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Situation and prospects of the world economy

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ECONOMIC TRENDS

Situation and Prospects of the World Economy

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.

In the industrialized Western countries the cyclical expansion persisted through the summer half year of 1978. In the USA the upswing was still continuing – albeit at a slower pace – while in Japan and Western Europe the recovery tendencies endured, and the international cyclical differentials have thus started to abate. This process has been furthered by economic policy developments. The prospects for the success of policies to bolster economic activity have improved in Japan and Western Europe in that the updrift of prices and costs has, viewed as a whole, eased notably. Added to this, the current accounts of the weak currency countries have improved.

USA

In the USA where the real gross national product had stagnated owing to adverse weather and strikes production rose very rapidly indeed in the spring of 1978. The expansion then continued at a more moderate pace. Distrust of the dollar was fueled by what was on the whole an inconclusive economic policy and by increased inflationary expectations, with the result that the dollar continued to depreciate in the summer months even though the current account deficit had already subsided perceptibly. In view of the faster rise of prices it can probably be assumed that US economic policy will be steered along a more definitely anti-inflationary course. The real gross national product may be expected to increase in the annual average by about 3% in 1979, against just under 4% in the current year. Prices will continue to rise strongly.

Japan

After strongly accelerating early in 1978 the cyclical expansion in Japan has slowed slightly due to a decline in real terms of the exports since the spring. The sharp rise of the yen and self-restrictions on exports contributed to the decline. The domestic demand has been rising faster owing to stimulatory measures by the Government. The expansion may be expected to con-

tinue despite the dampened export prospects. The comprehensive economic programme adopted in September will give a fresh stimulus to domestic demand. As already announced, the Government will probably take further economic measures if the expansionary forces weaken. The real national product may be expected to rise in 1979 at a rate not significantly lower than the 6% attained this year.

Western Europe

After a temporary levelling-off of production in the spring the cyclical upswing tendencies in Western Europe have come into their own again. The conditions for a further cyclical upsurge have been improved by the marked easing of the price updrift, a deceleration of wage rises in most countries and the abatement of the external economic difficulties of important countries. The budget figures for 1979 indicate that most Governments want to keep to a cautiously expansive financial course. Against this background the cyclical recovery in Western Europe may be expected to last through 1979. Real national products may rise by 3–3½% on average.

World Trade

Allowing for cyclical developments in important world trading regions and the large and abrupt increase early this year, the world trade seems set to show a volume increase of about 5% in the annual average of 1978. If the world economy develops as forecast, the world trade will probably grow by 5–6%. The imports and exports of the industrialized countries are likely to increase at the same rate as the world trade, the imports of the OPEC countries slightly above the average, and those of the state trading countries and the non-oil producing developing countries at a lower rate – about 4%.

¹ The participating institutes are: Deutsches Institut für Wirtschaftsforschung, Berlin; HWWA-Institut für Wirtschaftsforschung-Hamburg; Ifo-Institut für Wirtschaftsforschung, Munich; Institut für Weltwirtschaft, University of Kiel; and Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Essen.

The continuing predilection for protectionist measures is still hampering growth in the world economy. The GATT negotiations (Tokyo round) are at a critical stage. Not only would it probably prove impossible to remove more trade barriers if the negotiations fail but the — in any case strong and in part often successful — efforts to retreat from the so far achieved degree of liberalization would receive a fresh stimulus. The harm done thereby to world trade expansion may be of little significance in any one year but its repercussions over the medium term will significantly impair the conditions for growth in the world economy and therefore also obstruct a recovery of investment propensity.

Federal Republic of Germany

The economy of the Federal Republic of Germany is cyclically in a recovery phase. The increase of production in the summer was more than a reversal of the retrogressive development in the early months of this year to which adverse weather conditions, output losses in consequence of strikes and lock-outs and the unease about the prospects engendered by the turbulence of the foreign exchanges had contributed. In part it was an outcome of the economic measures by the Government to foster economic growth. The subsidence of the monetary turmoil and the expansion of foreign demand for German products lessened the impact of a major obstacle to an upswing. The chances for the success of the economic policy aimed at stimulating domestic demand have therefore improved.

The labour market situation has so far failed to improve noticeably. The number of unemployed is — seasonally adjusted — unchanged at about 1,000,000 although the number of persons in employment has increased slightly.

Prices are rising at a slower pace, not least because of favourable special influences. In September consumer prices were only 2.2 % higher than 12 months earlier.

Impulses from Private Consumption

Private household incomes rose quickly in the summer half year — at an annualized rate of 6 %. As a result of tax cuts, the net earnings from wages and salaries increased by about one percentage point more than the corresponding gross incomes. Private consumption advanced at about the same pace as disposable incomes but expanded slightly faster in real terms because the rise of consumer prices has been slowing down. In view of the persisting growth of private con-

sumption producers are entertaining greater sales expectations.

The basic volume trend of exports is certainly pointing upwards although the demand from abroad is vacillating sharply; in the summer half year it rose at an annual rate of 4–5 %. The various categories of goods showed however marked differences: the exports of primary materials and producer goods advanced strongly, and those of consumer goods were also better; investment goods exports on the other hand declined until mid-1978 and have not recovered since. The strong rise of imports was sustained by finished manufactures while those of intermediate industrial products were slightly lower in consequence of cautious inventory dispositions in the face of a slowly rising industrial production.

Strong Advance of Building Investments

The building investments have been advancing strongly in all sections since the spring. The increase was most marked in public construction work which derived great benefit this year from the Future Investments Programme contracts which have been placed with all speed since the autumn of 1977. In the first seven months of this year the number of residential building licences were 20 % higher than last year and the new contracts placed showed 28 % increase. While the demand for one- and two-family houses has been rising less markedly, houses for occupation by several families encountered a much larger demand. The licences for non-residential buildings went up by 15 % and the new contracts in this field — adjusted for price changes — by 7 %. Fitting-out investments have probably been increasing once more since the middle of the year. The domestic producers of investment goods have increased their deliveries; this now also holds good for the mechanical engineering and electro-technical industries.

Since the middle of 1978 expansionary forces, arising chiefly from the diverse Government measures to boost economic activity, have been dominant in the economy of the Federal Republic; the impulses derived from foreign demand are much weaker. The dispositions in industry and trade are so far indicating no strong expansive orientation either in plant investments or in inventory accumulation: significant self-reinforcing tendencies are as yet absent. The substantial improvement in business expectations suggests however that the self-reinforcing factors may strengthen in the course of next year. Incomes will rise again appreciably in 1979. The taxation policy will bring further relief; social insurance pensions and child allowances will go up once more. In view of the

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

Estimates for the Second Halfyear 1978 and the Year 1979

	1977	1978	1979	1978		1979	
	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	0	0.5	0	0	0.5	0.5
Working time (per working day)	- 0.4	- 0.5	- 0	- 0.9	0	0	- 0.5
Working days	- 0.3	- 0	- 0	0.3	- 0.5	- 0	- 0
Total work done, per calendar month	- 1.0	- 0.5	0	- 0.6	- 0.5	0.5	- 0
Productivity	3.8	3.5	3.5	3.2	4	4	3
Gross Domestic Product	2.8	3	4	2.6	3.5	4.5	3

2. Appropriation of the National Product

- at current prices -

Change in p.c. compared with the preceding year

Private consumption	7.0	6	7	6.9	5.5	6.5	7
Government consumption	5.6	6.5	6.5	4.9	8	7.5	5.5
Investment in fixed assets	7.6	9.5	11	8.1	10.5	12	10.5
Equipment	10.2	7	9.5	8.9	5.5	9	10
Buildings	6.0	11	12.5	7.6	14	14.5	10.5
Exports	5.6	5	8	5.0	5	8	7.5
Imports	6.5	3	9	2.7	3.5	8	10.5
Gross National Product	6.3	7	7.5	6.7	7.5	8.5	7

- at prices of 1970 -

Change in p.c. compared with the preceding year

Private consumption	3.1	3.5	3.5	4.0	3	4	3
Government consumption	1.0	3	2.5	2.9	3.5	2.5	2.5
Investment in fixed assets	4.1	4.5	5.5	4.0	5.5	6.5	4.5
Equipment	7.7	5	6	7.0	3	5.5	6.5
Buildings	1.7	4.5	5	2.0	7	6.5	3.5
Exports	3.9	4	6	4.3	4	6	5.5
Imports	4.3	5	6.5	6.0	4	6	7
Gross National Product	2.6	3	4	2.8	3.5	4.5	3

3. Price Level of National Expenditure (1970 = 100)

Change in p.c. compared with the preceding year

Private consumption	3.8	2.5	3.5	2.8	2.5	3	4
Government consumption	4.6	3.5	4	1.9	4.5	5	3
Equipment	2.2	2	3	1.8	2.5	3	3.5
Buildings	4.2	6	7	5.4	6.5	7	7
Exports	1.6	1	2	0.6	1	1.5	2
Imports	2.1	- 2	2.5	- 3.1	- 1	1.5	3
Gross National Product	3.6	4	3.5	3.8	4	3.5	3.5

Origin and Distribution of Income

Change in p.c. compared with the preceding year

Gross income from wagework	7.1	6	7	5.8	6	7.5	6.5
Gross wage and salary total	7.0	5.5	6.5	5.3	6	7	6.5
ditto per employed person	6.9	5.5	6	5.1	6	6.5	5.5
Net wage and salary total	5.8	6.5	7	6.0	7	7.5	7
Gross income from entrepreneurship and property	3.5	8.5	9.5	6.5	10	13	7
Net income from entrepreneurship and property	- 0.7	11	13	7.7	13	18	9
Disposable income of private households	5.9	6	7	6.3	6	7	6.5

favourable climate for consumption it is to be expected that the savings ratio will stay as low as in 1978. The real level of private consumption will rise fairly steadily and strongly – by about 3½ %. With more apartments and owner-occupied houses being completed, the trade in household goods, furniture and furnishings will benefit more than hitherto.

The advance of equipment investments will continue in 1979. Indications for this are the improvement of general conditions and the strikingly more favourable business climate. A rise in equipment investments in real terms – probably on a somewhat larger scale than this year – is to be expected according to Ifo investment test findings. The uptrend would still be as subdued as it has been – with at times wide fluctuations – since the end of the 1974/75 recession. Capacity extension investments will probably carry a little more weight than hitherto. The building activity will again be one of the motive forces for the cyclical upswing next year, not only because a large order stock has been accumulated but because important data such as the development of private household incomes and interest rates continue to favour it. There is an especially large demand overhang in residential building; the bunching of the public-sector demand for construction work will be slightly eased by the customers' intention to spin out orders and put off completions. The increase of building activity will be limited before long by shortage of labour, especially skilled workers.

Export Rising in Line with World Trade

The increase of exports will be determined chiefly by the restrained expansion of the world economy. The appreciation of the Deutschmark will have a very limited effect only as, viewed over a somewhat longer period, it has not gone very far in real terms. A significant real appreciation and a consequent worsening of the competitive position

can be noted in relation to the dollar area but hardly anywhere else; in the West European markets which are of much greater importance for the Federal Republic it is much less evident. In real terms exports will increase more or less in line with the expansion rate of world trade – at an ongoing annual rate of about 6%. The exports to Western Europe will rise slightly more than this year while those to the USA will ease off, not least because of the cyclical slow-down in this region. Imports will once again increase at an appreciably higher rate than the national product in the Federal Republic and also more than exports. Strong impulses will thus still be imparted to the production of the trading partners of the Federal Republic.

Slight Increase of Employment

The real national product will rise by about 4 % next year, against 3–3½ % this year. Employers, it may be assumed, will be slightly more ready to take on labour, especially in the fields closely related to the building industry. Recruitment of additional labour will therefore increase, especially in the artisan field. The number of wage- and salary-earners may rise by something like 100,000. Average unemployment throughout the year will as a result, for the first time in four years, fall significantly below the million mark. Prices at the consumer level will rise at an appreciably higher ongoing rate than in 1978. A number of factors which had hitherto a moderating effect on price advances will prove less important in the future. The phase of exceptional restraint in raising administered prices will end: motor vehicle insurance premiums, postal charges and radio and television fees will go up at the beginning of 1979, the relief from cheapened imports is likely to wear off, and the VAT rates will be raised at the middle of the year. The consumer prices which rose by a good 2½ % in 1978 will be about 3½ % higher in the annual average.

Index Numbers of World Market Prices of Foodstuffs and Industrial Raw Materials

Index and commodity group	1977	1978					
	October	January	April	July	October	Nov. 3	Nov. 17
HWWA-Index * (1952–1956 = 100)	304.1	317.5	313.6	310.2	334.1	335.9	333.5
Fuels	237.1	264.0	256.7	229.8	254.8	255.4	249.6
Raw materials for consumer goods ..	336.4	343.3	341.1	348.9	372.3	374.7	374.0
Fuels	550.9	563.5	558.3	557.5	564.8	564.0	566.7
Raw materials for consumer goods ..	180.2	180.1	181.9	191.2	210.3	211.8	209.5
Raw materials for capital goods	226.6	232.8	230.8	246.2	288.7	295.0	291.8
Reuter's Index (18. 9. 1931 = 100)	1,491.9	1,412.5	1,444.7	1,436.1	1,517.4	1,531.6	1,508.9
Moody's Index (31. 12. 1931 = 100)	824.3	893.5	903.2	914.2	974.9	983.5	971.8

* Index compiled by HWWA-Institut für Wirtschaftsforschung-Hamburg. On Dollar-basis.