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The economic situation in Germany

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The Economic Situation in Germany

The economic situation in Germany is unstable. From the middle of last year onwards, business activity in the western part of Germany has been slowing down; aggregate production has even been on the decline for the last six months. The utilization of capacity has declined substantially, the number of employed has dropped and unemployment figures have risen markedly. Although further progress has been made in converting the eastern German economy with production tending to rise since the summer of last year, the pace of recovery is still slow, the process of reconstruction lacks breadth and depth and there have been repeated setbacks. In many branches, particularly in industry, more obsolete production plant has had to be abandoned than new plant has been set up. The prospects on the labour market remain gloomy.

The economic downswing in western Germany has made itself felt in broad sections of the economy. The reasons for the recession are both domestic and international. The sluggishness in the western industrial countries has persisted longer than expected. Investment in machinery and equipment, which had at first remained at a high level, is now also being curbed. The current indicators do not augur a turnaround of the economy in the near future. This could, however, be achieved in the course of next year if the economies in the western industrial countries gradually emerge from stagnation and several preconditions are met at home: pressure from labour costs must be kept well below this year’s level, fiscal policy must take credible measures to curtail the increasing spending and monetary policy must be relaxed further in response to such signals. Even given these preconditions, however, western Germany’s economy is likely at first to achieve only moderate recovery.

In the coming months, the economy will without doubt continue to be dominated by contracting forces: declining investments in machinery and equipment are among these, as are certainly the negative influences of stock-shedding. Exports, too, can be expected to continue on their downward path for some time. There are, however, counterforces, particularly the continuing growth in building activity and increased sales to eastern Germany. Much indicates, however, that for the latter months of this year and the first months of next year these forces will produce a negative picture on balance. It is difficult to predict the magnitude and duration of the downswing. Given the present uncertainty amongst consumers and investors, it cannot be ruled out that it will reinforce itself and last longer than we assume here. We do not consider this likely, but the dynamic of a downswing once it has started is difficult to forecast. In any case, powerful, encouraging signals are needed to restore confidence in continued growth. We assume here that such impulses will actually be generated and that the decline in aggregate production will thus be confined to the coming winter six months. Given the continued basic health of the economy, the chance for an economic turnaround next year arises from the anticipated global recovery and falling interest rates, as well as from stock cycles, which are likely to show an expansive trend again soon.

The forecast is based on a number of assumptions which are largely the outcome of trend assessments but in some cases simply postulates. We assume that: the world economy will expand at a moderate pace in the course of next year; the price of oil will change little in the course of the year; the world prices for other raw materials will rise only slightly; demand from eastern Germany will continue

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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.
to expand, albeit at a slower pace; the wage agreements in
1993 will be considerably lower than this year in response
to the worsening situation on the labour market; the
measures so far passed in financial policy will be put into
effect and no new ones will be taken; the Bundesbank will
set its money supply target higher than in 1992; interest
rates will go down noticeably on the capital market and
sharply on the money market in the course of next year.

The general economic conditions for German exports
will tend to improve in the course of next year. Much points
towards an expansion in the industrial countries, but the
pace will remain moderate. The more conducive general
economic conditions are, however, offset by a noticeable
deterioration in the international competitiveness of the
German economy due to the appreciation of the D-Mark,
which, however, also cuts costs tangibly for imported
inputs and other goods. Experience shows that exports will
in the shorter term be more heavily influenced by the
business trends abroad than by changes in exchange
rates. This is an argument for German exports picking up
in the course of next year if and when the world economy
recovers; the rate of growth is, however, certain to remain
moderate.

After poor earnings and sales expectations have had a
severe impact on the propensity to invest this year, the
investment prospects ought to gradually improve again.
The interest-earnings ratio, which, as experience shows,
plays a key role in the propensity to invest, will improve in
the course of next year from two angles. For one thing, the
capital market rates are on the decline and for another the
wage push can be expected to relent tangibly in response
to the negative trends on the labour market. An additional
factor is that sales prospects for investors will improve with
worldwide recovery and the expected drop in interest
rates. Under these conditions the propensity to invest will
resuscitate, but this process has still not got underway and
there is little to date to indicate that it will lead to a
considerable rise in investment soon. Rather, it is more
likely that a turnaround in investment in machinery and
equipment will not occur until later on in 1993.

The situation in the various building sectors will
continue to develop in different directions for the time
being. The comparatively robust demand for residential
building will receive an additional boost from the drop in
interest rates. Real investments in public building activity
are likely to decline owing to spending restrictions in
regional and local authorities. Local governments in
particular, the major customer for public building, will hold
back. When faced with financial problems, they usually
first make cuts in investment expenditure. Commercial

![Real Gross National Product in West Germany](image)
ECONOMIC TRENDS

building will only begin to revive later in the year for the same reason as investments in machinery and equipment.

Private consumption will tend to stagnate during the winter six months, but ought to pick up tangibly by the end of the year because purchases will be carried forward to pre-empt higher value added tax as of 1 January 1993. The increase in private consumption will probably be very restrained over the course of next year as the disposable income of private households will rise somewhat more slowly than this year. At an inflation rate of 3½%, we can expect a real rise in consumer spending of 1% in 1993.

Seasonally and calendar adjusted, overall production will decline again in the fourth quarter of the current year. Production will continue to be slack in the first months of the coming year; a recovery cannot be expected until later. Both gross domestic product and gross national product will grow by a mere 0.5% on average in 1993 (1992: + 1.5% and 1% respectively). The weakness of economic activity will continue to stifle demand for labour. The slight revival expected for the summer six months in 1993 will not engender any fresh impulses for employment. The seasonally adjusted rise in the number of unemployed since the beginning of 1992 will continue into next year.

Two years after German unification, the east German economy is still in a state of upheaval. There have been some initial modernization successes but there is still no sign of a broad recovery. In the course of the second half of 1991 overall production in eastern Germany rose tangibly. We estimate that in the first half of this year it exceeded the figure for the corresponding period of last year by a good 6%, but it had fallen again in comparison with the previous six months. One reason for this was the renewed drop in eastern exports. Overall production in eastern Germany has now probably bottomed out, but recovery is by no means rapid. The labour market there is still in a desolate condition and there are no signs of an improvement. Employment declined again in the course of the first six months. Many new jobs have been created through modernization but even more redundancies are being registered.

As can be expected in such a process of flux, the developments in the individual branches differ greatly from one another. The most difficult process is the reorganization of industry. Only a third of the original production level of east Germany's manufacturing sector is left. The situation is particularly crucial in companies previously heavily dependent on exports to the Soviet Union. Particularly hard hit by the collapse of the markets in Eastern Europe have been major producers of capital goods: the capital goods industry suffered further severe production cuts in the first half of 1992. The building upswing, however, is stimulating production and investment in branches such as minerals, steel and building machinery. Production and investment are also growing in the foodstuffs, consumer goods and motor vehicles industries.

The most powerful impulses are presently emanating from the building sector, where demand and production are on a steep upward trend. Surveys show, however, that despite this many building firms are in difficulties. They complain of the sluggish awarding of contracts by public authorities, in particular the shortage of attractive large-scale projects, the bureaucratic procedures of the various public offices and the keen price competition. With wages going up fast and productivity still comparatively low, the

Key Data of the Forecast for the Federal Republic of Germany (as a whole)

<table>
<thead>
<tr>
<th></th>
<th>West Germany</th>
<th>East Germany</th>
<th>Federal Republic of Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross national product&lt;sup&gt;3&lt;/sup&gt; (% change on previous year)</td>
<td>3.6</td>
<td>1.0</td>
<td>0.5</td>
</tr>
<tr>
<td>Gainfully employed&lt;sup&gt;4&lt;/sup&gt; (1,000 persons)</td>
<td>29 219</td>
<td>29 450</td>
<td>29 350</td>
</tr>
<tr>
<td>Unemployed (1,000 persons)</td>
<td>1 690</td>
<td>1 800</td>
<td>2 030</td>
</tr>
<tr>
<td>Rate of unemployment&lt;sup&gt;5&lt;/sup&gt; (%)</td>
<td>5.5</td>
<td>5.8</td>
<td>6.5</td>
</tr>
<tr>
<td>Consumer prices&lt;sup&gt;6&lt;/sup&gt; (% change on previous year)</td>
<td>3.8</td>
<td>4.0</td>
<td>3.5</td>
</tr>
<tr>
<td>Net. gov. financial investment&lt;sup&gt;7&lt;/sup&gt; (DM bn.)</td>
<td>-93.6</td>
<td>-73.0</td>
<td>-64.0</td>
</tr>
<tr>
<td>Balance on current account&lt;sup&gt;8&lt;/sup&gt; (DM bn.)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

¹Forecast by the participating institutes in rounded figures. ²At 1985 prices for west Germany; at 1991 prices for east Germany and the Federal Republic. ³Domestic gainfully employed. ⁴Related to civil labour force (employed and unemployed). ⁵Price index for private consumption. ⁶As defined in the national accounts. ⁷As defined in the balance of payments statistics.

Sources: Statistisches Bundesamt; Deutsche Bundesbank; own calculations.

INTERECONOMICS, November/December 1992
eastern German building firms are evidently often undercut by western builders as well as by government sponsored Treuhand businesses and foreign firms.

Last year, DM 83 billion was invested in the new Länder, about half on machinery and equipment and half on buildings. Considering the numerous constraints, business investment in the first year after unification has been remarkably high. A contributory factor has undoubtedly been the massive government investment promotion. Last year, the Federal Government and east German regional and local government invested some DM 14 billion. Of business investment, about DM 55 billion last year, almost half was made by west German firms, with east German investors contributing some DM 30 billion. According to surveys, western companies (excluding residential tenancy and transport) are planning this year to almost double their investments in the new Länder compared to last year’s figure, to some DM 34 billion, and next year around DM 54 billion should be invested. In all, investments in the current year ought to amount to DM 100 to 110 billion and reach a good DM 130 billion next year.

Contrary factors have had an influence on the income of private households in eastern Germany since unification. High rises in wages, pensions and other social transfers have improved the income situation of private households, but the loss of jobs has worsened it. Last year disposable income of private households grew by about a quarter. After subtracting the rise in consumer prices of 13%, this came to a real rise in income of nearly a tenth. Next year east German private households will have to be content with a modest rise in real income. Consumer prices will rise again sharply by 8¼% as a result of the renewed rise in rents and value added tax. Real consumption ought not to increase more than negligibly.

In the first half of 1992, the new Länder exported a mere DM 7 billion worth of goods (excluding inner-German trade). The original hopes that the traditional markets in Eastern Europe could be sustained with the help of Hermes guarantees have largely vanished. On the other hand, after modernizing their plant, an increasing number of companies should be able to start exporting to the West. Export successes are, however, likely to remain modest as a whole, among other things because these markets are heavily contended under the present adverse global economic climate. As a whole, there will be no thoroughgoing recovery in east German exports in 1993 but at best a modest growth from a very low level. According to the definitions used in the national accounts the performance will be better because the more rapidly increasing supplies to the old Länder are included.

Major segments of the east German economy are still developing in different directions. Some are shrinking and plant must be closed down and others are already acquiring an impressive dynamic. Modernization investment and new investment are making themselves increasingly felt in production; privatized and newly established enterprises are intensifying their activities. Aggregate production in the east German economy will grow only a little in the second half of 1992, but growth will speed up somewhat in the course of next year. Average annual growth for 1992 will, therefore, show a rate of 3 to 4% and for 1993 of 7 to 8%. Major preconditions are still lacking for a powerful recovery, however, an especially important one being a moderate rise in costs to make more investment worthwhile without massive government support. The situation on the labour market will go on deteriorating, though not to the extent to date. The decline in total employment will probably not come to a gradual halt until next year. Registered unemployment will average 1.2 million, or 16% of the labour force in 1992 and 1993. Including those engaged in employment schemes, the number of those seeking work will remain at some 2 million or about a quarter of the labour force.

**HWWA Index of World Market Prices of Raw Materials**

(1975 = 100)

<table>
<thead>
<tr>
<th>Raw Materials and Groups of Materials</th>
<th>1991</th>
<th>July</th>
<th>August</th>
<th>September</th>
<th>October</th>
<th>6.11</th>
<th>20.11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total index</td>
<td>161.8</td>
<td>171.6</td>
<td>168.8</td>
<td>165.9</td>
<td>168.0</td>
<td>165.5</td>
<td>156.6</td>
</tr>
<tr>
<td>Total, excl. energy raw materials</td>
<td>136.4</td>
<td>133.7</td>
<td>137.6</td>
<td>136.4</td>
<td>134.5</td>
<td>130.3</td>
<td>124.8</td>
</tr>
<tr>
<td>Food, tropical beverages</td>
<td>89.0</td>
<td>90.1</td>
<td>88.3</td>
<td>85.2</td>
<td>85.5</td>
<td>84.7</td>
<td>85.7</td>
</tr>
<tr>
<td>Industrial raw materials</td>
<td>172.5</td>
<td>167.0</td>
<td>175.2</td>
<td>175.3</td>
<td>171.8</td>
<td>165.0</td>
<td>154.7</td>
</tr>
<tr>
<td>Agricultural raw materials</td>
<td>182.0</td>
<td>170.2</td>
<td>178.9</td>
<td>178.8</td>
<td>175.3</td>
<td>170.4</td>
<td>160.8</td>
</tr>
<tr>
<td>Non-ferrous metals</td>
<td>174.5</td>
<td>170.6</td>
<td>186.4</td>
<td>186.2</td>
<td>181.2</td>
<td>167.7</td>
<td>160.1</td>
</tr>
<tr>
<td>Energy raw materials</td>
<td>176.6</td>
<td>193.8</td>
<td>187.0</td>
<td>183.1</td>
<td>187.5</td>
<td>186.1</td>
<td>175.2</td>
</tr>
</tbody>
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1 On dollar basis.  2 Annual Average.