The current economic situation in Germany

Overview

Positive domestic demand supporting upswing

Global economy

The global economy probably continued to experience subdued growth in the third quarter of 2015. There are no signs of a perceptible slowdown, let alone a downturn, in global economic activity, contrary to fears expressed in the public debate in light of events in some emerging market economies (EMEs). On the whole, the EMEs' situation does not appear to have deteriorated further. There had been mounting concerns regarding, in particular, China's economy in connection with financial market turmoil. Nevertheless, official figures have put real gross domestic product (GDP) growth in China more or less unchanged from its second-quarter level. In the advanced economies, the upsurge has proven to be robust. Growth in economic output in the United States was admittedly weaker in the third quarter than in the second, yet the dampening impact caused by inventory changes masked a renewed substantial increase in domestic final demand. In the euro area and the United Kingdom, real GDP growth in the third quarter was not quite as buoyant as it had been in the preceding quarter.

With regard to annual average global growth for 2015, IMF staff now expect a slight deceleration compared with 2014. This slowdown is attributable, in unadjusted terms, to commodity-extracting regions, the economies of which are reeling from the impact of plummeting commodity prices. By contrast, there is no indication of an overall slowdown in aggregate demand in commodity-consuming regions. All things considered, the regional growth divide clearly shows that the slowdown in global economic activity this year is, if anything, a response to the decline in the prices of important commodities and not the cause. With the severe recessions in Russia and Brazil subsiding, as things stand today, global growth is expected to return to stable levels next year.

Financial markets

Concerns over growth in some major EMEs also influenced the international financial markets in the third quarter of 2015. In addition, monetary policy decisions by central banks and changing expectations of future monetary policy in the industrial countries played a key role. Overall, long-term government bond yields in the major currency areas have tended to decline – amid fluctuations – since the end of June, albeit to varying degrees. In the international equity markets, fears over the global economic outlook and expectations that monetary policy would remain accommodative in many countries ultimately balanced each other out. Intermittent sharp depreciations were, for the most part, quickly recuperated. In the foreign exchange markets, the aforementioned concerns over the global economy initially caused a spike in demand for the euro. Subsequently, the single currency came under pressure from market participants' expectations regarding the possibility of diverging monetary policy measures on both sides of the Atlantic. Overall, the euro has depreciated slightly in effective terms since mid-year.

Monetary policy

The Governing Council of the European Central Bank (ECB) kept the key interest rates unchanged in the reporting period. Moreover, it found that the expanded asset purchase programme (EAPP), adopted in January 2015 and launched in March 2015, was continuing to proceed smoothly and that the purchases were having a favourable impact on the cost and availability of credit for firms and households. After a review following the first six months of purchases, which was announced when the programme was launched, the Governing Council decided in September to increase the issue share limit for purchases of individual public sector assets from the initial limit of 25% to 33%. However, for each individual issue, it must be verified that a situation in which the Eurosystem has a blocking minority is avoided.

In light of the somewhat weaker-than-expected economic recovery and the renewed downward revision of ECB staff inflation forecasts, the Governing Council stressed at the beginning of September that, if required, the EAPP provided sufficient flexibility in terms of adjusting the size, composition and duration of the programme. It also noted that the purchase programme, with a monthly purchase target of €60 billion, was intended to run until the end of September 2016, or beyond if necessary, and, in any case, until it sees a sustained adjustment in the path of inflation towards its medium-term aim of achieving inflation rates below, but close to, 2%. Following the monetary policy meeting in October, the Governing Council announced that it would re-examine the degree of monetary policy accommodation at its December monetary policy meeting on the basis of Eurosystem staff macroeconomic projections.

Growth of the broad monetary aggregate M3 stabilised during the third quarter at an annual rate of around 5%. In this context, monetary developments were dominated by the effects of the EAPP, with growth in securitised lending by the MFI sector to general government again accelerating significantly thanks to Eurosystem purchases. In the quarter under review, loans to the private sector did not have a bolstering effect despite a further decline in lending rates; however, inflows of loans to the non-financial private sector remained sustained.

Germany

The German economy remained on its growth path in the third quarter. According to the Federal Statistical Office flash estimate, real GDP in the third quarter of 2015 was up by 0.3% from the previous quarter after seasonal and calendar adjustment. The pace of growth was somewhat more moderate than the 0.4% figure recorded in the second quarter and was broadly in line with potential. Buoyant consumption activity was the main driver of third-quarter economic growth, although it was not enough to fully compensate for the failure of external demand to provide any stimulus. Aggregate capacity utilisation remained in the upper part of the corridor of normal capacity utilisation.

As in the fourth quarter of 2014 and the first quarter of 2015, purchasing power gains owing to the decline in crude oil prices were one of the factors behind the stronger growth in private consumption in the third quarter. Households' real income also benefited from the considerable acceleration in employment growth. Consumer demand was additionally boosted by the mounting influx of refugees, which led to a rise in transfer payments as well as in expenditure for staff, accommodation and non-cash benefits at the central, state and local government levels. Housing construction investment probably continued its upward tendency, whereas enterprises remained cautious with regard to investment in new machinery and equipment and in new buildings. This may have been one of the reasons why external demand failed to provide any new impetus.

Export business did not grow any further in the third quarter of 2015 following the strong upswing in the second quarter. Exports of goods were down slightly on the quarter after adjustment for seasonal and price variations. Goods exports to other euro-area and non-euro-area countries probably did not surpass the highly elevated second-quarter level. By contrast, imports in the third quarter again managed to keep pace with the strong growth recorded in the last three months of 2014 and the first quarter of this year, with foreign manufacturers also benefiting from the buoyant consumption activity.

The labour market remains in very good shape. During the reporting period, employment growth gained momentum, the number of reported vacancies went up, and unemployment held steady at a low level. The very strong upturn in employment subject to social security contributions continued. Whereas job growth in the manufacturing and construction sectors was below average, in a number of services sectors it once again took off. The increase in the demand for labour is still being met to a considerable extent by immigrants, especially from other European Union countries. By contrast, the large number of refugees who have come to Germany this year are unlikely to have taken up gainful employment to date. According to the leading labour market indicators, employment growth could expand even further in the coming months. Job vacancies for more lower-level service activities appear to be particularly plentiful at present.

Negotiated rates of pay, including all ancillary agreements, rose slightly more sharply in the third quarter of 2015 than in the previous period; however, the annual increase, at just under 2½%, remained moderate. Nevertheless, annual actual earnings growth is again likely to have distinctly exceeded negotiated wage growth in the third quarter, owing mainly to the introduction of the general statutory minimum wage at the beginning of the year. In accordance with the transitional statutory provisions, the hourly minimum wage of €8.50 will only be undercut in the lowest pay groups of individual sectors.

The price climate continues to be characterised by the swings in crude oil prices, which were on their way back down in the third quarter, causing prices across all stages of the economy to fall further. This movement was amplified somewhat by the falling prices for other commodities – import prices dropped sharply in the third quarter across the board but even fell markedly excluding energy. Seasonally adjusted consumer prices fell slightly on the quarter in the summer months following strong second-quarter growth. This was due mainly to significantly lower energy prices. Excluding energy, however, the upward pressure on prices was almost as strong as in the second quarter. In October, consumer prices remained unchanged on the whole after adjustment for seasonal variations. As consumer prices had fallen quite distinctly in October of last year, annual CPI and HICP inflation were up in the reporting period.

The slight deceleration of German economic growth in the third quarter of 2015 could also continue into the final quarter. The favourable outlook for the labour market and compensation, together with sizeable immigration, have created the necessary conditions for the buoyant consumption activity to continue and for GDP growth to outpace potential over the medium term. These factors, along with the persistently low mortgage rates, are also boosting housing construction. Virtually no stimuli should be expected from industrial activity before the end of the year, however. The sharp decrease in orders in the third quarter, especially from non-euro-area countries, indicates that the industrial sector will remain in its slump up until the end of the year and that export activity will not gain any traction either. This means that firms will probably be more cautious in their investment planning. Nevertheless, firms' short-term export and production expectations remain rather optimistic, indicating that their assessment of industrial activity is robust on the whole.

Public finances

German public finances continued to develop favourably throughout the current year. The surplus is likely to have improved markedly on 2014 (0.3% of GDP), in particular due to beneficial one-off factors. In structural terms, it will – as in the previous year – probably be in the order of ½% of GDP. The reasons for expenditure growth, particularly in the second half of the year, include not only the strong rise in the number of refugees coming to Germany but also the pension benefits package which came into force in mid-2014. The reduction in the debt ratio will continue.

The surplus is expected to contract in the year ahead. As a result, the government budget could be more or less balanced, with the debt ratio continuing to fall. While positive economic developments and a further decline in interest expenditure could relieve budgets, no auction revenues will be collected in 2015 and various fiscal policy measures (tax cuts and additional expenditure, ie on infrastructure, education and research) have been weighing on public finances. The marked increase in expenditure related to the influx of refugees will have a particularly profound impact.

However, it is very hard at present to gauge how the migration of refugees and the associated implications for public finances will pan out. Besides immigration and emigration, the effects on government budgets will also depend on the specific amount of funds allocated to immigrants. Expenditure will fundamentally focus on basic dietary needs, accommodation, healthcare, administration, child day-care as well as education and training. In the long term, the better and more quickly immigrants are integrated into the labour market and earning their own income, the lower the burden on public finances will be. At present, additional government expenditure in the amount of up to ¼% of GDP in this year and ½% for the year ahead do not seem implausible.

According to the latest plans, the Federal budget will not have to be financed via net borrowing both this and next year, which would imply maintaining a balanced budget in 2016, too. This seems realistic. To this aim, the marked surplus is intended to be set aside this year for the creation of a reserve. A total of €5 billion have been earmarked, but the figure could also be markedly higher. These funds will then be used, particularly in the coming year, to cover the added costs associated with the influx of refugees. The central government debt brake envisages a limit of 0.35% of GDP for the structural deficit, although this figure must be adjusted for cyclical factors and financial transactions (ie granting of loans or privatisation proceeds) and include some of the common funds. There is a possibility that the latter will conclude the next year with a deficit, and it would make sense to treat a release of reserves just like a financial transaction, meaning a perceptible structural deficit can be expected. From today’s perspective, however, this deficit would still be below the limit of 0.35% of GDP.

The current situation demonstrates the advantage of having a relatively favourable structural budgetary situation and safety margins to the limits set by European and national budgetary rules. Especially unexpected developments and additional burdens which are difficult to gauge can initially be absorbed in the budgets without immediately having to take fiscal policy countermeasures or call into question the credibility of the rules by bending them. At this stage, the burdens in connection with the influx of refugees, which can only be roughly estimated at best, could initially be cushioned with appropriated funds, thereby narrowing the safety margins. Greater clarity regarding the continued migration of refugees, the direct budgetary impact and political decisions in Germany and also in the European Union, as well as the resulting overall impact on government finances, may be expected going forward. Structural burdens – ie if it takes a long time to integrate the large number of immigrants into the labour market – should be financed by budget cuts elsewhere. A moderate structural budget surplus for Germany is advisable not only to ensure compliance with the upper debt limits. It would also be a good idea to continue markedly reducing the still high debt ratio swiftly, not least because this would effectively cap the interest burden in the long term – especially given the possibility of interest rates going back up in the future. Sound public finances are not antithetical to tackling immigration, among other challenges, or to improving infrastructure and government educational programmes. Instead, they are precisely a key prerequisite for continuing to be able to cope with unexpected challenges in the future.

In the context of the Stability and Growth Pact, the European Commission has announced that it would make concessions when assessing whether the rules have been complied with regarding the additional financial burden associated with the influx of refugees. That would be justifiable if this development could be classified as unexpected and meant that fiscal targets were missed merely on a short-term and temporary basis due to no more than specifically documented direct net additional burdens. A further option on the table – factoring out, on a longer-term basis, any additional refugee-related burdens – would not be consistent with the Pact's aim of ensuring sound public finances. A structural public spending requirement therefore ought to be covered by corresponding income so as to keep government debt at a comfortably sustainable level. This does not mean that tasks considered to be important cannot be carried out, but that these should be financed in a sustainable manner.