Outlook for the German economy – macroeconomic projections for 2014 and 2015

The German economy has picked up momentum again. There has been a continuation of the expansion in aggregate output that was interrupted for a time by the escalating sovereign debt crisis in the euro area. The driving forces are changing, however. While external impulses had the upper hand during the upturn which followed the economic and financial crisis, domestic economic activity has come to the fore recently. A part in this is played by the German economy being in good shape, as is shown by the low unemployment rate, continuing growth in employment, and marked growth in earnings. Low interest rates are also having an effect. These factors are supporting private consumption and driving housing construction. By contrast, external trade has been tending to be weak of late. With the cyclical situation continuing to become brighter in the industrial countries and given the emerging improvement in the euro area, there should also be a pick-up in exports and, in their wake, an upturn in corporate investment and imports.

Under these conditions, the German economy could grow by 1.7% in the coming year and by 2.0% in 2015, after an increase of no more than 0.5% in 2013. In calendar-adjusted terms, this would result in growth rates of gross domestic product (GDP) amounting to 0.6% in 2013, 1.7% in 2014, and 1.8% in 2015. Given potential growth of 1.4% in each of the next two years, aggregate capacity utilisation will increase moderately from a normal level in 2013. This will be accompanied by a further rise in employment, predominantly fed by immigration. The current account surplus could go down to the level it had before the sovereign debt crisis escalated. Leaving aside the details of the new German government's coalition agreement, which were not yet known at the time this projection was completed, the government budget could show something of an improvement and achieve a surplus of just under ½% of GDP in 2015. There could be a distinct fall in the high debt ratio.

The sustained improvement in the labour market situation compared with the past decade is reflected in an acceleration of wage growth, which is to be seen as a normalisation. Consumer price inflation as measured by the HICP could initially moderate from 1.6% in 2013 to 1.3% in 2014, but then go up again to 1.5% in 2015. If energy is excluded, the rate is likely to increase to 1.9% in 2015 in the wake of the accelerated rise in wages.

The risks to the forecast are to be seen, first, in the external setting. The effects of the euro-area debt crisis have been contained and major reforms have been initiated. Nevertheless, the burdensome level of debt and the structural problems that continue to exist mean that the European and global economies remain highly vulnerable. Second, domestic risks exist. A number of the measures under discussion for the coalition agreement have the potential to harm the efficiency of the labour and goods markets, and the fiscal stance will probably be eased. The fact that the underlying pace of growth might be stronger than described here is to be seen as a cyclical upside opportunity.

Current situation

Rapid cyclical normalisation

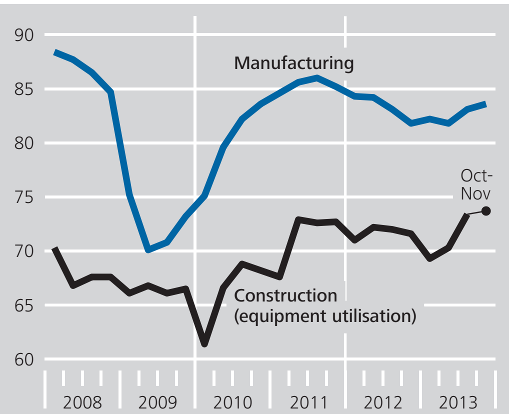
As expected in the June projection, the German economy quickly recovered from its weakness in the final three months of 2012 and the first quarter of 2013 and returned to an expansionary course. Following heightened GDP growth of 0.7% in the second quarter due to catch-up and backlog effects, overall output went up by 0.3% in the third quarter. This means that the German economy is likely to have returned to the range of normal capacity utilisation. This is suggested not only by the data on capacity and construction equipment utilisation, but also by the high degree of satisfaction with which firms describe their business situation in surveys undertaken by the Ifo Institute and the Association of German Chambers of Commerce and Industry (DIHK).

Domestic activity as supporting element of growth

The cyclical upturn has been sustained recently almost entirely by domestic economic activity. Private consumption has benefited from the prospect of substantial gains in real incomes, and housing construction has been driven by a sharp rise in demand for accommodation, especially in urban centres, as well as extremely favourable financing conditions and the lack of opportunities for investing capital that are deemed to be safe and profitable. This is also apparent in the steep rise in housing building permits. As construction activity in the first four months of the current year was very weak due to the weather, the high level of equipment utilisation already achieved last year in the main construction industry means that considerable backlog demand is now likely to have arisen.

Capacity utilisation

Quarterly, seasonally adjusted, as a percentage of firms' customary full capacity utilisation



Source: Ifo Institute.
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Exports and corporate investment remain subdued

In real terms, exports of goods have not yet fully recovered from their sharp decline towards the end of 2012. Exports to non-euro-area countries in particular were still tending to be weak. By contrast, exports to the rest of the euro area were pointing upwards again. Despite buoyant domestic demand, the expansion in industrial output was therefore no more than subdued. According to the Ifo Institute, it was not until October that manufacturing capacity utilisation approximately matched its longer-term average again. This is probably also the key reason for the lack of momentum so far in corporate investment.

Labour market characterised by strong immigration

On the labour market, developments in employment were more positive than assumed in the June projection, while unemployment – contrary to expectations – did not go down slightly, but rose somewhat instead. This is to be seen in connection with the extremely high level of immigration, which was already 13% higher in net terms in the first half of 2013 than it was in the same period of 2102 and thus also up on the June projection. On the one hand, this largely labour-market-oriented immigration is counteracting supply shortages and thus strengthening employment growth. On the other hand, it is tending to restrict the opportunities of domestic job-seekers if they are less mobile and do not have the same level of skills.

Temporarily slower wage growth

The rise in labour income in the second and third quarters was lower than was expected in the June projection. One major factor in this is that the wage bargainers in the retail trade have not yet been able to conclude a new pay agreement. Moreover, some of the new agreements make provision for a pay freeze in the first few months after they come into force. In contrast to expectations in spring, the rise in negotiated rates of pay in the current year will therefore probably be limited to 2.5%. Added to this is the fact that the scale of bonus payments in industry is probably somewhat smaller than last year.

Inflation initially within range of expectations

Measured by the annual HICP rates, the price trend flattened somewhat in the second and third quarters of 2013, as was also expected in the June projection. The fact that the price trend was overestimated chiefly in the case of industrial goods excluding energy, but also for services is an indication that the accelerated increase in wages, under the impact of the appreciation of the euro, is making itself felt in consumer prices more slowly than hitherto assumed. By contrast, the price increases for food products were distinctly sharper than expected. A considerable part in this was played by the weather conditions, which were not always favourable for agriculture.

Major assumptions

Assumptions-based forecast

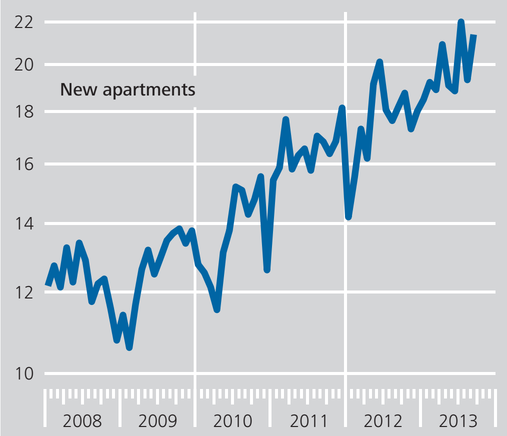
This projection is based on assumptions made by the Eurosystem's experts concerning global trade, exchange rates, commodity prices and interest rates. The assumptions are based on information available as at 15 November 2013. The assumptions regarding sales markets in the euro area are derived from projections by the national central banks of the other euro-area countries.

Global growth strengthening perceptibly

Against the backdrop of a pick-up in industrial activity, global economic growth became stronger again during 2013. There was a shifting of emphasis from the emerging economies to the industrial countries, which will probably continue during the projection period. Above-average growth rates are still expected from the emerging market economies, but, given growing structural impediments and rising long-term interest rates, overall output in this group of countries is unlikely to go on expanding at the same pace as in earlier years. In the industrial countries, negative factors such as

Housing construction permits

Thousands, seasonally adjusted, log scale



Source of the unadjusted figures: Federal Statistical Office.
Deutsche Bundesbank

the level of private sector debt and the consolidation efforts in the public sector are becoming less significant for economic activity. Overall, global growth could strengthen perceptibly without, however, matching the rapid pace of expansion achieved prior to the financial and economic crisis. Given a purchasing power parity weighting of 2¾% in the current year and 3½% in 2014, global expansion will be somewhat weaker than assumed in the June projection. For 2015, a further slight increase to 3¾% is expected.

Recovery process in the euro area has started

In the euro area, there are growing signs of a continuation of the recovery process that began in spring. There was a further rise in economic output in the third quarter of 2013, and the short-term indicators show that an increase is likely to be achieved in the fourth quarter, too. The key factor in this is that there is no further restriction of domestic demand. Even so, the strains resulting from the debt and adjustment crisis are still exerting an impact. Given ongoing low capacity utilisation and, in some countries, difficult access to bank loans, industrial investment is recovering only slowly. Furthermore, in many countries the high level of private sector debt and unemployment are depressing private consumption. At the same time, in a number of countries the adjustment of costs structures is making progress and enterprises are opening up new sales markets, enabling them to enjoy a larger share of global growth. It is to be expected that higher export growth will also generate stimuli for domestic activity. Owing to a negative statistical carryover effect and the weak start to the year, the GDP growth rate for the euro area in 2013 will be negative again at -0.4%, despite the incipient recovery process. It is not until 2014 and 2015 that positive growth rates of 1.1% and 1.5% are expected again. If Germany is excluded, a decline of 0.8% will be followed by increases of 0.9% and 1.4% respectively.

Sales market growth strengthening again

A dip in global industrial activity almost brought the expansion of world trade to a halt in the second half of last year. In the current year, there has been a marked recovery in international trade in line with the renewed pick-up in industrial output. It is anticipated that this process will continue in the coming year and that global imports of goods and services will then increase at a rate of 6%, compared with 2¾% this year and 5¼% in 2014. German exporters' sales opportunities were severely dampened last year by the decline in imports within the euro area in particular. In view of the initially muted upturn in intra-euro-area trade, sales market growth in 2013, at only 1¼%, should be well below the already depressed rate of expansion in world trade. Given that the recovery process within the euro area is strengthening only slowly, this is likely to apply to the next two years, too, albeit at decreasing intervals. With the expected expansion in export markets of 4% in 2014 and 5% in 2015, German enterprises would take a share of the stronger global growth.

Euro appreciation

Since a lull in spring, the euro has undergone a fairly steady trend appreciation. In the period that is relevant to the derivation of the exchange rate assumptions, the euro, at US$1.34, stood 2¼% higher than in the June projection. In nominal effective terms, ie compared with other currencies relevant to foreign trade, the euro appreciated by 1¾%.

Assumption of falling crude oil prices over the projection horizon …

Output losses and the fear of a military escalation of the political disputes in the Middle East led for a time in summer to a marked acceleration in crude oil prices, especially on the spot market, although futures prices were pointing downwards across all delivery periods. At US$108¼ per barrel of Brent crude oil, the assumptions for the current year, which are derived technically from futures prices, are 2½% higher than those of the June projection. For 2014, at US$104, they are around 4% higher than in the June projection, although the premium is clearly lower in euro terms owing to its appreciation against the US dollar in the intermittent period. According to the forward prices, a further decline in the price of crude oil to US$99¼ is assumed for 2015.

… and other commodity prices

A decline in the prices of food commodities set in on the international markets as early as the summer months and thus sooner than assumed in the June projection. This is likely to continue. Other agricultural commodities are expected to become more expensive, however. Overall, following a distinct decline this year, commodity prices will probably fall again in 2014 as well before going up on an annual average in 2015.

Almost no change in interest rates

At the beginning of November, the Governing Council of the ECB reduced the interest rate on the Eurosystem's main refinancing operations to a new all-time low, prompted by diminishing price pressures, very low recent HICP rates and still-subdued credit dynamics. This decision and the subsequent communication have somewhat dampened expectations regarding the path of short-term interest rates. As in the Bundesbank's June projections, this forecast assumes that the three-month interest rate for unsecured transactions on the interbank market will stand at 0.2% this year and at 0.3% in 2014, before rising to 0.5% in 2015. In the summer, the yield on nine to ten-year German government bonds rose well above the assumptions in the June forecast. The upward trend is likely to continue in this forecast period. Based on the yield curve, the forecast predicts that the yield of 1.6% this year will be followed by yields of 2.0% in 2014 and 2.4% in 2015. This puts next year's yields 20 basis points higher than predicted in the June projections.

Funding conditions remain favourable

The lending rates of German banks are almost unchanged compared with the spring. Given the assumed path of money market interest rates and long-term yields on government bonds, the lending rates for enterprises and consumers are also likely to rise slightly in the forecast period, starting from a very low level. The results of the Bank Lending Survey (BLS) indicate that banks left their credit standards for loans to enterprises largely unchanged in the third quarter of 2013, and barely any change is expected for the fourth quarter either. According to the Ifo Credit Constraint Indicator, the share of enterprises reporting restrictive access to bank credit remains very low by longer-term standards. Funding conditions are therefore still categorised as extremely favourable. This is unlikely to change in this forecast period.[1]

Fiscal policy measures considered in forecast do not include impact of coalition agreement

For public finances, the projections generally only include measures which have either already been approved by parliament or have been defined in detail and are likely to be implemented. In particular, they do not take account of the arrangements made in the German government's coalition agreement, which were not yet known when the forecast was completed. The fiscal policy measures included in this forecast would lead to a limited increase in the general government deficit in 2014 and have no net impact in 2015. The additional burden on public finances in 2014 is mainly the result of the assumption that the statutory pension contribution rate would be cut by another 0.6 percentage point to 18.3%, thus bringing the reserves back to their upper limit of 1.5 times the scheme's monthly expenditure, in line with the basic rule, at the end of 2014. The forecast assumes that the outpayments from the flood assistance fund set up in summer 2013 (totalling €8 billion) will be spread out over a number of years and will thus have relatively little impact on the fiscal balance in the individual years of the forecast period.

Major assumptions of the projection

Item	2012	2013	2014	2015
Exchange rates of the euro				
US dollar/euro	1.29	1.33	1.34	1.34
Effective[1]	97.8	101.5	102.3	102.3
Interest rates				
Three-month EURIBOR	0.6	0.2	0.3	0.5
Yield on government bonds outstanding[2]	1.5	1.6	2.0	2.4
Commodity prices				
Crude oil[3]	112.0	108.2	103.9	99.2
Other commodities[4, 5]	− 7.2	− 5.4	− 2.6	3.7
German exporters' sales markets[5, 6]	1.3	1.3	4.0	5.0

1 Compared with the 20 most important trading partners of the euro area (EER20 group of currencies); 1999 Q1 = 100. **2** Yield on German government bonds outstanding with a residual maturity of over nine and up to ten years. **3** US dollars per barrel of Brent crude oil. **4** In US dollars. **5** Year-on-year percentage change. **6** Working-day-adjusted.

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Coalition agreement unlikely to fundamentally change fiscal forecast

As things stand, the measures outlined in the coalition agreement, which are not included in these projections, are unlikely to fundamentally change the forecast picture for public finances in the next two years, although they do indicate a less stringent fiscal policy path. The agreement envisages additional expenditure on the pension and long-term care insurance schemes and on education and infrastructure, amongst other areas. From a general government perspective, the financial impact of the measures in the coalition agreement in comparison with the estimates underlying this forecast is likely to be limited by the fact that social security contribution rates are unlikely to be cut, contrary to what is assumed in the forecast.[2] The figures available so far suggest that government investment will probably also have only a limited macroeconomic influence in an-

1 It is assumed that the upcoming comprehensive assessment of bank balance sheets by the Eurosystem will not have any negative repercussions for credit supply.

2 The cut in the pension insurance contribution rate may be waived in order to fund additional spending by the statutory pension insurance scheme. In addition, the coalition agreement outlines plans to raise the statutory long-term care contribution rate by 0.3 percentage point in 2015 and by another 0.2 percentage point at a later point in time.

Orders received by industry

Volume, 2010 = 100, seasonally adjusted, quarterly, log scale

Source of the unadjusted figures: Federal Statistical Office.
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nual terms. The burdens on public finances may also have more of an impact in the second half of the legislative period, most of which lies beyond the forecast horizon.

Economic outlook[3]

Stronger cyclical upturn in 2013 Q4-2014 Q1

While economic growth was primarily driven by domestic activity in the second and third quarters of 2013, external factors are also likely to regain importance from autumn onwards. Alongside the significant improvement in expectations regarding both industrial output and exports reported in the Ifo surveys, this is also indicated by new orders in manufacturing, which rose by 1½% in both of the past two quarters. Notably, there was a marked increase in orders from non-euro-area countries and, more recently, in orders from within Germany. Greater cyclical momentum in industry should also help to at least maintain the current pace of growth in services. Given the excess demand for housing construction, the expansion of capacity in the construction sector is likely to continue and the growth rate for construction work should initially remain comparatively high. These factors combined suggest that growth in the German economy will be fairly strong in the final quarter of 2013 and the first quarter of 2014 provided that it is not slowed down temporarily by especially bad weather.

Continuing improvement in economic outlook

Over the medium term, the German economy should benefit not only from the rebound in global economic growth but also from the fact that the European economy is increasingly regaining its footing. The mere prospect of this improvement should induce enterprises to invest more in new machinery and equipment and in property. In addition, the outlook for private consumption is fairly positive, the expansionary phase in private residential construction is set to continue for some time and government consumption and investment expenditure is unlikely to place any restraints on growth, meaning that Germany's economic growth should strengthen over the forecast horizon.

Stronger economic growth

Under these conditions, real GDP in Germany could grow by 1.7% in 2014 and by 2.0% in 2015, following an increase of 0.5% in 2013. After working-day adjustment, GDP growth would thus come to 0.6% in 2013, 1.7% in 2014, and 1.8% in 2015. The fairly low rate of expansion in 2013 is attributable to a statistical carry-over effect from 2012. The stronger cyclical dynamics are also reflected in the annual rates of change, which are projected to rise from 1.6% in 2013 to 1.9% in 2015.

Increasing utilisation and stronger potential growth

With the growth profile outlined in this forecast, the utilisation of the German economy would increase moderately from a normal level in 2013. In this forecast, the estimated potential growth is slightly higher than in previous forecasts. The increase in immigration will

3 This projection for Germany was completed on 22 November 2013. It was incorporated into the projection for the euro area published by the ECB on 5 December 2013.

probably delay the point in time when labour shortages due to demographic change become noticeable. It therefore appears appropriate to raise the estimated potential growth rate for 2014 and 2015 to 1.4%, following rates of 1.3% in 2013 and 1.2% in 2012.

Slight upward revision of GDP forecasts

The projected GDP growth rates for 2013 and 2014 are thus both just under 0.2 percentage point higher than in the June forecast. In 2013, the picture for exports in particular is somewhat more favourable, although this is partly due to data revisions. In 2014, a better outlook for private consumption and residential construction are the decisive factors.

Significant rebound in exports

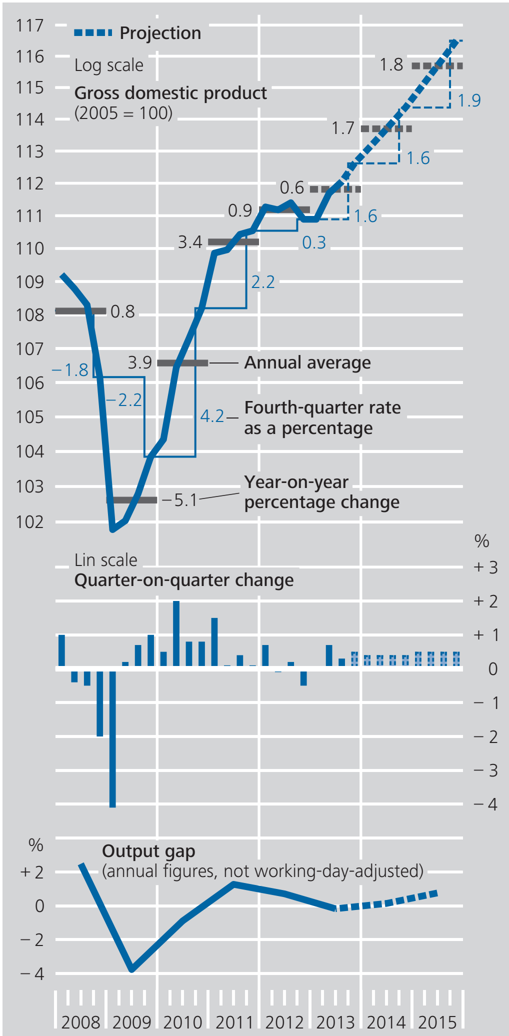
Exports should already experience a significant rebound in the final quarter of 2013, bringing the preceding weak phase to an end. This is indicated by the marked improvement in industrial firms' export expectations since August and the rise in new orders from abroad. According to the autumn survey by the Association of German Chambers of Commerce and Industry, exporters' sales expectations have improved distinctly for the medium term, too. While the pick-up in demand has been fuelled by non-euro-area countries so far, the recovery now on the horizon for the euro area will probably provide additional sales opportunities. Following a slight rise of ¼% this year, this means that a marked strengthening of export growth is likely. With the growth rates of 4% in 2014 and 5½% in 2015 assumed in this forecast, exports are broadly in line with developments on the sales markets. Unlike in the preceding years, disproportionately high growth is unlikely in view of changing cost trends and increasing competition from other euro-area countries. In addition, there is now a tendency, at least in some sectors, to replace or at least supplement exports with on-site production.[4]

Corporate investment increasing again

Germany's increasing exports, above all to other euro-area countries, mean that the weak phase in corporate investment should soon be over. Rising capacity utilisation in industry, abundant own funds and exceptionally favourable funding conditions should help to boost enterprises' investment. However, it should be borne in mind that the structural reforms in other euro-area countries and the progress made in adjusting their economies will also revive their appeal to German enterprises as a location for manufacturing. In addition, efforts to locate some parts of production close to end consumers will stimulate investment in non-euro-area countries. Consequently, this projection assumes a normalisation of corporate in-

Aggregate output and output gap

Price, seasonally and working-day-adjusted



Sources: Federal Statistical Office and Bundesbank calculations. 2013 and 2015 Bundesbank projections.
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4 See Deutsche Bundesbank, Reasons for the recent slump in German goods exports to China, Monthly Report, November 2013.

Technical components of the GDP growth projection

As a percentage or in percentage points

Item	2012	2013	2014	2015
Statistical carry-over at the end of the previous year 1	0.3	– 0.3	0.7	0.6
Fourth-quarter rate 2	0.3	1.6	1.6	1.9
Average annual GDP rate, working-day-adjusted	0.9	0.6	1.7	1.8
Calendar effect 3	– 0.2	– 0.1	0.0	0.2
Average annual GDP growth 4	0.7	0.5	1.7	2.0

Sources: Federal Statistical Office; 2013 to 2015 Bundesbank projections. **1** Seasonally and working-day-adjusted index level in the fourth quarter of the previous year in relation to the working-day-adjusted quarterly average of the previous year. **2** Annual rate of change in the fourth quarter, seasonally and working-day-adjusted. **3** As a percentage of GDP. **4** Discrepancies in the totals are due to rounding.

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vestment in Germany, but not a substantial increase in capacity.

Residential construction navigating tensions between sharply rising demand and high utilisation of equipment

The rising demand for both housing and investments which appear likely to retain their value has coincided not only with a distinct increase in rents for new tenancies and in housing prices but also strong growth in the number of new permits for construction projects. There was a year-on-year rise of just over 15% in the third quarter of 2013, and the upward trend appears to be continuing unabated. The national accounts data show that investment in residential construction – including investment in existing buildings, which is probably growing less strongly – was 3% up on the year overall in the third quarter. Given the high level of capacity utilisation, whether the sharp rise in demand will rapidly generate actual construction work will depend on how quickly capacity can be increased. In addition to immigration, the EU's open markets should help in this process. The fairly subdued growth to date in prices for construction work certainly suggests that the capacity constraints have not yet expanded the scope for price rises. It can therefore be assumed that, following the two mid-year quarters, which were particularly influenced by catch-up effects, the rate of growth in construction work will remain fairly high but start to decline. This would result in annual average growth rates of 5½% in 2014 and 3¾% in 2015 for investment in residential construction, following a rise of only 1¼% in 2013. In relation to aggregate economic output, investment in residential construction would continue to rise into 2015 and substantially exceed the low recorded in 2008. Yet it would still be well below the high recorded for post-reunification Germany in 1994.[5]

Public investment increasing

Growth in public investment has probably only been moderate in 2013. The forecast assumes a stronger pace of expansion in the coming years, not least in view of the relatively good financial situation of many municipalities. The coalition agreement, which has now been provisionally signed, envisages additional government investment. However, it is important to note that the total pool of investment funds still has to be allocated to specific years and investments are often only implemented after a fairly long planning phase.

Gross fixed investment: strong contribution to economic growth

Following a decline of ¾% in 2013, gross fixed investment will probably increase by 4¼% overall next year and by almost 5% in 2015. In addition, stocks are likely to be replenished in 2013 and 2014. Even though machinery and equipment in particular have a fairly high import component, gross fixed investment would therefore make a substantial contribution to the cyclical improvement in Germany's economic growth.

Somewhat stronger growth in private consumption than in disposable income

Private consumption is benefiting from households' growing conviction that the economic outlook has improved and that they themselves will profit from this through a distinct rise in income – at least that is what is indicated by the regular GfK surveys of consumer confidence. According to our projections, households' real disposable income should rise by almost 1½% in 2014 and by 1¾% in 2015, after increasing by only around ½% this year.

5 However, in the first half of the 1990s immigration was far higher and, above all, there was considerable demand for renovation and new buildings in eastern Germany.

Given the improvement in consumer sentiment, growth in expenditure on private consumption could be somewhat stronger than the rise in disposable income. The saving ratio would then continue to fall slightly, reaching 9.8% in 2015. Despite the mandatory contribution rates to the social security schemes probably being higher than assumed in this forecast, the additional social benefits envisaged in the coalition agreement could give disposable income and private consumption a slight added boost.

Higher growth in government consumption again

Growth in real government consumption is likely to remain subdued in 2013. However, a sharper nominal rise is likely, not least because the surgery visit charge has been abolished. In real terms, too, it is assumed that growth will regain strength in the subsequent years, and the increase in government consumption will probably be roughly in line with potential output.

Strong growth in imports again

The expected strong expansion in domestic final demand should go hand in hand with a marked increase in imports. Although the Federal Statistical Office's input-output tables, which were last published for 2009, show a lower intensity of imports for some important demand components than in the preceding years, this is probably due mainly to the 2008-09 economic crisis. For the forecast period, it is assumed that import behaviour will become more similar to that seen in the years before the crisis. Provided that this is the case, imports should grow by just over 5% next year and by 6½% in 2015, after increasing by only 1% in 2013. The other euro-area countries should benefit particularly strongly from the sharp rise in imports.

Declining current account surplus

In view of the strong import growth, Germany's current account surplus could decline from almost 7% of nominal GDP in 2013 to 6¼% in 2015. It would then be close to the level seen before the escalation of the euro-area debt crisis. The trade account surplus could decline from 6% to 5½% of GDP. In this forecast, the comparatively subdued dynamics in corporate investment and in the price component of nominal GDP in Germany will prevent a sharper decline. Looking at investment income, the continuing rise in external assets means that substantial inflows remain likely. However, current transfers to the rest of the world are likely to increase distinctly, partly because of the rise in immigration.

Key figures of the macroeconomic projection

Year-on-year percentage change

Item	2012	2013	2014	2015
GDP (real)	0.7	0.5	1.7	2.0
GDP (real, working-day-adjusted)	0.9	0.6	1.7	1.8
Components of real GDP				
Private consumption	0.8	0.9	1.4	1.9
Government consumption	1.0	0.7	1.5	1.5
Gross fixed capital formation	– 2.1	– 0.8	4.3	4.9
Exports	3.2	0.2	3.9	5.4
Imports	1.4	1.1	5.1	6.5
Contributions to GDP growth[1]				
Domestic final demand	0.2	0.5	1.8	2.2
Changes in inventories	– 0.5	0.3	0.2	0.0
Net exports	0.9	– 0.4	– 0.3	– 0.2
Labour market				
Total number of hours worked[2]	0.2	0.5	0.7	0.5
Persons employed[2]	1.1	0.6	0.5	0.4
Unemployed persons[3]	2.9	2.9	2.9	2.9
Unemployment rate[4]	6.8	6.9	6.8	6.7
Unit labour costs[5]	3.1	2.1	1.6	1.5
Compensation per employee	2.6	1.9	2.8	3.1
Real GDP per person employed	– 0.4	– 0.2	1.2	1.6
Consumer prices[6]	2.1	1.6	1.3	1.5
Excluding energy	1.6	1.6	1.5	1.9
Energy component	5.6	1.8	– 0.3	– 1.2

Sources: Federal Statistical Office; Federal Employment Agency; 2013 to 2015 Bundesbank projections. **1** In percentage points. **2** Domestic concept. **3** In millions of persons (Federal Employment Agency definition). **4** As a percentage of the civilian labour force. **5** Ratio of domestic compensation per employee to real GDP per person employed. **6** Harmonised Index of Consumer Prices (HICP).

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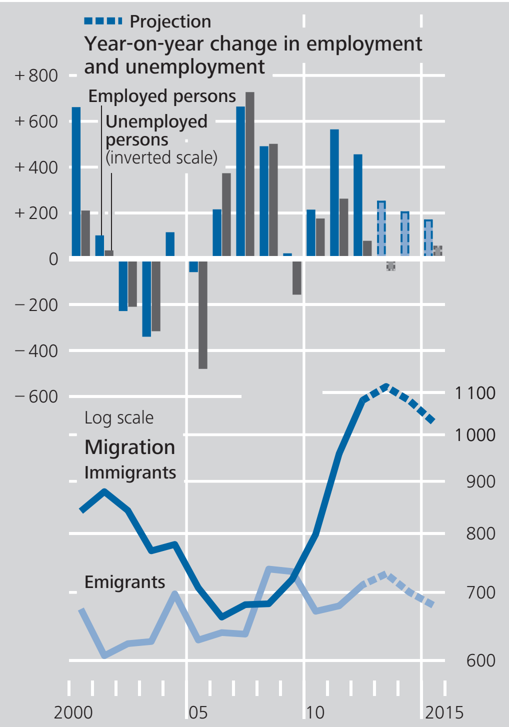
Labour market

Immigration levels remain high

During the forecast period, activity on the German labour market will be shaped to a large degree by persistently high levels of immigra-

Employment and migration

In thousands



Sources: Federal Statistical Office and Federal Employment Agency. 2013 to 2015 Bundesbank projections.
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tion. The flow of migrants in the first half of 2013 significantly exceeded last year's elevated level. According to the current projection, a net inflow of 385,000 people is expected for 2013 as a whole, compared to inflows of 370,000 people in 2012. Noticeably higher numbers of immigrants from other euro-area countries in particular are likely this year in view of the considerable labour market disparities, and this heightened level could largely be maintained over the following years. The net influx from the central and eastern European EU member states, which were granted full labour mobility in 2011, is expected to ease gradually over the forecast horizon. By contrast, inflows from Romania and Bulgaria will increase temporarily as restrictions on the freedom of movement for workers are lifted. Net immigration in 2014 is therefore expected to be broadly similar to 2013. In 2015, the number of immigrants could then fall to 350,000. Because the majority of these immigrants are pursuing employment opportunities, immigration significantly and directly increases the potential labour force. It will probably swell the labour force by 280,000 people in both 2013 and 2014, and by just over 250,000 people in 2015.

Further rise in employment

A large number of immigrants are expected to find work fairly quickly, especially as they often have good formal qualifications and target segments of the German labour market in which the demand for labour cannot always be met through local supply. Employment can thus continue to grow despite decreasing local reserves. However, it is still likely to continue to weaken slightly over the forecast horizon from 0.6% in 2013 to 0.4% in 2015. This slowdown is consistent with the ongoing return to normal wage growth.

Another slight decline in unemployment

The temporary cyclical weakness and large influx of qualified workers have caused a slight increase in unemployment since the second quarter of 2012. Although immigration levels remain high, the brighter economic outlook is likely at first to slow the increase in unemployment and then initiate a slight countermovement. The unemployment rate as defined by the Federal Employment Agency could fall from 6.9% this year to 6.7% in 2015, while the unemployment rate calculated according to international conventions could decrease from 5.3% to 5.2%.

Labour costs and prices

Growth in negotiated wages accelerating

To forecast the increase in negotiated wages, all the agreements concluded in previous years are analysed and extrapolated at the end of their validity periods, taking into account the macroeconomic framework and sector-specific features. In the retail sector, which employs around 10½% of the workers included in the Bundesbank's negotiated pay rate statistics, no agreement has been reached despite months of wage negotiations. This projection assumes that a new agreement will soon be reached which will include compensation for the past few months in which wages did not go up.[6] This is one of the main reasons why the negotiated wage projection for 2014 now predicts a 3.1% rise in remuneration, while the June projection calculated an increase of 2.9%. Assuming that the degree of success depends on the business cycle, the wage demands made for the 2014 pay round (5.5% in both the chemical industry and the printing industry) are in keeping with this picture. Wage growth of 3.1% is also expected in 2015, revealing an underlying trend of moderate acceleration in negotiated wages.

Neutral wage drift

While wage drift is likely to have been negative this year, due in part to somewhat smaller bonus payments, it is expected to be neutral on a monthly basis in 2014 and 2015. Various effects are likely to balance each other out. On an hourly basis, wage drift is likely to be negative again next year, but then move into neutral territory.

Impact of political measures

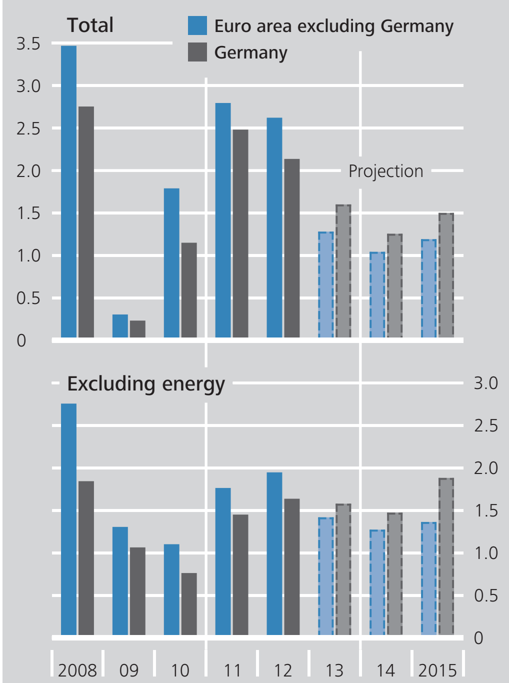
A reduction in employers' contributions to the statutory pension insurance scheme, which was assumed on the basis of the current legal situation, would lower growth in compensation per employee to 2.8% in 2014. Without the contribution rate cut, labour costs would be expected to rise by 3.1%, as in 2015. Raising the long-term care contribution rate as envisaged in the coalition agreement would result in a slightly sharper increase in labour costs in 2015. The introduction of a general minimum wage of €8.50 on 1 January 2015 would probably have a fairly small impact on aggregate wage costs to begin with, because transitional rules are to apply at first. These rules stipulate that sector-specific minimum wages and negotiated rates of pay that are below this level must only be replaced by the statutory minimum wage as of 1 January 2017.

Domestic inflation rising, wage share stable

If the macroeconomic distribution relationships remained unchanged and there were a 1% rise in trend productivity, an increase in wage costs of around 3% would result in a domestic inflation rate of around 2%. Actual productivity growth having fallen significantly short of the longer-term trend in recent years, during the projection period, a certain catch-up effect is expected to slow the rise in unit labour costs despite the acceleration in wage growth. Assuming that the wage share continues to stabilise at a level that – although higher than during the economic boom in 2006 and 2007 – is depressed from a long-term perspective, during the forecast period, the price for domestic value added would tend towards an increase of close to 2% pa, but might potentially not quite reach this level in 2015 either. The disproportionate increase in the GDP deflator in the current year can be attributed to a temporary

Price projection (HICP)

Year-on-year percentage change



Sources: Federal Statistical Office, Eurostat and Bundesbank calculations. 2013 to 2015 Bundesbank projections (for Germany) and calculations based on Eurosystem projections (for the euro area excluding Germany).
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6 After this projection was completed, it was announced on 5 December 2013 that the wage bargainers in Baden-Württemberg had reached an agreement for the retail sector that could be the forerunner for similar agreements throughout Germany. The agreement envisages a wage increase of 3%, backdated to 1 July 2013, and a further 2.1% rise from 1 April 2014. A larger share of the rise in wages could therefore be recorded for 2013 than assumed in the projection.

widening of margins resulting from the surprisingly strong improvement in the terms of trade.

Consumer prices for goods and services gradually rising more sharply

Generally subdued price developments and a gradually strengthening internal component have helped to shape the consumer price inflation forecast. Wage growth is primarily fuelling the price of services, while the accelerating increase in income is pushing up housing rents. Growing domestic distribution costs are also likely to affect the prices of industrial goods and food. In the short term, at least, this will be countered by the fact that the price of fruit and vegetables has risen very strongly this year owing to unfavourable weather conditions and the expected correction should slow the increase in food prices next year. In terms of the prices of industrial goods, the fairly significant appreciation of the euro and the depressed price trend caused by subdued global industrial activity should initially have an impact at the upstream stages of the economy. Excluding energy, HICP inflation is therefore likely to increase gradually from 1.6% in 2013 to 1.5% in 2014 and 1.9% in 2015. However, it should be borne in mind that German annual HICP inflation for 2013 is biased upwards due to chain-linking problems in the accommodation services sub-index in particular.[7] Without this effect, the increase in inflation in the forecast would appear much more pronounced. On the other hand, it should be remembered that the abolishment of the surgery visit charge has reduced the 2013 growth rate and this should also be seen as a special factor.

Falling energy prices

The forecast for the energy component of the HICP is primarily determined on the basis of assumptions regarding crude oil prices and exchange rates. These indicate a slight downward movement in the price of transport fuels and heating oil. With regard to electricity, cheaper purchase prices appear to largely compensate for additional expenses caused by higher contribution charges for energy from renewable sources. Consumer prices for gas and heat energy are likely to move sideways at first, potentially following heating fuel prices later. If the conditional assumptions prove to be accurate, energy prices should fall slightly by 0.3% in 2014 and 1.2% in 2015.

Moderate increase in consumer prices throughout the forecast period

Under these conditions, HICP inflation for German consumers would amount to 1.6% in 2013, 1.3% in 2014 and 1.5% in 2015. Despite the rather subdued price trend in Germany, these figures would be considerably higher than the average rate of inflation in other euro-area countries, at least towards the end of the forecast period.

Public finances

Government budget broadly balanced in 2013 and …

General government looks set to record another broadly balanced budget this year (2012: surplus of 0.1% of GDP). On the one hand, owing to the economic slowdown in the fourth quarter of 2012 and the first quarter of 2013, the cyclical impact, which was still distinctly positive in 2012, is expected to decline.[8] On the other, the temporary burdens created last year by the resolution of WestLB have been lifted and there are signs of a slight structural improvement in the budget. The general government budget is likely to be broadly balanced in 2013 in structural terms as well. The improvement on the previous year is due, amongst other factors, to further moderate developments in pension expenditure, the fall in interest expenditure and fiscal drag.[9] This more than compensates for any budgetary burdens, notably the lowering of the pension contribution rate.

7 See Deutsche Bundesbank, The contribution of the accommodation services sub-index to explaining the current deviations between CPI and HICP inflation rates, Monthly Report, April 2013, p 7.
8 The disaggregated ESCB cyclical adjustment procedure is used in this context; see Deutsche Bundesbank, A disaggregated framework for analysing public finances: Germany's fiscal track record between 2000 and 2005, Monthly Report, March 2006, pp 61-76.
9 In this context, the term "fiscal drag" encompasses the (positive) revenue effect of bracket creep in income taxation and the (negative) impact of the fact that specific excise duties are largely independent of prices.

… debt ratio declining

The debt ratio is still high (81.0% at the end of 2012), but looks set to decline perceptibly this year. The downward trend due to nominal GDP growth in the denominator, given the now only relatively limited deficits posted by central, state and local government, is being intensified by the ongoing portfolio reduction at government-owned bad banks. By contrast, this trend is being slowed by the capital injections – which increase gross debt – to the ESM and the EFSF assistance loans[10] as part of the measures to stabilise the euro area.

Limited surplus by 2015, leaving aside coalition agreements, …

No major budget movements are forecast for 2014 or 2015 either, leaving aside the new coalition agreement, which was not yet known when the forecast was finalised. By 2015, there could be a slight gradual improvement in the fiscal balance and a surplus of just under ½% of GDP could be achieved. This will be due primarily to the recovery in economic activity. In particular, the rule-based reduction of the contribution rate to the statutory pension insurance scheme as assumed in the forecast for 2014 will have a negative impact in structural terms. However, this may be outweighed by alleviating factors such as the further decline in interest expenditure and fiscal drag. Despite the slight improvement, the general government budget would therefore remain virtually balanced in structural terms. According to available information, the coalition agreement will only result in relatively limited budgetary burdens by 2015, especially if the pension insurance contribution rate is not lowered, in contrast to our current assumption.

… improvement in the budgets of central, state and local government and …

The developments in the general government budget reflect a noticeable improvement in the budgets of central, state and local government, but this improvement is accompanied by a deterioration in the social security funds. Central and state governments need to prepare to comply with the long-term budget ceilings imposed by the national debt brake, which in principle require balanced budgets for central government from 2016 and for state governments from 2020. There is likely to be stronger growth in social security spending, not least because various relief factors from previous years no longer apply (eg moderating factors regarding pension adjustments, savings in the area of active labour market policy). Significant deficits are to be expected in the statutory pension insurance scheme, in particular.

… swifter reduction of the debt ratio

In the scenario presented here, the debt ratio will decrease more rapidly over the next few years. This reflects the improvements in the fiscal positions of central, state and local government as well as stronger nominal GDP growth. In addition, it is assumed that the debt-increasing impact of the euro-area stabilisation measures will no longer be felt by 2015. However, the debt ratio would still be significantly higher than 70% in 2015.

Risk assessment

External risks to economic growth

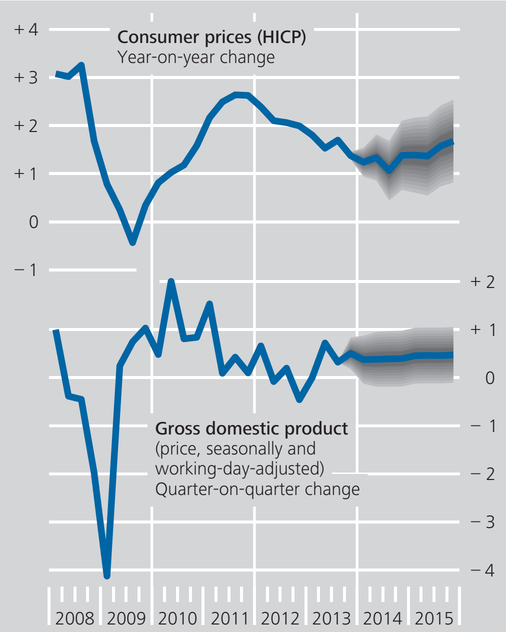
The risks to the forecast in the real economy are to be seen, first, in the external setting. The effects of the euro-area crisis have been contained and extensive reforms have been initiated in some crisis countries in order to enhance the functioning of the labour and goods markets and improve public finances. Steps have been taken at European level to better adapt the institutional framework to the challenges created by monetary union. Nevertheless, the burdensome debt and the structural problems that continue to exist in a number of non-euro-area countries, too, mean that the European and global economies will remain highly vulnerable for some time to come. The lesson learned is that economic downturns in other economic areas have a fairly direct impact on the German economy, which is highly integrated into the international division of labour.

Second, there are domestic risks to economic growth. A number of measures envisaged by

10 ESM: European Stability Mechanism, EFSF: European Financial Stability Facility.

Baseline and uncertainty margins of the projection*

As a percentage, quarterly



Sources: Federal Statistical Office. 2013 to 2015 Bundesbank projections. * Uncertainty margins calculated on the basis of the mean absolute forecast error. The width of the band that is distributed symmetrically around the most probable value equals double the mean absolute forecast error.

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Domestic risks to economic growth

the coalition agreement, such as a generous general minimum wage or measures to slow rent price increases, have the potential to impair the efficiency of the labour and goods markets. The agreed fiscal policy measures will probably relax the fiscal stance, although the impact on the general government deficit during the forecast period could be rather limited. Labour costs may end up slightly higher than assumed in this forecast due to the coalition agreement. Although the various economic and fiscal policy measures could strengthen aggregate demand in the short term, the anticipation of longer-term adverse side-effects may have the opposite effect.

Stronger underlying growth dynamics as an opportunity

The fact that the underlying pace of growth in Germany might be stronger than described here is to be seen as a cyclical opportunity. This is indicated, for example, by the latest results of the Ifo Institute's business surveys and the GfK's index of consumer confidence. First, this may be the result of the unusually low interest rate and the particularly favourable financing conditions, although it is difficult to estimate their overall impact on economic growth. Second, export opportunities may be better than assumed in this projection, especially if global investment activity were to receive an additional boost.

Price projection risks

Although growth expectations for the emerging market economies have been lowered compared to the June forecast, the question remains as to whether the still fairly high rates of expansion for the global economy are consistent with the marked downward movement in crude oil prices derived technically from futures prices, which is taken into account in the inflation forecast. Should the hoped-for global growth therefore be achieved, it appears likely that prices will increase more sharply than calculated here. Stronger underlying growth dynamics in Germany would also be reflected in sharper price increases, especially towards the end of the projection period. The introduction of a general minimum wage could also lead to higher inflation.