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Economic Insight

The German wage puzzle

Wage growth in Germany has not accelerated after the end of the financial crisis, even if negotiated wages increased 2.8% in the first quarter and therefore somewhat stronger than before. We analyse causes for the German wage puzzle. Furthermore, we demonstrate that wage increases and thus inflation in the Eurozone are set to remain low. All this argues against an early ECB rate hike.

The German economy is humming along quite nicely, and the unemployment rate is as low as 3.9% when measured on an internationally comparable basis. In an almost fully employed economy wages should rise sizably. However, this is nowhere to be seen. On the contrary, wage growth has not accelerated since the end of the financial crisis, despite the lower unemployment rate. Both negotiated wages and actual pay are in fact rising at a steady pace by around 2½% (chart 1). The increase of negotiated wages of 2.8% in the first quarter, released today, does not alter that trend.

The usual suspect: globalization

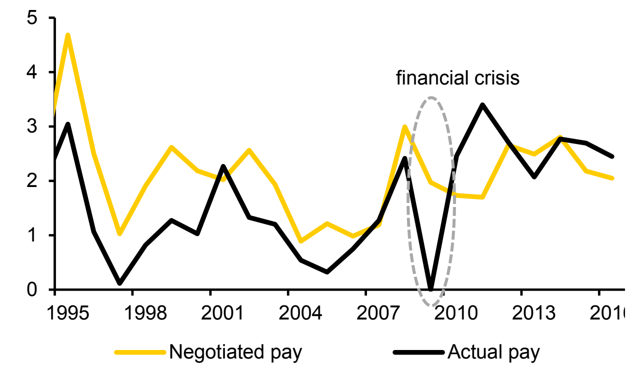
The moderate wage growth in all western countries is of course also linked to the usual suspect, i.e. globalization. Many companies now have global production chains and can move elsewhere if domestic labor costs increase too much.

But inflation and productivity are at least as important

But there are two other factors at least as important that have held back wage growth despite almost full employment in Germany.

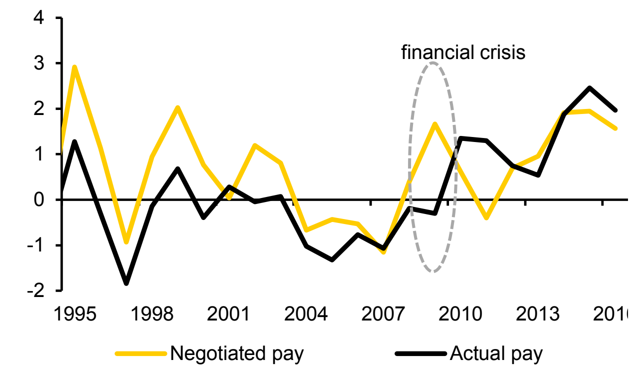
- Firstly, the inflation rate has fallen unexpectedly sharply since the end of the financial crisis – last year to only 0.5%. As a result, inflation expectations have been held in check, and consequently the trade unions have demanded less inflation compensation when negotiating wages. Nevertheless, wage growth in the past few years was higher than inflation. The increase in real pay has in fact picked up considerably (chart 2).
- Secondly, productivity growth was disappointing since the end of the financial crisis. Whereas in the 90s it rose by 2% p.a., and by over 1½% in run-up to the financial crisis, it has only amounted to 0.7% since then. The decline has been noted in most western countries, and limits companies' leeway in pay negotiations. A further aspect in Germany is the shortage of labor, so that employers have taken on fewer productive members of staff. This is the normal downside to an employment boom.

CHART 1: **wage growth has not accelerated lately**
negotiated hourly pay, actually paid wages per capita, Germany, in % year-on-year, shading marks the financial crisis



Source: Bundesbank, Commerzbank Research

CHAFRT 2: **but real wages have picked up sharply**
negotiated hourly pay, actually paid wages per capita, rise minus inflation rate, in percentage points, shading marks financial crisis



Source: Bundesbank, Commerzbank Research

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In the EMU even less signs of accelerating wages…

If wage growth hasn't yet risen even in a country like Germany with almost full employment, it is all the more the case in the rest of the eurozone, which with unemployment at almost 10% is suffering from mass unemployment.

This is probably preventing inflation from moving towards the ECB's target of close to but below 2%, at least once volatile energy prices are taken out of the picture.

… and the ECB will thus not hike rates early

The doves on the ECB Council will take the low inflation rate as an argument to hold on to zero interest rates for a long time despite healthy economic growth. True, the Bank is expected to start tapering off its bond purchases gradually from January, but this is only because it would otherwise hold more than one third of all government bonds, which would lead to legal problems.

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