Economic growth is strong and wellbeing is high but challenges lie ahead

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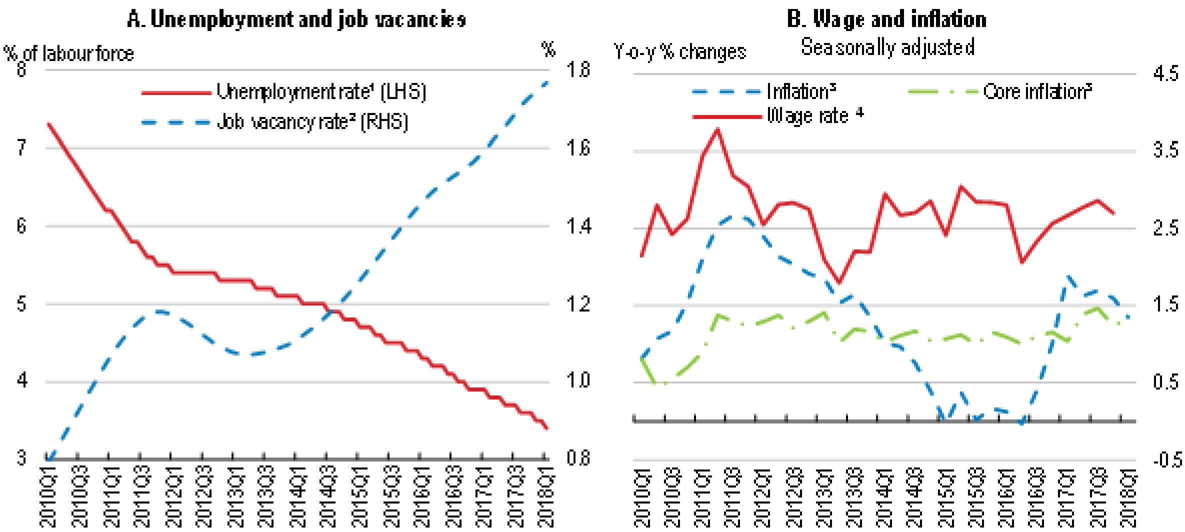
Germany’s strong and steady growth is set to stay – real GDP is projected to grow by 2.1% this year and next. Strong domestic demand and exports drive growth. As a strong exporter of capital goods, Germany is benefiting from the global recovery of trade and investment and the recovery in the euro area. Low interest rates and immigration boost residential construction. At 3.4% unemployment is record low, allowing wages to grow above inflation (Figure 1). Wages have grown across the board, breaking the trend of rising inequality and allowing private consumption to expand steadily. Germany also provides many jobs to immigrants, now mostly from Europe. Poverty is lower in Germany than in most OECD countries. But many workers are still on low wages, especially among women, the low and the middle-skilled (Figure 2). This may hold back growth if workers have little chance to move out of low-wage jobs. During the years of strong performance the government and businesses have reduced debt. Households also continue to save, in part for old age. The external counterpart of this is the large current account surplus.

Figure 1. The labour market is tight but nominal wage growth has remained broadly stable



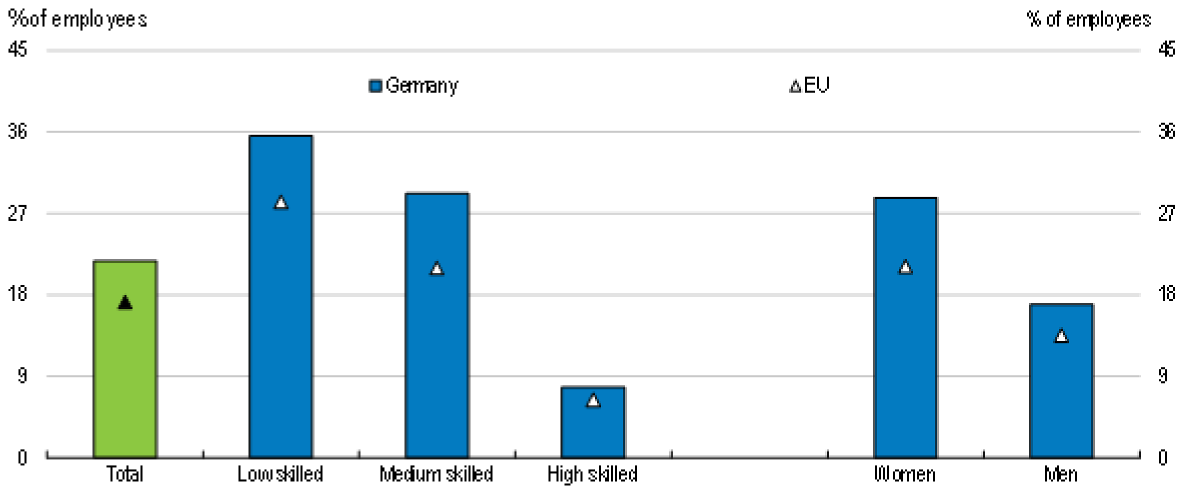
1. Population aged 15-74 years. Based on the German labour force survey.
2. Percentage of unfilled job vacancies relative to total employment.
3. Harmonised consumer price index (HICP). Core HICP excludes energy, food, alcohol and tobacco.
4. Average nominal wage per employee.

Source: OECD (2018), *OECD Economic Outlook: Statistics and Projections* (database) and Statistisches Bundesamt.

StatLink http://dx.doi.org/10.1787/888933737381

Figure 2. The incidence of low-pay employment is high

Low-wage earners by education and gender, 2014



Note: Low-wage earners are defined as those employees earning less than two thirds of the median gross hourly earnings. Low skilled, medium skilled and high skilled are defined respectively as educational attainments of below upper secondary (ISCED 0-2), upper and post-secondary (ISCED 3-4) and tertiary (ISCED 5-8). All employees excluding apprentices working in enterprises with 10 or more than 10 employees and which operate in all sectors of the economy except: agriculture, forestry and fishing (NACE Rev. 2, section A); and public administration, defence and compulsory social security (NACE Rev. 2, sections O).
Source: Eurostat (2018), *Employment and working conditions* (database).

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In this context, policy makers in Germany must ensure that strong social and economic outcomes are sustained in the future and inequality and poverty risk are reduced further, in the light of several challenges: Trend productivity growth has slowed, in Germany and elsewhere. As elsewhere in the OECD, productivity across firms has increasingly diverged between leaders and other firms. In Germany SMEs are 20 to 30% less productive than large firms and business creation has slowed. New technologies must be exploited more to benefit the whole society, and to realise strong growth consistent with the low-carbon transition. Entrepreneurship should be fostered through a more flexible insolvency regime, good e-government services and better access to high speed Internet. At the same time, technological change requires workers to adapt to new and changing jobs throughout their life time by updating skills. Across the OECD, middle-skill jobs have been the most affected by changes in tasks and automation. Technological change requires workers to adapt throughout their life time. The strong fiscal position provides room in the near term to fund spending priorities that will raise growth and wellbeing durably. Boosting investment in skills and technology and employability at higher age can also help reduce the current account surplus. The new government's coalition agreement contains welcome steps in this direction.

References:

OECD (2018), *Economic Surveys: Germany,* OECD Publishing, Paris.

Germany's economic

performance is strong but productivity and investment need a boost

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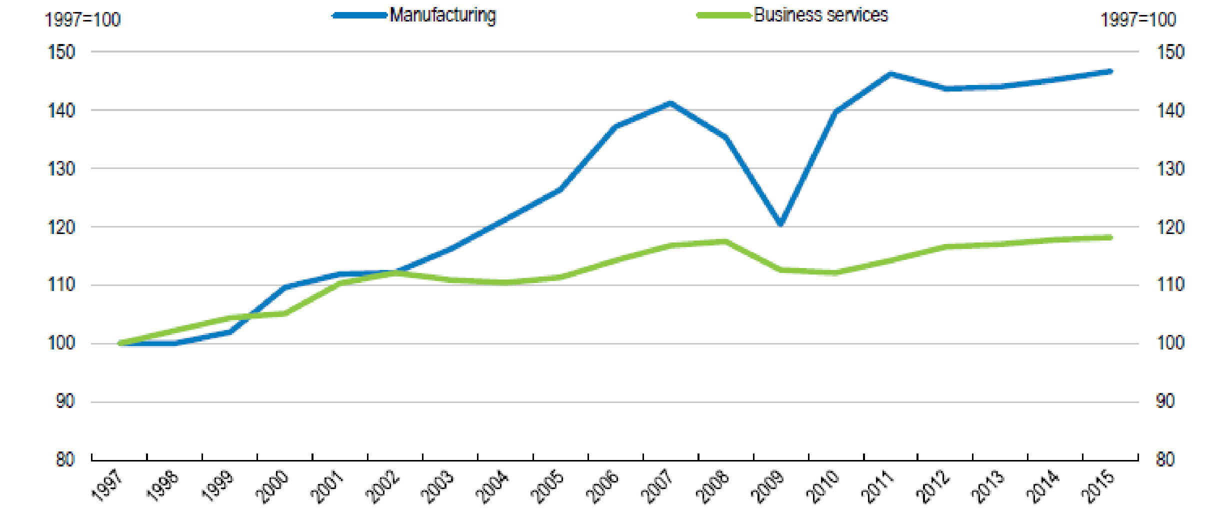
The German economy has steadily recovered from the 2008 global crisis. Thanks to past reforms, the labour market has proved strong and export performance has been impressive. The unemployment rate is now the lowest in the European Union. On the back of rising wages, private household demand has strengthened. Germany has lower income inequality than most OECD countries and scores well in most dimensions of well-being. The recently introduced minimum wage has improved the income situation of many low wage earners.

So economic performance has been excellent. But there is a weak spot: Labour productivity has grown little since the outbreak of the crisis (Figure 1) and is relatively low in the services.

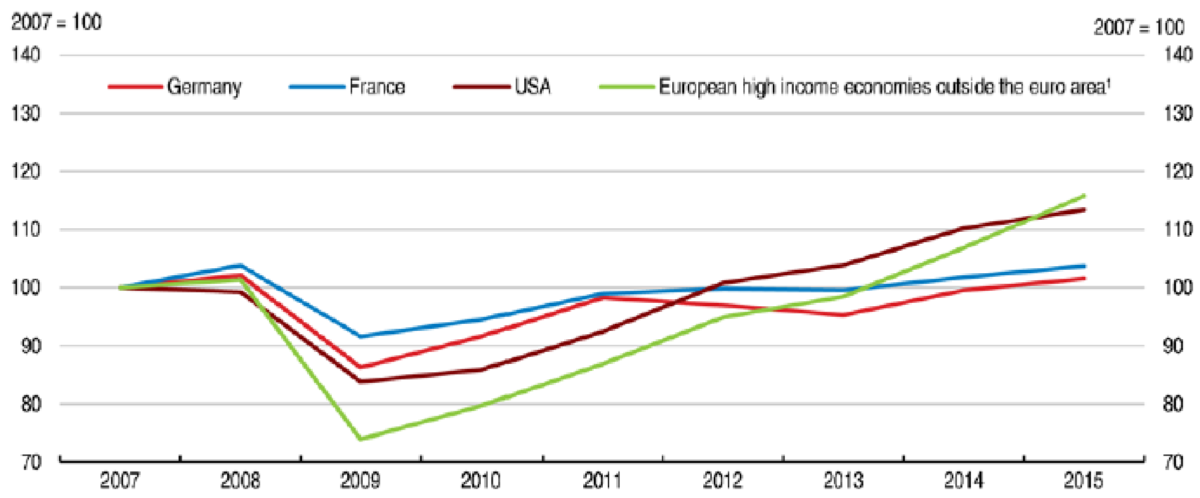
Figure 1. Gross value added per hour worked in Germany, at constant prices



Source: OECD (2016), *OECD Productivity Database*.

In part this is because business investment has been weak in both physical assets, like machinery, and knowledge based capital (KBC, like intellectual property and software) (Figure 2).

Figure 2. Business investment has grown little in recent years



1. Includes Denmark, Sweden, Switzerland and the United Kingdom. They are weighted on the basis of investment spending in 2011.
Source: OECD (2016), OECD Economic Outlook: Statistics and Projections (database), and OECD calculations based on OECD Economic Outlook: Statistics and Projections (database) and on Main Economic Indicators Database.

Demand is a key determinant of business investment. Weak demand conditions in geographically close export markets and increased uncertainty, notably in the euro area, have been particularly damaging to investment. Policies that improve stability and growth prospects in the euro area would therefore raise German investment and its economic potential. Reinvigorating investment in Germany would also reduce its large current account surplus, and thereby promote more balanced global growth.

Reducing regulatory barriers to competition and market entry stimulates business investment and improves productivity. In Germany investment in KBC is particularly low in the services. Some regulations in professional services and the network industries are too restrictive, and easing them would boost productivity throughout the economy because these services are inputs to downstream economic activities (IWU, 2015). For example, restrictions on advertising and firm ownership should be eased. In broadband networks, technologies which supply the fastest speeds, notably "fibre to the home", have barely been deployed. This has held back IT investment and the greater use of IT as a productivity generator.

Policies to avoid incumbents' interests disproportionately affecting the design of regulation can raise innovation and productivity. Germany has made significant improvements to its regulatory policy system, but the administration could focus more strongly on the analysis of the economy-wide impacts of policies, rather than on sector-specific impacts, and on efforts to improve transparency of lobbying.

OECD, Economic Survey of Germany, OECD, April 2016, OECD Publishing.

Institut für Wirtschaftspolitik an der Universität zu Köln (IWU), Der Dienstleistungssektor in Deutschland. Überblick und Deregulierungspotenziale, Otto-Wolff-Discussion Paper, No. 1a/2015.