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## The economic situation in the Federal Republic of Germany

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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>**

Overall production in the Federal Republic of Germany has been increasing substantially since the weather-induced setback at the beginning of the year. Ignoring the latter, output has been expanding at a rate of 2.5 %; the average utilisation of productive capacity has also been increasing slightly. However, in view of the large number of persons seeking employment and the currently considerable rise in productivity which is due not least to relative factor prices, this growth path is still too flat. Up until spring most of the momentum for demand came from abroad; since then, however, domestic expansionary forces have prevailed. Private consumption, which had stagnated at the beginning of the year, has increased markedly during recent months. Although this is partly due to the postponed purchasing of vehicles, a cyclical improvement of private consumption has probably also contributed to the increase.

Despite the still inadequate conditions for growth investment activity has been brisk. Stimuli primarily emanated from business abroad, both via increased sales and greater profit margins. Investments in fixed assets have tended to increase during the course of the year at roughly the same pace at which they had been increasing – ignoring the distortions induced by fiscal policy measures and industrial action – since the economic upswing began, i. e. at a current annual rate of approximately 6 %. Building activity was at a substantially lower level this year. At the beginning of the year this was not merely due to adverse weather conditions; what was clearly missing was that part of production which had been brought forward last year to qualify for the government's promotion measures in this sector. Residential building orders have been increasing again since spring; residential building activity, however, has not yet apparently been aligned to the – lower – level

of demand, which would indicate that a further contraction is to be expected for the time being. There is a clear upward trend, on the other hand, in the case of industrial and public building orders and activities.

The increase in orders from abroad has been less pronounced, since the economic recovery, above all in the USA and in its wake in developing and newly industrialising countries too, has slowed down. In addition, the appreciation in the value of the D-mark against other currencies since spring has been accompanied by an increase in the cost of goods from the Federal Republic of Germany. There has, however, still been quite a large increase in merchandise exports. The increase in merchandise imports has clearly lagged behind that of exports. As, in addition, the prices of imported goods have dropped substantially since spring, whereas those for exports have increased, albeit at a slower pace, there has been a marked increase in merchandise trade surpluses.

According to the latest figures presented by the Federal Statistical Office, the economic recovery has had an earlier and more significant effect on the labour market than indicated by earlier figures.

Since the low recorded during the first quarter of 1984 the number of gainfully employed persons has increased by almost a quarter of a million. Nevertheless, the number of unemployed persons has so far remained at its high level. This results, on the one hand, from an increase in the number of gainfully employable persons; on the other hand, persons who had previously opted out of the labour force are now again seeking employment. This is particularly the case in those regions in which there are already signs of a lack of adequately skilled workers.

The economic recovery in the Federal Republic of Germany will continue. 1986 will be the fourth year of an upswing, albeit an upswing with relatively little momentum. There is no indication of any notable change in the pace of economic recovery. There will be

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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 1985 and for the Year 1986

	1984 <sup>1</sup>	1985 <sup>2</sup>	1986 <sup>2</sup>	1985		1986	
	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	0.1	0.5	1	0.6	0.5	1	1
Working time (per working day)	0.1	-0.5	-0.5	-0.2	-1	-0.5	-0.5
Working days <sup>3</sup>	-0.2	-0.5	0	-0.9	0.5	0	0
Total work done, per calendar month	0	-0.5	0	-0.5	0	0.5	0.5
Productivity <sup>4</sup>	2.6	2.5	2.5	2.3	2.5	3	2
Gross Domestic Product at prices of 1980	2.6	2.25	3	1.8	2.5	3.5	2.5
<b>Appropriation of the National Product</b>							
- at current prices -							
Change in % compared with the preceding year							
Private consumption	3.1	3.5	5	2.6	4	5	5
Government consumption	4.1	4	4.5	4.1	4	4	4.5
Investment in fixed assets	3.0	0.5	6	-1.0	2	8.5	4
Equipment	1.5	13	9.5	16.6	10	11	8.5
Buildings	4.1	-7	3.5	-11.2	-4	7	0.5
Exports	11.6	12	7.5	12.6	11	8.5	6.5
Imports	10.3	8.5	5.5	9.2	7.5	4	6.5
Gross National Product	4.6	4.5	6	3.6	5	6.5	5
- at prices of 1980 -							
Change in % compared with the preceding year							
Private consumption	0.6	1.5	3	0.4	2	3	2.5
Government consumption	2.4	1.5	1.5	1.4	1.5	1.5	1.5
Investment in fixed assets	0.8	-1.5	4	-3.0	0	6.5	2
Equipment	-0.5	10	7	13.5	7.5	8.5	6
Buildings	1.6	-8	2	-12.2	-4.5	5.5	-1
Exports	8.0	8	5	9.0	7.5	5.5	4.5
Imports	5.5	5	5.5	4.5	6	5.5	6
Gross National Product	2.7	2.25	3	1.7	2.5	3.5	2.5
<b>Price Level of National Expenditure (1980 = 100)</b>							
Change in % compared with the preceding year							
Private consumption	2.5	2	2	2.2	2	2	2
Government consumption	1.7	2.5	2.5	2.6	2.5	2.5	2.5
Equipment	1.9	2.5	2.5	2.7	2.5	2.5	2.5
Buildings	2.5	1	1.5	1.2	1	1.5	1.5
Exports	3.3	3.5	2	3.3	3.5	2.5	2
Imports	4.5	3	-0.5	4.5	1.5	-1.5	0.5
Gross National Product	1.9	2	3	1.9	2.5	3	2.5
<b>Origin and Distribution of Income</b>							
Change in % compared with the preceding year							
Gross income from employment <sup>5</sup>	3.2	4	4.5	3.4	5	5	4.5
Gross wages and salaries total	3.0	4	4.5	3.3	4.5	4.5	4.5
Ditto per employed person	3.0	3	3.5	2.6	3.5	3.5	3.5
Net wages and salaries total	1.7	2.5	5	2.0	3	5	5
Gross income from entrepreneurship and property	8.6	6	9.5	4.9	7.5	12.5	7
Net income from entrepreneurship and property	8.6	5.5	10.5	3.9	7	14	7
Disposable income of private households	3.6	3.5	5	3.2	3.5	5	5

<sup>1</sup>Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 9/1985) 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.

a continuing shift in expansionary forces from external to domestic demand. As always, the forecast is based on a number of assumptions. These are the most important ones: Demand and production in industrialised countries will continue to increase at a moderate pace in 1986. Trade conflicts and problems of indebtedness will not intensify. World trade will expand by about 4 %, i.e. to the same extent as in 1985. There will be no substantial and lasting upward or downward deviation from the current level of the dollar exchange rate. The D-mark will appreciate against most partner currencies in the European Monetary System next year. The price level on international markets of industrial raw materials and oil will, if anything, tend to fall in view of their abundant supply and the only restrained economic upswing in industrialised countries. Fiscal policy will move along the lines set out in the 1986 budgetary plans. The first stage of the tax reform will come into force. The Bundesbank will extend the central bank money supply by about 5 %. In conjunction with the continuingly low rate of inflation and the relatively low government deficit this will enable a further reduction in interest rates. Collective bargaining will concentrate on wage increases rather than on the reduction of working time emphasised this year. The negotiated standard wage rates will be somewhat higher than they have been so far and will not vary substantially from one industry to the next.

The rise in exports, which levelled off this year, will hardly slow down any further during the course of 1986. On the whole, the economic trend in the importing countries will not change significantly. The considerable appreciation in the value of the D-mark against the dollar will reduce competitive strength in and vis-à-vis the dollar area; this will as usual have a delayed impact on exports. The competitive strength of West German suppliers vis-à-vis most other countries, on the other hand, will probably even increase to begin with, since the increase in prices and costs in the Federal Republic of Germany is lower. Under these circumstances, merchandise exports to West European countries will probably grow, in real terms, at at least the same pace as hitherto while the rise in exports to the USA will probably continue to slow down. Exports to OPEC countries are likely to decline again following a renewed decrease in the export earnings of these countries. All in all, West German exports are expected to increase by about 4 % during the course of next year, i. e. at the same rate as world trade.

A great deal would suggest that investment activity will be lively also next year. Although expectations for sales abroad will be less optimistic due to the

appreciation of the D-mark in real terms and the serious risk of protectionism, expectations will improve with regard to domestic sales. The stimulating effects of fiscal policy measures will play a part here. Business earnings will continue to increase. The financial situation of businesses will also ameliorate as a result of the stepping-up of reducing-balance depreciation allowances for industrial buildings. Falling capital market interest rates have cut borrowing costs and made financial assets less attractive in comparison with physical assets. The relative reduction in the cost of the factor capital in comparison with the factor labour encourages the substitution of labour by capital, i.e. rationalisation investments. At the same time, there are new legal provisions – such as the employment guarantee in the educational allowance law – which represent a burden for businesses. The coming pay settlements are also unlikely to take into account regional and branch-specific differences, a fact which stands in the way of a growing propensity to invest. All in all, investments in fixed assets in 1986 will probably expand at a current rate of 6 %.

Now that the building industry's order books have again started to fill up following the low level in spring, building investments will also increase somewhat during the course of 1986. The differences in the current development of the residential, industrial and public building sectors will become less pronounced. The volume of unfinished residential building projects will have diminished by the end of this year to such an extent that a further decline in the volume of construction output is initially probable; this will probably not come to an end before the latter part of next year. A clear obstacle to a more positive trend is the abundant supply of real estate. On the other hand, demand is encouraged by the drop in mortgage interest rates and the renewed increase in real incomes. As regards the industrial building sector, the improvement in the general investment climate and the more favourable depreciation terms have led to a marked increase in demand, which will continue in 1986. There will probably be a further increase in demand in the public building sector.

During the coming year private consumption will expand to a noticeably greater extent than during recent years, since incomes will increase at an accelerated pace. With a slightly higher total number of man-hours worked and probably somewhat higher pay settlements than this year, the gross wages and salaries total will increase by about 4½ %. Net incomes will even increase by about 5 % as a result of tax relief. There will also be a greater expansion in transfer incomes. Various

measures will lead to an additional income of DM 4 billion for private households. Disposable income will increase by 5 % in nominal terms and about 3 % in real terms, i.e. twice as much as during this year. An increase in the savings ratio is unlikely. Altogether, real consumption will probably rise in line with real disposable income, i.e. by about 3 %; this is the largest increase since the end of the seventies. Next year, prices will probably continue to increase only moderately. This probability is supported by both the stability-oriented monetary conditions and the moderate cyclical increase in demand. Furthermore, the appreciation of the D-mark will take a dampening influence on the price level, and the increase in unit labour costs will not be greater than this year. On the whole, the cost of living will probably rise at a rate of about 2 % till the end of next year; the increase will not be higher on an annual average.

GNP in real terms will probably increase by an average of 2½ % in 1985. The corresponding figure in 1986 will be 3 %, i.e. somewhat higher than during the years since the beginning of the current upswing. This does not, however, mean any basic change in the underlying trend, but is primarily due to a larger overhang at the end of the current year. The – for an economic upswing period – only moderate expansion of production is the decisive reason why, in the short term, the increase in demand for labour will remain moderate. For the medium-term development in this field the terms of employment will be just as important. In view of the imponderabilities associated with regulations on the job market many firms are still hesitant to take on new labour. Admittedly, problems also exist on the supply side; in some cases there is a lack of adequately skilled manpower. A further increase in employment is to be expected in 1986. By the end of next year there will probably be 200,000 more employed persons than at

the end of this year. The increase in employment will clearly exceed the simultaneous increase in the labour force potential. It is difficult to forecast the exact extent to which this will lead to a reduction in registered unemployment on the one hand, and in the latent reserve on the other. The average number of registered unemployed persons next year will probably amount to 2.25 million in comparison with 2.30 million this year. This figure will probably be about 100,000 lower if unemployed persons who are 58 years old or more and who no longer wish to remain available for the employment exchanges are no longer listed in employment statistics.

Real merchandise imports are expected to expand at a current annual rate which is twice as high as that of real overall demand. This ratio would be somewhat above the multi-year average, since a response to the considerable appreciation in the value of the D-mark against the dollar is probable. There will also be a renewed increase in stocks, the expectation of the afore-mentioned appreciation being a major reason why stocks were kept low. Nevertheless, imports will not increase much more than exports, and the merchandise trade surplus in real terms will not change significantly. With import prices remaining virtually stable and export prices increasing slightly there will be a further improvement in the terms of trade. In nominal terms, therefore, there will once more be a pronounced increase of about DM 20 billion in the merchandise trade surplus, which will reach a level of almost DM 100 billion. Although there will again be a slight increase in the deficit on the services account, and the transfer account will also record a markedly increased deficit, above all due to growing payments to the EC, the current account surplus will probably continue to increase in 1986. It will amount to about DM 50 billion, following a figure of DM 35 billion this year.

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

Raw Materials and Groups of Materials	1984	1985						
	AA <sup>2</sup>	June	July	August	September	October	1. 11.	15. 11.
Total index . . . . .	205.0	196.8	196.9	196.1	195.3	195.6	196.6	196.7
Total, excl. energy raw materials . . . .	125.1	111.4	111.6	110.4	109.2	109.3	111.7	112.0
Food, tropical beverages . . . . .	122.7	105.9	102.4	99.8	100.1	100.8	105.3	106.0
Industrial raw materials . . . . .	126.9	115.6	118.6	118.5	116.2	115.8	116.6	116.5
Agricultural raw materials . . . . .	128.6	109.5	113.3	113.5	113.9	114.3	113.6	114.5
Non-ferrous metals . . . . .	135.8	133.0	134.5	132.1	127.8	127.2	126.0	125.7
Energy raw materials . . . . .	251.7	246.6	246.8	246.2	245.6	246.0	246.1	246.1

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