The current economic situation in Germany

German economy slacker amid normal capacity utilisation

Global economy

In the third quarter the global economy probably remained on the path of moderate growth it had begun to trace in the second quarter after overcoming the negative exceptional factors from the start of the year. As long as no major disruptions occur, the growth rate expected for 2014 as a whole compared with 2013 is unchanged at 3¼% on the basis of purchasing power parity or 2½% based on market exchange rates. In contrast to the expectation that prevailed in the second quarter, however, the growth rate failed to accelerate appreciably. The moderate increase in global gross domestic product (GDP) in the third quarter was attributable to industrial countries as well as to emerging markets and developing countries. Of the major industrial countries, the United States and the United Kingdom recorded relatively strong expansion vis-à-vis the second quarter. The euro area grew only moderately, as it had between April and June. This muted performance was attributable to persistently weak growth in parts of the euro area, but also to the sanctions and countermeasures imposed in connection with the Ukraine conflict as well as deteriorating sentiment in the wake of the crises in eastern Europe and other regions of the world.

The moderate global upturn appears to be continuing in the current quarter. Within the group of industrialised countries, the US and UK economies are likely to remain on a marked upward growth trajectory, while the Japanese economy seems to have regained momentum. In the euro area, by contrast, the slacker growth dynamics probably continued into the start of the fourth quarter. If global growth is to accelerate in 2015 in line with the international institutions' forecasts, momentum will need to strengthen a little after the turn of the year. The economies of oil-consuming countries should be buoyed by both the ongoing expansionary monetary policy stance and the steep drop in the price of oil, providing it lasts. A global economic view, however, also needs to factor in the retarding effects from oil-producing countries, which are for the most part currently experiencing falling revenues.

Financial markets

Developments on the international financial markets in recent months have been shaped by geopolitical tensions and less sanguine expectations for global growth. The differing economic and inflation outlooks in the various currency areas are reflected in the disparate monetary policy approaches of the respective central banks. Thus the ECB Governing Council adopted additional expansionary monetary policy measures in September in order to safeguard price stability in the euro area. The same applies to the Bank of Japan, which announced in October that it would further accelerate the expansion of the monetary base. By contrast, the US Federal Reserve phased out its quantitative easing programme at the end of October, as most market participants had expected. In this setting, long-dated government bonds yields fell markedly on the major bond markets from the end of June onwards. By contrast, international stock markets showed divergent developments against the backdrop of temporary heightened volatility. European equities, in particular, recorded losses while share indices in the United States and Japan made gains. On the foreign exchange markets, exchange rates moved in favour of the US dollar. The euro, by contrast, depreciated by approximately 3½% in trade-weighted terms compared with the end of June. Its value against the US dollar slid sharply by 9%.

Monetary policy

On 4 September 2014, the ECB Governing Council adopted an additional package of monetary policy measures against the background of slackening growth and a persistently subdued inflation outlook in the euro area. Together with the decisions taken in June 2014, these measures are intended to help anchor medium and long-term inflation expectations and to bring the inflation rate back up to a level closer to 2%. As part of its package of measures, the Governing Council lowered policy rates by 10 basis points to 0.05% for its main refinancing operations, -0.20% for the deposit facility and 0.30% for the marginal lending facility.

In addition to lowering interest rates, the ECB Governing Council also adopted purchase programmes for asset-backed securities (ABS) and covered bonds. These measures are intended to improve monetary policy transmission, support the provision of credit to the real economy and contribute to an even more accommodative monetary policy stance. It is expected that these purchase programmes, along with the targeted longer-term refinancing operations (TLTROs) adopted in June with a maturity of up to four years, will significantly expand the Eurosystem's balance sheet towards the level seen at the start of 2012. However, the chief factor determining the monetary policy course going forward is and remains the inflation outlook.

German economy

Economic output in Germany rose only marginally in the third quarter of 2014. According to the Federal Statistical Office's flash estimate, real GDP edged up by just 0.1% on the preceding three-month period in seasonal and calendar-adjusted terms following a first-quarter boost from exceptional effects (+0.8%) and a second-quarter countermovement (-0.1%). The underlying growth path of the German economy has therefore been flattening off since the beginning of the year. In the reporting period, in particular, the slackening momentum was, however, more pronounced on the supply side than on the final demand side. Aggregate production capacity utilisation remained within normal bounds.

The cyclical slowdown emanated from the production sector. Industrial orders have not been growing since the beginning of the year, and business sentiment has deteriorated perceptibly. Industry already began scaling back its output slightly in the third quarter in anticipation of declining orders, even though it was able to increase its sales of goods again to both euro-area and non-euro-area countries, and the expansion of exports covered a wide range of goods. Goods imports in the third quarter largely made up for the losses sustained in the previous three months.

Investment in machinery and equipment in the summer half-year failed to continue the recovery trend that had started to emerge in the preceding winter half-year. Enterprises anticipate that demand can be comfortably met using the available domestic capacities. This is consistent with the picture that loans to domestic non-financial corporations showed a perceptible decline in the reporting quarter. Following the weather-induced upswings and downswings seen in the first half of the year, the construction sector was unable to match the higher level of activity seen in 2013. By contrast, business activity in the consumption-related service sectors fared better. This was driven primarily by the positive sentiment of households, which was boosted by strong income growth and the persistently favourable labour market situation. Private consumption expanded strongly in the third quarter of 2014.

The ongoing buoyancy on the labour market has so far not been dampened by the slackening economic momentum. The growth in employment in the third quarter was once again solely attributable to the increase in regular jobs subject to social security contributions. According to the available information, the influx of workers from other European countries over the course of the year so far seems to have been on a similar level to that recorded in 2013. Given the significant rise in the number of refugees and asylum seekers, the migration surplus for 2014 will, in all likelihood, be considerably higher than last year. The seasonally adjusted number of persons registered as unemployed has been hovering at around 2.9 million for the past six months. The unemployment rate has consequently remained unchanged at 6.7%. The labour market is likely to remain stable despite the subdued cyclical outlook. Following the introduction of legislation on 1 July allowing long-term contributors to the statutory pension insurance system to retire prematurely at the age of 63 yet still draw a full pension, the marked rise in the number of vacancies cannot, however, be interpreted as being purely of a cyclical nature.

The average increase in negotiated rates of pay in the second half of the year has to date not been quite as high as in the first six months of the year. Collective wages and salaries, including one-off payments and fringe benefits, went up by 2.8% year on year in the third quarter of 2014, after rising by 3.3% in the second quarter.

Overall price developments in Germany were trending moderately upwards in the third quarter of 2014. Although lower energy prices had a significant dampening impact on inflation, rising domestic cost trends gained in importance on the back of the euro's depreciation. As in the case of imports, the prices of intermediate, capital and consumer goods at the domestic producer level were also moving upwards, and there was no further slowdown in price inflation for construction services in the third quarter. Not least owing to the cooling of the – in some cases – overheated regional property markets, prices for owner-occupied housing are now rising only relatively moderately. The muted rise in consumer prices continued in the third quarter, although the prices of all larger components, excluding energy, were showing an upward trend. In October, however, seasonally adjusted consumer prices in Germany saw a perceptible month-on-month fall (0.2%) for the first time in a long while. Despite this, the year-on-year increase in the consumer price index remained unchanged at 0.8% and declined marginally to 0.7% as measured by the Harmonised Index of Consumer Prices.

The further deterioration in economic expectations and the stagnation of new orders point to a rather sluggish course of economic development in Germany until at least the end of 2014. Although global demand for goods is continuing to expand, it currently lacks strong stimuli. In addition, no marked recovery in important euro-area partner countries has yet materialised. Nonetheless, other external factors, such as the euro's considerable depreciation and the sharp fall in oil prices, could gradually boost economic activity. Given the favourable labour market situation, high levels of immigration and marked wage growth, the underlying domestic growth dynamics will receive continuing support from private consumption. In the light of increased global risks together with uncertainty about the implications of some economic policy measures, there may be a delay before the recovery in corporate investment resumes.

Public finances

The situation of public finances in Germany has remained relatively favourable this year. For the third consecutive year, general government is likely to achieve a broadly balanced budget and further decrease the debt ratio. Although sharper growth in social security spending is placing a strain on the general government budget, interest expenditure is continuing to fall due to the extremely benign financing conditions, and the Bundesbank's dividend has risen significantly. However, at present, a deficit – albeit a small one – appears likely next year. This is largely because the social security funds are expected to run up considerable deficits, which will substantially erode their relatively high reserves. As things currently stand, the impact of cyclical factors on the government budget will remain almost neutral this year and next, meaning that the cyclically adjusted balance will largely match the unadjusted balance.

Given the still high debt ratio and unfavourable demographic trends, Germany would be well advised to achieve a budget position that is at least structurally balanced in the medium term, too. In addition, central and state government should build up sufficient safety margins vis-à-vis the strict national deficit ceilings. Hence there is an ongoing need for consolidation. In view of the considerable uncertainties regarding global and European economic developments, however, it appears appropriate to initially maintain the fiscal policy course mapped out in the current plans. Not least given the social security funds' dwindling reserves, the financial course of general government will feature a fiscal easing next year, though its impact on the fiscal balance will be partially masked by savings on interest expenditure. The automatic stabilisers should be allowed to operate freely. Thus, if economic activity were to pick up, a better budget outturn would be possible, whereas a downturn would result in cyclically induced higher deficits. However, an additional debt-financed economic stimulus package would do little to benefit either Germany's economic situation or the rest of the euro area in view of the comparably small boost it could be expected to provide. There is enough leeway for fiscal policy measures aimed at strengthening the underlying conditions for growth without having to resort to borrowing by improving the budget structure and making government activities more cost-effective. For example, the infrastructure can be better maintained and expanded as necessary without incurring new debt.

The draft central government budget for 2015, approved by the Federal Cabinet at the beginning of July, envisaged an equal balance between revenue and expenditure without any new borrowing for the first time in four-and-a-half decades. Although the growth acceleration foreseen in the third quarter now seems unlikely and so will cause certain revenue shortfalls compared with the draft budget, the objective of a balanced budget was maintained. However, this did not necessitate extra saving measures. Instead, reductions are expected, especially in payments to the EU budget and interest expenditure. For the medium-term financial planning period from 2016 to 2018, the tax forecast was also reduced slightly. At the same time, a total of €10 billion of additional central government investment was announced for this period; this is to be financed without new net borrowing. The Federal Government will need to factor major adjustments into the medium-term budget plan vis-à-vis the summer of 2014 in the next benchmark figures in March 2015 at the latest.