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BY BRG

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 18 SAVING OF 29 JUNE 1984. Info all EC Posts, UKDel OECD, UKMis Geneva, all Consulates-General in the Fed Republic, Washington, Tokyo, Vienna

FEDERAL GERMAN ECONOMY

Summary

1. June was worse than May. The upward course followed by the economy in the early months of the year has flattened. Estimates for 1984 output are being revised downwards from 3 per cent to 2.5 per cent in real terms. Interest is centering on the extent to which the earlier momentum can be recovered. Some voices are saying that the recovery is over. Confidence is weaker. Government's touch perceived as less firm. Lambsdorff's departure a serious loss. But at least the metal strike is over and there are hopes that Q3 will be better than Q2.

Detail

2. Lambsdorff's resignation over the Flick affair robs the German economy of one of its most distinguished and experienced managers. He will be sorely missed. His departure comes at a weak point in Germany's economic recovery. Lambsdorff was a doughty protagonist of market economy principles. His successor, Bangemann, has not over time shown the same consistent attachment to these principles and will, in any case, need time to establish himself. March's poor figures were repeated in April and the predictions are that May and June will also be bad; Q2 will therefore register a decline on Q1 led by a fall in new orders, production and consumer expenditure. Most see the metal workers' strike as the culprit for the poor outturn in Q2. The strike had two adverse effects: firstly, the threat of strike action earlier in the year encouraged a build-up of stocks and a high level of orders in January and February in anticipation of the strike and secondly the strikes (the printers are still out) have adversely affected new investment and business confidence. However, it is widely held that the Q3 outturn could compensate for Q2 because many firms, on account of the strike, obliged their workers to take their holidays in the second quarter rather than at the traditional time in the third quarter.

3. Bangemann (the new Minister of the Economy, see Bonn teltnos 638 and 639 of 22 June) takes over at a difficult time. He is fortunate in that the metal workers' strike has been settled. His main aim no doubt will be to restore confidence in the Government's ability to get the economy back on the growth path.
4. It remains to be seen how much future growth will be hindered by the new metal workers' agreement. Weekly working time in the metal industry has been cut from 40 to 38.5 hours but will be subject to individual agreements at plant level thus allowing for flexibility. However, while it is unclear what the effects on costs, competitiveness (particularly in the automobile industry) and production will be, a direct result will be to encourage other unions to follow suit in demanding a real cut in working time. The long term cost and production effects must therefore be negative, while the employment effects are likely to be negligible.
5. What is clear however, is that the effect on confidence and investment has been serious. A mood of nervousness prevails and there is concern about the growth of the investment sector which a few months ago was widely held to be one of the keys to GNP growth in the second half of 1984. This nervousness, and the poor Q2 outturn has led some economists to revise their forecasts of 3% real GNP growth downwards to 2.5%. The Government view, as measured by their budget assumption, remains at 2.5%. A review of the leading economic institutes shows that growth of between 2.5 and 3% in 1984 is still possible. However, the Kiel Institute, the most pessimistic but with the best track record, is forecasting 2.5% which will be fuelled by exports with investment only increasing slightly on 1983. They see no prospect for improvement in the labour market and estimate that the number of unemployed will be 2.25 million on annual average this year as against their earlier estimate of 2.1 million.
6. While there is relief that decisions on tax reform have now been taken, the shape and volume of the reform is regarded by most as disappointing. The hopes that the government would proceed to a thoroughgoing reform of subsidies have not been fulfilled. In the context of the income tax reform a government spokesman said explicitly

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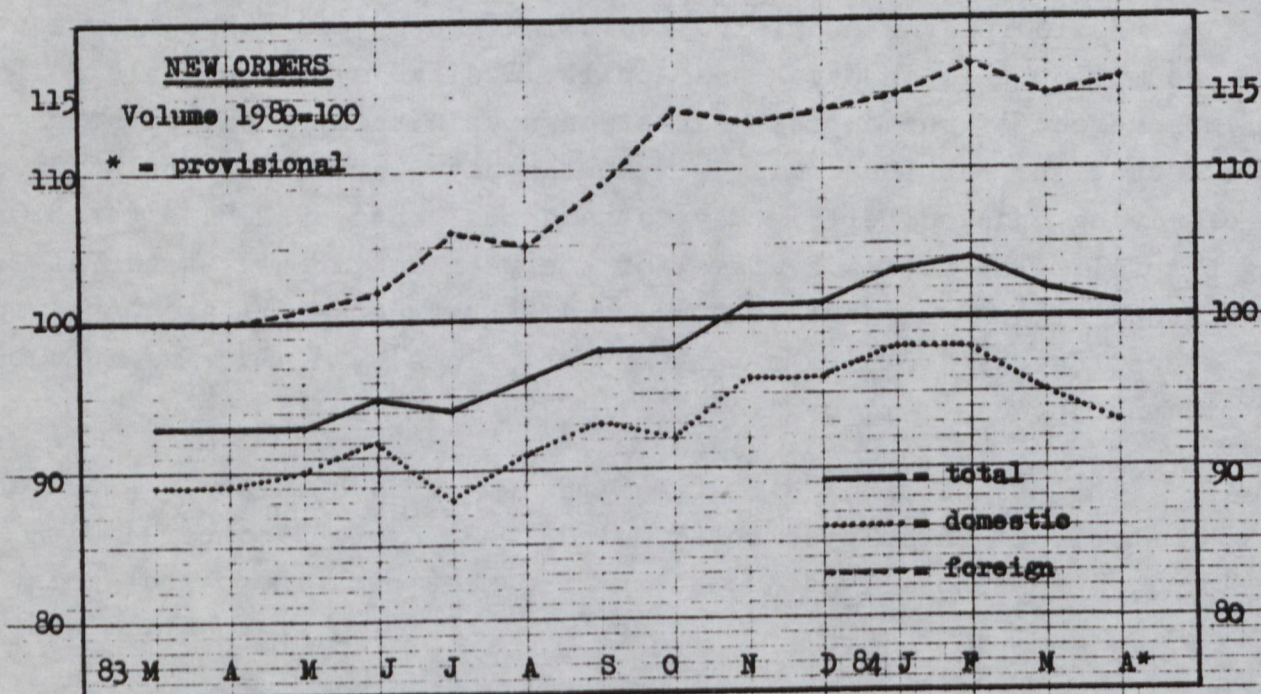
that subsidies would not be abolished to finance it. And the much criticised decision last month to compensate farmers (see Bonn saving telno 15) is seen as proof of the government's inability to grasp the subsidies nettle.

7. However, the government's announcement that it has reached agreement, after a long public debate will be welcomed. The government have proposed a 2-stage tax package (Bonn telno 647 of 29 June) amounting to DM 20.2 billion to come into effect in 1986 and 1988. The reform will reduce the high marginal tax rates on personal income and will correct distortions in the level and pattern of taxation. Its introduction should strengthen demand at a time when for external reasons demand may be weakening.

Prospects and Indicators

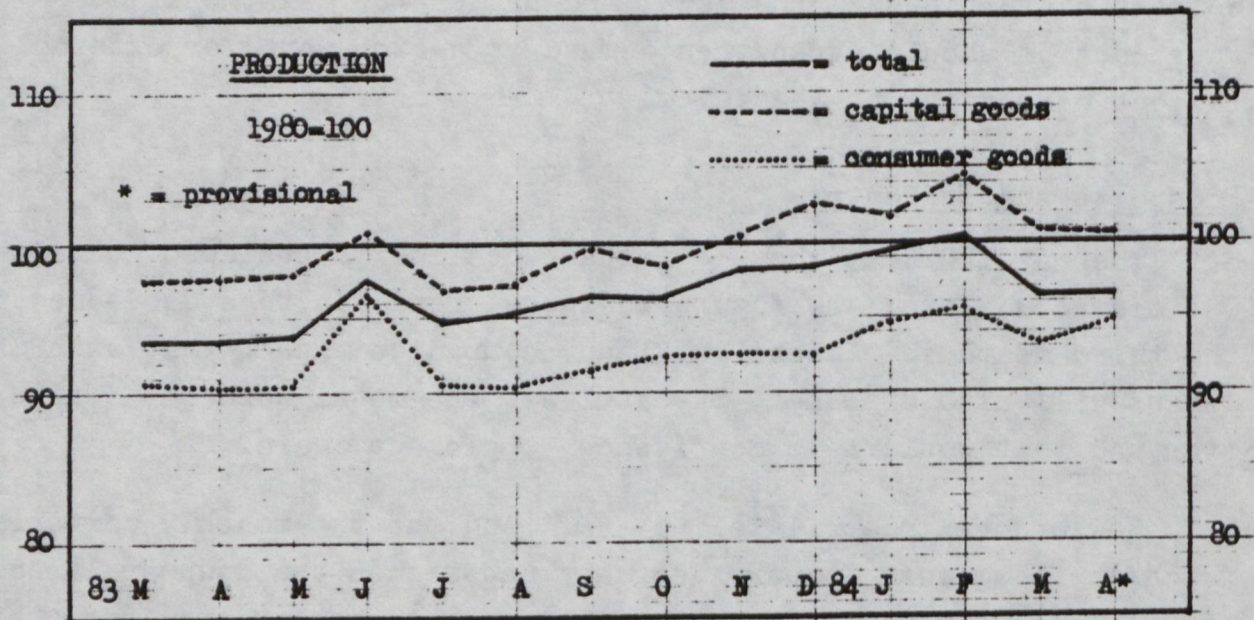
8. The May IFO test shows a further decline in business confidence. Optimism concerning the future business trend has thus decreased for the third month in succession. Many companies expect that external demand will also decline. But at least the metal workers' strike is over and that would help confidence to pick up again.

9. New orders in April fell by 1%. And the two-monthly comparison March/April against January/February underlines the downward trend: overall orders were down by 2% (real) with domestic demand down by 4% and exports by 0.5%. However, compared with a year ago new orders are up by 7% overall and exports up by 13%.



/10.

10. Production of the manufacturing industry did not recover in April and remains at the depressed level of March. Construction output fell by 3.5% in April and the May IFO survey confirms the worsening situation in the industry with growing pessimism about developments over the next six months. Although capacity utilisation rose to 81.2% in March business expectations and production schedules suggest that a further rise in Q2 is very doubtful.



11. Following the promising start in January and February private consumption fell in March and April. The IFO survey reveals a slight improvement of the current situation within this sector although expectations for the coming six months have worsened. Inflation cost of living indexed fell in May to an annual rate of 2.8% after 3.0% in April. The moving average for the year so far now stands at 2.9%; industrial producer prices rose by 1.2% between April and May, import prices rose by 1.6% in May and export prices by 0.4%. Agricultural producer prices fell by 1.3%.

12. The unemployment situation did not improve in May. Although the number of unemployed (unadjusted) fell by 5.3% compared with April, the seasonally adjusted unemployment rate increased again.

/ÖTV

ÖTV, one of the public service unions, has also threatened industrial action in October if they do not obtain a shorter working week.

Balance of Payments

13. The current account in April showed a small deficit of DM 0.5 billion compared with a surplus of DM 1.9 billion in March. A year earlier the current account had been practically in balance. The stronger increase in import prices compared with the trend of export prices has led to a slight decline in the terms of trade from 96.1 in March to 95.9 in April.

14. The Bundesbank increased the Discount rate from 4% to 4.5% on 28 June (Bonn telno 645), the first increase since 18 March 1983. This was thought necessary in order to counteract the effects of a strong US dollar. However, the Bundesbank, in order to provide more liquidity, also increased the rediscount quota by DM 8 billion which will enable banks to reduce their more costly Lombard liabilities. Commercial banks have not followed by increasing interest rates but there are some fears that the higher rate will have a negative effect on consumer expenditure (see para 11).

15. Monetary growth, which had been restrained at the start of the year accelerated strongly in April and weakened only slightly in May. The growth of Central Bank money, which had been at the lower end of the 4-6% target corridor in the first 4 months of the year edged up to 5% in May. However, so far this year monetary growth has been generally moderate due mainly to unusually strong monetary capital formation.

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New Orders

16. Provisional figures for April show a further fall of 1 per cent in real terms. However, as had been widely expected, the March results had to be revised upwards by a full 2 per cent. In April domestic demand fell by a further 2 per cent while foreign demand rose by 1 per cent. The two-monthly comparison, March/April against January/February, underlines the decline after a favourable start to the year. Overall orders were 2 per cent lower in real terms, with domestic demand down by 4 per cent and foreign demand by 0.5 per cent. Nevertheless, the level of new orders remains much higher than a year earlier (+ 7 per cent). While domestic demand stands 3.5 per cent higher, export orders are a full 13 per cent up on a year ago. The field is led by basic and producer goods (+ 9.5 per cent), followed by capital goods (+ 7 per cent) and consumer goods (+ 2.5 per cent).

NEW ORDERS

1980=100

	<u>Total</u>		<u>Domestic</u>		<u>Foreign</u>	
	<u>Value</u>	<u>Volume*</u>	<u>Value</u>	<u>Volume</u>	<u>Value</u>	<u>Volume</u>
<u>1983</u>						
January	113	101	113	101	114	103
February	102	92	97	87	112	101
March	103	93	99	89	111	100
April	103	93	99	89	110	100
<u>1984</u>						
January	117	103	111	98	131	115
February	119	104	112	98	134	117
March	116	102	108	95	131	115
April(p)	115	101	106	93	133	116

* = at constant prices

(p) = provisional

Production

17. Following the drop in production in March, provisional April figures suggest practically no change in the overall level of output. Manufacturing output rose by 0.5 per cent, while construction activity fell back again sharply (- 3.5 per cent). The two-monthly comparison, March/April against January/February, however, reveals a decline of 3.5 per cent, with manufacturing output down by 2.5 per cent and construction activity 15 per cent lower. Compared to the corresponding two-month period a year earlier, total production was 2 per cent higher with manufacturing output recording a 2.5 per cent rise. Basic and producer goods registered the largest rise (+ 4 per cent) followed by consumer goods (+ 2.5 per cent) and capital goods (+ 2 per cent). Construction activity in March/April was 4 per cent down on a year earlier.

/PRODUCTION

PRODUCTION

1980=100

	Total	Basic & producer goods	Capital goods	Consumer goods	Construction
<u>1983</u>					
January	93.8	90.8	95.5	89.8	96.0
February	91.7	89.7	96.2	89.0	76.4
March	93.5	91.3	97.5	90.8	79.3
April	93.5	91.6	97.7	90.2	79.8
<u>1984</u>					
January	99.2	99.8	101.8	94.7	94.6
February	100.2	100.7	104.5	95.8	89.1
March	96.4	95.8	100.8	93.1	79.2
April*	96.5	95.8	100.6	94.9	76.6

* = provisional

Prices

18. Inflation, as measured by the cost of living index, fell in May to an annual rate of 2.8 per cent after 3.0 per cent in April. Month-on-month, prices rose by only 0.1 per cent. The moving average for the year so far now stands at 2.9 per cent. Food prices in May were 2.5 per cent higher than a year earlier.

19. Industrial producer prices rose by 0.2 per cent between April and May with the annual rate of increase climbing only slightly from 3.1 per cent to 3.2 per cent. Import prices recorded a marked jump in May, up 1.6 per cent on the preceding month with the annual rate advancing to 7.9 per cent after 6.6 per cent in April. The month-on-month rise in export prices was also stronger than of late (0.4 per cent) but at an annual rate export prices were only 3.8 per cent higher than a year earlier after 3.7 per cent in April. Wholesale prices fell slightly in May (- 0.2 per cent) as did the annual rate, down to 4.1 per cent compared to 4.9 per cent in April. Due to adjustment of the index to base year 1980=100 the retail price index is only available for April, showing retail prices 2.8 per cent higher than a year earlier. Agricultural producer prices dropped quite sharply in April (- 1.3 per cent) to stand 3.7 per cent up on a year ago.

/Prices

Prices

1980=100

	Cost of living	Industrial producer prices	Agricultural producer prices	Retail prices (1976=100)	Import prices	Export prices
<u>1983</u>						
March	114.4	114.7	106.6	130.6	112.9	111.2
April	114.7	115.1	104.9	130.9	113.0	111.4
May	115.0	115.2	104.3	131.5	113.4	111.8
<u>1984</u>						
March	117.9	118.2	110.2*	134.3	119.8	115.1
April	118.1	118.6	108.8*	134.6	120.5	115.5
May	118.2	118.9			122.4	116.0

* = Provisional

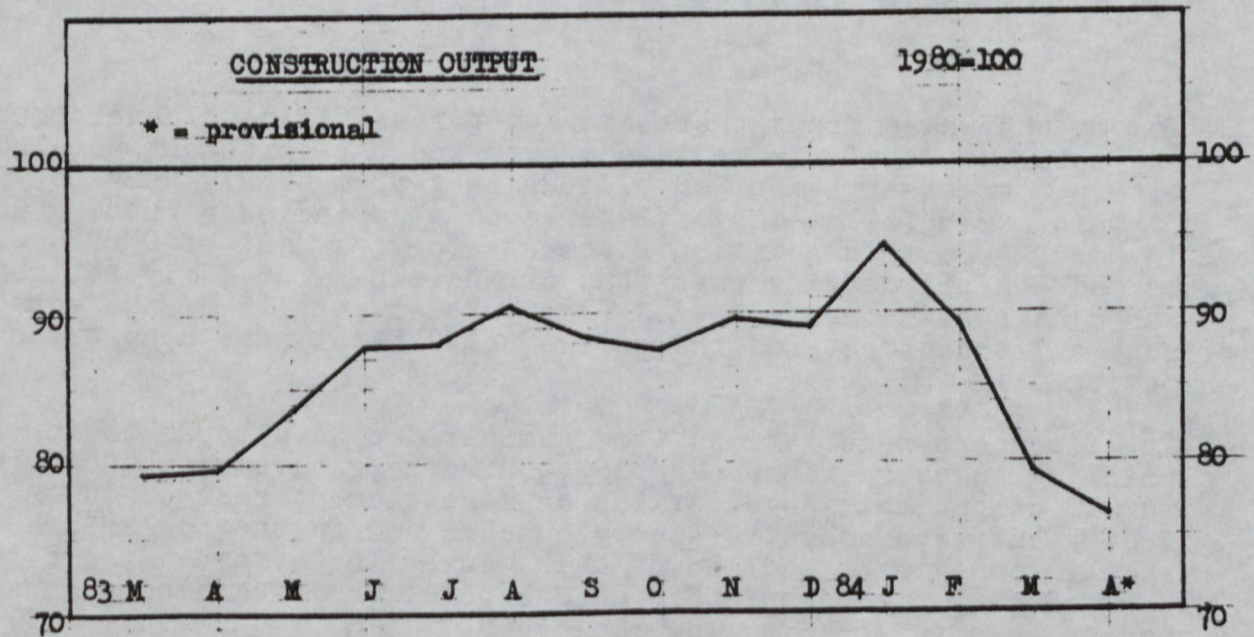
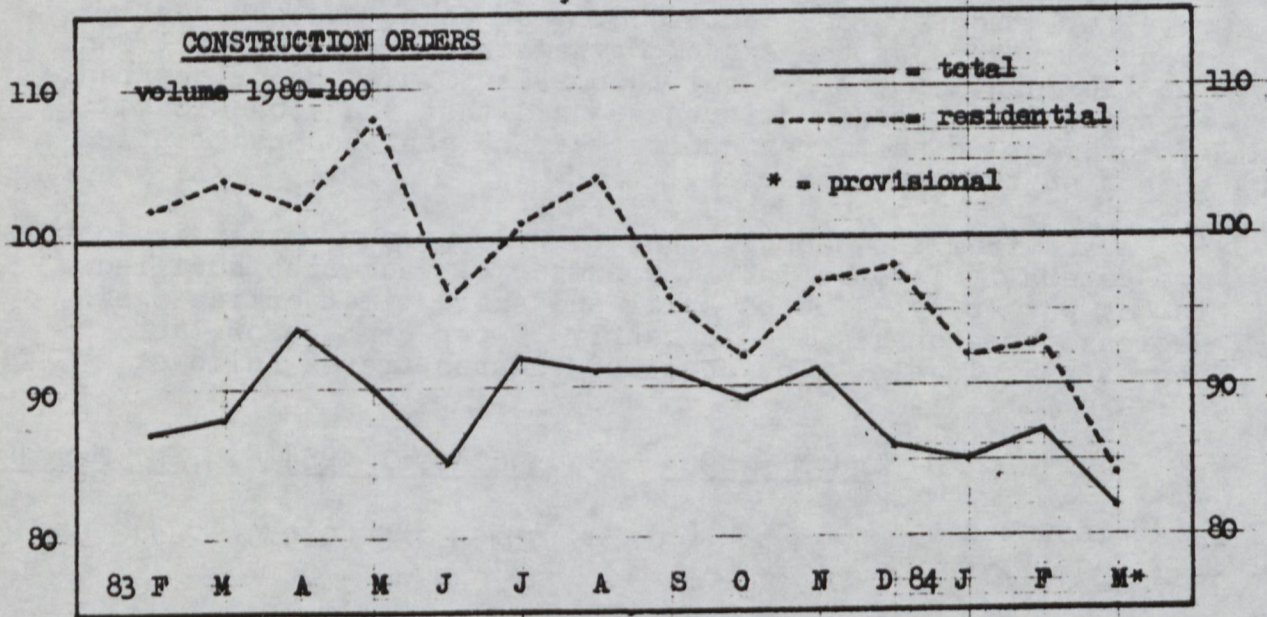
Private consumption

20. Retail trade turnover in April recorded a nominal rise of 6 per cent, in real terms an increase of 3 per cent over a year earlier. In the first four months of the year turnover has risen by 4.1 per cent nominal, 1.3 per cent real. Although the April result seems positive it is mainly due to Easter business falling in April as opposed to March last year. Taking March and April together there has been a marked fall from the promising start to the year in January/February. While the IFO survey reveals a slight improvement in the assessment of the current situation within the industry, expectations for the coming six months worsened once again. Price increases remained moderate, with retail prices standing 2.8 per cent up on a year earlier.

Construction

21. Construction output fell again in April (- 3.5 per cent). The two-monthly comparison, March/April against January/February, underlines the severity of the recent decline, showing a drop in output of a full 15 per cent. Compared to the corresponding two-month period a year earlier construction activity was 4 per cent lower. Incoming orders also show a downwards trend with a sharp fall in March, particularly in the residential sector. In February/March residential construction orders were 14.1 per cent lower than a year earlier. The latest IFO survey confirms the worsening situation within the industry, with pessimism regarding the next six months on the increase. The length of order books at 2.1 months has reverted to its low in the April 1982 recession. Capacity utilisation at 54 per cent was practically unchanged on a year earlier. The rate of price increases has slowed and only minor increases are expected over the coming months. A six-monthly IFO report on investment by the construction sector reveals that investment is likely to fall in 1984 after the 1983 recovery, with only 20 per cent of firms questioned planning to increase investment. The marked fall in demand since the middle of last year is given as the reason.

/CONSTRUCTION ORDERS



Labour Affairs

22. Although the total of unemployed fell by 120,000 and the rate fell from 9.1 per cent to 8.6 per cent, the seasonally adjusted figure at the end of May again rose to 2.27 million. The President of the Federal Labour Institute, Heinrich Franke, at his monthly press conference, said that the economic improvement in the first quarter of the year had had little effect on the labour market.

23. Apart from the unemployment figures proper, other indicators are generally favourable. The number of vacancies notified in May was up by 3,000 on April and short time working again decreased seasonally and is nearly 50 per cent below last year's peak levels. The detailed figures are as follows:

	<u>End May 1984</u>	<u>End April 1984</u>	<u>End May 1983</u>
a. Unadjusted total	2,133,211 (8.6%)	2,253,466 (9.1%)	2,148,700 (8.8%)
b. Adjusted total	2,279,000	2,267,000	2,320,000
c. Short time working	387,553	489,485	638,800
d. Unfilled vacancies	96,588	93,556	85,800
e. Total men in a.	1,189,748	1,283,686	1,199,758
f. Total women in a.	943,473	969,780	948,943

24. On the wages front there are several significant developments. The metal workers' strike is now over and the agreement concluded offers a wage settlement of 3.3 per cent from 1 July 1984 to 31 March 1985 followed by a 2 per cent wage increase running until 31 March 1986. In addition a compensatory payment of DM 250 will be made to all metal workers and arrangements for early retirement at 58 have also been agreed. (For further details of the settlement and the effects of the strike on IG Metall see Bonn telno 19 saving.)

25. Elsewhere negotiations were dominated by developments in the printing industry where over 170,000 workers have been on strike in 200 companies. Negotiations on a settlement resumed on 1 July but with no satisfactory outcome and further talks are likely to begin at the end of this week. The efforts at arbitration by Professor Biedenkopf were unsuccessful: his recommendations having been rejected by the employers.

/Balance of Payments

Balance of Payments

26. In April current account showed a small deficit of DM 0.5 billion, compared with a surplus of DM 1.9 billion in March. A year earlier current account had been practically in balance. The visible trade surplus in April fell to DM 2.6 billion after DM 4.5 billion in March and DM 2.7 billion in April 1983. Exports in April were 13 per cent higher than a year earlier while imports rose by 14.5 per cent. In the first four months of 1984 the visible trade surplus stood at DM 13.9 billion, only slightly lower than the surplus of DM 14.6 billion in the corresponding period 1983. The deficit on services account rose from 0.7 billion in March to DM 1.1 billion in April. Outgoing transfer payments remained unchanged at DM 2.2 billion. Current account in the first four months of the year showed a surplus of only DM 1.5 billion compared to DM 5.2 billion a year earlier. On long-term capital account outflows regained the upper hand (DM 1.6 billion) after inflows of DM 0.9 billion in March, due mainly to increased purchases of securities abroad. In contrast short-term capital account recorded strong inflows (DM 5 billion), with domestic banks increasing their short-term foreign liabilities.

27. The net foreign assets of the Bundesbank rose in April by DM 2.2 billion, falling again in May by DM 2.5 billion.

Monetary

28. To the apparent surprise of the market, the Bundesbank raised the Discount rate to 4.5 per cent with effect from 29 June. However, this measure had been rumoured for several weeks and had only been postponed to avoid exerting unnecessary pressure on the market during the difficult weeks of the labour dispute. Simultaneously the rediscount quota was increased by DM 8 billion. In a statement the Bundesbank stressed that the measures were merely a technical adjustment and not to be interpreted as a step towards a more restrictive monetary policy. The increase in the rediscount quota enables banks to reduce their more costly Lombard liabilities. The Lombard rate remains unchanged at 5.5 per cent.

29. Monetary growth, which had been restrained at the start of the year, accelerated strongly in April and weakened only slightly in May, a development which is also reflected in Central Bank Money figures. At the end of May M3 was 4 per cent higher than in May 1983, M2 3.5 per cent and M1 3 per cent. The growth of Central Bank Money which had been at the lower end of the 4 - 6 per cent target corridor in the first four months of the year, edged up to 5 per cent in May. Over the year so far monetary growth has been generally moderate, mainly due to unusually strong monetary capital formation. Credit to the private sector, however, remains at a high level.

FRG/UK Trade

£1 = DM 3.773

30. In the twelve months to the end of April 1984 FRG imports from the UK totalled DM 28.8 billion, 7.0 per cent of total FRG imports. A year earlier the UK market share had stood at 7.2 per cent. While total FRG imports rose by 10.2 per cent at an annual rate, imports from the UK increased by 7.1 per cent. Excluding oil, both total FRG imports and imports from the UK rose by 12.3 per cent with the UK share of the non-oil import market remaining unchanged at 5.4 per cent.

31. FRG exports to the UK continued strong, up 12.3 per cent year-on-year against an increase of 6.7 per cent in total FRG exports. The proportion of FRG exports destined for the UK climbed from 7.7 per cent to 8.1 per cent.

32. The trade gap in favour of the FRG widened to DM 7.9 billion after DM 5.8 billion a year earlier.

FRG: Main economic statistics

	Q1 1983	Q4 1983	Q1 1984	q/month	year
1. Expenditure on GNP (current prices)					
a) Gross National Product	408.6	429.0	432.0	0.7	5.7
b) Private consumption	230.8	236.9	240.0	1.3	4.0
c) Government consumption	82.0	84.9	83.1	-2.1	1.3
d) Fixed capital formation	82.3	90.0	90.4	0.4	9.8
e) Exports of goods & services	133.5	140.6	146.3	4.1	9.6
f) Imports of goods & services	121.7	131.0	136.7	4.4	12.3
g) Net exports	11.8	9.6	9.6		
2. Expenditure on GNP (constant prices)					
a) Gross National Product	312.0	319.7	323.5	1.2	3.7
b) Private consumption	173.5	173.9	174.9	0.6	0.8
c) Government consumption	61.7	62.5	61.1	-2.2	-1.0
d) Fixed capital formation	61.6	65.9	65.9	0.0	7.0
e) Exports of goods & services	103.7	107.5	110.9	3.2	6.9
f) Imports of goods & services	89.1	94.4	96.9	2.6	8.8
g) Net exports	14.6	13.1	14.0		
3. Income of households					
a) Gross wages & salaries	189.3	194.8	199.5	2.4	5.4
b) Disposable income	265.5	272.0	277.4	2.0	4.5
c) Savings as a % of b)	13.1	12.9	13.5		
		1976=100			
4. Productivity					
a) In the economy as a whole					
i) GNP per working person (1976 prices)	112.6	115.9	117.4	1.3	4.3
ii) wage and salary costs per production unit	126.8	127.8	128.8	0.8	1.6
		1980=100			
	Mar 83	Feb 84	Mar 84		
b) In industry					
i) output per employed person	104.0	113.0	109.0	-3.5	4.8
ii) wage and salary costs per production unit	107.0	109.0	107.0	-1.8	0.0
	Apr 83	Mar 84	Apr 84		
5. Industrial production					
a) Total	93.5	96.4	96.5	0.1	3.2
b) Manufacturing industry	94.7	97.8	98.2	0.4	3.7
c) Construction	79.8	79.2	76.6	-3.3	-4.0
6. New orders					
a) Total	93.0	102.0	101.0	-1.0	8.6
b) Domestic	89.0	95.0	93.0	-2.1	4.5
c) Foreign	100.0	115.0	116.0	0.9	16.0

	May 83	Apr 84	May 84	q/month	year
	in 1000's				

7. Unemployment					
a) i) unemployed	2,148.7	2,253.5	2,133.2	-5.3	-0.7
ii) as a % of the working population	8.8	9.1	8.6		
b) Short-time workers	638.7	489.5	387.5	-20.8	-39.3
c) Vacancies	83.8	93.6	96.6	3.2	15.3

1980=100

8. Prices					
a) Cost of living of all private households	115.0	118.1	118.2	0.1	2.8
c) Producer prices of industrial products	115.2	118.7	118.9	0.2	3.2
d) Export prices	111.8	115.5	116.0	0.4	3.8
e) Import prices	113.4	120.5	122.4	1.6	7.9

Apr 83 Mar 84 Apr 84

b) Retail prices (1976=100)	130.9	134.3	134.6	0.2	2.8
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9. Balance of payments					
a) Visible trade					
i) exports	33.8	42.3	38.2		
ii) imports	31.1	37.8	35.7		
iii) balance	2.7	4.5	2.5		
b) Supplementary trade items	0.2	0.1	0.3		
c) Services	-0.9	-0.7	-1.1		
d) Transfers	-2.0	-2.1	-2.2		
e) Current account	0.0	1.8	-0.5		

10. Net foreign reserves	82.3	73.2	75.8		
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Seasonally adjusted

11. Money stock					
M1	2.2	0.4	5.6		
M2	-1.0	-1.8	7.6		
M3	3.8	1.0	10.3		

Unadjusted

12. Monetary capital formation	3.0	6.6	5.5		
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Bank rates:

Since 29.6.84 Discount rate: 4.5%
Since 9.9.83 Lombard rate: 5.5%

Sources: Federal Statistical Office, Wiesbaden;
Deutsche Bundesbank, Frankfurt
Discrepancies in totals due to rounding (60) (16)