

Hamburg Institute of International Economics (HWWA) (Ed.)

Article — Digitized Version

The economic situation in the western countries

Intereconomics

Suggested Citation: Hamburg Institute of International Economics (HWWA) (Ed.) (1978) : The economic situation in the western countries, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 13, Iss. 5/6, pp. 153-156,
<https://doi.org/10.1007/BF02929184>

This Version is available at:

<https://hdl.handle.net/10419/139547>

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The Economic Situation in 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.

On a world scale the economic situation improved slightly in the autumn and winter of 1977/78: The uptrend in the USA continued while in most East European countries and in Japan economic activity tended to revive. More expansive economic policies played an essential role. Partly in connection with the depreciation of the dollar, the change of course in the field of economic policy was especially marked in the countries with strong currencies. The substantial appreciation of these currencies is however likely to hamper the revival of investment activity. Grave deviations from the objectives of economic policy are still to be seen.

Slower Expansion in the USA

The upswing in the USA is continuing although the pace of expansion has slowed. The number of gainfully employed persons went on rising strongly; the unemployment rate declined. The price trend has turned; the increased costs falling on enterprises seem to have played an important role in this respect. The quickening of the money supply expansion reinforced the inflationary expectations. The financial policy imparted impulses to the upswing right to the end of the period. After the small output increase due to adverse weather in the first quarter of 1978 production will probably at first be stepped up substantially. Later this year the pace of expansion is likely to ease. The growth rate of the real gross national product will be about 4% in 1978 (1977: 4.9%).

Slight Recovery in Japan

After the slackening of the expansion rate in Japan up to the autumn of 1977 the real national product has risen once again more strongly. Private consumption, public investments and house-building reflected the recovery. The foreign trade on the other hand provided no longer any expansionary impulses. Similar to 1977, the economic

development will this year be supported by public sector demand. The real national product may be expected to increase on the annual average by about 5% (1977: 5.1%); this implies an at best slight rise of capacity utilization. The increase of consumer prices may be at an annual average of 4% (after 8% in 1977).

Gradual Improvement in Western Europe

After a marked period of weakness production in most countries of Western Europe rose slightly in the six months' period from October to March. The improving trend is to be attributed chiefly to the more expansive direction of economic policies once more in evidence since the middle of 1977. It is reflected by a brisker expansion of private consumption and less restraint in inventory engagements. That the unemployment did not increase any further is to be attributed essentially to labour market policy measures. The price rise has been slowing continually since last summer. Given the present economic policy parameters, the recovery of domestic demand is likely to continue through 1978, especially in the large countries of Western Europe. In 1978 the expected 2.5% increase of the national product will be only slightly above the 1977 rate (of about 2%). The consumer prices will rise by over 7%, which is much less than the 1977 rate (of nearly 10%).

The crucial question at this juncture is whether the uptrend observed in the Western industrialized countries in the six months from October to March will turn into a lasting upswing which is sustained by increased investment activity. Our forecast is based on the assumption that most industrialized countries will in the current year continue along the more or less expansive course of financial policy set by their budget plans. It is

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.

also assumed that there will be some easing-off of the monetary expansion to ensure a steadier development in the future. Given these preconditions the economic trend is likely to go on improving in Japan and Western Europe while in the USA the expansion may be expected to slow down further. The current account deficit of the USA will probably not show any further significant increase as the trend differential between the USA on the one hand and Western Europe and Japan on the other is likely to narrow and the rise of US oil imports will probably subside. If more attention is paid to stability in US economic policy, which may be expected, it will be easier to finance this deficit through capital inflows. There are thus signs of improved preconditions for an easing of the turbulences around the dollar.

The Situation in the Federal Republic

The economy of the Federal Republic of Germany is in a state of marked unsteadiness. About the end of last year its overall production evidenced a recovery but this phase did not last long. Capacity utilization has therefore remained at a low level, and there has been little demand for more labour. That some areas are short of skilled workers is not inconsistent with this finding. The fact that unemployment did not rise although the domestic labour supply did is to be attributed chiefly to the temporary or final retirement of many workers from gainful employment. The unemployment is bearing more and more heavily on women.

The equipment investments have so far failed to attain the hoped-for break-through leading to an upturn in other areas. The demand for equipment goods which had slackened in the summer showed a distinct recovery towards the end of last year but the improvement was short-lived and stemmed from a few areas only, amongst them – in addition to the motor industry – the building trade, which benefited from stimulatory programmes, and agriculture. There was a greater demand for office machines and data processing equipment in particular, beside building and agricultural machines and machine tools. The building investments – only temporarily hampered by exceptionally bad weather – increased in recent months once more significantly under the impact of larger public contracts and tax concessions. Substantially larger orders were received for building work, especially from public sector customers for underground and ground-level work which have shown a steady increase since the spring of 1977. There has also been a distinct upturn in orders for residential buildings. Com-

mercial and industrial firms on the other hand still showed little inclination to place construction contracts.

Moderate Expansion of Exports

The export of goods was exposed to special influences of a particular nature so that it increased inordinately in the final quarter of 1977 and declined in the first months of the current year. This happened because of anticipatory purchases by foreign buyers induced by the raising of the value-added tax on higher-value goods in Austria (luxury tax), by strike fears and by unease about import restrictions and impediments. The expectation of further D-Mark appreciation may also have played a part. Over the half-year as a whole exports expanded at a moderate pace. The growth of imports has slackened in recent months.

After the upsurge of private consumption last summer which resulted from the release of large amounts of bonus-attracting savings there was at first no further improvement. In recent months however consumption has been increasing again in line with incomes. Private households were especially interested in motor cars and travel. The registration of ex-factory vehicles which had been stagnating well into 1977 revived about the end of the year. Holidays abroad became increasingly attractive because the appreciation of the D-Mark kept the rise in their cost down compared with holidays in the Federal Republic. The prices experienced a surprisingly moderate up-drift, in considerable measure because of the D-Mark's higher value. At the retail level prices rose in October 1977 – March 1978 at a current annual rate of 2.5%.

Outlook: Growth Rate Unsatisfactory

After the very feeble rise in the first months of 1978 the overall production of the economy will once more increase significantly but the expansion will be rather muted. The overall capacity utilization rate is not likely to go up much. The real gross national product will increase by about 2.5% only on the annual average. The imports will probably rise at more than twice this rate in real terms, partly owing to the D-Mark's appreciation. The exports of goods in real terms will increase only gradually over the remainder of the year, to go by the tardy improvement of foreign demand. The persisting cyclical recovery in important West European countries will certainly make for a greater demand for German export goods but the D-Mark appreciation will probably act as a brake. Effects of exchange rate variations

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

Estimates for the Year 1978

	1976	1977	1978	1977		1978	
		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	- 0.9	- 0.4	- 0.5	- 0.2	- 0.7	- 0.5	0
Working time (per working day)	0.3	- 0.4	- 0.5	0.2	- 1.0	- 0.5	0
Working days	0.7	- 0.3	0	- 0.3	- 0.3	0.5	- 0.5
Total work done, per calendar month	0.1	- 1.1	- 1	- 0.3	- 2.0	- 1	- 1
Productivity	5.5	3.7	3.5	3.4	4.2	3.5	3.5
Gross Domestic Product	5.6	2.6	2.5	3.1	2.1	2.5	3

2. Appropriation of the National Product — at current prices — Change in p.c. compared with the preceding year

Private consumption	8.2	6.9	6	6.5	7.3	7	5.5
Government consumption	5.7	5.6	7	4.8	6.3	6.5	7
Investment in fixed assets	8.5	6.4	8.5	7.9	5.2	7	10
Equipment	11.1	7.7	7	6.9	8.4	7.5	7
Buildings	7.0	5.6	9.5	8.5	3.2	6.5	12
Exports	14.1	5.7	5	7.0	4.4	5	5
Imports	16.3	6.5	5	8.5	4.6	4.5	5
Gross National Product	9.1	6.2	6.5	6.3	6.1	6.5	6.5

— at prices of 1970 — Change in p.c. compared with the preceding year

Private consumption	3.6	2.9	3	2.5	3.3	3.5	2
Government consumption	2.4	0.7	3	- 0.0	1.4	3	3
Investment in fixed assets	5.0	2.7	4	4.0	1.6	2.5	5.5
Equipment	7.2	4.4	4.5	3.1	5.5	5	4
Buildings	3.7	1.6	4	4.6	- 1.0	1	6.5
Exports	11.1	4.2	4	5.0	3.4	4.5	3.5
Imports	10.6	4.2	5.5	4.4	4.0	7	4
Gross National Product	5.7	2.4	2.5	2.9	2.0	2.5	3

3. Price Level of National Expenditure (1970 = 100) Change in p.c. compared with the preceding year

Private consumption	4.5	3.9	3	3.9	3.8	3	3
Government consumption	3.2	4.8	4	4.8	4.8	3.5	4
Equipment	3.6	3.1	2.5	3.7	2.7	2.5	2.5
Buildings	3.2	4.0	5	3.7	4.2	5	5
Exports	2.7	1.4	1	1.9	1.0	0.5	1.5
Imports	5.1	2.2	- 1	4.0	0.6	- 2.5	1
Gross National Product	3.2	3.7	4	3.3	4.0	4	3.5

Origin and Distribution of Income Change in p.c. compared with the preceding year

Gross income from waged work	7.0	7.0	6	7.7	6.3	6	6
Gross wage and salary total	6.5	7.0	6	7.6	6.4	6	6
ditto per employed person	7.0	6.9	6	7.2	6.7	6	5.5
Net wage and salary total	3.8	5.8	6.5	5.9	5.7	7	6.5
Gross income from entrepreneurship and property	15.6	3.1	7	1.5	4.4	7	7
Net income from entrepreneurship and property	13.4	- 1.4	11.5	- 5.4	1.8	11.5	11
Disposable income of private households	6.5	5.8	6.5	6.5	5.2	7	6

tend to show up late, as all experience shows. The D-Mark appreciation will be felt most acutely in fields where price is the determinant competitive factor and delivery terms are short.

Investment Activity Inadequate

The decline of the orders for investment goods after the turn of the year was not merely a reflection of an earlier excessive increase due to the placing of big contracts but an indication of fresh uncertainties among investors. This is shown especially clearly by the fact that the demand has eased also in the mechanical engineering and electrical trades where the order intake had not previously been helped by special factors. Concern about growing export difficulties and mounting import competition as well as the climate of social tension indicated by the tough wage negotiations are probably the principal causes of this new uncertainty among investors. The tax incentives for investments adopted last year will certainly have less effect than they would have had in the absence of such disturbing factors. Nevertheless there are good grounds to expect a further — albeit inadequate — rise of investment activity. The expansionary influence of financial and monetary policy will definitely work through to the building investments. Public sector and residential building will expand most markedly; but commercial and industrial construction work will also be stimulated by the state programme for future investments.

The disposable incomes of private households will increase, at first at a faster pace, but after the middle of the year at a markedly slower rate. The early speed-up will result from back-pay-

ments under delayed wage settlements in important industries. The subsequent slow-down will be more pronounced because of the decision last year to postpone the next increase of social insurance pensions. These time variations will not however effect private consumption in full measure. To judge from experience, the disbursement of the wage and salary back-payments will be delayed in part. The development of incomes seen as a whole is not unfavourable and the climate for consumption is if anything favourable, so that private consumption may be expected to remain a sustaining factor. The conditions for price stability will if anything worsen. The D-Mark appreciation will certainly have a damping effect on prices for several more months but be felt much less acutely later on.

No Relief for the Labour Market

The expected overall development in the economy will this year again bring no relief to the labour market. Even a somewhat bigger increase of the national product than assumed here could be accomplished with the available manpower. The increase of the domestic labour supply through demographic causes — by about 60,000 workers in 1978 — will put an extra burden on the labour market. The number of unemployed is nevertheless unlikely to go up because workers will continue to retire from gainful employment in considerable numbers; some will for a while desist from looking for jobs while others will make use of the possibility of drawing their social insurance pension earlier. The number of foreign workers will also decline again, though relatively little, through migration.

NEW PUBLICATION

Arnt Spandau

WIRTSCHAFTSBOYKOTT GEGEN SÜDAFRIKA

(Economic Boycott of South Africa)

The overall economic effects of a hypothetical economic boycott of South Africa are clarified in this study by means of a 52-pole input-output model. The calculations deal with the consequences of a boycott for incomes, employment and balance of payments. The author sums up that an investment boycott would cause relatively negligible damage to the South African economy, while a boycott of exports would certainly stop the growth of the economy in the short run. In medium and short term, however, considerable adaptations were to be expected which would lead to an autarchic orientation in South Africa. (In German.)

Large octavo, 140 pages, 1977, price paperbound DM 24,60

ISBN 0-7021-0861-8

JUTA AND COMPANY LIMITED, KAPSTADT, WETTON, JOHANNESBURG

Sales Agent for the Federal Republic of Germany: Verlag Weltarchiv GmbH, Hamburg