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GOOD FOR EUROPE: GERMANY'S JOBS MACHINE KEEPS HUMMING

Berenberg Macro Flash

Despite a temporary slowdown in growth caused by China and the crisis in some other emerging markets, Germany continues to create ever more jobs. Strong gains in real disposable incomes and a fiscal stimulus of at least 0.5% of GDP for 2016 point to further strength ahead. In turn, solid employment growth will underpin consumer spending, helping to cushion the German economy somewhat against external shocks. The robust labour market is largely the result of Germany's sweeping "Agenda 2010" labour market reforms of 2004. German domestic demand looks set to remain a pillar of strength at the core of Europe.

For two reasons, buoyant employment will also help Germany to deal with its major domestic challenge, namely to integrate the roughly one million migrants and refugees who came into the country in huge numbers between mid-2015 and February 2016. First, as demand for qualified labour continues to rise, companies are actively searching for new workers. While most of the refugees and migrants seem to lack the skills for the jobs on offer, potential employers and migrants both have a strong incentive to invest in a major upgrading of such skills. Second, strong employment growth shows up in rising tax receipts. Although Germany may spend an extra 0.5% of its GDP this year on sustaining and educating the migrants, it may still end up with a modest fiscal surplus again.

To understand why most migrants who have made it to Europe want to move on to Germany, look no further than the chart below. It shows core employment, that is the number of jobs above the threshold of €450 per month that are subject to payroll taxes. Shortly after the 2004 labour market reforms, the number started to go up and up for a total gain of almost 5 million over the last 10 years. The further increase of 55k in January 2016 (latest available data) suits the trend. Relative to January 2015, that is a whopping increase of 738k or 2.4%.

The gains in core employment surpass the overall increase in employment (+546k yoy or 1.3% in February). To some extent, that is good news. As demand for labour increases, people are moving into better-paid jobs. However, it also carries a warning. Roughly half the decline in the number of low-paid jobs by 225k since the summer of 2014 probably reflects a genuine loss of jobs caused by the minimum wage.

While employment growth remains solid, unemployment is no longer falling by much in Germany. In March, the seasonally adjusted number of unemployed held steady at 2.728k as the switch from a very mild January to more normal winter temperatures in late February and March weighed modestly on demand for seasonal labour. Despite a major increase in employment and a rise in registered job vacancies by almost 100k over the last twelve months (from 538k to 631k), the number of unemployed has fallen by just 80k over the last twelve months. This suggests that most of the current unemployed in Germany probably lack the skills needed for the jobs. Instead, employment is rising because Germans retire later, more women join the workforce and immigrants flock to the country.

Of course, not all is well in the German labour market. The number of migrants joining the labour market once their claims to stay in Germany have been processed and once they have gone through some basic language training looks set to increase significantly from mid-2016 onwards. As the labour force rises, unemployment will probably edge up modestly (perhaps by some 100k- 200k in 2H 2016) despite ongoing gains in employment. More importantly, the minimum wage of €8.5 per hour introduced in January 2015 and further reform reversals such as restrictions on temporary work contracts threaten to make the Ger-



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man labour market less flexible. That is especially bad news for domestic low-skilled workers who may be priced out of a job while they have to compete directly with the new immigrants. As long as the economy remains buoyant, this may not matter much. But in the next serious cyclical downturn, Germany may have to pay a heavy price for it. In terms of higher unemployment especially for the socially most vulnerable groups. Over time, that could create serious social problems in the decades ahead. What Germany would need to prevent that are reforms to make the labour market significantly more flexible especially at the low end of the market. Germany needs more flexible work contracts, very flexible rules for internships, temporary exceptions from the minimum wage and potentially even temporary wage subsidies to allow migrants and low-skilled domestic workers to upgrade their skills on the job.

Reforms pay off: German core employment continues to surge



Core employment subject to social security contributions, in million. Source: Bundesbank, Arbeitsagentur

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