



## On the record...



### Chief Economist Thomas Mayer about the current state of the economy

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*Mr Mayer, we've been seeing a growing number of positive reports on economic growth in Germany lately. How do you currently assess Germany's growth prospects for 2010 and 2011?*

In our World Outlook of December 2009 we forecast 2.1% growth for Germany in 2010 and 1.4% in 2011. At the time we were considered to be hopeless optimists. In the meantime, most other economic researchers have brought their forecast for 2010 into line with ours. Some of them have a higher projection for 2011 than we do. It really looks like Germany will be the euro area's growth engine this year and that German growth will considerably outstrip the expected eurozone average of 1% again next year.

*What are the main factors driving this development?*

As has often been the case, the recovery in Germany is being driven by exporting industry, but this is also helping to boost investment activity. The surprisingly good development in the labour market is helping consumption. Without this positive influence there probably would have been a sharper decline in private consumption after the car scrappage bonus expired.

*So the upswing was mainly export-driven at first. Is this going to continue or will the German economy also gather strength on the back of domestic demand in the coming months?*

Unfortunately, it looks like exports will have to keep things going for the time being. This year, net exports are set to generate 1.5 pp of the 2% growth. Next year, our forecast sees net exports accounting for 1.2 pp of 1.5% growth. So 75% of this year's growth will come from net exports, and even 80% of next year's, according to our forecast.

*You already mentioned the German labour market as being one of the key factors for domestic demand. It has remained astonishingly stable considering the depth of the recession. Can you name the reasons for this, and what are the short and medium-term prospects for German labour?*

The German government's short-time work scheme has undoubtedly played a part in the unexpectedly good development of the labour market. Another very important factor, though, is that companies did not assume – the way they used to – that they could quickly find highly skilled employees again if they laid off part of their core staff during the downswing. Over the past few years, the shift in demographics has thinned out the supply of promising new entrants to the labour market. So the outlook for qualified workers is really good also on the medium to long-term horizon. By contrast, people with poor skills will have little chance of getting a job.

*Well, do you see any way for domestic demand, rather than exports, to play a sustainably bigger role in driving Germany's labour market and economy over the medium to long term? Or to put it another way: what consequences will there be for the stability of the Eurosystem if Germany continues to maintain a current-account surplus at the expense of the other euro members?*

Germany is a world leader in industry and in an international comparison it has one of the strongest export sectors. This is in stark contrast to the services sector, which is pretty underdeveloped. Simple, low-skill services are either short in supply or non-existent, while the quality of higher-value services is often below average. Stronger growth in this sector would help to reduce the German economy's export bias and help in turn to achieve more stable growth in the euro area. To accelerate employment growth and thus incomes in the services sector there would have to be a reform of the social security system and of regulatory arrangements. Better possibilities for Hartz IV welfare recipients to earn a bit of additional income or a combi-wage model could increase the number of jobs in the low-wage sector. A reform of Germany's education system – for example, putting an end to federal particularism and introducing tuition fees at universities – could improve performance quality in this sector and create more jobs for highly qualified employees. What surprises me in particular is the amount of resistance



to tuition fees for social justice reasons. Tertiary education is an investment that promises a high return in the shape of an above-average income if completed successfully. Why should the taxpayer shoulder the entire investment costs in this area and thus further subsidise the minority of the population that is already privileged thanks to its higher educability?

*Let's take a look abroad. Greece and other countries of Southern Europe are having massive problems with their public finances. How can these countries in particular and European countries in general manage to run down their debt without running their economy into the ground at the same time?*

All things considered, the first ten years of Europe's monetary union were pretty successful, but one thing went wrong: access to credit was unexpectedly easy, tempting some countries to indulge in living beyond their means. They allowed their budget deficits to get excessively high and piled up debt. If EMU is to carry on, these deficits and debts will have to be cut back to a sustainable level. This will be a painful process and linked with income losses, but there is no alternative. At best, the stronger economies can help the others to adjust. Quite a while ago I suggested that the answer could be to establish a European Monetary Fund that could administer this aid and, in a pinch, also wind up state insolvency proceedings in an orderly manner. Naturally, the policymakers did not react in good time, so it took a fly-by-night rescue package to shore up the euro including, among other things, purchases by the ECB of otherwise unsellable government bonds. We now need to install these hastily resolved measures in a proper regulatory framework. If we fail to do so, EMU faces a dismal future.

*What consequences do you expect for economic growth after 2011 from the austerity packages that have been announced in many countries of Europe?*

The austerity programmes will have their biggest impact this year, and while they will have to be continued going forward, they will become less painful over time. Government spending and cheap credit will be out of the picture as growth drivers for the medium term. Therefore, trend growth in the eurozone is set to decline significantly, to about 1-1.5%.

*And outside Europe, how are things in the US economy, for example?*

In the past few quarters there was a strong recovery from the 2008/09 slump, so I expect there will be a soft patch in the coming quarters with GDP growth possibly easing to about 2%. During 2011, US growth ought to pick up slightly because of an upswing in the inventory cycle and in expenditures on consumer durables, which had been cut back to the bone.

*China seems to have emerged unscathed from the deepest global recession of the past few decades. Are double-digit growth rates to be expected in China in the years ahead too, or are asset bubbles already developing that could burst in the near future?*

We have already seen a decline in equity prices, and the real estate markets are also softening. This comes as a reaction to the measures taken by the Chinese government to cool economic activity. I expect that Chinese growth will settle in at around 9% and that a sweeping crash in the equity and real estate markets can be avoided.

*Some analysts already say that the Western world is facing a changing of the guard. How do you rate the overall opportunities and risks of the developed markets in comparison with the emerging markets?*

The emerging markets were in fact already the growth driver for the global economy over the past decade, and nothing is going to change in this respect in the current decade either. At present, the total GDP of the emerging markets accounts for slightly less than half of global GDP. By the end of this decade, the emerging markets will generate the larger part of global GDP. And another thing: they will have a younger population and be carrying less debt.

*How do you recommend that Deutsche Bank clients position themselves to react to the changes in the economic environment?*

As we've seen lately, people should be cautious about investing in sovereign bonds issued by developed countries that have amassed excessive debt. In the years ahead, emerging-market bonds are likely to perform better. The past ten years were not exactly encouraging for equity investors. Nevertheless, I think that the robust growth of the emerging markets will buoy the shares of companies that can capitalise on this growth. These companies don't necessarily have to be based in the emerging markets themselves. A whole raft of companies in the industrial countries, and in Germany in particular, benefit from the booming growth in the emerging markets.

What's more, I believe that demand for commodities is going to stay high. So clients should hold investments from this asset class in their portfolios, too. Finally, I expect gold to gain further significance as an alternative to the leading international currencies, these being the US dollar and the euro. Investors are quite understandably worried about a long-term increase in inflation and about the coherence of EMU. This will, in my opinion, support demand for the world's oldest currency.



Dr. Thomas Mayer is Chief Economist of Deutsche Bank Group and Managing Director of Deutsche Bank Research.

[Thomas Mayer](#) (+49) 69 910-30800

This interview was conducted by [Eric Heymann](#) (+49 69 910-31730) and [Jochen Möbert](#) (+49 69 910-31727).

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