

Weekly Report

DIW's 2009 Fall Forecast: Key Economic Trends

1.3% Growth Forecast for 2010, Despite Instabilities

Following an unprecedented contraction in GDP, the German economy returns to expansion. Growth will be modest in 2010, however, as the forces of the recovery are not yet stable. This is the key result of the Autumn outlook of the German Institute for Economic Research (DIW).

DIW expects Germany's GDP to grow by 1.3% in 2010. While this figure is higher than the forecast for the entire euro zone (+0.8%), it is not cause for celebration: Next year's growth is too low to compensate for the decline in output since the start of the crisis. By the end of 2010, Germany's GDP will have returned to its level at the beginning of 2006.

Stimulus from the world economy, but with a delay

Growth in the world economy in 2010 will be driven by emerging countries in Eastern Asia. These countries are not the main markets for German exports. Moreover, the demand for investment goods (one of the pillars of German export performance) is likely to be modest due to the low capacity utilization. In addition, the economic recovery is caused partially by temporary factors, such as the fiscal stimulus measures. They have massively increased government debt in numerous countries. Over the mid-term, these countries will be forced to consolidate their budgets. The pressure to consolidate will also increase over the next few years as tax revenues remain depressed by weak potential growth. Despite government rescue actions, the financial sector is still troubled and represents an additional risk factor that could prevent higher growth.

Unemployment Will Rise, But Not Excessively

In 2010 Germany's unemployment rate is also expected to rise to 9.2%, up from 7.7% in 2009. The effects of the recession on the labor market will thus be milder than initially feared. The majority of German firms have reacted to the abrupt fall in demand with reducing working hours, instead of layoffs. This has enabled them

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to retain human capital, and has prevented a sudden increase in the unemployment rate. However, the economic recovery will be rather weak and will require a long period of time. This puts pressure on the labor market. In the coming months, the number of short-time workers will be reduced and layoffs will raise. Employment losses will continue to be focused almost exclusively on export-oriented industries. Domestic demand is currently being supported by the low inflation rate. Due to automatic stabilizers like transfers, and the cut of social contribution rates, personal disposable income will continue to grow despite the increase in unemployment.

No huge effects from fiscal stimulus programs

Additional economic stimulus measures are not currently advised. Various measures have already helped to stabilize private consumption – even if their impact has been far less significant than the stimulating effects of lower energy prices. Not all measures are compatible with the policy goals of supporting sustainable economic growth and reducing energy consumption. The GDP growth triggered by stimulus measures is often modest due to the considerable leakage effects associated with their implementation.

No Signs of a Credit Crunch in Germany

While there has been a considerable excess of credit supply that contributed to easy lending standards during the last growth period, credit supply and credit demand are closely aligned at present. This is the finding of econometric studies. Claims that Germany is experiencing a credit crunch remain unfounded.

However, there is a risk that the supply of credit could become tighter, as the equity base of the German financial sector has shrunk considerably during the crisis. Therefore, it is recommended that the acceptance of capital flows from the government should be obligatory for banks as soon as their core capital ratios fall below a critical threshold. The introduction of concrete binding regulations would eliminate the reluctance of banks to accept government funds, as stigmatization effects could be avoided.

Unprecedented Budget Deficits

Despite signs of economic recovery, the German government will run unprecedented deficits in 2009 and 2010. While Germany nearly succeeded in passing a balanced budget in 2008, the country will run a deficit of 75 billion euros in 2009, and 120 billion euros in 2010. These figures correspond to 3.2% and 5.2% of nominal GDP. Germany thus has little hope of conforming any time soon with the provisions of the Maastricht Treaty (public deficit above 3% of GDP and a debt ratio higher than 60% of GDP).

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