

UNCLASSIFIED
SAVING TELEGRAM

BY BAG.
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FROM BONN

FRAME ECONOMIC

TO FCO TELNO 16 SAVING OF 31 OCTOBER 1985. Info all EC Posts,
UKDel OECD, UKMis Geneva, all Consulates-General
in the Federal Republic, Washington, Tokyo,
Vienna

FEDERAL GERMAN ECONOMY

Summary

1. The latest economic statistics (August) record a fall in orders and output. However the figures reflect a decline in economic activity resulting from the summer holiday period: the underlying trend is still relatively strong. This view is supported by the 5 Economic Insititutes who forecast 2.25% real GNP growth this year and 3% next. Growth is expected to become broader based and inflation will be around 2%; record trade surpluses will be registered for both years. The Institutes' report offers general support to the government but is critical of some aspects of economic policy, calling for less restrictive monetary targets and an earlier than planned implementation of income tax reform.

2. The Bundesbank's October report produces additional evidence that growth is broadening with results on company income showing an increase of 5% in the first half of the year and investment in machinery and equipment up 17.1% over the same period.

3. Despite a generally optimistic picture, unemployment still remains at slightly higher levels than a year ago. As a protest against the government's failure to secure a reduction in the number of unemployed, the trade union federation organised an "Action Week" in which they claim 600,000 people took part in 18 cities.

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Detail

4. The latest monthly statistics (for August) record a month on month fall of 2% for new orders and 3% for production. However the Ministry of the Economy point out that these decreases reflect a fall in economic activity during the summer holiday period and that the underlying trend remains upward. An examination of the two monthly figures supports this view with new orders for July/August rising by 6.5% on the same period a year ago while the July/August production figures increased by 4.5% on the same comparison.

5. The five major economic institutes' autumn report (Bonn Saving Telno 15 of 25 October) also supports the view that the economy is on an upwards path. In a report published on 21 October the institutes forecast an increase in real GNP of 2.25% in 1985 and 3% in 1986. Growth will be broader based with investment and domestic demand taking up the slack of relatively lower foreign demand. Inflation will be around 2% while the surpluses on current account will be about DM 35 billion this year and DM 50 billion in 1986. However, none of this will work through to affect the number of unemployed. The institutes forecast an increase of about 200,000 new jobs next year but demographic factors will ensure that the overall number of unemployed will remain unchanged.

6. The higher GNP figures forecast for 1986 will, however, reflect the overhang from 1985 and growth will start to decline in the second half of the year. The institutes argue that an increase in demand will therefore be necessary and they recommend that the second stage of income tax reform (DM 9 billion volume) planned to come into effect on 1.1.88 should be brought forward. The institutes also point out that earlier implementation of the second stage of income tax reform will go some way to answering foreign criticism that the FRG should reflate.