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## MACRO NEWS

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Holger Schmieding, Chief Economist | [Holger.schmieding@berenberg.com](mailto:Holger.schmieding@berenberg.com) | +44 20 3207 7889

### GERMAN LABOUR MARKET: SOLID TREND

#### Berenberg Macro Flash

Despite the recent drop in exports to China and 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 gains 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, helping the Eurozone to leave its current soft patch behind and return to trend growth of around 1.6% by mid-2016.

The chart below 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 5 million over the last 10 years. The further increase of 77k in February 2016 (latest available data) suits the trend. Relative to February 2015, that is a whopping increase of 700k or 2.3%.

The gains in core employment surpass the overall increase in employment (+525k yoy or 1.2% in March). 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 ultra-low paid jobs by 230k since the summer of 2014 probably reflects a genuine loss of jobs caused by the minimum wage.

While employment growth remains solid, unemployment is falling only slowly in Germany. In April, the seasonally adjusted number of unemployed declined by 16k after a 3k drop in March, keeping the unemployment rate steady at 6.2%. Despite a major increase in employment and a rise in registered job vacancies by almost 100k since early 2015 (from 527k to 633k), the number of unemployed has fallen by just 130k during this period. This suggests that most of the current unemployed in Germany probably lack the skills needed for the jobs available. 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 increases, 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 German 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 with 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.



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### 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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Joh. Berenberg, Gossler & Co. KG  
60 Threadneedle Street  
London EC2R 8HP  
Phone +44 20 3207 7889  
[www.berenberg.com](http://www.berenberg.com)  
[holger.schmieding@berenberg.com](mailto:holger.schmieding@berenberg.com)