

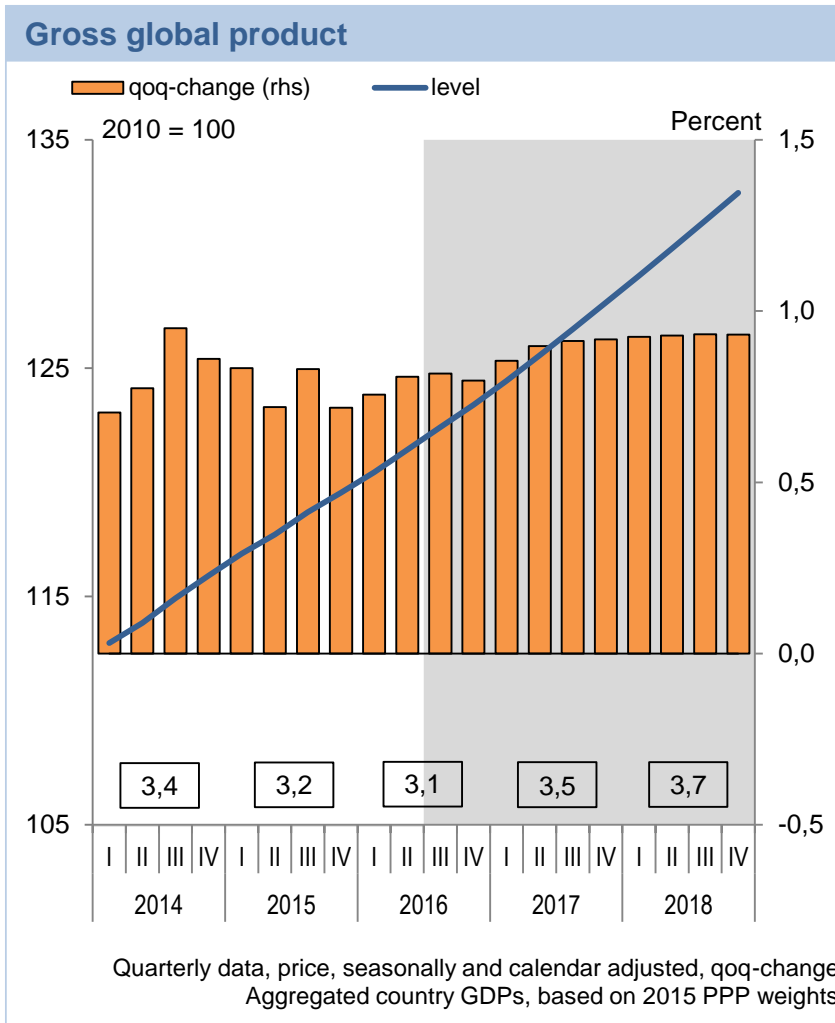
IHK Region Stuttgart | Stuttgart, 23. November 2016
12. Stuttgarter Konjunktorgespräch

Die konjunkturellen Aussichten in Deutschland

Schlussfolgerungen für die Wirtschaftspolitik

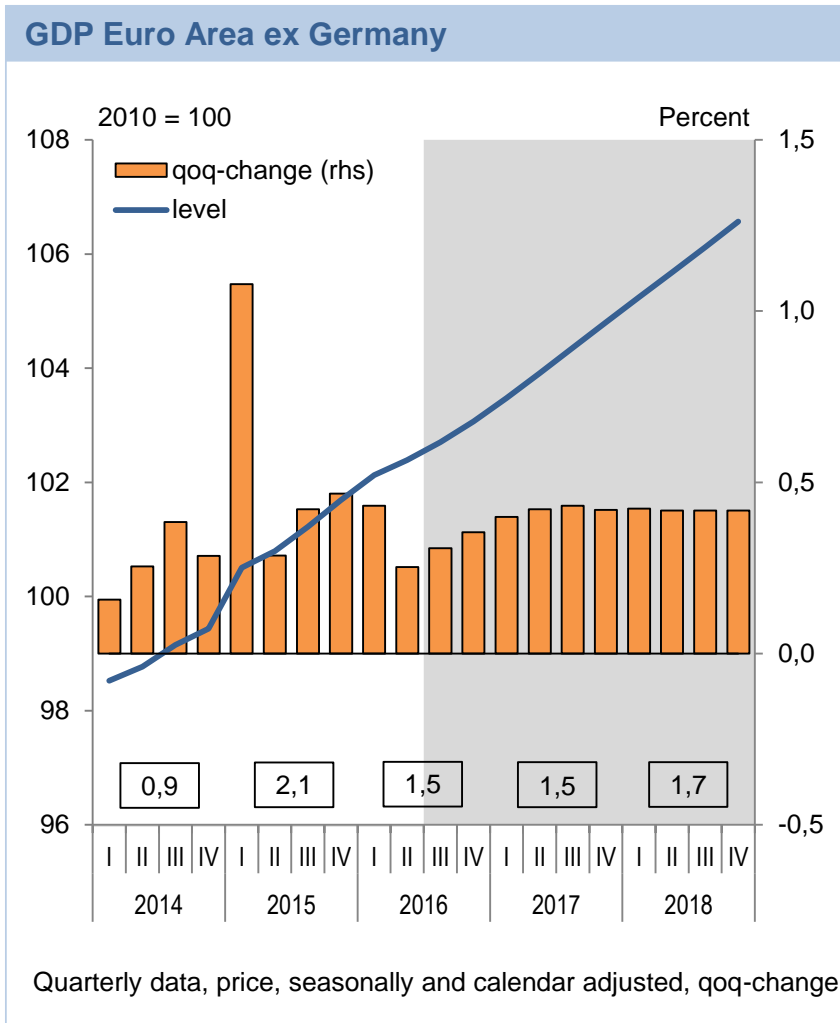
Prof. Dr. Stefan Kooths
Prognosezentrum





- 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**

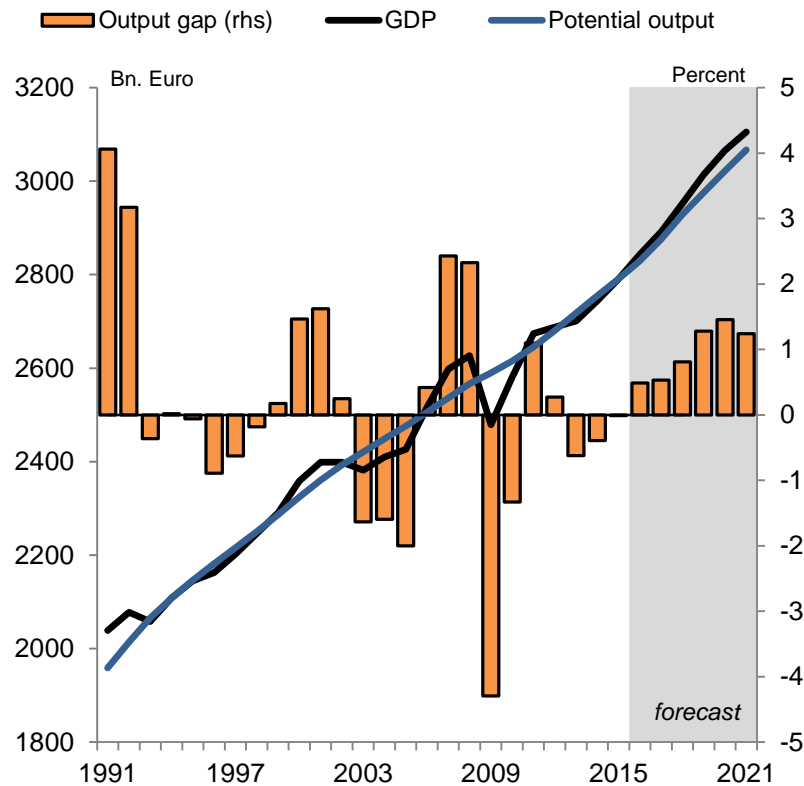
Moderate recovery in the Euro Area continues



- 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

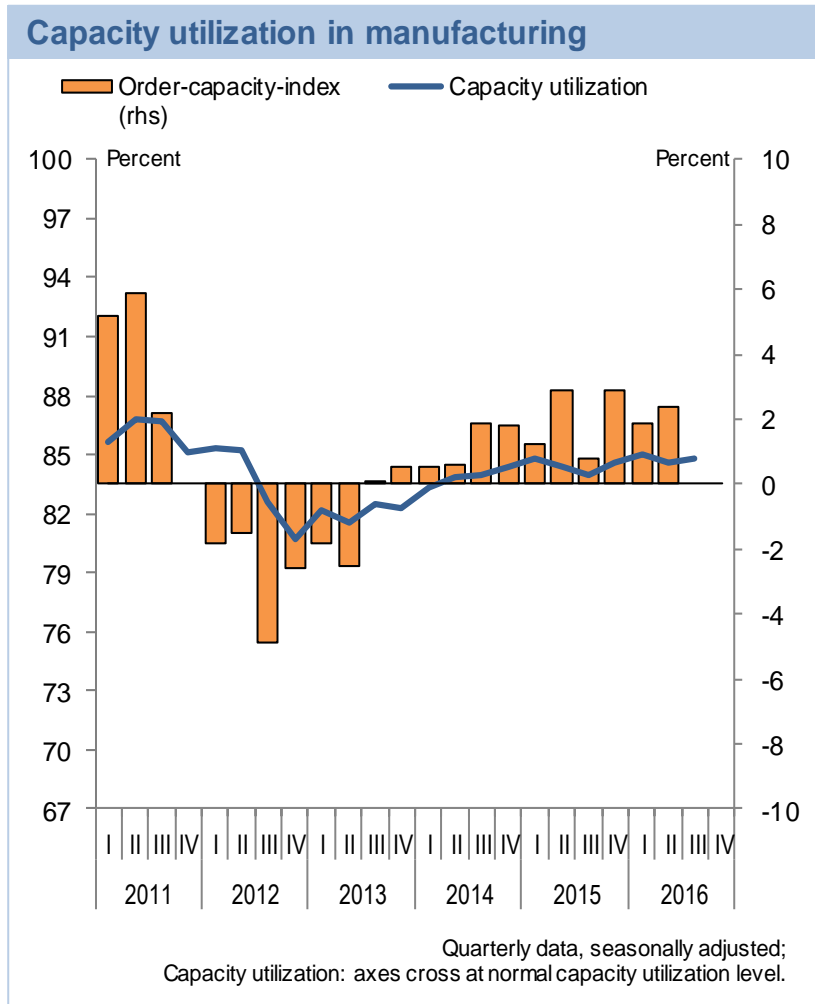
Production and potential output



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

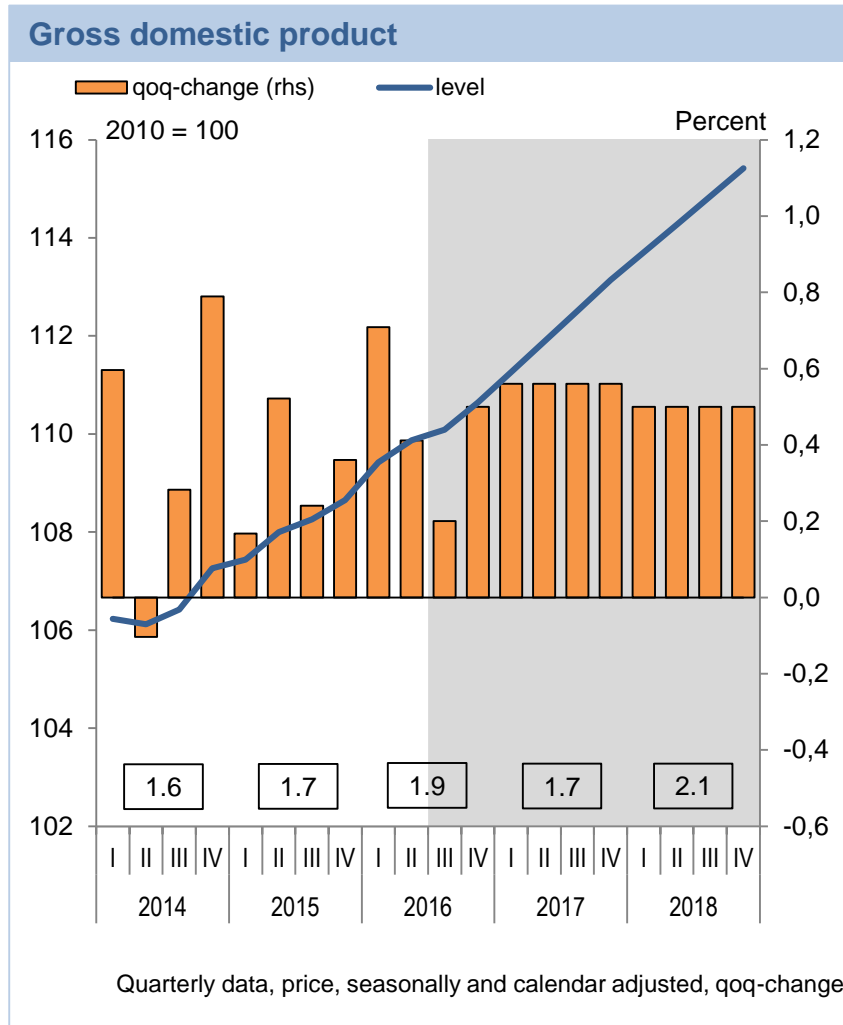
- Overall capacity utilization slightly above normal
- Cyclical pattern less pronounced
- Potential growth depends on net-immigration into the labor force
 - » + 460,000 (2016)
 - » + 540,000 (2017)
 - » + 480,000 (2018)

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

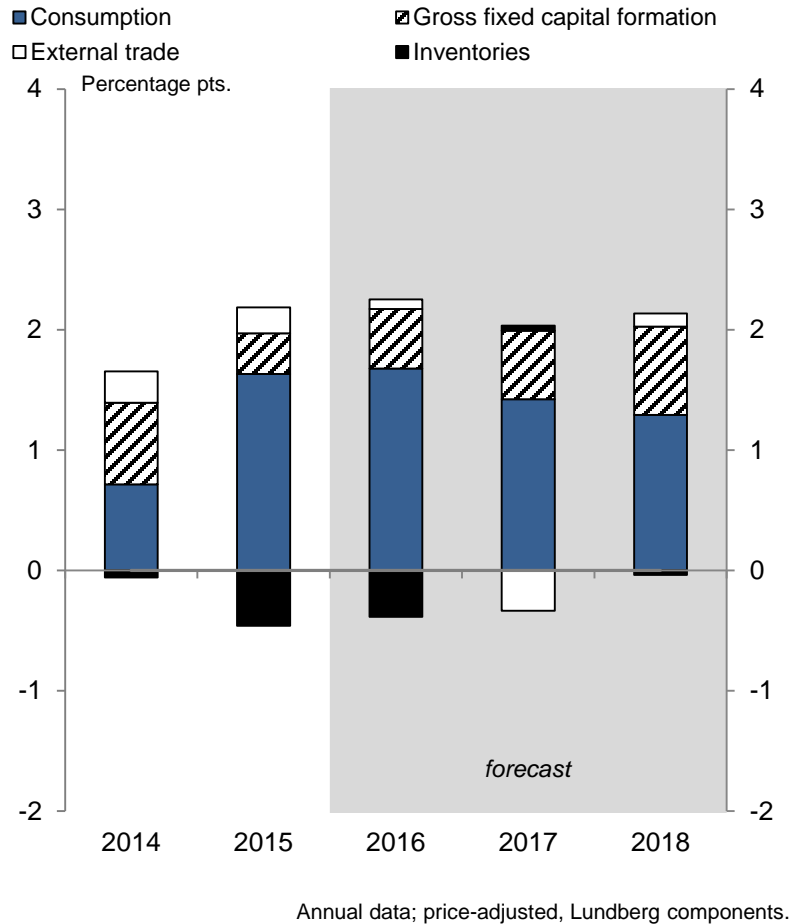
Economic activity regaining momentum



- 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)

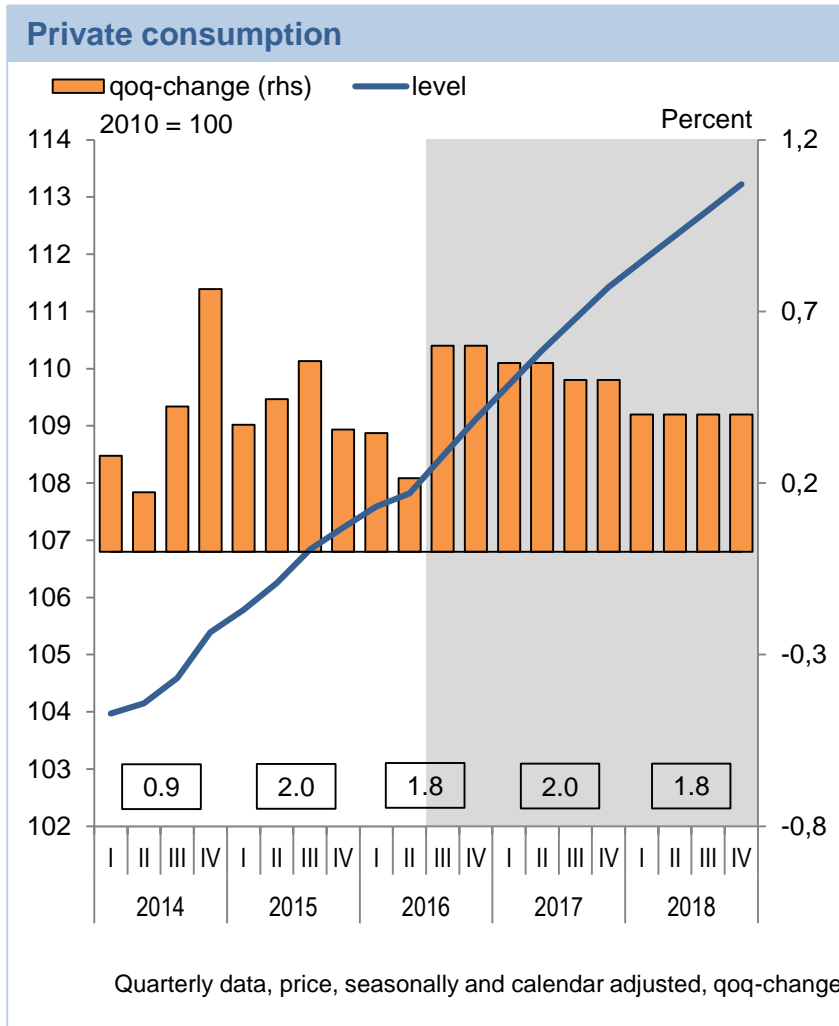
Expansion driven by domestic factors

Expenditure-side components to GDP-growth



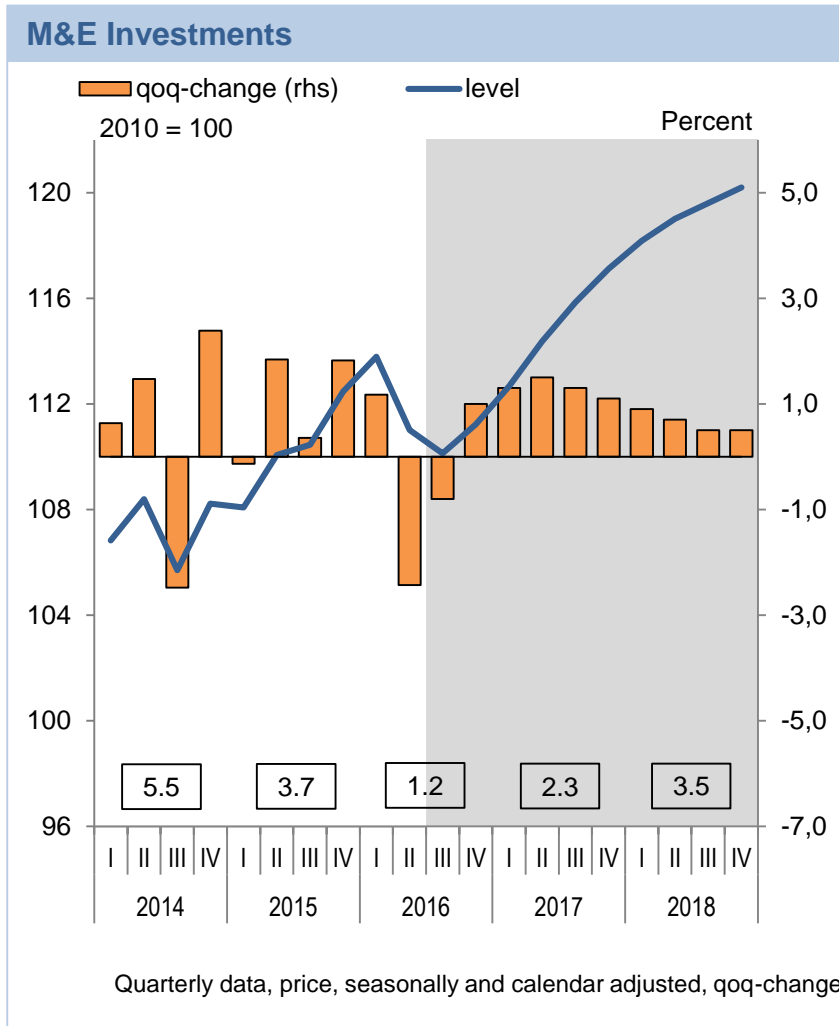
- 2015/2016 strongest boost in consumption for 15 years (private and public)
- Construction near to capacity limits
- M&E investment lagging behind and remaining moderate compared to past patterns

Strong growth in private consumption



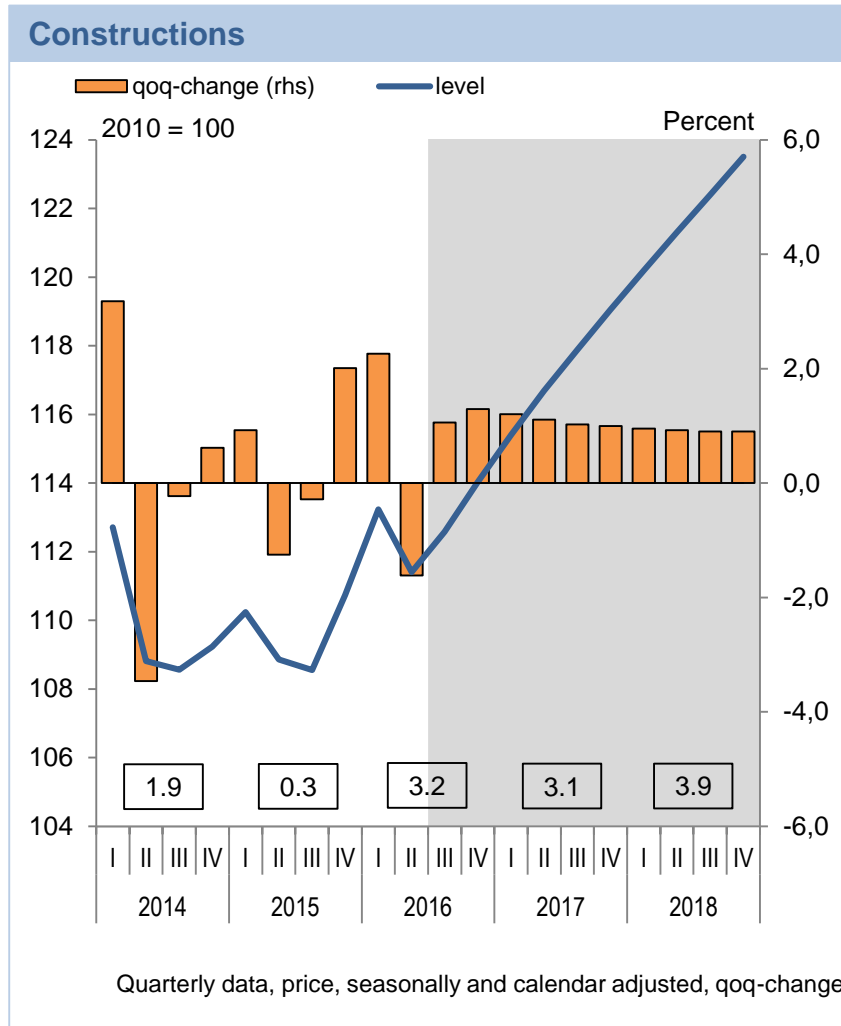
- 2016-Q2: Dip in line with energy price hike
- Strong 2016-H2 due to distinct pension increase
- Robust labor market (wage rates and employment) and public transfers feed into private households' purchasing power

Investment in M&E lagging behind

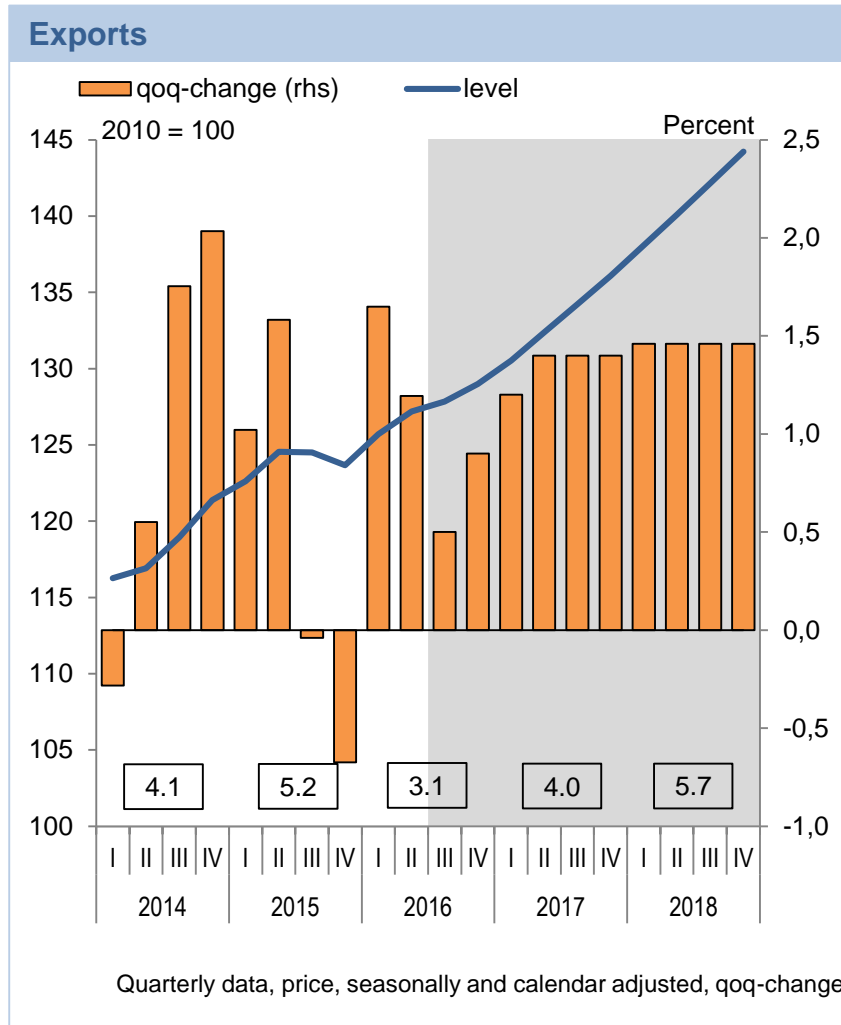


- Low 2017 annual rate
 - » Carry-over effect (- 0.7 pp)
 - » Calendar effect (- 0.8 pp)
- Cyclical pattern subdued due to creeping upswing
- Financing conditions remain extremely favorable
- Recent past saw series of uncertainty shocks (strain on investor confidence)
- Other theses
 - » Harbinger of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

Very stimulating environment for constructions



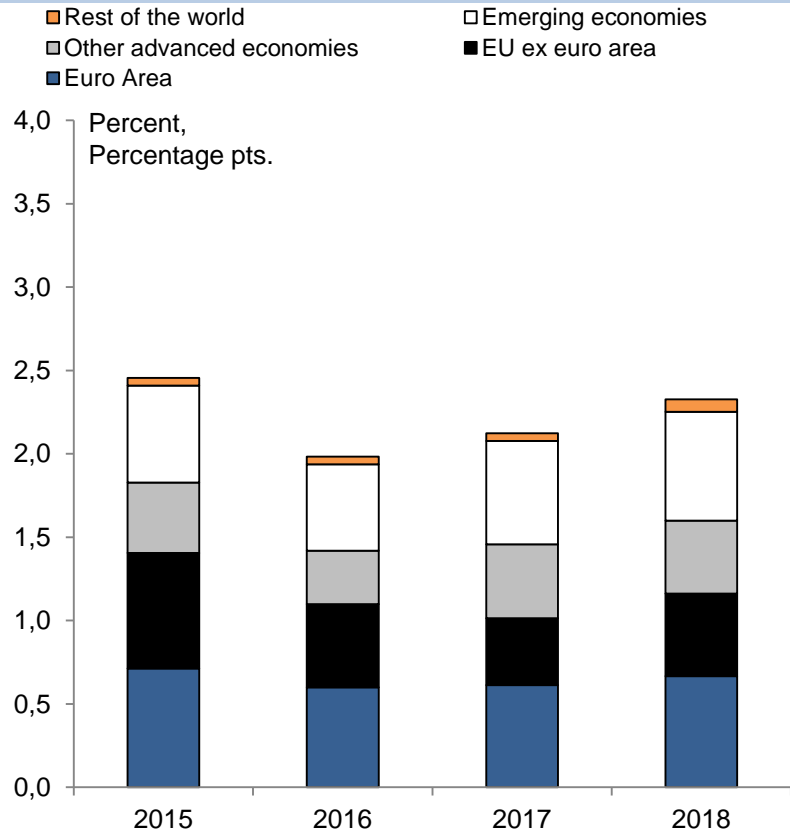
- Q1/Q2: weather effects
- Low interest rates
- Strong income growth
- High government revenues
- Increasing capacity utilization



- 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

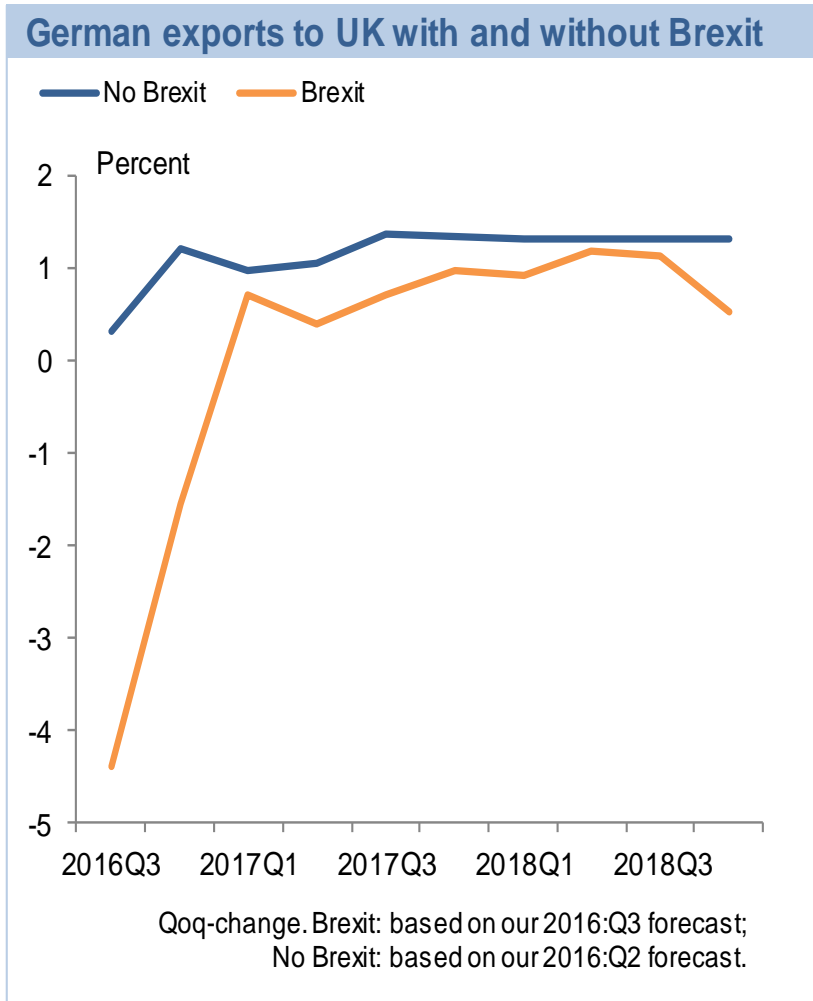
German Export Markets



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

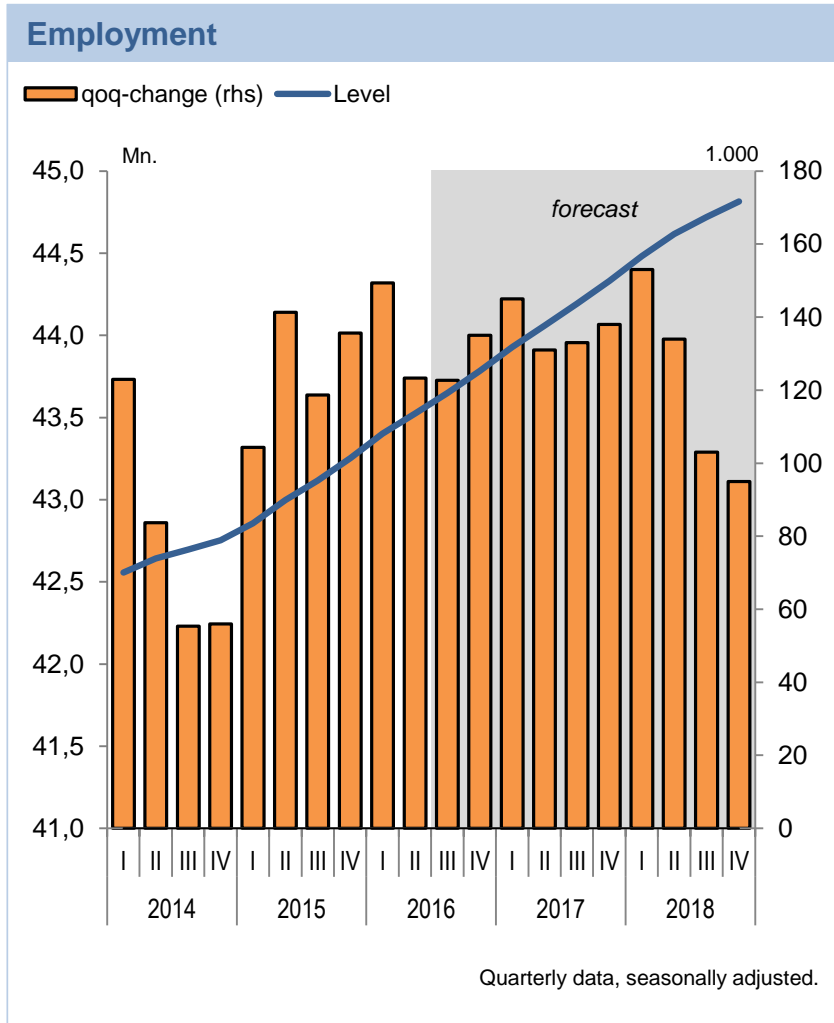
- Growth in foreign GDP
 - » 2.0 % (2016)
 - » 2.1 % (2017)
 - » 2.4 % (2018)
- Product portfolio and regional diversity

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	22.2	7.8	1.9	11.0

Key figures

	2015	2016	2017	2018
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?

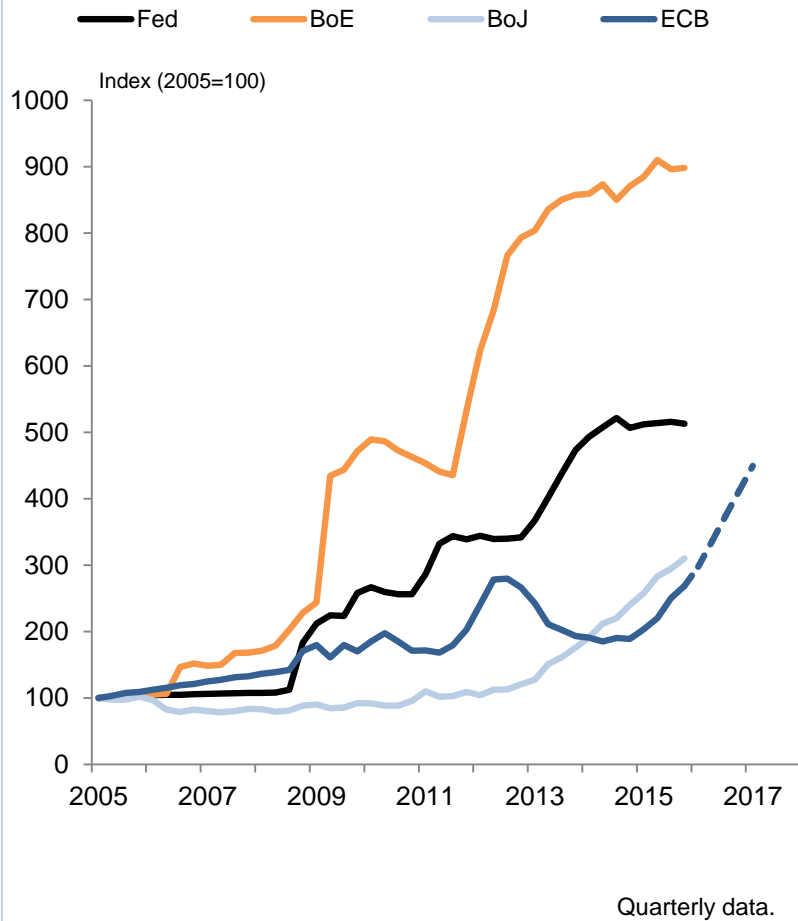
■ Neo-protectionism/economic disintegration

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

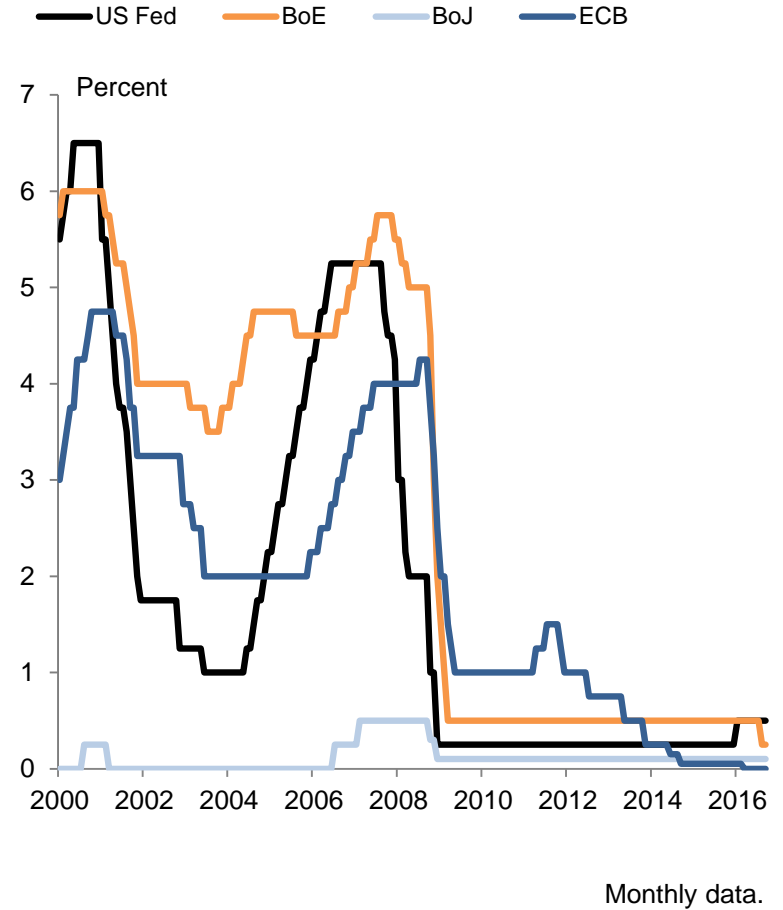
- **Structural Reforms**
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Monetary policy hits limits

Monetary Base



Monetary policy rates



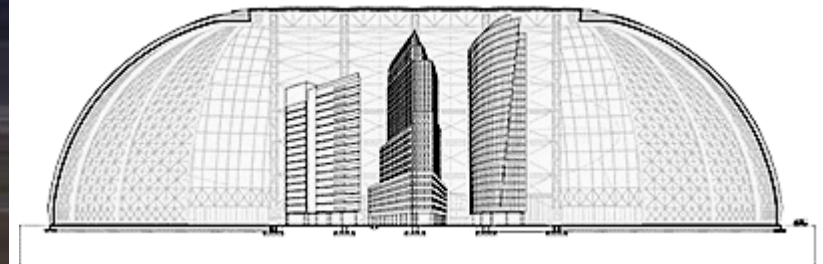
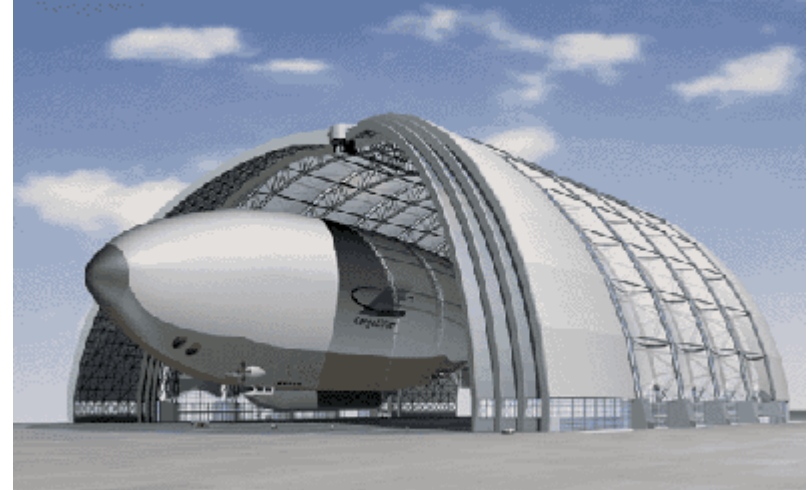
Two types of mal-investments

- **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)



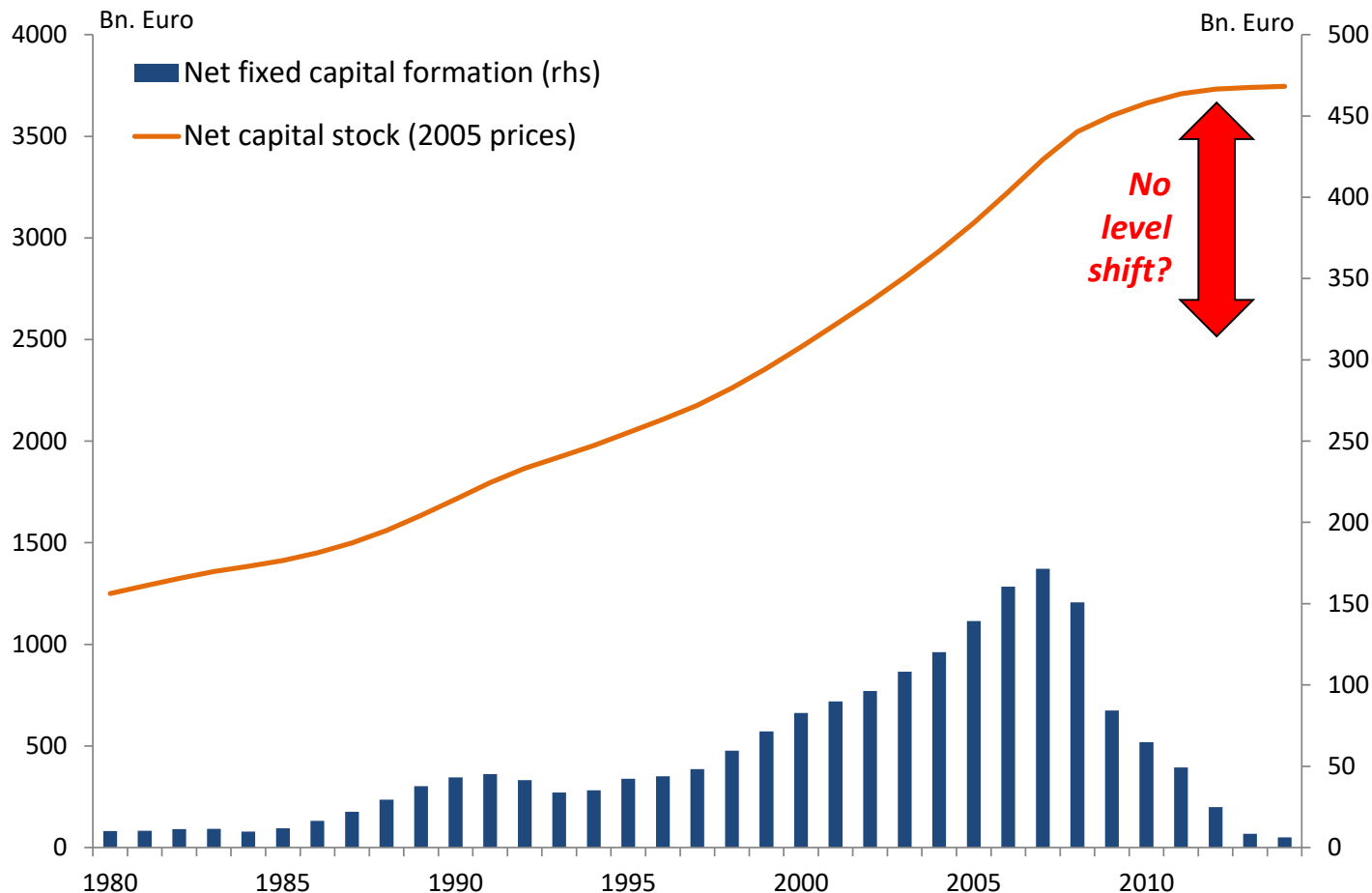
Liquidation value:
17.5 million euro (2003)

CargoLifter in the national accounts

A hangar is a hangar is a hangar ...

Case study "Spain"

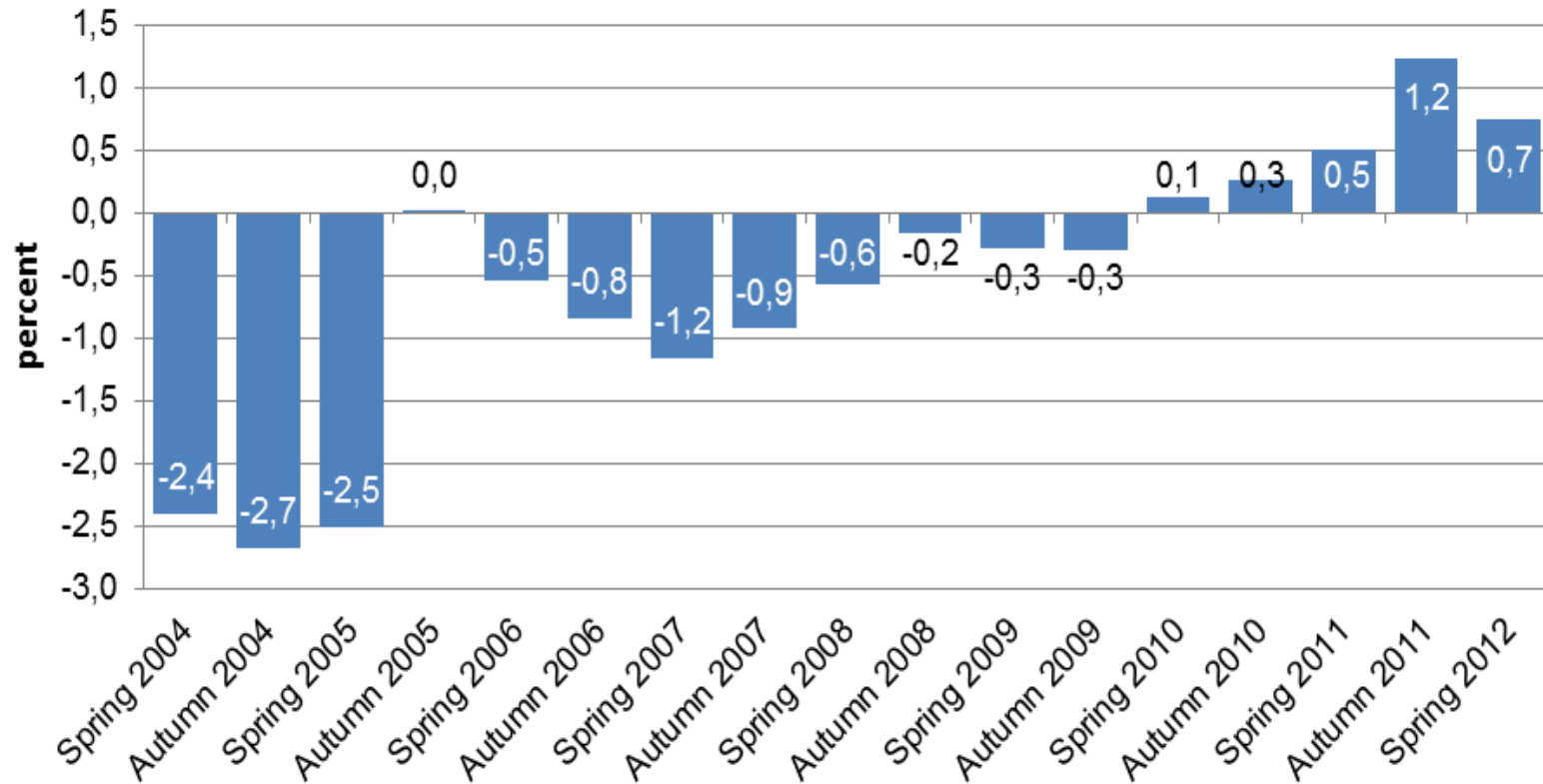
Value of the total capital stock?



Source: AMECO Database.

Case study "Spain"

Output gap in 2005 (revisions)



Source: European Commission, various years.

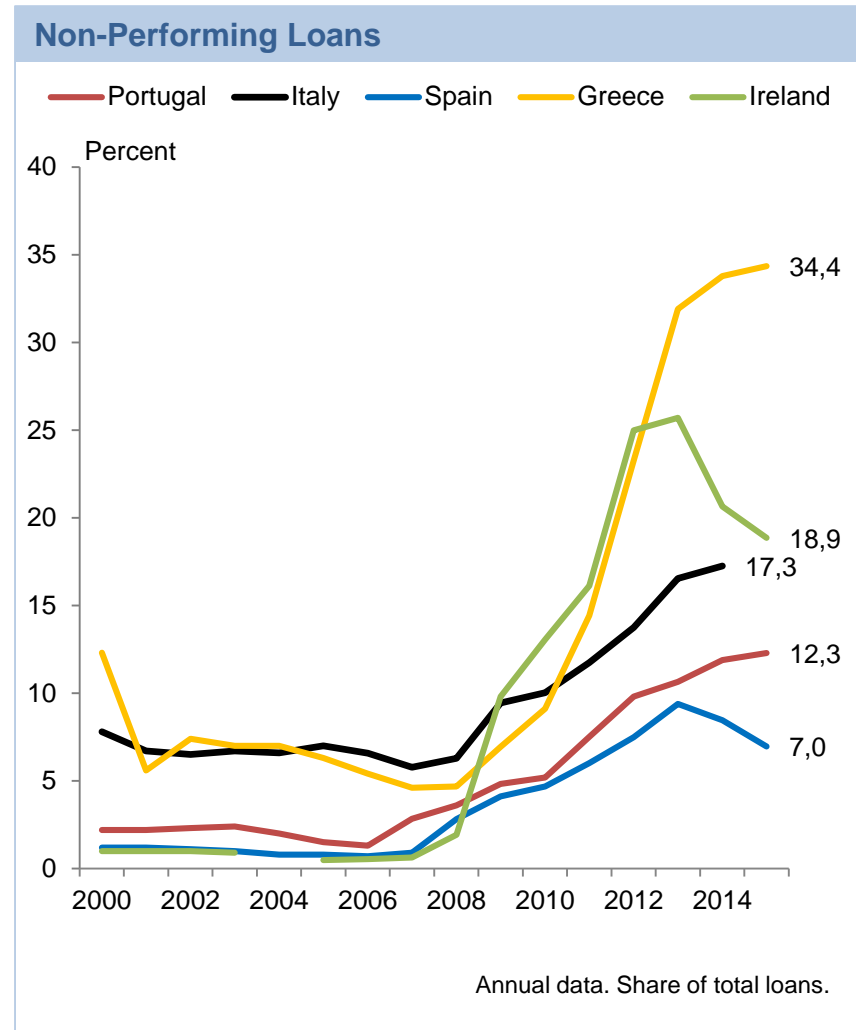
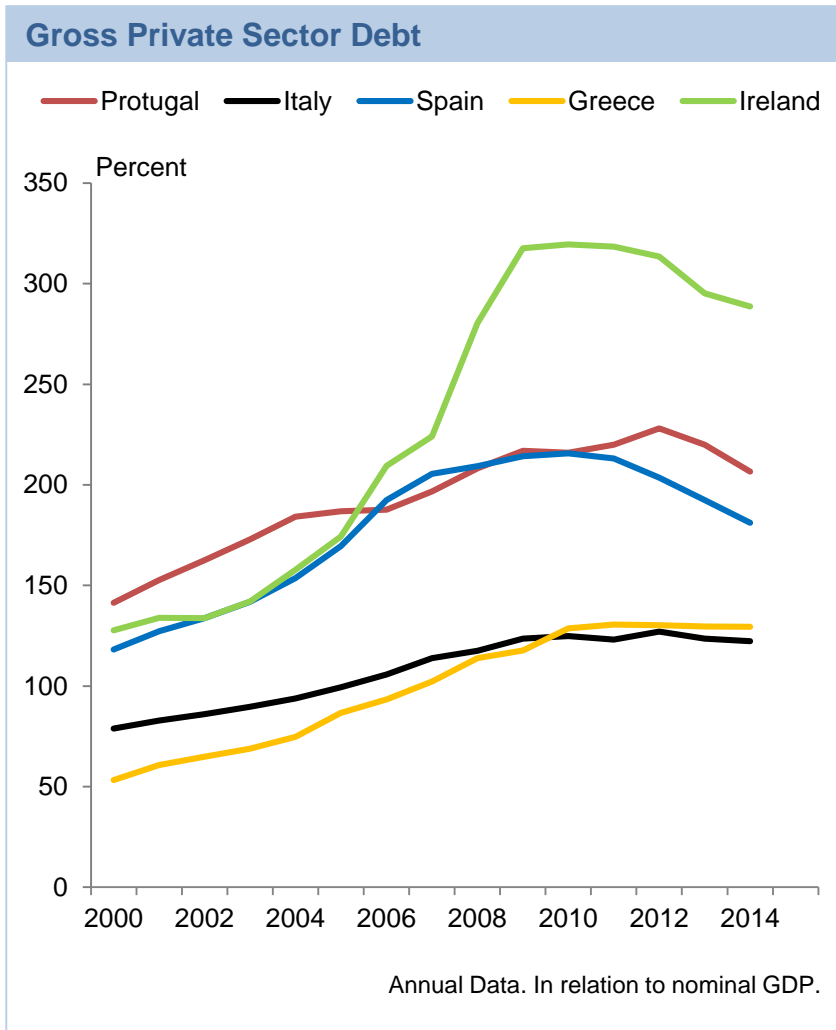
Three options of coping with debt-crises

- **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

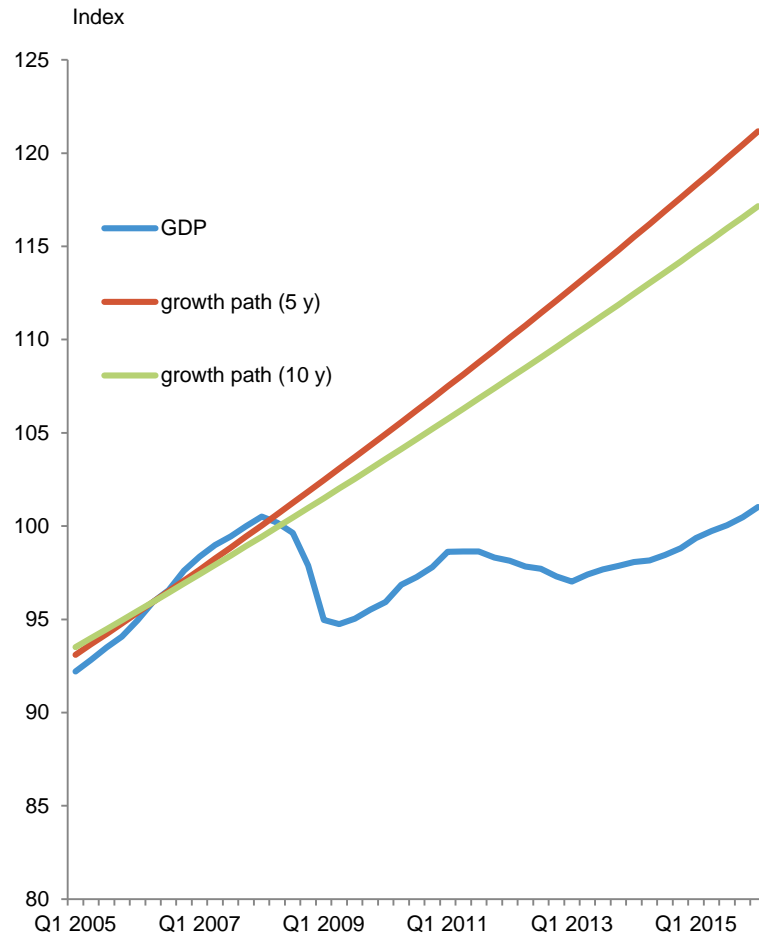
Anti-capitalist approach
(harms principle of accountability, creates moral hazard risks)

Capitalist approach
(in line with free market principles)

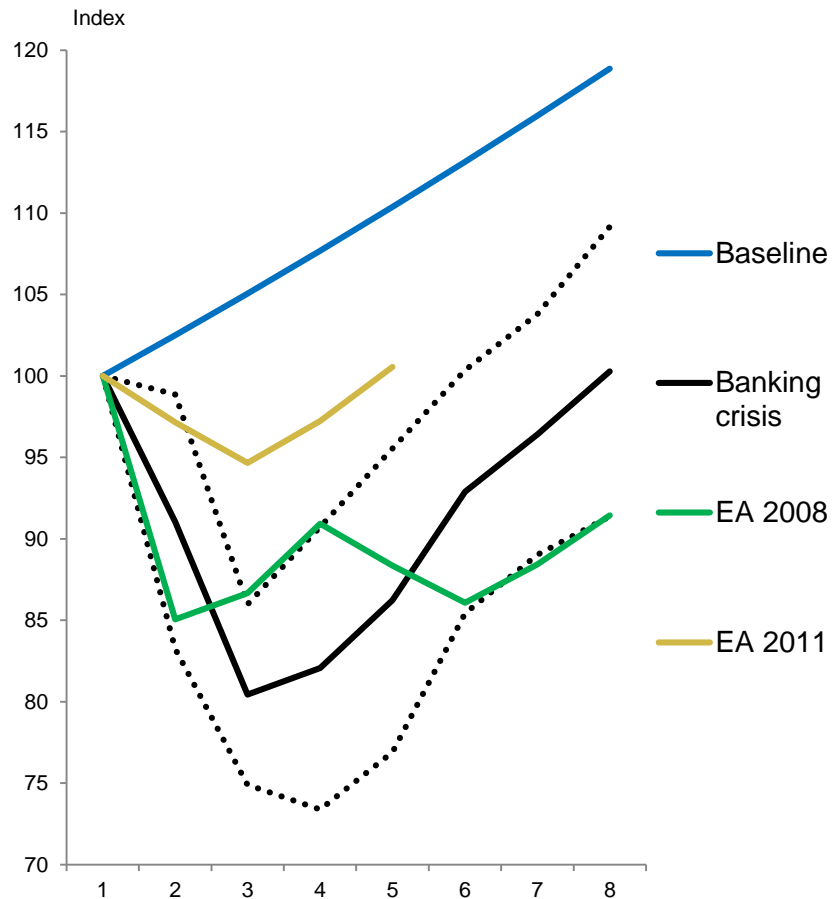
Flip-side of not liquidating (= “buying time”): Excess debt position hamper credit channel



Data source: Bank for International Settlements, World Bank.

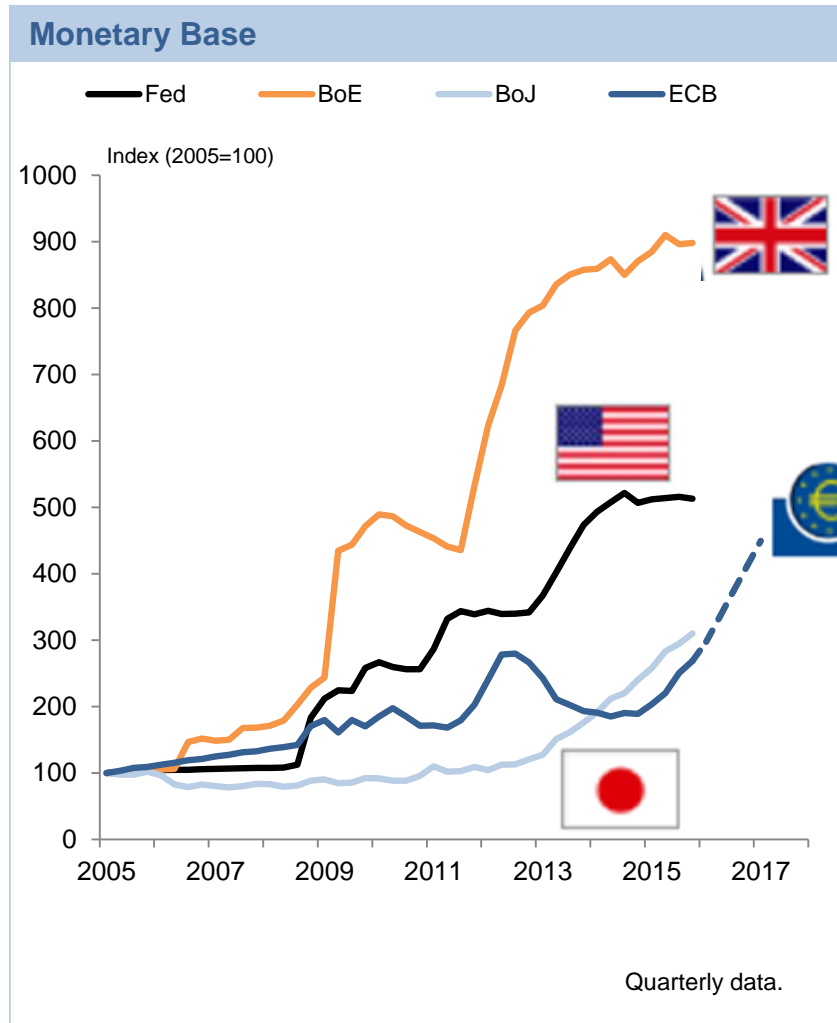


- Weak growth ...
 - » ... compared to pre-crisis trends
- Two crises in a row
 - » Global financial crisis (2007/2008)
 - » European debt crisis (2011 ff)



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

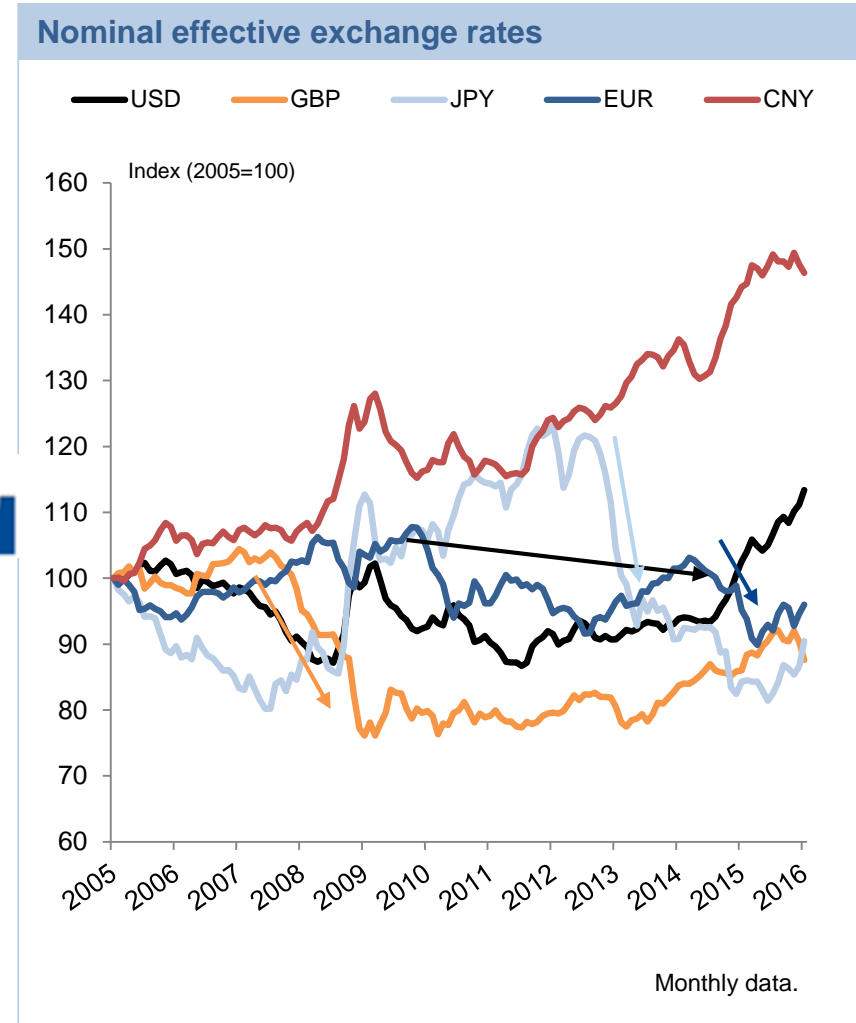
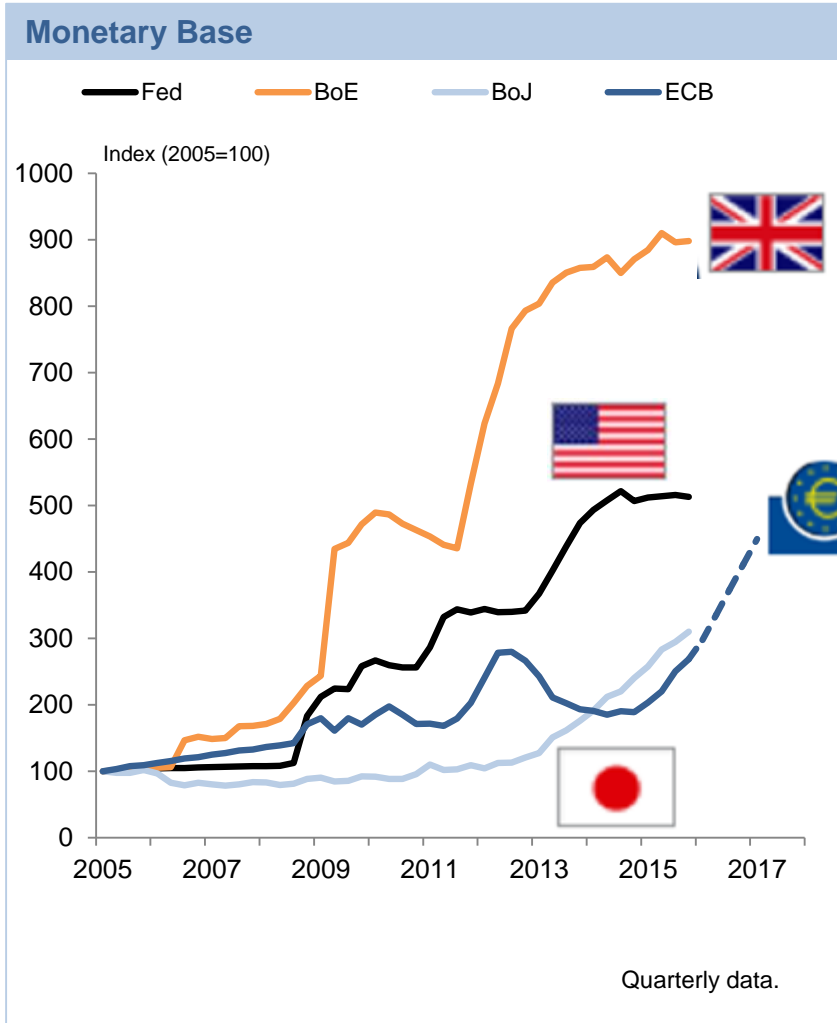
Quantitative „Easing“



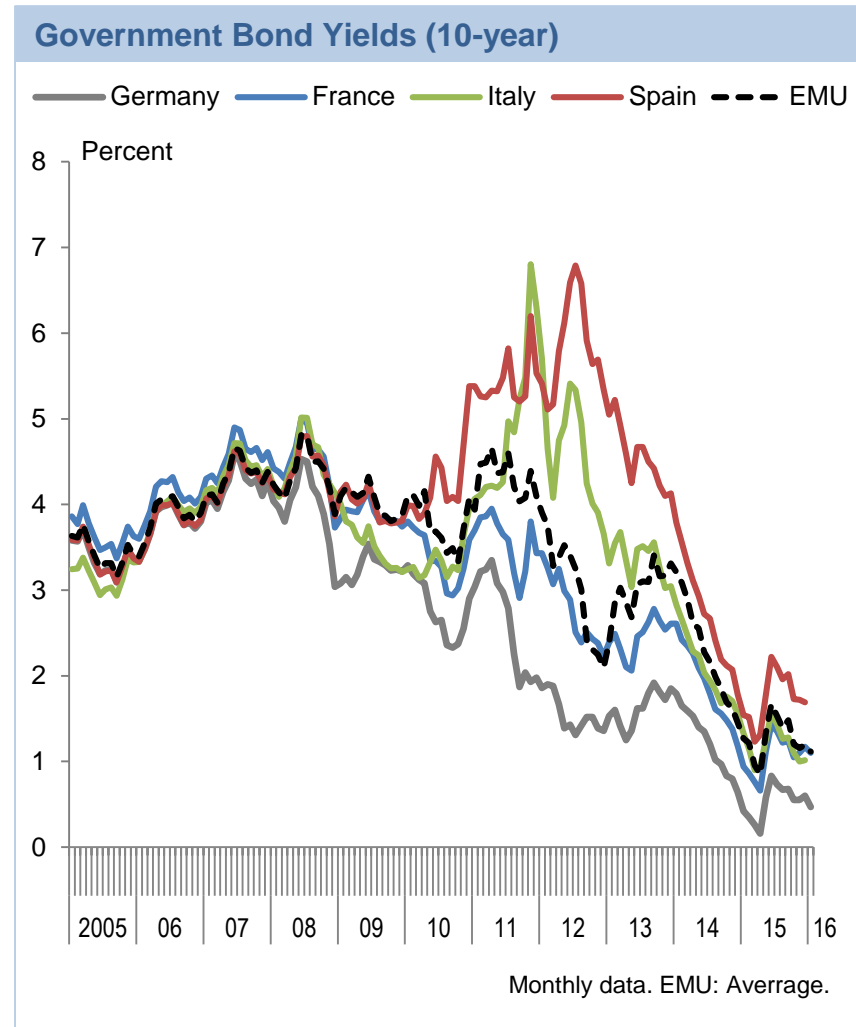
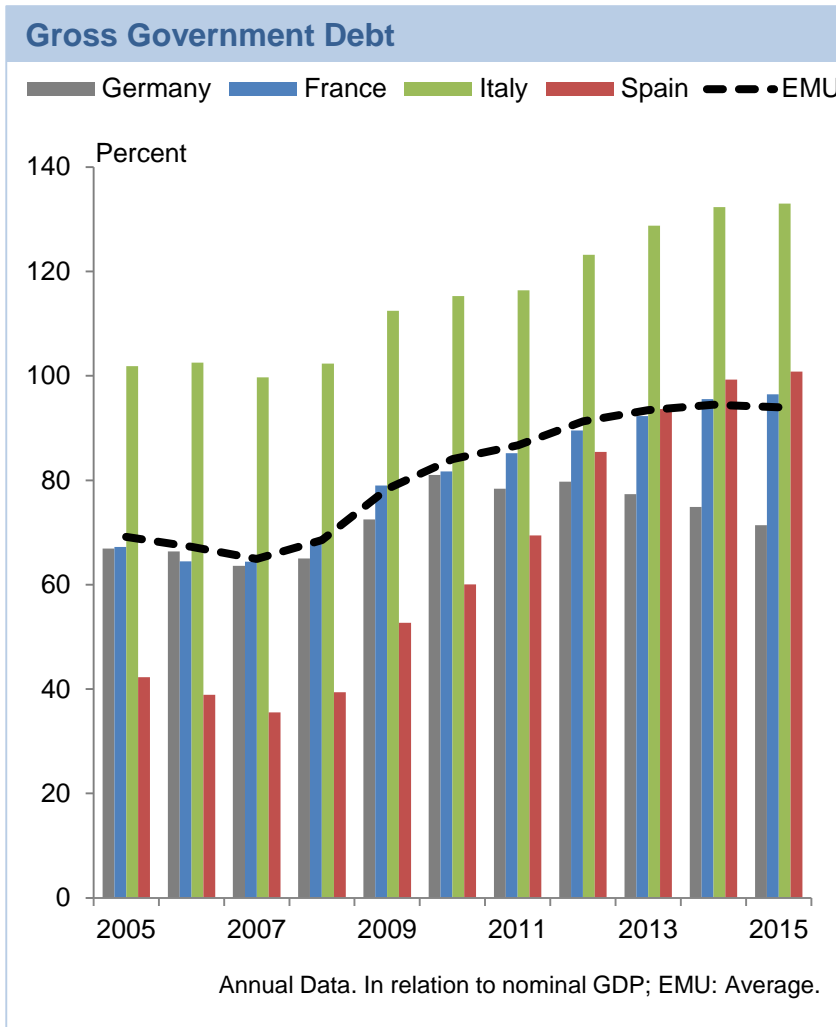
- Type 1: Liquidity provision in times of financial stress (effective)
 - Type 2: Stimulus at the zero lower bound (ineffective)
- ⇒ Exit strategy?
- ⇒ ECB: Need for softer criteria for next purchase programs

Global QE: Risk of currency wars

Source: Thomson Reuters Datastream, IfW-calculations



Euro Area: Monetary financing of governments

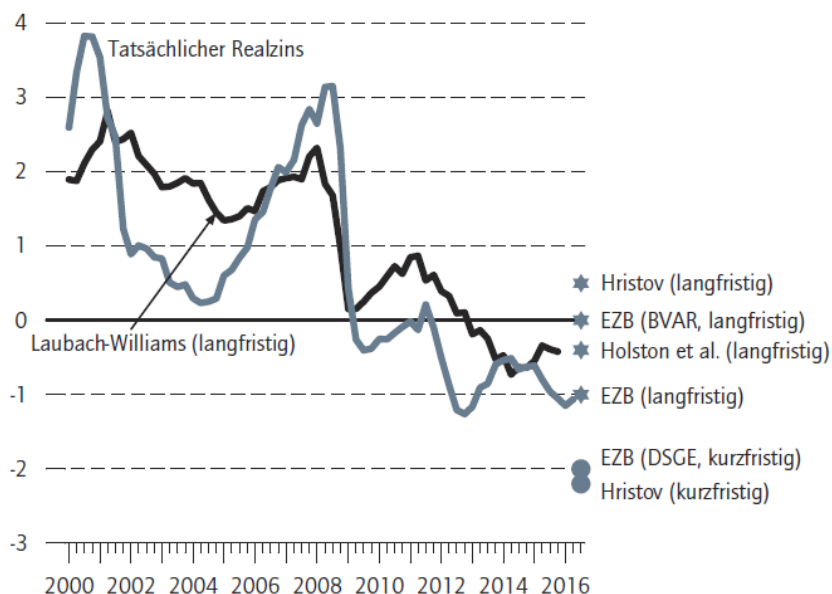


Data source: Eurostat, European Commission.

Monetary expansion: „Neutral“ negative real interest rates?

Tatsächlicher und neutraler Realzins

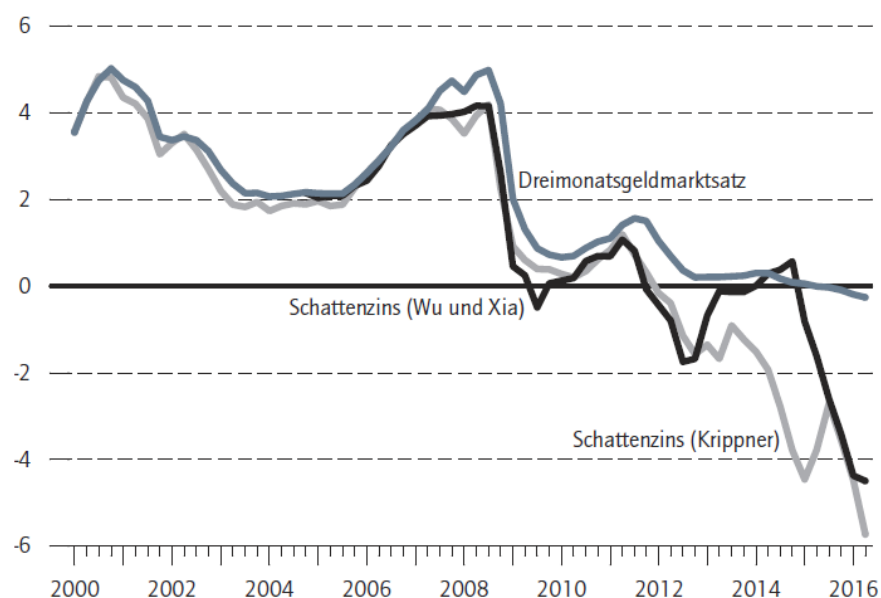
In Prozent



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

Schattenzinsen

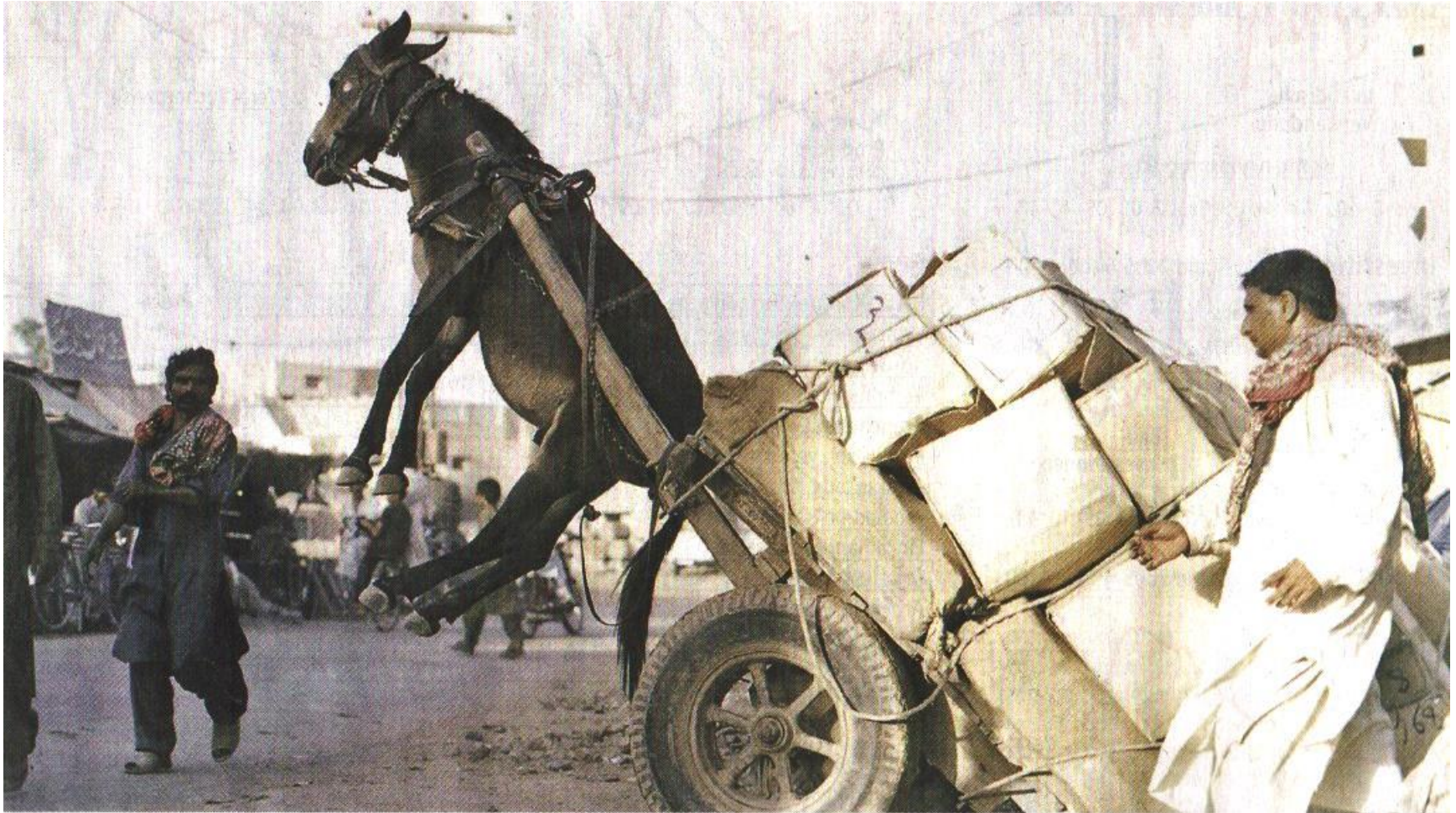
In Prozent



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.

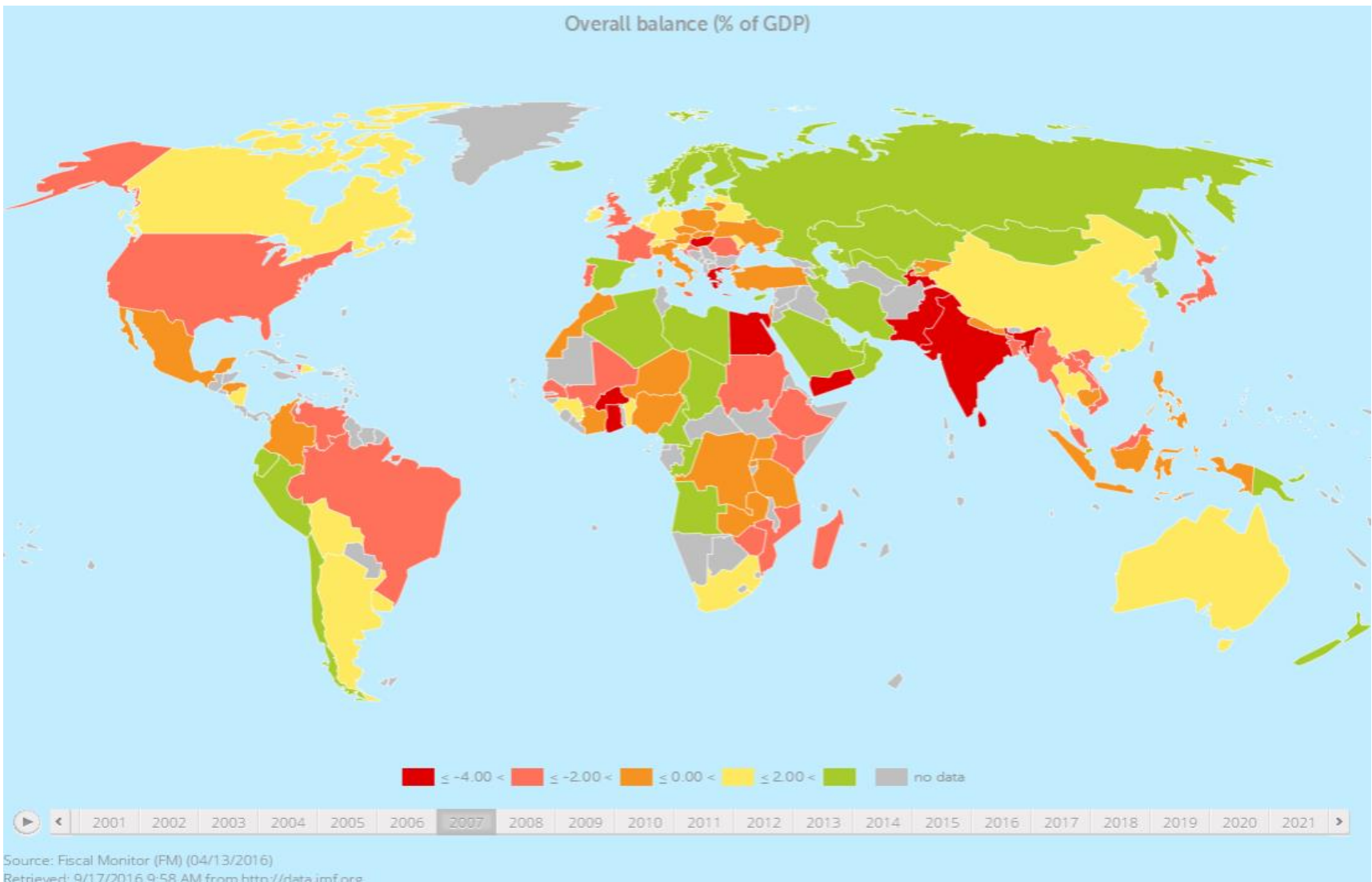
- Verzerrung der Kapitalstock- und Produktionsstruktur
 - Zombifizierung
 - Verzögerung der Konsolidierungs- und Reformpolitik
 - Verwässerung des strukturellen Budgetsaldos
 - Überschuldungskrise nicht gelöst, sondern vertagt
 - Monetäres Niemandsland schürt Unsicherheit
 - Anstieg der Inflationsrate 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)



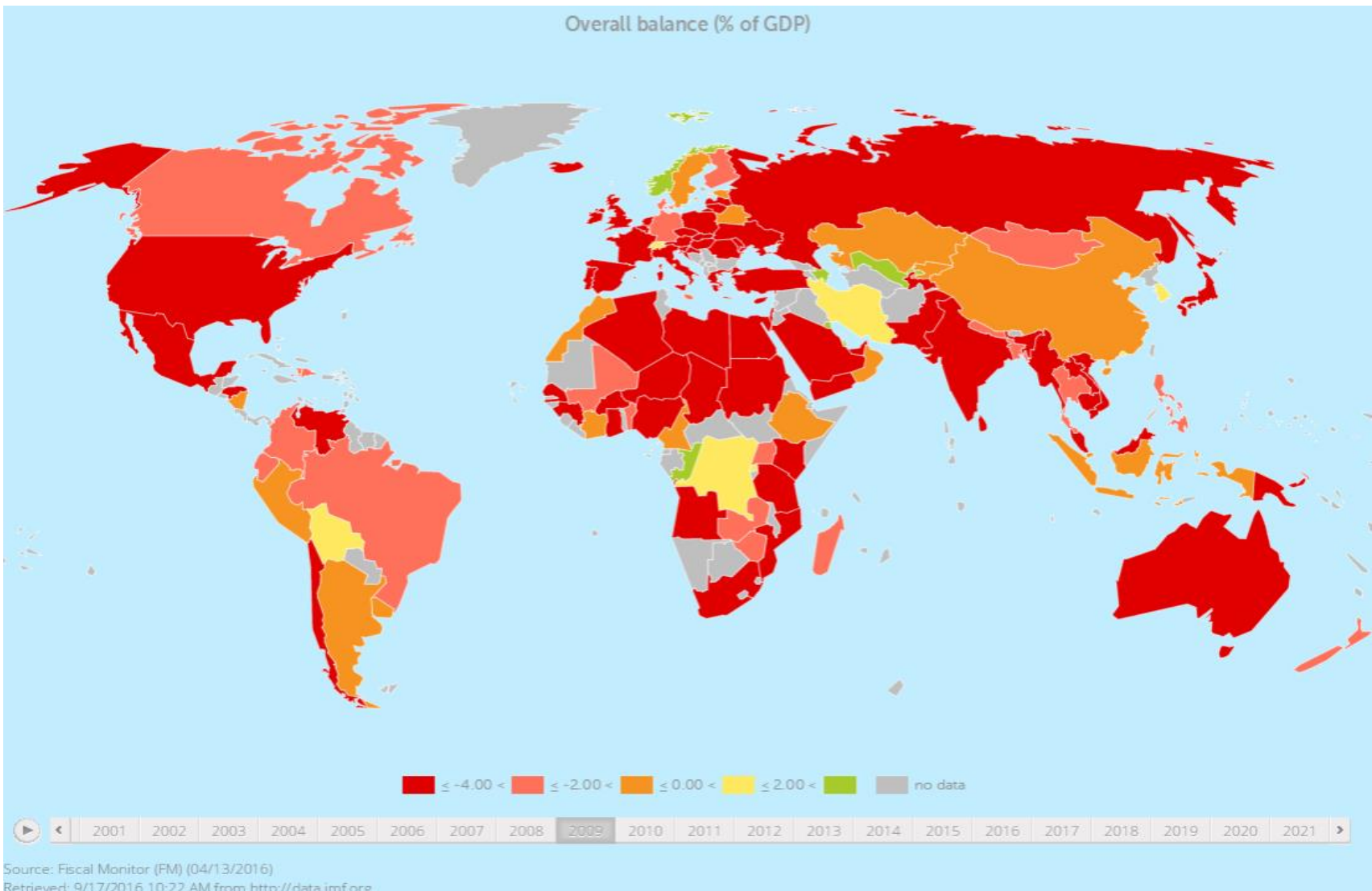
Quelle: FAZ, 26. Oktober 2011, S. 11

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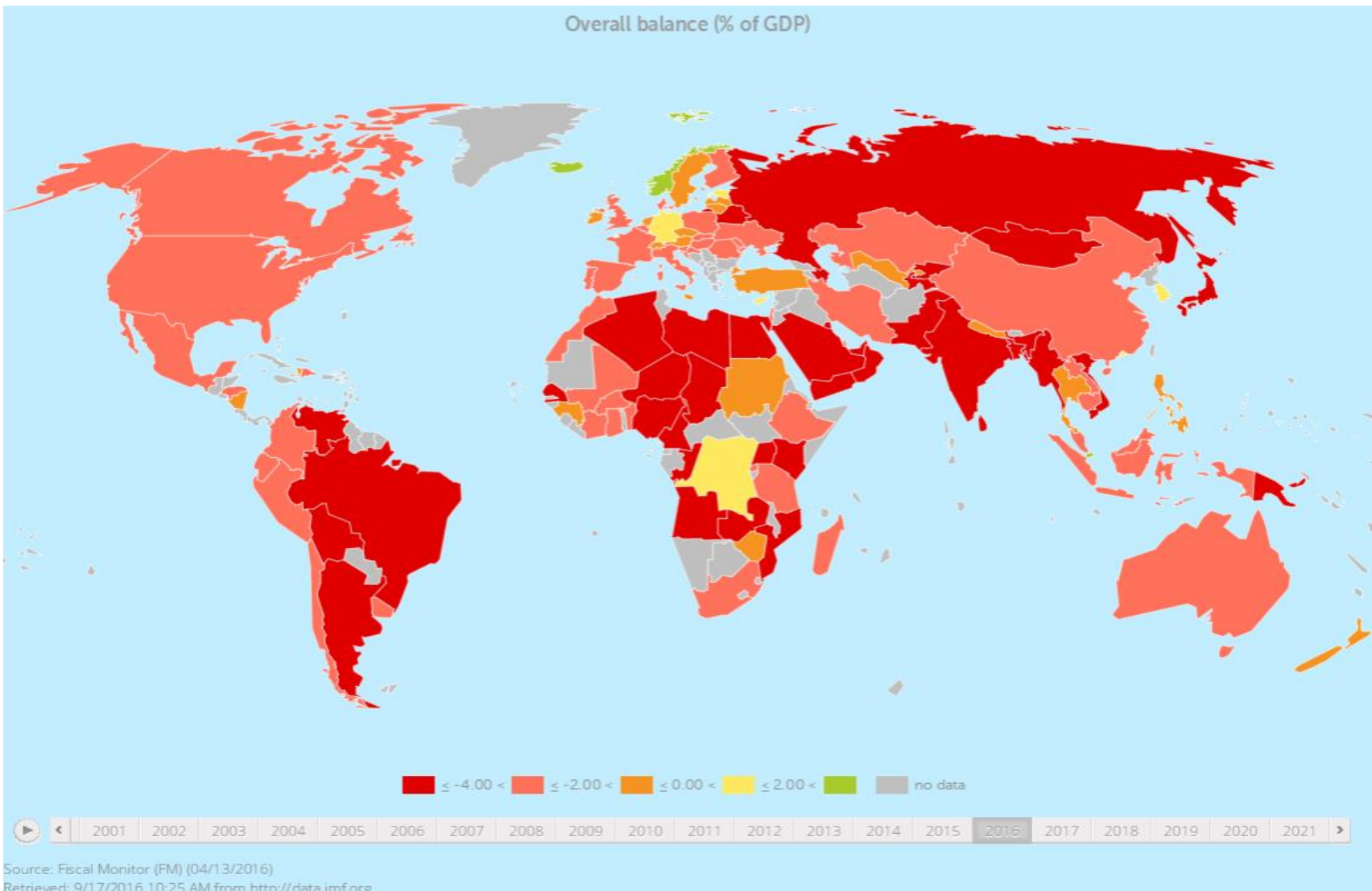
Fiscal stance 2007 (pre-crisis)



Fiscal stance 2009 (in crisis)

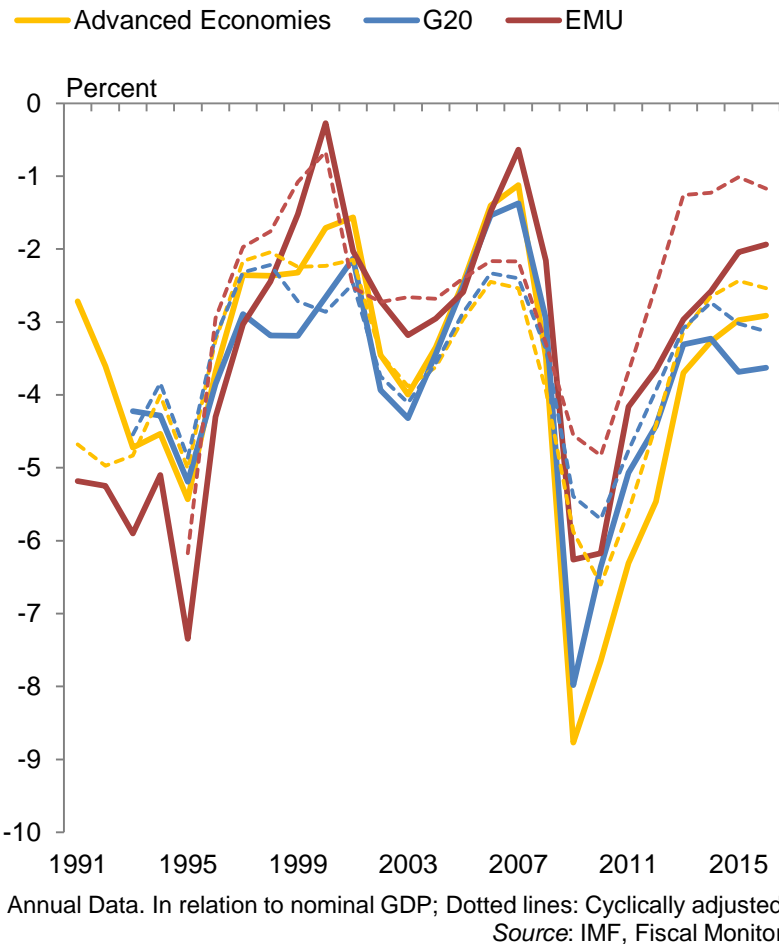


Fiscal stance 2016 (post-crisis?)

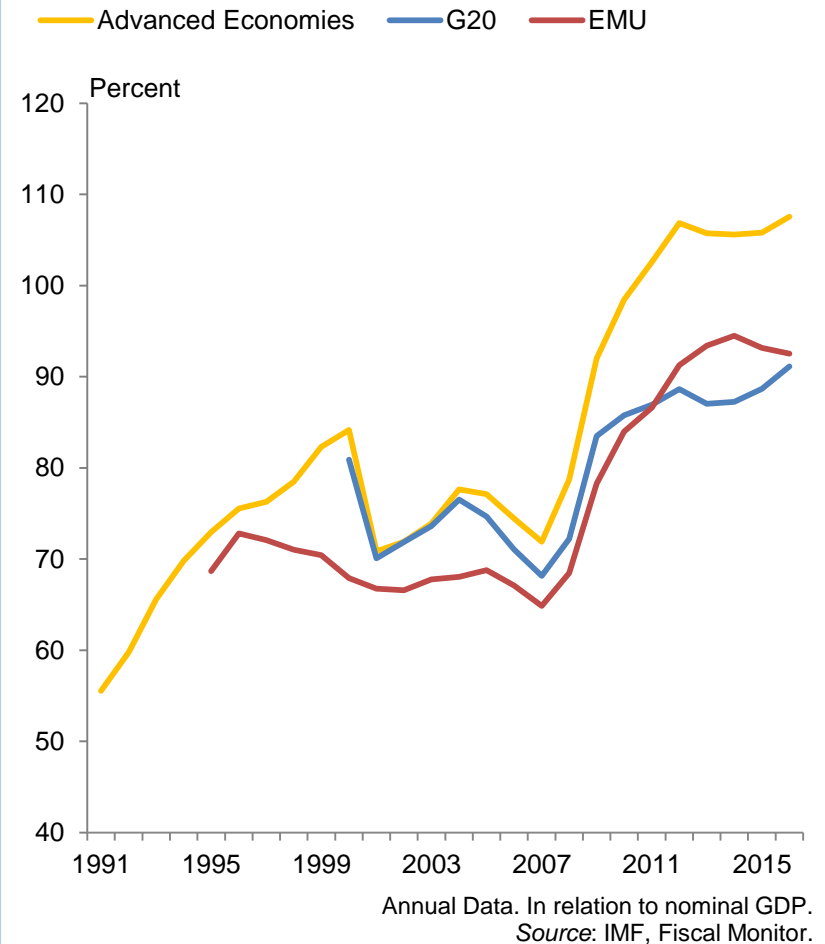


Fiscal stance and public debt

Net Public Lending



Gross Government Debt

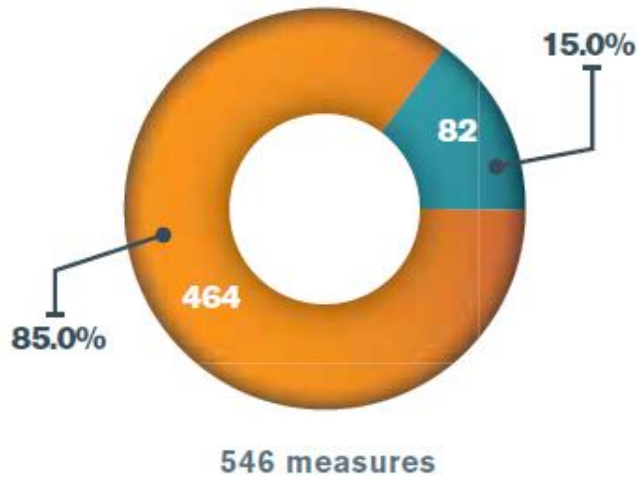


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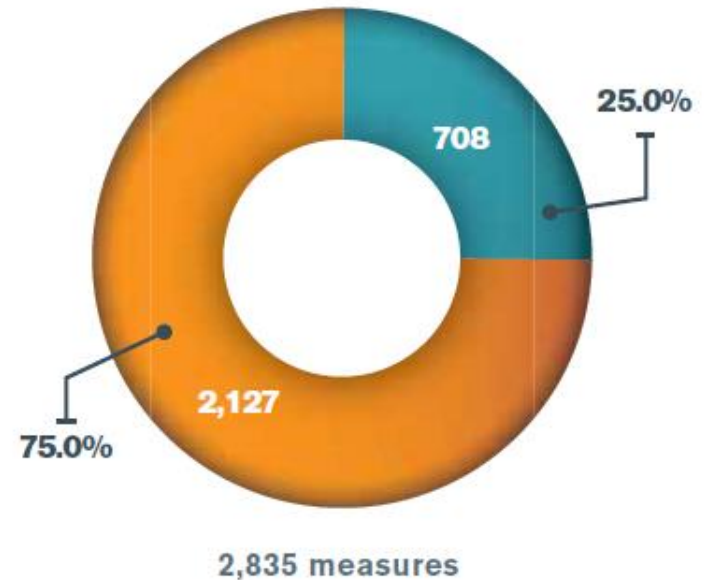
Neo-protectionism via non-tariff barriers to trade

Stockpile of trade-restrictive measures initiated since October 2008

By mid-October 2010



By mid-May 2016

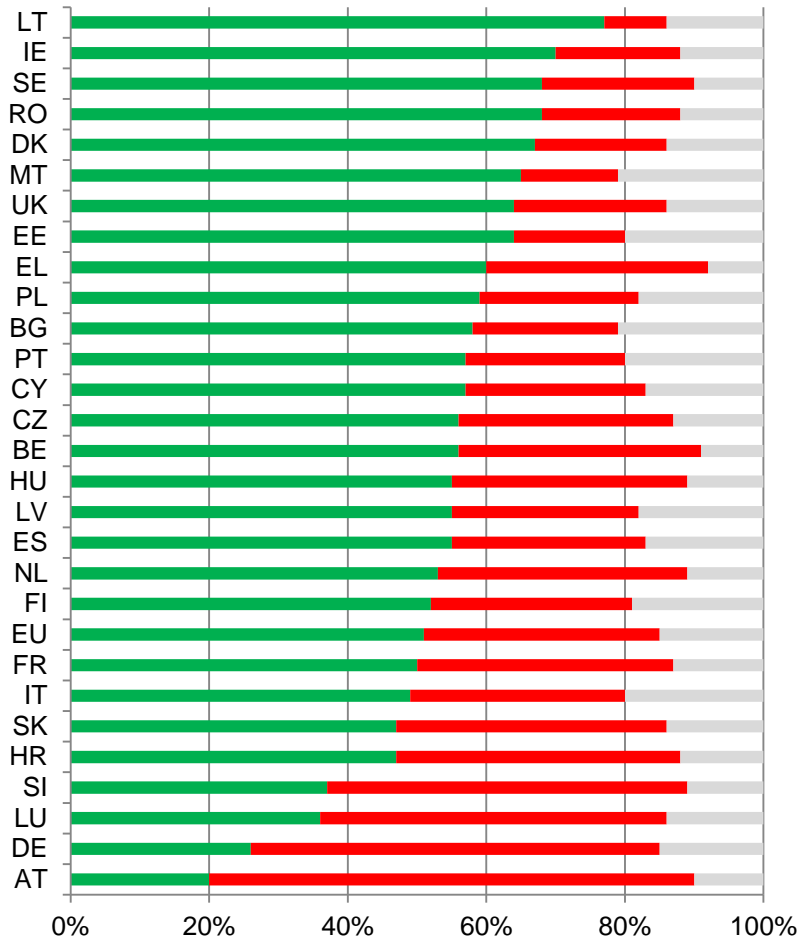


● Effectively eliminated measures ● Stockpile of restrictive measures

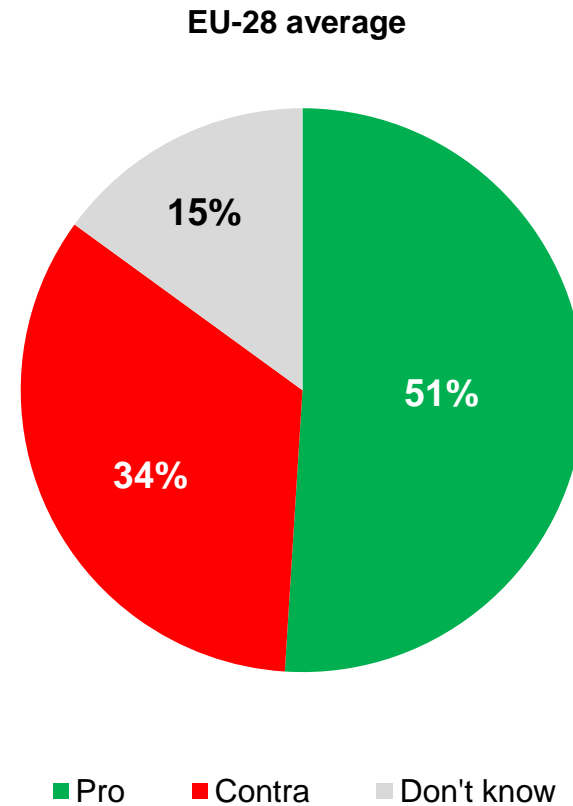
Note: The stockpile of trade-restrictive measures also includes trade remedy actions.

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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