

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC

TO FCO TELNO 20 SAVING OF 31 DECEMBER 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 Government announced a package of measures to stimulate investment and growth, the most important element of which was the offer of DM 16 billion in subsidised investment credits for municipal authorities to employ for urban renewal, transport infrastructure and environmental projects. Similar low cost loans to the value of DM 6 billion are to be made available to small and medium sized businesses. Some liberalisation and privatisation was also envisaged for the public and retail sectors. Many commentators have questioned the economic effects of the measures and there has been criticism that they lean too much towards the public sector.
2. Following reductions in leading interest rates in November, the Bundesbank, concerned at the effect on monetary growth and inflation, reluctantly cut the official Discount Rate by 0.5% to 2.5%, the lowest in post-war history. The move did not take pressure off the dollar which by the end of the month had reached a new low-point in Frankfurt of DM 1.5815.
3. Provisional third quarter GNP statistics indicate a real rise in exports of 0.6% compared with a year earlier, imports up 4%, domestic demand up 2.5%, private consumption up 3.2% and GNP up 1.4%. Growth continued to affect the labour market with employment up by 124,000 to 26.02 million but unemployment also up by 42,000 to 2.15 million. Capacity reductions were announced for the coalmining and steel industries, causing mass demonstrations in the Ruhr.
4. End-year forecasts by the leading economic institutes show the extent of the reduction in expectations which has taken place over the year. The consensus is for GNP growth around 1.5% in 1988 but many are more pessimistic. The Government has itself lowered its forecast and now predicts growth of between 1.5% and 2%. It is generally believed that the decline in stock values will have little effect on economic activity in Germany but that continued disturbance on the foreign exchanges will. The Ifo business climate survey for November fell slightly mainly because of the expected stagnation of exports.
5. New orders fell by 1% in October with overseas new orders declining by 2.5%. On a two-monthly comparison, however, foreign demand remained high. Production rose by 1% in October as capital

goods rose and the construction sector recovered some ground, rising by 1.5%. Unadjusted unemployment rose to 2.13 million (8.5%) in November but fell slightly when adjusted. Seasonally adjusted employment rose by 120,000 to 25.97 million, mainly in the services sector. Inflation, cost of living index, rose by 1% in November to bring the moving annual average up to 0.3% which is likely to be the outcome for 1987 as a whole.

6. The current account surplus fell in October to DM 6.9 billion to bring the accumulated nominal surplus for the first ten months to DM 59.9 billion, DM 1.1 billion lower than in the same period last year. The visible trade surplus also fell to DM 10.1 billion to bring the accumulated nominal surplus to DM 93.6 billion. In real terms this is a significant fall over the DM 90.8 billion recorded for the same period last year.

7. Monetary growth continued to be high in November with Central Bank Money rising by 8.2%, M3 by 6%, M2 by 5.5% and M1 by 8.5%.

DETAIL

8. The domestic economic debate moved on a stage at the beginning of December with the adoption of a DM 21 billion investment credit programme, further reductions in official interest rates, the release of third quarter GNP figures and developments in the steel and coalmining industries. Cabinet agreement to a stimulatory package, including the investment credit measures, followed a three hour Ministerial meeting on 1 December in which the Federal Ministers of Finance, Economics and Labour took part. The full package contained proposals to liberalise the postal and telephone services and to introduce some relaxation in the strictly controlled retail shopping hours; details of the Government's 1988 privatisation programme which will raise DM 2.5 billion; and a reaffirmation of the Government's willingness to accept a higher public sector deficit and not to attempt to lower it by cutting spending or raising taxes. Greatest attention focussed on the most tangible element of the package, the introduction of a three-year programme of investment loans at favourable interest rates starting in 1988. The loans will be made available through the state-owned Kreditanstalt für Wiederaufbau (Reconstruction Loan Corporation) with the Government covering the difference between the special interest rates and normal capital market rates. DM 15 billion of the loans are earmarked for municipal investment in urban renewal projects, transport infrastructure and the environment with the remaining DM 6 billion available to small and medium-sized industries. The cost to the Government of subsidising the loans is estimated to be DM 2.6 billion spread over 10 years.

9. The Government presented the package as a major contribution to stimulating the domestic economy. The Federal Economics Minister claimed that it would push growth in real GNP next year up to 2%. Nevertheless, reaction to the measures has been generally negative with few commentators able to claim more than that their introduction is a small step in the right direction. Doubt has also been thrown on the actual economic effect of the package. It has been pointed out that it depends entirely on the amount of loans taken up. Many