

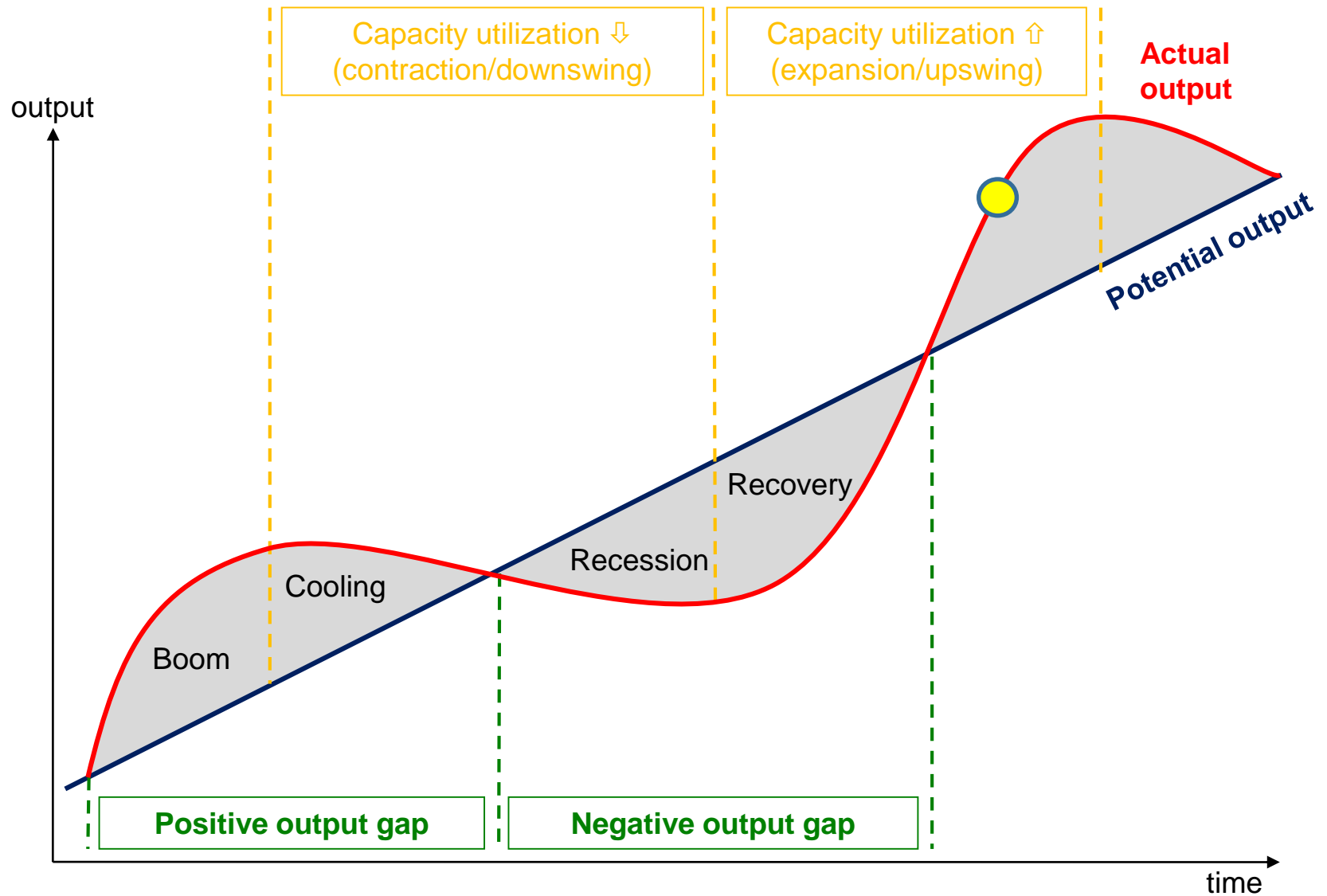
Institute of International and European Affairs (IIEA) | Dublin, 27th March 2018

The German Economic Boom: Sowing the seeds of crisis?

Stefan Kooths
Forecasting Center

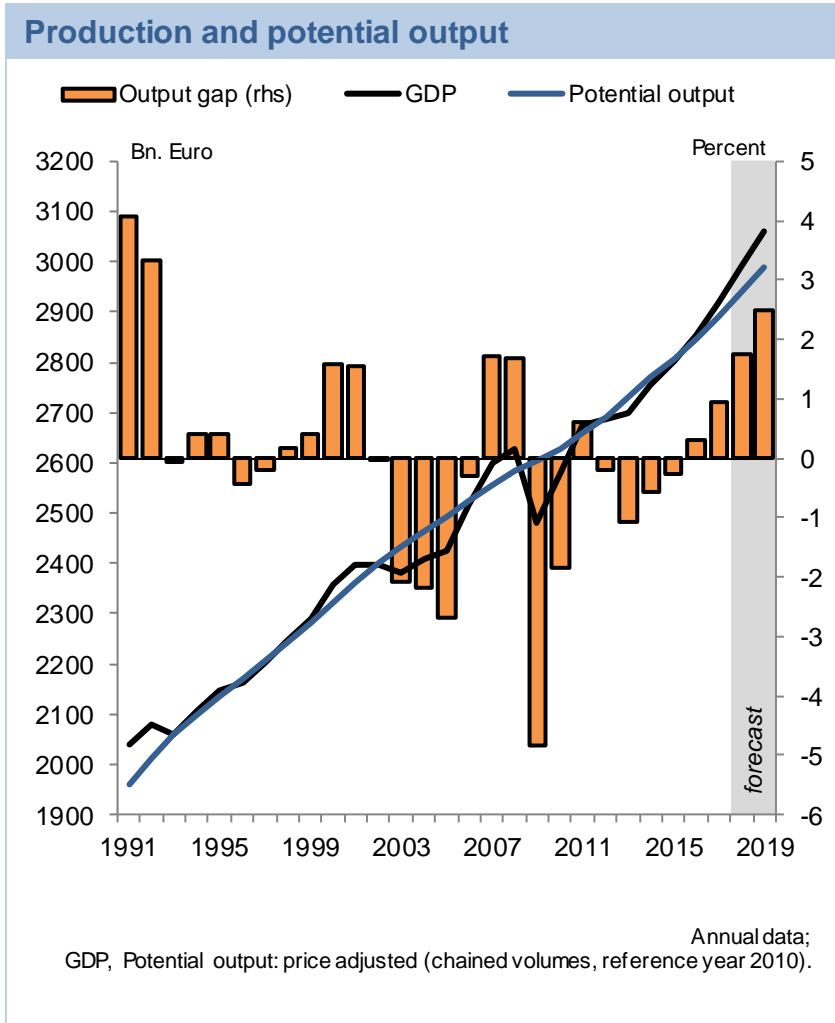


The stylized picture



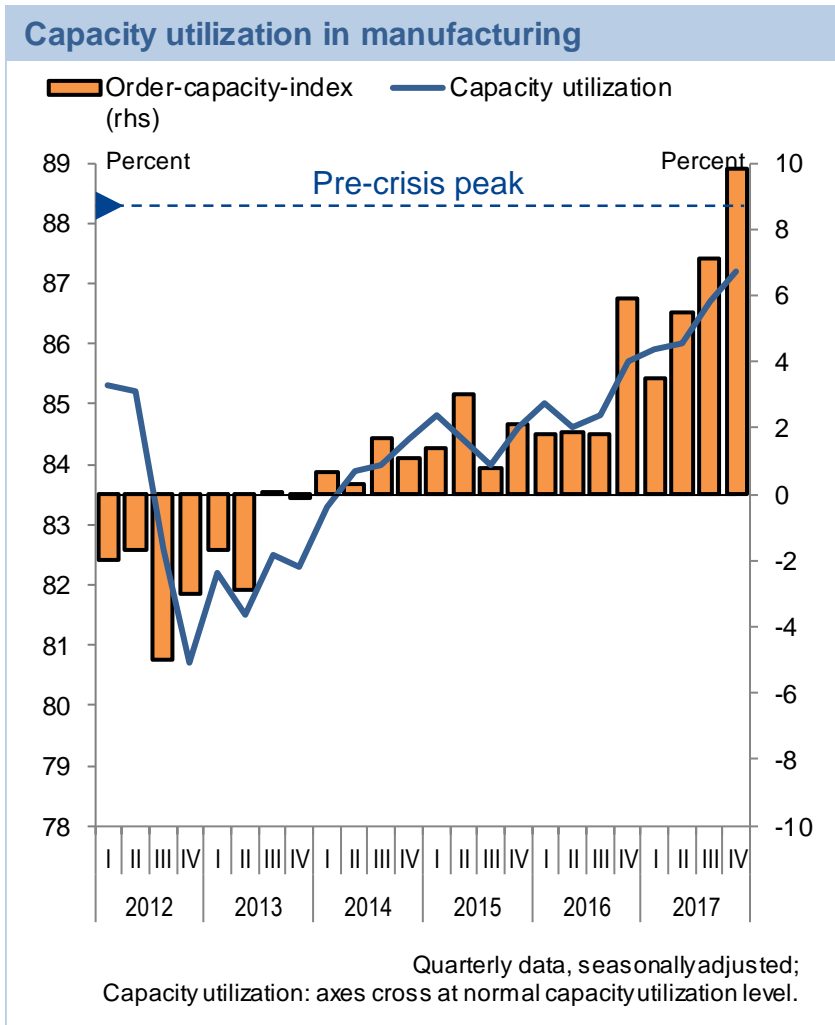
Diagnosis and forecast

Drifting towards overheating



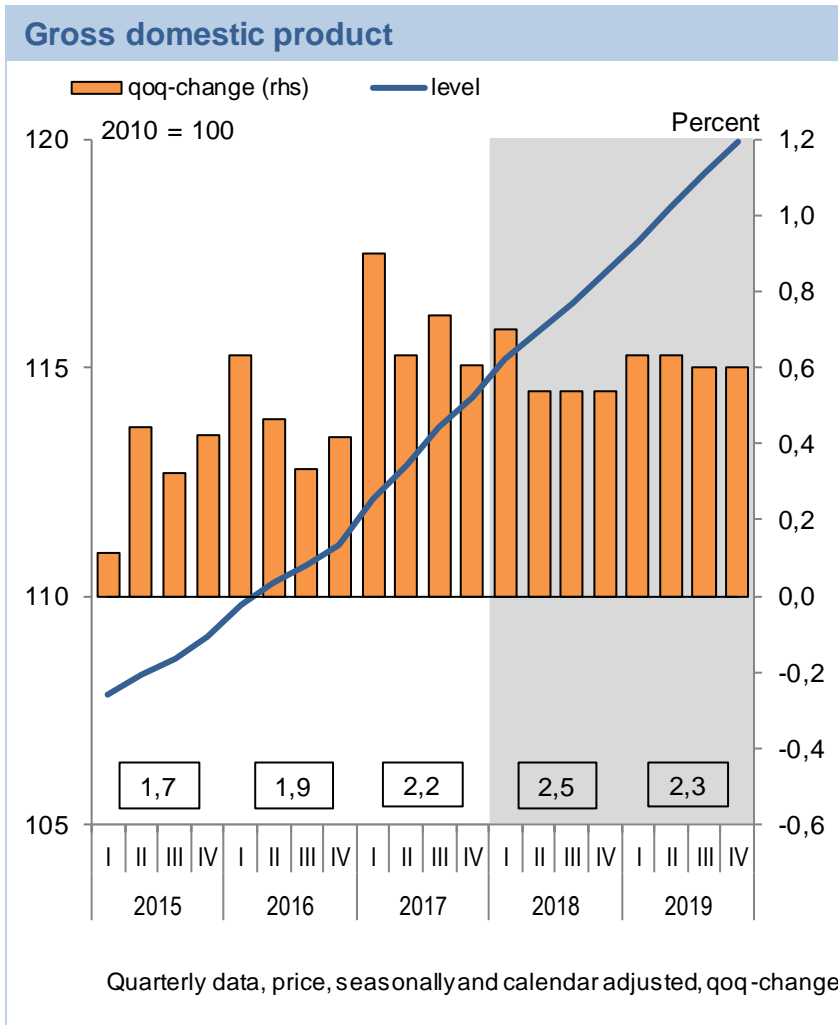
- Stretched upswing (5+ years) continues
- Weak cyclical pattern (“chewing gum cycle”)
- Immigration supports labor force and potential growth (refugees: large time lag)
 - » 2016: + 511.000
 - » 2017: + 500.000
 - » 2018: + 400.000
 - » 2019: + 300.000
- Capacity utilization in most industries clearly above normal levels

Upward capacity utilization trend



- Manufacturing
 - » 5-years upward trend, above normal since three years ...
 - » ... order inflow strongly exceeds capacities
- Construction
 - » Historically high levels, operating at capacity limits
- Services
 - » Lack of demand (ifo) at lowest level since 2005
- Elastic labor market

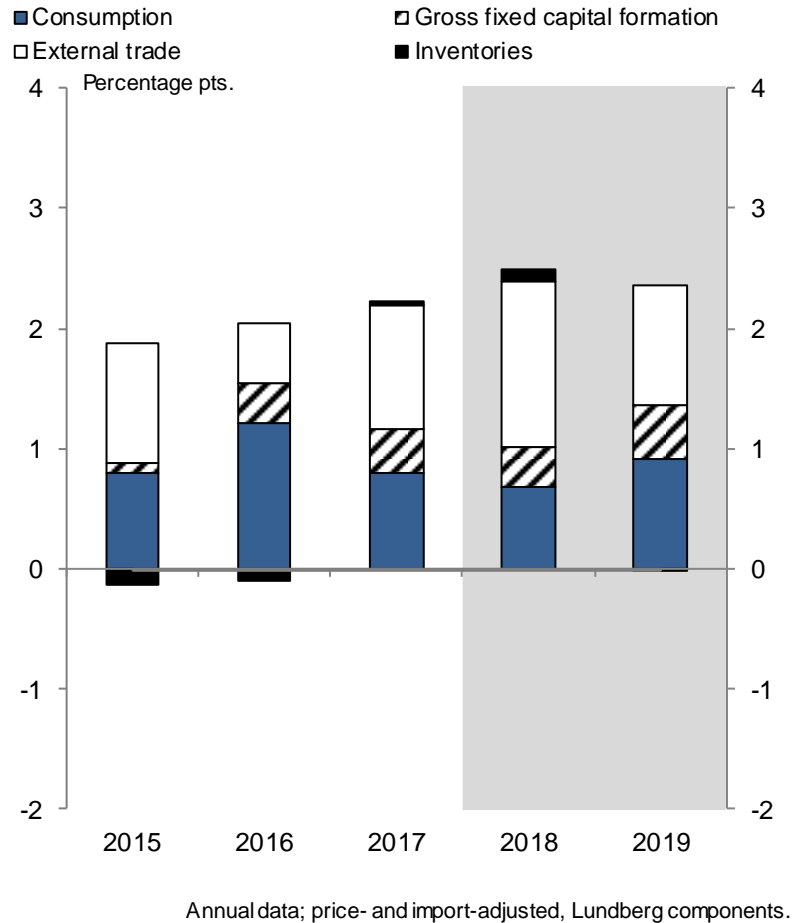
2018 starts with strong momentum



- Shiny business climate (ifo)
 - » Situation still near all-time high (June 2017)
 - » Expectations above average, but declining 4 months in a row
- Order inflow
 - » Accelerating in 2017, some correction in January
 - » Beyond pre-crisis peak
- Industrial production
 - » Upward trending
 - » Strong acceleration in 2017
- 2017: Dampening working-day effect (0.3 ppt)

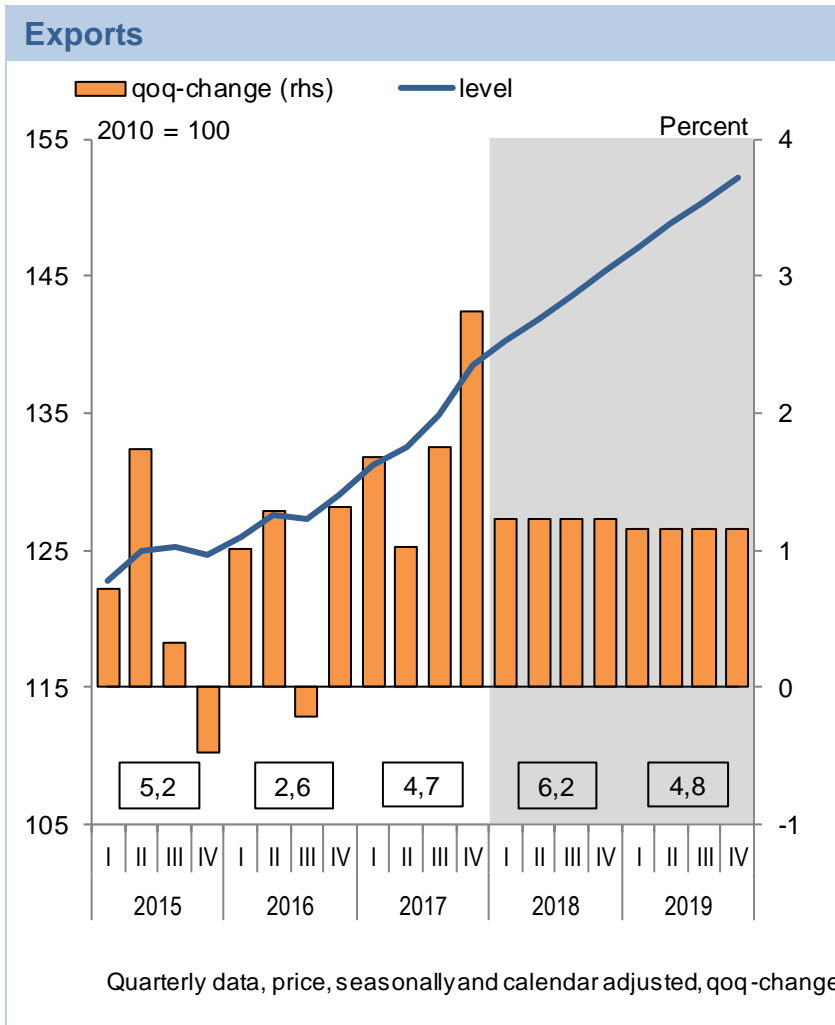
Broad-based expansion

Expenditure-side components to GDP-growth



- Foreign trade NOT neutral
 - » Favorable external environment
 - » Induced imports
- Investment activity
 - » Financing conditions
 - » Increase in capacity
 - » Dwellings
- Consumption only slightly weaker
 - » Private: Fading out oil-price effect
 - » Public: Fading impulse from refugee costs

Exports back on track



- Stronger order inflow
- Foreign markets
 - » Less uncertainty
 - » Brighter business climate
- Export markets
 - » 2017: + 3.0 %
 - » 2018: + 2.9 %
 - » 2019: + 2.5 %
- Risks
 - » EU environment (Brexit, Italy)
 - » Protectionist spirals

Transatlantic economic ties: Beyond the trade-centered debate

Fig. 1: Transatlantic trade links

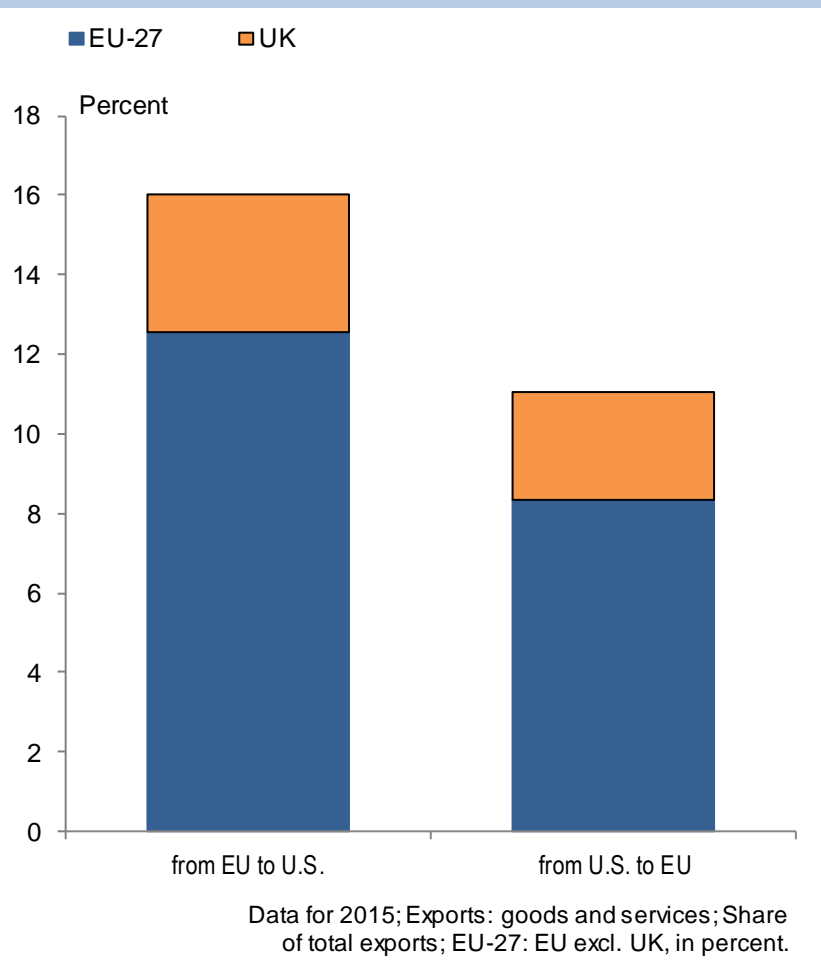
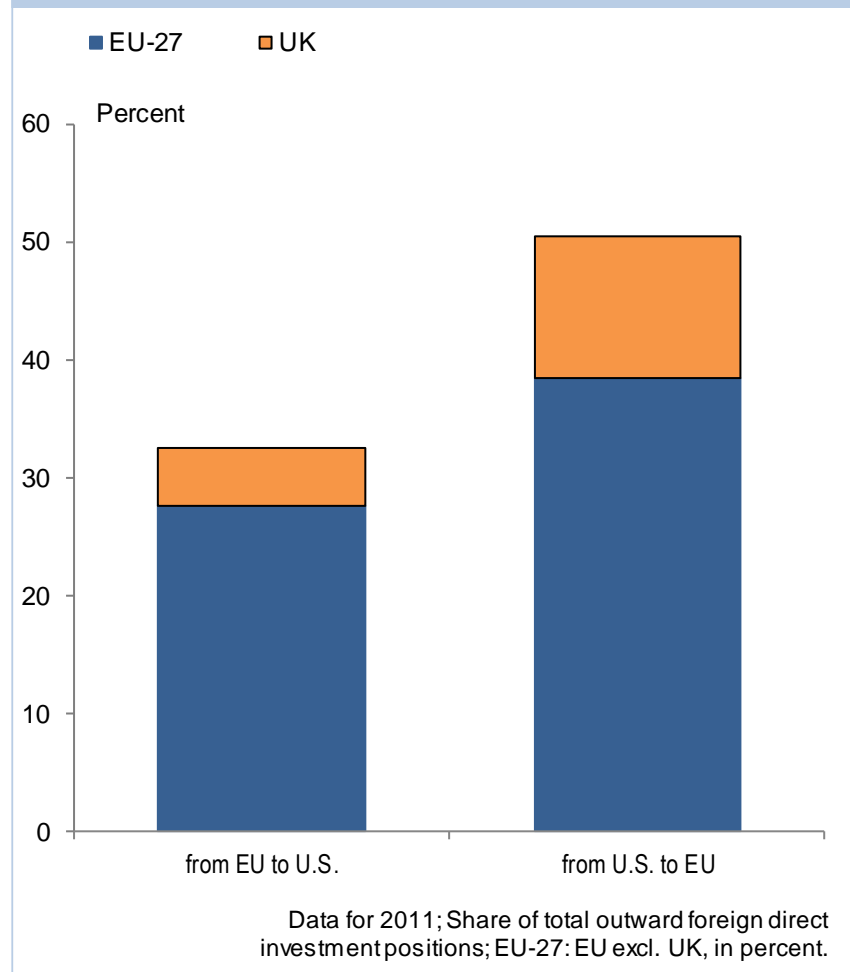


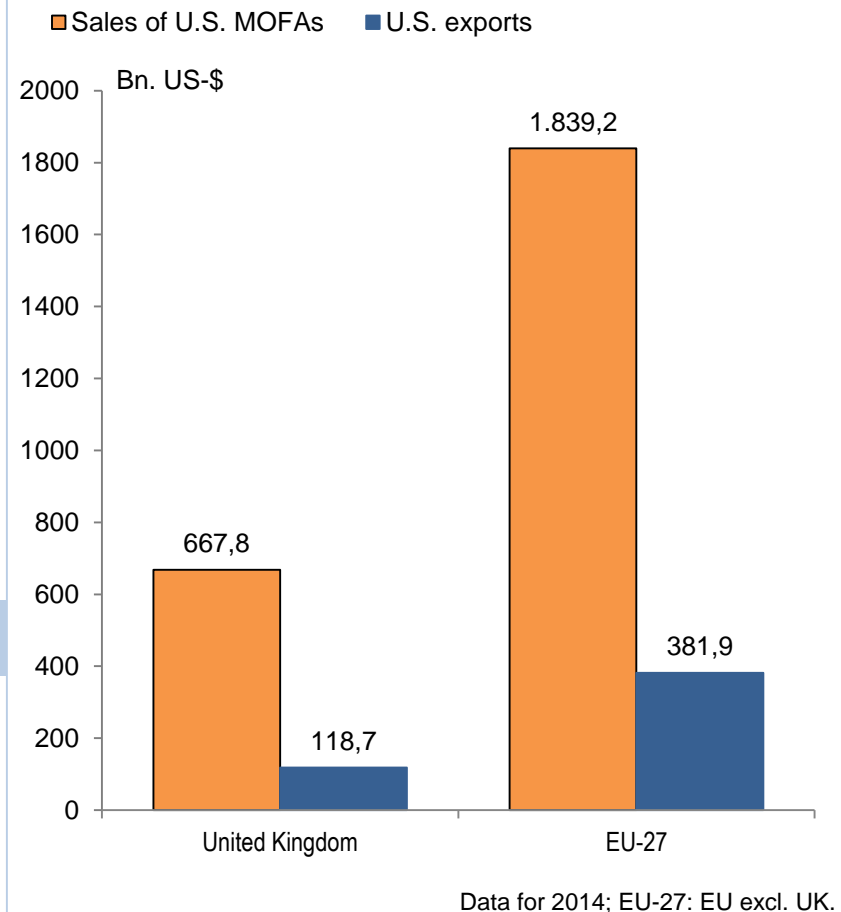
Fig. 2: Transatlantic direct investment positions



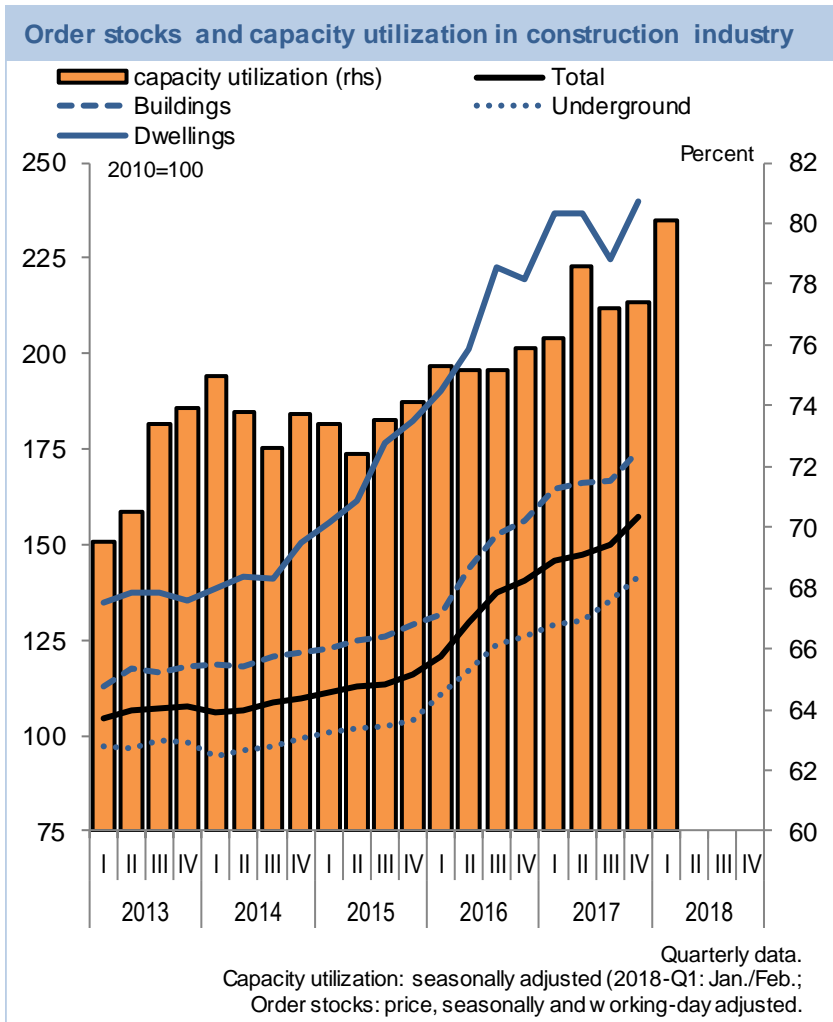
Transatlantic economic ties: FDI as (some) protection against protectionism

- Bilateral trade balance
 - » EU-surplus: 115 bn. Euro
 - » Germany: 49 bn. Euro
- Export shares
 - » From EU to U.S.: 16 percent
 - » From U.S. to EU: 11 percent
- FDI positions
 - » From EU to U.S.: 32 percent
 - » **From U.S. to EU: 50 percent**

Fig. 3: Importance of the EU Market for the U.S.

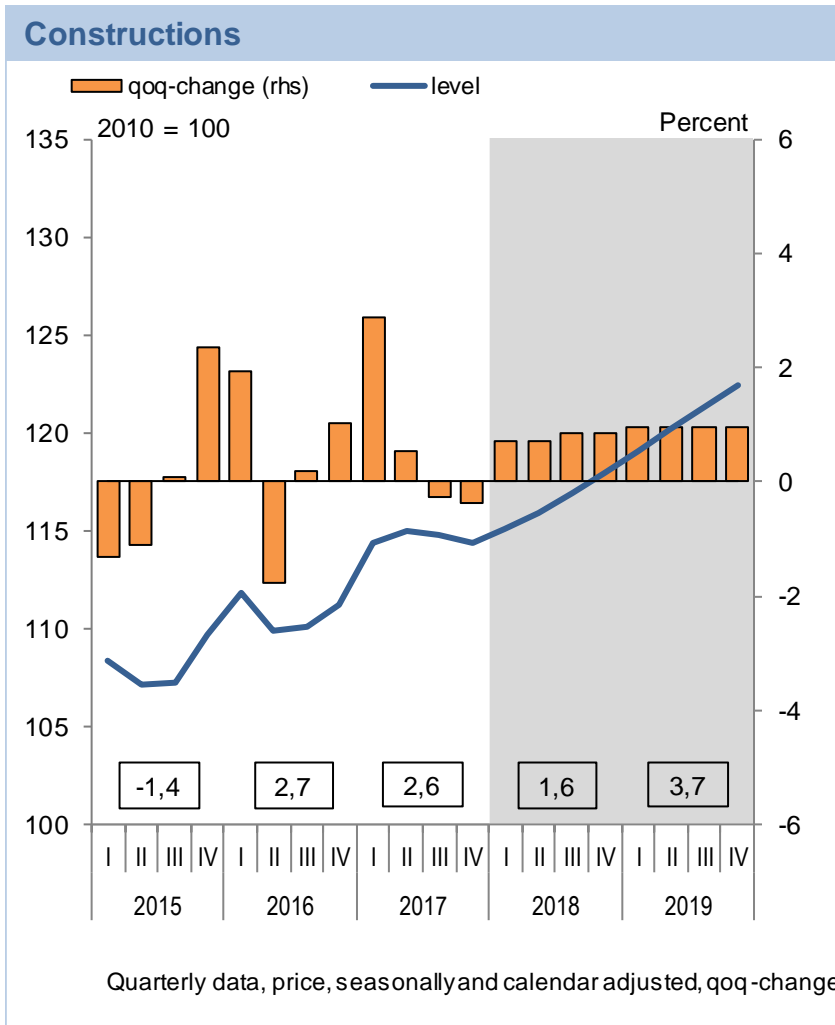


Construction activity is booming



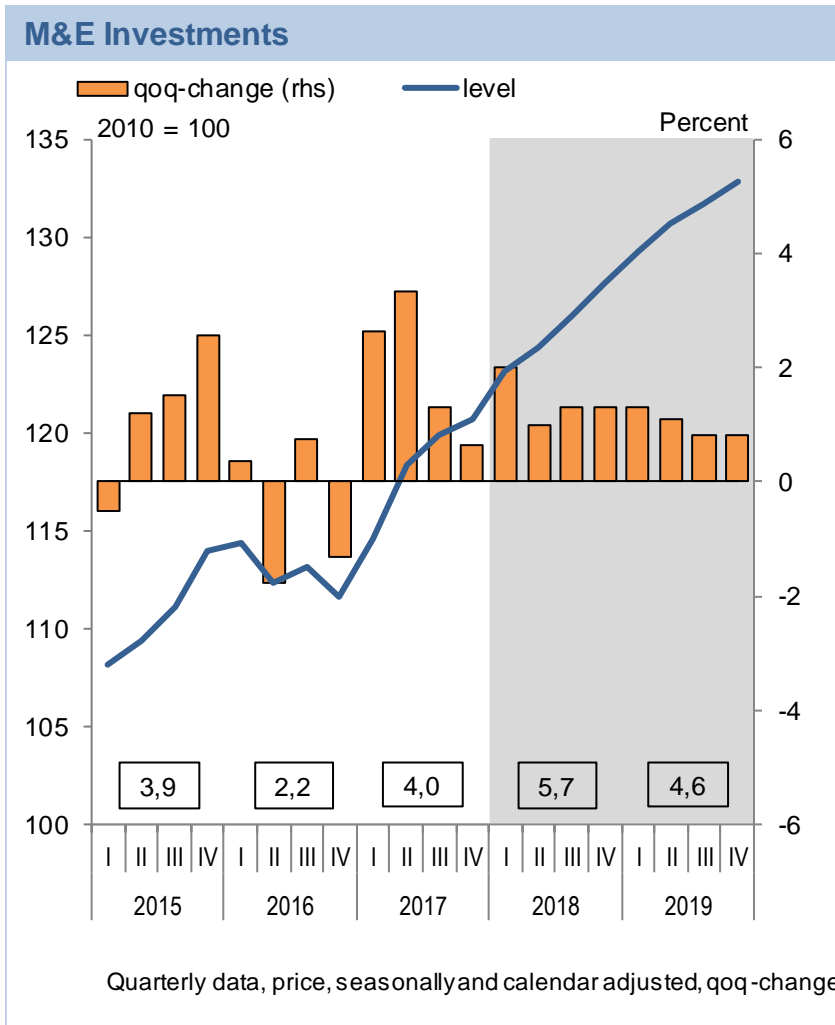
- Capacity utilization
 - » Record high level
 - » Long-term average: 66 percent
- Order books piling up
 - » Two-digit growth rates two years in a row (now broad based)
 - » Approaching post-unification peak of mid-1990s
- Price pressure
 - » Value added: Strong upward pressure since 2012
 - » Stock transactions (vdp)
 - 2015: + 5.0 %
 - 2016: + 6.4 %
 - 2017: + 6.8 %

Strong further increase in constructions



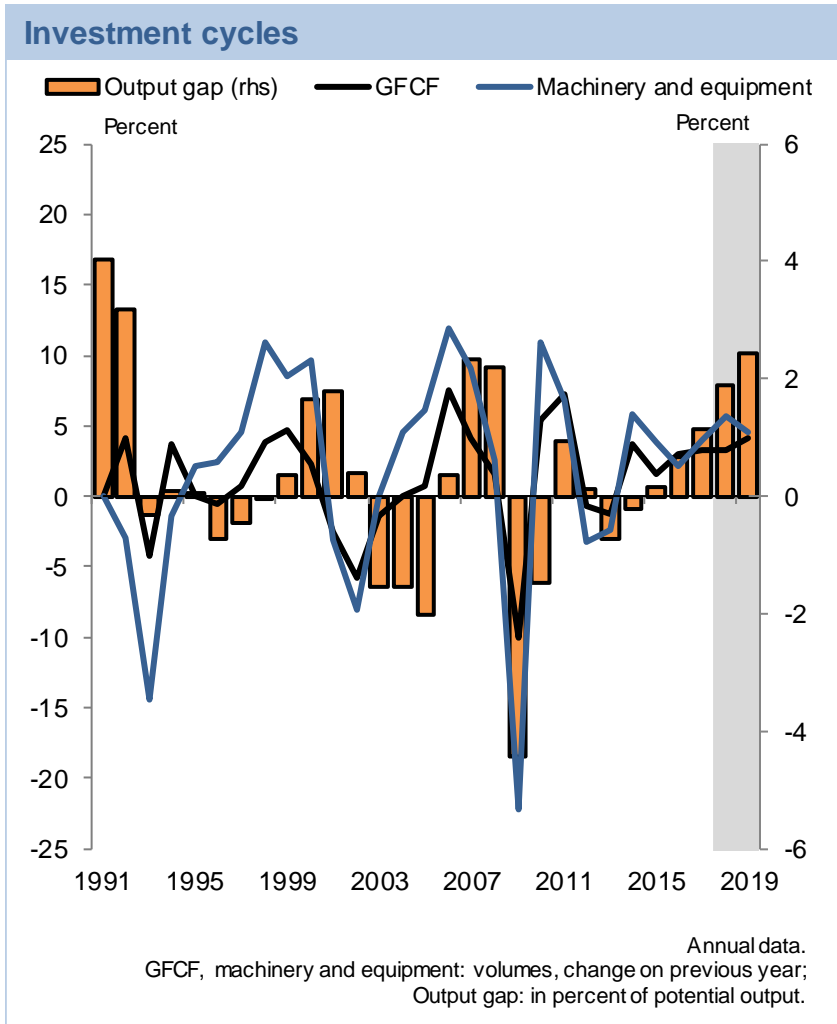
- Dwellings as key driver
 - » Extremely low financing cost
 - » Dynamic labor market
- Pro-cyclical public investment spending
- Capacity limits as forecasting risk

Comeback of M&E investment spending ...



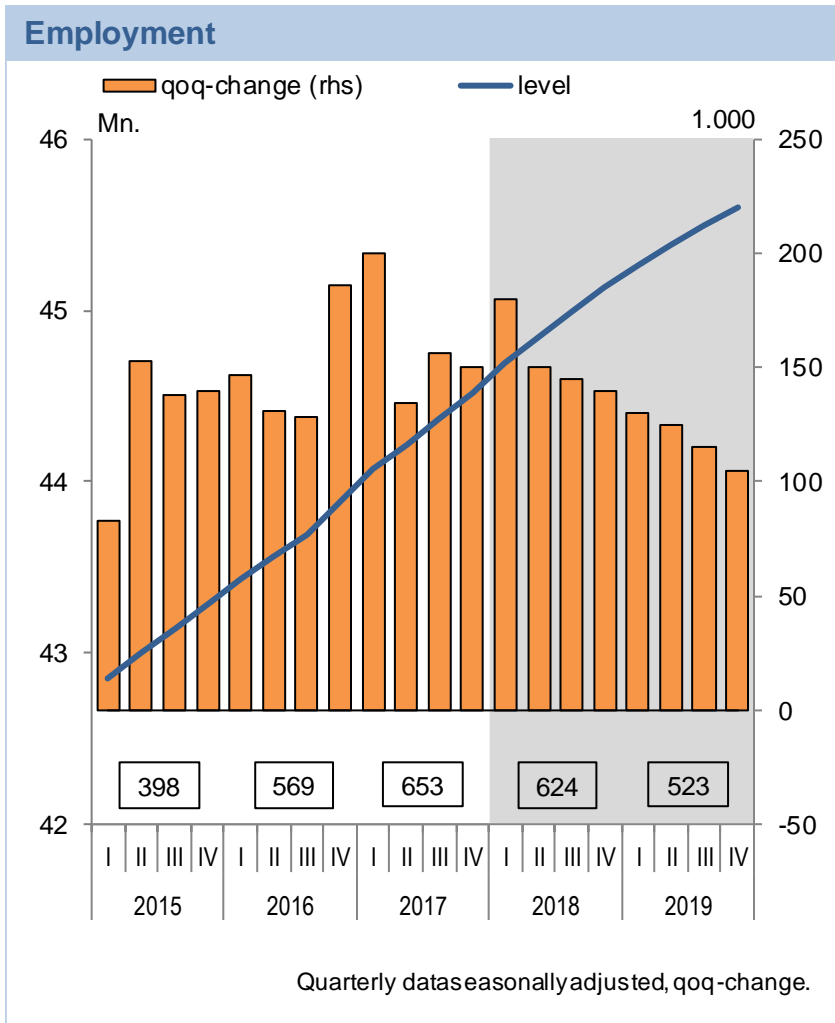
- Already above pre-crisis level
- Favorable global environment
- Near record high business climate in M&E industries
- High and increasing capacity utilization
- Extremely low financing cost

... but less pronounced cyclical pattern



- Lack of skilled labor
- Demographic outlook
- Higher plasticity (software replaces hardware)

Labor market increasingly tighter



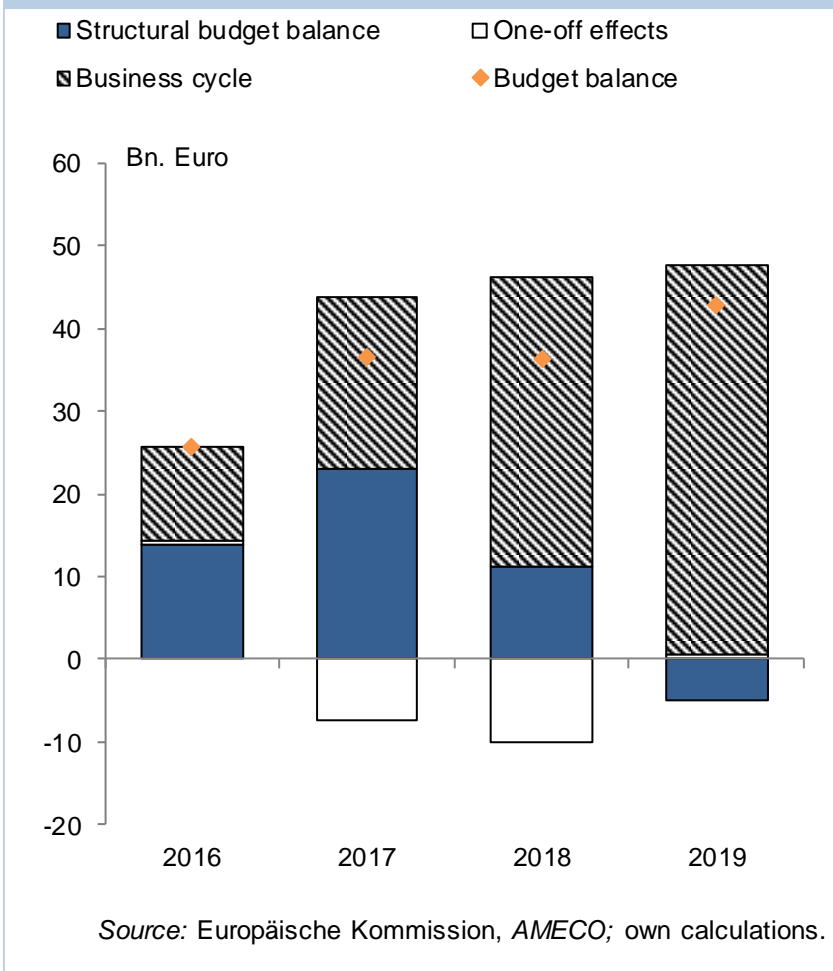
- Employment
 - » 2017: + 652,000
 - » 2018: + 624,000
 - » 2019: + 522,000

- Effective wages (hourly)
 - » 2017: + 2.7 %
 - » 2018: + 3.3 %
 - » 2019: + 3.5 %

- Unemployment rate

» 2017: 5.7 %	[3.6 %]
» 2018: 5.2 %	[3.3 %]
» 2019: 4.8 %	[3.0 %]
BA	ILO

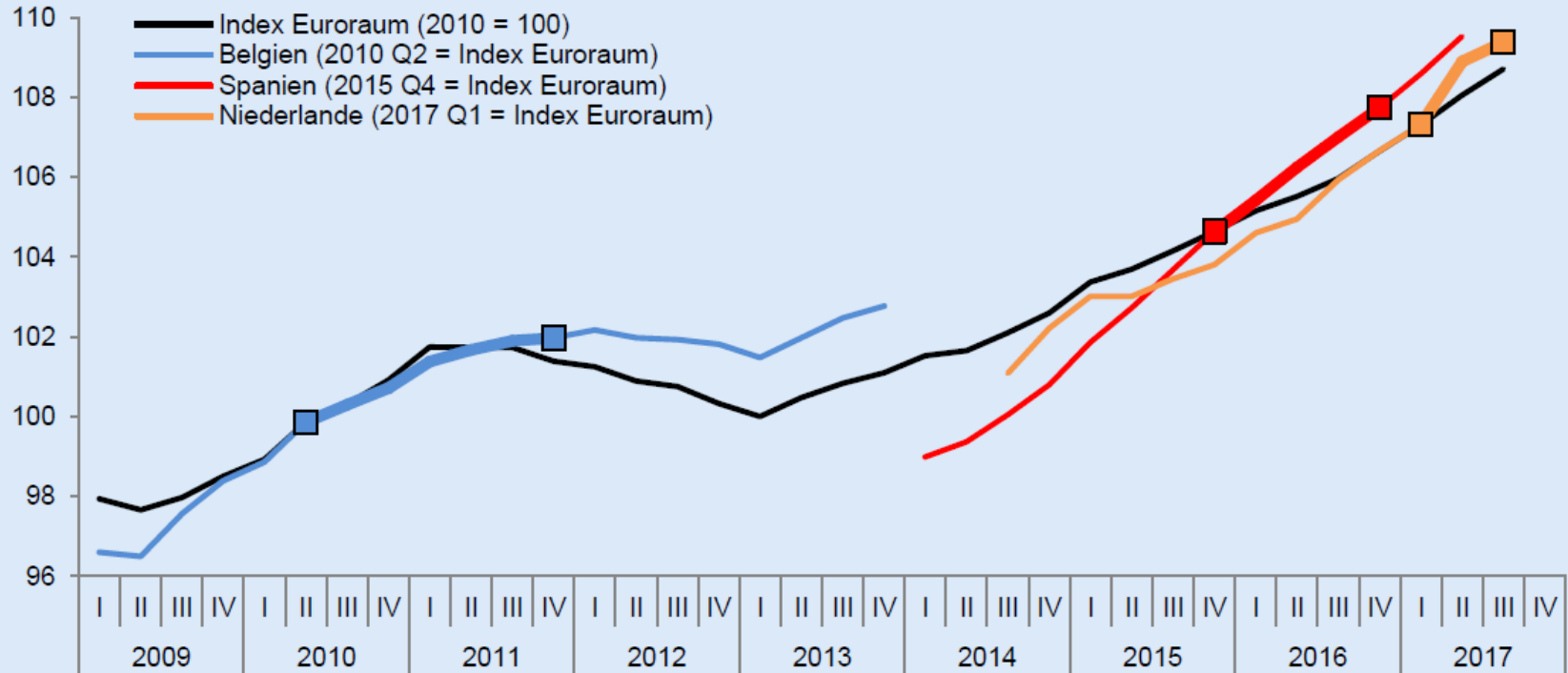
Structural budget balance



- Structural budget balance shrinks pro-cyclically
- „Black zero” leaves federal government with room for maneuver
- New government
 - » No significant impact in 2018
 - » Fiscal package is end-loaded (2021)
- Debt-to-GDP below 60 % in 2019

GDP: Don't be afraid of interim governments

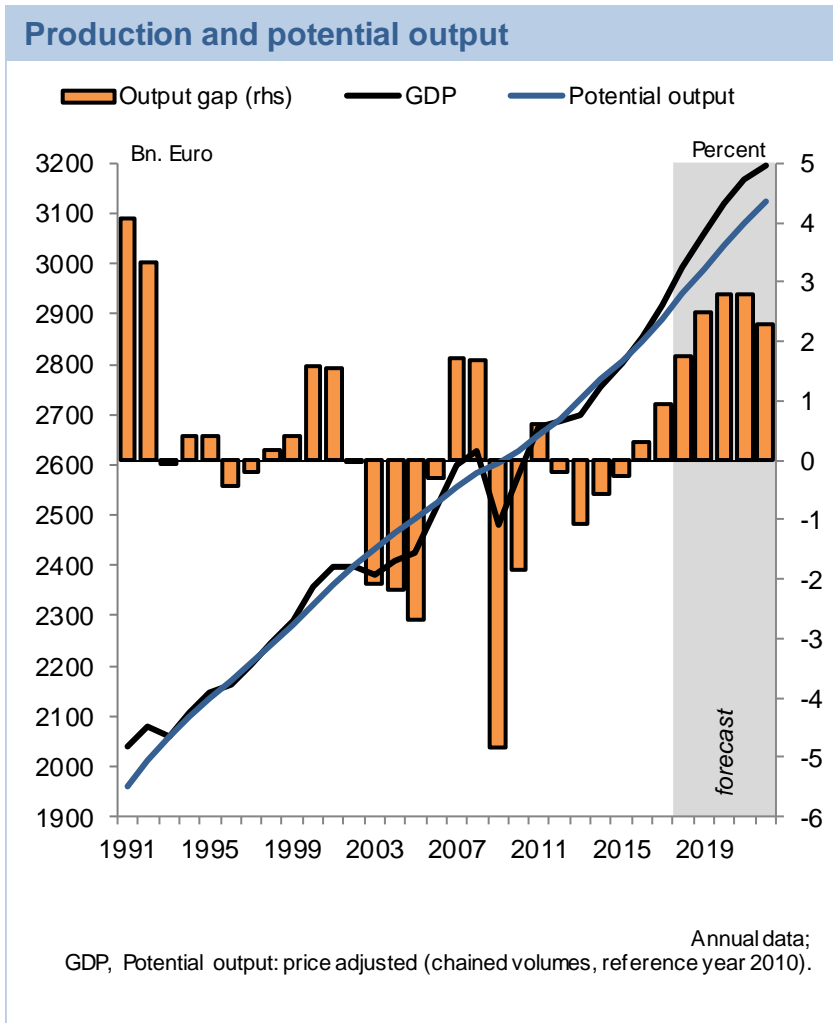
Entwicklung des Bruttoinlandsprodukts in Phasen verzögerter Regierungsbildung 2009–2017



Quartalsdaten, preis-, kalender- und saisonbereinigt.

Quelle: Eurostat, Volkswirtschaftliche Gesamtrechnungen; eigene Berechnungen.

Medium-term: Leaving the boom behind



- Temporary potential growth push (demographics) contrast to medium-term outlook
 - Immigration/increasing labor market participation
 - » Still compensating aging ...
 - » ... but fading out in the medium-term
- ⇒ **New decade: Cyclical cooling meets weaker potential growth**

Risk and policy assessment

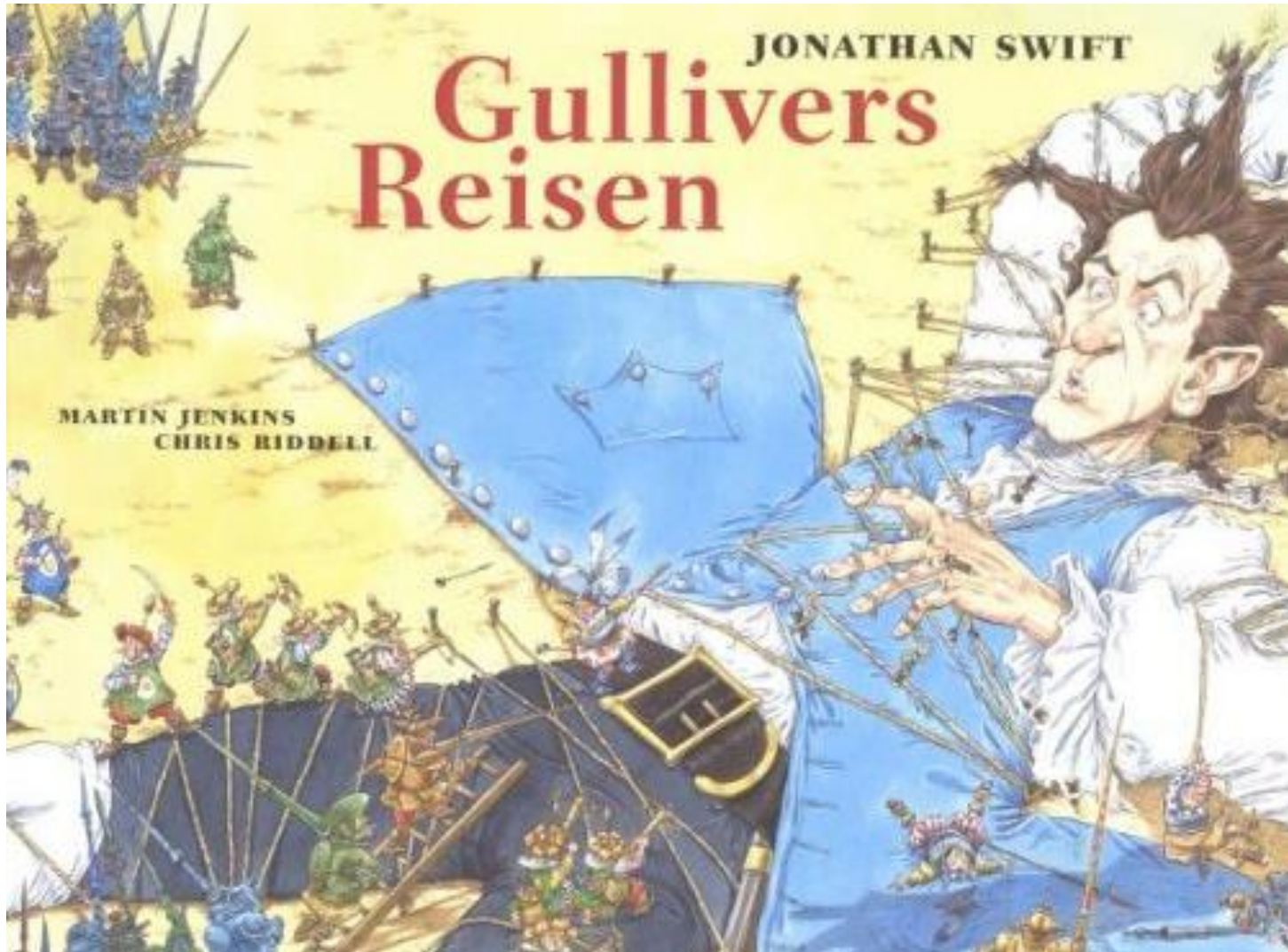
“Booms don’t die of old age,
they are murdered by policy makers.”

Really?

- Endogenous distortions
 - » Unsustainable business models
 - » Durable goods cycles
 - » Easygoing policy making
- Ultra-expansionary monetary policy
 - » Distortion of relative prices \Rightarrow production structures
 - Capital stock
 - Exchange rate
 - » Financial stability
 - Inadequate risk premia (“insolvency slack”, hampered structural change)
 - Overstretched maturity transformation
- Overestimating potential output
 - » Data edge problem
 - » Demographic interim high, future of refugees

- Pro-cyclical fiscal stance feeds into overheating
- Expanding the welfare state
 - » Ignoring demographics
 - » Aggravating inter-generational conflicts
- Redistribution debate
 - » Higher minimum levels ...
 - » ... instead of interlocking social security and market mechanisms
- Gulliver syndrome
 - » Reduces flexibility
 - » Makes next downturn even more painful

Minimum wage, equal pay, rent brake, gender quota, full-time/part-time guarantees ...



Feedback welcome!

Prof. Dr. Stefan Kooths
Head of Forecasting Center

T (Kiel) +49 431 8814-579

T (Berlin) +49 30 2067-9664

stefan.kooths@ifw-kiel.de

  @kielinstitute

www.ifw-kiel.de

