Report of the Deutsche Bundesbank

for the Year 1974

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Members of the Directorate of the Deutsche Bundesbank and of the Boards of Management of the Land Central Banks

Members as at April 1, 1975

of the Directorate of the Deutsche Bundesbank

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Dr. Otmar Emminger, Vice-President of the Deutsche Bundesbank

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Note: In order to expedite publication of the English version of this Report the following sections contained in the German original have been omitted:

Part A	Bank supervision, monetary and foreign exchange policy regulations of the Deutsche Bundesbank and permits under the Currency Act
Part C	Fund for the Purchase of Equalisation Claims
Appendices to Parts B and C	Nos. 1, 3, 4 and 5

Contents

The German original went to press on April 10, 1975

Part A: General part

The economy and the currency in 1974

I. Economic trends and central bank policy

1974 became a year of reorientation for the economy of the Federal Republic of Germany in many respects: pronounced shifts were initiated in the structure of production and the use of the national product, abrupt changes had to be contended with in external relations. Some sectors of the economy which for years had benefited strongly from very high demand due to inflation, such as construction, found themselves confronted with a marked downturn in sales as inflationary expectations moderated; in the end they were obliged to reduce their output step by step to a level promising long-term business success under more stable conditions. The effects of the oil crisis, particularly the drastic increase in the cost of petroleum, also triggered off far-reaching adjustment processes in the economy. In the field of energy supply new approaches sometimes had to be adopted so as to overcome bottlenecks and stimulate the use of lower-cost sources of energy. In the second half of the year, finally, the slowdown in business activity throughout the world set entirely new points of reference for the more export-oriented enterprises. In spite of this accumulation of radical changes — partly structural, partly cyclical in origin — the German economy proved to be very adaptable last year. The undesirable developments, which at first took the form of a faster rate of price increase and then — particularly towards the end of the year — that of a decline in production and employment, could however have been kept within stricter limits if the wage decisions of 1974 had taken sufficient account of these profound changes. Not until the beginning of the 1975 wage round were the necessary conclusions drawn in this field.

In its monetary policy in 1974 the Bundesbank primarily pursued the aim of reversing the price trend by limiting monetary expansion. The Bank did so as part of a joint strategy agreed with the Federal Government; this strategy at the same time assigned to fiscal policy the task of supporting overall business activity by adopting a moderately expansionary course, and of countering the particular danger to employment in some sectors by means of selective measures. In spite of numerous difficulties, caused not least by temporary disturbances on the international financial markets and also by certain weaknesses that came to light in the domestic credit system, the Bundesbank achieved its aim of permitting the central bank money stock to rise only to an extent consistent with stability. It helped materially to curb the inflationary tendency and to restore confidence in the value of money. However, this stabilisation process did not take place without exacting a price from the economy as a whole and without individual sacrifices. The only justification for these sacrifices was that there was no real alternative to the stabilisation policy. Some countries which initially tried to evade the necessary adjustment processes by permitting inflation to intensify only succeeded in delaying matters; the sole effect was that the economic setback and the growth of unemployment were felt there somewhat later; the undesirable trends simply became even more difficult to correct. For the Federal Republic of Germany, on the other hand, there is reason to hope that the period of stabilisation which began in 1973 and whose course in 1974 is described in this Report will be followed later on in 1975 by an upswing accompanied by further progress towards stability.

1. The economy in 1974 — progress towards stability under sluggish conditions

More difficult starting position at the beginning of the year as a result of structural adjustments and the oil crisis

At the beginning of 1974 a period of increasing uncertainty about the further course of German and international business activity began for the economy of the Federal Republic of Germany. As a consequence of some dramatic changes in the basic economic data in the course and particularly towards the end of 1973, profound structural adjustments took place in the production process. On the one hand, this was true of construction which, after the preceding housing boom, aimed for a lower production level more in conformity with medium-term demand. On the other, it applied to sectors in which adjustments became necessary after the oil crisis in order to replace or to conserve oil, both as a source of energy and as a raw material. The automobile market was particularly hard hit: the demand for new cars declined sharply at first, so that production had to be cut drastically. If only because of these problems of adaptation, only sluggish economic growth was to be expected for 1974. Initially there were also many signs of an intensification of the price rises. The world-wide raw material boom and the sharp increase in the prices of petroleum products led to a steep rise in the costs of materials, particularly those of imported products. Moreover, there was a great danger that this would result in a price-wage spiral which would accelerate the inflation attributable to domestic factors. The fact is, however, that in this respect the economy developed more favourably last year than had been expected. The rise in oil prices came to a stop, though at an extremely high level, the raw material boom tailed off, and soon afterwards the prices of some imports fell. On the other hand, the burdens which resulted for the national economy from world market conditions, and which had to be carried jointly, could not be distributed equally among the social groups in Germany. Steep wage increases further raised the real income of those employees who remained in employment. At the same time the pressure on entrepreneurial profits greatly increased, so that the business community had to reduce its capital investments noticeably. In the end this resulted in a decrease in employment.

After a short-lived high, a distinct slowdown in production in the course of the year

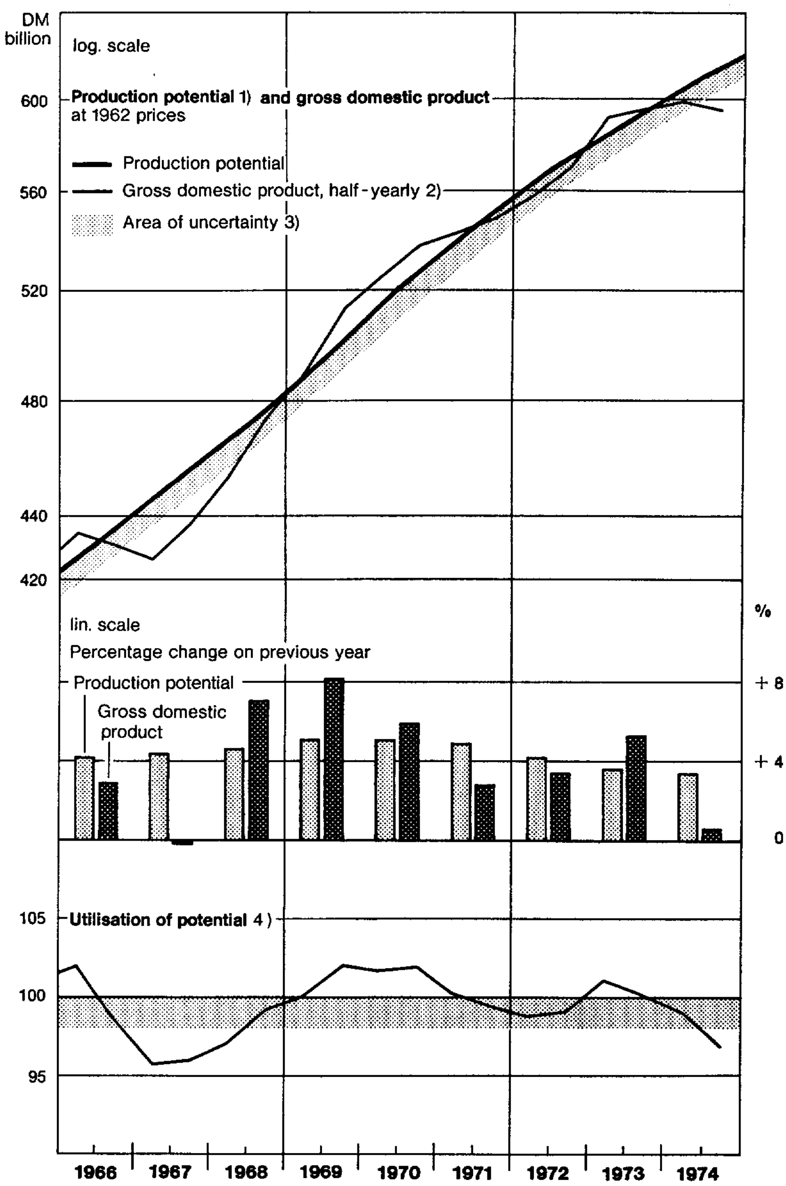
At the beginning of 1974, when the first shock of the oil crisis had been overcome and the pay agreements for the main areas had to be renewed, the overall economic situation at first appeared to be relatively favourable. Aggregate production was still increasing in that period, not least because construction activity was benefiting from the mild winter. The abolition of investment tax induced enterprises to place orders for capital goods which they had previously held back. In addition, strong foreign demand stimulated production in various branches of economic activity. However, the level of output in the first few months could not be maintained in the later part of the year. In the fourth quarter the real gross national product was for the first time smaller than a year before. Even so, it still grew by an average of 1/2 % in 1974.

In the course of the year there were particularly severe cuts in production in the motor industry and among its suppliers. Here, signs of weakness which had been evident for some time – approximately since the middle of 1973 – combined with the adverse effects of the oil crisis. In construction the decline in production which had started as early as the middle of 1973 persisted well into 1974; it was not until the autumn months that construction activity steadied at the lower level reached by then. Considerable falls in production were also recorded in the textile and clothing industry and in other branches of economic activity that are close to the consumer stage. On the other hand, overall production was supported by those sectors which, when domestic business slackened, were able to switch their products to foreign markets. But even these sectors could expand no further when in the second half of 1974 international economic activity flagged and sales opportunities on foreign markets deteriorated distinctly. The seasonally adjusted level of industrial production reached towards the end of 1974 was however maintained all in all at the beginning of 1975.

Increasing under-utilisation of the production potential

While production stagnated and later declined, the overall production potential increased further in 1974, by an amount estimated at approximately 3 1/2 %. The utilisation of the production potential thus went down appreciably in the course of last year; in the second half the degree of utilisation is likely to have fallen increasingly short of the area of optimum use. In industry the utilisation of the capital stock gradually fell to the level of the economic slowdown of 1967. Employment too was reduced relatively sharply. First of all, many enterprises tried to make the labour input match the lower production level by cutting overtime, introducing short-time working, and not replacing employees who left. In some cases financial compensation was granted when employees left voluntarily. In the last few months of 1974 there were also more dismissals, since there were no signs of an improvement in economic activity in the near future. In the fourth quarter of 1974 about 750,000 (or some 3 1/2 %) fewer persons were employed than a year earlier. A further 700,000 employees worked short-time in December, and an average of 890,000 did so in the first three months of 1975; the number of working hours lost was probably equivalent to about one third of normal working hours. Overtime working was cut down simultaneously and in some cases – for example in the public service – regular working hours were further reduced. Largely because of all this, the total number of man-hours worked decreased much more in 1974 than consonant with the release of employees alone. As an annual average the total of man-hours worked was nearly 3 % down on the previous year.

Production potential and national product



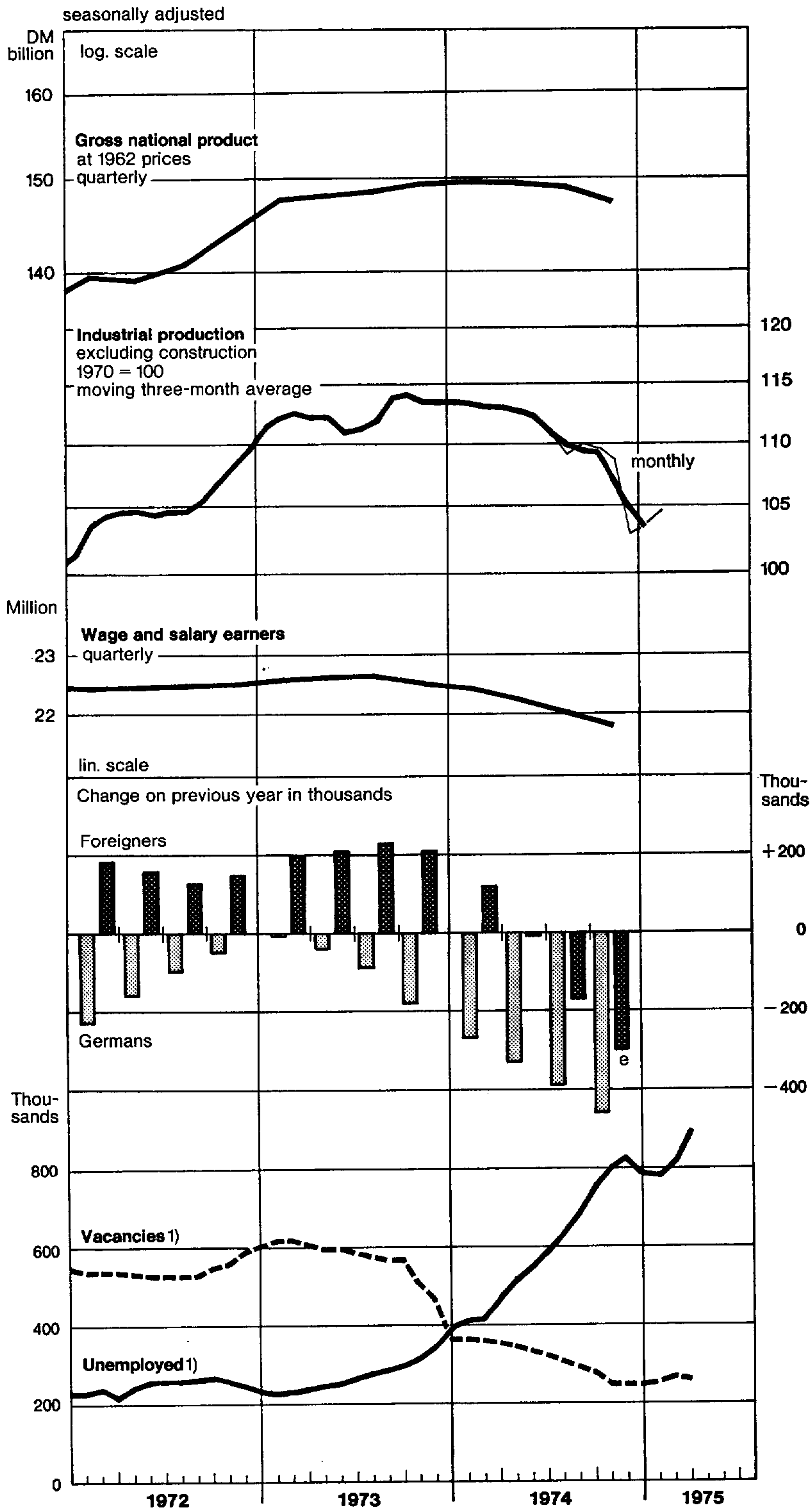
1) Calculated by Bundesbank (see Monthly Report of the Deutsche Bundesbank, October 1973).- 2) Seasonally adjusted half-yearly data extrapolated to yield annual figures.- 3) Attempt to depict the area of optimum overall production.- 4) Potential = 100.

Rise in unemployment for cycical and structural reasons

At the end of 1974 950,000 persons were registered as unemployed at the labour exchanges — nearly twice as many as a year earlier. At end-1974 the unemployment ratio was 3.5 %, seasonally adjusted, against 1.8 % at the end of 1973 or 1.4 % at the end of 1966, the comparable point of time in the preceding recession. At the end of March 1975 the number of unemployed persons was 1.1 million and the seasonally adjusted unemployment ratio 3.9 %.

However, the causes of the increase in unemployment were structural as well as cyclical. In the preceding phase of overheated activity, for example, many part-time jobs had been created in order to attract additional labour. Women in particular — many of whom had only been interested in part-time employment — had thus been incorporated in the labour force. Not infrequently these new jobs were the first to be sacrificed in the downswing in the course of internal economy and rationalisation measures, which — inter alia — explains the large proportion of women among the unemployed (an annual average of 45 %). These women, who formerly worked only part-time, are now counted as wholly unemployed in the

Production and labour market



1) At end of month.- e Estimated.

statistics. Furthermore, the behaviour of foreign employees in the event of dismissal has undergone a profound change. During the downswing of 1966/67 nearly all foreign employees who lost their jobs returned home; in 1974 about every fourth out-of-work foreigner registered with the German authorities as unemployed, for one thing because in the last few years more foreigners than before have had their families join them in Germany and have thus become less mobile, and for another because they had reason to fear (unless they came from an EEC country) that if the economic situation improved they would not receive another work permit for the Federal Republic of Germany owing to the present ban on recruitment. To this extent the ban on recruitment, justified though it is, also has a kind of "locking-in" effect. At the end of 1974 a total of 135,000 foreigners were registered as unemployed in the Federal Republic of Germany; this means that the unemployment ratio for foreign workers at that time was about one third higher than that for German employees. The comparatively great unemployment among younger German employees (those below 20 years of age) is also likely to have partly structural causes (e. g. lack of training facilities, discrepancy between school education and manpower requirements, etc.). The correction of these structural shortcomings, to which some of the unemployment is attributable, is not primarily a task for economic policy, but rather for longer-term measures designed to improve the structure of the labour market. The Federal Government has made some moves in this field, but success can be expected only in the longer run.

Sustained weakness of demand in housing . . .

Much of the decrease in production and employment in the course of 1974 can be explained by corresponding tendencies on the demand side. Housing was particularly hard hit by the decline in demand; in this sector the downturn started back in 1973, when the first doubts arose as to whether the acquisition of real property provided protection against losses through inflation. The demand for housing as such also lost something of its urgency. Interest in new dwellings was even smaller in 1974, the more so as it had become apparent that interest rates were moving more or less in line with the declining value of money, thus largely destroying the prospects of debtors' gains. As measured by building permits granted, only 420,000 new dwellings were planned last year, compared with 660,000 in 1973 and 770,000 in 1972. Of the dwellings finished in 1974 – 605,000 against 715,000 a year earlier – some proved impossible to sell or let for the time being as a result of the smaller demand for housing; the total of empty dwellings therefore continued to rise. In principle the increase in the number of unoccupied dwellings is a process conforming to market principles; in some respects it represents a belated step in the Federal Republic of Germany on the way to a situation which is quite usual in other countries where the supply of dwellings is larger (in the United States, for example, about 5½ % of all rentable dwellings have been estimated to be unlet). A growing supply of dwellings stimulates competition on the housing market and also raises the regional mobility of labour. Temporarily unlet dwellings in buildings erected with government assistance or in old buildings and unsold single-family houses generally present no great problem. What is problematic is essentially the concentration of the "stockpile of dwellings" in the sector of owner-occupied apartments built by property development companies and construction firms. In this sector, in which business has in many cases been conducted on an absolutely inadequate capital base, a certain shake-out took place in 1974 and has not yet been completed.

In other respects the return to normal in housing construction proceeded further. The number of dwellings which have been approved but not yet started or finished (the so-called housing backlog) at the end of 1974, at 780,000, was not much larger than the average figure for the years from 1966 to 1970, whereas it had amounted to about one million in each of the years from 1971 to 1973. The 1974 backlog probably includes numerous projects that were planned without consideration of market conditions and may well remain uncompleted for some time. Apart from this the planning of residential buildings continues, though the scale is smaller than it used to be. Obstacles which cannot easily be surmounted in the short run still stand in the way of a greater expansion of housing plans in the more traditional form of the small building. In particular, a revision of municipal development plans, in which less-sought-after large buildings frequently still play a major role, is required. The incentives for the construction of private rentable dwellings are also inadequate; in this connection rent legislation and pertinent court rulings are often mentioned as retarding factors.

. . . and in the automobile sector . . .

In the motor industry, the second major area of weakness in the economy last year, there had also been clear signs of a decline in demand already in 1973, after the costs of running a car had risen noticeably. Around the turn of 1973/74 domes-

Basic data on economic trends in the Federal Republic of Germany

Item	Unit	1971	1972	1973	1974	1971	1972	1973	1974
						Percentage change on previous year			
Overall demand									
Private consumption	DM billion	410.5	450.9	496.8	534.2	+11.2	+ 9.8	+10.2	+ 7.5
Government consumption	DM billion	130.6	146.5	168.6	195.7	+19.8	+12.1	+15.1	+16.0
Fixed capital formation	DM billion	203.1	217.4	230.0	226.1	+12.2	+ 7.0	+ 5.8	— 1.7
Machinery and equipment	DM billion	91.1	92.5	96.5	95.2	+ 9.9	+ 1.5	+ 4.3	— 1.3
Buildings	DM billion	112.0	124.9	133.6	130.9	+14.1	+11.5	+ 6.9	— 2.0
Expenditure on stocks	DM billion	+ 5.4	+ 4.4	+ 9.6	+ 1.3	.	.	.	.
Domestic expenditure	DM billion	749.7	819.2	905.0	957.3	+11.2	+ 9.3	+10.5	+ 5.8
Net exports of goods and services **1**	DM billion	+12.2	+15.4	+25.3	+38.3	.	.	.	.
Exports	DM billion	174.2	190.2	226.2	295.6	+ 9.9	+ 9.1	+18.9	+30.7
Imports	DM billion	162.0	174.8	200.8	257.4	+ 9.9	+ 7.9	+14.9	+28.1
Gross national product at current prices	DM billion	761.9	834.6	930.3	995.5	+11.1	+ 9.5	+11.5	+ 7.0
Memorandum item:									
Orders received by industry	1970 = 100	102.5	110.6	128.3	139.0	+ 2.5	+ 7.9	+16.0	+ 8.4
Domestic orders	1970 = 100	102.1	109.1	120.4	124.7	+ 2.1	+ 6.9	+10.3	+ 3.5
Foreign orders	1970 = 100	103.4	115.1	153.6	184.5	+ 3.4	+11.4	+33.4	+20.1
Income									
Gross wage and salary income	DM billion	400.2	439.2	498.7	547.3	+13.3	+ 9.7	+13.5	+ 9.8
Memorandum item:									
Gross wages and salaries per employee	DM thousand	(15.4)	(16.8)	(18.8)	(21.0)	+11.7	+ 9.0	+12.0	+11.8
Gross property and entrepreneurial income	DM billion	185.5	200.7	218.5	217.0	+ 5.4	+ 8.2	+ 8.9	— 0.7
National income	DM billion	585.7	639.9	717.2	764.4	+10.7	+ 9.3	+12.1	+ 6.6
Wage ratio **2**	%	68.3	68.6	69.5	71.6	.	.	.	.
Production									
Gross national product at 1962 prices	DM billion	545.2	564.0	593.8	596.3	+ 3.0	+ 3.4	+ 5.3	+ 0.4
do. per man-hour worked (productivity)	1962 = 100	158.7	165.5	175.1	180.9	+ 3.5	+ 4.3	+ 5.8	+ 3.3
Industrial production (excluding construction)	1970 = 100	101.5	105.7	113.2	111.9	+ 1.5	+ 4.1	+ 7.1	— 1.1
Employment									
Employed persons	Thousands	26,725	26,655	26,712	26,231	+ 0.2	— 0.3	+ 0.2	— 1.8
Wage and salary earners	Thousands	22,414	22,435	22,564	22,113	+ 0.8	+ 0.1	+ 0.6	— 2.0
Foreign workers	Thousands	2,128	2,284	2,493	**pe** 2,408	+17.8	+ 7.3	+ 9.1	— 3.4
Memorandum item:									
Total number of man-hours worked	1962 = 100	95.4	94.6	94.1	91.5	— 0.5	— 0.9	— 0.5	— 2.8
Unemployed	Thousands	185	246	274	583	+24.4	+33.1	+11.0	+113.0
Unemployment ratio **3**	%	0.9	1.1	1.3	2.6	.	.	.	.
Prices									
GNP deflator	1962 = 100	139.7	148.0	156.7	166.9	+ 7.9	+ 5.9	+ 5.9	+ 6.6
Cost of living index for all households	1970 = 100	105.3	111.1	118.8	127.1	+ 5.3	+ 5.5	+ 6.9	+ 7.0
Producer prices of industrial products	1970 = 100	104.3	107.0	114.1	129.4	+ 4.3	+ 2.6	+ 6.6	+13.4
Memorandum item:									
Unit labour costs in the economy as a whole **4**	1962 = 100	137.6	144.5	154.0	168.5	+ 8.7	+ 5.0	+ 6.6	+ 9.4

1 Balance of merchandise and service transactions with the rest of the world (including GDR). — **2** Wage and salary income as a percentage of national income. — **3** Unemployed as a percentage of wage and salary earners. — **4** Index of gross wages and salaries per employee divided by index of real GNP per employed person. — **pe** Partly estimated. — The data from the National Accounts are provisional.

tic demand for cars was additionally hit by the oil crisis and its consequences. In view of the very uncertain prospects at the beginning of 1974 many initial purchases and replacement purchases of cars were postponed. The average number of new passenger cars registered in 1974 was 16½ % down on the 1973 level, which itself was lower than before. Many car owners also changed to smaller, less expensive models as a result of the higher servicing and running costs, and this further depressed the production value of the cars manufactured last year. Around the turn of 1974/75 the situation improved, as will be explained below.

... spreads to consumer demand despite sharp expansion of incomes

Other consumer durables, too, were less in demand last year than in 1973, partly because fewer new dwellings were occupied, partly because the increasing risk to employment and the resultant uncertainty about the further trend of incomes induced consumers to defer major purchases, particularly if they would have involved borrowing. Purchases of everyday requisites, on the other hand, continued to rise steeply. Altogether, private consumption expenditure in 1974 was 7½ % higher than in 1973; in terms of volume (i. e. after elimination of price increases), however, private consumption went up only a little. From the income side, there was hardly any reason for consumers to feel restricted in their purchases. Because of short-time working and dismissals, aggregate gross wages and salaries did not go up as much in 1974 as a year earlier (by 9½ % against 12½ % in 1973), but a very considerable part of the shortfall in income was offset by payments by the Federal Labour Office. Moreover, old age and war victims' pensions were raised sharply in the course of the year. Wage and salary incomes (after taxes and other deductions) and public current transfers combined rose by 10 % in 1974 and thus no less than a year before. But apparently households felt increasingly uncertain about the further trend of incomes. This was reflected in a steep rise in private saving, which was nearly 15 % up on the year. At an annual average of 14½ % the saving ratio reached an exceptionally high level. Particularly in the second half of the year, when the downswing gained strength, saving increased markedly.

Subdued propensity to invest as a result of unfavourable business expectations and sharp rises in costs

The pronounced weakness of demand in the above-mentioned sectors naturally reduced the domestic sales of component suppliers after a certain time and thus led to a much less favourable assessment of business conditions in broad sectors of the economy. This was mirrored in a decline in the propensity to invest, particularly since – as will be explained later – massive cost pressure squeezed profit margins and caused quite a number of enterprises to suffer losses. Domestic orders for machinery and equipment consequently went down noticeably in the later part of 1974. Current expenditure on machinery and equipment during the year just failed to regain the 1973 level, and calculated at constant prices it fell by as much as 7½ %. The emphasis was apparently on investment for replacement and rationalisation purposes, while the expansion of capacities lost much of its importance since existing capacities were often not fully utilised in any case. This is also suggested by the fact that expenditure on industrial construction, which is usually necessary when capacity is extended, decreased much more last year than expenditure on machinery and equipment. Towards the end of the year, however, the decline appears to have stopped: in the fourth quarter the orders for non-residential buildings received by construction enterprises were about 9 % up on the year.

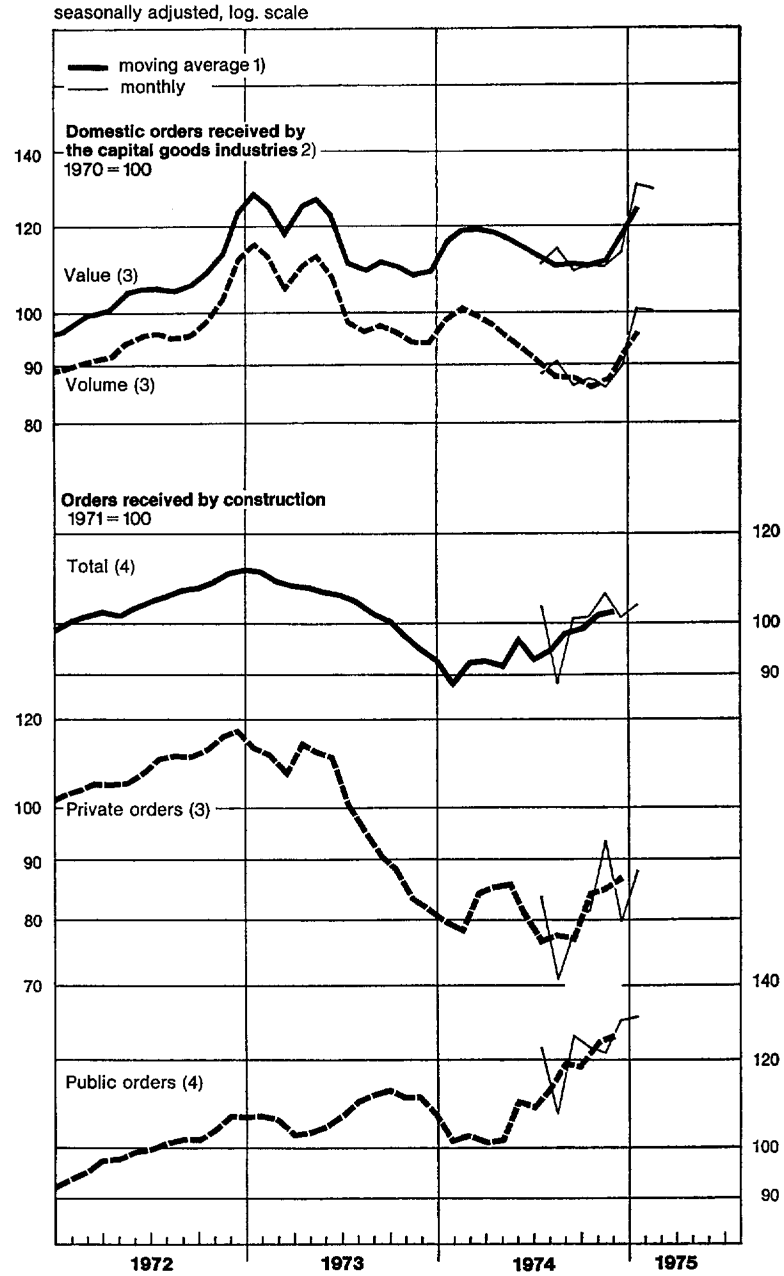
Smaller fixed capital formation reduces medium-term scope for growth

In real terms, the business community's total investments in fixed assets last year were no larger than in 1970, for instance. As replacements made up a greater part of these investments than in 1970, the stock of fixed capital is now growing at a slower pace than in earlier years. Even if investments rise again for cyclical reasons, the overall production potential – and thus the real national product – will presumably no longer increase as fast as it did a few years ago. Significant changes in trend, particularly the diminishing size of the population, are already casting their shadows before.

Low expenditure on stocks

In view of the uncertain future prospects and in an effort to reduce costs, the business community spent very little on stocks last year. In 1974 stocks are likely to have been built up by no more than DM 1.5 billion, against DM 9.5 billion a year earlier. Calculated at constant prices, the much smaller increase in stocks in itself accounts for a loss of growth of just over 1 % of the real gross national product. It appears that stocks have generally fallen to a very low level. Thus both fixed capital formation and expenditure on stocks contributed materially to the moder-

Demand for capital goods



1) The length of the moving average (in months) is indicated in brackets beside each curve.- 2) Including road vehicle building.

ation of demand. If all factors determining demand are taken together, however, this moderation was largely offset by the continued strong expansion of government demand and particularly by foreign demand.

Public authorities exert an expansionary effect . . .

Fiscal policy steered a cautiously expansionary course in conformity with monetary policy, which remained stability-oriented. Almost all the measures taken in the spring of 1973 in order to slow down private investment activity were suspended at the end of 1973. Investment tax, for instance, was removed and diminishing balance depreciation on machinery and equipment and the special depreciation allowances under section 7 (b) of the Income Tax Act were reintroduced; only the stability surcharge on income and corporation tax continued to be levied until the middle of 1974. It was also decided to speed up the placing of the orders for capital goods envisaged in the Federal budget and to make further funds available for publicly-assisted housing. Finally, in February and September 1974 the Federal

Cabinet approved special programmes of nearly DM 1 billion each which are to be financed jointly by the Federal and Länder Governments and are mainly intended to support construction demand in regions where the employment situation is relatively unfavourable. Not least on account of these additional programmes public construction orders increased considerably in the later part of 1974 (after having declined at the beginning of the year), which counteracted a further weakening in the construction sector. According to the National Accounts, the value of construction work done for the central, regional and local authorities last year was about one fifth higher than in 1973. This was not fully reflected in budgetary expenditure, however, which as a rule lags somewhat behind; this expenditure exceeded the 1973 figure by an estimated 9 to 10 %. What prevented public capital spending from providing an even greater stimulus was the fact that the financing possibilities were severely restricted by the very high pay rises conceded. The increase in wages and salaries in the public service agreed at the beginning of 1974 (basic salaries and local allowances were raised by 11 % or DM 170 per month, whichever was the greater), together with the further growth in personnel and "structural" salary increases, caused overall personnel costs to go up by an estimated 15 to 16 %. As total expenditure expanded by about 14 %, the central, regional and local authorities once more failed to slow down the advance of public consumption expenditure in the year under review.

... but scope for investments restricted by sharply growing public consumption expenditure

On the income side the slack economic activity in Germany resulted in tax receipts being much smaller than expected. In March 1974 the prospective tax revenue of the central, regional and local authorities was officially estimated at some DM 250 billion; actual receipts were however nearly DM 11 billion smaller, though still DM 15 billion, or 6½ %, larger than in the preceding year. The fact that the growth of the nominal gross national product, at 7 %, was two percentage points smaller than had originally been expected was not the only reason for the relatively small rise in tax receipts; shifts in the use of the national product and in the income structure were just as important. For one thing, the sharp expansion in tax-free exports, with which taxable imports nowhere near kept pace, meant that turnovers subject to tax grew much less than the national product. For another, profit-dependent taxes rose only a little on account of the depressed earnings situation.

Larger tax shortfalls as a result of slack economic activity in Germany

Since the overall receipts of the central, regional and local authorities thus expanded much less than their expenditure, the cash deficit grew steeply, namely by just over DM 15 billion to DM 25 billion. (The receipts from the anticyclical special taxes are included in both years.) These figures, too, attest the extent to which the central, regional and local authorities supported economic activity in 1974, even though the major part of the expansionary "swing" was only ascribable to the fact that the considerable cyclical shortfalls in receipts were not offset by correspondingly large cuts in expenditure.

Much greater cash deficit of the central, regional and local authorities

The social security funds also had a substantial anticyclical impact on the income circulation in the year under review. In contrast to preceding years, expenditure grew much more sharply than receipts in 1974, mainly because payments to unemployed persons and short-time workers trebled during the downswing and because pension payments continued to increase strongly. All in all, the surpluses of the social security funds declined by DM 5 billion to DM 2 billion in 1974, so that the expansionary "swing" – a change in the financial balance in the sense of a creation of additional demand by the government – deriving from all public authorities in the year under review increased to roughly DM 20 billion, or 2 % of the gross national product. In view of the fact that the use of the production potential by overall demand was lower in 1974 than in the preceding year, and also below the average of a business cycle, this change was quite appropriate in terms of anticyclical fiscal policy, although some features, e. g. the increased share of consumption expenditure, did not conform to the objectives.

Anticyclical impact of the social security funds

The abrupt rise in the deficits of the central, regional and local authorities made it necessary to borrow about DM 23.5 billion (net) in 1974; that was just under DM 9 billion more than in the previous year. The trend towards a sharp increase

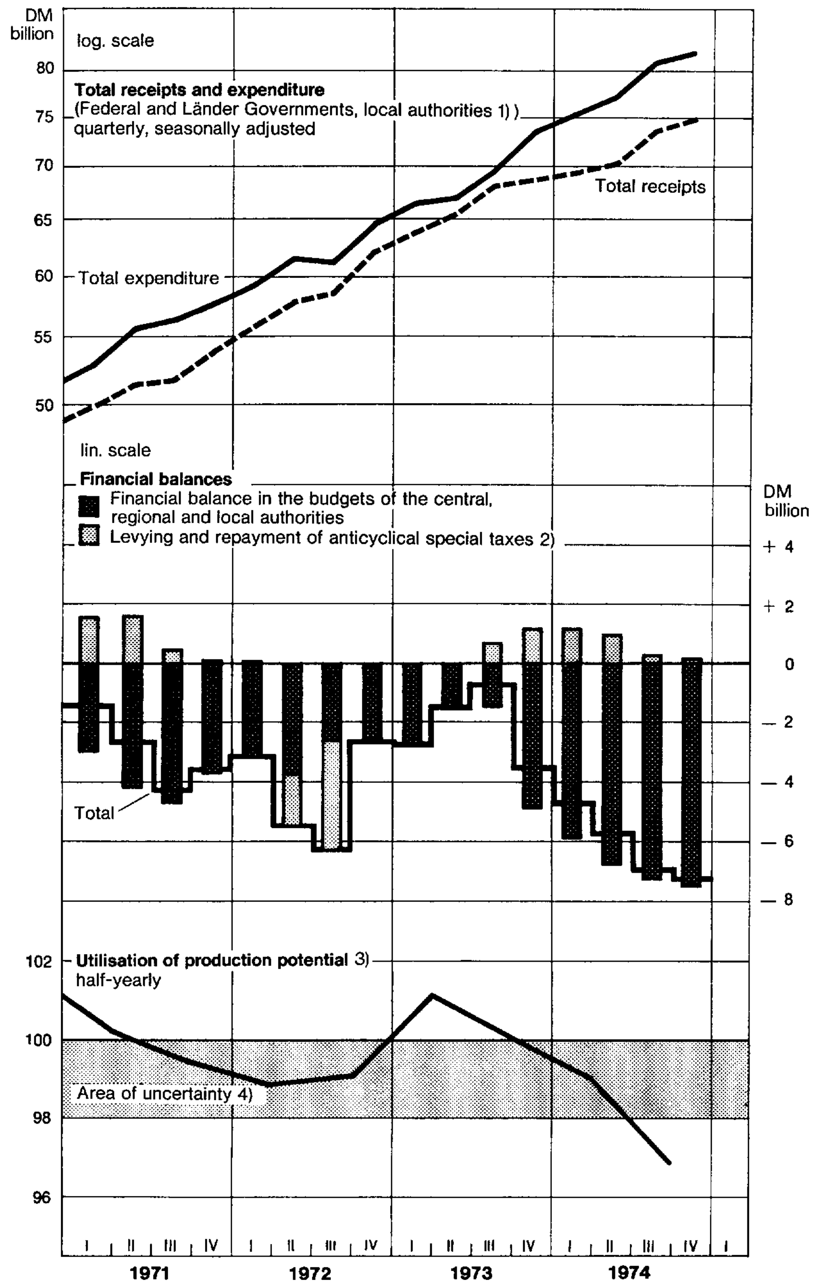
Sharp increase in borrowing due to soaring deficits

Public authorities' finances

Item	1971	1972	1973 pe	1974 pe	1971	1972	1973	1974
	Billions of Deutsche Mark				Percentage change on previous year			
I. Central, regional and local authorities								
(1) Expenditure								
Expenditure on personnel	73.1	81.5	93.5	108	+19.2	+11.5	+14.6	+15.5
Pensions and assistance grants	33.9	38.9	39.6	46.5	+12.0	+14.5	+ 1.8	+17
Fixed investments **1**	37.3	38.9	41.0	45	+17.1	+ 4.1	+ 5.5	+ 9.5
Indirect investments **2**	17.8	18.7	20.8	22.5	+18.3	+ 5.5	+10.7	+ 8.5
Other expenditure	61.0	68.6	82.3	93.5	+ 8.2	+12.5	+20.1	+13.5
Total	223.1	246.6	277.2	315.5	+14.5	+10.5	+12.4	+14
of which: Federal Government **3**	97.5	110.2	123.6	138	+12.0	**3** +12.6	+12.2	+12
Länder Governments	88.3	99.1	114.8	133	+15.4	+12.3	+15.8	+15.5
(2) Receipts (excluding special taxes)								
Tax revenue	172.4	197.0	224.8	239.5	+11.9	+14.3	+14.1	+ 6.5
Other receipts	34.9	37.5	41.7	48.5	+12.5	+ 7.6	+11.3	+16.5
Total	207.3	234.5	266.5	288	+12.0	+13.1	+13.7	+ 8
of which: Federal Government **3**	96.1	106.3	120.0	126.5	+11.1	+10.6	+12.9	+ 5.5
Länder Governments	82.8	97.8	112.7	124	+13.0	+18.1	+15.2	+10
(3) Cash surplus (+) or deficit (—) **4**	—16.1	—12.8	—11.5	—27.5	.	.	.	.
of which: Federal Government **3**	— 1.4	— 4.6	— 3.8	—11.5	.	.	.	.
Länder Governments	— 5.7	— 1.3	— 2.9	— 9	.	.	.	.
(4) Special taxes **5**	+ 3.7	— 5.6	+ 1.9	+ 2.5	.	.	.	.
(5) Cash surplus (+) or deficit (—) including special taxes	—12.4	—18.4	— 9.6	—25	.	.	.	.
II. Social security funds 6								
(1) Expenditure **7**	92.9	107.6	124.5	147	+14.4	+15.8	+16	+18
(2) Receipts	97.8	113.0	132.0	149	+13.8	+15.6	+17	+13
(3) Cash surplus (+) or deficit (—) **8**	+ 5.2	+ 5.3	+ 7.2	+ 2	.	.	.	.
III. Public authorities, total								
(1) Expenditure	303.0	338.6	386.6	442.5	+14.7	+11.7	+14	+14.5
(2) Receipts (including special taxes)	295.7	326.2	385.3	420.5	+13.2	+10.3	+18	+ 9
(3) Cash surplus (+) or deficit (—) **9**	— 7.2	—13.1	— 2.4	—23	.	.	.	.

1 Cash expenditure is recorded here, whereas production of public capital goods is shown on the government account of the National Accounts. — **2** Expenditure on investment grants and loans to third parties, trade investments. — **3** From 1972 onwards loans raised by the Public Works Corporation and for hospital financing have been included in the Federal budget. — **4** The discrepancies between the balance of receipts and expenditure and the cash deficit are due to special transactions. — **5** Levying and repayment of anticyclical surcharge, and receipts from stability surcharge and investment tax. — **6** Public pension funds, health insurance, accident insurance, agricultural pension funds and Federal Labour Office. — **7** Including fixed capital formation. — **8** On the basis of the change in financial assets, which differs slightly from the balance of booked receipts and expenditure. — **9** See footnotes 4 and 8. — **pe** Partly estimated.
Discrepancies in the totals are due to rounding.

Central, regional and local authorities' finances



1) Estimated figures for local authorities.- 2) Anticyclical surcharge, stability surcharge and investment tax.- 3) Potential = 100.- 4) Attempt to depict the area of optimum overall production.

in credit financing was wholly confined to the central and regional authorities. The borrowing was concentrated, to a more than seasonal extent, in the second half of the year; in that period the central and regional authorities met nearly three quarters of their total needs of credit market funds. On the one hand, the full size of the deficits only became apparent in the course of the year; on the other, the rather tight situation on the capital market in the first few months of 1974 prompted the public authorities to exercise restraint at first, but in the later part of the year their very high requirements of outside funds could be satisfied at falling interest rates as enterprises' demand for credit declined sharply and monetary policy was relaxed.

Strong foreign demand at first another counterweight to slack economic activity in Germany

Foreign demand, the second major counterweight to the weakness of economic activity in Germany, was mainly sustained by the overheated economic climate in many partner countries due to inflation. At the beginning of 1974 German exporters were still receiving a flood of foreign orders. In the middle of the year the seasonally adjusted inflow of orders from abroad was 20 % larger than at the end of 1973. German exporters benefited from the fact that the products they offered were particularly in demand and that in view of the downturn in domestic business it was usually not difficult for them to deliver on time, in contrast to some foreign competitors whose capacities were in most cases fully utilised and whose ability to deliver promptly was often hampered by strikes. Firms with a high proportion of exports thus not only managed to utilise their capacities more efficiently but also did better than other enterprises with respect to earnings, because export prices could in most cases be raised more than domestic prices owing to the greater inflation abroad. (That this did not impair the competitiveness of German exporters in spite of the appreciation of the Deutsche Mark on the foreign exchange markets is shown on page 33.) However, not even in the first half of the year were all domestic sectors able to profit equally from the heavy demand for exports. The motor industry, in particular, found that foreign markets could not provide adequate compensation for slack domestic business, on account of the downturn in sales triggered off by the oil crisis. On the other hand, some sectors of the basic and producer goods industries at first benefited very greatly from the export boom; notably the steel industry and the chemical industry were at times unable to satisfy the demand as a result of capacity bottlenecks. In mechanical engineering and in electrical engineering, too, which have traditionally had a high export ratio, foreign orders increased steeply and initially made up for the more sluggish sales in Germany. Nevertheless, the rise in export ratios due to the unbalanced development of domestic and foreign business caused considerable concern to the economic policy makers and also to many enterprises. The problems arising when the domestic economy is too dependent on foreign influences emerged very clearly when in the autumn of 1974 the upward trend of foreign demand reversed, after recessionary tendencies had begun to gain ground in other western industrial countries as well. The firms which had profited most from the preceding export boom were hit particularly badly. In December 1974 and in the first few months of 1975 exporters received distinctly fewer foreign orders than a year earlier.

Reversal of the trend in foreign demand in the second half of the year

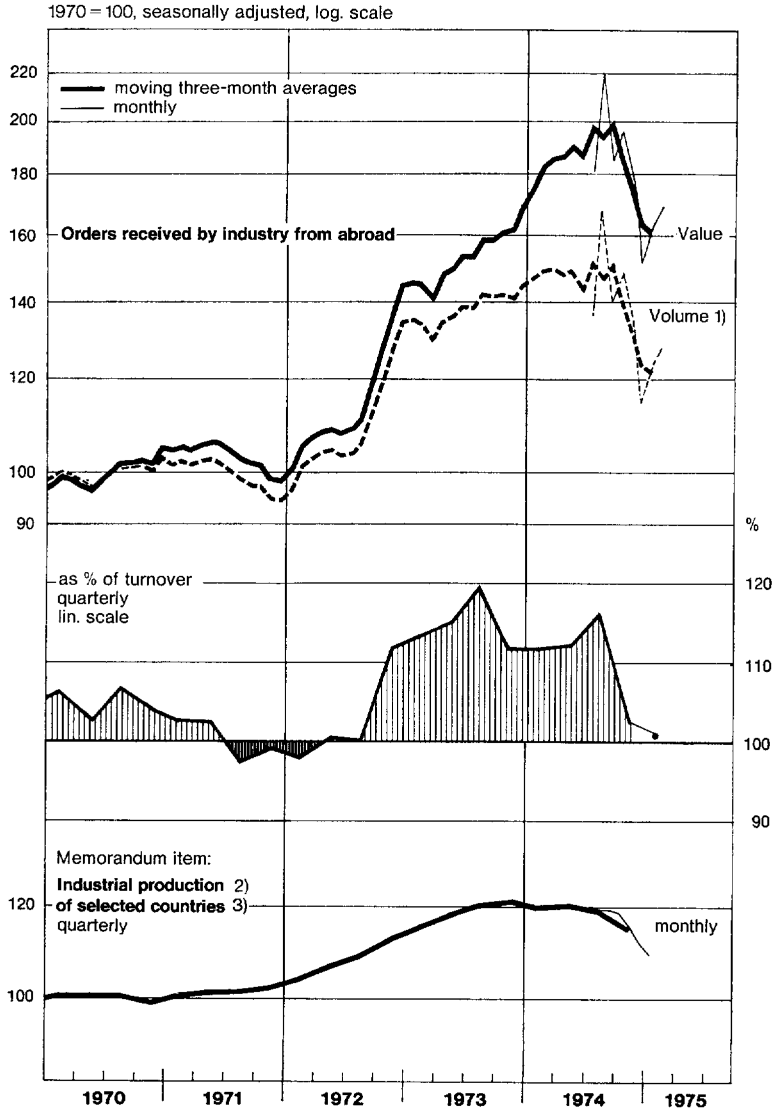
Steep increases in the cost of materials owing to the raw material boom and the oil crisis ...

But the above-mentioned tendencies in demand are not in themselves sufficient to explain the trend of production and especially the disproportionately sharp decline in employment in 1974, as already intimated. The analysis of causes would be incomplete if no account were taken of the massive cost rises, which in 1974 were more than ever a factor in their own right. The increase in the cost prices of imported raw and primary materials that had begun in 1973 must be rated a completely autonomous cost rise (i. e. one that was independent of the other processes in Germany). The oil crisis of the autumn of 1973 brought new sharp increases in the prices of petroleum and petroleum products. A world-wide wave of speculation pushed up the prices of other raw materials as well. However, around the middle of 1974 (and in some cases in the first half of the year) the uptrend came to a stop and the prices of some basic materials started to fall. Moreover, the fact that the external value of the Deutsche Mark began to rise again in the autumn meant that foreign raw materials and primary products became cheaper for German importers. But at the end of 1974 imported raw materials and semi-finished products – calculated in Deutsche Mark – were still nearly 30 % dearer than a year earlier. Simply on account of the increase in the prices of all imports of goods and services (22 % on an annual average) the production costs of all goods sold in Germany and abroad in 1974 went up by 4 % for the German business community.

... combine with a sharp rise in wage costs

Another factor of considerable importance for the cost trend was that wage costs rose steeply in 1974. This was, of course, not a completely autonomous process, for a certain increase in wages and salaries was unavoidable owing to the general rise in prices. At an early date the Federal Government, the Council of Economic Experts and the Bundesbank made it very clear that in view of the necessity of continuing the stabilisation policy excessive wage rises would have an adverse effect on employment. However, in pay negotiations backed at times by strikes the

Foreign demand



1) Orders received at 1970 prices.- 2) Including mining and energy, excluding construction.- 3) France, United Kingdom, Italy, Belgium, Netherlands, United States, Canada, Japan, Sweden, Norway, Switzerland, Austria.- • = Average January/February.

trade unions put forward very high wage demands in the first few months of 1974. The opinion that the impact of the raw material boom and the oil price explosion on employees' standard of living could be neutralised by very sharp wage rises doubtless played a part in this. In addition, estimates of the price increases to be feared in 1974 were at first pitched very high — too high, in fact, as it later transpired — and these expectations were taken into account in the wage negotiations. Employers, on the other hand, did not resist the trade unions' wage demands as firmly as would have been appropriate in the circumstances. Apparently they, too, underrated the prospects of success of the stabilisation policy and expected that it would be possible to pass on the cost increases resulting from the pay settlements as inflation proceeded further. The position of the employers in the wage negotiations at the beginning of 1974 was also made more difficult by the fact that the public service, as the first major pay sector, set a crucial signal in the middle of February by increasing pay rates by a total of 12½ %. When the metal industry followed suit with pay rises of about 11 % (plus certain fringe benefits and graduated increases of 2 % predominantly in the autumn of the year), the path had been mapped out for the entire wage round. In spite of the employment problems which had meanwhile emerged, two-digit wage increases remained the rule until the end of the year; the precedent set by the agreements at the beginning of

Two-figure pay increases at the beginning of the year set a precedent for the entire wage round the year thus proved to be a stronger influence on pay settlements than the change in economic conditions. In 1974 average pay rates in the economy as a whole were 13 % higher than a year before on an hourly basis and 12½ % higher on a monthly basis, rates which were markedly above those of 1973.

Cost rises lead to pronounced squeeze on profits

These pay rate increases pushed up enterprises' personnel costs sharply, for there was apparently little chance in 1974 of offsetting such increases by reducing the wage components that were paid in excess of the agreed scale. Actual wage and social security expenditure per employee in 1974 was on an average 12 % larger than a year previously. Since sales deteriorated in the same period, it became necessary to cut down on personnel. Although the cost pressure was in many cases relieved by gradual staff reductions, and although output per employee went up further, the additional burden of personnel costs on the overall production of goods sold in Germany and abroad in 1974, compared with the preceding year, came to 4½ %. Including the above-mentioned extra cost of imported products (+ 4 %), the overall cost level thus increased by a total of 8½ % within one year on account of these two factors alone. Other less significant cost elements (depreciation, indirect taxes) worked in the same direction. Attempts to pass on all of this spate of additional wage and material costs in prices were bound to conflict with the aims of economic policy, which since the beginning of 1974 had explicitly been to minimise the further effects of the surge of inflation resulting from the oil crisis and to continue the fight begun in 1973 against the inflation mentality. However, once enterprises had agreed to the exaggerated wage increases – and these were the only extra costs which might have been avoided – the consequences were inevitable. The rises in costs led to a squeeze on entrepreneurial profits, reduced the propensity to invest, endangered jobs and in quite a number of cases were presumably the ultimate reason for giving up business. The numerous insolvencies of enterprises in 1974 – all in all nearly 6,000 bankruptcy and composition proceedings were instituted last year, compared with 4,000 in 1973 and an average of less than 3,000 in the years from 1968 to 1972 – are a very clear indication of this. These developments were reflected in the distribution of incomes last year in the fact that entrepreneurial and property income failed to regain the 1973 level, whereas wage and salary income grew by roughly 10 %. Exclusive of households' property income, which always rises if only because of the growth of financial assets and which went up particularly sharply owing to the high interest rates, entrepreneurial income in the strict sense is likely to have fallen distinctly. The share of wage and salary income in national income came to 71.6 % in 1974, against 69.5 % in 1973 and 68.6 % in 1972. In 1974, in contrast to earlier years, the increase in that percentage was not influenced by the fact that the proportion of employees in the labour force went up; in fact, it decreased slightly.

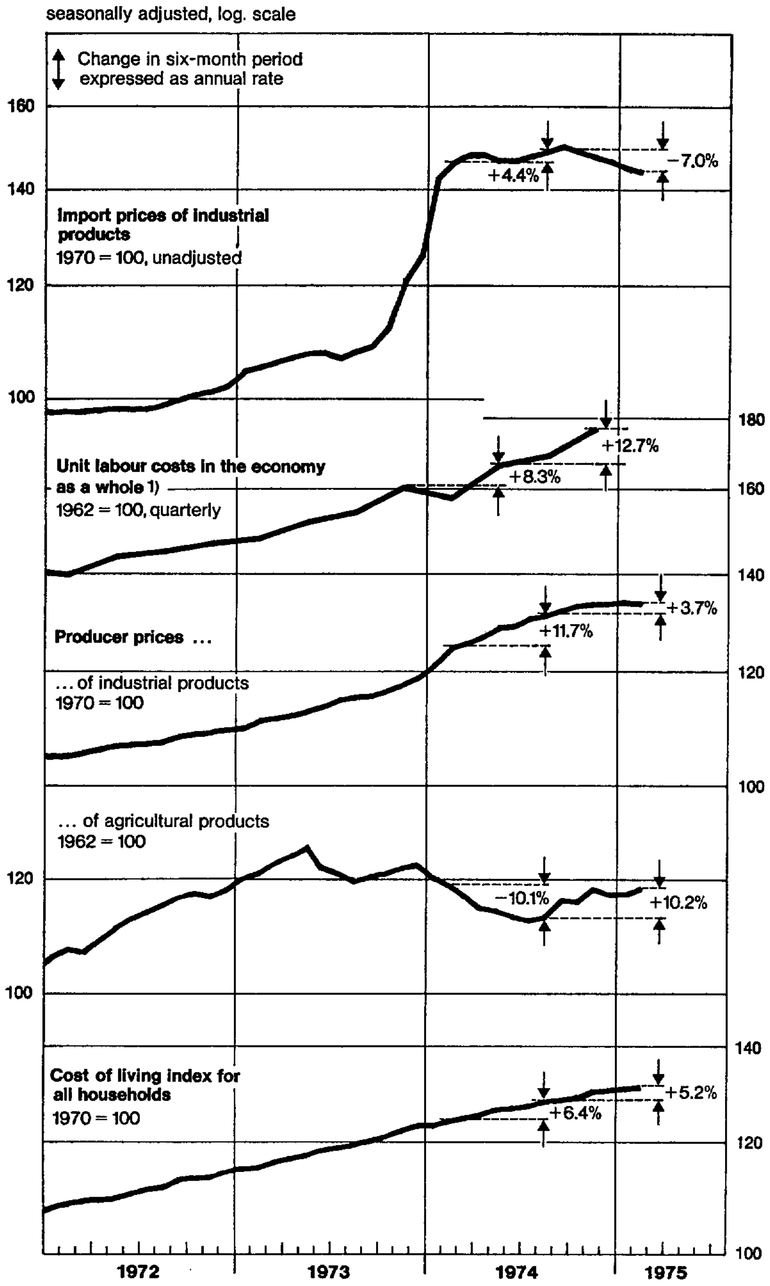
Cost trend puts stabilisation policy to a severe test

The efforts in the field of stabilisation policy were put to a severe test by the cost trend described above. On the one hand, it was necessary to tolerate the price effects of the oil crisis and the world-wide raw material boom where this appeared unavoidable, indeed indispensable, to prevent bottlenecks from developing in supply and to permit the functioning of those market forces which would initiate the requisite adjustments to the changed situation. On the other, it was essential to check additional "home-made" inflationary tendencies such as seemed to be inherent in, above all, the pay agreements of early 1974. But for this complicating factor, economic policy would undoubtedly have had more room for manoeuvre. But as things were it appeared necessary to continue the stability-oriented course in order not to endanger the first successes in combating inflation.

Increase in industrial producer prices checked in the course of the year

At first it looked as if the initial successes gained in 1973 in the fight against inflation had been nullified by the oil crisis, for prices in Germany began to move upwards very quickly at the beginning of 1974. In the first quarter of 1974 the producer prices of industrial products rose at an annual rate of no less than 26 %, seasonally adjusted. However, it soon became clear that the scope for price increases in Germany was limited and that the market reacted to the soaring prices with a distinct flagging of demand. At the producer level the price uptrend therefore slackened noticeably in the further course of the year. In the last three months of 1974 industrial producer prices rose at a seasonally adjusted annual rate of only 4½ %, and at the beginning of 1975 they virtually stopped increasing.

Costs and prices



1) Index of gross wages and salaries per employee divided by index of real gross national product per employed person.

In the course of the year smaller price rises at the consumer level as well

From the consumers' point of view the price prospects were also rather gloomy at first in 1974. Under the impact of the oil crisis and its anticipated consequences the rise in the cost of living had accelerated considerably towards the end of 1973; in the last quarter of 1973 prices increased at a seasonally adjusted annual rate of 11 %. Here, too, the response of demand to the faster increase was a drop in purchases, and in view of the widespread uncertainty about employment and incomes this determined the market situation during the remainder of the year and was the main reason for the gradual easing of the uptrend in prices. During the fourth quarter of 1974 prices rose at an annual rate of only 5½ %, seasonally adjusted. In December 1974 the cost of living was no more than 6 % higher than a year before, compared with 8 % in December 1973.

Consumer prices in selected countries

Percentage change in the cost of living index on previous year

Country	1972	1973	1974	1974 3rd qtr	1974 4th qtr	1975 Jan./Feb.
Belgium	5.4	7.0	12.7	14.6	15.9	15.5
France	6.2	7.3	13.4	14.6	15.0	14.2
Italy	5.7	10.8	19.1	20.6	24.7	23.7
Netherlands	7.8	8.0	9.6	9.9	10.9	10.3
United Kingdom	7.1	9.1	16.0	17.0	18.2	19.9
EEC countries, total **1**	6.4	8.6	15.1	16.3	17.9	17.8
Austria	6.3	7.6	9.5	10.0	9.7	9.4
Norway	7.2	7.5	9.4	9.7	10.7	12.2
Sweden	6.0	6.8	9.9	9.2	11.8	8.9
Switzerland	6.7	8.7	9.8	10.6	8.8	**p** 7.9
United States	3.3	6.2	11.0	11.5	12.1	11.4
Canada	4.8	7.6	10.9	11.0	12.0	11.9
Japan	4.5	11.7	24.5	24.8	24.6	**p** 15.7
Selected countries, total **2**	4.4	7.6	13.5	14.1	15.0	**p** 13.4
Compare:						
Federal Republic of Germany	5.5	6.9	7.0	7.1	6.5	6.0

1 Excluding Federal Republic of Germany, Denmark, Ireland and Luxembourg. — **2** Weighted with the share of these countries in the 1970 GNP of the OECD countries. — **p** Provisional.

Germany again at the end of the international scale of inflation rates in 1974

With an average annual rate of price increase of 8½ % for all products sold in Germany — and 7 % for private consumption — the Federal Republic of Germany was once again at the very end of the international scale of inflation rates. With a few exceptions, the industrial countries recorded two-digit rates of price increase. At an annual average of 13½ % in 1974, the rise in consumer prices in the western industrial countries was nearly twice as high as in the Federal Republic of Germany. At the end of 1974 and in the first few months of 1975 the discrepancy between the rise in consumer prices in Germany and that abroad became even greater. Even though this was only a relative success for Germany in the field of stabilisation, it did accomplish a great deal when viewed against the inflationary environment. The inflation mentality, i. e. the belief that inflation will persist and gather pace and that one must adapt to it by a flight into real assets and by incurring as much debt as possible, has been overcome. Saving money again appears to be attractive, even in comparison with the acquisition of real assets. In other words, the general public in the Federal Republic of Germany again has confidence in money and in the importance of saving money. There can be no dispute that this is more than just a temporary advantage, that it is in fact an indispensable basis for sound economic development.

Only stability guarantees employment in the long run

There is more dispute about the extent to which the stabilisation process has so far been detrimental to employment. In this connection at least two points must be made. First, the increase in unemployment in the Federal Republic of Germany was not, in the form it took, an inevitable consequence of the stabilisation process. Second, it would not have been possible to safeguard employment lastingly even by tolerating higher rates of inflation. As regards the first point, it has already been said that at the beginning of 1974 management and labour were free to agree on high or less high wage increases, within certain limits, and thus to augment or reduce the pressure on profit margins, and the adverse effects of this pressure on capital investment and employment. The Federal Government and the Bundesbank, which had clearly stated that they would continue the stabilisation policy in 1974 and had also pointed out that wage decisions that did not conform to this basic line of policy would enhance the risk to employment, thus cannot be blamed for the adverse consequences of the wage agreements reached. As regards the second point, international experience should be considered. The cost push due to the increase in the price of petroleum and the raw material boom hit the western industrial countries more or less equally. Some of these countries — unlike the Federal Republic of Germany — first of all let the cost and price wave more or less take its course, believing that the rises in import prices would have a deflationary impact and that this negative effect would have to be

Wages and wage ratios in selected countries

Country	Gross wage and salary income 1973 p	1974 e	Wage ratio 1 1973 p	1974 e
	Percentage rise on previous year		%	
Belgium	14.9	18.5	65.6	67.6
France	15.1	19.8	67.0	69.9
Italy	20.0	23.5	64.7	67.1
Netherlands	14.2	15.2	69.8	71.8
United Kingdom	14.1	18.3	76.8	81.2
United States	11.2	8.9	73.8	74.9
Compare:				
Federal Republic of Germany	13.5	9.8	69.5	71.6

1 Gross wage and salary income as a percentage of national income. — p Provisional. — e Estimates by the offices of the EEC Commission.

counteracted by a sharper expansion of domestic demand. This resulted, inter alia, in exceptionally high wage increases in those countries and an unprecedented shift in national income in favour of wage and salary income and at the expense of profits, a redistribution which in many cases was much greater than that in Germany (see the above table). Employment could not be safeguarded in those countries either. On the contrary: later in 1974 and at the beginning of 1975 a phase of rapidly increasing unemployment began. More inflation is not apt — not even under present circumstances — to safeguard the prospects of a high return on new capital investment in the longer run; hence employment does not receive the expected support. More inflation at a stage where all confidence in the stability of money is destroyed results in greater economic uncertainty than does the contrary, namely a return to more stable conditions, without which it is obviously impossible, particularly in view of the bitter experience of the last few years, for the economy to develop soundly.

2. Monetary trends on the desired path

(a) A steady course of monetary policy calls for flexible adaptation

Target:
not too much, but not too little, monetary expansion

The policy for 1974, conceived jointly by the Federal Government and the Bundesbank, assigned the Bundesbank the task of continuing the stabilisation policy, despite the difficulties caused by the oil crisis, in order to bring about a reversal of the price trends, while fiscal policy was to mitigate regional and structural tendencies towards weakness but without hampering the settlement of structural problems. In accordance with this target the Bundesbank endeavoured to keep monetary expansion within relatively strict limits during 1974. Although it did not expressly commit itself — as it did later for 1975 — to any quantitative target, it tried to ensure that monetary expansion was not too great, but not too small either. Its task was thus more complex than in 1973, when it had initially been necessary to bring down the excessively high rates of expansion in the monetary field. In 1974 taken as a whole no further restrictive measures were required to keep the growth of the monetary aggregates within the order of magnitude considered appropriate; in fact, a gradual relaxation proved necessary for the purpose, although this did not represent a fundamental change of policy. However, under the influence of the growing weakness of business activity and the first signs of progress in fighting inflation, a change was made in the last quarter of 1974; the target became a slightly faster rate of monetary growth, which was publicly announced towards the end of the year, as explained below. Some of the measures taken by the Bundesbank in 1974 just served the purpose of warding off undesirable influences, i. e. when the Bundesbank tried to compensate changes in bank liquidity due to inflows or outflows of foreign exchange by taking special measures. Some ad hoc measures were also necessary to allay quickly the disquiet that arose after the closing of the Herstatt Bank at the end of June 1974.

Low monetary growth during the first quarter of 1974

In the first few months of 1974 monetary expansion slackened markedly, or more precisely, the currency circulation and sight deposits grew very little. There was, however, a steep rise in time deposits, particularly in January, while savings deposits went up "normally". Seasonally adjusted, currency and sight deposits (M_1) increased at an annual rate of only 2 % in the first quarter, whereas the money stock plus time deposits (M_2) rose by about 9 %. The central bank money stock [1] grew at an annual rate of 4 % in the first quarter of 1974; it thus lay midway between the growth rates of the money stock in the other definitions and may be assumed to reflect actual monetary expansion best. When the slackening of monetary growth became evident, the Bundesbank eased the conditions on which it met the banks' marginal needs of central bank money; it thus responded early, though cautiously, to the first signs of an economic downswing.

Lowering of special rates for central bank credit

After the Bundesbank had suspended the granting of lombard credit on June 1, 1973 the rates relevant for the formation of interest rates on the day-to-day money market were those at which the Bundesbank granted special lombard credit or bought bills under repurchase agreements in open market operations during periods when conditions on the money market were tight. At the beginning of 1974 the Bundesbank assisted the banks by granting special lombard credit at 13 % p. a.; this was no longer needed once the Bundesbank had released roughly DM 4.5 billion of minimum reserves on January 11, with effect from January 1, to make up for outflows of foreign exchange. But by mid-March 1974 it was again necessary to support the money market; the Bundesbank then offered the banks both open market transactions in bills under repurchase agreements at an interest rate of 11.5 % (from April 8: 10 %) and special lombard credit at 13 %. Soon afterwards, however, the Bank was obliged to buy large amounts of foreign exchange under the arrangements for the joint float of European currencies, so that the situation on the money market eased and the banks had significant free liquid reserves for the first time for over a year. The Bundesbank therefore briefly restricted the utilisation of rediscount quotas to 75 % as from May 31. At the same time it lowered the rate for special lombard credit, which was acting as an upper limit for interest rates on the day-to-day money market, to 10 %.

Distinct reduction of the interest rate level ...

Under the influence of the above measures the interest rate level on the money market dropped further in the second quarter of 1974 by comparison with the first. The average rate for three-month interbank loans was only 9.5 %, against 11.3 % in the first quarter of 1974 and 13.8 % in the last quarter of 1973. The interest rates for time deposits declined correspondingly. In the process it appears that a point was reached at which depositors' interest in this form of investment waned or the banks themselves ceased to be interested in prolongations, even on the more favourable terms. At any rate, the turning point in the trend of time deposits came in May 1974. Whereas in the first four months of 1974 such deposits had risen at an annual rate of more than 20 %, thereafter they decreased virtually from month to month, seasonally adjusted, reaching an annual rate of 11 % at the end of February 1975. Some of the maturing time deposits appear to have been switched into sight deposits and some into savings accounts. The trends of the money stock in the different definitions then began to diverge,

... and acceleration of monetary expansion in the second quarter

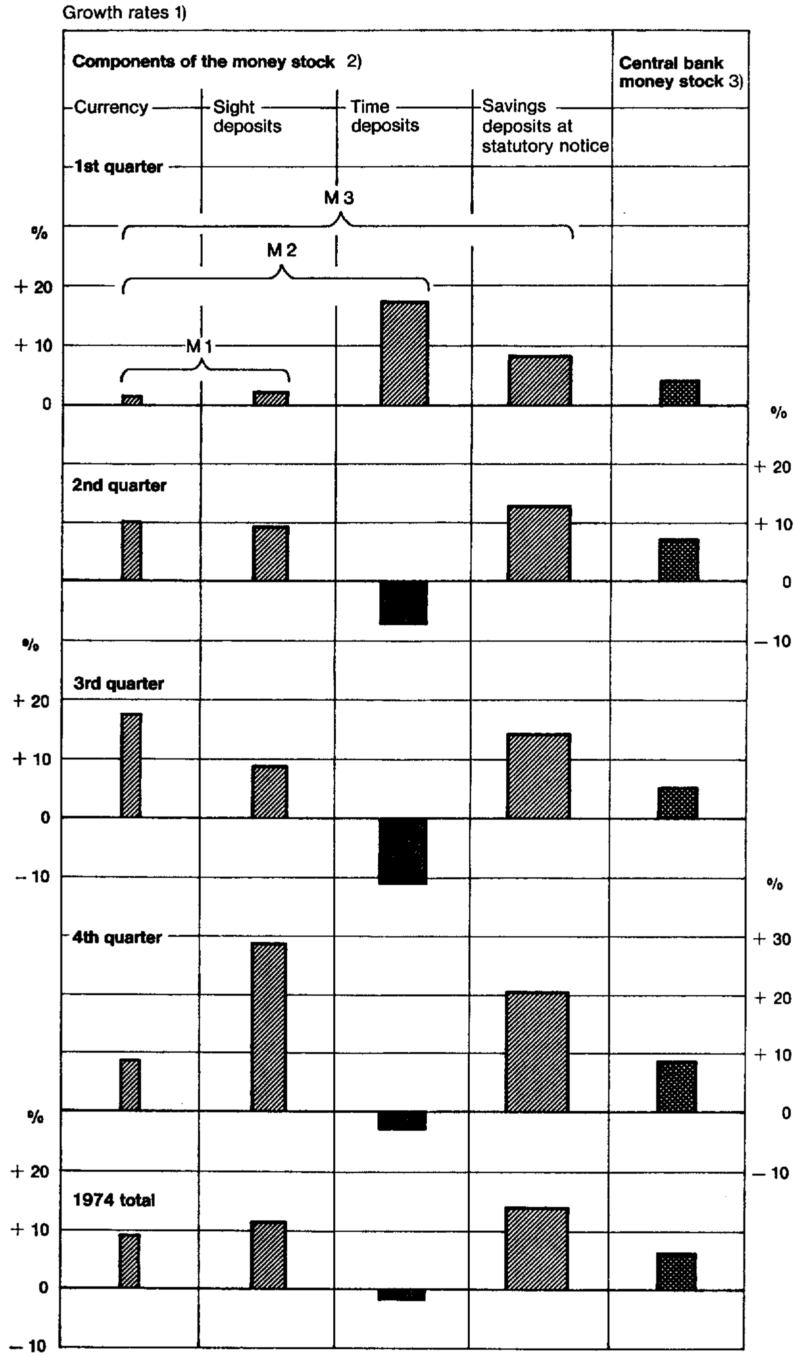
but in the opposite direction to that taken in 1973. M_1 started to signal relatively strong monetary expansion and M_2 showed sluggish rates of increase, while M_3 (M_2 plus savings deposits at statutory notice) and the central bank money stock indicated less extreme monetary growth. The weak monetary expansion in the initial months of 1974 could thus be considered largely cancelled out; the increase rates (on an annual basis) of M_1, M_2 and the central bank money stock were all between 5 % and 6 % in the first six months of the year, and that of M_3 was even higher.

Endeavours to overcome the crisis of confidence after the Herstatt closure

In the middle of the year the collapse of the Herstatt Bank caused a break in the trend in many fields of the monetary system. For the first time since World War II a major German bank with a broad range of depositors and extensive international ties had to declare its insolvency. The losses of this bank, chiefly

1 Currency in circulation on a monthly average and banks' required reserves on domestic liabilities at constant reserve ratios.

Central bank money stock and components of the money stock in 1974



1) Changes during quarters, expressed as an annual rate.- 2) The width of the columns shows the weight of the individual components.- 3) Currency and minimum reserves on domestic liabilities at constant reserve ratios (base: January 1974).

stemming from forward exchange transactions, were many times greater than its capital and reserves. To the Bundesbank it appeared a matter of priority at the time to prevent a major crisis of confidence. Since there was a danger of other banks running into liquidity difficulties owing to massive withdrawals of deposits, the Bundesbank removed the restriction on the utilisation of rediscount quotas and granted lombard loans at the lombard rate again. Besides these general measures, special steps were taken to assist smaller private institutions in particular. The raising of the central bank credit line granted the Privatdiskont AG by DM 0.2 billion to DM 1.1 billion, intended for private bankers and smaller regional banks only, and the promise of financial assistance, if needed, for a liquidity consortium formed ad hoc by the Federal Association of German

Record of economic policy measures

1974	I. Monetary policy
January 11	To offset the withdrawal of liquidity due to outflows of foreign exchange, the Bundesbank lowers the required minimum reserves by about DM 4.5 billion retroactively from January 1. Specifically, the 60 % reserve on increases in external liabilities is removed; the ratios for domestic liabilities are reduced by 5 % and those for external liabilities by 5 percentage points. No special lombard credit is granted after January 11.
January 21	France leaves the "joint float".
January 30	With effect from February 1 the Federal Government, in agreement with the Bundesbank, lifts the greater part of the administrative restrictions introduced to bar undesired capital inflows from abroad. In addition, the cash deposit requirement for external liabilities is reduced by lowering the deposit ratio from 50 % to 20 % and raising the exemption limit from DM 50,000 to DM 100,000.
February 7	With effect from March 1 the Bundesbank introduces a new procedure for calculating the standard quotas. At the same time the existing limits on the utilisation of the rediscount quotas are abolished (liquidity released: nearly DM 1 billion).
March 14	Until further notice the Bundesbank again grants special lombard credit at 13 %. To smooth the money market it again purchases trade bills in the open market outside the rediscount quotas, subject to an agreement that they are to be repurchased after ten days (interest rate 11½ %).
April 4	With effect from April 8 the Bundesbank lowers the rate for open market operations in bills under repurchase agreement to 10 %; the extension of special lombard credit is suspended until further notice.
April 24	The Bundesbank discontinues the purchase of bills under repurchase agreements. It also lowers the selling rates for the Treasury bills and discountable Treasury bonds included in its money market regulating arrangements.
May 22	The Bundesbank decides that from May 31 until further notice banks may utilise not more than 75 % of the rediscount quotas fixed for them. The effect of this measure is a reduction of DM 2.5 billion.
May 28	To moderate the interest rate fluctuations in the money market the Bundesbank grants special lombard credit at the rate of 10 %.
July 3	The Bundesbank cancels with immediate effect the limit on utilisation of the rediscount quotas. It also announces its willingness to grant lombard credit without quantitative restrictions at the lombard rate of 9 % up to July 31. The extension of special lombard credit is suspended until further notice.
July 18	The Bundesbank prolongs the period during which lombard credit is granted up to August 31. It also raises the upper limit for the total of prime bankers' acceptances which it is prepared to purchase in market-regulating operations by DM 200 million, with the proviso that this facility shall be solely to the benefit of private bankers and smaller regional banks. At the same time it promises its assistance to the liquidity consortium which has been formed. The Reconstruction Loan Corporation is enabled, by an increase in its special rediscount facilities at the Bundesbank, to finance credits to smaller and medium-sized enterprises up to a total of DM 500 million.
August 16	With effect from September 1 the Bundesbank lowers the minimum reserve ratios for domestic liabilities by 10 % (reduction in required minimum reserves: roughly DM 4.7 billion) to offset the drain on bank liquidity that has already occurred – mainly owing to the outflow of foreign exchange – and that is expected on seasonal grounds in September.
August 29	The Bundesbank decides to grant the banks lombard credit after August 31 and until further notice.
August 30	The Federal Banking Supervisory Office introduces a new Principle I (a) regarding the banks' foreign exchange positions. It lays down that, with effect from October 1, 1974, the difference between a bank's foreign exchange credit and debit positions, irrespective of their maturity, at the close of business each day is not to exceed 30% of the liable funds. If the positions mature within one calendar month or six calendar months, the limit is 40 %.
September 12	The Federal Government further reduces such restrictions on international monetary and capital transactions as still exist. The cash deposit requirement for external liabilities and the mandatory authorisation for the assignment of domestic claims to non-residents are abolished.
	The Bundesbank and the banks' associations agree to establish a Liquidity Consortium Bank in the form of a private limited company. The object of this enterprise is to conduct banking transactions with banks to ensure the latter's liquidity, with the overall aim of guaranteeing that due banking arrangements are made for domestic and international payments. The capital of the Liquidity Consortium Bank amounts to DM 250 million, with provision for further obligatory payments of capital up to a total of DM 750 million; the Bundesbank has a 30 % share.
September 26	The Bundesbank lowers the minimum reserve ratios for domestic and external liabilities by 8 % with effect from October 1, releasing roughly DM 4 billion.
October 24	With effect from October 25 the Bundesbank lowers the discount rate to 6½ % and the lombard rate to 8½ %. From November 1 the rediscount quotas are raised by DM 2.5 billion.

December 5	The Bundesbank for the first time announces a target for monetary growth: the central bank money stock is to increase by about 8 % during 1975. In this way the requisite monetary scope is to be provided for the desired real growth of the economy and the rate of price increase is to be reduced step by step.
December 19	With effect from December 20 the Bundesbank lowers the discount rate to 6 % and the lombard rate to 8 % in order to assist the downward tendency of interest rates in the market.
1975	
January 23	The Bundesbank raises the banks' rediscount quotas by about DM 2.5 billion until the end of March.
February 6	The Bundesbank decides to lower the discount rate to 5½ % and the lombard rate to 7½ % with effect from February 7, thus continuing its course of moderate monetary relaxation.
March 6	The Bundesbank lowers the discount rate to 5 % and the lombard rate to 6½ % with effect from March 7.
1974	**II. Economic and fiscal policy**
February 6	The Federal Government approves the 1974 Annual Economic Report reaffirming the economic policy course adopted on December 19, 1973 of counteracting falls in employment by means of selective measures of fiscal policy while continuing with a stability-oriented monetary policy. In pursuance of this policy it passes a "special programme for areas with particular structural problems" involving nearly DM 1 billion of expenditure by the central, regional and local authorities.
March 25	The Fiscal Planning Council discusses the 1974 budgets. There is general agreement that the expenditure envisaged in the 1974 budgets should be fully implemented to safeguard employment.
May 22	The Bundestag passes the 1974 budget, which totals DM 136.4 billion and shows a financial deficit of DM 8.4 billion.
June 21	The Federal Finance Minister decrees the blocking of some budget expenditure. In this way it is intended, by the end of the year, to cut expenditure by an amount equal to the shortfalls in the Federal Government's tax receipts (which are estimated at DM 1.9 billion) and to effect the overall reduction in spending of DM 0.5 billion envisaged in the budget.
June 24	The Fiscal Planning Council recommends that the total expenditure of the Federal and Länder Governments and local authorities should increase by less than 10 % in 1975 (disregarding the changes on the expenditure side caused by the tax reform, including the equalisation of family burdens).
June 30	The stability surcharge on income tax and corporation tax introduced in 1973 under the fiscal stability programme expires as scheduled.
July 25/26	The tax reform and reform of children's allowances, which are expected to provide roughly DM 14 billion of relief in 1975, are finally passed by the Bundestag and Bundesrat.
September 25	After reaching agreement in the Advisory Council on Anticyclical Policy for Public Authorities and the Fiscal Planning Council, the Federal Cabinet decides upon a "special programme for the regional and local support of employment" with an overall volume of DM 950 million, to be borne jointly by the Federal and Länder Governments and local authorities and to be financed mainly out of investment tax revenue immobilised at the Bundesbank.
November 20	The Council of Experts for Assessing Overall Economic Trends recommends in its Annual Report that monetary policy should pursue a course of gradual stabilisation; external monetary policy should not do anything to prevent the Deutsche Mark from being valued in conformity with market conditions, and fiscal policy could now aim more at neutralising the dampening effects of monetary policy on production and employment. The autonomous groups are called upon to contribute to an improvement in the propensity to invest by moderating cost increases. Moreover, the Council of Experts welcomes the Bundesbank's attempt to provide the economy with a "steady growth of the monetary base consistent with stability" as an experiment of high regulative standing.
December 12	The Federal Cabinet adopts a "programme to promote employment and growth in conditions of stability" with an overall volume of DM 1.73 billion. Specifically, it comprises additional expenditure to encourage investment (DM 1.13 billion) and in certain areas wage subsidies to employers (DM 0.5 billion) and non-recurring mobility grants to out-of-work employees (DM 0.1 billion); investment grants are also made for publicly assisted housing. Special reserves (particularly funds stemming from the stability surcharge) are used to finance the programme. In addition, an investment grant is made for fixed investments at the rate of 7.5 % of the purchase price or production cost of movable goods and buildings, provided the date of the order or the start of production is after November 30, 1974 and before July 1, 1975.
1975	
January 30	The Federal Government presents the 1975 Annual Economic Report. On the basis of the tax reform and reform of children's allowances and the programme of December 1974, it proposes to give priority in its economic and fiscal policy to overcoming the present period of weakness in the German economy while maintaining stability, and to initiating an upswing in stable conditions. Attention is drawn to the fact that disregard of the monetary scope set by the Bundesbank's regulation of the money supply would enlarge the risks to growth and employment.

Banks (the association of the private banking industry), should be mentioned in this context. To ensure greater security and to demonstrate to the world at large that a fundamentally sound bank which ran into liquidity difficulties owing to the withdrawal of deposits would be helped, the Bundesbank advocated the establishment of a Liquidity Consortium Bank in which all areas of German banking and the central bank participate (the Bundesbank has a 30 % share). This institution, which was established in September, has a paid-up capital of DM 250 million, which can be raised by calling in further payments to DM 1 billion. In support operations it primarily uses its own resources, but it also has a credit line at the Bundesbank (of at present DM 500 million). Since its establishment there have been no major calls on the Liquidity Consortium Bank; the crisis of confidence subsided in September. The deposit business of the smaller private and regional banks steadily returned to normal. A few smaller institutions which ran into difficulties had to close down. Non-bank customers were compensated partly by a group of private banks and partly by the so-called fire-fighting fund of the private banking industry, so that they did not suffer any losses.

Sharp rise in currency, but otherwise subdued monetary expansion following the Herstatt crisis

The short-term effect of the Herstatt crisis on monetary developments in the stricter sense was a sharp rise in currency circulation in July, while deposits grew very little in June and August. But the increased cash balances proved to be an undue precaution and private non-banks soon returned to more customary cash holdings. The growth rates of the currency circulation dropped not just to a "normal" level but if anything to somewhat below it for a few months. True, the currency circulation for some time remained slightly larger than it would presumably have been without the Herstatt crisis. The collapse of the Herstatt Bank no doubt also intensified the tendency discernible beforehand for time deposits to be switched back into sight and savings deposits — a shift that was accompanied by a certain preference for public banks over private banks. The special trend of the currency circulation temporarily impaired the informative value of those monetary indicators in which currency carries great weight, i. e. the central bank money stock and, to a slightly smaller extent, M_1; during that period of nervousness these indicators tended to exaggerate monetary growth somewhat. Nevertheless, the rise in the central bank money stock in the third quarter, at an annual rate of 5.5 %, was smaller than in the second (7 %); this was less than aimed at by monetary policy in the longer run.

Liquidity drain in the banking system ...

The repercussions of the Herstatt crisis were felt for some time on the foreign exchange markets, too. Although the Bundesbank did not massively resist the weakening of the Deutsche Mark on the exchange markets — a tendency which had begun shortly before the Herstatt crisis — it was compelled to sell large amounts of foreign exchange because of the interlinked exchange rates of the European countries participating in the joint float. This put bank liquidity under continuous pressure. But it was not only the outflows of foreign exchange, which persisted well into October, that squeezed bank liquidity; the cash transactions of public authorities also deprived the banks of considerable resources during that period. Finally, the growth of the money stock, and thus also of the currency circulation and the required minimum reserves, involved a steady constriction of the banks' liquidity. These withdrawals were at the expense of the banks' balances with the central bank, since they had no significant free liquid reserves at their disposal. Under these circumstances the banks would have found it impossible to meet their minimum reserve requirements had not the central bank made the necessary funds available in one form or another.

... offset by lowering the minimum reserves

Initially the banks had to draw on lombard credit on a substantial scale. The Bundesbank's rate for such lending had dropped to 9 % owing to the unlimited granting of "lombard credit at the lombard rate" (as distinct from the special lombard credit previously granted, finally at a rate of 10 %), but the day-to-day money rate was at first above the lombard rate because of the heavy recourse to lombard credit and probably also because of the disturbance of confidence in the banking system. As this effect on the short-term interest rate level ran counter to the Bundesbank's intentions in the field of monetary policy, and as lombard credit is only meant to meet a short-term need for funds and not to compensate a withdrawal of liquidity over a fairly long period, the Bundesbank lowered the

Monetary developments

Change during period indicated

Item	1971	1972	1973	1974 Total	1974 1st qtr	1974 2nd qtr	1974 3rd qtr	1974 4th qtr
A. Principal monetary aggregates	Seasonally adjusted, in % 1							
Central bank money stock **2, 3**	+11.9	+13.5	+ 7.8	+ 6.2	+ 4.1	+ 7.2	+ 5.3	+ 8.4
Money stock (M_1) **4**	+11.9	+13.9	+ 1.7	+11.0	+ 2.0	+ 9.8	+11.7	+21.3
Money stock and quasi-money (M_2) **5**	+14.3	+16.6	+14.0	+ 5.1	+ 9.2	+ 1.4	+ 0.5	+ 9.8
M_2 plus savings deposits at statutory notice (= M_3)	+13.1	+13.9	+ 9.0	+ 8.4	+ 8.9	+ 5.5	+ 5.5	+13.9
Lending by banks and Bundesbank to domestic non-banks	+13.2	+14.5	+ 9.8	+ 8.0	+ 7.8	+ 9.0	+ 9.6	+ 5.5
	Unadjusted, in billions of Deutsche Mark							
B. Determinants of central bank money stock and free liquid reserves 3								
(1) Bundesbank's net external position	+14.8	+16.9	+27.2	— 2.8	— 3.1	+ 5.6	— 6.3	+ 1.0
(2) Net balances of domestic non-banks (increase: —)	— 5.1	+ 1.6	— 1.5	— 2.9	— 2.9	— 0.6	— 3.0	+ 3.7
(3) Compulsory special reserves (increase: —)	— 2.0	— 9.6	— 5.1	+12.8	+ 4.5	— 0.3	+ 4.7	+ 3.9
(4) Quotas fixed for central bank credit	— 1.3	— 5.1	—13.2	+ 3.8	+ 0.8	— 2.5	+ 3.0	+ 2.5
(5) Unspecified determinants	— 3.6	— 0.8	— 4.9	— 3.5	— 3.2	+ 0.1	+ 3.2	— 3.6
Central bank money stock and free liquid reserves (total 1 to 5)	+ 2.8	+ 3.0	+ 2.5	+ 7.4	— 3.9	+ 2.3	+ 1.6	+ 7.5
Central bank money stock **6**	+ 7.2	+10.4	+ 6.9	+ 5.8	— 3.3	+ 2.9	+ 1.1	+ 5.0
Free liquid reserves **7**	— 4.4	— 7.5	— 4.4	+ 1.6	— 0.6	— 0.7	+ 0.5	+ 2.5
Memorandum item:								
Total of free liquid reserves at end of period	(14.8)	(7.3)	(3.0)	(4.5)	(2.2)	(1.5)	(2.0)	(4.5)
C. Determinants of money stock								
(1) Lending by banks and Bundesbank to domestic non-banks	+69.1	+86.4	+67.6	+59.8	+ 6.0	+17.1	+14.8	+21.8
(2) Net external claims of banks and Bundesbank	+11.5	+ 8.7	+24.0	+13.7	+ 0.3	+ 5.6	— 1.0	+ 8.8
(3) Monetary capital formation with banks from domestic sources	+46.4	+60.6	+48.3	+56.5	+ 7.6	+ 9.3	+ 9.5	+30.0
(4) Unspecified determinants	— 9.2	— 0.9	—11.3	— 3.3	— 8.9	— 7.0	— 8.4	+20.9
Money stock and quasi-money (M_2) (1 plus 2 plus 4 less 3)	+25.0	+33.5	+32.0	+13.7	—10.1	+ 6.5	— 4.2	+21.6
Currency	+ 3.5	+ 5.5	+ 1.7	+ 4.1	— 1.2	+ 2.2	+ 1.0	+ 2.1
Sight deposits	+ 9.7	+12.1	+ 0.8	+11.4	— 8.8	+ 5.7	— 0.4	+14.8
Time deposits for less than 4 years	+11.7	+16.0	+29.4	— 1.8	— 0.1	— 1.4	— 4.9	+ 4.6

1 Quarterly changes expressed as an annual rate. — **2** Currency and minimum reserves on domestic liabilities at constant reserve ratios (base: January 1974). — **3** Calculation based on the daily averages of the months, from 1971 to 1973 on the averages of the four weekly bank return dates in the months. — **4** Currency (excluding banks' cash holdings) and sight deposits of domestic non-banks. — **5** M_1 plus time deposits with maturities of less than four years (quasi-money). — **6** Minimum reserves on domestic liabilities here calculated at current reserve ratios. — **7** Excess balances (difference between required minimum reserves and banks' central bank balances), domestic money market paper and unused central bank credit quotas.
Discrepancies in the totals are due to rounding.

minimum reserve ratios by 10 % (the ratios for domestic liabilities only) and 8 % (all reserve ratios) from September 1 and October 1, respectively. This took the place of longer-term utilisation of lombard credit without creating free liquid reserves.

Change of course in monetary policy in October

To stimulate monetary conditions more strongly, the Bundesbank began to ease credit terms distinctly in October. It lowered the discount rate from 7 % to 6½ % and the lombard rate from 9 % to 8½ %, at the same time raising the banks' rediscount quotas so that they gained a liquidity margin again. Conditions on the money markets eased markedly, and the interest rate level dropped in nearly all fields from then onwards; in some sections of the market it fell faster than ever before. In this way the Bundesbank reacted in good time to the signs of a setback in economic activity. Further reductions of the discount and lombard rates by half a percentage point each followed on December 20 and February 7, 1975. On March 6, 1975 the discount rate was lowered by another half point to 5 % and the lombard rate by a full point to 6½ %.

Rapid acceleration of monetary growth in the fourth quarter

Much as in April 1974, when the Bundesbank for the first time departed briefly from its policy of a liquidity quota of "zero", monetary growth accelerated in November and December. Although swift reactions are by no means unusual in the monetary sphere, it appears that the increase in the money supply in November was caused not so much by domestic factors as by the relatively large inflows of foreign exchange. The net foreign exchange surpluses of domestic non-banks in that month were as usual sold to the banking system, so that non-banks' deposits, and consequently the money stock, increased. The acceleration of monetary growth during the final months of last year is attested by all the monetary indicators, though its strength varied greatly: the annual growth rates ranged between 8.5 % (central bank money stock) and 21.5 % (M_1) in the fourth quarter. Owing to these discrepancies the growth rates for 1974 as a whole also differ considerably: the central bank money stock went up by over 6 % during the year, the narrowly defined money stock (M_1) by 11 %, and the money stock in the broader definition (M_2) by 5 %. In this case, too, the central bank money stock must be rated the more reliable monetary indicator (see below).

Favourable outcome of central bank money control despite considerable difficulties

It had been shown in 1973 that, provided the safeguards against external influences are adequate, monetary policy can bring monetary expansion down to a level that promises success in the fight against inflation. In 1974 there was again experience to be gained in controlling monetary growth during periods of cyclical turnround. This experience consisted, as before, in the fact that it takes some time for a change of course to have its full impact on the monetary trend. First of all the central bank has to modify the conditions on which it is prepared to meet the banks' central bank money requirements, as it did by regularly lowering the lombard rate and then the discount rate and the minimum reserves. Only as a result of the changes in money market rates and subsequently in the banks' liabilities and assets-side business and on the capital market does this relaxation spread to all credit markets and thus to the demand for credit. Owing to these time lags one cannot gauge precisely how much stimulation is required to bring about the desired change. Regular adjustment and reexamination are therefore necessary if a fundamentally steady course of monetary policy is to be achieved.

A precondition for a steady course of monetary policy is that the central bank is not forced to conduct transactions, and thus to provide central bank money, through which the banks gain too much scope for creating money themselves. In creating money the banks must remain dependent on the central bank contributing to monetary expansion by supplying central bank money. True, in the very short run the central bank has no choice but to meet the central bank money requirements associated with monetary expansion. But in the somewhat longer run it controls the pace of monetary expansion – as already mentioned – through the conditions on which it is prepared to satisfy the banks' demand for central bank money.

Movement of interest rates since 1972

% per annum

Period	Bundesbank rates		Money market rates	Capital market rates	Bank interest rates 2					
					Lending rates			Deposit rates		
	Discount rate	Lombard rate 1	Three-month loans, Frankfurt 2	Yield on public authority bonds outstanding	Credits in current account 3	Discount credits	Mortgage loans secured by residential real estate	Time deposits (three months) 3	Savings deposits at statutory notice	Savings deposits at 12 months' notice
1972										
February	3.0	4.0	4.88	7.3	9.05	6.09	8.25	5.12	4.50	5.88
May	3.0	4.0	4.71	7.8	8.39	5.28	8.13	4.55	4.02	5.42
August	3.0	4.0	4.80	7.9	8.41	5.38	8.30	4.61	4.01	5.42
November	4.0	6.0	8.07	8.4	9.08	6.62	8.49	6.26	4.01	5.42
1973										
February	5.0	7.0	7.96	8.5	10.00	8.42	8.93	6.74	4.51	5.95
May	6.0	8.0	12.42	9.3	11.32	10.46	9.36	8.34	4.52	5.96
July	7.0	9.0	14.30	10.0	12.76	12.03	10.34	10.06	5.51	7.00
August	7.0	9.0	14.57	9.9	13.21	12.37	10.45	10.67	5.51	7.00
November	7.0	9.0	13.62	9.5	14.02	13.21	10.39	11.05	5.51	7.00
1974										
February	7.0	9.0	10.67	9.9	13.92	12.67	10.33	9.46	4 5.51	4 7.00
May	7.0	9.0	9.10	10.6	13.77	11.86	10.55	8.03	4 5.51	4 7.00
August	7.0	9.0	9.65	10.7	13.55	11.34	10.54	7.89	4 5.51	4 7.00
November	6.5	8.5	9.04	10.4	13.15	10.50	10.44	7.72	4 5.51	4 7.00
1975										
February	5.5	7.5	6.43	8.8	12.24	8.73	9.67	5.80	4 5.19	4 6.69
March	5.0	6.5	5.71	8.7	11.57	7.69	9.45	5.01	4 5.03	4 6.42

1 From June 1, 1973 to July 3, 1974 lombard credit was not in principle granted to the banks at the lombard rate. — 2 Average rates, calculated as an unweighted arithmetical mean. — 3 Less than DM 1 million. — 4 Bonuses were also granted in certain cases.

The central bank money stock as an indicator

In assessing monetary trends the Bundesbank used — as in 1973 — the central bank money stock as a key indicator of monetary developments. The central bank money stock, defined as the currency circulation and the required minimum reserves on domestic liabilities, is an indispensable element in the expansion of the overall money supply since the currency circulation is itself a part of the money in circulation and the required minimum reserves reflect the growth of the deposit money created by the banks. For the individual bank the increase in the currency circulation and the required reserves (as a consequence of the expansion of deposits subject to minimum reserve requirements) creates a demand for liquid funds which, taken as a whole, is at the expense of the free liquid reserves that the Bundesbank has granted the banks. The banks are able to meet non-banks' growing needs of currency and to comply with the higher reserve requirements only if they can draw on central bank money by using free liquid reserves or if the Bundesbank supplies them with additional central bank money in other ways. Thus the Bundesbank links the creation of deposit money by the banks with its own money creation. Because of these relationships the central bank money stock, though only a part, can stand for the whole, namely for the entire monetary expansion made possible by the central bank.

In comparison with competing indicators, such as the different concepts of the money supply, the central bank money stock has certain advantages. Since it depends on the development of all domestic liabilities subject to reserve requirements (sight and time liabilities and savings deposits for less than four years) as well as on the currency circulation, it is fairly independent of shifts between various kinds of liabilities, such as frequently occur when the pattern of interest rates changes; in this case the central bank money stock, as repeatedly mentioned, takes a midway position (see the chart on page 27). Another advantage is that the central bank money stock is based on averages (of all days for the currency circulation, and of bank week return days for the required reserves), so that chance factors on the return dates, which often play a part in the money stock data (which are based on end-of-month figures), are eliminated.[1]

(b) The banks under the impact of monetary policy

Improvement in the profitability of banks

For the banks in the Federal Republic of Germany 1974 was a year of improved earnings; the reduced profit margins of 1973 widened again. The cost of procuring funds went down – especially in the second and fourth quarters of 1974 – much faster than lending rates, so that the interest rate margin, which had come under heavy pressure in 1973 owing to the opposite movement, expanded again. The steep increase in interest rates on the capital market during the first half of 1974 at times led to substantial book losses in banks' security holdings, but in general these losses had disappeared by the end of the year after the interest rates had dropped rapidly. What caused the banks most concern was the creditworthiness of some debtors. The number of insolvencies rose sharply, and other loans got into difficulties. In some cases it appears that the banks held on to such loans in the hope that they could best avoid major losses in this way. In the light of this experience the standards of creditworthiness applied to a borrower seeking a new loan seem to have been tightened up. Many banks are again giving the soundness of their customers precedence over the extension of their balance sheets, whereas the priorities had often been the other way round in earlier years.

Moderate credit expansion

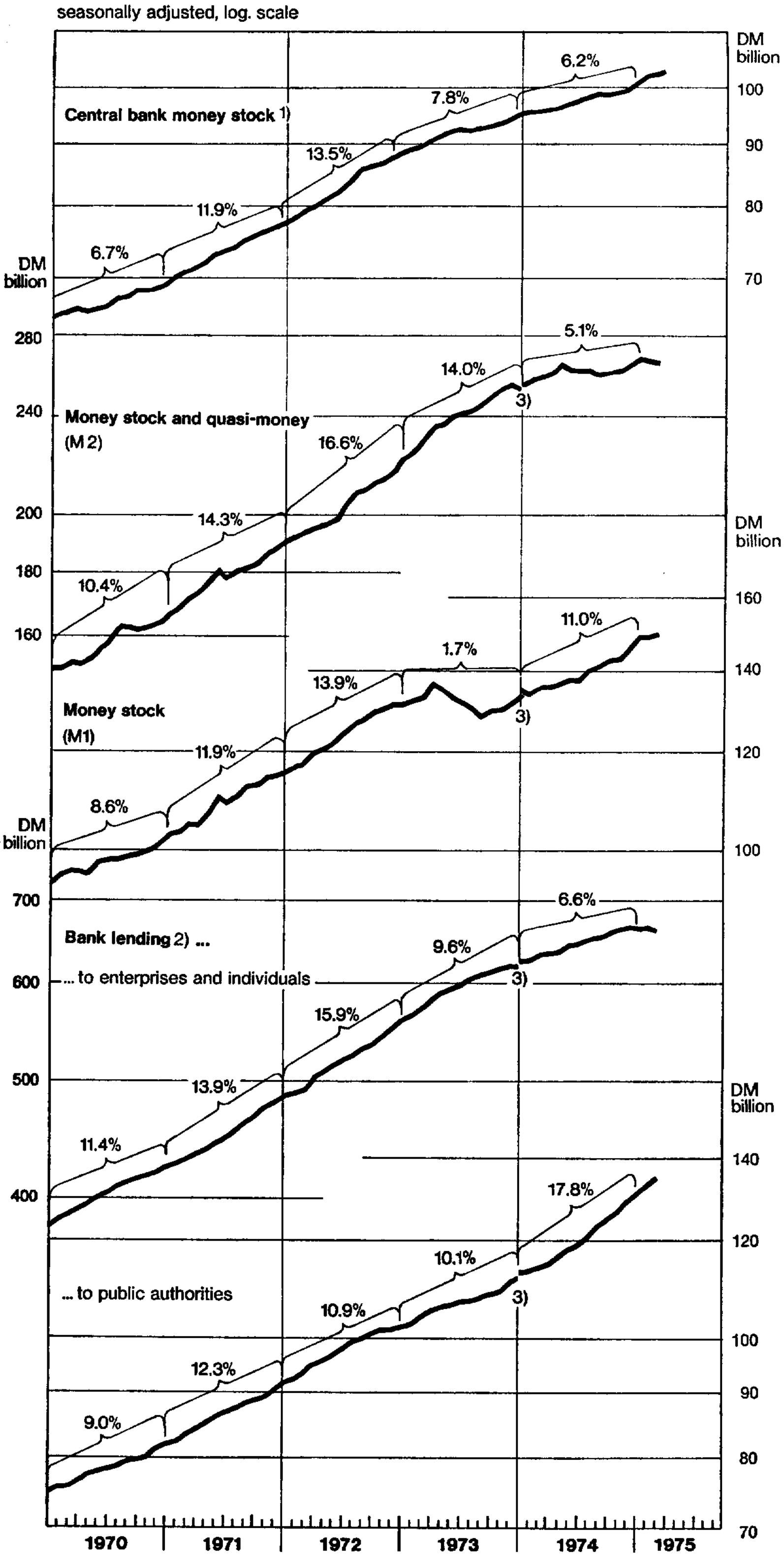
However, the chief reason for the moderate credit expansion in 1974 was the declining demand of enterprises and individuals for credit due to the slackening of private capital investment. The volume of credit outstanding to this sector at the end of 1974 was only 6.5 % larger than a year before; at end-1973 and end-1972 the corresponding growth rates had been 9.5 % and 16 %, respectively. The decline steepened in the second half of the year. Seasonally adjusted and expressed as an annual rate, such lending rose by about 8 % in the first six months of 1974, but only by little more than 5 % between the end of June and the end of December. All in all, bank lending to domestic non-banks (including purchases of securities) grew by DM 61 billion in 1974, and thus more slowly than in the preceding three years. The difference is greatest in comparison with 1972, when credit expansion had been almost half as large again. Consumer credits hardly increased at all in 1974 and the growth of housing loans, at DM 15.2 billion, was over a third smaller than in the previous two years. Enterprises (excluding housing) also took up relatively few new loans from domestic banks (DM 25 billion) last year, as in 1973. Three fifths of the loans raised were at short and medium term, apparently because enterprises deferred the consolidation of their liabilities until a time of lower long-term interest rates. On the other hand, lending by banks (including the Bundesbank) to public authorities went up very steeply in 1974, namely by some DM 19 billion, or more than half as much again as in 1973 and twice as much as in 1972 and 1971. In the fourth quarter public authorities borrowed DM 9.5 billion from banks.

Large monetary capital formation with banks

In the banks' liabilities-side business there has been a distinct shift of emphasis among the individual types of deposits. The decline in time deposits (for less than four years) and the simultaneous lowering of interest rates on them implies that in 1974 the banks had much less difficulty in raising money than in 1973. Monetary capital formation with banks – mainly consisting of non-banks' long-term financial investment with banks – was fairly large at about DM 56.5 billion, compared with slightly over DM 48 billion in 1973. As usual, the principal component was savings deposits; in 1974 inpayments to savings accounts exceeded outpayments by DM 12 billion, while in 1973 households had on balance withdrawn more than they had paid in. (In that year, however, households had placed more savings in time accounts, whereas this was only a minor factor in 1974.) Only savings deposits at statutory notice, the most liquid form of such deposits, increased in this way in 1974, since savers were evidently reluctant to tie up funds for longer periods in view of the uncertain economic situation. The other components of monetary capital formation were weaker in 1974 than in 1973.

1 Against these advantages of using the central bank money stock as a monetary indicator, there is one disadvantage which may at times become quite important, viz. the great weight attaching to the currency circulation. This results in exceptional movements in currency being reflected particularly strongly in the trend of the central bank money stock; however, such distortions are easily recognisable.

Central bank money stock, money stock and bank lending



1) Currency and minimum reserves on domestic liabilities at constant reserve ratios (base: January 1974), daily averages of the months.- 2) Including security holdings.- 3) Change in credit cooperatives' reporting requirements.

Business volume of the banking groups

Change during period indicated; decrease: —

Banking group	1973 DM bn	1973 %	1974 Total DM bn	1974 Total %	1974 3rd qtr %	1974 4th qtr %
Commercial banks	29.0	10.7	23.4	7.8	— 3.2	7.2
Big banks	8.4	7.8	10.8	9.3	— 3.6	5.2
Regional banks and other commercial banks	12.4	10.5	9.0	6.9	— 1.9	8.7
Branches of foreign banks	8.3	42.2	3.2	11.2	0.5	0.2
Private bankers	— 0.1	— 0.6	0.4	1.7	—13.1	18.9
Savings bank sector	42.2	10.1	51.7	11.2	2.5	4.9
Central giro institutions 1	20.1	11.3	25.7	13.0	2.8	6.2
Savings banks	22.1	9.2	26.0	9.9	2.3	3.8
Cooperative sector	15.8	12.2	24.6	16.1	5.1	6.8
Central institutions of credit cooperatives 2	4.6	11.6	12.2	27.4	10.9	12.2
Credit cooperatives	11.2	12.4	12.4	11.5	2.8	4.5
Mortgage banks	11.4	9.3	16.1	11.7	2.7	3.9
Instalment sales financing institutions	1.7	13.6	0.9	6.4	0.9	5.4
Banks with special functions	6.1	7.3	5.1	5.7	1.7	1.4
Postal giro and postal savings bank offices	2.1	9.6	2.6	10.8	— 2.4	10.9
All banks	108.3	10.2	124.4	10.6	1.2	5.4

1 Including Deutsche Girozentrale. — 2 Including Deutsche Genossenschaftskasse.

Repercussions of the Herstatt crisis on the private banks

In spite of the general easing of conditions on the credit markets, 1974 was a very difficult year for a number of banks since the collapse of the Herstatt Bank affected some banking groups quite severely at times. In particular, it was responsible for the differences between the banking groups in the movement of deposits in the third quarter of 1974. By the fourth quarter, however, all groups of banks were again receiving a share of the strong inflow of funds. This applies especially to the group of private bankers, which had been hit hardest by the Herstatt crisis (even though Bankhaus Herstatt, being a partnership limited by shares, did not belong to that group), and it is almost equally true of the regional banks. Over the whole of 1974 the deposits of domestic non-banks with all banking groups grew by 8.2 %. The deposits with commercial banks (excluding private bankers) increased by only 3.7 %, but those with private bankers decreased by 5.7 %. Deposits with savings banks and credit cooperatives rose at above-average rates. The difficulties encountered by some private banks made it clear that the institutional safeguarding of deposits was not identical for all banking groups. In this situation the idea of a deposit guarantee, ensuring equally good protection of deposits for all sectors of German banking (also from the institutional angle), became very topical. A bill to this effect is due to be discussed by the Federal Cabinet shortly; the main point will be to safeguard non-banks' deposits with private banks in much the same way as their deposits with public-law and cooperative banks.

(c) The security markets as a mirror of inflationary expectations

Growing inflationary expectations in the first half of the year paralyse the security market

On the capital market it became evident last year that sales of long-term securities are hardly possible when inflationary expectations are increasing. Even though the rate of interest on capital rose by 1.2 percentage points between January and June to 10.9 %, thus offering the investor an attractive real return, the issuing of bonds stagnated. The main reason for the low productiveness of the bond market was the fear of further acceleration of inflation and of bond price losses due to rising nominal interest rates, a fear which was enhanced by the oil crisis and the raw material boom. As long as no end to the rise in interest rates was to be seen, not even high rates could attract capital into long-term investment. On the other hand, the issuers were unwilling to incur long-term debt at such high rates of interest. In these circumstances lenders and borrowers alike were prepared to make short-term commitments only. The pronounced pessimism with respect to long-term investment could not be overcome. Neither the temporary suspension

Sales and purchases of securities

Billions of Deutsche Mark, market value

Item	1971	1972	1973	1974 Total	1974 1st hf	1974 2nd hf
Bonds						
Sales = total purchases	19.4	29.8	24.8	25.8	8.2	17.5
Sales						
(1) Domestic bonds 1	20.6	34.1	25.0	25.1	7.9	17.1
Bank bonds	14.9	26.1	21.4	19.6	7.7	11.9
Mortgage bonds	4.4	8.0	3.5	4.2	2.2	2.0
Communal bonds	7.1	12.9	4.2	8.6	1.7	6.9
Bonds of specialised banks	0.8	1.3	1.6	0.6	0.3	0.3
Other bank bonds	2.6	3.9	12.2	6.1	3.4	2.7
Public authority bonds	4.3	7.2	4.1	5.8	0.3	5.5
Industrial bonds	1.4	0.8	—0.5	—0.4	—0.1	—0.2
(2) Foreign bonds 2	—1.2	—4.3	—0.2	0.7	0.3	0.4
Purchases						
(1) Domestic purchasers	17.8	22.0	18.8	28.8	8.2	20.6
Banks	x 5.8	x 7.1	x 3.5	x 14.5	x 3.4	11.2
Bundesbank	x 0.0	—0.4	—0.0	0.4	0.6	—0.2
Non-banks	12.0	15.3	15.3	13.8	4.3	9.6
(2) Foreign purchasers	1.6	7.7	x 6.0	—3.0	—0.0	—3.0
Shares						
Sales = total purchases	6.9	5.9	5.5	6.2	3.0	3.2
Sales						
(1) Domestic shares	4.7	4.1	3.6	3.5	1.7	1.8
(2) Foreign equities 3	2.2	x 1.8	2.0	2.7	1.3	1.4
Purchases						
(1) Domestic purchasers	6.4	2.5	4.9	4.6	2.8	1.8
Banks	0.1	0.4	0.4	—0.7	—0.7	—0.0
Non-banks	6.3	2.1	4.5	5.3	3.5	1.8
(2) Foreign purchasers	x 0.5	x 3.4	x 0.7	x 1.6	0.2	x 1.4

1 Net sales plus less changes in issuers' holdings of own bonds. — **2** Net purchases (+) or net sales (—) of foreign bonds by residents. — **3** Net purchases (+) of foreign equities (including direct investments and investment fund units) by residents. — **x** Statistically adjusted.
Discrepancies in the totals are due to rounding.

of issues by occasional issuers, which was suggested by the Central Capital Market Committee and lasted from February to the end of May, nor the interventions of the Bundesbank on the bond market in the spring of 1974 altered the situation.

Sales in the first quarter of 1974 clearly reflected the setback on the bond market. During that period, when the bond market is normally particularly productive on seasonal grounds, domestic issuers sold no more than DM 2.4 billion net (market value) of fixed interest securities; sales thus shrank to roughly a quarter of their 1973 level and to a sixth of the 1972 figure. At times the market was entirely unreceptive to new issues; in February issuers' redemptions and price support purchases exceeded simultaneous gross sales by DM 0.2 billion.

Shortening of maturities

Apart from the interest rates, issuers had to accommodate investors with respect to maturities. In 1972, for instance, the majority of new issues (61 %) had had maturities of ten years and over, but by the second quarter of 1974 the emphasis had shifted to maturities of more than four but less than seven years (42 %). Issues with extremely short maturities of less than two years, which basically are only short-term bank deposits documented by securities (but which, unlike such deposits, are not subject to minimum reserve requirements), were also much larger. In the first half of 1974 they accounted for about 20 % of gross sales of domestic bonds.

Consolidation from mid-year . . .

In the summer months of 1974, when the interest rate structure on the credit markets returned to "normal" — partly under the influence of deliberate measures by the Bundesbank to ease conditions on the money market — and when short-term investments again yielded much less interest than long-term ones, the consolidation of the bond market began. Since monetary capital formation with banks mounted sharply while the demand for credit remained relatively moderate, the banks, whose purchases of securities had been insignificant for some time, greatly enlarged their bond holdings. As a result the market became much more productive; in the second quarter domestic issuers sold DM 5.5 billion (net) of fixed interest securities and in the third quarter DM 7.4 billion. The strengthening of the market also permitted a slight lengthening of the maturities of new issues. Fears that inflation would accelerate further began to wane. There were clear signs of a slowdown in price rises. However, the level of bond prices remained largely unchanged at first. Not until the Bundesbank lowered the discount and lombard rates by half a percentage point each as from October 25 was a turning point reached in the trend of interest rates on the capital market. This measure was regarded as a clear indication of the fact that no further increase in interest rates was to be feared but that a steady fall in rates might be expected for the time being. Under these circumstances the lowering of interest rates on the bond market proceeded at an unprecedented pace. Between the end of October 1974 and the middle of February 1975, i. e. within three and a half months, yields went down by 2 percentage points. During that period very considerable sums were raised on the bond market, thus making up for the low sales in the first half of 1974. Foreigners invested no funds in the bond market in 1974, in contrast to 1973, but sold German securities on balance, even though the acquisition of bonds with a (remaining) life of more than four years was no longer subject to authorisation as from February 1974. Germans invested a record amount of DM 28.1 billion in domestic bonds during 1974; banks were the principal buyers, for the first time since 1969.

... and rapid fall in interest rates towards end of year

The sales pattern clearly reflects the different credit requirements of the various groups of issuers, and also the changed financing conditions. Owing to the fall in the business community's demand for credit, sales of "other" bank bonds, which are mostly issued by central giro institutions, contracted to half the 1973 level. Apart from convertible bonds and option bonds, no industrial bonds have been issued for some time. Issues of mortgage bonds were only slightly larger than in 1973. The public authorities benefited most from this restraint on the part of traditional bond issuers; directly or indirectly – i. e. through sales of their own bonds or through the placing of communal bonds issued by mortgage banks and central giro institutions – they were able to meet a large part (DM 14.5 billion) of their borrowing requirements via the bond market.

3. Overall balance of payments in equilibrium despite large trade surpluses [1]

The system of predominantly flexible exchange rates worked well on the whole

It was of great importance for the economy of the Federal Republic of Germany in 1974 that monetary policy, geared as it was to domestic requirements, could by and large be pursued without monetary disturbances from outside, although the world economy and especially the international financial markets had to weather severe storms. The prime factor in the safeguarding of monetary policy in Germany against external influences was that under the system of predominantly flexible exchange rates strong forces are working in the direction of "quasi-automatic" equilibrium in the overall balance of payments. The equilibrium is attested by the fact that the Bundesbank's external assets declined by DM 2 billion (net) in 1974 even though Germany's current account showed a record surplus of DM 24 billion, for the outflows of money and capital to foreign countries were even greater, at DM 26 billion (including the balancing item of the balance of payments).

The offsetting of the record surplus on current account by movements of capital in the opposite direction – and not, as previously, by foreign exchange purchases by the Bundesbank – was in part attributable to special conditions in 1974. The German business community tried harder than in earlier years to promote its exports from the financing angle; in other words, it financed much of the increase in exports itself by granting periods of credit. Furthermore, as the year progressed an interest rate differential developed between Germany and other western industrial countries; especially in the field of long-term capital transactions, this

1 A detailed review of the balance of payments in 1974 was published in the Monthly Report of the Deutsche Bundesbank of March 1975, page 21; it contains additional statistical data on the various sections of the balance of payments.

International export prices

Percentage change in third quarter of 1974 against 1970

Country	Unit values of exports **1**	Weighted external value **2**	Total change in export prices **3**
Austria	+ 20	+ 16	+ 40
Belgium	+ 41	+ 8	+ 52
France	+ 52	— 1	+ 50
Italy	+ 86	— 19	+ 51
Japan	+ 54	+ 16	+ 78
Netherlands	+ 45	+ 13	+ 64
Sweden	+ 59	+ 1	+ 60
Switzerland	+ 29	+ 26	+ 63
United Kingdom	+ 67	— 14	+ 44
United States	+ 63	— 9	+ 49
Compare:			
Federal Republic of Germany	+ 27	+ 23	+ 56

1 In national currency. — **2** Against all countries. — **3** If the price increase rates adjusted for exchange rate movements are compared, the price differences between the various countries tend to diverge slightly more than they did in fact, since the bilateral exchange rate changes between the countries to be compared are included twice (e. g. as appreciation in one country and as depreciation in the other) in the weighted rates of appreciation and depreciation in relation to all countries. But this stastistical distortion is unlikely to seriously impair the informative value of the "Total change in export prices".

differential stimulated external lending and the return of foreign-owned German securities.

In addition to the factors mentioned, however, the virtual equilibrium in the balance of payments owed very much to the circumstance that the exchange rate of the Deutsche Mark was flexible against major world currencies. The change in the external value of the Deutsche Mark on the foreign exchange markets, like any free price mechanism, in itself largely ensured market equilibrium. Since the exchange rate of the Deutsche Mark, which was formed without major interventions by the Bundesbank, represented an equilibrium rate (at least in the short run), there was no basis for massive speculation on a Deutsche Mark appreciation, in contrast to the situation under the system of fixed exchange rates. It is true that the external value of the Deutsche Mark improved in the longer run, but it did so only with fluctuations. At times the Deutsche Mark rate even tended to depreciate, which enhanced foreigners' propensity to incur Deutsche Mark liabilities and thus to raise funds in Germany. Since it was not to be expected that exchange rates would move in a definite direction, enterprises were more prepared to repay, wherever possible, foreign currency loans taken up abroad. The direction of external capital transactions was once more primarily determined by interest rate considerations, which in earlier years had frequently been supplanted by expectations of possible exchange profits. The interventions by the Bundesbank, which were designed to prevent large-scale exchange rate fluctuations but were not directed against the underlying trend of the rate, at no time in 1974 reached a magnitude that would have been a real danger to monetary policy, especially since the interventions were in both directions and largely balanced each other out over the year. The latter applies in particular to the interventions under the arrangements for the European joint float (the so-called little snake).

Further improvement in the external value of the Deutsche Mark . . .

In the course of 1974 the external value of the Deutsche Mark against all currencies improved by about 7 %, with some marked fluctuations. This rate exaggerates the strength of the appreciation inasmuch as the Deutsche Mark was decidedly weak on the foreign exchange markets at the beginning of 1974 because of the effects it was feared the oil boycott would have on Germany. But after these fears had waned (oil became slightly cheaper again, and there were no supply bottlenecks) and under the influence of successful efforts in the field of stabilisation in Germany, the Deutsche Mark soon became firmer on the currency exchanges. This trend was interrupted in the summer of 1974, however, when the Herstatt collapse prompted foreigners to repay large amounts of Deutsche Mark liabilities at times. The average appreciation of the Deutsche Mark against all currencies in 1974, compared with the previous year, was therefore only about 4½ %, against, as stated, 7 % from the beginning of 1974 to the end.

... due to faster inflation in the rest of the world

The improvement in the underlying trend of the external value of the Deutsche Mark in 1974 was essentially due to the fact that the rate of inflation in the rest of the world was higher than in Germany. The competitiveness of German exporters on the world market was in effect hardly altered by exchange rate changes and price movements taken together. This is true of 1974, and also largely applies in the longer run. For example, the unit values of the exports of major industrial countries, calculated in national currency, rose by between 52 % (France) and 86 % (Italy) in the past four years, while Germany's export prices went up by only about 27 % in that period.[1] Since the exchange rates moved in the opposite direction (in the countries where export prices increased steeply the currency depreciated or remained unchanged, whereas in Germany there was an appreciation), exchange rate changes and export price movements taken together showed much smaller discrepancies between the various countries than when exchange rate changes are considered by themselves. The changes in the exchange rate structure largely offset the inflation differential, although there is a certain amount of feed-back in that an appreciating rate may curb inflation at home and depreciation may bring about the contrary. The inflation differential between the various countries is the cause and not the consequence of exchange rate changes. Otherwise it would be a simple remedy to recommend that the main inflation countries should revalue their currencies to combat inflation (the United Kingdom and Italy, for instance, have in fact tended to do so by preventing their currencies from depreciating further by massive interventions on the exchange markets and substantial government-sponsored imports of capital, thus at least avoiding an even steeper rise in the prices of imported goods).

Greatly increased trade surplus despite much higher "oil bill"

The principal factor in the record surplus on Germany's current account was foreign trade. Despite the unusually steep rise in the prices of petroleum, petroleum products and other raw materials, not only was it possible to pay for all of Germany's imports of goods in 1974 out of current export proceeds, but merchandise exports in the definition used here were in fact DM 56 billion larger than imports.[2] The trade surplus thus increased by a further DM 16 billion compared with 1973. The continued improvement in Germany's foreign trade balance is all the more remarkable as the "oil bill" rose substantially for Germany as well: taking the average of 1974, three times as much had to be paid for one ton of crude oil as in the summer of 1973. Although the quantities imported declined slightly (7 %), Germany had to spend some DM 23 billion on imports of crude oil in 1974, and nearly DM 30 billion if petroleum products are included; this was about DM 16 billion more than in 1973. Only the United States and Japan (a country which is particularly dependent on raw material imports) had a higher "oil bill" to pay in 1974 than Germany.

Decline in imports in real terms, but steep rise in value terms owing to increase in import prices

In 1974 petroleum was not the only product to be imported on a smaller scale, in real terms, than a year previously; total imports were also below the 1973 level in volume (−1½ %). This was attributable on the one hand to the virtual stagnation of the production of goods in Germany, and on the other to the reduction in stocks, or at least the failure to build up stocks, of imported raw and auxiliary materials. Imports of raw materials (excluding oil) declined by ½ % in terms of quantity against 1973. Imports of end products, on the other hand, continued to rise slightly in volume in 1974. But the situation was very different as far as the value of imports was concerned. Because of the soaring prices of imported goods due to the increase in oil prices and the raw material boom, but also to inflationary trends in major industrial countries, the value of imports in 1974 was almost one quarter higher than in 1973. The uptrend of import prices slackened perceptibly, however, in the course of 1974. A few raw materials even became cheaper for German importers from the late summer of 1974 onwards owing to the price trend on world markets and the appreciation of the Deutsche Mark.

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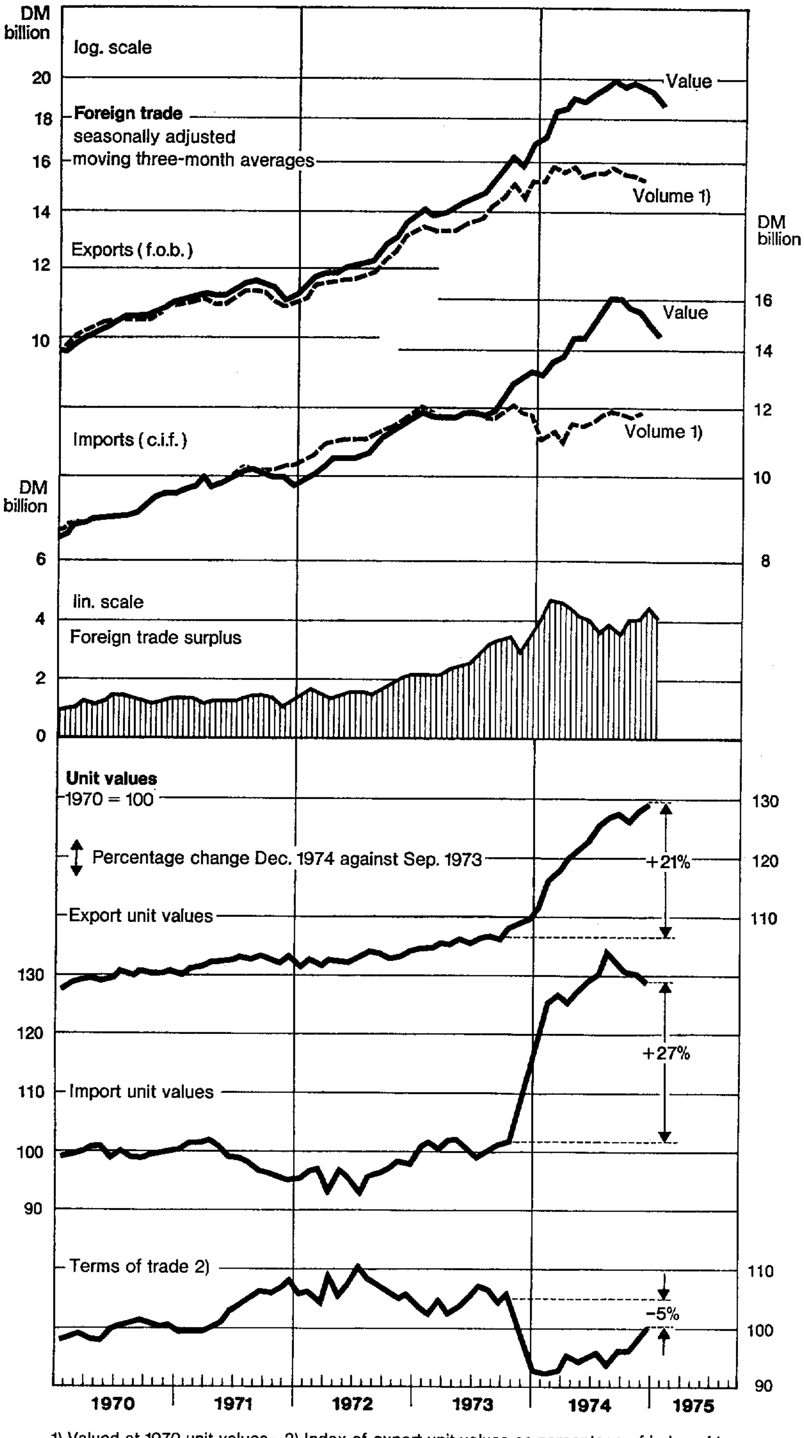
1 Change in the unit value of exports in the third quarter of 1974 against the unit value of 1970.

2 In accordance with international practice in compiling balances of payments, freight and insurance costs for imports of goods have been eliminated from the official import figures and included in expenditure on services. This regrouping of freight and insurance costs for imports, which leads in the statistics to an increase in the trade surplus on the one hand and a rise in the deficit on services on the other, does not affect the overall result of the current account. The underlying concept of merchandise transactions also takes account of so-called "supplementary trade items". These comprise all merchandise transactions between residents and non-residents not included in the official foreign trade statistics (special trade), such as merchanting trade and warehouse transactions for German account in bonded warehouses.

Foreign trade and foreign trade prices



1) Valued at 1970 unit values.- 2) Index of export unit values as percentage of index of import unit values.

The sharp increase in the value of imports was considerably exceeded by the growth of exports. In value terms, exports rose by 29 % to DM 230 billion. As export prices went up by 15 %, the volume of goods sold on foreign markets by the German export industries in 1974 was about 12½ % greater than a year earlier. German exporters thus increased their share in world export markets further, since the volume of world exports grew by no more than some 4 to 5 % in 1974. The strong expansion of exports, which at times were the most dynamic element in overall demand in 1974, can largely be traced back to developments which had started before the oil crisis broke but which have meanwhile lost much of their

Strong expansion of exports

importance. At that time the differences between Germany and foreign countries in the level of economic activity were of particular consequence. The marked upswing in some other countries contributed greatly to the sharp increase in orders received from abroad and exports until the early summer of 1974. The expansionary course of economic policy in major partner countries – a course which was intensified in many cases under the impact of the oil crisis – reinforced these tendencies at first, while enterprises in Germany increasingly had spare capacities at their disposal because demand was slackening at home. In the first few months of 1974 German exports therefore expanded very strongly. It is primarily due to this "leap" in the level of exports that the export figures for the whole of 1974 were much higher than those for 1973. From the spring of 1974 onwards, however, the volume of exports hardly grew at all, seasonally adjusted. When towards the end of the year the downturn in economic activity became more pronounced in other industrial countries as well, Germany's exports actually declined slightly in volume.

Substantial shifts between the various markets

The expansion of the market shares of German exporters in the aggregate export business of the world in 1974 also owed something to the remarkable flexibility with which the exporting enterprises adapted to the great changes in the world economy. In the export statistics this is chiefly attested by the fact that Germany's exports to western industrial countries (including Japan) grew relatively little, viz. by 23 % in value, while its exports to the other trade areas rose more than twice as much in percentage terms. The largest expansion was that of German exports to OPEC countries, which in 1974 were 73 % – and in the fourth quarter alone as much as 111 % – higher than a year previously. Germany thus proved able to respond more strongly than many other industrial countries to the growing purchasing power of the oil nations (even though the other western industrial countries, notably the United States, also exported much more to that area than in 1973). Germany's exports to the non-oil-producing developing countries, some of which were able to build up their monetary reserves substantially during the raw material boom, rose by 44 % in 1974. German deliveries to centrally planned economies were 47 % above the figure for 1973. All in all, the value of German exports to these trade areas outside the traditional markets thus grew by nearly 50 %. In terms of amount, exports to these areas came to some DM 61 billion, roughly corresponding to 60 % of German exports to EEC member countries and 26½ % of total exports. The expansion of German exports to countries not belonging to the group of western industrial nations, at DM 20 billion, was substantially larger than the increase in expenditure on imports of petroleum and petroleum derivatives (+ DM 16 billion).

Division of foreign trade into "oil" and "non-oil" sectors

This trend shows clearly that the division of foreign trade into "oil" and "non-oil" sectors – a division often made in international balance of payments discussions – is becoming more questionable the longer it is used. To argue, for instance, that Germany's trade surplus in 1974 is composed (according to the official foreign trade statistics) of an "oil deficit" of DM 30 billion and a surplus in the "non-oil sector" of DM 81 billion would vastly overstate the improvement in the "non-oil sector". The growth of the value of exports in this field would after all not have been possible without the sharp rise in the imports of OPEC countries, without the increase in the demand of the industrial countries for high-grade technological products (which was triggered off by the investments needed to conserve or replace petroleum), and without the rises in the export prices of products which are based on crude oil, as in the field of petrochemicals. In other words, but for the foreign exchange receipts of the oil countries and the secondary effects of the increase in oil prices, the value of Germany's exports would not have been as high as it actually was. When other countries distinguish more strongly between the "oil deficit" and the "non-oil sector" in their balance of trade, they normally do so to the effect that the "non-oil" balance has improved substantially and that the underlying state of their balance of payments is therefore not unsatisfactory. But insufficient account is taken of the fact that much of the improvement in the "non-oil" sector is feed-back from the increase in oil prices and to this extent not a balance of payments improvement in its own right. In the somewhat longer run, at all events, it is essential that every country tries to meet the higher cost of imports, including oil imports (only limited reductions in the price of which are possible), out of current exports – i. e. that every country is prepared to use a

Main items of the balance of payments

Millions of Deutsche Mark

Item	1967	1968	1969	1970	1971	1972	1973	1974
I. Current account								
1. Merchandise transactions								
(a) Balance of trade								
Exports (f.o.b.) **1**	86,790	99,279	113,300	125,019	135,697	148,703	178,039	229,728
Imports (f.o.b.) **1**	65,584	76,146	92,816	102,855	112,749	121,748	137,853	172,275
Balance	+21,206	+23,133	+20,484	+22,164	+22,948	+26,955	+40,186	+57,453
(b) Supplementary trade items (balance) **2**	– 197	– 430	– 165	– 1,344	+ 323	– 571	– 295	– 1,224
Balance of trade	+21,009	+22,703	+20,319	+20,820	+23,271	+26,384	+39,891	+56,229
2. Services	– 4,581	– 3,535	– 4,071	– 7,878	– 8,693	– 9,902	–12,553	–15,261
3. Transfer payments	– 6,422	– 7,312	– 8,750	– 9,759	–11,497	–14,009	–15,842	–16,905
Balance on current account (1 plus 2 plus 3)	+10,006	+11,856	+ 7,498	+ 3,183	+ 3,081	+ 2,474	+11,496	+24,064
II. Capital account (outflow: –)								
1. Long-term capital transactions **3**								
Private long-term capital transactions								
Direct investment	+ 2,019	+ 184	– 721	– 1,018	+ 249	+ 1,169	+ 907	+ 1,503
German investment abroad	– 1,342	– 1,979	– 2,788	– 3,194	– 3,656	– 4,988	– 4,417	– 4,774
Foreign investment in Germany	+ 3,361	+ 2,163	+ 2,067	+ 2,176	+ 3,905	+ 6,157	+ 5,324	+ 6,277
Portfolio investment in securities	– 2,014	– 5,614	–10,721	– 683	+ 2,540	+14,747	+ 6,367	– 4,187
Foreign securities	– 1,395	– 5,627	– 9,513	– 2,021	+ 532	+ 4,037	+ 358	– 1,093
of which								
Foreign Deutsche Mark bonds	– 123	– 3,696	– 4,266	– 839	+ 1,011	+ 4,191	+ 260	– 592
German securities	– 619	+ 13	– 1,208	+ 1,338	+ 2,008	+10,710	+ 6,009	– 3,094
Shares	+ 216	+ 164	– 255	+ 521	+ 392	+ 2,980	– 187	– 45
Bonds	– 835	– 151	– 953	+ 817	+ 1,615	+ 7,729	+ 6,196	– 3,049
Loans and advances	– 1,146	– 4,083	– 9,285	+ 3,699	+ 6,345	+ 2,071	+ 8,014	– 1,759
German loans to foreign countries	– 755	– 4,393	–10,028	– 3,027	– 313	+ 2,078	+ 4,112	– 2,832
Foreign loans to Germany	– 391	+ 310	+ 743	+ 6,726	+ 6,658	– 7	+ 3,902	+ 1,073
Other transactions	– 299	– 359	– 476	– 544	– 675	– 958	– 636	– 499
Total	– 1,440	– 9,872	–21,203	+ 1,454	+ 8,458	+17,029	+14,653	– 4,944
Official long-term capital transactions	– 1,490	– 1,329	– 1,837	– 2,388	– 2,166	– 1,483	– 2,216	– 804
Balance of long-term capital transactions	– 2,930	–11,201	–23,040	– 934	+ 6,293	+15,545	+12,437	– 5,748
2. Short-term capital transactions								
Banks	– 4,823	+ 2,455	+ 4,325	+ 7,927	+ 1,174	– 420	– 5,149	– 9,733
Enterprises	– 3,734	+ 1,436	+ 65	+ 8,417	+ 2,007	– 3,592	+ 5,175	– 9,815
Financial credits	– 1,634	+ 536	– 235	+ 6,417	– 1,393	– 4,592	+ 575	+ 3,118
Trade credits **4**	– 2,100	+ 900	+ 300	+ 2,000	+ 3,400	+ 1,000	+ 4,600	–12,933
Official **5**	– 361	+ 1,185	– 29	– 297	+ 1,142	+ 476	+ 251	– 200
Balance of short-term capital transactions	– 8,918	+ 5,076	+ 4,361	+16,047	+ 4,323	– 3,536	+ 277	–19,748
Overall balance of statistically recorded capital transactions (1 plus 2)	–11,848	– 6,125	–18,679	+15,113	+10,616	+12,009	+12,714	–25,496
III. Balance of all statistically recorded transactions (I plus II)	– 1,842	+ 5,731	–11,181	+18,296	+13,697	+14,483	+24,210	– 1,432
IV. Balance of statistically unclassifiable transactions (balancing item) **6**	+ 1,702	+ 1,278	+ 919	+ 3,616	+ 2,661	+ 1,207	+ 2,218	– 474
V. Overall balance on current and capital accounts (III plus IV)	– 140	+ 7,009	–10,262	+21,912	+16,358	+15,690	+26,428	– 1,906
VI. Contra-entry to changes in the Bundesbank's external position **7**	–	–	– 4,099	+ 738	– 5,369	– 496	–10,279	– 7,231
VII. Changes in the Bundesbank's net external assets (increase: –) **8**	– 140	+ 7,009	–14,361	+22,650	+10,989	+15,194	+16,149	– 9,137

1 Special trade. – **2** Mainly merchanting trade and warehouse transactions for account of residents. – **3** Capital transactions are classified as "Private" or "Official" according to the sector to which the German party concerned belongs. – **4** Data on trade credits until 1973 partly estimated. – **5** Chiefly concerning change in the Federal Government's assets resulting from prepayments on government imports and change in the Federal Government's liabilities to the European Communities on so-called deposit accounts. – **6** Net errors and omissions on current and capital accounts. – **7** See footnote 8. – **8** The change in the Bundesbank's net external assets also includes the depreciations of the Bundesbank's external position expressed in Deutsche Mark due to the 9.3 % Deutsche Mark revaluation of October 27, 1969, the fixing of central rates in December 1971 (which caused a 13.6 % revaluation of the Deutsche Mark against the U.S. dollar), the 10 % devaluation of the U.S. dollar of February 12, 1973, and the valuation adjustments in December 1972, 1973 and 1974. This item also takes account of the rise in the Bundesbank's external assets due to allocations of special drawing rights between 1970 and 1972 totalling DM 1,985 million. As these changes are not attributable to current or capital transactions, a contra-entry has been inserted under VI in order to square the overall balance of payments in mathematical terms.
Discrepancies in the totals are due to rounding.

correspondingly larger part of its national product to pay for its more expensive imports.

The fight against inflation facilitates redistribution in real terms in favour of OPEC countries

The course of German foreign trade in 1974 shows that the redistribution of the real national product initiated by the price increase which the oil-producing countries imposed can be carried out by combating inflation rather than by pursuing an inflationary policy. In this way the German economy solved within one year a problem which various other industrial countries still have to tackle. But only part of the "passing back" of the rise in the cost of imports, as reflected in the growth of German exports, took place in direct trade between Germany and the OPEC countries. Apart from the higher net imports of centrally planned economies and non-oil-producing developing countries from Germany, the main counterpart of the increase in Germany's foreign trade surplus is the larger current account deficits of other industrial countries. These disequilibria could, however, grow only because some other industrial countries did not combat inflation with sufficient energy, or at least failed to do so for a long time.

Improvement in Germany's trade balance partly due to undesirable international trends in earlier years

The improvement in Germany's trade balance in 1974 also owed a great deal to developments which had started before the oil crisis broke in the autumn of 1973. They were rooted in the fact that even after the exchange rates were floated in the spring of 1973 some countries tried to prevent the depreciation to which their currencies would have been exposed in the absence of intervention (their main aim being to protect themselves from further increases in the cost of imports), but failed to take domestic measures to reduce balance of payments strains and thus to relieve the depreciation pressure on their currencies. On the contrary, economic policy was not infrequently geared to sharply diverging national objectives, and differences in prices and costs grew. This was bound to augment the balance of payments disequilibria, unless corresponding counter-action was permitted through exchange rate changes. After the oil crisis broke, the disequilibria caused by such differences at first became more pronounced since the adjustments necessitated by the higher oil prices proceeded along different lines. Frequently it was not recognised – or not recognised in time – that the redistribution of the national income and national product in favour of the OPEC countries was within certain limits an established fact for the time being, and that it could not be prevented by each of the social groups attempting to keep for itself as large a slice of the national product "cake" as ever. To begin with, this only resulted in a faster rotation of the price-wage spiral. Not until the later part of 1974 did the economic policy makers in many countries take more determined action against the inflationary tendencies.

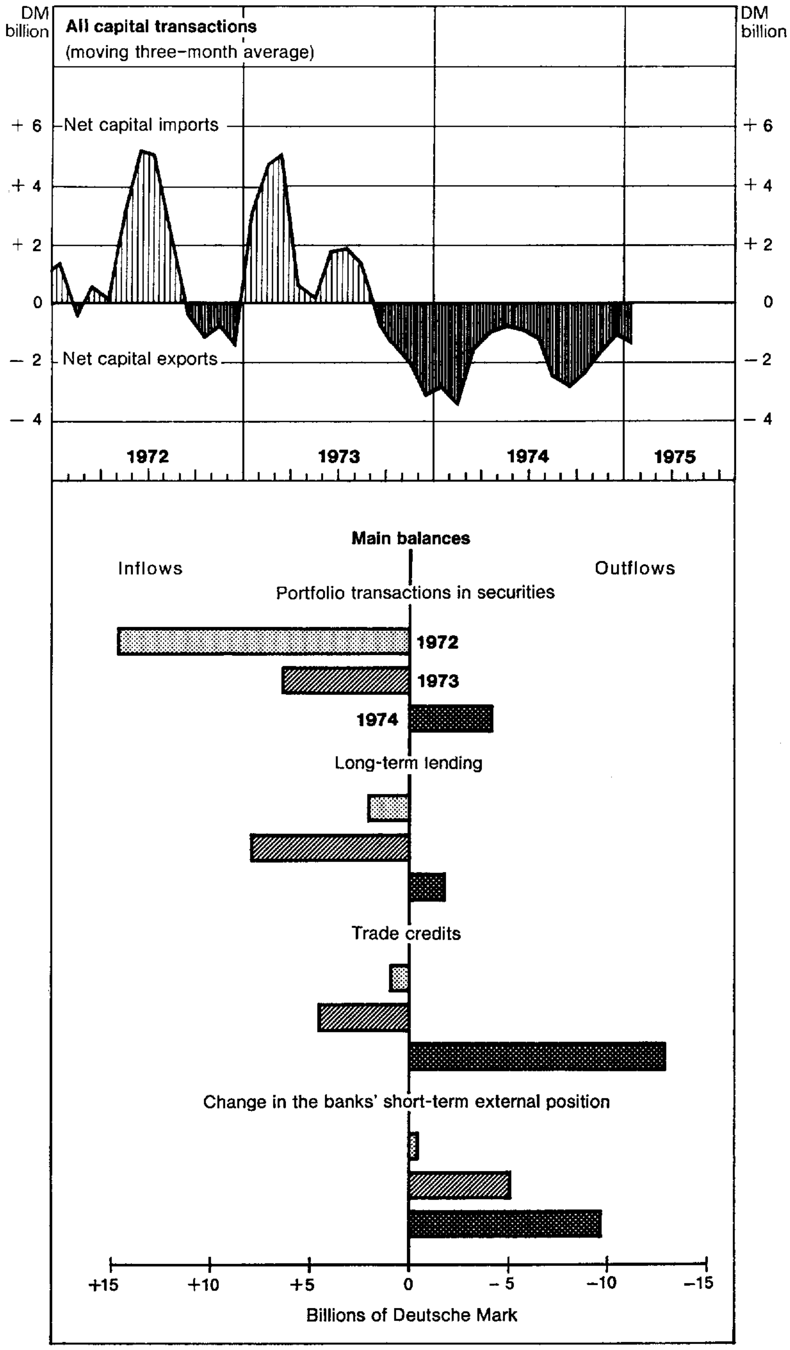
Further increase in the deficit on services and transfer payments

Contrary to the trend of Germany's foreign trade, in the field of services and transfer payments the deficits grew further in 1974, viz. by a total of DM 4 billion to DM 32 billion if the freight and insurance costs of merchandise imports are included. Germany has long been the world's leading importer of "invisibles", and its position in this field was thus strengthened. In the sectors which are strongly influenced by general economic factors the deficits hardly rose at all (as in foreign travel, where the deficit went up by only DM 0.9 billion to DM 12.3 billion) or even dropped (as in transportation or the home remittances of foreign workers in Germany). The main reason for the growth of the overall deficit was that net expenditure on commission fees, advertising and trade fairs increased sharply as exports expanded, and that the surpluses on investment income account dwindled. As a result of large profit distributions by domestic enterprises to foreign shareholders, who apparently abandoned the restraint they had previously shown with regard to the transfer of profits once expectations of an appreciation of the Deutsche Mark waned, the surplus on investment income account dropped from DM 1.6 billion in 1973 to a mere DM 40 million in 1974.

Large capital exports in the form of trade credits and financial investments abroad by banks

The most interesting feature of the balance of payments for 1974 is that the large current surplus (the highest ever recorded) was accompanied by equally large, indeed slightly larger, net exports of capital. In other words, all of the huge surplus on current account was financed via the money and capital markets, that is, without central bank intervention. It is hardly possible to visualise what the structure of Germany's balance of payments would have been under the conditions pre-

Main components of capital transactions with other countries



vailing in 1974 if the obligation to intervene against the U.S. dollar in force until the spring of 1973 had still been in effect. But it can be said with some confidence that in such circumstances a very considerable part of the current surplus (irrespective of its size) would have led to inflows of foreign exchange to the Bundesbank, with all the negative consequences this would have had for the creation of money and the fight against inflation. This should be kept in mind when considering the statistics on capital exports; but for the system of flexible exchange rates, the figures would not have reached the magnitude they did.

External position of the Deutsche Bundesbank

Millions of Deutsche Mark

Item	Change (+: increase in assets, decrease in liabilities) 1970	1971	1972	1973	1974	As at Dec. 31, 1974
I. Monetary reserves						
1. Gold	— 365	+ 353	+ 106	+ 30	+ 1	14,002
2. Reserve position in International Monetary Fund and special drawing rights	+ 3,198	+ 1,281	+ 1,504	+ 1,982	+ 388	8,055
3. Foreign exchange	+22,892	+15,304	+14,607	+23,401	—10,249	49,747
U.S. dollars	+26,337	+15,222	+14,571	+23,149	—10,178	49,513
Other foreign exchange balances **1**	— 3,445	+ 82	+ 36	+ 192	— 11	234
Claims on European Monetary Cooperation Fund (FECOM) **2**	—	—	—	+ 60	— 60	—
4. External liabilities	— 1,390	— 60	— 80	+ 1,031	— 329	2,202
Liabilities to foreign central banks	— 1,164	— 343	— 78	+ 1,241	— 192	1,450
Liabilities to European Monetary Cooperation Fund (FECOM) **2**	—	—	—	—	—	—
Other liabilities	— 226	+ 283	— 2	— 210	— 137	752
Net monetary reserves (1 plus 2 plus 3 less 4)	+24,335	+16,878	+16,137	+26,444	—10,189	69,602
II. Loans and other claims on foreign countries						
1. Loans in connection with EEC medium-term monetary assistance	—	—	—	—	+ 1,283	1,170
2. Claims arising from foreign exchange offset agreements with U.S.A. and U.K.	— 2,000	— 200	— 7	— 8	+ 1,688	3,190
3. Other loans to foreign monetary authorities	— 64	+ 35	— 101	— 22	+ 5,308	4,809
4. Loans to World Bank	+ 379	+ 272	+ 281	+ 14	+ 4	2,468
Total (1 plus 2 plus 3 plus 4)	— 1,685	+ 107	+ 173	— 16	+ 8,283	11,637
III. Overall external position of the Deutsche Bundesbank (I plus II)						
(a) Changes due to external current and capital transactions (1970 to 1972 including allocation of special drawing rights)	+22,650	+16,985	+16,310	+26,428	— 1,906	81,239
(b) Depreciation of external position of the Deutsche Bundesbank	—	**3**— 5,996	**4**— 1,116	**5**—10,279	**6**— 7,231	..
(c) Change in net external assets of the Deutsche Bundesbank shown in the balance of payments (increase: +)	+22,650	+10,989	+15,194	+16,149	— 9,137	..

1 Including foreign notes and coins. — **2** Excluding transactions with Norway and Sweden, which are not members of the European Economic Community and which, as participants in the European joint float, settle their claims and liabilities with the partner countries direct and not through the European Monetary Cooperation Fund (FECOM = Fonds Européen de Coopération Monétaire). — **3** Due to the fixing of central rates on December 21, 1971 (so-called Smithsonian Agreement). — **4** Attributable to new valuation of the gold holding, the drawing rights in the gold tranche and the special drawing rights; this valuation had been postponed for a time because of the fixing of central rates in December 1971. — **5** Caused by the 10 % devaluation of the U.S. dollar on February 12, 1973 and the new valuation of the external position at end-1973. — **6** Due to new valuation of external position at end-1974.

In terms of quantity, the most important item among capital exports was trade credits granted to foreigners. Net newly extended trade credits (i. e. the credit terms granted to non-residents), at DM 19 billion, were about six times as large in 1974 as in 1973. This vigorous expansion must be viewed against the background of an increase of no less than DM 52 billion in merchandise exports in 1974. Even if the periods of credit in export transactions remained unchanged, this would result in a steep increase in export claims. But the average periods of credit used by foreigners in fact lengthened somewhat. A crucial factor here was that foreign importers did not expect a substantial appreciation of the Deutsche Mark because the floating rates — despite fluctuations — remained roughly in a state of equilibrium. A further significant influence seems to have been that German enterprises offered favourable terms of payment in order to obtain orders. Although the trade credits used by German firms likewise increased (together with advance payments for exports, by about DM 6 billion), enterprises on balance "exported" DM 13 billion of capital in 1974 through trade credit transactions. A further DM 10 billion flowed abroad from the banking sector, which invested large sums on foreign money markets, particularly in the second half of the year when the banks' liquidity situation improved and the level of interest rates sank at home. In the summer of 1974, after the outbreak of the Herstatt crisis, considerable amounts of foreign money were withdrawn from German banks, but in the later part of the year foreign investors built up their Deutsche Mark balances again; at the end of 1974 the external liabilities of German banks were in fact slightly higher than at the beginning.

Reversal of long-term capital transactions

Long-term capital transactions, which had resulted in large inflows of funds in the years from 1971 to 1973, produced an outflow of approximately DM 6 billion in 1974. This reversal was facilitated by the interest rate differential against the rest of the world, which became more and more marked, especially in the second half of the year, and contributed materially to the net exports of capital both in portfolio transactions in securities and on the "credit account", which together totalled DM 6 billion in 1974. In the field of direct investment, on the other hand, there were net imports of capital into Germany in 1974 (DM 1.5 billion). For the first time major investments in Germany by OPEC countries were involved, notably one large transaction by Kuwait.

Decline in the monetary reserves due to deficits in external payments and lending by the Bundesbank to foreign countries

The freely disposable monetary reserves of the Bundesbank declined by some DM 2 billion in 1974 on account of the deficit in external payments; in the last analysis this reduction consists of outflows caused by sales to the exchange market and by the settlement of external payments of the Federal Government. In addition, the Bundesbank employed part of its monetary reserves at longer term during the year: it made DM 6.6 billion available to Italy by direct lending and by participating in EEC monetary assistance, and it acquired medium-term U.S. Treasury notes equivalent to DM 1.7 billion under the terms of the U.S.-German foreign exchange offset agreements. The total of freely disposable monetary reserves at the end of 1974, after taking account of the valuation adjustments at the end of the year (see pages 67 and 83), was approximately DM 70 billion (net), compared with DM 86 billion at the end of 1973. The amount of credit granted to foreign countries rose from DM 4.3 billion at the end of 1973 to DM 11.6 billion on December 31, 1974. The credit lines opened by the Bundesbank for foreign countries but not used at the end of 1974 came to some DM 5 billion; in liquidity terms they represent a prior charge on the freely disposable monetary reserves. It must also be borne in mind that at the end of 1974 enterprises, banks and public authorities had an estimated DM 60 billion of external liabilities maturing at short term or callable at short notice. Viewed in this light, the German monetary reserves appear quite adequate to meet possible risks but do not seem excessive, especially if the factual immobility of the gold holding (DM 14 billion) is considered. The size of Germany's short-term payment obligations in itself forbids an undue reduction in the disposable monetary reserves by conversion into longer-term external assets which are not available at any time.

4. Perspectives and economic policy requirements

Easing of monetary policy, but no unconditional opening of the monetary flood-gates

The slowdown in business activity in the autumn of last year necessitated a certain shift of emphasis in economic policy. The Federal Government and the Bundesbank had to concentrate more on averting the temporary dangers to employment and economic growth. This was all the easier since marked progress had meanwhile been made along the road to stability. A further moderation of price rises seemed attainable even if the public authorities had a more expansionary effect and the monetary margin was greater than hitherto. It was, however, conditional on a slackening of the cost rises in Germany, especially those resulting from wage and salary agreements. In this situation it was the Bundesbank's task to provide scope for faster economic growth from the monetary angle by easing monetary policy moderately but without creating new inflation potential.

Defining a monetary target for 1975

After consideration of the existing economic situation and future problems, the Central Bank Council declared in December 1974 that "from the present perspective ... a growth of about 8 % in the central bank money stock in the course of 1975 may be regarded as compatible with the aims of stabilisation policy". In formulating this target the Bundesbank acted in full agreement with the Federal Government. The figure of 8 % implies a distinctly easier monetary policy than that pursued by the Bundesbank last year. It also appeared consistent with the annual increase in the gross national product assumed by the Federal Government in its projection for 1975. The principal reason for announcing a growth target for the central bank money stock is to make intentions in the field of monetary policy clear to those involved in the economic process. In December 1974 this meant first of all that the Bundesbank would aim at facilitating monetary expansion somewhat, because the growth of the central bank money stock had been smaller until then. But secondly it defined the upper limit which the Bundesbank has set itself for such expansion in the slightly longer run, and which will only be reached if the growth of the central bank money stock accelerates. The somewhat longer time horizon used in this case also means that short-term deviations from this growth path will not be a reason for modifying monetary policy immediately, but will give occasion to reexamine at frequent intervals whether the conditions set are such as to enable the policy to be continued and the goal attained. The fact that measures by the Bundesbank – mainly changes in its interest rates and, where necessary, in bank liquidity – take time to produce results in the desired direction was explained in detail on page 24. But the quantitative target precludes the possibility of the Bundesbank aiming at a certain level of interest rates or a certain exchange rate at the same time. It is true that the Bundesbank is always conducting interest rate policy, but this is for the purpose of achieving the monetary growth target. For the central bank, interest rates are thus an instrument, and not a goal in their own right.

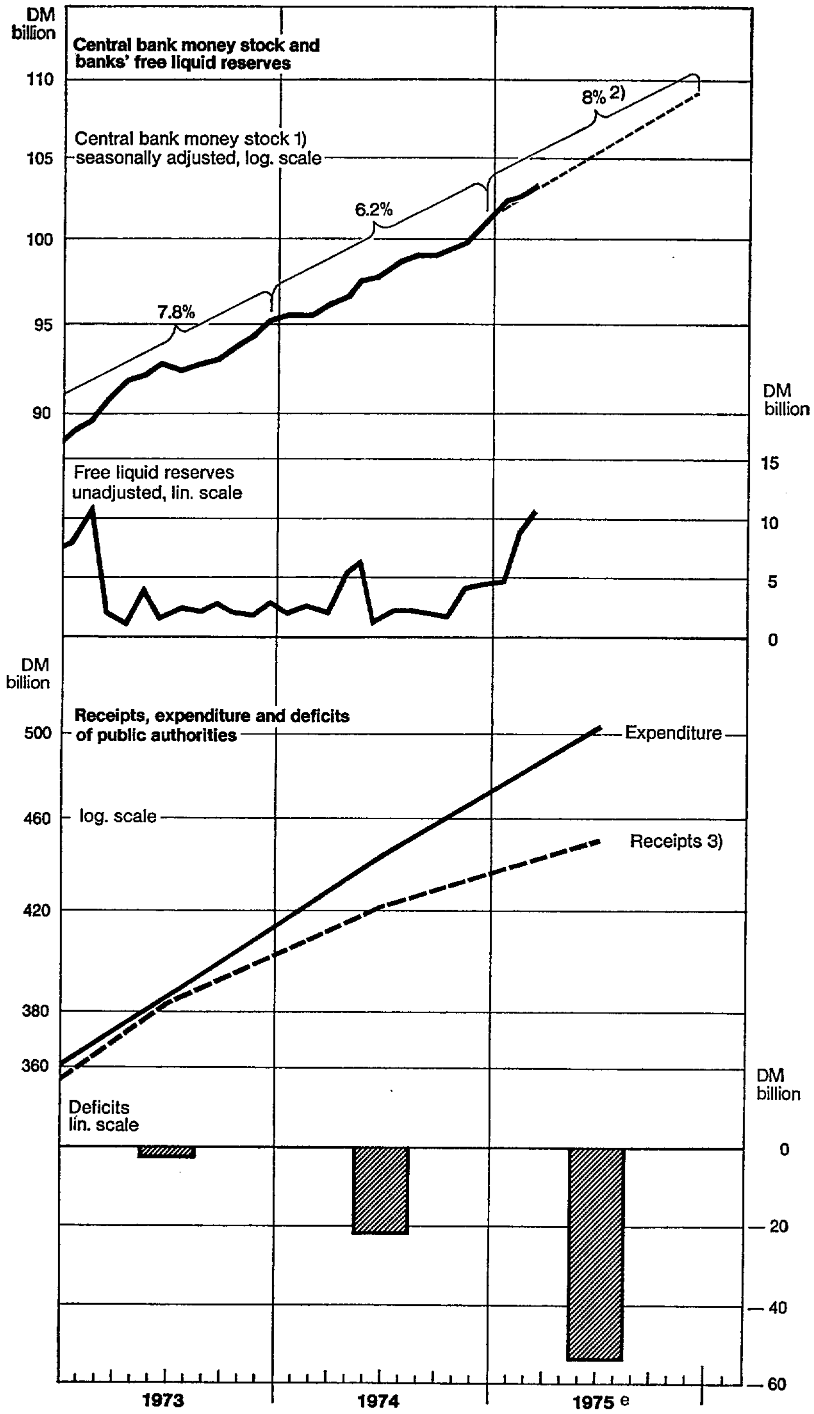
It goes without saying that the Bundesbank does not set its target for monetary growth as an end in itself, but regards it as a suitable means of contributing its share to satisfactory overall economic development. For this reason the wording of the Bundesbank's statement of December 5 could only be that a growth of 8 % in the central bank money stock seemed to the central bank compatible with stabilisation policy "from the present perspective". It would be necessary to consider correcting the chosen growth target if it turned out that the monetary aim was no longer in line with the overall economic situation.

Strong expansionary stimuli from the government budget deficits

In the economic strategy for 1975 an important part has also been assigned to fiscal policy in overcoming the present low growth rate. The relief brought by the tax reform and the reform of children's allowances, which is estimated at about DM 14 billion, is adequate to the economic situation. This applies both to the overall effect associated with the increase in the cash deficit and in particular to the aims in the field of incomes policy. The lowering of wage tax and the improvement of children's allowances made it easier for the trade unions to adopt a course more conducive to stability in their wage policy. The tax reform brought employees relief equivalent to a rise of about 3½ % in 1974. Thus, the programme provides for a 7½ % grant for all capital goods ordered between December 1974 and June 1975; this grant is intended to revive the private propensity to invest, which is the real centre of weakness of the present slowdown. This measure will not affect the budget until 1976, when the grants, which are estimated to total DM 8 billion, will become payable. In addition, the programme envisages extra capital expenditure by the Federal Government, especially in the construction sector, and selective assistance on the labour market. On the expenditure side a rise of about 10 to 11 % is therefore in prospect in the budgets of the central, regional and local authorities in 1975, excluding the higher expenditure on children's allowances. There are no signs of a sharp expansion in public capital spending in 1975. The Federal Government, admittedly, will increase its capital expenditure fairly steeply, but the Länder Governments are intending to spend little more than last year on fixed assets – even if the planned economic programmes are taken into consideration – and the local authorities, the principal public capital investors, are also unlikely to be able to increase their capital expenditure much in view of the tight financial situation. However, the share of spending on personnel is not expected to increase any further in 1975, and this may be regarded as a certain turning point in the trend of public expenditure.

The main changes in 1975 are on the receipts side of the budget. According to the latest official tax estimate, overall tax revenue will increase only a little (if the increase in expenditure due to the reform of children's allowances is deducted from the receipts side for the sake of comparability). This means that the deficit of the central, regional and local authorities will rise to over DM 50 billion and be more

Monetary and budget policy in 1975



1) Currency and minimum reserves on domestic liabilities at constant reserve ratios (base: January 1974); daily averages of the months.- 2) Growth path aimed at for 1975.- 3) Including special taxes.- e Estimated.

than twice as large as in 1974. Since the financial situation of the social security funds will continue to deteriorate (as always in a phase of slack activity), the expansionary swing of the public authorities in 1975, compared with 1974, must be put at over DM 30 billion. In other words, after the marked change in public budgets in 1974 (see page 8) private incomes will again be supported to an extent equivalent to about 3 % of the gross national product in 1975; the rise in the cash deficit in 1975, compared with 1973, will amount to DM 50 billion, or about 5 % of the gross national product in the latter year. Since the 7½ % investment grant will enhance the demand for capital goods but — as mentioned —

hardly affect the cash position of the central, regional and local authorities in the current year, the increase in their budget deficits in 1975 does not reflect all of the stimulus given to demand by the public sector.

According to present plans, the central, regional and local authorities will draw on their special anticyclical deposits at the Bundesbank to the extent of between DM 6 billion and DM 7 billion in the current year to finance their deficit. Since, moreover, a further DM 3.7 billion of the social security funds' investments in Bundesbank mobilisation and liquidity paper will mature and the proceeds will be used elsewhere, funds totalling some DM 10 billion will probably be released. To begin with, of course, this will only augment the banks' free liquid reserves; but as this will enable lending and bank deposits to expand more rapidly, the central bank money stock too will ultimately increase, other things being equal. In the interests of a liquidity management consistent with stabilisation, the timing of the release of the special deposits must be coordinated with the Bundesbank, as stated by the Federal Government in its Annual Economic Report.

Despite liquidation of special deposits, heavy demand for credit from the market

In spite of the liquidation of the special deposits the borrowing requirements of the central, regional and local authorities will increase considerably in 1975. Excluding the Federal Railways and Post Office (both government enterprises), the public authorities' credit needs can at present be put at about DM 45 billion, which is roughly twice last year's figure. A not inconsiderable part of this sum was met in the first quarter. In view of the nature of the funds available on the market, among which the shorter maturities often predominate, the central, regional and local authorities will be unable to avoid drawing more heavily than last year on the market's shorter-term borrowing facilities when raising further amounts. Over and above this, precautions should be taken to avert the danger of the public authorities' credit requirements being concentrated in the later part of the year, when they may coincide with greater private demand for credit. Problems would at any rate arise for the economic upswing if a reversal in the trend of interest rates were to occur at an early stage.

Economic policy continues to need protection against external influences

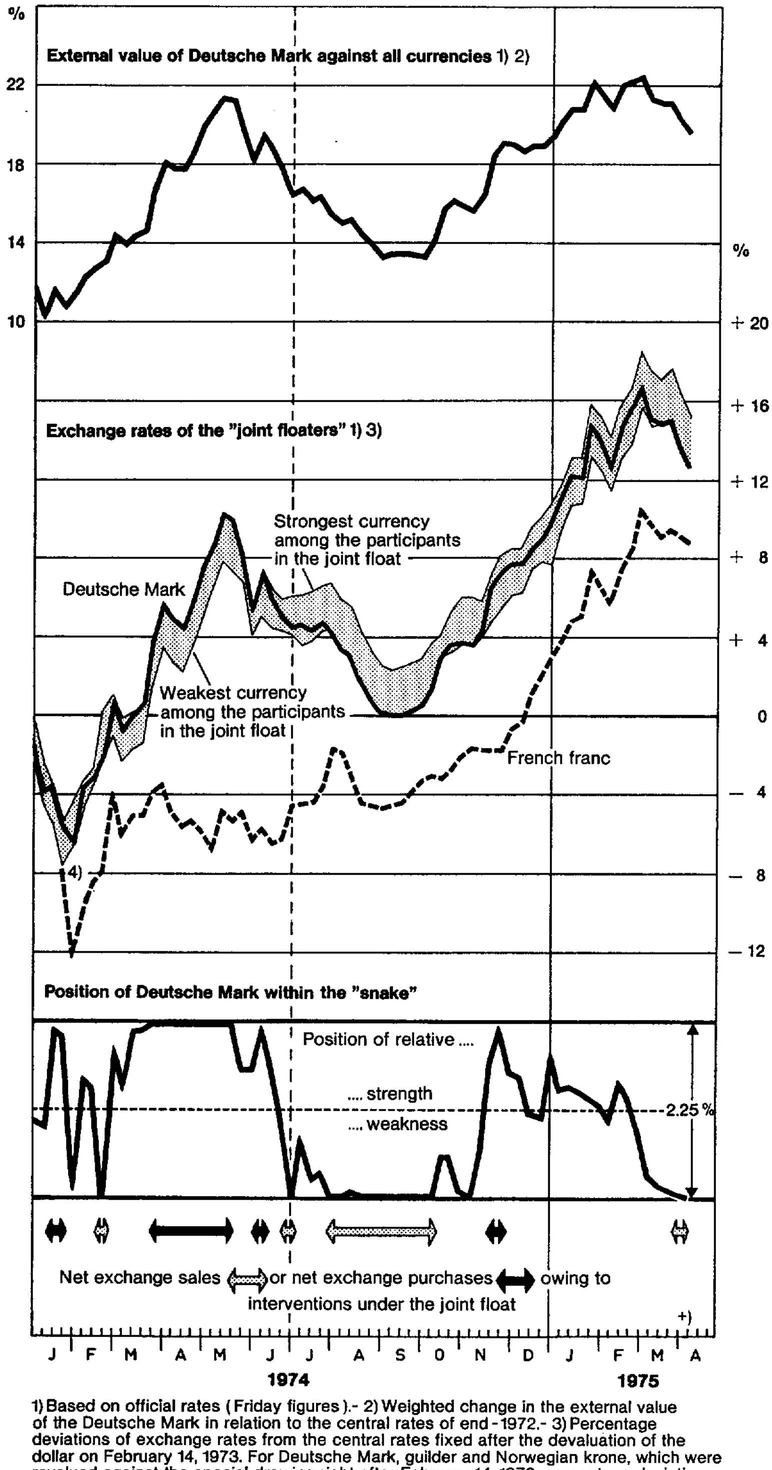
In 1975 economic policy still needs protection against external influences. As before, this protection consists in leaving the movement of exchange rates to market forces. This does not preclude preventing abrupt movements on the foreign exchange markets as far as possible by Bundesbank intervention. In the first few months of 1975 the Bundesbank, acting in close consultation with the central banks of other countries, considered it justifiable to counteract the fall in the rate of the U.S. dollar (which at times was very rapid), particularly as the causes of this weakness could largely be regarded as temporary. The interventions were not directed against the trend of the rate, however, as shown by the fact that the Deutsche Mark strengthened against the dollar and stood about 3 % higher at the end of March 1975 than at the beginning of the year. That this was primarily a problem of the dollar and not of the Deutsche Mark is attested by the circumstance that the external value of the Deutsche Mark against all currencies increased by less than 1 % during that period.

The reason for the slight appreciation of the Deutsche Mark against all currencies so far in 1975 (as in 1974) is, among other things, that price rises in the Federal Republic of Germany lagged behind those in other countries. This, at least, would be an economically convincing explanation, though there is no gainsaying that many other factors affect exchange rates in the shorter run. The appreciation of the Deutsche Mark enhances Germany's demand for foreign goods and thus the tendency for the foreign trade surpluses to fall. Since the inflow of orders from abroad has slackened considerably since the autumn of 1974, the prospects for such a trend are growing on the export side too. However, there cannot be a significant decrease in the trade surplus until domestic economic activity has recovered strongly and inflation has been curbed abroad.

Safeguarding the stability-oriented expansionary policy by more moderate pay agreements

Last year's experience has shown that a balanced economic policy, committed equally to all the targets of the Stability and Growth Act, requires not only protection against external influences but also the internal support of management and labour if it is to be successful. Recent wage agreements suggest that labour

Exchange rates changes



1) Based on official rates (Friday figures).- 2) Weighted change in the external value of the Deutsche Mark in relation to the central rates of end-1972.- 3) Percentage deviations of exchange rates from the central rates fixed after the devaluation of the dollar on February 14, 1973. For Deutsche Mark, guilder and Norwegian krone, which were revalued against the special drawing right after February 14, 1973, percentage deviations from the mathematical dollar central rate.- 4) Rate of the French franc floated with effect from January 21, 1974.- +) Latest position: April 4, 1975.

and management have indeed recognised this. At all events, the latest wage settlements have improved in a crucial respect the basis for a new economic upswing in stability. This makes it easier for those responsible for economic policy to steer the envisaged course in 1975. Construction was the first major sector this year to conclude new wage and salary agreements; they provide for a rise of 6.6 % in earnings from May 1, 1975 and the incorporation of an annual special payment of DM 200 in the wage contracts. Compared with last year's settlements, nearly all of which ran into two figures, this was a clear signal that reason was prevailing, and it was soon understood as such and emulated in the other sectors in which new pay agreements were due, especially the metal industry and the public service. On the assumption that the interdependence of pay settlements will result in the other pay rate increases remaining on about this scale in 1975, the average rise in the overall level of wages and salaries this year will probably be about 8 %. As the Federal Government postulated in its annual projection for 1975, this might involve a slight increase in the profit ratio of enterprises. There is no denying that a sustained improvement in profitability is indispensable if the greater private propensity to invest needed for the upswing is to be secured.

Further moderation of the rate of price rises within the realms of possibility

The price decisions recently taken by entrepreneurs also seem to have been more in keeping with the changed economic conditions than they were at times last year, when quite frequent attempts were made to make up for falls in profits due to declining sales by raising prices. At all stages of production, prices have been put up relatively little since the beginning of the year. Industrial producer prices on the home market increased in the period from December 1974 to February 1975 at an annual rate of only 1 %, seasonally adjusted, compared with 6½ % in the preceding three months (September/November) and even steeper rises in earlier periods. At the consumer stage, too, prices have recently (December to February) been going up at an annual rate of 4 %, seasonally adjusted, which is distinctly less than before. In February consumer prices were 5.8 % higher than a year previously. A further moderation of the rate of price rises in the direction of 5 % by the end of this year, as aimed at by the Federal Government according to its Annual Economic Report, seems possible provided there are no abrupt, unforeseen movements in the food prices which are influenced by harvest factors.

Promising conditions for an increase in domestic demand, especially because of the more favourable trend in enterprises' earnings

In view of the strong fiscal and monetary stimuli that have been given, the conditions for a revival of domestic demand are in general favourable. The indicators of demand available for January and February imply initial steps in this direction; at any rate, in major branches of industry (including the motor industry, where activity has hitherto been rather slack) domestic orders were well above the level of the fourth quarter. Domestic demand will probably also be bolstered by the fact that the measures of economic policy, coupled with the prospective more favourable trend in costs, will contribute to an improvement in enterprises' earnings, which have so far been very poor. This would remove a substantial obstacle to the revival of the propensity to invest. It will, however, presumably be some time before production and employment react to the stimuli given.

But the hoped-for economic upswing also entails risks. It will not follow the pattern of earlier cycles, if only because foreign demand will not act as the driving force. In spite of the great uncertainty about the future course of the world economy, German exports can still be expected to move upwards, but this is hardly likely to provide additional impetus. Thus, the upswing is primarily dependent on the rise in domestic demand and on the support given to activity by the public authorities. Monetary policy will make its contribution, but without losing sight of the limits set by the need for the economy to develop as far as possible without inflation. There would be no justification for hazarding the previous achievements of stabilisation policy, thus lessening the value of the efforts and sacrifices made to secure stability, just for the sake of a quick, but in the last analysis short-lived, success.

II. International monetary trends and external monetary policy

1. General survey

No acute monetary crises in spite of world-wide inflation and the oil price explosion . . .

In the period under review international monetary policy was confronted with problems of exceptional magnitude and difficulty. Soaring oil prices and the inflation differential between major industrial countries caused extreme tensions in international payments. In 1974 the world-wide wave of inflation reached its peak. As was to be expected, inflation rates varied greatly from country to country; in terms of consumer prices, they ranged between 7 % and 25 % in the industrial countries. The resulting distortions in international payments exacerbated the dislocations caused by oil prices. Thus, balance of payments disequilibria last year reached unprecedented dimensions. This applies both to the enormous global imbalance between the groups of oil-exporting and oil-importing countries, and to the balance of payments discrepancies among the industrial countries themselves. On top of these difficulties, first signs of recession emerged in many countries in the course of 1974.

It is noteworthy that despite these extreme strains no acute currency crises – let alone currency breakdowns – occurred in the period under review. Nor have the dreaded competitive depreciations and trade restrictions materialised up to the present. In spite of all difficulties, world trade still grew in 1974 by nearly 5 % on a price-adjusted basis. Even though this is much less than the 15 % of the preceding boom year, the international monetary system and world trade have thus far come off relatively well, considering the circumstances. This attests the flexibility of the international financial and monetary system. Two factors in particular contributed to this result: first, in the period under review financing balance of payments deficits by recycling the foreign exchange surpluses of the OPEC countries worked better than anticipated. Second, monetary tensions were eased by the increased flexibility of the present exchange rate system, which thus stood its first test under unusually difficult conditions. At the same time the European currency bloc ("snake") did surprisingly well as an island of fixed exchange rate relationships between countries with "homogeneous" economic policies, and has even increased its attractiveness of late.

. . . because balance of payments financing and the exchange rate system proved to be flexible

For some months there have been indications that the strains in international monetary relations have passed their peak in some areas. This applies to the payments imbalance between oil-importing and oil-exporting countries, although it still appears to be intolerably large by former standards and is likely to continue to raise difficult financing problems as time goes by. The balance of payments discrepancies between the most important industrial countries also seem to be narrowing of late. Some of the extreme deficit countries, for instance, are about to reduce their current account deficits significantly and thus alleviate their financing problems. However, there are still countries with such extreme deficit positions that it would be premature to assume that the monetary system is out of the wood in this respect. Furthermore, the persistent accumulation of foreign indebtedness might over time give rise to various problems for some deficit countries, whereas for the main surplus countries among the oil exporters the investment of funds might pose problems as time passes.

The international wave of inflation has meanwhile also ebbed somewhat, without, however, stability having come within easy reach world-wide. Little change is noticeable as concerns the inflation differential between individual industrial countries, which has accounted for many of the divergent balance of payments developments among them. And it is particularly regrettable that both in the rates of inflation and in the balance of payments positions there are still great discrepancies among some member countries of the European Community. The EEC is still far from a "convergence" of economic and monetary developments in the member countries, let alone from becoming a "Community of stability". Thus great obstacles to any progress towards European monetary unification based on stable par values still remain.

Finally, as regards recession, the picture varies from country to country. For some major industrial countries, among them Japan and the Federal Republic of Germany, there are initial indications that the business cycle may have reached its trough, or perhaps already passed it. In the most important country in the world economy, the United States, the recession has, it is true, left deeper marks than had generally been anticipated, and at the time of writing it was still uncertain when the U.S. economy would start to pick up. This, together with the economic slowdown in other countries, will continue to have dampening effects on world trade, with the result that – in terms of volume – little more can be expected for 1975 than stagnation at the level reached in the preceding year.

2. The petrodollars and their investment

Surpluses of oil-exporting countries past their peak

The overall foreign exchange surplus accruing to the OPEC countries as a result of the quadrupling of oil export prices since the autumn of 1973 is estimated at the immense sum of about US$ 55 billion for 1974.[1] Originally this surplus had been expected to be even higher. But already in 1974 a number of developments commenced the result of which was that the foreign exchange surplus of the OPEC countries has meanwhile passed its peak and that it will fall well below US$ 50 billion in 1975 and will probably continue to decline steadily in the years to come. On the one hand, oil imports into oil-consuming countries decreased, contrary to the trend in preceding years, and in 1975 will hardly exceed their 1973 level. On the other, the oil countries have drastically increased their imports of goods; at roughly US$ 32 billion in 1974 they were about 70 % up on the previous year in terms of value, and 40 to 45 % higher in terms of volume. According to the latest figures of major industrial countries on foreign trade and orders received these imports are likely to continue increasing rapidly. German exports to the oil countries fully kept pace with these developments in 1974 (as explained in more detail in Section I), increasing by 73 % in 1974, and in the last few months they have in fact been more than twice as large as before the upsurge in oil prices. Finally, OPEC countries made considerable sums available in various forms to other developing countries, mainly to those closely associated with them for political or religious reasons. This assistance was either used immediately to repay external debts or led relatively quickly to additional imports of goods by the beneficiary countries.

By far the greater part of the investable surpluses of the oil countries has, however, been recycled up to now via the large financial markets of the world. The most important role in this recycling process was played by the banking system. According to current estimates, oil funds equivalent to no less than US$ 23 billion were placed in the Euro-currency markets in 1974, the bulk of them denominated in U.S. dollars. A further US$ 11 billion was invested in the United States itself, of which roughly US$ 6 billion was placed in government and other public securities, US$ 4 billion was deposited with U.S. banks, and an estimated US$ 1 billion was channelled into direct investments. In the United Kingdom, the equivalent of roughly US$ 6 billion was placed in sterling assets and deposits, in addition to considerable amounts in non-sterling currencies deposited with Euro-banks. Thus, Euro-markets as well as the traditional investment markets of the United States and the United Kingdom together absorbed about US$ 40 billion, or over two thirds, of the investable oil funds; banks alone took in over US$ 28 billion of this amount. The rest, totalling US$ 15 billion, was used for contributions to international organisations (particularly the IMF for its oil facility, but also the World Bank and various regional development institutions) and other assistance to poorer developing countries, for direct bilateral loans to governments and public institutions in industrial countries, and finally, to a relatively modest extent, for other investments in countries besides the United States and the United Kingdom.

No recycling problems in 1974

The investment policies of the major oil surplus countries have become an important factor in international capital flows and thus in global economic and monetary equilibrium. From the outset it is by no means certain that the investment preferences of the oil countries will always coincide with the financing needs of deficit countries or can be made to match them by intermediaries. In addition, changes in the direction of investments, and above all changes in preferred currencies, may

1 The total current account surplus of the OPEC countries on a transactions basis was substantially larger. However, owing to the usual credit terms for the oil companies' payments the end-1973 price increases affected the actual foreign exchange receipts of the oil countries only after a certain time lag.

disturb foreign exchange markets as well as exchange rate relationships. In 1974 there were no major problems of this kind. The massive influx of petrodollars into the United States and the United Kingdom was needed by these two countries to finance their respective balance of payments deficits. In the United States the oil money inflow of US$ 11 billion matched the deficit of almost equal size in the basic balance (which does not include the influx of funds from monetary authorities of oil countries). The United Kingdom even had to borrow several additional billions of dollars through other channels. The oil billions lent to international organisations were re-channelled to the deficit countries needing them most. It was the Euro-currency markets, however, that proved to be the main turntable for recycling the oil billions. The Euro-banks were able to lend to final borrowers amounts even in excess of the US$ 23 billion deposited by the oil countries. At any rate, publicised loan commitments entered into by Euro-banks in the form of medium-term roll-over credits totalled over US$ 30 billion in 1974; this means that besides petrodollars other funds also flowed to the Euro-markets or were provided as a result of credit creation by the Euro-banks.

Short-term investment of petrodollars encounters some limits

Investing petrodollars in the Euro-currency markets has the advantage that these markets, in their capacity as a turntable, can recycle these funds in a very flexible manner to the various deficit countries, provided that the borrowers or borrowing countries make appropriate efforts to maintain their creditworthiness and not to overtax their borrowing potential. But an excessive concentration of the oil billions in the Euro-currency markets is not without problems. Up to now, the oil countries have in most cases invested their foreign exchange surpluses in these markets at very short term so that disturbances arising out of a shift into other forms of investment or other currencies cannot be ruled out in the event of confidence crises or for other reasons. There are also practical limits to the capacity of Euro-banks to recycle petrodollars. They are to be found in the capital ratios of the banks concerned and in the liquidity risks inherent in maturity transformation. Furthermore, over time the solvency risk, i. e. the creditworthiness and external borrowing limitations of individual borrowers or deficit countries, may assume more importance. It is therefore not surprising that the proportion of petrodollars recycled via the Euro-banks is no longer quite so large as it was in the first half of 1974. What is surprising is that the Euro-markets recovered so quickly after the setbacks in the summer months of last year caused by a loss of confidence resulting from bank failures and excessive strains. A factor contributing to the consolidation of the Euro-markets was that in September 1974 the central banks of the Group of Ten countries and Switzerland clearly defined their respective roles as lenders of last resort for the Euro-banks and that at the same time the Bank of England took steps to clarify the responsibility of the parent banks for consortium banks operating in the London Euro-market. But all this by no means removes the above-mentioned limits to the recycling capacity of the Euro-banks.

It would be premature to draw over-optimistic conclusions from the fact that the oil deficits have passed their peak and that it has so far been possible to finance them relatively easily. First, it is not certain whether in future the surplus funds of the oil countries will continue to flow as smoothly either direct to countries in need of foreign exchange or via international channels such as the Euro-markets and international organisations, to these countries. Second, with persistent large deficits on current account the external borrowing potential of individual countries as well as their future transfer capacity may emerge as a problem. Third, the investment policies of the major oil surplus countries will inevitably raise more problems as the volume of their foreign exchange surpluses grows. The fact that in the longer run the main surpluses will be concentrated in a few thinly populated desert countries and the main deficits in relatively few extreme debtor countries accentuates these problems. This may eventually turn into a severe burden for the international monetary and payments system. All this reinforces the conclusion that a rapid reduction in balance of payments disequilibria is more important than smooth recycling.

Attempts at diversifying oil fund investments create new problems

For some time it has been evident that a number of oil countries have been striving for greater diversification in their investments. This is true as concerns both the forms and the currencies of investment. As regards the former, the emphasis is no longer so exclusively on the investment of funds in a liquid form; the surpluses are now increasingly being invested in longer-term direct loans and "real assets", i. e. property, shares, and other holdings. As to the currencies involved, there is an increased interest in investments in so-called "strong" currencies. Both types of diversification raise problems which at times have also affected the Federal Republic of Germany as a haven for petrodollars seeking investment. Only some of the monetary problems involved are considered here.

In the first three months of 1975 the Bundesbank had to take in foreign exchange equivalent to roughly DM 5 billion, and inflowing petrodollars probably contributed towards this foreign exchange surplus. A continuation of such inflows would push up the exchange rate of the Deutsche Mark. Should the Bundesbank try to mitigate such a rise by large foreign exchange purchases this would swell domestic liquidity and therefore pose a problem from the point of view of domestic monetary stability.

Since the late autumn of 1974 the Swiss monetary authorities have been confronted with this dilemma in an accentuated form. They were forced to tolerate a sharp appreciation of the Swiss franc, even though they purchased large amounts of foreign exchange in the market to counteract this pressure and at the same time tightened the direct controls against capital inflows.

For countries with a surplus in their balance of payments, taking in large amounts of inflowing oil funds and recycling the resultant foreign exchange surpluses to deficit countries would not be a permanent solution. This would be tantamount to countries with strong currencies having to incur debts in their own currencies vis-à-vis the oil countries or having to transfer valuable industrial holdings to them and to convert the foreign exchange proceeds resulting therefrom into non-liquid claims on countries with weak currencies. No country could bear the inevitable liquidity and solvency risks involved for an indefinite period. Furthermore, recycling inflowing petrodollars in this way, particularly if undertaken via official institutions, would do nothing to alleviate the monetary problems connected with foreign exchange inflows — a swelling of domestic liquidity and/or upward pressures on the exchange rate. It would therefore be a better solution to the problem if international organisations offered sufficiently attractive investment outlets to the oil countries and then recycled these funds as required, with economic policy conditions attached to them. Thus, not only the industrial countries in need of foreign exchange but also those with strong currencies have a common interest in ensuring that the surpluses of the oil countries, which will be unavoidable for some time to come, are tied down in longer-term assets and channelled to countries where they are really required. For this purpose it is, however, necessary for the deficit countries to maintain and improve their international creditworthiness by making tangible progress in the reduction of their current account deficits.

3. Arrangements for recycling oil funds

Recycling oil and other surplus funds through the IMF . . .

In order to facilitate an appropriate recycling of oil funds, the Federal Republic of Germany and other industrial countries with strong currencies have supported the creation of a second oil facility within the International Monetary Fund. As compared with the IMF's first oil facility of some SDR 3 billion established last year, this new facility is planned to be larger, namely up to SDR 5 billion (about US$ 6.2 billion). Apart from the SDR value guarantee, it is to offer lenders an interest rate closer to the market rate (7¼ % has been envisaged). The resources of the new oil facility are to be used for loans of up to 7 years. In contrast to the first oil facility, more attention will now be paid to linking its utilisation with measures designed to reduce the balance of payments deficit and to conserve oil. Countries making funds available to the IMF under the oil facility acquire a so-called "reserve position" in the Fund, similar to the one obtained in the gold and super gold tranches in the IMF when their currency is drawn. The lenders under the oil facility thus acquire reserve assets which can be mobilised at any time in case of need and can be treated by central banks as fully-fledged monetary reserves. It was not least this fact which enabled the Deutsche Bundesbank to agree to a loan of up to SDR 300 million to the IMF for the second oil facility, in much the same way as Switzerland, the Netherlands and other industrial countries with strong currencies have done.

... and the EEC

The Community borrowing scheme of the EEC countries ("Community loans") decided on at the beginning of 1975 is also an international mechanism for attracting and recycling oil funds. Medium-term borrowings by the EEC in the international financial markets or direct from oil countries, up to a maximum of US$ 3 billion, are to be secured by guarantees of all EEC members to the Community. The funds thus raised are to be recycled to EEC countries in need of foreign exchange, on market terms and subject to economic policy conditions imposed by the EEC Council of Ministers. The guarantee of each member country is limited to twice its quota. The Federal Republic of Germany, whose quota is roughly 22 %, thus guarantees up to 44 % of the aggregate amount. Although the formal conditions for Community borrowings have been in existence for several months, no loans have been raised so far. This is mainly because recent improvements in the foreign exchange positions of major deficit countries in the EEC have reduced interest in such borrowing for the time being.

OECD Fund as a safety net

The Financial Support Fund of the OECD established in April 1975, also termed the "Kissinger Fund" after one of its initiators, differs from these and similar facilities for recycling petrodollars in several respects. The Fund will deliberately refrain from drawing on the foreign exchange surpluses of the oil countries for its financing, or at least from drawing on them directly. Thus one of the major advantages of the other mechanisms already described, namely that of tying up oil funds for years to come, is lacking here. In contrast, the OECD Fund is in case of need to be provided with contributions from the OECD members themselves; their contributions may, however, take the form of government guarantees, enabling the Fund to raise the capital required in national and international financial markets. Unlike the IMF, the OECD Fund lacks adequate liquid reserves to guarantee the lenders — in so far as they make direct contributions from their reserves — immediate repayment or mobilisation of their loans if necessary, and thus to impart to their loans the character of reserve assets. The Fund is a mutual support facility of the OECD members and is only regarded as a safety net and last resort after the fullest possible use has been made of all other sources of credit and national reserves. If an exceptional emergency arises, a Governing Committee will decide on borrowing, financing and conditions on a case-by-case basis. This mechanism is to remain in force for two years only, i. e. for the presumed period of immediate threat posed to the international monetary system because of the oil price increase. The Fund's total volume is to be about US$ 25 billion. Germany's share will be 12½ % of the total, i. e. slightly more than US$ 3 billion. The Federal Government has stipulated that its support will not be provided in the form of direct financial contributions, but in the form of guarantees for borrowing operations by the Fund. Since the money is to be obtained as far as possible in the capital markets, the borrowing country, in principle, will be charged market loan terms. It is to be hoped, and in fact its main proponents expect, that this support mechanism will not have to be activated but that it will fulfil its function through its very existence as a "fleet in being" for extreme emergencies.

4. Disturbances in the balance of payments structure of industrial countries

Deterioration in current accounts ...

The OECD group of countries, comprising nearly all western industrial countries, recorded an overall current account deficit in 1974 of some US$ 33 billion (see table "Current balances of OECD countries" on page 50). As compared with 1973 this meant a deterioration of almost US$ 36 billion. This was, however, much less than the additional burden of about US$ 65 billion that the OECD countries had to bear owing to the increase in oil prices. As already mentioned, these countries were not only able to offset part of the additional burden by sharply increased exports to the OPEC area; they also achieved unexpectedly large trade surpluses vis-à-vis developing countries and eastern countries. To be sure, they had to finance part of these larger surpluses themselves by granting additional trade credit and development aid.

Current balances of OECD countries *

Billions of U.S. dollars

Country	1969	1970	1971	1972	1973	1974
EEC countries	+ 3.7	+ 2.9	+ 5.4	+ 5.8	+ 0.8	—13.0
of which						
Germany (Federal Republic)	+ 1.9	+ 0.9	+ 0.9	+ 0.8	+ 4.4	+ 9.4
Netherlands	+ 0.0	— 0.5	— 0.2	+ 1.1	+ 1.8	+ 1.8
Belgium-Luxembourg	+ 0.5	+ 0.7	+ 0.5	+ 1.4	+ 1.4	+ 0.5
France	— 1.6	+ 0.1	+ 0.5	+ 0.3	— 0.7	— 6.0
United Kingdom	+ 1.1	+ 1.7	+ 2.7	+ 0.3	— 2.9	— 9.1
Italy	+ 2.3	+ 0.8	+ 1.6	+ 2.0	— 2.4	— 7.9
Denmark	— 0.4	— 0.5	— 0.4	— 0.1	— 0.5	— 1.0
United States	— 1.6	— 0.3	— 3.8	— 9.8	+ 0.5	1 — 1.3
Canada	— 0.8	+ 1.1	+ 0.3	— 0.7	— 0.4	— 1.9
Japan	+ 2.1	+ 2.0	+ 5.8	+ 6.6	— 0.1	— 4.5
Other OECD countries	— 1.1	— 2.0	— 1.0	+ 1.5	+ 1.7	—12.8
All OECD countries	+ 2.3	+ 3.7	+ 6.7	+ 3.2	+ 2.5	—33.5

* Balances of trade, services, and private and official transfers (transactions basis). — 1 In 1974 excluding some exceptional official transfers to less developed countries totalling US$ 2.7 billion. — Sources: National statistics and OECD.

In 1975 the current account deficit of the OECD group is likely to fall by a significant amount compared with 1974. According to recent estimates it is to be expected that under certain assumptions the overall deficit of the OECD countries on current account may have disappeared by 1980.

... distributed very unevenly among individual countries

Such a relatively optimistic global view of the balance of payments prospects of the OECD countries as a group should not, however, mislead one into underrating the difficulties posed by the present international balance of payments situation. There are, for instance, still great difficulties for those developing countries that neither produce oil nor were in a position to benefit from soaring prices in other raw material markets. But also among the OECD countries very diverse developments in individual cases lie behind the global figures. The overall OECD deficit on current account of some US$ 33 billion in 1974 was made up of deficits in a number of countries totalling more than US$ 45 billion and of surpluses in a few countries totalling US$ 12 billion. The Federal Republic of Germany alone accounted for a current surplus of nearly US$ 10 billion.

Among the major industrial countries three groups can be distinguished. One group, represented mainly by the United Kingdom and Italy, was already recording large deficits on current account before the price increase for oil. Throughout 1974 these countries were unable to reduce their non-oil deficits sufficiently, let alone to offset the extra oil burden by additional exports to a degree similar to that reached by other industrial countries.[1] Another group of countries achieved surpluses on current account despite the heavy supplementary burden resulting from the oil price increases – a burden which for the Federal Republic of Germany, for instance, was larger in absolute terms than for the United Kingdom or Italy. Apart from the Federal Republic of Germany, this group of countries in Europe comprises the Benelux countries and Switzerland. Other countries, such as Norway, Sweden and Canada, are able to finance their current deficits easily because of a favourable structure of their capital accounts. A third group of countries, including among the larger ones the United States, Japan and France, have in common that they have offset a considerable part of the balance of payments burden caused by oil prices through improvements in other current account items. These three countries, moreover, have had the financing of the remaining deficits well under control so far.

1 Owing to the fact that already in 1974 some part of the additional burden resulting from the oil price increase could be offset by additional exports to the oil countries, it would not be correct — as is still the practice in several countries — to equate the so-called "oil deficit" simply with the additional burden on the balance of payments resulting from the rise in oil prices (let alone with the total cost of oil imports). Rather, if the concepts of "oil deficit" and "non-oil deficit" are to be used at all for balance of payments policy, one should follow a recommendation by the IMF, i. e. to deduct an appropriate (normative) share of the country concerned in the higher imports of the oil countries from the gross burden due to the higher oil prices, in order to arrive at an "adjusted oil deficit".

Finally, the balance of payments developments of the "other OECD countries" (see table opposite) must also be taken into account. In 1974, this group of twelve smaller OECD members recorded an extraordinary deterioration on current account exceeding by far the additional burden due to oil prices. In this group, the main countries contributing to the total deficit of some US$ 13 billion were Australia, Spain, New Zealand, Finland, and Greece as well as Sweden and Norway, which have already been mentioned. In 1975, a further deterioration appears possible, which would imply that over 50 % of the overall OECD current deficit would then be concentrated in this group of countries.

Inflation differential as main cause of the balance of payments disequilibria among the industrial countries

The causes of the balance of payments discrepancies among industrial countries in the period under review are complex. They are not primarily related to the uneven burden resulting from the increase in oil prices. Some major countries coped relatively quickly with the rather heavy payments burden imposed upon them by soaring oil prices. This not only applies to the Federal Republic of Germany, which represents an extreme case on the surplus side, but also to the United States, whose additional burden of roughly US$ 17 billion was largely offset by an improvement in other current account items, and to Japan, which already in 1974 compensated two thirds of the additional oil burden of US$ 12 billion. Of decisive importance for the balance of payments developments in individual countries was, first, their starting position at the beginning of the period of more expensive oil and, second, their diverse efforts and successes in combating inflation.

The one-sided concentration of large current deficits in a few countries constitutes a permanent potential threat to international monetary relationships. Therefore, a gradual reduction, and finally elimination, of the exorbitant balance of payments discrepancies among the industrial countries is as important for the world's monetary equilibrium as the gradual reduction in the global deficit in relation to the oil-exporting countries. It is encouraging that trends in the last few months reveal some progress regarding the diminution of individual balance of payments disequilibria.

First successes in the adjustment of major deficit countries

As already mentioned, great progress was made by Japan and France; in 1975 current deficits of only about half the size incurred in 1974 or even less are anticipated for both countries. But also in Italy, with its extreme deficit, the balance of payments has been improving visibly since as long ago as mid-1974, a few months after the inception of a monetary and fiscal programme to curb inflation. Even in the case of the United Kingdom – the only major industrial country that so far has not recorded any progress in combating inflation – some improvement in the current account has been noticeable of late, though this was more a result of the cyclical slowdown in imports than of improved competitiveness and ability to deliver export goods.

Despite these signs of improvement the international balance of payments situation is still somewhat precarious. For even with the expected improvement in individual balances of payments, the total of current deficits to be financed in 1975 might still amount to approximately US$ 35 to 40 billion for the OECD deficit countries, with the European OECD deficit countries alone accounting for about US$ 20 to 25 billion.

These figures forcefully demonstrate how crucial it is to achieve further progress in balance of payments adjustment. Until better equilibrium is accomplished generally a difficult financing problem will still remain for the transitional period.

5. Financing the balance of payments deficits

Financing the deficits . . .

In 1974 the financing problems were solved smoothly, partly with the help of a sharp expansion of international liquidity. Even the large deficits of the non-oil-exporting developing countries did not present insuperable difficulties. These countries were in a position to finance their deficits without being forced on balance, i. e. as a group and for the year 1974 as a whole, to draw on their monetary reserves. On the contrary, the reserves of this group of countries still rose by over US$ 2 billion in 1974. Up to now their financing problems have been solved mainly in four ways: increased assistance from OECD countries, surprisingly large financial aid by the OPEC countries, continued heavy borrowing in the Euro-markets by quite a number of countries in this group (the known medium-term Euro-loans taken up by these countries alone amounted to roughly US$ 8.5 billion in 1974), and finally, greater support from the IMF, the World Bank and other international and supra-regional organisations. In 1975 the problem of financing will presumably become more difficult for many non-oil-producing developing countries, not least because their own foreign exchange receipts will be lower on account of raw material prices having fallen in the meantime, and owing to their limited capacity to incur debt in the form of Euro-loans. As has become apparent in several countries already in the last few months, in 1975 a number of less developed countries will probably have to draw on their monetary reserves, which in some cases have increased strongly in recent years.

... through borrowing, including official financial support

As already mentioned, deficit countries in the OECD area had to cope with current account deficits of no less than US$ 45 billion in 1974. Even though some smaller countries in this group had to draw on their monetary reserves, the group as a whole was able to finance the deficits without reducing gross monetary reserves (see table "Changes in world monetary reserves"). So here, too, the deficits on current account were covered by borrowing. Only a few OECD countries, and of the larger industrial countries only Italy, had to take recourse to official financial support. Already in 1973, before oil prices soared, a credit line of nearly 1.6 billion units of account (some US$ 1.9 billion) had been opened to Italy under the EEC short-term financial support mechanism, with the Deutsche Bundesbank contributing 403 million units of account. This credit line was drawn upon in March 1974, then repaid after several renewals in December 1974, and replaced by a loan with an average maturity of 3½ years under the EEC medium-term financial assistance mechanism. Furthermore, Italy was able to draw a total of some SDR 1 billion (about US$ 1.2 billion) under its IMF quota in several instalments in 1974, with a final tranche of SDR 0.3 billion being drawn in March 1975. These drawings were based on a stabilisation programme agreed upon with the IMF and reinforced by the EEC in connection with the use of its medium-term financial assistance mechanism. In retrospect it may well be said that this stabilisation programme, supplemented by measures taken by Italy on its own initiative, marked the beginning of the improvement in Italy's current account. In addition to its normal IMF drawings, Italy obtained some SDR 0.7 billion under the special "oil facility" of the IMF. Finally, in September 1974, the Deutsche Bundesbank granted the Banca d'Italia a six-month loan (with provision for several renewals) of US$ 2 billion against the deposit of an equivalent amount of monetary gold valued at US$ 120 per ounce fine. Technically, this loan operation was carried out by the Deutsche Bundesbank depositing U.S. dollars with the Banca d'Italia which for its part established a corresponding gold deposit in favour of the Bundesbank. Beyond its immediate purpose, this transaction was of fundamental significance since it demonstrated that under certain conditions, in spite of all difficulties, it is possible for central banks to utilise their monetary gold for the financing of balance of payments deficits. After the first six months, i. e. at the beginning of March 1975, the Banca d'Italia repaid one quarter of this foreign exchange loan; the remaining three quarters were renewed for a further six months. All in all, Italy raised some US$ 5.9 billion in official foreign exchange loans in the course of 1974.

The other large deficit countries of the OECD managed without official financial support in 1974. However, like Italy, they raised large amounts of medium and longer-term loans in the international financial markets, predominantly in the form of roll-over credits from Euro-banks. Some of the borrowers were government agencies, whilst others were public or private enterprises. In addition, several countries received large U.S. dollar deposits from certain oil countries, representing in effect prepayments several years in advance for goods and technological know-how to be supplied later. For its part the United Kingdom had, besides these financing facilities, the special advantage that several oil countries invested a considerable proportion of their oil receipts in sterling reserves on account of their traditional close ties with the United Kingdom as well as for interest rate reasons.

Changes in world monetary reserves between end-1971 and end-1974 *
(Gold, special drawing rights, IMF reserve positions, foreign exchange)

Billions of U.S. dollars

Country	Total reserve assets at end of		Change		
	1973 **1**	1974	1972	1973 **1**	1974
1. United States	14.4	16.1	— 0.0	+ 1.2	+ 1.7
2. Other industrial countries	100.6	103.8	+11.7	+ 8.1	+ 3.2
of which					
Germany (Federal Republic)	33.1	32.4	+ 5.1	+ 9.4	— 0.7
France	8.5	8.9	+ 1.8	— 1.5	+ 0.3
United Kingdom	6.5	6.9	**2** — 0.9	+ 0.8	+ 0.5
Italy	6.4	6.9	— 0.7	+ 0.4	+ 0.5
Japan	12.2	13.5	+ 3.0	— 6.1	+ 1.3
3. Other developed countries **3**	24.3	21.3	+ 7.9	+ 3.1	— 3.0
All developed countries	139.3	141.2	+19.5	+12.4	+ 1.9
4. Oil-exporting countries **4**	14.6	47.1	+ 2.5	+ 3.7	+32.5
of which					
Saudi Arabia	3.9	14.3	+ 1.1	+ 1.4	+10.4
Iran	1.2	8.4	+ 0.3	+ 0.3	+ 7.1
Venezuela	2.4	6.5	+ 0.2	+ 0.7	+ 4.1
Nigeria	0.6	5.6	— 0.0	+ 0.2	+ 5.0
Libya	2.1	3.6	+ 0.3	— 0.8	+ 1.5
5. Other less developed countries	30.2	33.7	+ 6.2	+ 9.0	+ 3.5
All countries	184.1	222.0	+28.2	+25.1	+37.9
Memorandum item:					
EEC countries	68.6	69.6	+ 6.9	+12.4	+ 1.1

Source: International Financial Statistics of the IMF. — * Gross reserves, including allocations of SDRs. — **1** Including increase in the dollar value of reserves due to the devaluation of the dollar on February 14, 1973 (about US$ 7 billion). — **2** The actual outflow of reserves was about US$ 1.9 billion (net) higher. This amount results from the liquidation of US$ 2.2 billion of "special swaps" and the repayment of US$ 0.3 billion of debt to the IMF (within the credit tranches). — **3** Finland, Ireland, Spain, Portugal, Greece, Turkey, Yugoslavia, Malta, Australia, New Zealand, South Africa. — **4** Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Saudi Arabia, Trinidad and Tobago, Venezuela.

Increase in reserves of the oil countries financed by creation of new monetary reserves

As may be seen from the table on this page showing changes in world monetary reserves, the above-mentioned sources of finance were so abundant and apparently functioned so smoothly in the period under review that even the main deficit countries among the industrial nations were not obliged to draw on their monetary reserves but on the contrary were able to build them up slightly, whereas the reserve account of Germany closed with a deficit in 1974. The officially recorded monetary reserves of the oil countries rose by roughly US$ 33 billion in 1974. However, this increase in reserves was not at the expense of the gross reserves of the rest of the world, at least not from a global point of view; instead, it was made possible by an even larger creation of new monetary reserves amounting to over US$ 36 billion. The main sources of this reserve creation were additional monetary liabilities incurred by the "traditional" reserve currency countries, the United States and the United Kingdom, amounting to about US$ 13 billion, reserve creation in the Euro-currency markets estimated at US$ 12 to 15 billion, and reserve credits by the IMF and official agencies in Europe totalling some US$ 7 billion.

Notwithstanding the foreign exchange needs of individual deficit countries there can thus certainly be no question of a lack of "international liquidity". On the contrary, at the end of 1974 the gross monetary reserves of the world, at US$ 220 billions (gold being valued at its former official price), were 20% larger than in 1973 and no less than 70 % larger than three years earlier. Confronted with the inevitable reserve accumulation by the oil countries, the international monetary system has so far created "spontaneously" even more additional reserves than were required for this purpose. In the light of this experience it is understandable that a new allocation of special drawing rights is generally deemed untimely at present. In view of the evident extraordinary capacity of the world monetary system to create reserves autonomously, the question remains how better control of international liquidity, which originally had been aimed at within the framework of the world monetary reform, can ever be achieved.

6. International inflation differential and monetary developments

Increase in the inflation differential between industrial countries

As already noted, the wide inflation differential between the various industrial countries was one of the main causes of their divergent balance of payments and exchange rate trends. The current wave of inflation reached its peak in 1974 under the impact of the surge in oil prices; but it had started long before – namely in 1972 – and in 1974 it went far beyond the oil-price-induced rise in costs. As measured by the cost of living, the pace of price increases in the industrial countries (excluding the Federal Republic of Germany) nearly doubled on average from 1973 to 1974, rising from 7.6 % in 1973 to 13.5 % in 1974 (see table in Section I, page 16). With the acceleration of inflation, discrepancies in the price trends in individual countries grew as well. In the group of the major industrial countries the difference between the highest and lowest rates of inflation, which was 5½ percentage points in 1973, increased to as much as 17 percentage points in 1974. Such wide divergencies in price movements – which as a rule reflect corresponding differences in domestic supply and demand trends – are bound to affect the balances of trade and payments. It is therefore not surprising that most of the countries with the highest rates of inflation belong to the group with extreme current deficits. Conversely, the countries at the lower end of the inflation scale usually achieved the best balance of payments results. Of course, the inflation differential as measured by price indices does not explain all the special characteristics of balance of payments developments. Japan, for instance, which in 1974 had to bear the highest inflation rate of all major industrial countries, was nevertheless able already in the course of last year to make much greater progress towards correcting its initially very large current deficit than, say, the United Kingdom or Italy, which ranged lower than Japan on the inflation scale in 1974. The rapid improvement in the Japanese current account was primarily due to a more stringent restrictive policy than that of most other deficit countries. This policy, supported by the world-wide turn-around in raw material prices, has of late also been clearly reflected in Japanese price developments as well as in the current account, which has almost reached balance. In several other major industrial countries, too, the restrictive policies introduced to combat inflation have achieved visible success in the last few months, and in most cases have been accompanied by a distinct improvement in the trade and current accounts. This holds true for France and the United States, for example. Overall, the average inflation rate in a group of major industrial countries (excluding the Federal Republic of Germany) has most recently – i. e. in the three months from December 1974 to February 1975, as compared with the preceding three months – been 11 % (at an annual rate), whereas it had been over 15 % at the peak of inflation (see table on page 55). In the Federal Republic of Germany, however, the annual rate of price increases on the basis of the comparison between the above-mentioned three-month periods was only 4.7 %. Thus the discrepancy in price developments between major foreign countries and Germany continues to exist.

Germany breaking away from the international inflation trend

The fact that German price movements broke away from the international price trend can be traced back to the floating of the Deutsche Mark in the spring of 1973. Between the beginning of 1972 and spring 1973 the German inflation rate had not been much below the average of the other industrial countries, and had been considerably higher than in the United States. After the transition to floating in March 1973, the restrictive policies introduced at the same time rapidly curbed the rate of inflation in the Federal Republic of Germany, though the direct and indirect repercussions of the surge in oil prices at end-1973 extended the time lag for the braking process by nearly a full year. But it has at any rate been demonstrated that with the help of a flexible exchange rate a country determinedly pursuing a domestic stabilisation policy can – even under difficult external circumstances – manage to detach itself from the convoy of international inflation.

Rates of inflation in major industrial countries

Percentage rise in the cost of living index

Country	Change on previous year			Change on previous three-month period at annual rate
	4th qtr 1973	4th qtr 1974	Dec. 1974 to Feb. 1975	Dec. 1974 to Feb. 1975
Germany (Federal Republic)	+ 7.3	+ 6.5	+ 5.9	1 + 4.7
Compare:				
Major industrial countries excluding Germany 2	+ 9.6	+ 15.0	+ 13.9	+ 11.1
of which United Kingdom	+ 10.3	+ 18.2	+ 19.7	+ 24.8
Italy	+ 11.7	+ 24.7	+ 24.0	+ 17.6
France	+ 8.3	+ 15.0	+ 14.5	+ 12.1
United States	+ 8.4	+ 12.1	+ 11.6	+ 8.5
Japan	+ 16.4	+ 24.6	+ 17.7	+ 8.9

1 Seasonally adjusted. — 2 France, United Kingdom, Italy, Belgium, Netherlands, Norway, Sweden, Austria, Switzerland, United States, Canada, Japan. Weighted with these countries' shares in the GNP of the OECD countries in 1970.

7. Exchange rate movements and exchange rate policy

Floating of the Deutsche Mark to protect domestic stabilisation policy

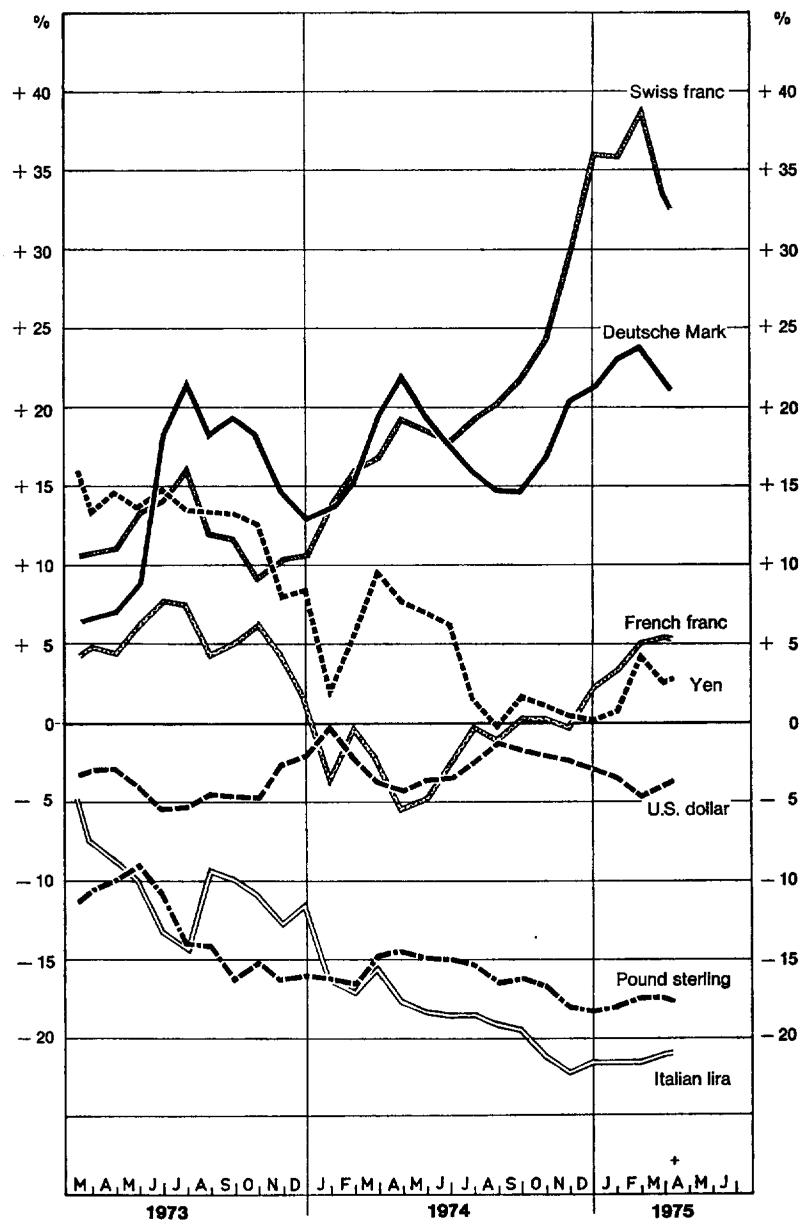
In retrospect it can be seen that the suspension of mandatory support of the U.S. dollar and the floating of the Deutsche Mark in March 1973 were not only inevitable under the prevailing circumstances, but also proved effective in the subsequent period as a flanking measure and as a shield to domestic stabilisation policy. Without flexible exchange rates vis-à-vis the U.S. dollar and other major currencies German monetary policy would hardly have had a chance in the following turbulent years to protect its efforts to achieve domestic stability against disturbances created by interest-rate-induced and speculative capital inflows and against the general inflation marasmus in the world economy. The appreciation of the Deutsche Mark following the decision to float dampened the effects both of the soaring raw material and oil prices of 1973—74 and of the inflationary demand pull from abroad on the German economy. Effective protection through flexible exchange rates against disturbing money flows also enabled the Federal Republic to dismantle in the course of 1974 most of the emergency measures taken against disruptive capital inflows from abroad, including the authorisation requirement for external borrowing, the sale of domestic securities to non-residents, and foreign direct investments, as well as the cash deposit ("Bardepot") requirement.

The potential for monetary disruptions from abroad has continued to grow in the period under review, not least due to the continued accumulation of huge liquid funds in the hands of a few oil countries. Moreover, the Deutsche Mark is still a potential currency of refuge for foreign funds seeking safety, although to a lesser extent than the Swiss franc. These two circumstances alone would make it very difficult to maintain fixed exchange rate relationships with mandatory intervention in the foreign exchange markets. Moreover, a system of fixed exchange rates is practically impossible as long as economic and monetary developments in important countries, and particularly their rates of inflation, diverge as much as they have done in the last few years. Hence, for some time to come there is no real chance of returning to a general system of fixed exchange rates. In the efforts to reform the international monetary system we will therefore have to be content for the time being with partial, step-by-step adjustments through ad hoc revisions of particular international monetary rules.

Exchange rate changes alone neither a cure for balance of payments disequilibria . . .

The last few years, however, have also revealed the limitations of exchange rate changes — be it via flexible rates or through parity changes — as an instrument for payments adjustment. The expectation that imbalances in the external position could be redressed by exchange rate changes alone and without any other efforts has been disappointed in a number of cases. From the outset, this has been true of the global balance of payments disequilibrium vis-à-vis the oil countries, which partially escapes the normal rules of adjustment — at least in the shorter run — due to the limited absorptive capacity of these countries. It has also applied to

Effective changes in the external value of major currencies against all currencies since the beginning of the joint float, in relation to the central rates of end-1971 *



* Based on the official spot middle rates (end-of-month figures) in Frankfurt in relation to the central rates of the realignment of December 18, 1971. The weights were chosen in accordance with the regional pattern of the average foreign trade turnover (exports + imports) of the individual countries, classified by countries of origin and countries of destination, in 1971-1973.- + Latest position: April 4, 1975.

some of the huge imbalances among the industrial countries, mainly because domestic economic policy was not oriented towards balance of payments needs, but partly also because some countries hesitated to fully accept for their currencies the market rates of exchange without supporting interventions. Accordingly, there can at present be no talk of a system of freely fluctuating exchange rates but only of managed floating.

As regards the effect of exchange rate changes on balance of payments adjustment, developments in major countries (see table on page 50) illustrate that the considerable shifts in exchange rate relationships which have occurred since 1972 had not led to better current account equilibrium by 1974. The discrepancies in the current accounts even increased in 1974, without this being explained by different absolute burdens resulting from the oil price increase. This applies, in particular, to the situation between Germany and the main deficit countries in Europe. The strong rise in the external value of the Deutsche Mark – of about 21 % on a weighted average between end-1971 and end-1974 – as well as the simultaneous downward movement of the pound sterling and the Italian lira, for instance, failed to prevent the German surpluses on the one hand and the British and Italian deficits on the other from growing further in 1974, even if the burden due to oil prices is left out of account. Here, as in some other cases, the effect of exchange rate changes on trade competitiveness was, at least for a time, compensated by other factors. These include first of all the differing trends in domestic demand and inflation rates, but also special influences on the capacity of individual countries to deliver export goods.

Developments in Japan and France (see pages 50/51), and of late also in Italy and in the United Kingdom, show that, as a rule, domestic economic policy and exchange rate policy must operate in concert if better equilibrium in the balance of payments is to be achieved. Only in the case of the United States has exchange rate policy worked relatively quickly in the direction of better adjustment of trade and payments. Here the several exchange rate depreciations of the U.S. dollar between 1971 and the spring of 1973 produced a clear tendency towards an improvement in the balance of payments from mid-1972 onwards. Since then, the U.S. share in world exports of industrial goods has risen almost continuously. This was complemented by the slowdown in domestic economic activity in 1974. Thus in 1974 the United States was able to offset a major part of the oil-induced burden on its balance of trade amounting to no less than US$ 17 billion through an improvement in the rest of its current account.

. . . nor a carte blanche for domestic economic policy

Experience gained so far leads to the following conclusions: increased exchange rate flexibility may be very useful in supplementing a domestic policy of stability. It is not, however, a carte blanche for domestic economic policy. For the extreme deficit countries this implies the necessity to exercise greater restraint than countries with strong currencies in expanding domestic demand. In the present situation of the world economy, with the forces of international inflation having diminished in strength, the latter countries now for the first time have an opportunity to take the lead in the process of stimulating business activity internationally without endangering their domestic stability. Thus the present German policy of economic expansion has an important external and international significance, even though it is mainly prompted by domestic considerations.

No danger of competitive depreciation

As mentioned above, the effectiveness of flexible exchange rates as an instrument for achieving better balance of payments equilibrium was somewhat impaired in the period under review by the fact that some countries were not prepared to fully accept the market-induced downward movement of their currencies, mainly because they were apprehensive of the resulting upward pressure on import prices (in terms of national currency) and thus on their national price levels. At times they supported the exchange rates of their currencies by massive intervention, either through sales of foreign exchange in the market or by systematically raising official and semi-official foreign exchange loans. These direct and indirect supporting measures at times reduced the adjustment effect of flexible exchange rates on the current account. In this connection the Managing Director of the International Monetary Fund, Mr. Witteveen, stated in mid-January 1975: "In this period (i. e. from the beginning of 1973 onwards) the exchange rate changes that have taken place in the major industrial countries have not done a great deal more, by and large, than to compensate for the concurrent differential changes in domestic costs and prices . . . (Consequently) exchange rate changes since early 1973 have not been such as to contribute substantially to adjustment . . ."

The widespread concern at the beginning of 1974 that the huge balance of payments deficits of many countries might produce dangerous competitive depreciations – a concern which led to international agreements or declarations of intent both in the OECD and in the IMF – proved largely unfounded. There was, rather, a tendency here and there to keep exchange rates artificially high in order to counteract domestic inflation. The fact that the strained balance of payments positions of deficit countries occasionally tended to give rise to specific ad hoc measures to bolster exports or diminish imports is a different matter.

8. Exchange rate movements of the Deutsche Mark and the U.S. dollar

Particular significance of the Deutsche Mark/U.S. dollar exchange rate

The movements in the exchange rates of the Deutsche Mark and the U.S. dollar were of particular interest in the period under review.

The U.S. dollar continues to be the most important currency internationally, not only as the currency of the most powerful economy in the western world but also as the key currency for several dozens of currencies pegged to the U.S. dollar (though their number has started to decline of late) and as by far the most important transaction and reference currency in world trade. The development of the Deutsche Mark exchange rate vis-à-vis the U.S. dollar is symptomatic of the exchange rate movements of a whole group of European currencies. This relates not only to the currencies participating in the European currency bloc ("currency snake") but also to a number of others. In addition, since mid-1973 the exchange rate relationship between the Deutsche Mark and the U.S. dollar has been the object of coordinated interventions by both the U.S. and German monetary authorities in order to moderate excessive exchange rate fluctuations.

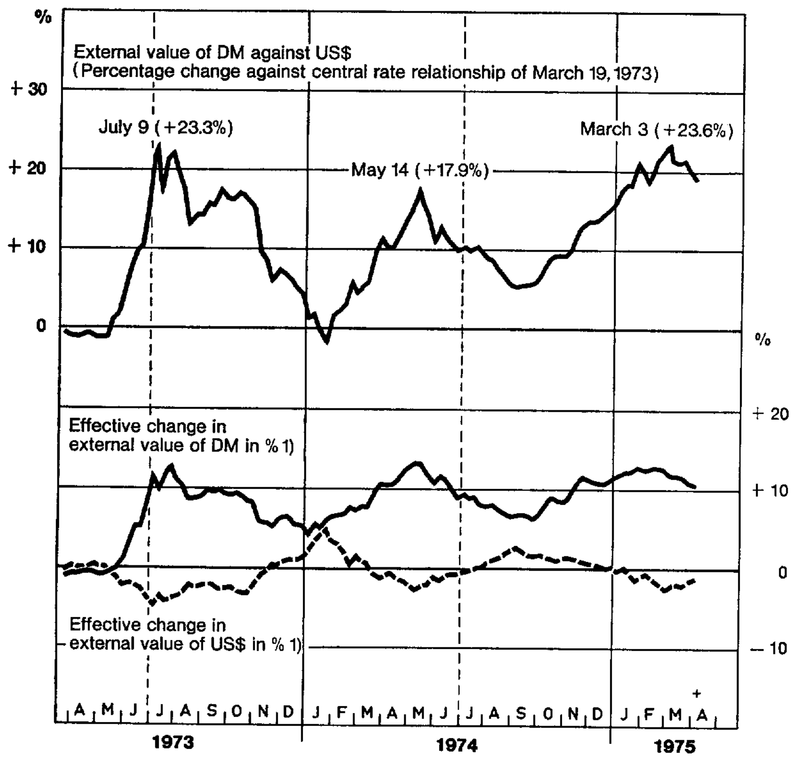
It is therefore not surprising that the exchange rate relationship between the U.S. dollar and the Deutsche Mark attracts particular attention internationally. The question of whether the external value of these currencies is appropriate – or "over"- or "undervalued" – is often evaluated simply on the basis of their bilateral exchange rate. Now the relationship between the Deutsche Mark and the U.S. dollar is certainly of great significance for the relative competitiveness of the United States and Germany and the bilateral trade relations between them. But as regards the overall appropriateness of the external value of a currency, a mere bilateral approach may easily lead to false conclusions. In a period of fluctuating rates between major currencies it is necessary to use, as a rule, a weighted average vis-à-vis a representative group of important currencies as a basis for assessment. This is, by the way, expressly recommended by the International Monetary Fund in its "Guidelines for the Management of Floating Exchange Rates" adopted in June 1974.

Bilateral exchange rate relationships no adequate yardstick

On this wider basis the appreciation of the Deutsche Mark since its transition to floating in March 1973 appears in a different light. Against the U.S. dollar, taken separately, the Deutsche Mark had appreciated by 20 % at the end of March 1975 in comparison with two years earlier; on a weighted average, however, the external value of the Deutsche Mark in relation to the 16 most important currencies (as quoted in Frankfurt) rose only by about 11 %. This average appreciation since March 1973 was very largely, though not fully, offset for German foreign trade by lower cost and price rises in the Federal Republic of Germany; it would, however, be more correct to say that the higher rate for the Deutsche Mark was primarily a consequence of the lower price rise in the Federal Republic.

Conversely, if average movements are taken as a basis, the fluctuations of the U.S. dollar were also far less spectacular than is often assumed in public discussion. Thus at the end of March 1975 the U.S. dollar rate was only 1 % lower on a weighted average than at the beginning of the float two years ago; it must, however, be taken into account that the main downward adjustments in the U.S. dollar rate took place already before March 1973, namely at the end of 1971 and in February 1973. The much discussed "weakness" of the U.S. dollar since the autumn of 1974 also remains within limits if average movements are taken as a basis (just over 3 % in the six months from end-September 1974 to end-March 1975). Above all it becomes apparent that, on a weighted average, the fluctuations of the U.S. dollar have remained within a margin of about ± 5 % in the two years since the beginning of the float and of only ± 2½ % within the last twelve months (see chart opposite).

Changes in the exchange rate of the Deutsche Mark and U.S. dollar since the beginning of the joint float on March 19, 1973

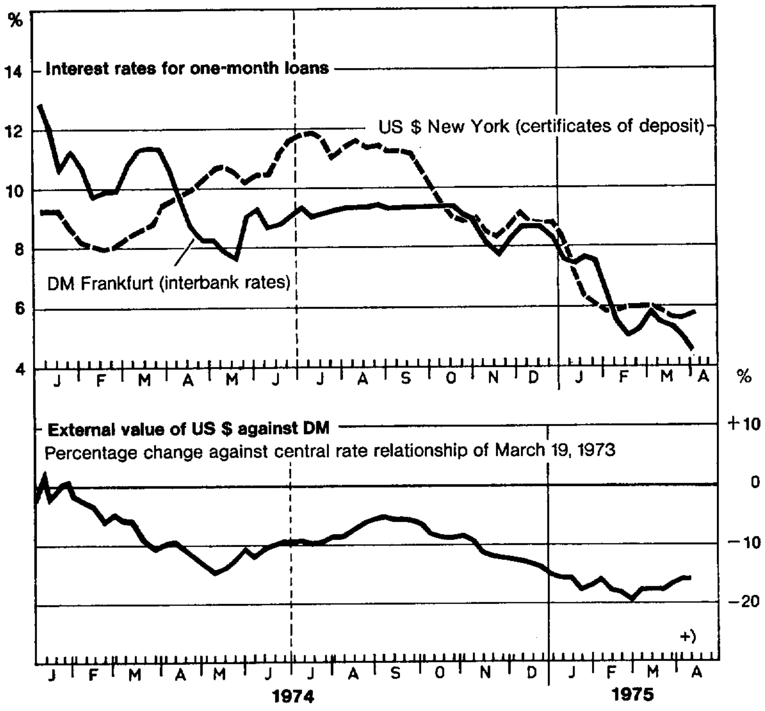


1) Weighted change against the 16 currencies officially quoted in Frankfurt. Based on the official spot middle rates (Friday figures) in Frankfurt in relation to the central rates at the beginning of the joint float on March 19, 1973. The weights were chosen in accordance with the regional pattern of average foreign trade turnover (exports + imports), classified by countries of origin and countries of destination, in 1971–1973.–
+ Latest position: April 4, 1975.

Significance of capital flows and interest rate movements for the external value of the U.S. dollar

Assessing the appropriateness of the external value of a currency is difficult not only because the exchange rate relations vis-à-vis all other partner countries must be taken into account; it is also debatable what standards are to be applied. As regards in particular the relationship between the Deutsche Mark and the U.S. dollar, a comparison of cost and price movements (taking into account the differing levels of productivity) may lead to conclusions different from those reached when comparing the current balance of payments of the Federal Republic of Germany with that of the United States. Moreover, the external value of a currency like the U.S. dollar may over lengthy periods be influenced more by capital movements than by the current account or cost and price differentials. Lasting changes in capital flows, e. g. including the investment of petrodollars, are as fundamental a factor in determining the external value of a currency as changes in the current account. Finally, the experience gathered in the period under review has shown on several occasions how much the dollar rate in relation to European currencies was influenced by changes in interest rates in the United States. The upward trend of the U.S. dollar between mid-May and mid-September 1974 was not least a consequence of the extremely high interest rates prevailing in the United States at that time (see chart "Interest rate movements and U.S. dollar rate" on page 60); the reversal in dollar rate movements in September 1974 coincided exactly with the rapid reduction in interest rates in the United States. In the Federal Republic of Germany, too, the significance of the interest rate differential for the capital account and thus for the exchange rate developments of the Deutsche Mark can be well substantiated by the experience of 1974 and again of March/April 1975. In this connection the hypothesis has been advanced that the U.S. dollar inevitably weakens in a U.S. recession because, although the U.S. trade account improves – as at present – the capital account deteriorates even more owing to the inevitable reduction in interest rates during a recession. However, the interest rate differential alone is by no means sufficient to explain capital and exchange rate movements, as was demonstrated by the particularly strong appreciation of the Swiss

Interest rate movements and U.S. dollar rate



+) Latest position: April 7, 1975.

franc vis-à-vis the U.S. dollar in the first few months of 1975. After all, Switzerland is the only country where interest rates both for short-term and longer-term funds are clearly below U.S. interest rates; in contrast to Germany, Switzerland does not have a significant surplus on current account either. Presumably, therefore, reasons other than the interest rate differential motivated the influx of foreign funds into Switzerland in this period – probably not so much speculative expectations but rather considerations of longer-term safety, the desire to diversify oil funds as well as the repatriation of Swiss assets from abroad.

Principles of intervention in the foreign exchange market

Since floating began the Deutsche Bundesbank has been confronted with the question: to what extent should and can interventions in the foreign exchange market be used to moderate exchange rate fluctuations vis-à-vis the U.S. dollar (and thus indirectly in relation to a number of other currencies)? Since July 1973, when for the first time since floating began hectic fluctuations took place in the exchange markets, the Bundesbank has devoted itself to this task systematically, acting in close consultation both with the U.S. monetary authorities and with those of the European currency bloc. In its intervention policy the Bundesbank's guiding principle is that interventions should be made only for the purpose of maintaining "orderly market conditions", and that fundamental trends in the market should not (and cannot) be counteracted. However, interventions have not only served to maintain orderly market conditions and avoid hectic exchange rate fluctuations from day to day. Rather, the attempt has been made to moderate excessive fluctuations in the Deutsche Mark rate vis-à-vis the U.S. dollar over extended periods of time. This has been done not least also in the interest, and with the full consent, of the other members of the European currency bloc.

As shown in the table on page 61 on changes in the Bundesbank's net external position in the period under review, the interventions in the exchange markets as well as other foreign exchange transactions in this period led to considerable fluctuations in the reserves of the Bundesbank. If the monthly aggregate net reserve movements are taken as a basis, purchases of foreign exchange in 1974 totalled just over DM 8 billion, with sales of foreign exchange amounting to as

Changes in the net external position of the Deutsche Bundesbank since the beginning of 1974 *

Billions of Deutsche Mark

Period and exchange rate trend	Change in net external position: Total	caused by: Interventions within the "snake"	caused by: Other foreign exchange movements
1974			
January: DM weak US$ strong	— 2.54	+ 0.31	— 2.85
February: Markets quiet	— 0.31	— 0.06	— 0.26
March-May: DM rising strongly US$ falling	+ 6.10	+ 4.03	+ 2.07
June: Markets quiet	— 0.36	+ 0.12	— 0.48
July–September: DM falling US$ strong	— 6.43	— 3.51	— 2.92
October–November: DM rising US$ falling	+ 2.01	— 0.73	+ 2.73
December: No clear trends	— 0.37	—	— 0.37
Total	— 1.91	+ 0.17	— 2.08
1975			
January–March: DM rising US$ mainly weak	+ 5.00	—	+ 5.00

* Excluding valuation adjustments.

much as about DM 10 billion; even larger aggregate turnovers would result if daily reserve fluctuations were used as a basis for calculation. Taking 1974 as a whole, reserve movements nevertheless almost balanced each other out. This suggests that over an extended period of time the objective of moderating exchange rate fluctuations was successfully pursued without distorting the fundamental market trends. In some of these periods net reserve movements were, however, so large that their effect on domestic liquidity had to be taken into account by the Bundesbank in its monetary measures. In the first three months of 1975 there was a net inflow of foreign exchange amounting to DM 5 billion. It remains to be seen whether, like last year, this will be offset by subsequent outflows as time passes.

No strains in European currency bloc

As the above table shows, some of the purchases and sales on the foreign exchange market resulted from mandatory interventions by the Bundesbank vis-à-vis other currencies within the European currency bloc that were made in conformity with the existing rules of the so-called "currency snake". This currency bloc which after the withdrawal of France in January 1974 now comprises, of the EEC members, only the Federal Republic of Germany, the three Benelux countries, and Denmark, together with Norway and Sweden as associated countries, operated without any particular strains in the period under review. At times the Deutsche Mark was at the upper intervention limit in the "snake", and the Bundesbank had to accept substantial foreign exchange inflows; at other times, particularly between July and September 1974, the Deutsche Mark was at the lower limit of the "snake", so that it had to be supported by sales of foreign exchange. Contrary to the apprehensions of some sceptics the inflows and outflows resulting from the "currency snake" were not of such dimensions as to seriously affect or even threaten the stability-oriented monetary policy pursued by the Bundesbank. Probably the main explanation for this is that the other participants in the currency bloc have also been trying to pursue stability-oriented policies. Hence a group of countries with relatively homogeneous economic policies is involved. Some of the other members are also surplus countries whose currencies were for the most part valued even higher in the "snake" than the Deutsche Mark. It goes without saying that the relative size of the member countries was also of importance. Between end-November 1974 and end-March 1975 no foreign exchange interventions involving the Deutsche Mark were required within the "snake", and interventions between other "snake" currencies were also of limited magnitude.

The smooth functioning of the European currency bloc has contributed to increasing its attractiveness of late. When this Report went to press it was not yet certain whether the current discussion in Switzerland as to whether it should join the "snake" as an associated member similar to Norway and Sweden will lead to a positive conclusion. Switzerland's joining the "snake" would usefully extend the zone of exchange rate stability in Europe.

Part B: Notes on the Deutsche Bundesbank's annual accounts for 1974

1. Legal bases, classification and valuation

Legal bases, accounting system and annual accounts

The legal basis for the annual accounts of the Bundesbank is provided by section 26 of the Deutsche Bundesbank Act (Gesetz über die Deutsche Bundesbank) of July 26, 1957 (Federal Law Gazette I, page 745); the provisions contained therein regarding the accounting system and the annual accounts are unchanged against the previous year.

Classification of annual accounts
Balance sheet

On the assets side of the balance sheet items 2 to 5 have been reclassified and some of their designations have been changed. The item "Other investment abroad" has been deleted. The claims arising from foreign exchange offset agreements with the United States hitherto appearing in that item are now shown as a separate sub-item under item 5 "Loans and other claims on foreign countries". Moreover, the sub-items "Loans in connection with EEC medium-term monetary assistance" and "Other loans to foreign monetary authorities" have been added to item 5; the sub-item "Other claims" has been deleted. Accordingly the classification is now as follows:

2. Reserve position in International Monetary Fund and special drawing rights
   - 2.1. Drawing rights within gold tranche
   - 2.2. Loans under General Arrangements to Borrow
   - 2.3. Special drawing rights

3. Balances with foreign banks and money market investment abroad

4. Foreign currency

5. Loans and other claims on foreign countries
   - 5.1. Loans in connection with EEC medium-term monetary assistance
   - 5.2. Claims arising from foreign exchange offset agreements with U.S.A.
   - 5.3. Other loans to foreign monetary authorities
   - 5.4. Loans to World Bank.

Otherwise the classification of the balance sheet is the same as a year earlier.

Profit and loss account

The following has been added to the profit and loss account:

1. Loss in 1974
2. Adjusting item relating to 1973 for new valuation of monetary reserves and other foreign exchange positions – loss brought forward –
3. Balance sheet loss.

Valuation

The provisions of the Companies Act (Aktiengesetz) have been taken into account mutatis mutandis in the valuation (section 26, Bundesbank Act).

2. Conversion account

The combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank is attached to the German original of this Report as Appendix 1.

Through the corrections of the partial conversion accounts for the Bank deutscher Länder and the Land Central Banks, which now give the position shown by the books at December 31, 1974, the Bank's title to allocation of equalisation claims rose by DM 26,455.13 to DM 8,103,735,946.44; the claim on the Federal Government arising from the non-interest-bearing debt certificate issued in connection with the currency conversion in Berlin remained unchanged at DM 547,168,481.20 during the year under review.

3. Annual accounts

The annual accounts for 1974 are attached to this Report as an Appendix; as usual, the notes thereon follow the order of the items in the balance sheet and profit and loss account. At the same time a report is rendered on the Bank's activities during 1974.

Balance sheet

Comparison of balance sheet figures

At December 31, 1974 total assets had decreased by DM 1,781.5 million, compared with end-1973, to DM 126,457.5 million.

Comparison of balance sheet figures

Millions of Deutsche Mark

Assets	December 31 1973	December 31 1974	Liabilities	December 31 1973	December 31 1974
Gold	14,001.2	14,001.7	Bank notes in circulation	46,246.9	50,272.5
Reserve position in the International Monetary Fund and special drawing rights			Deposits of banks	51,913.4	46,504.2
Drawing rights within gold tranche	3,886.4	3,807.0	Deposits of public authorities		
Loans under General Arrangements to Borrow	—	—	Federal Government	204.2	139.0
Special drawing rights	4,467.5	4,247.6	Equalisation of Burdens Fund and ERP Special Fund	174.3	162.7
Balances with foreign banks and money market investment abroad	65,819.2	49,734.1	Länder Governments	2,402.8	642.7
Foreign currency	4.4	14.2	Other public depositors	51.1	44.7
Loans and other claims on foreign countries			Special deposits of Federal and Länder Governments		
Loans in connection with EEC medium-term monetary assistance	—	1,169.8	Federal Government	6,145.6	7,176.6
Claims arising from foreign exchange offset agreements with U.S.A. 1	1,808.3	3,189.7	Länder Governments	2,150.4	3,576.0
Other loans to foreign monetary authorities	—	4,809.0	Anticyclical surcharge on income taxes	169.9	0.1
Loans to World Bank	2,471.4	2,467.7	Deposits of other German depositors		
Foreign bills of exchange	460.1	877.0	Federal Railways	15.6	5.2
Domestic bills of exchange	10,434.9	12,304.5	Federal Post Office	2,455.1	2,226.4
Lombard loans	320.8	2,334.1	Other depositors	460.8	507.1
Cash advances (book credits)	2,851.4	1,231.9	Balances on cash deposit special accounts	244.3	127.3
Treasury bills and discountable Treasury bonds 2	300.0	—	Liabilities for mobilisation and liquidity paper sold	9,859.8	8,867.3
Equalisation claims on Federal Government and non-interest-bearing debt certificate in respect of Berlin			Liabilities in respect of foreign business	918.1	1,284.2
Equalisation claims	8,136.0	8,136.1	Contra-entry to special drawing rights allocated	1,746.4	1,600.1
Non-interest-bearing debt certificate	547.2	547.2	Provisions	1,488.5	1,690.1
Securities	25.4	469.0	Other liabilities	52.9	85.8
German coins	583.9	423.1	Deferred expenses and accrued income	319.7	326.3
Balances on postal giro account	465.5	647.1	Capital	290.0	290.0
Other claims	685.7	759.0	Reserves	929.2	929.2
Land and buildings	576.2	661.9			
Equipment	32.3	30.4			
Items in course of settlement	2,744.6	4,685.1			
Other assets	821.5	954.9			
Prepaid expenses and deferred income	21.9	24.1			
Adjusting item for new valuation of monetary reserves and other foreign exchange positions — balance sheet loss —	6,773.2	8,931.3			
Total	128,239.0	126,457.5	Total	128,239.0	126,457.5

1 1973: "Other investment abroad". — 2 Including Treasury bills and discountable Treasury bonds shown in asset item "Loans to Federal Railways and Federal Post Office".

Assets

Gold

At DM 14,001.7 million, the gold holding at December 31, 1974 was DM 0.5 million larger than at the end of 1973. The balance sheet valuation (one ounce of fine gold = 42.2222 U.S. dollars; 1 U.S. dollar = 2.835 Deutsche Mark) remained unchanged in comparison with a year before.

Reserve position in the International Monetary Fund and special drawing rights

Drawing rights within gold tranche

At December 31, 1974 the drawing rights within the gold tranche amounted to DM 3,807.0 million. The new valuation at that day's rate (SDR value of the Deutsche Mark as at December 31, 1974) resulted in a depreciation of DM 299.2 million. Otherwise the change on the preceding year is attributable to other members' Deutsche Mark drawings and other transactions of similar effect totalling DM 1,507.4 million, against which there were Deutsche Mark repayments and other transactions of similar effect totalling DM 1,287.5 million. The holding of drawing rights within the gold tranche is the difference between the German quota of SDR 1,600 million and the Deutsche Mark balances at the disposal of the IMF equivalent to SDR 309.5 million.

Loans under General Arrangements to Borrow

In 1974 no loans were granted to the International Monetary Fund under the General Arrangements to Borrow (GAB).

Special drawing rights

The holding of special drawing rights (SDRs) at December 31, 1974 amounted to SDR 1,439.8 million (DM 4,247.6 million) against SDR 1,387.5 million (DM 4,467.5 million) at end-1973. The new valuation at that day's rate (SDR value of the Deutsche Mark as at December 31, 1974) resulted in a depreciation of DM 241.8 million for the SDRs acquired by the Bank against payment. The contra-entry on the liabilities side was reduced by DM 146.3 million, the amount by which the allocated SDRs depreciated. The increase on the year was due, in particular, to the Bank's acquisition of SDRs under European Community settlement arrangements.

Balances with foreign banks and money market investment abroad

Balances with foreign banks and money market investment abroad amounted to DM 49,734.1 million at December 31, 1974, against DM 65,819.2 million at December 31, 1973.

Foreign exchange deals

The Bank's turnover in foreign exchange spot deals (foreign currency against Deutsche Mark) amounted to DM 19,447.6 million in the year under review, against DM 51,159.0 million in 1973; the number of deals decreased from 6,453 in the previous year to 5,480. Such deals comprised

	1973		1974	
	Number	DM million	Number	DM million
Purchases	2,964	33,797.7	2,080	5,965.8.
Sales	3,489	17,361.3	3,400	13,481.8
	6,453	51,159.0	5,480	19,447.6.

The marked decline in turnover compared with the previous year is mainly due to the notable reduction of interventions; the 1973 figures include the U.S. dollar purchases made prior to the devaluation of the U.S. dollar and the start of the joint float (roughly DM 26.1 billion).

In addition, during the year under review the Bank effected 364 cross deals (one foreign currency against another foreign currency) totalling the equivalent of DM 2,319.6 million, as against 309 deals totalling the equivalent of DM 2,097.1 million in the previous year. Furthermore, 339 U.S. dollar inter-centre switch transactions amounting to US$ 39.3 million were concluded, as against 434 transactions amounting to US$ 41.7 million in 1973.

Sale of foreign cheques

During 1974 3,909 (1973: 3,490) foreign cheques payable to order worth DM 237.7 million (1973: DM 197.0 million) were sold.

In the same period the Bank sold 17,495 traveller's cheques worth DM 2.0 million, compared with 13,051 worth DM 1.4 million the year before.

Foreign currency

Purchases and sales

At DM 14.2 million the holding of foreign notes and coins at the end of 1974 was DM 9.8 million larger than at December 31, 1973. During the year under review the Bank effected 55,529 purchases of foreign notes and coins (1973: 47,780) and 29,439 sales of foreign notes and coins (1973: 24,512).

Loans and other claims to foreign countries

Loans in connection with EEC medium-term monetary assistance

The sub-item "Loans in connection with EEC medium-term monetary assistance" shows the German share of US$ 486.5 million in a credit totalling US$ 1,398.3 million which the members of the European Communities – with the exception of the U.K. – granted to Italy on December 18, 1974 under the arrangements for medium-term monetary assistance. This credit replaced the loan of equal size extended to the Banca d'Italia in March 1974 in the context of short-term monetary assistance; it has to be repaid in 1978 in fixed instalments.

Claims arising from foreign exchange offset agreements with U.S.A.

The U.S. dollar claims arising from foreign exchange offset agreements with the United States are shown here. In 1973 these claims were included in the item "Other investment abroad".

Other loans to foreign monetary authorities

This sub-item comprises the U.S. dollar deposit which has been held with the Banca d'Italia since September 1974 under a special agreement and against which the Banca d'Italia maintains a gold deposit with us.

Loans to World Bank

At end-1974 loans to the World Bank were shown at DM 2,467.7 million (end-1973: DM 2,471.4 million).

Foreign bills of exchange

Purchases

At the close of 1974 the holding of foreign bills arising from purchases within Germany was DM 877.0 million, as compared with DM 460.1 million at December 31, 1973.

Purchases of foreign bills of exchange in the Land Central Bank areas

Land Central Bank	1973 Number	1973 DM mn	1974 Number	1974 DM mn
Baden-Württemberg	20,242	460.3	17,780	475.3
Bavaria	9,799	351.7	7,770	383.2
Berlin	281	15.7	245	54.1
Bremen	923	57.4	634	55.3
Hamburg	3,732	230.5	4,039	355.5
Hesse	6,936	452.1	6,677	640.8
Lower Saxony	2,285	85.8	2,303	84.2
North Rhine-Westphalia	13,708	511.8	12,425	678.5
Rhineland-Palatinate	3,695	182.1	2,977	167.9
Saarland	2,573	157.0	2,407	234.4
Schleswig-Holstein	379	17.5	215	17.2
Total	64,553	2,521.9	57,472	3,146.4

The share of Deutsche Mark bills in the total value of foreign bills purchased averaged about 64% in 1974, as in 1973.

Foreign commission business

The Bank took in the following for realisation on a commission basis:

	1973 Number	1974 Number
Bills, cheques, etc.	10,094	9,913
Foreign currency	6,013	5,021
	16,107	14,934.

Domestic bills of exchange

Taking the average of all return days, the Bank's holding of domestic bills in the year under review, at DM 10,972 million, was slightly smaller than in 1973 (DM 11,947 million). At the end of 1974 the Bank held DM 12,304.5 million of domestic bills; this was considerably more than at the end of 1973 (DM 10,434.9 million) since banks used the November increase in rediscount quotas for large-scale additional rediscounting.

	Dec. 31, 1973 DM million	Dec. 31, 1974 DM million
The domestic bill holding comprised		
Domestic bills discounted	9,271.8	11,302.2
Import and Storage Agency bills	291.0	295.5
Prime bankers' acceptances acquired in the course of open market operations	872.1	706.8
	10,434.9	12,304.5.

Purchases of domestic bills of exchange * in the Land Central Bank areas

Land Central Bank	1973 '000	1973 DM mn	1974 '000	1974 DM mn
Baden-Württemberg	345	9,651.0	275	7,517.3
Bavaria	265	9,837.8	222	8,984.1
Berlin	19	1,497.1	18	1,926.6
Bremen	33	1,296.3	25	1,255.7
Hamburg	137	5,887.3	130	5,754.8
Hesse	263	28,343.9	211	21,065.4
Lower Saxony	139	3,999.9	106	3,385.4
North Rhine-Westphalia	416	19,010.5	340	16,933.4
Rhineland-Palatinate	67	2,278.0	53	1,468.7
Saarland	13	1,142.7	11	709.2
Schleswig-Holstein	45	1,400.6	32	1,022.3
Total	1,742	84,345.1	1,423	70,022.9

* Including domestic bills bought in open market operations under repurchase agreement, which will be dealt with below.

The average amount of the bills purchased in 1974 was DM 49,192, compared with DM 48,406 in 1973.

Of the bills purchased, the following were returned and charged, in the absence of payment, to the parties presenting them for rediscount:

	1973 Number	1973 DM million	1974 Number	1974 DM million
	6,685	46.0	7,441	70.2
as % of the total purchased	0.38	0.05	0.52	0.10.

Discount rate

The Bundesbank's discount rate for domestic and foreign bills in the year under review stood at 7% until October 24, at 6½% from October 25 and at 6% from December 20. With effect from February 7 and March 7, 1975 it was lowered by half a percentage point on each occasion to 5½ % and 5 %.

Storage Agency bills

The Bank's open market operations in Storage Agency bills dropped slightly below the previous year's figure. Purchases with a nominal value of DM 2,580.4 million (1973: DM 2,923.5 million) were accompanied by resales out of the Bank's holding prior to maturity with a nominal value of DM 1,100.0 million (1973: DM 1,439.2 million). DM 1,475.9 million of Storage Agency bills were kept in the Bank's portfolio until redemption. At December 31, 1974 the Bank's portfolio totalled DM 295.5 million (end-1973: DM 291.0 million).

Prime bankers' acceptances

The total amount of prime bankers' acceptances which the Bank is prepared to purchase in open market operations and take into its portfolio was reduced to DM 0.9 billion at the beginning of 1974, but raised again to DM 1.1 billion at mid-year. For this reason and because the tightness of the money market persisted over prolonged periods in the year under review, the Privatdiskont-Aktiengesellschaft again offered large amounts of prime bankers' acceptances to the Bank for refinancing. However, the Bank's purchases of prime bankers' acceptances, at DM 5,873.7 million, did not regain the especially high 1973 level of DM 7,128.6

million. Nevertheless, in the year under review resales of prime bankers' acceptances from the Bank's portfolio via the brokers to the market were greater than a year before, amounting to DM 3,028.3 million against DM 2,014.6 million in 1973. This implies that prime bankers' acceptances – in contrast to earlier years – were commonly used as a means of investment and not just as an instrument for providing finance. DM 3,010.7 million (1973: DM 5,471.0 million) of prime bankers' acceptances from the Bank's own holding were redeemed on maturity; at December 31, 1974 DM 706.8 million (end-1973: DM 872.1 million) of prime bankers' acceptances stemming from open market operations were held by the Bank.

Open market operations in bills under repurchase agreements

In 1974 the Bank conducted open market operations in bills under repurchase agreements only between March 14 and April 24, 1974. In the course of such operations the Bank acquired – outside the rediscount quotas – trade bills at market rates subject to the condition that the banks lodging the bills had to repurchase them after, as a rule, ten days. The Bank's maximum bill holding from such operations amounted to DM 2,240 million (on March 28, 1974). The market rates for open market operations under repurchase agreement stood at $11\frac{1}{2}$ % from March 14 to April 5, 1974 and at 10 % from April 8 to 24, 1974.

Domestic commission business

Domestic bills, cheques and the like were acquired on a commission basis as follows:

	Number	DM million
1973	68,935	782.9
1974	65,864	872.9.

Lombard loans

Taking the average of all the return dates of the year under review, the Bundesbank granted DM 2,194 million of lombard loans to banks (1973: DM 801 million). As in preceding years, such loans were subject to marked fluctuations, the largest amounts having been granted in August, September and December. The banks were not provided with lombard loans at the lombard rate until July 4, 1974. Previously the Bank had granted lombard credit at a special lombard rate (special lombard credit) for short periods only, in order to offset marked pressures on the money market.

Lombard loans in the Land Central Bank areas

Millions of Deutsche Mark

Land Central Bank	Lombard loans granted		Outstanding on	
	1973 **1**	1974 **1**	Dec. 31, 1973 **2**	Dec. 31, 1974
Baden-Württemberg	7,516.1	11,217.7	32.5	522.1
Bavaria	5,061.5	7,376.4	21.4	81.6
Berlin	780.7	1,691.2	—	—
Bremen	1 083.5	1,722.3	6.0	17.3
Hamburg	5,255.4	7,717.9	14.0	75.8
Hesse	31,533.0	74,215.7	132.5	1,183.5
Lower Saxony	2,560.4	4,821.7	23.5	64.1
North Rhine-Westphalia	13,918.1	19,147.2	50.0	328.6
Rhineland-Palatinate	1,694.3	3,878.8	38.2	44.0
Saarland	466.5	444.4	2.7	4.4
Schleswig-Holstein	1,464.3	1,399.9	—	12.7
Total	71,333.8	133,633.2	320.8	2,334.1

1 Including special lombard credit. – **2** Special lombard credit only.

Lombard rate and special lombard rate

In the year under review the lombard rate was 9 % until October 24; from October 25 it stood at $8\frac{1}{2}$ % and from December 20 at 8 %. With effect from February 7, 1975 it was lowered to $7\frac{1}{2}$ % and from March 7, 1975 to $6\frac{1}{2}$ %. In 1974 the special lombard rate stood at 13 % from January 1 to 11 and from March 14 to April 8 and at 10 % from May 28 to July 3.

Cash advances (book credits)
Federal Government
Equalisation of Burdens Fund
Länder Governments

Section 20 (1) 1 of the Bundesbank Act lays down the following credit ceilings:

	DM million
for the Federal Government	6,000
for the Federal Railways	600
for the Federal Post Office	400
for the Equalisation of Burdens Fund	200
for the ERP Special Fund	50

for the Länder DM 40 per inhabitant; for Berlin, Bremen and Hamburg DM 80 per inhabitant.

Treasury bills which the Bank holds in its portfolio or which it has promised to purchase are to be counted towards the credit ceilings, in addition to the book credits.

Cash advances (book credits)

Millions of Deutsche Mark

Borrower	December 31, 1973	December 31, 1974
Federal Government	2,720.9	1,076.7
Equalisation of Burdens Fund	130.5	15.5
Länder Governments		
Berlin	—	81.4
Hesse	—	27.7
Lower Saxony	—	3.1
Rhineland-Palatinate	—	27.5
Total	2,851.4	1,231.9

No book credits to the Federal Railways and Federal Post Office were outstanding at December 31, 1974; such credits are shown together with claims resulting from the purchase of Treasury bills and discountable Treasury bonds in the asset item "Loans to Federal Railways and Federal Post Office".

Interest rate

Throughout the year the rate of interest on book credits was equal to the Bundesbank's discount rate.

Treasury bills and discountable Treasury bonds
Federal Government
Länder Governments

On the market for money market paper the Bank was much more active than in previous years as the Federal Government's agent for issuing discountable Treasury bonds for financing purposes. The Bank also continued to support the market for mobilisation and liquidity paper (sections 42 and 42 (a), Bundesbank Act), as described separately below.

To meet the borrowing requirements of the Federal Government, the "B" and "BN" types of discountable Treasury bonds were issued on a relatively large scale, viz. DM 5,159.7 million (1973: only DM 525 million). The bulk of this paper (DM 3,831 million) consisted of bonds marked "BN", i. e. of paper which cannot be resold to the Bundesbank or the issuer prior to maturity and which bears higher interest by way of compensation. DM 1,086 million of Federal discountable Treasury bonds types "B" and "BN" fell due in the year under review (1973: DM 900 million), so that the outstanding total of such paper rose by DM 4,073.7 million in that year to DM 5,098.7 million at December 31, 1974.

The German Federal Railways redeemed the DM 300 million of Treasury bills outstanding at end-1973; in addition, it issued DM 200 million of new Treasury bills through the agency of the Bundesbank in the year under review (1973: DM 500 million) and redeemed all of them. The DM 231 million of Federal Railways discountable Treasury bonds which fell due in 1974 were renewed; the amount outstanding at December 31, 1974 therefore remained unchanged at DM 400 million.

In the year under review discountable Treasury bonds of the Federal Post Office marked "PN" and not redeemable before maturity were issued for the first time. At the end of the year the amount of such paper outstanding totalled DM 592.3 million.

At December 31, 1974 the outstanding total of money market paper issued for the account of the Federal Government and its special funds was DM 6,091 million (end-1973: DM 1,725 million). Further details will be found in the following table.

Money market paper issued for account of Federal Government and Federal special funds

Millions of Deutsche Mark

Category of paper	Outstanding on Dec. 31, 1973	in 1974 Issued	in 1974 Redeemed	Outstanding on Dec. 31, 1974
Discountable Treasury bonds of the Federal Republic of Germany "B" and "BN"	1,025.0	5,159.7	1,086.0	5,098.7
Treasury bills of the German Federal Railways	300.0	200.0	500.0	—
Discountable Treasury bonds of the German Federal Railways	400.0	231.0	231.0	400.0
Discountable Treasury bonds of the German Federal Post Office "PN"	—	592.3	—	592.3
Total	1,725.0	6,183.0	1,817.0	6,091.0

As for Länder Government money market paper, DM 200 million of discountable Treasury bonds issued by one Land Government were outstanding at end-1974. No public authority money market paper was held by the Bank at December 31, 1974 (end-1973: DM 300 million).

Equalisation claims on Federal Government and non-interest-bearing debt certificate in respect of Berlin
Equalisation claims

The Bank's equalisation claims on the Federal Government which are inscribed in the government stock register as at December 31, 1973, increased by DM 99.5 thousand in the year under review. The change, of DM 26.4 thousand, in the equalisation claims arising from the Bank's own conversion account is explained in the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank, as shown by the books at December 31, 1974, which account is attached to the German original of this Report as Appendix 1.

Non-interest-bearing debt certificate

In 1974 the Bank's claim on the Federal Government in respect of the currency conversion in Berlin remained unchanged at DM 547.2 million.

Equalisation claims and non-interest-bearing debt certificate in respect of Berlin in 1974

Thousands of Deutsche Mark

Category of paper	Total on December 31, 1973	Increase in 1974	Total on December 31, 1974
(a) Equalisation claims arising from			
Own conversion account			
Bank deutscher Länder	5,504,403.0	7.9	5,504,410.9
Land Central Banks	2,599,295.9	18.5	2,599,314.4
	8,103,698.9	26.4	8,103,725.3
Conversion of Berlin pre-capitulation balances	30,837.1	73.0	30,910.1
Conversion of RM balances at banks in the Eastern Sector of Berlin	1,461.6	0.1	1,461.7
	8,135,997.6	99.5	8,136,097.1
(b) Non-interest-bearing debt certificate	547,168.5	—	547,168.5
Total	8,683,166.1	99.5	8,683,265.6

Loans to Federal Railways and Federal Post Office

No credits to the Federal Railways and the Federal Post Office were outstanding at December 31, 1974. See also the notes on the items "Cash advances (book credits)" and "Treasury bills and discountable Treasury bonds".

Securities

In pursuance of its open market policy in the year under review the Bank at times took bonds issued by the Federal Government, the Railways and the Post Office out of the market for its own account and then sold some of them again when the market situation changed. The Bank's holding of securities – chiefly bonds of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office, together with small amounts of other domestic bonds – came to DM 469.0 million at the end of December 1974 (end-1973: DM 25.4 million).

Issue of bonds

In 1974 twelve bond issues totalling DM 6,030 million (1973: fourteen issues amounting to DM 7,900 million) were launched through the Federal Bond Consortium, which is under the direction of the Bank. Of this amount, DM 630 million (1973: DM 1,450 million) was reserved for the issuers' own institutions (mainly welfare institutions) and for longer-term price support operations.

Bonds of the Federal Republic of Germany, German Federal Railways and German Federal Post Office issued in 1974

Issuer	Amount issued: Total DM mn	Amount issued: of which sold through Federal Bond Consortium DM mn	Nominal interest rate % (yield)	Issue price %	Start of sales 1974
Federal Republic of Germany	600	500	$9^1/_2$ (9.50)	100	Jan. 18
German Federal Railways	440	400	$9^1/_2$ (9.50)	100	Jan. 30
Federal Republic of Germany	500	450	10 (10.47)	97.75	May 31
German Federal Post Office	530	500	10 (10.53)	98	July 16
German Federal Railways	440	400	10 (10.53)	98	Aug. 5
Federal Republic of Germany	600	550	10 (10.35)	98.50	Aug. 22
German Federal Post Office	440	400	10 (10.35)	98.50	Sep. 9
Federal Republic of Germany	500	450	10 (10.35)	98.50	Oct. 21
German Federal Railways	480	400	10 (10.31)	98.50	Nov. 14
German Federal Post Office	550	500	10 (10.09)	99.50	Nov. 28
Federal Republic of Germany	600	550	$9^1/_2$ (9.69)	99	Dec. 11
German Federal Post Office	350	300	$9^1/_2$ (9.69)	99	Dec. 17

Issue of Federal savings bonds

With the assistance of the Bank, DM 3,192.3 million (gross) of Federal savings bonds were sold to private investors through banks in 1974 (1973: DM 934.5 million). During the same period DM 1,461.6 million (1973: DM 2,125.8 million) of savings bonds from former tranches were resold to the issuer before maturity, so that the outstanding amount of Federal savings bonds rose from DM 3,012.2 million (end-1973) to DM 4,742.9 million on December 31, 1974.

As from May 1974 the interest paid on Federal savings bonds was raised to bring it into line with market interest rates (for the 1974/3 and 1974/4 tranches and – without change – for the 1974/5 and 1974/6 tranches). When the Federal savings bonds 1975/1 and 1975/2 were issued (sales started already on December 30, 1974), the interest payable was reduced, in conformity with the changed market conditions, to the level prevailing at the beginning of the year under review; the yield on the bonds sold at the end of the year was 8.98 % for type A and 9.21 % for type B.

The first issue of Federal savings bonds (issue 1969/1) finally fell due on January 1, 1975. Total sales of this tranche (1969/1) had been DM 102.6 million; DM 64.9 million thereof had been prematurely returned to the issuer so that at the end of December 1974 a balance of DM 37.7 million was to be redeemed.

Gross sales, interest rates and yields of Federal savings bonds in 1974

Issues	Sales period 1974	Gross sales in millions of Deutsche Mark: Federal savings bonds A 1	Federal savings bonds B 2	Total	Interest rate (%) in/ and yields (%) after . . . year after issue: 1st year	2nd	3rd	4th	5th	6th	7th
1974/1	Jan. 2–Apr. 30	248.4	210.4	458.8	7.5 7.50	9.0 8.22	9.0 8.46	9.5 8.69	9.5 8.82	10.0 8.98	
1974/2					7.5 7.50	9.0 8.25	9.0 8.50	9.5 8 75	9.5 8.90	10.0 9.08	10.0 9.21
1974/3	May 8–June 28	275.3	201.8	477.1	8.5 8.50	9.5 8.98	9.5 9.14	10.0 9.32	10.5 9.52	11.0 9.71	
1974/4					8.5 8.50	9.5 9.00	9.5 9.16	10.0 9.37	10.5 9.59	11.0 9.83	11.0 9.99
1974/5	July 1–Dec. 16	1,337.8	893.9	2,231.7	8.5 8.50	9.5 8.98	9.5 9.14	10.0 9.32	10,5 9.52	11.0 9.71	
1974/6					8.5 8.50	9.5 9.00	9.5 9.16	10.0 9.37	10.5 9.59	11.0 9.83	11.0 9.99
1975/1	Dec. 30/31	13.1	11.6	24.7	7.5 7.50	9.0 8.22	9.0 8.46	9.5 8.69	9.5 8.82	10.0 8.98	
1975/2					7.5 7.50	9.0 8.25	9.0 8.50	9.5 8.75	9.5 8.90	10.0 9.08	10.0 9.21
Total	Jan. 2–Dec. 31	1,874.6	1,317.7	3,192.3							

1 With yearly payment of interest. – **2** With accrual of interest.

Issue of medium-term notes

Through the agency of the Bank DM 252.6 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany were sold by tender during 1974 (1973: DM 426.5 million of paper of the German Federal Post Office). There were two tranches, running for three and four years and bearing a nominal interest of 10 %.

Moreover, in agreement with the Bank DM 945 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office were sold without the tender procedure (1973: none).

Treasury bonds (medium-term notes) issued in 1974

Issuer	Amount DM mn	Interest rate %	Running for . . . years	Selling price %	Yield on sale %	Month of sale
Federal Republic of Germany **1** 1st Issue	107.6	10	3 y	98.80	10.48	March
Federal Republic of Germany **1** 2nd Issue	145	10	4 y	98.20	10.58	March
Federal Republic of Germany **2** 3rd Issue	100	10	3 y	98.80	10.75	May
German Federal Railways **3**	95	7.8	3 y	100	7.8	June
German Federal Railways	100	10	2 y 9 m	99	10.44	June
Federal Republic of Germany 4th Issue	150	10	4 y 6 m	97.425	10.75	August
German Federal Post Office	50	10	3 y	98.375	10.66	August
Federal Republic of Germany 1st Issue	50	9½	3 y 11 m	96.90	10.50	September
Federal Republic of Germany 2nd Issue	50	9½	4 y	96.80	10.52	September
German Federal Railways 2nd Issue	100	10	2 y 9 m	99.55	10.195	October
German Federal Post Office 2nd Issue	50	10	3 y	99.125	10.35	October
German Federal Post Office 3rd Issue	50	10	4 y	98.40	10.51	October
German Federal Post Office 4th to 6th Issues	150	10	3 y	99.125	10.35	November

1 Sold by tender. – **2** Six-month coupon. – **3** Special arrangements.

Admission to stock exchange dealings

The Bank introduced the above-mentioned bond issues of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office for official dealings on all German stock exchanges; the medium-term notes launched by these issuers in the year under review and two series of medium-term notes of the Equalisation of Burdens Bank were introduced for regulated unofficial dealings on the stock exchange.

Price support operations

In the year under review, as in preceding years, the Bank undertook price support for the account of the issuers in respect of bonds issued by the Federal Government and its special funds, one Land Government, the Reconstruction Loan Corporation and the Equalisation of Burdens Bank.

The Bank as paying and collecting agent for bonds

As the paying and collecting agent for, in particular, bonds of the Federal Government (including external bonds) and its special funds the Bank paid 12,885,603 interest coupons and matured bonds during the year under review (1973: 13,085,830). Of this number, 302,554 interest coupons and matured bonds were presented to foreign agents for redemption (1973: 241,543).

German coins

The Bank's holding of German coins amounted to DM 423.1 million at the close of 1974 (end-1973: DM 583.9 million). In 1974 the Federal Government was credited with DM 359.3 million for coins taken from the Mints, and debited with DM 119.0 million for coins no longer fit for circulation. Altogether in the years 1948 to 1974 the Bank took over coins amounting to DM 6,179.2 million, and cashed, to the debit of the Federal Government, DM 627.3 million of coins which were no longer fit to circulate or had been called in.

The total amount of coins in circulation at the end of 1974 divided by the number of inhabitants of the Federal Republic of Germany, including the Land of Berlin, at September 30, 1974 (62 million) yields the figure of DM 82.72 per head of population (1973: DM 76.13).

In the year under review two DM 5 commemorative coins (25th Anniversary of the Basic Law (Grundgesetz) of the Federal Republic of Germany and Immanuel Kant) were put into circulation.

Balances on postal giro account

The postal giro account balances at December 31, 1974, including the branches' transfers in transit to the postal giro account of the Bank (Central Office) at Frankfurt am Main, totalled DM 647.1 million (1973: DM 465.5 million). Each day the Bank's credit balances on that account and on the postal giro account of the Land Central Bank in Berlin, except for those required for current payments, are offset, in rounded amounts, against the giro balances of the Central Cash Office of the Federal Post Office and the Postal Giro Office Berlin (West).

Postal giro transactions with third parties

	1973				1974			
	Transfers received from third parties		Transfers made to third parties		Transfers received from third parties		Transfers made to third parties	
Area	Number	DM mn	Number	DM mn	Number	DM mn	Number	DM mn
Land Central Bank								
Baden-Württemberg	89,494	15,172.6	16,169	1,054.0	95,129	17,320.2	19,403	1,396.6
Bavaria	85,753	15,049.5	12,195	3,168.5	91,496	16,517.3	13,471	4,011.0
Berlin	24,553	2,398.7	5,106	812.7	24,941	2,072.9	3,723	761.0
Bremen	12,394	532.8	1,323	0.2	13,729	544.6	1,604	0.2
Hamburg	56,044	10,967.4	1,929	45.8	55,103	12,198.3	2,032	103.8
Hesse	53,396	7,915.8	9,186	1,115.3	52,326	7,838.5	7,960	2,190.7
Lower Saxony	74,357	5,802.9	7,172	865.3	72,374	6,377.7	7,549	976.7
North Rhine-Westphalia	126,764	19,017.0	17,234	4,043.2	118,271	18,634.6	17,919	4,583.2
Rhineland-Palatinate	37,438	2,829.1	5,914	138.3	35,290	2,792.2	6,637	408.3
Saarland	4,779	1,670.0	1,194	0.1	5,027	1,796.2	1,131	0.1
Schleswig-Holstein	4,117	140.0	2,604	11.1	4,417	137.8	2,712	0.5
Total	569,089	81,495.8	80,026	11,254.5	568,103	86,230.3	84,141	14,432.1
Bundesbank – Central Office –	14,004	1,532.0	3,472	3.7	15,345	1,713.8	3,107	4.5
Grand total	583,093	83,027.8	83,498	11,258.2	583,448	87,944.1	87,248	14,436.6

Other claims

Other claims are shown at DM 759.0 million (end-1973: DM 685.7 million). They include the balance arising from intra-German settlements (commercial payments under the "Berlin Agreement"), which amounted to DM 620.0 million (1973: DM 613.3 million).

Turnover on the relevant sub-accounts amounted to:

	1973 DM million	1974 DM million
West/East deliveries and services	2,680.0	3,173.2
East/West deliveries and services	2,643.9	3,165.2
	5,323.9	6,338.4.

Land and buildings; equipment

With additions of DM 114.3 million and depreciation of DM 28.7 million, land and buildings are shown at DM 661.9 million. The balance sheet value of the equipment amounts to DM 30.4 million after additions of DM 12.4 million and depreciation of DM 14.3 million.

Items in course of settlement

The balance sheet item "Items in course of settlement" mainly comprises the intercity credit and debit transfers that were proceeding inside the Bank at the close of the year as well as the cheques and debit transfer orders in course of clearing. At December 31, 1974, the balance of the items in course of settlement stood at DM 4,685.1 million (end-1973: DM 2,744.6 million).

Other assets

The "Other assets" are shown at DM 954.9 million (end-1973: DM 821.5 million). As in the previous year, by far the greater part consists of interest due in 1975 but assignable to the profit and loss account for the year under review on funds employed abroad and on securities (DM 867.4 million against DM 815.6 million at end-1973).

In addition, this item includes the Bank's share in the DM 250 million capital of the Liquidity Consortium Bank of Frankfurt am Main (set up as a private limited company in 1974), namely DM 75 million or 30 %. The articles of association contain an obligation to pay up a further DM 750 million if required, payable in proportion to the existing holding; in the case of the Bank a maximum of DM 225 million would be involved.

Prepaid expenses and deferred income

The prepaid expenses and deferred income comprise salary and pension payments made in the year under review but relating to 1975.

Adjusting item for new valuation of monetary reserves and other foreign exchange positions — balance sheet loss —

See the notes on pages 81 and 83 of this Report.

Liabilities

Bank notes in circulation

The circulation of bank notes rose from DM 46,246.9 million at the end of 1973 to DM 50,272.5 million at December 31, 1974.

Currency

Millions of Deutsche Mark

End of year	Bank notes	Federal coins	Currency total
1969	34,616.5	2,657.9	37,274.4
1970	36,479.7	3,008.7	39,488.4
1971	39,493.8	3 665.3	43,159.1
1972	44,503.5	4,441.2	48,944.7
1973	46,246.9	4,727.6	50,974.5
1974	50,272.5	5,128.8	55,401.3

The denominations of the bank notes and Federal coins in circulation are shown in Appendix 4 to the German original of this Report.

In 1974 DM 18,754.5 million of new Bundesbank notes of various denominations were taken over from the printing offices and put into circulation or made ready for that purpose.

The bank notes (including small money tokens) destroyed as being no longer fit for circulation or after being called in totalled:

	1969	1970	1971	1972	1973	1974
Number (millions)	306.7	343.5	377.3	363.1	460.1	424.0
Value (DM million)	10,105.5	11,306.3	12,184.5	12,693.8	16,528.0	15,638.0.

The downward trend observed since 1971 in the number and value of counterfeit Deutsche Mark notes detained in payments continued in the year under review. The number and value of Federal coins thus detained dropped after increasing in 1973.

Counterfeits discovered

	Notes		Coins	
Year	Number	Thousands of DM	Number	Thousands of DM
1969	1,769	84.9	11,621	48.2
1970	4,772	243.0	10,902	46.4
1971	2,978	186.4	9,064	37.0
1972	1,848	124.2	7,487	29.5
1973	1,090	65.4	10,077	34.0
1974	881	59.4	8,181	28.6

Deposits of banks

The banks' deposits on giro account mainly comprise the minimum reserves to be maintained with the Bank. The sub-item "Other" contains deposits of domestic banks on U.S. dollar accounts. Compared with 1973, banks' deposits changed as follows:

Deposits of banks	Dec. 31, 1973 DM million	Dec. 31, 1974 DM million
On giro account	51,891.8	46,483.3
Other	21.6	20.9
	51,913.4	46,504.2.

Deposits of public authorities

The item "Deposits of public authorities" is composed of public authorities' current balances. These deposits showed the following year-on-year changes:

	Dec. 31, 1973 DM million	Dec. 31, 1974 DM million
Federal Government	204.2	139.0
Equalisation of Burdens Fund and ERP Special Fund	174.3	162.7
Länder Governments	2,402.8	642.7
Other public depositors	51.1	44.7
	2,832.4	989.1.

Special deposits of Federal and Länder Governments

Specifically, the Federal and Länder Governments' special deposits changed as follows:

	Dec. 31, 1973 DM million	Dec. 31, 1973 DM million	Dec. 31, 1974 DM million	Dec. 31, 1974 DM million
Federal Government				
Anticyclical reserves from 1969 to 1971	2,500.0		2,500.0	
Stability surcharge	388.6		1,545.0	
Investment tax	147.0		631.6	
Immobilisation of tax receipts	610.0		–	
Stability loan	2,500.0	6,145.6	2,500.0	7,176.6
Länder Governments				
Anticyclical reserves from 1969 to 1971	1,436.5		1,422.2	
Stability surcharge	545.5		1,917.2	
Investment tax	88.4		236.6	
Immobilisation of tax receipts	80.0	2,150.4	–	3,576.0
Anticyclical surcharge on income taxes		169.9		0.1
		8,465.9		10,752.7.

Deposits of other German depositors

The deposits of other German depositors were made up as follows:

	Dec. 31, 1973 DM million	Dec. 31, 1974 DM million
Federal Railways	15.6	5.2
Federal Post Office (incl. postal giro and postal savings bank offices)	2,455.1	2,226.4
Other depositors	460.8	507.1
	2,931.5	2,738.7.

Giro transactions, simplified cheque and debit transfer order collections

In the turnover on giro accounts, the percentage of cashless settlements was:

	Number	Amount
1973	99.57	98.14
1974	99.51	98.07.

Annual turnover on giro acounts of the Deutsche Bundesbank

Turnover	Credits		Debits		as % of total turnover (credits and debits)	
	1973	1974	1973	1974	1973	1974
	Millions of DM		Millions of DM		%	
Cash payments	146,869	156,027	153,053	165,214	1.86	1.92
Settlement with account-holders	2,442,075	2,450,070	2,421,917	2,434,407	30.23	29.27
Local transfers	2,612,964	2,589,789	2,612,964	2,589,789	32.48	31.03
Intercity transfers	2,067,775	2,210,960	2,073,923	2,254,780	25.75	26.94
Cheque and debit transfer order collection (total lodged and paid)	778,206	905,447	778,171	903,044	9.68	10.84
Total	8,047,889	8,312,293	8,040,028	8,347,234	100.00	100.00

In the field of cheque and debit transfer order collection, the Bank's six computer centres for payment transactions were in full operation during the whole of 1974, after the gradual extension of automation in previous years. These centres handled 62 % (1973: 45 %) of the paper presented for collection.

The inclusion of credit transfers in the automation was completed towards the end of 1974. The proportion of automatically processed credit transfers came to nearly 40 % over the entire year; in the last quarter of 1974 it was as high as 54 %.

In connection with the automation the number of items paid declined from 98.7 million in 1973 to 37.3 million in 1974 in spite of the simultaneous growth of the number of cheque and debit transfer orders presented for collection from 317.1 million to 374.0 million. In the case of intercity transfers the total number of items diminished by roughly half.

Balances on cash deposit special accounts

The balances maintained on cash deposit accounts at December 31, 1974 amounted to DM 127.3 million (end-1973: DM 244.3 million). The compulsory cash deposit, which was introduced with effect from March 1, 1972 in order to ward off undesired inflows of capital and which was modified several times thereafter, was rescinded by the 32nd order amending the Foreign Trade and Payments Order of September 12, 1974 (Federal Law Gazette I, page 2324); in consequence, no regular deposits had to be held after October 1, 1974. The balances shown at December 31, 1974 consisted entirely of deposits paid in arrears for earlier months, mainly as a result of notifications of liability.

Liabilities for mobilisation and liquidity paper sold

Owing to the changed situation in the credit and liquidity policy field, the Bank saw no cause in the year under review to resort in the same measure as in 1973 to the facilities afforded by sections 42 and 42 (a) of the Bundesbank Act for issuing mobilisation and liquidity paper in the open market in order to sterilise funds. In 1974 only DM 1,085.1 million of discountable mobilisation and liquidity Treasury bonds were issued (1973: DM 9,669.5 million). As redemptions totalled DM 3,322.2 million (1973: DM 3,296.3 million), the outstanding amount of such paper declined to DM 5,709.0 million at December 31, 1974 (end-1973: DM 7,947.0 million). In this context it was of importance that in the year under review the social security funds bought substantially fewer discountable Treasury bonds than in 1973 and that in the second half of the year they purchased paper issued by the Federal Government for financing purposes rather than mobilisation and liquidity paper, or even allowed their investments to expire altogether.

The outstanding amount of Bundesbank Treasury bonds (discountable mobilisation and liquidity Treasury bonds in small denominations which are sold in a standardised form to private investors) passed its previous peak in the middle of 1974. Since it was no longer necessary in terms of liquidity policy to provide a special inducement to buy such paper the Bank lowered its selling rates disproportionately sharply; moreover, it discontinued sales of discountable Treasury bonds running for only three months, which it had started in 1973.

In the spring of 1974 the Bank, under its short-term money market regulating arrangements, sold fairly large quantities of Treasury bills running for 30 days to domestic banks in order to neutralise in the short run the temporary excess of central bank money resulting from large inflows of foreign exchange.

Treasury bills with fixed periods to maturity of less than 30 days were not offered in the year under review (in 1973 bills running for about 5 and 10 days had been sold).

The turnover in Treasury bills declined by over a quarter compared with 1973 (sales totalling DM 17.5 billion, against DM 22.8 billion, and redemptions DM 16.2 billion, against DM 23.8 billion).

In 1974 total turnover in mobilisation and liquidity paper fell far below the 1973 level, sales coming to DM 18,557.4 million and redemptions to DM 19,549.9 million (1973: DM 32,507.3 million and DM 27,112.3 million, respectively). The total outstanding at December 31, 1974 was DM 8,867.3 million (end-1973: DM 9,859.8 million).

Mobilisation and liquidity paper sold and redeemed

Millions of Deutsche Mark

	1973	1974		
Category of paper	Outstanding on Dec. 31	Sold	Redeemed	Outstanding on Dec. 31
Treasury bills (running for up to 90 days)	1,912.8	17,472.3	16,227.7	3,157.4
Discountable Treasury bonds (running for 3 to 24 months)	7,947.0	1,085.1	3,322.2	5,709.9
Total	9,859.8	18,557.4	19,549.9	8,867.3

Liabilities in respect of foreign business

The liabilities in respect of foreign business comprised

	Dec. 31, 1973		Dec. 31, 1974	
	DM million	DM million	DM million	DM million
Deposits of foreign depositors				
Banks	644.8		755.7	
Other depositors	90.3	735.1	512.2	1,267.9
Other				
Provision of cover for credits by				
non-residents	0.3		0.1	
residents	20.7		15.8	
	21.0		15.9	
Miscellaneous liabilities	162.0	183.0	0.4	16.3
		918.1		1,284.2.

Contra-entry to special drawing rights allocated

The contra-entry to the special drawing rights allocated by the International Monetary Fund and shown on the assets side in sub-item 2.3 is equal to the allocations of SDRs to the Federal Republic of Germany in the years 1970 to 1972, totalling SDR 542.4 million.

Provisions for pension liabilities

After withdrawal of DM 80.3 million for the payment of pensions and widows' and orphans' allowances and an allocation of DM 280.3 million, the provision for pension liabilities is shown at DM 1,370.0 million.

Other provisions

The provision for hazards inherent in domestic and foreign business remained unchanged at DM 300 million. The provision of DM 18.5 million formed in 1973 to meet any exchange losses arising from U.S. dollar forward transactions with German exporters entered into between January 2 and February 13, 1973 and running for up to two years was raised to DM 20.1 million, after withdrawal of DM 6.3 million to the debit of the depreciation requirement for the new valuation of the monetary reserves and other foreign exchange positions. At December 31, 1974 there existed forward commitments totalling US$ 27 million, which had been settled by February 13, 1975.

Other liabilities

The "Other liabilities" are shown at December 31, 1974 at DM 85.8 million, against DM 52.9 million at the end of 1973.

Deferred expenses and accrued income

Deferred expenses and accrued income amounted to DM 326.3 million at December 31, 1974 (end-1973: DM 319.7 million). As previously, this item mainly comprises interest received in the year under review, but relating to the next year, on domestic and foreign commercial and Treasury bills.

Capital

The capital of the Bank remained unchanged at DM 290 million; it is held by the Federal Government (section 2, Bundesbank Act).

Reserves

The legal reserve and the other reserves are shown unchanged at DM 847.3 million and DM 81.9 million, respectively.

Contingent liabilities and claims

The contingent liabilities and claims diminished by DM 3.0 million to DM 0.3 million.

Profit and loss account

Comparison of expenditure and receipts

Millions of Deutsche Mark

Expenditure	1973	1974	Receipts	1973	1974
Interest on mobilisation and liquidity paper	1,115.6	191.8	Interest on money employed abroad	4,338.2	4,833.5
Other interest	4.5	4.9	Loans to domestic banks	866.5	1,027.7
	1,120.1	196.7	Equalisation claims	244.1	244.1
Administrative costs			Cash advances (book credits), Treasury bills and Treasury bonds, securities	57.4	142.6
Personnel	426.7	471.5			
Materials	88.0	95.9			
Note printing	56.2	65.1	Other interest	9.4	5.2
Depreciation on fixed assets	51.3	43.0		5,515.6	6,253.1
Transfer to provisions			Fees	7.6	9.2
Pension liabilities	221.0	280.3	Other receipts	25.8	25.4
Other	24.0	—		5,549.0	6,287.7
Pension payments in respect of Reichsbank	36.1	36.8	Loss	6,773.2	2,158.1
Other expenditure	20.0	25.9			
	2,043.4	1,215.2			
Depreciation on monetary reserves and other foreign exchange positions	10,278.8	7,230.6			
Total	12,322.2	8,445.8	Total	12,322.2	8,445.8

Before allowing for depreciation on monetary reserves and other foreign exchange positions, receipts exceeded expenditure by DM 5,072.5 million, which amount is shown as the operating surplus in the balance sheet note to asset item 22 "Adjusting item for new valuation of monetary reserves and other foreign exchange positions – balance sheet loss –" (1973: DM 3,505.6 million).

Receipts

Interest

	1973 DM million	1974 DM million
The interest received amounted to	5,515.6	6,253.1.
After deduction of the interest paid, namely	1,120.1	196.7,
interest receipts are shown in the profit and loss account at	4,395.5	6,056.4.

The interest received on funds employed abroad increased by DM 495.3 million to DM 4,833.5 million in 1974. Receipts from lending to German banks – domestic bills, lombard loans and foreign bills bought in Germany – rose by DM 161.2 million in the year under review to DM 1,027.7 million. Interest on equalisation claims remained unchanged at DM 244.1 million. Other interest income mounted by DM 81.0 million to DM 147.8 million in 1974.

The interest paid amounted to DM 196.7 million, compared with DM 1,120.1 million at end-1973; DM 191.8 million (1973: DM 1,115.6 million) was paid on Treasury bills and discountable Treasury bonds of the Federal Government (mobilisation and liquidity paper pursuant to sections 42 and 42 (a), Bundesbank Act), which were sold on a much smaller scale in the year under review.

Fees

DM 9.2 million of fees were received in the year under review (1973: DM 7.6 million).

Other receipts

"Other receipts" are shown at DM 25.4 million (1973: DM 25.8 million).

Expenditure

Administrative costs
Personnel

The administrative costs in respect of personnel rose in comparison with the previous year by DM 44.8 million to DM 471.5 million owing to the statutory or negotiated pay increases for established employees ("officials") and unestablished salary and wage earners. The Bank's staff decreased in number by 325 to 13,829. In 1973, for the first time for a number of years, there had already been a slight drop in the number of personnel (by 15) and this trend intensified in 1974.

The reduction in personnel was due to various rationalisation measures taken by the Bank, in particular the full operation of the six computer centres for the automated handling of cashless payments. In the branches automation brought about a perceptible easing of the staff situation so that, despite increases in staff necessitated by additional duties in other fields, there was on aggregate a not inconsiderable decline in the number of the Bank's employees.

Number of persons employed in the Bundesbank

	Beginning of 1974					Beginning of 1975				
				of whom					of whom	
	Central Office	Land Central Banks	Total	male	female	Central Office	Land Central Banks	Total	male	female
Established officials	683	4,669	5,352*)	5,209	143	710	4,721	5,431*)	5,261	170
Salaried employees	1,548	6,213	7,761*)	3,128	4,633	1,546	5,811	7,357*)	3,120	4,237
Wage earners	178	863	1,041*)	161	880	169	872	1,041*)	167	874
Total	2,409	11,745	14,154	8,498	5,656	2,425	11,404	13,829	8,548	5,281

* of whom, working part time	Beginning of 1974	Beginning of 1975
Established officials, female	1	3
Salaried employees	281	278
Wage earners	778	769

The payments to serving members of the Directorate of the Bank and the Central Bank Council amounted to DM 5,557,165.48 in the year under review. Former members of those bodies and of the Board of Directors and Board of Managers of the Bank deutscher Länder, and the Boards of Management of the Land Central Banks, including their surviving dependents, received payments totalling DM 4,076,921.25.

Changes in staff regulations

During 1974 the Bank again concluded a number of pay agreements for its unestablished employees which brought their legal position into line with that of the Federal Government's unestablished staff. As from October 1, 1974 the regular weekly number of working hours for all the Bank's employees was reduced from 42 to 40.

Administrative costs
Materials

The administrative costs in respect of materials rose by DM 7.9 million to DM 95.9 million in the year under review.

Note printing

The expenditure on note printing amounted to DM 65.1 million against DM 56.2 million in 1973.

Depreciation and transfer to provisions

The depreciation on land and buildings and on equipment, as well as the transfers to provisions, were discussed in connection with the respective balance sheet items.

Pension payments in respect of Reichsbank

The payments to members of the former Deutsche Reichsbank and other persons to whom the Act concerning Section 131 of the Basic Law applies, and for whom the Bank is required to provide in accordance with section 41, Bundesbank Act, amounted in the year under review to DM 36.8 million (1973: DM 36.1 million).

Other expenditure

"Other expenditure" is shown at DM 25.9 million (1973: DM 20.0 million).

Depreciation on monetary reserves and other foreign exchange positions

The valuation of the monetary reserves and other foreign exchange positions required depreciation totalling DM 7,230.6 million (1973: DM 10,278.8 million) in the 1974 annual accounts.

Loss

Balance sheet loss

	DM million
After entering this depreciation in the profit and loss account there remains a loss of	2,158.1.
Combined with the adjusting item relating to 1973 for new valuation of monetary reserves and other foreign exchange positions – loss brought forward – of	6,773.2
the resultant balance sheet loss to be carried forward to 1975 amounts to	8,931.3,

which is shown in the balance sheet under asset item 22 as adjusting item for new valuation of monetary reserves and other foreign exchange positions – balance sheet loss – and explained in a note to the balance sheet.

Frankfurt am Main, April 1975

Deutsche Bundesbank
The Directorate
Dr. Klasen Dr. Emminger
Dr. Emde Dr. Irmler Prof. Dr. Köhler Lucht Dr. Schlesinger Tüngeler

Report of the Central Bank Council

The annual accounts of the Deutsche Bundesbank for 1974, the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1974, and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1974, have been audited by the auditing companies Treuarbeit Aktiengesellschaft of Frankfurt am Main and Dr. Wollert – Dr. Elmendorff KG of Düsseldorf, whom the Central Bank Council had appointed to be auditors in accordance with section 26 of the Bundesbank Act.

In their notes of certification the auditors have unreservedly confirmed that the annual accounts for 1974, the bookkeeping and the conversion account as shown by the books at December 31, 1974, are in accordance with legal provisions and that the Fund for the Purchase of Equalisation Claims has been properly administered.

The Central Bank Council approved the annual accounts for 1974 on April 10, 1975. At the same time it confirmed the conversion accounts for the Bank deutscher Länder and the Land Central Banks as well as the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1974, and approved the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1974.

Since the publication of the Report for the Year 1973 the following changes have taken place in the Central Bank Council and the Directorate of the Deutsche Bundesbank.

Retired from service

as at the close of May 31, 1974
the President of the Land Central Bank in the Free and Hanseatic City of Hamburg
Herr Friedrich Wilhelm von Schelling,

as at the close of November 30, 1974
the Vice-President of the Land Central Bank in the Rhineland-Palatinate
Herr Bernhard Rohland,

as at the close of March 31, 1975
the Member of the Directorate of the Deutsche Bundesbank
Dr. Rolf Gocht.

Released from office at his own request

as at the close of July 31, 1974
the Vice-President of the Central Bank in the Free and Hanseatic City of Hamburg
Dr. Jürgen Mees.

Reappointed

with effect from July 1, 1974
Herr Johannes Tüngeler
Member of the Directorate of the Deutsche Bundesbank.

Newly appointed

with effect from June 1, 1974
Herr Hans Hermsdorf
to be President of the Land Central Bank in the Free and Hanseatic City of Hamburg,

with effect from August 1, 1974
Herr Helmut Dietze
to be Vice-President of the Land Central Bank in the Free and Hanseatic City of Hamburg,

with effect from October 1, 1974
Professor Dr. Claus Köhler
to be Member of the Directorate of the Deutsche Bundesbank,

with effect from December 1, 1974
Herr Walter Kulla
to be Member of the Board of Management of the Land Central Bank in Hesse,

with effect from January 1, 1975
Herr Ernst Adamski
to be Vice-President of the Land Central Bank in the Rhineland-Palatinate.

The Central Bank Council, acting also on behalf of the Directorate and of the Boards of Management of the Land Central Banks, expresses to the entire staff of the Deutsche Bundesbank its thanks for their loyal and understanding co-operation during the year 1974. The Council likewise wishes to record its appreciation of the excellent collaboration with the staff representative committees.

Frankfurt am Main, April 1975

Dr. Karl Klasen
President of the Deutsche Bundesbank

Appendix to Part B

Balance sheet of the Deutsche Bundesbank as at December 31, 1974

Assets

		DM	DM
1. Gold			14,001,704,645.99
2. Reserve position in the International Monetary Fund and special drawing rights			
2.1. Drawing rights within gold tranche		3,807,004,734.32	
2.2. Loans under General Arrangements to Borrow		—	
2.3. Special drawing rights		4,247,574,436.71	8,054,579,171.03
3. Balances with foreign banks and money market investment abroad			49,734,061,355.94
4. Foreign currency			14,164,061.01
5. Loans and other claims on foreign countries			
5.1. Loans in connection with EEC medium-term monetary assistance		1,169,789,250.—	
5.2. Claims arising from foreign exchange offset agreements with U.S.A.		3,189,729,592.59	
5.3. Other loans to foreign monetary authorities		4,809,000,000.—	
5.4. Loans to World Bank		2,467,671,277.50	11,636,190,120.09
6. Foreign bills of exchange			877,017,313.24
7. Domestic bills of exchange			12,304,530,974.62
8. Lombard loans			2,334,077,200.—
9. Cash advances (book credits)			
9.1. Federal Government		1,076,700,000.—	
9.2. Equalisation of Burdens Fund		15,500,000.—	
9.3. Länder Governments		139,753,000.—	1,231,953,000.—
10. Treasury bills and discountable Treasury bonds			
10.1. Federal Government		—	
10.2. Länder Governments		—	—
11. Equalisation claims on Federal Government and non-interest-bearing debt certificate in respect of Berlin			
11.1. Equalisation claims		8,136,097,115.63	
11.2. Non-interest-bearing debt certificate		547,168,481.20	8,683,265,596.83
12. Loans to Federal Railways and Federal Post Office			
12.1. Cash advances (book credits)		—	
12.2. Treasury bills and discountable Treasury bonds		—	—
13. Securities			469,018,639.25
14. German coins			423,134,118.57
15. Balances on postal giro account			647,118,826.63
16. Other claims			758,986,477.08
17. Land and buildings			661,907,943.87
18. Equipment			30,447,108.—
19. Items in course of settlement			4,685,090,484.75
20. Other assets			954,866,563.17
21. Prepaid expenses and deferred income			24,118,734.87
22. Adjusting item for new valuation of monetary reserves and other foreign exchange positions — balance sheet loss —			8,931,294,247.74
Loss brought forward from 1973	DM 6,773,228,677.08		
Depreciation in 1974	DM 7,230,647,097.01		
	DM 14,003,875,774.09		
less operating surplus 1974	DM 5,072,581,526.35		
	DM 8,931,294,247.74		
Right of recourse in respect of contingent liabilities		296,657.25	
			126,457,526,582.68

	DM	DM
1. Bank notes in circulation		50,272,488,665.—
2. Deposits of banks		
2.1. on giro account	46,483,347,822.02	
2.2. Other	20,852,011.36	46,504,199,833.38
3. Deposits of public authorities		
3.1. Federal Government	138,981,817.19	
3.2. Equalisation of Burdens Fund and ERP Special Fund	162,712,415.96	
3.3. Länder Governments	642,717,797.38	
3.4. Other public depositors	44,644,965.31	989,056,995.84
4. Special deposits of Federal and Länder Governments		
4.1. Federal Government	7,176,604,899.—	
4.2. Länder Governments	3,576,040,285.95	
4.3. Anticyclical surcharge on income taxes	93,107.76	10,752,738,292.71
5. Deposits of other German depositors		
5.1. Federal Railways	5,203,653.18	
5.2. Federal Post Office (incl. postal giro and postal savings bank offices)	2,226,419,196.75	
5.3. Other depositors	507,119,503.93	2,738,742,353.86
6. Balances on cash deposit special accounts		127,332,946.26
7. Liabilities for mobilisation and liquidity paper sold		8,867,289,000.—
8. Liabilities in respect of foreign business		
8.1. Deposits of foreign depositors	1,267,850,056.80	
8.2. Other	16,300,473.38	1,284,150,530.18
9. Contra-entry to special drawing rights allocated		1,600,117,968.—
10. Provision for		
10.1. Pension liabilities	1,370,000,000.—	
10.2. Other purposes	320,128,500.—	1,690,128,500.—
11. Other liabilities		85,808,265.58
12. Deferred expenses and accrued income		326,255,431.56
13. Capital		290,000,000.—
14. Reserves		
14.1. Legal reserve	847,300,000.—	
14.2. Other reserves	81,917,800.31	929,217,800.31
Contingent liabilities	296,657.25	
		126,457,526,582.68

Profit and loss account of the Deutsche Bundesbank for the year 1974

Expenditure

	DM	DM
1. Administrative costs		
1.1. Personnel	471,447,568.69	
1.2. Materials	95,935,032.72	567,382,601.41
2. Note printing		65,052,230.69
3. Depreciation		
3.1. on land and buildings	28,672,772.33	
3.2. on equipment	14,351,175.31	43,023,947.64
4. Transfer to provisions for pension liabilities		280,281,763.64
5. Pension payments in respect of Reichsbank		36,819,350.33
6. Other expenditure		25,861,315.64
7. Depreciation on monetary reserves and other foreign exchange positions		7,230,647,097.01
		8,249,068,306.36

Receipts

	DM
1. Interest	6,056,363,058.66
2. Fees	9,177,770.36
3. Other receipts	25,461,906.68
4. Loss	2,158,065,570.66
	8,249,068,306.36

Supplement to profit and loss account

	DM
1. Loss in 1974	2,158,065,570.66
2. Adjusting item relating to 1973 for new valuation of monetary reserves and other foreign exchange positions — loss brought forward —	6,773,228,677.08
3. Balance sheet loss	8,931,294,247.74

Deutsche Bundesbank
The Directorate
Dr. Klasen Dr. Emminger
Dr. Emde Dr. Gocht Dr. Irmler Prof. Dr. Köhler Lucht Dr. Schlesinger Tüngeler

Our audit, which was duly carried out, shows the bookkeeping and the annual accounts to be in accordance with the law and the Bank's by-laws.

Frankfurt am Main, March 4, 1975

Treuarbeit Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr. Scholz (Certified Auditor)   Dr. Haufschild (Certified Auditor)

D. Wollert – Dr. Elmendorff KG
Wirtschaftsprüfungsgesellschaft

Dr. Bargmann (Certified Auditor)   Thoennes (Certified Auditor)