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TELNO 694

OF 040846Z JULY 89

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FRG ECONOMY: JUNE SUMMARY REPORT

SUMMARY

1. JUNE INFLATION FIGURES SUGGEST SOME EASING OF PRESSURE ON PRICES, BUT THE CONTINUED WEAKNESS OF THE D-MARK AGAINST THE US DOLLAR AND SIGNS OF CAPACITY CONSTRAINTS BROUGHT A WARNING OF OVERHEATING FROM THE BUNDESBANK AND A DECISION TO RAISE INTEREST RATES BY A FURTHER 0.5 PER CENT.

2. RECENT INDUSTRIAL ECONOMIC FORECASTS HAVE CONFIRMED THE CONTINUED STRENGTH OF ECONOMIC GROWTH, PARTICULARLY INVESTMENT AND FOREIGN DEMAND, BUT THERE IS LESS CONSENSUS OVER DEVELOPMENTS NEXT YEAR.

3. THE DRAFT 1990 FEDERAL BUDGET WILL BE DISCUSSED IN CABINET LATER THIS WEEK. SPENDING IS SET TO RISE BY 3.4 PER CENT.

DETAIL

ECONOMIC DEVELOPMENTS

4. PROVISIONAL JUNE INFLATION FIGURES INDICATED AN EASING OF PRESSURE ON PRICES TO AN ANNUAL RATE OF 2.9 PER CENT, SLIGHTLY DOWN ON THE MAY FIGURE OF 3.1 PER CENT. IN ITS LATEST MONTHLY REPORT THE BUNDESBANK ATTRIBUTED MUCH OF THE INCREASE IN THE COST OF LIVING TO HIGHER IMPORT PRICES, UP 7.1 PER CENT IN THE 12 MONTHS TO MAY, EXACERBATED BY THE WEAKER D-MARK. THE BUNDESBANK ALSO POINTED TO SIGNS OF OVERHEATING IN THE ECONOMY, WITH STRONG FOREIGN DEMAND AND HIGH CAPACITY UTILISATION LEADING TO SUPPLY BOTTLENECKS. REPORTS FROM THE REAL ECONOMY INDICATE THAT ACTIVITY IS RUNNING AT A HIGH LEVEL. THE LATEST MONTHLY BUSINESS CLIMATE INDEX FROM THE MUNICH-BASED IFO ECONOMIC INSTITUTE CLIMBED FURTHER IN MAY, REACHING 114.3 (113.9 IN APRIL). COMPANIES REPORTED CONTINUED FIRM FOREIGN DEMAND. PRODUCTION WAS GENERALLY PLANNED TO EXPAND. SOME EASING OF PRESSURE FOR PRICE RISES WAS ALSO REPORTED. THE CONSTRUCTION SECTOR REMAINED PARTICULARLY STRONG. A TRADE ASSOCIATION REPORT FORECAST 5 PER CENT GROWTH DURING THE YEAR. IN THE FIRST FOUR MONTHS ALONE,

TOTAL CONSTRUCTION ACTIVITY EXPANDED BY 14 PER CENT WITH THE RESIDENTIAL SECTOR GROWING BY 15 PER CENT, THE COMMERCIAL SECTOR BY 12 PER CENT AND PUBLIC SECTOR CONSTRUCTION BY 14 PER CENT. BUT THE REPORT ALSO WARNED OF SKILLED LABOUR SHORTAGES.

FORECASTS FOR THE ECONOMY

5. THE CONTINUING STRENGTH OF ECONOMIC ACTIVITY IS REFLECTED IN THE CONSENSUS OF FORECASTS FOR THIS YEAR. THE BERLIN-BASED DIW INSTITUTE, KIEL UNIVERSITY AND THE FEDERAL ECONOMICS MINISTRY ALL PREDICT 3.5 PER CENT REAL GROWTH IN GNP. ALL ACKNOWLEDGE THAT STRONG EXPORT GROWTH, BETWEEN 8 PER CENT AND 9 PER CENT, WILL OUTSTRIP THE RISE IN IMPORTS. OPINIONS DIFFER FOR 1990. THE FEDERAL ECONOMICS MINISTRY AND THE DIW EXPECT EXPORT GROWTH TO FALL BACK TO 6 PER CENT, BUT THE INSTITUTE FORECAST A PICK UP IN PRIVATE CONSUMPTION, RISING BY 3.5 PER CENT, FUELLED BY CUTS IN INCOME TAX PLANNED FOR JANUARY 1990. IN A CONTROVERSIAL REPORT WHICH HAS RECEIVED WIDE PUBLICITY, HOWEVER, KIEL UNIVERSITY FORECAST THAT THE CURRENT GROWTH CYCLE WOULD PEAK THIS YEAR AND THAT ALL COMPONENTS WOULD SLOW IN 1990. AS A RESULT, THE INSTITUTE FORECAST REAL GROWTH IN GNP OF ONLY 2 PER CENT.

MONETARY POLICY.

6. THE BUNDESBANK CENTRAL BANK COUNCIL RAISED INTEREST RATES BY 0.5 PER CENT WITH EFFECT FROM 30 JUNE, THE SEVENTH INCREASE SINCE JULY 1988. THE DISCOUNT RATE NOW STANDS AT 5 PER CENT AND THE LOMBARD RATE AT 7 PER CENT. THE BUNDESBANK SAID THAT THE MOVE WAS TAKEN TO KEEP MONEY SUPPLY GROWTH AT THE TARGET FOR M3 OF QUOTE AROUND 5 PER CENT UNQUOTE, AND TO DAMPEN INFLATION. THE CENTRAL BANK ALSO WANTED TO BOOST THE D-MARK WHICH HAD CONTINUED TO WEAKEN AGAINST THE US DOLLAR DESPITE SOME INTERVENTION ON THE FOREIGN EXCHANGES. THE FEDERAL GOVERNMENT WELCOMED THE DECISION. THE BUNDESBANK ALSO ANNOUNCED THAT THE NEXT SECURITIES REPURCHASE TRANSACTION WILL CARRY A FIXED INTEREST RATE OF 6.6 PER CENT, SUGGESTING THAT IT INTENDS TO CAP MARKET INTEREST RATES. CALL MONEY HAS RECENTLY RISEN ABOVE THE LOMBARD RATE WHICH IS USUALLY REGARDED AS THE CEILING FOR MARKET INTEREST RATES.

STOCK MARKETS.

7. GERMAN STOCK MARKETS CONTINUED TO MAKE SUBSTANTIAL GAINS, ALTHOUGH THEY PAUSED FOLLOWING THE BUNDESBANK DECISION TO RAISE INTEREST RATES. ALL THE MAIN INDICES RECORDED NEW HIGHS FOR THE YEAR WITH THE BANKING AND INSURANCE SECTOR PARTICULARLY STRONG. PERFORMANCE WAS STRENGTHENED BY RENEWED INTEREST IN GERMAN EQUITIES FROM FOREIGN INVESTORS.

1990 FEDERAL BUDGET.

8. THE DRAFT FEDERAL BUDGET IS DUE TO BE DISCUSSED IN CABINET ON 5 JULY. REPORTS INDICATE THAT FEDERAL SPENDING WILL RISE BY 3.4 PER CENT TO DM 301.35 BILLION. FEDERAL REVENUES ARE EXPECTED TO BE DM 267.68 BILLION, INCLUDING DM 242.07 BILLION IN TAX RECEIPTS, SOME DM 600 MILLION HIGHER THAN THE EXPECTED OUTTURN FOR THIS YEAR DESPITE THE PLANNED INCOME TAX REDUCTIONS. THE FEDERAL GOVERNMENT BORROWING REQUIREMENT WILL RISE FROM DM 27.83 BILLION THIS YEAR TO DM 33.67 BILLION NEXT YEAR BUT THE MEDIUM TERM FINANCIAL PLAN WHICH WILL ACCOMPANY THE DRAFT BUDGET SEES THIS GRADUALLY TAILING OFF TO DM 25.6 MILLION BY 1993. THE LARGEST SPENDING MINISTRY, LABOUR AND SOCIAL AFFAIRS, RECEIVES A 4.4 PER CENT INCREASE TO DM 70.56 BILLION, WHILE THE SECOND LARGEST BUDGET, THAT OF DEFENCE, RISES BY 3.3 PER CENT TO DM 54.5 BILLION. THE DRAFT BUDGET WILL BE DEBATED IN PARLIAMENT AFTER THE SUMMER BREAK.

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