

The Gravity of Germany's Economic Problems

by Antonia Colibasanu - September 18, 2023

Last week, the European Commission lowered its growth predictions in the eurozone for 2023 and 2024 – overwhelmingly because of poor economic indicators from Germany. For Berlin, a year of significant growth in 2021 was followed by two years of decline, and the most recent estimates suggest the economy will grow only by a meager 1.5 percent by the end of 2023. The slowdown owes to a variety of factors, including the usual suspects of supply chain disruptions and high energy prices brought on by the pandemic and the war in Ukraine.

All of this has made inflation arguably the most significant problem in the German economy. The country's inflation rate hit 7.6 percent in August 2023. This is far higher than the European Central Bank's goal of 2 percent for the eurozone – and the country's highest since 1973 – which explains the commission's latest report on the zone's economic performance. High inflation reduces consumer spending power, which slows economic growth and makes corporate planning and investment more challenging. In addition to raising the interest rate, the German government is assisting firms and individuals that have been affected by inflation via grants, loans and tax benefits, especially for businesses that invest in energy efficiency and create new jobs. Berlin managed to keep unemployment low over the past three years, but even that is starting to change, climbing appreciably in recent months as German manufacturing reels from high energy costs.

According to the World Bank, international trade accounted for 99 percent of Germany's gross domestic product in 2022, with exports accounting for 50.3 percent of the GDP and imports accounting for 48.3 percent. Germany is thus highly exposed to the changes underway in the global economy. In 2022, Germany's main export product was motor cars and parts thereof, accounting for 15.6 percent of total exports. Machinery (13.3 percent) and chemical products (10.4 percent) were the second and third most important export commodities, respectively. All of these products have declined in output this year. In 2023, production in Germany's gas-hungry chemical industry has fallen 18 percent from 2019 levels, while German automobile output is down 26 percent. **According to the German Machine Tool Builders' Association**, machinery manufacturing will fall by 2 percent in 2023, while production will be supported mostly by backlogs from previous years. This would be the first drop in this sector's output since 2012.

The economic stagnation has also resulted in more businesses going bankrupt; **official statistics show** that requests for insolvency have been growing since 2022. Using data from the German Chambers of Commerce and Industry, Trading Economics **expects** that Germany's bankruptcy rate will reach 12.9 percent per year in 2023 – the highest rate since 2009.

And though unemployment is rising, short-term solutions such as increasing the use of migrants are no longer that viable. Instead, this strategy could become a problem, especially in areas where populism and nationalism have been steadily growing. Worryingly, a recent study conducted by the University of Leipzig **showed** that nearly a quarter of respondents said that national socialism had some advantages, and according to 33 percent of respondents, “we should have a leader who rules Germany with a strong hand for the good of all.” This view is supported by the fact that Alternative for Germany (AfD), the country's most successful far-right party since World War II, won two local runoff votes in eastern Germany, one in the town of Raguhn-Jessnitz and one in the district of Sonneberg. But eastern Germany is hardly alone. Last month, Germany's *Süddeutsche Zeitung* published a report accusing Hubert Aiwanger, the leader of the Free Voters, a small but prominent conservative group in Bavaria, of producing and circulating an anti-Semitic flyer as a high school student in the 1980s. He has refused to resign, accusing the newspaper of trying to launch a dirty campaign against him ahead of the elections in Bavaria. As a result, his small conservative party is now the second most popular in Bavaria, rising 5 percentage points to 16 percent.

This brand of populism may be gaining support among middle-class Germans too. A **survey from the Sinus Institute for Social Research** indicated that the AfD's share of middle-class voters jumped from 43 percent to 56 percent in two years. The survey also found that what the research center calls the “modern adaptive-pragmatic middle class” is rising, from 12 percent of the population to 19 percent, as is the “conservative-upscale class,” from 8 percent to 12 percent. Both groups are showing an increasing interest in the AfD as well as populism. They are generally open to change and forward-thinking but are currently confronted with significant demands that jeopardize their ability to meet their own expectations in terms of owning a car and a house, and raising their children in a safe environment. They blame the government and the political system for not creating solutions and are therefore seeking alternatives. Instead of driving social change, they appear to be getting increasingly pessimistic, with concerns over unemployment and other issues similar to those of other classes.

Berlin needs to find a solution to keep its economy going by working with foreign partners. Its top priority is the stability of the European Union, of course, but the interdependency of the German economy and the EU market highlights the fragility of the European economy altogether. **According**

to the **German statistical office Destatis**, roughly 60 percent of German exports are sold in other EU states while 52.3 percent of German imports come from EU states.

Its other major trading partners are **the United States and China**. Though the U.S. is its most important export market, its total trade turnover with China is higher. (Its highest trade deficit is with China, too.) Germany has been a massive beneficiary of China's low labor costs and indeed is unique among EU member states in the breadth and depth of its economic relations with Beijing.

It's no coincidence, then, that Berlin recently published its first-ever **comprehensive strategy for China**. The text will serve as a foundation for German policymakers in the coming months, informing everything from cybersecurity to industrial policy. But it is unexpectedly undiplomatic, going so far as to say China fundamentally undermines German interests. The new strategy could lead to one of the most profound transformations in German foreign and economic policy in decades, perhaps a final farewell to the concept of "change through trade" that has guided German-Chinese relations for years.

In many ways, the new strategy is a natural byproduct of the internal and external challenges Berlin faces. Though Germany benefited from China's economic rise, more recently German businesses have grown disappointed with China, where their opportunities have slowly shrunk as Chinese leaders push for greater control of the market. And in order to increase competitiveness, keep the German people employed and fix critical infrastructure problems, Berlin needs to reduce its dependencies while developing its own capabilities. In the new strategy document, Germany called for the need to diminish China's asymmetric strategic dependencies – the same dependencies Beijing **listed** as a strategic objective in 2020 – albeit in keeping with the so-called "de-risking" strategy the EU **proposed** earlier this year.

If Germany takes de-risking seriously, it requires not only greater transparency throughout the business sector but also a broad social debate about political and policy priorities. For example, Berlin needs to consider whether Chinese electric vehicles should be regarded as a threat to German competitiveness and implement anti-subsidy measures accordingly, even though it will all but guarantee retaliation from Beijing. (This is to say nothing of whether Chinese electric vehicles pose a cybersecurity or surveillance threat.) German policymakers would also have to consider whether they should reduce their reliance on Chinese green technology products and focus on their own industry. But Berlin will also need a compelling narrative to justify removing newly installed Chinese telecom equipment from 5G networks to improve the security of key infrastructure, even as it continues to struggle with high-speed connectivity issues across the board.

In implementing its new strategy, the German government will likely struggle to strike the correct balance between the various sets of risks that China poses. And as one set of potential risks and dependencies is reduced, another is likely to increase. German political realities will further complicate the process.

What's happening in Germany is happening in other European countries too, so Berlin will need to think about the interests of its fellow EU members as it struggles to improve its relationship with China. Germany is the economic engine of Europe, and whatever happens there reverberates throughout the Continent. If (and how) Germany implements its new strategy, it could be ideally positioned to dictate debate and coordination on new economic policies meant to restructure and support internal capabilities between Germany and the other EU member states. And the fact that it is considering this new strategy at all attests to the profound changes taking place in the global economy.

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