GERMAN COUNCIL of Economic Experts

Annual Report 2019/20

Dealing with Structural Change – Key Messages

ECONOMIC SITUATION: SIGNIFICANT SLOWDOWN

- ↘ Global economic growth has slowed noticeably. The prevailing high level of uncertainty seems to weigh on international trade and on investment demand.
- ↘ Economic momentum has weakened in the euro area. Monetary policy is already very expansionary. It would have been better if the ECB had refrained from new purchases of government bonds.
- ↘ The German economy, especially its industry, is in a downturn. A slow recovery can be expected over the course of 2020 at the earliest. An economic stimulus package is currently not necessary.

PRODUCTIVITY: IMPROVING CONDITIONS FOR GROWTH

- ↘ Productivity growth has been slowing in the developed economies. This is particularly problematic for Germany due to its ageing population.
- ↘ Education, research and innovation are required in order to achieve higher levels of productivity growth. It is important to strenghten the transformation of knowledge into economic success.
- ↘ Therefore, an environment that sets the right incentives for private investment is required. In turn, this will help to improve the German economy's ability to innovate.

INDUSTRIAL POLICY: STRUCTURAL CHANGE AS AN OPPORTUNITY

- ↘ Industrial policy should focus primarily on innovation. It should be designed in a non-discriminatory manner based on transparent criteria and evaluated at regular intervals.
- ↘ In order to benefit from structural change, Germany and Europe should strive for further integration of the single market, a deeper capital markets union and a rules-based framework for global trade.
- ↘ Improving digital infrastructures and human capital is a key prerequisite for creating conditions under which innovation policies can be effective, not least at the regional level.

CYCLICAL AND STRUCTURAL CHALLENGES FOR BANKS

- ↘ The low profitability of euro area banks is mainly due to structural and bank-specific factors. In the protracted low interest rate environment, banks are facing further challenges.
- ↘ High risks in the real estate sector and the looming increase in risks in the event of a recession justify further macroprudential measures.
- ↘ Digitalisation is bringing new market participants into the banking business, calling traditional business models into question and giving rise to additional risks.

PUBLIC DEBT AND INVESTMENT

- ↘ A credible reduction in the debt ratio that is brought about with the help of the debt brake constitutes an important signal to financial markets as well as other EU member states.
- ↘ Managing public debt on the basis of the interest rate-growth differential is unlikely to be a successful strategy, in particular because this differential could reverse sign in the medium term.
- ↘ Investment should not necessarily be prioritised over other types of public spending. Insufficient public investment is most likely attributable to factors other than the debt brake.

SECURING UPWARD MOBILITY, STRENGTHENING WORK INCENTIVES

- ↘ The distribution of income has remained broadly stable since 2005. Income inequality is lower within an age cohort throughout all stages of life than in a cross-sectional perspective.
- ↘ A cohort comparison so far does not show a reduction in income mobility. Early childhood education and equality of opportunity should be strengthened in order to secure income mobility in the future.
- ↘ Transfer withdrawal rates could be revised to improve upward mobility, to strenghten incentives for taking up employment or working more, and to leverage dormant potential in the labour market.