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July 5, 1985

To: Members of the Executive Board

From: The Acting Secretary

Subject: Federal Republic of Germany - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with the Federal Republic of Germany, which is tentatively scheduled for discussion on Friday, August 2, 1985.

Mr. Nyberg (ext. 8864) or Mr. Lipschitz (ext. 8862) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

FEDERAL REPUBLIC OF GERMANY

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985 Article IV Consultation with the Federal Republic of Germany

Approved by Brian Rose and J.T. Boorman

July 3, 1985

I. Introduction

Article IV consultation discussions were held in Bonn and Frankfurt from May 20-May 31, 1985. The German authorities were represented by officials of the Federal Ministries of Finance, Economics, Labor, Economic Cooperation and Agriculture, and of the Deutsche Bundesbank. Mr. Grosche, Executive Director for Germany, attended the meetings as an observer. The staff team consisted of Messrs. Rose, Fidjestol, Lipschitz, and Nyberg (all EUR), with Mrs. Ramos (ETR) as secretary. Germany has accepted the obligations of Article VIII, sections 2, 3, and 4. The last Board discussion was on July 20, 1984 (EBM/84/112 and EMB/84/113).

II. Background to the Discussions

The recession of the early eighties reached its trough in the final quarter of 1982 with inflation still relatively high but starting to fall and unemployment at an historically high rate and still rising. The recovery that began in 1983 was initiated by an autonomous increase in demand rather than any shift in policy; indeed, since 1982, macroeconomic policies have been firmly committed to reducing the size of the Government and of the fiscal deficit in the medium-term, and to lowering inflation. At the time of the discussions, the economy was into a third year of modest growth with the inflation rate less than half that in 1982 and a growing current account surplus. Unemployment, however, remained at around 8 percent of the total labor force with little prospect of rapid improvement, and the structure of demand was characterized by a considerable dependence on net exports.

Growth in 1983 was due initially to a rise in consumption and subsequently to a strengthening of fixed investment following an improvement in profitability. In 1984 the pattern of demand changed: private consumption and fixed investment grew less rapidly (though fiscal incentives have distorted the timing of investment expenditures) and, despite an increase in government current spending, the expansion of final domestic demand slackened. In contrast to 1983, the foreign balance had a large positive influence on GNP. In fact, of the 2 1/2 percent real growth in 1984, one percentage point was due to the foreign balance and another half percentage point to stockbuilding.

The relative weakness of domestic demand and the size of the contribution to growth of the foreign balance (even more pronounced when measured in through the year terms) are unusual for the phase of the cycle and in sharp contrast to the pattern of recovery in 1975-77 (Chart 1). The growth of consumption has been particularly slow, as both falling employment and small increases in wages have held back the growth of household real incomes. In the past, consumption has usually grown throughout the cycle, but in 1984 private consumption was still below the level achieved in 1980. Construction has been and remains fundamentally weak owing largely to an oversupply of residential housing already on the market and a restrained public construction program. Thus, the dynamism in the recovery has so far come chiefly from exports and investment in machinery and equipment.

Inflation fell to 2-2 1/2 percent in 1984 despite a rise in import unit values of 6 percent, induced in large part by the depreciation of the deutsche mark against the U.S. dollar. A slight quickening of price increases in the first quarter of 1985 was due largely to the sharp appreciation of the U.S. dollar. Average hourly wage and salary rates in the whole economy rose by less than 3 percent in 1984 and, for the second year in the row, productivity increased rapidly. As a result, unit labor costs rose by only 1/2 percent in the economy as a whole, while they fell in industry by 1 percent. Calculations by the Bundesbank show an increase in total production costs of only 1 1/2 percent, of which more than two-thirds was due to imported goods and services. Thus, while domestically generated inflation fell substantially, profit margins were widened and, with the higher volume of output, rates of return on capital rose considerably (Chart 2).

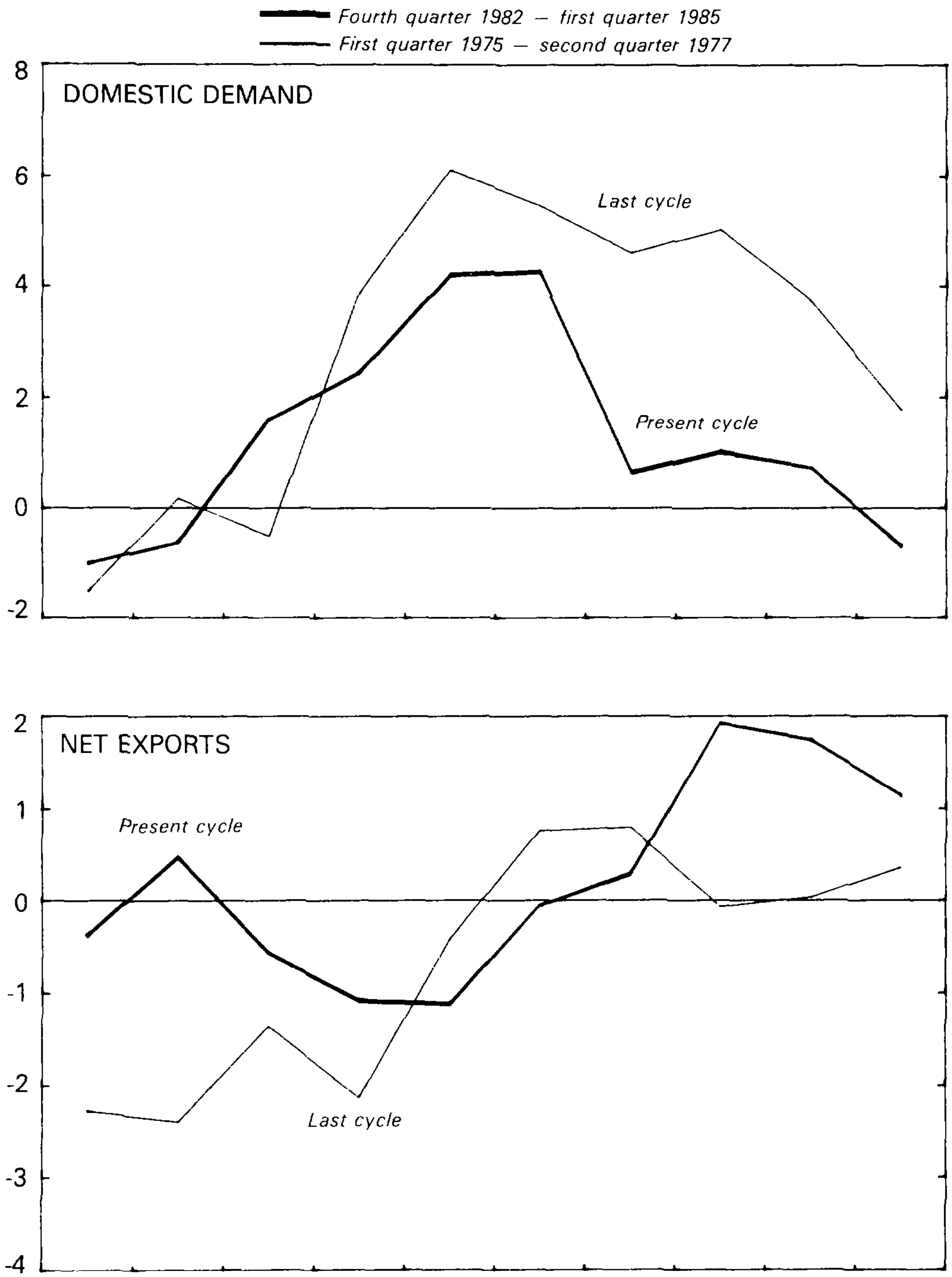
While relative price developments were generally favorable--as evidenced by real wage costs, profits, and external competitiveness--and aggregate price performance was excellent, there continued to be doubts about the potential response of the real economy to stronger nominal demand. An official estimate of the growth of productive potential, at around 2 percent, is about half that of the 1960s, owing to a weakening of total investment, an accelerated rate of obsolescence of capital equipment in recent years, and an increasing amount of structural unemployment. Actual growth should, of course, be higher than the growth of potential during an upswing, as slack in the economy is taken up, but there are questions about the amount of spare capacity in the economy and about how fast the slack can be taken up without reigniting inflation. The fall in employment came to an end during 1984 and since the third quarter employment has shown a slight rise. The improvement in the labor market is also reflected in a fall in the numbers of short-

CHART 1

GERMANY

CONTRIBUTIONS OF DOMESTIC DEMAND NET EXPORTS TO RECENT CYCLICAL UPSWINGS[1]

(Year-on-year in percentage points)



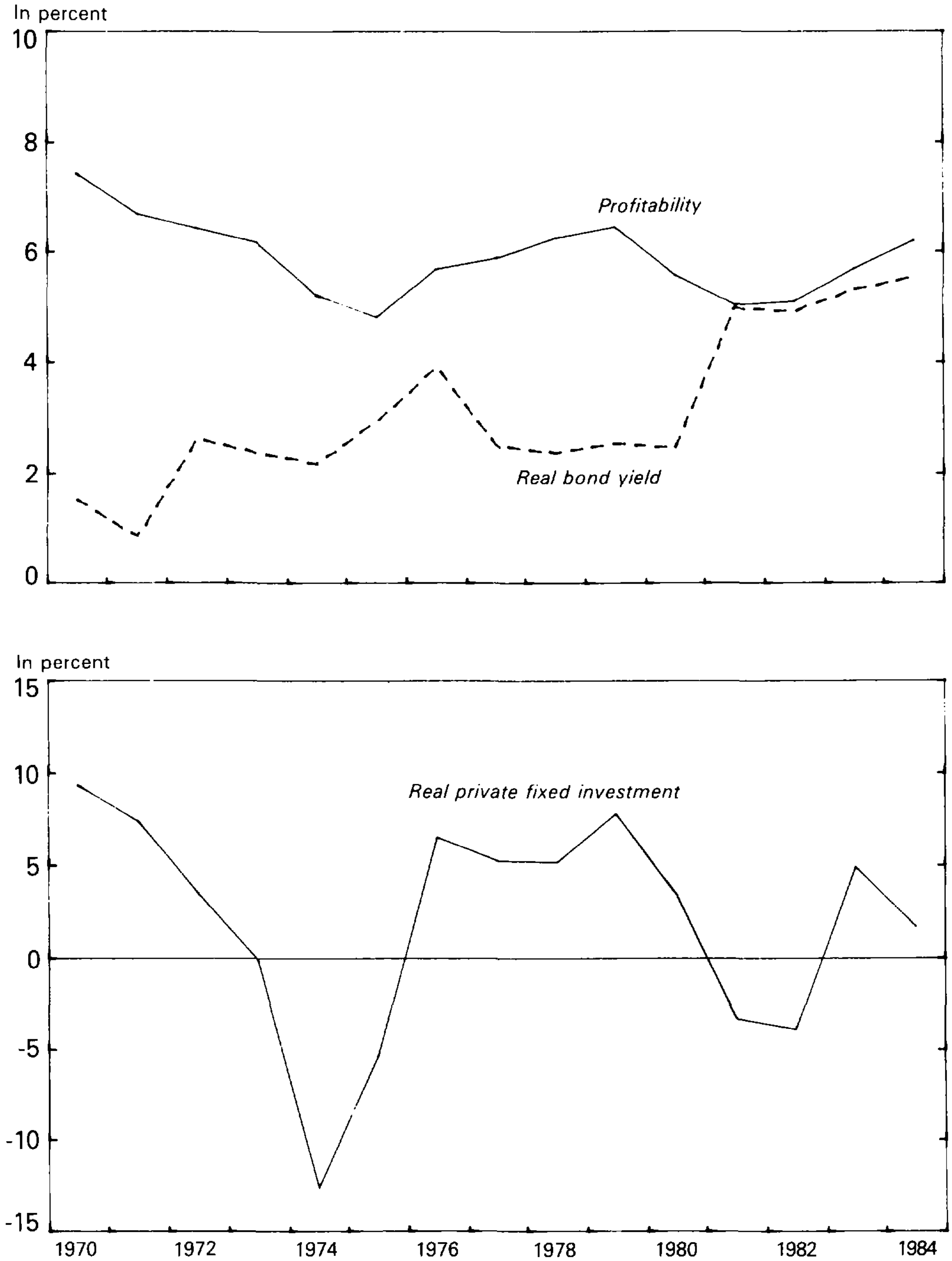
Source: Deutsche Bundesbank, *Monthly Report* and *Supplement 4*.

[1] Data are shown for ten quarters from the trough of the cycle. The trough of the present cycle was the fourth quarter of 1982, that of the last cycle was the first quarter of 1975.

CHART 2

GERMANY

PROFITABILITY,[1] REAL BOND YIELD,[2] AND GROWTH OF REAL PRIVATE FIXED INVESTMENT



Sources: Statistisches Bundesamt, *Volkswirtschaftliche Gesamtrechnungen, 1981;* and Deutsche Bundesbank, *Monthly Report;* and staff calculations.

[1]Gross entrepreneurial and property income less estimated remuneration of the entrepreneur, divided by capital stock valued at replacement cost.

[2]Yield on bonds outstanding deflated by the change in the total domestic demand deflator.

time workers and an increase in the number of vacancies. The unemployment rate, which had increased by more than 1 percentage point during each of the preceding three years, levelled out (Chart 3). In spite of the continuing high level of unemployment, capacity utilization in manufacturing has risen by nearly 7 percentage points since March 1983, though this is still somewhat below the last peak reached in the second half of 1979 (a time when the economy was suffering from inflationary pressures). It is, moreover, the manufacturing sector that is the principle beneficiary of the most dynamic components of demand--that is, exports and business fixed investment--and where bottlenecks are most likely to emerge.

As noted above external transactions provided a substantial fillip to German growth in 1984 and the first quarter of 1985. The current account surplus rose from DM 10.5 billion in 1983 to DM 17.7 billion in 1984. *Most of this increase was on account of merchandise trade,* despite a substantial deterioration in the terms of trade. While import unit values rose by 6 percent--about two-thirds of this directly related to the appreciation of the U.S. dollar in which about a third of imports are invoiced--export prices increased by only 3 1/2 percent. 1/ Developments in trade volumes clearly dominated the price effects on the trade balance as the rapid response to strong market growth abroad and improved competitiveness offset the usual short-run J-curve effects. The volume of exports rose by 9 percent and that of imports by a little more than 5 percent. Trade with the United States played an unusually important role: the value of exports to the United States increased by 42 1/2 percent and the share of the United States in overall export earnings rose from 7 1/2 percent to 9 1/2 percent. Data available only for the first three quarters of 1984 show that the current account surplus with the United States rose by almost DM 11 billion over the corresponding period of the previous year, while the total current account balance remained roughly unchanged.

More than DM 8 billion, of the almost DM 13 1/2 billion widening of the identified capital account deficit in 1984, was on account of long-term portfolio investment. German purchases of foreign currency bonds rose threefold (with U.S. and Canadian bonds attracting special interest), while nonresident purchases of German bonds fell substantially. Short-term nonbank capital outflows also increased sharply; long-term lending by German banks, however, was reduced as banks continued to be cautious in lending to developing countries and centrally planned economies, and concentrated on government-guaranteed export financing. The large (DM 7 billion) increase in errors and omissions in the balance of payments suggests that not all capital inflows were recorded.

1/ The deterioration in the terms of trade meant that the increase in real national income was approximately 1/2 a percent less than the rise in GNP.

Exchange rate movements of the deutsche mark have been difficult to explain in 1984 and the first half of 1985. At times the deutsche mark has depreciated sharply against the U.S. dollar despite changes in interest rate differentials in favor of deutsche mark investments and a strengthening of the current account position. In general, however, movements in the exchange rate seem to have been related in large part to shifts in the desired currency composition of portfolios. The value of the deutsche mark fell by 11 1/2 percent against the U.S. dollar and by 3 percent in effective (MERM) terms during 1984 (Chart 4). The effective depreciation of the deutsche mark was coupled with better price and cost performance in Germany than in its trading partners and the deutsche mark depreciated by 5 percent in real effective terms. 1/ The first quarter of 1985 saw particularly large fluctuations in the deutsche mark/dollar exchange rate. A sharp rise in the dollar in February was temporarily halted by a substantial and coordinated intervention at the end of that month and the beginning of March, and then the dollar began to fall back from mid-March, generally fluctuating between DM 2.98-DM 3.15 per dollar (end-1984, DM 3.15). On June 24 the rate was DM 3.07 per dollar.

Movements of the deutsche mark against the dollar in the first half of 1985 were broadly similar to those of most other currencies, so that between the end of 1984 and late June 1985 the effective value of the deutsche mark changed little, appreciating by something over 1 percent.

The stability of the European Monetary System (EMS) since the last realignment in March 1983 can be attributed to a number of factors. First, there has been a greater degree of convergence in policies. Second, although the cumulated differences in price and cost performance since the last realignment are significant, their effect on trade has been offset, in part, by cyclical factors as, for example, Germany's recovery preceded that of France. Third, interest rate differentials have produced stabilizing capital flows. Fourth, coordinated intramarginal intervention has left some of the other major central banks with large deutsche mark assets, available for intervention should the need arise.

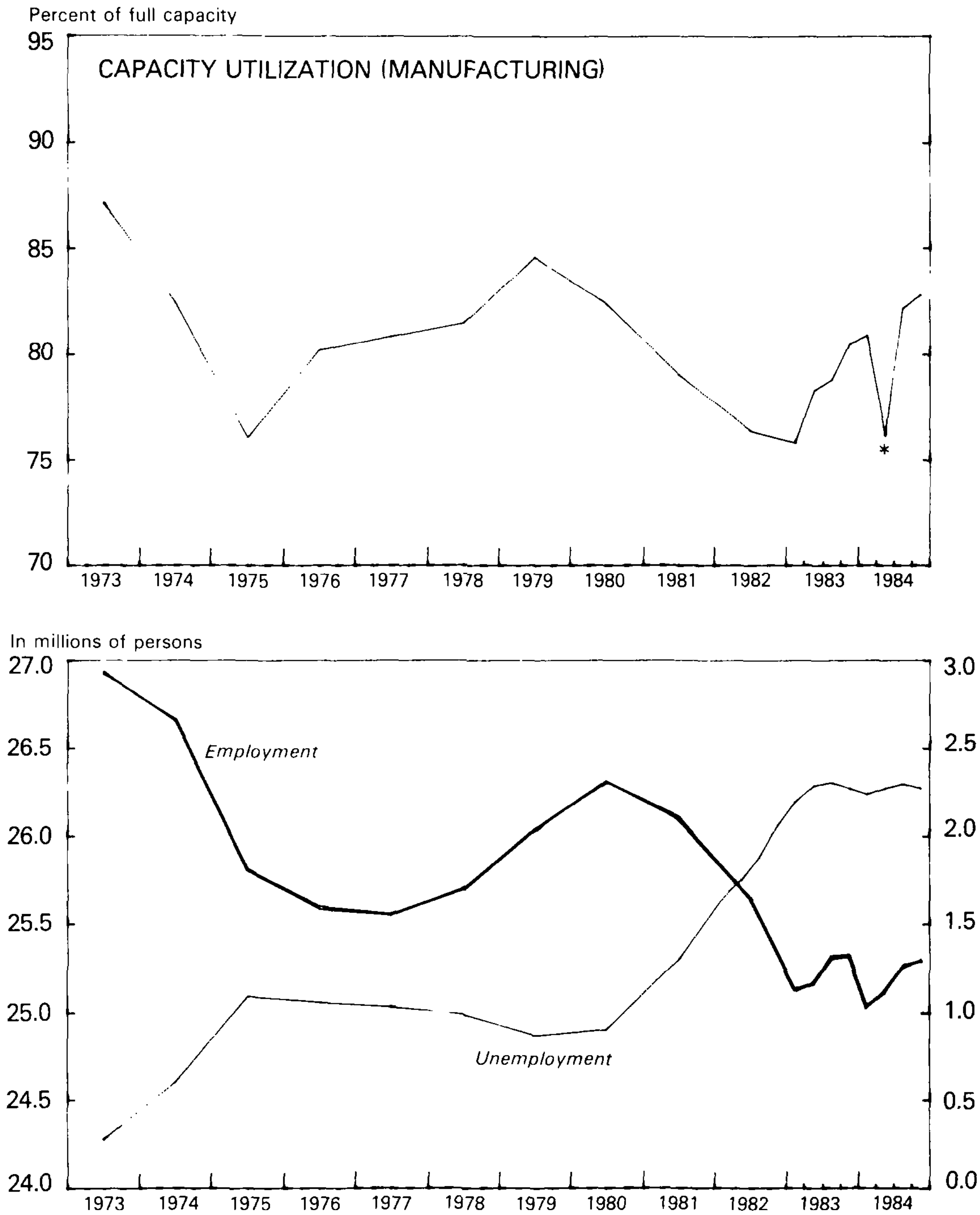
Intervention in the foreign exchanges (apart from mandatory intervention within the European Monetary System) was undertaken not to alter the level of (or trend in) any particular bilateral exchange rate, but only to prevent or counteract disorderly market conditions. The two major episodes of intervention since the last consultation--September 21 and 24, 1984 and end-February beginning-March, 1985--were undertaken to re-establish orderly conditions in a "one-way" market.

1/ Measured as relative unit labor costs adjusted for exchange rate changes and cyclical effects on productivity.

CHART 3

GERMANY

RESOURCE UTILIZATION



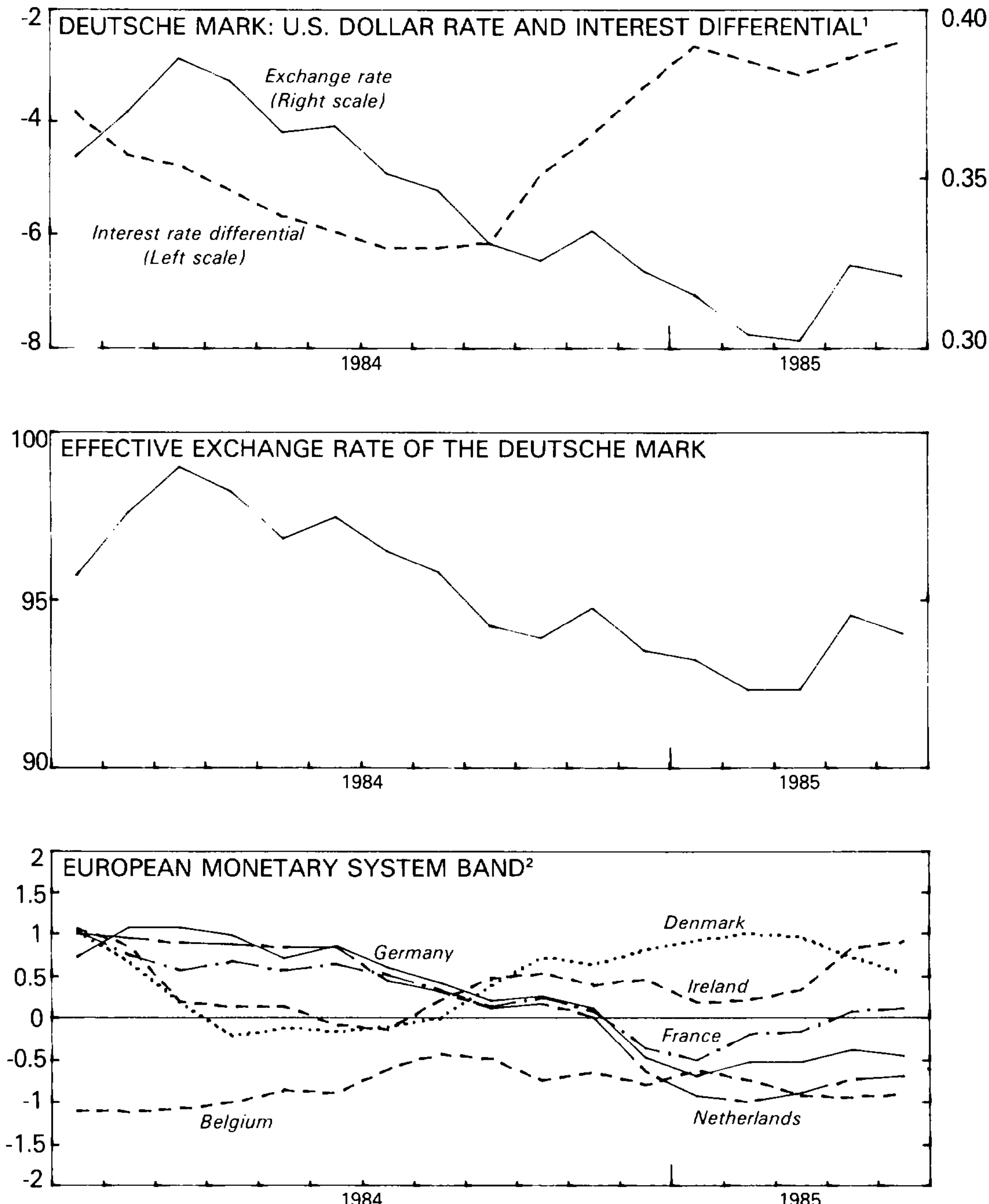
Sources: IFO, *Schnelldienst*, Deutsche Bundesbank, *Monthly Report* and *Supplement 4*, and Statistisches Bundesamt, *Wirtschaft und Statistik*.

* Affected by widespread strikes

CHART 4

GERMANY

RECENT EXCHANGE RATE DEVELOPMENTS



Source: I.M.F. Data Fund.

[1]The exchange rate is measured as dollars per deutsche mark; the interest rate differential is the yield on medium term German government bonds minus that on U.S. government bonds of similar maturity.

[2]Excluding Italy.

III. Discussions on Policy and the Short-Term Prospects

At the conclusion of the last Article IV consultation with Germany (July 1984) Executive Directors commended the German authorities for their consistent and markedly successful conduct of economic policy, though some uncertainties remained with regard to the sustainability of the recovery. Directors generally welcomed the policy of "fiscal consolidation", which they believed to be fundamental to a durable recovery in the private sector, and hence to an expansion of employment; they noted, however, that increased flexibility in the labor market was required to deal with the structural aspects of unemployment. Directors also emphasized the importance of maintaining a stable, but restrained, rate of monetary growth, which was essential for creating an environment conducive to economic growth and for controlling inflation.

Since the last consultation German economic policy has remained on the same steady course, that is to say, macroeconomic policies are aimed at establishing a stable financial environment, characterized by low inflation and inflationary expectations. Fiscal policy is oriented toward the medium-term objective of reducing the share of the Government in the economy and lowering the budget deficit, and monetary policy is aligned to the growth of potential output. Demand management is not seen as a useful tool of short-term countercyclical policy. The Government believes that, within a stable financial environment, market forces should be left to establish a sustainable path for the growth of output and employment.

The authorities are also concerned that the burden of taxation should be reduced over time, in order to improve economic incentives and strengthen the supply side of the economy. They are, moreover, committed to a loosening, over time, of rigidities in the labor and capital markets and in various other sectors of the economy. It is accepted, however, that many of the apparent impediments to a smoother functioning of the labor market originate in the collective bargaining process and are outside the scope of direct government action.

While accepting the medium-term orientation of financial policy, the staff raised a number of questions on the relative weakness of private consumption and the sustainability of the recovery. The German representatives acknowledged that a more rapid rate of growth of domestic demand would be desirable, though not if achieved through larger transfer expenditures. They believed that the benefits of a shift toward a more stimulatory demand management policy had to be weighed against the costs of departing from a steady and transparent stance of policies. These costs were seen as the risks of reigniting inflation and inflationary expectations and so halting the downward trend in interest rates, and of disrupting investor confidence by adopting a less steady and predictable policy stance. Besides, consumption would in due course be strengthened by the effects of investment and export growth on incomes, and also by the next stage in the process of tax reform that had been embarked upon. The German authorities did not believe that adjustments to German demand management policies could usefully help to offset the effects of slower U.S. growth on the world economy. Both domestic and international interests, in their view, would best be served by a steady and sustainable recovery of the German economy.

1. Fiscal policy

On fiscal policy the German representatives noted that short run countercyclical considerations had been eschewed in recent years in pursuit of the medium-term objective of consolidation. There were three aspects to consolidation. First, and most important, was the objective of a progressive reduction in the share of government expenditure in the economy. Second, the Government envisaged a continuing, albeit small, decline in the absolute size of the deficit. Third, spending was to be reoriented away from transfers and less productive current expenditure toward expenditures that enhanced the productive potential of the economy. In addition, the authorities envisaged a continuation of the process of tax reform and reduction.

There had been significant progress on the first two aspects of consolidation (Chart 5). The share of general government 1/ expenditure in GNP, which had risen from below 40 percent at the beginning of the 1970s to 50 percent in 1982, had been reduced to 48 3/4 percent by 1984. It was projected to fall to 48 percent in 1985 and a further reduction was expected in 1986. The Government was trying to limit the rate of growth of expenditure of the territorial authorities to about 3 percent per year and had set an intermediate target of reducing the share of general government expenditure to 45 percent of GNP by the end of the decade. In the budgets for 1983 and 1984, statutory changes in the Government's obligation to pay benefits had been necessary to the containment of total expenditure, but in 1985 no further changes of this sort had been required and the reduction in the share of public spending to GNP would be brought about by a more generally restrained spending policy.

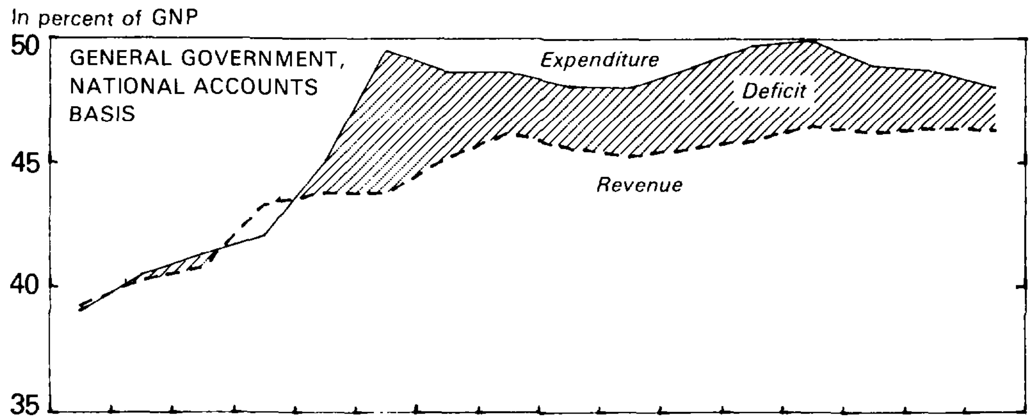
The general government financial deficit, which had been equivalent to 3 1/2 percent of GNP in 1982, had been reduced to 2 1/4 percent by 1984; it was expected to fall to 1 3/4 percent in 1985 and was not expected to change significantly in 1986 despite the substantial tax reduction planned for that year. Cyclical adjustment has confirmed that the improvement in the financial balance of the general government was not attributable to the upturn in the cycle, but rather to an underlying process of fiscal retrenchment.

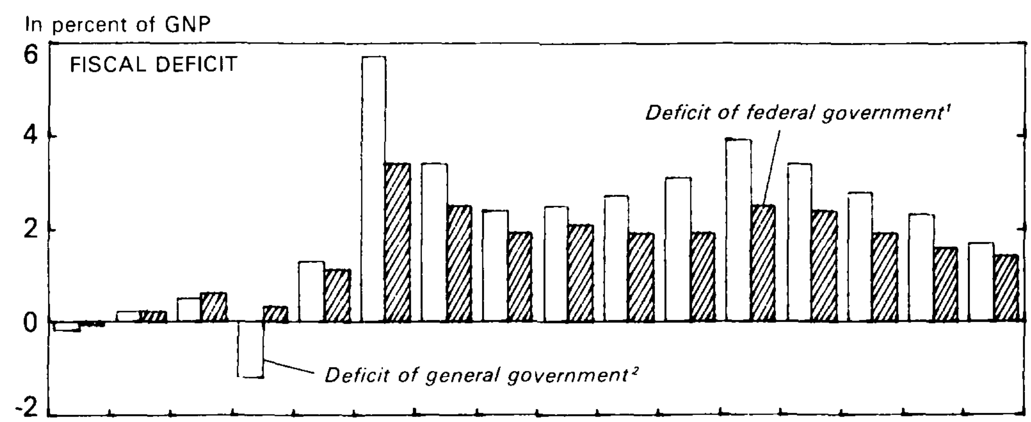
1/ The general government consists of the territorial authorities (the Federal Government, the Länder, and the municipalities) and of the social security system.

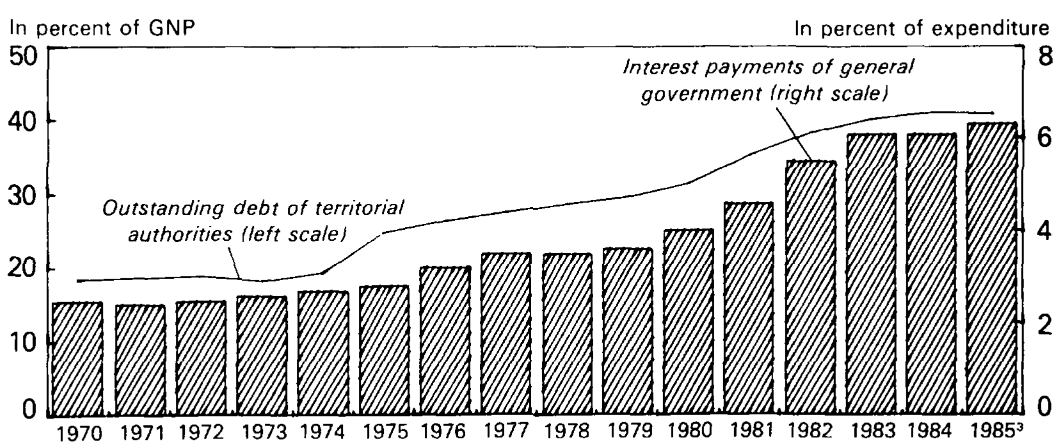
CHART 5

GERMANY

SELECTED INDICATORS OF FISCAL POLICY







Source: Data provided by the Ministry of Finance.
[1] Administrative basis
[2] National accounts basis
[3] Estimates by the German Ministry of Finance

Changes in the structure of government expenditure had, however, been less than ideal. A disproportionate burden of expenditure restraint had been borne by public investment, which had fallen by 25 percent in real terms since 1980; it was, however, budgeted to rise slightly in 1985. Also, in the last two years, government subsidies had grown rapidly, owing largely to greater support for coal mining, the steel industry, and agriculture; a smaller increase was budgeted for 1985. Another area where expenditure restraint had been markedly unsuccessful had been that of health insurance; expenditure in this area had far exceeded budget projections in 1984 and a further rapid increase was expected in 1985.

The staff mission, while supporting the policy of continuing to reduce the size of government expenditure in relation to GNP, raised the question of the extent to which reduced rates of growth of expenditure should be matched by lower taxes or by a lowering of the deficit. On the basis of the Government's medium-term fiscal projections, which were acknowledged to be simple statistical extrapolations rather than policy intentions, the general government deficit would continue to be reduced until, by 1989, the government accounts were in surplus. At what point would the negative effects on demand of a further withdrawal of fiscal stimulus outweigh the positive effects on real interest rates and confidence? Considered from the financial side, a deficit of about 2 percent of GNP would maintain the stock of general government debt more or less constant in proportion to GNP.

The German representatives responded that it was unlikely that the figures implicit in the medium-term fiscal projections would be fully realized. As the financial position of municipalities, which account for the bulk of public investment, improved, it was probable that they would raise their investment expenditures. As long as this investment enhanced productive potential, such an increase would be in line with the objectives of fiscal consolidation. It would, however, have to be accompanied by restraint at other levels of government so that the annual rate of growth of spending of the territorial authorities remained at about 3 percent.

There was no precise official target for the deficit but, in the view of the Government, the present deficit was still too high. One figure that was sometimes mentioned as a possible objective was a general government deficit of 1 percent of GNP (compared with the projected 1 3/4 percent in 1985). An important criterion (perhaps the most important in the minds of the German representatives) was that of limiting the share of interest payments in Federal Government expenditure. Such payments reduced the room for discretionary action in fiscal policy and, despite the success at reducing the deficit, the share of interest payments was still rising (11 percent in 1984, possibly rising to 13 percent by the end of the decade).

The Government's view was that a lowering and restructuring of taxes was essential, subject, for the immediate future, to the constraint of a continued slight downtrend in the absolute level of the deficit. It was acknowledged that tax reductions would stimulate private expenditure and have beneficial supply-side effects. In 1983 and 1984 there had been significant tax cuts for business which had had the desired effect of increasing after-tax profits and thereby stimulating investment. It was, therefore, appropriate that the next stage in the process provide tax relief to households. The Bill passed by parliament in June provided for personal income tax relief of DM 19 1/2 billion a year (about 1 percent of 1986 GNP) in two phases--DM 11 billion from 1986 and a further DM 8 1/2 billion from 1988. The first phase would consist chiefly of an increase in standard exemptions and family deductions (about DM 7 1/2 billion) and to a lesser extent (some DM 3 1/2 billion) of a reduction in marginal tax rates. The second phase would reduce marginal tax rates further. The full package would more or less correct for the effects of fiscal drag since the last income tax adjustment in 1981. It was intended in the life of the next parliament to reduce marginal tax rates on average incomes and to introduce further tax reductions for businesses as part of the ongoing process of tax reform.

2. Monetary policy

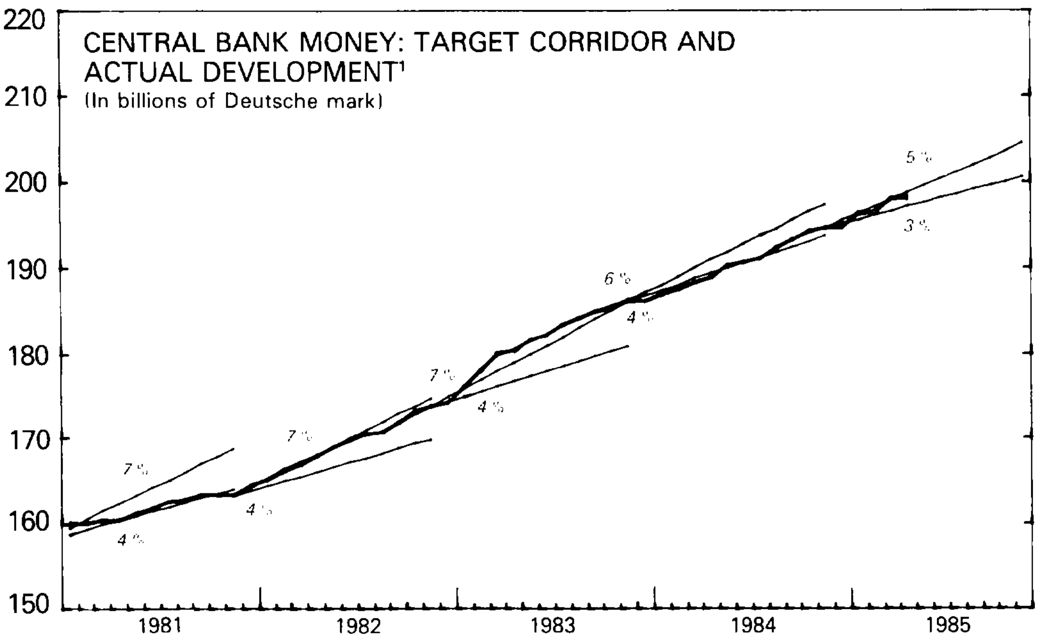
Monetary policy is also medium-term in orientation insofar as the authorities base their target growth range for Central Bank Money (CBM) on a projection of the growth of potential (rather than actual) real output and a tolerable rate of inflation. Insofar as the ultimate objective of monetary policy was the safeguarding of the real value of the currency, the Bundesbank had, at times, to take into account the impact of exchange rate changes on domestic price stability. The German representatives reaffirmed, however, that monetary policy was not set with any specific exchange rate target or target range in mind. Despite the size and speed of changes in the deutsche mark/dollar exchange rate in 1984 and 1985, and the effects of these changes on prices and the terms of trade, monetary policy had not been deflected from its set course which had been based largely on domestic considerations.

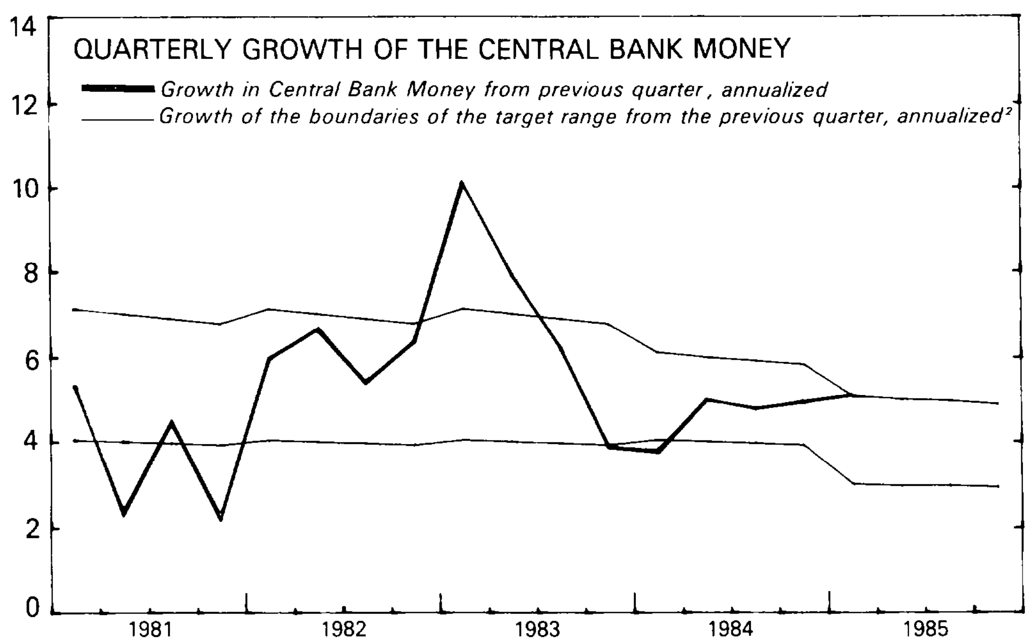
The target range for CBM growth during 1984 was 4-6 percent. Although real GNP growth turned out to be more rapid than the estimated growth of potential output, inflation was somewhat lower than expected and CBM grew at a rate of 4 1/2 percent, slightly below the mid-point of the target range (Chart 6). Both narrow money and the broad (M3) aggregate grew more slowly than CBM. Short-term interest rates were remarkably stable during the year, the three-month money market rate fluctuating narrowly around 6 percent. Longer-term rates trended downward in the second half, the government bond yield falling from 8 percent in mid-year to 7 percent by December. In all, monetary policy accommodated a 5 percent increase in nominal GNP (3 percent real and a 2 percent rise in the deflator) in through-the-year terms, without any evidence of undue financial stringency.

CHART 6

GERMANY

CENTRAL BANK MONEY





Source: Deutsche Bundesbank *Monthly Report, Supplement 4.*

[1] For each of the years 1981–83, the target growth corridor for central bank money, on a fourth quarter over fourth quarter basis, was 4–7 percent, for 1984 it was 4–6 percent and for 1985 3–5 percent.

[2] Central bank money growth would follow these lines if it was growing at exactly the rates that define the upper and lower bounds of the target range

The Bundesbank had set a target range of 3-5 percent for the growth of CBM during 1985 (fourth quarter over fourth quarter)--that is, lower by 1 percentage point than that for the previous year, owing chiefly to a reduced allowance for inflation. It was based on a projected increase in productive potential of just over 2 percent in real terms in 1985; this translated into a 4 percent nominal rate of growth through the year. No allowance was made for the fact that actual growth was expected to be somewhat higher than the growth of productive potential. This is consistent with the medium-term orientation of monetary policy which implies a monetary environment that is more relaxed when the growth of potential output exceeds that of actual output and more restrained when the growth of output is strong relative to potential production.

The staff observed that the rate of inflation underlying the monetary growth target was ambitious, and the question arises whether a monetary policy which could dampen actual growth of GNP of 2 1/2 percent or a little more might seem to imply a greater concern about the risks of higher inflation than about those of lower growth. The authorities thought that there was sufficient room for maneuver within the monetary target range. Thus far in the year, CBM had been growing at about the same rate as in 1984, that is, at or near the top of the target range, with broad money (M3) increasing at about the same rate. In the present circumstances there was no reason to reduce this rate of growth of CBM which, in their view, would be strong enough to support the ongoing recovery.

The yield on bonds, which had trended downward from mid-1984 to end-1984, had risen sharply, albeit temporarily, in the first quarter of 1985. The German representatives noted that they had little control over longer-term bond yields. These reacted both to interest rates abroad and to exchange rates and exchange rate expectations. When, early in 1985, the dollar had risen sharply, bond yields had increased. They noted that this rise had subsequently been corrected and that bond yields were back at the end-1984 levels. Interest rates, in the view of the authorities, were still unrealistically high because of the failure of inflationary expectations to move downward as fast as the actual inflation rate. The best strategy for reducing longer-term interest rates in Germany was, in the view of the German representatives, to maintain confidence in a steady noninflationary stance of fiscal and monetary policy. This would elicit a fall in inflationary expectations and thus nominal interest rates; it might also facilitate some decoupling of German rates from U.S. rates. In any event, the continuing fiscal consolidation should put downward pressure on real interest rates. External factors, particularly progress on the U.S. fiscal deficit, could also have a beneficial effect on the German bond market.

3. Constraints on supply

In accordance with the declaration at the Bonn summit 1/ the German authorities attach considerable importance to the strucural rigidities which inhibit the efficient functioning of the economy. Indeed, the authorities thought it difficult to understand the persistence of high unemployment without looking to longer-term structural developments. Various rigidities in the labor market, that had developed gradually over the last 20 years, had increased the rate of unemployment associated with any given rate of capacity utilization, and raised the rate of unemployment consistent with nonaccelerating inflation. 2/ Also, insofar as they had both lowered profits and reoriented investment away from capacity expansion toward labor replacement, they had further reduced the rate of growth of potential output.

First, in the area of wage determination, the substantial wage gap--that is excess of actual wages over estimated market-clearing wages--that opened up in the decade to 1982 had had a large, albeit lagged, effect on employment. 3/ Moreover, the downward inflexibility of wages coupled with the considerable costs to employers of reducing their workforce made profits and investment extremely vulnerable to the terms-of-trade shocks of the 1970s. The authorities pointed out, in this connection, that real labor costs had fallen during the period since 1982 and that the distribution of income had shifted in favor of profits. Clearly wage gaps had narrowed, but there was no consensus yet on the appropriateness of the current level of wages, and restraint on increases in wages was still thought to be warranted.

Second, the authorities pointed out that during the 1960s and 1970s there had been a narrowing of wage differentials between skilled and unskilled workers and between industries (and enterprises within an industry) with different developments in profits. In the economic climate of the 1980s this had reduced job opportunities for the unskilled and had exacerbated the difficulties of industries facing (even short-term) financial problems. While the data from the last two years indicated considerable progress in closing the aggregate wage gap, the German representatives thought that the problem of the structure of wages had proved less tractable.

1/ The Economic Declaration called for "greater adaptibility and responsiveness in all markets, particularly the labor market". It went on to specify that the "Government of the Federal Republic of Germany attaches high priority to strengthening the flexibility and vigor of the economy in order to achieve a lasting improvement in growth and to create new jobs."

2/ The "nonaccelerating inflation rate of unemployment" (NAIRU) in Germany has, according to a recent estimate (Commission of the European Communities, Economic Papers No. 31, April 1984) risen from below 1 1/2 in 1965-75 to around 6 percent in 1981-83.

3/ See DM/84/27.

Third, various fiscal influences on wage rates and wage costs had impinged on employment decisions. A relatively high ratio of unemployment benefits to wage earnings (the replacement ratio) had presumably reduced the downward flexibility of wages and the supply of labor. Large nonwage costs of employment--chiefly statutory contributions to social security--had reduced the demand for labor to the extent that they were borne by employers and the supply of labor to the extent that they were borne by the employees. Progress had been made recently on reducing replacement ratios although these were still high by international standards.

Finally, there was, in the view of the authorities, a set of rigidities in the form of regulatory limitations on employers. For example, companies became subject to regulations conferring certain rights on workers and imposing legal restraints on lay-offs when the number of employees reached as few as six. As the number of employees increased, the restrictiveness of the regulations grew, with even small companies subject to a mandatory "social plan" whereby compensation paid to workers could rise to very high levels if certain minimum numbers of workers in an enterprise were laid off. In addition, regulations governing youth employment and training, female employment, working hours, and the employment of temporary labor all served to impose severe limitations on employers.

Recently a number of measures had been taken to ease these regulatory restrictions. Changes had been made in the Youth Employment Protection Act in order to tailor the training and employing of youth more closely to the needs of the market. A proposal for changing the Working Time Act, in a way that would improve flexibility for managers, had been submitted to Parliament. Especially noteworthy, in the view of the German representatives, was the Employment Promotion Act which had become effective on May 1, 1985. Under this Act there was greater flexibility for employers in using short-term work contracts without having to show cause for not offering permanent contracts. Clearer criteria had been provided for payments under "social plans"; such payments were now obligatory in fewer cases than before (with new enterprises temporarily exempted) and they could not endanger the survival of the company. Finally, the law contained a number of changes that would reduce health care costs for employers, enlarge some employment support measures, and improve placement services for trainees. The government representatives emphasized that these changes were a small beginning, and that much more needed to be done.

The German representatives also pointed to a number of structural rigidities outside the labor market such as regulations and practices that made it difficult to start a new business, limitations on opening hours in the retail trade, and the operations of certain public monopolies, but they believed the rigidities in the labor market to be the most important ones.

The German representatives believed that these various rigidities had an impact on the rate of growth of productive potential, but that this impact was difficult to quantify. Labor market developments had exacerbated the shift from capacity-expanding investment into labor-replacing investment, but the weakness of overall investment in recent years was an even more important factor behind the slower growth of productive potential. For this reason considerable weight was assigned to the importance of maintaining rates of return consistent with a rapid growth of investment. Apart from the desirability of lowering the share of public expenditure in GNP so as to increase the dynamism of the economy, it was also desirable to reduce the share of consumption in GNP so as to make room for a faster growth of investment.

The staff discussed with the authorities the measurement of the rate of growth of potential output. Various calculations were discussed, ranging from the 1 1/2 percent figure for 1984 of the Council of Economic Experts to a more optimistic estimate (of 2 1/2 percent) by the staff mission. The Bundesbank, which is currently in the process of one of its regular reviews of these estimates, is at the moment using a figure for the growth of potential output of slightly over 2 percent.

4. The short-term economic prospects

At the time of the staff visit both the staff and the Government were projecting a real GNP growth rate of about 2 1/2 percent for 1985; while the German economic research institutes, who issue a combined forecast, had raised their projection from an earlier figure of 2 percent to 2 1/2 percent. Subsequent staff estimatees have not changed the picture. The main driving forces behind growth in 1985 are projected to be the foreign balance and domestic investment in machinery and equipment. Total domestic demand is expected to rise by some 1 1/2 percent in 1985 with the foreign balance contributing about another 1 percentage point to growth.

National accounts data for the first quarter, released after the return of the mission, were very much as expected. Real GNP was about 1 percent lower than in the fourth quarter of 1984 and only fractionally higher than in the first quarter of 1984. The fall in GNP was principally attributable to the effects of the extremely severe weather on construction; construction investment fell by 18 1/2 percent in real terms and this, by itself, would have reduced GNP by more than 2 percent.

Private consumption expenditure, which has been remarkably weak thus far in the recovery, is expected to increase by about 1 1/2 percent in 1985 (1/2 percent in 1984) on the basis of a more rapid increase in real household disposable incomes and an unchanged savings rate. Government current expenditure is expected to grow at about the same (2 percent) rate as in 1984. Investment in machinery and equipment is projected to strengthen considerably, growing by 8-9 percent. In part this is due to special factors (fiscal incentives in 1983 had distorted the time pattern of investment, substantially raising the level of investment in 1983 and artificially depressing the level in 1984), but the most recent evidence from investment intention surveys, domestic orders received by capital goods manufacturers, and capital goods imports all suggest an underlying strengthening of investment. The German representatives noted that the improvement in profits in this recovery had surpassed that of recoveries in recent cycles, and they thought that this profitability performance would help to sustain investment.

Construction investment is projected to fall by some 3 percent in 1985, as a small rise in business and government construction will not offset a large drop in residential construction. Part of the fall in 1985 reflects base effects--construction had been boosted in 1984 by fiscal incentives that expired at the end of the year--but the German representatives said that there was an underlying oversupply of residential buildings that could not (and indeed should not) be offset by special policy measures.

No significant change in price inflation from the current rate of 2-2 1/2 percent rate is projected in 1985. Productivity is expected to rise by 2-3 percent in the economy as a whole and, despite some picking up in the rate of wage increases, no appreciable rise in unit labor costs in manufacturing is expected. However, despite the continuing favorable development of labor costs and profits, not much, if any, reduction in unemployment is expected on average in 1985, although some improvement is expected in employment, particularly in the latter part of the year.

On the basis of the market growth and exchange rate assumptions in the current WEO exercise, the staff is projecting an increase in the current account surplus from around DM 18 billion in 1984 to almost DM 33 billion in 1985. The authorities envisage a somewhat smaller current account surplus in the region of DM 25-30 billion.

The staff foresees continued low inflation in 1986. It is projecting a somewhat stronger and more balanced structure of domestic demand in 1986 with the growth of consumption picking up to 2-2 1/2 percent and continued strong investment in machinery and equipment. The German representatives noted that three quarters of the tax cut at the beginning of 1986 was expected to be reflected in additional consumption within the year. They thought that the multiplier effects of the rapid growth of investment and exports in 1984 and 1985 would, by 1986, have a substantial positive effect on consumption, and that this would help to sustain the recovery in the face of a lessening contribution from the foreign balance. GNP growth is expected to remain in the 2 1/2 - 3 percent range.

Assuming a current account surplus of 2 percent of GNP during 1985 to 1990 and a growth rate of nominal GNP of 5 percent through the period, the net foreign asset position of Germany would improve from

14 percent of GNP at the end of 1984 (gold and foreign exchange reserves calculated at market values) to 21 percent of GNP at the end of 1990. If it is assumed that the current account surplus declines from 2 percent of GNP in 1985 to 1 percent of GNP during 1987 to 1990 the net foreign asset position would be 17 percent of GNP at the end of 1990.

5. Capital market policies

The mission took the opportunity of the consultation discussions to obtain the views of the German authorities on changes in the regulations governing the German capital market and its integration with the world market. In October 1984, in a move coordinated with the French Government, the German Government had authorized the ministry of Finance to table a draft bill repealing the 25 percent withholding tax on interest on securities held by nonresidents with retroactive effect from August 1. Even before this bill was passed by Parliament in December 1984, it had a significant influence on capital flows. Previously, foreign investors had exhibited a preference for foreign deutsche mark bonds or official borrowers' notes, neither of which had been subject to the withholding tax. From the latter part of 1984, the distortion in yields between foreign deutsche mark bonds and regular deutsche mark bonds had been corrected, and official borrowers' notes 1/ had declined in importance with the greater attractiveness of regular deutsche mark bonds.

New regulations on the German capital market had been issued in a Bundesbank statement and entered into force on May 1, 1985. The Bundesbank statement had replaced the "gentlemen's agreement" of January 1980 between the Bundesbank and the leading German banks in the field of foreign deutsche mark bonds. There were two aspects to the new agreement. First, all resident banks, including legally independent foreign-owned banks, would now be able to lead-manage issues of foreign deutsche mark bonds. The Bundesbank continued to consider it important that the market for deutsche mark bonds be based in Germany. It was assumed by the Bundesbank that German-owned banks would have reciprocal lead-management rights in the home countries of those foreign-owned banks operating in Germany.

Second, in the past the Bundesbank had resisted the introduction of various new types of instruments into the German capital market. There had been a concern that capital market paper should have clear and simple conditions, preferably with long maturities and fixed interest rates, and that money market instruments should not be traded in this market. From May 1, 1985, when the new regulations had become

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1/ Official borrowers' notes are a credit arranged between the Government and a financial institution and, while they can be negotiated two or three times, the borrower has to be informed each time ownership of the note changes. The transferability of such instruments is thus limited.

effective, the market had been opened to a number of types of bonds that had become popular in other markets. These included floating-rate notes, zero-coupon bonds, and swap-related bonds. The Bundesbank continued to resist the introduction of deutsche mark money market instruments, such as CDs and units of money market funds, because a principal objective of such instruments was the avoidance of reserve requirements. The risks and potential problems associated with various novel financing techniques, such as revolving underwriting facilities and note issuance facilities, which allowed banks to take part in international lending transactions without necessarily involving their capital, had been discussed in the Annual Report of the Bundesbank. Insofar as the new capital market regulations did not allow private placements with maturities of less than three years (or public placements of less than five years), such techniques were not applicable in the deutsche mark capital market. It was too early to determine whether the changes brought about by the new capital market regulations would have any significant influence on monetary policy or domestic monetary developments, but no major effect was expected.

6. Trade and aid

The staff mission also took the opportunity of the consultation discussions to review with the German authorities significant developments in trade policy in the light of the views expressed by Executive Directors in July 1984, when they urged Germany to intensify its efforts to resist protecionist tendencies, particularly with respect to some industrial sectors and to agricultural products. The German representatives confirmed that there had been no major changes in trade policy or, indeed, in the pressure for protection since the last consultation. There had, however, been two aspects of trade policy that had been liberalized. First, the EC had accelerated by one year the Tokyo Round tariff cuts in respect of 330 items of interest to developing countries with effect from January 1, 1985. Germany and the rest of the EC would be in favor of further steps toward accelerated Tokyo Round tariff reductions, but some of their trading partners seemed reluctant to move as quickly. Second, nearly 30 quantitative restrictions applied by member countries of the EC had been removed. Germany had dropped its restrictions against insulators from Japan, leaving only five quantitative restrictions still applied by Germany at the national level.

The German representatives expressed the strong support of their Government for a new GATT round, which they thought would be essential to a halting of protectionist tendencies. The limits imposed by GATT rules, the commitment implicit in the GATT Working Program, and the political appeals made by GATT were all very helpful in limiting protectionism. However, in the view of the German authorities, it was essential that the trading partners make a substantial political commitment to negotiating liberalization because, once the process began, it could not be allowed to fail.

On textiles, the German representatives noted that a common EC position had not yet been elaborated. However, the initial attitude of Germany was that it would be too early to abolish the MFA; they would rather favor a transitional arrangement, which should be more liberal in a number of respects: (a) it should have larger quotas--that is, start from a lower level of protection; (b) the degree of protection should be reduced over time so that there would be a movement back toward the application of general GATT rules which would apply after the expiration of the agreement; and (c) quota restrictions should be abandoned wherever there was evidence that they were clearly not fully utilized.

On steel trade, the German representatives noted that continued subsidization in other countries and the protectionist trend in the United States exacerbated the difficulties of moving toward freer trade. It was hoped that subsidization in the EC as a whole could be stopped by the end of 1985. Although it was acknowledged that the EC steel industry was vulnerable to criticism on grounds of subsidization, the attempt by the United States to limit imports from major trading partners to a fixed proportion of the U.S. market was thought to be counterproductive. For its own part, Germany would be prepared to eliminate subsidies and at the same time see the internationally agreed upon anti-dumping rules applied.

With respect to agriculture, the German Government had resisted lower prices for cereals within the Common Agricultural Policy (CAP), and had compensated farmers for reduced Monetary Compensatory Amounts (MCAs). In both of these areas German agricultural policy was conditioned by a sensitivity to changes in farm incomes. The staff mission pointed out that the Government's attitude to the price of cereals seemed at odds with its wish for reform of the CAP and would contribute to a prolongation of the situation of oversupply in the EC with the attendant pressures on world market prices.

On development assistance, data for 1984 were still partly provisional. Total net development assistance (that is official development assistance, other official flows, and net private flows) had increased by DM 0.6 billion to DM 18.5 billion; but as a ratio to GNP it had remained roughly unchanged at 1.1 percent. Net official development assistance (ODA), which had grown from 0.37 percent of GNP in 1978 to 0.48 percent in 1983, had decreased slightly to 0.45 percent of GNP in 1984. Within the limitations imposed by the budgetary situation, the German authorities will continue to increase the share of ODA in overall expenditures.

IV. Staff Appraisal

The performance of the German economy in 1984 turned out to be very much in line with that foreseen in the last Article IV consultation. The growth of GNP, at 2 1/2 percent, was within the range then projected, while inflation of 2-2 1/2 percent was about 1/2 percent below what was expected. On the external front, the current account surplus of nearly DM 18 billion was slightly above the forecast, and the foreign balance contributed about 1 percentage point to the growth of GNP. The worrisome spot in the economy continued to be the labor market. Although the fall in employment came to an end and unemployment levelled out, the rate of unemployment remained at a historically high level of about 8 percent of the total labor force.

These developments in general represented a continuation of the recovery which had begun in 1983 although there was a pronounced shift in the structure of demand: in 1983 the expansion came from domestic sources, but in 1984 the growth of total domestic demand fell fractionally, while the rest of the world (especially the United States) provided a strong impetus to German growth.

Staff projections of the likely performance of the economy in 1985 are not substantially different from the picture embodied in the latest forecast of the Government. The main elements of both sets of projections are a continued slow growth of private consumption--lower, in fact, than in any of the other G-7 countries--and a strong and welcome increase in business fixed investment. Even so, the expected rate of increase of total domestic demand is, again in 1985, less than 2 percent and the growth of GNP, of about 2 1/2 percent, is expected once again to depend to a considerable extent on the external sector.

The rate of growth in Germany is important both from an international and from a domestic point of view. From an international perspective, it is essential that the major industrial countries achieve the maximum rate of growth that is sustainable over the medium-term and is consistent with strict control of inflation. This, together with efforts to reduce protection, is a central element of an international environment that will facilitate a solution to the severe external debt problems of a number of developing countries. From a domestic point of view, the persistence of high rates of unemployment is worrying. In the medium run, as supply constraints are eased, a rate of growth sufficient to lower unemployment will depend upon a strengthening of domestic demand, all the more so as the economy is already vulnerable to a slackening in the growth of exports. It would not in any case be appropriate to expect the rest of the world to continue indefinitely to contribute to sustaining demand in Germany.

These considerations should not suggest that the appropriate policy response to the present situation is a pronounced shift to more stimulatory short-term demand management. Indeed such a shift in policy could well disrupt the important adjustments in the real economy that are currently taking place. It is difficult to determine the amount of excess capacity in the economy at present. The high rate of unemployment cannot be taken as an indicator of a sizeable amount of slack in the economy that could be taken up without any acceleration of inflation. Rather, given the present level and structure of wage costs, the capital stock is the binding constraint on more rapid growth in many sectors, and the evidence from manufacturing industry suggests that capacity utilization rates have risen considerably over the last two years. The present labor market difficulties can only be tackled by attacking supply constraints in order to remove the impediments to faster noninflationary growth.

There are a number of rigidities which need to be loosened if potential growth is to be substantially raised from the present low figure. Certainly, more capital is needed but that would not be enough to produce a strong rise in employment unless progress were made in tackling the serious rigidities in the labor market. From the discussions two main kinds of rigidity in the labor market emerged as particularly important. The first is in the area of wage determination: for example, the narrowing of wage differentials between skilled and unskilled workers which took place in the 1960s and 1970s has greatly damaged job opportunities for the latter, and there is also insufficient differentiation between increases in the rate of pay among different industries. Such rigidities are largely beyond the reach of direct government action. Initiatives in this area by both workers and employers are of course needed and would be welcome and the wage policy of the authorities vis-a-vis its own employees can have a useful influence. The second lies in the existence of numerous restrictions and regulations which limit the freedom of employers in managing their labor force, e.g., "social plans" under which large redundancy payments have to be made to workers who are dismissed and many other regulations that confer certain rights on workers when businesses achieve a certain size. The Act for the Promotion of Employment, which became effective in May, makes a useful start at modifying some of these practices. More can be done in this area, although it is recognised that this will necessarily be a slow process.

The medium-term orientation of both monetary and fiscal policy continues to be appropriate in Germany; the direction of macroeconomic policy must be set within the limits of the supply responsiveness of the real economy over the medium term. That being said, it is important to realise that for the recovery to be self-sustaining without undue reliance on foreign demand, the economic expansion will have to be more broadly based. While business investment needs to grow faster than GNP, in the longer run a more rapid rate of growth of private consumption will also be necessary to sustain domestic demand and to increase activity in such employment-intensive sectors as services. Weak consumption has been related to both low employment and to wage restraint. Clearly, household incomes cannot be increased by higher wage rates alone without further damaging employment prospects. But changes in taxation can resolve the dilemma by raising disposable incomes without increasing labor costs. The tax proposal passed by parliament in June is a helpful move in this direction: it calls for cuts in income taxes equal to slightly more than 1/2 percent of GNP at the beginning of 1986, and a further amount of about 1/3 percent at the beginning of 1988. Moreover, after the tax relief for business given in 1983 and 1984, this relief for consumers is to be welcomed as part of the ongoing process of tax reform.

So far in 1985, inflation (in terms of consumer prices) has quickened slightly, but this has been due to an increase in import prices rather than to an increase in cost pressures from domestic sources. With this still relatively low rate of inflation, monetary policy in 1985 should aim at supporting the expected increase in real output, as it did in 1983 and 1984. The lowering of the target range for the growth of the central bank money (CBM) stock to 3-5 percent for 1985 prompted questions from the staff team as to whether this might not run the risk of being too restrictive. The lower half of this range would probably be insufficient to accommodate developments in the real economy, but so far this year the CBM stock has been growing at, or near, the upper end of the range, and it is understood that this rate of growth will be maintained. The rate of monetary expansion would thus be roughly the same as last year and should be adequate to support the projected rate of real growth.

Such a rate of monetary expansion in 1984 proved to be consistent with a moderate fall in long-term bond yields, and although there was a temporary reversal of this movement in the first quarter of the year, rates have now fallen back again. The real rate of interest, measured on the basis of past increases in consumer prices, still appears to be uncomfortably high. There is probably little that Germany can do to alleviate this situation; but continued downward pressure on inflationary expectations from monetary policy and continued restraint on government borrowing offers the best chance of lowering interest rates and decoupling German real interest rates from those abroad.

Monetary policy has continued to be framed mainly on the basis of domestic considerations, but this has not proved inconsistent with a more or less stable pattern of exchange rates within the EMS. While the deutsche mark depreciated by a large amount against the dollar in 1984 and early 1985, the fact that the currencies of most of the other industrial countries have followed a similar path suggests that the main causes of this depreciation do not lie in Germany, and that it would not have been wise to try to resist it. Intervention policy has, quite appropriately in the view of the staff, continued to be aimed at maintaining orderly markets, but not at trying to go against a market trend.

The staff continue to support the policy of fiscal consolidation. In this connection the decision to limit increases in the expenditure of the territorial authorities to about 3 percent per year, i.e., a rate below the expected growth of nominal GNP, should be seen as the cornerstone of consolidation. Progress has already been made in reducing the share of expenditure in GNP from 50 percent in 1982 to an estimated 48 percent in 1985, but there is still some way to go to reach the intermediate target of 45 percent, itself well above the 40 percent characteristic of the early 1970s. Secondly, the staff supports the intention to shift government expenditure away from consumption and transfer payments toward investment. It is disappointing that public consumption in 1984 exceeded projections and that in the last two or three years no progress has been made in reducing subsidies, which remain as high as 5 percent of GDP. After four years in which public investment has fallen, there seems now to be a general wish to see it increase again, partly because of weak conditions in the construction sector. This will largely be effected through the local authorities, and it is hoped that the Federal Government will try to ensure that such expenditure is concentrated on enhancing productive potential.

The other major aspect of fiscal consolidation is the policy of reducing the fiscal deficit. The deficit of the general government, which reached nearly 4 percent of GNP in 1981, has been steadily reduced to an estimate of below 2 percent in 1985--the lowest among the G-7 countries. In spite of the tax cut which will come into effect at the beginning of 1986, it is unlikely to rise appreciably (as a percentage of GNP) in that year. If expenditure policy is strictly enforced, as it ought to be, the question will increasingly arise to what extent the benefits of expenditure restraint should be used, on the one hand, to reduce the deficit further and, on the other, to lower taxes. Given the modest level to which the deficit has now been reduced, the staff questions whether the extra confidence, and any beneficial effects on interest rates, that might arise from a continuing fall in the deficit would be enough to offset the withdrawal of demand that occurs as the deficit falls. In these circumstances the staff would put the emphasis of consolidation on restraint of expenditure and would assign a smaller significance to the issue of reducing the deficit.

In the context of trade, the staff welcome Germany's support for a new round of GATT talks. It is hoped, however, that Germany will do all it can in the sensitive areas--agriculture, coal, steel, textiles and clothing, etc.--to keep down both national and EC restrictions and subsidies, and so contribute to helping other countries also to avoid and reduce protection. In particular, liberalization of restrictions on clothing and textiles would contribute to the growth prospects of developing countries. The German authorities have long been strong advocates of reform of the Common Agricultural Policy (CAP) and in last year's Staff Report they were commended for their efforts in helping to bring about the measures introduced in 1984, which were important steps in this reform. It is, therefore, a matter for particular regret that Germany has found it necessary to veto a modest reduction in prices for cereals within the context of the CAP and the staff would urge the authorities not to back away from the free trade principles that they have so persuasively espoused in other contexts.

The staff have also noted in the past the progress made by Germany in increasing its assistance to developing countries. It is hoped that the small decline in official development assistance in 1984 will quickly be reversed and that such assistance will grow further in the ensuing years.

It is recommended that the Article IV Consultation with the Federal Republic of Germany be held on the standard 12-month cycle.

Germany - Fund Relations

(As of end-May 1985; in millions of SDRs)

I. Membership status

Germany became a member of the Fund on August 14, 1952. Germany has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Agreement.

A. Financial Relations

II. General Department

(a) Quota: SDR 5,403.7 million.

(b) Total Fund holdings of deutsche mark:
SDR 2,533.8 million (46.9 percent of quota).

(c) Fund credit:
None.

(d) Reserve tranche position:
SDR 2,869.9 million.

(e) Current (June-August) operational budget:
Purchases: SDR 120.9 million
Repurchases: SDR 138.7 million

(f) Lending to the Fund (SDR millions):

	Limits	Outstanding	Uncalled
GAB	2,380	--	2,380
SFF	832	832	--
Total	3,212	832	2,380

III. Current Stand-by or Extended Arrangement and Special Facilities

None.

IV. SDR Department

(a) Net cumulative allocation SDR 1,210.8 million.

(b) Holdings: SDR 1,422.1 million, or 117.5 percent of net cumulative allocation.

(c) Current (June-August) Designation Plan: -

V. Administered Accounts

Not applicable.

VI. Overdue Obligations to the Fund

None.

VII. Germany has not used Fund credit

B. Nonfinancial Relations

VIII. Exchange Rate Arrangements

Since March 13, 1979, Germany has participated together with Belgium, Denmark, France, Ireland, Italy, Luxembourg, and the Netherlands in the exchange rate mechanism of the European Monetary System (EMS). Under this agreement, Germany maintains spot exchange rates of the currencies of the other participants within margins of 2.25 percent (in the case of the Italian lira, 6 percent) from cross rates derived from central rates expressed in ECUs.

IX. Last Article IV Consultation was concluded at EBM/84/112 and EBM/84/113, 7/20/84. Germany is on a 12-month consultation cycle.

Basic Data

Area and population	
Total area	248,667 square kilometers
Total population (June 1984)	61,181,000
GNP per capita (1984)	US$10,051

	1984	1981	1982	1983	1984	1985 1/
	In percent	Volume changes; in percent 2/				
Demand and supply						
Private consumption	55.9	-0.6	-1.4	1.1	0.6	1 1/2
Public consumption	20.0	1.5	-1.0	0.2	2.0	2
Gross fixed investment	20.4	-4.2	-4.7	3.1	1.3	2 1/2
Construction	12.4	-4.6	-3.9	0.9	1.9	-3
Machinery and equipment	8.0	-3.5	-5.7	6.1	0.4	9
Final domestic demand	96.3	-1.0	-2.0	1.4	1.0	1 1/2
Stockbuilding 3/	0.9	-1.5	0.1	0.6	0.6	--
Total domestic demand	97.2	-2.5	-2.0	2.0	1.7	1 1/2
Exports of goods and services	34.3	8.4	4.6	-1.3	7.9	7
Imports of goods and services	31.5	0.7	2.1	0.5	5.7	5 1/2
Foreign balance 3/	2.8	2.3	0.9	-0.6	1.0	1
GNP	100.0	-0.2	-1.0	1.3	2.6	2 1/2
Manufacturing output		-1.7	-3.0	0.9	3.3	5
		In millions; period averages				
Employment and unemployment						
Labor force		27.37	27.47	27.49	27.44	27.60
Wage and salary earners		22.85	22.40	22.00	21.94	22.10
Foreign workers		1.91	1.79	1.70	...	...
Unemployed		1.27	1.83	2.26	2.27	2.25
(In percent of total labor force)		(4.8)	(6.7)	(8.2)	(8.1)	(8)
Vacancies		0.21	0.11	0.08	0.09	...

1/ Based on forecasts by the German authorities; and on staff estimates.
2/ Figures may not sum due to rounding.
3/ Change as percent of previous year's GNP.

	1981	1982	1983	1984	1985 1/
		Changes in percent			
Prices and incomes					
GNP deflator	4.2	4.6	3.2	1.9	2
Consumer price index	6.3	5.3	3.3	2.4	2 1/2
Terms of trade 2/	-6.6	3.8	1.7	-2.2	-1
Average hourly earnings (industry)	7.1	5.6	3.7	3.2	4 1/2
Unit labor costs (total economy)	4.6	3.1	1.1	0.4	1 1/2
Real disposable income 3/	-0.3	-2.8	-0.5	0.8	1 1/2
Personal savings ratio	(13.5)	(12.8)	(11.3)	(11.5)	(11 1/2)
		In billions of deutsche mark			
Public finances 4/					
General government					
Expenditure	768.1	798.0	818.8	852.4	880.8
Revenue	708.6	743.3	772.5	811.5	849.9
Financial balance	-59.5	-54.8	-46.3	-40.9	-30.9
(In percent of GNP)	(-3.8)	(-3.4)	(-2.8)	(-2.3)	(-1.7)
Federal Government					
Financial balance	-37.9	-37.7	-31.9	-28.6	-25.6
(In percent of GNP)	(-2.5)	(-2.4)	(-1.9)	(-1.6)	(-1.4)
Outstanding public sector debt					
Total debt	545.6	614.8	671.7	718.2	...
(In percent of GNP)	(35.3)	(38.4)	(40.1)	(41.0)	...
Foreign debt	66.8	79.3	94.6	103.6	...
(In percent of GNP)	(4.3)	(5.0)	(5.6)	(5.9)	...
Balance of payments					
Trade balance (f.o.b./c.i.f.) 5/	28.7	53.4	47.7	53.2	65 1/2
Services balance	-14.6	-17.1	-10.2	-3.9	-5
Net private transfers	-11.7	-11.9	-11.9	-11.9	)
Net official transfers	-14.9	-16.2	-15.1	-19.6	)-33
Current account	-12.4	8.2	10.5	17.7	27 1/2
Long-term capital balance					
Private	-9.7	-19.1	-12.5	-12.1	...
Official	18.0	4.8	5.1	-1.4	...
Short-term capital balance 6/	1.8	9.1	-7.2	-7.3	...
Adjustment items 7/	3.6	-0.4	2.4	2.1	...
Changes in net foreign position of the Deutsche Bundesbank	1.3	2.7	-1.6	-1.0	...
Current account balance in percent of GNP	-0.8	0.5	0.6	1.0	1 1/2

1/ Based on forecasts by the German authorities, and on staff estimates.
2/ Based on unit values.
3/ Deflated by the consumer price index.
4/ The data for the Federal Government are on an administrative basis; those for general government are on a national accounts basis. The data for 1985 refer to budget figures. Public sector debt of the territorial authorities.
5/ Including supplementary trade items.
6/ Including net errors and omissions.
7/ Valuation adjustment and increase in SDR allocation.

	1981	1982	1983	1984
	In billions of deutsche mark			
Foreign reserves of the Bundesbank 1/				
Net monetary reserves	65.3	69.1	67.5	66.5
	Annual averages; changes in percent			
Monetary data				
Central bank money	4.4	4.9	7.3	4.8
Money and quasi-money (M3)	6.4	6.5	6.6	3.9
Bank lending:	9.5	7.3	6.3	6.3
Of which:				
Public authorities	10.2	13.4	7.9	3.1
Private nonbanks	9.3	5.6	5.8	7.3
	End of period; in percent			
Three month money market rate	10.8	6.6	6.5	5.8
Yield on government bonds outstanding	9.9	8.0	8.3	7.0
	Changes in percent			
Exchange rates				
US$ per DM (end of period)	-13.1	-5.1	-12.7	-13.5
US$ per DM (annual average)	-19.6	-6.9	-5.0	-10.3
MERM effective rate, (end of period)	-0.7	5.1	-3.1	-3.1
MERM effective rate, (annual average)	-7.4	4.2	2.3	-2.7
Bundesbank effective rate (end of period) 2/	1.3	6.3	-1.7	-1.4
Bundesbank effective rate (annual average)	-5.4	5.1	3.1	-1.4
Relative normalized unit labor costs (annual average)	-10.9	0.2	-1.1	-4.1

1/ End of period.

2/ The Bundesbank effective rate is a double-weighted index (using trade data for industrial goods) of the currencies of 14 industrial countries. While the MERM index attaches a weight of 25 percent to the U.S. dollar, the Bundesbank index attaches a weight of 14 percent.

Germany - Statistical Issues

Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Germany in the June 1985 issue of *IFS*. The data are based on reports sent to the Fund's Bureau of Statistics by the Deutsche Bundesbank, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in June 1985 IFS
Real Sector	- National Accounts	Q4 1984
	- Prices: CPI	April 1985
	Industrial Products	April 1985
	- Production: Industrial	March 1985
	Investment goods	February 1985
	Other Prod. goods	February 1985
	Consumer goods	February 1985
	- Employment: Industrial	February 1985
	- Wages: Hourly Earnings	Q4 1984
Government Finance	- Deficit/Surplus	January 1985
	- Financing	January 1985
	- Debt	January 1985
Monetary Accounts	- Monetary Authorities	April 1985
	- Deposit Money Banks	February 1985
	- Other Financial Institutions:	February 1985
External Sector	- Merchandise Trade: Values	March 1985
	- Merchandise Trade: Prices	February 1985
	Unit Values	February 1985
	- Balance of Payments	December 1984
	- International Reserves	April 1985
	- Exchange Rates	April 1985