

– Press release –

Wiesbaden, 10 November 2010

The German Council of Economic Experts (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung*) is today publishing its Annual Report 2010/11 with the title

### Chances for a stable upturn

#### I.

The economic recovery in Germany that began in mid-2009 has gathered considerable momentum. Gross domestic product (GDP) is set to grow by 3.7 percent in 2010. Economic output will expand further in 2011, though less dynamically, with GDP likely to increase by 2.2 percent. The exceptionally rapid pace of the current recovery masks the fact that the level of German output in mid-2010 merely matched that recorded at the turn of 2006-2007.

The unexpectedly positive upswing offers the chance for Germany to achieve a stable if relatively flat growth path. The basis for this is a sustained revival of private domestic demand. Private consumption should be boosted by the buoyant employment trend, while investment should be lifted by comparatively low real interest rates. A stronger domestic demand will not only act as a counterweight to possible fluctuations in Germany's export performance but will also make a contribution to reducing international imbalances.

Downside risks exist, however, especially in the external sector. Many of Germany's trading partners are still struggling with entrenched high unemployment and unresolved problems in the financial and property sectors. Furthermore, many countries face very challenging fiscal consolidation requirements. Export dynamics could be additionally handicapped by tensions in the international exchange rate system, which could lead to an appreciation of the euro or to growing protectionism.

#### II.

The favourable overall outlook for the German economy should be underpinned by resolute economic policy initiatives. These should focus on **five areas of activity**.

The **euro area's** institutional framework needs to be fundamentally reformed. This must achieve the twin aims of effectively preventing misalignments and putting in place a crisis mechanism that will provide support to countries encountering serious liquidity problems but at the same time ensures that the private sector will bear its share of the costs if a country does not adhere to the rules of the Stability and Growth Pact.

Notable advances have been made in reforming the national and international **financial market architecture**, especially regarding the amended capital requirements (Basel III) and new German legislation for restructuring ailing banks. Even so, the G20 states are still a long way from permanently averting the danger of being held to ransom by financial institutions. The chief stumbling block is the failure to date to devise an adequate way of dealing with systemically important institutions. The German Council of Economic Experts presents two alternative solutions for discussion: a bank levy with a steering function, or capital surcharges for systemically important institutions. Another key need is for closer integration of prudential supervision at a national, European and global level.

**Government budgets** need to be rigorously consolidated and confidence in the long-term sustainability of public finances strengthened. On the taxation front, policymakers have now bowed to reality and shelved plans for unfunded tax hand-outs. But unfinished business remains in the form of the announced restructuring of municipal finances and the necessary reform of the turnover tax.

The reforms that have been initiated in the **social security systems** must be resolutely implemented and complemented. Thus a start has been made on reforming the method of financing the statutory health insurance scheme, which could pave the way to a funding system that is no longer coupled to labour income. The need in the statutory pension insurance scheme is to commence the planned incremental raising of the official retirement age.

Despite the welcome developments on the **labour market**, a number of problems still have to be tackled. They include strengthening the incentives for recipients of unemployment welfare benefits to find work on the primary labour market. The German Council of Economic Experts also cautions against overhasty reactions to the EU's extension of the freedom of movement and the Federal Labour Court's ruling allowing multiple plant-level agreements with different trade unions.

Table 1

Key economic indicators for Germany<sup>1)</sup>

	2007	2008	2009	2010 <sup>2)</sup>	2011 <sup>2)</sup>
Gross domestic product .....	2.7	1.0	- 4.7	3.7	2.2
Private consumption <sup>3)</sup> .....	- 0.2	0.7	- 0.2	0.1	1.6
Government consumption .....	1.6	2.3	2.9	3.0	1.0
Investment in machinery & equipment .....	10.7	3.5	- 22.6	9.2	6.0
Buildings .....	- 0.5	1.2	- 1.5	4.2	1.8
Other investment .....	6.8	6.5	5.6	6.7	6.5
Total domestic demand <sup>4)</sup> .....	1.2	1.2	- 1.9	2.2	1.9
Exports of goods and services .....	7.6	2.5	- 14.3	15.5	6.7
Imports of goods and services.....	5.0	3.3	- 9.4	13.3	6.8
Persons employed (domestic) <sup>5)</sup> .....	39.72	40.28	40.27	40.47	40.76
Registered unemployment, stocks <sup>5)</sup> .....	3.78	3.27	3.42	3.25	2.97
Persons employed, covered by social security <sup>5)</sup> .	26.94	27.51	27.49	27.80	28.17
Unemployment rate <sup>6)</sup> .....	9.0	7.8	8.2	7.7	7.0
Consumer prices <sup>7)</sup> .....	2.3	2.6	0.4	1.1	1.4
General government balance <sup>8)</sup> .....	0.3	0.1	- 3.0	- 3.7	- 2.4

1) Unless otherwise indicated: price-adjusted (changes over previous year); Change over previous year in percent (%).-  
 2) 2010: own estimate, 2011: forecast.- 3) Including non-profit institutions serving households.- 4) Domestic use.-  
 5) Thousands persons.- 6) Unemployment rate referred to entire civil sector workforce (employees, self-employed including unpaid family workers). Source: years 2007 to 2009 Federal Labour Office (Bundesagentur für Arbeit).- 7) Consumer price index (2005 = 100), change over previous year in %.- 8) Net lending of the central, state and local governments and the social security system, as % of nominal gross domestic product.

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