IWH
Halle Institute for Economic Research
Member of the Leibniz Association

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Recovery on shaky ground – tariffs dampen growth, but a change in fiscal policy is on the way

In late summer 2025, it is still unclear whether the German economy is on the road to recovery, as it has to cope with the dampening effect of higher US tariffs in the second half of the year. It is not until 2026 that fiscal policy stimulus measures, combined with low key interest rates, will probably lead to an economic upturn. According to the autumn forecast of the Halle Institute for Economic Research (IWH), production is then expected to increase by 0.8%, following 0.2% in 2025. Similar rates of expansion are also expected for East Germany. In June, the IWH economists were forecasting growth of 1.1% for 2026 and 0.4% for the current year.

Table
Forecast for Germany: Key Economic Indicators[a] for Germany, 2024–2027

	2024	2025	2026	2027
	percentage change over previous year (price adjusted)			
Germany	–0.5	0.2	0.8	0.6
East Germany[a]	–0.1	0.2	0.7	0.5
	percentage change over previous year in %			
hours worked	–0.2	–0.2	–0.2	–0.7
hourly union wages	4.7	2.8	2.6	2.6
hourly actual wages	5.3	3.6	2.9	3.2
unit labour costs[b]	5.6	3.7	1.9	2.1
consumer price index	2.3	2.2	1.8	2.0
	1,000 persons			
employment (domestic)	45 987	45 989	45 987	45 828
unemployment[c]	2 787	2 946	2 945	2 908
	in %			
unemployment rate[d]	6.0	6.3	6.3	6.2
East Germany[a]	7.5	7.8	7.8	7.7
	in % of nominal GDP			
general government overall balance	–2.7	–2.0	–3.1	–3.4
current account balance	5.6	4.8	4.6	4.3

[a] East Germany including Berlin. – [b] Per hour (IWH calculations). – [c] Federal Employment Agency (BA) concept. – [d] Unemployment in % of civilian labour force (Federal Employment Agency (BA) concept).

Sources: Federal Statistical Office; 2025-2027: IWH forecast (as of September 3, 2025).

US tariffs were raised drastically in the summer. The financial markets reacted to this calmly, probably because the global economy has up to now remained fairly robust despite the trade conflicts. Monetary policy has been loosened almost everywhere recently. In the US this was done only hesitantly, but for the coming quarters we expect the Fed to lower interest rates further. Fiscal policy in advanced economies is broadly neutral. Overall, the global economy is likely to continue expanding at a moderate pace, but in autumn the sharp US tariff increases will dampen global

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The IWH Forecasting Dashboard (ForDas)

The IWH-ForDas is an interactive platform for comparing macroeconomic forecasts from various institutes on the German economy.

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trade and production. Slightly stronger growth rates are expected for the rest of 2026, partly due to investments in the implementation of new technologies. All in all, global production will increase by 2.6% in 2025 and by 2.4% in the following year.

With the revision of data by the Federal Statistical Office, Germany's economic situation looks worse than before: we now know that production declined from the end of 2022 to mid-2024. Production expanded again in the winter half-year, but gross domestic product has recently contracted once again. Exports to the US have fallen following the elimination of pull-forward effects due to expected tariff increases, and there has been a very significant decline in housing investment. “The question arises as to whether the recovery that emerged in the winter months has merely been interrupted or whether the economy is still in a recession,” says Oliver Holtemöller, head of the Macroeconomics Department and Vice President at the IWH. So far, there are no signs of easing on the labour market. Capacity utilisation in the manufacturing sector, as derived from company surveys, has risen minimally recently, although industrial production has fallen. According to the ifo Business Climate Index, companies continue to assess their business situation as poor, but their expectations have risen. One reason for this could be the hope for positive effects from the extensive public investment programme. This is expected to take effect not before 2026. Because monetary policy is also likely to become somewhat more expansionary, the conditions for a recovery of the German economy in 2026 are quite favorable.

“Significant risks to the German economy lie in the uncertainty surrounding the future development of international trade,” says Oliver Holtemöller. This forecast takes into account losses due to higher US tariffs. The competitive position of German manufacturing, however, has been deteriorating for years in the face of foreign competition. Exports are losing their economic momentum for technological reasons. In addition, there will be a significant increase in the terms of trade this year due to the appreciation of the euro, not only against the US dollar but also against the Chinese renminbi. “Exports will probably fall as a reaction to the tariff increases in the summer, but if the decline continues into 2026, a sustained economic recovery is unlikely,” the IWH economist says.

The extended version of this forecast contains three boxes (all in German):

Box 1: On the current US tariff policy

Box 2: On the latest revision of the national accounts

Box 3: On the estimation of potential output

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