

UNCLASSIFIED

SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 5 SAVING OF 27 FEBRUARY 1987. 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. February was marked by further uncertainty on the Frankfurt Foreign Exchange which exacerbated the fears of German exporters. Despite some scepticism about the long-term effects, the meeting of G5 and later G7 (minus Italy) Finance Ministers in Paris on 21 and 22 February strengthened the dollar and Sterling at the expense of the D-Mark.
2. The protracted coalition negotiations took a major step forward when agreement was reached to raise basic tax allowances for single and married people, to lower the initial rate at which income tax is paid, to raise child allowances, to reduce the top marginal rate of income tax, to bring down corporation tax and on a package of relief measures for small and medium-sized businesses. There were, however, few indications of how these measures will be financed and decisions seem likely to be delayed for some months.
3. Industrial confidence declined further. The Ifo survey of the business climate recorded a sharp fall and share prices on the Frankfurt Exchange continued their decline. Industrial demand weakened in Q4 1986 with manufacturing orders down 3.5% in volume terms, though the decline appears to have slowed in December. Both foreign and domestic demand fell in Q4 1986 over Q4 1985. Production declined while construction activity increased.



4. Economic institutes continued to revise downwards the forecasts of growth in 1987. The Bundesbank outlined some of the strains to which the economy had been subjected by the rising D-Mark, falling exports and rising imports and warned that capital formation appeared to be tailing off as production costs rose and export prospects weakened.
5. Seasonally adjusted employment remained more or less static in January while seasonally adjusted unemployment rose. Suggestions that unemployment may not now fall below last year's levels and that it may be on a rising trend in the second half of the year.
6. In nominal terms imports fell by 10.5% in 1986 but in real terms they rose by 6.5%. Similarly, exports fell by 2% in nominal terms but rose by a real 1.5%. The year recorded a record nominal trade surplus of DM 112.2 billion but in real terms it declined during the second half of the year.
7. All monetary aggregates rose in January with M1 9% up on a year earlier, M2 up 7%, M3 up 7.5% and Central Bank Money up 7.5%.
8. The steady fall in interest rates, yield on bonds outstanding, which had begun in January, continued to the middle of February as foreign investors prolonged the demand for Government securities. A gradual rise towards the end of the month, however, brought the average up to 5.7%.
9. Inflation, cost of living index, stood at minus 0.8% in January after minus 1.1% in December.

/DETAIL