Germany – Upwards in the economic cycle

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The German economic cycle appears to have turned to the upside The main driver of the fairly robust growth over the past three quarters has been stronger foreign demand, while government investment has not yet risen sustainably, despite the special funds. Leading indicators offer hope that this recovery will continue. However, the continued weakness in private investment serves as a reminder that the structural problems facing the German economy will continue to hold back economic growth.

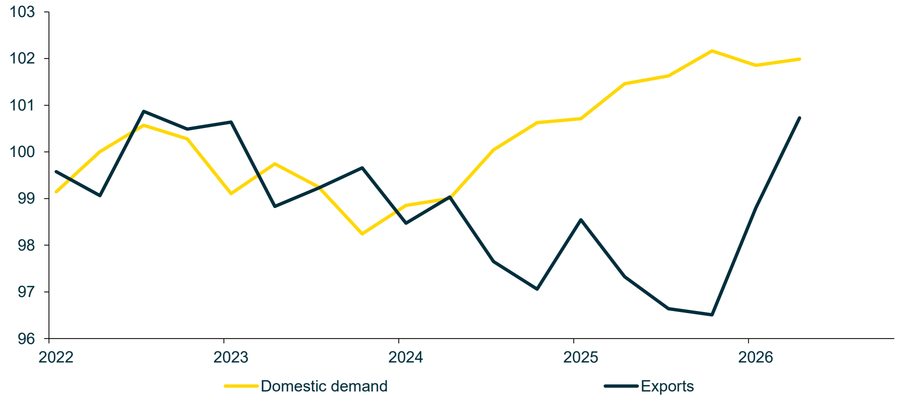
German Economy posts a fairly strong gain …

The economic situation in Germany has taken a turn for the better. According to the latest GDP figures released last Tuesday, the German economy grew even more strongly in the second quarter than previously assumed. As a result, economic output has risen by an average of 0.35% in each of the last three quarters compared to the previous quarter. Extrapolated over the year, this corresponds to a growth rate of 1.5%, which is significantly higher than the potential growth rate, generally estimated at less than 1%.

… due to a turnaround in exports

The key factor behind the recent positive trend is a turnaround in foreign demand. Exports rose significantly in the first two quarters of this year, after having been on a downward trend for nearly three years, which had noticeably slowed the economy (Chart 1). The monthly figures on goods exports show that demand from other EU countries, in particular, has picked up noticeably, while shipments to the U.S. and China have continued to decline. By contrast, domestic demand has barely increased in the first half of this year.

Chart 1 - Exports rose strongly
Volumes, seasonally adjusted quarterly figures, 2022=100



Quelle: Destatis, Commerzbank Research

Improved business sentiment suggests no decline in Q3 …

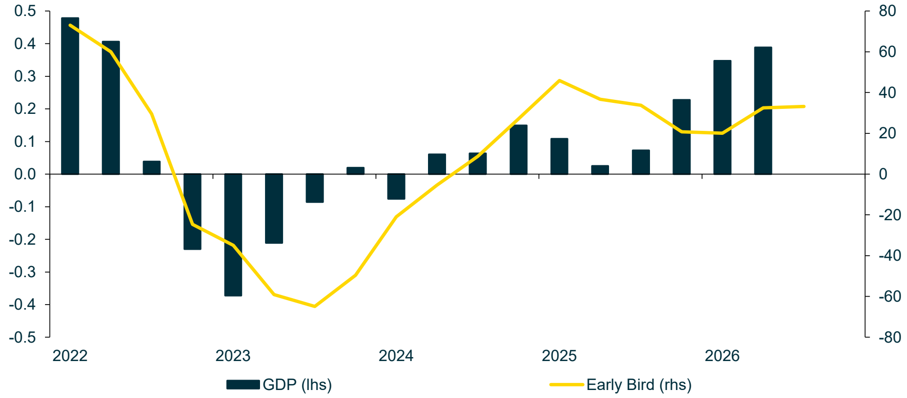
The recent improvement in business sentiment – particularly in the manufacturing sector – suggests that the renewed rise in energy prices and problems facing inland waterway transport and agriculture due to the prolonged drought, have so far weighed less heavily on the economy than feared. This has reduced the risk that the economy contracted temporarily in the third quarter as a result of these pressures.

… and for a further recovery in the coming quarters

The odds are also good that the recovery will continue later this year and into next year. This is supported, on the one hand, by businesses' somewhat more positive expectations as of late. In addition, our own leading indicator, the Early Bird, shows that economic conditions remain above average (Chart 2).

Chart 2 - Early Bird signals ongoing recovery

Early Bird, real GDP, sesonally adjusted quarterly figures, change-on-quarter in percent, 3-quarter average



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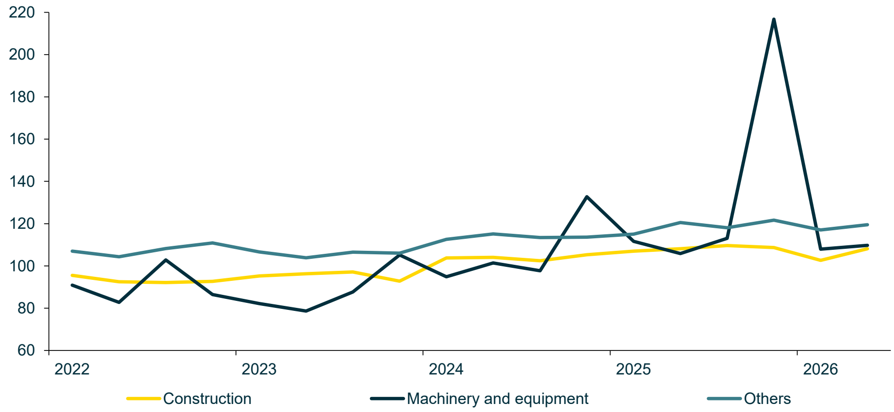
In addition the stimulus from fiscal policy, which our indicator does not take into account, is likely to increase significantly. It is true that government investment rose sharply in the final quarter of 2025 – that is, after the federal budget was passed – with particularly rising government investment in equipment, which includes military weapons systems. In the first half of this year, however, the government did not invest more in either infrastructure or equipment than it did before the establishment of the special funds or before the introduction of the “sectoral exemption” from the debt brake for a portion of defense spending (Chart 3).

Chart 3 - Public investments are not getting off the ground

Public investments, volumes, 2021=100, seasonally adjusted monthly figures



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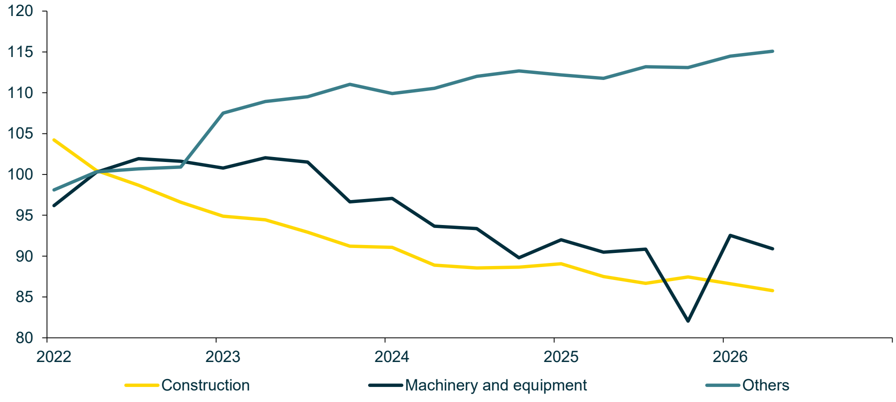
Given the upward revision to second-quarter figures and the expectation that the third quarter will be less weak than previously assumed, there are slight upside risks to our growth forecast of 1% this year. However, uncertainty remains regarding how the conflict in the Middle East – and thus energy prices – will continue to develop. Furthermore, the currently unusually low levels of natural gas storage could have a negative impact in the event of an exceptionally cold winter, so we are sticking to our forecast for the time being.

However: Private investment remaining weak ...

Furthermore, despite recent developments that have generally exceeded expectations, there is still no sign of a self-sustaining recovery. For that to happen, private investment would need to rise, but it fell again in the second quarter. That said, there are at least signs of stabilization in capital expenditure on machinery and equipment, while the trend in private construction investment continues to point downward (Chart 4). Only investment in intellectual property – the main component of so-called “other fixed investment” – has risen recently.

Chart 4 - Private investment remaining weak
Investments of the private sector, volumes, seasonally adjusted monthly figures, 2022=100



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... highlight structural problems

In particular, the weak private capital expenditures serves as a reminder that the German economy's structural problems have not yet been overcome. And this situation is not expected to change fundamentally. On the contrary, many companies may even face an additional burden by higher labor costs and rising taxes. And even if sweeping reforms were to be implemented in the coming months, it would take some time for them to translate into stronger underlying growth. For this reason, growth in the German economy is unlikely to pick up significantly in the coming quarters but will instead remain moderate.

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This report was completed 28/8/2026 07:10 CEST and disseminated 28/8/2026 07:10 CEST.

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