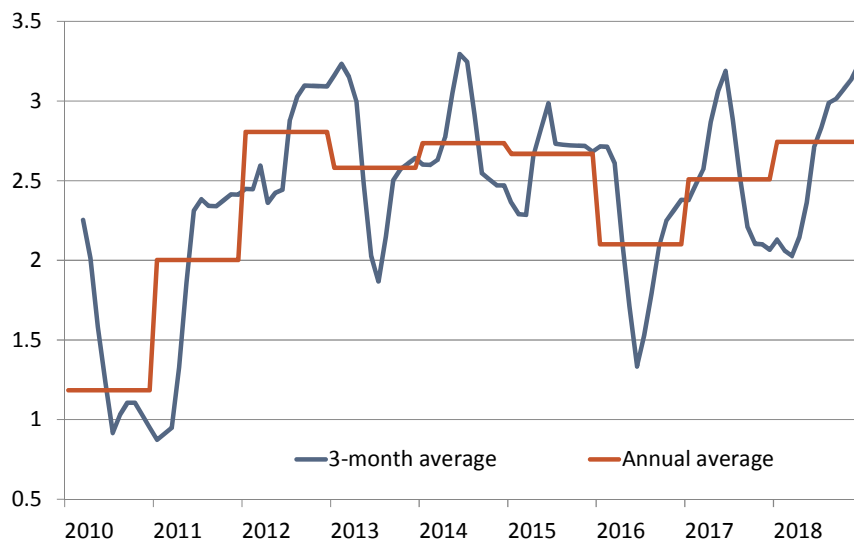


23 January 2019

German wage inflation: no reason to worry yet

Monthly wages in the German private sector, yoy change in %



Negotiated monthly wages excluding bonus, private sector, 3-month average; yoy change in %. Source: Destatis

- Too much wage inflation?** Many clients have asked us in the last two weeks whether firmer wage inflation could pose a serious risk to price stability or corporate profitability in Germany and the Eurozone. These concerns are overdone. The gain in monthly wages in the German private sector accelerated from 2.0% yoy in Q1 2018 to 3.2% in Q4. If we were to extrapolate these gains into the future, we would indeed have to worry. However, temporary spikes are quite common. The annual average increase in wages of 2.75% in 2018 came in only modestly above the 2017 advance (+2.5%) and remained in line with the 2012-2014 average of 2.7% (see chart).
- A matter of timing:** Many German wage deals extend for more than one year. They are often front-loaded, with the rise for the first year usually well in excess of that for the second one in multi-year deals. For example, Germany's mighty IG Metall union last year attained an upfront 4.3% pay hike for more than 3.6m workers from April 2018 onwards that will be followed by a gain of 2.3% in July 2019. Over the 27-month duration of the contract, this amounts to an average annualised increase of roughly 3%. A separate 30-month deal concluded in April 2018 is raising 2.1m federal and local government employees' pay at an average annual rate of 3.3%, while a 15-month deal for chemicals industry workers adds up to an average annual gain of 2.9%. The upfront element of new long wage deals explains much of the spike in German wage inflation over the course of last year.
- Reasons for moderation:** For three reasons, the pace of German wage inflation will likely moderate later in 2019 from the late-2018 rate. First, as unions struck a large number of long-duration wage deals in 2018, more workers will be covered by the usually restrained second year of such contracts in 2019 than by newly negotiated deals with a big upfront increase. Second, most of the new 2019 deals will be for workers represented by less powerful unions than the IG Metall and the chemicals sector union. Third, the storm clouds on the international horizon will not be lost on workers in Germany's export-orientated industries, who will take that into account in their wage demands.
- The grand bargain:** By and large, the grand bargain at the heart of German industrial relations still holds. In exceptionally good times, workers do not press their advantage to the fullest. In return, companies do their best in lean times to avoid mass dismissals. With a dose of wage moderation, workers de facto buy some job security.
- Strong labour market:** Amid a structural dearth of qualified labour, even the near-stagnation into which Germany's export-dependent economy fell in H2 2018 has not yet dented the desire of companies to hold on to their workers and to hire more of them. At 801k in December, registered vacancies have barely retreated from the record 805k of Q3 2018. If Germany rebounds in 2019 and 2020 from its current growth pause, wage inflation may edge up a little in 2020. However, it will remain well below a rate of 4%, which could scare the European Central Bank or cause serious problems for the bulk of German industry. We will look at Eurozone wages in a separate piece.

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