

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 13 SAVING of 30 August 1985. Info all EC Posts,
UKDel OECD, UKMis Geneva, all Consulates-General
in the Federal Republic, Washington, Tokyo, Vienna.

FEDERAL GERMAN ECONOMY

Summary

1. August has been a fairly uneventful month. A number of economic forecasts were published; all agree that growth will pick up in the second half of the year, that the underlying growth rate is 2.5% real GNP and that 1986 should see a slight improvement in both real GNP outturn and the number of employed. Inflation will remain low.
2. With Stoltenberg putting in a special appearance so as to emphasise the success of the Government's policy of reducing the budget deficit, the Bundesbank Council announced a further fall in leading interest rates. A decline in mortgage rates has followed to give a glimmer of hope to the ailing construction industry.
3. Unemployment is at a record high level, exacerbated by 180,000 school leavers.

Detail

4. Most of the major economic institutes published forecasts during August. The Berlin Institute maintained that domestic demand could rise in the third quarter of this year and compensate for a flattening in the recent steep growth rate for exports. Real GNP will grow between 2.5% and 3%. The other major institutes (Kiel, IFO, Hamburg and Essen) forecast real GNP growth of between 2% and 2.5% this year and 3% next. All agree that domestic demand will pick up. Forecasts for 1986 vary between 2.5% and 3% with inflation falling to around 2%.
5. The Government shares the institutes' overall view of future economic developments. Schlecht, the State Secretary at the Ministry of the Economy, said at the beginning of the month that growth is expected to speed up in the second half of this year. By 1986 domestic components should be more important growth factors with

/exports

exports playing a lesser role than this year. Domestic demand is expected to be supported by an increase in private consumption resulting from the introduction of the first stage of income tax reform while real wages will also improve. At the same time Schlecht forecasts that company investment will remain high and perhaps increase slightly on 1985 while public sector investment will also rise.

6. In a speech to managers of public enterprises on 26 August, Stoltenberg confirmed Schlecht's view. By 1986 domestic demand would be supported by a further fall in inflation to around 2% or even lower, while room existed for wage agreements which could produce an increase in real disposable incomes. Although acknowledging the problem of mass unemployment, Stoltenberg pointed out the substantial reduction in short-time working. Whereas in 1982/83 there had been around 1.2 million short-time workers, by July this year the number had fallen to 107,500. During the same period 100,000 new jobs had been created.

7. In his speech, Stoltenberg reaffirmed the Government's intention to privatise some of its holdings and promised details of the Government's exact plans in a few months' time.

8. On 15 August the Bundesbank Council cut both of its key lending rates for the first time in more than two years. Under this decision the Discount rate (the rate which the Bundesbank charges commercial banks for medium term borrowing) was cut by half a point to 4%. The Lombard rate (charged for temporary injections of liquidity to the banks) also fell by half a point to 5.5%. Stoltenberg, who attended the Bundesbank Council meeting, stressed the positive influence that the Government's policy on reducing the budget deficit had had on allowing a continuing fall in market rates. When the Government came to power market rates were 11.5% compared to 6.5% today.

9. Lower interest rates have led to a fall in mortgage rates. This, coupled with a halt in property and construction prices, together with the Government's incentives for investment in housing (Bonn telno saving 648), give a glimmer of hope to the construction sector. Nevertheless, most commentators do not believe that these positive developments will begin to bite before 1986.