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The Economic Situation in the Federal Republic of Germany

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

The general picture of trends in the West German economy did not brighten in the first months of the current year: the number of orders still tended to decline somewhat and businessmen remained pessimistic in their expectations. Gross national product did not increase, the decline in employment accelerated and the number of jobless grew even faster than had been feared last autumn. The reasons for this persistent weakness are to be found in the considerable rise in the cost of energy and the unfavourable trends in the world economy, as well as in the behaviour of economic policy-makers and of both employers and trade unions, whereby economic policy of course influenced the behaviour of the latter and vice versa. The general framework improved somewhat in recent months: increases in the prices of oil and oil products were replaced by price reductions, the Federal Republic's current account deficit disappeared, and the Deutsche Bundesbank increased the money supply and reduced interest rates step-by-step. The after-effects of shocks and errors have continued to exert an influence up to the present, however.

Although exports continue to enjoy the competitive advantages of German firms, the increase in exports lost some of its momentum in recent months. This was only to a lesser extent due to the fact that their competitive advantage decreased as a result of changes in the central rates in the European Monetary System; it was mainly due to a decline in demand by the USA, the OPEC-countries and the state-trading countries. Exports nevertheless continued to increase faster than world trade until very recently. Imports of commodities increased markedly at the beginning of the

year for the first time in a long time, but this is to be seen above all as compensating for the strong contraction at the end of last year. The current account was more or less in equilibrium in the winter six months.

The contraction of expenditure on capital equipment continued as an after-effect of previous commitments and as a result of the uncertainty regarding the line which fiscal policy would take in the conflict between the demand that a limit be set to the incurring of further public debt and the demand for the encouragement of employment by means of government programmes. There was also uncertainty as to the results of the wage negotiation round. The contraction of investment in buildings was strengthened. This was primarily due to the behaviour of the Government which, in order to consolidate its finances, above all reduced investment expenditure.

Private households' propensity to consume did not change noticeably. Nevertheless, private consumption declined. The increase in disposable income was curbed by the decline in employment and by increased social insurance contributions. This was not balanced out by the marked slowing-down in the increase in the cost of living. The upward tendency of prices has clearly slackened off since the autumn, mainly because prices for raw materials sank on world markets and the price increases for foreign products, which had accompanied the fall of the D-Mark, were replaced by price decreases. Those prices which are mainly determined by domestic factors showed no slowing-down in their upward tendency worth mentioning.

Altogether, demand was not sufficient to cause an increase in production. Production capacity continued to grow, however, even though slowly, and the utilisation of capacity therefore fell once again. Entrepreneurs were obviously not counting on a rapid economic recovery and reduced their labour forces even further. Since the number entering the workforce

¹ Participating institutes: Deutsches Institut für Wirtschaftsforschung, Berlin; HWWA-Institut für Wirtschaftsforschung-Hamburg; Ifo-Institut für Wirtschaftsforschung, Munich; Institut für Weltwirtschaft, Kiel; Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Essen. The Institut für Weltwirtschaft, Kiel, has published its more pessimistic view of future economic trends in a minority report appended to the main report.

continued to be greater than the number leaving, the number of jobless rose faster than the number of employed fell. At the end of March there were, seasonally adjusted, 1.7 million persons registered as unemployed.

The economic trend for the rest of 1982 is already mapped out to a considerable degree. Nevertheless, the making of a forecast requires assumptions as to such important constraints as influences from foreign trade, future monetary and fiscal policy and the results of current wage negotiations. The institutes base their forecast on the following suppositions: in the industrialised countries, production as a whole will show only a gradual increase during the rest of the year; the Deutsche Bundesbank will hold the central bank money supply in the upper half of the target corridor; the "General Initiative for Jobs, Growth and Stability" will, at least as far as the measures intended to stimulate the economy are concerned, successfully run the parliamentary obstacle race; instead of an increase in value-added tax in the middle of 1983 there will be a combination of reductions in expenditure and increased new borrowings; the agreements still to be reached in the 1982 wage round will not differ essentially from those already concluded.

Gradual Recovery of Production

On the basis of these assumptions, the majority of the institutes do not believe that the stagnation of national production will continue for long; rather, there should be a slight increase in the latter half of the year. This belief rests above all on the expectation of a relaxation of monetary policy, low wage agreements and the gradual recovery of demand in the industrialised countries, but also on the development of cyclical factors. Following the large reductions in stocks in the latter half of last year and the first few months of the current year, an end to stock reductions would now seem to be indicated. This alone will have a positive effect on production as current production will have to meet a larger share of demand than before.

The decline in the propensity to invest weakened in the winter six months. The anticipation of higher profits, due above all to the markedly weaker rise in unit labour costs as well as to the correction in the terms of trade caused by the stabilisation of import prices, and the fall in interest rates will cause an increase in the demand for industrial equipment. However, conditions have not yet improved so much that a sharp upswing in the propensity to invest could be expected, even though the pressure to invest more is great. In order to safeguard their long-term competitiveness, entrepreneurs are

forced to introduce new products and new methods of production. In spite of the fall in the prices of oil products, there is still occasion to press ahead with investments in oil substitution and energy-saving. Although the business community has criticised the investment allowance, it is to be expected that the allowance will lead – especially towards the end of the year – to increased orders and also to an increase in investment activities. The orders thus induced will, however, for the most part not be fulfilled until 1983. On an average, real investment on equipment in 1982 will again be lower than that of the previous year.

The fall in demand for building has continued up to the present. Demand, measured by orders received, has shrunk altogether by no less than one-third since the turn of the year 1979/80. A number of factors indicate, however, that the trough of demand for house-building and for industrial building has now been reached. The marked increase in the number of building permits granted since the turn of the year can be taken as an indication of a new upswing in the number of orders placed in the building trade. The seeds of this upswing have been sown by a large number of fiscal measures such as depreciation allowances, grants and special programmes, and by the fall in the level of interest rates and the improvement in company profits. In contrast to the recovery in demand for house-building and industrial building, no recovery worth mentioning is to be expected in public building this year. This is to a large extent due to the financial difficulties of local authorities. The expected recovery of demand for house-building and industrial building will, as has been shown by experience, be reflected in investment activity with a certain delay; investment in building will therefore probably continue to decline throughout the year. Expressed as an annual average, the decrease will be about twice as high as last year.

Private consumption will, in the course of the year, develop somewhat more favourably again than in 1981. One contribution to this will be the continued weakening of the increase in prices and the resulting support for the real income of private households. Another will be the expected decrease in the propensity to save; this is likely because of the fall in interest rates and – in connection with this – the growing tendency to make up leeway on postponed purchases. Consumption will only increase very hesitantly, however; on an annual average it will be somewhat lower than last year.

The impetus which was felt in the last two years from the devaluation of the D-Mark in real terms will markedly weaken in the course of the year. The international competitiveness of German suppliers will remain high,

ECONOMIC TRENDS

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

Forecast for 1982

	1980 ¹	1981 ¹	1982 ²	1981		1982	
	Years			1 st hf. yr. ¹	2 nd hf. yr. ¹	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	1.0	-0.6	-1.5	-0.3	-0.9	-1.5	-1.5
Working time (per working day)	-1.1	-1.1	-0.5	-1.3	-0.9	-1	-0.5
Working days ³	0.1	-0.1	0	-0.5	-0.3	0.5	0
Total work done, per calendar month	0	-1.8	-2	-2.1	-1.5	-2	-2
Productivity ⁴	1.9	1.8	2.5	1.2	2.3	2.5	3
Gross Domestic Product at prices of 1970	1.9	-0	0.5	-0.9	0.8	0.5	1

2. Appropriation of the National Product

– at current prices –

Change in % compared with the preceding year

Private consumption	7.2	4.8	4.5	4.6	4.9	4.5	4.5
Government consumption	9.2	7.1	5	8.5	5.9	5	5
Investment in fixed assets	11.5	1.0	-2	1.4	0.6	-3	-1.5
Equipment	6.8	0.6	0.5	2.7	-1.2	-2	3
Buildings	14.5	1.2	-3.5	0.6	1.7	-3.5	-3.5
Exports	12.4	14.8	12	8.0	21.5	16	8.5
Imports	17.3	11.1	6.5	8.9	13.3	8	5.5
Gross National Product	6.7	4.0	5	3.2	4.8	5	5

– at prices of 1970 –

Change in % compared with the preceding year

Private consumption	1.7	-1.1	-0.5	-0.9	-1.3	-1	0
Government consumption	2.8	2.1	1	3.4	0.8	1	1
Investment in fixed assets	3.6	-3.3	-5	-3.2	-3.4	-6.5	-3.8
Equipment	2.9	-3.1	-3	-1.0	-5	-6	-0.5
Buildings	4.1	-3.4	-6.5	-4.8	-2.3	-6.5	-6
Exports	5.9	8.9	6.5	3.2	14.7	10	3.5
Imports	5.8	2.1	3	1.3	2.9	3	3.5
Gross National Product	1.8	-0.3	0.5	-1.2	0.5	0.5	1

3. Price Level of National Expenditure (1970 = 100)

Change in % compared with the preceding year

Private consumption	5.4	5.9	4.5	5.6	6.3	5.5	4
Government consumption	6.2	4.9	4	4.9	5.1	4	3.5
Equipment	3.8	3.8	4	3.7	3.9	4	3.5
Buildings	10.0	4.8	3	5.6	4.1	3.5	2.5
Exports	6.2	5.4	5	4.7	5.8	5.5	5
Imports	10.9	8.8	3.5	7.5	10.1	5	2
Gross National Product	4.8	4.3	4.5	4.3	4.3	4.5	4

Origin and Distribution of Income

Change in % compared with the preceding year

Gross income from employment ⁵	8.3	5.0	3	5.2	4.8	3	3
Gross wages and salaries total	8.1	4.6	3	6.7	6.5	4.5	4.5
ditto per employed person	6.5	5.0	4.5	4.7	5.2	4.5	4.5
Net wages and salaries total	6.5	4.1	1.5	4.3	4.0	2	1.5
Gross income from entrepreneurship and property	0.4	-0.9	9.5	-6.4	4.0	9.5	9.5
Net income from entrepreneurship and property	2.1	0.7	11	-6.1	6.4	12	10
Disposable income of private households	7.4	5.4	4	5.6	5.2	4	4

¹Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 3/1982) and own calculations.

²Own forecasts; rate of change rounded off.

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

⁴Real Gross Domestic Product per hour worked.

⁵Including employers' social security contributions.

however. The improvement of their position vis-à-vis competitors in the dollar area was so great that an upward revaluation of the D-Mark against the dollar, which would cancel this out within a short period of time, is unlikely. The competitive position of Germany vis-à-vis the other Western European countries will worsen only very slightly, if at all. The marked improvement in the German current account and the price disparities vis-à-vis most other European countries will lead to an upward revaluation of the D-Mark but experience shows that this will probably be weaker than the inflation differential would lead us to expect. The increase in imports by the oil-exporting countries will probably continue to weaken in coming months as a result of falling oil prices and the considerable reductions in quantities sold; even a decrease in their imports cannot be excluded. On the other hand, demand and production in the industrialised countries will slowly begin to show a slight recovery. Total exports will therefore – following on a phase of relative weakness – increase more strongly again towards the end of the year. Exports thus lend support to business activity again in 1982, although to a far lesser extent than in the previous year.

Imports of goods will probably scarcely increase at first due to the stagnation of total real demand and the improvement in the price-competitiveness of German firms. Not until the recovery of demand and production in the second half of the year will imports increase again. Stockpiling will lead to a relatively sharp increase in imports of raw materials. The current account will show a surplus again this year for the first time since 1978, estimated at around DM 5 billion. Because of the large gross flows which lie behind the net balance, this forecast naturally has a high margin of error.

The anticipated development of total production means that real national product in the second half of the year will only be about one per cent higher than a year

previously. The rate of growth for the economy as a whole, at about one half of one per cent on a yearly average, remains very low. The recovery of production comes too late and is too weak to have a noticeable impact on the increase in unemployment already in the current year. The number of plant closures and business failures will remain high and a large number of entrepreneurs will continue to endeavour to improve profits through reductions in their labour forces. The decline in employment will therefore slacken off only slightly at first but it should be brought to a halt by the end of the year. Since the number of persons available for work is increasing, however, the upward trend in the number of unemployed will continue throughout the year. At the end of the year, the seasonally adjusted unemployment figure will probably be almost 2 million. On a yearly average there will be 1.8 million unemployed in 1982; this is equivalent to an unemployment rate of 7.5 %.

The development of both costs and demand indicates a continuation of price stabilisation: import prices will in all probability remain largely stable; the increase in unit labour costs is likely to show a halving of the rate to 2 ½ % on an annual average as a result of the new wage agreements and a more favourable tendency in productivity. The degree of price stabilisation will differ from sector to sector. Attempts by producers to pass on the highly increased steel prices will affect, above all, investments in buildings and equipment. On the consumer front the basic tendency toward a steadying of prices will, furthermore, be temporarily concealed by increases in indirect taxes, postal charges and electricity, gas and water rates. Nevertheless, for the year as a whole a noticeable reduction in the rate of increase of prices to 4 ½ % on average is to be expected; towards the end of the year the rate of increase will be less than 4 % compared to the previous year.

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

Raw Materials and Groups of Materials	1981		1982					
	AA ²	April	January	February	March	April	April 30	May 14
Total index	240.7	242.6	238.9	234.3	231.9	230.9	231.2	230.8
Total, excl. energy raw materials . .	135.6	143.1	126.3	126.0	122.0	122.5	123.0	122.5
Food, tropical beverages	126.1	137.5	115.6	116.6	111.9	110.0	109.3	107.4
Industrial raw materials	142.7	147.4	134.4	133.2	129.7	131.9	133.5	134.0
Agricultural raw materials	146.4	152.6	135.2	133.8	133.9	135.0	136.8	138.2
Non-ferrous metals	156.3	160.8	149.0	147.6	139.3	137.3	138.4	138.9
Energy raw materials	302.1	300.7	304.7	297.5	296.0	294.2	294.3	294.0

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