ECONOMICS

FEDERAL CHANCELLOR MERZ ANNOUNCES NEW DIRECTION OF ECONOMIC POLICY

Dr. Jörn Quitzau, 15 May 2025

- **Germany is in crisis. After two years of slight economic contraction, the economy is going to stagnate in 2025.**
- **In his first government statement, Federal Chancellor Friedrich Merz announced a new economic policy direction. However, the speech did not provide any new insights.**
- **Merz spread some market friendly reform optimism and announced a new basic understanding that should be characterized by trust - instead of mistrust - in citizens and companies.**

The new Federal Chancellor Friedrich Merz made his first government statement in the German Bundestag. Merz announced a new economic policy direction with which the coalition government of CDU/CSU and SPD aims to boost the economy and put Germany back on track.

Background: persistently weak growth

Germany's economy is stumbling. The country has not made any economic headway for years. German gross domestic product fell slightly in both 2023 and 2024. The underlying weakness in growth is not even adequately reflected in the GDP data alone, as the population has increased in recent years due to high net immigration. Economic output is therefore spread across more citizens, meaning that per capita prosperity has decreased more than the GDP figures suggest. The year 2025 is also unlikely to be much better. The International Monetary Fund (IMF) puts Germany at the bottom of the growth league among the major economies with economic growth of 0.0%.

If there are no major changes in economic policy, Germany will continue to have to cope with mini-growth in the future. In their latest economic forecast, the leading research institutes only see growth potential of around 0.3%. The challenges of our time can hardly be overcome with so little economic dynamism.

Not all problems are home-made. The last few years have been characterized by global upheavals such as the coronavirus crisis and geopolitical tensions, including the Russia-Ukraine war. But even before these shocks, the term “industrial recession” was already doing the rounds in Germany. The economic policy mistakes have accumulated over the last 10 to 15 years and the failures of the last legislative periods cannot be overlooked. They have contributed significantly to the current economic misery. The weakness is therefore anything but a snapshot.

Apart from the specific economic policy mistakes, Germany also has a mentality problem in some areas. The idea that economic growth is unnecessary given the level of prosperity achieved today has been surprisingly widespread in society in recent years. Even in the Federal Ministry of Economics, the discussion arose as to whether gross domestic product – i.e. economic output – was still the right measure of prosperity. The question may be intellectually interesting and has long been discussed at European level (keyword: “Beyond GDP”). However, Germany faces international competition and the level of prosperity achieved today does not simply fall from the sky – even a stagnating gross domestic product must first be generated year after year. Germany therefore not only needs a new economic policy direction, but also a change in mentality if the challenges ahead are to be overcome.

Although the media is full of reports on the decline of the German economic crisis, the crisis has clearly not yet fully sunk into the minds of many people. This may be due to the fact that the labor market is still in comparatively stable shape. Although the unemployment rate has gradually risen from 5.0% to 6.3% since mid-2022, this is not yet a dramatic figure in a longer-term comparison (see chart). However, the unemployment rate is considered a lagging indicator, meaning that the all-clear cannot be given from the relatively low unemployment rate.

Unemployment rate Germany

Source: Macrobond

Government statement: “Responsibility for Germany”

Federal Chancellor Friedrich Merz began and ended his first government statement with the title of the coalition agreement, “Responsibility for Germany”. He called for social cohesion and announced a new direction of economic policy. In terms of content, he presented little that was new in terms of economic policy realignment, but essentially listed the familiar points from the coalition agreement: tax relief, infrastructure programme, realignment of energy policy, CO2 pricing, modernization and digitalization of administration, fewer reporting obligations and bureaucracy (including from Brussels), basic security instead of citizen's income, active pension and much more. He promoted free trade initiatives and closer cooperation with the United Kingdom.

The coalition agreement is a long way from a genuine pro-growth reform agenda. However, when assessing German economic policy, it should be borne in mind that the German party landscape has changed in such a way that parties with different basic programmatic orientations are increasingly being forced into government coalitions. The new federal government consisting of the CDU/CSU and SPD has very different ideas on economic and financial policy. The CDU/CSU parties under Chancellor Friedrich Merz are more in favor of supply-side reforms, strengthening incentives to work and invest and a reduced role for the state. The SPD, on the other hand, is more in favor of state power and social equality. A genuine growth agenda was hardly to be expected in this constellation. Measured against its weak election result, the SPD was able to incorporate its positions into the coalition agreement to an astonishing degree. In this respect, yesterday's government statement did not provide any new insights in terms of content.

Aside from the individual points presented, the nuances and rhetoric of Chancellor Merz were interesting, as there was a slightly more market-friendly spirit. The previous government often relied on moral suasion in order to achieve the desired behavior from citizens and companies. Friedrich Merz clearly wants to focus more on economic incentives and individual responsibility. Experience has shown that this is much more effective.

Merz also announced a new basic understanding of the government: In future, citizens and companies should no longer be treated with mistrust, but with trust. The new government is not aiming for a major ideological project in which something is to be imposed on citizens. Instead, the new government is focusing on a stable regulatory framework within which citizens and companies can break new ground. The comments on reducing bureaucracy also sounded promising.

Ultimately, however, the new government will have to be judged not by its declarations of intent, but by the results of its work. As often as Friedrich Merz used the word “responsibility” during his government statement, there is at least hope that the new government will be more strongly guided by the ethics of responsibility (Max Weber), in which it is not primarily the good intentions that are decisive, but in particular the results achieved. This would be a real difference to the previous governments, which were all too often guided by good intentions in both economic policy and other policy areas – often with very disappointing results. Whether Germany can noticeably increase its growth potential over the next few years and get back on its feet economically will largely depend on whether Chancellor Merz can back up his rhetoric within the coalition with action.

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KREUZSTRASSE 5
8008 ZÜRICH, SCHWEIZ
T +41 44 284 20 20
BERGOS.CH