UNCLASSIFIED

SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 24 SAVING OF 30 AUGUST 1984. Info all EC Posts, UKDel OECD, UKMis Geneva, all Consulates-General in the Federal Republic, Washington, Tokyo, Vienna.

FEDERAL GERMAN ECONOMY

Summary

1. The strikes of the early summer continue to leave their traces. Latest figures confirm the expected downturn in production; it plunged in the automotive industry. With the strikes behind them businessmen's confidence has bounced back. The general view is that growth of 2.5% in real terms in 1984 should still be achieved, but only a minimal decline in unemployment can now be expected. Predictions for 1985 agree that growth will be a shade lower, around 2%. The consumer mini-boom of earlier in the year seems to be played out, domestic investment is still disappointing notably in the construction sector and increasingly exports are seen as holding out the main hope for continued growth. The increasing importance of developed markets highlights the FRG's vulnerability to a slow-down in the United States. The Deutschemark remained under its DM 2.90 high against the US dollar.

2. Bangemann, still playing himself in as Economics Minister, showed some lack of touch when early in the month he thought aloud in front of the press about the need to promote employment next year if growth disappointed. Added to that a number of economic commentators, including some of the respected economic institutes, voiced fears that the Government was set on a too restrictive economic course. Stoltenberg's rejoinder from the Finance Ministry was to restate that prudent budgeting remained the Leitmotif of the Government's economic strategy. Bangemann's absence in hospital for some days - the result of over work according to the press - did not prevent him signing a reassuring press article setting out his beliefs in the market and in the futility of short-term employment promotion schemes. His promises of further privatisation, rolling back bureaucracy and further encouragement for small and medium-sized industries were entirely in accord with Stoltenberg's.

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3. As Ministers reassemble after the summer break they can point to a number of solid achievements. Inflation looks likely to be well under 2% in August. The 1985 Budget and Finance Plan for 1984-88, newly presented to the Federal Parliament, set a course for real declines in public expenditure and in the Government's net borrowing. A new law has been introduced which should encourage employers to take on short-term workers. Nevertheless, the Government will be conscious that a more coordinated and consistent pursuit of their declared economic objectives could do much to bolster business confidence and with it the prospects for the economy as a whole.

Detail

4. On 8 August the Cabinet discussed the economy and agreed in principle to abolish withholding tax on Deutschemark bonds held by foreigners. Later in the month the Cabinet agreed proposals for a new labour law designed to introduce greater flexibility in employment contracts. At the end of the month the Government laid before the Bundestag its detailed proposals for the 1985 Budget (showing an estimated growth of 1.2% on 1984) and for the Finance Plan 1984-88 (showing a planned net Federal Government borrowing of DM 22.4 billion in 1984 compared with DM 37.2 billion in 1982).

5. Inflation looks set to be a major success. It fell to 2.2% (cost of living index) in July after 2.8% in June and is expected to fall further to around 1.7% in August. This will be the first time the rate of inflation has fallen below 2% since 1969.

6. But the effects of the strikes in the engineering and printing industries are still felt. Production and new orders were both down in June with the automotive industry producing one-third of what it had in April, the last strike-free month. New orders for industry were also down 9% in June compared with May, though as with production the figures owed something to extra activity beforehand to forestall some of the effects of the strikes.

7. The Government blamed the strikes for the decline in growth and for the disappointing picture on the employment front. An overall growth of 2.5% for the year was still likely. The conditions were right for the economy to regain its lost momentum in the remainder of the year. German industry was price competitive and

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therefore well placed to take advantage of the continuing expansion in world trade. Moreover, domestic investment would be encouraged by the removal of uncertainties caused by the strikes and private consumption should be encouraged by the fall in the rate of inflation.

8. Unemployment rose to 2.32 million (8.3%) at the end of July, seasonally adjusted, regaining the level of a year earlier. There is nervousness about the full impact of school leavers. Chancellor Kohl's solution was to appeal to employers to provide as many apprenticeships as they could. The business response was to say of course they would.

9. The latest IFO test of the business climate gave some support for the Government's optimism, a mood shared by businessmen with regard to export prospects, particularly of capital goods. However, allowance should be made for a disproportionate surge in confidence in the wake of the strike settlement. There is also concern in some quarters about the decline in exports of large plant to developing countries and the FRG's increasing dependence on the USA and other developed export markets. Over the past year turnover with developing countries has scarcely increased and with OPEC it has declined by 9.5%. Exports to the Soviet Union have declined by 7%.

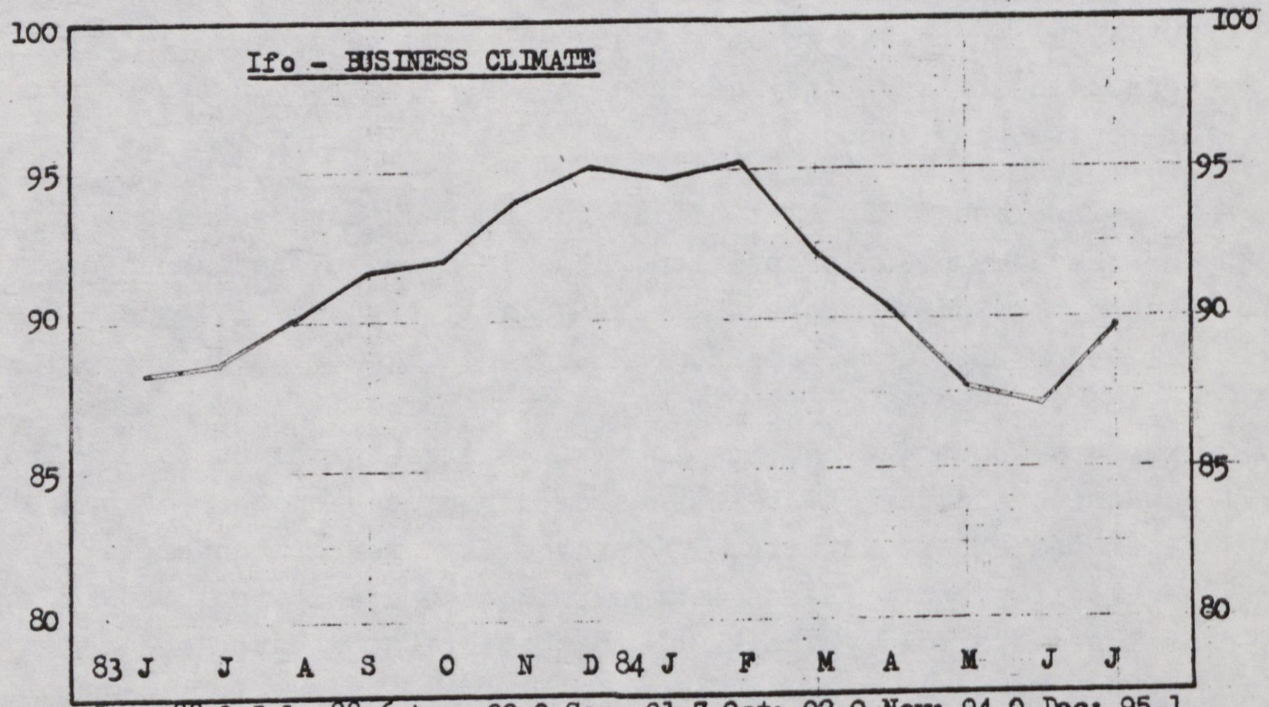
10. IFO's report earlier in the month agreed with the Government on the revised growth figure for 1984 and its causes. IFO predicted 8.5% real growth in exports in 1984, declining to around 5 or 6% in 1985 when the growth rate of the economy would flatten to 2%. IFO suggested that the Government should be thinking of pursuing a less stringent budgetary course and added that the Government's present plans for tax reform were too modest and too spread out to have a substantial effect. The Hamburg Economic Institute agreed, adding the accusation that the Government had failed too to live up to its promises to cut subsidies.

11. The Federation of German Industry, BDI, sought to correct the more pessimistic predictions. The strikes had had an effect but exports would certainly keep things turning for the rest of the year. The truth was that prospects had never been as good as portrayed in some quarters. Then as now the economic upturn lacked both the broad base and the intensity needed to make it self-sustaining.

/Prospects and Indicators

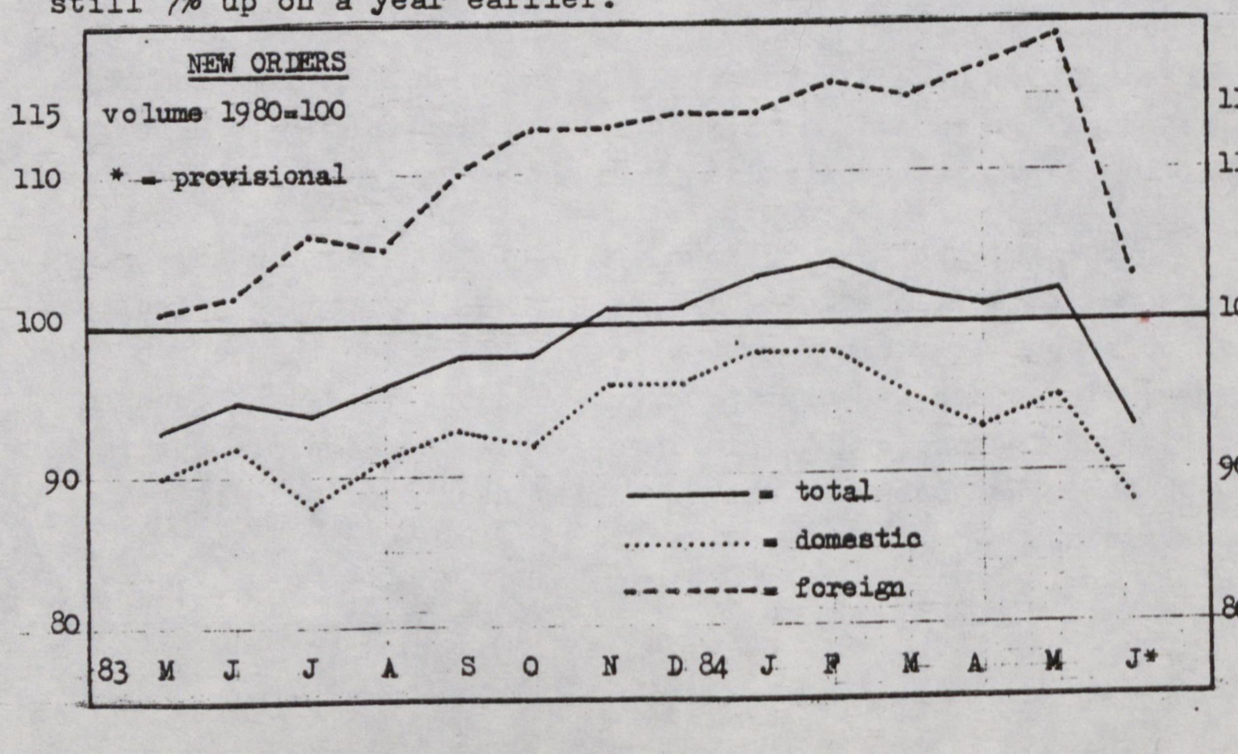
Prospects and Indicators

12. With the strikes over and the prospects for exports good, the business climate has improved for the first time since early in the year (IFO test).



Jun: 88.3 Jul: 88.6 Aug: 90.0 Sep: 91.7 Oct: 92.0 Nov: 94.0 Dec: 95.1
84 Jan: 94.7 Feb: 95.2 Mar: 92.1 Apr: 90.5 May: 87.8 Jun: 87.1 Jul: 89.7

13. June's figures for new orders were the expected disappointment showing clearly the effects of the strikes. June's figures were 9% down on May, and June and May together 3% down on March/April though still 7% up on a year earlier.



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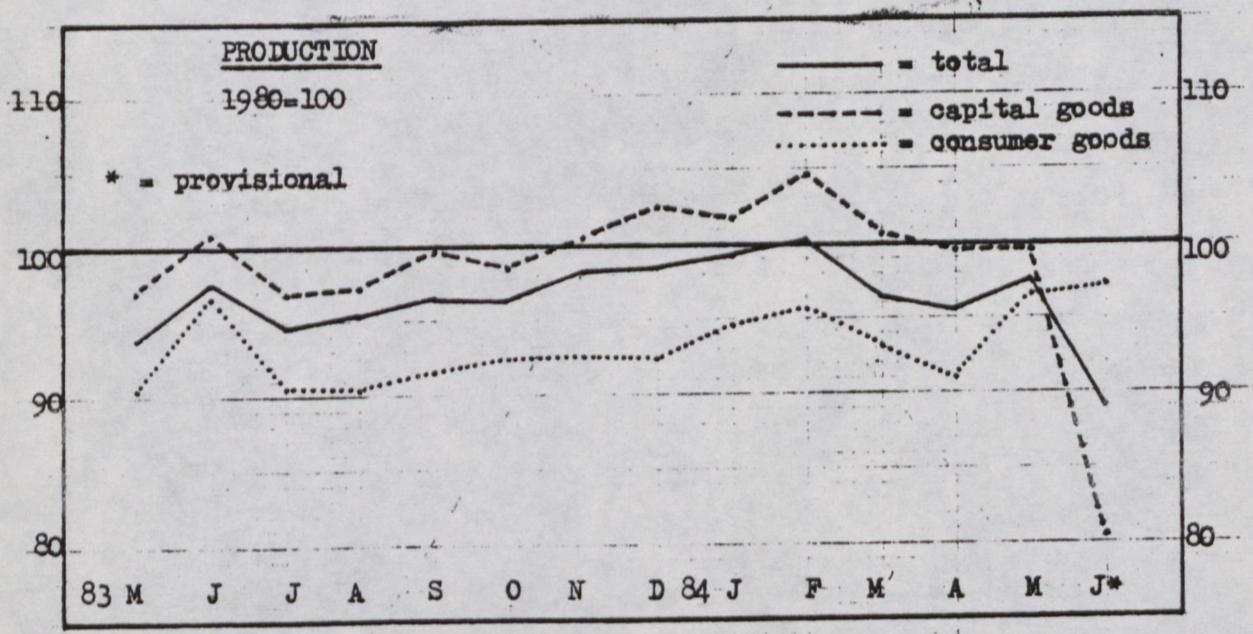
14. Production followed a similar course. In June it was 9% down on May and the two-monthly comparison May/June was also down by 10%, seasonally adjusted, on March/April. This was largely due to the tumble taken by the automotive industry.



15. The industrial difficulties made private consumers cautious in their spending despite the encouragement of relatively stable prices. Retail trade turnover was down by a real 6% in June year on year though again the automotive sector must take much of the blame.

16. Inflation, cost of living index, fell to 2.2% in July after 2.8% in June and 1.7% is predicted for August. Import prices continued to increase at an annual rate of 6.6% and market pressure from the strong dollar looks likely to continue. The annual rate of increase of export prices remained unchanged at 3.6%.

17. On the labour front, unemployment rose slightly to stand at the same level as July last year. The unadjusted total of 2.2 million represents 8.9% of the workforce (2.3 million adjusted, 8.3%). Short-time working declined. No substantial changes in unemployment are expected for the present though there is unease about the impact of this year's 735,000 school leavers on the employment market. A large proportion of those seeking training places should, however, find them. There is no change in the expected average number of unemployed in 1984 of some 2.25 million.

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18. The current account in July showed a deficit of DM 0.2 billion after a deficit of DM 3.2 billion in June and a surplus of DM 3.1 billion in May. The visible trade surplus in July was DM 3.0 billion after DM 1.3 billion in June.

19. Monetary growth, M3, averaged just under 4.5%, seasonally adjusted, over the first six months of the year. M3 was 3.5% above its level of a year earlier at the end of July.

20. Leading interest rates, Discount and Lombard, remained unchanged at 4.5% and 5.5% respectively as did market rates (8.1%).

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IFO Business Climate

21. As widely expected, the IFO business climate indicator recorded an improvement after the strike-affected results of the preceding three months. The climate in the construction sector, however, failed to improve, stagnating at a very low level.

New Orders

22. As expected the provisional figures for June reflect the effects of the printing and more particularly the metalworkers strikes: total orders were down by 9% on May. Strongest hit was the capital goods sector - down 13.5% (automobile sector down by 30%). However, other sectors not immediately affected by the strikes also produced poor month on month results; basic and producer goods orders fell by 6% and consumer goods orders by 3%. Interestingly the drop in foreign orders was more marked (- 13.5%) than the decline in domestic demand (- 7.5%). The two-monthly comparison, May/June against March/April, shows a 4% fall in volume terms. Domestic demand fell by 2.5% and foreign demand by 4.5%. Compared to the corresponding two-month period a year earlier overall orders were still 3.5% higher, domestic demand up by 1% and foreign demand 9%.

NEW ORDERS

1980=100

	Total		Domestic		Foreign	
	Value	Volume*	Value	Volume	Value	Volume
1983						
February	102	92	97	87	112	101
March	103	93	99	89	111	100
April	103	93	99	89	110	100
May	103	93	100	90	112	101
June	106	95	103	92	113	102
1984						
January	117	103	111	98	131	115
February	119	104	112	98	134	117
March	116	102	108	95	131	115
April	115	101	106	93	134	117
May	117	102	109	95	137	119
June(p)	107	93	101	88	119	103

* = at constant prices
(p)= provisional

/Production

Production

23. As with new orders, production results in June were affected by the effects of the strikes. Overall production fell by 9.5% from May to June, with manufacturing output down by 10.5%. Capital goods output suffered particularly strongly, down 19.5% influenced by a 60% drop in car production. The two-monthly comparison, May/June against March/April, shows a decline in production of 3.5%, with manufacturing output down 4%. Capital goods output fell particularly sharply (- 10%). Output of consumer goods rose by 5.5% and construction activity also recorded an increase (+ 6.5%). Compared to the corresponding two-month period a year earlier total output was down by 2.5%, capital goods outturn recording a 9% fall. Other sectors recorded marginal increases while construction activity was 4% lower.

PRODUCTION

1980=100

	Total	Basic & producer goods	Capital goods	Consumer goods	Construction
1983					
February	91.7	89.7	96.2	89.0	76.4
March	93.5	91.3	97.5	90.8	79.3
April	93.5	91.6	97.7	90.2	79.8
May	93.9	92.0	98.0	90.5	83.8
June	97.7	94.3	100.9	96.7	87.9
1984					
February	100.2	100.7	104.5	95.8	89.1
March	96.4	95.8	100.8	93.1	79.2
April	95.5	95.5	99.6	91.0	76.6
May	97.5	97.0	99.7	96.7	86.1
June*	89.0	93.6	80.3	97.1	80.0

* = provisional

Prices

24. Inflation, as measured by the cost of living index, fell in July by 0.2% on June. The annual rate of increase declined to 2.2%, after 2.8% in June. The moving average for the year so far now stands at 2.8%. Food prices in July were 2.0% higher than a year earlier.

25. Retail prices also fell by 0.2% month-on-month, with the annual rate dropping to 2.1% after 2.5% in June. Industrial producer prices rose in July by 0.2%, the annual rate of increase rising to 3.2% after 3.0% in June. Wholesale prices recorded a decline of 0.9% on June, the annual rate easing to 3.8% after 4.2% in June. Export prices in June were unchanged month-on-month with the annual rate standing at 3.6% after 3.8% in May. Import prices eased by 0.2% month-on-month, up 6.6% on a year earlier. The continued strength of the dollar is likely to exert marked pressure on import prices

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over the coming months. Agricultural producer prices rose by 1.3% on the previous month to stand 1.4% up on a year earlier. Latest Terms of Trade figures for June show a further decline of 0.9% to stand 4.4% lower than a year ago.

Prices

1980=100

	Cost of living	Industrial producer prices	Agricultural producer prices	Retail prices (1976=100)	Import prices	Export prices
1983 March	114.4	114.7	106.6	130.6	112.9	111.2
April	114.7	115.1	104.9	130.9	113.0	111.4
May	115.0	115.2	104.3	131.5	113.4	111.8
June	115.4	115.5	105.2	131.8	114.5	112.0
July	115.8	115.6	103.8	132.0	115.5	112.4
1984 March	117.9	118.2	110.0	134.3	119.8	115.1
April	118.1	118.6	108.0	134.6	120.5	115.5
May	118.2	118.9	105.3*	134.8	122.4	116.0
June	118.6	119.0	106.7*	135.1	122.1	116.0
July	118.4	119.3		134.8		

* = Provisional

Private Consumption

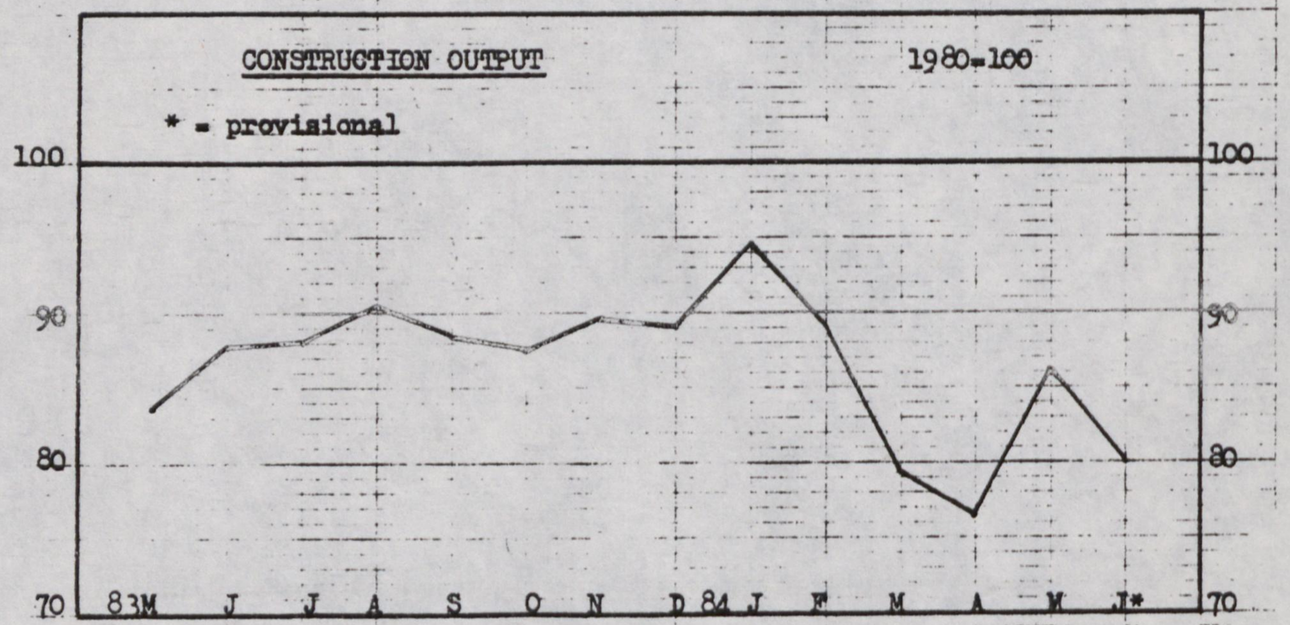
26. Retail trade turnover figures for June show a marked drop year-on-year, falling in nominal terms by 3%; in real terms this represents a decline of 6%. Turnover results for the first half of the year show a nominal increase of 3.1%, an increase in real terms of 0.3%. The poor June results were undoubtedly affected by the strikes, in particular by the loss in car sales. The July IFO survey confirms the current weakness of private consumption although prospects for the coming six months were no longer regarded quite as pessimistically as hitherto. Prices remain stable; in July the retail price index recorded an 0.2% fall on June with the annual rate of increase easing to 2.1% after 2.5% in June.

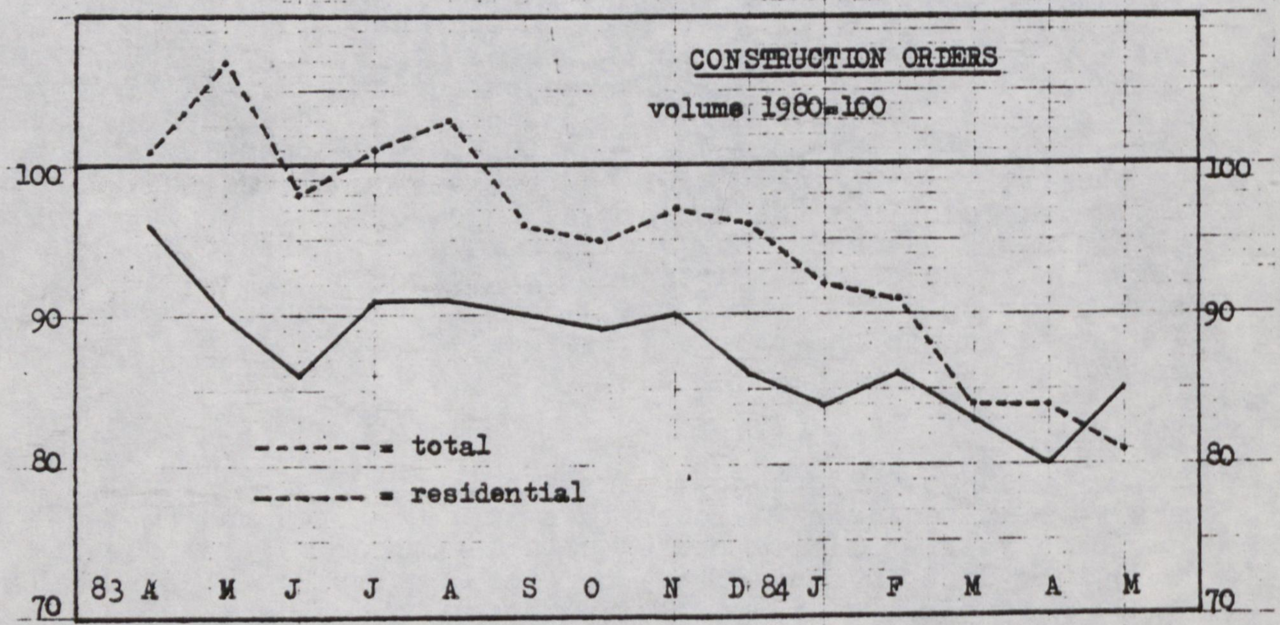
Construction

27. Construction output fell again in June (-7%), with construction activity in May/June 4% lower than in the corresponding two-month period a year earlier. Latest detailed order figures for May show a further drop in residential orders, continuing the steady decline since November last year, although total orders rose slightly month-on-month. The Federal Statistical Office reports a 4.7% fall in the level of orders in the first half of this year compared to a year earlier. A report by the DIW forecasts only a small increase in

/construction

construction output through the 80s, with a widening of the North/South gap as construction emphasis shifts southwards. The July IFO survey confirms the deepening mood of pessimism within the industry. The length of order books was down to only 2 months compared to 2.4 months a year earlier, with a full 70% of participating firms classifying the backlog of orders as too small. Capacity utilisation at 53% remains low and still below last June's level (55%). Price increases were minimal of late, a trend expected to continue.





/Labour Affairs

Labour Affairs

28. July brought mixed fortunes to the labour market. Both actual and seasonally adjusted unemployment rose again to the same level as last year. The number of vacancies on offer at the end of the month held steady but remained at an obstinately low level compared with the figures of 1982 and earlier. The number of foreign workers unemployed has fallen from a peak of 306,000 in January to 260,000 in July, so that they have formed a progressively smaller proportion of the total register (a trend which may not persist now that the scheme of incentives to return home has ended). Short-time working was at its lowest level in July since the summer of 1981. Taken together, the figures suggest that although current growth is too low to make any substantial inroads on unemployment the situation is unlikely to get markedly worse for the present. The detailed figures are as follows:-

	End July 1984	End June 1984	End July 1983
a. Unadjusted total	2,202,179(8.9%)	2,112,596(8.5%)	2,202,223(8.9%)
b. Adjusted total	2,311,000	2,295,000	2,320,000
c. Short-time working	262,327	338,327	434,698
d. Unfilled vacancies	98,646	99,329	82,498
e. Total men in a.	1,206,098	1,170,694	1,195,991
f. Total women in a.	996,081	941,902	1,006,224

29. There was much concern about the impact of this year's 735,000 school leavers on the employment market. Although only 170,000 under 20s were registered as unemployed at end-July, the Federal Labour Institute say that the demand for training places currently exceeds supply by about 213,000 - compared with 175,000 at the same time last year. The Federal Chancellor, and the Federal Ministers of Labour and Education severally expressed concern at the figures and urged industry on to greater efforts. Esser, the Employers' Organisation's president, pointed out that employers last year made available a record number of almost 700,000 training places. He saw no reason to suppose that this total could not be bettered this year. Although the gap between supply and demand in July was 38,000 more than in July 1983, it should be substantially reduced during the autumn and a high proportion of those seeking training places should find them. But the Chancellor has not repeated last year's unfulfilled promise that training places would be guaranteed for all those willing and qualified to take them, and school leavers face an even tougher outlook this year than last. There was talk during the month of plans to increase the length of military conscription from 15 to possibly 18 months or more. This would have the effect of removing upwards of 30,000 from the live register.

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30. In a dispute with Lufthansa over the pay and hours of air crews, the independent white collar union, DAG, which covers some 85% of pilots, balloted its members on the arbitrator's award. They voted 80% in favour of rejecting the award and of industrial action. A further round of talks between the two sides was fixed for 31 August and the strike threat remains in abeyance. No other industrial disputes came to notice during the month.

31. Proposals were published towards the end of the month for changes in labour law designed to introduce more flexibility into the labour market. They include relaxation of statutory controls on hours of employment and of provisions relating to joint consultation and redundancy payments. Union reaction was predictably hostile, seeing in the changes an attack on workers' rights. The proposals were generally welcomed by employers as a first necessary step in the right direction.

Balance of Payments

32. In June current account finished with a deficit of DM 3.2 billion, compared with a surplus of DM 3.1 billion in May. A year earlier current account had shown a deficit of only DM 0.2 billion. In the first six months of the year the current account was thus in surplus to the tune of DM 1.4 billion, down on last year's corresponding figure of DM 6.7 billion. The visible trade surplus in June fell markedly to DM 1.3 billion after DM 4.8 billion in May and DM 3.9 billion in June 1983, a clear reflection of the impact of the strike on exports. While imports grew by 3.7% on a year earlier, exports were 3.7% lower and 15% down on the May result. Nevertheless, detailed figures for the period January-May show exports 14% higher than a year earlier with particularly marked growth in exports to the USA (+57%) and Japan (+33%). In the first six months of 1984 the visible trade surplus stood at DM 20 billion, down on the corresponding period 1983 (DM 22 billion). Original estimates of a current account surplus in 1984 of over DM 20 billion now seem unlikely to be fulfilled; in a new estimate the Commerzbank believes that a surplus of more than DM 10 billion is "very possible".

33. The net foreign assets of the Bundesbank fell in June by DM 0.7 billion, falling again in July by DM 0.9 billion, as a result of the continued strength of the Dollar.

Monetary

34. Leading interest rates remained unchanged with Discount at 4.5% and Lombard at 5.5%. Market rates, yield on bonds outstanding, were unchanged at 8.1%.

35. Private sector credit expanded strongly in July, increasing by DM 3.6 billion and thus by DM 0.7 billion more than a year earlier. Demand was particularly high for short-term credit, in part a technical reaction to the weak credit demand during the strikes. Over the last six months private sector credit has grown by 7% at a seasonally adjusted annual rate. Monetary growth overall, however, was moderate in July as a result of strong capital outflows and lively monetary capital formation. M3 grew

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by DM 4.5 billion over the month, in seasonally adjusted terms at a similar rate as in June. Over the last six months and at a seasonally adjusted annual rate M3 has expanded by 4.5%, exceeding its corresponding level a year earlier at the end of July by 3.5%. M2 was up by 3% and M1 by 1.5%. Central Bank Money growth slowed in July; compared to the final quarter 1983 the annual growth rate currently stands at 4.25% and thus at the lower end of the target corridor of 4-6%.

FRG/UK Trade

29.8.84 £1 = DM 3.775

36. In the twelve months to the end of June 1984 FRG imports from the UK totalled DM 29.6 billion, 7.1% of total FRG imports. A year earlier the UK market share had stood at 7.2%. While total FRG imports rose by 11.0% at an annual rate, imports from the UK increased by 10.1%. Excluding oil, total FRG imports rose by 12.5%, while imports from the UK rose by 13.3% with the UK share of the non-oil import market improving slightly to 5.4%.

37. The strong increase in FRG exports to the UK over recent months eased slightly, up 10.2% year-on-year against an increase of 7.6% in total FRG exports. The proportion of FRG exports destined for the UK climbed from 7.9% to 8.1%.

38. The trade gap in favour of the FRG widened to DM 7.4 billion after DM 6.6 billion a year earlier.

FRG: Main economic statistics

	Q1 83	Q4 83	Q1 84	q/month	year
1. Expenditure on GNP (current prices)					
a) Gross National Product	408.6	429.0	432.0	0.7	5.7
b) Private consumption	230.8	236.9	240.0	1.3	4.0
c) Government consumption	82.0	84.9	83.1	-2.1	1.3
d) Fixed capital formation	82.3	90.0	90.4	0.4	9.8
e) Exports of goods & services	133.5	140.6	146.3	4.1	9.6
f) Imports of goods & services	121.7	131.0	136.7	4.4	12.3
g) Net exports	11.8	9.6	9.6		
2. Expenditure on GNP (constant prices)					
a) Gross National Product	312.0	319.7	323.5	1.2	3.7
b) Private consumption	173.5	173.9	174.9	0.6	0.8
c) Government consumption	61.7	62.5	61.1	-2.2	-1.0
d) Fixed capital formation	61.6	65.9	65.9	0.0	7.0
e) Exports of goods & services	103.7	107.5	110.9	3.2	6.9
f) Imports of goods & services	89.1	94.4	96.9	2.6	8.8
g) Net exports	14.6	13.1	14.0		
3. Income of households					
a) Gross wages & salaries	189.3	194.8	199.5	2.4	5.4
b) Disposable income	265.5	272.0	277.4	2.0	4.5
c) Savings as a % of b)	13.1	12.9	13.5		
		1976=100			
4. Productivity					
a) In the economy as a whole					
i) GNP per working person (1976 prices)	112.6	115.9	117.4	1.3	4.3
ii) wage and salary costs per production unit	126.8	127.8	128.8	0.8	1.6
		1980=100			
	May 83	Apr 84	May 84		
b) In industry					
i) output per employed person	105.0	108.0	110.0	1.9	4.8
ii) wage and salary costs per production unit	108.0	107.0	102.0	-4.7	-5.6
	Jun 83	May 84	Jun 84		
5. Industrial production					
a) Total	97.7	97.5	89.0	-8.7	-8.9
b) Manufacturing industry	98.7	98.9	88.6	-10.4	-10.2
c) Construction	87.9	86.1	80.0	-7.1	-9.0
6. New orders					
a) Total	95.0	102.0	93.0	-8.8	-2.1
b) Domestic	92.0	95.0	88.0	-7.4	-4.3
c) Foreign	102.0	119.0	103.0	-13.4	1.0

	Jul 83	Jun 84	Jul 84	q/month	year
		in 1000's			
7.Unemployment					
a) i) unemployed	2,202.2	2,112.6	2,202.2	4.2	0.0
ii) as a % of the working population	8.9	8.5	8.9		
b) Short-time workers	434.7	337.4	262.3	-22.3	-39.7
c) Vacancies	82.5	99.3	98.6	-0.7	19.5
		1980=100			
8.Prices					
a) Cost of living of all private households	115.8	118.6	118.4	-0.2	2.2
b) Retail prices (1976=100)	132.0	135.1	134.8	-0.2	2.1
c) Producer prices of industrial products	115.6	119.0	119.3	0.3	3.2
	Jun 83	May 84	Jun 84		
d) Export prices	112.0	116.0	116.0	0.0	3.6
e) Import prices	114.5	122.4	122.1	-0.2	6.6
Terms of Trade	99.7	96.2	95.3	-0.9	-4.4
		DM bn			
9.Balance of payments					
a) Visible trade					
i) exports	36.8	41.5	35.4		
ii) imports	32.9	36.7	34.1		
iii) balance	3.9	4.8	1.3		
b) Supplementary trade items	-0.2	0.8	-0.3		
c) Services	-1.5	-0.1	-1.4		
d) Transfers	-2.4	-2.4	-2.8		
e) Current account	-0.2	3.1	-3.2		
10.Net foreign reserves	71.7	78.0	75.5		
Seasonally adjusted					
11.Money stock					
M1	3.4	-3.6	-1.3		
M2	3.3	-1.2	2.3		
M3	4.3	-1.4	3.6		
Unadjusted					
12.Monetary capital formation	5.1	7.3	3.1		

Bank rates:

Since 29.6.84 Discount rate: 4.5%
Since 9.9.83 Lombard rate: 5.5%

Sources: Federal Statistical Office, Wiesbaden;
Deutsche Bundesbank, Frankfurt
Discrepancies in totals due to rounding (62)(17)

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