

UNCLASSIFIED  
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 10 SAVING OF 13 OCTOBER, 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.

THE FRG ECONOMY

SUMMARY

1. Optimism has broken out all over. Public opinion polls indicate general satisfaction with the Government's handling of the economy and the Government is itself forecasting real GNP growth above 3% this year. The Bundesbank's latest monthly report was also bullish as are the assessments of all the leading banks and economic institutes. (Paras. 9 and 10)
2. Unemployment in September fell to 2.099 million (8.1%), the second consecutive fall. Cautious optimism that the slight improvement can be maintained but it is generally felt that a dip below the 2 million level is unlikely. (Para 11)
3. Total public sector spending increased by 3.6% to DM 298.3 billion in the first half of the year while revenue rose by only 2.6% to DM 261.6 billion. Federal budget deficit for the period up by DM 6.5 billion to DM 25.1 billion. Details announced of Federal assistance to financially weak Länder. (Para 12)
4. July imports recorded a rise of 1.2% to DM 36 billion and exports rose by 3.5% to DM 47.1 billion. Provisional August details show imports over the first eight months of the year 5.5% higher than the same period last year while exports have risen by 6.5%. August visible trade surplus was DM 9.3 billion and the current account surplus was DM 4.8 billion. (Paras 13 and 14)
5. The Ifo Institute's survey of the business climate recorded a further significant improvement in August with optimism reflected across all sectors. The two-monthly comparison of new orders indicated a 3.5% increase in July/August compared to May/June with domestic orders up 4.5% and foreign demand 2% higher. Provisional August output figures indicate a rise of 5.5% across the board. Construction increased by 7.5% while manufacturing output rose by 6.5%. (Paras 15 to 18)
6. Inflation, cost of living index, for September rose to 1.4% but the moving annual average remained at 1%. Retail trade turnover rose by 5.1% in August to bring the total increase for the first eight months to 3.5%. The GfK consumer climate survey remained strong and a survey of the retail sector by the Ifo Institute indicated growing optimism. (Paras 19 to 21)

7. Interest rates, yield on bonds outstanding eased to 6.3% in September from 6.5% in August. Fidor fell back to 5% from 5.3%. Monetary growth slowed in August with M3 recording a 6.3% rise, only marginally above the target corridor of 3% to 6%. (Paras 22 and 23)

8. Details of FRG/UK trade. (Paras 24 to 26)

#### DETAIL

#### THE ECONOMY

9. The mood of optimism has continued. Results of an opinion poll conducted in late September for one of the television channels showed that 48% of those questioned thought that general economic developments were good. The last such poll conducted in April indicated that only 35% of those questioned were satisfied with the Government's economic record. The Government, which in September held one of its regular consultations with the independent Council of Economic Experts (the Five Wise Men), has increased its forecast for real growth this year to something over 3%. Bangemann, the outgoing Federal Economics Minister, was quoted as forecasting 3.5%. The bullish outlook was supported by the Bundesbank in its latest monthly report for September. In an assessment of the economy so far this year, the Bundesbank reported that business confidence was high and that all forecasts had been revised upwards. Although not given to predicting economic developments the report nevertheless indicated that the annual growth of 4% in real terms in the first half of the year looked to be a trend that would continue, though with the possibility of some slowdown as temporary factors worked through the economy in the second half of the year. The Bundesbank sounded a warning that price increases, mainly through exogenous causes, indicated that inflation was becoming a source of concern. Press comment has also latched onto the 3% growth rate. A leading economic weekly, *Wirtschaftswoche*, reported that its econometric model indicated growth of 3% this year, 2.4% in 1989, 3% in 1990 and 2.4% in 1991. Leading economic institutes and banks have all increased their forecasts to between 2% and 3%.

10. The reasons behind the better than expected economic performance are difficult to isolate. While it is clear that private consumption remains the main force behind the economy, its strong growth appears to be no more than was expected at the turn of the year. Indeed, there is now speculation that consumer spending patterns may be changed by a combination of the return of inflation and uncertainty over the effects of indirect tax increases next year and that as a result growth in private consumption may now have peaked, though it will continue to tick-over at current high levels. But there has been a clear improvement in business confidence, prompted by stronger than expected export performance, which has boosted investment in both machinery and equipment and construction. The Bundesbank September report said that between April and July German exporters received over 10% more foreign orders than a year earlier with manufacturers of capital goods benefitting most. In the construction industry there has reportedly been a strong rise in demand from both the residential and the corporate sector (see para. 17). In its latest September monthly report, however, the Federal Economics Ministry said that between 1982 and 1987 the growth in building activity was almost entirely confined to the corporate sector. On average corporate sector construction grew by 2.9% per year while residential construction fell by 1.6% and government construction fell by 1.4% annually.