

## Annual Economic Report 2015/16

# Focus on Future Viability

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Chairman

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December 2015

## Overview

- I. Economic Recovery, Expansionary Monetary Policy
- II. Responding to The Refugee Influx
- III. Conditions For Stronger Growth in Germany
- IV. Reform of the Euro Area Architecture
- V. Financial Stability Risks from The Low Interest Rate Environment

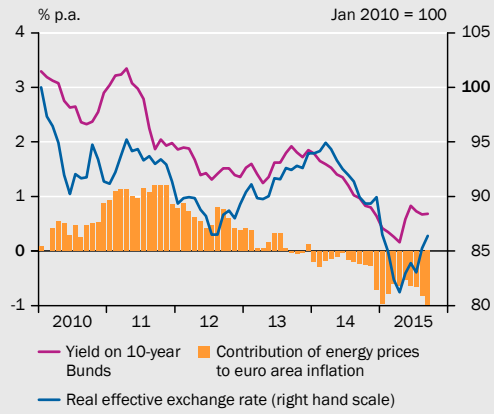
## Context: Crises distract from long-term challenges

- Two events marked the political landscape this year...
  - Re-emergence of the crisis in Greece
    - GCEE Special Report July 2015
  - Dramatic increase in refugee arrivals
- ...diverting from long-term economic challenges...
  - demographic change, globalisation, digitalisation
- ...while the economy recovers, albeit driven by special factors

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## I. Economic Recovery, Expansionary Monetary Policy

Expansionary monetary policy, decline in energy prices, and the euro depreciation supported economic growth.



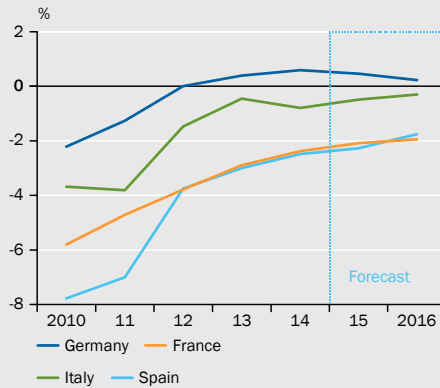
Sources: Deutsche Bundesbank, Eurostat  
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In addition, fiscal consolidation has come to an end.

Structural fiscal balance

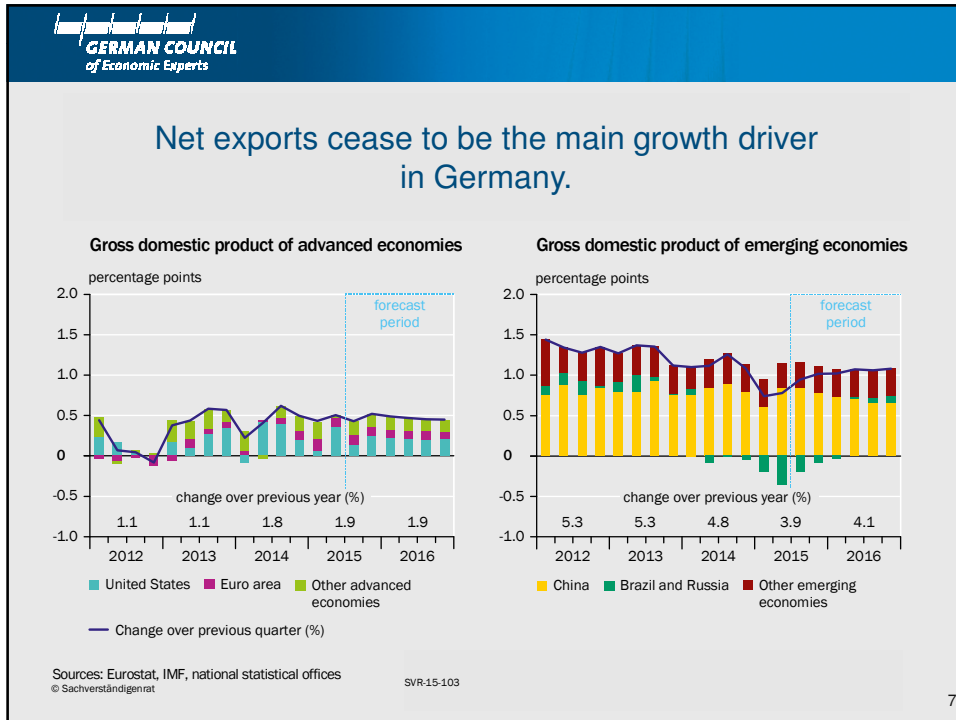


Source: IMF

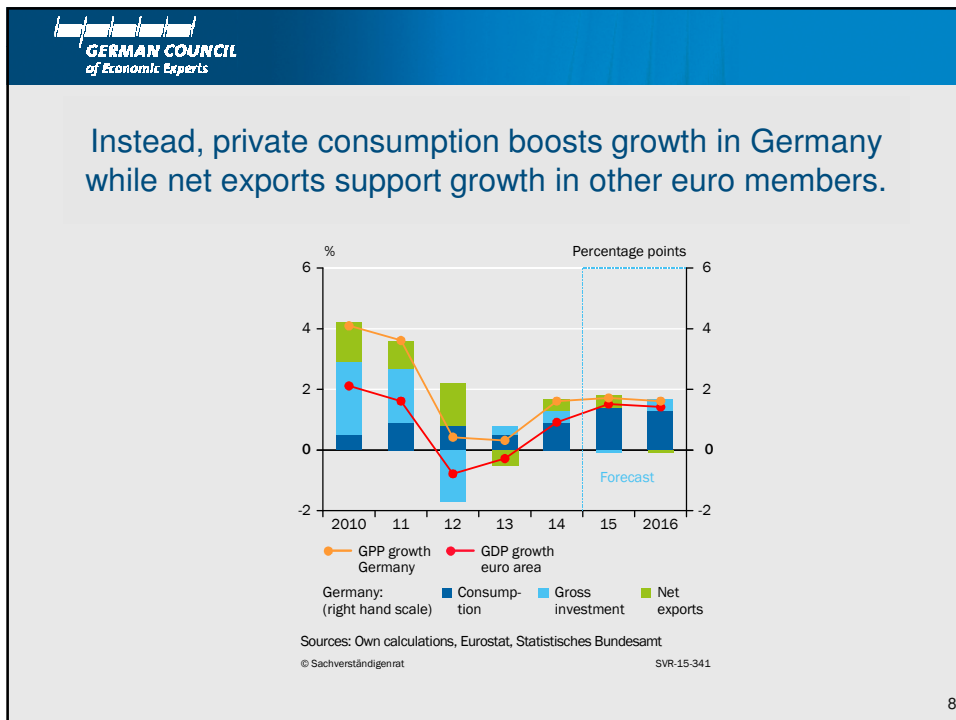
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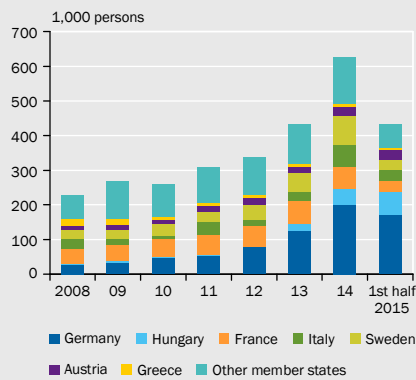


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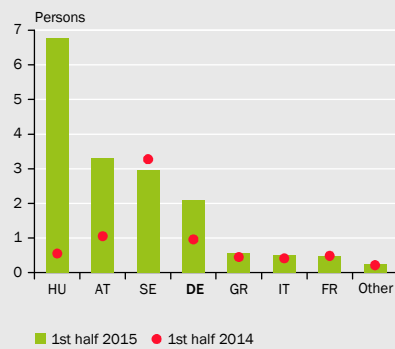
## II. Responding to The Refugee Influx

### The refugee influx puts European collaboration to the test.

**Asylum applicants**

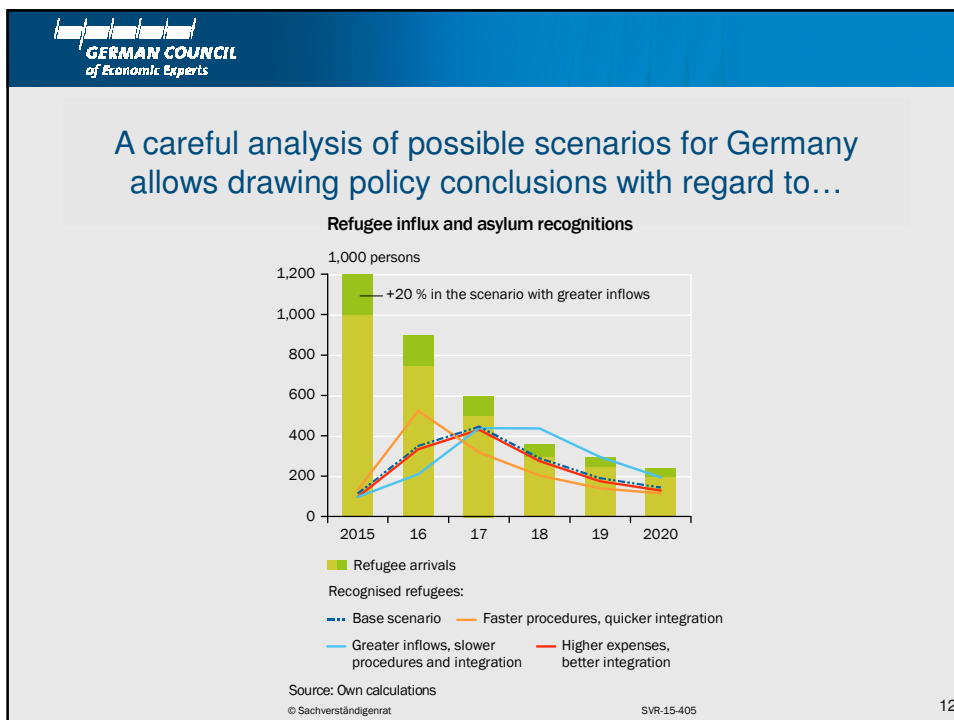
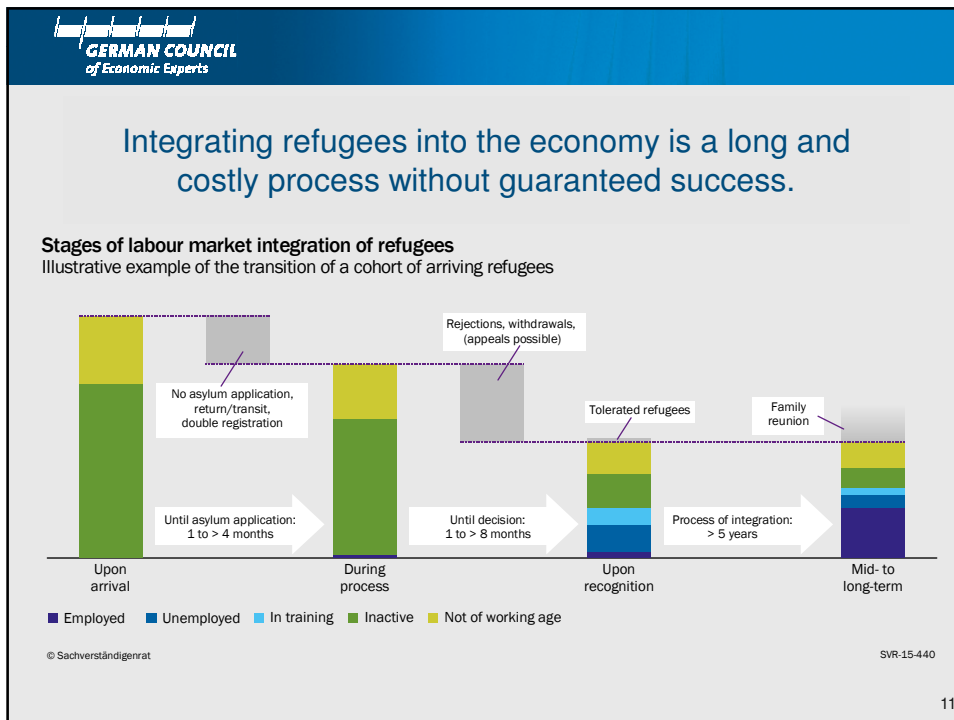


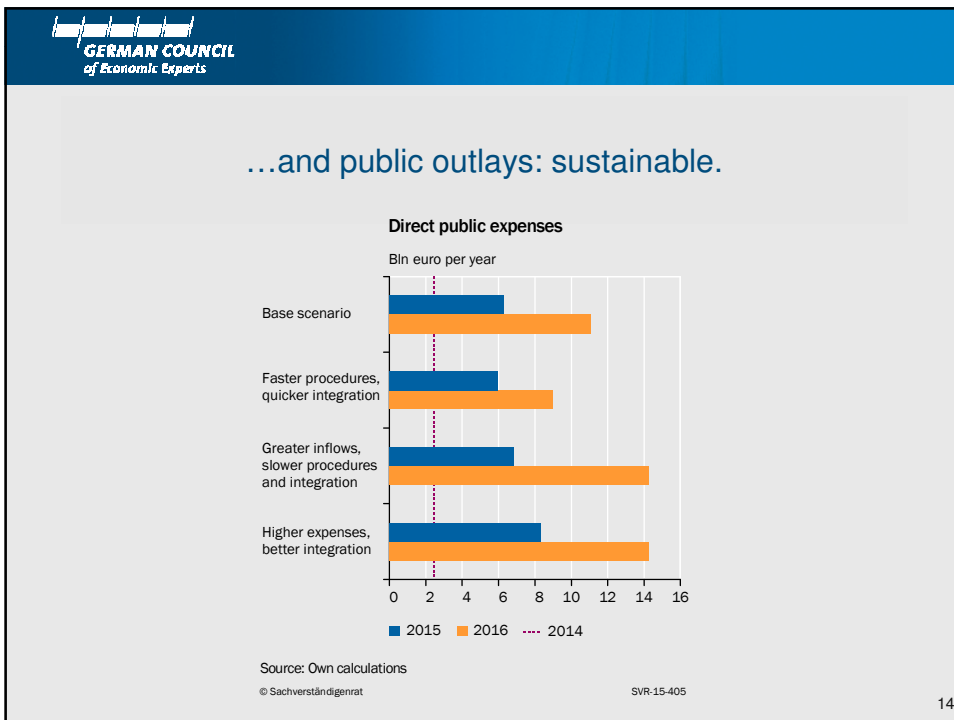
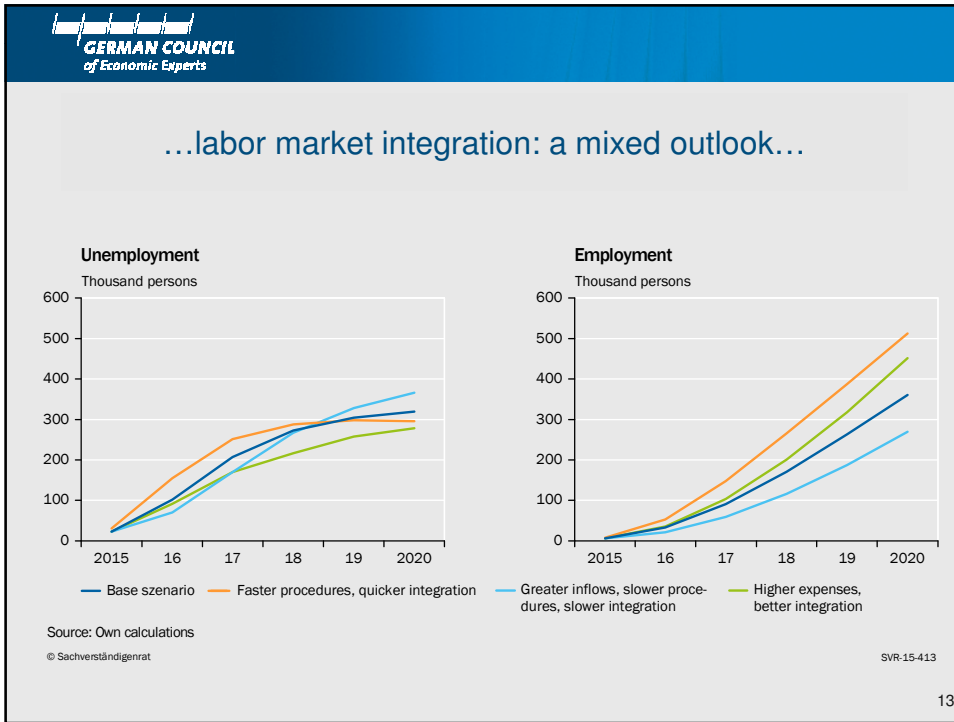
**Asylum applicants per 1,000 inhabitants**

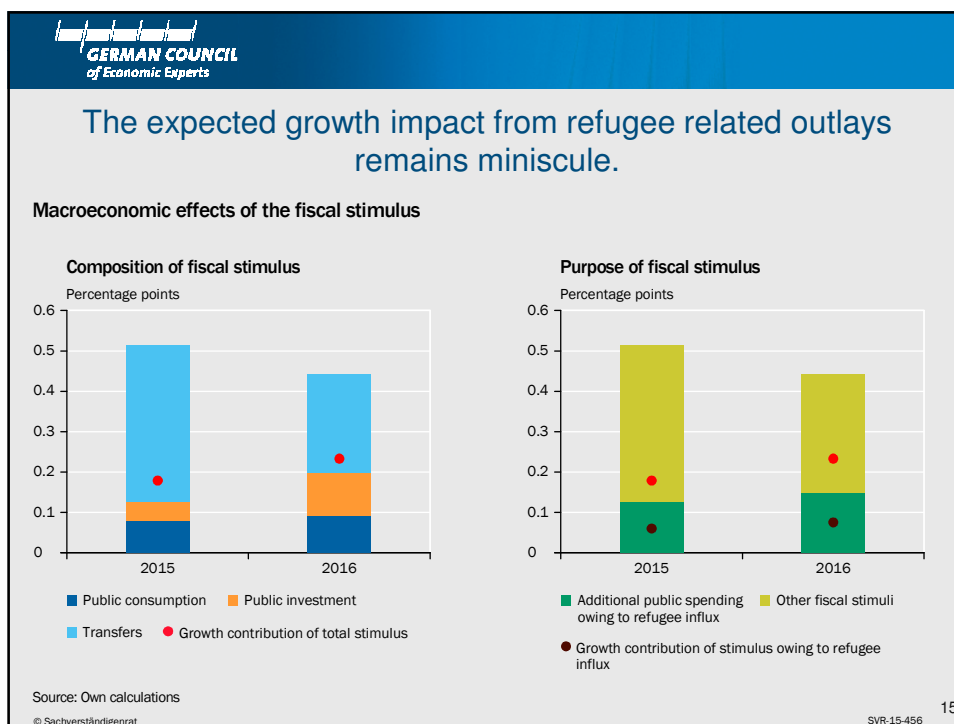


Source: Eurostat  
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## Policy implications for Germany

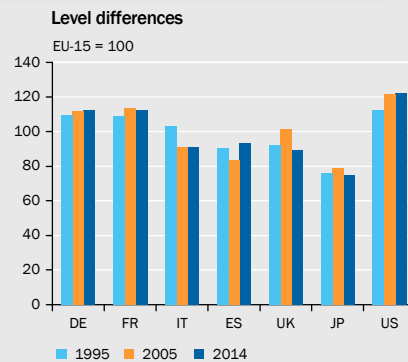
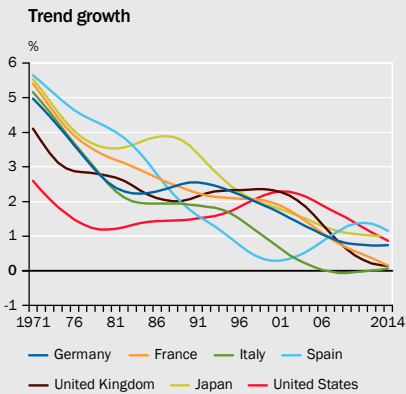
- Incentives for necessary education and training require a long term perspective for recognised refugees
- Barriers to labor markets must be lowered, including
  - Exceptions from minimum wage for all long term unemployed
  - Flexibility in temporary work contracts
- Policies to facilitate home construction instead of rent ceilings
- No reason for generous exceptions from fiscal rules

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### III. Conditions For Stronger Growth in Germany

### Sluggish labor productivity growth is common among advanced economies.

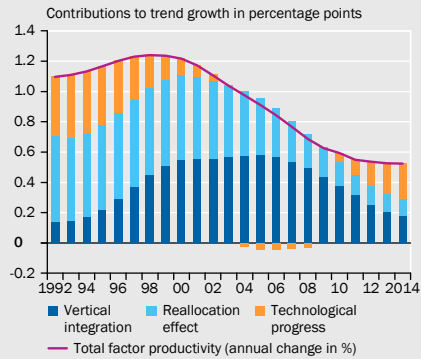


Source: European Commission  
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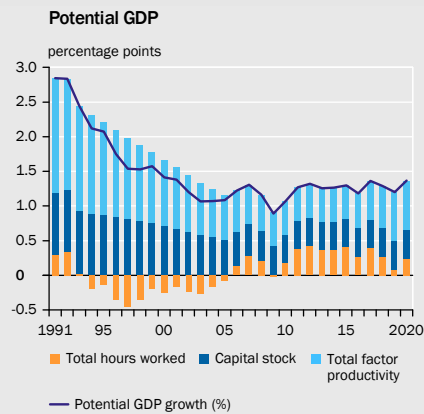
## In Germany, the ending trend towards outsourcing as well as higher employment slowed productivity growth...

However, low productivity growth highlights the need for conditions in support of economic growth.



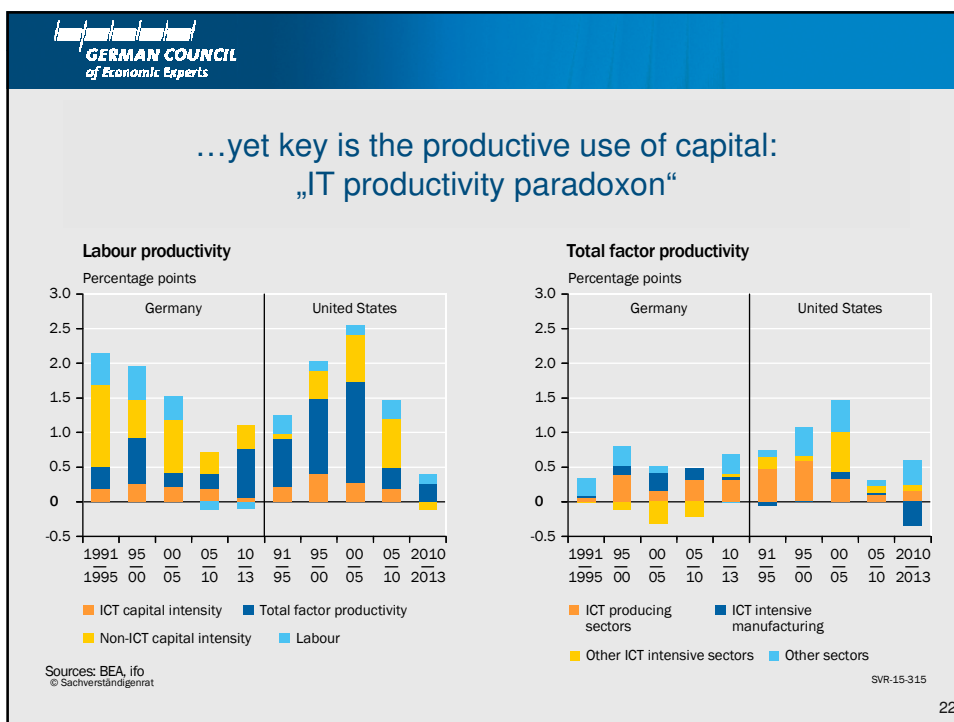
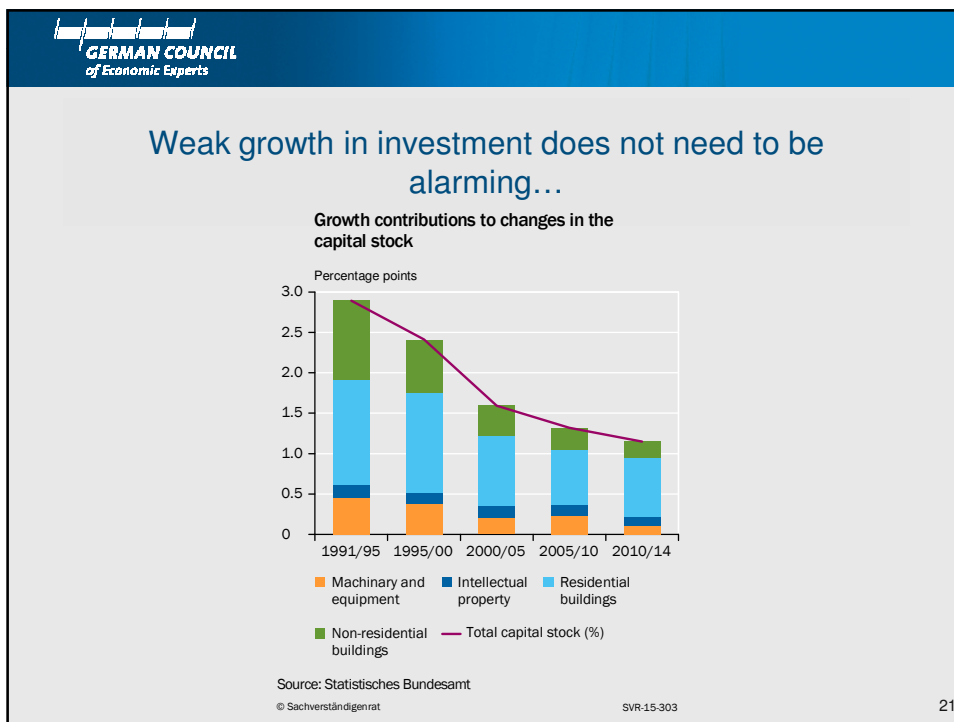
Sources: Own calculations, Statistisches Bundesamt  
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## ...leading to lower potential growth.



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Possibly...



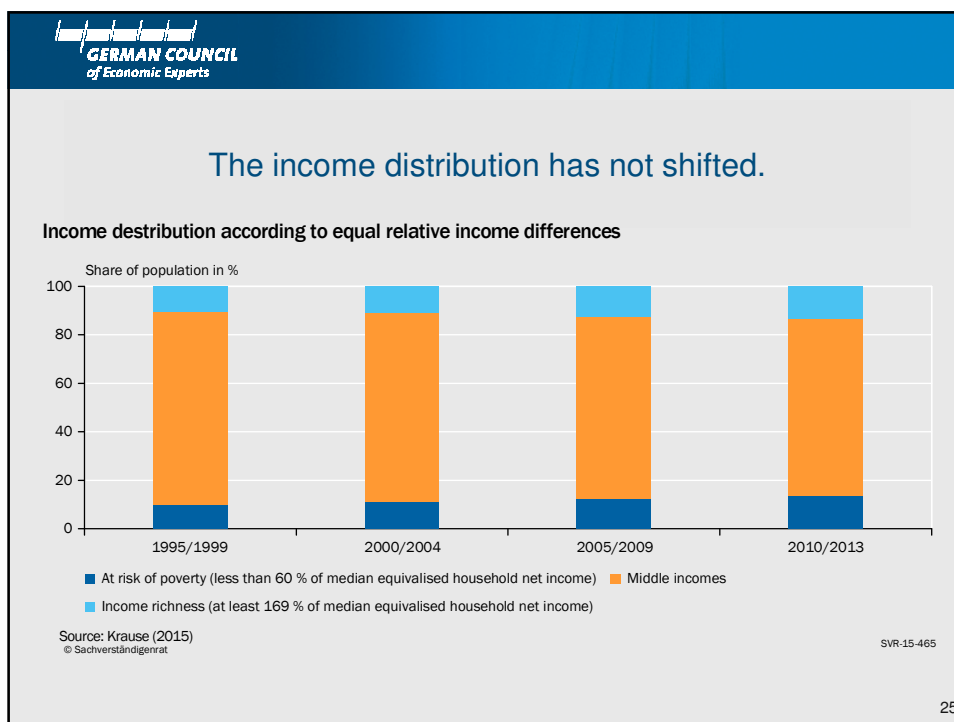
**“I’ve identified our productivity problem.  
We installed faster computers, but we forgot  
to install faster computer operators.”**

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What should policymakers do to lift productivity growth and secure prosperity in face of long-term challenges?

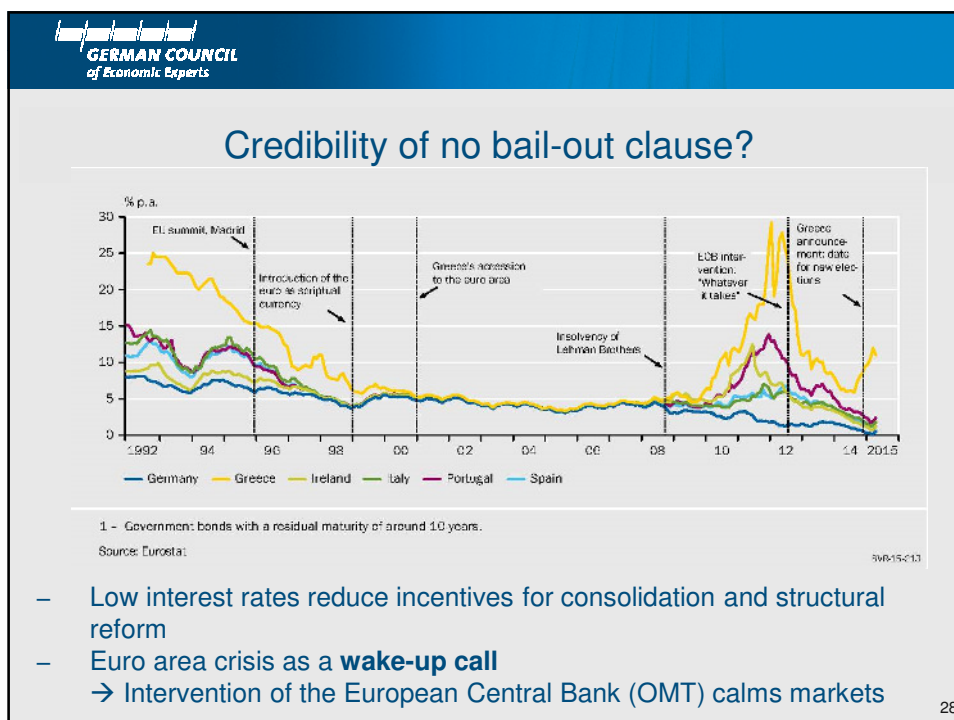
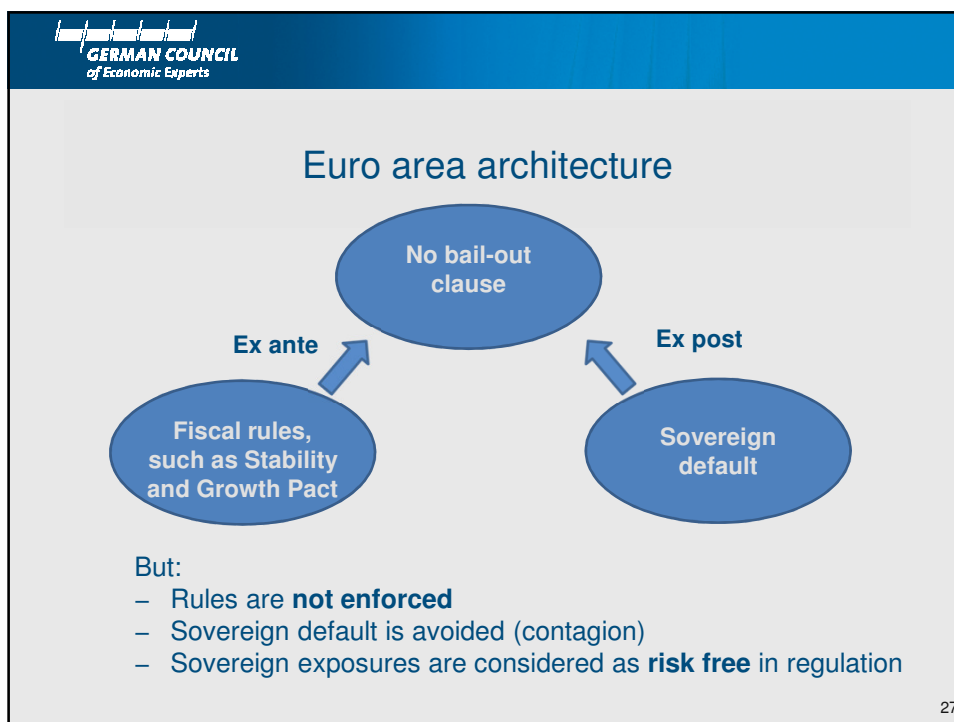
- Reduce regulations on product, service, and labor markets
- Provide more flexibility for work arrangements and retirement
- Invest more in education and training, re-introduce tuition fees
- Remove distortions in income tax, especially to the benefit of venture capital
- Facilitate improvements to infrastructure, e.g. high-speed internet

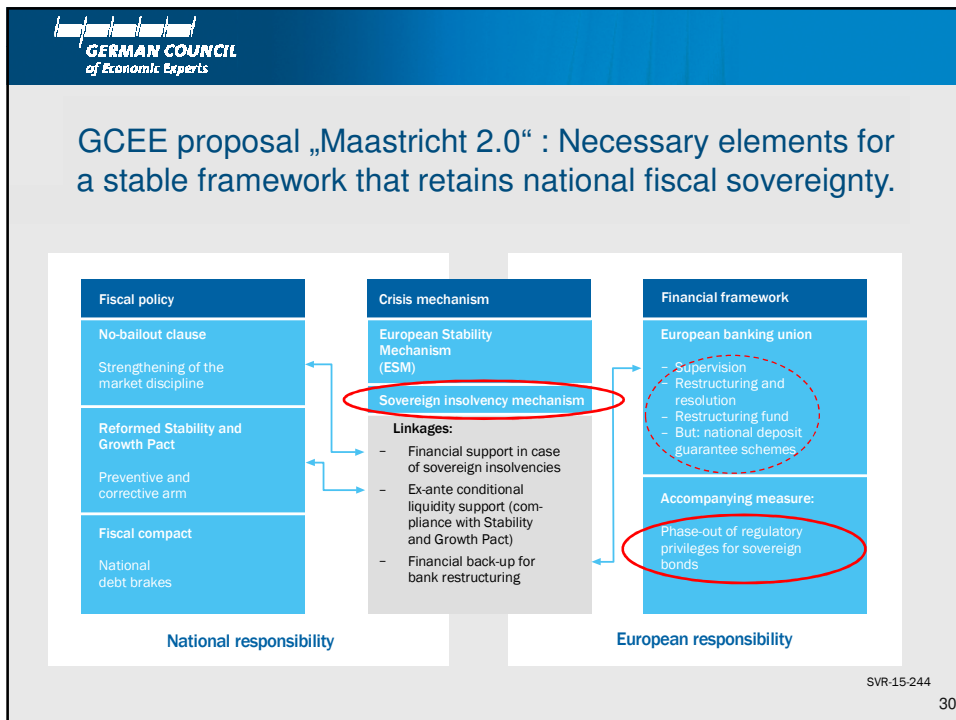
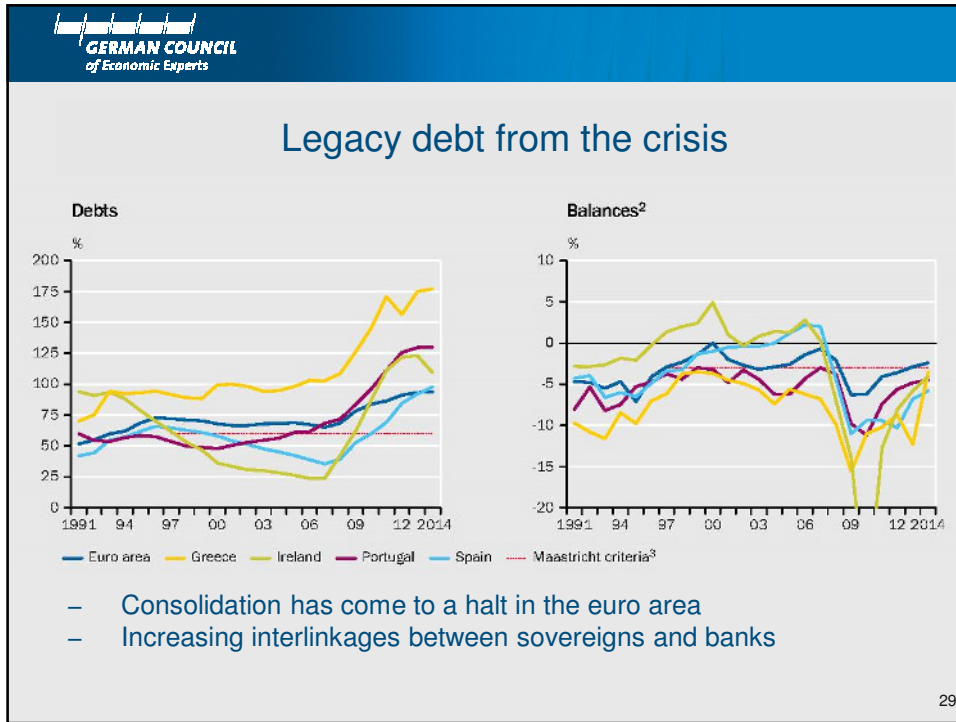
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## IV. Reform of Euro Area Architecture





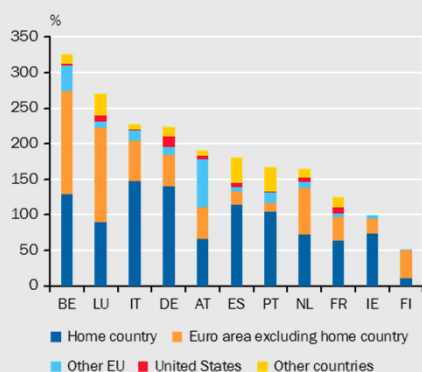
## Existing privileges for sovereign exposures

- No **large exposure limits**
- No **capital requirements** according to risk
- Privileged treatment in the new **liquidity regulation** (as level-1 assets)

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## Concentration risk in bank balance sheets (30 Jun 2015)

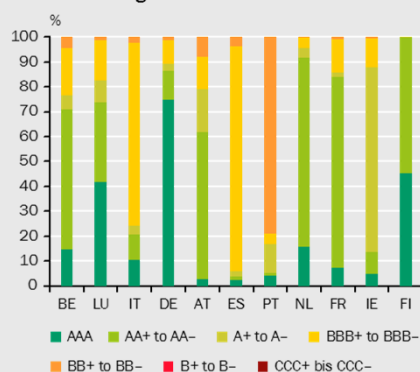
Exposures to selected counterparties, relative to own funds



Source: EBA  
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Exposures to EU-member states, distribution of credit ratings



Source: Standard & Poor's  
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- Large heterogeneity in sovereign exposures
- Strong **home bias**, especially in periphery countries and Germany

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## Proposal of the GCEE on the regulation of sovereign exposures

- 1. Risk-adjusted large exposure limits**
  - Depending on countries' creditworthiness
- 2. Risk-weighted capital requirements**
  - Basel risk weights

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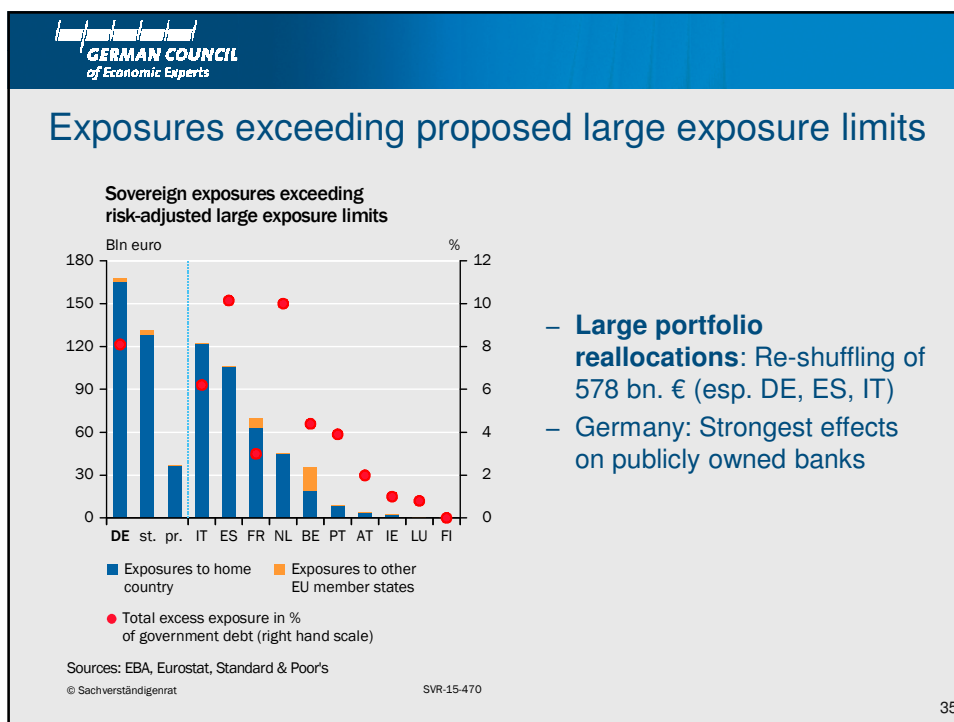
### Risk-adjusted large exposure limits and risk weights for sovereign exposures

Standard & Poor's credit ratings	Member states	Basel risk weight for sovereigns	Large exposure limit	Basel risk weight for corporations
			%	
AAA	DE, LU	0	100	20
AA+/AA/AA-	AT, FI, NL/BE, FR/EE			
A+/A/A-	IE/SK/LT, LV, SI	20	90	50
BBB+/BBB/BBB-	MT/ES/IT	50	75	100
BB+/BB/BB-	-/PT/-	100	50	
B+/B/B-	CY/-/-			
CCC+/CCC/CCC-	-/-/GR	150	25	

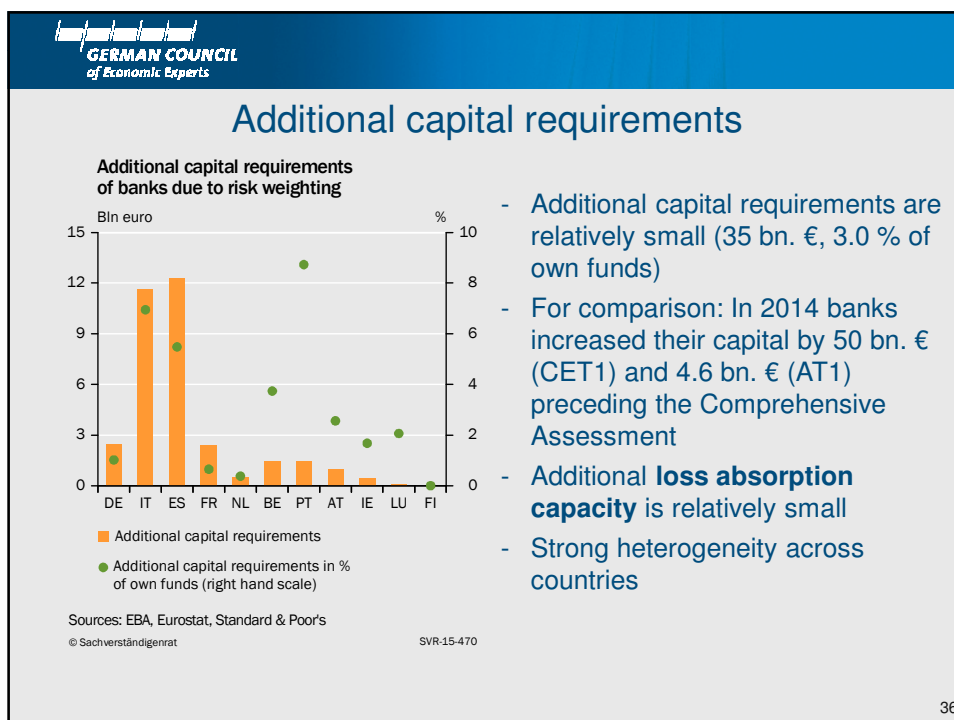
Sources: Basel Committee on Banking Supervision, Standard & Poor's  
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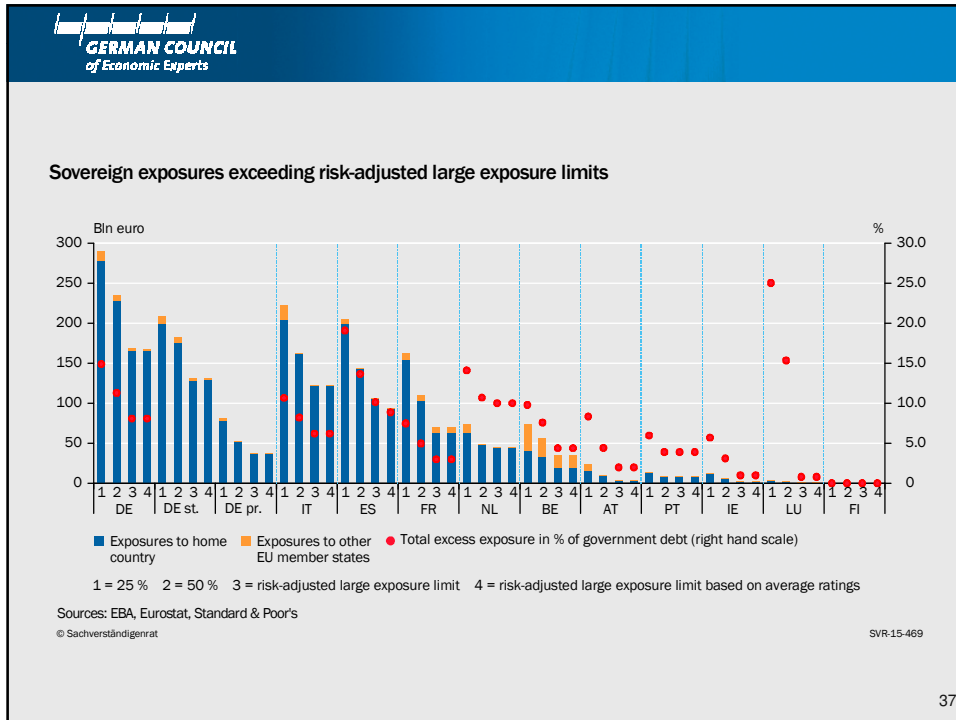
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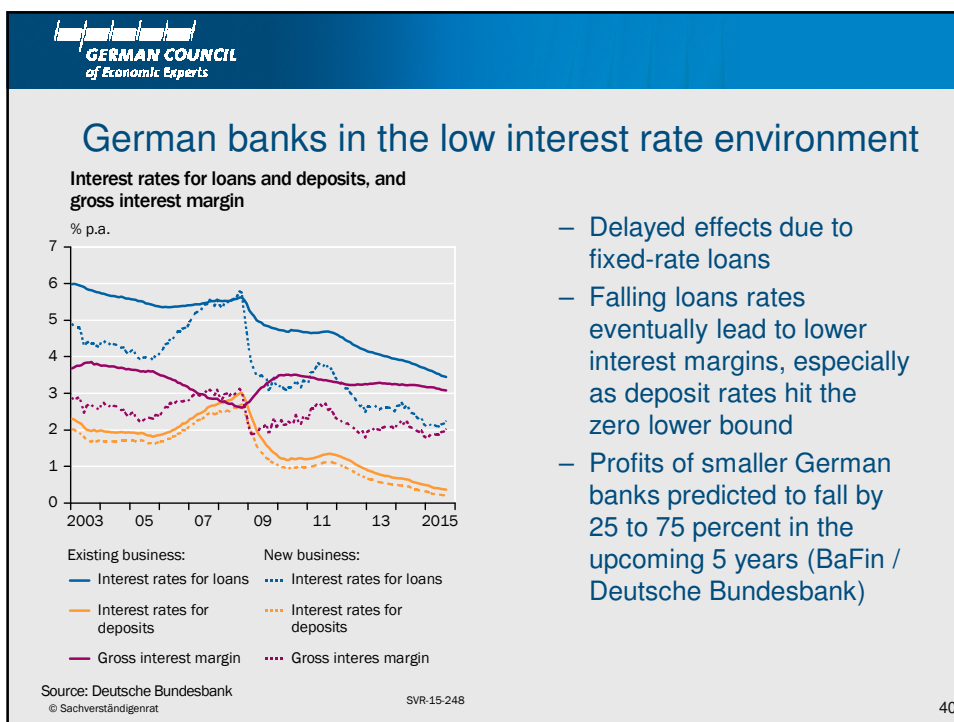
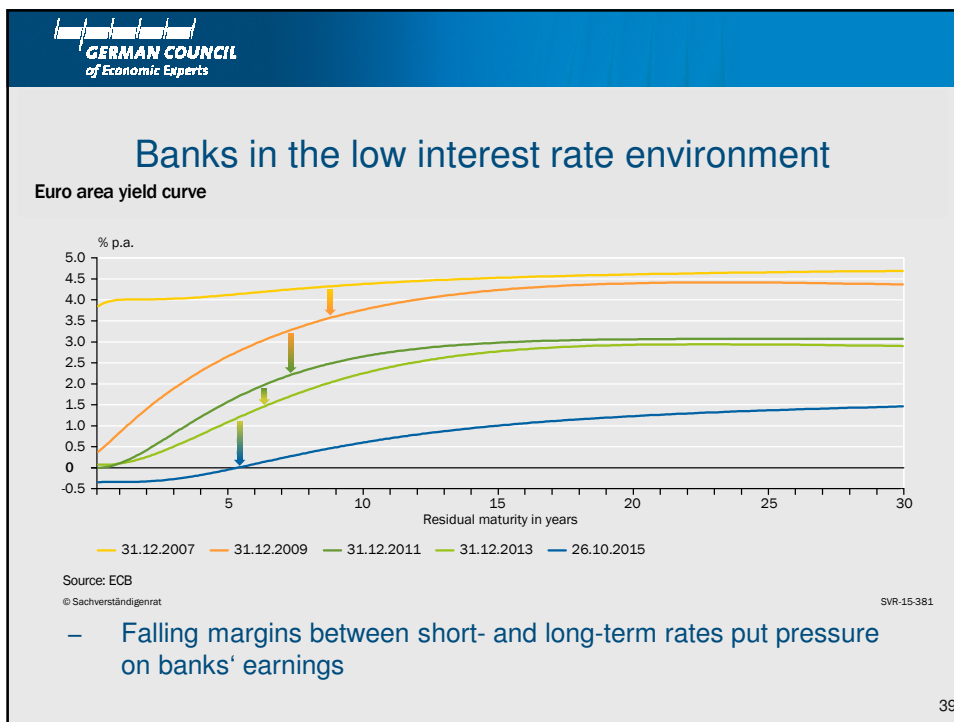


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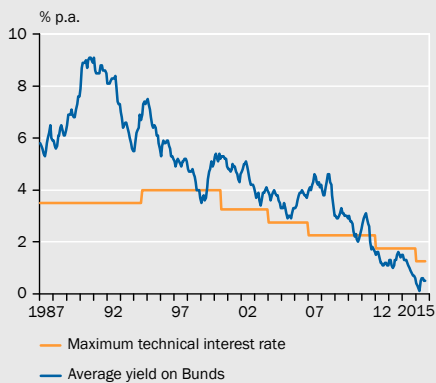
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## V. Financial stability risks from the low interest rate environment



## German life insurers in the low interest rate environment

### New business



Sources: Assekurata, Deutsche Bundesbank  
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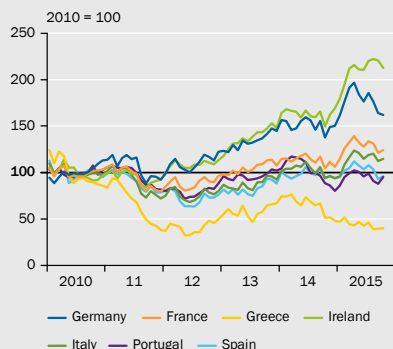
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- German life insurers are hit hard by low interest rates due to their specialization in **long-term guarantee** products
- In new business, guarantee rates (1.25%) cannot be earned when investing in German government bonds
- Average guarantee rates > 3%

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## Asset price bubbles?

### Stock indices in selected euro area member states



Source: National Stock Exchanges  
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- Sharp increase in stock prices in many countries
- But: Prices can largely be explained by low interest rates
- High sensitivity to changes in interest rates

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