

UNCLASSIFIED  
SAVING TELEGRAM

FROM BONN

FRAME ECONOMIC

TO FCO TEL NO 37 SAVING OF 31 DECEMBER 1984. Info all EC Posts,  
UKDEL OECD, UKMIS Geneva, all Consulates-General  
in the Federal Republic, Washington, Tokyo, Vienna.

FEDERAL GERMAN ECONOMY

Summary

1. Another good month and the year closes on a positive note with most indicators set fair.
2. Production is up 2.5% on the month. Inflation remains low and interest rates have fallen. Exports are at record levels - in October up 4% on a month earlier and 27% on the year. A current account surplus of some DM 10 billion is likely for the year. With improved company profitability an increase of 8% real in investment by manufacturing industry is predicted by the IFO economic institute for 1985. The scene could therefore be set for what even the sceptical Federation of German Industry, BDI, concedes are the traditional motors for German growth to carry the economy forward well into 1985.
3. The latest surveys confirm business confidence in all sectors except construction. Most commentators, along with the Government, expect growth in the order of 3% real in 1985, though with little benefit to the number of unemployed. Some are less convinced. The Hamburg and especially the Kiel economic institutes doubt that investment will be adequate to sustain growth at more than 2.5% or 2.0% respectively. There are also unresolved problems. High unemployment remains a concern. Competitiveness has to be sustained despite technological deficiencies in some areas and the consequences of agreements on shorter working time. The Government is seen as lacking decisiveness in its economic management. It did confirm this month that income tax reform would be introduced in two stages and that no alternative would be introduced to the investment levy on higher earners which had been ruled unconstitutional, but these decisions may only mark a temporary end to the squabbles. Dissent within the Coalition also

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prevented decisions on privatisation this year and it could become a bone of contention next.

4. In December the Bundesbank announced slightly lower monetary targets for 1985.

#### Detail

5. Exports are continuing to provide the major demand side impulse. They were up by 4% (October on September). Exports to industrial countries have picked up remarkably with the accent on North America. From January to September exports to the USA grew by 46.9% on the same period a year earlier, by 48.8% to Canada, 25.6% to Japan and by 10.5% to EC countries. Exchange rate bonuses were clearly prominent in this performance but in the Government's opinion there is sound evidence of traditional German strengths in non-price factors as well.

6. Production also showed a marked rise in October with overall output up by 2.5% on September with a slightly stronger rise in the manufacturing sector. Construction picked up in October rising by 7% but this is subject to strong monthly fluctuations and the trend in construction is still downwards.

7. On 18 December a draft bill for tax reforms was agreed by Cabinet. The reform provides for tax relief totalling DM 20.2 billion spread over two stages, 1986 and 1988. The first stage, worth DM 10.8 billion, will mostly (70%) benefit families with children though they represent only 39% of tax payers. The two stage plan had been questioned within the Coalition even after last June's announcement (Bonn tel 647 of 29 June). Thus although Stoltenberg has won the day against the one stage reform favoured by the CSU and FDP, the general feeling is that if for political or economic reasons a fiscal stimulus is seen to be necessary some further changes could be made.

8. As part of the package the Coalition leaders also agreed to shelve plans for a substitute surtax for the investment levy which was declared unconstitutional by the Federal Constitutional Court (Bonn tel No 33 saving of 30 November). This represents a victory for the line expounded by the CSU and FDP although again