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FROM BONN

FRAME ECONOMIC

TO FCO TELNO 12 SAVING of 28 FEBRUARY 1983. Info all EC Posts, UKDel OECD, UKMis Geneva, all Consulates-General in the Federal Republic, Washington, Tokyo, Vienna.

FEDERAL GERMAN ECONOMY

Summary

1. The 6 March election dominates the economic scene. The governing coalition has probably had the better of the economic argument. Positive developments continue on prices, the trade balance and inflation. Businessmen's confidence, not least in the prospects of an electoral victory for the government of Chancellor Kohl, seems to be growing. But unemployment remains high and the latest figures, due to be published 3 days before the election, will be very high. The stock market is buoyant. There is no doubt still some hesitancy among investors prior to the outcome of the election being known. The Bundesbank's January report was generally supportive of the optimistic tone adopted in the government's Annual Economic Report (Bonn saving telegram 9). The Bank pointed to increased domestic demand, continuing progress in the anti-inflation battle and lower oil prices. There can be no doubt, however, that both the German authorities and businessmen have been stressing the positive elements in the current economic scene. In this they have been influenced both by economic and electoral considerations.

Prospects and Current Indicators

2. There are signs that the trough of the recession may have been reached. Domestic orders overall increased by 10 per cent (November/December compared with September/October). Capital goods orders increased in November/December by 7.5 per cent compared with the preceding 2 months. Domestic orders for capital goods seasonally adjusted for November/December increased 16.5 per cent (excluding heavy vehicles) compared with September/October. Domestic orders overall for the same period increased by 10 per cent. This impulse is due in part to the

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investment premium which was available only to orders placed before the end of 1982. However it is still not entirely certain whether demand for machinery and equipment will continue to develop favourably.

3. Business confidence (surveyed in January by the IFO) continues to improve and is affected by a number of factors including a widely held belief that interest rates will be lowered after the election (helped by a current account surplus in 1982 of DM 7.5 billion); a further fall in the rate of inflation; plus a continuing recovery in the construction sector (orders for October/November were up 1 per cent on third quarter of 1982 and 9.5 per cent on October/November 1981).

4. But the picture given by the production figures is less happy. December's provisional production figures show a 1 per cent fall compared with November with manufacturing down 2 per cent. On a two-monthly basis (November/December against September/October) the decline is 1.5 per cent, 2 per cent in manufacturing. And, according to the IFO, utilisation of industrial capacity fell in December to just below 75 per cent, the lowest recorded since the establishment of the Federal Republic. December also recorded the highest ever number of insolvencies (1676 against 1193 in December 1981). Meanwhile the problems of Germany's steel industry loom ever larger and the cries of pain from Germany's shipyards louder.

5. Apart from a fall in the rate of inflation to 3.9 per cent (the lowest since June 1979) other price indicators are also moving downwards: retail prices eased to 3.9 per cent in January from 4.6 per cent in December while wholesale prices actually fell by 1 per cent on the previous month (0.2 per cent down on a year earlier). However, in contrast to the downward trend in prices, unemployment has increased for the first time in the history of the Federal Republic to above 10 per cent. February's figures are expected to be worse than January.

Bundesbank Report for February

6. The pre-election report received widespread coverage. It was generally optimistic (speaking of a "lightening economic horizon") and was in general agreement with the government's earlier Annual Economic Report. The report endorses the government's

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contention that a return to growth can be expected in the course of 1983. The report cited demand for industrial goods in November/December as particularly encouraging, describing it as "a dynamic increase" but makes the point that the expected improvement in economic activity will have to be based primarily on domestic demand.

7. Critics of the report (eg Handelsblatt, "based more on faith, hope and charity than new facts") highlighted December's production figures and manufacturing output and said that increased demand has merely been boosted by the need to capitalise on investment incentives before their expiring at the end of 1982. However, the Bank's report maintains that future growth is not dependent on investment incentives; rather it argues that sales prospects, a lower inflation rate and lower interest rates provide the grounds for improvement. The report stresses however that favourable economic development will be critically dependent on wage settlements in 1983, as also will the declining level of productivity

Production

8. Despite disappointing figures for December, the general view (based on new orders and business confidence) is that following a steady decline in production the trough in the recession may have been reached. Provisional figures for December indicate a 1 per cent fall in overall production compared to November (November figures show production at the same level as in October and not down as reported last month). Manufacturing output in December fell by 2 per cent on November, while the construction industry registered a 1 per cent increase (see paragraph 21). Although the December production figures are seasonally adjusted, the statistical authorities warn that they should be regarded with caution as the large number of holidays tend to distort the results.

9. The comparison November/December against September/October reveals a decline in overall production of 1.5 per cent and in the manufacturing sector of 2 per cent. All major sectors suffered with capital goods output down by 3 per cent followed by basic and producer goods (-1 per cent) and consumer goods (-0.5 per cent). Compared to the corresponding 2-month period a year earlier overall production was 6 per cent lower. Manufacturing output recorded a 7 per cent decline with basic and producer goods down by 8 per cent, capital goods (-7.5 per cent) and consumer goods (-4.5 per cent).

10. Quarterly figures show overall production at its lowest level of the year for Q4 1982, down almost 3 per cent on Q3 and 5 per cent lower than Q4 1981.

Production

1976 = 100

	<u>Total</u>	<u>Basic & producer goods</u>	<u>Capital goods</u>	<u>Consumer goods</u>	<u>Construction</u>
1981 October	108	104	114	99	105
November	107	104	113	98	99
December	105	101	111	96	84
Q4	106	103	113	98	98
1982 October	101	94	107	94	95
November	101	94	107	94	94
December*	100	95	103	94	95
Q4*	100	95	105	94	95

* = provisional

New Orders

11. The spate of new orders placed with domestic capital goods producers is especially noticeable in the figures for December (11.5 per cent higher than the third quarter). All major sectors of manufacturing industry registered an improvement in incoming orders. The December figures also show a continuing increase in overall domestic demand. The total volume of new orders rose by 3 per cent (domestic component 7.5 per cent) compared to November. These figures were boosted by the investment incentives which were

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available only until the end of the year, but first signs in the New Year are that investment activity may be holding up. Export orders fell (-5.5 per cent).

12. The two-monthly comparison, November/December against September/October, reveals a marked increase in the total volume of new orders (+7.5 per cent), again due to a strong upsurge in domestic demand (+10 per cent). While orders for capital goods were particularly strong, basic and producer goods and consumer goods also registered an increase. Overall export orders were down slightly in the final two months of the year (-0.5 per cent), but the decline affected only the capital goods sector. Compared to the corresponding two-month period a year earlier, the overall volume of new orders was down by 3 per cent, with domestic demand up by 3.5 per cent and export orders down 13.5 per cent.

New Orders

1976 = 100

	Total		Domestic		Foreign	
	Value	Volume ¹	Value	Volume	Value	Volume
1981 October	128	105	121	98	147	121
November	130	106	119	97	153	126
December	131	106	120	97	153	125
1982 October	120	94	115	90	133	105
November	128	100	122	95	139	109
December*	132	103	131	102	131	103

1 = at constant prices

* = provisional

Prices

13. The annual rate of inflation fell in January to 3.9 per cent, the first time inflation has been below 4 per cent since June 1979. In November and December 1982 the rate was 4.7 per cent and 4.6 per cent respectively. Between December 1982 and January 1983 prices rose by only 0.2 per cent. Food prices rose by 2 per cent at an annual rate.

14. The annual increase in retail prices eased to 3.9 per cent, from 4.6 per cent at the end of 1982. Wholesale prices in January fell by one per cent on December giving a fall of 0.2 per cent on January 1982. Industrial producer prices remained unchanged month-on-month in January, the year-on-year increase dropping to 2.3 per cent after 3.6 per cent in December. Import prices fell by 1.8 per cent in December compared to November, the annual rise declining to 0.8 per cent after a rise of 2.7 per cent in the preceding month. In 1982 import prices increased by only 1.6 per cent compared to an overall rise of 14 per cent in 1981. The annual increase in export prices in December reached a low for the year of 3 per cent, the average for 1982 finishing at 4.2 per cent (5.4 per cent in 1981). Agricultural producer prices in December were 1.2 per cent down on a year earlier. Latest Terms of Trade figures for December show a marked improvement on November, up by 1.7 per cent, to stand 4.9 per cent up on a year earlier. In the course of 1982 the Terms of Trade improved by 4.4 per cent over their 1981 level.

Prices

1976 = 100

	<u>Cost of living</u>	<u>Industrial producer prices</u>	<u>Agricultural producer prices</u>	<u>Retail prices</u>	<u>Import prices</u>	<u>Export prices</u>
1981 November	126.4	129.5	110.3	124.3	143.3	122.8
December	126.8	129.8	111.4	124.7	143.3	123.1
1982 January	127.9	131.5	111.0	125.7	144.4	124.8
November	132.3	134.8	109.2*	130.3	147.2	127.0
December	132.6	134.5	110.1*	130.4	144.4	126.8
1983 January	132.9	134.5		130.6		

* = provisional

Private Consumption

15. Measured in terms of retail trade turnover, private consumption in December was nominally 0.4 per cent up on December 1981; in real terms this represents a fall of 4.5 per cent. For 1982 as a whole retail trade turnover also recorded a real decline of 4.5 per cent.

16. According to the January Bundesbank report, private consumption showed signs of stabilisation towards the end of last year. In the final quarter private consumption registered a nominal 1 per cent increase over the preceding quarter, the first time over an extended period that there has been no decline in real terms. Compared to the corresponding quarter a year earlier private consumption rose by 2 per cent. The IFO survey also registers continued improvement in the current and short-term retail trade business climate. The easing of price rises is expected to continue; in January the year-on-year increase in retail prices fell to 3.9 per cent after 4.6 per cent in December 1982.

Labour Affairs

17. For the first time in the history of the Federal Republic unemployment rose above 10 per cent at the end of January, despite the continuing mild weather. The February figures are expected to be worse although January is normally the peak month. The unadjusted figure rose to 2.49 million and the seasonally adjusted figure also rose by 36,000 to 2.12 million. In addition, the number of workers on short time continued to increase and has now reached 1.19 million against 539,000 a year ago. Foreign workers continued to be the worst hit section of the population; the unemployment rate among them is now 15.1 per cent. The number of unfilled vacancies showed a slight seasonal rise to just under 62,000, about half last January's figure and a quarter of the figure for January 1981. There is no sign in these figures that the government is having much success in stimulating firms to retain or recruit more labour. The detailed figures are as follows:

/End Jan

	<u>End Jan 1983</u>	<u>End Dec 1982</u>	<u>End Jan 1982</u>
a.Unadjusted total	2,487,075(10.2%)	2,223,352(9.1%)	1,949,754(8.2%)
b.Adjusted total	2,121,000	2,085,000	1,593,000
c.Short time working	1,190,397	1,114,301	538,675
d.Unfilled vacancies	61,828	57,799	122,148
e.Total men in a.	1,490,652	1,280,910	1,153,004
f.Total women in a.	996,423	942,442	796,750

18. On the wages front, negotiations have continued on a series of major claims, with the metalworking employers making an offer of 2.2 per cent, subsequently raised to 2.5 per cent. The employees, as last year, have resorted to short warning strikes but the expectation is that a negotiated settlement will be reached. There is still quite a long way to go but the previous forecasts of 3 per cent seem unlikely to be exceeded.

19. The chemical workers' demand for a shorter working week for older workers is being considered by the chemical employers, somewhat to the annoyance of other employers' organisations, who have set their faces firmly against any further reduction in the working week. They have been criticised for this by Labour Minister Blüm, who argues that the idea should at least be considered as a step towards easing the unemployment problem. There is no question of government action: hours of employment are regarded by both sides of industry and the government as a matter for collective bargaining.

20. The public service union ÖTV is in dispute with the US and British Armed Forces over the pay and conditions of civilian security guards. The guards unexpectedly voted in favour of authorising the union to call a strike (at least 75 per cent must vote in favour) but negotiations which broke down earlier in the month have now been resumed. There are no other industrial disputes of note.

Construction

21. All analysts highlight a continuing recovery in the construction sector. December's output was up by 1 per cent on November but of more significance, orders for October/November were up 1 per cent on the 3rd quarter of 1982 and 9.5 per cent on October/November 1981.

22. Reports indicate that Länder governments have committed their total subsidies under the Federal Government scheme (paragraph 25 Bonn Saving tel No 9) and in addition say that they are inundated with applications for building permits (eg Dusseldorf report a 60 per cent increase in December on December 1981). However January's output figures will doubtless be coloured by the effects of the winter weather and it is therefore unlikely that the results of increased construction activity will be apparent before March/April.

Balance of Payments

23. As expected the West German current account in December ended in surplus, pulling the current account for 1982 into the black for the first time since 1978. The December surplus was DM 5.3 billion

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compared to DM 4.7 billion in November and DM 5.1 billion in December 1981. The surplus for 1982 amounted to DM 7.5 billion compared with deficits of DM 16.6 billion and DM 29.5 billion in 1981 and 1980 respectively.

24. The visible trade surplus in December climbed to DM 6.4 billion, resulting in the largest annual trade surplus in the history of the Federal Republic (DM 51.2 billion), almost double the 1981 figure. On an annual basis, exports in 1982 rose by 8 per cent while imports were up by only 2 per cent. The seasonally normal surplus on services account at the end of the year remained stable in December at November's level of DM 1.1 billion, bringing the deficit for 1982 down to DM 16.7 billion, a small improvement on 1981 (DM 17.9 billion), due in part to reduced tourist expenditure abroad. Outgoing transfer payments rose to DM 2.4 billion in December, the cumulative deficit for 1982 totalling DM 28.1 billion, up marginally on the 1981 figure (DM 27.2 billion). On long-term capital account there were outflows of DM 0.7 billion in December; in the course of last year outflows amounted to DM 16.2 billion, compared to inflows of DM 9.4 billion in the previous year. Outgoing investment exceeded incoming investment by DM 5.6 billion, with a decline in both compared to 1981. On short-term capital account, which saw a high level of outflows in December, total inflows for the year amounted to DM 8.9 billion against only DM 0.4 billion in 1981.

25. The net foreign assets of the Bundesbank rose by DM 0.8 billion in December; in January they expanded by a further DM 1.6 billion.

Monetary

26. Although it is widely held that there is scope for a further reduction in leading interest rates, this is unlikely to occur until after the 6 March election; the Bundesbank being anxious to distance themselves from accusations of political partiality.

27. Lombard therefore remains at 6 per cent and the Discount rate at 5 per cent. Monetary figures for 1982 show a growth rate of 7 per cent in M3 (expanding slightly more rapidly than Central Bank Money). M1 also rose by 7 per cent, while M2 was 5 per cent up on 1981. The level of private sector credit last year rose at an annual rate of 5.5 per cent with a slight acceleration towards the end of the year in demand for long-term credit. Monetary capital formation in the final quarter of 1982 was stronger than in the three preceding quarters, attaining practically the same level as a year earlier. Central Bank Money, for which January figures are available, showed rapid growth at the start of the year; over the last six months Central Bank Money grew at an annual rate of 6 per cent, ie towards the upper margin of the 4 - 7 per cent Bundesbank target band.

FRG/UK £1 = DM 3.69

28. In 1982 FRG imports from UK totalled DM 27.1 billion, a fall of 1.4 per cent on 1981. Our share of the market thus fell from 7.4 per cent to 7.2 per cent.

29. Non oil imports from the UK increased by 1.7 per cent. However, total FRG non oil imports in 1982 increased by 3.7 per cent on 1981

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leading to a drop in the UK share from 5.4 per cent (1981) to 5.3 per cent (1982).

30. FRG exports to the UK in 1982 (DM 31.3 billion) rose by 19.7 per cent on 1981. A total of 7.3 per cent of all FRG exports now go to the UK.

31. The 1981 trade balance in favour of the UK (DM 1.3 billion) was reversed in favour of the FRG in 1982 (DM 4.2 billion).

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Federal Republic of Germany: Main economic statistics

<u>Seasonally adjusted</u>	<u>Q4 1981</u>	<u>Q3 1982</u>	<u>Q4 1982</u>	<u>% change on prev. quarter year</u>	
1. Expenditure on the GNP (current prices)		<u>DM mrd</u>			
a) Gross National Product	393.8	401.5	404.5	+ 0.7	+ 2.7
b) Private consumption	223.1	225.2	227.7	+ 1.1	+ 2.1
c) Government consumption	80.5	83.2	83.5	+ 0.4	+ 3.7
d) Fixed capital formation	83.0	83.3	82.5	- 1.0	- 0.6
e) Exports of goods & services	133.2	132.0	134.5	+ 1.9	+ 1.0
f) Imports of goods & services	123.3	121.9	123.3	+ 1.1	+ 0.0
g) Net exports	9.9	10.1	11.2		
2. Expenditure on the GNP (constant prices)					
a) Gross National Product	316.3	310.0	309.8	- 0.1	- 2.1
b) Private consumption	175.6	170.6	171.2	+ 0.4	- 2.5
c) Government consumption	62.8	63.2	63.2	+ 0.0	+ 0.6
d) Fixed capital formation	63.1	62.8	61.6	- 1.9	- 2.4
e) Exports of goods & services	107.0	103.5	104.6	+ 1.1	- 2.2
f) Imports of goods & services	89.7	89.4	88.5	- 1.0	- 1.3
g) Net exports	17.3	14.0	16.1		
3. Income of households					
a) Gross wages & salaries	189.1	191.1	192.1	+ 0.5	+ 1.6
b) Disposable income	262.6	262.3	264.7	+ 0.9	+ 0.8
c) Savings as a % of b)	15.0	14.1	14.0		
4. Productivity		<u>1976=100</u>			
a) In the economy as a whole					
i) GNP per working person (1976 prices)	111.1	110.6	111.2	+ 0.5	+ 0.1
ii) wage and salary costs per production unit	123.8	127.6	128.9	+ 1.0	+ 4.1
b) In industry	<u>Nov 81</u>	<u>Oct 82</u>	<u>Nov 82</u>		
i) output per employed person	111	108	109	+ 0.9	- 1.8
ii) wage and salary costs per production unit	128	133	133	+ 0.0	+ 3.9
	<u>Dec 81</u>	<u>Nov 82</u>	<u>Dec 82</u>		
5. Industrial production					
a) Total	105	101	100	- 1.0	- 4.8
b) Manufacturing industry	106	101	99	- 2.0	- 6.6
c) Construction	84	94	95	+ 1.1	+ 13.1
6. New orders					
a) Total	131	128	132	+ 3.1	+ 0.8
b) Domestic	120	122	131	+ 7.4	+ 9.2
c) Foreign	153	139	131	- 5.8	- 14.4

<u>unadjusted</u>	<u>Jan 82</u>	<u>Dec 82</u>	<u>Jan 83</u>	<u>change</u> <u>month</u>	<u>prev.</u> <u>year</u>	
		<u>in 1000's</u>				
7. Unemployment						
a) i) unemployed	1 949.8	2 223.4	2 487.1	+ 11.9	+ 27.6	
ii) as a % of the working population	8.2	9.1	10.2			
b) Short-time workers	538.7	1 114.3	1 190.4	+ 6.8	+121.0	
c) Vacancies	122.1	57.8	61.8	+ 7.0	- 49.4	
		<u>1976=100</u>				
8. Prices						
a) Cost of living of all private households	127.9	132.6	132.9	+ 0.2	+ 3.9	
b) Retail prices	125.7	130.4	130.6	+ 0.2	+ 3.9	
c) Producer prices of industrial products	131.5	134.5	134.5	+ 0.0	+ 2.3	
	<u>Dec 81</u>	<u>Nov 82</u>	<u>Dec 82</u>			
d) Export prices	123.1	127.0	126.8	- 0.2	+ 3.0	
e) Import prices	143.3	147.2	144.4	- 1.8	+ 0.8	
Terms of Trade	88.0	90.8	92.3	+ 1.7	+ 4.9	
		<u>DM mrd</u>				
9. Balance of payments						
a) Visible trade						
i) exports	35.9	36.6	38.0			
ii) imports	30.8	31.8	31.6			
iii) balance	+ 5.1	+ 4.8	+ 6.4			
b) Supplementary trade items	+ 0.6	+ 0.7	+ 0.2			
c) Services	+ 1.3	+ 1.1	+ 1.1			
d) Transfers	- 1.9	- 1.8	- 2.4			
e) Current account	+ 5.1	+ 4.7	+ 5.3			
10. Net foreign reserves	68.9	70.7	71.5			
<u>Seasonally adjusted</u>					<u>Total in DM mrd</u> <u>at the end of:</u>	
11. Money stock						
M1	+ 0.4	+ 2.9	+ 4.2		Dec 82: 259.6	
M2	- 5.7	- 6.3	- 4.0		Dec 82: 475.2	
M3	+ 2.8	- 3.1	+ 6.7		Dec 82: 799.7	
<u>Unadjusted</u>						
12. Monetary capital formation	+ 13.9	+ 4.5	+ 15.5		Dec 82: 945.6	
13. Bank rates:	Since 3.12.82	Discount rate: 5%				
	Since 3.12.82	Lombard rate: 6%				

Sources: Federal Statistical Office, Wiesbaden; Deutsche Bundesbank, Frankfurt
Discrepancies in the totals are due to rounding (1)

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