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GLOBAL MACRO

# Germany's Minimum Wage: A New Deal, But What Kind of New Deal?

It isn't easy to get a clear sense of how the introduction of a statutory minimum wage in Germany will play out. From one angle of vision, it should raise household disposable income and at the same time contribute to a much-needed rebalancing in the euro area. From another perspective, such a guaranteed minimum is likely to trigger an upward wage trend that couldn't happen at a worse time for German manufacturers who are increasingly struggling to keep exports up. Assuming the Social Democratic Party (SPD) membership approves the deal between the coalition partners on December 17, two basic trends should help us determine the relative weights of these factors and grasp the implications of such a move:

- The extent to which wage increases spread to export industries, which already pay considerably higher wages than the agreed-upon minimum,
- Whether or not international demand for capital goods will recover. If it doesn't, Germany will inevitably slip from its position as a leading exporter and will be unable to power the euro area economy.

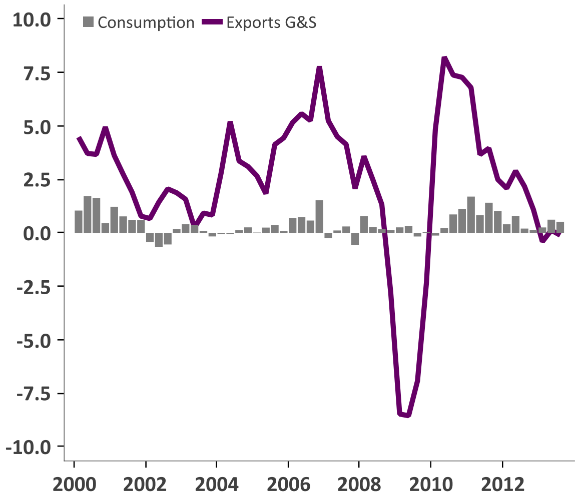
On both scores, the introduction of a minimum wage will mean radical change in relation to the pre-euro era—not only for Germany, but for the entire currency bloc.

## A Minimum Wage: Good News for German Consumers…

Germans are not exactly what you'd call big spenders. Between 2000 and 2007, consumer spending contributed less than 0.4 percentage points to average annual real GDP growth in Germany, versus 1.1 points in France. And while this contribution has inched up in the last few years to 0.7 percentage points since 2010—whereas it has slumped to 0.2 points in France—most of the uptick is attributable to a short-lived improvement between 2010 and 2011. German consumer spending has been marking time since the middle of last year—and there are no real signs of an upcoming trend reversal.

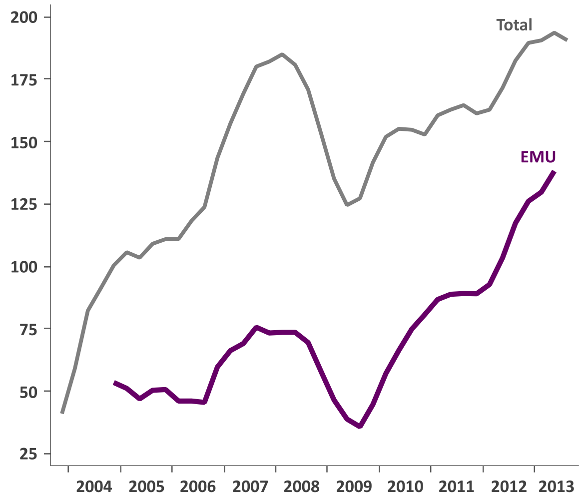
So the vital role German consumers are supposed to play in offsetting the impact of fiscal retrenchment elsewhere in the euro area has yet to materialize. Germany is experiencing import stagnation and its trade surplus continues to balloon to a dangerous extent.

**Contribution to Annual German Growth**




Sources: RichesFlores Research, Macrobond

**German Current Account Balance, billion EUR**




Sources: RichesFlores Research, Macrobond

### What's Up With Germany's Consumers?

In a country with 1.7 million more workers in the labor force than prior to the 2008 crisis and a 6.9 percent unemployment rate—close to a historic low—sluggish consumer spending may seem puzzling. But it seems less so when you consider how little disposable income has increased, due to a combination of slower job creation, rising taxes and social security contributions, and accelerating inflation until the middle of the year.

German Unemployment Rate

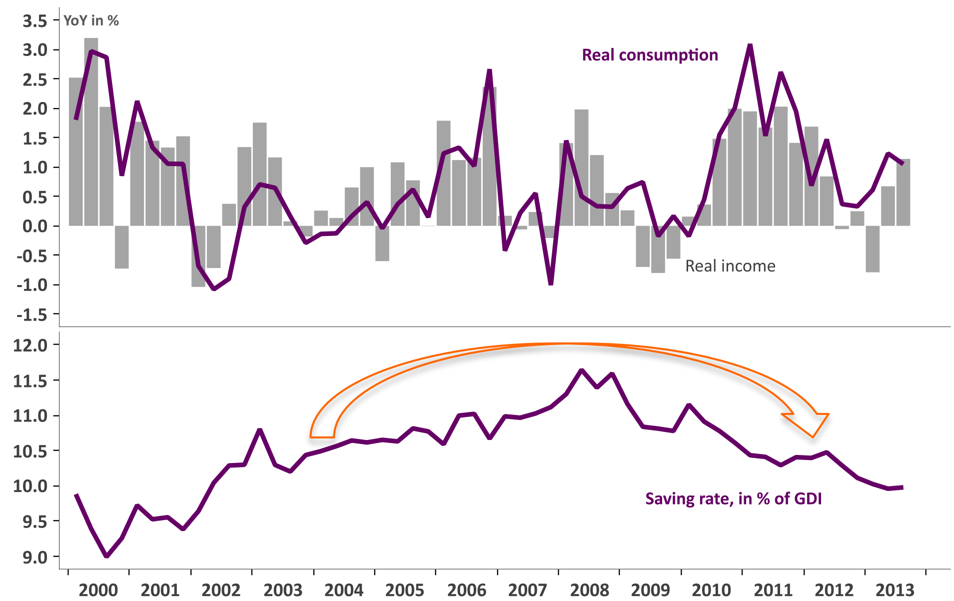
Sources: RichesFlores Research, Macrobond

Employees in Germany


Sources: RichesFlores Research, Macrobond

Besides, German consumers have been putting less of their earnings aside for the past three years, even consistently outspending their meager gains in spending power. Breaking with both their own behavior in the first decade of the century and the trend observable in most other European economies since the 2008 slump, they have steadily reduced their savings rate to 10 percent of disposable income today—a low since 2002.

German Disposable Income, Consumption and Saving Rate



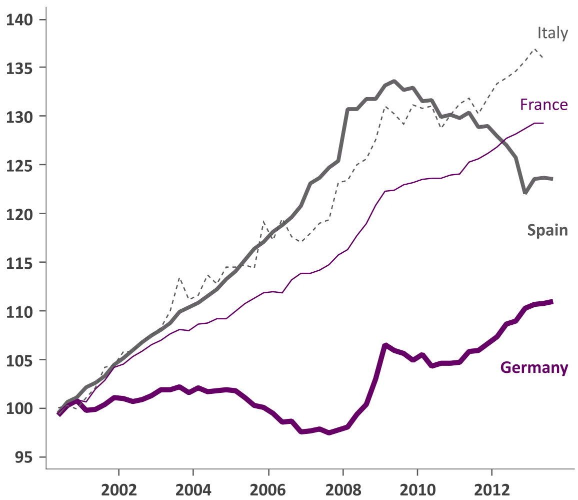

Sources: RichesFlores Research, Macrobond

This suggests that the nationwide minimum hourly wage included in the CDU-SPD coalition agreement—€8.50 as of 2015—will pay off. Now that they have rediscovered the joys of spending, the Germans are poised to take advantage of higher incomes—virtually a guaranteed byproduct of a new minimum wage—to consume more. According to the DIW economic research institute, 6.6 million workers, or a full 17 percent of the labor force, currently earn less than €8.50 an hour. The proposed measure is therefore likely to give overall wage levels a hefty boost.

Moreover, because the mere prospect of higher earnings should lift consumer confidence, the new minimum wage can be expected to have a significant impact on economic growth even before it goes into effect. In all likelihood, Germany will have to import more—and the rest of the euro area stands to benefit. A mandatory minimum wage will have another effect: it will reduce the competitive advantage the country has derived until now from employing Eastern European migrants who settle for much lower pay than local workers.

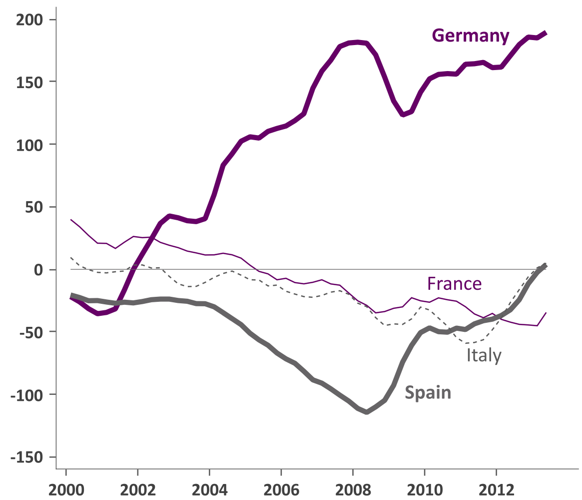
As a result, Germany is likely to make a larger contribution than before to tackling imbalances in the currency bloc, and this will automatically ease the pressure on its eurozone peers to carry out deflationary adjustments. The recent trend toward unit labor-cost convergence, particularly between Germany and Spain, should therefore accelerate. This is not only very good news; it is also crucial to the success of the structural policies the euro area has adopted in the past few years.

**Unit Labor Cost**




Sources: RichesFlores Research, Macrobond

**Current Account, 4-Quarter Sum, billion EUR**




Sources: RichesFlores Research, Macrobond

## … But What About Germany as an Export Powerhouse?

We may, however, lose sight of the bigger picture if we focus on this aspect of the problem alone. In such a quintessential export nation, the higher labor costs likely to result from the CDU-SPD deal could undermine German industry's competitive edge—to such an extent that the macroeconomic advantages of a minimum wage would soon begin to look doubtful. German export growth has been flat for over a year. Meanwhile, Chinese competitors have been steadily gaining ground in sectors that were previously German industry's pride and joy, and the euro's appreciation, particularly against the yen, is increasingly becoming a liability. In other words, the foreseeable upward drift in wages may well happen at the worst possible time for the German economy.


Sources: RichesFlores Research, Macrobond


Sources: RichesFlores Research, Macrobond

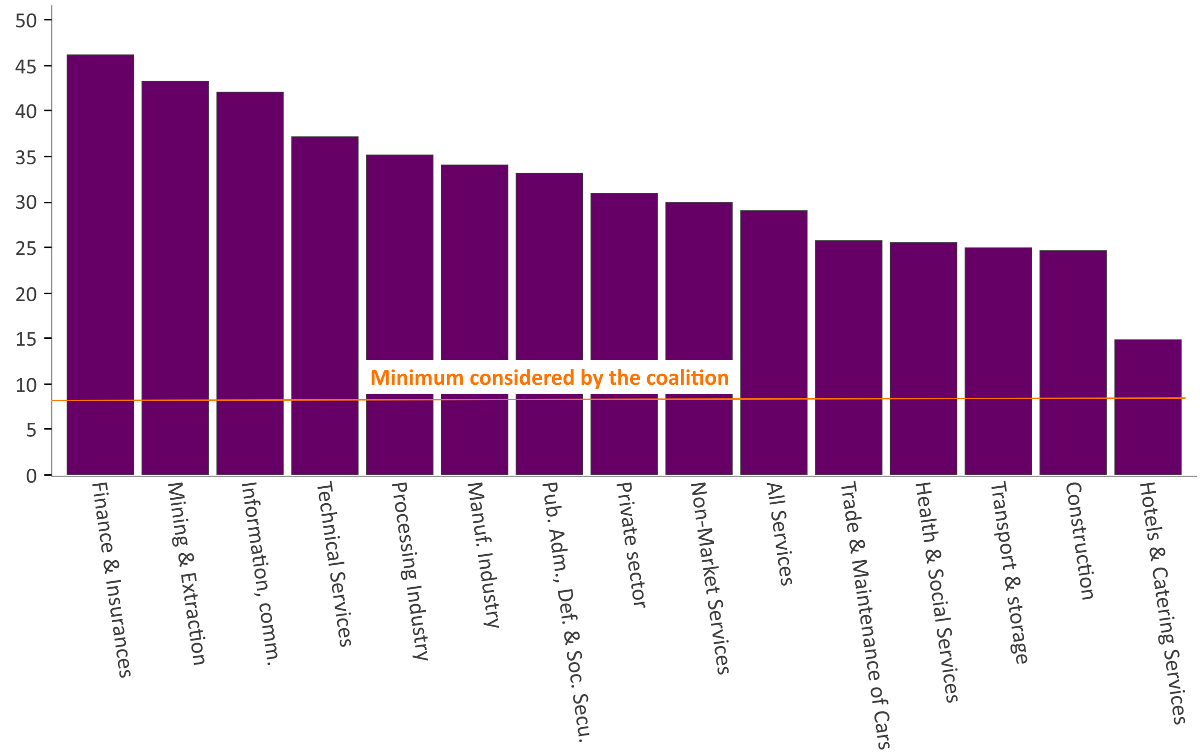
The fact of the matter is that German demand for goods from other eurozone countries is fueled less by domestic consumption than by exports. If its strength as an exporter were to diminish, Germany would probably find itself no better equipped to power the European economy than it is today—especially since the potential loss of domestic jobs in such a case could cancel out most of the positive spillover from higher wages.

So we are clearly dealing with an issue that is sufficiently complex to make it impossible at this stage to gauge the macroeconomic implications of the “Grand Coalition” agreement. How the resulting policies play out in practice is likely to depend on two basic trends:

- The extent to which the new minimum wage affect Germany’s export industries. It is worth noting that the introduction of a minimum wage should have a greater impact on services, which are less often covered by sectoral collective bargaining agreements and where the bulk of low-wage jobs are to be found (see graph and table below).

- Whether or not international demand for capital goods will recover. If it does, the German exporters should have less trouble handling higher labor costs. But if it doesn’t, sooner or later, a large number of German jobs will inevitably go down the drain).

## Average Hourly Labor Cost by Sector of Activity - 2012




Sources: RichesFlores Research, Macrobond

## Statutory Agreed Minimum Wages, EUR/hour

| | Valid to | West (Berlin) | East |
|---|---|---|---|
| Commercial cleaning | valid to 31.03.13 | 8 (7) | 7 |
| Main construction industry | 01.01.13 - 31.12.13 | | |
| - skilled workers | | 13.70 (13.55) | 10.25 |
| - unskilled workers | | 11.05 | 10.25 |
| Electrician trade | 01.01.13 - 31.12.13 | 9.90 (8.85) | 8.85 |
| Roofing trade | 01.01.13 - 31.12.13 | 11.20 | 11.20 |
| Industrial cleaning | 01.01.13 - 31.12.13 | | |
| - Interior and maintenance | | 9 | 7.56 |
| - Windows and facades | | 11.33 | 9 |
| Long-term care activities | 01.07.13 - 31.12.14 | 9 | 8 |
| Painting and varnishing trade | 01.05.13 - 30.04.14 | | |
| - skilled workers | | 12.15 | 9.90 |
| - unskilled workers | | 9.90 | 9.90 |
| Scaffolding trade | 01.08.13 - 28.02.14 | 10 | 10 |
| Security activities | 01.01.13 - 31.12.13 | 7.50 – 8.90 | 7.50 |
| Special mining | valid to 31.03.13 | | |
| - skilled workers | | 12.81 | 12.81 |
| - unskilled workers | | 11.53 | 11.53 |
| Vocational education and further training services | 01.07.13 - 31.12.13 | 12.60 | 11.25 |
| | 01.01.14 - 31.12.14 | 13 | 11.65 |
| | 01.01.15 - 31.12.15 | 13.35 | 12.50 |
| Temporary employment agency activities | 01.11.12 - 31.10.13 | 8.19 (7.50) | 7.50 |
| Waste management | 01.02.13 - 30.06.14 | 8.68 | 8.68 |

Sources: RichesFlores Research, Statistisches Bundesamt

So a great deal is at stake in the CDU-SPD agreement, which requires SPD rank-and-file endorsement on December 17 before it can be finalized and before Ms. Merkel can officially take office. The “Grand Coalition” could mark a radical break with how Germany has operated for the past decade. It could also signal the start of a structural transition for the euro area by eliminating the region’s deflationary bias—championed by Germany since the inception of the common currency.

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