UNCLASSIFIED
SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC
TO FCO TELNO 8 SAVING OF 30 APRIL 1987. Info. Brussels, Luxembourg, The Hague, Paris, Rome, UKRep Brussels, UKDEL OECD, UKMis Geneva, all Consulates-General in the Federal Republic and West Berlin, Washington, Tokyo, Vienna.

FRG ECONOMY

SUMMARY

1. The Spring Report of the five leading economic institutes was published on 13 April and revealed a sharply differing assessment of economic performance this year. All five institutes agreed that the current downturn in economic activity is temporary but two of them believed that the resumption would not appear until the end of this year. As a result three institutes forecast growth in real GNP of 2% while two opted for 1%. All five institutes agreed on the need for the early introduction of fiscal stimulus for the economy.

2. Despite a small improvement in the business climate indicator for March, underlying industrial confidence remains weak. Capacity utilisation fell back slightly in March to 83.6% from 84.7% in February. The capital goods sector suffered from weak domestic demand, particularly for mechanical and electrical engineering goods, brought about by the continued fall in investment. Production prospects in the medium term are uncertain, as are sales and profits prospects.

3. The Cabinet approved the addition of DM 5.2 billion net tax relief to the DM 9.2 billion already programmed to come into force on 1 January 1988. Discussion continued on how the larger package planned for 1990 should be financed but the Government reiterated its intention not to be diverted from the policy of budgetary consolidation. Nevertheless, new projections for Federal debt indicate that the Federal budget deficit will grow to DM 33 billion in 1990.

4. The new round of budgetary negotiations began with indications that the Government wishes to restrict the growth of Federal spending to 2%-2.5%. Figures for the outturn of the general public sector budget last year record that expenditure grew by 3.7% against an increase in revenue of 3.3%. Municipal spending increased strongly by 5.6%, mainly on social assistance and capital investment.

5. Seasonally adjusted unemployment rose to 2.23 million in February from 2.19 million in January. Employment fell on a monthly basis by 125,000 but grew over the same period last year. Employers and the trade union in the metalworking industry reached a significant agreement about pay increases and working hours. The three-year agreement means that wages and salaries will rise in each of the three years and that weekly working hours will fall to 37 in 1989.

6. Inflation, cost of living index, rose to minus 0.2% in March after minus 0.5% in February.

7. New orders rose by 2% in February with domestic demand up 4% but foreign demand down 1.5%. The signals from the construction sector continue to confuse. Activity increased by 19% in February following poor performance during the winter but demand appears still to be falling. Capacity utilisation fell to 44%.

8. The current account surplus reached DM 6.6 billion in February after DM 4.8 billion in January. The surplus on visible trade was DM 10.4 billion but compared to the previous year the surplus is now falling in both nominal and real terms.

9. Central Bank Money grew in March by 7.25%, above the target range of 3%-6%. All other monetary indicators also rose.

DETAIL

10. The Easter break was preceded by renewed intensive debate about the direction of the economy and whether, and if so when, stimulative fiscal measures needed to be introduced. This interest was occasioned by the issue on 13 April of the Spring Report of the five leading economic institutes (our telno 7 Saving of 23 April). For the first time the report revealed a sharply differing assessment among the institutes of economic performance over the year. Three institutes forecast growth in real GNP of 2% while two of their number opted for 1% real growth. The main cause of the dispute was the performance of foreign trade and its effect on domestic production. The institutes of Kiel, Essen and Hamburg said that they believed that exports would drop by 0.5% in real terms over the year but that the fall would tail off towards the end of the year as German industry adjusted to the high D-Mark and took advantage of the turnaround in economic activity in industrial countries. Munich and Berlin disagreed, however, because in their opinion growth in the world economy of around 3% would be insufficient to turn around until late in the year a German export industry still suffering from the effects of the high value currency. In their assessment exports will fall by a real 2.5% over the year as a whole and imports will grow by 3%. Capital and corporate investment will suffer as a result and what investment does take place will only help to draw in greater volumes of imports. All institutes agreed that the Government needed to take action to stimulate the economy by bringing in, earlier than the planned dates of 1988 and 1990, some of the measures to reduce the tax burden.

11. Confidence within industry, which has taken a heavy knock in recent months, appears to remain weak, although investment from both domestic and foreign sources on the stock exchanges has been generally more positive during the month. In particular, export dependent stocks such as automobile manufacturers have been firmer. Nevertheless the main industrial organisation, the BDI, has continued to voice concern about industrial performance and have said privately that they lean towards the Munich and Berlin view of economic development. They too support the call for the early implementation of fiscal stiumulus for the economy, although they naturally favour an emphasis on relief for the business sector. Various industrial surveys carried out by the Ifo Institute in Munich have given

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