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Germany: Economic Prospects Remain Bright

The repercussions of the changes in Iran on German-Iranian economic relations and the international oil market call for a re-appraisal of the economic prospects in the Federal Republic. At the moment it is as yet impossible to do more than assess tendencies in the light of the statements of intent by the new Iranian Government and the — no less important — material constraints experienced by Iran. In the last two years Iran absorbed only a little under 2.5 % of the German exports; mechanical engineering accounted for 31 % of the deliveries in 1977, followed by the electrotechnical industry with 16 %, vehicles 14 %, chemicals 9 % and steel construction 7 %; besides, the German construction industry did a great deal of work in Iran. The Federal Republic drew c. 18 % of its oil from Iran — more than from any other country — while the OECD countries received on average c. 15 % of their oil imports from Iran. This does not mean that the risk to oil supplies is greater in the Federal Republic than in the other countries — the supply problem has to be seen in the context of the world market as a whole.

It is generally expected that when conditions have been normalized Iran's imports will not be restored to the former level. But the country will still depend upon large imports and therefore have to export oil on a substantial scale in order to cover its foreign currency requirements. Considerable changes are likely to occur in the pattern of imports — for the Federal Republic for instance because deliveries connected with the

erection of nuclear power stations will play a much smaller role in the future. In the current year German exports to Iran will no doubt be substantially lower than last year, and this by itself would reduce the anticipated growth rate of total exports by something like one percentage point. The shortfall will however be offset at least in part by larger than expected export gains elsewhere, especially in West European countries. In important customer countries the economic trend is more favourable than assumed only a few months ago. Even allowing for repercussions by way of third countries, the "Iran effect" does not necessitate a significant downward revision of export projections for the Federal Republic.

No major supply problem would have arisen in the short term even if the stoppage of Iranian oil shipments had continued because other oil countries have made up part of the shortfall and the oil importing countries dispose of ample stocks. The new Iranian Government has exerted itself to resume oil production and exports quickly. It is at present difficult to judge how quickly and extensively these efforts will bear fruit; the reports have been contradictory. For the time being there is no reason to fear that economic developments in the Federal Republic will be hampered later this year by an insufficiency of oil supplies. But it is fairly certain that the effects of the change in the oil market scene already in evidence will be prolonged although the excessive oscillations of product prices due to the cold weather are likely to abate. The market

situation will probably remain such as to allow of steeper price rises than decided on by the OPEC but the price hoist has been so much smaller than in 1973/74 that fears of similar consequences as at that time would be unwarranted.

To what extent new uncertainties such as emerged recently as a result of the events in Iran will affect business dispositions depends essentially upon the overall demand which betokens strengthened expectations of an upsurge. This is another reason why the "Iran effect" is unlikely to carry much weight generally — provided that oil supplies remain adequate. The internal conditions bearing on the economic trend have if anything improved since the start of this year, not least because of the course and outcome of the negotiations in the metal-using industry which will probably set the trend for the 1979 round of wage bargaining. It may now be taken for granted that economic growth and employment will not be impaired this year from the side of wage policy; wage unit costs are likely to rise, in line with previous forecasts, at a moderate rate similar to last year's. In view of the difficult structural and employment problems the fresh evidence for an abiding basic consensus on the role of wage policy will be of importance beyond the current year.

General Outlook

The favourable influence on business expectations is especially important for the propensity to invest. The latter has improved further as is shown by the investment intentions as well as investment goods orders. The trend must be viewed against the background of a notably large increase — for a full two years — in equipment investments, which are essen-

tially investments by business enterprises. The larger price increases for mineral oils and other raw materials add to the importance of the efforts to slow down the money supply expansion. Taking an overall view, the economic prospects have not worsened as a result of events in recent months. Forecasts for the economic trend in 1979 can still be based on the quantified projections presented at the end of last year.

Expansion of German Exports

The brisk expansion of economic activity in the industrial countries was also reflected in the German exporters' order books; orders from abroad showed a further increase. The speed of the current expansion is however overstated due to a heavy order in December; the steep decline in orders in January has probably to be judged against this background. In the fourth quarter of 1978 the exports of goods, in real terms and adjusted for seasonal variation, have undergone a further increase over the preceding quarter. This was mainly due to larger deliveries to the EC countries. The basic and producer goods industries achieved another vigorous expansion of their exports; until the end of the year the labour dispute in the steel industry had no significant effect on exports. While in the second half of 1978 export prices had hardly risen any more, there were some heavier increases at the beginning of 1979.

Faster Increase of Imports

During the last months of 1978 the expansion of goods imports in real terms accelerated once again. The fact that their growth exceeded by far the one of production may be taken as an indication of a more expansive inventory policy of the enterprises. Stimuli of this kind played a part not only with industrial primary

products, but with final products, particularly consumer goods; the latter were imported on an increasing scale during the last months of 1978. The abrupt rise of imports of capital goods is certainly mainly a reaction to the decline during the summer months. Last November, when the US-Dollar became stabilised vis-à-vis the Deutschemmark and thus an important price-curbing factor no longer existed, import prices began to rise again. The substantial increase in import prices registered at the beginning of the year 1979 reflects not least the price rises for raw materials.

The heavy revaluations of the Deutschemmark which occurred in the winter half year 1977/78 and in the autumn of 1978 impaired the international competitiveness of the German economy only to a limited extent. Between September 1977 and February 1979 the value of the Deutschemmark increased by 10.7% vis-à-vis the foreign currencies quoted in Frankfurt. However, the rise of the real exchange rate — i.e. the effective exchange rate adjusted for divergencies in the price and cost trends as compared with other countries — was much smaller than the increase of the effective external value. Consequently, the deterioration of the international competitive position which had resulted from the revaluation in the winter half year 1977/78 was, in terms of relative prices, largely compensated for already in the last summer. The renewed increase of the exchange value of the Deutschemmark, however, led again to a slight deterioration; the statistical data for this period are not yet complete. The international competitiveness was weakened substantially vis-à-vis the US and Canada and slightly vis-à-vis the West European countries; vis-à-vis Japan the German competitiveness even showed a significant improvement.

The international competitive position is only one among several determinants of exports. True, regression computations with demand components and indicators of competitiveness (allowing for seasonal components and a trend factor) confirmed its influence. At the same time, however, these computations indicated that the effect of a cyclically induced change of demand is markedly larger than that of a change of price competitiveness. Furthermore, the findings support the supposition that the latter factor is reflected in the orders from abroad with a noticeable delay; exports are affected even later. Obviously, in the short term, a relative increase in German export prices does not provoke any significant reactions of customers abroad. Thus it is not necessary for German exporters to react to every temporary revaluation of the Deutschemmark by lowering their prices. At the same time this leaves exporters a certain adjustment period in cases of lasting changes.

Forecast

Possible current account problems of the oil-importing countries as a consequence of markedly higher expenses for oil are not likely to affect the business cycle and world trade already this year. Thus it can still be expected that the year 1979 will be characterised by an altogether moderate cyclical expansion and a slight increase of investment activity in the industrialised countries. The German economy will benefit from the stronger expansion in Western Europe while the cyclical slowdown anticipated for the US will, because of the United States' relatively low share in exports, be of smaller importance. Adjusted for price, total exports are expected to rise by around 6% in 1979 (1978: 5.1%, in prices of 1970).

Goods imports are mainly determined by cyclical developments in the Federal Republic. Imports of industrial primary products will continue getting impulses from arrangements for carrying stocks apart from the expansion of production. Imports of final products are being favoured by the rising expenditure on consumption and the

strong increase in investment activity. In the aggregate goods imports adjusted for price will exceed the previous year's results by about 8.5% (1978: 8.1%, price basis 1970 in each case). This will initiate again considerable production incentives for the Federal Republic's trade partners.

of the wage conflicts: The money supply (M3) is to expand by 8 to 12% until mid-October (comparison with a year earlier). The monetary policy has certainly contributed to the stability of the exchange rate of the pound on the foreign exchange markets and thus could so far prevent that an enhancement of the price increases came about in an interplay with devaluation effects.

Great Britain: Wage Increases Endangering Growth

In Great Britain the cyclical development is once again being impaired by the wage trend. The wage demands which since December have been urged by extensive strikes do not show any more orientation towards economic criteria than the wage agreements of the last months. This fact is all the more remarkable as the increase in consumer prices at the end of 1978 was by 4 percentage points lower than a year ago and the unemployment ratio remained quite high at 5.5%.

A rise in real wages of 5 to 6% resulted on an average for the past year. This contributed to a noticeable stimulation of private consumption and thus total demand. The profit situation of enterprises did not deteriorate to any significant extent, mainly because the terms of trade improved conspicuously vis-à-vis 1977. Therefore industrial investments continued rising until mid-1978. A considerable part of the additional demand was however covered by imported goods. Excluding energy imports, which owing to the increasing mineral oil output in the North Sea declined by about 2.5%, the volume of imports (according to the classification of foreign trade statistics) rose by 9%.

With increasing duration the strong upward tendency of wages became more and more

an encumbrance for cyclical expansion. Adjusted for seasonal variation industrial investments did not rise any more after mid-year and even private consumption remained in the fourth quarter at the level of the preceding quarter. At present it cannot yet be clearly discerned whether the simultaneous reduction of industrial production is to be traced back to the strikes alone or already to declining cyclical impulses. In any case the prospects for the further economic development have become less favourable again.

For 1979 effective wage increases of about 15% are indicated on an annual average. An acceleration of the upward trend of prices — primarily induced by the increase in wages — can therefore hardly be avoided. The "concordate" recently concluded between Government and trade unions provides *inter alia* for a reduction of the price increase to 5% in the framework of a kind of "concerted action" within three years, but statements on the current general wage-increase are not included. The effectiveness of monetary policy, directed towards stabilisation for about one year already, remains limited under these circumstances. For this year, too, last November a continuation of the course of stabilisation was announced before the outbreak

In 1979 the increase in real wages will be noticeably smaller than in 1978. Consumption in real terms will therefore rise considerably more slowly than in the past year. Industrial investments, too, will, if at all, expand only slowly; this is indicated by a poll of the Ministry for Industries closed by mid-December. In conformity with the medium-term planning, an expansion in real terms of only 2% is to be expected for public expenditure. Exports — as world trade — will probably grow somewhat more than last year. In 1979 the growth of GNP should reach about 2 to 2.5%, one third of it due to the expected strong increase of the mineral oil output in the North Sea which will lead to a substantial reduction of oil imports. Total imports will therefore rise only moderately. The current account will again register a surplus.

In spite of the slowing down of demand and production and the probably again rising unemployment, there is no alternative to a restrictive course for an economic policy looking beyond the immediate future. In view of this year's parliamentary election it is however possible that economic policy will nevertheless yield to inflationary pressures. With that, growth and employment could be supported, if at all, only in the short-term. Soon already the economic dilemma would grow all the more — not least due to the anticipated tendency towards devaluation.