

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 26 SAVING OF 28 SEPTEMBER 1984. Info all EC Posts, UKDel OECD, UKMis Geneva, all Consulates-General in the Federal Republic, Washington, Tokyo, Vienna.

FEDERAL GERMAN ECONOMY

Summary

1. Some mixed signals on prospects, but the majority view from the authorities and commentators is positive. A bullish Bundesbank monthly report, said that low domestic inflation (1.7% in August), favourable world economic trends and a high dollar were all helping to promote export led growth in 1984. This optimism was confirmed by July's statistics which, reflecting the catching up process following the metal workers' strike, and bearing in mind that the first week of July was affected by the strike, show that new orders grew by 11% on June, export orders by 19.5% and output by 14%. Other commentators agree with most of this but a discordant note was struck by the Kiel Economic Institute who forecast lower GNP growth for 1984 (around 2%) as a result of a decline in domestic demand since the spring. The Ministry of the Economy forecast growth of 2.5% for 1984, and Stoltenberg, introducing the 1985 Federal Budget earlier this month, said that growth prospects were good and were assisted, amongst other things, by world trade growth of 8%, a price development unmatched for 15 years, and steady domestic interest rates: while at the same time the continuing policy of budgetary consolidation at all levels of government would ensure that pressure on the financial markets continued to ease. In addition Stoltenberg said that there would be no acceleration in the rise of unit wage costs in 1984: all of these factors would produce an economic setting against which the recovery, which began at the start of 1983, should continue beyond 1984.

?? 2. Concerned at likely effect on interest rates of the sudden acceleration of the dollar to even dizzy heights, the Bundesbank, with neat timing, intervened massively and seem, for the moment at any rate, to have reduced the volatility of the DM/dollar rate. Pöhl and Stoltenberg echoed earlier German fears about the danger of a 'hard landing' which would be disruptive and likely to weaken German

export performance. Herr Pöhl also expressed concern that the high US dollar was inhibiting some investment decisions. As the month ended the fluctuations in the dollar led to uncertainty on the stock markets with most stocks falling slightly.

3. Broadly satisfactory though prospects are and notwithstanding the optimism of the authorities, there is concern that the peak of the current modest upswing is not far away and that the rate of GNP growth at the end of 1985 will be lower than it is now and trending downwards, which lies behind the Kiel forecast.

Detail

4. The late summer has produced a mixed bag of economic forecasts. The Kiel Economic Institute, the most pessimistic of the Five Institutes, but with the best track record, argued that signs of a cyclical downturn are already evident: the economic impetus of the spring had been lost with domestic demand down particularly influenced by a poor outturn in the construction sector and stagnation in private consumption. Unemployment had added to the problem with an increase of 100,000 from the beginning of the year while the failure of the Government to get to grips with structural problems and state aids to industry together with a stagnation of M1 also contributed to a dampening of hopes for economic growth.

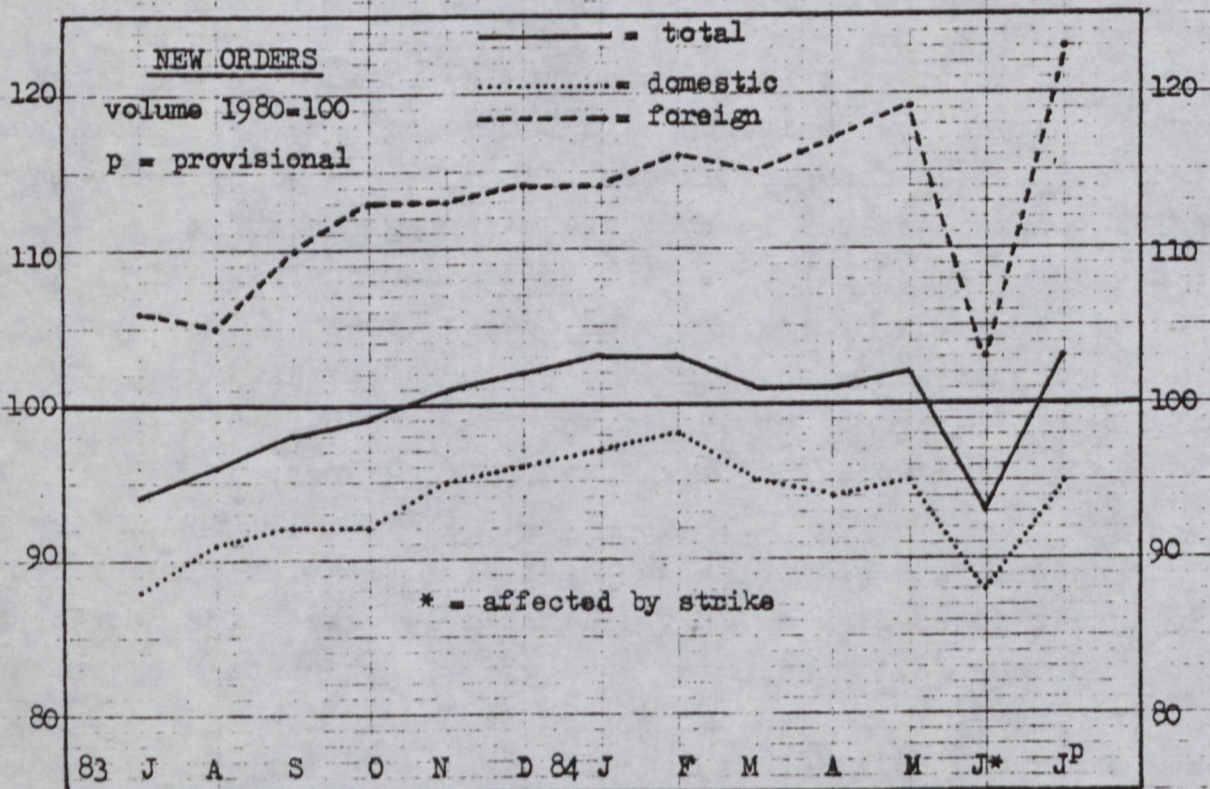
5. On the other hand the Bundesbank, the Ministry of the Economy, the Berlin and the Hamburg Institutes are more optimistic. In its September report the Bundesbank presented a confident picture of the economy which while acknowledging the negative effects of the metal workers' dispute and the consequent fall in real GNP growth in Q2, pointed out that exports remained buoyant, particularly in the capital goods sector, and that broader based growth was still possible. (The Bundesbank maintains that the IFO Institute's forecast of a 5% increase in fixed capital formation in the manufacturing sector is still possible in 1984.) This view is confirmed by the Hamburg Institute who see an upward trend in the propensity to invest despite the labour conflict. The Bundesbank also points out that even in the construction sector where demand for private housing has dried up, partly as a result of government deregulation, prospects for growth in public construction (two-thirds of which are accounted for by the local authorities) are good.

6. The more optimistic view of growth in 1984 is shared by most banks. The Commerzbank, who describe 1984 as the year of foreign trade, forecast real GNP growth of 2.5%: exports will remain the major impulse: West German exporters are gaining strongly from the rise in the dollar with earnings from exports to the US at DM 20.9 billion in the first half of the year (over 45% up on a year ago), and in the first eight months of the year a real increase in exports of 10% (imports up 8%).

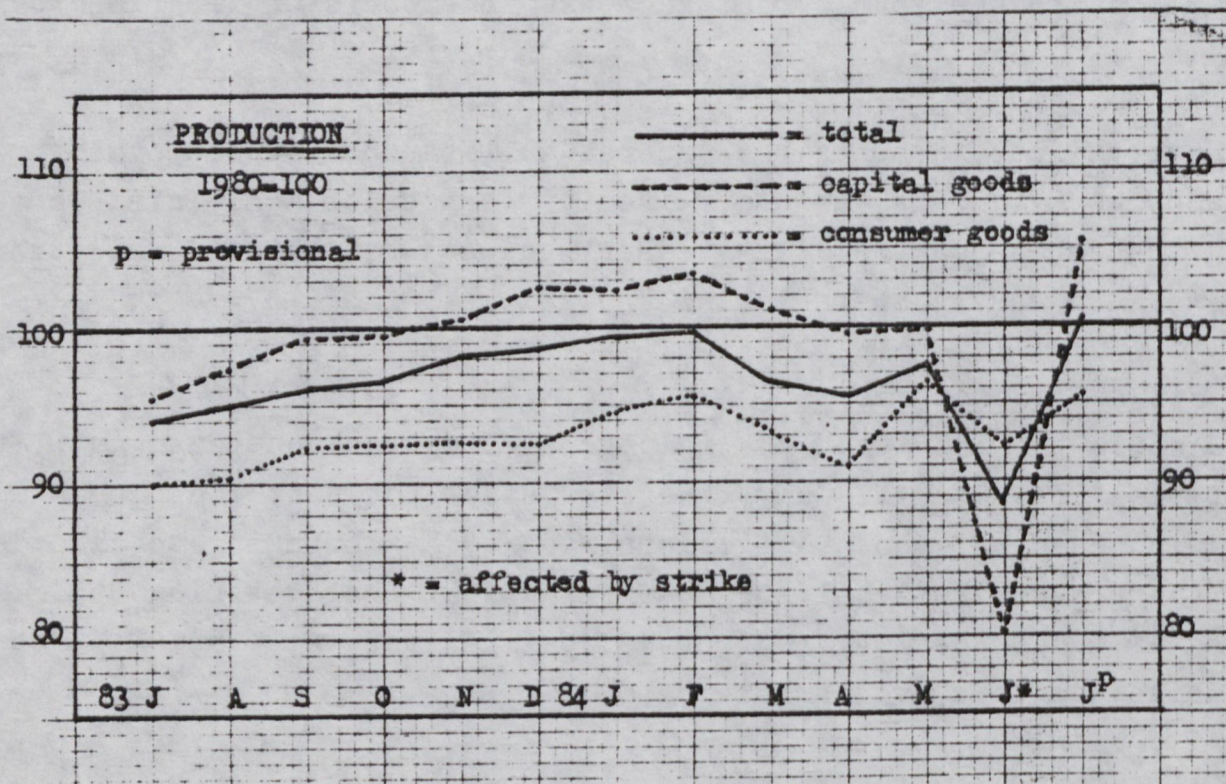
7. Nevertheless, despite the general bullish mood, unemployment remains the major worry. This was underlined by Chancellor Kohl in his speech during the debate on the draft Federal budget when he confirmed that there were no easy answers to the problem.

Prospects and Indicators

8. Despite the fact that the industrial disputes continued until the end of the first week of July, the statistics for that month show a marked increase on June. New orders rose by 11% bringing total orders above the pre-strike level and confirming that the "catching up" process is well under way. Export orders led the way - up 19.5% on June while domestic orders rose by 8%.



9. Production showed a similar positive development with total output increasing by 13.5% (July on June). Of this the manufacturing sector rose by 16% and capital goods (the leading export sector) rose by almost 30%. The underlying trend continued to show upwards movement from its pre-strike level.



10. The high level of private consumption attained in the first quarter of the year was maintained in the second quarter. This was achieved despite the drop in disposable income caused by early payments of special bonuses and the loss of wages during the strikes. These losses however were offset by a fall in the savings ratio from 13.5% in Q1 to 11.7% in Q2. There are conflicting views on the future course of private consumption with some commentators forecasting an upturn in activity following the strikes. But the IFO Institute, for example, expect only a slight upturn for the rest of the year.

11. The annual rate of inflation, cost of living index, declined to 1.7% in August after 2.2% in July and flash forecasts for September suggest a further fall to 1.6% or even 1.5%. Forecasts for 1984 as a whole are therefore now being revised downwards from 3% to 2.5%. To some extent the fall is due to base effects following the 1% VAT increase on 1 July last year. But the rate of price increases is

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clearly slowing down. The moderate price trend, the lowest for 15 years, is strengthening confidence in price stability, an essential pre-condition for a favourable investment climate.

12. There was no change on the unemployment front with the number of unemployed at the end of August remaining at 8.9%. But there are some hopeful signs: employment offices are busier than a year ago, the number of vacancies was up 12.4% and 158,000 people were placed, an increase of 15.5% on August 1983.

13. The current account for August records a deficit of DM 1.3 billion although the overall deficit for the first 8 months of the year is DM 0.1 billion compared to DM 1.2 billion a year earlier. The decline results from the depressed level of exports during the strikes. The majority of forecasters still expect a surplus on current account this year of between DM 8 billion and DM 10 billion.

14. Central Bank money figures show a growth rate of 5% - the middle of this year's target range of 4-6%. Leading interest rates remain unchanged with Discount at 4.5% and Lombard at 5.5% while market rates fell to 7.9% in August and to 7.7% by the middle of September. The increase in the Discount rate at the end of June has had little effect on interest rate movement. The financial markets appear to attach more importance to domestic determinants which are acting in the direction of an interest rate reduction eg further progress in reducing the budget deficits and price stability.

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New orders

15. With the settlement of the strike in early July, new orders picked up markedly from their strike-depressed level in June, recording an 11 per cent increase. Total orders were thus slightly above the level before the strike, at a similarly high level as at the beginning of the year. Domestic demand rose by 8 per cent on the previous month, while foreign demand, which had weakened sharply as a result of the strike, rose by 19.5 per cent. The two-monthly comparison, June/July on April/May, obviously also affected by the strike, shows a 3.5 per cent decline, with domestic orders falling by 3 per cent and foreign orders by 4 per cent. In the capital goods sector orders were down by 5 per cent, basic and producer goods orders by 3 per cent and capital goods orders, least affected by the strike, by 0.5 per cent. Compared to the corresponding two-month period a year earlier, overall orders show an increase of only 3.5 per cent. The month of July alone, however, recorded a 13.5 per cent increase on a year earlier, with export orders almost 20 per cent higher.

NEW ORDERS

1980=100

	<u>Total</u>		<u>Domestic</u>		<u>Foreign</u>	
	<u>Value</u>	<u>Volume*</u>	<u>Value</u>	<u>Volume</u>	<u>Value</u>	<u>Volume</u>
<u>1983</u>						
April	103	93	99	89	110	100
May	103	93	100	90	112	101
June	106	95	103	92	113	102
July	105	94	98	88	118	106
<u>1984</u>						
April	115	101	106	93	134	117
May	117	102	109	95	137	119
June	107	93	101	88	119	103
July (p)	119	103	109	95	142	123

* = at constant prices
(p) = provisional

/Production

Production

16. As with new orders, production results in July showed a strong recovery from the depressed level in June. Total production recorded a 13.5 per cent increase with manufacturing output rising by 16 per cent. In part this development reflects the endeavours of companies to offset the losses in production incurred during the industrial dispute. Construction output rose by 5.5 per cent from June to July. The two-monthly comparison, June/July on April/May, continues to show a decline (- 3.5 per cent) as a result of the strike. The capital goods sector suffered most severely (- 7 per cent), with motor vehicle production down by a full 25 per cent. Consumer goods unsteady in recent months, recorded a 6 per cent rise. In the month of July alone, however, overall production was 8 per cent higher than a year earlier; capital goods outturn was up by 11 per cent, basic and producer goods by 8.5 per cent and consumer goods 7.5 per cent. Construction activity was 6 per cent higher than a year ago.

PRODUCTION

1980=100

	<u>Total</u>	<u>Basic & producer goods</u>	<u>Capital goods</u>	<u>Consumer goods</u>	<u>Construction</u>
<u>1983</u>					
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
July	94.8	93.0	96.9	90.7	88.0
<u>1984</u>					
February	100.2	100.7	104.5	95.8	89.1
March	96.4	95.8	100.8	93.1	79.2
April	95.6	96.5	99.7	91.0	76.5
May	97.7	97.0	99.9	96.5	86.0
June	88.3	93.0	80.1	92.2	81.7
July*	100.3	98.9	105.2	95.6	90.9

* = provisional

/Prices

Prices

17. Inflation, as measured by the cost of living index, fell in August by 0.2 per cent on July. The annual rate of increase declined to 1.7 per cent, after 2.2 per cent in July. The moving average for the year so far now stands at 2.7 per cent. Food prices in August were 1.8 per cent higher than a year earlier.

18. Retail prices fell by 0.4 per cent month-on-month, with the annual rate dropping to 1.8 per cent after 2.1 per cent in July. Wholesale prices fell again sharply in August (- 1.3 per cent on July) with the annual rate declining to 1.6 per cent after 3.8 per cent in July. Other indicators are for July. Industrial producer prices rose in July by 0.3 per cent, the annual rate of increase rising to 3.2 per cent after 3.0 per cent in June. Export prices in July were rose 0.2 per cent month-on-month with the annual rate standing at 3.4 per cent after 3.6 per cent in June. Import prices rose by 0.3 per cent month-on-month, up 6.1 per cent on a year earlier. The continued strength of the Dollar is likely to exert marked pressure on import prices over the coming months. Agricultural producer prices fell by 2.5 per cent on the previous month to stand 1.4 per cent up on a year earlier. Latest Terms of Trade figures for July show an improvement of 1.7 per cent to stand 1.6 per cent lower than a year ago.

Prices

1980=100

	<u>Cost of living</u>	<u>Industrial producer prices</u>	<u>Agricultural producer prices</u>	<u>Retail prices (1976=100)</u>	<u>Import prices</u>	<u>Export prices</u>
<u>1983</u>						
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
August	116.2	116.3	105.3	131.9	117.7	112.9
<u>1984</u>						
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	111.0	134.8	122.5	116.2
August	118.2			134.3		

* = Provisional

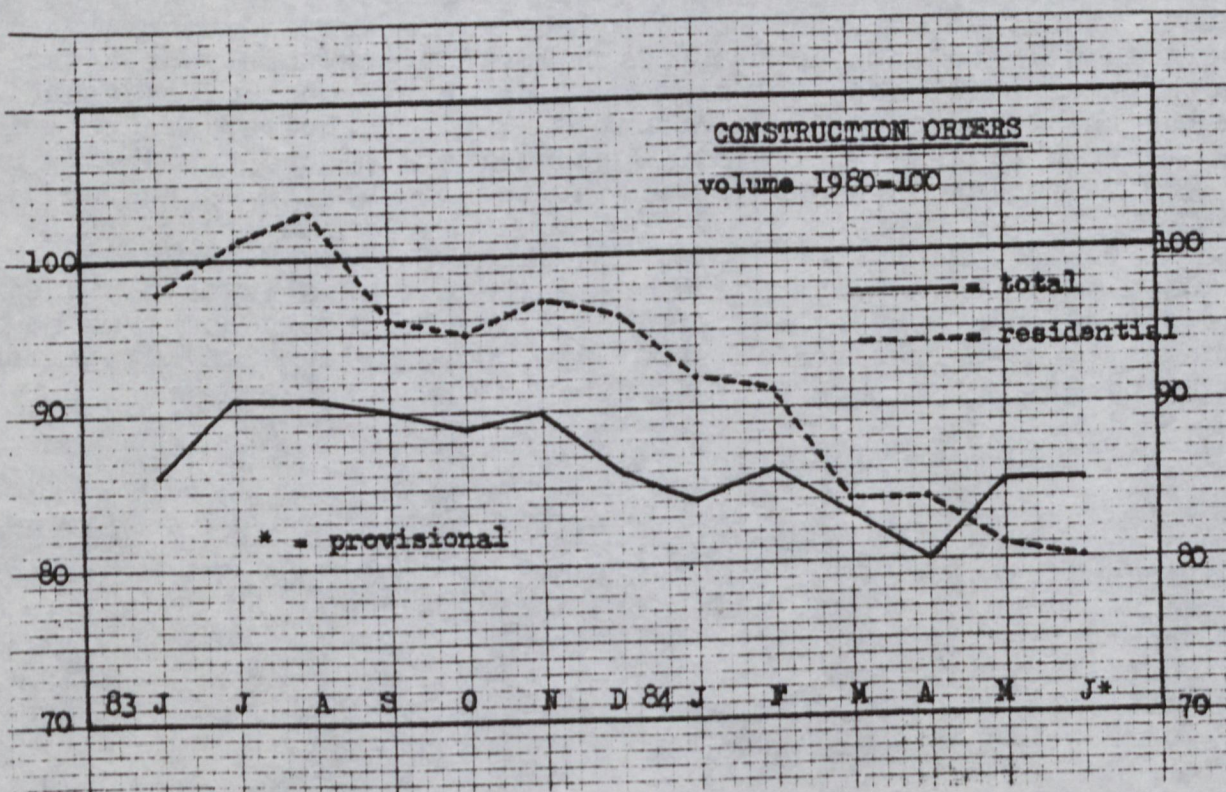
/Private consumption

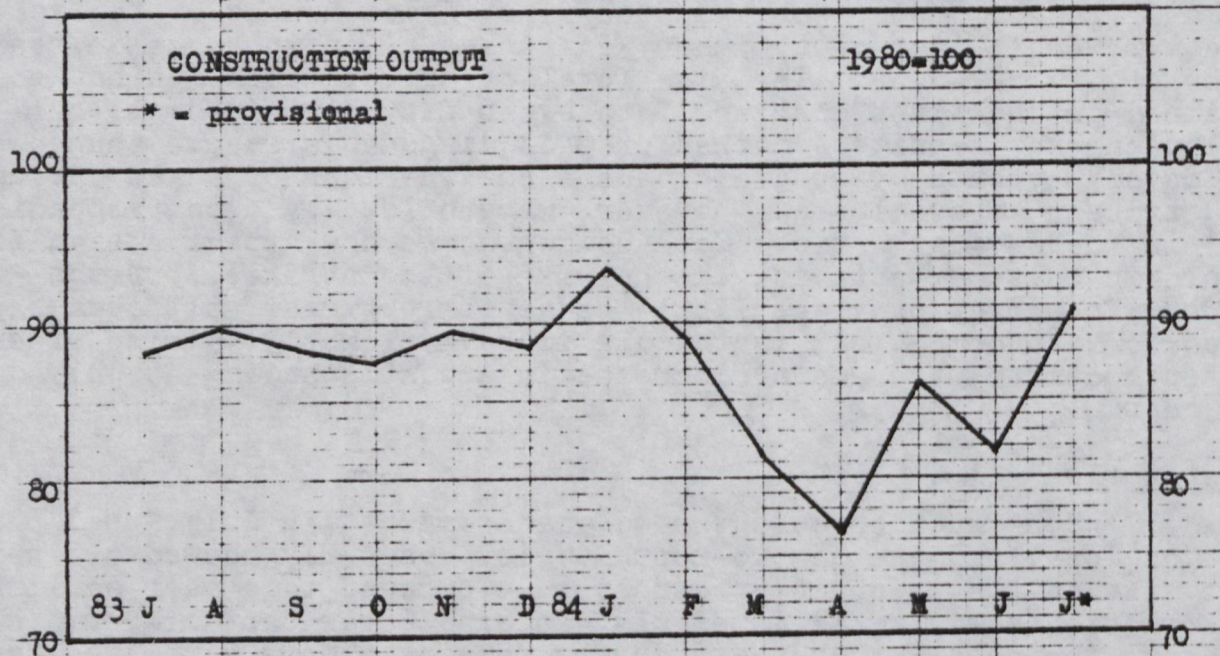
Private Consumption

19. Retail trade turnover in July made up some of the losses incurred in June, rising by 6 per cent nominal on July 1983, in real terms a rise of 4 per cent. In the first seven months of the year turnover was 3.4 per cent higher year-on-year, an increase in real terms of 0.7 per cent. The high level of private consumption attained in the first quarter of the year was maintained in the second quarter despite a marked drop in disposable income caused by preempted payments of special bonuses and the loss of wages during the strikes. These losses, however, were offset by a corresponding fall in the savings ratio. Some commentators now expect a significant upturn in consumer activity in the wake of the strikes, but the August Ifo survey provides little cause for optimism, although expectations for the coming six months did improve slightly. Price rises remain moderate, the annual increase in August standing at only 1.7 per cent.

Construction

20. Construction output recovered somewhat in July, up 5.5 per cent on June, and in the two-month period June/July showed a 6 per cent rise on the preceding two months. Compared to a year earlier construction activity in June/July was also 6 per cent higher. However, the mood within the industry remains gloomy with the August Ifo survey suggesting no improvement in the prospects for the coming six months. The backlog of civil engineering orders has reached an all-time low. In the construction industry as a whole, the length of order books in July stood at 1.9 months, almost one month below the long-term July average. This thin cushion is also mirrored by firms' expectations that the labour force in the construction sector will decline over the coming months. Capacity utilisation was unchanged on the previous month's level (53%) but below its level a year earlier (55%). Prices remained calm, a trend expected to continue.





Labour Affairs

21. The end-August labour market figures showed little change. The actual number of unemployed fell by 500 - an unchanged 8.9% - while the seasonally adjusted figures rose by 5,000 to 2.32 million. The number on short time fell by 50,000 to 212,000 - about the same level as in 1977/78 when unemployment averaged 4.5%. The Federal Labour Institute say that this reflects increased industrial activity as firms seek to make up production lost during this year's strikes. Another marginally hopeful sign was that employment offices are busier than a year ago. In August 124,000 vacancies were notified, 12.4% up on August 1983; 158,000 people were placed (up 15.5%) and 95,000 vacancies were outstanding at the end of the month (up 15%).

22. Unemployment among foreign workers fell by 0.5% during August, to 12.6%, against 13.8% a year ago. This is mainly due to the operation of the scheme of incentives to return home, which is thought to have resulted in about 150,000 families leaving Germany for good.

The detailed figures are:

	<u>End August 1984</u>	<u>End July 1984</u>	<u>End August 1983</u>
a. Unadjusted total	2,201,829(8.9%).	2,202,179(8.9%)	2,196,220(8.9%)
b. Adjusted total	2,316,000	2,311,000	2,324,000
c. Short-time working	212,149	262,327	379,182
d. Unfilled vacancies	94,715	98,646	82,493
e. Total men in a.	1,193,321	1,206,098	1,182,034
f. Total women in a.	1,008,508	996,081	1,014,156

/During

23. During the month the public services union, ÖTV, formulated its claim. This was for a general salary increase of 5% with a minimum of DM 100, plus shorter working time in the form of 10 additional days of paid holiday. It also demanded the ending of the wage freeze for established civil servants which is otherwise due to last until April 1985. A similar claim has been lodged by the Rail Workers' Union. Negotiations on both claims will take place during October.

24. The dispute between the independent white collar union, DAG, and Lufthansa was settled without recourse to industrial action. There were no other disputes of note during the month.

25. It was confirmed that there was thought in government circles of increasing the length of national service, but the necessary legislation seemed unlikely to take effect for a couple of years.

Balance of Payments

26. In July current account finished almost in balance compared to a deficit of over DM 3 billion in July 1983 and a strike-affected deficit on DM 3.2 billion in June. The improvement is due in particular to a visible trade surplus of DM 3 billion compared to only DM 1.3 billion in June. Exports in July were 19 per cent up on a year earlier, having dropped sharply in the weeks of the industrial dispute, while imports recorded an increase of 17.5 per cent. In seasonally adjusted terms, exports were expanding more rapidly than imports. A further positive factor was a decline in the services deficit from DM 1.2 billion in June to only DM 0.7 billion in July. Despite the holiday peak and resulting outflows of tourist expenditure abroad (DM 3.2 billion), interest and dividend inflows heavily outweighed outflows resulting in a surplus of DM 1.1 billion. The deficit on transfers also fell from DM 3 billion in June to DM 2.7 billion in July as a result of temporarily lower payments to the EC. On long-term capital account outflows were also reduced, down to DM 3 billion, while on short-term capital account inflows at DM 5 billion were still strong.

27. The net foreign assets of the Bundesbank fell in July by DM 0.9 billion, a result of intervention on the exchange markets in the face of the strong dollar. Although in August they rose again slightly, the recent turbulence caused by the dollar is certain to have necessitated massive dollar releases by the Bundesbank resulting in a marked fall in net foreign assets in September.

28. Latest figures for August show a current account deficit of DM 1.3 billion. The overall deficit was well down on the corresponding figure a year earlier, with the seasonally adjusted visible trade surplus touching record levels. In the first eight months of the year current account was DM 0.1 billion in deficit compared to a surplus of DM 1.2 billion a year earlier.

Monetary

29. Leading interest rates remained unchanged with Discount at 4.5 per cent and Lombard at 5.5 per cent. Market rates, yield on bonds outstanding, fell to 7.9 per cent in August after 8.1 per cent in July. In the middle of September they had declined further to 7.7 per cent. With US interest rates on the increase the differential reached 5 per cent. In September the dollar reached record levels against the DM, peaking to date at DM 3.16.

30. Private sector credit, which had increased only marginally in June, expanded strongly in July. Over the last six months and at a seasonally adjusted annual rate private sector credit has risen by 7 per cent with the emphasis on short-term loans. Monetary capital formation, however, was also strong. In total monetary development was somewhat more lively than in June. M3 over the last six months has expanded at a seasonally adjusted annual rate of 4.5 per cent, exceeding its corresponding 1983 level at the end of July by 3.5 per cent. M2 was 3 per cent higher and M1 1.5 per cent. Central Bank Money figures for August indicate a growth rate on the final quarter 1983 of 5 per cent, in the middle of this year's target corridor of 4-6 per cent.

FRG/UK Trade

28.9.84 £1 = DM 3.776

31. In the twelve months to the end of July 1984 FRG imports from the UK totalled DM 29.8 billion, 7.1 per cent of total FRG imports. A year earlier the UK market share also stood at 7.1 per cent. While total FRG imports rose by 12.4 per cent at an annual rate, imports from the UK increased by 11.8 per cent. Excluding oil, total FRG imports rose by 13.8 per cent, while imports from the UK rose by 15.6 per cent with the UK share of the non-oil import market improving slightly to 5.4 per cent.

32. The increase in FRG exports to the UK regained momentum in July, having eased slightly in June, up 12.0 per cent year-on-year against an increase of 9.4 per cent in total FRG exports. The proportion of FRG exports destined for the UK climbed from 7.9 per cent to 8.1 per cent.

33. The trade gap in favour of the FRG widened to DM 7.8 billion after DM 6.9 billion a year earlier.

FRG: Main economic statistics

	Q2 83	Q1 84	Q2 84*	q/month	year
1. Expenditure on GNP (current prices)					
a) Gross National Product	414.8	433.9	425.2	-2.0	2.5
b) Private consumption	236.6	243.4	244.6	0.5	3.4
c) Government consumption	82.7	84.1	86.1	2.4	4.1
d) Fixed capital formation	85.8	89.5	86.4	-3.5	0.7
e) Exports of goods & services	132.5	146.3	142.2	-2.8	7.3
f) Imports of goods & services	122.5	137.7	135.0	-2.0	10.2
g) Net exports	10.0	8.6	7.2		
2. Expenditure on GNP (constant prices)					
a) Gross National Product	316.1	324.5	317.7	-2.1	0.5
b) Private consumption	177.5	178.2	178.2	0.0	0.4
c) Government consumption	62.1	61.8	62.7	1.5	1.0
d) Fixed capital formation	63.8	65.1	62.6	-3.8	-1.9
e) Exports of goods & services	103.3	111.0	107.4	-3.2	4.0
f) Imports of goods & services	91.2	97.4	95.7	-1.7	4.9
g) Net exports	12.1	13.6	11.7		
3. Income of households					
a) Gross wages & salaries	189.0	199.2	190.3	-4.5	0.7
b) Disposable income	269.7	281.0	276.5	-1.6	2.5
c) Savings as a % of b)	12.3	13.4	11.5		
		1976=100			
4. Productivity					
a) In the economy as a whole					
i) GNP per working person (1976 prices)	114.4	117.8	115.5	-2.0	1.0
ii) wage and salary costs per production unit	124.9	128.1	125.6	-2.0	0.6
		1980=100			
	Jun 83	May 84	Jun '84*		
b) In industry					
i) output per employed person	109.0	110.0	98.0	-10.9	-10.1
ii) wage and salary costs per production unit	106.0	102.0	115.0	12.7	8.5
	Jul 83	Jun 84*	Jul 84		
5. Industrial production					
a) Total	94.0	88.3	100.3	13.6	6.7
b) Manufacturing industry	94.7	87.5	101.4	15.9	7.1
c) Construction	88.1	81.7	90.9	11.3	3.2
6. New orders					
a) Total	94.0	93.0	103.0	10.8	9.6
b) Domestic	88.0	88.0	95.0	8.0	8.0
c) Foreign	106.0	103.0	123.0	19.4	16.0

* = affected by strike

*Germany
West*

14.

	Aug 83	Jul 84	Aug 84 q/month	year	
	in 1000's				

7. Unemployment					
a) i) unemployed	2,196.2	2,202.2	2,201.8	0.0	0.3
ii) as a % of the working population	8.9	8.9	8.9		
b) Short-time workers	379.2	262.3	212.1	-19.1	-44.1
c) Vacancies	82.4	98.7	94.7	-4.1	14.9
	1980=100				

8. Prices					
a) Cost of living of all private households	116.2	118.4	118.2	-0.2	1.7
b) Retail prices (1976=100)	131.9	134.8	134.3	-0.4	1.8
	Jul 83	Jun 84	Jul 84		

c) Producer prices of industrial products	115.6	119.0	119.3	0.3	3.2
d) Export prices	112.4	116.0	116.2	0.2	3.4
e) Import prices	115.5	122.1	122.5	0.3	6.1
Terms of Trade	98.5	95.3	96.9	1.7	-1.6
		DM bn			

9. Balance of payments					
a) Visible trade					
i) exports	33.2	35.4	39.5		
ii) imports	31.0	34.1	36.5		
iii) balance	2.2	1.3	3.0		
b) Supplementary trade items	-0.2	-0.2	0.2		
c) Services	-2.8	-1.2	-0.7		
d) Transfers	-2.4	-3.0	-2.6		
e) Current account	-3.2	-3.1	-0.1		
10. Net foreign reserves Seasonally adjusted	71.4	74.8	73.9		
11. Money stock					
M1	0.0	3.5	0.7		
M2	4.0	1.3	3.4		
M3	9.0	0.2	4.5		

Unadjusted

12. Monetary capital formation	5.1	7.3	3.1
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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 (63) (18)

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