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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>

During recent months there have been signs of an economic recovery in the Federal Republic of Germany. Domestic demand has picked up earlier than expected and there has been no further decline in external demand. Building orders, in particular for residential building, in fact accelerated after a recovery which had lasted already for almost a year. The recovery of demand was followed at the beginning of the year by an increase in real gross national product. As was to be expected, this has not yet exerted an influence on the labour market, where the situation continued to deteriorate. The speed at which demand and production freed themselves from their low, however, exaggerates the basic tendency of overall economic development. True, a trend reversal was to be expected after monetary policy, during 1982, had departed from its previously very restrictive course. However, the rapid improvement in the situation is also due to special influences resulting from fiscal policies and external factors.

At the start of 1983, the decline in exports, which had been a crucial factor in bringing about the setback in economic activity in the summer six months of 1982, came to a halt.

Since then there has been a slight increase in exports. However, this development can only with considerable reservations be referred to as a trend reversal. The economic recovery in several industrialised countries, especially in the USA, together with the continuing high price competitiveness of German exporters in the dollar area would indicate a lasting improvement. However, the latter is still confronted by obstacles resulting from the payments problems faced by many countries. Merchandise imports in real terms have shown an almost parallel development to the general tendency in production.

The restraining influences on businesses' propensity to invest have on the whole become less severe during the second half of 1982. The drop in interest rates is of primary importance in this respect. In addition, there has been a reduction in the cost of imported inputs. The restraining effect of the still unsatisfactory profit situation on the propensity to invest has not as yet been compensated for by more favourable medium-term sales prospects. However, the waning influence of the restraining factors has led to an improvement in the mood of the business community. Past experience has shown, that there is a delayed reaction by business investments in capital equipment to changes in the economic environment. The slight increase at the start of the year, which may, however, have been influenced by the investment allowance, would indicate that the low has been overcome. Company building investments, on the other hand, already stopped falling during the second half of 1982. As regards residential building, above all more favourable interest terms, yet also reductions in prices, have led to a clear recovery in demand. After the new government had been formed, further measures were decided upon to encourage residential building.

Somewhat surprisingly, the development of real private consumption in the winter half year also contributed to the general brightening-up of the overall economic situation. Private households have been substantially relieved by falling prices for motor fuels and heating oil. However, this alone would not have been able to check a further slackening-off of consumption in line with the development of incomes and indeed bring about an increase during the first few months of 1983. The improvement in the development of private consumption is above all due to a marked reduction in saving. The noticeable slowdown in the increase of consumer prices during the final months of 1982 was in fact followed, after adjustment for seasonal variation, by a decline. However, this casts too favourable a light on the present basic tendency in the development of prices as the marked reduction in motor

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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, Kiel; Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Essen.

fuel and heating oil prices has heavily depressed the price level.

As opposed to earlier periods, the recovery this time is not determined by the export situation; the global economic environment is still too unfavourable. The development will be determined primarily by domestic stimulating forces, above all by stock-cyclical factors, which have played a large part in the trend reversal. Their influence, however, is expected to tail off in the foreseeable future. As public-sector demand cannot be expected to contribute towards the recovery of final demand on account of budgetary pressures and private consumption will increase only hesitantly, the upward trend can only continue if investments pick up. The forecast is based on the following assumptions:

- The international economic development will gradually improve and there will be an increase in world trade.
- The gradual increase in raw materials consumption and the associated reversal in the raw material stocks situation will lead to further price rises on the world market. There will be no further significant drop in oil prices.
- As the D-mark is likely to appreciate somewhat against the dollar, there will only be a slight increase in the cost of raw materials for German buyers.
- The Bundesbank will try to bring down the increase in the central bank money supply to a level corresponding to its target figure, avoiding however abrupt moves. Yet the money supply is likely to exceed its originally planned level at the end of the year. The economic and fiscal policy measures decided upon will be carried out.
- The settlements still to be reached during this year's round of wage negotiations will correspond to levels agreed on up to now; the settlement in the public service sector will be lower.

During 1983 business investments will be noticeably encouraged by the investment allowance. However, the general conditions for investments have also improved: reduced interest rates, lower wage settlements, higher productivity increases and cheaper oil imports have meant relief on the cost side. Nevertheless, the investment climate still faces substantial strains. A fundamental change has been promised in economic policies. However, the course pursued up to now is marked by a lack of clarity, consistency, and thus credibility and cannot guarantee a lasting upward development. Businesses are still restrained in their assessment of medium-term sales prospects. Despite lower payment settlements, it is also still doubtful

whether there has been a decisive improvement in enterprises' profit expectations. Businesses fear that the demand made by the unions for a reduction in weekly working hours will lead to additional costs in the coming year. In addition, the real interest rate level is still relatively high, despite the substantial reduction in nominal interest rates. These afore-mentioned strains mean that for the time being the investment recovery will keep within relatively narrow limits. Capital widening will still be hesitant. Emphasis will be placed on projects designed to maintain competitiveness via product and process innovations. Residential building will prove to be a dynamic sector. Here, we find a combination of low interest rates for mortgage loans, a variety of government assistance schemes and increasing fears of new price rises. Building investments by the state, on the other hand, will once more drop. Although the Federal budget would indicate an increase in building expenditure, the Lands and local communities are planning to cut down spending in this field.

After the stimulating influence of certain special factors has died down, the development of private consumption during the course of this year will again to a larger extent be determined by incomes. In nominal terms, these will increase only slowly, in real terms they will stagnate. This trend is at least more favourable than the trend recorded over the past two years where real incomes fell. As regards the gross wages and salaries figure, the increase will be slowed down by both lower payment settlements and a further decrease in the number of employed. Due to progressive taxation and the raising of contribution rates to the pension schemes, the development of net wages and salaries will be even less favourable. There will also be a much slower increase in transfer incomes. The pronounced increase in payments to the unemployed and short-time workers is counteracted by cuts in child allowances and other social benefits, the postponement by six months of the increase in pensions and the introduction of a health insurance contribution for pensioners. The efforts by consumers to at least maintain the standard of living in the face of the unfavourable development of incomes are helped by the drop in interest rates. Borrowing is cheaper, money investment has become less profitable. In addition, there would appear to be impulses to buy more consumer durables and, as experience has shown, such purchases are made partly at the expense of the saving ratio.

The improvement in the economic development of industrialised countries, which also benefits the developing countries, has led to somewhat better prospects for exports by the Federal Republic of

## ECONOMIC TRENDS

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

Forecast for 1983

	1981 <sup>1</sup>	1982 <sup>1</sup>	1983 <sup>2</sup>	1982		1983	
	Years			1 <sup>st</sup> hf. yr. <sup>1</sup>	2 <sup>nd</sup> hf. yr. <sup>1</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	-0.7	-1.8	-1.5	-1.7	-1.8	-1.5	-1.5
Working time (per working day)	-1.1	-0.6	-0.5	-0.4	-0.8	-0.5	0
Working days <sup>3</sup>	-0.1	0.2	0	0.3	0.1	0.5	-0.5
Total work done, per calendar month	1.9	-2.2	-2	-1.8	-2.5	-2	-2
Productivity <sup>4</sup>	2.0	1.2	2.5	1.8	0.7	1.5	3.5
Gross Domestic Product at prices of 1976	0.1	-1.0	0.5	0	-1.8	-0.5	1.5
<b>Appropriation of the National Product</b>							
- at current prices -							
Change in % compared with the preceding year							
Private consumption	4.7	2.9	3	3.7	2.1	2.5	4
Government consumption	7.2	3.3	3	3.3	3.3	3	2.5
Investment in fixed assets	0.4	-3.2	4.5	-4.0	-2.4	3	6.5
Equipment	0.7	-3.0	4	-2.7	-3.3	-0.5	7.5
Buildings	0.2	-3.2	5.5	-4.8	-1.9	5	5.5
Exports	15.0	7.9	2.5	14.6	2.0	0.5	4.5
Imports	11.2	2.9	1.5	7.3	-1.3	-1.5	4.5
Gross National Product	4.0	3.7	4	4.4	3.1	3	4.5
- at prices of 1976 -							
Change in % compared with the preceding year							
Private consumption	-1.2	-2.3	0	-1.7	-2.8	-1	1
Government consumption	2.0	-0.1	0	0	-0.3	0	0
Investment in fixed assets	-3.8	-5.6	2	-6.9	-4.5	1	3
Equipment	-3.4	-7.2	1	-7.0	-7.3	-3	4.5
Buildings	-4.2	-4.5	3	-6.7	-2.5	3.5	2
Exports	8.5	3.5	0	9.0	-1.6	-1.5	2
Imports	1.2	0.5	0.5	3.0	-2.0	-2	3
Gross National Product	-0.2	-1.1	0.5	-0.3	-1.8	-0.5	1.5
<b>Price Level of National Expenditure (1976 = 100)</b>							
Change in % compared with the preceding year							
Private consumption	6.0	5.2	3	5.6	5.0	3.5	3
Government consumption	5.1	3.4	3	3.2	3.6	3	2.5
Equipment	4.2	4.5	3	4.7	4.3	3	3
Buildings	4.6	1.3	2.5	2.1	0.6	1.5	3.5
Exports	6.0	4.2	2.5	5.1	3.6	2.5	2.5
Imports	9.9	2.4	1	4.2	0.7	0.5	1
Gross National Product	4.2	4.8	3.5	4.7	4.9	3.5	3
<b>Origin and Distribution of Income</b>							
Change in % compared with the preceding year							
Gross income from employment <sup>5</sup>	4.7	2.3	2	2.8	1.9	1.5	2
Gross wages and salaries total	4.3	2.1	1.5	2.6	1.8	1.5	2
ditto per employed person	4.8	4.1	3.5	4.4	3.7	3.5	3.5
Net wages and salaries total	3.8	1.0	0	1.4	0.7	0	0
Gross income from entrepreneurship and property	-0.5	6.7	7.5	7.0	6.5	4.5	10
Net income from entrepreneurship and property	0.9	8.1	9	9.5	6.8	5	12
Disposable income of private households	5.6	2.7	2.5	4.0	1.6	1.5	3.5

<sup>1</sup>Based on data from the Federal Statistical Office (cf. Wirtschaft und Statistik, No. 3/1983) 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.

## ECONOMIC TRENDS

Germany. Furthermore, even following the latest EMS realignment, the international competitiveness of the West German economy is still at a relatively high level. Nevertheless, there are many reasons for a restrained assessment of export prospects for this year. First of all, the increase in demand in industrialised countries will on the whole be moderate. Secondly, although many non-oil developing countries will benefit from the new increase in the prices of raw materials and the low price of oil itself, they must also reduce their net borrowing. Thirdly, many of the oil-exporting countries will find themselves having to make a downward adjustment of their level of imports on account of the drop in oil prices at the beginning of the year. Fourthly, the structure of German exports would at present seem rather disadvantageous in view of the considerable importance of capital goods. Fifthly, the increase in protectionism will adversely affect sales abroad. All in all, therefore, the expected increase in exports will be much less than at the start of previous recovery phases. Imports will also increase as the economy recovers. As always, the initial impulses will come from stock orders. With export prices rising more rapidly than import prices, there will be a renewed increase in the terms of trade. Even taking into account the anticipated unchanged real net exports there will be an increase in the current account surplus, the latter being expected to reach approx. DM 15 billion.

In view of the increased level of demand, enterprises will continue to expand their production in the further course of the year. Although this increase will be markedly less noticeable than during previous recovery phases on account of the still existing pressures of the economic climate, by the end of the year the overall level of production will exceed the level of the previous year by 2½ to 3 per cent. Contrary to the forecast made in autumn, the real national product will on an annual average be slightly higher than the 1982 figure. The

main reason is not a more forceful economic recovery than was expected at the time but the earlier setting-in of the change. Despite economic recovery, the problems facing the labour market will worsen. Businesses will, to begin with, increase their production without increasing manpower. As a rule, an increase in capacity utilisation will be accompanied by an increase in output per working hour. In addition, firms will cut down short-time work and in some cases introduce over-time. The decline in the number of employed will therefore only gradually slow down and come to a halt at the end of the year. Altogether, the number of employed wage and salary earners will decrease by more than 250,000, compared to the figure at the beginning of the year. The number of unemployed, seasonally adjusted, will reach approx. 2.5 million by the end of the year; this figure is also influenced by the further increase in the number of employable persons. The annual average for 1983 is expected to figure at 2.35 million which corresponds to an unemployment rate of about 10 %. At the seasonal peak of the coming winter the number of unemployed, before seasonal adjustment, will reach 2.8 million.

The influence of the lower oil prices, the excellent harvests and the mild weather on prices will gradually recede during the coming months. Nevertheless, price rises will remain in check. As regards labour costs, the pressure on enterprises to increase prices will in fact become less; this year's wage settlements accompanied by increased productivity advances will lead to a lower increase in unit labour costs compared to the previous year. However, the increase in rates of value added tax in July will upset the smooth development of prices. The rate of price increase for consumer prices at the end of the year will be less than 3 % compared to the previous year's level; without the increase in value added tax, this figure would probably have been only 2½ %.

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

Raw Materials and Groups of Materials	1982		1983					
	AA <sup>2</sup>	December	January	February	March	April	April 29	May 5
Total index . . . . .	228.6	225.0	225.2	225.8	214.1	203.1	203.5	203.8
Total, excl. energy raw materials . . .	117.9	111.8	113.1	115.3	116.4	119.4	120.5	121.5
Food, tropical beverages . . . . .	106.1	103.4	104.0	106.0	105.7	109.4	111.2	111.8
Industrial raw materials . . . . .	126.4	118.2	120.0	122.4	124.6	127.0	127.6	128.9
Agricultural raw materials . . . . .	127.1	114.3	114.5	115.4	118.5	122.7	122.2	124.7
Non-ferrous metals . . . . .	134.9	128.7	135.3	141.2	142.8	148.3	151.2	152.6
Energy raw materials . . . . .	293.4	291.1	290.7	290.3	271.1	252.0	252.0	251.8

<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.