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SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC

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Our telno 319:

FIVE INSTITUTES' SPRING REPORT.

SUMMARY

1. The Spring Report of the five leading economic institutes was published on 13 April. The institutes are divided in their forecast of growth in the FRG economy in 1987, with three of their number forecasting real growth of 2% and two opting for a minority report putting real growth at no more than 1%. Inflation is forecast to average below 1% over the year. The fall in exports will tail off towards the end of the year but the annual average will nevertheless be 0.5% down on 1986 (-2.5% according to the minority report). Imports will increase by 4%, as will private consumption.
2. The institutes criticise the Government for failing to give details of how the tax cuts promised for 1990 are to be financed. They repeat their call for the proposals to be implemented earlier than planned. There is also criticism of the Bundesbank's monetary policy.
3. The Government's response to the report has concentrated on those aspects which conform to established policy, to emphasise that their overall policies will remain unchanged and to criticise the minority report as being far too pessimistic. Media comment has centred on the general scaling down of the forecasts and has highlighted the call for speedy action on the fiscal front.
4. The degree of disagreement between the institutes is unusual but the general tenor of the report confirms what most authoritative commentators have been saying for some months.

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DETAIL

5. The five leading economic institutes published their forecast for the FRG economy in 1987 on 13 April. The Press had already reported on the unusual lack of consensus among the five institutes (Jenkinson's letter of 10 April to Dolphin, Treasury). The DIW, Berlin, and Ifo, Munich, insisted for the first time ever on the inclusion of a minority report which is markedly more pessimistic than the majority opinion. The main reason behind the differing forecasts is explained in the assessment of the impact of declining competitiveness on exports and the effect this will have on corporate investment. As a result, while Hamburg, Kiel and Essen forecast real growth of 2% in 1987, Berlin and Munich forecast only 1% growth.

ASSUMPTIONS

6. The forecast is based on the following assumptions:

- a) world trade will grow by around 3 per cent;
- b) the US dollar has now fallen to levels similar to those of the early 80's. While it is unlikely to fall further, the overall situation on international exchange markets will remain unstable. EMS rates will remain unchanged;
- c) Oil prices will remain at around \$18 per barrel;
- d) raw material prices will remain low with demand remaining stable and supplies abundant;
- e) monetary growth is likely to be above the Bundesbank's 3%-6% target for the main indicator, Central Bank Money;
- f) State expenditure will increase as planned despite lower revenue. There will be no deviation from current economic policy;
- g) wage agreements will be only slightly lower than last year. In important sectors a shorter working week is likely to be a component of settlements, but this will not come into effect until next year. Major industrial disputes are not expected.

PRIVATE CONSUMPTION

7. Private consumption will continue to provide the main impetus to economic growth. Disposable income will increase by 4 per cent, only slightly less than last year. Private households are expected to devote a higher proportion of their income to consumption this year following the surge in savings last year in the wake of the unexpected fall in oil prices. The decline in interest rates will also dampen the propensity to save and stimulate borrowing. Despite the return to positive rather than negative inflation rates, private consumption is forecast to expand at a similar rate to last year, around 4 per cent.