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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 German economy continues to be in a state of marked weakness: overall production has been stagnating for a year, employment is declining and the number of unemployed is rapidly approaching the 1½ million mark. The reasons for this are to be found not only in the drastic increase in the cost of energy and the unfavourable development of the world economy but also in the attitudes of both employers and unions and in economic policy. Although the economic trend in most industrialised countries has been similarly weak, German exports increased considerably. The main reason was the fact that, with the weakening of the D-Mark and the (compared with other countries) slight price increases, the competitiveness of the West German economy has considerably increased. Imports of manufactures have been declining in nearly all categories of goods ever since the summer of last year. This reflects not only the improved competitiveness of the German economy, but also the weakness of domestic demand and production. Added to this are economies made in crude oil and oil products. Although overall expenditure and revenue in current transactions with foreign countries continued to amount to an appreciable deficit, this deficit has lately been considerably smaller than at the beginning of the year.

Private consumption – in previous downturn phases invariably a prop of economic development – has been declining since the beginning of the year. The wages and salaries total increased only slightly due to the decline in employment, the more marked rise in the cost of living reduced the purchasing power of the total available income of private households, and finally there was also an increase in savings. Although investment in equipment has likewise been increasingly affected by the weakness of the economy, this effect has not been nearly as marked as might have been expected in view of the significant pressure on profits. Apparently the substantial rise in the cost of energy and labour has

resulted in a premature “obsolescence” of the production apparatus; growing pressure towards structural change has triggered off product and process innovations. Building activity is declining over a wide front: in public building the cuts stem predominantly from the consolidation of public finance, in residential building they are predominantly due to the high level of interest. The decline in industrial building reflects the lowered propensity to invest.

The national product – if one eliminates seasonal factors and fluctuations in the number of working days – did not increase during the summer six months but, if anything, slightly declined. Initially enterprises had tried to meet the decline in demand and production by short-time working and by not filling jobs that fell vacant. The persistent pressure on profits led them to reduce their labour input also by way of layoffs. Since the number of new entries in the labour force is far greater than the number of withdrawals from it, the number of unemployed is rising faster than the number of persons in employment is declining. Although a lack of demand is observed in many markets, it is only in the building market that there has so far been any appreciable levelling out of the rise in prices. Indeed the cost of living index has been rising at an increased rate. This is due mainly to the higher cost of foreign goods and services resulting from the weakening of the D-Mark, to the delayed rise in the cost of energy, to officially regulated prices catching up with increased costs and to an increase in excise duties.

The forecast is based predominantly on the following assumptions. International trade will increase appreciably in 1982. The strengthening of the D-Mark, especially vis-à-vis the US dollar, will continue. This assumption is supported not least by continuing differences in cost and price trends in favour of Germany. The rate of imported price increases will be rapidly slowed down. Although the international competitiveness of the German economy will decline, it will nevertheless remain relatively favourable. The Deutsche Bundesbank is pursuing a potential-oriented

<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.

policy, i. e. it uses the improvement in the rate of exchange and the current account for supporting the trend towards a lower interest level. Fiscal policy, as a matter of principle, adheres to its course towards consolidation, as outlined in the resolutions and statements of intent in connection with the Federal Budget for 1982. Larger amounts have been assumed for expenditure and national deficit than those corresponding to the budget appropriations of September. As for the 1982 wage negotiation round, lower collective wage agreements are expected than in 1981. Admittedly the fact that the rate of increase of the cost of living index will still be high at the time of the negotiations – albeit lower than at present – will make agreement considerably more difficult. On the other hand there are the rapid rise in the total of unemployed and the shrinking profits of the current year.

As a result of the latest appreciation of the D-Mark the competitive advantage of German suppliers has again been somewhat diminished. This trend is likely to continue in relation to the USA also in the future. With regard to the countries of the European Monetary System the D-Mark will once more depreciate in real terms because of the greater price increases in those countries; this will favour exports to those countries. Added to this is the economic recovery in the Western industrialised countries and the resulting expansion of international trade. Overall visible exports will again increase considerably with a 1982 average of 5½ % in real terms, following 6½ % in the current year. Imports will not revive until demand and production in Germany have appreciably increased. This may be expected during the first six months of 1982. Real visible imports, which this year will have diminished by about 1 % compared with last year, are likely to increase again by 1 % on average for 1982. The price-adjusted foreign trade surplus, which will be considerably higher for 1981 than last year, will continue to increase. Germany's terms of trade are likely to improve in the near future. This will lead to a rapid increase in the nominal trade surplus. Since the debit balance in invisibles and in unrequited exports will not greatly change the current account deficit for 1981 will work out at approximately DM 25 bn, which is 5 bn less than last year; in 1982 the current account will approach a balance.

A continuing high level of interest, the continuing shortage of public finance and the rather pessimistic income expectations of enterprises and private households are still depressing the demand for building work. Building activity may be expected to decline heavily in the near future. The delayed braking effect of high interest rates and the continuing slight demand for

public building are only now having their full effect on building activity. The most that can be expected in the latter part of 1982 is a stabilisation at a low level.

Important conditions which are decisive for the development of the private propensity to invest, will improve gradually. Thus the pressure of costs on profits is likely to diminish. On the one hand, the costs of imported intermediate inputs are now rising quite slowly or are indeed declining as a result of the strengthening of the D-Mark. On the other, some relief for enterprises may be expected from unit wage costs. Moreover, conditions for debt financing are becoming more favourable. Fiscal policy, measured by direct demand effects, will presumably have a restrictive effect; from the point of view of growth policy contrary factors are coming into play. Overall the propensity to invest will probably strengthen again soon after the turn of the year, though at first only slowly, seeing that the burdens due to appreciable losses of profit by enterprises during the downturn phase will disappear only gradually. On an annual average, however, a decline in equipment of about 2 % is again likely. Stocks at present are probably close to the technically necessary minimum or indeed, in certain cases, below that level. Hence the risk of losing sales due to incomplete assortment has increased. This fact, together with a decline in stockkeeping costs due to reduced interest, will lead to a reversal in the inventory investment cycle which will produce a considerable stimulus to production.

Private consumption has probably reached its lowest point at present. This assessment is largely based on the fact that, in connection with the appreciation of the D-Mark, the rate of price increase will clearly slow down in private consumption, i. e. the foreign-trade-caused drain on spending power will diminish. During the coming year the gross total of wages and salaries will increase by only 3½ % given a further decline in the number of persons employed as well as the moderate collective wage agreements assumed in this forecast. Income transfers will likewise increase only at a slower rate. A more rapid increase, on the other hand, may be expected for distributed profits. Overall the available income will rise at an only slightly reduced rate compared with the average for the present year. The savings rate is likely to decline as a result of reduced rates of interest and the no longer postponable replacement of durable consumer goods. Consumer expenditure will rise further during the course of the year. As price rises slacken off private consumption will increase also in real terms. On an annual average, however, this will produce no more than a slight rise over 1981.

# ECONOMIC TRENDS

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

Forecasts for the 2nd Half Year 1981 and for the Year 1982

	1980 <sup>1</sup>	1981 <sup>2</sup>	1982 <sup>2</sup>	1981		1982	
	Y e a r s			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>
<b>Origin of National Product, in real terms</b>							
Change in % compared with the preceding year							
Number of employed	0.9	-1	-1.5	-0.6	-1.5	-1.5	-1
Working time (per working day)	-1.1	-1	-0.5	-1.4	-1	-0.5	0
Working days <sup>3</sup>	0.1	0	0	-0.5	0.5	0.5	0
Total work done, per calendar month	-0.1	-2	-1.5	-2.5	-2	-2	-1
Productivity <sup>4</sup>	2.0	1	2.5	1.5	1	2	3
Gross Domestic Product at prices of 1970	1.9	-1	1	-1.0	-0.5	0	1.5
<b>Appropriation of the National Product</b>							
— at current prices —							
Change in % compared with the preceding year							
Private consumption	7.2	4.5	5	4.5	4	4.5	5
Government consumption	9.0	7	5	8.3	6	4.5	5.5
Investment in fixed assets	11.6	0	-1	2.0	-1.5	-2.5	1
Equipment	6.8	0.5	1.5	2.7	-1	-1	4
Buildings	14.8	0	-2.5	1.6	-1.5	-3.5	-1
Exports	12.4	12.5	9	8.1	16.5	10.5	8
Imports	17.3	10.5	5	9.0	12	4	6.5
Gross National Product	6.7	3.5	5	3.0	4	5	5.5
— at prices of 1970 —							
Change in % compared with the preceding year							
Private consumption	1.7	-1.5	0.5	-1.0	-2	-0.5	1
Government consumption	2.6	2	1	3.1	1	0.5	1.5
Investment in fixed assets	3.7	-4	-3.5	-2.6	-5	-5.5	-2
Equipment	2.9	-3	-2	-1.0	-4.5	-4.5	0.5
Buildings	4.4	-4.5	-5	-3.8	-5	-6.5	-3.5
Exports	5.9	6.5	5	3.2	9.5	5	5
Imports	5.8	1	3	0.9	1.5	1	5
Gross National Product	1.8	-1	1	-1.3	-0.5	0	1.5
<b>Price Level of National Expenditure (1970 = 100)</b>							
Change in % compared with the preceding year							
Private consumption	5.4	6	4.5	5.5	6	5	4
Government consumption	6.2	5	4	5.0	5	4	4
Equipment	3.9	4	3.5	3.7	4	3.5	3.5
Buildings	10.0	4.5	2.5	5.7	4	3	2.5
Exports	6.1	6	4	4.7	6.5	5	3
Imports	10.9	9	2	8.0	10	3	1.5
Gross National Product	4.9	4.5	4.5	4.3	4.5	5	3.5
<b>Origin and Distribution of Income</b>							
Change in % compared with the preceding year							
Gross income from wagework <sup>5</sup>	7.9	5	3.5	5.3	4.5	3	4
Gross wage and salary total	7.9	4.5	3.5	4.9	4	3	4
Ditto per employed person	6.5	5	5	5.2	5	4.5	5
Net wage and salary total	6.4	3.5	3	4.3	3	2.5	3
Gross income from entrepreneurship and property	1.4	-3	7.5	-7.5	0.5	10	5.5
Net income from entrepreneurship and property	2.4	-3	7	-7.9	1.5	10.5	4
Disposable income of private households	7.4	5	4.5	5.5	4.5	4	5

<sup>1</sup>Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 9/1981) and own calculations.

<sup>2</sup>Own forecasts; rates of change 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.

Given a continuing favourable development of exports the turn in the development of domestic demand will mark the beginning of a renewed increase in overall production in the first half of 1982. The rate of increase is likely to be higher than the growth of production potential so that a slight improvement may be expected in the utilisation of capacities throughout the economy. On an annual average the growth, in real terms, of the national product will, because of the low starting-level at the beginning of 1982, amount to no more than about 1 %. The number of persons in employment will drop until next spring at a similar rate to the present. This decline will continue even after the upturn in overall production. Firms will begin by utilising productivity reserves and by cancelling reductions of working time (short-time work). The decline in the number of persons employed is not likely to be halted before the second half of 1982. From annual average to annual average the number of persons gainfully employed will admittedly drop even more markedly in 1982, by approximately 350,000, than this year, when it has dropped by 250,000. In view of the continuing massive growth of the labour force

unemployment will increase by more than the shrinkage in the number of persons employed. The number of unemployed will probably rise over the whole year, though at a gradually reduced rate. On an annual average this total will be in excess of 1.6 million compared with 1¼ million in 1981.

With the reversal of the exchange rate trend the inflationary impulses from that quarter are petering out. Nevertheless the effects of the increase in import prices of the past few months will continue to be felt for some time. The price climate in 1982 will be characterised by a lesser scope for passing on cost increases; this is ultimately the result of a tight money policy. The settling down of prices is admittedly being impeded by the fact that state-regulated prices are being massively increased. Lower wage settlements and growing productivity gains in the course of the economic recovery will substantially reduce the wages bill pressure. Generally speaking, an appreciable slackening of price increases may be expected, even though they will still amount to 4½ % on an annual average.

## The International Economic Situation

Following the recessive development of the world economy over the previous year, demand and production during 1981 revealed little change. Although domestic demand in most industrialised countries continued to be weak, exports, above all to the OPEC countries, increased at the same time. In addition to Japan the West European countries, too, succeeded in markedly extending their exports as their competitive position became appreciably more favourable as a result of the considerable rise in the value of the dollar; their current accounts improved.

Utilisation of capacities and employment continued to decline in nearly all countries and the number of unemployed increased considerably. In spite of this the only appreciable slackening in the price rise so far has been in the USA and Japan. In Western Europe, by contrast, prices once more rose at an accelerated rate during the summer months as imports became substantially dearer as a result of the strengthening of the dollar. The profit situation of enterprises continued to deteriorate, especially as, on the whole, the upward trend in the wages bill did not diminish.

Most central banks throughout the summer of 1981 persevered with their policy aimed at price stabilisation, especially as in the USA the money supply was once again tightened appreciably. Interest and the exchange

rate of the dollar rose to a very high level. Most other countries similarly kept the money supply tight in order to keep within limits the weakening of their currencies and hence external price stimuli. In the autumn of this year the interest trend, starting from the USA, surpassed its peak. In this connection the exchange rate of the dollar dropped back appreciably.

The forecast of the economic trend in the industrial countries in 1982 is based on the expectation that the easing in the money and capital markets will continue. In the USA, following the very slight monetary expansion over the past few months, monetary policy will probably orient itself again on the proclaimed money supply targets, and in many Western European economies the central banks, as a consequence of strengthening tendencies of their currencies vis-à-vis the dollar, will find some scope for relaxing restrictions and indeed make use of that scope. On the other hand, the problems of inflation are setting limits to such a development, albeit in a measure varying from one country to another.

Fiscal policy follows different concepts, though efforts towards consolidation predominate. In many cases budget appropriations have been appreciably cut. Announced measures to stimulate economic activity are confined as a rule to limited promotion of investment,

sometimes financed by increased taxes. In the USA, on the other hand, extensive tax reductions have been decided on for the next two years, although these go hand in hand with cuts in planned increases of expenditure. France, by way of contrast, pursues a policy of stimulating demand and accepting increasing deficits.

The conditions for the industrialised countries' foreign trade are likely to improve as the terms of trade, which had drastically deteriorated since the beginning of 1979, will improve for the time being. Export prices of the industrialised countries will rise more rapidly – in terms of US dollars – than the cost of raw materials and especially of oil. Admittedly the rumbling conflicts in the Middle East continue to represent a substantial uncertainty factor in the development of oil prices.

The reduction in interest rates, which has now started, improves the prerequisites for overcoming the recessionist trends in the industrialised countries. Hence there are improved prospects that the decline of domestic demand – with further increasing exports to the raw material and oil-exporting countries – will come to a halt about the turn of the year and be followed by a trend towards recovery. The expectation of an economic upturn and the reduction in the cost of loans will probably be reflected before long in more optimistic stock ordering behaviour. The reduction in interest will also stimulate investment in plant and equipment, especially as in most countries wage settlements may be expected which will permit a distributional shift in favour of enterprises. Initially there will be a particular increase in investments which will serve the necessary structural adaptation to the higher cost of energy. At the same time private consumption in Western Europe will be buttressed by the fact that the most recent reversal in the development of exchange rates – from depreciation to appreciation vis-à-vis the US dollar – acts as a brake

on the rise of consumer prices. In the USA consumption is being stimulated by the planned tax cuts. In Western Europe the price rise will now be appreciably checked especially in those countries where the depreciation of the US dollar and the altered structure of exchange rates within the European Monetary System have led to a marked strengthening of the currency. This is not likely to lead to any significant change in the inflation differential from one country to another. In consequence there will again be tension within the European Monetary System so that an adjustment of central rates may be expected again next year.

If only because of the obstacles which the continuing strong inflationary pressures represent to a relaxation of economic policy in the industrialised countries demand is expected to revive only gradually over the next year. The increase in the real gross national product in the industrialised countries is unlikely, with a 1982 average of just under 2 %, to be very much greater than in 1981 (1 %). In view of the sluggish development of demand and production the decline in employment will initially only slow down; in most industrialised countries unemployment will continue to rise in 1982.

The reduction of current account deficits will continue in the industrialised countries into next year. Contributory factors to this are the import boom in the oil-exporting countries – which will probably decline only slowly – the continuing oil conservation practised in the industrialised countries and the improvement of their terms of trade initially to be expected. In relations among the industrialised countries the shifts in competitive positions which have arisen in the course of the last year are likely to affect their current accounts to an increasing degree. Thus a further move towards deficit is to be expected for the USA, whereas in most Western European economies the deficits will probably continue to diminish.

### **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>	October	July	August	September	October	Oct. 10	Nov. 6
Total index . . . . .	226.0	237.8	238.1	237.8	236.8	237.1	236.7	242.6
Total, excl. energy raw materials . .	157.5	162.5	131.5	131.1	127.7	127.6	126.7	127.7
Food, tropical beverages . . . . .	150.4	164.1	121.3	118.3	112.9	115.2	113.8	116.2
Industrial raw materials . . . . .	162.9	161.3	139.3	140.8	138.9	137.0	136.5	136.6
Agricultural raw materials . . . . .	164.3	167.4	143.5	140.6	138.9	135.5	134.8	136.0
Non-ferrous metals . . . . .	185.5	179.0	152.5	160.3	156.0	152.5	152.7	152.8
Energy raw materials . . . . .	265.9	281.7	300.4	300.2	300.5	301.1	301.0	309.7

<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.