– Presse release –

Wiesbaden, 12 November 2008

The German Council of Economic Experts (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung)* is today publishing its Annual Report 2008/09 with the title

Mastering the financial crisis – Strengthening the forces for growth

I.

The worldwide financial crisis escalated dramatically in 2008. For a brief period there was a danger that the global financial system might collapse, which would have had unforeseeable consequences for the real economy. This danger was averted by resolute intervention by the policymakers. The financial market turbulence is nevertheless having a marked negative impact on real economic developments.

The shockwaves of the crisis hit a German economy which had already entered a cyclical slowdown. The overall economic outlook deteriorated sharply as the year progressed. Germany's gross domestic product managed to grow by 1.7 per cent overall in 2008, though this was largely attributable to a surprisingly robust performance in the first quarter. The German economy is slipping into recession, accompanied in part by negative quarter-on-quarter rates of change in output. In 2009 aggregate output will stagnate on an annual average. This year's economic forecast is subject to a very high level of uncertainty, with pronounced downside risks.

Key economic data for Germany

	Unit	2005	2006	2007	2008[1]	2009[1]
Gross domestic product	%[2]	*0.8*	*3.0*	*2.5*	*1.7*	*0.0*
Private housholds[4]	%[2]	*0.2*	*1.0*	*– 0.4*	*– 0.3*	*0.4*
General government	%[2]	*0.4*	*0.6*	*2.2*	*2.0*	*2.2*
Investment in machinery & eq.	%[2]	*6.0*	*11.1*	*6.9*	*5.1*	*– 6.3*
Construction investment	%[2]	*– 3.0*	*5.0*	*1.8*	*3.3*	*– 0.5*
Other investment	%[2]	*4.9*	*8.0*	*8.0*	*7.9*	*2.6*
Total domestic demand	%[2]	*0.0*	*2.1*	*1.1*	*1.1*	*– 0.1*
Exports of goods and services	%[2]	*7.7*	*12.7*	*7.5*	*4.2*	*0.4*
Imports of goods and services	%[2]	*6.5*	*11.9*	*5.0*	*3.4*	*0.5*
Employment (domestic)	million	38.85	39.10	39.77	40.30	40.22
Registered unemployed	million	4.86	4.49	3.78	3.27	3.30
Employees[5]	million	26.24	26.37	26.94	27.48	27.43
Unemployment rate[6]	%	*11.7*	*10.8*	*9.0*	*7.8*	*7.9*
Consumer prices[7]	%[3]	*1.5*	*1.6*	*2.3*	*2.8*	*2.1*
General government balance[8]	%	*– 3.3*	*– 1.5*	*– 0.2*	*– 0.1*	*– 0.2*

1) 2008: own estimate, 2009: forecast.– 2) Price-adjusted; changes over previous year.– 3) Change over previous year.– 4) Including private non-profit institutions.– 5) Employees subject to social insurance contributions.– 6) Share of registered unemployed in total civilian labour force (dependent civilian employed persons, self-employed, family workers). Source: years 2005 to 2007 Federal Labour Office (Bundesanstalt für Arbeit).– 7) Consumer price index (2005 = 100).– 8) Net lending of the central, state and local governments and the social security funds, as % of nominal gross domestic product. In the data of 2008 and 2009 the potential effects of the Financial Market Stabilisation Act (Finanzmarktstabilisierungsgesetz) are not included.

It is unlikely that the economy will pick up speed anytime soon. Although the direct impact of the financial crisis on Germany's real economic development has been limited so far, the indirect consequences are apparent. Germany's most important trading partners have been particularly hard hit by the worldwide recessionary tendencies. A combination of the financial crisis and imploding real estate markets has directly begun to strongly weaken the dynamics of business activity there. This results in a protracted decline in those key trading partners' external demand, which plays a pivotal role in Germany's heavily export-dependent economy.

II.

The turbulence which has buffeted the financial markets in successive waves of growing amplitude since the middle of 2007 has dealt a severe blow to market participants' and the public's confidence in the stability of the financial system. The policymakers consequently responded appropriately in launching a comprehensive rescue programme encapsulated in the Financial Market Stabilisation Act (*Finanzmarktstabilisierungsgesetz*). The next step must be to ensure that German financial institutions can stand firmly on their own as soon as possible, so that government support measures can be swiftly severed.

In order to significantly lessen the likelihood of global financial crises in the future, the supervision of the financial markets needs to be given an enhanced international dimension. To this end, a new global early warning system will have to be put in place. At the same time, the activities of the national supervisory agencies will have to be regularly reviewed. The authority most suited to perform these tasks is the International Monetary Fund (IMF). In addition, the need to reinforce the financial system's resilience means that financial institutions' risk buffers will have to be strengthened.

III.

Given the pronounced weakening of the German economy, fiscal policymakers are called on to initiate a growth-oriented policy aligned with short-term cyclical needs which will both quickly stimulate domestic demand and increase potential output. With this aim in mind, the German Council of Economic Experts advocates financing growth-promoting measures next year by temporarily incurring a higher deficit. This growth package should amount approximately to between 0.5 and 1 per cent of gross domestic product.

Stabilising the financial markets and strengthening the forces for growth are the most pressing policy issues at the present time. However, they must not be misused as ans excuse to relax the drive to dismantle the existing distortions in the taxation system, to further reduce the level of entrenched unemployment and to safeguard the sustainability of the social security systems.

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