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The Economic Situation in Germany

*In its latest joint report on the economic situation, the Association of German Economic Research Institutes reaches the following conclusions, presented here in abridged form.**

The upswing in Germany has continued this year, but the pace of production growth has diminished somewhat compared to last year. The reasons are similar to those in other Western European countries: the slackening off of last year's comparatively strong stockbuilding stimuli, the inhibiting effects of last year's sharp rise in capital market interest rates, which hampered development well into this year, and the slowdown in North America. In Germany itself, economic policy has also acted as a brake. At the start of the year there was a further marked rise in taxes. Residential building has fallen back because projects were brought forward to take advantage of tax allowances for mortgage interest payments, which expired at the end of 1994. Due to these factors a temporary levelling off of the upswing at the beginning of the year was expected, though not in as pronounced a form. In spring, the economic climate was adversely affected to a considerable degree by the jump in the external value of the D-mark against the dollar and a number of other European currencies and by the high wage agreements in this year's round of negotiations, which were generally construed as a departure from the previous pro-employment course. Owing to their resultant gloomier earnings and sales prospects, businesses have been more reticent to invest. The general mood began to improve gradually as the currency turbulences died down and the upward revaluation of the D-mark was partially reversed; businesses' export expectations have improved a little since the middle of the year.

In west Germany the economy lost momentum at an early stage of the upswing. In the summer half-year aggregate production expanded more slowly than capacity so that utilization of capacity declined. A more moderate pace of economic activity following the subsiding of the stimuli from stockbuilding, which are always quite powerful in the first upswing phase, is typical of other, previous economic cycles; in the

mid-80s, too, the recovery slowed down again after two years of upswing, but in the past the decline in stockbuilding was increasingly offset by higher business investment. There were, at first, indications that the present upswing would also follow this pattern. In the course of 1994, investment in machinery and equipment picked up sharply but due to the steep rise in interest rates last year and the appreciation of the D-mark the pace of investment slowed again in the spring. As a result of special developments in the residential building sector, building investments have even been on the decline since the start of the year. Private consumption, in contrast, has developed surprisingly well despite the heavier burden on income caused by additional taxes and other deductions.

The labour market, which always shows a certain delay before following economic developments, responded slightly to the cyclical recovery last year but it will take longer for it to revive now as a result of the slowdown in the upswing. The decline in employment has slowed down again noticeably this year but there has not as yet been a reversal in the trend. The slight drop in unemployment which had begun in summer 1994 came to a standstill in spring. Following that there was even a slight increase. Businesses have evidently continued rationalizing production very much longer this time and the disappointment over the high wage agreements and the burden posed by the higher D-mark have made firms additionally reluctant to recruit labour.

In east Germany aggregate production growth has slowed down slightly this year. The weaker expansion of the economy in west Germany possibly also contributed to this, as the closer interlinkages between the two economies mean a closer convergence in economic trends. Nevertheless, real gross domestic product in the new Länder has kept to a strong growth path; in the first half of 1995 it was about 7% higher than a year previously. Manufacturing, which has seen robust growth for a year, topped the previous year's figure by roughly a tenth. East Germany is therefore catching up on a broader

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front. The expansion of production in manufacturing has slowed down somewhat recently, though. Both public and commercial building show much lower growth rates than last year. The public building sector has undergone very high growth in recent years, particularly in connection with infrastructure projects. In commercial building the return on investment in many cases is not as high as in previous years; some buildings are even standing empty. In residential building, however, the pace of growth has remained fast. As income grows rapidly, the demand for housing continues to expand markedly. This, along with ongoing government promotion measures and the planned introduction of a rent equalization system in 1998 make for bright yield expectations.

There are signs of further improvement on the labour market. The number of employed has risen in the course of the year, though not as much as last year when labour policy measures were stepped up quickly. The number of unemployed has again dropped a little; the rate of unemployment is still nearly 14%, however, far higher than in west Germany despite extensive labour policy measures. Notwithstanding unmistakable progress in modernizing the economy and the improved competitiveness of east German companies, there is still an evident lack of self-sustained momentum. This means that as the government-sponsored stimulus is scaled down the economy will now expand more slowly.

Major parameters for the upswing at home and abroad are still conducive; some have even improved markedly for the German economy since spring. The dampening effects of the high D-mark appreciation in

the first months of this year continue to be felt for the moment, however. From the turn of the year to its high point in March the real exchange rate rose by a good 5% but some of this appreciation had receded again by October. After the sharp rise in 1994, interest rates on the capital market have dropped considerably under the influence of a world wide decline and helped by low inflation in Germany; yield on bonds outstanding has dropped by nearly one and a half per cent to slightly above 6%. The Bundesbank has further loosened the monetary reins and cut its key rates in two steps. Considering the only moderate expansion in money supply a change of course is unlikely soon. Altogether, then, the monetary side can be expected to give tangible impulses to the economy, some of which will not make themselves felt immediately. Finally, following this year's tax rises fiscal policy plans to introduce considerable cuts in 1996 and although these will be partly offset by higher social insurance payments, this will stimulate private consumption on balance.

The forecast is based on a number of assumptions, most of which are themselves based on predictions but in some cases are simply postulates: demand and production in the industrial countries will continue to rise at a moderate pace, gaining a little momentum in 1996. World trade will expand rapidly. The oil price and world market prices for industrial raw materials will hardly change at all. The D-mark will depreciate somewhat against the dollar and there will be no significant changes against the other European currencies. The real external value of the D-mark will decline slightly. Wage agreements next year will remain slightly below this year's. The fiscal policy

Key Data of the Forecast for the Federal Republic of Germany

| | Federal Republic of Germany | | | West Germany | | East Germany | |
|--|-----------------------------|--------|--------|--------------|--------|--------------|-------|
| | 1994 | 1995 | 1996 | 1994 | 1995 | 1994 | 1995 |
| Gross national product ¹ (% change on previous year) | 2.9 | 2¼ | 2½ | 2.4 | 2 | 8.5 | 6½ |
| Gainfully employed ² (1,000 persons) | 34,957 | 34,915 | 35,095 | 28,654 | 28,475 | 6,303 | 6,440 |
| Unemployed (1,000 persons) | 3,698 | 3,600 | 3,550 | 2,556 | 2,560 | 1,142 | 1,040 |
| Rate of unemployment ³ (%) | 9.6 | 9.4 | 9.2 | 8.2 | 8.2 | 15.3 | 13.9 |
| Consumer prices ⁴ (% change on previous year) | 2.8 | 2.0 | 2.0 | 2.7 | 2.0 | 3.7 | 2.0 |
| Unit labour costs ⁵ (% change on previous year) | -0.6 | 1.5 | 2.5 | -1.0 | 1.0 | -0.4 | 1.5 |

¹ At 1991 prices. ² Domestic gainfully employed. ³ Fed. Rep.: related to the resident labour force (employed and unemployed); west and east Germany: related to the domestic labour force (employed and unemployed). ⁴ West and east Germany: price index for the cost of living of all private households; Fed. Rep.: price index for private consumption. ⁵ Gross income from dependant employment originating within the region related to real gross domestic product.

Sources: Statistisches Bundesamt; Bundesanstalt für Arbeit; calculations by the institutes. 1995 and 1996: forecasts by the institutes; rounded figures.

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The Most Important Data of the National Accounts of the FR Germany¹

Forecasts for 1995 and 1996

| | 1994 | 1995 | 1996 | 1995 | | 1996 | |
|---|--------|-------------------------------|-------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| | Years | | | 1 st hf. yr. | 2 nd hf. yr. | 1 st hf. yr. | 2 nd hf. yr. |
| Origin of National Product | | | | | | | |
| Change in % compared with the preceding year | | | | | | | |
| Number of domestically employed | -0.7 | 0 | 0.5 | -0.1 | 0 | 0.5 | 0.5 |
| Working time (per working day) | -0.4 | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 |
| Working days | -0.3 | -0.5 | 0 | 0.0 | -0.5 | -0.5 | 0.5 |
| Total work done, per calendar month | -1.4 | -1 | 0 | -0.6 | -1 | -0.5 | 0.5 |
| Productivity ² | 4.3 | 3 | 2.5 | 3.2 | 3.5 | 2.5 | 2 |
| Gross Domestic Product at 1991 prices | 2.9 | 2 ¹ / ₄ | 2 ¹ / ₂ | 2.6 | 2 | 2 | 3 |
| Appropriation of the National Product | | | | | | | |
| - at current prices - | | | | | | | |
| Change in % compared with the preceding year | | | | | | | |
| Private consumption | 3.7 | 3.5 | 5 | 3.6 | 3.5 | 4.5 | 5.5 |
| Government consumption | 3.0 | 4 | 4 | 3.8 | 4 | 4.5 | 4 |
| Investment in fixed assets | 5.9 | 4 | 3.5 | 4.9 | 3.5 | 3.5 | 3.5 |
| Equipment | -1.4 | 4 | 5.5 | 4.5 | 3 | 4 | 7 |
| Buildings | 10.3 | 4.5 | 2.5 | 5.0 | 3.5 | 3.5 | 1.5 |
| Exports | 8.2 | 6 | 7 | 5.7 | 6 | 6.5 | 7.5 |
| Imports | 7.6 | 3.5 | 6 | 4.1 | 3 | 6 | 5.5 |
| Gross Domestic Product | 5.2 | 4.5 | 4.5 | 4.8 | 4.5 | 4.5 | 5 |
| - at 1991 prices - | | | | | | | |
| Change in % compared with the preceding year | | | | | | | |
| Private consumption | 0.9 | 1.5 | 3 | 1.6 | 1.5 | 2.5 | 3.5 |
| Government consumption | 1.2 | 1.5 | 1.5 | 1.7 | 1.5 | 1.5 | 1.5 |
| Investment in fixed assets | 4.3 | 2.5 | 2 | 3.2 | 1.5 | 2 | 2 |
| Equipment | -1.2 | 3.5 | 4.5 | 4.7 | 2.5 | 3 | 6 |
| Buildings | 7.8 | 1.5 | 0 | 2.4 | 1 | 1 | -1 |
| Domestic Demand | 2.8 | 2 | 2 | 2.5 | 1.5 | 2 | 2.5 |
| Exports | 7.5 | 4 | 5 | 4.0 | 4 | 4.5 | 5.5 |
| Imports | 7.1 | 3.5 | 4.5 | 3.8 | 3 | 5 | 3.5 |
| Gross Domestic Product | 2.9 | 2 ¹ / ₄ | 2 ¹ / ₂ | 2.6 | 2 | 2 | 3 |
| Gross National Product | 2.4 | 2 | 2.5 | 2.0 | 2.5 | 2 | 2.5 |
| Price level of National Expenditure (1991 = 100) | | | | | | | |
| Change in % compared with the preceding year | | | | | | | |
| Private consumption | 2.8 | 2 | 2 | 2.0 | 2 | 2 | 2.5 |
| Government consumption | 1.7 | 2.5 | 2.5 | 2.1 | 2.5 | 2.5 | 2.5 |
| Equipment | -0.2 | 0 | 1 | -0.2 | 0.5 | 1 | 1 |
| Buildings | 2.3 | 2.5 | 2 | 2.6 | 2.5 | 2.5 | 2 |
| Exports | 0.6 | 1.5 | 2 | 1.7 | 1.5 | 1.5 | 2 |
| Imports | 0.5 | 0 | 1.5 | 0.3 | 0 | 1 | 2 |
| Gross Domestic Product | 2.3 | 2 | 2.5 | 2.2 | 2.5 | 2.5 | 2 |
| Origin and Distribution of Income | | | | | | | |
| Change in % compared with the preceding year | | | | | | | |
| Gross income from employment | 2.2 | 3.5 | 5 | 3.0 | 4 | 4.5 | 5 |
| Gross wages and salaries total | 1.4 | 3.5 | 4.5 | 3.0 | 4 | 4.5 | 4.5 |
| Ditto per employed person | 2.4 | 4 | 4 | 3.4 | 4.5 | 4.5 | 4 |
| Net wages and salaries total | -0.7 | 0.5 | 6.5 | 0.3 | 1 | 6.5 | 6.5 |
| Gross income from entrepreneurship and property | 11.1 | 8.5 | 6 | 9.1 | 7.5 | 6 | 6 |
| Net income from entrepreneurship and property | 15.8 | 11 | 5.5 | 13.0 | 9 | 6 | 5.5 |
| Disposable income of private households | 3.0 | 3.5 | 5.5 | 3.3 | 3.5 | 5 | 5.5 |
| Further Key Data | | | | | | | |
| Net gov. financial investment ^{3, 4} (DM bn.) | | | | | | | |
| incl. Treuhandanstalt | -123.9 | -109.5 | -94 | - | - | - | - |
| excl. Treuhandanstalt | -86.8 | -109.5 | -94 | - | - | - | - |
| Balance on Current Account ⁵ (DM bn.) | -34.2 | -37 | -35 | - | - | - | - |

¹ 1994 and 1st half-year 1995 based data from the Statistisches Bundesamt (cf. Fachserie 18: Volkswirtschaftliche Gesamtrechnungen) and calculations by the institutes; 2nd half-year 1995 and 1996 forecasts by the institutes. Figures are rounded off. ² Gross domestic product at 1991 prices per man-hour worked. ³ As defined in the national accounts. 1995 incl. the redemption fund set up to deal with costs inherited from the GDR. ⁴ The figures for 1995 do not take into account the debts of the Treuhandanstalt to the tune of DM 204 bn. which were transferred to the redemption fund nor the transferred part of the debts of the east German residential building sector to the tune of DM 31 bn. ⁵ As defined in the balance of payments statistics.

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measures adopted will be implemented. We assume no new decisions affecting cyclical trends in the forecast period. After the steep drop this year, capital market interest rates will rise slightly in the course of 1996; the same applies to short-term interest rates.

Given low interest rates, tax relief and the waning influence of the higher D-mark, the upswing will gain in strength next year; the expansionary forces will thus shift more to domestic demand. Private consumption in particular will underpin the general upward trend. Decisive here will be above all the effects of tax relief. Thanks to fiscal relaxation, even with somewhat lower wage rises in 1996 average net income per employee after tax and social insurance will rise by over 6%. Unlike 1995, the number of employed will rise somewhat, widening the income base more. With the increase in the cost of living index at only slightly over 2%, a considerable increase in real income will remain. As tax relief this time will for the most part benefit the low-income groups, who tend to have a high propensity to consume, there is no likelihood of a significant rise in the rate of saving. Private consumption will rise by about 3% in 1996, nearly twice the rate this year.

The cyclical reluctance to invest in plant and equipment will be overcome; measured against the pronounced upswing phases in the second half of the 70s and 80s, however, the rate of expansion will probably remain comparatively low for this category of investment, which reacts sensitively to cyclical trends. With very diverse sectoral and regional trends, building investment will stagnate on the whole. Exports will catch up with developments in world trade in the course of the coming year. Altogether, the economy will not develop any great momentum in 1996, either. Aggregate output will probably only start to increase faster than production capacity in the

second half of the year, so that average annual utilization of capacity will record about the same rate as this year. Under these conditions, the situation on the labour market will only improve slowly. Nevertheless, the number of employed next year ought to rise and unemployment decline somewhat. A broad recovery on the labour market front presupposes a substantial speed-up in growth in the medium term. As developments in the second half of the 80s, i.e. before reunification, demonstrate, this is quite conceivable assuming conducive economic and wage policies.

Public opinion tends to mistakenly assume that east Germany is a particularly expansive region because it has the highest growth rates in Europe. It is highly problematic, however, to infer self-sustained growth simply from high growth rates. A glance at the constitution of the economy in east Germany reveals too many weak points to warrant the hope that growth can sustain itself even when transfer payments are rolled back. After three years of rapid growth there are first signs in the new Länder that the pace is slackening. The building sector, the motor of recovery at the beginning, is noticeably losing momentum as apparently too few follow-on projects have been planned in the commercial and public sectors following high investment in the start-up phase. Growth rates in industry are still high, but here too the higher D-mark and the slowdown in Western Europe are making themselves felt; the basic pattern in west Germany is becoming increasingly apparent in the sister economy. This year east Germany ought to record a growth rate of 6½%, and slightly less next year. The high growth rates of aggregate output in recent years were largely the outcome of specific conditions in the reconstruction phase after a deep slump and the push given to production by government assistance.

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

| Raw Materials and Groups of Materials | 1994 | | 1995 | | | | | |
|---------------------------------------|-----------------|---------|-------|--------|-----------|---------|--------|--------|
| | AA ² | October | July | August | September | October | 3. 11. | 17. 11 |
| Total index | 147.8 | 156.6 | 158.0 | 158.8 | 159.2 | 156.0 | 160.6 | 162.2 |
| Total, excl. energy raw materials | 143.2 | 156.4 | 165.2 | 162.3 | 159.5 | 159.5 | 162.5 | 163.1 |
| Food, tropical beverages | 113.5 | 123.8 | 117.5 | 119.0 | 113.7 | 112.6 | 114.6 | 114.9 |
| Industrial raw materials | 165.9 | 181.2 | 201.6 | 195.3 | 194.4 | 195.2 | 199.0 | 199.9 |
| Agricultural raw materials | 171.8 | 191.5 | 215.9 | 204.1 | 206.8 | 212.0 | 215.9 | 216.9 |
| Non-ferrous metals | 171.2 | 187.3 | 217.1 | 217.3 | 208.1 | 201.4 | 209.7 | 211.2 |
| Energy raw materials | 150.4 | 156.7 | 153.8 | 156.7 | 159.0 | 154.0 | 159.5 | 161.6 |

¹ On dollar basis. ² Annual Average.