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FRAME ECONOMIC

FRG ECONOMY: MONTHLY REPORT FOR MAY

SUMMARY

1. GOOD FIRST QUARTER RESULTS EXPECTED TO BE RELEASED ON 1 JUNE BUT FORECASTS FOR THE YEAR AS A WHOLE REMAIN LOW. CONTINUED CONCERN OVER THE LEVEL OF INVESTMENT. GOVERNMENT PLANS TO RAISE CONSUMER TAXES IN 1989 HEAVILY CRITICISED AND CONCERN EXPRESSED MORE GENERALLY ABOUT THE MANAGEMENT OF FISCAL POLICY. FEBRUARY VISIBLE TRADE SURPLUS DOWN TO DM 8.2 BILLION. MONEY SUPPLY CONTINUES TO GROW WELL ABOVE TARGET RANGE. REPLACEMENT FOR THE FEDERAL ECONOMICS MINISTER, WHO HAS DECLARED HIS CANDIDACY AS A EUROPEAN COMMISSIONER, NOT EXPECTED TO BE NAMED UNTIL TOWARDS THE END OF THE YEAR.

DETAIL.

2. THE ECONOMY CONTINUES TO GIVE MIXED SIGNALS. FIRST QUARTER GROWTH FIGURES, DUE TO BE RELEASED ON 1 JUNE, ARE EXPECTED TO INDICATE GROWTH IN REAL GNP WELL IN EXCESS OF THE 2 PERCENT NOW GENERALLY FORECAST FOR THE YEAR AS A WHOLE - UP TO 4 PERCENT ACCORDING TO SOME ASSESSMENTS. PRIVATE CONSUMPTION AND BUILDING INVESTMENT ARE FORECAST TO HAVE BEEN PARTICULARLY STRONG, THE LATTER BECAUSE OF THE GENERALLY MILD WINTER. IN ITS LATEST MONTHLY REPORT THE BUNDESBANK SAID THAT THERE WERE INDICATIONS THAT DEMAND AND PRODUCTION HAD BOTH BEEN HIGH. THE SECTOR GIVING THE GREATEST CAUSE FOR CONCERN IS MACHINERY AND EQUIPMENT INVESTMENT. IN A REPORT PUBLISHED IN THE MIDDLE OF THE MONTH, THE DIW ECONOMIC INSTITUTE IN BERLIN FORECAST THAT THE FIGURES WOULD SHOW NO GROWTH IN THIS SECTOR. THIS HAS TEMPERED THE MOOD OF OPTIMISM OTHERWISE ENGENDERED BY THE EXPECTED DATA AND FEW ANALYSTS HAVE DARED TO REVISE UPWARDS THEIR FORECAST FOR THE YEAR AS A WHOLE.

3. THE FEDERAL FINANCE MINISTER ANNOUNCED THAT ON 7 JULY THE CABINET WOULD TAKE THE FINAL DECISIONS REGARDING THE SUPPLEMENTARY BUDGET FOR THIS YEAR, THE DRAFT BUDGET FOR 1989 AND THE PROPOSED INCREASES

IN CONSUMER TAXES. THE SUPPLEMENTARY BUDGET HAS BEEN MADE NECESSARY BECAUSE OF HIGHER EC PAYMENTS THAN ALLOWED FOR AND BY A HIGHER THAN EXPECTED FEDERAL BUDGET DEFICIT - DM 40 BILLION INSTEAD OF DM 30 BILLION ACCORDING TO GOVERNMENT ESTIMATES. THE PROPOSED INCREASES IN CONSUMER TAXES ARE INTENDED PARTLY TO OFFSET THE INCREASED DEFICIT. THE OPPOSITION HAS CLAIMED TH AT THE FEDERAL FINANCE MINISTER HAS ALREADY HELD TALKS WITH THE OIL INDUSTRY AND THAT INCREASES IN THE TAXES ON PETROL AND HEATING OIL, AS WELL AS THAT ON GAS, HAVE ALREADY BEEN AGREED. THE GOVERNMENT HAS DENIED THESE CLAIMS. BUT ONCE AGAIN THE GOVERNMENT'S HANDLING OF ITS FISCAL PROGRAMME HAS BEEN HEAVILY CRITICISED. THE PROPOSED CONSUMER TAX INCREASES, WHERE EVER THEY ARE APPLIED, ARE EXPECTED TO DAMPEN CONSIDERABLY THE STIMULATIVE EFFECTS OF THE THIRD STAGE OF THE TAX REFORM PROGRAMME - WORTH DM 20.4 BILLION IN NET RELIEF - SCHEDULED FOR IMPLEMENTATION IN JANUARY 1990. IN ADDITION, THE PLANNED INTRODUCTION OF A 10 PER CENT WITHHOLDING TAX ON CERTAIN SAVINGS AND INVESTMENTS HAS CONTINUED TO MEET WITH ALMOST UNIVERSAL CONDEMNATION, TOGETHER WITH THE GOVERNMENT'S APPARENT INABILITY TO GET TO GRIPS WITH A MUCH NEEDED REFORM OF CORPORATE TAXATION. THE GOVERNMENT'S RESPONSE TO THIS CRITICISM HAS APPEARED WOODEN AND UNIMAGINATIVE.

4. UNLESS ACTION IS TAKEN SOON IT IS DIFFICULT TO SEE HOW THE GOVERNMENT WILL GET OUT OF THE FISCAL DILEMMA WITH WHICH IT IS FACED. ITS OWN FINANCIAL PLANNING COUNCIL AND THE TAX ESTIMATES COMMITTEE ARE REPORTED TO HAVE FORECAST GROWTH OF ONLY 2 PER CENT REAL GNP THIS YEAR AND NEXT YEAR. AT THAT LEVEL THE LOSS IN TAX REVENUE ALONE IS ESTIMATED AT DM 40 BILLION IN THE PERIOD UP TO 1992. FEDERAL SPENDING IS PLANNED TO INCREASE BY 2.5 PER CENT ANNUALLY BUT THE GOVERNMENT IS LIKELY ONCE AGAIN TO BE FACED WITH SPENDING INCREASES BY THE LAENDER WELL IN EXCESS OF THAT. THEREFORE, WHILE THE GOVERNMENT HOPES TO REDUCE THE FEDERAL BUDGET DEFICIT TO DM 27 BILLION BY 1992, THE GENERAL GOVERNMENT DEFICIT, WHICH STOOD AT DM 48 BILLION IN 1987, OR ALMOST 2.5 PER CENT OF GNP, WILL PROBABLY CONTINUE TO INCREASE.

5. GERMANY'S FOREIGN TRADE BALANCE HAS CONTINUED TO IMPROVE. FIGURES RELEASED FOR FEBRUARY INDICATE A RISE IN IMPORTS OF 5 PER CENT COMPARED TO A YEAR EARLIER, WHILE EXPORTS FELL BY 1.6 PER CENT. THE SURPLUS ON VISIBLE TRADE FELL TO DM 8.2 BILLION COMPARED TO DM 10.4 BILLION IN FEBRUARY LAST YEAR. THE SURPLUS ON CURRENT ACCOUNT ALSO FELL TO DM 9.8 BILLION FROM DM 12.2 BILLION LAST YEAR. BECAUSE OF DIFFICULTIES WITH THE SINGLE ADMINISTRATIVE DOCUMENT NO DETAILED TRADE STATISTICS HAVE BEEN ISSUED SINCE DECEMBER. THE FEDERAL STATISTICAL OFFICE HAVE TOLD US THAT FIGURES ARE NOT EXPECTED TO BE

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AVAILABLE UNTIL MID-JUNE AT THE EARLIEST.

6. THERE WERE NO CHANGES TO MONETARY POLICY DURING THE MONTH. DESPITE CONTINUED RUMOURS IN FRANKFURT OF PRESSURE ON THE BUNDESBANK TO RAISE INTEREST RATES, SECURITIES REPURCHASE TRANSACTIONS CONTINUED AT 3.25 PER CENT AND THE DISCOUNT AND LOMBARD RATES REMAINED AT 2.5 PER CENT AND 4.5 PER CENT RESPECTIVELY. YIELDS ON BONDS OUTSTANDING ROSE TO 6.1 PER CENT FROM 5.75 PER CENT IN APRIL. MONETARY GROWTH CONTINUED TO BE STRONG. M3 EXPANDED BY 7.3 PER CENT, WELL OUTSIDE THE TARGET RANGE OF 3 PER CENT TO 6 PER CENT

7. AS HAS ALREADY BEEN REPORTED (OUR TELNO 476 NOT TO ALL) THE FEDERAL ECONOMICS MINISTER, BANGEMANN, ANNOUNCED HIS INTENTION TO RESIGN AND TO STAND AS CANDIDATE FOR THE EUROPEAN COMMISSION. HIS DEPARTURE MEANS THAT THE LIBERAL FDP PARTY WILL HAVE TO FIND A NEW PARTY CHAIRMAN AND CHANCELLOR KOHL WILL HAVE TO FIND A NEW ECONOMICS MINISTER. VARIOUS HATS HAVE BEEN THROWN INTO THE RING FOR BOTH JOBS AND THERE HAS BEEN SOME SPECULATION THAT THE ECONOMICS MINISTRY MAY PASS OUT OF FDP HANDS. A DECISION IS UNLIKELY UNTIL TOWARDS THE END OF THE YEAR.

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