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## Article

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# Despite uncertainty in the global economy, Germany is on a solid growth path

**By Ferdinand Fichtner, Marcel Fratzscher, Guido Baldi, Karl Brenke, Marius Clemens, Christian Dreger, Hella Engerer, Stefan Gebauer, Michael Hachula, Simon Junker, Robert Lange, Claus Michelsen, Malte Rieth, Thore Schlaak und Kristina van Deuverden**

The current global economic environment presents numerous risks – but the German economy remains robust, with expected growth rates of 1.4 percent for 2017 and 1.7 percent for 2018.

The 2017 growth rate projected here is higher than what was originally published in DIW Berlin's December 2016 forecast. The main reason behind this upward adjustment is that the Federal Employment Agency has massively revised its labor market data in early March. According to the new calculations, employment growth has not been stagnating since mid-2016, as previously believed: rather, it has continued to expand – and this growth is expected by DIW Berlin to continue. This year will likely see the addition of 600,000 jobs, and this momentum will slow down only slightly in 2018, when 440,000 more jobs will be added. The number of unemployed persons will drop by 170,000 this year and 150,000 next year – even though more and more refugees are obtaining work permits and joining the labor pool.

Although private consumption remains the GDP's primary growth driver, impulses are relatively weak despite the considerable increase in employment. The current tempo, which will remain subdued for at least the first half of 2017, can be traced to the fact that the growth momentum of income and wages, in real terms – that is, taking into account price developments – has slowed down significantly. Inflation experiences a considerable increase this year, with an overall annual average of 1.8 percent. In comparison, consumer prices rose by only 0.5 percent in 2016. This difference is primarily due to the significant increases in crude oil prices that took place in the final months of 2016 – which in turn resulted from the supply cuts in oil-exporting countries –, not from a powerful economic upturn nor an overheating of the German economy.

Collective bargaining agreements currently in place imply comparatively low nominal wage increases for 2017 – and those will be compromised by the higher inflation rates. Consumer demand – and thus imports, which are already weak – should thus begin to lose some momentum this year. Apart from the rise in inflation, there are other key factors that could have encouraged higher wage increases, such as the favorable economic situation and the low unemployment rates. Nevertheless, wage increases are expected to be only slightly higher in the coming year.

But since inflation is unlikely to remain at the 2017 level, private consumption should pick up again in the further course of the forecast period. The core inflation rate – that is, the price development excluding food and energy – is still well below two percent. If there are no further oil price increases, energy prices' current impact on the inflation rate will gradually subside.

The development in the euro area is similar: the higher inflation rates here are also temporary. In addition, since euro area production capacities are expected to remain underutilized into 2018, claims against the European Central Bank to scale back or even end its expansionary monetary policy are premature. Given the euro area's overall robust economic performance, however, there is currently also no sign that monetary policy should become more expansionary – for example through an expansion of the current bond purchase programs.

Although production is expected to increase during the forecast period, the European economy remains vulnerable to risks: if the outcome of the upcoming elections in the Netherlands and France leads to friction in the fragile financial markets, it could weaken the economy once again. The Brexit negotiations, which have already led to uncer-

tainty in the private sector, could be end up being more arduous and complicated than assumed. In addition, the U.S. government's unpredictable approach to economic policy could have a negative impact on world trade, and thus export-oriented countries such as Germany.

The effects of this uncertainty can already be seen in Germany's persistently weak business investment, which stands in stark contrast to the generally robust economic development and employment growth. Given the growing shortage on the labor market and the fact that it will become more and more difficult to fill certain job positions, it appears that companies are currently avoiding layoffs and even creating new jobs; these kinds of strategic deliberations are likely to play a minor role in investment expenditure. In addition, because the employment growth has been highest in sectors where investment plays less of a role – that is, company service providers and public services as well as the health, education, and retail sectors – it has not been accompanied by any major investment activity. Employment growth in the industrial sector, where investment plays a more critical role, has been comparatively low.

The current account surplus remains excessively high, and is expected to amount to 8.0 percent of GDP in 2017; this could feed into the emerging trade conflict with the U.S. government as well as criticism of the European Commission. The problem is not the high exports, however; rather, it is the relatively low imports which are also the result of the weak investment dynamics in Germany. This hurts the local economy by inhibiting productivity and dampening income. It is thus all the more important that policy exploits the (limited) fiscal leeway to encourage higher public expenditure in the form of investment, especially when it comes to education and infrastructure. Sustainable growth potential could also be achieved by reducing the tax burden – namely, through a reasonable increase in federal subsidies to the social security funds – thus facilitating a higher net income.

This kind of focus would help to ensure long-term growth and prosperity. If investment increases in Germany, and the country is able to strengthen its growth forces, it would benefit not only the domestic economy, but the neighboring countries as well.



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