

Economic conditions in Germany

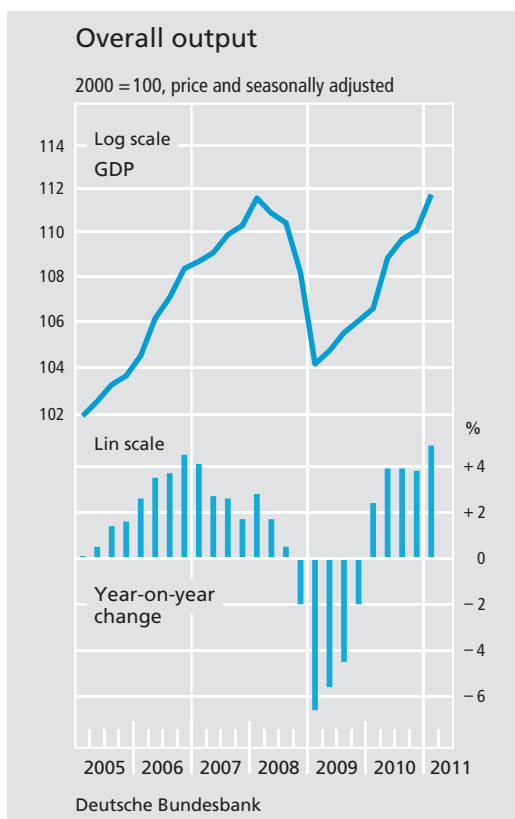
Macroeconomic situation

The German economy grew very strongly after the new year 2011. According to a flash estimate released by the Federal Statistical Office, seasonally and calendar-adjusted real gross domestic product (GDP) rose by 1.5% in the first quarter of 2011, compared to the previous quarter in which overall economic output had expanded only moderately, at 0.4%, given cold and snowy winter weather in December. During the period under review, output growth was affected perceptibly by catching-up effects. Quarter-on-quarter GDP therefore considerably overstates underlying economic momentum. Nonetheless, economic progress is unmistakable. The massive drop in economic activity caused by the financial and economic crisis have been completely recouped in the past two years, with two-thirds of the upswing coming in the past twelve-month period. Year-on-year GDP growth stood at a calendar-adjusted rate of 4.9% in the first quarter of 2011.

German economy grew very strongly in 2011 Q1

The economic upswing in Germany, triggered by the global economic recovery, has now spread beyond the directly affected sectors to the overall economy. Despite the fact that foreign demand lost some steam over the past winter two-quarter period, the overall global economic environment has remained stable; on this basis, domestic enterprises have retained their confidence. Many sectors' investment and employment schedules are geared towards growth given normal utilisation of production capacity, thereby generating an increasing amount of further-reaching stimuli. The exceptionally good state of the

Increasingly balanced demand profile



labour market, in conjunction with the prospect of perceptible earnings growth, is promoting households' propensity to make big-ticket purchases. Private consumption and residential housing construction have benefited, especially as financing conditions are favourable.

Upward trend in exports still intact

Following the turn of 2010-11, exports maintained their subdued trend of the preceding months – after seasonal adjustment – before then skyrocketing in March. Average first-quarter total exports were a seasonally adjusted 4% higher in terms of value than a quarter earlier. Taking inflation into account reduces this figure by around one-half. The basis for the upward trend remains intact since economic activity in key sales markets has remained brisk.

In the first two months of 2011, business with China once again showed the strongest growth. Moreover, the value of goods sales to the USA rose more strongly than in the three preceding quarters. Among Germany's trading partners in Europe, exports to its eastern neighbours showed the strongest growth once again; the sharp growth in exports to Russia following the turn of the year, however, has to be seen in the light of the weak autumn 2010 result.

The gap between nominal and real movements was more pronounced for imports than for exports. Imports probably rose only slightly in real terms but cost a seasonally adjusted 5½% more than a quarter earlier; prices rose considerably towards the end of the reporting period. In this situation, energy imports declined, above all. Enterprises were also reluctant to purchase other goods from foreign manufacturers. The deterioration in the terms of trade was the major reason why the trade surplus closed lower in the winter of 2011, after seasonal adjustment, than in the two preceding quarters.

Imports virtually unchanged amidst strong price rises

The tragic events in Japan which have caused extensive output losses there since March are unlikely to be having any tangible impact on the growth process in Germany. However, Japan's small share of the German economy's exports and imports is not the major factor. Whether or not, with respect to Germany's imports from Japan, supply bottlenecks are impairing domestic value added is not just a function of the extent of bilateral trade relations. Given that Japan is very highly networked with all of East Asia and this does

Tragic events in Japan probably impacted little on activity in Germany

Key groups of goods sold by Japanese firms in Germany's range of imports *

Results for 2010

Group of goods	Japan's share of total imports (as a percentage)	Memo item Imports (€ million)	
		From Japan	Total
Optical and photographic instruments and equipment	37.2	1,282	3,443
Office machinery	32.8	2,317	7,069
Machinery for other goods sectors (including machines to manufacture electronic construction components)	17.0	976	5,753
Other electrical equipment and components (inter alia LED/LCD)	16.9	818	4,836
Instruments and appliances for measuring, testing and navigating	10.1	1,160	11,464
Bearings, gears, gearing and driving elements	9.5	525	5,507
Hydraulic and pneumatic systems as well as other pumps and compressors	9.1	720	7,878
Consumer electronics	7.2	727	10,090
Electronic construction components	6.7	1,555	23,356
Other chemical products	6.6	650	9,867
Motor vehicles and engines, motorcycles	3.4	1,357	40,154
Parts and accessories for motor vehicles	3.0	861	28,276
Computers and peripheral equipment	2.8	665	23,363
All goods	2.7	22,065	806,163

* Imports from Japan with a volume in excess of € 500 million.

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have a magnitude that is significant for Germany's imports, indirect effects, in and of themselves, could cause more damage. Disruptions in international production links, however, are likely only if Japanese sellers of complex inputs and intermediate goods – such as possibly some electronic components – have a central position in the world market and are simultaneously not able to ensure deliveries through factories other than those currently disrupted by earthquakes, the tsunami or power shortages. There currently seem to be few signs of this being the case, though.

The range of products exported by Japan to Germany also shows specialisation not just in motor vehicles but also in particular in electrical machinery and equipment and also

optical and photography instruments. These are largely capital goods or higher-end consumer goods, the time of purchase of which can usually be flexibly chosen by buyers within product-related or technological constraints – with the exception of unforeseen disruptions.

Investment is likely to have been the main driver of growth in Germany in the first quarter of 2011. The key factor was construction, which rapidly recouped the considerable weather-related output losses of last December in the winter months amidst normal weather conditions and also benefited from sharply rising demand. The procurement of machinery and equipment is also likely to have risen further. The favourable economic outlook has led most firms, looking at healthy

Investment extremely buoyant also due to catching-up effects in construction



capacity utilisation and ample scope for internal financing, to make further investment, even though investment in large equipment and vehicles calmed down in a sense following the expiry of the favourable tax depreciation rules at the end of 2010. Moreover, during the period under review inventory investment is likely to have developed favourably. This is based on offsetting effects following autumn 2010, in which dampening

factors played a role. For instance, at that time inventories of just-finished capital goods, in particular, were being depleted. In addition, towards the end of 2010, the increased output of, in particular, machinery and commercially used automobiles depleted inventories of inputs and intermediate goods, especially since ice and snow on transport routes brought the flow of spare parts to a standstill in many places.

The moderate increase in private consumption probably continued after the turn of the year 2010-11. Although rising consumer price inflation had, in and of itself, a dampening impact on purchasing power, household incomes improved perceptibly, however, thanks to rising employment and a continued return to normal in working hours as well as high bonus payments. Amidst all the current uncertainty surrounding the statistical data, which remain unsatisfactory, retail sales are still likely to have risen on the quarter after seasonal adjustment. In addition, fuel consumption recovered following sharply limited mobility the preceding December owing to bad weather. In the light of high prices, heating oil was in much less demand than at the beginning of the heating season. Private car business tended to be muted during the period under review.

Muted increase in household consumption

Sectoral trends

A solid underlying pace has been the defining feature of the upswing in the industrial sector for months. In the first quarter of 2011, the growth of industrial output, at a seasonally

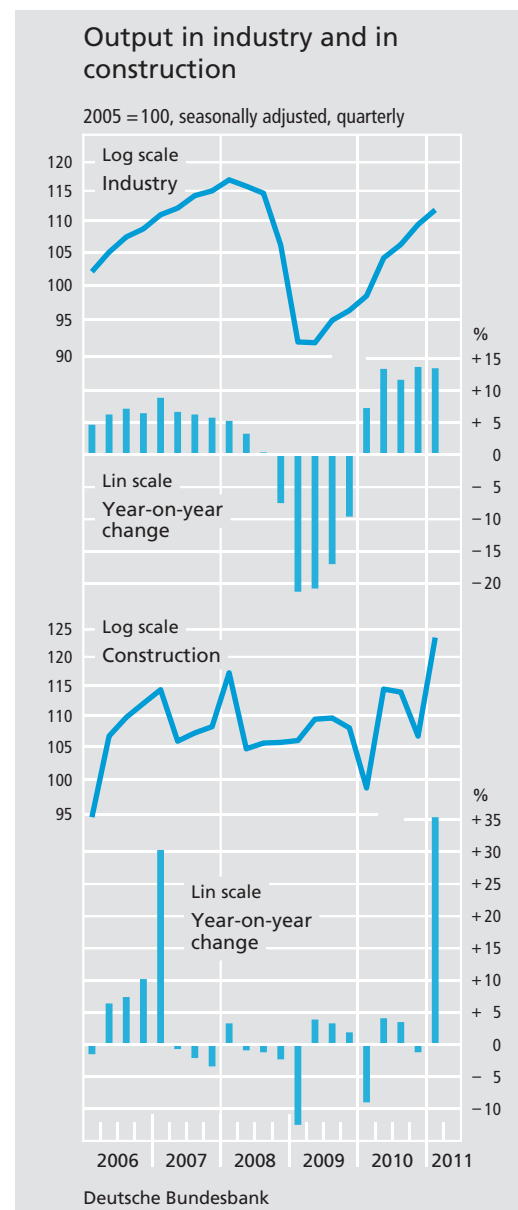
Solid upswing in the industrial sector

adjusted 2¼% on the quarter, did not match its rate of autumn 2010 (+3%); however, this is largely the mathematical consequence of certain fluctuations in the monthly trend.

After a second half of 2010 in which output of capital goods was clearly the leader in growth, the production of inputs regained the lead following the turn of the year. One reason this sector grew by 4½% was that firms scaled back production last December in the light of stoppages in the transport of goods. Another was that inputs and intermediate products for the manufacture of cars and machinery, which was running full throttle in the final quarter of 2010 and was slowed down somewhat in the reporting quarter, were increasingly being taken from inventories. The subsequent return of inventories to normal levels triggered a surge in demand in upstream business sectors. After a half with no output growth, the seasonally adjusted manufacture of consumer goods once again rose perceptibly.

Manufacturing capacity utilisation surpassed normal levels

In the winter of 2011, manufacturing capacity utilisation continued to increase. The ifo institute survey results for April were visibly above their multi-year average, indicating that the use of industrial plant and equipment has now surpassed normal levels. It is not least thanks to output growth in the reporting quarter that capacity utilisation in the manufacture of inputs was significantly higher than its sectoral average, whereas in the manufacture of capital goods the corresponding benchmark was not surpassed by very much.



The construction sector used the first few months of 2011 to rapidly catch up on work that was not completed because of the early and severe onset of winter weather in December, with construction output rising during the reporting period by a seasonally adjusted 15¾% following a fall of 6¼% in autumn 2010. In building construction, the surplus, despite perceptibly lower falls in the preceding quarter, was only slightly weaker

Construction output running full steam ahead

than in civil engineering. This shows that the business situation was relatively favourable owing to the pick-up in residential and commercial construction. In civil engineering, on the other hand, the cutbacks in spending on public infrastructure projects have left a visible mark.

Services sectors overall growing

Activity in wholesale trade and the transport sector have recovered visibly after seasonal adjustment following the turn of 2010-11. Since these areas had also been hit very hard by the inclement winter weather the previous December, catching-up effects played a substantial role here. One sign of this is that the mileage of toll-liable vehicles in March 2011 was, after seasonal adjustment, not only 6½% higher than in a weak December but even up by 2¾% from the level of October and November 2010. Business in the other services sectors is likely to have continued its positive trends. This is indicated both by a renewed increase in surveyed institutions' assessment of the business situation according to the ifo institute's survey in the reporting quarter and also by the continued growth of employment in these sectors. According to the ZEW's surveys, in the first quarter of 2011 the very favourable overall sentiment among sellers of information and communication technology, advertising and consultancy services took a damper.

Employment and labour market

Strong growth in employment...

The labour market continued its recovery in the first few months of 2011. According to Federal Statistical Office estimates, the num-

ber of persons in work in Germany rose by 142,000 after seasonal adjustment. This represents an increase of 0.3% over the average of the autumn months. Like last year, an above-average number of jobs subject to social security contributions were created. In the first two months of the winter, the increase in this area amounted to 168,000 persons or 0.6%. The seasonally adjusted number of self-employed persons rose as well, whereas exclusively low-paid part-time work virtually stagnated.

Additional jobs subject to social security contributions were created in nearly all sectors. It is particularly in manufacturing where employment growth accelerated significantly as of late, rising in the first two months of the winter by a seasonally adjusted 34,000 persons, around double the growth of the two preceding quarters. In the temporary employment sector, the employees of which are often active in the industrial sector, the rise was of similar strength. Staffing also increased in other business-related services, transport and logistics, trade and in the health and education sector.

Employment growth in industry is likely to have gained momentum because working hours, which were sharply reduced there during the crisis, have now almost returned to pre-crisis levels. By contrast, the industrial sectors, according to data from the Federal Statistical Office, were still employing 3¼% less staff in the reporting quarter than three years earlier despite perceptible gains in the past few months. This is due largely to the automotive industry, the mechanical en-

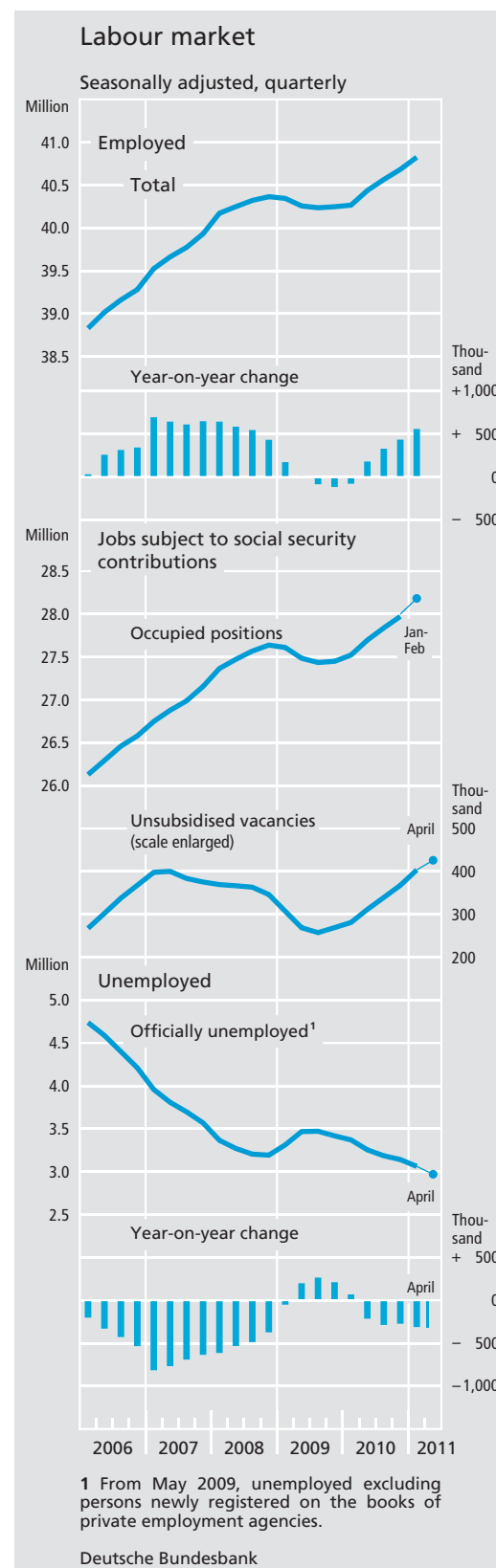
... rests particularly on broadly based rise in employment subject to social security contributions

Employment gains also now accelerating in industrial sector

gineering sector and the metal-working and electrical engineering industries. There should accordingly be a considerable scope for rehiring, even if the employment figures for 2007 and 2008 are not necessarily a firm yardstick because of advancing structural change and also in the light of the exceptionally favourable sectoral conditions at the time.

Accelerated decline in official unemployment

The decline in unemployment accelerated in the first quarter of 2011. A seasonally adjusted 3.06 million people were officially unemployed, 80,000 fewer than in the fourth quarter of 2010. The unemployment rate declined by 0.2 percentage point to 7.3%. This was due exclusively to the reduction in job seekers receiving unemployment benefits under the statutory unemployment insurance scheme, whereas the number of unemployed receiving the basic welfare allowance remained unchanged on the quarter. It must be noted, however, that the cyclical effect, which also exists in the case of the largely long-term unemployed, was obscured by the fact that, in the past few months, only a very few one-euro jobs were created. This labour market policy instrument had already been cut back at the end of last year, yet the pace of the reduction increased further after the turn of the year. In April 2011 there were only 135,000 workfare placements, just half as many as a year earlier. Since other active labour market policy measures such as employment grants for recipients of the basic welfare allowance, placement by private employment agencies or the promotion of self-employment have likewise been cut back considerably, total underemployment has fallen faster than official unemployment. The



year-on-year decline was 488,000 persons in the first quarter of 2011, as against a decline of 312,000 under the narrower definition. In April 2011, official unemployment continued to decline, dropping under the three-million mark after seasonal adjustment for the first time since 1992. The unemployment rate went down to 7.1%.

Outlook remains very positive for the labour market

Leading labour market indicators suggest that employment growth will continue. The seasonally adjusted number of job vacancies reported to the Federal Labour Agency rose to 437,000 in the first quarter of 2011. Of these, 403,000 vacancies alone were for jobs subject to social security contributions – a quarter-on-quarter increase of around one-tenth after seasonal adjustment. The vast majority of these vacancies need to be filled immediately. This value was once again considerably higher in April. Want ads by temporary work agencies, with a share of more than two-fifths, were once again dominant, yet there were also considerable increases in vacancies in manufacturing, transport, trade and the technical and scientific activities. The health and education sector continued to seek staff in large numbers. As the Federal Employment Agency sees only part of the jobs on offer throughout the economy, the number of job vacancies is actually likely to be significantly higher. According to the IAB survey on job vacancies in the economy as a whole, in the first quarter there were 1.05 million vacancies, which represents an increase of three-fifths on the year. The ifo employment barometer, which measures the planned staffing levels for trade and industry over the next three months, hit a new all-

time high in the winter. It was particularly in manufacturing that enterprises' willingness to hire new staff picked up significantly.

Wages and prices

The pay agreements concluded in the first quarter, with perceptible increases in scheduled rates of pay, reflect the favourable economic situation. The pay settlement for the chemical industry envisages a 4.1% increase in base pay starting in May 2011 over a period of 15 months. In construction, gradual pay rises were agreed in a total volume of 3.9% for western Germany, with the increase somewhat higher than that in eastern Germany owing to the intended adjustment of wage levels. In the textiles industry, the current year will see an increase in scheduled rates of pay of 3.6%; the increase at Deutsche Telekom will be somewhat more than 3% but at least €75. In the public sector of the Federal states (excluding Berlin and Hesse), the wage bargainers agreed on a gradual increase in pay of 1.5% starting in April 2011 and a further 1.9% plus a basic amount of €17 beginning in January 2012.¹ In addition, several other sectors are seeing one-off payments of varying sizes.

Significantly higher pay agreements in 2011 Q1 ...

The new agreements will not have a substantial impact on the level of total negotiated wages until the second quarter of 2011. The underlying momentum of wage growth will therefore pick up visibly in the coming months. Wages resulting from collective

... but increase in negotiated wages initially only slightly stronger

¹ The agreement is generally transferred to state and local government civil servants.

agreements rose during the reporting period by 1.7% on the year according to Bundesbank statistics, only slightly faster than in the fourth quarter of 2010 (+1.5%).² Growth of actual earnings is likely to have outpaced that of negotiated pay in the first quarter of 2011 owing to a normalisation of regular working hours and the granting of premium and bonus payments.

Expansion of sector-specific minimum wages in spring 2011

There are near-term plans to introduce additional sector-based minimum wage levels. Now that full mobility of labour within the EU has been introduced with effect from 1 May 2011,³ the social partners had an interest in enforcing mandatory minimum wages for temporary work throughout the sector. Even though the Act on Labour Leasing (*Arbeitnehmerüberlassungsgesetz*) created the pre-conditions, the relevant legal regulation had not yet been adopted as this report went to press. In addition, the minimum wages in the security services industry, which vary from one Federal state to another, will be declared generally binding with effect from 1 June 2011.

Significant increase in import prices, ...

The first few months of 2011 saw a continuation of the price increases driven mainly by the international commodity markets. This was evidenced particularly by import prices, which rose nearly 5% on the period after seasonal adjustment. Leaving out everything else altogether, energy prices, which rose by over 17%, accounted for around half of the overall increase in import prices. The prices of inputs, which often have a large share of commodity goods, rose sharply, at 4.3%. Consumer goods inflation, at 1.4%, was rela-



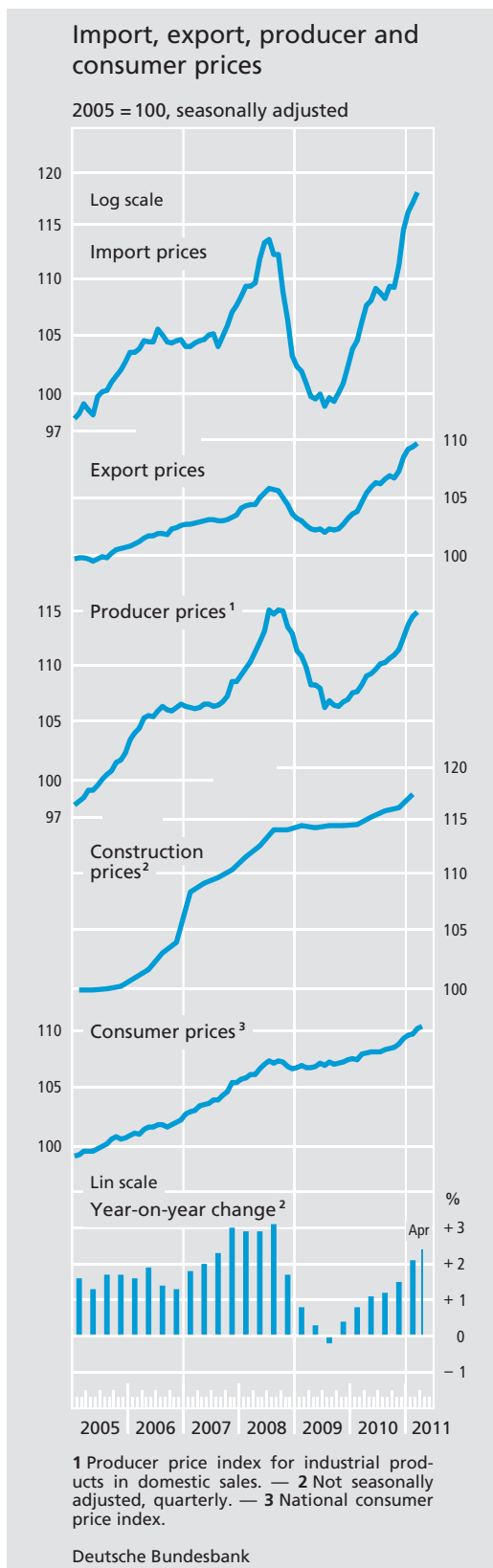
tively moderate, yet still considerably higher than in the two preceding quarters. The sharp rise in the price of food, beverage and tobacco imports had a direct impact on domestic consumer prices. The prices of capital goods remained unchanged. Compared to the first quarter of 2010, import prices were up by nearly 12%.

As was already the case in autumn 2010, this pattern also shows up in sales prices in the German industrial sector (albeit in a weaker form owing to the lesser importance of refined petroleum products). For the same

... sales prices in the industrial sector, ...

² The Federal Statistical Office, whose index excludes civil servants, reports an increase of 0.9% for the negotiated rates of basic pay, as against 1.1% according to the Bundesbank's negotiated pay rate statistics.

³ Exceptions are Romania and Bulgaria, whose nationals will be eligible for full labour mobility within the EU by 1 January 2014 at the latest.



reason, foreign sales prices (+1.8% seasonally adjusted) grew less strongly on the period than domestic sales prices (+2.5%). Excluding energy, the gap was much smaller. The prices obtained domestically by enterprises were 6.1% higher on the year and those for foreign sales 5.3% higher. With export prices having fully recovered for some time already and imports even solidly outperforming their pre-crisis levels during the reporting period, domestic prices just about pulled even with their pre-crisis levels in line with the development of economic activity. Overshooting import prices caused the terms of trade in goods to deteriorate considerably.

Surging prices for commodities have probably joined the buoyant construction activity as the key reason for the sharp rise in construction prices of not less than 1.1% quarter-on-quarter. They were thus up by 2.5% on the year. Real estate prices likewise continued their ascent. According to calculations by the Association of German Pfandbrief Banks (*Verband deutscher Pfandbriefbanken*), the prices for owner-occupied housing rose by 0.6% from the last quarter of 2010 and 3.1% year-on-year.

... construction and real estate prices ...

Sharply higher crude oil prices impacted directly on consumer prices for petrol, diesel and heating oil. Refined petroleum products were just over 8% more expensive on the period, after seasonal adjustment, after already going up by just under 7% in the autumn. Other than that, price developments were subdued overall. Nonetheless, those components more influenced by domestic supply and demand conditions clearly evi-

... and consumer prices

denced a slow, though not always continual, increase in price inflation. This is equally the case for housing rents and for services and other goods (excluding energy and food). Among foods, the global markets projected price stimuli particularly for dairy products and coffee, which were nearly fully offset by favourable developments in the area of seasonal foods. On average for the quarter, year-on-year consumer price inflation was running at 2.1% following 1.5% a quarter earlier. Excluding energy, the figure was 1.1%.

Outlook

In April 2011, owing, amongst other things, to a continued rise in crude oil prices, annual consumer price inflation picked up once again to 2.4% according to the national Consumer Price Index (CPI) and 2.7% according to the Harmonised Index of Consumer Prices (HICP). Year-on-year CPI inflation excluding energy rose to 1.5%, for which the late Easter date was partly responsible. Price developments in the coming months will be decisively influenced by whether the extremely violent corrections in the international commodity markets that began in early May represent a permanent level shift, which would benefit consumers relatively quickly in the case of energy and, with caveats, foods and flatten the upward trend in consumer prices.

Orders received and outlook

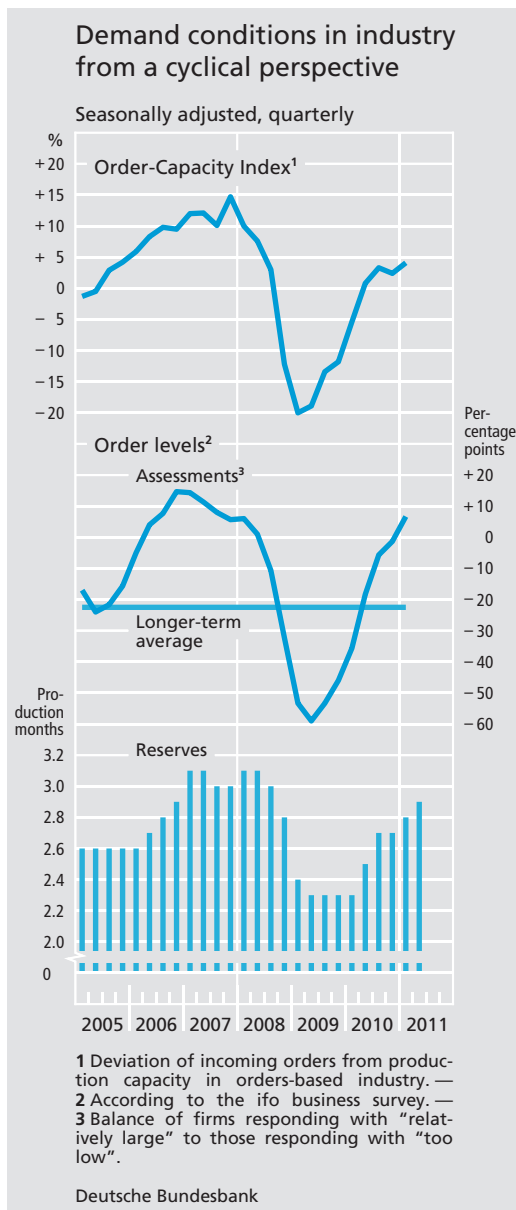
Chances of a longer-term upturn

The current upturn, which is becoming increasingly broad-based, could support economic activity in Germany for some time. This

is favoured by favourable external and internal conditions. The growth opportunities as a result of increasing migration to Germany could also play a role (see also box on pages 58 and 59). The stabilising effects emanating from domestic demand can only take full effect in a stress-free environment, however. Risks exist also because, to date, the economy appears to be growing at virtually undiminished pace compared to the previous recovery phase even given normal utilisation, and both enterprises' business expectations and consumers' economic and income prospects have peaked at an exceptionally early stage in this cycle. In addition, the price climate has deteriorated significantly.

Whereas manufacturing firms' assessment of their business situation continued to improve after the turn of 2010-11 according to the ifo business survey, the expectations component was down a bit. This could indicate that the impressive start to 2011 is likely to be followed by an easing of the pace of growth in the foreseeable future. In addition, events in Japan have amplified uncertainty about future economic developments, which could have caused a certain reluctance to place new orders; order activity in March was considerably weaker, after seasonal adjustment, than in the preceding two months. On the whole, the industrial sector received a seasonally adjusted 2½% more orders in the first quarter of 2011 than in the preceding quarter, the favourable result of which (+3%) had been aided by particularly numerous large orders.

Goods orders up further ...



... and broadly based ...

The flow of orders was broadly based during the reporting period. Capital goods orders, already at an elevated level a quarter earlier owing to special effects, were up by 1% after seasonal adjustment. Demand for inputs showed considerable growth (+4½%) for the first time since last spring. Consumer goods orders were up by 1¼%, or just as strongly as in autumn 2010. The flow of orders was also regionally more balanced than a quarter ear-

lier, with the industrial sector once again receiving considerably more new orders not just from domestic customers. Following several months of stagnation, orders from euro-area partners rebounded considerably; some large orders also had a significant impact. During the reporting period, orders from outside the euro area fell off slightly, although this was tempered by the exceptionally strong growth of nearly 10% a quarter earlier.

According to the Order-Capacity Index, orders received in the first quarter of 2011 surpassed the production capacity of the industrial sector working on orders by just over 4%. However, it is not just the high number of continuously incoming orders which is influencing demand conditions; in the meantime, the manufacturing industry's assessment of order books is as favourable as in the first quarter of 2008, just before the crisis-related slump. Moreover, the order backlog stood at just under three production months during the reporting period, a level typically associated with boom periods.

The outlook for the construction sector has improved considerably since the beginning of 2011. Although the previous quarter's weather-related low level is part of the reason for the strong growth in new orders received by the construction industry in the first two winter months (+6¼%), a more decisive factor has been the skyrocketing demand for new dwellings as well as for commercial office buildings. Commercial customers placed just under one-fifth more orders in January and February 2011 (more recent data are not yet available), after seasonal adjustment,

... and stocks of orders have returned to substantial sizes

Strong increase in demand for construction

than last autumn; this is probably related to plans to expand capacity in many sectors of the economy, thus leading to an increased need for production facilities and office buildings. The strength and structure of the revival of residential construction are likewise noteworthy. The volume of new orders was just under 8% higher than the previous quarter's average, after seasonal adjustment, in the first two months of this year. Apartment construction is likely to have been the main driver, as it was in the second half of the past year. This is consistent with a considerable pick-up in real-estate prices, especially in large cities.

Household consumption dominated by inflationary tendencies

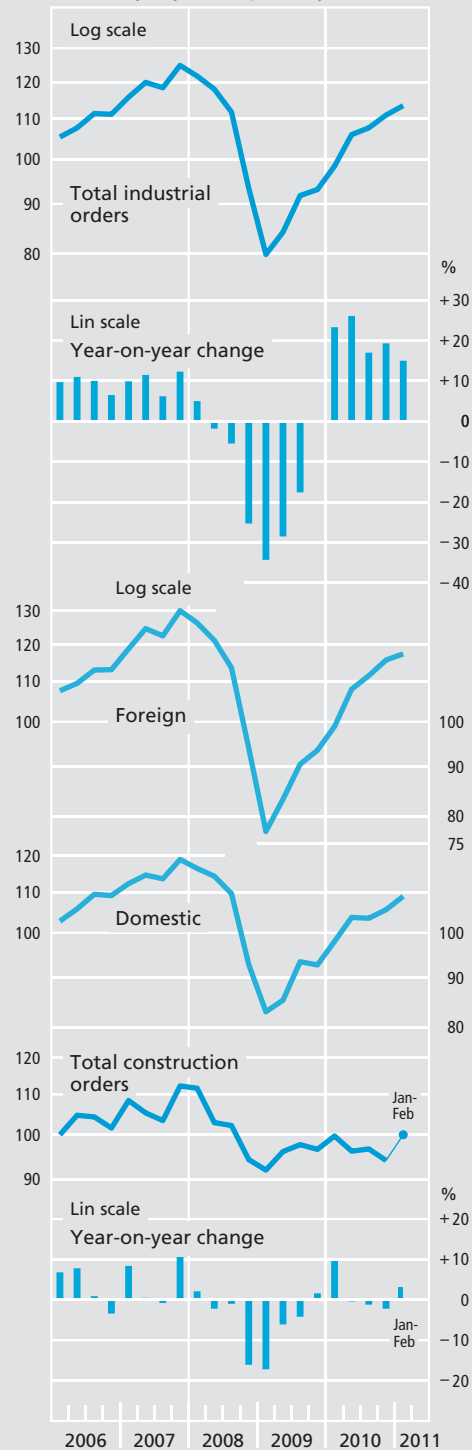
Although consumer sentiment has remained good, all in all, workers are increasingly realising that a considerable portion of agreed wage increases could be eroded by rising inflation. Despite the fact that this, in and of itself, dampens the consumer climate, consumers' propensity to purchase remained in expansionary territory. This indicates that, in particular, the favourable employment outlook is currently dominating consumer sentiment. Household consumption could therefore continue its muted upward movement in the months to come.

Sound growth path despite a calming of sorts

Despite the fact that the very strong GDP growth in the first quarter of 2011 is proof of the robustness of the German economic upturn, it must not be overlooked that the output growth was marked by special effects. Given that the economy's capacity utilisation has already reached a very high level, economic activity is likely to slow down.

Demand for industrial goods and construction work

Volume, 2005 = 100, seasonally adjusted, quarterly



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The possible growth effects of increased immigration from the new EU member states

Since the start of May, workers in the eight central and east European countries that joined the EU in 2004 (EU-8) have been able to move freely within the European Union.¹ A possible result may be that migration from these countries to Germany and Austria in particular, which maintained restrictions on the free movement of workers from the EU-8 to the last, will increase significantly.² Against this background, questions were raised about the magnitude of the expected migration movements and their macroeconomic implications, both for the German economy and for the immigrants' countries of origin.

In the years 2004 to 2010, on balance an estimated 1½ million people migrated from the EU-8 to the old EU member states (EU-15). Most immigrants came from Poland, the most populous new member, with a tradition of relatively high labour mobility. Migrants from the EU-8 have focused on countries such as the United Kingdom and Ireland, which had opened their labour markets early due to temporarily very buoyant labour demand. In consequence, only about one-tenth of the migration stream from the EU-8 moved to Germany between 2004 and 2010,³ while the UK benefited from about half of this net migration. Now that Germany and Austria have lifted their restrictions on freedom of mobility for people from the EU-8 countries, migration flows will now probably shift, partly because the economies of these two countries are performing much better than those states that were the main destination countries before the crisis.

The current forecasts of migration from the EU-8 to Germany vary considerably in some cases. According to recent press reports, the European Commission expects some 100,000 migrants per year from this region. The Federal Employment Agency and the Institute for Employment Research (*Institut für Arbeitsmarkt und Berufsforschung*, IAB) expect up to 140,000 such immigrants annually.⁴ A recent study by the Cologne Insti-

tute for Economic Research (*Institut der deutschen Wirtschaft, IW*) put the level of Germany-bound migration from these countries even higher still.⁵

In the following, the possible effects on the medium-term growth potential of Germany based on three scenarios for migration from the EU-8 to Germany will be analysed. The benchmark is the (hypothetical) path of potential output that would arise if cross-border migration in the future were to almost even out – as happened on average for the years 2006 to 2009.⁶ In this case, an important component of the macroeconomic picture is that the currently very high demand for labour will probably not be covered adequately by domestic reserves, therefore possibly creating additional wage and price pressures. The enterprises' earnings prospects would receive a damper, and fixed capital formation would progress slower.

The estimates documented here are subject to great uncertainty. Currently, the level of net immigration can only be roughly estimated. There are also few clues about the qualifications of potential migrants and their relationship to the domestic labour pool.

The main scenario, the median of the variants considered here, assumes annual net immigration of 100,000 people from the EU-8 this year and in the next two years. It is natural to assume that this influx is due to the domestic knock-on effect and therefore primarily consists of those willing to work. Structural unemployment and wages in Germany would consequently develop largely along the previously foreseen paths. The labour supply would widen accordingly, and potential output would *ipso facto* be an estimated 0.4% above the reference path until 2013. The total capital stock would also adjust – usually with a slight time-lag. Capacity effects on the production technology would have to be included. But this would also give an added boost to housing construction, the

1 Workers from Romania and Bulgaria, which acceded in 2007, will be granted free movement in full not later than 1 January 2014. — 2 In addition, during the transition period both countries limited the freedom to provide services for certain economic activities, such as in the construction sector. On the other hand, there were exemptions for particular groups of people, at least in Germany. See Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, Annual Report 2010/2011, p 292 (in German only). — 3 See T Baas and

H Brücker (2011), Mehr Chancen als Risiken für Deutschland, IAB Kurzbericht (IAB Brief Report) 10/2011, particularly Table 1 (in German only). — 4 See press reports from late April and the IAB press release of 29 April 2011. — 5 In the IW study, based on the surveys in the EU-8, potential net migration in the years 2011 and 2012 is projected to be around 800,000, which is understood to be an upper limit. The IW points out, however, that polls only reflect intentions and that usually a proportion of respondents will not follow through

arithmetical indirect effect of which would be around 0.3%. The overall effect on potential output, which is not expected to peak until 2013, however, would thus run to an increase of 0.7%.

A "conservative" variant for the years 2011 to 2013 predicts the migration of approximately 50,000 EU-8 citizens per year. It is assumed that, due to a sharp hike in the years prior to the crisis, a large proportion of those willing to migrate from central and eastern Europe have now migrated and that numerous migrants from the EU-8 have established themselves as self-employed in Germany⁷ or work in the shadow economy. Although this group might now change or legalise its status, the actual labour supply in Germany would not rise. Compared with the main scenario, it would indeed lead to a greater reduction in structural unemployment, but the moderating influence of immigration on wage and price formation would be limited. The medium-term overall effect on potential output would be 0.4% in this "conservative" variant.

The scenario with relatively high immigration assumes a net addition of 200,000 persons per year from the EU-8. This boost would lead in the short term to greater competition for vacancies, meaning the number of unemployed would initially likely decline less sharply than in the main scenario. However, the risk of wage growth being driven by labour supply shortages would fall considerably. Given the plausible assumption that needs-based immigration via complementarity would precisely benefit the problem groups in the German labour market, the risk of persistent displacement effects would be limited. Moreover, overall employment growth, in conjunction with the additional demand for goods that this would induce, could lead to increased investment and create additional labour demand stimuli in many sectors of the economy. Under these conditions, the estimates sug-

gest an overall medium-term effect of 1.2% on potential output.

For the countries of origin, the migration scenarios considered here definitely represent a bleeding of human capital, which in and of itself may result in growth loss.⁸ Since the processes are based on economic incentive effects, however, efficiency gains are likely, and growth opportunities thus greater, if one looks at the single European market as a whole. Furthermore, in the next few years migration could be more important as an instrument for evening out economic cycles within Europe. The roles of individual member states could change, as the example of Germany shows. Whereas during the past decade many workers from eastern Germany in particular were searching for work in other European countries, such as in the tourism industry of German-speaking Alpine regions and the Swiss health system, in Germany the need for foreign workers is growing again. Conversely, a country like Ireland has transformed within a short space of time from a country of immigration to a country of emigration because of the crisis. It is also conceivable that emigration from the southern member countries, which are currently going through a tough period, will resurge after largely drying up during the 1990s and the last decade.

In essence, migration within a single economic and monetary area is normal and desirable from an economic perspective. In the United States, internal migration has long been much more pronounced than in Europe, which may partly be due to the lack of a language barrier. Increased migration within the euro area could reduce the differences between member states' labour markets, which alleviates the adjustment burden to be borne by wages and facilitates monetary policy in achieving its primary objective of ensuring price stability.

on these intentions. See Cologne Institute for Economic Research, *Migrations- und Arbeitsmarktwirkungen der Arbeitnehmerfreizügigkeit*, April 2011, especially p 13 (in German only). — ⁶ According to a recent report by the Federal Statistical Office, net immigration to Germany amounted to 128,000 in 2010, the strongest rise since 2003; this shows that Germany is increasingly becoming a migration destination once again. — ⁷ Entrepreneurs from a member state of the European Union can move to any other member state and pursue self-employ-

ment throughout the Union (freedom of establishment). However, they must meet the qualification requirements of that profession in the country of establishment. Independent Polish craftsmen are already on the German labour market and are recorded in the official statistics as migrants. — ⁸ See R Barrell, J Fitzgerald and R Riley (2010), *EU Enlargement and Migration: Assessing the Macroeconomic Impacts*, *Journal of Common Market Studies*, Vol 48, pp 373-395.