The current economic situation in Germany

Overview

Ongoing upturn

Global economy

Following a weak start to the year, global economic growth appears to have picked up only slightly in the second quarter of 2015. One important factor behind this minor improvement was the economic upturn in the United States. Although the adjustment process in the oil industry persisted, the US economy managed to shake off other exceptional constraints. In China, the previously observed deceleration in macroeconomic growth did not continue in the second quarter. Nevertheless, risks of a stronger cyclical slowdown remain high. The Chinese central bank's decision to allow the renminbi to depreciate against the US dollar may be interpreted as evidence of uneasiness. The recovery in the euro area continued despite the renewed intensification of the sovereign debt crisis in Greece. All things considered, the pace of global economic expansion remained moderate compared with the previous momentum. The global industrial sector and the international goods trade remained sluggish.

The monetary policy stances became even more accommodative over the past few months in a number of countries, not least China. This, combined with other factors – the positive effects of lower oil prices are often cited in this context – will support the continuation of the moderate recovery of the world economy. Prerequisites for steady growth, however, are that no major disruptive factors materialise. The macroeconomic consequences of the crisis in Greece are likely to be largely limited to the Greek economy.

Financial markets

Developments on the international financial markets in the second quarter were driven to a great extent by the central banks. In March 2015 the Eurosystem began implementing the Governing Council's decision of mid-January to launch the expanded asset purchase programme (EAPP), under which public and private-sector securities totalling, on average, €60 billion in value are to be bought each month on the secondary market. Interest rates on euro-area bond markets initially responded by falling – in some cases to record lows. But yields on US Treasuries also dipped for a while due to a string of unexpectedly negative economic data. Sentiment on the bond markets made a turnaround at the end of April, however. Investors worldwide perceived that yields had dropped to an unsustainably low level, triggering a considerable counterswing. The euro, too, temporarily made distinct gains in the forex markets against the US dollar, pound sterling and yen. While the financial markets were subsequently gripped for a time by rising uncertainty about the outcome of the negotiations between the Greek government and its creditors as well as developments in China, yields on both sides of the Atlantic rose over the reporting period on balance. Stock markets in the United States and, above all, in Japan posted price gains at the end of the second quarter despite rising bond yields and intermittent heightened uncertainty, whereas share prices in the euro area were down – in some cases, clearly – compared with the end of the first quarter. Overall, the euro gained considerable ground in nominal effective terms, primarily because China's central bank – as mentioned – changed its reference rate.

Monetary policy

Based on its regular economic and monetary analyses, the ECB Governing Council decided to keep key interest rates unchanged in the reporting period. In addition, the Eurosystem continued to implement the EAPP with the announced monthly purchase volume averaging €60 billion. Moreover, the fourth of eight targeted longer-term refinancing operations was carried out in June. In this operation, banks borrowed a total of close to €74 billion from the Eurosystem.

The marked recovery of the broad monetary aggregate M3 that set in at the beginning of 2014 gained further momentum during the reporting quarter. The renewed rise in the annual M3 growth rate to 5.0% at the end of June was driven mainly by the money-holding sector's continued preference for highly liquid assets as the extremely low general interest rate level persisted. The upward trend in loans to the non-financial private sector is likewise to be seen in the context of both the very favourable financing conditions and the modest yet broadly based cyclical upturn. The monetary aggregate was increasingly buoyed in addition by securitised lending to the euro-area general government sector, which grew further on balance in the quarter to June in the wake of the EAPP.

The Greek banking system experienced massive outflows of liquidity caused by the uncertainty that followed the general election in Greece. Given the lack of other sources of funding, these huge outflows were primarily financed in the past months through loans granted by the Greek central bank – notably in the form of emergency liquidity assistance. These loans increased by over €80 billion from December 2014, and the situation did not stabilise until capital controls were imposed after the assistance programme ended and it was agreed that negotiations would be held regarding a possible follow-up programme. Unlike the implementation of monetary policy operations, Eurosystem national central banks may – under their own responsibility and at their own risk and by way of exception – provide emergency liquidity assistance to solvent financial institutions facing temporary liquidity problems. Developments in Greece should be viewed critically, however, particularly in view of the prohibition on the monetary financing of sovereigns.

German economy

The German economy's relatively robust upswing continued in the second quarter. According to the Federal Statistical Office's flash estimate, real gross domestic product (GDP) grew by 0.4% in the second quarter of 2015 compared with the first three months of the year after seasonal and calendar adjustment. This means that the increase in economic output nearly matched that of the two preceding quarters at an average of 0.5% per quarter. The underlying output rate has been distinctly exceeding the potential rate ever since the cyclical lull in the middle of 2014 was overcome. The aggregate rate of utilisation of production capacity was in the upper part of the corridor of normal capacity utilisation of late.

Economic activity in the second quarter was given a sharp boost by exports, which benefited from the slight firming of global economic dynamics following the sluggish start to the year and probably also from the euro's earlier depreciation and returned to the faster-paced development seen in the second half of 2014. Export momentum was broadly based in terms of both geographic range and product range. The very sharp rise in exports was aided by large-scale deliveries from the aircraft and aerospace industry. The pick-up in imports seen previously tailed off in the second quarter.

The more dynamic export growth offset the fact that the impulses from the domestic economy were less substantial in the reporting period than in the fourth quarter of 2014 and the first quarter of 2015 combined. However, the environment for consumer spending remains favourable given the positive labour market situation and a considerable rise in real earnings. Yet private consumption was relatively subdued in the second quarter after oil price-related gains in purchasing power, additional pension payments and the introduction of the general minimum wage had expanded the income base and had triggered a major adjustment in household spending patterns already in the preceding two quarters. Construction investment in the first half of the year showed a somewhat distorted development in that building activity was impaired far less than usual by the winter weather. Investment in machinery and equipment basically continued to point upwards despite a possibly somewhat muted procurement trend on the part of enterprises in the reporting period. Firms' ample scope for internal financing, thanks to their ongoing stable profit and liquidity situation, is likely to have been a decisive factor behind the slight contraction in lending to corporates in the real sector during the second quarter.

The labour market situation showed a further improvement between April and June. Both the level of employment and vacancies rose again, while unemployment fell. The unusually sharp decline in mini-jobs since the beginning of the year, coupled with a comparatively strong expansion in jobs subject to social security contributions in some relatively labour-intensive services sectors, can probably be interpreted largely as an adjustment by enterprises in response to the introduction of the general statutory minimum wage. Apart from this transmutation effect, the impact of the introduction of the minimum wage on the total number of hours worked appears to be very limited in the context of the currently favourable economic environment.

The rise in negotiated rates of pay in the second quarter of 2015 was barely higher than in the preceding three months. The fact that the increase of around 2% in negotiated wages during the period under review also fell perceptibly short of the year-on-year growth rate of close to 3% underlines the moderate basic tenor of the current pay round. However, the increase in actual earnings in the second quarter probably again outstripped that in negotiated pay rates. The first quarter of 2015 had witnessed a positive wage drift for the first time in just over two years. This turnaround was chiefly attributable to the introduction of the general minimum wage. This particularly benefited low-skilled workers and employees in low-paid sectors in eastern Germany, and presumably also persons in low-paid part-time jobs (up to €450 per month) all over Germany. Initial estimates on the basis of the quarterly earnings survey suggest that the minimum wage may have contributed around 1¾ percentage points to the rise in wages for employees outside the low-paid part-time sector in eastern Germany. Assuming that the introduction of the minimum wage had no impact on wage developments of workers outside the low-paid part-time sector in western Germany, the contribution to the wage increase calculated for Germany as a whole amounts to ¼%. Projections based on the Socio-Economic Panel (SOEP) indicate that this value could double if the impact on the earnings of low-paid part-time workers in the whole of Germany is additionally taken into account.

On the whole, prices returned to an upward trajectory in the second quarter. This turnaround in import, producer and consumer prices can largely be explained by the fact that crude oil prices rebounded from their low level in January well into May. In addition, the euro depreciated slightly further. Consumer prices went up appreciably in the second quarter after having fallen in the first three months of the year. Almost half of this growth was attributable to the recovery in crude oil prices. Of late, however, oil prices have weakened significantly again on the international markets. While this has initially led to an easing of import prices, in particular, it is likely to have a knock-on effect on downstream prices as well. After stripping out the volatile energy component, the core inflation measure, too, currently appears less dynamic than had been expected several months ago. Should these lower crude oil prices become entrenched, the headline inflation rate will probably hover at around 0% in the coming months before picking up again at the end of the year, driven mainly by the baseline effect in the energy component.

The conditions are currently in place for solid economic growth in the second half of 2015, fuelled by both external and domestic demand. Domestic demand components will feature more prominently in the second half of the year – in contrast to the dynamics in the second quarter of 2015, which were dominated by exceptional factors. This will push up not only consumer spending, which remains buoyed by the highly favourable underlying setting, but also investment, particularly as enterprises that, looking ahead, may soon be facing above-average capacity utilisation levels are becoming increasingly likely to invest in capacity expansion. For one thing, export business may benefit from the continuing recovery in the euro area. For another, the economic outlook for the United States and the United Kingdom, which are traditionally major sale markets for German exports outside the euro area, is comparatively favourable. In addition, the euro's low external value will boost exports to non-euro-area countries. But it should also be borne in mind that external demand also currently faces downside risks stemming largely from emerging market economies.

Public finances

The favourable development of public finances in Germany has continued thus far into the year. In the absence of any major disruptions, the general government surplus is expected to remain relatively stable in 2015 and 2016, at around ½% of GDP, and the debt ratio is likely to fall further. Public finances are chiefly benefiting from the economic upswing and an ongoing decline in interest expenditure This is obscuring the underlying expansionary fiscal policy stance with its bias towards higher spending.

Despite this relaxation of the fiscal stance, distinct safety margins have been established vis-à-vis the borrowing limits. This applies to both the general government deficit limit as defined in the European fiscal compact and to central government's debt brake. According to its most recent financial plan, the Federal Government remains committed to its objective of achieving a balanced central government budget by 2019. However, since this is predicated on the expectation of an improving economic situation, simply maintaining a balanced budget would equate to a deterioration in the structural balance. Growing relaxation of the fiscal stance is also apparent in relation to the financial plan of summer 2014. The targets were not altered even though savings on interest expenditure are expected to rise to almost €10 billion at their maximum. To sum up, the Federal Government's financial plan appears to be based on rather cautious estimates, on the one hand, while, on the other, risks exist not least from the international environment.

It is precisely in the good times that safety margins vis-à-vis borrowing limits should be built up. They make it easier to withstand negative shocks without endangering the credibility of budgetary rules or potentially rendering it necessary to initiate procyclical countermeasures. At the same time, it would make sense to use the current protracted demographic lull to rapidly cut the debt ratio to below 60%. The resulting containment of the interest burden would create budgetary scope and strengthen the resilience of German public finances to possible future shocks. The favourable economic outlook would also suggest that the moderate structural surpluses planned by the Federal Government are far from overambitious. By contrast, calls that have been made in some quarters to additionally boost the economies of other member states by launching a major fiscal demand stimulus in Germany appear unconvincing owing, inter alia, to the very limited transmission effects that such a national stimulus programme would be likely to entail.

Measures aimed at maintaining a good public infrastructure or generally increasing potential growth do not require a further easing of the budgetary stance or creating additional spending via shadow budgets; instead, they can be implemented within the planned financial framework. It is ultimately a question of setting the right priorities; furthermore, tapping efficiency reserves should also remain firmly on the agenda. In previous years, foreseeable budgetary scope has mainly been used to increase spending – for instance, on pensions. Should additional scope arise in the future, it would seem far more appropriate instead to consider easing the burden of taxes and social contributions, which are set to rise further in the face of growing demographic challenges. Thus the German government could do more to counter income tax bracket creep, lower social contributions by financing non-insurance-related social benefits out of general taxation or consider a more rapid reduction of the "solidarity surcharge" on income and corporation tax, for which the justification as a federal tax surcharge is becoming less and less apparent now that the special-purpose grants to the federal states in east Germany are being phased out.