

	Actual					Projections						Debt-stabilizing primary balance 11/ 0.8	
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		
I. Baseline Projections													
1 Public sector debt 1/ o/w foreign-currency denominated	54.9 0.0	52.8 0.0	53.5 0.0	55.5 0.0	58.7 0.0	60.8 0.0	62.3 0.0	62.8 0.0	62.8 0.0	62.8 0.0	62.8 0.0		
2 Change in public sector debt	1.6	-2.0	0.7	2.0	3.2	2.1	1.6	0.5	0.0	0.0	0.0		
3 Identified debt-creating flows (4+7+12)	0.2	-2.7	1.7	2.8	3.3	2.1	1.6	0.5	0.0	-0.3	-0.3		
4 Primary deficit	-2.0	-4.7	-0.4	0.5	0.7	0.9	0.5	-0.1	-0.6	-0.9	-1.1		
5 Revenue and grants	47.3	47.1	45.5	45.1	45.0	43.5	43.4	43.2	43.2	43.3	43.4		
6 Primary (noninterest) expenditure	45.3	42.4	45.0	45.6	45.7	44.4	43.8	43.1	42.6	42.3	42.2		
7 Automatic debt dynamics 2/	2.2	2.0	2.1	2.3	2.6	1.1	1.1	0.6	0.5	0.6	0.8		
8 Contribution from interest rate/growth differential 3/	2.2	2.0	2.1	2.3	2.6	1.1	1.1	0.6	0.5	0.6	0.8		
9 Of which contribution from real interest rate	3.2	3.5	2.6	2.3	2.5	2.3	2.1	2.0	2.0	2.0	2.0		
10 Of which contribution from real GDP growth	-1.1	-1.5	-0.4	0.0	0.1	-1.2	-1.1	-1.4	-1.4	-1.3	-1.2		
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0		
12 Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
13 Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
16 Residual, including asset changes (2-3) 5/	1.5	0.7	-1.0	-0.9	-0.1	0.0	0.0	0.0	0.0	0.3	0.3		
Public sector debt-to-revenue ratio 1/	116.1	112.3	117.8	123.1	130.4	139.7	143.7	145.5	145.4	145.1	144.8		
Gross financing need 6/ In billions of U.S. dollars	1.5 31.4	-1.3 -24.9	2.8 52.5	3.7 73.2	3.8 92.0	3.9 105.1	3.3 92.5	2.7 77.0	2.2 64.7	1.8 54.7	1.6 51.3		
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation						Projected Average
Real GDP growth (in percent)	2.0	2.9	0.8	0.1	-0.1	1.4	1.0	2.0	1.8	2.4	2.4	1.9	2.1
Average nominal interest rate on public debt (in percent) 7/	6.7	6.3	6.3	5.9	5.7	7.1	1.2	5.2	4.9	4.6	4.5	4.5	4.7
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	6.2	6.5	5.0	4.4	4.6	6.0	1.0	4.1	3.7	3.4	3.3	3.3	3.5
Nominal appreciation (increase in US dollar value of local currency, in percent)	-13.9	-7.4	-5.3	14.1	20.7	1.4	11.7
Inflation rate (GDP deflator, in percent)	0.5	-0.3	1.3	1.5	1.1	1.2	0.8	1.1	1.2	1.2	1.2	1.2	1.2
Growth of real primary spending (deflated by GDP deflator, in percent)	2.2	-3.7	7.1	1.4	0.0	1.4	2.7	-0.8	0.4	0.7	1.2	1.5	1.7
Primary deficit (+)	-2.0	-4.7	-0.4	0.5	0.7	-1.0	1.5	0.9	0.5	-0.1	-0.6	-0.9	-1.1
													Debt-stabilizing primary balance 10/
A. Alternative Scenarios						60.8	62.5	64.3	66.2	68.4	70.8	3.1	
A1. Key variables are at their historical averages in 2005-09 8/						60.8	62.8	64.3	65.8	67.7	69.8	0.9	
A2. No policy change (constant primary balance) in 2005-09						60.8	62.3	62.8	62.8	62.8	62.8	0.8	
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 9/						60.8	62.3	62.8	62.8	62.8	62.8	0.8	
A4. Selected variables are consistent with market forecast in 2005-09						60.8	62.3	62.8	62.8	62.8	62.8	0.8	
													Debt-stabilizing primary balance 10/
B. Bound Tests						60.8	64.8	68.2	68.2	68.2	68.3	0.9	
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						60.8	64.8	69.6	71.9	74.3	76.8	1.0	
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						60.8	64.0	66.7	66.7	66.7	66.8	0.9	
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						60.8	65.2	70.0	70.0	70.1	70.2	0.9	
B4. Combination of 2-4 using one standard deviation shocks						60.8	62.3	62.8	62.8	62.8	62.8	0.8	
B5. One time 30 percent real depreciation in 2005 10/						60.8	72.3	72.9	73.0	73.1	73.2	1.0	
B6. 10 percent of GDP increase in other debt-creating flows in 2005						60.8	62.3	62.8	62.8	62.8	62.8	0.8	

1/ General government net debt.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\epsilon(1+r))/(1+g+\pi+g\pi)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ϵ = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\epsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ Derived as nominal interest expenditure divided by previous period debt stock.

8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

9/ The implied change in other key variables under this scenario is discussed in the text.

10/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

11/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

INTERNATIONAL MONETARY FUND

GERMANY

Staff Report for the 2004 Article IV Consultation

Supplementary Information

Prepared by the European Department
(In consultation with the Policy Development and Review Department)

Approved by Alessandro Leipold and Martin Fetherston

October 20, 2004

1. This supplement reports on information that has become available since the issuance of the staff report and reflects contacts with the authorities during the Annual Meetings in early October 2004 and more recently. The new information does not change the thrust of the staff appraisal.

Economic developments and outlook

2. **Monthly economic indicators show some tentative signs of firming in domestic demand but a slowing in net export growth:**

- **Retail sales** in the third quarter of 2004 were up slightly from the previous quarter, but still below activity of a year earlier. Value-added taxes in real terms also increased slightly in the third quarter.
- **Business investment** in machinery and equipment has resumed growing, albeit at a moderate pace, as profitability continues to strengthen. However, construction spending is still falling.
- **Employment** on a seasonally adjusted basis increased slightly in the last four monthly observations from May to August. However, labor supply also increased and headline unemployment has risen by 0.1 percentage point to 9.9 percent (ILO definition).
- **Manufacturing output and exports** have been closely linked and have provided the impetus behind growth this year, reflecting strong global demand for German capital goods and machinery. Orders for manufactured goods, however, have slowed somewhat in recent months, alongside export orders, from high levels earlier in the year—consistent with moderating expectations for the coming months.

- **The IFO business climate index** has declined somewhat from the first quarter of the year, reflecting an easing of the expectations component of the index, while the current business conditions component has remained stable. This development is consistent with strong orders already on the books for exporters, but with increasing concern about oil prices and the pace of global economic expansion leading into 2005. Indeed, the ZEW index of investor and analyst sentiment fell sharply in October and is at a 16-month low.

3. **The rise in oil prices will affect Germany via lower external demand growth and also as a supply shock.** Through about mid-2004, the growth impulse for Germany from the global expansion surprised on the upside. However, early indicators for the third quarter showed the emergence of some softening, and the new sharp rise in oil prices to above US\$50 a barrel (which has triggered an update of WEO baseline assumptions) is now causing a downward revision in output growth for 2005 in many trading partners—suggesting some slowing in Germany’s net export growth next year. In addition, although the appreciation of the euro had dampened considerably the rise in domestic energy prices in the early part of the year, this effect is now receding and oil prices are also rising in euro terms. Thus, the risk factor for the outlook involving oil mentioned in the staff report is now materializing.

4. **On balance, with domestic demand still fragile and export growth likely to slow, the projections for output growth have been revised downward.** Specifically, the staff projection for real GDP growth is revised from 2.0 percent to 1.9 percent for 2004; and from 1.8 to 1.5 percent for 2005 (in line with the latest consensus forecast of the main German research institutes for 2005). Even with these revisions, the growth outlook remains within the range of 1½-2 percent for 2004 and 2005 envisaged by the authorities.¹ The underlying expansion from 2004 to 2005, corrected for the number of working days, is now just under ½ percentage point of GDP, down from an estimate of ⅔ percentage point in the staff report.²

5. **Inflation and wage setting continue to be moderate.** Headline inflation in the period July-September 2004 (annualized) was 1.5 percent; excluding energy it was 1.1 percent. Moreover, there has been no evidence of oil price increases spilling over into wage setting behavior so far.

Fiscal developments and outlook

6. **In early October, the authorities issued a supplement to the 2004 federal government budget, and obtained authorization to widen the borrowing requirement for 2004.** The supplementary budget reflects that tax revenue had been below original

¹ The authorities expect growth to be at the upper limit of the range in 2004, as does the staff.

² Corrected for working days, real GDP growth is projected to be 1.3 percent in 2004 and 1.7 percent in 2005.