# Report of the Deutsche Bundesbank

# for the Year 1975

**Members of the Central Bank Council of the Deutsche Bundesbank in the accounting year 1975**

Dr. Karl Klasen, Chairman of the Central Bank Council
Dr. Otmar Emminger, Deputy Chairman of the Central Bank Council
Prof. Fritz Duppré
Dr. Hans Georg Emde
Ernst Fessler
Dr. Leonhard Gleske
Dr. Rolf Gocht (until March 31, 1975)
Werner Gust
Dr. Alfred Härtl
Hans Hermsdorf
Dr. Heinrich Irmler
Prof. Dr. Claus Köhler
Werner Lucht
Wilhelm Rahmsdorf
Dr. Fritz Schiettinger
Dr. Helmut Schlesinger
Dr. Johann Baptist Schöllhorn
Dr. Paul Schütz
Johannes Tüngeler
Carl Wagenhöfer

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

Members in April 1976

**of the Directorate of the Deutsche Bundesbank**

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

Dr. Hans Georg Emde
Dr. Leonhard Gleske
Dr. Heinrich Irmler
Prof. Dr. Claus Köhler
Werner Lucht
Dr. Helmut Schlesinger

**of the Boards of Management of the Land Central Banks**

| | | |
|---|---|---|
| Baden-Württemberg | Dr. Fritz Schiettinger (until April 23, 1976) | President |
| | Prof. Dr. Norbert Kloten (from April 24, 1976) | President |
| | Dr. Volkhard Szagunn | Vice-President |
| | Walter Offner | |
| Bavaria | Carl Wagenhöfer | President |
| | Erich Küspert | Vice-President |
| | Kurt Wiesser | |
| Berlin | Werner Gust | President |
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| | Georg Lippert | Vice-President |
| Schleswig-Holstein | Dr. Johann Baptist Schöllhorn | President |
| | Heinz Ruppert | Vice-President |

**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 |

# Contents



The German original went to press on April 22, 1976

# Part A: General part

## The currency and the economy in 1975

# I. Economic trends and central bank policy



In 1975 the Deutsche Bundesbank directed its monetary policy towards bringing on the recovery of the economy and providing the monetary scope necessary for a new phase of economic growth. At the same time further progress was to be made towards achieving stability; during the recession and the initial stage of the upswing there was in any case some prospect of accomplishing this. To make the envisaged course of monetary policy clear at an early date to all those involved in economic activity, the Bundesbank formulated a quantitative target for an appropriate expansion of central bank money shortly before 1975 began. In order to attain this target, which is of course only an intermediate objective on the way to the ultimate goal of economic recovery accompanied by advances in stabilising prices, the Bundesbank lowered its interest rates in several steps in relatively rapid succession during 1975, and this, together with measures to enlarge bank liquidity, encouraged a general reduction in interest rates. This paved the way in monetary terms for an increase in the domestic demand for credit and thus eventually for goods and services too. At first the public sector made most use of the more plentiful and cheaper supply of credit. The high government deficits thus acted as a stimulus to private domestic demand as well.

The coordinated reflationary measures of the Federal Government and the Bundesbank were not unsuccessful. This is shown by the fact that the recession tailed off in mid-1975 and the business climate improved, at first gradually but in the end along a broad front. In 1975, at the beginning of which production had widely been cut back sharply and unemployment had risen fast, progress was therefore made after all – contrary to some apprehensions – towards a new economic upswing. Near the end of that year and early in 1976 production increased steeply again in many sectors and the greater part of the preceding decline in output was made good. On the labour market the situation did not deteriorate any further, but the fact that enterprises were initially able to step up production without engaging additional manpower was an obstacle to a general improvement. For these and other reasons more of a structural nature, the reduction in unemployment was slow to get under way.

Substantial advances were made in 1975 in the further curbing of inflationary tendencies, even though the goal of price stability was by no means reached. However, the year-on-year rate of inflation, as measured by the cost of living index, was lowered to 5½ %, and in the last few months before this Report went to press price increases (seasonally adjusted and expressed as an annual rate) were distinctly smaller still. At the other stages of production the slowdown in the pace of price rises was even greater on cyclical grounds; this applies, for instance, to industrial producer prices and construction prices. At first this process of price containment was accompanied by a further decline in profits, but then production costs also moderated – to an increasing extent, in fact, as time went by. The first wage increases agreed in the new year were within limits, so that it will be possible to offset a substantial part of them by the regular improvement in productivity.

Foreign trade and payments presented a fairly balanced picture in 1975. The extreme surplus position which Germany had previously had on current account was virtually eliminated, and the remaining surpluses could be financed via capital transactions without difficulty and without much Bundesbank intervention in the exchange market. Thus with the slackening of inflation and the better payments balance distinct progress was made during 1975 with respect to two points of the "magic quadrangle" of macro-economic goals. With regard to the steadying of economic growth and an appropriate utilisation of productive capacity initial successes were likewise scored after the severe setback in 1974 and the first half of 1975. Considering that economic developments are never completely uniform and that major structural changes had to be coped with, these results may be regarded as satisfactory. To the extent that the price and cost inflation has already been curbed, and must be curbed still further, a dependable basis has been laid for an early increase in employment and a reduction in unemployment. At all events, in 1976 the monetary policy of the Bundesbank will once again be directed – as stated when announcing the monetary growth target for this year – towards ensuring that economic growth can continue at as steady a rate as possible, while at the same time further advances are made in the fight against inflation.

### 1. The economic situation at the turn of 1974/75

Cuts in production and decreasing capacity utilisation at the beginning of the year

At the beginning of 1975 the economy of the Federal Republic of Germany was in a pronounced downswing. Industrial production was cut back sharply; around the middle of 1975 it was no larger than the average of 1970. The slowdown was even more marked in the construction industry. The net value added also declined in other economic sectors, particularly in transportation and distribution. In the first half of 1975 the real gross national product – as an indicator of the overall output of the economy – was 5 % lower than a year earlier. The cuts in production were accompanied by decreasing capacity utilisation. According to the Ifo Institute fixed capacities in industry were only about 75 % utilised in the spring of 1975, seasonally adjusted, compared with 83½ % a year before and 85½ % on a multi-year average (1966/74). The trend of capacity utilisation in the construction industry was more unfavourable still: even though plant capacities were reduced considerably under the pressure of circumstances (not least because of the numerous insolvencies), the degree of utilisation fell to 51 %, seasonally adjusted, which must be rated extremely low even if allowance is made for the fact that capacity utilisation in construction is always below that in stationary industry. As the utilisation of fixed capacities decreased, costs per unit of output rose. Enterprises endeavoured to ease the additional cost pressure by rationalising and disposing of less efficient plant, but the possibilities for such measures were rather limited, at least in the short run.

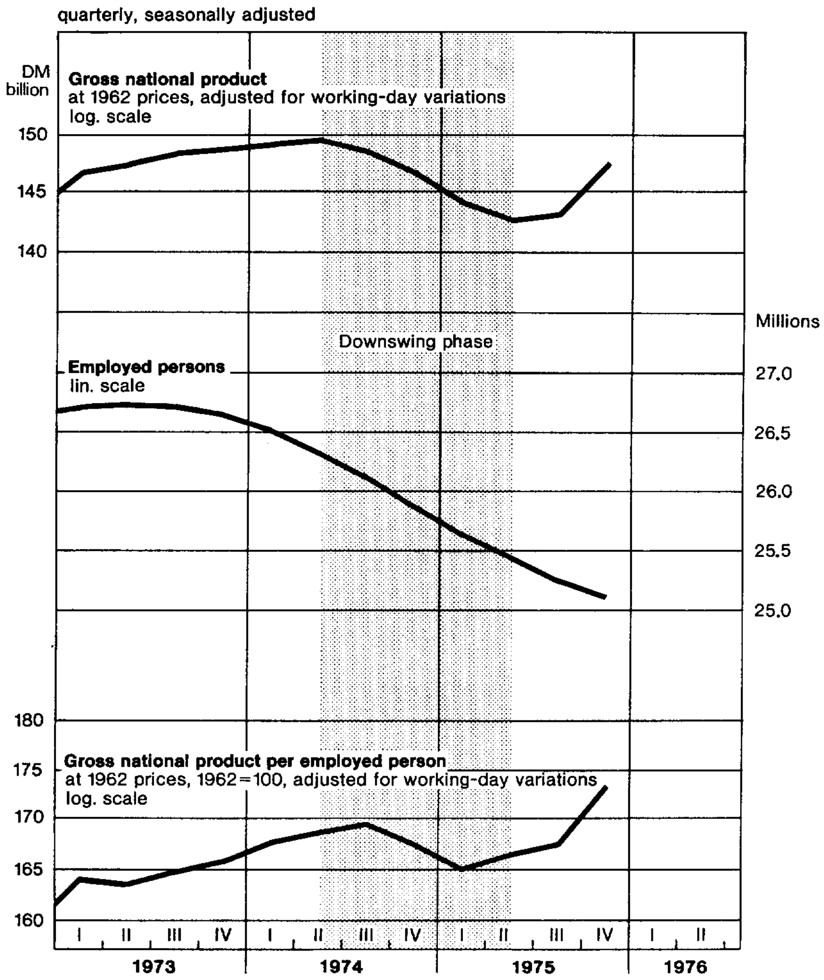
Adjustment of employment to the lower level of production

Enterprises thus felt all the more obliged to cut their variable costs, particularly their personnel costs. They introduced short-time working or dismissed staff. In the first quarter of 1975 the number of persons employed in industry and construction was about 650,000 smaller than a year before. The craft and distributive trades also released labour. Only in some service industries and in the public sector was additional staff engaged on balance in order to fill gaps which in some cases had existed for several years. Altogether the number of employees fell by 760,000 or 3½ % in that period. However, among those who stopped work there were some older employees who drew their old age pensions, women who no longer wanted to go to work, and foreigners, fairly many of whom returned to their home countries. The number of unemployed persons therefore did not increase to the same extent; even so, it went up sharply and exceeded the one million mark at the beginning of 1975, for the first time since the late fifties. On an average 1,070,000 persons were registered as unemployed in 1975, or 4.7 % of the dependent labour force compared with 2.6 % in 1974. At the same time the average number of short-time workers rose from 290,000 in 1974 to 770,000 in 1975.

Declining earning power of enterprises accentuates the economic setback

The sudden downturn of production and employment at the beginning of last year undoubtedly had several causes. Some of them certainly conformed to the pattern of earlier cycles. However, the long duration and severity of the economic setback were mainly attributable to the fact that particular elements of weakness in the domestic economy coincided with a decrease in foreign demand which, though not fully contemporaneous, took place only shortly afterwards. Chief among the domestic elements of weakness was the decline in the earning power of many enterprises, which increasingly curtailed enterprises' scope for self-financing and their willingness to invest. Enterprises' incomes had been under pressure from three sides for some years: first, enterprises had been unable to resist the demands made by employees regarding the redistribution of incomes; second, they had had to accept an exceptionally large increase in the prices of imported primary products, especially after the oil crisis; and last, the tendency of public authorities to enlarge their share in incomes had been partly at the expense of enterprises. As a result, entrepreneurial income after deduction of taxes and other levies grew by only 9½ % between 1971 and 1974, and in real terms it fell by 14 %, whereas households' net income from wages and salaries and from pensions and assistance grants rose in the same period by 47½ % at current prices and 16 % at constant prices.

## National product, employment and productivity



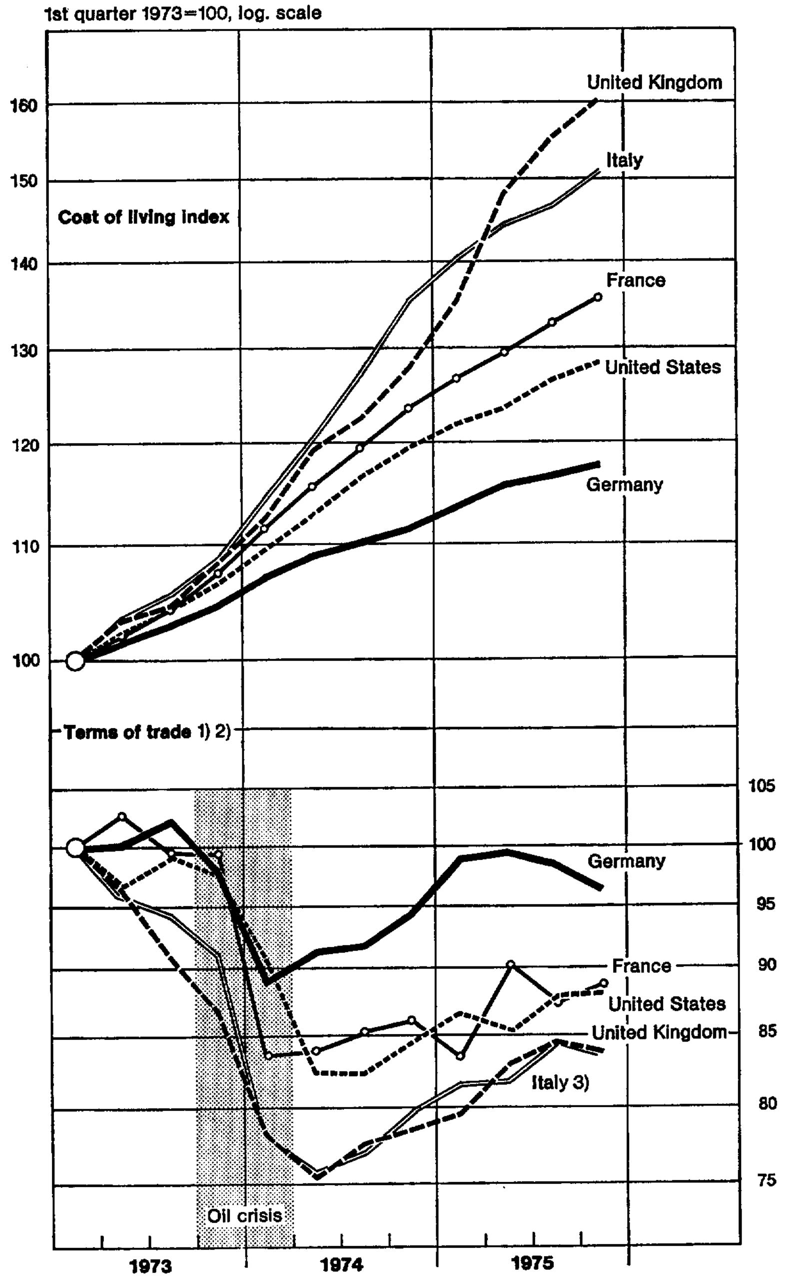

The unfavourable trend of profits left a distinct mark on the annual accounts of enterprises. According to the extrapolated results of consolidated annual accounts submitted to the Bundesbank by enterprises of all forms of organisation, the annual surplus in 1974 was equivalent to only about 2 % of sales against 3½ % in 1970. Under these circumstances the scope for self-financing decreased on the one hand, while the inclination to invest funds in enterprises, accepting all concomitant risks, diminished on the other. The capital base of enterprises deteriorated accordingly; whereas in 1970 capital and reserves had been equal to about 26 % of the balance sheet total, in 1974 this ratio fell to 24 %. It is not surprising that under these more difficult earnings conditions the business community's propensity to invest declined. Calculated at constant prices, total business spending on plant and stocks in 1974 was even smaller than in 1970; the share of such spending in the overall real gross national product went down in this period from 29 % to only 23½ %. In the last two years aggregate production potential has therefore risen less than previously, namely by only 2 % to 2½ % per year compared with about 5 % per year at the beginning of this decade. The weakness in enterprises' propensity to invest can thus be traced back some while.

Profits squeeze weakens enterprises' capital base

In addition, the starting conditions for 1975 were complicated by the fact that the construction industry had not yet escaped from the critical situation in which it found itself in 1973/74 after the collapse of construction speculation. Although demand for construction work picked up somewhat in the course of 1974, the adjustment of output — particularly housing output — to the lower level of demand was not completed in that year. Furthermore, the considerable number of new

More difficult starting conditions owing to the crisis in the construction industry . .

**Level of inflation and terms of trade in selected countries**




1) Index of unit values of exports as a percentage of index of unit values of imports.-
2) Rising curve: improvement in the terms of trade; falling curve: deterioration.-
3) Average of October/November.

dwellings which could not be let or sold and the large amount of new office space depressed the market; many construction and property development companies finally proved to be too weak to bear the increased financial responsibilities this entailed. The effects of the construction crisis naturally extended far beyond the construction industry in the stricter sense. They also weighed very heavily on other closely associated industrial sectors, such as the building materials industry and parts of mechanical engineering as well as some sectors of the textile and furniture industries.

... and the decline in foreign demand

The situation of the domestic economy was thus unstable and beset with structural problems; in addition, from the autumn of 1974 onwards exports declined under the impact of the world-wide recession. Between their peak in the middle of 1974 and the spring of 1975 export orders received by German industry went down by about one fifth (seasonally adjusted) both in value and in volume. Exports followed the fall in demand with a short time lag. In the third quarter of 1975 they were 8 % smaller than a year previously. In contrast to earlier downswings, the slackening of domestic demand was not offset by higher foreign demand; the cyclical downward slide of production and employment in Germany could at first not be halted.

"Stability-oriented economic policy" — a cause of the recession?

On several occasions the economic policy-makers have been blamed for having caused the recession themselves by their stability-oriented course in 1973 and at the beginning of 1974, or for having acted too late and too timidly to counter the downswing. In the circumstances, however, not even earlier or more massive resort to an expansionary policy in Germany could have done more than delay the downswing; it could not have prevented it, as shown not least by the example of those countries which adopted such a stance. In the absence of a stabilisation policy the exaggerated expectations both about the scope available for passing on cost increases to customers and about wage rises would have been preserved, and a return to more price stability would have been deferred to the distant future. Nevertheless, real adjustment in Germany to the new conditions prevailing in the world economy, and particularly to the fact that owing to the higher oil prices a much larger part of domestic production has to be transferred abroad and domestic incomes have to be reduced accordingly, would have been unavoidable. Countries which tried to evade this correction of their income distribution and production structure only postponed the problem, and at the same time they had to contend with rising inflation rates at home, persistent deficits in their balances of payments and in some cases the depreciation of their currencies. In the event of such delays the overall costs of this adjustment process were ultimately much higher than in the Federal Republic of Germany and other countries which accepted the domestic consequences of the new conditions on world markets and were thus able in the external field to respond quickly to the opportunities afforded by trade with the oil-producing countries and at home to counteract a decline in demand without having to fear that this would lead to a new flare-up of inflation.

## 2. Central bank policy in the service of economic stabilisation

Announcement of a monetary growth target

In the cyclical conditions prevailing at the end of 1974 and the beginning of 1975, which were unique in many respects, the Bundesbank also broke new ground in the field of monetary policy by announcing for the first time a quantitative target for its policy. In December 1974 it published a decision of the Central Bank Council stating that "from the present viewpoint" it considered "a growth rate of about 8 % in central bank money during the year 1975 justifiable in the light of the aims of stabilisation policy". In 1974 central bank money had grown by only about 6 %. The formulation of this target suggested that the Bundesbank meant to continue the policy of monetary relaxation which it had adopted in the autumn of 1974. An acceleration of monetary growth was intended to stimulate demand and provide the monetary scope necessary for the desired real growth of the economy. On the other hand, the target rate was also intended to show that no precipitate action would be taken to ease monetary conditions, in order not to jeopardise further progress towards containing the inflationary tendencies. The announcement of a monetary growth target met with widespread approval among the general public. It was regarded as a promising experiment in preventing developments from taking a wrong course, which might happen if those involved in the economic process have misconceptions about future monetary policy, as they may have had in 1974.

(a) Measures to control monetary expansion

Lowering of interest rates in several steps . . .

In order to bring monetary growth on to the desired path and thus eventually to stimulate economic activity the Bundesbank lowered its interest rates in several steps and extended the banks' liquidity margin considerably. As early as October and December 1974 the Bundesbank reduced the discount rate and the lombard rate — which since mid-1973 had remained unchanged at 7 % and 9 % respectively — by ½ % each. At that time, however, interest rates were already long past their peak. This was not reflected in the discount and lombard rates because between mid-1973 and mid-1974, when the rediscount quotas had been fairly fully utilised and normal lombard credit had been suspended, these rates had lost touch with money market rates. The banks' marginal needs of central bank money had been met by the Bundesbank through other channels and at substantially higher rates – up to 16 % – during that period. These rates were lowered step by step in 1974; the interest rate level in the money market fell accordingly until from mid-1974 onwards the rate for lombard credit, which had been reintroduced, once more determined the day-to-day money rate. The latter dropped further between October and December 1974, in tune with the two cuts in the discount and lombard rates. In the first half of 1975 the discount rate was reduced three more times by ½ % on each occasion to 4½ %, and the lombard rate was lowered four times by 2½ % altogether to 5½ %. The fall in the level of short-term interest rates was roughly equal to the reduction in the lombard rate.

... and liquidity policy measures to stimulate monetary expansion

The measures taken to ease liquidity conditions were no less marked. In October 1974, when the discount and lombard rates were lowered for the first time, the banks had no free liquid reserves of note – as indeed since the spring of 1973. In other words, they had hardly any promises of central bank credit or assets which the central bank would have been obliged to purchase. This situation changed when simultaneously with the October 1974 cut in the discount rate the Bundesbank raised the rediscount quotas by DM 2.5 billion, even though foreign exchange was flowing to the central bank and liquidity was increasing as a result of movements in the public authorities' central bank balances. The banks' liquidity position eased on account of these influences. Free liquid reserves accumulated fairly quickly at the banks once more. As early as February 1975 they reached just on DM 10 billion, a level below which they did not fall substantially later on and which they eventually exceeded to a growing extent. In January 1975 the Bundesbank raised the rediscount quotas by a further DM 2.5 billion until the end of March. With effect from June 1 the minimum reserve ratios on domestic liabilities were reduced by 5 %, which represented a further release of some DM 2 billion of liquidity.

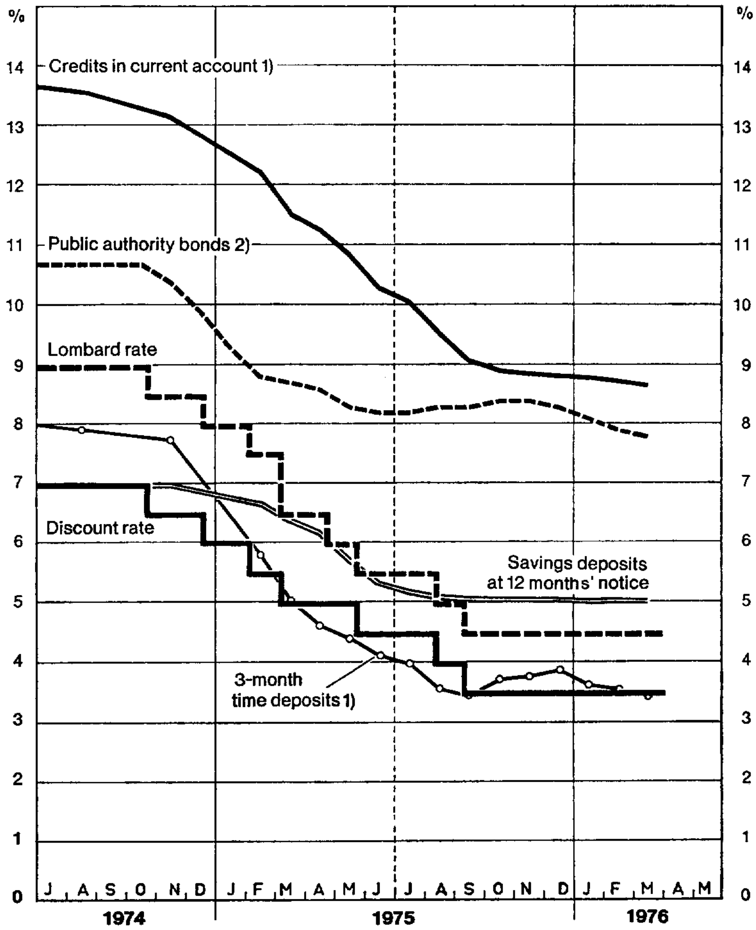
Review of the monetary situation at mid-year

Around the middle of 1975 the Bundesbank was unable to detect any major expansionary effect in spite of the numerous measures it had taken. In December 1974 and January 1975 the growth of central bank money, which had hitherto been moderate, accelerated considerably, it is true, but this was attributable to short-term influences only and was not a reaction to the measures adopted shortly before to ease monetary conditions. Between February 1975 and mid-year the growth of central bank money was sluggish and uneven; the rise in the required reserves lagged behind that in currency in circulation. In the first half of the year central bank money increased by 6.6 %, seasonally adjusted and expressed as an annual rate. Monetary expansion as reflected in the movement of central bank money was thus undoubtedly small up to then and out of line with the Bundesbank's objectives. The slow monetary growth and cyclical trends strongly implied that the recession was not as yet overcome. In the security market, on the other hand, the interest rate, which had fallen from 10.9 % to 8.4 % within eight months, was threatening to rise again for wholly non-cyclical reasons.

Easing of monetary conditions continues

In the circumstances the Bundesbank saw no alternative but to intensify its measures to ease monetary conditions. It lowered its interest rates in two further steps by ½ % each. From mid-September onwards the discount and the lombard rates, at 3½ % and 4½ % respectively, were precisely half as high as a year before. In order to bring money market rates down even further than was possible by reducing the discount and lombard rates alone, the Bundesbank resumed its open market operations by taking up bills subject to an agreement that they were to be repurchased after ten days, at a rate which was identical with the discount rate. This additional central bank credit facility, which allowed the banks greater flexibility than the normal rediscounting procedure without their having to pay the higher lombard rate, in practice conserved the banks' free liquid reserves (in the main the free rediscount quotas). The day-to-day money rate only occasionally approached the level of the lombard rate. The Bundesbank also lowered all minimum reserve ratios by 10 % in July (releasing over DM 4 billion) and in August adjusted the reserve ratios on foreign liabilities to conform substantially to those on domestic liabilities (releasing about DM 1.5 billion). In addition, with effect from October 1 the rediscount quotas were raised by DM 3 bil-

**Movement of interest rates since mid-1974**




1) Of less than DM 1 million.- 2) Yield on bonds outstanding.

lion. Finally – and this was the most significant factor in quantitative terms – the Bundesbank decided, as it had done once before under similar circumstances in 1967, to purchase long-term securities of the Federal Government and the Federal special funds in the open market as part of its liquidity policy. This decision was taken at a time when the expectations of falling interest rates in the bond market, which had resulted in an exceptionally large amount being raised in the market in the first half of the year, had disappeared and pronounced pessimism about the movement of interest rates was spreading, primarily because of new prospects regarding the size of the government deficits and the fact that the inflation rates were temporarily tending to rise. Between end-June and end-October, when the Bundesbank discontinued its open market purchases, it provided the banks with about DM 7.5 billion of liquid funds in this way. However, the banks' free liquid reserves did not rise as steeply as might be supposed from this list of liquidity policy measures. By the autumn of 1975 they had increased to almost DM 16 billion. For one thing, the exchange transactions of the Bundesbank during that period tended to reduce liquidity, for another the public authorities' cash transactions at times also withdrew liquidity from banks.

Rapid acceleration of monetary expansion

In line with the renewed increase in bank liquidity, overall monetary expansion also gathered pace and caused the banks' demand for central bank money to rise sharply. As early as July and August the growth of central bank money was faster than the average increase in the first half of the year. But in the last four months of last year central bank money grew so considerably that the expansion in the second half of the year – seasonally adjusted and expressed as an annual

## Monetary trends

**Change during period 1**

| Item | 1972 | 1973 | 1974 Total | 1974 1st half | 1974 2nd half | 1975 Total | 1975 1st half | 1975 2nd half |
|---|---|---|---|---|---|---|---|---|
| **A. Creation of central bank money and banks' free liquid reserves 2** | Unadjusted, in billions of Deutsche Mark | | | | | | | |
| 1. Net external position of Bundesbank | + 16.9 | + 27.2 | — 2.8 | + 2.5 | — 5.4 | — 2.1 | + 1.1 | — 3.2 |
| 2. Net balances of central and regional authorities (increase: —) | + 3.0 | — 1.1 | — 3.0 | — 4.3 | + 1.4 | + 1.7 | + 2.1 | — 0.4 |
| 3. Changes in compulsory special reserves and rediscount quotas | — 14.6 | — 18.4 | + 16.7 | + 2.5 | + 14.2 | + 9.8 | + 1.6 | + 8.2 |
| 4. Open market transactions and lombard loans | — 2.1 | — 5.3 | + 0.5 | — 0.1 | + 0.6 | + 9.6 | + 0.1 | + 9.5 |
| 5. Unspecified determinants | — 0.2 | + 0.1 | — 4.0 | — 2.3 | — 1.7 | + 0.9 | — 0.2 | + 1.0 |
| Central bank money and free liquid reserves (1 to 5) | + 3.0 | + 2.5 | + 7.4 | — 1.7 | + 9.1 | + 19.9 | + 4.7 | + 15.1 |
| Central bank money **3** | + 10.4 | + 6.9 | + 5.8 | — 0.4 | + 6.2 | + 9.5 | + 0.1 | + 9.4 |
| Banks' free liquid reserves **4** | — 7.5 | — 4.4 | + 1.6 | — 1.3 | + 2.9 | + 10.4 | + 4.6 | + 5.8 |
| Memorandum item: | | | | | | | | |
| Level of free liquid reserves at end of period | 7.3 | 3.0 | 4.5 | 1.5 | 4.5 | 14.9 | 9.1 | 14.9 |
| **B. Money stock and its determinants** | | | | | | | | |
| 1. Lending by banks and Bundesbank to domestic non-banks | + 86.4 | + 67.5 | + 59.8 | + 23.2 | + 36.6 | + 85.5 | + 19.1 | + 66.4 |
| to | | | | | | | | |
| Enterprises and individuals | + 78.2 | + 54.6 | + 41.0 | + 19.3 | + 21.7 | + 34.7 | + 4.9 | + 29.9 |
| Public authorities | + 8.3 | + 13.0 | + 18.7 | + 3.9 | + 14.9 | + 50.8 | + 14.2 | + 36.6 |
| 2. Net external claims of banks and Bundesbank | + 8.7 | + 23.5 | + 13.2 | + 5.4 | + 7.8 | + 16.8 | + 13.6 | + 3.2 |
| 3. Monetary capital formation with banks from domestic sources | + 60.6 | + 47.7 | + 56.0 | + 16.4 | + 39.6 | + 100.2 | + 49.1 | + 51.0 |
| 4. Unspecified determinants | + 10.0 | + 11.4 | + 3.3 | + 15.9 | — 12.5 | + 2.6 | + 8.3 | — 5.7 |
| Money stock and quasi-money (= $M_2$) (1 plus 2 less 3 plus 4) | + 33.5 | + 31.9 | + 13.7 | — 3.6 | + 17.3 | — 0.4 | — 24.8 | + 24.4 |
| Currency in circulation and sight deposits (= $M_1$) | + 17.5 | + 2.6 | + 15.5 | — 2.1 | + 17.6 | + 21.4 | + 2.2 | + 19.2 |
| Time deposits for less than 4 years (= quasi-money) | + 16.0 | + 29.4 | — 1.8 | — 1.5 | — 0.3 | — 21.8 | — 26.9 | + 5.2 |
| Memorandum item: | | | | | | | | |
| $M_2$ plus savings deposits at statutory notice (= $M_3$) | + 47.1 | + 34.0 | + 35.2 | + 1.1 | + 34.1 | + 38.4 | — 8.6 | + 47.0 |
| **C. Principal monetary indicators** | Seasonally adjusted, in % 5 | | | | | | | |
| Central bank money **2, 6** | + 13.6 | + 7.9 | + 6.2 | + 5.2 | + 7.2 | + 10.1 | + 6.6 | + 13.6 |
| $M_3$ (= $M_2$ plus savings deposits at statutory notice) | + 14.3 | + 9.0 | + 8.5 | + 8.2 | + 8.5 | + 8.5 | + 3.4 | + 13.8 |
| $M_2$ (= money stock and quasi-money) | + 16.9 | + 13.7 | + 5.1 | + 7.0 | + 2.8 | — 0.1 | — 8.7 | + 8.6 |
| $M_1$ (= currency in circulation and sight deposits) | + 14.4 | + 1.8 | + 10.8 | + 6.4 | + 15.2 | + 13.5 | + 12.9 | + 14.0 |
| Lending by banks and Bundesbank to domestic non-banks | + 14.5 | + 9.9 | + 7.9 | + 8.4 | + 7.5 | + 10.5 | + 7.0 | + 14.2 |
| Monetary capital formation with banks from domestic sources | + 13.7 | + 9.4 | + 9.9 | + 7.0 | + 12.9 | + 16.1 | + 17.3 | + 14.9 |

**1** Unless otherwise indicated based on end-of-month figures. — **2** Calculated from daily averages of the months. — **3** Currency in circulation and required reserves on banks' domestic liabilities. — **4** Excess balances, domestic money market paper and unused rediscount quotas. — **5** Half-yearly changes expressed as an annual rate. — **6** Reserve component calculated at constant reserve ratios (base: January 1974). Discrepancies in the totals are due to rounding.

rate – eventually amounted to as much as 13.6 %. The target set – 8 % in the course of the year – was thus not only reached but in the end appreciably exceeded; in December 1975 central bank money was 10 % higher than in December 1974. While in the first half of the year currency in circulation had risen more rapidly than the required reserves calculated at constant reserve ratios, in the second half of the year this faster increase was fully offset; over the year as a whole the growth rates of the two components were identical.

(b) Experience with the monetary growth target

Target for year-on-year growth and target for average annual growth

The fact that the target was exceeded in 1975 shows that it may not be possible to control monetary expansion in quantitative terms as precisely as is perhaps suggested by the formulation chosen for the target. The rise of 10 % – rather than 8 % as envisaged – in central bank money between end-1974 and end-1975 was entirely due to the acceleration in the last quarter, whereas the average growth in the first nine months had been 8 % (annual rate). Over short periods such as one year monetary expansion is not completely steady; marked fluctuations can at times play an important role. Thus the massive government borrowing from banks during a few months was undoubtedly largely responsible for the exceptionally strong increase in central bank money towards the end of 1975. From December 1975 onwards, when the public authorities realised that their deficits would not be as great as initially expected so that they were able to reduce their borrowing, monetary expansion – as measured by the various definitions of the money stock and also by central bank money – slowed down distinctly again. In other words: the steep rise in central bank money that results from comparing December 1975 with December 1974 owed a not inconsiderable amount to temporary influences and overstated the underlying trend of monetary expansion in 1975.

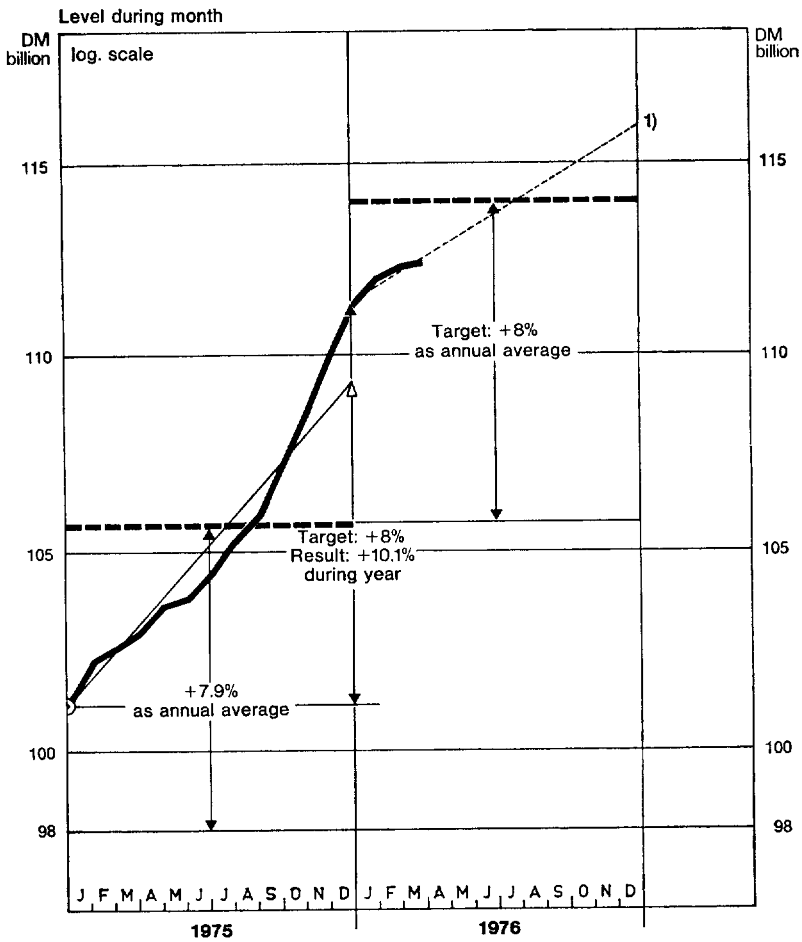
On the basis of this experience the Bundesbank decided, when setting a new target for 1976, to choose the average increase during 1976 as the target rather than the growth in the course of the year. This will better cancel out chance fluctuations; in particular, movements at the end of the period which can hardly be influenced any more by monetary policy will carry less weight. Taking the average of 1975, for example, central bank money was only 7.9 % greater than the average of 1974 in spite of the acceleration in the closing months of 1975. In December 1975 the Deutsche Bundesbank announced that it intends to control monetary expansion in such a way that, on an annual average, central bank money in 1976 will be about 8 % larger than in 1975. In December 1975 central bank money was already 5.4 % above the 1975 average, so that its growth in the course of 1976 will have to be kept within very narrow limits if this target is not to be exceeded. However, a target for the average increase during the year cannot be converted into a target for the growth in the course of the year without making assumptions about the movement of central bank money during this year. Broadly speaking, the slower growth is in the first few months of the year, the faster it must be in the later part of the year to conform to the average increase target, and vice versa. In fact, between January and March 1976 the growth in central bank money slackened substantially, as already noted (to an annual rate of about 4 %); but if the target of an average increase of 8 % during the year, as formulated in December 1975 on the basis of the assessment of future developments at that time, is to be achieved, monetary expansion must not become much greater in the following months.

Was it right to abide by the original target in 1975?

The practical application for the first time of a publicised quantitative monetary target, the thinking behind which was, as mentioned, well understood by the general public, gave rise to some questions and also to some misunderstandings. It was widely believed, for example, that the Bundesbank should have altered its monetary target of 8 % – which corresponded to the nominal increase in the gross national product envisaged in the Federal Government's annual projection – when it turned out that the nominal gross national product would grow less steeply and the real national product was even going to decline. But the Bundesbank had pointed out in its decision of December 5, 1974 "that in the short run there is no close connection between the movement of the national product and that of central bank money". The relationship of central bank money – like that of the other defi-

## Increase in central bank money

**Target and movement to date***




* Seasonally adjusted, at constant reserve ratios (base: January 1974).- 1) Along this path the average target would be reached at a constant growth rate.

nitions of the money stock – to the nominal gross national product is subject to procyclical fluctuations. In other words: during an upswing the national product rises faster than the money stock – put simply, though not quite correctly as regards "central bank money", one could also say that the "velocity of circulation" increases – and the opposite occurs during a downswing. In 1975, when the nominal gross national product grew only a little and thus fell considerably short of expectations while central bank money – as noted – expanded quite strongly, the overall money supply was therefore by no means excessive. A substantial part of the additional money supply was "tied up" by the fact that the liquidity needs of enterprises and individuals increase during a recession on grounds of prudence, so that the "velocity of circulation" slows down accordingly. By adjusting its monetary growth target downwards in these circumstances the Bundesbank would have intensified the recession.

In setting a monetary growth target the Bundesbank was mainly guided by the following variables: the growth of the production potential, the change in the utilisation of the production potential, the rate of "unavoidable" price rises and the change in the "velocity of circulation". Of these four variables, two – the utilisation of the production potential and the "velocity of circulation" – are equally dependent on cyclical conditions. It can therefore be assumed that the utilisation of the production potential and the "velocity of circulation" both change in the same direction and that there is a relatively great probability of such changes continuing to run fairly parallel in future. Hence two components are particularly important in determining the target: the growth of the production potential and the rate of "unavoidable" price rises. Wrong estimates of the utilisation of the production potential and the "velocity of circulation" may roughly balance out. The disappointing performance of the economy in 1975 – clearly reflected in the decline in the real national product despite the further growth of productive capacities – was therefore not a reason for adjusting the monetary target. These reservations apply equally, although in some cases in reverse, to 1976. The fact that the real national product is likely to grow more than the production potential in 1976 need not necessarily give rise to a greater expansion of the money supply than planned, for the "velocity of circulation" will probably increase as well. But this question will certainly have to be reviewed after some time. On the other hand, if the national product grew more steeply than originally assumed entirely because of sharper price rises, this would not be a reason for an upward revision of the monetary growth target.

Central bank money as the target

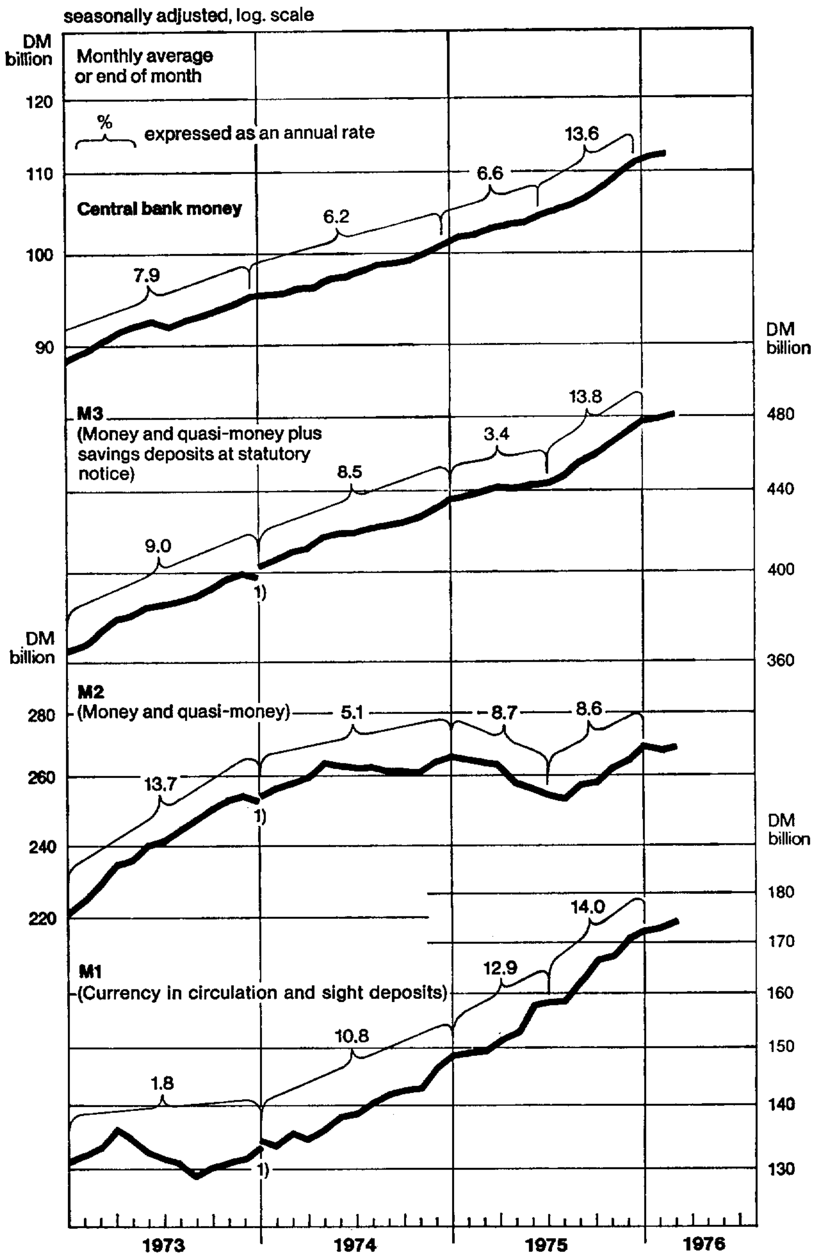
A second aspect of the Bundesbank's monetary policy which was not always easily understood related to the fact that central bank money was chosen as the target rather than one of the more familiar definitions of the money stock, viz. $M_1$ (currency in circulation and sight deposits) or $M_2$ ($M_1$ plus time deposits for less than four years). The reason for this was that neither of these aggregates met as fully as central bank money all the requirements which a target has to satisfy: (1) it must be sufficiently controllable by the central bank; (2) it must accurately reflect the underlying monetary trend; and (3) it must be closely related to economic developments. As regards the latter criterion, all the definitions are more or less suitable depending on the approach chosen. But in recent years the interest-induced shifts between sight and savings deposits on the one hand and time deposits on the other have assumed proportions which in the case of $M_1$ and $M_2$ have completely obscured the underlying monetary trend. The Bundesbank would presumably not only have been incapable of keeping either of these aggregates roughly on the envisaged growth path, it would also have been unable to be certain that by pursuing such a policy it was contributing its share to the satisfactory overall development of the economy. Since mid-1973 $M_1$ and $M_2$ have been moving in opposite directions almost continuously. In 1975 $M_1$ grew by just on 14 % with only minor fluctuations in the course of the year, whereas $M_2$ declined by 9 % (annual rate) in the first half of the year and increased by almost the same rate in the second half, so that as a whole it fell insignificantly in 1975. Judging by $M_1$, it would seem that the Bundesbank has been allowing a great inflation potential to develop for the last one and a half years, while on the basis of $M_2$ its reflationary policy would appear to have been too weak. As long as there are such wide divergences in trends it would be irresponsible to let the course of monetary policy be guided by either of these definitions alone.

Correspondence between central bank money and $M_3$ tends to be close

In formulating a monetary growth target only a broad money stock definition such as $M_3$ ($M_2$ plus savings deposits at statutory notice), which very largely eliminates interest-induced shifts in deposits, or central bank money, which greatly reduces them, could be used. $M_3$, which has received more attention since movements in savings deposits also started to be influenced by interest rate differentials, and central bank money have the common feature that in addition to currency in circulation they include sight, time and savings deposits. But in the case of $M_3$ all these types of deposits and currency in circulation are simply added together, whereas in the case of central bank money the weight of the types of deposits depends on the reserve ratios, which are twice as high for sight deposits as for savings deposits. The ratios for time deposits lie between. This tends to take better account of the money-like character of these deposits than simple addition does. Central bank money must be rated superior to the other definitions as a monetary indicator also in terms of its statistical basis and its rapid availability.[1] However, central bank money is prone to distortions caused by special movements in currency in circulation, which carries very great weight in this aggregate. So far this has not significantly affected its usefulness as such special movements have always cancelled each other out quickly. As shown by the chart overleaf, $M_3$ and central bank money have moved largely in parallel in spite of the divergences

1 Central bank money is based, per month, on daily averages for the currency in circulation and on average bank liabilities calculated from the four bank week return dates for the required minimum reserves (which have to be maintained as daily averages), while the money stock figures are affected by chance influences at the end of the month. Moreover, the monthly figure for central bank money is available two to three days after the end of the month.

## Central bank money and money stock in various definitions




1) Change in credit cooperatives' reporting requirement.

mentioned: after a considerable acceleration in the second half of the year $M_3$ rose by 8½ % in 1975, and central bank money – as noted – by 10 %.

**The dual function of central bank money as an indicator of money creation**

Another reason why the choice of central bank money as the target commended itself particularly to the Bundesbank was that it brings out the central bank's responsibility for monetary expansion especially clearly. The money creation of the banking system as a whole and the money creation of the central bank are closely linked through currency in circulation and the banks' obligation to maintain a certain proportion of their deposits with the central bank. Central bank money, which comprises these two components, can therefore readily serve as an indicator of both. A rise by a certain rate in central bank money shows not only the size of the money creation of the banking system but also the extent to which the central bank has provided funds for the banks' money creation.

Practical control of the money stock

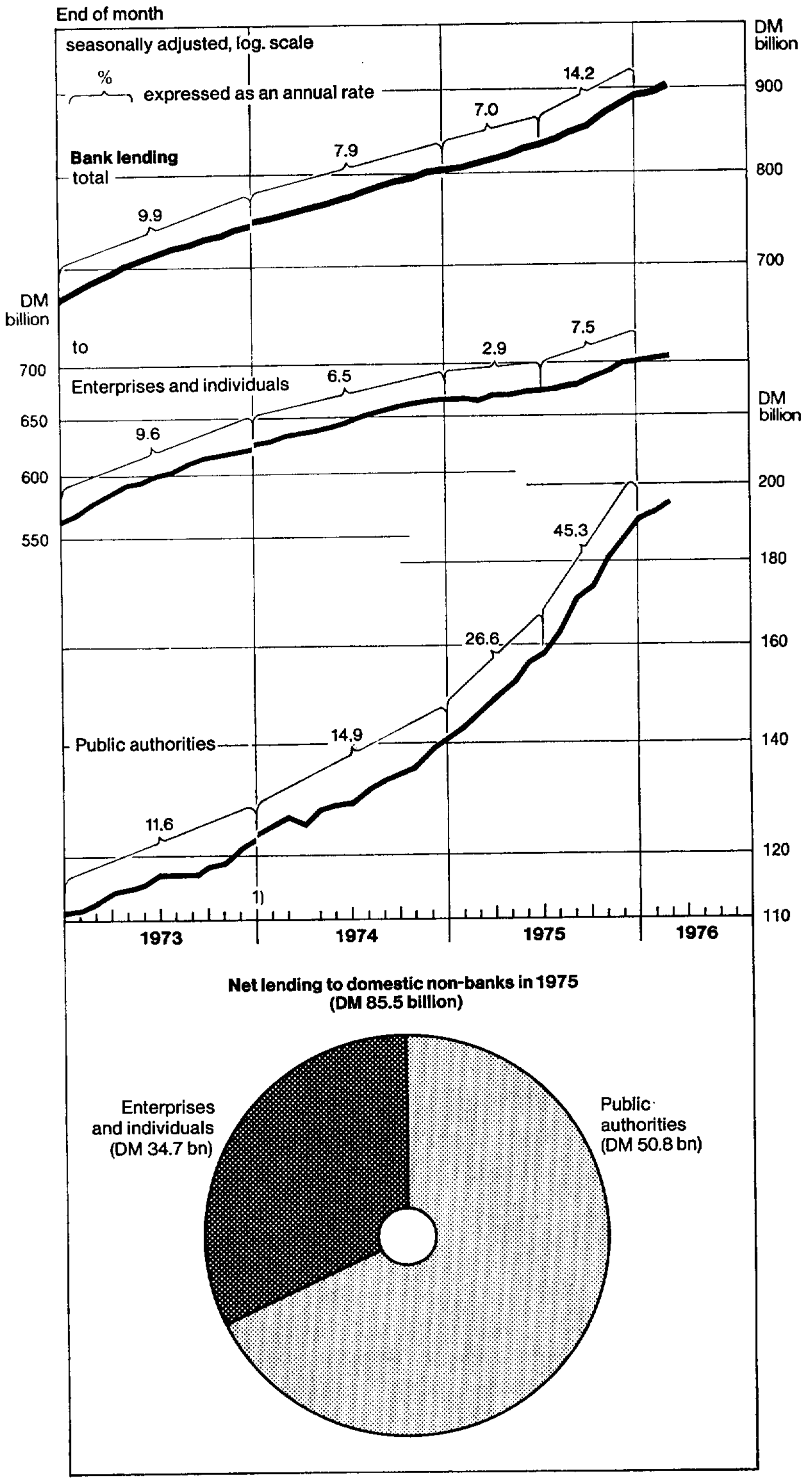
The selection of central bank money as the target is also open to certain misunderstandings inasmuch as it gave rise to some wrong ideas about the practical operation of monetary policy. In the light of the practice of some foreign central bank systems where the central bank cannot be induced by the banks to supply central bank money as directly as is possible in Germany within the framework of the Bundesbank's credit assurances, the view gained ground that the Bundesbank is able to manipulate central bank money at any time – i. e. even in the very short run – precisely in accordance with the longer-term target. It is open to doubt whether this actually is or could be the case in those countries which are often quoted as object lessons in this connection, like the United States. As far as Germany is concerned, at all events, it is necessary to distinguish between the short and the longer term. Over very short periods such as the span of one month within which the banks have to fulfil their minimum reserve requirements the demand for central bank money is a given quantity, and the Bundesbank can only decide how and at what price it will satisfy this demand unless it wants to make it impossible for the banks to meet their reserve requirements in full. In the very short run the Bundesbank has to provide the required central bank money even if this results in a major departure from its quantitative monetary target. In the somewhat longer term the situation is different. Since the Bundesbank determines the conditions on which central bank money is supplied – the central bank's interest rates, the scope for central bank credit, etc. – it forces the banks, by changing these conditions, to react in a similar way in their lending business, i. e. to be more liberal or more restrictive in granting new credit. This in turn influences the movement of the money supply and, in the form of currency in circulation and required minimum reserves, central bank money. It is perhaps self-evident – although it must be mentioned in view of occasional misapprehensions – that this process takes time. The success of central bank control of the money stock can therefore only be assessed over a fairly long period. Short-term deviations from the desired path are not serious as long as they do not point to an irreversible development. For these reasons the Bundesbank did not respond precipitately last year to discernible upward and downward deviations from the planned rate of monetary growth, and did not follow advice to this effect, such as to take deliberate measures to create excess reserves in order to augment the expansion of central bank money. Events have shown that the desired rate of expansion was reached comparatively quickly and that on past experience it is far more difficult to keep an expansion within the necessary limits once it has started.

### (c) Changes of emphasis in bank lending

Lending to public authorities the most important expansionary factor

Among the determinants of monetary expansion in 1975, lending to the public authorities was much the most important factor. Inclusive of lending by the Bundesbank and credit based on the acquisition of securities, the total volume of bank lending to domestic non-banks rose by DM 85 billion in 1975; this increase was over two fifths greater than that in 1974 (DM 60 billion) and was almost as large as in the boom year 1972 (DM 86 billion). It is characteristic of the special situation in the year under review, when the recession was being fought with fiscal means while the public budgets were heavily in deficit, that only the central, regional and local authorities needed more credit. Private credit demand in three quarters of 1975 was considerably smaller than in previous years. The rise in public credit demand, however, far more than offset this decline. This indicates that in a situation like that of 1975 monetary policy would have been unable to achieve a specific monetary growth without the help of fiscal policy. Under the prevailing circumstances, private credit demand responded to the comparatively swift improvement in credit terms only with a considerable time lag. In 1975 (mainly in the second half of the year) the Federal and Länder Governments and the local authorities took up about DM 51 billion of new credit from the banking system (including the Bundesbank), compared with DM 19 billion in 1974 and DM 13 billion in 1973. The steepest rise in absolute terms was in longer-term direct loans (DM 37 billion), a large part of which were granted out of funds raised in the bond market by the issuing institutions by selling communal bonds. In the year under review the banks also increased their holdings of Federal and Länder bonds by over DM 7 billion (including the open market purchases of such securities by the Bundesbank) and took up more than DM 5 billion of Treasury bills and discountable Treasury bonds

## Bank lending to domestic non-banks *




* Lending by banks and Bundesbank, including credit based on the acquisition of securities.- 1) Change in credit cooperatives' reporting requirement.

of domestic issuers. In the closing months of 1975 public sector borrowing soared; in the fourth quarter the central, regional and local authorities raised more than DM 21 billion from the banking system. Their borrowing coincided with a revival in private credit demand.

Private demand primarily for long-term credit

Bank lending to enterprises and individuals, which had been very moderate in the spring and summer of 1975, increased from the autumn onwards. In the fourth quarter of 1975 lending to the private sector alone rose by DM 23 billion and thus almost twice as fast as in the fourth quarter of 1974 (DM 12 billion). Thus of total lending by banks to domestic enterprises and individuals (including advances of the Bundesbank to the Federal Railways and the Federal Post Office) in 1975 (which amounted to DM 35 billion compared with DM 41 billion in 1974), two thirds was granted in the last quarter. Private demand for long-term credit picked up first. From March 1975 onwards the rise in such credit, taken by itself, was faster than in the same period of 1974. Over the whole of 1975 it went up by DM 43 billion or DM 17 billion more than in the previous year (DM 26 billion) whereas shorter-term lending to the business community in 1975, far from rising, decreased sharply for some time. Enterprises' short and medium-term liabilities to banks were apparently funded by means of long-term loans in many cases. "Manufacturing", i. e. industry in the stricter sense of the word, the service field, and "gas, electricity and water supply, mining" in the private sector of the economy, together with the Railways and the Post Office, took up considerably more long-term loans from banks in the period under review than in the year before. By contrast, residential construction on the whole received fewer funds than in previous years. However, in the year under review appreciably more housing mortgages than in 1974 were promised by the issuing institutions and the savings banks (DM 17 billion compared with DM 14 billion), so that loans for residential construction are also likely to increase more sharply again in the future.

Short and medium-term lending to the business community dropped by just over DM 10 billion in 1975, against a rise of DM 15 billion in 1974. Apart from the above-mentioned funding operations, the decline in shorter-term lending to the business community in the spring and the summer of 1975 was probably largely due to cyclical factors. The fact that demand for shorter-term credit picked up again towards the end of last year, parallel to the course of economic activity, shows how close this correlation is. However, in the first eight months of 1975 the effects of the heavy inflows of funds from abroad to domestic non-banks during that period were felt as well. To a large extent these inflows merely represented shifts in loans which had previously been extended by domestic banks and which were now being granted, at lower interest rates, by subsidiaries of German banks abroad, mainly in Luxembourg. The net external claims of the banking system (including the Bundesbank), the growth of which reflects the inflow of funds from abroad to non-banks as a result of loans and current transactions, rose by DM 16 billion between January and August 1975 compared with DM 3 billion in the same period of the year before. In the last four months of 1975, by contrast, they increased by only about DM 1 billion.

Wide divergences in lending by the various banking groups

The lending of some banking groups to domestic non-banks showed a number of different trends, at variance with past experience, which were primarily connected with the rapid expansion of public sector borrowing. This particularly benefited those groups of banks which traditionally engage in such transactions. The divergences in the expansion of lending also owed a great deal – as noted – to the sharp growth in German enterprises' borrowing from the foreign subsidiaries of German banks. Although this movement reversed in the last quarter, this did not alter the overall picture. The volume of "domestic" lending by the big banks – traditionally the principal lenders to the major private enterprises and indirectly also heavily involved in their foreign subsidiaries' lending to German customers – rose by only 8 % in 1975 and thus distinctly less than the average for all banks (10 %). The credit expansion of the other commercial banks was also below the average. The savings bank sector and the credit cooperatives more or less held their own in lending business. By contrast, the growth of lending by the mortgage banks was well above the average, at over 15 % (private mortgage banks: 18 %; public mortgage banks: 12 %). The public authorities accounted for almost 60 % of the steep rise in the medium and long-term loans granted by these banks (DM 21.6 billion), compared with no more than some 30 % in 1974. Total lending by instalment sales financing institutions grew relatively moderately in 1975 although consumer credit increased considerably from the second quarter onwards. The other non-specialised banks had a greater share in this type of lending than the specialised institutions.

**Lending to domestic non-banks, by banking group ***

| Banking group | Change during year 1973 DM bn | 1973 % | 1974 DM bn | 1974 % | 1975 DM bn | 1975 % | Level at end-1975 DM bn |
|---|---|---|---|---|---|---|---|
| Commercial banks | 10.1 | 6.2 | 10.3 | 5.9 | 12.4 | 6.7 | 196.9 |
| Big banks | 4.1 | 6.1 | 4.8 | 6.8 | 6.1 | 8.1 | 81.7 |
| Regional banks and other commercial banks | 5.5 | 7.4 | 4.2 | 5.2 | 5.7 | 6.7 | 90.6 |
| Branches of foreign banks | 0.9 | 10.8 | 0.8 | 8.7 | — 0.0 | — 0.3 | 10.0 |
| Private bankers | — 0.4 | — 3.0 | 0.5 | 3.8 | 0.6 | 4.1 | 14.7 |
| Savings bank sector | 31.3 | 11.6 | 24.0 | 8.0 | 30.9 | 9.5 | 356.6 |
| Central giro institutions 1 | 16.7 | 15.1 | 12.9 | 10.1 | 14.1 | 10.0 | 155.3 |
| Savings banks | 14.6 | 9.2 | 11.1 | 6.4 | 16.8 | 9.1 | 201.3 |
| Cooperative bank sector | 7.1 | 10.3 | 8.2 | 10.0 | 7.8 | 8.7 | 97.9 |
| Central institutions of credit cooperatives 2 | 0.6 | 7.4 | 3.8 | 41.5 | 0.9 | 6.9 | 13.8 |
| Credit cooperatives | 6.5 | 10.7 | 4.4 | 6.1 | 6.9 | 9.0 | 84.1 |
| Mortgage banks | 11.4 | 10.4 | 15.2 | 12.2 | 21.6 | 15.4 | 161.9 |
| Instalment sales financing institutions | 1.5 | 13.3 | 0.6 | 5.1 | 0.9 | 7.1 | 14.1 |
| Banks with special functions | 2.9 | 7.8 | 2.1 | 5.3 | 3.1 | 8.1 | 41.3 |
| Postal giro and postal savings bank offices | 0.9 | 7.8 | 0.8 | 7.1 | 2.2 | 17.2 | 14.9 |
| All banks | 65.2 | 9.7 | 61.2 | 8.2 | 78.9 | 9.8 | 883.6 |

* Including lending against Treasury bills, security holdings, equalisation and covering claims. — 1 Including Deutsche Girozentrale. — 2 Including Deutsche Genossenschaftskasse. Discrepancies in the totals are due to rounding.

Exceptionally large monetary capital formation

The strong expansionary impact of lending in 1975 was accompanied by exceptionally large monetary capital formation by customers at banks. In all, the banks received more than DM 100 billion of longer-term funds (excluding time deposits with maturities of less than four years, but including all savings deposits); this was about twice as much as in any of the four preceding years. Savings deposits increased most; in 1975 they went up by DM 65 billion, or DM 35 billion more than in the previous year. This very sharp rise in savings deposits was chiefly due to households' exceptionally great propensity to save in the first half of the year, when their saving ratio climbed to 17 %. The interest-induced shifts mentioned above were also significant, however. For example, the shorter-term time deposits (which are not included in "monetary capital formation") of employees dropped by about DM 11 billion to DM 7 billion in 1975; this group of depositors had placed considerable funds in time deposits, at the expense of savings deposits, for the first time in 1973, because the interest rates on savings deposits had followed the general uptrend of rates with a time lag, and in some cases only in less pronounced form. In the meantime time deposits have completely lost their interest rate advantage; in the second half of 1975 and in the initial months of 1976 some of the rates on time deposits were in fact perceptibly lower than those on savings deposits. This induced other groups of depositors as well to place financial assets in savings accounts. It need hardly be stressed that where the boundaries are so ill-defined the term "monetary capital formation" (i. e. excluding time deposits for up to four years but including all savings deposits) does not reflect the fact of the longer-term placing of funds with banks quite accurately.

(d) The bond market between extremes

Psychological influences in the bond market

In the bond market it was particularly evident last year that the functioning and productiveness of the market depend not only on quantitative factors such as ample bank liquidity, heavy saving, and attractive yields compared with other forms of investment, but also to a large extent on psychological influences. Expectations about the value of money and — in close connection with this — the movement of interest rates had a very strong favourable or unfavourable effect on the propensity to invest. In the first half of the year, when — not least as a result of further relaxations in the Bundesbank's interest rate and liquidity policy — the downward trend of interest rates in the capital market was widely expected to continue, there

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

**Billions of Deutsche Mark market value**

| Item | Year | Domestic bonds: Total 1 | Bank bonds | Industrial bonds | Public authority bonds | Foreign bonds 2 | All bonds |
|---|---|---|---|---|---|---|---|
| Domestic buyers | 1973 | 18.5 | 14.2 | — 0.4 | 4.8 | — 0.2 | 18.3 |
| | 1974 | 27.6 | 21.5 | — 0.3 | 6.4 | 0.7 | 28.3 |
| | 1975 | 51.4 | 37.0 | — 0.1 | 14.5 | 1.4 | 52.8 |
| Banks | 1973 | 3.6 | 2.8 | — 0.1 | 0.8 | — 0.0 | 3.5 |
| | 1974 | 14.2 | 12.3 | — 0.1 | 2.1 | 0.3 | 14.5 |
| | 1975 | 27.0 | 25.1 | — 0.2 | 2.2 | 0.1 | 27.2 |
| Bundesbank | 1973 | — 0.0 | — | — | — 0.0 | — | — 0.0 |
| | 1974 | 0.4 | — | — | 0.4 | — | 0.4 |
| | 1975 | 7.5 | — | — | 7.5 | — | 7.5 |
| Non-banks | 1973 | 15.0 | 11.4 | — 0.3 | 3.9 | — 0.2 | 14.8 |
| | 1974 | 13.0 | 9.2 | — 0.1 | 3.9 | 0.3 | 13.3 |
| | 1975 | 16.8 | 11.9 | 0.1 | 4.8 | 1.2 | 18.1 |
| Foreign buyers 3 | 1973 | 6.5 | e 7.2 | e — 0.1 | — 0.6 | × | 6.5 |
| | 1974 | — 2.5 | e — 1.9 | e — 0.1 | — 0.6 | × | — 2.5 |
| | 1975 | — 3.4 | e — 2.0 | e — 0.1 | — 1.3 | × | — 3.4 |
| Purchases (= sales), total | 1973 | 25.0 | 21.4 | — 0.5 | 4.1 | — 0.2 | 24.8 |
| | 1974 | 25.1 | 19.6 | — 0.4 | 5.8 | 0.7 | 25.8 |
| | 1975 | 48.0 | 35.0 | — 0.2 | 13.2 | 1.4 | 49.4 |

1 Net sales plus/less changes in issuers' holdings of their own bonds. — 2 Net purchases or net sales (—) 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.

seemed to be almost no limit to the receptiveness of the market. During that period nearly DM 30 billion (net) of bonds was sold, which was more than in 1974 or 1973 as a whole. The demand for bonds was so heavy at that time that the yield on bonds outstanding, which had been about 9.7 % at the beginning of the year (and thus over 1 % lower than at the interest rate peak), had declined by just over one percentage point (to 8.4 %) by mid-year in spite of the much heavier recourse to the market.

The mood changed abruptly — as noted — around mid-year and the hitherto great receptiveness gave way to strong sales pressure, which caused prices to fall and thus yields to rise again in all sections of the market. The main reason for this reversal in trend was the release of new figures showing further steep rises in the deficits for 1975 — and on that basis also for 1976 — upon the introduction of the supplementary budgets of the Federal Government and some Länder Governments for 1975. Irrespective of the fact that the estimates in these supplementary budgets later proved to be much too high, this adversely affected the market in two respects. Many investors feared that it was now impossible to make further progress towards stability, that for this reason interest rates had reached their lowest level, and thus that further bond price rises were unlikely. At the same time it was thought that the financing of the exceptionally large government deficits might prove more difficult than previously supposed and that an upturn in the long-term interest rate was therefore to be expected because of the growing calls on the market.

Long-term interest rate continues to fall

That this was a reversible dip in sentiment did not become fairly certain until, on October 23, the Bundesbank suspended its open market operations in the bond market, on which it had spent some DM 7.5 billion. Until then the interest rates of securities not purchased by the Bundesbank had risen at times, while the interest rates of Federal Government securities had remained unchanged, in keeping with the policy pursued by the Bundesbank. A widened interest rate differential, to some extent reflecting the differing degree of liquidity of these securities, continued in existence in a certain measure even after the Bundesbank had discontinued its purchases in the open market. Yields on all types of bonds started to fall as soon as the propensity to invest recovered and a certain shortage of securities became manifest. From the beginning of 1976 onwards the market continued to strengthen. This is shown not only by the large increase in sales in the first quarter but also by the more rapid fall in long-term interest rates. At present (mid-April) the average yield on all bonds outstanding is 7.8 %, and that on Federal bonds 7.6 %. This roughly corresponds to the level of spring 1972.

## Record of economic policy measures

| | |
|---|---|
| **1975** | **I. Domestic and external monetary policy** |
| January 23 | The Bundesbank raises the banks' rediscount quotas by about DM 2.5 billion until the end of March. |
| February 6 | The Bundesbank lowers the discount rate to $5^1/_2$ % and the lombard rate to $7^1/_2$ % with effect from February 7. |
| February 12 | The Bundesbank sells Treasury bills (mobilisation and liquidity paper) to the banks for a time to smooth fluctuations in interest rates on the money market. |
| March 6 | The Bundesbank lowers the discount rate to 5 % and the lombard rate to $6^1/_2$ % with effect from March 7. |
| April 9 | In Paris the OECD countries sign an agreement establishing a support fund totalling US$ 25 billion for member countries in balance of payments difficulties ("Kissinger Fund"). |
| April 24 | The Bundesbank lowers the lombard rate to 6 % with effect from April 25. |
| May 22 | The Bundesbank lowers the discount rate to $4^1/_2$ % and the lombard rate to $5^1/_2$ % – i. e. by half a percentage point each – with effect from May 23. It also reduces the minimum reserve ratios on domestic liabilities by 5 % with effect from June 1, thus releasing some DM 2 billion. The amount of prime bankers' acceptances which the Bundesbank is prepared to purchase under its money market regulating arrangements is increased from DM 1.1 billion to DM 1.5 billion. |
| July 3 | The Bundesbank lowers the minimum reserve ratios on domestic and foreign liabilities by 10 % retroactively from July 1 (reducing the required minimum reserves by over DM 4 billion). |
| July 10 | France, which left the joint float on January 21, 1974, returns to the European system of narrower exchange rate margins. |
| July 17 | The Bundesbank decides to bring the minimum reserve ratios on foreign liabilities substantially into line with the ratios on domestic liabilities with effect from August 1. The liquidity set free by the reduction of the reserve ratios on foreign liabilities amounts to about DM 1.5 billion. |
| July 23 | The Bundesbank again buys trade bills under repurchase agreement for ten days on the open market to steady the money market (the rate of interest is identical with the discount rate). |
| August 14 | The Bundesbank lowers the discount rate to 4 % and the lombard rate to 5 % – i. e. by half a percentage point each – with effect from August 15. |
| September 4 | The Federal Government, acting in agreement with the Bundesbank, lifts the authorisation requirement introduced on May 10, 1971 for the payment of interest on non-residents' deposits with domestic banks. The acquisition of bonds by non-residents is facilitated at the same time. |
| September 11 | The Bundesbank lowers the discount rate to $3^1/_2$ % and the lombard rate to $4^1/_2$ % with effect from September 12. Moreover, the banks' rediscount quotas are raised by DM 3 billion with effect from October 1. |
| October 23 | The Bundesbank discontinues its intervention policy on the bond market. Since July, when it started buying public authority bonds on the open market, about DM 7.5 billion in liquid funds has been supplied to the banking system in this way. |
| November 15 to 17 | The Heads of State and Government of France, the Federal Republic of Germany, Italy, Japan, the United Kingdom and the United States meet at Rambouillet to discuss common economic and monetary problems. They agree, among other things, to take action to counter disorderly market conditions and erratic fluctuations in exchange rates. |
| November 18 | Pursuant to section 17 of the Bundesbank Act and with the agreement of the Bundesbank, temporarily free balances of the Federal Government are transferred to the banking system to smooth fluctuations in interest rates on the money market. |
| December 18 | The Bundesbank once again announces a quantitative target for its monetary policy. It intends to conduct monetary policy in 1976 in such a way that monetary conditions permit a continuation of the incipient economic upswing, while at the same time further progress can be made towards curbing price rises. An increase of 8 % in central bank money (comparing the average of 1976 with the average of 1975) is to be aimed at. |
| **1976** | |
| January 7 and 8 | At the meeting of the International Monetary Fund in Kingston, Jamaica, it is agreed inter alia to abolish the official gold price and legalise floating exchange rates by amending Article IV of the Fund's Articles of Agreement. In addition, part of the Fund's gold holding is to be sold and the profits are to be made available to developing countries. |

| | |
|---|---|
| February 4 | The Deutsche Bundesbank grants the Banco de Portugal a credit of US$ 250 million secured by gold. |
| March 5 | The Banca d'Italia takes up a credit of US$ 500 million from the Bundesbank, so that the entire credit increases to US$ 2 billion again; it is secured by a gold deposit in favour of the Bundesbank. |
| March 15 | France leaves the joint float a second time. |
| **1975** | **II. Economic and fiscal policy** |
| January 1 | The tax reform and reform of children's allowances come into effect. They place a cash burden amounting to some DM 18 billion on the public authorities in 1975. |
| January 30 | The Federal Government presents the 1975 Annual Economic Report. It intends to concentrate its economic and fiscal policy on overcoming the period of weakness in the German economy while maintaining stability, and on initiating an upswing under stable conditions. It draws attention to the fact that disregard of the basic monetary situation created by the Bundesbank's control of the money stock would increase the danger to economic growth and employment. |
| March 21 | The Bundestag approves the 1975 Federal budget, which shows expenditure totalling DM 155.1 billion and a financial deficit of DM 25.7 billion. |
| June 30 | The investment grant of 7.5 % – the central measure of the "Programme to promote employment and growth in stability" of December 12, 1974 – duly comes to an end. |
| August 27 | After reaching agreement with the Advisory Council on Anticyclical Policy for Public Authorities and the Fiscal Planning Council, the Federal Cabinet adopts a "Programme to encourage investment in construction and other fields" with a volume of DM 5.8 billion, mainly financed by the central, regional and local authorities (Federal Government: DM 3.2 billion; Länder Governments: DM 1.4 billion; local authorities: DM 0.8 billion). The major parts of the programme are "Municipal infrastructure and urban renewal" (DM 2.5 billion) and "Federal investments" (DM 1.2 billion); the remaining sections comprise the modernisation of dwellings (DM 0.7 billion), job creation measures (DM 0.6 billion), the interim financing of loans granted under contracts with building and loan associations (DM 0.3 billion), and loans for special purposes (DM 0.5 billion).<br><br>At the same time the Federal Government approves a draft supplementary budget for 1975 containing an additional borrowing requirement of about DM 15 billion. |
| September 10 | Final discussions take place within the Federal Government on the draft Federal budget for 1976 and the fiscal plan for 1975 to 1979. At the same time a Budget Structure Bill embodying cuts in expenditure is presented; among other things it provides for the amendment of numerous Acts involving payments by the government and an increase from 2 % to 3 % in the contribution rate to the unemployment insurance fund (overall improvement: DM 7.9 billion in 1976, DM 12.5 billion in 1979). Finally, the Federal Government announces its intention of increasing taxes with effect from January 1, 1977 (by raising value-added tax – by 2 percentage points for the standard rate – and tightening up the taxation of tobacco and spirits, it is expected to augment Federal revenue by DM 8.2 billion in 1977 and DM 11.0 billion in 1979). |
| November 20 | The Council of Experts for Assessing Overall Economic Trends concludes in its Annual Report that the "most severe recession since the war" was caused by the excessively long toleration of inflationary tendencies. The Council appeals to the political decision-makers to provide room for the upswing in 1976 without hampering the slowdown in the pace of price rises. It regards an expansion of just under 8 % in central bank money in 1976 as consistent with objectives; moreover, it calls upon those responsible for fiscal policy to continue supporting aggregate demand and at the same time to start the consolidation of government finance. In the Council's view it is the duty of management and labour to embark on the necessary readjustment of the distribution of incomes as soon as possible. |
| **1976** | |
| January 28 | In its 1976 Annual Economic Report the Federal Government sets out the economic and fiscal goals it is pursuing. By its policy it means to make a contribution to strengthening the present economic recovery, improving the basis for a durable inflation-free upswing and thus creating sufficient jobs for longer-term needs. It underlines the necessity of a steep increase in capital investment, which is conditional upon an improvement in enterprises' profitability from the cost side.<br><br>At the same time the Federal Government adopts additional work promotion measures for unemployed young people and unemployed persons for whom it is difficult to find jobs; a total of DM 300 million is to be made available for this purpose. |
| April 9 | The one-year loss carry-back not exceeding DM 5 million in respect of income tax and corporation tax is finally adopted. |

**Continued preference for shorter maturities**

As regards maturities, however, there has not been a return to the conditions of earlier years. Whereas, for example, in 1972 three fifths of the bonds sold had been issued with maturities of 10 years and over, only one eighth had such maturities last year – and no more than one tenth in the second half of 1975. Not until recently has it been possible to lengthen maturities slightly again: those of public authority bonds to eight years, and those of mortgage bonds to ten years and over in some cases. The lengthening of maturities seems desirable to finance long-term capital expenditure on housing and on gas and electricity supply. On the other hand, investors have to consider the risk of changes in interest rates and prices, a risk which may arise from differences in inflation rates and which increases with the maturity of the bonds. As long as these risks cannot be eliminated or reduced – most durably by further successes in combating inflation – a certain preference for shorter maturities will persist. These interests of savers must not be left out of account when considering capital market policy. Even today we are still awaiting the solution (although the matter is less pressing now) of some of the social problems caused by the acquisition of low-interest securities with long maturities, resulting in large price losses for private investors. Accelerated developments – and this applies to the lengthening of maturities just as much as to the envisaged volume of issues – have never been helpful to the bond market in the long run; not infrequently, they have been the seed of a subsequent setback.

**Large volume of sales**

In spite of the slowdown in the second half of the year, far more securities than in any previous year were placed in the bond market in 1975. In all, net sales of domestic bonds (at market values plus/less changes in issuers' holdings of their own paper) came to DM 48 billion in 1975, which was almost twice as much as in the two preceding years and about DM 14 billion more than in 1972, hitherto the most productive year. Even if the amount spent by the Bundesbank in the course of its open market operations in public authority bonds is deducted (DM 7.5 billion), remaining sales, at DM 40 billion, are still well above those of previous years. The amount raised in the bond market last year was equivalent to 37 % of the overall acquisition of financial assets by the domestic non-financial sectors. This ratio was distinctly higher than that of 1972 (27 %) and almost twice as large as that of 1974 (20 %). However, these figures are liable to overstate the true significance of the bond market. The great bulk of the purchases in 1975 was accounted for by banks, which took up over DM 27 billion of bonds; this was nearly twice the amount of the previous year. As usual, they mostly bought bank bonds (DM 25 billion), whereas they took only DM 2 billion of public authority bonds into their portfolios. Not counting the purchases of the Bundesbank, the banks bought about two thirds of the bonds sold (net) in 1975. This was more than in almost any year since 1960; only in 1967 and 1968 was the share acquired by the banks larger or about as large (but at no time has the actual amount been so great). The underlying cause of these purchases was the high liquidity of the banks, which resulted on the one hand from the increase in the banks' holdings of assets which are eligible for Bundesbank credit at any time and on the other hand from the comparatively low credit demand. In making these purchases the banks performed an important function in 1975, for they helped in this way to ensure that the fairly small number of institutions that granted direct credit to public authorities (the principal borrowers) could obtain the funds they required for their lending from the other banks, which acquired their securities. It should be borne in mind, however, that the situation was exceptional. As the traditional borrowers from these banks, viz. enterprises, begin to require more credit again and as liquidity ceases to be as plentiful as hitherto, the banks will play a more modest role as buyers of securities. Between 1970 and 1974 they invested, on an average, in bonds of all issuers only one tenth of the amount they applied to direct lending, whereas in 1975 the extremely high figure of one third was reached.

In 1975 domestic non-banks likewise bought more bonds than in previous years. They took up over DM 18 billion of such securities compared with over DM 13 billion in 1974 and DM 15 billion in both 1973 and 1972. The increase on the 1974 figure is due to purchases by institutional investors; the amount bought by households, by contrast, was smaller than in the previous year. Domestic non-banks, like banks, primarily bought bank bonds (DM 12 billion). The acquisition of public authority bonds, at just on DM 5 billion, was also comparatively large. This paper seems to have consisted entirely of Federal savings bonds, i. e. securities which bear virtually no price risk; at any rate, this is suggested by the sharp increase in the amount of such bonds outstanding. Foreign investors sold DM 3.4 billion (net) of German bonds in 1975 (1974: DM 2.5 billion).

Public authorities the principal borrowers in the bond market as well

The greater part of the funds raised in the bond market flowed to the public authorities. Inclusive of the amounts procured through sales of communal bonds (DM 24 billion), they received funds totalling almost DM 37 billion, equivalent to three quarters of aggregate net sales of domestic bonds. In the previous year they had received DM 14.5 billion or just on three fifths. The private sector drew only slightly more on the bond market in 1975 than a year before. The supply of foreign Deutsche Mark bonds increased steeply last year. Altogether DM 7.5 billion (gross) of such securities were issued in 1975 compared with DM 1.6 billion in 1974 and DM 6.6 billion in 1969, when the previous record for such sales had been set up. Foreigners acquired the bulk of the new issues, the interest on which was often not very attractive to residents.

**3. Fiscal stimulation**

Antirecessionary measures a feature of fiscal policy

In 1975 fiscal policy, like monetary policy, was aimed at counteracting the recession as far as possible. The budgets for 1975 envisaged a strong expansion of expenditure, namely by 13 to 14 %, not least because of the long-planned tax reform and reform of children's allowances, which came into force at an appropriate time in the cycle. The relief thus granted to taxpayers, at DM 14 billion (as was at first supposed), was also important in that it made it easier for the trade unions to adopt a stance more compatible with stabilisation in wage negotiations, thus indirectly mitigating the cost pressure on enterprises. On the basis of these budgets the high cash deficits already incurred by all central, regional and local authorities in 1974 were expected to double to approximately DM 50 billion. So as not to enlarge the deficits further, it was intended that the special economic stimulation programme approved by the Federal Government at the end of 1974 should affect the cash position chiefly in the years after 1975. The principal measure of this programme, besides additional capital expenditure by the Federal Government (DM 1.1 billion), wage cost subsidies and mobility allowances, was a 7½ % grant for capital goods ordered up to mid-1975; the aim was to provide enterprises with about DM 7 billion in this way at the expense of the budgets for subsequent years (as a result of this grant the drop in industrial investment was only half as large as enterprises had originally planned according to a recent Ifo survey). The economic stimulation programme of August 1975, which amounted to DM 5.8 billion (including the complementary funds of the Länder Governments and local authorities), likewise hardly affected the 1975 budgets, but it probably generated additional orders totalling roughly DM 10 billion.

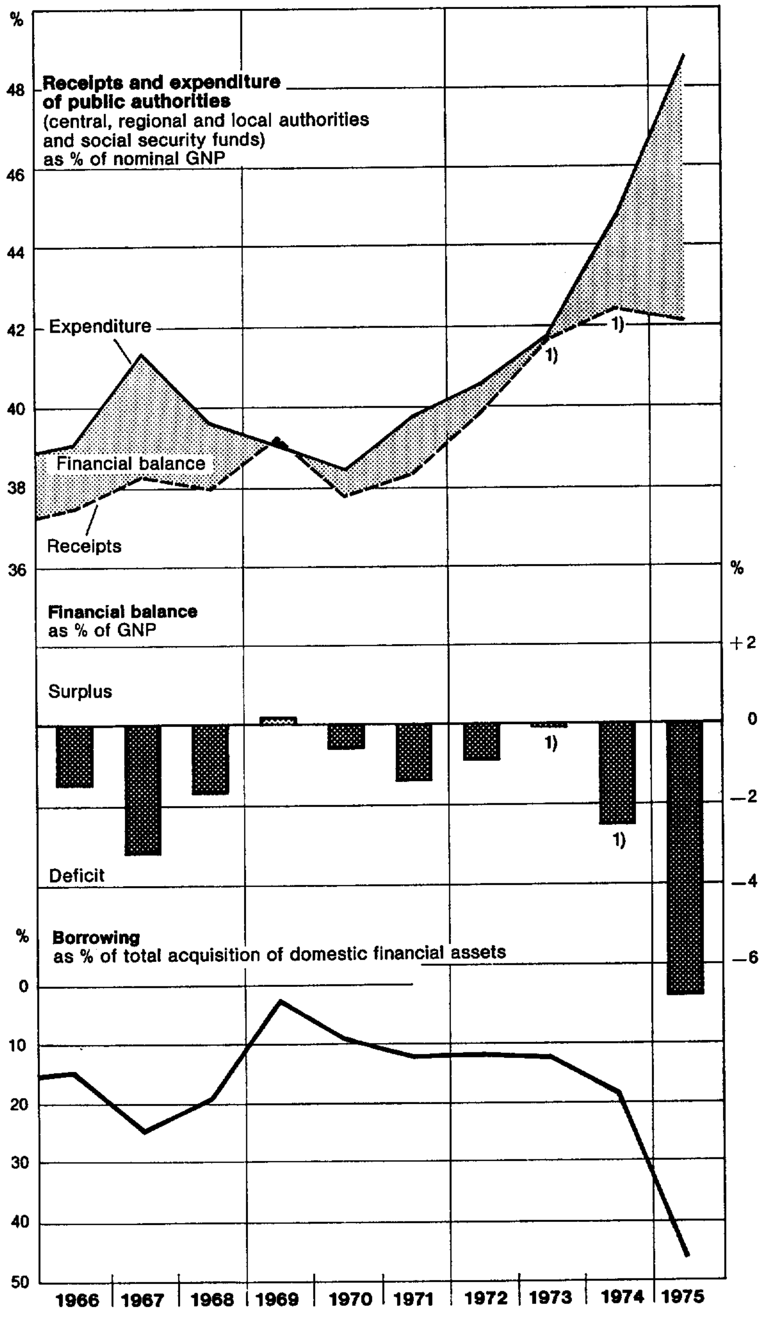
Record deficits . . .

Primarily because of the unexpectedly severe recession, the deficit of the central, regional and local authorities in 1975, at DM 66 billion, was considerably larger than had been assumed at the beginning of the year, although it did not reach the size predicted as late as the autumn. Inclusive of the social security funds, the deficit came to as much as DM 70.5 billion (or about 7 % of the gross national product). The amount supplied to the economy through public cash transactions was therefore this much in excess of the amount withdrawn again through taxes and other levies. Thus the deficit surpassed the already high end-1974 level by DM 45 billion or 4½ % of the gross national product. This enormous expansionary swing no doubt made a major contribution to curbing the economic slowdown and bringing on a turnround in the business cycle towards mid-year.

. . . due to steep rise in expenditure . . .

The anticyclical impact owed much to the fact that the massive 1975 deficit was largely attributable to a steep rise in expenditure. Overall, the growth of expenditure of all public authorities, at 13½ %, was at roughly the rate envisaged in the budgets at the beginning of the year. There were quite considerable shifts between individual types of expenditure, however, by comparison with the original expectations. For instance, the marked increase in unemployment and short-time working because of the recession led to an unexpectedly sharp rise in the corresponding assistance payments; at DM 11 billion, such expenditure was DM 6 billion

## Public finance as part of the national economy




1) 1973 and 1974 figures including stability surcharge and investment tax.

higher than in 1974. Since pension payments likewise went up strongly again under the influence of the time lag in the adjustment procedure, and since the reform of children's allowances entailed extra expenditure totalling DM 10 billion, current transfers to households expanded by more than a quarter in all. On the other hand, staff costs rose less steeply than before, viz. by about 9 %; the pay settlements were relatively moderate, but the number of employees continued to increase. The growth of capital expenditure decelerated even more – to as little as 2 %, compared with 9 % in 1974, since the central, regional and local authorities reduced such spending considerably in view of their strained financial situation. The cuts in capital expenditure, which are not in accordance with accepted ideas on anticyclical fiscal policy, demonstrate that the scope for expansionary fiscal policy was very small given the size of the deficits and the growing debt burden. It must be borne in mind, however, that hardly any cash resources were disbursed during the 1975 fiscal year under the programme of autumn 1975 to assist the construction industry. Much the same can be said of the investment grant, which – as mentioned before – generated strong demand in the private sector towards the middle of 1975, but will not affect the budgets until 1976. All in all, the pure cash figures thus convey too unfavourable a picture of the economic stimulation provided by fiscal policy; a major part of the boost was given by the placing of the orders.

... accompanied by a slow growth of receipts

The recession also left its mark on the receipts side, particularly on tax revenue. There were unexpectedly large shortfalls in such revenue for cyclical reasons; in addition, because of the tax reform cash receipts declined by over DM 4 billion more than had been estimated at the beginning of the year (about DM 3.5 billion). [1] Altogether, tax revenue was therefore roughly DM 30 billion lower than had been anticipated in June 1974, at the time of the official estimate for 1975 (when a downturn in economic activity was not assumed). Wage tax yield was hit especially hard by these influences: it was lower than a year before. Total tax revenue grew by no more than 1 % in 1975, [2] and inclusive of the special anticyclical levies collected in 1974 it actually stagnated. The fact that the total receipts of the public authorities were nevertheless about 3½ % up on the year must be ascribed to the contribution income of the social security funds; income liable to compulsory insurance grew relatively slowly, it is true, owing to the drop in employment, but the contribution rates for both the health insurance and the Federal Labour Office were raised.

Growth of the government deficit in keeping with the economic situation

The expansion of the government deficit in 1975 was in keeping with the economic situation; at all events, any smaller growth of the deficit would have retarded the economic recovery. The problems inherent in the consolidation, which is essential in the longer run, were, however, exacerbated by the enormous size of the deficit, especially since – as will be shown below – the expansion of the deficit in 1975 was partly due to measures that were not elements of anticyclical policy in the sense that they automatically ceased to operate once the economic upswing began. In the monetary field the central, regional and local authorities' demand for credit formed a counterweight to the steep growth of households' saving inasmuch as the credit requirements of enterprises were for a long time subdued. The magnitudes involved are illustrated by the fact that the government ultimately used almost half (45 %) the domestic acquisition of financial assets (amounting to about DM 140 billion) to meet its deficit, compared as a rule with one to two tenths in earlier years and no more than a quarter even in the recession year 1967. The financial flows are of course always in arithmetical balance since the liabilities of one sector are necessarily always accompanied by corresponding claims of another sector. But it is very important to know, if the shifts in overall payment flows were marked, how balance was finally achieved in the markets and, in particular, to what extent tensions arose in the process.

Financing problems emerge in the course of the year

In the first half of 1975 the large credit requirements of the central, regional and local authorities were predominantly met at longer term and at declining rates of interest. Towards the middle of the year, however, difficulties emerged. After the lowering of interest rates had proceeded relatively far, interest rate expectations suddenly reversed, as mentioned earlier in this Report. This reversal was mainly caused by the deterioration in the outlook for public finance, but it also owed something to upward trends in international interest rates. In particular, the large deficits in prospect for the years ahead gave rise to fears that the credit market would be persistently overextended. As interest rates were expected to go up, banks and the general public showed little inclination to commit themselves at longer term; the losses suffered in this way in earlier years had been all too heavy.

1 This increased the overall cash burden imposed by the tax reform and reform of children's allowances to DM 18 billion in 1975. Estimated in this way, however, the relief afforded by the tax reform in 1975 will be partially offset in 1976 by the fact that the total amount refunded to taxpayers under the wage tax adjustment for 1975 will presumably be smaller than it was prior to the reform. This is to be expected primarily because a considerable part of the special expenditure that was formerly not taken into account until the time of the annual adjustment is now allowed for in the regular deductions at source owing to the inclusion of a lump-sum tax allowance ("Vorsorgepauschale") in the wage tax scale.

2 If children's tax allowances had not been abolished in connection with the revision of the equalisation of family burdens scheme, tax revenue would have declined by 1 %; however, expenditure would have been about DM 10 billion lower even without the reform.

## Finances of the public authorities

| Item | 1972 | 1973 | 1974 p | 1975 pe | 1972 | 1973 | 1974 p | 1975 pe |
|---|---|---|---|---|---|---|---|---|
| | Billions of Deutsche Mark | | | | Percentage change on previous year | | | |
| **I. Central, regional and local authorities** | | | | | | | | |
| (1) Expenditure | | | | | | | | |
| Staff costs | 81.5 | 93.6 | 107.4 | 117 | + 11.5 | + 14.7 | + 14.8 | + 9 |
| Pensions and assistance grants | 38.9 | 39.7 | 47.0 | 70 | + 14.5 | + 2.0 | + 18.6 | + 49 |
| Fixed investment **1** | 38.9 | 41.0 | 45.3 | 46 | + 4.1 | + 5.5 | + 10.5 | + 1.5 |
| Indirect investment **2** | 18.7 | 20.9 | 22.2 | 23 | + 5.5 | + 11.6 | + 5.9 | + 4.5 |
| Other expenditure | 68.6 | 82.3 | 95.5 | 103.5 | + 12.5 | + 20.0 | + 16.0 | + 8 |
| Total | 246.6 | 277.5 | 317.4 | 359 | + 10.5 | + 12.5 | + 14.4 | + 13 |
| of which Federal Government | 110.2 | 123.6 | 138.2 | 164 | + 12.6 | + 12.2 | + 11.8 | + 19 |
| Länder Governments | 99.1 | 114.8 | 132.4 | 146 | + 12.3 | + 15.8 | + 15.3 | + 10 |
| (2) Receipts | | | | | | | | |
| Tax revenue **3** | 197.0 | 226.7 | 242.3 | 242 | + 14.3 | + 15.1 | + 6.8 | — 0 |
| Other receipts | 37.5 | 42.7 | 48.4 | 51 | + 7.6 | + 13.8 | + 13.4 | + 5.5 |
| Total | 234.5 | 269.4 | 290.7 | 293 | + 13.1 | + 14.9 | + 7.9 | + 1 |
| of which Federal Government | 106.3 | 120.9 | 128.1 | 130 | + 10.6 | + 13.8 | + 5.9 | + 1.5 |
| Länder Governments | 97.8 | 113.7 | 124.9 | 125 | + 18.1 | + 16.2 | + 9.9 | — 0.5 |
| (3) Cash deficit (—) **4** | — 12.8 | — 8.9 | — 27.2 | — 66 | . | . | . | . |
| of which Federal Government | — 4.6 | — 2.9 | — 10.1 | — 34 | . | . | . | . |
| Länder Governments | — 1.3 | — 1.9 | — 8.0 | — 21 | . | . | . | . |
| (4) Anticyclical surcharge | — 5.6 | — 0.1 | — 0.2 | — | . | . | . | . |
| (5) Cash deficit (—) | — 18.4 | — 9.0 | — 27.4 | — 66 | . | . | . | . |
| **II. Social security funds 5** | | | | | | | | |
| (1) Expenditure **6** | 107.7 | 125.1 | 148.1 | 174.5 | + 15.9 | + 16.2 | + 18.4 | + 18 |
| (2) Receipts | 113.1 | 132.5 | 149.4 | 170 | + 15.7 | + 17.1 | + 12.8 | + 13.5 |
| (3) Cash surplus (+) or deficit (—) **7** | + 5.3 | + 7.9 | + 1.6 | — 4.5 | . | . | . | . |
| **III. Public authorities, total** | | | | | | | | |
| (1) Expenditure | 338.6 | 387.2 | 445.9 | 506.5 | + 11.7 | + 14.4 | + 15.2 | + 13.5 |
| (2) Receipts | 331.9 | 386.6 | 420.5 | 436 | + 13.7 | + 16.5 | + 8.8 | + 3.5 |
| (3) Cash deficit (—) (including anticyclical surcharge) **8** | — 13.1 | — 1.1 | — 25.7 | — 70.5 | . | . | . | . |

**1** Cash expenditure is recorded here, whereas production of public capital goods is shown on the government account of the national accounts. — **2** Expenditure on investment grants and loans to third parties, trade investments. — **3** Including stability surcharge and investment tax. — **4** The discrepancies between the balance of receipts and expenditure and the cash deficit are due to special transactions. — **5** Public pension funds, health insurance, accident insurance, agricultural pension funds and Federal Labour Office. — **6** Including fixed capital formation. — **7** On the basis of the change in financial assets, which differs slightly from the balance of booked receipts and expenditure. — **8** See footnotes 4 and 7. — **p** Provisional. — **pe** Partly estimated. Discrepancies in the totals are due to rounding.

Efforts to consolidate public finance

The critical situation which this engendered was remedied in the second half of the year, though at the price of forgoing further public issues on the bond market; in the first half of 1975 the central, regional and local authorities had met nearly a fifth of their credit requirements by issuing bonds amounting to DM 4.5 billion (net). This tightness on the bond market was eventually overcome by the Bundesbank's purchases of securities issued by the Federal Government and its special funds – purchases that were desirable for easing conditions on the money market – and by the decisions of the Federal Government (of September 10, 1975) to improve the budget structure. Through these decisions the Government embarked on the longer-term consolidation of public finance by means of cuts in expenditure and increases in taxes and contributions. Confidence in the viability of the capital market began to recover, as described above (page 17). This process was facilitated by a great measure of flexibility in government debt management. Public borrowers complied with investors' wish for increased liquidity by taking up more loans with shorter maturities. Banks in particular offered large quantities of medium-term credit.

Remarkable elasticity of the financial markets

The financing of the government deficits in some cases necessitated changes in the business policy of the lenders, much the most important of which were – as usual – the banks. Last year domestic banks again supplied almost three quarters of the total credit required by the public authorities (DM 65 billion inclusive of the acquisition of securities). This meant, however, that the banks' lending to public authorities accounted for 60 % of their aggregate new lending to domestic non-banks,[1] against 33 % in 1974 and an average of 14 % between 1970 and 1973. Thus the debtor structure of new business changed completely in 1975. Of the total new loans granted by saving banks and central giro institutions – traditionally the principal banking group for public credit – almost two thirds went to the central, regional and local authorities, compared with about a quarter as a rule in the past. Among the mortgage banks the share of new lending to the public sector, which had previously averaged about one sixth, climbed to more than one half in 1975. The change was even greater in the case of the private commercial banks: whereas lending to the government had previously been of only minor importance in this banking group, in 1975 all the growth in this group's lending was attributable to loans to public authorities.

Altogether, more funds than were needed for meeting the deficit were raised for the government in the financial markets in 1975. Towards the end of the year expenditure no longer flowed out at the rate forecast as late as the autumn, while the trend of tax revenue ultimately became quite favourable, not least owing to the economic recovery. The central, regional and local authorities – taken as a whole – consequently built up substantial credit balances; at the end of the year their cash resources maintained with the Bundesbank, at DM 13 billion, were somewhat larger than in December 1974 despite the liquidation of special deposits. To prevent this from leading to a major tightening of the money market, the Bundesbank agreed – in accordance with section 17 of the Bundesbank Act – to the temporary transfer of part of these large Federal balances to the banking system (end-December roughly DM 5 billion).

Structural deficit as a belated consequence of the inflation

1975 was the first year in which about half the gross national product (49 %) was channelled through the public accounts. This was admittedly due in part to the slow growth of the gross national product, but it also owed something to the continued rapid expansion of government expenditure – an expansion which was desirable in trend from the standpoint of anticyclical policy. At the same time it became apparent that there was a considerable structural deficit in the public budgets – as a belated unwelcome consequence of the inflation, so to speak. Such a deficit does not return to its original size, not even in a pronounced upswing, unless new measures are taken on the receipts and expenditure sides. This large deficit arose because receipts grew only a little while expenditure went on climbing steeply from a very high base, not only owing to cyclical factors (which sooner or later would operate in the opposite direction again) but also partly on account of measures with a long-term effect, notably the tax reform and reform of

1 Including lending against Treasury bills, security holdings, and equalisation and covering claims.

**Indebtedness of central, regional and local authorities**

**Billions of Deutsche Mark**

| Item | Level at end of year | | | Change during year | | |
|---|---|---|---|---|---|---|
| | 1973 | 1974 | 1975 **pe** | 1973 | 1974 | 1975 **pe** |
| **I. Borrowers** | | | | | | |
| 1. Federal Government | 61.4 | 72.1 | 108.5 | + 6.1 | + 10.8 | + 36.4 |
| 2. Equalisation of Burdens Fund | 5.9 | 5.4 | 5.2 | — 0.5 | — 0.5 | — 0.2 |
| 3. ERP Special Fund | 1.2 | 1.2 | 1.3 | — 0.3 | + 0.0 | + 0.1 |
| 4. Länder Governments | 39.5 | 47.3 | 67.0 | + 2.5 | + 7.9 | + 19.7 |
| 5. Local authorities | 55.5 | 61.3 | 70.0 | + 7.0 | + 5.8 | + 8.7 |
| Total (1 to 5) | 163.3 | 187.3 | 252.0 | + 14.8 | + 23.9 | + 64.7 |
| **II. Types of debt** | | | | | | |
| 1. Book credits of Bundesbank | 2.9 | 1.2 | 0.4 | + 2.4 | — 1.6 | — 0.9 |
| 2. Money market paper | 1.1 | 5.3 | 12.3 | — 0.4 | + 4.3 | + 6.9 |
| 3. Federal savings bonds | 3.0 | 4.7 | 9.8 | — 1.2 | + 1.7 | + 5.1 |
| 4. Medium-term notes | 1.8 | 2.0 | 6.4 | — 0.6 | + 0.2 | + 4.4 |
| 5. Bonds | 24.4 | 26.2 | 30.9 | + 4.0 | + 1.8 | + 4.7 |
| 6. Bank advances | 87.9 | 102.9 | 145.7 | + 10.2 | + 15.0 | + 42.8 |
| 7. Loans of non-banks **1** | 20.3 | 23.6 | 26.0 | + 1.3 | + 3.3 | + 2.4 |
| 8. Other debt **2** | 22.0 | 21.2 | 20.5 | — 0.9 | — 0.7 | — 0.7 |
| Total (1 to 8) | 163.3 | 187.3 | 252.0 | + 14.8 | + 23.9 | + 64.7 |

**1** Including government inscribed stock held by the social security funds. — **2** Chiefly old debt. — **pe** Partly estimated. — Discrepancies in the totals are due to rounding.

children's allowances introduced at the beginning of 1975. It also emerged that the growth trend of incomes will probably become flatter from now on; as a result, substantial shortfalls in receipts appeared likely in the future in the medium-term fiscal plans, in which some past developments had been extrapolated all too readily. This served to show once again that in a struggle over the distribution of incomes conducted under inflationary conditions the public authorities will themselves be among the losers in the end. For one thing, government goods were bound to rise in price particularly steeply if wages and salaries grew disproportionately fast, since the provision of such goods calls for more labour than production in the private sector. For another, the steep wage rises were reflected in a strong increase in public current transfers — albeit sometimes with a time lag — owing to the adjustment mechanisms of social security payments.

Even on a somewhat longer-term view there was no adequate counterweight to this trend on the receipts side. True, the taxes and social security contributions levied on wages and salaries continued to go up markedly. But on the other hand, property and entrepreneurial income, which on an average is subject to much heavier taxation, expanded far less than wage and salary income or even dropped, which had an adverse impact on the respective tax revenue. At the latest from the beginning of 1975, when wage and salary earners were relieved of the effects of inflation-induced "hidden" tax increases by the tax reform, a wide gap opened up in the budgets; this revenue had after all previously served to finance expenditure that could hardly be cancelled. Although the ground had been prepared for the structural deficit prior to the economic setback owing to the above-described inflationary mechanism, the full extent of the shortfall only became apparent during the recession. The decision of those responsible for fiscal policy to announce at the trough of the cycle a medium-term fiscal rehabilitation programme embodying expenditure cuts and tax increases was therefore essential in order to restore confidence in the stability of the economy and government finance in the long run; it later transpired that the rehabilitation programme — at variance though it may have been with the orthodox rules of anticyclical fiscal policy — was in no way detrimental to the developing economic recovery but was, if anything, beneficial. The longer-term problem of public finance has not been finally solved, however, by the measures envisaged by the Federal Government in the medium-term fiscal plans from 1977 onwards. If the rate of value-added tax is raised — the Federal Government intends to increase the standard rate from 11 % to 13 % — repercussions on the price level cannot be ruled out; these repercussions would be especially serious if the main social groups refused to accept the resultant slowdown in the rise in real incomes, so that prices and incomes started spiralling. It therefore appears urgently necessary to endeavour to reduce the structural budget deficit inter alia by curtailing public expenditure — particularly so, indeed, in a pronounced economic upswing.

Social security funds still in need of consolidation

A number of financial problems in the social security field still await solution. Only in the case of the Federal Labour Office has the requisite consolidation been started, under the Budget Structure Act of 1975. This task has still to be performed for the pension insurance funds. In view of the slower increase in wages and salaries and the high annual rates of pension adjustment (owing to the inflationary tendencies of previous years), growing deficits are to be expected for the time being. Moreover, the situation is aggravated by the fact that in 1972 it was decided to improve benefits; these improvements could be realised at the ruling contribution rate only if the over-full employment and the strongly inflationary wage movements of that time had persisted. Given the present status quo, and if pensions were again adjusted in accordance with the procedure of recent years, the deficit of the pension insurance funds in 1977 would probably be even larger than in the current year. Only part of the deficit could then be met out of the insurance funds' liquid resources. It is also necessary to reduce substantially the enormous expansion in the costs of the statutory health insurance, which hardly slackened at all in 1975.

**4. Balance of payments nearly in equilibrium**

Rapid reduction of the surplus position on current account

In foreign trade and payments in 1975 the Federal Republic of Germany achieved a near-equilibrium, although it may have owed something to chance in this form and is therefore unlikely to be durable in some respects. The main contributing factor was the reduction in the extreme surplus position which had developed in foreign trade in 1974, primarily because of inflated foreign demand. Last year the world-wide recession adversely affected sales of German products abroad at times, while foreign competitors stepped up their efforts to penetrate German markets in view of the sluggish demand in their home countries. The expansionary fiscal policy and monetary ease in Germany no doubt greatly facilitated these tendencies. On the basis of f. o. b. figures for both imports and exports,[1] Germany's export surpluses declined from about DM 57 billion in 1974 to DM 42 billion in 1975, that is by some DM 15 billion. The drop in exports accounted for about DM 9 billion of this decline, and the rise in imports for just over DM 5 billion.

Severe setback in exports in the first half of the year . . .

In the export field, the inflow of foreign orders to German industry decreased significantly as early as the autumn of 1974, and before long actual exports also fell appreciably. Between the autumn of 1974 and mid-1975 seasonally adjusted exports sank by about 8 % in value and 11 % in volume. The sharpest reduction was in exports to western industrial countries, from which a considerable part of the inflated demand had emanated until well into 1974. Inconvenient though this decline in exports was for Germany in domestic terms, it did reflect the fact that some of these partner countries were trying harder to curb the inflationary tendencies. An important result of the associated slowdown in economic activity was that enterprises abroad ran down their stocks and thus imported fewer goods than they had done during the preceding period of excess demand. Although exports picked up in the second half of 1975, over the whole of the year Germany exported 4 % less than a year previously; as export prices rose on an average by 7 % in 1975, this means that the volume of goods sold by German exporters on foreign markets was about 10 % smaller than in the preceding year. Exports of capital goods, which are generally considered to be particularly sensitive to cyclical fluctuations, held up relatively well: in value terms they actually grew by 4 % and in real terms they fell at a below-average rate (7 %). Exports of durable capital goods, some of which were based on orders placed much earlier and which moreover benefited greatly from the purchasing ability of the oil-producing countries, showed positive rates of growth even in real terms in 1975. Food exports, too, increased in volume last year. The setback sustained by the consumer goods industries was

. . . due not so much to smaller exports of capital goods . . .

1 "F.o.b.", i.e. "free on board", denotes the value of exports and imports exclusive of the cost of freight and insurance, which is not deducted from the import values in the monthly foreign trade statistics, thus leading to higher import values and lower export surpluses.

*... as to stock cycle movements in other countries*

comparatively small; their exports sank by 7 % in real terms. The fact that aggregate German exports nevertheless dropped so sharply was mainly attributable to exports of basic and producer goods. They decreased by almost 20 % in real terms, not least owing to a drastic reduction in stocks of these products in some of Germany's major customer countries. Steel producers and the chemical industry were affected most by this. However, these two industries had profited greatly from the world-wide boom in the preceding two years, during which they had raised their foreign sales exceptionally sharply despite extreme price increases (in 1974 the chemical industry had exported 75 % more in value terms than in 1972, and steel exports had been as much as 130 % higher). The decline in exports therefore means in some sense a return to normal; the 1972 volume of exports was exceeded once again.

*Exports begin to recover in the second half of 1975*

Developments in the further course of 1975 strengthened the impression that the contraction in exports in the first half of the year could mainly be ascribed to cyclical influences in other countries, and especially to movements of the stock cycle. As soon as economic activity began to recover in major customer countries and the much depleted stocks started to rise slightly, the inflow of orders from abroad increased and before long actual exports followed suit — the strongest growth being in those products (apart from iron and steel) exports of which had previously fallen most. By December 1975 exports had already regained the level of a year before, and at the beginning of 1976 they were distinctly above that level without, however, having quite reached the peak recorded prior to the export downturn. Since the additional demand is coming from Germany's traditional — and most important — market, viz. the western industrial nations, exports are now on a much firmer basis than they were in 1974/75, when German exporters managed to offset at least some of the fall in sales to industrial countries by stepping up their exports to developing countries, oil-producing countries and centrally planned economies.

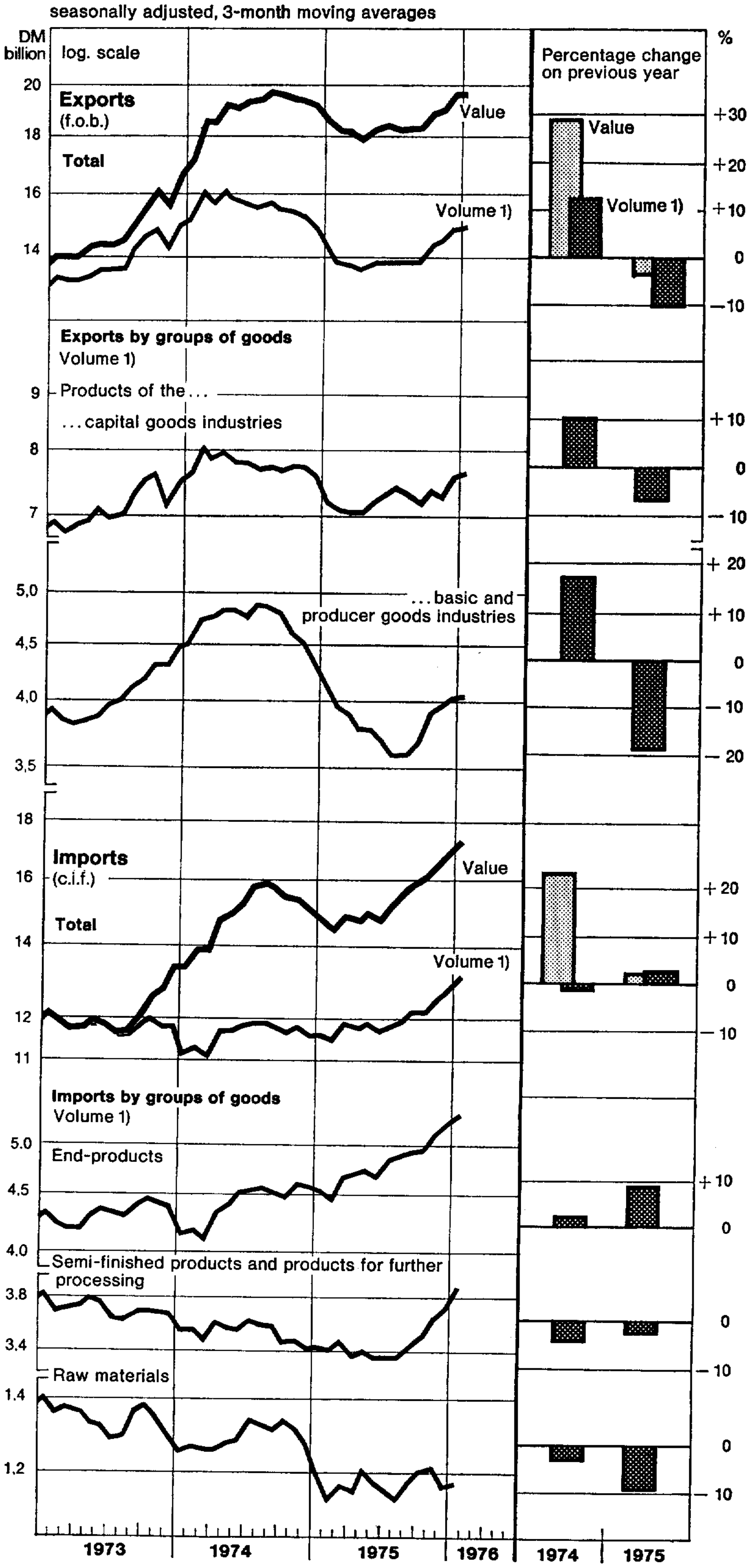
*Increase in German imports boosts international business activity*

Despite the temporary economic setback, relatively large quantities of foreign products were imported last year, thus stimulating business activity in partner countries. Altogether, Germany increased its imports, both in value and in volume, by 3 % against the previous year. There were considerable shifts, however, in the pattern of the goods imported. On the one hand, imports of raw materials and primary products dropped sharply in 1975, in volume terms by 4 %. This is presumably a direct consequence of the temporary decline in production in Germany and the running down of stocks, which reduced demand for such goods. Imports of crude oil were particularly low. Besides reflecting the mild winter of 1974/75 this might point to the generally more sparing use of oil. On the other hand, imports of end-products rose steeply, namely by no less than 9 % in volume terms compared with 1974. Certain types of goods even underwent an import boom in 1975, for example automobiles and other vehicles (+ 37 %) and the products of the clothing industry (+ 14 %). The main reason for this seems to have been that foreign suppliers invested more effort in exports since business activity in their own countries was slack, although the effects of the economic revival that was just beginning in Germany were also noticeable. From mid-1975 onwards more semi-finished goods and primary products were imported — in addition to the continued rise in imports of end-products — for augmenting production at home and replenishing the much reduced stocks.

*Drastic reduction in trade surpluses vis-à-vis industrial countries*

The contrasting trends in Germany's exports and imports led to a drastic reduction in its trade surpluses vis-à-vis western industrial countries, which had swollen considerably in the period of world-wide inflation. According to the official foreign trade statistics, in which imports are shown c. i. f. (cost-insurance-freight, i. e. inclusive of the cost of freight and insurance) rather than f. o. b. (free-on-board) as in the annual balance of payments statistics, the export surpluses with these countries dropped from DM 44 billion in 1974 to DM 21 billion in 1975. The large trade surpluses recorded in 1974 with the United States and Italy even gave way to deficits. This development was just as much in the interest of more balanced world trade as the simultaneous reduction in Germany's trade deficit with OPEC countries from DM 13.5 billion to DM 3.5 billion. Thus the deficit vis-à-vis the oil-producing countries sank to the level of 1972, the year before the outbreak of the

## Foreign trade




1) Quantities at unit values of 1970.

oil crisis. True, in 1975 German imports of crude oil from OPEC countries, at roughly DM 19 billion, were DM 11.5 billion higher than in 1972, but in the same period Germany's exports to this group of countries went up slightly more, viz. by DM 12 billion to not quite DM 17 billion.

Exports to centrally planned economies largely financed on credit

In trade with centrally planned economies the German surplus grew by a further DM 1.3 billion to nearly DM 9 billion, mainly owing to larger exports to the USSR. In the course of 1975, however, German exports to these countries did not rise any further, seasonally adjusted. Apparently they came up against the limits set in the last analysis by the heavy external debt incurred in western currencies by centrally planned economies in recent years. According to the returns for the balance of payments statistics, the short and long-term liabilities accumulated vis-à-vis Germany within only a few years amounted to some DM 16.5 billion (net) at end-1975. This was about DM 5 billion more than a year before; this growth was equivalent to approximately 30 % of Germany's exports to centrally planned economies in the same year. (Trade with the GDR or the indebtedness of the GDR to the Federal Republic of Germany is not included, since these are intra-German transactions. In relation to the volume of trade – DM 3.3 billion of purchases by the Federal Republic of Germany from the GDR and DM 3.9 billion of sales to the GDR in 1975 – the indebtedness of the GDR in all forms of credit is also quite substantial; it amounted to approximately DM 2.5 billion net at end-1975).

Persistently high deficits on services and transfer payments

Germany's deficits on external services and current transfers reached a record level in 1975. Inclusive of the cost of freight and insurance for imports of goods they grew by more than DM 1 billion to DM 33 billion. The deficits in this sector of the current account thus offset approximately four fifths of the trade surplus, demonstrating that Germany's external position must not be judged only in the light of its trade surplus, which in many respects is inextricably linked with "imports" of foreign services and with current transfers by foreigners living in Germany. In 1975 Germany maintained its position as the world's largest "net importer" of all types of services (e. g. also as regards tourism and foreign travel); with an "import volume" of DM 89 billion, including unrequited transfers, and exports amounting to only DM 57 billion, it contributed in this manner to safeguarding economic activity and employment in other countries. There was a significant increase on the previous year in Germany's transfers to the European Communities (of DM 1.8 billion net to a total of DM 3.8 billion) and in the deficits on foreign travel (of DM 1.5 billion to DM 13.7 billion). On the other hand, the deficit on transportation account dropped steeply, not least owing to the slump in the oil transport market, and in the investment income sector Germany had a considerable surplus again (DM 0.9 billion) after a temporary slight deficit in 1974. As many foreign employees have returned to their home countries, the wage remittances of such workers also fell by DM 1.5 billion to DM 6.5 billion. This moderation of the downward trend on services and transfer payments accounts will in all probability persist for some time.

Adequate financing of the remaining surplus on current account

From the standpoint of balance of payments policy, the decline in the surplus on current account to DM 9 billion in 1975 (compared with DM 25 billion in the preceding year and DM 11.5 billion in 1973) is to be regarded as a welcome return to normal. The remaining surplus is not large considering Germany's role in the world economy in general and its special position as a net exporter of industrial machinery and equipment; this position often entails the granting of credit to foreign purchasers and thus necessarily leads to capital exports. The surplus on current account raised no problems in 1975 – neither for Germany nor for the rest of the world – inter alia because it was adequately financed. The measures which the Bundesbank had to take on cyclical grounds to ease monetary conditions created a considerable differential in liquidity and interest rates between Germany and other countries, and this above all strengthened the tendency towards long-term capital exports. In contrast to the preceding year, in which most of the surplus on current account had been financed by the business community by granting export credits (that is, primarily at fairly short term), the current account surplus was financed on balance at long term in 1975.

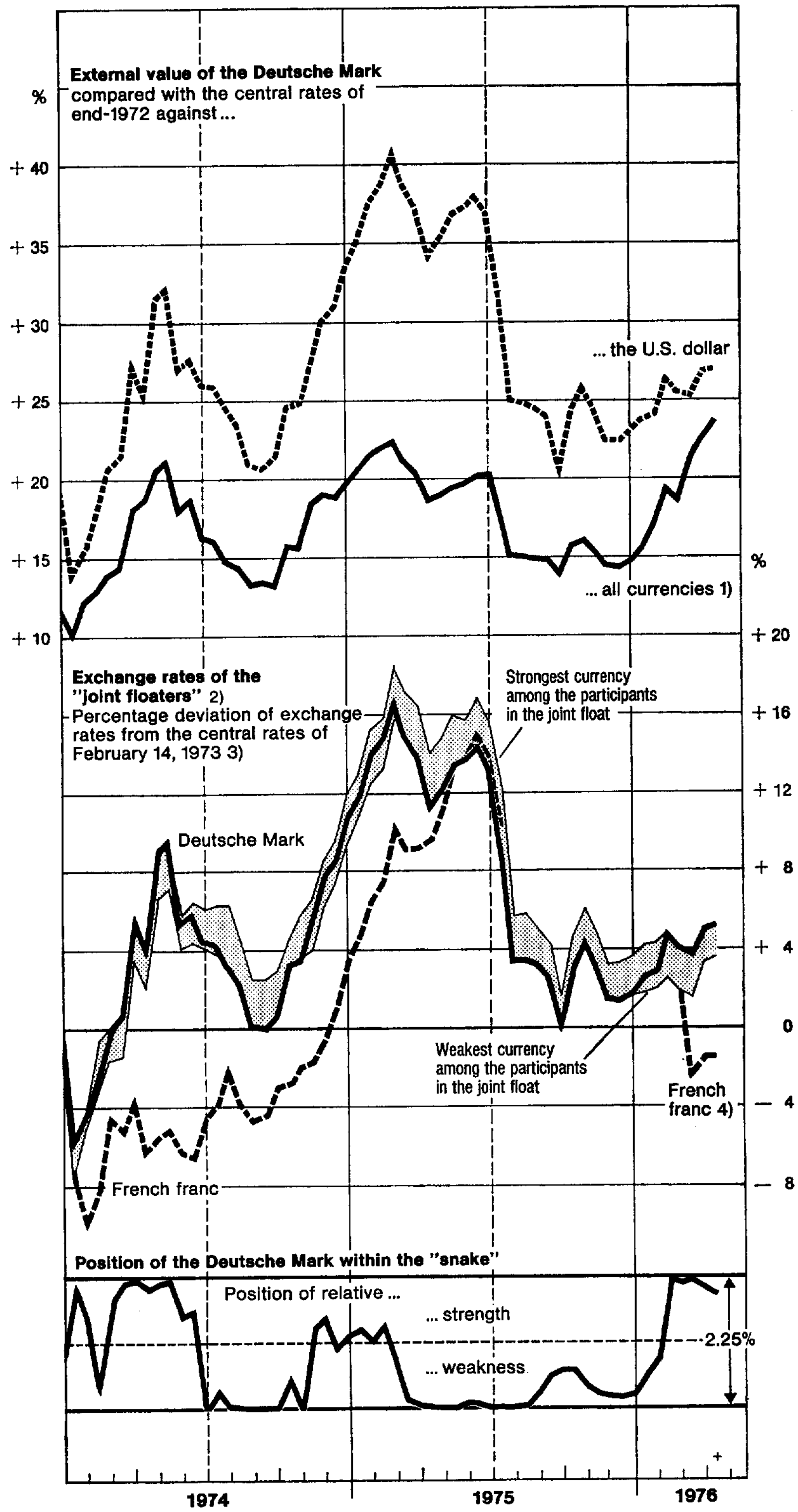
## Main items of the balance of payments

Millions of Deutsche Mark

| Item | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|---|---|
| I. Current account | | | | | | | | |
| 1. Merchandise transactions | | | | | | | | |
| (a) Balance of trade | | | | | | | | |
| Exports (f.o.b.) 1 | 99,551 | 113,557 | 125,276 | 136,011 | 149,022 | 178,396 | 230,578 | 221,600 |
| Imports (f.o.b.) 1 | 76,146 | 92,816 | 102,855 | 112,749 | 121,748 | 137,853 | 172,221 | 177,545 |
| Balance | +23,405 | +20,741 | +22,421 | +23,262 | +27,274 | +40,543 | +58,357 | +44,055 |
| (b) Supplementary trade items (balance) 2 | – 702 | – 422 | – 1,601 | + 9 | – 890 | – 652 | – 1,620 | – 2,127 |
| Balance of trade | +22,703 | +20,319 | +20,820 | +23,271 | +26,384 | +39,891 | +56,737 | +41,928 |
| 2. Services | – 3,535 | – 4,071 | – 7,878 | – 8,693 | – 9,902 | –12,553 | –15,247 | –15,729 |
| 3. Transfer payments | – 7,312 | – 8,750 | – 9,759 | –11,497 | –14,009 | –15,842 | –16,353 | –17,005 |
| Balance on current account (1 plus 2 plus 3) | +11,856 | + 7,498 | + 3,183 | + 3,081 | + 2,474 | +11,496 | +25,136 | + 9,193 |
| II. Capital account (outflow: –) | | | | | | | | |
| 1. Banks | | | | | | | | |
| Long-term | – 5,156 | –10,824 | + 1,041 | + 3,366 | + 3,532 | + 3,985 | – 1,477 | –11,567 |
| Loan business | – 3,299 | – 9,104 | + 544 | + 2,722 | + 1,935 | + 4,261 | – 1,273 | –11,529 |
| Other | – 1,857 | – 1,720 | + 497 | + 644 | + 1,597 | – 276 | – 204 | – 38 |
| Short-term | + 2,455 | + 4,325 | + 7,927 | + 1,174 | – 420 | – 5,149 | – 9,733 | – 2,262 |
| Total capital transactions of banks (net) | – 2,701 | – 6,499 | + 8,968 | + 4,540 | + 3,112 | – 1,164 | –11,210 | –13,829 |
| 2. Enterprises and individuals | | | | | | | | |
| Long-term | – 4,716 | –10,379 | + 413 | + 5,092 | +13,497 | +11,168 | – 3,428 | – 6,192 |
| Direct investment | + 314 | – 704 | – 1,055 | + 246 | + 931 | + 1,428 | + 1,624 | – 1,700 |
| Security transactions 3 | – 3,887 | – 9,018 | – 1,143 | + 1,899 | +13,388 | + 6,622 | – 3,400 | – 4,069 |
| Foreign securities | – 3,900 | – 7,810 | – 2,481 | – 109 | + 2,678 | + 113 | – 877 | – 2,542 |
| German securities 4 | + 13 | – 1,208 | + 1,338 | + 2,008 | +10,710 | + 6,509 | – 2,523 | – 1,527 |
| Loan business | – 784 | – 181 | + 3,155 | + 3,622 | + 137 | + 3,754 | – 1,151 | + 119 |
| Other | – 359 | – 476 | – 544 | – 675 | – 958 | – 636 | – 499 | – 542 |
| Short-term | + 1,436 | + 65 | + 8,417 | + 2,007 | – 3,592 | + 5,175 | – 9,289 | + 6,443 |
| Financial credits | + 536 | – 235 | + 6,417 | – 1,393 | – 4,592 | + 575 | + 3,102 | + 2,503 |
| Trade credits 5 | + 900 | + 300 | + 2,000 | + 3,400 | + 1,000 | + 4,600 | –12,391 | + 3,940 |
| Total capital transactions of enterprises and individuals (net) | – 3,280 | –10,314 | + 8,830 | + 7,099 | + 9,905 | +16,343 | –12,717 | + 251 |
| 3. Public authorities | | | | | | | | |
| Long-term | – 1,329 | – 1,837 | – 2,388 | – 2,166 | – 1,478 | – 2,203 | – 877 | + 1,127 |
| Loans to developing countries and international organisations | – 1,277 | – 956 | – 1,001 | – 1,400 | – 1,418 | – 1,912 | – 2,020 | – 1,897 |
| Assignment of borrower's notes | — | — | — | — | — | — | + 1,242 | + 3,454 |
| Other | – 52 | – 881 | – 1,387 | – 766 | – 60 | – 291 | – 99 | – 430 |
| Short-term 6 | + 1,185 | – 29 | – 297 | + 1,142 | + 476 | + 251 | – 31 | + 692 |
| Total capital transactions of public authorities (net) | – 144 | – 1,866 | – 2,685 | – 1,024 | – 1,002 | – 1,952 | – 908 | + 1,819 |
| Total capital transactions of all sectors (1 plus 2 plus 3) | – 6,125 | –18,679 | +15,113 | +10,616 | +12,015 | +13,227 | –24,835 | –11,759 |
| Long-term | –11,201 | –23,040 | – 943 | + 6,293 | +15,551 | +12,950 | – 5,782 | –16,632 |
| Short-term | + 5,076 | + 4,361 | +16,047 | + 4,323 | – 3,536 | + 277 | –19,053 | + 4,873 |
| III. Balance of all statistically recorded transactions (I plus II) | + 5,731 | –11,181 | +18,296 | +13,697 | +14,489 | +24,723 | + 301 | – 2,566 |
| IV. Balance of statistically unclassifiable transactions (balancing item) 7 | + 1,278 | + 919 | + 3,616 | + 2,661 | + 1,201 | + 1,705 | – 2,207 | + 347 |
| V. Overall balance on current and capital accounts (III plus IV) | + 7,009 | –10,262 | +21,912 | +16,358 | +15,690 | +26,428 | – 1,906 | – 2,219 |
| VI. Contra-entry to changes in the Bundesbank's external position 8 | — | – 4,099 | + 738 | – 5,369 | – 496 | –10,279 | – 7,231 | + 5,480 |
| VII. Change in the Bundesbank's net external assets (increase: +) 9 | + 7,009 | –14,361 | +22,650 | +10,989 | +15,194 | +16,149 | – 9,137 | + 3,261 |

1 Special trade. – 2 Chiefly merchanting trade and warehouse transactions for account of residents. – 3 Portfolio transactions only, i. e. excluding transactions in shares for the purpose of acquiring permanent investments. – 4 Transactions in German securities are all ascribed to the sector "Enterprises and individuals", since the statistics do not show precisely which residents are involved in each transaction. – 5 Up to 1973 partly estimated. – 6 Chiefly changes in the Federal Government's assets resulting from pre-payments on government imports and changes in the Federal Government's liabilities to the European Communities on so-called deposit accounts. – 7 Net errors and omissions on current and capital accounts. – 8 See footnote 9. – 9 These figures include the changes due to the 9.3 % Deutsche Mark revaluation of October 27, 1969, the fixing of central rates in December 1971 (which led to a 13.6 % revaluation of the Deutsche Mark against the U.S. dollar), the 10 % devaluation of the U.S. dollar of February 12, 1973 and the valuation adjustments made in December of the years 1972 to 1975. This item also includes the increase in the Bundesbank's external assets owing to the allocation of special drawing rights between 1970 and 1972 totalling DM 1,985 million. As these changes are not attributable to current or capital transactions, contra-entries are inserted under VI for the sake of achieving an arithmetical balance.
Discrepancies in the totals are due to rounding.

## Exchange rate movements *




* Based on official rates ( middle and end of month ).- 1) Weighted change in the external value of the Deutsche Mark.- 2) On March 19, 1973 six EEC countries ( Belgium, Denmark, France, Germany, Luxembourg, Netherlands ) and Norway and Sweden adopted the joint float against the U.S. dollar while maintaining a common spread of 2.25 % in relation to one another.- 3) Deutsche Mark, Dutch guilder and Norwegian krone: percentage deviation from computed dollar central rates.- 4) From March 15, 1976 - as also between January 21, 1974 and July 9, 1975 - France does not participate in the joint float.-
+ Latest position: April 14, 1976.

Large money and capital exports of banks

German banks were the principal exporters of long-term funds in 1975. Through the granting of "long-term" loans alone (i. e. loans running for more than one year) DM 11.5 billion (net) flowed abroad in 1975. To some extent this may have been because certain countries which in 1974 had financed a large part of their trade and current account deficits by taking up short-term foreign credit consolidated their short-term foreign debt in 1975, especially since this was quite frequently possible at interest rates which were not only lower than those charged a year previously but also lower than the rates charged on their own markets at the same time. German banks also greatly expanded their short-term foreign business in 1975. In aggregate, the short-term external assets of German banks (including the branches of foreign banks in Germany) grew by DM 13 billion to DM 50 billion in 1975, and short-term external liabilities rose by DM 11 billion to DM 47 billion in the same period. The banks' short-term money management thus produced net outflows totalling over DM 2 billion. At the beginning of 1975, when the foreign exchange surpluses of non-banks were fairly considerable (owing to the very large surpluses on current account and the widespread raising of financial credits by German enterprises) while the long-term capital exports of banks were still comparatively small, the banks increased their short-term external claims particularly sharply, so that net capital exports amounted to nearly DM 5.5 billion in the first half of 1975. In the further course of the year, when long-term capital exports were rising fairly rapidly, the banks imported money on balance. These inflows were primarily due to a steep increase in foreign non-banks' deposits with German banks, the main reasons for which seem to have been that the remaining barriers erected against capital imports had been very largely dismantled (e. g. the ban on the payment of interest on non-residents' deposits and the special minimum reserve ratios on external liabilities) and that an authorisation was now to be expected when non-residents purchased domestic bonds maturing within two to four years. The ban on the assignment of public authority borrower's notes to non-residents was also relaxed to a limited extent. The last barrier remaining in effect is the prohibition of the sale to non-residents of fixed interest securities maturing within two years.

Reversal in enterprises' capital transactions

Enterprises' short and long-term capital transactions, which had resulted in outflows totalling some DM 9 billion in 1974, produced net capital imports amounting to DM 5 billion in 1975. This was mainly because of changes in the field of trade credits. As already stated, in 1974 the German business community had financed the greater part of the much increased trade surpluses itself by granting trade credits (on balance it made some DM 12.5 billion available to non-residents in this way), but in 1975 German enterprises borrowed funds. They received some DM 4 billion (net) from abroad, mainly in the form of advance payments for exports and credit terms for imports. In addition, German enterprises took up over DM 2.5 billion of short-term financial credits in other countries, not least because the cost of credit was at times distinctly lower abroad. By contrast, enterprises' long-term capital transactions resulted in net outflows, mainly on account of direct investments. Whereas a number of OPEC countries had acquired some major assets in Germany in 1974, German investments in other countries (almost DM 5 billion) outweighed corresponding foreign investments in Germany (DM 3.3 billion) in 1975. Some DM 4 billion flowed abroad in 1975 as a result of private security transactions; classifying such transactions by domestic sectors raises certain statistical problems, but it may be assumed that most of them can be ascribed to households. Compared with the previous year, in which approximately DM 3.5 billion (net) was exported through security transactions, residents' purchases both of foreign bonds and of shares increased.

On the other hand, the public sector imported funds on balance last year, although these imports, at almost DM 2 billion, were insignificant by comparison with the substantial capital exports of the banks. This did not place any burden on international financial markets, which on the contrary were very well supplied with funds owing to the money and capital exports of German banks.

Bundesbank interventions on the whole within narrow limits in 1975

The change in monetary conditions, together with the flexible adjustment of the exchange rate structure, ensured overall payments balance without major strains. At times, it is true, the outflows of money and capital were so strong that the Bun-

## External position of the Deutsche Bundesbank

**Millions of Deutsche Mark**

| Item | Changes (+: increase in assets, decrease in liabilities) 1971 | 1972 | 1973 | 1974 | 1975 | Level at Dec. 31, 1975 |
|---|---|---|---|---|---|---|
| **I. Monetary reserves** | | | | | | |
| 1. Gold | + 353 | + 106 | + 30 | + 1 | — | 14,002 |
| 2. Reserve position in International Monetary Fund and special drawing rights | + 1,281 | + 1,504 | + 1,982 | + 388 | + 906 | 9,309 |
| 3. Foreign exchange | +15,304 | +14,607 | +23,401 | —10,249 | — 2,903 | 51,303 |
| U.S. dollar investments | +15,222 | +14,571 | +23,149 | —10,178 | — 2,889 | 51,056 |
| Other foreign exchange balances **1** | + 82 | + 36 | + 192 | — 11 | — 14 | 247 |
| Claims on European Monetary Cooperation Fund (FECOM) **2** | — | — | + 60 | — 60 | — | — |
| 4. External liabilities | — 60 | — 80 | + 1,031 | — 329 | + 333 | 1,869 |
| Liabilities to foreign central banks | — 343 | — 78 | + 1,241 | — 192 | + 258 | 1,192 |
| Liabilities to European Monetary Cooperation Fund (FECOM) **2** | — | — | — | — | — | — |
| Other liabilities | + 283 | — 2 | — 210 | — 137 | + 75 | 677 |
| Net monetary reserves (1 plus 2 plus 3 less 4) | +16,878 | +16,137 | +26,444 | —10,189 | — 1,664 | 72,745 |
| **II. Loans and other claims on foreign countries** | | | | | | |
| 1. Loans in connection with medium-term EEC monetary assistance | — | — | — | + 1,283 | — | 1,273 |
| 2. Claims arising from foreign exchange offset agreements with United States and United Kingdom | — 200 | — 7 | — 8 | + 1,688 | + 562 | 4,102 |
| 3. Other loans to foreign monetary authorities | + 35 | — 101 | — 22 | + 5,308 | — 1,145 | 3,926 |
| 4. Loans to World Bank | + 272 | + 281 | + 14 | + 4 | + 28 | 2,502 |
| Total (1 plus 2 plus 3 plus 4) | + 107 | + 173 | — 16 | + 8,283 | — 555 | 11,803 |
| **III. Overall external position of the Deutsche Bundesbank ( I plus II)** | | | | | | |
| (a) Changes due to external current and capital transactions (1971 and 1972 including allocation of special drawing rights) | +16,985 | +16,310 | +26,428 | — 1,906 | — 2,219 | 84,548 |
| (b) Valuation adjustment of the Deutsche Bundesbank's external position | 3 — 5,996 | 4 — 1,116 | 5 —10,279 | 6 — 7,231 | 6 + 5,480 | . . |
| (c) Change in the Deutsche Bundesbank's net external assets as shown in the balance of payments (increase: +) | +10,989 | +15,194 | +16,149 | — 9,137 | + 3,261 | . . |

**1** Including foreign notes and coins. — **2** Excluding transactions with Norway and Sweden, which are not members of the European Communities and which, as participants in the European joint float, settle their claims and liabilities with partner countries direct and not through the European Monetary Cooperation Fund (FECOM = Fonds Européen de Coopération Monétaire). — **3** Deriving from the fixing of central rates on December 21, 1971 (the so-called Smithsonian Agreement). — **4** Owing to valuation adjustments of gold holdings, drawing rights within the gold tranche and special drawing rights which were not made when central rates were fixed in December 1971. — **5** Caused by the 10 % devaluation of the U.S. dollar on February 12, 1973 and the valuation adjustment of the external position at end-1973. — **6** Deriving from the valuation adjustment of the external position at the end of 1974 and 1975.

desbank intervened in the foreign exchange markets to moderate and smooth exchange rate movements, but over the whole of 1975 interventions remained within narrow limits and the Bundesbank's net external assets fell by DM 2.2 billion during the year. This change in reserves is in itself very small, but the tendency towards balance of payments equilibrium is brought out even more clearly by a glance at the movements of exchange rates. In 1975 the exchange rate of the Deutsche Mark admittedly showed variations which were relatively marked at times, especially in relation to individual currencies. Even before the Rambouillet decisions whereby the monetary authorities will take action to counter erratic fluctuations in exchange rates the Bundesbank had been acting along these lines, but without distorting the fundamental trend of the rates. In relation to the fluctuations of the various exchange rates, the "external value" of the Deutsche Mark as derived from the average of all the relevant exchange rates was fairly stable in 1975. On an average it was only 1.7 % higher than in 1974; this was the smallest change since 1969. During the year, too, the external value of the Deutsche Mark altered only moderately; in December 1975 it was 3.6 % lower than in December 1974. The comparatively small scale of the interventions of the Bundesbank and the modest fluctuations of the exchange rates bear out the statement made at the beginning of this section that Germany's external trade and payments were largely in equilibrium in 1975. As shown by developments on the foreign exchange markets in February and March 1976, however, this state of affairs does not preclude the possibility of occasional, more substantial changes in the exchange rate of the Deutsche Mark against other currencies. Such changes are unavoidable from time to time if, as has so far been the case, rates of inflation differ greatly in the principal partner countries.

**5. The economy in the upswing**

Coordinated monetary and fiscal policies of particular importance for the economic turnround

Owing to the interaction of a number of factors the recession in the Federal Republic of Germany came to a halt in the summer of 1975, and since then the economic recovery has become more pronounced from month to month. The monetary and fiscal measures to boost economic activity were doubtless of particular importance; they were joined by purely cyclical influences such as the ending of the reduction in stocks, and finally the downward trend of foreign demand reversed. It is noteworthy that on this occasion – in contrast to a number of other economic cycles in the Federal Republic of Germany – this stimulus was not at the beginning of the chain of causation leading to the upswing.

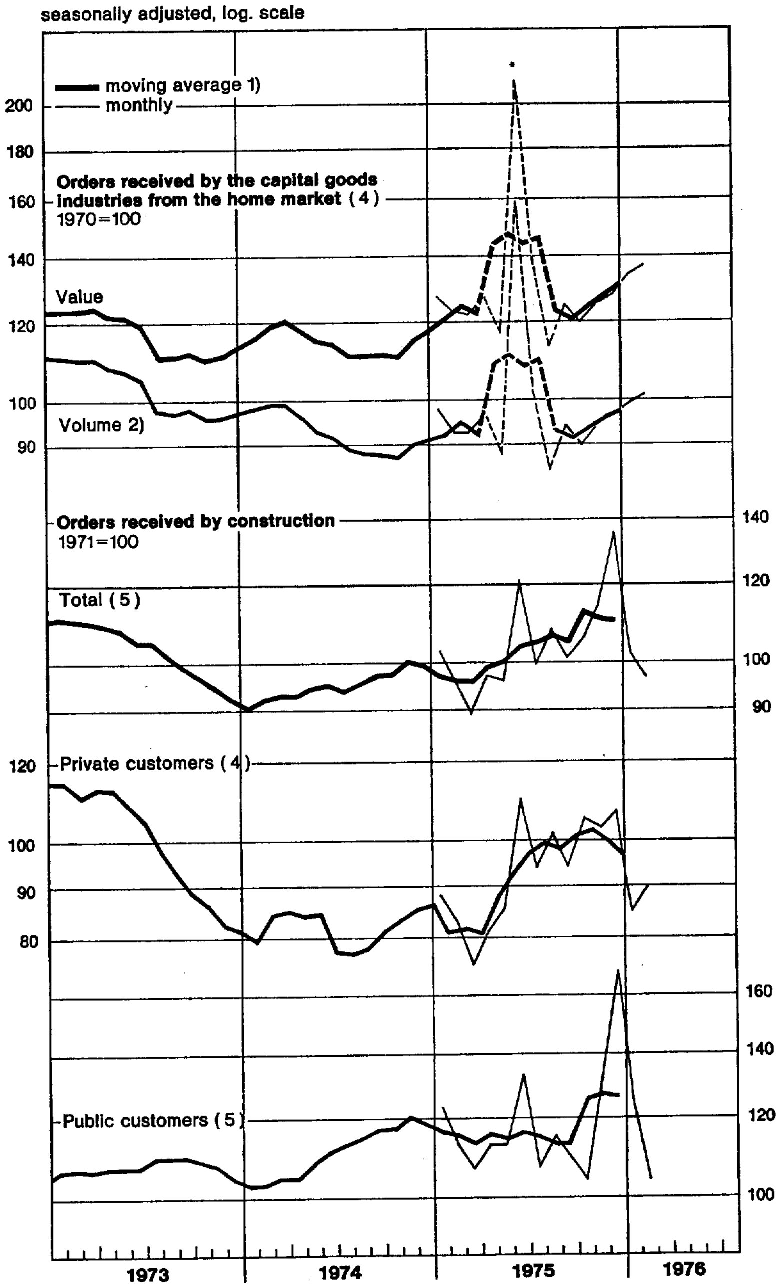
What did give a significant stimulus to domestic demand at the end of the first half of 1975 was the investment grant adopted in December 1974. At first it seemed as if this concession would mainly be used for those car purchases which had been planned in any case; after all, a certain pent-up demand had developed for such vehicles. But in June, immediately before the deadline for placing orders under the investment grant scheme (June 30, 1975), German capital goods producers received a surge of new orders. In some cases, admittedly, orders that had originally been planned for later on were simply advanced, but the downturn in orders expected in the autumn turned out to be considerably smaller than had been feared. In the fourth quarter of 1975 domestic orders received by the capital goods industries (excluding vehicle building) in fact increased distinctly; seasonally adjusted, they were roughly 5 % larger than in the first quarter and no smaller than at the beginning of 1974, i. e. before the economic slowdown started in that sector. In the first few months of 1976 the upward trend of demand for capital goods continued at an undiminished pace. From the longer-term point of view, however, the level which demand has meanwhile reached must still be regarded as low. In volume terms it was no higher at the beginning of 1976, for example, than the average of 1970. Considering that much production capacity was lost during the recession owing to insolvencies and voluntary liquidations, the demand for capital goods around the turn of 1975/76 was not yet running at a level which would permit longer-term advances in growth approaching the size of those of earlier years; but this is not the problem in 1976, in which production can be increased considerably and productivity improved accordingly because the utilisation of capacities was initially low.

Revival of demand for all kinds of construction work

The demand for construction work also responded favourably to the stimuli given in the course of 1975. The first spate of orders received by the construction industry towards the middle of the year was probably likewise mainly due to the investment grant. During the second half of the year, however, there were signs that the demand for construction work was increasing in depth and intensity independently of the grant. The construction orders placed in the fourth quarter of 1975, seasonally adjusted, were roughly as high as they had been before construction demand turned down in the spring of 1973. Virtually all sectors of construction were affected by the revival of demand. Public developers placed particularly many orders towards the end of last year, though this was certainly in part because orders under the special programmes of August 1975 for Federal investment and municipal investment in infrastructure had to be placed by the end of the year. In the field of commercial and industrial construction, too, more projects were started in the second half of 1975. In housing, which had long been the weakest sector of construction for cyclical and structural reasons, there were signs of a change for the better as early as the spring; between the low in the first quarter of 1975 and the fourth quarter orders for basic construction work increased by more than one third. Demand for finishing work was augmented significantly, not least by special measures to promote the modernisation of housing. In particular, people showed more inclination to acquire a home of their own. In the field of the commercial

## Demand for capital goods

seasonally adjusted, log. scale




* Influenced by the approach of the deadline for qualifying for the investment grant (June 30, 1975).- 1) The length of the moving average (in months) is indicated in brackets beside each curve.- 2) Orders received at 1970 prices.

construction of rented dwellings as well, more projects have been registered of late. The increasingly favourable terms of financing played a major part in this; the effective interest rates on mortgage loans, for example, fell to about 8½ % in the second half of the year and to 8 % in March 1976, i. e. to the level of 1972. The relatively stable construction prices and the raising of rents in publicly-assisted housing (the "competitor" of commercial housing) also had a slightly stimulating effect. In addition, demand picked up on the real estate market from the middle of the year onwards. Sales of well designed and favourably situated owner-occupied dwellings improved, and the "stockpiles" of unsold properties began to diminish.

Strong recovery of fixed capital formation towards the end of the year

Capital expenditure responded with a relatively short time lag to the stimuli given by demand. Seasonally adjusted, fixed capital formation started to rise in the third quarter of 1975, and in the fourth quarter it grew at a fairly rapid pace, not least

**Income, consumption and saving of households**

| Period | Disposable income | of which: Net wage and salary income | of which: Government current transfers | Private consumption | Private saving | Saving ratio 1 |
|---|---|---|---|---|---|---|
| | Billions of Deutsche Mark | | | | | % |
| 1973 | 577.7 | 317.9 | 116.1 | 495.7 | 82.0 | 14.2 |
| 1974 | 628.1 | 342.7 | 133.7 | 532.9 | 95.1 | 15.1 |
| 1975 Total | 687.1 | 355.5 | 167.0 | 577.7 | 109.4 | 15.9 |
| 1st half 2 | 340.5 | 177.0 | 80.2 | 282.5 | 58.0 | 17.0 |
| 2nd half 2 | 346.6 | 178.5 | 86.9 | 295.2 | 51.4 | 14.8 |
| | Percentage change on previous period | | | | | |
| 1973 | 9.0 | 9.0 | 11.7 | 9.9 | 3.8 | . |
| 1974 | 8.7 | 7.8 | 15.1 | 7.5 | 16.0 | . |
| 1975 Total | 9.4 | 3.7 | 24.9 | 8.4 | 15.0 | . |
| 1st half 2 | 5.4 | 2.0 | 14.6 | 3.9 | 13.5 | . |
| 2nd half 2 | 1.8 | 0.8 | 8.4 | 4.5 | —11.4 | . |

1 Private saving as % of disposable income. — 2 Seasonally adjusted. — Provisional.

because many investors asked for the goods they had ordered to be delivered before the end of the year if possible, so that they could apply for and collect the investment grant during 1976. But in spite of the rapid progress of the recovery towards the end of the year, the level of fixed capital formation was still relatively low. In the longer run there is undoubtedly pent-up demand in this field — demand which can only emerge if there is a sustained improvement in the profitability and the capital base of enterprises.

Reversal in the stock cycle

The strengthening of domestic economic activity in the later part of the year was assisted by the stockbuilding of trade and industry. In the preceding downswing phase stocks of primary products and finished goods had been reduced to a size which soon proved to be too small when economic activity began to recover. There were also signs in the course of 1975 of new price increases on the raw material markets: the prices of spun fibres went up in the first half of 1975, and rises in the prices of steel and chemical products were to be expected later in the year. Enterprises therefore started to build up their stocks in the autumn. This stockbuilding was facilitated by the fact that they had a substantial cushion of liquid funds at that time, as usual in a phase of slack economic activity, and were able to obtain outside funds on relatively favourable terms.

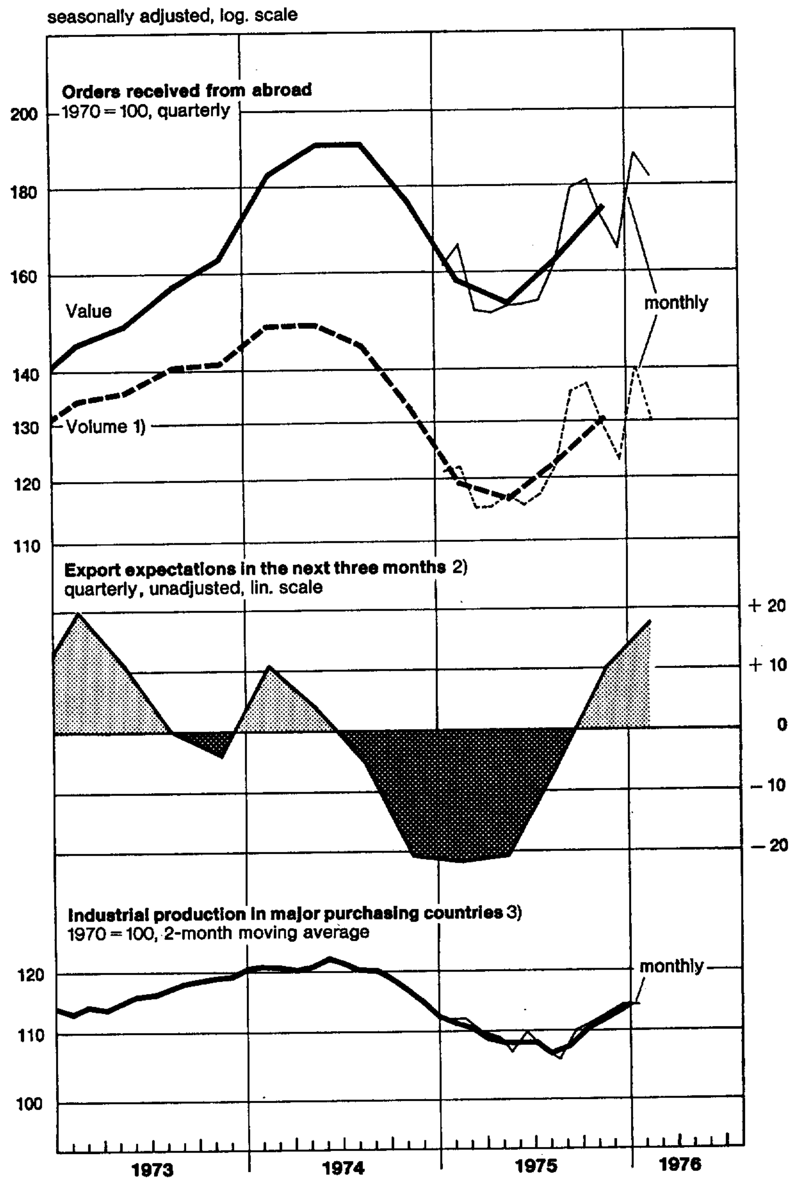
Private consumer demand a mainstay of economic activity

Private consumer demand turned out to be a major support of economic activity in the course of 1975. It did not decline during the whole of the recessionary phase, although there were marked shifts of emphasis within private consumption at times. In the second half of the year private consumer demand gathered momentum; sales of the goods offered by the retail trade increased appreciably and car purchases went up fast. The numbei of passenger cars newly registered in the fourth quarter of 1975 was over one third larger than a year previously. Over the entire year the number of new car registrations, at 2.1 million, was no smaller than in 1972/73 — i. e. before the oil crisis — and at the beginning of 1976 new car purchases regained the record level of early 1973. In 1975 households also spent distinctly more than a year before on services, rents and trips abroad. Total private consumption expenditure in 1975 grew by 8½ % and thus slightly more than a year earlier (7½ %). Even after adjustment for price increases it rose by just over 2 %.

Additional income increasingly saved

The movement of incomes would, however, have granted scope for a perceptibly stronger expansion of consumption in 1975. True, negotiated pay rate increases were appreciably smaller than a year earlier; the wage and salary level (on a monthly basis) in the fourth quarter of 1975 was about 7 % up on the year, whereas it had risen by roughly 13 % in 1974. The sizable payments previously made on top of agreed wage and salary rates were also reduced considerably. Moreover,

## Foreign demand




1) Orders received at 1970 prices.- 2) Source: Ifo Institute.- 3) Indexes of industrial production of the following countries (weighted with their share in German exports): France, United Kingdom, Italy, Netherlands, Belgium, Austria, Switzerland, Norway, Sweden, United States, Canada and Japan. Source: National statistics.

earnings fell owing to the widespread introduction of short-time working and the decline in employment. However, these influences tending to curb the expansion of incomes were fully offset by larger current transfers of public authorities: the reform of children's allowances, the increase in social security pensions (of 11 % as from July 1, 1975) and the large assistance payments to short-time workers and unemployed persons all acted in the same direction. Including withdrawals from entrepreneurial income and property income, the total income at the disposal of households in 1975 was 9½ % higher than a year earlier. The fact that households saved less in the second half of the year than in the first had a favourable influence on economic activity; the saving ratio fell to 14½ % (seasonally adjusted) in the fourth quarter, compared with the extremely high figure of 17 % in the first half of 1975.

Foreign demand strengthens after the middle of the year

Foreign demand soon aided the economic recovery in Germany, though chronologically it was only a secondary factor as the economic upturn in the industrial countries — other than the United States and Japan — lagged behind that in Germany to a greater or lesser extent. Orders received from abroad

**Movement of wages and unit labour costs in industry in selected countries**

**Percentage change on previous year**

| Country | Gross wage and salary income | | Labour costs per unit of output 1 | |
|---|---|---|---|---|
| | 1974 | 1975 2 | 1974 | 1975 2 |
| Belgium | + 19.5 | + 12.5 | + 14.9 | + 21.5 |
| France | + 20.0 | + 13 | + 16.1 | + 21.5 |
| Italy | + 26.0 | + 22 | + 21.0 | + 34 |
| Netherlands | + 13.8 | + 9 | + 12.3 | + 15 |
| United Kingdom | + 16.7 | + 27 | + 20.9 | + 33 |
| United States | + 7.5 | — 1 | + 7.9 | + 9 |
| Selected countries, total 3 | + 17.1 | + 13 | + 15.1 | + 21.5 |
| Compare: | | | | |
| Federal Republic of Germany | + 7.6 | — 0.5 | + 9.0 | + 6.5 |

1 Gross wage and salary income per unit of real gross value added in industry. — 2 Rounded to the nearest half or full percentage point. — 3 Weighted with the share of these countries in German exports in 1974. — Source: Offices of the Commission of the European Communities.

started to rise again around the middle of the year, after having fallen exceptionally sharply, as noted above. In the second half of 1975 they were 8 % larger than in the first half of the year, seasonally adjusted, and around the turn of the year they were for the first time higher than a year before; by the first quarter of 1976 the decline in foreign demand since the middle of 1974 had nearly been offset.

Competitiveness of German industry not impaired

The rapid response of foreign demand to the incipient economic recovery abroad refutes the view held in some quarters that the slump in exports in the winter of 1974/75 was in large part a belated consequence of the appreciation of the Deutsche Mark in preceding years, as a result of which the competitiveness of German industry on world markets was not just temporarily reduced but rather lost for a prolonged period. It is true that in 1975 some German suppliers had to relinquish market shares abroad owing to the more severe competition associated with the decline in international trade. But most German export firms seem to have held their own on foreign markets, mainly no doubt because the rise in prices and costs in Germany was moderate by comparison with that in other countries. Labour costs per unit of output in German industry — as measured by gross income from wages and salaries per unit of real gross value added — rose by 6½ % in 1975; this was only one third as much as in the other western industrial countries. In 1974, too, unit labour costs in Germany had gone up appreciably less than in almost all other industrial countries, even though they had increased by 9 %; in previous years labour costs in Germany and abroad had moved approximately in parallel. Even if it is taken into account that the external value of the Deutsche Mark has risen in the last few years, German industry has retained a certain cost advantage over the other industrialised countries. In the second half of 1975, when the external value of the Deutsche Mark was falling, this advantage was particularly marked and facilitated the renewed growth of exports. After the turn of 1975/76, when the Deutsche Mark rate went up again on the foreign exchange markets, the assistance given by the exchange rate came to an end; between end-December 1975 and end-March 1976 the external value of the Deutsche Mark against all currencies rose by about 7 %, mainly because the currencies of countries with high rates of inflation depreciated whereas the rate of the Deutsche Mark against the currencies of countries where prices rose more moderately remained largely unchanged. If the movement of costs and prices in Germany continues to be favourable, German exports will therefore not decrease in competitiveness despite this exchange rate change; instead, they will participate fully in the economic upswing that has started in the industrial countries and will increase further.

At first only a sluggish expansion of production

At first industrial production responded only very sluggishly to the gradual improvement of the sales situation in Germany and abroad. The after-effects of the shock caused by the preceding recession were still too great, and many enterprises were not willing to step up output until the volume of orders on hand had increased somewhat so that the continuation of production at a higher level was more or less assured. In industry (excluding construction) output remained relatively low in the summer of last year, and it was autumn before it gradually rose again. In the last three months of 1975, however, industrial production grew fairly fast. The basic and producer goods industries, in particular, expanded their output rapidly. In the capital goods sector production was increased only cautiously — even after the spate of orders received in mid-1975 owing to the investment grant scheme — because firms feared that there might be no subsequent orders. In many industrial sectors nearer to the consumer stage production was likewise rather slow to react to the stimuli imparted by domestic and foreign demand (many of which were fairly strong), not least it seems because the distributive trades ordered circumspectly at first, so that the momentum generated by final demand was not immediately passed on in full to the producer stage. Vehicle building was an exception to this tendency. In this sector output has increased continuously since the beginning of last year, when demand for cars picked up distinctly, and it has recently been only a little below the record level reached at the beginning of 1973. The repercussions on the industries supplying components for vehicle building have been correspondingly favourable.

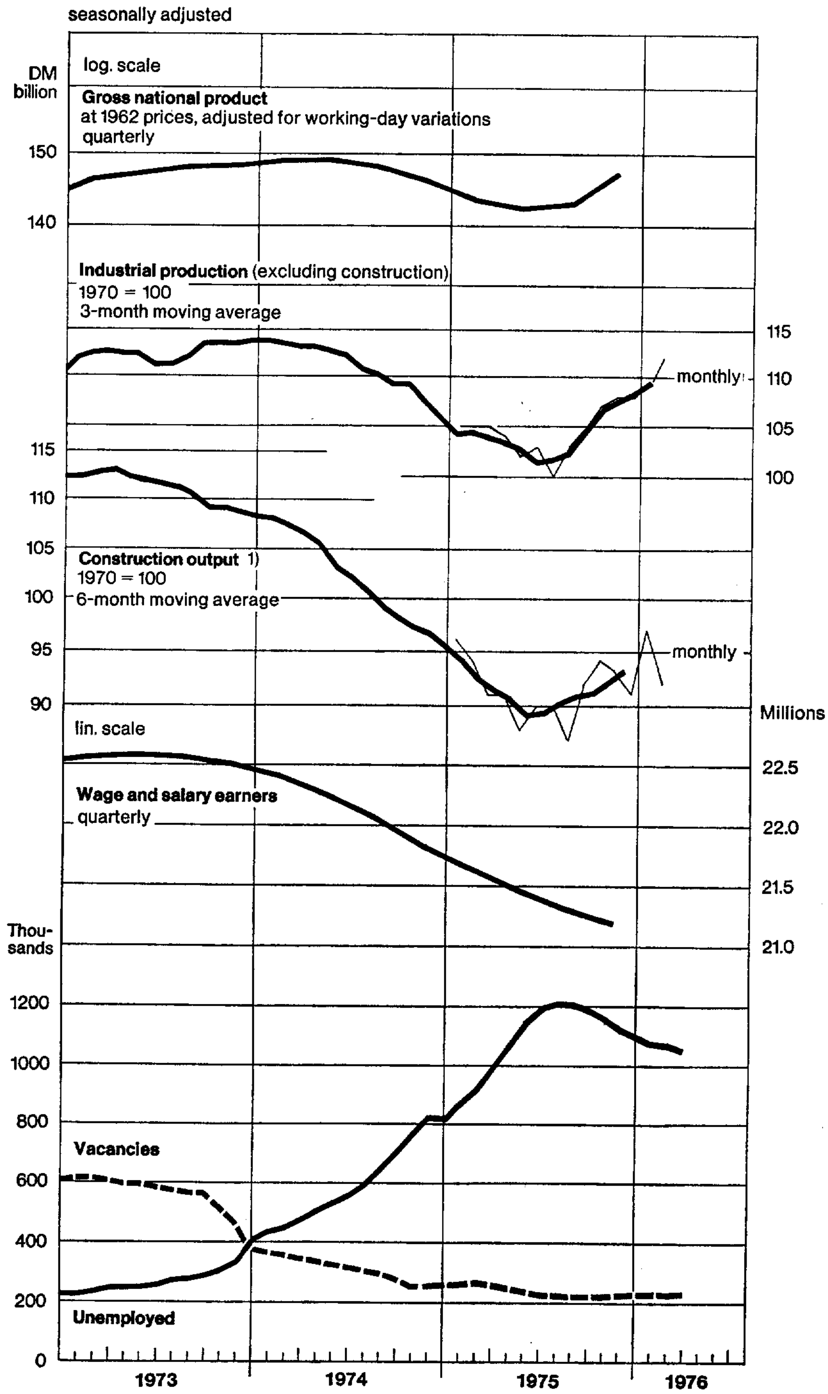
Recovery of construction activity after a long slump

In the construction industry the adjustment of output to the much reduced level of orders, compared with earlier years, was completed by about the middle of 1975. When orders on hand started to grow slightly again after the summer break, construction activity increased, and it benefited further from the good weather towards the end of the year. Nevertheless, in the fourth quarter construction output was not as large as a year before. Production in the finishing trades, which profited from the Federal Government's programme of August 1975 to encourage investment in construction and other fields, fared slightly better. In housing, where activity has long been particularly slack, the number of dwelling units completed in 1975, at 435,000, was distinctly smaller than in earlier years. For the first time for some while this annual figure was within the range of estimated medium-term requirements — viz. between 400,000 and 450,000 new dwellings per year. In each of the preceding five years 600,000 dwellings had been completed on an average; this was far more than warranted by the demand, at least in recent years, given the prevailing level of rents and prices. The "stockpile" of dwellings produced during that period is now gradually being run down. Furthermore, the number of dwelling units approved in 1975 (not quite 370,000) was well down on the low 1974 level, even though housing demand began to recover in the course of last year; but it appears that the trough of housing demand and housing construction has been reached — and passed — in the meantime.

In the other industrial sectors, particularly in the distributive trades and the transport industry, the recovery likewise gathered pace in the last few months of 1975. The aggregate real gross national product, which reached its cyclical low around the middle of the year, thereafter increased again. In the fourth quarter it rose relatively sharply, namely by 3 %, seasonally adjusted. Thus over half of the decline in production since the spring of 1974 had been offset by then. The fact that the real gross national product over the whole of 1975 was 3½ % smaller than in 1974 was mainly attributable to the low in the first half of the year.

Higher imports slow down the improvement in capacity utilisation

One of the reasons why overall production did not respond even more strongly to the stimuli given by demand may have been that foreign suppliers increased their efforts to penetrate markets in Germany in view of the sales problems they still often faced in their home countries. At all events, imports of goods, calculated at constant prices, went up much more than domestic output in the last few months of 1975. The rise in imports of primary products was particularly steep. Imports of finished goods also increased much faster than production in Germany. If imports of goods and services are combined (in accordance with the methods of the national accounts), the share of foreign countries in the overall real supply of goods rose to 25 % in 1975, against just over 24 % in 1974 and an average of not quite 22 % in the preceding five years. This development is no doubt part of the structural adjustment process which was unavoidable following the world-wide realignment of exchange rates for the sake of more balanced trade relations between the principal participants in world trade. For the business community of the Federal Republic of Germany this meant, however, that foreign suppliers at first




1) Also adjusted for unusual winter weather.

benefited more than German producers from the upturn in domestic demand. The utilisation of domestic production potential therefore went up only slowly during the second half of 1975 in spite of the increase in economic activity. Although overall production potential grew only a little in 1975 – viz. by an estimated 2 % over the entire year – utilisation of this potential seems to have run at only 92½ % in the first half of 1975 and 93½ % in the second half, compared with 98½ % a year before and 96 % in 1967, the year of the recession.

In spite of increasing production, further decline in employment

The underutilisation of the labour potential posed particular problems last year. Even when production started to pick up slightly in the second half of the year, staff was reduced further in many cases. Only in a few economic sectors (e. g. in vehicle building and the construction industry) was new labour engaged on balance. In general, enterprises were reluctant to take on employees and tried to satisfy the growing demands on production by cutting down short-time working, increasing overtime and introducing special shifts. The total number of employees declined further in the second half of 1975, seasonally adjusted, though not as much as in the first half of the year. The average number of employees in 1975 was 730,000 (or 3½ %) smaller than a year before. The resources of labour market policy were continuously applied to counteract this trend. For example, the possibilities provided by the Work Promotion Act (short-time working allowances, vocational training measures) were fully exploited. Furthermore, the Federal Government made additional funds available for job creation measures under the economic stimulation programmes of December 1974 and August 1975. Even so, the average number of unemployed persons in 1975 could not be prevented from exceeding the one million mark for the first time for 20 years, so that in all 4.7 % of the dependent labour force was out of work. Towards the end of the year, however, conditions became perceptibly more stable; as usual, the stabilisation lagged distinctly behind the rise in production. The growth of unemployment in the autumn of 1975 was on the whole slightly smaller than customary at that time of year. In some major occupational groups (i. e. metal-working, electrical engineering and construction) unemployment even decreased appreciably, seasonally adjusted. On the other hand, the number of unemployed persons in office, administrative and commercial occupations continued to be large. A further sign of the improved situation on the labour market is the fact that the number of vacancies registered at the labour exchanges has been rising slightly for some time, seasonally adjusted. Major advances have been made since the beginning of 1976 in reducing short-time working. The number of short-time workers fell to an average of 660,000 in the second half of 1975 (against 880,000 in the first half of the year), and by March 1976 it had decreased further to 500,000. In the same month the number of unemployed persons declined more than usual at that time of the year.

**Structural components of unemployment**

The assessment of developments on the labour market from the cyclical point of view has, however, recently presented considerable problems since some structural components of unemployment appear to have increased in significance in the past few years. For example, the number of persons who are out of work for personal reasons has grown substantially. Finding new jobs for these persons will probably not be easy even in the event of a lasting economic recovery. Furthermore, the regional mobility of some unemployed persons is limited. This applies particularly to married women, and in this connection it must be borne in mind that women at present account for a disproportionately large share of the persons registered as unemployed, at about 45 % (women make up about 36 % of the dependent labour force). The government tried to encourage the regional mobility of employees under the programme to stimulate economic activity of December 1974 by temporarily granting a so-called mobility allowance from Federal funds, but little use was made of this facility. Quite apart from the unemployment benefit normally paid, as a result of prior contributions, in the event of unemployment, the share of those kinds of income which are received irrespective of employment (e. g. children's allowances) or which may increase if wages and salaries fall (housing allowances, vocational training allowances) has been growing in many family budgets in the last few years. To this extent unemployed persons are thus in many cases not forced to accept for a while jobs which do not match their qualifications; in view of the hardships which would otherwise arise, this is a major social advance. Another consequence is, however, that the reduction of unemployment in the upswing may take considerable time; not even when the demand for labour in particular branches and regions gathers pace is it likely to proceed quickly. The demand for labour will also follow the cyclical upswing in production only gradually because available manpower is often not fully utilised as yet.

**Progress towards more price stability**

Last year further progress was made towards more price stability. This owed something to the fact that world market prices for many basic materials declined until well into 1975 and only tended to rise again towards the end of the year, when demand started to pick up in the industrial countries. Important industrial raw materials, such as iron, steel and non-ferrous metals, were cheaper for

## Basic economic data in the Federal Republic of Germany

| Item | Unit | 1972 | 1973 | 1974 | 1975 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Percentage change on previous year | | | |
| **Overall demand** | | | | | | | | | |
| Private consumption | DM billion | 450.9 | 495.7 | 532.9 | 577.7 | + 9.8 | + 9.9 | + 7.5 | + 8.4 |
| Government consumption | DM billion | 146.5 | 168.3 | 198.0 | 221.4 | + 12.1 | + 14.9 | + 17.7 | + 11.8 |
| Fixed capital formation | DM billion | 217.4 | 228.6 | 223.9 | 219.3 | + 7.0 | + 5.1 | — 2.1 | — 2.1 |
| Machinery and equipment | DM billion | 92.5 | 96.5 | 94.8 | 99.8 | + 1.5 | + 4.3 | — 1.8 | + 5.3 |
| Buildings | DM billion | 124.9 | 132.1 | 129.1 | 119.5 | + 11.5 | + 5.8 | — 2.3 | — 7.5 |
| Expenditure on stocks | DM billion | + 4.4 | + 9.6 | + 1.1 | — 2.8 | . | . | . | . |
| Domestic expenditure | DM billion | 819.2 | 902.2 | 956.0 | 1,015.6 | + 9.3 | + 10.1 | + 6.0 | + 6.2 |
| Net exports of goods and services **1** | DM billion | 14.7 | 24.7 | 39.8 | 24.8 | . | . | . | . |
| Exports | DM billion | 190.2 | 227.4 | 298.9 | 293.4 | + 9.1 | + 19.6 | + 31.4 | — 1.8 |
| Imports | DM billion | 175.5 | 202.6 | 259.1 | 268.5 | + 8.3 | + 15.5 | + 27.9 | + 3.6 |
| Gross national product at current prices | DM billion | 833.9 | 926.9 | 995.7 | 1,040.4 | + 9.5 | + 11.2 | + 7.4 | + 4.5 |
| Memorandum item: | | | | | | | | | |
| Orders received by industry | 1970 = 100 | 110.6 | 128.3 | 139.1 | 136.1 | + 7.9 | + 16.0 | + 8.4 | — 2.2 |
| Domestic orders | 1970 = 100 | 109.1 | 120.4 | 124.7 | 128.0 | + 6.9 | + 10.3 | + 3.6 | + 2.6 |
| Foreign orders | 1970 = 100 | 115.2 | 153.6 | 184.5 | 162.0 | + 11.4 | + 33.4 | + 20.1 | — 12.2 |
| **Income** | | | | | | | | | |
| Gross wage and salary income | DM billion | 439.2 | 498.6 | 546.6 | 569.0 | + 9.7 | + 13.5 | + 9.6 | + 4.1 |
| Memorandum item: | | | | | | | | | |
| Gross wages and salaries per employee | DM thousand | (16.8) | (18.8) | (20.9) | (22.4) | + 8.9 | + 12.0 | + 11.5 | + 7.0 |
| Gross property and entrepreneurial income | DM billion | 200.0 | 215.3 | 218.6 | 225.4 | + 7.9 | + 7.6 | 1.5 | + 3.1 |
| National income | DM billion | 639.2 | 713.9 | 765.2 | 794.3 | + 9.1 | + 11.7 | + 7.2 | + 3.8 |
| Wage ratio **2** | % | 68.7 | 69.8 | 71.4 | 71.6 | . | . | . | . |
| **Production** | | | | | | | | | |
| Gross national product at 1962 prices | DM billion | 563.5 | 592.4 | 595.0 | 574.8 | + 3.4 | + 5.1 | + 0.4 | — 3.4 |
| do. per man-hour worked (productivity) | 1962 = 100 | 165.5 | 174.9 | 181.1 | 183.8 | + 4.3 | + 5.7 | + 3.5 | + 1.5 |
| Industrial production (excluding construction) | 1970 = 100 | 105.7 | 113.2 | 111.9 | 105.0 | + 4.1 | + 7.1 | — 1.1 | — 6.2 |
| Overall production potential at 1962 prices **3** | DM billion | 570 | 590 | 600 | 620 | + 4.5 | + 3.5 | + 2.5 | + 2.0 |
| Utilisation of production potential **3** | % | 99 | 100.5 | 98.5 | 93 | . | . | . | . |
| **Employment** | | | | | | | | | |
| Employed persons | Millions | 26.7 | 26.7 | 26.2 | 25.4 | — 0.3 | + 0.2 | — 1.9 | — 3.2 |
| Wage and salary earners | Millions | 22.4 | 22.6 | 22.2 | 21.4 | + 0.1 | + 0.6 | — 1.8 | — 3.3 |
| Foreign workers | Millions | 2.3 | e2.5 | e2.3 | e2.1 | + 7.3 | e+ 7.7 | e— 5.3 | e— 11.6 |
| Memorandum item: | | | | | | | | | |
| Total number of man-hours worked | 1962 = 100 | 94.5 | 94.0 | 91.3 | 86.9 | — 0.9 | — 0.5 | — 2.9 | — 4.8 |
| Unemployed persons | Thousands | 246 | 274 | 583 | 1,074 | + 33.1 | + 11.0 | + 113.0 | + 84.4 |
| Unemployment ratio **4** | % | 1.1 | 1.3 | 2.6 | 4.7 | . | . | . | . |
| **Prices** | | | | | | | | | |
| GNP deflator | 1962 = 100 | 148.0 | 156.5 | 167.3 | 181.0 | + 5.9 | + 5.7 | + 7.0 | + 8.2 |
| Cost of living index for all households | 1970 = 100 | 111.1 | 118.8 | 127.1 | 134.7 | + 5.5 | + 6.9 | + 7.0 | + 6.0 |
| Producer prices of industrial products | 1970 = 100 | 107.0 | 114.1 | 129.4 | 135.5 | + 2.6 | + 6.6 | + 13.4 | + 4.7 |
| Memorandum item: | | | | | | | | | |
| Unit labour costs in the economy as a whole **5** | 1962 = 100 | 144.7 | 154.5 | 168.3 | 180.4 | + 5.1 | + 6.7 | + 8.9 | + 7.2 |

**1** Balance of merchandise and service transactions with the rest of the world (including GDR). — **2** Gross wage and salary income as a percentage of national income. — **3** Calculated by Bundesbank, rounded figures. — **4** Unemployed persons as a percentage of the dependent labour force. — **5** Index of gross wages and salaries per employee divided by index of real GNP per employed person. — **e** Estimated. — The data from the national accounts are provisional.

German importers at the end of 1975 than a year before. The decline in prices in the basic materials sector affected subsequent production stages as well. Later in the year, as already described, the cost situation in industry also improved as output expanded, in part because many enterprises had embarked on extensive rationalisation measures during the economic slowdown, and these measures now bore fruit. Thus the way was paved for a rise in the earnings of trade and industry without a major increase in prices. In view of the keen competition among suppliers, it would in any case hardly have been possible to raise industrial prices in the market. However, this does not apply to energy prices (which are mostly regulated administratively or in longer-term agreements); the prices of coal, electricity and natural gas increased in the course of 1975 in keeping with oil prices, which had been raised steeply in previous years. Oil prices themselves, by contrast, went up only slightly last year. Altogether, average industrial producer prices in 1975 were only 4½ % higher than a year before, against 13½ % and 6½ %, respectively, in the two preceding years. In March they were on an average 3.2 % higher than a year previously. The prices of construction work remained almost unchanged during the entire second half of 1975 and in the end – last November – they exceeded the corresponding 1974 level by only 1.5 %.

Slower uptrend in industrial and construction prices

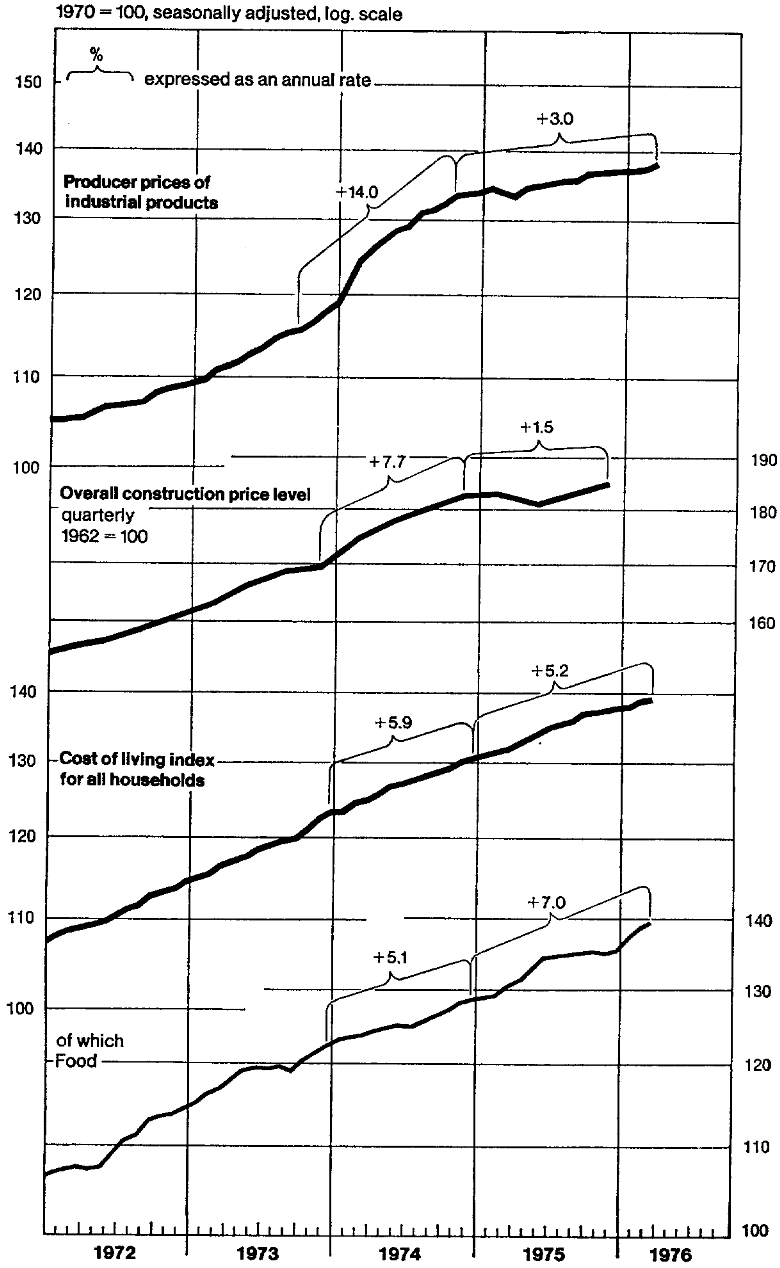
Steep increase in prices of agricultural produce

This favourable trend, from the point of view of stability, in industrial and construction prices was, however, accompanied by sustained sharp increases in the prices of agricultural produce. The poor harvest, particularly of root crops and vegetables, pushed up the prices of vegetable products; at the end of 1975 these prices were one third higher than a year before. Animal products, too, increased appreciably in price, not least because of a "cyclical" low in the fatstock supply. The average prices of agricultural products in 1975 were 13½ % above the 1974 level. Early in 1976 the uptrend in agricultural producer prices accelerated; in March 1976 these prices were about 25 % higher than a year earlier. The recent European Community decisions to increase agricultural market prices by an average of 7 to 8 % will tend to raise prices further, though not as much in Germany as in the other Community countries because the border tax was reduced at the same time; in view of the comparatively low rates of price increase which farmers in Germany have to face both as purchasers of agricultural supplies and as buyers of consumer goods, they can be expected to accept this reduction. In Germany, too, the recommended prices of agricultural products included in the market regulation in the 1976/77 financial year will on an average be about 4½ % higher than in the previous financial year. What consequences this will have for the market prices of these products cannot yet be foreseen; at present these prices are in many cases above the intervention prices. At all events, one effect of the latest rise in the prices of agricultural products is that, as stated in the Agricultural Report of the Federal Government, farm incomes may be expected to grow considerably (it has been estimated by 19 %) in the 1975/76 financial year. This would ensure conformity in the medium term with the incomes of employees, which, given the greatly increased share of wage and salary income in national income, means that the share of farm income also rose much faster than that of other income, i. e. in effect faster than the income of enterprises excluding farms. If these income prospects were realised it could not be said – not even on a medium-term view – that agriculture had made a special contribution to the stabilisation efforts incumbent on the entire economy.

Slowdown in price rises at the consumer stage

At the consumer stage the price rises continued to slow down during 1975. True, food prices increased comparatively steeply at this stage, too, but the higher prices charged by German producers did not reach consumers in full because scarce and dear domestic foodstuffs were supplemented by lower-priced imports, and because the profit margins of the processing industry and the distributive trades were narrowed somewhat. In the sector of industrially produced goods, and to some extent in the services sector as well, the moderation of price rises continued. On the other hand, increases in rents were relatively large, particularly in publicly-assisted housing. On an average, the overall cost of living in 1975 was 6 % higher than a year before compared with 7 % in each of the two preceding years. The slackening of the rate of price rises persisted at the beginning of 1976,

## Prices




although the prices of food went up markedly. In March 1976 the consumer price level was 5½ % above the comparable 1975 figure.

Price prospects for 1976 not unfavourable

The price prospects for 1976 are thus not unfavourable, a fact which has already made it easier – and will no doubt continue to do so in future – for management and labour to agree on relatively moderate wage settlements for the current year. In the metal industry, the largest economic sector in Germany, for example, employers and trade unions recently agreed on pay rate increases totalling 5½ to 6 %. Thus after in some cases long and tough negotiations they set a signal which is of great importance for other sectors as well. Very soon after the initial results of the regional negotiations in the metal industry were announced, a settlement of similar size was reached in construction. On the wage front, therefore, conditions in private enterprises are probably such that the improvement in earnings which is essential to the strengthening of the economic expansion is possible without a new upsurge in prices. This makes it all the more necessary that the safeguarding of the upswing from the incomes side, the first signs of which are now visible, is supported by price restraint. Substantial price rises would jeopardise the basis which facilitated the agreement of the trade unions to the recent wage settlements, which are justifiable in terms of the national economy. Monetary policy may bear a special responsibility for limiting the monetary scope for passing on higher costs in prices. The vigorous efforts of all those concerned — economic policy-makers, management and labour — to contain costs and to provide a basis for sustained economic growth without inflation were started with a substantial measure of confidence in the future — confidence also in a stability-oriented monetary policy. As indicated in the formulation of the target for monetary growth in 1976, the Bundesbank will continue to conduct its monetary policy so as to ensure not only that the economic upswing can persist but also — and this is just as important — that further progress is made in curbing price rises.

## II. International monetary trends and external monetary policy



### 1. General survey

Signs of stabilisation in the world economy . . .

In the world economy and in world payments first signs of normalisation and stabilisation became visible in the course of 1975:

– The world-wide recession, the most serious since the last war, bottomed out in the summer of 1975. In a number of major industrial countries an economic recovery then set in, in the wake of which world trade is likely in the current year to make good its sharp decline of 1975.

– Rates of inflation, as measured by conventional price indices, decreased in almost all industrial countries.

– Some balance of payments disequilibria, after having assumed extreme proportions in 1974, were reduced surprisingly far in 1975 as concerns both the global imbalance with the oil-exporting countries and the disequilibria between major industrial countries.

– Competitive depreciation did not take place as had been feared, mainly because in an inflationary situation countries wished to avoid the upward pressure on prices associated with a depreciation of their currencies.

– Through the agreements reached at the conference in Jamaica in January 1976 a partial reform of the international monetary system was achieved after prolonged efforts.

. . . but considerable uncertainties remain

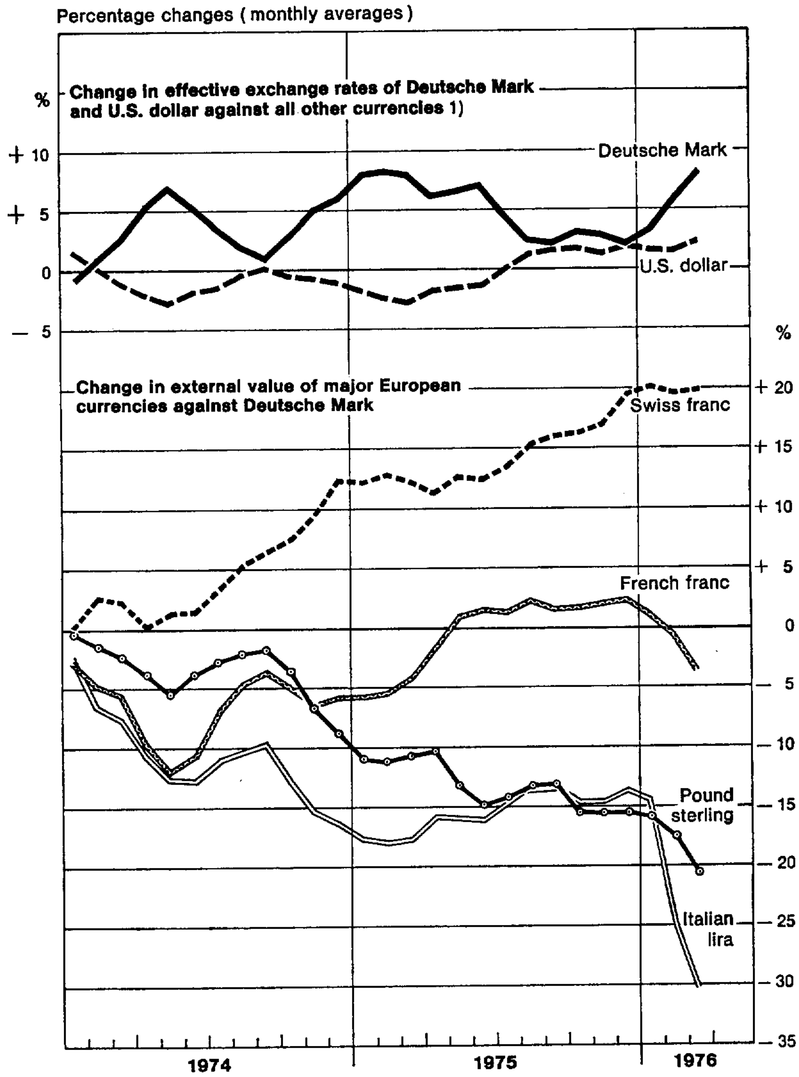
In spite of these favourable developments, however, the international economic and monetary scene is still beset with some uncertainties. For instance, it is not yet certain whether the present economic recovery will be followed everywhere by a self-sustaining and balanced upswing. The decrease in inflation rates was mainly due to the recession, at least in a number of countries; it is therefore not certain that this tendency will be durable in all cases. Moreover, the plateau of inflation from which the new economic upswing is starting is alarmingly high almost everywhere. While the inflation differential between industrial countries has narrowed, it is still so wide that repercussions on exchange rate relationships are inevitable. Overcoming inflation must therefore – in the interests of international monetary equilibrium as well as for its own sake – continue to be accorded high priority in economic and monetary policy.

The diminution of the balance of payments disequilibria was likewise partly due to the recession, although some countries did make progress towards a more lasting reduction of their severe imbalances. Progress was, however, confined to the larger industrial countries, whereas the balance of payments deficits of the smaller OECD countries and the non-oil-producing developing countries in many cases tended to increase in 1975. Another factor causing uncertainty is that protectionist tendencies have become evident again of late in spite of the improvement in the world economic climate. Finally, the movement in the exchange rates of major European currencies since the beginning of 1976 has clearly demonstrated how unstable and sensitive the exchange rate structure is to losses in confidence in the event of actual or expected differences in inflation rates and balance of payments positions.

Polarisation between strong and weak currencies

The unrest in the exchange markets in the first few months of this year has accentuated the polarisation between stronger and weaker currencies. As Germany has a distinctly better stability record than most other European countries, the Deutsche Mark belongs, as before, to the group of stronger currencies, which also includes notably the U.S. dollar and the Swiss franc. The sharp losses in the value of the Italian and British currencies, in particular, have appreciably widened the exchange rate gap between the stronger and the weaker currencies in the last few months. As so often, the Deutsche Mark – together with the Swiss franc – was forced into the role of a currency of refuge for capital flowing out of currencies prone to weakness. The defence of fixed exchange rates within the European system of narrower margins brought massive inflows of foreign exchange to Germany in the

**Changes in the external value of major currencies in comparison with the market rates of end-1973 ***




* Based on official spot middle rates in Frankfurt am Main.- 1) The weights were chosen in accordance with the regional pattern of the foreign trade turnover (exports plus imports) of the individual countries, classified by countries of origin and countries of destination; until December 1975 as the average of 1971-1973, from January 1976 as the average of 1972-1974.

first quarter of 1976, raising problems for German domestic and external monetary policy. However, the scale of the difficulties was smaller than at the time when fixed parities had to be maintained not only on a regional but also on a world-wide basis, i. e. against the dollar as well. The European system of narrower margins, otherwise known as the snake, was again put to the test by these monetary disturbances.

## 2. Exchange rate movements and exchange rate policy

(a) Movements in the dollar rate

Sharp initial fluctuations of the dollar rate due to interest rate differentials ...

In the period under review international monetary policy focused on exchange rate movements and the principles of exchange rate policy. The most important exchange rate relationship, namely that between the U.S. dollar and the currencies in the European snake arrangement, was initially subject to quite substantial fluctuations during this period. From October 1975 to early March 1976, however, these fluctuations remained within remarkably narrow limits. At the beginning of 1975 the dollar was under great pressure, primarily because interest rates in the United States fell particularly sharply in the winter half-year of 1974/75 owing to the recession. Early in February 1975 an informal arrangement was therefore concluded between the Federal Reserve System on the one hand and the Swiss and German central banks on the other to counteract the decline in the rate of the dollar by coordinated intervention in the dollar market. On March 3, 1975 the dollar reached its absolute low against the Deutsche Mark since the beginning of floating at DM 2.2785 per dollar. In the same month interest rates stopped falling in the United States and the interest rate spread widened slightly again in favour of that country. The dollar rate then began to rise, although with fluctuations; the rise gathered pace from mid-June onwards, when the Federal Reserve Board applied a temporary credit squeeze that pushed interest rates up in the U.S. money market. In October 1975 the dollar again came under pressure because of international interest rate differentials and apprehensions in connection with the financial crisis affecting New York City. With the aid of sizable support operations by several European central banks this weakness of the dollar was swiftly overcome. Subsequently the dollar rate remained relatively stable in most markets without major intervention, even when in January and February 1976 substantial strains showed up among European exchange rates. Not until March 1976 did the monetary disturbances in Europe put temporary pressure on the dollar as well. At the time this Report went to press (mid-April 1976) the dollar rate, at DM 2.54, was at roughly the same level as in the summer of 1975 (average rate July/August 1975: DM 2.52 per U.S. dollar).

... followed by greater stability of the dollar

In view of the drastic shifts in balances of payments from 1974 to 1975 (as described below) the movements of the dollar must be regarded as relatively moderate, particularly if one considers the relationship of the dollar not to individual currencies but to the weighted average of all other currencies. In relation to all other currencies the external value of the dollar improved by ½ % in 1975 over the previous year (in terms of annual averages) and a further 2 % on an average in the first quarter of 1976. The range within which its average external value fluctuated was less than ± 3 % in 1975 and about ± ½ % in the first quarter of 1976.

It is striking that the extraordinary improvement in the U. S. current account — from a deficit of more than $ 3 billion in 1974 to a surplus of almost $ 12 billion in 1975 — was not reflected in a greater strengthening of the dollar. Indeed, despite the huge surplus on current account the dollar had to be supported at times during 1975 through substantial dollar purchases of European and extra-European central banks. On the other hand, the strong contraction from the end of 1975 onwards in the U.S. surplus on current account likewise had relatively little effect on the dollar, at least up to the time when this Report went to press. Over the short term, evidently, capital movements, including those motivated by interest rate differentials and confidence factors, had more influence on the dollar rate than movements in the U.S. current account.

(b) Agreements on exchange rate policy

International agreement on foreign exchange intervention

Major agreements on exchange rate policy were concluded during the period under review. In November 1975 a joint Declaration on foreign exchange policy was made at the summit conference of the six principal industrial countries[1] at the Château de Rambouillet near Paris. The participants affirmed their intention to work for greater stability in exchange rate relations. At the same time it was stated explicitly that "this involves efforts to restore greater stability in underlying economic and financial conditions". This wording recognises a point of view long maintained by Germany in particular, not least during the deliberations on the preconditions for European monetary union. At the same time it was agreed that the "monetary authorities will act to counter disorderly market conditions or erratic fluctuations in exchange rates" (paragraph 11 of the Declaration of Rambouillet). In addition, a compromise was reached at Rambouillet between the widely differing U.S. and French views on the exchange rate provisions in the prospective revised version of the IMF Articles of Agreement (for further details see section 6, page 63).

1 The Federal Republic of Germany, France, the United Kingdom, Italy, the United States, Japan.

**Changes in the net external position of the Deutsche Bundesbank due to interventions within the snake and other foreign exchange movements since 1974 ***

**Billions of Deutsche Mark**

| Period | Changes in total net external position | caused by interventions within the snake **1** | caused by other foreign exchange movements **2** |
|---|---|---|---|
| 1974 | | | |
| January–February | — 2.9 | + 0.3 | — 3.1 |
| March–May | + 6.1 | + 4.0 | + 2.1 |
| June–September | — 6.8 | — 3.4 | — 3.4 |
| October–December | + 1.6 | — 0.7 | + 2.4 |
| Entire year | — 1.9 | + 0.2 | — 2.1 |
| 1975 | | | |
| January–March | + 5,0 | — | + 5.0 |
| April–September | — 6.6 | — 1.8 | — 4.8 |
| October | + 1.1 | — | + 1.1 |
| November–December | — 1.6 | — | — 1.6 |
| Entire year | — 2.2 | — 1.8 | — 0.4 |
| 1976 | | | |
| January | + 0.1 | — | + 0.1 |
| February–March | + 9.7 | + 8.8 | + 0.9 |
| 1st quarter | + 9.8 | + 8.8 | + 1.0 |

* Excluding changes due to valuation adjustments. — **1** From January 21, 1974 to July 9, 1975 France did not participate in the European joint float, and on March 15, 1976 it left the snake again. — **2** Interventions in U.S. dollars and purchases and sales of foreign exchange by the Bundesbank outside the exchange market.
Discrepancies in the totals are due to rounding.

The implementation of the Rambouillet agreement on stabilising interventions in the exchange market is to be ensured by occasional consultations between the finance ministers of the countries concerned or their deputies, and in day-to-day operations by the central banks. For this purpose the daily telephonic coordination of foreign exchange intervention which has been taking place for a considerable time between EEC central banks has been extended to include other countries of the Group of Ten. The Rambouillet agreement to counter "disorderly market conditions" refers primarily to the relationship of the dollar to other major currencies for which the dollar remains the most important intervention currency. Interventions in European currencies are mainly subject to the intervention arrangements in the European system of narrower margins.

The task of absorbing, or at least mitigating, "erratic" exchange rate movements vis-à-vis the dollar by means of intervention – but without counteracting fundamental market trends – is nothing new for the Bundesbank. As it stated already in its Report for 1974,[1] the Bundesbank's intervention policy has been guided by this principle for over two years. It has tried in this context not only to prevent erratic variations in the rate from day to day but also to smooth unduly large fluctuations in the rate of the Deutsche Mark against the dollar over longer periods. The above table shows that already in 1974 and 1975 substantial compensatory or "cushioning" interventions were carried out in both directions by purchases or sales of foreign exchange. On balance there was a small exchange outflow for the two years. This may be regarded, not least by the criteria of the International Monetary Fund,[2] as indicating that in the medium term (in this case, over a period of two years) the foreign exchange interventions of the Bundesbank did not distort the fundamental market trend of the Deutsche Mark.

(c) Changes in the European exchange rate structure

Currency unrest in Europe

At the beginning of 1976, however, substantial amounts of foreign exchange flowed into Germany, viz. the equivalent of almost DM 10 billion (net) in February and March. This was by far the heaviest influx of foreign exchange since floating began

**1** Page 60.
**2** Set out in the "Guidelines for the Management of Floating Exchange Rates" of June 1974.

three years ago. Much the greater part of it – namely DM 8.8 billion – was due to interventions to maintain the fixed exchange rate limits in the European system of narrower margins; almost three fifths of this exchange inflow was attributable to interventions to support the French franc. At the height of the monetary disturbances the Bundesbank also intervened in the dollar market to reduce the fluctuations of the dollar in accordance with the Rambouillet agreement. On balance, however, exchange movements outside the snake resulted in a net exchange inflow of only DM 1 billion.

The monetary unrest leading to substantial changes in the European exchange rate structure was by no means limited to tensions within the snake. There were in fact at least three different causes of crises, two of which lay outside the snake. It is no accident that the two European countries which in 1974/75 had much the highest rates of inflation of the major industrial countries in Europe, namely Italy and the United Kingdom, were among the sources of unrest.

Crisis of the lira . . .

The first crisis affected the Italian currency. Italy's current account had improved to an astonishing extent in 1975 (see the table on page 57), but from November 1975 onwards both the balance of trade and – mainly as a consequence of capital outflows – the overall balance of payments deteriorated again. In the last two months of the year the Italian monetary authorities used about $ 0.8 billion of their scarce monetary reserves to support the rate of the lira, in order to keep it as far as possible unchanged against the major currencies, in spite of a drastic deterioration in the Italian cost situation. At the beginning of January 1976 a speculative attack was launched on the lira in connection with a protracted government crisis; after suffering further substantial exchange losses, the Italian monetary authorities were forced to allow the lira to float freely from January 21, 1976 onwards. Once a new government had been formed and the monetary reserves had been replenished by assistance from abroad, the free float was superseded on March 1, 1976 by a phase of "managed floating", i. e. floating smoothed by market interventions. The lira rate could not, however, be prevented from falling further, primarily because of a persistent flight of capital. By the middle of April 1976 it had dropped by no less than 23 % against the Deutsche Mark and by 21 % against the weighted average of all currencies in relation to the exchange rates of January 20, i. e. immediately before the free float of the lira began.

. . . and of sterling

The second crisis affected the pound sterling. The current account of the United Kingdom had also improved considerably in 1975, though not as strikingly as that of Italy. Moreover, the British Government succeeded in reaching agreement with the trade unions in the autumn of 1975 about the development of wages up to the summer of 1976, with the aim of reducing the rate of inflation from 24 % in 1975 to about 10 % by the end of 1976. In spite of these more promising prospects there was a sudden fall in sterling from March 4, 1976 onwards. Triggered off by an unfortunate coincidence of several factors, it quickly gathered considerable momentum of its own. The fall was reinforced by the public debate that took place in the United Kingdom at the time on the necessity of allowing sterling to decline further in the course of 1976 to offset the much larger price and cost increases compared with other countries. As a result of all this, sterling dropped in value by 8 % in the six weeks to mid-April 1976 against the average of all other currencies, even though the British monetary authorities used very large amounts of foreign exchange in support of sterling. Thus the market carried out in a very short time a movement which might perhaps have been appropriate over an extended period. This shows how difficult it is to spread adjustments of exchange rates to differing rates of inflation evenly over time.

Pressure on the franc . . .

Finally, the French franc became a source of unrest as well. The French currency, which had left the snake in January 1974 under the pressure of foreign exchange outflows, returned to the narrower margins arrangement in July 1975 at its former exchange rate against the other participating currencies. Although in the case of France, too, the current account developed quite favourably in 1975 (see the table on page 57), although the French monetary reserves were boosted by about $ 4 billion in 1975 owing to capital inflows and government-sponsored borrowing abroad, and although the rate of the franc was consistently above the rate of the

Deutsche Mark in the snake in the second half of 1975, it proved impossible to maintain the credibility of the exchange rate relationship between the franc and the other snake currencies. As regards the relationship between the franc and the Deutsche Mark in particular, comparisons between the exchange rate relationship and the inflation differential stimulated speculation on necessary exchange rate adjustments. It is true that in the two years between the beginning of 1974 and the end of 1975 the differential between France and Germany in the movement of consumer prices amounted to 13 %, although that in export prices was much smaller. Complaints of French exporters about their reduced competitiveness abroad, the effects of the downward slide of the lira and sterling, and the psychological impact of the results of the French local elections in March all had a destabilising effect. In spite of the highly restrictive French regulations on external capital transactions, substantial outflows of funds took place, partly owing to an outright flight of capital and partly because of a shift in the terms of payment for French imports and exports as a hedge against exchange losses.

... results in withdrawal of the franc from the snake

A considerable part of the foreign exchange that flowed out of France moved into Germany or the German currency. A first major movement of this kind took place in mid-February; it was counteracted relatively quickly by central bank interventions. In the second week of March there was a second wave of speculation within the snake. This time the Belgian franc and the Danish krone were caught up in the monetary unrest as well. After the members of the European system of narrower margins had failed to agree on a credible realignment of exchange rates within the snake, the French Government on March 15, 1976 withdrew the franc from the fixed exchange rate arrangement in order to prevent any further reserve losses. At the same time it stated that this withdrawal – which was declared to be temporary – would not lead to competitive depreciation but would be handled in a controlled, "orderly" manner and in close contact with the snake. Pressure on the franc in fact remained moderate up to the time this Report went to press. Between its withdrawal from the snake and mid-April 1976 the franc declined by only about 4 % against the Deutsche Mark; thus it was still higher than at the beginning of 1975 against both the Deutsche Mark and the average of all other currencies. This is partly due to the fact that the French balance of payments position is not unfavourable at the moment; in addition, during the period of speculation the foreign exchange needed for part of France's imports had been obtained for months ahead.

(d) Lessons of recent monetary events

A number of lessons and tentative conclusions can be drawn from the monetary events of the period from January to March 1976:

Strength of the dollar and floating prevent world-wide disturbances

(i) The fact that the dollar is relatively firm again, and also protected by its more flexible exchange rate, prevented the weakness of some European currencies from developing into world-wide disturbances, let alone a monetary crisis comparable to those of the early seventies. The dollar, as the principal reserve and intervention currency, was sold in the market in large quantities by some of the European deficit countries in order to support their currencies; but this only temporarily exerted any significant pressure on the rate of the dollar against the Deutsche Mark and some other currencies and could be kept within bounds relatively easily through counteractive interventions by the Bundesbank and other central banks. However, the dollar cannot be expected to remain completely unaffected by the monetary difficulties of other countries which have to draw on their dollar reserves.

Snake only viable as a "zone of stability"

(ii) The European system of narrower margins has proved to be more vulnerable than had widely been assumed. Recent events have confirmed that fixed exchange rate relationships, even if they only apply to a limited region, cannot be defended in the longer run unless they are supported by parallel trends among all participants in prices, costs, and balances of payments. If trends diverge, a timely exchange rate adjustment within the snake – or a withdrawal of the affected member country from the narrower margins arrangement – is indispensable if

**Competitive positions of major countries**

Percentage changes between end-1971 and the 1st quarter of 1976

| Country | Effective exchange rate of the currency of the exporting country 1 | Relative movement in the wholesale prices of manufactures in the exporting country against price movements abroad in national currencies 2 pe | Relative movement in the wholesale prices of manufactures adjusted for exchange rate changes 3 |
|---|---|---|---|
| Switzerland | + 42 | — 16 | + 19 |
| Japan | + 1 | + 5 | + 6 |
| France | + 8 | — 5 | + 3 |
| Federal Republic of Germany | + 19 | — 15 | + 1 |
| United States | — 2 | — 4 | — 6 |
| Italy | — 32 | + 35 | — 8 |
| United Kingdom | — 30 | + 23 | — 14 |

1 Against the 16 other currencies quoted in Frankfurt am Main, in relation to the central rates of end-1971. — 2 Deviation of the price movement in the individual country (in Germany: industrial producer prices) from the trade-weighted average of movements in 13 other industrial countries since the 4th quarter of 1971. A minus sign indicates that the prices in that country have risen more slowly than those abroad. — 3 An increase indicates a deterioration in competitiveness. — **pe** Partly estimated.

the snake is not to develop into a source of unrest in international monetary policy. In the long run it will only be viable as a "zone of stability".

(iii) A "softening" of the rules for the snake, as implied in certain reform proposals (especially through a steep increase in mutual credit lines or even the partial pooling of monetary reserves), would not make it possible to dispense with the above-mentioned basic requirement — i. e. uniform stabilisation policies. It would merely delay necessary adjustments, either in domestic economic policy or in exchange rates. But in the meantime the inflationary financing of deficits by central bank assistance would be so much greater. This would increase the danger that the snake, instead of contributing to joint stability, might degenerate into a community of inflation.

Lack of confidence leads to exaggerated exchange rate movements

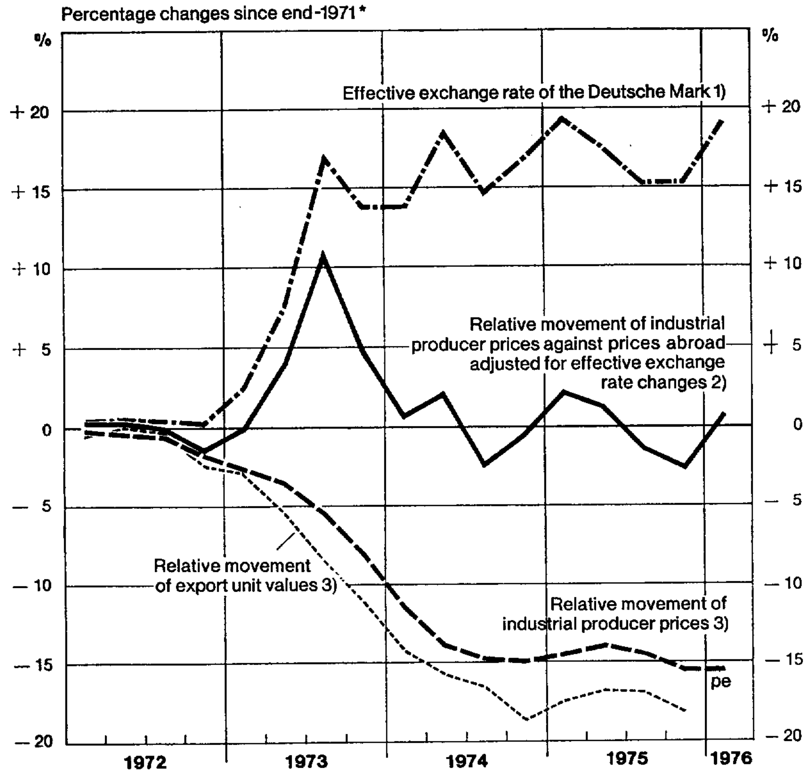
(iv) The depreciation of the currencies of Italy and the United Kingdom in the first few months of 1976 shows that in the absence of confidence in domestic economic and political conditions exchange rate shifts may overshoot the mark, i. e. the mere offsetting of cost and price differentials (see the above table). This reflects on the one hand anticipatory capital outflows, which in the case of Italy amount to nothing less than a flight of capital, and on the other hand the inadequate ability of the countries concerned to deliver goods owing to production stoppages caused by strikes and similar problems. It is obvious that this can engender a vicious circle of falling exchange rates, rising import prices, excessive wage increases, and further pressure on exchange rates. The problem cannot be solved, however, simply by providing more balance of payments assistance from abroad, but only by eliminating the disequilibria at the root. It has sometimes been inferred from the sharp descent in the Italian and British currencies that this constituted deliberate "competitive depreciation". In reality, the monetary authorities of both countries did not manipulate their exchange rates downwards; on the contrary, they tried hard to resist the depreciation of their currencies, using substantial amounts of their reserves in this process.

Appreciation of the Deutsche Mark offsets the inflation differential

(v) Owing to the depreciation of major European currencies and a slight appreciation of the Deutsche Mark against the dollar and the currencies still in the snake, the external value of the Deutsche Mark rose by an average of about 7 % between January and mid-April 1976. In effect it only regained the peak level of the first few months of 1975. This average figure masks highly divergent movements, however, in relation to individual currencies: in March 1976, compared with the average rates of March 1975, the Deutsche Mark had appreciated by 18 % against the lira and by 12½ % against sterling; against the dollar, by contrast, it had depreciated by 9½ %. Since most major commodity prices are quoted in dollars, the depreciation of the Deutsche Mark against the dollar has an unfavourable impact on German import prices expressed in Deutsche Mark. The appreciation against European currencies in many cases only roughly offsets the better stability

**External value of the Deutsche Mark and relative movement of German prices against prices abroad**

Percentage changes since end-1971 *




* Quarterly averages.- 1) Against the 16 currencies officially quoted in Frankfurt/M. in relation to the central rates of end-1971.- 2) An ascending line indicates a deterioration in competitiveness.- 3) Deviation of price movements in Germany from the trade-weighted average of movements in national currencies of 13 other industrial countries; the weights were chosen in accordance with the regional pattern of German foreign trade turnover. A descending line indicates that price increases in Germany were lower than those abroad.- pe First quarter of 1976 partly estimated.

record which Germany already has vis-à-vis these countries or will certainly register during 1976 owing to its much more stable development. As can be seen from the above chart, in terms of prices and exchange rates the competitive position of German industry vis-à-vis other industrial countries has not changed very much on an average since 1974.

**3. International economic activity and inflation differentials**

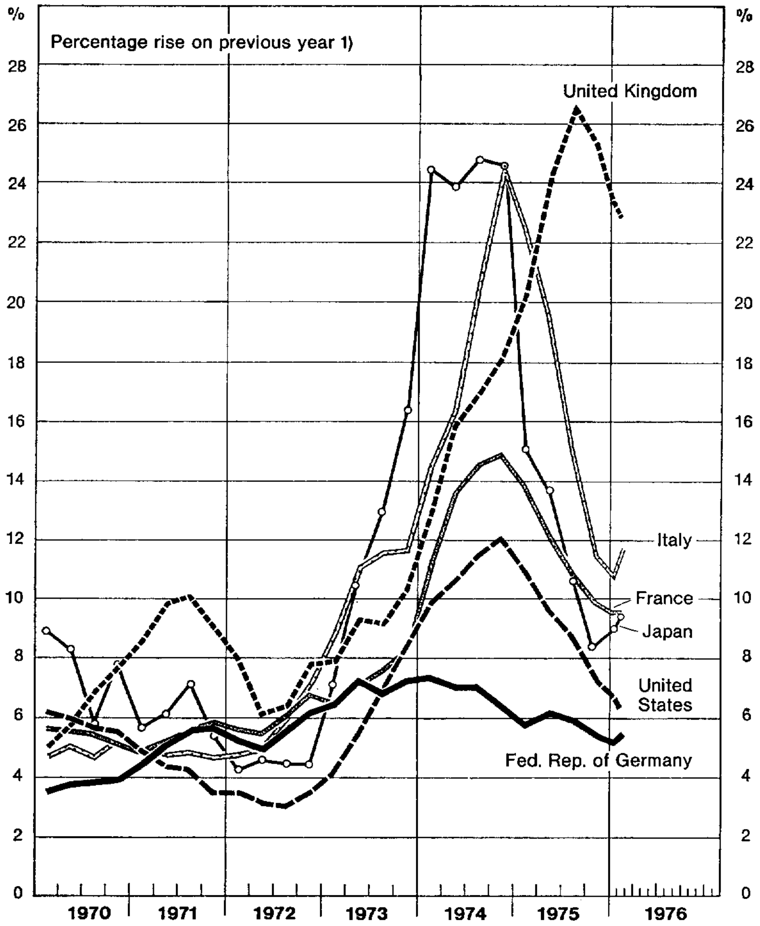
Good prospects of an increase in world trade

The development of world trade in 1975 was profoundly influenced by the cyclical downturn in industrial countries. Mainly because of the marked tendency to run down stocks, the volume of world trade last year fell by 6 %, which is much more than the drop in the national product of industrial countries, which is given as 2 % in real terms for all OECD countries. On the other hand, this opens up the prospect that, in the event of a reversal in the stock cycle due to the economic recovery, the foreign trade of industrial countries will expand much more than their national product in real terms.

Growth of German imports supports countries with weak balances of payments

In most major industrial countries, including the United States, the discrepancy between the decline in real national product and the volume of imports in 1975 was even more pronounced. Germany was an exception to this. As described in the preceding chapter, the volume of its imports went up by about 3 % in 1975 even though the German national product decreased in real terms as well; thus during the world-wide recession Germany, thanks to its buoyant domestic market, acted as a mainstay of world trade and business activity in its partner countries. This applies particularly to the European industrial countries, whose trade balances with Germany improved unusually fast in 1975; for instance, the United Kingdom and Italy, the main deficit countries, improved their combined trade balance with Germany by no less than DM 6.4 billion. This tendency persisted in the first few

**Movement of consumer prices in major industrial countries**




1) Quarterly averages, from January 1976 monthly.

months of 1976. As sales prospects in various other countries have also taken a turn for the better in the meantime, the European deficit countries now have a chance of bringing about an export-led recovery, and hence simultaneously strengthening their balances of payments, by refraining from domestic reflationary measures.

The fact that countries in a strong balance of payments position, like the United States and Germany, have assumed the role of pace-setters in the business cycle — i. e. are ahead of the other industrial countries in their economic recovery — provides a good starting-point for lessening the disruptive balance of payments disequilibria between industrial countries. However, a really viable and durable improvement in the balance of payments structure and thus a firmly rooted stabilisation of exchange rate relationships cannot be expected until inflation and hence the inflation differential among industrial countries have been further diminished.

Diminution of inflationary trends . . .

This problem is still far from having been solved. True, the rates of price increase, which in most countries reached their highest level during 1974, decreased in the period under review. The weighted rate of inflation in the OECD countries, measured in terms of consumer prices, which amounted to as much as 15 % at its peak in the autumn of 1974, had fallen to 9 % by the turn of 1975/76. In several countries, including the Federal Republic of Germany, Switzerland, the United Kingdom and the United States, the inflation may slow down further in the course of 1976. In a number of other countries, by contrast, price trends are moving upwards again. In several cases the after-effects of cost pressures originating in earlier years are still being felt, with the result that prices are being increased as soon as market conditions allow, despite the fact that capacity is underutilised. Raw material prices are also beginning to rise again owing to the general recovery in economic activity. This means that in global terms the slowdown in the pace of inflation made little further progress in the early months of 1976. The danger cannot be overlooked that, as was the case in 1972/73, a simultaneous rise in economic activity in a number of major industrial countries could once again lead to a mutual escalation not only in economic expansion but also in inflationary trends.

... but inflation differentials are still too high

Following the decline in the previously extremely high rates of inflation in Japan, the United Kingdom and Italy, the absolute inflation differential between the industrial countries has decreased. Nevertheless, inflation rates, in terms of consumer prices, still range from 1½ % in Switzerland via 4 % in Germany to 15 % in the United Kingdom and Italy, not to mention the even higher rates in a number of smaller OECD countries.[1] The differences in cost movements, measured in terms of unit labour costs, are greater still in some cases (see the table on page 39).

It is obvious that in the face of such a large differential in prices and costs, fixed exchange rate relationships between the countries concerned cannot be maintained over the longer run. Public discussion of the persistent inflation differentials within Europe contributed greatly in the initial months of this year to expectations of a change in existing exchange rate relations.

**4. Drastic shifts in the international balance of payments structure**

The shifts that came about in the balance of payments structure of the world in 1975 were no less drastic than those of the previous year, but they went overwhelmingly in the opposite direction. While the aggregate trade balance of the OECD countries had deteriorated in 1974 by no less than $ 34.5 billion under the influence of the oil price explosion, it improved in 1975 by almost $ 32 billion. Two thirds of this improvement was achieved in trade with the OPEC countries, which continued to push up their imports in 1975 while their exports of oil to industrial countries dropped off in the wake of the recession. However, in the course of the economic revival and as a result of the increase in oil prices of September 1975, the foreign exchange cost of oil imports will increase again in 1976.

Reduction of payments imbalances between industrial and OPEC countries ...

... but balance of payments positions of developing countries remain weak

Another part of the improvement in the trade balance of the industrial countries took place vis-à-vis the non-oil-producing developing countries and the centrally planned economies. The position of many developing countries deteriorated sharply because the strains exerted on them by the increase in oil prices coincided with the impact of the world-wide recession on their exports of commodities. As a result, the aggregate deficit of this group of countries on current account rose from about $ 15 billion in 1974 to an estimated $ 23 billion in the following year.[2]

In the combined balance on current account of the OECD countries the improvement in their trade balance was reflected in a shift of $ 27 billion (see the table opposite). A number of industrial countries whose current account deficits had reached ominously high proportions in 1974 were able to eliminate them almost completely in 1975. This applies particularly to Japan, France and Italy.

The United Kingdom, after having recorded the largest deficit of all countries in the world in 1974, succeeded in reducing it to less than half in the subsequent year. However, the greatest contribution to the improvement in the aggregate current account balance of the OECD countries was made by the United States,

1 Computed on the basis of price movements over the latest six-month period for which data are available and converted to annual rates.
2 The current account deficit of this group of countries excluding the "official transfers" received – in the main official development aid other than loans – increased in the same period from about $ 23 billion to an estimated $ 33 billion.

**Balances on current account of the OECD countries ***

**Billions of U.S. dollars**

| Country | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 p |
|---|---|---|---|---|---|---|
| Federal Republic of Germany | + 0.9 | + 0.9 | + 0.8 | + 4.4 | + 9.7 | + 3.8 |
| Netherlands | — 0.7 | — 0.2 | + 1.3 | + 2.0 | + 1.7 | + 1.7 |
| Belgium-Luxembourg | + 0.7 | + 0.5 | + 1.4 | + 1.4 | + 0.7 | + 1.2 |
| Switzerland | + 0.1 | + 0.1 | + 0.2 | + 0.3 | + 0.2 | + 3.0 |
| France | + 0.1 | + 0.5 | + 0.3 | — 0.7 | — 6.0 | — 0.1 |
| United Kingdom | + 1.8 | + 2.6 | + 0.3 | — 2.0 | — 8.6 | — 3.8 |
| Italy | + 0.8 | + 1.6 | + 2.0 | — 2.7 | — 7.8 | — 0.5 |
| Denmark | — 0.5 | — 0.4 | — 0.1 | — 0.5 | — 1.0 | — 0.5 |
| United States | — 0.3 | — 3.9 | — 9.7 | + 0.3 | 1 — 3.4 | +11.9 |
| Canada | + 1.1 | + 0.4 | — 0.5 | + 0,0 | — 1.6 | — 5.1 |
| Japan | + 2.0 | + 5.8 | + 6.6 | — 0.1 | — 4.7 | — 0.7 |
| Other OECD countries | — 2.0 | — 2.0 | + 0.7 | + 0.1 | —12.5 | —16.9 |
| All OECD countries | + 4.0 | + 5.9 | + 3.3 | + 2.5 | —33.3 | — 6.0 |

* Balances of trade, services, and private and official transfers (transactions basis). — **1** Including some exceptional transfers to developing countries. — **p** Provisional.
Sources: National statistics and OECD.

because it achieved, within one year, a really sensational turnround in its current account of over $ 15 billion. Germany was the only major industrial country in Europe whose current account and trade balance developed against this trend in 1975; its surplus on current account fell back in 1975 to little more than one third of the — admittedly very high — surplus of the previous year. In this way, the Federal Republic of Germany contributed considerably to the improvement in the international balance of payments structure. By contrast, the fact that the group of smaller OECD countries recorded an even higher current account deficit in 1975 than in the previous year is a cause for concern.

These developments in the world's balance of payments structure raise a number of questions: do they point to genuine — and durable — progress towards better balance of payments equilibrium? What prospects are in store in international payments, and in particular: must we expect crises and convulsions in this sector? And finally, what about the possibilities for financing the deficits that have in some cases been accumulating for years?

As to the durability of the improvements in current account positions, there are some that can clearly be attributed to the recession but others that are of a more basic nature. This applies in particular to the overall disequilibrium in the balance of payments vis-à-vis the OPEC countries: it can be assumed that in global terms the increase in imports of crude oil in the current year due to the economic revival will be approximately balanced by a further increase in exports to the OPEC countries. The current accounts of a number of oil-exporting countries are no longer in surplus. Some of them have already had to borrow abroad in order to be able to carry through their ambitious investment programmes. In other words, the global process of adjustment vis-à-vis the OPEC countries is in full swing.

Better payments balance between industrial countries

Progress has also been achieved towards better balance of payments equilibrium between the industrial countries themselves. This is true of a large part of the improvement in the current accounts of Japan, France, Italy and the United Kingdom. In addition, the strengthening of the balance of payments of the United States, together with the noticeable reduction in Germany's surplus on current account, also represent genuine advances in the international adjustment process. However, the surplus in the current account of the United States cannot by any means be expected to stay in 1976 at the high level of last year, partly because of the increase in imports of oil and other commodities resulting from the economic revival — a development that has already become visible in the last few months.

The combined current account balance of the OECD countries can be expected to deteriorate again in 1976 owing to the business upturn. However, over half of this deterioration will probably be due to the reduction in the current account surplus of the United States. As for the rest, the degree of the deterioration will probably stay within limits which, taken by themselves, need not lead to critical distortions in international monetary relations. It is a different matter that in individual cases even a relatively slight deterioration in the current account balance, or the mere expectation of such a development because of a noticeable inflation differential or cyclical increase in imports, may lead to losses in confidence and produce considerable outflows of capital. As the experience of the first few months of 1976 has shown, such capital movements can assume critical proportions, particularly when they are amplified by political factors.

A further neuralgic point in the international balance of payments situation is the unusually high current account deficits of the non-oil-producing developing countries. Buoyed up by a high level of foreign exchange earnings during the previous commodity boom as well as by heavy borrowing from supplier countries and on international money and capital markets, some of these countries were able to maintain their imports at a relatively high level up to the middle of 1975. Since then, however, they have partly had to reduce their imports drastically and in some cases they have also had to draw on the monetary reserves they had accumulated previously. But it must be borne in mind in this context that, taking the average of the last two years, this group of countries increased its volume of imports at an annual rate of approximately 14 %, i. e. about twice as fast as the long-term trend. Some of these countries can be expected to see an early improvement in their balance of payments as a result of the world-wide business revival. For example, German imports from this group of countries have been increasing strongly again in recent months. It is expected that the global current account deficit of these countries will fall appreciably in 1976 as compared with last year.

### 5. Balance of payments financing and international liquidity

No major difficulties in financing balance of payments disequilibria in 1975

The fact that at present the industrial countries are not maintaining fixed exchange rates but are allowing their currencies to float either in isolation or together (joint float within the snake) has by no means eliminated the problem of financing balance of payments disequilibria. This is true in particular of the current account surpluses of the oil-exporting countries; these surpluses cannot be eliminated simply by exchange rate movements because even in this way the imports of the oil-exporting countries cannot be immediately adjusted to the sudden steep increase in the value of their exports. This means that despite rising imports the unavoidable surpluses of many OPEC countries must either be offset by capital exports of these countries or be financed by transferring reserves. In the period under review, the considerable current account surpluses of the United States and Germany did not give rise to any financing problems in global terms as they were completely offset by market-induced capital movements within the framework of floating exchange rates. In both cases total net capital exports actually exceeded the surplus on current account, with the result that the reserve balance of both countries even showed a slight deficit in 1975. As for the countries in deficit, the most pressing financing problems arose in connection with the large current account deficits of the non-oil-producing developing countries. Here, too, considering the circumstances, it would in most cases be practically impossible to adjust the balance of payments simply through movements in exchange rates, even though greater use of the exchange rate as an instrument for achieving equilibrium would probably have been appropriate in individual cases.

Shifts in petro-dollar investments

In 1975, as in the previous year, it was possible to finance the still enormous deficits of the rest of the world vis-à-vis the oil-exporting countries without having to draw on the monetary reserves of the oil-importing countries to any considerable degree. However, a number of striking changes occurred in the investment of the petro-dollars as compared with 1974. Thus, in 1975 the OPEC countries used only about one third of their current account surpluses, totalling $ 30 to 35 billion, to build up their monetary reserves (see the table opposite), while in the previous year they had employed more than half of their investable surpluses, totalling

**Changes in world monetary reserves**

(Gold, special drawing rights, reserve positions in the IMF, foreign exchange)

**Billions of U.S. dollars**

| Country/ group of countries | Total reserve assets at end of period | | | Change 1 | |
|---|---|---|---|---|---|
| | 1973 | 1974 | 1975 | 1974 | 1975 |
| 1. Industrial countries | 115.5 | 119.9 | 121.9 | + 3.6 | + 4.3 |
| of which | | | | | |
| United States | 14.4 | 16.1 | 15.9 | + 1.4 | + 0.5 |
| Federal Republic of Germany | 33.2 | 32.4 | 31.0 | — 0.9 | — 1.0 |
| France | 8.5 | 8.9 | 12.6 | + 0.2 | + 4.0 |
| United Kingdom | 6.5 | 6.9 | 5.5 | + 0.4 | — 1.4 |
| Italy | 6.4 | 6.9 | 4.8 | + 0.5 | — 2.0 |
| Japan | 12.2 | 13.5 | 12.8 | + 1.2 | — 0.6 |
| 2. Other developed countries 2 | 24.0 | 21.1 | 17.9 | — 3.0 | — 3.0 |
| All developed countries (1 plus 2) | 139.5 | 141.0 | 139.8 | + 0.7 | + 1.3 |
| 3. Oil-exporting countries 3 | 14.9 | 48.0 | 58.0 | + 33.0 | + 10.3 |
| of which | | | | | |
| Saudi Arabia | 3.9 | 14.3 | 23.3 | + 10.4 | + 9.1 |
| Venezuela | 2.4 | 6.5 | 8.9 | + 4.1 | + 2.4 |
| Iran | 1.2 | 8.4 | 8.7 | + 7.1 | + 0.4 |
| Nigeria | 0.6 | 5.6 | 5.8 | + 5.0 | + 0.2 |
| Iraq | 1.6 | 3.3 | 2.7 | + 1.7 | — 0.5 |
| Libya | 2.1 | 3.6 | 2.2 | + 1.5 | — 1.4 |
| 4. Other developing countries | 29.3 | 31.7 | 30.0 | + 2.4 | — 1.5 |
| All countries | 183.7 | 220.7 | 227.9 | + 36.0 | + 10.1 |

1 Excluding changes in the dollar value of holdings of gold, SDRs and reserve positions in the IMF arising from fluctuations in the value of the SDR since mid-1974. — 2 Australia, Finland, Greece, Iceland, Ireland, Malta, New Zealand, Portugal, South Africa, Spain, Turkey, Yugoslavia. — 3 Algeria Bahrain, Brunei, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, Trinidad and Tobago, Venezuela, United Arab Emirates.
Source: IMF, International Financial Statistics.

approximately $ 55 billion, in liquid form as reserves. In 1975 they recycled the bulk of their current account surpluses to the rest of the world through genuine capital exports in a variety of forms. This also implied regional shifts: investments in the United States and particularly in the Euro-money market increased considerably less than in 1974, not only in absolute but also in percentage terms; investments in sterling did not increase at all as compared with the level at end-1974 and have even been reduced on balance since the beginning of 1976. Instead, a higher proportion of petro-dollars was placed with international financial institutions, including the IMF (Oil Facility), and in countries other than the United States and the United Kingdom, including developing countries.

At the other end of the scale, among the oil-importing countries, financing problems were eased most by the marked fall in the current account deficits of the large industrial countries. While in 1974 these countries had taken up very large loans on the Euro-markets to finance their deficits, the volume of loans they raised for this purpose in 1975 fell to a fraction of the previous year's figure. Partly because of the reduction in the demand for reserve credit, the total amount of monetary reserves created in 1975, at $ 10 billion, was far below the figure of $ 36 billion for the previous year. This shows clearly that in view of the immense capacity of international financial markets the creation of monetary reserves depends to a considerable degree on the demand for balance of payments loans in the international markets, hence that it is to a large extent demand-determined. This is by no means without its problems. However, the demand-determined creation of reserves cannot increase without limit; as time goes on, more and more deficit countries will probably reach the limits of their borrowing capacity. This happened in fact in individual cases in the period under review.

Creation of new monetary reserves no longer so explosive in 1975 . . .

The expansion in international liquidity, i. e. in world monetary reserves, by no less than $ 36 billion in 1974 has revived the discussion on better control of international liquidity. Whereas under the former dollar standard the balance of pay-

**Composition of changes in international liquidity between 1970 and 1975 ***

**Billions of U.S. dollars**

| Item | 1970–72 | 1973 | 1974 | 1975 |
|---|---|---|---|---|
| Claims of monetary authorities on the United States 1 | + 45.5 | + 5.3 | + 9.8 | + 3.3 |
| Sterling claims of monetary authorities on the United Kingdom 1 | + 3.6 | — 0.9 | + 2.3 | — 2.6 |
| Identified foreign exchange holdings of monetary authorities in Euro-dollars and other Euro-currencies 2 | + 17.7 | + 8.3 | + 16.9 | + 6.5 |
| Other foreign exchange holdings of monetary authorities | + 4.3 | + 5.9 | + 3.8 | — 1.4 |
| Total official foreign exchange holdings | + 71.1 | + 18.6 | + 32.8 | + 5.8 |
| Gold, special drawing rights, reserve positions in the IMF | + 5.2 | — 0.0 | + 3.2 | + 4.4 |
| Total monetary reserves | + 76.3 | + 18.6 | + 36.0 | + 10.1 |
| **Memorandum item** | | | | |
| Total monetary reserves including changes in the value of gold, etc. | + 80.4 | + 24.7 | + 37.0 | + 7.2 |

* Excludes valuation gains on holdings of gold, SDRs, and reserve positions in the IMF due to the devaluations of the dollar in 1971 and 1973, and changes arising from fluctuations in the value of the SDR since mid-1974. — 1 Investments in money market paper and other readily marketable securities plus claims on banks. — 2 Figures for 1975 are estimates on the basis of data from the BIS.
Sources: IMF publications and national statistics.

ments deficits of the United States used to be the main source of the expansion of international liquidity, today every deficit country that is creditworthy in the international money markets is able to contribute to the expansion of the world's gross monetary reserves by taking up reserve credits. As a result, the Euro-markets have since 1973 become the main source of international liquidity (see the above table). In the special situation of 1974, when enormous amounts of foreign exchange suddenly had to be transferred to the oil-exporting countries and when in addition the world economy was faced with recession, heavy recourse to the international money markets and the resultant creation of reserves were justifiable. Under other circumstances, however, this great elasticity of the international reserve system is detrimental to balance of payments discipline; moreover, it can lead to a dangerous piling up of external indebtedness. It also stands to reason that the rapid increase in world monetary reserves in the six years from 1970 to 1975 — by a total of $ 149 billion or 190 % — has created an international liquidity potential that may have a stronger inflationary impact again in the future. In the longer run, better control over international liquidity therefore remains a challenge, although this goal will be difficult to attain. Better control over international liquidity was explicitly mentioned in the Communiqué following the Monetary Conference in Jamaica in January 1976 as one of the objectives to be aimed at.

... but control over international liquidity still an unsolved problem

Decline in medium-term Euro-currency borrowing ...

In 1975, the reduction in the demand for external loans of the industrial countries together with the continuing urgent need for loans on the part of the developing countries also led to considerable shifts in the Euro-markets. The total of newly agreed syndicated loans on the Euro-market (medium-term roll-over credits) dropped from over $ 28 billion in 1974 to $ 21 billion in 1975 (see the table opposite). In the process, the share of the OECD countries in total borrowing diminished sharply, while the developing countries as a group, including the oil-exporting countries, increased their borrowing from $ 7.5 billion to almost $ 12 billion. However, the bulk of this increase was due to intensified borrowing by the oil-exporting countries. The centrally planned economies, whose global trade deficit in 1975 exceeded that of the previous year by $ 4 to 6 billion, also drew heavily on the Euro-markets in 1975 for the first time. Owing to the increase in borrowing by the non-oil-producing developing countries, including several that are already heavily in debt, the quality of Euro-bank loans deteriorated in a number of cases in the period under review.

... but increase in long-term financing in the international financial markets ...

On the other hand, far more funds than ever before were made available in the form of medium and long-term Euro-bond and foreign bond issues, although very few of them to developing countries outside Europe. The total of new issues placed in the Euro-bond market as well as in the traditional national markets for foreign

**International credit and bond markets**

**Billions of U.S. dollars**

| Item | 1972 | 1973 | 1974 | 1975 p |
|---|---|---|---|---|
| A. Medium-term Euro-currency loans 1 | | | | |
| to OECD countries | 4.1 | 11.7 | 17.6 | 5.4 |
| Developing countries | 2.5 | 7.8 | 7.6 | 11.8 |
| Centrally planned economies 2 | 0.3 | 0.7 | 0.9 | 2.3 |
| Other 3 | 5 . | 1.4 | 2.2 | 1.2 |
| Total | 6.9 | 21.6 | 28.3 | 20.6 |
| B. International bond markets | | | | |
| Euro-bonds 4 | 6.5 | 3.6 | 2.1 | 9.4 |
| of which in Deutsche Mark | 1.2 | 1.0 | 0.6 | 3.0 |
| Foreign bonds on national capital markets | 3.9 | 4.5 | 5.2 | 10.9 |
| of which in the Federal Republic of Germany | 0.4 | 0.4 | — | 0.4 |
| Special issues | 0.5 | 1.4 | 4.3 | 1.5 |
| Total | 10.9 | 9.4 | 11.7 | 21.8 |

1 Publicised Euro-currency loans running for more than 12 months and predominantly financed on a roll-over basis which have not necessarily been taken up yet. — 2 Including Comecon institutions but excluding Cuba, North Korea and North Vietnam, which are shown in the group of developing countries. — 3 Including international organisations. — 4 Internationally syndicated bond issues. — 5 Insignificant amounts are shown under OECD countries. — p Provisional.
Sources: OECD, Financial Statistics; figures for 1972 are estimates of Morgan Guaranty Trust Co., World Financial Markets.

bonds soared from $ 12 billion to $ 22 billion. In the first few months of 1976 issues of such bonds proceeded at record levels. If syndicated loans on the Euro-market and bond issues are taken together, the volume of loans and bonds taken up in the international currency and bond markets in 1975, at $ 42 billion, was approximately the same as in the previous year. But the total amount of international financing was still higher, since conventional short and longer-term bank lending to foreigners not recorded under syndicated Euro-market loans grew considerably at the same time, in particular that of U.S. and German banks.

Consequently, the total of short, medium and long-term international loans and bond issues increased heavily in the period under review. This is all the more remarkable since in 1974 the Euro-money markets were harassed and disturbed by several bank failures. It is also noteworthy that international bond issues have increased so enormously in spite of floating exchange rates. The elasticity and efficiency of the international financial markets have facilitated the direct and indirect recycling of the petro-dollars in the past two years and have up to now helped many deficit countries to overcome their financing difficulties. However, there are certain limits to the further expansion of these markets. The speed of future credit expansion may be reduced by considerations of risk on the part of the international banks involved as well as by the necessity to adjust their liable funds to the greatly increased volume of business. Moreover, debtor risk is often determined not only by the solvency of the individual client but also by the borrowing capacity of the debtor countries and their ability to transfer funds. As a result of such considerations, balance of payments loans have in some cases been taken up in international markets with the help of international institutions rather than by the deficit country itself. The largest transaction of this type that has been carried out so far took place in March and April 1976 when the European Economic Community, on the basis of a common guarantee system set up by its members at the beginning of 1975, raised loans and medium-term credits in the Euro-markets totalling $ 1.3 billion. Of this amount, $ 300 million and DM 500 million were accounted for by Euro-bonds with maturities of six to seven years, while $ 800 million was procured by direct placements with international bank consortia. The equivalent was passed on to Italy ($ 1 billion) and Ireland ($ 300 million). Furthermore, the rate of expansion of the international financial markets may slow down if in the wake of the world-wide business upswing the downward trend in interest rates comes to a halt and banks no longer have as much excess liquidity as they have had up to now owing to the antirecessionary policies of major countries.

... and growing intermediation of international organisations

**Balance of payments assistance by the IMF**

Since some developing countries seem to be close to the limit of their borrowing capacity in the international financial markets, it is not surprising that precisely these countries are pressing for increased availability of loans through official channels. Besides bilateral and multilateral development aid, e. g. through the World Bank and the regional development banks, which indirectly provide balance of payments assistance via their loans, the call of these countries for increased balance of payments assistance is directed particularly at the International Monetary Fund. In 1975 the IMF granted reserve loans amounting to $ 5.6 billion. The greater part of this sum — $ 3.7 billion — was provided by the IMF's "Oil Facility", and the remainder through loans under its normal drawing policies or by special drawing facilities such as the IMF Facility for the Compensatory Financing of Export Fluctuations.

The Oil Facility was created in June 1974 and was prolonged by a further year in April 1975; it was designed to grant medium-term balance of payments assistance — with maturities of up to seven years — to countries particularly hard hit by the increase in oil prices. The IMF procured the necessary funds by taking up special loans from countries with strong currencies. The greater part was provided by the oil-exporting countries, but a considerable part was also supplied by industrial countries. During the two years 1974 and 1975 in which these programmes operated, a total of 6.9 billion SDRs (units of special drawing rights), or approximately $ 8.3 billion, was made available and has in the meantime been disbursed to 55 countries. Two industrial countries, however, the United Kingdom and Italy, drew as much as 2.5 billion SDRs for themselves.

A total of 1.9 billion SDRs was supplied to the Oil Facility by industrial countries, the Bundesbank being the major source of funds in this group with a contribution of 600 million SDRs (approximately $ 700 million). These funds were given to the IMF for a maximum period of seven years; the interest rates are 7 % (1974 Oil Facility) and 7¼ % (1975 Oil Facility). Much as in the case of loans granted under the "General Arrangements to Borrow" of the Fund with the Group of Ten countries, the creditors can mobilise their claims at any time, in case of a balance of payments need, by drawing on the general resources of the IMF. These loans to the IMF have therefore the character of reserves. The Oil Facility was aimed at cushioning the initial shock of the upsurge in oil prices; it will therefore not be renewed.

The International Monetary Fund has also eased access to its resources in other ways. Thus, a decision by its Executive Board of December 1975 has considerably improved the conditions for the "Compensatory Financing of Export Fluctuations" available to commodity-exporting countries. In addition, special concessions were introduced on the occasion of the fourth general increase in quotas by approximately one third, i. e. from approximately 29 billion SDRs to 39 billion SDRs, which has meanwhile been agreed on but has not yet come into effect. Since it will take another 12 to 15 months before this quota increase comes into force, access to IMF credit has been temporarily increased by 45 % to bridge this time-span. This improved access is open not only to developing countries but also to other countries in a weak balance of payments position.

In the coming years an additional contribution to financing the deficits of the most seriously affected developing countries will be made by the IMF Trust Fund, the establishment of which was decided on at the beginning of 1976. The loans it will grant, bearing very low rates of interest, are to be financed in the main from the proceeds which the International Monetary Fund will receive during the next four years from the sale of one sixth of its gold holdings in excess of the book value.

With respect to the special balance of payments assistance which the IMF has made available most recently, in particular to developing countries, it has frequently been asked whether the Fund is not gradually departing from its original function of a guardian of the world monetary system and monetary discipline and is turning increasingly into an institution for development aid. It is admittedly true that in view of the sharp deterioration in the balance of payments positions of numerous developing countries, as a combined result of the oil price explosion and the recession, the IMF has devoted its special attention to these balance of payments problems; this is quite understandable since balance of payments problems are, after all, the special responsibility of the IMF. What is more, the Oil Facility and the temporary increase in the normal drawing facilities of the Fund, being the most extensive recent arrangements for balance of payments assistance, will not only benefit developing countries but are also accessible to other deficit countries. Economic policy conditions are attached to them. In addition, these special mechanisms for balance of payments assistance are not a permanent feature but are temporary in nature. Nevertheless, the criticism cannot entirely be dismissed that the IMF is concentrating too much on the establishment of new credit facilities. Greater problems arise from another development: in recent years the international financial markets have made available many times the amount of the IMF's contribution for bridging balance of payments deficits, doing so without economic or monetary policy conditions attached and sometimes even without having an adequate knowledge of the total indebtedness of the borrowing countries. It would be worth considering whether in some cases financial support granted by the international financial markets should not be run parallel with IMF balance of payments programmes.

Gold-secured balance of payments loans by the Bundesbank

In the period under review the Bundesbank granted bilateral balance of payments loans to the central banks of Italy and Portugal, with gold pledged as security. Of the gold-secured loan of $ 2 billion granted to the Bank of Italy in September 1974 for a period of six months with the possibility of three renewals, the Italian central bank had repaid $ 500 million in March 1975. When Italy's balance of payments deteriorated acutely in the first months of 1976, this latter amount was made available again in the form of a gold-backed loan. It is due for repayment together with the rest of the loan in September 1976. In February 1976 the Bank of Portugal also received a gold-secured loan of $ 250 million from the Bundesbank on a similar basis. Shortly afterwards the Bank for International Settlements (BIS) in Basle, of which the Bundesbank is a shareholder, also granted a gold-secured loan of the same amount to the central bank of Portugal.

**6. Partial reform of the monetary system**

At a meeting of the Interim Committee of the International Monetary Fund in Jamaica at the beginning of January 1976, agreement was reached – besides the decisions already mentioned on the fourth general increase in IMF quotas and the temporary extension of the normal drawing rights in the Fund – on new international rules on the exchange rate system and gold. Together with other, more technical adjustments such as the regulations for special drawing rights, the new rules on these two central elements of the international monetary system have now been submitted in the form of a revision of the Articles of Agreement of the IMF to the member countries for formal voting among the Fund Governors and subsequent ratification by national parliaments. The discussion on the reform of the international monetary system which had been conducted since 1972 in various groups and bodies of the IMF has thus been concluded by a partial reform. The former aim of a comprehensive new set of international monetary rules on the basis of "stable but adjustable par values" had to be abandoned in 1974 under the pressure of world-wide inflation and the balance of payments strains resulting from soaring oil prices.

Legalisation of floating

As regards the exchange rate system, the present mixed system, and hence also floating, are being legalised by the new regulations. Article IV Section 2 of the revised IMF Articles approves the following exchange rate arrangements: "(i) the maintenance by a member of a value for its currency in terms of the special drawing right or another denominator, other than gold, selected by the member, or (ii) cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, or (iii) other exchange arrangements of a member's choice". Possible further developments are taken care of by the prescription that the Fund "by an eighty-five percent majority of the total voting power, may make provision for general exchange arrangements without limiting the right of members to have exchange arrangements of their choice consistent with the purposes of the Fund". A "general exchange rate arrangement" may also take the form of a parity system. For the event that such a system should be introduced in the future, some basic rules have already been envisaged. However, these rules do not contain any reference to how the responsibility for interventions to defend parities in such a system will be allotted to the countries concerned, and in what way the foreign currency balances that accrue as a result of interventions are to be settled. Furthermore, IMF members will be obliged under the new Article IV to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members". While the latter requirement – the avoidance of competitive depreciation – is laid down in the present IMF Agreement, the explicit call for undistorted and realistic exchange rates in the interest of better balance of payments equilibrium is an innovation forced on the system by past experience.

Reduced role of gold

As to the future role of gold in the international monetary system, three things are of particular importance:

First, the "official gold price" is being abolished and gold will lose its previous function as the numeraire for currency parities. Since the gold weight definition of special drawing rights embodied in the present Articles of Agreement will cease to exist with the revision of the Articles, it will no longer be possible to refer to any kind of official gold price even if eventual new parities should be expressed in terms of special drawing rights.

Second, it was decided to return, at its book value, one sixth of the IMF gold holdings, i. e. approximately 25 million ounces, to the members ("restitution") and to auction a further one sixth over the course of the next four years in order to mobilise resources for the financing of the forthcoming Trust Fund in the interest of the poorest IMF members. The new Articles of Agreement envisage that the remaining two thirds of the IMF's gold holdings could also be restituted or sold at a later date; however, decisions carrying a very high majority are prerequisite in this event.

Third, monetary authorities will be free as to the price in gold transactions between themselves or with the gold market (in the past they were entitled to sell, but not to buy, gold at free market prices). However, the Group of Ten countries have committed themselves to voluntary restraint, initially for a period of two years, in that gold purchases of their monetary authorities, no matter from what source, are not to raise the total gold holdings of these countries, together with the IMF's gold holdings, above an agreed ceiling. Other countries can accede to this agreement, which is to be jointly supervised by the Bank for International Settlements (BIS) and the IMF. Within the framework of this voluntary self-restraint, the participating monetary authorities have also agreed that "there will be no action to peg the price of gold".

As a result of these agreements the former central role of gold in the international monetary system is being noticeably reduced, for gold will no longer be the common yardstick for currency parities; moreover, the sale of monetary gold from the IMF's holdings means an initial, though very modest, step towards lessening official gold reserves. On the other hand, the holdings of gold in the monetary reserves of the world – including the IMF's gold, approximately 1.17 billion ounces with a value of approximately 41 billion SDR units [1] – are so large that gold will continue to be of considerable importance for a long time to come as a component of monetary reserves. However, in view of the continued possibility of great gold price fluctuations it appears doubtful at present whether any large amounts of gold will in future be used for the direct settlement of payments among central banks. It is much more likely that it will primarily be used merely as collateral for balance of payments loans, as practised for the first time in 1974 on a significant scale in the case of the Bundesbank's gold-secured reserve loan of $ 2 billion to the Bank of Italy.

1 Computed on the basis of 1 ounce = 35 SDR units.

The new rules on the exchange rate system and gold are basically a legalisation of the realities created by developments in recent years. The evolution of the international monetary system will certainly continue to be determined less by written rules than by actual developments. One of the crucial factors determining the direction in which the international monetary system is going to evolve will probably be the degree to which the major countries succeed in regaining domestic monetary stability on a durable basis.

# Part B: Notes on the Deutsche Bundesbank's annual accounts for 1975

## 1. Legal bases, classification and valuation

Legal bases, accounting system and annual accounts

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

Classification of annual accounts

By comparison with 1974 sub-item 2.2 on the assets side of the balance sheet was changed to

Loans under special borrowing arrangements,

and the item

Gains from valuation adjustment of monetary reserves and other foreign exchange positions

was added to the profit and loss account.

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 correction of the partial conversion accounts for the Bank deutscher Länder and the Land Central Banks, which now give the position shown by the books at December 31, 1975, the Bank's title to the allocation of equalisation claims rose by DM 15,505.50 to DM 8,103,751,451.94; the claim on the Federal Government arising from the non-interest-bearing debt certificate issued in connection with the currency conversion in Berlin remained unchanged at DM 547,168,481.20 during the year under review.

## 3. Annual accounts

The annual accounts for 1975 are attached to this Report as an Appendix; as usual, the notes thereon follow the order of the items in the balance sheet and profit and loss account. At the same time a report is rendered on the Bank's activities during 1975.

Balance sheet

Comparison of balance sheet figures

At December 31, 1975 total assets had decreased by DM 5,079 million, compared with end-1974, to DM 121,378.5 million.

## Comparison of balance sheet figures

**Millions of Deutsche Mark**

| Assets | December 31 1974 | December 31 1975 |
|---|---|---|
| Gold | 14,001.7 | 14,001.7 |
| Reserve position in the International Monetary Fund and special drawing rights | | |
| Drawing rights within gold tranche | 3,807.0 | 4,394.2 |
| Loans under special borrowing arrangements | — | 460.5 |
| Special drawing rights | 4,247.6 | 4,454.0 |
| Balances with foreign banks and money market investment abroad | 49,734.1 | 51,280.4 |
| Foreign currency | 14.2 | 22.9 |
| Loans and other claims on foreign countries | | |
| Loans in connection with EEC medium-term monetary assistance | 1,169.8 | 1,273.3 |
| Claims arising from foreign exchange offset agreements with U.S.A. | 3,189.7 | 4,102.3 |
| Other loans to foreign monetary authorities | 4,809.0 | 3,925.9 |
| Loans to World Bank | 2,467.7 | 2,502.1 |
| Foreign bills of exchange | 877.0 | 903.5 |
| Domestic bills of exchange | 12,304.5 | 5,910.2 |
| Lombard loans | 2,334.1 | 1,707.6 |
| Cash advances (book credits) | 1,231.9 | 361.2 |
| Treasury bills and discountable Treasury bonds | — | — |
| Equalisation claims on Federal Government and non-interest-bearing debt certificate in respect of Berlin | | |
| Equalisation claims | 8,136.1 | 8,136.1 |
| Non-interest-bearing debt certificate | 547.2 | 547.2 |
| Securities | 469.0 | 7,952.6 |
| German coins | 423,1 | 945.8 |
| Balances on postal giro accounts | 647.1 | 358.0 |
| Other claims | 759.0 | 948.7 |
| Land and buildings | 661.9 | 698.4 |
| Equipment | 30.4 | 30.4 |
| Items in course of settlement | 4 685.1 | 5,098.9 |
| Other assets | 954.9 | 1,336.9 |
| Prepaid expenses and deferred income | 24.1 | 25.8 |
| Adjusting item in respect of valuation adjustment of monetary reserves and other foreign exchange positions — balance sheet loss — | 8,931.3 | — |
| Total | 126,457.5 | 121,378.5 |
| Contingent claims | 0.3 | 2.4 |

| Liabilities | December 31 1974 | December 31 1975 |
|---|---|---|
| Bank notes in circulation | 50,272.5 | 55,143.2 |
| Deposits of banks | 46,504.2 | 44,590.6 |
| Deposits of public authorities | | |
| Federal Government | 139.0 | 2,290.6 |
| Equalisation of Burdens Fund and ERP Special Fund | 162.7 | 358.3 |
| Länder Governments | 642.7 | 2106.5 |
| Other public depositors | 44.7 | 45.5 |
| Special deposits of Federal and Länder Governments | | |
| Federal Government | 7,176.6 | 3,263.8 |
| Länder Governments | 3,576.0 | 190.6 |
| Anticyclical surcharge on income taxes | 0.1 | 0.1 |
| Deposits of other German depositors | | |
| Federal Railways | 5.2 | 4.8 |
| Federal Post Office | 2,226.4 | 1,961.8 |
| Other depositors | 507.1 | 535.2 |
| Balances on cash deposit special accounts | 127.3 | 256.0 |
| Liabilities in respect of mobilisation and liquidity paper sold | 8,867.3 | 4,173.2 |
| Liabilities in respect of foreign business | 1,284.2 | 840.4 |
| Contra-entry to special drawing rights allocated | 1,600.1 | 1,665.1 |
| Provisions | 1,690.1 | 1,835.0 |
| Other liabilities | 85,8 | 43.3 |
| Deferred expenses and accrued income | 326.3 | 247.2 |
| Capital | 290.0 | 290.0 |
| Reserves | 929.2 | 929.2 |
| Balance sheet profit | — | 608.1 |
| Total | 126,457.5 | 121,378.6 |
| Contingent liabilities | 0.3 | 2.4 |

### *Assets*

**Gold**

At DM 14,001.7 million, the gold holding at December 31, 1975 was the same as at end-1974.

**Reserve position in the International Monetary Fund and special drawing rights**

**Drawing rights within gold tranche**

At December 31, 1975 the drawing rights within the gold tranche amounted to DM 4,394.2 million. The valuation adjustment at the rate ruling on that day (SDR value of the Deutsche Mark as at December 31, 1975) resulted in a write-up of DM 173.8 million. Otherwise, the change compared with the preceding year is attributable to other members' Deutsche Mark drawings and to transactions of similar effect totalling DM 924.9 million, net of Deutsche Mark repayments and other transactions of similar effect totalling DM 511.5 million. The drawing rights within the gold tranche constitute the difference between the German quota of SDR 1,600 million and the Deutsche Mark balances at the disposal of the IMF equivalent to SDR 168.6 million.

**Loans under special borrowing arrangements**

A loan of SDR 150 million (DM 460.5 million) was granted to the International Monetary Fund (IMF) during the year under review under a SDR 300 million credit line accorded by the Bundesbank to finance drawings by other member countries in connection with the 1975 IMF oil facility. No loans were granted to the IMF in 1975 under the General Arrangements to Borrow (GAB).

**Special drawing rights**

The amount of special drawing rights (SDRs) held at December 31, 1975 was SDR 1,450.9 million (DM 4,454.0 million) against SDR 1,439.8 million (DM 4,267.6 million) at end-1974. The valuation adjustment at the rate ruling on that day (SDR value of the Deutsche Mark as at December 31, 1975) resulted in a write-up of DM 173.9 million. The contra-entry on the liabilities side was increased by DM 64.9 million, this being the amount accounted for by SDRs allocated. The increase in the SDR holding compared with the previous year represented the difference between the interest received from SDRs acquired by the Bank against payment and the SDRs disposed of under European Community settlement arrangements.

**Balances with foreign banks and money market investment abroad**

Balances with foreign banks and money market investment abroad amounted to DM 51,280.4 million at December 31, 1975, against DM 49,734.1 million at December 31, 1974. The increase was entirely due to the valuation adjustment at the end of 1975.

Foreign exchange deals

The Bank's turnover in foreign exchange spot deals (foreign currency against Deutsche Mark) amounted to DM 16,690.6 million in the year under review, against DM 19,447.6 million in 1974; the number of deals decreased only slightly, viz. from 5,480 in the previous year to 5,424. Such deals comprised

| | 1974 | | 1975 | |
|---|---|---|---|---|
| | Number | DM million | Number | DM million |
| Purchases | 2,080 | 5,965.8 | 2,328 | 5,758.1 |
| Sales | 3,400 | 13,481.8 | 3,096 | 10,932.5 |
| | 5,480 | 19,447.6 | 5,424 | 16,690.6. |

The decline in turnover as compared with the previous year was mainly caused by the reduction in interventions under the European system of narrower exchange rate margins.

Cross deals (one foreign currency against another foreign currency) increased steeply both in amount and in number. In the year under review the Bank effected 666 cross deals totalling the equivalent of DM 4,350.8 million, as against 364 deals totalling the equivalent of DM 2,319.6 million in 1974. Furthermore, 328 U.S. dollar inter-centre switch transactions amounting to US$ 41.6 million were concluded, against 339 transactions amounting to US$ 39.3 million in the previous year.

Sale of foreign cheques

During 1975 5,245 (1974: 3,909) foreign cheques payable to order worth DM 276.0 million (1974: DM 237.7 million) were sold.

In the same period the Bank sold 21,231 traveller's cheques worth DM 2.2 million, compared with 17,495 worth DM 2.0 million in 1974.

**Foreign currency**
Purchases and sales

At DM 22.9 million, the amount of foreign notes and coins held at the end of 1975 was DM 8.7 million larger than at December 31, 1974. During the year under review the Bank effected 60,533 purchases of foreign notes and coins (1974: 55,529) and 40,164 sales of foreign notes and coins (1974: 29,439).

**Loans and other claims on foreign countries**

**Loans in connection with EEC medium-term monetary assistance**

The sub-item "Loans in connection with EEC medium-term monetary assistance" includes the German share of US$ 486.5 million in a credit totalling US$ 1,398.3 million which the members of the European Communities – with the exception of the United Kingdom – granted to Italy on December 18, 1974 under the arrangements for medium-term monetary assistance. This credit has to be repaid in fixed instalments in 1978.

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

The U.S. dollar claims arising from foreign exchange offset agreements with the United States are shown here.

**Other loans to foreign monetary authorities**

This sub-item comprises the U.S. dollar deposit which has been held with the Banca d'Italia since September 1974 under a special agreement and against which the Banca d'Italia maintains a gold deposit with us. In the year under review the dollar deposit was reduced by US$ 500 million to US$ 1,500 million; the gold deposit was diminished correspondingly at the same time.

**Loans to World Bank**

At end-1975 loans to the World Bank amounted to DM 2,502.1 million (end-1974: DM 2,467.7 million).

**Foreign bills of exchange**

Purchases

At the end of 1975 the portfolio of foreign bills accumulated through purchases within Germany was DM 903.5 million, as compared with DM 877.0 million at December 31, 1974. The share of Deutsche Mark bills in the total value of foreign bills purchased averaged about 57 % in 1975 (1974: 64 %).

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

| | 1974 | | 1975 | |
|---|---|---|---|---|
| Land Central Bank | Number | DM million | Number | DM million |
| Baden-Württemberg | 17,780 | 475.3 | 17,273 | 520.7 |
| Bavaria | 7,770 | 383.2 | 6,216 | 569.5 |
| Berlin | 245 | 54.1 | 245 | 75.8 |
| Bremen | 634 | 55.3 | 776 | 93.2 |
| Hamburg | 4,039 | 355.5 | 4,828 | 402.7 |
| Hesse | 6,677 | 640.8 | 6,776 | 753.5 |
| Lower Saxony | 2,303 | 84.2 | 1,539 | 134.4 |
| North Rhine-Westphalia | 12,425 | 678.5 | 13,749 | 911.1 |
| Rhineland-Palatinate | 2,977 | 167.9 | 3,056 | 229.9 |
| Saarland | 2,407 | 234.4 | 1,828 | 232.6 |
| Schleswig-Holstein | 215 | 17.2 | 234 | 13.2 |
| Total | 57,472 | 3,146.4 | 56,520 | 3,936.6 |

Foreign commission business

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

| | 1974 Number | 1975 Number |
|---|---|---|
| Bills, cheques, etc. | 9,913 | 13,875 |
| Foreign currency | 5,021 | 4,341 |
| | 14,934 | 18,216. |

**Domestic bills of exchange**

Taking the average of all return days, the Bank's portfolio of domestic bills in the year under review, at DM 7,078 million, was notably smaller than in 1974 (DM 10,972 million). At the end of 1975 the Bank held DM 5,910.2 million of domestic bills; this was considerably fewer than at the end of 1974 (DM 12,304.5 million). During the year the portfolio of domestic bills varied in size in accordance with the movement of liquidity described in Part A of this Report.

| | Dec. 31, 1974 DM million | Dec. 31, 1975 DM million |
|---|---|---|
| The domestic bill portfolio comprised | | |
| Domestic bills discounted | 11,302.2 | 5,238.8 |
| Import and Storage Agency bills acquired in the course of open market operations | 295.5 | 137.6 |
| Prime bankers' acceptances acquired in the course of open market operations | 706.8 | 533.8 |
| | 12,304.5 | 5,910.2. |

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

| Land Central Bank | 1974 '000 | 1974 DM million | 1975 '000 | 1975 DM million |
|---|---|---|---|---|
| Baden-Württemberg | 275 | 7,517.3 | 206 | 7,698.1 |
| Bavaria | 222 | 8,984.1 | 134 | 6,754.7 |
| Berlin | 18 | 1,926.6 | 14 | 2,161.9 |
| Bremen | 25 | 1,255.7 | 20 | 1,513.1 |
| Hamburg | 130 | 5,754.8 | 109 | 8,192.4 |
| Hesse | 211 | 21,065.4 | 182 | 18,564.6 |
| Lower Saxony | 106 | 3,385.4 | 60 | 3,044.4 |
| North Rhine-Westphalia | 340 | 16,933.4 | 230 | 15,151.8 |
| Rhineland-Palatinate | 53 | 1,468.7 | 36 | 1,258.2 |
| Saarland | 11 | 709.2 | 7 | 717.9 |
| Schleswig-Holstein | 32 | 1,022.3 | 22 | 872.6 |
| Total | 1,423 | 70,022.9 | 1,020 | 65,929.7 |

* Including domestic bills bought in open market transactions under repurchase agreements, as discussed below.

The average value of the bills purchased in 1975 was DM 64,616 compared with DM 49,192 in 1974.

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

| | 1974 Number | 1974 DM million | 1975 Number | 1975 DM million |
|---|---|---|---|---|
| | 7,441 | 70.2 | 4,104 | 34.1 |
| as % of the total purchased | 0.52 | 0.10 | 0.40 | 0.05. |

Discount rate

The Bundesbank's discount rate for domestic and foreign bills in the year under review stood at 6 % until February 6, at 5½ % from February 7, at 5 % from March 7, at 4½ % from May 23, at 4 % from August 15 and at 3½ % from September 12.

Storage Agency bills

The Bank's open market operations in Storage Agency bills continued to decline in the year under review. Purchases reached a nominal value of DM 2,013.8 million (1974: DM 2,580.4 million), while a nominal DM 1,142.7 million (1974: DM 1,100.0 million) was sold from the Bank's portfolio prior to maturity. Bills amounting to DM 1,029.0 million were redeemed from the Bank's portfolio (1974: DM 1,475.9 million); at December 31, 1975 the portfolio totalled DM 137.6 million (end-1974: DM 295.5 million).

Prime bankers' acceptances

In May 1975 the amount of prime bankers' acceptances which the Bank is prepared to purchase in open market operations was raised from DM 1,100 million to DM 1,500 million. Owing to the predominantly liquid state of the money market in the year under review, however, this enlarged scope for recourse to the Bank was utilised only in part and only for relatively short periods.

The Bank's purchases from the Privatdiskont-Aktiengesellschaft, at DM 2,801.6 million, were less than half as large as a year before (DM 5,873.7 million). Resales from the Bank's portfolio via the broker to the market, on the other hand, at DM 2,254.7 million, ran at a high level by comparison with 1974 (DM 3,028.3 million), implying that bank demand for prime bankers' acceptances as a form of investment was fairly strong last year (as in 1974). DM 719.9 million (1974: DM 3,010.7 million) of prime bankers' acceptances from the Bank's portfolio were redeemed on maturity; at December 31, 1975 the Bank held DM 533.8 million (end-1974: DM 706.8 million) of prime bankers' acceptances stemming from open market operations.

Open market transactions in bills under repurchase agreements

To ease particular strains on the money market, the Bank offered open market transactions in bills under repurchase agreements on three occasions in 1975, in each case for a few days or weeks. In the course of these transactions the Bank acquired — outside the rediscount quotas — trade bills at market rates on the condition that the banks selling the bills repurchased them after as a rule ten days.

The maximum amount of bills held by the Bank as a result of such operations was DM 4,532 million (on September 24, 1975). The market rates for open market transactions under repurchase agreements stood at 4½ % from July 23 to 31, at 4 % from August 29 to September 11 and at 3½ % from September 12 to October 6 and from October 21 to December 1.

Domestic commission business

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

| | Number | DM million |
|---|---|---|
| 1974 | 65,864 | 872.9 |
| 1975 | 65,077 | 980.1. |

**Lombard loans**

Taking the average of all return dates of the year under review, the Bundesbank granted DM 551 million of lombard loans to banks (1974: DM 2,194 million). As in preceding years, such loans were subject to marked fluctuations, the largest amounts being granted in April, May and June.

**Lombard loans in the Land Central Bank areas**

**Millions of Deutsche Mark**

| Land Central Bank | Lombard loans granted | | Outstanding at | |
|---|---|---|---|---|
| | 1974 1 | 1975 | Dec. 31, 1974 | Dec. 31, 1975 |
| Baden-Württemberg | 11,217.7 | 6,028.4 | 522.1 | 172.4 |
| Bavaria | 7,376.4 | 3,058.0 | 81.6 | 68.3 |
| Berlin | 1,691.2 | 1,310.3 | — | — |
| Bremen | 1,722.3 | 457.9 | 17.3 | 0.3 |
| Hamburg | 7,717.9 | 3,455.8 | 75.8 | 92.2 |
| Hesse | 74,215.7 | 39,860.1 | 1,183.5 | 1,082.5 |
| Lower Saxony | 4,821.7 | 2,269.7 | 64.1 | 24.5 |
| North Rhine-Westphalia | 19,147.2 | 8,116.4 | 328.6 | 220.1 |
| Rhineland-Palatinate | 3,878.8 | 2,793.9 | 44.0 | 41.3 |
| Saarland | 444.4 | 337.6 | 4.4 | 3.6 |
| Schleswig-Holstein | 1,399.9 | 701.0 | 12.7 | 2.4 |
| Total | 133,633.2 | 68,389.1 | 2,334.1 | 1,707.6 |

1 Including special lombard credit.

Lombard rate

In the year under review the lombard rate was 8 % until February 6; from February 7 it stood at 7½ %, from March 7 at 6½ %, from April 25 at 6 %, from May 23 at 5½ %, from August 15 at 5 % and from September 12 at 4½ %.

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

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

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

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

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

**Cash advances (book credits)**

**Millions of Deutsche Mark**

| Borrower | December 31, 1974 | December 31, 1975 |
| --- | --- | --- |
| Federal Government | 1,076.7 | — |
| Equalisation of Burdens Fund | 15.5 | — |
| Länder Governments | | |
| Berlin | 81.4 | 114.0 |
| Hesse | 27.7 | 88.6 |
| Lower Saxony | 3.1 | 23.8 |
| Rhineland-Palatinate | 27.5 | 134.8 |
| Total | 1,231.9 | 361.2 |

No book credits to the Federal Railways or Federal Post Office were outstanding at December 31, 1975; such credits are shown together with claims resulting from the purchase of Treasury bills and discountable Treasury bonds in the asset item "Loans to Federal Railways and Federal Post Office".

Interest rate

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

**Treasury bills and discountable Treasury bonds**

On the market for money market paper the Bank was again increasingly active as the selling agent for the "financing" discountable Treasury bonds of the Federal Government and its special funds. These securities are distinct from the mobilisation and liquidity paper issued pursuant to sections 42 and 42 (a) of the Bundesbank Act, which paper will be commented on below.

**Federal Government**

To meet the borrowing requirements of the Federal Government, DM 7,159.9 million (1974: DM 5,159.7 million) of discountable Treasury bonds were issued; almost all of these securities were of the type (marked "BN") which is not repurchased by the Bundesbank prior to maturity. From February 1975 onwards bonds of this kind in small denominations were also sold in a standardised form to private investors as "financing bonds" of the Federal Government. After the redemption of DM 704.7 million (1974: DM 1,086.0 million) of matured bonds, the amount of discountable Treasury bonds of the Federal Government types "B" and "BN" (including "financing bonds") outstanding at December 31, 1975 was DM 11,553.9 million (end-1974: DM 5,098.7 million). Of this total, DM 1,562.5 million was repurchasable by the Bundesbank (type "B").

Federal Railways

The (returnable) discountable Treasury bonds of the German Federal Railways which fell due in 1975, amounting to DM 400 million, were all renewed. In addition, bonds which are not returnable before maturity (marked "BaN") were issued for the Federal Railways for the first time (DM 420 million). As a result the amount of the Federal Railways' discountable Treasury bonds outstanding at end-1975 was DM 820 million (end-1974: DM 400 million).

Federal Post Office

The German Federal Post Office redeemed DM 386 million of outstanding discountable Treasury bonds on maturity in the year under review. The Post Office issued only DM 93.7 million of discountable Treasury bonds last year, so that the amount of such paper (all of it of the non-returnable type) outstanding at end-1975 dropped to DM 300 million (end-1974: DM 592.3 million).

At December 31, 1975 the outstanding amount of money market paper issued for the account of the Federal Government and its special funds was DM 12,673.9 million (end-1974: DM 6,091.0 million). Further details will be found in the following table.

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

**Millions of Deutsche Mark**

| Type of paper | Outstanding at Dec. 31, 1974 | Issued in 1975 | Redeemed in 1975 | Outstanding at Dec. 31, 1975 |
|---|---|---|---|---|
| Discountable Treasury bonds of the Federal Republic of Germany "B" and "BN" (including "financing bonds") | 5,098.7 | 7,159.9 | 704.7 | 11,553.9 |
| Discountable Treasury bonds of the German Federal Railways "Ba" and "BaN" | 400.0 | 820.0 | 400.0 | 820.0 |
| Discountable Treasury bonds of the German Federal Post Office "PN" | 592.3 | 93.7 | 386.0 | 300.0 |
| Total | 6,091.0 | 8,073.6 | 1,490.7 | 12,673.9 |

**Länder Governments**

With respect to Länder Government money market paper, DM 100 million of discountable Treasury bonds of one Land Government were redeemed and DM 592.4 million were issued (DM 72.4 million via the Bundesbank). The amount of discountable Treasury bonds outstanding at end-1975 was DM 692.4 million (end-1974: DM 200 million).

No public authority money market paper was held by the Bank at December 31, 1975.

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

The Bank's equalisation claims on the Federal Government, as inscribed in the government stock register as at December 31, 1974, increased by DM 73,800 in the year under review. The change of DM 15,500 in the equalisation claims arising from the Bank's own conversion account is explained in the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1975, which account is attached to the German original of this Report as Appendix 1.

**Non-interest-bearing debt certificate**

In 1975 the Bank's claim on the Federal Government in respect of the currency conversion in Berlin remained unchanged at DM 547.2 million.

**Equalisation claims and non-interest-bearing debt certificate in respect of Berlin in 1975**

**Thousands of Deutsche Mark**

| Type of paper | Total at December 31, 1974 | Increase in 1975 | Total at December 31, 1975 |
|---|---|---|---|
| (a) Equalisation claims arising from | | | |
| Own conversion account | | | |
| Bank deutscher Länder | 5,504,410.9 | 4.6 | 5,504,415.5 |
| Land Central Banks | 2,599,314.4 | 10.9 | 2,599,325.3 |
| | 8,103,725.3 | 15.5 | 8,103,740.8 |
| Conversion of Berlin pre-capitulation balances | 30,910.1 | 57.8 | 30,967.9 |
| Conversion of RM balances at banks in the Eastern Sector of Berlin | 1,461.7 | 0.5 | 1,462.2 |
| | 8,136,097.1 | 73.8 | 8,136,170.9 |
| (b) Non-interest-bearing debt certificate | 547,168.5 | — | 547,168.5 |
| Total | 8,683,265.6 | 73.8 | 8,683,339.4 |

**Loans to Federal Railways and Federal Post Office**

No credits to the Federal Railways or Federal Post Office were outstanding at December 31, 1975. See also the notes on the items "Cash advances (book credits)" and "Treasury bills and discountable Treasury bonds".

**Securities**

In pursuance of its open market policy, the Bank again bought bonds issued by the Federal Government, the Railways and the Post Office for its own account in the year under review, doing so in fact over a longer period and on a larger scale than in 1974. The Bank's portfolio of securities – chiefly bonds of the Federal Republic of Germany, the Federal Railways and the Federal Post Office – consequently rose by about DM 7,500 million to DM 7,952.6 million (end-1974: DM 469.0 million). Most of the transactions took place between July and October 1975;

the reasons for these security purchases in the open market by the Bundesbank are explained in Part A of this Report.



Issue of bonds

In 1975 nine bond issues totalling DM 5,500 million (1974: twelve issues amounting to DM 6,030 million) were launched through the Federal Bond Consortium, which is under the direction of the Bank. Of this amount, DM 630 million (1974: DM 630 million) was reserved for the issuers' own institutions (mainly welfare institutions) and for longer-term price support operations.

**Bond issues of the Federal Republic of Germany, German Federal Railways and German Federal Post Office in 1975**

| Issuer | Amount issued: Total DM million | Amount issued: of which sold through Federal Bond Consortium DM million | Nominal interest rate (yield) % | Issue price % | Start of sales 1975 |
|---|---|---|---|---|---|
| Federal Republic of Germany | 660 | 600 | 9¼ (9.43) | 99 | Jan. 10 |
| German Federal Railways | 500 | 420 | 9¼ (9.39) | 99.25 | Jan. 20 |
| German Federal Post Office | 500 | 400 | 9 (9.09) | 99.50 | Feb. 4 |
| Federal Republic of Germany | 660 | 600 | 8½ (8.77) | 98.50 | April 1 |
| German Federal Railways | 540 | 450 | 8¼ (8.52) | 98.50 | April 30 |
| Federal Republic of Germany | 660 | 600 | 8¼ (8.34) | 99.50 | May 21 |
| Federal Republic of Germany | 660 | 600 | 8 (8.22) | 98.75 | June 9 |
| Federal Republic of Germany | 660 | 600 | 8 (8.22) | 98.75 | June 26 |
| Federal Republic of Germany | 660 | 600 | 8 (8.11) | 99.50 | Dec. 30 |

Issue of Federal savings bonds

With the assistance of the Bank, DM 5,287.9 million of Federal savings bonds were sold to private investors via banks in 1975 (1974: DM 3,192.3 million). Sales were particularly large in January, at DM 1,115.9 million, and June, at DM 1,022.6 million. Against this, DM 70.2 million (1974: DM 1,461.6 million) of savings bonds from former tranches were resold to the issuer before maturity, and a further DM 86.0 million were redeemed on maturity. The amount of Federal savings bonds outstanding rose from DM 4,742.8 million (end-1974) to DM 9,874.5 million at December 31, 1975. In the course of the year under review the rate of interest paid on Federal savings bonds was reduced three times to bring it into line with market interest rates; details are given in the following table.

**Gross sales, interest rates and yields of Federal savings bonds in 1975**

| Issues | Sales period 1975 | Gross sales DM million: Federal savings bonds A 1 | Federal savings bonds B 2 | Total | Interest rate (%) in and yields (%) after . . . year after issue: 1st | 2nd | 3rd | 4th | 5th | 6th | 7th |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1975/1 | Jan. 2-31 | 708,8 | 407,2 | 1,116,0 | 7.5<br>7.50 | 9.0<br>8.22 | 9.0<br>8.46 | 9.5<br>8.69 | 9.5<br>8.82 | 10.0<br>8.98 | |
| 1975/2 | | | | | 7.5<br>7.50 | 9.0<br>8.25 | 9.0<br>8.50 | 9.5<br>8.75 | 9.5<br>8.90 | 10.0<br>9.08 | 10.0<br>9.21 |
| 1975/3 | Feb. 14-Apr. 10 | 0 749,7 | 360,6 | 1,110,3 | 6.5<br>6.50 | 7.5<br>6.98 | 8.0<br>7.30 | 8.5<br>7.57 | 9.0<br>7.81 | 9.5<br>8.04 | |
| 1975/4 | | | | | 6.5<br>6.50 | 7.5<br>7.00 | 8.0<br>7.33 | 8.5<br>7.62 | 9.0<br>7.90 | 9.5<br>8.16 | 9.5<br>8.35 |
| 1975/5 | Apr. 16-June 16 | 1,042,8 | 480,3 | 1,523,1 | 6.0<br>6.00 | 7.0<br>6.48 | 8.0<br>6.96 | 8.5<br>7.30 | 8.5<br>7.50 | 9.0<br>7.71 | |
| 1975/6 | | | | | 6.0<br>6.00 | 7.0<br>6.50 | 8.0<br>7.00 | 8.5<br>7.37 | 8.5<br>7.60 | 9.0<br>7.83 | 9.0<br>7.99 |
| 1975/7 | June 20-Dec. 31 | 963,2 | 575,3 | 1,538,5 | 5.25<br>5.25 | 6.5<br>5.86 | 7.25<br>6.29 | 8.0<br>6.68 | 8.5<br>6.99 | 9.0<br>7.27 | |
| 1975/8 | | | | | 5.25<br>5.25 | 6.5<br>5.87 | 7.25<br>6.33 | 8.0<br>6.75 | 8.5<br>7.09 | 9.0<br>7.41 | 9.0<br>7.63 |
| Total | Jan. 2—Dec. 31 | 3,464,5 | 1,823,4 | 5,287,9 | | | | | | | |

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

**Issue of medium-term notes**

Through the agency of the Bank DM 3,746.6 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany were sold by tender during 1975 (1974: DM 252.6 million). There were seven issues running for three or four years and bearing a nominal rate of interest of 7, 7½ or 7¾ %.

Moreover, in agreement with the Bank DM 1,350 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany and the Federal Railways were sold without using the tender procedure (1974: DM 945 million of the Federal Republic of Germany, the Federal Railways and the Federal Post Office).

**Treasury bonds (medium-term notes) issued by tender in 1975**

| Issuer | Amount DM mn | Interest rate % | Running for . . . years | Selling price % | Yield on issue % | Month of sale |
|---|---|---|---|---|---|---|
| Federal Republic of Germany | 581.1 | 7.50 | 4 | 98.10 | 8.08 | February |
| Federal Republic of Germany | 529.7 | 7 | 3 | 98.80 | 7.46 | April |
| Federal Republic of Germany 2nd Issue | 544.4 | 7.50 | 4 | 98.70 | 7.89 | April |
| Federal Republic of Germany 2nd Issue | 353.1 | 7 | 3 | 99.10 | 7.34 | August |
| Federal Republic of Germany 3rd Issue | 90.6 | 7.50 | 4 | 99.20 | 7.74 | August |
| Federal Republic of Germany 5th Issue | 608.6 | 7 | 3 | 98.90 | 7.42 | November |
| Federal Republic of Germany 2nd Issue | 1,039.1 | 7.75 | 4 | 99 | 8.05 | November |

**Admission to stock exchange dealings**

As usual, the Bank introduced the bond issues of the Federal Republic of Germany, the Federal Railways and the Federal Post Office, together with one issue of the Equalisation of Burdens Bank and one of the Reconstruction Loan Corporation, for official dealing on all German stock exchanges; the medium-term notes of the Federal Republic of Germany (with the exception of two tranches running for less than 2½ years) and the Federal Railways, and an issue of medium-term notes of the Reconstruction Loan Corporation, were introduced for regulated unofficial dealing on the stock exchange.

**Price support operations**

In the year under review, as in preceding years, the Bank undertook price support operations for the account of the issuers in respect of bonds issued by the Federal Government and its special funds, one Land Government, the Reconstruction Loan Corporation and the Equalisation of Burdens Bank in order to iron out 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 10,351,004 interest coupons and matured bonds during the year under review (1974: 12,885,603). Of this number, 458,108 interest coupons and matured bonds were presented to foreign agents for redemption (1974: 302,554).

**German coins**

The amount of German coins held by the Bank was DM 945.8 million at the end of 1975 (end-1974: DM 423.1 million). The increase in comparison with end-1974 is principally due to the redeeming of the silver DM 5 coins which were withdrawn from circulation with effect from August 1, 1975. They were replaced from February 1975 onwards by DM 5 coins made of a three-layer material better suited for vending machines.

In 1975 the Federal Government was credited with DM 1,219.1 million for coins taken over from the Mints (including DM 1,005.5 million for the new DM 5 coins), and debited with DM 418.9 million for coins no longer fit for circulation (including DM 403.9 million for the silver DM 5 coins). Altogether, between 1948 and 1975 the Bank – acting for the account of the Federal Government – took over coins amounting to DM 7,398.2 million and redeemed DM 1,046.1 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 1975 (DM 5,406.3 million) divided by the number of inhabitants at September 30, 1975 (61.7 million) yields a figure of DM 87.62 per head of population (1974: DM 82.72).

In the year under review the silver DM 5 commemorative coins "Friedrich Ebert", "European Architectural Heritage Year 1975" and "Albert Schweitzer" were put into circulation.

**Balances on postal giro accounts**

The postal giro account balances at December 31, 1975, including the branches' transfers in transit to the postal giro account of the Bank (Central Office) at Frankfurt am Main, totalled DM 358.0 million (1974: DM 647.1 million). The Bank's credit balances on that 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 Postal Giro Office Berlin (West).

**Postal giro transactions with third parties**

| | 1974 | | | | 1975 | | | |
|---|---|---|---|---|---|---|---|---|
| | Transfers received from third parties | | Transfers made to third parties | | Transfers received from third parties | | Transfers made to third parties | |
| Area | Number | DM mn | Number | DM mn | Number | DM mn | Number | DM mn |
| Land Central Bank | | | | | | | | |
| Baden-Württemberg | 95,129 | 17,320.2 | 19,403 | 1,396.6 | 99,380 | 18,498.1 | 18,931 | 1,952.3 |
| Bavaria | 91,496 | 16,517.3 | 13,471 | 4,011.0 | 83,177 | 13,150.3 | 14,230 | 4,976.4 |
| Berlin | 24,941 | 2,072.9 | 3,723 | 761.0 | 25,765 | 2,303.0 | 3,346 | 799.1 |
| Bremen | 13,729 | 544.6 | 1,604 | 0.2 | 12,362 | 560.8 | 1,472 | 0.2 |
| Hamburg | 55,103 | 12,198.3 | 2,032 | 103.8 | 62,816 | 13,206.3 | 2,039 | 109.6 |
| Hesse | 52,326 | 7,838.5 | 7,960 | 2,190.7 | 54,785 | 8,075.0 | 8,481 | 3,821.6 |
| Lower Saxony | 72,374 | 6,377.7 | 7,549 | 976.7 | 69.346 | 6,336.3 | 7,580 | 885.8 |
| North Rhine-Westphalia | 118,271 | 18,634.6 | 17,919 | 4,583.2 | 114,360 | 18,768.1 | 18,660 | 4,985.9 |
| Rhineland-Palatinate | 35,290 | 2,792.2 | 6,637 | 408.3 | 32,582 | 2,717.8 | 7,121 | 653.9 |
| Saarland | 5,027 | 1,796.2 | 1,131 | 0.1 | 5,319 | 1,788.7 | 1,058 | 0.1 |
| Schleswig-Holstein | 4,417 | 137.8 | 2,712 | 0.5 | 4,787 | 126.3 | 2,858 | 0.4 |
| Total | 568,103 | 86,230.3 | 84,141 | 14,432.1 | 564,679 | 85,530.7 | 85,776 | 18,185.3 |
| Bundesbank – Central Office – | 15,345 | 1,713.8 | 3,107 | 4.5 | 17,497 | 1,722.2 | 3,009 | 5.8 |
| Grand total | 583,448 | 87,944.1 | 87,248 | 14,436.6 | 582,176 | 87,252.9 | 88,785 | 18,191.1 |

**Other claims**

Other claims are shown at DM 948.7 million (end-1974: DM 759.0 million). They include the balance arising from intra-German settlements (commercial payments under the "Berlin Agreement"), which amounted to DM 754.9 million (1974: DM 620.0 million). The turnover on the relevant sub-accounts is shown in Part A, IV, of the German original of this Report.

**Land and buildings**
**Equipment**

With additions of DM 75.4 million and depreciation of DM 38.9 million, land and buildings are shown at DM 698.4 million. The balance sheet value of the equipment remained unchanged at DM 30.4 million after additions of DM 16.9 million and depreciation of equal amount.

**Items in course of settlement**

The balance sheet item "Items in course of settlement" mainly comprises the intercity credit and debit transfers that were proceeding inside the Bank at the end of the year as well as cheques and debit transfer orders being cleared. At December 31, 1975 the balance of items in course of settlement stood at DM 5,098.8 million (end-1974: DM 4,685.1 million).

**Other assets**

The "Other assets" are shown at DM 1,336.9 million (end-1974: DM 954.9 million). As in the previous year, much the greater part consists of interest due in 1976 but assignable to the profit and loss account for the year under review on funds employed abroad and on securities (DM 1,240.9 million, against DM 867.4 million at end-1974).

In addition, this item includes the Bank's share in the DM 250 million capital of the Liquidity Consortium Bank of Frankfurt am Main (set up as a private limited company in 1974), namely DM 75 million or 30 %. The provision embodied in the articles of association that, if necessary, a further DM 750 million of capital is to be paid up in proportion to the existing share entails for the Bundesbank a maximum obligation 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 1976.

*Liabilities*

**Bank notes in circulation**

The bank notes in circulation at December 31, 1975 amounted to DM 55,143.2 million, against DM 50,272.5 million at end-1974; currency in circulation (bank notes and coins) totalled DM 60,549.5 million, compared with DM 55,401.3 million a year before.

**Currency in circulation**

**Millions of Deutsche Mark**

| End of year | Bank notes | Federal coins | Currency in circulation, total |
|---|---|---|---|
| 1970 | 36,479.7 | 3,008.7 | 39,488.4 |
| 1971 | 39,493.8 | 3,665.3 | 43,159.1 |
| 1972 | 44,503.5 | 4,441.2 | 48,944.7 |
| 1973 | 46,246.9 | 4,727.6 | 50,974.5 |
| 1974 | 50,272.5 | 5,128.8 | 55,401.3 |
| 1975 | 55,143.2 | 5,406.3 | 60,549.5 |

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

In 1975 DM 18,837.4 million of new Bundesbank notes of various denominations were taken over from the printing offices and put into circulation or made ready for that purpose.

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

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|---|
| Number (millions) | 343.5 | 377.3 | 363.1 | 460.1 | 424.0 | 399.4 |
| Value (DM million) | 11,306.3 | 12,184.5 | 12,693.8 | 16,528.0 | 15,638.0 | 15,110.5. |

The number and value of the counterfeit notes and coins detained in payments increased, following a decline in 1974. The steep growth in the counterfeit coins detained is attributable to the fact that when the silver DM 5 coins were called in as at August 1, 1975 the counterfeits of these coins (numbering 12,114 with a total value of DM 60,600) were also withdrawn from circulation.

**Counterfeits discovered**

| Year | Notes | | Coins | |
|---|---|---|---|---|
| | Number | DM '000 | Number | DM '000 |
| 1970 | 4,772 | 243.0 | 10,902 | 46.4 |
| 1971 | 2,978 | 186.4 | 9,064 | 37.0 |
| 1972 | 1,848 | 124.2 | 7,487 | 29.5 |
| 1973 | 1,090 | 65.4 | 10,077 | 34.0 |
| 1974 | 881 | 59.4 | 8,181 | 28.6 |
| 1975 | 927 | 92.3 | 14,151 | 65.0 |

**Deposits of banks**

The banks' deposits on giro accounts mainly comprise the minimum reserves to be maintained with the Bundesbank. The sub-item "Other" contains deposits of domestic banks on U.S. dollar accounts. Compared with 1974, banks' deposits changed as follows:

| Deposits of banks | Dec. 31, 1974 DM million | Dec. 31, 1975 DM million |
|---|---|---|
| Deposits on giro accounts | 46,483.3 | 44,563.0 |
| Other | 20.9 | 27.6 |
| | 46,504.2 | 44,590.6. |

**Deposits of public authorities**

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

| | Dec. 31, 1974 DM million | Dec. 31, 1975 DM million |
|---|---|---|
| Federal Government | 139.0 | 2,290.6 |
| Equalisation of Burdens Fund and ERP Special Fund | 162.7 | 358.3 |
| Länder Governments | 642.7 | 2,106.5 |
| Other public depositors | 44.7 | 45.5 |
| | 989.1 | 4,800.9. |

**Special deposits of Federal and Länder Governments**

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

| | Dec. 31, 1974 DM million | Dec. 31, 1974 DM million | Dec. 31, 1975 DM million | Dec. 31, 1975 DM million |
|---|---|---|---|---|
| Federal Government | | | | |
| Anticyclical reserves from 1969 to 1971 | 2,500.0 | | 2,477.0 | |
| Stability surcharge | 1,545.0 | | 542.5 | |
| Investment tax | 631.6 | | 244.3 | |
| Stability loan | 2,500.0 | 7,176.6 | – | 3,263.8 |
| Länder Governments | | | | |
| Anticyclical reserves from 1969 to 1971 | 1,422.2 | | 190.6 | |
| Stability surcharge | 1,917.2 | | – | |
| Investment tax | 236.6 | 3,576.0 | – | 190.6 |
| Anticyclical surcharge on income taxes | | 0.1 | | 0.1 |
| | | 10,752.7 | | 3,454.5. |

**Deposits of other German depositors**

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

| | Dec. 31, 1974 DM million | Dec. 31, 1975 DM million |
|---|---|---|
| Federal Railways | 5.2 | 4.8 |
| Federal Post Office (including postal giro and postal savings bank offices) | 2,226.4 | 1,961.8 |
| Other depositors | 507.1 | 535.2 |
| | 2,738.7 | 2,501.8. |

Giro transactions, simplified cheque and debit transfer order collections

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

| | Number | Amount |
|---|---|---|
| 1974 | 99.51 | 98.07 |
| 1975 | 99.52 | 97.94. |

**Annual turnover on the giro accounts of the Deutsche Bundesbank**

| Turnover | 1974 Number of transactions | 1974 Total amount | 1974 Average amount | 1975 Number of transactions | 1975 Total amount | 1975 Average amount |
|---|---|---|---|---|---|---|
| | '000 | DM mn | DM '000 | '000 | DM mn | DM '000 |
| (a) Credits | | | | | | |
| Cash payments | 1,100 | 156,027 | 141.8 | 1,105 | 164,512 | 148.9 |
| Settlement with account-holders | 7,942 | 2,450,070 | 308.5 | 9,036 | 2,293,828 | 253.9 |
| Local transfers | 33,527 | 2,589,789 | 77.2 | 33,166 | 2,357,603 | 71.1 |
| Intercity transfers | 122,529 | 2,240,960 | 18.3 | 161,205 | 2,420,796 | 15.0 |
| Cheque and debit transfer order collections (total presented) | 374,010 | 905,447 | 2.4 | 423,123 | 970,178 | 2.3 |
| Total | 539,108 | 8,342,293 | — | 627,635 | 8,206,917 | — |
| (b) Debits | | | | | | |
| Cash payments | 1,457 | 165,214 | 113.4 | 1,487 | 173,843 | 116.9 |
| Settlement with account-holders | 4,556 | 2,434,407 | 534.3 | 4,141 | 2,260,349 | 545.8 |
| Local transfers | 33,527 | 2,589,789 | 77.2 | 33,166 | 2,357,603 | 71.1 |
| Intercity transfers | 123,285 | 2,254,780 | 18.3 | 163,207 | 2,450,866 | 15.0 |
| Cheque and debit transfer order collections (total paid) | 373,018 | 903,044 | 2.4 | 422,536 | 968,833 | 2.3 |
| Total | 535,843 | 8,347,234 | — | 624,537 | 8,211,494 | — |
| (c) as % of total turnover (credits and debits) | | % | | | % | |
| Cash payments | | 1.92 | | | 2.06 | |
| Settlement with account-holders | | 29.27 | | | 27.74 | |
| Local transfers | | 31.03 | | | 28.72 | |
| Intercity transfers | | 26.94 | | | 29.67 | |
| Cheque and debit transfer order collections (total presented and paid) | | 10.84 | | | 11.81 | |
| | | 100.00 | | | 100.00 | |

Most of the cheque and debit transfer order collections were carried out by the Bank's six computer centres. They handled 66 % (1974: 62 %) of the paper presented for collection. Credit transfers are likewise increasingly being handled by the computer centres; the proportion of automatically processed credit transfers rose to 48 %.

When considering these figures it should be borne in mind that in 1975 the majority of bulk payments by means of direct debit and credit transfers (e. g. wireless licence fees or children's allowances) were effected by issuing vouchers. Beginning in the autumn of 1975, however, some of these payments (about 10 % of the automatically processed payments, which average 2.35 million items per day) were included in the voucherless exchange of data media scheme. After the introduction of the new and uniform "Guidelines for the voucherless exchange of data media (magnetic tape clearing procedure)" of the banking industry and the corresponding "Special regulations of the Deutsche Bundesbank governing the voucherless exchange of data media" at the beginning of 1976, this procedure – which is far more economic than the voucher system – is being used to a growing extent by those handling payments with EDP equipment.

As a consequence of automation the number of items debited in collections declined further (from 37.3 to 33.0 million), and that of items credited in credit transfers fell from 37.4 to 21.3 million, in spite of a simultaneous rise in the number of items presented in both cases.

**Balances on cash deposit special accounts**

The balances maintained on cash deposit accounts at December 31, 1975 amounted to DM 256.0 million (end-1974: DM 127.3 million). Since the cash deposit requirement had been rescinded, it was not necessary to hold ordinary deposits after October 1, 1974; the balances shown at December 31, 1975 therefore consisted entirely of deposits paid in arrears for earlier months, mainly as a result of notifications of liability.

**Liabilities in respect of mobilisation and liquidity paper sold**

In the year under review sales of mobilisation and liquidity paper pursuant to sections 42 and 42 (a) of the Bundesbank Act were as a whole – i. e. taking Treasury bills and discountable Treasury bonds together – at DM 18,156.5 million slightly down on the year (1974: DM 18,557.4 million). The amount of mobilisation and liquidity discountable Treasury bonds issued was, however, somewhat above the 1974 figure (DM 1,085.1 million); it totalled DM 1,381.2 million, while redemptions came to DM 5,772.6 million (1974: DM 3,322.2 million). The amount of such paper outstanding thus declined sharply, viz. by about DM 4.4 billion to DM 1,318.5 million at December 31, 1975 (end-1974: DM 5,709.9 million).

Sales of Bundesbank Treasury bonds (mobilisation and liquidity discountable Treasury bonds in small denominations sold in a standardised form to private investors) were discontinued at the end of April 1975 for reasons of liquidity policy.

In February 1975 the Bank, under its short-term money market regulating arrangements, again sold fairly large quantities of 30-day Treasury bills to domestic banks. Treasury bills running for less than 30 days were not offered during the year under review.

Turnover in Treasury bills was of the same high order as in 1974 (sales amounted to DM 16.8 billion against DM 17.5 billion and redemptions to DM 17.1 billion against 16.2 billion).

In 1975 total turnover in mobilisation and liquidity paper comprised DM 18,156.5 million of sales and DM 22,850.6 million of redemptions (1974: DM 18,557.4 million and DM 19,549.9 million, respectively). The amount of such paper outstanding at December 31, 1975 was DM 4,173.2 million (end-1974: DM 8,867.3 million).

**Mobilisation and liquidity paper sold and redeemed**

**Millions of Deutsche Mark**

| Type of paper | 1974 | 1975 | | |
|---|---|---|---|---|
| | Outstanding at Dec. 31 | Sold | Redeemed | Outstanding at Dec. 31 |
| Treasury bills (running for up to 90 days) | 3,157.4 | 16,775.3 | 17,078.0 | 2,854.7 |
| Discountable Treasury bonds (running for 6 to 24 months) | 5,709.9 | 1,381.2 | 5,772.6 | 1,318.5 |
| Total | 8,867.3 | 18,156.5 | 22,850.6 | 4,173.2 |

**Liabilities in respect of foreign business**

The liabilities in respect of foreign business consisted of

| | Dec. 31, 1974 | | Dec. 31, 1975 | |
|---|---|---|---|---|
| | DM million | DM million | DM million | DM million |
| Deposits of foreign depositors | | | | |
| Banks | 755.7 | | 374.5 | |
| Other depositors | 512.2 | 1,267.9 | 453.8 | 828.3 |
| Other | | | | |
| Provision of cover for credits of | | | | |
| non-residents | 0.1 | | 0.2 | |
| residents | 15.8 | | 11.4 | |
| | 15.9 | | 11.6 | |
| Miscellaneous liabilities | 0.4 | 16.3 | 0.5 | 12.1 |
| | | 1,284.2 | | 840.4. |

**Contra-entry to special drawing rights allocated**

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

**Provisions**
**Provision for pensions**

After withdrawal of DM 88.5 million for the payment of pensions and widows' and orphans' allowances and an allocation of DM 253.5 million, the provision for pension liabilities is shown at DM 1,535.0 million.

**Other provisions**

The provision for hazards inherent in domestic and foreign business remained unchanged at DM 300 million. The provision of DM 20.1 million formed in 1974 to meet any exchange losses arising from U.S. dollar forward transactions with German exporters entered into between January 2 and February 13, 1973 and running for up to two years was used on the maturity of the forward transactions.

**Other liabilities**

The "Other liabilities" are shown at December 31, 1975 at DM 43.3 million, against DM 85.8 million at the end of 1974.

**Deferred expenses and accrued income**

Deferred expenses and accrued income amounted to DM 247.2 million at December 31, 1975 (end-1974: DM 326.3 million). As previously, this item mainly comprises interest received in the year under review, but relating to the next year, on domestic and foreign commercial and Treasury bills.

**Capital**

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

**Reserves**

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

**Contingent liabilities and claims**

The contingent liabilities and claims amounted to DM 2.4 million (end-1974: DM 0.3 million).

**Comparison of expenditure and receipts**

**Millions of Deutsche Mark**

| Expenditure | 1974 | 1975 | Receipts | 1974 | 1975 |
|---|---|---|---|---|---|
| Interest paid on mobilisation and liquidity paper | 191.8 | 171.9 | Interest received on funds employed abroad | 4,833.5 | 4,268.4 |
| Other interest paid | 4.9 | 5.4 | Loans to domestic banks | 1,027.7 | 451.9 |
| | 196.7 | 177.3 | Equalisation claims | 244.1 | 244.1 |
| Administrative costs | | | Securities | 39.9 | 228.0 |
| Personnel | 471.5 | 493.6 | Cash advances (book credits), Treasury bills and Treasury bonds | 102.7 | 40.3 |
| Materials | 95.9 | 104.0 | Other interest received | 5.2 | 6.9 |
| Note printing | 65.1 | 63.9 | | 6,253.1 | 5,239.6 |
| Depreciation | 43.0 | 55.8 | Fees | 9.2 | 10.5 |
| Increase in provision for pensions | 280.3 | 253.5 | Gains from valuation adjustment of monetary reserves and other foreign exchange positions | — | 5,479.8 |
| Pension payments in respect of Reichsbank | 36.8 | 37.5 | Other receipts | 25.4 | 22.3 |
| Other expenditure | 25.9 | 27.2 | Loss | 2,158.1 | — |
| Write-downs on monetary reserves and other foreign exchange positions | 7,230.6 | — | | | |
| Annual surplus | — | 9,539.4 | | | |
| **Total** | 8,445.8 | 10,752.2 | Total | 8,445.8 | 10,752.2 |

*Receipts*

**Interest**

| | 1974 DM million | 1975 DM million |
|---|---|---|
| The interest received amounted to | 6,253.1 | 5,239.6. |
| After deduction of the interest paid, namely | 196.7 | 177.3, |
| interest receipts are shown in the profit and loss account at | 6,056.4 | 5,062.3. |

In the year under review total interest income was DM 1,013.5 million smaller than in 1974. The interest received on funds employed abroad decreased by DM 565.1 million to DM 4,268.4 million in 1975. Receipts from lending to German banks – domestic bills, lombard loans and foreign bills bought in Germany – fell by more than half, from DM 1,027.7 million to DM 451.9 million. Interest received from securities rose by DM 188.1 million to DM 228.0 million, while that received from equalisation claims remained unchanged at DM 244.1 million. Other interest income diminished by DM 60.7 million to DM 47.2 million.

The interest paid, at DM 177.3 million, was DM 19.4 million lower than at end-1974; DM 171.9 million (1974: DM 191.8 million) was paid on Treasury bills and discountable Treasury bonds of the Federal Government (mobilisation and liquidity paper pursuant to sections 42 and 42 (a) of the Bundesbank Act).

**Fees**

DM 10.5 million of fees were received in the year under review (1974: DM 9.2 million).

**Gains from valuation adjustment of monetary reserves and other foreign exchange positions**

In the annual accounts for 1975 the valuation adjustment of monetary reserves and other foreign exchange positions resulted in gains amounting to DM 5,479.8 million (1974: write-downs amounting to DM 7,230.6 million).

**Other receipts**

"Other receipts" are shown at DM 22.3 million (end-1974: DM 25.4 million).

**Administrative costs**
**Personnel**

The administrative costs in respect of personnel rose in comparison with the previous year by DM 22.1 million to DM 493.6 million owing to the statutory or negotiated pay increases for established employees ("officials") and unestablished salary and wage earners. The Bank's staff decreased by 284 to 13,545 during the year under review. Thus the number of employees has diminished by 624 in all over the last three years.

The further reduction in personnel was due to the progressive automation of labour-intensive operations, especially in the field of cashless payments. In the branches alone about 1,320 jobs were done away with between the beginning of the automation of cashless payments and the end of 1975. In addition, it was possible to forgo the creation of over 500 new jobs which, but for automation, would have been unavoidable owing to the much greater volume of business. Most of the personnel thus released were found employment in other fields, unless they left the Bank on reaching retirement age or for other personal reasons.

Whereas automation brought a perceptible easing of the work load in the branches, the additional duties at the Central Office and the Main Offices again necessitated a moderate increase in staff during the year under review.

**Number of persons employed in the Bundesbank**

| | Beginning of 1975 | | | | | Beginning of 1976 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | of whom | | | | | of whom | |
| | Central Office | Land Central Banks | Total | male | female | Central Office | Land Central Banks | Total | male | female |
| Officials | 710 | 4,721 | 5,431* | 5,261 | 170 | 704 | 4,705 | 5,409* | 5,223 | 186 |
| Salary earners | 1,546 | 5,811 | 7,357* | 3,120 | 4,237 | 1,594 | 5,520 | 7,114* | 3,152 | 3,962 |
| Wage earners | 169 | 872 | 1,041* | 167 | 874 | 165 | 857 | 1,022* | 168 | 854 |
| Total | 2,425 | 11,404 | 13,829 | 8,548 | 5,281 | 2,463 | 11,082 | 13,545 | 8,543 | 5,002 |
| * of whom, working part time | | | | | | | | | | |
| Officials, female | | | 3 | | | | | 4 | | |
| Salary earners | | | 278 | | | | | 289 | | |
| Wage earners | | | 769 | | | | | 750 | | |

Payments to serving members of the Directorate of the Bank and the Central Bank Council amounted to DM 5,959,417.22 in the year under review. Former members of those bodies and of the Board of Directors and Board of Managers of the Bank deutscher Länder, and the Boards of Management of the Land Central Banks, including their surviving dependants, received payments totalling DM 4,448,122.99.

Changes in staff regulations

To conform to the Second Act on the Standardisation and Revision of Federal and Länder Legislation on Public Service Pay of May 23, 1975, the main provisions of which entered into force on July 1, 1975, the Central Bank Council approved on September 11, 1975 a revised version of the principles governing the promotion of officials, which came into effect on October 1, 1975.

During 1975 the Bank again concluded a number of pay agreements for its unestablished employees which brought their legal position into line with that of the Federal Government's unestablished staff.

**Administrative costs**
**Materials**

Administrative costs in respect of materials rose by DM 8.1 million to DM 104.0 million in the year under review.

**Note printing**

Expenditure on note printing amounted to DM 63.9 million against DM 65.1 million in 1974.

**Depreciation and increase in provisions**

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

**Pension payments in respect of Reichsbank**

Payments to members of the former Deutsche Reichsbank and other persons to whom the Act concerning Section 131 of the Basic Law applies, and for whom the Bank is required to provide in accordance with section 41 of the Bundesbank Act, amounted in the year under review to DM 37.5 million (1974: DM 36.8 million).

**Other expenditure**

"Other expenditure" is shown at DM 27.2 million (1974: DM 25.9 million).

**Annual surplus**

| | DM |
|---|---|
| The profit and loss account for 1975 shows an annual surplus amounting to | 9,539,394,658.98. |
| After elimination of the adjusting item relating to 1974 in respect of the valuation adjustment of monetary reserves and other foreign exchange positions – loss brought forward – amounting to | 8,931,294,247.74 |
| there remains a balance sheet profit (net profit) amounting to to be distributed pursuant to section 27 of the Bundesbank Act. | 608,100,411.24 |

**Balance sheet profit**

Proposed distribution of profit

| | DM | |
|---|---|---|
| The Directorate proposes to the Central Bank Council that the following allocations be made: | | |
| To the legal reserve | 121,700,000.00 [1] | |
| To other reserves | 48,582,199.69 [1] | |
| To the Fund for the Purchase of Equalisation Claims | 40,000,000.00 | 210,282,199.69. |
| The remaining profit amounting to | | 397,818,211.55 |
| will be paid over to the Federal Government. | | |

Frankfurt am Main, March 1976

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

1 Following these allocations the legal reserve will amount to DM 969,000,000.00 and the other reserves to DM 130,500,000.00.

## Report of the Central Bank Council



The annual accounts of the Deutsche Bundesbank for 1975, the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1975, and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1975, 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 1975, the bookkeeping and the conversion account as shown by the books at December 31, 1975, 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 1975 on April 1, 1976. The balance sheet profit (net profit) shown will be distributed pursuant to section 27 of the Bundesbank Act and as proposed by the Directorate. After allocations to the reserves and the Fund for the Purchase of Equalisation Claims the remaining profit amounting to DM 397,818,211.55 will be paid over to the Federal Government.

In addition, the Central Bank Council 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, 1975, and approved the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1975.

Since the publication of the Report for the Year 1974 the following changes have taken place in the Central Bank Council and the Directorate of the Deutsche Bundesbank:

Retired from service

as at the close of December 31, 1975
the Vice-President of the Land Central Bank in Bremen
Herr Ludwig Preiss,

as at the close of March 31, 1976
the Member of the Directorate of the Deutsche Bundesbank
Herr Johannes Tüngeler,

as at the close of April 23, 1976
the President of the Land Central Bank in Baden-Württemberg
Dr. Fritz Schiettinger.

Reappointed

with effect from September 1, 1975
Herr Josef Thoma
Vice-President of the Land Central Bank in North Rhine-Westphalia,

with effect from October 1, 1975
Herr Erich Küspert
Vice-President of the Land Central Bank in Bavaria,

Herr Kurt Wiesser
Member of the Board of Management of the Land Central Bank in Bavaria,

with effect from February 28, 1976
Herr Werner Lucht
Member of the Directorate of the Deutsche Bundesbank,

with effect from April 1, 1976
Dr. Volkhard Szagunn
Vice-President of the Land Central Bank in Baden-Württemberg,

Herr Walter Offner
Member of the Board of Management of the Land Central Bank in Baden-Württemberg.

Newly appointed

with effect from January 1, 1976
Herr Joachim Treskow
to be Vice-President of the Land Central Bank in Bremen,

with effect from April 1, 1976
Dr. Leonhard Gleske
to be Member of the Directorate of the Deutsche Bundesbank, at the same time resigning from his office as President of the Land Central Bank in Bremen,

Dr. Kurt Nemitz
to be President of the Land Central Bank in Bremen,

with effect from April 24, 1976
Prof. Dr. Norbert Kloten
to be President of the Land Central Bank in Baden-Württemberg.

The Central Bank Council, acting also on behalf of the Directorate and of the Boards of Management of the Land Central Banks, expresses to the entire staff of the Deutsche Bundesbank its thanks for their loyal and understanding cooperation during 1975. The Council likewise wishes to record its appreciation of the excellent collaboration with the staff representative committees.

Frankfurt am Main, April 1976

Dr. Karl Klasen
President of the Deutsche Bundesbank

# Appendix to Part B

# Balance sheet of the Deutsche Bundesbank as at December 31, 1975



## Assets

| | DM | DM |
|---|---|---|
| 1. Gold | | 14,001,658,080.92 |
| 2. Reserve position in the International Monetary Fund and special drawing rights | | |
| 2.1. Drawing rights within gold tranche | 4,394,237,892.45 | |
| 2.2 Loans under special borrowing arrangements | 460,471,500.— | |
| 2.3. Special drawing rights | 4,453,959,808.15 | 9,308,669,200.60 |
| 3. Balances with foreign banks and money market investment abroad | | 51,280,376,271.85 |
| 4. Foreign currency | | 22,895,525.03 |
| 5. Loans and other claims on foreign countries | | |
| 5.1. Loans in connection with EEC medium-term monetary assistance | 1,273,316,450.— | |
| 5.2. Claims arising from foreign exchange offset agreements with U.S.A. | 4,102,258,963.34 | |
| 5.3. Other loans to foreign monetary authorities | 3,925,950,000.— | |
| 5.4. Loans to World Bank | 2,502,108,022.50 | 11,803,633,435.84 |
| 6. Foreign bills of exchange | | 903,468,221.62 |
| 7. Domestic bills of exchange | | 5,910,240,570.90 |
| 8. Lombard loans | | 1,707,595,500.— |
| 9. Cash advances (book credits) | | |
| 9.1. Federal Government | — | |
| 9.2. Equalisation of Burdens Fund | — | |
| 9.3. Länder Governments | 361,157,200.— | 361,157,200.— |
| 10. Treasury bills and discountable Treasury bonds | | |
| 10.1. Federal Government | — | |
| 10.2. Länder Governments | — | — |
| 11. Equalisation claims on Federal Government and non-interest-bearing debt certificate in respect of Berlin | | |
| 11.1. Equalisation claims | 8,136,170,921.86 | |
| 11.2. Non-interest-bearing debt certificate | 547,168,481.20 | 8,683,339,403.06 |
| 12. Loans to Federal Railways and Federal Post Office | | |
| 12.1. Cash advances (book credits) | — | |
| 12.2. Treasury bills and discountable Treasury bonds | — | — |
| 13. Securities | | 7,952,574,537.87 |
| 14. German coins | | 945,792,453.39 |
| 15. Balances on postal giro accounts | | 358,034,301.84 |
| 16. Other claims | | 948,685,710.04 |
| 17. Land and buildings | | 698,424,609.30 |
| 18. Equipment | | 30,419,204.— |
| 19. Items in course of settlement | | 5,098,792,443.70 |
| 20. Other assets | | 1,336,929,166.32 |
| 21. Prepaid expenses and deferred income | | 25,767,486.96 |
| Right of recourse in respect of contingent liabilities | 2,399,721.10 | |
| | | 121,378,453,323.24 |

| | DM | DM |
|---|---|---|
| 1. Bank notes in circulation | | 55,143,176,855.— |
| 2. Deposits of banks | | |
| 2.1 Deposits on giro accounts | 44,563,008,118.20 | |
| 2.2. Other | 27,619,834.90 | 44,590,627,953.10 |
| 3. Deposits of public authorities | | |
| 3.1. Federal Government | 2,290,629,836.23 | |
| 3.2. Equalisation of Burdens Fund and ERP Special Fund | 358,316,258.18 | |
| 3.3. Länder Governments | 2,106,475,693.01 | |
| 3.4. Other public depositors | 45,489,381.94 | 4,800,911,169.36 |
| 4. Special deposits of Federal and Länder Governments | | |
| 4.1. Federal Government | 3,263,798,051.19 | |
| 4.2. Länder Governments | 190,658,000.— | |
| 4.3. Anticyclical surcharge on income taxes | 76,979.93 | 3,454,533,031.12 |
| 5. Deposits of other German depositors | | |
| 5.1. Federal Railways | 4,770,968.19 | |
| 5.2 Federal Post Office (including postal giro and postal savings bank offices) | 1,961,869,921.08 | |
| 5.3. Other depositors | 535,200,357.13 | 2,501,841,246.40 |
| 6. Balances on cash deposit special accounts | | 256,003,816.03 |
| 7. Liabilities in respect of mobilisation and liquidity paper sold | | 4,173,174,000.— |
| 8. Liabilities in respect of foreign business | | |
| 8.1. Deposits of foreign depositors | 828,262,904.66 | |
| 8.2. Other | 12,078,654.95 | 840,341,559.61 |
| 9. Contra-entry to special drawing rights allocated | | 1,665,064,944.— |
| 10. Provisions | | |
| 10.1 Provision for pensions | 1,535,000,000.— | |
| 10.2 Other provisions | 300,000,000.— | 1,835,000,000.— |
| 11. Other liabilities | | 43,271,439.97 |
| 12. Deferred expenses and accrued income | | 247,189,097.10 |
| 13. Capital | | 290,000,000.— |
| 14. Reserves | | |
| 14.1. Legal reserve | 847,300,000.— | |
| 14.2. Other reserves | 81,917,800.31 | 929,217,800.31 |
| 15. Balance sheet profit | | 608,100,411.24 |
| Contingent liabilities | 2,399,721.10 | |
| | | 121,378,453,323.24 |

## Profit and loss account of the Deutsche Bundesbank for the year 1975



**Expenditure**

| | DM | DM |
|---|---|---|
| 1. Administrative costs | | |
| 1.1. Personnel | 493,563,080.80 | |
| 1.2. Materials | 103,991,257.52 | 597,554,338.32 |
| 2. Note printing | | 63,925,882.10 |
| 3. Depreciation | | |
| 3.1. on land and buildings | 38,920,924.79 | |
| 3.2. on equipment | 16,928,314.84 | 55,849,239.63 |
| 4. Increase in provision for pensions | | 253,544,889.53 |
| 5. Pension payments in respect of Reichsbank | | 37,451,903.66 |
| 6. Other expenditure | | 27,176,215.63 |
| 7. Annual surplus | | 9,539,394,658.98 |
| | | 10,574,897,127.85 |

**Receipts**

| | DM |
|---|---|
| 1. Interest | 5,062,358,034.01 |
| 2. Fees | 10,475,709.87 |
| 3. Gains from valuation adjustment of monetary reserves and other foreign exchange positions | 5,479,766,288.17 |
| 4. Other receipts | 22,297,095.80 |
| | 10,574,897,127.85 |

**Supplement to profit and loss account**

| | DM |
|---|---|
| 1. Annual surplus | 9,539,394,658.98 |
| 2. Adjusting item relating to 1974 in respect of the valuation adjustment of monetary reserves and other foreign exchange positions — loss brought forward — | 8,931,294,247.74 |
| Balance sheet profit | 608,100,411.24 |

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

Frankfurt am Main, March 5, 1976

Treuarbeit Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

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

D. Wollert — Dr. Elmendorff KG
Wirtschaftsprüfungsgesellschaft

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