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Is Germany Looking Like Japan?

By MARK LANDLER

FRANKFURT, Oct. 31 — Think of a once-mighty economy, sapped by years of sclerotic growth, a parlous banking system and a political elite that seems culturally incapable of tackling its problems.

Japan, surely. But also Germany?

Comparing the world's second- and third-largest economies has become something of a fashion among analysts here. The comparison is disturbing, not least because it implies that Germany is only at the beginning, rather than near the end, of a lengthy period of stagnation.

But is Germany really another Japan?

Some of the portents look depressingly similar. Germany's government said today that the anemic 0.75 percent growth rate it had forecast for 2002 now looked too optimistic, and lowered it to 0.5 percent. Next year is expected to be little better, with growth of just 1.5 percent, and some economists are saying Germany could lag behind the rest of the Europe for the next decade.

The country's flagship financial institution, Deutsche Bank, reported a third-quarter loss of $178 million today, because of lower trading revenue and higher provisions for loans gone bad.

Germany's other major banks are in even worse straits, with credit-rating agencies putting them on notice for possible downgrades and investors twitching at the slightest hint of a Japan-style banking crisis.

Chancellor Gerhard Schröder, who was narrowly re-elected in September, has not offered any new remedies for Germany's ills since then. Instead, he has proposed a familiar mix of tax increases and spending cuts that critics have called just as timid as the watered-down banking measures put forth in Tokyo this week.

On top of all that, some observers say, there is little or no public outcry in Germany about the state of the economy, mirroring the longtime quiescence of the Japanese.

"There is a belief among people, here and in Japan, that they don't have to worry about their futures," said Hilmar Kopper, Germany's commissioner for foreign investment and a former chief executive of Deutsche Bank. "As long as we Germans have our summers in Majorca, life is wonderful."

"Without pressure from below," Mr. Kopper said in an interview, "nothing will change in Germany."

Despite the surface similarities, though, other analysts say the roots of Germany's problems are very different from Japan's.

In a new report, Goldman, Sachs traces Germany's troubles back to reunification in 1990, which led to wage shocks and huge public spending that still burden the economy. As their costs soared, German companies curtailed investment and cut payrolls.

Japan, by contrast, is trapped in a deflationary spiral that originated in the collapse of a bubble in its real estate market a decade ago. The central bank has cut short-term interest rates all the way to zero and flooded the money markets without managing to stimulate much growth. The country's mountain of bad bank loans, numbering at least $420 billion and perhaps double or triple that, continues to mount, and consumers are holding tight to the money they have.

"In rough terms, Germany's problems are supply-side, while Japan's problems are demand-side," said Dirk Schumacher, an economist at the Goldman, Sachs office in Frankfurt and a co-author of the new report.

Inflation in Germany is among the slowest in any European country at 1 percent a year, but it remains positive. A few economists have suggested that Germany could slip into deflation, though most think it would be unlikely. Prices in Japan, by contrast, have been falling for the last three years, a condition that can have profound effects on economic behavior.

"We're a long way from that sort of psychology in Germany," said David Walton, the chief European economist at Goldman, Sachs.

Mr. Walton noted that the benchmark short-term interest rate in the 12 nations using the euro currency stands at 3.25 percent, leaving the European Central Bank some flexibility to lower rates, an option the Bank of Japan has exhausted.

Japanese banks are also a world apart from those in Germany. While Deutsche Bank's quarterly results disappointed analysts, its chief executive, Josef Ackermann, said in a letter to shareholders that he expected results for the full year to be "satisfying," following a round of cost cuts and asset sales.

Deutsche Bank set aside about $742 million to cover bad loans — a figure it said peaked in the third quarter. Salomon Smith Barney estimates that Deutsche Bank's bad loans amount to barely 1 percent of its total amount of loans outstanding.

The figures for the big Japanese banks are orders of magnitude higher, to the point that many analysts say the banks cannot even acknowledge all their nonperforming loans without risking insolvency. Only regulators' forbearance and government aid is keeping Japan's banking system afloat.

The Japanese government's latest plan for the banks, announced Wednesday, calls for the number of bad loans to be halved early 2005. Political pressure thwarted the new financial services minister, Heizo Takenaka, from pursuing a bolder plan that would have set stricter deadlines for purging the bad loans.

Critics see a similar pattern among German leaders, who they say have been reluctant to attack structural problems like the rigid labor market. Chancellor Schröder has pledged to reduce unemployment, but his plans fall short of the radical measures advocated by economists.

Michael Hartnett, the director of European equity strategy at Merrill Lynch in London, said in a recent report that he expected Germany to follow "the Japanese reform mantra of `no pain, no pain.' "

Given its deep reluctance to change, Germany will probably muddle through the next 5 to 10 years growing only marginally less slowly than it is now, most economists predict. Some even say matters will worsen after the European Union adds new members in 2004, because investment will flow to the cheaper, faster-growing economies of Central and Eastern Europe.

To other observers, however, Germany's location at the heart of a greater Europe may be its ultimate salvation. Both Japan and Germany have low birth rates and aging populations, but while Japan takes in almost no immigrants, Germany gets a steady flow of new citizens, many of them from nations to the east. These new arrivals, some analysts say, can spark the country out of its torpor.

"In the long run, I would bet on Germany," said Simon Ogus, the chairman of DSG Group, an investment research firm in Hong Kong. "In Japan, I just don't see what is going to provoke a revolution."