

UNCLASSIFIED
SAVING TELEGRAM

By BAG

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 15 SAVING OF 31 October 1986. Info all EC Posts,
UKDel OECD, UKMis Geneva, all Consulates-General
in the Federal Republic, Washington, Tokyo, Vienna

FEDERAL GERMAN ECONOMY

Summary

1. American pressure for a reduction of interest rates has eased. The month has been dominated in economic terms by the continuing appreciation of the Deutschemark against both the dollar and the Pound and by the publication of the half-yearly report from the five leading economic institutes.
2. The President of the Bundesbank in a speech given in London underlined the need for continued stability in FRG fiscal and monetary policies.
3. Visible trade surplus declined slightly in August to DM 8.1 billion but provisional figures for September show a sharp jump to DM 10.4 billion.
4. Central Bank Money rose in September at an annual rate of 7.5% up on the August figure of 7% and against a target of 3.5% - 5.5%.
5. Inflation, cost of living index, in September stood at -0.4%.
6. Unemployment fell seasonally to 8.2% (2.05 million) in September.

Detail

7. The FRG authorities maintained their resistance to interest rate reductions pointing to the increase in the money supply as a reason in itself why rates should remain as they are (3.5% Discount and 5.5% Lombard). American pressure eased to the point where a US spokesman,

commenting during the visit to Washington by Chancellor Kohl from 20-23 October, was quoted as saying that the US now appreciated the reasons why an increase was not possible. Despite increasing worries about the effect of the high Deutschemark on export performance, there has been no noticeable decrease in domestic support for the authorities' stand. Confirmation of this support came from another source when the five leading economic institutes published on 20 October their half-yearly report on the FRG economy (Bonn telno 14 Saving) which insisted that the German economy is too small to take on the locomotive role allotted to it by the US. Other commentators have pointed out that even when the Japanese economy is taken into account, the combined national products are only half that of the US.

8. In a speech to the German Chambers of Commerce in the UK in London on 20 October, the Bundesbank President spoke of the advantages of membership of the exchange rate mechanism of the European Monetary System. He acknowledged that participation by Sterling in the mechanism could lead to management difficulties but it would "be worth the effort". Pöhl went on to call on the US to finance its current account deficit in an orderly fashion, and defended the FRG trade surplus by pointing out that low oil import prices had caused distortions and that in volume terms the surplus was declining. On the FRG domestic economy, Pöhl said that he was optimistic that the current growth rate could be maintained. He argued that fiscal policy should remain unchanged in the medium term but, pointing to the large growth in money supply, he said that monetary measures would have to be taken if inflation began to look threatening.

9. The report of the five economic institutes generally echoed Pöhl's views although it expressed some concern about the effect of an appreciating Deutschemark on FRG export prospects. These worries need to be viewed against the background that so far this year the moving annual average for the exchange rate of the Pound against the