The current economic situation in Germany

Overview

Consumption brisk, foreign demand sluggish

Global economy

The global economy probably did not grow quite as fast in the final quarter of 2015 as in the second and third quarters, in which it had rebounded somewhat after a mixed start to the year. However, the recent deceleration does not reflect a regionally broad-based economic slowdown. It was mainly caused by a perceptible weakening of economic growth in the United States. The disappointing performance in the last quarter of the year should be seen against the backdrop of comparatively high volatility in the quarterly seasonally adjusted changes in US real gross domestic product (GDP). Other indicators, such as labour market activity, show no flattening of the upward path. Despite many fears to the contrary, economic growth in China remained virtually unabated according to information provided by the country's national statistics office. Similarly, economic activity proved robust in the euro area and the United Kingdom. In both economic areas, overall economic output grew almost as fast as before. By contrast, the economic situation in the major commodity-exporting countries remained difficult. The continued decline in the prices of many commodities is likely to further weigh on these countries' economies.

According to an estimate by the International Monetary Fund (IMF) in January 2016, global output, measured by purchasing power parity exchange rates, merely rose by just over 3% on the year during 2015, the lowest rate of growth since the global financial and economic crisis of 2008-09. This dashed expectations in many quarters that falling prices on the crude oil market would lend the global economy greater traction. To reflect this and other factors, the IMF lowered its global growth forecast for 2016 and 2017 slightly in its regular January update of the World Economic Outlook (WEO), but it is still forecasting a gradual strengthening of the economy in its baseline scenario.

Financial markets

In recent months, events on the international financial markets have been dominated by the monetary policy decisions of the central banks in the major currency areas. The Eurosystem, for instance – and later the Bank of Japan – took further expansionary measures, while the US Federal Reserve rolled back its monetary expansion policy somewhat with the first interest rate rise in seven years. These measures had been expected to varying degrees, which was reflected for a time in some market segments in considerable, yet on the whole short-lived reactions on the bond markets. Equities, by contrast, which had previously risen noticeably worldwide on the back of benign economic indicators, came under pressure from December onwards. The share price slide accelerated in the new year as the financial markets were increasingly gripped by uncertainty, emanating from China, about the robustness of global growth. These concerns were aggravated by falling prices on the commodity and oil markets, which some financial market participants interpreted as evidence of economic weakness rather than as a stimulus for stronger consumption growth in the consumer countries. In addition, low commodity prices are not only eroding the revenue and, therefore, the growth potential, of major emerging market economies, they are also putting pressure on enterprises in the commodity-producing and energy sectors, which are often saddled with substantial US dollar debt. Consequently, investments were shifted into safe assets. Since the end of September, both yields on government bonds and share prices in the major currency areas have dropped overall, with bank stocks being particularly hard hit. Funding conditions for enterprises have changed only slightly and remain favourable. On the foreign exchange markets, the euro appreciated on balance in real terms, amid considerable volatility.

Monetary policy

At its monetary policy meeting at the beginning of December, the Governing Council of the ECB reviewed the degree of monetary policy accommodation – as it had announced it would back in October – based in part on the latest macroeconomic projections drawn up by Eurosystem staff. A majority of the Council were of the opinion that a further easing of monetary policy was necessary given the weak inflation dynamics and continued downside risks for the inflation outlook and therefore decided on a further package of monetary policy measures. One of the Governing Council's decisions was to lower the interest rate on the deposit facility by 10 basis points to -0.30%. The main refinancing rate and the marginal lending rate were left unchanged at 0.05% and 0.30%, respectively.

Besides lowering the deposit rate, the ECB Governing Council also extended the asset purchase programme (APP). The monthly purchases of €60 billion under the APP are to be extended until the end of March 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term.

The Council further decided to reinvest the principal payments on the securities purchased under the APP as they mature. Moreover, the list of assets that are eligible for regular purchases by the respective national central banks under the public sector purchase programme (PSPP) was expanded to include marketable debt instruments issued by regional and local governments provided they fulfil the requirements for the purchase programme.

In addition, it was decided to continue conducting the main refinancing operations and three-month longer-term refinancing operations as fixed-rate tender procedures with full allotment for as long as necessary, and at least until the end of the last reserve maintenance period of 2017.

In January, the ECB Governing Council also announced its intention to review and possibly reconsider its monetary policy stance at its meeting in March, when the new macroeconomic projections become available. The Governing Council made this announcement on the basis of its perception that, despite the continued economic recovery, there were increased downside risks for inflation at the start of the year stemming from the heightened uncertainty about emerging economies' growth prospects, volatility in financial and commodity markets and geopolitical risks.

Monetary developments in the euro area

The analysis of monetary indicators continues to provide no indication of a growing need for monetary policy action. The broad M3 monetary aggregate once again saw substantial growth in the fourth quarter. The growth was driven by a rise in loans to the private sector, which thus continued their upward trend, and – as in the previous quarter – by the Eurosystem's asset purchases. Taken as a whole, securitised lending by the MFI sector to general government was once again the mainstay of monetary growth in the final quarter of the year. However, the positive direct effect of the asset purchases on the money stock was partly offset by the outflow of funds from the euro area caused by foreign investors' net sales of euro-area bonds and greater demand among euro-area residents for debt securities issued outside the monetary union. As for the money components, the main factor driving the growth in M3 was the continued strong preference among money-holders for highly liquid assets, which was encouraged by the low interest rate environment.

German economy

The upturn in the German economy continued at a solid pace in the final quarter of 2015. According to the Federal Statistical Office's flash estimate, real GDP again saw quarter-on-quarter growth of 0.3% in the fourth quarter of 2015 after seasonal and calendar adjustment. Economic growth in the second half of the year was therefore slightly weaker than in the first half and matched the rise in potential output.

Impetus for economic growth in the fourth quarter came from buoyant domestic demand, whereas external demand was notably subdued. Domestic demand was driven by brisk consumption, which was predominantly attributable to robust increases in employment and significant rises in wages. This was probably boosted by transfer payments and other government expenditure related to the influx of refugees. An additional stimulus was provided by sharply growing housing investment. However, there was only a slight rise in enterprises' willingness to invest in equipment and new buildings. At the end of the year, the German economy felt the effects of failing demand stimuli not only from China and commodity-producing emerging economies, but also from some industrialised countries outside of the euro area. The expanding demand from the euro area and the euro's ongoing favourable exchange rate were unable to make up for this.

The labour market in the final quarter of 2015 saw a stable, strong rise in employment and – following a sideways movement in the second and third quarters – a significant decline in unemployment. The demand for labour continued to be met to a considerable extent by immigrants, particularly those from other EU countries. Even so, the number of reported job vacancies rose further. The largest increase in employment subject to social security contributions was seen in some services industries. The public sector also witnessed its first notable increase in staffing levels for a long time, presumably to deal with the massive surge in refugee numbers as of late summer. It is unlikely, however, that the new immigrants will have been able to find jobs yet. According to the leading labour market indicators, it is possible that the positive employment trend will continue in the coming months and that unemployment will remain stable.

Last year both actual earnings and negotiated wages grew at rates significantly higher than the average of the last ten years. In 2015 as a whole, negotiated wage rates including additional benefits grew by 2.3% year on year. According to provisional data of the Federal Statistical Office, actual earnings grew by 2.8%, thus considerably outstripping the rise in negotiated wage rates. A key driver pushing wage drift back into positive territory (0.5 percentage point) was the introduction of the general statutory minimum wage. The slightly higher bonus payments outside of the agreed pay scales at large industrial firms probably also contributed to the rise in wages. In fact, real growth, as measured in terms of the increase in actual earnings adjusted for the rise in the consumer price index, reached its highest level since 1992.

In particular, the slump in crude oil prices towards the end of 2015 prolonged the third-quarter negative price trend at the upstream stages of the economy into the fourth quarter. Import prices dropped markedly in the final quarter of 2015 in seasonally adjusted terms, with the non-energy component of import prices declining, too. This was due to the fact that price reductions in intermediate goods on the back of falling industrial commodity quotations outweighed price increases in some consumer goods segments, which were probably linked to the euro's persisting depreciation. The situation in respect of domestic sales prices for industrial goods was very similar. Construction prices expanded again moderately. Seasonally adjusted consumer prices in the final quarter of 2015 remained at the prior-quarter level. Consumers paid significantly less for energy, especially refined petroleum products, than they did in the third quarter. By contrast, non-energy prices continued to rise. Food products became dearer after stagnating in the third quarter. The services sector, too, showed a considerable price increase across all major subsectors. Given the currently assumed development of crude oil prices, the year-on-year changes in consumer prices are, however, likely to be negative in some of the coming months.

The German economy might expand at a somewhat faster pace in the first quarter of 2016 compared with the end of 2015 thanks chiefly to strengthening domestic dynamics. Greater momentum is likely to be provided by consumption, which is continuing to benefit from the buoyant labour market situation. Additional impetus may be expected notably from households' substantial purchasing power gains owing to the further fall in crude oil prices at the turn of the 2015-16. The revival of construction activity also looks set to continue in the early part of the year. It has been buoyed of late by a considerable surge in demand in the business and public sectors, while housing construction continues to be bolstered by both the fundamentals and favourable financing conditions. Given the above-average level of capacity utilisation in broad segments of the economy, firms' propensity to invest in machinery and equipment should also revive. A key prerequisite for stronger economic growth and a greater corporate willingness to invest is that external demand picks up, following a lull in the second half of 2015, and thus spurs industrial activity.

Public finances

The public finance situation in Germany remained favourable last year, with the fiscal surplus increasing slightly to 0.5% of GDP. This improvement largely reflects the dropout of temporary burdens from 2014, while the structural surplus declined slightly. Although interest expenditure decreased further, social benefits, in particular, increased considerably, especially in the areas of the statutory retirement pension scheme, health care and long-term care but also partly owing to the influx of refugees. This year, the surplus is likely to be eroded and the government budget might be more or less balanced. The expected deterioration in the fiscal performance is attributable to growing additional expenditure on asylum seekers and the generally rather lax budget policy course. The upshot is an expansionary fiscal stance which will tend to have a procyclical impact in the current rather favourable German economic setting. The debt ratio fell until the third quarter of 2015, chiefly because of nominal GDP growth, and could well decline further by the end of 2016.

The massive influx of asylum seekers poses tough challenges for Germany in many respects. Thanks to the current favourable economic situation, however, there is sufficient scope within the government budgets to absorb the associated financial burdens without breaching the deficit ceilings. The longer-term effects on government budgets are still difficult to gauge. Fiscal policymakers would be well advised to restore the safety margins in future budgets following their temporary depletion. The pursuit of sound public finances and the implementation of important reforms are not contradictory aims. Rather, reliable compliance with budgetary rules creates trust in fiscal policy and a dependable economic framework. For Germany, the unfavourable demographic outlook poses a particular challenge, so that for this reason, too, it would make good sense to swiftly reduce the debt ratio to below the 60% ceiling.

Central government generated a budget surplus of €12 billion in 2015, due in part to one-off proceeds from the mobile phone frequency auction and bolstered by a further sharp fall in interest expenditure. The surplus was allocated in full to the new reserves to cover future additional expenditure on refugees. In 2016, the expected funding gap in the central government budget is to be covered by withdrawing €6 billion from the reserves, meaning that another break-even budget outturn should be possible. All things considered, the planned deficit appears to be amply calculated, although risks exist, particularly in connection with the costs caused by the influx of refugees. Under the debt brake, the ceiling of 0.35% of GDP for the structural funding gap was to be adhered to for the first time when drawing up the central government budget for 2016. This was facilitated by the fact that – in contrast to the EU fiscal rules that the debt brake is actually intended to underpin – the withdrawal from the reserves was recorded as budget relief, although it does not actually increase the stock of net financial assets. But at the current juncture it seems feasible to comply with the debt brake even without this accounting convenience.