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FM BONN

TO PRIORITY FCO

TELNO 593

OF 021510Z JUNE 89

INFO ROUTINE EC POSTS, WASHINGTON, TOKYO, OTTAWA, UKDEL OECD
INFO SAVING CGS IN THE FRG AND BERLIN, BMG BERLIN

FRG ECONOMY: MAY REPORT

SUMMARY

1. STRONG ECONOMIC ACTIVITY CONTINUES, WITH INVESTMENT, PARTICULARLY IN THE CONSTRUCTION SECTOR, MAINTAINING HEALTHY GROWTH. UNEMPLOYMENT MAY HAVE FALLEN BELOW 2 MILLION, BUT INFLATION AT 3 PER CENT IS LESS PROMISING. ONE ESTIMATE SUGGESTS THAT GROWTH IN THE FIRST QUARTER WAS THE STRONGEST ON RECORD. PUBLIC SPENDING APPEARS SET TO REMAIN UNDER TIGHT CONTROL IN THE 1990 BUDGET NOW UNDER PREPARATION.

2. DESPITE PRESSURE ON INTEREST RATES AND EXCHANGE RATES, THE CENTRAL BANK COUNCIL AGAIN DEFIED THE MARKETS AND DID NOT RAISE OFFICIAL INTEREST RATES.

DETAIL

ECONOMIC DEVELOPMENTS

3. ON 24 MAY, STATE SECRETARY SCHLECHT (ECONOMICS MINISTRY) REAFFIRMED THE GOVERNMENT'S CONFIDENCE IN STRONG GROWTH THIS YEAR. HE FORECAST REAL GNP GROWTH OF 3 PER CENT, WITH INVESTMENT, PARTICULARLY CONSTRUCTION ACTIVITY PROVIDING THE MAIN STIMULUS. CORPORATE INVESTMENT IS EXPECTED TO RISE BY 7 PER CENT IN REAL TERMS, WHILE RESIDENTIAL CONSTRUCTION ALONE IS FORECAST TO SHOW A 4 PER CENT INCREASE. SCHLECHT SAID THAT UNEMPLOYMENT FIGURES WERE EXPECTED TO BE BELOW 2 MILLION FOR MAY (THE APRIL TOTAL WAS 2,035,104) AND THAT THE TOTAL FALL DURING THE YEAR WOULD BE 200,000. ON THE MAJOR SOURCE OF CONCERN, INFLATION, SCHLECHT CONFIRMED THAT THE GOVERNMENT HAD INCREASED ITS FORECAST FOR THE YEAR TO 3 PER CENT.

4. SCHLECHT'S REMARKS COINCIDED WITH THE RELEASE OF A REPORT BY THE BERLIN-BASED DIW ECONOMIC INSTITUTE CLAIMING RECORD GROWTH OF GNP IN Q189. OFFICIAL NATIONAL ACCOUNTS STATISTICS FOR THE PERIOD HAVE NOT YET BEEN RELEASED BUT THE DIW, WHICH HAS AN ENVIABLE RECORD FOR ACCURATE PREVIEWING OF NATIONAL ACCOUNTS DATA, SAID THAT Q1 GROWTH WAS 3 PER CENT HIGHER IN REAL TERMS THAN Q488 AND 4.4 PER CENT

HIGHER THAN Q188. ACCORDING TO THE INSTITUTE, THE MAIN COMPONENTS OF GROWTH WERE INVESTMENT (UP 10.9 PER CENT COMPARED TO Q188) AND EXPORTS (UP 8.8 PER CENT). IMPORTS ROSE BY 4 PER CENT. THE INSTITUTE FORECAST 4.5 PER CENT GNP GROWTH FOR Q289.

FISCAL POLICY

5. THE DRAFT BUDGET WILL BE PUBLISHED BEFORE PARLIAMENT RISES ON 23 JUNE. THE LATEST MEETING OF THE GOVERNMENT'S FINANCIAL PLANNING COUNCIL REAFFIRMED ITS INTENTION TO LIMIT THE RISE IN PUBLIC SPENDING TO 3 PER CENT. THE GOVERNMENT MAY INTEND TO RETAIN TIGHT CONTROL OVER FEDERAL SPENDING - A RISE OF 2.0 PER CENT WAS PROJECTED FOR 1990 IN THE LAST FIVE YEAR FINANCIAL PLAN, BUT THIS MAY BE SLIGHTLY EXCEEDED - WHILE ALLOWING LAENDER AND MUNICIPAL AUTHORITIES GREATER LATITUDE. THE GOVERNMENT HAS ALSO GIVEN NOTICE THAT IT WILL PROPOSE AN INCREASE IN THIS YEAR'S SUPPLEMENTARY BUDGET, CURRENTLY AT THE COMMITTEE STAGE IN THE BUNDESTAG, FROM DM222 MILLION TO SOMETHING OVER DM1.2 BILLION TO TAKE ACCOUNT OF ADDITIONAL SPENDING ON REFUGEES, MAINLY FROM EASTERN EUROPE. MUCH OF THE ADDITIONAL SPENDING WILL BE OFFSET BY HIGHER THAN EXPECTED TAX REVENUE.

MONETARY POLICY AND FINANCIAL MARKETS

6. THE CENTRAL BANK COUNCIL AGAIN DEFIED MARKET EXPECTATIONS AND DECLINED TO RAISE OFFICIAL INTEREST RATES. IN ITS REGULAR SECURITIES REPURCHASE TRANSACTIONS, THE BUNDESBANK CONTINUED TO FUND THE MONEY MARKETS ADEQUATELY THROUGH VARIABLE RATE TENDERS. THE PRESSURE ON MARKET INTEREST RATES REMAINED, AND BOTH LONG AND SHORT-TERM RATES REACHED NEW HIGHS FOR THE YEAR. IN THE FACE OF THIS PRESSURE AND UNCERTAINTY ON THE FRANKFURT FOREIGN EXCHANGE STOCK MARKETS FOR THE MOST PART REMAINED SLUGGISH, THOUGH AT A HIGH LEVEL. THEY FINALLY RALLIED TOWARDS THE END OF THE MONTH AND THE MAIN INDICATORS RECORDED NEW HIGHS FOR THE YEAR ON 31 MAY. DEALERS ARE OPTIMISTIC THAT THE RECOVERY CAN BE SUSTAINED. ON THE FOREIGN EXCHANGE, THE US DOLLAR RECORDED ITS HIGHEST LEVEL FOR THE YEAR OF DM2.0137 AT THE FRANKFURT MIDDAY FIXING ON 22 MAY. MEANWHILE, STERLING CONTINUED TO DECLINE AGAINST THE D-MARK, REACHING DM3.124, ITS LOWEST MIDDAY FIXING SINCE SEPTEMBER 1988.

COMMENT

7. THE DECISION TO LEAVE INTEREST RATES UNCHANGED CAME AFTER A LONG MEETING OF THE CENTRAL BANK COUNCIL IN BERLIN ON 1 JUNE. IT SURPRISED MANY OBSERVERS, BUT THERE IS GENERAL SUPPORT FOR THE BUNDESBANK'S HANDLING OF MONETARY POLICY AND A RECOGNITION THAT WITH MONEY SUPPLY GROWTH EASING AND NO FURTHER INCREASE IN INFLATION, THE PRESSURE FOR HIGHER INTEREST RATES WAS EXTERNAL RATHER THAN

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DOMESTIC. THERE REMAINS SPECULATION THAT THE BUNDESBANK IS
CONSIDERING A FUTURE ADJUSTMENT TO THE LOMBARD RATE.

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