ODDO BHF

# MARKET *view*

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## *Germany before the election: hope dies last*

> *Hope dies last. A clear reform agenda could revitalise growth and lead to greater prosperity and employment.*

**Is Germany once again the "sick man of Europe"?, economics columnist Martin Wolf in an article for the Financial Times in the summer of 2024.**[1] In the election campaign ahead of the early Bundestag elections on 23 February, the question is becoming a hot topic again. In its economic outlook from January 2025, the International Monetary Fund (IMF) predicts a decline in German GDP of 0.3 per cent in 2023 and a further decline of 0.2 per cent in 2024. We expect Germany's growth this year to remain below the eurozone's weak growth of 1.0 per cent. The severity of the crisis in Germany can be seen in the latest figures on industrial production in Germany. According to the Federal Statistical Office (Destatis), price-adjusted production in the manufacturing sector fell by 2.4 per cent in December 2024 compared to the previous month.[2] The automotive industry recorded a particularly sharp decline in production. Production in energy-intensive industries is also very weak, which is not surprising given that energy prices in Germany are currently more than twice as high as in the USA.

**Germany's weak growth is of a structural nature. Labour productivity in Germany has been stagnating for some time.** From an economic perspective, the findings are clear: investment is needed to increase value creation, particularly in new technologies and artificial intelligence. In our view, the state's share of the economy in Germany is too high, as is the burden of taxes and duties on companies. Another topic that is unfortunately unpopular and often concealed before elections is that social transfers and subsidies should be reduced if they inhibit employment and the economy. A comparison also shows that Germans work too little in relation to the number of hours they work. We are convinced that the highly consumptive government spending should focus more on investments in education, infrastructure and - in view of the geopolitical challenges - also on defence

This morning, a medium-sized entrepreneur told me that the approval of fibres that go into building materials, for example, can take over three years in Germany, while comparable approval procedures in other countries take a few weeks or months. You hear this kind of comment all the time when you talk to SMEs, which employ the majority of the labour force in Germany.

[1] Martin Wolf: Is Germany the 'sick man' of Europe once again? Financial Times, 16 July 2024.
[2] Destatis, 7 February 2025.

The excessive bureaucracy and misguided regulation must be radically reduced so that Germany's meagre potential growth, which at 0.4 per cent currently corresponds to less than a third of the country's historical growth according to the German Council of Economic Experts, can finally be revived. "Complaining is the businessman's favourite song", as the saying goes. However, the justified complaints of German SMEs in particular should finally be taken seriously.

While we believe the economic findings are clear, we should not forget Germany's strengths. One of its greatest strengths is its education system. Skilled workers in Germany are generally very well trained. A close link between practice and study has proved its worth, particularly in the technical and scientific professions. SMEs also benefit from this. According to a study by the Institute for SME Research in Bonn, the approximately 3.4 million small and medium-sized enterprises in Germany contributed 55.7 per cent to net value added in the German economy in 2023, 6 per cent more than in 2021.

**The German economic model is largely based on the achievements of its engineers and technicians.** In Germany, researchers from the Fraunhofer-Gesellschaft, the Helmholtz Association, the Leibniz Association and the Max Planck Society in particular continue to conduct basic research with great success, as evidenced by the fact that six researchers from the Max Planck Society won the Nobel Prize between 2020 and 2023.

This also benefits German companies, which are innovation leaders in Europe according to the EU Commission. 106 companies invested a total of 119 billion euros in the research and development of their products in 2023.[3] This puts them in the top spot in the EU, far ahead of France, which follows in second place with 50 companies and 34 billion euros. The demand for German products is also reflected in the fact that exports totalled 1560 billion euros in 2024. **This means that the export industry accounts for around 36 per cent of Germany's gross domestic product.** However, in order for German products to remain successful on the global markets, we believe that the transfer between research and application, the path from invention to innovation, must be improved.

**To put it bluntly, Germany is the country of "hidden champions", especially in the SME sector.** It is regrettable that there are not more companies listed on the stock exchange that manufacture top products for the global market. Nevertheless, the German stock market continues to offer interesting stocks: companies with a convincing business model that are leaders in their field and achieve a comparatively high return on equity with moderate debt. There are also many companies listed in the Dax share index that are very successful in the world. They benefit from reliable economic conditions in Germany and at the same time take advantage of higher growth rates elsewhere in the world.

We are convinced that the next German government's most urgent economic policy task will be to relieve companies of excessive bureaucracy and excessive taxes. We believe that a tax rate of 39.3 per cent for German companies is too high. Companies should also be given more support to invest more in Germany as a production location. We believe that the modernisation of public infrastructure, internationally competitive energy prices and reliable framework conditions are essential for this. According to the Federal Statistical Office, companies' gross fixed capital formation has fallen in each of the last three years.[4]

Despite all the criticism of production conditions in Germany, it should not be overlooked that companies in this country benefit from a stable constitutional state and from the fact that they are active in the EU, one of the largest economic areas in the world. Stability also means that the state in this country operates with a sense of proportion - in the first half of 2024, the state's financing deficit fell by EUR 1.3 billion compared to the previous year to EUR 38.1 billion and thus to a deficit ratio of just 1.8 per cent of gross domestic product.

**Hope dies last. A clear reform agenda could revitalise growth and lead to greater prosperity and employment. And this is precisely why we are convinced that it is frightening from an economic perspective that the major parties are primarily promising benefits instead of tough economic reforms.** The CDU/CSU is currently at just over 30 per cent, the AfD at 20 per cent, the SPD at 16 per cent and the Greens at 14 per cent. Whether the FDP and the BSW will make it into parliament is questionable. But one thing seems certain: after the election, Germany will form a government supported by a coalition of at least two parties. A grand coalition that provides benefits for different clienteles could be expensive. Perhaps the crisis in Germany is not yet big enough for a real reform agenda that will finally lead to Germany utilising its strengths in and for Europe again.

[3] European Commission: EU Industrial R&D Investment Scoreboard 2024. page 18.
[4] Federal Statistical Office: Development of investments in Germany. National Accounts Monitor Germany.

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