Next German Chancellor faces economic growth challenges

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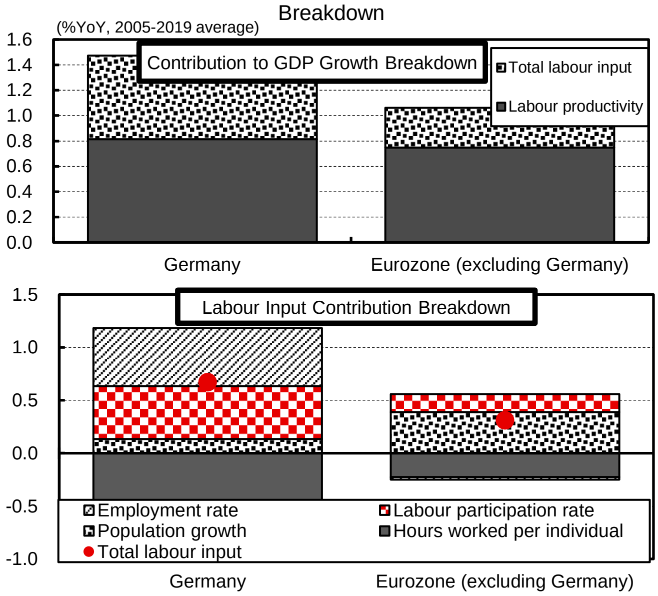
This month in Germany, Armin Laschet was chosen as the new leader at the Christian Democratic Union (CDU) leadership election. He is currently serving as the Minister-President of the state of North Rhine-Westphalia. He has become the most likely candidate to succeed Angela Merkel who is stepping down as Chancellor after 16 years of service.

When considering Germany's economy under Merkel's administration (which began in 2005), it is clear that its rate of economic growth had been outstanding within the Eurozone. When looking at the breakdown of GDP, it is clear that the driver of the relatively high economic growth has been the increase in labour input, which is generated by higher participation and lower unemployment rate (Figure 1). Structural reforms under the previous Schröder administration, such as the increase of the pension age and the reduction in employment insurance benefits, were a driver of the acceleration in female and middle-aged employment.

However, it should be noted that after a significant rise during the 16 years of the Merkel administration, the middle-aged labour participation rate (55-64 years old) is now high compared to other economically advanced countries excluding Japan. The rate peaked in Q2 2019 and started to decline (Figure 2). Given constrains in terms of population growth and demographic composition, the room for further sustainable growth may already be limited. The focus will be on how to improve labour productivity. On this point, it is necessary to improve capital deepening, which is growing at a sluggish pace. However, we think that there is still room for improvement in labour input by reducing possible mismatches in the labour market.

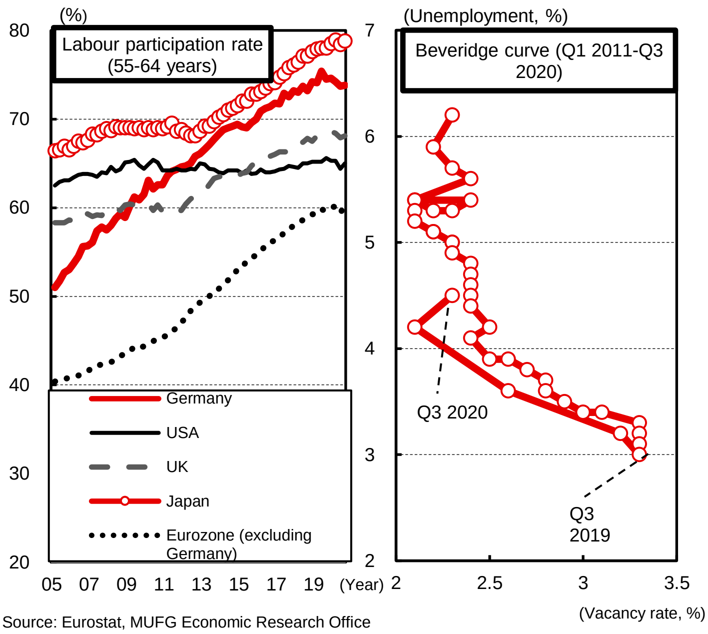
In Germany, the pandemic-induced increase in the unemployment rate has been limited so far due to the short-time work scheme provided by the government. However, if the overarching priority is to preserve jobs, there is a possibility that the labour market will not keep up with the shift in industry structures over the medium-term. The present priority is the pandemic, but for the Chancellor's successor, there may be a new focus on job placements and training to be able to respond smoothly to the shift to the new normal with or after COVID-19, and a more digitalised and environmentally-friendly "mid-21st century" industrial structure.

Figure 1：Real GDP Growth Rate and Labour Input Contribution Breakdown



Source: European Commission, Eurostat, MUFG Bank Economic Research Office

Figure 2：Labour Participation Rate (55-64 years) & Beveridge Curve



Source: Eurostat, MUFG Economic Research Office

Translated by Rebecca Whitter

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