Report of the Deutsche Bundesbank

for the Year 1979

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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, domestic and external monetary and foreign exchange policy regulations of the Deutsche Bundesbank
Part C	Fund for the Purchase of Equalisation Claims
Appendices to Parts B and C	Nos. 1, 3, 4 and 5

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Contents

The German original went to press on April 17, 1980

Part A: General part

The currency
and the economy in 1979

I. Economic developments and central bank policy

The economic performance of the Federal Republic of Germany was on balance favourable last year. The main positive features were the strong growth of the economy and the further reduction in unemployment. In spite of some hindrances the real gross national product increased by 4 ½ % in 1979 – a rate of growth that was not only one of the highest in the world but also above the original expectations. Owing to the steep rise in production, full utilisation of capacity was generally achieved in the later part of the year. At the same time the demand for labour went up sharply; many persons who were looking for work were found new jobs and the seasonally adjusted unemployment figure declined steadily. The strength of economic activity was primarily due to the fact that, in view of the underlying conditions, industrial enterprises were prepared to expand their capital spending substantially. The current wave of private capital investment is likely to last until well into 1980 at least and thus to have a beneficial effect on further economic trends. Nevertheless, it is foreseeable that the pace of business activity will slacken this year because of the reduced margin for growth and also because of additional external burdens.

But the economic performance in 1979 also had unfavourable aspects. Germany was less able than in previous years to evade the impact of escalating world inflation. As a result of the abrupt rises in oil prices many western countries found it increasingly difficult to keep domestic inflationary tendencies under control, which caused the oil-producing countries to raise their prices further. The upward movement of prices in Germany accelerated in the course of 1979, and in view of the new oil price surge at the turn of 1979/80 there can at the moment be little hope of a rapid reduction in the pace of domestic price rises, even though the inflation rate in Germany is near the bottom of the international scale.

The higher prices of imports are also largely responsible for the fact that the current account of the German balance of payments moved into deficit in 1979 after showing major surpluses in preceding years. In 1980, following the latest price decisions of the OPEC countries, a substantial increase in Germany's deficits on current account is to be expected. These deficits have in the meantime assumed proportions which make it unlikely that the German balance of payments can soon be restored to equilibrium, since the necessary adjustment processes take time. Even so, a reduction in the current account deficits must be aimed at in the medium run.

The domestic and external inflationary dangers which became evident towards the end of 1978 forced the Bundesbank to make its monetary policy more restrictive. Last year it pursued a consistent policy of tight money, which was reflected during the year in several increases in central bank interest rates and in measures to contain bank liquidity. In the quantitative implementation of its monetary policy the Bundesbank aimed increasingly at the lower limit of the target range of 6 to 9 % it had set for the growth of the central bank money stock. The "monetary cloak" of the economy accordingly became tighter. By announcing a monetary growth target for 1980 that appears appropriate to the present overall situation (an increase of 5 to 8 % in the central bank money stock), and by the monetary policy decisions it has taken in the first few months of the current year, the Bundesbank has reaffirmed its determination to go on fighting inflation to the best of its ability. Up to now domestic economic activity has not been impaired by this monetary policy stance. The continuation of the stability-oriented monetary policy is, moreover, essential in order to ensure appropriate economic growth and, as far as possible, steady employment for a long time to come. The profound changes in the German balance of payments also require monetary policy to be oriented in this way, so that external equilibrium, which is indispensable, may be restored in the longer run.

1. High level of economic activity despite external burdens

Capital formation the mainstay of the upswing

In 1979 economic developments in the Federal Republic of Germany were characterised by a marked upswing which was fuelled mainly by enterprises' capital formation. Last year the amount spent by enterprises (excluding housing) on machinery, equipment and construction was 14 ½ % – and at constant prices 9 ½ % – larger than in 1978. The significance of capital spending for economic activity is also reflected in the fact that enterprises' fixed capital formation accounted for as much as 30 % of the total growth of production last year. In view of the challenge faced by the economy as a result of the rapid increase in the cost of raw materials and energy, it is undoubtedly a step in the right direction if, after years of relatively declining investment, a growing proportion of the goods produced is used for fixed capital formation, thus permitting improvements in productivity and strengthening the basis for growth.

Capital formation stimulated by fiscal policy and by appropriate rises in pay rates . . .

The marked upswing in capital formation was mainly due to enterprises' favourable profitability and their consequent relatively large scope for self-financing. This was partly because the economy was additionally stimulated by fiscal policy, both directly through the tax cuts approved in 1977 and 1978 and the promotion of investment to conserve heating energy and indirectly through the programme of future investments. Management and labour likewise helped to strengthen investment activity last year by agreeing, in the wage round at the beginning of 1979, on wage and salary increases which largely took account of the new external risks and burdens apparent at that time. As an annual average, negotiated wages and salaries were not quite 5% higher than in 1978. Since labour became scarcer and since overtime work and payments over and above the agreed scale became more frequent as the economic upswing gathered pace, actual earnings rose rather more than this (by 5 ½ %). However, owing to the sharp increase in production, overall unit labour costs went up comparatively moderately, viz. by about 2 ½ %. It was only because of this that enterprises as a whole were able to cope with the external cost burdens, which grew in the course of 1979, and with the rising cost of finance. In the first half of 1979 entrepreneurial and property income — which is admittedly a rather rough yardstick of enterprises' profitability because it includes a number of very heterogeneous elements[1] — was 12 ½ % larger than a year earlier. But in the second half of the year, in which the external cost burdens began to weigh more heavily, enterprises' earnings came under substantial pressure again. In that period entrepreneurial income was only 6 ½ % higher than a year before, and its share in national income decreased slightly, seasonally adjusted; however, at 29.0% it remained at a level which roughly corresponded to that of 1976 and 1973, when capital formation had likewise been considerable.

. . . as well as by the increase in relative energy prices

Capital formation was also stimulated by the fact that, in view of the sharply rising energy prices, there was more incentive to save as much energy as possible by increasing the capital input. In 1979 the cost of the economy's total energy input went up by nearly one fifth; compared with the level prior to the oil crisis of 1973/74 the prices of energy of all kinds rose by an average of about 175% up to 1979. In the same period the purchase prices of fixed assets grew by only 31%, judging from the data of the national accounts. Even if the noticeably higher cost of borrowed funds is taken into account, the replacement or conservation of energy by stepping up the capital input therefore seems to have become more worth while last year. Moreover, following the rapid succession of increases in OPEC petroleum prices it is more generally appreciated that energy is likely to remain scarce and expensive in the long run. More investment to conserve energy and to rationalise production is therefore indispensable if further cost rises are to be absorbed and if the international competitiveness of German enterprises is to be safeguarded.

Continuation of the high level of investment seems assured

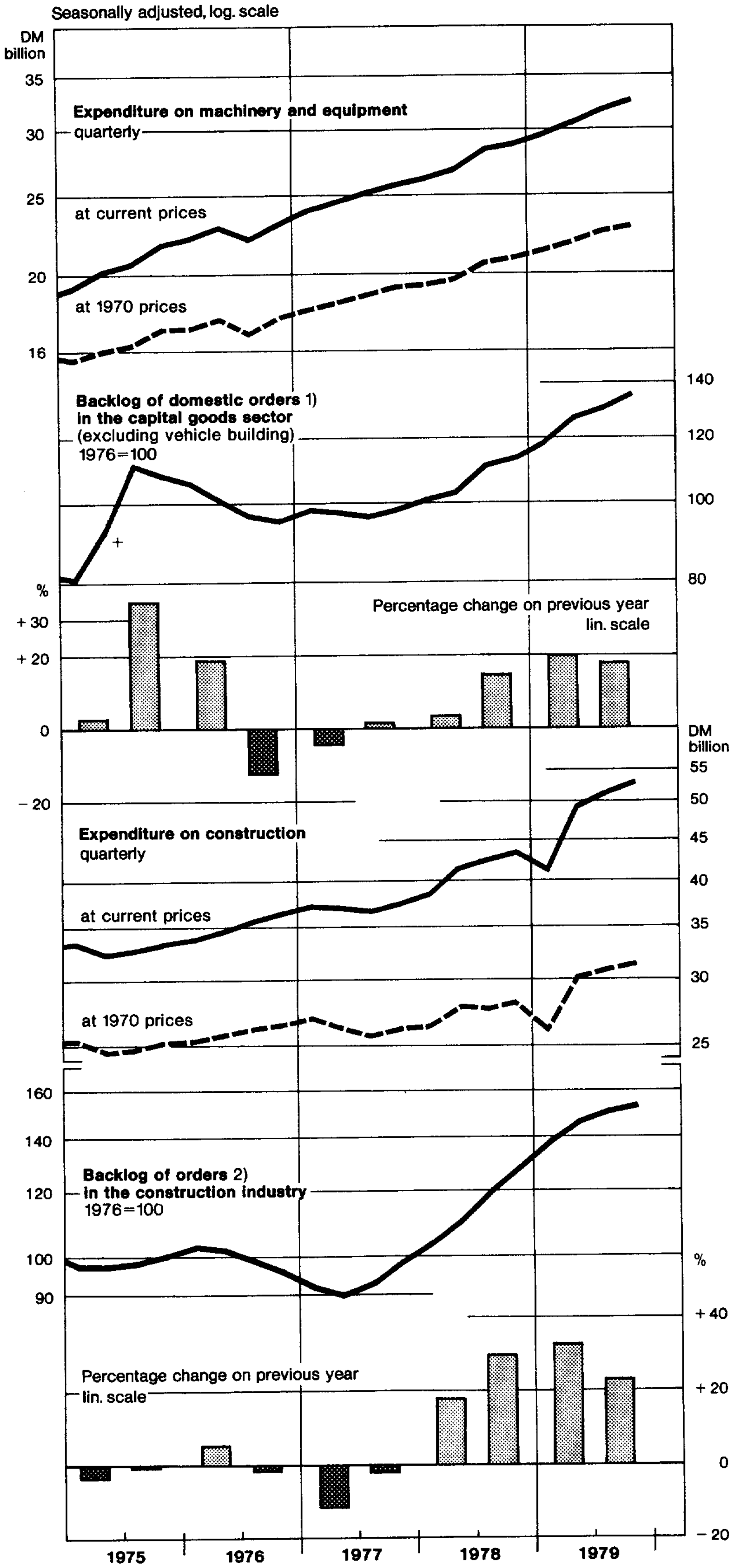
There is strong evidence that, despite the new burdens, the favourable investment climate will initially persist in the current year. At all events, investment plans could be made on the basis of a very sound self-financing position. About 87% of the investment effected by enterprises (excluding housing and financial institutions) was financed out of internal resources in 1979; this was not as much as in 1978, but rather more than in earlier years of heavy capital formation. In particular, the fact that the capital goods industries started the new year with a large backlog of domestic orders and that quite sizeable orders were received from the home market in the first few months of 1980 implies that the investment climate will remain favourable. The level of new orders for industrial buildings was likewise high, which suggests that enterprises' investments included substantial capacity extensions as well as rationalisation projects.

Large, partly speculative stockbuilding

Demand was also stimulated considerably by stockbuilding last year; according to the calculations of the Federal Statistical Office the increase in stocks in 1979 was about

1 In addition to enterprises' profits in the narrower sense this aggregate includes the results of the Federal Railways and Federal Post Office, the income of farmers, the housing sector and the professions, and households' property income.

Demand for capital goods



1) Calculated by the Bundesbank on the basis of data from the Federal Statistical Office (monthly averages in the period stated).- 2) Averages of end-of-quarter levels in the period stated.- + Influenced by the deadline for qualifying for the investment grant (June 30, 1975).

three times as large as in 1978. In some sectors this restored stocks, which had previously been very low, to a normal level, but additional stockbuilding was not infrequently motivated by fears of possible bottlenecks in supply and expectations of rising prices. Another significant factor was that the stocks of crude oil and petroleum products prescribed by the Act to Safeguard the Energy Supply were brought close to the required level in the course of the year.

Sharp growth of expenditure on housing

One of the particularly buoyant elements of economic activity in 1979 was housing construction. Expenditure in this field was 17 ½ % higher than in 1978; calculated at constant prices, this represents a growth of 8 %. The number of new dwellings completed in 1979, at an estimated 400,000 units, was 8 ½ % larger than a year earlier. Besides the construction of new buildings, the modernisation of existing dwellings steadily increased in importance; it was stimulated further by government promotion programmes, for instance in the field of energy conservation. Whereas the demand for housing was fostered by relatively favourable credit terms at the beginning of 1979, the financing conditions deteriorated noticeably in the later part of the year. Moreover, the prices of construction work and building land rose sharply. The placing of new orders for residential buildings consequently slackened slightly at times during 1979, but from the beginning of the autumn onwards the inflow of orders was larger than in the first half of the year. Despite the pronounced expansion of output the backlogs of housing orders did not decrease towards the end of last year, but rather grew slightly again; at that time they probably exceeded the end-1978 level by 8 ½ % in real terms. The price rises in the field of housing construction and the upturn in lending rates have thus not reduced the demand for new residential buildings, but have only slowed down or temporarily interrupted the previous steep growth. From the point of view of prospective building owners, the fear of further cost and price increases apparently weighs more heavily than the rises in interest rates and construction prices that have already occurred.

Further expansion of private consumption

Private consumption expenditure continued to go up sharply last year (+7 %), but — unlike in 1978 — the major part of the increase was absorbed by accelerating inflation in the course of the year; at constant prices private consumption expenditure grew by 3 % in 1979. The extra spending on heating materials and petrol due to the price rises was particularly large. In 1979 roughly 80 % more than a year earlier was spent on heating oil alone, while the consumption of heating oil did not increase in real terms. Households offset a large part of this additional expenditure by cutting down their spending for other purposes. Demand for new cars, for example, slackened distinctly in the course of 1979, and at times households significantly reduced their purchases of other durable consumer goods. Since the beginning of 1980, however, private consumer demand — particularly that for consumer durables — has expanded again.

Steep rise in disposable income

The increase in households' consumption expenditure was based on a marked rise in disposable income. Gross wages and salaries went up last year by just over 7 %, and net wage and salary income grew slightly more owing to the further tax cuts. After adjustment for inflation, net income per employee increased by 1 ½ % in real terms. Thus even under the adverse conditions of 1979, when the scope for the growth of real income was narrowed by the sharp rise in import prices, a distinct expansion of average real income was achieved in Germany, which can be said of only a few industrial countries.

Considerable private saving despite the burden imposed by higher energy prices

In spite of the higher cost of energy households saved relatively much in 1979; their saving ratio increased from not quite 14 % of their disposable income in 1978 to roughly 14 ½ %. Particularly in the first half of the year households built up their savings considerably. This owed something to the fact that the volume of bonus-carrying savings deposits released at the beginning of last year was much smaller than a year earlier, so that the withdrawal of savings which is regularly associated with such releases remained relatively small. But in the course of 1979 the additional burdens imposed by the oil price increases became more apparent, which significantly affected saving. The saving ratio of lower-income households, in particular, declined sharply, in close connection with the steep rise in their relative expenditure on energy.

Strong, but temporarily slackening, foreign demand

Foreign demand likewise developed quite favourably last year. The export orders received by industry expanded by 9 ½ % in real terms and thus more than domestic orders; once again, this was partly because of large-scale orders, which, judging from

Basic economic data in the Federal Republic of Germany

Item	Unit	1976	1977	1978	1979	1976	1977	1978	1979
						Percentage change on previous year			
Aggregate demand									
Private consumption	DM billion	623.6	667.2	707.9	757.9	+ 8.0	+ 7.0	+ 6.1	+ 7.1
Public consumption	DM billion	227.2	239.5	256.8	276.6	+ 5.5	+ 5.4	+ 7.2	+ 7.7
Fixed capital formation	DM billion	231.9	249.1	276.5	319.0	+ 8.1	+ 7.4	+ 11.0	+ 15.4
Machinery and equipment	DM billion	90.7	99.9	110.4	124.3	+ 10.2	+ 10.2	+ 10.5	+ 12.6
Buildings	DM billion	141.2	149.3	166.1	194.7	+ 6.8	+ 5.7	+ 11.3	+ 17.2
Expenditure on stocks	DM billion	+ 13.7	+ 11.9	+ 9.3	+ 29.0	.	.	.	.
Domestic expenditure	DM billion	1,096.4	1,167.7	1,250.5	1,382.5	+ 9.0	+ 6.5	+ 7.1	+ 10.6
External surplus 1	DM billion	28.6	29.5	37.0	12.5	.	.	.	.
Exports	DM billion	312.1	330.6	348.6	381.9	+ 14.4	+ 5.9	+ 5.4	+ 9.6
Imports	DM billion	283.4	301.1	311.5	369.4	+ 16.3	+ 6.2	+ 3.5	+ 18.6
Gross national product at current prices	DM billion	1,125.0	1,197.2	1,287.5	1,395.0	+ 8.7	+ 6.4	+ 7.5	+ 8.3
Memorandum items									
Orders received by manufacturing	1976 = 100	100.0	101.3	106.3	117.8	+ 13.7	+ 1.3	+ 4.9	+ 10.9
Domestic orders	1976 = 100	100.0	103.2	108.5	118.5	+ 8.5	+ 3.2	+ 5.2	+ 9.3
Foreign orders	1976 = 100	100.0	97.2	101.5	116.3	+ 26.3	− 2.8	+ 4.4	+ 14.6
Orders received by construction	1976 = 100	100.0	115.6	142.5	160.8	− 6.2	+ 15.6	+ 23.2	+ 12.9
Production									
Gross national product at 1970 prices	DM billion	792.0	812.2	840.8	877.5	+ 5.3	+ 2.6	+ 3.5	+ 4.4
Productivity 2	1970 = 100	128.7	133.4	137.7	142.8	+ 5.3	+ 3.6	+ 3.3	+ 3.7
Output in the producing sector (excluding construction)	1970 = 100	112.7	116.0	118.5	124.8	+ 7.3	+ 2.9	+ 2.2	+ 5.3
Construction output	1970 = 100	95.2	95.2	102.5	109.3	+ 3.0	+ 0.0	+ 7.7	+ 6.6
Distribution of income									
Wage and salary income	DM billion	626.3	669.7	714.6	766.7	+ 7.4	+ 6.9	+ 6.7	+ 7.3
do. as a percentage of national income	%	71.3	71.8	71.3	70.9	.	.	.	.
Entrepreneurial and property income	DM billion	251.7	263.3	288.0	314.8	+ 12.8	+ 4.6	+ 9.4	+ 9.3
do. as a percentage of national income	%	28.7	28.2	28.7	29.1	.	.	.	.
National income	DM billion	878.0	933.0	1,002.6	1,081.5	+ 8.9	+ 6.3	+ 7.5	+ 7.9
Employment									
Employed persons	Millions	25.1	25.0	25.2	25.5	− 0.9	− 0.2	+ 0.7	+ 1.2
Wage and salary earners	Millions	21.3	21.3	21.6	22.0	− 0.5	+ 0.3	+ 1.2	+ 1.8
Memorandum item									
Total number of man-hours worked	1970 = 100	90.5	89.7	89.7	90.3	− 0.1	− 0.9	− 0.1	+ 0.7
Unemployed persons	Thousands	1,060	1,030	993	876	− 1.3	− 2.9	− 3.6	− 11.8
do. as a percentage of									
the total labour force	%	4.0	3.9	3.8	3.3	.	.	.	.
the dependent labour force	%	4.6	4.5	4.3	3.8	.	.	.	.
Prices									
GNP deflator	1970 = 100	142.0	147.4	153.1	159.0	+ 3.3	+ 3.8	+ 3.9	+ 3.8
Memorandum item									
Unit labour costs in the economy as a whole 3	1970 = 100	146.2	151.7	155.7	159.2	+ 1.5	+ 3.8	+ 2.6	+ 2.3
Cost of living index for all households	1976 = 100	100.0	103.7	106.5	110.9	+ 4.3	+ 3.7	+ 2.7	+ 4.1
Producer prices of industrial products	1970 = 100	140.8	144.5	146.3	153.6	+ 3.9	+ 2.6	+ 1.3	+ 5.0
Overall construction price level	1970 = 100	137.8	143.9	152.6	165.9	+ 3.1	+ 4.4	+ 6.0	+ 8.7
Index of import prices	1970 = 100	151.8	154.1	146.2	165.1	+ 6.7	+ 1.5	− 5.1	+ 12.9

1 Balance of transactions in goods and services with other countries (including GDR). — 2 Gross domestic product at 1970 prices per man-hour worked. — 3 Index of gross wages and salaries per employee divided by index of real GNP per employed person. — The figures from the national accounts from 1977 onwards are provisional.

Economic growth and employment

Period	Gross domestic product 1	Productivity 2	Total number of man-hours worked 3	Employed persons 4		Memorandum item Unemployed persons
	Percentage change on previous year				Change on previous year in thousands	
1970 to 1973 5	+ 4.4	+ 4.6	− 0.2	+ 0.4	+102	+ 24
1974 to 1979 5	+ 2.3	+ 3.8	− 1.4	− 0.7	−192	+101
1974	+ 0.5	+ 3.6	− 2.9	− 1.9	−493	+309
1975	− 1.8	+ 3.2	− 4.9	− 3.4	−889	+492
1976	+ 5.2	+ 5.3	− 0.1	− 0.9	−233	− 14
1977 p	+ 2.7	+ 3.6	− 0.9	− 0.2	− 40	− 30
1978 p	+ 3.2	+ 3.3	− 0.1	+ 0.8	+188	− 37
1979 p	+ 4.4	+ 3.7	+ 0.7	+ 1.3	+315	−117

1 At 1970 prices. — 2 Real gross domestic product per man-hour worked. — 3 Calculated by the Bundesbank. — 4 Persons employed in Germany. — 5 Annual averages. — p Provisional.

past experience, affect production only gradually. But in the course of last year foreign demand lost some momentum at times, in line with economic trends in western industrial countries. However, exporters benefited from the fact that investments in the energy sector seem to be gathering pace in other countries as well. The sales prospects for German capital goods producers, with their wide range of technologically sophisticated machinery and equipment, are likely to be good in this field. This is suggested by the gratifying trend of the foreign orders received by the German capital goods industries towards the end of last year and particularly in the first few months of 1980. According to the latest Ifo business survey, capital goods producers are quite optimistic about their future export prospects in spite of all uncertainties.

Maintenance of competitiveness the precondition for new external equilibrium

For future economic developments in Germany much will depend on enterprises remaining competitive in relation to foreign suppliers both in export markets and at home. The chances of this happening are not unfavourable, since enterprises have apparently been able to keep up with technological progress and have responded very flexibly to altered market conditions (as in earlier periods of radical structural change); the abovementioned rise in the overall investment ratio last year is an indication of this. Moreover, enterprises have benefited from the lower rate of inflation in Germany, as reflected in the fact that German firms' export prices are increasing distinctly less than those of their foreign competitors. The external value of the Deutsche Mark has also been declining recently, so that competitiveness has been strengthened by exchange rate movements as well as by price trends.

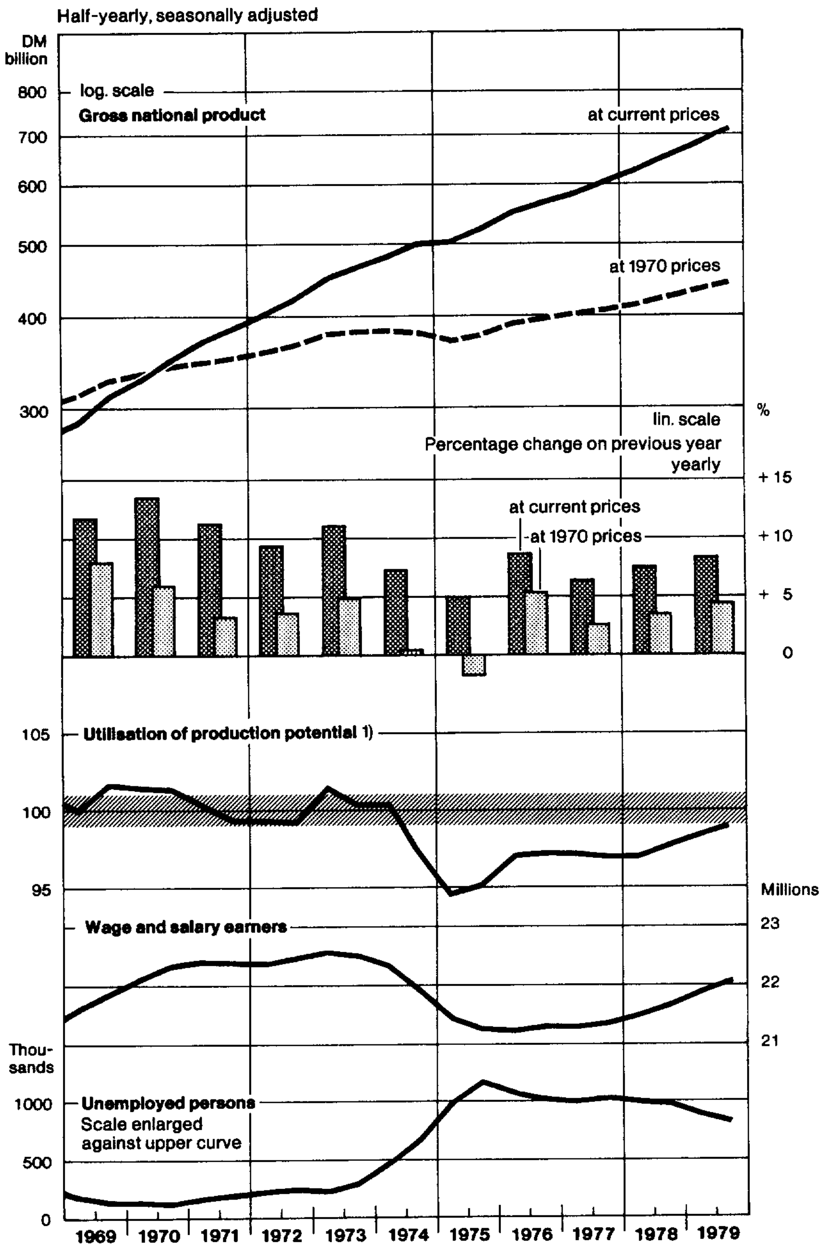
Overall growth target surpassed in 1979

Following the sharp expansion of demand, overall production also increased last year, albeit to a more limited extent than nominal demand, which was swollen by inflation. In 1979 the real gross national product — the most comprehensive indicator of economic activity — was 4.4 % larger than a year before. Its growth rate thus slightly exceeded the target of 4 % set by the Federal Government in its Annual Economic Report. With this rise in output the utilisation of overall production capacities increased further, and probably reached an almost normal level in the later part of 1979.

Sharp rise in the output of the producing sector . . .

The producing sector (i. e. gas and electricity undertakings, industry and craft enterprises), whose output expanded by 5½ % in 1979, played a major role in the strong growth of economic activity. For the future trend in production a very important factor will be how far enterprises manage to adjust to the profound changes in production conditions caused by the energy price shock. If only for cost reasons, enterprises will be forced to use energy — especially that based on petroleum — more efficiently than before. Particularly in the basic goods field, which accounts for about 70 % of the energy consumed in the manufacturing sector, the technical possibilities of conserving energy are no doubt considerable. Of course, the need to adjust is likely to vary from industry to industry. For example, the very large energy requirements in the iron and steel industry are already met for the most part by coal. Heating oil is relatively little used in

National product and employment



1) Calculated by the Bundesbank, potential = 100; area of uncertainty shaded.

electricity generation on account of the energy policy measures adopted in the past ("coal penny", etc.), and its use will continue to decrease as a result of the decisions taken by the Federal Cabinet on March 26, 1980 in connection with the planned electricity supply agreement between the coal mining and electricity industries. Restructuring in favour of coal and natural gas is also taking place in other energy-intensive fields of production, such as the building materials industry. However, it is a precondition of substitution processes of this kind that the chosen source of energy is available for a long time and, if possible, in growing quantities, for instance through expanding (as planned) the facilities for importing coal. In the chemical industry, on the other hand, dependence on oil will remain relatively great even when less oil is used as a source of energy, for naphtha — a raw material which is irreplaceable in the foreseeable future — plays an important role in this industry.

. . . and the construction industry

Construction output also grew very sharply last year, as in 1978, although construction activity was greatly hampered in the first few months of 1979 by the extremely unfavourable weather. As a whole, production was expanded by 6 ½ % last year; this was possible only because of the sustained high level of investment, the increased utilisation of the available construction capacity and the recruitment of additional labour (which was frequently rather difficult). According to the Ifo Institute the utilisation of fixed capacity in the construction industry averaged 65 % in 1979 and as much as about 70 %, seasonally adjusted, towards the end of the year; such a level of utilisation had not been reached since the construction boom at the beginning of the decade.

Only a moderate improvement in productivity

As the utilisation of production capacity had already been rather high at the beginning of 1979, the improvement in productivity among German enterprises was comparatively small last year. Calculated per man-hour worked, the real gross domestic product in 1979 was 3 ½ % larger than a year earlier. Productivity thus grew distinctly less than in the early seventies (1970/73: an average of 4 ½ %). A major reason for this, besides the high degree of capacity utilisation already mentioned, was no doubt that the efficiency of the additional capital input relative to output has declined noticeably in the last few years, among other things because a larger part of capital expenditure is used for the protection of the environment, the conservation of energy and the replacement of petroleum products.[1]

Sharp increase in employment

In 1979, more than in earlier years, the expansion of overall production was accompanied by an increase in employment. This owed much to the fact that numerous new jobs were created through enterprises' heavy fixed capital spending. The average number of wage and salary earners went up by nearly 400,000 persons (or 1.8 %) last year. This was the sharpest rise for nearly a decade. Particularly many new employees were recruited in the services sector; the public service accounted for one quarter of the growth of employment in the economy as a whole, the number of its employees increasing by about 100,000. But the staff of the producing sector and especially of construction firms was also enlarged; indeed, the demand for labour could not be fully satisfied in these fields. Some of the new employees were presumably young people starting work and women who had not had jobs before and were often only interested in part-time employment, for the business community considerably expanded its training facilities and supply of part-time jobs. The number of foreign workers employed in Germany also seems to have increased distinctly again, for the first time for some years, mainly because at the beginning of last year the German labour market was made more accessible to members of the families of foreigners working in Germany.

Further progress in reducing unemployment

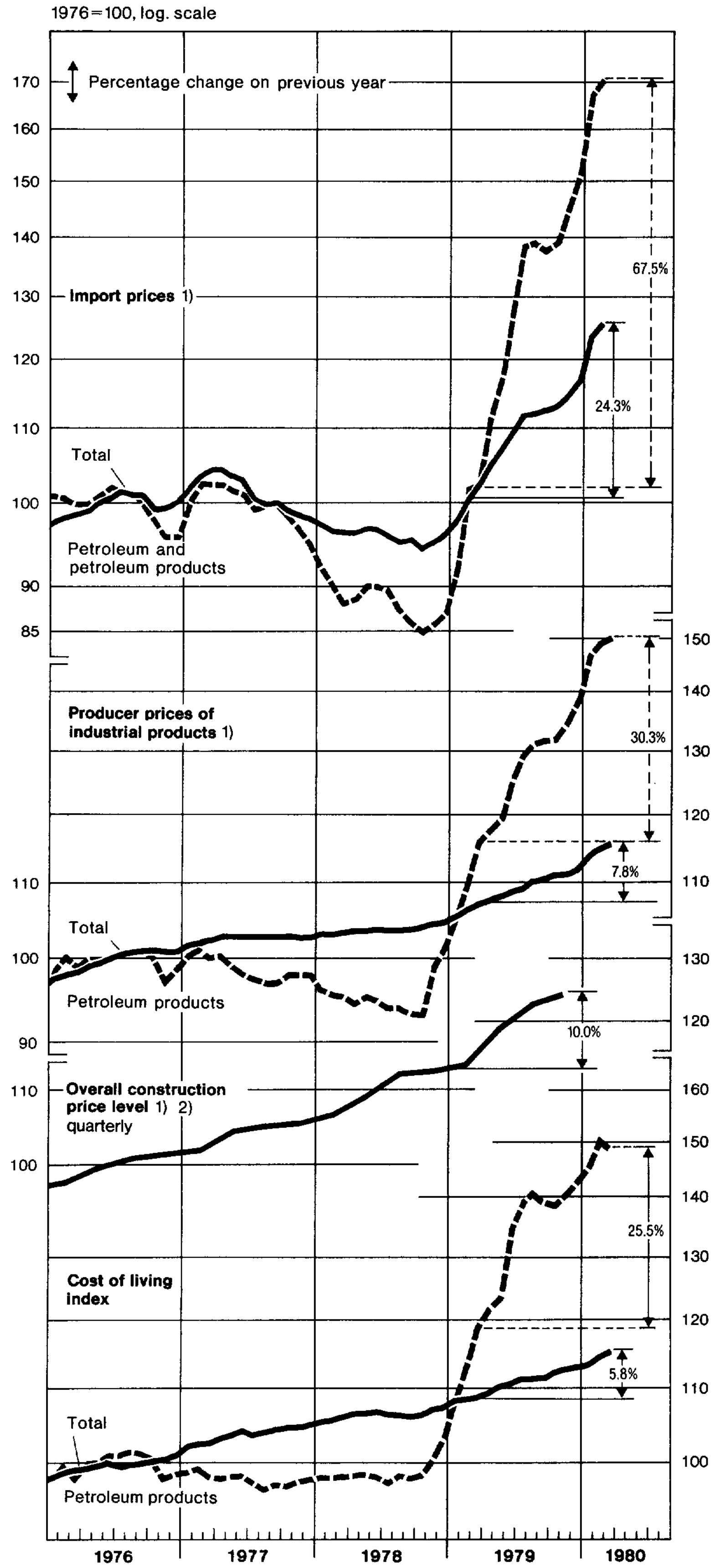
Quite a considerable proportion of the new employees came from the ranks of the unemployed persons registered at labour exchanges, the number of whom decreased by an average of 117,000 in 1979, as against the preceding year, to 876,000. Relative to the total labour force, the unemployment ratio thus averaged 3.3 % in 1979. Compared with the dependent labour force, it averaged 3.8 % last year; at the end of March 1980 it stood at 3.6 %, seasonally adjusted. As these figures include about 160,000 persons looking for part-time jobs, the ratio of full-time unemployed persons was lower.

Greater discrepancies between the demand for and the supply of labour

As a result of the improvement of the situation in the labour market, the long-standing discrepancies between the qualifications required for the jobs on offer and those possessed by persons seeking work became more marked than ever. For instance, according to the latest structural survey by the Federal Labour Office of September 1979, more than one fifth of the unemployed persons were looking for part-time jobs, whereas only 10 % of the reported vacancies were for such employment. More than half of those registered as unemployed — i. e. nearly 400,000 persons — had not completed any occupational training. By contrast, the business community's demand was mainly for skilled labour, which became increasingly scarce. The regional differences in the labour market — between areas with over-full employment and areas with less demand for labour — also continued to exist, but in September last year only 16 % of the persons registered as unemployed were willing to be found jobs in any part of Germany. Other problem groups (such as persons over 55 years of age or persons who are difficult to place be-

1 See "The growth of productivity in the Federal Republic of Germany and its determinants", Monthly Report of the Deutsche Bundesbank, Vol. 32, No. 1, January 1980, p. 11.

Prices



1) Rebased from the original base 1970=100.- 2) Calculated by the Bundesbank.

cause they are not completely fit), whose incorporation in the labour force is a special concern of the labour exchanges, make up a growing proportion of those registered as unemployed. Although the demand for labour is very strong, the number of persons registered as unemployed continues to be greater than it was prior to 1973; this suggests that the number of unemployed persons would decrease only slowly even if economic activity were more buoyant still.

Pace of inflation quickened by price surges from abroad

The movement of prices in Germany last year was increasingly determined by price surges from abroad, which quickened the pace of domestic inflation and thus made stabilisation policy more difficult. The imported price rises were mainly due to the raising of oil prices in several large steps by the OPEC countries. At the time of going to press their average contract prices for crude oil amounted to US$ 32 per barrel, which was about twice as much as a year earlier. Altogether, import prices went up by just over one fifth in the course of 1979, whereas they had declined a year before; in the first few months of 1980 the rate of price rises has accelerated further (February 1980: +24 ½ % as against the preceding year). More than half of the increase in import prices in 1979 was attributable to the higher prices of petroleum and petroleum products alone. But the prices of other imported industrial products, particularly in the basic and consumer goods sectors, were also raised sharply; in February 1980, for example, goods imported for private consumption, excluding petroleum products, were about 10 % dearer than a year earlier. The prices of imported capital goods, on the other hand, increased by only 3 % in that period.

Price rises continue in Germany

The wave of price rises emanating from abroad spread throughout the domestic markets. The extent to which the higher cost of the material input and other cost increases were passed on to customers, or whether firms even raised prices over and above this (i. e. whether profit margins widened), cannot be established for certain. There is some evidence that it was not possible to pass on all cost increases to customers in the second half of last year, and that profit margins consequently narrowed again. Nevertheless, at the end of 1979 the producer prices of industrial products were 7 % higher than a year earlier, and excluding petroleum and petroleum products they were just over 5 % greater. By March 1980 the year-on-year growth rate of prices had accelerated to 7.8 % and 6.2 %, respectively.

Sharp increase in construction prices

The prices of construction work went up particularly steeply in the course of 1979. In November last year they were 10 % higher than a year earlier. This was primarily due to the continued very strong demand in the construction industry, which probably enabled construction firms to pass on to building owners not only the above-average wage cost rises of last year but also the increases in the cost of materials caused by the higher oil prices (the building materials industry is one of the branches of economic activity which depend especially heavily on petroleum).

Faster rise in consumer prices

The price increases at the producer level and among imports soon caused prices at the consumer level to move upwards last year. Around the turn of 1979/80 the cost of living index of all households was about 5 ½ % higher than a year before; just over a year earlier — in the autumn of 1978 — the inflation rate had been little more than 2 %, the lowest figure since the end of the sixties. The rise in consumer prices owed a great deal to the higher cost of petroleum products; at the end of 1979 households had to pay almost twice as much as a year earlier for light heating oil alone. In addition, the rate of value-added tax was increased in the middle of 1979. But even if the direct effects of these two factors are eliminated, the year-on-year price rise came to 3 ½ % at the end of 1979. Besides the indirect consequences of the higher oil prices and greater cost of other imported raw materials and primary products, this was to some extent due to the acceleration of food prices and — partly in connection with the modernisation of housing and the conservation of energy — to the raising of rents in the second half of 1979.

Germany in the lower part of the international inflation scale

With a year-on-year increase in the cost of living averaging 4.1 % in 1979 and 5.8 % in March 1980, Germany is still in the lower part of the inflation scale as compared with other industrial countries. In the last few months inflation rates have been lower in Austria and Switzerland and about the same in the Netherlands and Belgium, but consumer prices have recently been going up at rates between 13 and 21 % in France, the United States, the United Kingdom and Italy. The average inflation differential between Germany

Movement of prices abroad

Percentage increase in the consumer price index against the previous year

Country	1970 to 1973 **1**	1974 to 1979 **1**	1975	1976	1977	1978	1979	Feb. 1980
France	6.1	10.7	11.8	9.6	9.4	9.1	10.8	13.4 **p**
United Kingdom	8.0	15.6	24.2	16.5	15.8	8.3	13.4	19.1 **p**
Italy	6.6	16.1	16.9	16.8	17.0	12.1	14.8	20.8 **p**
Netherlands	7.0	7.2	10.5	8.8	6.4	4.1	4.2	5.8° **p**
Belgium	5.2	8.4	12.8	9.2	7.1	4.5	4.5	6.6°
EEC countries 2,4	6.8	13.2	16.7	13.4	13.0	9.0	12.0	16.5 **p**
United States	4.9	8.5	9.1	5.8	6.5	7.7	11.3	14.1 **p**
Japan	7.5	9.9	11.9	9.3	8.1	3.8	3.6	7.5° **p**
Austria	5.7	6.3	8.5	7.3	5.5	3.6	3.7	5.4 **p**
Switzerland	6.4	4.0	6.7	1.8	1.2	1.1	3.6	3.9° **p**
Selected countries 3,4	5.7	9.9	11.4	8.4	8.6	7.5	10.2	13.6 **p**
Memorandum item **Federal Republic of Germany**	5.3	4.6	6.0	4.3	3.7	2.7	4.1	5.8°

1 Annual averages. — **2** Excluding Federal Republic of Germany, Denmark, Ireland and Luxembourg. — **3** Including Norway, Sweden and Canada. — **4** Weighted with the share of these countries in the gross national product of all OECD countries in 1970. — **p** Provisional. — ° March.

and other major countries has therefore widened further.[1] So far, at all events, Germany has been able to evade the impact of escalating inflation better than many other countries. At the beginning of the year, however, new price rises took place abroad and have not yet worked through in full to the domestic market, particularly at the consumer level. The price situation is complicated further by the fact that the higher cost of foreign products is no longer — as in earlier years — partly offset by an appreciation of the Deutsche Mark, although the lower inflation rate in Germany would justify such a change. As a result of the large deficit on current account and the comparatively low level of domestic interest rates, the Deutsche Mark has in fact depreciated in the past few months, which has reinforced the importation of inflation.

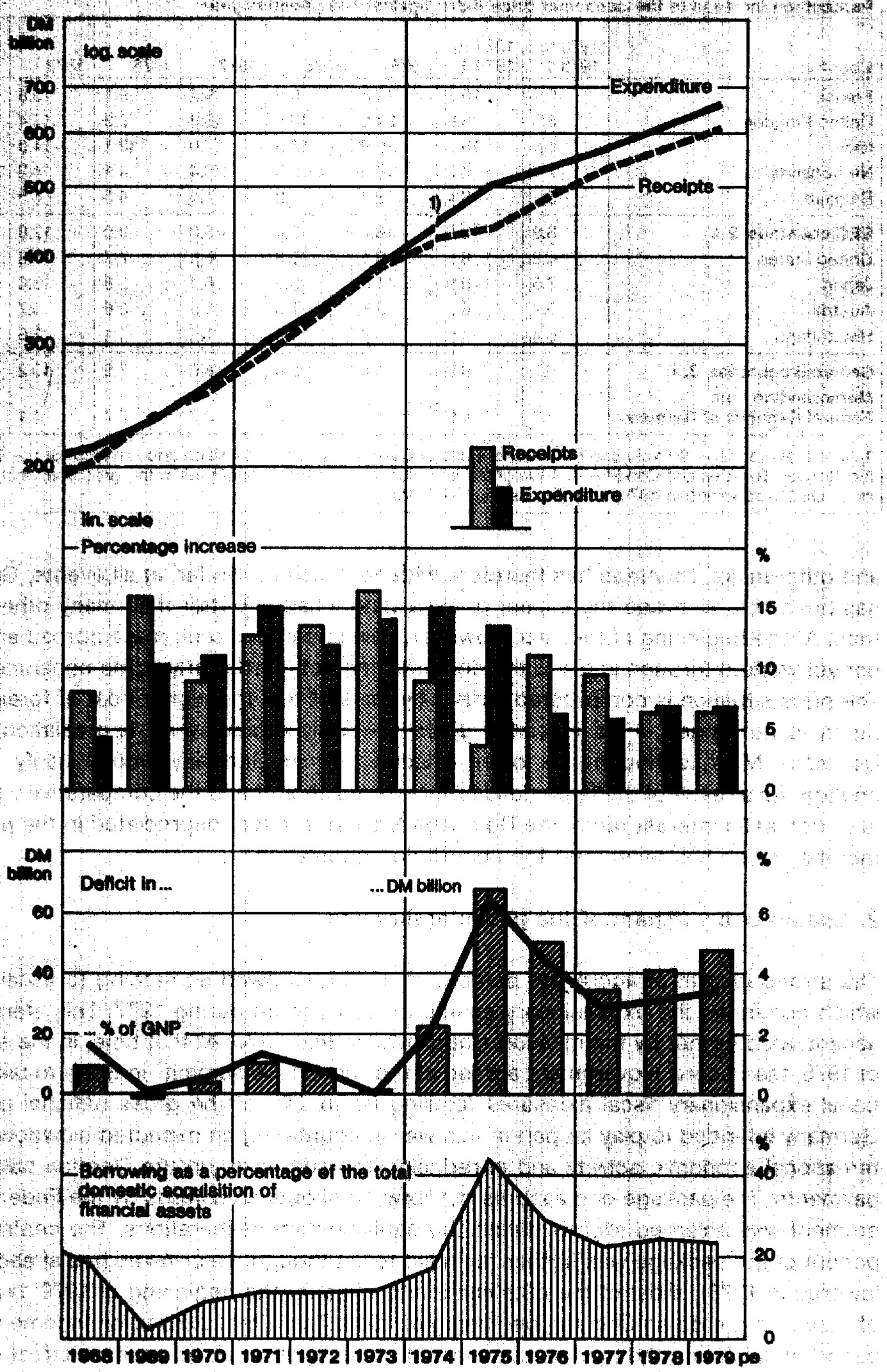
2. Expansionary impact of the public authorities

Major signal set for fiscal policy in the summer of 1978

The strong growth of aggregate demand in 1979 also owed something to fiscal policy, which continued the expansionary stance it had adopted during 1977. This stance was accentuated further by the measures approved in mid-1978. At that time, in the summer of 1978, the Federal Government agreed at the "economic summit" in Bonn to take additional expansionary fiscal measures totalling up to 1 % of the gross national product. Germany intended to play its part in this way in countering an expected slowdown in international economic activity and in reducing the surpluses on the German balance of payments. The package of measures put forward shortly afterwards by the Federal Government was enlarged slightly during the parliamentary deliberations. The central component of the package was further tax relief (even though major taxes had already been lowered in 1978); most of the cuts came into effect at the beginning of 1979, but some of them did not do so until the beginning of 1980. The direct burden on income was reduced by adjusting the income tax scale in order to diminish its adverse effect on performance; for enterprises, the abolition in 1980 of the tax on total wages paid lowered costs and thus ultimately acted as an investment incentive. The loss of revenue associated with the tax cuts was estimated at DM 10.5 billion for 1979 and DM 15.5 billion for 1980. To keep the costs incurred by the public authorities within limits, value-added tax was raised by 1 percentage point, albeit not until mid-1979. The tax relief was supplemented by measures in the family policy field, notably by an increase in children's benefits. Programmes to promote certain investments and innovations rounded off the package of measures. Its cash effects (net of the additional value-added tax revenue) amounted to over DM 13 billion in 1979, and a further DM 2 billion is to be added in 1980.

1 The informative value of cost of living indices varies from country to country. The price indices of private consumption in the national accounts are defined more uniformly. According to these indices consumer prices rose by 4.1 % in Germany last year compared with an average increase of 8 ½ % in the other OECD countries.

Finances of the public authorities *



* Central, regional and local authorities and social security funds.- 1) As from 1974 including special-purpose associations and supplementary pension funds for government employees.- pe Partly estimated.

Further stimulus to construction activity

Government capital spending likewise imparted a strong stimulus to economic activity in 1979. The central, regional and local authorities started more new building projects in 1978, some of them under the programme of future investments. However, the spate of new orders coincided with a steep rise in private demand for construction work. In view of the signs of tension in the construction market, the Federal Government recommended in the autumn of 1978 that orders under the programme of future investments should be extended over a longer period; nevertheless, public demand for capital goods continued to increase up to the spring of 1979. This led the Fiscal Planning Council to

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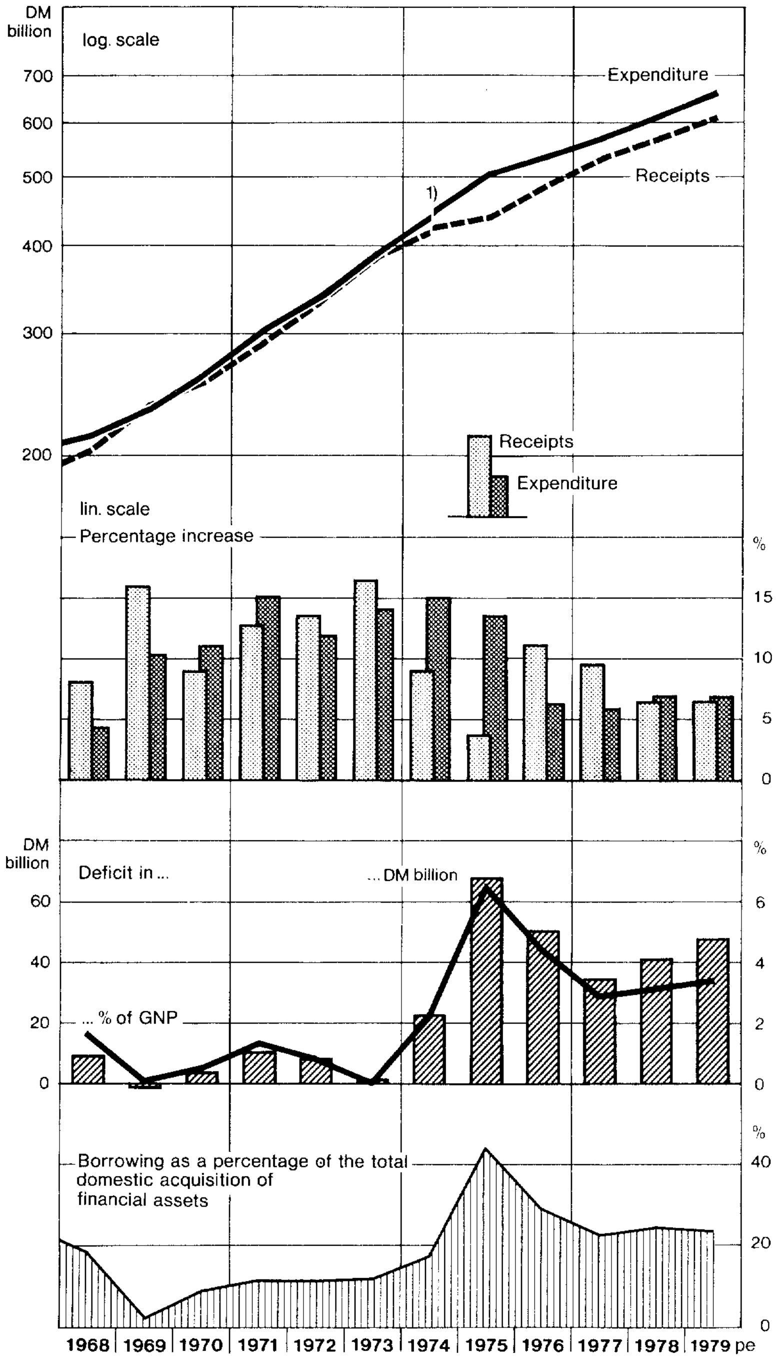
Finances of the public authorities *



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Tax cuts slow down the growth of receipts

The expansionary underlying trend of fiscal policy in 1979 was also reflected in the budgets of the central, regional and local authorities. The growth of receipts was slowed down appreciably by the tax cuts; although business activity was favourable on the whole, the increase in the central, regional and local authorities' receipts, at 6 ½ %, was slightly smaller than in the preceding year and distinctly below the rise in the gross national product at current prices (+8 ½ %). Even tax revenue (which accounts for over four fifths of receipts) went up less, at 7 ½ %, than the nominal gross national product. The overall tax ratio accordingly declined further — albeit only slightly — in 1979; at 24.6%, it was ½ percentage point below its all-time peak in 1977. The new tax cuts resulted in a relatively slow rise in wage tax revenue, which increased by 5 ½ % and thus distinctly less than wages and salaries. The receipts of assessed income tax were likewise reduced by the reform of the tax scale; moreover, amendments made to tax law in earlier years also tended to lessen receipts, so that the revenue from assessed income tax stagnated even though the income of self-employed persons continued to grow. A sharp contrast to this was formed by the further steep rise in receipts of corporation tax, the advance payments of which were quickly adjusted to enterprises' improved profitability. The strong increase in turnover tax (+15%) was largely due to the vigorous expansion of domestic demand, as well as to the raising of the tax rates at mid-year. Another particularly significant factor was that imports, which are liable to value-added tax, went up sharply.

Continued steep rise in expenditure

In 1979 the expenditure of the central, regional and local authorities again increased more than their receipts. The expansion of their spending, at 8%, was somewhat larger than had been assumed at the beginning of the year. This was mainly because of the strong growth (of almost one tenth) in their fixed capital formation, which however owed something to price rises. The central, regional and local authorities enlarged their loans and grants towards investments by third parties to an even greater extent, namely by about one fifth, last year. In contrast to capital spending, the share of personnel costs in the budgets of these authorities decreased slightly in 1979, as in the previous year. The below-average rise in staff costs was mainly attributable to the moderate pay settlement in the public service; the number of persons employed by the public authorities grew faster than in the preceding year. Total spending on personnel went up by 6 ½ %. Current transfers to individuals increased by only about 4%, and thus by less than all the other items of expenditure, despite the improvements in children's benefits at the beginning and in the middle of 1979. The spending of the central, regional and local authorities on interest rose very sharply in percentage terms (+12%), primarily because of borrowing and higher interest rates in 1978; in 1979 expenditure on interest accordingly absorbed 5 ½ % of the budget volume, compared with only 3 ½ % at the beginning of the seventies.

Deficit of the central, regional and local authorities again mainly financed by banks

The deficit in the budgets of the central, regional and local authorities grew by almost DM 8 billion in 1979 to DM 47 billion. However, their borrowing, at DM 44 billion net, fell slightly short of this figure, and was only a little higher than in 1978. This was because these authorities reduced their cash reserves by DM 3 billion in 1979, whereas they had

Finances of the public authorities

Item	1976	1977	1978 p	1979 pe	1976	1977	1978 p	1979 pe
	DM billion				Percentage change on previous year			
Central, regional and local authorities 1								
Expenditure								
Personnel expenditure	124.1	132.4	140.5	149.5	+ 5.4	+ 6.7	+ 6.1	+ 6.5
Other operating expenditure	56.8	60.0	65.2	70.5	+ 7.0	+ 5.5	+ 8.7	+ 8.5
Expenditure on transfers	101.2	105.6	116.8	121.5	+ 3.3	+ 4.3	+ 10.6	+ 4
Interest expenditure	18.1	21.0	22.3	25	+ 22.5	+ 15.7	+ 6.2	+ 12
Capital expenditure **2**	45.4	44.8	49.8	54.5	− 4.0	− 1.4	+ 11.2	+ 9.5
Indirect investment **3**	23.6	22.1	28.6	34	+ 4.2	− 6.2	**7** + 29.3	+ 20
Other **4**	6.0	6.2	6.1	7.5	− 3.0	+ 2.6	− 0.9	+ 20
Total	375.3	392.0	429.2	462.5	+ 4.3	+ 4.4	**8** + 8.5	+ 8
of which								
Federal Government	171.6	179.2	196.9	213	+ 4.5	+ 4.5	+ 9.8	+ 8
Länder Governments	152.7	160.7	175.5	192	+ 4.5	+ 5.2	+ 9.2	+ 9.5
Receipts								
Tax receipts	268.1	299.4	319.1	343	+ 10.7	+ 11.7	+ 6.6	+ 7.5
Other receipts	57.6	61.4	70.6	73	+ 8.6	+ 6.7	+ 15.0	+ 3
Total	325.6	360.8	389.7	415.5	+ 10.4	+ 10.8	**8** + 7.1	+ 6.5
of which								
Federal Government	141.5	157.0	171.2	186.5	+ 8.7	+ 11.0	+ 9.0	+ 9
Länder Governments	137.6	152.4	163.5	176.5	+ 10.1	+ 10.8	+ 7.3	+ 8
Cash deficit (−)	− 49.6	− 31.1	− 39.5	− 47	.	.	.	.
of which								
Federal Government	− 30.1	− 22.2	− 25.7	− 26	.	.	.	.
Länder Governments	− 15.1	− 8.3	− 12.0	− 15	.	.	.	.
Social security funds								
Expenditure **5**	194.6	209.4	221.1	234	+ 9.7	+ 7.6	+ 5.6	+ 6
Receipts	193.5	205.0	219.5	233	+ 11.2	+ 5.9	+ 7.0	+ 6
Cash deficit (−)	− 1.1	− 4.3	− 1.6	− 1	.	.	.	.
Public authorities, total								
Expenditure **6**	541.9	574.0	617.8	663	+ 6.3	+ 5.9	**8** + 6.9	+ 7.5
Receipts **6**	491.2	538.5	576.6	616	+ 11.2	+ 9.6	**8** + 6.5	+ 6.5
Cash deficit (−)	− 50.7	− 35.4	− 41.1	− 48	.	.	.	.

1 Including public hospitals that keep commercial accounts. — **2** Cash expenditure is recorded here, whereas the production of public capital goods is shown in the government account of the national accounts. — **3** Expenditure on investment grants and loans to third parties, and the acquisition of participations. — **4** Transfer of the Community share in tax revenue, differences in clearing transactions between the central, regional and local authorities, and special transactions. — **5** Including differences between the balance of receipts and expenditure and the change in financial assets, which forms the basis of the cash figures here. — **6** After adjustment for payments of the central, regional and local authorities to the social security funds. — **7** Overstated owing to changes in the method of assessment. — **8** Increase adjusted for the break in the statistics on local authority finance. — **p** Provisional. — **pe** Partly estimated. Discrepancies in the totals are due to rounding.

increased their liquid resources a year earlier. In 1979 they raised more credit than in the preceding year from domestic non-banks; foreigners, too, bought more government securities. The banks played a somewhat smaller part in financing the deficit; nevertheless, in 1979 they provided about three quarters (and thus once again the great bulk) of the borrowed funds. Indeed, the banks' direct lending in 1979 was larger than a year before, but they reduced their holdings of longer and shorter-term government securities. They were particularly reluctant to assume the price risk attached to securities, which increases as interest rates rise, whereas direct credits for which borrowers' notes have been issued are — unlike securities — not subject to compulsory write-downs. In general, security issues made up a smaller part of net government borrowing than in 1978. The fact that banks ceased to buy government securities was not offset by the circumstance that non-banks purchased almost twice as many such securities as in 1978.

Further reduction of the deficits of the social security funds

For the public sector as a whole the expansionary swing was not quite as great as for the central, regional and local authorities alone, since the social security funds managed to run down their deficit slightly more. It was the limitation of the 1979 pension adjustment to 4.5% that brought them the greatest relief. The social security funds — like the central, regional and local authorities — also profited from the high level of economic activity, which resulted in unexpectedly large contribution receipts and caused expenditure on unemployment payments to drop sharply. On the other hand, the provision by the Federal Labour Office of substantial additional funds for selective assistance in reducing unemployment in problem areas led to a rise in spending. A less favourable feature is that the expenditure of the health insurance institutions went up more than their receipts last year.

Much greater need for consolidation

The overall deficit of the public sector (central, regional and local authorities plus social security funds), at DM 48 billion — i. e. 3 ½% of the nominal gross national product — in 1979, was DM 7 billion larger than in the preceding year. It therefore expanded less than had been assumed at the beginning of 1979. However, the improvement in the public sector's financial position was not as great as would have been consistent with the rise (mainly due to the unexpected strength of economic activity) in its receipts of taxes and social security contributions. The reason was that expenditure went up faster than had been anticipated in a number of areas. According to the concept of anticyclical fiscal policy, the steeper economic upswing — which finally led to a very heavy utilisation of production capacity and in view of which domestic demand increasingly had to be met by sharply expanding imports — should have been accompanied by a reduction in the public sector deficit. However, this was prevented by the measures to reduce receipts that became effective in 1979 and by the limited scope for containing the rise already approved in expenditure.

3. Monetary policy directed towards stabilisation

(a) Money stock on target

Monetary growth target for 1979

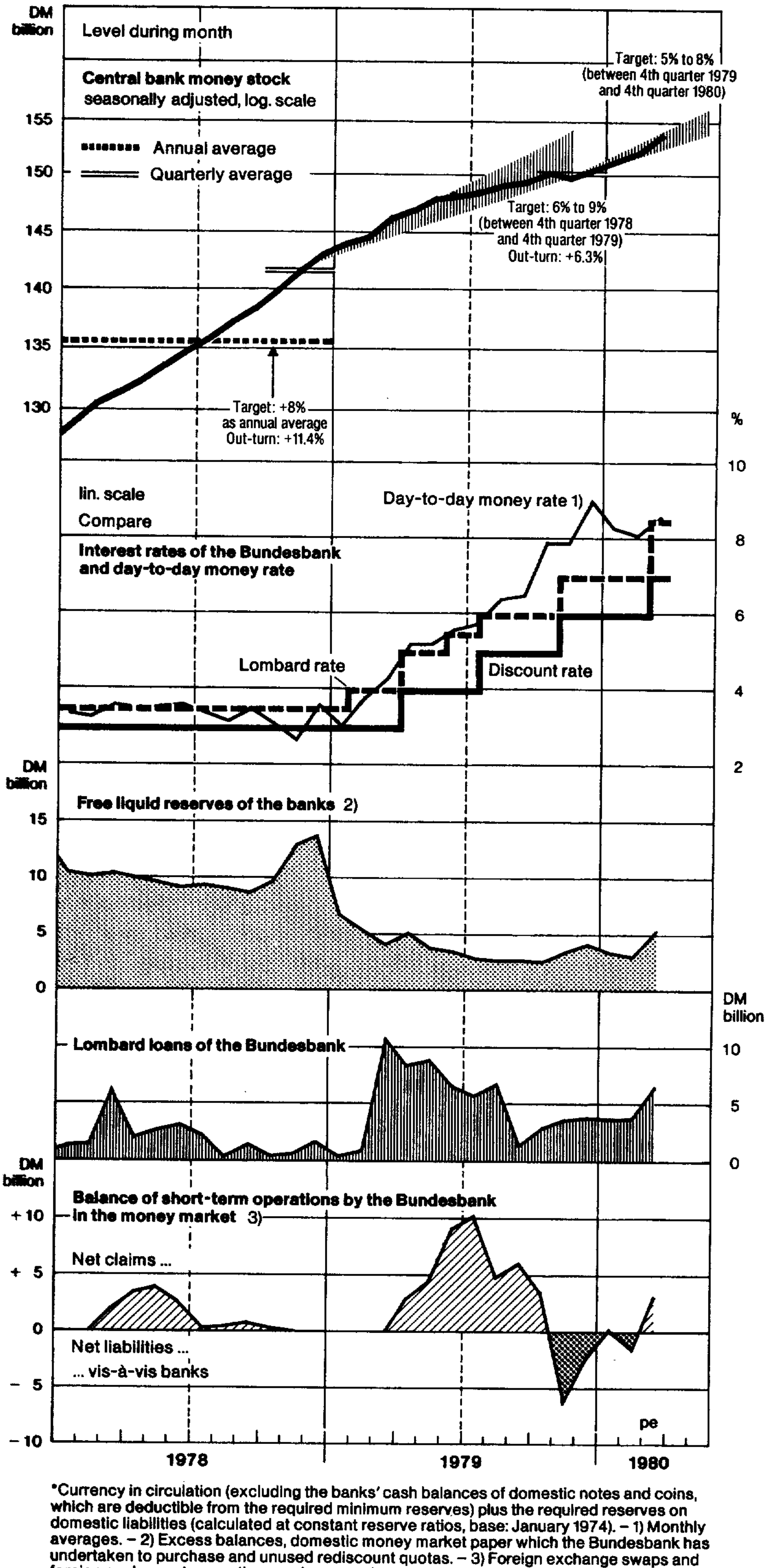
The strengthening of domestic economic activity, the easing of tensions in the exchange market and the inflationary dangers triggered by the sharp rises in the prices of raw materials and oil created a new situation for the Bundesbank's monetary policy at the turn of 1978/79. In December 1978 the Bundesbank announced that the expansion of the central bank money stock between the fourth quarter of 1978 and the fourth quarter of 1979 was to be kept within a range of 6 to 9%. It thus indicated to the general public at home and abroad that a change in the stance of monetary policy was needed, for the target chosen showed clearly that the growth of the money stock was to be gradually curbed, not least because of the substantial overshooting of the target in 1978. The monetary growth target was formulated in terms of a range since, in view of the prevailing uncertainties about the strength of the upswing and the external situation, it seemed advisable to remain flexible in the orientation of monetary policy.

Rapid monetary expansion in the first half of 1979

As the central bank money stock had been expanding at double-digit rates in the final months of 1978, the Bundesbank's first task in the year under review was to bring monetary growth more into line with the target. After the turn of 1978/79 it therefore progressively reduced the banks' liquidity and raised its interest rates in several steps up to early June. At first — i. e. until May — the central bank money stock remained above the target range. But at that time, the strength of the economic recovery, the

Growth of the central bank money stock*

Target and movement to date



*Currency in circulation (excluding the banks' cash balances of domestic notes and coins, which are deductible from the required minimum reserves) plus the required reserves on domestic liabilities (calculated at constant reserve ratios, base: January 1974). – 1) Monthly averages. – 2) Excess balances, domestic money market paper which the Bundesbank has undertaken to purchase and unused rediscount quotas. – 3) Foreign exchange swaps and foreign exchange transactions under repurchase agreements, open market operations in securities and trade bills under repurchase agreements, shifts under section 17 of the Bundesbank Act and short-term sales of Treasury bills. – pe Partly estimated.

tendency of the Deutsche Mark to weaken against the U.S. dollar (which persisted until the beginning of June) and the deterioration in the domestic price climate made it clearly desirable to keep the "monetary cloak" of the economy tight in order to minimise the scope for raising prices and passing on higher costs.

Concretisation of the monetary objective within the target range

The Bundesbank therefore decided at mid-year to steer the growth of the central bank money stock in the second half of 1979 towards the lower limit of the target range. A significant point in this connection was that, even beyond the end of 1979, monetary policy would have to endeavour to cut down the expansion of the money stock and make it conform more to medium-term economic requirements. Hence the Bundesbank had to tighten its monetary policy once again in the second half of the year. As described in more detail in the following section, it further reduced the liquidity of the banking system and raised central bank interest rates several times up to the autumn. In the further course of the year the growth of the money stock slackened to the requisite extent, above all because monetary capital formation at banks accelerated. In the fourth quarter of 1979 the central bank money stock was 6.3 % higher than a year before; it was thus, as desired, at the lower limit of the target range set for monetary growth in 1979.

Monetary growth target for 1980

For 1980 the Central Bank Council fixed a target range of 5 to 8 % for the increase in the central bank money stock (between the fourth quarter of 1979 and the fourth quarter of 1980). This new range is set in such a way that it seems compatible with the economic policy objectives for 1980.[1] When deriving the target it had to be borne in mind that in 1980 real economic growth is unlikely to be as large as in 1979; as the production potential was almost fully utilised at the end of 1979, further economic growth appeared desirable only to the extent that productive capacity and the labour potential increased, i. e. a margin for growth of about 3 % was to be laid down. Another factor that had to be considered was that inflationary pressures would mount owing to the higher cost of imports, but that precisely for this reason the scope for passing on price rises would have to be kept small. Finally, account also had to be taken of the fact that in preceding years, and particularly in 1978, the money stock had gone up faster than the nominal gross national product, so that the "velocity of circulation" of the central bank money stock had decreased further. However, if a policy of tight money was continued, there was reason to expect a change in cash-holding habits in the economy, especially as there were signs of such a change in the second half of 1979. In the light of these considerations the target range, at 5 to 8 %, was set 1 percentage point lower than in 1979. By retaining the range of 3 percentage points the Bundesbank made allowance, as in the previous year, for the uncertainties attached to economic prospects, price developments at home and abroad and exchange rate movements. As long as economic activity is buoyant, inflationary tendencies are pronounced and the Deutsche Mark is not particularly strong, it seems advisable to keep the growth of the money stock in the middle or if possible in the lower half of the target range.

(b) Monetary measures and money market conditions in the course of the year

Gradual change to a restrictive stance at the beginning of the year

In order to meet its monetary growth target, which in the last analysis is intended to help ensure that the economy can expand to an appropriate extent while price stability is maintained, the Bundesbank used its instruments of interest rate and liquidity policy with varying emphasis in the course of 1979, so as to respond flexibly to the prevailing domestic and external conditions. Much as in previous periods of restriction, monetary policy was initially tightened by sharply reducing the banks' free liquid reserves — substantially bills eligible for purchase under the rediscount quotas — by means of absorptive measures (cuts in the rediscount quotas and increases in minimum reserves). No less important for liquidity policy during that period was the reversal in foreign exchange flows which began in mid-January 1979 and lessened the banks' liquidity until mid-year. As a result of the liquidity policy measures and the contractionary effects exerted by the outflows of foreign exchange, the banks had only a technical minimum of free liquid reserves at their disposal by the spring of 1979. With the transition to a restrictive liquidity policy the Bundesbank raised the lombard rate from 3 ½ % to 4 % in January, thus setting a first interest rate signal that underlined the planned change in the monetary policy stance.

1 For details of how the monetary growth target for 1980 was arrived at, see also the Monthly Report of December 1979, p. 7.

Record of economic policy measures

1979	**I. Domestic and external monetary policy**
January 18	With effect from January 19 the lombard rate of the Bundesbank is raised from 3½% to 4%. In addition, the minimum reserve ratios on banks' domestic and foreign liabilities are increased by 5% as from February 1.
March 13	The European Monetary System enters into force.
March 29	The Bundesbank decides to raise the discount rate from 3% to 4% and the lombard rate from 4% to 5% with effect from March 30. Furthermore, with effect from April 1 the banks' rediscount quotas are increased by DM 5 billion in order to reduce the contractionary impact of massive foreign exchange outflows on bank liquidity.
April 4	To support the money market the Bundesbank for the first time conducts foreign exchange swap transactions with domestic banks (spot purchase of U.S. dollars with simultaneous agreement on forward sale).
May 17	To offset foreign exchange outflows the Bundesbank repurchases from banks by tender DM 3.2 billion of mobilisation and liquidity paper before maturity.
May 31	The Bundesbank decides to purchase bonds from banks in future, in the context of its open market operations, for later resale. (Initial amount purchased on June 19: DM 7.6 billion, at the market rate of 5%, for resale after 30 days.) In connection with this decision the lombard rate of the Bundesbank is raised from 5% to 5½% as from June 1.
June 28	The Bundesbank reviews its monetary growth target for 1979. It decides to keep to the announced target range for the growth of the central bank money stock (6 to 9% between the fourth quarter of 1978 and the fourth quarter of 1979) and to steer the growth of the money stock in the second half of the year towards the lower limit of this range.
July 12	With effect from July 13 the discount rate is raised from 4% to 5% and the lombard rate from 5½% to 6%.
August 23	The Bundesbank decides to introduce lombard limits. As from September lombard loans are to be granted, as a monthly average, only within limits based on the rediscount quota of a bank (15% of its arithmetical standard rediscount quota). At the same time the Bundesbank resumes its security purchases from banks for later resale; by this means the banks are supplied with DM 11 billion of central bank money for 30 days to repay lombard loans, which have grown exceptionally strongly as a result of foreign exchange outflows and contractionary public cash movements.
August 29	To regulate the money market the Bundesbank for the first time conducts foreign exchange transactions under repurchase agreements with domestic banks (the Bundesbank's rights to dollar assets are transferred for a limited period).
September 23	With effect from September 24 the exchange rates in the European Monetary System (EMS) are realigned for the first time; the Deutsche Mark is revalued by 2% and the Danish krone is devalued by just under 3% against the other EMS currencies.
October 10	To support the money market the Bundesbank buys trade bills in the open market on condition that they are repurchased after ten days (interest rate: 7¾%).
October 31	With effect from November 1 the discount rate is raised from 5% to 6% and the lombard rate from 6% to 7%. At the same time the rediscount quotas are increased by DM 4 billion.
November 29	The Bundesbank announces its monetary growth target for 1980: the expansion of the central bank money stock between the fourth quarter of 1979 and the fourth quarter of 1980 is to be kept within a range of 5 to 8%. Whether the Bundesbank aims more at the lower or more at the upper limit of this range will depend on the risks to prices and economic activity and on the movement of the exchange rate of the Deutsche Mark during the year.
1980	
Mid-February	To smooth out interest rate swings in the money market the Bundesbank sells Treasury bills running for four to ten days to banks (interest rate: 8½%).
February 28	With effect from February 29 the Bundesbank's discount rate is raised from 6% to 7% and its lombard rate from 7% to 8½%. In addition, the banks' rediscount quotas are increased by DM 4 billion (as from March 3). The lombard limits are abolished, notwithstanding the ruling principle that lombard loans are to be granted only for the short-term bridging of a temporary liquidity need.
March 13	In view of the changed external situation, the Bundesbank advocates relaxing the remaining restrictions on capital imports into Germany.
Mid-March	To offset foreign exchange outflows the Bundesbank repurchases before maturity the mobilisation and liquidity paper held by banks (DM 3.1 billion).
March 27	The Bundesbank decides to resume its security purchases from banks for later resale (after 30 days in the amount of DM 3 billion at the rate of 8.9%).

1979	**II. Economic and fiscal policy**
January 1	Major parts of the 1979 Tax Amendment Act (especially the reform of the income tax scale) and the increase in children's benefits for third and subsequent children from DM 150 to DM 200 a month enter into force.
January 24	The Federal Government presents the 1979 Annual Economic Report. It regards the gradual raising of the level of employment, while avoiding any new risk of inflation, as the central problem of economic policy. Under the prevailing conditions it considers an average annual real economic growth of about 4 % to be attainable in 1979.
January 26	The Bundestag approves the 1979 Federal budget, which totals DM 204 billion and shows a financial deficit of DM 31.5 billion.
May 16	The Federal Cabinet approves a special programme to combat unemployment. It provides DM 500 million for labour cost subsidies in areas where the average unemployment ratio in 1978 was above 6 % (e. g. the Ruhr area). The Federal Cabinet also approves further measures to reduce energy consumption, including the drawing-up of a conservation programme for the public sector and the promotion of district heating and of the use of electrically powered heat pumps. The 1975 Act to Safeguard the Energy Supply is to be prolonged indefinitely.
May 23	The Fiscal Planning Council recommends extending government construction expenditure over longer periods in order to steady demand in the capital formation field. Any additional tax revenue should primarily be used for reducing the level of borrowing.
June 27	The Bundestag approves the first supplementary budget for 1979 totalling just over DM 200 million. It mainly comprises initial expenditure on the special programme to combat unemployment. The funds are obtained by economies in other items of the Federal budget.
July 1	The rise of one (or, in the case of goods and services taxed at the reduced rate, one half of one) percentage point in the rate of value-added tax and the increase in children's benefits for second children from DM 80 to DM 100 a month enter into force.
July 5	The Federal Government approves the draft Federal budget for 1980 and the fiscal plan for the period from 1979 to 1983 on the basis of the key data announced at the end of May. In 1980 expenditure is to amount to DM 215.5 billion and the financial deficit to DM 28.5 billion.
September 12	The Federal Cabinet approves additional economies in the energy field; among other things, the heat insulation requirements for old and new buildings are to be made more stringent, the Länder Governments are to be asked not to subsidise oil central heating systems any longer, and local public transport services are to be improved.
October 11	The Bundestag approves the second supplementary budget for 1979 embodying additional expenditure amounting to almost DM 1.5 billion. Through economies in other items, however, the total expenditure provided for in the Federal budget is reduced on balance by DM 0.5 billion. Since tax revenue is expected to increase, the financial deficit is now estimated at just under DM 29 billion, which is almost DM 3 billion below the original estimate.
November 18	The Council of Economic Experts regards economic conditions as being characterised by a broadly-based underlying tendency towards expansion. The most important task of economic policy is to initiate a return to lower rates of price rises without interrupting the decline in unemployment. The Council also deals with the energy problem, which makes a reduction in dependence on oil imperative; the process of conservation and substitution must therefore be accelerated.
December 14	The Bundestag approves the 1980 Federal budget, which totals DM 214.5 billion and shows a financial deficit of DM 24.5 billion.
1980	
January 1	In accordance with decisions taken in 1978, further tax cuts enter into force, notably the abolition of the tax on total wages paid and the increase in the allowance on trade earnings tax.
January 28	The Federal Government's coal refining programme is approved: to foster the preliminary plans for the large-scale coal refining plants proposed by industry, the Federal Government makes an initial grant of DM 70 million. With the aid of refining technology, large quantities of domestic coal are to be converted into synthetic natural gas and liquid petroleum products.
January 30	The Federal Government presents the 1980 Annual Economic Report. It states that a key objective of its economic policy is to prevent price movements from getting out of hand and to distinctly reduce the pace of price rises in the later part of the year; at the same time this is conducive to the targets of sustained economic growth and a higher level of employment. Provided that unforeseen developments in the oil markets and the behaviour of the social groups do not run counter to overall economic requirements, the Federal Government regards an average annual real economic growth of just over 2½ % as being within reach.
February 20	The Federal Government approves a Tax Relief Bill for 1981. It provides for tax relief and improvements in benefits totalling DM 17.5 billion, which are to come into effect in stages between the end of 1980 and the beginning of 1982, but mostly in 1981. The principal features are a further adjustment of the income tax scale and measures of family policy.
March 26	The Federal Cabinet approves supporting statutory measures in connection with the planned new electricity-from-coal agreement between the coal mining industry and the electricity industry; these measures include the amendment of the Electricity-from-Coal Act and the prolongation of the Coal Tariff Quota Act to 1995, with a substantial increase in import quotas.

Tightening of monetary policy in the spring

The restrictive course of monetary policy was continued in the interest rate field at the end of March with the raising of the discount rate to 4% and the lombard rate to 5%. A sharper tightening of interest rate policy seemed inadvisable for the time being in the light of domestic considerations, and particularly owing to the lack of complete certainty about the momentum of the upswing on the one hand and the strength of "home-made" inflation on the other. During this period, which was characterised by persistent outflows of funds to other countries and which lasted until about mid-year, it was essential for liquidity policy reasons to ease the pressure on bank liquidity resulting from the massive outflows of foreign exchange, at least sufficiently to ensure that a certain degree of tension in the money market (which was quite conducive to the Bundesbank's aims) did not get out of hand — especially since funds were withdrawn from the banks in the spring of 1979 by the public authorities' cash transactions as well as by the foreign exchange outflows. The Bundesbank therefore increased the banks' rediscount quotas by DM 5 billion in April and prematurely repurchased mobilisation and liquidity paper not included in its money market regulating arrangements (DM 3.2 billion) at the end of May. Other funds were made available to the banks only in forms that were reversible at short notice because it was thought possible that at least part of the outflows to other countries would very soon change direction (as they indeed did from June 1979 onwards).

Increased fine tuning of the money market

The fine tuning of bank liquidity which this entailed was effected in part through new intervention techniques in the money market. In April 1979 the banks were for the first time provided with funds on a major scale through foreign exchange swaps (the Bundesbank buys dollars spot and at the same time sells them back to the banks forward). In June 1979 the Bundesbank for the first time increased bank liquidity by purchasing eligible fixed interest securities in the open market for resale after 30 days; these transactions were conducted with banks which have access to rediscount credit. In the prevailing circumstances the Bundesbank regarded this new form of open market operation, which left the initiative with respect to maturity and rate with the central bank (in accordance with the monetary policy intentions), as a means of funding some of the heavy recourse to lombard loans arising from the sustained withdrawals of liquidity. During this phase of the Bundesbank's policy, which lasted throughout the spring and early summer and during which large quantities of central bank money had to be channelled into the money market by means of liquidity policy measures, central bank interest rates were increased to a moderate extent. After the lombard rate had been raised by ½ percentage point to 5½% at the beginning of June, the discount rate was increased from 4% to 5% and the lombard rate from 5½% to 6% in mid-July. By putting up its interest rates around the middle of the year the Bundesbank on the one hand conformed to the existing situation, since interest rates had already risen in the interbank market and the bond market under the impact of the heavy demand for credit and also of the withdrawal of liquidity; on the other hand, the higher central bank interest rates were intended to help trigger an increase in the interest rates in retail banking business, so that all borrowers and savers would be affected.

Money market policy with the aid of a ceiling on lombard loans intensifies the squeeze

The introduction in September of lombard limits, which restricted the banks' recourse to lombard loans to 15% of their arithmetical standard rediscount quotas as a daily average of a month, enhanced the significance of the liquidity policy component of the Bundesbank's actions. This measure was designed to curb the heavy recourse to lombard credit (which in principle is intended only for the bridging of short-term liquidity needs) evident since the spring, so that residual central bank money requirements had to be met through other channels. This enabled the Bundesbank to induce the banks to restrain the expansion of their lending and securities investment business on liquidity grounds. The greater difficulties encountered by the banks in obtaining funds were reflected in the fact that the day-to-day money rate subsequently ran 1 to 2 percentage points above the ruling lombard rate as a monthly average. At the same time the rates for fixed-term funds and the corresponding rates on time deposits went up sharply, and in the further course of the year they exceeded central bank interest rates to a greater extent than usual. The rise in the money market and time deposit rates was not at first followed by an equal increase in the interest rates charged for loans to customers, but the narrowing of interest margins generally exerted pressure to adjust lending rates and also to cut down the expansion of lending. This did not mean, however, that the Bundesbank's measures to control the money market had failed to take account of the seasonal and random fluctuations in the banks' central bank money requirements. On the contrary, the Bundesbank took care to offset unavoidable peaks in the money market in

Monetary developments

Change during period 1

Item	1973	1974	1975	1976	1977	1978	1979
	DM billion						
A. Creation of central bank money and free liquid reserves of banks 2							
1. Net external position of the Bundesbank (excluding foreign exchange swaps)	+ 27.2	− 2.8	− 2.1	+ 8.3	+ 8.4	+ 20.3	− 5.2
2. Net balances of central and regional authorities (increase: −)	− 1.1	− 3.0	+ 1.7	+ 3.7	+ 5.0	− 2.1	+ 4.0
3. Change in minimum reserves (increase: −)	− 6.4	+ 12.7	+ 7.2	− 4.6	+ 8.1	− 1.8	− 3.2
4. Change in rediscount quotas (reduction: −)	− 11.9	+ 4.5	+ 4.5	+ 0.7	+ 6.5	+ 4.4	+ 5.1
5. Open market operations **3**	− 6.3	− 1.5	+ 11.6	− 8.6	− 0.7	− 3.6	+ 0.3
6. Lombard or special lombard loans	+ 1.1	+ 2.0	− 2.0	+ 6.5	− 6.5	+ 1.0	+ 2.2
7. Unspecified determinants	− 0.1	− 4.6	− 1.1	− 5.6	− 3.5	− 3.8	− 5.1
Central bank money stock and free liquid reserves (1 to 7)	+ 2.5	+ 7.4	+ 19.9	+ 0.3	+ 17.3	+ 14.3	− 1.9
Central bank money stock **4**	+ 6.9	+ 5.8	+ 9.5	+ 7.9	+ 10.9	**12** + 14.1	+ 7.8
Free liquid reserves of banks **5**	− 4.4	+ 1.6	+ 10.4	− 7.6	+ 6.3	+ 0.2	− 9.7
Memorandum items							
Level of free liquid reserves in the last month of the period	3.0	4.5	14.9	7.3	13.6	13.8	4.1
Lombard or special lombard loans outstanding in the last month of the period	0.8	2.8	0.8	7.3	0.8	1.8	3.9
	in %						
B. Key monetary indicators							
Central bank money stock **2, 6**	+ 7.3	+ 6.3	+ 9.8	+ 8.3	+ 10.0	**12** + 11.8	+ 5.3
Memorandum item							
As an annual average	+ 10.6	+ 6.1	+ 7.8	+ 9.2	+ 9.0	**12** + 11.4	**12** + 9.1
Lending by banks and the Bundesbank to domestic non-banks	+ 9.8	+ 7.9	+ 10.4	+ 10.1	+ 9.4	+ 11.5	+ 11.5
M1 (= currency in circulation and sight deposits)	+ 1.3	+ 11.1	+ 14.3	+ 5.0	+ 11.7	+ 14.2	+ 3.8
M2 (= M1 plus time deposits for less than 4 years)	+ 13.1	+ 4.7	− 0.1	+ 7.1	+ 11.1	+ 12.9	+ 7.9
M3 (= M2 plus savings deposits at statutory notice)	+ 8.4	+ 8.3	+ 8.7	+ 8.6	+ 11.0	+ 10.8	+ 5.7
	DM billion						
C. Money stock and its counterparts							
Money stock M3 (= 1 plus 2 less 3 less 4 less 5)	+ 34.0	+ 35.2	+ 38.4	+ 41.0	+ 58.9	+ 64.8	+ 39.2
Counterparts in the balance sheet:							
1. Volume of credit **7**	+ 67.5	+ 59.8	+ 85.5	+ 91.2	+ 94.2	+ 125.4	+ 139.0
of which							
Bank lending to domestic non-banks, total	+ 65.2	+ 61.2	+ 78.9	+ 96.3	+ 95.8	+ 122.6	+ 140.9
— to enterprises and individuals **8**	+ 31.1	+ 26.0	+ 16.6	+ 46.5	+ 42.3	+ 49.0	+ 67.5
— to the housing sector **9**	+ 23.5	+ 15.2	+ 14.3	+ 19.3	+ 26.8	+ 38.9	+ 44.8
— to public authorities	+ 10.6	+ 20.1	+ 48.0	+ 30.5	+ 26.7	+ 34.7	+ 28.5
2. Net external assets **10**	+ 23.5	+ 13.2	+ 16.8	+ 8.3	+ 10.1	+ 7.1	− 21.8
3. Monetary capital	+ 45.6	+ 34.5	+ 61.3	+ 59.1	+ 42.9	+ 54.8	+ 75.8
of which							
Savings deposits at agreed notice	+ 12.0	+ 8.5	+ 25.9	+ 12.2	+ 0.8	+ 7.7	+ 3.3
Bank savings bonds	+ 5.5	+ 4.8	+ 8.9	+ 10.4	+ 13.4	+ 10.3	+ 14.8
Time deposits for 4 years and over	+ 10.2	+ 8.0	+ 9.4	+ 11.4	+ 13.6	+ 17.0	+ 18.7
Bank bonds outstanding **11**	+ 14.3	+ 10.1	+ 12.9	+ 19.3	+ 9.7	+ 14.2	+ 33.6
4. Central bank deposits of domestic public authorities	+ 4.2	+ 0.4	+ 1.4	− 10.2	− 0.8	+ 2.5	− 1.7
5. Other influences	+ 7.2	+ 2.9	+ 1.2	+ 9.6	+ 3.3	+ 10.4	+ 3.8

1 Unless otherwise indicated, based on end-of-month figures. — **2** Based on daily averages of the last month of the period and the last month of the previous period, respectively. — **3** In 1979 including foreign exchange swaps and foreign exchange transactions under repurchase agreements. — **4** Currency in circulation (as from March 1978 excluding the banks' cash balances of domestic notes and coins, which are deductible from the required minimum reserves) and required reserves on the banks' domestic liabilities at current reserve ratios. — **5** Excess balances, domestic money market paper which the Bundesbank has undertaken to purchase, unused rediscount quotas and — up to May 1973 — unused scope for raising lombard loans. — **6** Reserve component calculated at constant reserve ratios (base: January 1974). — **7** Banks and the Bundesbank; including credit based on the purchase of securities. — **8** Excluding housing. — **9** Excluding credit based on the purchase of securities. — **10** Banks and the Bundesbank. — **11** Excluding bank holdings. — **12** The statistical break caused by the redefinition of the central bank money stock (see footnote 4) has been eliminated.
Discrepancies in the totals are due to rounding.

good time by means of compensatory operations since the effectiveness of the quasi-automatic "safety valve" function of lombard credit had been reduced by its quantitative limitation.

Control of the money market "within seeing distance"

In order to cope with the growing tasks of short-term fine tuning, the Bundesbank used newly-developed and old-established intervention techniques at the same time. In addition to the above-mentioned foreign exchange swaps, which were employed with both expansionary and contractionary effect, the Bundesbank began at the end of August to purchase foreign exchange for later resale. Through such transactions external assets of the Bundesbank (or more precisely: rights to U.S. dollar assets) were temporarily transferred to the banks, which tied up a corresponding amount of liquidity. Furthermore, the Bundesbank used proven methods of fine tuning on several occasions (shifts of Federal funds to the money market under section 17 of the Bundesbank Act and open market operations in trade bills for resale after ten days). As a result of the money market control practised by the Bundesbank, the above instruments were sometimes used at relatively short intervals and in alternating directions, i. e. at first to absorb liquidity and then to increase it. However, this did not reflect changing objectives of the Bundesbank in the money market; it was, rather, the only way to ensure that the desired tight conditions in the money market were maintained even under the fluctuating impact of liquidity factors that were determined by the market. Up to October bank liquidity rose more steeply than was desirable owing primarily to inflows of foreign exchange to the Bundesbank, and in November and December the seasonal run-down of the public authorities' balances (which started early) substantially increased the banks' liquidity. Both factors called for compensatory operations by the Bundesbank to mop up liquidity. The growing "turnover" in compensatory operations extended the scope for "unobtrusive" measures of fine tuning, i. e. for purchases and resales of assets by the Bundesbank for short periods (e. g. purchases of trade bills, bonds and external assets for later resale as well as in the form of swaps) and for sales and repurchases of mobilisation and liquidity paper. In purely economic terms, this constitutes a type of policy in the "open market" such as is feasible under the conditions prevailing in Germany, where the money market (which in effect is only an interbank market) is comparatively restricted and where there is no major short-term government debt (which often forms the basis for open market operations in other countries).

Gradual adjustment of interest rate and liquidity policy control

The Bundesbank's more restrictive policy stance in the money market and the provision of central bank money by means of the above-described compensatory operations from the beginning of September onwards were partly dictated by the need to minimise the effects of announcing interest rate policy measures in view of the unstable state of the foreign exchange market and to make liquidity policy preparations for mopping up expected foreign exchange inflows. When towards the end of last year the reversal in the balance of payments and in foreign exchange flows became increasingly evident and in the first few months of the present year the exchange rate of the Deutsche Mark even showed unwelcome signs of weakness, the Bundesbank responded to the new situation by gradually adjusting its key interest rates, i. e. the discount and lombard rates. At the beginning of November the discount rate was increased to 6% and the lombard rate to 7%. This facilitated some necessary changes in the interest rate pattern, and especially in the terms ruling in retail banking (credit in current account, savings deposits). At the same time the rediscount quotas of the banks were raised by some DM 4 billion. This measure was intended to meet the growing demand for central bank money by traditional means — and spread over the banking system as a whole — since no further massive inflows of funds from abroad were to be expected.

Central bank interest rates brought into line with market rates

Another increase in rediscount quotas took place at the end of February 1980 (+ DM 4 billion). It was accompanied by a further raising of central bank interest rates (the discount rate to 7% and the lombard rate to 8½%) in order to bring them more into line with market rates, which had raced ahead again owing to the world-wide upward trend of interest rates. Once central bank interest rates were closer to market rates, the ceiling on lombard loans was lifted; it was assumed that in future it will be possible, without having to resort to rigid quantitative restrictions, to confine the use of lombard credit in principle to the short-term bridging of temporary liquidity needs of individual banks. However, the Bundesbank may still at times be faced with the necessity of influencing the money market, depending upon circumstances, with the above-mentioned instruments of fine tuning since the processes which the Bundesbank cannot influence directly and which increase or reduce liquidity (such as foreign exchange movements) may remain large and unforeseeable.

(c) Subdued money creation process

Barely reduced credit expansion . . .

Domestic credit expansion responded only gradually to the change in the monetary policy stance. In 1979 it continued the strong upward trend which it had started in 1978 and thus kept the money creation process going throughout the year. The outstanding credit of banks (including the Bundesbank) to domestic non-banks increased by 11 ½ % in 1979 and thus just as fast as in 1978. Lending to individuals predominated, and did not slacken in pace until the second half of the year (see page 25). Public authorities, by contrast, raised far fewer funds from the banking system in 1979 than a year previously, although their overall borrowing requirements remained high.

. . . but increased monetary capital formation

Monetary capital formation at banks formed a strong counterweight last year to the expansionary impact of domestic credit expansion on the growth of the money stock. Stimulated by the rise in interest rates at the longer end of the financial markets (a tendency which was fostered by the liquidity policy of the Bundesbank), monetary capital formation in 1979 was much larger than a year before; it came to DM 76 billion as against DM 55 billion in 1978. Much the most important component of monetary capital formation was sales of bank bonds; the amount of such securities placed with domestic non-banks, at not quite DM 34 billion, was almost two and a half times as large as a year earlier. This record figure was ascribable to the initially sharp increase in yields on bonds and to the subsequently more stable interest rate expectations at the long end of the market which characterised conditions in the bond market for many months (see pages 27—29). Domestic non-banks also showed great interest in bank savings bonds, which are not subject to any price risks, after their yields had been adjusted to the upward trend in interest rates in the bond market. At the end of 1979 bank savings bonds with current interest payments and four-year maturities yielded 7.5 %, which was 2.2 percentage points more than at the beginning of the year. Interest rates on savings deposits with the same maturities were at first not raised at all during that period and were then increased in major steps — particularly in April, August and November — by a total of 1 ½ percentage points to over 6 %. Savings deposits at one year's notice bore interest at a rate of some 5 % at the end of 1979; the interest rates obtainable in this field have been lower than the current rate of inflation since mid-1979, virtually for the first time since mid-1976. Savings deposits at statutory notice yielded 4 % at the end of 1979 against 2 ½ % in March last year. As the interest rates paid were unattractive, the banks' savings deposit business was on the whole rather sluggish in 1979.

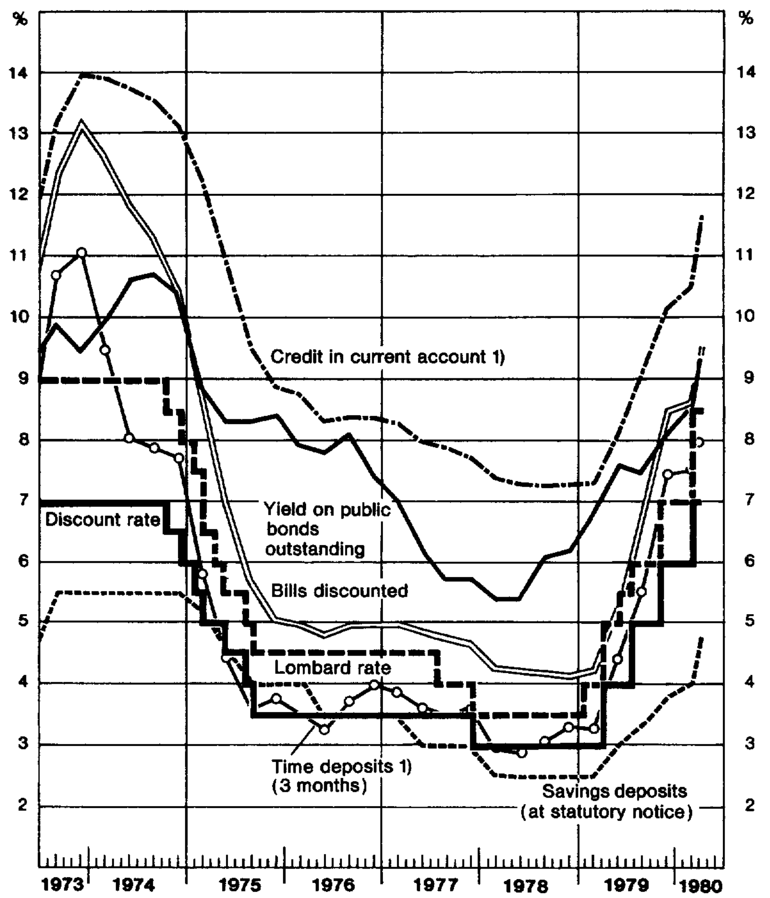
Contractionary external influences

The domestic money creation process was also curbed in 1979 by non-banks' external payments, which resulted in major outflows of funds for the first time for ten years. The net external assets of the banks and the Bundesbank, the decrease in which reflects this development, went down by DM 22 billion after having increased by DM 7 billion in the preceding year. This swing was mainly due to the sharp deterioration in the current account of the German balance of payments, but it was exacerbated by large outflows of capital from the non-bank sector (see also pages 34—36). At the beginning of 1979 enterprises apparently drew more heavily on the funds they had accumulated during the period of capital inflows in the autumn of 1978 (notably their shorter-term time deposits) to finance the withdrawals of funds arising from their external payments. Later in the year they also seem to have offset some of these outflows by taking up additional short-term bank credit.

Slower, but divergent, growth rates of the various components of the money stock

Mainly as a result of the increased monetary capital formation, the growth of the money supply slackened appreciably in the course of 1979, in conformity with the trend of the central bank money stock. This goes for all money stock definitions, but the slowdown in growth differed considerably among the individual aggregates. While the broadly defined money stock M3 (currency, sight deposits, time deposits and funds borrowed for less than four years, savings deposits at statutory notice) went up by over 5 ½ % and thus at much the same rate as the central bank money stock, the year-on-year rise in the money stock M2 (M3 excluding savings deposits at statutory notice) amounted to 8 % at the end of 1979 and that in the money stock in the narrowest definition M1 (currency and sight deposits) to barely 4 %. These divergent trends are mainly due to large

Movement of selected interest rates since mid-1973



1) Of under DM 1 million.

shifts out of sight deposits and savings deposits at statutory notice into shorter-term time deposits, which are sensitive to interest rate changes and whose rates followed suit when money market rates increased. Thus the interest rates on fixed-term deposits with agreed maturities of three months, which move broadly in line with money market rates, went up by an average of some 4 ½ percentage points between December 1978 and December 1979; by contrast, the "basic savings rate" was raised by only 1 ½ percentage points during that period, as mentioned (and thus, incidentally, by only half as much as the discount rate of the Bundesbank). Cash balances (currency and sight deposits) naturally yielded no interest. A relatively large loss of interest was therefore the price that had to be paid for the preference for very liquid assets last year; this preference accordingly declined. In such circumstances a more efficient employment of money holdings and their concentration in high-interest-bearing fixed-term deposits is almost inevitable. A year previously, by contrast, non-banks had shown a strong preference for cash, not least because of the persistently low level of interest rates.

Elasticity of the demand for money impairs guidance by the narrowly defined monetary aggregates

Such interest-rate-induced fluctuations in liquidity preference make it more difficult correctly to evaluate the rate of growth of the narrowly defined monetary aggregates and the impact thereof on economic activity. For instance, the restrained growth of the money stock M1 in 1979 does not permit any reliable conclusions to be drawn as to the degree of restrictiveness of monetary policy, for it was attributable not to any general weakening of the demand for money but in part only to a shift out of highly liquid money holdings into forms of investment which are regarded by non-banks in almost the same way as liquid funds (which are available, if not "daily", then rapidly when needed) or, more precisely, as "quasi-money". The subdued trend of the money stock M1 is therefore more a measure of the "monetary stimuli" generated by the increase in short-term interest rates; it does not so readily allow any direct inferences to be drawn on the impact of monetary policy measures on the real economy. The investment of funds at somewhat longer term does not imply that non-banks might in future feel restricted from the financing angle when planning their expenditure, since the (mainly short-term) holdings of "quasi-money", which are the favourite alternative investment, are likewise fairly liquid. Accordingly, no particular significance is to be attached to a sharp expansion of the money stock M2 if — as in 1979 — it also reflects major shifts from savings deposits, which in fact are slightly less liquid, to short-term time deposits. Because of the (by no means new) finding that the more narrowly defined aggregates M1 and M2 may be subject to random fluctuations which lead to misinterpretations, the Bundesbank is primarily guided by the development of the broadly defined monetary aggregates M3 and central bank money stock, whose correlation with economic activity is comparatively stable in the medium term.

(d) Bank lending to the private sector

Private demand for bank credit as strong as ever

In spite of the increasing stringency of the monetary policy stance since the beginning of 1979, the growth of bank lending to enterprises and individuals last year, at 12%, was much greater than in any year since 1973. This was attributable not only to the strong upswing and the faster pace of inflation but also to the above-mentioned outflow of funds to other countries, which probably triggered some additional domestic borrowing. Considering this, it cannot be said that the Bundesbank's measures of interest rate and liquidity policy failed to affect the credit supply of banks and the credit demand of non-banks. The tight state of the money market caused the banks to discontinue on balance their "indirect" lending (i. e. their purchases of securities issued by domestic non-banks) and to reduce their holdings of such paper by over DM 2 billion in the course of the year. Another indication of the banks' response is the fact that they gave fewer assurances of new long-term credit; however, the volume of loans actually granted increased more steeply than in 1978.

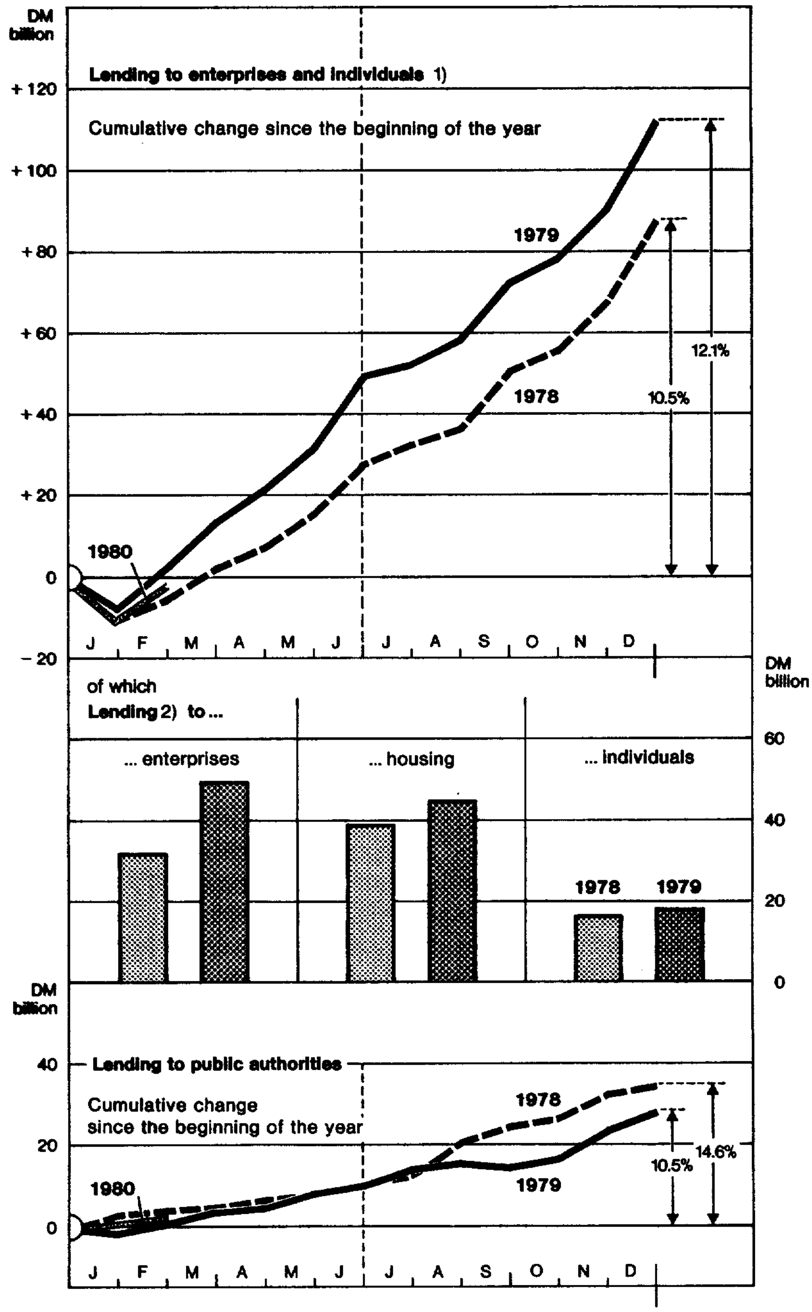
Rise in interest rates encourages short-term borrowing

The cost of credit rose fairly rapidly in 1979. Interest rates on credit in current account, at just on 10% and more — depending on the amount agreed — in December, were over 3 to 3½ percentage points higher than at the beginning of 1979, while the cost of discount credit went up by 4½ percentage points. Loans secured by first mortgages on residential real estate, the interest rates on which averaged 8¾% (excluding incidental costs) in December 1979, were about 2½ percentage points dearer than in May 1978, when they had reached their lowest level. The rise in interest rates in "retail banking" only became more pronounced in the wake of the increases in the discount rate between the end of March and the beginning of November 1979, but its moderating effect on the demand for credit slackened at the same time because inflationary expectations strengthened. In the field of direct bank advances to individuals, short-term lending rose disproportionately fast, at 15%, which suggests that hopes were entertained (at least at times) of a reversal in the interest rate trend in future. Whether this was more than a temporary "evasive reaction" — i. e. whether the rise in borrowing by industrial investors, private building owners and consumers will gradually slow down — is still an open question at the moment; in view of the persistent inflationary tendencies, such a reaction would be desirable.

Broadly based credit expansion

In contrast to 1978, the strong private credit expansion extended to all areas of the economy. In 1979 lending to enterprises (outside the housing sector) — including notably lending to industry and goods-producing craft enterprises — was very substantial, in keeping with the economic situation, for the first time since 1976; it grew by 10½% (or almost DM 50 billion). In the first half of 1979 borrowing by enterprises soared; in the second half of the year it slackened slightly, no doubt because many enterprises drew more heavily on their sizeable liquid reserves in view of the rising cost of credit. In the case of housing loans, which expanded by 13% (or DM 45 billion), the growth rate moderated in the first half of the year, but it picked up again later on. It seems that the sharp increase in construction costs (which necessitated supplementary financing) and construction work for the sake of conserving energy finally outweighed the dampening effect of rising interest rates on borrowing for house-building purposes. Owing to the slightly reduced demand for passenger cars and probably also to the increase in interest rates, the growth of "consumer credit" slowed down somewhat in 1979.

Bank lending to domestic non-banks *



* Including credit based on the purchase of securities.- 1) Including housing.- 2) Excluding credit based on the purchase of securities.

Divergent growth rates of lending among the banking groups

In accordance with the focal points of private demand for credit, the expansion of lending by credit cooperatives and savings banks was above the average in 1979, as in the preceding year. Their leading position probably owed just as much to the wide range of customers of these banking groups — which are actively involved in financing small and medium-sized firms, housing construction and private consumption — as to the fact that they obtained the funds they required for their lending relatively "cheaply" last year since the interest rates paid on savings deposits were low; hence they were able to offer more attractive terms in their lending business. The fact that the mortgage banks (which have to raise the rates they charge for new long-term loans in line with the yields on securities) and private bankers and central institutions of credit cooperatives (which are more dependent on time deposits and interbank business) lost ground is partly attributable to the exceptionally sharp increase in the amount they had to pay for funds;

however, these are structural differences which, as past experience has shown, are favourable to these banking groups in other periods, e. g. when particularly sensitive interest rates, such as yields on securities, are falling sharply. In addition to such divergences between banking groups, there are of course also major differences between individual banks. Banks which made extensive use of the scope for maturity transformation in their lending business may have been affected so rapidly and strongly by the rise due to market factors in the interest rates on their deposits that they were hardly able to pass on the higher cost of funds in their lending to customers. Especially if they had previously entered into comparatively large commitments, some banks were faced with a significant loss of income, at least relative to banks which had acted more prudently. Attention was drawn to this danger in a letter of November 1977 by the Federal Banking Supervisory Office concerning the annual accounts of banks.

Credit commitments as a "leading indicator"

The monitoring of credit commitments again proved to be a useful aid to forward-looking monetary policy in 1979. The assumption that private credit expansion, in view of its accelerated growth in 1978, would remain as rapid as ever in 1979 was fully borne out. Last year, too, the movement of short-term credit assurances did not indicate any change in trend. This suggests that the demand for short-term credit is virtually undiminished. Over 1979 as a whole the increase in shorter-term credit lines, at over DM 35 billion, was again larger than in the previous year. Unused credit assurances went up more slowly, however, owing to the heavy recourse to the lines granted. Although the information obtainable from the statistics on credit commitments is not yet absolutely reliable because the length of time covered is too short, the statistics do seem to confirm that considerable periods may elapse between the promising and the drawing-down of long-term loans. Thus the growth rate of long-term loan assurances has been slackening since mid-1979, and the level of outstanding commitments has even been declining since then as outpayments of long-term loans have remained high. This generally slow response of shorter and long-term lending to the restrictive measures of the Bundesbank shows that it is important to influence not only the demand for but also the supply of credit effectively by monetary policy means.

(e) Efficient bond market

Bond market responds flexibly to the change in the monetary policy stance

In 1979 the bond market increased in importance as a reservoir for longer-term funds. The flexibility of the bond market was severely tested by the change in the monetary policy stance, the fluctuating willingness of foreigners to invest and, at times, the very marked uncertainty about the further development of yields. In these circumstances the productiveness of the bond market was remarkable; last year, in spite of the difficult conditions, the amount newly invested by residents and non-residents, at about DM 47 billion, was over DM 7 billion larger than a year before. This outcome appears all the more notable in the light of the more restrictive monetary policy stance adopted by the Bundesbank, for in 1979 the squeeze on bank liquidity caused the banks to virtually stop buying bonds from the spring onwards, whereas they had bought half of the bonds sold in 1977 and 1978. However, the rise in bond yields to which this development contributed induced the general public to purchase bonds on a much larger scale than in the preceding years. As a result no less than four fifths of the growing amount raised in the bond market in 1979 came from the non-bank sector, in which households predominate (the remaining fifth was divided roughly equally between banks and foreign investors).

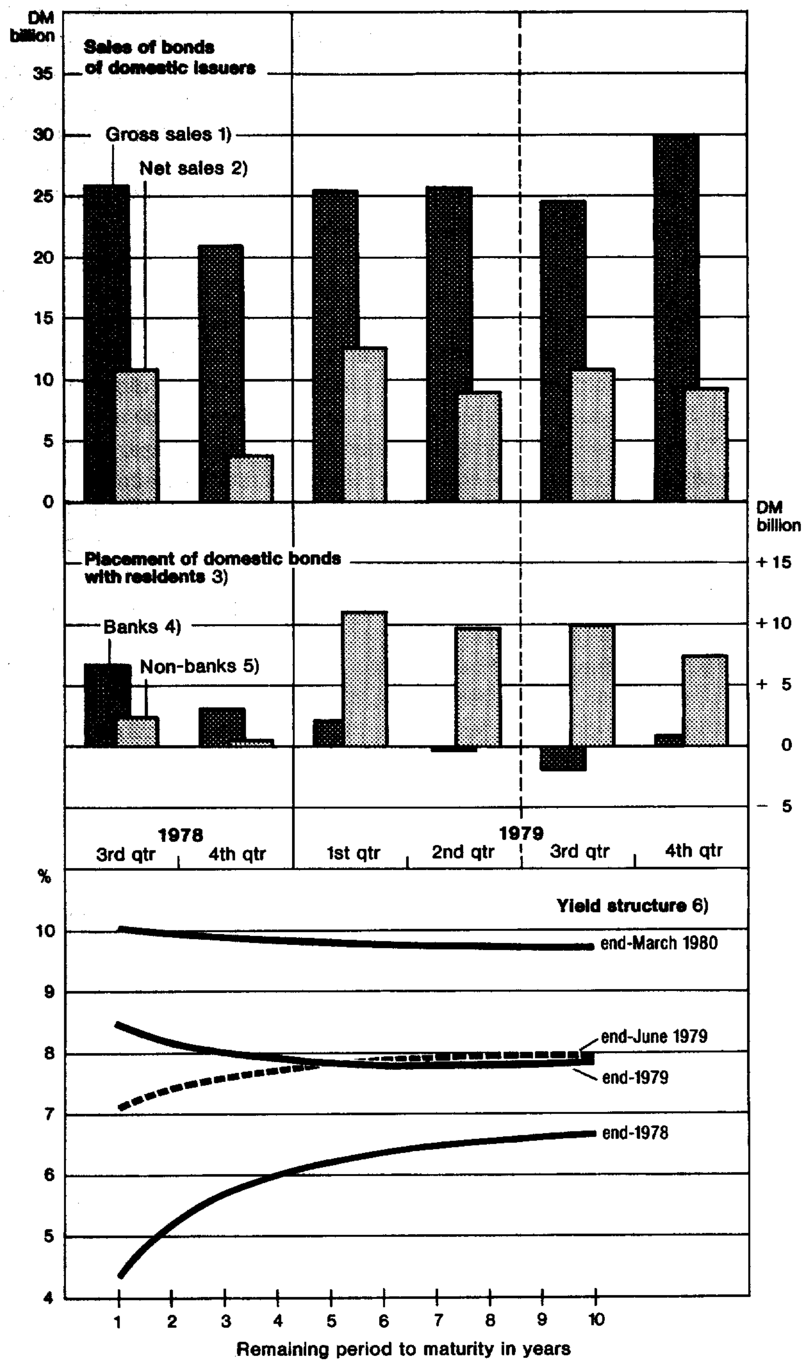
Large bond purchases by non-banks support monetary policy

The pattern of purchasers in the bond market that emerged in 1979 strongly supported the Bundesbank's monetary aims. The steep increase in private investors' purchases of bank bonds, at the expense of the growth of their liquid funds, greatly helped to curb the money creation process (see page 23). Admittedly, foreigners' heavier buying of domestic bonds (it went up from just over DM 0.5 billion in 1978 to DM 4 billion) likewise increased the supply of funds in the bond market in 1979. However, foreigners' bond purchases, which depend on exchange rate expectations, at times tended to unsettle the market and also affected the exchange rate on occasion because of their sharp fluctuations in volume.

Differing movements of yields

The gradual but unmistakable change to a more restrictive monetary policy stance at the turn of 1978/79 largely dispelled investors' uncertainty about the future movement of interest rates. A rise in bond yields that took account of the altered inflationary expectations sufficed to make the general public willing to invest in the bond market again.

Bond market



1) Market values.- 2) Net sales at market values plus/less changes in issuers' holdings of their own bonds.- 3) Excluding open market operations of the Bundesbank.- 4) Book values.- 5) Residual.- 6) Regression lines for yields on outstanding fully taxed bonds of the Federal Government, Railways and Post Office.

Around mid-year the average yield on domestic bonds outstanding, at 8 %, was roughly 1 ½ percentage points higher than at the beginning of 1979. The increase in yields at the short end of the bond market was much more pronounced. The yields on bonds with maturities of up to two years went up by about 2 to 2 ½ percentage points in the first half of the year, rather as in the money market and in banks' shorter-term lending and deposit business (excluding savings rates). The divergent trends in yields were particularly pronounced after central bank interest rates were raised in July, when the yields on short-dated securities went up distinctly while those on bonds with longer maturities came under pressure.

Unusual pattern of interest rates

Until the summer of 1979 the normally positive relationship between interest rates and maturities seems to have been increasingly overshadowed by market participants' expectations that longer-term interest rates would not significantly exceed the ruling level of some 8 % in the medium run, but would if anything decrease again. Lenders therefore preferred longer-term investments, whereas potential borrowers in the mortgage market and in the banks' industrial credit business became more and more reluctant to enter into long-term commitments. The tendency towards an atypical interest rate differential between (higher) short-term and (lower) longer-term yields on bonds was reinforced in the summer months by the strong demand of foreign investors for German bonds; in July and August they bought DM 2.5 billion of such securities. Since purchases by non-residents of domestic bonds with maturities of up to four years were prohibited at that time, foreign demand centred on the longer-term sector, so that interest rates fell appreciably at times at the long end of the bond market. Within three weeks after the raising of central bank interest rates in mid-July, the yield on domestic bonds outstanding dropped to 7.7 % and remained at about that level until October.

Market unsettled in the autumn

The initially stable state of the bond market was jeopardised during the later part of last year by temporary uncertainties, which were reflected in sharp monthly fluctuations in sales and erratic yield movements. The decrease in the supply of foreign capital in the autumn, in particular, led to tensions in the market which were aggravated by a temporary slowdown in bond purchases by residents. When the long-term interest rate rose distinctly in October, the market picked up again. But it was not until mid-November, after the yield on bonds had reached its peak for the year at 8.4 %, that a lasting improvement in sentiment took place. In that month alone about DM 8 billion (net) was raised in the bond market. At the same time the yield on domestic bonds outstanding declined, to 8 % at the beginning of December. It remained at roughly that level up to the end of the year, the net sales being very small.

Bond market tightens after the turn of 1979/80

Immediately after the turn of the year the bond market tightened again under the impact of new uncertainties caused by the changed political situation and the growing risks to economic developments at home and abroad. For the first time during the present phase of monetary policy, the yields at the long end of the capital market rose appreciably. However, the interest paid on short-dated bonds remained higher than the yield on longer-term securities. Bond yields went up further in February, when long-term interest rates began to increase rapidly abroad under the impact of a world-wide acceleration of inflation and rising central bank interest rates. In the middle of April the yield on domestic bonds outstanding, at 9.6 %, was 1 ¼ percentage points above its peak level in 1979. From the saver's point of view the "real" long-term interest rate was thus again comparatively high, at least if measured by the difference between the nominal interest rate and the growth rate of consumer prices; however, this is not necessarily identical with the investor's expectations as regards inflation and the real return on his savings in future.

Diminishing "transformation pressure"

In 1979 the rise in interest rates and the widespread expectation that longer-term interest rates would decline in the future (an expectation which was reflected in the yield structure curve and in purchasers' behaviour in the bond market) were also mirrored in changes in the maturity structure of the acquisition of financial assets and incurrence of liabilities by the domestic non-financial sectors. The discernible shifts suggest that the "transformation pressure" exerted by the behaviour of non-banks, the final lenders and final borrowers, and thus the tensions between supply and demand at the longer end of the overall financing cycle, diminished during 1979. Such shifts in the maturity structure, which contribute to equilibrium in the market, were particularly pronounced in households' investment behaviour. While households' total acquisition of financial assets last year, at DM 121 billion, was DM 15 billion larger than in the previous year, they cut down their new liquid investments drastically in 1979. On the other hand, their bond purchases alone (i. e. their investments in for the most part relatively long-dated securities), at about DM 30 billion, were roughly three times as large as in 1978. This admittedly owed something to the fact that saving through accounts had become much less attractive because of the low savings rates, which at times completely lost touch with long-term interest rates. Another notable feature was the reduced liquidity preference of enterprises, whose cash balances expanded only half as much in 1979 as a year before in spite of the stronger economic growth and the associated increases in turnover. On the whole it is true to say of all the domestic non-financial sectors, which include the public

Acquisition of financial assets and incurrence of liabilities by the domestic non-financial sectors *

Item	1977 p		1978 p		1979 pe		Memo item Change on previous year	
							1978	1979pe
	DM billion	% of total	DM billion	% of total	DM billion	% of total	DM billion	
Acquisition of financial assets								
Longer-term	108.3	72.7	108.0	64.7	121.0	72.4	– 0.3	13.0
of which								
at banks	49.5	33.2	48.7	29.1	36.3	21.7	– 0.9	–12.4
at building and loan associations and insurance enterprises	26.3	17.6	30.0	18.0	32.6	19.5	3.8	2.6
in the security market	17.2	11.5	17.4	10.4	38.5	23.1	0.2	21.2
abroad	4.4	3.0	5.3	3.2	6.3	3.8	0.9	1.0
Short-term	40.7	27.3	59.0	35.3	46.1	27.6	18.3	–12.9
of which								
at banks	34.4	23.1	50.9	30.5	33.4	20.0	16.5	–17.5
abroad	7.1	4.7	6.5	3.9	11.3	6.7	– 0.6	4.8
Total	149.0	100	167.0	100	167.1	100	18.0	0.1
Households	99.6	66.8	106.3	63.6	121.2	72.6	6.7	15.0
Enterprises	42.2	28.3	52.2	31.3	43.7	26.2	10.0	– 8.5
Government	7.2	4.9	8.5	5.1	2.1	1.3	1.3	– 6.4
Incurrence of liabilities								
Longer-term	124.0	83.0	147.0	91.3	156.6	82.3	22.9	9.6
of which								
at banks	73.5	49.2	107.6	66.8	114.6	60.2	34.0	7.0
at building and loan associations and insurance enterprises	13.6	9.1	15.8	9.8	22.7	11.9	2.2	6.9
in the security market	23.9	16.0	14.8	9.2	8.8	4.6	– 9.1	– 6.0
abroad	2.8	1.9	3.0	1.8	4.2	2.2	0.1	1.2
Short-term	25.3	17.0	14.0	8.7	33.8	17.7	–11.3	19.7
of which								
at banks	13.4	9.0	11.9	7.4	32.3	17.0	– 1.5	20.4
abroad	12.4	8.3	0.6	0.4	0.4	0.2	–11.8	– 0.2
Total	149.4	100	161.0	100	190.3	100	–11.6	29.4
Households	14.6	9.7	17.7	11.0	19.6	10.3	3.2	1.9
Enterprises	98.3	65.8	98.7	61.3	128.4	67.5	0.4	29.7
Government	36.6	24.5	44.6	27.7	42.3	22.2	8.0	– 2.2
Financial surplus (+) or deficit (–) 1	– 0.4	×	6.0	×	–23.3	×	6.4	–29.3
Households	85.0	×	88.6	×	101.6	×	3.6	13.1
Enterprises	–56.1	×	–46.5	×	–84.7	×	9.6	–38.2
Government	–29.3	×	–36.1	×	–40.2	×	– 6.7	– 4.2

* Households, enterprises (including housing), government (including social security funds). — 1 Acquisition of financial assets less incurrence of liabilities. — **p** Provisional. — **pe** Partly estimated. Discrepancies in the totals are due to rounding.

authorities, that longer-term investment gained ground last year in the overall acquisition of financial assets.

Tendency towards shorter-term borrowing

Under the impact of the interest rate trends described above, the incurrence of liabilities by the domestic non-financial sectors simultaneously shifted in favour of the shorter maturities. Borrowing by all domestic sectors from banks and other lenders went up exceptionally sharply (by about DM 30 billion) last year to DM 190 billion, but the longer-term part of it expanded by only DM 10 billion while the domestic sectors' new short-term indebtedness (in Germany and abroad) increased by DM 20 billion. Particularly in the enterprise sector (excluding housing) a comparatively large proportion of the borrowing (about 40% against 20% in the previous year) was in the short-term field.

Large net sales in the bond market and shorter periods to maturity

As investors were more willing to enter into longer-term commitments, the amount raised in the bond market went up in 1979, but at the same time the periods to maturity desired by borrowers shortened. Last year domestic issuers sold bearer bonds to the nominal value of DM 106 billion in the German bond market; this was DM 11 billion more than in 1978. Redemptions rose by DM 14 billion to DM 64 billion. If, in order to determine the overall productiveness of the bond market, security sales connected with open market operations by the Bundesbank and sales from issuers' own holdings are taken into account, the total amount raised from sales of domestic bonds, at market value, came to DM 43 billion (net) against DM 36 billion in the previous year. The agreed maturities of the newly issued securities were shorter than in earlier years. No less than 28 % of the net sales of domestic bonds consisted of shorter-term securities (up to and including four years), compared with 11 % in 1978. The net volume of newly issued short-dated bonds with maturities of up to one year came to almost DM 10 billion (whereas in 1978 no such securities were sold on balance).

Banks the principal group of issuers

More than four fifths of the total amount raised by domestic issuers flowed to the banks as a result of sales of their own bonds to residents and non-residents; the issuing institutions' sales accordingly exceeded the 1978 figure by DM 7 billion. However, this overall result masks very different trends among the various types of bank bonds — trends which, at least in part, are typical of periods of growing demand for credit and rising interest rates. The most striking feature was the much greater significance of "other" bank bonds. Net sales of these bonds in 1979, at DM 16 billion, were almost four times as large as in preceding years, and accounted for nearly half of the aggregate net sales of bank bonds. (Issues of "other" bank bonds last played a comparable role in the bond market in 1973.) The main advantage of this financing instrument is that the funds raised by this means can be used in many different ways, while issues of mortgage bonds and communal bonds are tied to certain types of lending business. Many banks, particularly the central giro institutions, therefore made considerable use of this method of raising funds in view of the financing requirements of the government and the much stronger short and medium-term credit demand of trade and industry. About 90 % of the "other" bank bonds sold on balance in 1979 (DM 14.5 billion) was therefore in the shorter-term maturity categories of up to four years. These securities permitted the relatively low-cost financing of shorter-term lending business with matching maturities, particularly since they are not subject to minimum reserve requirements (unlike funds raised through bank deposits with identical maturities). Issuing activity in the mortgage bond sector last year showed just the opposite trend to sales of "other" bank bonds. The amount of mortgage bonds sold in 1979, at just over DM 3 billion net, was not even half as large as in the previous year (DM 7.5 billion net). This fall in sales mirrors the decline in the mortgage banks' share in the financing of housing construction owing to the movement of interest rates and other factors. On the other hand, net sales of communal bonds (DM 15 billion), which are issued for financing public or government-guaranteed lending, and of bonds of specialised banks (just under DM 2 billion) remained at about the same level in 1979 as in the preceding years.

Declining public issuing activity

In 1979 public issuers sold distinctly fewer bonds of their own than in 1978, at DM 6 billion net against DM 11.5 billion. However, this "withdrawal" of public issuers from the bond market merely resulted in a change in the pattern of debt (owing to the absence of security purchases by banks) since the overall borrowing of public authorities remained as high as ever in 1979 (see page 13). Only the Federal Government raised funds on balance in the bond market last year (DM 9 billion), while the redemptions of the other public borrowers exceeded their new sales. The great bulk of the total gross issues of public bonds (about DM 20 billion) was therefore made up of Federal Government securities (DM 18 billion). More than a third of this amount came from current sales of Federal savings bonds (DM 6.5 billion). In spite of the high level of gross sales, the amount of Federal savings bonds outstanding rose by no more than DM 2 billion as many investors resold previously purchased Federal savings bonds before maturity or exchanged them for newly issued bonds bearing higher interest. At the beginning of December 1979 "Federal bonds" (Bundesobligationen) were introduced, in the form of tap issues tailored to the needs of private investors; they have maturities of five years only and thus fill a gap in the range of Federal Government issues between financing bonds and Federal savings bonds. Sales of Federal bonds came to DM 0.6 billion up to the end of 1979 and to DM 0.9 billion in the first quarter of 1980.

Waning interest in foreign Deutsche Mark bonds

In the field of foreign Deutsche Mark bonds a remarkable change took place in the course of last year. Under the impact of a large supply of foreign funds, the yields on foreign Deutsche Mark bonds lagged further and further behind those on domestic bonds in the summer of 1979 (which may be explained by the fact that the income from foreign Deutsche Mark bonds held by foreigners is not subject to coupon tax). However, in the autumn the movement of yields reversed; by the end of 1979 the yield differential be-

Purchases of bonds, by group of buyers and type of securities

DM billion market value

Item	Year	Domestic bonds: Total 1	Bank bonds	Industrial bonds	Public bonds	Foreign bonds 2	All bonds
Residents	1976	44.7	31.7	− 0.5	13.6	1.4	46.1
	1977	49.1	29.2	− 0.4	20.3	4.6	53.6
	1978	39.2	30.1	− 0.8	9.9	3.6	42.8
	1979	37.2	36.0	− 1.0	2.3	3.7	40.9
Banks	1976	20.2	12.2	0.2	7.8	0.3	20.5
	1977	30.6	19.8	0.0	10.8	1.7	32.3
	1978	20.2	16.7	− 0.2	3.7	1.2	21.4
	1979	1.1	3.3	− 0.2	− 2.0	2.6	3.7
Non-banks	1976	31.1	19.4	− 0.7	12.3	1.0	32.1
	1977	19.3	9.5	− 0.4	10.2	2.8	22.1
	1978	15.5	13.4	− 0.6	2.7	2.3	17.8
	1979	38.2	32.7	− 0.9	6.4	1.1	39.3
Open market operations of the Bundesbank	1976	− 6.5	—	—	− 6.5	—	− 6.5
	1977	− 0.7	—	—	− 0.7	—	− 0.7
	1978	3.5	—	—	3.5	—	3.5
	1979	− 2.1	—	—	− 2.1	—	− 2.1
Non-residents 3	1976	3.1	e 0.1	e − 0.0	3.1	×	3.1
	1977	0.7	e − 0.3	e − 0.0	1.0	×	0.7
	1978	0.6	e − 0.7	e − 0.2	1.5	×	0.6
	1979	4.0	e 0.4	e − 0.1	3.7	×	4.0
Purchases (= sales), total	1976	47.9	31.7	− 0.5	16.7	1.4	49.2
	1977	49.8	28.9	− 0.4	21.3	4.6	54.3
	1978	39.8	29.4	− 1.0	11.4	3.6	43.4
	1979	41.2	36.4	− 1.1	6.0	3.7	45.0

1 Net sales plus/less changes in issuers' holdings of their own bonds. — **2** Net purchases of foreign bonds by residents. — **3** Net purchases or net sales (—) of domestic bonds by foreigners. — **e** Estimated. Discrepancies in the totals are due to rounding.

tween domestic bonds and foreign Deutsche Mark bonds had almost completely disappeared; in other words, even though they were exempt from coupon tax, foreign Deutsche Mark bonds were no longer particularly attractive, at least not to foreigners. But foreigners are normally the most important group of purchasers of foreign Deutsche Mark bonds; in 1979 they bought about two thirds of the total amount sold (some DM 7 billion net). At the beginning of 1980 non-residents' interest in foreign Deutsche Mark bonds waned even further. This was primarily because of the change in expectations regarding the exchange rate of the Deutsche Mark, which at that time was no longer unequivocally considered to be an "upvaluation currency". Once the Deutsche Mark was hardly expected to appreciate, the effects of international interest rate differentials were felt more strongly; but the interest income from newly issued foreign Deutsche Mark bonds — in spite of the distinct increase in the yield on these securities — did not nearly keep pace with the rise in interest rates in foreign bond markets.

4. Basic swing in the current account

German current account deteriorates owing to the oil crisis

Following the new oil price shock, Germany's external position changed fundamentally in the course of 1979. For the first time for 14 years the German current account moved into deficit (to the extent of DM 10.5 billion over the whole of 1979), whereas a year before there had been a surplus of DM 17.5 billion. The deficit on current account is likely to increase considerably again in 1980 — to over DM 20 billion from the present perspective — and thereafter only a gradual reduction is to be expected. The situation is thus radically different from that in the middle of the sixties, when the current account was last in deficit; at that time the deficit was only a brief episode. A major factor in the huge swing in the current account last year was the rise in the price of oil. While the additional imports of oil and oil derivatives were relatively small (in volume terms such imports grew by 3 ½ %), Germany's oil bill increased by one half, namely from DM 32 billion in 1978 to DM 48 billion in 1979.

The new price rises by the oil-producing countries at the turn of 1979/80 pushed up the cost of German oil imports again, so that Germany's total expenditure on imported oil (including petroleum products) will grow by another DM 15 billion at least in 1980; hence Germany's oil bill will have roughly doubled within only two years. The oil price rises were accompanied by steep increases in the prices of other imported goods, especially industrial raw materials. In terms of volume, too, the growth of imports (particularly those of services) was decidedly strong.

Sharp decline in the trade surplus

The development of the current account in 1979 also owed much to the fact that — unlike the situation during the first oil crisis of 1973/74 — the additional expenditure on imports could not nearly be offset by a corresponding rise in exports. The higher spending on imports therefore worked through to the balance of trade, so that Germany's export surplus, on an f.o.b. basis, decreased from DM 51 billion in 1978 to DM 32 billion in 1979, i. e. by DM 19 billion.[1] The main reason why exports went up less in 1979 than they had done in 1974 is that the oil countries have not yet greatly expanded their demand for industrial products. Even if the special case of Iran is left out of account (exports to which reached only one third of the 1978 level because of the political upheavals), German exports to the OPEC countries fell by 5% in 1979. The absorptive capacity of these countries is apparently no longer as great as it was after 1973; besides, it now seems to be directed more towards exports (e. g. technical consumer goods) in which Germany is often less competitive than other industrial countries such as Japan. After the first oil price explosion in 1973 Germany's principal exports, namely capital goods, had conformed to the import wishes of the oil countries particularly well. Finally, Germany was unable to profit — in contrast to 1974 — from a pronounced boom in major customer countries; in that year the boom had led to a strong demand for German products, especially since the slackening of domestic economic activity in 1974 had set capacities free for exports. In 1979 the level of business activity in Germany was, if anything, higher than in other industrial countries, so that the foreign trade "valve" operated the other way round: imports from industrial countries increased considerably, namely by 18 ½ % on a c.i.f. basis, and thus more than exports to those countries (which rose by 14%). The German economy will probably continue to expand a little more than that of most other industrial countries in 1980, in spite of the expected slowdown; hence no relief for the current account is likely from this angle.

Deterioration in the terms of trade in the non-oil sector

The movement of other prices (i. e. excluding oil prices) also had an adverse effect upon the balance of trade, as already mentioned. In 1979 import prices (excluding the prices of oil and petroleum products), as measured by unit values, rose by just under 5%, and thus by 2 percentage points more than export prices; hence the terms of trade in the non-oil sector likewise deteriorated distinctly. This applies — apart from the more expensive raw materials — particularly to end-products, which account for more than half of Germany's foreign trade. The fact that prices in this field remained relatively stable on an average during 1979 (import unit values increased by only 2.8% and export unit values by as little as 1%), seems to have been mainly due to a delay in adjusting to the new price shock for oil and raw materials. In the course of the year, however, the upward movement of the prices of imported end-products greatly accelerated, and export prices, too, went up sharply around the turn of 1979/80. Of course, in the longer run there is little point in dividing changes in the terms of trade into those caused by the higher oil prices and those attributable to other price influences, since the deterioration resulting from the higher oil prices, like any other deterioration in the terms of trade, leads to a corresponding decrease in the real income of all those involved in economic activity. The significance of this factor becomes clear if the overall terms of trade at the beginning of 1980 are compared with those at the beginning of 1979: the deterioration is then seen to have come to approximately 8%. As the share of imports and exports of goods and services in the gross national product amounts to roughly 27%, this means that within one year the margin for the distribution of income has been reduced by more than 2% of the gross national product. Never before has Germany experienced such a profound and, as it seems, lasting change in external economic conditions.

1 In contrast to the official foreign trade statistics of the Federal Statistical Office, which records exports on an f.o.b. basis and imports on a c.i.f. basis and thus arrives at a smaller export surplus of DM 22.5 billion, the Bundesbank — in accordance with international practice when drawing up balances of payments — includes expenditure on the transport and insurance of imports not in merchandise transactions but in services. The overall balance on current account is not affected by this adjustment.

Notable expansion of exports

Taken by themselves (and calculated as an annual average), exports expanded strongly in 1979, namely by 7% in volume and by 10½% in value. As Germany's export markets seem to have grown to a slightly smaller extent, Germany's market share presumably increased again during that period, even though the competitive pressure was no doubt substantial following the "real" appreciation of the Deutsche Mark — i. e. the appreciation in excess of the inflation differential — between 1976 and early 1979. German exporters profited particularly much last year from the sustained economic upswing in western European industrial countries, deliveries to which went up by 16%. Exports to non-oil developing countries also increased strongly (+14%), but the future of this market is rather in doubt in view of the dramatic deterioration in the balances of payments of many developing countries due to the oil price surge. Exports to centrally planned economies (+7%) and the United States (+3%) rose only slightly; exports to OPEC countries (−5% excluding Iran) have already been discussed.

Strong rise in the volume and prices of imports

In 1979 imports grew at a particularly rapid pace; in volume terms their rise, at 9%, was even faster than that of exports, as mentioned. Apart from the higher level of domestic economic activity, this was mainly because of the increased competitiveness of foreign suppliers in German markets. In particular, the demand for imported finished goods remained as strong as ever (+12% in real terms), partly no doubt as a belated consequence of the real appreciation of the Deutsche Mark. Germany's imports from its western European neighbours went up especially fast, but much more was imported from the United States as well — not least, it seems, because of the lower exchange rate of the dollar. The fact that the increase in the value of German imports, at 20%, was over twice as large as the growth of their volume is mainly attributable to the enormous rise in the prices of crude oil and petroleum products, which inflated imports from the respective countries correspondingly in nominal terms. For instance, imports from the OPEC countries increased by 39% in value, and imports from the European oil-producing countries also expanded strongly for the same reason: those from the United Kingdom by 43%, those from Norway by 34% and those from the USSR by 36%.

Steep increase in the deficits on "invisibles"

The sharp deterioration in the current account owed something not only to the development of foreign trade but also to the persistent trend towards rising deficits on "invisibles". The traditionally large deficits on services and transfer payments on an f.o.b. basis (i. e. including expenditure on the transport and insurance of imports) increased by no less than DM 8.5 billion to DM 42 billion; it was our European partner countries that benefited most from this. To a large extent, these massive deficits on invisibles have to be considered in conjunction with Germany's surpluses on foreign trade. For one thing, the level of gross national product achieved in Germany would not be conceivable without the contribution of foreign workers. And to a certain degree Germany's trade surpluses generate the income which permits many residents to spend their holidays abroad and many foreign workers to support their families who have remained in their home countries. For another, their receipts from services and from the remittances of migrant workers enable the southern European countries, in particular, to constantly enlarge their demand for German products. Germany's trade surpluses, and its currently much higher deficits on invisibles, therefore reflect an "international division of labour" between countries in Europe with different locational advantages. The expenditure of Germans travelling abroad rose especially steeply again in 1979, namely by more than DM 4 billion to DM 33 billion. On foreign travel account alone there is thus a gap of over DM 22 billion in the German balance of payments. The increased "oil burden" on households — the full extent of which admittedly emerged only in the course of the year, i. e. after holidays had been planned — has therefore hardly impaired the travel boom so far. In addition, Germany's net payments to the European Communities, which had decreased for two successive years, went up considerably, namely by just under DM 1.9 billion to DM 3.9 billion. Following many years of decline, the home remittances of foreigners working in Germany increased slightly (by DM 0.5 billion to DM 6.4 billion) in 1979, mainly because of a special development in the case of remittances to Turkey.

Current account deteriorates most vis-à-vis oil countries, but also vis-à-vis industrial countries

The basic swing in the German current account in 1979 is largely a consequence of the new conditions created for the world economy by the oil-producing countries. Germany's current account deficit thus also reflects to a certain degree the huge surplus position of the oil countries. Current transactions with the oil countries alone deteriorated by DM 11 billion in 1979; even if the special factor of Iran is eliminated, the deterioration still amounts to DM 6.5 billion. But current transactions with industrial countries,

Major items of the balance of payments

DM billion

Item	1972	1973	1974	1975	1976	1977	1978	1979
A. Current account								
1. Foreign trade								
Exports (f.o.b.) **1**	149.0	178.4	230.6	221.6	256.6	273.6	284.9	314.5
Imports (f.o.b.) **1**	121.7	137.7	171.9	177.1	214.6	227.7	235.8	283.1
Balance	+27.3	+40.7	+58.7	+44.5	+42.1	+45.9	+49.2	+31.3
2. Supplementary trade items **2** and merchanting trade	– 0.6	– 0.1	– 1.3	– 1.2	– 0.1	+ 0.0	+ 2.1	+ 0.5
Overall balance of trade	+26.7	+40.6	+57.4	+43.3	+42.0	+46.0	+51.2	+31.9
3. Services	–10.1	–12.7	–14.8	–15.5	–14.2	–18.2	–16.1	–21.6
of which								
Foreign travel	– 8.6	–10.9	–12.4	–14.7	–14.6	–16.4	–19.0	–22.4
Investment income	+ 1.1	+ 1.6	+ 0.9	+ 2.4	+ 3.3	+ 0.4	+ 4.6	+ 4.3
4. Transfer payments	–14.0	–15.6	–16.1	–17.9	–18.1	–17.9	–17.6	–20.7
of which								
Remittances of foreign workers	– 7.5	– 8.2	– 7.7	– 7.4	– 6.7	– 6.1	– 5.9	– 6.4
Payments to the European Communities (net)	– 1.6	– 2.2	– 1.9	– 3.7	– 3.7	– 3.2	– 2.1	– 3.9
Balance on current account	+ 2.6	+12.3	+26.6	+ 9.9	+ 9.7	+ 9.8	+17.5	–10.5
B. Capital account (outflows: –)								
1. Non-banks								
Direct investment	+ 0.9	+ 1.4	+ 0.5	– 3.3	– 3.5	– 3.0	– 3.6	– 6.1
German investment abroad	– 4.7	– 3.8	– 4.6	– 4.7	– 5.9	– 4.8	– 6.9	– 8.1
Foreign investment in Germany	+ 5.6	+ 5.2	+ 5.1	+ 1.4	+ 2.5	+ 1.8	+ 3.3	+ 2.1
Portfolio investment	+13.4	+ 6.6	– 2.8	– 4.1	+ 4.1	– 1.5	+ 0.1	+ 5.3
Foreign securities	+ 2.7	+ 0.1	– 0.9	– 2.5	– 0.6	– 3.9	– 3.0	– 0.5
Domestic securities **3**	+10.7	+ 6.5	– 1.9	– 1.6	+ 4.8	+ 2.3	+ 3.2	+ 5.9
Short-term financial credits	– 4.6	+ 0.6	+ 3.1	+ 2.5	– 0.0	+ 8.5	+ 1.1	– 3.2
Short-term trade credits	+ 1.0	+ 4.6	–12.4	+ 4.1	– 5.7	– 3.9	– 3.9	– 1.7
Official transactions, total	– 1.0	– 2.0	– 0.9	+ 1.9	+ 1.9	– 2.1	– 2.0	– 1.6
of which								
Loans to developing countries	– 1.3	– 1.5	– 1.6	– 1.4	– 1.3	– 1.2	– 2.3	– 1.5
Other	– 0.9	+ 3.1	– 1.7	– 0.4	+ 0.6	– 0.5	– 0.9	– 1.7
Capital transactions of non-banks, total	+ 8.9	+14.4	–14.1	+ 0.5	– 2.5	– 2.5	– 9.1	– 9.0
2. Banks								
Long-term lending	+ 1.9	+ 4.3	– 1.3	–11.5	– 4.8	– 4.6	+ 6.2	+16.9
Assets	+ 2.1	+ 3.7	– 2.6	–13.5	– 9.7	– 9.6	– 8.5	– 5.4
Liabilities	– 0.2	+ 0.6	+ 1.3	+ 2.0	+ 4.9	+ 5.0	+14.8	+22.4
Security transactions	+ 1.4	+ 0.2	– 0.2	– 0.1	– 0.3	– 1.6	– 1.2	– 2.4
Short-term capital movements	– 0.4	– 5.1	– 9.7	– 2.3	+ 6.7	+ 8.1	+10.1	+ 4.4
Assets	– 1.6	– 7.9	–12.0	–13.0	– 2.7	+ 1.2	– 2.2	– 1.7
Liabilities	+ 1.2	+ 2.8	+ 2.3	+10.8	+ 9.4	+ 6.9	+12.3	+ 6.2
Other	+ 0.2	– 0.5	+ 0.0	+ 0.0	– 0.0	– 0.2	– 0.3	– 0.3
Capital transactions of banks, total	+ 3.1	– 1.2	–11.2	–13.8	+ 1.6	+ 1.7	+14.9	+18.7
Balance on capital account	+12.0	+13.2	–25.3	–13.3	– 0.9	– 0.8	+ 5.8	+ 9.7
C. Balance of recorded transactions	+14.6	+25.5	+ 1.2	– 3.4	+ 8.8	+ 9.0	+23.3	– 0.8
D. Balance of unclassifiable transactions (balancing item)	+ 1.1	+ 0.9	– 3.2	+ 1.1	+ 0.0	+ 1.4	– 3.5	– 4.1
E. Overall balance on current and capital accounts	+15.7	+26.4	– 1.9	– 2.2	+ 8.8	+10.5	+19.8	– 5.0
F. Balancing item to the external position of the Bundesbank **4**	– 0.5	–10.3	– 7.2	+ 5.5	– 7.5	– 7.9	– 7.6	– 2.3
G. Change in the net external assets of the Bundesbank (increase: +)	+15.2	+16.1	– 9.1	+ 3.3	+ 1.3	+ 2.6	+12.2	– 7.3

1 Special trade. – **2** Mainly warehouse transactions for account of residents and deduction of goods returned and of commission processing. – **3** Transactions in German securities are all ascribed to non-banks, since the statistics do not show precisely which residents are involved in such transactions. – **4** Counterpart of changes in the Bundesbank's external position which are not caused by external current and capital transactions: mainly the allocation of IMF special drawing rights and changes in the DM value of the external position of the Bundesbank owing to valuation adjustments.
Discrepancies in the totals are due to rounding.

which had led to a German surplus of DM 4 billion in 1978, likewise produced a deficit (of DM 7.5 billion) last year — although here, too, about DM 6 billion was attributable to higher expenditure on oil and petroleum products due to the price rises. Despite certain regional concentrations in the deterioration of the German current account (which are of course closely connected with the regional distribution of oil imports), there is no reason to conclude from this that the swing could be largely reversed by short-term, self-adjusting factors, especially since sharp falls in the prices of oil and petroleum products are hardly to be expected. A reduction of the deficit will therefore be possible only in the longer run.

Large capital outflows from the non-bank sector

The German balance of payments situation was also characterised by the fact that in 1979 the outflows on current account were accompanied by only small capital inflows from abroad, and that in early 1980 considerable amounts even flowed out through capital transactions. Already in 1979 non-banks exported over DM 13 billion (net) of capital (including the balancing item of the balance of payments); this was about as much as in 1978, but far more than in the preceding two years. Direct investment by enterprises made up the largest part of the capital exports (over DM 6 billion net). On the one hand, German firms' investment abroad in 1979, at more than DM 8 billion, increased further (in accordance with a long-standing trend); on the other, foreign enterprises' investment in Germany, at roughly DM 2 billion, was distinctly smaller than in most previous years. The gap between the two flows of capital thus widened even further. The growing interest of German firms in investing abroad probably owed much to longer-term sales strategy considerations. The strong appreciation of the Deutsche Mark that began after the transition to floating reduced the sales prospects of some exporters, but at the same time it lowered the cost of participating in enterprises abroad. By contrast, Germany — being a high-wage country, and in view of the movement of the exchange rate of the Deutsche Mark in recent years — has meanwhile become a relatively expensive location for investment, and now attracts far less foreign capital than it did up to the beginning of the seventies. Another source of persistent capital outflows from Germany has for years been trade credits, i. e. enterprises' credit transactions in connection with foreign trade. However, the net amount exported in this context in 1979, at approximately DM 2 billion, was only about half as large as in the preceding two years, partly no doubt because imports increased particularly strongly in value in 1979, so that more credit was raised from foreign suppliers, whereas previously lending by exporters had been much more significant. Further substantial amounts flowed abroad from the enterprise sector in 1979 in the form of financial credits (over DM 3 billion net). One of the reasons for this was that short-term Euro-DM loans were generally more expensive for domestic non-banks than comparable domestic loans in the second half of the year. Enterprises consequently repaid financial credits and increased their short-term financial assets with foreign banks. In the field of security transactions, by contrast, there were net inflows of capital to Germany (DM 5.5 billion). This was primarily because non-residents bought almost DM 6 billion of German securities (excluding securities purchased for the sake of participations). They consisted mainly of bonds, the acquisition of which was probably motivated to some extent by speculative interest rate and exchange rate expectations. On the other hand, residents bought relatively few foreign securities on balance, not least because foreign Deutsche Mark bonds yielded less than domestic bonds over a large part of the year. At the beginning of 1980, however, the interest rate pattern and the direction of capital movements in bonds underwent a change. The yield on foreign Deutsche Mark bonds again exceeded that on domestic bonds and prompted domestic investors to buy foreign securities while, conversely, non-residents disposed of some of their holdings of German bonds.

Substantial long-term capital inflows to banks

In 1979, taken as a whole, the considerable outflows in the field of non-banks' external payments were accompanied by substantial compensatory inflows to the banks. In that year the banks imported roughly DM 16 billion of short and long-term funds,[1] which offset roughly two thirds of the outflows caused by the deficit on current account and the capital exports of non-banks (DM 23.5 billion). The decisive role was played by the larger flow of longer-term foreign funds to the banks; this was partly a symptom of the growing importance of the Deutsche Mark as an international investment currency and partly a

1 Excluding the foreign exchange swaps with the Bundesbank outstanding at the end of the year, in the amount of just over DM 2 billion.

sign of German banks' active procurement of funds in other countries in the light of the strong demand for credit in Germany and the squeeze on domestic liquidity. In 1979 the longer-term external liabilities of banks increased by no less than DM 22 billion, which was over one half more than the inflow in 1978. This amount was made up roughly equally of deposits and loans against borrowers' notes, mostly with remaining maturities of at least four years. The funds raised were therefore exempt from minimum reserve requirements for the debtor bank. (Conversely, and unlike the situation when bonds are bought, the foreign investor was not faced with the question of whether or not coupon tax had to be paid.) At the same time the banks extended longer-term loans to non-residents; inclusive of security purchases, they totalled DM 8 billion. Most of this amount consisted of the acquisition of the DM-denominated U.S. Treasury Notes and DM-denominated bearer U.S. Treasury Notes ("Carter bonds") issued in the German capital market. On balance, however, the amount of long-term funds received by the banks from abroad in 1979, at DM 14.5 billion, was almost three times as great as in 1978; this inflow contributed very significantly to the financing of the deficits incurred in the external payments of non-banks. As already mentioned, this trend did not persist at the beginning of 1980; on the contrary, it gave way to considerable capital outflows. This caused the Federal Government and the Bundesbank to relax the remaining restrictions on capital imports. These few restrictions concerned the acquisition of domestic bonds maturing within four years and the raising of loans against borrowers' notes abroad. For such capital imports the maturity limits have been reduced to two years.

Significance of the short-term capital transactions of banks

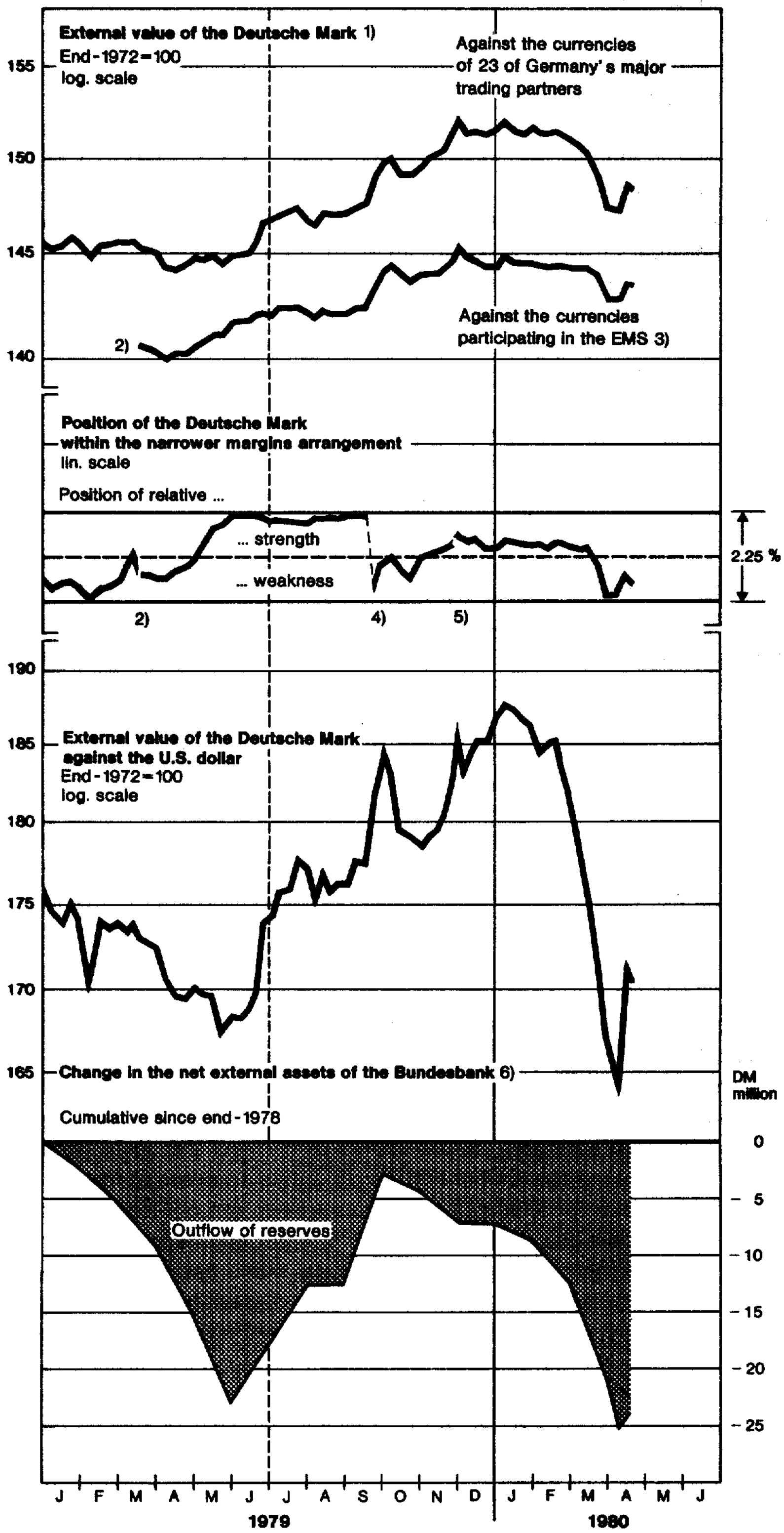
In themselves, the short-term capital transactions of the banks contributed little to the financing of the balance of payments deficit in 1979. Last year the banks received only just over DM 2 billion (net) of short-term funds from abroad (excluding the foreign exchange swaps with the Bundesbank outstanding at the end of the year). In this case, too, the situation changed radically at the beginning of 1980 because, in view of the growing interest rate advantage of short-term dollar assets and the initially favourable exchange rate expectations for the dollar, the banks built up their short-term external assets more rapidly on the conclusion of their window-dressing operations at the end of the year. At the same time short-term foreign funds were withdrawn from German banks. These two factors together led to an improvement in the net external position of the banks amounting to no less than DM 12 billion in the first quarter of 1980 (again excluding foreign exchange swaps with the Bundesbank). These outflows from the Bundesbank tended to increase the pressure on the Deutsche Mark and thus the intervention burden on the Bundesbank.

Outflows of foreign exchange from the Bundesbank

The changed situation of the German balance of payments was not without consequences for the official monetary reserves. They decreased by about DM 7 billion last year owing to transactions; this was equivalent to roughly two thirds of the deficit on current account (although, of course, a comparison with only this part of the balance of payments is somewhat arbitrary).[1] In the course of the year the development of the reserves was marked by the fact that at first considerable amounts of foreign funds which had previously flowed in for speculative reasons flowed out of Germany. In connection with the period of weakness of the U.S. dollar which began around the middle of the year, it became necessary to intervene more heavily within the European Monetary System. Following the first realignment with effect from September 24, the situation in the EMS eased, but without any significant amounts of foreign exchange flowing out again. On balance more than DM 8 billion accrued to the Bundesbank in 1979 as a result of interventions within the EMS (including interventions in the "little snake" existing up to March). In the dollar market exchange rate movements did not quieten down until the beginning of October, when the U.S. monetary authorities adopted a more restrictive policy in order to combat inflation. Taken as a whole, the monetary reserves of the Bundesbank declined by about DM 13 billion in 1979 owing to transactions of its own and of the U.S. authorities in the Deutsche Mark/dollar market. At the end of 1979 the net external assets of the Bundesbank came to DM 93.0 billion; DM 88.9 billion of this amount consisted of monetary reserves in the stricter sense and DM 4.0 billion of credits to and other claims on non-residents. At that date the monetary reserves for the first time in-

1 The difference between this figure and the balance of payments deficit (overall balance on current and capital accounts), which is shown at DM 5.0 billion, is due to the fact that roughly DM 2 billion of foreign exchange was temporarily transferred from the banks to the Bundesbank at the end of the year for the purpose of regulating the money market.

Exchange rate movements and external position of the Bundesbank



1) Weighted external value, geometric mean. For end-1972 the ruling central rates were used in principle; in the case of the pound sterling, the Irish pound and the Canadian dollar, whose exchange rates were floating, the market rates of end-1972 were used instead.- 2) Entry into force of the European Monetary System (EMS) on March 13, 1979.- 3) Excluding the pound sterling.- 4) Realignment of exchange rates in the EMS with effect from September 24, 1979.- 5) Devaluation of the Danish krone in the EMS with effect from November 30, 1979.- 6) Excluding changes due to valuation adjustments and allocations of special drawing rights, and excluding changes on account of swap transactions with domestic banks.- Latest position: April 15, 1980.

cluded claims (totalling DM 28.5 billion) denominated in European Currency Units (ECUs) on the European Monetary Cooperation Fund (EMCF). Of this total, DM 25.7 billion was accounted for by ECUs issued by the EMCF against the temporary contribution by the Bundesbank of 20% of its gold and dollar reserves, while the Bundesbank had received ECUs equivalent to DM 2.8 billion from its EMS partners in connection with the financing of interventions. The Bundesbank's own gold holding, which (less the amount contributed to the EMCF) amounts to about 95 million ounces, continues to be shown in the books at DM 13.7 billion.

No further real appreciation of the Deutsche Mark

As a result of the considerable outflows on capital account and also of the further reduction in exchange rate flexibility associated with the EMS, the "weighted" external value of the Deutsche Mark against the major currencies rose no further in the first half of 1979. In view of the prevailing inflation differential between Germany and other countries, the Deutsche Mark thus depreciated somewhat in real terms. It was only in the later part of the year, and especially after the realignment within the EMS, that an upward tendency in excess of the inflation gap made itself felt at times. As an annual average the Deutsche Mark accordingly appreciated by 9½% against the dollar and by almost 5% against the currencies of 23 of Germany's major trading partners, but if the inflation differential existing between Germany and its major trading partners is taken into account, the rising trend in the real external value of the Deutsche Mark in recent years came to a halt on average in 1979. Between the beginning of 1980 and the time of going to press the weighted nominal external value of the Deutsche Mark actually declined by about 2%, so that, since the inflation gap vis-à-vis other countries is tending to grow, the Deutsche Mark has depreciated even more strongly in real terms.

5. Implications of the changed external situation

Change in the current account creates a new situation

The profound change which took place in the German current account last year creates a new situation in many respects for the economy, and also for economic policy. The reason why the altered external conditions are of momentous significance for Germany is that they are in all likelihood not a temporary phenomenon which will right itself automatically in the next phase of the cycle or when the economic differential between Germany and other countries reverses. On the contrary, there is much to suggest that at present the current account deficits are in large part attributable to factors whose impact can at best be reduced only gradually. As already described in detail, the principal cause of this change is the further increase in the cost of petroleum, which must very probably be regarded as irreversible. Since the reductions in oil consumption throughout the world have only been small in recent years, so that dependence on oil continues to be considerable, it is not impossible that the OPEC countries will decide to raise prices further after some time, not only in order to offset the inflationary tendencies in industrial countries but also so as to increase the oil price further "in real terms". More and more adjustments and changes are being made to the production process and will no doubt lead to the conservation of energy in future, but such measures take a long time to have a pronounced effect. Hence they can hardly be expected to ease the burden on the current account significantly in the near future. In these circumstances those responsible for economic policy are faced with two main tasks. In the short run the financing of the existing current account deficit must be arranged in such a way as not to impede domestic stabilisation. At the same time the problem of restoring the current account to equilibrium, which can only be solved in the longer run, must be tackled.

Current account deficits mainly a financing problem in the short run

A current account deficit such as is in prospect for 1980 does not present financing problems for Germany because of any shortage of foreign exchange; at the time of going to press Germany's official monetary reserves amounted to some DM 72 billion. But seeking to finance substantial balance of payments deficits for any length of time solely by running down the monetary reserves would be a short-sighted policy. Such a strategy would conflict with international rules according to which, under a system of floating exchange rates such as are in effect for the Deutsche Mark against the U.S. dollar and many other currencies, central bank intervention in the exchange markets is deemed appropriate only for the purpose of smoothing out "erratic" fluctuations in exchange rates. And there are other obvious reasons for not adopting such a course. It would not be enough to seek to finance only the deficit on current account by using the foreign exchange reserves, since in future considerable "autonomous" outflows from Germany are to be expected on capital account as well. Such capital exports are largely independent of the interest rate differential vis-à-vis other countries and are closely associated with exports of goods; capital outflows of this type, such as direct investment, export credits and development aid loans, amounted to almost DM 10 billion in 1979. Furthermore, it would have to be borne in mind, if Germany's monetary reserves were to be used on a major scale, that part of them is tied up owing to international commitments and hence is not necessarily available at once. Moreover, a rapid reduction in the monetary reserves might be regarded internationally as an indication of a sustained German external disequilibrium and might thus have additional adverse effects on exchange rate expectations for the Deutsche Mark.

Financing of the deficit as far as possible through the market

Hence the aim must be, even at this early stage, to adjust the balance of payments not only by using foreign exchange reserves but also as far as possible through the market, which initially means above all through capital imports. To bring about a reversal of the present tendency towards capital outflows, the support of monetary policy is required. The raising of the Bundesbank's interest rates at the end of February was directed to this end; it was closely connected with the upward movement of interest rates throughout the world, which siphoned funds out of Germany. To underpin this policy the remaining restrictions on capital imports were also significantly relaxed, as already mentioned.

International interest rate differentials and inflationary expectations

The monetary policy measures of the Bundesbank, and particularly the raising of its interest rates so far, must not be understood to imply that it is important to close the absolute gap between interest rates in the German credit market and those in the market for Euro-dollar loans or dollar loans in the United States. This gap is largely due to the varying rates of inflation in Germany and the United States. How large this nominal interest rate differential can continue to be without stopping capital from flowing into Germany depends very much on whether market participants remain confident that Germany can safeguard the real value of its currency more effectively than most other countries. Financing the deficit exclusively by drawing on the monetary reserves would be unlikely to engender such confidence, as already suggested; what is required in Germany is, rather, a comprehensive stabilisation policy which, even if its target can be achieved only in the longer run, must be pursued right now.

Efforts to reduce energy consumption ...

There are several possible ways of gradually reducing and eventually eliminating the deficits on current account, although none of these strategies on its own, but only all of them in combination, will produce the desired result. In the first place, it is essential to ease the burden on Germany's current account significantly by lowering or at least stabilising the consumption — and therefore the importation — of oil and oil derivatives. In the period between 1974 and 1979, i. e. since the first oil crisis, imports of crude oil and petroleum products already decreased slightly (by 2½ %), although the real gross national product rose by about 15 % during those years. In other words, oil consumption did respond to the price increases, albeit not very strongly. Further efforts in this direction are indispensable. They must be increasingly aimed not only at reducing the consumption of petroleum products but also at their replacement, even though this calls for some very heavy investment if meaningful results are to be achieved. The coal refining projects alone, according to the recently announced plans of the Federal Government, will entail investment totalling DM 13 billion (based on 1979 costs) before they reach their final stage in 1993; about 1½ to 2 % of the estimated requirements of primary energy in the early nineties are to be met in this way.

... and increase the transfer of real resources

Secondly, adjustment to the upheavals in the world economy necessitates the release of domestic economic resources in order that imports may increase less and exports more in future. This adjustment process does not seem to have started in 1979, since overall output expanded by 4½ % in real terms while total real expenditure on goods for domestic consumption and capital formation went up by 5½ %. Considered as a whole, this difference in growth rates between domestic production of and domestic expenditure on goods and services is one of the reasons for the current account deficit in 1979. There has been no change in this situation in the first few months of 1980: taking the average of January and February (seasonally adjusted), the German current account showed a deficit of over DM 2 billion. A reversal is essential here in the longer run. Only if domestic expenditure on goods for consumption and capital formation increases less than domestic production can the transfer of real resources to other countries, and thus a reduction in the current account deficit, get under way. In the field of foreign trade this means that exports must go up faster than imports. The oil-producing countries' willingness to buy provides German exporters with additional sales opportunities, even though a boom in exports to OPEC countries such as took place after the first oil crisis of 1973/74 is unlikely to recur. German exporters, with their specialised range of capital goods, will probably also benefit from the wave of investment to conserve energy and replace oil that is now to be expected world-wide. The other area in which external equilibrium must be restored in the longer run is that of imports. The important thing here is that domestic producers remain sufficiently competitive, and are not crowded out of the domestic market by rising costs.

Depreciation not an instrument of economic policy

The reaction of the exchange rate of the Deutsche Mark against the principal currencies may foster this adjustment process, at least in the longer term. In fact, the Deutsche Mark has been tending to depreciate since the turn of the year. Given floating exchange rates against the dollar and other currencies and a large deficit on the balance of payments, such a tendency is indeed unavoidable at times. But there is no reason to use the depreciation of the Deutsche Mark as an economic policy instrument for adjusting the balance of payments. To begin with, the depreciation primarily increases the importation of inflation, raises the cost of imports, and tends to reduce the foreign exchange revenue from exports. Only after some while can a reaction to the depreciation in the sense of a decline in imports and greater success in the export field be expected. As experience in countries with sharp depreciations shows, it may take a long time before productive capacity for such a restructuring is released through this process, and the more the change is delayed, the more radical are the adjustment measures required.

Continuation of stabilisation policy

The economic policy alternative to such a "self-adjustment" of the balance of payments is the continuation of a systematic domestic stabilisation policy which improves the international competitiveness of German enterprises in terms of prices and delivery periods but tries to contain the importation of inflation by strengthening confidence in the national currency and by stabilising the exchange rate as far as possible. Such an objective is by no means inconsistent with Germany's international economic responsibilities; on the contrary, it accords particularly well with them. As stated elsewhere (page 44), Germany accounted in 1979 — and will probably account again in 1980 — for an unusually large part of the deterioration in the current account of the industrial countries; only Japan is in a similar position. The increase in the German current account deficit is to be tolerated in the short run (especially since it slightly reduces other countries' adjustment burdens), but in the long run it would be of little value to the world economy if such a major nation as Germany were to remain a deficit country and, instead of providing the rest of the world with certain net exports of goods, were to absorb goods from it.

However, a stabilisation policy that is appropriate in both external and domestic economic terms depends on an improvement in the pattern of production and a change in the expenditure of national product. Some of the available resources must be diverted out of the more consumption-oriented or less productive areas into the field of investment — either investment for the purpose of increasing productivity or investment in the energy sphere. But additional private capital spending can be financed without inflation only if the share of national product absorbed by private consumption and the government is reduced; fiscal measures that resulted in a further expansion of private or government consumption would be incompatible with this aim. Generally speaking, at all events, a higher relative coverage of government expenditure by current receipts would be desirable from the present perspective.

Furthermore, a stabilisation policy conceived in overall economic terms requires the support of management and labour. Those responsible for wage policy should take due account of the need for more business investment, but also of the deterioration in the real income of the economy as a whole owing to the profound change in the terms of trade. However, they can only be expected to do so if enterprises act judiciously when setting their prices. Preventing undesirable developments is necessary even in the short run in this field, since otherwise a conflict might arise between stabilisation policy and the target of keeping economic growth as steady as possible. But this applies even more in the longer term, since experience has shown that only confidence in a stable currency and the preservation of a consensus about the underlying objectives of economic policy ensure that inescapable major economic changes can be initiated through the operation of the market economy.

II. International monetary developments and policy

1. The situation of the world economy in 1979

World economy governed by renewed surge in oil prices

Last year the development of the world economy was increasingly determined by the new oil price explosion. Within the OECD the average rate of inflation increased over 1978 by 2 percentage points to approximately 10%, and the process of reduction in the current account surpluses of the OPEC countries that lasted up to the beginning of the year ceased abruptly. In 1979 their current account surpluses jumped to almost $ 65 billion, whereas in 1978 they had come to as little as $ 3.5 billion.

Taking the year as a whole, the level of world economic activity and world trade developed quite satisfactorily all in all despite the rapid succession of escalating oil price increases. Although the pace of economic activity slowed down world-wide towards the end of 1979, the OECD countries as a group nevertheless achieved a respectable growth rate, with gross national product increasing in real terms by 3.5%. World trade probably grew by 6 to 7% in real terms last year, after about 5.5% in 1978. The factors contributing to this level of growth were on the one hand the powerful upsurge in economic activity in Japan and western Europe, particularly in Germany, and on the other hand the fact that the long-expected recession in the United States did not materialise.

New challenge to energy policy . . .

The movement of oil prices last year underlines once again how urgent a determined policy of both conserving energy and opening up new sources of energy is if dependence on imported oil is to be reduced. Of course, the sins of omission in the years following the first oil price explosion of 1973/74 cannot be made good today within a short period of time. Nevertheless, experience shows that, at least as far as drastic price changes are concerned, energy consumption does not react inelastically, and that appropriate measures in the field of energy policy make it possible to reduce imports of petroleum and petroleum products over the longer term.

. . . as well as to economic and monetary policy

The direct burdens resulting from increases in oil prices for economic growth, monetary stability and balances of payments also make it imperative to take prompt and decisive action in the field of economic and monetary policy. As was the case after the first oil crisis, this once again raises the question as to the correct policy mix between adjustment in real terms to the changed conditions in the world economy on the one hand and the interim financing of current account deficits induced by the oil price increases on the other, without placing an excessive burden on domestic economic developments as a result of the higher cost of oil. In this context, it is encouraging that governments and central banks have learned from the experience in the period following 1973/74. At that time many countries considered the risks to economic activity posed by the explosion in oil prices to be greater than the dangers this implied for inflation and foreign trade. Correspondingly, too much emphasis was frequently placed on financing balance of payments deficits as smoothly as possible and too little on adjustment in real terms in an endeavour to minimise losses in income arising from the increase in oil prices. The pursuit of such policies resulted in persistently high rates of inflation and balance of payments disequilibria, which in the end only exacerbated the problem of adjustment. It is obvious that those countries which in the past did not, or could not, eliminate the burden of the first oil crisis by adopting timely domestic economic measures will be particularly hard hit by the renewed increases in oil prices.

Increasing need for international finance . . .

. . . and greater risks in international banking

Despite the greater willingness of all countries to undertake more in terms of adjustment, an increasing need for international finance can be expected for the foreseeable future to enable countries to adjust to the latest explosion in oil prices in an orderly manner. The dimensions of the necessary recycling process, which are now becoming apparent, together with other influences mentioned below, will once again place a heavy burden on the international monetary system. Although the international financial markets proved to be very elastic and efficient after 1973/74, this is no guarantee of a similar smooth provision of funds to finance sustained deficits. Many factors indicate that today the risks involved in international banking are higher than they were after the first oil crisis. It is for this reason that increased importance attaches to the efforts to bring international banking transactions under greater control as regards monetary policy and bank supervision. The resources available in the International Monetary Fund and other official institutions should be drawn upon more heavily in order to meet the inevitable need for finance.

The more stable conditions in the international foreign exchange markets last year are a clear indication of the fact that the rapid growth in balance of payments deficits could initially be financed without any major problems. A decisive influence on this development was, on the one hand, the marked drop in a number of current account balances among the industrial countries; on the other hand, with the spectacular swing in their current accounts Germany and Japan ran up considerable deficits which, however, could be financed without difficulty because these two countries have a high level of foreign exchange reserves. The interest rate policy pursued by many countries also created conditions in the money and capital markets which led to compensatory capital movements despite the increase in international inflation differentials. Moreover, the development of the exchange rate of the U.S. dollar testified to the more active policy pursued by the U.S. monetary authorities, as reflected in particular in the U.S. stabilisation programmes of November 1978 and October 1979. Finally, the European Monetary System has contributed to the stability of exchange rates in Europe since it entered into force about a year ago.

In the initial months of 1980 exchange rates have once again begun fluctuating more strongly. The new surge in interest rates in the United States from about mid-February 1980 onwards helped the dollar to strengthen its exchange rate considerably vis-à-vis most other major currencies; however, these gains were partly lost again in the week after Easter. Within the European Monetary System as well marked shifts in exchange rates took place, with the Deutsche Mark at times moving into the weakest position. Not quite unexpectedly, the Deutsche Mark was again at the centre of events in the foreign exchange markets in this new, and in many respects unaccustomed, situation.

2. The adjustment of current account balances

Explosive increase in OPEC surpluses

The development observed since 1977 towards better equilibrium in the international pattern of balances of payments ceased abruptly last year as a result of the successive oil price increases. While the current account surplus of the OPEC countries had fallen in 1978 to a residual amount of about $ 3.5 billion that no longer disrupted foreign trade and payments relationships, it jumped last year to approximately $ 65 billion, i. e. to about eighteen times that figure. The other groups of countries suffered a corresponding and no less spectacular shift of their aggregate current account balances into deficit. After a surplus of $ 9.5 billion in 1978, the current account of the OECD countries taken as a group reached a record deficit of almost $ 30 billion in 1979, while the aggregate current account deficit of the non-oil developing countries went up by $ 7 billion to approximately $ 32 billion. (Besides the current account balances of other countries, including the CMEA countries and the People's Republic of China, the difference in the totals contains a very large unexplained balancing item by which the statistically recorded deficits exceed the surpluses.)

As a result of last year's oil price increases the current account balances of the oil-importing countries have been subjected to a burden that is just as heavy as that of 1974 in U.S. dollar terms. However, taking 1979 as a whole ignores the fact that the increases in oil prices were greater in the second half of the year. This implies that their full impact will not be felt until 1980, particularly since oil export prices have risen again since the beginning of the present year. As rapid a reduction in OPEC surpluses as took place after the first oil crisis is hardly to be expected this time. The imports of the oil-producing countries will probably not increase to the same degree as they did after 1973/74 owing to the distinctly slower rate of development in these countries as well as to world political events. As a result the overall potential for adjustment by deficit countries has greatly deteriorated. All available forecasts point to an unprecedented gap in 1980 between the current account positions of the OPEC countries and the rest of the world; even on the rather optimistic assumption of unchanged real oil prices in comparison with the beginning of 1980, this gap can be estimated at some $ 100 billion. In this context the OECD points out that the anticipated external deficit of the OECD countries in 1980, amounting to $ 80 billion, implies a swing in the current account position of this group of countries in comparison with 1978 of more than 1 % of their gross national product, and hence exceeds the comparable swing that took place between 1972 and 1974.

Balances on current account of major countries and groups of countries*

Country/group of countries	1976	1977	1978	1979 pe	1978	1979
	US$ billion				Percentage of gross domestic product	
OECD countries	−18	−24	+ 9.5	−29.5	0.2	0.4
of which						
EEC countries, total	− 6.5	+ 1.5	+17	− 9.0	0.9	0.4
Germany	+ 3.9	+ 4.3	+ 9.0	− 5.8	1.4	0.8
(Memorandum item: DM billion)	(+ 9.7)	(+ 9.8)	(+17.5)	(−10.5)		
France	− 6.1	− 3.3	+ 3.9	+ 2.4	0.8	0.4
United Kingdom	− 1.5	+ 0.5	+ 2.0	− 5.0	0.6	1.3
Italy	− 2.8	+ 2.3	+ 6.4	+ 5.0	2.5	1.6
United States	+ 4.6	−14.1	−13.5	− 0.3	0.6	0.0
Japan	+ 3.7	+10.9	+16.5	− 8.6	1.7	0.8
Switzerland	+ 3.5	+ 3.4	+ 4.4	+ 2.8	5.2	3.0
OPEC countries	+36.5	+29	+ 3.5	+63.5	.	.
Developing countries (excluding OPEC countries)	−18.0	−12.5	−25.0	−32.0	.	.

* Balances of trade, services, and private and official transfers (transactions basis). — **pe** Partly estimated.
Source: OECD and national statistics.

Large deficits of Japan and Germany ease the burden on other countries

However, the external burden on a number of OECD countries will probably be eased this year (as in 1979) by the changed current account pattern within this group of countries, which is characterised in the main by the continuing deficits on current account of Germany and Japan. Classified for almost 15 consecutive years as a typical case of a country with a structural surplus, Germany registered a deficit of DM 10.5 billion on current account in 1979, after a swing of no less than DM 28 billion in comparison with 1978. In terms of the absolute amount involved, this deterioration was exceeded only by that of Japan. After current account surpluses of almost $ 11 billion and $ 16.5 billion, respectively, in 1977 and 1978, Japan recorded a current account deficit of nearly $ 9 billion last year, representing a swing of over $ 25 billion in comparison with 1978. In contrast, the current account of the United States was in approximate balance in 1979 after showing deficits of about $ 14 billion in both 1977 and 1978.

The shifts in exchange rates in recent years and, in particular, factors relating to the level of economic activity have contributed to this changed pattern of current account balances. Thus, economic growth in Germany and Japan in 1979 was significantly above the average for all OECD countries and led to a correspondingly rapid growth of imports in both these countries. The marked rise in the yen up to the end of 1978 was probably the main reason why the average annual volume of Japan's exports practically stagnated in 1979. In contrast, the reduction of some $ 4.5 billion in the U.S. foreign trade deficit to just over $ 29 billion last year can be attributed to the slight slowdown in economic activity in the United States and the strengthening of its competitive position in world markets owing to the fall in the exchange rate of the dollar.

In 1979 France and Italy once again succeeded in achieving considerable current account surpluses; in each case, however, the surpluses were about $ 1.5 billion smaller than in the previous year. This reduction was due entirely to foreign trade, the decline of approximately $ 2 billion and almost $ 3 billion, respectively, in the export surpluses being partly offset by a significant improvement in the services accounts of these two countries. In contrast, the United Kingdom's current account slipped from a surplus of $ 2 billion in 1978 into a deficit of $ 5 billion. The main reason for this development seems to have been the deterioration of the United Kingdom's competitiveness in the industrial sector and the higher level of profits transferred to the foreign companies involved in North Sea oil production. These factors apparently had a greater impact than the favourable effects of North Sea oil production on the balance of trade.

Unfavourable prospects for oil-importing developing countries

While the pattern of the balances on current account of the OECD countries did not give rise to any direct problems in 1979 despite the marked swing in their overall position, the external position of the oil-importing developing countries fared far less favourably. Although their aggregate current account deteriorated less significantly in comparison with 1978 than that of the OECD countries, there is no mistaking the fact that the imbalances are concentrated to a large degree on the so-called threshold countries, i. e. developing countries that have made relatively good progress towards industrialisation. The rapid increase in the price of oil is hitting these countries, which already have a heavy burden of debt, particularly hard, especially because a number of them are extremely dependent on oil as a source of energy. In addition, the external prospects of the oil-importing developing countries as a group have generally clouded owing to the decline in economic activity which is becoming apparent in the OECD area; moreover, their chances of the burden being reduced as a result of higher imports by the oil-exporting countries are far less favourable than those of the industrial countries.

This scenario in the field of foreign trade and payments indicates that the oil-importing developing countries in particular are facing a difficult period of adjustment. Individual members of this group, especially countries that have considerably increased their indebtedness through exploiting favourable financing conditions, may now be confronted with grave problems. However, the experience gained from the first oil crisis warrants the hope that measures will be adopted that are conducive to improving current account balances within a foreseeable period and to the requisite degree.

Adjustment in real terms to the higher oil prices inescapable

Also within the group of OECD countries the need to stabilise developments in the external sphere will become more acute as a result of the higher oil import bill. Even though the need for adjustment within this group of countries has been shifted markedly to Germany and Japan, this cannot be seen as a reason for other countries to reduce their efforts to adjust to the new external conditions. On the one hand, the additional costs caused by the higher oil prices must be passed on as quickly as possible to domestic consumers of energy; at the same time, the leeway for passing on further the immediate burdens arising from oil price increases should be limited. On the other hand, it is necessary to free domestic resources for exports in order to raise the level of exports, in particular those to the oil-producing countries. Numerous countries within the OECD area adjusted their economic policies in this direction last year and thus created an important condition for their balances of payments to develop along a reasonable path. In contrast, a policy designed to stimulate demand in the industrial countries, such as was attempted in 1973/74 as a reaction to the first oil price shock, would only postpone the necessary solution through a transfer of real resources.

3. Financing the balance of payments deficits

Generally smooth financing of balances of payments in 1979

Last year it was in general possible to finance the growing balance of payments deficits smoothly at first. The main reason for this was the continuing abundance of liquidity in the international financial markets, together with the fact that the deficits were mostly incurred by countries with a relatively high level of foreign exchange reserves. At the same time the total of all statistically recorded current account deficits remained roughly the same as in 1978.

A further factor that reduced the burden of financing current balances was that the propensity of countries to build up their foreign exchange reserves no longer increased, mainly as a consequence of the rapid rise in international lending rates over the course of the year. In a few countries the revaluation of gold stocks following the surge in the gold price may have had a favourable impact on this attitude of restraint. The amount by which the foreign exchange reserves of deficit countries were built up for contingency purposes by taking up loans, and hence the degree to which deficits on current account were "overfinanced", at about $ 30 billion, was hardly smaller than in the previous year.

In global terms, the deficit countries at least had no difficulties in satisfying their financing requirements in 1979. Not until the latter part of the year did the first signs appear that the period of an extreme debtor market was coming to a close — owing inter alia both to the adoption of a tougher anti-inflationary monetary policy stance by major in-

International credit and bond markets

US$ billion

Item	1974	1975	1976	1977	1978	1979 p
A. Medium and long-term Euro-currency loans 1	28.5	20.6	27.9	33.8	65,8	78.3
Borrowers						
Public agencies 2	19.5	14.0	20.7	27.2	50.2	58.8
Private agencies	9.0	6.6	7.2	6.6	15.6	19.6
Borrowing countries						
OECD countries	18.3	6.2	9.9	13.0	30.4	28.6
Seven major industrial countries 3	13.2	1.8	4.4	6.2	18.2	12.7
Smaller industrial countries	3.4	3.0	3.4	4.7	8.5	7.2
Southern European countries	1.7	1.5	2.1	2.2	3.6	8.7
Non-European developing countries	8.0	11.0	14.2	17.8	31.5	41.5
Oil-exporting countries	0.8	3.2	3.4	6.3	9.7	8.6
Other developing countries	7.2	7.8	10.8	11.5	21.8	32.9
Centrally planned economies 4	1.1	2.7	2.5	2.6	3.6	7.7
Other 5	1.1	0.7	1.3	0.3	0.3	0.5
B. International bond issues 6	12.2	22.8	34.3	36.1	37.5	38.7
of which						
in U.S. dollars	8.4	11.8	20.9	20.8	14.9	15.6
in Deutsche Mark	0.9	3.7	4.2	6.7	8.2	8.2
in Swiss francs	1.0	3.6	5.6	5.0	7.7	9.3
Types of issues						
Euro-bonds 7	3.5	9.1	14.6	18.8	15.1	17.9
Traditional foreign bonds	5.2	11.6	18.3	16.3	20.7	19.4
Special issues 8	3.6	2.1	1.5	1.1	1.6	1.3
Issuers						
Public agencies 2	9,4	15.8	24.2	24.7	27.6	24.8
Private agencies	2.8	7.0	10.1	11.4	9.8	13.9
Issuing countries or institutions						
Industrial OECD countries	5.7	15.8	23.5	23.8	22.9	26.3
Developing countries, total	0.9	0.9	2.3	4.7	5.6	3.6
International organisations	5.4	5.3	8.3	7.2	8.4	8.4
European organisations	1.7	1.7	3.1	2.5	3.3	3.8
International development institutions	3.7	3.7	5.2	4.6	5.1	4.6
Other	0.2	0.8	0.3	0.4	0.5	0.4

1 Publicised internationally syndicated loans running for more than 12 months and almost entirely financed on a roll-over basis which have not necessarily been taken up yet; excluding redemptions. — **2** Including public enterprises and financial institutions and including international organisations. — **3** Canada, France, Germany, Italy, Japan, United Kingdom, United States. — **4** Including CMEA institutions. — **5** Including international organisations. — **6** The country of residence of the issuer is not identical with the country or countries of sale; excluding redemptions. — **7** Internationally syndicated bond issues. — **8** Direct placements with monetary authorities and governments. — **p** Provisional.
Discrepancies in the totals are due to rounding. — Source: OECD and World Bank.

dustrial countries and to a deterioration in the international political situation in the Middle East, which emphasised the country risks of a political nature associated with international loans.

(a) The role of the international financial markets

International financial markets again play the dominating role in deficit financing

After deducting capital repayments and eliminating double-counting and exchange rate effects, the international financial markets provided an amount estimated at over $ 140 billion in the form of short, medium, and long-term loans and bond issues in 1979, compared with just over $ 110 billion in the previous year. Also in real terms, i. e. after taking account of the rise in the U.S. dollar export prices of industrial goods and the even steeper price increases in the commodity field, this implies a considerable acceleration in the international expansion of credit.

The above table gives details of the medium and long-term loans that were taken up or granted via the Euro-markets, as well as of the development of the volume of international bond issues, ignoring in each case capital repayments in the individual years. On this basis, the credit demand of the industrial countries in international financial markets fell significantly in general terms last year. The decline was concentrated on the volume of medium and long-term Euro-loans, which fell by some 30% in comparison with 1978.

In contrast, the total credit demand of the developing countries registered a strong rise of just under one quarter; the oil-importing developing countries even took up one and a half times as many loans as before. However, owing to the deterioration in the general market situation the developing countries were less successful in the international bond markets than in the previous two years. The marked increase of $ 8 billion in loans granted to countries with centrally planned economies is due in the main to the appearance of the People's Republic of China as a borrower for the first time, although the loans granted to China have been disbursed only in part up to the present. Countries in eastern Europe such as Hungary and Poland also stepped up their borrowing from foreign banks.

Once again high level of investments of reserves and petrodollars

The abundance of funds in the international financial markets and in particular the Euro-market was primarily due to the sustained high level of monetary reserves and petrodollars seeking investment in these markets. Through the investment of official foreign exchange reserves alone $ 37 billion flowed into the Euro-markets in 1979, after roughly $ 11 billion in the previous year; some $ 15 billion of this amount was denominated in Deutsche Mark and other non-dollar currencies, according to the Euro-currency market statistics of the BIS. In contrast, inflows from the United States played a far less important role than in earlier years in the expansion of the international financial markets in 1979. The international bond markets were also of only minor significance in the growth of international lending. As the table opposite illustrates, the volume of new issues in these markets, at approximately $ 39 billion in 1979, was slightly above the previous year's level, but — when capital repayments, repurchases and external bonds bought by banks are deducted from this gross amount — the "genuine" financing contribution of the international bond markets, at about $ 20 billion, was distinctly lower than in 1978. Owing to the continuing exchange risk involved, investors tended to refrain from entering these markets. Added to this was the increased interest rate risk resulting from the upsurge in international interest rates, which was initially concentrated at the shorter end of the market. In fact, money market rates for Euro-dollar deposits had soared to about 15% p. a. by the end of 1979 compared with about 8½ to 9% p.a. in the fourth quarter of 1978. In contrast, the rise in yields on bonds initially lagged more behind developments in the money market. In the meantime the market has enforced noticeable corrections to bond prices; thus, in March 1980 the yield on dollar-denominated bonds reached about 14%, although money market rates were approaching the 19% mark.

Increasing competition in international banking

As a result of the high degree of liquidity of the Euro-markets competition between international banks grew increasingly fierce until well into the autumn of last year. The average spread over LIBOR for roll-over loans fell in the process to ⅝%, compared with ⅞% p.a. a year before; prime borrowers were even able to reduce this margin to ⅜ to ½% p.a. At the same time the average maturity period for newly granted medium and long-term Euro-loans increased by one year to a little over ten years in comparison with 1978.

(b) Official loans

Little use made of official balance of payments assistance

Official loan assistance played only a minor role in financing the deficits. However, for a large number of developing countries with low per capita incomes and no or only very limited access to the free markets for financing their balance of payments deficits, official bilateral and multilateral loans containing a large grant element were of great and often decisive importance. It is a welcome fact that, judging from preliminary figures, major countries that belong to the Development Assistance Committee of the OECD, including the Federal Republic of Germany, significantly increased their assistance in 1979 as compared with the previous year.

In contrast to this, the amount of balance of payments assistance granted by official institutions was relatively modest in the period under review. As in the preceding year, outstanding loans granted by the International Monetary Fund (IMF) fell once again in 1979; many countries preferred to take advantage of the easier access to loans from the market, to which no economic policy conditions are attached. The repayment of loans to the IMF, at SDR 4.1 billion (after SDR 4.8 billion in 1978), was again extremely high last year. Of the repayments made in the period under review, roughly SDR 2.2 billion was accounted for by loans outstanding under the Oil Facility set up in 1974/75. The repayment of debts by the United Kingdom and Italy made up a large proportion of the total.

At the same time, new drawings on the Fund's resources fell from SDR 3.7 billion in 1978 to SDR 1.8 billion. Thus, in 1979 repayments exceeded new drawings on the IMF by SDR 2.3 billion, after there had been net repayments totalling SDR 1.1 billion in the previous year. (However, it must be taken into account in this context that new lending by the Fund in 1978 was affected by drawings by the United States on its IMF reserve tranche amounting to approximately SDR 2.2 billion as part of its dollar stabilisation measures of November 1978.) In 1979 all the Fund's new lending went to developing countries (40 in number).

(c) Prospects

More difficult to finance deficits through the markets . . .

As mentioned above, owing to the low absorptive capacity of the OPEC countries it is hardly to be expected that the imbalance between the oil-exporting and oil-importing countries will be reduced as quickly as after the first oil crisis. Persistent balance of payments disequilibria will therefore have to be financed for a correspondingly longer period and in all probability on a considerably larger scale. The recycling of the surpluses of the oil-exporting countries will no doubt pose greater problems than in past years because, in the face of the substantial foreign debt of a number of developing countries, their economic prospects are relatively unfavourable, and it is not least for this reason that banks operating in the international sphere have become more risk-conscious.

. . . owing to the heavy indebtedness of individual countries and . . .

Financing difficulties could arise, in particular, for those developing countries which in most cases are more advanced and which have accumulated a high level of foreign debt in recent years in the light of their favourable development prospects. It is typical of the strong concentration of foreign debt within the group of oil-importing developing countries that in 1978 more than half of the debt service payments was accounted for by only six countries. However, up to the present the aggregate economic burden on these countries resulting from their foreign debt has been kept within limits by increasing the total maturity periods of the Euro-loans granted on a roll-over basis between 1976 and the autumn of 1979 from 4½ to over 10 years, as well as by undertaking extensive refinancing operations and owing to the fact that interest rates in the Euro-markets have been relatively low. In the wake of the renewed oil price explosion and the more than doubling of market rates of interest since the low point in 1977, and given the decreasing maturities and shorter grace periods for capital repayments on new loans since the end of 1979, this picture has deteriorated significantly; as a consequence, individual countries have meanwhile come dangerously close to the limits of their indebtedness.

. . . the greater risk-consciousness of banks

Moreover, it is improbable that the level of loans offered in the international financial markets will increase in future to the same degree as it did in earlier years, particularly because the risk-consciousness of the Euro-banks has grown, owing in part to the blocking of Iranian deposits with U.S. banks and the prevailing tensions in East-West and North-South relations.

It would no doubt be wrong to assess a more cautious lending policy by international banks as a result of this development only in terms of their ability to ensure the recycling of OPEC funds. In this context, the doubts occasionally voiced that the efficiency of the banking system could be impaired by official endeavours to gain better control over the Euro-markets in particular (see subsection (d) below) are similarly misplaced. After the unrestrained growth in lending in recent years, taking greater account of differing country risks when granting international loans would be just as welcome as an increase in interest rate margins commensurate with the risks involved, as seems to have been happening since the end of 1979. Finally, it is in the best interests of the banks and the international financial system for OPEC funds to be recycled from a basically sound position.

Extended role of official balance of payments assistance just as desirable as . . .

Even if, for the reasons mentioned above, individual countries should come up against the limits of their indebtedness in the estimation of the international financial markets, this need not necessarily lead to major financial crises. If the countries concerned fulfil the conditions for gaining access to official sources of loans, sufficient funds are available to them from these sources. It would indeed be desirable for greater use to be made this time of the credit facilities of international institutions when financing current account deficits than was the case in the years from 1974 to 1976, not to mention the subsequent three-year period of "over-recycling". The institutions able to meet these needs have adequate funds for the purpose. Thus, the international development banks have significantly increased their lending potential as a result of a large rise in their capital. According to present projections, the loan commitments of the World Bank alone are expected to grow from approximately $ 24 billion between 1974 and 1978 to about $ 43 billion in the period from 1979 to 1983. After the increase in quotas expected at the end of 1980 comes into force, the quotas in the International Monetary Fund will total approximately $ 75 billion. At present there are no signs that calls will be made on the IMF by the industrial countries to the same degree as after the first oil crisis. The financial resources of the IMF should therefore be chiefly available to developing countries that are unable to meet their balance of payments needs by means of recourse to the international financial markets. In this context, any economic policy conditions imposed by the Fund could prove to be very advantageous, particularly for countries that are approaching the limits of their indebtedness as a result of recent developments. In the longer term this would also strengthen the willingness of banks to increase their lending.

. . . increased contribution of the OPEC countries to financing deficits

Apart from this, many developing countries have succeeded in significantly expanding their monetary reserves in recent years. Part of these reserves could be employed, at least for a certain period of time, to finance current account deficits. Admittedly, in many cases it is probable that a sufficiently large amount of liquidity will be "defended" as far as possible in order to maintain these countries' international creditworthiness. Finally, it is to be hoped that, in accordance with their direct responsibility for the radical change that has taken place in the international pattern of balances of payments, the OPEC countries will make an active contribution to the recycling process. In the interest of a fairer distribution of the risks involved in recycling petrodollars it is urgently desirable for these countries to increase their direct loan assistance to the developing countries that are dependent on imported oil. A greater participation of the oil-exporting surplus countries in the loans taken up by international development banks, such as occurred in 1974 and 1975, would be equally welcome. At that time, i. e. in the financial years of 1973/74 and 1974/75, the OPEC countries financed 30% and as much as 57%, respectively, of the gross amount of loans raised by the World Bank

(d) Progress in the discussion on improving control over the Euro-markets

Stronger international interest in better control over the Euro-markets

The accelerated expansion of both the Euro-markets and traditional foreign lending activities, together with the risks this involves, has given a new impetus to the discussion of the possibilities of exercising better control over international banking. Germany's special interest in this subject is explained on the one hand by the fact that international lending by German banks is increasingly carried out through foreign subsidiaries because foreign regulations are in some cases significantly less stringent or non-existent and particularly because of the lack of minimum reserve requirements and the less strict rules governing bank supervision. On the other hand, the Deutsche Mark plays such an important role today in Euro-market transactions that it appears prudent to carefully examine the consequences of unchecked growth and to adopt appropriate measures where necessary. But it has often been found that effective measures can only be introduced jointly with other countries and that such measures must be based on a uniform assessment of these markets.

There is full agreement on the necessity to enforce bank supervision regulations on the basis of consolidated balance sheets for banks. Special attention has long been paid to this need by the central banks that participate in the relevant discussions within the framework of the BIS; it is further underlined by the greater role envisaged for banks in recycling OPEC surpluses. In this context, there is generally greater willingness to include in these discussions not only the risks involved for individual banks but also the dangers that might arise for the banking system as a whole. Agreement also exists on the fact that the transparency of Euro-market operations must be improved all round.

Monetary control still disputed

In contrast, there is less agreement with respect to the question whether a certain amount of global management of international lending by banks on a coordinated basis is called for and could be achieved in practice. In this connection, the authorities of the United States have proposed the general introduction of basic minimum reserve requirements for short-term Euro-currency and other external liabilities. Among the obstacles to the implementation of such a proposal is the fact that a number of countries that do not have minimum reserve regulations would have to modify their national monetary policy instruments accordingly. Another proposal — which would not necessarily exclude the introduction of basic minimum reserve requirements, but might also serve to complement them — envisages the linking of international lending to general ratios related, for example, to banks' own funds, on a consolidated basis in each case. Besides a general reduction in risks to banks, these proposals are primarily designed to restrict the excessive growth of official and private international liquidity through the markets and hence to avoid the excessively generous financing of balance of payments deficits and remove hindrances to national monetary and exchange rate policy.

Greater efforts to achieve improved transparency of Euro-market operations

In the meantime, the central bank governors of the countries comprising the Group of Ten and Switzerland have agreed to examine the development of international lending by banks at six-monthly intervals using data collected by the BIS and, if necessary, to propose harmonised measures. A group of experts has been given the task of clarifying the technical details involved, with the aim of establishing a comprehensive reporting system on maturity transformation in international bank lending on the basis of reports drawn up at the national level. Up to the present national reporting systems exist only in the United Kingdom and — in a rudimentary form — in a few other countries, but they do not provide an accurate overall picture.

In the period under review and at the beginning of 1980 a number of new bank supervision measures came into force in the Federal Republic of Germany; they are designed to improve the transparency of international lending operations and to indirectly support general economic objectives. Thus, as a result of a voluntary agreement between the Federal Banking Supervisory Office and the associations of the banking industry, annual auditors' reports on the foreign subsidiaries of German banks were submitted for the first time last year. However, this is not in itself sufficient to enable the activities of German banks abroad to be supervised regularly. For this reason the Bundesbank considers it necessary to create the legal framework for the regular submission of up-to-date consolidated statements as soon as possible and to apply bank supervision rules on this basis.

German banks that have already been submitting a monthly report containing balance sheet statistics showing the business transactions of their foreign branches with partners abroad, broken down according to sectors and periods of maturity, have been reporting in addition since the end of March 1980 on the composition of this part of their foreign transactions classified by various countries and currencies. Hence banks with foreign branches submit not only a report on the external status of the domestic sector of the bank, as in the past, but also a separate report on the external positions of their branches abroad. However, the informativeness of these reports is limited as long as no corresponding data are available on the foreign subsidiaries of German banks, which operate on a larger scale than these banks' foreign branches. Thus, at present less than 40 % of the medium to long-term Euro-loans granted by German banking groups on a roll-over basis are covered.

Growing importance attaches to the assessment of country risks, which, apart from the problem of creditworthiness, result from uncertainty as to whether the debtor country is able and willing to effect interest and capital payments promptly. After the BIS, on the initiative of the central bank governors, had drawn up and published a detailed guide to the statistical coverage of the foreign indebtedness of individual countries some time ago, the Federal Banking Supervisory Office issued instructions at the beginning of 1980 that the extent of the country risks assumed by banks and the way they are monitored are to be described and explained in detail in auditors' reports. However, this does not relieve the banks in any way of the need to assess country risks or of the responsibility for their foreign lending activities.

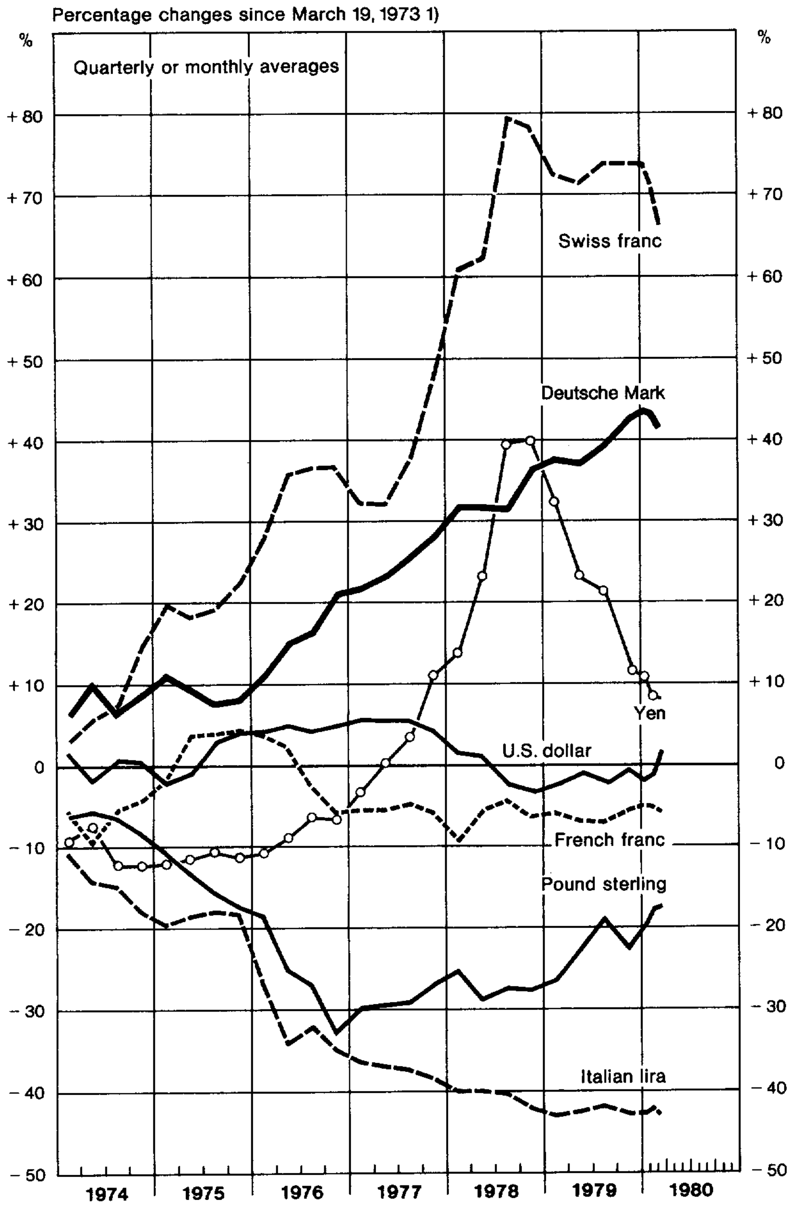
4. Exchange rate developments and exchange rate policy

(a) Return to more stable exchange rates?

Shifts in exchange rates generally less marked than in 1978

Last year the international foreign exchange markets gave far less cause for concern than in the previous two years. Although exchange rate developments in individual weeks — particularly in June, from September to the beginning of October and in December — were reminiscent of past exchange market turmoils, the shifts between the

Effective exchange rates of major currencies against the currencies of 23 countries*



* The calculation is based on the spot middle rates of the currencies officially quoted in Frankfurt and the spot rates of the currencies of other major trading partners of Germany.- 1) Central rates or market rates. Calculated on the basis of a geometric mean. The weights correspond to the regional structure of the average foreign trade turnover (exports plus imports) of the individual countries between 1975 and 1977.

exchange rates of major currencies, with the exception of special movements centring on the yen and sterling, were of relatively small dimensions, both in the course of the year and for the year taken as a whole. A decisive contribution to this generally more balanced picture was made by the greater stability of the U.S. dollar. All in all, after its violent fluctuations and marked losses in value in 1977 and 1978, the dollar's exchange rate developed much more smoothly in 1979 vis-à-vis the currencies of most other industrial countries. While the losses in the external value of the dollar against the other major currencies varied in the main within a range of 10 % to just under 20 % between end-1977 and end-1978, they did not generally exceed a margin of 5 % in the course of last year. The dollar went beyond this mark only vis-à-vis the pound sterling, depreciating by approximately 8.5 %; sterling in contrast rose strongly against all currencies, particularly in the early summer and in the last two months of the year, no doubt mainly owing to the effects of North Sea oil and the adoption of more resolute stabilising measures in U.K. economic policy. With an overall loss of more than 5 % against the Deutsche Mark, the dollar depreciated much less in 1979 than in the course of the previous year (−13.2%). In contrast to the general weakness of the dollar, its exchange rate rose impressively vis-à-vis the yen; by the end of 1979 it had regained the same level against the yen as at the end of 1978. The world-wide decline in the exchange rate of the yen occurred with violent fluctuations, particularly in the spring and autumn of 1979, and proceeded at an alarming pace. Vis-à-vis the Deutsche Mark the yen lost 23% of its external value in 1979. This extreme reappraisal of the yen by the foreign exchange markets in comparison with 1978 can partly be explained as a technical reaction to the obviously excessive appreciation of the yen that had taken place previously; however, a major role was played by the strong swing into deficit of Japan's current account last year, the dependence of Japan on imported oil and international interest rate differentials operating against the yen.

Owing to the large volume of bilateral trade between the United States and Japan, the rise in the exchange rate of the U.S. dollar vis-à-vis the yen was one of the main reasons why the external value of the U.S. dollar, weighted according to the share of 23 countries in U.S. foreign trade, fell by an average of only about 0.5% in 1979, i. e. far less than in 1978 (−5.7%). As the chart on page 51 indicates, the weighted external value of most other major currencies also changed less in 1979 than in the previous year. This applies to the weighted external value of the Deutsche Mark as well; it rose by less than 5% after 6.5% in 1978. However, the weighted external value of sterling is an exception; its increase of some 6.5%, compared with just over 2% in 1978, reflects the strength of sterling in the international foreign exchange markets last year. The weighted external value of the Swiss franc, which went up by an average of almost 24% in 1978, increased by only 1.5% in 1979. This development reflects the endeavours of the Swiss monetary authorities to avoid an additional appreciation of the Swiss franc, inter alia by pursuing a corresponding interest rate policy. Over the course of the year the exchange rate of the Swiss franc fell by almost 4% vis-à-vis the Deutsche Mark, after having risen in the previous year by over 7%.

After a relatively stable trend at the beginning of 1980 the exchange rate of the U.S. dollar increased significantly world-wide up to the second week in April despite large-scale sales of dollars by central banks. The rise in the exchange rate of the dollar vis-à-vis the Deutsche Mark was particularly marked, with the result that the Deutsche Mark also weakened against most other major currencies. The widening interest rate differential between dollar assets and Deutsche Mark assets, together with the persistent deficit on Germany's current account, were probably the major factors behind this development. In the last week before this Report went to press the dollar fell sharply in the international foreign exchange markets, owing inter alia to a drop in the interest rates on short-term dollar assets and the exacerbation of the U.S.-Iran conflict.

(b) Exchange rate and intervention policy

Reorientation of exchange rate policy . . .

The more stable conditions in the foreign exchange markets last year can be attributed to a number of factors. The more balanced pattern of exchange rates at the beginning of the year resulting from the preceding shifts in exchange rates, together with the development towards better equilibrium in the pattern of current accounts within the group of industrial countries (see section 2), undoubtedly count among them. However, the decisive influence was probably the far-reaching reorientation of exchange rate policy, which was designed to re-establish more stability in foreign exchange relationships and which manifested itself in particular in the measures to stabilise the dollar taken by the United States in November 1978 and October 1979 and in the establishment of the European Monetary System. In this context, it was especially important that a number of central banks geared their monetary policy to external needs to a greater degree than in earlier years and that interest rate policy, in particular, took greater account of international inflation gaps by widening the interest rate differentials.

. . . under the impact of the U.S. stabilisation measures . . .

The measures taken by the U.S. monetary authorities in November 1978 and the European Monetary System were described in detail in this section of last year's Report. The especially important role played by the strengthening of confidence in the U.S. dollar in stabilising the foreign exchange markets was also stressed there. The public acknowledgement by the United States, through the November measures, of its responsibility for the dollar was honoured by the foreign exchange markets with a marked rise in the dollar's exchange rate, which continued until about the middle of the year. The at times

Changes in the net external position of the Bundesbank due to interventions in the foreign exchange market and other foreign exchange movements *

DM billion

Period	Changes in the net external position, total	Caused by interventions: in the DM/dollar market **1**	Caused by interventions: in the European narrower margins arrangement or EMS **2**	Caused by other foreign exchange movements: Total **3**	Caused by other foreign exchange movements: of which Liquidity swaps
1979					
January — March 12					
Markets stabilised, intervention balances run down	− 6.9	− 2.2	− 1.3	− 3.4	—
March 13 — end of April					
Start of EMS, upward pressure on the dollar	− 4.7	− 7.7	− 0.6	+ 3.6	+ 4.7
May — June 13					
Dollar mainly firm, first compulsory interventions in the EMS	− 4.5	− 4.1	+ 2.3	− 2.7	+ 1.9
Mid-June — September 23					
Dollar under heavy pressure at times	+15.1	+18.6	+ 8.8	−12.3	− 5.3
Deutsche Mark revalued and Danish krone devalued in the EMS					
September 24 — October 6					
Decline of the dollar checked by the U.S. October programme	+ 2.8	+ 2.4	+ 0.0	+ 0.4	+ 1.9
October 8 — end of December					
Dollar tends to be weak again towards the end of the year, Danish krone devalued in the EMS	− 7	+ 0.4	− 1.1	− 6.3	− 1.0
1979, total	− 5.1	+ 7.3	+ 8.2	−20.6	+ 2.2
1980					
January — mid-April					
Dollar increasingly firm from about the end of February	−15.5	−13.9	− 4.0	+ 2.4	+ 0.2

* Transactions basis. Excluding changes due to valuation adjustments. — **1** Interventions in U.S. dollars by the Bundesbank and in Deutsche Mark by the Federal Reserve Bank of New York, including changes in U.S. swap liabilities. — **2** Including intramarginal interventions. — On March 13, 1979 the European narrower margins arrangement ("snake") was superseded by the European Monetary System (EMS). France, Italy and Ireland joined the group of participating countries. — **3** Including outflows of dollars due to conversions through the Bundesbank of foreign Deutsche Mark bonds and of notes and credits raised by foreigners.
Discrepancies in the totals are due to rounding.

very bullish sentiment centring on the dollar led a number of central banks, including the Federal Reserve and the Bundesbank, to sell dollars on a large scale in the foreign exchange markets in order to prevent an exaggerated rise in the exchange rate of the dollar. Towards the middle of the year the unfavourable development of important basic U.S. economic data once again became the determining factor for the dollar's exchange rate. In particular, the continuing high rate of inflation, the renewed deterioration of the U.S. trade balance and the powerful surge in monetary growth combined to impose a burden on the dollar. Although a number of central banks, especially the Federal Reserve, again attempted to ease the downward pressure on the dollar through heavy intervention, the exchange rate of the dollar fell significantly world-wide.

This development prompted the Federal Reserve to announce new support measures for the dollar on October 6, 1979; in contrast to the November measures of the previous year, which were designed primarily to procure intervention resources for the foreign exchange market, the stabilisation programme of October 1979 with its monetary policy measures was aimed at the fundamental inner cause of the weakness of the dollar, namely the persistent high level of inflation in the United States.

In particular, the fact that the Federal Reserve clearly considered the dangers emanating from inflation to be greater than the danger of a recession was seen by the foreign exchange markets as proof of the will of the United States to stabilise the dollar, which was correspondingly able to strengthen its position markedly in response to these decisions. Although the dollar fell sharply in the international foreign exchange markets for a short period at the beginning of December last year and the beginning of January 1980 under the impact of events in Iran and Afghanistan, so that a new record low exchange rate for the dollar vis-à-vis the Deutsche Mark was reached, the dollar has all in all remained remarkably stable since the announcement of the October 1979 measures despite the burdens arising from world political events. The improvement in the U.S. current account position has undoubtedly also contributed to this trend. The remarkable strength of the dollar at the beginning of 1980 was clearly determined by the high interest rates on dollar assets, which stifled the influence of the inflation differential on the exchange rate — an influence which in any case is operative only over the medium term.

Very recent developments cannot detract from the fact that the dollar can regain lasting health only if inflationary forces are firmly curbed. For the time being inflation in the United States has reached crisis proportions. It is to be hoped that the new anti-inflation measures of March 14, 1980, together with the budgetary measures adopted in the meantime, will halt the upward trend of prices and break inflationary expectations, thus simultaneously providing a firm domestic basis for the stronger external position of the U.S. dollar. In view of the continued dominating role of the U.S. dollar as an international transaction and investment currency, this would also be a major precondition for a lasting stabilisation of the international monetary system.

... and the European Monetary System

Despite the generally more stable conditions in the foreign exchange markets, developments within the European Monetary System, which entered into force on March 13, 1979, have not been without tensions. After a quiet start to the currency bloc, significant changes occurred during May in the positions of currencies within the exchange rate band, accompanied by increasing intramarginal interventions. Around the turn of May/June obligatory interventions at the intervention points became necessary for the first time. After a temporary period of calm the central banks had to intervene once again on a major scale in September, when expectations of an adjustment in the central rates of the EMS currencies determined events in the foreign exchange market. On September 23, 1979 the ministers and central bank governors of the member states of the European Monetary System agreed to realign the bilateral central rates of the participating currencies. Specifically, the Deutsche Mark, measured in terms of its bilateral central rate in each case, was revalued by 2% against the other EMS currencies; at the same time the Danish krone was devalued by just under 3% vis-à-vis the other EMS currencies. Since these exchange rate measures were adopted, the situation in the currency bloc has become noticeably less tense. Nevertheless, on November 30, 1979 the Danish krone was devalued by a further 4.76% against the other partner currencies within the EMS as part of a comprehensive package of measures to stabilise the Danish economy.

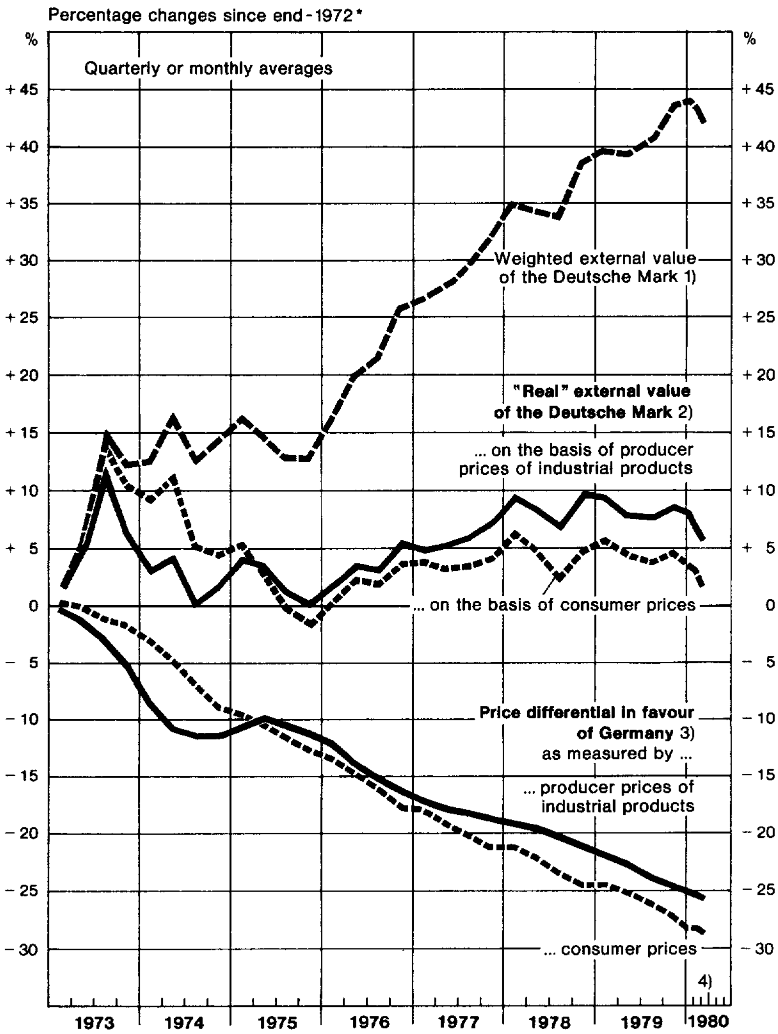
Inflow of foreign exchange from Deutsche Mark interventions more than offset by other foreign exchange movements

As the table on page 53 showing changes in the net external position of the Bundesbank illustrates, the interventions against the Deutsche Mark both in the dollar market and within the EMS were very large again last year. The inflows of foreign exchange to the Bundesbank which were triggered by these developments, and which were equivalent to DM 7.3 billion and DM 8.2 billion, respectively, were more than offset by other outflows of foreign exchange. The net external position of the Bundesbank fell correspondingly by a total of over DM 5 billion. The heavy use of the Deutsche Mark as an intervention currency is mainly explained by the fact that the United States almost exclusively employed the Deutsche Mark in order to smooth movements in the exchange rate of its currency. In addition, the Deutsche Mark seems to have assumed an even greater role than in earlier years as the opposite pole for confidence-induced capital movements into and out of the U.S. dollar.

Equilibrating function of exchange rates not visibly impaired by interventions

Despite the world-wide efforts to achieve more stable exchange rate relationships, which have sometimes been labelled "competitive non-depreciation" or "competitive appreciation", there are no clear indications that the equilibrating function of exchange rates with respect to international price and cost differentials as well as to the international pattern of current account balances was impaired in 1979 by the exchange market operations of central banks. As the chart opposite indicates, this applies in particular to

Effective exchange rate of the Deutsche Mark and international price differential



* Calculated on the basis of a geometric mean.- 1) Against the currencies of 13 other industrial countries in relation to the central rates of end-1972.- 2) Weighted external value of the Deutsche Mark adjusted for the price differential in favour of Germany.- 3) Ratio of price movements in Germany to those in 13 other industrial countries (in national currencies, trade-weighted averages). A descending line indicates that price increases in Germany were lower than those abroad.- 4) Prices estimated.

the Deutsche Mark, whose exchange rate rose hardly less last year than is consistent with Germany's lead over its major trading partners in the field of monetary stability, as measured by changes in industrial producer prices or consumer prices. Thus, the competitiveness of German industry in terms of prices was not adversely affected last year by developments in exchange rates. However, since the beginning of the present year the Deutsche Mark has depreciated distinctly in real terms.

Generally speaking, it is a striking fact that last year the average change in the real external value of the major currencies, after taking account of variations in industrial producer prices, was mostly smaller than in 1978 and that the changes which did occur in international competitive positions are quite compatible with the development of current account balances. The pound sterling, the French franc and the Italian lira, whose real external values went up despite the deterioration in the current account balances of these countries, are marked exceptions to the general rule. In contrast, the distinct depreciation of the yen by some 10 % in real terms must be seen against the background of the spectacular rise in the yen in 1978; nevertheless, the international competitive position of Japan still deteriorated between 1977 and 1979 by about 3 % on balance. The deterioration in the competitive position of the United States, as reflected in the appreciation of the U.S. dollar in real terms by some 1 %, also seems exaggerated (particularly vis-à-

Diversification of monetary reserves continues

vis its competitors in Europe) because, owing to the relatively large volume of trade conducted between the United States and Japan, the computed real exchange rate of the U.S. dollar is strongly influenced by the drop in the external value of the yen.

The degree to which efforts to spread official and private foreign exchange holdings more widely among several currencies continue, thus encouraging moves towards a multi-reserve currency system, will have a major impact on future developments in the foreign exchange markets. Both the desire to minimise the exchange risk involved in investing foreign exchange under a system where individual currencies are floating and the explosive increase in private and official investible funds have contributed to the process of foreign exchange diversification. (What is often overlooked in this context, however, is the risk of inducing relatively large fluctuations in exchange rates when investing, and particularly disinvesting, holdings in non-traditional reserve currencies such as the Deutsche Mark, whose financial markets, and especially secondary markets, are narrow in comparison with the markets for the U.S. dollar.) Pressures to diversify foreign exchange holdings will probably not ease until the United States durably succeeds in achieving better equilibrium in its balance of payments — the principal source of international liquidity in the past — and in stabilising the dollar in the foreign exchange markets so as to make it sufficiently attractive for investible funds again.

As past experience shows, interest in seeking alternative investment possibilities centres on only a few currencies. The average share of the Deutsche Mark in the foreign exchange reserves of foreign monetary authorities at the end of 1978 was estimated at over 11 %, and excluding the countries whose currencies play a reserve role at as much as 15 %; its share rose again in the course of the year under review. In recent months, however, this trend has apparently ceased, not least owing to the upsurge in interest rates in the United States. At the end of 1979 the statistically recorded Deutsche Mark investments of foreign monetary authorities totalled just under DM 65 billion ($ 37 billion), more than DM 20 billion of which was accounted for by Deutsche Mark investments in Germany and about DM 42 billion by Deutsche Mark deposits in the Euro-currency market (excluding official investments in foreign Deutsche Mark bonds).

The reassessment of balance of payments and exchange rate developments apparently put a stop to the "rush into the Deutsche Mark" at the beginning of 1980. Extremely high interest rates on dollar assets also played a part. However, in view of the expected large OPEC surpluses, a strong increase in the liquid funds seeking investment seems probable in the coming years as well. Despite continuing misgivings in principle about the Deutsche Mark assuming greater functions as a reserve currency, a certain amount of additional demand for Deutsche Mark for investment purposes will have to be accepted and perhaps even met in a suitable form. It would in fact be desirable for the search for alternative possibilities of investing foreign reserves other than the U.S. dollar and for the concomitant development of a multi-reserve currency system to be guided along orderly channels, and for the instability inherent in such a system to be kept as small as possible. The potential risks involved in the development of the Deutsche Mark into a reserve currency (albeit a long way behind the U.S. dollar) became clear for the first time at the beginning of 1980, when capital exports induced by interest rate and exchange rate expectations were added to Germany's deficit on current account and outflows of long-term capital. If the Deutsche Mark were to assume an even greater reserve currency role in the future, this could have a marked influence on its exchange rate as well as on domestic monetary developments.

5. The development of international liquidity

Sustained expansion of international liquidity

If monetary gold is valued at SDR 35 per ounce, as is done by the IMF for example, world monetary reserves rose last year by approximately $ 33 billion to some $ 400 billion.[1] As the table opposite illustrates, this means that the growth of world monetary reserves

1 For last year considerable uncertainties attach to the statistical recording of world monetary reserves and the assessment of them with respect to the adequacy of international liquidity. In particular, the valuation of the gold element of monetary reserves seems to raise increasing problems after the free market price of gold went up by no less than 125 % in 1979; as a result, at the end of last year the free market price of gold was about ten times higher than the former official gold price of SDR 35 per ounce. Valuation difficulties also exist with respect to ECU holdings newly created within the European Monetary System (EMS) because these holdings can only be used regionally within the context of the European Monetary Cooperation Fund (EMCF) and only for specific limited purposes.

World monetary reserves
(Foreign exchange, ECUs, special drawing rights, reserve positions in the IMF, gold)

US$ billion

Item	Change: Average annual change 1970-75	1976	1977	1978	1979	Level at end-1979
I. Development by type of reserves						
1. Foreign exchange holdings and ECUs						
Claims of monetary authorities on the United States	+10.6	+11.3	+34.1	+30.5	−14.0	142.5
Sterling claims of monetary authorities on the United Kingdom	+ 0.5	− 3.8	+ 0.3	− 0.3	+ 1.3	4.9
ECU claims on the EMCF in respect of gold swaps	—	—	—	—	+25.6	25.6
Identified foreign exchange holdings of monetary authorities in the Euro-market	+ 8.0	+11.4	+ 9.6	+11.1	**pe** +36.7	**pe** 122.4
Other foreign exchange holdings of monetary authorities	+ 2.1	+ 6.5	+13.3	+ 3.4	**1** −13.9	28.1
Total	+21.2	+25.5	+57.3	+44.7	+35.7	323.5
2. Special drawing rights, reserve positions in the IMF, gold **2, 3**	+ 2.0	+ 5.6	− 0.1	− 3.8	− 2.5	74.6
Total monetary reserves	+23.2	+31.1	+57.2	+40.8	+33.2	398.1
Memorandum item						
Total monetary reserves including changes due to valuation adjustments	+24.7	+30.6	+60.4	+46.1	+34.0	398.1
II. Regional development 2						
1. Industrial countries	+11.3	+ 9.9	+36.0	+40.7	+10.5	238.0
of which						
EEC countries, total	+ 6.9	+ 1.8	+28.5	+15.9	+22.9	142.4
of which						
Germany	+ 3.8	+ 3.8	+ 4.5	+13.4	+ 2.9	56.9
France	+ 1.3	− 2.8	+ 0.2	+ 3.3	+ 7.4	21.4
Italy	− 0.1	+ 1.9	+ 4.8	+ 3.0	+ 6.3	21.2
United Kingdom	+ 0.4	− 1.2	+16.8	− 4.1	+ 3.6	20.7
Japan	+ 1.5	+ 3.8	+ 6.5	+10.0	−12.9	20.6
Switzerland	+ 0.9	+ 2.6	+ 0.7	+ 7.4	− 1.3	20.3
United States	− 0.6	+ 2.6	+ 0.2	− 1.0	+ 0.2	20.0
2. Oil-exporting countries **4**	+ 8.6	+ 8.8	+ 9.9	−15.9	+13.8	74.1
of which						
Saudi Arabia	+ 3.8	+ 3.7	+ 2.9	**5** −10.8	+ 0.1	19.5
Iran	+ 1.4	− 0.1	+ 3.4	− 0.2	+ 3.2	15.4
Venezuela	+ 1.3	− 0.3	− 0.4	− 1.8	+ 1.2	7.8
3. Other developing countries **6**	+ 3.3	+12.5	+11.2	+16.0	+ 8.9	86.0
All countries	+23.2	+31.1	+57.2	+40.8	+33.2	398.1

1 Decrease largely caused by the fact that the foreign exchange holdings of monetary authorities in the Euro-market, as reported by the banks, include OPEC holdings which are not shown as foreign exchange reserves by the IMF. — **2** Excluding valuation gains on SDRs, reserve positions in the IMF and holdings of gold due to the devaluation of the dollar in 1971 and 1973, and excluding changes arising from fluctuations in the value of the SDR since mid-1974. — **3** Gold valued at SDR 35 or at the ruling dollar value of the SDR per ounce. — **4** Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates, Venezuela. — **5** US$ 7 billion of which owing to change in statistical recording. — **6** Including the following European countries: Cyprus, Greece, Malta, Portugal, Turkey, Yugoslavia. — **pe** Partly estimated.
Discrepancies in the totals are due to rounding. — Source: IMF, BIS and national statistics.

slowed down considerably in comparison with previous years. The main reason for this is that the dollar holdings of foreign monetary authorities in the United States fell by $ 14 billion in 1979. This decrease was far more than offset by the upsurge in official investments in the Euro-market, including investments by OPEC countries not covered by the statistics of the IMF. The creation of ECU holdings in the EMCF also contributed to the growth of international liquidity in so far as these holdings were created against the provisional transfer of part of the gold reserves of Community member countries in connection with the EMS. In contrast to the holdings of U.S. dollars, the transfer of which had no net effect on the creation of liquidity, the gold holdings paid into the EMCF were accompanied at the end of 1979 by ECU holdings equivalent to $ 25.6 billion, which was $ 21.7 billion more than if this gold were valued at SDR 35 per ounce. By valuing the gold transferred to the EMCF (through swap agreements) at market-oriented prices that are brought into line with actual market developments at quarterly intervals, a "liquidity gain" results which can easily lead to the financing potential of these resources being overestimated. (This gain is offset in the Bundesbank's balance sheet by a contra-entry on the liabilities side.) In 1979, for the first time for several years, the increase in official holdings of sterling in the United Kingdom and the allocation of special drawing rights (SDRs) by the IMF also played a role in the growth of world monetary reserves. The allocation of SDRs by the IMF at the beginning of 1979 totalling SDR 4 billion was the first tranche of an allocation of special drawing rights extending over a three-year period and amounting to SDR 12 billion pursuant to a decision taken by the IMF in December 1978; the second tranche was allocated at the beginning of January 1980.

Problematical valuation of monetary gold

Valuing official gold holdings generally at the free market price of gold would undoubtedly pose problems. On the basis of such a valuation, an enormous inflation of international liquidity would result for 1979. There are several reasons for not valuing monetary gold at its free market price when assessing the adequacy of global liquidity. First and foremost among them is the fact that the gold price is subject to wide fluctuations induced by speculation and that the gold markets are relatively narrow; these reasons taken together imply a high liquidity risk. However, as the sales in the free gold markets by the Canadian monetary authorities at the beginning of 1980 prove, individual central banks can certainly utilise their gold holdings in order to finance their balances of payments and achieve prices that are far above SDR 35 per ounce. It must therefore be assumed that international liquidity in fact increased far more strongly last year than calculations on the basis of the former official gold price suggest.

6. The European Monetary System

Favourable basic conditions facilitate the start of the EMS

The European Monetary System (EMS) entered into force on March 13, 1979. The period of time that has elapsed since then allows at best an interim assessment of this system to be made. Any such assessment is additionally complicated by the impact of the new oil price shock on balances of payments and by the acceleration of global inflation. It can nevertheless be stated that the rules and mechanisms of the system have generally worked satisfactorily. The Council of Finance Ministers of the European Communities therefore saw no need to make changes to the system when they reviewed it for the first time last autumn. However, this does not detract from the fact that up to the present no progress has been made towards the harmonisation of economic developments on the basis of a high level of monetary stability, such as is necessary if the EMS is to prove durable.

In the initial months after the EMS had been launched the general conditions for the functioning of the system were relatively favourable. Both the stabilisation of the U.S. dollar as a result of the measures adopted by the U.S. monetary authorities on November 1, 1978 and the improvement in the balance of payments position of the Community countries that were not participants in the former "snake" arrangement contributed to this development. Thus, contrary to original expectations, the lira (just like the pound sterling, which does not participate in the exchange rate mechanism of the EMS) was notably firm in the foreign exchange markets. The price surge in the EMS member countries emanating from the higher oil prices and varying in strength from country to country has, however, once again dimmed the prospects of enhancing the harmonisation of economic developments within the Community. The real test for the EMS therefore still lies ahead.

Monetary policy increasingly directed towards fighting inflation and stabilising exchange rates

With the increase in inflation rates, efforts have also been strengthened to curb the upward movement of prices. Central bank policy in particular is geared everywhere to regaining greater price stability. The high interest rates that reflect this policy especially clearly are at the same time dictated by external needs.

Owing to the impact on other partner currencies within the EMS, the use of interest rate policy in individual countries has occasionally raised problems. At times, some partner countries have objected to the increase in interest rates in Germany, primarily because the Deutsche Mark was already in a strong position within the EMS. To this it could be countered that the Deutsche Mark was at no time in an extreme position vis-à-vis all other EMS currencies. In fact, considerable amounts had to be employed on occasion to support the exchange rate of the Deutsche Mark against the U.S. dollar. As events showed, after the interest rate decisions of the Bundesbank in the middle of June, for example, no additional tensions arose within the EMS; indeed, there was even some easing of tension.

Adjustments of central rates prevent serious tensions

However, experience has also confirmed the fact that, although exchange rates can be influenced for a time by the interest rate differentials prevailing between individual countries, the effects of unfavourable fundamental conditions cannot as a rule be completely offset in the long run. This explains the importance of the two adjustments in central rates of September 23 and November 30, 1979. With their aid it was possible to prevent the serious disturbances that had to be reckoned with in the circumstances. At the same time these adjustments in central rates at least reduced the danger inherent in every fixed rate system of transmitting inflationary stimuli to other countries. Nevertheless, between the establishment of the system and March 1980 the real exchange rate of the Deutsche Mark against the average of the other EMS currencies weakened quite considerably, although the change varied widely from currency to currency within the EMS. It remains to be seen whether the adjustments in central rates up to the present warrant the hope that sufficient exchange rate flexibility exists within the EMS as long as an adequate degree of harmonisation in the direction of greater monetary stability in all the partner countries still has to be achieved.

Considerable intra-marginal interventions

The Community central banks exercised considerable influence on exchange rate developments within the EMS through intervention operations, most of which were not carried out at the obligatory intervention points but took place within the margins. The EEC currencies needed for intervention purposes were procured by the Community central banks mainly by selling dollars to the other partner central banks and by transferring ECU holdings. In contrast, the arrangements for the very short-term financing of interventions via the European Monetary Cooperation Fund were utilised to only a minor degree. Belgium was the only member country that made use on several occasions of the possibility of prolonging (by a maximum of three months) repayments beyond the period of renewal that is automatically available. The Bundesbank agreed to these prolongations in order to give Belgium the option of meeting its liabilities in Deutsche Mark, since this also corresponded to the liquidity policy intentions of the Bundesbank. No recourse was made to the other facilities of the system (short and medium-term assistance).

Further development of the EMS raises difficult institutional and legal problems

For the final stage of the EMS, after the transitional period initially envisaged for two years, the European Council laid down as early as 1978 a number of guidelines which could prove to be a decisive turning-point in the direction of closer integration in the monetary policy field. The planned establishment of a European Monetary Fund is of particular importance in this context. The intention is to transfer to this institution tasks which have in the past been exclusively reserved to national monetary authorities. Especially the authority to create ECUs against the transfer of monetary reserves, as well as administering these reserves and granting ECU-denominated loans, would invest this Fund with powers corresponding to the basic duties of a central bank. The special demands placed on the responsibility and independence of the Fund must be taken into account, particularly with respect to its institutional framework, in order to prevent government and central bank areas of responsibility from being intermixed.

In view of the differing historical experience and areas of responsibility in the member countries, an agreement on the questions that are central to the further development of the EMS presupposes a high degree of willingness to re-examine national positions; the preparations will therefore take some time. The countries concerned are agreed that the transitional period of two years originally envisaged will not be sufficient to accomplish this task. The "qualitative jump" to the final stage of the EMS requires a new legal basis, both at Community and at national level, and this in turn means that it will be essential for national parliaments to deal with this question. From the point of view of the Bundesbank, when designing the institutional framework of the Fund and further developing the ECU only structures that are compatible in every respect with the creation of a zone of stability in Europe should be chosen.

7. Recent developments in the International Monetary Fund

Intensive efforts to set up a dollar substitution account . . .

Both in 1979 and in the current year the International Monetary Fund has worked intensively on the plan to create a possibility, via a "substitution account", for monetary authorities to exchange a part of their dollar reserves for SDR-denominated assets. The substitution account would in turn invest the U.S. dollars it receives in interest-bearing U.S. Government securities.

The establishment of this account was an important topic at the Annual Meeting of the IMF in Belgrade at the beginning of October 1979, at which the IMF Executive Board was entrusted with the task of submitting a report with as concrete proposals as possible on the design of the account to the Interim Committee of the IMF at its meeting in Hamburg on April 25, 1980. Preparatory work for putting this plan into effect has meanwhile progressed very far. However, a number of important questions still need clarification before the substitution account can be established.

... with the aim of fostering the SDR and exchange rate stability

Behind this proposal are two main objectives to which, however, their proponents attach differing importance. On the one hand, the substitution account is intended to strengthen the role of the SDR as an international reserve asset; on the other hand, it is meant to stabilise exchange rates by trying to meet the wishes of many monetary authorities to diversify their foreign exchange holdings.

The first objective is reminiscent of the establishment of a substitution account discussed at the beginning of the seventies by the "Committee of Twenty" for the reform of the international monetary system. However, in contrast to the present proposal the idea was pursued at that time within the context of a comprehensive reform of the international monetary system, with the aim of achieving better control through the IMF over the creation of international liquidity, together with rules for the obligatory settlement of balance of payments disequilibria in reserve assets.

The substitution account as proposed today could offer countries with large balance of payments surpluses and foreign exchange holdings — not least the oil-exporting countries — a very interesting possibility of investing their assets if the substitution assets are sufficiently attractive (in terms of the rate of interest they bear, the possibility of redeeming them in the case of balance of payments needs and the maintenance of value). Correspondingly, the account could also contribute to guiding the trend towards diversifying monetary reserves along orderly channels. However, it is not yet possible to assess how willing countries will be to exchange dollar reserves for SDR-denominated assets. A sufficient degree of attractiveness of such assets is of central importance from Germany's point of view, particularly since it was agreed at the very beginning that dollar holdings would be placed in the account only on a voluntary basis. Apart from this, the substitution account can make the envisaged contribution to stabilising foreign exchange markets and enhancing the role of the SDR as a reserve asset only if efforts to reduce balance of payments disequilibria are strengthened at the same time, rather than weakened as a result of the establishment of the account. The surveillance of exchange rate policies by the IMF could play a significant part in this context. As provided in Article IV of the IMF Agreement, this task includes assessing all aspects of the economic and monetary policy of the individual member countries of the IMF.

Easier access to IMF loans

Last year the IMF considerably eased its conditions for granting balance of payments assistance to its members. On the one hand, the maximum limit for drawings on the facility for the compensatory financing of export fluctuations was increased from 75% to 100% of a member's quota; this facility provides commodity-producing countries, in particular, with additional loan assistance to which practically no economic policy conditions are attached. On the other hand, the period for which loans are granted under the Extended Fund Facility was prolonged from 8 to 10 years. This measure will especially benefit those developing countries that arrange with the IMF a programme designed to reduce structural distortions in production, foreign trade and price patterns in their economies. In addition, in March 1979 the IMF adopted a revised version of its principles for granting loans. In doing so it made clear its general willingness to take sufficient account of the special circumstances of the borrowing country with respect to the economic policy conditions it lays down (the Fund's "conditionality"). However, this does not mean that the IMF will in future refrain from requiring borrowers to pursue an economic policy aimed at eliminating balance of payments disequilibria, as has been publicly demanded on several occasions recently.

As a result of all these measures, the conditions for financing increasing balance of payments deficits — particularly those of the developing countries — via the IMF have been significantly improved. Should it become evident that the less developed countries which are dependent on imported oil need additional official assistance in order to cope with tasks of a longer-term and structural nature, then other possible ways of solving their problems will have to be considered. These might include the greater participation of oil-exporting countries in recycling their surpluses to developing countries, as mentioned above, and in granting supply guarantees for the oil imports of these countries, as was recommended by a working committee of the OPEC countries at the end of February 1980. If new financing channels were to be opened up in this process, the IMF could undoubtedly contribute its wide experience. However, there are limits to the use of its resources for such purposes, particularly owing to their revolving character and the fact that the financing contributions of its members are included by them in their monetary reserves.

Extension of the GAB until 1985

The members of the "Group of Ten" (i. e. ten western industrial countries), Switzerland and the IMF agreed in the autumn of 1979 to a further extension until 1985 of the General Arrangements to Borrow that have been in existence since 1962. In the past the GAB have proved to be an important support for the liquidity of the IMF when large-scale balance of payments assistance has been required for industrial countries. These arrangements were last activated in November 1978 for reserve tranche drawings by the United States in connection with the programme it adopted at the time to stabilise the dollar.

1976 programme of gold sales almost completed

The four-year programme initiated by the IMF in 1976 to utilise one third (50 million ounces) of its gold holdings will soon come to a close. The fourth and final tranche totalling 25 million ounces of gold, which was to be restituted to all members at the former official gold price, was transferred to them in December 1979. The sale of a further 25 million ounces of the IMF's gold through monthly gold auctions in favour of the developing countries will end in May 1980. The net earnings from the 40 gold auctions held up to the end of 1979 came to $ 3.45 billion. Of this amount, about 30% will be distributed direct to all the developing countries while the remaining 70% is available for granting loans at an extremely low rate of interest to developing countries in particular need from the Trust Fund administered by the IMF.

Increased uses for SDRs

Finally, over the course of 1979 and at the beginning of 1980 the IMF once again increased the possible uses for special drawing rights. In addition to the SDR transactions permitted in the past, participants in the SDR Department can now use special drawing rights for swap and forward transactions as well as for making grants. Moreover, a number of official financing institutions are interested in becoming "other holders" of SDRs and using them in their own transactions.

Part B: Notes on the Deutsche Bundesbank's annual accounts for 1979

1. Legal basis, classification and valuation

Legal basis, accounting system and annual accounts

The legal basis for the annual accounts of the Bank 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 it contains regarding the accounting system and the annual accounts remained unchanged during the year under review.

Classification of the annual accounts

On the assets side of the balance sheet item 4 "Claims on the European Monetary Cooperation Fund" was replaced by a new item 3

> Claims on the European Monetary Cooperation Fund in connection with the European Monetary System

after the European Monetary System had entered into force. The former item 3 became item 4. On the liabilities side the sub-item

> Liabilities to the European Monetary Cooperation Fund

of item 6 was deleted and item 8

> Counterpart in respect of the valuation of the gold contributed to the European Monetary Cooperation Fund

was added.

In the profit and loss account the item

> Gains from the write-up of gold

was deleted.

Valuation

The provisions of the Companies Act (Aktiengesetz) were taken into account mutatis mutandis in the valuation (section 26 of the 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 adjustment of the partial conversion accounts for the Bank deutscher Länder and the Land Central Banks to the position shown by the books at December 31, 1979, the Bank's title to the allocation of equalisation claims rose by DM 98.93 to DM 8,103,771,446.61; 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.

The combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank was finally closed at December 31, 1979 (Act on the Closing of the Currency Conversion of December 17, 1975, Federal Law Gazette I, page 3,123).

3. Annual accounts

The annual accounts for 1979 are attached to this Report as an Appendix; as usual, the notes on them are in the same order as 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 1979.

Balance sheet

Comparison of balance sheet figures

At December 31, 1979 the balance sheet total had increased by DM 7,407.1 million, compared with end-1978, to DM 173,513.1 million.

Comparison of balance sheet figures

DM million

Assets	December 31 1978	December 31 1979
Gold	17,082.5	13,693.2
Reserve position in the International Monetary Fund and special drawing rights		
Drawing rights within the reserve tranche	4,820.6	3,248.4
Loans under special borrowing arrangements	3,043.0	2,162.9
Special drawing rights	3,283.8	3,595.3
Claims on the European Monetary Cooperation Fund in connection with the European Monetary System	[1] 2,251.1	28,487.7
Balances with foreign banks and money market investments abroad	72,316.3	51,801.4
Foreign notes and coins	16.9	24.4
External loans and other external assets		
Loans in connection with EEC medium-term monetary assistance	–	–
Claims arising from foreign exchange offset agreements with the United States	1,636.4	1,549.8
Other loans to foreign monetary authorities	276.9	–
Loans to the World Bank	2,483.3	2,481.5
Foreign bills of exchange	1,684.6	3,089.5
Domestic bills of exchange	16,401.9	30,025.5
Lombard loans	6,164.9	3,130.7
Cash advances (book credits)	155.7	308.5
Treasury bills and discountable Treasury bonds	–	–
Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin		
Equalisation claims	8,136.4	8,136.4
Non-interest-bearing debt certificate	547.2	547.2
Securities	4,217.6	2,114.1
German coins	698.3	721.5
Balances on postal giro accounts	1,214.3	375.5
Other claims	1,170.7	951.2
Land and buildings	843.3	922.7
Furniture and equipment	50.1	70.4
Items in course of settlement	6,718.7	8,905.1
Other assets	1,309.4	1,379.8
Prepaid expenses and deferred income	29.0	30.6
Balancing item in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — accumulated loss —	9,553.1	5,759.8
Total	166,106.0	173,513.1
Contingent claims	0.7	0.6

Liabilities	December 31 1978	December 31 1979
Bank notes in circulation	74,799.1	79,385.6
Deposits of banks	59,366.1	64,780.1
Deposits of public authorities		
Federal Government	2,384.3	1,842.5
Equalisation of Burdens Fund and ERP Special Fund	162.7	290.1
Länder Governments	2,027.6	728.5
Other public depositors	56.7	78.1
Deposits of other domestic depositors		
Federal Railways	6.5	12.7
Federal Post Office	3,515.4	579.4
Other depositors	564.7	637.5
Liabilities arising from mobilisation and liquidity paper sold	13,204.6	6,687.0
Liabilities arising from foreign business	4,544.4	3,328.8
Counterpart of special drawing rights allocated	1,291.7	1,748.6
Counterpart in respect of the valuation of the gold contributed to the European Monetary Cooperation Fund	–	9,070.4
Provisions	1,985.0	2,025.0
Other liabilities	116.5	92.1
Deferred expenses and accrued income	691.2	837.2
Capital	290.0	290.0
Reserves	1,099.5	1,099.5
Total	166,106.0	173,513.1
Contingent liabilities	0.7	0.6

1 Claims on the European Monetary Cooperation Fund in connection with the European narrower margins arrangement (snake).

Assets

Gold At December 31, 1979 the gold holding amounted to DM 13,693.2 million against DM 17,082.5 million at end-1978. The decrease is attributable to the contribution of 20% of the Bank's gold holding to the European Monetary Cooperation Fund (EMCF) in connection with the European Monetary System (EMS). This decrease was accompanied by a small increase stemming from resales of gold by the International Monetary Fund to its members ("fourth restitution").

Reserve position in the International Monetary Fund and special drawing rights

Drawing rights within the reserve tranche

At December 31, 1979 the drawing rights within the reserve tranche amounted to DM 3,248.4 million against DM 4,820.6 million at end-1978. The change is due to other members' Deutsche Mark repayments and transactions of similar effect equivalent to SDR 650.0 million and to the valuation adjustment at the end of the year. These decreases were accompanied by increases deriving from the International Monetary Fund's drawings on its Deutsche Mark balance for repayments of loans to creditor countries and transactions of similar effect equivalent to SDR 50.0 million. The level of drawing rights within the reserve tranche represents the difference between the German quota of SDR 2,156 million and the Deutsche Mark balances at the disposal of the IMF equivalent to SDR 731.9 million.

Loans under special borrowing arrangements

Loans under special borrowing arrangements amounted to DM 2,162.9 million at December 31, 1979 against DM 3,043.0 million at December 31, 1978. During the year under review loans totalling SDR 64.4 million were granted to the International Monetary Fund under a commitment of the Bank amounting to SDR 1,050 million to finance drawings by other member countries under the Supplementary Financing Facility (Witteveen Facility), which entered into force on February 23, 1979. Of the loans outstanding at end-1978 under the General Arrangements to Borrow (GAB), the loans granted to the IMF in 1977 to finance Deutsche Mark drawings by the United Kingdom, of which SDR 247.3 million was still outstanding at end-1978, were repaid before maturity, so that the Bank now has only one claim of SDR 582.9 million on the IMF arising from the financing of a Deutsche Mark drawing by the United States in 1978. The loans under the 1975 IMF Oil Facility came to SDR 300.9 million after SDR 146.6 million had been repaid before maturity in the year under review.

Special drawing rights

The amount of special drawing rights (SDRs) held at December 31, 1979 is shown at DM 3,595.3 million against DM 3,283.8 million at end-1978. Increases resulting from the allocation of SDRs at the beginning of 1979 (SDR 224.2 million), from purchases under the EMS settlement arrangements (SDR 42.5 million), from designations and other transactions (SDR 66.6 million) and from the payment of interest on SDRs purchased by the Bank (SDR 25.5 million) were accompanied by decreases deriving from freely agreed transactions (SDR 161.5 million) and from the valuation adjustment at the end of the year. The valuation adjustment affected both the total holding (SDR 1,576.2 million) and the counterpart of SDRs allocated, which is shown on the liabilities side (SDR 766.6 million).

Claims on the European Monetary Cooperation Fund in connection with the European Monetary System

This item comprises both the claims arising from the transfer of 20% of the Bank's gold and dollar reserves to the EMCF and the balances and claims denominated in ECUs (European Currency Units) which have resulted from the settlement of balances and from exchange market operations in support of the currencies of other Community countries participating in the intervention system of the EMS.

Balances with foreign banks and money market investments abroad

The balances with foreign banks and money market investments abroad amounted to DM 51,801.4 million at December 31, 1979 against DM 72,316.3 million at December 31, 1978. The contribution of 20% of the Bank's dollar reserves to the EMCF and current transactions led to a decrease of DM 18,083.5 million in 1979. The valuation adjustment of the foreign currency assets at December 31, 1979 resulted in a further decline of DM 2,431.4 million in the Deutsche Mark equivalent of the balances and money market investments abroad.

Foreign exchange deals

The Bank's turnover in foreign exchange spot deals (foreign currency against Deutsche Mark) amounted to DM 60,498.5 million in the year under review against DM 56,881.0 million in 1978. The number of deals decreased to 5,435 compared with 6,837 in the preceding year. These deals consisted of

	1978		1979	
	Number	DM million	Number	DM million
Purchases	4,002	29,263.5	2,729	23,058.4
Sales	2,835	27,617.5	2,706	37,440.1
	6,837	56,881.0	5,435	60,498.5.

The growth of turnover compared with the previous year was caused by the further rise in U.S. dollar transactions.

Cross deals (foreign currency against foreign currency) increased during the year under review, at 555 deals equivalent to DM 4,375.7 million against 544 deals equivalent to DM 4,041.5 million in 1978. In addition, 188 U.S. dollar inter-centre switch transactions amounting to US$ 26.6 million were concluded, against 175 transactions amounting to US$ 25.8 million in the preceding year.

For the short-term regulation of bank liquidity the following transactions were conducted with domestic banks:

	US$ million	DM million
Foreign exchange swaps to increase liquidity	10,937.0	19,941.0
Foreign exchange swaps to reduce liquidity	6,400.0	11,443.3
Foreign exchange transactions under repurchase agreements to reduce liquidity	9,167.3	16,384.5.

The foreign exchange swaps to increase liquidity which ran beyond the end of the year, amounting to US$ 1,258.0 million = DM 2,163.2 million, were settled in January 1980.

External payments

The Bank executed the following payment orders in the context of external payments:

External payments

Number of orders

Year	Outgoing external payment orders: in foreign currency	in Deutsche Mark	Total	of which Processed by automated standing order procedure	Incoming external payment orders: in foreign currency	in Deutsche Mark	Total
1978	550,546	1,444,987	1,995,533	1,746,988	15,355	197,652	213,007
1979	486,960	1,531,194	2,018,154	1,770,356	15,484	199,350	214,834

Sales of foreign cheques

During 1979 8,965 (1978: 8,501) foreign cheques payable to order totalling DM 577.3 million (1978: DM 516.9 million) were sold. In addition, the Bank sold 34,954 traveller's cheques amounting to DM 3.5 million against 27,755 traveller's cheques amounting to DM 2.9 million in the preceding year.

Simplified collection procedure for foreign cheques

The number and amount of items received under the simplified collection procedure for foreign cheques continued to rise during the year under review. Further details are given in Appendix 4 of the German original of this Report.

Foreign commission business

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

	1978 Number	1979 Number
Bills, cheques, etc.	30,018	32,399
Foreign notes and coins	5,191	5,834
	35,209	38,233.

Foreign notes and coins

Purchases and sales

The amount of foreign notes and coins held at December 31, 1979 came to DM 24.4 million compared with DM 16.9 million at end-1978. During the year under review the Bank effected 24,825 purchases (1978: 40,232) and 39,148 sales (1978: 38,881) of foreign notes and coins.

External loans and other external assets

Loans in connection with EEC medium-term monetary assistance

As during the preceding year, no loans were granted under the EEC medium-term monetary assistance arrangements during the year under review.

Claims arising from foreign exchange offset agreements with the United States

The U.S. dollar claims arising from foreign exchange offset agreements concluded with the United States for the years from 1973 to 1975 are shown here.

Other loans to foreign monetary authorities

The U.S. dollar loan granted to the Banco de Portugal against the security of gold, which was shown in this item at the end of 1978, was repaid during the year under review.

Loans to the World Bank

As in preceding years, the loans to the World Bank were mainly granted against borrowers' notes denominated in Deutsche Mark.

Foreign bills of exchange

At the end of 1979 the portfolio of foreign bills accumulated through purchases in Germany amounted to DM 3,089.5 million compared with DM 1,684.6 million at December 31, 1978. The share of Deutsche Mark bills in the total value of the foreign bills purchased averaged 82% in 1979 (1978: about 75%).

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

Land Central Bank	1978		1979	
	Number	DM million	Number	DM million
Baden-Württemberg	26,649	1,039.7	29,969	1,210.7
Bavaria	10,698	1,355.6	12,768	1,817.1
Berlin	674	515.4	1,143	1,020.3
Bremen	1,849	194.7	1,906	171.4
Hamburg	6,962	849.8	9,135	1,327.9
Hesse	11,309	1,870.8	16,105	3,131.0
Lower Saxony	2,794	186.8	3,137	299.2
North Rhine-Westphalia	22,312	1,684.3	26,654	2.369.5
Rhineland-Palatinate	4,287	362,7	5,789	397.8
Saarland	2,104	317.7	2,394	471.0
Schleswig-Holstein	610	37.5	658	70.5
Total	90,248	8,415.0	109,658	12,286.4

Domestic bills of exchange

At the end of 1979 the Bank's portfolio of domestic bills came to DM 30,025.5 million against DM 16,401.9 million at end-1978. The Bank's average portfolio of domestic bills — excluding bills bought in open market transactions under repurchase agreements — on all the return days of the year under review, at DM 25,386 million, was likewise substantially larger than in the preceding year (DM 17,224 million). The increase in purchases was made possible by the raising of the rediscount quotas in April and November 1979 by DM 5 billion and DM 4 billion, respectively, to a total of DM 31.7 billion.

The domestic bill portfolio comprised	Dec.31,1978 DM million	Dec.31,1979 DM million
Domestic bills discounted	14,646.6	27,560.2
Prime bankers' acceptances acquired in the course of open market operations	1,755.3	2,465.3
	16,401.9	30,025.5.

The average value of the bills purchased in the year under review was DM 61,900 compared with DM 63,000 in the preceding year.

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

Land Central Bank	1978 Thousands	1978 DM million	1979 Thousands	1979 DM million
Baden-Württemberg	494	18,255.0	508	17,744.0
Bavaria	328	18,221.4	321	18,196.5
Berlin	22	2,930.1	25	3,860.7
Bremen	42	3,314.2	42	3,513.1
Hamburg	149	12,314.2	113	11,601.3
Hesse	329	29,823.5	324	28,007.6
Lower Saxony	128	6,460.0	145	7,979.7
North Rhine-Westphalia	526	38,436.9	519	34,326.2
Rhineland-Palatinate	65	2,342.8	83	3,545.7
Saarland	27	1,482.7	22	1,588.1
Schleswig-Holstein	35	1,597.0	38	2,139.7
Total 1	2,145	135,177.8	2,140	132,502.6
1 of which Domestic bills bought in open market operations under repurchase agreements	416	35,694.3	62	4,989.0

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

	1978 Number	1978 DM million	1979 Number	1979 DM million
	4,114	55.1	4,380	68.9
as % of the total purchased	0.19	0.04	0.20	0.05.

Discount rate

During the year under review the discount rate for domestic and foreign bills stood at 3% until March 29, at 4% as from March 30, at 5% as from July 13 and at 6% as from November 1.

Prime bankers' acceptances

The amount of prime bankers' acceptances which the Bank is prepared to purchase in the course of its open market operations was increased by DM 500 million with effect from March 30, 1979, subject to the proviso that the additional amount was not to be assigned rigidly to particular banks but was to be used flexibly as required. The Bank also reserved the right to revoke the increase at short notice, allowing a run-down period. The raising of the ceiling and the fact that the Bank's buying rates, which were changed four times during the year under review, were favourable relative to the money market rates again resulted in heavier recourse to this source of central bank funds. The Bank's purchases of prime bankers' acceptances through the Privatdiskont-Aktiengesellschaft came to DM 10,224.1 million, which was much more than in the previous year (DM 6,922.5 million). There were no resales to the market via the broker in 1979, but DM 700 million was sold direct to a public authority.

The amount of prime bankers' acceptances that remained in the Bank's portfolio until payment on maturity, at DM 8,814.1 million, was therefore much larger than in the preceding year (DM 5,444.4 million). At December 31, 1979 the Bank held prime bankers' acceptances stemming from open market operations amounting to DM 2,465.3 million (end-1978: DM 1,755.3 million).

Open market operations in bills under repurchase agreements

In order to ease particular tensions in the money market the Bank conducted open market operations in bills under repurchase agreements between October 10 and October 31, 1979. In the course of these operations the Bank purchased trade bills at the market rate outside the rediscount quotas on condition that the banks submitting the bills simultaneously repurchased them forward. The largest amount of bills held by the Bank as a result of such operations was DM 2,627.4 million (on October 26, 1979). The market rate for open market operations in bills under repurchase agreements was $7^3/_4$%.

Open market operations in securities under repurchase agreements

During the year under review the Bank conducted open market operations in securities under repurchase agreements with banks for the first time. In the course of these operations the Bank purchased, on June 19 and August 27, 1979 (with a payment period of two business days), bonds eligible as collateral for lombard loans amounting to DM

7,586.7 million and DM 11,090.1 million, respectively, on condition that the sellers repurchased the securities forward after 30 days. The repurchase price was calculated by adding a premium to the purchase price, on the basis of 5% p.a. (on June 19, 1979) and 6½% p.a. (on August 27, 1979). At the end of the year the Bank held no securities stemming from open market operations under repurchase agreements.

Lombard loans

Taking the average of all the return dates of the year under review, the Bank granted DM 5,280 million of lombard loans to banks (1978: DM 2,251 million). As in preceding years, the outstanding amount of such loans was subject to marked fluctuations, being largest between March and May and in July.

Lombard loans in the Land Central Bank areas

DM million

Land Central Bank	Lombard loans granted		Outstanding at	
	1978	1979	Dec. 31, 1978	Dec. 31, 1979
Baden-Württemberg	22,820.6	53,416.1	1,491.4	647.7
Bavaria	9,882.7	25,580.0	285.1	352.6
Berlin	1,441.3	7,414.0	5.0	55.0
Bremen	1,626.4	4,835.3	–	19.8
Hamburg	7,276.4	19,286.9	271.2	104.8
Hesse	100,761.4	245,523.9	2,775.5	773.4
Lower Saxony	8,481.3	15,701.4	352.1	117.6
North Rhine-Westphalia	21,368.1	53,206.6	775.3	857.1
Rhineland-Palatinate	6,320.9	12,367.6	155.4	132.7
Saarland	764.5	2,341.1	34.2	45.1
Schleswig-Holstein	4,290.4	6,927.8	19.6	24.9
Total	185,034.0	446,600.7	6,164.8	3,130.7

Lombard rate

During the year under review the lombard rate stood at 3½% until January 18, at 4% as from January 19, at 5% as from March 30, at 5½% as from June 1, at 6% as from July 13 and at 7% as from November 1.

Cash advances (book credits)

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

Besides book credits, the credit ceilings are to include Treasury bills which the Bank holds in its portfolio or which it has undertaken to purchase.

Federal Government
Equalisation of Burdens Fund
Länder Governments

Cash advances (book credits) outstanding

DM million

Borrower	December 31, 1978	December 31, 1979
Länder Governments		
Bremen	30.4	42.8
Hamburg	125.3	–
Lower Saxony	–	187.3
Schleswig-Holstein	–	78.4
Total	155.7	308.5

No cash advances (book credits) to the Federal Government and the Equalisation of Burdens Fund were outstanding at December 31, 1979, as in the preceding year.

Federal Railways Federal Post Office

No book credits to the Federal Railways or Federal Post Office were outstanding at December 31, 1979; such credits, together with claims arising from the purchase of Treasury bills and discountable Treasury bonds, are to be shown in the item "Loans to the Federal Railways and Federal Post Office" on the assets side.

Interest rate

Throughout the year the rate of interest on book credits was identical with the Bank's discount rate.

Treasury bills and discountable Treasury bonds

In the placing of discountable Treasury bonds the Bank was again very active as the selling agent for the Federal Government and its special funds. These securities, which serve financing purposes, are distinct from the mobilisation and liquidity paper issued pursuant to sections 42 and 42 (a) of the Bundesbank Act, which will be reported on below. No Treasury bills serving financing purposes were issued during the year under review.

Federal Government

To meet part of the borrowing requirements of the Federal Government, discountable Treasury bonds amounting to DM 3,997.3 million (1978: DM 4,299.8 million) were issued.

Sales to non-banks of a special type of discountable Treasury bond of the Federal Government, namely Federal "financing bonds", at DM 1,727.3 million, accounted for a larger part of total sales, at well over two fifths, than in the preceding year (DM 937.1 million or just over one fifth). Since February 1975 these securities have been sold to non-banks by a standardised procedure, mostly through banks (but also by the Bundesbank and Land Central Banks direct) as discountable Treasury bonds that are not returnable before maturity.

As usual, the bulk of the remaining discountable Treasury bonds were purchased by banks and — on a smaller scale — by other institutional investors. For placing these securities the Bank again used a tender procedure in November 1979.

After the redemption of DM 4,386.6 million (1978: DM 4,244.4 million) of matured discountable Treasury bonds (including financing bonds), the amount of Federal Government discountable Treasury bonds types "B" and "BN" (the latter not being returnable before maturity) outstanding at December 31, 1979 came to DM 8,186.1 million (end-1978: DM 8,575.4 million). Of this amount, DM 1,423.7 million was repurchasable by the Bank (type "B").

Federal Railways

Of the (returnable) discountable Treasury bonds of the German Federal Railways (type "Ba") which fell due in 1979, totalling DM 400 million, DM 231 million was reissued. The amount of Federal Railways discountable Treasury bonds (type "Ba") outstanding at end-1979 came to DM 231 million (end-1978: DM 400 million).

Federal Post Office

In the year under review the German Federal Post Office refrained from issuing any discountable Treasury bonds, so that no such bonds of the Federal Post Office were outstanding at the end of 1979.

At December 31, 1979 the outstanding amount of money market paper issued for the account of the Federal Government and its special funds came to DM 8,417.1 million (end-1978: DM 8,975.4 million). Further details are given in the following table.

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

DM million

Type of paper	Outstanding at Dec. 31, 1978	1979 Issued	1979 Redeemed	Outstanding at Dec. 31, 1979
Discountable Treasury bonds of the Federal Republic of Germany "B" 1 and "BN" 2	8,575.4	3,997.3	4,386.6	8,186.1
of which "Financing bonds"	(1,642.4)	(1,727.3)	(881.3)	(2,488.4)
Discountable Treasury bonds of the German Federal Railways "Ba"	400.0	231.0	400.0	231.0
Total	8,975.4	4,228.3	4,786.6	8,417.1

1 The letter "B" serves to distinguish these bonds from the mobilisation and liquidity paper dealt with below. — 2 The letters "BN" denote securities which may not be returned before maturity.

Länder Governments

No money market paper was issued by the Länder Governments in 1979, so that no such securities were outstanding at the end of the year.

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

The Bank's equalisation claims on the Federal Government, as inscribed in the government stock register at December 31, 1978, increased by DM 2,400 during the year under review.

The combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1979 is attached to the German original of this Report as Appendix 1. The non-interest-bearing debt certificate in respect of Berlin — DM 547.2 million since 1967 — and the equalisation claims arising from the Bank's own conversion account will remain unchanged in future, as the conversion account was finally closed at the end of 1979.

Equalisation claims and non-interest-bearing debt certificate in respect of Berlin in 1979

DM thousand

Type of paper	Outstanding at December 31, 1978	Increase in 1979	Outstanding at December 31, 1979
Equalisation claims arising from			
Own conversion account			
Bank deutscher Länder	5,504,421.5	—	5,504,421.5
Land Central Banks	2,599,339.2	+ 0.1	2,599,339.3
	8,103,760.7	+ 0.1	8,103,760.8
Conversion of Berlin pre-capitulation balances	31,188.6	+ 1.6	31,190.2
Conversion of RM balances at banks in the Eastern Sector of Berlin	1,464.7	+ 0.7	1,465.4
	8,136,414.0	+ 2.4	8,136,416.4
Non-interest-bearing debt certificate	547,168.5	—	547,168.5
Total	8,683,582.5	+ 2.4	8,683,584.9

Loans to the Federal Railways and Federal Post Office

No loans to the Federal Railways or Federal Post Office were outstanding at December 31, 1979, as in the preceding year. See also the notes on the items "Cash advances (book credits)" and "Treasury bills and discountable Treasury bonds".

Securities

During the year under review the Bank's portfolio of securities — chiefly bonds of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office — decreased by DM 2,103.5 million on balance to DM 2,114.1 million as a result of open market operations (end-1978: DM 4,217,6 million).

Issue of bonds

In 1979 twelve bond issues totalling DM 11,650 million (1978: fifteen issues amounting to DM 9,250 million) were launched through the Federal Bond Consortium, which is under the direction of the Bank. Of this total, DM 1,950 million (1978: DM 1,750 million) was reserved for the issuers' own institutions and for price support operations.

At the end of 1979 the outstanding amount of bonds of the Federal Republic of Germany came to DM 40,575.2 million (end-1978: DM 31,053.8 million), that of the German Federal

Railways to DM 13,810.8 million (end-1978: DM 13,837.7 million) and that of the German Federal Post Office to DM 7,445.4 million (end-1978: DM 8,490.8 million).

Bond issues of the Federal Republic of Germany and the German Federal Railways in 1979

Issuer	Amount issued in DM million: Total	Amount issued in DM million: of which Sold through Federal Bond Consortium	Terms: Nominal interest rate (%)	Terms: Period to maturity in years	Terms: Issue price (%)	Terms: Yield (%)	Start of sales
German Federal Railways	600	500	6½	6	100	6.50	Jan. 24
Federal Republic of Germany	600	500	7	6	100	7.00	Apr. 5
Federal Republic of Germany	600	500	7¼	10	99.25	7.36	Apr. 5
Federal Republic of Germany	750	650	7¼	6	99.25	7.41	May 10
Federal Republic of Germany	750	650	7½	10	99	7.65	May 10
Federal Republic of Germany	600	500	7¾	6	99.50	7.86	June 7
Federal Republic of Germany	900	800	8	10	99.50	8.07	June 7
German Federal Railways	650	500	8	10	99.75	8.04	June 28
Federal Republic of Germany	1,600	1,400	8	10	100	8.00	July 5
Federal Republic of Germany	1,600	1,300	7½	10	99.50	7.57	Aug. 15
Federal Republic of Germany	1,500	1,200	7¾	10	100	7.75	Oct. 15
Federal Republic of Germany	1,500	1,200	7¾	10	99	7.90	Dec. 28

Issue of Federal savings bonds

With the assistance of the Bank DM 6,350.9 million (gross) of Federal savings bonds were sold to private investors through banks and to a certain extent by the Bank itself in 1979 (1978: DM 3,161.0 million).

In the course of the year under review the rate of interest paid on Federal savings bonds was raised three times to bring it into line with market rates.

During 1979 DM 4,067.5 million of Federal savings bonds from former tranches were returned to the issuer before maturity (1978: DM 22.6 million), and a further DM 430.1 million were redeemed on maturity. The amount of Federal savings bonds outstanding rose from DM 24,791.8 million (end-1978) to DM 26,691.7 million at December 31, 1979.

Gross sales, interest rates and yields of Federal savings bonds in 1979

Issues	Sales period 1979	Gross sales in DM million: Total	Federal savings bonds A 1	Federal savings bonds B 2	Interest rate (%) in, and yield (%) after, ... year after issue: 1st	2nd	3rd	4th	5th	6th	7th
1978/5+6	Jan. 2 — Jan. 22	227.3	119.3		3.25	5.00	5.50	6.25	6.50	6.75	
					3.25	4.11	4.55	4.94	5.22	5.44	
				108.0	3.25	5.00	5.50	6.25	6.50	6.75	6.75
					3.25	4.12	4.58	4.99	5.29	5.53	5.71
1979/1+2	Jan. 31 — March 23	659.5	300.8		3.50	5.25	6.25	7.00	7.50	7.75	
					3.50	4.36	4.96	5.42	5.79	6.07	
				358.7	3.50	5.25	6.25	7.00	7.50	7.75	7.75
					3.50	4.37	4.99	5.49	5.89	6.20	6.42
1979/3+4	Apr. 2 — May 21	833.0	397.7		4.00	5.75	6.75	7.50	8.00	8.25	
					4.00	4.85	5.45	5.92	6.28	6.55	
				435.3	4.00	5.75	6.75	7.50	8.00	8.25	8.25
					4.00	4.87	5.49	5.99	6.39	6.70	6.92
1979/5+6	June 1 — Dec. 31	4,631.1	1,998.8		4.50	6.25	8.00	8.75	9.00	9.25	
					4.50	5.35	6.18	6.76	7.14	7.43	
				2,632.3	4.50	6.25	8.00	8.75	9.00	9.25	9.25
					4.50	5.37	6.24	6.86	7.29	7.61	7.84
Total	Jan. 2 — Dec. 31	6,350.9	2,816.6	3.534.3							

1 With annual payment of interest. — **2** With accrual of interest.

Issue of Federal bonds

In December 1979 "Federal bonds" (Bundesobligationen) were issued for the first time; these are new debt instruments of the Federal Government offered in the form of "tap" issues with the assistance of the Bank. Federal bonds, which have maturities of five years, are issued in consecutive series for purchase by domestic natural persons and domestic institutions serving publicly beneficial, charitable or church purposes. Once the sale of a series has been completed, they are introduced to the German stock exchanges for official dealing; from then on they may be bought by anyone, i. e. also by banks and enterprises. Purchases by non-residents are, however, contractually barred.

By the end of the year DM 616.1 million of Federal bonds had been sold to private investors. During that period the terms, which did not change, were as follows: interest rate: 7.75%; issue price: 99.20%; yield: 7.95%.

Issue of medium-term notes

Through the agency of the Bank, DM 1,401.6 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany were sold by tender in two tranches in 1979 (1978: DM 8,207.4 million in five tranches). The terms of these two issues are shown in the following table.

Treasury bonds (medium-term notes) of the Federal Republic of Germany sold by tender in 1979

Amount sold in DM million	Nominal interest rate (%)	Period to maturity in years	Selling price (%)	Yield on issue (%)	Month of sale
1,035.8 365.8	6 6¼	3 4	99.30 99	6.26 6.54	February

At the end of 1979 the outstanding amount of medium-term notes of the Federal Republic of Germany came to DM 20,846.9 million (end-1978: DM 24,358.3 million) and that of the German Federal Railways to DM 595.0 million (end-1978: DM 995.0 million); no medium-term notes of the German Federal Post Office were outstanding at the end of 1979 (as at the end of 1978).

Borrowing by the United States in Deutsche Mark

As part of the measures to strengthen the U.S. dollar announced on November 1, 1978, the Bank assisted the United States of America in raising funds in the German capital market during the year under review (as in 1978). By means of Public Offers on fixed terms the U.S. Treasury took up loans against DM-denominated U.S. Treasury Notes (Schuldscheine) in February 1979 and issued DM-denominated bearer U.S. Treasury Notes (Inhaberschuldverschreibungen) in November 1979.

The terms of these borrowing operations were as follows:

Borrowing by the United States of America in the Federal Republic of Germany

Type of borrowing	Payment date	DM million	Period to maturity in years	Interest rate = yield in % p. a. (issued at par)
DM-denominated U.S. Treasury Notes	Dec. 15, 1978	1,773.5 1,265.0	3 4	5.95 6.20
DM-denominated U.S. Treasury Notes	March 1, 1979	1,259.5 1,242.8	2½ 3½	6.30 6.70
DM-denominated bearer U.S. Treasury Notes	Nov. 12, 1979	808.4 1,197.2	2½ 3½	8.55 8.50

Admission to stock exchange dealings

The Bank introduced the new bond issues of the Federal Republic of Germany and the German Federal Railways, as well as one bond issue of the Reconstruction Loan Corporation and one of the Equalisation of Burdens Bank, to official dealing on all German stock exchanges. The Bank also introduced two tranches of medium-term notes of the Federal Republic of Germany, one tranche of medium-term notes of the Reconstruction Loan Corporation and two tranches of DM-denominated bearer Treasury Notes of the United States of America, all issued in the year under review, to regulated unofficial dealing on the Frankfurt stock exchange.

Price support operations

In the year under review, as in preceding years, the Bank conducted price support operations for the account of the issuers on the eight German stock exchanges in respect of the bonds issued by the Federal Government and its special funds, one Land Government, the Reconstruction Loan Corporation and the Equalisation of Burdens Bank, in order to smooth price fluctuations.

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 4,973,700 interest coupons and matured bonds during the year under review (1978: 5,749,151). Of these, 402,297 interest coupons and matured bonds were presented to foreign agents for payment (1978: 399,974).

German coins

The amount of German coins held by the Bank came to DM 721.4 million at end-1979 (end-1978: DM 698.3 million). In 1979 the Federal Government was credited with DM 446.2 million for coins taken over from the Mints and debited with DM 11.8 million for coins no longer fit for circulation (including about DM 5.8 million for silver DM 5 coins, which have been withdrawn from circulation). Altogether, between 1948 and 1979 the Bank — acting for the account of the Federal Government — took over coins amounting to DM 9,343.7 million and redeemed DM 1,633.6 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 1979 (DM 6,988.7 million) divided by the number of inhabitants of the Federal Republic of Germany including the Land of Berlin on September 30, 1979 (61.4 million) yields a coin circulation of DM 113.82 per head of population (1978: DM 107.30).

In the year under review the DM 5 commemorative coin "150 Jahre Deutsches Archäologisches Institut" (150th Anniversary of the Foundation of the German Archaeological Institute) was put into circulation.

Balances on postal giro accounts

The postal giro account balances, including the branches' transfers in transit to the postal giro account of the Bank (Central Office) at Frankfurt am Main, amounted to DM 375.5 million at December 31, 1979 (1978: DM 1,214.3 million). The Bank's credit balances on the latter account and on the postal giro account of the Land Central Bank in Berlin, other than those required for current payments, are offset daily, in rounded amounts, against the giro balances of the Central Cash Office of the Federal Post Office and the Berlin (West) Postal Giro Office.

Postal giro transactions with third parties

	1978				1979			
	Transfers received from third parties		Transfers made to third parties		Transfers received from third parties		Transfers made to third parties	
Area	Number	DM million	Number	DM million	Number	DM million	Number	DM million
Land Central Bank								
Baden-Württemberg	72,900	17,496.4	10,116	1,625.1	65,319	17,325.8	9,598	2,137.0
Bavaria	58,147	10,933.6	11,948	6,072.6	52,629	11,817.9	13,326	6,433.0
Berlin	20,952	2,705.1	3,286	910.5	20,619	2,521.5	3,143	854.7
Bremen	8,024	455.6	1,893	0.2	5,981	424.3	2,043	0.2
Hamburg	58,958	17,323.7	1,824	122.9	54,200	17,642.4	1,688	225.9
Hesse	49,075	7,832.9	7,762	5,109.1	43,605	7,188.2	7,326	5,887.5
Lower Saxony	61,094	6,446.6	5,566	1,580.7	56,028	6,348.4	5,686	1,798.8
North Rhine-Westphalia	112,985	19,206.1	26,675	5,207.9	110,185	18,817.2	28,768	6,493.1
Rhineland-Palatinate	27,960	1,985.5	8,687	914.3	24,954	1,797.3	9,075	900.3
Saarland	6,546	1,712.7	600	0.2	5,649	1,713.9	320	0.1
Schleswig-Holstein	5,289	51.2	3,477	0.6	3,748	51.6	4,130	0.9
Total	481,930	86,149.4	81,834	21,544.1	442,917	85,648.5	85,103	24,731.5
Bundesbank — Central Office —	31,088	1,766.6	1,648	5.0	35,968	1,790.5	1,570	5.5
Grand total	513,018	87,916.0	83,482	21,549.1	478,885	87,439.0	86,673	24,737.0

Other claims

Other claims are shown at DM 951.2 million (end-1978: DM 1,170.7 million). They include the balance arising from intra-German settlements (commercial payments under the "Berlin Agreement"), which amounted to DM 798.0 million (1978: DM 795.0 million). The turnover on the relevant sub-accounts is shown in Part A IV of the German original of this Report.

Land and buildings

After additions totalling DM 135.1 million and depreciation totalling DM 55.7 million, land and buildings are shown at DM 922.7 million.

Furniture and equipment

The balance sheet value of furniture and equipment amounts to DM 70.4 million after additions totalling DM 49.3 million and depreciation totalling DM 29.0 million.

Items in course of settlement

The "Items in course of settlement" mainly comprise the intercity credit and debit transfers proceeding inside the Bank at the end of the year and the cheques and direct debit orders being cleared. At December 31, 1979 the balance of items in course of settlement stood at DM 8,905.1 million (end-1978: DM 6,718.7 million).

Other assets

The "Other assets" are shown at DM 1,379.8 million (end-1978: DM 1,309.4 million). As in the previous year, much the greater part of this amount consisted of interest due in 1980 but assignable to the profit and loss account for the year under review on funds invested abroad and on securities (DM 1,281.1 million against DM 1,211.2 million at end-1978).

This item also includes the Bank's 30% share, amounting to DM 75 million, in the capital of the Liquidity Consortium Bank of Frankfurt am Main (set up as a private limited company). The provision included in the articles of association of that bank that, if necessary, further capital is to be paid up in proportion to the existing share entails for the Bank a maximum commitment of DM 225 million.

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 1980.

Balancing item in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — accumulated loss —

See the note on page 83 of this Report.

Liabilities

Bank notes in circulation

The amount of bank notes in circulation rose from DM 74,799.1 million at end-1978 to DM 79,385.6 million at December 31, 1979.

Currency in circulation

DM million

End of	Bank notes	Federal coins	Currency in circulation, total
1974	50,272.5	5,128.8	55,401.3
1975	55,143.2	5,406.3	60,549.5
1976	59,038.3	5,699.8	64,738.1
1977	65,567.4	6,097.6	71,665.0
1978	74,799.1	6,577.5	81,376.6
1979	79,385.6	6,988.7	86,374.3

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

In the year under review the Bank again took over Bundesbank notes of various denominations from the printing offices and put them into circulation or made them ready for that purpose.

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

	1974	1975	1976	1977	1978	1979
Number (millions)	424.0	399.4	486.4	459.1	560.9	505.9
Value (DM million)	15,638.0	15,110.5	18,556.5	18,086.2	22,682.1	20,829.6.

The number and value of the counterfeit bank notes detained in payments in the Federal Republic of Germany and Berlin (West) decreased by almost half against the preceding year; the decline is chiefly attributable to the gradual disappearance of two types of counterfeit DM 100 Bundesbank notes. The number of counterfeit Federal coins detected likewise decreased; in 1979 the most frequently detained counterfeits were again those of the DM 5 coins in circulation.

Counterfeits detected

	Bank notes		Federal coins	
Year	Number	DM thousand	Number	DM thousand
1974	881	59.4	8,181	28.6
1975	927	92.3	14,151	65.0
1976	2,709	275.0	8,249	31.0
1977	9,754	946.0	6,754	25.7
1978	6,341	586.4	9,835	35.5
1979	3,388	296.6	7,405	24.3

Deposits of banks

The banks' deposits on giro accounts 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 end-1978 the deposits are shown as follows:

	Dec. 31, 1978 DM million	Dec. 31, 1979 DM million
Deposits on giro accounts	59,338.0	64,755.3
Other	28.1	24.8
	59,366.1	64,780.1.

Deposits of public authorities

In the item "Deposits of public authorities" the current balances of public authorities are shown as follows:

	Dec. 31, 1978 DM million	Dec. 31, 1979 DM million
Federal Government	2,384.3	1,842.5
Equalisation of Burdens Fund and ERP Special Fund	162.7	290.1
Länder Governments	2,027.6	728.5
Other public depositors	56.7	78.1
	4,631.3	2,939.2.

Deposits of other domestic depositors

The deposits of other domestic depositors are composed as follows:

	Dec. 31, 1978 DM million	Dec. 31, 1979 DM million
Federal Railways	6.5	12.7
Federal Post Office (including postal giro and postal savings bank offices)	3,515.4	579.4
Other depositors	564.7	637.5
	4,086.6	1,229.6.

Giro transactions, simplified cheque and direct debit collections

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

	Number	Amount
1978	99.86	98.27
1979	99.87	98.46.

Annual turnover on the giro accounts of the Bank

Turnover	1978 Number of transactions	1978 Total amount	1978 Average amount	1979 Number of transactions	1979 Total amount	1979 Average amount
	Thousands	DM million	DM thousand	Thousands	DM million	DM thousand
(a) Credits						
Cash payments	1,095	182,594	166.8	1,061	191,633	180.6
Clearings with account-holders	5,119	3,094,342	604.4	4,665	3,811,363	817.0
Local transfers	33,394	3,127,542	93.7	31,804	3,535,035	111.2
Intercity transfers	177,138	3,088,775	17.4	191,307	3,528,824	18.4
Cheque and direct debit collections (total presented)	694,377	1,371,696	2.0	774,827	1,574,180	2.0
Total	911,123	10,864,949	–	1,003,664	12,641,035	–
(b) Debits						
Cash payments	1,472	194,141	131.9	1,458	198,334	136.0
Clearings with account-holders	3,063	3,027,429	988.4	3,011	3,741,721	1,242.7
Local transfers	33,394	3,127,542	93.7	31,804	3,535,035	111.2
Intercity transfers	182,883	3,138,060	17.2	191,800	3,590,936	18.7
Cheque and direct debit collections (total paid)	672,821	1,367,250	2.0	762,754	1,572,682	2.1
Total	893,633	10,854,422	–	990,827	12,638,708	–
(c) Percentage of total turnover (credits and debits)		%			%	
Cash payments		1.73			1.54	
Clearings with account-holders		28.19			29.88	
Local transfers		28.80			27.97	
Intercity transfers		28.67			28.16	
Cheque and direct debit collections (total presented and paid)		12.61			12.45	
		100.00			100.00	

In 1979 the turnover on the giro accounts of the Bank increased against the previous year by 10% in terms of the number of transactions and by 16% in terms of the total amount. The number of items presented by the banks under the simplified collection procedure for cheques and direct debit orders again rose at an above-average rate, namely by 12% (1978: 18%); by contrast, the number of intercity transfers went up by only 5 % (1978: 8 %). The number of local transfers outside the clearing system continued to decline (1979: 5 %; 1978: 7 %). If, however, the local transfers inside the clearing system are added, the Bank's aggregate local transfers rose against the previous year by 2 % in terms of the number of transactions and by 15 % in terms of the total amount.

The percentage of automatically processed intercity transfers continued to rise both in paper-based operations and in the paperless exchange of data media. In the year under review, 97 % of the 456 million vouchers presented for collection (1978: 93 %) and 88 % of the 108 million paper-based credit transfers (1978: 77 %), as well as 319 million direct debits (1978: 251 million) and 84 million credit transfers (1978: 68 million) recorded on magnetic tape, were processed by the Bank's computer centres. The volume of payments executed through the paperless exchange of data media was approximately 26 % larger than in the preceding year. Such payments thus accounted for 43 % (1978: 39 %) of the payment items presented under the automated procedure. In the aggregate, 97 % of the intercity transfers — paper-based as well as paperless — were processed automatically in the year under review. The development of the automation of intercity transfers since 1973 is shown in the following table.

Automation of intercity transfers

	Collection orders presented							Intercity credit transfers presented						
		processed							processed					
		in paper-based operations							in paper-based operations					
	Total	conventional		automated		through the paperless exchange of data media		Total	conventional		automated		through the paperless exchange of data media	
Year	millions	millions	%	millions	%	millions	%	millions	millions	%	millions	%	millions	%
1973	317	175	55	142	45	—	—	113	113	100	—	—	—	—
1974	374	142	38	232	62	0.2	0	123	75	61	48	39	0.1	0
1975	423	143	34	272	64	8	2	163	85	52	73	45	5	3
1976	501	83	17	313	62	105	21	174	62	36	83	48	29	16
1977	587	47	8	359	61	181	31	169	36	21	87	51	46	28
1978	694	31	5	412	59	251	36	183	26	14	89	49	68	37
1979	775	15	2	441	57	319	41	192	13	7	95	49	84	44

If local payments and clearing transactions, which are not yet processed automatically, are also taken into account, about 68 % of the cashless payments at the Bank are automated. It should be borne in mind in this connection that magnetic tapes containing payments are increasingly being exchanged locally between banks in clearing transactions, although only the overall amounts are cleared by this (conventional) procedure.

As a result of the increased automation, the concentration of the incoming payment items continued in 1979. Since 1973 the number of items entered in intercity payments has fallen from 166 million to 34 million on the dispatch side, in spite of the simultaneous rise in the number of payments from 430 million to 967 million.

In 1979 four more computer centres for processing payments went into operation (in Bremen, Hanover, Mainz and Saarbrücken), so that, inclusive of the computer centre opened in Kiel at the end of 1978, there is now a computer centre in each of the eleven Land Central Bank areas.

Domestic commission business

Domestic bills, cheques, etc., were acquired on a commission basis as follows:

	Number	DM million
1978	65,532	706.2
1979	64,182	715.7.

Liabilities arising from mobilisation and liquidity paper sold

In the aggregate — i. e. taking Treasury bills and discountable Treasury bonds together — sales of mobilisation and liquidity paper pursuant to sections 42 and 42(a) of the Bundesbank Act in the year under review were much smaller than in the preceding year, at DM 21,851.2 million against DM 30,129.0 million. The Bank sold only DM 58.8 million of mobilisation and liquidity Treasury bonds (1978: DM 9,240.8 million). DM 5,882.6 million of such securities were redeemed. The outstanding amount of mobilisation and liquidity Treasury bonds accordingly decreased to DM 3,157.0 million at December 31, 1979 (1978: DM 8,980.8 million).

During the year under review the redemptions of outstanding non-returnable mobilisation and liquidity Treasury bonds for the first time included securities which the Bank repurchased before maturity on its own initiative, since such repurchases appeared advisable for liquidity policy reasons. In May 1979 DM 3,178 million of securities maturing by the end of the year were bought by tender. In December 1979 the Bank also repurchased before maturity DM 1,258 million of such Treasury bonds maturing between January and March 1980 by means of two direct offers to the banks holding securities maturing in January, February and March 1980.

The turnover in mobilisation and liquidity Treasury bills went up slightly during the year under review. The amount outstanding decreased to DM 3,530.0 million (1978: DM 4,223.8 million) owing to sales totalling DM 21,792.4 million (1978: DM 20,888.2 million) and redemptions totalling DM 22,486.2 million (1978: DM 19,552.5 million). As usual, the revolving investment of funds of foreign institutions was a prominent feature of the issues.

The liabilities arising from mobilisation and liquidity paper outstanding amounted to DM 6,687.0 million at December 31, 1979. Compared with end-1978 (DM 13,204.6 million) the amount outstanding declined by about half.

Mobilisation and liquidity paper sold and redeemed

DM million

	1978	1979		
Type of paper	Outstanding at December 31	Sold	Redeemed	Outstanding at December 31
Treasury bills (running for up to 90 days)	4,223.8	21,792.4	22,486.2	3,530.0
Discountable Treasury bonds (running for 6 to 24 months)	8,980.8	58.8	5,882.6	3,157.0
Total	13,204.6	21,851.2	28,368.8	6,687.0

Liabilities arising from foreign business

At December 31, 1979 the liabilities arising from foreign business, at DM 3,328.8 million compared with DM 4,544.4 million at end-1978, were lower than a year before. This reduction is wholly attributable to a decline in the deposits of foreign central banks. Specifically, the liabilities arising from foreign business were made up as follows:

	Dec. 31, 1978 DM million	Dec. 31, 1978 DM million	Dec. 31, 1979 DM million	Dec. 31, 1979 DM million
Deposits of foreign depositors				
Banks	4,092.1		2,480.3	
Other depositors	439.3	4,531.4	739.1	3,219.4
Other				
Provision of cover for credits, etc.	12.5		109.2	
Miscellaneous liabilities	0.5	−13.0	0.2	109.4
		4,544.4		3,328.8.

Counterpart of special drawing rights allocated

The counterpart of the special drawing rights allocated by the International Monetary Fund and shown on the assets side in sub-item 2.3 corresponds to the allocations of SDRs to the Federal Republic of Germany between 1970 and 1972 and in 1979, which totalled SDR 766.6 million.

Counterpart in respect of the valuation of the gold contributed to the European Monetary Cooperation Fund

In connection with the entry into force of the European Monetary System (EMS) in the year under review, the Bank contributed 20 % of its gold holding to the European Monetary Cooperation Fund at a value higher than that used in the balance sheet. During the transitional period of the EMS the resultant difference in value is shown in this item.

Provisions
Provision for pensions

DM 118.6 million was withdrawn from the provision for pensions in order to pay pensions and widows' and orphans' allowances. After an increase of DM 158.6 million this provision amounted to DM 1,725.0 million at December 31, 1979 against DM 1,685.0 million at end-1978.

Other provisions

The provision for hazards inherent in domestic and foreign business remained unchanged at DM 300 million.

Other liabilities

The other liabilities are shown at DM 92.1 million against DM 116.5 million at end-1978.

Deferred expenses and accrued income

Deferred expenses and accrued income amounted to DM 837.3 million at December 31, 1979 (end-1978: DM 691.2 million). As before, this item mainly comprises interest received in the year under review, but relating to the following year, on domestic and foreign bills and U.S. Treasury Notes.

Capital

The capital of the Bank amounts to DM 290 million; it is held by the Federal Government (section 2 of the Bundesbank Act).

Reserves

The legal reserves and other reserves remained unchanged at DM 969.0 million and DM 130.5 million, respectively.

Contingent liabilities and claims

The contingent liabilities and claims amounted to DM 0.6 million against DM 0.7 million at end-1978.

Profit and loss account

Comparison of expenditure and receipts

DM million

Expenditure	1978	1979	Receipts	1978	1979
Interest paid on foreign exchange transactions under repurchase agreements and swap transactions with domestic banks	–	162.0	Interest received		
			Funds invested abroad	5,270.5	6,160.9
			Loans to domestic banks	670.4	1,527.3
Interest paid on mobilisation and liquidity paper	683.4	53.0	Equalisation claims	244.1	244.1
			Securities	194.5	265.2
Other interest paid	18.4	8.4	Cash advances (book credits)	8.0	26.3
	701.8	223.4	Other interest received	2.6	3.3
Administrative expenditure				6,390.1	8,227.1
Staff costs	546.3	582.7	Fees received	12.1	10.1
Other	108.7	118.1	Gains from the write-up of gold	2,988.5	–
Note printing	121.8	157.9	Other receipts	86.8	47.4
Depreciation	71.2	84.7	Loss for the year	2,955.2	–
Increase in the provision for pensions	151.1	158.5			
Pension payments in respect of the Reichsbank	34.6	33.7			
Other expenditure	122.3	264.0			
Write-downs of monetary reserves and other foreign currency positions	10,574.9	2,868.3			
Profit for the year	–	3,793.3			
Total	12,432.7	8,284.6	Total	12,432.7	8,284.6

Before allowing for the valuation adjustment of the external positions at the end of the year (write-downs of monetary reserves and other foreign currency positions), receipts exceeded expenditure by DM 6,661.6 million in 1979 (1978: DM 4,631.2 million).

Receipts

Interest

	1978 DM million	1979 DM million
Interest received amounted to	6,390.1	8,227.1;
after deduction of interest paid, namely	701.8	223.4,
interest is shown in the profit and loss account at	5,688.3	8,003.7.

In the year under review total interest income, at DM 8,227.1 million, was DM 1,837.0 million larger than a year before. The interest received from funds invested abroad rose by DM 890.4 million to DM 6,160.9 million owing to higher interest rates. Interest income from lending to domestic banks — domestic bills, security transactions under repurchase agreements, lombard loans and foreign bills bought in Germany — went up by DM 856.9 million to DM 1,527.3 million as the volume of such lending expanded and interest rates rose. The interest received from securities increased by DM 70.7 million to DM 265.2 million, the average security portfolio during the year under review being larger than in the previous year. The interest accruing from equalisation claims remained unchanged at DM 244.1 million. Other interest income went up by DM 19.0 million to DM 29.6 million.

The interest paid, at DM 223.4 million, declined by DM 478.4 million against the preceding year. DM 162.0 million was spent on foreign exchange transactions under repurchase agreements and swap transactions; DM 53.0 million (1978: DM 683.4 million) was paid on Treasury bills and discountable Treasury bonds of the Federal Government (mobilisation and liquidity paper pursuant to sections 42 und 42(a) of the Bundesbank Act).

Fees

Fees totalling DM 10.1 million were received in the year under review (1978: DM 12.1 million).

Other receipts

At DM 47.4 million, the other receipts were DM 39.4 million smaller than at end-1978.

Expenditure

Administrative expenditure
Staff costs

Administrative expenditure on personnel rose by DM 36.4 million compared with the previous year to DM 582.7 million. This was mainly due to statutory or negotiated pay rate increases for established employees ("officials") and unestablished salary and wage earners and to the rise in the Bank's staff during the year under review.

While the period from 1973 to 1977 was marked by a reduction in the number of employees — mainly because of the automation of cashless payments — the Bank's staff has been increasing again since the beginning of 1978. After a rise of 451 in 1978, this trend accelerated during the year under review. Compared with the previous year the number of employees grew by 750 to 14,408 — the highest figure ever recorded by the Bundesbank. This growth is mainly attributable to the increased recruitment of junior staff for the money handling service and the executive service (about 450 officials and salary earners in all).

Payments to serving members of the Directorate of the Bank and the Central Bank Council amounted to DM 6,702,735.49 in the year under review. Former members of these bodies and of the Board of Directors and Board of Managers of the Bank deutscher Länder and the Managing Boards of the Land Central Banks, including their surviving dependants, received payments totalling DM 6,249,583.29.

Changes in staff regulations

In conformity with the amended career regulations of the Federal Government, the Central Bank Council approved, on July 12, 1979, a revised version of the Regulations on the Educational Background and Careers of Officials of the Deutsche Bundesbank, which,

Staff of the Bank

	Beginning of 1979					Beginning of 1980				
	Central Office	Land Central Banks	Total 1	of whom male	of whom female	Central Office	Land Central Banks	Total 1	of whom male	of whom female
Officials	778	4,802	5,580	5,301	279	822	5,084	5,906	5,540	336
Salary earners	1,557	5,493	7,050	3,255	3,795	1,593	5,848	7,441	3,453	3,988
Wage earners	195	833	1,028	182	846	214	847	1,061	194	867
Total	2,530	11,128	13,658	8,738	4,920	2,629	11,779	14,408	9,187	5,221

1 of whom, working part time

	1979	1980
Officials	8	10
Salary earners	336	368
Wage earners	738	749

with the agreement of the Federal Government, entered into force on October 1, 1979. In accordance with section 18 of the Federal Officials Act, the new career regulations prescribe technical college training for candidates for the executive service of the Bank; to provide this training, the Central Bank Council has established the Deutsche Bundesbank Technical College, which is located in Hachenburg and was officially recognised by the Minister of Education of Rhineland-Palatinate with effect from September 1, 1979.

In 1979 the Bank again concluded a number of new pay agreements for its wage and salary earners, thereby bringing their legal situation into line with that of the wage and salary earners of the Federal Government.

Other

Other (non-staff) administrative expenditure increased by DM 9.4 million to DM 118.1 million in the year under review.

Note printing

Expenditure on note printing amounted to DM 157.9 million against DM 121.8 million in the previous year.

Depreciation and increases in provisions

Depreciation of land and buildings and of furniture and equipment, as well as increases in provisions, were discussed in connection with the respective balance sheet items.

Pension payments in respect of the Reichsbank

Payments to members of the former Deutsche Reichsbank and other persons to whom the Act concerning Section 131 of the Basic Law applies, for whom the Bank is required to provide in accordance with section 41 of the Bundesbank Act, amounted to DM 33.7 million (1978: DM 34.6 million).

Other expenditure

Other expenditure rose from DM 122.3 million in 1978 to DM 264.0 million in 1979. As in the preceding year the increase is chiefly accounted for by the write-downs of the portfolio of securities required at the end of the year.

Write-downs of monetary reserves and other foreign currency positions

The valuation of the monetary reserves and other foreign currency positions entailed write-downs totalling DM 2,868.3 million in the 1979 annual accounts (1978: DM 10,574.9 million).

Profit for the year

		DM million
	The profit and loss account for 1979 shows a profit for the year of	3,793.3;
	together with the balancing item brought forward from 1978 in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — loss brought forward — of	9,553.1
Accumulated loss	there arises an accumulated loss to be carried forward to 1980 of	5,759.8.

This amount is shown in the balance sheet, in item 23 on the assets side, as the balancing item in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — accumulated loss —.

Frankfurt am Main, April 1980

Deutsche Bundesbank
The Directorate
Pöhl Dr. Schlesinger
Dr. Emde Dr. Gleske Prof. Dr. Köhler Werthmöller

Part D: Report of the Central Bank Council

The annual accounts of the Deutsche Bundesbank for 1979, the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1979, and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1979, were audited by Treuarbeit Aktiengesellschaft Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft of Frankfurt am Main and Dr. Wollert — Dr. Elmendorff KG Wirtschaftsprüfungsgesellschaft of Düsseldorf, whom the Central Bank Council had appointed to be auditors in accordance with section 26 of the Bundesbank Act.

In their certificates of audit the auditors confirmed without qualifications that the annual accounts for 1979, the bookkeeping and the conversion account as shown by the books at December 31, 1979, complied with German law and that the Fund for the Purchase of Equalisation Claims had been properly administered.

The Central Bank Council approved the annual accounts for 1979 on April 17, 1980. 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, 1979, and approved the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1979.

Since the publication of the Report for the Year 1978 the following changes have taken place in the Central Bank Council and the Directorate of the Deutsche Bundesbank:

Retired

as at the close of September 30, 1979
the Member of the Directorate of the Deutsche Bundesbank
Dr. Heinrich Irmler,

as at the close of December 31, 1979
the President of the Deutsche Bundesbank
Dr. Otmar Emminger.

Reappointed

with effect from June 16, 1979
Dr. Paul Schütz
President of the Land Central Bank in Saarland,

with effect from July 1, 1979
Dr. Werner Tratzsch
Vice-President of the Land Central Bank in Berlin.

Appointed

with effect from May 16, 1979
Lothar Müller
to be President of the Land Central Bank in Bavaria,

with effect from January 1, 1980
Karl Otto Pöhl
to be President of the Deutsche Bundesbank,
simultaneously relinquishing his office as Vice-President of the Deutsche Bundesbank,

with effect from January 1, 1980
Dr. Helmut Schlesinger
hitherto Member of the Directorate
to be Vice-President of the Deutsche Bundesbank.

The Central Bank Council, acting also on behalf of the Directorate and of the Managing Boards of the Land Central Banks, expresses to the entire staff of the Deutsche Bundesbank its thanks for their loyal and understanding cooperation during 1979. The Council likewise wishes to record its appreciation of the excellent collaboration with the staff representative committees.

Frankfurt am Main, April 1980

Karl Otto Pöhl
President of the Deutsche Bundesbank

Appendix to Part B

Balance sheet of the Deutsche Bundesbank as at December 31, 1979

Assets

	DM	DM	DM
1 Gold			13,693,214,681.31
2 Reserve position in the International Monetary Fund and special drawing rights			
2.1 Drawing rights within the reserve tranche		3,248,401,406.03	
2.2 Loans under special borrowing arrangements		2,162,880,222.58	
2.3 Special drawing rights		3,595,277,581.12	9,006,559,209.73
3 Claims on the European Monetary Cooperation Fund in connection with the European Monetary System			28,487,729,204.61
4 Balances with foreign banks and money market investments abroad			51,801,370,111.95
5 Foreign notes and coins			24,435,541.47
6 External loans and other external assets			
6.1 Loans in connection with EEC medium-term monetary assistance		—	
6.2 Claims arising from foreign exchange offset agreements with the United States		1,549,812,826.93	
6.3 Other loans to foreign monetary authorities		—	
6.4 Loans to the World Bank		2,481,527,795.93	4,031,340,622.86
7 Foreign bills of exchange			3,089,509,669.90
8 Domestic bills of exchange			30,025,512,285.68
9 Lombard loans			3,130,704,100.—
10 Cash advances (book credits)			
10.1 Federal Government		—	
10.2 Equalisation of Burdens Fund		—	
10.3 Länder Governments		308,525,600.—	308,525,600.—
11 Treasury bills and discountable Treasury bonds			
11.1 Federal Government		—	
11.2 Länder Governments		—	—
12 Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin			
12.1 Equalisation claims		8,136,416,458.33	
12.2 Non-interest-bearing debt certificate		547,168,481.20	8,683,584,939.53
13 Loans to the Federal Railways and Federal Post Office			
13.1 Cash advances (book credits)		—	
13.2 Treasury bills and discountable Treasury bonds		—	—
14 Securities			2,114,055,313.01
15 German coins			721,440,644.83
16 Balances on postal giro accounts			375,531,480.19
17 Other claims			951,229,288.54
18 Land and buildings			922,676,023.06
19 Furniture and equipment			70,434,445.—
20 Items in course of settlement			8,905,066,782.98
21 Other assets			1,379,759,663.25
22 Prepaid expenses and deferred income			30,629,511.68
23 Balancing item in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — accumulated loss —			5,759,836,190.07
Rights of recourse in respect of contingent liabilities	649,434.63		
			173,513,145,309.65

	DM	DM	DM
1 Bank notes in circulation			79,385,567,075.–
2 Deposits of banks			
2.1 Deposits on giro accounts		64,755,258,004.16	
2.2 Other		24,848,136.29	64,780,106,140.45
3 Deposits of public authorities			
3.1 Federal Government		1,842,480,537.–	
3.2 Equalisation of Burdens Fund and ERP Special Fund		290,086,875.01	
3.3 Länder Governments		728,542,229.11	
3.4 Other public depositors		78,105,914.28	2,939,215,555.40
4 Deposits of other domestic depositors			
4.1 Federal Railways		12,667,609.56	
4.2 Federal Post Office (including postal giro and postal savings bank offices)		579,413,466.85	
4.3 Other depositors		637,489,665.20	1,229,570,741.61
5 Liabilities arising from mobilisation and liquidity paper sold			6,687,020,000.–
6 Liabilities arising from foreign business			
6.1 Deposits of foreign depositors		3,219,389,910.44	
6.2 Other		109,381,780.78	3,328,771,691.22
7 Counterpart of special drawing rights allocated			1,748,631,012.80
8 Counterpart in respect of the valuation of the gold contributed to the European Monetary Cooperation Fund			9,070,399,617.58
9 Provisions			
9.1 Provision for pensions		1,725,000,000.–	
9.2 Other provisions		300,000,000.–	2,025,000,000.–
10 Other liabilities			92,111,614.85
11 Deferred expenses and accrued income			837,251,860.74
12 Capital			290,000,000.–
13 Reserves			
13.1 Legal reserves		969,000,000.–	
13.2 Other reserves		130,500,000.–	1,099,500,000.–
Contingent liabilities	649,434.63		
			173,513,145,309.65

Profit and loss account of the Deutsche Bundesbank for the year 1979

Expenditure

	DM	DM
1 Administrative expenditure		
1.1 Staff costs	582,686,113.12	
1.2 Other	118,135,535.01	700,821,648.13
2 Note printing		157,853,521.24
3 Depreciation		
3.1 of land and buildings	55,716,369.69	
3.2 of furniture and equipment	29,000,723.16	84,717,092.88
4 Increase in the provision for pensions		158,551,868.34
5 Pension payments in respect of the Reichsbank		33,752,721.53
6 Other expenditure		263,974,226.41
7 Write-downs of monetary reserves and other foreign currency positions		2,868,254,957.92
8 Profit for the year		3,793,264,685.14
		8,061,190,721.59

Receipts

	DM
1 Interest	8,003,665,474.61
2 Fees	10,144,626.82
3 Other receipts	47,380,620.16
	8,061,190,721.59

Appendix to the profit and loss account

	DM
1 Profit for the year	3,793,264,685.14
2 Balancing item brought forward from 1978 in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — loss brought forward —	9,553,100,875.21
3 Accumulated loss	5,759,836,190.07

Frankfurt am Main, February 6, 1980

Deutsche Bundesbank
The Directorate
Pöhl Dr. Schlesinger
Dr. Emde Dr. Gleske Prof. Dr. Köhler Werthmöller

According to the audit which we have duly carried out, the bookkeeping and annual accounts comply with German law and the Bank's by-laws.

Frankfurt am Main, March 7, 1980

Treuarbeit Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr. Scholz, Certified Auditor — Dr. Haufschild, Certified Auditor

Dr. Wollert — Dr. Elmendorff KG
Wirtschaftsprüfungsgesellschaft

Thoennes, Certified Auditor — Dr. Geuer, Certified Auditor

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