

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 02 SAVING OF 31 JANUARY 1986. Info all EC Posts,
UKDel OECD, UKMis Geneva, all Consulates-General
in the Federal Republic, Washington, Tokyo, Vienna.

FRG: ANNUAL ECONOMIC REPORT

Summary

1. The Federal Government's Annual Economic Report was approved by the Cabinet on 29 January and will be discussed in the Bundestag in the second half of February. With the Federal elections only 12 months away, the report emphasises the positive achievements of 1985 and predicts an even better performance in 1986. Real GNP is expected to increase by 3%; inflation will be below 2%; trade and current account surpluses will reach new record high levels, but growth will broaden with domestic demand, particularly investment and private consumption, coming to the fore, 300,000 new jobs will be created and unemployment will fall to 8.5%. (This may be on the optimistic side.)

2. The report considers various policy changes including a major review of tax structure, but these are unlikely to be introduced before the next Federal elections in 1987.

Detail

3. The Federal Minister of the Economy, Bangemann, presented his Annual Economic Report to Cabinet on 29 January. The report reviews economic activity in 1985 and forecasts developments for 1986. It draws on the opinion of the Five Wise Men (Bonn telno 17 Saving of 26 November) to which, formally speaking, it is a reply.

1985

4. Economic development in 1985 was adversely affected by a poor outturn in Q1 due to severe winter weather. The construction sector, particularly housing (already in decline for structural reasons) was badly hit. Investment in construction fell by 6.7%

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on 1984's level, drawing down overall investment which therefore declined by 0.8% despite the increase of 8.8% in investment in machinery and equipment. Although investment in machinery and equipment achieved good results - particularly in the capital goods sector - exports remained the main motor of the economy with domestic demand beginning to support growth towards the end of the year.

5. Exports grew by 7.2% and imports by 4.6%, producing a trade surplus of DM 72.3 billion or 3.9% of GNP and a surplus on current account of DM 38.6 billion or 2% of GNP.

6. Domestic demand grew by 1.7% of which the main components were private consumption, up 1.7%, government consumption, up 2.5% and an increase in inventories of DM 17.1 billion (about 1% of GNP). The increase in private consumption was due partly to a 1% rise in real wages and also to a slight fall in the savings ratio.

7. Cost of living inflation was 2.2% on annual average and real GNP growth was 2.5% (GDP 2.6%). The number of employed was 25.5 million on annual average around 200,000 or 0.8% higher than in 1984. However, the number of unemployed increased by about 40,000 to reach 2.304 million or 9.3%. The number of hours worked declined by 0.8%.

8. With the exception of unemployment, the point of departure for 1986 was therefore favourable with improvements in both internal and external economic conditions. Domestic company profitability had improved and investment plans showed a marked increase particularly in the capital goods sector. The government's budgetary and monetary policies helped to create virtual price stability and lower interest rates. Externally risks remained but there were no signs of a collapse in trading and financial conditions which many had predicted earlier in the year.