German economy ‘collapsed in late 2008, worse on the way’

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Snared by the global economic slump, the German economy contracted sharply late last year, suggesting a disastrous 2009 for Europe’s industrial powerhouse.

Gross domestic product (GDP) shrank by an estimated 1.5-2.0 percent in the fourth quarter from the third, an official said, as the financial crisis and strong euro plunged the world’s leading exporter deeper into recession.

The contraction was in line with suggestions from officials in recent weeks, and underscored problems facing Europe’s biggest economy.

“Germany is witnessing its worst economic period in decades. It is a situation in which economic textbooks serve no purpose,” Chancellor Angela Merkel told the Bundestag, or lower house of parliament, after the estimate was released.

With German exports plunging and industrial orders for November showing no signs of relief on the way, many economists had forecast a bleak fourth quarter.

“This means the starting point for 2009 is really bad,” Commerzbank chief economist Joerg Kraemer said.

“We still expect GDP to shrink by 2.0 to 3.0 percent in 2009, which would be the sharpest decline in the history of the Federal Republic,” he added.

German economic activity expanded by 1.3 percent for all of 2008, nearly half the 2007 figure, the Destatis national statistics service said, and below the government’s forecast of 1.7 percent.

The financial crisis and and global economic downturn had a strong impact in 2008, Economy Minister Michael Glos acknowledged.

Growth of exports, the main pillar of the economy, was cut nearly in half, and the trend in business investment began to weaken as well.

Consumption stagnated meanwhile, even though the number of people at work in Germany reached a record high point last year since the country’s reunification in 1990.

Higher oil prices in the middle of 2008 pushed up petrol prices however, and traditionally thrifty Germans kept spending to a minimum.

"I am sure the package of support measures will have marked repercussions this year," Glos said in reference to a government economic stimulus plan worth about 50 billion euros (66 billion US dollars).

The plan, which was approved by Merkel's cabinet on Monday, includes heavy spending on infrastructure such as roads and schools and cuts in taxes and payroll deductions.

Germany's Institute for Employment Research (IAB) said Wednesday that the stimulus package could save a quarter of a million jobs, but others remain sceptical.

Business leaders say the projected tax cuts are too small and complain that the measures will only take effect in July, which they say is too late.

As a result, the economy is unlikely to get a real boost from the plan this year, according to several economists.

Meanwhile, the announcement of a strong contraction in the fourth quarter "is just the latest piece in a dismal series of economic data," Bank of America's senior European economist Holger Schmieding said.

And if it wanted to mark a pause in its cycle of interest rate cuts, the European Central Bank will now have no choice but to react swiftly and strongly, he added.

"For the sake of its own credibility, the ECB cannot stay on hold at 2.5 percent or deliver a cosmetic 25 basis point easing," when the bank's governing council meets here on Thursday, Schmieding said.

Most analysts expect therefore that the central bank will cut its main lending rate from its current level to 2.0 percent.

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