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FM BONN

TO DESKBY 251600Z FCO

TELNO 1132

OF 251345Z NOVEMBER 85

MIPT: ANGLO-GERMAN SUMMIT, 27 NOVEMBER: FIVE WISE MEN'S REPORT ON THE FRG ECONOMY

1. THE ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS WAS PRESENTED TO KOHL ON 22 NOVEMBER. THE REPORT PRAISES THE GOVERNMENT'S ECONOMIC RECORD AND RECOMMENDS THAT CONTINUITY, CONSISTENCY AND CREDIBILITY SHOULD REMAIN THE BY-WORDS OF ECONOMIC POLICY SO AS TO ENCOURAGE FURTHER OPTIMISM AND CONFIDENCE.

2. THE REPORT FORECASTS REAL GNP GROWTH OF 2.5 PER CENT THIS YEAR FOLLOWED BY 3 PER CENT NEXT. GROWTH IN 1986 WILL BECOME BROADER-BASED, WITH EXPORTS STILL LEADING DEMAND (ALTHOUGH THE RATE OF GROWTH WILL SLOW DURING THE YEAR) BUT SUPPORTED BY AN INCREASE IN PRIVATE CONSUMPTION (PLUS 3 PER CENT REAL) WHICH WILL BE BOOSTED BY THE INTRODUCTION OF THE FIRST STAGE OF INCOME TAX REFORM IN JANUARY 1986 (MAGNITUDE DM 11 BILLION). THE REPORT PREDICTS AN INCREASE OF 300,000 IN THE NUMBER OF EMPLOYED AND INFLATION AT 1.5 PER CENT TO 2 PER CENT. INVESTMENT IN MACHINERY AND EQUIPMENT IS EXPECTED TO INCREASE BY 9 PER CENT (REAL) AND THE CONSTRUCTION SECTOR IS ALSO EXPECTED TO PICK UP (PLUS 1 PER CENT) AFTER A POOR PERFORMANCE THIS YEAR. THE REPORT SUGGESTS THAT INVESTMENT GROWTH WILL CONTINUE INTO 1987 AND BEYOND.

3. THE REPORT IS OPTIMISTIC ON EMPLOYMENT, DRAWING ANALOGIES WITH EMPLOYMENT GROWTH TRENDS IN THE 1979/80 UPSWING, SUGGESTING THAT AN INCREASE OF 1 MILLION JOBS OVER THE PRESENT CYCLE IS POSSIBLE. HOWEVER DETAILED EXAMINATION OF THE REPORT SHOWS THAT THE NET CREATION OF NEW JOBS WILL BE ROUND 300,000 IN 1986 (MOSTLY IN THE SERVICE SECTOR), BUT THAT OWING TO DEMOGRAPHIC FACTORS THE NUMBER OF UNEMPLOYED WILL FALL BY ONLY 80,000, THUS PRODUCING A FIGURE OF AROUND 2.2 MILLION UNEMPLOYED (ANNUAL AVERAGE) IN 1986.

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4. DESPITE BROADENING AND STRENGTHENING GROWTH, THE FIVE WISE MEN POINT OUT THAT THE 1986 WAGE ROUND MUST BE KEPT MODERATE AND THAT THEIR UNDERLYING OPTIMISM SHOULD NOT BE REGARDED AS AN EXCUSE FOR PROFLIGATE WAGE DEMANDS. OUR USUAL SAVINGRAM ON THE FIVE WISE MEN'S REPORT WILL FOLLOW.

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FM BONN
TO DESKBY 251600Z FCO
TELNO 1131
OF 251345Z NOVEMBER 85

ANGLO-GERMAN SUMMIT, 27. NOVEMBER

SUMMARY

1. CHANCELLOR KOHL IN BUOYANT MOOD, WITH MORE TO BE PLEASED WITH THAN WORRIED ABOUT. MAJOR FLY IN THE ANGLO-GERMAN OINTMENT IF KOHL DOES NOT HEED THE PRIME MINISTER'S APPEAL ON FALKLANDS.

DETAIL

2. KOHL HAD A DIFFICULT EARLY AUTUMN, HIS LOOSE STYLE OF GOVERNMENT ALLOWING PROBLEMS TO DRIFT AND ATTRACTING A LOT OF CRITICISM. BUT SEVERAL THINGS HAVE RECENTLY TAKEN A TURN FOR THE BETTER:

- THE GENEVA SUMMIT HAS ALLOWED KOHL TO TAKE CREDIT BOTH FOR STANDING FIRM OVER INF DEPLOYMENT AND FOR PRESSING REAGAN TO MEET GORBACHEV AND TO PUT ARMS CONTROL INTO A BROAD US-SOVIET POLITICAL FRAMEWORK.

- THE LATEST FRANCO-GERMAN SUMMIT, ALTHOUGH IT FELL BELOW THE USUAL DITHYRAMBIC LEVEL AND LEFT MOST OF THE POINTS OF DISAGREEMENT IN PLACE, SEEMS TO HAVE REDUCED THE VOLUME OF WASPISH COMMENT FROM PARIS ABOUT UN-EUROPEAN ATTITUDES IN BONN.

- THE EUREKA MINISTERIAL MEETING IN HANOVER WENT WELL: HERE TOO FRANCO-GERMAN DIFFERENCES HAVE BEEN MUTED EVEN IF NOT ELIMINATED.

- THE MINISTRY OF TRANSPORT'S LARGE-SCALE TRIALS SHOWED THAT SPEED LIMITS WOULD REDUCE NOX EMISSIONS BY ONLY A SMALL PERCENTAGE, BECAUSE MOST GERMAN MOTORISTS WOULD NOT OBSERVE THEM: THIS ENABLED THE CABINET TO DROP SPEED LIMITS LIKE THE POLITICAL HOT POTATO THAT THEY ARE, AND REAFFIRM ITS CONCENTRATION ON 'THE MODERN TECHNOLOGY OF LOW EMISSION CARS'. (ADMITTEDLY THIS IS NOT THE LAST OF THE MATTER BECAUSE THE EC COMMISSION INTENDS TO PURSUE IT.)

- IT IS BECOMING GENERALLY ACCEPTED (THOUGH NOT BY THE SPD) THAT SOME KIND OF INTER-GOVERNMENTAL AGREEMENT WITH THE UNITED STATES ON SDI IS (A) NECESSARY AND (B) HARMLESS PROVIDED AT LEAST ONE OTHER EUROPEAN GOVERNMENT DOES LIKEWISE: GENSCHER, WHO CAMPAIGNED AGAINST THIS, IS EXECUTING A NIMBLE RETREAT.

3. ON TOP OF THIS THE GERMAN ECONOMY HAS BEEN GIVEN ANOTHER PAT ON THE BACK, THIS TIME FROM THE 5 LEADING ECONOMISTS WHO REPORT IN MID-NOVEMBER EVERY YEAR: THEIR PRESCRIPTION IS 'CONTINUITY, CONSISTENCY AND CREDIBILITY', IE MORE OF THE SAME: SEE MIFT.

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4. THIS IS NOT TO SAY THAT KOHL FACES NO PROBLEMS. THERE IS UNEMPLOYMENT, WHICH HE SEEMS TO BE ALONE IN EXPECTING TO DIP BELOW 2 MILLION IN 1986. THERE IS AGRICULTURE, ON WHICH HE TOLD ME THAT HE EXPECTED 5 DIFFICULT YEARS. THERE IS STRAUSS, AGED 70 BUT AS SHARP-TONGUED AS EVER AND RE-ELECTED THIS WEEKEND AS CHAIRMAN OF THE BAVARIAN CSU BY 967 VOTES OUT OF A POSSIBLE 979. THERE IS GENSCHER, RESENTING KOHL'S INCURSIONS INTO FOREIGN POLICY AND MANOEUVRING TO SECURE HIS OWN JOB AS FOREIGN MINISTER AFTER 1987. THERE ARE THE USUAL LAND ELECTIONS IN THE OFFING, THE TRICKIEST FOR KOHL BEING LOWER SAXONY (JUNE 1986), WHERE ALBRECHT WILL BE LUCKY TO HOLD ON TO HIS ABSOLUTE MAJORITY. THERE ARE THE BUNDESTAG ELECTIONS IN JANUARY 1987, ALTHOUGH AT PRESENT I CANNOT SEE THE COALITION LOSING THESE. THERE IS RAU, WHOM YOU SAW IN LONDON LAST WEEK: NOT PERHAPS A FULLY CONVINCING ALTERNATIVE CHANCELLOR BUT AN ANTAGONIST TO BE TAKEN SERIOUSLY.

5. WITH HIS OPTIMISTIC TEMPERAMENT, KOHL WILL BE MORE CONSCIOUS OF THE PLUSES IN PARA 3 ABOVE THAN OF THE MINUSES IN PARA 4. SO IT WILL BE A BUOYANT CHANCELLOR WHOM THE PRIME MINISTER MEETS ON WEDNESDAY.

6. IT SHOULD ALSO BE A FRIENDLY ONE. THERE CANNOT BE MUCH WRONG WITH ANGLO-GERMAN RELATIONS IF KOHL'S STAFF THINKS HE WILL HAVE TIME TO SPEAK TO THE PRIME MINISTER ABOUT DRAFT-DODGERS IN BERLIN AND REDUCING THE USE OF THE SOLTAU-LUENEBUG TRAINING AREA. CONSULTATION ON EC QUESTIONS HAS BEEN ENORMOUSLY CLOSER THAN BEFORE MILAN, AND WILL I HOPE CONTINUE SO RIGHT UP TO AND DURING THE LUXEMBOURG EUROPEAN COUNCIL.

7. KOHL WILL NEED TO BE EVEN CLUMSIER AND THICKER SKINNED THAN I THINK HE IS TO WANT TO SPOIL THIS PICTURE BY AUTHORISING THE FRG DELEGATION IN NEW YORK TO VOTE FOR THE ARGENTINE DRAFT RESOLUTION ON THE FALKLANDS. HE HAS HAD THE PRIME MINISTER'S MESSAGE AND WILL BE EXPECTING HER TO REINFORCE IT WHEN THEY MEET.

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