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OECD warns on German growth

By Gerrit Wiesmann in Berlin

The German economy faces markedly slower growth and "considerable downside risks" if the country fails to stem the eurozone debt crisis which could force Germany's already weak banking sector to stop lending, the Organization for Economic Co-operation and Development warned.

The Paris-based organisation said in its latest Germany report on Tuesday that the country's economy would grow by only "around ½ per cent" this year – after expanding by 3 per cent in 2010 – as domestic investments and consumption are hit by falling confidence among companies and consumers.

Should things get worse and the country's as-yet stable labour market sag, the OECD said Berlin should accept a bigger budget deficit by letting jobless benefits and other "automatic stabilisers" kick in without making savings elsewhere – and even "a temporary stimulus" should growth turn out to be "significantly weaker" than projected.

The report comes as a warning shot to Germany as eurozone governments haggle over final details of a second big bail-out package for Greece, with a growing number of German politicians signalling that the country should be allowed to default.

The OECD noted an "unusually high level of uncertainty" given events in the eurozone. It warned that the possibility of "a further significant worsening" of the crisis would have "considerably adverse effects" on the German banking system, bringing a domestic credit crunch in conjunction with a drop-off in exports to European trading partners.

Banks in Germany and other eurozone countries have been forced by their governments to improve their capital bases by this summer, with all German banks vowing they will be able to do this without recourse to government money and conditions.

But the OECD said there were signs that German banks that had not assessed all risks had "a high vulnerability" to "financial market stress" and called on the government "to intensify discussions with the banking sector" about capital levels.

It singled the *Landesbanken*, owned by state governments and municipal savings banks, as remaining particularly vulnerable because of their ongoing "lack [of] a viable business model and their resulting "low capitalisation and profitability".