UNCLASSIFIED
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC
TO FCO TELNO 3 SAVING OF 28 FEBRUARY 1986. Info all EC Posts, UKDel OECD, UKMis Geneva, all Consulates-General in the Federal Republic, Washington, Tokyo, Vienna.

FEDERAL GERMAN ECONOMY

Summary

1. Falls in mineral oil prices have provided a bonus for the German economy. As a result real GNP should increase by an additional 0.5%. GNP forecasts for 1986 growth are now in the range of 3.5% to 4%.

2. The fall in oil prices has been accompanied by a further fall in inflation (0.9% in February); the joint effects will be to boost private consumption and domestic demand.

3. Helped by a record current account surplus of DM 36.8 billion in 1985, the Deutschemark continues to strengthen against all major currencies.

4. The number of unemployed rose to 10.4% in January but a slow improvement in the labour market seems to be under way.

5. The debate on the private use of the ECU continues.

Detail

6. Expectations about the prospects for higher GNP growth were greatly encouraged during the month as a result of the steep decline in mineral oil prices. If the fall in Deutschemark prices of fuel and heating oil proves to be durable, this year's savings on the oil bill should be between DM 12 and DM 24 billion depending on a number of other factors, particularly the ability to continue to apply energy savings measures. The net effect on the economy should be to increase real GNP by 0.5%. Thus earlier forecasts of 3% real GNP growth have been revised upwards to 3.5% which Stoltenberg has said is likely, although others believe 4% can be achieved.

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7. The effect of oil price reductions will add a further boost to households' disposable incomes which have already seen an increase through the introduction last month of tax cuts worth DM 11 billion. Households' disposable incomes will also receive a further impetus from falling consumer prices (the flash estimate for cost of living inflation in February was 0.9%). Thus private consumption has developed into an important element of economic expansion. At the same time investment in machinery and equipment continues to show strong growth. Investment activity has been stimulated by favourable business expectations and increasing capacity utilisation. All in all, domestic demand has clearly begun to pick up and seems on course to provide an important stimulus in 1986.

8. December's current account figures show a surplus of DM 6.9 billion and over 1985 as a whole the current account surplus totalled DM 38.6 billion. However, as the February Bundesbank report points out, trends on the current account moderated perceptibly on both sides. The lower rate of export growth (increasing by 3% compared with 5.5% a year ago) reflects the slower expansion of world trade in real terms. The depreciation of the Deutschemark against the US dollar has been another significant factor. A correction of the high surplus position on the German current account was thus initiated on the export side and the only reason why this has not made itself more apparent was the sharp drop in prices on the import side. In Deutschemark terms, goods for importing could be bought abroad in December at 6.5% cheaper than a year earlier.

9. As a result of this favourable current account position the Deutschemark strengthened considerably against most other foreign currencies. By the end of February the average value of the Deutschemark was 8% higher than a year ago against the currencies of the major partner countries and 40% against the US dollar. Consequently Deutschemark assets have remained attractive and there has been a heavy inflow of long term foreign funds into Frankfurt. Towards the end of the month Pöhl, President of the Bundesbank, announced that he saw room for a further fall in the US dollar against the Deutschemark.

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