

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC

TO FCO TELNO 9 SAVING OF 29 MAY 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. With the debate in the Bundestag on the Government's Annual Economic Report came revised Government projections of growth in real GNP of around 2% in 1987. Unemployment is expected to fall only slightly to 2.2 million (9%) and inflation is forecast to average 0.5%.
2. There is uncertainty over the some of the components of growth. Construction activity dropped 24% in March and expectations are weak. Investment in machinery and equipment low with new orders in the capital goods sector in March falling by 7.5% over a year earlier. Overall domestic new orders fell by 3% in March while foreign new orders also weakened by 2%. Provisional production figures show a 3% fall in March over a year earlier.
3. Seasonally adjusted unemployment rose in April by 30,000 over March to 2.231 million (8.8%) but remained below the figure of 2.244 million in April last year. The head of the Federal Labour Office warned of a pause in the improvement in the labour market and speculated that unemployment will remain above 2.15 million this year.
4. The Federal Finance Minister has resisted calls to bring forward the tax reduction programme and also reiterated the Government's intention to continue its policy of reducing the tax burden while maintaining budgetary consolidation. The Federal budget deficit is expected to grow to something over DM 30 billion in 1990 before falling again. Tax cuts with a net value of DM 44.4 billion in the period to 1990 will be financed by adjustments to special tax reliefs and increases in certain consumption taxes. Working Group on Tax Revenue estimated that General Government tax receipts in 1987 will be DM 9.8 billion lower than expected at DM 468.5 billion. Estimates to 1991 also scaled down.
5. Current account surplus in March totalled DM 8.8 billion, over twice that in March last year. The March visible trade surplus was DM 10 billion to bring the provisional total for the first quarter to DM 27.8 billion, up from last year's figure of DM 22.6 billion. Exports in March fell 2% month on month while imports rose by 4.5%.

6. All monetary aggregates accelerated sharply in April with Central Bank Money rising by 7.8%. There was criticism of the Bundesbank's adherence to the policy of sustaining interest rates at their current levels despite a lowering of the rate for securities repurchase agreements from 3.8% to a minimum tender rate of 3.5%. Interest rates, yield on bonds outstanding, eased to a monthly average of 5.3% in May.

7. Inflation, cost of living index, in April rose by 0.1% to produce the first positive inflation figure for thirteen months.

Detail

8. The pace of the budgetary cycle warmed up during the month with the issue of revised Government forecasts of the development of the economy, the biennial tax revenue projection and further details of the likely consequences of the tax reform proposals. The revised forecasts were hinted at by the Federal Economics Minister, Dr Martin Bangemann, during the debate in the Bundestag at the beginning of the month on the Government's Annual Economic Report for 1986. The debate had been delayed by the Federal Elections and the ensuing coalition negotiations. Opening the debate on 6 May, Dr Bangemann admitted that earlier forecasts of economic growth above 2.5% were unlikely to be met. He claimed, however, that there was no danger of a downturn in economic activity and said that half a percentage point more or less was not a decisive factor. Bangemann blamed the lower than expected growth on the rise in the value of the D-Mark which he said had appreciated against the US dollar by 8% in two years. In reply, the Opposition ridiculed the Annual Economic Report as being not worth the paper it was printed on and accused Bangemann of blind optimism in saying when it was issued at the beginning of the year that 1987 would be a year of growth and economic achievement. Soon after, however, the Government issued its official assumptions for economic development over the coming five year period. This data is formulated annually by the Ministry of Finance and issued to participants in the Working Group on Tax Revenue to enable them to draw up revenue projections (see para. 13 below). The revised figures put growth in real GNP at 1.8% to 2% in 1987. Unemployment was forecast to fall by only 30,000 during the year to 2.2 million, with the annual average rate remaining at 9% instead of falling to 8.5%. On the brighter side, the Ministry said that it then expected unemployment to begin falling again in the following years to reach 1.8 million in 1991. The number of employed will continue to rise during 1987 but at a slower rate than envisaged in the Annual Economic Report, to end the year 130,000 higher rather than 250,000. Inflation was predicted to increase by 0.5%.

9. Growth of something under 2% now appears to becoming the consensus figure. The Government's revised figures were followed by the issue of a new OECD forecast for the FRG which put real GNP growth in the range of 1.5% to 2% for 1987. Many of the leading economic institutes as well as economic analysts in commercial finance support that range, but there is less agreement on how the various components of growth will perform. While many argue, for example, that construction activity will become a dominant factor this view was not helped by March production figures which indicated that construction output had tumbled by 24%. The President of the Construction Industry has warned of weak demand and revised downwards his forecast of growth in that sector to a 2% real increase in 1987.

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