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The Economic Situation in the Federal Republic and the Western Countries

In its latest joint assessment of the economic situation the Working Group of German Economic Research Institutes comes to the following conclusions, presented here in an abridged form¹.

After near stagnation last summer the Federal Republic of Germany in the autumn experienced another fairly strong increase in total economic production. This trend was occasioned mainly by a recovery of industrial investments, assisted by a more marked advance of private consumption. The plant capacities were used at higher rates, and the decline of the work force came to a halt — a year and a half after the upswing had got under way. The number of workers on payrolls actually increased slightly, for the first time since the beginning of 1973. The relatively fast pace of expansion was no doubt in part due to transitory influences. The uptrend therefore slowed somewhat in the first months of the current year; there was probably only a small further increase in general capacity loading.

Weaker External Impulses

The external impulses activating the German economy have been fading considerably since the autumn of 1976. The exports of goods have risen little in real terms, partly because of special factors: in anticipation of a revaluation of the Deutschemark the countries with DM-linked currencies had stepped up their purchases quite considerably in the summer; the autumn brought a reaction. The trend of exports is still basically upward but the expansion of goods imports has been slowed in real terms by the easing of the impulses from the inventory cycle, by the reaction following anticipatory buying of crude oil and petroleum products on the news of an impending price rise for oil, and by the regression of food imports in the winter months.

The demand for equipment goods surged in the final months of last year but, to go by the statistics showing the order receipts of investment goods producers, definitely eased off later. To what extent the decline is to be regarded as cyclical, a "technical reaction" or due to a change in

the official statistics cannot be safely judged at present. The building investments certainly recovered in the final quarter of 1976 after a slackening in the summer months. Favoured by the weather, the better trend seems to have been maintained in the first quarter of the current year. The upswing started in the residential and commercial building sectors which benefited from investment grants and the dwelling-house modernization and homestead bridging-loan programmes.

Strongly Increased Consumption

The demand from private households, which had risen little during the summer months, improved substantially at the end of last year. The crucial factor was a more rapid rise in private households' disposable incomes which stemmed in the main from the faster increase of effective wages. The savings ratio of private households remained almost unchanged. The demand revival centred on a few sectors. The expansion of consumer spending slackened after the turn of the year. The rise of consumer prices accelerated around the turn of the year but this was mainly due to higher taxes on tobacco and spirits.

A distinctive feature of the present upswing is that periods of rapid expansion alternate in quick succession with phases of more restrained advance. This inconstancy is not the least of the causes which have led to differences of opinion about the strength of the upswing also among those who do not question its continuance as such. The Deutsche Institut für Wirtschaftsforschung in Berlin, the HWWA-Institut für Wirtschaftsforschung-Hamburg and the Institut für Weltwirtschaft an der Universität Kiel regard a

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. The Ifo-Institut and the Rheinisch-Westfälisches Institut have stated their more sceptical appraisal of the economic progress in a minority report.

further fairly strong increase of total economic production during 1977 as probable. Demand will, they assume, soon rise again at a faster pace. The export trade continues to provide an important impulse for the domestic economic trend: having been held back by special factors at the end of 1976, it may be expected to show an appreciable improvement in future. The renewed rise of foreign orders for products of the basic and producer goods industries suggests that pre-products will once again help towards an expansion of exports. The goods imports into the Federal Republic will also increase substantially.

Equipment Investments Expanding Strongly

That the recession of real equipment investments after the middle of 1976 was short-lived and the current demand has revived since is indicative of noticeably stronger private investment propensity. The framework conditions which influence investment activity are also developing favourably: the confidence in a steady if moderate cyclical upturn in the western industrialized countries rests now on a sounder foundation than last autumn. More industries are approaching a state of full employment of their capacities as their production increases; investments are once again needed for capacity extensions. Favourable conditions for the raising of outside funds, as well as the continuing improvement of profits and profit expectations, facilitate investment commitments. In these circumstances it may be expected that real equipment investments will increase more rapidly. Contrary to the general cyclical trend, building investments will increase only tardily in 1977 and thus act as a restraint on the general economic upturn. This is in great measure still a consequence of the dates laid down in the Investment Grants legislation. Relatively few new projects will be started during the remainder of this year as the issue of building licences for commercial and residential buildings seems to have passed the lowest point only a short while ago. There is no evidence of larger public building investments providing an offset: the figures in the 1977 schedules are even lower than last year.

Consumer Spending Rising Faster

Income movements and savings attitudes suggest that private consumption will make a stronger contribution to the cyclical recovery in the further course of this year than they did last year; the slow-down of the rise in consumer spending early this year was probably temporary. Increased employment and higher hourly wages will raise gross wages and salaries by 9 p.c. compared with last year. The public income transfers to private

households will increase as fast as in 1976. The total of household incomes will therefore expand more rapidly. Moreover, it is possible that households will draw on funds which will become available in substantial amounts under bonus savings contracts. It is estimated that an additional sum of about DM 4 bn from this source will be used by households for consumption purposes. *In toto* the expansion of consumer spending may be expected to accelerate. The consumer prices will probably again rise at a moderate rate only in 1977.

Further Output and Capacity Load Rises

The increase of the GNP in real terms will accelerate later this year. By the end of 1977 it will probably have risen at a current annualized rate — per working day and seasonally adjusted — of about 6 p.c. This implies a substantial increase in the use of the production potential. In view of the comparatively quiescent development in the six winter months which led only to a small “backlog”, the GNP will, as far as foreseeable today, rise by no more than about 4.5 p.c. in the annual average. This general economic development will be reflected by a perceptible increase in the number of people in employment — chiefly in industry; the service sector, retail trade and the state will probably also employ more people. Unemployment will decline but in the annual average there will still be over 900,000 unemployed.

The International Economic Situation

After a definite slow-down last summer the winter months brought a somewhat faster production rise in the western industrialized countries taken as a whole. The capacity load rates generally advanced only slightly, and the labour markets showed for the most part no improvement at all. Prices went on rising almost as fast as ever although the rate of increase varied greatly from country to country. This in outline is how the German institutes see the economic development in the world.

In the USA the cyclical expansion quickened at the end of last year. The unemployment rate fell in the six winter months from 7.9 to 7.3 p.c., and the forces making for a further upsurge will strengthen in the course of this year. Additional impulses will come from inventory restocking and public expenditure. The investment activities of private firms can be expected to stay up as the prospects for sales and profits have on the whole improved. Private consumption and residential building will still expand steadily in line with the more favourable incomes trend. The real GNP can be expected to rise as a whole by approxi-

The Most Important Data of the National Accounts of the FR Germany

Estimates for 1977

	1975	1976	1977	1976		1977	
	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	-3.3	-1.0	0.5	-1.6	-0.5	0	0.5
Working time (per working day)	-1.7	0.4	0.5	0.4	0.3	0.5	0.5
Working days	0.1	0.7	-0.5	1.0	0.5	-0.5	-0.5
Total work done, per calendar month	-4.8	0.0	0.5	-0.2	0.3	0.5	1
Productivity	1.6	5.5	4	5.9	5.1	3.5	4.5
Gross Domestic Product	-3.3	5.5	4.5	5.7	5.4	3.5	5.5

2. Appropriation of the National Product

- at current prices -

Change in p.c. compared with the preceding year

Private consumption	8.9	8.1	8.5	9.1	7.2	7.5	9.5
Government consumption	11.0	6.8	7.5	7.6	6.0	7	8
Investment in fixed assets	-1.3	7.2	8.5	7.7	6.8	7.5	9.5
Equipment	6.2	9.0	11.5	11.8	6.6	8	14.5
Buildings	-6.8	5.7	6	4.3	6.9	7.5	5
Exports	-1.6	13.8	11	11.7	15.7	11.5	11
Imports	3.8	15.9	12	14.9	16.9	13	11.5
Gross National Product	4.6	8.8	8.5	9.3	8.4	7.5	9.5

- at prices of 1962 -

Change in p.c. compared with the preceding year

Private consumption	2.6	3.4	4.5	3.8	3.1	3.5	5.5
Government consumption	3.6	2.9	2.5	4.2	1.6	2.5	2.5
Investment in fixed assets	-4.1	4.7	5	5.8	3.8	4	6
Equipment	0.4	6.7	7.5	9.5	4.2	4.5	10.5
Buildings	-8.6	2.5	2	1.6	3.3	3	1
Exports	-8.7	10.9	7.5	9.3	12.5	7.5	7.5
Imports	0.8	11.4	8.5	10.2	12.5	9	8
Gross National Product	-3.2	5.6	4.5	5.9	5.3	3.5	5.5

3. Price Level of National Expenditure (1962 = 100)

Change in p.c. compared with the preceding year

Private consumption	6.1	4.5	4	5.1	4.0	4	4
Government consumption	7.1	3.8	5	3.3	4.3	5	5.5
Equipment	5.8	2.2	3.5	2.1	2.3	3.5	3.5
Buildings	2.1	3.1	4	2.6	3.5	4	4
Exports	7.7	2.6	3.5	2.2	2.9	3.5	3
Imports	2.9	4.1	3.5	4.3	3.9	3.5	3.5
Gross National Product	8.1	3.1	3.5	3.2	3.0	4	3.5

Origin and Distribution of Income

Change in p.c. compared with the preceding year

Gross income from wagework	4.1	7.3	9	6.4	8.2	8.5	9.5
Gross wage and salary total	3.5	6.6	9	5.8	7.3	8.5	9.5
ditto per employed person	7.0	7.4	8	7.1	7.5	8	8
Net wage and salary total	3.6	3.7	7.5	2.9	4.4	7.5	7.5
Gross income from entrepreneurship and property	3.5	13.9	8.5	18.6	9.9	6	11
Net income from entrepreneurship and property	5.8	12.4	8	18.6	7.1	3.5	12
Disposable income of private households	9.7	6.7	7.5	6.0	7.3	7.5	7.5

mately 5 p.c. in 1977 (1976: 6.1 p.c.). The prices will go up by about 6 p.c., which is roughly the same as in 1976.

Stronger Impulses Felt Once More in Japan

In Japan the cyclical expansion has been proceeding at a very modest pace since the middle of last year. The upward movement of exports has weakened and the domestic demand expansion has slowed down thus contributing to this trend. Several indicators foreshadow a more marked expansion in 1977. For one thing, a distinct improvement may once again be expected for the exports. Stronger stimuli will be at work from now on but in view of the small backlog at the beginning of 1977 it must nevertheless be expected that the real GNP as a whole will grow at a lower rate than last year (5 p.c. instead of 6.3 p.c.).

Moderate Expansion in Western Europe

In Western Europe production has been rising somewhat faster in the winter of 1976/77 following the marked slow-down in the preceding summer. The upswing was on the whole moderate with clear differences between the various countries. Since last autumn the economic authorities have been aiming at a more restrained expansion, or even resorted to restrictive action, because little progress has been made in damping down the inflation. The updrift of wages and prices may be expected to moderate slightly as the year advances. Most countries will probably see a somewhat faster expansion of private investment activity, including house-building in particular, than last year but the private consumption and the public sector demand may well show a moderate advance only. The growth of the GNP of the West European countries taken together will work out at only about 3.5 p.c., after 4.5 p.c. last year.

Slower Expansion of World Trade

In the international trade the cyclical impulses weakened perceptibly after mid-1976 when the inventory accumulation in the industrialized countries slowed down and the imports for current consumption also rose more gradually. After seasonal adjustments the industrialized countries showed substantially higher deficits in their balances of trade. In 1977 the world trade must be expected to expand only slowly. The volume of international trade may be 7–8 p.c. higher in the annual average, after a rise of 11 p.c. last year. Some of the world markets for industrial raw materials experienced strong price movements in the first months of 1977. During the remainder of the year the prices will on balance probably rise only moderately.

Outlook: Economic Policy Needs Medium-Term Orientation

Stimulatory programmes by strong-currency countries to reinforce the upswing would help the weak-currency countries and boost the world economy only for a short while, for they would not solve the economic problems in the industrialized countries. Their settlement would if anything be delayed by short-term cyclical stimuli at the expense of price stability and in disregard of the principles of a monetary and financial policy related to the existing potentialities. The economic authorities and the social partners should redouble their efforts to achieve the major economic objectives at one and the same time. Consistent efforts should be made through monetary policy to slow the advance of prices. In the employment sphere it is crucial that the conduct of the social partners should conform to the needs of stability. Simultaneously the financial policy should assist in steadying the course of demand and production.

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