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INFO ROUTINE WASHINGTON, PARIS, ROME, OTTAWA, TOKYO, UKDEL OECD  
INFO SAVING CONSULATES-GENERAL IN THE FRG AND BERLIN

FRG ECONOMY: ANNUAL REPORT OF THE FIVE WISE MEN: FEDERAL AND  
GOVERNMENT REACTIONS

SUMMARY

1. A REPORT WHICH CARRIES MORE WEIGHT THAN MOST: THE GOVERNMENT IS LEGALLY OBLIGED TO REPLY FORMALLY IN PARLIAMENT EARLY NEXT YEAR. FORECAST OF SLUGGISH GROWTH IN 1988. GENERALLY SUPPORTIVE OF GOVERNMENT POLICIES, BUT SOME SUGGESTIONS FOR STIMULATION OF THE ECONOMY NEXT YEAR. SIGNS THAT THE GOVERNMENT IS LOOKING FOR WAYS OUT OF THE GROWTH DILEMMA, BUT THEY MAY SEEK FURTHER REASSURANCE FROM THE US ABOUT EXCHANGE RATES BEFORE TAKING PRACTICAL RATHER THAN COSMETIC MEASURES.

DETAIL

2. THE COUNCIL OF ECONOMIC EXPERTS COMPOSED OF FIVE LEADING ACADEMICS (THE FIVE WISE MEN) PRESENTED THEIR ANNUAL REPORT TO CHANCELLOR KOHL ON 23 NOVEMBER. IN A COUNTRY AWASH WITH ECONOMIC ANALYSIS, THE WISE MEN'S REPORT CARRIES MORE WEIGHT THAN MOST. THEY HAVE ACCESS TO OFFICIAL STATISTICS: THE GOVERNMENT IS LEGALLY OBLIGED TO RESPOND FORMALLY IN PARLIAMENT TO THEIR REPORT (USUALLY IN THE FOLLOWING FEBRUARY): AND THEY HAVE IN THE PAST USED THEIR CONSTITUTIONAL INDEPENDENCE TO QUESTION WITH AUTHORITY THE GOVERNMENT ANALYSIS OF ECONOMIC DEVELOPMENTS.

3. FULL DETAILS OF THE REPORT ARE CONTAINED IN MY TELNO 18 SAVING. IN SHORT THE WISE MEN FORECAST CONTINUED SLUGGISH GROWTH IN THE GERMAN ECONOMY - 1.5 PERCENT GROWTH IN REAL GNP NEXT YEAR - LOW INVESTMENT AND LOW GOVERNMENT CONSUMPTION. PRIVATE CONSUMPTION IS EXPECTED TO PROVIDE THE MAIN MOTOR FOR GROWTH. INFLATION AND UNEMPLOYMENT WILL RISE SLIGHTLY. EXPORTS ARE EXPECTED TO PERFORM BETTER THAN MOST ANALYSTS FORECAST, BUT THIS IS BASED ON AN OPTIMISTIC ASSESSMENT OF A STABLE US DOLLAR/D-MARK EXCHANGE RATE, SLIGHTLY HIGHER THAN CURRENT LEVELS. IMPORTS ARE FORECAST TO INCREASE BY 4 PERCENT. THE NOMINAL VISIBLE TRADE SURPLUS IS EXPECTED

TO DECLINE LITTLE BUT THE COUNCIL EMPHASISE THAT IN REAL TERMS THERE HAS BEEN A SHARP DROP SINCE 1985 AND THAT NET EXPORTS IN 1988 WILL FALL FURTHER BY 0.5 PERCENT TO 2.5 PERCENT OF GNP.

4. THE REPORT GENERALLY SUPPORTS THE GOVERNMENT AND THE BUNDESBANK IN THEIR POLICIES TO DATE, ALTHOUGH IT EXPRESSES CONCERN AT THE CONTINUING EXCESSIVE GROWTH IN THE MONEY SUPPLY. IT MAKES A NUMBER OF SUGGESTIONS FOR FUTURE POLICY, THE MOST IMPORTANT OF WHICH IS THE NEED FOR GREATER DEREGULATION, ESPECIALLY IN THE TERTIARY SECTOR. THE REPORT CRITICISES THE PROPOSED TAX CUTS IN 1990 AS BEING GEARED TOO MUCH TO PERSONAL INCOMES AND NOT ENOUGH TO ENCOURAGING INDUSTRIAL PERFORMANCE AND INVESTMENT. ONE OF THE FIVE PROFESSORS ARGUES THAT THE CUTS SHOULD BE IMPLEMENTED EARLIER THAN 1990 TO BOOST THE ECONOMY, BUT THE OTHER FOUR DISAGREE. COMMENTING ON THE RECENT EVENTS IN THE WORLD FINANCIAL MARKET, THE COUNCIL SAY THAT THEY DO NOT EXPECT A RECESSION TO RESULT FROM THE DISTURBANCE.

5. INTERNATIONALLY, THE REPORT ATTEMPTS TO GIVE THE GOVERNMENT AMMUNITION TO REBUT CRITICISM THAT THE FRG IS NOT PLAYING TO THE FULL ITS ROLE IN THE EXPANSION OF THE WORLD ECONOMY. THERE ARE, HOWEVER, CLEAR SIGNS THAT THE COUNCIL RECOGNISE THE DANGER OF CONTINUING LOW GROWTH. THE REPORT'S POLICY RECOMMENDATIONS REFLECT THE CONFUSION IN OTHER QUARTERS IN GERMANY ABOUT EFFECTIVE MEASURES TO STIMULATE THE DOMESTIC ECONOMY.

6. THE INITIAL GOVERNMENT RESPONSE HAS BEEN TO DESCRIBE THE REPORT AS OVERLY PESSIMISTIC. THE FEDERAL MINISTERS FOR FINANCE AND ECONOMICS HAVE BOTH REJECTED BRINGING FORWARD THE PLANNED TAX CUTS. NEVERTHELESS, THERE ARE HINTS THAT THE GOVERNMENT AND THE BUNDESBANK MAY BE PREPARED TO TAKE LIMITED ACTION TO COUNTER INTERNATIONAL CRITICISM. STOLTENBERG SAID YESTERDAY IN THE BUDGET DEBATE IN THE BUNDESTAG THAT THE GOVERNMENT WAS STUDYING WAYS TO BOOST ECONOMIC GROWTH, APPARENTLY BY SOME UNSPECIFIED CHANGES IN FISCAL POLICY. BANGEMANN HAS REPEATED THAT THE GOVERNMENT IS PREPARED TO TOLERATE A HIGHER FEDERAL DEFICIT NEXT YEAR THAN PREVIOUSLY ENVISAGED AND TO DROP PLANNED INCREASES IN SOME EXCISE DUTIES.

7. MEANWHILE, THE BUNDESBANK, IN A MOVE CO-ORDINATED WITH OTHER EMS PARTNERS, THIS WEEK SHAVED 0.25 PERCENT OFF ITS SECURITIES AND REPURCHASING INTEREST RATE, A KEY INFLUENCE ON SHORT TERM MONEY MARKET RATES. TAKEN WITH THE DECISION YESTERDAY TO TRIM THE INTEREST RATE FOR TREASURY BILLS, THESE MOVES ARE PROBABLY INTENDED TO SIGNAL TO THE INTERNATIONAL COMMUNITY THAT GERMANY IS WILLING TO BE MORE FLEXIBLE IN THE WAKE OF THE WASHINGTON AGREEMENT TO CUT THE PUBLIC

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SECTOR DEFICIT. THE FINANCIAL MARKETS ARE INTERPRETING THESE MOVES AS PAVING THE WAY FOR A CUT IN THE DISCOUNT RATE, CURRENTLY 3 PERCENT, WHICH DIRECTLY INFLUENCES CAPITAL MARKET INTEREST RATES FOR 1 AND 3 MONTH MONEY. THE DISCLUDJAIA

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M ONCE BEFORE BEEN LOWER THAN 3 PERCENT, IN 1959, WHEN FOR JUST UNDER 8 MONTHS IT STOOD AT 2.75 PERCENT. A MOVE TO A SIMILAR LEVEL COULD THEREFORE BE COUNTENANCED AT NEXT THURSDAY'S MEETING OF THE CENTRAL BANK COUNCIL, THOUGH THE WISE MEN'S COMMENTS ABOUT THE INFLATIONARY POTENTIAL OF HIGH MONETARY GROWTH WILL STRENGTHEN THE ARM OF THOSE, LIKE THE DEPUTY PRESIDENT OF THE BUNDESBANK, WHO HAVE ARGUED AGAINST A CUT.

8. THE SIGNS ARE THAT THE FEDERAL GOVERNMENT MAY AT LAST BE PREPARED TO BE LESS INTROSPECTIVE IN ITS ECONOMIC MANAGEMENT, BUT IT IS NOT YET CLEAR WHETHER IT IS PREPARED TO GRASP THE NETTLE COMPLETELY. AN AIR OF CONFUSION AND COMPLACENCY IS STILL VERY APPARENT AND THERE ARE REAL POLITICAL DIFFICULTIES. THERE REMAIN STRONG DOMESTIC PRESSURES AGAINST ANY ACTION WHICH COULD BE PERCEIVED AS OVER HASTY AND JEOPARDISING THE STABILITY OF THE NATIONAL ECONOMY. THE POLICY SPLIT BETWEEN FRANKFURT AND BONN HAS BEEN ONLY PAPERED OVER. THE KEY MAY BE THE EXCHANGE RATE. A FURTHER FALL IN THE DOLLAR WOULD WORRY THE GERMANS. WITH THE DOLLAR REMAINING WEAK DESPITE THE LOWERING OF SHORT TERM INTEREST RATES, THE GOVERNMENT MAY LOOK TO THE US FOR REASSURANCE ABOUT EXCHANGE RATES BEFORE IT TAKES ANY PRACTICAL AND POLITICALLY CONTROVERSIAL MEASURES TO STIMULATE THE DOMESTIC ECONOMY.

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