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FRAME ECONOMIC

MIPT: GEMU

SUMMARY
1. GERMAN UNITY FUND ESTABLISHED, TO BE FINANCED MAINLY THROUGH BORROWING ON THE CAPITAL MARKETS. SECOND SUPPLEMENTARY BUDGET TO BE AGREED.

DETAIL
2. A MEETING BETWEEN THE FEDERAL FINANCE MINISTER AND HIS COUNTERPARTS FROM THE LAENDER ON 15 MAY AGREED TO ESTABLISH A GERMAN UNITY FUND. THE FUND WILL TOTAL DM 115 BILLION OVER A FOUR-AND-A-HALF YEAR PERIOD. THE FEDERAL AND LAENDER BUDGETS WILL CONTRIBUTE SAVINGS FROM CANCELLATION OF SUBSIDIES TO SPECIAL BORDER AREAS AND OTHER REDUCTIONS IN GDR RELATED EXPENDITURE, BUT A MAJOR PART OF THE FUND - SOME DM 95 BILLION - WILL BE RAISED ON THE CAPITAL MARKETS. THE FUND WILL INVOLVE A TOTAL OF DM 22 BILLION IN 1990, WITH A FURTHER DM 35 BILLION NEXT YEAR. THE BUNDESBANK HAVE DENIED CLAIMS IN A FINANCIAL TIMES ARTICLE OF 15 MAY THAT THE ''UNITY BOND'' WILL BE TAILORED TO JAPANESE INVESTORS. DETAILS HAVE YET TO BE RELEASED, BUT THE BUNDESBANK HAVE TOLD US THAT THE BONDS ARE LIKELY TO BE ISSUED ON THE DOMESTIC MARKET, THOUGH FOREIGN PARTICIPATION WILL BE ENCOURAGED.

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3. THE FEDERAL FINANCE MINISTRY HAVE CONFIRMED TO US THAT CABINET WILL BE ASKED ON 18 MAY TO APPROVE A SECOND SUPPLEMENTARY BUDGET. THEY WOULD NOT REVEAL ITS SIZE BUT DID NOT DENY NEWSPAPER SPECULATION THAT IT WOULD RUN INTO DOUBLE FIGURES. THE BUDGET WILL ESTABLISH THE GERMAN UNITY FUND.

COMMENT
4. THE NEW FUND IS INTENDED TO GIVE THE GOVERNMENT MORE FLEXIBILITY IN RAISING MONEY TO PAY FOR UNIFICATION. BORROWING TO FINANCE THE FUND WILL NOT COUNT AGAINST THE FEDERAL BORROWING REQUIREMENT, THUS AVOIDING CONSTITUTIONAL CONSTRAINTS. BUT THE MONEY MARKETS ARE

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NERVOUS, PARTICULARLY THE BOND MARKET, WHERE YIELDS ROSE SHARPLY FOLLOWING THE FINANCIAL TIMES ARTICLE. IT IS NOT CLEAR HOW FAR THIS IS JUSTIFIED. KEY ISSUES, ON WHICH WE SHALL REPORT FURTHER, ARE HOW FAR OVERALL BORROWING WILL INCREASE AND HOW THIS RELATES TO THE SIZE OF DOMESTIC SAVINGS AND OVERSEAS TRANSFERS. THE BUNDESBANK ARE CONFIDENT THAT THE MARKETS CAN COPE, BUT SOME PRESSURE ON INTEREST RATES SEEMS INEVITABLE.

MALLABY

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