Germany

Fiscal stimulus and structural challenges

After several years of stagnation, the German economy has begun to recover, supported by fiscal policy. We expect gross domestic product (GDP) to grow by just over 1% in 2026 and 2027, with a temporary inflation rebound driven by higher energy prices and a labour market that will take time to reflect the improvement in activity. Improving industrial competitiveness and addressing demographic pressures remain key structural challenges.

The economy is emerging from several years of virtually no growth, although the recovery is still uneven. Fiscal stimulus, a modest uptick in domestic demand and an external sector that continues to lose weight as competitiveness declines will shape the way the economy rallies. Fiscal policy is expected to be the main support for activity in the coming years.

We expect GDP to grow by 1.1% in 2026 and 1.2% in 2027. Private consumption should gradually gain traction, supported by moderating inflation and rising nominal wages, which should improve real disposable income and reduce precautionary saving. Investment will also make a growing contribution, particularly through higher public spending on defence and infrastructure. Its impact will depend on the government's ability to execute projects and whether fiscal stimulus encourages stronger private investment. The external sector is likely to be less dynamic than in previous cycles because of trade tensions and declining competitiveness in some industries.

The labour market is expected to remain weak, with unemployment averaging 6.4% in 2026 and 6.3% in 2027. A significant share of employment growth in recent years has been concentrated in public-sector-related activities, while industry and other private-sector activities have lost jobs. We expect this pattern to reverse only gradually. A clearer recovery in private employment will be needed to confirm a broad-based improvement.

Inflation should gradually move towards 2% following the temporary rebound caused by higher energy prices, assuming no new geopolitical shocks. We expect average inflation of 2.8% in 2026 and 2.6% in 2027, with some normalisation in energy prices and limited second-round effects.

Despite the cyclical recovery, **Germany faces a structural transformation of its growth model.** For decades, growth relied on technologically competitive industry, cheap energy and strong external demand, particularly from China. These conditions have changed. Energy costs are higher, productivity and business investment have advanced

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slowly, and delays in physical and digital infrastructure are hampering firms' adaptation. China has also shifted from being a major market for German exports to becoming a direct competitor, notably in the automotive sector.

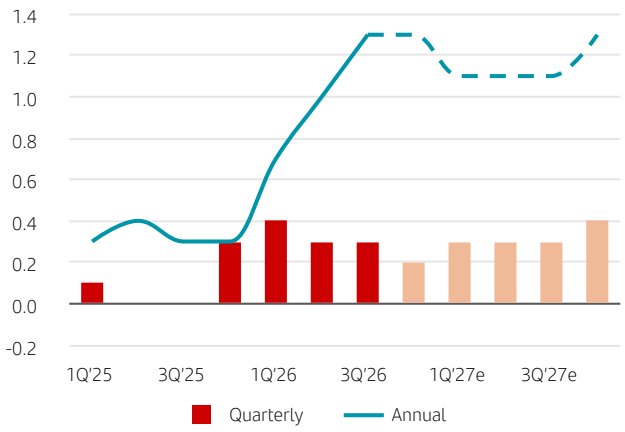
Demographic pressures add to the competitiveness challenge, with an ageing population and growing shortages of skilled workers. Raising labour-force participation, attracting skilled workers and improving productivity will be essential to lift potential growth.

The structural reform package presented in July, covering fiscal and labour-market reforms, investment incentives, bureaucracy reduction and pensions, could raise potential growth by up to 0.3 percentage points if implemented.

The international environment is still a key source of uncertainty. Prolonged geopolitical tensions could keep energy prices and inflation elevated, delaying interest-rate cuts. Higher public financing needs could put upward pressure on long-term rates.

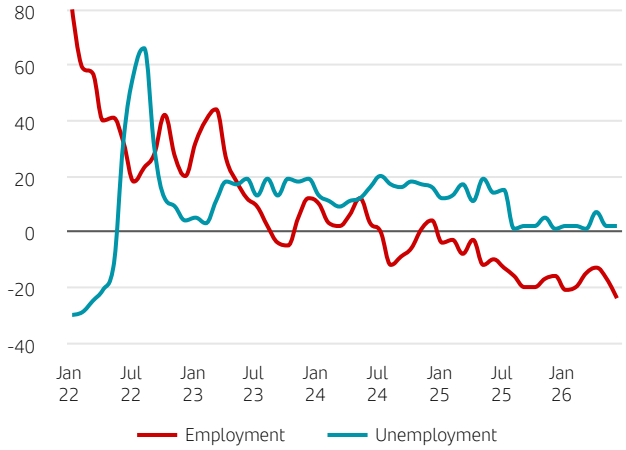
In conclusion, Germany is leaving behind its period of stagnation with a gradual recovery expected in 2026–27, driven mainly by fiscal policy. The key challenge will be to translate this stimulus into stronger private investment, technological capabilities and productivity, thereby raising potential growth.

Germany: GDP is leaving stagnation behind
(%)



Source: Fiscal Monitor IMF.

Germany: Employment and unemployment
(monthly change, 3 month moving average, thousands)



Source: Refinitiv.

Macroeconomic forecasts

	2026e	2027e	2028e
GDP growth (%)	1.1	1.2	1.4
Unemployment rate	6.4	6.3	6.1
CPI inflation	2.8	2.6	1.9

Source: Santander Research. Annual average.