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## The economic situation in the Federal Republic

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# The Economic Situation in the Federal Republic

This article offers an extract of the findings published in the latest expertise on the Federal Republic's economic situation undertaken by the Association of German Economic Research Institutes<sup>1</sup>.

At the middle of the year the cyclical trough had been reached in the Federal Republic of Germany. A retrospective view shows that the recession was considerably more pronounced than had been anticipated in spring. GNP in real terms has declined strongly; in the first half of 1975 it was 5 p.c. below the previous year's level. Decisive for the force of the downward movement had been the dramatic contraction of foreign demand in the winter half year 1974/75, that impaired production and employment not only directly but also indirectly through a further decrease of the propensity to invest. During the last months, however, the shrinking of foreign demand, which originated mainly from the industrial countries, has been replaced by a slight upward trend. The cyclical programmes introduced in numerous countries have certainly contributed to this development. Simultaneously the reduction of stocks, that had strengthened the downward trend, seems to have come to an end. Goods exports to the western industrial countries have stabilised since spring, goods imports did not decline any more.

## Batch of New Orders through Investment Allowance

At first the enterprises reacted hesitantly only to the investment allowance but shortly before the expiration of the preferential period they ordered a considerable quantity of capital goods. Although thereupon orders declined again a "demand gap" did not emerge. Equipment investment in real terms, including imports, has already risen slightly again in the third quarter. In the summer half year total investment in building in real terms decreased again, although more slowly at last. Private consumption did not set the pace for the upswing as had been hoped for. True, due to the Tax and Children's Allowances Reform private households received considerably increased incomes and social insurance pensions were raised by about 11 p.c. The sum total of gross wages and salaries, however, rose but slightly, because the

increases of wage rates were opposed by a continuously declining employment. Since, moreover, private households saved almost on third of their additional incomes, private consumer spending rose to a comparatively small extent only.

## Continuous Decline in Employment

In spite of the stabilisation of production the number of employed labour dropped almost at the same rate: In the third quarter it was approximately 2 p.c. smaller than in the first quarter. The continuously strong reduction of staff in industry and building sector was decisive for this trend. In view of the growing deficits the formerly usual expansion of staff was discontinued in the public sector. The decline in employment had particularly drastic effects on foreign labour. The number of employed foreigners dropped by more than 300,000 within a year. At present it amounts to about 2 million after 2.6 million workers in autumn of 1973, its highest level so far. The number of unemployed remained above the one-million mark also during the summer months, but adjusted for seasonal variation the increase slowed down. The extent of short-time work seems to decline gradually.

## Forecast: Favourable Conditions for Growing Exports

Forecasting the further economic development is not as risky as it was last spring. For, in the meantime it has become a largely assured fact that demand from abroad has passed its lowest level; most recently there has been a slight upward trend. Thus it may be anticipated that exports will again rise during the oncoming months. Even if the economic recovery will succeed but hesitantly in the western industrial countries, soon already the expansive export impulses will originate more markedly from the worldwide reversal of the inventory cycle which is to be expected. In the course of the next year German exports will grow at least at the same speed as world trade. This is indicated mainly by the structure of the German supply of goods. As compared to former years of cyclical upswings, the growth of exports will, how-

<sup>1</sup> 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.

ever, be moderate because the cyclical recovery will only proceed relatively slowly in most countries. Even considering such impediments an increase of exports in real terms of about 7 p.c. may be anticipated for the next year. Imports in real terms will probably rise to about the same extent.

#### **Hesitant Stimulation of the Propensity to Invest**

The pronounced use of the investment allowance and the hitherto only slight reduction of orders after their peak around the middle of the year indicate an again more favourable investment climate. In order to take advantage of the investment allowance already in 1976, many firms will press for the delivery of the ordered capital goods already before the end of 1975. Therefore equipment investment will probably rise markedly during the last months of this year. For 1976 present plans do not permit a reliable estimate of actual investment. On an annual average of 1976 an altogether moderate growth rate of equipment investment is to be expected only. The prerequisite to this is, indeed, that the enterprises need not apprehend the profit situation expected for 1976 to be a temporary one only. Since the Federal Government promotes mainly building projects with its cyclical programme of August 1975, a stop of the decline in demand for building should be secured. In 1976 the aggregate production of the building industry will in spite of a slight stimulation in the course of the year reach only the result of 1975.

#### **Public Budgets Less Expansive**

After at the beginning of 1975 the course of financial policy had been unambiguously directed towards expansion, the Lands' and communities' propensity to stick to a consistently anti-cyclical policy slackened because of declining tax revenues. Although public expenditure continued growing rapidly, this high increase is to be explained mainly by unemployment and short-time payments as well as by social insurance pensions. On the other hand, expenditure on capital investments increased but slightly. This year's financial state deficit of probably DM 70 bn reflects only to a small extent active anti-cyclical policies. It is mainly a result of cyclically conditioned low revenues together with cyclically conditioned or legally fixed expenditure increases. This involved the territorial authorities as well as the social insurance. The territorial authorities' deficit of DM 16 bn in 1974 will rise to approximately DM 66 bn in 1975. The social insurance surplus in 1974 of DM 4 bn will be replaced by a deficit of about DM 5 bn in 1975.

#### **Only Slight Rise in Private Consumption**

Although the private households' propensity to save seems to have declined somewhat most re-

cently, it is still an open question whether this is already a lasting tendency. As the expansion of the private households' incomes will be continuously weak together with a continuing decline of the work volume, private consumption will probably rise only slightly even on the assumption of a slightly decreasing rate of saving in the last months of this year. If in 1976 the collective wage agreements come about, which are deemed necessary for investment growth, the net increase of wages and salaries will be only weak during the first half of the year, also because the burden of social insurance contributions will increase strongly. But in the later course of the year the expansion of private consumption should grow in consequence of a rising work volume and a probably continuing decline of the saving rate. Regarding the annual average of consumer prices the rate of increase will hardly be lower than 5.5 p.c. even if assuming a noticeable weakening of the present price rises.

#### **GNP Stopped Shrinking**

Up to the middle of the year GNP in real terms still declined owing to the steep reduction in industrial production and building trade. The utilisation of the production potential continued shrinking and was lower than during the recession of 1966/67. A remarkable exception was vehicle construction which recovered strongly.

After the middle of the year the decline of GNP seems to have discontinued, mainly under the influence of the push of orders in the capital goods industries. The fact that in numerous branches stocks had been reduced to such an extent that a major part of demand had to be covered from current production contributed also to this trend.

#### **Improvement on the Labour Market Hardly before Summer 1976**

A quantitative forecast of GNP growth in 1976 is difficult not only owing to the uncertain date of the change in the economic trend but also because the intensity of the expansive forces can only be roughly estimated. Under these circumstances the GNP growth rate in real terms of 4 p.c. as shown in the table can only be interpreted as a rough magnitude. The number of persons employed will only rise during the second half of the year because after the change in the economic tendency at first a normalisation of work hours and a full utilisation of production reserves is to be anticipated. Employment will probably even decline during the coming months. Although in the later course of the year unemployment will decline distinctly, the number of unemployed will, on an annual average of 1976, be as large as in 1975.

## The Most Important Data of the National Accounts

Estimates for the years 1975 and 1976

	1974	1975	1976	1975		1976	
	Years			1. hf.yr.	2. hf.yr.	1. hf.yr.	2. hf.yr.
<b>1. Origin of National Product, in real terms</b>							
Change in p.c. compared with the preceding year							
Number of employed	- 1.9	- 3.5	- 1.5	- 3.3	- 3.5	- 2.5	- 0.5
Working time (per working day)	- 1.1	- 2	1	- 2.5	- 1.5	0.5	1
Working days	- 0.2	0	0.5	- 0.1	0	1	0.5
Total work done, per calendar month	- 3.2	- 5	0	- 5.8	- 4.5	- 1	1
Productivity	3.9	1	3.5	0.8	1.5	3.5	3.5
Gross Domestic Product	0.6	- 4	4	- 5.0	- 3	2.5	5
<b>2. Appropriation of the National Product</b>							
- at current prices -							
a) Billion DM							
Private consumption	532.9	575	618	273.5	301.5	291.5	326.5
Government consumption	196.3	219.5	236.5	101.3	118	109.5	127
Investment in fixed assets	223.9	212	222	100.7	111.5	103	119
Equipment	94.8	95.5	103	45.7	50	49.5	53.5
Buildings	129.1	116.5	119	54.9	61.5	53.5	65.5
Change in stocks	+ 1.1	+ 2	+ 17	+ 6.3	- 4.5	+ 15	+ 2
External contribution	+ 39.8	+ 24	+ 24	+ 14.7	+ 3.5	+ 12.5	+ 11.5
Exports	298.9	293.5	328.5	143.3	150	157.5	171
Imports	255.1	263.5	305	123.6	141	145	160
Gross National Product	994.0	1,032.5	1,117.5	496.5	536	531.5	586
b) Change in p.c. compared with the preceding year							
Private consumption	7.5	8	7.5	8.2	7.5	6.5	8.5
Government consumption	16.7	11.5	8	12.8	11	8	7.5
Investment in fixed assets	- 2.1	- 5.5	4.5	- 6.1	- 4.5	2.5	6.5
Equipment	- 1.8	1	7.5	0.8	1.5	8.5	7
Buildings	- 2.3	- 10	2	- 11.2	- 9	- 3	6.5
Exports	31.4	- 2	12	0.1	- 3.5	10	14
Imports	27.9	4	13	4.1	4	13	13.5
Gross National Product	7.2	4	8	4.1	3.5	7	9.5
- at prices of 1962 -							
a) Billion DM							
Private consumption	337.8	343.5	350.5	165.4	178	166.5	184
Government consumption	83.9	86	87.5	41.2	45	42	45.5
Investment in fixed assets	135.1	127.5	130	61.1	66.5	61	68.5
Equipment	63.4	66	68	37.1	34	33.5	35
Buildings	69.8	61.5	61.5	29.1	32.5	28	34
Change in stocks	+ 0.8	+ 1.5	+ 11.5	+ 4.3	- 3	+ 10	+ 1.5
External contribution	+ 33.5	+ 13	+ 13.5	+ 7.5	+ 5.5	+ 1.5	+ 6.5
Exports	224.4	204.5	219.5	100.6	103.5	106	113.5
Imports	160.9	191.5	206	93.1	98.5	99	107
Gross National Product	595.0	571	582.5	279.5	291.5	284	305.5
b) Change in p.c. compared with the preceding year							
Private consumption	0.2	1.5	2	1.9	1.5	0.5	3.5
Government consumption	4.7	2.5	1.5	3.4	2	2	1
Investment in fixed assets	- 8.1	- 8.5	2	- 9.6	- 7	0	3.5
Equipment	- 7.9	- 5	3	- 5.8	- 4	4	2.5
Buildings	- 8.3	- 11.5	0.5	- 13.5	- 10	- 4.5	4.5
Exports	13.3	- 9	7.5	- 10.8	- 7	5.5	9.5
Imports	4.8	0.5	7.5	- 0.7	1.5	6	8.5
Gross National Product	0.4	- 4	- 4	- 5.0	- 3	2.5	5
<b>3. Price Level of National Expenditure (1962 = 100)</b>							
Change in p.c. compared with the preceding year							
Private consumption	7.3	6	5.5	6.2	6	6	5
Government consumption	11.4	9	6	9.1	9	6	6.5
Investment in fixed assets	6.6	3.5	3	3.9	2.5	2.5	3
Equipment	6.7	6.5	4	7.1	5.5	4.5	4
Buildings	6.6	2	2	2.7	1.5	1.5	2
Exports	16.0	8	4	12.2	4	4	4
Imports	21.9	3.5	5.5	4.9	2.5	6	4.5
Gross National Product	6.8	8	4.5	9.6	7	4.5	4