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The situation of the West German economy

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The Situation of the West German Economy

This article offers an extract of the findings published in the latest joint expertise on the Federal Republic's economic situation undertaken by the Association of German Economic Research Institutes¹.

In the Federal Republic of Germany the economic development during the winter months was determined by strongly recessive influences: GNP in real terms contracted vigorously for the second time after the currency reform following World War II; unemployment and short-time work accelerated while at the same time the upward trend of costs and prices slowed down noticeably.

But the risk that the downward movement will increase cumulatively seems to be banned. In industry domestic orders tend to rise again while orders from abroad do not continue to decline any more. On the building market, too, demand has probably touched the bottom.

This development occurred against the background of a cyclical policy aiming at a stimulation: With its economic policy programme of December 1974 the Federal Government directed its efforts towards the initiation of a cyclical upward movement; the German Federal Bank, that in 1973 and 1974 restrained monetary expansion considerably, began to expand increasingly the monetary base in order to give an upward trend the required financial scope.

The expansive impulses of financial and monetary policy are together so strong that, measured against the experiences of the 1966/67 recession, they should suffice abundantly to stimulate a new upswing. For the further development the question only remains open when the upward trend will start and how strong it will be.

Uppermost in fiscal policy is the tax and children's allowance reform decided on in the summer of 1974, whose effects will become noticeable in the coming months after the mastering of the organisational initial difficulties concerning the children's allowance. This reform will strengthen the purchasing power — mainly of private households — by about DM 14 bn during the current year. Added to this there is the "Pro-

gramme for the Promotion of Employment and Growth in Connection with Stability" of December 1974, which provides for additional expenditures of DM 1.7 bn, placing of government investment orders prematurely within the first half-year and — as focal point — the granting of an investment allowance, for a fixed period, of 7.5 p.c. of acquisition or production costs.

Although by far the largest part of the investment allowance will be paid only in 1976 and later — for 1975 expenditure of less than DM 0.5 bn only will be payable — public deficits will rise drastically during the current year due to an altogether rapid expansion of government expenditure and cyclically conditioned slow growth of revenues. For the public authorities, in the definition of the public accounts, a financing deficit of DM 52 bn is to be anticipated; and also the expenditure of the social insurance institutions will exceed receipts by DM 2.5 bn.

The expansive course of fiscal policy is made possible and is supported by monetary policy. During the winter half-year the monetary base adjusted for the effects of changes in the minimum reserve ratio increased more rapidly. Besides, the credit institutions could raise their liquidity reserves, which increased to DM 10 bn by the end of March; arithmetically this is sufficient for financing the increase by 8 p.c. of the monetary base stipulated for 1975.

The swing of wage policy into a stabilisation course was the decisive prerequisite to enabling the expansive economic policy to stimulate production and employment — and not only to leading to another promotion of inflation. This year's collective wage agreements allow a certain latitude for an improvement of entrepreneurs' profits and thus meet an important condition for a lasting stimulation of the propensity to invest.

The reason for it that nevertheless uncertainty exists about the beginning and strength of the cyclical upswing is the fact that so far the economy employs but hesitantly the chances offered by economic policy. Obviously it is still under the impression of the worldwide depression and the

¹ Participating Institutes: Deutsches Institut für Wirtschaftsforschung, Berlin, HWWA-Institut für Wirtschaftsforschung-Hamburg, IFO-Institut für Wirtschaftsforschung, München, Institut für Weltwirtschaft an der Universität Kiel, Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Essen.

widely held anticipation of a principal and long-term deterioration of growth chances.

The probability of an early economic upward trend in the Federal Republic is resulting from balancing the expansive and the retarding influences.

Domestic demand for capital goods rising for several months already will increase more strongly up to the middle of the year. Shortly before the deadline-date is reached (June 30), which must be observed as a precondition to the investment allowance of 7.5 p.c., a boom of incoming orders will emerge, doubtlessly followed by a temporary falling off of orders in response. But the prospects for a lasting stimulation of the propensity to invest are to be estimated quite favourably because due to the already noticeable improvement of the business climate, the data set by economic and wage policies will begin to tell. Therefore equipment investment adjusted for seasonal variation will rise again in the second half of the year.

Concerning investment in building another decline is not to be apprehended; a small increase seems to be possible even. In housing a growing propensity to build is rather conceivable owing to the fallen mortgage interest rates and declining worries about the security of jobs. A certain obstruction, however, is the large number of apartments not sold or rented yet (estimates fluctuate between 200,000 and 300,000). But it depends on the — not sufficiently known — structure of these "stocks" to what extent they will actually block the conversion of housing demand into building activities. For that part of dwellings, which does not meet demand, this does not apply anyway.

For industrial building considerations apply similar to those for equipment investment, however with the modification that, for the time being, the comparatively still less important motivation for expansion justifies the anticipation of a weaker growth than in the case of equipment investment. In public building the hitherto vivid demand, caused also by the placing of orders already in the first half of the year, will lead to a further rise in building activities. Whether as a result of this policy the increase will weaken at the end of the year remains to be seen.

In this early phase of a stimulation of building activities, only production in building and civil engineering will again rise to begin with, while production in the finishing trade will continue declining.

In the further course of the year private consumption will revive distinctly and with that also influence favourably the propensity to invest. Differ-

ently from the last months the households' available incomes will expand strongly due to the growing effects of impulses originating from the tax and children's allowance reform, but firstly also due to supplementary wage payments resulting from the wage agreements during the first months of this year. In addition the increase of private consumption will not be kept down any more by the more than proportional rise in savings. Quite the contrary, the declining risks of jobs as well as the dammed up demand for durable consumer goods indicate a reduction of the saving ratio.

The steep decline of demand from abroad, that contributed considerably to strengthening the recession, seems to be over. Exports have probably reached their lowest level. While for the time being goods exports to industrialised countries should not grow again, deliveries to the OPEC-countries will go on growing considerably and so initiate another increase of total exports. Nevertheless, because of the pronounced recession during the winter months, goods exports in real terms will this year, for the first time since the foundation of the Federal Republic, lag behind the preceding year's volume.

With this development of ultimate demand and the expected turn in arrangements for carrying stocks, GNP in real terms adjusted for seasonal variation will rise noticeably in the further course of the year, although in 1975 the annual result will be only slightly higher than a year ago. This is to be explained by the reduction in the winter half-year and not by the assumption that a cyclical turn will not be achieved later this year. The fact that in the table a margin of 0 to 1 p.c. is shown for the expansion rate does not express any doubt in a turn as such, but only points at the uncertainty about the date of the turn and the intensity of the upward trend.

Imports will also rise again quickly with a revival of the domestic business trend. To begin with, purchases of industrial primary products will increase, particularly since a replenishing of stocks is to be anticipated. The probable price development on the raw material markets will also contribute to this trend. Following the boom in consumer goods, imports of finally finished goods will rise, too. In the aggregate imports in real terms of goods and services will grow distinctly more strongly than exports. The external contribution in terms of money will, however, increase again, since the terms of trade are improving.

The price increase will decline further in all sectors. After the lower wage rises and the again rising productivity, the increase in the pay load will slow down distinctly, and import prices will,

The Most Important Data of the National Accounts

Estimates for 1975

	1973	1974	1975	1974		1975	
	Years			1. hf.yr.	2. hf.yr.	1. hf.yr.	2. hf.yr.
1. Origin of National Product, in real terms Change in p.c. compared with the preceding year							
Number of employed	0.3	- 1.8	- 2.5	- 1.0	- 2.6	- 3.5	- 2
Working time (per working day)	- 0.6	- 1.1	- 1	- 0.7	- 1.5	- 1.5	0
Working days	- 0.1	- 0.2	0	- 0.8	0.4	0	0
Total work done, per calendar month	- 0.4	- 3.1	- 3.5	- 2.5	- 3.7	- 5	- 2
Productivity	5.7	3.8	4	4.0	3.7	4	4.5
Gross Domestic Product	5.3	0.6	0 - 1	1.4	- 0.1	- 1.5	2.5
2. Appropriation of the National Product - at current prices - a) Billion DM							
Private consumption	496.8	534.2	580	253.1	281.1	273.5	306.5
Government consumption	168.6	195.7	215.5	89.4	106.3	98.5	116.5
Investment in fixed assets	230.0	226.1	231	107.0	119.1	107.5	123.5
Equipment	96.5	95.2	101	45.4	49.9	48.5	53
Buildings	133.6	130.9	129.5	61.6	69.3	59	70.5
Change in stocks	+ 9.6	+ 1.3	+ 4	+ 7.3	- 6.0	+ 6.5	- 2
External contribution	+ 25.3	+ 38.3	+ 41	+ 19.9	+ 18.4	+ 22.5	+ 18.5
Exports	226.2	295.6	312.5	142.2	153.4	151.5	161
Imports	200.8	257.4	271.5	122.4	135.0	129	142.5
Gross National Product	930.3	995.5	1071.5	476.6	518.9	508.5	563
b) Change in p.c. compared with the preceding year							
Private consumption	10.2	7.5	8.5	6.6	8.4	8	9
Government consumption	15.1	16.0	10	15.9	16.1	10.5	9.5
Investment in fixed assets	5.8	- 1.7	2	- 2.2	- 1.2	0.5	3.5
Equipment	4.3	- 1.3	6.5	- 3.7	1.1	6.5	6
Buildings	6.9	- 2.0	- 1	- 1.0	- 2.8	- 4	2
Exports	18.9	30.7	5.5	32.0	29.5	6.5	5
Imports	14.9	28.1	5.5	27.4	28.8	5.5	5.5
Gross National Product	11.5	7.0	7 - 8	6.6	7.4	6.5	8.5
- at prices of 1962 - a) Billion DM							
Private consumption	337.8	338.4	348	162.3	176.1	165.5	182.5
Government consumption	79.9	83.4	85.5	39.8	43.6	40.5	45
Investment in fixed assets	152.1	140.1	136	67.5	72.6	64	72
Equipment	75.3	69.6	69	34.0	35.5	33.5	35.5
Buildings	76.8	70.5	67.5	33.5	37.1	31	36.5
Change in stocks	+ 7.9	+ 1.0	+ 2.5	+ 5.4	- 4.4	+ 4.5	- 1.5
External contribution	+ 16.0	+ 33.4	+ 27	+ 19.4	+ 14.0	+ 15.5	+ 11.5
Exports	196.8	223.1	223	112.4	110.7	110.5	112.5
Imports	180.8	189.8	196	93.0	96.7	95	101
Gross National Product	593.8	596.3	599.5	294.4	301.9	290.5	309
b) Change in p.c. compared with the preceding year							
Private consumption	2.9	0.2	3	- 1.0	1.2	2	3.5
Government consumption	4.0	4.4	2.5	4.8	4.0	2	2.5
Investment in fixed assets	1.1	- 7.9	- 3	- 8.3	- 7.6	- 5	- 1
Equipment	2.0	- 7.7	- 1	- 9.1	- 6.3	- 2	0
Buildings	0.3	- 8.1	- 4.5	- 7.5	- 8.7	- 8	- 1.5
Exports	16.2	13.4	0	17.6	9.3	- 1.5	1.5
Imports	9.8	4.9	3.5	3.3	6.6	2	4.5
Gross National Product	5.3	0.4	0 - 1	1.3	- 0.5	- 1.5	2.5
3. Price Level of National Expenditure (1962 = 100) Change in p.c. compared with the preceding year							
Private consumption	7.0	7.3	5.5	7.6	7.1	6	5
Government consumption	10.7	11.3	7.5	10.6	11.7	8	7
Investment in fixed assets	4.6	6.7	5	6.6	6.8	5.5	4.5
Equipment	2.3	6.9	7.5	5.9	7.8	9	6
Buildings	6.6	6.7	4	7.0	6.5	4	3.5
Exports	2.3	15.3	5.5	12.3	18.4	8.5	3
Imports	4.6	22.1	2	23.4	20.8	3.5	1
Gross National Product	5.9	6.6	7	5.2	7.9	8	6

to begin with, still lead to cost cutting. From demand no impulses will as yet originate which might end the stabilisation process. Thus at the end of the year the inflation rate of consumer prices should fall below 5 p.c. as compared with the previous year's level; on an annual average it will amount to about 5.5 p.c. The increase of food prices will become somewhat stronger owing to the EC's decisions on agricultural prices, but prices of industrially produced goods and private services will rise considerably less than hitherto.

Cyclical policy measures point towards a boom. Investors and consumers, however, are so far reacting only reluctantly. Without doubt this is a hard trial of patience for the economic authorities, because thus the date at which unemployment will decrease is being delayed.

Nevertheless it should be attempted to enforce developments by further measures. The hitherto recognisable effects of the expansion policy are still small, but no negative conclusion should be arrived at about the final effects. The time-span since the introduction of the measures is still too short for a conclusive evaluation. As known by experience the time-lags are particularly long in monetary policy. Some more time will pass again between a revival of production and a noticeable reduction of unemployment. If one does not take these relations into consideration, one risks to take measures that later would prove to be procyclical — with all the negative consequences for the steadying of the cyclical development and the stabilisation of the price level.

The present implementation of the territorial authorities' budgets indicates that the items in the estimates of expenditure are adhered to. In contrast to the recession of 1966/67 there seems to be no race between cyclically conditioned lower tax revenues and cuts in expenditures. This together with the loss of revenues resulting from the tax reform leads to the expected high budget

deficit. In view of the private sector's low propensity to run into debts such deficits are not disquieting; they are rather in tune with the cyclical trend. But it follows, too, that in a phase of increasing propensity to run into debts of the private sector, these deficits must be reduced again.

The German Federal Bank's policy is now on a course corresponding with its own target figures and the requirements of the cyclical development. It should continue on this course even if interest rates would again begin to rise and another relaxation of monetary policy should be demanded owing to the uneasiness about the capital market. Sooner or later the target of limiting the expansion of money supply will become inconsistent with the target of preventing a rise in the interest rate. In the interest of steadying and stabilising the business trend the control of money supply should be given priority. This is simultaneously required for the credibility of monetary target figures, which the private sector already follows and is supposed to adhere to further.

When judging the Federal Bank's future policy, it must be taken into consideration that during the last months the business banks were able to form a large amount of liquidity reserves which alone would suffice to finance the expansion of the monetary base aimed at for this year. Should another rise in liquidity emerge, the Federal Bank might see itself compelled to skim off liquidity again; otherwise it might become difficult to stick to the planned monetary expansion rate, if the release of liquidity reserves, probable in the course of a boom, comes about. This would not mean a change of course in monetary policy.

In particular the Federal Bank would face the necessity of skimming off liquidity, if it would be forced to buy a considerable amount of foreign exchange. This would become more likely if such countries would join the monetary "snake", that carry through a stabilisation policy of less consequence than the Federal Republic of Germany.

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