UNCLASSIFIED
SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC
TO FCO TELNO 03 SAVING OF 29 FEBRUARY 1988. 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 labour market dominated the agenda in February. Chancellor Kohl hosted a conference of Ruhr steel and mining unions and employers in Bonn on 24 February called to agree a package of measures to ease the social consequences of restructuring in these industries. The final package of DM 1 billion in retraining assistance and encouragement for investment projects achieved the objective but the practical effects are uncertain. Unemployment in January rose to 2.5 million unadjusted (9.9%) or 2.2 million seasonally adjusted. Most analysts remain gloomy about the labour market this year.

2. The Government continues to be optimistic about the economy claiming that the industrial climate is improving, domestic demand remains high and there is no threat to price stability. Other reports are mixed with some indication of confidence about exports but concern about investment. The Ifo business survey for January recorded some upturn in the business climate but a DIHT survey of 14,000 firms revealed that 20% expected some improvement in prospects, 51% foresaw no change and 29% feared a worsening. Pressure on the Government from industry has eased for the moment but the next two months or so will be an important test of industrial confidence.

3. Provisional new orders for December fell by 3% compared with November with the domestic sector down by 4%. Foreign orders slipped by 1%. Production in December increased by 0.5% compared with November but construction activity fell by 2.5%.

4. Inflation, cost of living index, rose by 0.2% in January compared with a month earlier to give an annual rate of 0.7%. Retail trade turnover rose in December by 2.2% in real terms compared to a year earlier.

5. The current account surplus in December fell back to DM 9 billion from DM 9.6 billion in November to give a year-end surplus of DM 79.5 billion. The visible trade surplus reached DM 13 billion in December to total DM 117.5 billion for the year as a whole. In real terms the trade surplus fell by DM 8 billion to DM 45 billion.

6. The newly targetted M3 rose by 6% in January compared to a year earlier, the top of the target range. Over the last six months M3 has risen by 6.5% at a seasonally adjusted annual rate. M2 rose by 5.5% in January and M1 by 8.5%.

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7. February was dominated by developments in the labour market. In the public debate concerning the economy it now seems to be accepted that low domestic growth in the short term is unavoidable, and not necessarily a bad thing. The fiscal stimulus provided by the programme of tax reduction is generally considered to be the limit to which the Government can influence medium term economic development without jeopardising price stability. There is a growing acceptance among economists that progress in the long term is dependent on structural change, though there is no consensus as to the form this should take, nor how the Government might take it forward. It is, however, recognised that part of the process must include restructuring and job losses in industries such as steel and coal. In this respect opinion among economists is moving ahead of the political debate and public opinion, which are not yet prepared to tolerate any reduction in what are seen as the State's obligation to provide a comprehensive social security net or, as workers in the affected industries would like, job security. As already reported, capacity reductions in the steel industry announced in January, which would have meant the loss of some 70,000 jobs, led to mass unrest in the Ruhr. The Government responded by calling a conference in Bonn of delegates from the coal and steel employers, the unions and Government to discuss assistance for the region.

8. The conference took place on 24 February. In the run up to it the DGB (TUC equivalent) kept up the pressure on the Government with a programme of protests against Government policy. In five hours of discussion the conference agreed the provision of DM 1 billion to be spent on retraining and alternative employment measures for the Ruhr. Of this, DM 400 million will be contributed by the Federal authorities, DM 500 million will come from the Land and DM 100 million will be found from EC funds. In addition, investment by the Bundespost and the Federal Railways will be increased and the Federal Transport Ministry will encourage investment in transport infrastructure. The Rhine port of Duisburg will be accorded the status of a free port and the plans to site the proposed Federal Space Agency in the region were announced. The agreement allows all sides to claim progress. The Government, hemmed in by spending constraints, has got away with minimal financial commitment yet it has been seen to stand by its social responsibilities; the unions have displayed to their membership that they are prepared to fight to "save" the industries; and the employers are now free to continue with their rationalisation plans. The social partnership has demonstrated its effectiveness. The practical effect is more difficult to assess. The space agency site appears to have been tacked onto the agreement at the whim of the Chancellor. It will make little contribution to the Ruhr economy, if any. It is to be sited in Bonn, 100 km from Duisburg, and its staff will be drawn mainly from existing organisations. The claimed additional investment on transport and by the Bundespost appears to be a rehash of existing projects.

9. Developments in the Ruhr coincided with a period of unrest, still not resolved, among public sector workers stemming from a claim for a 5% wage increase and a shorter working week. Employers responded by rejecting a reduction in hours and offering wage rises of only 1.3%. When this resulted in a series of warning strikes on public transport they threatened to stop the wages of those involved. The dispute has now gone to arbitration and the Government will hope that it does not become another running sore in industrial relations.