Report of the Deutsche Bundesbank

for the Year 1976

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

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

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The German original went to press on April 21, 1977

Part A: General part

The currency and the economy in 1976

I. Economic developments and central bank policy

The aim of the Deutsche Bundesbank's monetary policy in 1976 was to curb the rate of price increases further and to support the process of economic recovery at the same time. In the course of the year under review this objective was largely achieved. In two respects the result was in fact better than initially expected: the pace of price rises was reduced more than had been thought attainable at the beginning of the year; at the end of 1976 the rate of inflation fell to 4 %. Furthermore, real economic growth – at just over 5½ % – was stronger than had originally been considered possible. Employment responded less favourably than anticipated, although the number of unemployed persons declined and short-time working even fell sharply. However, as enterprises mobilised their internal labour reserves first and rarely recruited additional staff, unemployment decreased less than might have been expected in the light of previous experience, given the strong expansion of production.

In distinct contrast to earlier upswing phases, last year the main impetus was imparted by domestic demand, whereas in the field of external transactions the demand stimuli from abroad, strong though they were in themselves, and the stimuli given to other countries through higher imports largely cancelled each other out. Germany's surplus on current account decreased noticeably again in 1976; it amounted to only 0.7 % of gross national product, which was less than in earlier years, apart from a few boom years. Germany thus came quite close to the objective of external equilibrium.

Nevertheless, economic activity was not free from external disturbances in 1976. Germany was twice the target of large speculative foreign exchange inflows which temporarily made it more difficult to contain money creation. These influences are at least partly responsible for the fact that last year's monetary growth target was slightly exceeded. On the whole, however, the expansion of the credit markets that accompanied the upswing proceeded remarkably smoothly, in part because public credit requirements, while still very large in 1976, were much smaller than in 1975, which left sufficient room for the sharp growth of private demand for credit. The long-term interest rate continued to move downwards, in conformity with the further moderation of price rises. When this Report went to press the interest rate on the bond market had reached its lowest level since 1968 despite the fact that the Bundesbank has been keeping bank liquidity tight for some while – though not tighter than is compatible with the planned monetary expansion. The absence of abrupt movements on the credit markets and the further decline in the interest rate level while the national product and incomes are rising reflect among other things the favourable effects of a monetary policy which has been directed for years towards steadying growth and making headway in the stabilisation of prices.

Although the economy of the Federal Republic of Germany came closer to the economic policy targets in many respects in 1976, this does not mean that further progress in the desired direction can be expected quasi-automatically. Among the economic problems which remain to be solved, unemployment takes pride of place. Lasting success in this field will presumably only be possible through special labour market measures in conjunction with strong economic growth and further advances towards stability. This stabilisation must apply not just to prices but also to costs and the longer-term expectations of enterprises, not least with respect to the burden of public levies imposed on them in future; in other words, the business community's cost-earnings ratio must be durably stabilised at a satisfactory level. By selecting a monetary growth target for 1977 which sets distinct limits to price increases but at the same time leaves sufficient scope for strong economic growth if the necessary conditions are created on the cost side, the Bundesbank has clearly indicated how it intends to contribute again in 1977 to the solution of the outstanding problems.

1. Continuing economic recovery

Steep rise in production

From the point of view of economic policy the most significant feature of developments in 1976 was that the continued stabilisation policy once more proved to be compatible with strong economic growth. One of the main contributory factors was that the upswing proceeded at a moderate pace and that expectations of a boom, which always include inflationary expectations, did not arise at any time. On the contrary, the expansionary forces were underrated in many cases, particularly in the summer, when it appeared for a time as if they might slacken. In view of the manifold problems in individual industries, and also in the economy as a whole (problems which will be dealt with in detail on the following pages), such reservations are understandable. However, they must not obscure the fact that a great amount of ground has been covered since the trough of the recession. At the end of 1976 overall production distinctly exceeded the pre-recession level. In the first half of 1976 economic growth was significantly stimulated by the increase in stocks of basic goods. In addition, the capital goods industries had to speed up their deliveries in that period because of the deadline set for the manufacture of goods qualifying for the investment grant. These special stimuli were absent in the summer months. After a short phase in which the relative weight of the various expansionary forces shifted, production started to grow again, though not quite as strongly as in the spring. In 1976 overall industrial production (excluding construction) exceeded the 1975 level by 9 %, and by 7½ % after adjustment for the larger number of working days. The economic recovery did not progress so far in all the other economic sectors. In construction, output likewise increased in the course of 1976 but not nearly as much as in industry. The smaller demand for construction work is not due to cyclical factors alone. Even in the longer run construction is unlikely to regain its old importance for the economy; the share of this sector in total net value added amounted to only 6 % in 1976 against an average of 7½ % in 1972 and 1973, the last boom period in construction. In the distributive trades, too, net value added increased at a slower pace than in industry, but in this sector the preceding economic downswing had been less pronounced. According to provisional calculations, in 1976 real gross national product, as a reflection of overall production, was 5½ % higher than in 1975 and 2 % larger than in 1974.

Better utilisation of the production potential

Germany's production potential, which seems to have grown by about 2½ % in 1976, was again much better utilised than a year earlier; as measured by the average degree of utilisation in preceding years, the utilisation of production potential in 1976 ran at 96½ %, and at more than 97 % towards the end of the year. In industry the utilisation rose more sharply than in the economy as a whole in 1976, after it had previously fallen more steeply in that sector. The utilisation of plant in industry at the end of 1976 and the beginning of 1977, however, was even further removed from the average degree of utilisation than in the economy in general, although there were considerable differences in individual cases. In road vehicle building, for instance, capacity utilisation has distinctly exceeded the average level of late, but in other sectors, such as most of the basic and producer goods industries, mechanical engineering, shipbuilding and other capital goods industries, it has fallen well short of previous figures.

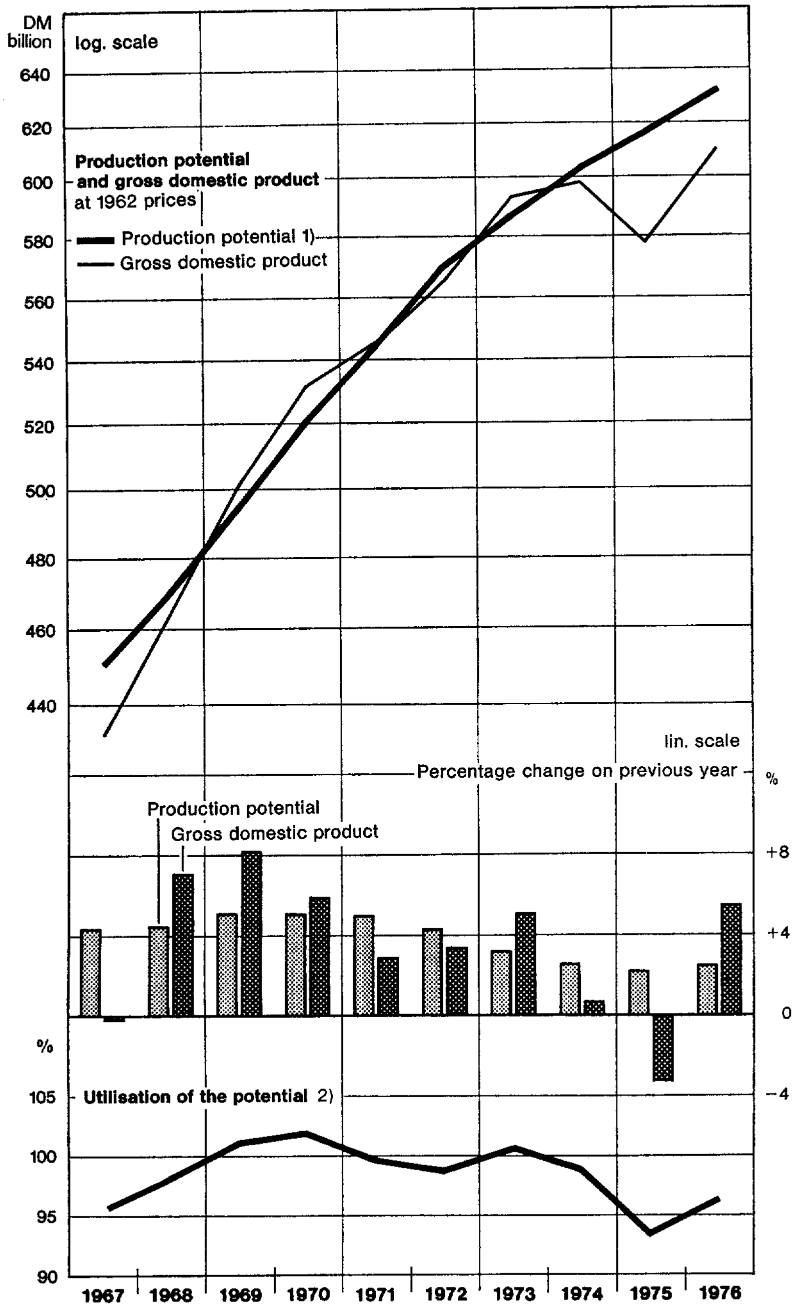
Considerable productivity advances

At that stage of the economic upswing enterprises' productivity improved considerably, for output was initially expanded with an unchanged, and in some cases even a reduced, number of employees; the rationalisation investments of previous years and the staff rundown at last made a full favourable impact on production costs. Over the whole of 1976 overall production per man-hour increased by about 5½ % against only 1½ % in 1975. In industry (excluding construction and energy) productivity per man-hour rose by an average of no less than 9 % in 1976, though there were large divergences in individual sectors.

Increase in number of hours worked . . .

In recruiting new staff the business community continued to act rather cautiously, particularly as the first requirement was to give full employment to those staff members who had previously been affected by short-time working. Accordingly, the number of short-time workers who received financial assistance from the Federal Labour Office fell from an average of 770,000 in 1975 to 280,000 in 1976. This was equal to the additional employment of about 150,000 full-time workers. As measured by the total number of employed persons (i.e. leaving the return to normal working hours out of account), employment decreased once more in the first half of last year. However, in the course of 1976 some especially dynamic

Production potential and national product



1) Calculated by Bundesbank.- 2) Potential = 100.

industries started to enlarge their staff again. Seasonally adjusted, the number of employees therefore increased slightly from the autumn onwards.

... but only gradual reduction in unemployment

Nevertheless, the reduction in unemployment proceeded slowly, apart from the sharp decline in short-time working. As explained in more detail later on, the problems on the labour market did not become less acute in the economic upswing; in fact, the structural difficulties preventing a balance between the supply of and demand for labour in individual economic sectors or regions tended to become more marked. As unemployment gradually declined the shortage of skilled labour became more and more manifest, especially in the metal-working occupations but also in other production-oriented trades. Among the less qualified employees and the employees in commercial and administrative occupations unemployment remained relatively high. Despite the unmistakable improvement in the overall situation on the labour market the labour exchanges again registered an average of slightly more than one million (1,060,000) unemployed persons in 1976; the average unemployment ratio, at 4.6 %, was only a little lower than in 1975. In the first few months of 1977 the gradual reduction in unemployment continued, seasonally adjusted; at the end of March 1977 the unemployment ratio was 4.3 %

Private domestic demand the most important stimulus of the expansion

The major driving force behind the economic upswing last year was private domestic demand. Compared with the preceding year enterprises and individuals raised their expenditure on consumption and capital formation in 1976 by DM 81 billion, which was nearly 90 % of the total rise in nominal gross national product. For economic activity it was of particular significance that capital spending expanded sharply. Initially the investment grant scheme had a stimulating effect in this field, for the deadline for the completion of machinery and equipment qualifying for the investment grant (other than energy projects) was June 30, 1976. After a short interruption, which was only natural after this acceleration, the upward trend of private capital formation resumed in the autumn. The expenditure of the private sector on machinery and equipment and non-residential buildings, taken together, rose by 2½ % in the second half of 1976, seasonally adjusted. During the entire year it was 10 % larger than a year earlier at current prices and 7½ % larger at constant prices, a favourable result which had hardly been thought possible beforehand. An improvement in the business community's propensity to invest may be inferred from the fact that the orders placed with capital goods producers and — in the case of non-residential construction projects — the construction industry increased steeply in the course of 1976. Imports of capital goods, too, rose considerably last year; they were over 21 % higher than in 1975.

More favourable investment climate due to improved profitability and financial situation

Besides the stimuli provided by the government, the more favourable investment climate was primarily due to the fact that the profitability of enterprises improved markedly in the first stage of the economic upswing after the sharp drop in profits in earlier years. This process did not continue on the same scale in the later months of last year, when there were in fact great divergences in individual cases; nevertheless, in 1976 enterprises' gross income appears to have exceeded the depressed 1975 level by about one fifth. The financial situation of enterprises was correspondingly favourable; by and large, firms were fairly liquid and, in relation to their capital expenditure, they had substantial internal resources at their disposal. In 1976 these resources went up by roughly one fifth, which was only a little less than the increase in expenditure on fixed assets and stocks. This admittedly owed something to the fact that in 1976 enterprises received more than DM 4 billion from the investment grant, which — like a non-recurring tax bonus — raised enterprises' disposable funds above the level of the income they earned.

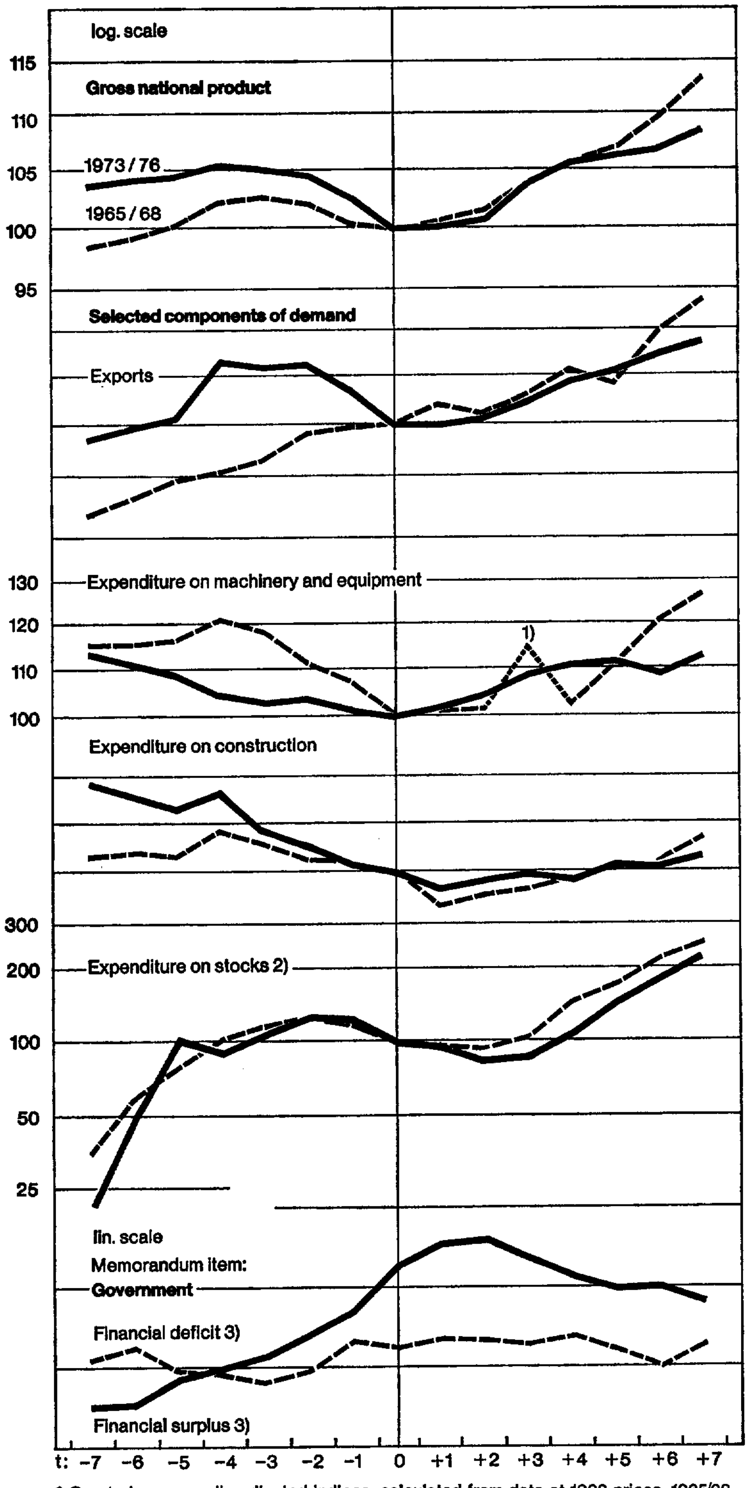
Investment mainly for rationalisation and replacement purposes

Thus the improved profitability and financial conditions strengthened investment activity last year, contrary to opinions expressed on several occasions, and also supported employment through the associated expansion of demand. This statement is not invalidated by the fact that, as before, the investment was rarely motivated by the desire to expand capacity and that the bulk of the capital formation continued to be determined by the need to replace and the wish to modernise and rationalise existing production plant. Regardless of the motive for investment, however, the direct impact of the demand for capital goods on production and employment is to be considered favourable. The fact that rationalisation is the predominant motive does not raise any general economic problems, even in the long run, provided that demand grows sufficiently to realise the potential increase in rationalisation and helps to utilise available productive capacity in full or — as in 1976 — at least to a greater extent.

Significance of stockbuilding for the recovery process

Demand was stimulated especially strongly by expenditure on stocks in 1976. In particular, stocks of primary products, which had been sharply run down during the preceding downswing, soon proved to be too low when production gathered pace again. In the course of the year stockbuilding admittedly lost momentum at times, especially as stocks of both primary products and finished goods had been built up too sharply in some sectors under the influence of rather exaggerated expectations about the intensity of the upswing. Roughly one third of

Two recessions and how they were overcome *



* Quarterly seasonally adjusted indices, calculated from data at 1962 prices. 1965/68 cycle: t=1st qtr 1967=100; 1973/76 cycle: t=1st qtr 1975=100.- 1) Influenced by the introduction of value-added tax.- 2) Cumulative.- 3) Financial balance as defined in the national accounts as % of gross national product at current prices, shown inversely.

the real growth of the national product was accounted for by the increase in expenditure on stocks in 1976; for an upswing year this is by no means an excessive proportion. In 1968, when overall production for the first time rose distinctly above its low point in the preceding recession, this share had amounted to 40 %.

Private consumer demand bolsters economic activity

Households' demand was another element that supported economic activity last year. In 1976 total private consumption expenditure did not increase quite as much as a year earlier, namely by 8 % against 9 % in 1975, but this was entirely due to the slackening of the price uptrend; at constant prices private consumption went up by 3½ % in 1976, and thus more than a year before (2½ %). The relative importance of the various components of private consumption expenditure shifted considerably at the same time, partly because of differences in the movement of prices. Spending on food, drink and tobacco went up comparatively steeply in 1976 because real growth in consumption coincided with rather large price rises. In the case of textiles and shoes the additional expenditure roughly corresponded to the increase in the prices of these products, i.e. in real terms consumption remained virtually unchanged. In the case of more durable consumer goods real demand increased sharply, especially towards the end of last year. In particular, purchases of cars rose considerably in 1976; in all, 2.3 million new passenger cars were registered last year, a record number, which exceeded the very large 1975 registration figure by 10 %. The total stock of passenger cars (19 million) thus continued to grow in accordance with long-term expectations, after the upward trend had faltered owing to the oil crisis of 1973.

Smaller increase in households' incomes

Remarkably enough, the strong expansion in private consumption was accompanied by smaller growth in households' disposable income. True, total gross wages and salaries rose by 6½ % last year, and thus more than in 1975 (3½ %), mainly because employment was not reduced any further in 1976, in contrast to the year before. Calculated per employee, too, earnings went up a little more sharply in 1976 (by 7½ % against 7 % in 1975) despite distinctly smaller increases in negotiated wage and salary rates; this was partly because short-time working was succeeded by full working hours in many cases and because special shifts and more overtime were introduced in some sectors which benefited greatly from the economic situation (e.g. the motor industry). On the other hand, in 1976 deductions of wage tax and social security contributions rose sharply again whereas in 1975 wage and salary earners' wage tax payments had fallen owing to the tax reform. Net wage and salary income therefore increased by only 4 % in 1976. At the same time government payments of pensions and assistance grants rose much less than a year earlier, not least because payments to unemployed persons and short-time workers declined. Altogether, in 1976 households had about 6½ % more income at their disposal than a year before. The larger rise in consumption expenditure (of 8 %, as noted) was therefore partly at the expense of saving; over the whole of 1976 private saving, at DM 107 billion, narrowly failed to regain the record level of 1975. The decline in the saving ratio – from nearly 16 % in 1975 to 14½ % last year – must however largely be regarded as a return to normal after the exceptionally high level of 1975 (caused by the effects of the tax reform, fears about further economic developments and other factors) and not necessarily as a break in the trend of the saving ratio, which until then had been moving slightly upwards. This is suggested, inter alia, by the fact that according to present information households responded in quite a "normal" way when more savings deposits than usual became available at the beginning of 1977 (these were deposits which had previously been blocked under the statutory savings promotion scheme), i.e. the major part of these funds was not used for private consumption purposes but was reinvested in one form or another.

Much slower rise in government expenditure

In 1976 the public authorities did not stimulate economic activity as much as a year earlier. For one thing, the beneficial effect on production of the investment grant approved at the end of 1974 tailed off. For another, in the field of fiscal policy considerable efforts were made to slow down the growth of expenditure and to reduce the large financial deficits that had arisen in the recession. In 1976 the central, regional and local authorities and social security funds spent roughly 7½ % more than a year before, whereas public expenditure had gone up by about 14½ % in 1975.[1] The curbing of the expansion of expenditure was facilitated by the fact that in 1976 the increases in public service wages and salaries conformed better than before to overall economic objectives. The Act to Improve the Budget Structure, which came into effect at the beginning of 1976 and resulted

1 These figures were calculated according to the concept of the national accounts, which differs methodologically in some respects from the concept of the financial statistics used elsewhere in this Report, the main difference being that in the national accounts lending and the acquisition of permanent interests are not shown as expenditure when determining the financial balance.

Use of goods

Item	Change in 1976 against 1975 at current prices: DM billion	Change in 1976 against 1975 at current prices: %	Change in 1976 against 1975 at current prices: Percentage of total	Change in 1976 against 1975 at 1962 prices: %	Change in 1976 against 1975 at 1962 prices: Percentage of total	Compare: Change in 1968 against 1967 at 1962 prices: %	Compare: Change in 1968 against 1967 at 1962 prices: Percentage of total
1. Private use of goods	+ 80.9	+ 10.7	87.8	+ 6.7	94.7	+ 8.7	92.1
Private consumption	+ 46.8	+ 8.1	50.9	+ 3.4	36.5	+ 3.8	30.0
Private gross capital formation	+ 34.1	+ 19.3	36.9	+ 17.4	58.2	+ 23.0	62.1
Machinery and equipment and non-residential buildings	+ 13.4	+ 10.1	14.5	+ 7.4	20.1	+ 10.8	21.1
Residential buildings	— 3.9	+ 8.1	4.2	+ 4.6	3.3	+ 0.5	0.4
Expenditure on stocks	+ 16.8	.	18.2	.	34.8	.	40.6
2. Public use of goods	+ 13.5	+ 5.2	14.7	+ 1.1	3.8	+ 1.8	4.6
Public consumption	+ 14.8	+ 6.8	16.1	+ 2.9	7.7	— 0.0	— 0.1
Public gross capital formation	— 1.3	— 3.2	— 1.4	— 5.4	— 3.9	+ 8.6	4.7
3. Domestic use of goods (1 plus 2)	+ 94.4	+ 9.3	102.5	+ 5.6	98.5	+ 7.3	96.7
4. Net exports of goods and services 1	— 2.3	— 9.2	— 2.5	+ 3.9	1.5	+ 6.5	3.3
Exports	— 40.5	+ 13.8	44.0	+ 10.9	69.5	+ 13.4	44.9
Imports	+ 42.8	+ 15.9	46.5	+ 11.4	68.0	+ 14.7	41.6
5. Gross national product (3 plus 4)	+ 92.1	+ 8.8	100	— 5.6	100	+ 7.3	100

1 Balance of merchandise and service transactions with the rest of the world (including GDR).

in cuts estimated at DM 2 billion in various types of consumption expenditure and current transfers, also moderated the rise in expenditure. The spending of the social security funds on payments in kind in the health field increased much less than previously. In 1976 the central, regional and local authorities and social security funds together spent about 7½ % more than a year before on current purchases of goods and services; this was the lowest growth rate since the end of the sixties.

Lower public capital formation

The efforts at consolidation hit public capital spending even harder than public consumption expenditure although the measures adopted by the Federal Government in August 1975 to promote public capital formation counteracted this trend, which was undesirable from the point of view of employment policy. According to the national accounts, in 1976 public capital expenditure was 3 % lower than in 1975 in value and 5½ % down in volume despite the programmes to promote economic activity. This owes something to the fact that needs are no longer as pressing as they were in some fields of public capital spending (e.g. the construction of schools, nursery schools, hospitals). The decrease in the size of the population, and especially in the number of children, has already made it necessary to use existing public buildings for other purposes in some cases. In addition, the public authorities are more cautious than they used to be about embarking on traditional building projects, if only in view of the subsequent costs.

Decline in the public sector financial deficit

On the receipts side the efforts to reduce the government deficits were aided by the fact that tax revenue expanded sharply as the income situation improved, although this was partly due to large final payments for past years and much smaller refunds under the annual adjustment of wage tax. The income of the social security funds increased as well since the employment situation improved and the contribution rates to the Federal Labour Office and the statutory health insurance funds were raised. In all, the receipts (excluding borrowing) of the central, regional and local authorities and the social security funds rose last year by 12 %, i.e. much more than expenditure. The public sector financial deficit in the definition of the national accounts, which conforms to the concept used internationally but differs from that of the cash analysis, consequently declined markedly last year, namely from DM 61 billion in 1975 to DM 45 billion; this was justifiable in terms of business cycle policy as the endogenous expansionary forces were strengthening progressively, and it was moreover necessary since the consolida-

Public sector expenditure and receipts*

DM billion

Item	1973	1974 p	1975 p	1976 p
Expenditure	378.2	437.5	501.1	539.0
Percentage increase on previous year	(13.5)	(15.7)	(14.5)	(7.6)
of which				
Public consumption	168.9	198.2	220.1	235.0
Gross capital formation	32.8	39.3	41.0	39.7
Receipts	391.5	424.8	440.4	493.7
Percentage increase on previous year	(18.0)	(8.5)	(3.7)	(12.1)
of which				
Taxes	238.2	225.0	255.9	287.5
Social security contributions	122.5	135.8	148.2	166.0
Financial balance	+13.3	—12.7	—60.7	—45.3
Memorandum item:				
Financial balance as percentage of nominal gross domestic product	(+ 1.4)	(— 1.3)	(— 5.8)	(— 4.0)

* Central, regional and local authorities and social security funds as defined in the national accounts. — p Provisional.

tion of the public budgets is essential in the longer run. In 1976 the government financial deficit still came to 4 % of the nominal gross national product, compared with a maximum of 1 to 1½ % in earlier years but as much as almost 6 % in 1975.

Below-average increase in housing investment

Housing did not enhance economic activity very greatly last year. Expenditure on residential buildings in 1976 exceeded the 1975 level by about 8 % in value and just over 4½ % in volume. These figures include more and more large-scale repairs and modernisation work, prompted in part by public programmes. The number of new dwellings completed in 1976 was smaller than in 1975 (392,000 against 436,000). This was only about 55 % of the number finished in 1973, the largest-ever annual figure, which far outstripped the level of current demand at the time and led to the "stockpile" of dwellings that has still not been run down entirely. In 1976, as in the two preceding years, the construction of apartment houses declined further since the demand for rented and owner-occupied apartments could partly be met out of the existing stock of empty dwellings and since the unfavourable relationship between rents and costs provided little incentive to construct new accommodation for letting. Of the dwellings completed in new buildings in 1976, only 43 % were in apartment houses compared with 61 % in 1973. However, the decline in apartment house construction was accompanied by a sharp rise in the building of owner-occupied homes: the number of dwellings in one and two-family houses finished in 1976 was as much as 6½ % higher than a year earlier. This improved the order-books and the employment situation of some construction firms, particularly the smaller ones, but the problem of excess capacities in construction was only mitigated, especially as the inflow of public construction orders was rather small at times in 1976. Inclusive of the above-mentioned extra expenditure on commercial and industrial buildings, the overall construction volume rose by 2½ % (at constant prices) in 1976; in other words, the utilisation of available capacity in the construction industry in Germany was not very much greater than a year earlier. For a number of construction firms — not only the large ones — foreign business offered at least partial compensation. In Germany, however, the weeding-out process in the construction industry inevitably continued, with further closures of firms and also insolvencies.

Changed pattern of demand for residential buildings

Strong stimulus imparted by foreign demand . . .

Quite generally, foreign demand was a major support of economic activity in Germany in 1976. The orders received by industry from abroad increased by over one quarter in 1976, some orders of exceptional size booked around the middle of the year being a particularly significant factor. Such large-scale orders affect production only after an extended planning period and take several years to complete but, while they benefit only a few firms at first, they eventually result in a great number of orders to subcontractors so that other sectors of the economy profit as well. Actual exports of goods did not rise as much as incoming orders in 1976; they were 16 % higher than a year before in value and nearly 14 % up in

Basic economic data in the Federal Republic of Germany

Item	Unit	1973	1974	1975	1976	1973	1974	1975	1976
						Percentage change on previous year			
Aggregate demand									
Private consumption	DM billion	495.7	533.0	580.2	627.0	+ 9.9	+ 7.5	+ 8.9	+ 8.1
Public consumption	DM billion	168.9	198.2	220.1	235.0	+15.3	+17.4	+11.0	+ 6.8
Fixed capital formation	DM billion	228.6	223.9	221.1	237.0	+ 5.1	— 2.1	— 1.3	+ 7.2
Machinery and equipment	DM billion	96.5	94.8	100.6	109.7	+ 4.3	— 1.8	+ 6.2	+ 9.0
Buildings	DM billion	132.1	129.1	120.4	127.3	+ 5.8	— 2.3	— 6.8	+ 5.7
Expenditure on stocks	DM billion	+ 9.6	+ 2.1	— 3.6	+13.2	.	.	.	.
Domestic expenditure	DM billion	902.8	957.2	1,017.8	1,112.2	+10.2	+ 6.0	+ 6.3	+ 9.3
Net exports of goods and services 1	DM billion	24.7	39.8	25.3	22.9	.	.	.	.
Exports	DM billion	227.4	298.8	294.0	334.5	+19.6	+31.4	— 1.6	+13.8
Imports	DM billion	202.6	259.0	268.7	311.6	+15.5	+27.8	+ 3.8	+15.9
Gross national product at current prices	DM billion	927.5	997.0	1,043.0	1,135.1	+11.2	+ 7.5	+ 4.6	+ 8.8
Memorandum item:									
Orders received by manufacturing	1970 = 100	128.2	138.9	135.9	154.7	+16.9	+ 8.4	— 2.2	+13.8
Domestic orders	1970 = 100	120.3	124.6	127.9	139.5	+10.7	+ 3.6	+ 2.6	+ 9.1
Foreign orders	1970 = 100	153.7	184.7	126.2	204.5	+33.4	+20.1	—12.2	+26.1
Income									
Gross wage and salary income	DM billion	498.6	546.7	569.3	611.0	+13.5	+ 9.6	+ 4.1	+ 7.3
Memorandum item:									
Gross wages and salaries per employee	DM thousand	(18.8)	(20.9)	(22.4)	(24.0)	+12.0	+11.4	+ 7.0	+ 7.4
Gross property and entrepreneurial income	DM billion	215.9	219.9	227.7	259.3	+ 7.9	+ 1.9	+ 3.5	+13.9
National income	DM billion	714.5	766.6	796.9	870.3	+11.2	+ 7.3	+ 4.0	+ 9.2
Wage ratio 2	%	69.8	71.3	71.4	70.2	.	.	.	.
Production									
Gross national product at 1962 prices	DM billion	592.4	595.6	576.6	608.8	+ 5.1	+ 0.5	— 3.2	+ 5.6
do. per man-hour worked (productivity)	1962 = 100	174.7	181.0	184.0	194.1	+ 5.6	+ 3.5	+ 1.6	+ 5.5
Overall production potential at 1962 prices 3	DM billion	590	600	620	630	+ 3.0	+ 2.5	+ 2.0	+ 2.5
Utilisation of production potential 3	%	101	99	93.5	96.5	.	.	.	.
Output in the producing sector (excluding construction)	1970 = 100	112.9	111.3	105.0	112.8	+ 6.8	— 1.4	— 5.7	+ 7.4
Employment									
Employed persons	Millions	26.7	26.2	25.4	25.1	+ 0.2	— 1.9	— 3.3	— 1.0
Wage and salary earners	Millions	22.6	22.2	21.4	21.3	+ 0.6	— 1.8	— 3.3	— 0.7
Foreign workers e	Millions	2.5	2.3	2.1	1.9	+ 7.7	— 5.3	—11.5	— 6.0
Memorandum item:									
Total number of man-hours worked	1962 = 100	94.1	91.3	87.0	87.1	— 0.5	— 2.9	— 4.8	+ 0.1
Unemployed persons	Thousands	274	583	1,074	1,060	+11.0	+ 113.0	+ 84.4	— 1.3
Unemployment ratio 4	%	1.3	2.6	4.7	4.6	.	.	.	.
Prices									
GNP deflator	1962 = 100	156.6	167.4	180.9	186.5	+ 5.8	+ 6.9	+ 8.1	+ 3.1
Cost of living index for all households	1970 = 100	118.8	127.1	134.7	140.8	+ 6.9	+ 7.0	+ 6.0	+ 4.5
Producer prices of industrial products	1970 = 100	114.1	129.4	135.5	140.7	+ 6.6	+13.4	+ 4.7	+ 3.9
Memorandum item:									
Unit labour costs in the economy as a whole 5	1962 = 100	154.6	168.1	179.6	180.8	+ 6.8	+ 8.8	+ 6.9	+ 0.6

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. — The data from the national accounts from 1974 onwards are provisional. — e Estimated.

volume. As the growth of world trade is estimated at 11 % in real terms, Germany's share of the export market apparently increased further; it may be inferred from this that the competitive position of German exporters did not deteriorate significantly last year despite the sharp rise in the external value of the Deutsche Mark (for details see page 30). Indeed, the progressive appreciation of the Deutsche Mark and the associated elimination of distortions in the international pattern of exchange rates enabled the advantages of the world-wide division of labour to be exploited further.

... while imports rise sharply at the same time

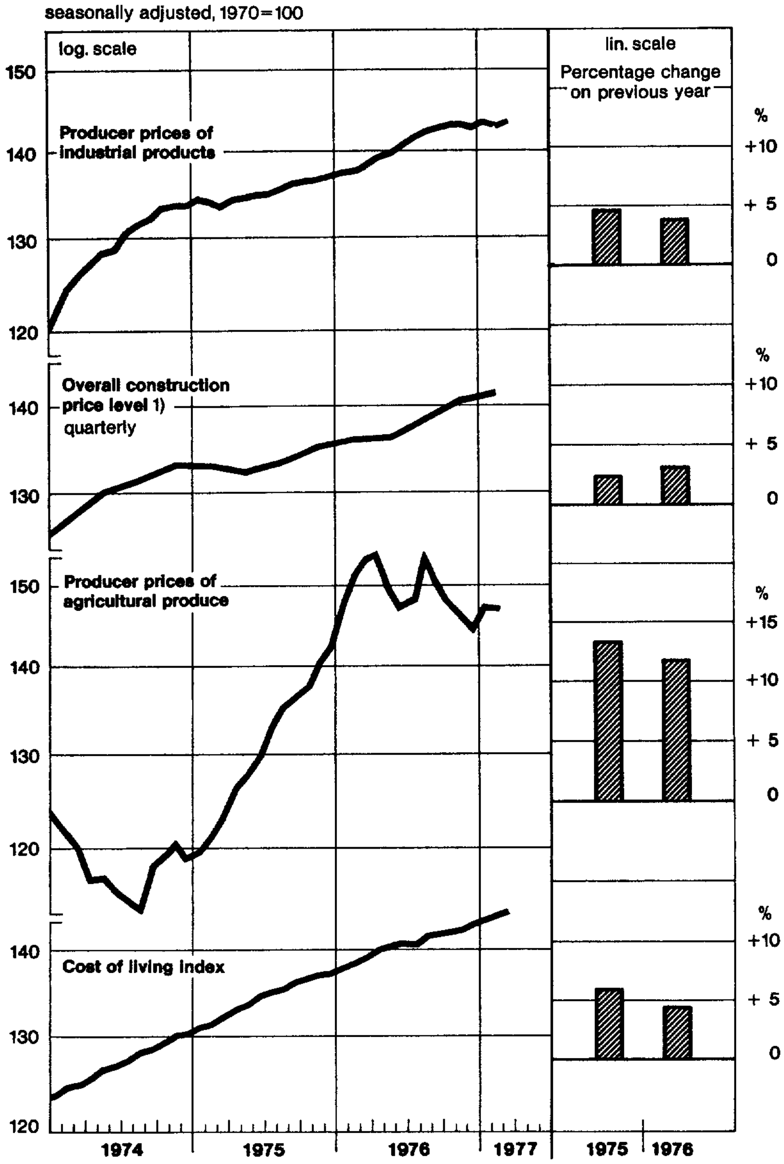
The increase in the international exchange of goods was also reflected in the strong expansion of imports in nearly all fields. In 1976 imports of goods exceeded the 1975 level by 21 % in value and about 17 % in volume, and including imports of services the rise was hardly smaller (+ 16 % in value). Roughly 25 % of the total supply of goods came from abroad last year; at the beginning of the seventies the import ratio had been only about 20 %. The process of integration in world trade has rarely made such progress as in 1976; this applies both to the Federal Republic of Germany and, to a lesser degree, to the other industrial countries, whose foreign trade turnover likewise increased substantially more than their domestic turnover. The advances in the international division of labour which this mirrors derive more than ever from the fact that the production facilities of German firms have been moved abroad and now supply the German market or supplement German exports by performing assembly work. The growing proportion of imported goods on the domestic market confronts domestic producers with additional competitive problems. It is obvious that, given the level of wages in Germany, firms producing labour-intensive goods of simple design feel the effects of foreign competition more acutely than firms using advanced technology and with a lower labour cost ratio. Nevertheless, there are examples of the contrary. For instance, the exports of products of the textile and clothing industry – i.e. of a basically "old" industry some of which has become highly capital-intensive in the meantime – rose by nearly 26 % to DM 12.7 billion in 1976 and thus distinctly more than imports of such goods (+ 16½ %).

Further decrease in the surplus on current account

If exports and imports of goods and services are set off against each other, it is found that the traditional surplus in this part of Germany's balance of payments fell to DM 23 billion last year against DM 25.5 billion in 1975 and DM 40 billion in 1974. The decline in the surplus on merchandise and service transactions and the simultaneous continued growth of the national product suggest that the economic expansion in Germany owed more to domestic forces than to stimuli from abroad, substantial though the latter were. In this respect the situation in 1976 differed considerably from that in 1968, which otherwise had many points of similarity: at that time the surplus on merchandise and service transactions increased further – more, indeed, than the nominal gross national product: hence demand, which had already been greatly stimulated by developments in Germany, was on balance boosted further by other countries. This is no doubt one of the reasons why the upswing was soon succeeded by a phase of cyclical overheating. The automatic correction of external transactions, which is now possible as a result of flexible exchange rates and which in 1976 both caused the Deutsche Mark to appreciate sharply and fostered the adjustment processes for imports and exports, did not take place at that time.

However, the surplus on goods and services does not sufficiently characterise the state of Germany's current transactions with the rest of the world, for the bulk of this surplus was offset by the deficit on transfer payments, which came to DM 17.5 billion in 1976. More than any other country, Germany is obliged to use part of its export proceeds for unilateral transfers – for pension payments abroad and for financial contributions to the European Communities and other international organisations; the remittances of foreign workers to their home countries, which are also recorded under transfers in the statistics, have the same effect. In 1976 Germany's current account surplus (as defined in the balance of payments), which includes all these transfers, amounted to DM 7.5 billion or 0.7 % of the nominal gross national product. Only on this comparatively small scale can current account deficits of other countries be related to the surplus position of Germany. To this extent Germany came very close to external equilibrium and

Prices



1) Calculated by Bundesbank.

thus supported the trends towards smaller disequilibria in the balances of payments of other countries.

Definite progress towards stability

From the point of view of the domestic economy the decrease in Germany's current account surplus in 1976 was not a drawback. On the contrary, it reflected the fact that the comparative cost advantages of goods from abroad were being exploited, thus enhancing the process of price stabilisation and the productivity of domestic firms. In the first few months of 1976 enterprises tried to raise their prices and thus to improve their earnings, which had been reduced sharply in the preceding recession. It appeared to be a favourable time to effect the price increases which previously had to be deferred, if only because there were signs of a boom on international raw material markets in connection with the worldwide economic recovery and because the higher prices for basic goods spread to Germany despite the appreciation of the Deutsche Mark. However, it very soon became evident that the planned price rises could not be realised in all cases; the upward trend of prices in Germany slowed down markedly. On world markets as well – especially those for industrial raw materials – the stimuli previously imparted by stockbuilding slackened after the middle of the year, and some speculative positions were liquidated.

Smaller rises in the prices of industrial products

The pace of price rises moderated not only on the basic goods markets but increasingly also in sectors nearer to the final consumer. In the autumn of 1976 the rise in the producer prices of industrial products came virtually to a halt, seasonally adjusted; industrial sales prices went up by an average of 3.9 % in 1976 and thus much more slowly than a year before (4.7 %). Even after the turn of the year there was no basic change in the very quiet price situation at the producer stage. Admittedly, the increase in tobacco and spirits taxes from January 1977 onwards resulted in a rise which – relative to the overall producer price level – must be estimated at almost half a percentage point; but this rise does not mirror market tendencies. The increase in the prices of construction work was also very limited last year, as competition for new orders generally remained keen so that it was often hardly possible to pass on the higher costs of materials and labour in full. In 1976 the overall construction price level was about 3 % up on the year. On the markets for agricultural goods producer prices rose steeply in the first few months of last year, among other things because of the poor harvest in 1975. Moreover, the European Community market organisation prices were raised further in important fields despite the persistent over-production, in Germany by as much as some 4½ % if a partial reduction in border tax is taken into account. But in the second half of 1976 the upward price trend reversed in this sector as well, even though agricultural prices had originally been expected to increase further because of the crops lost during the long dry spell last summer. Despite the small crops of many vegetable products – e.g. potatoes – prices could not be raised since consumers often turned to substitutes instead. Supplies of animal products also remained ample, not least because more livestock came on to the market during the dry summer months. At the end of 1976 the producer prices of agricultural produce were therefore hardly higher than a year before; however, compared with earlier years – e.g. 1970 – they went up more than the producer prices of industrial products although the latter were affected much more than agricultural products by the quadrupling of the oil price and increases in the prices of other raw materials.

Reversal of the agricultural price trend

Increase in consumer prices moderates

The slackening of price rises on the agricultural markets had a favourable effect on the movement of consumer prices. The growth rate of the prices of many industrial goods whose suppliers were competing keenly for consumers at the retail stage also declined. In the field of services and housing accommodation – where, as noted, numerous empty dwellings still depressed the market – the pace of price increases likewise slowed down distinctly last year. As a result, the average annual rise in the cost of living index moderated to 4.5 % in 1976 against 6 % in 1975 and 7 % in 1974. In the last three months of 1976 the consumer price level was about 3.8 % up on the year; this was only half as much as at the peak of the inflation in 1974. The rate of price increases accelerated only a little at the beginning of 1977, too, in spite of the raising of the tobacco and spirits taxes, as already mentioned. In March consumer prices were 3.9 % higher than a year before.

2. Monetary policy fosters growth and stability

(a) Aims of monetary policy

Fostering growth and stability

In 1976 the Bundesbank's monetary policy aimed at fostering both the growth of the economy and the return to greater price stability. In 1976, just as in 1975, these objectives proved to be by no means incompatible, but rather to be ultimately conditional upon one another. The fact that such considerable successes could be scored in both directions in 1976 – the real national product grew by more than 5½ % after declining by over 3 % in 1975, and the pace of consumer price rises decelerated from 6 % in 1975 to 4½ % – was however partly due to the favourable conditions that obtain in the early stages of an economic upswing, when on past experience the prospects of productivity increases are good and wage rises are comparatively moderate owing to the level of unemployment. Encouraging though the progress made may be, it would be wrong not to recognise that the real test of the success of this monetary policy still lies ahead. Nevertheless: better results could hardly have been achieved in 1976.

Another monetary growth target announced

As in the previous year, the Bundesbank informed the general public about its monetary aims for 1976 by announcing a target rate for the expansion of the money stock which would be consistent with the above-mentioned economic policy objectives of fostering growth and stability. However, the experience of the last quarter of 1975 showed that setting a target for monetary growth in the course of precisely one year is expecting too much of the capabilities of monetary control; the Bundesbank therefore formulated not a target for the expansion of the money stock in the course of 1976, i. e. between the end of 1975 and the end of 1976, but rather an average growth target.

Relationship between this target and the overall economic target projection

The monetary growth target for 1976 took account of the expectations about overall economic trends in 1976 which seemed realistic in December 1975 and were reflected in the Federal Government's target projection. The principal assumptions were: a growth of 2 % in overall production potential in 1976, a rise of 2½ % in capacity utilisation, and hence a real increase of 4½ % in the gross national product. It also had to be borne in mind that, even with a stability-oriented economic policy, price increases could not be completely eliminated in 1976 but could only be reduced; the virtually unavoidable rise in the price level was put at 4 to 5 %. Altogether this amounted to a growth of about 9 % in the gross national product at current prices, which would have to be financed. In an upswing year, admittedly, this did not require an equal rate of expansion of the money stock since increased use of the ample supply of money (relative to the level of economic activity) — in other words, a higher velocity of circulation of money — was to be expected under those conditions. In formulating its growth target the Bundesbank made allowance for this fact and accordingly considered a rise of 8 % in central bank money,[1] comparing the average for 1976 with the average for 1975, to be appropriate. At first glance the target might appear unchanged as against 1975, but the rate of increase during 1976 had in fact to slow down considerably compared with the previous year if the growth target was not to be exceeded.

(b) Monetary developments and monetary policy in the course of 1976

Moderate monetary growth in the first half of the year

In the first half of 1976 — or more precisely, between February and May — the growth of central bank money was much slower than in 1975, without any special restrictive action by the Bundesbank. A major factor in this deceleration was that credit expansion was at first relatively sluggish, mainly because public authorities, which had raised loans "in advance" at the end of 1975, cut down their borrowing at the beginning of the new year, while the rise in private demand for credit did not fill this gap entirely. In February and March there were admittedly large speculative inflows of foreign exchange, which continued until the French franc withdrew again from the European narrower margins arrangement. In the initial stages, however, the expansionary impact of these inflows of funds could be countered.

Precautionary measure to prevent a further rise in bank liquidity

At the beginning of 1976, as in November and December 1975, the Bundesbank had released substantial Federal cash balances for placing with banks (under section 17 of the Bundesbank Act). Between December and February an average of DM 3.9 billion had been invested in the banking system in this way, which had enlarged bank liquidity accordingly. When the banks' central bank balances increased owing to the Bundesbank's purchases of foreign exchange — in all, the Bundesbank's external assets went up by DM 9.7 billion in February and March — these funds could be withdrawn from the market; this initially precluded an excessive rise in liquidity. It was to be expected, however, that the Federal Government would soon draw on its deposits to finance its expenditure, so that these funds would then finally flow to banks and non-banks. To prevent excess liquidity from arising for a considerable time, the Bundesbank decided to raise the minimum reserve ratios for all bank liabilities subject to minimum reserve requirements by 5 % of their previous level with effect from May 1 and June 1; this increased the required reserves by a total of some DM 4 billion.

1 The term "central bank money" as used by the Bundesbank comprises currency in circulation and the minimum reserves on the banks' domestic liabilities. When central bank money is employed as an indicator of monetary developments or as a target variable, the required minimum reserves are calculated at constant reserve ratios (base: January 1974).

Record of economic policy measures

1976	**I. Domestic and external monetary policy**
January 7 and 8	At the meeting of the International Monetary Fund (IMF) 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.
January 30	The Deutsche Bundesbank grants the Banco de Portugal a credit of $ 250 million secured by gold.
March 15	France withdraws from the European narrower margins arrangement for the second time.
	The Council of Ministers of the European Communities decides to issue the first "Community loan" amounting to $ 1.3 billion and guaranteed by the member states.
March 30	The temporary transfers of available Federal Government balances to the banking system ("Transactions pursuant to section 17 of the Bundesbank Act"), which have helped to smooth fluctuations in interest rates in the money market since the end of 1975, are discontinued.
May 4	The Bundesbank raises the minimum reserve ratios for all bank liabilities subject to reserve requirements by 5% with effect from May 1 and by a further 5% with effect from June 1; in all, this ties up some DM 4 billion of bank liquidity in May and June.
June 7	Central banks of the Group of Ten countries, Switzerland and the BIS grant the Bank of England a credit line amounting to $ 5.3 billion. (Only $ 1.5 billion of the stand-by credit is used, and it is repaid at the beginning of December 1976.)
End of August	The Bundesbank resumes the open market operations in the bond market which it began in the spring of 1976. By means of heavy sales it reduces its holdings of public authority bonds by about DM 4.5 billion up to the end of November.
September 3	The Deutsche Bundesbank and the Banca d'Italia agree to renew the maturing $ 2 billion loan dating from 1974.
October 17	Exchange rates within the European narrower margins arrangement are realigned: the Deutsche Mark is revalued by 2 %, the Danish krone is devalued by 4 % and the Norwegian krone and Swedish krona are each devalued by 1 % with effect from October 18, 1976; the central rates of the Netherlands guilder and the Belgian franc remain unchanged.
October 21	The Bundesbank decides that agricultural market organisation bills (formerly "Storage Agency bills"), which were intended to facilitate the financing of German food imports and food storage, will cease to be included in the money market regulating arrangements as from January 1, 1977.
October 22	The Bundesbank temporarily sells discountable Treasury bonds (mobilisation paper) to banks in order to smooth fluctuations in interest rates in the money market. Some DM 2.5 billion of these securities, which are not included in the money market regulating arrangements, are sold by the end of the year.
December 16	For the third time the Bundesbank announces a monetary growth target. In 1977 monetary policy is to be conducted in such a way that price rises are curbed further and the real national product is able to increase strongly. Once again, the target is an increase of 8 % in central bank money as an annual average, which – given steady monetary growth – is equivalent to a rise of 6 to 7 % in central bank money between the fourth quarter of 1976 and the fourth quarter of 1977.
1977 January 3	The IMF grants the United Kingdom a credit line of SDR 3.36 billion ($ 3.9 billion), SDR 2.86 billion of which is financed through the IMF's General Arrangements to Borrow (GAB) with Group of Ten countries and by Switzerland. The Deutsche Bundesbank provides the IMF with a loan of SDR 785 million for this purpose.
January 10	Central banks of the Group of Ten countries, Switzerland and the BIS agree in principle on a medium-term facility for the Bank of England amounting to $ 3 billion and intended for the financing of any withdrawals of official sterling balances. The Deutsche Bundesbank contributes $ 600 million to this amount.
February 3	With effect from March 1 the Bundesbank changes its procedure for calculating minimum reserves. To avoid sudden jumps in required reserves, the old system of reserve classes for banks with different volumes of liabilities subject to reserve requirements is replaced by a progressive scale of reserve ratios, identical for all banks. This change is accompanied by a curtailment of the privilege granted to banks located in places without a Bundesbank office (reduction in the required reserves: some DM 1 billion).

March 3	The banks' rediscount quotas are raised by DM 2.5 billion with effect from March 4. This allows for the fact that the banks' central bank money requirements are increasing, within the limits set by the monetary growth target, owing to the expansion of the economy, and have to be met to this extent.
March 9	The Bundesbank buys trade bills in the open market subject to an agreement to repurchase them after 20 days or – as from April 13 — after 10 days (interest rate: 4 %).
April 1	The exchange rates of the Scandinavian currencies in the European narrower margins arrangement are realigned: the Swedish krona is devalued by 6 % and the Danish krone and Norwegian krone are each devalued by 3 % with effect from April 4.
1976	**II. Economic and fiscal policy**
January 1	The Budget Structure Act enters into force; it provides for a number of measures to improve the budget situation of the central, regional and local authorities; among other things the contribution rate to the unemployment insurance fund is increased from 2 % to 3 %.
January 21	The Federal Cabinet approves in principle the one-year loss carry-back (estimated loss of tax revenue in the 1977 fiscal year: DM 200 million) in respect of income tax and corporation tax.
January 28	In its 1976 Annual Economic Report the Federal Government sets out its economic and fiscal objectives. Through its policy it intends to make a contribution to strengthening the economic recovery, improving the basis for a durable inflation-free upswing and thus creating sufficient jobs for longer-term needs. It underlines the necessity for a steep increase in capital investment, which depends on an improvement in enterprises' profitability on the cost side. At the same time the Federal Government adopts a labour market and vocational training programme totalling DM 300 million to combat unemployment among young people.
May 13	The Bundestag decides to raise the tax on tobacco by 18 % and the tax on spirits by 20 % with effect from January 1, 1977 (expected increase in tax revenue: DM 1.3 billion a year) and also to raise value-added tax from the same date; the latter increase is however rejected by the Bundesrat shortly afterwards.
May 20	The Bundestag approves the 1976 Federal budget, which shows expenditure totalling DM 164 billion and a financial deficit of just on DM 33 billion.
June 10 to 25	The Bundestag and the Bundesrat finally approve the corporation tax reform, which puts an end to the double taxation of distributed corporate profits as from 1977.
November 10	The Federal Cabinet adopts a labour market programme to increase the mobility of unemployed persons and to facilitate their occupational rehabilitation. The Federal Government provides DM 430 million for this purpose.
November 19	In its Annual Report the Council of Experts for Assessing Overall Economic Trends notes a marked recovery in economic activity in Germany. To regain a high level of employment it recommends a programme designed to safeguard growth, i. e. to increase the prospects of a sustained rise in capital investment and at the same time to ensure a production structure which promises lasting full employment. Within the framework of such a programme monetary policy should endeavour to make the financial margin conform to the production potential. The government's task is to continue the consolidation of the public budgets and to adopt measures to enhance the propensity to invest and to increase the mobility of employees. Wage policy should strengthen confidence that the movement of wages is compatible with full employment in the medium term.
1977	
January 26	The Federal Government approves the draft Federal budget for 1977, which totals DM 172 billion and shows a financial deficit of DM 23 billion, and the fiscal plan for 1976 to 1980.
January 27	The Federal Government presents the 1977 Annual Economic Report. It considers restoring and safeguarding a high level of employment to be the central problem of economic policy in the next few years. It points out that the structural causes of unemployment can be eliminated only in the longer run. To accomplish this, progress in the stabilisation of prices and a marked increase in enterprises' propensity to invest are required.
February 16	The Federal Cabinet approves the 20th pension adjustment with effect from July 1, 1977 and legal changes to improve the financial basis of the pension and health insurance funds. The principal measures are the postponement of the 21st pension adjustment until January 1, 1979, a partial updating of the general assessment basis, and the introduction of pension insurance contributions for unemployed persons to be paid by the Federal Labour Office. An Act to curb the expansion of the cost of health insurance is mainly intended to strengthen the position of the health insurance funds.
March 23	The Federal Government adopts a DM 16 billion "programme of future investments" extending over several years. Orders totalling DM 3.5 billion are due to be placed under this programme during the current year. At the same time it approves a fiscal programme providing for an increase in value-added tax to 13 % or 6.5 % as from January 1, 1978 and for tax reliefs and improvements in children's allowances.

Free liquid reserves reduced

In connection with these measures, which were then supported by outflows of foreign exchange and a new accumulation of public authority balances with the Bundesbank, the banks' free liquid reserves fell to DM 8 billion between May and July after having amounted to some DM 15 billion at the beginning of the year. At first the banks made little use of their scope for rediscounts, which was still large, and preferred to procure any additional funds they needed to meet their minimum reserve requirements by raising lombard loans. The average amount of such loans outstanding in July was DM 2.5 billion. In the money market the interest rate level rose in June and July as a result of the reduction in the free liquid reserves. The rate for one-month funds, which had been close to the discount rate of 3.5 % in the first five months of the year (with minor fluctuations), reached 4.4 % in July. The rate for three-month funds was always about 0.2 percentage points higher. The period of exceptionally plentiful bank liquidity, as reflected in the free liquid reserves and the historically very low money market rates, thus came to an end; in no year since 1968 had three-month funds been as cheap as they were in the first half of 1976.

Acceleration of monetary expansion ...

The fact that the high level of liquidity in the banking system, which had been appropriate for overcoming the recession, could not be maintained in a progressive economic recovery was also demonstrated by the acceleration of monetary expansion. Lagging behind the foreign exchange inflows of February and March, and enhanced by the increase in lending, a faster rise in the money stock was discernible from June onwards. As from July central bank money (seasonally adjusted) expanded much more rapidly than in the first two quarters of 1976. In August the rate of increase slackened again but thereafter the growth rates were exceptionally high for three months. Whereas the rise in central bank money, expressed as an annual rate, had amounted to about 5.5 % in the first half of 1976 in line with the Bundesbank's target, it accelerated to no less than 13.5 %, at an annual rate, in the following five months; a deviation of this size and duration from the target had to be taken seriously, while shorter-term fluctuations in the growth rate may well be due to chance and are not relevant for monetary policy.

... due to new inflows of foreign exchange and increased demand for credit

This acceleration was no doubt partly attributable to the after-effects of the expansionary stimuli received from abroad in the spring. Unfortunately, from August onwards the Bundesbank was again obliged to purchase foreign exchange – primarily under the European narrower margins arrangement – to the extent of some DM 7 billion, until exchange rates within the system of narrower margins were finally realigned in mid-October. These "external" influences on money creation in Germany were increasingly reinforced by internal factors operating in the same direction. With the continued expansion of turnovers and in particular the rise in capital expenditure (including stockbuilding) described in the previous section of this Report, bank lending to enterprises went up substantially.

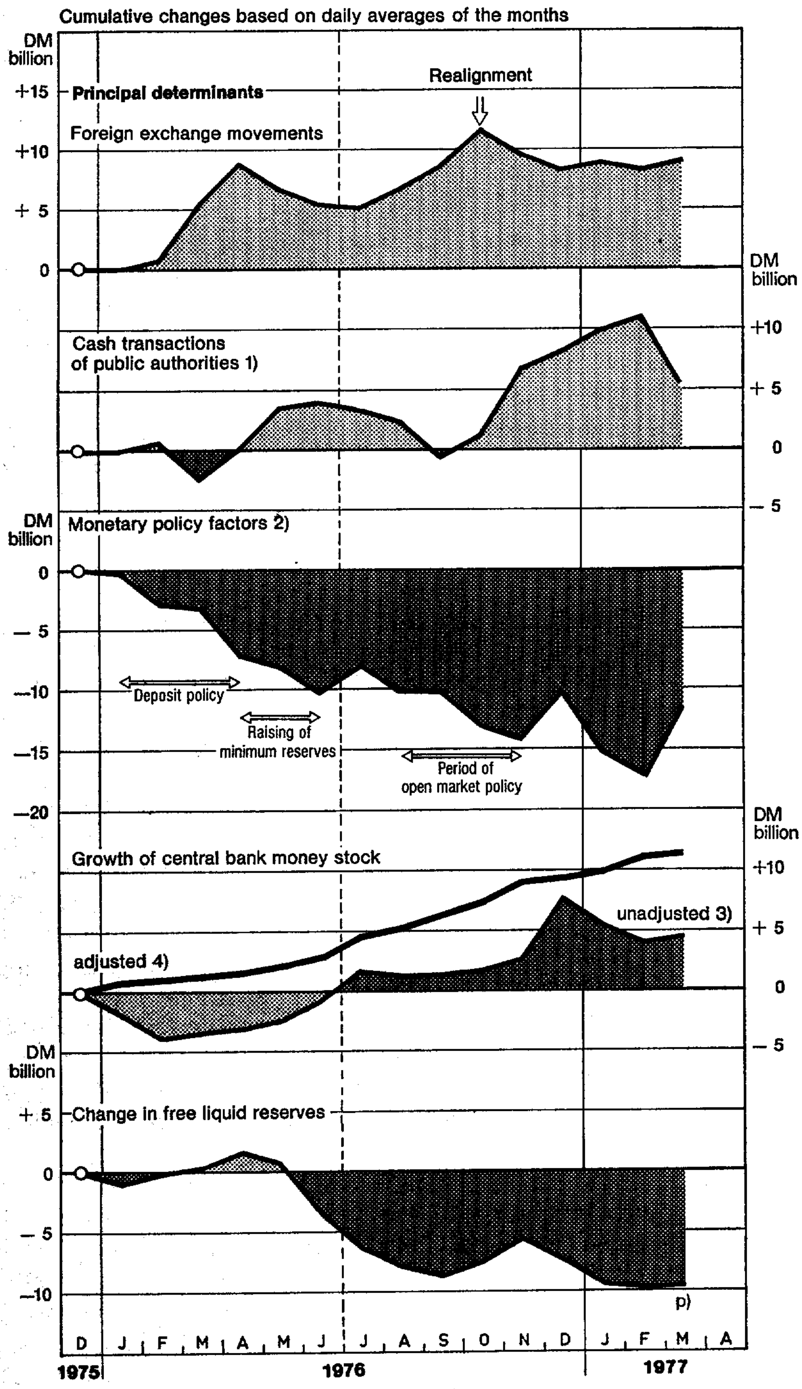
Liquidity position of the banks still under control

At this juncture it was important to keep bank liquidity at the level reached in July and to stabilise interest rates in the money market at the corresponding level in spite of the inflows of funds from abroad. The renewed increase in public authority balances at first offset the purchases of foreign exchange. The marked rise in central bank money requirements in the second half of the year due to the expansion of currency in circulation and the increase in the required minimum reserves also reduced liquidity. Moreover, the Bundesbank curbed the inflows of liquidity resulting from its foreign exchange purchases by other measures which would not be construed as signals.

Large-scale open market operations ...

The principal instrument of this compensatory liquidity policy was open market operations in fixed interest securities. As early as February and March the Bundesbank had sold some DM 1.5 billion of bonds from the portfolio of at times almost DM 8 billion which it had accumulated in 1975 without stopping the decline in the long-term interest rate. Between April and August no securities could be sold from the Bundesbank's portfolio as the situation in the bond market was unstable and interest rates were temporarily rising. Not until a boom started in the bond market in August was the Bundesbank able to reduce the banks' liquidity by open market transactions again. The Bundesbank's security holdings dropped from over DM 6 billion at the end of August to some DM 1.5 billion at the

Central bank money stock and banks' free liquid reserves



1) Excluding shifts under section 17 of the Bundesbank Act.- 2) Including lombard loans.- 3)Currency in circulation and banks' required minimum reserves on their domestic liabilities (at current reserve ratios).- 4) Seasonally adjusted, calculated at constant reserve ratios (base: January 1974).

end of November; since then they have not decreased much further. There were also open market transactions in mobilisation paper. The Bundesbank offered the banks such paper from the end of October onwards, when the money market eased considerably as a result of the massive inflows of foreign exchange. By the end of the year the banks had bought DM 2.5 billion of such securities, which are not included in the money market regulating arrangements and thus absorb liquidity for the whole of their life (six months, one year and two years).

... thanks to the capital market situation

Open market policy assumed a new role in 1976 for it was proved that in certain circumstances bonds may be not only purchased in great quantities, as in 1975, but also resold on a large scale. This type of liquidity control undoubtedly had certain advantages. Without major public announcements, which are open to misunderstanding as the raising of the minimum reserve requirements in May and June showed, the banks' liquidity was influenced through participation in market activity. Nevertheless, under the conditions prevailing in Germany open market operations in the bond market are exclusively a "fair-weather" instrument. Only as long as the market is very receptive can billions of Deutsche Mark be siphoned off through open market sales by the Bundesbank. If the Bundesbank had tried to use this instrument restrictively without regard to the market situation, it would only have caused interest rates to soar without tying up all the funds it wished to neutralise.

Impact of open market operations on the money stock

As intended, the open market operations had a direct impact on bank liquidity, and this could be expected – with the usual time lag – to exercise an indirect influence on the growth of the money stock. The open market transactions could not, however, be expected to curb the growth of the money stock directly to any great degree. At a rough estimate, about half of the bonds sold by the Bundesbank were bought by domestic "non-banks". In some cases the non-banks may have been substituting securities for bank deposits, and only to this extent could money holdings have been reduced directly by the open market transactions. But the principal significance of the open market policy was, as mentioned, that it curtailed the banks' liquidity, and thus no doubt ultimately prevented the creation of a much larger amount of deposits.

Record recourse to lombard loans

After the realignment within the European system of narrower margins bank liquidity was on the one hand reduced by outflows of foreign exchange and on the other increased by the draining of the public balances (to the amount of about DM 8.5 billion between November and January alone). On the whole, however, the banks were unable to cover the seasonal expansion of central bank money towards the end of the year – the sharp increase in currency in circulation, and also in required minimum reserves – out of their available liquid reserves. They therefore raised lombard loans at the Bundesbank on a considerable scale (DM 7.3 billion on an average in December). During this period the banks did not make full use of the cheaper rediscount facilities. Apart from the fact that they probably expected conditions in the money market to ease in January 1977 and were unwilling to start this period with a large volume of rediscount liabilities, the banks may have preferred lombard loans to rediscount credit for window-dressing reasons since Bundesbank lombard credit cannot be distinguished from other liabilities in a bank's balance sheet while the amount of bills rediscounted has to be shown as a contingent liability and a debt to the Bundesbank, and it is believed that this might adversely affect the assessment of a bank's liquidity position.

Free liquid reserves not a general criterion of the availability of central bank finance

The scale on which the banks raised lombard loans last year shows that their scope for recourse to the Bundesbank is at present much larger than implied by the total of "free liquid reserves", which essentially comprise the amount of trade bills still rediscountable within the normal rediscount quotas and of limit "B" bills and prime bankers' acceptances in the unused part of the Bundesbank's commitment to buy such paper. The banks' scope for obtaining central bank balances by raising lombard loans, for which no precise quantitative limits have been set for some time, is not reflected in the liquid reserves. Virtually the sole constraint on lombard loans, apart from the fact that they are available only for short periods, is the circumstance that they are more expensive than rediscount credit, at present by one percentage point. When lombard loans are the last remaining source of central bank money, the rates for day-to-day money rise to the level of the lombard rate. This may be quite consistent with the objectives of monetary policy, especially if increases in the discount rate, as the basic rate of interest, are considered undesirable for domestic or external reasons. This was the case from mid-1976 onwards, when on the one hand – as mentioned – monetary expansion accelerated sharply while on the other more extensive use of the monetary instruments appeared to be inopportune in view of the economic conditions. However, these changes in the availability of central bank money – reflected in a day-to-day money rate close to the lombard rate of 4½ % compared with 3½ to 4 % beforehand, i. e. a fairly moderate change – have apparently helped to keep

Monetary developments

Change during period 1

Item	1972	1973	1974	1975	1976 Total	1976 January to June	1976 July to December
A. Creation of central bank money and banks' free liquid reserves 2	DM billion						
1. Net external position of Bundesbank	+16.9	+27.2	— 2.8	— 2.1	+ 8.3	+ 5.4	+ 2.8
2. Net balances of central and regional authorities (increase: —)	+ 3.0	— 1.1	— 3.0	+ 1.7	+ 3.7	— 0.4	+ 4.0
3. Changes in compulsory special reserves and rediscount quotas	—14.6	—18.4	+16.7	+ 9.8	— 4.4	— 4.6	+ 0.2
4. Open market operations	— 2.1	— 6.3	— 1.5	+11.6	— 8.6	— 1.6	— 7.0
5. Lombard loans	×	+ 1.1	+ 2.0	— 2.0	+ 6.5	— 0.2	+ 6.6
6. Unspecified determinants	— 0.2	+ 0.0	— 4.0	+ 0.8	— 5.1	— 3.3	— 1.9
Central bank money and free liquid reserves (1 to 6)	+ 3.0	+ 2.5	+ 7.4	+19.9	+ 0.3	— 4.6	+ 4.9
Central bank money 3	+10.4	+ 6.9	+ 5.8	+ 9.5	+ 7.9	— 0.9	+ 8.8
Banks' free liquid reserves 4	— 7.5	— 4.4	+ 1.6	+10.4	— 7.6	— 3.7	— 3.9
Memorandum items:							
Level of free liquid reserves in the last month of the period	7.3	3.0	4.5	14.9	7.3	11.2	7.3
Lombard loans outstanding in the last month of the period	1.3	0.8	2.8	0.8	7.3	0.6	7.3
B. Key monetary indicators	Percentage change on previous year 5						
Central bank money 6	+12.5	+10.6	+ 6.1	+ 7.8	+ 9.2	+ 9.1	+ 9.3
Bank lending to domestic non-banks	+14.6	+13.1	+ 8.3	+ 7.9	+11.3	+10.9	+11.8
M_1 (= currency in circulation and sight deposits)	+13.1	+ 6.1	+ 4.2	+13.7	+10.8	+12.8	+ 8.1
M_2 (= M_1 plus time deposits for less than 4 years)	+13.8	+17.8	+ 7.5	— 0.4	+ 5.2	+ 2.6	+ 8.3
M_3 (= M_2 plus savings deposits at statutory notice)	+12.6	+11.9	+ 7.6	+ 7.4	+10.0	+ 9.6	+10.4
C. Money stock in a balance sheet context	Change in DM billion						
Money stock M_3 (= C 1 plus 2 less 3 less 4 less 5)	+47.1	+34.0	+35.2	+38.4	+41.0	+ 2.9	+38.1
Counterparts in the balance sheet:							
1. Bank lending, total	+86.4	+67.5	+59.8	+85.5	+91.1	+34.9	+56.3
2. Net external assets	+ 8.7	+23.5	+13.2	+16.8	+ 8.3	+ 7.1	+ 1.2
3. Monetary capital formation 7	+47.0	+45.6	+34.4	+61.3	+59.1	+29.5	+29.6
4. Central bank deposits of domestic public authorities	— 3.8	+ 4.2	+ 0.4	+ 1.4	—10.2	— 3.8	— 6.4
5. Other influences	+ 4.8	+ 7.2	+ 2.9	+ 1.2	+ 9.5	+13.3	— 3.9

1 Unless otherwise indicated, based on end-of-month figures. — 2 Comparison of the last month of the period with the last month of the previous period, based on daily averages of the months (in 1972 and 1973 based on averages of the bank week return dates of the months). — 3 Currency in circulation and required reserves on banks' domestic liabilities at current reserve ratios. — 4 Excess balances, domestic money market paper and unused rediscount quotas (up to May 1973 including scope for raising lombard loans within the "warning mark"). — 5 Taking the average of the years or half-years, calculated on the basis of seasonally adjusted data. — 6 Reserve component calculated at constant reserve ratios (base: January 1974). — 7 Excluding savings deposits at statutory notice.
Discrepancies in the totals are due to rounding

monetary expansion on the desired growth path, at least in the period since then. The economic situation, which precluded further monetary measures, at the same time fostered this slowdown in monetary expansion. To put it another way: if the economic upswing had been stronger towards the end of 1976, the demand for credit and hence the money stock would probably have grown more and the overall situation would no doubt have called for greater restraint in the provision of central bank money than was in fact required.

(c) Moderate overshooting of the target

No slowdown in monetary expansion until December

The period of sharp expansion in the money stock which had started in the summer of 1976 ended in November. In December central bank money hardly rose at all, though this was partly due to special influences. Even so, in the second half of 1976 it went up by 11.4 % (seasonally adjusted and expressed as an annual rate). Over the year as a whole it increased by 8.4 %. Compared with 1975, when central bank money had risen by about 10 % during the year, its growth thus clearly slowed down. However, the target of an increase of 8 % formulated in terms of an annual average was exceeded in 1976 since, taking the average of all the months of the year, the central bank money stock was 9.2 % higher than in 1975.

Diverging trend of the components

The two components of central bank money, namely currency in circulation, which is included in full, and the required minimum reserves on domestic liabilities (calculated at the reserve ratios of January 1974), did not quite run parallel in 1976. The latter rose on an average by 10.1 % in 1976, but the former by 8.4 %. As the required minimum reserves represent the total volume of deposits, which far exceeds the currency in circulation, central bank money as an indicator of monetary expansion shows too small an increase in 1976. The money stock in the broadest definition (M_3) grew by an annual average of 10 % last year. By contrast, the money stock excluding savings deposits (M_2) was only 5.2 % higher than in 1975. Money holdings in the narrowest definition (currency in circulation and sight deposits = M_1) went up somewhat faster than M_3 in 1976 (by 10.8 %), contrary to the long-term trend. However, as early as the second half of the year there were signs of a "return to normal", in that the rise in currency in circulation and sight deposits was already considerably slower than that in other deposits.

(d) Experience with the monetary growth target

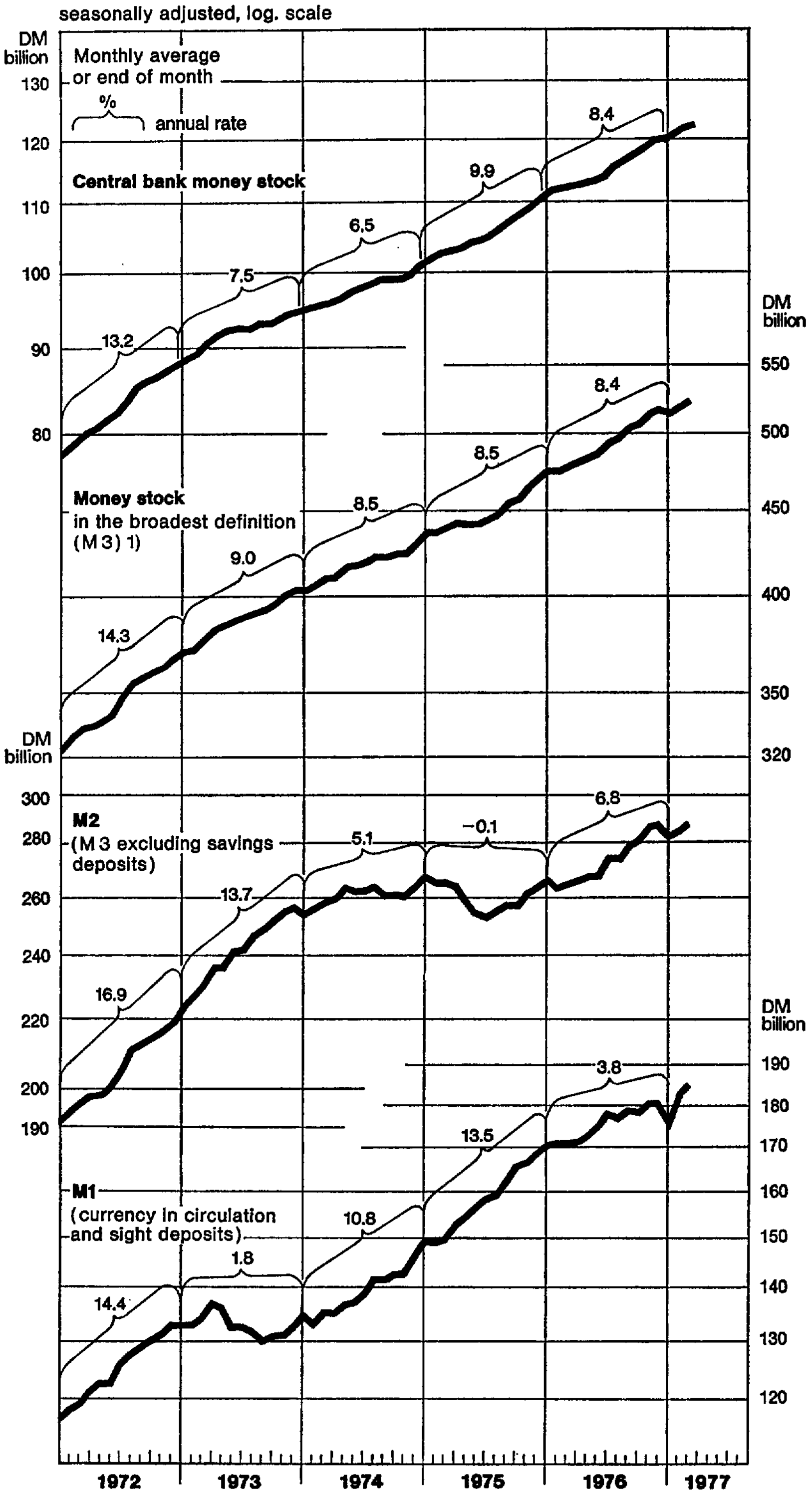
Guideline correctly chosen

The overshooting of the monetary growth target by one percentage point in 1976 raises the question of whether this experiment of specifying a quantitative guideline for monetary policy was not too ambitious. Apart from the basic question of whether or not setting such a quantitative target is useful at all – the Central Bank Council answered this question in the affirmative on the basis of an experiment for 1975, 1976 and now also for 1977 – the first thing to examine is whether the target figure chosen was right or not. In some respects the trend of economic activity in 1976 turned out to be more favourable than had originally been projected. The real growth of the national product was larger and the increase in prices smaller than had been planned; hence a faster monetary expansion than that actually aimed at might appear to have been warranted. However, the nominal growth of the national product in 1976, at 9 %, conformed to original expectations; this was precisely the rate of growth of nominal demand which it had been declared justified to finance, albeit on the basis of a growth of 8 % in the money stock. Thus the crux of the question is why the "velocity of circulation" did not increase in 1976, as had originally been assumed.

Development of the "velocity of circulation"

This development, which is contrary to experience in previous business cycles, was caused by various factors. It is significant that this "abnormal" pattern was confined to the second half of 1976, when – in contrast to the first half of the year – the velocity of circulation even slowed down somewhat. One reason put forward to explain this is that economic activity was sluggish in the second half of 1976 and that the business community tended to keep its earnings in liquid form and to invest less than usual in fixed assets, thus deliberately increasing the ratio of money holdings to turnover, or put differently: reducing the velocity of circulation

Central bank money and money stock in various definitions



1) Currency in circulation, sight deposits, time deposits and funds borrowed for less than four years, savings deposits at statutory notice.

of money. If this view were correct, it would indeed have been dangerous deliberately to curb the growth of the money stock.

Another reason advanced is, however, that the exceptionally fast expansion of the money stock in the second half of 1976 was primarily due to monetary influences, in particular to the fact that the after-effects of the inflows of funds from abroad coincided with the beginning of the sharp credit expansion at home that was discussed in more detail above. As turnovers and incomes cannot follow such a very rapid expansion of money holdings immediately, the velocity of circulation, which is the relationship between the faster increase in the money supply and the slower growth of turnovers, is bound to fall for a transitional period. This is a temporary phenomenon, however, as turnovers and incomes are also likely to grow more steeply after a while. According to this view it would have been consistent if monetary policy had tried to check the faster expansion of the money stock.

Both factors – the deliberate expansion of enterprises' cash holdings and the autonomous influence of the increase in the money stock – probably played a role in the second half of 1976 without it being possible to assess precisely the relative importance of each. For the Bundesbank this meant on the one hand that it had to accept a certain overshooting of the monetary growth target for 1976 – and to this extent also to consider that its assumption of a rising velocity of circulation was perhaps not quite correct – and on the other that it had to conduct its future monetary policy such that the expansion of the money stock slowed down again, as it clearly did from December 1976 onwards. If the Bundesbank had not reacted in this way, it would have laid itself open to the charge that it had done nothing to counteract the effects which an excessive expansion of the money stock might be expected to have on prices in the long run.

Monetary growth target again proves its worth as a guideline in 1976

In spite of these reservations the monetary growth target again proved its worth as a guideline in 1976, both internally for the central bank itself and for the general public. Through the announcement of this target all those involved in economic activity are confronted with the question of how their behaviour can be reconciled with this aim. But a monetary target whose intentions were in essence only psychological would be unable to perform this task for any length of time. To remain credible in this connection it is not enough to pursue the objective with determination; it is also necessary to re-examine the target – which was originally formulated in a particular situation and on particular assumptions – from time to time and to correct it if need be, for it is of course not an end in itself but only a means to the end of a more successful and more smoothly operating economic policy.

(e) Monetary growth target for 1977

Continuation of the "experiment"

The Bundesbank also announced a monetary growth target for 1977, i. e. for the third successive year. Its target is once more an annual average growth of 8 % in the central bank money stock. To meet this target it will strive to achieve steady monetary expansion with central bank money rising by 6 to 7 %, comparing the average of the fourth quarter of 1977 with that of the fourth quarter of 1976. This formulation is used to preclude misunderstandings such as might arise in connection with an average growth target. Monetary growth in accordance with the target in the course of 1977 has in fact – contrary to some critical comments – been set at quite a low figure. The 8 % change on an annual average is partly determined by the steep increase in central bank money towards the end of 1976. In 1977 the monetary target is again an integral part of the overall economic projection; the Federal Government and the Bundesbank are aiming at an increase of 3 % in production potential and 2 % in capacity utilisation, and thus at a real growth of 5 %. The rise in prices is to be held below 4 % and the nominal national product is to go up by about 9 %. The money stock target can be kept somewhat below this growth rate of the gross national product because a slight increase in the velocity of circulation is quite compatible with the projection. So far this year monetary expansion has largely been in line with the target.

(f) Banking business in detail

Lending to the private sector predominant again

In 1976 private borrowers regained the predominant place in the banks' loan business which they had lost to the public authorities in 1975. At DM 66 billion, they accounted for over two thirds of the rise in the total volume of lending (about DM 96 billion), a proportion which was just about as large as in 1974; in 1975, by contrast, their share had amounted to less than two fifths. However, there remained considerable differences in the structure of lending to the private sector

Bank lending* to domestic non-banks

Item	1974	1975	1976 Total	1976 1st half-year	1976 2nd half-year	Amount outstanding End of 1973	Amount outstanding End of 1976
	Change during period in DM billion					DM billion	
Bank lending, total	+61.2	+78.9	+96.2	+36.8	+59.4	745.1	980.0
to enterprises and individuals	+41.2	+30.9	+65.8	+24.0	+41.8	631.3	769.2
enterprises and self-employed persons	+25.7	+ 9.6	+33.3	+ 9.5	+23.8	351.8	420.1
of which:							
Manufacturing 1	+ 7.6	— 5.3	+ 4.4	— 1.9	+ 6.4	113.3	119.2
Distribution 1	+ 2.3	+ 0.6	+10.9	+ 4.5	+ 6.5	51.2	65.5
Employees and other individuals	— 0.1	+ 6.5	+13.2	+ 6.4	+ 6.9	50.0	69.3
Housing	+15.2	+14.3	+19.0	+ 8.0	+11.0	225.3	274.4
Non-profit organisations	+ 0.4	+ 0.5	+ 0.3	+ 0.1	+ 0.1	4.2	5.3
to public authorities	+20.0	+48.0	+30.4	+12.8	+17.6	113.8	210.8
	Percentage change on initial level					Percentage of amount outstanding	
Bank lending, total	+ 8.2	+ 9.8	+10.9	+ 4.2	+ 6.5	100.0	100.0
to enterprises and individuals	+ 6.5	+ 4.6	+ 9.4	+ 3.4	+ 5.7	84.7	78.5
enterprises and self-employed persons	+ 7.3	+ 2.5	+ 8.6	+ 2.5	+ 6.0	47.2	42.9
of which:							
Manufacturing 1	+ 6.7	— 4.4	+ 3.8	— 1.7	+ 5.6	15.2	12.2
Distribution 1	+ 4.5	+ 1.1	+20.1	+ 8.2	+11.0	6.9	6.7
Employees and other individuals	— 0.2	+13.0	+23.5	+11.4	+11.0	6.7	7.1
Housing	+ 6.7	+ 5.9	+ 7.4	+ 3.1	+ 4.2	30.2	28.0
Non-profit organisations	+ 9.5	+11.1	+ 6.0	+ 2.2	+ 3.2	0.6	0.5
to public authorities	+17.6	+36.3	+16.9	+ 7.1	+ 9.2	15.3	21.5

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

compared with earlier years. Although lending to enterprises grew about three times as fast in 1976 as in 1975, it increased more slowly (by 8 %) than other types of lending. In particular, borrowing from banks by manufacturing (industry and craft enterprises) at the end of 1976 was no larger than at the end of 1974; the increase in 1976 only roughly offset the decline in the previous year. However, lending to the manufacturing sector is not of such outstanding importance for the trend of bank lending as is often assumed in discussions. At the end of 1976 this sector accounted for only 12 % of the total volume of credit; other sectors borrowed much more heavily from banks in 1976. The distributive trades, for example, increased their bank liabilities by 20 % last year (in 1975, admittedly, these liabilities had hardly risen at all); they therefore accounted for 7 % of the total volume of lending. Lending to employees gained particular ground, increasing by almost 24 % in 1976 after already growing unusually fast in 1975, at 13 %; at the end of 1976 its share in the total volume of lending amounted to 7 % compared with only 5 % in 1968.

But steep increase in public authority debt to banks continues

In 1976 the public authorities borrowed some DM 30 billion from banks (excluding the Bundesbank) compared with DM 48 billion a year before. As explained in more detail elsewhere in this Report, in 1976 the public authorities' deficits were smaller than in 1975, and the credit balances accumulated towards the end of 1975 could moreover be used to finance them. In percentage terms the public authorities' bank debt still rose almost twice as fast (+ 17 %) as that of private bank customers (+ 9.4 %) in 1976, but progress towards a more normal debtor structure among the banks was unmistakable.

Diverging trend of interest rates in banks' assets-side and liabilities-side business

Interest rates in domestic credit markets tended to fall — although not continuously — in 1976; this is also true, despite differences in individual cases and with the exception of the money market rates, of interest rates in banking business. The interest rates charged for short-term bank credit declined in the first half of 1976; thereafter they remained roughly constant. The interest rates for long-term bank credit have been falling until recently parallel to interest rates in the bond market. In the banks' liabilities-side business there was a slight upward adjustment from the summer of 1976 onwards in the interest rates paid on time funds, in keeping with the trend in the money market. Interest rates on savings deposits remained substantially unchanged after a general decline of about half a percentage point in the spring of 1976, but the average interest rate on bank savings bonds — in line with that on Federal savings bonds — decreased slightly around the turn of 1976/77. On an average the banks' interest margin is likely to have narrowed somewhat in 1976, but this reduced the extremely good 1975 operating results only in degree. The earnings position of individual banks continued to be adversely affected, however, by loan losses and provisions for losses on loans which had been doubtful for some time and finally had to be written off.

Development of the volume of business of the banking groups

In 1976 there were very large differences in the growth of the volume of business of the various banking groups. Increase rates ranged between 13.7 % for the mortgage banks and 4.6 % for the postal giro and postal savings bank offices. There was also a sharp rise in the business of the big banks (13.4 %) and the credit cooperatives (12.5 %), i. e. of banks which have a wide range of customers, so that changes in the pattern of demand for credit largely cancel each other out. The growth in the business of the savings banks was equal to the average (about 10 %). The expansion in the volume of business of the central giro institutions, by contrast, was only moderate last year (6 %), one reason being that their share in lending to the public authorities was no longer as large as it had been in 1975. The mortgage banks, on the other hand, again strongly increased their lending to the government, the amount of credit granted to the public authorities being more than twice as large in absolute terms as that provided by the central giro institutions.

3. Growing importance of the bond market

Overall trend determined by the investment behaviour of households

Looking beyond banking in the stricter sense to the other financial institutions and the security markets, the most striking feature in 1976 is the sharp increase in the importance of the bond market. To provide a consistent reference basis for such comparisons, the table opposite shows the claims of households, public authorities and enterprises (i. e. the "domestic non-financial sectors"), mainly on financial institutions and in the form of securities. The financial assets of these domestic sectors grew by a total of DM 141 billion in 1976 and amounted to some DM 1.6 trillion at the end of that year; the domestic acquisition of financial assets was thus 6 % larger than in 1975 and 15 % up on 1974.

By far the greater part of this rise in financial assets, viz. DM 95 billion or some two thirds, was accounted for in 1976, as in previous years, by households, whose investment behaviour thus largely determined the structure of the domestic placing of funds. By tradition, the principal financial assets of households are savings deposits; the increase in such deposits in 1976, at DM 35 billion, made up some 37 % of the total acquisition of financial assets. However, the amount invested by households in bonds, Federal savings bonds and bank savings bonds in 1976, at DM 30 billion, was not much smaller than that placed in savings accounts, an unprecedented ratio. Taken together, these two types of investment accounted for nearly 70 % of the total growth of households' financial assets in 1976. The funds placed by households with insurance enterprises and building and loan associations were of roughly the same order as in 1975 (together some DM 23 billion).

A departure from the usual pattern was that enterprises (including housing) also increased their financial assets exceptionally sharply in 1976, viz. by DM 44 billion as against DM 31 billion in 1975. They primarily accumulated balances with banks (DM 17 billion), for the most part time balances (DM 12 billion). The rise in external assets was likewise considerable (DM 17.5 billion); it mainly consisted of additional claims in connection with exports and direct investments abroad. The remainder was chiefly accounted for by securities, primarily bonds and shares. The public authorities built up their financial assets only a little in 1976, as in 1975, but in contrast to the trend in almost all earlier years. This was mainly because the

Financial assets of the domestic non-financial sectors [1] p

Item	Change 1974 DM bn	%	1975 DM bn	%	1976 DM bn	%	Level End-1976 DM bn	%
Funds placed with financial institutions								
1. Funds placed with banks	54.1	44.1	81.5	61.2	68.0	48.2	896.7	55.7
Currency and sight deposits	16.7	13.6	22.0	16.5	1.8	1.3	211.7	13.1
Time deposits and borrowed funds	1.6	1.3	—16.7	—12.5	19.5	13.8	222.2	13.8
Savings deposits	30.9	25.2	67.3	50.5	36.5	25.9	426.0	26.5
Savings bonds	4.9	4.0	8.9	6.7	10.2	7.2	36.8	2.3
2. Funds placed with building and loan associations	5.9	4.8	7.3	5.5	6.9	4.9	82.4	5.1
3. Funds placed with insurance enterprises	15.5	12.7	16.8	12.6	18.5	13.1	174.8	10.9
Investments in securities	14.2	11.6	17.4	13.1	28.3	20.1	243.7	15.1
1. Bonds	9.7	7.9	11.8	8.9	25.7	18.2	155.2	9.6
2. Shares	4.5	3.7	5.6	4.2	2.6	1.9	88.5	5.5
Investments in other assets 2	32.8	26.8	10.1	7.6	19.4	13.7	213.3	13.2
Financial assets of the non-financial sectors	122.5	100	133.1	100	141.1	100	1 610.9	100
Households	79.4	64.8	97.5	73.2	95.1	67.4	946.9	58.8
Enterprises	31.9	26.0	31.4	23.6	44.4	31.5	390.1	24.2
Public authorities	11.2	9.2	4.2	3.2	1.6	1.1	273.9	17.0

1 Households, enterprises (including housing), public authorities (including social security funds). — 2 Mainly external assets. — **p** Provisional.

social security funds and the Federal Government financed part or all of their deficits by drawing on their cash resources.

Households the only sector to show financial surpluses

Taken by itself, the development of the financial assets of the above-mentioned domestic sectors does not, of course, fully reflect their financial position in 1976, since at the same time they took up credit on a larger or smaller scale from banks or by issuing securities in the capital markets. While borrowing by households in 1976 was again much smaller than their simultaneous acquisition of financial assets and enterprises were net borrowers in line with their traditional role, the public authorities were likewise net borrowers in 1976 — as in 1975 — whereas previously they had normally been net lenders. In 1976 borrowing by the public authorities remained comparatively high and they also acquired few financial assets.

Increased recourse to the bond market by public authorities

The fact that the public authorities have become more important borrowers in the last few years is one of the main reasons for the greatly increased significance of the bond market relative to other credit markets, as this form of borrowing very much suits the government's needs. In 1976 the public authorities met one third of their total borrowing requirements by issuing bonds, compared with just over one fifth in 1975 and about one seventh in 1974 and 1973. This, moreover, does not take account of the fact that in the past few years the public authorities have taken up substantial loans from the issuing institutions, which procured the funds required for this purpose by selling communal bonds. If the net sales of communal bonds are added to the public authorities' own bond issues, the funds raised directly or indirectly in the bond market made up over three quarters of the public authorities' total borrowing in 1976. In 1975 this proportion had amounted to just under three fifths and in 1974 to not quite one half.

For enterprises, by contrast, financing through the issuing of securities plays a comparatively minor role. In the last few years it has accounted (bond issues and share issues combined) for only 6 % of enterprises' total borrowing; if the issues of the Federal Railways and the Federal Post Office, which are classified as enterprises in the sectoral analysis, are excluded, the figure is much lower still. Considering how productive the security market is, enterprises' calls on it are remarkably small. It remains to be seen whether the situation will change now that the corporation tax reform has made shares more attractive as financial assets and financing instruments. Recourse to the bond market through issues of in-

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

DM billion market value

Item	Year	Domestic bonds				Foreign bonds 2	All bonds
		Total 1	Bank bonds	Industrial bonds	Public authority bonds		
Residents	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
	1976	44.7	31.7	— 0.5	13.6	1.4	46.1
Banks	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
	1976	20.2	12.2	0.2	7.8	0.3	20.5
Non-banks	1974	13.0	9.2	— 0.1	3.9	0.3	13.3
	1975	16.9	11.9	0.1	4.8	1.2	18.1
	1976	31.1	19.4	— 0.7	12.3	1.0	32.1
Open market operations of the Bundesbank	1974	0.4	—	—	0.4	—	0.4
	1975	7.5	—	—	7.5	—	7.5
	1976	— 6.5	—	—	— 6.5	—	— 6.5
Non-residents 3	1974	— 2.5	e — 1.9	e — 0.1	— 0.6	×	— 2.5
	1975	— 3.4	e — 2.1	e — 0.1	— 1.3	×	— 3.4
	1976	3.1	e 0.1	e — 0.0	3.1	×	3.1
Purchases (= sales), total	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
	1976	47.9	31.7	— 0.5	16.7	1.4	49.2

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.

dustrial bonds is likely to remain low since, owing to the comparatively high cost of such issues, this mode of financing has few if any advantages for enterprises over borrower's note loans from banks and insurance enterprises.

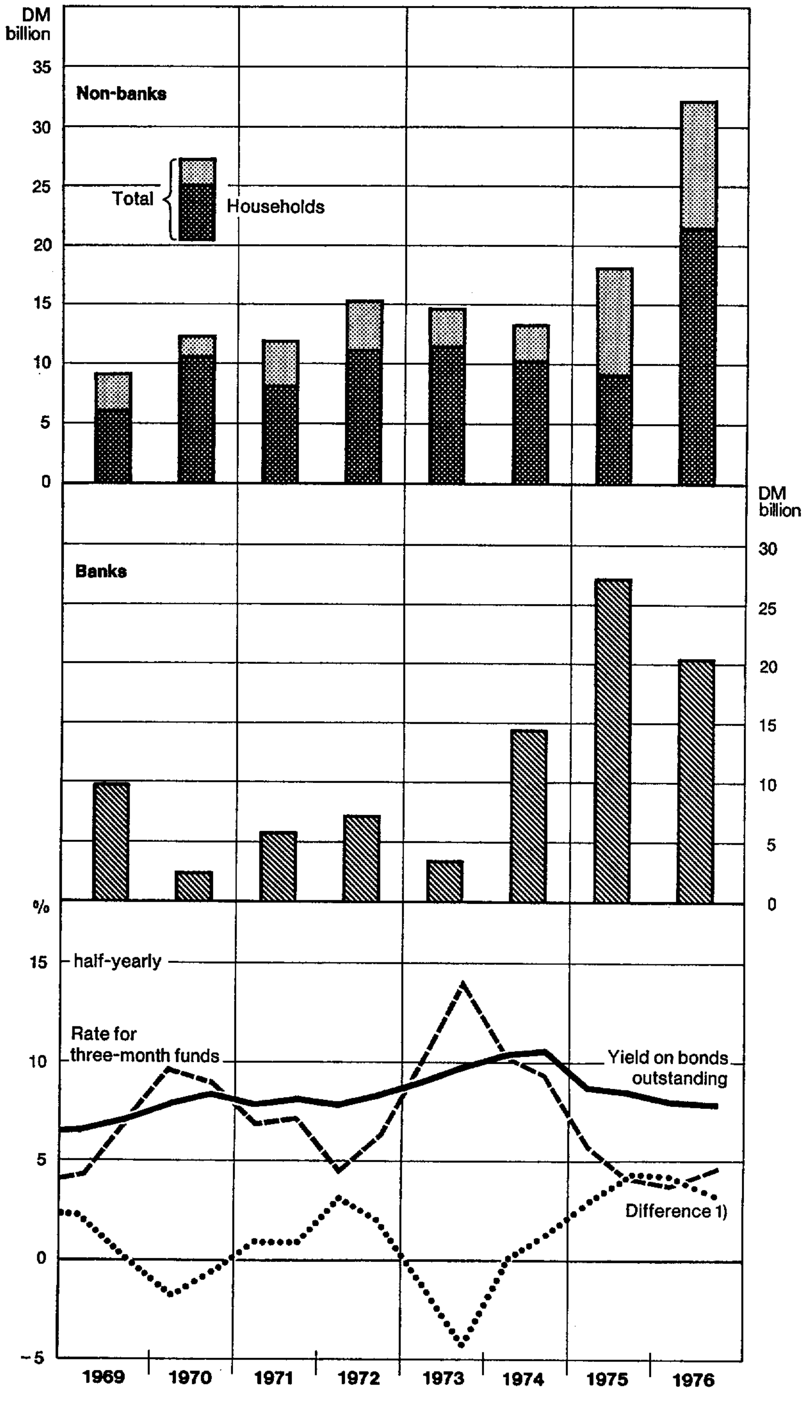
Domestic non-banks step up bond purchases by one third

The capacity of the bond market to mobilise funds in 1976 was no doubt also enhanced by the fact that the inflationary tendencies were curbed further and that – in close connection with this and with the steady trend of economic activity – the long-term interest rate declined and prospects of price gains arose. However, the figures on net sales of domestic bonds (gross sales at market values less redemptions less the increase in issuers' holdings of their own bonds) do not adequately reflect the change compared with 1975. In this definition net sales in 1976, at almost DM 48 billion, were only about as high as in 1975; in that year, however, the Bundesbank had bought DM 7.5 billion (net) of public authority bonds in the course of its open market operations, while in 1976 these securities were resold to the market, except for a balance of DM 1.4 billion. Not counting the Bundesbank, the market absorbed some DM 56 billion of bonds (market value) in 1976; this was one third more than in 1975. It was in the main the German general public (i. e. all "non-banks") that in 1976 bought more bonds than in 1975, namely DM 32 billion compared with DM 18 billion a year before. Non-residents also bought German bonds again on balance in 1976 (DM 3.1 billion) after having sold such paper in 1975 and 1974. The banks, by contrast, bought considerably fewer bonds in 1976 (DM 20.5 billion) than in the previous year (DM 27.2 billion). As regards the structure of purchasers, this gave the bond market a more durable base since private and institutional investors (excluding banks) have so far proved to be less sensitive than banks to the various market influences and expectations. The growing interest of the general public also owed something to the fact that the securities on offer suited their requirements particularly well since the maturities were relatively short or – as in the case of Federal savings bonds – the price risk was eliminated completely.

Maturities lengthen again

The terms of the newly issued securities also reflected the progress towards more settled market conditions. As far as the maturities are concerned, the proportion of short-term securities (up to and including four years) in total gross sales declined appreciably in 1976, particularly in the second half of the year, while the significance of securities running for eight years and over, whose share in the market had at times (1974) amounted to no more than one fifth, increased. However, the scope for a lengthening of maturities is unlikely to be large. If issuers were to go much further in this direction, relying on the firmness of the market, setbacks could not be ruled out. In particular, private investors, who

Placing of bonds and movement of interest rates



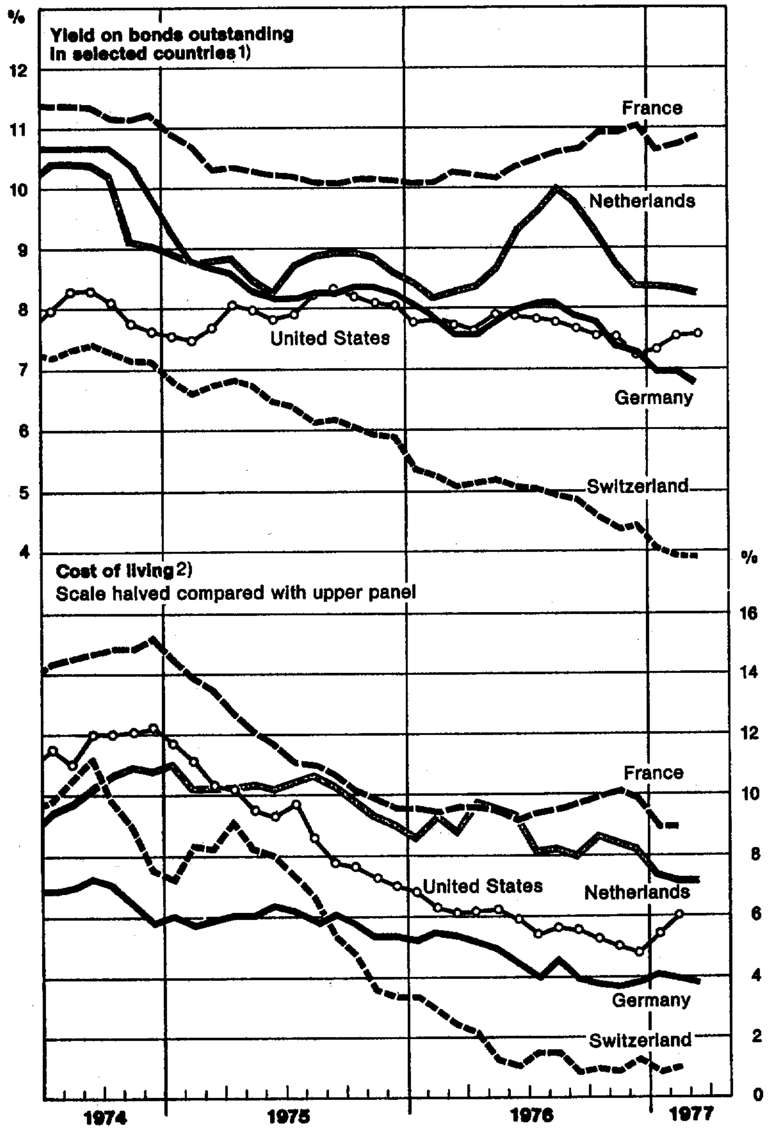
1) Yield on bonds outstanding above (+) or below (−) rate for three-month funds.

have contributed most to the strengthening of the market, are understandably anxious to limit the price risk by selecting securities which do not run for too long.

Long-term interest rate and money market rate move in opposite directions

In 1976 the long-term interest rate, or more precisely the yield on domestic issuers' bonds outstanding, dropped to a lower level than in any year since 1970, and in April 1977 that on public authority bonds, at 6¼ %, even fell below the average figure for 1968. The average yield on bonds outstanding in 1976 was 8 % against 8.7 % in 1975 and 10.6 % in 1974. In the course of 1976 and in the first few months of 1977 interest rates declined with fluctuations; between May and July, in particular, the downward trend gave way to a brief upturn. The continuation of the declining interest rate trend called in question the widely accepted view that

Movement of interest rates and cost of living in the Federal Republic of Germany and abroad



1) Public authority bonds.- 2) Percentage increase on previous year.

the long-term interest rate is primarily determined by monetary policy through the influence it exerts on money market rates. The rate for three-month funds, for example, which had averaged 4.1 % in the second half of 1975, was appreciably higher in the second half of 1976, averaging 4.7 %; but in the same period the long-term interest rate was roughly the same amount lower than a year before. In 1976, as indeed in 1973 and 1974, it was evident that the short-term interest rate, while undoubtedly a determinant of the long-term rate, is but one of several factors, and by no means always the principal one. With respect to all offers of long-term interest, creditors and debtors include their expectations about the future rates of change of prices in their calculations, for the inflation rate determines not only the real value of the interest but also whether there is any loss in the real value of the capital. In periods when prices increased at a slow pace and fluctuated little, this factor was not particularly significant in the bond market, but the steep rise in the inflation rate in the early seventies, followed by a fall since 1974, has changed the situation completely. The dwindling money illusion of creditors and debtors more than ever limits the capacity of monetary policy to exert a sustained influence on the long-term interest rate. If, for example, the Bundesbank tried to push down the long-term interest rate for an extended period by means of interest rate and liquidity policy, it would have to abandon this course as soon as the general public began to expect a rekindling of the inflationary tendencies as an inevitable consequence of this policy. On the other hand, a monetary policy which gives priority to curbing the rate of inflation also proves to be successful in achieving a more or less lasting reduction in the interest rate level. Significantly, in no other western industrial country except Switzerland has the long-term interest rate declined as sharply as in Germany since 1974, but Switzerland, being the country in which the long-term interest rate is traditionally lower than in any other industrial country, is to this extent a special case (see the chart opposite).

Long-term interest rate and return on fixed assets

From the point of view of business cycle policy this decline in the interest rate level in Germany is sometimes held to be inadequate as, it is claimed, the fall in the nominal interest rate has only been equal to the slowdown in the inflation rate and the "real rate of interest" has failed to decline. If – notwithstanding the problems involved in such a calculation – a rough approximation to the "real rate of interest" is derived from the yield on bonds outstanding, adjusted for the rise in the cost of living index for all households, it is found that this variable has indeed fluctuated around 3 % since 1971; at this level, however, it was distinctly below the average for the period between 1955 and 1970. By April 1977 the nominal interest rate after deduction of current price rises – a calculation which of course raises problems, especially at short term – had fallen to about 2½ %. However, it is not this "real rate of interest" as such which is important for business cycle policy but rather its relationship to the return on fixed assets, which broadly speaking is also lower today than it was in preceding decades. Investment decisions primarily depend not on the overall relationship between the nominal interest burden and the prevailing inflation rate but rather on interest costs and the possible future return on the new investment for each investor, but – for lack of a better yardstick – the assessment is in fact generally made on the basis of the prevailing interest rate and price relationships. The estimation of inflationary trends is important not only with respect to the "real" interest burden but also for judging the development of other costs, particularly labour costs, which in most areas of production are many times higher than interest costs. It would therefore be doubly short-sighted to try to give a durable stimulus to investment by pursuing a deliberately expansionary monetary policy primarily aimed at lowering interest rates. First, such a policy would prove short-lived owing to the interdependence of the factors determining interest rates. Second, the policy would create the danger of an even steeper increase in labour costs and thus in the long run prevent new investment from generating the expected return. The upshot would be, after an apparent boom in investment, an economic downturn such as occurred in drastic form in 1973 and 1974, albeit as a result of other influences predominantly relating to the world economy. The steady course of the Bundesbank's monetary policy has so far brought about a natural decline in the interest rate level which permits a sustained strengthening of investment but prevents sudden boom-like jumps.

4. Balance of payments aspects

Further reduction in the surplus on current account

In 1976 the foreign trade and payments of the Federal Republic of Germany were marked by the world-wide economic upturn, a substantial appreciation of the Deutsche Mark on the exchange markets and at times massive speculative movements of foreign exchange. After the recessionary trends of the previous year, the progressive recovery in major industrial countries and the vigorous economic growth in Germany led in 1976 to a distinct expansion of world trade, in which Germany's share was above the average. As business activity in Germany revived somewhat more rapidly than in other industrial countries, German imports grew much more than exports, the more so since the persistent appreciation of the Deutsche Mark enhanced residents' inclination to import. Whereas the Deutsche Mark appreciated by 15 % against all other currencies between the end of 1972 and the end of 1975, i. e. over a period of three years, its external value rose by another 15 % in the course of 1976 alone. The German surplus on current account went down in 1976, as mentioned, by about DM 2 billion to DM 7.5 billion, or approximately 0.7 % of the nominal gross national product.

The exceedingly steep rise in the external value of the Deutsche Mark in 1976 mirrors not least the weakness of other major currencies. A further significant factor was that the external value of the Deutsche Mark had dropped by some 4 % in the course of 1975. As, however, a price differential had developed between countries with higher rates of inflation and Germany in 1975, the exchange rate adjustment of 1976 must also be viewed in this context. The adjustment of exchange rates to the basic differences in economic developments in the various countries is neither a continual process nor determined in the shorter run exclusively by price discrepancies. In the event of capital movements (also those of a speculative nature), the adjustment of exchange rates may slow down or accelerate, so that the rates do not accurately reflect at times the divergent movement of prices in Germany and other countries.

No fundamental deterioration in the competitive position owing to exchange rate adjustments

In the longer run and viewed in global terms, Germany's competitive position has not deteriorated fundamentally on account of the sharp increase in the external value of the Deutsche Mark during the last four years of floating exchange rates. The appreciation of the Deutsche Mark against the currencies of the thirteen most important industrial countries between end-1972 and end-1976 amounted to 30 %; in the same period the export prices of foreign countries, expressed in their own currencies, also rose some 30 % more than those of Germany. The disparity between Germany and other industrial countries as regards consumer prices and the producer prices of industrial products is not quite so clearly in favour of Germany (see the chart on page 55). A certain residual "loss" of German competitive power seems to have remained, particularly in relation to individual countries; considering the size of earlier surpluses on current account, however, it is a no doubt unavoidable adjustment factor in the interest of longer-term external equilibrium.

Exports stimulate domestic activity

The fact that the performance of the German economy, taken as a whole, remained high by international standards despite the appreciation of the Deutsche Mark is shown by German exports. They rose by 16 % in value terms and almost 14 % in real terms in 1976. These growth rates indicate how far the cyclical revival of demand in other countries progressed in 1976 after the decline in 1975 due to the world recession; Germany was even able to increase its share in total real world exports (from 12½ % in 1975 to 13 % in 1976), approximately regaining the share it had in 1974. The rise in exports gave a strong stimulus to domestic economic activity. This applies particularly to the consumer goods industries, since exports of their products grew most, namely by no less than 26 % against 1975. Above all, more textiles and clothing were exported, which plainly demonstrates that international trade is not a one-way street, not even in sectors which are exposed to fierce competition from cheap imports and which by no means rank among the technologically very advanced fields. Of the products of the capital goods industries, exports of which likewise grew impressively (by 18 %), more motor vehicles were exported – mainly to neighbouring European countries – as well as more electrical goods. Exports of mechanical engineering products, on the other hand, rose relatively little (by 11 %). This may have owed something to the price policy of that industry on foreign markets, for while the unit values of all German exports went up by only 2 % in 1976, the sales prices of mechanical engineering products, as measured by the unit values of exports, climbed by 8 %; this means that, if the appreciation of the Deutsche Mark is added, the prices of German mechanical engineering products abroad probably rose more than those of competing foreign goods. From mid-1976 onwards, however, the inflow of foreign orders to the mechanical engineering industry increased considerably, mainly because of some large-scale projects. The exports of the basic and producer goods industries went up relatively little in 1976, namely by 10 %. This was largely attributable to the world-wide slump in steel sales, which hit the German steel industry particularly hard because it is at an increasing competitive disadvantage in cost terms; German exports of iron and steel sank by 15 % in 1976. The share of the iron and steel industry in Germany's total exports came to only 5.5 % last year, against, for example, 8.6 % in 1974. Exports of chemical products, on the other hand, rose by 22 % in 1976 after the sharp decline in 1975; with a share of 13 % in total exports, they again approached the record figure of 1974.

Main items of the balance of payments

DM billion

Item	1969	1970	1971	1972	1973	1974	1975	1976
I. Current account								
1. Goods								
(a) Balance of trade								
Exports (f.o.b.) **1**	113.6	125.3	136.0	149.0	178.4	230.6	221.6	256.2
Imports (f.o.b.) **1**	92.8	102.9	112.7	121.7	137.7	171.9	177.1	214.5
Balance	+20.7	+22.4	+23.3	+27.3	+40.7	+58.7	+44.5	+41.7
(b) Supplementary trade items (balance) **2**	— 0.4	— 1.6	+ 0.3	— 0.6	— 0.1	— 1.3	— 1.2	— 0.5
Overall trade balance	+20.3	+20.8	+23.5	+26.7	+40.6	+57.4	+43.3	+41.2
2. Services	— 4.1	— 7.9	— 9.0	—10.2	—13.3	—15.9	—16.5	—16.0
3. Transfer payments	— 8.8	— 9.8	—11.5	—14.0	—15.8	—16.4	—17.5	—17.7
Balance on current account (1 plus 2 plus 3)	+ 7.5	+ 3.2	+ 3.1	+ 2.5	+11.5	+25.1	+ 9.4	+ 7.5
II. Capital account (outflow: —)								
1. Enterprises								
Short-term financial credits	— 0.2	+ 6.5	— 1.4	— 4.6	+ 0.6	+ 3.1	+ 2.5	— 0,0
Short-term trade credits **3**	+ 0.3	+ 2.0	+ 3.4	+ 1.0	+ 4.6	—12.4	+ 3.8	— 5.1
Direct investments	— 0.7	— 1.1	+ 0.2	+ 0.9	+ 1.4	+ 1.6	— 1.9	— 2.2
Other	— 0.7	+ 2.6	+ 2.9	— 0.8	+ 3.1	— 1.7	— 0.4	+ 0.6
Total capital transactions of enterprises (net)	— 1.3	+10.0	+ 5.2	— 3.5	+ 9.7	— 9.3	+ 3.9	— 6.7
2. Security transactions **4**								
German securities	— 1.2	+ 1.3	+ 2.0	+10.7	+ 6.5	— 2.5	— 1.6	+ 4.8
Foreign securities	— 9.5	— 2.0	+ 0.5	+ 4.0	+ 0.4	— 1.1	— 2.6	— 0.9
Total security transactions (net)	—10.7	— 0.7	+ 2.5	+14.7	+ 6.9	— 3.6	— 4.2	+ 3.9
3. Public authorities								
Loans to developing countries and international organisations	— 1.0	— 1.0	— 1.4	— 1.4	— 1.9	— 2.0	— 1.9	— 1.4
Direct and indirect assignment of borrower's notes **5** (inflow: +)	—	—	—	—	—	+ 1.2	+ 3.5	+ 4.3
Other	— 0.9	— 1.7	+ 0.4	+ 0.4	— 0.0	— 0.1	+ 0.3	— 1.0
Total capital transactions of public authorities (net)	— 1.9	— 2.7	— 1.0	— 1.0	— 2.0	— 0.9	+ 1.9	+ 1.9
4. Banks								
Long-term loan business	— 9.1	+ 0.5	+ 2.7	+ 1.9	+ 4.3	— 1.3	—11.5	— 4.8
Short-term money movements	+ 4.3	+ 7.9	+ 1.2	— 0.4	— 5.1	— 9.7	— 2.3	+ 6.7
Other	— 0.0	+ 0.0	+ 0.0	+ 0.2	— 0.5	+ 0.0	+ 0.0	— 0.0
Total capital transactions of banks (net)	— 4.8	+ 8.5	+ 3.9	+ 1.8	— 1.4	—11.0	—13.7	+ 1.9
Total capital transactions of all sectors (1 plus 2 plus 3 plus 4)	—18.7	+15.1	+10.6	+12.0	+13.2	—24.8	—12.2	+ 0.9
Long-term	—23.0	— 0.9	+ 6.3	+15.6	+13.0	— 5.8	—16.8	— 0.2
Short-term	+ 4.4	+16.0	+ 4.3	— 3.5	+ 0.3	—19.1	+ 4.6	+ 1.1
III. Balance of all statistically recorded transactions (I plus II)	—11.2	+18.3	+13.7	+14.5	+24.7	+ 0.3	— 2.8	+ 8.4
IV. Balance of statistically unclassifiable transactions (balancing item)	+ 0.9	+ 3.6	+ 2.7	+ 1.2	+ 1.7	— 2.2	+ 0.6	+ 0.4
V. Overall balance on current and capital accounts (III plus IV)	—10.3	+21.9	+16.4	+15.7	+26.4	— 1.9	— 2.2	+ 8.8
VI. Contra-entry to changes in the Bundesbank's external position **6**	— 4.1	+ 0.7	— 5.4	— 0.5	—10.3	— 7.2	+ 5.5	— 7.5
VII. Change in the Bundesbank's net external assets (increase: +)	—14.4	+22.7	+11.0	+15.2	+16.1	— 9.1	+ 3.3	+ 1.3

1 Special trade. — **2** Mainly merchanting trade and warehouse transactions for account of residents. — **3** Up to 1973 partly estimated. — **4** Portfolio transactions only, i. e. excluding transactions in shares for the purpose of acquiring direct investments. — **5** Regarding the sectoral classification see the Monthly Report of February 1976, pages 36/37. — **6** Contra-entry to changes in the Bundesbank's external position (foreign exchange account) which are not caused by current and capital transactions: mainly the allocation of IMF special drawing rights and changes in the DM value of the Bundesbank's external position owing to valuation adjustments.

Steep increase in German imports enhances world business activity

German imports, which had already supported international business activity in 1975, helped to strengthen the expansionary economic forces in the western world again in 1976. They increased by 21 % in value and some 17 % in volume, i. e. about three times as much as the percentage rise in the real gross national product in Germany. All major groups of commodities were affected by the higher demand for imports. The necessity to rebuild stocks, which had been run down during the recession, and in addition to provide for the continuous growth of consumption, caused enterprises to step up their imports of raw materials (+ 20 %) and primary products (+ 24 %). For the first time since 1973 the quantity of crude oil imported also grew, namely by 10 % (one reason being that stocks were built up towards the end of 1976 in anticipation of price increases by the OPEC countries as from January 1977). Imports of food products likewise went up sharply (+ 16 %), mainly because crops were poor in Germany owing to the unfavourable weather. The most striking feature is, however, the steep rise in imports of final products (+ 20 %). In this field foreign suppliers again clearly gained ground in the German market. Apart from the cyclical increase in demand in Germany, the chief reason for this was that the appreciation of the Deutsche Mark on the exchange markets gave imported finished products, in particular, a price advantage.

Particular rise in imports of capital goods

Imports of capital goods rose especially steeply (+ 23 %). German enterprises are apparently turning increasingly to foreign products when purchasing machinery and equipment. More motor vehicles, electrical consumer goods and textiles were also imported into Germany, although foreign cars, for instance, failed to maintain their share of the German market in 1976 (it dropped from 25 % to 22 %, calculated in terms of the number of vehicles). The western industrial countries profited most from the expansion of German imports of finished products, but the non-oil developing countries, where industrialisation is beginning to produce results, also benefited. Imports of consumer goods of simple design from the Far East grew particularly sharply.

Pressure of foreign competition reduces scope for passing on price increases

The headway made by foreign final products on the German market may create structural adjustment problems in some sectors, but from a macroeconomic point of view the advantages of this progressive integration process probably outweigh the drawbacks. In the first place, the scope for passing on price increases at home was narrowed markedly, as explained before, by the pressure of foreign competition: in 1976 the import prices of final products, as measured by the unit values of imports, were on an average no higher than a year before; in the fourth quarter they even dropped by 2 %. Secondly, Germany, like its trading partners, derived productivity gains from the growing international division of labour. By opening up its domestic market to foreign final products, Germany is moreover making a significant contribution towards maintaining the freedom of world trade, which is an essential precondition for the further development of German exports.

Large deficit on "invisibles"

Germany's deficits in service transactions with other countries and transfer payments were again very large in 1976, although at DM 33.6 billion they remained more or less unchanged compared with the previous year.[1] This war chiefly attributable to the sharp increase in the interest received on credits granted to foreigners. Even so, Germany remains the world's largest net importer of "invisibles". The deficits in this sector of the current account offset more than four fifths of Germany's trade surplus. This shows clearly that the sizable trade surplus must not be used on its own as a criterion of Germany's external position, but that it must always be seen in conjunction with the simultaneous deficits on services and transfer payments. After all, numerous services such as transport costs, commission fees, publicity and trade fairs are directly associated with merchandise transactions; without these "invisible" imports Germany's merchandise exports would not be possible. Moreover, some countries (e.g. Spain, Yugoslavia, Greece and Turkey) can finance their large deficits in trade with Germany only because they receive substantial amounts through tourism and the wage remittances of their nationals living in Germany. Germany has become the country with the highest industrial production in Western

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1 The freight and insurance costs associated with merchandise imports are included here, whereas they are not included in the import values.

Europe, in which many foreigners are involved; conversely, and to some degree as a consequence, it is not a particularly popular destination for holiday-makers. German travellers spent DM 22.5 billion abroad in 1976; after deduction of receipts from foreign visitors to Germany there remains an outflow of as much as DM 14.5 billion (net), which is DM 0.5 billion more than in 1975. The result of these locational preferences and disadvantages is that in the context of the growing international division of labour Germany has become – and will remain – a country with persistently high surpluses on merchandise transactions and large deficits on services and transfer payments. This conclusion is not invalidated by the fact that in one sector, namely the wage remittances of foreign workers to their home countries, the payments effected in 1976, at DM 6.4 billion, were slightly smaller than those made in 1975 because some foreign workers had returned home. The other services and transfer payments, consisting of a wide range of very diverse transactions such as indemnification payments and contributions to international organisations (notably the European Communities), were almost unchanged in 1976, at not quite DM 13 billion.[1]

German current account signals external near-equilibrium

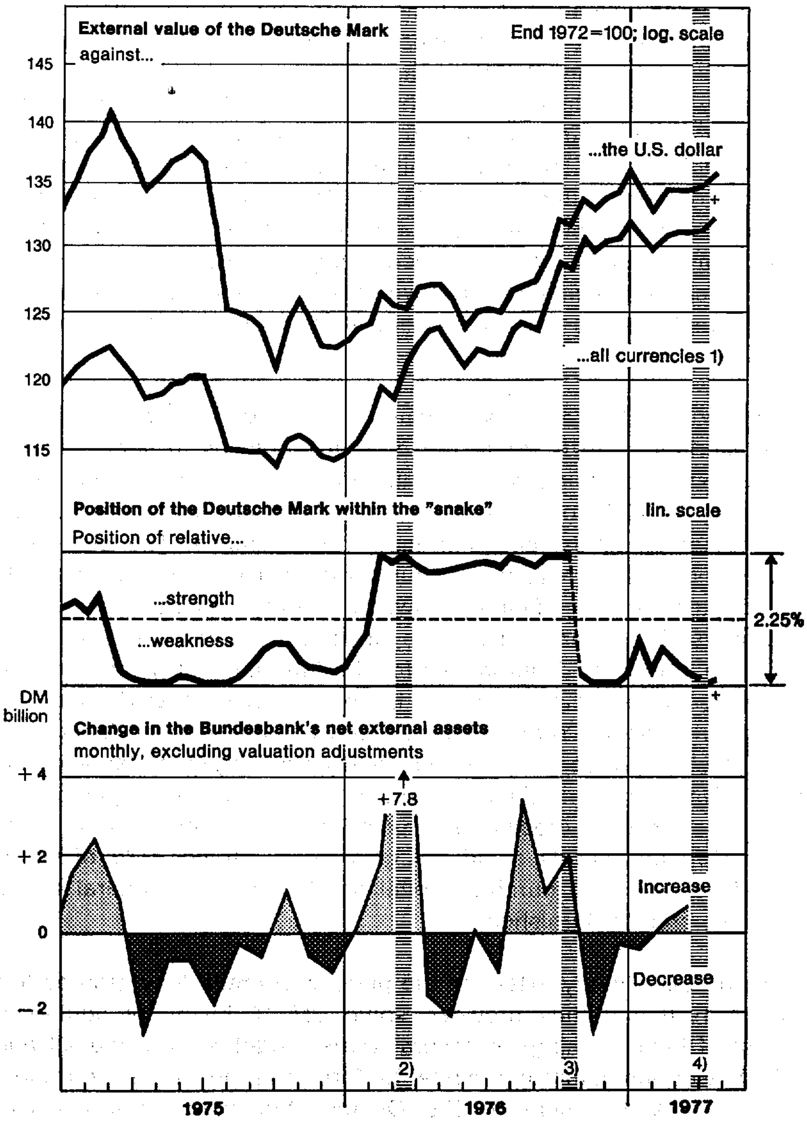
The current account figures show distinctly that Germany came fairly close to external equilibrium in 1976. While the current surpluses in some other surplus countries were still increasing, the German surplus on current account was declining once more. At 0.7 % of the gross national product, Germany's surplus was smaller than that of almost all other industrial countries. The current account figures at the beginning of 1977 imply a further decrease during this year. Germany has thus contributed significantly towards easing global balance of payments pressures. The remaining surplus on current account is no longer large enough to be a source of disturbances for the international balance of payments pattern. This seems especially true if it is borne in mind that Germany normally exports long-term capital. Year by year several billion Deutsche Mark flow out in the form of official development aid and usually also of private lending and direct investment. Private long-term financial credits were of no great significance in this context in 1976, but trade credits were most important; without them a considerable part of German exports could not grow at all (some 20 % of German exports consists of so-called durable capital goods, which in general can only be sold if adequate credit is furnished).

Capital exported through trade credits, direct investments and long-term bank loans

German enterprises sharply extended the periods of credit they granted to foreign customers in 1976 and thus provided some DM 10 billion of additional trade credits, most of them running for several years. Together with the advance payments which German importers made to foreign suppliers, new trade credits granted totalled DM 11 billion in 1976. On the other hand, enterprises received substantial amounts from abroad (DM 6 billion) in the form of advance payments from foreign clients for future German export deliveries. On balance, therefore, enterprises' trade credit transactions resulted in capital exports amounting to DM 5 billion in 1976. So-called direct investments, which are connected with external trade inasmuch as the safeguarding of markets is a prime motive for them, also led to net outflows of German capital in 1976. Approximately DM 6 billion, which is much more than in preceding years, was spent on German direct investments abroad. Foreigners, by contrast, invested only about DM 4 billion in enterprises and permanent interests in Germany; this was more than in 1975 but distinctly less than in earlier years. German direct investments in other countries thus predominated by just over DM 2 billion; until 1974 the trend had been in the opposite direction. It has now become more worth while for German enterprises to invest abroad, whereas the contrary applies to foreign investments in Germany, because in many cases a cost differential to the disadvantage of Germany exists for producers. German banks' long-term credit transactions with foreigners, which directly or indirectly serve to finance foreign trade, likewise

1 In the balance of payments concept which is used by the IMF in its Annual Report (and which in this respect is not supported by its Balance of Payments Manual) the German surplus on current account is shown higher because the so-called government transfers are not included in current transactions. This approach appears unsatisfactory since these funds, which are made available to other countries without any effective quid pro quo, must also be "earned" through receipts in current transactions. In terms of figures this is of little significance for most countries, but not for Germany. In 1976 Germany's government transfers amounted to DM 9.4 billion net. Of this amount, DM 4.7 billion represented contributions to international organisations (mainly the European Communities), DM 1.8 billion indemnification payments, and DM 3.0 billion pensions to persons living abroad.

Exchange rate movements * and external position of the Bundesbank



* Based on official spot rates (middle and end of month).- 1) Weighted external value of the Deutsche Mark in relation to the central rates of end-1972.- 2) Withdrawal of France from the European joint float on March 15, 1976.- 3) Realignment of exchange rates in the joint float as from October 18, 1976.- 4) Devaluation of the Scandinavian currencies in the joint float with effect from April 4.- + Latest position: April 15, 1977.

resulted on balance in exports of capital. These capital exports came to some DM 5 billion (net) in 1976, compared with as much as DM 11.5 billion a year earlier.

Speculative inflows in external security transactions...

In the other areas of Germany's external money and capital transactions speculative foreign exchange movements due to the exchange rate unrest in the spring and late summer of 1976 led at times to massive inflows of funds. This applies in the first place to security transactions, where foreigners were particularly attracted by German fixed interest securities. Encouraged by some rather steep price gains, and also by expectations of a further appreciation of the Deutsche Mark on the exchange markets, foreigners bought DM 3 billion of German bonds in 1976. Interest rate considerations alone fail to explain these purchases, since the yield on German securities was perceptibly lower than that on Euro-dollar bonds and Euro-DM bonds. All told, some DM 4 billion flowed into Germany in 1976 through security transactions; a year previously an equal amount had flowed out.

... and above all in banks' short-term capital transactions

The speculative influences were even more evident, however, in the short-term capital transactions of banks. During the phases of particular exchange rate unrest, i.e. in the spring and late summer, German banks received especially large amounts of short-term funds from abroad; this contributed greatly to the pressure on exchange rates and ultimately, owing to the interventions, to the foreign exchange inflow to the Bundesbank. After each of these periods of influx, funds invested at short term drained out of the banking system again, but over the year as a whole more than DM 6.5 billion (net) was imported. Banks' short-term external liabilities alone grew by DM 9.5 billion in 1976. The banks eventually passed on the greater part of the resultant inflow of foreign exchange to the Bundesbank, which under the regulations of the European narrower margins arrangement must intervene once the limit rates are reached in order to maintain the agreed exchange rate pattern. The banks increased their short-term external assets by less than DM 3 billion.

Massive intervention by the Bundesbank on the exchange market until mid-October 1976

In 1976, more than in the two preceding years, the Bundesbank was obliged to intervene on the exchange market over prolonged periods owing to tensions in the European narrower margins arrangement, although these interventions were not always as large as they had been in the period of fixed exchange rates in relation to the dollar. As a result of such transactions the Bundesbank's net external assets grew by DM 8.8 billion in 1976, whereas in each of the two previous years they had – with fluctuations – declined on balance by some DM 2 billion. The largest inflow occurred in February and March, immediately before the withdrawal of France from the narrower margins system. The second wave of inflows took place in the autumn; after the realignment of exchange rates in the European narrower margins arrangement in mid-October 1976, which for the Deutsche Mark meant an average revaluation of 2½ % against the other currencies participating in the joint float (if the middle rates are compared), the situation greatly eased and the Bundesbank was able to sell substantial quantities of foreign exchange. In the first few months of 1977 the exchange market in Germany was largely in balance: even before the new realignment in the European narrower margins arrangement at the beginning of April there were neither major exchange rate movements nor significant changes in the monetary reserves of the Bundesbank. This situation at the same time reflects the present basic state of the German balance of payments, which indicates external near-equilibrium. This means not only that foreign trade and payments are not adversely affecting domestic economic equilibrium but also that Germany is not contributing of its own accord to the external imbalance of other countries, be they surplus or deficit countries.

5. Problems in the medium term

(a) Reduction of unemployment

"Structural" components of unemployment impede the improvement of the labour market situation

In spite of the progress of the economic upswing the reduction in unemployment got off to a relatively slow start last year, as noted in the first section of this Report. By the end of March 1977 the number of unemployed persons, seasonally adjusted, had decreased by about 200,000 (to just under 1 million) compared with its peak, but at 4.3 % the ratio of unemployed persons to the aggregate dependent labour force has latterly still been high. After the cyclical trough of 1967 the unemployment figure declined more quickly; compared with its peak (mid-1967: 540,000) it nearly halved within one year and in mid-1969, i.e. after two years of economic upswing, it stood at only just over one quarter of its highest level in 1967. The comparatively weaker response last year – although the movement in the first 1½ years of the present upswing has in fact been only a little smaller – shows that in the last few years unemployment has owed less to cyclical factors than it did in 1967; in other words, "structural" unemployment has increased in importance. This is attested by the fact that the unemployment which has always existed among older persons and persons who are not completely fit has recently been augmented by other problem groups. According to a special survey made by the Federal Labour Office in September 1976, 103,000 young persons below 20 years of age were registered at the labour exchanges as being out of work in that month, or about 11½ % of the total number of unemployed. Compared with 1968, when economic conditions were comparable, this is a twelvefold rise in number; young persons accounted for 5 % of total unemployment at that time. The number of women in the middle age groups looking for jobs also increased sharply compared with 1968: at 358,000 they made up 40 % of all persons registered as unemployed in September last year against 41,000 (or 24 %) in September 1968. A large proportion of these women – 140,000 or 15½ % of all unemployed – were only interested in part-time work, mainly in the distributive trades or in office and administrative occupations, where many jobs have been eliminated in the last few years as a result of internal economies and rationalisation measures. By contrast, the number of unemployed older workers (between 55 and 65 years of age) has risen relatively little compared with 1968; in September 1968, at 80,000, they were only slightly less numerous than in September 1976 (106,000). Of the total number of unemployed persons registered in September last year (nearly 900,000), about half must be assigned to one of the problem groups – older persons or persons who are not completely fit, young persons, and women looking for part-time work. This disregards the fact that part of the unemployment is explained by regional differences in economic structure and that normal labour turnover always involves a certain minimum of temporary unemployment, even in boom periods, although there is no doubt some overlapping with the above-mentioned problem groups. On the whole, however, it is found that the purely cyclical component of unemployment accounts for only about half of those out of work. This finding by no means reduces the significance of the social problems faced by unemployed persons – on the contrary, from the social point of view the structural causes are more serious as they can be put right only slowly – but it makes it clear that the present level of unemployment cannot be corrected by means of cyclical policy measures alone.

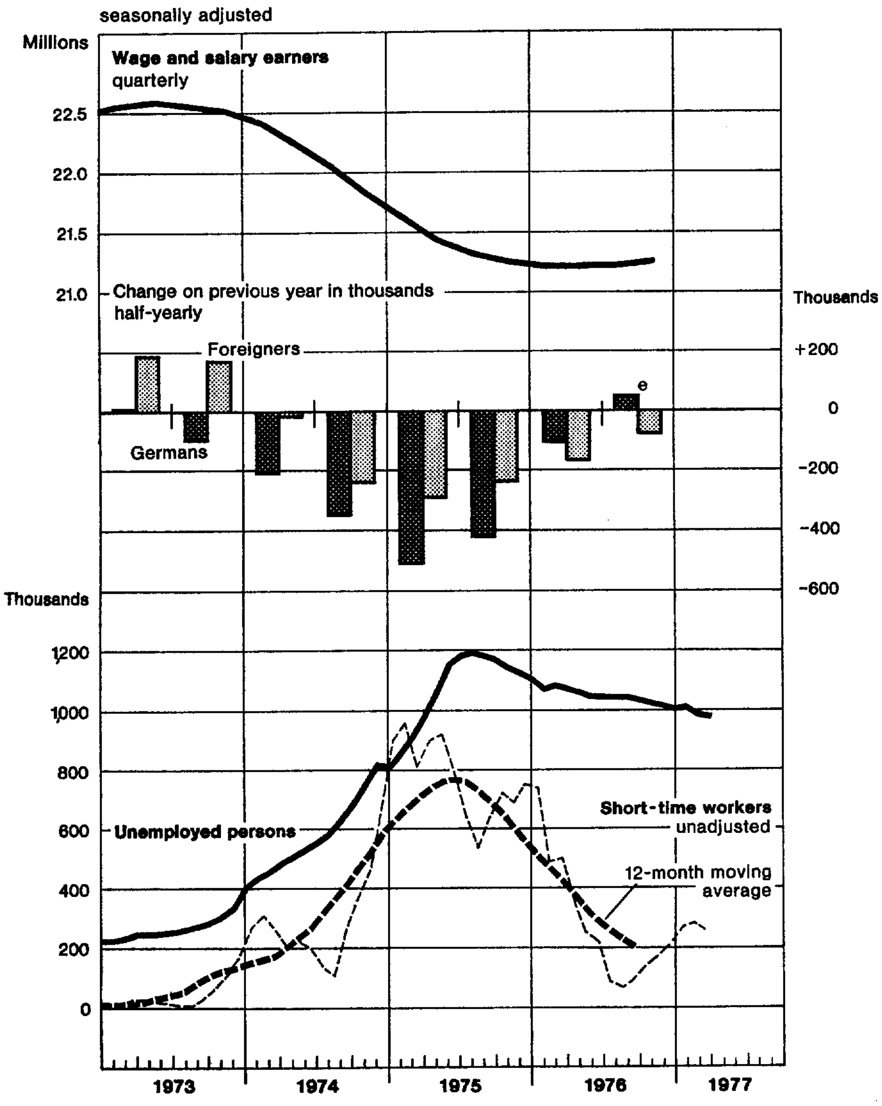
Labour market problems partly due to earlier inflationary exaggerations

The causes of today's labour market problems undoubtedly date back in part to the period of inflationary exaggerations in the early seventies. This is true for instance of the high level of unemployment among women, many of whom started work at the beginning of the seventies, when there was an extreme shortage of labour, and lost their jobs when the tensions on the labour market eased; they then returned to the domestic sphere. Not all of these women have applied to the labour exchanges for new employment, but some of them are definitely interested in being placed in a new job. However, the possibilities open to the labour exchanges are often limited in such cases, for the place of residence of these women is commonly determined by their husband's job and they frequently wish to take part-time work only, so that the demand for part-time jobs is far larger than the supply. It also owes something to inflation-induced excess demand in the past that in the early seventies many school-leavers were less interested in qualified vocational training – with relatively low income at first – than in the comparatively large amount they could earn at once as unskilled workers. This certainly contributed to the fact that today there is a shortage of skilled workers in some fields and a glut of less qualified labour lacking full vocational training. Even among the younger unemployed persons (up to 20 years of age) there are many – more than half – who have not completed a vocational training course.

Excessive level of costs depresses the labour market

Another major set of causes of the present labour market problems is the movement of wages in the first half of the seventies. Wages and salaries per employee rose by an annual average of 10½ % between 1970 and 1976, whereas productivity (as measured by the real gross national product per employed person) grew by only 3½ % in the same period. Unit labour costs alone have thus risen at the rate of about 6½ % a year since 1970. As the cost of materials, and particularly of imported raw materials, soared at the same time, overall costs increased much more than could be offset by higher sales prices. Enterprises' profit margins therefore narrowed considerably in that period. The business community was forced to respond to the heavier cost pressure by embarking on substantial rationalisation measures. This meant the closure of unprofitable plants, economies (particularly in the administration of firms), the transfer of production to countries with a relatively low wage level, the replacement of expensive home-produced components by cheaper imports, and finally greater concentration on the manufacture of advanced ("sophisticated") products, which however often call for a more highly qualified workforce. In principle, of course, such processes

Labour market



e Estimated.

have long been an integral part of economic development, but the pressure of wage costs has undoubtedly accelerated them. This applies particularly to the exploitation of the cost advantages offered by imports and the transfer of production to foreign countries. At least in industry the level of wages, including indirect wage costs, in Germany is one of the highest in the world (expressed in Deutsche Mark). According to findings of the EEC Commission, unit labour costs in industry in Germany have risen more sharply than in other major industrial countries since 1970, if exchange rate changes are taken into account. In 1976, admittedly, unit labour costs went up only a little while business earnings increased strongly again, but this only made up for a (significant) part of the preceding loss of earnings and the effects on capital formation and especially employment remained relatively small.

Rising unemployment owing to pay agreements that even out incomes

For the German labour market and especially for the problem groups of less qualified unemployed persons (school-leavers, unskilled workers and some female employees) an additional handicap was that – understandably in social policy terms – pay in the lower wage grades has been raised relatively more than in the higher grades for a considerable period owing to the basic sums and the like agreed in wage negotiations. In the metal-processing industry of North Rhine-Westphalia, for example, pay rates in the lowest wage grade rose by an average of 11½ % a year between 1970 and 1976, whereas those in the highest grade increased by "only" 9½ %. The economic consequence was that labour became much more expensive precisely in those sectors in which on the one hand manpower can be reduced relatively easily by rationalisation and technological progress while on the other the number of unemployed persons is especially large; roughly half of those out of work in September 1976 were persons who had not completed a vocational training course, i. e. they were looking for a job in the lower wage grades. Unless wage policy takes account of the special situation of these employees with little or no vocational training, the size of this group of unemployed persons will be very slow to decline.

Labour market also depressed by unwelcome side-effects of social progress

In conclusion, it is not impossible that the sluggish pace of the reduction in unemployment may be partly ascribable to certain unwelcome side-effects of useful and generally accepted measures of social policy. There can be no doubt, for instance, that the employment prospects of older unemployed persons, especially if they are not completely fit, have been adversely affected by the fact that enterprises attach particular importance to filling vacancies with younger, healthy employees because of their obligation to grant full pay to wage earners during sickness – an obligation which is certainly an important social advance. Even the statutory quotas for the employment of physically disabled persons are frequently not complied with. The raising of the standards of internal training and of the demands made on instructors together with the sharp increase in trainees' pay – measures designed to facilitate the transition from school to working life – have pushed up training costs for enterprises and tended to contribute to a reduction in the number of traineeships offered. Finally, for the person affected, the size of the income available in the event of unemployment – comprising unemployment benefit, children's allowances, possibly housing allowances and payments under the Federal Training Promotion Act – is a "market factor" which significantly influences his decision as to whether or not to look for a new job and perhaps accept a relocation when taking up new employment. The consequence is that the balance between supply and demand on the labour market is often imperfect or at least slow to materialise.

Solution to labour market problems by consensus on income trend compatible with stability . . .

One important precondition for the reduction in unemployment is as broad a consensus as possible between management and labour, permitting a balanced development of incomes free from "pointless distributional struggles" (Council of Economic Experts). In addition, the problem of "structural" unemployment calls for selective measures to improve the situation of the "problem groups", such as have already been announced and initiated by the Federal Government. These include measures designed to mitigate the undesirable side-effects of the social security system on the labour market. The total number of vacancies will presumably rise if the risk of enlarging the number of employees – also with respect to only temporary jobs in individual cases – does not become too great.

. . . and improvement in the basic conditions for investment

The future supply of jobs depends largely on how rapidly enterprises' propensity to invest increases. Present and anticipated labour costs are a major, but not the only, determinant of the business community's investment decisions. An important part is also played, for example, by questions of safeguarding the energy supply and energy costs. There can be no doubt that the uncertainty currently affecting energy policy as a result of the debate on the construction of power stations has an adverse impact on enterprises' longer-term investment plans. A further, no less difficult set of problems is the mounting burden imposed on the business community by measures to protect the environment: additional capital expenditure for this purpose – spending that has virtually no effect on capacity – increases the capital input per unit of production or reduces the productivity of capital. Current expenditure on environmental protection is an additional cost item which must be taken into account when considering the overall pattern of enterprises' costs and earnings. These factors have undoubtedly heightened the psychological barrier impeding investment decisions, particularly as it is difficult to say which burdens in the field of environmental protection and energy supply are to be expected in future. Removing these uncertainties swiftly is a priority task for economic policy, and the energy policy guidelines adopted by the Federal Government in March 1977 in conjunction with the medium-term

Structure of unemployment

at end-September

Item	Unemployed persons in thousands				Percentage of total			
	1974	1975	1976	Memorandum item: 1968	1974	1975	1976	Memorandum item: 1968
Young persons (under 20 years of age)	69.8	115.8	102.6	8.3	12.6	11.5	11.4	4.9
Men (20–55 years of age)	215.5	425.7	332.0	41.8	38.8	42.3	37.0	24.5
Women (20–55 years of age)	207.0	362.2	357.6	40.7	37.2	36.0	39.8	23.9
Older persons (55–65 years of age)	63.6	102.9	106.0	79.5	11.4	10.2	11.8	46.7
Unemployed persons, total 1	555.8	1,006.6	898.3	170.2	100	100	100	100
of which, problem groups:								
Young persons (under 20 years of age)	69.8	115.8	102.6	8.3	12.6	11.5	11.4	4.9
Unemployed persons who are not completely fit 2 (20–55 years of age)	78.5	142.4	135.2	.	14.1	14.1	15.1	.
Women who are looking for part-time jobs (20–55 years of age)	80.6	134.9	140.1	.	14.5	13.4	15.6	.
Older persons (55–65 years of age)	63.6	102.9	106.0	79.5	11.4	10.2	11.8	46.7
Problem groups, total	292.5	496.0	483.9	.	52.6	49.3	53.9	.

1 Excluding unemployed persons over 65 years of age (1968: 4,286; 1974: 1,125; 1975 and 1976: no data). — **2** Only half of the number of unemployed women who are not completely fit has been included in order to avoid overlapping with the group of women who are looking for a part-time job.

"programme of future investments" are major steps in this direction. Here, too, there should be general agreement that the higher cost of energy and environmental protection must be borne by all socio-economic groups if the propensity to invest is to strengthen further in spite of the above-mentioned higher barrier. Economic and fiscal policy can contribute to this by continuing the efforts to consolidate the government budgets, thus tending to ease the credit markets and improving enterprises' access to outside funds. The fiscal programme announced in the Government's policy statement of December last year includes further measures designed to stimulate capital spending, in particular the planned reduction in the rates of property tax and the extension of section 7 (b) of the Income Tax Act to cover old housing. Further fiscal measures to encourage investment are under discussion. The "programme of future investments" of the central, regional and local authorities will also help to improve the basis for private investment decisions. On the whole there is therefore no reason for pessimism about the future course of capital investment. However, an essential requirement for any further increase in the willingness to invest is a consensus that the unavoidable rise in overall costs — whether for energy and environmental protection or for safeguarding the future in other respects — must be distributed equitably among all groups. Should the impression arise that only enterprises are having to shoulder the additional costs, these measures would lessen the propensity to invest and cloud employment prospects once again.

Correction of the distribution ratios in 1976 inadequate as a basis for a lasting upswing

Enterprises' income position undoubtedly improved in 1976. Entrepreneurial and property income rose relatively steeply last year, i. e. by 14 %, which was more than wage and salary income (7½ %), for the first time since 1968. The overall wage ratio, i. e. the ratio of income from wages and salaries to national income, accordingly declined, after adjustment for changes in the structure of employment, from its record level in the two preceding years (71½ %) to 70 % in 1976, which roughly corresponded to the level of 1973 but not to that of earlier years (average between 1960 and 1969: 68 %). This correction of the income distribution ratios was probably inadequate as a basis for a sustained upswing.

First wage decisions in 1977 hardly commensurate with the overall economic situation

Moreover, the first results of the 1977 wage round give grounds for fearing that the wage cost pressure in the economy may intensify this year: the pay agreements so far reached in trade and industry have embodied wage and salary improvements which, inclusive of all subsidiary agreements and prior burdens, will lead on an annual average to a distinctly steeper rise in wage and salary income, and thus also in labour costs, than a year before. Agreements on such wage increases appear to ignore the fact that the cost of living went up much less than anticipated in 1976. Whereas at the beginning of 1976 wage increases were agreed on the assumption of a $5\frac{1}{2}$ % price rise in that year, at the start of the 1977 wage round price rises of only about 4 % had to be allowed for, and half a percentage point of this rate is attributable to tax increases which management and labour should not take as a reason for raising wages. The prospects of taking a further step in the direction of price stability were moreover good at the beginning of 1977, but the outcome of the new wage round to date has clouded them. It is already clear that several enterprises have taken the opportunity provided by the recent large wage and salary improvements to raise their sales prices sharply wherever the market permitted. A new increase in wage cost pressure would also be quite inappropriate in the present situation on the labour market. If additional costs cannot be passed on in prices, as is likely to be the case in numerous industries that are exposed to keen competition on domestic and foreign markets, firms have no choice but to make internal cuts, not least in the personnel sector. There is thus a very real danger that the reduction in unemployment in Germany will be hampered as a result. This in turn would adversely affect or even seriously jeopardise further progress towards overall economic consolidation – progress which is supported by the economic policy of the Federal Government and the Bundesbank and which made good headway in 1976.

The present situation in the field of wage policy, which of course does not allow a final judgment to be passed on the behaviour of management and labour in this year's wage round but which does reveal the existing risks, shows how difficult it is to reach a general consensus among those mainly responsible on key issues of economic policy. Recent experience has demonstrated that all those involved in economic activity benefit from observing the basic conditions for the national economy, which are largely determined by economic policy. Not just monetary policy but the entire economic strategy in Germany, which is aimed at gradually lessening unemployment through strong economic growth while simultaneously reducing price rises further, is thus about to be put to the test. The success achieved so far will continue only if this strategy is accepted in principle by management and labour, too, and backed by the systematic use of measures of competition policy.

(b) Consolidation of the public budgets

Structural deficit arises during the recession . . .

One of the principal unsolved future problems of economic policy is the consolidation of the public budgets. On the surface it looks as if the main cause of the present financial situation of the public authorities was the abrupt growth of the deficit during 1975, when it reached DM 70 billion or 7 % of the gross national product. The determining factors have, however, been latent in developments since the beginning of the seventies, like a fire that had smouldered for a long time largely unnoticed and then flared up all of a sudden in the 1975 recession. At that time it became obvious to everybody that the government, too, was ultimately a loser in the inflationary distribution struggle at the beginning of the seventies.

. . . owing to sharp increase in the expenditure ratio . . .

The decisive factor in the formation of these serious deficits was the great acceleration in the growth of expenditure during the seventies. Between 1972 and 1975 total public spending mounted on an average by almost 14 % a year, and thus 1.7 times as fast as the gross national product; in the preceding four-year period between 1968 and 1971 the growth rate had been slightly lower than that of the national product. As a result there was a sharp increase in the expenditure ratio. While total government spending had accounted for approximately 40 % of the gross national product in the second half of the sixties, the proportion went up to nearly 45 % in 1974 and as much as $48\frac{1}{2}$ % in the recession year 1975. Unlike the situation after the recession of 1967, however, there are so far no signs of a corresponding decline in the expenditure ratio in the wake of the economic upswing; in 1976 it still stood at $47\frac{1}{2}$ % and in 1977 – at 47 % – it is not likely to fall much below that level. In the early seventies the budgets were heavily burdened by the expansion in staff costs and the steep rise in construction prices, which together account for nearly one half of the central, regional and local authorities' expenditure. The accelerated measures in the social and educational fields reinforced the tendency for the expenditure ratio to increase. The far-reaching decisions necessary for this purpose were based on medium-term plans in which not only strong real economic growth without setbacks but also sharp rises in prices and incomes were projected into the future, thus creating deceptive financial margins, especially in the case of the social security funds.

... and unsatisfactory growth of receipts

The steep increase in expenditure was initially accompanied by a corresponding rise in the receipts ratio, partly because of the progressive nature of the wage and income tax scales. However, the government could not avoid relinquishing a considerable proportion of these additional tax receipts in the 1975 tax reform – viz. roughly DM 15 billion in the first year of the reform. Moreover, it became evident that the medium-term growth of receipts must be put at a much lower rate. Hence the resultant gap between the level of expenditure, which can be reduced only with difficulty, and the much lower level of receipts has proved to be fairly long-lived.

Deficits still high in 1976

In the course of the 1976 economic upswing the deficit declined quite markedly (to DM 52 billion or about 4½ % of the gross national product), but not nearly as fast as it had risen. The deficit of the central, regional and local authorities alone contracted by DM 17 billion to DM 49 billion, but despite the consolidation measures taken in the meantime under the Budget Structure Act it remained far above the level tolerable in the medium term. The reduction in the deficit in the past year was due, on the one hand, to the unexpectedly steep rise in tax revenue, which owed much to the fact that the central, regional and local authorities, in view of their tight budget situation, apparently tried to make good the investment grants they paid to enterprises by drawing on existing "assessment reserves". On the other hand, the Federal and Länder Governments and local authorities endeavoured with some success to curb the expansion of spending, which – as mentioned – was possible only at the cost of a fall in government investment. As far as the structure of expenditure is concerned, the dual strategy introduced in the autumn of 1975 – pressing on with the consolidation of the budgets and at the same time taking account of the below-average utilisation of overall production potential by stepping up government investment – thus did not produce entirely satisfactory results.

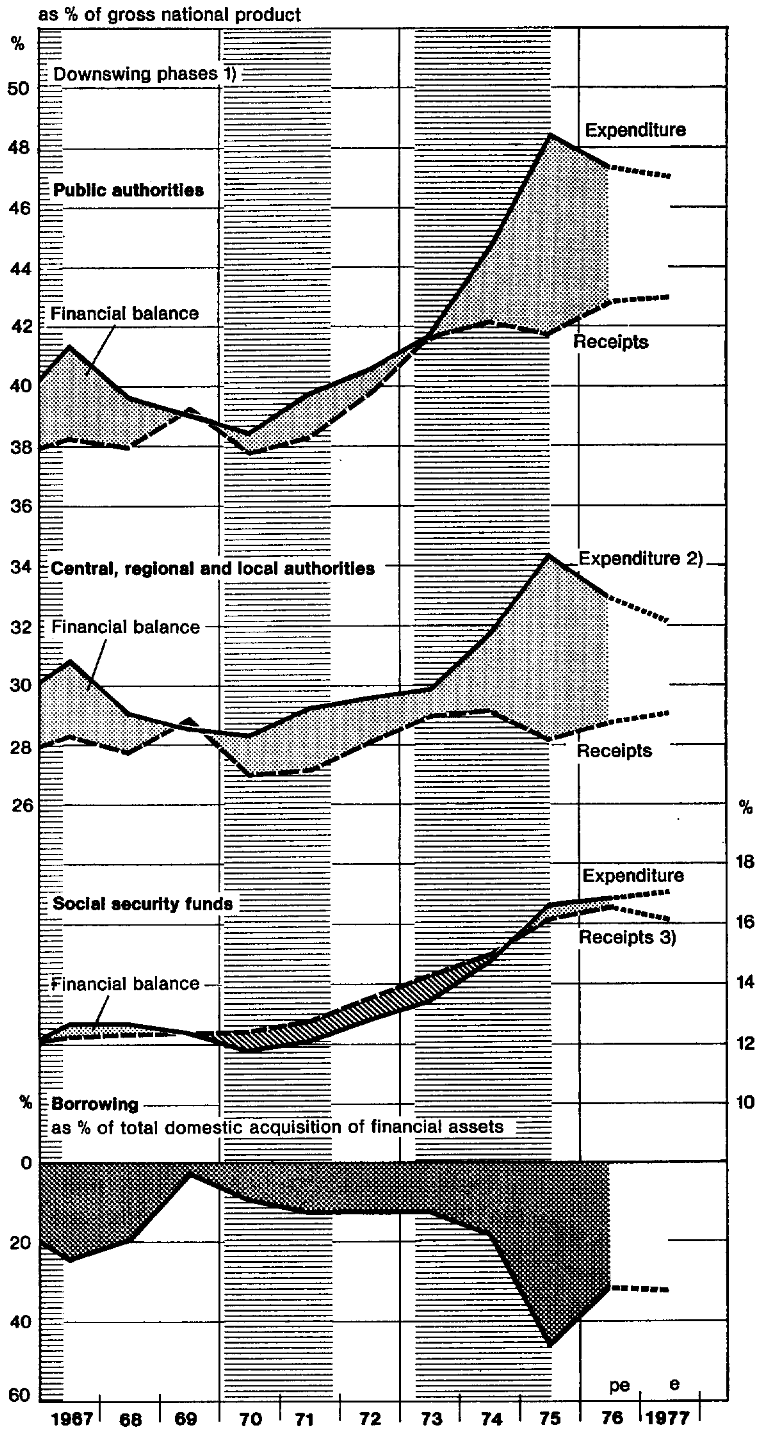
Local authorities' deficits run down furthest

The local authorities made the most progress in consolidating their budgets; at roughly DM 4 billion, their deficit fell to about a third of the 1975 level and thus was smaller than in the early seventies. More than in the case of the other authorities, this decline was at the expense of capital expenditure, which made up only 30% of the local authorities' total spending in 1976 compared with 40 % in 1970. The Länder Governments' deficit dropped from DM 21 billion to just over DM 15 billion during 1976. The cash deficit of the Federal Government, which had expanded fastest owing to the recession and the tax reform, decreased more slowly, namely from DM 34 billion to DM 30 billion. Although the consolidation measures introduced under the Budget Structure Act (especially those designed to reduce the grants needed by the Federal Labour Office) significantly eased the Federal Government's financial position, considerable extra expenditure also arose, above all on interest payments, grants to the pension insurance funds and savings bonuses.

Delayed deficits of the social security funds ...

The deficits of the social security funds, which are rooted in the inflationary trends at the beginning of the seventies, emerged only with a great delay, mainly because of the pension adjustment mechanism. Already in the early seventies financial developments in this field differed from those among the central, regional and local authorities in that financial surpluses were recorded at first as a result of the wage explosion and the correspondingly steep rise in contribution receipts (but delayed pension adjustments). These surpluses had an anticyclical effect and were thus in accordance with the system. The fateful factor was that longer-term projections prepared on that basis, in which the obvious risk of a subsequent recession and its impact on the pension funds' finances was disregarded and a cumulative financial margin of roughly DM 200 billion was consequently computed for the years up to 1985, served as an occasion for expanding benefits considerably in 1972. This imposed burdens on the pension insurance funds which

Public finance in the context of the national economy



1) As measured by the decline in the trend-adjusted industrial production figures (excluding construction and energy).- 2) Including grants to social security funds.- 3) Including grants from central, regional and local authorities.- pe Partly estimated.- e Estimated.

have in the meantime proved to be unacceptable in the long run. In view of the progressive reduction of the inflation component in the economy — and not least in wage increases — and the lower level of employment since 1975, the large, lagging pension adjustments result in growing deficits for the pension insurance funds. Although 1976 was a year of economic recovery, the deficit of the pension insurance funds rose further — a tendency that will most probably continue in 1977.

... due to lagging pension adjustments

This demonstrated that the pension insurance system does not always have an anticyclical effect. Given the present adjustment lag of three years and with unchanged legal provisions, it would in general exert a strictly anticyclical impact only if business cycles lasted six years and were largely symmetrical. But if, as in the past, incomes rise in line with the trend, and if wages do not initially respond at all to the economic slowdown (as in 1974), the lagging pension adjustments continue far into the period when, as economic activity recovers and inflationary tendencies wane, wages go up at a slower pace. Under these circumstances the shift in favour of pensioners in the relative distribution of income in Germany – a shift which has been evident for several years – continued in 1976. Besides the fact that pensions rise faster, in percentage terms, than gross wages and salaries, it is significant in this connection that pensions are virtually tax-free, whereas gross wages and salaries, which represent the yardstick for the adjustment, were subject to a sharply growing tax burden. Pension expenditure per recipient rose by an average of 4 % in real value (i. e. after allowing for the decline in the value of money) between 1973 and 1976, while real net income from wages and salaries per employee increased by only 1 % per annum. In 1972, when the adjustment date was brought forward by six months, the current pension of an insured person whose gross earnings had always been equivalent to the average and who had been insured for a period of 45 years came to 62 % of average net earnings at that time, but by 1976 this proportion had risen to about 70 % and with the planned adjustment in mid-1977 it will probably reach about 73 % in the current year (see the chart opposite). Another factor that has pushed up the expenditure of the pension insurance funds is that the number of pensioners has soared in recent years. This was due not only to demographic tendencies but also to the introduction of the flexible retirement age scheme.

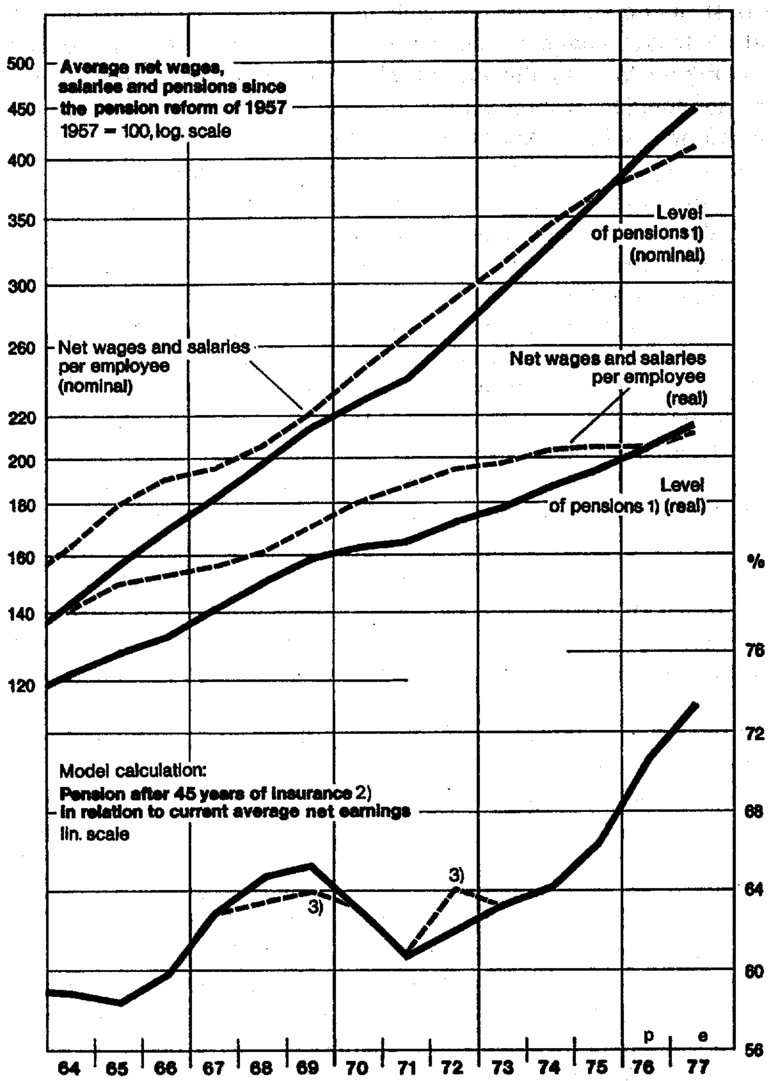
Deficits not reduced sufficiently during the economic upswing

A sustained reduction in the share of government spending in the national product has thus been hampered by the social security field during the upswing phase since mid-1975 owing to the far more than proportional growth of pension payments. The indispensable rundown of the public deficits to a size that is acceptable in the medium term is thus making little progress in the absence of major fiscal and social measures. This combination of continued large deficits of the central, regional and local authorities and growing deficits of the social security funds puts the Federal Republic of Germany in a more difficult position than other industrial countries which have not moved so markedly into deficit in recent years (see the table on page 46). In 1977 the reduction of the public deficit is unlikely to make much further headway, although it ought really to do so if the economic recovery continues. The deficit of the central, regional and local authorities will probably decrease further (from DM 49 billion in 1976 to an estimated DM 40 billion), primarily owing to the cyclically-induced rise in tax revenue, but the gap between the receipts and expenditure of the social security funds will widen by an estimated DM 7 billion to DM 10 billion. Of the measures planned by the Federal Government to improve the financial position of the pension insurance funds, only the cuts in spending on pensioners' health insurance will become effective in 1977. The overall government deficit is therefore unlikely to change much in comparison with 1976 (DM 52 billion).

Growing burden on the credit markets in 1977

In spite of their reduced deficit the central, regional and local authorities' credit demand in 1977 may be expected to remain about as large as it was last year when considerable cash reserves could be drawn on, while this will hardly be possible in 1977. By itself this would not raise so many problems, but the growing financial requirements of the pension insurance funds must also be considered; they are due to be met partly out of deposits maintained with the banking system and normal redemption payments received and partly out of sales of securities and premature redemptions of Federal Government inscribed stock, which likewise imposes a burden on the credit market in one way or another. In the aggregate, therefore, the public authorities will raise an estimated DM 50 billion – i. e. somewhat more than in 1976 – in the credit market this year if the deficit remains at about last year's level. At the same time, however, enterprises will again make larger calls on the market since, as their propensity to invest increases further, their financial requirements will probably rise distinctly faster than the resources available from depreciation and undistributed profits. As saving by households

Level of pensions compared with the earnings of employees



1) Taking account only of annual adjustments to current pensions, not of structural improvements in benefits.- 2) Current pension of an insured person whose earnings have always been equivalent to the average and who has been insured for the period of 45 years typical of a full working life.- 3) Inclusive of pensioners' contributions to the cost of their health insurance, as levied in 1968/69 and repaid in 1972.- p Provisional.- e Estimated.

will hardly increase correspondingly, this situation undoubtedly involves some risks even though no strains have arisen on the credit market up to now.

Continued consolidation the primary task for fiscal policy

The crucial problem for fiscal policy in the near future thus remains the reduction of the public deficit to proportions that are tolerable in the medium run. The financial margin for the public sector in these circumstances is probably slightly greater than it was under earlier conditions, primarily because households' saving ratio is showing an upward trend and because housing construction, where the share of outside finance is especially large, will not nearly regain the level of the early seventies. There is thus some evidence to suggest that the cash deficit of all public authorities that would be justifiable in the event of a return to full capacity utilisation can now be put at around 2 % of the gross national product (i. e. – relative to the national product of the years 1978 to 1980 – at roughly DM 30 billion). A glance at the deficit to be expected in the current year (about 4 % of the gross national product) reveals that great efforts still have to be made to reduce the government deficit in order to come near this figure. The central, regional and local authorities intend to achieve the necessary consolidation partly by continuing to increase their expenditure at a disproportionately slow rate, partly by tax measures (although, after various reliefs in other fields have been deducted, only

Finances of the public authorities

Item	1973	1974	1975	1976 **pe**	1973	1974	1975	1976 **pe**
	DM billion				Percentage change on previous year			
I. Central, regional and local authorities								
1. Expenditure								
Staff costs	93.6	107.4	116.6	123	+ 14.7	+ 14.8	+ 8.5	+ 5.5
Pensions and assistance grants	39.7	47.0	70.0	72.5	+ 2.0	+ 18.6	+ 48.8	+ 3.5
Fixed investments **1**	41.0	45.1	45.7	43.5	+ 5.5	+ 10.0	+ 1.2	— 4.5
Indirect investments **2**	20.9	22.3	24.1	25	+ 11.6	+ 6.8	+ 7.8	+ 3
Other expenditure	82.3	95.5	102.6	112	+ 20.0	+ 16.0	+ 7.4	+ 9
Total	277.5	317.4	358.9	376	+ 12.5	+ 14.4	+ 13.1	+ 4.5
of which								
Federal Government	123.6	138.2	164.2	171.5	+ 12.2	+ 11.8	+ 18.8	+ 4.5
Länder Governments	114.8	132.4	145.1	153	+ 15.8	+ 15.3	+ 9.6	+ 5.5
2. Receipts								
Tax revenue **3**	226.7	242.3	242.1	268	+ 15.1	+ 6.8	— 0.1	+ 10.5
Other receipts	42.7	48.4	52.0	59	+ 13.6	+ 13.6	+ 7.3	+ 13.5
Total	269.4	290.7	294.0	327	+ 14.9	+ 7.9	+ 1.2	+ 11
of which								
Federal Government	120.9	128.1	130.1	141.5	+ 13.8	+ 5.9	+ 1.6	+ 8.5
Länder Governments	113.7	124.9	125.0	137.5	+ 16.2	+ 9.9	+ 0.0	+ 10
3. Cash deficit (—) **4**	— 9.0	— 27.4	— 65.9	— 49	.	.	.	.
of which								
Federal Government	— 2.9	— 10.1	— 34.0	— 30	.	.	.	.
Länder Governments	— 1.9	— 8.0	— 21.2	— 15.5	.	.	.	.
II. Social security funds 5								
1. Expenditure **6**	125.0	148.0	174.3	191	+ 16.2	+ 18.3	+ 17.8	+ 9.5
2. Receipts	132.5	149.3	169.3	188	+ 17.1	+ 12.7	+ 13.4	+ 11
3. Cash surplus (+) or deficit (—) 7	+ 7.9	+ 1.6	— 4.9	— 3	.	.	.	.
III. Public authorities, total								
1. Expenditure	387.2	445.8	506.1	538.5	+ 14.4	+ 15.1	+ 13.5	+ 6.5
2. Receipts	386.6	420.4	436.2	486.5	+ 16.5	+ 8.7	+ 3.8	+ 11.5
3. Cash deficit (—)	— 1.1	— 25.7	— 70.8	— 52	.	.	.	.

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, direct 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. — **pe** Partly estimated. Discrepancies in the totals are due to rounding.

Financial balances of the public sector* as % of nominal GDP (GNP)

Country	Average of the years 1968–1972	1973	1974	1975	1976 p
Federal Republic of Germany	+ 0.2	+ 1.4	— 1.3	— 5.8	— 4
Italy	— 4.1	— 6.4	— 5.4	—11.1	— 8
United Kingdom	0.0	— 3.6	— 4.4	— 5.2	— 6
Japan 1	+ 1.8	+ 2.7	+ 0.2	— 4.4	— 4
United States	— 0.8	+ 0.2	— 0.3	— 4.5	— 3.5
France	+ 0.4	+ 0.6	+ 0.6	— 2.3	— 1.5

* Central, state and local governments and social security funds as defined in the UN System of National Accounts. Source: OECD. — **1** Fiscal year: April 1 to March 31. — **p** Provisional.

a much smaller part of the rise in value-added tax planned by the Federal Government for 1978 would remain for lowering the deficit). According to its medium-term fiscal plans the Federal Government proposes to run down its deficit progressively to DM 16 billion or 1 % of the national product by 1980. Since the deficits of the Länder Governments and local authorities, which together will probably amount to just on 1½ % of the gross national product in the current year, are likewise to be reduced according to the medium-term plans, the above-mentioned guideline of 2 % of the gross national product will be approached provided that a balance between the receipts and expenditure of the social security funds has been achieved by then.

The degree of improvement in the pension insurance funds' finances, and whether equilibrium will be restored in the medium run, depends on the extent to which the phased measures planned by the Federal Government are implemented and on whether longer-term changes in the law governing benefits are approved. As the Social Advisory Council, which includes a representative of the Bundesbank, explained in the report it submitted in February, there is a certain risk that the (fairly far-reaching) statutory measures so far envisaged to consolidate the pension insurance funds' finances will not quite suffice. The risk derives mainly from the assumed economic trends. The programme to improve the pension insurance funds' financial basis was drawn up on the assumption that wages and salaries would increase at the rate of 7½ % a year until 1980 and that the unemployment ratio would have dropped below 3 % by then. It is unlikely, however, that actual developments will be so steady, even though economic policy, and not least monetary policy, are aiming at further continuity. Greater progress in the fight against inflation might also mean that the inflationary component of wage increases turns out smaller than has so far — with annual wage rises of 7½ % — been assumed. But if costs really went up so much (or even more), this might impede the reduction of unemployment. All these factors have to be taken into account to prevent the reserves needed to offset fluctuations in the pension insurance funds' receipts and expenditure from being underestimated. It is in this sense that the objections to the proposal to provide for a statutory "fluctuation reserve" equal to only one month's expenditure are to be understood. The Social Advisory Council unanimously advocated the retention of a compulsory reserve amounting to three months' expenditure. If it transpires that the reserves fall below the three months' level not just for cyclical reasons and hence only temporarily, this should continue to serve Parliament as a warning to improve the financial position for the future. The retention of the three months' reserve would not mean, of course, that the pension insurance funds will make a significant contribution to overall capital formation in the years ahead; instead, it would primarily prevent a further rundown of assets to finance consumption expenditure, such as occurred in 1976 and will probably happen again on a far greater scale in 1977.[1] Another reason why it is urgently necessary to curb the deficit trends in the pension insurance

1 The problems arising in the shorter and medium term for the pension insurance funds' finances were analysed by the Bundesbank in its Monthly Report of February 1977, page 22.

funds' finances is that it is not to be expected that the central, regional and local authorities will be able to provide all or even most of the additional funds needed for the "programme of future investments" (which totals DM 16 billion) by cutting current expenditure. This hampers the medium-term reduction of the deficits, which should give all the more cause to diminish public authorities' other calls on the credit market.

II. International monetary trends and external monetary policy

Recovery of the world economy . . .

In 1976 and so far in 1977 world economic activity has on the whole developed satisfactorily, if not uniformly. International trade has recovered remarkably well from the setback it sustained in the global recession; at about 11 % in real terms, its growth in 1976 was impressive. There are numerous signs that the increase in production and the expansion of world trade will continue at a reasonable pace in the current year, contrary to some pessimistic assumptions. Under these circumstances it is all the more important to persevere in the fight against inflation – along with the efforts to promote economic growth and reduce unemployment – in order to provide a firm foundation for the recovery of international economic activity. The fact that inflation rates are being brought down only gradually in some countries and that inflationary tendencies are regaining strength in others is a cause for grave concern.

. . . with considerable exchange rate adjustments

Extensive exchange rate adjustments took place in 1976. The French franc withdrew from the European narrower margins arrangement in March – which was followed by a considerable weakening of this currency, particularly from mid-year onwards – and exchange rates among the currencies remaining in the arrangement were adjusted in October. This autumn realignment greatly eased conditions in the foreign exchange markets. It was insignificant, however, compared with the market-induced changes in exchange rates against other currencies. In 1976 the exchange rate relationships between the currencies floating against each other diverged more than in any other year since exchange rates were floated in the spring of 1973. Taking 1976 by itself, these exchange rate movements were greater than was necessary to offset the newly arisen price and cost differentials; to some degree, however, this was simply a catching-up process as regards adjustments in exchange rates which had not materialised before. In exchange rate terms, therefore, the conditions for better balance of payments equilibrium among industrial countries have improved.

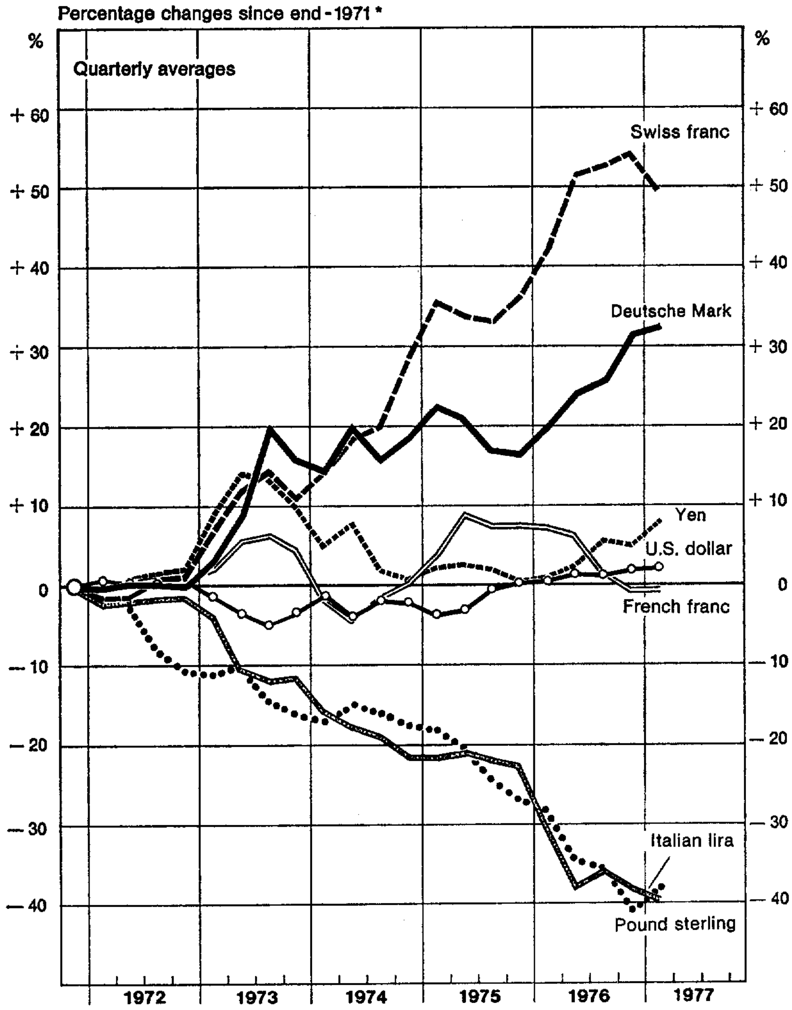
Renewed growth of global balance of payments disequilibria . . .

The balance of payments disequilibria of major groups of countries increased again in 1976. This does not, however, apply to the oil-importing developing countries; their current accounts improved distinctly in global terms, compared with the previous year, because the industrial countries' demand for their exports grew in line with the economic recovery and because they raised their export prices. But the global current account deficit of the industrial countries increased all the more, if only as a result of the higher oil imports which were induced by the economic recovery last year and which entailed a new expansion of the OPEC countries' surplus. The United States, in particular, exacerbated the imbalance between OPEC and industrial countries by raising its oil imports sharply. The problems this posed were accentuated further by the persistence of disequilibria within the group of industrial countries. Reducing the differences between the current accounts of industrial countries in a strong balance of payments position and of those in a weak position is therefore a major task calling for joint efforts. The countries in a weak balance of payments position must, of course, make a substantial contribution by pursuing domestic policies designed to stabilise costs and prices.

. . . but in general no difficulties in financing balance of payments deficits

Financing the balance of payments deficits presented no difficulties in 1976, except in isolated cases. The international money and capital markets once again proved their capacity to provide finance. A record amount of balance of payments assistance was also made available through official channels. Although no financing problems exist at present in general, the situation has become critical for individual countries. Seeking to remedy this problem by a general increase in international liquidity or by facilitating access to official balance of payments assistance would not be the right course, however. This might delay the necessary processes of adjustment, which would be undesirable. What is required is to direct aid to cases of urgent need in which the affected countries' own potential is inadequate even if they make serious efforts to adjust. Smaller countries without raw material resources of their own will be the main candidates for such aid. Besides a few OECD countries, these primarily include the poorest developing countries.

Effective exchange rates of major currencies



* Weighted average changes in external value against all currencies, based on official spot middle rates in Frankfurt. For end-1971 the central rates agreed in the exchange rate realignment of December 18, 1971 were used; for the Canadian dollar, for which no central rate was fixed, the market rates of December 21, 1971 were applied. The weights were chosen in accordance with the regional pattern of the foreign trade turnover (exports plus imports) of the individual countries.

1. Shifts in the pattern of exchange rates

(a) Sharp decline in the rates of major currencies

Greater polarisation of currencies

The process of polarisation in the external value of major currencies, which had begun with the general transition to more flexible exchange rates, continued at an accelerated pace in 1976. A clearly defined group of countries with strong currencies – Switzerland, Germany, the Netherlands, Japan and the United States – contrasted with a number of other countries whose currencies were subject to almost continuous erosion, sometimes on an exaggerated scale. The rates of the pound sterling and the Italian lira, in particular, fell sharply (see the above chart). The weak state of both currencies can be traced back mainly to domestic economic developments in the United Kingdom and Italy. The high rates of inflation in these countries, which of late have tended to climb again, made the sceptical attitude of the markets towards sterling and the lira understandable, especially since other countries have had greater and more lasting success in their anti-inflationary policies.

The market forces down the value of sterling . . .

The fall in the pound sterling in 1976 assumed alarming proportions at times. To some extent, however, this movement was a belated adjustment, the need for which had arisen back in 1975. The sharp drop in the sterling rate was triggered by large withdrawals of foreign capital, and particularly by a continued reduction in foreign official sterling balances. As a further weakening of the British currency was widely feared, the terms of payment shifted correspondingly as well; this greatly strengthened the pressure on sterling. Finally, the scale of the weakness of sterling seems to have owed much to the apprehension that the domestic economic policies of the United Kingdom would not be geared sufficiently to the country's external economic needs.

When even massive exchange market intervention by the Bank of England in support of sterling proved to be unsuccessful, the U. K. authorities finally adopted wider-ranging monetary measures under the impact of the accelerating fall in the British currency. Interest rates in the United Kingdom thereupon soared to a record level. But not even these exceptionally high interest rates strengthened sterling permanently because they were little higher than the rate of inflation; real interest rates remained low, if not in fact negative. The short-term credit arranged for the United Kingdom at the beginning of June 1976 by central banks of the countries constituting the Group of Ten together with Switzerland and the BIS, which in effect was to be regarded as an advance on the subsequent drawing on the IMF, likewise resulted in only a temporary recovery in confidence in sterling. The pound did not strengthen durably until November 1976, when agreement on the IMF standby arrangement seemed imminent and the conviction grew that the domestic stabilisation measures on which IMF assistance is conditional would be successful.

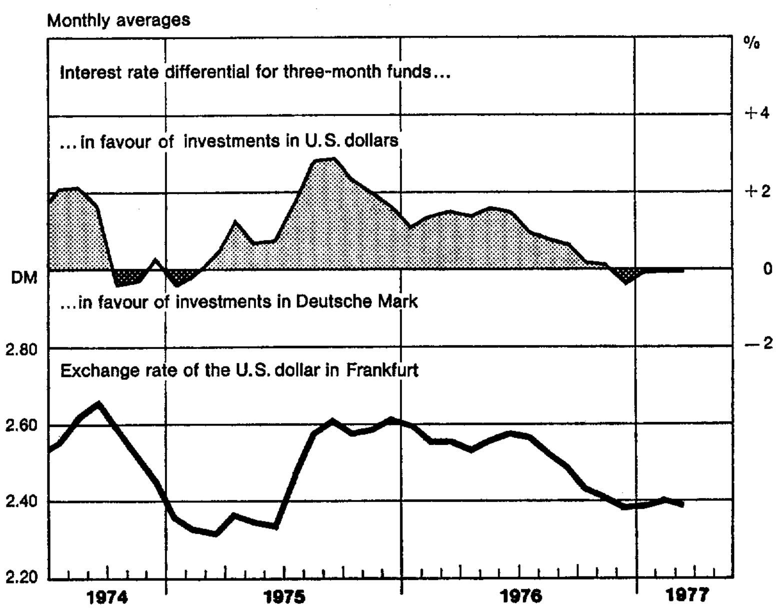
The arrangement made at the beginning of January 1977 under the auspices of the BIS to finance reserve losses arising from the liquidation of foreign official sterling balances — the third such arrangement since 1966 — further enhanced confidence in the market that the sterling rate would prove more stable. In the first few months of 1977, however, the market sometimes tended to move too far in the other direction. Return flows into sterling and new investments of foreign capital in the United Kingdom obliged the Bank of England to intervene heavily in the foreign exchange market; an unduly rapid appreciation of the pound and hence a deterioration in the British competitive position would otherwise have been unavoidable.

... and of the lira

The decline in sterling was at times even surpassed by the fall of the lira. Both economic and political factors played a role, in particular the large government deficit, most of which was financed by the central bank, and the inflationary rise in costs and prices, aggravated by wage indexation. The Italian currency passed through a particularly critical phase in the first four months of 1976, when the need for adjustment which had built up in 1975 with a further widening of the inflation gap relative to other countries became more and more obvious. Since even heavy interventions in the exchange market — partly financed by recourse to official credit assistance — were hardly able to slow down the fall of the lira, the Banca d'Italia progressively raised the discount rate by a total of six percentage points to 12 % by mid-March. After even this increase in the cost of central bank credit had failed to produce the desired effect, the Italian Government imposed a cash deposit amounting to 50 % of the lira equivalent on almost all foreign exchange payments at the beginning of May; the deposit was to be maintained at the Banca d'Italia for the three months following each payment. The Government's aim in adopting this measure was both to contain the flight out of the lira and to bring about an urgently needed reduction in domestic liquidity. The measure did in fact succeed in keeping the lira rate stable for a time. The summer months then saw a further market-induced strengthening of the lira owing to foreign exchange inflows from tourism.

When the lira weakened once again in the autumn, the Banca d'Italia reacted with a further drastic increase in the discount rate to 15 %. At the same time the Italian Government introduced a 10 % foreign exchange purchase tax for a limited period of a few weeks. Shortly after this tax had been lifted in mid-October it was reintroduced for another four months at a reduced rate of 7 %. Since then the lira has ceased falling. Earlier than originally planned, the foreign exchange purchase

International interest rate differential and exchange rate of the U.S.dollar



tax was halved in December; from then onwards it was progressively lowered and finally removed altogether. Even after this measure to reduce the demand for foreign exchange was cancelled, and although the cash deposit on almost all external payments was phased out completely by the middle of April 1977, the lira remained remarkably stable. At times, however, the Italian central bank supported the lira by intervening in the foreign exchange market.

(b) Shifts in exchange rates among strong currencies

At the opposite end of the spectrum, there emerged a group of strong currencies including in particular the Swiss franc, the Deutsche Mark, the guilder, the yen, and the U.S. dollar. The respective countries account for about two thirds of the national product and one half of the foreign trade of all OECD countries.

Weakening of the U.S. dollar against other strong currencies . . .

Within this group of relatively strong currencies there were, however, marked shifts in exchange rates during the period under review. While the Deutsche Mark and Swiss franc appreciated steadily against the average of all other currencies and the yen appreciated too (albeit much less), the external value of the U.S. dollar in relation to all other currencies remained practically unchanged since it depreciated against the other strong currencies just as much as it appreciated against the weaker currencies.

In spite of the extremely sharp deterioration in the U.S. current account last year, the dollar held up well against all other currencies taken together. Being the most important reserve and investment currency, the dollar still occupies a special position which may cause a deterioration in the current account to have a smaller impact on the external value of the currency than it does in other countries whose currencies do not perform this function. Hence, even after the transition to floating the United States is less exposed than other countries to balance of payments pressure to adjust.

. . . reflects differences in inflation rates and changes in interest rate differentials

The weakening of the dollar against the Swiss franc and the Deutsche Mark partly reflects the differences in inflation rates between the strong currencies. However, the considerable decline in the dollar against the Deutsche Mark in the course of

1976 also owed a great deal to the reduction of the interest rate differential, which had previously benefited the dollar (see the chart on page 51).

Considerable fluctuations in the exchange rate relationship between the Swiss franc and the Deutsche Mark

There were likewise considerable exchange rate movements in the relationship between the Swiss franc and the Deutsche Mark in 1976. Strong money and capital inflows into Switzerland during the first half of the year led to a steep rise in the rate of the Swiss franc also against the Deutsche Mark, namely of 8 % between the beginning of the year and early June 1976. Thereafter the movement reversed, partly as a result of numerous Swiss measures to ward off foreign exchange inflows and partly because interest rates were reduced to an exceptionally low level. At the end of March 1977 the value of the Swiss franc in relation to the Deutsche Mark was 6 % lower than at the beginning of 1976.

(c) Tensions in the European narrower margins arrangement

The polarisation of weak and strong currencies also led to tensions within the European narrower margins arrangement in the year under review. Persistent divergences in costs and prices in member countries aroused expectations of exchange rate changes in the arrangement and frequently resulted in substantial speculative foreign exchange movements. The central banks of the member countries used large amounts of foreign exchange to defend exchange rate relationships within the agreed margin of fluctuation of ± 2.25 %. However, experience has again shown that once the cost of defending this margin has become unacceptable in terms either of reserve losses or of members' domestic monetary policies, a realignment of exchange rates is unavoidable in the end, unless the country whose currency is temporarily weak prefers to withdraw from the narrower margins arrangement, as France has done for the second time.

Withdrawal of the French franc from the narrower margins arrangement . . .

The loss of confidence in the French franc in February/March 1976, which resulted in massive currency speculation and, under the pressure of large reserve losses by the Banque de France, finally led to the franc being floated, was not borne out by the ensuing movement of the rate. On the contrary, the franc fell by only a very moderate amount; in fact, the French central bank was able to take in dollars at times. The exchange rate of the franc did not drop sharply until the summer months of 1976, when the French balance of trade began to deteriorate owing to both economic conditions and the weather while cost and price rises remained as large as ever. In the meantime the franc rate has firmed again, although at a lower level more in line with underlying economic conditions. This reflects, not least, the first positive results of the stringent stabilisation measures introduced in France in the autumn.

The divergent development of costs and prices in the narrower margins arrangement, which continued after the withdrawal of the French franc, stimulated new rumours towards the middle of 1976 about an impending revaluation of the Deutsche Mark. The foreign exchange movements which this caused, and which also owed much to shifts in the terms of payment, necessitated extensive intervention by the participating central banks, primarily in support of the Belgian franc, the Danish krone and the Swedish krona. Between the beginning of the monetary unrest at the end of July 1976 and its waning in mid-October, interventions in Deutsche Mark in support of partner currencies amounted to no less than DM 8 billion, considerably increasing the Bundesbank's monetary reserves (see the table opposite).

The countries with particularly weak currencies reacted to these renewed severe tensions not only by tolerating the tightening of their money markets due to the foreign exchange outflows but also by taking further economic and monetary measures which they expected to restore confidence in the maintenance of the exchange rate pattern. The reluctance of these countries to allow changes in their exchange rates to occur is mainly attributable to their concern that by permitting their currencies to depreciate they might additionally stimulate inflation through the resultant increase in import prices. In these countries the proportion of imports from other participants in the European narrower margins arrangement is indeed considerable (40 to 45 %). Moreover, in some partner countries (notably

Changes in the net external position of the Deutsche Bundesbank due to interventions within the joint float and other foreign exchange movements *

DM billion

Period	Changes in net external position, total	Caused by interventions within the joint float 1, 2	Caused by other foreign exchange movements 3
1973	+ 26.4	+ 6.8	+ 19.7
1974	— 1.9	+ 0.2	— 2.1
1975	— 2.2	— 1.8	— 0.4
1976			
January			
Markets quiet	+ 0.1	—	+ 0.1
February–March			
First crisis within the joint float	+ 9.7	+ 8.7	+ 1.0
April–June			
Markets quiet	— 3.6	— 1.4	— 2.2
July–mid-October			
Second crisis within the joint float	+ 6.7	+ 8.0	— 1.4
Mid-October–December			
Reactions to exchange rate adjustments within the joint float	— 4.1	— 3.9	— 0.2
1976, total	+ 8.8	+ 11.5	— 2.7
1977			
January–March			
Markets quiet	+ 0.6	— 0.1	+ 0.7

* 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 joint float again. — 2 Including intra-marginal interventions. — 3 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.

Belgium) wages and salaries are index-linked to prices, which imparts an additional twist to every inflationary spiral. Furthermore, the share of foreign semi-manufactured products in the value of these countries' exports is sometimes very high, so that exports hardly benefit from a depreciation in these cases unless domestic action is taken to curb costs.

... and adjustment of the exchange rate relationships between the remaining member currencies

As the overall situation remained unstable, however, there was reason to fear that new speculative foreign exchange movements would occur on the next possible occasion. On October 17, 1976, at a time when the foreign exchange markets were quiet, the countries participating in the system of narrower margins therefore decided to adjust their exchange rates. The outcome of this realignment, from the point of view of the German currency, was a revaluation of the Deutsche Mark by 2 % against the guilder and the Belgian and Luxembourg franc, by about 3 % against the Norwegian krone and the Swedish krona, and by 6¼ % against the Danish krone.

Although this exchange rate adjustment was widely regarded as insufficient initially, in the case of some currencies the market did not make use of the new scope for exchange rate movements created by the change in the buying and selling rates at all, and in the case of other currencies made use of only part of it. The Deutsche Mark, the strongest currency over long periods, exchanged positions with the Danish krone, which had previously been the weakest currency. The Deutsche Mark remained in this position of weakness until mid-January, but even thereafter it stayed in the lower third of the exchange rate band while the strongest position was occupied alternately by the guilder and the Danish krone. This exchange rate pattern, which can be traced back to a reversal in the flows of money and capital and the normalisation of the terms of payment (and, as far as Denmark is concerned, also to the raising of substantial loans abroad), enabled Germany's partners to buy considerable amounts of Deutsche Mark in the markets within a few weeks of the realignment at rates lying between the limit rates (so-called "intra-marginal" Deutsche Mark purchases). These amounts of Deutsche Mark were mainly used to repay intervention debts which had accumulated during the period of speculation. Using the creditor's currency to settle the debts, unlike settlement in dollars and IMF reserve assets at the expense of a country's own reserves, had the welcome side-effect of directly reducing the liquidity of German banks and non-banks, which had previously expanded as a result of the interventions.

German monetary policy severely handicapped by monetary unrest

However, the partial reversal of the payment flows did not alter the fact that German monetary policy was seriously handicapped in 1976 by Germany's membership of the narrower margins arrangement. As a result of interventions under this arrangement, monetary reserves amounting to DM 11.5 billion net accrued to the Bundesbank last year. Mainly for this reason the Bundesbank's total net external assets went up on balance by DM 8.8 billion in 1976 (excluding changes through valuation adjustments). The corresponding increase in the liquidity of banks and non-banks was unwelcome for monetary developments in Germany. Thus the experience of 1976 once again graphically demonstrates that the system of narrower margins, even if the number of participants in it is small, may have a substantial adverse impact on stabilisation policy unless a minimum degree of convergence in the economic development of the member countries is assured.

Continued interest in the narrower margins arrangement . . .

The fact that the European narrower margins arrangement did not break up last year, even though individual members were subjected to severe strains, but rather remained in existence (albeit in diminished form) reflects the great interest still felt by the remaining member countries in its continuation. The explanation of this interest is that it is an advantage for enterprises in member countries to be able to base their business relations with each other on fixed exchange rates. This also applies to Germany, which conducts about one quarter of its foreign trade with countries that participate in the narrower margins arrangement. Furthermore, this arrangement has proved to be a stabilising factor, particularly for countries whose currencies tend to be relatively weak. However, it is worth defending these advantages only if exchange rates which are recognised to be unrealistic are corrected without much delay so that the "price" of belonging to the narrower margins arrangement does not become too high for any of the economies involved. The realignment of autumn 1976 and the further exchange rate adjustments of April 1977 – devaluation of the Swedish krona by 6 % and of the Danish krone and Norwegian krone by 3 % each – have demonstrated that it is quite possible to readjust exchange rates promptly rather than under the pressure of monetary unrest and thus to avert a collapse of the narrower margins arrangement.

. . . requires intensive efforts in the field of stabilisation policy

However, the possibility of adjusting exchange rates should not distract attention from the basic requirements for the smooth operation of such a system, which are just as valid today as they ever were. These requirements include a maximum of price discipline in member countries and the preservation of the rules of the narrower margins arrangement. The prospects of these conditions being respected improved recently. In the European Community the will to pursue a more convincing stabilisation policy has grown. It also appears that the constraints imposed by the narrower margins arrangement are regarded as a welcome support for domestic efforts to achieve stabilisation to a greater degree than they were in the past.

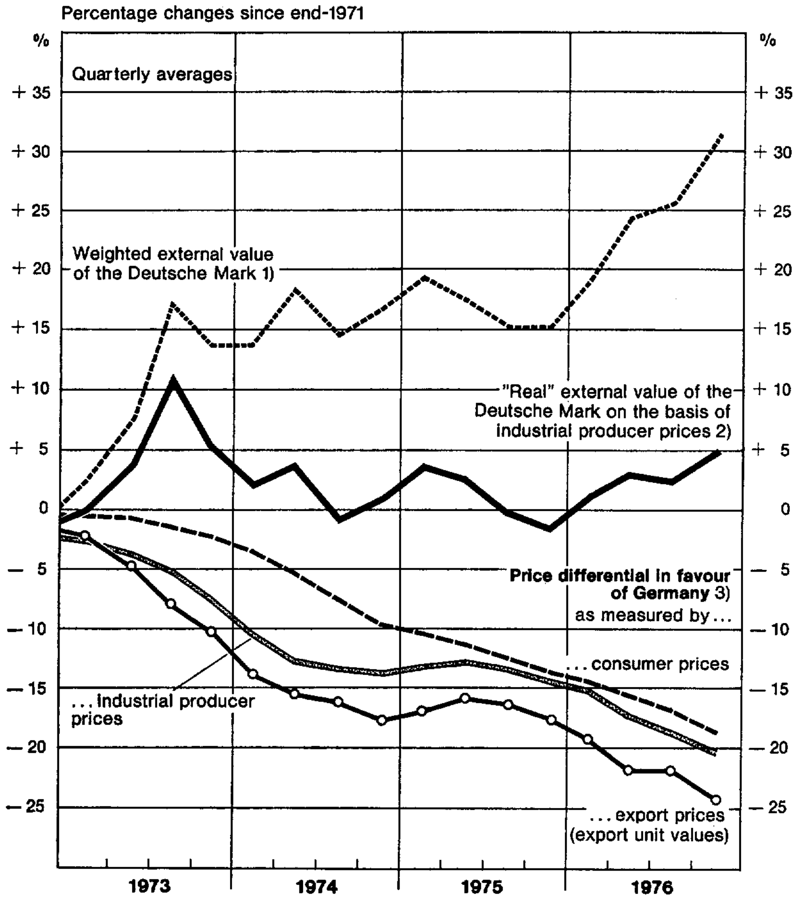
(d) Correction of international competitive positions

Strong appreciation of the Deutsche Mark in 1976 . . .

. . . but German competitiveness not seriously impaired in the longer run

As a consequence of the exchange rate shifts in 1976 the external value of the Deutsche Mark against all other currencies rose by 15 % in the course of the year. This appreciation more than offset the lead in stability gained by Germany over other countries in 1976. It is no doubt partly due to the corresponding "real" appreciation of the Deutsche Mark that German imports expanded so very strongly last year, in particular increasing more than exports. In terms of international competition, however, Germany's price position is at present no worse than it was at the beginning of 1975, i. e. in the middle of the recession. To this extent last year's developments merely corrected the relative increase in competitiveness during 1975 – an increase which was ascribable to a slight weakening of the external value of the Deutsche Mark together with a consistently

Effective exchange rate of the Deutsche Mark and international price differential



1) Against the 16 currencies officially quoted in Frankfurt in relation to the central rates of end-1971.- 2) Weighted external value of the Deutsche Mark adjusted for the price differential in favour of Germany.- 3) Ratio of price movements in Germany to the trade-weighted average of movements in national currencies in 13 other industrial countries. A descending line indicates that price increases in Germany were lower than those abroad.

better stability record than other countries. Also in comparison with earlier years such as 1972, the price competitiveness of the German economy, taken as a whole, has not deteriorated seriously, if at all (see the above chart). However, developments in relation to particular countries and in particular industries have differed widely and in some cases have led to considerable competitive handicaps.

Competitive positions of other countries also shifted in the right direction

In 1976 other major currencies, strong and weak alike, also experienced exchange rate movements that were too large to be explained by the cost and price discrepancies which arose during that year. As in the case of Germany, these movements corrected the competitive positions of the countries concerned, which in 1975 had in general shifted to the disadvantage of deficit countries owing to the partial stabilisation of exchange rates in spite of continuing differences in the movement of costs and prices. It remains to be seen how far the deficit countries will be able to exploit the situation by making efforts to step up their exports.

(e) General experience with floating

Last year's pronounced exchange rate movements have again led to calls for a return to partially stabilised exchange rates through heavier intervention in the exchange markets. These calls are based, on the one hand, on the apprehension that with the transition to floating the pressure to maintain discipline in economic policy has eased, thus fostering international inflation. On the other hand, it is pointed out that monetary depreciation may fuel inflation by making imports more costly and lead to a vicious circle of falling exchange rates and inflation.

Sharp fall in exchange rates enforces stabilisation measures

To dispel these fears the experience may be cited that depreciations, precisely because of their impact on the domestic price level, have in many cases been the decisive factor in changing the course of domestic economic policy. All the major countries that had to contend with monetary difficulties last year have in the meantime made strenuous efforts to stop the decline in their exchange rate by taking domestic measures. Thus, an actual or imminent fall in the external value of a currency has often exerted more effective pressure to initiate adjustment measures than reserve losses, which, since private credit and official monetary assistance are often readily available, do not always enforce adjustment effectively enough.

World trade not adversely affected by floating

Other objections frequently raised to floating have also proved to be unwarranted. Last year, for example, the world economy by no means disintegrated. On the contrary, during that period of extreme economic disequilibria between major countries, flexible exchange rates acted as hinges ensuring the cohesion of the world economy despite discrepancies between individual countries. This is clearly underlined by the fact that last year, when exchange rate movements were unusually numerous and far-reaching, world trade recovered strongly. The only alternative to these shifts in exchange rates would probably have been the spreading of protectionist tendencies in the world economy. The attendant disadvantages for employment and growth would have been far greater than the isolated difficulties that floating may have entailed.

Central banks smooth exchange rate fluctuations

Furthermore, the short-term movements of exchange rates around the basic trend implied by economic factors remained limited in scale. This is due not least to the coordinated intervention policies of the principal central banks for smoothing such exchange rate fluctuations. These successful exchange market operations, which are designed to maintain orderly market conditions without running counter to the underlying trend of exchange rates, invalidated one of the main arguments against floating exchange rates.

Floating has been a success

For all these reasons and in the light of present world economic conditions, it may be concluded that the floating of the major currencies has been a success. A return to more rigid exchange rates world-wide would seem illusory as long as the present discrepancies in cost and price developments between the principal countries continue. Numerous countries have furnished concrete proof of this in recent years by trying to stabilise the external value of their currencies in spite of lack of success in the fight against inflation. In most cases these efforts ended with substantial foreign exchange losses and, owing to the pent-up need to adjust, very abrupt exchange rate changes. Any attempts to chart the course of future exchange rate movements over certain periods in the form of "target zones" before the necessary harmonisation of costs and prices has been achieved would involve the danger of repeating in modified form the errors committed under the earlier system of fixed exchange rates. The objective of moving closer to more stable exchange rates for sustained periods can be attained only by a successful domestic stabilisation policy.

2. World economic activity and the balance of payments adjustment process

(a) Efforts by countries in a strong currency position and those in a weak currency position

The events in the exchange markets in the past year did not prove to be a serious obstacle to the further recovery of world economic activity from its severest setback in the post-war period. In fact, the world economy developed quite satisfactorily on the whole. After recovering strongly in the first six months of 1976, production growth admittedly weakened a little in the summer months, but it regained momentum towards the end of the year. Thus, the gross national product of all OECD countries taken together grew by over 5 % in real terms in 1976 partly because world trade – the volume of which rose by about 11 % last year, whereas in 1975 it had fallen by some 6 % – exerted a strong stimulus. Be that as it may, the almost unchanged high level of unemployment in most countries gives cause for grave concern. This problem can be solved only to a limited

World-wide unemployment cannot be eliminated by global measures

Development of imports into three major industrial countries

Item	Percentage change in 1976	
	from 1975	from 1974
Total imports		
Germany		
(c.i.f.; DM basis)		
Value	+ 21	+ 24
Volume	+ 17	+ 20
United States		
(f.o.b.; US$ basis)		
Value	+ 26	+ 20
Volume	+ 22	+ 8
Japan		
(c.i.f.; US$ basis)		
Value	+ 12	+ 4
Volume	+ 10	— 4
Value of imports from OECD Europe excluding Germany		
Germany (c.i.f.; DM basis)	+ 19	+ 26
United States (f.o.b.; US$ basis)	+ 11	— 1
Japan (c.i.f.; US$ basis)	+ 15	— 0

degree, if at all, through global measures to stimulate demand. A large proportion of unemployment can be traced back to structural factors which are partly due to inflationary developments that were accepted for too long; to this extent, underemployment can be eliminated only by longer-term measures designed to improve the structure of the economy. In addition, it is at any rate necessary to reduce inflation over and above the successes achieved so far because this alone will provide a chance of safeguarding the economic upswing. Apart from this, the scope for introducing measures to stimulate economic activity is very limited in many countries owing to the need for them to improve their balance of payments positions.

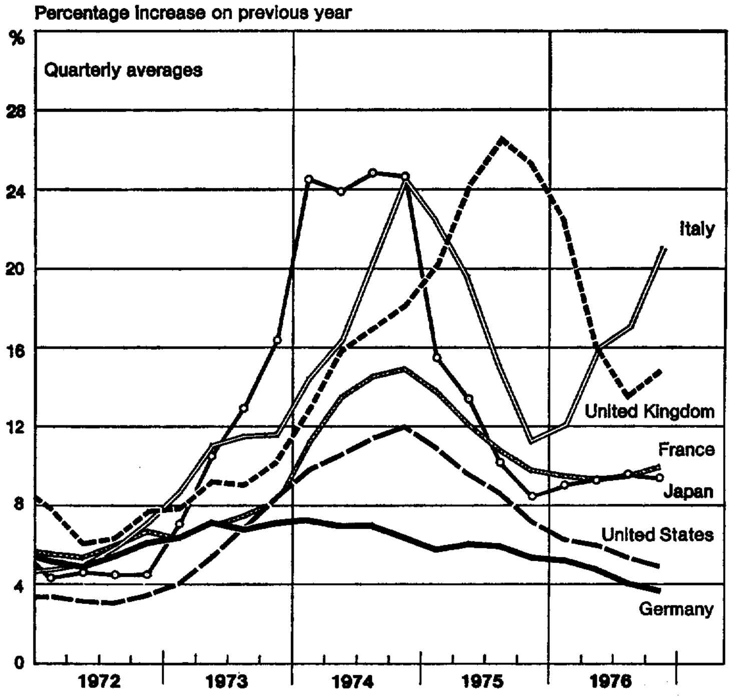
Countries in a strong currency position support exports of deficit countries

Up to the present, the countries in a strong currency position have taken due account of their special responsibility for supporting world economic activity. They have ensured a sufficient degree of economic growth at home, thus providing the deficit countries with additional opportunities to sell their products. Thus, in 1976 the imports of the United States, Japan, and Germany rose considerably in terms both of value and of volume. In this context, Germany made a relatively large contribution, bearing in mind that German imports — unlike those of the United States and Japan — increased in the recession year 1975 as well, and hence expanded in 1976 from a high level. The development of German imports also greatly benefited the exports of other European OECD countries, i. e. countries that in most cases urgently need an improvement in their balance of payments position (see the above table). However, the countries in a strong currency position can allow domestic demand to expand only in so far as this is compatible with a successful stabilisation policy. Apart from this, their major contribution to supporting the deficit countries — a contribution which is also useful for stabilisation policy — lies in their not resisting an appreciation of their currencies in the exchange market. Such a policy corresponds both to an OECD recommendation and an approach which was agreed in Manila in September 1976 at the Annual Meeting of the IMF and the World Bank and which found broad support.

Efforts by countries in a weak currency position still insufficient in many cases

The countries in a weak currency position, which must try to slow down cost and price increases by curbing domestic demand and gain control over their imports, have also made considerable efforts in the right direction, but in many cases the success of their endeavours has tended to be disappointing. In fact, in a number of major countries prices are even rising more strongly again (see the chart on page 58). It is to be hoped that some countries will apply the brakes more strongly before renewed pressure on their exchange rate reminds them of the necessity to do so.

Movement of consumer prices in major industrial countries



(b) Partial success in improving the international balance of payments pattern

Additional burdens for balance of payments position of the industrialised countries owing to economic activity ...

The efforts of the industrial countries to reduce their balance of payments disequilibria were not reflected in the global balance on current account of this group of countries in 1976 because the increase in imports of crude oil and other raw materials following the economic recovery produced additional heavy burdens. Thus, in 1976 the deficit on current account of the OECD countries rose by about \$ 20 billion to an estimated \$ 26 billion. According to OECD estimates, this renewed deterioration contrasts with a further increase in the surplus of the OPEC countries of some \$ 12 billion to \$ 45 billion. On the other hand, owing to the upturn in business activity the balance of payments position of the oil-importing developing countries improved markedly in global terms. At all events, the deficit on current account of this group of countries fell by an estimated \$ 11 billion to \$ 23 billion in the past year.

... but improvement in the international balance of payments pattern compared with 1974

The development of the balance of payments last year demonstrated once again that for the industrial countries taken as a whole a deficit on current account is unavoidable under circumstances of normal business activity so long as the structural surplus in the balance of payments of the OPEC group is excessively high. Since about 80 % of the OPEC surplus is accounted for by only three countries, which moreover have a low population and a limited – albeit rapidly increasing – capacity to absorb imports, near-equilibrium in the global balance on current account of this group of countries is not to be expected in the foreseeable future. It is quite possible, of course, to achieve partial success on the way to more balanced current account positions between the industrial countries and the OPEC countries. The prime example of such success is the considerable decrease in the global deficits and surpluses of both groups of countries in comparison with 1974. At that time, the aggregate deficit on current account of the OECD countries amounted to some \$ 33 billion, and the combined surplus of the OPEC group of countries to no less than \$ 62 billion.

Current account gap between industrial countries still too large

If the global deficit of the industrial countries vis-à-vis the OPEC area is not to result in major difficulties in the long run, it is essential that first the imbalances

Balances on current account of the OECD countries *

US$ billion

Country	1973	1974	1975	1976 p
Germany	+ 4.4	+ 9.8	+ 3.9	+ 3.0
Netherlands	+ 2.3	+ 2.0	+ 1.6	+ 2.3
Belgium-Luxembourg	+ 1.3	+ 0.7	+ 0.3	— 0.0
Denmark	— 0.5	— 0.9	— 0.5	— 1.9
Sweden	+ 1.2	— 0.9	— 1.6	— 2.5
Norway	— 0.4	— 1.2	— 2.5	— 3.4
All participants in the joint float	+ 8.3	+ 9.5	+ 1.2	— 2.5
France	— 0.7	— 5.9	— 0.1	— 5.8
United Kingdom	— 2.0	— 8.6	— 3.7	— 2.5
Italy	— 2.5	— 7.8	— 0.5	— 2.9
Switzerland	+ 0.3	+ 0.2	+ 2.6	+ 3.4
Austria	— 0.3	— 0.5	— 0.3	— 1.5
Other European OECD countries **1**	— 1.0	— 5.9	— 9.8	—10.8
United States	+ 0.0	— 3.6	+11.7	— 0.6
Canada	+ 0.1	— 1.5	— 4.9	— 4.4
Japan	— 0.1	— 4.7	— 0.7	+ 3.7
Australia, New Zealand	+ 0.7	— 3.7	— 2.0	— 2.1
All OECD countries	+ 2.8	—32.5	— 6.5	—26.0

* Balances of trade, services, and private and official transfers (transactions basis). — **1** Finland, Iceland, Ireland; Greece, Portugal, Spain, Turkey. — **p** Provisional.
Sources: National statistics, IMF and OECD.

on current account within the group of industrial countries be reduced significantly, and that second all countries make equal efforts to minimise the burden arising from the increase in the price of imported oil by conserving energy and by increasing their exports to those OPEC countries where demand is high. Although a certain amount of progress was achieved in this direction in 1976, the balance of payments gap between the industrial countries is still far too large. Thus, last year current account surpluses of a handful of countries amounting to $ 12 billion contrasted with deficits of the other OECD countries totalling $ 38 billion.

Major contribution by Germany to the adjustment process

In 1976, a major contribution to the adjustment process was made by Germany. As a result of a steep increase in imports, the German surplus on current account continued to decline last year and is now almost $ 7 billion smaller than it was in 1974 (see the above table). An even greater decrease in this surplus was prevented primarily by the strong rise in the imports of some major European "problem countries" from Germany. If German exports to these five or six countries — which increased by one quarter in 1976 — had gone up only to the same degree as exports to the rest of the world (+ 12 %), then the German current account would have been almost in balance last year. This fact underlines the great responsibility of the deficit countries for the functioning of the adjustment process.

The development of the U.S. balance on current account also supported the efforts of the weaker countries to eliminate their balance of payments deficits. However, the swing in the U.S. balance on current account from a high surplus in 1975 (+ $ 12 billion) to a slight deficit in 1976 (— $ 1/2 billion) contributed considerably less to the improvement in the pattern of the balance of payments within the OECD area than would appear at first sight. About half of the reduction in the U.S. surplus is due to the cyclically-induced increase in crude oil imports — which incidentally have hardly been affected so far by energy conservation measures in the United States — while the remaining deterioration is mainly attributable to a steep increase in imports from Japan, i. e. it only improved the position of another country in a strong currency position.

Among the deficit countries in the OECD area, the United Kingdom was again able to improve its position a little last year. Italy, whose slight deficit on current account increased to just under $ 3 billion, nevertheless achieved pronounced success in adjustment in comparison with 1974. On the other hand, there are numerous countries that have not made any progress towards improving their balances of payments in comparison either with last year or with 1974. However, according to OECD projections, there is reason to hope that partial success will be achieved in this respect in the current year.

No global balance of payments problems for the developing countries

The above-mentioned improvement in the balance of payments situation of the oil-importing developing countries is due to a steep rise in the volume of exports and in export prices. Although this trend is likely to continue in the current year, a further increase in the global deficit on current account of this group of countries is anticipated. This expectation is based on the assumption that the prospects of financing the high import needs of the developing countries will probably improve. This assumption is supported in particular by the present trends in development aid and direct investments. Thus, if world trade expands at a normal pace no acute balance of payments difficulties are in sight for the developing countries as a whole. There is consequently no need for global balance of payments support for the developing countries. However, the balance of payments situation in some developing countries has become quite serious, either as a result of an excessive upturn in imports or owing to sharply increased debt service payments. In individual critical cases assistance will probably be unavoidable. However, any such assistance should not be limited to balance of payments support or to easing the burden of debt service payments, but instead these countries' problems must be tackled at their roots by fostering domestic equilibrium to reduce their extreme current account deficits and to help such countries to restore their credit standing.

3. Financing the balance of payments deficits

The international money and capital markets again made the largest contribution towards financing balance of payments disequilibria (which increased once more in 1976), and thus continued to be the main "turntable" for recycling the OPEC surpluses. They remained the major source of finance for both developing and industrial countries. Official loan assistance, the volume of which also rose considerably, went to a few industrial countries such as the United Kingdom and Italy, and to a greater degree than before to the poorer developing countries. Such assistance flowed mainly to those developing countries that encountered difficulties in procuring funds on the international financial markets owing to the high level of their foreign debt.

(a) Recourse to the international financial markets

Large increase in international bond issues and loans

The volume of newly issued international *bonds* on the Euro-capital market and the traditional international bond markets increased over the previous year by almost half to \$ 32 billion (see the table opposite). *Syndicated Euro-loans* granted by international banking syndicates and mostly running for medium-term periods also rose by more than one third to approximately \$ 27 billion, thus regaining the record level attained in 1974 directly after the oil crisis. *Short-term* Euro-loans, together with short and medium-term traditional foreign loans granted by banks, proved to be the third source for financing balance of payments deficits, particularly in the second half of 1976. Including medium-term Euro-loans, the external assets of banks in the Group of Ten countries and Switzerland and of the foreign branches of U.S. banks in the Caribbean area and the Far East rose in all by about \$ 105 billion, or 23 %, in 1976. Of this amount, an estimated \$ 45 billion consists of interbank loans.

The growth in the volume of international bond issues primarily benefited issuers in the OECD countries. They were able to place \$ 22 billion publicly or privately as against approximately \$ 15 billion in 1975. More than three quarters of the "Euro-bonds" and traditional international bonds issued was accounted for by only six countries, with Canada far in the lead at almost \$ 9 billion. Centrally planned economies and developing countries were of only marginal importance in the international bond markets. Western European institutions and international development banks each accounted for roughly \$ 3 billion of the amount provided by these markets.

International credit and bond markets

US$ billion

Item	1973	1974	1975	1976 p
A. Medium-term Euro-currency loans 1	20.9	28.5	20.6	27.4
1. By type of borrower				
Public agencies 2	15.6	20.2	15.6	20.1
Private agencies	5.3	8.3	5.0	7.3
2. By group of countries				
OECD countries	11.6	17.4	5.5	9.2
Developing countries (incl. OPEC countries)	7.1	7.7	11.2	13.9
Centrally planned economies 3	0.7	0.9	2.4	2.2
Other 4	1.5	2.5	1.5	2.1
B. International bond markets	9.9	12.3	22.1	31.8
Euro-bonds 5	4.1	3.5	8.7	14.6
of which in Deutsche Mark	(1.0)	(0.6)	(2.9)	(3.0)
By type of issuer				
Public agencies 2	2.0	2.6	5.1	.
Private agencies	2.1	0.8	3.6	.
Foreign bonds on national capital markets	4.4	5.2	11.2	16.4
of which in Germany	(0.4)	(—)	(0.4)	(0.7)
Special issues 6	1.4	3.6	2.2	0.8
Total (A plus B)	30.8	40.8	42.7	59.2

1 Publicised internationally syndicated loans running for more than 12 months and almost entirely financed on a roll-over basis which have not necessarily been taken up yet. — 2 Including public corporations, financial institutions and international organisations. — 3 Including Comecon institutions but excluding Cuba, North Korea and Vietnam, which are shown in the group of developing countries. — 4 Including international organisations. — 5 Internationally syndicated bond issues. — 6 Including special issues in Deutsche Mark. — p Provisional.
Source: OECD.

The OECD countries played a greater role as recipients of medium-term Euro-loans as well; their share rose to more than $ 9 billion. Just under $ 4 billion went to a number of oil-exporting countries, which surprisingly enough drew more heavily on the Euro-market; other developing countries took up over $ 10 billion. The eastern European centrally planned economies raised medium-term Euro-loans amounting to only about $ 2 billion; nevertheless, including the western export credits and short-term bank loans granted to centrally planned economies, the amount of credit extended by western banks to this group of countries went up by just over $ 7 billion.

The performance of the international financial markets in the past year again clearly demonstrated that there is no *global* financing problem with respect to the existing balance of payments disequilibria. However, the financing of the current account deficits of a few countries did not proceed smoothly. Owing to the high level of their foreign debt or for other reasons connected with their credit standing, the market no longer provided loans on the desired scale, with the result that these countries had to rely more heavily on official assistance.

High debts of individual developing countries demand special attention

The high level of debt, particularly among the oil-importing developing countries, is considered an urgent problem in various quarters. Total indebtedness of these countries amounted to approximately $ 180 billion at the end of 1976 and was thus more than twice as high as at the end of 1973. Of this total indebtedness, just under $ 80 billion consisted of debts contracted with western banks. This no doubt poses a serious problem. However, in 1976 the ratio of the developing countries' debt service payments to their export receipts was hardly higher than in 1973, even despite the vast amount of loans taken up in the meantime. In addition, the new borrowing of the developing countries in the international financial markets in recent years has chiefly been carried out by a few countries that are already at an advanced stage of development, such as Brazil and Mexico.

Should the indebtedness of the developing countries lead to refinancing difficulties in individual cases, banks operating in the international loan market cannot, of course, expect official financing or debt rescheduling assistance to be available automatically and free of conditions. It would therefore be advantageous for all concerned if cooperation between international organisations and private banks could be strengthened, either through joint financing operations or by making private loans dependent on the fulfilment of official economic policy conditions.

(b) Increase in official loan assistance

Record increase in official balance of payments assistance

In the period under review industrial countries and developing countries together received more loans of an official nature to finance their balance of payments and strengthen their reserves than ever before. In the calendar year 1976 the IMF alone granted balance of payments assistance in the *gross* amount of about $ 8 billion; its previous lending record was over $ 5 billion (1975). In the same period the central banks that cooperate within the BIS granted loans totalling almost $ 6 billion, partly in anticipation of loans extended by the IMF at the beginning of 1977. The European Economic Community provided financial assistance in the amount of more than $ 2 billion. In addition, balance of payments assistance totalling more than $ 3 billion was provided on a bilateral basis (bilateral new loans or prolongations of existing loans). This development has gathered pace so far in 1977: in January the United Kingdom entered into standby arrangements amounting to $ 3.9 billion with the IMF and received a special-purpose credit line totalling $ 3 billion from a group of central banks. Loan assistance for Italy by the IMF and EEC in the amount of some $ 500 million each is also planned.

The International Monetary Fund granted a large part of its substantial financial assistance under its special facilities, the use of which is not tied to economic programmes to restore equilibrium. It provided approximately $ 2.5 billion under its oil facility (which has meanwhile been terminated) and $ 2.7 billion under its compensatory financing facility. Comparatively little use was made of regular IMF loans, which in general are available only if economic policy conditions are fulfilled; they totalled just under $ 3 billion. At the end of 1976, the developing countries had made use of only about one tenth of their normal credit facilities.

The IMF was not able to grant all these sizable loans out of its own resources. As envisaged, it financed all its lending under the oil facility by taking up loans from oil-exporting countries and other countries in a strong balance of payments and reserve position. As regards the drawings by the United Kingdom under the standby arrangements of January 1977, the IMF will contribute just under $ 600 million from its own resources and will finance the bulk of the remainder also through special loans granted by members of the Group of Ten in a strong payments position and Switzerland.

Particularly high official balance of payments assistance for the United Kingdom ...

The greater part of the official loan assistance went to the United Kingdom. The fall in sterling prompted the central banks of the Group of Ten countries and Switzerland, together with the BIS, to grant the Bank of England a standby loan of $ 5.3 billion – which was then only partially drawn on – at the beginning of June to restore "orderly market conditions"; the Bundesbank undertook to contribute $ 800 billion towards it. In December 1976 the Bundesbank agreed to extend to the Bank of England a short-term standby loan of $ 350 billion (which has since been terminated) parallel to a loan of $ 500 million granted by the U.S. monetary authorities.

In early 1977 the IMF agreed to provide the United Kingdom with a standby loan of $ 3.9 billion. This is the largest individual loan operation in the history of the Fund. However, the United Kingdom can draw on this loan only in stages and only provided that it fulfils the economic and fiscal policy conditions agreed with the Fund. In order to conserve its own resources, the Fund will raise approximately $ 3.3 billion in outside funds for this transaction, to be supplied by the Group of Ten within the framework of the General Arrangements to Borrow (GAB) agreed in 1962, and by Switzerland. The Bundesbank will provide a comparatively large share of this amount, at approximately $ 900 million (= some 27 %). The claims arising from the GAB and held by the countries granting the loans can be mobilised at short notice, like all claims on the IMF, if the country in question itself has a balance of payments need. The Bundesbank therefore shows them under its monetary reserves.

After agreement had been reached in principle in January 1977, an arrangement was concluded under the auspices of the BIS at the beginning of February according to which the BIS, backed by the participating central banks, is providing the Bank of England with a medium-term facility of up to $ 3 billion to finance possible withdrawals of official sterling balances ("Third Group Arrangement"). The withdrawal of official balances had subjected the reserve position of the United Kingdom and the development of sterling to severe strains in the past and had produced additional disturbances in monetary relations. For this reason the United Kingdom is not alone in desiring an orderly reduction of these balances, which were equivalent to $ 3.7 billion at the end of December 1976. The safety net set up by other central banks and the BIS is intended to facilitate the process of running down these balances in an orderly manner by spreading the burden on the British reserve position over a longer period of time. A further contribution to the continued gradual decrease in the reserve role of sterling is the offer made by the U. K. Government to foreign official holders of sterling balances to exchange these balances for long-term foreign currency bonds, this offer being the condition for making the facility available. The Bundesbank has underwritten a large proportion of the financial guarantee for this Third Group Arrangement. After the United States, it bears the second largest share, namely $ 600 million, of the total liability of the financing group amounting to $ 3 billion.

. . . Italy . . .

Last year Italy received loan assistance from the European Communities and the Bundesbank after it had already taken up large loans from these and other bodies in the two previous years. In spring 1976 the EEC granted Italy a medium-term loan totalling $ 1 billion out of the proceeds of an issue of Community bonds and notes, simultaneously imposing budgetary and monetary policy conditions. In May 1976 the central banks of the Community countries also agreed to grant the Italian central bank a short-term currency standby loan of $ 482.5 million, which has not been drawn on. In September 1976 the Deutsche Bundesbank agreed with the Banca d'Italia to renew the $ 2 billion bilateral loan facility extended by the Bundesbank in 1974, the actual utilisation of which was backed by gold; initially, however, only $ 1.5 billion was used. As a result of the periodic adjustment in the valuation of the pledged gold, the recourse to this loan was increased to approximately $ 1.7 billion in December 1976, and to approximately $ 1.8 billion in March 1977. A $ 486.5 million loan granted to the Banca d'Italia by the Bank of England in December 1974 had to be terminated because of the United Kingdom's foreign exchange position; this led to negotiations for a further Community loan of $ 500 million to Italy at the end of 1976. This transaction was postponed until the conclusion of the loan negotiations between the Italian Government and the IMF, which had been suspended at the time. After the negotiations between the IMF and Italy regarding a loan of about $ 500 million had been concluded in mid-April 1977, the EEC Council of Ministers also agreed to the planned issue of Community bonds and notes in favour of Italy.

. . . and Portugal

In the period under review Portugal received various loans secured by gold. In January 1976 the Deutsche Bundesbank granted a loan amounting to $ 250 million. One month later the BIS opened a loan facility for the Banco de Portugal in the same amount, which has been drawn on in full in the meantime; ten European central banks, including the Deutsche Bundesbank, assumed a guarantee of 10 % each for this facility. The Deutsche Bundesbank contributed $ 75 million to further monetary assistance totalling $ 250 million granted by a group of eight European central banks. In February 1977 the BIS opened up a loan facility amounting to $ 100 million; the Deutsche Bundesbank helped to set up this facility by assuming a guarantee for 25 % of the total.

4. Steep increase in international liquidity

With the considerably larger volume of international financing operations in 1976, international liquidity expanded strongly. Last year reserve creation totalled roughly $ 30 billion (disregarding changes in the value of gold, SDRs and IMF reserve positions). It was thus three times higher than in 1975, when the demand for international financing operations fell sharply in the wake of the global

Composition of changes in international liquidity between 1970 and 1976

US$ billion

Item	1970–72	1973	1974	1975	1976
Claims of monetary authorities on the United States	+ 45.1	+ 5.1	+ 10.3	+ 5.2	+ 13.1
Sterling claims of monetary authorities on the United Kingdom	+ 2.7	— 0.0	+ 3.3	— 2.6	— 3.8
Identified foreign exchange holdings of monetary authorities in Euro-dollars and other Euro-currencies	+ 17.7	+ 8.2	+ 17.1	+ 8.3	[1] + 11.3
Other foreign exchange holdings of monetary authorities	+ 5.6	+ 5.2	+ 2.0	— 5.5	+ 3.5
Total official foreign exchange holdings	+ 71.1	+ 18.5	+ 32.7	+ 5.4	+ 24.1
Gold, special drawing rights, reserve positions in the IMF [2]	+ 5.2	— 0.0	+ 3.2	+ 4.4	+ 5.7
Total monetary reserves [2]	+ 76.3	+ 18.5	+ 36.0	+ 9.8	+ 29.8
Memorandum item					
Total monetary reserves including changes due to valuation adjustments	+ 80.4	+ 24.6	+ 36.9	+ 6.8	+ 29.3

1 Estimate based on BIS data. — **2** Excluding valuation gains on holdings of gold, SDRs and reserve positions in the IMF due to the devaluation of the dollar in 1971 and 1973, and excluding changes arising from fluctuations in the value of the SDR since mid-1974.
Sources: IMF and national statistics.

recession. However, the increase in reserves in 1974, when balance of payments deficits were also larger, was even greater. This means that in the three years since the end of 1973 the volume of official international liquidity has risen by about $ 76 billion to $ 257 billion, and since the end of 1969 reserves, including valuation gains in reserve holdings, have increased by as much as approximately $ 178 billion. Lending by the IMF contributed some $ 6 billion to the growth of global reserves in 1976. The remaining increase is due in small part to bilateral central bank assistance, but in the main to balance of payments financing via the international credit and bond markets.

High level of reserve investment in the United States

Nearly half the newly created monetary reserves took the form of a rise in dollar claims on the United States. In contrast, reserves held in the form of pounds sterling fell by the equivalent of some $ 4 billion. After the sharp reduction in sterling deposits in the previous year, this means that the reserve role of sterling continued to decrease considerably. Slightly more monetary reserves were invested in the Euro-market last year than a year before, but the share of new deposits of this type in the total increase in international liquidity declined markedly in comparison with 1975 (see the above table).

The growth of global monetary reserves was distributed almost evenly among the three groups of the industrial, oil-exporting and developing countries (see the table opposite). In earlier years the increase in reserves was not distributed in such an even manner; this is particularly true of 1974, when almost all the reserve growth accrued to the oil-exporting countries. The changed distribution pattern reflects above all the lower liquidity preference of the oil-exporting countries, compared with earlier years, as regards the investment of their financial surpluses. In the interest of the smooth financing of balance of payments disequilibria the investment for longer periods of a large part of the surpluses accruing to the oil countries is to be welcomed.

The upsurge in international liquidity could prove to be a dangerous source of inflation if there is a change in the world economic climate. Admittedly, a number of countries have recently undertaken considerable efforts to improve their balance of payments position and this could contribute to a slackening in the pace at which international liquidity is expanding. Support should continue to be given to this trend. For this reason, in the present discussion of possibilities of increasing international balance of payments assistance the principle should at all costs be adhered to that such facilities be made available only "conditionally", i.e. be tied to economic policy conditions.

Regional development of world monetary reserves
(Gold, special drawing rights, reserve positions in the IMF, foreign exchange)

US$ billion

Country/group of countries	Change 1: Annual average change 1970–1973	1974	1975	1976	Amount outstanding at end-1976
1. Industrial countries	+ 13.1	+ 3.6	+ 4,3	+ 10,3	131.8
of which					
United States	— 1,3	+ 1.4	+ 0.5	+ 2.5	18.3
Germany	+ 6.2	— 0.9	— 1.0	+ 3.8	34.8
France	+ 1.0	+ 0.2	+ 4.0	— 2.8	9.7
United Kingdom	+ 0.9	+ 0.4	— 1.4	— 1.2	4.2
Italy	+ 0.2	+ 0.5	— 2.0	+ 1.9	6.7
Japan	+ 2.1	+ 1.2	— 0.6	+ 3.8	16.6
2. Other developed countries 2	+ 3.9	— 2.9	— 3.1	+ 0.4	18.3
All developed countries (1 plus 2)	+ 17.0	+ 0.8	+ 1.3	+ 10.7	150.2
3. Oil-exporting countries 3	+ 2.5	+ 32.4	+ 9.8	+ 8.8	65.3
of which					
Saudi Arabia	+ 0.8	+ 10.4	+ 9.1	+ 3.7	27.0
Iran	+ 0.2	+ 7.1	+ 0.4	+ 0.1	8.8
Venezuela	+ 0.3	+ 4.1	+ 2.4	— 0.3	8.6
Nigeria	+ 0.1	+ 5.0	+ 0.2	— 0.6	5.2
Iraq	+ 0.3	+ 1.7	— 0.5	+ 1.9	4.6
Libya	+ 0.3	+ 1.5	— 1.4	+ 1.0	3.2
4. Oil-importing developing countries	+ 4.3	+ 2.8	— 1.2	+ 10.2	41.2
All countries	+ 23.7	+ 36.0	+ 9.8	+ 29.8	256.7

1 Excluding 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 excluding changes arising from fluctuations in the value of the SDR since mid-1974. — 2 Finland, Iceland, Ireland; Greece, Malta, Portugal, Spain, Turkey, Yugoslavia; Australia, South Africa, New Zealand. — 3 Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates, Venezuela.
Source: IMF.

5. Further development of the world monetary system

Partial reform of world monetary system about to be finalised

The partial reform of the international monetary system, on which the Interim Committee of the International Monetary Fund had agreed in Jamaica at the beginning of January 1976,[1] made further headway. In April 1976 the Board of Governors approved the revised Articles of the IMF and passed them on to the member countries for final approval. By the end of March 1977 21 member countries representing approximately 30 % of the total voting power, including the United States and Japan, had given their final approval to the revised Articles. In Germany a corresponding bill has been submitted to the legislative bodies. The revised IMF Articles will enter into force when they have been accepted by three fifths of the members, i.e. at present by 78 member countries, representing four fifths of the total voting power. This can be expected to happen in the course of 1977.

While the fourth general increase in IMF quotas of roughly one third to SDR 39 billion, which was approved by the Board of Governors in March 1976, cannot become effective before the revised Articles enter into force, the envisaged auction of one sixth of the IMF's gold holdings (approximately 25 million ounces) for the benefit of the developing countries and the restitution of a further one sixth to all member countries at its book value are not tied to the date on which the revised Articles come into effect. In its capacity as administrator of a legally independent Trust Fund, the IMF has carried out eight gold auctions since June 1976 in which about 5.7 million ounces of gold have been sold. The auctions held up to the present have yielded some $ 500 million for the Trust Fund. This is the amount which results from the difference between the market price and the book value of SDR 35 per fine ounce of the gold auctioned. In the summer of 1977 up to 30 % of the net proceeds is to be distributed to all developing countries directly;

1 A detailed account of this was given in the Report of the Deutsche Bundesbank for the Year 1975, page 63 ff.

the remaining approximately 70 % will go to developing countries in particular need in the form of virtually interest-free long-term loans. The first such loans have already been granted by the Trust Fund.

At the beginning of 1977 the IMF paid the first of four planned annual instalments of gold in the context of restituting the second sixth of its gold holdings; 6.25 million ounces of gold were sold at their book value to member countries in proportion to their quotas in the IMF. Corresponding to its quota of 5.48 %, Germany received 342,502 ounces, which were added to Germany's monetary reserves. In addition, the Bundesbank acted as a "turntable" in this first restitution operation in order to pass on IMF gold to countries whose currencies could not be accepted in this operation by the Fund for legal reasons; according to the regulations of the present IMF Articles, the Fund may sell gold only to replenish its currency holdings and may do so only for currencies which need to be replenished.

Part B: Notes on the Deutsche Bundesbank's annual accounts for 1976

1. Legal bases, classification and valuation

Legal bases, accounting system and annual accounts

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

Classification of annual accounts

On the assets side of the balance sheet item 22

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

has been added. On the liabilities side sub-item 8.2

Liabilities to the European Monetary Cooperation Fund

has been inserted under item 8. The previous sub-item 8.2 has become 8.3. Since the Länder Governments used up their special deposits with the Bank during the year under review, item 4 on the liabilities side has been renamed

Special deposits of the Federal Government

and the sub-items have been deleted. The item

Write-downs on monetary reserves and other foreign currency positions

has been 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, 1976, the Bank's title to the allocation of equalisation claims rose by DM 14,109.05 to DM 8,103,765,560.99; the claim on the Federal Government arising from the non-interest-bearing debt certificate issued in connection with the currency conversion in Berlin remained unchanged at DM 547,168,481.20 during the year under review.

The closing of the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank is envisaged for December 31, 1978, now that the ground has been prepared by the Act on the Conclusion of the Currency Conversion of December 17, 1975 (Federal Law Gazette I, page 3123).

3. Annual accounts

The annual accounts for 1976 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 1976.

Balance sheet

Comparison of balance sheet figures

At December 31, 1976 the balance sheet total had increased by DM 7,121.8 million, compared with end-1975, to DM 128,500.3 million.

Comparison of balance sheet figures

Millions of Deutsche Mark

Assets	December 31, 1975	December 31, 1976
Gold	14,001.7	14,001.7
Reserve position in the International Monetary Fund and special drawing rights		
Drawing rights within the gold tranche	4,394.2	4,207.2
Loans under special borrowing arrangements	460.5	1,646.9
Special drawing rights	4,454.0	4,795.9
Balances with foreign banks and money market investments abroad	51,280.4	51,982.5
Foreign notes and coins	22.9	21.3
External loans and other external assets		
Loans in connection with EEC medium-term monetary assistance	1,273.3	1,146.9
Claims arising from foreign exchange offset agreements with the United States	4,102.3	3,321.7
Other loans to foreign monetary authorities	3,925.9	4,837.9
Loans to the World Bank	2,502.1	2,541.5
Foreign bills of exchange	903.5	1,222.9
Domestic bills of exchange	5,910.2	12,184.7
Lombard loans	1,707.6	6,109.2
Cash advances (book credits)	361.2	1,795.5
Treasury bills and discountable Treasury bonds	—	—
Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin		
Equalisation claims	8,136.1	8,136.3
Non-interest-bearing debt certificate	547.2	547.2
Securities	7,952.6	1,419.3
German coins	945.8	719.9
Balances on postal giro accounts	358.0	271.3
Other claims	948.7	929.1
Land and buildings	698.4	726.9
Furniture and equipment	30.4	29.9
Items in course of settlement	5,098.8	1,740.3
Other assets	1,336.9	1,092.9
Prepaid expenses and deferred income	25.8	26.7
Balancing item in respect of valuation adjustment of monetary reserves and other foreign currency positions — balance sheet loss —	—	3,044.7
Total	121,378.5	128,500.3
Contingent claims	2.4	1.5

Liabilities	December 31, 1975	December 31, 1976
Bank notes in circulation	55,143.2	59,038.3
Deposits of banks	44,590.6	51,297.5
Deposits of public authorities		
Federal Government	2,290.6	272.4
Equalisation of Burdens Fund and ERP Special Fund	358.3	304.1
Länder Governments	2,106.5	2,094.0
Other public depositors	45.5	58.5
Special deposits of the Federal Government	[1] 3,454.5	209.6
Deposits of other domestic depositors		
Federal Railways	4.8	4.1
Federal Post Office	1,961.8	2,070.5
Other depositors	535.2	513.6
Balances on cash deposit special accounts	256.0	58.0
Liabilities arising from mobilisation and liquidity paper sold	4,173.2	6,476.4
Liabilities arising from foreign business	840.4	1,097.1
Contra-entry to special drawing rights allocated	1,665.1	1,488.8
Provisions	1,835.0	1,885.0
Other liabilities	43.3	38.9
Deferred expenses and accrued income	247.2	204.0
Capital	290.0	290.0
Reserves	929.2	1,099.5
Balance sheet profit	608.1	—
Total	121,378.5	128,500.3
Contingent liabilities	2.4	1.5

1 Including DM 190.7 million of Länder Government special deposits.

Assets

Gold

At DM 14,001.7 million, the gold holding at December 31, 1976 was the same as at end-1975.

Reserve position in the International Monetary Fund and special drawing rights

Drawing rights within the gold tranche

At December 31, 1976 the drawing rights within the gold tranche amounted to DM 4,207.2 million against DM 4,394.2 million at end-1975. The changes are due to other members' Deutsche Mark drawings and transactions of similar effect equivalent to SDR 362.7 million, to Deutsche Mark repayments and transactions of similar effect equivalent to SDR 261.3 million, and to the valuation adjustment at the end of the year. The level of drawing rights within the gold tranche constitutes 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 67.2 million.

Loans under special borrowing arrangements

Loans amounting to SDR 450 million were granted to the International Monetary Fund during the year under review to finance drawings of other member countries under the 1975 IMF oil facility, which has expired in the meantime, after an SDR 150 million loan had been made available in 1975. These loans, totalling SDR 600 million in all, were equivalent to DM 1,646.9 million at December 31, 1976. No loans were granted to the IMF under the General Arrangements to Borrow (GAB) in 1976.

Special drawing rights

The amount of special drawing rights (SDRs) held at end-1976 was DM 4,795.9 million compared with DM 4,454.0 million at end-1975. The change was due to the acquisition of SDRs under the European Community settlement arrangements (SDR 301.7 million), the interest paid on SDRs acquired by the Bank against payment (SDR 35.5 million), the sale of SDRs in freely agreed transactions (SDR 40.8 million) and the valuation adjustment at the end of the year. The valuation adjustment affected both the total holding of SDR 1,747.3 million and the contra-entry to SDRs allocated (SDR 542.4 million) shown on the liabilities side.

Balances with foreign banks and money market investments abroad

Balances with foreign banks and money market investments abroad amounted to DM 51,982.5 million at December 31, 1976, against DM 51,280.4 million at December 31, 1975. In the year under review current transactions resulted in an increase of roughly DM 6 billion, but this rise was largely absorbed by the valuation adjustment of foreign exchange claims as at December 31, 1976; on balance there was a growth of DM 702.1 million.

Foreign exchange dealing

The Bank's turnover in foreign exchange spot deals (foreign currency against Deutsche Mark) amounted to DM 24,720.8 million in the year under review, against DM 16,690.6 million in 1975. The number of deals increased from 5,424 in 1975 to 6,931 in 1976. Such deals comprised

	1975		1976	
	Number	DM million	Number	DM million
Purchases	2,328	5,758.1	3,488	12,245.3
Sales	3,096	10,932.5	3,443	12,475.5
	5,424	16,690.6	6,931	24,720.8.

The increase in turnover was caused both by a rise in U.S. dollar transactions and by the growth of interventions in connection with the European system of narrower margins.

Cross deals (foreign currency against foreign currency) showed only a small change on the year; in 1976 the Bank effected 612 cross deals equivalent to DM 4,383.6 million, against 666 deals equivalent to DM 4,350.8 million in 1975. In addition, 403 U.S. dollar inter-centre switch transactions amounting to US$ 48.6 million were concluded, against 328 transactions amounting to US$ 41.6 million in the previous year.

External payments

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

External payments

Number of orders

Year	Outgoing external payment orders				Incoming external payment orders		
	in foreign currency	in Deutsche Mark	Total	of which settled under automated standing order procedure	in foreign currency	in Deutsche Mark	Total
1975	563,827	1,212,043	1,775,870	1,487,245	16,562	191,350	207,912
1976	552,083	1,225,617	1,777,700	1,506,411	17,143	199,156	216,299

Sale of foreign cheques

During 1976 7,268 (1975: 5,245) foreign cheques payable to order worth DM 345.2 million (1975: DM 276.0 million) were sold. In addition, the Bank sold 24,994 traveller's cheques worth DM 2.7 million in the year under review (1975: 21,231 worth DM 2.2 million).

Foreign commission business

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

	1975 Number	1976 Number
Bills, cheques, etc.	13,875	20,683
Foreign notes and coins	4,341	4,272
	18,216	24,955.

Foreign notes and coins
Purchases and sales

At DM 21.3 million, the amount of foreign notes and coins held at the end of 1976 was DM 1.6 million lower than at December 31, 1975. During the year under review the Bank effected 59,653 purchases of foreign notes and coins (1975: 60,533) and 36,653 sales of foreign notes and coins (1975: 40,164).

External loans and other external assets
Loans in connection with EEC medium-term monetary assistance

As in 1975, 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 the United States

The U.S. dollar claims arising from foreign exchange offset agreements concluded with the United States in 1971 and 1974 are shown here.

Other loans to foreign monetary authorities

This item comprises the U.S. dollar loans granted to the Banca d'Italia and the Banco de Portugal against the security of gold.

Loans to the World Bank

As in the preceding years, loans to the World Bank were mainly granted against borrower's notes expressed in Deutsche Mark.

Foreign bills of exchange

At the end of 1976 the portfolio of foreign bills accumulated through purchases within Germany was DM 1,222.9 million, as compared with DM 903.5 million at the end of 1975. The share of Deutsche Mark bills in the total value of foreign bills purchased averaged about 60 % in 1976 (1975: 57 %).

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

Land Central Bank	1975 Number	1975 DM million	1976 Number	1976 DM million
Baden-Württemberg	17,273	520.7	20,544	668.9
Bavaria	6,216	569.5	6,760	695.3
Berlin	245	75.8	348	108.8
Bremen	776	93.2	779	158.7
Hamburg	4,828	402.7	5,906	463.9
Hesse	6,776	753.5	7,141	1,028.4
Lower Saxony	1,539	134.4	1,285	223.8
North Rhine-Westphalia	13,749	911.1	17,439	1,161.1
Rhineland-Palatinate	3,056	229.9	3,594	335.6
Saarland	1,828	232.6	1,804	271.7
Schleswig-Holstein	234	13.2	207	23.5
Total	56,520	3,936.6	65,807	5,139.7

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 9,043 million, was notably larger than in 1975 (DM 7,078 million). At the end of 1976 the Bank held DM 12,184.7 million of domestic bills, against DM 5,910.2 million at end-1975. The reasons underlying the increase in purchases of bills of exchange are set out in Part A of this Report.

The domestic bill portfolio comprised	Dec. 31, 1975 DM million	Dec. 31, 1976 DM million
Domestic bills discounted	5,238.8	10,146.2
Promissory notes of the Federal Office for Agricultural Market Organisation acquired in the course of open market operations	137.6	718.0
Prime bankers' acceptances acquired in the course of open market operations	533.8	1,320.5
	5,910.2	12,184.7.

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

Land Central Bank	1975 1 '000	1975 1 DM million	1976 '000	1976 DM million
Baden-Württemberg	206	7,698.1	243	7,985.2
Bavaria	134	6,754.7	150	7,960.0
Berlin	14	2,161.9	14	2,131.9
Bremen	20	1,513.1	20	1,457.1
Hamburg	109	8,192.4	106	7,028.1
Hesse	182	18,564.6	162	17,151.2
Lower Saxony	60	3,044.4	70	2,959.1
North Rhine-Westphalia	230	15,151.8	228	14,377.1
Rhineland-Palatinate	36	1,258.2	39	1,478.8
Saarland	7	717.9	8	731.1
Schleswig-Holstein	22	872.6	24	978.5
Total	1,020	65,929.7	1,064	64,238.1

1 Including domestic bills bought in open market transactions under repurchase agreements.

The average value of the bills purchased in 1976 was DM 60,373 compared with DM 64,616 in 1975.

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

	1975 Number	1975 DM million	1976 Number	1976 DM million
	4,104	34.1	3,335	35.9
as % of the total purchased	0.40	0.05	0.31	0.06.

Discount rate

The Bank's discount rate for domestic and foreign bills stood at 3½ % throughout the year under review.

Agricultural Market Organisation bills

The Bank's open market operations in promissory notes of the Import and Storage Agency and its successor, the Federal Office for Agricultural Market Organisation, increased in the year under review. Purchases reached a nominal value of DM 2,975.4 million (1975: DM 2,013.8 million), while a nominal DM 1,171.0 million (1975: DM 1,142.7 million) was sold from the Bank's portfolio prior to maturity. Bills amounting to DM 1,224.0 million (1975: DM 1,029.0 million) were redeemed from the Bank's portfolio; at December 31, 1976 the portfolio totalled DM 718.0 million (end-1975: DM 137.6 million). At the end of the year under review the Bank's commitment to purchase promissory notes of the Federal Office for Agricultural Market Organisation and the inclusion of such bills in the Bank's money market regulating arrangements expired.

Prime bankers' acceptances

The amount of prime bankers' acceptances which the Bank is prepared to purchase in its open market operations remained unchanged at DM 1.5 billion.

In the year under review the Bank's purchases from the Privatdiskont-Aktiengesellschaft, at DM 5,116.2 million, were much larger than in the preceding year (DM 2,801.6 million), possibly owing to the Bank's relatively favourable buying rates throughout the year. Resales from the Bank's portfolio via the broker to the market, at DM 2,173.6 million, ran at approximately the same level as in 1975 (DM 2,254.7 million), implying that – as in previous years – bank demand for prime bankers' acceptances as a form of investment was quite strong at times. DM 2,155.9 million (1975: DM 719.9 million) of prime bankers' acceptances from the Bank's portfolio were redeemed on maturity; at December 31, 1976 the Bank held DM 1,320.5 million (end-1975: DM 533.8 million) of prime bankers' acceptances stemming from open market operations.

Open market transactions in bills under repurchase agreements

No open market operations in bills under repurchase agreements were conducted by the Bank in 1976.

Lombard loans

Taking the average of all return dates of the year under review, the Bank granted DM 1,419 million of lombard loans to banks (1975: DM 551 million). As in preceding years, such loans were subject to marked fluctuations, the largest amounts being granted in July, November and December.

Lombard loans in the Land Central Bank areas

Millions of Deutsche Mark

Land Central Bank	Lombard loans granted		Outstanding at	
	1975	1976	Dec. 31, 1975	Dec. 31, 1976
Baden-Württemberg	6,028.4	14,275.3	172.4	1,637.1
Bavaria	3,058.0	5,271.4	68.3	295.8
Berlin	1,310.3	1,137.1	—	—
Bremen	457.9	761.2	0.3	18.0
Hamburg	3,455.8	5,526.5	92.2	193.3
Hesse	39,860.1	70,232.7	1,082.5	2,650.6
Lower Saxony	2,269.7	3,193.3	24.5	438.1
North Rhine-Westphalia	8,116.4	11,504.8	220.1	608.1
Rhineland-Palatinate	2,793.9	2,893.8	41.3	100.0
Saarland	337.6	534.6	3.6	24.1
Schleswig-Holstein	701.0	1,925.8	2.4	144.1
Total	68,389.1	117,256.5	1,707.6	6,109.2

Lombard rate

Throughout the year under review the lombard rate stood at 4½ %.

Cash advances (book credits)

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

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

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

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.

Federal Government
Equalisation of Burdens Fund
Länder Governments

Cash advances (book credits)

Millions of Deutsche Mark

Borrower	December 31, 1975	December 31, 1976
Federal Government	—	1,651.0
Länder Governments		
Berlin	114.0	138.7
Hesse	88.6	5.8
Lower Saxony	23.8	—
Rhineland-Palatinate	134.8	—
Total	361.2	1,795.5

At December 31, 1976, just as at end-1975, no cash advances (book credits) to the Equalisation of Burdens Fund were outstanding.

Federal Railways
Federal Post Office

No book credits to the Federal Railways or Federal Post Office were outstanding at December 31, 1976; such credits are shown together with claims arising 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 Bank's discount rate.

Treasury bills and discountable Treasury bonds

The Bank was again very active as the selling agent for the discountable Treasury bonds of the Federal Government and its special funds. These securities, which serve financing purposes, are distinct from the mobilisation and liquidity paper issued pursuant to sections 42 and 42 (a) of the Bundesbank Act, which will be commented on below. Treasury bills serving financing purposes were not issued in the year under review.

Federal Government

To meet the borrowing requirements of the Federal Government, DM 4,181.5 million (1975: DM 7,159.9 million) of discountable Treasury bonds were issued. As usual, the bulk of these securities were purchased by banks and other institutional investors. To place this paper the Bank for the first time used the tender procedure, which had previously been employed only to sell medium-term notes. The issue of 2-year discountable Treasury bonds by tender between November 8 and 11 yielded DM 1,620.6 million. It resulted in the fixing of a selling rate of 5.45 % for these securities, representing a yield of 5.94 % per annum.

Not quite a quarter of the total sales (DM 911 million) of discountable Treasury bonds of the Federal Government consisted of a special type, Federal "financing bonds", which have been sold to private investors, mostly through banks, since February 1975 under a standardised procedure as securities not returnable prior to maturity.

After the redemption of DM 7,823.8 million of discountable Treasury bonds which fell due in 1976 (1975: DM 704.7 million), the amount of discountable Treasury bonds of the Federal Government types "B" and "BN" (the latter not being returnable prior to maturity) outstanding at December 31, 1976 was DM 7,911.6 million (end-1975: DM 11,553.9 million). Of this total, DM 1,324.5 million was repurchasable by the Bank (type "B").

Federal Railways

The (returnable) discountable Treasury bonds of the German Federal Railways which fell due in 1976, amounting to DM 100.0 million, were reissued. Of the securities of the German Federal Railways which are not returnable before maturity (marked "BaN"), DM 170.0 million was redeemed and DM 10.6 million reissued. The amount of Federal Railways discountable Treasury bonds outstanding at end-1976 was DM 660.6 million (end-1975: DM 820.0 million).

Federal Post Office

The German Federal Post Office redeemed DM 292.3 million of outstanding discountable Treasury bonds on maturity in the year under review. The Post Office issued no discountable Treasury bonds last year, so that the amount of such paper (all of it of the non-returnable type) outstanding at end-1976 dropped to DM 7.7 million (end-1975: DM 300.0 million).

At December 31, 1976 the outstanding amount of money market paper issued for the account of the Federal Government and its special funds was DM 8,579.9 million (end-1975: DM 12,673.9 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, 1975	Issued in 1976	Redeemed in 1976	Outstanding at Dec. 31, 1976
Discountable Treasury bonds of the Federal Republic of Germany "B" and "BN" (including "financing bonds")	11,553.9	4,181.5	7,823.8	7,911.6
Discountable Treasury bonds of the German Federal Railways "Ba" and "BaN"	820.0	110.6	270.0	660.6
Discountable Treasury bonds of the German Federal Post Office "PN"	300.0	—	292.3	7.7
Total	12,673.9	4,292.1	8,386.1	8,579.9

Länder Governments

With respect to Länder Government money market paper, in 1976 DM 391.2 million of discountable Treasury bonds of one Land Government were redeemed and DM 200.0 million were issued in agreement with the Bank. The amount of discountable Treasury bonds outstanding at end-1976 was DM 501.2 million (end-1975: DM 692.4 million).

No public authority money market paper was held by the Bank during the year under review.

Equalisation claims on the 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 at December 31, 1975, increased by DM 117,949.03 in the year under review. The change of DM 14,109.05 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, 1976, which account is attached to the German original of this Report as Appendix 1.

Non-interest-bearing debt certificate

In 1976 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 1976

Thousands of Deutsche Mark

Type of paper	Total at December 31, 1975	Increase in 1976	Total at December 31, 1976
Equalisation claims arising from			
Own conversion account			
Bank deutscher Länder	5.504,415.5	4.3	5,504,419.3
Land Central Banks	2,599,325.3	9.8	2,599,335.1
	8,103,740.8	14.1	8,103,754.9
Conversion of Berlin pre-capitulation balances	30,967.9	103.6	31,071.5
Conversion of RM balances at banks in the Eastern Sector of Berlin	1,462.2	0.3	1,462.5
	8,136,170.9	118.0	8,136,288.9
Non-interest-bearing debt certificate	547,168.5	—	547,168.5
Total	8,683,339.4	118.0	8,683,457.4

Loans to Federal Railways and Federal Post Office

No credits to the Federal Railways or Federal Post Office were outstanding at December 31, 1976. See also the notes on the items "Cash advances (book credits)" and "Treasury bills and discountable Treasury bonds".

Securities

In the year under review, as part of its open market policy, the Bank sold by far the greater part of the bonds of the Federal Government, Railways and Post Office that it had bought in 1975. The Bank's portfolio of securities – chiefly bonds of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office – consequently diminished by DM 6,533.3 million to DM 1,419.3 million (end-1975: DM 7,952.6 million). Most of the transactions took place in March and between September and November 1976. An analysis of these sales of bonds by the Bank and an account of the reasons of open market policy underlying them are given in Part A of this Report.

Issue of bonds

In 1976 thirteen bond issues totalling DM 7,960 million (1975: nine issues amounting to DM 5,500 million) were launched through the Federal Bond Consortium, which is under the direction of the Bank. Of this amount, DM 1,490 million (1975: DM 630 million) was reserved for the issuers' own institutions and for price support operations.

Bond issues of the Federal Republic of Germany and German Federal Railways in 1976

Issuer	Amount issued: Total DM million	Amount issued: of which sold through Federal Bond Consortium DM million	Terms: Nominal interest rate (%)	Terms: Period to maturity in years	Terms: Issue price (%)	Terms: Yield (%)	Terms: Start of sales 1976
German Federal Railways	700	600	8	7	100	8.00	Jan. 26
Federal Republic of Germany	250	200	7½	5	99.50	7.62	Feb. 11
Federal Republic of Germany	450	400	8	8	100	8.00	Feb. 11
Federal Republic of Germany	660	600	7½	8	99.50	7.59	Mar. 22
Federal Republic of Germany	800	700	8	5	99.50	8.13	July 12
German Federal Railways	700	600	8	5	99.50	8.13	Aug. 2
Federal Republic of Germany	500	400	8	5	99.75	8.06	Aug. 16
Federal Republic of Germany	300	270	8¼	8	99	8.43	Aug. 16
German Federal Railways	400	300	8¼	8	99.75	8.29	Aug. 30
Federal Republic of Germany	700	600	8	9	100	8.00	Sep. 29
Federal Republic of Germany	1,000	800	7¼	10	99.50	7.32	Nov. 25
Federal Republic of Germany	750	500	7	6	100	7.00	Dec. 29
Federal Republic of Germany	750	500	7¼	10	99.50	7.32	Dec. 29

Issue of Federal savings bonds

With the assistance of the Bank, DM 4,976.7 million (gross) of Federal savings bonds were sold to private investors via banks in 1976 (1975: DM 5,287.9 million). Sales were particularly large in March, at DM 842.0 million, and December, at DM 1,578.2 million. DM 47.7 million (1975: DM 70.2 million) of savings bonds from former tranches were resold to the issuer before maturity, and a further DM 295.4 million were redeemed on maturity. The amount of Federal savings bonds outstanding rose from DM 9,874.5 million (end-1975) to DM 14,508.1 million at December 31, 1976. In the course of the year under review the rate of interest paid on Federal savings bonds was reduced twice 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 1976

		Gross sales DM million			Interest rate (%) in and yield (%) after . . . year after issue						
Issues	Sales period 1976	Federal savings bonds A 1	Federal savings bonds B 2	Total	1st	2nd	3rd	4th	5th	6th	7th
1976/1	Jan. 2–Mar. 22	890.5	538.1	1,428.6	5.25 5.25	6.50 5.86	7.25 6.29	8.00 6.68	8.50 6.99	9.00 7.27	
1976/2					5.25 5.25	6.50 5.87	7.25 6.33	8.00 6.75	8.50 7.09	9.00 7.41	9.00 7.63
1976/3	Apr. 1–Dec. 15	2,138.9	1,285.4	3,424.3	4.75 4.75	6.00 5.36	7.00 5.87	7.50 6.24	8.00 6.55	8.50 6.82	
1976/4					4.75 4.75	6.00 5.37	7.00 5.91	7.50 6.31	8.00 6.64	8.50 6.95	8.50 7.17
1977/1	Dec.21–Dec.31	61.0	62.8	123.8	4.75 4.75	6.00 5.36	7.00 5.87	7.25 6.19	7.50 6.42	8.50 6.71	
1977/2					4.75 4.75	6.00 5.37	7.00 5.91	7.25 6.25	7.50 6.50	8.50 6.83	8.50 7.06
Total	Jan. 2–Dec. 31	3,090.4	1,886.3	4,976.7							

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

Issue of medium-term notes

Through the agency of the Bank DM 2,409.4 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany were sold by tender during 1976 (1975: DM 3,746.6 million). There were two issues running for three and four years and bearing nominal rates of interest of 7 and 7¼ %.

Treasury bonds (medium-term notes) issued by tender in 1976

Issuer	Amount DM mn	Interest rate %	Running for . . . years	Selling price %	Yield on issue %	Month of sale
Federal Republic of Germany	1,912.9	7	3	99.60	7.15	May
Federal Republic of Germany	496.5	7¼	4	99.30	7.46	May

Moreover, in agreement with the Bank DM 2,765 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany and the Federal Railways were sold without using the tender procedure (1975: DM 1,350 million).

Admission to stock exchange dealing

In the year under review the Bank introduced the bond issues of the Federal Republic of Germany and the German Federal Railways, together with two issues of the Equalisation of Burdens Bank and one issue of the Reconstruction Loan Corporation, for official dealing on all German stock exchanges. The Bank also introduced, in fourteen cases, medium-term notes issued in 1976 by the Federal Republic of Germany, three issues of medium-term notes of the German Federal Railways and five issues of medium-term notes of the Reconstruction Loan Corporation for regulated unofficial dealing on particular stock exchanges.

Price support operations

In the year under review, as in preceding years, the Bank undertook price support operations for the account of the issuers on the eight German stock exchanges 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 price fluctuations. Such price support operations for the account of the issuers were not necessary at times because, as explained above, the Bank conducted open market operations using its own holdings of these issuers' bonds.

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 8,346,756 interest coupons and matured bonds during the year under review (1975: 10,351,004). Of this number, 422,057 interest coupons and matured bonds were presented to foreign agents for redemption (1975: 458,108).

German coins

The amount of German coins held by the Bank was DM 719.9 million at the end of 1976 (end-1975: DM 945.8 million). In 1976 the Federal Government was credited with DM 579.4 million for coins taken over from the Mints (including DM 311.5 million for DM 5 coins, second issue), and debited with DM 511.8 million for coins no longer fit for circulation (including DM 500.8 million for the silver DM 5 coins which had been withdrawn from circulation). Altogether, between 1948 and 1976 the Bank – acting for the account of the Federal Government – took over coins amounting to DM 7,977.6 million and redeemed DM 1,557.9 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 1976 (DM 5,699.8 million) divided by the number of inhabitants of the Federal Republic of Germany including the Land of Berlin at September 30, 1976 (61.5 million) yields a figure of DM 92.70 per head of population (1975: DM 87.62).

In the year under review the DM 5 commemorative coin "Hans Jacob Christoph von Grimmelshausen" was put into circulation.

Balances on postal giro accounts

The postal giro account balances at December 31, 1976, including the branches' transfers in transit to the postal giro account of the Bank (Central Office) at Frankfurt am Main, totalled DM 271.3 million (1975: DM 358.0 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

	1975				1976			
	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	99,380	18,498.1	18,931	1,952.3	100,416	19,546.6	18,869	2,015.0
Bavaria	83,177	13,150.3	14,230	4,976.4	79,145	12,127.8	14,748	5,463.2
Berlin	25,765	2,303.0	3,346	799.1	28,831	2,632.6	2,837	850.1
Bremen	12,362	560.8	1,472	0.2	11,902	577.8	1,534	0.2
Hamburg	62,816	13,206.3	2,039	109.6	70,183	14,788.4	1,762	88.6
Hesse	54,785	8,075.0	8,481	3,821.6	62,901	7,768.0	8,412	4,162.0
Lower Saxony	69,346	6,336.3	7,580	885.8	65,722	6,677.9	7,096	1,009.5
North Rhine-Westphalia	114,360	18,768.1	18,660	4,985.9	115,793	18,734.1	18,760	4,826.0
Rhineland-Palatinate	32,582	2,717.8	7,121	653.9	30,507	2,320.2	6,644	690.8
Saarland	5,319	1,788.7	1,058	0.1	5,162	1,670.6	1,006	0.1
Schleswig-Holstein	4,787	126.3	2,858	0.4	5,063	87.8	2,671	0.4
Total	564,679	85,530.7	85,776	18,185.3	575,625	86,931.8	84,339	19,105.9
Bundesbank – Central Office –	17,497	1,722.2	3,009	5.8	20,106	1,245.6	2,084	4.7
Grand total	582,176	87,252.9	88,785	18,191.1	595,731	88,177.4	86,423	19,110.6

Other claims

Other claims are shown at DM 929.1 million (end-1975: DM 948.7 million). They include the balance arising from intra-German settlements (commercial payments under the "Berlin Agreement"), which amounted to DM 718.3 million (1975: DM 754.9 million). The turnover on the relevant sub-accounts is shown in Part A, IV, of the German original of this Report.

Land and buildings
Furniture and equipment

With additions of DM 75.6 million and depreciation of DM 47.1 million, land and buildings are shown at DM 726.9 million. The balance sheet value of the furniture and equipment amounted to DM 29.9 million after additions of DM 19.5 million and depreciation of DM 20.0 million.

Items in course of settlement

The balance sheet item "Items in course of settlement" mainly comprises the intercity credit and debit transfers that were proceeding inside the Bank at the end of the year as well as cheques and direct debits being cleared. At December 31, 1976 the balance of items in course of settlement stood at DM 1,740.3 million (end-1975: DM 5,098.8 million).

Other assets

The "Other assets" are shown at DM 1,092.9 million (end-1975: DM 1,336.9 million). As in the previous year, much the greater part consists of interest due in 1977 but assignable to the profit and loss account for the year under review on funds employed abroad and on securities (DM 998.0 million, against DM 1,240.9 million at end-1975).

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

Prepaid expenses and deferred income

The prepaid expenses and deferred income comprise salary and pension payments made in the year under review but relating to 1977.

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

See the notes on page 87 of this Report.

Liabilities

Bank notes in circulation

The bank notes in circulation at December 31, 1976 amounted to DM 59,038.3 million, against DM 55,143.2 million at end-1975.

Currency in circulation

Millions of Deutsche Mark

End of year	Bank notes	Federal coins	Currency in circulation, total
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
1976	59,038.3	5,699.8	64,738.1

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

In 1976 DM 29,825.0 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:

	1971	1972	1973	1974	1975	1976
Number (millions)	377.3	363.1	460.1	424.0	399.4	486.4
Value (DM million)	12,184.5	12,693.8	16,528.0	15,638.0	15,110.5	18,556.5.

The number and value of the counterfeit notes and coins detained in payments almost trebled in comparison with 1975, since a substantial quantity of counterfeit DM 100 notes was detected in 1976.

By contrast, the amount of counterfeit coins detected declined in the year under review, after rising steeply in 1975 owing to the withdrawal of the silver DM 5 coins then in circulation.

Counterfeits detected

Year	Bank notes		Federal coins	
	Number	DM '000	Number	DM '000
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
1976	2,709	275.0	8,249	31.0

Deposits of banks

The banks' deposits on giro accounts mainly comprise the minimum reserves to be maintained with the Bank. The sub-item "Other" contains deposits of domestic banks on U.S. dollar accounts. Compared with 1975 banks' deposits changed as follows:

Deposits of banks	Dec. 31, 1975 DM million	Dec. 31, 1976 DM million
Deposits on giro accounts	44,563.0	51,269.3
Other	27.6	28.2
	44,590.6	51,297.5.

Transfers between the U.S. dollar accounts of German banks numbered 88,916 in the year under review against 81,393 in 1975.

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, 1975 DM million	Dec. 31, 1976 DM million
Federal Government	2,290.6	272.4
Equalisation of Burdens Fund and ERP Special Fund	358.3	304.1
Länder Governments	2,106.5	2,094.0
Other public depositors	45.5	58.5
	4,800.9	2,729.0.

Special deposits of the Federal Government

The special deposits of the Federal Government changed as follows:

Federal Government	Dec. 31, 1975 DM million	Dec. 31, 1976 DM million
Anticyclical reserves	2,477.0	1.0
Stability surcharge	542.5	91.8
Investment tax	244.3	116.8
	3,263.8	209.6.

The special deposits of the Länder Governments, which had amounted to DM 190.7 million at end-1975, were all used to finance certain economic stimulation programmes.

Deposits of other domestic depositors

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

	Dec. 31, 1975 DM million	Dec. 31, 1976 DM million
Federal Railways	4.8	4.1
Federal Post Office (including postal giro and postal savings bank offices)	1,961.8	2,070.5
Other depositors	535.2	513.6
	2,501.8	2,588.2.

Giro transactions, simplified cheque and direct debit collections

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

	Number	Amount
1975	99.52	97.94
1976	99.82	98.06.

Annual turnover on the giro accounts of the Deutsche Bundesbank

	1975			1976		
	Number of trans-actions	Total amount	Average amount	Number of trans-actions	Total amount	Average amount
Turnover	'000	DM mn	DM '000	'000	DM mn	DM '000
(a) Credits						
Cash payments	1,105	164,512	148.9	1,120	172,384	153.9
Clearings with account-holders	9,036	2,293,828	253.9	10,906	2,569,968	235.6
Local transfers	33,166	2,357,603	71.1	30,094	2,592,238	86.1
Intercity transfers	161,205	2,420,796	15.0	171,005	2,643,873	15.6
Cheque and direct debit collections (total presented)	423,123	970,178	2.3	500,901	1,117,396	2.2
Total	627,635	8,206,917	—	714,026	9,095,859	—
(b) Debits						
Cash payments	1,487	173,843	116.9	1,460	180,083	123.3
Clearings with account-holders	4,141	2,260,349	545.8	4,042	2,510,217	621.0
Local transfers	33,166	2,357,603	71.1	30,094	2,592,238	86.1
Intercity transfers	163,207	2,450,866	15.0	174,090	2,691,563	15.6
Cheque and direct debit collections (total paid)	422,536	968,833	2.3	502,309	1,120,537	2.2
Total	624,537	8,211,494	—	711,995	9,094,638	—
(c) as % of total turnover (credits and debits)		%			%	
Cash payments		2.06			1.94	
Clearings with account-holders		27.74			27.93	
Local transfers		28.72			28.50	
Intercity transfers		29.67			29.33	
Cheque and direct debit collections (total presented and paid)		11.81			12.30	
		100.00			100.00	

The annual turnover on the giro accounts of the Bank rose steeply in comparison with 1975. The reason for this continued upward trend was that banks, in particular, made increasing use of the Bank's services. This applies especially to collections, where the number of items presented grew by roughly 18 % in 1976, so that it has more than doubled in the last five years.

The proportion of automatically processed intercity transfers continued to rise steeply in the year under review. In 1976 83 % (1975: 66 %) of the items presented for collection and 64 % (1975: 48 %) of the credit transfers were handled by the Bank's six computer centres. It is worth mentioning in this connection that the banks have channelled a growing proportion of the local transfers through the computer centres since 1973; the number of local transfers accordingly declined by about 10 % last year.

In 1976 the voucherless exchange of data media — the latest service in the field of automated processing, only introduced at the end of 1975 — was for the first time operative over a whole year. The number of payments (direct debits and credit transfers) submitted to the Bank recorded on magnetic tape amounted to 134 million in 1976; this means that 25 % of the payment orders presented under the automated processing procedure were handled without issuing vouchers. This clearly attests the trend towards the increasing use of this method, which is far more economic than the voucher system.

For the recipient Bank branches the result of the rise in the proportion of automatically processed payments owing to the greater channelling of payments through the computer centres was a pronounced concentration of the incoming material. In 1976 the number of items debited in collections therefore declined further from 33.0 million to 25.9 million and that of items credited in credit transfers from 21.3 million to 20.8 million.

Domestic commission business

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

	Number	DM million
1975	65,077	980.1
1976	65,223	800.6.

Balances on cash deposit special accounts

The balances on cash deposit special accounts decreased from DM 256.0 million at end-1975 to DM 58.0 million at December 31, 1976. As in 1975, these balances consisted entirely of deposits paid in arrears; last year they were subject to marked fluctuations.

Liabilities arising from 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 in the aggregate — i. e. taking Treasury bills and discountable Treasury bonds together — slightly up on the year at DM 21,892.6 million (1975: DM 18,156.5 million). This was due to increased sales of discountable Treasury bonds, which came to DM 3,493.4 million in 1976 (1975: DM 1,381.2 million), and particularly to the fact that the Bank offered such securities to the general public in the fourth quarter of 1976, for the first time for some while, in order to absorb liquid funds. In this way the Bank supplemented the open market operations which it had been conducting until then with its own security holdings, which were gradually dwindling. The amount of mobilisation and liquidity Treasury bonds outstanding consequently rose in the course of the year by DM 2,305.4 million to DM 3,623.9 million at December 31, 1976.

The turnover in mobilisation and liquidity Treasury bills slightly exceeded the relatively large 1975 volume. Sales totalling DM 18.4 billion in the year under review (1975: DM 16.8 billion) compared with redemptions of about the same size. The revolving investment of foreign institutions' resources again played an important part in these transactions.

Mobilisation and liquidity paper sold and redeemed

Millions of Deutsche Mark

Type of paper	1975 Outstanding at Dec. 31	1976 Sold	Redeemed	Outstanding at Dec. 31
Treasury bills (running for up to 90 days)	2,854.7	18,399.2	18,401.4	2,852.5
Discountable Treasury bonds (running for 6 to 24 months)	1,318.5	3,493.4	1,188.0	3,623.9
Total	4,173.2	21,892.6	19,589.4	6,476.4

Liabilities arising from foreign business

At December 31, 1976 the liabilities arising from foreign business were DM 256.7 million larger than at end-1975; they consisted of

	Dec. 31, 1975 DM million	DM million	Dec. 31, 1976 DM million	DM million
Deposits of foreign depositors				
Banks	374.5		289.3	
Other depositors	453.8	828.3	490.0	779.3
Liabilities to the European Monetary Cooperation Fund		–		306.0
Other				
Provision of cover for credits of				
non-residents	0.2		3.2	
residents	11.4		8.3	
	11.6		11.5	
Miscellaneous liabilities	0.5	12.1	0.3	11.8
		840.4		1,097.1.

The liabilities to the European Monetary Cooperation Fund arose from support operations in favour of the Deutsche Mark which were necessary after the re-alignment of exchange rate relationships within the European system of narrower margins (October 18, 1976) in order to maintain the newly agreed limit rates between the Danish krone and the Deutsche Mark.

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 between 1970 and 1972 totalling SDR 542.4 million.

Provisions

Provision for pensions

After withdrawal of DM 95.5 million for the payment of pensions and widows' and orphans' allowances and an increase of DM 145.5 million, the provision for pension liabilities is shown at DM 1,585.0 million.

Other provisions

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

Other liabilities

The "Other liabilities" are shown at December 31, 1976 at DM 38.9 million, against DM 43.3 million at the end of 1975.

Deferred expenses and accrued income

Deferred expenses and accrued income amounted to DM 204.0 million at December 31, 1976 (end-1975: DM 247.2 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

In accordance with the Central Bank Council's decision of April 1, 1976, DM 121.7 million of the net profit for 1975 was added to the legal reserve and DM 48.6 million was added to the other reserves; the reserves consequently rose from DM 929.2 million to DM 1,099.5 million.

Contingent liabilities and claims

The contingent liabilities and claims amounted to DM 1.5 million (end-1975: DM 2.4 million).

Profit and loss account

Comparison of expenditure and receipts

Millions of Deutsche Mark

Expenditure	1975	1976	Receipts	1975	1976
Interest paid on mobilisation and liquidity paper	171.9	341.2	Interest received		
Other interest paid	5.4	4.8	Funds invested abroad	4,268.4	4,423.5
	177.3	346.0	Loans to domestic banks	451.9	402.1
Administrative expenditure			Equalisation claims	244.1	244.1
Staff costs	493.6	506.2	Securities	228.0	476.5
Other	104.0	108.4	Cash advances (book credits), Treasury bills and Treasury bonds	40.3	1.8
Note printing	63.9	86.4	Other interest received	6.9	3.0
Depreciation	55.8	67.1		5,239.6	5,551.0
Increase in provision for pensions	253.5	145.5	Fees received	10.5	7.8
Pension payments in respect of Reichsbank	37.5	36.4	Gains from valuation adjustment of monetary reserves and other foreign exchange positions	5,479.8	—
Other expenditure	27.2	22.6	Other receipts	22.3	204.0
Write-downs on monetary reserves and other foreign exchange positions	—	7,488.9	Annual loss	—	3,044.7
Annual profit	9,539.4	—			
Total	10,752.2	8,807.5	Total	10,752.2	8,807.5

Before allowing for the valuation adjustment of monetary reserves and other foreign exchange positions at the end of the year, receipts exceeded expenditure in 1976 by DM 4,444.2 million (1975: 4,059.6 million).

Receipts

Interest

	1975 DM million	1976 DM million
Interest received amounted to	5,239.6	5,551.0.
After deduction of interest paid, namely	177.3	346.0,
interest is shown in the profit and loss account at	5,062.3	5,205.0.

In the year under review total interest income, at DM 5,551.0 million, was DM 311.4 million higher than a year before. The interest received from funds invested abroad rose slightly (by DM 155.1 million to DM 4,423.5 million) owing to larger investments, although interest rates declined. Interest receipts from lending to German banks – domestic bills, lombard loans and foreign bills bought in Germany – fell by DM 49.8 million to DM 402.1 million, despite heavier borrowing by the banks, because the rates charged were lower than in 1975. The interest received from securities went up by DM 248.5 million to DM 476.5 million as the security portfolio was very large, especially in the first half of 1976. The interest accruing from equalisation claims remained unchanged at DM 244.1 million. Other interest income diminished by DM 42.4 million to DM 4.8 million, mainly because recourse to cash advances was low.

The interest paid, at DM 346.0 million, was DM 168.7 million higher than at end-1975; DM 341.2 million (1975: DM 171.9 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), which in the year under review were sold in larger quantities than in 1975.

Fees

DM 7.8 million of fees were received in the year under review (1975: DM 10.5 million).

Other receipts

"Other receipts" are shown at DM 204.0 million (end-1975: DM 22.3 million). The increase in comparison with 1975 was predominantly due to price gains realised in the sale of securities.

Expenditure

Administrative expenditure
Staff costs

Administrative expenditure on personnel rose in relation to the previous year by DM 12.6 million to DM 506.2 million owing to the statutory or negotiated pay rate increases for established employees ("officials") and unestablished salary and wage earners.

The Bank's total staff on January 1, 1977 numbered 13,275. By comparison with the all-time peak around the middle of 1973 this represents a decline of about 950 (= 6.7 %), 270 of whom left during the year under review.

The reduction in personnel in the last few years – as pointed out in the Report for the Year 1975 – has been due to the automation of labour-intensive operations, especially in the field of cashless payments. Since the beginning of the automation of cashless payments – a process which has now largely been completed – the number of jobs in the Bank's branches has been reduced by over 1,400. In addition, it has been possible to forgo the creation of over 650 new jobs which, but for automation, would have been indispensable owing to the greatly increased volume of business. Most of the staff members 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 further perceptible reduction in personnel in the branches, the number of staff in the Central Office and the Main Offices remained almost constant in comparison with 1975.

Number of persons employed in the Bundesbank

	Beginning of 1976					Beginning of 1977				
				of whom					of whom	
	Central Office	Land Central Banks	Total	male	female	Central Office	Land Central Banks	Total	male	female
Officials	704	4,705	5,409*)	5,223	186	713	4,635	5,348*)	5,150	198
Salary earners	1,594	5,520	7,114*)	3,152	3,962	1,570	5,327	6,897*)	3,107	3,790
Wage earners	165	857	1,022*)	168	854	188	842	1,030*)	182	848
Total	2,463	11,082	13,545	8,543	5,002	2,471	10,804	13,275	8,439	4,836

	Beginning of 1976	Beginning of 1977
* of whom, working part time		
Officials, female	4	8
Salary earners	289	281
Wage earners	750	744

Payments to serving members of the Directorate of the Bank and the Central Bank Council amounted to DM 6,108,440.38 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 4,669,382.52.

Changes in staff regulations

On April 1, 1976 and October 21, 1976 the Central Bank Council adopted revised regulations on the staffing of the various career groups in the Central Office, the Main Offices and the branches. Through this revision the Bank took account of the changes in performance in recent years. At the same time allowance was made for the provisions of the Budget Structure Act, in effect since January 1, 1976, and also for the provisions of the Fifth Federal Act on the Increase in Public Service Pay, in effect since September 1, 1976, regarding the introduction of upper limits for the lowest promotion grades of officials, after the abolition of the so-called "promotion after satisfactory service" from the entrance grade to the lowest promotion grade.

On May 3, 1976, with retroactive effect from December 1, 1975, a revision of the pay scale for the unestablished salary earners of the Bank (appendix 1 to the pay agreement for unestablished salary earners of the Deutsche Bundesbank) was agreed upon. The Bank adopted, for its unestablished salary earners, the amendments to appendix 1 (a) (pay scale) of the pay agreement for unestablished salary earners of the Federal Government (revision of sub-grade 1), to the extent that they are relevant. In a further pay agreement the Bank also arranged with the trade unions on May 3, 1976 for a change in the overtime regulations (section 17 of the pay agreement for unestablished salary earners of the Deutsche Bundesbank); this change came into force on July 1, 1976.

Administrative expenditure
Other

Other (non-staff) administrative expenditure rose by DM 4.4 million to DM 108.4 million in the year under review.

Note printing

Expenditure on note printing amounted to DM 86.4 million against DM 63.9 million in 1975.

Depreciation and increase in provisions

Depreciation on land and buildings and on furniture and 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 36.4 million (1975: DM 37.5 million).

Other expenditure

"Other expenditure" is shown at DM 22.6 million (1975: DM 27.2 million).

Write-downs on monetary reserves and other foreign currency positions

The valuation of the monetary reserves and other foreign currency positions necessitated write-downs totalling DM 7,488.9 million in the 1976 annual accounts (1975 brought gains totalling DM 5,479.8 million).

Annual loss

After entering these write-downs in the profit and loss account there remains an annual loss of DM 3,044.7 million.

This amount is shown on the assets side of the balance sheet under item 22 as the balancing item in respect of the valuation adjustment of monetary reserves and other foreign currency positions — balance sheet loss —.

Frankfurt am Main, April 1977

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

Part D: Report of the Central Bank Council

The annual accounts of the Deutsche Bundesbank for 1976, the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1976, and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1976, 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 1976, the bookkeeping and the conversion account as shown by the books at December 31, 1976, 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 1976 on April 21, 1977. At the same time it confirmed the conversion accounts for the Bank deutscher Länder and the Land Central Banks as well as the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank as shown by the books at December 31, 1976, and approved the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1976.

Since the publication of the Report for the Year 1975 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 August 31, 1976
the President of the Land Central Bank in North Rhine-Westphalia
Herr Ernst Fessler,

as at the close of September 30, 1976
the President of the Land Central Bank in Lower Saxony,
Herr Wilhelm Rahmsdorf,

as at the close of January 31, 1977
the President of the Land Central Bank in Bavaria
Herr Carl Wagenhöfer,

as at the close of March 15, 1977
the Vice-President of the Land Central Bank in Schleswig-Holstein
Herr Heinz Ruppert.

Reappointed

with effect from June 1, 1976
Dr. Gerhard Hauptmann
Vice-President of the Land Central Bank in Lower Saxony,

with effect from April 1, 1977
Prof. Dr. Dr. Adolf Hüttl
Vice-President of the Land Central Bank in Hesse.

Newly appointed

with effect from September 1, 1976
Herr Hans Wertz
to be President of the Land Central Bank in North Rhine-Westphalia,

with effect from October 1, 1976
Dr. Julia Dingwort-Nusseck
to be President of the Land Central Bank in Lower Saxony,

with effect from February 1, 1977
Herr Kurt Stadler
to be President of the Land Central Bank in Bavaria,

with effect from March 16, 1977
Herr Erich Lange
to be Vice-President of the Land Central Bank in Schleswig-Holstein.

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 1976. The Council likewise wishes to record its appreciation of the excellent collaboration with the staff representative committees.

Frankfurt am Main, April 1977

Dr. Karl Klasen
Governor of the Deutsche Bundesbank

Appendix to Part B

Balance sheet of the Deutsche Bundesbank as at December 31, 1976

Assets

	DM	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 the gold tranche		4,207,168,070.42	
2.2 Loans under special borrowing arrangements		1,646,892,000.—	
2.3 Special drawing rights		4,795,963,100.40	10,650,023,170.82
3 Balances with foreign banks and money market investments abroad			51,982,522,737.45
4 Foreign notes and coins			21,300,755.02
5 External loans and other external assets			
5.1 Loans in connection with EEC medium-term monetary assistance		1,146,923,750.—	
5.2 Claims arising from foreign exchange offset agreements with the United States		3,321,693,280.62	
5.3 Other loans to foreign monetary authorities		4,837,901,414.59	
5.4 Loans to the World Bank		2,541,481,875.—	11,848,000,320.21
6 Foreign bills of exchange			1,222,904,354.64
7 Domestic bills of exchange			12,184,695,211.89
8 Lombard loans			6,109,188,900.—
9 Cash advances (book credits)			
9.1 Federal Government		1,651,000,000.—	
9.2 Equalisation of Burdens Fund		—	
9.3 Länder Governments		144,455,000.—	1,795,455,000.—
10 Treasury bills and discountable Treasury bonds			
10.1 Federal Government		—	
10.2 Länder Governments		—	—
11 Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin			
11.1 Equalisation claims		8,136,288,870.89	
11.2 Non-interest-bearing debt certificate		547,168,481.20	8,683,457,352.09
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			1,419,284,605.30
14 German coins			719,883,787.25
15 Balances on postal giro accounts			271,327,917.74
16 Other claims			929,116,831.77
17 Land and buildings			726,899,401.41
18 Furniture and equipment			29,882,167.—
19 Items in course of settlement			1,740,331,607.33
20 Other assets			1,092,901,207.87
21 Prepaid expenses and deferred income			26,676,827.35
22 Balancing item in respect of valuation adjustment of monetary reserves and other foreign currency positions — balance sheet loss —			3,044,757,536.68
Rights of recourse in respect of contingent liabilities	1,485,671.36		
			128,500,267,772.74

	DM	DM	DM
1 Bank notes in circulation			59,038,317,260.—
2 Deposits of banks			
2.1 Deposits on giro accounts		51,269,293,051.06	
2.2 Other		28,176,433.48	51,297,469,484.54
3 Deposits of public authorities			
3.1 Federal Government		272,391,534.31	
3.2 Equalisation of Burdens Fund and ERP Special Fund		304,141,616.19	
3.3 Länder Governments		2,093,964,620.60	
3.4 Other public depositors		58,504,956.66	2,729,002,727.76
4 Special deposits of the Federal Government			209,640,514.31
5 Deposits of other domestic depositors			
5.1 Federal Railways		4,117,727.11	
5.2 Federal Post Office (including postal giro and postal savings bank offices)		2,070,521,424.64	
5.3 Other depositors		513,571,194.84	2,588,210,346.59
6 Balances on cash deposit special accounts			58,021,051.—
7 Liabilities arising from mobilisation and liquidity paper sold			6,476,387,000.—
8 Liabilities arising from foreign business			
8.1 Deposits of foreign depositors		779,318,291.26	
8.2 Liabilities to the European Monetary Cooperation Fund		306,030,608.99	
8.3 Other		11,777,200.09	1,097,126,100.34
9 Contra-entry to special drawing rights allocated			1,488,790,368.—
10 Provisions			
10.1 Provision for pensions		1,585,000,000.—	
10.2 Other provisions		300,000,000.—	1,885,000,000.—
11 Other liabilities			38,857,444.52
12 Deferred expenses and accrued income			203,945,475.68
13 Capital			290,000,000.—
14 Reserves			
14.1 Legal reserve		969,000,000.—	
14.2 Other reserves		130,500,000.—	1,099,500,000.—
Contingent liabilities	1,485,671.36		
			128,500,267,772.74

Profit and loss account of the Deutsche Bundesbank for the year 1976

Expenditure

	DM	DM
1 Administrative expenditure		
1.1 Staff costs	506,194,471.92	
1.2 Other	108,392,757.33	614,587,229.25
2 Note printing		86,442,850.90
3 Depreciation		
3.1 on land and buildings	47,131,547.66	
3.2 on furniture and equipment	19,991,692.24	67,123,239.90
4 Increase in provision for pensions		145,509,570.26
5 Pension payments in respect of Reichsbank		36,450,138.67
6 Other expenditure		22,603,287.40
7 Write-downs on monetary reserves and other foreign currency positions		7,488,862,001.45
		8,461,578,317.83

Receipts

	DM
1 Interest	5,205,015,504.06
2 Fees	7,849,649.60
3 Other receipts	203,955,627.49
4 Annual loss	3,044,757,536.68
	8,461,578,317.83

Frankfurt am Main, March 2, 1977

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

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

Frankfurt am Main, March 3, 1977

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)

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