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Why it feels different

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This crisis is truly global, but it still hits different countries in different ways. It has become a popular pastime to rank countries by the fall they have experienced in GDP and then pass judgment accordingly on their 'economic model'. But one should ask, particularly for this crisis, whether the fall in GDP is the appropriate measure for a cross-country comparison of the political impact of the crisis. GDP refers to the amount of goods and services produced in a given economy, but in reality such statistics have little real meaning for the wider public whose lives are affected much more by the amount they can spend and the stability of their jobs. Hence, public attitudes and confidence should be affected much more by what happens to consumption and employment.

These considerations apply in particular to Germany – especially in comparison to the US or other EU countries. The key to understanding why Germans so far are relatively relaxed about this crisis is the country's huge current account, which provides a cushion and allows consumption to remain constant. In Germany GDP is now projected to fall during 2009 by about 5-6%, but consumption should remain roughly constant. The discrepancy between consumption and production is due to two factors: the current account surplus is projected to decline by about 4 percentage points of GDP and investment should fall by about 2 percentage points of GDP (this means a fall in investment of about 15%).

These two factors, the swing in the current account and the fall in investment, can thus account for the 6 percentage points difference between the growth rate of GDP (-6%) and consumption (0).

In the US, the current account is swinging in the other direction. This implies that even if the US GDP declines by less (the latest forecast by the IMF predicts a decline of about 3-4%) than that in Germany, US consumption has to fall. The US current account is projected to improve by about 2% points of GDP this year. This implies that domestic absorption in the US must fall by about 5% this year (3% decline in production plus a 2% decline in net resource transfer from abroad), which is much more than in Germany. Part of this overall decline in domestic absorption should be reflected in a fall in investment. The IMF projects a fall in investment in the US worth about 3% of GDP, which implies that consumption will have to fall by an amount worth about 2% of GDP.

Since consumption accounts for roughly 70% of GDP, this translates into a fall of consumption of about 3% (2009 versus 2008). In the US consumption had been increasing trend wise by about 2.5% to 3% in recent years. US consumers will thus have to accept a swing in the growth rate of consumption of 5.5-6%! By contrast, in Germany consumption had in any event been stagnant since about 2001. Thus, for the Germany consumer the present crisis implies little change.

Many commentators have recently argued that Germany should rethink its export-led growth model because this model did not prevent a fall in its GDP, which was even larger than that experienced in

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the US or France, for example. However, is this model so bad if it allowed Germany to carry on consuming in the midst of the most severe recession in 70 years while consumers elsewhere have to tighten their belt considerably?

The wide difference in terms of the current account in the starting positions of Germany (+6% of GDP) and the US (-6% of GDP) implies that in the case of Germany stable consumption is sustainable in the longer run even if GDP does not recover. By contrast, in the case of the US, the same longer-term sustainability considerations imply the opposite: consumption has to fall even if there is a recovery.

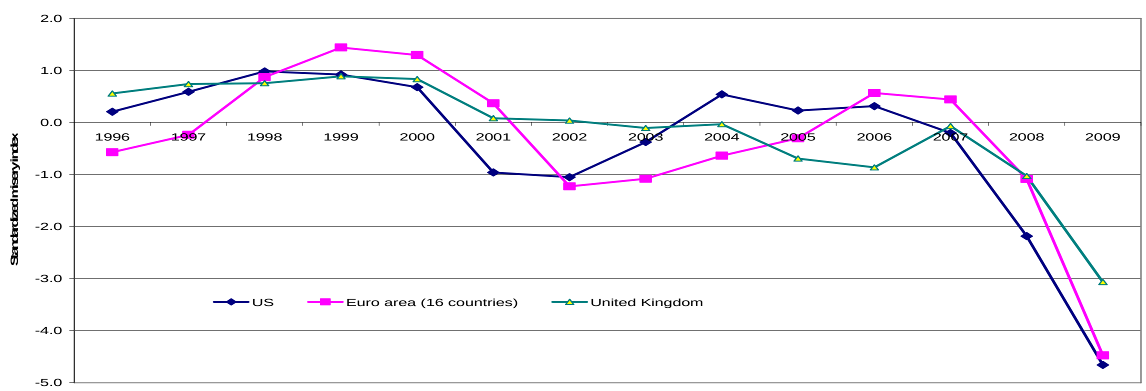
But why do German consumers continue to spend? The best answer is: "why not?" German consumers did not rely on credit or on inflated housing prices to finance their expenditures. Consumers in the US (or Spain) are in a completely different position. As the value of their houses tumbles and access to credit becomes more difficult, they have little choice but to spend less.

Another reason why German consumption remains stable is the performance of its labour market: so far employment has not fallen noticeably.

This leads to the second indicator of whether the crisis really hurts: the unemployment rate. Here again there are wide differences across countries. In Germany unemployment has so far increased only marginally (by 0.5%, from 7.2% in July 2008 to 7.7% in July 2009), compared to an increase of 3.6 percentage point over the same time period in the US (from 5.8% to 9.4%) or over 7 percentage points in Spain (from 11.4% to 18.5%). What is the reason for these differences? German enterprises have invested strongly in the skills of their labour force and therefore hold on to their skilled workers even if some of them are temporarily not needed. Generous provisions providing financing for temporary part-time work also help to stabilise employment. But other European countries have similar labour market rules. The key difference here is that in Spain most of the increase in employment over the last decade was in low-skilled workers in the construction and tourism industries. Since these sectors are contracting, Spanish enterprises see no reason to retain these workers, which do not possess the highly specialised skills necessary for globally competitive manufacturing. Moreover, these workers were usually hired on the flexible fringe of the Spanish labour market using temporary or other atypical contracts.

By putting the two policy-relevant variables, consumption and unemployment, together in one 'misery index', one obtains a quite different picture from the one revealed by just looking at GDP. Figure 1 shows first a transatlantic comparison of a misery index, which is simply the average of the growth rate of real consumption and the increase in the unemployment rate. In order to make these two series comparable, they have first been 'standardised'[1] so that a value of minus four means that the index has fallen four times the standard deviation below its average – which should be an extremely rare event.

Figure 1. Misery index for the euro area, the US and the UK



Sources: Data for growth in consumption extracted from Eurostat, July 2009 and for rates of unemployment, from AMECO (database of DG Ecofin, European Commission), July 2009.

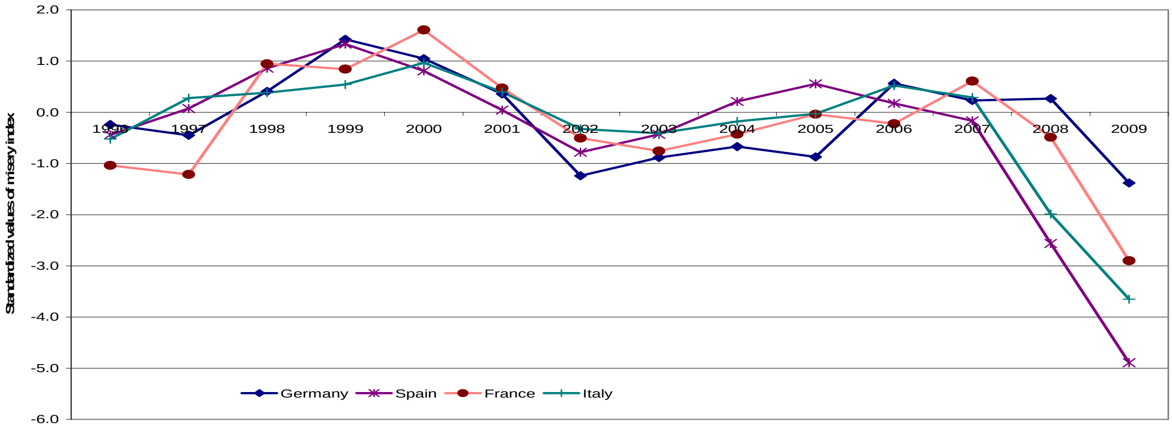
[1] In the usual way, that is by subtracting the mean and dividing by the standard deviation.

Standardising the variables in this way has the advantage that it takes into account the expectations of what constitutes a 'normal' or acceptable economic performance, which are usually based on the actual data over the last few years. The misery index based on standardised variables thus represents the element of surprise in the combination of negative growth and unemployment experienced by the economies under consideration.

On this account, 'Europe' does only slightly better than the US. The difference between the euro area and the US is small because unemployment used to be much more stable in Europe. Although unemployment had increased much less in the euro area than in the US, this translates into a similar deterioration because with the lower variance in Europe such an event is equally exceptional.

But it is not useful to compare the US to the euro area average since the latter comprises both bubble economies (e.g. Spain) and export-led ones, such as Germany. Stronger differences emerge therefore within the euro area, as shown in Figure 2. A clear hierarchy emerges: Germany is clearly better off than all the others, with barely any deterioration in its index. Spain is clearly at the other extreme: its value of -5 means that the current combination of growth and unemployment is five times below the previous average. Italy and France are between these two extremes.

Figure 2. Misery index for major euro area countries



Sources: Data for growth in consumption extracted from Eurostat, July 2009 and for rates of unemployment, from AMECO (database of DG Ecofin, European Commission), July 2009.

It is apparent that Germany is the country least affected by the crisis in Europe. The German export-led model might not have prevented (possibly only temporarily) a sharp fall in GDP, but it seems to have provided a much more stable background for its consumers and workers than the housing bubble-led economies of the US or, even worse, Spain.