

UNCLASSIFIED
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 10 SAVING OF 31 August 1989. 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. GNP growth remained strong. Reliable estimates show 3.9% growth in the second quarter, and the consensus is that GNP growth for the full year will be between 3.5 and 4%. (Paras 7 & 8)
2. Employment continued to rise. Short time working was at its lowest level since 1973. (Para 9)
3. Industrial and business activity maintained a high level. New orders and production increased. Capacity utilisation rose. The business and consumer climate indices remained high, and retail trade turnover is now expected to grow by 3% this year. (Paras 10 to 14)
4. Inflation fell to 2.9% in August. Interest rates remained steady. Monetary growth accelerated in July, but M3 remained within the 5% target. (Paras 15 to 18)
5. On the foreign exchanges the Dollar regained ground and the Pound held up against the Mark. Stock markets attained an all time high. (Paras 19 & 20)
6. Foreign trade reached record levels in June. The trade surplus was the second highest at DM 13.9 bn. The current account surplus rose to DM 10 bn. Capital flows were positive for the first time in two years. The trade gap with the UK rose from DM 18.5 bn to DM 24.9 bn. (Paras 21 to 23)

DETAIL

GNP

7. Indications were of continued strong growth in the second quarter of 1989. Although official figures are not yet available, GNP estimates issued by the DIW Institute in Berlin, whose previous estimates have proved to be extremely accurate, show real growth in Q2 of 3.9% after 4.2% in Q1. Many economists had feared that the slowdown in growth would be more marked as the first quarter was boosted by exceptional factors such as the mild winter and the high level of earnings on investment abroad. The makeup of growth shifted from Q1 to Q2 with building investment growth trailing off to 2.7% from 10.8%

while growth in machinery and equipment investment rose from 7.5% to 12%. Exports too made a greater contribution towards overall growth, up by a real 15.4% on Q288 against a 12.9% rise in imports, pushing net exports up to DM 17.7bn compared with DM 12.5bn a year earlier. The expansion in private consumption edged up to 1.9% after 1.3% in Q1.

REAL GNP (% change on a year earlier)

	1987	1988	Q188	Q288	Q388	Q488	Q189	Q289
Priv consumption	3.6	2.5	3.3	1.4	2.5	1.2	1.3	1.9
Gov't consumption	1.5	1.8	1.8	2.1	2.2	1.2	0.4	0.4
Fixed capital formation	2.5	5.8	14.3	4.7	2.6	4.3	9.3	6.5
Machinery & Eqpt	1.6	7.1	7.1	6.8	7.0	8.8	7.5	12.0
Buildings	0.2	4.5	21.0	3.3	-0.2	0.4	10.8	3.7
Exports	0.8	5.5	5.7	5.6	5.4	5.3	9.9	15.4
Imports	4.9	5.9	6.5	5.2	9.3	6.5	4.6	12.9
GNP	1.8	3.4	4.4	3.4	3.4	2.7	4.2	3.9

Source: DIW Berlin

8. In the light of the continued strength of economic indicators, forecasts for 1989 as a whole are busily being revised upwards. While the Economics Ministry spoke confidently of 3.5% growth, the Ifo Institute released its forecast of 4%. The consensus lies somewhere in-between. The current optimism has also spread to expectations for 1990 with most commentators now predicting further expansion of around 3%. The Economics Ministry's economic projection for 1989-1993 shows expected average growth of 2.5% real. Inflation is expected to be contained around 2%. With domestic demand growing faster than overall GNP, boosted by lively corporate investment, nominal net exports as a proportion of GNP will decline from 5.6% in 1988 to 4% in 1993. Building investment is also predicted to remain strong while government consumption and public sector investment will lag behind as a result of continued efforts to reduce both state spending and tax ratios.

LABOUR & SOCIAL AFFAIRS

9. Although unemployment in July rose by 57,300 or 3% to 1,972,500, this was lower than the usual rise at this time of year when the holiday period and school-leavers swell the numbers. The unemployment rate climbed from 7.4% to 7.7%. Seasonally adjusted unemployment fell. Compared with a year earlier unadjusted unemployment in July was 226,800 or 10% lower. Short-time working fell to its lowest level since July 1973 at 32,624 while the number of vacancies was steady at 255,000. Employment figures for June show a rise on a year earlier of 313,000 to 27.6 million but the rate of increase is no longer as strong as at the turn of the year. Attention is already being focussed on the 1990 wage round which sees the expiry of the three-year wage agreements in a number of important industries. The powerful IG Metall trade union has already reaffirmed its objective of achieving the 35-hour week while at the same time highlighting the marked rise in corporate profits over the last few years. Economic institutes, the Government and employers are warning of the need for moderation on the wages front if the current economic upswing is to be maintained.