

## ZEW Celebrating its Tenth Anniversary

Since its foundation in 1991, the ZEW has developed into one of the leading economic research institutes in Germany and Europe. The national Science Council's excellent rating is not the only finding that attests to the ZEW's strong performance. A further indicator is the step rise in external funds the ZEW has managed to attract since it was set up.

■ Ten years have passed since the ZEW was founded. Although short compared with other anniversaries, such a period presents an opportunity to look back on what has been accomplished and to look ahead. In the course of the last ten years according to the national Science Council the ZEW acquired an excellent reputation, both nationally and internationally, in the field of application-related empirical economic research. It has distinguished itself in particular on account of its work on international comparative issues and the creation of databases that are of great value for researchers. The key tasks of the ZEW are economic research, economic policy recommendations and the dissemination of its research findings through publications and further training seminars. The institute targets decision-makers in politics, industry and public administration, national and foreign researchers and the interested public.

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The local press reports about the ZEW taking up its work on April 1, 1991. From the left: ZEW founding directors E.-O. Schulze and Prof. Dr. Dr. h.c. H. König, minister K. von Trotha, H. Freudenberg.

The decision to establish the ZEW was taken in 1990 on the initiative of the state government of Baden-Württemberg, the business community of Baden-Württemberg and the University of Mannheim. The institute started its work soon after in April 1991. Whereas at the beginning of 1992 the ZEW employed 17 staff, 15 of whom were researchers, the number now stands at 118, 78 of whom do research.

### Research approach and research departments

In its research the ZEW chiefly pursues a microeconomic and microeconomic approach. In doing so, the ZEW sets high value on interdisciplinary work:

Although it is mainly economists and business management experts that work on research projects, industrial engineers, specialists in business applications of computer science and lawyers are also involved.

Among other things, the research institute has devoted itself to working on international comparative issues. For instance, it examines the effects of increasing European integration or of the introduction of the euro on the German labour market or compares the tax burden of companies in selected European countries and the US. Some of the ZEW's databases, which serve as a basis for its research, have also gained great significance. It is the ZEW that possesses Germany's largest data record on company

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innovations, the Mannheim Innovation Panel. A database on start-ups used to analyse the setting-up, growth and closure of companies was developed as well. The ZEW now also makes selected databases available to external users for academic research in accordance with stipulations governing data privacy.

In terms of its organisation, the ZEW is divided into the following five research departments:

- International Finance and Financial Management
- Labour Markets, Human Resources and Social Policy
- Industrial Economics and International Management
- Corporate Taxation and Public Finance
- Environmental and Resource Economics, Environmental Management.

Currently the ZEW is busy setting up an additional research focus "New Information and Communications Technologies in Global Networks". It will take up

scientific advisory board made up of renowned German and foreign experts as well as senior managers from industry and public administration. This scientific advisory board meets regularly to discuss and evaluate the ZEW's research projects. When the ZEW was thoroughly evaluated by the national Science Council in 1998, it confirmed the high quality of the research done at the institute and recommended that the ZEW be included in the joint support scheme of the Federal government and the constituent states ("Blue List").

### National and international cooperation

For the research done at the ZEW, research professors are of great significance. These university professors assume the role of project managers at the ZEW and thus constantly provide the research done at the institute with new impetus and scientific findings.

scholars at the ZEW, like Nobel prize winner Prof. James J. Heckman, encourages the creation of such a network as does the organisation of academic workshops with national and international participants. The frequent and active attendance of ZEW's research staff at conferences in Germany and abroad also contributes to this.

Every year since 1999 the ZEW has organised a so-called Summer Workshop that is meant to further advance the knowledge of young economic researchers. Ph.D. students from Germany and elsewhere enjoy the possibility to discuss their theses with internationally renowned academics and their peers, as well as the possibility to get involved in the ZEW's research projects.

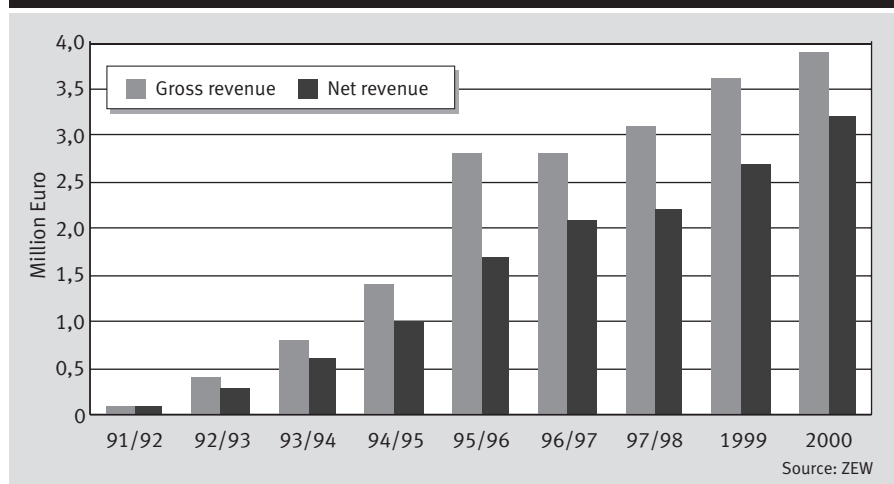
### Research funding

In 2000 the ZEW's budget amounted to about 10 million euro. Accounting for around 60 per cent, financial contributions from the state of Baden-Württemberg represent the most important source of revenue. They are mostly made available for economic research geared towards basic research and for the funding of infrastructure. The remaining 40 per cent of the budget come almost exclusively from externally funded research projects. The institutions commissioning research are the European Commission, federal and state ministries and institutions, companies and associations, the German Research Foundation, foundations like the Volkswagen Foundation or Thyssen Foundation, and national and international organisations.

The ZEW's increasing importance is not only reflected in its staff figures, as was mentioned at the beginning, but also in the increase in external funds. The volume of external funds rose from 350,000 euro in the financial year 1992/93 to some four million euro at present.

The ZEW receives ideational and financial support from the Club of ZEW Friends and Sponsors (Förderkreis "Wissenschaft und Praxis am ZEW e.V.") founded in 1993. It comprises companies mostly based in the Rhine-Neckar-Triangle, but also elsewhere in Baden-

Development of third-party funds in million Euro



economic developments related to the "digital economy" and their repercussions on the "old economy". This new focus fits into the ZEW's existing structures, for here too applied basic research is combined with empirical analyses and interdisciplinary work.

The standard of the work done in the research departments and the degree to which it is geared towards the institute's research programme is monitored through regular evaluations. These evaluations are carried out by the ZEW's

The institute cultivates intensive cooperation with a host of cooperation partners, in particular universities and economic research institutions in Europe and the US. Cooperation with Mannheim University is especially close. For example, the president of the ZEW also holds a chair at the university's faculty of economics. Through these diverse contacts with researchers from all over the world, the ZEW is integrated into a close-knit national and international research network. The presence of visiting

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Württemberg or in other states. This group of friends and patrons is an excellent example of the link between academia and industry that the ZEW cultivates. The ZEW's research departments benefit from suggestions made by the friends and patrons and vice versa.

### Knowledge transfer

Apart from doing research, communicating the ZEW's research findings to companies, politicians, the research community and the general public represents another essential aim of the institute. Dissemination occurs in the form of statements made to the media, lectures, and comments and expert opinions, via the internet and various publications. Among others, the ZEW has three series of publications: the English-language ZEW Economic Studies, ZEW

### ZEW – Historical Data

**1990:** Decision is made to set up the ZEW. The ZEW is founded as a subsidiary of GKW, a limited liability company for the advancement of science and the arts, on the initiative of the state government of Baden-Württemberg, the business community of Baden-Württemberg and the University of Mannheim.

**April 1991:** Located in Mannheim, Kaiserring 14-16, the ZEW starts with its research projects headed by the directors Professor Dr. Dr. h.c. Heinz König (scientific director) and Ernst-Otto Schulze (commercial director).

**1993:** The "Club of ZEW Friends and Sponsors" is set up to support the work done by the ZEW. Many large companies and SMEs as well as public figures from the region, the state of Baden-Württemberg and the whole of Germany have become members and more are joining.

**1 Dec 1996:** Relocation to the new building in L7,1.

**1 April 1997:** The state of Baden-Württemberg becomes a direct partner of ZEW Ltd.

**1 April 1997:** Professor Dr. Wolfgang Franz succeeds Professor Dr. Dr. h.c. Heinz König as the scientific director/president of the ZEW.

**Dec 1998:** The national Science Council evaluates the ZEW. It decides to recommend the inclusion of the ZEW in the "Blue List".



*K. van Miert, Prof. Dr. W. Franz and Prof. Dr. Dr. h.c. mult. O. Issing at the ZEW Economic Forum 1999.*

Wirtschaftsanalysen (ZEW Economic Analyses) and Umwelt- und Ressourcenökonomie (Environmental and Resource Economics). Moreover, the research institute makes its know-how available to national and international specialists and executives in further training seminars and company-specific seminars. In seminars on issues such as the management of financial markets, business management and company organisation as well as on taxes, accounting and public finance, the ZEW passes its research findings on to practitioners. Apart from in-house research staff, speakers include university professors and acclaimed practitioners.

### ZEW events

Activities with respect to the series of lectures for the wider public have been stepped up, too. The beginning of 1993 saw the first lecture of the biannual "Economic policy by practitioners" ("Wirtschaftspolitik aus erster Hand") where a distinguished representative of German politics or economics is invited to provide an insight into current economic developments. Speakers have included Dr. Rolf-E. Breuer, spokesman for the board of management of Deutsche Bank AG, Federal Minister of Economics Dr. Werner Müller and the head of the Confederation of German Employer Associations Dr. Dieter Hundt.

Over the years numerous events have been added. They include the "Mann-

heim Economic and Monetary Talks" ("Mannheimer Wirtschafts- und Währungsgespräche"), a series of lectures focusing on banking, organized by the ZEW together with Mannheim University, the region's banking association and the Academy of Administration and Business Management Rhine-Neckar. A further event is the "ZEW Economic Forum" ("ZEW Wirtschaftsforum") which lasts a whole day and brings together entrepreneurs and representatives from associations and public institutions for the purpose of discussing topical questions related to economic policy. Speakers at the most recent forums included Professor Dr. Dr. h.c. mult. Otmar Issing, member of the ECB's board of directors, and Karel van Miert, at the time EU Commissioner for competition policy, as well as state finance ministers Professor Dr. Georg Milbradt and Gerhard Stratthaus.

On the occasion of its tenth anniversary the ZEW hosted a birthday party on 2 February 2001, the focus of which was a panel discussion. As one would expect from a centre for European economic research, the discussion revolved around a topic of international relevance: "The economic integration of Europe – challenges, opportunities, risks". The panelists were Erwin Teufel, Premier of the state of Baden-Württemberg, Professor Dr. Dr. h.c. mult. Otmar Issing, member of the ECB's board of directors, and Professor Dr. Jürgen Strube, chief executive officer of BASF AG. ◀

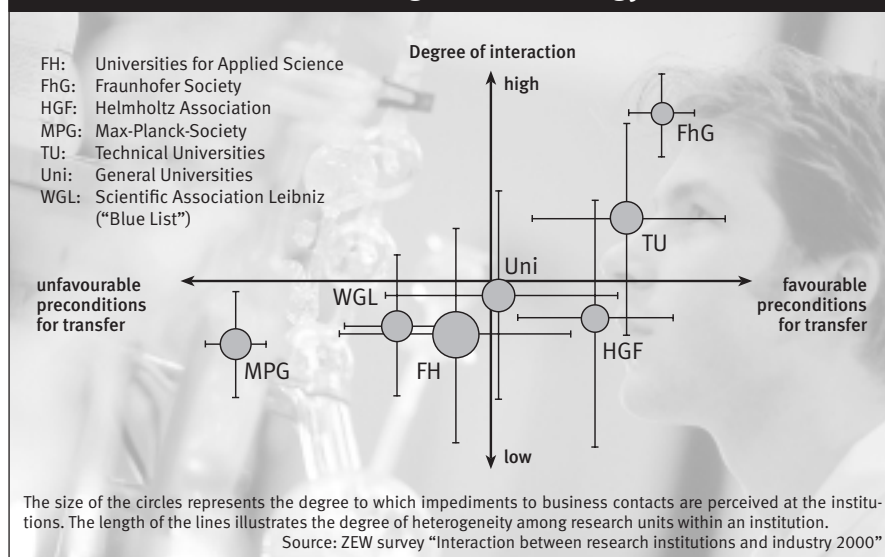
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## Research Findings

# Knowledge Transfer from Public Research Better Than it is Said to be

The knowledge and technology transfer between public research institutions and industry has achieved a high level in Germany. Companies and scientists use a host of different transfer channels to exchange new findings. However, the extent to which the different public research institutions cooperate with industry varies greatly. But a new ZEW study reveals that due to impediments and a lack of structures that act as incentives in public research institutions, a lot of potential for cooperation is still untapped.

### Positioning of public research institutions in Germany in terms of knowledge and technology transfer



■ The ZEW, the Fraunhofer Institute for Systems Technique and Innovation Research (ISI) and the ifo Institute for Economic Research were commissioned by the German Federal Ministry of Education and Research to conduct a comprehensive analysis of the knowledge and technology transfer system in Germany. The study shows that over the past years the transfer of knowledge has been continuously improved in Germany and has reached a high level. In the government-funded research scene it is the institutes belonging to the Fraunhofer Society and the technical universities that boast particularly intensive interactions with industry. They both combine favourable conditions for firm interaction in terms of disciplinary structure, size and research orientation with a high level of transfer activities. Institutions geared towards pure research

with a large share of basic funding such as many Max-Planck-Institutes and institutes forming part of the Leibniz association are less committed to transfer. In the case of the Helmholtz association (HGF), comprising 16 large research centres, the level of interaction is considerably lower than one would expect as many HGF-centres are specialised in technical fields with significant transfer potentials. Universities for applied science and general universities are also less involved in interaction with firms.

This pattern reflects the diversity of the tasks assigned to public research institutions in an economy. This diversity demands to weigh up business orientation, scientific research and the teaching of students. The intensity of transfer activities varies considerably within the individual institutions (see diagram).

Universities and public research institutions use various types of interaction for their business contacts. Contract research represents just one aspect. From the point of view of the research institutions, informal forms of exchanging knowledge, but also the passing on of knowledge via publications are equally important, too. Knowledge transfer resulting from personnel mobility is regarded as significant in all the types of institutions that were analysed. At present, new firms set up by scientists are still of minor importance for the transfer of knowledge and technology, although this transfer channel is expected to gain importance in the years to come.

### Barriers to knowledge transfer

Yet, there are a number of impediments obstructing the transfer of knowledge and technology. They include a lack in qualified personnel, financing problems, time-consuming teaching and administrative responsibilities and a (perceived) lack of openness on the part of the companies.

The study identifies starting points for an intensification of knowledge transfer between public research and companies. These starting points include improving incentive mechanisms for scientists, for instance in the field of public service law or patent exploitation. Moreover, the study recommends that cooperation between public research institutions focusing on pure research and institutions geared towards industry be stepped up. ◀

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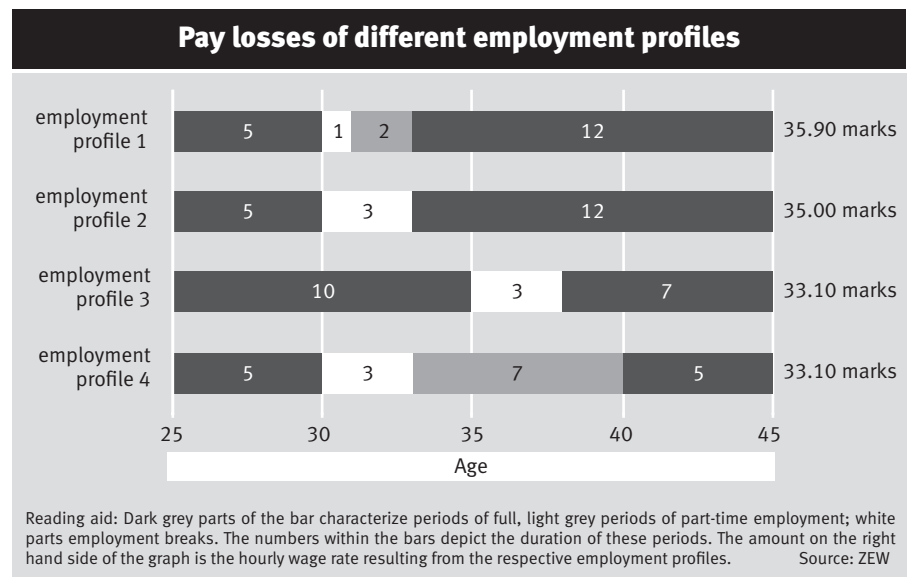
## Research Findings

# Late Motherhood Causes Pay Losses

Discontinuous employment biographies generate negative income effects. This problem affects mainly women who still raise the children in most cases and thus give up their job for a while. A recent ZEW study analysed the extent of their pay losses and the income effect associated with the timing of an employment break.

■ When starting a family it is not only the consumption expenditure of the household that increases. What makes an even greater difference is the income loss of one parent, usually the mother, who temporarily gives up or reduces her job and devotes herself to child rearing. Additionally, her future income potential decreases. Work experience is regarded as one of the most important factors influencing the wage rate that each individual can attain. Not only do deviations from full-time employment represent an interruption in human capital formation, they may also cause a devaluation of the human assets that were accumulated in the past. Deviations are thus suspected of causing severe income losses. On the one hand, the accumulated human capital becomes obsolete after an employment break due to technical progress and innovations in the work process. On the other hand, people participate to a lesser degree in vocational training programs during their employment break or part-time period. The later a person takes time off, the more professional experience he or she will have gained, and the higher the negative income effect resulting from skill obsolescence.

This finding is confirmed by a recent ZEW study, for which the Thyssen Foundation granted financial assistance. Based on a representative sample of the Socio-Economic Panel consisting of women aged 30 to 55 years, holding a technical college, college, or university degree, the influence of work experience on the wage rate is analyzed. In a simultaneous Maximum Likelihood estimation, the depreciation rates of employment breaks (including parental leave, work as housewife and unemployment), and part-time work periods, as well as the return to the resulting effective years of full employment are estimated.



The findings of the ZEW study reveal that a woman's pay rate depends strongly on her work history. Devaluation of accumulated work experience due to the withdrawal from full employment is 33 percent for each year of discontinuity. Conversely, part-time work periods do not reveal any significant depreciation effects for previous years of full time employment.

Simulations help to illustrate how the devaluation of work experience affects the hourly wage rate (see figure). While a 45-year-old woman who has been continuously employed full time attains an average hourly pay rate of 36.20 marks, the employment profiles 1 to 4 show varying deductions. If a 30-year-old woman takes time off from work for one year, and subsequently works part-time for two years, her hourly wage rate will be 0.30 marks lower. A three-year employment break will result in an income loss of 1.20 marks per hour. The reduction is even worse if the same employment break occurs at the age of 35. The hourly wage rate will then be just over 33.00 marks, i.e. just as high as after a ten-year discontinuity phase starting at

the age of 30 and consisting of three years out of work and seven years of part-time employment. This illustrates the strong influence of the timing of discontinuities: The later the break occurs the more human capital is in danger of becoming depreciated.

### The later the employment break, the higher the pay losses

The trend towards delayed motherhood, which can be observed not only in Germany, thus leads to distinct income losses, provided it is linked with a long employment break. Negative income effects of part-time employment are much smaller. But not all women have the opportunity to work a reduced number of hours due to a lack in child care facilities and part-time jobs. This is where politicians need to act. They can contribute to reducing the outlined income losses by improving the conditions for gainfully employed mothers (and fathers) and by encouraging employers to offer more part-time jobs. ◀

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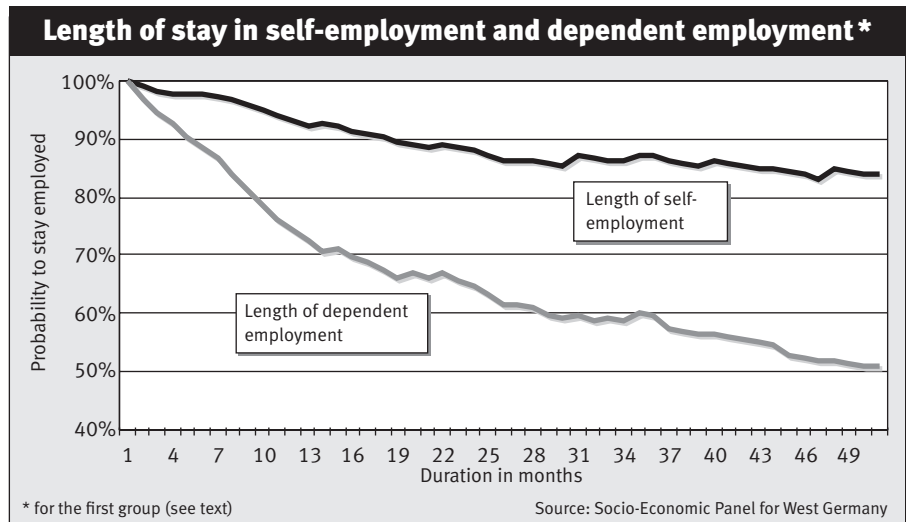
## Research Findings

# Self-Employment – A Permanent Escape Route from Unemployment

In the light of the high unemployment rate, many governments rely on grants for business start-ups. Particularly the jobless increasingly set up their own business not least because the development criteria were improved in the mid-nineties with the introduction of the so-called bridging allowance. From 1990 to 1998 approx. 458,000 jobless founders of businesses received financial assistance from the employment office. The persons benefiting from the assistance increased from approx. 13,000 in 1990 to nearly 100,000 in 1998.

■ The ZEW investigated the opportunities and limits of self-employment of formerly jobless persons on the basis of a sample from the Socio-Economic Panel of 3,782 persons for the period from 1983 to 1996. The results suggest that formerly unemployed founders of firms regard self-employment by no means as their last chance to work again. Rather, when comparing them to the other unemployed, they have good qualifications and only set up a business, if this kind of employment ensures an income that is much higher than their unemployment benefit. The duration of unemployment does not matter either when becoming self-employed. The hypothesis that the long-term unemployed establish their own business because they are discriminated against when seeking dependent employment was thus not confirmed in this study.

The study distinguishes between two groups. On the one hand it analyses how successful the alternative of dependent employment would have been for the unemployed who set up their own business. In the second group, the ZEW examined unemployed persons that took up dependent employment and analyzed self-employment as an alternative. For the first group, the renewed risk of unemployment is lower for self-employed persons than for those in dependent employment (see chart). This finding, however, does not allow the conclusion that an extension of the bridging allowance would lead to a noticeable, additional reduction of unemployment. This would be erroneous because dependent employment is more stable for the second group than self-employment. This result clearly demonstrates



that the unemployed do find their optimum solution for reemployment and that they are not pushed into taking up self-employment.

### Bridging allowance does hardly reduce unemployment

In a next step the ZEW analyzed the efficiency of the bridging allowance. The study revealed that in phases of restrictive grant allocations the unemployed that took up dependent employment bear a higher risk of renewed unemployment than in a situation where they would have set up their own business. Credit market restrictions can thus be overcome with the help of the bridging allowance. It smoothes the way into self-employment for unemployed persons that are suited for self-employment but cannot raise a credit because they are unemployed.

However, the effectiveness of bridging allowance in fighting unemployment should be viewed carefully. It

might be true that the offer of bridging allowance in the current form is the right way, but it should also be noted that a broad extension of that programme would hardly reduce unemployment. In the light of the self selection process leading to self-employment or to dependent employment one should not underestimate dead-weight effects. It might happen, for instance, that persons in dependent employment intending to set up their own business choose to become unemployed just in order to benefit from the bridging allowance. An extension of bridging allowance thus might not result in an increased number of self-employed persons but only in an increase of the short-term unemployed. For this reason the unlimited granting of bridging allowance to all those willing to found their own business is not so much the problem, but rather the negative incentives resulting from the structure of this incentive: Bridging allowance do not have to be paid back. ◀

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## Research Findings

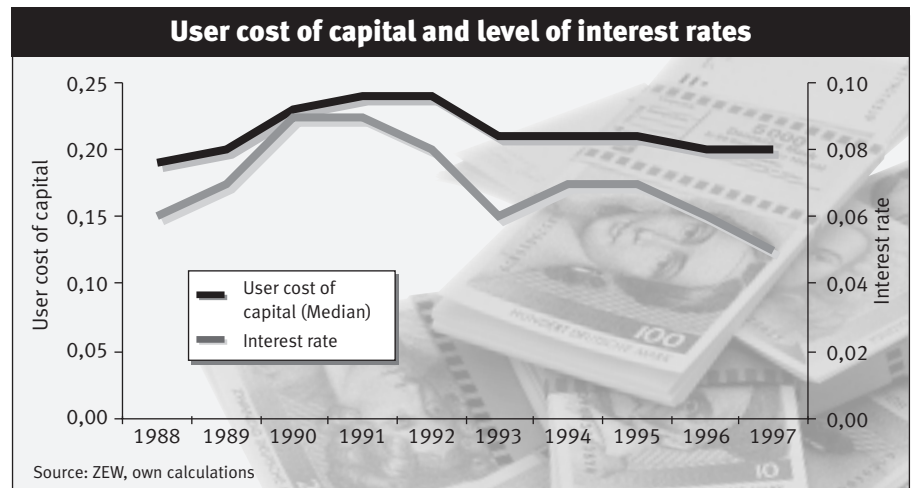
# Investment Behaviour and Taxation

How does corporate investment behaviour react to changes in taxation parameters? Even before the most recent discussion about tax reform this had been a topical, but empirically controversial question. The ZEW examined this question and came to the conclusion that taxation parameters influence investment behaviour far less than is generally thought.

■ In an empirical study, the ZEW estimated several microeconomic investment functions. The key task was to measure how corporate investment behaviour responded to changes in user cost of capital in the period 1987-1997. To that end, company-specific user cost of capital were calculated for the first time from annual account data. The Deutsche Bundesbank's corporate balance sheet statistics provided the basis.

In the period under review the evolution of user cost of capital was markedly determined by the level of interest rates (see diagram). Other determinants were the corporate tax rate, sources of financing driven by retained earnings, debt and new equity, and the asset structure that distinguishes between buildings, machinery and equipment. The analyses show that apart from the reduction in the corporate tax rate, the shift from debt financing to financing by retained earnings also contributed to the increase in user cost of capital.

As part of panel-econometric analyses, the ZEW estimated autoregressive distributed lag models (ADL) and error correction models (ECM). The estimated elasticities of the investments with regard to user cost of capital are on the



order of -0.4 and thus significantly lower than the values macroeconomic studies for Germany arrived at. However, comparable microeconomic studies for the US produced results similar to those of the ZEW analyses.

### Tax reform 2001 has negative income effects

Estimated elasticities allow for quantification of tax reform measures on investment. For instance, the taxation parameters coming into effect in 2001 result in an increase in quantifiable user

cost of capital. This would cause the propensity to invest to decline. However, it has to be said that the approach used only allows the reduction in the corporate tax rate and the restriction of depreciations allowances on buildings and machinery to be quantified. Other elements of the assessment basis cannot be taken into account. In particular it has so far been impossible to quantify investment effects brought about by the switch in the corporate tax system from a full imputation system with a split tax rate to shareholder relief system. ◀

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## ZEW Economic Studies

Karl Ludwig Brockmann, Marcus Stronzik (Eds.):

### Flexible Mechanism for an Efficient Climate Policy

In the Kyoto Protocol to the UN Framework Convention on Climate Change, industrialized countries agreed on binding absolute targets for greenhouse gas emissions and on the admission of flexible market-economy instruments – such as emissions trading, joint implementation and the clean development mechanism – used for reaching these targets. The contributions reveal that flexible instruments can lower the costs of climate protection considerably – not only in theory, but also in practice. Concerning implementation, it will be necessary to take care of possible loopholes, uncertainties and transaction costs which may be too high if no proper design is chosen.

Physica-Verlag, Vol. 11, Heidelberg/New York, 2000, ISBN 3-7908-1314-1

## ZEW Workshop

### Expert Workshop on “Transition to Flexible Pay”

■ In September 2000, the ZEW organised an expert workshop on “Transition to Flexible Pay” in cooperation with Prof. Walter Oechsler of the chair and seminar for business management, personnel management, and occupational science at the University of Mannheim. The workshop took place within the framework of the joint DFG project “Transition to Flexible Pay from an Economic and Legal Viewpoint”. The participants consisted of company representatives from personnel departments and works council members.

#### Strong resistance in companies

The participants discussed various issues and sought answers to the question as to why many companies do not adjust their wages and salaries in the light of continuously high unemployment, even though they would be legally entitled to do so. Nowadays, the adjustment of worktime is relatively widespread in the German economy, however, the transition to flexible pay was met and still meets with strong resistance in companies. Labour market economists explain this phenomenon, inter alia, with performance pay models. On the basis of these models, it seems to be a rational measure for the companies to pay wages and salaries exceeding the market equilibrium so as to attain a productivity edge or to save recruiting costs. Moreover, the insider-outsider theory which points out the role of unions and works councils as representatives of the workers and not of the unemployed is being discussed as a possible explanation for the existing wage rigidities despite high unemployment.

From the viewpoint of firms, potentials for flexible pay exist primarily in high-yield sectors. In the crisis-ridden construction industry, however, there are hardly any possibilities to adapt wages to the economic situation. This is mainly due to provisions in collective wage agreements which basically do not allow for flexible salary systems. Therefore crisis-ridden companies as a rule react with redundancies instead of wage

reductions to fluctuating sales, and thus put even more strain on the tight labour market.

Enterprises identify the existing collective wage agreements and employment protection laws as the most decisive factors hampering the transition to flexible pay. Compared to that, the remittance of work councils seems to play no decisive role for the majority of firms. However there are different mechanisms in different labour markets. In the case of lower qualified employees, it is the existing collective agreements but also implicit wage agreements that are stated as important reasons speaking against wage reductions. Wage reductions for highly qualified employees will have negative impacts when recruiting new staff, and entail the risk of losing long-standing top performers.



According to company representatives, it would be desirable for corporate success to differentiate pay to a higher degree on the basis of individual performance. At present, many enterprises are planning to extend premiums for the attainment of production targets and profit-related pay components. This, however, requires objective appraisal methods. Provisions in collective wage agreements stipulating binding uniform appraisal criteria are not helpful for a

further transition to flexible wages. Appraisal methods and criteria will only make sense if they are negotiated in the companies within the respective framework conditions.

It was pointed out that legal provisions aggravate the transition to flexible wages in many ways and sometimes even prevent it. On the other hand, however, there seem to exist unexplored scope of action for more flexibility which the companies have not used effectively thus far. For instance, companies voluntarily apply collectively agreed wages to out-of-tariff employment relationships, or tariff-bound companies pay wages exceeding the agreed scale. Furthermore, more flexible wage agreements are possible from a legal point of view, for instance hardship clauses, reduced pay schemes for the unemployed, etc.

Such measures are however seldomly used by firms. This might be due to the above mentioned economic mechanism which restricts more wage competition as a result of efficient wages or insider-outsider forces or is perhaps due to the ignorance of potentials for more flexible pay even despite the restrictive German labour laws. ◀

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## ZEW Financial Market Test

# Results of the Survey in January 2001

■ The Financial Market Test conducted by the ZEW is a monthly business survey of German financial market experts which started in December 1991. The survey asks for the predominant expectations about the development in six international financial markets.

As a whole around 400 experts take part in the survey. 270 of them work in banks, 50 in insurance companies, 40 in investment companies and 40 in other industries. Participants in the survey are

financial experts of the finance departments, the research departments and the economic departments as well as the investment and securities departments of the firms. In detail, the financial experts are questioned on their medium term expectations about the development of important international financial markets with respect to the business cycle, the inflation rate, short term and long term interest rates, the exchange rate and share prices.

To construct forecasted figures, the qualitative response categories (increasing, unchanged, declining) are transformed into quantitative figures by the Carlson/Parkin procedure. Additional information to the applied procedure is available as an abridged version published by the ZEW. The present survey was conducted between Dec. 27, 2000 and Jan. 16, 2001 and all calculations are termed to Jan. 19, 2001. ◀

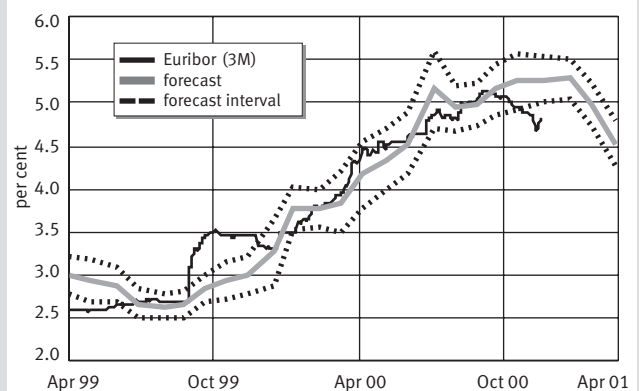
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### Euro zone: Experts expect ECB to cut interest rates

■ Compared with the previous month, there has been a landslide in expectations regarding the money market rates in the euro zone. Now a good 60 per cent of the analysts anticipate the ECB cutting key interest rates. As recently as December not even a quarter of the respondents held this view. According to the forecast, in April the three-month Euribor will stand at 4.5 per cent and thus be 30 basis points lower than at present. Surprisingly, the Fed's rate cut of 3 January has not had any quantifiable effect. A comparison of the answers given before and after this date does not reveal any significant discrepancies in the euro interest rate expectations. Yet, the impetus for a reassessment of the monetary policy situation is coming from the US, particularly from drastically deflated expectations concerning the economic situation in the US. The resulting cooling-off of the world economy has lessened fears of inflation in Germany, too. ◀

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### Money market: Actual development and forecast



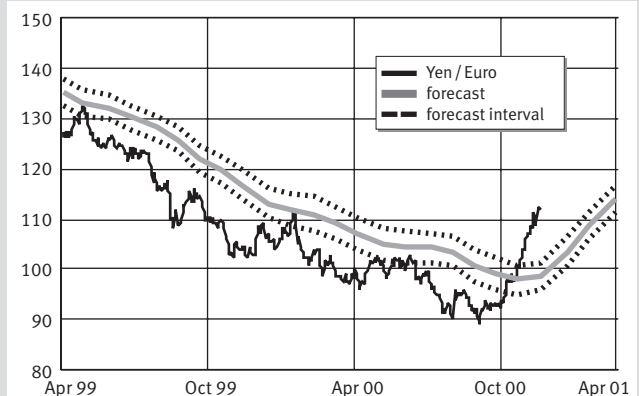
Source: Thomson Financial Datastream, ZEW

### Japan: Risk of recession increasing

■ Is Japan facing a recession? That is what business expectations are strongly indicating. Whereas a month ago the balance of positive and negative economic expectations was as high as 14.9, in January it dropped to -2.9. Thus the trend, which has been heading downwards for some months, has gathered further momentum. At the same time analysts – influenced by the Fed's interest rate cut right at the beginning of the new year and by the expectation that inflation figures will remain low – no longer assume the Bank of Japan will raise interest rates. Currently only the weaker yen may affect the economic situation positively. Compared with the previous month, expectations that the yen will continue to be weak have grown considerably. Together with the looming risk of recession and the unappealingly low interest rates, this could cause invested funds to be withdrawn, mainly from Japanese bonds and from money market securities. ◀

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### Yen: Actual development and forecast



Source: Thomson Financial Datastream, ZEW

## Publications

### ZEW Economic Studies

*Smolny, Werner:*

#### ***Endogenous Innovations and Knowledge Spillovers. A Theoretical and Empirical Analysis.***

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