

Wages and inflation in Germany (Session 1)

Introductory statement by Stephan Kohns

Deputy Head, Directorate General Economics, Deutsche Bundesbank

Outline

- Talking about wages as a central bank → wage growth not a policy variable
- Wage growth → supported by growing labour market tightness, but dampened by various factors
- Inflation → dynamics in line with past experience, levels (above EA average) in line with cyclical position
- Outlook → gradual pick-up of wage growth and inflation as upswing continues

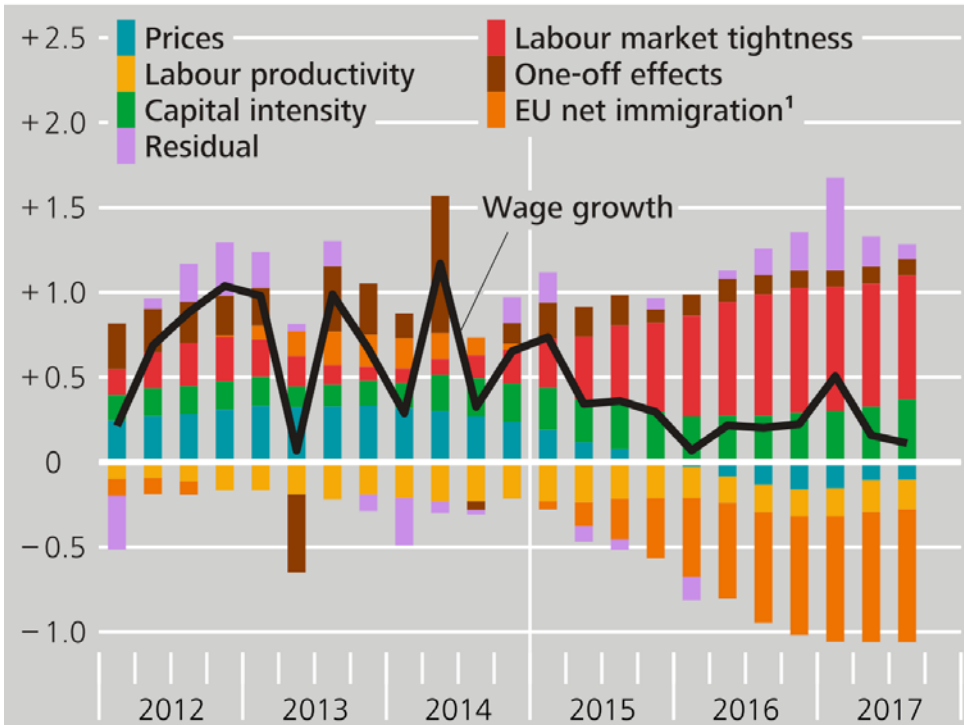
Talking about wages as a central bank

- Wage developments matter for consumer prices in Germany and hence in the euro area (weight of German HICP of about a quarter in euro area aggregate), however...
 - ... one factor among several others,
 - ... no policy variable, but endogenous outcome of bargaining process → direct intervention bears risk of distortions.
- BBk's assessment of wage outcomes not normative, but positive: Information on state of the business cycle, input to inflation projections and possibly scenarios.

Wage growth: Contribution of labour market tightness counterbalanced by dampening factors

Contributions to wage growth in Germany*

year-on-year in percentage points



* Deviations from model implied mean. Sample period: 1996Q1 to 2017Q3. Based on a modified version of the equation for negotiated hourly wages in the Bundesbank Macroeconometric Model, which assumes a cointegrating relationship between hourly real labour productivity and the hourly real wage. ¹ Net immigration from EU member states in changing official composition to Germany.

Deutsche Bundesbank

11 Jan 2018, 09:23:20, Vo3PR0451A.Chart

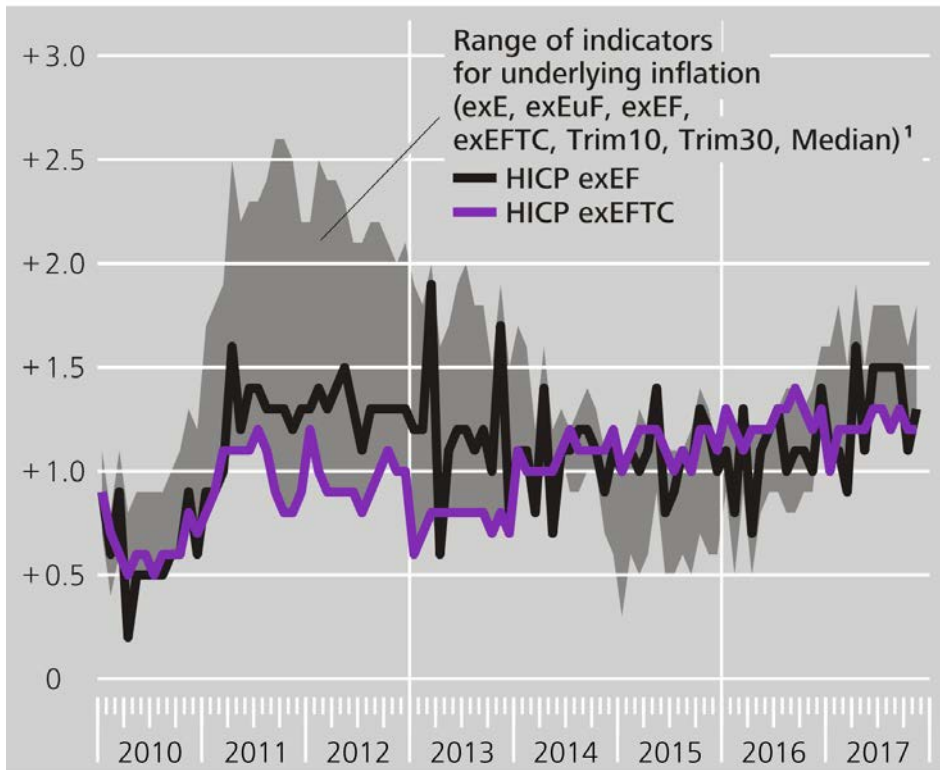
Large positive contribution of labour market tightness counterbalanced by several factors:

- Net immigration from EU member states major drag on wage growth in recent years.
- Merely average contributions of other factors, also due to low inflation and weak productivity growth in recent years.
- On top: Increasing role of non-wage components in collective bargaining.

Above average inflation in Germany corresponds well with tight labour market and favourable cyclical situation

Underlying inflation, Germany

Year-on-year percentage change



¹ exE = HICP ex energy, exEuF = HICP ex energy and unprocessed food, exEF = HICP ex energy and food, exEFTC = HICP ex energy, food, travels and clothing, Trim10 = 10% trimmed mean, Trim 30% = 30% trimmed mean.

Deutsche Bundesbank

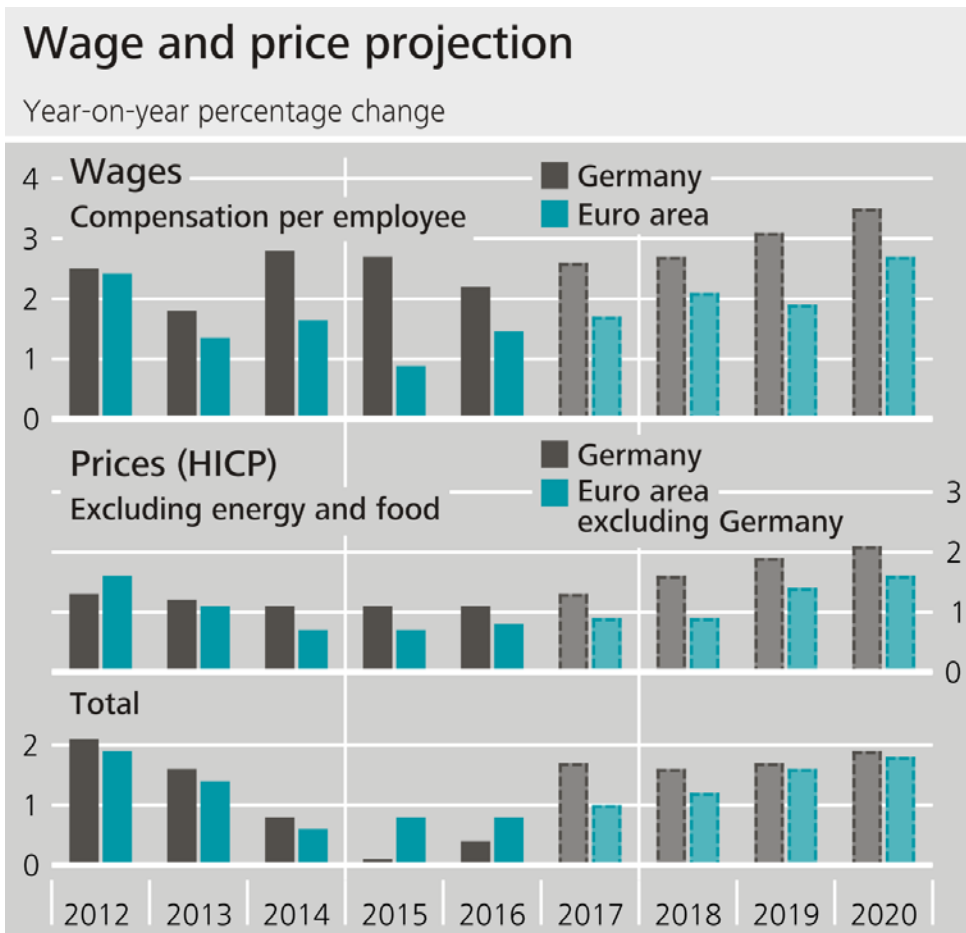
11 Jan 2018, 15:04:11, Vo3PR0467A.Chart

Underlying inflation already picked up somewhat; drivers: wages, slack (Phillips curve still valid).

Some factors have dampened stronger increase of inflation, though:

- HICP-components independent of wages and slack or dominated by other factors.
- Pass-through from wages to prices < 50%.
- Small role of slack in PC estimates – import prices and oil prices more important.
- General relevance of global factors?

Outlook for wage growth and inflation in Germany: Gradual pick-up



Sources: Federal Statistical Office, Eurostat and Bundesbank calculations. 2017 to 2020 Bundesbank projections (for Germany), Eurosystem projections (for the euro area) and calculations based on Eurosystem projections (for the euro area excluding Germany).

Deutsche Bundesbank

9 Jan 2018, 14:11:41, Vo3PR0468.Chart

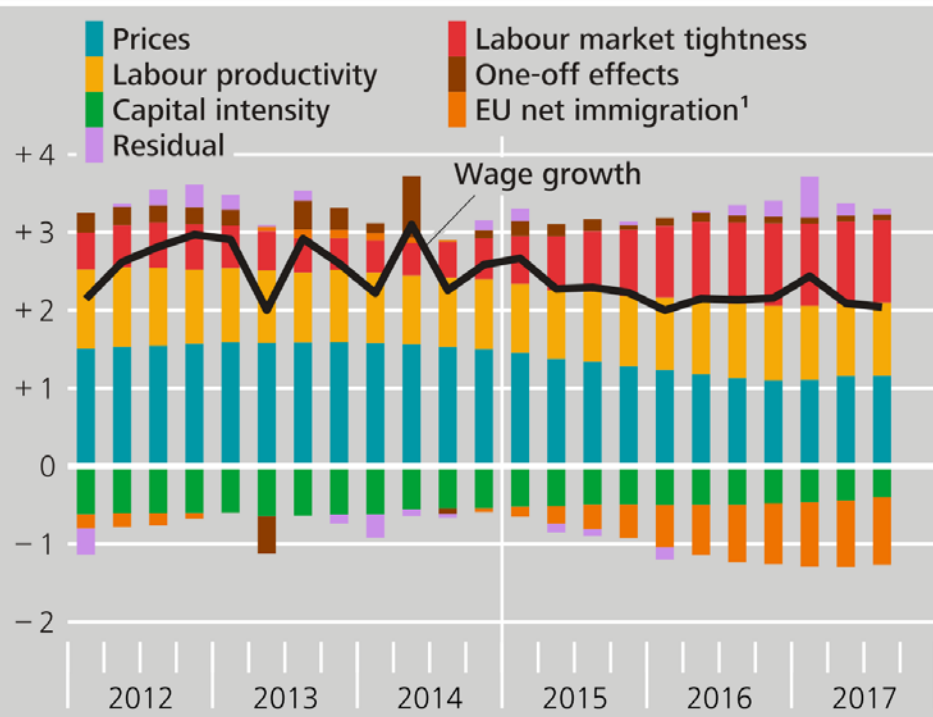
- BBk December forecast: Gradual pick-up in wages and domestic inflation.
Positive wage drift should persist.
- Expected increase of inflation to 1.9 % in 2020 (core: 2.1 %), which is considerably above historical average in Germany and higher than inflation outlook for the rest of the euro area.

Backup slides

Wage growth: Alternative representation of the decomposition

Contributions to wage growth in Germany*

year-on-year in percentage points



* Sample period: 1996Q1 to 2017Q3. Based on a modified version of the equation for negotiated hourly wages in the Bundesbank Macroeconometric Model, which assumes a cointegrating relationship between hourly real labour productivity and the hourly real wage. ¹ Net immigration from EU member states in changing official composition to Germany.

Deutsche Bundesbank

11 Jan 2018, 09:21:28, Vo3PR0451C.Chart

- Instead of deviations from mean, graph now shows the overall contributions (economically more intuitive, but dynamics more difficult to discern).