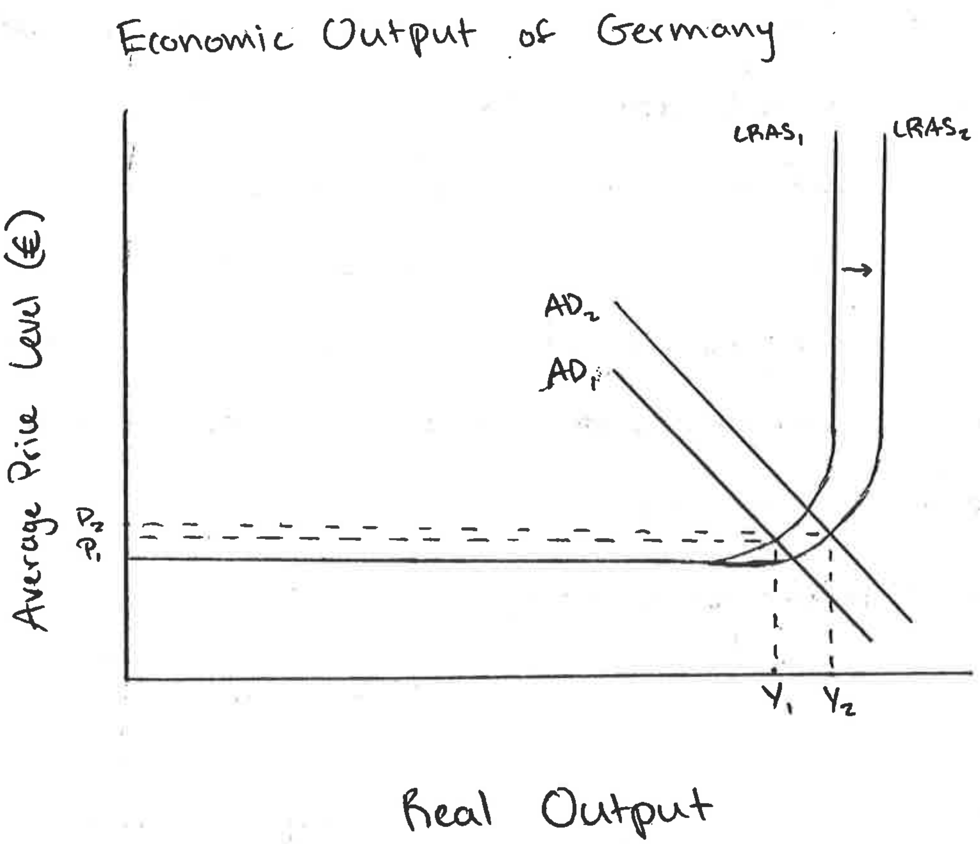
Migrants Find a New Home in Germany

Refugees seeking asylum in European countries are pouring into Germany, which was expected to receive over 1 million immigrants in 2015. This influx of people is expected to raise Germany's GDP by up to one fourth of a percentage point in 2016. The government is also expected to spend an estimated 9-14 billion € to manage the situation.



An increase in Germany's population will lead to more consumers, and therefore more consumption. The government is also planning to increase its spending in order to handle the newcomers. The graph above illustrates this situation. Consumption and government spending are both components of **aggregate demand** (The total spending on goods and services within a period of time and at a given price level), and their increases will lead to a shift in the aggregate demand curve (AD_1 to AD_2). Aggregate demand starts at a high level of employment (AD_1)

because Germany's economy is doing well, and their unemployment is low. The increase in population will also increase the quantity of labor and human capital, which are both factors of production. It's also likely that the migrants will bring any money and assets they have to Germany, which would increase the amount of capital available for investment. Increasing these factors of production will increase potential output, and thus a shift in the long run aggregate supply curve will occur ($LRAS_1$ to $LRAS_2$). The real output of the economy will increase (Y_1 to Y_2). It is difficult to say, based on the graph, how the average price level will change. It is likely, however, that it will increase (P_1 to P_2), since immediate increased government spending and consumption will most likely augment aggregate demand to a greater degree than the improvements in the factors of production will increase long run aggregate supply. If the average price level increases persistently, it will result in inflation, specifically **demand-pull inflation** (inflation caused by increasing aggregate demand), since aggregate demand is leading to an increase in overall price levels.

The migrants moving to Germany have left their previous jobs, and will now be in search of new ones. This is an example of **frictional unemployment** (short-term unemployment that occurs while people are between jobs), while the refugees look for new jobs and are out of the labor force. The government could choose to not take any action, and migrants may be able to find jobs, especially given the boost in aggregate demand from government spending. However, given the migrants' potential lack of skills and language barriers, they may have difficulty getting hired. Unemployment is problematic for the government, because it means the economy is foregoing potential output, and low unemployment is one of the five macroeconomic goals. In order to reduce unemployment the government could ensure education and training for the

Works Cited

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fleeing a brutal civil war in Syria. It went much further than other European countries in terms of how many it was willing to accommodate, and the number of refugees is expected to top one million this year.

At the time, some fixed income investors told IFR the development would be positive for Germany.

"In terms of the scale of migration, it is unparalleled since World War II, but we believe it will be an economic positive and will lift the long-term growth potential of Germany," Mark Dowding, partner and co-head of investment grade at BlueBay Asset Management, said in September.

Another investor's estimate was a bit more conservative than KfW's, though he agreed with the premise. The [redacted] could translate into a 0.1%-0.2% boost for German GDP, said Michael Krautzeberger, head of the pan-European fixed income team within BlackRock's fundamental fixed income platform.

"In terms of economic growth, that is quite relevant, it accounts for about [redacted] of projected growth," he said.

Though the German bond market is currently trading on technical factors such as the effect of the ECB's 60bn-a-month quantitative easing programme, economic fundamentals are likely to have a strong impact as 2016 wears on, said one banker covering public sector debt.

The yield on the 10-year German Bund is currently at 0.66%, compared to the 0.78% level at the start of the September when the refugee situation first intensified.

INJECTION OF YOUTH

There is also a long-term potential growth impact because of the positive impact of an influx of young, skilled people on Germany's demographics, according to KfW.

However, there are [redacted] over this.

"It's obvious that [redacted]or for the labour market is the refugees' human capital, if I may use the phrase," said Arne Leifels, economist at KfW.

"Yet we don't know very much about their education and job skills. So it will be crucial to swiftly [redacted] - apart from [redacted]. Getting people in jobs; that is the point where the future will be decided." (Reporting by Abhinav Ramnarayan; Editing by Philip Wright and Robert Smith)

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Bank voted 8-1 to maintain rates

The Bank of England voted eight to one to keep interest rates on hold at 5%, minutes of its last meeting show.

Inflation has risen in recent months, driven by high oil and food prices, making policymakers reluctant to cut rates despite the cooling economy.

March's 0.8% monthly rise in consumer prices was the steepest for nearly seven years.

"Given the sharp rise in inflation in April it is not surprising that eight of the nine-strong Monetary Policy Committee (MPC) voted in favour of interest rates on hold two weeks ago," said George Buckley, head economist at Deutsche Bank.

Recent figures showing weakness in both the manufacturing and service sector have increased pressure on the MPC to cut rates to 4.75%.

"Most believe that a significant slowdown is required to get inflation back to target and were concerned that another cut this month would give the impression that the committee was targeting growth, not inflation."

increasing the quantity of labour as well. Structural unemployment refers to those actively seeking employment but cannot find jobs due to a mismatch between their skills and location and the jobs available. As with all government spending, there is an opportunity cost, as other alternatives are foregone and the government is likely to run a deficit. Moreover, supply side policies are only effective in the long run.

This leads to an increase in the general price level (PL → PL_1) and a decrease in real output (Y → Y_1). This inflation with negative growth is called stagflation and is particularly dangerous for the economy. Consumers with incomes that are not linked to inflation, or those with inflation-linked incomes when inflation is higher than expected, will experience a loss of purchasing power and, hence, a decrease in living standards because they can buy less goods and services for their money. It is important that the MPC "give the impression that [they are] targeting … inflation", so that workers and labour unions do not start demanding higher wages, which will increase costs of production further and initiate a wage-price spiral. For richer sections of society, this decrease in living standards may be less significant but they are also more likely to have large savings, which will lose value. Fortunately, the UK is currently not experiencing higher inflation than its trading partners, so British goods' competitiveness on foreign markets should not be significantly affected.

Dixon implies that "rate hikes" could be used to combat this inflation. However, the costs of production are not largely affected by interest rates and therefore it is unlikely that raising them will counter-act this primarily cost-push inflation. Interest rates do, on the other hand, affect aggregate demand, which Blanchflower fears is weakening. Lowering interest rates would increase the incentive for firms to invest and add to the capital stock of the economy because loans are cheaper. Similarly, it increases consumption on durable goods, because consumers are more likely to take a loan to buy for example, a new car, if interest rates are lower. Investment and consumption are both components of aggregate demand so aggregate demand would increase (AD → AD_1)