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The Economic Situation in the Federal Republic of Germany

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

In the Federal Republic of Germany demand and production had experienced another upsurge at the start of this year, largely because of fears of supply shortages and more hefty price increases. The slide which followed it in the spring was as much of an overreaction to the cyclical downward-pointing factors as the earlier upsurge had been to the preceding uptrend. This hectic up and down obscured the – foreseen – weakening of the cyclical trend by the coercion of steeply rising oil prices and a policy of tight money. The higher oil prices had affected the economy adversely in the preceding year already but their effects on production were delayed into the current year by extremely heavy stock-piling by business firms and anticipatory purchases by private households and foreign buyers. The higher oil prices spilled over onto internal costs during this year's wage-round. This may be why the Bundesbank kept the expansion of central bank money in the lower half of the target band. Another factor were the deep scars left by the high cost of oil in the current account of the balance of payments.

Declining External Trade

In many neighbouring countries the cyclical trend was similar. The exports of basic and capital goods as well as of consumer goods suffered a corresponding

decline which – like the previous increase – showed up chiefly in trade with other industrialised countries. The production cuts and restraint in inventory building affected the imports of industrial upstream products and in particular those of raw materials. As the investment activity and consumption weakened, imports of finished products also receded. The real trade surplus contracted as exports declined slightly more than imports. The buying by private households ahead of expected big price rises early in the year was succeeded by falling-off demand in the following months. Since the middle of the year private consumption has again gone up, albeit slowly. This chimes in with the only slight income increases resulting mainly from the less favourable employment trend.

The misgivings felt in the business community about the durability of the favourable cyclical trend spread as the year advanced, affecting investment decisions to an increasing extent. The upswing of the demand for investment goods had in the final phase owed its momentum in increasing measure to capacity

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.

ECONOMIC TRENDS

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

Forecast for 2nd half year 1980 and for 1981

	1979 ¹	1980 ²	1981 ²	1980		1981	
	Years			1 st hf. yr. ¹	2 nd hf. yr. ²	1 st hf. yr. ²	2 nd hf. yr. ²
1. Origin of National Product, in real terms							
Change in % compared with the preceding year							
Number of employed	1.2	0.5	-1	1.0	0	-1	-1
Working time (per working day)	-0.4	-1	-1.5	-0.5	-1.5	-1.5	-1
Working days ³	-0.1	0	0	-0.3	0.5	-0.5	0.5
Total work done, per calendar month	0.7	-0.5	-2.5	0.2	-1	-3	-1.5
Productivity ⁴	3.9	2.5	2.5	3.5	2	2	3
Gross Domestic Product at prices of 1970	4.6	2	0	3.7	1	-1.5	1.5
2. Appropriation of the National Product							
- at current prices -							
Change in % compared with the preceding year							
Private consumption	7.2	7	5.5	7.0	7	5.5	5.5
Government consumption	8.0	8	6.5	8.7	7.5	7	6.5
Investment in fixed assets	15.6	12	2.5	16.4	8	2	3.5
Equipment	12.1	8	2.5	9.2	7.5	2	3
Buildings	18.0	14	2.5	21.2	8.5	1.5	3.5
Exports	9.9	12.5	4.5	16.4	9.5	1	8
Imports	19.1	16.5	2.5	23.3	10.5	-0.5	5.5
Gross National Product	8.5	7	5	8.2	6.5	4	5.5
- at prices of 1970 -							
Change in % compared with the preceding year							
Private consumption	3.2	1.5	1.5	1.5	2	1.5	2
Government consumption	2.9	2.5	2	2.8	2	2	2
Investment in fixed assets	8.7	4	-2	7.5	0.5	-3.5	-1
Equipment	9.5	4	-0.5	5.3	2.5	-1.5	0
Buildings	8.1	3.5	-3	9.2	-0.5	-4.5	-1.5
Exports	5.4	6	0	8.8	3	-3.5	4
Imports	11.2	5.5	-0.5	9.1	2	-3	2.5
Gross National Product	4.5	2	0	3.6	1	-1	1.5
3. Price Level of National Expenditure (1970 = 100)							
Change in % compared with the preceding year							
Private consumption	3.9	5	4	5.4	5	4	3.5
Government consumption	4.9	5.5	4.5	5.8	5.5	4.5	4.5
Equipment	2.3	4	3.5	3.7	4.5	3.5	3
Buildings	9.2	10	6	11.0	9	6.5	5
Exports	4.2	6.5	4	7.0	6.5	4.5	4
Imports	7.0	10	3	13.0	8	3	3
Gross National Product	3.9	5	4.5	4.5	5.5	5.5	4
Origin and Distribution of Income							
Change in % compared with the preceding year							
Gross income from wagework ⁵	7.3	7.5	4.5	8.1	7	4.5	4.5
Gross wage and salary total	7.4	7.5	4	8.1	7	4	4
ditto per employed person	5.6	6.5	5	6.7	6.5	5	4.5
Net wage and salary total	7.7	6	4	6.1	6	4	4
Gross income from entrepreneurship and property	10.3	5	4	6.3	3.5	0.5	6.5
Net income from entrepreneurship and property	12.0	6.5	3.5	8.7	4.5	-0.5	6.5
Disposable income of private households	7.9	7.5	5.5	7.8	7	5.5	5.5

¹ Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 9/1980) and own calculations.

² Own forecasts; rate of change 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.

extensions. The order books had been filled up, and plant and equipment investments therefore went on rising until the middle of the year. Since then they seem to have stood still. In the construction market demand had already turned down last year. The building activity passed its peak in the spring. The building firms have evidently been trying to stretch the large amount of work on order because they do not expect demand to revive in the near future. After the further replenishment of stocks early in the year the inventory dispositions of the business firms acted in recent months as a strong curb on demand, and the overall production followed suit. The initial effect of the cyclical letup in the labour market was a reduction of working hours by cutting-out of overtime and introduction of short-time working. The number of persons employed also declined in the end whereas the number of unemployed went up already while the rise in employment was slowing down. This happened because of a further substantial growth of the labour force. At the end of the year unemployment may – seasonally adjusted – be around one million.

Assumptions Underlying the Forecast

The parameters of the economic developments in 1981 are not yet sufficiently settled to allow unequivocally quantified trend projections. There is great uncertainty about future oil supplies and crude oil prices. For our forecast it is assumed that the oil prices – in US dollars – will rise about as much as the prices of industrial goods but that this will not be felt fully in the Federal Republic because the exchange rate of the D-Mark will probably undergo a nominal rise. The oil market problems make it also difficult to assess the cyclical trend in other countries. As far as the industrialized western countries are concerned, it is thought likely that the trend will turn upwards in the course of the coming year and that international trade will also expand. It is not assumed that the rise of the D-Mark exchange rate will make up fully for divergent cost and price movements in the average of the forecasting period. The competitive position of German producers is likely to be improved in this way. Under these circumstances it is likely that the Bundesbank will augment the money supply in line with internal economic requirements and that the money and capital market interest rates will come down. As for the fiscal policy for 1981, important decisions have already been taken but it is still uncertain how their actual impact is to be assessed. The central, regional and local authorities' spending will probably rise slightly more than envisaged. In the 1981 wage-round the parties

will, it is assumed, bear in mind that there is little scope for real redistributive action and less room for passing on costs. Under these circumstances the wage agreements will presumably provide for markedly lower increases than in 1980.

The exports from the Federal Republic will at first decline further in real terms as world trade continues to contract. They cannot be expected to improve before economic activity and trade improve internationally. This should happen during the summer half of 1981. Larger imports into the OPEC countries will probably complement the impulses from the industrialized western countries; so there are signs pointing to a faster growth of exports later next year. In the 1981 average total exports will be slightly lower, in real terms, than this year. With the internal demand as a whole still subdued, the volume of imports will decline further and inventory movements will accentuate the decline. At some time in 1981 the imports may be expected to recover – if not very much – provided the economic activity improves as expected. In real terms the imports will in the annual average probably be slightly down on the current year. The prices of imports will probably rise a little less than those of exports, mainly due to differences in their composition. If real exports and imports and the terms of trade develop as forecast, 1981 will produce a markedly higher trade surplus. The deficit of the invisible balance is likely to rise only slightly while the unrequited payments will hardly increase any further. The current account deficit is therefore likely to come down from DM 25-30 bn this year to an estimated DM 20 bn in 1981.

Building Activity Slowing Down

The real value of the public capital expenditure on building as well as the housing investments has been declining since last spring under the impact of fiscal measures and monetary policy. To judge by the present course of building demand and government budget figures, this trend will continue for quite a while in 1981. The rise of industrial building investments will flatten; a distinct recession would indeed have to be anticipated if they were determined solely by cyclical factors. Seeing however that capacity extension investments played no major role in the present upturn and industrial civil engineering has a stabilizing effect on demand, industrial building investments will probably stay near their 1980 level. The construction and building activities as a whole thus seem to be in for a faster decline at first but this may be contained later under the influence of probably more favourable financing conditions and distinctly smaller building

price rises. In the annual average the building investments will in 1981 be about 3 % lower in real terms than this year.

There are several reasons for taking a relatively optimistic view of the investment activities in 1981. On the assumption underlying this forecast investors will be encouraged by improved exports and lower interest rates. The next wage-round will also tend to improve the investment climate if it leads to moderate increases. Profit margins, it is true, have narrowed because it was impossible to pass on the full rise of internal and external costs in higher prices but the business firms evidently do not expect the pressure on profits to last very long. It seems that investments in plant and equipment will be slightly lower in the 1981 average: they will tend to decline at first and recover later.

Private consumption will in the main follow the trend of disposable incomes. Wage rates are likely to rise less than in 1980. There will certainly be less work available. Gross wages and salaries will probably increase overall by no more than about 4 %. Owing to tax relief the net aggregate of wages and salaries will rise by the same percentage. Part of the shortfall of workers' earnings due to reduced employment will be offset by higher income transfers. It is mainly for this reason that the aggregate increase of disposable incomes of the private households in 1981 – put at 5½ % – is expected to exceed the rise in total net wages and salaries. Uncertainties due to rising unemployment will increase the propensity to save while the wish to maintain the achieved living standard will have the opposite effect and lower interest rates will act as a disincentive. These various influences suggest on balance that the savings ratio will not change significantly. A further slowing of the price

updrift will cause the real private consumption to rise again a little faster – in the annual average by no more than 1½ %.

Worsening Labour Market Situation

The aggregate demand will, in real terms, at first still fall back, but it is likely to rise slightly in the further course of the year. Projections of the course of production depend upon the assumed turning points of the various demand components and the strength of the downturn and the subsequent upswing. The institutes participating in the present forecast hold different views on this point and arrive therefore at small up- or downward deviations from the forecast of a by and large unchanged real gross national product. The labour market situation is in any case certain to worsen perceptibly. The reduced availability of work will show up in less overtime and considerably more short-time working and also in a decline of the number of persons in employment. An adjustment of the employment level to the lower production level will involve more than leaving vacancies due to retirement and seasonal fluctuations unfilled. As, besides, the manpower potential is liable to increase once more – by about 100,000 – unemployment will definitely go up next year to, in the annual average, well over 1,100,000. The trend of import prices and the restrictive monetary policy had a major share of late in the dampening of price increases. The uptrend of internal costs was still becoming more marked when the uprise of consumer prices already weakened because it had become more difficult to pass on higher costs. The calmer trend may be expected to continue next year even though it will be interrupted in the spring by administrative price increases and the raising of the taxes on spirits and motor fuel. In the 1981 average consumer prices will rise by only about 4 %.

HWWA-Index of World Market Prices of Raw Materials¹⁾
(1975 = 100)

Raw Materials and Groups of Materials	1979		1980					
	AA ²⁾	October	July	August	September	October	Oct. 24	Nov. 7
Total index	152.7	165.3	230.3	230.8	233.5	237.8	238.1	237.2
Total, excl. energy raw materials . . .	138.5	146.6	156.8	158.2	161.1	162.5	163.5	161.4
Food, tropical beverages	130.3	138.9	149.6	153.1	158.9	164.1	165.7	167.1
Industrial raw materials	144.7	152.4	162.2	162.1	162.7	161.3	161.8	157.1
Agricultural raw materials	142.8	152.3	163.3	166.4	169.1	167.4	167.7	164.9
Non-ferrous metals	169.6	178.8	183.5	181.5	180.3	179.0	181.2	173.2
Energy raw materials	161.1	176.3	273.2	273.1	275.7	281.7	281.6	281.4

¹⁾On dollar basis. - ²⁾Annual Average. For the new method of computation of the HWWA Index cf. INTERECONOMICS No. 5, 1980, p. 261 ff.