

UNCLASSIFIED  
SAVING TELEGRAM

FROM BONN  
FRAME ECONOMIC

TO FCO TELNO 02 SAVING OF 02 March 1990. 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.

FRG ECONOMY

SUMMARY

1. Economic activity still strong. Real growth of around 4% in Q489. Domestic demand has assumed locomotive role. 1990 growth expected to exceed 3%. (para 9)
2. Supplementary budget of DM 6.9bn passed by Cabinet. Bulk of funds allocated to GDR-related expenditure. Unlikely to suffice. (paras 10 and 11)
3. Unemployment rose above 2.1 million in January but still lower than a year earlier. Labour market pressures intensify as flood of resettlers continues. No sign of breakthrough in wage negotiations. (paras 12 and 13)
4. Business confidence at unprecedented levels, inspired by prospect of unification. Both new orders and production ended last year on a high note. Construction sector reassumes role of key growth sector. Concern that rising mortgage rates could throttle current boom. (paras 14 to 16)
5. Inflation eases to 2.6% in February but could rise later this year. (para 17)
6. Bundesbank leaves key interest rates unchanged against background of tumbling bond market. Average bond yield scales heights unseen for eight years as nervousness about FRG/GDR economic and monetary union takes hold. (para 19)
7. Strong monetary growth in January but 6-monthly M3 indicator within target corridor. DM subdued. Stock markets unsettled by the prospects of GEMU. (paras 20 to 22)
8. Record foreign trade and current account surplus in 1989. UK share of FRG non-oil import market edges up to 6.3% in 1989. Trade gap in favour of FRG widens to DM 24.7bn. (paras 23 to 25)

## DETAIL

### GROWTH AND OUTLOOK

9. The momentum of economic activity continues undiminished. Provisional estimates suggest continued strong growth in the final quarter of last year with real GNP some 4% up on a year earlier. The expected shift in emphasis set in towards the end of the year, with domestic demand increasingly taking over from exports as the mainspring of economic expansion as foreign demand faded slightly. This shift is likely to become more marked during 1990 as the strong rise in incomes stemming from Stage III of the tax reform is reflected in higher private consumption. Lively corporate demand for capital goods has held up (capital investment rose by an estimated 11.5% in Q489) and, with sales and earnings prospects favourable, the propensity to invest can be expected to remain high throughout 1990. Company profits are forecast to rise by 12% this year after the 13% increase recorded in 1989. Overall GNP growth in 1990 is already expected to exceed 3% comfortably.

### BUDGET

10. On 14 February the Federal Cabinet passed a supplementary budget for 1990 totalling DM 6.9bn net, necessitated by developments in the GDR and Eastern Europe. This will push total Federal expenditure up to DM 307bn. The bulk of the funds has been earmarked for GDR-related expenditure, though mainly within the FRG, and for costs caused by the continuing influx of resettlers. The expenditure in detail: -

- DM 2bn will be put aside as contingency for future needs under the loosely defined heading "immediate measures caused by developments in GDR and arrival of Über- and Aussiedler"
- DM 2.15bn reserved for foreign exchange fund
- DM 400m as first instalment to ERP special fund. By 1993 this figure will total DM 2bn in order to finance low-interest credits amounting to DM 6bn for small and medium-sized firms in the GDR
- DM 90m will go to small and medium-sized firms for seminars, courses, R&D and technology transfer
- DM 200m for improvement to roads, motorways and railways situated near the border
- DM 140m for environment projects in the GDR
- DM 75m for health care for GDR visitors to FRG. An immediate DM 320m is intended to ensure upkeep of medical welfare in GDR
- the Länder will receive an additional DM 500m in investment grants to assist in provision of housing for new arrivals
- Berlin aid will be increased by DM 400m to help cope with influx of resettlers
- DM 1bn for other Eastern European countries.