

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 19 SAVING OF 31 DECEMBER 1985. Info all EC Posts, UKDel OECD, UKMis Geneva, all Consulates-General in the Federal Republic, Washington, Tokyo, Vienna

FEDERAL GERMAN ECONOMY

Summary

1. Another good month and the year closes on a positive note with nearly all the indicators pointing in the right direction. Production is up 2% on the month as are new orders. Inflation remains low.
2. The Bundesbank announced a slightly less restrictive monetary target for 1986 and gave the go-ahead for the introduction of CDs in an attempt to further liberalize the financial market. Plans for reforms aimed at making the German Stock Exchanges more competitive were also announced during the month.
3. On the labour front, the Cabinet agreed draft legislation to limit further the extent of unemployment benefit payable to strikers.
4. A good year for the FRG economy in 1985; 1986 expected to be even better.

Detail

5. The November IFO survey of business confidence shows a further improvement, with November up on October and good prospects for the next six months. The IFO business climate indicator now stands at levels last recorded in 1979. This optimism is firmly supported by the latest (October) statistics. New orders are up 2% on the month as is production; construction recorded a 7% increase while private consumption in Q3 grew by 2.4% on the year earlier. Prices (cost of living index) remain stable at 1.8% and inflation over the year as a whole is likely to be 2.2%. Only unemployment spoils the picture with a rise of 62,000 in November to stand at 2.21 million.
6. The main event of the month was the announcement by the Bundesbank Council (Bonn telno 1205 of 19 December) that it would raise its CBM target range to 3.5% to 5.5% in 1986 (after 3% to 5% this year) to allow for stronger economic growth without encouraging inflationary pressures. This move will satisfy those who have called for a less restrictive monetary target. On the other hand, it does not meet the demands of those who recommend a medium-term monetary strategy or call for a greater degree of deflation.

7. The Bundesbank also announced that it would allow the introduction of Deutsche Mark Certificates of Deposit in early 1986. The decision is seen as a further attempt to liberalize West German financial markets and increase their competitiveness.

8. However Bangemann, the Minister of the Economy, confirmed that a remaining impediment to liberalization - the Stock Exchange turnover tax - would not be abolished during the current legislative period. In terms of international competitiveness this will leave West German Stock Exchanges at a disadvantage and discourage current efforts to bring about reform. The latest reform measure was announced on 19 December under which the eight regional exchanges will be up-graded into an association with their headquarters in Frankfurt. Although all exchanges will remain independent, voting procedures will take account of the importance of the Frankfurt and Düsseldorf exchanges (which account for over 80% of business). Further plans for reform include the introduction of option dealings in bonds in April 1986 and continued pressure on the government to abolish the Stock Exchange turnover tax.

9. On 18 December the Cabinet approved draft legislation, which will be tabled in early 1986, amending the law affecting strikers' benefits. There has been fierce controversy about the amendment which relates to the practice of paying unemployment benefit to workers laid off as a result of the indirect effects of industrial disputes. Unions (latterly in the 1984 metal workers' strike) have pulled out key workers in selected regions (paying them strike money) knowing that members in other regions would qualify for unemployment benefit if they were thrown out of work because of the strike. The proposed legislation is designed to stop this practice. However the measures fall short of the demands of employers who called for the disqualification from benefit of anyone dismissed or locked out as a result of an industrial dispute, regardless of whether he had a direct or indirect interest in its outcome. On the other hand the unions are likely to exert pressure on the government to tone down the amendment, through a series of "actions" (most likely in the form of demonstrations and marches but not widespread industrial action) in the run-up to the amendment's passage through Parliament.

10. This slightly sour note apart, and despite the continuation of high unemployment figures, the government go into 1986 with growing confidence in their economic policies and performance. They now know that if the forecasters are right 1986 will be an even better year than 1985, with all that that means for the Federal elections in early 1987.

11. They have good reason to be confident. Despite appalling weather in the first quarter, real GNP in 1985 is likely to grow by 2.5%, the third successive year of growth. Since taking office in October 1982 the government have reduced inflation from the levels of 5.3% and 6.3% in 1982 and 1981 respectively to today's level of 1.8%. In the same years real wages fell by 2% while an increase of 2% has been achieved under Kohl's stewardship. Reaching these levels of price stability through the pursuit of a fairly restrictive monetary policy and through budgetary consolidation has

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