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Prime Minister

BY BAG

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 14 SAVING OF 30 MARCH 1983. Info all EC Posts,
UKDel OECD, UKMis Geneva, all Consulates-General
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FEDERAL GERMAN ECONOMY

Summary

1. Chancellor Kohl's election victory was the best result for business. His Cabinet contains great economic experience. Confidence that the upswing in the economy has arrived is continuing to grow and is supported by a number of positive developments. New orders, production, construction work have all increased. The Bundesbank has reduced interest rates by a full percent. There has been a further fall in the rate of inflation and improvement in current account. In addition business confidence has been boosted by lower oil prices and the early declarations of the new Coalition on economic policy. At the same time early indications are that German business will be able to live with the EMS realignment. The stockmarket remains buoyant. Stock prices have risen by 20 per cent since last autumn. All this has led a number of commentators to revise their forecasts for a GNP growth this year of a real 1 to 2 per cent compared with earlier predictions of nil.
2. However, unemployment continues to grow while short time working has reduced slightly. The Kiel Economic Institute (the most successful economic forecasters in 1982 and consistently pessimistic) have pointed to the risks if the Government is unsuccessful in controlling the budget and wage settlements are not held below the rate of inflation. They also point to the sensitivity of German exports to protectionist moves and to debt problems in LDCs. Business confidence will need nurturing if it is to be translated into new investment.

Detail

Prospects and Current Indicators

3. Most commentators see the beginning of an upturn although some remain sceptical and point particularly to the continuing rise in

/unemployment

unemployment and the effects of rationalisation on further unemployment. However, there appears to be continuing evidence that recovery is now on the way. The February IFO report records a continuing rise in business confidence and this will no doubt be further encouraged by the Coalition's announcement of its intention to reduce the budget deficit (see paragraph 9) and by the reduction in interest rates (Discount Rate down to 4 per cent, Lombard 5 per cent).

4. Provisional figures for January show a marked increase in new orders. Incoming orders in the manufacturing sector rose by 6.5 per cent on December, the third successive month-on-month rise. The two-monthly comparison, December/January against October/November shows an 11 per cent increase. Domestic orders increased by 4 per cent and export orders by 8.5 per cent. The focal point of increased order activity was in the capital goods sector which increased by 7 per cent in January compared with January 1982. The level of new orders, on a year-on-year basis, increased by 4.5 per cent, the first increase for almost a year.

5. Production figures also show a significant improvement, albeit from a relatively low level. Production in January increased by 4 per cent on December. As with incoming orders, the capital goods sector rose most, by 6 per cent: other sectors also registered increases. However, the overall level of production remains low when compared on a year-on-year basis. Total production in December/January was down 5 per cent on the corresponding period a year earlier. The quarterly IFO survey of industrial capacity shows that in the fourth quarter of 1982 capacity utilisation increased to 75.3 per cent from the record low of 74.9 per cent at the end of the third quarter.

6. The latest construction industry statistics are keenly awaited as the construction sector provided one of the first signs of an upturn in the economy. January showed an increase in output by just over 14 per cent compared with December and by 18 per cent compared with January 1982. Capacity utilisation rose to 57 per cent, 4 per cent higher than in December. The length of order books also improved to 2.2 months. However optimism should be tempered by the fact that improvement comes from a very low base as can be seen from the graph on page 9.

7. Prices also continue to improve: inflation (cost of living indexed) in February fell to 3.7 per cent from 3.9 per cent in January. Over the last 6 months prices have risen by under 3 per cent at an annual rate. The annual increase in retail prices also continued to ease falling to 3.6 per cent in February from 3.9 per cent in January, while wholesale prices fell by 0.8 per cent compared with January. In contrast to the progress on prices, unemployment has continued to increase and has reached 2.54 million (10.4 per cent) its highest level since the establishment of the Federal Republic although short-time working fell. However, the number of insolvencies in January was down on the high level of December 1982 although up 30 per cent on January 1982.

8. The current account in January 1983 was in balance, compared with a DM 2.9 billion deficit a year earlier. February showed a current account surplus of DM 0.8 billion.

9. The Coalition parties have said that they intend to keep the Federal budget deficit to under DM 40 billion in 1984 from the present level of DM 41 billion. This will entail a reduction in Federal expenditure of DM 6.5 billion. At the same time they hope to hold Federal budget growth to 2 per cent per annum (DM 258 billion in 1984) rising to 3 per cent in 1985-87. It is planned to reach the 1984 target by cutting unemployment benefit, limiting public sector pay, limiting increases in pensions, increasing pension contributions, increasing health insurance contributions and restructuring the qualifications for social security benefits. However it will be difficult for the Government to reach these targets. Although some commentators predict real growth of 1 to 2 per cent in 1983, unemployment is also expected to increase to about 3 million by the end of the year. This will reduce tax revenue while increasing Government expenditure. The Government will also be faced with large extra expenditure in troubled industrial sectors and, in addition, the Bundesbank's windfall profit will be reduced from DM 11 billion to DM 6 billion as a result of lowering interest rates.

10. This has been the best month for the German economy for some time. Hopes are rising but there is no euphoria. The intractability of the unemployment situation and the likelihood of further large

/redundancies

redundancies in steel, coal and shipbuilding, make clear that even if recovery proceeds steadily the German economy and German society have no early answers to the problems of massive unemployment.

Production

11. Provisional production figures for January show a 4 per cent increase in output on December, a significant upturn although the overall level of production remains relatively low. In line with the revival in incoming orders, capital goods output rose most sharply (+ 6 per cent), although other sectors also improved. Construction activity in January was up by 14.5 per cent on December, in part due to the mild weather but also the first statistical confirmation of improving demand in the construction sector.

12. The two-monthly comparison, December/January against October/November, reveals a 1 per cent increase in both overall production and manufacturing output. Capital goods output was stable, while other sectors recorded small improvements. Construction activity was 3 per cent up on the preceding two-month period. However, the overall level of production still remains low, as reflected in the year-on-year comparison: total production in December/January was 5 per cent down on the corresponding two-month period a year earlier, with manufacturing industry showing a decline of 6 per cent. The output of all major sectors was lower than a year earlier. However the construction sector registered an increase of 10 per cent although this should be considered against the severe winter of 1981/82 and the correspondingly poor output figures for that period.

Production

1976 = 100

	<u>Total</u>	<u>Basic & producer goods</u>	<u>Capital goods</u>	<u>Consumer goods</u>	<u>Construction</u>
1981 December	105	101	111	96	84
1982 January	106	102	112	99	88
October	101	94	107	94	95
November	101	94	107	94	94
December	100	93	104	95	91
1983 January*	104	96	110	95	104

* = provisional

New Orders

13. Provisional figures for January show a marked increase in order activity at the beginning of the year. In real terms incoming orders in the manufacturing sector rose by 6.5 per cent on December, the third successive month-on-month rise. Domestic orders were up by 4 per cent, while export orders rose by 8.5 per cent. As in December, the focal point of increased order activity was the capital goods sector.

14. The two-monthly comparison, December/January against October/November, also shows an upwards trend - manufacturing sector orders were up by 11 per cent overall, with domestic demand particularly strong (+ 15.5 per cent). The steady decline in foreign demand since early 1982 was also halted, orders from abroad rising in December/January by 1.5 per cent on the preceding two-month period. Capital

/goods

goods again led the field (+ 18.5 per cent), followed by consumer goods (+ 4 per cent) and basic and producer goods (+ 0.5 per cent). Significantly, the level of new orders in December/January exceeded the corresponding level a year earlier (+ 4.5 per cent), the first time in almost a year that a year-on-year increase has been registered. Although export orders remained below the relatively high level of a year earlier (- 10 per cent), domestic orders recorded a real increase of 13 per cent. Incoming orders for capital goods were up by 7 per cent year-on-year and consumer goods by 2.5 per cent, while basic and producer goods orders were slightly lower than a year earlier (- 1 per cent).

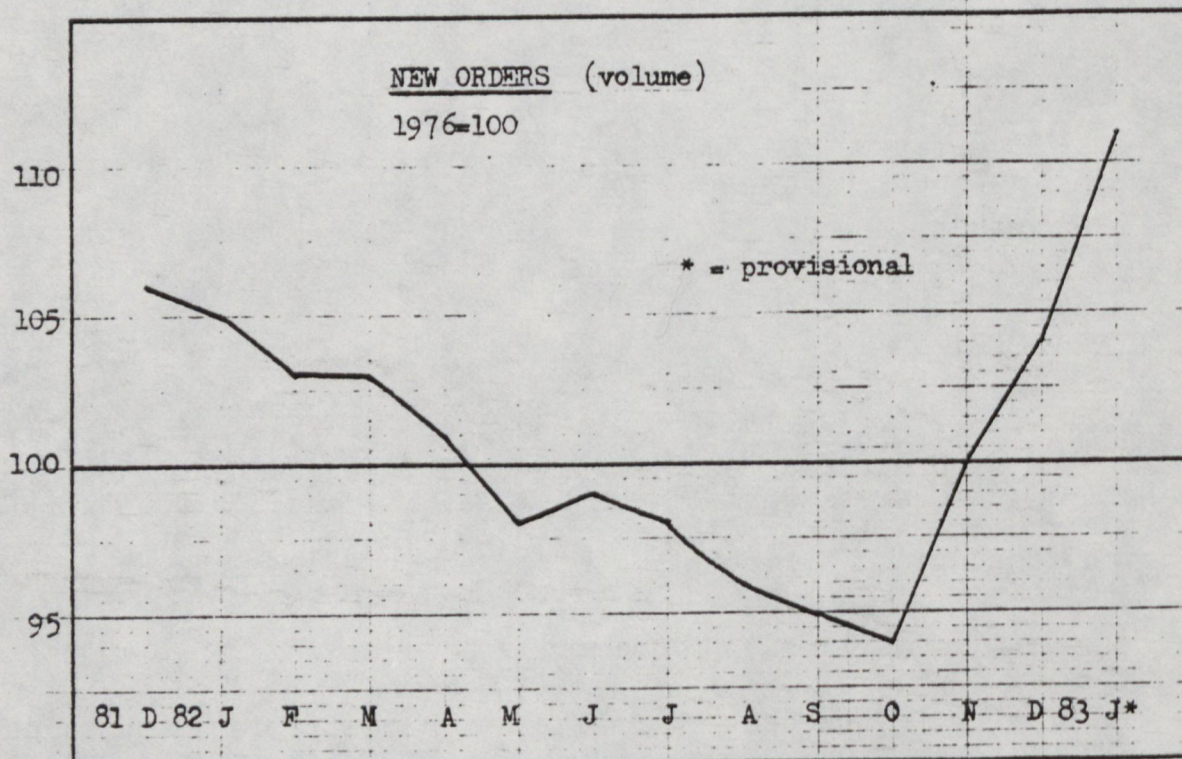
New Orders

1976 = 100

	<u>Total</u>		<u>Domestic</u>		<u>Foreign</u>	
	<u>Value</u>	<u>Volume¹</u>	<u>Value</u>	<u>Volume</u>	<u>Value</u>	<u>Volume</u>
1981 December	131	106	120	97	153	125
1982 January	131	105	122	97	152	123
October	120	94	115	90	133	105
November	128	100	122	95	139	109
December	134	104	134	105	132	104
1983 January*	141	111	140	109	144	113

1 = at constant prices

* = provisional



Prices

15. Continuing success on the price front. The West German cost of living index rose by only 0.1 per cent month-on-month in February to stand 3.7 per cent up on a year earlier after 3.9 per cent in January and 4.6 per cent in December 1982. Over the past six months and calculated at an annual rate, prices have risen by under 3 per cent. Food prices in February were 1.8 per cent up on a year earlier.

16. The annual increase in retail prices also continued to ease, down to 3.6 per cent in February after 3.9 per cent in January. Wholesale prices fell by 0.8 per cent on January, down also by 0.8 per cent on February 1982. Import prices were also lower than a year earlier, down by 2.1 per cent in February after an annual fall of 0.9 per cent in January, while the year-on-year increase in export prices dropped to 1.7 per cent after 2.1 per cent at the beginning of the year. Industrial producer prices, February figures for which are not yet available due to a readjustment of the base year, stood 2.3 per cent up on a year earlier in January, well down on the level of increase at the end of 1982. Agricultural producer prices in January were 3.2 per cent lower than a year earlier. Latest Terms of Trade figures for February indicate a slight worsening compared to January (- 1 per cent) but were nevertheless 2.8 per cent up on their February 1982 level.

Prices

1976 = 100

	<u>Cost of living</u>	<u>Industrial producer prices</u>	<u>Agricultural producer prices</u>	<u>Retail prices</u>	<u>Import prices</u>	<u>Export prices</u>
1982 January	127.9	131.5	111.0	125.7	144.4	124.8
February	128.2	131.6	109.5	126.2	145.4	125.5
1983 January	132.9	134.5	107.4*	130.6	143.1	127.4
February	133.0			130.7	142.4	127.6

* = provisional

Private Consumption

17. Bundesbank figures on retail trade turnover in January indicate a nominal increase of 1.4 per cent on a year earlier, in real terms a fall of 2.5 per cent.

18. It is widely accepted, however, that the worst is now over. The February IFO survey reveals an improvement within the industry in both the assessment of the current situation and in expectations for the next months. In seasonally adjusted terms, turnover showed an improvement of 1.4 per cent in January compared to December. Retail price increases practically reached a standstill with the annual rate of increase falling to 3.6 per cent in February and although price rises are reportedly in the pipeline, they are likely to remain well below the level of early 1982. In more general terms, private

/consumption

consumption is expected to receive a boost from falling oil prices which could lead to a fall in heating costs, coupled with the widespread optimism associated with the upswing. Over the year as a whole, however, private consumption is unlikely to exceed last year's level in real terms.

Labour Affairs

19. As expected, the February unemployment figures showed a further deterioration in the employment situation with 2.54 million (10.4 per cent) unemployed against 1.94 million (8.1%) a year earlier. The seasonally adjusted figure also rose to 2.2 million and although the numbers on short time working fell, thus reversing the trends in previous years, there were still 1.15 million on short time. Nor was there any sign in the vacancy statistics that the economy was picking up. At the end of February there were still only 69,000 vacancies. This was 7,000 more than in the previous month but was still only half the number outstanding in February 1982. The unemployment rate among foreign workers rose to 15.4 per cent. The detailed figures were as follows:

	<u>End Feb 1983</u>	<u>End Jan 1983</u>	<u>End Feb 1982</u>
a. Unadjusted total	2,535,836(10.4%)	2,487,075(9.1%)	1,935,316(8.1%)
b. Adjusted total	2,209,000	2,121,000	1,636,000
c. Short time working	1,148,200	1,190,397	587,159
d. Unfilled vacancies	68,800	61,828	132,034
e. Total men in a.	1,538,712	1,490,652	1,144,321
f. Total women in a.	997,124	996,423	796,750

20. The wage negotiating round continued with the first major settlement in the metal-using industries creating some controversy. Volkswagen settled at 4% spread over 15 months for its 117,000 workers and this is said to have made negotiations at regional level for other private sector metal employers particularly difficult. Negotiations at regional level broke down at one point but at the end of the month were set to resume with the employers still sticking to their revised offer of 2.5%.

21. A major settlement affecting 660,000 chemical workers was reached at the end of the month. It provided for a pay rise of 3.2 per cent over 14 months, for increased holiday pay and, most significantly, for a shorter working week (38 hours from September 1984 and 36 hours from 1987) for workers aged 58 and over. The settlement is likely to have a significant effect on negotiations on hours of work which in most industries will take place next year.

Construction

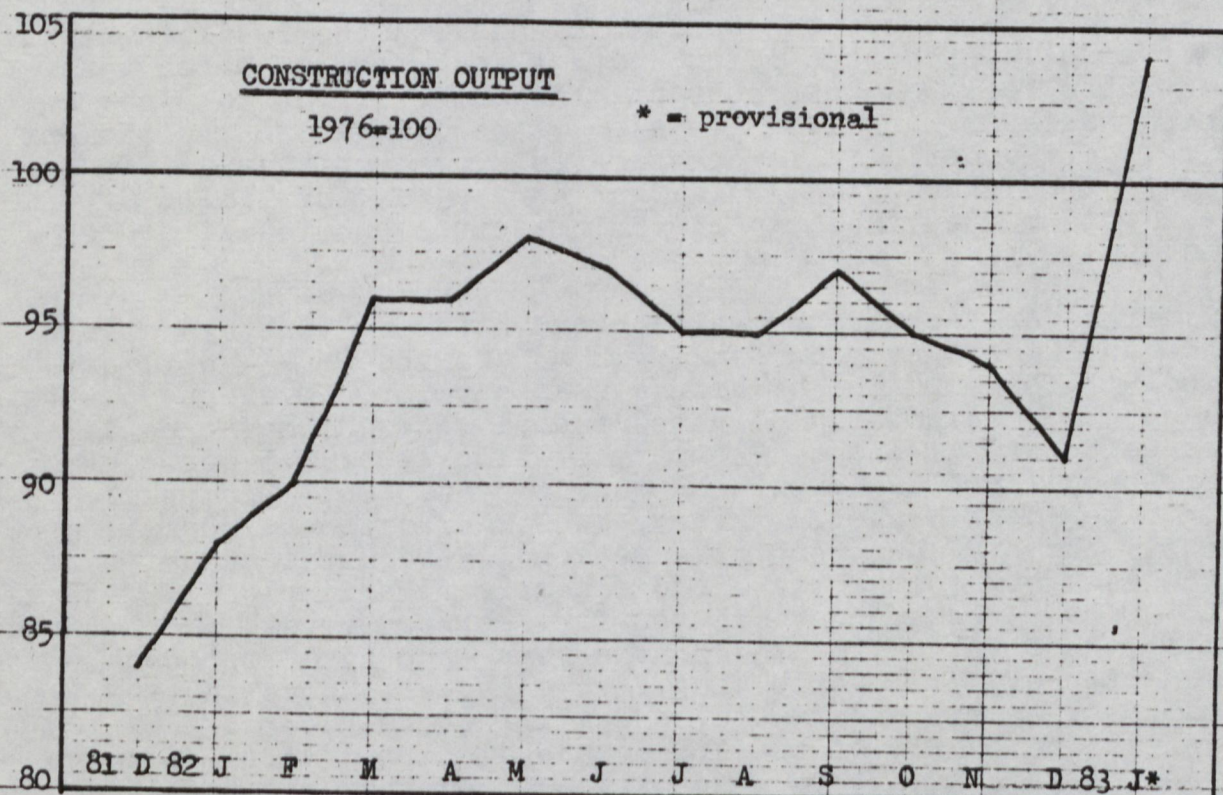
22. The construction industry statistics are eagerly awaited as one of the leading indicators of the upswing in the economy. Figures for January showed a sharp upturn; output up by just over 14 per cent on December. While the improvement was undoubtedly helped by a distinct upsurge in demand, the exceptionally mild weather was

/also

also a supporting factor. The two-monthly comparison, December/January against October/November, reveals a 3 per cent increase in construction activity, while compared with the corresponding two-month period a year earlier output was up by 10 per cent, the result favoured somewhat by the low level of output attained in the severe winter 1981/82.

23. The February IFO survey confirms the growing optimism within the industry, in particular in regard to the coming six months. A reflection of the mild weather is the figure of only 40 per cent of firms who reported production difficulties due to the weather, compared to over 90 per cent at the beginning of the two previous years. As a result of increased output, capacity utilisation climbed to 57 per cent, 4 percentage points higher than in December. The length of order books also improved on recent months, at 2.2 months unchanged on a year earlier. Prices remained on a downwards trend at the beginning of the year, although they are expected to start to rise again in the coming months - a further indication of recovering demand.

24. However the President of the Construction Industry Association has warned against premature optimism; the overall situation in the construction industry remained poor, only the housing sector offering growth opportunities, while demand in the public buildings sector, which constitutes half of construction industry's domestic turnover, would remain depressed. The chances for the 262,200 construction workers unemployed in February of regaining employment were slight because 184,481 workers on short time will first have to return to full shifts.



/Balance

Balance of Payments

25. In January 1983 the West German current account (foreign trade, services and transfer payments combined) finished in balance after a large surplus of DM 5.9 billion in December 1982; compared to a year earlier, however, when the current account showed a deficit of DM 2.9 billion, this indicates a marked improvement. Seasonally adjusted, the current account continued to enjoy a sizeable surplus. The favourable underlying tendency in the visible trade balance also continued, recording a surplus of DM 2.7 billion against a surplus of only DM 1.1 billion a year earlier. Compared with January 1982 exports grew by 3 per cent, while imports fell by 2 per cent. On the services account, as always at this time of year, a renewed deficit was incurred, DM 1.3 billion against a surplus of DM 1.7 billion in the preceding month. The deficit on transfer payments in January, at DM 2 billion, was down slightly on December 1982, due mainly to lower payments to the EC. On long-term capital account capital exports were dominant (DM 2.4 billion). Direct investment abroad exceeded incoming investment by DM 0.6 billion. On short-term capital account there were large inflows (DM 5.9 billion).

26. The net foreign assets of the Bundesbank rose by DM 1.6 billion in January. In February the high level of activity on the exchange markets, in particular within the EMS, led to a rise of DM 4.1 billion.

27. In 1983 the current account surplus is expected to increase further from the DM 7.5 billion attained in 1982 to around DM 15 billion.

Monetary

28. As widely forecast, the Bundesbank has reduced leading interest rates by a full percentage point; with effect from 18 March the Discount rate fell to 4 per cent and the Lombard rate to 5 per cent, returning to their March 1979 level. Fears of the EMS realignment delaying the reduction in interest rates proved unfounded. The President of the Bundesbank said that he regards the limits of interest rate manoeuvrability in the present economic climate as reached.

29. Figures for February reveal continued strong monetary growth, although easing slightly on January. M3 grew by DM 4.4 billion compared with only DM 3.3 billion a year earlier. Over the last six months and at a seasonally adjusted annual rate, M3 has expanded by 7.5 per cent; at the end of February it also stood 7.5 per cent up on its corresponding 1982 level. M2 was up by 4.5 per cent, while M1 was a full 10 per cent higher. Private sector credit continued to grow moderately, up by 4 per cent at a seasonally adjusted annual rate over the last six months, with the emphasis remaining on long-term credit. Central Bank Money figures for February reveal accelerated growth in the first two months of the year - up by 11 per cent on the final quarter of 1982; while this figure is well above the 4-7 per cent target for 1983 as a whole, special factors such as EMS intervention on behalf of the Franc have distorted inflows at the start of the year and it is generally assumed that the targetted growth rate will be reattained over the coming months.

/FRG/UK

G/UK £1 = DM 3.53

30. In the 12 months to the end of January 1983 West German imports from the UK were DM 27 billion or 7.2 per cent of total imports. A year earlier the UK share of the market had stood at 7.3 per cent. Total German exports rose by 1.3 per cent on the preceding 12 month period while imports from the UK fell by 0.8 per cent.

31. Excluding oil, imports from the UK were up by 2.4 per cent year on year, marginally less than the increase in total West German non-oil imports (up 3.0 per cent). The UK market share remains at 5.4 per cent.

32. The trade gap over the last twelve months continued to grow in favour of West Germany (DM 4.8 billion). This compares with a UK surplus (DM 0.5 billion) in the preceding 12 month period.

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Federal Republic of Germany: Main economic statistics

Seasonally adjusted	Q4 1981	Q3 1982	Q4 1982	% change on prev.	
				quarter	year
1. Expenditure on the GNP					
(current prices)					
		<u>DM mrd</u>			
a) Gross National Product	393.6	402.6	404.8	+ 0.5	+ 2.8
b) Private consumption	222.5	225.0	227.1	+ 0.9	+ 2.1
c) Government consumption	80.7	82.5	84.0	+ 1.8	+ 4.1
d) Fixed capital formation	83.0	83.1	83.0	- 0.1	+ 0.0
e) Exports of goods & services	133.0	132.1	134.2	+ 1.6	+ 0.9
f) Imports of goods & services	123.4	123.1	122.3	- 0.6	- 0.9
g) Net exports	9.5	9.0	11.9		
2. Expenditure on the GNP					
(constant prices)					
a) Gross National Product	316.5	311.0	310.5	- 0.2	- 1.9
b) Private consumption	175.2	170.8	170.7	- 0.1	- 2.6
c) Government consumption	62.8	62.6	63.2	+ 1.0	+ 0.6
d) Fixed capital formation	63.3	62.5	62.1	- 0.6	- 1.9
e) Exports of goods & services	106.8	103.4	104.0	+ 0.6	- 2.6
f) Imports of goods & services	89.8	90.0	87.7	- 2.6	- 2.3
g) Net exports	17.1	13.4	16.2		
3. Income of households					
a) Gross wages & salaries	188.7	190.5	191.2	+ 0.4	+ 1.3
b) Disposable income	262.0	262.8	265.1	+ 0.9	+ 1.2
c) Savings as a % of b)	15.1	14.4	14.3		
4. Productivity					
<u>1976=100</u>					
a) In the economy as a whole					
i) GNP per working person (1976 prices)	111.1	110.6	111.0	+ 0.4	- 0.1
ii) wage and salary costs per production unit	123.4	127.1	128.1	+ 0.8	+ 3.8
b) In industry	<u>Dec 81</u>	<u>Nov 82</u>	<u>Dec 82</u>	<u>month</u>	<u>year</u>
i) output per employed person	110	109	109	+ 0.0	- 0.9
ii) wage and salary costs per production unit	127	133	132	- 0.8	+ 3.9
5. Industrial production					
	<u>Jan 82</u>	<u>Dec 82</u>	<u>Jan 83</u>		
a) Total	106	100	104	+ 4.0	- 1.9
b) Manufacturing industry	107	100	104	+ 4.0	- 2.8
c) Construction	88	91	104	+ 14.3	+ 18.2
6. New orders					
a) Total	131	134	141	+ 5.2	+ 7.6
b) Domestic	122	134	140	+ 4.5	+ 14.8
c) Foreign	152	132	144	+ 9.1	- 5.3

<u>unadjusted</u>	<u>Feb 82</u>	<u>Jan 83</u>	<u>Feb 83</u>	<u>% change on prev.</u>	
				<u>month</u>	<u>year</u>
7. Unemployment		<u>in 1000's</u>			
a) i) unemployed	1 935.3	2 487.1	2 535.8	+ 2.0	+ 31.0
ii) as a % of the working population	8.1	10.2	10.4		
b) Short-time workers	587.2	1 191.8	1 148.2	- 3.7	+ 95.5
c) Vacancies	132.0	61.8	68.8	+ 11.2	- 47.9
8. Prices		<u>1976 =100</u>			
a) Cost of living of all private households	128.2	132.9	133.0	+ 0.1	+ 3.7
b) Retail prices	126.2	130.6	130.7	+ 0.1	+ 3.6
c) Export prices	125.5	127.4	127.6	+ 0.2	+ 1.7
d) Import prices	145.4	143.1	142.4	- 0.5	- 2.1
Terms of Trade	87.2	90.5	89.6	- 1.0	+ 2.8
e) Producer prices of industrial products	<u>Jan 82</u> 131.5	<u>Dec 82</u> 134.5	<u>Jan 83</u> 134.5	+ 0.0	+ 2.3
9. Balance of Payments		<u>DM mrd</u>			
a) Visible trade					
i) exports	31.4	38.0	32.4		
ii) imports	<u>30.3</u>	<u>31.6</u>	<u>29.6</u>		
iii) balance	+ 1.1	+ 6.4	+ 2.7		
b) Supplementary trade items	+ 0.0	+ 0.2	+ 0.6		
c) Services	- 2.0	+ 1.7	- 1.3		
d) Transfers	<u>- 2.0</u>	<u>- 2.3</u>	<u>- 2.0</u>		
e) Current account	- 2.9	+ 5.9	- 0.0		
10. Net foreign reserves	66.9	71.5	73.1		
<u>seasonally adjusted</u>				<u>Total in IM mrd at the end of:</u>	
11. Money stock				Jan 83:	265.1
M1	+ 1.2	+ 4.0	+ 7.6	Jan 83:	484.9
M2	+ 10.2	- 2.0	+ 8.2	Jan 83:	814.2
M3	+ 14.2	+ 4.3	+ 16.5		
<u>unadjusted</u>				Jan 83:	947.1
12. Monetary capital formation	+ 3.6	+ 15.4	+ 1.5		
13. Bank rates:	Since 18.3.83	Discount rate: 4%			
	Since 18.3.83	Lombard rate: 5%			

Sources: Federal Statistical Office, Wiesbaden; Deutsche Bundesbank, Frankfurt
 Discrepancies in the totals are due to rounding (2)

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