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The Economic Situation in the Federal Republic of Germany

In its latest joint assessment of the economic situation the Association of German Economic Research Institutes reaches the following conclusions, which are presented here in an abridged form¹.

Demand and production have stayed until very recently on their upward course – despite the external impediments, which have been mounting during the last twelve months, and much higher interest charges. In the first two months of 1980 exports and new orders from abroad rose considerably; in the second half of last year they had gone up only slightly. A major contributing factor was probably the anticipation of hefty price increases due to the further rise of the oil prices and to the political tension in the world. With import prices much higher, the terms of trade worsened further in the winter half year. This caused a further contraction of the nominal trade surplus although the visible trade early this year yielded an appreciably higher surplus in real terms.

Surprisingly great was the expansion of the purchases by private households at the beginning of this year. Since the incomes rose relatively little and prices advanced faster, this entailed a distinctly lower savings ratio. Concern about impending big price advances is probably the cause. Consumers made some purchases earlier than normal and also made up for the postponement of purchases under the impact of high fuel charges last autumn, as is evidenced by the durable consumer goods purchases of which had fallen off but recovered after the turn of the year. A lasting decline of the propensity to save cannot be inferred from this change.

The investments in plant and equipment continue to present a stable element in the current phase of the business cycle; they show a marked uptrend. Process and product innovations designed to improve the investors' competitive position have been a dominant feature of the investment activities for some time. Impulses emanating from the high cost of energy are of increasing importance. The demand for building work

reached a climax a year ago and has tended to fall off since. The demand for residential building has stayed at a high level. Having to choose between higher interest charges now or higher builder's prices later, many placers of building orders presumably decided against postponing their building projects and even brought them forward. A growing proportion of the building work in recent years has been for modernization and energy conservation. As far as non-residential building is concerned, the demand for overground work has eased meanwhile but the civil engineering orders from industry are still rising uninterruptedly. In real terms the building investments showed – seasonally adjusted – a further definite advance in the autumn and winter, to some extent because of the well-filled order books.

Higher Number of Employed Persons

Overall production advanced at a slightly lower rate although the final demand continued to increase substantially in the winter half year; it follows that part of the demand was met from inventories. The number of wage- and salary-earners increased no less than before but the labour market situation did not improve significantly. There were evidently only just enough additional jobs to absorb the extra labour coming on the market. The price climate has deteriorated further, mainly because of another sharp price rise for crude oil and other industrial raw materials. These did not only hit the consumer directly – this time chiefly by way of dearer motor fuels – but added noticeably to the cost of many other goods and services.

¹ Participating institutes: Deutsches Institut für Wirtschaftsforschung, Berlin; HWWA-Institut für Wirtschaftsforschung, Hamburg; Ifo-Institut für Wirtschaftsforschung, Munich; Institut für Weltwirtschaft an der Universität Kiel; Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Essen. The Institut für Weltwirtschaft takes in its minority report a less favourable view.

ECONOMIC TRENDS

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

Forecast for the Year 1980

	1978 ¹	1979 ¹	1980 ²	1979		1980	
	Years			1. hf. yr. ¹	2. hf. yr. ¹	1. hf. yr. ²	2. hf. yr. ²
1. Origin of National Product, in real terms							
Change in % compared with the preceding year							
Number of employed	0.8	1.3	0.5	1.2	1.3	1	0.5
Working time (per working day)	-0.6	-0.4	-1	-0.4	-0.4	-0.5	-1.5
Working days ³	-0.2	-0.1	0	-0.1	-0.1	-0.5	0.5
Total work done, per calendar month	0	0.8	-0	0.7	0.8	0.5	-0.5
Productivity ⁴	3.2	3.6	2.5	3.8	3.5	3.5	2
Gross Domestic Product	3.2	4.4	2.5	4.5	4.3	4	1.5
2. Appropriation of the National Product							
- at current prices -							
Change in % compared with the preceding year							
Private consumption	6.1	7.1	7.5	6.8	7.3	8	7.5
Government consumption	7.2	7.7	8	8.4	7.2	7.5	8
Investment in fixed assets	11.0	15.4	14	12.9	17.4	18.5	10.5
Equipment	10.5	12.6	12	13.1	12.2	13.5	10.5
Buildings	11.3	17.2	15.5	12.8	20.8	22	10.5
Exports	5.4	9.6	12.5	8.4	10.7	15	10
Imports	3.5	18.6		14.5	22.4	22.5	14
Gross National Product	7.5	8.4	7	8.5	8.3	8	6.5
- at prices of 1970 -							
Change in % compared with the preceding year							
Private consumption	3.4	2.8	2	3.6	2.1	2	2
Government consumption	3.9	2.8	2	3.1	2.6	2	2
Investment in fixed assets	6.3	8.5	6	6.9	9.9	9.5	3.5
Equipment	8.2	10.0	7	10.6	9.5	8.5	6
Buildings	4.9	7.4	5.5	4.3	10.1	10	1.5
Exports	4.4	5.0	5	5.1	4.9	6.5	3
Imports	5.9	10.2	5	9.9	10.4	6.5	3.5
Gross National Product	3.5	4.4	2.5	4.5	4.3	4	1.5
3. Price Level of National Expenditure (1970 = 100)							
Change in % compared with the preceding year							
Private consumption	2.6	4.2	5.5	3.2	5.1	5.5	5
Government consumption	3.2	4.8	5.5	5.2	4.5	5.5	5.5
Equipment	2.2	2.4	4.5	2.2	2.5	4	5
Buildings	6.1	9.1	9.5	8.2	9.7	10.5	8.5
Exports	1.0	4.3	7.5	3.1	5.5	8	7
Imports	-2.3	7.6	12.5	4.2	10.8	15	10.5
Gross National Product	3.9	3.8	4.5	3.8	3.8	4	5
Origin and Distribution of Income							
Change in % compared with the preceding year							
Gross income from wagework ⁵	6.7	7.3	7.5	7.5	7.1	8	6.5
Gross wage and salary total	6.4	7.4	7.5	7.4	7.3	8	7
ditto per employed person	5.2	5.5	6.5	5.5	5.4	6.5	6.5
Net wage and salary total	7.5	7.7	6	7.6	7.7	6.5	6
Gross income from entrepreneurship and property	9.4	9.3	5.5	12.7	6.7	5	6
Net income from entrepreneurship and property	13.0	10.9	6	15.1	7.8	7	6
Disposable income of private households	6.1	8.1	7	8.1	8.2	7.5	7

¹ Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 2/1980) and own calculations.

² Own forecasts; rate of change for 1980 rounded off.

³ Only half of the change of the number of working days has been allowed for.

⁴ Real Gross Domestic Product per hour worked.

⁵ Including employers' social security contributions.

Forecasting Assumptions

The economic policy parameters for the further development in the current year have been set by monetary and fiscal decisions, and the wage negotiators have, by and large, completed the current round. An economic forecast at this juncture still depends, however, on certain assumptions. The most important of these concerns the international political scenario. It has been assumed here that the political tension will not become so severe as to disrupt the world economy and the supplies of major raw materials in particular. Other assumptions underlying the present forecast are: The Bundesbank will hold the expansion of the central bank money stock near the middle of the target range of 6 – 9 %; public expenditure will rise more than indicated in the budgets; the tax allowance for Christmas will be increased; over the remainder of the year the world market price of oil will not rise more steeply than the prices of industrial goods; the D-Mark will strengthen against the dollar so as to end the year at more or less the same exchange rate as when it began; and the exchange rates within the European Monetary System will not change significantly.

After a sharp rise in the first months of this year the exports of goods will at first not rise any further but probably slightly decline. Nevertheless they will stay at a higher level during the spring and summer than that towards the end of 1979. As the year advances, the expected cooling of the economic climate in the world will make itself felt increasingly. The export trade will however benefit from the growing importance also in other countries of investments to save energy and open up new sources of energy. Besides, the demand from the oil exporting countries will expand further. Exports to the state trading countries may be temporarily boosted by embargo fears – without a change in the weak basic trend however. The shipments to non-oil developing countries will if anything fall off as they have to pay much more for crude oil and oil products while their export earnings situation is worsening and there remains little scope for adding to their debts. Overall the 1980 exports may be about 5 % (by volume) higher than in the preceding year.

Current Account Deficit Higher

Although the imports of goods will probably increase at a similar rate as the exports, the trade surplus will again fall away. The main reason for this is the steep rise of import prices and the consequent further worsening of the terms of trade. The trade surplus will decline about as much as last year. The deficits on

services and transfers are likely to go up further, especially in the travel sector but also as a result of larger remittances by foreign workers to their home countries. Overall the current account deficit will probably rise above DM 25 bn, after well over DM 10 bn in 1979.

Although this year's wage increases are definitely larger than those negotiated last year, the disposable incomes of private households will rise more slowly: In the further course of the year the number of employed persons will no longer go up but if anything down, and the progressive income tax rates will – after last year's relief – again have their full effect. This factor and the big price rises result in a more moderate advance of the real incomes. Recent surveys among private households show a corresponding change of consumer attitudes. On the other hand, experience shows that consumers try to maintain the standard of living which they have attained even when prices rise faster. This being so, the savings ratio may well recover, but not to last year's level. Having risen strongly in the early part of this year, private consumption in real terms is unlikely to increase much further in 1980. In the annual average the rise will work out at no more than 2 %.

Building Boom Easing Off

The investments in plant and equipment will continue on their clear upward trend and, on the evidence of the investment goods demand to date, prove fairly resistant to restraining influences; the findings of the Ifo Institute's investment test point in the same direction. Not the least important factors sustaining the investment demand are the higher oil prices and fears of continuing tightness of supplies; these encourage investments in the interest of energy conservation and for the development of other energy sources. Deteriorating sales and profit expectations will however slow the rise of investments on equipment in real terms – to 7 % in the annual average, against 10 % in 1979.

The mounting building costs and mortgage rates combined with persistently rising property prices have pushed up the cost of new building to such levels that many people who would like to build find it increasingly onerous to do so. The housebuilding orders are therefore certain to fall off while contracts for modernization, maintenance and, especially, heat preservation and energy economy will still be plentiful. A decline of public sector building is indicated by the budget provisions of the Federal and *Länder* (states) governments in particular. The local authorities are

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receiving smaller funds under the Programme for Investments for the Future than last year but they are still in such a favourable financial situation that they will probably place a larger volume of contracts in the current year than they did in 1979. Industry and commerce will keep their construction orders at the previous high level. Capacity extensions were not as important for the building investments in the last few years as in previous upswing phases. Hence it need not be feared that the demand for industrial building will be as greatly affected by the cooler economic climate than happened in these earlier periods. The order books are still very full, and the building activity will for the time being remain at a high level even though the demand is currently weakening. In 1980 the building investments will in real terms show a 5½ % overall rise over the preceding year.

Little Production Growth

In the light of the trends in the individual sectors it seems that the overall production will at best increase only slightly. Even a temporary decline of the real national product cannot be ruled out but there are no signs of self-reinforcing downward tendencies. The profile of the business cycle will be determined to a significant degree by inventory dispositions which are particularly difficult to assess in the present situation. If business firms consider their supplies of various imports to be threatened by political risks, they will hold on to precautionary stockpiles despite high interest rates; they may even add to them. For the present forecast it has been assumed that such motives do play a role and that relatively large inventories will therefore be maintained. The real gross national product will in the annual average of 1980 be 2½ %

higher than in 1979. The productive capacity will be utilized at a declining rate over the year.

If production develops as assumed, the situation in the labour market will get worse. Productivity will rise more slowly, but not as slowly as production. There will thus be less man-hours needed. The necessary adjustments will probably in the main take the form of shorter working weeks rather than of layoffs, for there are signs that the firms do not expect a prolonged or deep recession. The number of workers in employment will therefore decline slightly; owing to the overhang at the beginning of the year it will, however, in the annual average be about 200,000 higher than in 1979. Unemployment will rise perceptibly in the second half of 1980; the annual average is estimated at 850,000, which is still 25,000 less than last year.

Prices under Pressure

The prices will remain buoyant in the next few months owing to the repercussions of the higher oil prices but also because wage unit costs are rising more steeply. Later in the year prices in the commodity markets are expected to come under pressure and it will be less easy to pass on cost increases. This is likely to determine the trend of prices. The prices of imported intermediate products are on balance expected to recede in D-Mark terms, the more so as the dollar rate is expected to ease. The prices of imported finished goods on the other hand will rise more steeply as most of these come from countries with currencies closely linked to the D-Mark through the European Monetary System. Most of them have higher inflation rates than the Federal Republic. In the annual average consumer prices will be about 5½ % higher than last year; at the end of 1980 they may be less than 5 % higher than twelve months earlier.

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

Index and commodity group	1979			1980			
	April	July	October	January	April	May 9	May 23
HWWA-Index* (1952-1956=100) . . .	362.6	406.4	431.9	491.5	508.2	522.6	535.0
Foodstuffs	248.9	291.0	301.2	308.5	316.0	357.0	377.0
Raw materials other than foodstuffs . .	417.3	462.0	494.9	579.7	600.9	602.5	611.2
Fuels	641.5	738.4	824.4	998.3	1062.8	1062.8	1088.8
Raw materials for consumer goods . .	225.4	243.1	237.4	263.0	271.7	272.8	267.6
Raw materials for capital goods	322.2	332.6	338.3	373.6	359.9	363.5	364.1
Reuter's Index (18. 9. 1931 = 100) . . .	1551.0	1569.2	1658.3	1737.3	1704.8	1709.1	1714.0
Moody's Index (31. 12. 1931 = 100) . .	1048.0	1084.2	1151.0	1415.7	1128.9	1124.2	1106.6

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