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The German Economy: Employment Boom in Germany, but no Overheating of the Economy

Employment in Germany continues to increase healthily, and private consumption expands due to rising real incomes. Investment in equipment, however, remains modest. Overall, economic demand is expanding at roughly the growth rate of potential Gross Domestic Product (GDP), and the output gap is nearly closed. "In 2017, GDP will increase by 1.3% and thus at a lower rate than in the previous year, but this is only due to fewer working days and not to sliding demand," says Oliver Holtemoeller, Head of the Department Macroeconomics and IWH vice president.

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Forecast for Germany: Key Economic Indicators^a

	2016	2017	2018
percentage change over previous year (price adjusted)			
private consumption	2,0	1,5	1,5
public consumption	4,0	2,4	1,4
gross fixed capital formation	2,3	1,7	3,2
machinery and equipment	1,1	0,9	3,8
construction	3,0	1,9	3,0
other	2,6	2,3	2,6
inventory accumulation ^b	-0,2	0,1	0,0
domestic demand	2,3	1,8	1,9
foreign balance ^b	-0,2	-0,4	-0,1
exports	2,6	4,8	4,6
imports	3,7	6,8	5,7
Gross Domestic Product (GDP)	1,9	1,3	1,6
GDP (calendar adjusted)	1,8	1,6	1,6
world production	1,2	3,6	3,3
United States	1,6	2,3	2,4
euro area	1,7	1,7	1,6
percentage change over previous year			
hours worked	0,7	1,0	0,6
hourly union wages	2,1	2,1	2,2
hourly actual wages	2,7	3,0	2,9
unit labour costs ^c	1,4	2,7	1,8
consumer price index	0,5	1,8	1,7
1 000 persons			
employment (domestic)	43 475	44 095	44 414
unemployment ^d	2 691	2 630	2 714
in %			
unemployment rate ^e	5,8	5,6	5,8
unemployment rate BA ^f	6,1	5,9	6,0
in % of nominal GDP			
general government overall balance	0,8	0,5	0,2
current account balance	8,3	7,7	7,6

^a For the effects of the revision of the number of employed in 2016 on the forecast see box 3 (German version).
– ^b Contribution to GDP growth in % (Lundberg component). – ^c Per hour (IWH calculations). – ^d Federal Employment Agency (BA) concept. – ^e Unemployment in % of labour force (domestic). – ^f Unemployment in % of civilian labour force (Federal Employment Agency (BA) concept).

Source: Federal Statistical Office; Eurostat; Bureau of Economic Analysis; 2017 and 2018: forecast (as of March 15, 2017).

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The global economy

At the beginning of 2017, the global economy appears rather strong. Business sentiment has risen in many places, and both industrial production and world trade increased at the end of last year. In the U.S. as well as in the euro area, domestic demand further strengthened at the end of 2016.

The price of crude oil is currently (midmonth March) about 40% higher than it was in March 2016. This base effect is passed on to the rates of increase of consumer price indices all over the world. There is, however, hardly any sign of a strong increase in inflationary dynamics besides this effect, although inflation expectations in financial markets have been revised upwards somewhat in the past months. This also corresponds to a rather optimistic view dominating at financial markets regarding the effects of the future U.S. economic policy. All in all, economic policy currently bolsters the economies in many places. If no serious shocks hit the global economy, the robust expansion should continue over the course of the year. "This is quite remarkable, considering the extensive uncertainties surrounding economic policy. In particular, it is uncertain how much of the protectionist views of the new U.S administration will find their way into actual politics," Holtemoeller says.

The German economy

At the end of 2016, the German economy, mainly supported by domestic demand, expanded at about the same rate as potential GDP. The expansion is based on strong employment growth and real incomes per capita that have been rising for the last three years now. The contribution of exports to the expansion of GDP, however, was outdone by strongly growing imports.

At the beginning of 2017, the business outlook improved further in the private industry, although less favourable weather conditions probably dampened gross value added of the construction sector and its suppliers. In sum, overall production is expected to expand by 0.4% in the first quarter.

Domestic demand will continue to be the main source of expansion in the later periods of the forecast. Construction in particular will return to a strong growth path, since the volume of new orders is high, as costs of refinancing are still very low and local authorities have ample means to spend. Capacity utilisation is above average by now, and since the expansion will go on and refinancing costs stay low, investment of firms in both construction and equipment will increase a bit faster. Private household spending will continue at the current pace, although the rise in prices of energy and food has a dampening effect on private consumption, because the labour market is in an exceptionally strong state. Overall, domestic demand will remain strong, advancing at a rate of 1.9%. Exports will, in accordance with expected global demand, slightly decelerate over the course of the years 2017 and 2018.

Based on this forecast, GDP is expected to increase by 1.3% in 2017 and by 1.6% in 2018. This difference is mainly due to the different numbers of working days, and not due to a cyclical downswing. Capacity utilisation in Germany is expected to be about normal over the forecast horizon.

In 2016, the unemployment rate dropped below the level of 6% for the first time since the German reunification. However, in the course of the year 2017, the unemployment rate will gradually increase, as the number of refugees registered as unemployed will rise noticeably. Still, on average the unemployment rate will be only 5.6% in 2017.

The East German economy in 2017 will expand about as strongly as in Germany as a whole, and unemployment declines further: This forecast has an unemployment rate of 7.7% for East Germany on average in 2017.

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