

ifo Pressemitteilung

Munich, 26/6/2001

ifo press release

Ifo forecast: The world economy and the economic situation in Germany

Embargoed until 1:40 p.m. on 26/6/2001

Last year the world economy achieved a record growth of 4.8%, the highest level in the past ten years. But despite this robust growth for the year as a whole, economic expansion clearly slowed during the course of the year. This slow-down was triggered, firstly, by the rapid price increase for oil and other energy sources. Secondly, central banks in the US and Western Europe tightened monetary policy to stem the danger of inflation. The boom in America also came to an end. Here, the strong expansion in the IT sector up to mid-2000 covered up the cyclical slowdown that had already begun in other sectors as early as autumn 1999. The cooling of the US economy affected especially Japan and the industrialised economies of Asia. In contrast, the European economy continued to expand at a comparatively fast pace.

In Germany, the economy has been weakening significantly since the middle of last year. This was partly caused by the slowdown in the world economy. Another factor was the drastic worsening in the terms of trade from the cumulative effects of the oil price explosion and the weak euro. The higher energy prices and higher food prices in the wake of the BSE and FMD epidemics led in recent months to a clear hike in consumer prices and an accompanying weakening in domestic demand. From the second quarter of 2000 to the first quarter of 2001, seasonal adjusted domestic demand stagnated. Consumer spending in the same period declined, despite the significant tax cut that took effect at the beginning of the year. Much of this is attributable to the sharp rise in consumer prices, which absorbed purchasing power for other goods. Construction spending also de-

clined, and the construction industry is still in a state of recession. The only sector with robust growth for a time was equipment expenditure. Exports rose strongly up to the end of 2000, boosted by improvements in German competitiveness as a result of the weak euro. After the beginning of this year, however, a rapid decline in foreign demand became evident. With the slowdown of the economy, the decline in seasonally adjusted unemployment came to a halt, and an increase has now begun. Hence, the labour market situation is more unfavourable than was expected only recently.

A forecast of the world economic situation depends primarily on when the US economy will recover and on how strong the recovery will be. The Federal Reserve Bank has lowered key interest rates this year in five successive stages by 2½ percentage points to 4%, and further reductions are likely to bring an end to the economic slowdown. American fiscal policy is also becoming increasingly expansive. Also for these reasons, the US economy will gradually recover. Cyclical improvement in the US will stimulate exports to Southeast Asia, which will also boost the Japanese economy. The impetus will not be strong enough, however, to touch off a robust and sustainable recovery in Japan; the “Japanese patient” will remain in the intensive care unit. For all industrial countries, after a growth of 3.7% last year, economic expansion this year will amount to only about 1½%. Next year the growth pace will expand to more than 2%.

In Germany the economy has still not bottomed out. The latest results of the Ifo Business Survey for May were very disappointing. The business climate in trade and industry has clearly worsened in western Germany: both components of the business climate, the business situation and the business outlook, again deteriorated. The Ifo Institute assumes, however, that very moderate economic recovery will be noticeable in the second half of the year, both in Germany and the euro area. A recession – negative growth over several quarters – is not likely, even though the German economy at the moment, and for 2001 as a whole, is nearing stagnation.

The Ifo Institute expects the European Central Bank to lower interest rates slightly in the latter course of the year; taking into account the low real exchange rate of the euro, monetary conditions remain quite favourable. Owing to the tax cut, fiscal policy will have an expansive effect this year. We assume that wage developments will remain moderate in light of the unfavourable labour market situation. But here we also see considerable risks in light of the stronger recent increases in consumer prices. As the world economy recovers, the momentary slump in exports should gradually come to an end, with the weak euro helping to stimulate exports to the dollar area. Nevertheless, despite an acceleration in the course of the year, export growth in 2001 will average only 5%, half the pace recorded in 2000. Private consumption will not help boost the economy until the end of the year; average annual growth will only be 1%, which is weaker than in the preceding three years, despite the generous tax cut. Equipment expenditure will only grow at half the rate of last year owing to a weakening in sales. A further brake on the overall economy is the on-going recession in the construction industry, especially in eastern Germany. The growth pace of gross fixed capital formation (machinery and buildings together) in Germany will thus lag behind the results of all euro countries. Altogether, economic growth in Germany this year will only amount to 1.2%. Next year, as the retarding factors lose their strength, economic growth will accelerate to 2.2%. In the whole euro area, GDP will expand by 1.9% this year and 2.4% next year, which means that Germany will continue to show below-average growth. Continuing deterrents to expansion in Germany are the structural problems in the eastern Germany economy and continuing declines in the construction sector. Other growth-retarding factors are labour-market rigidities and the continuingly high taxes on the factor labour.

The economic growth we have forecast means that no sustainable improvement in employment can be expected in the coming months. Unemployment will not decline again until next year. The initially weak increases in production will be achieved almost completely by improvements in productivity. The number of unemployed this autumn will probably surpass the previous-year level. Thus, an aver-

age annual decline in 2001 vis-à-vis 2000 of about 60,000 to ca. 3.8 million unemployed will only be attributable to the lower numbers at the beginning of 2001. The number of gainfully employed will increase again next year as the economy recovers and the unemployment numbers are expected to fall again somewhat. Nevertheless, in 2002 average unemployment will not fall below the 3½ million level; as this year unemployment will stand at ca. 3.8 million people, in autumn 2002 at a seasonally adjusted 3.7 million. The goal of the German government to reduce unemployment to below 3½ million by autumn next year will not be reached, according to this forecast.