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FRAME ECONOMIC

FRG ECONOMY: MONTHLY REPORT FOR JUNE

SUMMARY

1. FISCAL POLICY CONTINUES TO CAUSE THE GOVERNMENT DISCOMFORT. INCREASES IN TAXES ON PETROL, HEATING OIL, TOBACCO AND INSURANCE PREMIUMS PROPOSED FOR 1989 ARE DEEPLY UNPOPULAR. THE TAX REFORM PACKAGE FOR 1990 CONTINUES ITS TROUBLED COURSE THROUGH PARLIAMENT. APPROVAL BY THE BUNDESTAG GAINED DESPITE DISAFFECTION AMONG GOVERNMENT SUPPORTERS. BUNDES RAT APPROVAL THREATENED BY INTRA-COALITION ARGUMENTS ABOUT THE BURDEN OF SOCIAL WELFARE. CRUCIAL MEETING OF PARTY LEADERS TODAY.

2. INTEREST RATES INCREASED. BUNDESBANK DISCOUNT RATE RAISED FROM 2.5 PERCENT TO 3 PERCENT. HAVING ALREADY RISEN ONCE DURING THE MONTH, THE INTEREST RATE ON SECURITIES REPURCHASE TRANSACTIONS WILL GO UP AGAIN ON 5 JULY TO 3.75 PERCENT FROM 3.25 PERCENT AT THE BEGINNING OF JUNE.

3. MAY UNEMPLOYMENT FELL TO 2.15 MILLION UNADJUSTED (8.4 PERCENT) BUT REMAINS HIGHER THAN LAST YEAR. EMPLOYMENT IN APRIL CONTINUED TO IMPROVE BUT AT A SLOWER RATE THAN IN THE FIRST QUARTER WHEN HIGHER THAN EXPECTED GROWTH BOOSTED EMPLOYMENT. PROVISIONAL FIGURES RELEASED FOR Q1 INDICATED ANNUAL GROWTH OF 4.2 PERCENT REAL GNP. THE STATISTICS WERE INCOMPLETE AND ARE LIKELY TO NEED SUBSTANTIAL REVISION. FEW EXPECT THEM TO LEAD TO ANY SUBSTANTIAL INCREASE IN ECONOMIC ACTIVITY OVER THE YEAR AS A WHOLE. A BUNDESBANK ANALYSIS OF THE FIGURES REPORTED THAT 3 PERCENT REAL GROWTH WAS INDICATED BUT EVEN GOVERNMENT FORECASTS HAVE NOT GONE BEYOND A CAUTIOUS 2 PERCENT TO 2.5 PERCENT.

DETAIL

4. TAX REFORM CONTINUES TO DOMINATE THE ECONOMIC AGENDA. THE COALITION ANNOUNCED ON 10 JUNE DETAILS OF ITS PLANS TO RAISE

CONSUMER TAXES IN 1989. THE INCREASES COVER LEADED AND UNLEADED PETROL, VEHICLE TAX, THE TAXES ON HEATING OIL AND TOBACCO AND THE TAX ON INSURANCE PREMIUMS (EXCLUDING LIFE AND HEALTH INSURANCE). THE INCREASES ARE EXPECTED TO RAISE FEDERAL REVENUES BY AT LEAST DM 6.02 BILLION IN 1989 RISING TO AN ADDITIONAL DM 7.59 BILLION IN 1992. IN ADDITION, THE GOVERNMENT ANNOUNCED THAT TO HELP THE BUDGET OF THE FEDERAL LABOUR INSTITUTE, WHICH IS RESPONSIBLE FOR ALL PAYMENTS OF UNEMPLOYMENT BENEFIT AND THE ADMINISTRATION OF TRAINING, AND WHICH IS FORECAST TO RUN INTO DEFICIT BY UP TO DM 5.1 BILLION NEXT YEAR, UNEMPLOYMENT INSURANCE CONTRIBUTIONS WILL BE INCREASED, PAYMENT PERIODS WILL BE SHORTENED AND AN ADDITIONAL DM 1 BILLION WILL BE FOUND FROM FEDERAL FUNDS.

5. PUBLIC OPINION POLLS SHOW UP TO 90 PERCENT OF THE ADULT POPULATION EXPECTING TO BE WORSE OFF UNDER THE TAX AND BENEFIT MEASURES. THE PACKAGE HAD BEEN WIDELY TRAILED BEFOREHAND, WHICH APPEARS TO HAVE HAD THE EFFECT OF LIMITING MEDIA ANALYSIS POST-ANNOUNCEMENT. BUT THE MEASURES ARE DEEPLY UNPOPULAR AND HAVE LED TO RENEWED SPECULATION ABOUT THE FUTURE OF THE FEDERAL FINANCE MINISTER. THE DISTINCTION BETWEEN THE 1989 INCREASES AND THE 1988 AND 1990 DECREASES IS NOT CLEAR TO THE PUBLIC: NOR IS THE INTER-RELATION BETWEEN THE VARIOUS COMPONENTS OF TAX REFORMS. THE GOVERNMENT HAVE ACHIEVED THE RARE FEAT OF ALIENATING PEOPLE BY REDUCING TAXES. UNFAVOURABLE COMPARISONS HAVE BEEN MADE PUBLICLY WITH CURRENT PROPOSALS TO INCREASE THE FUNDING GIVEN TO POLITICAL PARTIES FROM THE PUBLIC PURSE AND WITH ASPECTS OF THE 1990 TAX REDUCTION PACKAGE WHICH ARE SEEN TO FAVOUR THE WELL-OFF.

6. THAT PACKAGE RECEIVED ITS FINAL EXAMINATION BY THE LOWER HOUSE, THE BUNDESTAG, ON 23 JUNE. IN ILL-TEMPERED DEBATES AND AMID SCENES OF UTTER CONFUSION, THE PACKAGE WAS PASSED WITH A 47 VOTE MAJORITY. DURING NO LESS THAN NINE ROLL CALL VOTES, ONE OF THE MOST CONTROVERSIAL AND PARADOXICALLY FISCALLY UNIMPORTANT MEASURES, THAT GRANTING TAX RELIEF ON FUEL FOR PRIVATE AIRCRAFT PILOTS, SCRAPPED THROUGH WITH A SEVEN VOTE MAJORITY. THIS MEASURE HAD BEEN FORCED ON THE COALITION BY THE BAVARIAN MINISTER-PRESIDENT, STRAUSS, HIMSELF A KEEN PILOT. IT REMAINS THE SUBJECT OF MUCH WRY HUMOUR. STRAUSS'S OBJECTIVE SEEMS TO HAVE BEEN TO DEMONSTRATE THAT MUNICH CAN STILL CALL THE SHOTS IN BONN. THE POLITICAL WEIGHT GIVEN TO THIS UTTERLY UNIMPORTANT ELEMENT OF THE PACKAGE HIGHLIGHTS THE WORST ASPECT OF COALITION GOVERNMENT AND IT IS A MEASURE OF THE DIFFICULTIES FACED BY CHANCELLOR KOHL'S ADMINISTRATION IN IMPLEMENTING ANY SENSIBLE TAX REFORM.

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7. THE 1990 PACKAGE IS NOT YET OUT OF THE WOODS. THE UPPER HOUSE, THE BUNDESRAT, IS DUE TO GIVE IT FINAL CONSIDERATION ON 8 JULY. BUT THE CDU MINISTER-PRESIDENT OF LOWER SAXONY, ALBRECHT, HAS LINKED HIS LAND'S CRUCIAL VOTES IN FAVOUR OF THE PACKAGE TO COMPENSATION FROM THE FEDERAL GOVERNMENT FOR WHAT HE PERCEIVES AS THE UNFAIR BURDEN OF SOCIAL WELFARE COSTS ON HIGH UNEMPLOYMENT NORTHERN LAENDER. AS A WARNING SHOT THE LOWER SAXONY REPRESENTATIVES ON THE BUNDESRAT FINANCE COMMITTEE ABSTAINED IN A VOTE ON THE PACKAGE LAST WEEK. ALBRECHT HOPES THAT HIS BRINKMANSHIP WILL BE REWARDED FOLLOWING A MEETING TODAY 1 JULY BETWEEN THE LEADERS OF THE THREE COALITION PARTIES.

8. INTEREST RATES PROVIDED SOME RELIEF FROM THESE MIDSUMMER THEATRICALS. THERE WAS INTENSE SPECULATION ABOUT A RISE IN INTEREST RATES DURING WHICH THE YIELD ON BONDS OUTSTANDING PEAKED AT 6.27 PERCENT, THE HIGHEST SINCE OCTOBER 1987, AND THREE MONTH FIBOR CLIMBED FROM 3.65 PERCENT AT THE BEGINNING OF JUNE TO 4.5 PERCENT ON 30 JUNE. IN RESPONSE, THE BUNDESBANK RAISED ITS RATES FOR SECURITIES REPURCHASE OPERATIONS BY 0.25 PERCENT TO 3.5 PERCENT ON 21 JUNE AND THEY HAVE GIVEN NOTICE THAT THERE WILL BE A FURTHER 0.25 PERCENT INCREASE AT THE WEEKLY TRANSACTION ON 5 JULY. IT IS SIGNIFICANT THAT THE BUNDESBANK HAS GIVEN NO INDICATION THAT IT INTENDS TO MOVE FROM FIXED RATE TO VARIABLE TENDERS. IN ADDITION, THE BUNDESBANK INCREASED ITS DISCOUNT RATE ON 30 JUNE FROM 2.5 PERCENT, AN HISTORIC LOW, TO 3 PERCENT. THE LOMBARD RATE WAS LEFT UNCHANGED AT 4.5 PERCENT. THE INCREASE WILL BRING RELIEF IN THE BUNDESBANK WHICH HAS TOLERATED HIGHER MONETARY GROWTH THAN MANY THOUGHT COMFORTABLE. TARGETTED M3 GREW BY A SEASONALLY ADJUSTED ANNUAL RATE OF 7.3 PERCENT IN APRIL (SET AGAINST A TARGET RANGE OF 3 PERCENT TO 6 PERCENT).

9. MAY UNEMPLOYMENT FELL TO 2.15 MILLION UNADJUSTED (8.4 PERCENT), A SEASONAL REDUCTION OF 112,500 FROM APRIL. BUT THE FIGURE WAS 50,400 HIGHER THAN IN MAY 1987. SEASONALLY ADJUSTED THE TOTAL ROSE TO 2.268 MILLION, COMPARED WITH 2.263 MILLION IN APRIL AND 2.217 MILLION IN MAY 1987. THE RISE IN EMPLOYMENT CONTINUED TO SLOW. IN APRIL, THE LATEST MONTH FOR WHICH STATISTICS ARE AVAILABLE, 25.92 MILLION PEOPLE WERE EMPLOYED, A SEASONALLY ADJUSTED INCREASE OF 10,000 COMPARED TO MARCH, ONLY HALF THE AVERAGE INCREASE FOR THE FIRST THREE MONTHS OF THE YEAR. IN AN ADDRESS TO THE FEDERATION OF GERMAN INDUSTRY (BDI) THE FEDERAL PRESIDENT CALLED FOR A NEW APPROACH TO THE UNEMPLOYMENT PROBLEM WHICH WOULD ENTAIL SACRIFICES BY BOTH LABOUR AND MANAGEMENT. THE FEDERAL LABOUR INSTITUTE ATTRIBUTED THE IMPROVEMENT IN EMPLOYMENT IN Q1 TO HIGHER THAN EXPECTED GNP GROWTH

PAGE 3
CONFIDENTIAL

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BUT IT WARNED THAT UNEMPLOYMENT WAS UNLIKELY TO FALL BELOW TWO MILLION AT PROJECTED GROWTH RATES.

10. PROVISIONAL FIGURES ISSUED FOR Q1 GROWTH INDICATE AN ANNUAL INCREASE IN REAL GNP OF 4.2 PERCENT. PRIVATE CONSUMPTION REMAINED HEALTHY RISING BY 4.6 PERCENT IN REAL TERMS COMPARED TO A YEAR EARLIER. CONSTRUCTION ACTIVITY RECOVERED BY A MASSIVE 20 PERCENT FROM THE LOW LEVELS OF LAST YEAR. FEW ANALYSTS EXPECT THESE BETTER THAN EXPECTED FIGURES TO INDICATE A MAJOR INCREASE IN ECONOMIC ACTIVITY OVER THE YEAR AS A WHOLE. THE INCREASE IN THE CONSTRUCTION SECTOR IS GENERALLY THOUGHT TO BE UNSUSTAINABLE, ALTHOUGH THE CONSTRUCTION ASSOCIATION HAS REVISED UPWARDS TO 1 PERCENT OR 2 PERCENT REAL GROWTH ITS EARLIER FORECAST OF STAGNATION IN THE SECTOR. THE RETAIL TRADE SHARE OF PRIVATE CONSUMPTION IS FORECAST TO SLOW TO BETWEEN 2 PERCENT AND 3 PERCENT REAL INCREASE THIS YEAR. IN ADDITION, THE Q1 STATISTICS CONTAINED SO MANY GAPS AS TO BE EVEN MORE PROVISIONAL THAN USUAL.

11. NEVERTHELESS, THE CONSENSUS OF FORECASTS HAS MOVED UP TO THE RANGE OF 2 PERCENT TO 2.5 PERCENT REAL GROWTH FOR THIS YEAR. BUT THERE IS SOME CONFUSION ABOUT THE EFFECT THIS YEAR IN ANTICIPATION OF TAX INCREASES NEXT YEAR. THE FEDERAL ECONOMICS MINISTRY HAS ESTIMATED THE WITHDRAWAL EFFECT IN 1989 AT 0.5 PERCENT OF GNP. IN ITS MONTHLY REPORT FOR JUNE, THE BUNDESBANK SAID THAT ANALYSIS OF MAJOR DEMAND INDICATORS IMPLIED THAT CYCLICAL EXPANSIONARY FORCES HAVE STRENGTHENED IN THE LAST TWO QUARTERS. AFTER ALLOWANCE FOR UNUSUALLY GOOD Q1 CONSTRUCTION ACTIVITY, THE BUNDESBANK SAID THAT ANNUAL GROWTH OF 3 PERCENT THIS YEAR WAS INDICATED. GOVERNMENT SPOKESMEN AND THE MAIN ECONOMIC INSTITUTES REFUSE TO BE DRAWN HIGHER THAN 2.5 PERCENT.

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PAGE 4
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