

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN
FRAME ECONOMIC

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Vienna.

FRG ECONOMY

SUMMARY

1. It was announced that monetary growth had slowed in July with Central Bank Money rising at an annual rate of 7.5%, still however outside its target range of 3% to 6%. The Bundesbank saw the cause as the reversal of speculative capital inflows and the slowing of the growth in cash in circulation and sight deposits.
2. There is continued confusion over the Government's plans for the tax reduction programme planned for 1990 and the delay in reaching firm decisions is coming in for increasing criticism. Decisions are promised after two important Land elections on 13 September.
3. The Ifo institute in Munich forecast real growth of only 1.25% in 1987 and 1.75% in 1988. Unemployment is expected to rise slightly this year, though not above the 9% recorded in 1986, and again next year to 9.1%. The business climate survey for July, however, recorded a further sharp increase following that shown in June. The Ifo reported that this was due to firming in the retail trade but the Government has drawn comfort from better than expected export performance.
4. New order figures indicate some recovery in industrial demand in Q2 but overall demand remains 4% lower than a year earlier with both foreign and domestic demand suffering. Production figures indicate a similar picture. Production was up in Q2 over Q1 but it is still below the levels of a year earlier. The building sector performed particularly badly with activity down by 5% in Q2 compared to a year earlier.
5. Private consumption recorded a real increase of 1% in Q2 over the same quarter last year. Retail prices increased slightly by 0.7% in July. Inflation, cost of living index, also rose to 0.7% in July after 0.2% in June.
6. Foreign trade figures for Q2 reveal a marked upturn in exports and imports which both rose by 4% in seasonally adjusted terms over Q1. With exports level in July compared to a year earlier and imports rising strongly, the trade surplus fell from DM 10.9 billion in July 1986 to DM 9.9 billion. The current account surplus fell to DM 4.6 billion in June after DM 7.8 billion in May but this was still slightly up on June 1986 when it recorded DM 4.3 billion.
7. The upward trend in unemployment continued in June and July with respectively 2.097 million (8.3%) and 2.176 million (8.7%) recorded. The rate of job creation slowed further. Short-time working recorded a sharp increase to 184,012 in June and 215,705 in July, mainly in the coal mining industry.

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8. The dog days of August were notable in economic terms only for the continued bickering about the form and scope of the tax reduction programme for 1990, and further disagreement over medium-term economic development. The Bundesbank celebrated the thirtieth anniversary of its establishment by leading its monthly report with the news that monetary growth had slowed in July, although at an annual rate of 7.5% Central Bank Money continued to increase outside the target range of 3% to 6%. The seasonally adjusted rise by DM 0.7 billion brought the total to DM 229.8 billion. Nevertheless, this marks a considerable improvement on the 8% and 7.9% rates of increase recorded in June and May respectively. The report also confirmed the provisional figures for other monetary aggregates in June with M3 7.5% (DM 8.7 billion) higher than a year earlier, a seasonally adjusted monthly growth rate of 7% over the first six months of the year. M2 rose by 7% (DM 8.4 billion) compared to June 1986 and M1 by 8.5% (DM 10.8 billion). The Bundesbank noted that the slowdown in monetary growth was due in large measure to an easing of speculative investment and that cash in circulation and sight deposits had also risen less strongly than in the previous two months. The report commented that bank credit had increased strongly in June by DM 3.4 billion. The Bundesbank continued to play down the inflationary dangers of above target monetary growth in the face of criticism from some quarters that it had lost control of monetary policy. The spirited defence put up by the President, Karl Otto Pohl, and other members of the Directorate took a knock with the news that inflation in July jumped by 0.5% to 0.7%. The DIW institute in Berlin called the policy a mistake and compared it to 1977/78 when they blamed the slack monetary stance as having contributed to inflation rising steadily thereafter to 6.3% in 1981.

9. The continuing financial scandal involving major currency mishandling at the Volkswagen company touched the Bundesbank briefly when investigating police arrested a secretary reportedly employed in the office of the President of the Bundesbank on suspicion of having sold information to a currency broker thought to have been connected with the scandal. The Bundesbank made no comment on the arrest. Police investigations, in which the Bundesbank has also been assisting, have continued with the arrest of a third currency dealer from Volkswagen. The scandal is thought to involve the fraud of forward currency contracts to the value of DM 480 million and has delayed the Government's intended disposal of its remaining holdings of the company. This has dealt a further blow to the lacklustre privatisation programme.

10. As the date approaches for two important Land elections (in Schleswig-Holstein, where Federal Finance Minister Stoltenberg has his seat, and in Bremen), there has been continued political posturing over the prospects for the 1990 tax reduction package. On his return from holiday, Chancellor Kohl proclaimed that the Government would stick by its plans for the package but at least publicly those plans are no more than general aims. The Government is known to be examining some 150 special tax reliefs with a view to reducing or abolishing some to assist with the financing of the package. The Government has been at pains to assure local authorities, which suspect that their tax revenues may suffer disproportionately when decisions are taken on the package, that it will have their interests in the forefront of its mind in discussion