The current economic situation in Germany

Overview

Global economy

The global economy seems to have got off to a relatively weak start this year, after global activity had already lost momentum in the final quarter of 2014. In the first quarter, macroeconomic growth tailed off in a number of key emerging market economies, in particular. In China, growth in real gross domestic product (GDP) slowed distinctly, while GDP in Russia and Brazil probably even shrank on the previous quarter. Furthermore, growth in the US economy virtually came to a standstill. However, the slowdown there is likely to have been exaggerated by the intermittently harsh winter weather. The upturn in the UK economy also slowed down. The euro area's performance was favourable by comparison. Despite the weakness in the global economy, the pace of the euro area's economic recovery increased slightly.

In the past, too, the growth rates for global economic output had fluctuated heavily at times from quarter to quarter, without the underlying cyclical trend ultimately changing. The deceleration in the past few quarters is noteworthy in that many additional cyclical stimuli had been expected, primarily owing to the drop in the price of oil. Ultimately, however, it is unclear how much, if at all, this price slump is stimulating the global economy as a whole. In the meantime, retarding influences are emerging, and not just in oil-exporting countries such as Russia. In the United States, too, which is still importing crude oil on balance, the domestic oil industry has substantially reined in its investment and thus dampened price-adjusted GDP growth. US households have not made full use of their greater real income, which means that the saving ratio has risen significantly. Overall, there are few indications at present that the global economy is on the verge of changing its pace of growth, the underlying tendency of which is moderate.

Financial markets

Developments in the financial markets in the year to date were strongly influenced by monetary policy as well as major portfolio shifts. In the euro area, a majority in the Governing Council of the ECB decided in mid-January to significantly expand the asset purchase programme. Even beforehand, yields in the euro-area sovereign bond markets declined sharply as a result of expectations of quantitative easing and initially again sank perceptibly as soon as the purchases had begun. At times, Federal bonds with a maturity of ten years yielded just 0.04%. The low bond yields also strengthened the equity markets. In the euro area, steep price rises continued into April; at its peak, EuroStoxx added around 23% since the start of the year. Other contributing factors here were that the economic outlook brightened in the euro area and that the euro recorded distinct losses in the foreign exchange markets during this period against the US dollar, pound sterling and yen. Yields on US Treasuries also declined at times. A role could have been played in this drop in yields by the fact that the pace of growth in the USA was weaker than previously estimated and that, following the March meeting of the US Federal Open Market Committee, market players expected the monetary policy stance to be tightened later than previously thought.

Since the end of April, however, there has been a massive countermovement in the financial markets, as some investors apparently came to believe that yields on benchmark bonds have dropped to an unsustainable level. This led to international investments being realigned. As a result, bond yields rose significantly around the world, and the equity markets in many economies trended more weakly from their high levels. The euro regained some of its lost ground. The uncertainty amongst investors concerning further price developments recently increased clearly in the financial markets.

Monetary policy

In the period under review, the ECB Governing Council left the key interest rates in the euro area at the levels reached following the interest rate cut of 4 September 2014. Therefore, the main refinancing rate remains at 0.05%, the marginal lending rate at 0.30% and the deposit rate at -0.20%. On 9 March 2015, the Eurosystem began purchasing additional bonds issued by euro-area central governments, agencies and European institutions under the expanded asset purchase programme (EAPP). These additional purchases form the new public sector purchase programme (PSPP), the third and most significant component of the EAPP, complementing the already existing purchase programmes for asset-backed securities (ABSPP) and covered bonds (CBPP3). For the months of March and April, the volume of securities purchased under the EAPP corresponds to the monthly volume of around €60 billion previously announced. On 19 March 2015, the third of eight targeted longer-term refinancing operations (TLTROs) was carried out. In this operation, an overall volume of €97.8 billion was borrowed from the Eurosystem.

Monetary developments in the euro area

Increasingly supported by loans to the private sector, the recovery in the broad monetary aggregate M3 seen in previous quarters gained further momentum over the winter months. The pick-up in euro-area lending also included loans to non-financial corporations, which once again experienced noticeable gains in the quarter under review, having recorded a net increase in the previous quarter for the first time since summer 2011. Demand for credit is benefiting from exceptionally favourable financing conditions and the positive underlying trend in real economic activity in the euro area. In addition, banks taking part in the Bank Lending Survey reported having somewhat relaxed their credit standards again for loans to enterprises. However, despite signs of recovery, underlying monetary dynamics in the euro area remain very modest.

Credit dynamics in Germany

In Germany, banks once again issued more loans to the domestic non-bank sector during the quarter under review. As in previous quarters, growth in private sector lending was primarily supported by loans to households. A decisive factor here was the persistently brisk demand for private housing loans, which was probably driven by another slight decline in borrowing costs as well as by the positive household income situation and the relative unattractiveness of alternative investment opportunities. In addition to loans to households, banks also increased their lending to non-financial corporations in the reporting period – loans with longer maturities experienced particularly strong growth. Apart from a further drop in interest rates on long-term loans, this was most likely due to the underlying trend of positive economic and business expectations.

German economy

The upturn in German economic activity, which got underway at the end of 2014, continued into the early months of 2015. According to the flash estimate of the Federal Statistical Office, real GDP in the first quarter of 2015 was 0.3% up on the previous three-month period after seasonal and calendar adjustment. Thus, despite buoyant domestic demand, the strong growth of 0.7% seen in the previous quarter could not be maintained. While exports were hampered by the dip in global economic activity, imports grew strongly. Utilisation of aggregate capacity has remained at more or less normal levels.

Domestic demand continued to expand considerably and private consumption, in particular, upheld the strong momentum seen in the second half of 2014 almost without any interruption. In addition to the boost from the favourable labour conditions, which include rising employment, lower unemployment and perceptibly higher wages which have prevailed for some time now, the economy was further strengthened by an increase in purchasing power due to the dramatic fall in crude oil prices at the end of 2014 and its lingering impact going into 2015. Added to this, a range of economic policy measures served to support growth in the short term. Housing construction likewise continued to expand, presumably helped by the exceptionally mild winter weather at the beginning of the year and the fact that order books, though slightly less full, remained healthy. Enterprises also boosted their investment for the first time in almost a year.

By contrast, in the first quarter of 2015, German firms' foreign business failed to maintain the momentum experienced in the second half of 2014. The impact of the relatively subdued pace of global economic activity at the start of the year was greater than that of the stimulating effects of the sharp depreciation in the euro which, as might be expected, only normally become apparent after some time has elapsed. In price and seasonally adjusted terms, exports of goods just about held up at the same high level of the previous quarter. This contrasted with the figures for goods imports, which saw marked real growth during the reporting period, after trailing behind final demand in the second half of 2014.

Labour market

The upward trend in the labour market continued at the beginning of 2015. Although the number of persons in work expanded only moderately in the first quarter of the year, there was a pronounced drop in unemployment. According to initial estimates issued by the Federal Employment Agency, this was mainly attributable to the combined effect of a sharp fall in the number of persons employed in low-paid part-time work and the ongoing creation of new jobs subject to employment contributions. Signs suggest that enterprises will continue to recruit a growing body of workers in the next few months, one of these indicators being the large number of vacancies.

Wages

The 2015 pay round settlements that have been concluded thus far envisage rather moderate wage increases. In this context, it should be noted that in a number of cases the social partners agreed on additional measures which, though not manifested in the negotiated wages, are of benefit to employees and entail costs for employers. The pace of growth in negotiated rates of pay is likely to accelerate slightly in the spring months compared with its depressed first-quarter level (which had been due to special factors) but not quite match the 2014 growth figures. Conversely, unlike in preceding reporting periods, actual earnings in the first quarter may have risen at a somewhat higher rate than negotiated wages. Presumably, this reversal in the wage drift was in large part triggered by the introduction of the general statutory minimum wage on 1 January 2015 which probably led to a large pay increase for individuals in the lower wage segments in a number of sectors.

Prices

Throughout the first quarter of 2015, price developments remained strongly influenced by plummeting crude oil prices, which continued to have an impact right into January. With respect to imports, average first-quarter energy prices in 2015 were almost one-sixth below their level in the autumn months of 2014. Moreover, the seasonally adjusted composite index for import prices was well down. However, if energy is excluded, there was a noticeable upturn in the figures, chiefly owing to the depreciation of the euro, with imported consumer goods recording a particularly large price increase. After seasonal adjustment, domestic industrial producer sales prices contracted once more, both in aggregate terms and excluding energy. In the first quarter of 2015, seasonally adjusted consumer prices were again down on the quarter, having already fallen in the previous quarter. The decline was primarily due to the considerably lower energy prices that persisted until the end of January. The year-on-year figures as measured by the national consumer price index (CPI) showed a further decline to 0.0% which in fact turned slightly negative at -0.2% as defined by the Harmonised Index of Consumer Prices (HICP). However, this development is likely to have been short-lived. Indeed, in the course of the same quarter, the price trend flipped on the back of the partial pick-up in crude oil prices and the depreciation of the single currency. In April, prices continued their ascent, with the year-on-year CPI and HICP going up by 0.5% and 0.3% respectively.

Outlook

The German economy will probably continue to expand over the coming months. Households are increasingly using the growing scope for expenditure for consumption purposes. Consumer spending is therefore set to continue to bolster macroeconomic growth, even though the main impact of the purchasing power effect arising from the substantial drop in the price of oil has probably already been felt. The broad-based surge in orders in the construction sector at the beginning of this year gives reason to believe that construction activity could gain greater momentum. Investment in machinery and equipment is likely to increase at a rather subdued pace. Although production capacity utilisation is now at a high level, enterprises are currently still rather hesitant about investing extensively in expansions owing to mixed external signals. In the industrial sector, in particular, the economic upswing is intact, but it is likely to initially remain sluggish given the overall disappointing growth in orders at the start of the year. Nevertheless, the improving global economy and the comparatively low external value of the euro should soon open up new opportunities to export goods to markets outside the euro area.

Public finances

German public finances have benefited for some time now from very favourable underlying conditions. From today's perspective, these are set to continue, although there are uncertainties at the international level, in particular. If the economy develops smoothly on the whole, there is likely to be little change in the financial balance, with a surplus of around ½% of GDP on the cards for 2015. In this context, favourable cyclical factors and declining interest expenditure mask a rather expansionary fiscal policy stance. Thus, there is likely to be a further significant drop in the debt ratio, with this development currently expected to continue in 2016.

In its updated stability programme for Germany, the Federal Government essentially presents a similar picture. It also sets out an expansionary path for public finances for 2015 and 2016, with a deterioration in the balance after adjustment for cyclical factors and interest expenditure. A structural surplus of around ½% of GDP is envisaged, which complies with the European requirement. Moderate structural surpluses seem wholly appropriate in view of both the structural and economic conditions for Germany. The debt ratio remains at a high level and ought to be reduced as quickly as possible in light of the foreseeable demographic adjustment burdens. It also makes sense to plan in a safety margin below the upper limits of the budgetary rules, particularly in the case of the central government debt brake, in order to be prepared for unpleasant surprises if the situation takes a turn for the worse. This also means that a certain level of surpluses would be advisable. Furthermore, experience shows that pleasant surprises should not be completely used up in the budget plans, and this applies, not least, in view of the risks with regard to international developments. Up until now, unexpectedly favourable developments have been used, in particular, to increase expenditure. If further scope is envisaged in future, tax relief – like that recently announced to curtail cold progression – would now seem more worthy of consideration.

The German debt brake, which was agreed during the crisis year of 2009, has formed a sound basis for budgetary consolidation since 2011. It continues to be the case that the debt brake does not stand in the way of important reforms or investment, but rather creates an essential basis by ensuring sustainable public finances. In terms of economic development, it is at the same time important to provide high-quality infrastructure and cover specific government investment needs. However, this can be achieved without worsening the financial position. Moreover, trying to circumvent the debt brake by means of shadow budgets, for example, would be a major step backwards. This is all the more the case as most of it would probably be replacement investment anyway. In addition, there are likely to still be substantial efficiency reserves in the area of government investment. Proposals aimed at improving efficiency, for example through centralised provision of expertise on the planning, implementation and cost management of investment projects, should therefore be given serious consideration. In addition, greater involvement of the private sector could also be considered in individual cases, if this has clear advantages. In particular, it needs to be ensured that risks are actually transferred to the private sector, rather than creating preferential forms of capital investment at the government's expense.