

UNCLASSIFIED
SAVING TELEGRAM

BY BFG.
FROM BONN

FRAME ECONOMIC

TO FCO TELNO 11 SAVING OF 29 AUGUST 1986. Info all EC Posts,
UKDel OECD, UKMis Geneva, all Consulates-General
in the Federal Republic, Washington, Tokyo, Vienna.

FEDERAL GERMAN ECONOMY

Summary

1. The usually quiet August economic scene was dominated by renewed US pressure for a reduction of German interest rates. This pressure had so far been resisted. At its meeting on 28 August, the Bundesbank Council decided to leave German rates unchanged, while holding out the possibility of reconsidering the matter during the round of international economic meetings in September.
2. Bangemann and others claim that the latest economic indicators support the case for refusing to stimulate domestic demand in order to take up the slack of declining US economic growth. Although trade and current account surpluses reached record levels in July, the trend of "real" exports is down and imports up. Continued economic growth, albeit unspectacular, allows Bangemann to argue that West Germany is already doing as much as it can to serve as locomotive to the global economy.
3. Despite the influx of school leavers on the labour market, unemployment rose by only 54,000 to 8.6% - the smallest July increase since July 1979. At the same time the number of employed rose to 25,701 million in May a 100,000 increase on April. The trend in unemployment is now downwards and the annual average for this year looks set to fall by 100,000 on 1985 to 2.2 million.
4. Stoltenberg reaffirmed his intention to reduce direct taxes in the next legislative period.
5. Inflation, cost of living index, in July fell to -0.5%.

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Detail

6. Voluble US criticism of West Germany's failure to stimulate economic demand continued during August culminating in considerable pressure on the Bundesbank to reduce its leading interest rates. Although this pressure was resisted, the Bundesbank Council announced on 28 August that while a reduction of leading rates was inappropriate at the moment the subject could be for further consideration during the round of economic meetings leading up to and including the IMF meeting at the end of September.

7. The US case for West Germany to take up the locomotive role has been refuted by Ministers and officials alike during the month. In early August the Bundesbank Vice-President Schlesinger said that the US request for a loosening of West German monetary policies was based on the lack of information about the latest economic trends. Schlesinger highlighted in particular the shift from foreign to domestic demand. He also reminded critics of German economic policy that when the FRG adopted expansionary fiscal and monetary policies in 1978, the result was a series of current account deficits, a weakened currency and increased inflation.

8. On 27 August Bangemann announced that real GNP grew by between 1.5% and 2% in the second quarter which meant that West Germany was on target for an expansion of 3% real GNP for the whole of 1986. Bangemann argued that the second quarter pick-up was proof that West Germany was already doing as much as it could to serve as a locomotive for the global economy. He said that in the second half of 1986 an annual growth of about 3.5% would be necessary to achieve an outturn of 3% real GNP for the whole year, adding that recent experience showed that growth in the second half is usually better than the first. Bangemann stressed that there was now clear evidence to indicate that domestic demand, particularly corporate investment and private consumption, had taken over from exports as the principal economic motor.