

Hamburg Institute of International Economics (HWWA) (Ed.)

**Article — Digitized Version**

## The economic situation in the Federal Republic of Germany

Intereconomics

*Suggested Citation:* Hamburg Institute of International Economics (HWWA) (Ed.) (1984) : The economic situation in the Federal Republic of Germany, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 19, Iss. 6, pp. 301-304, <https://doi.org/10.1007/BF02928356>

This Version is available at:

<https://hdl.handle.net/10419/139949>

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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.<sup>1</sup>

The improvement of the general economic situation in the Federal Republic of Germany continued during 1984. Exports have been the primary motor behind this recovery, domestic demand expanding only weakly. This uptrend, however, was disrupted somewhat by strike action and lockouts as well as the consequences of these both prior to and after the event. Furthermore, the overall trend has also been eclipsed by other special factors. It is difficult at present to adequately assess the impact of these disturbances and disruptions on the pace of economic improvement. However, a great deal would indicate that the upward trend has not been consolidated, but has in fact lost momentum. Fluctuations in production have almost exclusively been reflected in changes in working time and productivity. The number of employed persons has remained virtually untouched by this development. The decline in this number has almost come to a standstill. The jobless figure has again increased. During recent months it has matched levels recorded one year previously.

Yet again, the economy has been stimulated by export activities, even though these too have not remained unaffected by industrial action. The economic upswing in the USA, greater investment activities in neighbouring Western European countries, and, last but not least, the depreciation of the D-mark in real terms against the dollar, the yen and even most European currencies, have all improved the export situation. As regards merchandise imports, the upward trend has clearly been sagging. This levelling-off is not merely due to the exchange-rate induced reduction in the competitive strength of foreign suppliers compared with domestic suppliers, but also results from the waning thrust of domestic economic recovery.

Investments in fixed assets fell during the first few months of the year following the expiry of the qualification deadline for the government's investment allowance and the associated accumulation of

investments at the end of last year. They were subsequently kept at their low level by strike action and lockouts. However, some ground has already been made up in this respect. The increase in orders for capital goods, which rose steeply during the second half of 1983, has revealed a clear downhill trend this year. There has only been a restrained increase in building activity. Although orders had increased markedly due to numerous fiscal support measures, the backlog of orders does not appear to have lasted very long; in all probability, many orders have been cancelled. Residential building orders continue to decline; there has been no further decrease in the cases of industrial buildings, and the upward trend in the field of civil engineering has in fact been slightly reinforced.

Following the marked increase in private consumption at the beginning of the year, influenced strongly by the advance payments to workers and the release of substantial sums from premium savings agreements, industrial action resulted in a declining consumption level, albeit not to the extent to which incomes fell. Incomes increased strongly following industrial action, back payments and overtime figuring as major determinant factors. Private consumption, however, increased only slightly, since private households were initially keen on replenishing their financial reserves. On the whole, consumption shows a rather flat upward trend, increasing at an annual rate of about one per cent. The decline in the increase of consumer prices, which was interrupted in the middle of 1983 by the raising of the value added tax rates, has reasserted itself this year. In September, the figure was only 1.5 % up on the previous year's level. This drop in the rate of inflation is all the more surprising in view of the fact that the D-mark depreciation against the dollar made imports much more expensive.

The future course of economic development in the Federal Republic of Germany will continue to be influenced by special determinant factors, some of which are reflexes to the production losses caused by industrial action during early summer, some of which are connected with the completion deadlines for buildings set as part of fiscal and residential policy measures. On the whole, overall economic demand and

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<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.

**ECONOMIC TRENDS**

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

Forecasts for the 2nd Half Year 1984 and for the Year 1985

	1983 <sup>1</sup>	1984 <sup>2</sup>	1985 <sup>2</sup>	1984		1985	
	Years			1 <sup>st</sup> hf. yr. <sup>1</sup>	2 <sup>nd</sup> hf. yr. <sup>2</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	-1.7	-0.5	0	-0.5	0	0	0
Working time (per working day)	-0.1	0	-0.5	-0.3	0.5	0.5	-1
Working days <sup>3</sup>	0	0	-0.5	0.4	-1	-1	0.5
Total work done, per calendar month	-1.8	-0.5	-1	-0.4	-0.5	-0.5	-1
Productivity <sup>4</sup>	2.8	3	3	2.6	3.5	3	2.5
Gross Domestic Product at prices of 1976	1.0	2.5	2	2.2	3	2.5	1.5
<b>Appropriation of the National Product</b>							
- at current prices -							
Change in % compared with the preceding year							
Private consumption	4.1	3.5	3.5	3.7	4	3.5	4
Government consumption	2.7	3	4	3.4	3	4	3.5
Investment in fixed assets	4.8	5	4	4.1	5.5	6.5	1.5
Equipment	8.5	3.5	7.5	0.5	6	11	5
Buildings	2.5	6	1.5	6.4	5.5	4	-0.5
Exports	0.2	10.5	9	8.5	12.5	11	7
Imports	0.1	10.5	6.5	11.5	9.5	7.5	5.5
Gross National Product	4.5	4.5	4.5	4.2	5	5	4
- at prices of 1976 -							
Change in % compared with the preceding year							
Private consumption	1.1	1	1.5	0.6	2	1.5	1.5
Government consumption	0	0.5	0.5	0.6	0.5	1	0.5
Investment in fixed assets	3.1	2.5	2	1.4	3.5	4.5	-0.5
Equipment	6.1	1	5	-1.5	3.5	8.5	2
Buildings	0.9	3.5	-0.5	3.5	3.5	1.5	-2.5
Exports	-1.3	7	6	5.5	8.5	7.5	5
Imports	0.5	6	4	7.0	4.5	4	4
Gross National Product	1.3	2.5	2	2.2	3	2.5	1.5
<b>Price Level of National Expenditure (1976 = 100)</b>							
Change in % compared with the preceding year							
Private consumption	2.9	2.5	2	3.0	2	2	2.5
Government consumption	2.7	2.5	3	2.8	2	3	3
Equipment	2.3	2	2.5	2.0	2.5	2.5	3
Buildings	1.6	2.5	2	2.8	2	2	2
Exports	1.5	3.5	2.5	2.8	4	3	2
Imports	-0.4	4.5	2	4.2	4.5	3	1.5
Gross National Product	3.2	2	2.5	2.0	2	2.5	2.5
<b>Origin and Distribution of Income</b>							
Change in % compared with the preceding year							
Gross income from employment <sup>5</sup>	1.7	3.5	3.5	2.9	4	3.5	3.5
Gross wages and salaries total	1.4	3.5	3.5	2.9	3.5	3.5	3.5
Ditto per employed person	3.4	4	4	3.6	4	4	3.5
Net wages and salaries total	0.4	2	3	1.6	2.5	3	2.5
Gross income from entrepreneurship and property	11.2	7	6	5.3	9	8.5	4.5
Net income from entrepreneurship and property	12.9	7.5	7	4.6	10	9.5	4.5
Disposable income of private households	2.3	3.5	3.5	3.6	4	3.5	4

<sup>1</sup>Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 9/1984) 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.

production will be characterised by a generally upward trend during the rest of this year and in 1985. However, the increase in production will be slight, too slight to lead to higher employment. The urgently needed acceleration in the increase of productive capacity will not be achieved.

The forecast is based on the following assumptions. The expansion of world trade will continue at roughly the same – diminished – pace recorded towards the middle of 1984. The dollar will maintain its international strength. The average ratio of the D-mark to the dollar in 1985 will more or less correspond to the 1984 figure. There will be a slight appreciation of the D-mark against European currencies. There will hardly be any change in the price of major industrial raw materials on international markets; the dollar price of oil will fall somewhat. The fiscal policy course will by and large move along the path marked out for the government in the 1985 budget. The increase in public spending will be kept low and there will be a continued reduction in the government deficit. The Bundesbank will set a monetary target for 1985 closely resembling this year's level, keeping the money supply around the middle of the target funnel. The decrease in borrowing, particularly by the government and the housing sector, provides scope for the continuation of the trend towards falling interest rates on the capital market. Negotiated hourly wage rates will increase to a greater extent than during 1984, since in many areas the agreements reached on the reduction of working time without loss of income will take effect. Employers will also have to face additional labour costs resulting from early retirement provisions.

Merchandise exports will also continue their relatively strong increase in coming months, representing the economy's most important expansionary force. The slowing down of the expansion of world trade will not initially affect this upward trend; any adverse influence is still being offset by the stepping up of deliveries postponed on account of industrial action and by the slightly growing demand for capital goods in Western European countries, a trend which is particularly beneficial to German exporters. In the dollar area, the favourable competitive position resulting from the high exchange rate against the US-dollar is likely to lead to further market share gains. A further marked increase in merchandise exports can be expected next year. The marginal increase in world trade will not fully affect German exports, since the expansion of demand on the relevant markets will not slow down so fast. In view of the restrained expansion of demand and production, retardant stock-cyclical factors and the unfavourable competitive position of many foreign suppliers caused

by the exchange-rate situation, only a relatively slight increase is likely in the case of imports. Assuming that the external value of the D-mark develops as forecast, any further deterioration in the terms of trade is unlikely; this means that the increase in real terms of the export surplus will become fully effective for the balance on current account. The latter's surplus will increase substantially, moving from about DM 10 billion in 1984 to about DM 20 billion next year.

Following the termination of industrial action there was a substantial jump in domestic orders for capital goods; the latest figures show that orders have climbed to the high level recorded at the beginning of the year. This would indicate an increase in fixed assets investments during the final six months of 1984, even though the losses caused by strike action will not be fully recouped. A continued, albeit relatively weak, upward trend is likely for investments in fixed assets during the course of 1985. The continually favourable sales prospects for German industry abroad would support this forecast. In addition, the increase in profits and the recent decline in interest rates have improved financing conditions. Finally, there is still a need for modernisation and innovation, and in some sectors for an extension of capacities. However, the persistent weakness of domestic demand together with the uncertainty as to whether the economic situation abroad and the exchange-rate relations will remain the same have an adverse effect on the propensity to invest. The latest pay settlements are likely to influence the extent and structure of investment made. It will not be possible, at least in the immediate future, to pass on any additional costs, a factor which may squeeze profits. A slackening of the investment propensity thus seems likely. In view of the relative increase in labour costs, the share of rationalisation investments will probably rise. The upward trend of fixed assets investments during the course of 1985 will be a moderate one; the forecast annual average increase of 5 % exaggerates the cyclical trend.

The development in the field of building investments during 1985 will be adversely affected by the fact that in connection with the various support measures for residential and industrial building many investments are being made at an earlier date. The decline in the number of building permits and orders placed is indicative of the probable trend here. There has been a particular drop in the demand for residential buildings. There are no signs of impetuses which could stimulate building activity in the immediate future. In view of the only slight increase in incomes during recent years, building has simply become too expensive for many potential builders, even

if, as forecast, interest rates continue to fall; in addition, the at least temporary real estate surplus and the accompanying pressure on prices are likely to make this an appealing current alternative. A further factor leading to caution with regard to new commitments is the uncertainty concerning the planned reform of housing subsidisation, where clear final decisions have yet to be taken. As regards industrial buildings, current demand, which fell back to its earlier level following the jump in orders caused by the investment allowance, stabilised towards the middle of the year, and now exhibits a slightly rising trend. This would indicate that industrial building will again pick up following the decline to be expected after the jump in orders triggered by the investment allowance. Public building investments have recently shown an increase. Although demand has been growing in this field for some time, it has been at a low level. Both the improved financial situation of the municipalities and the backlog demand would support the continuation of this trend. A slight decline for building investment in general can be expected next year.

There will only be a moderate increase in private consumption next year. Although the upward trend for private household incomes will not be so strongly curbed as they were during the current year by the austerity measures of the government's consolidation policy, the improvement in the income situation will be limited by the reduction in working time agreed upon for 1985. According to the latest information, the negotiated standard weekly working time will be reduced for almost 5 million workers. The pay settlements with reduced working time will lead to a marked increase in hourly earnings. However, this will not apply to employee incomes, since it is unlikely that the reduction in working time will result in any noticeable increase in employment, whether in the form of the recruitment of additional workers, of reduced short-time work or of more overtime. The number of employed persons,

however, will hardly decline. On the whole, the gross wages and salaries total will increase during 1985 to the same extent as during the previous year. The same applies to the development of disposable incomes. No appreciable change is to be expected next year in the savings ratio; expenditure on consumption, therefore, will continue to expand at an almost unchanged pace. Since on an annual average the increase in consumer prices in 1985 will be somewhat lower than in 1984, there will be a slightly greater increase in private consumption in real terms. However, it will only reach the modest figure of 1.5 %.

The current forecast of the components of overall economic demand arrives at a 2 % rate of increase for national product in real terms in 1985, as against 2.5 % during 1984. The degree of productive capacity utilisation will hardly change. The assessment of effects on the labour market which result from the predicted increase in production poses greater difficulties than usual; the reaction of employers and employees to the reduction of weekly working hours and early retirement provisions is uncertain. However, labour market effects will probably not weigh heavily in 1985. On the other hand, the number of gainfully employable persons will continue to increase. The number of registered unemployed persons in 1985 will be slightly higher than in 1984. Prices will not develop as favourably during 1985 as during the current year. Although there will be a substantial drop in the rate of inflation for imports compared with 1984 due to the levelling-off of international economic activity, the probable fall in the value of the dollar, and the appreciation of the D-mark within the European Monetary System, unit labour costs will increase further. Under these conditions, consumer prices can be expected to increase at a somewhat faster pace. The annual average rate of increase will be about 2 %. This will allow a considerable degree of price stability to be maintained.

**HWWA Index of World Market Prices of Raw Materials<sup>1</sup>**  
(1975=100)

Raw Materials and Groups of Materials	1983	1984						
	AA <sup>2</sup>	June	July	August	September	October	Nov. 2nd	Nov. 9th
Total index . . . . .	209.3	206.8	204.7	204.0	203.3	202.8	202.9	202.9
Total, excl. energy raw materials . . . . .	122.8	129.3	124.2	122.1	120.7	119.5	119.3	119.3
Food, tropical beverages . . . . .	116.8	128.1	120.0	117.0	116.8	116.2	116.7	116.9
Industrial raw materials . . . . .	127.4	130.2	127.3	125.9	123.7	122.0	121.2	121.1
Agricultural raw materials . . . . .	125.5	134.5	132.5	131.5	129.1	125.8	119.9	120.1
Non-ferrous metals . . . . .	145.0	137.2	132.9	131.8	127.1	125.8	132.3	132.7
Energy raw materials . . . . .	259.8	252.0	251.7	251.8	251.6	251.5	251.7	251.7

<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.