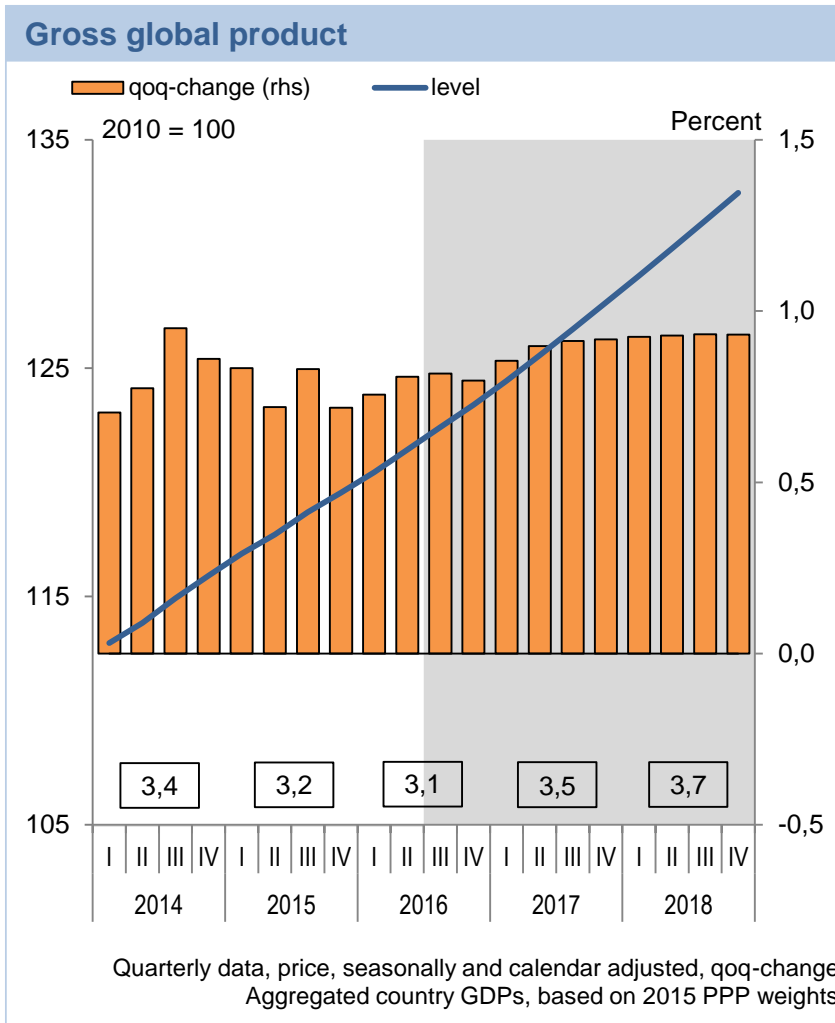


Institut für strategische Innovation und Technologiemanagement | München, 10. November 2016  
*Strategic Management Perspectives (10)*

# Weltwirtschaft im Zeichen zunehmender Politikrisiken

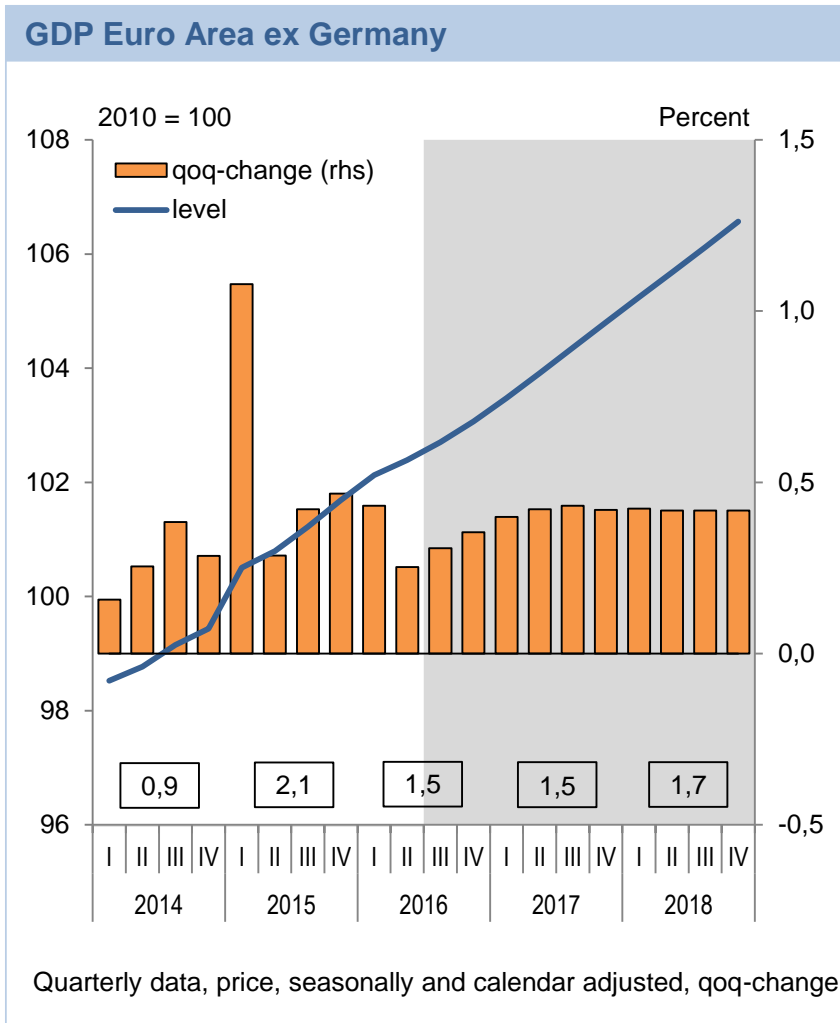
Prof. Dr. Stefan Kooths  
*Prognosezentrum*





- World trade
    - » +1.5 % (2016)
    - » +2.5 % (2017)
    - » +3.0 % (2018)
  - German export markets
    - » +2.0 % (2016)
    - » +2.1 % (2017)
    - » +2.4 % (2018)
  - Recovery of raw materials
  - Risks of disintegration and neo-protectionism
- ⇒ **Mixed picture**
- » **No strong tailwinds ...**
  - » **... but weaker headwinds also**

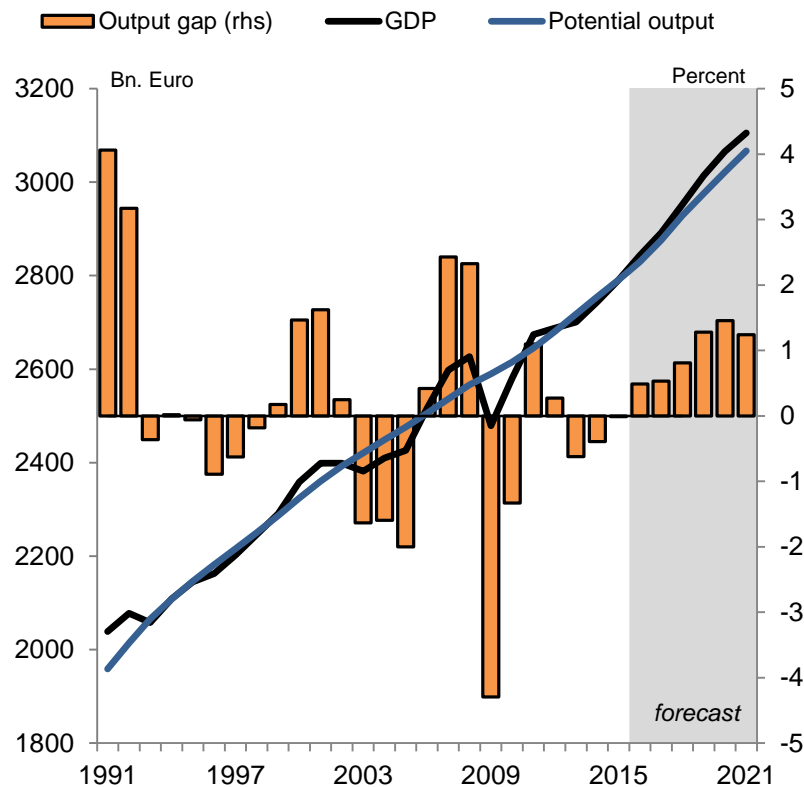
# Moderate recovery in the Euro Area continues



- Narrowing output gap
    - » – 1.2 % (2016)
    - » – 0.8 % (2017)
    - » – 0.5 % (2018)
  - ECB expected to prolong its expansionist policy stance
  - Record-low interest rates at record-high debt levels
  - Fragile politics
- ⇒ **Debt overhang and financial sector distress unsolved**

# Germany: Chewing gum cycle

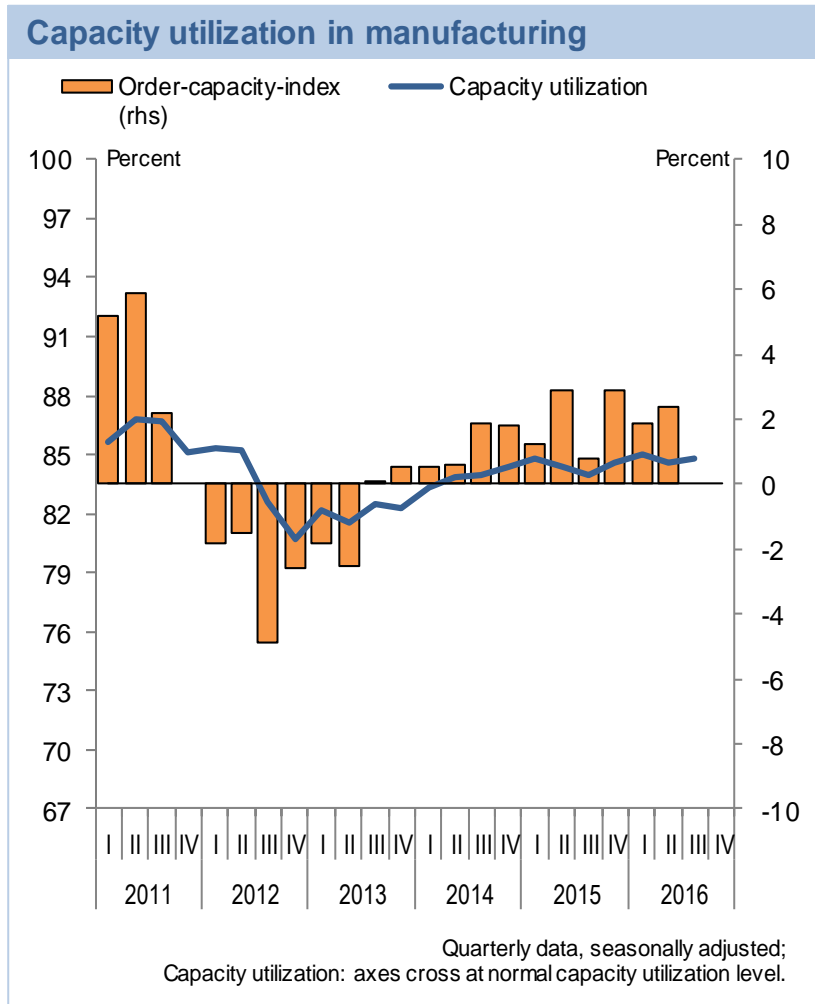
## Production and potential output



Yearly data;  
GDP, Potential output: price adjusted (chain index volumes, 2005=100).

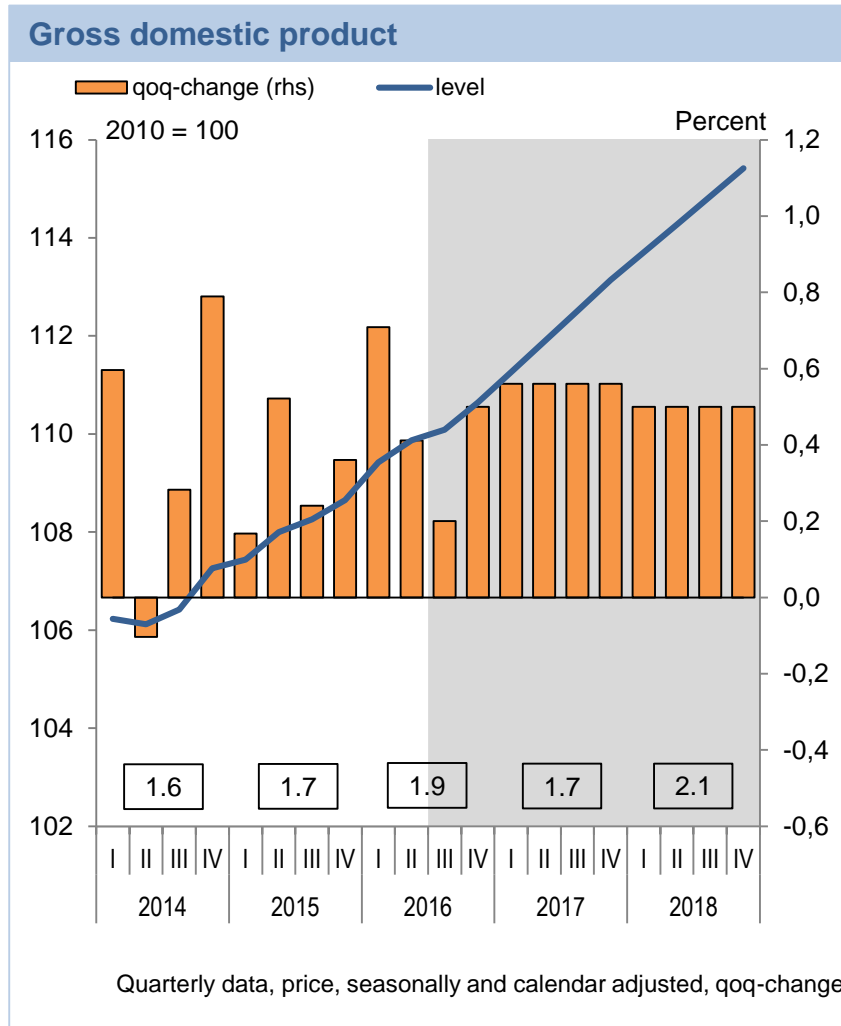
- Overall capacity utilization slightly above normal
- Cyclical pattern less pronounced
- Potential growth depends on net-immigration into the labor force
  - » + 460,000 (2016)
  - » + 540,000 (2017)
  - » + 480,000 (2018)

# Data edge: Positive output gap confirmed by survey-based capacity utilization in manufacturing



- Manufacturing
  - » Capacity utilization in manufacturing somewhat above normal for more than two years ...
  - » ... while incoming orders surpass production capacities
- Construction
  - » Capacity utilization at record high levels
- Vibrant labor market

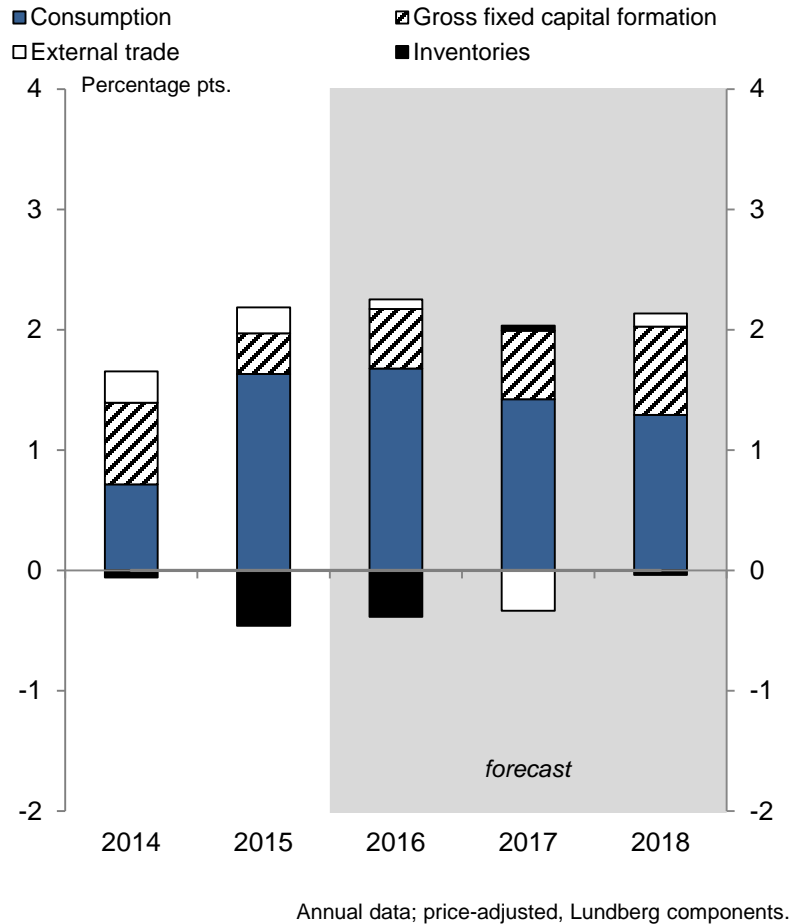
# Economic activity regaining momentum



- Q1/Q2 pattern distorted by weather effects
- Industrial production
  - » - 2.3 % (July)
  - » Bounce-back expected for August (works holidays)
  - » Mirrored in export numbers
- Main business climate (ifo)
  - » - 1.8 % (August)
  - » +3.0 % (September)
- Business climate in the service industries still at high levels (ifo, DIHK)
- GDP in 2017 affected by calendar effect (- 0.3 pp)

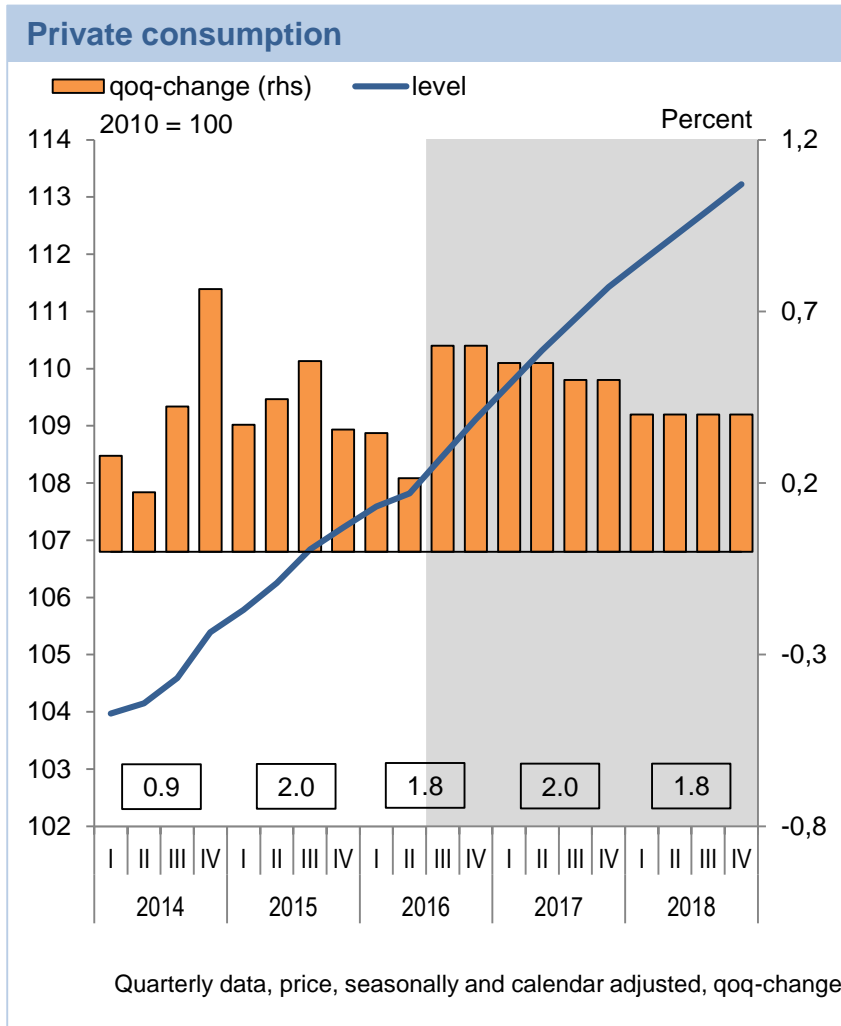
# Expansion driven by domestic factors

## Expenditure-side components to GDP-growth



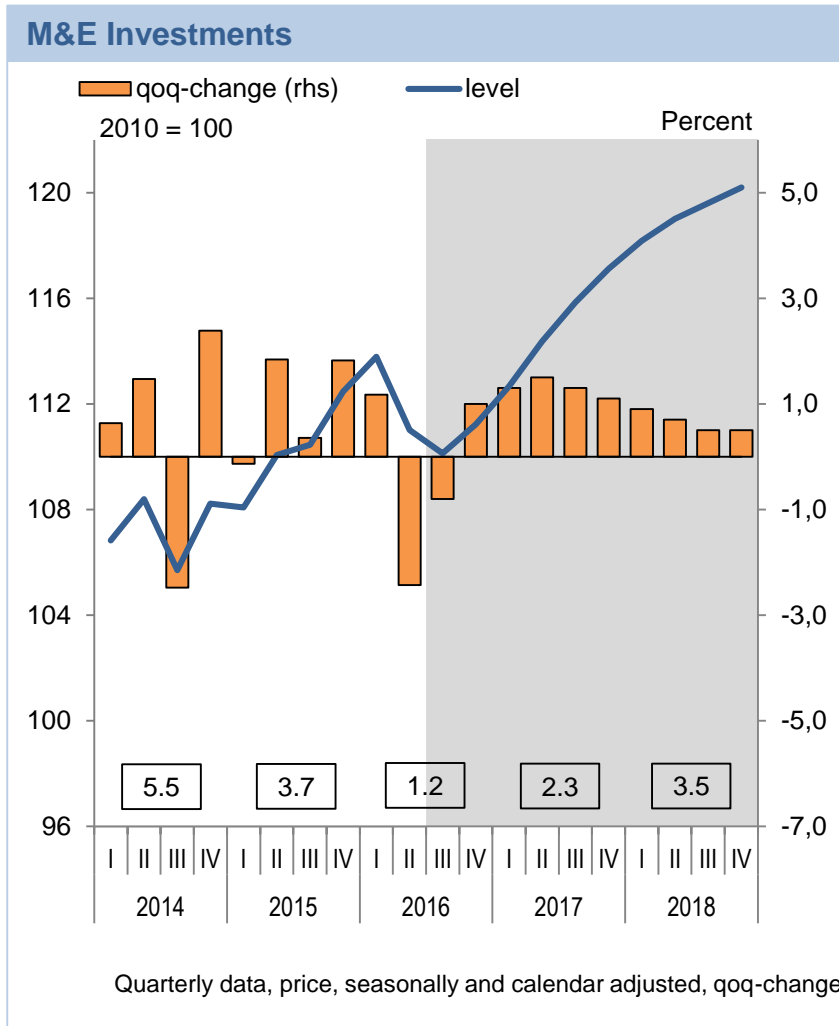
- 2015/2016 strongest boost in consumption for 15 years (private and public)
- Construction near to capacity limits
- M&E investment lagging behind and remaining moderate compared to past patterns

# Strong growth in private consumption



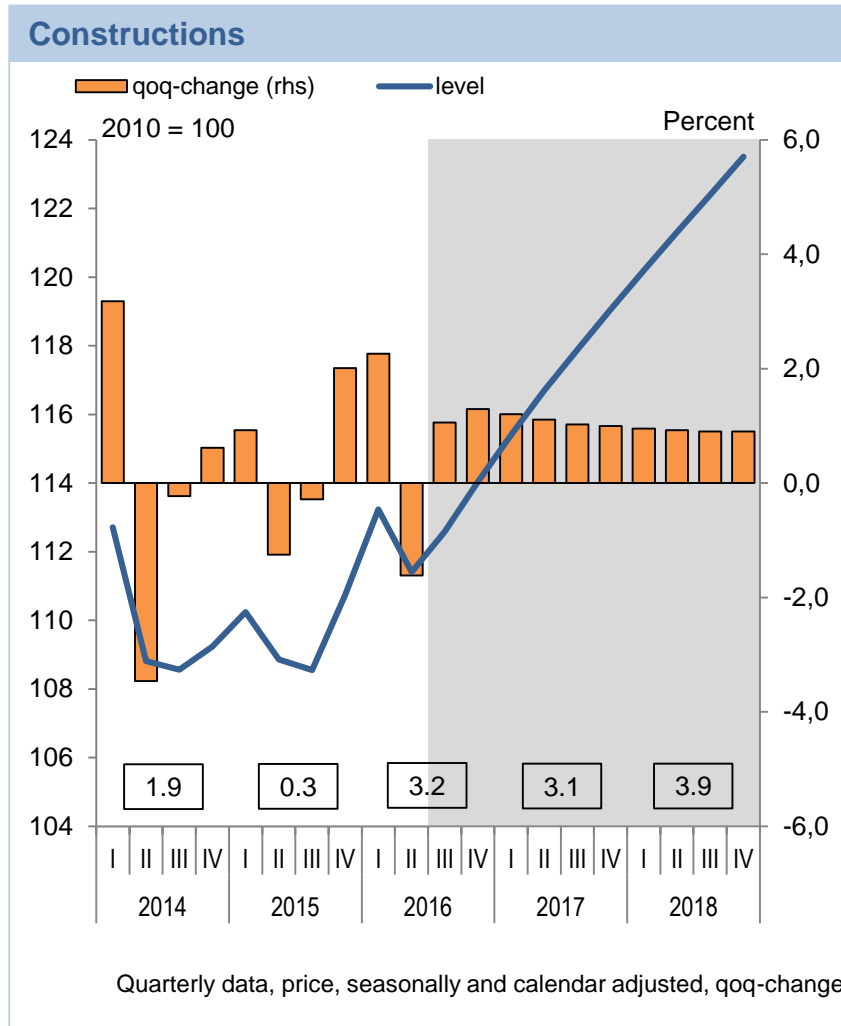
- 2016-Q2: Dip in line with energy price hike
- Strong 2016-H2 due to distinct pension increase
- Robust labor market (wage rates and employment) and public transfers feed into private households' purchasing power

# Investment in M&E lagging behind

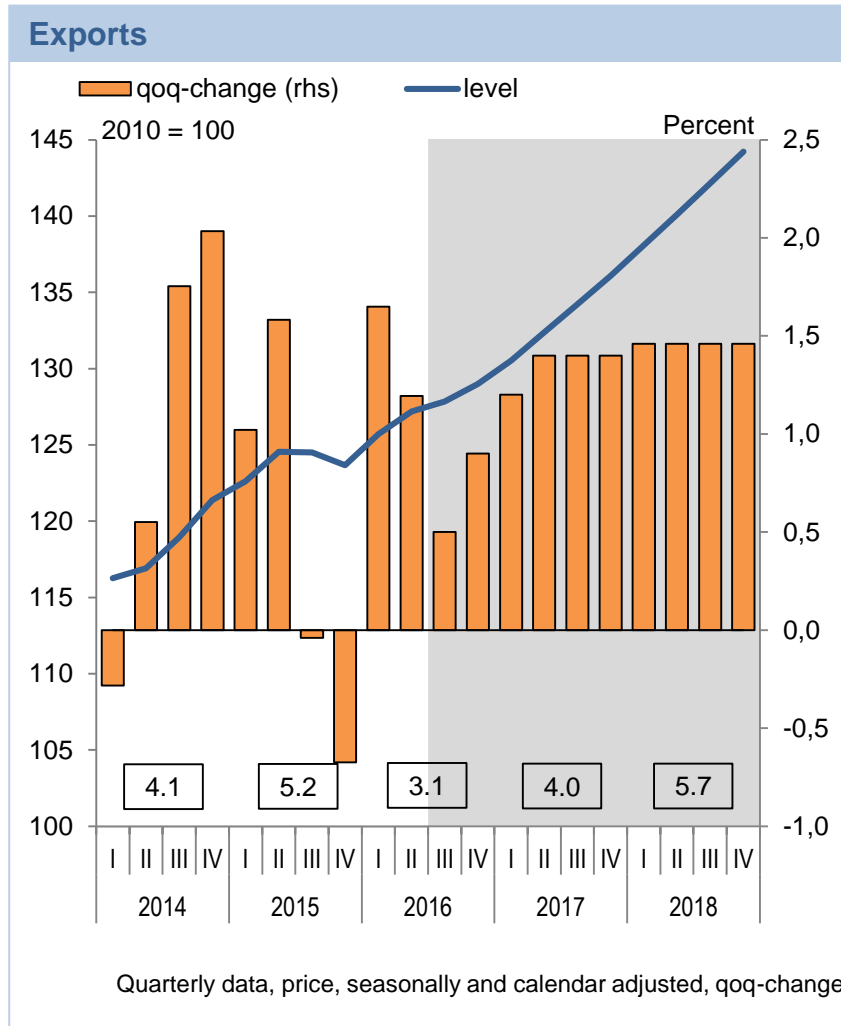


- Low 2017 annual rate
  - » Carry-over effect (- 0.7 pp)
  - » Calendar effect (- 0.8 pp)
- Cyclical pattern subdued due to creeping upswing
- Financing conditions remain extremely favorable
- Recent past saw series of uncertainty shocks (strain on investor confidence)
- Other theses
  - » Harbinger of demographics?
  - » Productivity slowdown?

# Very stimulating environment for constructions



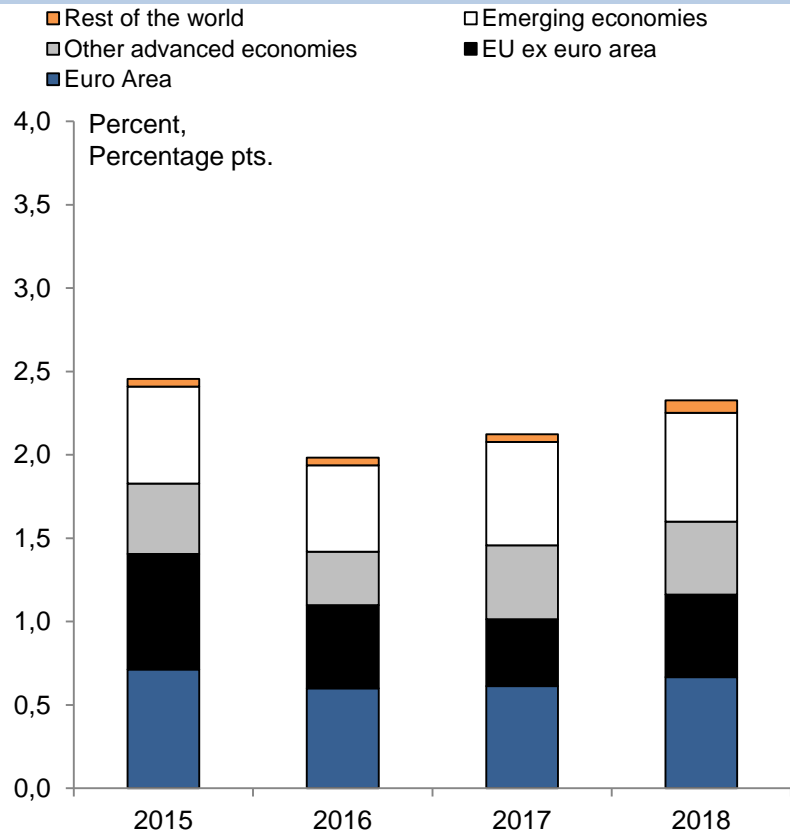
- Q1/Q2: weather effects
- Low interest rates
- Strong income growth
- High government revenues
- Increasing capacity utilization



- Deceleration in 2016-H2
  - » Low car production in July
  - » Slower growth in foreign markets
- Brexit
  - » Dampens 2017 annual rate of exports by 0.4 pp
  - » Negative GDP impact only 0.1 pp
- Recovery in 2017/2018, but moderate pace compared to pre-crisis dynamics

# Growth in German export markets

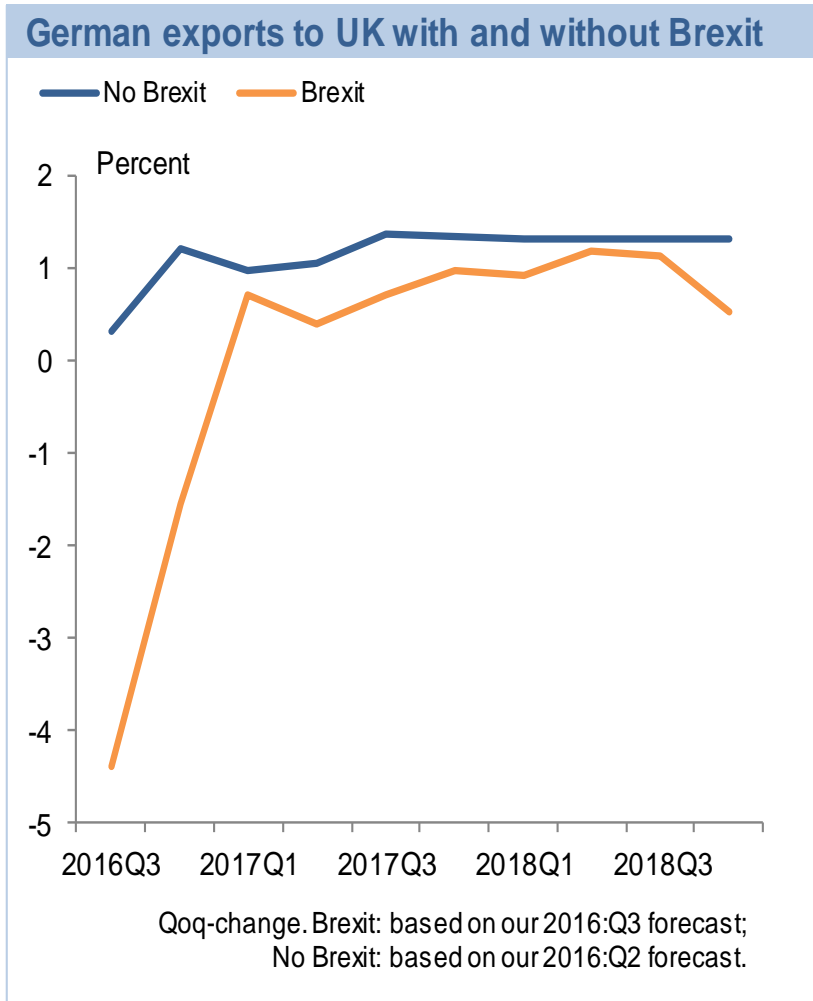
## German Export Markets



Annual data, volumes; GDP growth in 59 countries, weighted with shares in German exports.

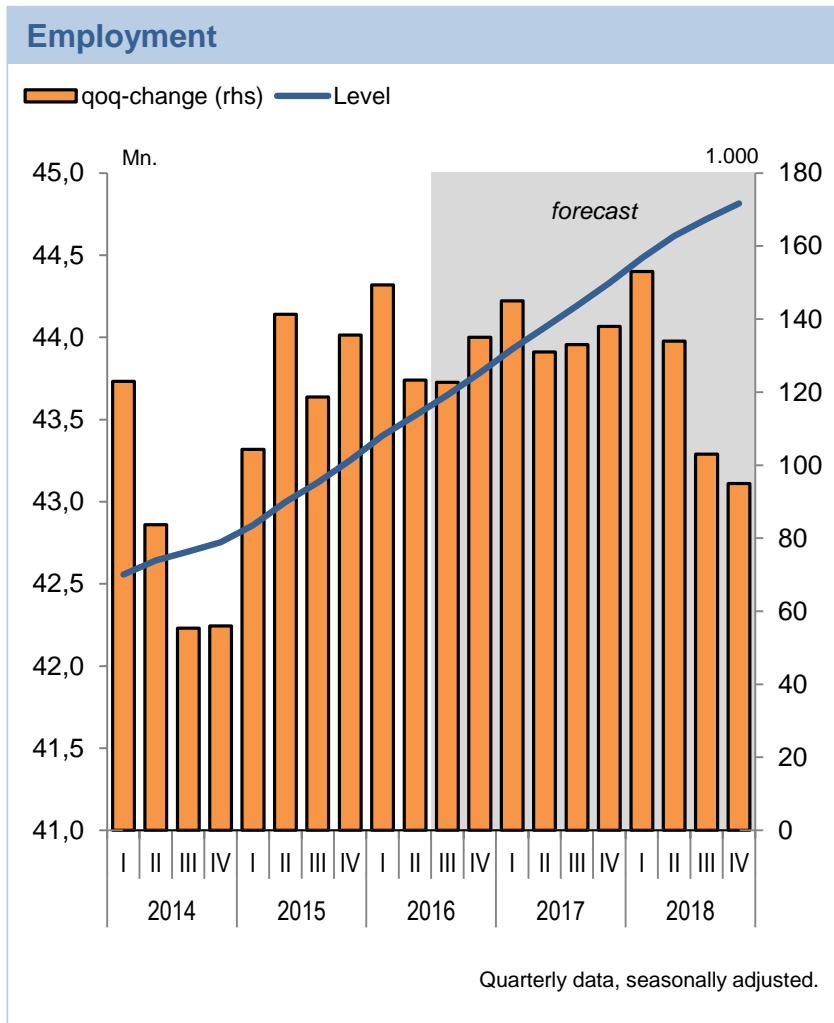
- Growth in foreign GDP
  - » 2.0 % (2016)
  - » 2.1 % (2017)
  - » 2.4 % (2018)
- Product portfolio and regional diversity

# Brexit vote: Impact on German exports



- D-UK-export function
  - » UK GDP (long-run elasticity: 1.9)
  - » Exchange rate GBP/EUR (-0.5)
- UK GDP [June forecast]
  - » 2016: 1.6 % [1.8 %]
  - » 2017: 0.6 % [2.1 %]
  - » 2018: 1.6 % [2.5 %]
- Depreciation of pound sterling to euro exchange rate: about 8 percent

# Labor market remains in good shape



- Record high employment
  - » + 533,000 (2016)
  - » + 538,000 (2017)
  - » + 531,000 (2018)
- Registered unemployment [vs. ILO unemployment]
  - » 6.1 % [4.0 %]
  - » 6.0 % [3.5 %]
  - » 5.8 % [3.0 %]
- Still employment friendly effective wage increases
  - » + 2.0 % (2016)
  - » + 3.1 % (2017)
  - » + 3.2 % (2018)

|   |                       | 2015        | 2016       | 2017       | 2018        |
|---|-----------------------|-------------|------------|------------|-------------|
| Fiscal balance                              | Bn. Euro              | 22.6        | 16.7       | 15.2       | 26.2        |
| Fiscal balance                              | in % of GDP           | 0.7         | 0.5        | 0.5        | 0.8         |
| Output gap                                  | in % of potential GDP | 0.0         | 0.5        | 0.5        | 0.8         |
| Cyclically adj. balance                     | in % of GDP           | 0.7         | 0.2        | 0.2        | 0.3         |
| Cyclically adj. balance                     | Bn. Euro              | 22.8        | 7.8        | 5.7        | 11.2        |
| One-off income                              | Bn. Euro              | 0.6         | 0.0        | 3.8        | 0.2         |
| Cyclically adj. balance less one-off income | Bn. Euro              | <b>22.2</b> | <b>7.8</b> | <b>1.9</b> | <b>11.0</b> |

# Key figures

|                                    | <b>2015</b> | <b>2016</b> | <b>2017</b> | <b>2018</b> |
|------------------------------------|-------------|-------------|-------------|-------------|
| GDP (% yoy)                        | 1.7         | 1.9         | 1.7         | 2.1         |
| GDP-Deflator (% yoy)               | 2.0         | 1.4         | 1.6         | 1.8         |
| Consumer prices (% yoy)            | 0.2         | 0.5         | 1.4         | 1.6         |
| Unit labor cost (% yoy, hourly)    | 1.6         | 1.1         | 1.8         | 2.0         |
| Employment (1000 persons)          | 43,056      | 43,589      | 44,127      | 44,659      |
| Unemployment (1000 persons)        | 2,896       | 2,693       | 2,669       | 2,609       |
| Fiscal balance (% of GDP)          | 0.7         | 0.5         | 0.5         | 0.8         |
| Current account balance (% of GDP) | 8.6         | 9.0         | 8.6         | 8.7         |

## ■ Structural Reforms

- » Become even more important as economies are aging ...
- » ... but remain unpopular

## ■ Monetary policy

- » Did (more than) enough
- » Runs out of (positive) impact, risk of negative side-effects

## ■ Fiscal policy

- » Hampered after heavy GFC interventions, sustainability issues
- » Back on stage? „Keynes put“? Implications for European governance?

## ■ Neo-protectionism/economic disintegration

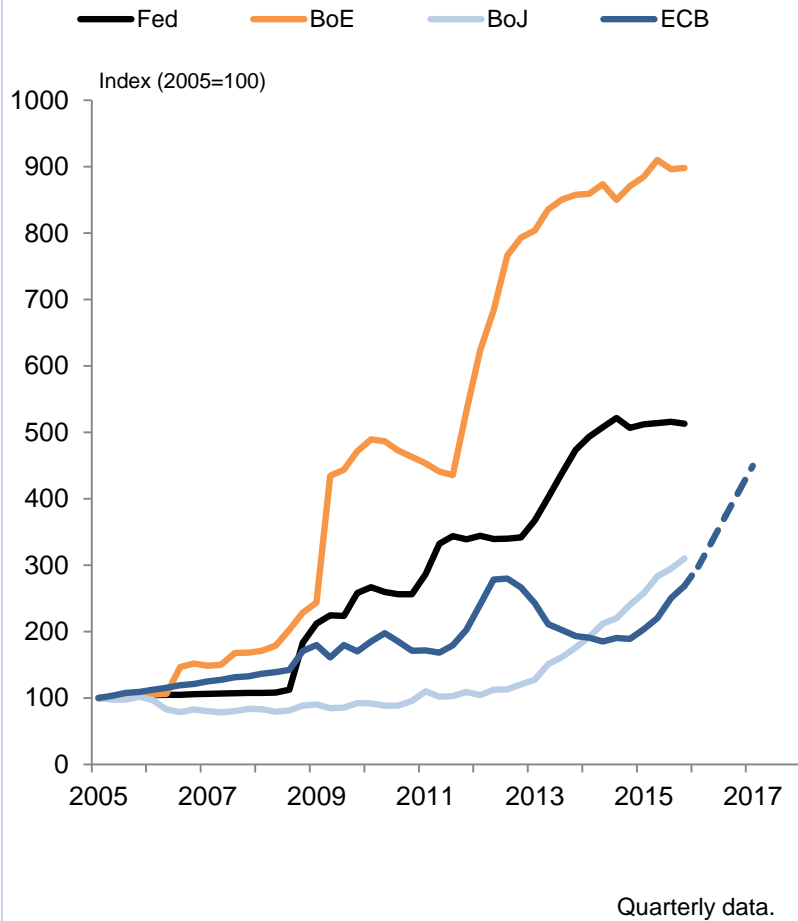
- » Popular (but destructive) temptation: Beggar-thy-neighbor ...
- » ... gains momentum

- **Structural Reforms**
  - » Become even more important as economies are aging ...
  - » ... but remain unpopular
- **Monetary policy**
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- **Neo-protectionism/economic disintegration (Brexit)**
  - » Popular (but destructive) temptation: Beggar-thy-neighbor ...
  - » ... gains momentum

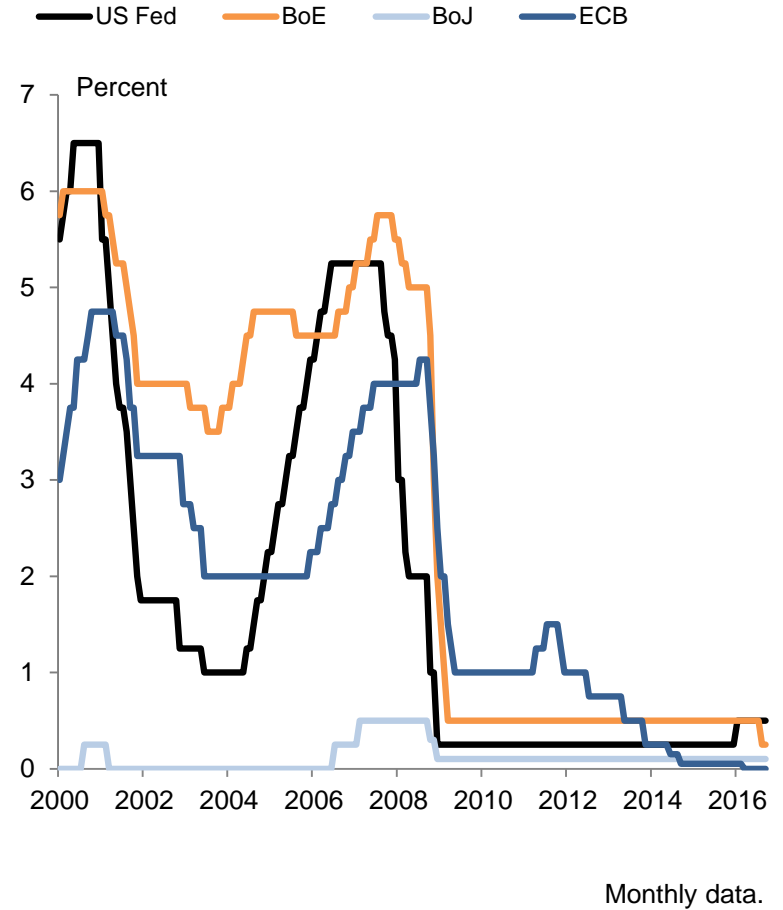
Mankind's largest monetary experiment  
of all (peace) times

# Monetary policy hits limits

## Monetary Base

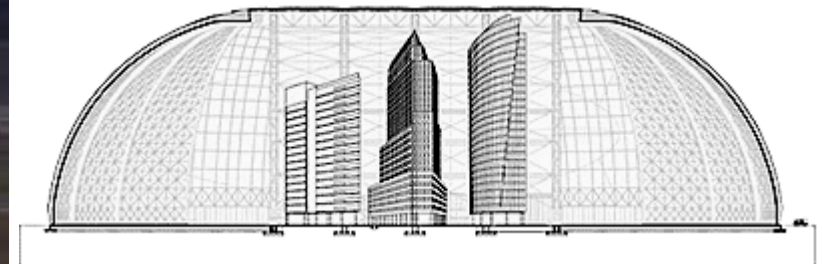
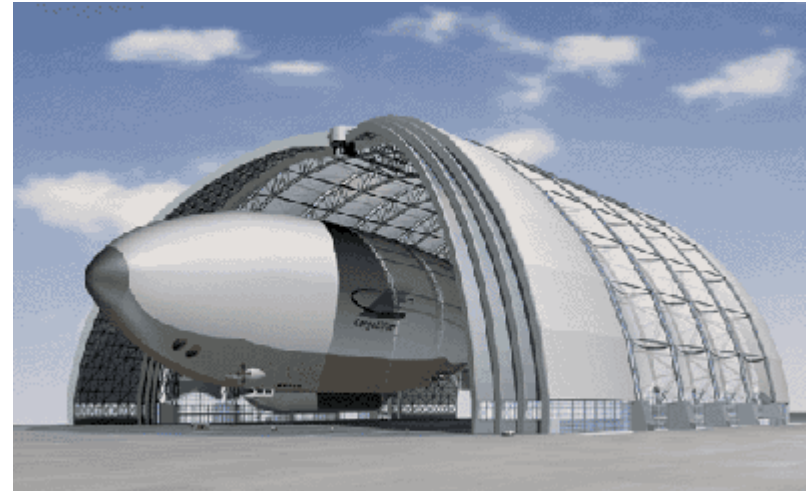


## Monetary policy rates



- **Idiosyncratic: Entrepreneurial ventures**
  - » Wrong expectations of one market participant
  - » Happens every day, no systemic risk
  - » Liquidation, reallocation of resources
  
- **Pervasive: Expansionary monetary policy**
  - » Systematically wrong expectations of all market participants
  - » Financial crisis (debt crisis = flip-side of heavy capital stock distortion)
    - Fragile financial system
    - Excess debt positions destabilizes monetary system

# Case study "CargoLifter" The plan ...



# Case study “CargoLifter” ... and the outcome: Tropical Islands



*Case study “CargoLifter”*  
**Hangar ⇒ Tropical Islands hall**

**Production cost:**  
78 million euro (1999/2000)



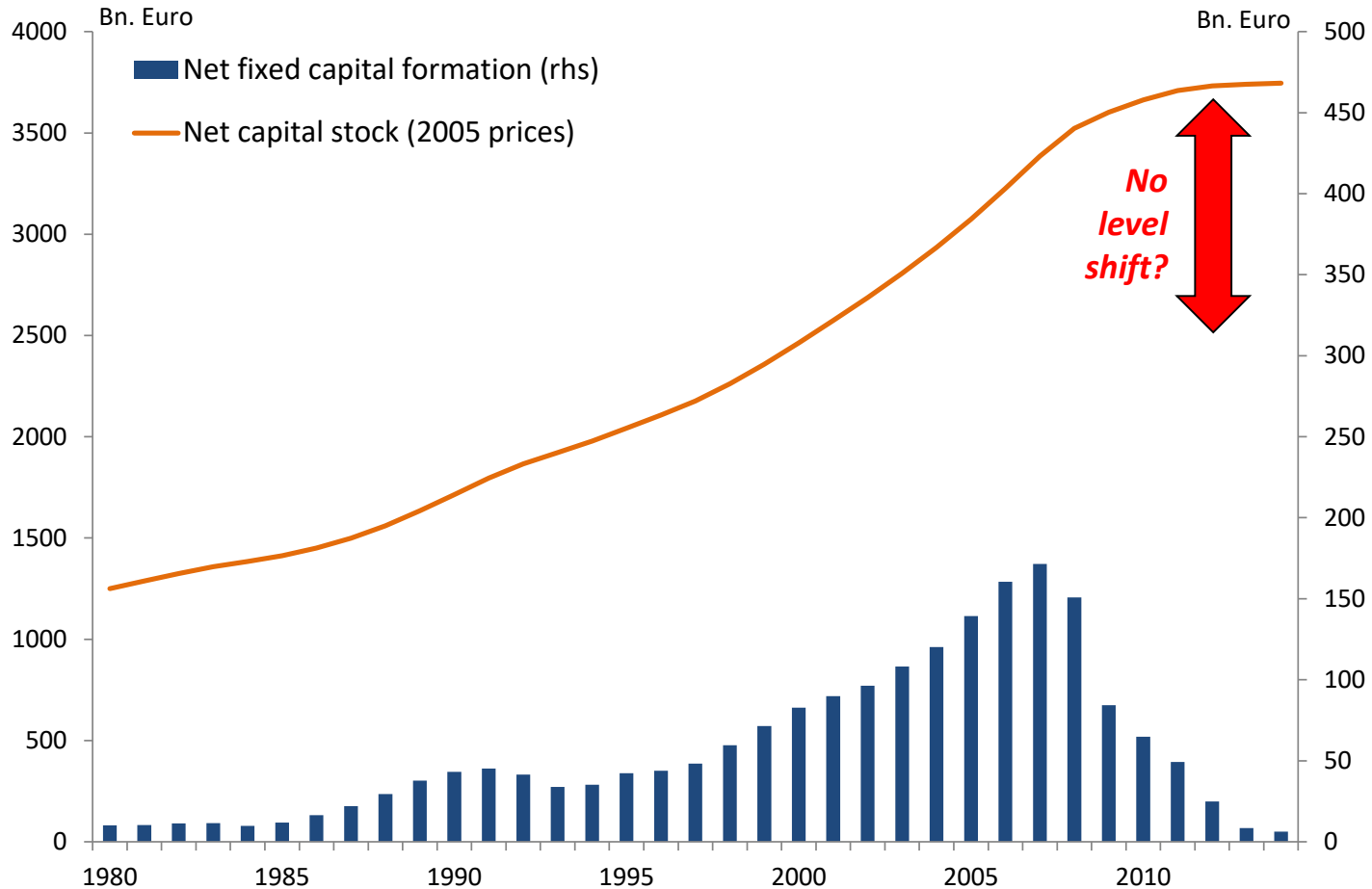
**Liquidation value:**  
17.5 million euro (2003)

# CargoLifter in the national accounts

A hangar is a hangar is a hangar ...

# Case study "Spain"

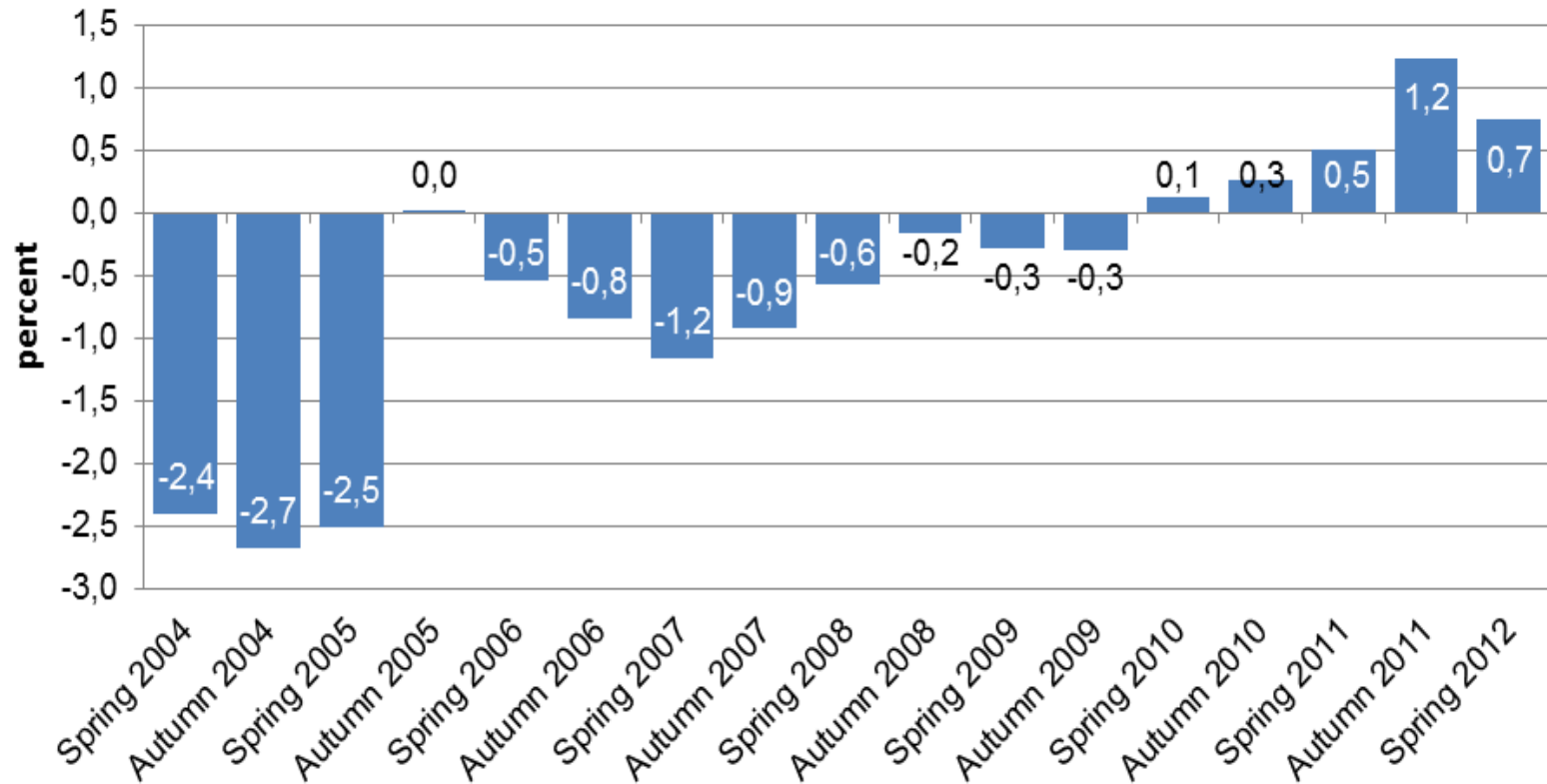
## Value of the total capital stock?



Source: AMECO Database.

# Case study "Spain"

## Output gap in 2005 (revisions)



Source: European Commission, various years.

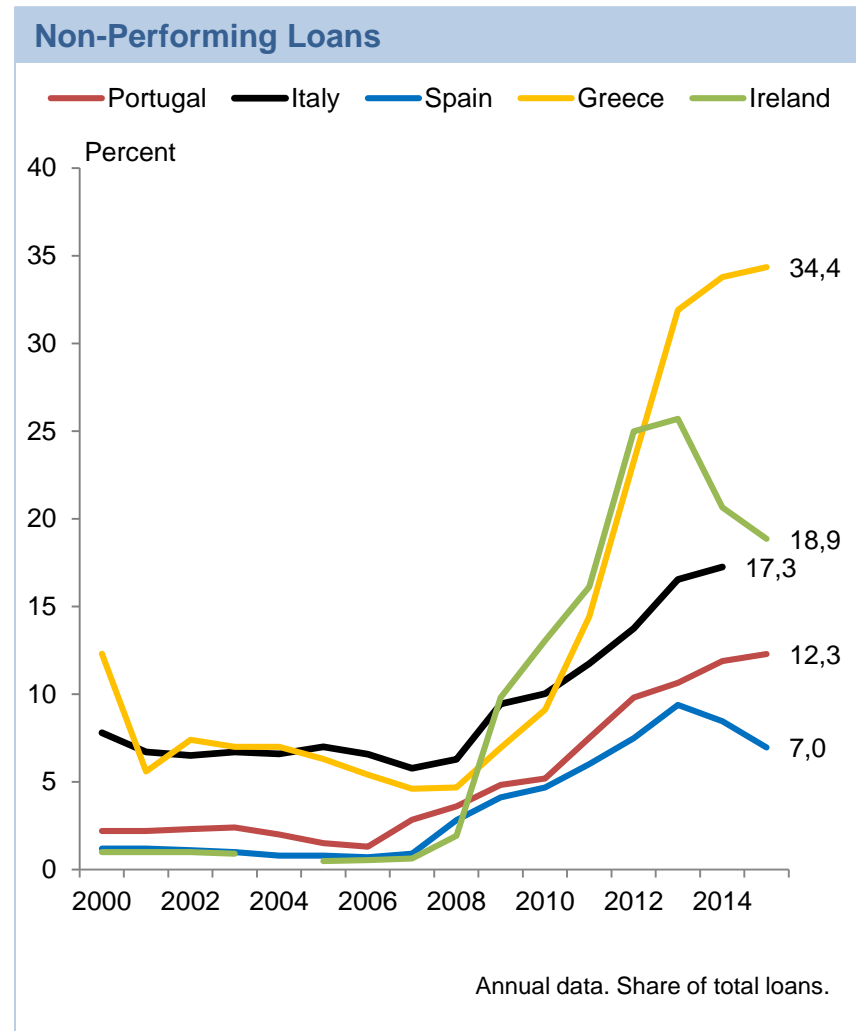
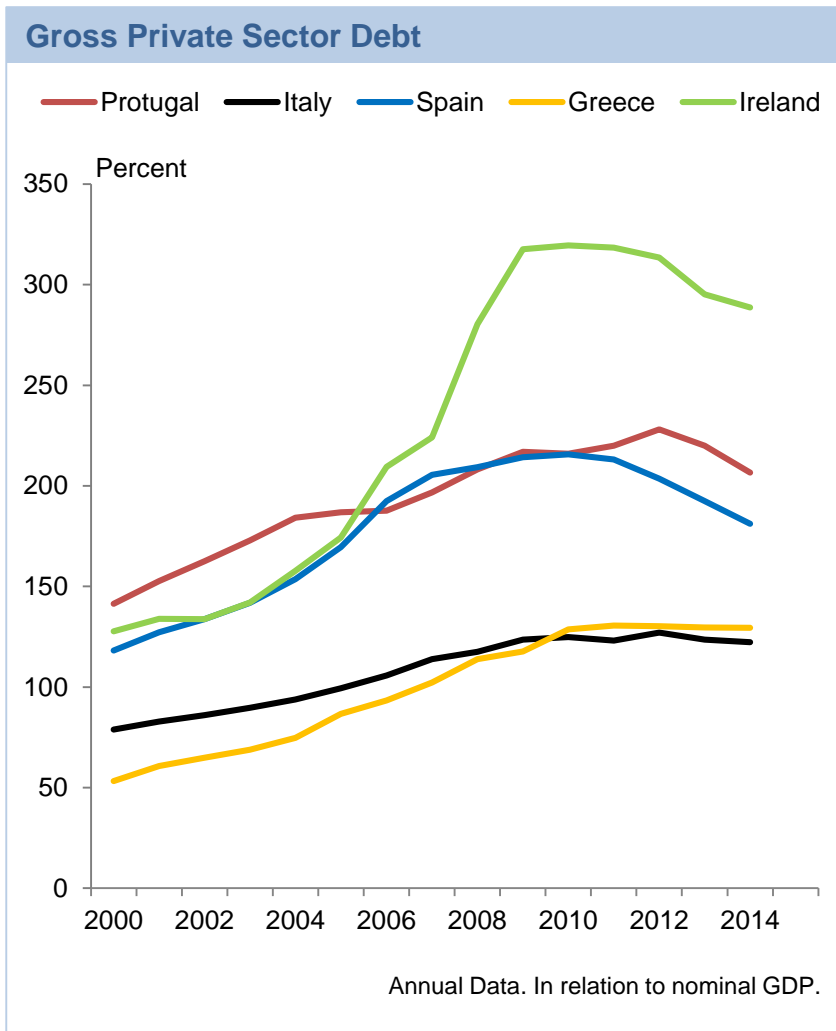
# Three options of coping with debt-crises

- **Public bail-outs**
  - » Shifts private debt to public sector
  - » Private debt crisis  $\Rightarrow$  sovereign debt crisis
  - » No solution for fiscally distressed countries
- **Inflating the debt away**
  - » Takes a long time, promotes zombification
  - » Puts the currency at risk
  - » Not targeted towards non-performing loans
- **Liquidation**
  - » Tough (cold turkey) in the short-run ...
  - » ... but targeted (and root cause oriented)
  - » Puts capital at second (now first) best use

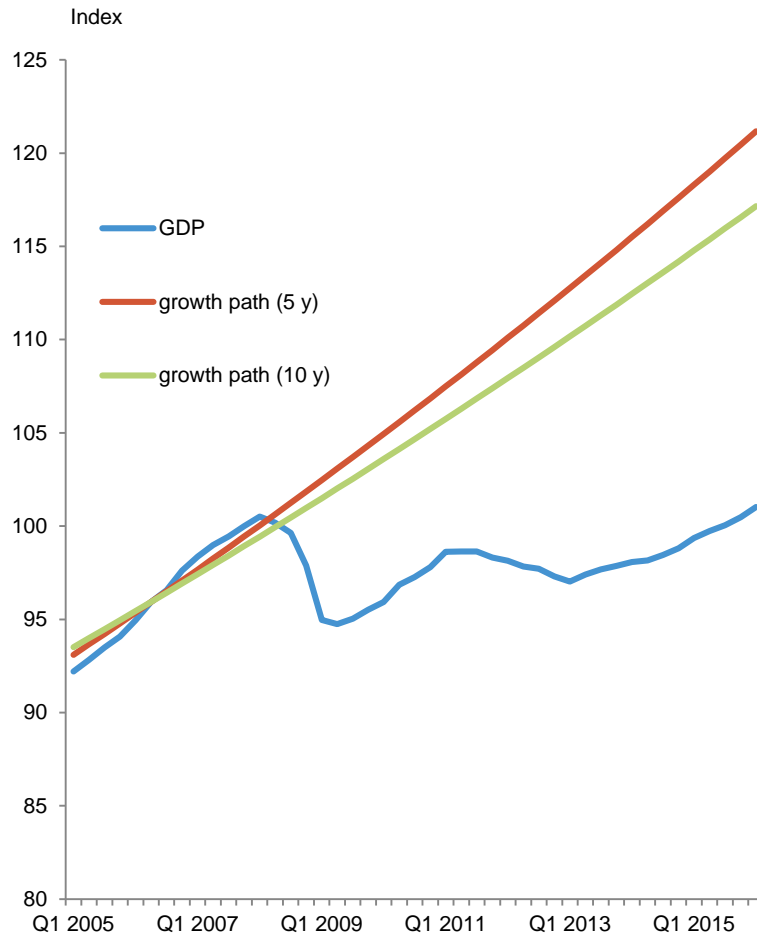
**Anti-capitalist  
approach**  
(harms principle of  
accountability,  
creates moral  
hazard risks)

**Capitalist  
approach**  
(in line with free  
market principles)

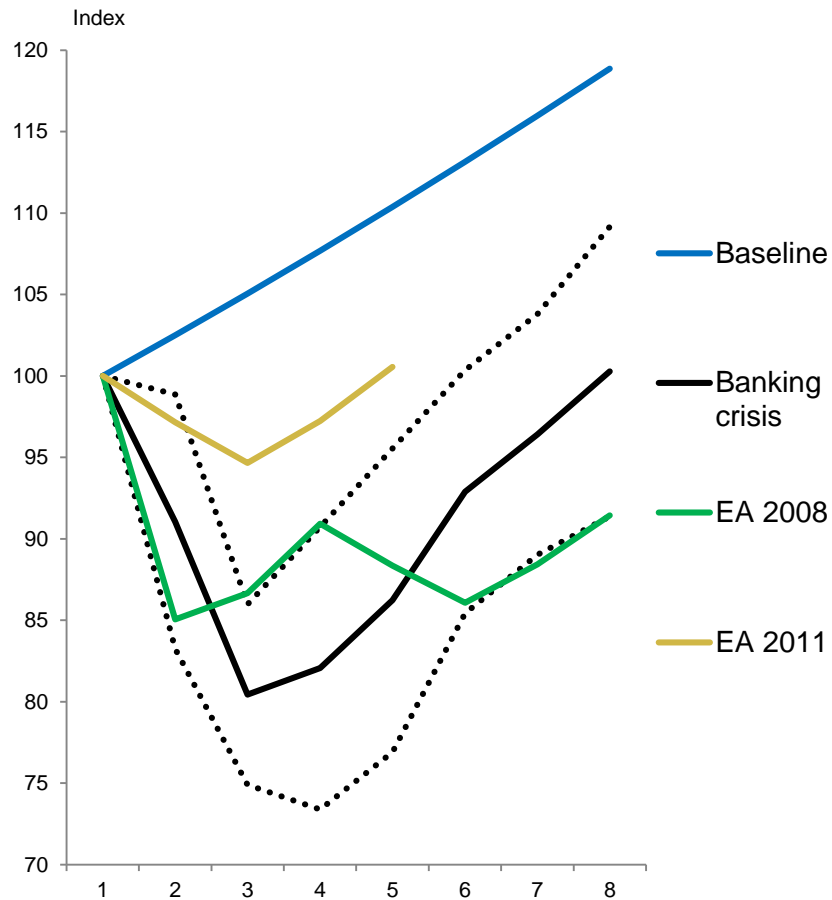
# Flip-side of not liquidating (= “buying time”): Excess debt position hamper credit channel



Data source: Bank for International Settlements, World Bank.

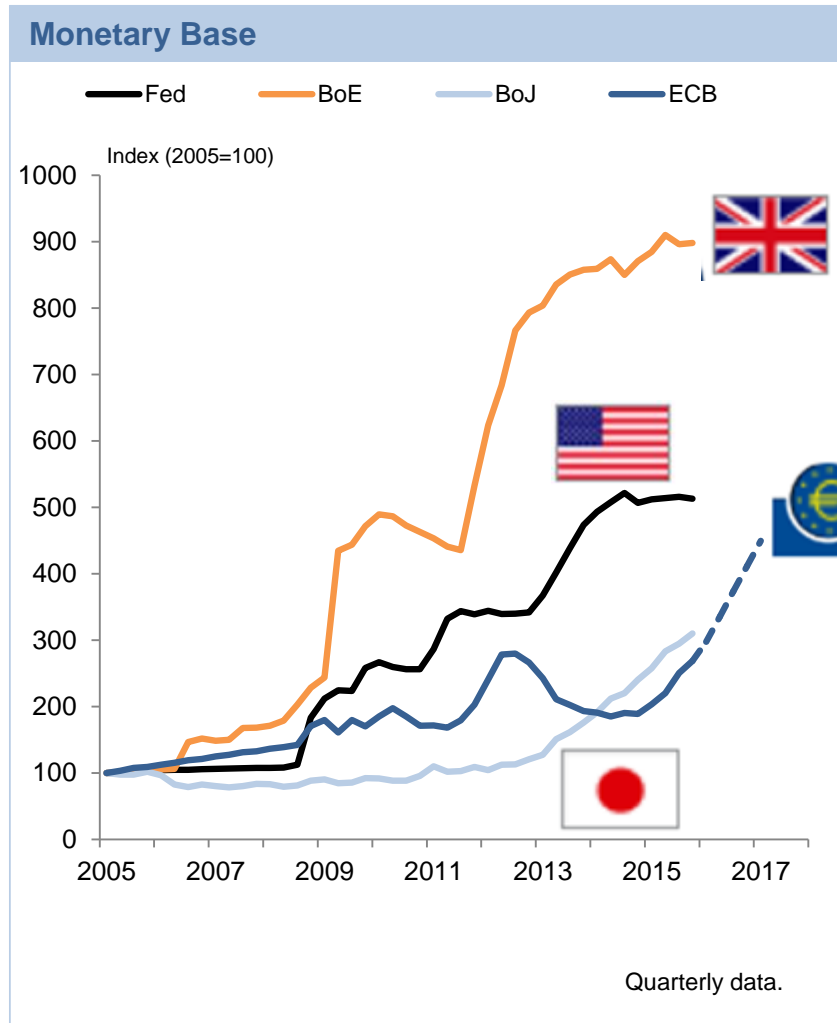


- Weak growth ...
  - » ... compared to pre-crisis trends
- Two crises in a row
  - » Global financial crisis (2007/2008)
  - » European debt crisis (2011 ff)



- Typical post-crisis pattern
- Investment stimulus?
  - » Capacity creation ...
  - » ... or cacapity utilization?

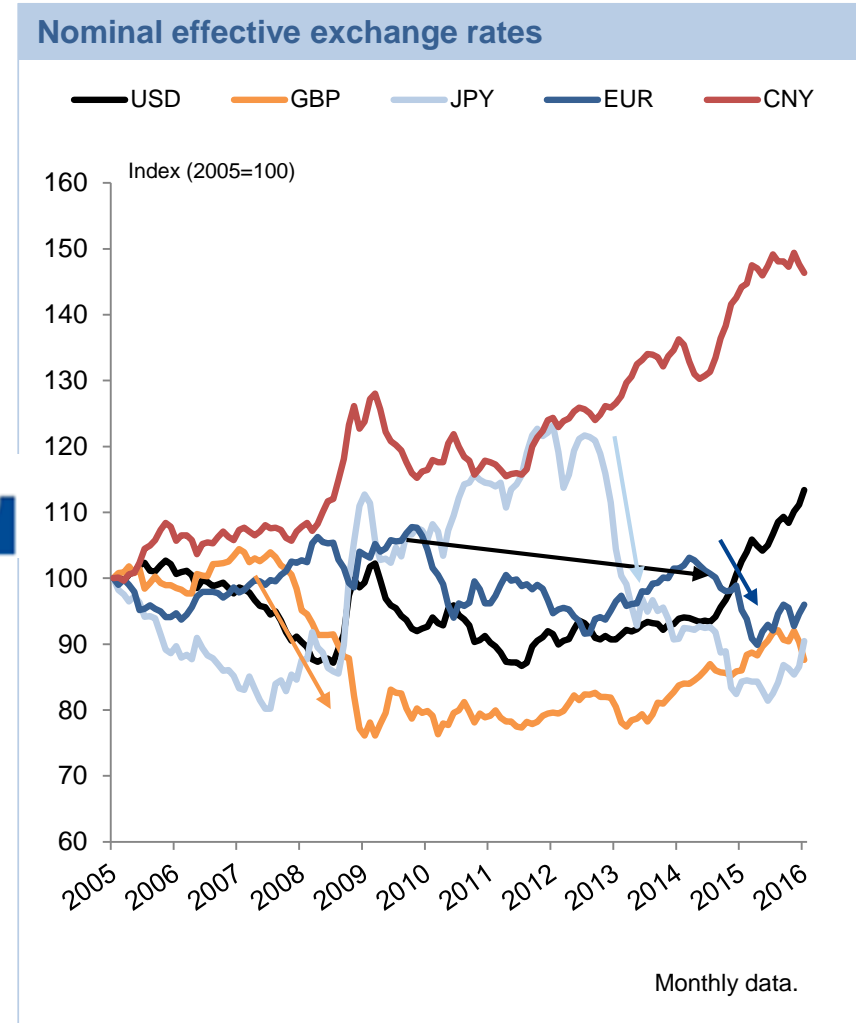
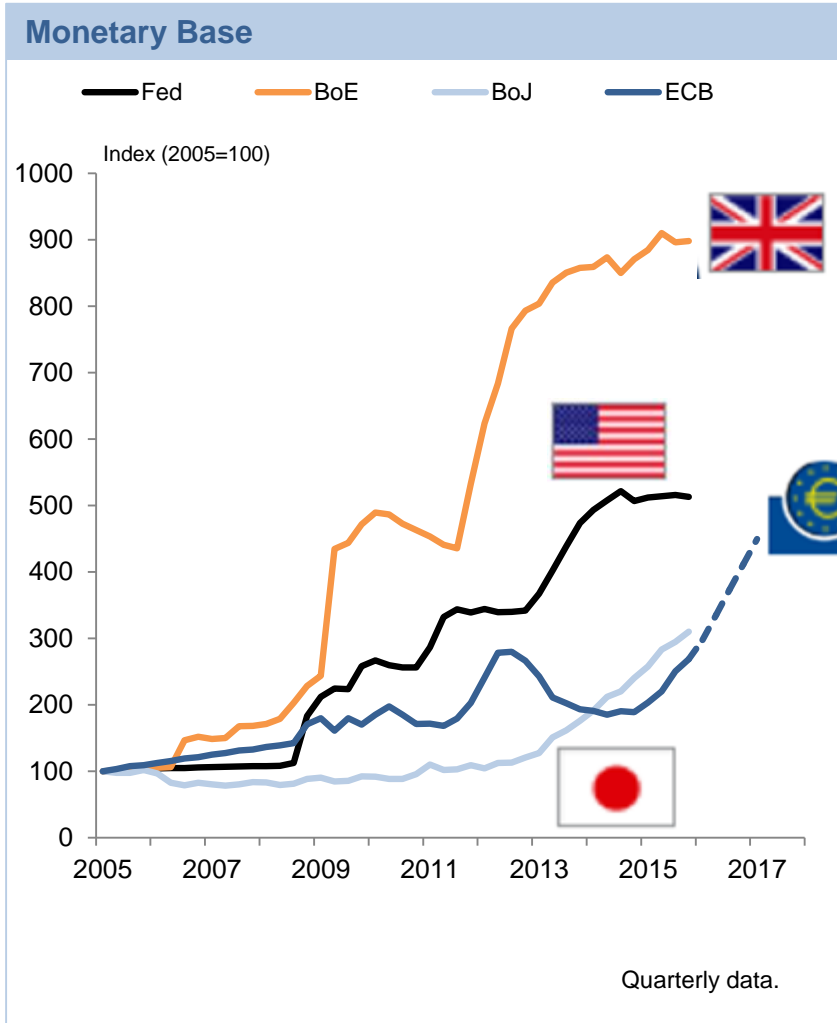
# Quantitative „Easing“



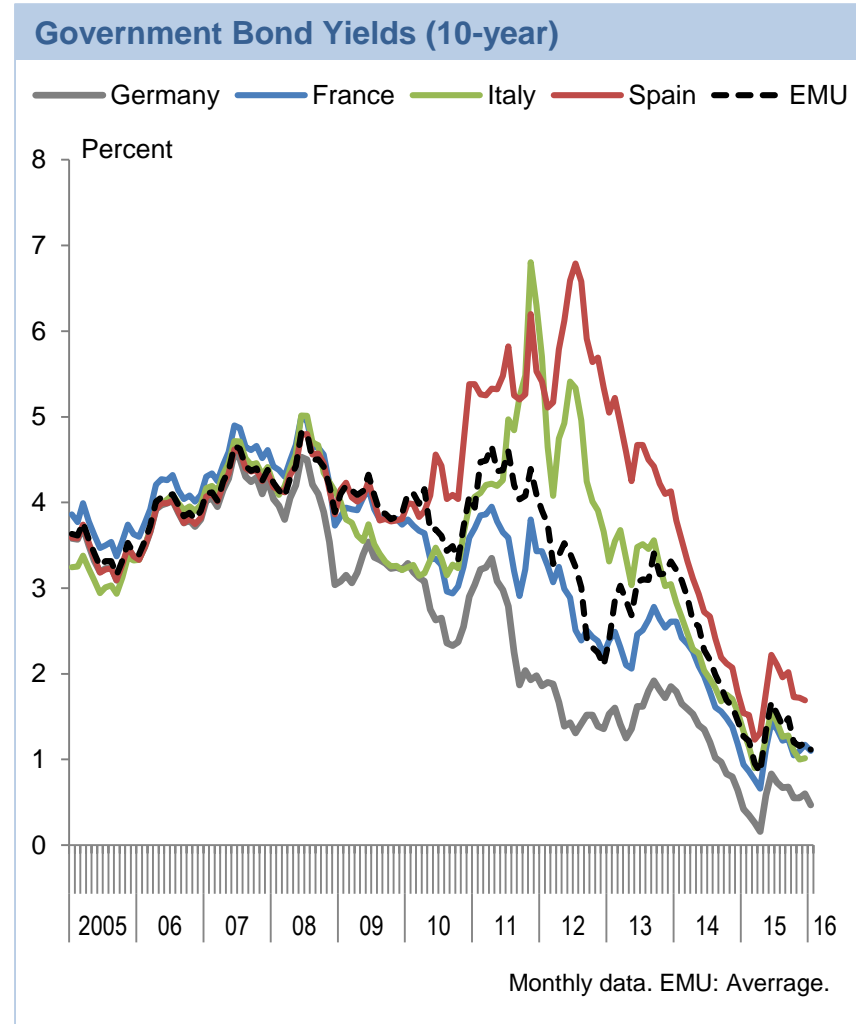
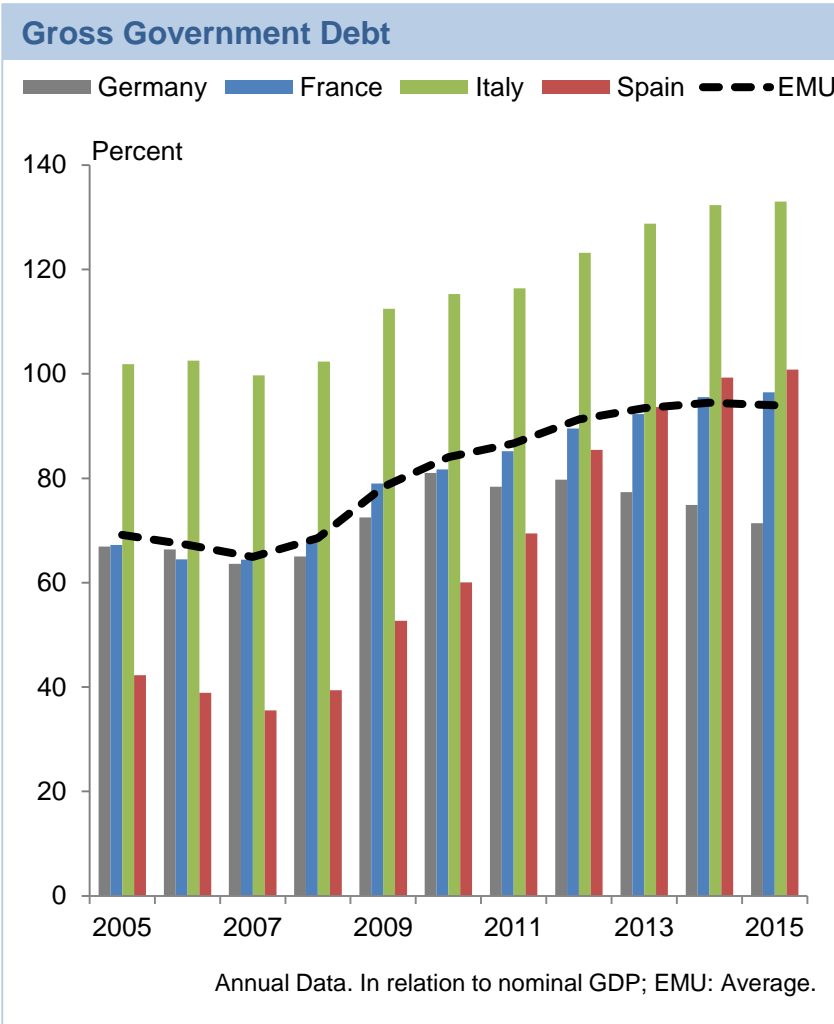
- Type 1: Liquidity provision in times of financial stress (effective)
  - Type 2: Stimulus at the zero lower bound (ineffective)
- ⇒ Exit strategy?
- ⇒ ECB: Need for softer criteria for next purchase programs

# Global QE: Risk of currency wars

Source: Thomson Reuters Datastream, IfW-calculations



# Euro Area: Monetary financing of governments

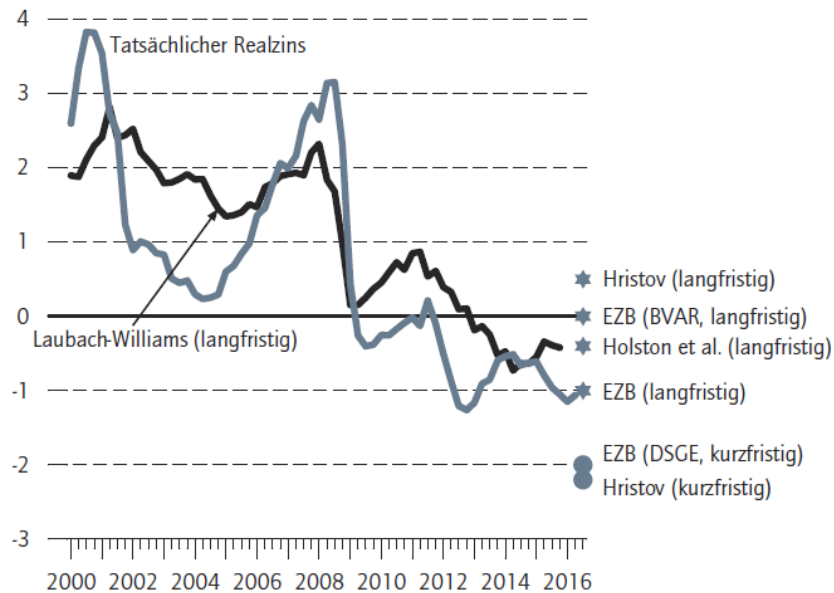


Data source: Eurostat, European Commission.

# Monetary expansion: „Neutral“ negative real interest rates?

## Tatsächlicher und neutraler Realzins

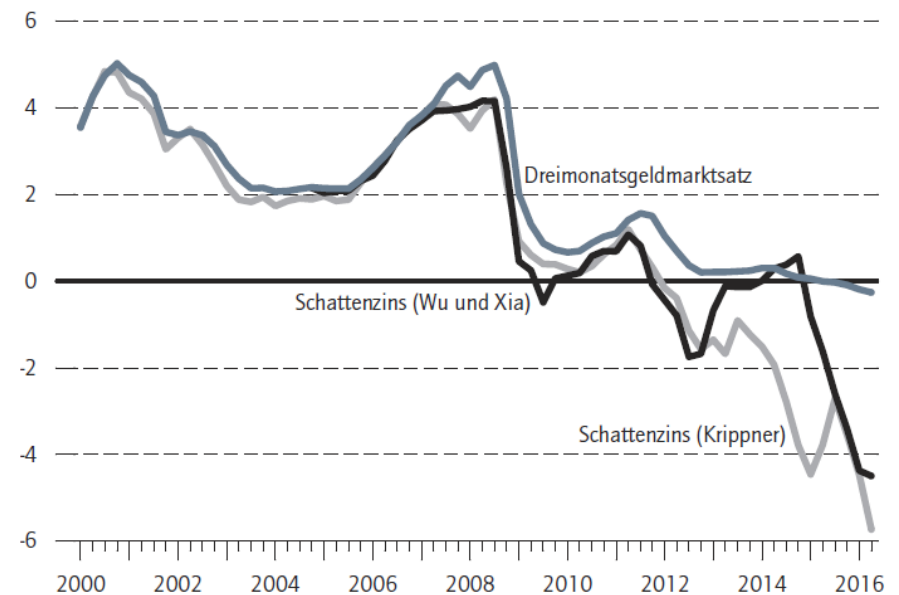
In Prozent



Quellen: Eurostat; EZB; OECD; Holston et al. (2016); Hristov (2016); Berechnungen der Institute.

## Schattenzinsen

In Prozent



Quellen: Wu, J. C., Fan, D. X. (2016): Measuring the Macroeconomic Impact of Monetary Policy at the Zero Lower Bound. *Journal of Money, Credit and Banking*, 48 (2-3); Krippner, L. (2016): Documentation for measures of monetary policy. 13. Juli 2016. Berechnungen der Institute.

Source: Gemeinschaftsdiagnose Herbst 2016.

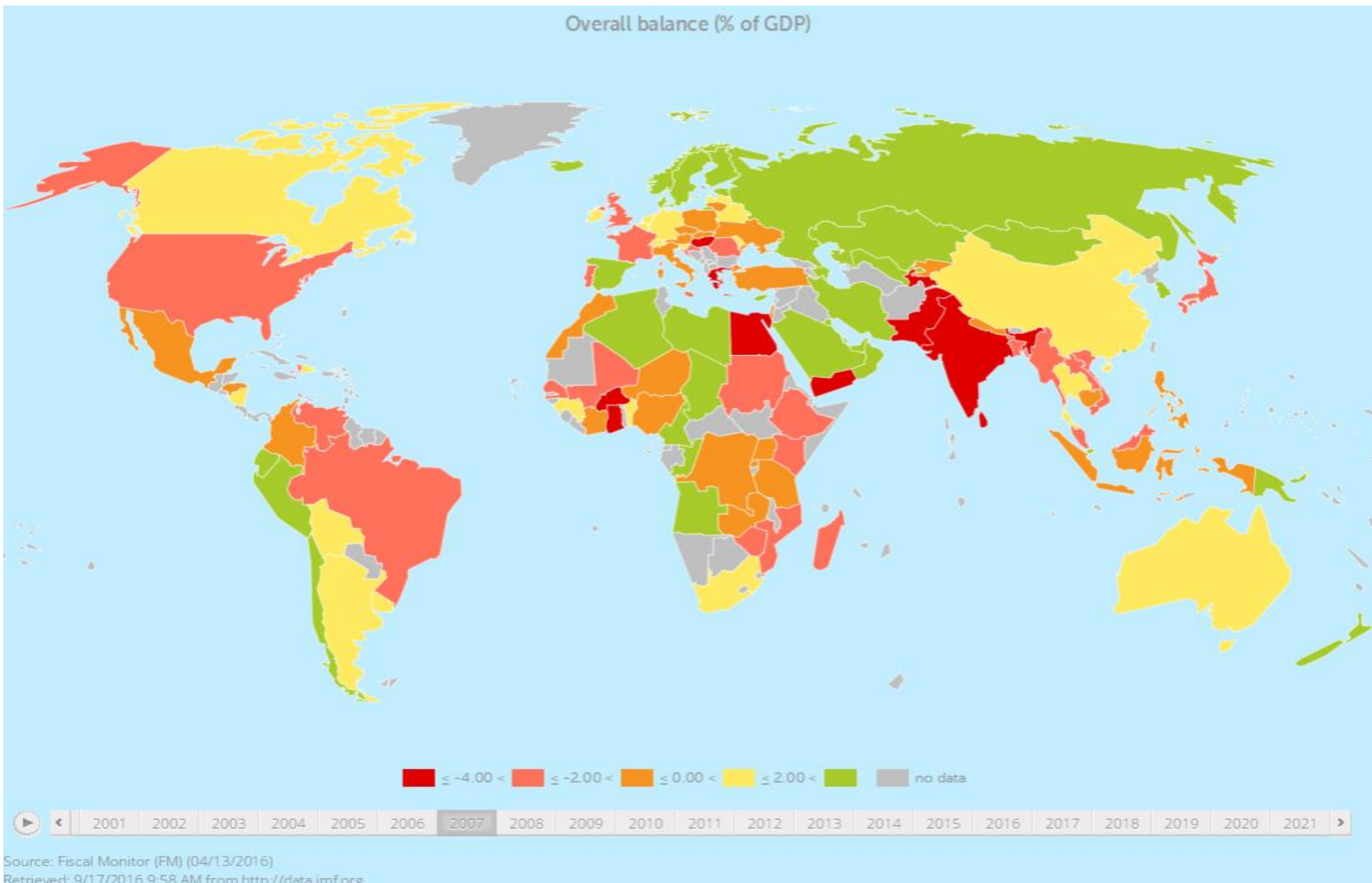
- Verzerrung der Kapitalstock- und Produktionsstruktur
  - Zombifizierung
  - Verzögerung der Konsolidierungs- und Reformpolitik
  - Verwässerung des strukturellen Budgetsaldos
  - Überschuldungskrise nicht gelöst, sondern vertagt
  - Monetäres Niemandsland schürt Unsicherheit
  - Anstieg der Inflationsrate offenbarte Dilemma für die EZB
  - Gefahr globaler Abwertungswettläufe
  - Interventionsspirale: Too-big-to-fail vs. Too-small-to-perform?
- ⇒ **Monetäres Umfeld für D auf Jahre hinaus zu expansiv**
- ⇒ (Monetäre Strategie des „Inflation Targeting“ überdenken)

# (Radical) Policy instruments to enhance the effectiveness of QE

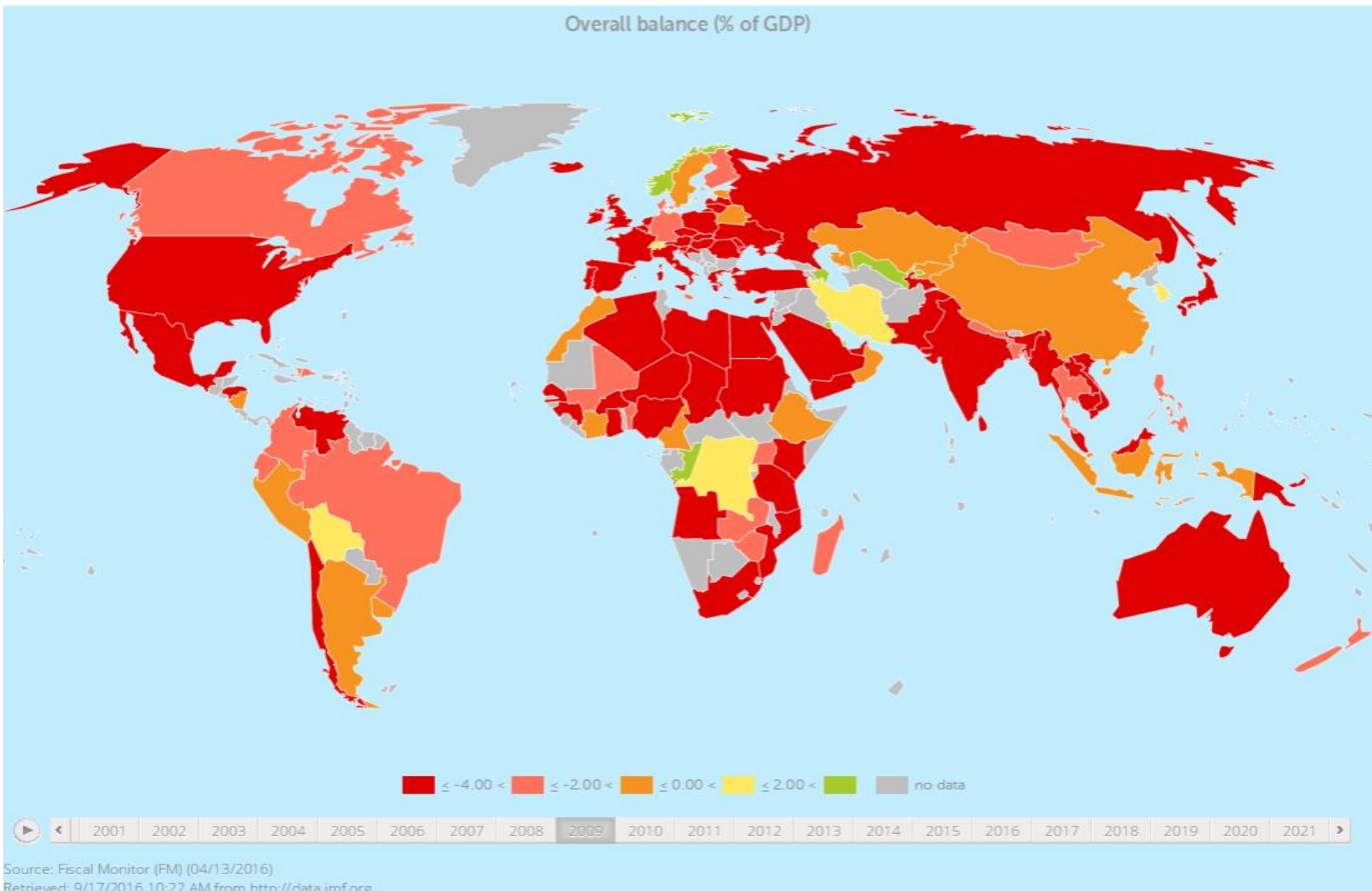
- Buying risks upfront instead of lowering risk free yields
    - » More private sector securities
    - » Distortion of risk premia and related cost of capital
  - Targeting non-performing assets
    - » Monetary bail-out
    - » Turning the Eurosystem into a bad bank
  - Helicopter money
    - » Bypassing the credit channel to inflate the debt-overhang away
    - » Transforms the Eurosystem into a pure fiat money system
- ⇒ **Hardly in line with ECB's mandate, radical consequences**
- ⇒ **Chicago plan 2.0 requires credible post-resolution design**

- **Structural Reforms**
  - » Become even more important as economies are aging ...
  - » ... but remain unpopular
- **Monetary policy**
  - » Did (more than) enough
  - » Runs out of (positive) impact, risk of negative side-effects
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  - » ... gains momentum

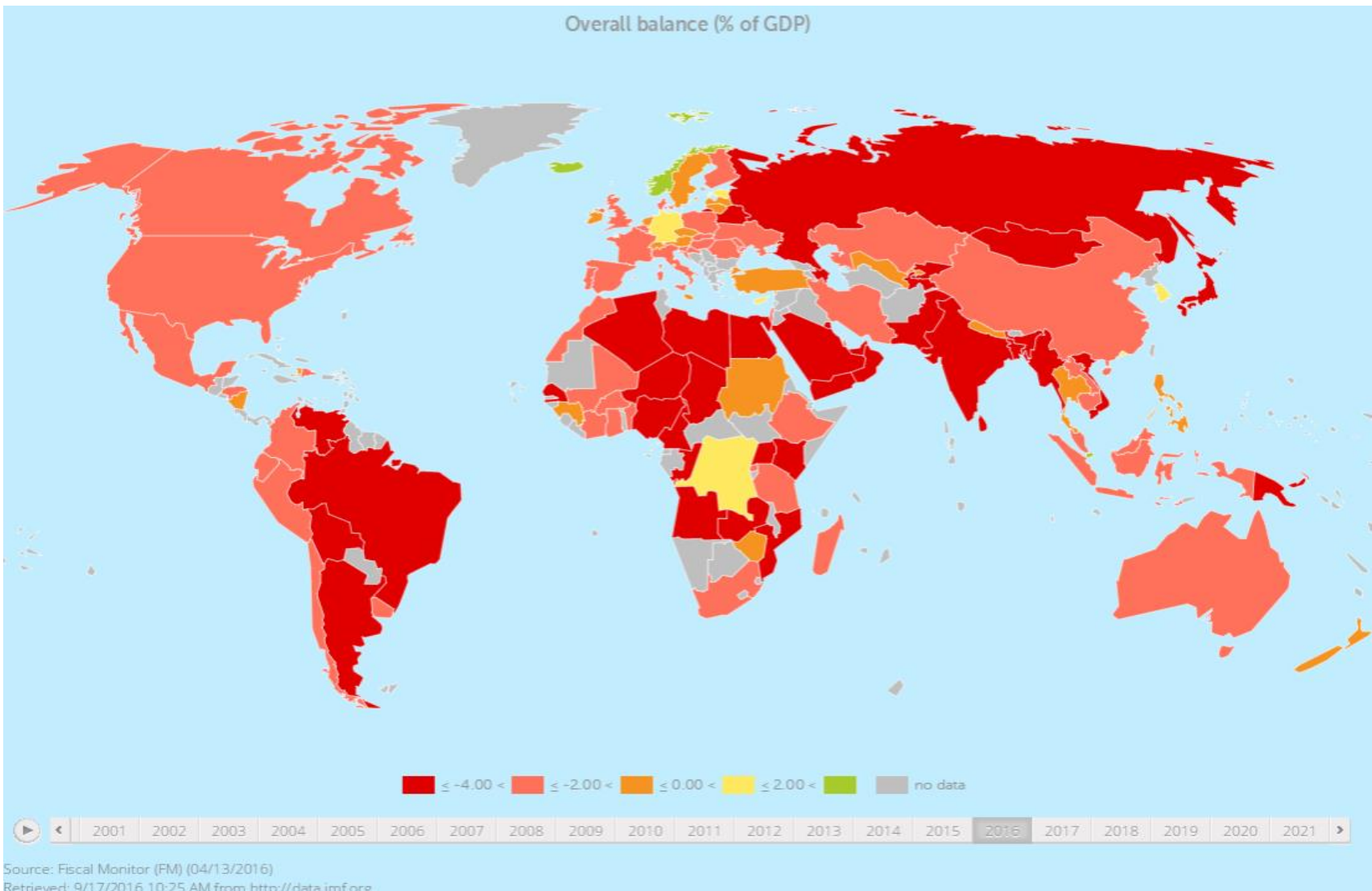
# Fiscal stance 2007 (pre-crisis)



# Fiscal stance 2009 (in crisis)

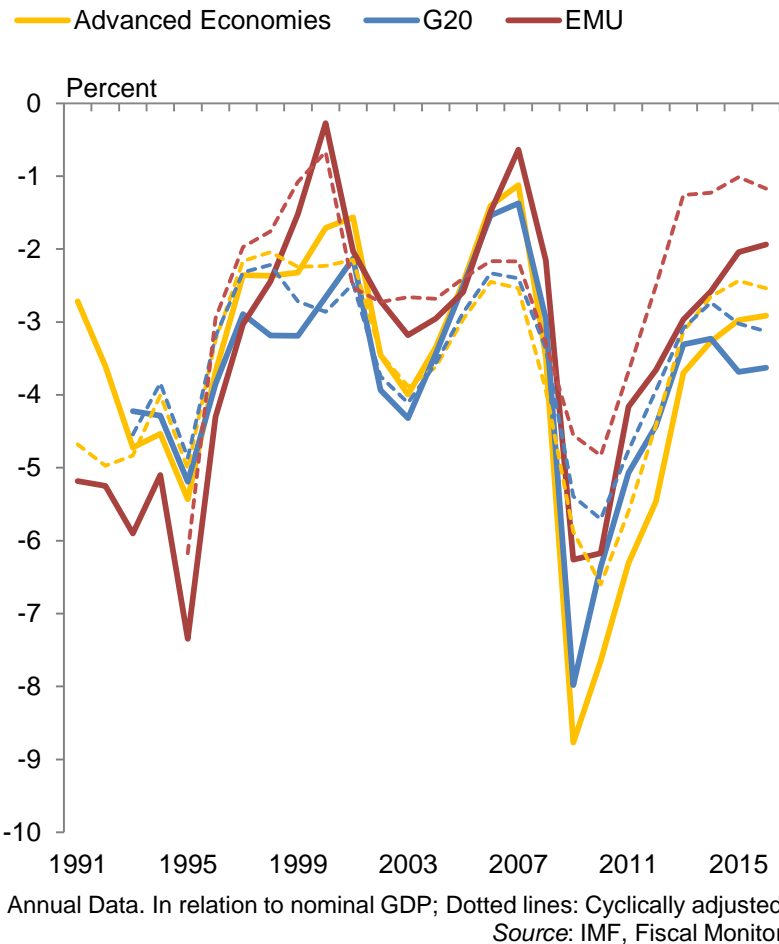


# Fiscal stance 2016 (post-crisis?)

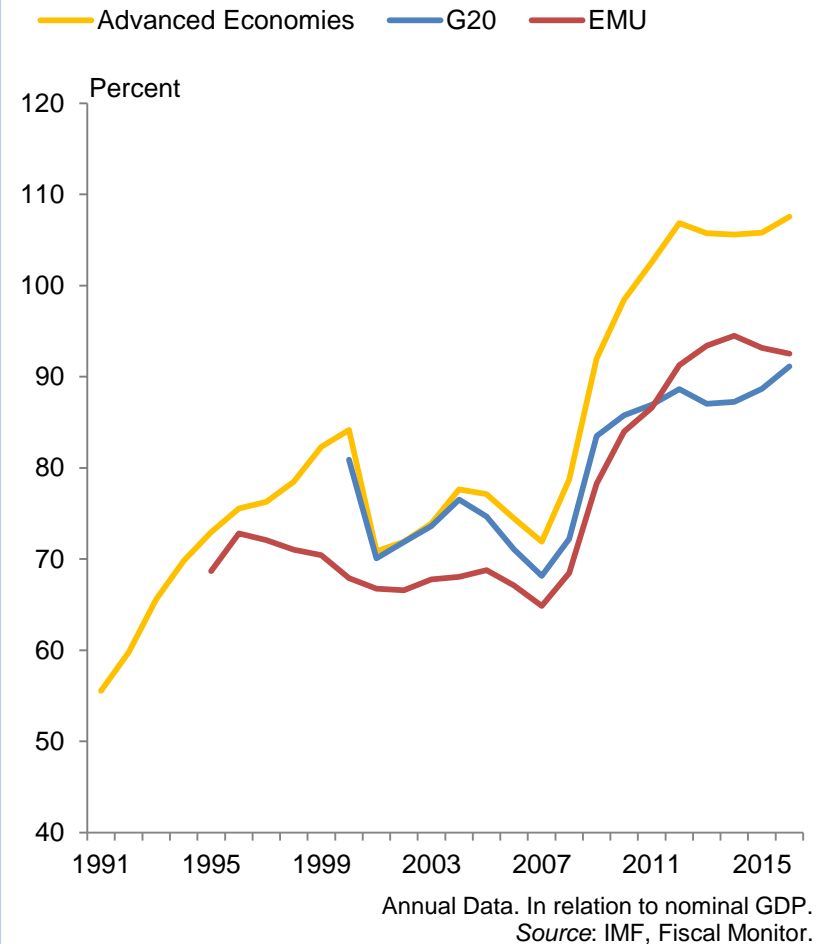


# Fiscal stance and public debt

## Net Public Lending



## Gross Government Debt

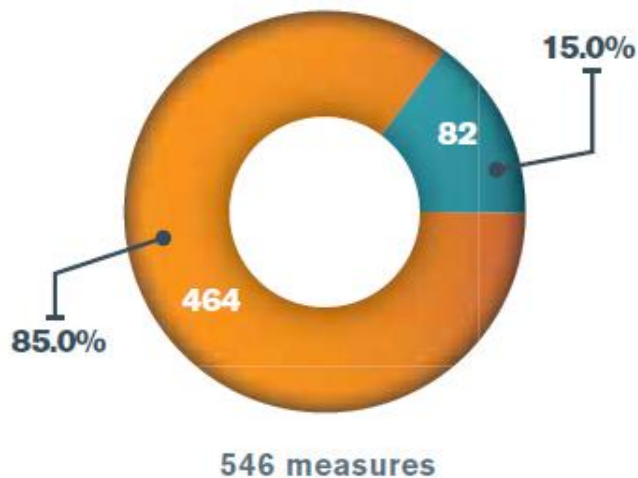


- **Structural Reforms**
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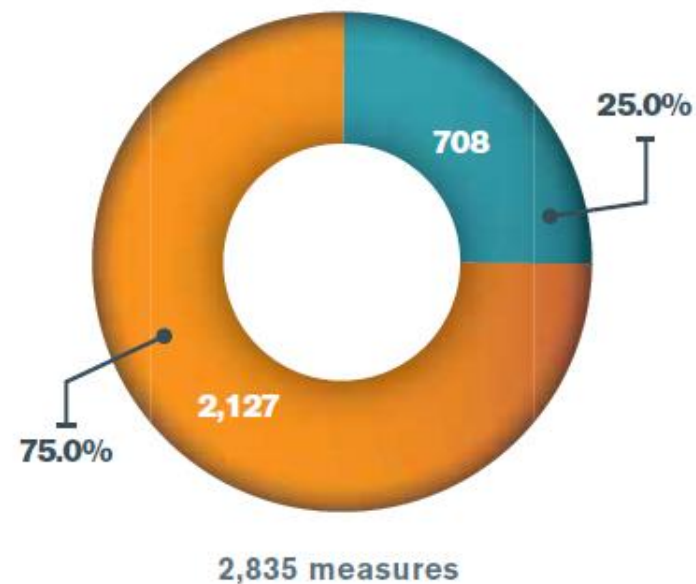
# Neo-protectionism via non-tariff barriers to trade

Stockpile of trade-restrictive measures initiated since October 2008

By mid-October 2010



By mid-May 2016



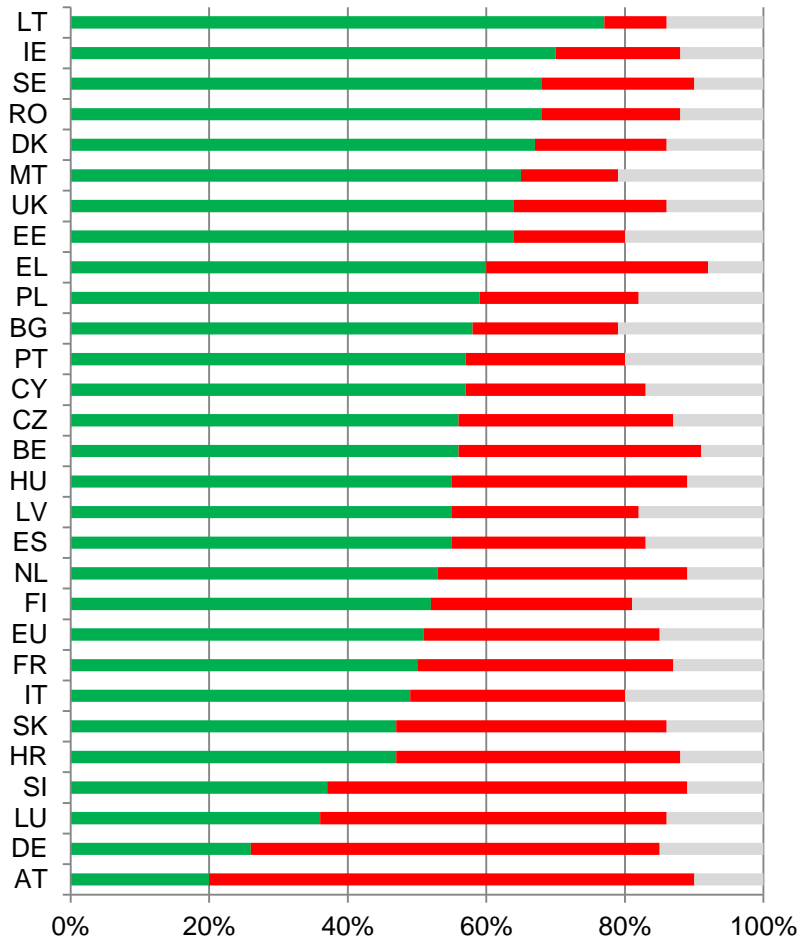
● Effectively eliminated measures

● Stockpile of restrictive measures

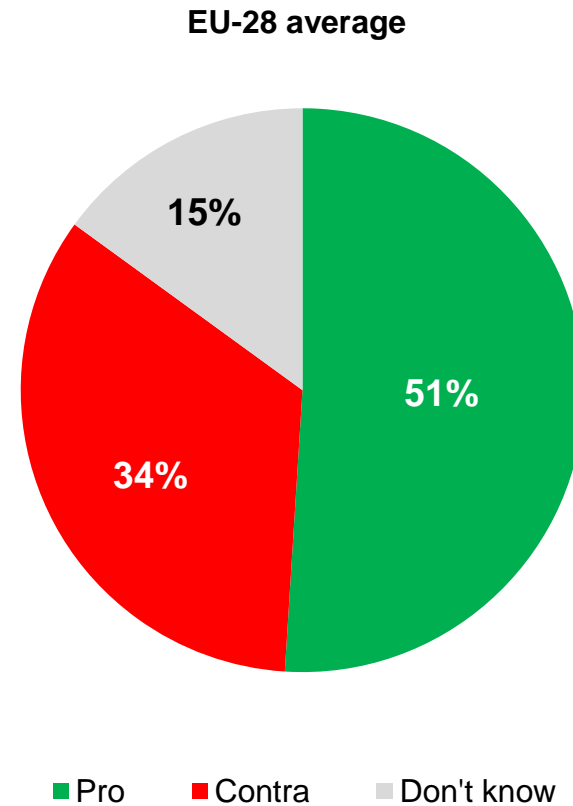
Note: The stockpile of trade-restrictive measures also includes trade remedy actions.

Source: WTO, World Trade Statistical Review 2016.

# EU citizens' attitudes towards TTIP



Source: Eurobarometer 85.2 (Spring 2016).



- Harmful uncertainty calls for clarity in fundamentals
- **Spirit of maximum cooperation** vs. exemplary warning
- EU as a club
  - » Stability by valuable club goods (voting rights!)
  - » Sanctions for leaving belittle benefits from membership
  - ⇒ **Focus on union-wide collective goods (principle of subsidiarity)**
- Hidden mercantilism in EU politics
  - » Free trade (cherries?) vs. free movement of labor (bitter pill?)
  - » Free trade as a bargaining chip (belligerent great-power policy)
  - » Trade surplus not relevant for benefits from integration
- Protectionism backfires (social poison)
- Integration must rest on understanding, not on coercion
  - » Constructive agreement on everything enjoying consensus support
  - » No “all-or-nothing” ultimatums, but time for adjustment
  - ⇒ **Multiple speeds to keep overall integration processes alive**

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