2023 . Figures of around 40% are reported for the Netherlands, Denmark and Poland, and around 55% for the UK.

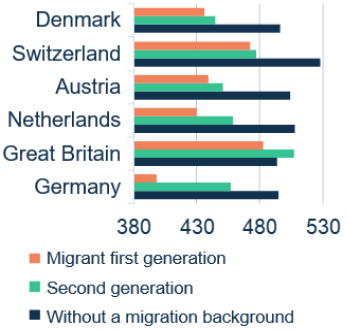
In general, Germany seems to have a particular problem with the integration of migrants **with higher educational qualifications**. In 2021, before the start of the war in Ukraine, less than a third of all arrivals with a university degree were working in Germany. Italy, Spain and Austria performed worse in Europe, while the Netherlands, Belgium, Denmark, Sweden and Norway did much better. Obviously, effective integration management is needed to leverage the potential that refugees bring with them.

Fig. 23: Germany's position in the PISA test 2000-2022



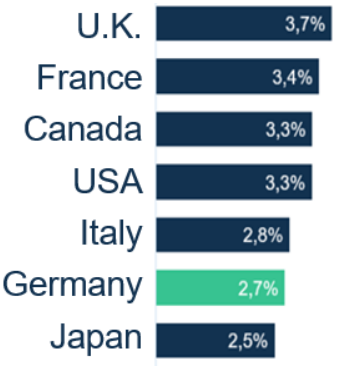
Source: OECD, LBBW Research. This is based on the 28 countries that have participated continuously since the beginning.

Fig. 24: Score in the PISA mathematics test 2022



Source: OECD, LBBW Research (OECD average for immigrant children: 435)

Fig. 25: Public spending on education*



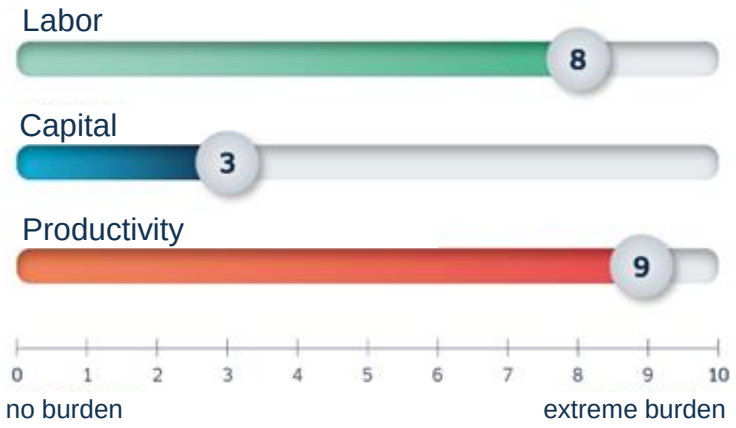
(average 2010-2020, % of GDP)

Source: OECD, LBBW Research
*Expenditure on primary and secondary education

Conclusion

Germany's deficits in school, training and further education have long-term consequences. Employees, the production factor **labor**, will be paid less than they could be; less highly qualified, simpler work will be offered: an unfortunate trend for a highly developed country.

In the long term, this depresses the production potential of the entire economy. A slowdown in education efforts and investment is reflected in a flatter **productivity** progress in the long term. The alternative is an influx of well-trained specialists from abroad. Alone: The population in Germany appears to be increasingly hostile to the influx of migrants. The integration of well-educated people in Germany is also only successful to a limited extent. There is no way around improving school, training and further education.



Source: LBBW Research

08 | Mindset

In the previous chapters, we have highlighted the hard facts and figures on economic reality in order to analyze the causes of the misery. However, **soft factors** such as motivation, willingness to change and willingness to take risks also affect labor input, capital stock and productivity in different ways. If we disregard geographical conditions and historical path dependencies, cultural and social developments are decisive for a country's sources of growth in the long term. This is because they determine the institutions, i.e. the laws and norms of an economy, which set the economic behavioral incentives for citizens.

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New challenges

Unfortunately, there are very few systematic analyses of the mindsets of peoples and nations and their economic effects. In the following, we therefore provide some anecdotal evidence to illustrate how mindset issues can hold back Germany's economy. The examples show that the German mindset, which tends to be risk-averse and has become somewhat comfortable thanks to the globalization and export successes of the last four decades, is increasingly clashes with a rapidly changing global environment.

This new environment is characterized by a fundamental **transformation** of the global economy. This transformation includes, in particular, the decarbonization and digitalization of the products and services in demand as well as the reorganization of global and increasingly digital value chains. While globalization has mostly played a positive role for the German economy since 1989, but now this dominance is being reversed. Digitalization will take over as key contributor to prosperity in the 21st century. However, due to the inherent first-mover and network effects of successful digital innovations, digitalization rewards speed, agility, entrepreneurial thinking and a willingness to take risks and innovate - all characteristics that are not necessarily ascribed to Germans today.

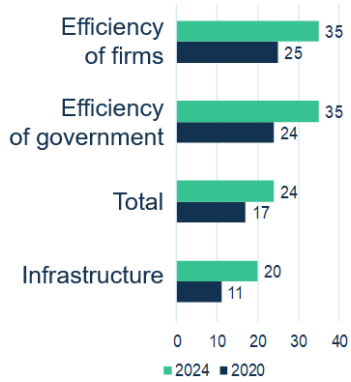
20 years after Agenda 2010, Germany perhaps has not so much become the sick man of Europe as the anxious and somewhat comfortable man of Europe. At least in terms of economic performance, this is not doomsday rhetoric, but a verifiable perception: In an international comparison of **competitiveness**, Germany is only average (see Fig. 26).

Relatively low labor input

In every economy, prosperity arises, among other things, from the efficient use of labor as a factor of production. However, this has developed alarmingly in Germany in recent years: In Germany, fewer hours are worked per year per employee than in all other OECD countries. This is due in particular to the strikingly high **part-time rate** (Fig. 27), especially among women. More than in many other countries, a woman who has her child looked after by someone else until kindergarten age must expect to be called an uncaring mother. Even today, the task of childcare or caring for family members will still predominantly fall to women. This is also the result of the fact that there is a shortage of more than 300,000 daycare places in Germany. However, it only explains part of the high part-time rate among women. Not only is the part-time rate very high in Germany, the birth rate is also very low. This is proba-

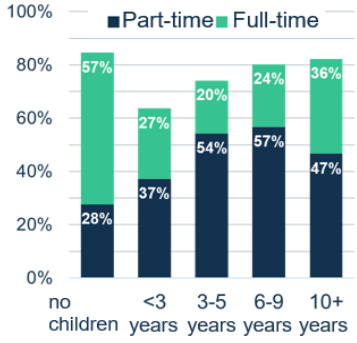
Germans have not changed, but the world has!

Fig. 26: Germany's competitiveness



Source: World Competitiveness Index, LBBW Research
The chart shows Germany's ranking among 67 countries for various competitiveness indices and factors

Fig. 27: Employment status of women by age of youngest child



Source: Destatis (Microcensus 2022), LBBW Research

bly why entrenched cultural role models still play a strong role in Germany. At the same time, the propensity to work hard is increasingly becoming less widespread.

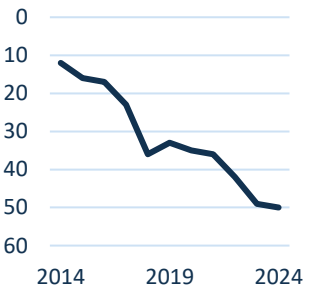
Recently, the conspicuously high number of **sick days** has also reduced the volume of work. The average annual sickness rate of German employees in 2023 was 5.5 %. One possible reason for this could be that patients have been able to take up to five days off sick by telephone again since the end of 2023 - which relieves the burden on practices on the one hand, but also encourages a certain degree of convenience and cheating on the other.

Monetary incentives influence the supply of labor, especially in the lower income groups. Those who work should have noticeably more in their wallets than those who are inactive. However, politicians must also enforce this wage gap requirement against accusations of "social hardship". But we also need incentives in the higher-ranking jobs to ensure that the goal in life is not to retire as early as possible. Politicians can and must set the right framework conditions here - for example by making things more flexible and establishing fair rules for those who want to work beyond the statutory retirement age.

Immigrants less welcome

Looking at the demographic change described above, however, Germany will be less and less able to cover its own labor needs, even if the volume of work performed by people of working age were to increase. Without immigration, economic growth will hardly be possible in this country. But this is a problem in more ways than one: This is because word of Germany's weaknesses is spreading beyond our borders, with the result that Germany **is not popular with foreign skilled workers**. We rank 50th out of 53 countries of immigration in the latest Expat Insider survey conducted by the expatriate network Internations.(Fig. 28). Particularly poor marks are awarded in the categories "Basics" and "Arrival": When it comes to digital life, for example, Germany is in last place, and unsurprisingly in 45th place for administrative issues. Ranked 49th for friendliness and 52nd for culture and welcome.

Fig. 28: Germany's popularity as a country of emigration
Placement*



Source: Internations, LBBW Research
*Number of countries included varies between 53 and 68

Overall, this is the worst ranking in the annual survey, which has been published since 2014. And it can be explained not only by many of the factors we have already discussed: unpunctual trains, patchy internet, confusing bureaucracy and educational problems. This is also due to the fact that Germany has recently been making international headlines with **anti-foreigner sentiment** - most recently, for example, with the high election results for the far-right xenophobic AfD in the state elections in Thuringia, Saxony and Brandenburg and its high poll ratings at national level.

In addition, Germany is finding it difficult to retain skilled workers: Among the 38 OECD countries, Germany has the third-highest emigration rate of nationals. Only the British and Poles are more mobile.

Resistance to change

The current and upcoming changes in the world require two characteristics in particular: Courage and willingness to change. Both have probably never been typical German characteristics. It is not for nothing that "German Angst" is an international buzzword, as terms such as "Bedenkenträger" (a person who frequently raises concerns or objections focusing on risk and potential negative outcome) do not exist in other languages. In recent years, however, the **aversion to change** has evidently increased, as Fig. 29 shows.

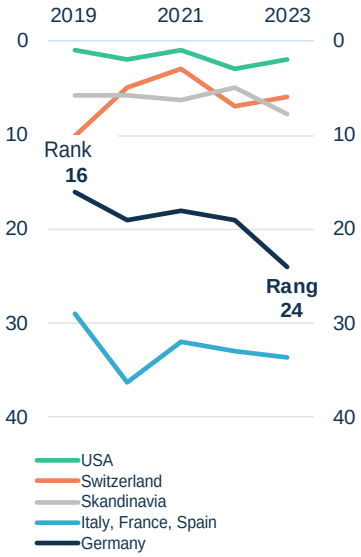
The German risk aversion is particularly evident in the **investment behavior** of Germans, which also has an impact on the provision of capital: People do put a lot on the high side. They are the EU leaders with a savings rate of 21% in the first quarter of 2024. The EU average is only 14%. However, Germans are risk-averse in their specific investment behavior: in 2022, German households held 43% of their financial assets in the form of cash and bank deposits, compared to 34% in the EU. According to the German Shareholder Institute (DAI), the equity ratio was recently only 18%. The majority of savings continue to flow into low interest-bearing investments and not into higher-yielding and riskier assets such as shares. As a result, people in this country are not managing to build up any significant wealth despite their devotion to saving.

Comprehensive, holistic investment advice from banks and financial service providers as well as targeted government subsidies could help to change investment behavior. For example, state-subsidized mandatory savings plans ("investment accounts"), in which citizens could invest small amounts on the stock market from an early age, could be put in place. This would build up higher assets, which among other things would bring financial independence in old age. This would also expand the **productive capital**, as there would be sufficient equity (via shares and venture capital) for financing.

But the German aversion to change is also evident in many other areas. Clear majorities are quickly found for **overarching goals** such as the energy transition or the defense of our freedom. But as soon as it comes to implementation, only a few are prepared to accept the personal cost or restrictions involved. In order to create majorities, politicians and administrations try to find solutions that meet as many needs and individual cases as possible - a source of German bureaucracy.

In order to tackle huge projects such as the energy transition or to prune back the bureaucratic jungle, we need to be prepared to take on personal responsibility and take more risks. This applies to the state as well as to citizens and companies. Examples include the scrappage scheme or the EV-bonus, with which the German government supported the economy. As a result, nothing will happen without a corresponding subsidy. In the face of higher energy prices or economic difficulties at individual companies, there will be immediate calls for industrial electricity prices, **state aid** or reduced VAT rates. A side effect of these life-sustaining measures is often that the state slows down the market economy and cushions the necessary **structural change** too much, if not prevents it altogether.

Fig. 29: Germany is less and less willing to change
"Ready for something new" ranking in international comparison



Source: World Competitiveness Index, LBBW Research.

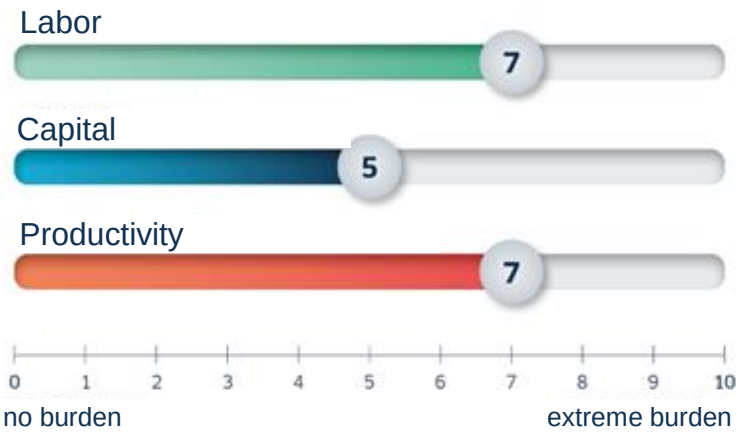
Positioning within a country panel of 64 countries worldwide. The "Future Readiness" shown is made up of the factors "Adaptive Attitudes", "Business Agility" and "IT Integration".

Investments in shares strengthen productive capital

Conclusion

The mindset, the sum of our attitudes, shapes the **labor** market and overall economic **productivity** growth through our daily actions: The more industrious we are, the greater the input of labor as a factor of production. The more digital we try to be, the more productivity increases. And indirectly, our willingness to take entrepreneurial risks has an impact on **capital** formation in our economy. However, the mindset also determines government action. After all, this is ultimately driven by the wishes and needs of the electorate. Not everything has to be regulated or secured by the state. We have to accept more risk and take responsibility: In the development of our society and our living environment, in our own life planning and in our investments. We have to move away from always looking for solutions until every individual interest is satisfied. And we must accept that it is precisely this responsible risk-taking that is rewarded and encouraged, for example through entrepreneurial Investment will flow into the right channels and productivity will

increase only when citizens, companies, and the state have the courage to let go of the old ways and embrace new approaches. The following applies to the Mindset aspect: **More courage, Germany!**



Source: LBBW Research

09 | All things considered

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"Think I of Germany at night / all thoughts of sleep are put to flight / my eyes I can no longer close / and down my cheek, a hot tear flows" lamented Heinrich Heine 1844 from his exile in Paris. He was driven by homesickness and political worries. Today, many people are losing their sleep over the perceived economic decline on this side of the Rhine. Reason enough for LBBW Research to take a closer look at the underlying cause of the economic downturn.

Dear reader, we have demanded a lot from you in this publication. But unfortunately, there was no other way. After all, the motivation for this publication was our unease that the public debate too often refers with a tone of conviction to the simplistic and monocausal reasons for the economic downturn. And it's always supposedly someone else's fault (in case of doubt always blame Economy Minister Robert Habeck). That falls short. Our aim was to objectify and systematize the diagnosis of Germany's economic weakness. And if you take the trouble to look under the hood, you will see many parts that no longer fit together or are simply no longer functional. The "sick man of Europe" therefore has various ailments that exacerbate each other.

Objectifying and systematize

The following figure summarizes our findings. The assessment of the impact on the production factors of labor, capital and productivity on a scale from 0 (no impact) to 10 (extreme impact) is subjective and is intended to illustrate relative relevance. It is immediately apparent that stagnation is driven by all components of the production function. However, different problem areas have a differentiated effect on the respective factors.

As a result, we have to put to rest the hope that a simple solution, a hidden growth turbo, is lurking somewhere. Some of the challenges are of an external nature that no federal government, regardless of political color, can significantly influence. These include developments in international trade and demographic trends. Both are hitting Germany harder than other economies.

There is no quick and easy solution

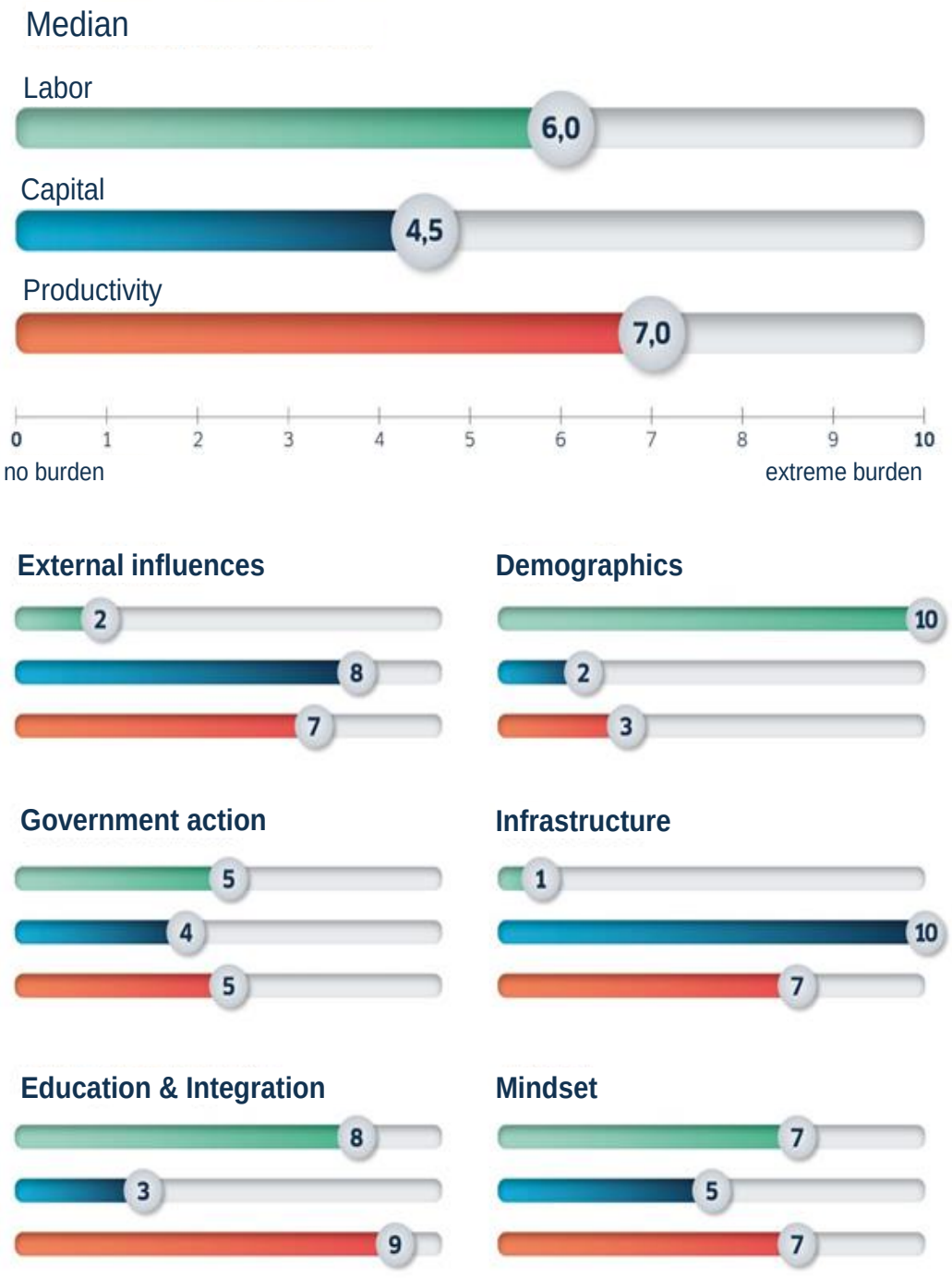
But we have also identified numerous policy areas that we can and must tackle. The evergreens of bureaucracy reduction, better education and more modern infrastructure are certainly among them. The tasks ahead of us are considerable. They have grown over many years. And the solutions will also take a considerable amount of time. Anyone hoping that a change of government will be enough will be disappointed. If only it were that simple. But a political reboot could still be helpful. Ludwig Erhard, the father of Germany's social market economy, is credited with saying that half of economic policy is psychology. There might be something to it. German companies have rarely been as pessimistic as they are today. And the pessimism is probably partly self-reinforcing.

The mood has deteriorated more drastically than the situation. The difference is the Erhardian psychology of economic policy. A fresh start in Berlin could thus help to dispel the pessimism and attentiveness among investors. But replacing the people involved is not enough.

In order for the economy to regain momentum in the long term and structurally, a comprehensive and bold reform package is needed that removes as many of the obstacles to growth as possible. Next year is the general election. LBBW Research will analyze the programs of the most important political parties in advance. To what extent are the promised projects suitable for solving or at least reducing the obstacles

to growth? You will not receive a voting recommendation from us. But orientation through an unbiased analysis is.

Let's end on a positive note. There is a lot of vehement criticism of Germany, but somehow most people seem to like it here. I recently asked on LinkedIn: "Where would you most like to live?" In Germany or in one of the three countries to which Germans emigrate particularly frequently (Switzerland, Austria, U.S.). The result: Gold for Germany! Albeit Switzerland was breathing down its neck. But far ahead of the rest of the competition. Heinrich Heine would agree. There is hope.



Source: LBBW Research

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