The current economic situation in Germany

Overview

Domestic economy supports German growth

Global economy

The global economy is on a moderate and slightly accelerating growth path. In the emerging economies in particular, the pace of growth appears to have picked up slightly in the summer, with somewhat faster growth especially in China and some central and eastern European countries. In other emerging economies, however, the rate of growth remained modest, partly as a result of serious structural problems and turbulence on the financial markets in some emerging economies with high current account deficits. In the industrialised countries, the momentum which gave the economy a lift in the spring continued after mid-year. For instance, the United States and the United Kingdom almost maintained the same level of expansion. By contrast, the Japanese economy, which recorded robust growth in the first half of the year, and the euro area were unable fully to match their prior-quarter result.

In the current quarter, the upward movement in the global economy is likely to continue at more or less the same rate. The budget dispute in the United States, which was settled for the time being in mid-October, and which led to a two-week shutdown at government offices and other expenditure cuts, will place only a minor drag on the country's economic output, judging from experience in the mid-1990s when a similar escalation occurred. It should also be borne in mind that the US central bank has so far maintained its highly expansionary monetary policy unchanged – despite discussions in the spring – and that there has been no disturbance from the crude oil markets recently.

Financial markets

Events on the international financial markets in the third quarter were considerably affected by factors connected with monetary policy and with macroeconomic developments. The financial markets came fully under the influence of altered expectations about the future course of Federal Reserve monetary policy. Whilst most market participants had previously been expecting a gradual tapering of bond purchases by the US central bank along with rising yields in the near future, and had reduced their provision of capital to the emerging markets, the yield trend turned around in September on both sides of the Atlantic. This was prompted by the US central bank affirming that it would maintain its accommodative monetary policy and its asset purchases in their full extent against a backdrop of weak labour market figures and the then unresolved budget dispute. The continuation of monetary easing was also echoed in price gains on the equity markets, which received additional support from largely positive economic data in several countries.

On the currency markets, changing expectations about US monetary policy exerted significant pressure for a time on the currencies of a number of emerging economies with weak fundamentals in particular. Some countries reacted by tightening monetary policy or intervening in the foreign exchange markets. By contrast, the euro gained slightly on balance on a weighted average against the currencies of 21 major trading partners. It will be crucial for the emerging economies affected to make use of the time they have gained from the postponement of the US central bank's tapering of its asset purchases in order to reduce their external vulnerability.

Monetary policy

Declining price inflation prompted the ECB Governing Council to cut its main refinancing rate by another 25 basis points to 0.25% at its meeting on 7 November 2013. The interest rate on the marginal lending facility was also lowered by 25 basis points to 0.75%, while the rate on the deposit facility was left unchanged at 0.00%.

The ECB Governing Council's decision was based on the assessment that the surprisingly sharp drop in the HICP inflation rate to 0.7% in October signals modest price inflation in the euro area over the medium term. In addition, moderate growth in the stock of money and a continued weak lending trend point in the same direction. The accommodative monetary policy stance will also continue to provide support for the gradual recovery in economic activity observed since the spring. Besides cutting its key interest rate, the ECB Governing Council decided to continue to conduct the regular monetary policy refinancing operations as fixed-rate tenders with full allotment at least until the end of the second quarter of 2015.

Given the low rates of inflation to be expected over the medium term and sluggish economic growth, an expansionary monetary policy stance in the euro area is justified at present. At the same time, however, a watch needs to be kept on the medium to long-term risks of an environment of very low interest rates, in keeping with a forward-looking stability policy.

Monetary developments in the euro area

In the summer months, as in previous quarters, monetary trends in the euro area were driven mainly by weak lending, inflows from abroad and the interest rate constellation. For instance, sight deposits recorded further expansion owing to the low opportunity costs of liquid money holdings. Loans to the private sector, on the other hand, were still being held back by weak economic growth and balance sheet adjustment processes in the euro-area peripheral countries, though the outflows slowed in comparison to the previous quarter.

German economy

The German economy is on a healthy growth path. According to the flash estimate by the Federal Statistical Office, third-quarter real gross domestic product (GDP) was up 0.3% on the quarter after seasonal and calendar adjustment. This is equal to the average quarterly growth rate in the first half of 2013, though growth in the first two quarters showed a high degree of fluctuation owing to weather-related factors. Thus, in its underlying cyclical trend, the German economy is expanding at about its potential growth rate, after recovering from the temporary phase of weakness three quarters ago. The balanced nature of the overall economic picture is also reflected in the fact that production is in line with normal utilisation of overall economic capacity.

Economic growth is being borne up by a domestic economy which is for the most part trending upwards, and is now also free from external disturbances. However, international trade for German exporters has so far remained lacklustre. Shipments of goods to the euro area rose slightly in the period under review. On the other hand, demand from countries outside the euro area in the third quarter failed to match the prior-quarter figure. Imports in the summer are likely to have just about maintained their elevated level recorded in the second quarter.

Private sector capital formation did not move onto a clear recovery path in the third quarter, either. However, there is reason to be confident: according to Ifo surveys, capacity utilisation in industry has recently returned almost to its longer-term average. This means that enterprises can be expected to increase their capital investment if the upward trend in demand continues to consolidate. Furthermore, the terms on loan capital remain very favourable, and many procurement items can also be financed out of enterprises' own resources.

There was a further substantial expansion in housing construction in the period under review. In addition, the upward trend in household consumption continued. Healthy consumer spending is based on very optimistic income expectations and a marked propensity on the part of households to make purchases.

Developments in lending were in line with the profile for demand. Loans to non-financial corporations in Germany declined again in the third quarter of 2013, reflecting restrained capital investment in the German economy and the increasing use of alternative sources of finance. In contrast, loans to households maintained the moderate growth recorded in recent years. The main driver was sustained demand for loans for house purchase. The continued favourable environment for household consumption was also reflected in accelerated growth in consumer credit in the third quarter.

On the labour market, both employment and unemployment are still increasing moderately. The main reason for this atypical co-movement is the high level of labour-market-focused immigration. The increase in employment was still attributable primarily to growth in jobs subject to social security contributions. Over the summer months, the number of registered unemployed was, on average, only slightly higher than during the second quarter. However, registered unemployment rose relatively sharply in September after a comparatively positive development during the holiday months and remained at this level in October. Unlike in the preceding quarters, the increase in unemployment over the summer did not result from unemployment within the insurance system. With demand expected to pick up, recruitment could have been stepped up from among the ranks of the recently unemployed. By contrast, the number of those receiving the basic welfare allowance has been rising for six months. Low barriers to employment are one of the factors needed to improve the labour market opportunities of the more than two million recipients of unemployment benefit II.

One-sixth of employees currently receive an hourly wage of less than €8.50. A relatively high general minimum wage would probably have an impact on the entire wage structure and could trigger further pay rises. With the argument that the wages of the low paid, primarily in areas not governed by collective wage agreements, should be raised to a level where they would no longer require top-up benefits, socio-political objectives are entering into the determination of collective wages, which have previously been set by the social partners based primarily on qualifications and industry-specific aspects. Lawmakers, in dictating a general wage floor, would be interfering considerably in decades-old wage-setting structures, which could imply significant employment risks.

Growth in negotiated wages accelerated again in the third quarter of 2013, after temporarily weakening in the second quarter, in part because wage increases were delayed in large industries governed by collective wage agreements.

In the upstream stages of the economy, the downward price tendency as a result of the appreciation of the euro and still subdued global industrial activity continued over the summer. It was, however, masked by rising crude oil prices, which meant that import prices overall remained unchanged in the third quarter after seasonal adjustment, having dropped noticeably in the second quarter. By contrast, seasonally adjusted domestic producer prices and export prices, which are little influenced by crude oil prices, fell slightly on the quarter. Consumer price inflation accelerated somewhat in the third quarter. The main reason was a slight quarter-on-quarter rise in oil prices in euro terms, which meant that prices for oil products picked up moderately. In the summer months, annual consumer price inflation came in at 1.6%. In October, the rate fell to 1.2%, because energy prices went down again and tuition fees were abolished in Bavaria.

There is a good chance that the economic upward movement in Germany will strengthen further over the next few months. There is nothing to suggest that the main pillars of domestic demand will lose any of their stability. Meanwhile, industry should receive more support from the external sector again. This is underpinned by a perceptible rise in industrial orders in the third quarter – as in the second. Moreover, the business outlook for large swathes of the economy brightened further in the third quarter. The fact that demand is again expected to visibly outstrip normal capacity utilisation could give enterprises' investment activity the necessary boost. However, another important prerequisite for an investment-friendly climate is that the new German government adopts a forward-looking economic policy agenda.

Public finances

Public finances in Germany last year achieved a slight surplus, and a close-to-balance budget is also likely for the current year. In structural terms, revenues and spending should also be roughly balanced. The debt ratio, which is still high, will probably fall significantly this year. A key factor are the portfolio sales at government-owned bad banks, while the euro-area stabilisation measures are perceptibly slowing the reduction in the debt ratio. For the coming year, as for the current year, no major budget movements and a continued drop in the debt ratio are on the cards assuming no new measures or costs, in particular as a result of the euro-area debt crisis.

In terms of the central government budget, net borrowing looks likely to be roughly in line with guidance in the current year. The structural deficit (excluding advance payments made to the flood assistance fund) is likely to drop, which is possible in part by the new cuts to the transfers to the social security funds of €5 billion net. For the subsequent years, the outgoing government's financial plans mapped out a steady improvement in central government's structural budget situation, culminating in a surplus of €9 billion in 2017.

By contrast, the medium-term plans for general government included only limited consolidation. Improvements at the various levels of government, and central government in particular will be offset by lower surpluses in the social security funds. Finally, a moderate structural surplus of ½% of GDP was expected. Even given the underlying favourable baseline scenario accompanied by high uncertainty, the plans do not appear overly ambitious.

If the budget stance is maintained as planned and not relinquished in favour of more expansionary policies, the high debt ratio could nonetheless be reduced comparatively rapidly. This would also help manage the foreseeable burdens as a result of demographic change. In view of the national budget rules, it would also be a good idea to make the most of the currently favourable conditions for Germany's public finances and rapidly reduce the remaining deficits at the various levels of government. In addition, central government and the Federal states would be well advised to plan to leave generally clear safety margins vis-à-vis the debt ceilings – which were very sensibly tightened in 2009 – in order, if possible, to avoid the need for short-term and procyclical adjustments should the assessment of the budget situation change. Given past developments, a structural surplus of roughly 1% of GDP for central government and the Federal states together does not appear exaggerated. There is also much to be said for not exploiting to the full the deadlines, which from today's perspective look very long for most government levels, before the final limits of the debt brake enter into force. Overall, the budget surpluses outlined in some of the medium-term projections, characterised as they are by considerable uncertainty, should not be seen as giving leeway for unfunded budget expenses.