

6 August 1986

MEMORANDUM FOR THE RECORD

[redacted] prepared the attached memorandum
 at the request of [redacted] the Office of Intelligence Liaison
 at Commerce. It answered questions raised by Deputy Assistant Secretary
 Frank Vargo in connection with an article he was drafting for
 Secretary Baldrige. [redacted] Vargo was very pleased
 and grateful for the effort.

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Chief, WE/GN

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**Commerce Department Scenarios
West German Growth, 1986-1990
August 5, 1986**

I. Effect of West German Growth on the EC

West German real GNP growth has a significant impact on other West European economies due to trade linkages. Simulations of our econometric model indicate a one-quarter percentage point increase in EC growth for every one-half percentage point increase in West German growth. We estimate that EC growth would reach 3.0 percent, based on current projections for non-European countries, if the West German growth rate were to reach 3.75 percent.

Increase in West German growth (relative to baseline 2.5%)	+0.5 pp	+1.0 pp	+1.5 pp	+2.0 pp
Increase in EC Growth -- excluding West Germany (relative to baseline 2.4%)	+0.2 pp	+0.4 pp	+0.7 pp	+0.9 pp
	pp = percentage points			

II. Scope for Stronger West German Growth

Real GNP in West Germany is significantly below its potential level, based on extrapolations of factor input growth since 1979, the country's last cyclical peak. Our econometric model estimates a shortfall between actual and potential GNP of 10-12 percent, as of last year. As a result, we believe that West German growth could exceed the 2.5 percent level by one or perhaps two percentage points for the remainder of the decade without incurring supply-side bottlenecks or significant domestically-generated inflation.