

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

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FRG ANNUAL ECONOMIC REPORT

SUMMARY

1. The Federal Government's Annual Economic Report was approved by Cabinet on 24 January. The report stresses the strength of the economy in 1988 accompanied by improvements in the labour market, a strong foreign trade performance and relative stability of prices. It forecasts real growth of 2.5% in 1989 with the major contribution coming from investment. Private consumption expected to be weaker. Exports and imports will remain strong.
2. The report devotes much of its length to the development of the German economy within the framework of the Single Market, emphasising the adjustments which will be needed. The Government reaffirms its commitment to working towards a freer and more competitive economy firmly grounded on social market principles. Stress is laid on the need for greater flexibility in the labour market, particularly in working hours.
3. On European monetary union, the report says that the Government will explore with the Bundesbank the progress which may be made. It recognises that greater convergence of monetary, fiscal and economic policies will be necessary as well as progress towards political union. It advocates a gradual approach avoiding hasty institutional agreements.
4. The report has been widely covered in the German media which has picked up the main European and social themes. On the macro-economic side there is little in the report which is new. The emphasis on the social aspects of the Single Market and on the Government's commitment to the development of the economy within an orderly framework in the approach to 1992 reflect the pre-occupations of the new Federal Economics Minister, Haussmann.

DETAIL

5. The Federal Government's Annual Economic Report was approved by Cabinet on 24 January and released publicly the following day. It is the Government's formal response, required by law, to the report of the Five Wise Men (our telno 13 Saving) and a statement of their medium-term economic strategy. We understand that it is likely to be debated in the lower house, the Bundestag, around 17 February.

/Economic developments

Economic developments in 1988

6. The report emphasises that 1988 saw the strongest growth in Germany since the beginning of the 1980s. Despite criticism of its last report, the Government had been correct in its prognosis that the underlying strength of the economy would weather the aftermath of the turbulence on world financial markets in 1987. Many factors had helped including the unseasonably mild winter weather last year, stability on foreign exchanges brought about by increased international cooperation of economic, financial and monetary policies, and domestic policies pursued by the Federal Government and the Bundesbank. The robust growth which resulted had encouraged industry to invest more strongly than at any time since the beginning of the 1970s and to utilise production capacity to the full, thus ensuring Germany's continued international competitiveness and the creation of more jobs.

7. Turning to the labour market, the report stresses the increase in the numbers of people in work which rose by 170,000 in 1988 to 26.2 million, 900,000 more than the lowpoint reached at the end of 1983. While average unemployment for the year, 2.24 million, was higher than in 1987, numbers had begun to shrink noticeably in the second half of the year. In December the number of unemployed was 120,000 lower than December 1987 with both male and female unemployment down, despite the complication posed by an influx into the labour market of 243,000 refugees from Eastern Europe. The number of young people under 20 out of work was the lowest since the Autumn of 1981 while the number of short-time workers had been reduced by approximately 25% compared to 1987. The improvements had happened in almost every region in Germany.

8. Cost of living inflation had risen by 1.2%, higher than in 1987 but when viewed over a three-year period it reflected a level of price stability not seen since the 1950s. The report calls for restraint in pay increases and for industry to moderate its pricing policies.

9. The report notes that the strength of the domestic economy lead to a marked increase in imports. But a corresponding growth in world trade, particularly the demand in industrialised countries for capital goods in which German manufacturers have a technological edge, produced a surge in exports. Nevertheless, since 1985 there had been a noticeable reduction in the trade surplus in real terms and in nominal terms the trade surplus grew more slowly last year than in 1987.

Outlook 1989

10. The Federal Government agrees with the Five Wise Men that the upward trend in the economy will continue. The Government expects:-

- continued strong expansion in overall output of goods and services with GNP growing on an annual average by 2.5%
- a further rise in employment with the number of people in employment increasing by 0.5% on an annual average and the unemployment rate easing to 8.5% of the dependent labour force