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Vigorous Expansion of German Exports

Visible exports have been increasing rapidly in all sectors during the course of the year and as yet show no sign of slowing down. Deliveries to OPEC countries again showed a particularly large increase. Their seasonally adjusted value in the second quarter of 1981 was almost half as high again as in the summer of last year; the deficit in visible trade with these countries has already shrunk considerably. Whereas in 1978 there had been a surplus of approx. DM 5 bn, this changed to a deficit of approx. DM 15 bn in 1980, following the latest oil price explosion. In the first six months of 1981 the deficit was "only" DM 5 bn, compared to DM 8 bn for the corresponding period in 1980. The above-average increase in exports to non-European developing countries is also noteworthy; in the second quarter of 1981 these were almost 25 % higher than in 1980. The noticeable improvement in the competitiveness of German goods probably played an important role here.

Visible imports continue to decline slightly; this reaction to the weakness of domestic demand is very much stronger than in previous years. This is partly due to intensified efforts to cut back on oil consumption, which led to a considerable reduction in the quantity of oil imported in the first six months of the year. The depreciation of the D-Mark also played a considerable role in the slowing-down of imports, however, since it noticeably improved the competitiveness of German suppliers in domestic markets. The influence of this factor varied, of course, from commodity group to commodity group. Thus, the share of imported consumer goods in domestic markets has gone down, whereas the share of imported capital goods seems to have increased slightly this year in spite of the fact that prices of imported capital goods have increased by roughly 8 % since the middle of 1980 – almost twice as much as the prices of domestic products. International specialization is probably so far advanced that a "re-substitution" would require a longer period of adjustment.

Rapidly expanding exports and declining imports have led to a vigorously increasing export surplus at

constant prices since the autumn of last year. An improvement in the balance of trade at current prices was not to be seen until this spring, however; up till that point the effects of the deterioration in the terms of trade following devaluation were dominant. As this factor became less important, the quantitative effect took over; the seasonally adjusted deficit on current account was halved (to DM 5.3 bn) from the first to the second quarter. The rise in import prices, which had distinctly slowed down temporarily in the spring, had become stronger again by the middle of the year following the rapid depreciation of the D-Mark. Seasonally adjusted export prices also rose somewhat more rapidly than before in recent months.

Improvement of Current Account

The impetus to exports resulting from the depreciation of the D-Mark is probably weakening gradually. An appreciation of the D-Mark is apparently being increasingly held for likely in view of the continuing inflation differential between Germany and other countries and the declining deficit on current account; a reversal of trends in exchange rates is therefore to be expected soon. It is, however, improbable that the D-Mark – following a certain "correction of level" – will again enter a lengthy phase of continuous appreciation. Whether or not the slackening-off of the depreciation impulses will lead to a weakening of exports depends on business trends abroad. Since a gradual revival in the industrialized countries is expected in the first half of next year, there should be no more than a brief pause in the upward trend of exports. Taking everything into account, visible exports at constant prices should show an increase of 4 to 5 % in 1982 – about the same as in 1981.

The improved competitiveness of domestic suppliers and the efforts to save and substitute oil will continue to have a dampening effect on visible imports. Only a revival of demand and production in the Federal Republic will cause an expansion of imports; this is likely in the first six months of 1982. Altogether, imports at constant prices will probably increase by 2 to 3 % in

1982 (1981: -3½ %). Thus, the real export surplus will continue to increase. This year it will already be considerably larger than in 1980. The increase over last year is equivalent – in 1970 prices – to about 1½ % of real GNP. This shows the extent to which the economy is influenced by foreign trade. Since the expected appreciation of the D-Mark will improve the terms of trade again, the deficit on current account will shrink considerably. It is estimated at about DM 15 bn for next year – about half the size of the deficit in 1980 (1981:

approx. DM 25 bn). In the case of a considerable “overshooting” of exchange rates, which often happens after such a reversal of trends, an even greater reduction of the deficit is possible.

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Slow-down in the US Economy

In the course of the first six months of the year there was a renewed slowing-down of economic activity in the USA due, in particular, to the restrictive monetary policy. Demand slackened off again on a wide scale and real GNP fell in the second quarter by somewhat more than ½ % over the previous quarter; without the considerable – mainly involuntary – increases in stocks the decline would have been approximately twice as large. Government demand also decreased noticeably. During the summer months this recessive tendency appears to have slowed down, however, at least as far as private consumption is concerned. The situation on the labour market shows no essential changes despite the renewed recession; unemployment continued to be somewhat over 7 % in the last few months.

Low Investment

The high interest rates are now obviously beginning to affect investment. Companies reduced their investments considerably in the second quarter of 1981. The slow trend of incoming orders to producers of equipment indicates that investment in the third quarter has remained low. The building industry is suffering most from the high interest rates. Investment in residential building has been clearly declining again since the spring, having remained stationary in the first quarter of the year. In the business sector only the extension of stocks mentioned above had an expansive effect in the second quarter.

Seasonally adjusted private consumption also decreased in the second quarter, although disposable real income was still rising, albeit at a considerably slower pace than before. The increase in the propensity to save should, however – perhaps with an allusion to the worsening economic and employment situation –

not be over-interpreted; it had reached a low of 4.6 % in the first quarter. Consumer demand had obviously stabilized by the middle of the year; retail sales increased again. The reason for this was obviously a considerable increase in disposable income as a result of an increase in welfare benefits in the middle of the year.

Slowing-down of Inflation

Price increases clearly slowed down in the first six months of the year. In addition to the anti-inflationary efforts of the Central Bank, the particular developments in fuel and food prices also played a role. Consumer prices rose from March to June by a current rate of, on average, “only” 7½ %; prices in June were approx. 9½ % higher than in June 1980. In July, however, the increases had speeded up again – partly as a result of increasing mortgage rates – and prices were 10.7 % higher than a year previously. The trend for producer prices for finished products continued to be favourable; in August they were barely 8 % higher than a year before.

The strong rise of the dollar against the most important other currencies since last autumn is obviously having an increasingly detrimental effect on the international competitiveness of American goods. In the course of this development and of the world-wide economic slow-down the volume of exports fell considerably from the first to the second quarter of 1981. The volume of imports, on the other hand, remained constant despite the recent cooling-off of business activity in the USA and the reduction in imports of oil. Since the appreciation of the dollar meant an improvement in the terms of trade, the deficit on the balance of trade increased only slightly and the current account probably continues to show a small surplus.

Following the extensive cuts in budgetary spending the President was also able to get his own way to a large extent on the question of taxation policy. In addition to a series of further tax reliefs, income tax rates, in particular, will be reduced by 25 % in the course of the next two years and depreciation allowances considerably extended. These measures are designed to give new impetus to economic growth and at the same time, by investment leading to increased productivity, counter cost and price increases. This strategy is not without risk; above all, the budget plans appear to be based on too optimistic assumptions concerning growth, prices and interest rates in the coming years. It is already unlikely that the planned reduction in budget deficits by 1984 will be achieved without further consolidating measures. The fear that the planned budget deficits will be exceeded could itself make the curbing of inflationary expectations more difficult, impair the chances of a perceivable fall in interest rates and thus reduce the programme's impulses to growth.

There are many indications at present that the weakness of the economy will continue for a time. Exceptionally high mortgage rates, for example, mean that residential building will probably continue to decline. Also, as far as company investments are concerned the cumbersome factors will probably continue at first to have more influence than the tax reductions and improvements in depreciation allowances. Following the involuntary increases in stocks in the first six months of the year, negative impulses from inventory disinvestment are also to be expected. Private consumption, on the other hand, will be spurred on by the coming into force of the reductions in income tax, and this should make itself increasingly felt in the final months of this year. Whether or not this will mark the beginning of a renewed improvement in

the economic situation, depends especially on monetary developments.

The slow-down of the economy and the decline in inflation achieved since the spring have improved the conditions for a certain reduction in interest rates. This would presuppose, for one thing, a monetary policy which allows for an increase in the supply of money, at least within certain defined limits. For another, fiscal policy would have soon to make it clear that the reduction of budget deficits is not in doubt despite broad tax reductions.

Chance for Revival

There are at present some indications that the necessary improvements in economic policy will be made. Thus, there is a chance that at the end of the year a revival of overall demand following the tax reductions will take place, affecting not only private consumption but also company investment. The dynamics of this process will probably develop relatively slowly however, since further progress as regards stabilization will only be achieved gradually. Although the decline of real GNP, in accordance with the trends described above, will not cease until the final months of this year, an increase of almost 2 % is to be expected for 1981 as a whole; this is above all a result of the large increase in the first quarter. Even with this forecast improvement in the economic situation the rate of growth in 1982 will probably be somewhat lower because of the expected low level of production at the turn of the year. The rise in consumer prices, which in 1981 will, on average, be somewhat more than 10 % (1980: 13.5 %), should continue to decline slowly next year.

*Compiled by the Department of
World Business Trends of the
HWWA-Institut für Wirtschaftsforschung-Hamburg*

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

Raw Materials and Groups of Materials	1980				1981			
	AA ²	August	May	June	July	August	Aug. 28 th	Sept. 11 th
Total index	226.0	230.8	239.4	237.9	238.1	237.8	236.9	236.8
Total, excl. energy raw materials . .	157.5	158.2	135.1	131.4	131.5	131.1	128.5	128.0
Food, tropical beverages	150.4	153.1	123.5	118.6	121.3	118.3	112.6	112.6
Industrial raw materials	162.9	162.1	143.9	141.1	139.3	140.8	140.5	139.8
Agricultural raw materials	164.3	166.4	149.8	148.6	143.5	140.6	141.0	140.8
Non-ferrous metals	185.5	181.5	155.2	152.5	152.5	160.3	158.2	157.9
Energy raw materials	265.9	273.1	300.3	300.1	300.4	300.2	300.2	300.4

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