DWS View

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Marketing material

Germany: Better than sentiment suggests

Recent growth figures, leading indicators and financial market signals suggest that Germany's economy is performing better than prevailing sentiment implies

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IN A NUTSHELL

- Germany has weathered recent shocks more successfully than many expected.
- Improving business surveys and rising order inflows point to further economic stabilization.
- A notable gap remains between economic reality and public perception, creating potential opportunities for investors.

Executive Summary

Public perception suggests that the German economy remains shaped by the crises of recent years. The energy crisis, the inflation shock and the prolonged weakness of the industrial sector have all weighed heavily on confidence. Yet the latest data tell a more encouraging story. Germany's economy expanded in the first half of 2026, proving remarkably resilient in the face of both the Iran conflict and a sharp rise in energy prices. At the same time, a range of leading indicators points to further improvement in economic activity. Business surveys have strengthened, industrial orders are recovering and financial markets show little sign of an economy in crisis.

This does not mean that Germany's well-known challenges have been resolved. Nevertheless, much of the recent evidence suggests that economic reality is less negative than public debate often implies. Germany is not experiencing a boom, but the economy is proving more resilient than its reputation would suggest. Should the federal government's reform agenda, published in July, be implemented in full, the current cyclical recovery could be reinforced by an improvement in sentiment and, over the longer term, by more favorable supply-side conditions.

1 / Germany's economy is surprising on the upside

1.1 A stress test with an unexpected outcome

Anyone following the public debate about Germany's economy could easily conclude that the country remains stuck in a period of persistent weakness. Discussions continue to focus on structural disadvantages, deindustrialization, excessive bureaucracy and a perceived loss of competitiveness. Many of these challenges are undoubtedly real. At the same time, however, they have contributed to a narrative that is no longer fully aligned with the latest economic data. It is also worth noting that the federal government unveiled a comprehensive reform package in July aimed precisely at addressing many of these concerns.

A particularly revealing example came during the Iran conflict earlier this year. As oil prices surged, memories of the energy crisis quickly resurfaced across financial markets. Concerns about a combination of weaker growth and higher inflation, a classic stagflation scenario, intensified noticeably. Bond markets initially reflected these fears through rising inflation expectations and falling real yields. For many investors, it appeared that the European economy, and Germany in particular, would struggle to absorb another external shock of this magnitude.

1.2 More resilient than perceived

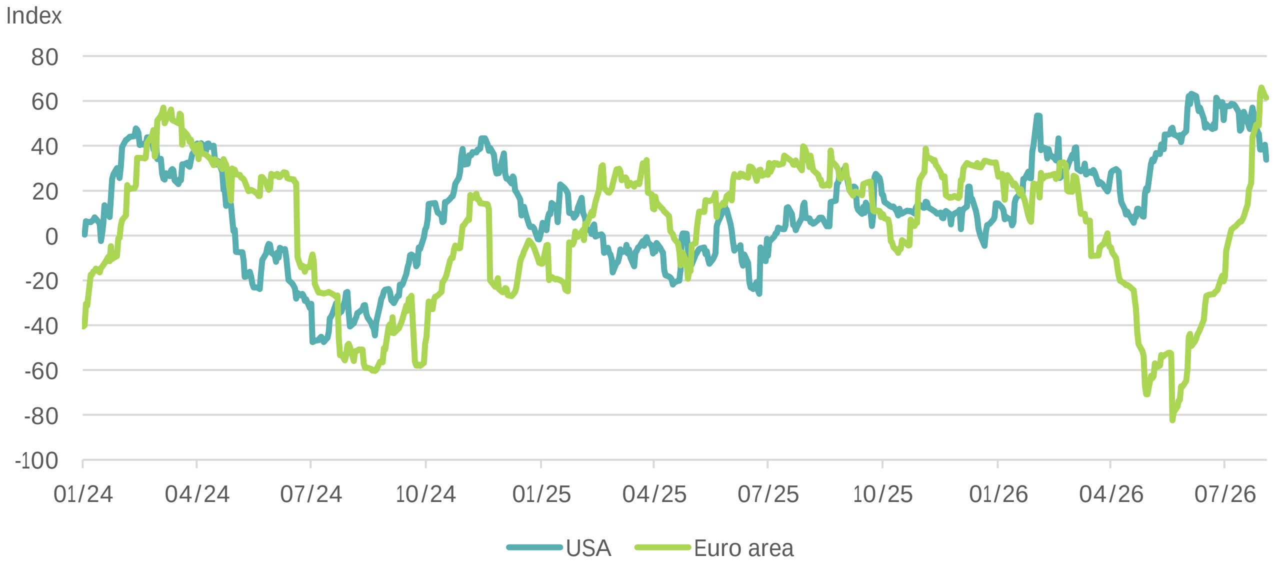
Yet Germany's economy proved remarkably resilient. There was neither a sharp slowdown nor a lasting deterioration in the economic outlook. German gross domestic product expanded by 0.2% quarter-on-quarter in the second quarter of 2026, following growth of 0.4% in the first quarter. For the first half of the year as a whole, this amounts to cumulative growth of 0.6%, equivalent to roughly 1.2% on an annualized basis.[1]

Germany also compares favorably with its international peers. After adjusting for Ireland's exceptional volatility, the euro area expanded at an annualized pace of around 1.2%, broadly in line with Germany. The U.S. economy performed somewhat better at 1.5%, but it has recently benefited from a powerful investment cycle linked to artificial intelligence as well as positive wealth effects driven by rising equity markets. Against this backdrop, both Germany and the euro area have held up remarkably well.

1.3 Positive surprises are becoming more frequent

Economic momentum has also shown increasing signs of improvement in recent months. The euro area's Economic Surprise Index has risen from around -80 points in May to +66 recently, placing it above the corresponding U.S. indicator. This sharp increase suggests that economic data have repeatedly exceeded analysts' and investors' expectations. Historically, such levels have often marked the beginning of periods in which both growth and earnings forecasts are revised upward.

Citigroup's economic surprise indices: Euro area jumps



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 8/5/26

[1] All financial and economic data – unless otherwise quoted – from Bloomberg Finance L.P. as of 8/5/26

Taken together, the data point less to an economy in crisis than to one that is gradually recovering while demonstrating a notable capacity to withstand external shocks. Better economic data do not imply that all of Germany's structural challenges have been resolved. They do, however, suggest that current economic reality is considerably less negative than prevailing sentiment would imply. This gap between perception and reality may well be one of the defining features of the German economy in 2026.

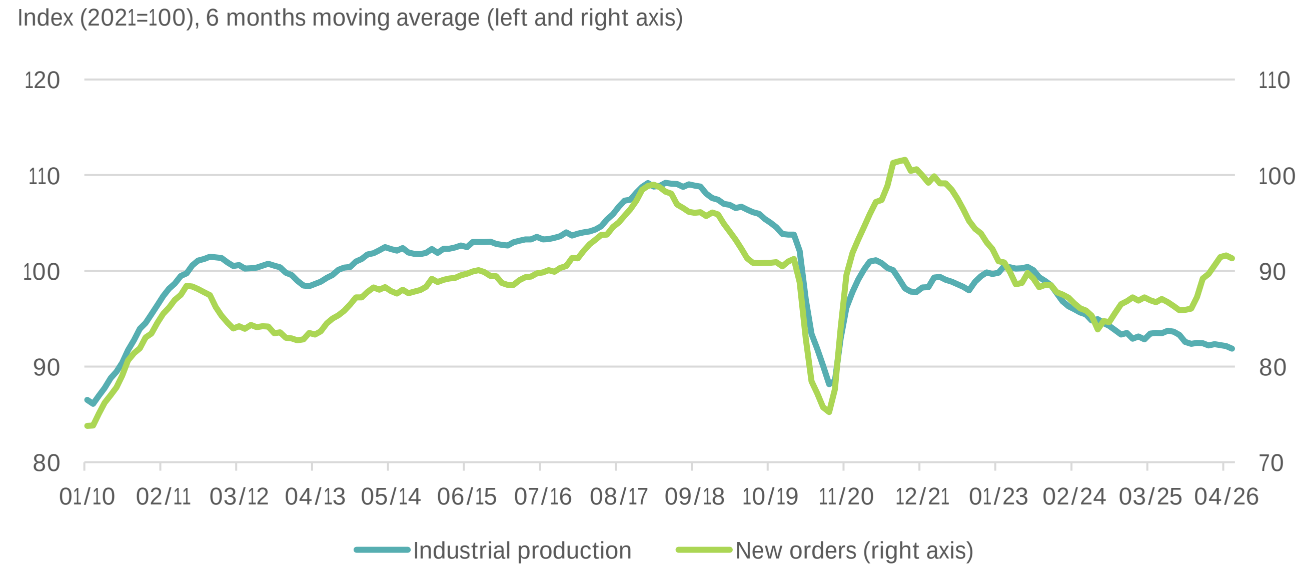
2 / The signals point to a recovery

2.1 Order books are filling up again

Much of the current debate about Germany's economy continues to focus on areas that still appear weak. Industrial production, in particular, remains well below the peaks reached in previous years despite signs of stabilization. Yet concentrating solely on these lagging indicators risks overlooking an important development: many of the traditional leading indicators have been moving higher for months.

This is particularly evident in industrial orders. While manufacturing has struggled for years against both cyclical and structural headwinds, incoming orders have been recovering since the fourth quarter of 2025. Adjusting for the exceptional distortions caused by the pandemic, order growth has now reached its strongest pace since 2016 and 2017. According to the latest data, new orders are running roughly 6% above their level of a year ago, and the improvement extends well beyond a handful of large-ticket contracts. Industrial production, by contrast, remains broadly unchanged from a year earlier. As a result, order backlogs are steadily expanding, creating a pipeline of activity that is likely to translate into higher production only with a lag. In other words, the strongest phase of the recovery may still lie ahead.

A gap is emerging between German industrial orders and production



Sources: Haver Analytics Inc., DWS Investment GmbH as of June 2026

2.2 Businesses are becoming more optimistic

The improvement in business surveys tells a similar story. Germany's manufacturing Purchasing Managers' Index has fully recovered from the temporary weakness triggered by the Iran conflict and most recently moved back above the 50-point threshold that separates contraction from expansion. Particularly noteworthy is the improvement in the orders component, which is often regarded as one of the most reliable leading indicators of industrial activity. The ifo Business Climate Index has also stabilized in recent months, with companies' expectations improving in particular.

Yet even this does not capture the full picture. Beyond the current stabilization, the contours of a broader and more durable investment cycle are beginning to emerge. In the years ahead, Germany faces substantial spending needs in infrastructure, defense, energy systems and the modernization of its capital stock. The Bundesbank expects the public-sector deficit to increase significantly in 2026 compared with the previous year, potentially providing a fiscal impulse equivalent to around 1.5% of gross domestic product. By German standards, that would be exceptional. As a result, economic activity is no longer being driven primarily by consumption but increasingly by investment. Such investment impulses typically unfold with a longer lag, but they also tend to be more persistent.

Importantly, this support is not coming from Germany alone. Investment spending is also rising across Europe in areas such as infrastructure, energy security, digitalization and defense. This matters for Germany because its industrial sector has traditionally been closely linked to European investment cycles. Unlike in recent years, support is therefore increasingly coming not only from external demand or individual export markets but also from the European single market itself.

None of this suggests that Germany is on the verge of a new economic boom. Not every investment project will automatically translate into stronger growth, and many structural reform challenges remain unresolved. Nevertheless, current developments imply that the economy is more likely to be underestimated than overestimated. The combination of rising orders, improving business indicators and a strengthening investment cycle suggests that the current stabilization has further room to run. For that reason, the widespread skepticism surrounding Germany's economy is becoming increasingly difficult to reconcile with the data.

3 / Between perception and reality

3.1 The long shadow of the crisis years

The weakness in sentiment did not emerge without reason. The energy crisis, the inflation shock, geopolitical tensions and the prolonged downturn in manufacturing have all left a lasting mark on the confidence of businesses and consumers alike. Unlike previous cyclical slowdowns, this was not a brief period of weakness but a multi-year adjustment process. Against that backdrop, it is hardly surprising that sentiment has been slow to recover.

Perhaps the real puzzle surrounding Germany's economy today lies not in the data but in how those data are perceived. While new economic indicators have repeatedly pointed to stabilization, public opinion continues to be shaped by the experiences of recent years. This appears to be particularly true in Germany. Public debate remains heavily focused on the challenges that emerged during the crisis years, even as many current indicators suggest improving conditions. At the same time, cyclical weakness is often interpreted as evidence of deeper structural decline. The distinction between an economy's long-term growth path and the cyclical fluctuations around that trend is frequently blurred.

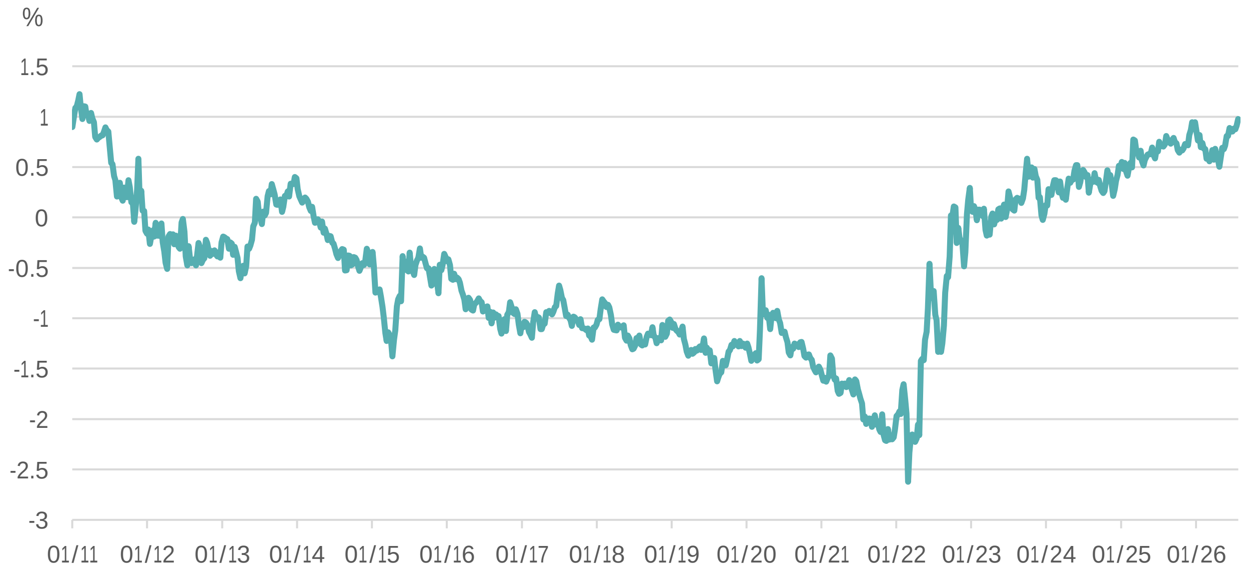
3.2 Financial markets see no crisis

Interestingly, this gap between perception and reality is especially visible in financial markets. Every day, investors reassess the economic outlook of countries through asset prices. If Germany were genuinely heading toward a severe economic crisis, this would eventually be reflected in higher financing costs or a deterioration in perceived credit quality. So far, neither development has materialized.

The cost of insuring German government debt against default, as measured by credit default swaps (CDS), remains among the lowest in the world. At around nine basis points, German CDS spreads are well below those of many other major advanced economies. Financial markets therefore continue to view Germany's creditworthiness as exceptionally strong.

Bond markets tell a similar story. Following the temporary stagflation fears triggered by the Iran conflict, investor expectations have improved markedly. Since early July, both inflation expectations and real yields on German government bonds have moved higher. The latter recently reached their highest level since 2011. Such a pattern is typically associated not with a shrinking economy but with expectations of more stable growth prospects.

Real yield on 10-year German government bonds at its highest level since 2011



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 8/5/26

3.3 More than just a sentiment issue

There is also another factor that remains underappreciated in the public debate. Germany appears to be entering an unusually long investment cycle. Large-scale spending on infrastructure, defense, energy networks, digitalization and industrial modernization will require substantial resources over the coming years. Many of these investments are still in their early stages and are therefore only partially reflected in current growth figures. At the same time, they are contributing to a gradual improvement in corporate investment and hiring expectations.

None of this suggests that Germany's fundamental challenges have disappeared. The country still faces important tasks, from addressing demographic pressures and strengthening competitiveness to modernizing its infrastructure. Yet there is a crucial difference between acknowledging these challenges and concluding that the economy is in crisis. Increasingly, the data support the former interpretation rather than the latter.

Germany is not experiencing an economic boom. Growth remains moderate, structural challenges persist and some weaknesses are likely to remain for years to come. Yet the evidence is also mounting that economic reality looks considerably better than public sentiment suggests. Recent growth figures, improving leading indicators, the economy's resilience during the Iran conflict and the signals coming from financial markets all point to an economy that is more adaptable and resilient than its reputation would imply. The federal government's reform agenda, although not yet adopted, provides further evidence that Germany may be more capable of change than many observers, both abroad and at home, often assume.

Perhaps that is the most surprising conclusion of 2026: it is not the economy that has proven overly optimistic, but sentiment that has been excessively pessimistic.

Glossary

Artificial intelligence is the theory and development of computer systems able to perform tasks normally requiring human intelligence.

The Bundesbank is the central bank of Germany.

The Citi Economic Surprise Index (CESI) tracks for various locales how actual economic data compares to consensus forecasts.

Credit default swaps (CDS) is a financial derivative that allows an investor to swap or offset their credit risk with that of another investor.

Cyclical describes an economic variable, sector, or asset whose performance rises and falls in line with the business cycle.

The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

The ifo Business Climate Index is a highly regarded indicator of economic sentiment in Germany.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Purchasing Managers' Index (PMI) is a survey-based indicator of business activity in manufacturing, services, or the broader economy.

In economics, a real value is adjusted for inflation.

Real yield is the inflation-adjusted return on a bond, showing how much an investor earns in real purchasing power terms.

Stagflation is the combination of the words "stagnation" and "inflation," referring to a period where inflation is high while the economy is stagnating.

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