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Germany at the Crossroads

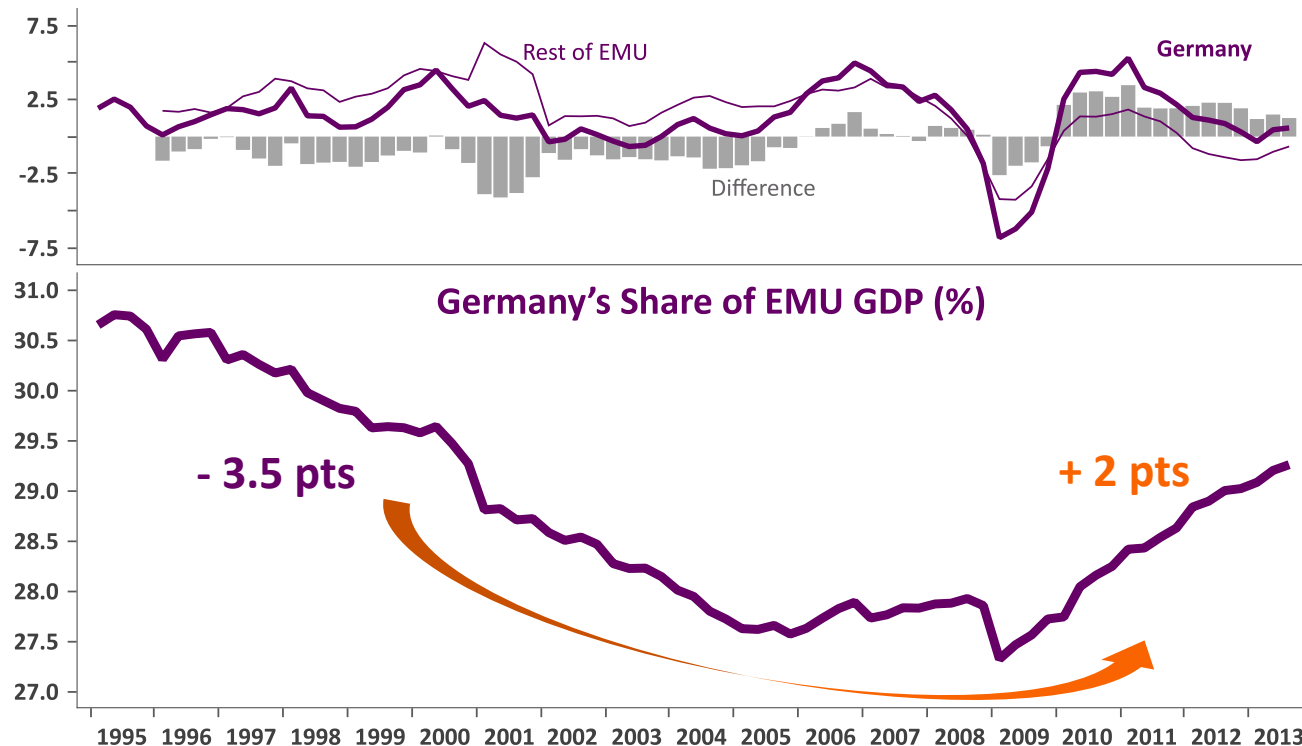
V. Riches-Flores

JANUARY 28, 2014

Germany Is Back

Germany portrays itself as a model after regaining all the ground it lost to its EMU peers since 2009.

Growth Rates Compared Between Germany and the Rest of the Euro Area

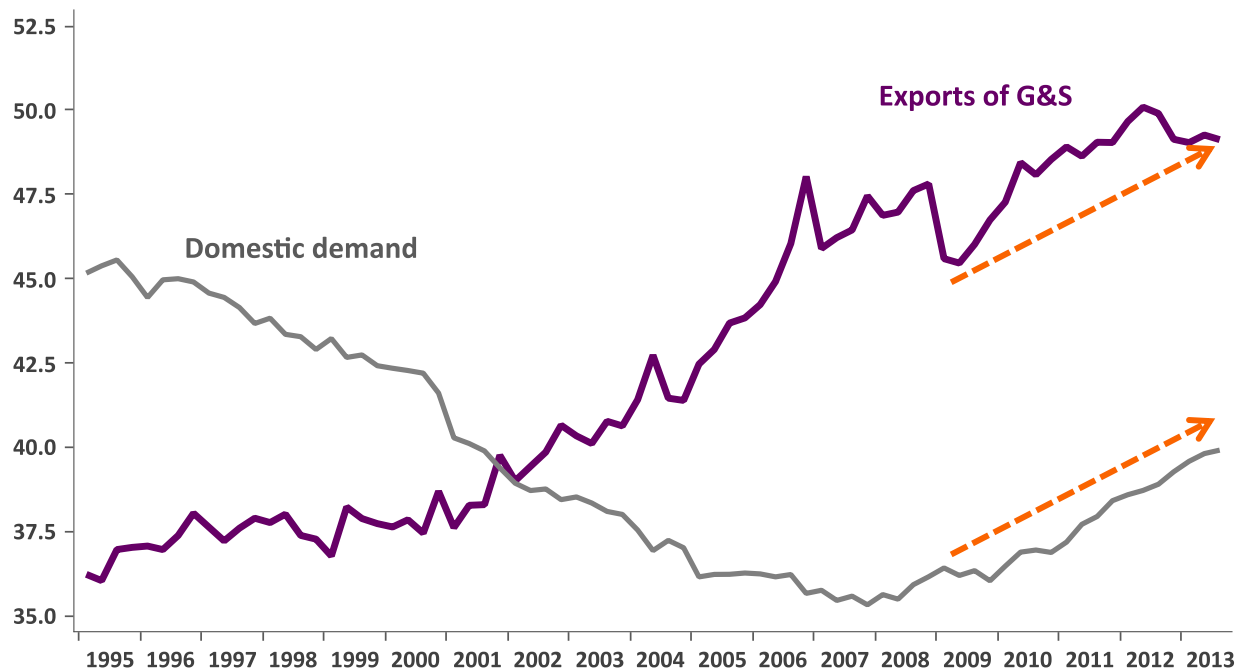


Sources: RichesFlores Research, Macrobond

Export Strength Is Stimulating Domestic Demand – At Last

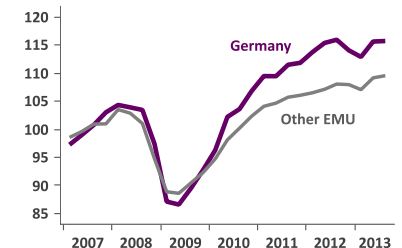
Export momentum has at long last pulled domestic demand out of a prolonged period of sluggish growth. The 2009 recovery marks the start of a virtuous phase.

German Domestic Demand and Exports, % of Total for the Rest of the EMU



Sources: RichesFlores Research, Macrobond

Exports of G&S, 2007=100



Sources: RichesFlores Research, Macrobond

Domestic Demand, 2007=100



Sources: RichesFlores Research, Macrobond

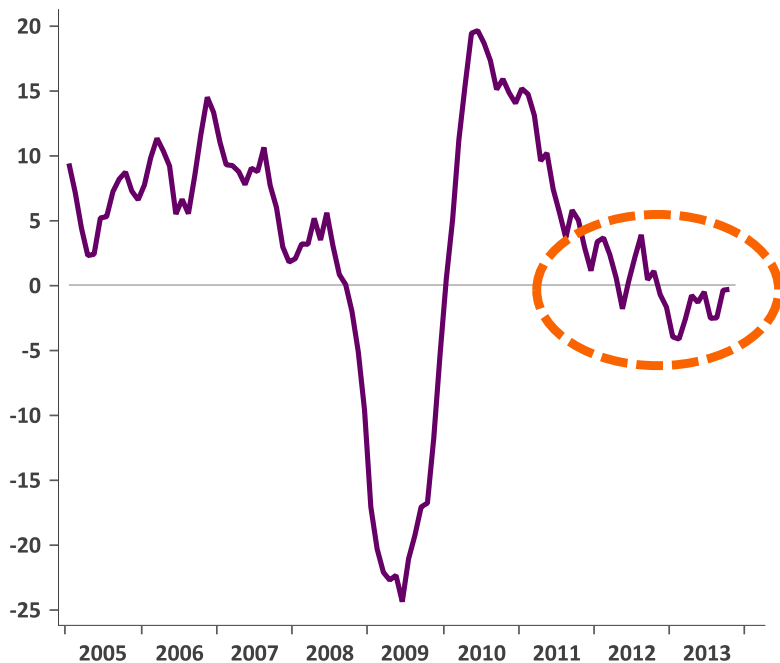
Is Powerhouse the Right Word?

- **The German economy was supposed to be the powerhouse the eurozone needed to make up in part for the woes afflicting other Member States. How well has it done?**
- **In 2013:**
 - Germany's GDP increased by just 0.5%—the rate of increase for its exports of goods and services,
 - Corporate investment slid by nearly 2%, after contracting by 3% in 2012,
 - Household spending inched up by 0.9%, after 0.8% in 2012...
 - ...while imports to Germany from the rest of the euro area stagnated for the second year straight.

Germany Only Imports When It Exports

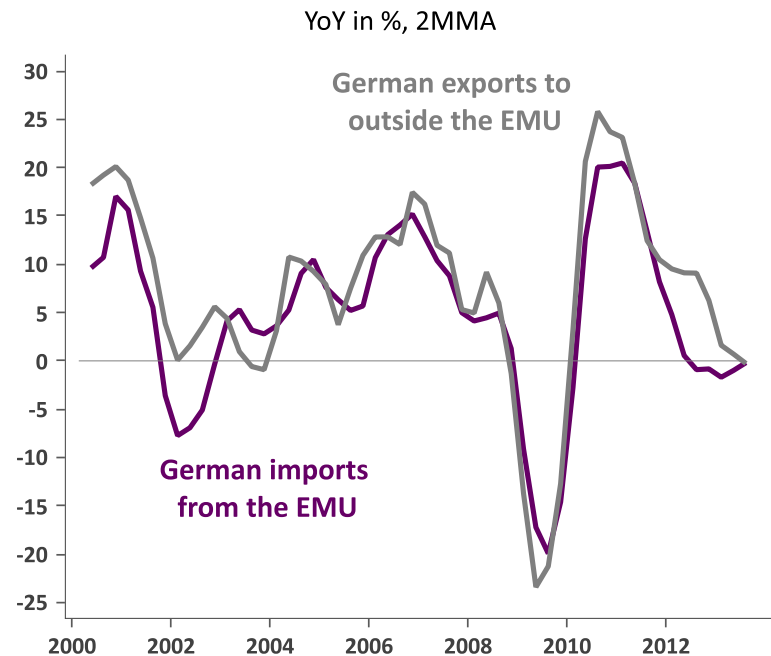
German GDP growth depends to a large extent on exports. Export stagnation over the past two years has had a depressive effect on demand for imports.

Annual German Export Growth in Volume Terms



Sources: RichesFlores Research, Macrobond

German Exports to Outside the EMU, German Imports from the EMU

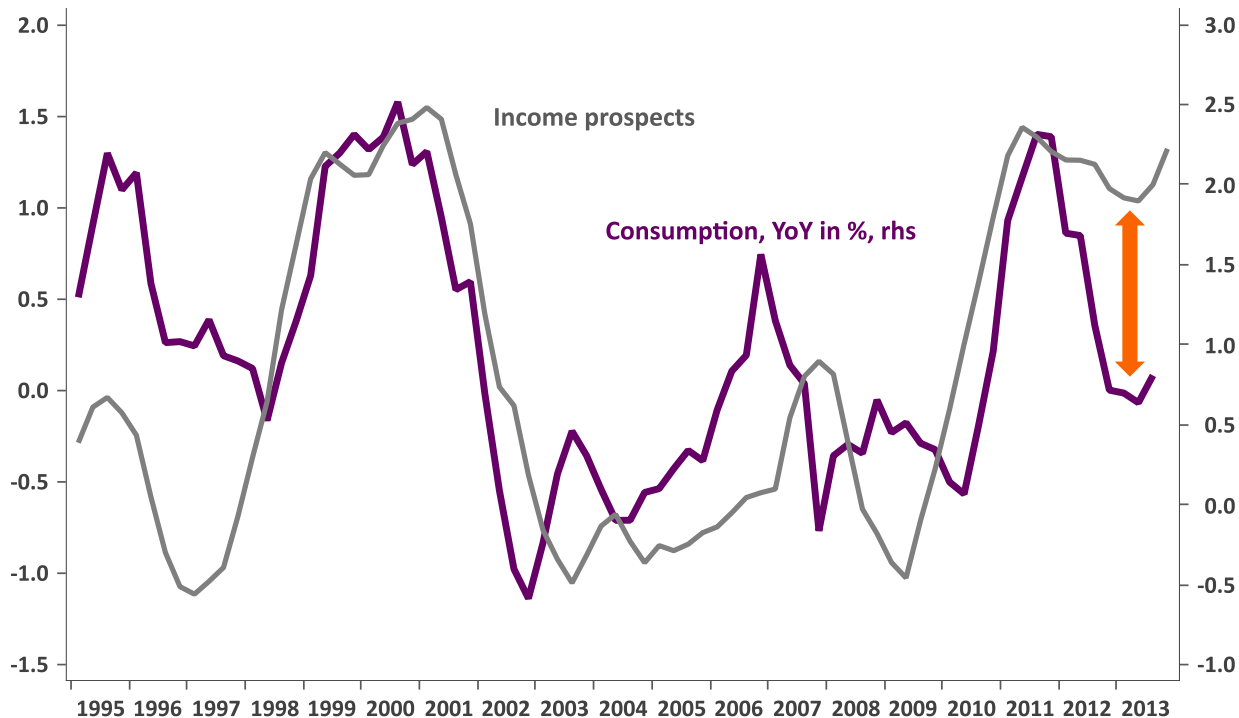


Sources: RichesFlores Research, Macrobond

Consumer Spending Has Barely Risen—Even With Unemployment at a Historic Low

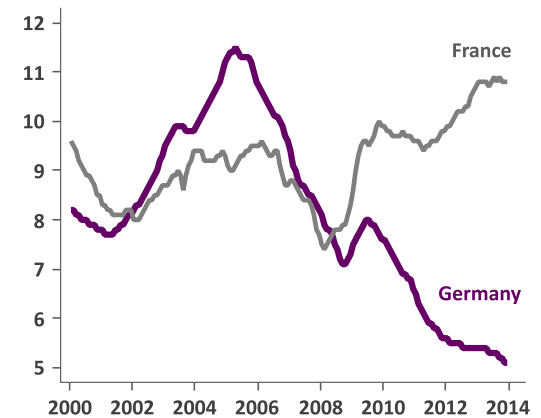
In 2012 and 2013, consumer spending growth did not exceed the 0.9% mean growth rate since 1995, although income prospects are close to an all-time high and the jobless rate has hit a historic low.

German Consumer Spending and Confidence



Sources: RichesFlores Research, Macrobond

Jobless Rate



Sources: RichesFlores Research, Macrobond

A Giant With Feet of Clay

Can Germany live up to current expectations?

- **Its primary sources of export strength are drying up**
 - The deglobalization trend under way affects Germany more than any other country
 - European demand for German exports is down—and will stay down
- **The “graying” of Germany is picking up speed**
 - The German economy now has the lowest growth potential of any OECD country
 - The country has only limited ability to stimulate domestic growth
 - An aging population is in no position to sustain industrial dominance
- **What are the coalition government’s chances of maintaining Germany as the euro area’s number-one economy?**

The Key Ingredients of German Export Strength Are Slipping Away

1

The country is losing its competitive edge, due to dwindling trade, exhaustion of previous sources of productivity gains and a cheaper yen.

2

The booming worldwide demand for capital goods between 2005 and 2012 is a thing of the past. Capital spending is marking time in the advanced countries, China is shifting gears, while other emerging economies are having a harder time catching up.

3

Europe is not about to revert to the strong demand it experienced before the crisis: despite a brighter outlook in 2014, the structural indicators still show serious weakness.

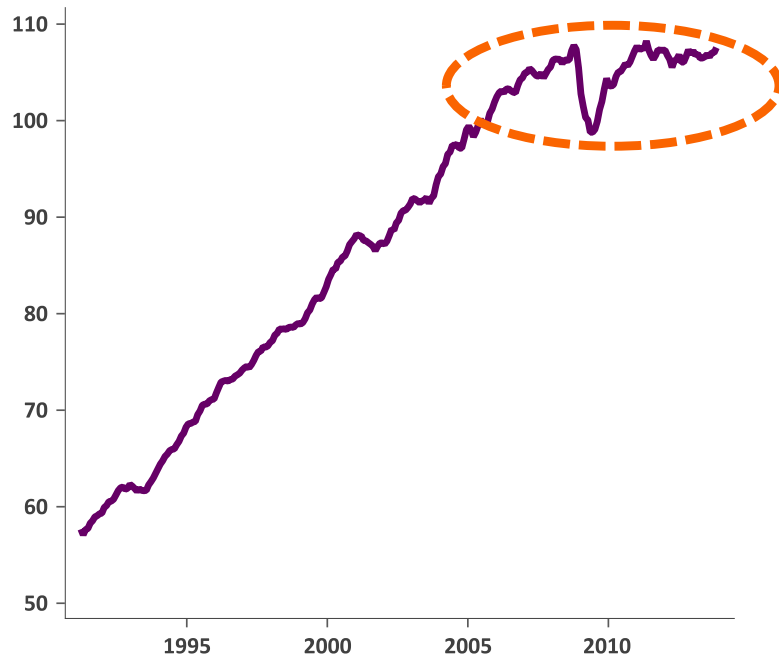
4

Germany's specialized industry sectors are losing ground to Asian rivals.

I- Deglobalization Is Undermining German Productivity

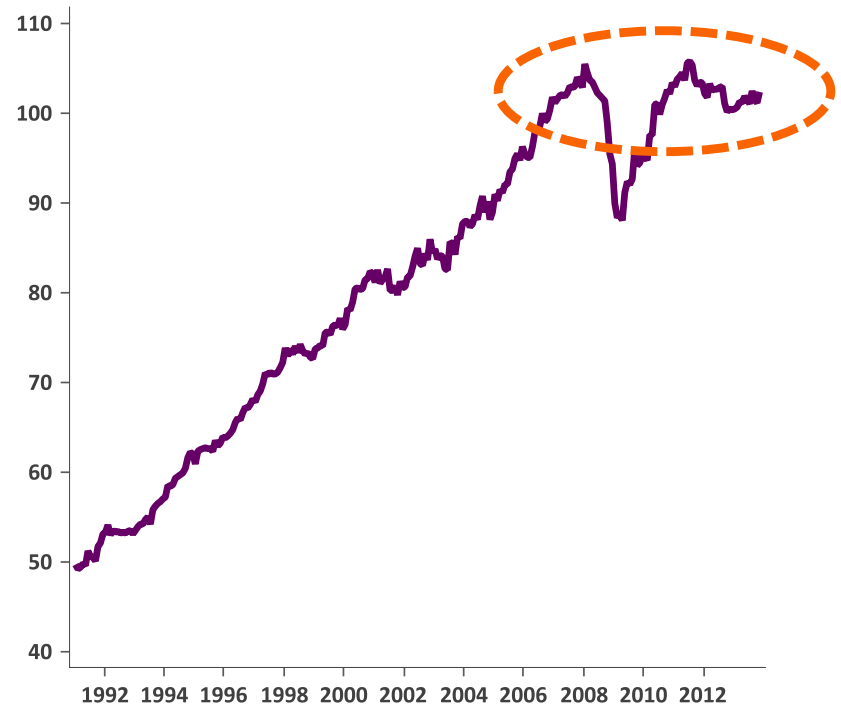
The import content of global output has leveled off, thus depriving German productivity of a key growth driver.

Import Content of World Industrial Production (Imports/Production)



Sources: RichesFlores Research, Macrobond

Hourly Labor Productivity in German Industry

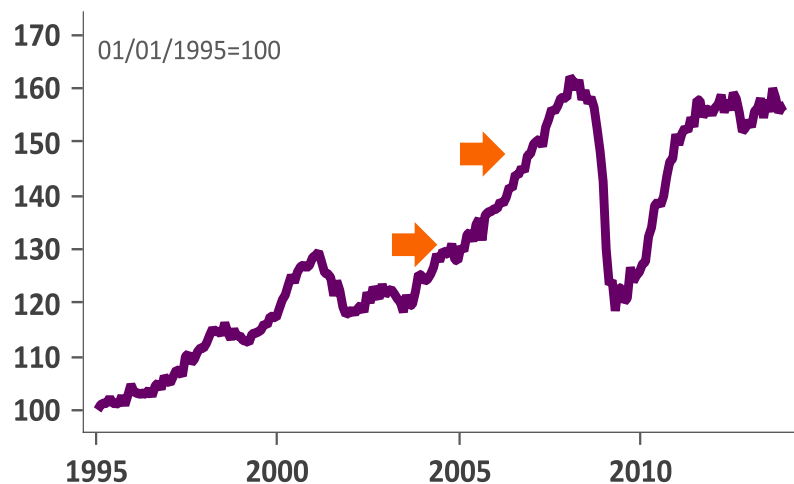


Sources: RichesFlores Research, Macrobond

Global Capital Spending—The Primary Outlet for German Exports

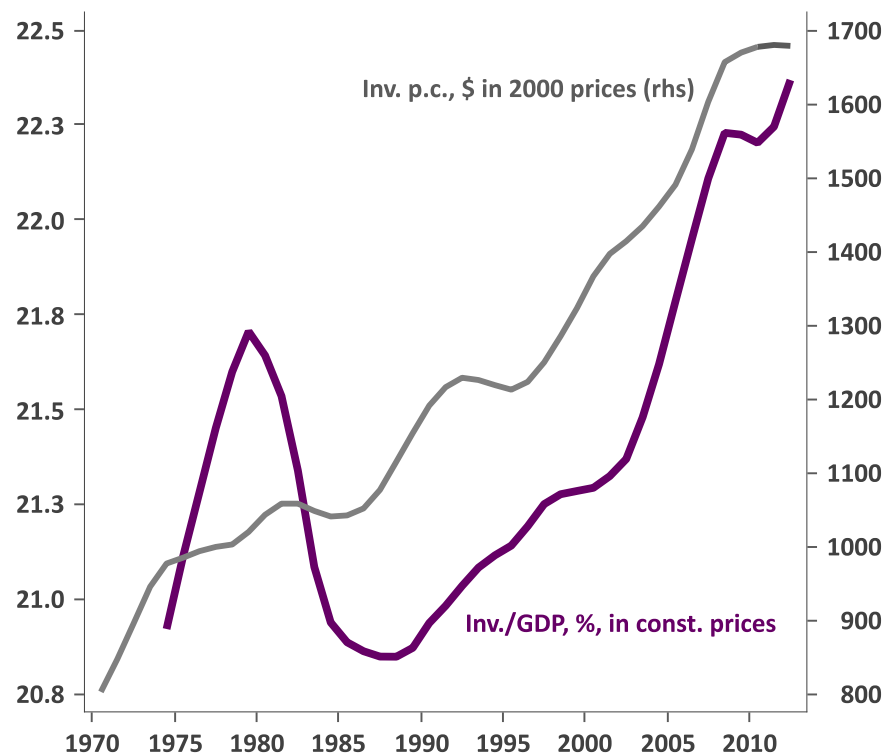
- Rising manufacturing capacity, China in catch-up mode, a savings glut: **the first decade of this century witnessed a worldwide capital spending boom**. This worked to the advantage of Germany, the world's second-leading capital goods producer after Japan, with a 13% share of the global market in 1995.

Worldwide Capital Goods Production



Sources: RichesFlores Research, Macrobond

Investment Per Capita and Worldwide Investment Rate, Smoothed Over 5 Years



Sources: RichesFlores Research, Macrobond

II- Deleveraging and the Chinese Transition Mark the End of an Unprecedented Expansion in Global Capacity

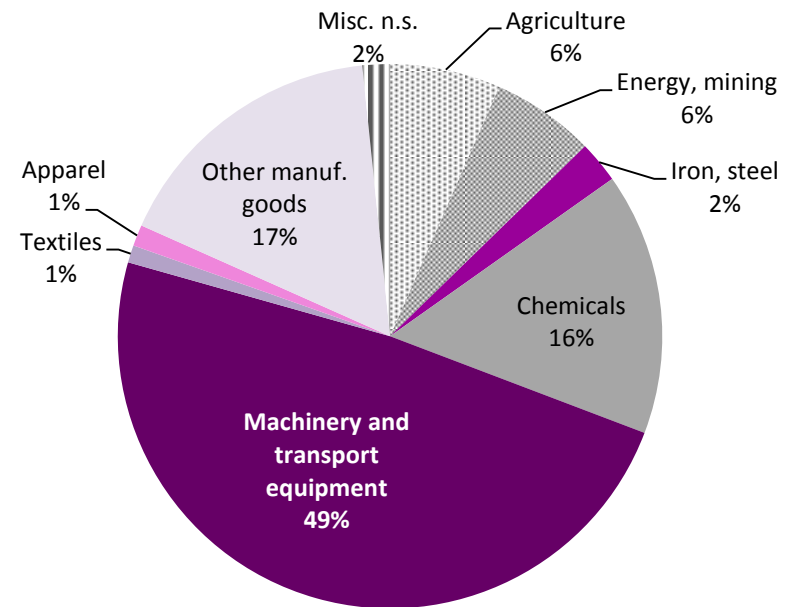
The boom in global manufacturing capacity is over and done with. A number of Asian economies have excess capacity and the slump has reduced Western firms' appetite for capital spending. The market for German exports is drying up.

Annual Growth in Chinese Imports, in %



Sources: RichesFlores Research, Macrobond

Structure of German Imports in 2012

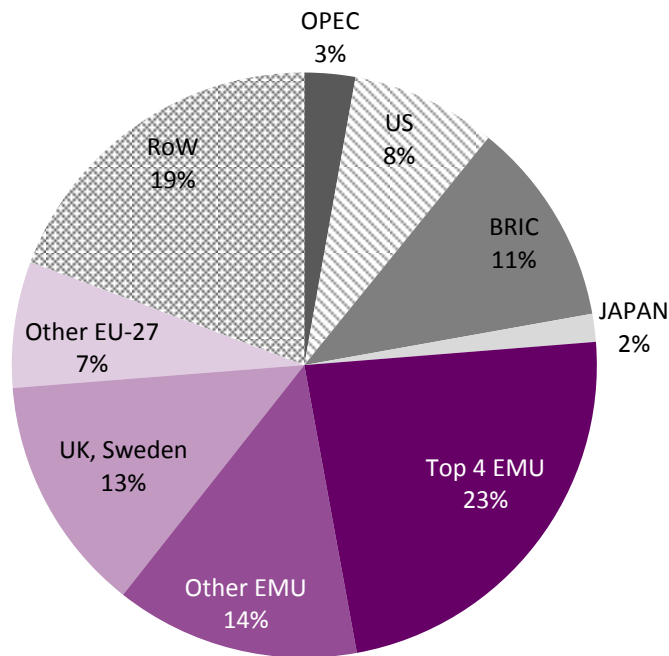


Sources: UNCTAD, RichesFlores Research

III- Hard Times in the EMU Mean a Loss of Outlets That Absorbed One Fourth of German Exports in the Last 13 Years

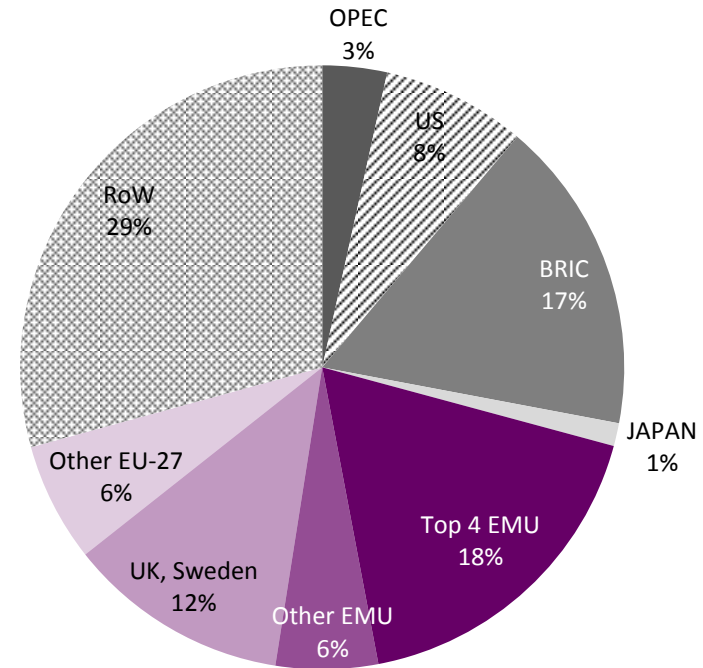
In 2012, the EU-27 purchased 57% of German exports, with 37% going to the euro area alone. Since 2000, the larger group of countries accounted for 38% of Germany export growth and the smaller for 24%.

Destination of German Exports in 2012



Sources: UNCTAD, RichesFlores Research

Contributions to German Export Growth, 2000-2013, in %

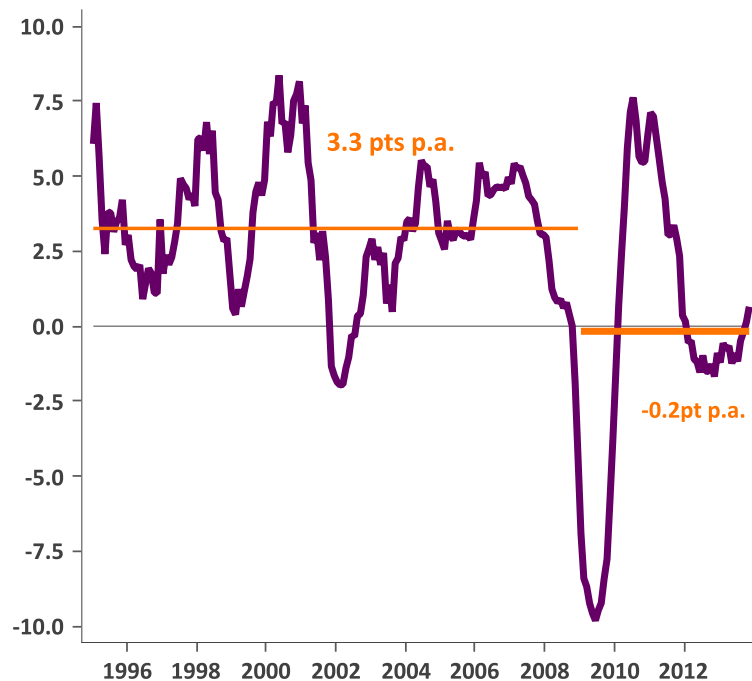


Source: UNCTAD, RichesFlores Research

The Recovery Under Way Won't Solve the Problem

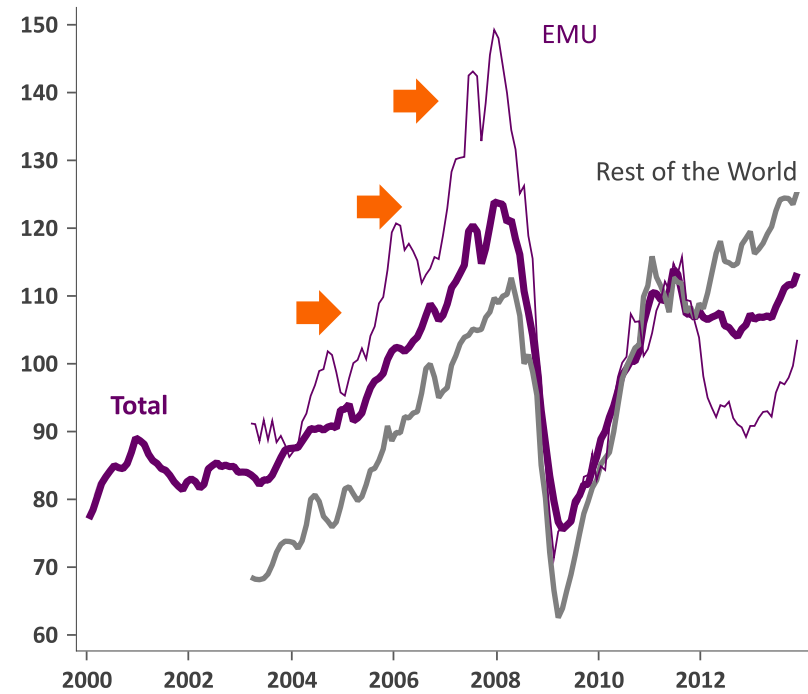
The exit from recession will improve Germany's export prospects in the short run, but there is no evidence that it will usher in a boom like the previous one.

The EMU's Contribution to Germany's Annual Export Growth



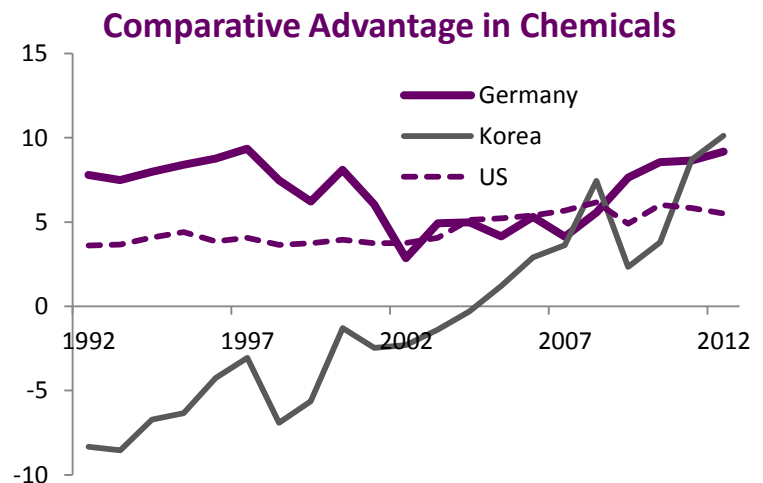
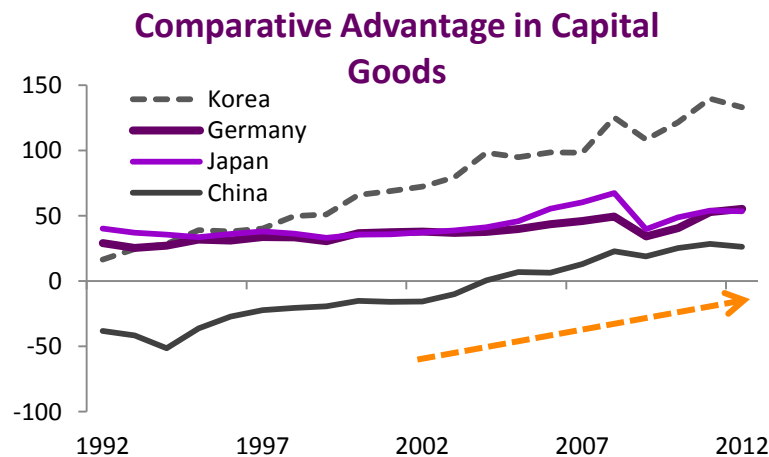
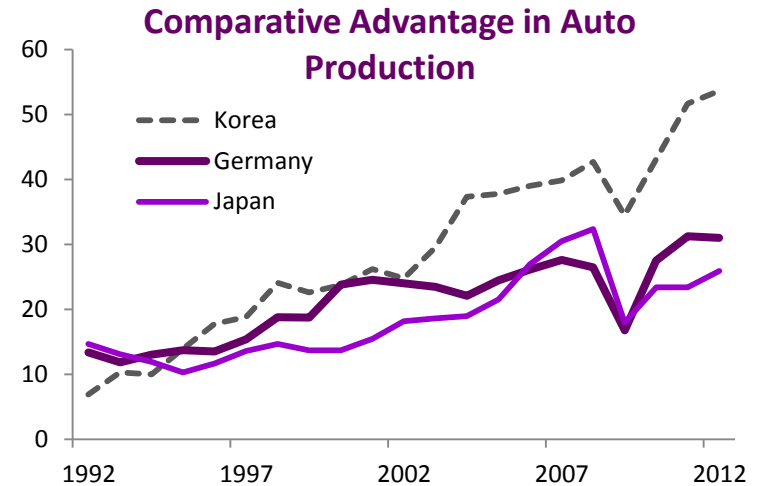
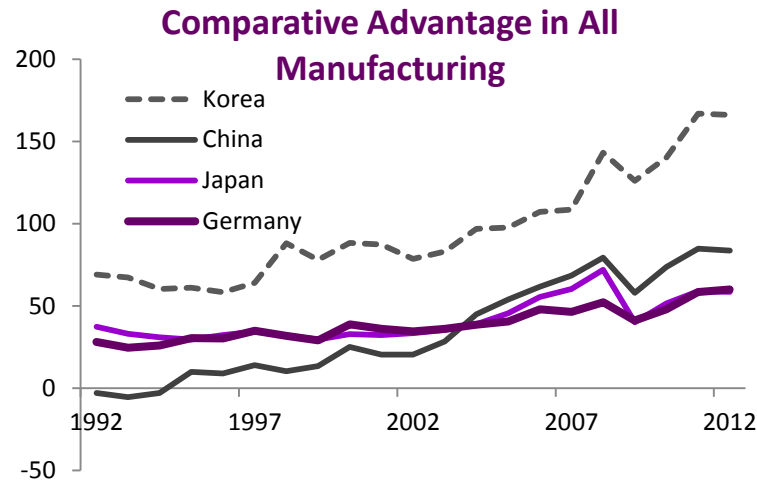
Sources: RichesFlores Research, Macrobond

Foreign Orders for German Capital Goods, Indices in Volume Terms



Sources: RichesFlores Research, Macrobond

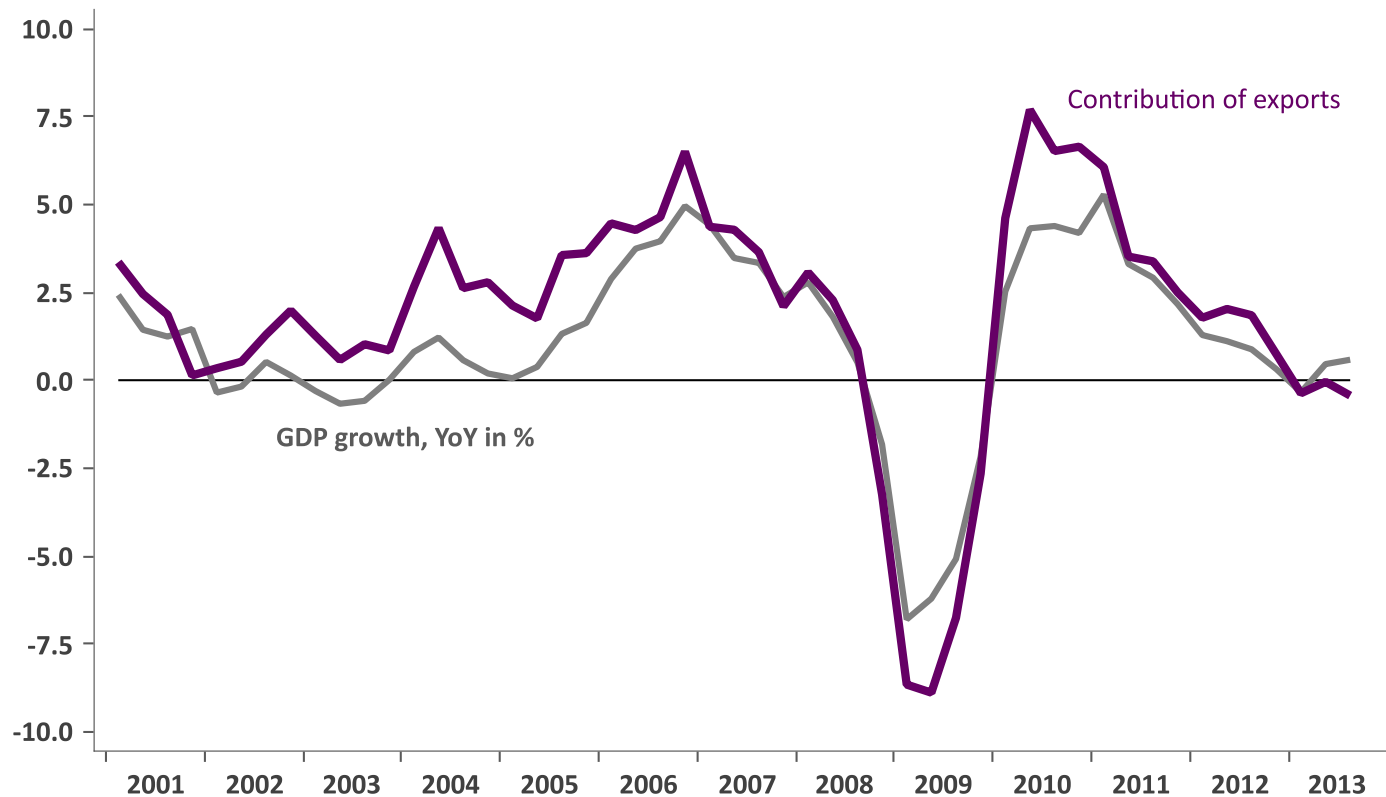
IV- Asian Competitors Are Catching Up With Germany's Specialized Manufacturers



Sources: RichesFlores Research. WTO

Without Foreign Markets for its Goods, What Options Are Open to Germany?

Contribution of Exports to German GDP Growth



Sources: RichesFlores Research, Macrobond

New Demographic Realities

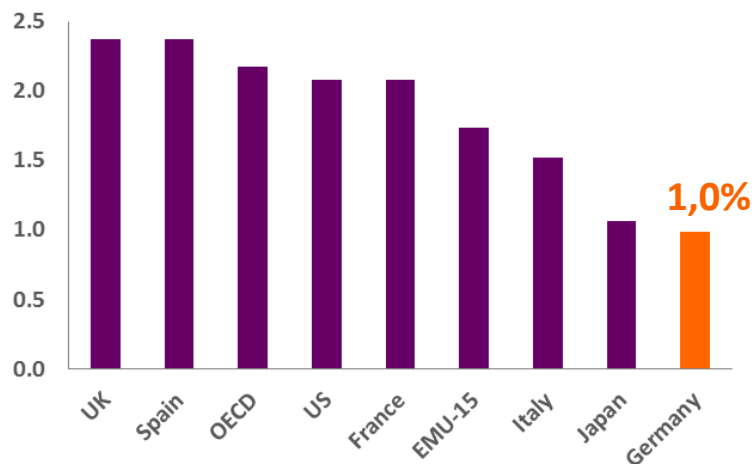
- **Germany has an aging population**

- According to the OECD, the German economy's potential output won't exceed 1% a year between 2013 and 2030—the lowest growth rate of any OECD country
- The root cause is unfavorable demographics—which even higher productivity can't fully offset
- Germany's share of eurozone GDP is forecast to decline from 29% in 2013 to under 25% by 2030, moving closer to France's and possibly even falling below it by 2050
- **Germany may prove unable to maintain its status as the leading EMU economy**
 - ❖ The country has only limited ability to stimulate domestic demand...
 - ❖ ... or, most likely, to sustain its export-driven model of growth. How can an aging country remain an industrial heavyweight?

The OECD Country With the Lowest Growth Potential

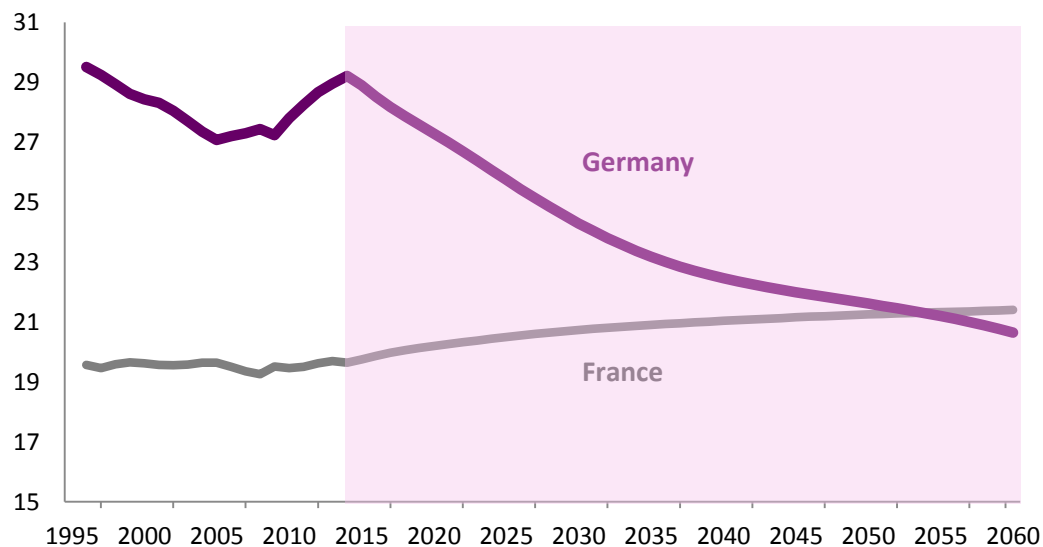
The German economy's growth potential has been undermined by demographic decline and its rapidly dwindling share of eurozone GDP.

**Growth Potential, 2012–2030
According to the OECD**



Sources: OECD LT Projections, June 2013, RichesFlores Research

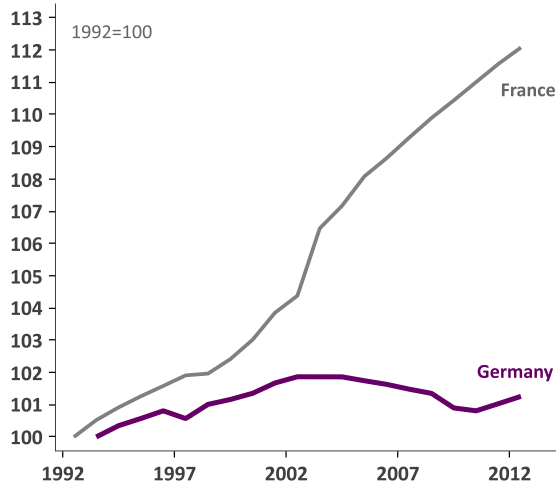
**Germany's and France's Share of EMU-15
GDP**



Sources: OECD LT Projections, June 2013, RichesFlores Research

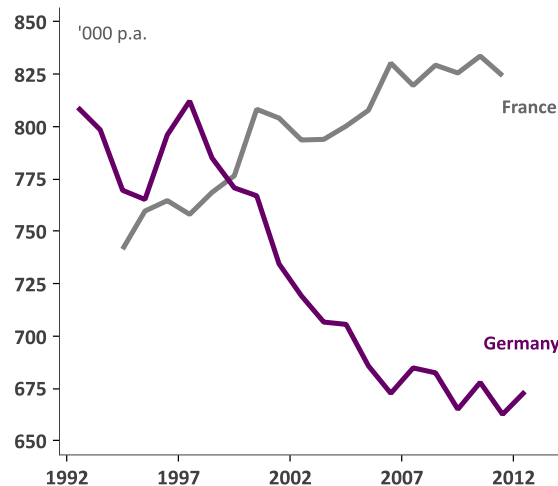
A Rapidly Aging Population

Population Trends in France and Germany



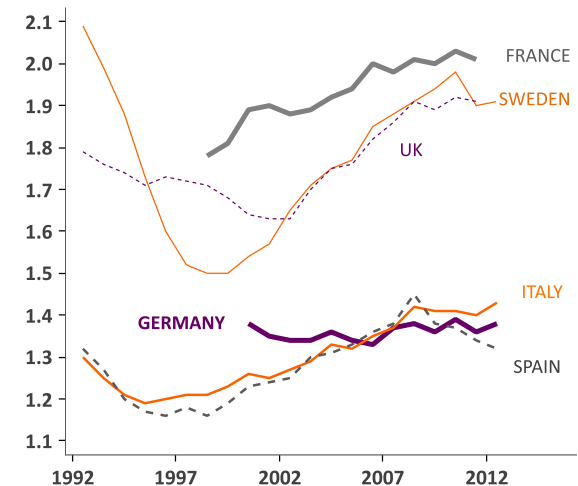
Sources: RichesFlores Research, Macrobond

Births Per Year in France and Germany



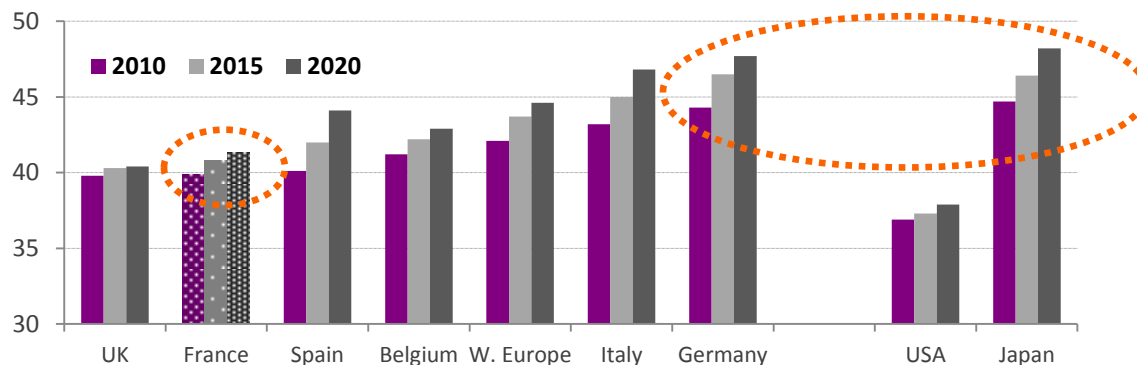
Sources: RichesFlores Research, Macrobond

Fertility Rate



Sources: RichesFlores Research, Macrobond

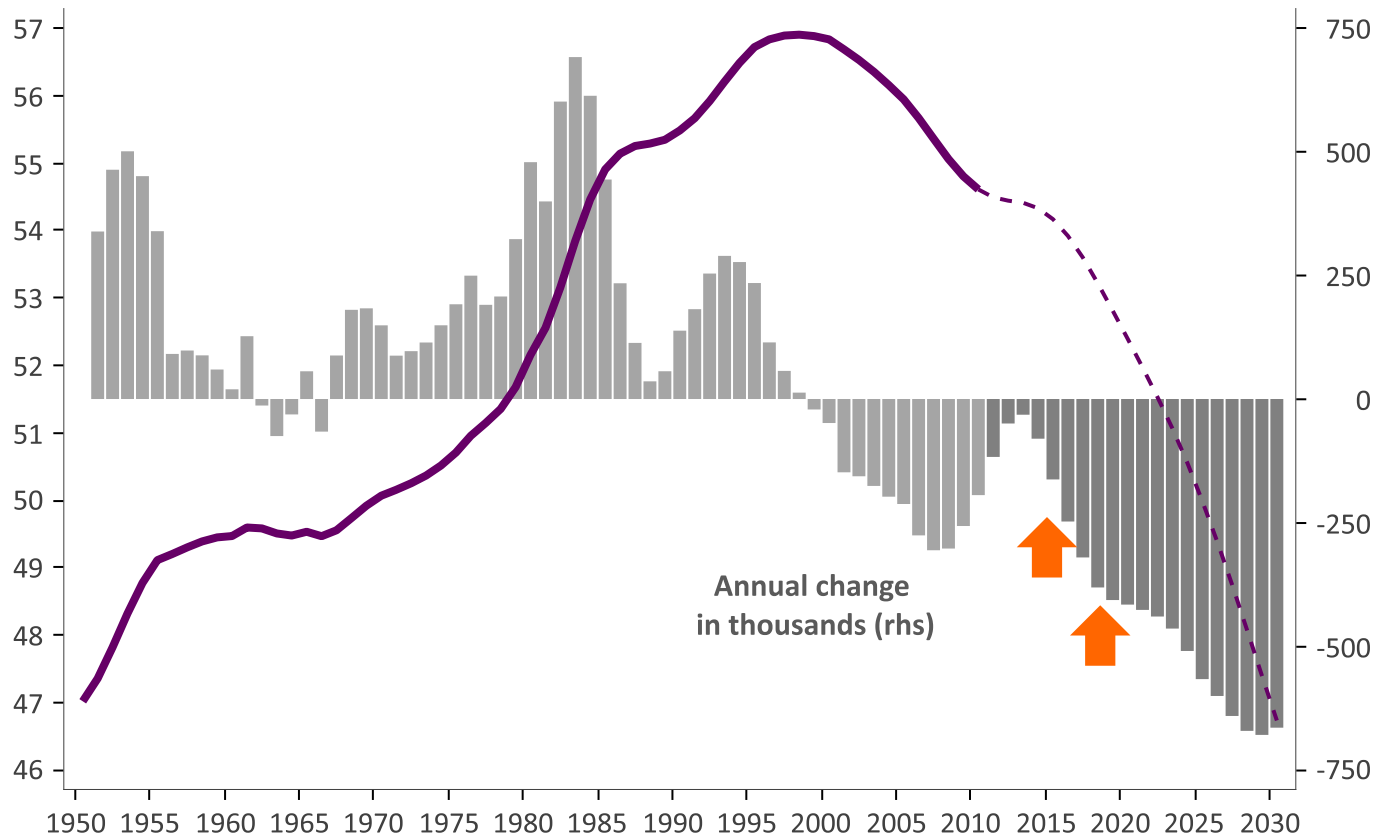
Median Age Forecasts, 2010-2020



Sources: UN population division, RichesFlores Research

Plunge in the Working-Age Population (16-65) by 2030

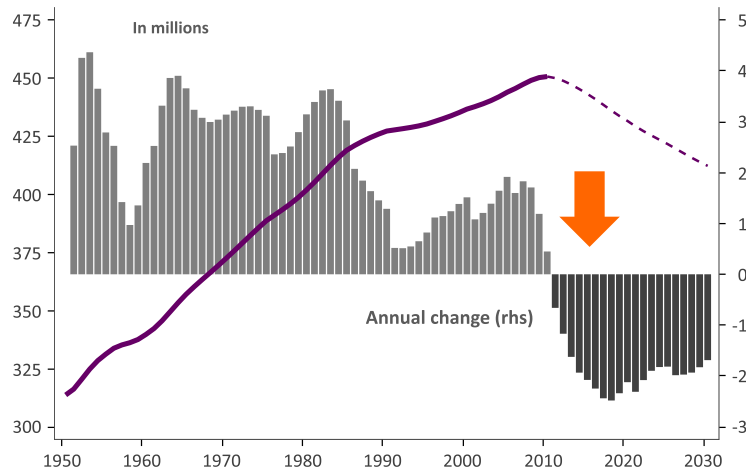
German Working-Age Population, in Millions



Sources: RichesFlores Research, Macrobond

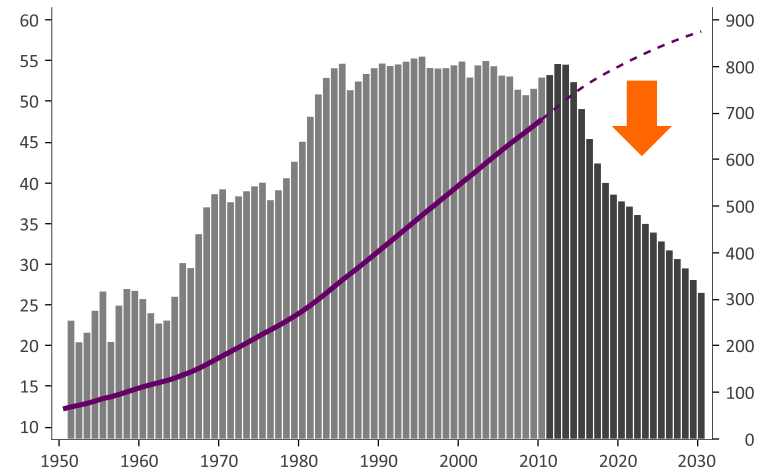
Immigration May Not Suffice, Given Trends in the Region (Excepting France)

Europe Excluding Germany



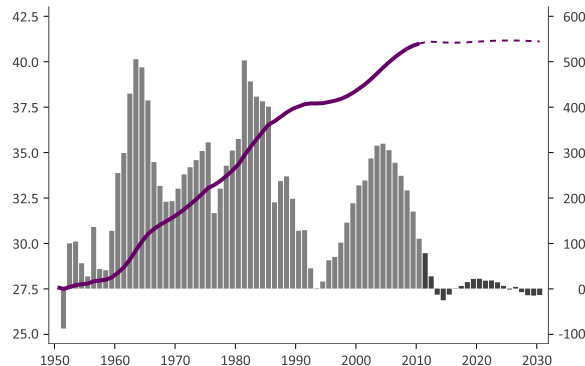
Sources: RichesFlores Research, Macrobond

Turkey



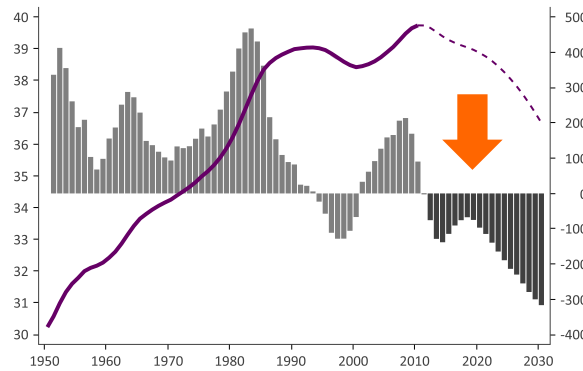
Sources: RichesFlores Research, Macrobond

France



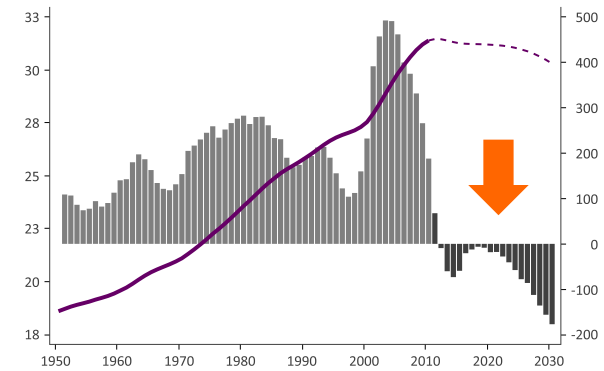
Sources: RichesFlores Research, Macrobond

Italy



Sources: RichesFlores Research, Macrobond

Spain



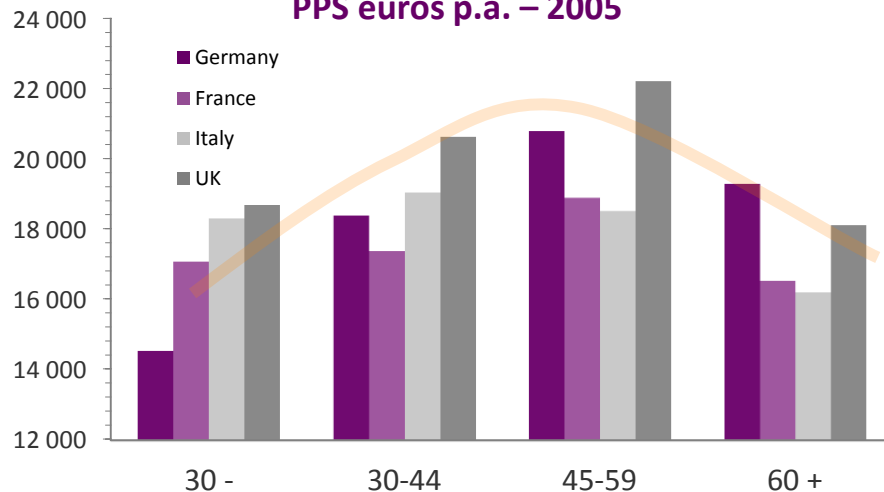
Sources: RichesFlores Research, Macrobond

Aging as Brake on Consumer Spending

The impact of an aging population on consumer spending varies from country to country and from period to period. It depends on the average age and income of the elderly.

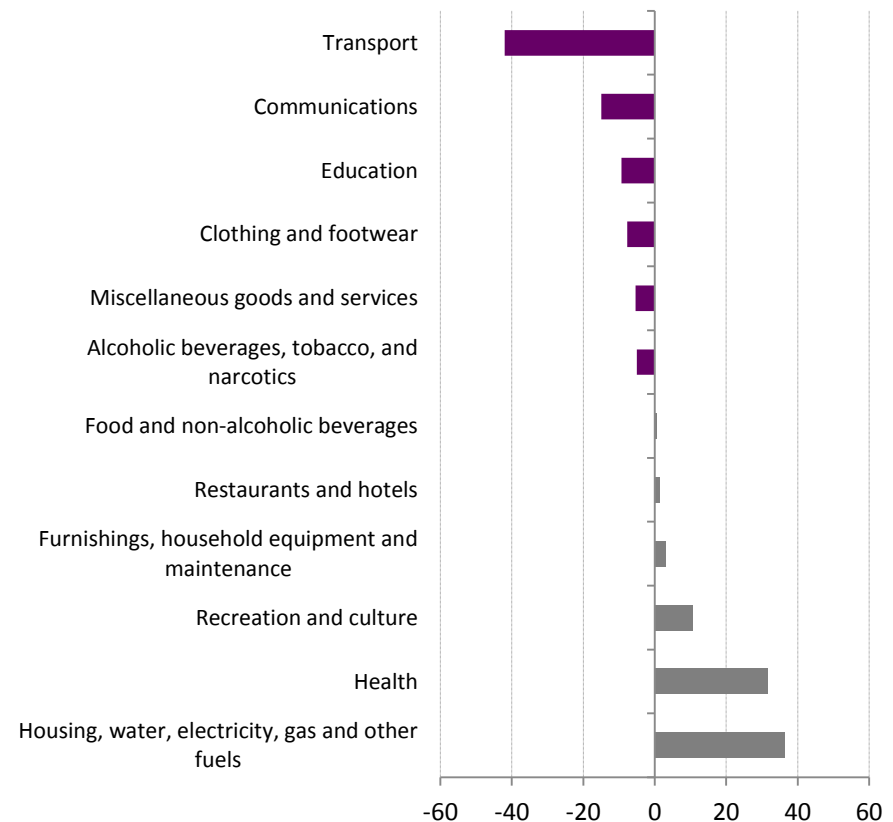
The squeeze on budgets for older consumers is particularly detrimental to demand for manufactured goods (e.g., household equipment, motor vehicles, clothing).

**Consumer Spending per Adult by Age Cohort,
PPS euros p.a. – 2005**



Sources: Eurostat (Household Budget Survey), RichesFlores Research

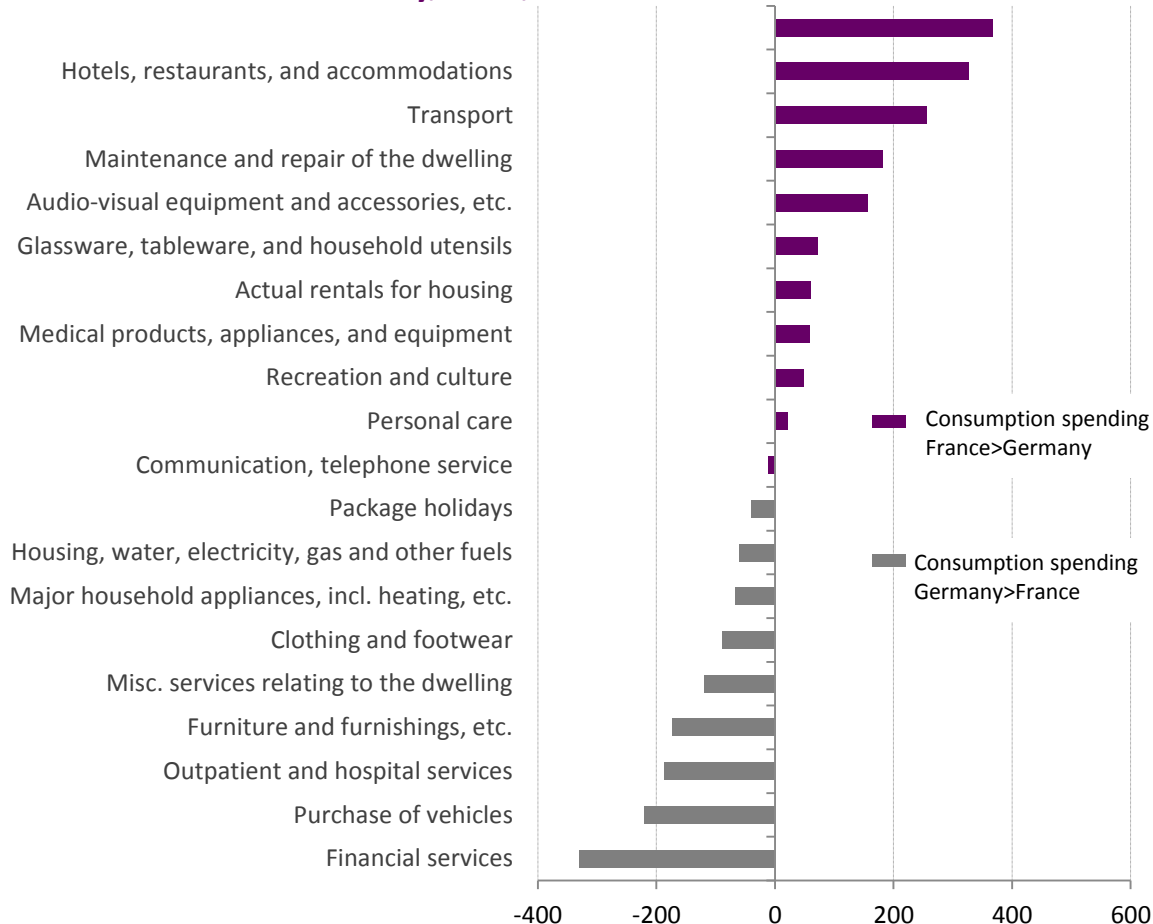
**Germany: Per Capita Spending Gap Between
60-and-Over Households and Other
Households**



Sources: Eurostat (Household Budget Survey), RichesFlores Research

A Widening Demographic Gap Already Affecting Consumer Spending in France and Germany

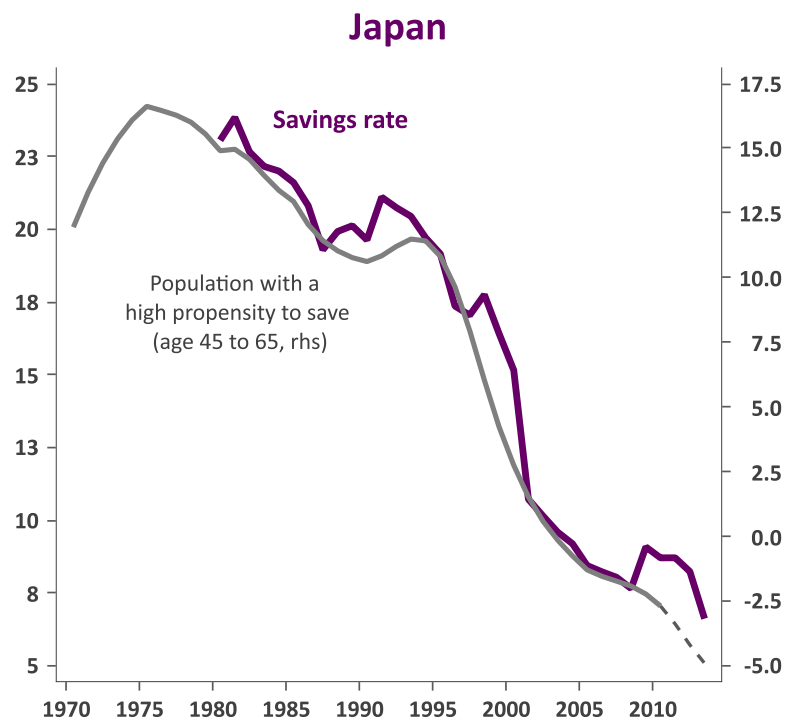
Per Capita Consumer Spending Gap Between France and Germany, 2011, EUR in 2005 Prices



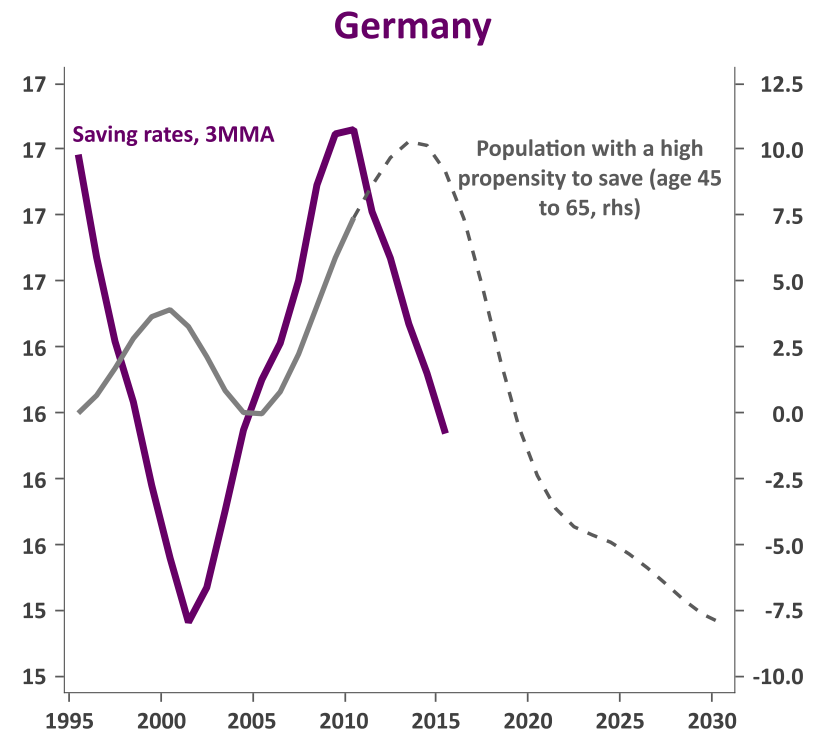
Sources: Eurostat (Household Budget Survey). RichesFlores Research

Accelerated Graying Leads to Dissaving

Household savings rates can be expected to decline as the 45-65 age group of recent years approaches retirement age. Sooner or later, this will make it harder for Germany to accumulate surpluses.



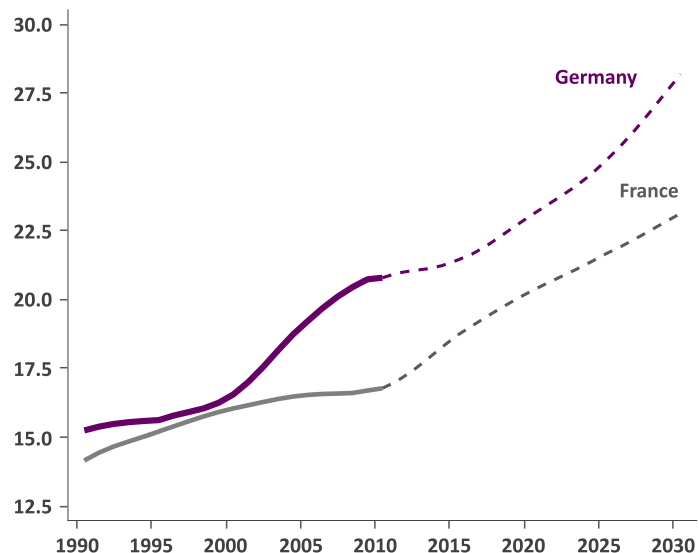
Sources: RichesFlores Research, Macrobond



Sources: RichesFlores Research, Macrobond

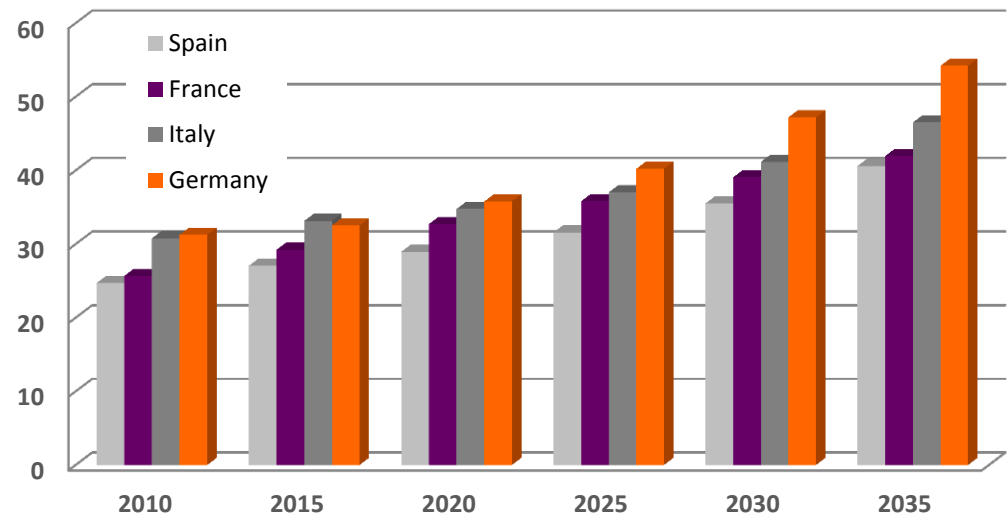
The High Redistribution Cost of Graying for Active Workers

Share of the 65+ Age Group in the Total Population (%)



Sources: RichesFlores Research, Macrobond

Old-Age Dependency Ratio as a Percentage of the 16-65 Population, Eurostat Projections

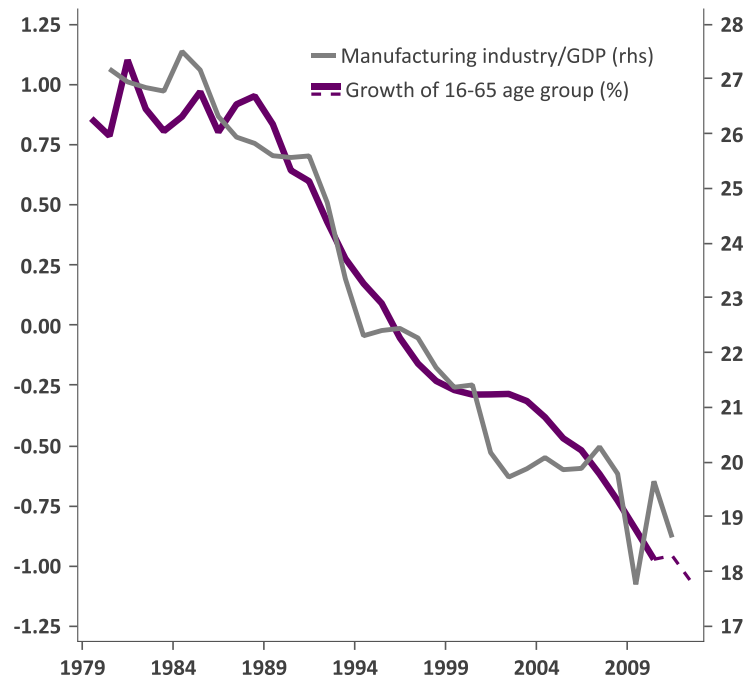


Sources: Eurostat, RichesFlores Research

How can an aging country remain an industrial heavyweight?

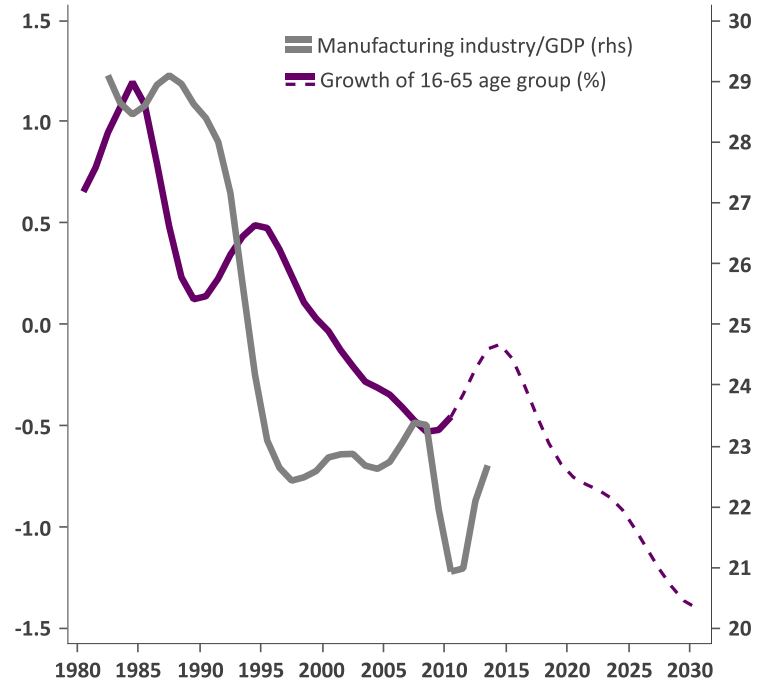
The increasing labor scarcity caused by population aging is incompatible with long-term manufacturing strength. The decrease in Germany's working-age population suggests the country is on its way to industrial decline.

Japan



Sources: RichesFlores Research, Macrobond

Germany



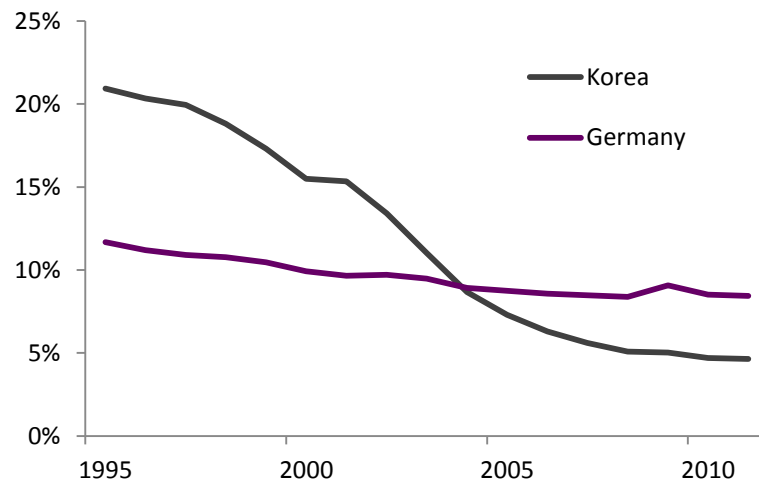
Sources: RichesFlores Research, Macrobond

German Industry Is Still Fairly Labor-Intensive

Even after widespread relocation to Eastern Europe and elsewhere, German industry is still fairly labor-intensive. At the same time, successful performance in the past few years has lessened the pressure to restructure.

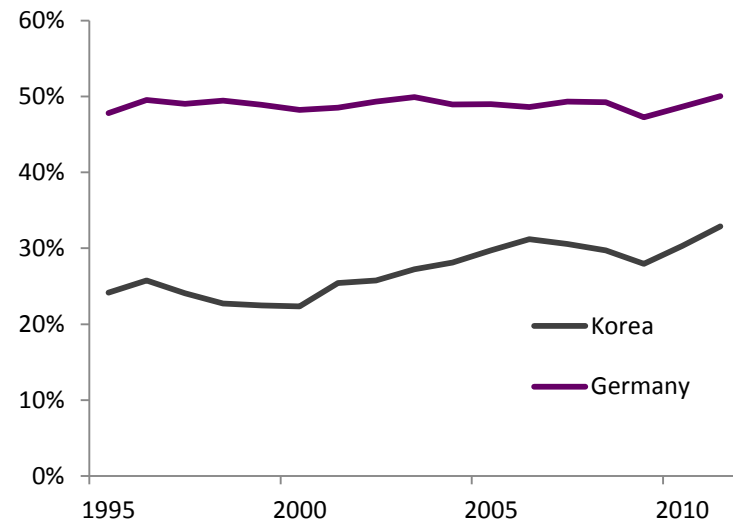
Share of Manufacturing Exports

Labor-Intensive and Natural Resource-Based Manufactures



Sources: RichesFlores Research, UNCTAD

Medium-Technology and Medium-Skill Manufactures



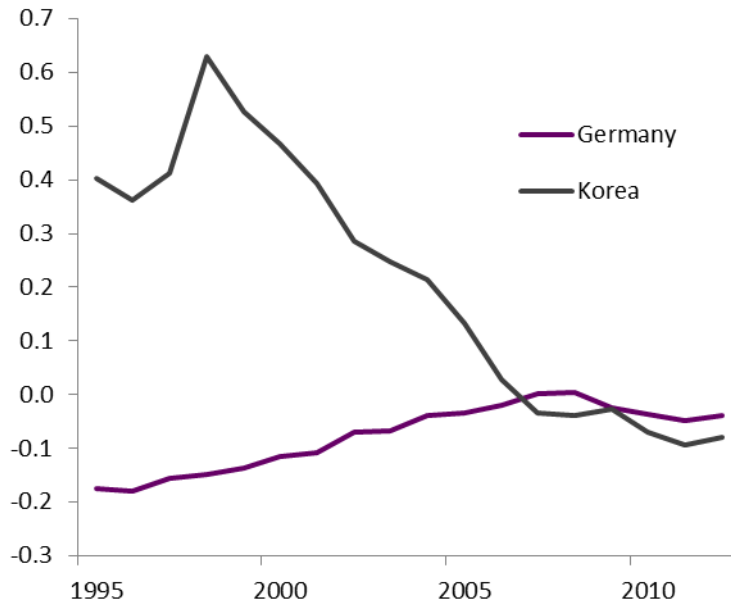
Sources: RichesFlores Research, UNCTAD

Germany Has Done Little to Develop High Value-Added Manufacturing

The country now lags somewhat behind its main competitors—Japan and South Korea—with China beginning to catch up.

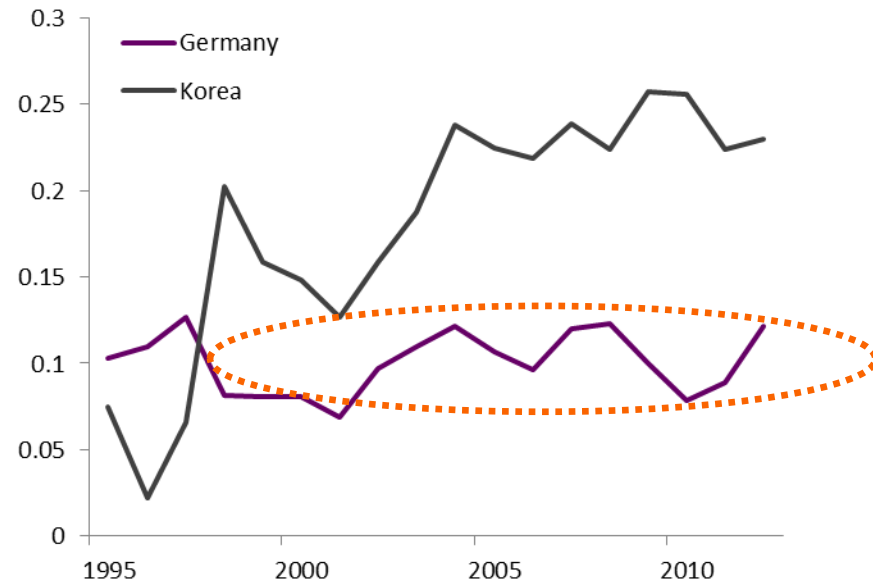
Export Specialization Indices

Labor-Intensive and Natural Resource-Based Manufactures



Sources : RichesFlores Research, UNTAD

High-Technology and High-Skill Manufactures



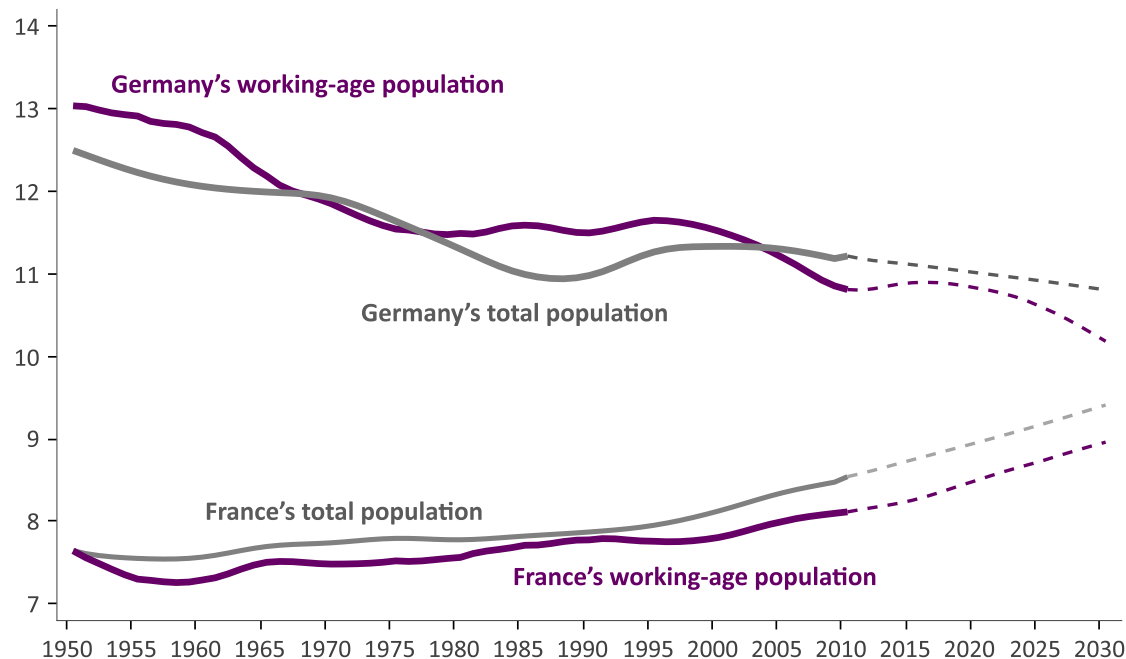
Sources : RichesFlores Research, UNTAD

After Schröder's Agenda 2010, What Will the New Coalition's Agenda Be?

An imperative that is both economic and political.

If it fails to implement far-reaching reforms, the new coalition will be setting Germany up for a potentially serious loss of influence in Europe.

The Germans and the French as a Percentage of Europe's Working-Age Population and Total Population



Sources: RichesFlores Research, UN, Macrobond

Major—and Costly—Reforms to be Tackled by the Coalition

- **Birth rate/female employment, or how to promote a better work-life balance**

- After the parental allowance introduced in 2007, creating more flexible working time arrangements for young parents (proposal for a 32-hour week)
- Expanding child-care facilities
- Having children start school at an earlier age and scheduling a longer school day
- Introducing a minimum wage to make employment a more appealing prospect

- **Immigration**

- Relaxing immigration laws and lowering the income threshold for permission to work in Germany

- **Pensions/independence of the elderly/poverty**

- The reforms passed ensure the survival of the retirement system, but cuts in pensions have significantly increased the risk of poverty for older Germans
- Replacing the legal duty of adult children to provide for their indigent parents with a broader social protection system

- **R&D/energy transition**

- Boosting R&D to promote the development of new growth drivers and high value-added manufacturing
- The energy transition as growth driver

Will these changes involve more Europe—or
less Europe?

Germany may well be tempted to turn its back
on Western Europe. But what would the
country gain from that?

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- « [Strong Buy Latvia!](#) », weekly of Jan. 3, 2014
- « [Is the U.S. Economy Really Out of the Woods?](#) », Dec. 19, 2013
- « [Germany's Minimum Wage: A New Deal, But What Kind of New Deal?](#) », Nov. 28, 2013
- « [China: Population Decline on the Horizon](#) », Thematic, Nov. 11, 2013



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