Institut für Wirtschaftsforschung an der Universität München

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Press release on the German economy in 2004/2005

"Germany towed along by the world economy"

The world economy is currently growing at the fastest pace in fifteen years. The main growth impulses are from the robust upswing in Asia and the United States, as confirmed by Ifo's World Economic Survey. In the US the economy is being stimulated by an expansive monetary and fiscal policy that is almost unprecedented. Ifo expects the world economy to expand by 4.7% in 2004 and 3.4% next year. The recent hikes in prices for oil and commodities will not dampen the upswing, since this is not primarily due to exogenous causes but is particularly the result of the demand boost that has accompanied growth.

The German economy is being towed along by the international trend. Although economic output has been expanding since mid-2003, the pace of growth is not as strong as in other countries. Germany's many structural problems are preventing it from fully participating in the upswing of the world economy. These problems are caused by exogenous factors, such as German firms' loss of interest-rate advantages under the euro and the loss of relative advantages of its own larger domestic market in the wake of European integration. The problems are also caused by endogenous factors, such as the financial costs of German unification and the well-known deficits in the German labour and social systems.

Nevertheless, production and incoming orders in the first months of the current year have been expanding. According to the results of the Ifo Business Survey, the business situation of industrial enterprises continued to improve in May. The business expectations of the surveyed enterprises stopping soaring and have returned to more realistic levels. Ifo estimates that real GDP in the first half of 2004 grew over the comparable previous year period by 1.6%. On average for 2004, compared to the average of 2003, economic growth will be 1.7%, although it must be kept in mind that approximately 0.5 percentage points of growth is attributable to the unusually large number of working days. Corrected for this factor, growth would only be 1.2%. Next year, the same calendar-adjusted output will show growth of 1.9%. Since 2005 will have fewer working days, non-calendar-adjusted growth will be 1.7%.

The mainstay of economic growth is exports, although investment in plant and equipment is now gradually expanding, and private consumption could recover this year and next as a late effect of the economic upswing.

Inflation is still not a problem, the euro having brought too little rather than too much inflation.

The situation on the labour market in the forecasting period remains a problem, as the business conditions of the enterprises have become more and more uncoupled from the labour market. High German labour costs have induced the enterprises to engage in excessive rationalisation and outsourcing to other countries.

Employment will continue to decline, with a slight improvement not coming until the end of the year. Employment will decline by 145 000, on average for 2004. Since February of this year, unemployment has already increased by 100 000.

Although unemployment was 50 000 below the level of 12 months ago, this was not the result of true economic effects but rather various measures of statistical adjustment. The Federal Labour Office initiated special activation efforts that induced many people not to register as unemployed. Also, at the beginning of the year, people engaged in training were removed from the unemployment statistics. Without these adjustments, unemployment would be 230 000 higher. Average unemployment for 2004, according to the old statistical system, would have stood at 4.6 million and would surpass the 5 million mark next winter. Statistical adjustments alone will not solve Germany's labour market problems.

This also applies to part-time employment schemes, in which an estimated 200 000 people participated in 2003. These "mini jobs" replaced to a large extent jobs with full social insurance and thus have not made a significant contribution to boosting employment numbers.

Government finances continue to be marked by the weak recovery and the unwillingness of those in charge to consolidate the budget. The deficit this year will be approximately €79 billion, or 3.6% of GDP, exceeding the Maastricht limit for the third time in succession. Also the 3¼% deficit limit in the German stability programme in the January 2004 version will be clearly surpassed. The promise made to the European Commission of reducing the deficit by 0.6 percentage points will also not be kept. Also for 2005 no lasting improvement is in sight since tax revenue will be lower because of implementation of the last phase of the 2000 tax reform and because of the one-off effect of health care reform on the spending side. The overall government deficit will be approximately €75 billion (3.4% of GDP), which means a further violation of the Stability Pact. The national debt will be 67% of GDP at the end of 2004 and 66% at the end of 2005. The trend in German public finances must be seen as alarming in light of economic growth that is weak for structural reasons.

Hans-Werner Sinn
President of the Ifo Institute for Economic Research

Federal Republic of Germany
Key Forecast Figures

	2002	2003	2004 (1)	2005 (1)
Percentage change over previous year[a)]				
Private consumption	-1,0	-0,1	0,5	1,5
Government consumption	1,7	0,9	-0,2	0,3
Gross fixed capital formation	-6,7	-2,0	1,8	1,7
Machinery and equipment, other investment	-7,6	-0,4	3,4	3,7
Buildings	-5,8	-3,4	0,5	-0,1
Domestic demand	-1,6	0,4	1,1	1,8
Exports of goods and services	3,4	1,8	7,9	5,1
Imports of goods and services	-1,7	3,4	7,0	6,0
Gross domestic product (GDP)	0,2	-0,1	1,7	1,7
Employment[b)] (1.000 persons)	38671	38246	38101	38159
Unemployment (1.000 persons)	4061	4377	4368	4382
Unemployment rate[c)] (in %)	9,5	10,3	10,3	10,3
Consumer prices[d)] (% change on the previous year)	1,4	1,1	1,6	1,4
General government financial balance[e)]				
- DM billion	-74,3	-82,1	-79,4	-75,2
- in % of GDP	-3,5	-3,9	-3,6	-3,4
memo item:				
Real GDP in the EMU (% change on the previous year)	0,9	0,4	1,8	2,2
Consumer prices in the EMU[f)] (% change on the previous year)	2,3	2,1	2,1	1,9

1) Forecast by the Ifo Institute.- a) At 1995 prices.- b) Domestic employment.-
c) Unemployment as a % of labour force (employed and unemployed).- d) Consumer Price Index.-
e) On national accounts definition (ESA 1995).-f) Harmonized index of consumer prices (HICP).

Source: Eurostat, Federal Statistical Office, Federal Labour Office, forecast by the Ifo Institute.