The current economic situation in Germany

Overview

Weather conditions delay cyclical recovery in Germany

Global economy

In the first three months of 2013, real global gross domestic product (GDP) is likely to have expanded at a somewhat faster pace than in previous quarters, although the underlying cyclical trend shown by the global economy remained rather subdued. The upturn in growth was notably fuelled by the industrial countries distinctly stepping up their overall economic output, which had practically stagnated in the last quarter of 2012. The USA and Japan, in particular, increased their growth rates. Economic output in the UK likewise had an upward tendency, after having posted negative growth. The euro area saw its cyclical downturn continue, but the contraction was significantly less pronounced than it had been in the last quarter of 2012. Conversely, China and other major emerging market economies were unable to maintain the strong momentum they had built up in autumn.

However, the available leading indicators signal that the economy is unlikely to gain additional traction during the current quarter. Having risen perceptibly at the start of the year, the global Purchasing Managers' Index for manufacturing even declined again in April, meaning that it is only barely above the expansion threshold. The index for the services sector signals that growth remains sound but suggests that momentum looks set to wane slightly. Global economic growth is thus likely to be rather muted in the second quarter, even though the sharp drop in crude oil prices is boosting purchasing power in consumer countries.

Financial markets

The international financial markets proved to be relatively robust in the first few months of 2013 despite the rather troubled political and economic setting. The highly accommodative monetary policy measures taken by key central banks, most of which were directly targeted at the capital markets, counteracted the impact that the political uncertainty in connection with the elections in Italy and the aid package for Cyprus as well as some negative economic reports were having on the bond and equity markets. In May, some economic data that met with a positive reception among market participants helped to buoy sentiment, clearly lifting the yields on long-term government bonds from their depressed levels. As this report went to press, yields on this paper in the major currency areas were, for the most part, slightly up on their levels at the beginning of the year on balance. In the year to date, Germany likewise has seen yields on its ten-year public debt securities increase slightly, though with considerable fluctuation, to a level of 1.3% most recently. Equity prices have been climbing strongly of late, with only the European exchanges repeatedly being hit by short-lived setbacks in the face of the economic and political uncertainties mentioned above. Bank stocks were mainly affected by this. The Japanese equity market posted particularly strong gains (+44.7%); at the same time, the yen depreciated significantly against most other currencies, including the euro, chiefly on account of the highly expansionary new stance adopted by Japanese monetary policymakers.

Monetary policy

At its monetary policy meeting in early May 2013, the ECB Governing Council decided to lower the interest rate on the main refinancing operations of the Eurosystem by 25 basis points to 0.50%. The cut in interest rates is intended to contribute to supporting economic recovery prospects later in the year. The decision was based on the assessment that price pressure in the euro area is low over the medium term. Two factors support this view. First, the necessary balance sheet adjustments in both the public and private sectors are continuing to place a burden on the frail economy. Second, the moderate underlying monetary dynamics and the persistently weak lending to the euro-area private sector also indicate that price pressure is low.

The interest rate cut on 2 May 2013 narrowed the interest corridor formed by the Eurosystem's standing facilities. Banks' balances in the deposit facility – as well as their excess reserves on current accounts – are still being remunerated at 0%. Meanwhile, the Eurosystem's counterparties can now obtain overnight loans through the marginal lending facility for as little as 1.00%, ie for 50 basis points less than before.

Besides cutting its key interest rate, the ECB Governing Council decided to continue to conduct the regular monetary policy refinancing operations as fixed-rate tenders with full allotment at least until the end of the second quarter of 2014.

Lending in Germany

The quarter under review saw German banks' lending business with domestic non-banks deteriorating again appreciably owing to another distinct drop in lending to general government. By contrast, there was a slight increase in lending to the domestic private sector, which was once again mostly driven by lending to households, notably for housing construction purposes. Despite the persistently low lending rates, loans extended to the non-financial corporate sector rose only marginally on balance owing to the ongoing subdued investment in machinery and equipment by domestic enterprises and also, in part, to firms making greater use of internal funding as well as alternative forms of external financing.

German economy

The German economy grew only moderately at the beginning of 2013. According to the Federal Statistical Office's flash estimate, real first-quarter GDP increased in seasonally and calendar-adjusted terms, as expected, by 0.1% on the previous quarter, which had seen a decline of 0.7%. The countermovement was no more than subdued because the long winter had mainly impeded the construction industry but also affected the transport sector. Disregarding weather-related factors, economic output expanded roughly in line with the rate of potential growth so that macroeconomic capacity utilisation did not decline further in terms of the underlying cyclical trend. This is consistent with the further positive development observed in the labour market.

The export motor, though, has not yet come back to life. Following the sharp reduction between October and December last year, exports saw a further seasonally adjusted decline in the first quarter of 2013. The fact that exports of goods to the euro area at least partly compensated for the steep drop at the end of 2012 should be regarded as a glimmer of hope. The situation outside the euro area, however, was mostly bleak, even though the overall decrease in the period under review was probably less pronounced than it had been in the final quarter of 2012. Seasonally adjusted imports were once again down in the first quarter of 2013, mostly on account of the drop in energy imports, which had expanded strongly in autumn. By contrast, imports of intermediate goods as well as machinery, motor vehicles, computers and electrical equipment showed an upward tendency.

Investment in the corporate sector continued to be restrained, primarily on account of demand conditions, which industry widely believes to be inadequate for lifting capacity utilisation above normal levels in the foreseeable future. Restrictions on the financing side, on the other hand, do not play a perceptible role here. In many cases, enterprises' current revenues give them sufficient scope for funding their operations internally. Added to this, debt financing conditions are exceptionally favourable, and there are no signs that large firms or small and medium-sized enterprises in Germany are finding it noticeably more difficult to access credit. Construction investment suffered from the bad weather conditions in the first quarter of 2013. With ice, snow and persistently low temperatures afflicting many parts of Germany until the beginning of April, the usual seasonal upturn in construction activity was delayed until well into spring this year.

Private consumption made a good start to the new year. The beginning of spring also saw consumer sentiment rising to an unprecedented level in the current business cycle. Not only do consumers continue to have very optimistic income expectations; they are demonstrating a strong willingness to make major purchases, mirroring their reduced propensity to save.

Enterprises continued to hire significant numbers of additional employees throughout the winter. Additional regular jobs subject to social security contributions were entirely responsible for the increase in the number of persons in work. The reduction in labour market policy measures is a notable factor driving the ongoing decline in the number of self-employed positions and one-euro jobs alike. Seasonally adjusted unemployment dipped slightly in winter following the muted increase seen in the nine months previous to that. The reserve pool of unemployed, which has shrunk dramatically in recent years, can now only cover a small share of the additional demand for labour from the corporate sector. Instead, persons close to the labour market are being activated from the latent labour force, and Germany is experiencing a significant influx of labour from abroad on a scale not seen for quite some time.

Negotiated rates of pay rose by 2.9% on the previous year in the first quarter of 2013. In this year's pay round, the social partners have agreed on increases in scheduled rates of pay – so far without any major disputes – amounting to a volume of between 2½% and 3% in annualised terms. Recent minimum wage agreements in the construction and hairdressing sectors could potentially give rise to cost pressure.

In the first quarter of 2013, the appreciation of the euro drove down import prices in seasonally adjusted terms while domestic producer prices continued their upward trend. The distinct reduction in export prices is likely to have gone hand in hand with margin compression. Prices of owner-occupied housing saw another considerable increase. There was only a muted rise in seasonally adjusted consumer prices in the first three months of 2013 owing to the appreciation of the euro and a number of special effects. The increase in the renewable energy (EEG) levy drove energy prices sharply higher despite the decline in prices for refined petroleum products on the back of the stronger euro. World market factors might have played a role in the perceptibly slower increase in prices for food and other goods. The abolition of the surgery visit charge contributed to the increase in the price of services coming to a halt. The increase in existing rents which are mostly reflected in the consumer price index picked up pace slightly. There was a 1.5% year-on-year rise in the national consumer price index in the first quarter.

Overall economic activity is expected to improve markedly in the second quarter of 2013, a view that is supported not only by the likely catching-up effects in response to the weather-related downturn in construction activity during last winter. With industrial new orders picking up appreciably after a poor start to the year, there is reason to hope that exports and investment in machinery and equipment – the demand components that can usually be relied upon most to set the pace for the German economy – will recover as well. However, the poor economic conditions prevailing in many parts of the euro area and the current problems associated with the sovereign debt crisis mean that macroeconomic risks remain high.

Public finances

The general government budget recorded a narrow surplus in 2012 – the first time it has done so since 2007 – and looks set to post a slight deficit this year, chiefly because the positive cyclical impact last year is now beginning to fade. The structural deficit, meanwhile, will remain largely unchanged. While the reduction in the pension contribution rate will result in noticeable revenue shortfalls, government budgets will be eased particularly by the continued decrease in interest spending owing to the lower interest rates. Differences in the distribution of burdens and relief, and the shift in burdens from central government to the social security funds, will play a role in the diverging development of central, state and local government budgets. The social security funds are likely to scale back almost all their high surpluses while central government, in particular, will see its budget situation improve. The debt ratio rose again in 2012 to around 82%. However, as things stand, this ratio will recede distinctly during the course of this year. In addition to a very small deficit ratio relative to nominal GDP growth, it is likely that the public resolution agencies will redeem liabilities on balance. These factors are much more significant than the debt-increasing impact of the stabilisation measures currently envisaged for the euro area.

In April, the German government presented its updated stability programme. Given the assumed slightly negative cyclical impact, general government ran a structural surplus of just under ½% of GDP last year, surpassing the medium-term budget target. A structural budget surplus in this range should ordinarily be achieved in subsequent years as well. The fiscal policy orientation would thus be more or less neutral in the next few years. According to the March benchmark figures, a further gradual improvement in the central government budget is envisaged, thereby achieving a marked structural surplus by 2017. The fiscal situation is therefore more favourable than in last year's financial plan. Interest expenditure was once again the decisive factor. The improvement in the fiscal balance will be smaller than interest cost savings, which had thus previously been used in part to finance fiscal policy loosening elsewhere.

The envisaged structural general government surpluses are appropriate owing to the high debt ratio and the foreseeable burdens caused by demographic developments, and continuous overachievement of the self-imposed medium-term budget target is welcome. In addition, in connection with national budget rules, it is advisable for central and regional governments to leave a considerable safety margin below the future upper limits when preparing budgets. The currently exceptionally good underlying conditions in Germany are characterised by relatively moderate unemployment figures, a growth structure that is beneficial to government revenue and low interest rates present a very favourable opportunity. Thus they should be used in full, not least given the fiscal risks in connection with the euro-area crisis, macroeconomic developments in Germany and a return to normal levels of interest rates which are, particularly for central government, currently exceptionally low. In order to ensure the long-term success of the national rules, it would be worth considering setting ambitious minimum milestones for improving states' structural budgets, which are not taking full advantage of the very long-term (from today's vantage point) transitional periods before the national budget rules take effect. Central and regional governments could also enshrine marked binding safety margins that generally have to be observed when preparing budgets.

At the European level, it appears important that German fiscal policy support European budget rules by adhering to these rigorously and also by advocating strict implementation of the reformed budget rules, which contain numerous exceptions. After all, these rules are intended to preserve the euro area's standing as a community of stability; inadequate implementation of the old fiscal rules was a key cause of the current crisis of confidence. How they are applied specifically is currently of particular importance in the wake of the adjustment processes in individual member states. During the current European semester, the Ecofin council, upon a recommendation by the European Commission, will also decide on deadlines by which member states under an excessive deficit procedure can make corrections. In many cases, it looks like the deadlines may be moved back one or two years. There is generally a certain discretionary scope, and macroeconomic developments, which are very unfavourable in some quarters, surely need to be taken into account. However, in many cases the problem is not merely one of cyclical weakness; in addition, structural adjustments are ongoing following earlier excesses and undesirable developments.

Great caution is advised when considering how to use any available discretionary scope, with debt ratios now up to very high levels, among other factors. The main objectives of budgetary reform include establishing the reliable prospect of consolidation, and thereby winning back public confidence in the sustainability of euro-area public finances. However, the binding effect could be undermined from the very outset if the impression is created that a necessary deficit reduction can be put off repeatedly – through political pressure or negative "surprises" following overly optimistic plans – or that the European Commission is exercising the stronger overall role assigned to it less in order to enforce stricter implementation and more to enable recourse to the numerous exceptions. It is precisely the unadjusted upper deficit limit of 3% but also the 60% deficit, which is floating further and further out of reach – not least given delays in consolidation efforts – which represent a key anchor, for the public debate and elsewhere.