The Economist

Economics focus

Vorsprung durch exports

Which G7 economy was the best performer of the past decade? And can it keep it up?

Feb 3rd 2011 | from the print edition

THE euro zone may be limping, but its largest member is sprinting. Germany grew at its fastest pace for two decades in 2010. An expansion rate of 3.6% put it ahead of most other rich economies, including America, whose GDP grew by 2.9% last year. Sceptics argue that Germany's strong rebound merely follows a deeper drop in output during the recession than in most other economies. For a proper assessment of countries' relative performance, you need to take a longer period, such as a decade.

At first glance, the popular perception of Germany as a laggard seems borne out by the numbers. Germany's GDP has expanded by an annual average of only 0.9% over the past ten years, just half the pace in America. (For countries which have not yet published their full-year figures, we have used 2010 estimates from *The Economist*'s poll of forecasters.) But that is misleading. America's economy grew more quickly partly because its population rose by almost 1% a year, thanks to immigration and a higher birth rate. In contrast, the number of German citizens is shrinking. That matters because a better gauge of prosperity is not growth in GDP, but growth in GDP per person or average income.

This measure produces a very different ranking. Over the past decade Germany had the fastest growth in GDP per person among the G7 club of rich economies; America was in only fifth place (see chart). Using GDP per head also casts new light on the recent recession. Measured by the fall in output per head from the fourth quarter of 2007, Germany's recession was no deeper than America's. Germany is also the only G7 country where GDP per head last year was back above its 2007 level.

Berlin beats Bay Area

Germany scores highly on several other economic gauges, too. It is one of only two countries in the G7 where the unemployment rate ended the decade lower than it began. Its current

rate of 6.6% (using the standardised international definition) is the second-lowest, well below America's 9.4%. For the first time eastern Germany now has a lower jobless rate than California.

Germany's public- and private-sector finances are also in much healthier shape, mainly because a conservative mortgage system helped it avoid a housing and credit bubble. Household debt has fallen over the past decade from 115% of their disposable income to 99%. Over the same period, Britain's soared from 117% to 170%, America's from 100% to 128%. Germany also has the smallest budget deficit and least government debt relative to GDP. Based on the measures in the chart—growth in GDP per head, unemployment, budget deficits and household debt—Germany has been the G7's best performer over the past decade. The IMF forecasts that Germany will also have the fastest growth in GDP per head over the next five years.

Two potential problems spoil this rosy picture, however. The first lies in another standout number—the country's huge current-account surplus, which stood at 5% of GDP in 2010 and is seen by Germans as further proof of the country's economic prowess. Germany is the only G7 economy whose share of world exports has not fallen since 2000, despite Chinese competition. An increase in net exports has accounted for no less than two-thirds of Germany's total GDP growth over the past decade, far more than any other big economy. Net exports accounted for half of Japan's GDP growth and only about one-tenth of China's.

This is not a sustainable engine of growth. To contribute to GDP as it has in the past, Germany's trade surplus would have to keep rising every year. That would leave Germany increasingly vulnerable to recessions elsewhere, as well as to the risk of a protectionist backlash. It is also improbable. Germany's trade surplus has swollen only partly at the expense of other rich countries: two-fifths of the increase over the past decade was with emerging economies. Indeed, its surplus with America has shrunk as a share of America's GDP over the past decade. But Germany does run a large surplus with the rest of the EU, where demand will be much weaker over the coming years.

Germany's external surplus reflects chronically weak domestic demand as much as external strength. Consumer spending has grown by an annual average of only 0.3% over the past decade, depressed by prolonged wage restraint and high household saving. An ageing country such as Germany should save more than it invests (ie, run a current-account surplus) to build up a nest-egg of foreign assets that will pay for future pensions as the labour force shrinks. But Germany's external surplus is too big. Much of it has also been poorly invested, in everything from American subprime bonds to Greek government bonds.

Germany's second big weakness is that its productivity growth has been relatively slow. Productivity in manufacturing is high by international standards but lags in the services sector, in part because of red tape that restricts competition. Over the past decade slow productivity growth has been offset by the fact that Germany has put more people to work, thanks to labour-market reforms in 2003-05. But over the coming years Germany's labour force will shrink as a share of its population. Unless productivity growth perks up, the rise in GDP per head will slow.

Germany has topped the G7 league over the past decade mainly because it avoided a credit bubble. But to maintain its performance over the next decade it needs to boost both domestic spending and its services sector. The good news is that most of Germany's growth last year

did come from domestic demand, not exports. Business investment took the lead, but in the fourth quarter real consumer spending was almost 2% higher than a year ago. The lowest unemployment rate for almost 20 years is likely to push up wages this year and to encourage households to spend more of their income. A recovery which is "Made in Germany" would enable the country to keep up the pace.

from the print edition | Finance and Economics