
ECONOMIC FORECAST 2017 AND 2018

20 March 2017

ECONOMIC FORECAST FOR 2017 AND 2018

The German economy is continuing to experience an upturn. The German Council of Economic Experts (GCEE) expects average annual growth rates for gross domestic product (GDP) of 1.4 % in 2017 and 1.6 % in 2018. Adjusted for the different number of working days, the growth rates are 1.7 % (2017) and 1.6 % (2018). The forecast for 2017 has been raised by 0.1 percentage points compared to the Annual Report 2016/17. The prospects for the German economy are thus almost unchanged in spring 2017.

The situation on the labour market also remains good. The expansion of production is due entirely to an increase in domestic demand, whereas growth contribution of net exports is slightly negative. The upturn is driven by the ECB's expansionary monetary policy and a pro-cyclical fiscal policy. Growth remains considerably above its potential, and one can already see overutilisation of economic capacity. Climbing consumer prices have recently slightly weakened increases in real income. Consumer price inflation in Germany is likely to be 2.2 % in 2017 and 1.6 % in 2018.

Foreign trade prospects have improved slightly compared to autumn 2016. The economic recovery in the euro area continues. With anticipated growth rates of 1.7 % this year and 1.6 % next year, GDP is likely to reach the estimated potential output in 2018. At the same time, the forecast core inflation rate is rising. In view of the macroeconomic development, the ECB's monetary policy remains too expansionary and the resulting risks, for example to financial stability, continue to increase. The ECB should therefore begin winding down its asset purchase programme as soon as possible.

The high German current account surplus does not signal macroeconomic imbalance in the opinion of the GCEE. In fact, temporary and structural factors are responsible, for example the expansionary monetary policy of the independently acting ECB, the significant drop in the oil price, demographic change and rising capital ratios in the corporate sector. Instead of aiming to reduce the current account balance for its own sake, German economic policy should use supply-side measures to attract investment to Germany and thereby strengthen potential output.

I. GLOBAL ECONOMY

1. The **global economy** appears to be **in robust shape** at the beginning of 2017. Economic uncertainty fuelled by the Brexit vote and the outcome of the US presidential election seems not to have had a noticeably negative effect on the financial markets or the real economy to date. [↪ CHART 1](#) A continuation of the moderate global growth is to be expected for the current year. Following 2.6 % growth in GDP in 2016, the German Council of Economic Experts (GCEE) expects somewhat higher rates for 2017 and 2018, of 3.0 % in both cases. In addition, global trade volume is expected to increase by 2.6 % in 2017 and 2.4 % in 2018, following 1.2 % in 2016. [↪ TABLE 1](#)
2. Compared to the forecast in the Annual Report 2016/17, there is only a **slight need for revision** of the expected growth rates for global GDP. Overall, the picture looks slightly more positive; the anticipated expansion of global production is now 0.2 percentage points higher for 2017 than was forecast in autumn. This is primarily due to **growth momentum in the large advanced economies being somewhat stronger** than expected. For example, the forecasts for the United States were revised slightly upward, as were those for the United Kingdom and the euro area. For Japan, slightly higher growth is also expected, with part of the change here being based on the fact that the GDP calculation method has been adjusted. This alone led to an average upward revision of the growth rates by close to 0.4 percentage points per year for the past five years.

↪ CHART 1

Uncertainty indices and stock market volatility indices of selected countries

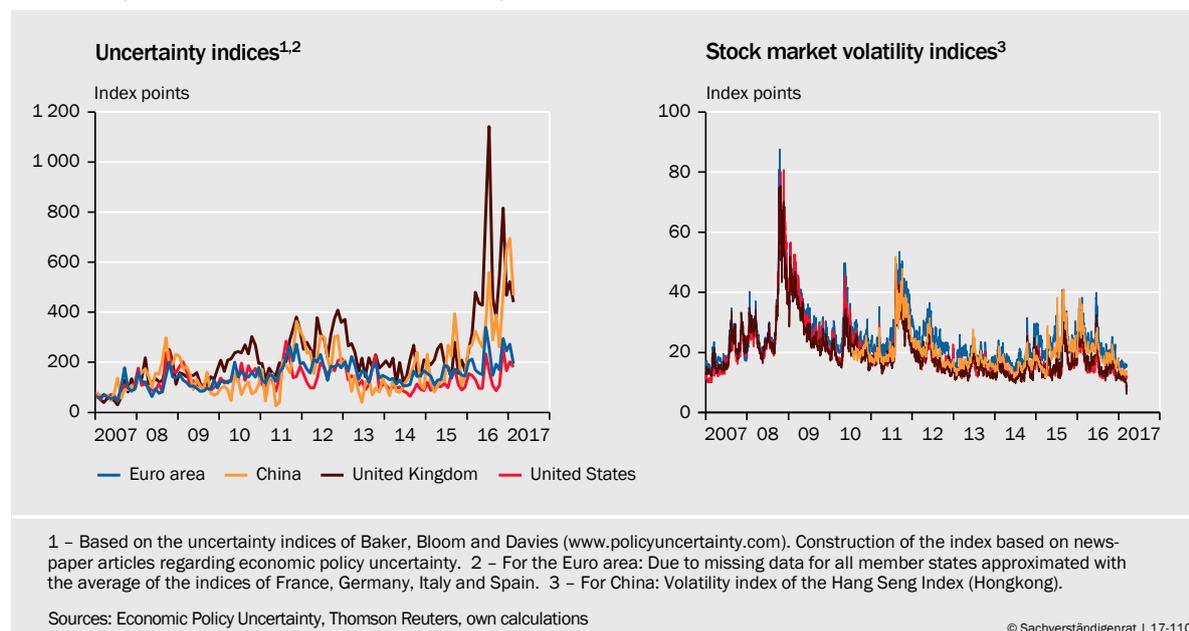


TABLE 1

Real gross domestic product and consumer prices of selected countries

Country/country group	Weight in % ¹	Gross domestic product				Consumer price index			
		Change on previous year in %							
		2016	2017 ²		2018 ²	2016	2017 ²		2018 ²
			Update	Diff. to AR 2016/17 ³			Update	Diff. to AR 2016/17 ³	
Europe⁴	29.9	1.6	1.8	(0.1)	1.7	1.1	2.4	(0.4)	2.1
Euro area ⁴	17.9	1.7	1.7	(0.2)	1.6	0.2	1.9	(0.6)	1.5
United Kingdom	4.4	1.8	1.8	(0.4)	1.3	0.7	2.5	(0.1)	2.0
Russia	2.0	- 0.6	1.4	(0.2)	1.8	7.0	5.1	(- 1.2)	6.1
Middle- and Eastern Europe ⁵	1.6	3.0	3.3	(- 0.0)	3.1	- 0.2	2.1	(1.2)	1.7
Turkey	1.1	1.5	1.3	(- 2.1)	3.2	7.8	8.7	(0.4)	7.4
other countries ⁶	2.8	1.7	1.8	(- 0.1)	1.9	0.9	1.4	(0.1)	1.3
America	36.5	1.1	2.1	(- 0.0)	2.5	3.1	3.7	(0.3)	3.3
United States	27.8	1.6	2.5	(0.2)	2.6	1.3	2.6	(0.4)	2.4
Latin America ⁷	3.6	0.8	2.2	(0.3)	2.5	14.1	11.6	(1.6)	9.6
Brazil	2.7	- 3.6	- 1.5	(- 1.7)	1.6	8.7	5.0	(- 2.0)	4.9
Canada	2.4	1.4	2.3	(0.8)	2.0	1.4	2.2	(0.3)	2.0
Asia	33.5	5.0	5.0	(0.2)	4.7	2.0	2.2	(0.0)	2.4
China	17.3	6.7	6.5	(0.2)	6.1	2.3	2.2	(- 0.1)	2.4
Japan	6.4	1.0	1.3	(0.6)	0.9	- 0.1	0.7	(0.3)	0.7
Asian advanced economies ⁸	3.9	2.3	2.5	(0.1)	2.6	1.1	2.0	(0.6)	1.8
India	3.2	7.5	7.1	(- 0.3)	7.4	5.0	4.4	(- 0.8)	5.7
Southeast Asian emerging economies ⁹	2.8	4.8	4.8	(- 0.1)	4.8	2.3	3.4	(0.3)	3.5
Total	100	2.6	3.0	(0.2)	3.0	2.1	2.8	(0.2)	2.6
Advanced economies ¹⁰	67.2	1.7	2.1	(0.2)	2.1	0.8	2.1	(0.4)	1.9
Emerging economies ¹¹	32.8	4.5	4.8	(0.0)	5.0	4.9	4.2	(- 0.2)	4.2
memorandum:									
weighted by exports ¹²	100	2.1	2.4	(0.1)	2.3	.	.	.	.
following IMF concept ¹³	100	3.1	3.5	(0.1)	3.6	.	.	.	.
World trade ¹⁴		1.2	2.6	(- 0.1)	2.4	.	.	.	.

1 – Nominal GDP (US dollar) of the named countries or country groups in 2015 as a percentage of total nominal GDP. 2 – Forecast of the German Council of Economic Experts. 3 – Difference in percentage points. 4 – In contrast to Table 1 in Annual Report 2016/17 the GDP figures considered for Germany are calendar-adjusted. 5 – Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania. 6 – Denmark, Norway, Sweden, Switzerland. 7 – Argentina, Chile, Colombia, Mexico. 8 – Hong Kong, Republic of Korea, Singapore, Taiwan. 9 – Indonesia, Malaysia, Philippines, Thailand. 10 – Asian advanced economies, euro area, Middle- and Eastern Europe, Canada, Denmark, Japan, Norway, Sweden, Switzerland, United Kingdom, United States. 11 – Latin America, Southeast Asian emerging economies, Brazil, China, India, Russia, Turkey. 12 – Total of all named countries. Weighted by the respective shares of German exports in 2015. 13 – Weights according to purchasing power parities and extrapolated to the countries covered by the IMF. 14 – As measured by the Netherlands Bureau for Economic Policy Analysis (CPB).

Sources: CPB, IMF, national statistical offices, OECD

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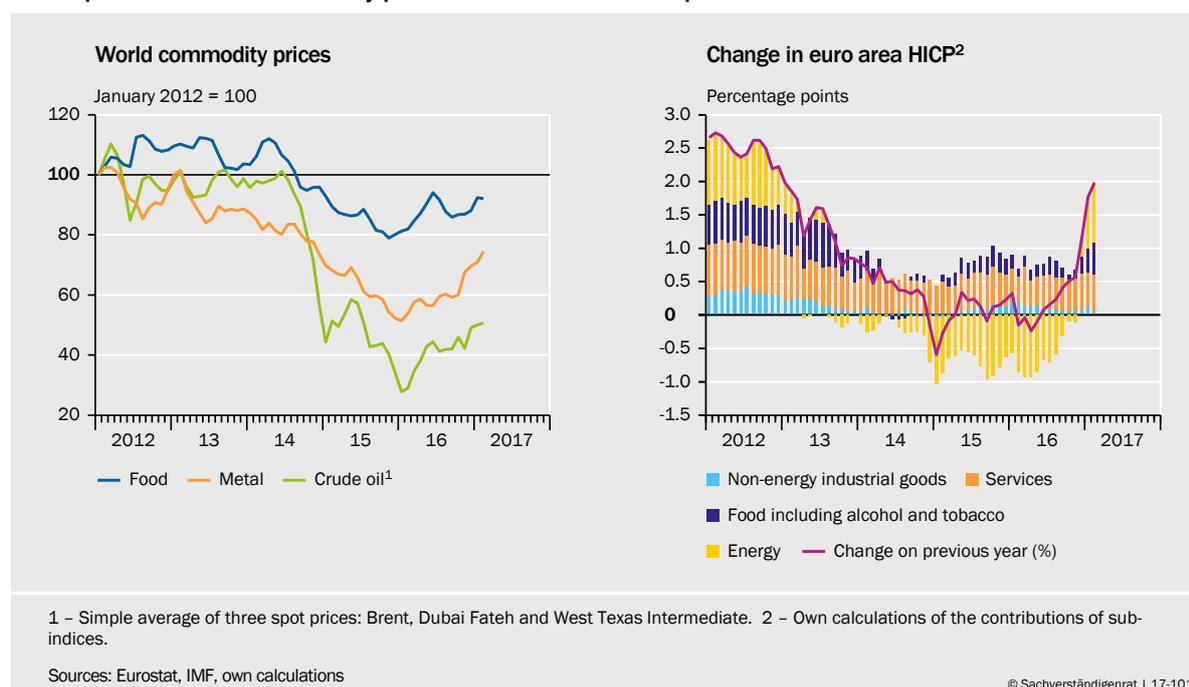
3. In the **emerging economies**, by contrast, the **picture is mixed**. The statistically reported growth of the Chinese economy developed almost as predicted in 2016 and is likely to be somewhat stronger in 2017 than assumed in the Annual Report 2016/17. At the same time, Brazil, for example, remains in recession and political conflicts in Turkey contributed to growth falling significantly and even becoming negative in the third quarter of 2016. Given these contrary developments, there is no change to the growth forecast for 2017 for the group of emerging economies as a whole. Growth is likely to remain almost unchanged in 2018.

4. Many **commodity prices** have **increased significantly** since autumn 2016.
 ↘ CHART 2, LEFT For example, the price of oil in US dollars rose on average to almost 9 % above the average price of the final quarter of 2016 in the first quarter of 2017 according to current data. This contributes to the fact that inflation rates in most economies at the beginning of 2017 are significantly higher than expected. For example, in the euro area the **inflation rate** in February rose to 2.0 % compared to February last year. In addition to the latest rise in the oil price, another key factor for the rise in the inflation rate is a base effect taken into account in the forecast in the Annual Report 2016/17: the sharp decline in the oil price in the previous years is now no longer of consequence when considering the annual rates. The lows reached at the beginning of 2016 now form the basis of comparison. As a consequence, the inflation rate in the euro area would have risen to around 1.2 % in the first quarter of 2017 without the latest unexpectedly sharp increase in the prices of oil and food.

5. In addition to this foreseeable base effect, the price of oil, however, has risen more strongly since the forecast in autumn 2016 than could be expected based on the prices on futures markets. This causes the GCEE to raise its **inflation forecasts** for many countries.
 ↘ TABLE 1 The German Council of Economic Experts now expects inflation rates for the euro area of 1.9 % in 2017 and 1.5 % in

↘ CHART 2

Development of world commodity prices and of the consumer price index in the euro area



2018. Core inflation, which excludes energy and food prices, is likely to rise to 1.1 % in 2017 and 1.3 % in 2018 with increasing capacity utilisation and ongoing labour market recovery.

6. In the **United States**, GDP grew more strongly in the second half of 2016 than in the first half of the year, as expected. The rise in employment also continued. In view of this positive development and the increasing rise in prices, the US central bank (Fed) raised the target range for the key interest rate by 0.25 percentage points in December 2016 and again in March 2017, to currently between 0.75 % and 1.0 %. The rate is still classed as very low given the healthy labour market situation and core inflation of 1.7 %, based on the personal consumption expenditures price index. The GCEE now expects consumer price inflation for the United States of 2.6 % in 2017 and 2.4 % in 2018.

Despite the **continuing upturn** and the already **good situation on the US** labour market, the newly elected President Trump announced his wish to further strengthen growth through massive infrastructure investments and tax cuts. However, the plans have so far remained too non-specific to be able to estimate the size, date and effects of these measures. In addition, some of the **plans announced** and economic targets mentioned are **contradictory** and there is **great uncertainty** as regards their political implementability in view of in some cases conflicting interests within the Republican Party. The majority of the members of the US central bank's Federal Open Market Committee appear to expect only minor cyclical effects in the short term. For example, they have barely revised their growth forecasts for 2017 and 2018 upward since September 2016 (FOMC, 2016, 2017).

In light of this, the GCEE expects only relatively minor fiscal stimulus in the forecast period. Deviation from this assumption would cause a corresponding need for adjustment to the forecast. [↘ BOX 1 PAGE 9](#)

7. In the **United Kingdom**, there has been no weakening of growth in the second half of the year since the Brexit vote in June 2016 according to the figures now available, not least due to the depreciation of the British pound. Due to relatively strong growth, particularly in the fourth quarter of 2016, there is a significant statistical overhang, which is a factor in the need to increase the forecast for annual growth in 2017 by 0.4 percentage points to 1.8 %. The continuing elevated uncertainty and the feared decline in the attractiveness of the location may have a dampening effect on investment. The loss of purchasing power associated with the rise in inflation is also likely to have a negative impact on the development of consumption in the forecast period. The GCEE therefore only expects a 1.3 % rise in UK GDP for 2018.
8. The **economic recovery** in the **euro area** continued in the winter. [↘ TABLE 2](#) At 1.7 %, the GDP growth rate in 2016 was significantly above the potential growth of about 1 %. The estimated capacity underutilisation continues to decrease. With anticipated growth rates of 1.7 % this year and 1.6 % next year, GDP is likely to reach estimated potential output in 2018. Inflation is also normalising. Not only oil prices have risen, but the forecast core inflation rate is also increasing.

9. Nevertheless, the European Central Bank (ECB) **extended its asset purchase programme** until the end of 2017 in December 2016, even though monthly volume will be reduced to € from April 2017. In view of macroeconomic developments, **the ECB's monetary policy** is still too expansionary (GCEE Annual Report 2016 items 405 ff.). The ECB has not yet tightened monetary policy in response to the improved growth momentum. Due to the rise in the inflation rate, the real interest rate has in fact even decreased. The risks of ultra-expansionary monetary policy are also gaining increasing relevance, for example for financial stability. For instance, considerable risks of interest rate changes are building up in the banking system (GCEE Annual Report 2016 items 509 f.) and the risk of exaggerated asset prices continues to increase.

The ECB should therefore prepare to **end the purchase programme** as soon as possible by communicating an exit strategy. For example, it could announce a reduction of the purchase programme from summer 2017 and in this way gradually reduce it to zero by the end of the year. At the same time, it should point out that mechanisms already exist that absorb risks potentially arising from the exit for highly indebted countries and banks.

TABLE 2

Real gross domestic product, consumer prices and unemployment rates in the Euro area

Country/ country group	Weight in % ¹	Gross domestic product ²				Consumer prices (HICP) ³				Unemployment rate ⁴			
		Change on previous year in %								%			
		2016	2017 ⁵		2018 ⁵	2016	2017 ⁵		2018 ⁵	2016	2017 ⁵		2018 ⁵
			Update	Diff. to AR 2016/17 ⁶			Update	Diff. to AR 2016/17 ⁶			Update	Diff. to AR 2016/17 ⁶	
Euro area ^{7,8}	100	1,7	1,7	(0,2)	1,6	0,2	1,9	(0,6)	1,5	10,0	9,5	(- 0,2)	9,1
including:													
Germany ⁸	29,0	1,8	1,7	(0,1)	1,6	0,4	2,1	(0,6)	1,5	4,1	4,0	(- 0,2)	4,0
France	20,9	1,2	1,3	(0,1)	1,2	0,3	1,6	(0,4)	1,3	10,0	9,8	(0,0)	9,5
Italy	15,7	0,9	0,8	(0,2)	0,8	- 0,1	1,6	(0,8)	1,4	11,7	11,7	(0,5)	11,5
Spain	10,3	3,2	2,6	(0,0)	2,1	- 0,3	2,5	(1,4)	1,9	19,6	17,7	(- 0,6)	16,1
Netherlands	6,5	2,1	2,2	(0,5)	2,0	0,1	1,7	(0,6)	1,6	6,0	5,3	(- 0,6)	4,9
Belgium	3,9	1,2	1,6	(0,1)	1,6	1,8	2,5	(0,4)	2,0	8,0	7,6	(- 0,5)	7,5
Austria	3,2	1,5	1,8	(0,4)	1,4	1,0	2,3	(0,7)	1,8	6,0	5,7	(- 0,1)	5,7
Ireland	2,4	4,3	4,7	(0,9)	3,6	- 0,2	0,7	(- 0,3)	1,0	7,9	6,4	(- 1,0)	5,6
Finland	2,0	1,6	1,4	(0,1)	1,6	0,4	1,3	(0,0)	1,2	8,8	8,7	(0,2)	8,5
Portugal	1,7	1,4	1,9	(0,5)	1,4	0,6	1,4	(0,2)	1,4	11,2	10,0	(- 0,5)	9,9
Greece	1,7	0,0	0,3	(- 0,2)	1,6	0,0	1,2	(0,3)	1,0	23,5	22,4	(0,0)	21,2
memorandum:													
Euro area without Germany	71,0	1,7	1,7	(0,2)	1,5	0,2	1,8	(0,6)	1,5	12,2	11,5	(- 0,1)	10,9

1 – Nominal GDP in the year 2015 as a percentage of the nominal GDP of the euro area. 2 – Calendar-adjusted. 3 – Harmonised index of consumer prices. 4 – Standardised according to the ILO concept. For the total euro area and euro area without Germany weighted by the labour force of 2015. 5 – Forecast of the German Council of Economic Experts. 6 – Difference in percentage points. 7 – Weighted average of the 19 euro area member states. 8 – In contrast to Table 2 in Annual Report 2016/17 the GDP figures considered for Germany are calendar-adjusted.

Source: Eurostat

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10. Finally, monetary policy cannot create sustainable growth momentum (GCEE Annual Report 2016 items 165 ff.). A continuation of **fiscal consolidation and growth-friendly structural reforms** would be urgently necessary in all member states. However, these are currently on hold. The structural problems persist in many member states.
11. The outlook for the future development of the global economy is subject to **risks**. These include possible effects of political uncertainty, for example in the United States and Europe, more pronounced weakening of Chinese economic growth and possible turbulences on the international financial markets. For the forecast it has been assumed that none of these risks will occur.

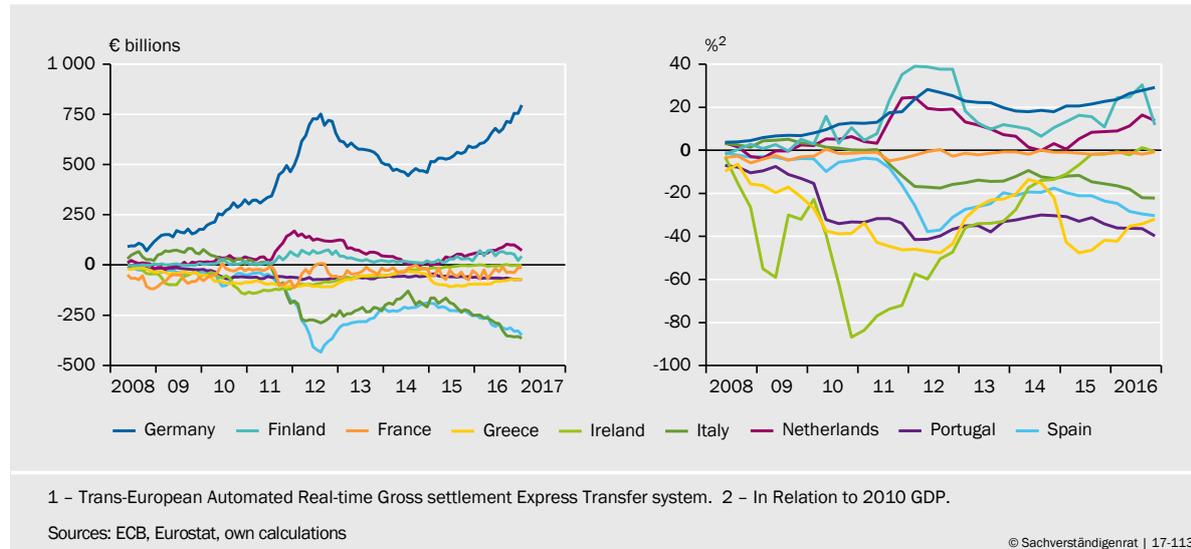
The **protectionist measures** demanded by President Trump constitute a **danger to the global trading system** and a risk for the global economy. Import taxes would breach international trade law. If the United States were to challenge the World Trade Organisation (WTO), this would fundamentally change the international trading system. Other tax policy measures cannot be conclusively assessed without knowledge of their details. Furthermore, although extensive **deregulation of the financial system** in the United States could lead to more growth in the short term, it would also increase the likelihood of future financial crises and put the international cooperation on financial market regulation into question.

Furthermore, there are political risks for the euro area. In many member states, the popularity of eurosceptic parties remains high. If these parties are successful at the upcoming elections, **new risks for the stability of the monetary union would arise**.

12. The **crisis of the monetary union** has in fact **not yet been solved**. There is still considerable heterogeneity within the euro area. Some member states remain highly indebted and have low growth rates and considerable structural problems. This is reflected, among other things, in high levels of non-performing loans on bank balance sheets. It is therefore not surprising that participants in financial markets are discussing exit scenarios for individual member states. At the same time, the **TARGET2 deficits** of some national central banks, in particular those of Spain, Italy and Portugal, have risen significantly since the second half of 2014. In contrast, there has been a considerable rise in the TARGET2 surplus, particularly that of Deutsche Bundesbank. [↘ CHART 3](#)
13. The expansion of the TARGET2 deficits partially relates to the ECB's asset purchase programmes (BIS 2017, Deutsche Bundesbank 2016). For example, a purchase by the Italian central bank of securities issued by a foreign investor that maintains a correspondent account in Germany initially leads to an increase in Italy's TARGET2 deficit and Germany's TARGET2 surplus. Because many foreign investors hold accounts in Frankfurt, for example, this may explain a first-round effect on the TARGET2 balances. The high excess liquidity in the euro system reduces the need for the liquidity to shift from the countries with a TARGET2 surplus to the countries with TARGET2 deficit in a second-round effect. The rise in TARGET2 deficits can, however, be interpreted as a **reduction in financial ties** because foreign investors have scaled back their risk exposures

↘ CHART 3

TARGET2¹ balances of selected euro area member states



in particular to Italy, Portugal and Spain. It therefore cannot be ruled out that this signals **increased risk assessment** for these member states.

14. At the same time, there are **opportunities** for better development. For example, there could be higher growth rates in the short term if the fiscal stimulus measures in the USA were implemented more quickly and on a larger scale than assumed in the forecast. ↘ [BOX 1](#)

↘ BOX 1

Impact of a possible fiscal stimulus in the United States

Forecasting economic development in the United States is hampered by the fact that there has been a lack of clarity about the new US government's fiscal policy plans. In light of this, only minor fiscal stimulus measures in the next two years have been assumed for the basic forecast. Nevertheless, government representatives have announced considerable fiscal policy interventions. The tax system is to be reformed, investment in infrastructure stepped up and military spending increased. Various scenario calculations are made below that quantify the possible short-term effects of a stimulus under various assumptions. In general, more rapid implementation would be accompanied by a greater fiscal stimulus than assumed in the forecast.

The scenario calculations are made with the aid of a structural New Keynesian model (GCEE Annual Report 2013 box 10). The model is a two-country version of the ECB's New Area-Wide Model (NAWM; Coenen et al., 2008), as used by Cogan et al. (2013). It has a detailed fiscal sector and was extended to include the instrument of public investment, for which a productivity-increasing effect is assumed (Cwik and Wieland, 2011; Leeper et al., 2010). It also includes two types of household: forward-looking households with access to the financial market, and households who always consume their disposable income in full.

Because very little information is currently available about the scale of a possible fiscal stimulus, a stylised scenario of the OECD (2016) has been used in the first simulation. This assumes that public consumption and public investment will be temporarily increased by 0.25 % of GDP in both 2017 and 2018. In addition, the income tax rate falls by 0.8 percentage points from 2017 and tax on capital income falls by 9.4 percentage points from 2018. As in the OECD simulation, this reduction re-

sults in a decrease in tax revenue (*ceteris paribus*) by around 0.5 % and 0.75 % of GDP, respectively.

Based on these assumptions, GDP growth in the United States increases by around one percentage point in 2017 and 0.2 percentage points in 2018. [↘ CHART 4, UPPER LEFT](#) It should be noted here that the reduction in corporate tax, modelled as a decrease in tax on capital income, is anticipated as early as 2017 and thus has an expansionary effect earlier. The remaining measures each contribute to growth to an approximately equal extent in 2017. In 2018, the decrease in capital tax primarily promotes growth because the growth stimulus of the other measures has ended. In the euro area, this results in a moderate growth effect of around 0.15 percentage points in 2017 and 0.2 percentage points in 2018. [↘ CHART 4, UPPER RIGHT](#)

Spillover effects occur primarily as a result of the reduction in capital tax. This triggers a private investment boom in the United States. Because the share of foreign goods in investments is particularly high, this leads to a noticeable demand stimulus in the euro area. As the model used is a two-country model, the euro area is representative of the rest of the industrialised world, meaning that the spillover effect on the euro area is likely to be exaggerated. The OECD (2016) simulates its scenario using the NiGEM macroeconomic simulation model. [↘ CHART 4, TOP](#) Compared to the OECD (2016), the total growth effect across both years is of a similar size, but with different timing. The effects in the model used by the GCEE are shifted towards 2017.

The measures assumed in the OECD scenario should be barely realisable at present with regard to the time lines assumed. The political decision-making process for the necessary changes to legislation is not likely to be concluded before the third quarter of 2017. It can also be assumed that there will be further delays in implementation, particularly with a large-scale tax reform or the additional government investment. These aspects will be taken into account in a second scenario below. [↘ CHART 4, BOTTOM](#)

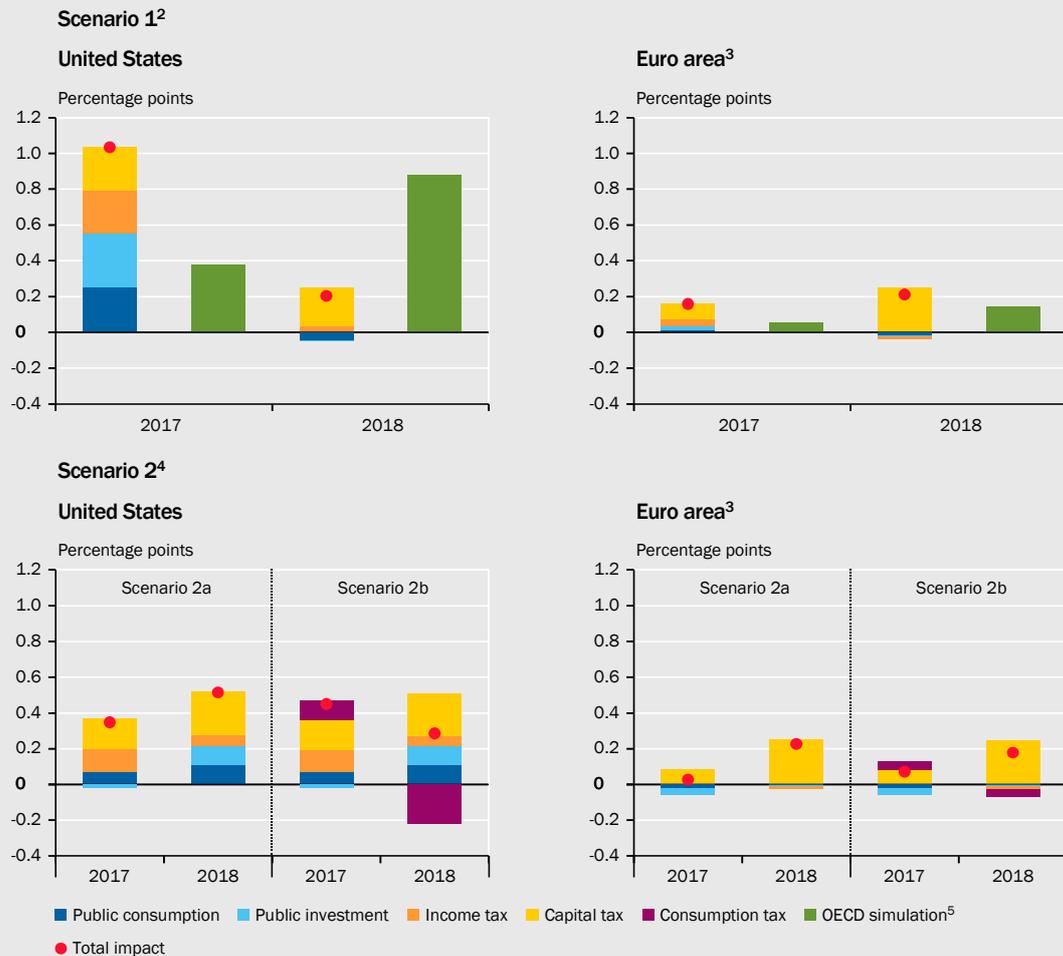
Here, the same fiscal policy stimuli are assumed in terms of scale, but with delayed implementation. Hence, public consumption increases in the third quarter instead of the first quarter of 2017. Income tax will only be decreased from 2018 and thus at the same time as capital tax. Public investment is made across a period of three years and increases productivity only after completion of the investment projects, i.e. after three years (Leeper et al., 2010). Based on these assumptions, there is a significantly smaller effect of approximately 0.4 percentage points on US growth in 2017. In the following year, the growth effect would be approximately 0.5 percentage points. The whole growth effect would thus be significantly smaller. The spillover effects on the euro area would remain noticeably positive at 0.05 and 0.2 percentage points, respectively. This is largely due to the unchanged effect of the capital tax.

The corporate tax reform has also involved discussion of destination-based cash flow taxation (Becker and Englisch, 2017). Farhi et al. (2017) argue that this type of tax reform coupled with a reduction in corporate tax would have the effect of “fiscal devaluation”. This involves tax on a domestic production factor being lowered and at the same time tax on consumption increased. As a result, domestic production becomes cheaper and the export industry is promoted, while imports become relatively more expensive.

Such “fiscal devaluation” is simulated in an extension of the second scenario. An increase in consumption tax from 2018 is additionally assumed, which (*ceteris paribus*) is accompanied by an increase in tax revenue of around 0.5 % of GDP. As a result of the tax increase, an additional positive growth effect of around 0.1 percentage points would initially result in the USA in 2017 because consumption spending would be brought forward. [↘ CHART 4, BOTTOM](#) However, the additional growth effect in 2018 is significantly negative at around 0.2 percentage points.

↳ CHART 4

Impact of a fiscal stimulus on GDP in the United States¹



1 – Annual growth rates. 2 – Scenario 1 assumes the fiscal stimulus of OECD (2016). The simulation of the OECD is based on the NiGEM macroeconomic simulation model. The simulation of the German Council of Economic Experts is based on a two-country-version of the NAWM (Cogan et al., 2013). 3 – Representative for the rest of the industrialised world. 4 – Scenario 2a assumes the same fiscal stimulus as scenario 1 in terms of scale, but with delayed implementation. Scenario 2b additionally assumes an increase in consumption tax. 5 – Results of OECD (2016).

Sources: OECD, own calculations

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Finally, it must be pointed out that the scenarios presented are of a hypothetical nature. Whether the fiscal policy announcements will be implemented is uncertain, meaning that there are reasons to doubt significant stimulus for the economy in the forecast period. In particular, it is unclear to what extent the government can finance new measures with increases in its debt level or will have to implement new measures for financing. The type of financing will very strongly influence the size of the fiscal multiplier here. The model assumes that the level of debt will be stabilised in the long-term by transfer reductions. These are typically associated with a smaller effect on GDP (GCEE Annual Report 2013 box 10). However, if, for example, the financing is ensured through a reduction in government consumption, the overall effect of the stimulus is likely to be smaller. The simulation results also suggest that a tax reform of this nature would tend to increase the US current account deficit. As a result, the euro area's export industry may possibly even benefit.

II. GERMAN ECONOMY

1. Overview: Strong growth at the turn of the year

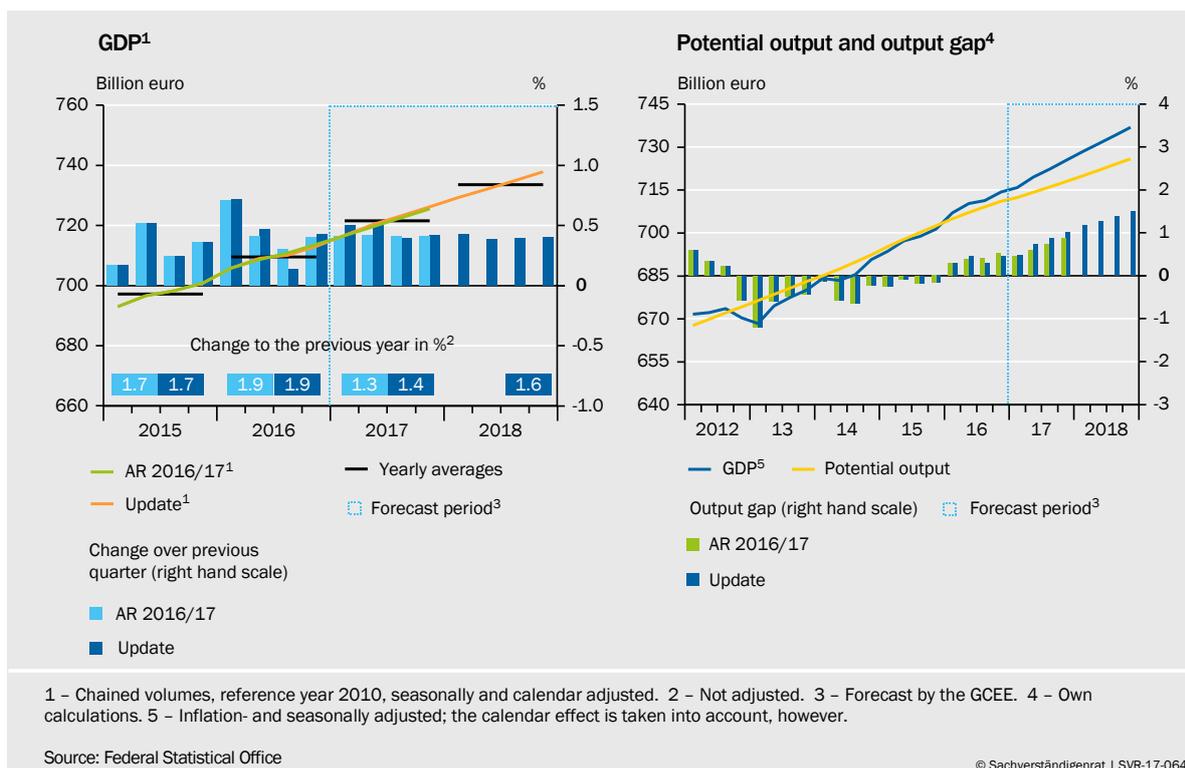
15. The **German economy's upturn** continued in winter 2016. The third and fourth quarter real GDP growth rates were 0.1 % and 0.4 % respectively. [↪ CHART 5, LEFT](#) Real GDP grew at an annual rate of 1.9 % in 2016, and thus faster than estimated potential output for the third consecutive year. Macroeconomic production capacity was slightly overutilised in 2016, at 0.4 %. [↪ CHART 5, RIGHT](#)

The **economic forecast** for Germany remains **practically unchanged** from the Annual Report 2016/17. The ECB's expansionary monetary policy continues to be a key factor in the upturn. Furthermore, positive development in the labour market has resulted in rising income. However, climbing consumer prices have recently weakened the increases in real income to a small extent.

16. Domestic demand contributed 2.1 percentage points to GDP growth in 2016, around 0.4 percentage points more than forecast last autumn. [↪ TABLE 3](#) Particularly **private and state consumption increased more heavily**. The upward correction to private consumption, however, is due to significantly revised data for the first quarter of 2016. [↪ CHART 6 LOWER LEFT](#) Development for the remainder of the year was slower, in contrast, than predicted in autumn.

[↪ CHART 5](#)

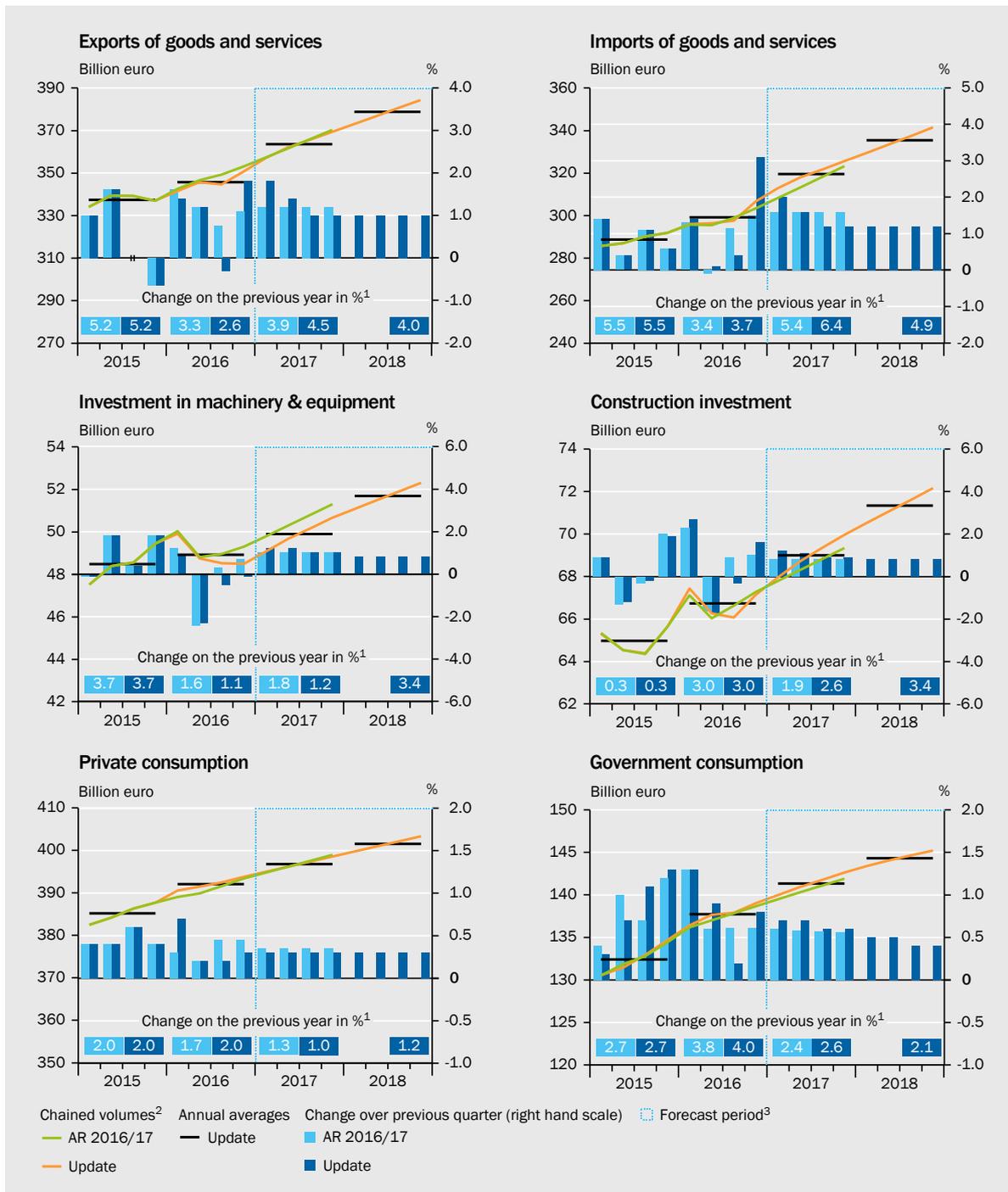
Economic forecast for Germany



17. Unlike domestic demand, **net exports** contributed less to growth than expected. This is firstly due to weaker development of exports, which actually declined in the third quarter of 2016. ↘ CHART 6, UPPER LEFT Secondly, there was a rise in imports particularly at the end of the year. ↘ CHART 6 UPPER RIGHT **Investment activity** during the second half of the year developed largely in line with autumn 2016 expectations. Housing investment continued its dynamic growth while corporate investment progressed at a more moderate rate.

↘ CHART 6

Components of GDP



1 - Not adjusted. 2 - Reference year 2010, seasonally and calendar-adjusted. 3 - Forecast by the GCEE.

Source: Federal Statistical Office

↘ TABLE 3

Contributions to growth of gross domestic product by expenditure components¹
percentage points

	2012	2013	2014	2015	2016	Forecast ²		
						2017		2018
						Update	Difference to AR 2016/17	
Domestic demand	- 0.8	0.9	1.3	1.5	2.1	1.8	(0.3)	1.7
Final consumption expenditure	0.9	0.6	0.7	1.6	1.8	1.0	(- 0.1)	1.1
Private consumption ³	0.7	0.4	0.5	1.1	1.1	0.5	(- 0.2)	0.7
Government consumption	0.2	0.2	0.2	0.5	0.8	0.5	(0.0)	0.4
Gross fixed capital formation	- 0.1	- 0.2	0.7	0.3	0.5	0.4	(0.0)	0.6
Investment in machinery & equipment	- 0.2	- 0.1	0.4	0.2	0.1	0.1	(- 0.0)	0.2
Construction investment	0.1	- 0.1	0.2	0.0	0.3	0.3	(0.1)	0.3
Other products	0.0	0.0	0.1	0.1	0.1	0.1	(- 0.0)	0.1
Changes in inventories	- 1.6	0.5	- 0.1	- 0.5	- 0.2	0.3	(0.3)	0.0
Net exports	1.3	- 0.4	0.3	0.2	- 0.2	- 0.4	(- 0.2)	- 0.1
Exports of goods and services	1.3	0.9	1.9	2.4	1.2	2.1	(0.3)	1.9
Imports of goods and services	0.0	- 1.3	- 1.6	- 2.1	- 1.5	- 2.4	(- 0.4)	- 2.0
For information purposes:								
Gross domestic product (%)	0.5	0.5	1.6	1.7	1.9	1.4	(0.1)	1.6

1 – Real values; Deviations in sums due to rounding. 2 – Forecast by the GCEE. 3 – Including non-profit institutions serving households.
Source: Federal Statistical Office

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2. Macroeconomic environment remains stimulating

18. **Monetary and fiscal policy** continue to stimulate aggregate demand. Fiscal policy will likely continue to be expansionary for the forecast period. The GCEE anticipates additional positive discretionary stimuli as well as a decline in the national structural fiscal balance for 2017 and 2018. ↘ ITEMS 29 FF.

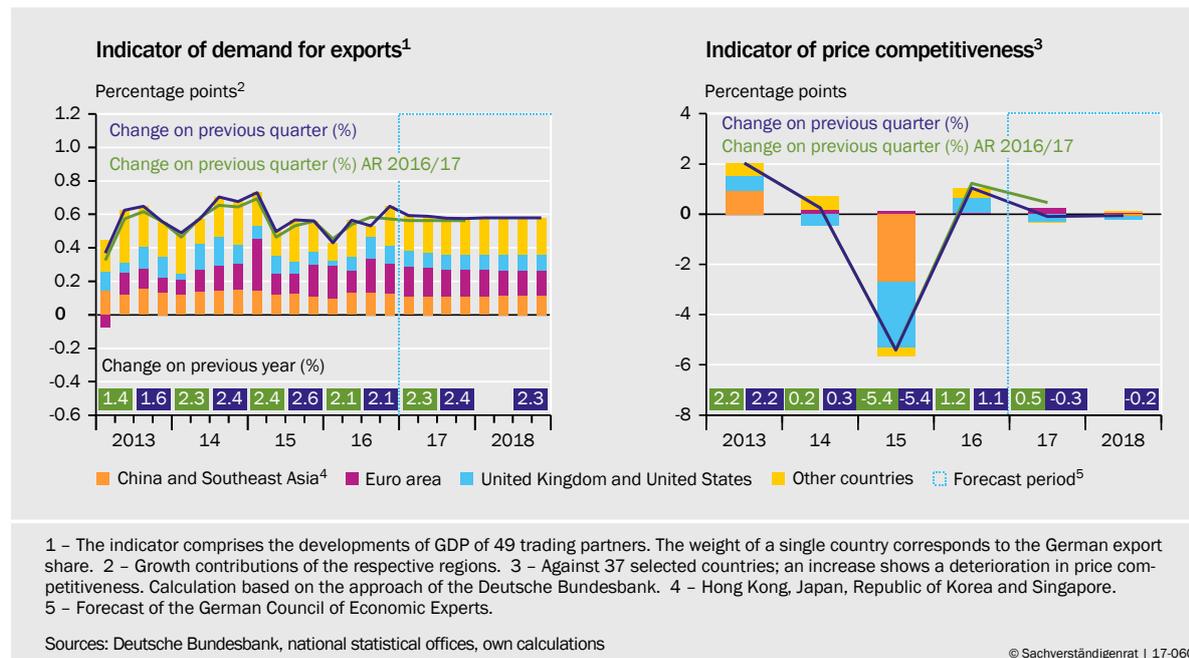
The **financing conditions** of the German economy have improved even more since autumn 2016. The ECB decided in December 2016 to continue its bond purchases until the end of 2017, in light of which, interest rates on loans to non-financial corporations continued their downward trend. Financing conditions can be expected to remain favourable for the entire forecast period.

19. Foreign trade prospects have improved slightly compared to autumn 2016. The GCEE expects **moderate growth in export demand** for 2017 and 2018. ↘ CHART 7 LEFT Demand from the other euro area member states and the United States is likely to be slightly greater than in 2016.

Moreover, **price competitiveness** remains **at an extraordinarily high level**. While the 2016 annual average deteriorated by over 1 % compared to the 37 most important trading partners due to the somewhat sharper rise in consumer prices, ↘ CHART 7 RIGHT the depreciation of the euro in recent months has improved the price situation of German exporters. Assuming constant nominal exchange rates, the inflation forecasts of the GCEE see price competitiveness sustained at this high level for the forecast period.

↘ CHART 7

Expected development of the external environment



3. Outlook – expansionary economic policy drives upturn

20. As of spring 2017, the German economy is experiencing an upturn, with **real economic indicators** painting a **positive picture** at the beginning of the year. Following a temporary slowdown at the end of 2016, industrial production rose again considerably in January 2017. Strong GDP growth is also expected given the development in incoming orders, despite the recent dip in January; a clear upward trend in orders from euro area trading partners is worth noting. **Survey-based indicators** point even more clearly than real economic indicators to an expansion of overall economic activity in Germany in the spring.
21. A **short-term forecast** for this quarter and the next, based on available indicators, yields a 0.5 % growth rate for each compared with the previous quarter. The German economy can thus be expected to grow somewhat more strongly in the first half of 2017 than predicted in the Annual Report 2016/17.
22. Economic output will continue to rise more strongly than its growth potential over the course of 2017. This is largely due to the expansionary monetary and fiscal policy stimuli. Taking the short-term forecast into account, the GCEE expects an average annual **GDP growth rate** of 1.4 % for 2017. ↘ TABLE 4

It should be noted that this forecast does not represent any economic slowdown compared to last year's growth. The decline in growth of 1.9 % in 2016 to 1.4 % in 2017 actually reflects the **different number of working days** in the two years. There are around three fewer working days in 2017 than in 2016 due to how the official holidays fall. On this basis, the German Federal Statistical Office has calculated a **calendar effect** of around -0.3 percentage points on the GDP

growth rate. Stripped of this effect, the German economy is likely to grow by 1.7 % in 2017. The calendar effect will have no impact on growth in 2018. GDP growth of at least 1.6 % is expected for 2018 with or without application of the calendar effect.

- 23. Exports during the forecast period are likely to increase somewhat more strongly**, contrary to the Annual Report forecast. This is due to more dynamic development in the foreign trade environment. In line with the upward revision of the forecast for exports, imports are also expected to climb more sharply due to the high import content of German exports. A somewhat higher increase can also be expected in gross fixed capital formation in machinery and equipment.

▾ TABLE 4

Key economic indicators for Germany

	Unit	2015	2016	Forecast ¹		
				2017		2018
				Update	Difference to AR 2016 /17	
Gross domestic product²	%	1.7	1.9	1.4	(0.1)	1.6
Final consumption expenditure	%	2.2	2.5	1.4	(- 0.2)	1.5
Private consumption ³	%	2.0	2.0	1.0	(- 0.3)	1.2
Government consumption	%	2.7	4.0	2.6	(0.2)	2.1
Gross fixed capital formation	%	1.7	2.3	2.0	(0.0)	3.1
Investment in machinery & equipment	%	3.7	1.1	1.2	(- 0.6)	3.4
Buildings	%	0.3	3.0	2.6	(0.7)	3.4
Other products, other fixed assets	%	1.9	2.6	2.0	(- 0.9)	2.0
Domestic uses	%	1.6	2.3	1.9	(0.2)	1.9
Net exports (growth contribution in percentage points)		0.2	- 0.2	- 0.4	(- 0.2)	- 0.1
Exports of goods and services	%	5.2	2.6	4.5	(0.6)	4.0
Imports of goods and services	%	5.5	3.7	6.4	(1.0)	4.9
Current account balance⁴	%	8.6	8.3	7.5	(- 0.7)	7.1
Persons employed (domestic)	thousand	43,057	43,593^a	44,159	(207)	44,642
Employees subject to social security contributions	thousand	30,822	31,504^a	31,940	(173)	32,329
Registered unemployment, stocks	thousand	2,795	2,691	2,653	(- 60)	2,696
Unemployment rate⁵	%	6.4	6.1	6.0	(- 0.1)	6.0
Consumer prices⁶	%	0.3	0.5	2.2	(0.6)	1.6
General government balance⁷	%	0.7	0.8	0.4	(0.0)	0.2
Gross domestic product per capita⁸	%	0.8	1.1	1.3	(0.1)	1.6
Annual rate of change of GDP, calendar-adjusted	%	1.5	1.8	1.7	(0.1)	1.6

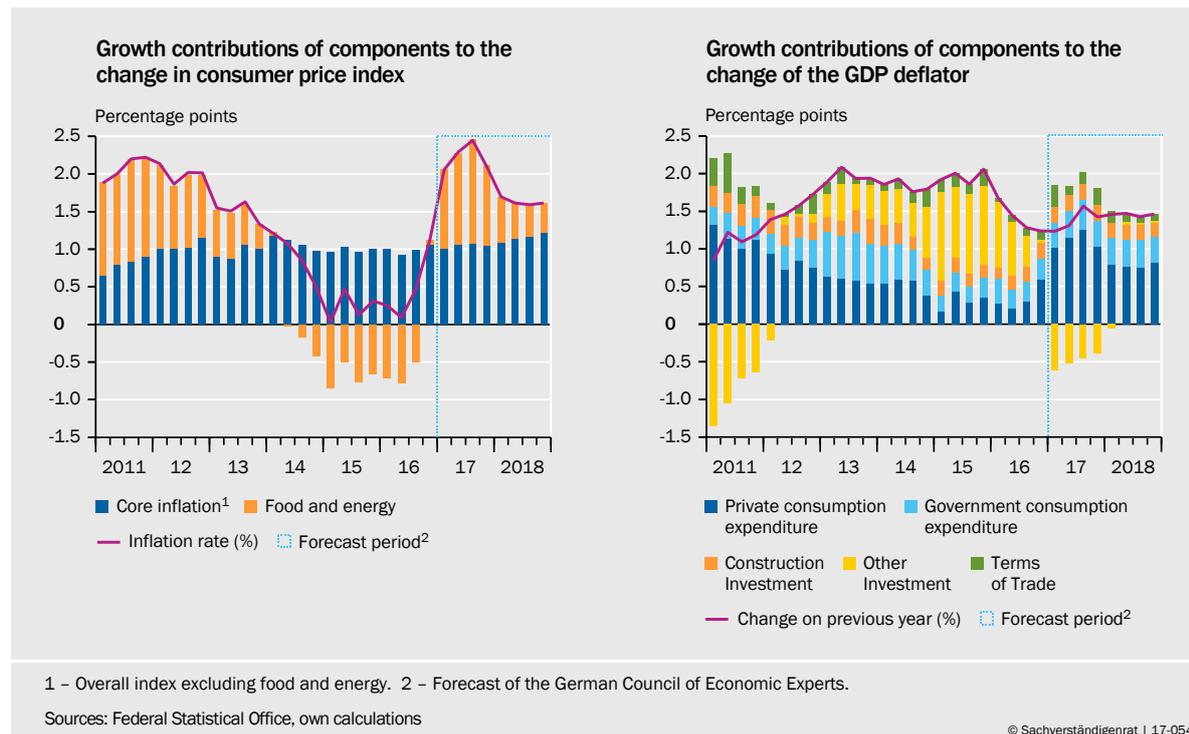
1 – Forecast by the GCEE. 2 – Inflation-adjusted year-on-year change; For Difference Percentage points. Also applies to all listed components of GDP. 3 – Including non-profit institutions serving households. 4 – In relation to nominal GDP. 5 – Registered unemployed in relation to civil labour force; Difference in percentage points. 6 – Year-on-year change; For Difference Percentage points. 7 – Regional authorities and social security in according to national accounts; in relation to nominal GDP. 8 – Own calculations, year-on-year change; For Difference Percentage points. a – Due to the correction of employment statistics by the Federal Employment Agency, the number deviates from the official statistics. The official numbers state 43.475 million employed persons and 31.489 million employees subject to social security contributions.

Sources: Federal Bureau of Statistics, Federal Employment Agency

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CHART 8

Inflation measures and its components



Private consumption, on the other hand, is not likely to increase as strongly as predicted in the Annual Report 2016/17. This is indicated primarily by the weaker real income growth as a result of the recent **rise in consumer price inflation**. [CHART 8 LEFT](#) The GCEE expects an increase to 2.2 % for 2017 as a whole. Assuming that oil prices rise only slightly in the forecast period, in line with the available oil future prices, slightly lower consumer price inflation is likely again in 2018 (1.6 %).

The further slightly deterioration of terms of trade in the forecast period combined with the strong import development expected indicate a likely decline in the **current account balance** for 2017 and 2018 to 7.5 % and 7.1 % of nominal GDP, respectively. The current account surplus does **not signal macroeconomic imbalance** in the opinion of the GCEE. [BOX 2](#)

BOX 2

Current account surplus and macroeconomic imbalance

The German current account surplus hit a new high in 2016 of €261 billion (8.3 % of nominal GDP), further stoking the criticism which has been voiced against it for some years now. The US government and the European Commission, for example, regard the high surplus as an indication of macroeconomic imbalance caused by aggregate demand being too low in relation to supply. In their opinion, this should therefore be corrected by boosting aggregate demand in Germany – a correction they feel would benefit others too. They also believe that this supposed imbalance is clouding the German economy's growth prospects, and simultaneously harms other national economies. They see the German current account surplus generating deflationary tendencies in the global economy and threatening euro area stability.

This criticism is based on several counts of misjudgement. National economies cannot be equated to large companies controlled by governments. Furthermore, proposals such as massively expanding government spending and debt would have more of a destabilising effect on Germany and the euro area. Ultimately, a current account surplus would only pose a threat to the stability of the euro area or even the global economy if the economic adjustment mechanisms that typically lead to a reduction of current account balances were permanently obstructed. Boosting German aggregate demand would certainly not reduce such impediments.

Illusions of control with the mechanism of net balances

The high level of abstraction in aggregate macroeconomic analysis obstructs the fact that a large number of players with their discretionary decisions and actions are responsible for macroeconomic outcomes. The international exchange of goods and services is just as little a zero sum game as the international movement of capital. Economic policymakers are thus not in a position to manipulate these macroeconomic results by means of a simple mechanism of net balances (*Saldenmechanik*) – fewer exports here, more imports there. Their actions are instead limited to tweaking the points that affect the macroeconomic aggregate in multiple ways. They would be particularly ill-advised to use a simple mechanism of net balances and to trust that the moves they make will not cause any significant negative side effects.

Macroeconomic equilibrium

Concluding that Germany has a macroeconomic imbalance based on the size of its current account surplus alone is an oversimplification. There would be a macroeconomic imbalance in Germany if, at a given price level, aggregate demand, which is derived from domestic demand and the difference between export and import demand, deviated significantly from aggregate supply. This would be reflected in either heavily underutilised production capacities, as occurred in the recession in 2008 and 2009, or dramatic declines in prices and price expectations. None of this is currently evident in Germany.

Based on the estimates of the German Council of Economic Experts, the European Commission, Deutsche Bundesbank, and the Joint Economic Forecast Project Group, the German economy's production capacities are currently utilised at normal rates or even overutilised. Employment levels are high and unemployment is decreasing. Moreover, prices are rising. Inflation of consumer prices excluding food and energy, and the rises in the GDP deflator and the domestic demand deflator have been noticeably positive for years. On the basis of this evidence, there is reason to fear that economic intervention aimed at further stimulating demand could destabilise the German economy. However the question must also be asked as to whether this favourable economic situation is at the expense of trading partners.

Impact of economic policy on the euro exchange rate

The question of the extent to which the German current account balance represents an international problem is further complicated by membership of the EMU. In international debate, a current account surplus is often interpreted as a sign of an undervalued currency, trade barriers or dumping of export goods. However, the German economy is characterised by a low level of trade barriers on an international scale. As wage-setting is also largely independent of politics, the idea of politically motivated dumping measures is not convincing either.

It would be completely misguided to accuse the German Federal Government of manipulating its currency in order for German companies to have a competitive edge through a weak euro, as the head of the United States' newly created National Trade Council, Peter Navarro has alleged (FT, 2017). Firstly, the German government has never questioned the ECB's independence. And secondly, many

experts, especially in Germany, have been cautioning for some time now that the ECB's monetary policy is too expansionary for the euro area, not just for Germany (GCEE Annual Report 2016 items 416 f.).

German economic policy is also accused of impeding economic recovery in other euro area member states in its calls for structural reforms and stronger efforts to reduce public spending in those countries. However, boosting the growth momentum of the EMU states and not relying on short-term stimulus that favours even higher debt levels is the best approach for all involved. This can only be achieved through structural reforms.

Reasons for the current account surplus

Germany's high current account surplus does however warrant an explanation. Temporary factors play a major role, for example, the ECB's expansionary monetary policy has a noticeable effect on the German current account surplus via the exchange rate. It is first and foremost an expression of the euro area crisis. To try at the same time to cushion the adjustment processes in the crisis countries and to demand that the German current account surplus with euro area countries that have a high current account deficit be swiftly decreased is contradictory. Nonetheless, the German economy has reduced its current account surplus with all euro area crisis countries over the past few years. It is a different story with France, whose need for reform is also considerable. France continues to have a high current account deficit with Germany. [↘ CHART 9, LOWER RIGHT](#)

The calculations by the GCEE also indicate that the improvement in price competitiveness since mid-2014 can account for at least one percentage point of the current account surplus in 2016. The dramatic fall in the price of oil from 2014 until 2016 reflected in declining import prices is responsible for around two percentage points of the trade surplus (GCEE Annual Report 2016 item 239). These partial effects combined significantly exceed the total current account balance increase since 2014 of 0.8 percentage points.

Further explanations for the high capital export are found in net lending/net borrowing of Germany's economic sectors. Given the necessity to reduce debt in combination with the current economic situation, public finances have improved (GCEE Annual Report 2016 items 81 ff.). Moreover, the expanding current account balance coincides with private sector consolidation. A strong consolidation process can be observed in private households as a reaction to heavy debt resulting from the real estate bubble in the 1990s (GCEE Annual Report 2014 items 413 ff.).

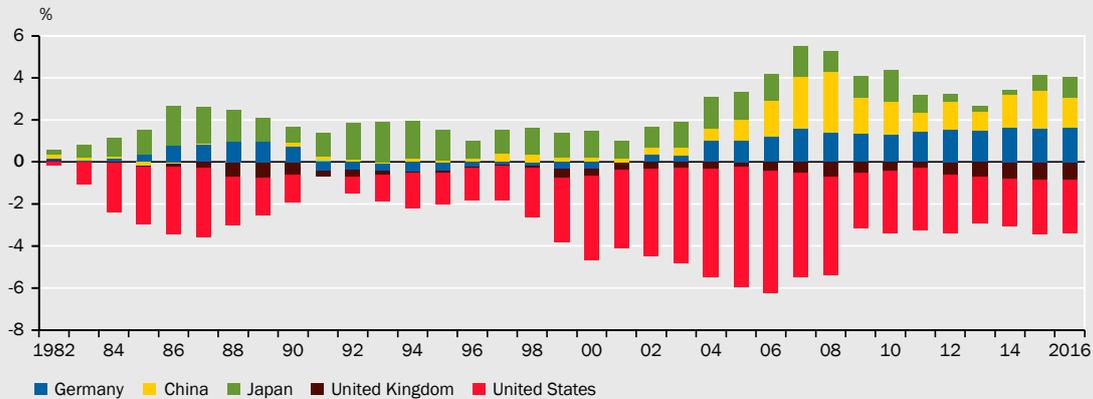
Lastly, there is evidence of the impact of demographic change (GCEE Annual Report 2014 items 418 ff.). The calculations by the GCEE quantify the partial effect of the demographic structure on the current account balance at around two percentage points (GCEE Annual Report 2014 box 20). The demographic effect will, however, decrease from the mid-2020s onwards, according to the estimates, from which time it will actually negatively affect the current account balance.

The corporate sector is recording increasing capital ratios, due chiefly to tax factors and the creation of a risk buffer in reaction to the global and euro area financial crises (GCEE Annual Report 2014 item 423 ff.). The rise in corporate savings is also accompanied by stepped up investment activity abroad. When making investment decisions, German companies seem frequently to conclude that opportunities in Germany are not sufficiently attractive. The opinion expressed occasionally that German foreign assets are a bad form of investing capital fails to stand up to more critical analysis. Calculations demonstrate that despite financial crisis losses, investment income on German foreign assets still exceeded that from foreign-held investments in Germany (GCEE Annual Report 2014 items 475 ff.). Irrational investment behaviour of German companies can therefore hardly be the major driving force behind comparatively high foreign investment.

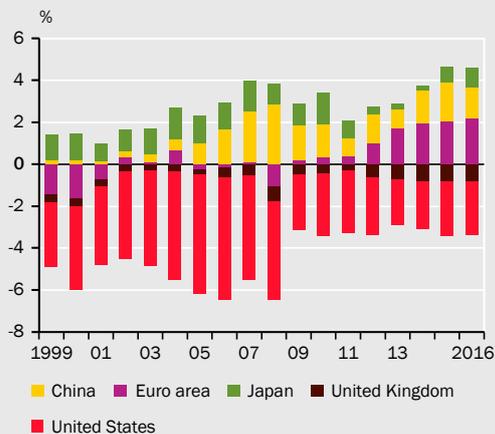
↳ CHART 9

Current account balances of selected countries

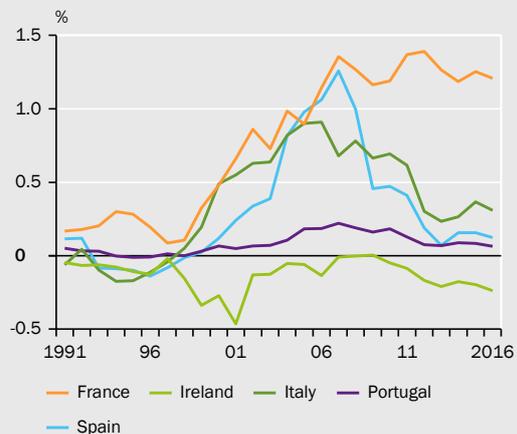
Long-term comparison of the current account balances of selected countries^{1,2}



Current account balances of selected economies including the euro area^{1,3}



Germany's current account balance vis-a-vis selected countries of the euro area⁴



1 – In Relation to the GDP of the United States. 2 – Total nominal GDP of the selected economies equals 53.8 % of world GDP in 2015. 3 – Total nominal GDP of the selected economies equals 64.9 % of world GDP in 2015. 4 – In Relation to nominal GDP of Germany.

Sources: Deutsche Bundesbank, Federal Statistical Office, IMF, OECD, own calculations

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The US and its permanent deficit

In any case, it is not the German current account balance but the overall current account balance of the euro area that is of interest in international comparison and assessment of current account balances. The euro area's current account surplus has averaged close to zero since 1999. The euro area has only created a current account surplus due to adjustments it was forced to make in recent years as a result of the crisis. ↳ CHART 9, LOWER LEFT This shows not least that current account balances are subject to fluctuation over time. The United States' permanent current account deficit vis-à-vis different trade partners over time stands in noteworthy contrast. ↳ CHART 9, TOP The permanent borrowing from other countries is an expression of the United States' "exorbitant privilege" due to the US dollar's role as a reserve currency.

Implications for economic policy

Given that a current account surplus is only a symptom of underlying developments, it does not represent a suitable economic policy target. Instead of reducing the current account balance for the sake of it, economic policymakers should ask themselves why German companies invest so heavily

abroad or how to revive private investment in Germany. Assessment of the high savings rate of companies often actually carries a reproachful undertone, as if foreign investment were unpatriotic and by not investing in Germany, German companies were harming Germany – and indirectly the entire world through the effects it has on the current account balance. This argument is misleading.

The best way to reduce the German current account surplus is by increasing potential output growth. To do so, supply-side economic policy measures would need to be implemented instead, to increase the level of return on investment in Germany, which would also strengthen potential output growth. Such measures include, for example, switching to an energy transition that limits the current level of waste of the country's economic resources. A corporate tax reform could bring about similar effects by creating funding neutrality. Deregulation and opening up the service sector, as also advocated by the European Commission, would also be prudent. Higher public investment could play a positive role too; however it should be primarily at the expense of public consumption. Such measures boost potential growth while also reducing the current account surplus.

4. Labour market situation remains positive

24. The annual average number of people in employment rose by around 540,000 in 2016 to a new **high of almost 43.6 million**. The increase in the number of employees subject to social security contributions of 680,000 was particularly high. After having fallen by 170,000 people following the introduction of the statutory minimum wage in 2015, marginal employment decreased by a further 50,000 in 2016.
25. The overall rise in employment was higher than both in the previous year and as forecast by the GCEE in November 2016. The reason for this was a **significant upward revision to employment statistics** by the Federal Employment Agency (Bundesagentur für Arbeit, 2017). As a result, the annual average number of people in work in 2016 was 118,000 higher according to current data. This correction raises the forecast of the GCEE for the number of employed persons in 2017 accordingly from the figure assumed in autumn 2016.
26. The GCEE expects 44.2 million people in employment in 2017, of whom some 31.9 million will be subject to social security contributions. [↘ TABLE 5](#) The GCEE anticipates a slightly weaker **rise in employment** in 2018, to around 44.6 million people, of whom 32.3 million will be subject to social security contributions. Gross wages and salaries of the average employee can be expected to rise in 2017 and 2018 as strongly as last year – by around 2.0 % and 2.3 % respectively.
27. The annual average number of registered unemployed in 2016 was just under 2.7 million people, which was nearly 100,000 fewer than in the previous year. In contrast, **underemployment**, which primarily comprises participants in labour market measures in addition to the registered unemployed, **recently increased slightly** in seasonally adjusted terms. The main reason for this is the rise in the number of recognised asylum seekers, who are increasingly taking advantage of labour market policy measures such as integration courses. Once

TABLE 5

Labour market in Germany

Thousand persons

	2015	2016	Forecast ¹					
			2017		2018	2017		2018
			Update	Diff. to AR 2016/17		Update	Diff. to AR 2016/17	
			yearly averages			Change on previous year in % Diff. in percentage points		
Labour force ^{2,3}	44,929	45,286	45,822	(123)	46,335	1.2	(0.3)	1.1
Unemployed persons ⁴	1,950	1,775	1,746	(- 85)	1,778	- 1.6	(- 1.6)	1.8
Commuter balance ⁵	78	82	83	(0)	85	1.2	(0.8)	2.4
Employed persons ⁶	43,057	43,593 ^a	44,159	(207)	44,642	1.3	(0.4)	1.1
Employees subject to social security contributions ⁷	30,822	31,504 ^a	31,940	(173)	32,329	1.4	(0.3)	1.2
Exclusively marginally employed ⁸	4,856	4,806	4,827	(- 28)	4,836	0.4	(- 0.3)	0.2
Registered unemployed persons ⁷	2,795	2,691	2,653	(- 60)	2,696	- 1.4	(- 1.6)	1.6
Underemployment excluding short-time work ^{7,9}	3,631	3,578	3,642	(30)	3,705	1.8	(0.9)	1.7
For information purposes:								
Unemployment rate (FEA) ^{7,9,10}	6.4	6.1	6.0	(- 0.1)	6.0	- 0.1	(- 0.1)	0.0
Unemployment rate (ILO) ^{11,12}	4.6	4.1	4.0	(- 0.2)	4.0	- 0.1	(- 0.1)	0.0

1 – Forecast of the GCEE. 2 – Persons in working age with residence in Germany (national concept). 3 – As defined by the national accounts systems. 4 – ILO concept. 5 – Difference of employed workers commuting from foreign countries to Germany and those commuting from Germany to foreign countries. 6 – Employed persons in Germany irrespective of their residence (domestic concept). 7 – Source: Federal Employment Agency (FEA). 8 – Employed workers with a wage up to 450 Euro. 9 – According to the concept of underemployment by the FEA. 10 – Registered unemployed persons in relation to civilian labour force. 11 – Change of yearly averages in %; change on previous year in percentage points. 12 – Unemployed persons in relation to the labour force, for persons in private households aged from 15 to 74 years. Source: Eurostat. a – Due to the correction of employment statistics by the Federal Employment Agency, the number deviates from the official statistics. The official numbers state 43.475 million employed persons and 31.489 million employees subject to social security contributions.

Sources: Federal Bureau of Statistics, Federal Employment Agency, Eurostat

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these measures have expired, it is likely that a majority of these individuals will initially be registered as unemployed.

28. After a further slight reduction in the number of unemployed in 2017 to around 2.65 million, the GCEE consequently anticipates an increase in registered unemployment back to just under 2.7 million people in 2018. Annual average underemployment in 2017 and 2018 is likely to rise somewhat for the first time since 2009. The **unemployment rate** will likely **drop** slightly from 6.1 % in 2016 to 6.0 % in 2017, and remain at this rate in 2018.

5. Public finances – expectations exceeded

29. At €23.7 billion, **Germany's government surplus** turned out higher than expected last autumn. Although total expenditures rose stronger than forecast, this was more than offset by the even more dynamic increase especially in assessed taxes and social contributions.
30. As expenditures were expanded by 4.0 %, and thus stronger than nominal GDP, **the public spending ratio increased even more sharply** than recently assumed. This rising trend is likely to continue throughout the forecast period,

putting total expenditures in 2018 at an expected 44.7 % of nominal GDP. [TABLE 6](#) This is particularly due to higher transfer payments and fiscal policy measures that have already been agreed.

Discretionary measures ranging from 0.3 % to 0.4 % of nominal GDP are likely to be carried out this year, and ranging from 0.1 % to 0.2 % next year. **Fiscal policy** will thus remain **expansionary** for the forecast period. These measures chiefly affect the spending side of the budget. On the one hand, services have been expanded in the area of health and long-term care, on the other hand, investments are planned primarily in infrastructure.

31. On the **revenue side**, in contrast, income tax reliefs and the expiring nuclear fuel tax will be nearly completely offset by heavier levies in other areas. For example, higher contribution rates for long-term care insurance in 2017 and in-

TABLE 6

Public revenues and expenditures and fiscal indices¹

	2016	Forecast ²			Forecast ²		
		2017		2018	2017		2018
		Update	Diff. to AR 2016 /17		Update	Diff. to AR 2016 /17	
		Billion euro			% ³	Percentage points	% ³
Total revenues	1,411.4	1,447.0	(5.3)	1,493.8	2.5	(- 0.3)	3.2
Taxes	731.2	747.3	(2.5)	770.1	2.2	(- 0.4)	3.0
Social contributions	523.1	544.7	(5.5)	564.8	4.1	(0.5)	3.7
Other revenues ⁴	157.1	154.9	(- 2.8)	158.9	- 1.4	(- 2.9)	2.6
Total expenditures	1,387.7	1,434.5	(5.3)	1,485.9	3.4	(0.1)	3.6
Intermediate consumption	151.7	157.3	(4.9)	161.8	3.7	(1.0)	2.9
Compensation of employees	235.8	242.9	(1.6)	250.0	3.0	(0.5)	2.9
Property income (including interest) payable	43.4	41.5	(0.7)	40.2	- 4.4	(- 0.9)	- 3.0
Subsidies payable	27.6	28.4	(0.3)	29.2	3.0	(- 0.1)	2.7
Social benefits other than social transfers in kind	487.7	506.4	(1.0)	522.8	3.8	(- 0.1)	3.2
Social benefits in kind	268.1	284.1	(- 0.6)	298.1	6.0	(0.4)	4.9
Gross capital formation	66.5	69.9	(- 1.9)	73.4	5.2	(0.0)	5.0
Other expenditures ⁵	107.0	103.9	(- 0.9)	110.4	- 2.9	(- 1.5)	6.3
Net borrowing/net lending	23.7	12.5	(0.1)	7.9	x	x	x
Fiscal indices (%)⁶							
Public spending ratio ⁷	44.3	44.6	(0.2)	44.7	x	x	x
Tax ratio ⁸	23.7	23.6	(0.3)	23.3	x	x	x
Tax and contribution ratio ⁹	39.3	39.4	(0.4)	39.2	x	x	x
Net lending/net borrowing	0.8	0.4	(0.0)	0.2	x	x	x
Structural balance ¹⁰	0.6	0.0	(- 0.1)	- 0.3	x	x	x
Debt-to-GDP ratio ^{2,11}	68.0	65.8	(0.1)	63.5	x	x	x

1 – National accounts (nominal values). 2 – Forecast by the GCEE. 3 – Change on the previous year in %. 4 – Sales, other subsidies on production, property income, other current transfers, capital transfers. 5 – Other current transfers, capital transfers, other taxes on production, and net acquisition of non-financial non-produced assets. The revenues from the allocation of mobile phone licences reduce the expenditures by lowering the net acquisition of non-financial non-produced assets. 6 – In relation to nominal GDP. 7 – Total expenditures. 8 – Taxes including inheritance tax and taxes to the EU. 9 – Taxes including inheritance tax and taxes to the EU, and actual social contributions. 10 – Cyclically adjusted budget balance net of temporary measures, see Annual Report 2007 appendix IV D. 11 – Government debt as defined in the Maastricht Treaty.

Source: Federal Statistical Office

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creases in additional contributions for health insurance in 2018 will result in higher social contributions. Moreover, tax privileges on corporation tax are due to end as of 2018. General government revenue is expected to increase slower than general government expenditure in these two years.

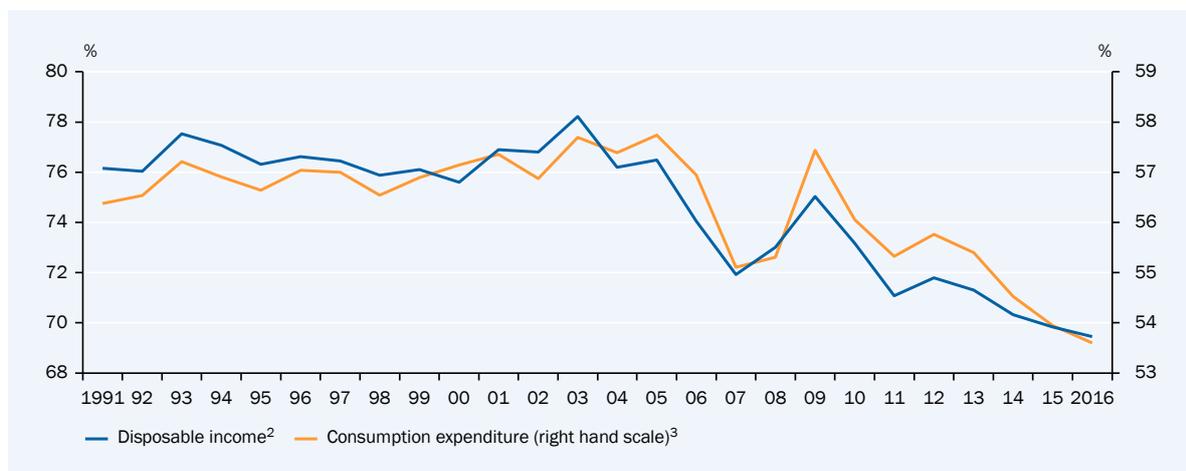
32. Nevertheless, the GCEE still **expects slight surpluses**. These will likely amount to €12.5 billion this year (0.4 % of nominal GDP) and €7.9 billion (0.2 % of nominal GDP) next year. The structural balance adjusted for temporary measures and cyclical effects shows, however, that there is **no leeway for its utilisation**. The estimate particularly accounts for the fact that the low interest expenditures are not permanent, that the proceeds from auctioning mobile communications licenses in the forecast period are only a one-time contribution to the surplus, and that the economic situation considerably relieves the overall budget. A structural surplus is no longer anticipated for 2017, with a structural deficit of 0.3 % of nominal GDP actually expected for 2018.

A differing opinion

33. One member of the German Council of Economic Experts, Peter Bofinger, does not agree with the opinion held by the majority of Council members that the high German current account surplus should not be considered a **macroeconomic imbalance**.
34. A current account surplus basically means that a country's aggregate income, in other words its domestic supply, is greater than its domestic demand. A current account surplus of 8.3 % of gross domestic product thus means that there is a **domestic demand gap** of this amount which is compensated by foreign demand. This may not seem to be a problem from a national point of view, which argues as does the majority of the Council members that capacity is overutilised in Germany, which has a high employment rate and price development compatible with the ECB's inflation target.
35. However, this is a simplistic view. It falls short of the **prescribed objectives** of the Act to Promote Economic Stability and Growth (*Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft*) and the Act on the Appointment of a Council of Experts on Economic Development (*Gesetz über die Bildung eines Sachverständigenrates zur Begutachtung der gesamtwirtschaftlichen Entwicklung – SVR-Gesetz*). These state equilibrium in foreign trade and payments as an objective, which –in addition to the purely domestic economic objectives (price stability, a high employment rate and a steady, appropriate rate of growth) – should be used as an **independent criterion for determining the existence of a macroeconomic imbalance**.

36. There are good reasons for doing so. From a global perspective, “**surplus saving**” in a country with a high current account surplus results in a global demand deficit, which in itself leads to contraction of the global economy. If this did not materialise in the past it is because the governments of many major countries have been willing to run **high budget deficits** for years on end. In terms of the mechanism of net balances (*Saldenmechanik*), the German aggregate current account surplus is made possible, at least to some extent, by budget deficits in the United States, the United Kingdom and France, i.e. countries with which Germany has particularly high bilateral current account surpluses. If, like the majority of the Council members, one takes a very critical view of budget deficits in general, we should not consider a current account surplus that has resulted in such a way to be “in balance”.
37. Viewed in this context, criticism of Germany's current account surplus is indeed justified. In contrast to the majority's diagnosis, this surplus is not largely due to “temporary factors”. The substantial rise in the balance over the past decade can be traced to a very large extent to severe **wage restraint**, particularly from 2004 to 2007. This considerably slowed domestic demand and above all private consumption. ↘ CHART 10 Sustained but not as severe wage restraint, in which unit labour costs per hour fell completely short of the ECB price development target, is also evident from 2013 to 2016. Calculations by the GCEE are evidence of the important role that price competitiveness plays in the current account balance (GCEE Annual Report 2016 item 239).
38. Wage cost development can only be controlled to a certain extent by **policy-makers**, but it is not entirely independent. The shifting of parity in health insurance contributions at the expense of employees in 2005 is an example of a targeted economic policy contribution to a reduction in unit labour costs. The value-added tax rate was raised in 2007, with a portion of the revenues used as a federal subsidy to unemployment insurance, which enabled a further cut in contributions. This is referred to as **internal devaluation**. Moreover, the public

↘ CHART 10
Income and consumption of the private households¹



1 - Including non-profit institutions serving households. 2 - In relation to national disposable income. 3 - In relation to nominal GDP.

Sources: Federal Statistical Office, own calculations

sector is the country's largest employer. Wage increases that at 2 % do not even offset inflation, as were agreed in the collective bargaining round just completed, send the wrong signal.

39. German economic policy could also contribute directly to reducing the current account surplus by abandoning its **budget surplus policy**. With a government surplus of almost €24 billion in 2016, there would certainly be far more useful purposes for it than debt repayment, particularly in education and research.

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Key figures of the national accounts

Absolute values

	Unit	2016	2017 ¹	2018 ¹	2017 ¹		2018 ¹	
					1. half-year	2. half-year	1. half-year	2. half-year
Use of domestic product								
at current prices								
Final consumption expenditure	Billion euro	2,295.3	2,374.7	2,446.8	1,158.3	1,216.4	1,193.7	1,253.1
Private consumption ²	Billion euro	1,679.2	1,731.0	1,777.9	845.5	885.5	867.6	910.3
Government consumption	Billion euro	616.1	643.7	668.9	312.8	330.9	326.1	342.9
Gross fixed capital formation	Billion euro	626.7	650.3	680.6	313.1	337.2	328.0	352.6
Investment in machinery & equipment	Billion euro	204.4	208.9	217.3	99.9	109.0	103.8	113.5
Construction investment	Billion euro	309.4	324.3	342.2	156.1	168.2	165.0	177.2
Other products	Billion euro	112.9	117.1	121.0	57.1	59.9	59.2	61.9
Domestic demand	Billion euro	2,893.9	3,014.0	3,120.8	1,475.4	1,538.6	1,527.2	1,593.7
Exports of goods and services	Billion euro	1,441.4	1,533.0	1,604.1	758.5	774.6	794.3	809.8
Imports of goods and services	Billion euro	1,202.6	1,322.4	1,396.5	644.8	677.6	682.4	714.1
Gross domestic product	Billion euro	3,132.7	3,224.6	3,328.4	1,589.0	1,635.6	1,639.1	1,689.4
Chained volumes								
Final consumption expenditure	Billion euro	2,121.9	2,152.2	2,184.0	1,057.6	1,094.5	1,073.3	1,110.6
Private consumption ²	Billion euro	1,570.7	1,586.2	1,605.8	777.8	808.4	786.7	819.1
Government consumption	Billion euro	551.0	565.3	577.3	279.4	285.9	286.1	291.2
Gross fixed capital formation	Billion euro	567.7	579.3	597.5	279.3	300.0	288.3	309.2
Investment in machinery & equipment	Billion euro	196.8	199.2	206.0	94.8	104.5	98.0	108.1
Construction investment	Billion euro	268.2	275.1	284.4	133.1	142.1	137.8	146.7
Other products	Billion euro	103.0	105.0	107.1	51.4	53.6	52.5	54.7
Domestic demand	Billion euro	2,655.3	2,706.2	2,756.5	1,337.1	1,369.1	1,360.5	1,396.0
Exports of goods and services	Billion euro	1,388.4	1,451.2	1,509.5	720.0	731.3	748.3	761.1
Imports of goods and services	Billion euro	1,200.0	1,276.3	1,338.5	625.0	651.3	655.3	683.2
Gross domestic product	Billion euro	2,843.0	2,883.1	2,930.5	1,432.4	1,450.7	1,454.5	1,476.1
Price Development (deflators)								
Final consumption expenditure	2010=100	108.2	110.3	112.0	109.5	111.1	111.2	112.8
Private consumption ²	2010=100	106.9	109.1	110.7	108.7	109.5	110.3	111.1
Government consumption	2010=100	111.8	113.9	115.9	112.0	115.7	114.0	117.7
Gross fixed capital formation	2010=100	110.4	112.2	113.9	112.1	112.4	113.8	114.0
Investment in machinery & equipment	2010=100	103.9	104.9	105.5	105.4	104.4	106.0	105.0
Construction investment	2010=100	115.4	117.9	120.3	117.3	118.4	119.8	120.8
Other products	2010=100	109.6	111.5	113.0	111.1	111.8	112.7	113.2
Domestic demand	2010=100	109.0	111.4	113.2	110.3	112.4	112.3	114.2
Terms of Trade	2010=100	103.6	102.0	101.9	102.1	101.8	101.9	101.8
Exports of goods and services	2010=100	103.8	105.6	106.3	105.3	105.9	106.1	106.4
Imports of goods and services	2010=100	100.2	103.6	104.3	103.2	104.0	104.1	104.5
Gross domestic product	2010=100	110.2	111.8	113.6	110.9	112.7	112.7	114.5
Production of domestic product								
Employed persons (domestic)	thousand	43,593 ^a	44,159	44,642	43,858	44,461	44,342	44,942
Labour volume	Million hours	59,280	59,461	59,953	29,291	30,169	29,483	30,471
Labour productivity (per hour)	2010=100	106.0	106.8	107.6	108.0	106.0	108.9	106.8
Distribution of net national income								
Net national income	Billion euro	2,338.4	2,408.2	2,488.0	1,175.1	1,233.2	1,213.2	1,274.8
Compensation of employees	Billion euro	1,593.2	1,650.2	1,711.0	789.8	860.4	819.2	891.8
Gross wages and salaries	Billion euro	1,305.9	1,352.1	1,401.6	645.1	707.0	668.8	732.8
among them: net wages and salaries ³	Billion euro	863.1	893.4	924.8	422.3	471.2	437.0	487.8
property and entrepreneurial income	Billion euro	745.2	758.0	777.0	385.2	372.8	394.0	382.9
Disposable income of private households ²	Billion euro	1,811.8	1,867.8	1,920.2	924.9	942.9	951.4	968.8
Savings rate of private households ^{2,4}	%	9.7	9.7	9.7	10.9	8.5	11.1	8.4
For information purposes:								
nominal unit labour costs ⁵	2010=100	110.2	112.5	114.7	108.4	116.7	110.7	118.8
real unit labour costs ⁶	2010=100	100.0	100.6	101.0	97.7	103.5	98.2	103.8
Consumer prices	2010=100	107.4	109.8	111.6	109.2	110.4	111.0	112.2

1 – Forecast by the GCEE. 2 – Including non-profit institutions serving households. 3 – Compensation of employees minus social contributions of employers and employees and in-come of employees. 4 – Savings relative to disposable income. 5 – Compensation of employees per working hour (employee concept) in relation to real GDP per working hour (employed person concept). 6 – Compensation of employees per working hour (employee concept) in relation to nominal GDP per working hour (employed person concept). a – Due to the correction of employment statistics by Federal Employment Agency, the number deviates from the official statistics. The official numbers state 43.475 million employed persons (domestic).

Source: Federal Statistical Office, own calculations

Key figures of the national accounts

Change on the previous year in %

2016	2017 ¹	2018 ¹	2017 ¹		2018 ¹		
			1. half-year	2. half-year	1. half-year	2. half-year	
Use of domestic product							
at current prices							
3.4	3.5	3.0	3.4	3.5	3.1	3.0	Final consumption expenditure
2.6	3.1	2.7	3.0	3.2	2.6	2.8	Private consumption ²
5.6	4.5	3.9	4.4	4.6	4.2	3.6	Government consumption
3.8	3.8	4.7	3.1	4.4	4.8	4.6	Gross fixed capital formation
2.1	2.2	4.0	1.2	3.2	4.0	4.1	Investment in machinery & equipment
4.9	4.8	5.5	4.2	5.4	5.7	5.3	Construction investment
3.9	3.7	3.4	3.7	3.7	3.5	3.3	Other products
3.2	4.1	3.5	4.2	4.1	3.5	3.6	Domestic demand
1.6	6.4	4.6	6.4	6.3	4.7	4.6	Exports of goods and services
1.1	10.0	5.6	10.3	9.6	5.8	5.4	Imports of goods and services
3.3	2.9	3.2	2.9	3.0	3.1	3.3	Gross domestic product
Chained volumes							
2.5	1.4	1.5	1.4	1.4	1.5	1.5	Final consumption expenditure
2.0	1.0	1.2	1.0	1.0	1.2	1.3	Private consumption ²
4.0	2.6	2.1	2.5	2.7	2.4	1.9	Government consumption
2.3	2.0	3.1	1.4	2.7	3.2	3.1	Gross fixed capital formation
1.1	1.2	3.4	0.1	2.3	3.4	3.4	Investment in machinery & equipment
3.0	2.6	3.4	2.0	3.2	3.5	3.2	Construction investment
2.6	2.0	2.0	2.1	1.9	2.0	2.0	Other products
2.3	1.9	1.9	2.0	1.8	1.7	2.0	Domestic demand
2.6	4.5	4.0	4.7	4.4	3.9	4.1	Exports of goods and services
3.7	6.4	4.9	6.6	6.1	4.9	4.9	Imports of goods and services
1.9	1.4	1.6	1.5	1.3	1.5	1.7	Gross domestic product
Price Development (deflators)							
0.9	2.0	1.5	2.0	2.1	1.5	1.5	Final consumption expenditure
0.6	2.1	1.5	2.0	2.1	1.5	1.5	Private consumption ²
1.5	1.8	1.8	1.8	1.9	1.8	1.7	Government consumption
1.5	1.7	1.5	1.7	1.7	1.5	1.4	Gross fixed capital formation
1.0	1.0	0.6	1.1	0.8	0.6	0.6	Investment in machinery & equipment
1.9	2.2	2.1	2.2	2.2	2.1	2.0	Construction investment
1.3	1.7	1.4	1.6	1.7	1.5	1.3	Other products
0.9	2.2	1.7	2.1	2.3	1.7	1.6	Domestic demand
1.5	- 1.6	- 0.1	- 1.8	- 1.3	- 0.2	- 0.0	Terms of Trade
- 1.0	1.8	0.6	1.7	1.8	0.8	0.4	Exports of goods and services
- 2.5	3.4	0.7	3.5	3.3	0.9	0.5	Imports of goods and services
1.4	1.5	1.5	1.4	1.6	1.6	1.5	Gross domestic product
Production of domestic product							
1.2	1.3	1.1	1.3	1.3	1.1	1.1	Employed persons (domestic)
0.7	0.3	0.8	0.5	0.1	0.7	1.0	Labour volume
1.2	0.8	0.8	0.8	1.0	0.8	0.7	Labour productivity (per hour)
Distribution of net national income							
3.3	3.0	3.3	3.0	3.0	3.2	3.4	Net national income
3.5	3.6	3.7	3.4	3.7	3.7	3.7	Compensation of employees
3.6	3.5	3.7	3.3	3.8	3.7	3.6	Gross wages and salaries
							among them: net wages and salaries ³
3.2	3.5	3.5	3.1	3.9	3.5	3.5	property and entrepreneurial income
3.0	1.7	2.5	2.0	1.5	2.3	2.7	Disposable income of private households ²
2.8	3.1	2.8	2.8	3.4	2.9	2.7	Savings rate of private households ^{2,4}
.	.	.	.	.	.	.	For information purposes:
1.4	2.1	2.0	1.8	2.4	2.1	1.8	nominal unit labour costs ⁵
- 0.0	0.6	0.4	0.4	0.8	0.5	0.3	real unit labour costs ⁶
0.5	2.2	1.6	2.2	2.3	1.7	1.6	Consumer prices

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