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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 form.¹

The economic recovery in the Federal Republic of Germany, which had set in at the beginning of the year, gathered considerable momentum during the first six months of 1983. Up until the middle of the year, overall production grew at such a fast pace that the decline in the level of employment slowed down markedly and unemployment increased but slightly. Due to improved utilisation of plant capacity output per man-hour rose, the pressure of labour costs eased off, and business profits picked up strongly. There was no further increase in production after the middle of the year, but this was probably just a response to the extremely high increase recorded previously. Up until mid-1983 the exclusive motor for this recovery was domestic demand. Since the summer, however, export orders, which had stagnated up until this time, began to increase again.

There has been a considerable increase in investment in capital equipment in the wake of the jump of orders triggered by the Government's investment allowance. General investment conditions have also improved. Although there has been no further drop in interest rates, company earnings have recovered appreciably. One of the main reasons why supplies have been able to meet the sudden rise in demand so speedily was the concentration of demand on goods which were either in stock or could be produced at short notice, such as motor vehicles and data processing equipment. Industrial building investments have also been stepped up once more albeit to a far lesser extent than investments in capital equipment. This is due to the

fact that buildings need not be completed before the end of 1984 to qualify for the investment allowance. Demand for residential buildings had already been increasing since the beginning of last year. This is partly due to improved interest terms but even more to the measures favouring residential building agreed on in 1982 and 1983. The considerable upturn in demand led to a recovery in residential building activities.

Private consumption maintained its high level following a sharp increase at the beginning of the year. More and more households fell back on their savings or increased their borrowing. Between autumn last year and summer this year the savings ratio dropped by 1½ percentage points; this meant an expansion of the amount available for spending to the tune of DM 8 billion. The release of premium-aided savings and the drop in interest rates up until spring played an important part in this context; both factors made it easier for households to cater for pent-up demand, particularly for motor vehicles and fixtures. On the other hand, consumption was not supported by the development of incomes; incomes from dependent employment dropped even further, since the increase in hourly earnings was offset by the drop in employment and social insurance contributions were raised. State transfer incomes increased only slightly. The cost-of-living index, which had stopped climbing during the first few months of the year on account of falling prices for heating oil and petrol, increased again; this was also partly due to the increase in import prices caused by depreciation and to the raising of the rates of value added tax.

The stagnation of orders from abroad and of merchandise exports, which had lasted from autumn 1982 until early summer this year, gave way to an

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.

ECONOMIC TRENDS

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

Forecasts for the 2nd Half Year 1983 and for the Year 1984

	1982 ¹	1983 ²	1984 ²	1983		1984	
	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	-1.9	-2	-0.5	-2.1	-1.5	-0.5	-0.5
Working time (per working day)	-0.5	-0.5	0	-0.5	-0	0.5	0
Working days ³	0.2	0	-0	0.3	-0.5	0.5	0.5
Total work done, per calendar month	-2.2	-2	-0.5	-2.3	-2	0	-1
Productivity ⁴	1.2	3	2.5	2.1	4	2.5	3
Gross Domestic Product at prices of 1976	-1.0	1	2	-0.2	2	2.5	2
Appropriation of the National Product							
– at current prices –							
Change in % compared with the preceding year							
Private consumption	2.9	4	4	3.5	4.5	4	4
Government consumption	2.2	2.5	2.5	1.5	3	2.5	2
Investment in fixed assets	-3.1	5	8	3.0	7	8.5	7.5
Equipment	-2.7	8.5	7	6.6	9.5	6	8
Buildings	-3.3	3	8.5	0.6	5.5	9.5	7.5
Exports	8.0	0.5	6	-0.9	1.5	7	5.5
Imports	3.1	-0.5	5.5	-3.2	2.5	6.5	5
Gross National Product	3.6	4	5	3.6	5	5	4.5
– at prices of 1976 –							
Change in % compared with the preceding year							
Private consumption	-2.2	1	1	0.2	1.5	0.5	1
Government consumption	-1.1	-0.5	0	-1.1	0.5	0.5	0
Investment in fixed assets	-5.4	3.5	4.5	1.9	5	5	4
Equipment	-6.6	5.5	4	4.1	7	3	5
Buildings	-4.5	2	4.5	0.4	3	6	3.5
Exports	3.7	-1	3.5	-2.4	0.5	4.5	2.5
Imports	0.8	-0	3	-2.3	2.5	3.5	2.5
Gross National Product	-1.1	1	2	0.1	2	2.5	2
Price Level of National Expenditure (1976 = 100)							
Change in % compared with the preceding year							
Private consumption	5.3	3	3	3.3	3	3.5	2.5
Government consumption	3.4	2.5	2	2.6	2.5	2	2
Equipment	4.3	2.5	3	2.5	2.5	3	3
Buildings	1.3	1.5	3.5	0.2	2	3.5	3.5
Exports	4.2	1.5	2.5	1.5	1	2	3
Imports	2.3	-0	2.5	-0.9	0.5	3	2.5
Gross National Product	4.8	3	2.5	3.4	2.5	2.5	2.5
Origin and Distribution of Income							
Change in % compared with the preceding year							
Gross income from wagework ⁵	2.3	1.5	3.5	1.0	1.5	3.5	3
Gross wage and salary total	2.0	1	3	0.8	1	3.5	3
Ditto per employed person	4.2	3	3.5	3.2	3	4	3
Net wage and salary total	0.8	0	2	-0	0	2	1.5
Gross income from entrepreneurship and property	6.2	11	7.5	11.3	11	7	8
Net income from entrepreneurship and property	7.5	13	9	13.2	12.5	8	9.5
Disposable income of private households	2.3	2.5	3.5	1.7	3.5	4	3.5

¹Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 9/1983) 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.

increase. This recovery is rooted in the improved economic situation of the Western industrialised countries and in the strengthened competitiveness brought about by the depreciation of the D-mark. The strong expansion of demand and production was accompanied by a lively increase in merchandise imports. As, in addition, the terms of trade deteriorated as a result of the rise in commodity prices and the depreciation of the D-mark, there was initially a substantial drop in the merchandise trading surplus. On the other hand, the deficit on invisibles was reduced, primarily because of the decrease in external interest payments. After the middle of the year the balance of trade surplus, and with it that of the current account, increased once more.

In autumn, production can be expected to revert to the upward movement recorded during the first six months of 1983. This will be mainly supported by investments, as capital equipment has to be delivered by the end of the year if it is to qualify for the investment allowance. Exports, too, will support the uptrend. The marked increase in profits and the more optimistic assessment of sales prospects by the companies themselves would indicate a continued recovery next year. Its intensity and duration however are uncertain, particularly as it is difficult to assess the degree to which the recovery in investments is merely due to temporary incentives. The forecast is based on the following assumptions: although the payment problems facing major developing countries in Latin America were, for the time being, relieved by coordinated action by creditor banks, international organisations and the countries involved, they have not yet been solved and will continue to weigh heavily on the international economic development. Here, the assumption is made that it will be possible to keep crises under control during the coming year. World trade will continue to expand. The price competitiveness of German exporters will remain high even if – as assumed by this forecast – the D-mark slightly recovers against the dollar. The differences between the development of prices and costs in the Federal Republic of Germany and in its partner countries within the European Monetary System will be evened out by graduated realignment of respective currencies. The supply of oil will remain abundant and there will be no sudden jumps in prices. It is assumed that political conflicts will not seriously interfere with the supply situation.

As regards fiscal policy, the assumption is made that the measures announced in the laws accompanying the federal budget will come into force. This year's monetary policy will attempt to move the money supply

to the upper limit of the target funnel. In the coming year, the Bundesbank will extend the money supply by about 5 % current annual rate in line with the potential-oriented path. Taking into account the remaining determinant factors, this would result in slightly falling interest rates. The next round of wage negotiations will be accompanied by discussions on the reduction of working time. These negotiations will be very tough, putting a strain on the overall business climate. The forecast assumes that any agreements reached will not yet lead to any significant reduction in working time in 1984. What is more, the development during the forecast period will, however, not be solely determined by the afore-mentioned assumptions but also to a considerable extent by the monetary and fiscal stimuli of 1982 and 1983.

During the final months of the year there will be a marked increase in investments in capital equipment, since the delivery period for goods which qualify for the investment allowance expires at the end of 1983. In some cases, investments will merely be carried out in advance, suggesting a decline in investments at the beginning of 1984. In the meantime, however, there has been an improvement in investment conditions; this applies particularly to company profits. To a growing extent companies are able to fall back on their own funds to finance investments. In addition, borrowing will also become somewhat cheaper. Industrial building activities, backed by full order books, will increase at a rapid pace up until the end of 1984, the deadline for the completion of buildings qualifying for the investment allowance. Supported by fiscal support programmes and low interest rates, the recovery in residential building will continue, particularly in view of the fact that certain benefits can only be claimed for buildings that are completed before the end of 1984. This year's public building investments will yet again be down on last year's figure, although an increase is likely next year. For some time now, orders in this field have been indicating an upward trend.

Private consumption during the coming months will again mainly depend on the development of real incomes and will increase only very slowly. With an only slightly lower level of employment and with increases in negotiated wage rates similar to this year's figure, incomes from employment will increase at a slightly faster pace in 1984. If state transfers, profits drawn and incomes from property are included, private households will have about 3½ % more income at their disposal. The propensity of private households to save will probably remain low. This assumption is supported by the fact that interest rates will not increase the incentive

to save or decrease the incentive to borrow and that the motive of saving "for harder times" will become less important as unemployment increases only slightly. What is more, the number of young households with a relatively low propensity to save will increase. There are strong indications that price increases will remain relatively low during the rest of this year and during the coming year. The D-mark will tend to regain value, suggesting a stabilisation of import prices. The increase in overall unit labour costs will again be low at approximately 1 %. Altogether, the increase in the cost of living in 1984 will – like the 1983 average – amount to approx. 3 %.

Since the middle of the year the economic recovery in the industrialised countries has been reflected in new orders from abroad. The increase in demand and exports can be expected to continue next year, sustained by the trade with industrialised countries. Since the recovery in these countries, as in the Federal Republic of Germany itself, exerts an influence on other regions, the prospects for exports to such regions will also improve somewhat. This applies to both the OPEC countries and to the remaining developing countries, whose export earnings will increase. The relatively low valuation of the D-mark against the dollar and the yen will favour the competitiveness of German suppliers. The moderate increase of overall demand and the more or less completed adjustment of raw materials stocks to the higher level of production would indicate that merchandise imports will increase only slowly. Following the sharp increase in imports during the first six months of 1983 net exports this year will be lower in real terms than the figure for the previous year. However, the more favourable annual average terms of trade will lead to a higher level of net exports in nominal terms. The improvement will continue next year, this time however due to an enlarged real surplus, the terms

of trade changing only slightly. This year's current account surplus will figure at about DM 10 billion, moving to a slightly higher level next year.

Overall production will increase again during the final four months of this year. The main factors will be the export expansion and the increased investments in capital equipment carried out in order to benefit from the investment allowance by the end of the year. In addition, there will be an increase in building activities. During the year, real gross domestic product will have risen – adjusted for working days – by about 3 %; this corresponds to an average annual increase of 1 %. The increase in overall production will continue next year, though slowing down as the year goes on. Nevertheless, the rate of increase in 1984 will with 2 % be higher than the 1983 figure. This production increase is too low to be able to drastically change the labour market situation, even though the number of employed persons will hardly fall any more. This will be due not only to less persons being made redundant but also to the fact that in certain sectors the number of employed persons will increase, namely in the building industry and in vehicle construction. On an average, the number of employed persons in 1984 will probably be 100,000 (or 0.5 %) down on this year's figure, which is likely to experience a drop of about 450,000 (or 2 %). As in 1983, the potential of gainfully employable persons will rise much more slowly than in previous years, since the demographically induced increase will diminish and be balanced out to a certain extent by the remigration of foreign workers. Allowing for the expected retreat of many gainfully employable persons into the "latent reserve", the increase in unemployment will roughly equal the decrease in the number of employed persons. The number of registered unemployed in 1983 is expected to average 2.3 million and about 2.4 million in 1984.

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

Raw Materials and Groups of Materials	1982		1983					
	AA ²	October	July	August	September	October	Nov. 4	Nov. 18
Total index	228.6	224.3	204.8	205.8	206.3	206.5	205.8	205.9
Total, excl. energy raw materials	117.9	110.6	124.2	127.4	128.8	128.9	127.4	127.9
Food, tropical beverages	106.1	99.1	116.3	124.0	126.6	127.1	126.2	127.7
Industrial raw materials	126.4	119.3	130.3	129.9	130.5	130.2	128.4	128.0
Agricultural raw materials	127.1	115.3	130.3	130.3	131.5	131.6	131.1	131.0
Non-ferrous metals	134.9	131.4	150.4	149.3	147.5	142.9	138.8	138.7
Energy raw materials	293.4	290.7	251.8	251.6	251.6	251.8	251.6	251.5

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