Germany Ignores Soros as Exports Boom at Consumers' Expense

By Jana Randow and Holger Elfes - Aug 18, 2010 7:06 AM GMT-0300

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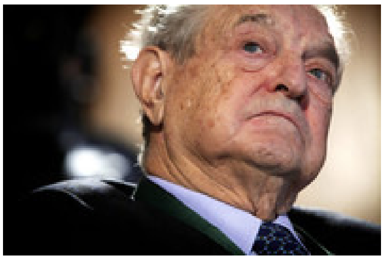

Billionaire George Soros, seen here, has urged Germany to do more to smooth out trade flows which pose an obstacle to a global recovery. Photographer: Jason Alden/Bloomberg

Germany may have become too competitive for its own good.

With exports driving the fastest economic growth since reunification, consumers are failing to respond in kind as companies from Siemens AG to Daimler AG hold fast to the wage restraint that's given them an international edge. The result: Europe's largest economy, four times more reliant on exports than the U.S., is firing on only one cylinder.

That's unlikely to change as Germany spearheads a push for European fiscal prudence and ignores calls from investors and the Obama administration to do more to help rebalance the global economy by reviving domestic demand. While Chancellor Angela Merkel's plan to cut 80 billion euros ($103 billion) of spending helps make government bonds attractive to Pacific Investment Management Co., retail stocks may suffer, and the country's dependence on exports leaves it vulnerable to a global slowdown.

"Germany has got to work on its domestic demand," said Andrew Bosomworth, Munich-based head of portfolio management at Pimco, which oversees the world's largest mutual fund. "Not everybody can export. Somebody has to import."

French Finance Minister Christine Lagarde, the U.S. Treasury and billionaire George Soros have already urged Germany to do more to smooth out trade flows they say are still too lopsided and pose an obstacle to a global recovery.

'Germany Is a Problem'

Foreign sales accounted for 41 percent of German gross domestic product in 2009, compared with 13 percent in Japan and 11 percent in the U.S.

The International Monetary Fund says Germany will have a current account surplus of 5.5 percent of GDP this year. China's surplus will be 6.2 percent. The U.S. current account, the broadest measure of trade because it includes investment income, will have a shortfall worth 3.3 percent of GDP, the IMF says.

"Anybody who believes China is a problem has to believe Germany is a problem," Nobel Prize-winning economist Joseph Stiglitz said in an interview in Sydney on Aug. 5. Germany should consider more stimulus measures to encourage spending and investment at home, he said.

Exports are driving Germany's recovery. The economy grew 2.2 percent in the second quarter from the first, yielding an annualized growth rate of about 9 percent that puts it on a footing with emerging markets like China and India.

The benchmark DAX share index has gained 4.2 percent this year compared with a 0.2 percent decline in the Dow Jones Industrial Average. The DAX was little changed at 6207.71 points today. The yield on the German 30-year bund fell to a record 2.978 percent.

'Our Strengths'

Merkel has defended Germany's right to engage as competitively as possible in international trade.

"We won't surrender our strengths just because our exports are perhaps purchased more than those of other countries," she said in parliament in Berlin on March 17. "That would be the wrong European answer to the competitiveness of our continent."

At the same time, wage restraint and fears over pension security are taking their toll on the aging German consumer.

Since Germany's reunification in 1990, private consumption has risen 21 percent, reflecting a 21-percent increase in real disposable income. In the U.S., by contrast, income surged 71 percent in the same period and private consumption jumped 75 percent.

"Private consumption will remain sluggish because Germany hasn't allowed real disposable income to grow more strongly," said Andreas Scheuerle, an economist at Dekabank in Frankfurt, who co-authored a book on the 100 most important global economic indicators. "Income and consumption walk hand-in-hand."

Shunning Retailers

The gap between German retail stocks and the DAX is widening. Metro AG, Germany's largest and the world's third biggest retailer, has declined 3 percent this year as domestic sales fell. Praktiker AG, Germany's second biggest home- improver, is down 19 percent and Beiersdorf AG, the maker of Nivea handcream, has dropped 5 percent.

"German retailers are no investment story for me," said Stephan Thomas, a fund manager at Frankfurt Trust Investment GmbH. His 2 billion-euro FTF fund doesn't contain any retail stocks and has risen 8 percent in the past six months. "Exporting companies in general are a good investment to play the German economy though," Thomas said.

Foreign sales will grow 8 percent in 2011 after expanding 11 percent this year, the DIHK chamber of industry and commerce said on Aug. 9. That would outpace world trade, which DIHK predicts will expand about 7 percent this year and next.

'Crown Jewels'

Germany's critics say Merkel's refusal to bolster the domestic economy is strangling other countries' export prospects by damping demand for their goods in a country with 82 million people. Those missives are unfair, said Thomas Mayer, chief economist at Deutsche Bank AG in London.

"We were successful in building one of the most competitive economies in the world, why should we ruin that by pumping up wages now?" he said. "That would increase unemployment. And we shouldn't punish our exporters, that's idiotic, they're our crown jewels."

Germany's export strength has its roots in the country's efforts to rebuild its economy through foreign trade after

World War II. While consumer demand soared in the U.S. after troops returned home and the economy boomed, spending in poverty- stricken Germany was weak.

European Divergence

In the 1970s, when Germany's post-war recovery had faded and unemployment increased, the country responded by cutting costs instead of building a stronger domestic services sector. That approach set the tone for future reforms.

Germany once again squeezed labor costs and boosted productivity when it adopted the euro in 1999, attempting to redress the competitive disadvantage its overvalued Mark had left it with after the reunification boom of the early 1990s.

Meanwhile, economies from Spain to Greece allowed employment costs to rise. Today, those nations are grappling with the biggest budget deficits in the region while Germany enjoys a trade advantage.

The country became 13 percent more competitive against its neighbors in the 11 years through 2009, mirroring similar declines in Spain and Greece, according to a wages-based indicator designed by the European Central Bank. Germany is also reaping the benefits internationally of the euro's 10 percent decline against the dollar this year.

Bunds 'Attractive'

"By cutting its budget deficit and resisting a rise in wages to compensate for a decline in the purchasing power of the euro, Germany is actually making it more difficult for other countries to regain competitiveness," Soros said in a speech on June 23 at Berlin's Humboldt University. Germany is "the main protagonist" for Europe's debt crisis, he added.

Merkel's four-year plan to cut German spending from next year contrasts with U.S. President Barack Obama, who is urging his Group of 20 counterparts to focus on economic growth, saying restoring order to public finances should come in the "medium term."

Pimco's Bosomworth said Germany's propensity to save, both at a state and household level, make the country's bonds "attractive in the sense that they're a safe place to be in a world not so friendly to risky assets."

"We will see still lower yields on German bunds," he said. The yield on Germany's 10-year bund fell to 2.33 percent this week, a record low. U.S. 10-year bonds yield 2.63 percent.

German policy makers say Europe's debt crisis shows why it would be a mistake to stimulate domestic spending again, and ask why Germany should pick up the bill for other nations' profligacy.

'One Good Knife'

"Attempts to blame Germany for problems in those countries and policy recommendations of symmetrical adjustment needs are questionable," Bundesbank President Axel Weber said on April 26. "Rather, the adjustment process that Germany underwent in the decade preceding the financial crisis may serve as an example."

Germans' reluctance to spend is partly due to cultural traits, said Thomas Kemmsies, head of fixed income at Nomura Asset Management in Frankfurt.

"We're like the Japanese, we like quality, we buy one good knife," he said. "It's also not in the German DNA to go out and borrow to consume."

In addition, Germany's aging population is putting a strain on the country's pension system, making it harder for the government to afford income-tax cuts that might get consumers spending. The number of pensioners increased from 2.8 million in 1960 to 17.5 million in 2009, while the average duration of benefit payments almost doubled.

Poverty Fears

Government moves to manage pension costs have fueled fears of old-age poverty, prompting people to save more. Germany's savings ratio rose to 11.4 percent last year from 9.1 percent in 2000. In the U.S., consumers saved 5.5 percent of their disposable income last year.

Rising employment and improving confidence in the economic recovery may bolster spending in the coming months. Germany's IG Metall labor union said on Aug. 4 it will seek higher wages for workers, ending a policy of temporary restraint during the economic crisis.

Still, "for a sustained improvement, Germany needs less wage restraint and increased employment," said Stuart Thomson international fixed-income fund manager at Glasgow-based Ignis Asset Management, which manages about 70 billion pounds ($110 billion). "This is about breaking the habits of a lifetime. It will take time to rebalance the economy."

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