

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC

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Luxembourg, The Hague, Paris, Rome, UKRep Brussels,
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FRG ECONOMY

SUMMARY

1. The Federal Finance Minister admitted that Federal borrowing in 1988 will amount to DM 40 billion because of reduced Bundesbank profits caused by the decline in the dollar, and additional payments to the EC for which no provision was made in the budget. Stoltenberg warned that consumer taxes would have to rise in 1989 to reduce borrowing by DM 10 billion. The admission prompted widespread criticism and has once again harmed Stoltenberg's reputation for prudent fiscal management.
2. In response to a gloomy New Year statement by the Federal Economics Minister, Bangemann, apparently calling for a change in economic policy, Chancellor Kohl denied that additional stimulus was required and forecast growth of 1.5% to 2% this year. Predictions by leading figures in other organisations suggest a range 0.5% lower. Worries about public sector investment and fixed capital formation have resurfaced.
3. Stoltenberg presented the detailed draft programme of measures to implement a net DM 20.6 billion tax reduction programme in 1990. Gross tax cuts will total DM 39.5 billion to be partly offset by changes in 45 separate corporate and personal tax reliefs and regional incentives plus the introduction of a 10% withholding tax on certain savings and investments (excluding DM Eurobonds issued outside Germany).
4. The Bundesbank cut the rediscount quota by DM 6 billion to DM 46.7 billion, a move seen as a slight tightening of monetary policy following the December reduction in the Discount Rate to 2.5%. It later also announced a target range of 3% to 6% for monetary growth in 1988 but changed the targetted aggregate from Central Bank Money to the more broadly defined M3.
5. The terms of reference for the newly established Franco-German Economic and Finance Council were announced at the Summit in Paris on 22 January. The Bundesbank expressed irritation that it had not been consulted about the Council and saw a possible threat to its constitutional autonomy.

6. GNP in 1987 grew by 1.7% in real terms according to provisional statistics. Private consumption rose by 3%, Government consumption by 1.5%, investment in machinery and equipment by 4.2% and domestic demand by 2.9%. Construction investment fell by 0.4%. Exports rose by 0.3% in real terms and imports rose by 4%. The visible trade surplus rose in nominal terms to DM 117.55 billion but fell in real terms by 17.7% compared to 1986. The Government's Annual Economic Report forecasts growth of 1.5% to 2% in 1988 but lower than expected private consumption and little change in unemployment. No policy initiatives are planned to boost the economy further.

7. Public spending increased by 2.9% in 1987 to DM 269.1 billion. Revenue rose by 1.26% to DM 241.6 billion giving an increased Federal Budget Deficit for the year of DM 27.6 billion.

8. The Ifo business climate survey for December recorded a sharp fall mainly based on poor export expectations. New orders in November fell by 3% on a two-monthly comparison with domestic orders down 4% and foreign demand down 2.5%. Industrial output in November was unchanged.

9. Inflation, cost of living index, in December reached 1% but the average for 1987 as a whole was only 0.2%.

10. Unadjusted unemployment rose sharply in December to 2.3 million (9.2%) to give a practically unchanged annual figure of 2.228 million. Employment improved by 150,000 over the year as a whole.

11. The current account surplus in November rose to DM 10.3 billion, to give an accumulated surplus of DM 70.5 billion, and the visible trade surplus reached DM 11 billion, giving a cumulative total of DM 104.6 billion. Exports grew by 8% compared to a year earlier while imports rose by 8.5%. Figures just released for December confirm a surplus on current account for the month of DM 8.9 billion and on visible trade of DM 12.99 billion.

12. Monetary growth weakened in December. In H2, M3 rose at a seasonally adjusted annual rate of 5%. M2 grew 6% on the year while M1 rose by 8%.

DETAIL

13. For the Federal Finance Minister, Stoltenberg, the new year started as did 1987, with a questionmark over his handling of the economy. In the face of mounting rumours about low Government revenue and increased expenditure, he was forced to announce a higher than expected Federal Budget Deficit for 1988 of DM 40 billion, a post-war record and over DM 10 billion higher than allowed for in the budget which had been approved by Parliament only days earlier. The deficit outturn for 1987 was also higher than forecast at DM 27.5 billion. Stoltenberg blamed the 1988 figure on a forecast shortfall of approximately DM 6 billion in the contribution to Government revenues from the profits made by the Bundesbank on dollar denominated investments, caused by the depreciation of the dollar. He also said that Germany would have to contribute an additional DM 4 billion to the EC this year for which no provision had been made. Stoltenberg warned that a supplementary budget would be introduced in