

RESTRICTED

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INFO ROUTINE EC POSTS, WASHINGTON, TOKYO, OTTAWA, UKDEL OECD
INFO SAVING CGS IN FRG AND BERLIN, BMG BERLINFRG ECONOMY: OCTOBER REPORT. *mt*

SUMMARY.

1. GROWING CRITICISM OF THE GOVERNMENT'S FISCAL POLICY CENTRING ON ITS UNWILLINGNESS TO PUT FORWARD QUICKLY PROPOSALS TO REFORM CORPORATE TAXATION, ITS INSISTENCE ON GOING AHEAD WITH CONSUMER TAX INCREASES NEXT YEAR AND THE INTRODUCTION OF A WITHHOLDING TAX. BUT THE GOVERNMENT IS ABLE TO TAKE SHELTER BEHIND UNEXPECTEDLY STRONG ECONOMIC ACTIVITY AND THE CONFIDENCE GIVEN TO DOMESTIC INDUSTRY. NO POLICY CHANGES IN VIEW BUT THERE WILL PROBABLY BE SOME STICKY MOMENTS FOR THE GOVERNMENT IN THE APPROACH TO CHRISTMAS.
2. MAJOR IMPROVEMENTS IN STOCK MARKET ACTIVITY REFLECTING RENEWED CONFIDENCE FROM DOMESTIC INVESTORS AND THE RETURN OF FOREIGN MONEY. SOME HOPE THAT THE OUTWARD FLOW OF CAPITAL HAS BEEN ARRESTED.
3. TECHNICAL CHANGES IN BUNDESBANK MONEY MARKET TRANSACTIONS INDICATE A FURTHER STEP TOWARDS THE MORE SOPHISTICATED USE OF AVAILABLE INSTRUMENTS TO ADJUST MONETARY POLICY: GENERALLY WELCOMED BY THE MARKETS AND NOT REGARDED AS AN ATTEMPT TO TIGHTEN MONETARY POLICY.

DETAIL

FISCAL POLICY

4. THE GOVERNMENT HAS ONCE AGAIN COME UNDER FIRE OVER ITS FISCAL POLICY. THE BDI (CBI EQUIVALENT) RELEASED PROPOSALS EARLY IN THE MONTH FOR A THOROUGH REFORM OF CORPORATE TAXATION. IT ATTACKED THE GOVERNMENT FOR NOT INCLUDING CORPORATE TAXATION IN THE CURRENT REFORM PROGRAMME - THE GOVERNMENT HAS SAID THAT IT WILL NOT PUT FORWARD PROPOSALS TO REFORM CORPORATE TAXES UNTIL 1991 AT THE EARLIEST. LATER, THE CONGRESS OF THE FDP LIBERAL PARTY, THE SMALLEST OF THE GOVERNMENT COALITION PARTIES, PASSED A RESOLUTION INSTRUCTING ITS NEWLY-ELECTED CHAIRMAN, LAMBSDORFF, TO PRESS FOR CHANGES IN THE PACKAGE OF INCREASES OF INDIRECT TAXES PLANNED FOR NEXT YEAR. THERE ARE ALSO GROWING COMPLAINTS FROM THE BANKING SECTOR ABOUT THE COSTS TO THEM OF THE INTRODUCTION OF A 10 PERCENT WITHHOLDING TAX ON

CERTAIN SAVINGS AND INVESTMENTS NEXT YEAR. FINALLY, THE 5 LEADING ECONOMIC INSTITUTES, WHOSE BI-ANNUAL REPORT ON THE ECONOMY WAS PUBLISHED ON 24 OCTOBER (MY TELNO 11 SAVING) TOOK THE GOVERNMENT SEVERELY TO TASK FOR CONCENTRATING REFORM TOO MUCH ON PERSONAL TAXATION: FOR UNNECESSARILY PERSISTING WITH THE PLAN TO RAISE INDIRECT TAXES NEXT YEAR: AND FOR FAILING TO INTRODUCE SOONER THE THIRD AND FINAL STAGE OF TAX REFORM PLANNED FOR 1990 (A QUOTE ZIG-ZAG POLICY UNQUOTE).

THE ECONOMY

5. THOUGH THE FDP DECISION, BROUGHT ON BY THEIR DISLIKE OF THE INTRODUCTION OF A TAX ON NATURAL GAS, IS AN EMBARRASSMENT FOR THE COALITION, THESE CRITICISMS ARE UNLIKELY TO FORCE A CHANGE OF DIRECTION OF GOVERNMENT FISCAL POLICY. THE GOVERNMENT IS BASKING IN THE GLOW OF HIGHER THAN EXPECTED OUTPUT GROWTH THIS YEAR. THE LATEST FORECAST FROM THE FEDERAL ECONOMICS MINISTRY FORESEES REAL GROWTH IN GNP OF 3.5 PERCENT. THE BUSINESS CLIMATE SURVEY CONDUCTED RECENTLY FOR THE GOVERNMENT BY THE MUNICH-BASED IFO INSTITUTE, SHOWS CONFIDENCE AND CAPACITY UTILISATION IN THE MANUFACTURING SECTOR AT THE HIGHEST LEVELS SINCE 1979. THE BUNDESBANK HAS ESTIMATED THAT INVESTMENT IN MACHINERY AND EQUIPMENT WAS 4.3 PERCENT HIGHER IN THE FIRST HALF OF THE YEAR THAN IN THE SAME PERIOD IN 1987. RETAIL TRADE IN THE PERIOD JANUARY TO AUGUST GREW BY 3.5 PERCENT IN REAL TERMS. UNEMPLOYMENT FELL IN SEPTEMBER FOR THE SECOND MONTH IN SUCCESSION TO 2.1 MILLION (8.1 PERCENT). AND AUGUST MONTHLY TRADE FIGURES INDICATE EXPORTS 23 PERCENT HIGHER THAN A YEAR EARLIER AND IMPORTS 18 PERCENT HIGHER, GIVING A VISIBLE TRADE SURPLUS FOR THE FIRST EIGHT MONTHS OF THE YEAR OF DM 79.6 BILLION AND A CURRENT ACCOUNT SURPLUS OF DM 49.5 BILLION.

FIVE INSTITUTES AUTUMN REPORT.

6. THE REPORT BY THE 5 INSTITUTES (PARA 4 ABOVE) CONFIRMED THE ESTIMATE OF STRONG GROWTH. IT ALSO FORECAST A 3.5 PERCENT RISE IN REAL GNP THIS YEAR WITH STRONG FIXED CAPITAL FORMATION AND PRIVATE CONSUMPTION. REAL EXPORT GROWTH IS EXPECTED TO BE 5.5 PERCENT AND IMPORTS ARE FORECAST TO RISE BETWEEN 7 PERCENT AND 8 PERCENT. FOR 1989, THE REPORT FORECASTS REAL GNP GROWTH OF JUST UNDER 2 PERCENT, MAINLY DUE TO CONTINUED HIGH EXPORT PERFORMANCE. BUT THE REPORT IS PESSIMISTIC ABOUT THE PROSPECTS FOR IMPROVEMENT IN THE LABOUR MARKET, SAYING THAT UNEMPLOYMENT WILL PROBABLY RISE SLIGHTLY NEXT YEAR.

STOCK MARKETS.

7. OCTOBER SAW A MAJOR IMPROVEMENT IN TRADING ON THE STOCK MARKETS.