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FM BONN

TO IMMEDIATE FCO

TELNO 916

OF 041505Z DECEMBER 87

INFO PRIORITY WASHINGTON, PARIS, TOKYO

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INFO SAVING CONSULATES-GENERAL IN FRG, BMG BERLIN

FRG ECONOMY: STIMULATORY MEASURES

SUMMARY

1. THE GERMANS HAVE TAKEN ACTION ON TWO FRONTS. IN A MOVE COORDINATED WITH OTHER EUROPEAN CENTRAL BANKS, AND UNDER PRESSURE INTERNATIONALLY AND FROM THE BONN GOVERNMENT, THE BUNDESBANK YESTERDAY CUT ITS DISCOUNT RATE TO 2.5 PERCENT, THE LOWEST EVER THE PREVIOUS DAY, THE GOVERNMENT ANNOUNCED A PACKAGE OF MEASURES THE MAIN ELEMENT OF WHICH IS A PROGRAMME OF DM 21 BILLION IN LOW INTEREST DEVELOPMENT CREDITS. OTHERWISE IT CONSISTS OF A RE-STATEMENT OF MEASURES ALREADY IN THE PIPELINE OR PROMISES OF FUTURE ACTION. WIDESPREAD CRITICISM. THE GOVERNEMENT HAS FALLEN BEHIND IN THE DOMESTIC ECONOMIC DEBATE AND HAS MISSED AN OPPORTUNITY. STOLTENBERG ONCE AGAIN IN THE FIRING LINE.

DETAIL

2. THE BUNDESBANK YESTERDAY ANNOUNCED A REDUCTION IN THE DISCOUNT RATE OF 0.5 PERCENT TO 2.5 PERCENT, THE LOWEST EVER IN ITS HISTORY. THE BANK HAD BEEN MOVING TOWARDS A CUT FOR SOME TIME BUT ITS ROOM FOR MANOEUVRE HAD IN RECENT DAYS BEEN SEVERLY LIMITED BY EXPECTATIONS BUILDING UP IN THE FINANCIAL MARKETS FUELLED BY GOVERNMENT STATEMENTS AND OFF THE RECORD BRIEFINGS.

3. AS WIDELY REPORTED IN THE PRESS, THE PREVIOUS DAY THE CABINET AGREED A HURRIEDLY CONCEIVED PACKAGE OF FISCAL MEASURES CONSISTING OF THE FOLLOWING ELEMENTS:

A) BETWEEN 1988 AND 1990 DM 21 BILLION OF SPECIAL INTEREST LOANS TO BE MADE AVAILABLE THROUGH THE STATE-OWNED RECONSTRUCTION LOAN CORPORATION (KFW), BROKEN DOWN AS FOLLOWS:

- DM 15 BILLION FOR MUNICIPAL AUTHORITIES FOR DEVELOPMENT OF INDUSTRIAL AREAS, URBAN RENEWAL - PARTICULARLY TRANSPORT INFRASTRUCTURE - AND ENVIRONMENTAL PROJECTS. INTEREST TO BE FIXED AT

5 PERCENT WITH THE FEDERAL AUTHORITIES SUBSIDISING THE DIFFERENCE BETWEEN THAT AND NORMAL CAPITAL MARKET RATES AT A COST OF DM 2.6 BILLION OVER TEN YEARS:

- DM 6 BILLION TO BE MADE AVAILABLE FOR LOANS TO SMALL AND MEDIUM SIZED INDUSTRIES AND 0.5 PERCENT UNDER CAPITAL MARKET RATES:

B) THE BUNDESPOST WILL INCREASE ITS INVESTMENT PROGRAMME IN 1988 BY DM 1.5 BILLION TO ALMOST DM 20 BILLION:

C) PROPOSALS TO BE PUT BEFORE CABINET IN THE FIRST QUARTER OF NEXT YEAR TO INTRODUCE A MORE OPEN MARKET IN POSTAL SERVICES AND TO PAVE THE WAY FOR THE PRIVATISATION OF THE TELEPHONE SERVICE. MEASURES TO LIBERALISE THE TELEPHONE MARKET WILL IN ANY CASE BE INTRODUCED IN THE FIRST HALF OF THE YEAR:

D) THE GOVERNMENT WILL INTRODUCE IN THE FIRST HALF OF NEXT YEAR A PROPOSAL TO AMEND THE SHOP CLOSING HOURS LAW TO ALLOW LONGER OPENING ONE EVENING A WEEK:

E) THE PRIVATISATION PROGRAMME FOR 1988 WILL CONSIST OF THE DISPOSAL OF THE GOVERNMENTS'S REMAINING HOLDINGS IN:

- VOLKSWAGEN AG (16 PERCENT)
- VIAG AG (47.44 PERCENT)
- DSL BANK (99 PERCENT)

IT IS CLAIMED THE PROGRAMME WILL RAISE DM 2.5 BILLION:

F) THE GOVERNMENT WILL PUSH FORWARD THE COMPLETION OF THE EC INTERNAL MARKET DURING ITS PRESIDENCY:

G) ACCEPTANCE OF HIGHER PUBLIC SECTOR DEFICIT, ASSUMING GOVERNMENT REVENUES REMAIN AS FORECAST. (STOLTENBERG WARNED, HOWEVER, THAT THIS SHOULD NOT BE SEEN AS A CHARTER FOR UNCONTROLLED GROWTH IN SPENDING.):

H) PAY SETTLEMENTS WILL NEED TO BE LESS GENEROUS IN FUTURE TO KEEP IN LINE WITH DOMESTIC ECONOMIC GROWTH.

4. THERE HAS BEEN WIDESPREAD CRITICISM FROM THE FINANCIAL COMMUNITY, THE PRESS AND TRADES UNIONS AMONG OTHERS. THE ASSOCIATION OF GERMAN CHAMBERS OF COMMERCE, THE FEDERATION OF GERMAN INDUSTRY (CBI EQUIVALENT) AND THE COUNCIL OF ECONOMIC EXPERTS, WHO PRODUCED THEIR ANNUAL REPORT ON 23 NOVEMBER (MY TELNO 18 SAVING), COMPLAINED THAT THE PACKAGE WAS MISCONCEIVED. THE ASSOCIATION OF SMALL AND MEDIUM SIZED INDUSTRIES AND ALL THE LEADING ECONOMIC INSTITUTES CALLED INTO

QUESTION THE ECONOMIC AND PRACTICAL EFFECTS. THE OPPOSITION SPD PREDICTABLY LABELLED THE PACKAGE A CONFIDENCE TRICK, CLAIMED THAT IT WOULD HAVE NO POSITIVE EFFECT ON THE LABOUR MARKET AND CALLED FOR GREATER INCENTIVES FOR PUBLIC SECTOR INVESTMENT. THE OUTSPOKEN ECONOMIC SPOKESMAN FOR THE FDP, LAMBSDORFF, WAS HARSHLY CRITICAL, CLAIMING THAT THE ECONOMIC STIMULUS WOULD PRODUCE LESS THAN 0.5 PERCENT GROWTH. BY CONTRAST THERE ARE ALSO REPORTS OF SOME CONCERN IN CERTAIN QUARTERS OF THE GOVERNMENT AT WHAT IS SEEN AS A MOVE TOWARDS SPD STYLE REFLATIONARY METHODS.

COMMENT

5. THE MOST POSITIVE ASPECT IS THE DM 21 BILLION DEVELOPMENT CREDITS PROGRAMME AIMED AT REVIVING FLAGGING PUBLIC INVESTMENT. IT WILL NOT, HOWEVER, PROVIDE AN IMMEDIATE ECONOMIC BOOST AND IT IS QUESTIONABLE WHETHER ALL OF THE PROGRAMME WILL BE TAKEN UP. IN BUDGETARY TERMS THE FINANCIAL BURDEN IS LIMITED BUT EVEN SO THE GOVERNMENT HAS AS YET NO CLEAR IDEA OF HOW IT WILL BE FINANCED. THE REST: (PRIVATISATION OF THE BUNDESPOST, MODEST EXTENSION OF SHOP OPENING HOURS) IS OLD HAT. THE GOVERNMENT HAS DONE SO LITTLE TO CAMPAIGN FOR THESE MEASURES HOWEVER THAT THEY WILL HAVE DIFFICULTY GETTING PAST THE FIERCE RESISTANCE OF THE SPECIAL INTEREST GROUPS AFFECTED. THE PRIVATISATION PROGRAMME IS MUCH AS EXPECTED EXCEPT THAT IT OMITTS MENTION OF THE PART DISPOSAL OF A PUBLIC-OWNED MORTGAGE BANK, DEUTSCHE PFANDBRIEFANSTALT. NO ATTEMPT HAS BEEN MADE TO BRING IN ADDITIONAL PRIVATISATION PROCEEDS TO REDUCE PUBLIC SECTOR DEBT EVEN IN PRESENT STOCK MARKET CONDITIONS WHEN ESTIMATES OF THE AMOUNTS TO BE RAISED MUST BE SPECULATIVE.

6. THE GOVERNMENT IS ON THE DEFENSIVE. THE FEDERAL FINANCE MINISTER WAS AT PAINS TO INTRODUCE THE PACKAGE AS GROWTH RATHER THAN A SPENDING INITIATIVE. THIS SHOWS HE STILL REMAINS PREOCCUPIED BY THE DANGERS OF INFLATION RATHER THAN RECESSION. THE DOMESTIC CRITICISM WITH WHICH THE PACKAGE WAS GREETED HOWEVER SHOWS TWO THINGS: EVEN SUPPORTERS OF THE GOVERNMENT'S ECONOMIC POLICIES ARE NOW SUFFICIENTLY WORRIED ABOUT THE LIKELY ECONOMIC SLOW-DOWN TO BREAK THEIR CUSTOMARY PUBLIC SILENCE WHILE PUBLIC OPINION GENERALLY IS HAVING ITS ATTENTION INCREASINGLY FOCUSED BY THE MEDIA ON THE CONTINUED RISE, ALBEIT SLOW, IN UNEMPLOYMENT AND INFLATION. PUBLIC APPREHENSION AND DEBATE IS THUS RUNNING AHEAD OF THE GOVERNMENT. THERE IS NO CONSENSUS ON WHAT MORE OUGHT TO BE DONE. NOR IS THERE YET MUCH DISCUSSION OF UNDERLYING STRUCTURAL ISSUES. BUT SOMETHING IS STIRRING IN THE FOREST.

7. TENSION REMAINS BETWEEN THE BUNDESBANK AND THE GOVERNMENT. THE

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BANK, WHICH WAS IN ANY CASE MOVING TOWARDS CUTTING THE DISCOUNT RATE, RESENTS THE WAY IN WHICH IT SEES THE GOVERNMENT AS CONTRIVING TO HAVE CALLED THIS SHOT. IN A WEEK THEREFORE WHEN CENTRAL BANK AND GOVERNMENT HAVE BOTH TAKEN ACTIONS WHICH JOINTLY COULD HAVE BEEN PRESENTED AS FORMING PART OF A COORDINATED STRATEGY, THE IMPRESSION HAS INSTEAD BEEN CONVEYED OF POLICY IMPROVISATION AND CONTINUING INSTITUTIONAL BICKERING OVER COMPETENCE. WE MAY HEAR MORE OF THIS. THE GOVERNMENT HAS MISSED AN OPPORTUNITY AND STOLTENBERG, STILL PREOCCUPIED BY SCHLESWIG HOLSTEIN, IS BACK IN THE FIRING LINE.

8. FCO PLEASE ADVANCE TO BRAITHWAITE, FCO
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LITTLER, HM TREASURY
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