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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.¹

This autumn's assessment of the future course of the Federal Republic's economic development must surely rank as one of the most difficult since the 50s. The economy is characterised by a situation in which an acute drop in demand coincides with a fundamental weakness of growth. As yet, experience has not been gathered on how investors and consumers react in such a situation. What is more, an unusual accumulation of international economic risks and continuing uncertainties in economic policy combine to create an atmosphere of considerable imponderability.

The world economy is not only marked by a lasting cyclical downswing but also by a crisis of the international financial system. Were a break to occur in international credit chains, the implications for the world economy, and thus for the German economy, would be most critical. However, there are chances of preventing such an occurrence. The treatment hitherto of illiquidity cases by banks and international organisations has demonstrated that the effects can be kept within limits. Of course, there is no guarantee that all cases will be handled in the same manner. However, the acceptance of the reasonableness of such behaviour in the common interest would appear to be sufficiently widespread as to suggest its continuation in the future.

Following the change of government, uncertainty also abounds with regard to future economic policy. The intentions proclaimed by the new government are too vague as regards medium-term prospects. In the short term, some of the measures announced in the government's programme would appear to be contradictory: measures aimed at boosting demand in the short term are confronted by others likely to weaken it, thus possibly prejudicing expectations held by investors.

During the coming months a special brand of uncertainty results from the question as to whether the

national elections, planned for 6 March 1983, will bring about a result conducive to the realisation of the policy concepts put forward by the present government. Admittedly, some of the proposed measures will be carried out regardless of the election outcome; the question is, however, whether this has any great influence on the appraisal of the situation by investors and consumers. The impulses ensuing from the government's programme, therefore, will be much weaker up until the election than might otherwise have been the case.

Gradual Stabilisation

Despite the considerable uncertainties surrounding some of the important preconditions, therefore, the forecast is based on the following "firm" suppositions:

- It is assumed that the international financial system will not collapse. Economic trends in the industrialised countries will initially remain low-key. Chances of a tendency towards recovery will not exist before the latter months of the coming year. As there will be a delay before this recovery is felt by developing countries exporting oil and other raw materials, imports by the latter will remain subdued throughout 1983. A similar development is to be expected for state-trading countries struggling to come to terms with payment troubles.
- Under such circumstances, world market prices for oil and raw materials will initially remain under pressure. As, in addition, the D-Mark is likely to appreciate somewhat against the dollar, the currency in which oil and other raw materials are invoiced, German import prices for these goods will continue falling well into the coming year.
- In all probability the Deutsche Bundesbank will maintain its course of an expansion of money supply geared to capacity. Accompanied by this monetary policy, the continuing price stabilisation, the policy of public spending consolidation and weak economic development will lead to a marked drop in interest rates.

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.

Support for this can be expected from international conditions.

- With regard to economic and fiscal policies, the measures announced in the new coalition agreement and in the government's policy speech – including resolutions adopted from the previous government – can be expected to be implemented.
- The 1983 annual round of wage negotiations will see union and management representatives faced by a rapid deterioration of the employment situation, a further slowing-down of the increase in prices and continuingly unfavourable profit prospects. This would suggest that the wage settlements agreed upon will be lower than this year's level of 4 %. There are signs that once again the negotiated percentage increase will be virtually the same right down the line, i.e. no special consideration will be given to the different situations in different individual economic sectors.

Under such circumstances the institutes regard a self-reinforcement of recessionary forces as unlikely; rathermore, they expect a gradual stabilisation of demand and production during the winter six months 1982/83. Due to a certain improvement in the general economic framework, and due to the likelihood of upward cyclical reactions, particularly in stock movements, the institutes see the possibility of a slight increase in overall economic activity during the course of the coming year. In view of the continuing problems it would be too early to term this an economic turning-point. The prerequisites for lasting economic growth are still absent. The accumulation of uncertainties must be stressed here. This particular forecast of trends is merely regarded by the institutes as one which is more probable than less favourable alternatives, for which arguments could also have been found.

Investment Propensity Still Shaky

The numerous uncertainties have undoubtedly had a particularly adverse effect upon the investment climate. Were it not for the special influence exerted by the expiry of the investment allowance period, the clear decline in demand for equipment could be expected to continue. As it is, however, orders for capital goods will increase up until the end of the year, dropping off at the start of 1983. This will not, however, be reflected in investment activity during the winter six months, which will exhibit a more uniform course with a falling tendency.

Investments will be encouraged in particular by lower interest rates, the reduced pressure of costs and economic incentives. There can be no doubt, however, that no other economic activity will depend so much on

the outcome of the election as company investments. The election will decide whether, and in which way, medium-term investment plans need to be rectified. Admittedly, even in the event of a confirmation of the course embarked upon by the present government, 1983 is not likely to bring a substantial increase in investment activity. The forecast assumes only a gradual increase during the course of the coming year, induced in part by the afore-mentioned investment allowance; this means only a very moderate annual average increase.

Upturn in Building Investments

Demand for construction, which had already stepped up over the past months, will probably recover even further. Apart from the continuing drop in interest rates, this will be supported by a whole set of policy measures.

In residential building in particular a marked recovery in demand is to be expected. Alongside the decline in mortgage rates, the primary reason is the huge financial support granted via policy measures which are partially already in force and partially planned for the future. The following are particularly important:

- improved depreciation provisions for residential buildings,
- promotion of the construction of owner-occupied houses and flats via the tax deductability of up to DM 10,000 interest charges over a period of three years, accompanied at the same time by unlimited depreciation in accordance with Article 7b of the German Income Tax Law,
- interest reduction for interim financing of building society savings contracts,
- prolongation of the heating energy savings programme in a modified form,
- financing of additional publicly subsidised building units, and
- relaxation of existing rent control with the aim of turning house-letting into a more profitable business.

On the whole, residential building investments will expand substantially in real terms during the course of 1983.

A certain increase in demand can also be expected in industrial building, above all as a result of raising degressive depreciation rates for factory buildings, of the investment allowance and of the thermal lagging regulations. Altogether, real investments in industrial building will gradually increase next year. Prospects are not so bright for public building investments. The

ECONOMIC TRENDS

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

Forecasts for the 2nd Half Year 1982 and for the Year 1983

	1981 ¹	1982 ²	1983 ²	1982		1983	
	Years			1 st hf. yr. ¹	2 nd hf. yr. ²	1 st hf. yr. ²	2 nd hf. yr. ²
Origin of National Product, in real terms							
Change in % compared with the preceding year							
Number of employed	-0.7	-2	-2	-1.7	-2	-2	-1.5
Working time (per working day)	-1.1	-0.5	-0.5	-0.4	-0.5	-0.5	0
Working days ³	-0.1	0	0	0.3	0	0.5	-0.5
Total work done, per calendar month	-1.9	-2	-2	-1.8	-2.5	-2.5	-2
Productivity ⁴	2.0	1.5	2	2.2	0.5	1	3.5
Gross Domestic Product at prices of 1970	0.1	-1	0	0.4	-2	-1.5	1.5

Appropriation of the National Product
– at current prices –
Change in % compared with the preceding year

Private consumption	4.7	3.5	3	3.9	3	3	3
Government consumption	7.2	4	3	3.9	4.5	4	2.5
Investment in fixed assets	0.4	-4	3	-3.8	-4	1	5.5
Equipment	0.7	-2	3.5	-2.0	-1.5	1.5	5.5
Buildings	0.2	-5	3	-4.9	-5.5	0	5.5
Exports	15.0	8.5	4.5	14.5	3.5	3	6
Imports	11.2	4	2.5	7.7	1	0	5.5
Gross National Product	4.0	4	4	4.7	3	3	4.5

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

Private consumption	-1.2	-1.5	-0.5	-1.6	-2	-1	0
Government consumption	2.0	0.5	0.5	0.6	0.5	0.5	0.5
Investment in fixed assets	-3.8	-6.5	0.5	-6.7	-6	-1.5	2.5
Equipment	-3.4	-6	0.5	-6.5	-5.5	-1.5	2.5
Buildings	-4.2	-6.5	0.5	-6.8	-6.5	-1.5	2.5
Exports	8.5	3.5	1	8.9	-1.5	-1	3
Imports	1.2	1.5	1	3.4	0	-1.5	3
Gross National Product	-0.2	-1	0	0	-2	-1.5	1.5

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

Private consumption	6.0	5	3.5	5.6	5	4	3.5
Government consumption	5.1	3.5	3	3.2	3.5	3.5	2.5
Equipment	4.2	4.5	3	4.7	4.5	3	3
Buildings	4.6	1.5	2	2.1	1	1.5	3
Exports	6.0	5	3.5	5.1	5	4	3
Imports	9.9	2.5	2	4.2	1	1.5	2
Gross National Product	4.2	5	3.5	4.6	5	4.5	3

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

Gross income from wagework ⁵	4.7	2.5	2	2.7	2	2	2
Gross wage and salary total	4.3	2	2	2.5	1.5	2	2
Ditto per employed person	4.8	4	3.5	4.3	4	4	3.5
Net wage and salary total	3.9	1	0.5	1.4	0.5	0.5	0.5
Gross income from entrepreneurship and property	-0.7	6.5	6.5	8.5	5	5	8.5
Net income from entrepreneurship and property	0.7	8	8	11.7	5.5	6	10
Disposable income of private households	5.7	3.5	2.5	3.9	3	2.5	2.5

¹Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 9/1982) and own calculations.

²Own forecasts; rates 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.

continuing consolidation efforts by central, regional and local authorities, especially by a large number of communes, means that public building investments are expected to decline well into the coming year. On the whole, however, building investments will soon begin to increase, expansion speeding up noticeably during the course of 1983.

Private Consumption Still a Problem

The drop in demand by private households will continue during 1983; the most decisive factor in this respect is the development of real income levels. Lower wage settlements, fewer jobs and the growing burden of taxation and other contributions will only allow a marginal increase in workers' incomes. Due to the government's austerity measures the increase in income transfers to private households will be much lower than it was this year. Worth mentioning in this respect are the six-month deferment of pension adjustment, the introduction of a health insurance contribution for pensioners in the middle of 1983, the cutback in child allowance for higher-income earners, and reductions in rent rebates and in government grants for students. All in all, the disposable income of private households will not increase up until mid-1983, and only slightly thereafter. Over the year as a whole, the increase will probably average less than 3%. As the rise in the cost of living, induced in part by the raising of value added taxation, will overtake the rate of income increase, real income levels will yet again fall.

Numerous factors determine the exact distribution of income between consumption and saving. Growing concern about job security and the comparatively large increase in incomes ensuing from entrepreneurship and property, of which more is saved than in the case of other incomes, will undoubtedly tend to enhance saving activities. On the other hand, falling interest rates and certain other special factors, such as the compulsory loan, the deferment of pension adjustment and the release of a substantial number of premium-carrying savings deposits will tend towards a reduction in savings. On the whole, the propensity to save can be expected to fall slightly during the course of 1983. Real private consumption in 1983 will once again decrease somewhat.

Recovery of Exports

During the coming months visible exports will most probably continue their downhill trend, although the rate of decrease will decelerate. The gradual economic recovery expected in the USA and the slight improvement in Western European demand forecast for

the final months of the coming year hold promise of a trend reversal during 1983. At the same time, the drop in imports registered by oil-exporting countries will not be as pronounced as during 1982. Particularly with regard to imports by the remaining developing countries, however, considerable risks still exist. The exact moment in time for a recovery of demand in the industrialised countries and its exact extent are equally very uncertain.

In view of the assortment of German exports, sagging investments on a worldwide scale will pose particular problems. On the other hand, the immense improvement in Germany's competitive position over recent years will definitely prove beneficial. All in all, visible exports will increase during the course of the coming year, albeit at a restrained pace. The annual average, however, will not exceed this year's level.

Improved Current Account Surplus

During the winter half-year real visible imports will once again decline slightly as a result of the continuing weakness in domestic demand. However, the fact that reduction in stocks is coming to an end will stop the downhill movement in imports of energy raw materials. Only when demand and production begin their recovery will German imports expand once more. Experience shows that stock-building provides initial impulses in this respect, resulting in increased purchasing of industrial primaries. A recovery of imports of manufactures can at the earliest be expected towards the end of the coming year.

Real net exports in 1983 will match this year's level. On an annual average the terms of trade are expected to be up on 1982; nominal net exports will increase further. This means that the current account surplus, in excess of the 1982 level, will be heading for the DM 10 billion mark.

Gloomy Labour Market Prospects

In view of the still declining demand for goods and services, overall economic production during the winter half-year will continue to fall; it will gradually pick up during the course of 1983. On the whole, gross domestic product (in real terms) will be no higher than this year's², falling well short of it during the first six months and clearly exceeding it during the second half of the year.

This trend in production, together with the continuing increase in the labour force, means there will be a

² The Rheinisch-Westfälisches Institut für Wirtschaftsforschung regards it as more probable that gross national product in 1983 will be 1% down on the 1982 level.

marked exacerbation of problems on the labour market. The number of employed will decrease more rapidly during the winter six months. The improvement in the situation during the second half of 1983 will only suffice to gradually slow down this decrease. Initially, firms will begin to utilise productivity reserves and reduce short-time working. It must be emphasised, however, that the future behaviour of firms with regard to employment is difficult to predict, since earlier experiences can only be partially related to the present situation.

During the coming months unemployment will increase considerably. At its seasonal winter peak the number of registered unemployed may well top the 2.5 million mark. Ignoring seasonal fluctuations, unemployment will continue rising during the coming year, albeit at a slower rate. As opposed to 1982, the increase in the number of registered unemployed will only slightly outpace the corresponding decrease in the number of employed. This is due to the expectation that unfavourable job prospects will induce an increasingly large section of the workforce to refrain from job-seeking and retire into the "latent reserve". There will probably be an annual average of 2.3 million unemployed in 1983, 450,000 up on 1982. The rate of unemployment – the percentage of unemployed in the total labour force – will rise to 9.5 %, as compared with 7.5 % this year.

Enhanced Consolidation Efforts

The starting position for future fiscal policy and government budgets resembles that of one year ago. Efforts on all budgetary levels still centre on consolidation; at the same time, attempts are being made to stimulate the economy by resorting to individual measures.

Cuts will particularly affect the social sector, the most far-reaching measures being the six-month deferment of

pension increases and the reduction of child allowance. Additional revenue is to be obtained by raising value added tax on 1 July 1983 and by levying a repayable "compulsory loan" over a period of two years.

The intention is to channel all the revenue obtained via the compulsory loan and part of the revenue from the rise in value added tax into investment promotion. With the exception of a certain degree of trade tax relief, however, the proposed measures exclusively affect residential building. Since, to begin with, the envisaged promotion will only lead to a slight increase in public spending, this programme will ease the pressure on the national budget in 1983 to the tune of DM 9 to DM 10 billion. Nevertheless, due to the weak economic situation the government's budget deficit is not likely to be down on this year's, again reaching about DM 65 billion. Once again the reduction of the structural deficit will be more or less balanced out by the increase in the cyclical deficit. It must, however, be stressed that the margin of error here is extremely large due to the uncertainties of economic developments and as regards the conclusive nature of budgetary plans.

Real government consumption is expected to stagnate during the coming year. Real government investments will again decline; since certain federal states and local authorities are beginning to take budgetary countermeasures, this decline will not be as severe as during 1982. Together with interest payments, expenditure related to unemployment will again increase substantially. The total increase in public spending will slow down to a rate of 3.5 %.

Despite increases in taxation and other contributions, government revenue will increase less than in 1982, namely at a rate of 3.5 %. In estimating revenue, profit transfer by the Deutsche Bundesbank was assumed to figure at a similar level to that recorded for this year.

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

Raw Materials and Groups of Materials	1981		1982					
	AA ²	October	July	August	September	October	Oct. 22	Nov. 5
Total index	240.7	237.1	226.5	225.8	225.2	224.3	223.9	224.6
Total, excl. energy raw materials	135.6	127.6	115.4	113.4	112.7	110.6	109.7	110.8
Food, tropical beverages	126.1	115.2	103.4	99.7	99.0	99.1	98.6	100.6
Industrial raw materials	142.7	137.0	124.5	123.8	123.1	119.3	118.2	118.5
Agricultural raw materials	146.4	135.5	125.1	123.9	122.2	115.3	112.1	113.6
Non-ferrous metals	165.3	152.5	130.7	131.8	131.7	131.4	134.0	133.1
Energy raw materials	302.1	301.1	291.4	291.5	290.9	290.7	290.6	291.0

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