The economic scene in Germany around the turn of 2003-04

Overview

In the wake of the global upturn

Global expansion is gathering pace

The upswing in the global economy has gained momentum in recent months. At the same time, it is now also more broadly based. Although economic developments continue to be driven by the USA (with an increase in gross domestic product (GDP) similar to the boom of 2000) and the East Asian emerging economies (led by the dynamically growing Chinese economy), the upturn in the central and east European countries in transition has likewise strengthened and the economic recovery in Japan has stabilised. Favourable financing terms are proving to be an important mainstay of the current upswing. This applies both to the acquisition of new capital on the equity markets as well as to debt financing. In addition, important stimuli to global economic recovery are being provided by the ongoing structural changes in the corporate sector as well as moderate price developments, which are minimising purchasing power losses.

Limited impact of US dollar's depreciation

Owing to the dynamic global momentum, which has surpassed previous expectations, the depreciation of the US dollar against other major currencies has, up to now, not disrupted the expansion process in the euro area. The external stimuli fuelling the economic recovery are therefore still intact despite the fact that the US economy's real net demand for goods and services from the rest of the world was already in decline in seasonally adjusted terms in the second half of 2003. This points to a certain correction of the USA's current account deficit, but the risks of excessive or abrupt exchange rate movements as a result of global imbalances will remain as long as the adjustment is not also based on sustainable macroeconomic policies and structural reforms. However, when assessing exchange rate developments and their impact on the euro area it must be borne in mind that the trade-weighted exchange rate of the euro has risen much less than its bilateral exchange rate against the dollar, which is often the focus of current discussions. Whereas the euro rose by 20½% against the US dollar in the course of 2003, it appreciated by "only" 11½% on a trade-weighted average vis-à-vis the euro area's 12 most important partner currencies. Furthermore, it must be taken into account that the deterioration in competitiveness as a result of appreciation is offset by income gains on the part of domestic economic agents owing to improved terms of trade. Overall, in the fourth quarter, euro-area GDP increased by ¼% vis-à-vis the previous quarter.

Steady interest rate policy course with balanced price risks

Against the background of a virtually unchanged rate of consumer price inflation of 2% in the fourth quarter and balanced price risks, the Governing Council of the ECB left the Eurosystem's key interest rates at their prevailing low level during the period under review. Monetary conditions therefore remained fairly generous in the euro area and did not stand in the way of a real economic recovery. The dynamics of M3 growth, which remained high, weakened somewhat at the end of the period under review. Nonetheless, care must be taken to ensure that the liquidity overhang does not give rise to higher prices as the economic recovery progresses.

Gradual cyclical improvement in Germany

The economic outlook has also brightened in Germany. The situation in industry in particular has improved perceptibly as measured by the sharp increase in production and the renewed rise in the number of orders received. Domestic demand picked up significantly at the end of the period under review, although the picture is still very mixed. The optimistic expectations of the business community as well as the overall improved underlying conditions suggest that the recovery process will continue.

Higher investment, buoyant exports ...

The upturn in investment is particularly encouraging. Moreover, German exporters are continuing to benefit from global growth. Export business in the fourth quarter remained at largely the same high level that it had reached in the third quarter, while at the same time export expectations and orders received from abroad likewise increased noticeably in comparison with the previous quarter. This shows that German suppliers are certainly able to withstand competitive pressures on the price side and know how to exploit the growth potential of foreign markets. This is no doubt partly due to the fact that the cost advantages enjoyed by German suppliers within the euro area and as a result of obtaining intermediate goods from new production sites in central and eastern Europe and other regions of the world form a certain counterweight to the burdens arising from the euro's appreciation. The fact that the German economy has not grown more strongly under these conditions is, in nominal terms, due to the sharp rise in imports.

... and imports

For example, imports typically increase when foreign business picks up as the input of imports into export goods is relatively high. Stock management may also have played a role following the pronounced destocking of inventories in the previous quarter. Moreover, the more attractive prices of imported goods were no doubt also an important factor.

Consumption still weak ...

One of the weak points of the economic recovery process is the pronounced consumer restraint at the present time. Real household consumption fell again in the fourth quarter and the sentiment indicated by consumer confidence surveys deteriorated noticeably in December and January. Both the propensity to purchase and households' assessment of their income prospects worsened around the turn of the year. Households' real disposable income was boosted by subdued price developments. However, despite the announced tax cuts, particularly the expected burdens arising from the health system reform and widespread uncertainty about further reforms needed to restore the financial sustainability of the social security systems are likely to have curbed households' propensity to consume. Rapid and cogent clarification concerning the further urgently required reform measures is therefore needed to give both consumers and investors greater planning certainty beyond the current year and to regain their confidence and trust in the sustainability of public finances. The ongoing difficult situation on the labour market is also curtailing consumer spending.

... and declining employment

The demand for labour has continued to decline. The number of persons in work fell by a seasonally adjusted 40,000 in the fourth quarter. However, as greater numbers of unemployed persons were concurrently deregistered, above all as a result of increased reviews of their willingness and availability to work by the labour exchanges, registered unemployment fell. Furthermore, when interpreting the most recent figures, legislative changes must also be taken into account. For example, persons taking part in aptitude tests and training measures were previously recorded as being unemployed. Since the beginning of the year, they, like other participants in labour market policy measures, are no longer counted as being unemployed. Without this change in the methodology, unemployment would have increased in January in seasonally adjusted terms.

Favourable price climate

Prices remained virtually stable in the last quarter. The appreciation of the euro also played a key role in this respect as it more than compensated for the rise in oil and refined petroleum product prices denominated in US dollars. The relatively sharp rise in the consumer price index as provisionally calculated by the Federal Statistical Office (0.4% on the month in seasonally adjusted terms in January) should be viewed above all in connection with the increased charges under the health system reform which, strictly speaking, are not attributable to an increase in healthcare prices but rather to a change in healthcare financing. Excluding healthcare, the year-on-year inflation rate fell from 1.2% to 0.6%.

The poor state of public finances ...

Public finances are still a matter of concern. Although the budget deficits of central, state and local government fell in the fourth quarter of 2003 year on year, this was largely attributable to sizeable privatisation proceeds. In 2003 as a whole, the deficits are likely to have amounted to €70 billion, thereby exceeding the already high figure for 2002 by €10 billion. Sluggish tax receipts were accompanied by a marked increase in expenditure. The deficit of the social security funds still amounted to around €6 billion (compared with €8½ billion in 2002) even though the contribution rates and the income ceiling for contributions were raised markedly. According to provisional figures from the Federal Statistical Office, the deficit ratio increased by ½ percentage point to 4.0% in 2003 in the wake of the muted macroeconomic momentum. Most of this is of a structural nature, however. The general government deficit could decrease significantly this year despite comprehensive tax cuts. However, the decline to 3¼% of GDP as expected by the Federal Government requires comprehensive cost-cutting measures at all levels of government.

... calls for comprehensive consolidation ...

The scenario also contains risks, not least with regard to the partly uncertain financial impact of various fiscal policy measures.

... and no changes to be made to the Stability and Growth Pact

It is of crucial importance that the deficit ratio be reduced this year and that it is brought below the 3% deficit ceiling next year so as to limit the loss of credibility suffered by the Stability and Growth Pact as the central fiscal policy instrument for supporting and protecting a stable monetary union. There is no cause to alter the pact. If applied consistently, it is suitable for ensuring sound public finances and, in its current form, also affords sufficient flexibility, although its implementation could undoubtedly be improved. Especially given the positive growth effects of sound government finances and the foreseeable demographic developments, the obligation to ensure a balanced budget in the course of the economic cycle must be fulfilled as quickly as possible.