

GRS 690

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FRAME [ECONOMIC]

FM BONN 261800Z OCT 82

TO IMMEDIATE FCO

TELEGRAM NUMBER 911 OF 26 OCTOBER

INFO IMMEDIATE UKDEL OECD UKREP BRUSSELS WASHINGTON TOKYO BMG BERLIN

INFO SAVING ATHENS EMBASSY BRUSSELS COPENHAGEN DUBLIN THE HAGUE

LUXEMBOURG PARIS ROME CGS IN FRG

MIPT (NOT TO ALL) : THE FEDERAL GOVERNMENT'S ECONOMIC POLICY

1. ALTHOUGH WE ARE STILL SHORT OF FACTS ON WHICH TO BASE CONSIDERED JUDGEMENTS YOU MAY FIND IT HELPFUL, IN PREPARING FOR THE UK/GERMAN CONSULTATIONS, TO HAVE AN ASSESSMENT FROM HERE OF THE FACTORS AFFECTING THE NEW GOVERNMENT'S ECONOMIC POLICY.

2. ECONOMIC POLICY POSES TRICKY PROBLEMS FOR THE GOVERNMENT. THEIR ROOM FOR MANOEUVRE IS NARROW. IT WAS DISAGREEMENT ABOUT ECONOMIC POLICY THAT BROUGHT THE LAST GOVERNMENT DOWN. BUT IN THE FOUR MONTHS TO MARCH THERE IS LITTLE PROSPECT OF ACHIEVING MUCH. IN ORDER TO MAKE THIS PLAIN TO THE VOTER THEY NEED TO EMPHASISE THE DIFFICULTIES OF THE SITUATION THEY HAVE INHERITED AND SHOW THAT TIME WILL BE NEEDED TO PUT IT RIGHT. AND THEY HAVE BEEN DOING THAT. BUT SUCH A LINE CAN DAMAGE THE GROWTH OF CONFIDENCE SO ESSENTIAL TO IMPROVING THE PROSPECTS FOR GETTING THE ECONOMY MOVING AGAIN. UNCERTAINTIES ABOUT THE DEVELOPMENT OF THE ECONOMY, ESPECIALLY ABOUT DEMAND AND INVESTMENT PROSPECTS, ARE INCREASED BY THE TEMPORARY CHARACTER OF THE GOVERNMENT. ROOM FOR MANOEUVRE IS FURTHER NARROWED BY THE NEED TO GET EARLY AGREEMENT ON A 1983 BUDGET SO AS TO MAKE IT POSSIBLE TO DISSOLVE THE BUNDESTAG IN TIME TO GO TO THE POLLS IN MARCH 1983.

3. BUNDESBANK PRESIDENT POEHL, AFTER ANNOUNCING REDUCTIONS IN THE BANK'S INTEREST RATES ON 22 OCTOBER (BONN TELNO 50 SAVING), URGED THE BANKS AND OTHER CREDIT INSTITUTES TO PASS ON THE REDUCTIONS TO THEIR CUSTOMERS. THIS ECHOED AN APPEAL THAT HE MADE, WITHOUT ANY MARKED SUCCESS, WHEN INTEREST RATES WERE LAST REDUCED (IN AUGUST) UNDER THE PREVIOUS GOVERNMENT (BONN TELNO 45 SAVING). ON THIS OCCASION HE WAS FLANKED BY STOLTENBERG WHO HAD ATTENDED THE BUNDESBANK'S BOARD MEETING THAT DECIDED THE NEW INTEREST RATE CUTS. MOST BANKS HAVE ALREADY FOLLOWED THE BUNDESBANK DOWN. ALTHOUGH BUDGETARY DIFFICULTIES ARE ACUTE, BOTH THE BUNDESBANK AND THE GOVERNMENT BELIEVE THAT THE UNDERLYING SITUATION OF THE ECONOMY IS SOUND AND PROVIDES FAVOURABLE CONDITIONS FOR GROWTH.

4. ON 27 OCTOBER THE CABINET WILL DECIDE ON STOLTENBERG'S BUDGET PROPOSALS. INDICATIONS WE HAVE HAD FROM THE FINANCE MINISTRY ARE THAT, FAR FROM CUTTING GOVERNMENT EXPENDITURE, THE NEW GOVERNMENT WILL ADOPT A BUDGET FOR 1983 PROVIDING FOR HIGHER EXPENDITURE (DM 254 BILLION) THAN THAT OF THEIR PREDECESSORS (DM 250.9 BILLION)

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BUT BASED ON MORE OPTIMISTIC GROWTH ASSUMPTIONS). THE 1982 FIGURE IS DM 246 BILLION. WITHIN THIS TOTAL THERE WILL BE A SHIFT IN GOVERNMENT EXPENDITURE FROM CONSUMPTION TO INVESTMENT, AND WEAKER REVENUE ESTIMATES AND HIGHER UNEMPLOYMENT PAYMENTS WILL BE COVERED BY HIGHER BORROWING (DM 41 BILLION). GOVERNMENT SPOKESMEN HAVE JUSTIFIED THE INCREASE BY UNDERLINING THE NEED TO AVOID ACTING COUNTER-CYCLICALLY AT THIS POINT IN THE CYCLE, ESPECIALLY WHEN THE GOVERNMENT IS, IN ANY CASE, HAVING TO CUT SOCIAL SECURITY SPENDING TO KEEP PUBLIC SECTOR FINANCING UNDER CONTROL. THE PROPOSED REDUCTION IN PUBLIC EXPENDITURE ON PENSIONS, SICKNESS BENEFIT AND PUBLIC SECTOR PAY DOES NOT EXTEND TO CUTS IN UNEMPLOYMENT PAY, YET LAMBSDORFF AS A MINISTER IN THE PREVIOUS GOVERNMENT LOUDLY CHAMPIONED SUCH CUTS. WITH THE PROSPECT OF UNEMPLOYMENT RISING TO 2.5 MILLION THIS WINTER THERE IS OBVIOUS ATTRACTION IN AVOIDING GRASPING THIS PARTICULAR NETTLE.

5. THE REPORT OF THE 5 INSTITUTES PUBLISHED YESTERDAY IS RATHER CRITICAL OF GOVERNMENT POLICY AND, WITHOUT COMING TO ANY CLEAR CONCLUSIONS, EXPRESSES THE FEAR THAT POLICY COULD HAVE THE EFFECT OF WEAKENING ALREADY WEAK DEMAND FURTHER. THIS FEAR IS TO A CERTAIN EXTENT SHARED BY THE BUNDESBANK. SPECULATION AS TO THE IMPACT OF THE BUDGET IS RIFE. OBSERVERS ARE UNCERTAIN WHETHER ITS EFFECT WILL BE INFLATIONARY, DEFLATIONARY OR NEUTRAL. ONE COMMENTATOR SUMS THE SITUATION UP BY DESCRIBING THE BUDGET (NOT YET, OF COURSE, PRESENTED) AS QUOTE WITHOUT CONTOURS UNQUOTE. SINCE OCTOBER 1981, THE BUNDESBANK HAVE BEEN GRADUALLY EASING MONETARY POLICY. IT IS ACCEPTED THAT FURTHER EASEMENT OUGHT TO BE POSSIBLE IN DUE COURSE. THE NEW GOVERNMENT'S ACCEPTANCE OF THE NEED TO INCREASE BORROWING AND THE RELATIVE MODESTY OF THEIR ATTACK ON SOCIAL EXPENDITURE SUGGESTS THAT THEY TOO ARE CONSCIOUS OF THE DANGER OF DEFLATING THE ECONOMY AND WILL BE KEEN TO AVOID IT, ESPECIALLY IN THE RUN UP TO THE ELECTION NEXT MARCH.
FCO PLEASE PASS SAVING TO ABOVE ADDRESSES EXCEPT CGS IN FRG.

TAYLOR

(REPEATED AS REQUESTED)

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