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MIPT IMF/IBRD MEETINGS, 27-29 SEPTEMBER : FRG ECONOMY

SUMMARY

1. THE FEDERAL FINANCE MINISTER WILL GO TO BERLIN WITH THE GERMAN ECONOMY APPARENTLY IN BETTER SHAPE THAN IT HAS SEEMED FOR SOME TIME. RESULTS FOR THE FIRST HALF OF THE YEAR INDICATE STRONG AND BROADLY BASED GROWTH. STOLTENBERG USED THEM TO SILENCE HIS CRITICS TO GOOD EFFECT IN HIS KEY NOTE SPEECH FOR THE BUDGET DEBATE. TEMPORARILY AT LEAST THE GOVERNMENT APPEARS MORE IN CHARGE AND INDUSTRY HAS TONED DOWN ITS GRUMBLING.

2. BUT DOUBTS LIE NOT FAR BELOW THE SURFACE. THERE IS A SUSPICION THAT HIGHER GROWTH HAS HAPPENED DESPITE RATHER THAN BECAUSE OF GOVERNMENT ACTION. DIFFICULT DECISIONS OVER A RANGE OF ISSUES REMAIN TO BE FACED. BUT THE INDICATIONS ARE THAT THE GOVERNMENT WILL CONTINUE ITS HANDS-OFF ATTITUDE.

DETAIL

FISCAL POLICY

3. STOLTENBERG'S KEY NOTE SPEECH IN THE BUNDESTAG DEBATE ON THE BUDGET ON 6 SEPTEMBER WAS HIS MOST IMPRESSIVE PERFORMANCE FOR SOME TIME. HE USED GOOD ECONOMIC RESULTS RELEASED THE SAME DAY TO WRONG-FOOT HIS OPPONENTS AND SILENCE HIS CRITICS. HE FORECAST GNP TO GROW BY 3 PER CENT THIS YEAR AND SAID THAT THE INCREASED LEVEL OF OUTPUT WAS CONTRIBUTING TO TAX REVENUES SOME DM 1.5 BILLION HIGHER THAN EXPECTED. HE DISMISSED SUGGESTIONS THAT THIS SHOULD BE USED TO REDUCE CONSUMER TAX INCREASES ALREADY PLANNED FOR NEXT YEAR, EMPHASISING INSTEAD THE NEED TO STABILISE THE RATION OF DEBT SERVICING TO PUBLIC SECTOR SPENDING. STOLTENBERG ANNOUNCED THAT THE FEDERAL BUDGET DEFICIT FOR 1988 WAS NOW EXPECTED TO BE DM 37.7 BILLION AND HE REAFFIRMED THE GOVERNMENT'S INTENTION TO BRING THIS DOWN FURTHER. WHILE ADMITTING THAT INDUSTRIAL AND AGRICULTURAL SUBSIDIES WOULD RISE NEXT YEAR BY DM 1.2 BILLION TO DM 16.7 BILLION, STOLTENBERG SAID THAT THE GOVERNMENT INTENDED BY 1992 TO REDUCE

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SUBSIDIES BY 20 PER CENT. WITH THE EFFECTIVENESS OF THE OPPOSITION SPD REDUCED THROUGH THE EVE-OF-DEBATE RESIGNATION OF THEIR VETERAN FINANCE SPOKESMAN, APEL, AND STOLTENBERG'S FDP COALITION PARTNERS SUBDUED IN THEIR COMPLAINTS ABOUT CONSUMER TAX INCREASES, THE CONSENSUS IN THE FOLLOWING MORNING'S PRESS WAS THAT THE DAY BELONGED TO STOLTENBERG.

ECONOMIC DEVELOPMENTS

4. THOUGH FOR A NUMBER OF REASONS SOME RECENT ECONOMIC AND TRADE STATISTICS NEED TO BE TREATED WITH CAUTION, THERE IS SOME JUSTIFICATION FOR THE GOVERNMENT'S CONFIDENCE. PROVISIONAL FIGURES FOR THE ECONOMY IN THE FIRST HALF OF THE YEAR INDICATE A SHARP RISE IN REAL GNP OF 3.9 PER CENT, THE STRONGEST HALF YEARLY GROWTH SINCE 1979. THIS HAS SILENCED MANY OF THE GOVERNMENT'S HARSHTEST CRITICS SOME OF WHOM HAD BEEN FORECASTING ANNUAL GROWTH OF 1 PER CENT OR LESS EARLIER THIS YEAR. INVESTMENT APPEARS TO HAVE LED THE WAY IN THE RECOVERY, REPORTEDLY EXPANDING BY 11 PER CENT. PRIVATE CONSUMPTION GREW STRONGLY BY 3.2 PER CENT. INFLATION WAS ESTIMATED AT 1.2 PER CENT.

FOREIGN TRADE

5. THE FIRST HALF OF THE YEAR ALSO SAW THE RETURN OF EXPORT GROWTH. FOREIGN DEMAND IN THE MANUFACTURING SECTOR ALONE IS REPORTED TO HAVE INCREASED BY SOME 10 PER CENT. THE VISIBLE TRADE SURPLUS IS ESTIMATED TO HAVE RISEN TO DM 59.2 BILLION, DM 3.5 BILLION HIGHER THAN THE FIRST HALF OF 1987. OVERALL EXPORTS INCREASED BY 4.8 PER CENT AND IMPORTS BY 4.4 PER CENT. IN VALUE TERMS THERE WAS A MARKED DECLINE IN EXPORTS TO THE US AND AN INCREASE IN EXPORTS TO EC MARKETS. THE CURRENT ACCOUNT SURPLUS FOR THE FIRST HALF WAS ESTIMATED AT SOME DM 40.2 BILLION, SLIGHTLY LOWER THAN THE SAME PERIOD LAST YEAR. NEVERTHELESS, THERE APPEARS TO BE LITTLE PROSPECT OF ANY SIZEABLE REDUCTION IN THE SURPLUSES IN THE IMMEDIATE FUTURE. THE GOVERNMENT IS AWARE THAT THIS COULD LEAD TO A RESUMPTION OF INTERNATIONAL CRITICISM.

CONCLUSION

6. THE GOVERNMENT HAS WEATHERED A SQUALLY PERIOD DURING WHICH OUTPUT APPEARED TO BE SUFFERING, INDUSTRIAL CONFIDENCE WAS LOW AND ITS FISCAL POLICIES AND ECONOMIC MANAGEMENT CAME UNDER HEAVY CRITICISM. THE POOR HANDLING OF THE TAX REFORM PROGRAMME, MARKED BY DELAY AND INTER-COALITION BICKERING WILL HOWEVER NOT SOON BE FORGOTTEN. THE CONFUSION WHICH AROSE FROM THE CONTROVERSY, COUPLED WITH AN ARGUABLY UNNECESSARY DECISION TO RAISE CONSUMER TAXES NEXT YEAR, SUCCEEDED IN AROUSING CRITICISM EVEN FROM THE VERY CONSTITUENTS WHO WOULD MOST

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BENEFIT FROM THE TAX REFORM PROGRAMME.

7. FOR THE PRESENT, HAVING REFUSED TO MODIFY THE MAIN ELEMENTS OF ITS POLICIES, THE GOVERNMENT IS IN THE COMFORTABLE POSITION OF BEING ABLE TO CLAIM THAT THEY HAVE BEEN VINDICATED. BUT TIME ALONE WILL SHOW WHETHER THE IMPROVEMENT IS PURELY CYCLICAL OR A SUSTAINABLE RETURN TO HIGHER GROWTH - MANY ARE SCEPTICAL AND THE GOVERNMENT ITSELF HAS LIMITED ITS FORECAST FOR GROWTH NEXT YEAR TO BETWEEN 1.5 PER CENT AND 2 PER CENT. CRITICS IN INDUSTRY AND ELSEWHERE CONTINUE TO ARGUE THAT THE MAIN CHALLENGES OF STRUCTURAL ADJUSTMENT, REFORMS OVER A RANGE OF SOCIAL ISSUES AND AN OVERHAUL OF CORPORATE TAXATION HAVE YET TO BE GRIPPED EFFECTIVELY. THE FACT THAT GOVERNMENT REVENUES HAVE SHOT UP HOWEVER REDUCES THE PRESSURE FOR REFORM, AT LEAST IN THE SHORT TERM AND WE CAN EXPECT HANDS OFF MANAGEMENT TO CONTINUE.

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