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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 improvement of the general economic situation in the Federal Republic of Germany continued during the 1983/84 winter six months. Whereas domestic demand was the primary motor behind this uptrend up until mid-1983, it was subsequently accompanied by a strong recovery of exports. The pace of the increase of demand and production has been so great as to produce a noticeable increase in capacity utilisation. Recovery, therefore, has now developed into a proper economic upturn. This economic improvement was able to check the decline in the level of employment. There has been a drop in the number of unemployed persons and short-time workers. The substantial recovery of domestic demand is partly due to the fairly expansionist monetary policies pursued up until mid-1983, and partly to fiscal support programmes for residential building and industrial investments. The propensity to invest was also enhanced by the more favourable profit situation and expectations. Since the end of 1982 domestic demand for capital goods has demonstrated an upward trend. The development was initially marked by the bringing forward of investments due to the Government's investment allowance; the large number of new orders since autumn 1983 signals a consolidation of the propensity to invest. Investment activities have speeded up considerably during the 1983/84 winter six months. The main reason for the particularly sharp increase towards the end of the year was to meet the expiry deadline set to qualify for the afore-mentioned investment allowance.

The gradual economic recovery and the accompanying mild improvement in the labour market situation have led to a greater inclination to buy on the part of consumers. This trend has been reinforced by more favourable terms for consumer credits. Private household incomes have been subject to counteracting influences: the government's consolidation policies,

with their cutbacks in transfer-payment increases and higher tax and fiscal charges, have had a retardant effect; the increase in the total number of man-hours worked a more favourable one. On the whole, there was a slight acceleration in the increase of disposable incomes. This time, as opposed to earlier upturn periods, exports have initially figured only marginally in economic recovery. A major reason has been the persistently poor economic situation in important customer countries. Only after the economic situation began to pick up in these countries, and the import pull grew stronger in countries which had already passed through their economic trough, was there a marked, almost surging, increase in exports. Admittedly, a significant aspect was the strengthened price competitiveness of German producers resulting from the D-mark's exchange-rate losses and the comparatively low level of price increases in the Federal Republic of Germany.

The upswing has eased the labour market situation. Seasonally adjusted, the unemployment figure has been decreasing since autumn 1983, and short-time work was halved within a year. The number of employed persons has not fallen since autumn. The fact that a noticeable drop in the number of registered unemployed persons has nevertheless been recorded would indicate that many unemployed persons have, at least for the time being, given up their search for employment and that a greater number of foreign workers have decided to remigrate. Increased further training, vocational retraining and job orientation measures may have also played a part in improving unemployment statistics. Since autumn 1983 the cost of living for private households has increased more slowly than before this period; seasonally adjusted and viewed on an annual basis, consumer prices are rising at about 2 %. The fact that at the start of 1984 this figure exceeded the level recorded one year previously by over 3 % was due to the decrease in consumer prices at the beginning of 1983 caused mainly by falling prices for mineral oil products.

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.

Ever since the revival of worldwide economic activity enabled a pronounced expansion of German exports, economic improvement has been more broadly based. This is undoubtedly one reason why the propensity of businesses to invest continues to rise, even though the benefits of the government's investment allowance are no longer available. The expansive forces are strong enough to guarantee a continuation of the overall increase in production. During the course of this year this increase will be greater than the increase in the economy's overall productive capacity; the degree of capacity utilisation will continue to increase substantially. The upturn will thus continue, and can be described as self-sustaining if this term is understood to signify an upward trend which will endure even after monetary and fiscal impulses have died down. However, this is not synonymous with a lasting strengthening of the – currently inadequate – growth of productive capacity. The latter, however, is a decisive factor if a solution is to be found to employment problems. In view of both national and international economic uncertainties and the persistent shortcomings in the general economic setting, it remains an open question whether this goal can be attained or not.

The forecast is, as usual, based on a number of assumptions, the most important of which are referred to here. It is assumed that there will be a marked expansion in world trade, helping to ease the debt problems facing developing countries. The exchange rate of the dollar against the D-mark will fall, albeit in a fluctuating manner, to a figure of about DM 2.40 during the course of the year. The central rates of the European Monetary System will not be realigned before autumn. There will only be a slight decrease in the price competitiveness of German exporters. The supply of oil will remain abundant despite the continuing conflict in the Persian Gulf and there will be hardly any change in prices on the international market. Industrial raw materials will be only slightly more expensive. As regards fiscal policy, it is assumed that the course outlined in budgetary plans and laws accompanying the 1984 federal budget will be maintained. The Bundesbank will keep the money supply around the middle of the target funnel. In conjunction with other determinant factors this will enable a slight interest rate reduction. Negotiations on shorter working time will be lengthy and accompanied by industrial action; it is assumed that this will not affect adversely the development of overall production to any pronounced degree. Any settlements reached on this issue will not lead already in 1984 to a noticeable reduction in working

time, and subsequently to additional costs. Apart from agreements in the public sector, negotiated wage-rate increases will figure at about the same level as that accepted in recent agreements.

The lasting international economic improvement and the continuing international competitive strength of German suppliers indicate a surge in exports. There will be changes in the tempo of trade with individual regions. On the one hand, the remarkably vigorous expansion in exports to the USA will lose considerable momentum, primarily due to the diminishing intensity of the economic upswing there. However, the appreciation of the D-mark against the dollar will not have an immediate impact on exports. On the other hand, with the economic situation in Western European countries continuing to improve, exports to these countries will increase, since the competitive position of German exporters is initially likely to improve. Furthermore, developing countries, including OPEC countries, will assume greater importance as potential markets, as their export earnings increase again, primarily thanks to the industrialised countries' growing demand for raw materials. Economic improvement in the Federal Republic of Germany will also lead to a further marked expansion of merchandise imports. Although the price competitiveness of foreign suppliers from the dollar area is likely to improve, the effects will not be felt immediately. Net exports will increase substantially in real terms. The current account surplus will probably move up to about DM 20 billion.

Even after the expiry of the qualification deadline for the government's investment allowance, businesses reveal a growing propensity to invest. The improvement of major determinants in this respect would suggest that this trend will continue. The increasing recovery of both domestic and external demand has led to a much more optimistic appraisal of sales prospects. After profits had already improved substantially last year, starting as they did from a very depressed level, prospects are looking even better this year. Tax reliefs for businesses will definitely improve profit expectations and thus the investment propensity. Expectations of better equity returns on the one hand, and slightly falling interest rates on the other, encourage investments in physical assets as opposed to financial assets. However, these favourable factors which enhance the propensity to invest are still faced by a number of risks. A significant and serious risk is presented by the demand for a reduction of working time without loss of income. Any settlements reached on this point involving high cost burdens would, in the medium term, have an adverse effect on profit expectations and thus on the propensity

ECONOMIC TRENDS

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

Forecast for 1984

	1982 ¹	1983 ¹	1984 ²	1983		1984	
	Years			1 st hf. yr. ¹	2 nd hf. yr. ¹	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	-1.8	-1.7	0.5	-2.1	-1.4	0	0.5
Working time (per working day)	-0.6	-0.1	0.5	-0.4	0.2	0.5	0
Working days ³	0.2	0	0	0.3	-0.3	0.5	-0.5
Total work done, per calendar month	-2.2	-1.8	0.5	-2.2	-1.5	0.5	0.5
Productivity ⁴	1.3	2.7	3	2.2	3.2	3	2.5
Gross Domestic Product at prices of 1976	-1.0	0.9	3	0	1.7	3.5	3
Appropriation of the National Product							
— at current prices —							
Change in % compared with the preceding year							
Private consumption	3.0	4.0	4.5	3.7	4.2	4.5	4.5
Government consumption	2.4	2.5	2.5	1.3	3.5	3	2.5
Investment in fixed assets	-2.7	4.6	8.5	2.4	6.5	8.5	8.5
Equipment	-2.7	8.1	9	5.7	10.2	7.5	10
Buildings	-2.7	2.5	8.5	0.4	4.3	9.5	7.5
Exports	8.1	0.5	11.5	-0.9	1.8	12	11
Imports	3.1	0.3	9.5	-3.4	4.0	12	7
Gross National Product	3.6	4.5	6	3.8	5.1	6	6
— at prices of 1976 —							
Change in % compared with the preceding year							
Private consumption	-2.2	1.0	1.5	0.4	1.5	1.5	2
Government consumption	-1.0	-0.2	0.5	-1.2	0.8	0.5	0.5
Investment in fixed assets	-5.1	2.9	5	1.3	4.3	5.5	5
Equipment	-6.6	5.7	5.5	3.4	7.8	4.5	6.5
Buildings	-3.9	0.9	5	-0.2	1.9	6	4
Exports	3.7	-0.9	8.5	-2.4	0.5	9.5	7.5
Imports	0.8	0.8	6.5	-2.6	4.2	8.5	5
Gross National Product	-1.1	1.3	3	0.4	2.1	3.5	3
Price Level of National Expenditure (1976 = 100)							
Change in % compared with the preceding year							
Private consumption	5.3	3.0	3	3.3	2.7	3	2.5
Government consumption	3.4	2.7	2	2.6	2.7	2.5	2
Equipment	4.3	2.2	3	2.3	2.2	3	3
Buildings	1.3	1.6	3.5	0.5	2.4	3	3.5
Exports	4.2	1.5	3	1.6	1.3	2.5	3
Imports	2.3	-0.5	2.5	-0.8	-0.2	3	1.5
Gross National Product	4.8	3.2	2.5	3.5	3.0	2.5	3
Origin and Distribution of Income							
Change in % compared with the preceding year							
Gross income from employment ⁵							
Gross wages and salaries total	2.1	1.7	4.5	1.1	2.2	5	4
ditto per employed person	2.1	1.4	4.5	0.8	1.9	5	4
Net wages and salaries total	4.2	3.4	4	3.1	3.6	5	3
Gross income from entrepreneurship and property	0.9	0.4	3	-0.1	0.8	3.5	2.5
Net income from entrepreneurship and property	6.8	11.2	9.5	12.3	10.2	6.5	12
Disposable income of private households	7.2	13.0	10.5	14.7	11.5	7	14

¹Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 3/1984) and own calculations.

²Own forecasts; rates of change rounded off.

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

⁴Real Gross Domestic Product per hour worked.

⁵Including employers' social security contributions.

to invest. In addition, concern has been expressed that only inadequate use is being made of the possibility of effectively organising tax reform to achieve a fundamental improvement in growth conditions. If these risks are not averted, the chances of achieving the necessary growth in productive capacity must be rated as slim.

Production in the building industry this year will to a large extent be determined by the clearance of the increased backlog of orders. A relatively lively increase in construction activities is likely even though the demand for construction work has stagnated since the middle of last year. There will be a marked production increase in industrial building due, on the one hand, to the fact that the building covered by the government investment allowance must be completed before the end of the year and, on the other, to the expected renewed increase in orders once the temporal distortions caused by the investment allowance have disappeared. There has already been a slight decrease in demand in the field of housing construction. An increase in the near future is not likely, especially since the housing need is not growing to the same extent it has done up to now. However, due to full order books a clear increase in residential building investments can still be expected this year. As for public buildings, demand and production will expand only slightly, the government seeing only a limited scope for expansion in this field.

Private consumption will continue to climb this year. Whereas last year's consumption increase mainly took place at the expense of savings, this year's rise will primarily be supported by expanding incomes. There will be a substantial increase in the gross wages and salaries total with the level of employment gradually increasing following last year's decline. Net incomes are expected to exhibit a similar trend, even though the extension of the definition of income subject to compulsory social insurance to cover special payments, tax-rate progression and the halving of the educational

allowances will lead to greater burdens on incomes. Austerity measures and the decline in unemployment, on the other hand, will lead to a further slowing-down in the increase of government transfer payments. Altogether, at about 4 % the increase in the disposable incomes of private households will be greater than last year. How this increased income will be split between consumption and savings is, as always, difficult to forecast. However, a renewed increase in the savings ratio, which fell appreciably last year, is improbable; in fact, a further slight decrease can be expected.

At about 3 % the increase in overall production will match last year's figure. Due to the overhang at the start of the year the average annual increase will be slightly more than 3 %. This development of overall production will lead to an increase in the number of employed persons of about 200,000 during the course of the year. Over the same period there will be a drop in the unemployment figure; by the end of the year there will probably be 200,000 fewer jobless. Together with the growing demand for labour the main reasons for this reduced jobless tally are the increased tendency of unemployed persons to retreat into the latent reserve and the fact that more funds are being made available for further occupational training, vocational retraining and job orientation measures. The labour supply will increase more slowly than hitherto, above all on account of the increased remigration of foreign workers. It is fair to assume that this year's level of price increases will be moderate. Overall unit labour costs will increase only slightly, and the prices of imported goods can, on the whole, be expected to remain more or less stable due to exchange rate trends. The restrained monetary development and the continuingly high elasticity of supply would also suggest that a deterioration of the price climate is unlikely. All in all, there will only be a moderate rise in consumer prices up until the end of the year; compared to the previous year the rate of increase by then will be less than 2.5 %. The annual average will be just under 3 % up on the level for the previous year.

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

Raw Materials and Groups of Materials	1983		1984					
	AA ²	December	January	February	March	April	May 11	May 18
Total index	209.3	205.7	206.1	206.3	207.6	207.6	207.0	207.3
Total, excl. energy raw materials	122.8	127.4	128.7	128.8	131.9	131.2	130.1	130.7
Food, tropical beverages	116.8	126.7	128.4	126.1	129.5	129.2	131.3	133.2
Industrial raw materials	127.4	127.9	128.9	130.9	133.8	132.8	129.3	128.9
Agricultural raw materials	125.5	130.0	129.6	131.0	132.7	131.6	129.8	129.9
Non-ferrous metals	145.0	139.8	140.3	142.0	146.1	146.8	140.0	138.6
Energy raw materials	259.8	251.4	251.3	251.5	251.8	252.2	251.9	251.9

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