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## The economic situation in the Federal Republic of Germany

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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, presented here in an abridged form<sup>1</sup>.**

The economic trend in the Federal Republic of Germany is still basically weak. The decline of demand and production has slowed and by now probably come to a halt but this seems to have been brought about chiefly by transient influences. While the cyclical trend in most of the major countries trading with the Federal Republic continued to point downward, orders from abroad have increased steadily since last autumn, and the flow of visible exports has been following the rising trend of demand since the beginning of this year. The main reasons for the contrast between the economic trend abroad and the exports from the Federal Republic are these: the lower D-Mark rate has made German products more competitive; the sizable depreciation of the D-Mark has touched off expectations that it may soon be up-valued and this may have led to some future orders being placed earlier; the de-stocking process abroad has slowed down; and the long-expected expansion of demand from OPEC countries has got under way. Visible imports fell sharply from the spring of 1980 right to the end of the year but then apparently steadied. In view of the low production and the deterioration of the competitive position of foreign suppliers the decline of imports might have been expected to continue but it seems to have been checked by the abatement of the de-stocking process.

The investments on equipment have so far shown only a slight decline in response to the cyclical

slowdown and adverse financing conditions. The investment propensity of the business firms as a whole has up to date proved relatively robust. The big price increases for energy have been working in various ways: they stimulate investments in oil substitution and energy conservation and also force industry to replace before time machinery and vehicles which have become uneconomical because of their excessive energy consumption. The building investments on the other hand declined faster, after an only slight falling-off in the course of last year. The trend differences between building and equipment investments result from the greater susceptibility of building activity to worsened financing conditions, on the one hand, and the drastic curtailment of public investments which account for as much as one-third of all construction work, on the other. Private consumption has not been rising any further since the spring of 1980, leaving short-term fluctuations out of account. Early this year it fell off again owing in the main to the slower rise of disposable incomes as well as the more substantial increases in the cost of living.

## Slower Decline of Production

The decline of overall production which began in the spring of 1980 proceeded much more slowly in the winter half-year. At first the business firms were either unwilling or unable to adjust the total of man-hours worked fully to the production trend so that productivity per working hour no longer rose — and in manufacturing industry even declined — and unit wage costs increased substantially. Later the business firms began to reduce their work forces, the more so as their profits were more and more adversely affected. Unemployment grew

<sup>1</sup> 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 1981

	1979 <sup>1</sup>	1980 <sup>1</sup>	1981 <sup>2</sup>	1980		1981	
	Years			1 <sup>st</sup> hf. yr. <sup>1</sup>	2 <sup>nd</sup> hf. yr. <sup>1</sup>	1 <sup>st</sup> hf. yr. <sup>2</sup>	2 <sup>nd</sup> hf. yr. <sup>2</sup>

### 1. Origin of National Product, in real terms Change in % compared with the preceding year

Number of employed	1.3	0.9	-1.5	1.3	0.5	-1	-1.5
Working time (per working day)	-0.4	-1.1	-1.5	-0.5	-1.7	-2	-1
Working days <sup>3</sup>	-0.1	0.1	0	-0.3	0.5	-0.5	0.5
Total work done, per calendar month	0.8	-0.1	-3	0.5	-0.7	-3.5	-2.5
Productivity <sup>4</sup>	3.8	2.0	1.5	3.2	0.9	1	2
Gross Domestic Product at prices of 1970	4.6	1.9	-1.5	3.7	0.2	-2.5	-0.5

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

Private consumption	7.3	6.9	5	6.9	7.0	5	4.5
Government consumption	8.3	8.9	6	9.1	8.7	6	5.5
Investment in fixed assets	15.2	11.6	0	16.5	7.8	0	0.5
Equipment	12.1	6.8	0	8.1	5.8	0.5	-0.5
Buildings	17.2	14.8	0	22.4	9.0	-0.5	0.5
Exports	9.9	12.1	6.5	16.3	8.1	3.5	9.5
Imports	19.1	16.5	5.5	23.3	10.5	4	6.5
Gross National Product	8.5	6.9	3.5	8.3	5.7	2.5	4.5

### — at prices of 1970 — Change in % compared with the preceding year

Private consumption	3.3	1.5	-0.5	1.4	1.6	-0.5	0
Government consumption	3.3	2.4	1.5	2.7	2.2	1	1.5
Investment in fixed assets	8.4	3.7	-4	7.5	0.6	-4.5	-3.5
Equipment	9.5	2.9	-3.5	4.2	1.8	-3	-4
Buildings	7.6	4.4	-4.5	10.1	-0.2	-6	-3.5
Exports	5.4	5.5	0	8.7	2.5	-2	2.5
Imports	11.2	5.9	-2	9.3	2.8	-3	-0.5
Gross National Product	4.5	1.8	-1.5	3.6	0.2	-2.5	-0.5

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

Private consumption	3.9	5.4	5	5.4	5.3	5.5	4.5
Government consumption	4.9	6.3	4.5	6.3	6.4	5	4
Equipment	2.4	3.8	3.5	3.7	4.0	4	3.5
Buildings	9.0	10.0	5	11.2	9.2	6	4.5
Exports	4.2	6.2	6.5	7.0	5.5	5.5	7
Imports	7.0	10.0	7.5	12.8	7.6	7.5	7.5
Gross National Product	3.8	5.0	5	4.6	5.5	5.5	4.5

### Origin and Distribution of Income Change in % compared with the preceding year

Gross income from waged work <sup>5</sup>							
Gross wage and salary total	7.7	7.9	3.5	8.4	7.4	3.5	3
ditto per employed person	7.5	7.9	3	8.5	7.4	3	2.5
net wage and salary total	5.5	6.5	4	6.7	6.5	3.5	4.5
Gross income from entrepreneurship and property	7.9	6.4	3	6.7	6.0	3	2.5
Net income from entrepreneurship and property	9.1	2.5	0.5	5.9	-0.4	-4	4.5
Disposable income of private households	11.6	3.7	0.5	7.8	0.5	-4.5	4.5

<sup>1</sup>Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 3/1981) and own calculations.

<sup>2</sup>Own forecasts; rates of change for 1981 rounded off.

<sup>3</sup>Only half of the change of the number of working days has been allowed for.

<sup>4</sup>Real Gross Domestic Product per hour worked.

<sup>5</sup>Including employers' social security contributions.

faster. Retail prices have also risen faster in the last few months — after the previous slowdown — not least because of the more marked decline of the D-Mark rate.

The forecast for the remainder of this year is based on the following assumptions: The cumulative effect of the latest rise of oil prices, the restrictive fiscal and monetary policies and the squeezing profits is past its peak. The economic development continues to be cyclical: endogenous processes like inventory movements, but also corporate investment activity, still follow a cyclical pattern. The economic downswing is thus moving towards a turning point. In view of the continuing strong uprise of prices, the still high current account deficit and the weakness of the D-Mark compared with the dollar, the economic authorities are as yet reluctant to switch to a potential-oriented course. This is one reason why the predetermination of the timing of the turning point is subject to heavy uncertainties. It is also difficult to forecast the intensity of the next upswing. Seeing however that the tide is unlikely to turn until late this year, these uncertainties will have no great bearing on the forecast for the year 1981 as a whole. Demand and production are expected to resume their expansion later this year in the industrialized countries; the volume of world trade will again expand. The price of oil will, at worst, rise in line with worldwide inflation. The D-Mark is likely to attract more attention in the course of the year in connection with expected upward exchange rate adjustments, but these will probably not go far beyond corrections for inflation differentials. With the D-Mark rate likely to improve, the current account deficit tending to contract and interest rates abroad expected to decline, monetary policy will probably be relaxed somewhat. The Federal Government is opposed to "classic" anti-cyclical programmes and gives preference to a medium-term programme for the promotion of structural changes. The signs for the 1981 wage-round are that most agreements will provide for rises between 4 and 5 %.

### **Current Account Improving**

Earlier deliveries ahead of an anticipated rise of the D-Mark rate were probably a factor in the rise of exports in the early months of this year. A reaction taking the form of another decline of exports is therefore likely to occur in the spring. A lasting recovery will probably not come about before the second half of the year by which time the contractive influences deriving from the slowdown in the other industrialized countries will have run their course. Since total demand will at first continue to recede and production will accordingly also decline, the volume of imports will for the time being contract.

The marked depreciation of the D-Mark in real terms plays a major role in this respect. However, as final demand will gradually steady and the inventory cycle approaches a turning point, the decline of imports will give way to a slight increase. The surplus on the visible account is estimated to rise by a nominal DM 5 bn although the terms of trade are expected to worsen in the annual average. The current account deficit will thus probably be slightly lower; in the next few months it is likely to undergo a trend change, not least because the terms of trade will improve as the year advances.

### **Stable Investment Propensity**

The investment propensity cannot be counted upon to improve in the near future because the profitability projections of business firms are still exposed to great hazards. The sales and profit expectations have, if anything, continued to worsen, mainly under the impact of the tight money policy and the high interest rates. The latter encourage financial investments to the detriment of investments in real assets. The economic need for product and process innovations to adapt to structural changes brings compensatory factors into play which prevent a more marked decline of investment propensity, but a trend change cannot be expected until the prevailing handicaps lose their momentum. Even if a turning point is reached at some time in the second half of this year, the effect on the 1981 investments will be insignificant; no more than a stabilization of the investment situation could be expected in this case.

In the housebuilding sector demand is likely to recede further. House prices have by now risen so far that the number of private households able to bear the financial burden at present interest rates is falling all the time. Besides there are the depressed income expectations. Only if the interest rates come down in the course of this year will there be a change in the demand trend, and even then demand will not rise quickly. Experience shows that private house-buyers, looking forward to further interest rate cuts, tend to adopt a reserved attitude at first. Rehabilitation and modernization work, promoted by various programmes, provide some support for housebuilding activity. Efforts to economize on public-authority spending, mostly at the expense of investments, have their effect on public building. The demand for commercial and industrial building has so far declined only slightly and will probably continue to be kept up by rising investment by the postal services and the energy sector. If the demand in the various sections of the building industry develops as indicated, the real investment will decline substantially in public building and also markedly in residential building while the

amount of building for commercial and industrial purposes will decline only slightly. The prices will rise not nearly as fast as before.

### Stagnation of Private Consumption

The trend of private consumption in the further course of this year will be determined by stagnating or even slightly falling real incomes of the private households. The amount of man-hours worked is likely to show a decline of about 3 % in 1981 while the gross wages and salaries paid will be barely 3 % up on 1980. With the tax burden lighter but social security contributions higher, the net income will rise at about the same rate. The public income transfers to private households will rise much more than the total of wages and salaries, chiefly because of increasing unemployment and short-time working. The total disposable income of the private households is estimated to increase by 5 %; allowing for higher retail prices the private households will have only as high a real income as last year. Fears that the savings ratio may increase to the detriment of private consumption because of greater job insecurity and higher interest rates cannot be dismissed out of hand. On the other hand, households do not tend to alter their consumption habits greatly at short notice. Real private consumption is likely to suffer a slight cyclical decline for some time yet, but a small increase will probably occur later as the decline in man-hours worked and the increase in retail prices are likely to slow down in the course of the year.

The decline of the national product will probably gradually come to a halt and about the turn of the year

give way to a slight upturn. The labour market situation will worsen right through the year. Business firms will at first adjust employment more than previously to declining production levels and try to raise productivity in order to ease the cost burden. The number of employed persons will probably fall throughout the year and rise only in 1982; the average for 1981 will be about 250,000 lower than in the previous year. Unemployment will increase considerably over the remainder of this year, the more so as the labour force potential will rise. The number of registered unemployed is likely to average 1¼ million compared with 890,000 in 1980; the unemployment rate will go up from 3.8 % to 5.3 %.

### Steadiness of Prices

The continuing depreciation of the D-Mark in real terms, the further hefty oil price increase and the substantial increase of unit wage costs have precluded the further weakening of the uprise of prices forecast in the Joint Assessment last autumn. These factors will probably prove effective for some time to come. More price increases must be expected on the consumer level for gas, electricity and other forms of energy and also for energy-intensive durable and other consumer goods. In addition, there are administrative price increases: the increase of the taxes on mineral oils and spirits of April 1 adds 0.3 percentage points to the cost of living index, and the raising of the agricultural prices has a similar effect. Later monetary policy will again act as a curb on rising prices. Nevertheless prices will about the end of 1981 still be over 4 % higher than a year earlier; the 1981 average will be 5 % higher.

**HWWA Index of World Market Prices of Raw Materials<sup>1</sup>**  
(1975 = 100)

Raw Materials and Groups of Materials	1980				1981			
	AA <sup>2</sup>	April	January	February	March	April	May 8	May 22
Total index . . . . .	226.0	215.5	246.2	244.1	243.6	242.6	240.0	239.0
Total, excl. energy raw materials . .	157.5	149.6	152.6	148.0	145.7	143.1	136.4	134.2
Food, tropical beverages . . . . .	150.4	139.6	150.6	144.9	141.0	137.5	125.3	122.2
Industrial raw materials . . . . .	162.9	161.2	154.0	150.3	149.2	147.4	144.8	143.3
Agricultural raw materials . . . . .	164.3	159.9	163.1	158.2	156.0	152.6	150.3	149.4
Non-ferrous metals . . . . .	185.5	183.5	163.8	159.2	160.7	160.8	156.6	154.0
Energy raw materials . . . . .	265.9	252.6	300.9	300.3	300.8	300.7	300.4	300.2

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