Report of the Deutsche Bundesbank

for the Year 1981

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Members on April 1, 1982

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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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Part A: General part

The currency and the economy in 1981

I. Economic developments and central bank policy

The economy of the Federal Republic of Germany made progress in the domestic and external adjustment and stabilisation process last year even though the starting conditions were not very favourable. The current account deficit was greatly reduced, owing mainly to an increase in German exports and significant cuts in energy consumption. The deficit that remained was financed largely through capital inflows, so that the Bundesbank was no longer obliged to draw heavily on its foreign exchange reserves. The pressure on the exchange rate for the Deutsche Mark, which was strong at first, eased from the spring onwards, and finally gave way to a new strengthening of the Deutsche Mark against major currencies. Domestic price rises, which initially accelerated because of exchange rate movements and heavy cost pressure in Germany, have also slowed down since last autumn. In spite of the fact that foreign trade and payments stimulated domestic economic activity in some areas, aggregate production failed to emerge from its period of stagnation. Throughout the year domestic demand remained weak; private consumption declined in real terms, and capital spending also slackened. 1

Under these conditions the economy was unable to provide sufficient jobs for the large number of people wishing to enter the labour market. On the contrary, the number of employees was reduced, especially in manufacturing and construction, to enable productivity to be increased and costs cut despite the stagnation of production. The employment problem was aggravated by the fact that the adjustment required to both the changed energy situation and the keener competition in world markets necessitated, and still necessitates, radical changes in the production process.

During the year under review the Bundesbank was unable to take as much account as in previous years of domestic economic problems (which it always kept very much in mind) in its policies, which had to be oriented more towards external requirements at times. At the beginning of 1981 the external disequilibrium was so pronounced that the Deutsche Mark was threatened with a serious loss of confidence world-wide. In the first quarter of last year the current account showed a seasonally adjusted deficit of some DM 10 billion, and the interest rate level in Germany at that time was well below that in the United States and lower than in the international financial markets. The hope that this would not make the Deutsche Mark any less attractive, in view of the possibility of an appreciation later on, turned out to be illusory in the circumstances, above all because of the massive current account deficit. The Bundesbank was therefore obliged to tighten its monetary policy in order to strengthen confidence in the Deutsche Mark at home and abroad. The more restrictive course pursued from mid-February onwards not only gradually produced the desired results in the monetary field — namely a moderation of monetary expansion, an internationally competitive level of interest rates and the stabilisation of the exchange rate mentioned above — but also assisted the economy in adjusting to the changed external conditions. The decline in domestic demand on the one hand released resources which forced producers to devote more attention to exports, and on the other hand it curbed the inflow of imports. Aided by the temporary depreciation of the Deutsche Mark, current account equilibrium and the hoped-for strengthening of the position of the German currency were finally achieved towards the end of the year.

This adjustment process was, however, not without hardships in some areas. The unsatisfactory trend in employment, leading to growing unemployment, is one aspect of this. A no less serious undesirable economic development, which has contributed to the employment problems, is the sharp fall in enterprises' earnings. In 1981 it was again enterprises that bore the brunt of the decrease in real income resulting from the deterioration in the terms of trade in 1980/81 due to the oil price rises and the depreciation of the Deutsche Mark,

Key data on overall economic developments

Period	Gross domestic product 1	Employed persons 2		Unemploy- ment ratio 3	Consumer prices; 4 annual increase	Balance on current account
	Annual change					
	%	%	Thousands	%	%	DM billion
1970 to 1973 5	+ 4.4	+ 0.4	+ 100	0.8	5.3	5.3
1974 to 1979 5	+ 2.4	− 0.7	− 190	3.5	4.6	10.5
1974	+ 0.5	− 1.9	− 490	2.2	7.0	26.6
1975	− 1.8	− 3.4	− 890	4.0	6.0	9.9
1976	+ 5.2	− 0.9	− 230	4.0	4.3	9.9
1977	+ 3.0	− 0.2	− 40	3.9	3.7	9.5
1978	+ 3.2	+ 0.8	+ 190	3.8	2.7	18.1
1979 p	+ 4.5	+ 1.3	+ 340	3.3	4.1	−11.0
1980 p	+ 1.9	+ 1.0	+ 260	3.3	5.5	−29.5
1981 p	− 0.0	− 0.6	− 150	4.8	5.9	−17.3

1 At 1970 prices. — 2 Persons employed in Germany; absolute figures rounded. — 3 Unemployed persons as % of the total labour force.— 4 Cost of living index for all households. — 5 Annual averages. — p Columns 1 to 3 provisional.

while the real income of wage and salary earners declined only a little. One of the principal prerequisites for a revival of investment, and thus of economic growth and employment, is a correction of this uneven distribution of burdens. The sooner progress is made in this field, the sooner the basic conditions for monetary policy will improve as well.

The tendencies evident in the first few months of 1982 in this respect were quite encouraging, and monetary policy took this into account. This applies on the one hand to wage and price movements and on the other to the exchange rate for the Deutsche Mark. When announcing its monetary growth target for 1982, the Bundesbank stated that it regards a rate of monetary growth in the middle or the upper part of the target range (an increase of 4 to 7 % in the central bank money stock) as acceptable under favourable stability conditions. The rise in bank liquidity since the turn of 1981/82 and the reductions of the interest rates for central bank money are in line with this objective. In the meantime the growth of the money stock has in fact responded as desired. However, the overall economic environment continues to hinder a more expansionary policy stance. In the first place, the successes achieved in the external field cannot yet be regarded as assured. It will probably become more difficult in the course of this year to increase exports further, and sooner or later the volume of imports will go up again, in contrast to last year. Secondly, the favourable trends in the field of incomes, especially the probable rise in entrepreneurial profits, will have to be supplemented by corrections to government budgets, which are imperative in the longer run. In the current year a first step has been taken, in the form of "Operation '82", towards containing the public sector deficit over the medium term (in large part by cutting consumption expenditure), but the government budgets are not yet sufficiently consolidated. If economic growth is to be strengthened, it is essential for official recourse to the capital market to be reduced — in other words, for the access of enterprises and the housing sector to longer-term outside funds, and ultimately also for the raising of liable capital by public limited companies, to become easier and cheaper. Monetary policy cannot foster such necessary changes directly, let alone bring them about. This is possible only through political decisions in the context of financial and economic policy. But this would improve the basic conditions for monetary policy.

1. Monetary policy under the impact of undesirable domestic and external developments

(a) The target and course of monetary policy over the year

Monetary growth target for 1981

Undesirable domestic and external developments in the past year caused the Bundesbank to continue the tight monetary policy it had adopted in preceding years. This was in keeping with the monetary policy objectives announced for 1981. At the end of November 1980 the Bundesbank had stated that it planned to keep the rise in the central bank money stock between the fourth quarter of 1980 and the fourth quarter of 1981 within a range of 4 to 7 %. When announcing the target range, which was 1 percentage point below that set for 1980, the Bundesbank had indicated its intention of keeping monetary growth in the lower half of the range in the event of new risks to domestic and external stability. Growth in the upper part would have been acceptable only if "home-made" price and cost increases had slackened, the exchange rate for the Deutsche Mark had steadied and external disequilibrium had lessened at an early stage. In fact, 1981 was initially marked by new inflationary pressure, which was partly due to exchange rate movements and had adverse repercussions on the price climate that narrowed the Bundesbank's room for manoeuvre in the monetary policy field.

Tightening of monetary policy at the beginning of the year

At the beginning of the new target period the Bundesbank aimed to keep monetary growth in the middle of the target range announced for 1981. At first no change in policy in the money market seemed necessary to achieve this goal. It soon became apparent, however, that interest rates in Germany could not be held at the level obtaining around the turn of 1980/81 for any length of time. Although international interest rates were declining, the Deutsche Mark came under pressure in the exchange market in the first two months of 1981. The persistent weakness of the German current account, an acceleration of the inflation rate, uncertainties in the fields of fiscal and energy policy and disturbances in the international political arena placed a growing burden on the financial markets. Finally, in mid-February a general decline in confidence in the Deutsche Mark seemed imminent. In these circumstances the Bundesbank had to give a clear signal to strengthen confidence in the German currency and counteract the danger of importing inflation. It therefore raised the cost and cut the supply of liquidity to the banking system at the end of February/beginning of March last year so strongly that the Deutsche Mark had recovered by the spring. It became the strongest currency within the European Monetary System (EMS), and from the summer onwards it also appreciated again against the U.S. dollar.

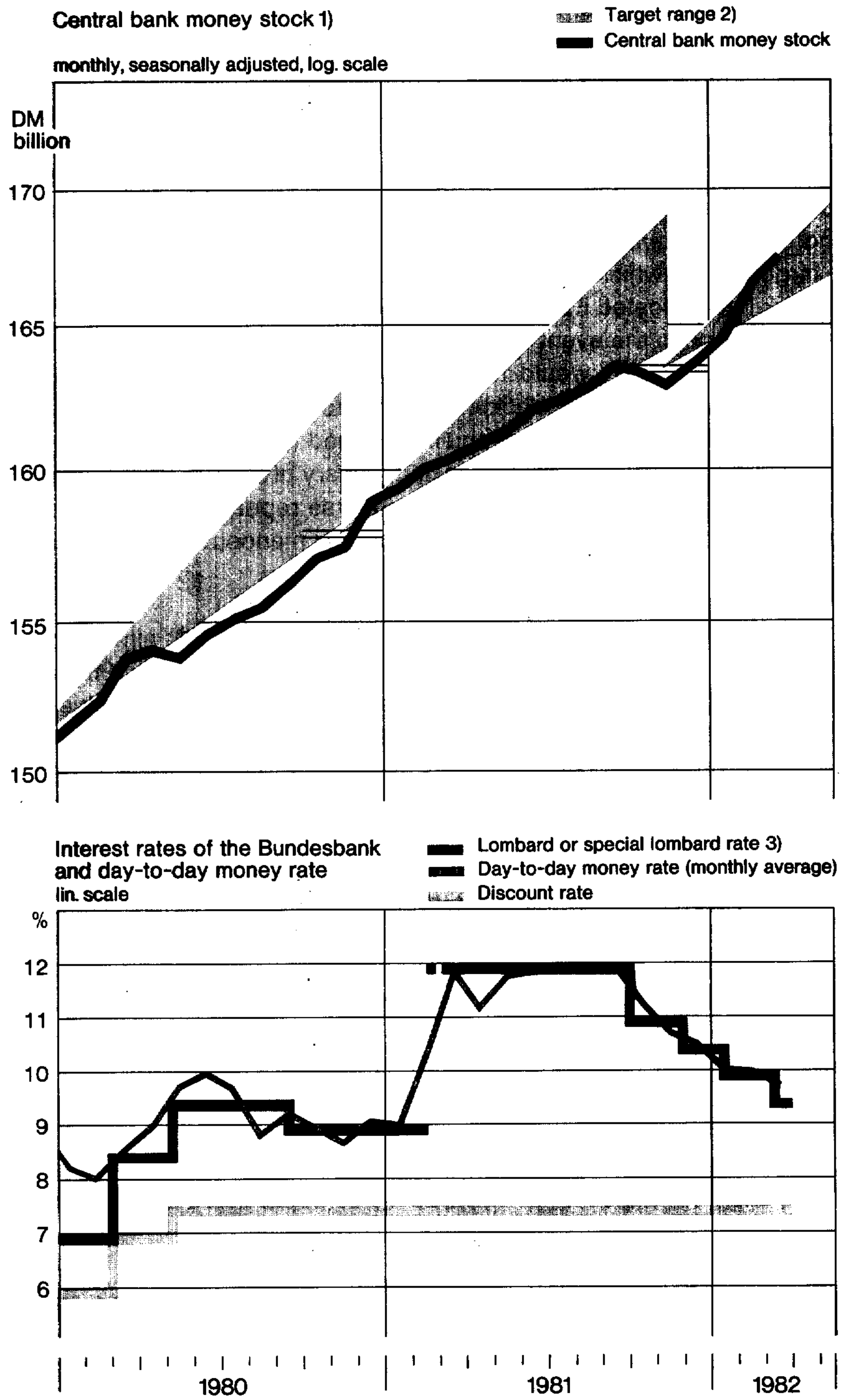
Effects of the depreciation of the Deutsche Mark limited by rising interest rates

Domestic banks adjusted their rates in the field of short-term lending and time deposits to the higher money market rates with a certain time-lag. The capital market yield, which had been rising since the turn of the year in view of the high level of international interest rates, growing inflationary expectations and mounting public sector deficits in Germany, also went up further. As the increase in the cost of imports caused by the depreciation of the Deutsche Mark and the ensuing upsurge in domestic costs and prices triggered additional demand for money and credit, the general rise in the domestic interest rate level also helped to keep monetary expansion within the desired narrow limits. In fact, throughout the spring the central bank money stock remained on the growth path envisaged at the beginning of the year.

Review of the monetary growth target in mid-year

Although the current account deficit decreased substantially in the second quarter of last year, the unstable overall state of the balance of payments did not permit a departure from the more restrictive stance of monetary policy before the summer. In particular, the renewed considerable depreciation of the

Growth of the central bank money stock and movement of interest rates



1) Currency in circulation and required reserves on domestic liabilities (calculated at constant reserve ratios, base: January 1974).- 2) 1980: 5% to 8%, 1981: 4% to 7%, 1982: 4% to 7%, between the fourth quarter of the preceding year and the fourth quarter of the current year.- 3) As from February 20, 1981 until further notice lombard loans are not being granted at the lombard rate (since then the Bundesbank has granted the banks special lombard loans at a special rate as and when required).

Deutsche Mark against the dollar which started in April 1981 showed how susceptible Germany's external flank was to disturbances. At the same time the acceleration of domestic inflation clearly indicated the need to contain monetary growth so as to limit the monetary scope for raising prices or passing on higher costs. Following its periodical review of the monetary growth target in mid-year, the Bundesbank therefore decided not to change the growth target announced for 1981 but to keep monetary expansion during the rest of the year in the lower half of the target range, i.e. at a rate of some 4 to 5½ %. To achieve this objective the policy adopted in the money market could at first be continued.

Fostering monetary expansion from the autumn onwards

At the beginning of the autumn the Bundesbank gained some room for monetary relaxation, and cautiously exploited it. Monetary growth lost momentum from the summer onwards. Moreover, the exchange rate for the Deutsche Mark began to strengthen markedly in August 1981. There were therefore grounds for hoping that the inflationary pressure from abroad would abate. After the realignment in the EMS in the autumn, which took account of the improved underlying position of the Deutsche Mark vis-à-vis a number of European currencies, the Bundesbank gradually introduced interest rate and liquidity policy relaxations in the money market. A real change in its policy stance did not seem advisable to it, however, because interest rates in the United States and hence also the exchange rate for the U.S. dollar started to move up once more towards the end of the year, and domestic price rises remained unexpectedly strong.

(b) Controlling the central bank money stock by interest rate and liquidity policy

Adjustment of central bank lending policy at the beginning of 1981

To take account of changing domestic and external conditions and at the same time steer the growth of the central bank money stock in the desired direction, the Bundesbank used its interest rate and liquidity policy instruments flexibly in 1981. At the beginning of the year, by releasing minimum reserves and raising rediscount quotas, the Bundesbank had again enabled the banks to reduce and consolidate some of their short-term central bank debt. It soon became evident, however, that under the conditions prevailing in the international credit markets such a purely "accommodating" liquidity policy would aggravate the external pressure on the Deutsche Mark. Until then the drain on bank liquidity caused by the massive outflows of funds had been offset fairly smoothly by the Bundesbank at the rates ruling in the domestic money market, which were considerably lower than international interest rates. Conditions in the money market were therefore no barrier to outflows of capital. When in mid-February 1981 the situation in the exchange markets deteriorated, the Bundesbank consequently decided to make a drastic change in interest rate and liquidity policy: by replacing "normal" lombard loans by special lombard loans, which cost 3 percentage points more, the Bundesbank not only raised money market rates steeply, but also indicated that under the new special facility — which could be terminated at any time and carried rates that could be varied from day to day — it was no longer prepared to finance outflows of funds abroad without consequences for domestic interest rates and liquidity. To make this quite plain the "special lombard loan window" was closed completely for some days at the end of February/beginning of March 1981. During that period the day-to-day money rate fluctuated exceptionally sharply. After that, however, special lombard loans were continuously available to the banks at an interest rate of 12 % (which remained unchanged for a long while) as, in view of the improvement in conditions in the foreign exchange market, it no longer seemed necessary to tolerate extreme tensions in the domestic money market.

Compensatory operations to control liquidity until the late summer

During the spring and summer months of 1981 the Bundesbank's prime objective was to keep money market rates at the high level reached in March and at the same time prevent undesirable fluctuations in the growth of bank liquidity. Fine-tuning measures in the money market played a major part in these endeavours at times. One factor which increased the need for short-term money market operations by the Bundesbank was the recourse to central bank credit on the part of the banks. As it was at first uncertain for how long the "special lombard loan window" would remain open, the banks initially tended to take up more special lombard loans at the beginning of the monthly reserve periods

Monetary developments

Change during period 1

Item	1975	1976	1977	1978	1979	1980	1981
	DM billion						
A. Central bank money requirements of banks and liquidity policy measures of the Bundesbank 2							
1. Provision (+) or absorption (−) of central bank balances by							
Rise in central bank money 3 (increase: −)	− 9.5	− 7.9	−10.9	[11] − 14.1	− 7.8	− 6.5	− 2.7
Foreign exchange movements (excluding foreign exchange swaps and foreign exchange transactions under repurchase agreements)	− 2.1	+ 8.3	+ 8.4	+ 20.3	− 5.2	− 24.6	− 3.1
Cash transactions of the central and regional authorities (excluding shifts of Federal balances under section 17 of the Bundesbank Act)	− 2.8	+ 8.1	+ 5.0	− 2.1	+ 3.9	+ 0.3	+ 1.1
Other factors	− 1.2	− 5.4	− 4.5	− 3.8	− 5.2	− 7.9	− 7.1
Total 1	−15.5	+ 3.2	− 2.1	+ 0.3	− 14.3	− 38.8	− 11,8
2. Liquidity policy measures							
Change in minimum reserves	+ 7.1	− 4.4	+ 8.2	− 1.8	− 3.2	+ 10.5	+ 4.1
Change in refinancing facilities	+ 4.5	+ 0.7	+ 6.5	+ 4.4	+ 5.1	+ 12.1	+ 5.1
Open market transactions (with non-banks, in "N paper" and in long-term securities)	+11.4	− 8.4	− 0.7	− 3.6	+ 2.7	+ 4.5	− 0.1
Reversible compensatory operations 4	+ 4.7	− 4.7	−	−	− 2.3	+ 10.5	+ 3.9
Total 2	+27.7	−16.8	+14.0	− 1.1	+ 2.4	+ 37.6	+ 13.0
3. Remaining deficit (−) or surplus (+) (1 plus 2)	+12.2	−13.7	+11.9	− 0.8	− 11.9	− 1.2	+ 1.2
covered or absorbed by							
Recourse to unused refinancing facilities (reduction: +)	−10.2	+ 7.2	− 5.5	− 0.2	+ 9.7	− 1.4	+ 1.3
Raising (+) or repayment (−) of lombard or special lombard loans	− 2.0	+ 6.5	− 6.5	+ 1.0	+ 2.2	+ 2.6	− 2.5
	%						
B. Key monetary indicators							
Central bank money stock 2, 5	+ 9.9	+ 8.3	+10.0	[11] + 11.8	+ 5.5	+ 5.3	+ 3.0
Memorandum item							
As an annual average	+ 7.8	+ 9.3	+ 9.0	[11] + 11.4	[11] + 9.1	+ 4.8	+ 4.5
Lending by banks and the Bundesbank to domestic non-banks	+10.4	+10.0	+ 9.4	+ 11.5	+ 11.5	+ 9.4	+ 8.9
M1 (= currency in circulation and sight deposits)	+14.5	+ 4.1	+11.3	+ 14.2	+ 3.9	+ 4.3	− 0.9
M2 (= M1 plus time deposits for less than 4 years)	+ 0.0	+ 6.7	+11.1	+ 13.1	+ 8.2	+ 8.7	+ 8.4
M3 (= M2 plus savings deposits at statutory notice)	+ 8.9	+ 8.4	+11.0	+ 10.9	+ 5.9	+ 6.3	+ 4.8
	DM billion						
C. Money stock and its counterparts							
Money stock M3 (= 1 plus 2 less 3 less 4 less 5)	+38.4	+41.0	+58.9	+ 64.8	+ 39.2	+ 42.8	+ 36.1
Counterparts in the balance sheet:							
1. Volume of credit 6	+85.5	+91.2	+94.2	+125.4	+139.0	+126.3	+132.0
of which							
Bank lending to domestic non-banks	+78.9	+96.3	+95.8	+122.6	+140.9	+122.4	+129.9
− to enterprises and individuals 7	+16.6	+46.5	+42.3	+ 49.0	+ 67.5	+ 56.3	+ 41.6
− to the housing sector 8	+14.3	+19.3	+26.8	+ 38.9	+ 44.8	+ 44.5	+ 40.8
− to public authorities	+48,0	+30.5	+26.7	+ 34.7	+ 28.5	+ 21.6	+ 47.5
2. Net external assets 9	+16.8	+ 8.3	+10.1	+ 7.1	− 21.8	− 10.6	+ 11.9
3. Monetary capital	+61.3	+59.1	+42.9	+ 54.8	+ 75.8	+ 61.7	+ 86.0
of which							
Savings deposits at agreed notice	+25.9	+12.2	+ 0.8	+ 7.7	+ 3.3	− 1.9	− 2.1
Bank savings bonds	+ 8.9	+10.4	+13.4	+ 10.3	+ 14.8	+ 17.8	+ 14.0
Time deposits for 4 years and over	+ 9.4	+11.4	+13.6	+ 17.0	+ 18.7	+ 14.6	+ 13.8
Bank bonds outstanding 10	+12.9	+19.3	+ 9.7	+ 14.2	+ 33.6	+ 26.7	+ 53.6
4. Central bank deposits of domestic public authorities	+ 1.4	−10.2	− 0.8	+ 2.5	− 1.7	− 1.9	− 0.2
5. Other factors	+ 1.2	+ 9.6	+ 3.3	+ 10.4	+ 3.8	+ 13.2	+ 22.1

1 Unless otherwise indicated, based on end-of-month figures. — 2 Based on daily averages of the last month of the period and the last month of the previous period, respectively. — 3 Currency in circulation (as from March 1978 excluding the banks' cash balances of domestic notes and coins, which are deductible from the required minimum reserves) and required reserves on the banks' domestic liabilities at current reserve ratios; changes in the required reserves resulting from changes in the reserve ratios are shown in item A2. — 4 Open market transactions under repurchase agreements in bills and securities, foreign exchange swaps and foreign exchange transactions under repurchase agreements, and shifts of Federal balances under section 17 of the Bundesbank Act. — 5 Reserve component calculated at constant reserve ratios (base: January 1974). — 6 Banks and the Bundesbank; including credit based on the purchase of securities. — 7 Excluding housing. — 8 Excluding credit based on the purchase of securities. — 9 Banks and the Bundesbank. — 10 Excluding bank holdings. — 11 The statistical break caused by the redefinition of the central bank money stock (see footnote 3) has been eliminated.
Discrepancies in the totals are due to rounding.

than they actually needed. In the further course of the month the Bundesbank then had to absorb the resultant excess reserves. Another factor which tended to enhance liquidity was the speculative inflows of foreign exchange within the EMS in the spring. For several months the Bundesbank therefore carried out a fairly large amount of foreign exchange transactions under repurchase agreements to mop up liquidity and safeguard stability in the money market. Since it appeared advisable at times to create a safe lower limit for the day-to-day money rate, for some while the Bundesbank offered the banks very short-dated Treasury bills (4 to 7 days) at an interest rate of 11½% as a temporary investment. In this way the Bundesbank tried to ensure that until the late summer the banking system constantly remained dependent on a certain basic amount of special lombard loans. But as the Bundesbank neutralised inflows of funds from abroad only through compensatory operations that were reversible at short notice and kept the banks' special lombard borrowing within moderate limits, the banks' liquidity position did not deteriorate further during that period as compared with the first few months of the year, but tended to ease slightly.

"Active" relaxation of the liquidity position from the autumn onwards

In the gradual relaxation initiated last autumn the Bundesbank's short-term open market operations had a "test function" to play. The Bundesbank's approach was to trigger a slight fall in interest rates by means of fine-tuning measures to increase liquidity in the money market, so as to explore the scope for domestic interest rate cuts without putting pressure on the exchange rate. First, the above-mentioned "Treasury bill facility" was discontinued at the beginning of September, i. e. conditions in the day-to-day money market were allowed to ease rather more at times. Later in the month the Bundesbank made additional funds available through foreign exchange swaps and shifts of public cash balances into the money market to help the banks cope with the "major" tax payment date. After the Deutsche Mark had strengthened further in the exchange markets, security-based repurchase agreements were concluded from the end of September onwards at interest rates below the special lombard rate. These favourable central bank credit terms tended to act as a signal and cause interest rates in the money market to move downwards. In lowering the special lombard rate from 12% to 11% at the beginning of October and again to 10½% at the beginning of December, the Bundesbank consolidated the drop in interest rates it had initiated with its fine-tuning measures.

Tight liquidity in 1981

Despite the somewhat easier conditions in the money market in the autumn, 1981 as a whole was marked by a tendency for liquidity in the banking system to be in short supply. This is particularly apparent in the change in the overall picture of bank liquidity in 1981 as compared with the preceding year. In 1980 the Bundesbank financed the greater part of the current account deficit of DM 30 billion by drawing on its monetary reserves, and it offset the drain on liquidity in the banking system and met the remaining need for central bank money more or less smoothly by permanently releasing funds. In 1981, taking all its policy measures together, the Bundesbank provided considerably less liquidity, at DM 13 billion, than in the preceding year. Of this total, DM 9 billion was made available lastingly by releasing minimum reserves and raising the rediscount quotas. With these funds the Bundesbank met firstly the banks' long-term liquidity needs, which resulted from the expansion of the central bank money stock in 1981, and secondly the deficits caused by the outflows of foreign exchange, which were no longer very large. In contrast to 1980, sizable outflows of foreign exchange from the Bundesbank — which, owing to the ample supply of central bank credit, did not affect money market rates for a long while — were not of major significance after the spring of 1981. One of the main reasons for this was that the need for exchange market operations to smooth exchange rate fluctuations lessened noticeably after the external adjustment process had come under way; this was of course very largely a consequence of the tighter monetary policy.

Record of economic policy measures

	I. Domestic and external monetary policy
1981	
January 22	The minimum reserve ratios for domestic and foreign liabilities are lowered by 7% as from February 1 (releasing DM 3.7 billion of liquidity). At the same time the banks' rediscount quotas are increased by DM 3 billion in order to reduce the banks' recourse to short-term central bank credit.
February 19	The Bundesbank decides not to grant the banks any more lombard loans at the lombard rate in principle with effect from February 20 until further notice. It reserves the right to provide special lombard loans as and when required at a special lombard rate which may be changed daily.
	The last remaining restrictions on capital imports are de facto lifted; the Bundesbank also authorises, with immediate effect, sales of German bonds maturing within one year and, from March 12 onwards, of money market paper to non-residents.
February 25	The Bundesbank for the first time grants special lombard loans at an interest rate of 12%. Initially they are available to the banks on two days, and from March 3 onwards — after a temporary suspension — they are provided without further interruptions.
March 22	The Italian lira is devalued by 6% against the partner currencies in the EMS with effect from March 23.
May 5	The Bundesbank offers the banks short-dated Treasury bills (four to seven days) at an interest rate of 11½% to create a lower limit for the day-to-day money rate.
July 2	Following its periodical review of the monetary growth target in mid-year, the Bundesbank decides to keep monetary growth in the lower half of the target range (i. e. between 4 and 5½%) during the rest of the year in the light of external conditions and the rapid pace of price rises.
September 11	The Bundesbank discontinues its sales of Treasury bills.
September 29	The Bundesbank buys securities under repurchase agreements at an interest rate which, at 11.4%, is for the first time below the special lombard rate.
October 4	Exchange rates in the EMS are realigned with effect from October 5. The Deutsche Mark and Netherlands guilder are revalued by 5.5%, and the French franc and Italian lira devalued by 3%, against the Danish krone, the Belgian and Luxembourg franc and the Irish pound.
October 8	The special lombard rate is lowered from 12% to 11% with effect from October 9.
December 3	The Bundesbank announces its monetary growth target for 1982: the rise in the central bank money stock between the fourth quarter of 1981 and the fourth quarter of 1982 is to be kept within a range of 4 to 7%. Paying due regard to prices, the economic situation, the balance of payments and the exchange rate for the Deutsche Mark, the Bundesbank will regularly review — as in preceding years — whether the central bank money stock should increase more in the lower or more in the upper half of the target range.
	The special lombard rate is lowered from 11% to 10½% with effect from December 4.
1982	
January 13	To support the money market the Bundesbank buys trade bills for resale after ten days (interest rate: 10%) up to January 21.
January 21	The Bundesbank continues its policy of gradually easing conditions in the money market and lowers the special lombard rate from 10½% to 10% with effect from January 22.
February 21	The Belgian and Luxembourg franc is devalued by 8.5% and the Danish krone by 3% against the other currencies in the EMS with effect from February 22.
March 18	The special lombard rate is lowered from 10% to 9½% with effect from March 19.
	II. Economic and fiscal policy
1981	
January 1	Major provisions of the 1981 Tax Relief Act (especially the new income tax scale) enter into force. In addition, children's benefits are raised from the second child onwards.
January 27	The Federal Government presents the 1981 Annual Economic Report. It states that priority must be given to containing the adverse effects on the economy of the massive increase in oil prices and to strengthening the basis for new economic growth, while at the same time improving the external position. Provided that no new external or domestic constraints emerge in the course of the year, the Federal Government considers it possible for the gross national product to increase again in real terms during 1981 and to turn out little or no lower than a year before.

April 1	The increase in petroleum tax and spirits tax enters into force.
April 8	After Franco-German consultations, the Federal Government approves a credit programme to encourage investment, notably in the energy sector. For Germany the Reconstruction Loan Corporation is to raise DM 6.3 billion in the international capital market in order to grant low-interest loans, mainly to small and medium-sized enterprises, out of the funds obtained.
June 5	The Bundestag adopts the 1981 Federal budget, with a volume of DM 231 billion and a financial deficit of just over DM 34 billion. Expenditure is to rise by 7% over the out-turn for 1980.
July 3	Referring to its discussions of March 1981, the Fiscal Planning Council states that the central, regional and local authorities' new indebtedness in 1982 must be lower than in 1981, and should not exceed the level of 1980. The growth of expenditure in 1982 should therefore be considerably smaller than the increase in the gross national product.
July 30	The Federal Government specifies the key data for the draft Federal budget for 1982 and the fiscal plan for the period from 1981 to 1985. At the same time a package of measures comprising expenditure cuts and revenue increases is adopted, some of the details being left open.
September 2 and 3	The Federal Government approves the draft Federal budget for 1982 (which provides for expenditure totalling DM 241 billion and a financial deficit amounting to DM 27 billion) and the fiscal plan for the period from 1981 to 1985. At the same time the details of the decision of end-July on expenditure cuts and revenue increases are filled in; for the most part they are to enter into effect on January 1, 1982. As part of "Operation '82" it is planned to raise the contribution rate to the Federal Labour Office from 3% to 3½% (reducing the contribution rate to the pension insurance funds by ½ percentage point at the same time), to lower children's benefits for second and third children and to reduce various tax concessions. The package also includes measures to stimulate employment, notably improved depreciation facilities and assistance to the steel industry.
October 29	The Federal Minister of Finance informs the Budget Committee of the Bundestag about the amendments to the 1982 Federal budget approved by the Federal Government. The additional deficit of DM 7.8 billion which is now in prospect is to be met mainly by an increase in the envisaged profits of the Bundesbank and by raising the contribution rate to the Federal Labour Office further to 4%.
November 20	In its Report for 1981/82 the Council of Economic Experts describes the economic situation as the longest period of stagnation in the history of the Federal Republic of Germany. Its lengthy duration owes much to stabilisation crises abroad and the reduced room for manoeuvre in the economic policy field at home. The Council emphasises the priority and urgency of supply-side policies to enhance the adaptability of the economy and step up its momentum.
December 14	The Fiscal Planning Council reaffirms its recommendation of July 1981 to the effect that the growth of public expenditure in the budgets from 1982 to 1985 should be strictly limited and the deficits perceptibly reduced. Net borrowing in 1982 should not significantly exceed the level of 1980.
1982	
January 1	Major provisions of the laws accompanying the 1982 Federal budget ("Operation '82") enter into force. Under the agreement reached in the Mediation Committee at the end of 1981, the overall volume of the statutory measures taken to relieve the pressure on the budget in 1982 (including the excise tax increases becoming effective in the course of that year) will amount to DM 15 billion for the Federal Government and DM 3.5 billion for the Länder Governments and local authorities. Economies in the implementation of the budgets will be added to this. Some provisions of the 1981 Tax Relief Act (which was adopted in the summer of 1980) enter into force at the same time, and place new burdens on public budgets; these include, in particular, improvements in special allowances.
January 22	The Bundestag adopts the 1982 Federal budget, with a volume of DM 240.5 billion and a financial deficit of just over DM 27 billion.
February 3	The Federal Cabinet approves a "Joint initiative on jobs, growth and stability". Its cornerstone is the introduction, for a limited period of time, of a 10% investment grant for capital spending over and above the average level of the last three years, the relevant orders having to be placed in 1982. To offset the resultant burden on the budgets, which will be felt from 1983 onwards, turnover tax rates are to be raised from 13% (6.5%) to 14% (7%) with effect from July 1, 1983. As from 1984 the additional revenue is to be used to lower wage tax and income tax.
February 4	In its 1982 Annual Economic Report the Federal Government states that the primary task of German economic and fiscal policy is to strengthen the growth forces in the economy on the basis of further progress in the external adjustment process and the fight against inflation, and thus to improve the prospects in the labour market. Unless economic activity is impaired by severe external constraints, the Federal Government considers it possible for the real gross national product to rise slightly during the year and exceed last year's level by an average of 1 to 1½%.
April 1	The increase in spirits tax and sparkling wine tax enters into force.

Slower monetary growth in the latter part of the year

Under the impact of these money market operations, the rise in the central bank money stock was roughly on target until last autumn. The rate of growth slackened appreciably, however, after mid-year. In the last quarter of 1981 the central bank money stock actually declined for a time as, when interest rates started to fall on a broad front, many investors switched large amounts of short-term time deposits into longer-term financial assets which are not reflected in the money stock. The growth rate of the central bank money stock, at 3.5 % between the fourth quarter of 1980 and the fourth quarter of 1981, finally fell slightly short of the target range announced for 1981, although monetary expansion regained momentum towards the end of the year.

Monetary growth understated

When assessing the result for 1981 it should be borne in mind that the growth of the central bank money stock last year was significantly affected by special influences. Between the fourth quarter of 1980 and the fourth quarter of 1981 only the minimum reserve component expanded, while currency in circulation stagnated throughout the period. As the currency component accounts for some 50 % of the central bank money stock — and thus carries greater weight than in other usual money stock definitions — that aggregate understated the underlying trend of monetary expansion last year. The demand for currency dropped sharply after interest rates soared at the beginning of the year. Furthermore, in 1981 currency in circulation was reduced in purely statistical terms owing to the return to the Bundesbank of unusually large amounts of Deutsche Mark notes that had been hoarded abroad. Such foreign holdings of notes cannot be recorded separately and eliminated, but they are deducted from total currency in circulation at the time they return to the central bank. If sizable amounts of notes are returned from foreign holdings, the change in domestic currency holdings — which is what is really of interest — will appear too low (just as the opposite will apply if foreign hoarding of Deutsche Mark notes and coins increases, as in 1978). Finally, the function of the central bank money stock as an indicator was impaired last year by the fact that domestic non-banks invested an exceptionally large amount of liquid funds in "near-money" bank bonds with very short maturities. These are counted towards monetary capital rather than the money stock. If these distortions, all of which understated monetary growth, are eliminated as far as possible, it seems justifiable to say that the expansion of the central bank money stock was within the envisaged target range last year.

"Potential-oriented" expansion of the money stock over the longer term

After the moderate increase in the central bank money stock in 1981, monetary expansion in the Federal Republic of Germany is more or less back on the growth path aimed at over the longer term. After the considerable overshooting of the monetary growth target in 1977/78, the Bundesbank has tried gradually to reduce the monetary carry-overs relative to the national product. This process may now be regarded as complete. In view of the numerous disruptions to which economic activity has been subject in the past, however, it seems hardly possible to take as a yardstick a single base year which could confidently be assumed to describe a state of relative equilibrium between the gross national product and the central bank money stock. To eliminate the influence of cyclical fluctuations on the velocity of circulation, it appears more advisable to observe the relationship between the potential volume of production at current prices and the existing money stock over an extended space of time that includes periods both of comparatively strong and comparatively weak economic activity. If the average level of this relationship over many years is taken as a criterion, the impression is borne out that all in all the "monetary cloak" is neither too loose nor too tight on a medium-term perspective. Under the prevailing conditions, however, this is no reason to aim only at a medium-term monetary growth target from now on and ignore current economic problems. In its monetary policy the Bundesbank has always endeavoured to take due account of the whole range of economic policy action required, although the weight it attaches to undesirable developments in individual fields may vary.

(c) Slower money creation process

Overall money supply grows faster than the central bank money stock

In line with the weak underlying growth trend of the central bank money stock, the expansion of the total amount of money held by enterprises and individuals also slowed down last year. But the stagnation of currency in circulation had a less marked effect on the money stock in the traditional definitions, which include the various money components on an "unweighted" basis and thus without regard to their degree of "moneyness". Hence there was only a relatively minor decline in the pace of growth of the broadly defined money stock (M3)[1] as compared with the preceding year. The main reason for this was that domestic credit expansion and sizable inflows of funds to non-banks from abroad stimulated the money creation process last year; the strong formation of monetary capital at the banks was the only factor that curbed the growth of the money stock.

Domestic credit expansion slackens only slightly

Domestic credit expansion, the principal factor fuelling the money creation process, slowed down only a little last year. The outstanding amount of lending by the banking system (including the Bundesbank) to domestic non-banks increased by 9 %, compared with 9½ % a year earlier. The rise in absolute terms, at DM 132 billion as against DM 126 billion in 1980, was actually somewhat higher. It should not be inferred from these overall figures, however, that the interest rate and liquidity policy stance of the Bundesbank had no effect on developments in the credit markets. The expansion of bank lending to the private sector clearly slackened (see page 14). The growth of lending to the public authorities, on the other hand, accelerated sharply. In financing its growing deficits the public sector therefore again proved highly insensitive to the movement of interest rates, whereas private borrowers had to cut down the amount of credit they raised last year.

Expansionary impact of borrowing abroad on monetary growth

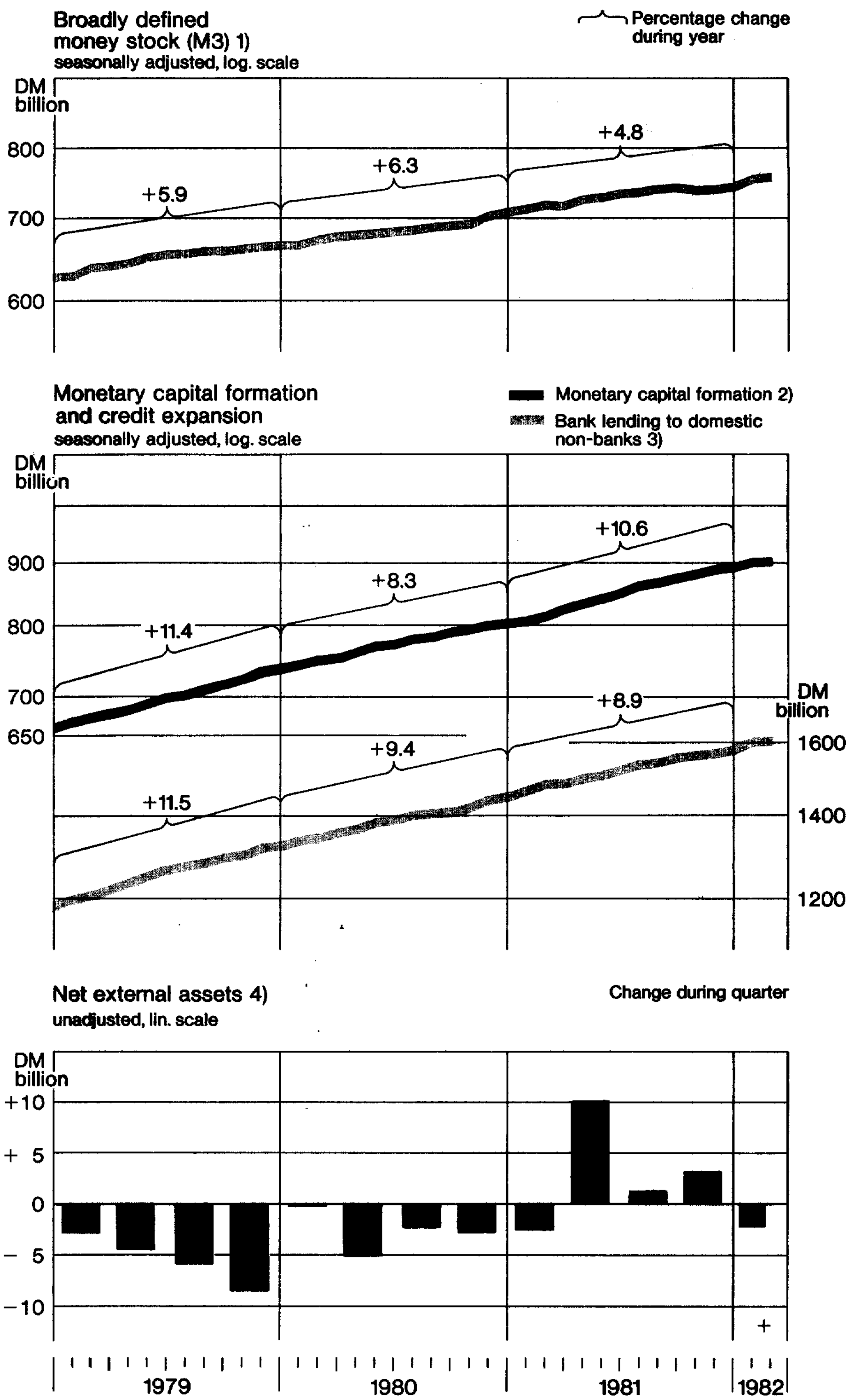
Much as in the preceding year, domestic credit expansion understates the actual scale of new borrowing by non-banks, as private and public borrowers again met a large part of their credit needs in the international financial markets. Domestic non-banks' overall external payments, which reflect the expansionary effect of German non-banks' borrowing in foreign markets, last year led to considerable inflows of funds, which substantially enhanced the growth of the money supply. The net external assets of the banks and the Bundesbank, the rise in which mirrors this trend, went up by DM 12 billion. In the two preceding years they dropped by DM 10.5 billion and DM 22 billion respectively; in other words, there was a net outflow of funds from the German economy rather than inflow. As already indicated, the reversal in external payments began after the Bundesbank, in February 1981, had taken interest rate policy decisions which made German interest rates more attractive internationally. Towards the end of the year the improvement in the German current account also encouraged an inflow of funds from abroad (see page 24). The Bundesbank welcomed these developments, as they indicated that progress was being made in external adjustment without an undesirable forcing of the monetary expansion process.

High level of monetary capital formation

Monetary capital formation provided a strong counterweight to these expansionary influences on monetary developments in 1981. At DM 86 billion, the rise

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

Monetary developments



1) Currency, sight deposits, time deposits and funds borrowed for less than 4 years, savings deposits at statutory notice.- 2) Domestic non-banks' longer-term financial investments at banks, excluding time deposits and funds borrowed for less than 4 years and excluding savings deposits at statutory notice.- 3) Including credit based on the purchase of Treasury bills and securities; also including lending by the Bundesbank.- 4) Banks and the Bundesbank.- + Change in January and February 1982.

in the inflow of funds which are not counted towards the money stock to the banks was nearly two fifths larger than a year previously (DM 62 billion), reflecting in part the stabilising effects of the monetary policy pursued last year. There was a marked tendency towards monetary capital formation throughout the period from the spring to the autumn of 1981 when long-term interest rates were climbing or at a high level. In fact, whenever "interest rate peaks" had just been passed, monetary capital formation soared temporarily as securities in particular became more attractive owing to the prospect of price gains. In 1981, even more than in previous years, bank bonds accounted for the bulk of monetary capital formation at banks. At DM 54 billion, the banks sold a record amount of these securities to non-banks last year. Apart from the attractive yield, this owed something, as already indicated, to the fact that these issues satisfied investors' demand for shorter-term assets. Approximately one fifth of the bank bonds placed with non-banks in 1981 consisted of bonds with an original maturity of not more than one year. These bonds are, as it were, on the borderline between the money and capital markets; unlike deposits of the same maturity, they are not subject to minimum reserve requirements, although they do not represent a longer-term investment of funds. In many cases these assets appear to have been acquired instead of time deposits, so that for some holders they no doubt constitute "quasi-money" and thus a liquidity reserve which can be drawn upon to meet future expenditure. In economic terms monetary capital formation therefore appears to have been overstated in the statistics in 1981, or at least its quality as capital seems to have deteriorated.

Monetary growth slows, but the trends in the components continue to differ

The growth of the overall money supply did not decelerate appreciably until the second half of last year. But apart from this, the pace of expansion changed several times, even over shorter periods, mainly because of temporary distortions in monetary capital formation due to interest rate speculation and fluctuations in non-banks' external payments. The money stock in the broad definition M3 (currency, sight deposits, time deposits and funds borrowed for less than four years, savings deposits at statutory notice) increased by not quite 5 % between December 1980 and December 1981, compared with just over 6 % in the preceding twelve months. As in the previous two years, the money stock M2 (M3 excluding savings deposits at statutory notice) grew much faster in 1981, at 8½ %, than the overall money supply, while the money stock in the narrowest definition M1 (currency and sight deposits) declined by 1 %.

These divergent trends reflect the "economisation" of cash balances which is normally associated with rising or high interest rates. Since in 1981 the rates for three-month time deposits had risen by an average of 3 percentage points by the late summer, those who held money in forms which bear no or traditionally little interest — i.e. currency, sight deposits or short-term savings deposits — suffered considerable losses of interest. Substantial amounts of sight deposits and savings deposits at statutory notice were therefore switched into shorter-term time deposits during this period. After time deposit rates had passed their peak — at the end of the year the rates for three-month time deposits were about 1½ percentage points below their highest point in August/September — time deposits were run down again sharply at times, albeit not enough to offset the previous expansion. The strong reactions of investors to changes in the interest rate pattern showed once more that the liquidity preference of enterprises and also of households fluctuates sharply in the short run. This illustrates yet again that the informative value of the narrowly defined monetary aggregates (M1 in particular) can be rather limited over the short term; they should not, in other words, be taken as indicators for monetary policy.

(d) The main areas of private demand for credit

Less private borrowing

In 1981, in contrast to the two preceding years, bank lending to domestic enterprises and individuals clearly reflected the changes in the monetary situation and in general economic conditions. The low level of activity in the domestic economy, the growing restraint exercised by the banks in lending business and the rising cost of credit led to a slower increase in the amount of new loans granted by the banks to private borrowers. Bank lending to the private sector expanded by little more than 7 % in the year as a whole, compared with almost 10 % a year earlier. In the longer-term field the pace of growth slackened fairly steadily, but recourse to short-term credit fluctuated sharply. This was partly due to speculation on interest rate movements and partly to variations in enterprises' borrowing in the Euro-markets.

Determinants of the demand for credit

A more detailed analysis of borrowing shows that a number of different factors curbed private demand for credit last year. Firstly, the low propensity to invest caused by enterprises' poor earnings situation and the erosion of their capital base reduced private willingness to borrow. Secondly, enterprises' need for short-term working funds in particular was eased by large inflows of funds from abroad and the expansionary cash transactions of the public authorities. The steep rise in interest rates seems to have delayed the satisfaction of the latent demand for credit, but it also appears to have affected some potential borrowers more lastingly. Following the Bundesbank's interest rate policy decisions in February, which increased the cost of central bank credit for marginal requirements by 3 percentage points, the banks' short-term lending rates were raised to about the same extent. The rates for long-term loans, which tend to follow the movement of capital market rates, were increased rather less. But even after the special lombard rate had been lowered by 1½ percentage points in October and December, lending rates eased only very slowly (particularly in retail banking) as the banks sought to make good, by widening their profit margins, some of the loss of earnings they had suffered previously. As a consequence the rates for credit in current account, at an average of 14 to 15 %, were some 2½ percentage points higher at the end of 1981 than at the beginning of the year.

Slowdown in borrowing in all sectors of the economy

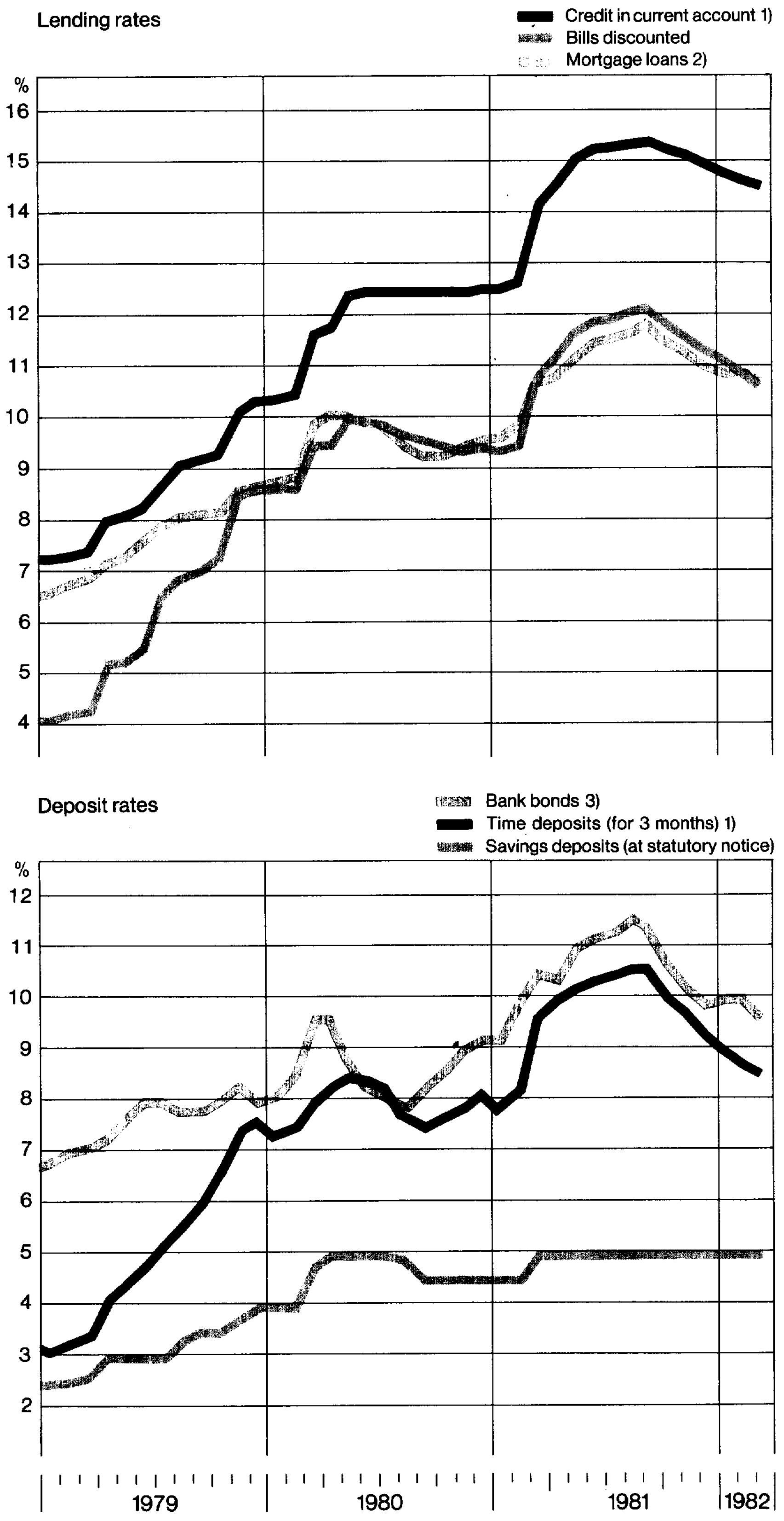
Under the influence of these factors, borrowing slowed down in all the major sectors of the economy in 1981. Lending to the housing sector once again rose most, at 9½ %. In the first few months of 1981 in particular housing loans remained at a very high level. After the upsurge in interest rates in the spring, however, the rate of expansion slackened. Lending to enterprises (other than housing) went up by 6½ %, with major fluctuations during the year. Lending to individuals decelerated most sharply, as in 1980. Consumer credit expanded by no more than 4½ %, probably owing to the uncertain employment and income prospects and the rise in interest rates; this was only half as much as a year before.

(e) The position and business policy of individual banking groups

Differentiated expansion of business

In 1981 the rapid increase in government demand for credit benefited the business of those groups of banks which traditionally engage in lending to the public authorities, such as the mortgage banks and central giro institutions. The growth of their lending to domestic non-banks, at 14.0 % and 12.3 % respectively, was much greater than that of all banks taken together (8.9 %) and even steeper than in the previous year. These banks profited from their ability to adapt very flexibly to market conditions by offering loans with shorter maturities or shorter interest rate commitments, which they financed by issuing shorter-dated bank bonds. The credit granted by the other major banking groups, which obtain most of the funds they need for lending through their deposit

Movement of selected bank interest rates



1) Of under DM 1 million.- 2) Secured by residential real estate; effective rate. - 3) Yield on bonds outstanding.

business and cater mainly for the borrowing requirements of the private sector, expanded at a slower pace. In addition to the slackening of private demand for credit and the higher cost of funds, this owed something to the fact that some banks or banking groups preferred to concentrate on the most profitable types of lending in view of their unfavourable earnings position. Domestic lending by credit cooperatives continued to grow at an above-average rate (10.1 %); these institutions presumably benefited from the wide range of customers using their services. The increase in lending by the savings banks, on the other hand, was not so great, at 7.8 %, while the sluggish trend was even more marked in the case of the big banks, whose domestic credit volume rose by only 0.4 %. One reason for this was that their customers were borrowing heavily in the Euro-markets, in the main no doubt from the big banks' subsidiaries. For the rest, the big banks stepped up their long-term lending to foreign non-banks.

Improvement in profitability, but more risks in banking business

All in all, the banks have recently adjusted their business policy more to the changes in domestic and external conditions and the Bundesbank's operations in the money market. In particular, interest rate trends and the scope for expansion in lending business are now being assessed more soberly. In many cases it is likely that profitability has already increased, especially in the period since last autumn, as the cost of funds to the banks has been falling ever since the policy of monetary relaxation began, while the same cannot normally be said of lending rates. However, underlying profitability in the banking sector has continued to be adversely affected by the after-effects of the expansionary business policy of previous years. The internationalisation of lending business and the transformation of maturities, which was carried out on a very considerable scale and resulted in substantial disparities between low-interest loans and high-cost funds for financing them, appear to have depressed profits in some instances. Actual or impending losses in national, and even more in international, lending business have also impaired profitability.

Credible strengthening of the banks' capital base required

The greater risks in banking business make it seem advisable to strengthen the "buffer function" of the capital base in the banking industry. One possible approach would be to prevent the multiple use of liable capital under the bank supervision regulations by introducing a consolidation procedure for participations in domestic and foreign banks. The voluntary agreement concluded in this field with individual banking groups last year can only be regarded as a preliminary step. Quite apart from the fact that public banks have not so far associated themselves with the agreement, a regulatory measure of this kind requires legislative backing. A second approach should be to increase the banks' directly and unrestrictedly liable capital. Proposals at present under discussion amount to little more than diluting the definition of the term "capital", and fail to comply with this requirement. In the forthcoming amendment to the Banking Act it would therefore be better to accept a reduction in existing types of capital substitutes than to adopt makeshift solutions which in the last analysis would only seemingly broaden the existing capital base by creating new surrogates.

(f) The overall state and structural characteristics of the capital market

Strong expansion of the bond market

The deterioration of the external situation and the consequent tightening of monetary policy also affected developments in the capital market last year. The German long-term interest rate fluctuated sharply, reaching its highest level ever in the summer of 1981, at 11¾ %. This rise in interest rates brought very large quantities of funds for investment into the bond market at times. In all, the amount raised in the German bond market last year went up by DM 20 billion to DM 73 billion, mainly because of larger bond purchases by non-banks. The share of investment in bonds in the overall financial asset accumulation of the domestic non-financial sectors soared from 15 % in 1980 to more than 23 % in

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

Item	1979 p DM billion	1979 p %	1980 p DM billion	1980 p %	1981 pe DM billion	1981 pe %	1980p Memo item Change on previous year DM billion	1981 pe Memo item Change on previous year DM billion
Acquisition of financial assets								
Longer-term 1	124.8	74.7	118.0	68.9	122.0	61.2	− 6.8	4.0
of which								
Bonds	33.9	20.3	25.6	15.0	46.1	23.2	− 8.3	20.5
Short-term	42.2	25.3	53.2	31.1	77.2	38.8	11.0	24.0
Total	166.9	100	171.2	100	199.1	100	4.2	28.0
Households	120.5	72.2	123.4	72.1	129.5	65.1	2.8	6.2
Enterprises	43.0	25.8	41.6	24.3	63.0	31.6	− 1.4	21.4
Government	3.4	2.0	6.2	3.6	6.6	3.3	2.8	0.4
Incurrence of liabilities								
Longer-term	159.9	83.1	163.1	75.6	166.7	71.7	3.2	3.6
of which								
Bonds	4.9	2.6	3.0	1.4	− 3.7	− 1.6	− 2.0	− 6.7
Short-term	32.6	16.9	52.6	24.4	65.8	28.3	19.9	13.2
Total	192.5	100	215.6	100	232.4	100	23.1	16.8
Households	19.6	10.2	11.8	5.5	6.9	3.0	− 7.7	− 5.0
Enterprises	129.8	67.4	148.1	68.7	150.4	64.7	18.3	2.3
Government	43.2	22.4	55.7	25.8	75.2	32.3	12.5	19.5
Financial surplus (+) or deficit (−) 2	−25.6	×	−44.4	×	−33.3	×	−18.8	11.1
Households	+101.0	×	111.6	×	+122.7	×	+10.6	11.1
Enterprises	−86.8	×	−106.5	×	−87,4	×	−19.7	19.1
Government	−39.8	×	−49.5	×	−68.6	×	− 9.7	−19.1

* Households, enterprises (including housing), government (including social security funds). — **1** Including all purchases of securities, regardless of their maturity. — **2** Acquisition of financial assets less incurrence of liabilities. — **p** Provisional. — **pe** Partly estimated.
Discrepancies in the totals are due to rounding.

1981. The strong growth of the bond market's role as an intermediary in the overall financing cycle owes much to the higher bond purchases of households. In 1981 alone these bought bonds totalling roughly DM 45 billion, i. e. DM 20 billion more than a year earlier, while reducing their savings deposits and purchasing noticeably fewer bank savings bonds than before. In 1981 the share of bond investment in households' total acquisition of financial assets therefore rose from one fifth to more than one third.

Short-dated bonds come to the fore

However, the powerful expansion was entirely confined to bonds with shorter maturities of up to four years. Fixed interest securities with such short maturities can only be assigned to the capital market with certain reservations. From an economic point of view these short-dated bonds — virtually all of which were issued by banks — should rather be seen as substitutes for bank deposits for similar periods, which also increased very strongly last year. The greater prominence of short-dated bonds and the associated statistical expansion of the bond market are due in no small part to the tight liquidity situation of the banks and the business community's reaction to the interest rate conditions prevailing last year. The marked reluctance to enter into longer-term commitments which long characterised borrowers' and investors' attitudes caused their borrowing and acquisition of financial assets — seen over the year — to shift to the shorter maturities on an even greater scale than in 1980. At the same time the strong competition among banks for shorter-term funds prompted these institutions to offer non-banks highly attractive interest rates for short-term financial investments. This applied in particular to bank bonds, while the interest rates for "smaller" time deposits were not raised quite as much and savings rates were increased only a little.

Interest rate expectations dashed in the spring

The very tight conditions in the money market in the initial months of 1981 coincided with a sense of uncertainty in the bond market, where unfavourable external and domestic economic reports had already pushed interest rate expectations upwards. The measures the Bundesbank took in February 1981 to strengthen confidence together with a temporary fall in interest rates in the United States then brought a brief reversal of the mood. In March 1981 investors began nothing less than a run on bonds. Sales broke all previous records, and within a few days the yield on bonds had dropped by ¾ percentage point from its peak at the beginning of the month (10.8 %). But the euphoric phase soon came to an end when, in the second half of March, interest rates in the international capital markets started to move up again. Two months later, under the influence of international interest rate links, the yield on German bonds had passed the 11 % mark. The interest rate differential vis-à-vis the U.S. capital market temporarily narrowed to roughly 2 percentage points. During the summer the rise in interest rates was interrupted on several occasions, but this did not immediately cause investors to secure a high interest income for a long period by buying more long-term securities. Instead, they preferred interim investment in the form of short-dated bonds and short-term time deposits, the interest rates on which were even higher than those on longer-term securities in view of the "inverse" interest rate structure in the financial markets. Only at the beginning of September, when the upward movement of longer-term interest rates abroad had already begun to slow down again and the dollar rate for the Deutsche Mark had passed its lowest point, did interest rates in the German capital market start to fall from their peak of 11¾ %.

Interest rates fall from the late summer onwards

Since then investors have become steadily less cautious about entering into longer-term commitments. In repeated waves of buying the banks in particular turned their attention more to longer-term securities, with the result that the yield on bonds dropped below the 11 % mark again within little more than two weeks. From the beginning of September onwards the fall in interest rates was supported at the short end of the market by the Bundesbank's relaxation measures. Towards the end of 1981 the decline in interest rates clearly lost momentum, especially after U.S. interest rates started to rise again. During this decline the interest rate structure in the bond market largely levelled off; in other words, at the turn of 1981/82 the yields on long maturities were only slightly below those on short maturities, which seems to suggest that expectations of a further fall in interest rates over the longer term were no longer so strong. In December the yield on domestic bonds reached a new low, at 9¾ %.

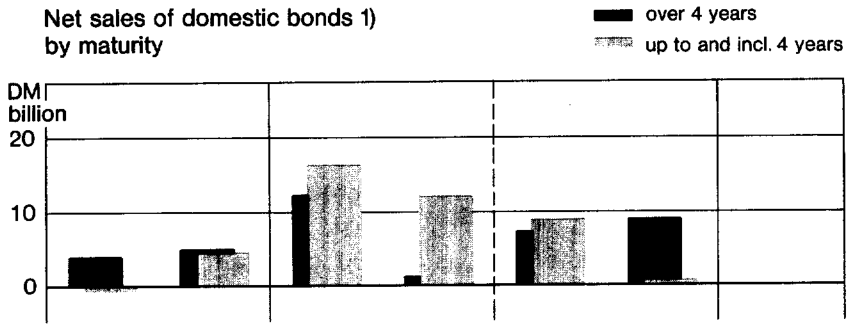
Growing interest rate differential vis-à-vis other countries

The yield differential between German and U.S. bonds widened sharply in December 1981 as interest rates decreased in the domestic bond market and firmed again in the U.S. market. Since the turn of 1981/82 the differential, at about 4½ to 5 %, has been more than twice as large as it was in the early summer of last year. To a certain degree the German bond market has thus been able to detach itself from the erratic movements in international interest rates. But there are of course limits to the extent to which the German interest rate level can "escape". Towards the end of 1981 the issuing activity of non-residents in the market for foreign Deutsche Mark bonds picked up strongly in view of the lower level of domestic long-term interest rates. Foreign investors' purchases in the German bond market decreased significantly at the same time. From October 1981 onwards capital exports predominated in the field of German private long-term capital transactions; this inevitably slowed the fall in domestic interest rates. It also tended to exert pressure on the exchange rate for the Deutsche Mark, which temporarily prevented the Bundesbank from fostering the interest rate reduction process further by its policies.

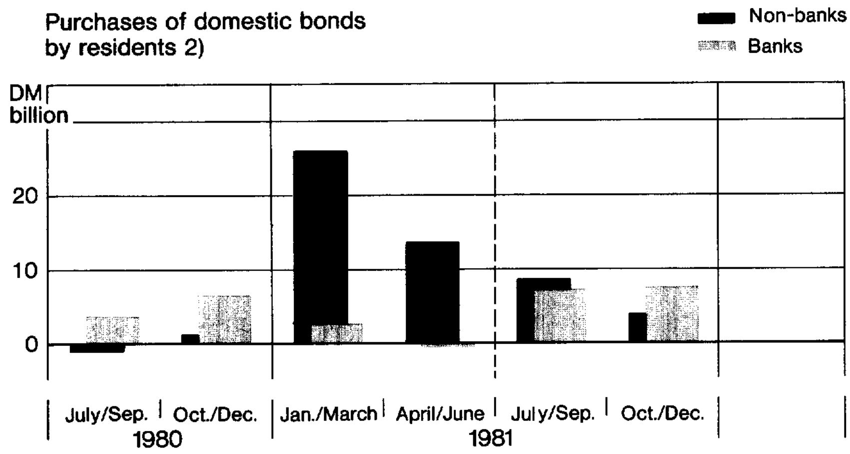
Banks' propensity to buy bonds varies

The fluctuating interest rates which characterised the financial markets in Germany last year triggered pronounced structural shifts on both sides of the

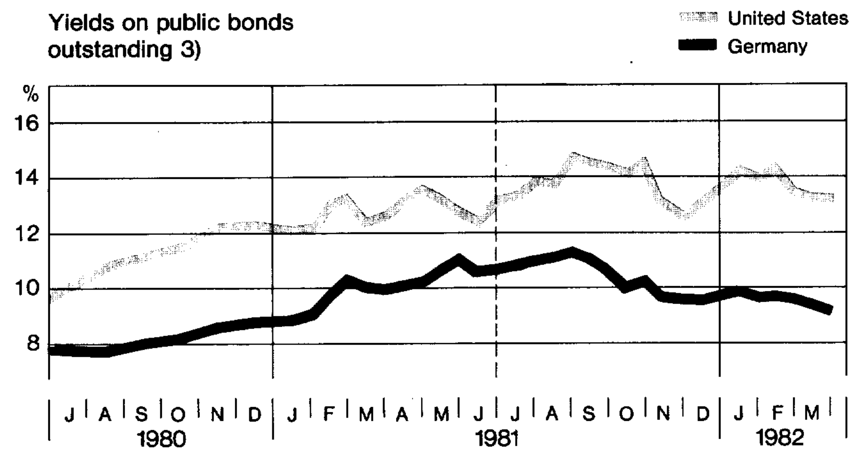
Net sales of domestic bonds 1) by maturity



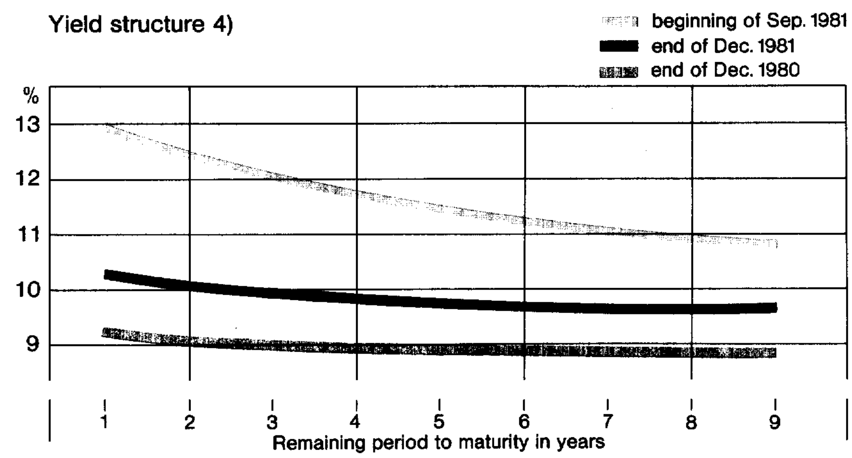
Purchases of domestic bonds by residents 2)



Yields on public bonds outstanding 3)



Yield structure 4)



1) Net sales at market values plus/less changes in issuers' holdings of their own bonds.- 2) Net purchases excluding open market operations of the Bundesbank.- 3) Until end-1980 monthly averages; as from the beginning of 1981 mid-month and end-of-month figures.- 4) Regression lines for yields on fully taxed outstanding bonds of the Federal Government, Railways and Post Office.

bond market. On the purchasing side the variations in the banks' propensity to buy were particularly striking. After the tightening of the money market in February 1981, banks largely withdrew from the purchasing side of the bond market until the summer months, and at times actually ran down their bond holdings to a certain extent. Even in March, when the mood in the market was definitely bullish, the banks' investment in bonds remained almost unchanged. Only when conditions in the money market began to ease perceptibly in the summer did their bond purchases pick up again. After the general reversal of the interest rate trend in September, the banks bought extremely large amounts of bonds for a time. In 1981 as a whole their acquisition of bonds, at DM 17.5 billion, was therefore on the same scale as in 1980, despite their initial restraint.

Non-banks' bond purchases relatively steady

However, it was domestic non-banks that provided the great bulk of the total funds accruing to the bond market. They built up their bond holdings by DM 57 billion last year as against DM 33 billion in 1980. Hence the entire increase in bond sales was due to demand from domestic non-banks. After the strong fluctuations up to the spring in the general public's willingness to invest, the non-bank sector engaged relatively steadily in bond purchases during the remainder of the year. The wide range of short-dated bonds with attractive interest rates meant that it was not difficult for investors to become increasingly impervious to the changes in interest rate conditions.

Short-term refinancing needs of the issuing institutions

On balance, the funds available in the bond market, which were rising sharply, flowed almost entirely to the banks. Until the interest rate reversal in the late summer, shorter-term bonds accounted for an exceptionally large part of the banks' issues. Even issuing institutions whose business is traditionally at long term evidently felt obliged to engage in shorter-term refinancing operations. The average period to maturity of new communal bonds, which make up the majority of the banks' bond issues, shortened perceptibly up to the autumn of last year. This trend towards shorter maturities even affected issues of mortgage bonds. The ground gained by short-dated bonds was most strikingly reflected in the strong increase in issues of "other" bank bonds. These serve chiefly to finance shorter-term loans by the issuing institutions to the business community. After the interest rate reversal in September, however, the importance of these bonds decreased abruptly. This would appear to confirm the experience that issues of short-dated bonds generally decline when, in the market's view, the long-term interest rate has passed its peak.

Public issuers withdraw from the bond market

In view of the volatile interest rate conditions last year, public issuers, who chiefly offer long-term bonds, largely withdrew from the bond market on balance, preferring to meet their credit requirements through loans against borrowers' notes (see page 35). The outstanding amount of bonds of the Federal Government — by far the most important public issuer — dropped by about DM 2.5 billion, mainly because of a decline of roughly DM 10 billion in aggregate Federal savings bonds outstanding. These bonds, the interest rate on which rises with the period to maturity (in contrast to the interest rate structure prevailing in the market over the last 2½ years), met with little interest, not only on their issue; the Federal Government had to repurchase just under DM 11 billion of them prematurely, in addition to scheduled redemptions totalling DM 4.5 billion. However, a counterweight was provided by sales of Federal bonds, the outstanding amount of which rose by almost DM 12 billion last year. But the outstanding amount of standard bonds and medium-term notes went down by DM 4.5 billion at the same time. The frequently expressed intention of meeting a larger proportion of the government deficit directly in the bond market — i. e. to the detriment of bank loans — was therefore not realised in 1981. But to a major extent this failure must be attributed to the special situation in the capital market (inverse interest rate structure, repurchases of Federal savings bonds). As the market situation eases, conditions will no doubt return more to normal.

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 bonds		
Residents	1978	39.7	30.6	– 0.8	9.9	3.6	43.3
	1979	37.2	36.0	– 1.0	2.3	3.7	40.9
	1980	44.9	41.9	– 1.2	4.3	7.3	52.3
	1981	68.3	70.7	– 0.9	– 1.5	6.1	74.5
Banks	1978	20.2	16.7	– 0.2	3.7	1.2	21.4
	1979	1.1	3.3	– 0.2	– 2.0	2.6	3.7
	1980	14.1	15.6	– 0.1	– 1.5	3.3	17.3
	1981	17.0	18.0	– 0.0	– 1.0	0.5	17.6
Non-banks	1978	16.0	13.9	– 0.6	2.7	2.3	18.3
	1979	38.2	32.7	– 0.9	6.4	1.1	39.3
	1980	29.1	26.2	– 1.1	4.0	4.1	33.2
	1981	51.5	52.7	– 0.9	– 0.3	5.6	57.1
Open market operations of the Bundesbank	1978	3.5	–	–	3.5	–	3.5
	1979	– 2.1	–	–	– 2.1	–	– 2.1
	1980	1.8	–	–	1.8	–	1.8
	1981	– 0.2	–	–	– 0.2	–	– 0.2
Non-residents 3	1978	0.1	e – 1.2	e – 0.2	1.5	×	0.1
	1979	4.0	e 0.4	e – 0.1	3.7	×	4.0
	1980	0.3	e – 0.3	e – 0.0	0.7	×	0.3
	1981	– 1.5	e – 0.3	e – 0.0	– 1.1	×	– 1.5
Purchases (= sales), total	1978	39.8	29.4	– 1.0	11.4	3.6	43.4
	1979	41.2	36.4	– 1.1	6.0	3.7	45.0
	1980	45.2	41.5	– 1.3	4.9	7.3	52.6
	1981	66.9	70.5	– 1.0	– 2.6	6.1	73.0

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

Independent movements in the share market

In 1981 price movements in the share market differed from the movements of capital market rates to an unusual degree at times. Until well into the summer the share market was characterised by a gradual increase in domestic and foreign demand and a tendency towards rising prices. The change in mood owed much to the improvement in the current account, which was already evident in the early summer of 1981 and exercised a favourable influence on investors' expectations regarding exchange rates, interest rates and yields. But the further progress in the external adjustment process and the associated fall in interest rates failed to buoy up share prices during the rest of the year. The relaxation which spread through the financial markets from last autumn onwards hardly affected the share market at all; indeed, share prices moved noticeably downwards at times. As measured by the index of share prices calculated by the Federal Statistical Office, share prices at the end of last year were little higher than a year before and thus far below their peak of summer 1981. Only very recently does a slightly more optimistic mood seem to have started to gain ground again in the share market.

Unfavourable earnings situation of enterprises

Prices in the share market were particularly depressed by the deterioration in profitability in many sectors of the economy up to the summer. The sustained erosion of both their capital base and their earnings perceptibly diminished the powers of resistance of numerous enterprises. This makes the business community more sensitive to temporary burdens (such as higher import prices and rising interest rates) and less willing to take entrepreneurial risks, and at the same time it discourages potential share buyers. The long apparent contraction of German enterprises' capital base and their inadequate protection against risks are therefore ominous developments. In this context it must be emphasised that the capital obtained through the market by issuing shares is not an adequate counterweight to the low level of capital formed by retaining profits.

Low capacity of the share market

The low sales of shares last year mirrored larger enterprises' reluctance to raise capital on the stock exchange and security buyers' lack of interest in shares. In 1981 domestic enterprises obtained only DM 5.5 billion in the share market. This was roughly as much as in preceding years, if the record sales of just under DM 7 billion in 1980 are disregarded. But sums of this order are only a very small contribution to the business community's capital needs. In 1981 the amount raised in the share market by non-financial enterprises (excluding housing), which accounted for more than two thirds of total sales of shares, made up only about 5% of their external financing. Of the overall supply of domestic shares, only DM 2.5 billion were purchased by German investors. Domestic shares amounting to DM 3 billion (1980: DM 1 billion) were bought by non-residents, whose interest in German shares increased last year. Non-residents' purchases were apparently attributable not so much to expected dividend yields as to monetary considerations and efforts at diversification by international investors.

Support for the share market urgently required

It would be very dangerous if the German banking industry and official capital market policy were to come to accept the narrowness and low capacity of the German share market. In view of the medium-term tasks ahead of it, the German business community urgently needs an efficient market for risk capital. At the same time, domestic and foreign investors who wish to diversify their portfolios should be able to draw on a wide range of fungible German equities. From the point of view of economic policy, it may at present be of greater importance to create better underlying conditions that open up prospects of adequate profits for those willing to take entrepreneurial risks. But at the same time every effort should be made to render the German share market so attractive to enterprises seeking capital and security buyers interested in equities that, in the long run, it will become as efficient as the share markets of other major industrial countries. Such efforts should include the promotion of the public limited company under company and tax law, with the aim of making this form of organisation more attractive, also to medium-sized and smaller firms. Certainly the banks engaged in issuing business could help to make it easier for enterprises to approach the stock exchange. At all events, it would not be correct to assume that there is a lack of risk capital in Germany; but tax concessions ("Abschreibungsgesellschaften" — companies specialising in the exploitation of tax privileges) and supposed or real advantages presented by other forms of organisation (fewer disclosure requirements, co-determination) quite frequently direct such capital into economically dubious channels.

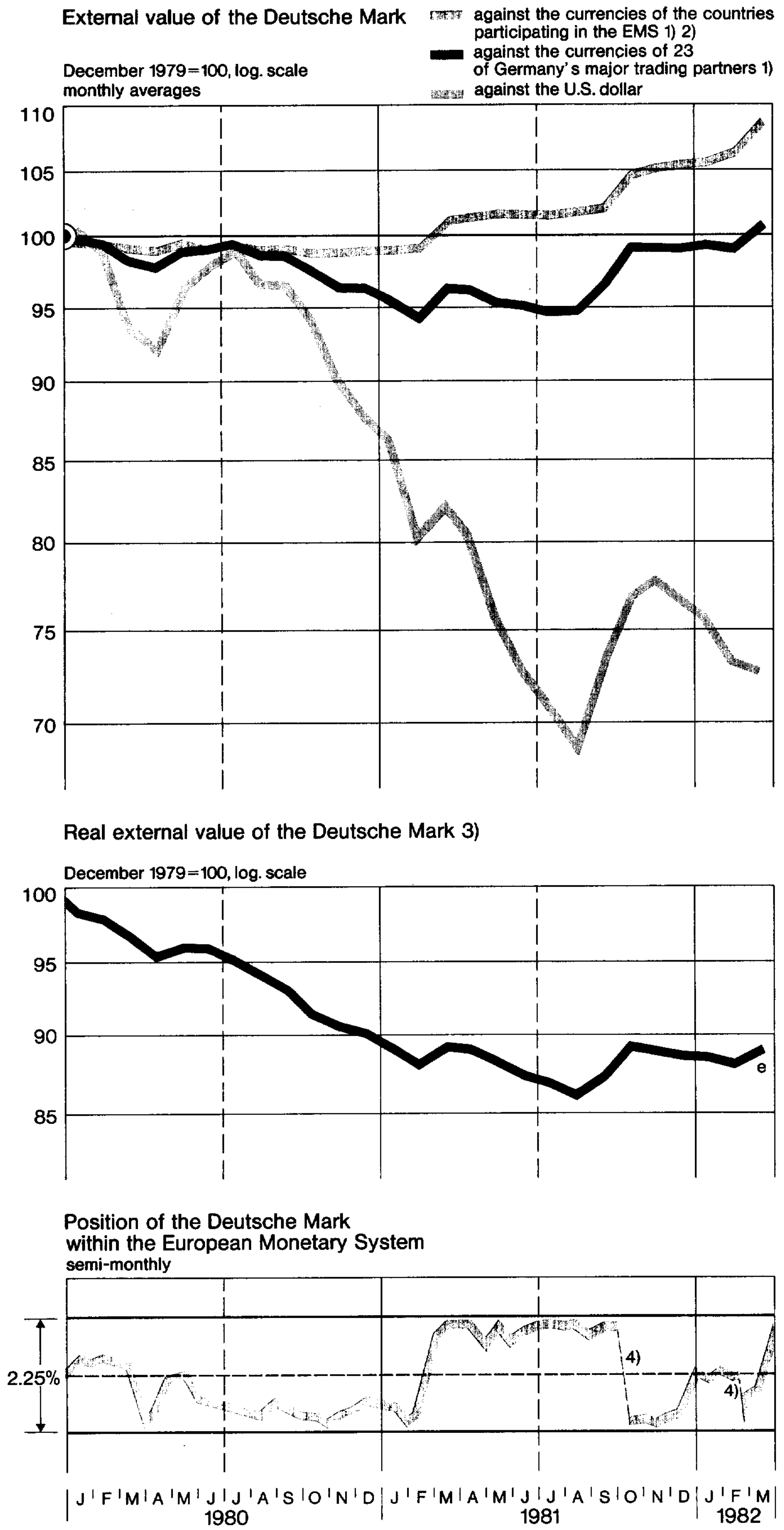
2. Successful adjustment in foreign trade and payments

Exchange rate for the Deutsche Mark stabilises during the year

The Federal Republic of Germany made considerable headway in the external adjustment process in 1981. This was evident particularly in the fact that the trend in the exchange rate for the Deutsche Mark was reversed in the course of the year, so that — despite a substantial fall in value against the dollar — the Deutsche Mark ultimately appreciated slightly in nominal terms on average against the currencies of major trading partners. The marked tightening of German monetary policy in February was an important factor in the gradual stabilisation of the exchange rate. The associated increase in interest rates served to greatly reduce the interest rate differential vis-à-vis the dollar, mitigate the pressure on the Deutsche Mark and strengthen its position over the longer term in the EMS. Without this curb, further reserves would have flowed out or the pressure would have continued. In view of the large amount of Deutsche Mark assets held by foreigners — at the end of 1980 they came to nearly DM 400 billion (short and long-term assets together)[1] — a loss of confidence in the

1 Excluding interbank deposits in the Euro-market; partly estimated.

Exchange rate movements



1) Weighted external value of the Deutsche Mark; geometric mean.- 2) Excluding the pound sterling.- 3) Weighted external value against the currencies of 13 industrial countries after adjustment for price discrepancies (as measured by consumer prices).- 4) Realignment of exchange rates in the EMS.- e Estimated.- Latest position: end of March 1982.

Deutsche Mark might have led to a cumulation of withdrawals of funds from the German currency and further depreciation. It would probably also have had a destabilising effect on the current account, which was already seriously affected by the increase in the cost of imports at the beginning of 1981 owing to exchange rate movements. An additional deterioration in the terms of trade would have outweighed to an even greater extent the adjustment process which had already started in real trade flows and further enlarged the deficit on current account. Moreover, the imported inflation that accompanied the rise in import prices would soon have resulted in higher wage claims. This would finally have offset at least part of the increase in Germany's price competitiveness that has occurred since 1979 through the real depreciation of the Deutsche Mark.

Differing exchange rate movements in the EMS and vis-à-vis third currencies

After the move to a more restrictive monetary policy the Deutsche Mark strengthened even outside the EMS: during the renewed dollar rise in the summer of last year it also gained ground against other currencies that are not linked to the dollar. When the level of interest rates in the United States fell sharply in August and a rather more sceptical view began to be taken of U.S. economic policy, the dollar weakened somewhat world-wide, while the Deutsche Mark benefited from the more and more manifest progress in the external adjustment process. Hence, although the Deutsche Mark strengthened significantly against the dollar in the autumn of 1981 (in August the U.S. dollar cost up to DM 2.57, but in October only DM 2.25 on average), its value was still considerably lower than at the beginning of the year. In the EMS the stronger position of the Deutsche Mark and the weakness of partner currencies brought a realignment of exchange rates at the beginning of October. Largely as a result of this, the Deutsche Mark appreciated against the EMS currencies by an average of some 6½ % in the course of the year; at least the price differences that had accumulated since the end of 1980 between Germany and its EMS partners were offset to this extent. Taken as a whole, in December 1981 the Deutsche Mark was therefore quoted about 2½ % higher than a year before relative to the currencies of the industrial countries. But it must be borne in mind that prices in Germany rose less than prices abroad during this period (as measured by the cost of living, by almost 4 percentage points less on a weighted average), so that the real external value of the Deutsche Mark at the end of 1981 was some 1½ % lower than at the end of 1980 and about 11 % below the average level for 1979, the year in which the weighted external value of the Deutsche Mark reached its peak.

Sharp reversal in the current account

The improvement in Germany's foreign trade and payments position is most clearly reflected in the change in the current account. In the first quarter of 1981 this showed a record deficit of almost DM 10 billion, seasonally adjusted. By the second quarter, however, the deficit had been reduced to some DM 6 billion. The external adjustment process stagnated for a short while in mid-year in connection with a temporary weakness of the Deutsche Mark. But in the fourth quarter the improvement resumed, and for the first time in two and a half years Germany actually achieved a surplus on current account, although this surplus overstated the extent of the improvement. Nevertheless, it sufficed to bring down the deficit on current account over the whole of 1981 to DM 17 billion (compared with a record figure of roughly DM 30 billion in 1980). The change was mainly due to developments in foreign trade, where a considerable increase in the surplus (on an f.o.b. basis)[1] was recorded: it went up by DM 21 billion to DM 40 billion, even though the terms of trade deteriorated by a further

1 In contrast to the official foreign trade statistics, but in accordance with international balance of payments practice, both exports and imports are recorded here on an f.o.b. basis, i.e. exclusive of expenditure on the transport and insurance of imports, which is shown in the services account. This change does not affect the overall balance on current account. On an f.o.b./c.i.f. basis — i.e. inclusive of expenditure on the transport and insurance of imports — the trade surplus rose by DM 19 billion to just under DM 28 billion.

Major items of the balance of payments

DM billion

Item	1974	1975	1976	1977	1978	1979	1980	1981
A. Current account								
1. Foreign trade								
Exports (f.o.b.) 1	230.6	221.6	256.6	273.6	284.9	314.5	350.3	396.9
Imports (f.o.b.) 1	171.9	177.1	214.6	227.7	235.8	282.7	331.4	357.2
Balance	+58.7	+44.5	+42.1	+45.9	+49.2	+31.8	+18.9	+39.7
2. Supplementary trade items 2 and merchanting trade	−1.3	−1.2	−0.1	+0.0	+2.1	+0.2	+0.1	+0.5
Balance of trade	+57.4	+43.3	+42.0	+46.0	+51.2	+32.0	+19.0	+40.2
3. Services	−14.8	−15.5	−14.2	−18.2	−15.3	−22.1	−24.3	−30.4
of which								
Foreign travel	−12.4	−14.7	−14.6	−16.4	−19.0	−21.7	−25,5	−26.2
Investment income	+0.9	+2.4	+3.3	+0.4	+5.1	+3.1	+3.2	−1.0
4. Transfer payments	−16.1	−17.9	−17.9	−18.2	−17.8	−20.8	−24.3	−27.1
of which								
Remittances of foreign workers	−7.7	−7.4	−6.7	−6.1	−6.3	−6.6	−7.3	−8.3
Transfers to the European Communities (net)	−1.9	−3.7	−3.5	−3.5	−1.9	−4.0	−4.5	−6.6
Balance on current account	+26.6	+9.9	+9.9	+9.5	+18.1	−11.0	−29.5	−17.3
B. Capital account								
1. Long-term capital transactions								
(a) German investment abroad (increase: −)	−11.6	−24.1	−19.9	−23.1	−24.1	−20.8	−29.5	−28.0
of which								
Direct investment	−5.0	−4.9	−6.2	−5.1	−7.2	−8.1	−8.1	−10.5
Advances and loans of enterprises	−0.2	−0.3	−0.3	−0.3	−0.2	−1.0	−0.6	−0.8
Portfolio investment	−1.1	−2.6	−0.9	−5.4	−4.2	−3.0	−7.7	−6.2
Advances and loans of banks	−2.6	−13.5	−9.7	−9.6	−8.5	−5.4	−9.4	−5.3
Official	−2.1	−2.2	−2.4	−2.1	−3.3	−2.4	−2.3	−3.5
(b) Foreign investment in Germany (increase: +)	+5.3	+5.9	+18.4	+10.2	+21.2	+32.9	+35.9	+38.0
of which								
Direct investment	+5.5	+1.7	+2.7	+1.9	+3.1	+3.0	+2.1	+4.2
Advances and loans of enterprises	−0.9	+0.4	+1.4	+0.5	+0.2	+0.4	+1.4	+3.9
Portfolio investment	−1.9	−1.6	+4.8	+2.3	+3.2	+5.9	+0.9	+1.0
Advances and loans of banks	+1.3	+2.0	+4.9	+5.0	+14.8	+22.8	+8.5	+7.0
Official	+1.2	+3.4	+4.8	+0.5	−0.0	+0.9	+23.1	+21.9
Balance of long-term capital transactions	−6.3	−18.2	−1.5	−12.9	−2.9	+12.1	+6.4	+10.0
2. Short-term capital transactions (net capital exports: −)								
(a) Enterprises and individuals	−9.3	+6.5	−5.7	+4.6	−2.9	−5.3	+7.6	+8.2
Financial credits	+3.1	+2.5	−0.0	+8.5	+1.0	−3.7	+13.3	+13.0
Trade credits	−12.4	+4.1	−5.7	−3.9	−3.9	−1.7	−5.7	−4.8
(b) Official	+0.0	+0.7	−0.6	−0.0	+1.2	−0.3	−0.4	+2.5
(c) Banks	−9.7	−2.3	+6.7	+8.1	+10.1	+4.1	−8.8	−10.1
Assets	−12.0	−13.0	−2.7	+1.2	−2.2	−1.7	−7.1	−10.9
Liabilities	+2.3	+10.8	+9.4	+6.9	+12.3	+5.8	−1.7	+0.8
Balance of short-term capital transactions	−19.0	+4.9	+0.4	+12.6	+8.4	−1.5	−1.5	+0.6
Balance on capital account	−25.3	−13.3	−1.0	−0.3	+5.4	+10.5	+4.9	+10.5
C. Balance of unclassifiable transactions (balancing item)	−3.2	+1.1	−0.1	+1.2	−3.8	−4.5	−3.2	+4.4
D. Overall balance on current and capital accounts	−1.9	−2.2	+8.8	+10.5	+19.8	−5.0	−27.9	−2.3
E. Balancing item to the external position of the Bundesbank 3	−7.2	+5.5	−7.5	−7.9	−7.6	−2.3	+2.2	+3.6
F. Change in the net external assets of the Bundesbank (increase: +)	−9.1	+3.3	+1.3	+2.6	+12.2	−7.3	−25.7	+1.3
of which External liabilities (increase: −)	−0.3	+0.3	−0.9	+0.8	−4.9	+1.9	−9.4	+3.0

1 Special trade. — **2** Mainly warehouse transactions for account of residents and deduction of goods returned and of commission processing. — **3** Counterpart of changes in the Bundesbank's external position which are not caused by external current and capital transactions: mainly the allocation of IMF special drawing rights and changes in the Deutsche Mark value of the external position of the Bundesbank owing to valuation adjustments.
Discrepancies in the totals are due to rounding.

4%. But the large deficits on "invisible" transactions continued to grow (by DM 9 billion to DM 57.5 billion). This rise owes much to Germany's specific geographical position and its integration in the international division of labour, so that it is difficult to curb; recently, however, it has also reflected the decrease in Germany's net external assets resulting from the current account deficits.

Strong rise in the trade surpluses

The renewed rise in the trade surpluses is partly attributable to influences from other areas of the world economy, such as the sharp growth of the oil countries' demand for imports. Moreover, energy imports reacted strongly to the extreme increase in prices. But the decisive factor in the improvement of the current account was that Germany, in its economic policy, did not simply accept the "march into deficit" as being inevitable, but finally took action to correct the external disequilibrium. Monetary policy, by resisting the depreciation of the Deutsche Mark, prevented an inflationary spiral of import price rises, higher domestic prices, further exchange rate depreciation and renewed increases in import prices from developing. It thus proved possible largely to preserve Germany's better stability record last year and to improve the price competitiveness of German industry. This facilitated the expansion of exports and helped domestic industry to gain ground — also in the German market — vis-à-vis foreign competitors, especially foreign manufacturers of finished products. This would not have been possible if, owing to the depreciation of the Deutsche Mark, the inflationary spiral mentioned above had started turning and rises in domestic prices and costs had quickly ensued. Moreover, the weakness of domestic demand forced enterprises to step up the volume of exports while keeping prices relatively stable. The combination of both factors — greater price competitiveness and lower absorption of the gross national product by residents — brought a rapid reduction in the deficit on current account. This would not have happened if, in the absence of support from monetary policy (and particularly in the absence of the increase in interest rates), the exchange rate for the Deutsche Mark had continued to fall, making substantial domestic price rises inevitable.

External adjustment process not yet concluded

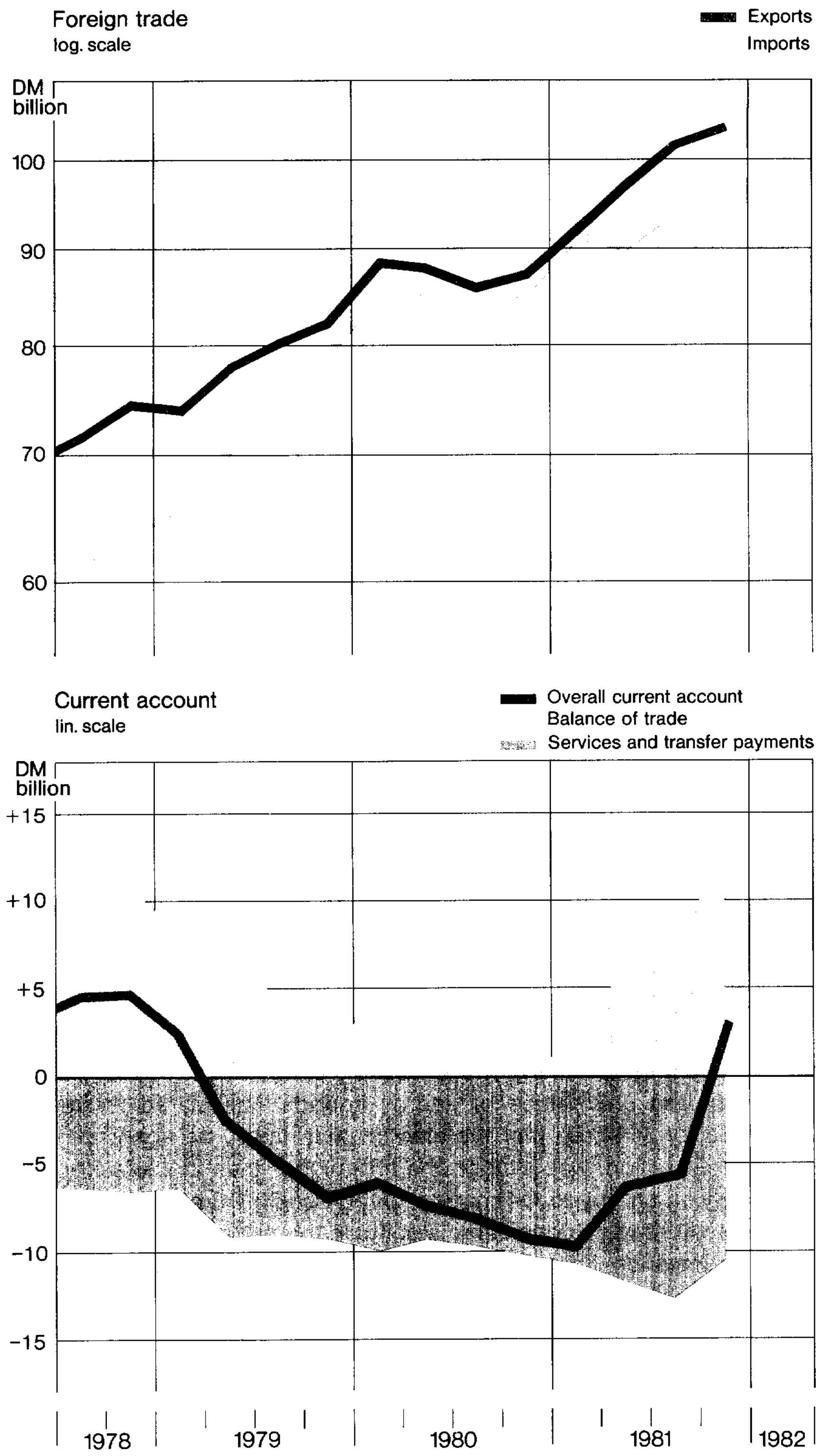
Despite the improvement in 1981, the external adjustment process is not yet concluded. The pattern of expenditure of national product is still unsatisfactory; in particular, the investment ratio is too low and the competitive position has not yet been strengthened sufficiently to rule out the possibility of a renewed severe deterioration of the current account in the event of an economic upswing. If the external adjustment now achieved is to be consolidated, it would seem essential (as pointed out elsewhere in this Report) that in the course of the coming growth process a structural change in domestic demand should be encouraged (in accordance with longer-term requirements), that priority should be given to expanding investment in the energy field and that productivity and innovation should be increased.

Improved competitiveness in exports

But the structural disequilibria which still exist should not lead us to underestimate what has been achieved. In 1981 exports increased by 13% in value and over 5% in volume despite a relatively small expansion of Germany's sales markets, at 2%. German exporters were thus able to regain market shares which they had lost. By utilising their price advantages enterprises succeeded in making up, through exports, for at least part of the missing domestic demand. The share of exports in the total turnover of manufacturing industry, which had changed very little since 1976, therefore increased by 2 percentage points to over 30%. The most conspicuous growth in the export ratio was in iron and steel (by 4½ percentage points to almost 44%), road vehicles (by 4 points to 45½%) and mechanical engineering products (by 3 points to 50%).

Foreign trade and current account

quarterly, seasonally adjusted



The greatest successes in the export field were scored in those areas where most of the former disequilibria on current account had arisen, namely the oil countries in the broadest sense. In terms of value, exports to the OPEC countries increased by 53 % and those to the other (non-OPEC) net oil-exporting developing countries by 41 % in 1981. There was also a considerable rise in German exports to other oil suppliers, such as Norway (+ 23 %) and the United Kingdom (+ 14 %), despite the slowdown in economic activity there. But in

Notable success in exports to the oil countries

BERICHTIGUNG

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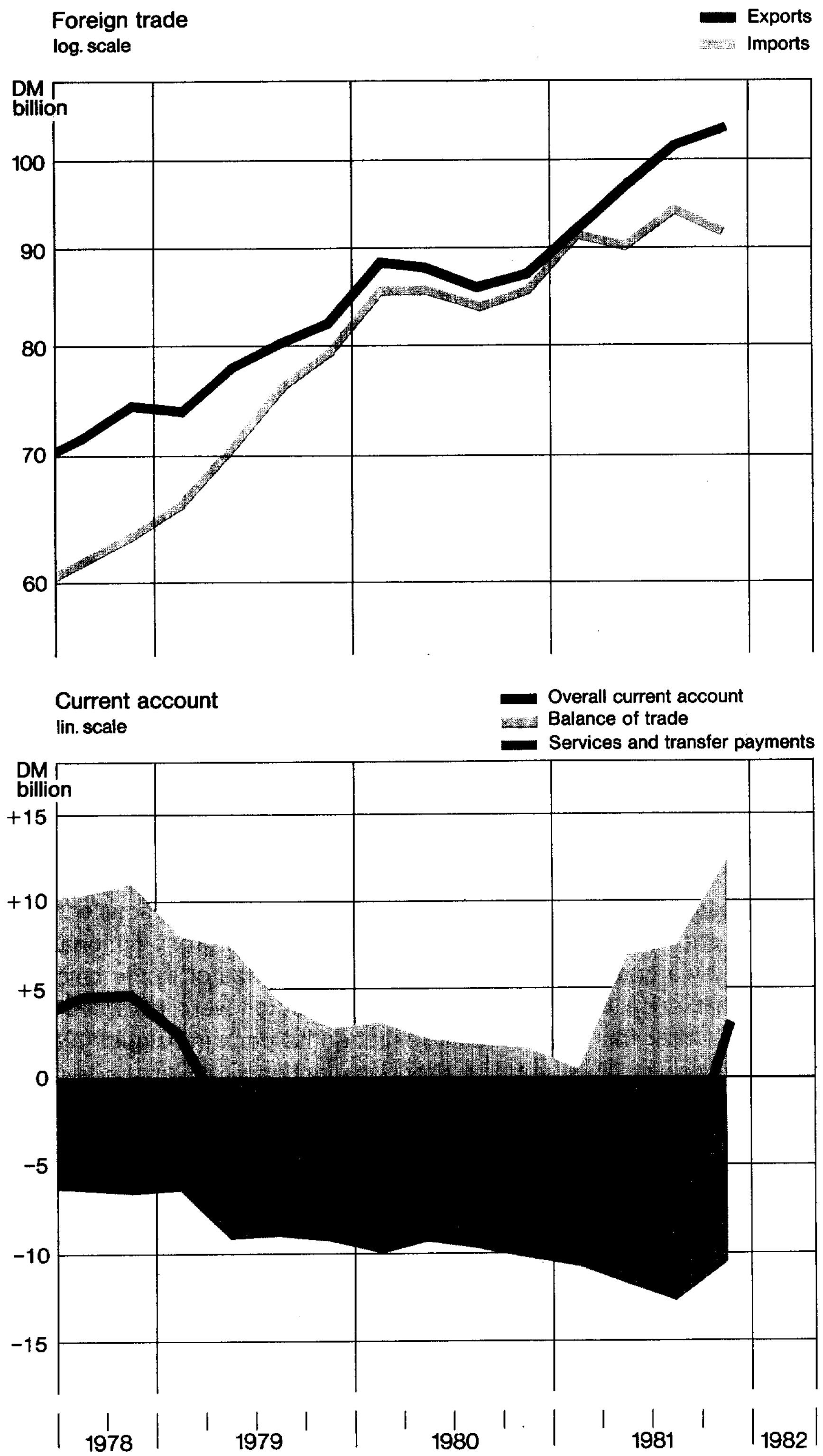
Foreign trade and current account

quarterly, seasonally adjusted



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Notable success in exports to the oil countries other major sales areas, such as Belgium/Luxembourg and Italy (+ 5% each), Austria and Switzerland (+ 4% each), Sweden (+ 3%), the Netherlands (+ 2%) and the centrally planned economies (+ 1% in all), the growth in exports was relatively modest. By concentrating its exports on the oil countries, Germany was largely able to offset the greater demands these countries made on the German national product owing to the rise in oil prices by supplying more goods to them (in the fourth quarter of 1981 Germany actually recorded surpluses again in trade with the OPEC countries). This rapid settlement of the higher oil bill — especially from the OPEC countries — by a corresponding transfer of real resources is, moreover, an important contribution to reducing the still substantial disequilibria in world payments balances. German exports to the oil countries have helped to lessen the polarisation between the current account positions of the oil-producing countries, with large surpluses, and those of the oil-consuming countries, with large deficits; this in turn has reduced the pressure on the international credit markets to finance these imbalances.

Distinctly slower rise in imports of goods

Developments in imports also contributed greatly to the considerable expansion of the German trade surplus. In terms of value, imports of goods increased by only 8% in 1981, or very much less than in 1980 (17%). The rise in import unit values, at 12%, was again unusually strong (largely due to exchange rate movements), but at the same time the volume of imports fell by 3½%, while the national product stagnated. Energy imports alone declined by 12% in volume terms, after a 9% drop in 1980. The steep increase in oil prices by the OPEC countries as well as corresponding price rises for the other sources of energy have caused the demand for imported energy to go down by one fifth since 1980. However, this is due not only to great success in the conservation of energy but also to the moderate pace of economic activity in Germany and the relatively large stocks in hand at the beginning of the period under review. Nevertheless, the strong and quick reaction of energy consumers to the increases in prices is a notable feature. The volume of energy imports (petroleum, natural gas, coal, nuclear fuels, etc.) in 1981 was actually smaller than in 1972, the year prior to the first oil crisis, although the real gross national product has grown by a quarter since then. Another major factor in the balance of payments is that price trends in the petroleum sector were reversed in the course of 1981. After the dollar rate had reached its peak in August 1981, the Deutsche Mark prices of oil imports dropped noticeably. Over the year as a whole, however, the unit values of energy imports (calculated in Deutsche Mark) increased by 34%, so that the amount that had to be spent on energy imports, at DM 91 billion, was almost one fifth higher than in 1980. Not all the countries supplying energy to Germany profited equally from this rise in its energy bill. In fact, there were considerable shifts in the pattern of German energy purchases. For instance, imports from the OPEC countries went up no further in nominal terms while imports from Norway (+ 22%) and the United Kingdom (+ 20%) grew strongly as the significance of supplies of oil and natural gas from the North Sea increased. Imports from the USSR (+ 23%) and the Netherlands (+ 13%) also rose steeply since both countries have substantial amounts of natural gas and petroleum products such as petrol and heating oil to offer. As the sources of supply changed, oil importers adjusted flexibly to the sometimes quite pronounced differences in oil prices in the various regions.

Change in the trend of imports of finished goods

There was also a remarkable change in the trend of imports of finished goods, which account for roughly half of German imports. After having grown strongly for years, these imports increased in value by only 6½% in 1981; in real terms imports of finished products were actually slightly lower than in the preceding year (— 1%), for the first time since 1974. This no doubt partly reflects the downturn in domestic demand in Germany. But the further penetration of imported finished goods in the German market was also noticeably retarded by the improved price competitiveness of German industry. Hence imports from major partner countries in Europe rose relatively little, e.g. those from France and Austria (in value terms + 5% each),[1] from Switzerland and Denmark (+ 4% each), from Italy (+ 2%) and from Belgium and Luxembourg (+ 1%).

Strong growth of deficits on services and transfer payments

In contrast to the development of foreign trade, Germany's deficits on services and transfer payments continued to grow strongly; including expenditure on the transport and insurance of imports, they went up by a total of DM 9 billion to DM 57.5 billion. Germany thus remained the largest net importer of "invisibles" in the world. The foreign exchange required in this connection has to be "earned" from trade surpluses. These deficits largely mirror the specific international division of labour between a densely populated and highly industrialised, but climatically less favoured, country like Germany and economically less developed countries with a high "holiday value". Other structural factors also play a part here, e.g. the small size of Germany's merchant fleet and the employment of millions of foreigners who transfer part of their income home. At all events, Germany's trade surpluses and large deficits on services and transfer payments are closely related. Without receipts from German visitors and home remittances by foreigners living and working in Germany the countries of southern Europe, in particular, would not be able to purchase German goods on the scale that they have done so far.

Swing in the investment income account

The sharp increase in the deficits on "invisible" transactions in 1981 was, however, due less to these structural factors than, above all, to the swing in the investment income account. The current account deficits of the last three years brought a rise mainly in Germany's external indebtedness. In 1981 the public authorities, in particular, for the first time had to pay large amounts of interest (DM 3.2 billion) on their sharply increased external debt. On balance, payments of investment income between Germany and the rest of the world showed a deficit of DM 1 billion in 1981, for the first time for more than ten years, compared with a surplus of just over DM 3 billion a year previously. Net transfers to the European Communities also went up sharply (by DM 2 billion to DM 6.6 billion). Furthermore, foreign workers in Germany, particularly the Turks, sent more money home than a year before (DM 8.3 billion against DM 7.3 billion in 1980). On the other hand, the deficit on foreign travel rose only slightly, in contrast to preceding years, viz. by DM 0.7 billion to DM 26.2 billion. The higher cost of foreign travel and the slower growth of incomes appear to have caused German tourists to moderate such spending. Another factor which improved the foreign travel account was the considerable increase in German receipts from foreign visitors; these rose by almost 20%, as the more favourable exchange rate seems to have made Germany more attractive to travellers from abroad.

Current account deficit largely financed through the market

The preconditions for financing the remaining current account deficit through capital imports also bettered in 1981. While in 1980 almost all the massive deficit on current account was financed from the monetary reserves (not least because the pressure on the exchange rate and the domestic price level would otherwise have been even greater), last year there was only a minor decline in the Bundesbank's foreign exchange reserves on a transactions basis. Long-term capital imports by public authorities, at some DM 22 billion, again proved a significant and comparatively steady source of funds in 1981. Firstly, the Federal Government once more took up direct credit in Saudi Arabia, with which general agreements on the direct recycling of petrofunds are concluded every

1 In the case of France excluding imports of aircraft, the exchange of which as part of joint projects statistically inflates foreign trade turnover on both sides.

year; secondly, German banks placed borrowers' notes of the Federal Government (and also of the Länder Governments) abroad, again mainly in OPEC countries. Altogether, however, public authorities did not raise more long-term funds abroad last year than they had done in 1980 (approximately DM 23 billion), despite the much larger budget deficit. By the end of 1981 the long-term external indebtedness of the public authorities, excluding public bonds held by non-residents, had grown to about DM 47 billion.

Decline in net private capital exports

Private long-term capital transactions also contributed (at least indirectly) to better overall payments balance in 1981: net capital exports, at about DM 8.5 billion, were little more than half as large as in the preceding year (DM 14.5 billion). A somewhat smaller amount of long-term funds flowed abroad on balance from enterprises as a result of heavier borrowing. Moreover, the banks' exports of funds, at DM 5.5 billion, were much lower than in the previous year (DM 9.5 billion). However, this was not only due to market influences, such as the higher cost of long-term Deutsche Mark credit and the improvement in the exchange rate expectations for the Deutsche Mark during the year. A further factor was that the banks, under a gentlemen's agreement with the Bundesbank, refrained from granting long-term credit to foreigners in the first quarter of 1981. The amount exported in portfolio transactions, at DM 5 billion net, was also perceptibly smaller than a year before (DM 7 billion); this was mainly because non-residents took up fewer foreign Deutsche Mark bonds.

Pronounced fluctuations in private long-term capital transactions . . .

Over the course of 1981 private long-term capital movements changed direction several times, partly owing to the assessment of the Deutsche Mark abroad. At the beginning of the year net exports of capital continued for some while, though on a smaller scale than in the fourth quarter of 1980; this was due to the agreement reached with the banks. After the level of interest rates in Germany had risen, the outflow of long-term funds slackened; despite the strength of the dollar and the increase in yields in the United States, non-residents' interest in Deutsche Mark assets grew, and in the summer months (for the first time for a long while) net private imports of capital were registered, and went on until September. In the fourth quarter, however, there was a drastic reversal in long-term capital movements; as a result of the realignment in the EMS and a renewed widening of the interest rate differential in favour of the dollar, substantial amounts of funds were now exported. These net capital outflows continued at the beginning of 1982.

. . . as well as short-term capital transactions

The fluctuations in short-term capital transactions were particularly pronounced. After the tightening of domestic monetary policy and the strengthening of the position of the Deutsche Mark in the EMS, a large volume of short-term funds flowed into Germany as Deutsche Mark liabilities were apparently repaid or covered more effectively in the EMS countries on account of the higher interest cost and greater exchange risk. After the realignment in October there was a renewed outflow of short-term funds, as usual when exchange rates have been adjusted. Over 1981 as a whole these fluctuations largely offset each other. As in the preceding year, enterprises raised substantial amounts of short-term financial credit (mainly in the Euro-DM market), to a total of DM 13 billion net, and public authorities also on balance took in DM 2.5 billion in short-term funds, likewise partly in the form of Euro-DM loans. On the other hand, a sizable volume (approximately DM 10 billion) of short-term funds flowed out from the banks, primarily to the Euro-DM market. Finally, there were the customary outflows through trade credits (about DM 5 billion); these necessarily expand parallel to exports.

Only slight outflow of reserves

In 1981 the net external assets of the Bundesbank decreased by only DM 2.3 billion as a result of transactions; in the preceding year the Bundesbank contributed almost DM 28 billion to the financing of the deficit on current account or the offsetting of capital outflows. The movement of the reserves thus also reflects the reduction in the external disequilibrium. The development of the reserves was strongly affected by the interventions in the EMS. After the weak phase of the Deutsche Mark (which lasted for almost a year) had been overcome, the underlying divergences between the currencies of partner countries in the EMS re-emerged, and weak partner currencies needed massive support. A substantial volume of funds flowed out after the realignment in October, but over the entire year interventions in the EMS resulted in an inflow of foreign exchange totalling DM 15 billion (compared with an outflow amounting to DM 10 billion in 1980). In the Deutsche Mark/dollar market, on the other hand, considerable dollar sales were required last year (as in 1980) to moderate exchange rate fluctuations, which were very severe at times. As the U.S. monetary authorities almost completely refrained from intervening in the market after March 1981, these interventions were predominantly carried out to the detriment of the Bundesbank's dollar reserves.

Dollar assets remain the most important reserve component

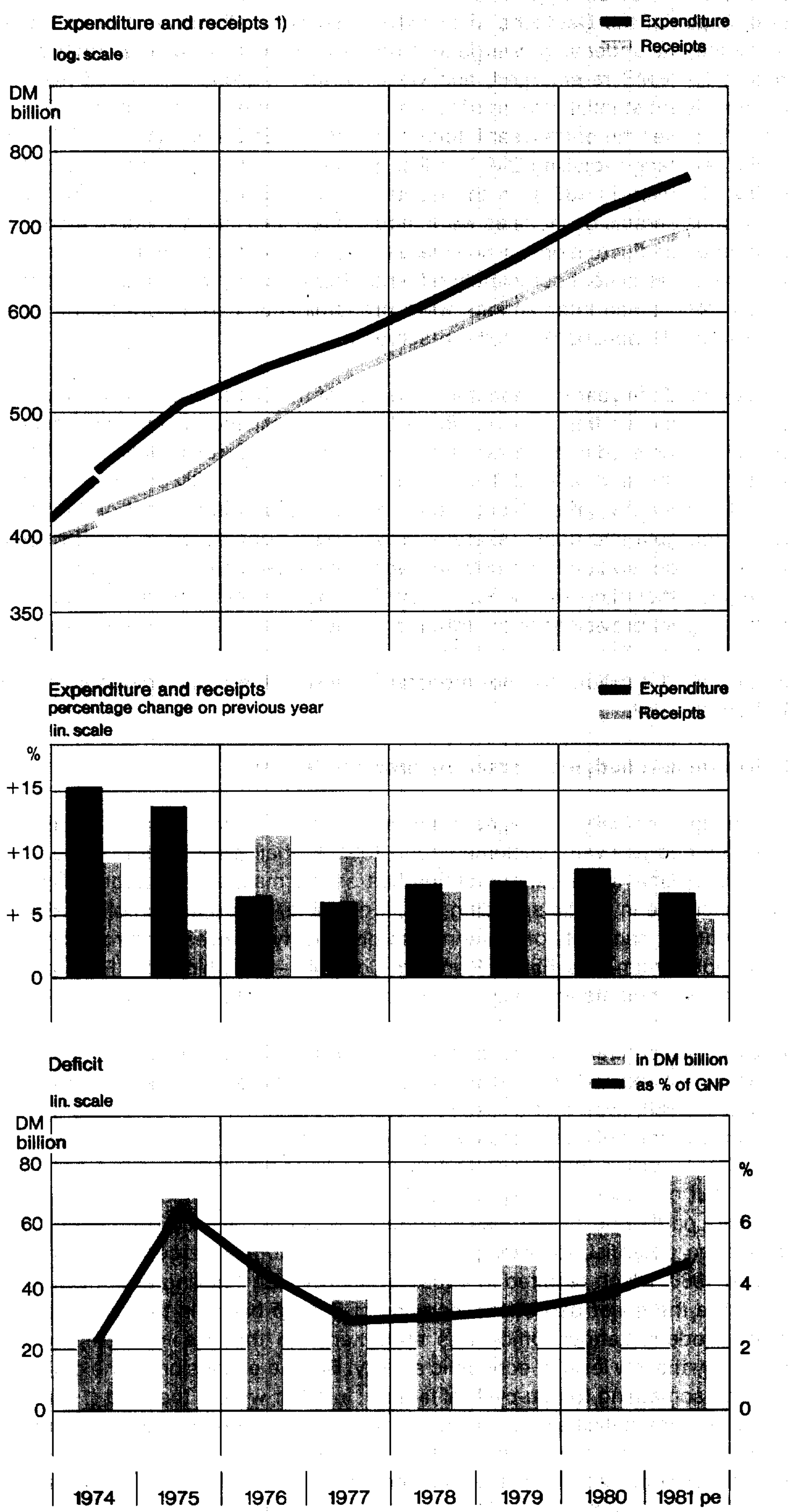
At the end of the year the monetary reserves of the Bundesbank were shown at DM 76.7 billion. Of this amount, DM 37.2 billion consisted of U.S. dollar assets, which were entered in the balance sheet at a rate of approximately DM 1.73 per dollar, as at the end of 1980. The Bundesbank also held ECU balances totalling DM 16.6 billion net (after deduction of the counterpart in respect of the valuation of the gold and dollar reserves provisionally contributed to the European Monetary Cooperation Fund (EMCF)) and assets denominated in special drawing rights amounting to DM 9.2 billion. The gold holding of the Bundesbank (less the gold provisionally contributed to the EMCF) remained unchanged at DM 13.7 billion. The reserve assets were accompanied by external liabilities totalling DM 11.4 billion; the net monetary reserves therefore amounted to DM 65.3 billion in all.

3. Government budgets marked by growing deficits

Renewed rise in public deficits

The change originally envisaged in the stance of fiscal policy was not achieved when the budgets were implemented in 1981. In their planning for last year the central, regional and local authorities had set themselves the target of only a minor increase in public spending and, if possible, no expansion of the deficit. In view of the necessity of fostering the propensity to invest and restoring external equilibrium, the Fiscal Planning Council — in which the Federal and Länder Governments and local authorities discuss the basic principles of budget policy — recommended at its meeting of December 12, 1980 that the fiscal policy of the central, regional and local authorities in 1981 should be directed towards "not exceeding, if at all possible, the level of new indebtedness recorded in 1980, even if this results in a rise of less than 4% in public spending". In fact, the deficits of the central, regional and local authorities in 1981, at some DM 80 billion (corresponding to over 5% of the gross national product), turned out one third or about DM 20 billion higher than in the preceding year. This was partly due to the less favourable economic trend. The utilisation of production potential, for example, dropped by about 2 percentage points as against 1980, which resulted in a loss of tax revenue totalling about DM 8 billion, while the major part of the increase of DM 6.5 billion in the grant needed by the Federal Labour Office was attributable to the rise in unemployment caused by the low level of economic activity. But the expansion of the deficit also owed something to non-cyclical factors; in other words, the hard ("structural") core of the deficit also grew. This core would remain even after a return to "normal" economic conditions, i. e. it cannot be expected to shrink without resolute fiscal policy action. The social security funds, however, recorded a surplus of approximately DM 6 billion last year; this was a more favourable result than in 1980.

Finances of the public sector*



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

Growth of expenditure far stronger than intended

In 1981 the central, regional and local authorities did not succeed in curbing the rise in their expenditure as much as had originally been intended. The budgets envisaged an increase in spending of at most 4%. The appropriations had been kept so low largely to take account of the heavy extra burdens imposed by the reduction in income tax agreed for 1981. In fact, expenditure by the central, regional and local authorities grew by 6½%; in absolute terms this was about DM 15 billion more than had originally been planned.

Substantial additional expenditure on consumption . . .

The main reason why expenditure was so much in excess of the appropriations was the continued relatively sharp rise in consumption spending by the central, regional and local authorities. It went up last year by 8½%, just as in 1980. A major factor in this increase was that last year the Federal Government had to give the Federal Labour Office DM 6.5 billion more liquidity assistance than in 1980. This was DM 4.5 billion more than planned for this item alone in the draft budget, partly because of the unexpectedly steep rise in unemployment but partly also owing to various other causes. However, the Federal Government was able to ease some of its burden by reducing its grant to the pension insurance funds by DM 3.5 billion. Another factor in the social security sector that called for extra expenditure totalling DM 2.5 billion was the increase in children's benefits and housing allowances under the 1981 Tax Relief Act. Altogether, current transfers by the government (including grants to the social security funds) rose by 8½% last year and thus even more than in 1980. Among all the items of expenditure, spending on interest went up by far the most steeply (+ 24½%), to reach around DM 37 billion or almost 7% of total expenditure; hence about one Deutsche Mark in every five paid out *additionally* last year was spent on interest. Roughly half of the increase in interest expenditure (calculated at a constant average rate of interest) was ascribable to the expansion of public borrowing, while the remainder was due to higher interest rates on new and renewed debts; most of the interest payable in 1981 was on credits that had been raised up to the end of 1980. However, unforeseen additional expenditure was incurred through massive repurchases of Federal savings bonds before maturity, especially those on which interest accumulates (see also page 20). Personnel spending was also in excess of the appropriations, growing by 6%, which was distinctly more than was consistent with the rise in negotiated pay rates. This is because the central, regional and local authorities significantly expanded their staff again in 1981. There was also a sharp increase in current operating expenditure (+ 7%), largely owing to considerable extra spending on military equipment.

. . . accompanied by a decline in public investment

Efforts by the central, regional and local authorities to curb the growth of their expenditure were mostly to the detriment of public investment. The full extent of this cut-back was not reflected in capital spending (primarily on construction), which was only 5% lower in 1981 than a year previously, as in many instances payments still had to be made on construction projects that had been started earlier. The restraint exercised by the central, regional and local authorities in the investment field was more evident in the planning of new construction orders than in capital expenditure; such orders declined by over one fifth in value terms in 1981. Public investors once again played a major part (this time, however, the converse of the role they had played in the 1978/79 building boom) in the extreme fluctuations in order books and employment conditions in the construction industry. Much of the investment by the central, regional and local authorities admittedly serves only to form public "consumption assets", which moreover generate high current secondary costs. But some public capital projects which might have improved the economic infrastructure, increased overall productivity or fostered adjustment in the energy sector may well have been sacrificed in the effort to economise.

Finances of the public authorities*

Item	1978	1979 p	1980 p	1981 pe	1978	1979 p	1980 p	1981 pe
	DM billion				Percentage change on previous year			
Central, regional and local authorities 1								
Expenditure								
Personnel expenditure	140.2	149.4	160.9	170.5	+ 5.9	+ 6.3	+ 7.7	+ 6
Other operating expenditure	65.3	70.6	75.9	81	+ 8.9	+ 8.1	+ 7.6	+ 7
Transfers	115.8	121.7	131.0	142.5	+ 9.7	+ 4.2	+ 7.7	+ 8.5
Interest	22.1	24.9	29.4	36.5	+ 5.6	+12.2	+17.8	+24.5
Direct capital outlays	49.2	54.5	61.8	58.5	+ 9.7	+ 9.6	+13.5	− 5
Indirect capital expenditure 2	28.6	34.2	36.1	37.5	6 +29.4	+19.8	+ 5.4	+ 4.5
Other expenditure 3	5.7	7.4	10.5	12.5	− 7.1	+20.9	+42.1	+19
Total expenditure	426.9	462.6	505.5	539	+ 8.9	7 + 7.8	+ 9.3	+ 6.5
of which								
Federal Government	196.9	212.7	228.3	247.5	+ 9.8	+ 8.1	+ 7.3	+ 8.5
Länder Governments	175.5	191.6	208.4	216.5	+ 9.2	+ 9.1	+ 8.8	+ 4
Receipts								
Tax receipts	319.1	342.8	365.0	370.5	+ 6.6	+ 7.4	+ 6.5	+ 1.5
Other receipts	69.3	73.1	81.5	89	+12.8	+ 3.6	+11.4	+ 9
Total receipts	388.4	415.9	446.4	459	+ 7.6	7 + 6.7	+ 7.3	+ 3
of which								
Federal Government	171.2	186.7	199.5	208	+ 9.0	+ 9.1	+ 6.9	+ 4
Länder Governments	163.5	176.6	185.2	189	+ 7.3	+ 8.0	+ 4.9	+ 2
Cash deficit (−)	− 38.6	− 46.7	− 59.1	− 80	.	.	.	.
of which								
Federal Government	− 25.7	− 26.0	− 28.8	− 40	.	.	.	.
Länder Governments	− 12.0	− 15.0	− 23.2	− 27.5	.	.	.	.
Social security funds								
Expenditure 4	221.1	235.0	252.8	271.5	+ 5.6	+ 6.3	+ 7.6	+ 7.5
Receipts	219.3	235.5	255.4	277.5	+ 7.0	+ 7.4	+ 8.5	+ 8.5
Cash deficit (−) or surplus (+)	− 1.8	+ 0.5	+ 2,6	+ 6	.	.	.	.
Public authorities, total 5								
Expenditure	615.5	664.3	720.6	767.5	+ 7.2	7 + 7.5	+ 8.5	+ 6.5
Receipts	575.2	618.1	664.1	693.5	+ 6.8	7 + 7.2	+ 7.4	+ 4.5
Cash deficit (−)	− 40.3	− 46.1	− 56.5	− 74	.	.	.	.

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

Little increase in tax revenue

In view of the substantial reduction in income tax, the central, regional and local authorities had to reckon with a relatively weak trend in receipts from the outset. But the actual increase, at 3%, was even smaller than had originally been expected. While non-tax receipts showed a relatively powerful rise, partly owing to the transfer of profits from the Bundesbank to the Federal Government (DM 2.25 billion), the increase in tax revenue, at only 1½%, was 2 percentage points (or DM 7 billion) below the figure on which the budgets had been based at the end of 1980. This was not just because economic activity, taken as a whole, was slightly more sluggish than had been forecast (a growth of just over 4½% in the nominal gross national product had been expected, while the actual increase amounted to 4%). In addition, the results were adversely affected by a factor which has contributed to the slow growth rates for some time, namely the shift in the distribution of incomes to the disadvantage of profits, which on average are subject to higher taxation. Receipts of assessed taxes dropped significantly in 1981, not least owing to the sharp decline in entrepreneurial income. Assessed income tax yielded 10½% and corporation tax 5½% less than in the preceding year. The revenue from corporation tax, the rates of which have been higher since the reform of 1977 (when tax credits for the receipt of dividends were made deductible), came to as little as DM 20 billion; apart from property tax, this amount constitutes the direct tax payment of the roughly 290,000 enterprises organised in the form of a public limited company (2,100), private limited company (over 275,000), cooperative society (7,000) and corporation under public law. These tax payments by corporations, which were already running at more than half their present level twelve years ago and have been declining since 1980, clearly reflect the consequences for tax revenue of structural shifts in income. For some considerable time only wage tax revenue has been a dynamic factor, largely owing to the more than proportionate growth of total wages and salaries. Receipts of wage tax in 1981, though affected by the revision of the tax scale, were 4½% higher than in the preceding year. Turnover tax revenue rose relatively sharply (likewise by 4½%); this showed that a greater proportion of the national product was being used for consumption. Despite the increase in the taxes on petroleum and spirits with effect from April 1, 1981, special excise taxes yielded only 3% more than in 1980; this was mainly because of the more economical use of petroleum products owing primarily to permanent, rather than cyclical, factors.

Available funds increasingly absorbed by the government

The larger deficits obliged the central, regional and local authorities to draw on the financial markets even more heavily than before. Altogether, these authorities borrowed DM 74 billion net in the credit markets in 1981, almost DM 22 billion more than in 1980 (a small proportion of the deficits was financed, as in the preceding year, by withdrawing deposits or taking up more book credit from the Bundesbank). In 1981 the central, regional and local authorities absorbed approximately one third of the overall domestic acquisition of financial assets, including the supply of foreign capital, against about one quarter in 1980 and roughly one seventh in the first half of the seventies. The principal means of raising funds in 1981 was loans against borrowers' notes, which are particularly flexible; as in 1980, new indebtedness in this form alone was almost equal to the total amount of net public borrowing. The outstanding amount of securities of the central, regional and local authorities, on the other hand, remained almost unchanged on balance. A sizable quantity of Federal bonds was sold, but the rise in interest rates led to massive premature repurchases of Federal savings bonds. The central, regional and local authorities (above all the Federal Government) again obtained a considerable part of the requisite funds abroad through loans against borrowers' notes; these were taken up direct or via German banks. The overall external indebtedness of the public sector, including short-term liabilities, grew by DM 25 billion in 1981 (DM 3 billion more than a year previously). These transactions, which of course were dependent on interest rates that were attractive to foreign investors, made a decisive contribution to financing the current account deficit through the market.

Budgets for 1982 characterised by extensive consolidation measures

When budget planning for 1982 began in the summer of last year, the central, regional and local authorities faced not only a considerable deterioration in the initial position, but also the prospect of a further drastic increase in the deficits during the new financial year. The main reason for this was the lower rate of economic growth that was to be expected (in the medium term as well) under the more difficult overall conditions. The rise in tax revenue had to be estimated at a lower figure, and on the expenditure side substantially larger spending on unemployment was to be anticipated — in addition to other, non-cyclical burdens. After the deficits had increased in 1981, they were not to be allowed to grow any further in the present year. The Fiscal Planning Council therefore recommended last July, as a guideline for budget planning, that in 1982 the deficits should be reduced to the 1980 level. The Federal Government accordingly adopted a package of measures designed mainly to cut current expenditure, but also to raise excise taxes and social security contributions and abolish tax concessions. "Operation '82" also included special measures to stimulate investment; the most important of these was an extension of the depreciation allowances on machinery, equipment and buildings. As approved by Parliament, the programme comprised budget relief to the amount of approximately DM 20 billion on balance; in the main it benefits the Federal Government and to a lesser degree the Länder Governments and local authorities. The fact that the Federal Government was able to limit its deficit in the 1982 budget to DM 27 billion — and hence roughly the volume envisaged for 1982, as part of the projected consolidation, in the 1980 medium-term financial plan — was, however, partly a consequence of the unusually large profit transfer by the Bundesbank. The budgets of the central, regional and local authorities for 1982 provide for a total deficit of some DM 60 billion; this is in line with the recommendation of the Fiscal Planning Council. What matters now is to maintain the course adopted in "Operation '82" as far as possible (although a few risks are becoming apparent) by substantially lowering the deficits as the budgets are implemented in 1982, and continue this course consistently in the budgets for 1983.

Fiscal support for the structural change in the economy

The reduction in the government deficits was necessary not only in fiscal terms, especially in view of the growing interest burden; in addition, it was the economic policy reflection of the fact that the sluggish growth in economic activity apparent since 1980 has been due less to cyclical phenomena than to the much greater difficulties involved in the overall adjustment process, primarily as a result of the huge rises in energy prices. A mere stimulation of demand therefore could not be regarded as an adequate remedy. What was — and still is — needed is a lasting improvement in the conditions for higher investment, an increase in enterprises' efficiency and hence a stronger demand for labour. This includes easing the burden on the credit markets by reducing public borrowing and so helping to create more favourable conditions for financing private investment. But it cannot be expected that, when the economic situation improves, the public deficits will contract again of their own accord, as it were, to the same extent as they expanded. As a result of the flatter trend in overall economic growth, tax receipts are growing more slowly than previously assumed. Moreover, the labour market will remain a heavy financial burden on the public authorities, especially as demographic factors have brought an increase in the potential labour force. Other factors which have contributed to the massive deficits will continue to make themselves felt even after economic activity improves — one example being the subsidies required by the Federal Railways. The reduction of the deficits will be hampered equally by the fact that expenditure on interest would go on rising steeply for some time to come, in line with the level of debt, even if new borrowing were to be cut back as business activity picked up again and the rates of interest payable on new credit fell. But where the deficits are of a structural (i. e. lasting) nature, it will not be possible to reduce them without measures designed specifically for the purpose.

The rise in public consumption expenditure must be curbed

As part of a strategy intended to achieve these objectives, the approach used to lower the deficits is no less important. If capital spending is not to be lessened further and the overall tax ratio is not to be raised, the only possible solution is to reduce the share of consumption expenditure. This policy suggests itself since the rise in the public spending ratio has been determined by consumption expenditure over the longer term as well. The public spending ratio (the ratio of overall government expenditure to the gross national product) is admittedly subject to comparatively severe cyclical fluctuations; it increases in a recession or stagnation and declines in an upswing or boom. But even if the public spending ratio of the various recession or stagnation years is examined, it will be found that its growth from 41.5 % in 1967 via 40.1 % in 1971 and 49.3 % in 1975 to 49.5 % in 1981 is entirely ascribable to consumption expenditure, while the share of public capital spending in the national product has declined (from 7.5 % in 1967 via 6.8 % in 1975 to 6.2 % in 1981). Hence what is required is to release more funds for public capital formation by changing the structure of expenditure. On the other hand, a higher public revenue ratio and a consistently high, or even rising, level of net borrowing by the government would hamper the private sector of the economy and be an obstacle to the strengthening of private investment activity. This would run counter to the requirements of economic policy. In its Annual Economic Report for 1982 the Federal Government therefore expressly states that "all economic and fiscal policy decisions must contribute to the restructuring of the use of the national product away from consumption towards investment, since such restructuring is indispensable in the medium and longer run".

4. Sluggish activity and higher inflation in the domestic economy

Economic activity subdued despite external stimulus

The German economy stagnated in 1981. The sharp increase in exports discussed above imparted some stimulus to economic activity: the manufacturing sector, for instance, received about 16½ % more orders from abroad in value and roughly 11 % more in volume in 1981 than in the preceding year. Moreover, foreign suppliers of finished goods were unable to strengthen their market positions in Germany last year; in some cases they actually had to give up ground they had gained in earlier years. Both trends are an indication of the general improvement in the international competitiveness of the German economy. However, the external stimulus sufficed only to offset the decline in domestic demand in some areas and to prevent overall production from decreasing.

Domestic activity hampered by heavy cost increases

The main causes of the weakness of domestic economic activity were the further deterioration in the profitability of private enterprises in 1981 and the corresponding decline in the will to take new entrepreneurial risks. Last year German enterprises found themselves facing steep cost increases which they could not pass on in full to their customers even though they raised their sales prices sharply. Unit costs in the economy as a whole went up by 6½ % in 1981 relative to sales at home and abroad. Nearly two fifths of this growth (about 2½ percentage points) was due to the higher cost of imported goods and services; price increases by foreign suppliers and the depreciation of the Deutsche Mark, which was pronounced at times (particularly against the U.S. dollar), both worked in the same direction. "Home-made" cost rises were an even more important factor, accounting for just over three fifths or 4 percentage points of the upward movement. The increase in wages and salaries alone, including social security contributions, made up over 2½ percentage points of the overall growth of unit costs, and thus about as much as the rise in the cost of imports. Further factors were higher taxes and, as for some time past, larger consumption of fixed capital.

Interest a cost factor of limited importance to trade and industry

In 1981 the increase in interest rates was an extra burden on enterprises' cost accounts. However, the significance of interest as a cost factor in the production process is sometimes overrated. The level of interest rates and interest rate expectations certainly play a major part in enterprises' decisions on investment projects, and especially on the timing of their implementation. But interest is generally of less importance as a current item in enterprises' profit and loss accounts, even though the situation no doubt varies greatly from one enterprise to another; for instance, smaller enterprises are normally affected more than larger ones. According to the annual accounts for 1980 in the Bundesbank's possession (more recent data are not available), interest expenditure by enterprises was equivalent to about 4½ % of gross earnings in that year, while staff costs, for instance, amounted to more than 50 % of gross earnings. Furthermore, it is often overlooked that enterprises not only pay interest but also receive sizable amounts of interest on their financial assets. After deduction of such receipts, the net interest paid by enterprises in 1980 corresponded to only 3 % of gross earnings. Changes in interest rates in the credit markets therefore generally affect both sides of the profit and loss account, albeit to differing extents. Moreover, the interest rates on enterprises' claims and liabilities are often fixed, or can be adjusted only with a time-lag, so that — judging by past experience — the effects of both rises and falls in interest rates work through to enterprises' cost accounts only in a much attenuated form.

Entrepreneurial earnings depressed

In 1981 the prices of German products sold at home and abroad went up on average by 5½ %, and therefore less than was needed to cover the additional costs. Entrepreneurial income in the narrower definition[1] — which is admittedly only a rough yardstick of the trends in earnings — was about 8 % lower in 1981 than a year earlier; after adjustment for price increases, the decline was even greater. However, the annual figure masks divergent trends in the two halves of the year; after a slump in earnings in the first half of 1981, entrepreneurial income recovered slightly later on. But the level of earnings remained depressed compared with earlier years.

Enterprises' self-financing capacity and will to take risks reduced

It is obvious that enterprises' self-financing capacity was noticeably impaired by the difficult earnings situation; this was felt all the more keenly as enterprises' capital base and hence their cushion against business risks have been subject to almost continuous erosion for several years. In 1980 the ratio of capital and reserves to the balance sheet total in the producing sector and the distributive trades taken together was only about 21 %, compared with 24 % in the seventies and 30 % in the second half of the sixties. In 1981 the capital base is likely to have deteriorated further. The fact that this has weakened the business community's resistance and made the financial structures as a whole more vulnerable is demonstrated not least by the large number of insolvencies last year: roughly 8,500 firms (as against 6,300 in 1980 and an average of 5,100 a year between 1970 and 1979) had to file bankruptcy petitions.

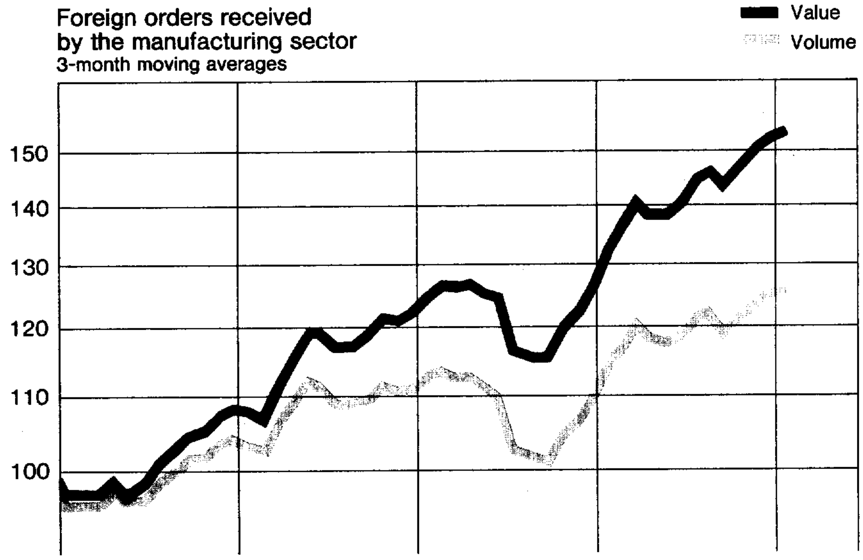
Uneven distribution of the burden of adjusting to the lower income level

The marked decline in business earnings ultimately reflects the fact that the burden of adjusting to the generally lower level of real income was again very unevenly distributed last year. As a result of the stagnation in overall output and the pronounced deterioration in the terms of trade, in 1981 about 1½ % less real income than a year earlier was available for distribution in Germany. But as already shown, entrepreneurial income went down much more, namely by an estimated 13 % in real terms. Real income from wages and salaries was also lower in 1981 than a year before, but this decline, at not quite 1 %, was smaller than the decrease in overall real income. The signals were set for this develop-

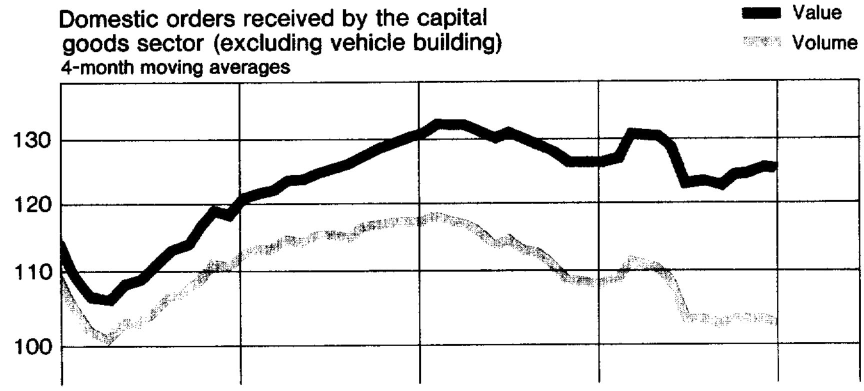
1 Private entrepreneurial and property income less households' income from financial assets and the income of the financial sectors (banks, including the Bundesbank, building and loan associations and insurance enterprises) and the housing sector.

1976=100, seasonally adjusted, log. scale

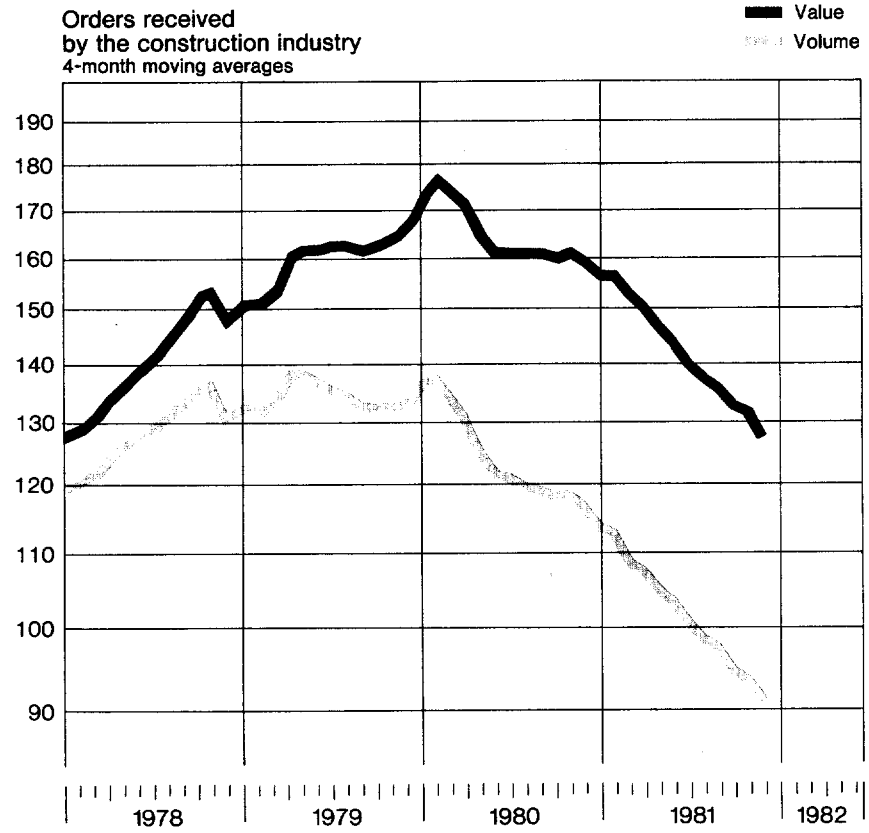
Foreign orders received
by the manufacturing sector
3-month moving averages



Domestic orders received by the capital
goods sector (excluding vehicle building)
4-month moving averages



Orders received
by the construction industry
4-month moving averages



ment in the 1981 wage round, in which management and labour agreed on negotiated wage and salary increases of generally 5 to 6% (including fringe benefits). But with the rise in the cost of imports and the additional burden of larger social security contributions, these growth rates proved to be too high, even though they were about 2 percentage points below those of the preceding wage round. In the course of the year the business community responded by cutting down personnel, reducing expensive overtime and introducing more short-time working. Nevertheless, gross income from wages and salaries went up in 1981 by as much as 5% and, calculated per employee, by 5½%. After adjustment for price increases and deduction of taxes and social security contributions, this meant only a relatively small reduction (−1%) in average wage and salary income.

Decline in real retirement pensions, but sharp rise in other government current transfers

In 1981 households received about 5% more than a year earlier in retirement pensions, mainly because of the 4% pension increase. Calculated per recipient and after adjustment for price rises, this was a reduction of 1½% over the preceding year — likewise more than the drop in average real wage and salary income. However, this must be seen against the background of the disproportionate growth of pensions between 1975 and 1977, which was later corrected under the 20th and 21st Pension Adjustment Acts. There was a relatively strong increase in 1981 in those current transfers from the government which are intended to act as "built-in stabilisers" and counter the losses in wage and salary income associated with the decline in employment. These include, in particular, unemployment benefits and unemployment assistance. Altogether, in 1981 about 8% more income than a year earlier was transferred to households in nominal terms as part of the redistribution of income by the government. Including private withdrawals from entrepreneurial income, which — according to rough estimates — stagnated, and income from financial assets, which increased sharply (by about 20%), the total disposable income of households rose by 5½%.

Investment ratio falls owing to the uneven development of incomes

Owing to the uneven development of incomes, no progress was made in 1981 in the shift from consumption expenditure to capital spending — a shift which is imperative if more favourable growth and employment conditions are to be achieved. The share of fixed capital formation in the gross national product last year, at 23%, was actually rather lower than in 1980. Besides, more than half of total expenditure on new fixed assets merely offset current capital consumption; thus only 10½% of the gross national product was devoted to expanding the capital stock last year, compared with an average of 12% a year between 1971 and 1980 and 15½% from 1961 to 1970.

Decrease in real expenditure on machinery and equipment

Expenditure on machinery and equipment rose slightly in 1981 (by ½%, against about 7% in the preceding year), but after adjustment for price increases it declined (by 3%), for the first time since 1974. In the course of last year, after sales expectations had been disappointed and profits had turned out smaller than anticipated, a number of firms evidently either slowed down their capital projects or refrained altogether from implementing them. The main cancellations seem to have been in the field of investment for extension purposes, while priority was apparently given, in view of the cost pressure mentioned above, to starting projects to rationalise and modernise the production process. In some areas of the consumer goods sector, in particular, capital expenditure was noticeably below its 1980 level. But overall investment in mining and the energy sector showed a considerable increase. The continued efforts to find substitutes for oil provided a special stimulus in this field.

Energy conservation still a major investment motive

In general, energy conservation appears to have remained a most important investment motive in view of the higher energy prices. That efforts to save energy have been successful over the last few years is indicated by the 5% decrease

Consumption of primary energy

Source of energy	1979	1980	1981 p	1979	1980	1981 p
	Million tonnes of coal equivalent			Percentage change on previous year		
Petroleum	206.8	185.7	165.0	+ 1.7	−10.2	−11
Coal	75.8	77.1	78.5	+ 9.5	+ 1.7	+ 2
Lignite and pitch coal	38.1	39.2	40.0	+ 6.1	+ 2.9	+ 2
Natural gas 1	66.0	64.4	59.8	+ 9.3	− 2.4	− 7
Nuclear energy	13.9	14.3	17.2	+17.8	+ 2.9	+20
Hydroelectric power 2	5.8	7.6	8.4	−12.1	+31.0	+10
Other sources of energy	1.8	1.9	2.1	+ 0.0	+ 5.6	+11
Total consumption of primary energy	408.2	390.2	371.0	+ 4.9	− 4.4	− 5

1 Including petroleum gas, methane and sewage gas. — 2 Including net imports of electricity. — p Provisional.

in the total consumption of primary energy in 1981, while sales of oil went down by as much as 11 % — owing in part, admittedly, to the de-stocking which began last year. The share of oil in primary energy consumption declined to just under 45 %, approximately the 1966 figure. The use of gas as a source of energy also decreased, while the importance of coal and nuclear energy grew further, as in 1979 and 1980.

Business community reluctant to order capital goods . . .

The reluctance of enterprises to start new investment projects was also reflected in the orders they placed. Until the summer of last year the domestic orders received by the capital goods sector (excluding road vehicle building) showed a declining trend; on average they were about 2½ % lower in 1981 than a year earlier, and calculated at constant prices they were as much as 6½ % down on the year. It was not until the end of 1981 that they started to move upwards slightly.

. . . and increase stocks

In 1981 enterprises' stockbuilding had pronounced contractionary effects on domestic demand. Whereas in 1980 stocks were built up by approximately DM 19 billion, in 1981 they were run down (by about DM 1 billion) in the economy as a whole, for the first time in six years. Special factors played a part here: the oil industry's stocks of crude oil and refinery products, for instance, were greatly reduced after the supply situation had eased noticeably last year. This enabled the oil companies to lower their stocks and thus avoid the heavy costs involved. In the other industries the reduction in stocks was no doubt due mainly to disappointed sales expectations and the expense of stock financing.

Construction activity generally very weak . . .

Expenditure on construction was very low in 1981. In the aggregate it increased slightly last year (by about 1 %), but after adjustment for price rises construction investment was nearly 3½ % smaller than a year before. Industrial construction remained at a relatively high level during the greater part of last year, as many construction projects which had been started in 1980 were completed despite the more difficult earnings and financing situation. But during the second half of the year activity in this field declined noticeably. In all, expenditure on industrial buildings increased slightly in nominal terms in 1981 since building prices continued to rise (albeit at a slower pace) despite the recession in the construction industry. In terms of volume, however, such investment was 1 % down on the year. Over 1981 as a whole the value of orders for industrial buildings was actually about 10 % lower than in the preceding year. As already mentioned, the underutilisation of business capacities led to a reduction of spending on extension projects (which generally involve expenditure on construction) while investment for rationalisation purposes, in which construction mostly plays a smaller part, tended to be continued.

... especially in public construction

The setback was particularly marked in public construction because of the tight government budget position and the large public consumption spending commitments, which are often laid down in laws involving government payments. Public construction expenditure decreased by 2½ % in 1981, and after adjustment for price rises by nearly 6 %. New construction orders, some of which will not be executed until this year, were over one fifth lower in 1981 than a year before. Civil engineering was particularly hard hit; the orders it received from the public authorities in 1981 were about one quarter fewer than in the preceding year. Towards the end of last year the competition for these orders led to a slight decline in the prices for road construction work.

Pronounced setback in housing construction as well

Housing construction, which had long been one of the mainstays of construction activity, also suffered a pronounced setback in 1981. In value terms capital expenditure in this sector admittedly increased slightly, but in volume terms it was 4 % lower than in 1980. The number of housing units completed in 1981, at just over 365,000, was distinctly lower than in the previous year. Construction firms began 1981 with smaller backlogs of unfilled orders and unfinished buildings. In the course of the year there was a continuous decline in the inflow of orders for new residential buildings. Over 1981 as a whole the value of new orders for residential buildings was about 10½ % lower than a year earlier, and after adjustment for price increases it was down by 15 %. The backlogs of housing orders therefore shrank noticeably in 1981, and the starting position for 1982 was consequently worse than that for 1981.

Problems in the housing market due to the high cost of funds and distorting government regulations

Much of the marked decline in the demand for new housing was due to the high level of interest rates. Moreover, construction costs continued to rise on the whole. In these circumstances many potential owners of one and two-family houses or owner-occupied apartments postponed their building plans. Even in the second half of the year, when interest rates started to move down from their peak, potential home-owners continued to hold back in the expectation of further reductions in rates. Another significant factor was that numerous distorting interventions and regulations in the housing market (e. g. in rents) apparently caused people to rate the risks of financial engagement in this field higher than any advantages which might be expected over the longer term. This was also indicated by the weakness of the real estate market in 1981; many hopes of making a profit on the sale of a house or flat were disappointed. Moreover, cost-covering rents for privately financed new housing, at more than DM 20 per square metre of floor space, have now reached a level at which profitable letting is out of the question for the foreseeable future. However, financial engagement in privately financed housing (including apartments originally intended for owner occupation) for letting purposes still seems to be worth while for certain sections of the population on account of tax concessions (what is known as the "Bauherrenmodell"); but these tax incentives (which are to be reduced as from 1985) do give some cause for concern. The disinclination of prospective tenants to pay high rents for apartments in new buildings is considerable as there is a large market in older housing, the rents for which are often held at a relatively low level by government regulations. This includes housing built with public funds, for which more than 50 % of all tenant households are eligible according to the income limits applied to such accommodation. However, this housing accounts for only about 30 % of the total stock of rented dwellings. Moreover, much of it is occupied by households whose income has in the meantime far outstripped the limits laid down for eligibility. The division of the market for rented housing into various sectors with different levels of rents (some of which are affected by administrative measures) and a very high degree of protection against ejection for the tenants means that, on the one hand, the market for comparatively low-cost housing has become inflexible — even though many such apartments are no longer fully utilised and demand in this area of the market is particularly strong — while, on the other hand, the con-

Key economic data in the Federal Republic of Germany

						1978	1979	1980	1981
Item	Unit	1978	1979	1980	1981	Percentage change on previous year			
Aggregate demand									
Private consumption	DM billion	713.9	766.4	821.6	860.9	+ 6.6	+ 7.3	+ 7.2	+ 4.8
Public consumption	DM billion	257.1	278.6	304.1	325.8	+ 7.4	+ 8.3	+ 9.2	+ 7.1
Fixed capital formation	DM billion	273.0	314.4	350.4	353.8	+ 9.7	+ 15.2	+ 11.5	+ 1.0
Machinery and equipment	DM billion	110.4	123.7	132.2	132.9	+ 10.5	+ 12.1	+ 6.8	+ 0.6
Buildings	DM billion	162.6	190.7	218.2	220.9	+ 9.1	+ 17.2	+ 14.5	+ 1.2
Expenditure on stocks	DM billion	9.4	25.6	18.9	— 0.8	.	.	.	.
Domestic expenditure	DM billion	1,253.5	1,384.9	1,495.0	1,539.7	+ 7.0	+ 10.5	+ 7.9	+ 3.0
External surplus **1**	DM billion	37.3	13.3	— 3.1	12.2	.	.	.	.
Exports	DM billion	348.1	383.0	430.6	494.2	+ 5.3	+ 10.0	+ 14.4	+ 14.8
Imports	DM billion	310.8	369.7	433.7	482.0	+ 3.2	+ 18.9	+ 17.3	+ 11.1
Gross national product at current prices	DM billion	1,290.7	1,398.2	1,491.9	1,551.9	+ 7.5	+ 8.3	+ 6.7	+ 4.0
Memorandum items									
Orders received by manufacturing	1976 = 100	106.3	117.8	122.2	127.6	+ 4.9	+ 10.8	+ 3.8	+ 4.4
Domestic orders	1976 = 100	108.5	118.5	122.0	120.4	+ 5.2	+ 9.2	+ 3.0	— 1.2
Foreign orders	1976 = 100	101.5	116.3	122.8	143.1	+ 4.4	+ 14.6	+ 5.6	+ 16.5
Orders received by construction	1976 = 100	142.5	160.8	165.2	140.9	+ 23.2	+ 12.9	+ 2.7	— 14.7
Distribution of income									
Wage and salary income	DM billion	714.7	769.4	833.0	874.4	+ 6,7	+ 7.7	+ 8.3	+ 5.0
do. as a percentage of national income	%	71.0	70.9	72.4	73.6	.	.	.	.
Entrepreneurial and property income	DM billion	291.2	315.5	316.8	314.0	+ 9.1	+ 8.3	+ 0.4	— 0.9
do. as a percentage of national income	%	29.0	29.1	27.6	26.4	.	.	.	.
National income	DM billion	1,006.0	1,084.9	1,149.8	1,188.4	+ 7.4	+ 7.8	+ 6.0	+ 3.4
Production									
Gross national product at 1970 prices	DM billion	843.5	880.8	896.7	894.0	+ 3.6	+ 4.4	+ 1.8	— 0.3
Productivity **2**	1970 = 100	141.4	146.5	149.0	151.5	+ 3.5	+ 3.6	+ 1.7	+ 1.7
Output in the producing sector (excluding construction)	1976 = 100	104.4	109.8	109.8	108.4	+ 1.8	+ 5.2	0	— 1.3
Construction output	1976 = 100	110.0	117.4	114.2	105.5	+ 6.3	+ 6.7	— 2.7	— 7.6
Employment									
Employed persons	Millions	25.2	25.6	25.8	25.7	+ 0.7	+ 1.4	+ 1.0	— 0.6
Wage and salary earners	Millions	21.6	22.0	22.3	22.3	+ 1.2	+ 1.9	+ 1.5	— 0.4
Memorandum item									
Total number of man-hours worked **3**	1970 = 100	87.6	88.3	88.5	87.0	— 0.3	+ 0.8	+ 0.2	— 1.7
Unemployed persons	Thousands	993	876	889	1,272	— 3.6	— 11.8	+ 1.5	+ 43.1
do. as a percentage of									
the total labour force	%	3.8	3.3	3.3	4.8	.	.	.	.
the dependent labour force	%	4.3	3.8	3.8	5.5	.	.	.	.
Prices									
GNP deflator	1970 = 100	153.0	158.7	166.4	173.6	+ 3.8	+ 3.7	+ 4.8	+ 4.3
Memorandum item									
Unit labour costs in the economy as a whole **4**	1970 = 100	155.2	159.2	168.5	177.0	+ 2.6	+ 2.6	+ 5.8	+ 5.1
Cost of living index for all households	1976 = 100	106.5	110.9	117.0	123.9	+ 2.7	+ 4.1	+ 5.5	+ 5.9
Producer prices of industrial products	1976 = 100	103.9	108.9	117.1	126.2	+ 1.1	+ 4.8	+ 7.6	+ 7.7
Overall construction price level	1976 = 100	110.5	120.1	133.2	140.2	+ 6.0	+ 8.7	+ 10.9	+ 5.3
Index of import prices	1976 = 100	97.7	109.1	125.3	142.9	— 3.7	+ 11.6	+ 14.9	+ 14.0

1 Balance of transactions in goods and services with other countries (including GDR). — **2** Gross domestic product at 1970 prices per man-hour worked; calculated by the Bundesbank. — **3** Calculated by the Bundesbank. — **4** Index of gross wages and salaries per employee divided by index of real GNP per employed person. — The figures from the national accounts from 1979 onwards are provisional.

struction of privately financed rented housing is in general no longer an attractive proposition.

First steps towards easing the situation in the housing market

Within the framework of "Operation '82" the two Houses of the German Parliament have agreed on the first steps to overcome this "stalemate" in the housing market. It is intended that higher-income tenants of housing built with public funds in large cities should pay an "ineligibility levy", and that the interest rates on loans granted in the past for publicly-assisted housing should be raised. Moreover, under its "Joint initiative on jobs, growth and stability" the Federal Government has proposed easing the rent regulations somewhat (e. g. changing the definition of "comparative rent" and authorising graduated rents for new housing). These are undoubtedly steps in the right direction, and in the longer run they may help to bring trends in housing construction more into line with market forces. It is planned to use the funds accruing to the central, regional and local authorities from the ineligibility levy and the higher interest rates on loans (or premature loan repayments) to build more publicly-assisted housing.

Consumer demand less affected by the lower income level

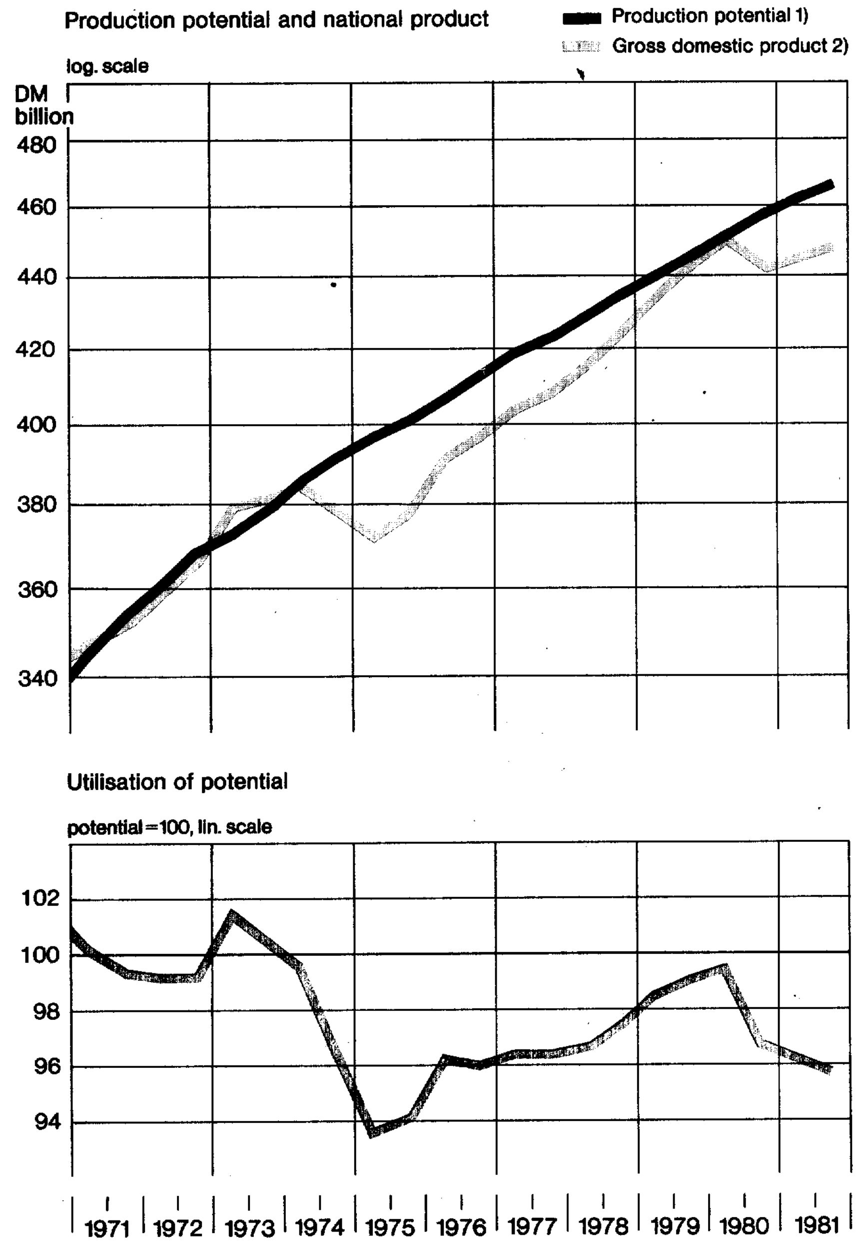
The changes described in the distribution of income in 1981 were the main reason why the reduction in the level of overall income affected consumer demand less than demand for capital goods. In 1981 the public authorities actually spent about 7% more than in the preceding year on consumption (mainly the staff costs and other operating expenses of the central, regional and local authorities and the social security funds); this means that government consumption grew in real terms as well. Last year households spent nearly 5% more on consumption than in 1980. After adjustment for price increases, private consumption was roughly 1% lower than a year earlier. A growing proportion of private consumption spending in 1981 consisted of expenditure on energy. Although more energy was saved (calculated in units of energy, about 5%, as noted), households had to spend an estimated 13% more on fuel and petrol last year than in 1980, as energy prices rose sharply at the consumer level on account of the oil price hike of 1980 and the temporary deterioration of the external value of the Deutsche Mark. Almost one quarter of the extra expenditure on consumer goods was accounted for by the additional spending on energy. This was no doubt one of the reasons why households cut down their other consumption expenditure. The retail trade, in particular, felt this very keenly. Turnover there, excluding fuel, in 1981 was only 2½% higher than a year before, and in real terms it was noticeably lower than in 1980. Households were especially reluctant to purchase goods with which they are in general already well supplied. The number of new passenger cars bought in 1981 also failed to regain the 1980 level, although sales picked up in the course of the year as more energy-saving models were introduced. Expenditure on foreign travel did not expand nearly so much as in former years, no doubt in view of the other costs incurred.

Increase in private saving

The rise in their disposable income left households with some scope for increasing their saving in 1981. Total saving went up by about 9% compared with the preceding year, while the saving ratio rose by ½ percentage point to about 15%. For one thing, the high level of interest rates stimulated saving and made individuals less willing to raise consumer credit. For another, households earned about one fifth more on their financial assets in 1981, partly because of the high interest rates, and a considerable part of this income was reinvested. As a rule, about three quarters of private interest and dividend income seems to flow more or less automatically into new financial investments, either as a result of interest credited or owing to the interest-bearing accumulation of profit distributions or through savings schemes. In 1981 this part of property income alone accounted for about 40% of the total private acquisition of financial assets, compared with about one third towards the end of the seventies and only one quarter at the beginning of the seventies. It must also be borne in mind

Overall production potential

seasonally adjusted, half-yearly



1) Calculated by the Bundesbank.- 2) At 1970 prices.

that a further part of property income (the size of which depends on the motive for saving or yield considerations) is generally saved as well, e. g. income from security holdings.

Great interest in high-yielding investments

The choice of investment last year was mainly determined by savers' desire to secure attractive yields. At times — for example in the second quarter of last year and again after the summer break, when it was widely expected that interest rates would start fo fall — there was nothing less than a run on high-interest-bearing investments. In 1981 private investors bought considerable quantities of bonds, among them — as noted elsewhere in this Report (page 17) — a particularly large amount of short-dated securities. At the same time they paid substantial sums into time accounts with banks. There was some demand for bank savings bonds, but rather less than a year earlier. On savings accounts, however, outflows predominated, primarily no doubt because of shifts to investments with more attractive interest rates. The fact that households were very slow to raise credit for consumption purposes because of the high lending rates also had a positive effect on the overall saving figure. In all, only about half as much new consumer credit was taken up in 1981 as a year before.

Overall production stagnates

As already indicated, the seasonally adjusted level of overall production remained virtually unchanged over the course of the year. On an annual average, too, the real gross domestic product (i. e. the value added in all fields of production in Germany) was about as large in 1981 as in the preceding year.[1] As described in more detail below, in the course of 1981 domestic output was generated by a decreasing number of employed persons, whose average working hours were reduced as well. Overall productivity therefore improved; over the whole of the year productivity gains, as measured by the real gross domestic product per man-hour worked, came to about 1½%.

Further decline in the utilisation of production potential

In 1981 the production capacities of the German economy were once again not fully used. Utilisation of overall production potential seems to have run at about 96% of the standard level in 1981, against 98% in 1980 and 99% in 1979. Production potential itself grew by 2% last year, after having increased by 2½% a year since 1975 and by an annual average of 3½% in the decade from 1966 to 1975. The above-mentioned weakness of investment activity played a role in the latest slowdown in the expansion of production potential, reducing the growth of potential all the more since, as stated before, an increasing part of gross expenditure on new fixed assets served only to replace plant which was out of date or had to be discarded because of structural adjustment problems. The fact that a number of investments were primarily intended to conserve energy and replace oil, as well as to improve rationalisation and environmental protection, while production capacities as such were hardly enlarged, also had a dampening effect. Investment of this kind makes production more capital-intensive and increases enterprises' "energy productivity". It has turned out that the same quantity of goods can now be produced with a smaller input of energy. But generally such investment does not lead directly to more jobs. This can be expected only indirectly and over the longer term as energy-saving investment makes enterprises more competitive.

Divergent production trends in the individual sectors

The individual sectors of the economy made very different contributions to the domestic product in 1981. This was partly due to the varying influence of foreign demand and oil substitution in the individual sectors. In areas where exports play only a minor role, output often declined. This was particularly apparent in the construction sector and the building materials industry. In the distributive trades and transportation, too, the value added decreased noticeably last year. In contrast, output in the producing sector (excluding construction) fell only slightly, viz. by about 1%, partly on account of the growing contribution from mining and the energy industry, partly because of higher exports (especially in road vehicle building, the chemical industry and the food, drink and tobacco industry). The output of other traditional consumer goods industries, notably textiles and clothing, dropped sharply. Petroleum processing also declined perceptibly. On the other hand, the value added in most of the services sectors continued to increase. Hence the long-term trend towards an expansion of the tertiary sector of the economy to the detriment of the goods-producing sector persisted last year, although a shift of emphasis in the opposite direction would be desirable in view of the adjustment problems which still remain to be solved.

1 The main reason why the gross national product nevertheless declined slightly last year was that in 1981, in contrast to the preceding years, Germany paid more factor income (mainly investment income) to non-residents than it received from abroad. This was because Germany's net assets position has deteriorated in the last two years as a result of the current account deficits (see also pp. 30—1).

Conditions in the labour market

Item	1978	1979	1980	1981	1980	1981
	Thousands, annual averages				Change on previous year in thousands	
Employment						
Employed persons	25,230	25,573	25,833	25,680	+ 260	− 153
of whom						
Wage and salary earners	21,605	22,008	22,337	22,251	+ 329	− 86
Unemployed persons	993	876	889	1,272	+ 13	+ 383
Short-time workers	191	88	137	347	+ 49	+ 210
Vacancies	246	304	308	208	+ 4	− 100
Structure of unemployment	Thousands, end-September levels				Percentage of total unemployed	
Unemployed persons, total	864	737	823	1,256	100	100
of whom 1						
up to 25 years of age	246	192	225	375	27	30
Foreigners	90	77	101	181	12	14
Problem groups of unemployed persons 2	413	386	406	523	49	42

1 Not adjusted for double-counting. — 2 Unemployed persons who are not completely fit, women looking for part-time jobs, unemployed persons over 54 years of age.

Deterioration in the labour market situation

The situation in the labour market deteriorated considerably in 1981. Under the impact of high costs and in the light of the unfavourable sales and earnings prospects, enterprises aimed to achieve the same output with fewer employees than before. Closures and insolvencies also brought more redundancies. Altogether, the number of employed persons decreased by about 150,000 (or ½ %) last year, the number of wage and salary earners alone falling by 90,000. Particularly in construction (−3 %) and the other parts of the producing sector (−2 %) labour was shed on balance. In the services sectors, however, the average number of employed persons seems to have increased further in 1981. The rise in unemployment last year was much greater than the fall in employment; the number of persons registered as out of work went up by an average of about 380,000 (or more than two fifths) to 1.3 million during the year. The unemployment ratio increased in 1981 to 5½ % of the dependent labour force and not quite 5 % of the total labour force.

Structural problems in the labour market as serious as ever

In 1981 the problems in the labour market were aggravated by the fact that a large number of persons for whom no jobs were available started to look for work. According to calculations by the Federal Statistical Office, in 1981 the number of Germans aged between 15 and 25 alone was about 150,000 higher than in the preceding year. Besides, the inflow of foreigners to the German labour market continued, partly because family members came to join migrant workers and partly because persons seeking asylum in Germany were granted work permits. In addition, an increasing number of young foreigners who have been living in Germany with their parents for some time are now looking for jobs. In the autumn of 1981 the number of foreigners aged between 15 and 25 living in Germany was over 45,000 larger than twelve months earlier (together with the Germans of the same age, the increase thus came to nearly 200,000). Unemployment in this age group rose at a far above-average rate. According to a structural survey carried out by the Federal Labour Office, in September last year 375,000 unemployed persons (or roughly 30 % of the total) were not above 24 years old. Moreover, the structural labour market problems which have been evident for a long time are still being felt. In September last year more than 50 % of the unemployed persons (about 690,000) had not completed any vocational training, while in many areas skilled workers remain easier to place. The block of unemployed persons for whom it is difficult to find jobs for personal reasons — because they are not completely fit, only interested in part-time work or no longer young — also continued to grow in 1981 (about 520,000 on the same date). However, their share in the total unemployment figure declined owing to the larger cyclical component of unemployment.

Strong rise in domestic prices as a result of sharp cost increases

On the price front, the hopes of greater stability which were cherished at the beginning of the year were not nearly fulfilled. The steep increases in costs mentioned above could not be passed on in full to final customers as the scope for raising prices remained limited, not least because of the restrictive stance of monetary policy. Nevertheless, the cost pressure largely determined the pace of inflation. Until the summer of last year imports pushed up prices in Germany sharply. This applies particularly to imports of raw materials, where the temporarily rather low valuation of the Deutsche Mark in the foreign exchange markets had a strong effect. Even though the world market prices of internationally traded raw materials (excluding energy), most of which are quoted in dollars, decreased by an average of nearly 14% in 1981 according to the index compiled by the Hamburg Institute for Economic Research (HWWA), the Deutsche Mark cost of the same raw materials rose markedly (by almost 7%, compared with 13% in 1980). Furthermore, international energy markets continued to boost prices well into 1981 after dollar prices had gone up steeply at the beginning of the year. The situation began to ease somewhat in the second half of last year, as many oil-producing countries were forced to lower their dollar sales prices in view of the world-wide decline in demand. The prices of imported finished goods also went on rising sharply until the summer. Altogether, in August last year import prices (calculated in Deutsche Mark) were about 20% above the level of the preceding year. Subsequently they declined, seasonally adjusted, in connection with the appreciation of the Deutsche Mark in the foreign exchange markets; in February 1982 import prices were 4½% higher than a year earlier.

Faster rise in industrial producer prices until mid-year

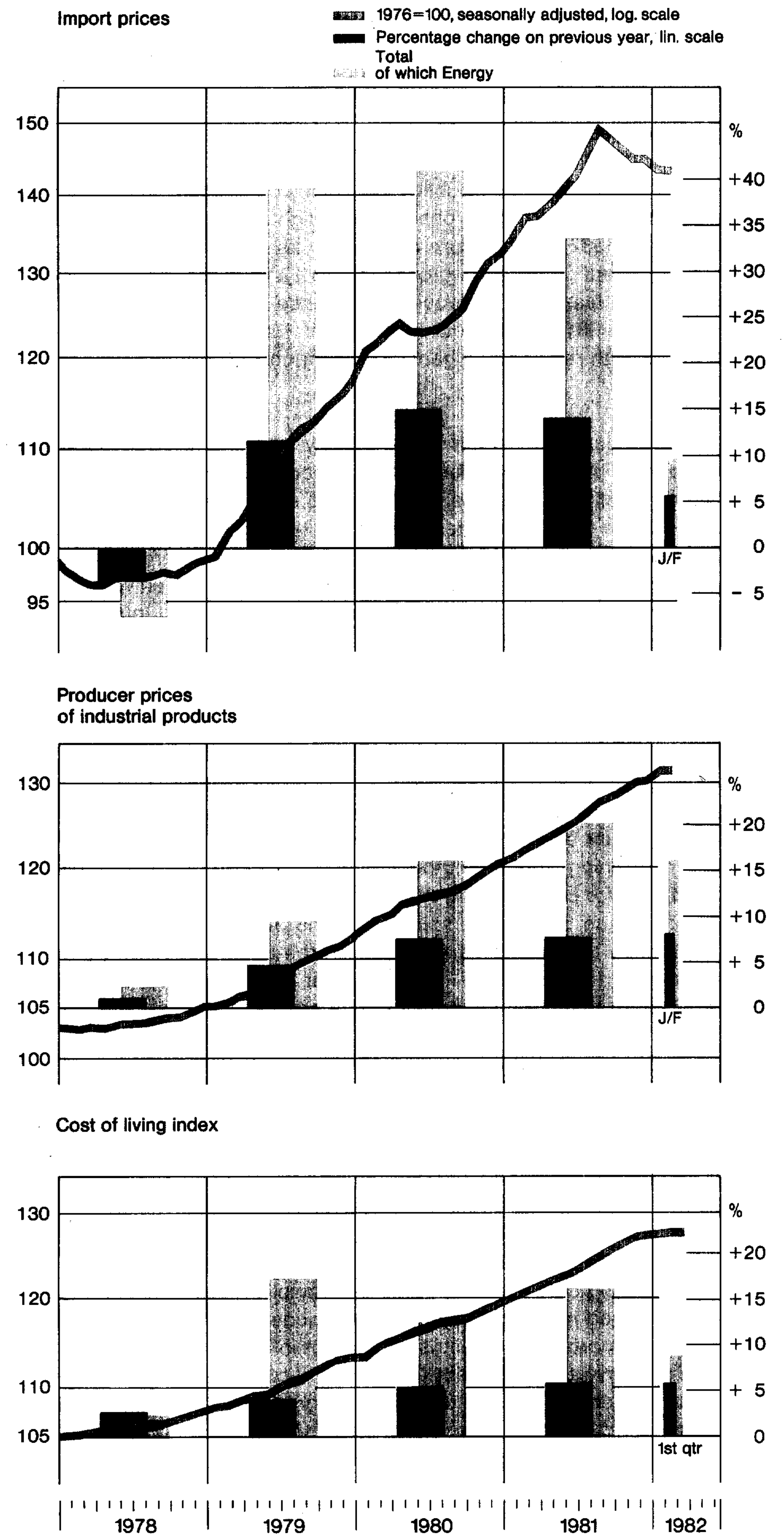
At the industrial producer level in Germany, too, the upward trend of prices strengthened until about the middle of 1981 and then eased somewhat. The increase in industrial producer prices during the year, at just over 7½%, was about as great as a year before. This again was largely due to energy prices, which went up by an annual average of 20% in 1981. Price rises in the other sectors, however, were slightly lower than in the preceding year.

Slower increase in the cost of construction work

The increase in construction prices moderated under the impact of the dwindling demand for construction work. On an annual average the level of construction prices still showed a sharp rise in 1981, at 5½%, but this growth rate was much lower than a year earlier (11%); in the fourth quarter of 1981 construction prices were only 4½% up on the year.

Consumer prices go up more in 1981 than in the previous year

Last year consumers in Germany were confronted with even larger price increases than a year before — contrary to original expectations, as already stated. The cost of living index of all households went up by an annual average of about 6% in 1981 (compared with 5½% in 1980), a rate which was last reached after the first oil crisis of 1973/74. The sharp rises in the cost of energy — not only of petroleum products but also of electricity and gas — contributed much to this trend, just as at the lower levels of production and distribution; excluding energy, the increase in consumer prices last year, at 5%, was virtually no higher than in 1980. The prices of services and food also went up at a faster pace, whereas the prices of industrial products (other than energy) were not raised as much as a year before. The growth of rents was comparatively low in 1981, but this was less a market trend than a consequence of the rent regulations now in force in the "free" housing market (with the current "comparative rent") and in publicly-assisted housing (with the government-subsidised rent). A need to adjust prices is building up in this field, and this might lead to a rath-


Import prices
1976=100, seasonally adjusted, log. scale
Percentage change on previous year, lin. scale
Total
of which Energy
150
140
130
120
110
100
95
%
+40
+35
+30
+25
+20
+15
+10
+ 5
0
- 5
J/F
Producer prices
of industrial products
130
120
110
105
100
%
+20
+15
+10
+ 5
0
J/F
Cost of living index
130
120
110
105
%
+20
+15
+10
+ 5
0
1st qtr
1978
1979
1980
1981
1982

er sharp rise in this element of the cost of living if the changes in rent legislation now in progress or preparation (see page 44) become effective. Regrettable though this would be for overall price trends, it would be of little advantage if these (cautious) steps towards adjusting to the market price level were not taken, the prospects of increasing the supply of housing not improved and the pressures apparent in the housing sector exacerbated.

5. Better overall economic prospects for 1982

Improved starting conditions for 1982

The economy of the Federal Republic of Germany began 1982 in a better starting position than last year. The prospects of a slight upturn in economic activity in the course of 1982 are therefore not bad. In its projection for this year the Federal Government considers a growth of 1 to 1½ % in the real gross domestic product to be feasible; this would imply a rise of 2 to 2½ % between the fourth quarter of 1981 and the fourth quarter of 1982. Other forecasts predict rather lower growth rates, but in general a slight upward trend in production is expected this year.

Closer approach to external equilibrium in 1982

The economy is currently benefiting particularly from the significant advances made in reducing the external disequilibrium. Foreign demand remained heavy at the beginning of 1982, and this is buttressing economic activity in Germany. The demand of the OPEC countries and other oil-producing nations in the Third World for industrial products cannot be expected to go on growing as vigorously as last year, since the surpluses of some of these countries have decreased noticeably while other countries have already moved into deficit. On the other hand, business activity seems to be strengthening slightly in some of Germany's other major customer countries, especially in the EEC area, and German exporters are likely to profit from this. However, it must also be expected that imports of goods and services will grow faster when domestic economic activity picks up and particularly when stocks are rebuilt. Nevertheless, provided there are no new dramatic external disturbances or political complications, the deficit on current account could be reduced further in 1982 and current account equilibrium approached. This is not only a crucial precondition for maintaining and strengthening confidence in the Deutsche Mark abroad, and thus for consolidating the exchange rate; it would also have direct beneficial effects on domestic employment. The optimistic assumption about production trends this year is partly based on the continued strong growth of exports of goods and services — stronger, that is, than imports of goods and services, which in themselves tend to reduce employment.

Public authorities aim at consolidation in 1982 despite many risks

The budget plans — and above all the associated "Operation '82" — have set the first signals for the consolidation of public finance which is necessary as part of the overall economic adjustment process. According to the present state of planning, the budget deficits will drop markedly in 1982 compared with last year; the decrease will be most pronounced for the Federal Government as a result of the large transfer of profits from the Bundesbank. However, the central, regional and local authorities face a number of risks in the implementation of their budgets. It is, for instance, still uncertain how far they will be able to realise the spending cuts aimed at in the personnel sector, including the slight reduction envisaged in staff; a comparatively moderate pay settlement for the public service, important though it is, would not in itself suffice to ensure that the budget appropriations are kept to. In several other fields, too, it is not yet certain that the measures taken to restrict the growth of expenditure will actually prove as effective as is necessary. In addition, it currently looks as if the budgets slightly overstate tax revenue. Moreover, the Federal budget in particular will probably come under extra pressure as the Federal Labour Office will need more liquidity assistance, primarily because the estimates for unemployment payments are rather the minimum of what is likely to be required. Finally, the "Joint initiative on jobs, growth and stability" approved by the Federal Government at the beginning of February 1982 includes several measures which will affect the Federal budget this year, to the extent of perhaps DM 0.5 billion. (The Federal Government will shortly introduce a supplementary budget to take account of the foreseeable changes as compared with the 1982 budget.) If a sustained effort to economise is made, the central, regional and local authorities should succeed in limiting the additional burdens in 1982, so that at least the basic objective of taking a first step towards lowering the deficits can be achieved.

Additional stimulus planned through investment grant

The temporary investment grant[1] planned by the Federal Government is intended to give a further stimulus to private investment activity, following the extension of depreciation allowances under "Operation '82". However, the later the legislature reaches a final decision on the overall programme of the "Joint initiative" (disagreement has arisen, in particular, over the increase in value-added tax envisaged for the middle of 1983 to finance it), the less benefit will economic activity be able to derive from the investment grant in the current year. Of course, the investment grant can have a stimulating effect only where an expansion is expected over the longer term. Hence its impact depends partly on enterprises' overall assessment of future economic trends. The outlook for the government budgets in 1983 and later is therefore an important factor. At all events, the positive influence expected from the investment grant (and from the better depreciation facilities already approved) would be weakened or cancelled out altogether if new burdens in the form of higher taxes and/or social security contributions had to be imposed for 1983 and later. The effect would presumably be similar if the progress anticipated and announced towards reducing the structural deficits in public budgets were to prove unattainable.

Prospects improved by moderate pay settlements in the 1982 wage round

The pay settlements in the 1982 wage round which have been announced so far represent a major step in the direction of improving longer-term economic prospects. The rises negotiated in pay rates range between 4 and 4½%, if fringe benefits and increases previously arranged are included. The growth rates are therefore distinctly lower than in the preceding wage round. This is a sign that management and labour have recognised the need to slow down the expansion of costs and leave slightly more scope for entrepreneurial earnings. This will undoubtedly contribute to overcoming the present slack in investment activity, and it also paves the way for more growth and employment.

Progress in the stabilisation process facilitates moderate wage settlements

These wage decisions were certainly facilitated for management and labour by the fact that the rate of inflation in Germany decelerated noticeably in the first few months of 1982. The flattening of the price trend owes much to the sharp drop in the prices of petroleum products in the initial months of the year, in line with the world market trend. In other sectors, too, a decline or only moderate rise in the basic cost of imported primary products and finished goods eased the cost pressure on enterprises. At least some of these cost savings are likely to have been passed on to final customers to maintain or expand firms' market positions. On an overall view this is a favourable development, not only in the light of current stability considerations. It is also important that, with the distinct reduction in price increases which is a necessary supplement to the moderate wage decisions now taken, the mechanism of the wage-price (or price-wage) spiral which fuels inflation has been broken. If it proves possible to consolidate and extend the progress achieved in this field — and there are legit-

1 This grant, amounting to 10% of the cost, is to encourage investment in machinery, equipment and industrial buildings ordered in 1982 and delivered by the end of 1983 (buildings: completed by the end of 1984). However, only expenditure which exceeds the average level of capital spending in the last three years will be eligible for the grant. The grant and the measures planned to finance it will not affect public budgets until 1983.

imate hopes that this will be the case — medium-term expectations in the economy might brighten considerably.

Better prospects for the labour market as well

Over the rather longer term the general improvement in the key economic variables also opens up more favourable prospects for the labour market. If output picks up in the course of 1982 after the extended phase of slack activity, the first effect will presumably be an increase in the utilisation of existing production capacities. Only after a time-lag will the employment situation also start to improve. But a reduction in unemployment can be expected only in the longer term as the inflow of persons to the labour market is still greater than the economy can absorb. Moreover, differences between the structures of supply and demand in the labour market are making it more difficult to place persons in employment. Nevertheless, there is still movement in the labour market. Although the number of employees decreased steadily on balance, many persons succeeded in finding a job in 1981. In the course of the year the labour exchanges, for instance, were able to place about 1.6 million people. However, an increase in the number of persons out of work for a considerable period could not be avoided. In September 1981 about 200,000 persons, or 16% of the total unemployed, had been without a job for more than a year. The situation can only be expected to improve when economic conditions return to normal, and that will hardly be possible within a short period.

Monetary growth target for 1982

Recent economic developments have enabled the Bundesbank to continue the cautious relaxation of monetary policy which it started in the autumn of 1981. This is in line with the basic objectives of monetary policy for 1982. The monetary growth target for the current year announced at the beginning of December envisages an expansion of the central bank money stock within a range of 4 to 7% between the fourth quarter of 1981 and the fourth quarter of 1982. When announcing this target, the Bundesbank made clear that in 1982 it will aim at a growth of the central bank money stock in the middle or upper part of the target range if the progress made in the domestic and external adjustment and stabilisation process continues, and if management, labour and fiscal policy lend their support. It was assumed that the utilisation of production capacities, which are growing only moderately at present, can be increased in the course of this year, and that at the same time it should prove possible, with the good will of all concerned, to keep the inflation rate below the level forecast at the end of 1981 for the current year.

"Conditional" target range

In fixing a range of 4 to 7% (the same as last year) for this year's monetary growth target, the Bundesbank is continuing the practice it has followed in recent years of redefining in the course of the year the rate of monetary growth it is aiming at within the target range if unexpected disturbances make monetary counter-measures appear necessary. The present basic economic conditions suggest that in 1982 the Bundesbank can aim at a monetary expansion in the upper half of the target range; indeed, the growth of the money stock in the first quarter of this year was already at that level. The fact that the Bundesbank has attached stability policy conditions to the adoption of this course is meant to ensure that its monetary policy intentions are not misunderstood and not undermined by wage and budget policies.

Cautious relaxation continues at the beginning of 1982

On the basis of the objectives described, the Bundesbank tried in the first few months of the current year to exploit the growing scope for further relaxation in the domestic money market as far as was justifiable in the light of stability policy requirements. As it had done last autumn, it prepared the way for reductions in the special lombard rate by taking fine-tuning measures. These eased conditions in the money market without triggering undesirable signals in Germany or abroad. Since the beginning of the year the special lombard rate has been lowered twice to 9½%. Under the influence of these measures and with the price climate gradually improving, interest rates began to fall sharply in the financial markets in the first few months of this year. At times there was a comparatively wide interest rate differential between foreign countries and Germany, but this did not seriously affect the overall position of the Deutsche Mark in the foreign exchange markets. On the monetary side, therefore, favourable conditions have been created for the intended longer-term stimulation of growth and employment. While these conditions must be fulfilled, they are not sufficient to enable the envisaged goals to be achieved. This calls for efforts in the same direction in the other fields of economic and fiscal policy.

1. The world economy and the adjustment process

Persistent problems due to high energy prices and global inflation

Weak economic growth, persistently strong inflationary trends and rising unemployment were the dominant features of the world economy in 1981. These developments are connected with the renewed surge in energy prices since 1979; however, weak economic performance and high unemployment also reflect the efforts to overcome inflation, which they inevitably accompany over the short term. This time hardly any country attempted to offset the direct consequences of higher energy prices for economic activity and employment by increasing government expenditure and relaxing monetary policy. The reason is that most countries incurred too much debt after the first oil price hike in 1973/74 — domestically by running large budget deficits and externally in financing their current account deficits — without succeeding in ensuring satisfactory growth and sufficiently high employment on a sustainable basis. The necessary adjustment measures were merely postponed. In quite a number of cases the inevitable need to adjust became all the more apparent this time as the impact of the renewed increase in oil prices was felt.

Better prospects of the world economy recovering

In the meantime the prospects of individual economies adjusting to the new economic scenario have improved, particularly if the government, management and labour make their respective contributions to ensuring that this process of adjustment occurs rapidly. Not a few countries do indeed seem to be making progress in this direction. This raises the hope that in global terms it will be possible to avoid a situation which some countries have experienced in the past as "stagflation", and which is all the harder to escape, the longer stagnation and inflation persist simultaneously.

Successful efforts to conserve energy

Endeavours to conserve energy have been successful. Both energy consumption and energy output have reacted to a particularly striking degree to the changed market scenario, and especially to higher prices. The link between energy consumption and economic growth has become looser as a result — an important precondition for regaining satisfactory economic growth. At the same time oil imports have fallen even more strongly than energy consumption, with the result that the situation in the world oil market has undergone a distinct change in favour of oil consumers; recently oil producers have even been forced to reduce their prices. This once again demonstrates clearly that the power of producer cartels encounters limits at the point where consumers prove to be capable of adjusting to the changed conditions. However, this development partly reflects the weak state of the world economy; moreover, the high cost of holding stocks caused by the level of interest rates is helping to keep oil stocks at a minimum. Exaggerated hopes should therefore not be entertained with respect to the future trend in energy costs.

Tensions in the global pattern of current accounts ease

The ability of the industrial countries in particular to cope with the changed situation in the world oil market is also reflected in a partial improvement in the global pattern of current account positions. The rapid growth in the imports of a number of oil-producing countries has contributed to this improvement. At all events, both the aggregate deficit of the OECD countries and the corresponding surplus of the OPEC countries have fallen. However, the developing countries have moved even deeper into deficit despite the fact that a number of them have also achieved considerable success in terms of adjustment. The further rise in the aggregate deficit of the developing countries owes a great deal to the high interest payments on their growing foreign debt.

Inflation rates decrease, but remain too high

In addition to achieving greater economies in the use of energy and a better external balance, overcoming inflation and deep-rooted inflationary expectations is the most important condition that must be met by a large number of industrial and developing countries if growth and employment are to rise once again on a durable basis. Seen in this perspective, it is encouraging that the rate of inflation has fallen distinctly in several OECD countries. But at 10.5% on average for the OECD countries as a group (after 13% in 1980, the highest level since the beginning of the second oil price hike), it is nevertheless still much too high. Japan, the United States and the United Kingdom were particularly successful in their efforts to stabilise prices. In contrast, Germany was forced to accept a temporary deterioration in the price climate; as a result, Japan is at present the country with the most stable price level in the world, while the gap in inflation rates between Germany and the United States has become noticeably smaller.

Conditions for a fall in interest rates need to be improved further

With inflation rates declining, particularly in the United States, an important condition will also be fulfilled for interest rates to tend to fall globally. However, according to calculations by the OECD Secretariat, the real interest rate (i. e. the nominal rate of interest less the rate of inflation) for longer-term funds, at about 4%, was extremely high in the principal countries towards the end of last year. Whether or not it will go down as inflation rates decline has still to be seen. But persistent uncertainty about the future trend of inflation as well as the impact of large budget deficits on interest rates support the assumption that real interest rates will continue to be relatively high. They are reflected in a correspondingly greater risk premium for new investments. This makes it all the more desirable for governments to take account of these uncertainties by adopting a corresponding stance in their fiscal policy and to firmly support a monetary policy oriented towards achieving lasting price stability. The magnitude of the corrective measures needed in the field of public finance can be judged from the fact that, according to studies carried out by the IMF, the ratio of budget deficits to national income in the industrial countries has almost doubled since 1973. The gap that has to be closed in terms of productive investment after years of excessive expenditure on consumption, not least by the public sector, also implies higher real interest rates than have been customary in the past, particularly since many countries have witnessed a fall in the saving ratio.

Key role of fiscal and wage policy

This makes it all the more important for the government, management and labour to make their individual contributions, by consolidating public budgets and moderating wage claims, to ensuring that the use of the national product is directed less towards consumption and more towards the enlargement of the capital stock. Such a policy would also create the best conditions for interest rates — both in real and in nominal terms — to sink to a level that will durably lower the cost of financing investment, thus allowing other investment incentives to make themselves felt. In most countries this will not be possible without a temporary decline in the real income of employees in view of the tight squeeze on profit margins, while the drop in real income will in fact be considerable in a number of countries that are in a weak position in structural terms. The United States and Canada are already leading other countries in this respect; in Japan as well real wages rose only slightly after the second oil price hike despite comparatively strong overall economic growth. In contrast, the European countries, including Germany, are experiencing this process with a delay. A temporary fall in real income should be all the more acceptable to those affected in so far as it tends ultimately to foster overall economic growth and employment, and does not — as is so often maintained — jeopardise them through a shortfall in demand. Finally, the progress made in consolidating public sector budgets will be greater if growth is quite strong and employment rising than if the economy is stagnating.

Increase in protectionist tendencies

Under the impact of high unemployment and stagnating world trade the danger of protectionist tendencies has again loomed larger. It would be a dangerous step backwards and would adversely affect the opportunities that the freedom of world trade provides for economic growth, employment, and payments balance in both the industrial countries and the developing world if these dangers were not resolutely withstood from the very beginning. Yielding to protectionist pressures would mean destroying the basis of prosperity and economic development in every country. The endeavours to maintain and increase the freedom of world trade therefore deserve widespread support. It is to be hoped in particular that the current trade negotiations between North America, Japan and the European Community will be brought to a satisfactory conclusion.

2. Partial improvement in the global pattern of current accounts

Reduction in the current account imbalance between OPEC and industrial countries

1981 witnessed an unexpectedly large decrease in the aggregate current account surplus of the OPEC countries. In 1980 the OPEC surplus, at $ 113 billion, exceeded all previous records by far; in 1981 it fell back to an estimated $ 61 billion, i. e. about the level of 1979 (see the table opposite). This was due on the one hand to a reduction in oil revenue and on the other hand to an increase in the OPEC countries' imports. In contrast, the traditional deficit of these countries on services and transfer payments remained practically unchanged. The mirror image of this was a decline of $ 44 billion to $ 28 billion in 1981 in the aggregate current account deficit of the OECD countries. The current account deficits of the developing countries increased by a total of $ 10 billion to $ 70 billion. There was also a rise in the current account deficits of the centrally planned economies and other countries. However, the sum total of these current account deficits exceeds the surplus of the OPEC countries by $ 45 billion, although deficits and surpluses in the current accounts of the various countries and country groups should actually cancel out globally. According to studies by the OECD Secretariat, this discrepancy is primarily due to the incomplete coverage of receipts from service transactions of many different kinds. There is some evidence that a large part of these receipts flows both to the industrial and the developing countries, reducing their global deficits, although at present it is not possible to break these figures down in detail.[1] For this reason, only the trends in current account balances should generally be considered to be more or less reliable information, and to a far lesser degree their size and regional distribution.

Subdued price movements in the crude oil market . . .

With the end of the second oil price hike and with oil prices even beginning to decline, the conditions for a more balanced pattern of current accounts in the world improved substantially. From the beginning of 1979, when the new oil shock began, up to January 1981 the average posted price for OPEC oil went up by about 170 %. After this, it remained stable until the middle of 1981 and then began to decline slightly. Nevertheless, at the end of 1981 official OPEC selling prices were still well over 6 % higher than a year before, and the average price increase in 1981 was as much as 11 %. From the middle of 1981 onwards world market prices for oil — which also reflect price reductions by the OPEC countries, sales by other oil-exporting countries and spot market contracts — fell distinctly faster than the OPEC posted prices. This is the reason why the actual prices for imported oil, in terms of the U.S. dollar, increased over the course of the year by only 2 %, but went up on an annual average by as much as 8 %. In addition, oil imports rose in price for most countries owing to the marked appreciation of the dollar vis-à-vis their currencies. This means that for many countries oil import prices continued to increase considerably in real

1 As exports and imports are recorded at different times, the sum of exports is usually larger than the sum of imports — all the more so, in fact, the faster world trade grows. In statistical terms this asymmetry usually almost completely offsets the incomplete coverage of receipts from services, with the result that the sum total of current account deficits does not exceed the total of surpluses by very much. The recent weakening of world trade together with the slower rise in world market prices have reduced the impact of this compensating factor, however, showing up to an exceptional degree the receipts from service transactions that are not completely covered in the global current account statistics.

Balances on current account of selected groups of countries and countries

US$ billion

Group of countries/Country	1978	1979	1980	1981 p
A. OECD countries				
Seven principal countries	+20	−13	− 36	− 3
United States	−14	+ 1	+ 4	+ 7
Japan	+17	− 9	− 11	+ 5
Canada	− 4	− 4	− 2	− 6
Germany	+ 9	− 6	− 16	− 8
France	+ 4	+ 1	− 8	− 8
United Kingdom	+ 2	− 2	+ 7	+16
Italy	+ 6	+ 6	− 10	− 8
Other countries	−10	−16	− 36	−25
OECD countries, total	+10	−29	− 72	−28
B. OPEC countries				
Sparsely populated 1	+16	+42	+ 92	+78
Densely populated 2	−11	+19	+ 21	−17
OPEC countries, total	+ 4	+62	+113	+61
C. Other developing countries				
Threshold countries 3	−10	−24	− 36	−45
Other countries	−13	−14	− 24	−25
Other developing countries, total	−23	−38	− 60	−70
D. Other non-OECD countries 4	− 9	− 4	− 1	− 8
E. Statistical discrepancy (Total A less D)	−18	− 9	− 20	−45

1 Kuwait, Libya, Qatar, Saudi Arabia, United Arab Emirates and the non-member Oman. — **2** Algeria, Ecuador, Gabun, Indonesia, Iran, Iraq, Nigeria, Venezuela. — **3** Countries which in 1979 had a per capita income of at least US$ 1,500 and a share of the manufacturing sector in the gross domestic product of at least 20%: Argentina, Brazil, Chile, Hong Kong, Israel, Mexico, Singapore, South Korea, Taiwan, Uruguay. — **4** Centrally planned economies (China, Indo-Chinese countries, Mongolia, North Korea, eastern European countries, USSR), Malta, South Africa, Yugoslavia. — **p** Provisional.
Sources: OECD and IMF.

terms, i. e. after taking into account the rise in the prices of manufactured products.

... largely a result of oil conservation

The subdued movement of prices in the world oil market is largely a result of the intensive endeavours of most countries to cut back their consumption of oil significantly and on a lasting basis. This development was well under way by 1980 and led to a reduction of about 15% in oil consumption by the OECD countries in 1981 as against 1979. The fact that this drop in oil consumption is due mainly to the more economical use of energy and oil substitution and only in small part to a cyclical weakening of demand is revealed by a comparison between the development of consumption and national product during the last two oil price hikes. While the consumption of oil in volume terms in 1975 was only about 8% lower than two years earlier despite the economic stagnation, in 1980 and 1981 almost double the amount of oil was saved even though there was a simultaneous increase of 2.5% in real GNP in the OECD countries.

Further oil conservation a priority task

Continuing the progress already achieved in oil substitution must remain a priority task for every oil-importing country. Only in this way is there a possibility that, when world economic activity picks up again, cyclical rises in oil consumption will not result in another sharp increase in prices in the energy markets and lead to renewed dangers for payments balances and for steady and stronger economic growth. At all events, the oversupply of crude oil that has been evident for some months should not be expected to persist over the longer term. A number of OPEC countries have already adjusted their oil output to market conditions. Moreover, no basic change in the OPEC countries' pricing policy is in prospect. The oil-consuming countries would therefore do well to continue to develop alternative sources of energy, as is necessary to safeguard their energy supply over the long term, and to ensure the profitability of the large-scale investments required for this purpose by taking suitable measures as the need arises.

Oil conservation and the OPEC countries' demand for imports concentrated in the industrial countries

Despite creditable success in conserving oil, the continuing considerable rise in oil prices on average in 1981 led to a further increase in the oil bills of the oil-consuming countries. Since, however, the imports of the OPEC countries expanded sharply, quite a few countries succeeded in substantially improving their trade balances. In volume terms, imports of industrial products by the OPEC countries rose by over 25% last year, following 13% in 1980. Not surprisingly, the developing countries were able to exploit the potential for conserving oil as well as to take advantage of market opportunities in the OPEC countries to a far smaller extent than the industrial countries.

Differing current account trends within individual country groups

The improved current account balances of major country groups do not mean that current account deficits have declined generally in the world. As a result of widely differing developments within individual country groups, the opposite has rather been the case. The financing of current account deficits has accordingly continued to pose problems.

Decline in the OPEC surplus largely to the detriment of densely populated countries

The sharp decline in the current account surplus of the OPEC countries was primarily to the detriment of the densely populated countries within this group. They were forced to reduce their oil output by one quarter and suffered corresponding losses in earnings, while their imports continued to climb rapidly. Owing to the excessive prices they demanded they lost market shares in some cases to the other OPEC countries, which had to reduce their oil output by only 10%, as well as to other oil producers. Iraq and Iran sustained additional production losses due to the war in which they are engaged. In the light of these developments, the imports of these countries and of the OPEC group as a whole will probably rise at a distinctly slower pace in the current year.

Improvement in the current accounts of industrial countries restricted to a few countries

The improvement in the current account balance of the OECD countries was restricted in the main to only five countries within the group. The United States was once again able to achieve a higher surplus, Japan registered a swing in its current account balance of no less than \$ 16 billion, and both the United Kingdom and the Netherlands — themselves energy exporters — recorded considerable improvements in their current account positions (\$ 9 billion and \$ 7 billion, respectively). Moreover, Germany succeeded in reducing its current account deficit by \$ 9 billion;[1] a detailed analysis of the factors that led to this result is presented elsewhere in this Report. A number of other countries also managed to improve their current account positions, while many countries made no progress in adjusting their economies or even had to accept higher current account deficits, Canada and Australia being chief among them.

Further increase in the U.S. current account surplus

The further increase in the current account surplus of the United States from \$ 4 billion in 1980 to \$ 7 billion last year was due primarily to another rise in net investment income, itself a result of a surge in lending operations by U.S. banks and the high dollar interest rates charged on such loans. In contrast, the trade balance of the United States deteriorated slightly. In value terms, imports and exports went up by 6% and 5%, respectively, generating an increase of \$ 2.5 billion in the traditional deficit on trade account. U.S. exports, which had risen by 21% in 1980, lost some of their dynamism owing to the weak state of

1 Expressed in Deutsche Mark, the deficit fell by about DM 12 billion. The large dollar equivalent of this improvement in the current account position is due to the simultaneous depreciation of the Deutsche Mark against the dollar. The deficit of approximately DM 30 billion in 1980 is equivalent to \$ 16.4 billion when converted at an average rate of 55 U.S. cents per Deutsche Mark, while the deficit of DM 17 billion in 1981 is equivalent to only \$ 7.6 billion when converted at 44 U.S. cents per Deutsche Mark. The decline in the deficit from \$ 16.4 billion to \$ 7.6 billion is the \$ 9 billion improvement mentioned here.

economic activity in major European countries which are U.S. customers. Moreover, the marked appreciation of the dollar made it increasingly difficult for U.S. industry to compete internationally in price terms. The customary export surplus in the industrial products sector, for example, dropped sharply and will probably continue to fall when economic activity picks up in the United States and additional orders in the defence sector absorb production capacity.

Sharp swing into surplus on the Japanese current account

As mentioned before, Japan succeeded in improving its current account balance considerably and, with a surplus of $ 5 billion, once again became one of the main surplus countries in the world economy. In volume terms, Japan's exports rose by approximately 11 %. This increase in exports not only redressed the balance of payments but also provided Japan with considerable economic growth. These successes were in essence the result of low wage rises, the timely introduction of a more restrictive stance in fiscal policy and a marked decline in the rate of inflation. Last but not least, Japanese exports benefited from the depreciation of the yen against the dollar primarily for interest rate reasons. However, Japan's success in the export field has led to more widespread international criticism, particularly since the level of imports into Japan stagnated.

Further strong increase in the British surplus

Last year the United Kingdom considerably increased its sales of crude oil at the expense of the OPEC countries, and this was the main factor behind the further marked improvement in its current account position. With a 10 % growth in its purchases of oil from the United Kingdom, Germany also contributed to this development. Other British exports suffered a decline. However, imports fell even more (owing in part to de-stocking in view of the state of economic activity), thus also helping to improve the current account. Moreover, there was a further rise in the traditionally large net receipts on services account.

Slow adjustment in the developing countries

Last year the developing countries not only had to contend with higher expenditure in the wake of the increase in oil prices and sluggish economic activity in their export markets; as already mentioned, they were additionally burdened by larger interest payments on their foreign debt. With the relatively strong economic growth in a number of these countries it was almost inevitable that their aggregate current account deficit should increase once again. However, some of these countries have meanwhile exhausted the possibilities open to them and have had to revise their development programmes downwards. A growing number of countries have admittedly had to adopt these adjustment measures because the development of their economies has got out of control. Brazil is one such example. Despite its oil wealth, Mexico is also coming under increasing pressure to adjust, and has taken a first step in this direction with the recent decision to allow its currency to float. Confronted with urgent social problems, it is naturally difficult for countries to bring their ambitious development programmes into line with what they can actually achieve. The countries concerned will, however, feel all the more encouraged to do so, the more they can rely on the sales of their goods in the industrial countries not encountering protectionist obstacles, so that there is a prospect of their being able to solve their balance of payments problems through their own endeavours.

3. Financing the current account deficits

Limits to financing via the market become more apparent

Last year the international financial markets in general once again played the most important role in financing the high current account deficits. Tougher credit conditions — owing partly to international interest rate movements and partly to critical developments in a number of countries — together with occasional difficulties in mobilising funds in the private markets revealed with greater clarity the limits to financing imbalances via the market. The outcome was that numerous developing countries sought greater financial support from the IMF and other official institutions.

Reserve movements between major country groups remain small

On the other hand, the financing of current account deficits was reflected to only a relatively slight degree in changes in the reserves of the major groups of countries. Excluding changes due to valuation adjustments, the gross monetary reserves of the OECD countries declined only slightly, while the aggregate gross reserves of the developing countries actually increased again. However, the OPEC countries once more added only a small proportion of their foreign exchange earnings to their published monetary reserves. The bulk of their net receipts was invested on comparatively favourable terms as part of their other financial assets. The OPEC countries showed a preference for long-term investments in the major industrial countries, including a considerable amount of direct lending to public authorities in those countries. For their part, the industrial countries maintained a high level of capital exports and thus made it possible for petrofunds to be indirectly recycled to other oil-importing countries.

(a) Developments in the international financial markets

Strong expansion of the medium and long-term financial markets, but contraction in the short-term field

1981 witnessed a considerable rise in medium to long-term Euro-currency loans and international bond issues. After only a slight increase in new lending in 1980 (to approximately $ 120 billion), the total amount of newly granted loans and bond issues, including loan commitments, went up to $ 194 billion in 1981 (see the table opposite). However, this growth was due in the main to unusually high loan commitments to U.S. corporations; to this extent, it was not related to the international financing of current account deficits. Moreover, the upsurge in medium to long-term lending was accompanied by a decline in short-term loans. In 1980, which saw only a slight increase in medium to long-term business, there was in contrast a steep rise in short-term lending. In 1981, according to estimates by the BIS, the volume of newly granted short and long-term loans taken together, less repayments, was therefore slightly lower than in the previous year ($ 185 billion).

Interdependence between the Euro-dollar and U.S. credit markets

The above-mentioned large loans to U.S. corporations amounted to $ 50 billion and were granted in the second half of 1981 in connection with mergers and diversification operations in the U.S. oil industry. They have been taken up only in part so far and, moreover, some of them are being financed from domestic sources and hence are affecting the international bank lending market to only a limited extent. On the other hand, these developments are symptomatic of the growing interdependence between the Euro-dollar market and the domestic U.S. credit market. Particularly with respect to borrowing by U.S. corporations, it is becoming customary for the borrowers to be offered financing options between the Euro-dollar market and the domestic money market; in addition, these options can be exercised several times during the lifetime of a loan. According to studies in the United States, incidentally, this is a prime reason for the unusually high positive balancing item in the U.S. balance of payments. A substantial part of these capital imports is not covered by the balance of payments statistics because it has not yet been sufficiently ensured that switching the financing of such loans to sources abroad is followed by corresponding balance of payments reports.

Development of Euro-currency loans

Excluding the large loans to U.S. corporations mentioned above, the volume of newly granted medium and long-term syndicated Euro-currency loans rose by $ 15 billion to $ 95 billion. The loans taken up by the industrial countries were only slightly higher than in the previous year. They played an important role in financing the current account balances of, in particular, Australia, France, Italy and Canada, while capital imports into Germany were mainly due to unpublicised Euro-loans to the private sector and loans against borrowers' notes de-

International credit and bond markets

US$ billion

Item	1978	1979	1980	1981 p
A. Medium and long-term Euro-currency loans 1	74.2	79.1	79.9	145.3
Borrowing sectors				
Public 2	56.2	59.8	49.7	52.6
Private	18.0	19.3	30.2	92.7
Borrowing countries 3				
OECD countries	35.8	29.1	41.2	97.1
Seven principal countries	23.2	12.9	23.5	9 78.1
Other countries	12.6	16.2	17.7	19.0
OPEC countries	10.2	8.8	6.7	5.9
Other developing countries	24.0	33.0	27.8	39.8
Centrally planned economies 4	3.9	7.8	3.0	2.0
Other countries 5	0.3	0.4	1.2	0.4
B. International bond issues	37.5	38.9	39.4	48.7
Borrowing sectors				
Public 2	27.6	25.2	24.6	27.7
Private	9.9	13.7	14.8	21.0
Borrowing countries 3				
OECD countries	23.2	26.6	28.4	36.6
OPEC countries	1.9	0.4	0.2	0.3
Other developing countries	3.4	2.6	1.6	3.0
Other countries	0.6	0.4	0.3	0.2
International organisations				
European	3.4	3.8	3.6	2.5
Other	3.4	3.5	3.9	5.0
Types of issues				
Euro-bonds 6	15.1	17.4	20.0	26.4
Traditional foreign bonds 7	20.7	20.0	18.0	21.3
Special issues 8	1.6	1.6	1.4	1.1
Currencies of issue				
U.S. dollar	14.1	15.3	16.8	29.1
Deutsche Mark	8.2	7.9	8.7	2.7
Swiss franc	7.6	9.6	7.6	8.4
Yen	4.8	3.0	2.1	3.3
Other	2.8	3.2	4.2	5.3
Total (A plus B)	111.7	118.0	119.3	194.0

1 Publicised internationally syndicated loans running for more than 12 months and almost entirely financed on a rollover basis which have not necessarily been taken up yet. — 2 Including public enterprises and financial institutions and including international organisations. — 3 For the definition of the groups of countries see the table on page 57. Borrowing operations by foreign subsidiaries are included under the country of domicile of the parent company. — 4 Including CMEA institutions. — 5 Including international organisations. — 6 Internationally syndicated issues. — 7 Nationally syndicated issues in domestic currency. — 8 Direct placements with monetary authorities and governments. — 9 Including large loans to U.S. enterprises amounting to US$ 50 billion granted in connection with take-overs of other U.S. corporations, including Conoco and Texasgulf; only part of these loans resulted in transactions affecting the balance of payments. — p Provisional.
Source: OECD Financial Statistics.

nominated in Deutsche Mark to public authorities, including funds equivalent to $ 6.4 billion provided by OPEC countries. Centrally planned economies were able to borrow only $ 2 billion in the form of longer-term Euro-loans, corresponding to two thirds of the previous year's total and no more than some 25% of the amount taken up two years ago. They therefore again had to have greater recourse to short-term international loans and draw on their monetary reserves. In contrast, the developing countries raised a much larger volume of Euro-loans, namely $ 40 billion. They were led by Mexico ($ 10.5 billion) and Brazil ($ 7 billion), followed by South Korea and Argentina. Not only these four countries but also most of the other developing countries with a relatively high or medium per capita income financed their current account deficits mainly via international bank loans. The OPEC countries that were running deficits also took up syndicated Euro-loans to a total of about $ 6 billion. Since the other OPEC countries at the same time invested most of their net earnings outside the western banking system, the aggregate net claims of the OPEC countries on banks declined slightly from the middle of the year onwards, for the first time since 1978.

With their foreign debt increasing rapidly, the credit terms for the Latin American countries deteriorated, in some cases sharply. In contrast, the terms generally improved for the developing countries in South East Asia which continue to register high growth rates and stable monetary conditions.

Development of international bond issues

With a rise of $ 9 billion to $ 49 billion, the volume of bonds placed in the international bond market also grew considerably. This increase was accounted for in the main by the United States, Canada and Japan. However, the developing countries also managed to place more bonds in the market; their share of new bond issues went up from 4% in 1980 to 6% last year — admittedly still a modest figure. The bond issues of the World Bank group and the other international development banks also rose by over $ 1 billion. Of the financial resources made available via bond issues in 1981, less repayments, it is estimated that half came from non-banks.

In the year under review the U.S. dollar was a coveted investment currency. With a share of over 60% (after more than 40% in 1980), it reinforced its leading position as an international currency of issue. There was also a further increase in issues denominated in Swiss francs and the yen. Both these currencies were able to maintain or even strengthen their position in the international bond market. The use of the Deutsche Mark fell correspondingly sharply to a share of only 5% (after 22% in the previous year). However, this is partly due to the fact that few bonds denominated in Deutsche Mark were issued in the first quarter of 1981 owing to a gentlemen's agreement which the Bundesbank and the issuing banks concluded with the objective of reducing the pressure capital exports exerted on the exchange rate for the Deutsche Mark. From the autumn of 1981 onwards there was not only a powerful upsurge in issues of DM-denominated bonds but, given the renewed confidence in the Deutsche Mark, it was also possible to place a large proportion of the bonds abroad again.

Better transparency of country risks an urgent matter in view of the steep rise in foreign debt

With the steep rise in foreign debt in 1981, however, the limits of indebtedness of individual developing countries as well as of a number of OPEC countries and centrally planned economies have probably been reached or are quite close. It is therefore imperative for these countries to adjust to the changed economic environment and reduce their current account deficits. At all events, banks will have to be even more prudent when granting international loans, especially since their earnings position has been weakened by other developments as well and their capital base does not always seem to be sufficiently strong. With this in mind, it is particularly urgent for the transparency of country risks, from the point of view both of the lending countries and primarily of the banks granting loans, to be further improved on the basis of consolidated balance sheets.

(b) The development of official loan assistance

Increased use of the resources of the IMF

In March 1981 the IMF provided its members with the possibility of "Enlarged Access" to the Fund's resources. As a consequence, the IMF's loan commitments to developing countries under stand-by arrangements (including the Extended Fund Facility created in 1974) rose by $ 17.9 billion in the year under review, after new commitments had totalled $ 9.1 billion in 1980. The fact that the actual use of the Fund's resources under such arrangements, at $ 6.5 billion (1980: $ 4.3 billion), was again considerably lower than the loan commitments is primarily attributable to the circumstance that most loans are disbursed in instalments. However, the wide gap between commitments and the actual use of resources also reflects the difficulties a number of countries are experiencing in adhering to the adjustment programmes agreed with the Fund. Last year the non-fulfilment of economic policy conditions obliged the Executive Board of the Fund to cancel previously agreed credit lines to a total of $ 2.9 billion. Moreover, disbursements were sometimes delayed because specific major conditions were not fulfilled or because, where lending arrangements were spread over several years, agreement was not reached in time on how adjustment programmes should be extended into the future. The rise in the number of such programmes that were discontinued or encountered difficulties was also the main reason why some of the resources available to the Fund for lending purposes under the Supplementary Financing Facility ("Witteveen Facility") had not been disbursed by February 1982 as originally scheduled. The Executive Board of the IMF has therefore recently adopted a decision which allows the remaining resources under the Witteveen Facility to be used under the "Enlarged Access" facility.

Apart from the resources made available under stand-by arrangements, the Fund also provided the developing countries with approximately $ 1.9 billion from its other drawing facilities — in particular via the compensatory financing of export fluctuations — and $ 0.5 billion in the form of very low-cost loans from the Trust Fund. This means that in 1981 the Fund contributed a total of $ 8.9 billion towards financing the balance of payments of the developing countries (as against $ 6.5 billion in 1980).

Strengthening of credit standing by adjustment programmes agreed with the IMF

Continued large-scale recourse to the Fund's resources is also to be expected in the period immediately ahead. Apart from countries which have little or no access to the private markets anyway, many developing countries will be able to take advantage of other possibilities of incurring debt only if they strengthen their credit standing in the international financial markets by adjustment programmes agreed with the Fund. The recent increase in the number of rescheduling operations by developing countries, which the Fund has had to support by stand-by credits granted simultaneously, is an indication of this.

To finance the "Enlarged Access" facility the IMF has, besides its own resources, a credit commitment by Saudi Arabia for 1981/82 equivalent to SDR 8 billion — an additional amount has been promised by SAMA for 1983 — as well as short-term credit lines currently amounting to some SDR 1.3 billion that have been granted to the Fund by various industrial countries either bilaterally or via the BIS.

Growing significance of international development banks

In addition to the balance of payments assistance provided by the IMF, the developing countries once again received more funds from multilateral development banks last year. Both the World Bank group and the regional development banks for Africa, Asia and Latin America increased their loan disbursements from a total of $ 8.8 billion in 1980 to an estimated $ 10 billion or more in the year under review. In each case, a quarter of these resources were granted on particularly soft conditions via the special development funds attached to these institutions. Rather like the assistance provided by the IMF, these loans make up a major share of the total inflows of foreign capital to a number of developing countries, in particular the poorer ones, and also act as an important catalyst for inflows from other sources.

Further development of the financial instruments must be carefully considered

The multilateral development banks will have an important contribution to make in the coming years towards financing balance of payments deficits and fostering the adjustment process. How large this contribution will finally be, however, cannot be estimated at present. The budget difficulties of major donor countries set limits to the endeavours of the development banks to obtain more resources of their own. Moreover, the refinancing of these banks is hampered by persistently high interest rates and the limited size of their sources of long-term loans. In the years ahead it will therefore be all the more important for the development banks to maintain their high creditworthiness in the international capital markets by adhering to their established principles of business and financial policy. A carefully considered improvement in their financial instruments, such as creating attractive conditions for co-financing operations together with private lenders, could be helpful in expanding the volume of funds they can mobilise, as could borrowing across a wider segment of the international markets. On the other hand, too extensive innovations in the lending and borrowing operations of the development banks, such as granting and raising loans with variable rates of interest or stepping up recourse to central banks for refinancing their activities, could prove in the end to be detrimental to the creditworthiness of these institutions — quite apart from the monetary policy problems they involve.

Long-term financial assistance of the European Community

In 1981 no medium to long-term balance of payments assistance was mobilised within the European Community. However, some member states, particularly Italy, profited considerably from the loans granted by the various Community institutions to foster investment. The volume of these loans in terms of the ECU was roughly equal to the amount for the previous year; on a dollar basis, however, new loan disbursements, at $ 4.6 billion, were much lower than a year before, owing to the weakening of the European currencies against the U.S. dollar. The new loans within the Community accounted for by the European Investment Bank were equivalent to $ 3.7 billion (including $ 0.6 billion from the resources of the "New Community Instrument"). In addition, the EIB granted developing countries with an association agreement with the Community about the same amount of support as in the previous year; on a dollar basis this came to approximately $ 0.6 billion in 1981.

(c) The role of reserve changes

Not inconsiderable reserve movements in some countries

Even though on a transactions basis the gross monetary reserves of the major country groups changed only a little, not inconsiderable reserve movements were registered in individual countries. Behind the modest reduction of $ 2 billion in the reserves of the OECD countries there was a loss of $ 11 billion in the reserves of the EEC countries, which however was accompanied by substantial foreign exchange inflows into the United States and Japan (see also the table opposite). Among the developing countries, the monetary reserves of the threshold countries rose by just under $ 2 billion, while the aggregate reserves of the other countries went up only slightly. There were also marked differences in the development of the reserves of the individual OPEC countries. A number of them suffered reserve losses because their current account balances had shifted back into deficit and capital inflows were not sufficient to close the gap. The published reserves of the other OPEC countries increased by $ 8 billion on a transactions basis, corresponding to only about 10% of their current account surplus.

4. The development of international liquidity

Strong influence of valuation adjustments on changes in global monetary reserves

For a number of years changes in official global monetary reserves have been greatly affected by fluctuations in reserve holdings due to valuation adjustments. Movements in the exchange rate between the dollar and other currencies play just as important a role in this process as influences exerted by the gold price on the level of the ECU holdings of the EMS countries. For this reason the underlying trend of international liquidity becomes apparent only if movements in official global monetary reserves are split up according to changes on a transactions basis and fluctuations that are due to valuation adjustments.

Gross monetary reserves of the IMF countries*

US$ billion

Type of reserves/Group of countries	Change 1: on a transactions basis, 1980	Change 1: on a transactions basis, 1981 pe	Change 1: due to exchange rate and gold price movements, 1980	Change 1: due to exchange rate and gold price movements, 1981 pe	Change 1: Total, 1980	Change 1: Total, 1981 pe	Level at end-1981 pe
Type of reserves							
Gold	+ 0.4	− 0.0	− 1.4	− 3.7	− 1.0	− 3.7	38.7
Special drawing rights	− 0.9	+ 5.6	− 0.5	− 1.6	− 1.4	+ 4.0	19.1
Reserve position in the IMF	+ 6.6	+ 5.5	− 0.6	− 2.2	+ 6.0	+ 3.3	24.8
Foreign exchange	+31.9	− 4.2	+17.6	−19.5	+49.5	−23.7	352.4
ECU balances 2	− 0.8	− 3.0	+21.6	−10.5	+20.8	−13.5	50.2
U.S. dollars	+ 7.2	−17.9	−	−	+ 7.2	−17.9	181.3
Deutsche Mark	+15.2	− 0.5	− 4.4	− 5.5	+10.8	− 6.0	36.6
Swiss francs	+ 4.5	− 1.8	− 1.0	− 0.2	+ 3.5	− 2.0	7.6
Yen	+ 1.7	− 0.3	+ 1.5	− 0.4	+ 3.1	− 0.7	10.0
Pounds sterling	+ 2.8	+ 0.2	+ 0.5	− 1.8	+ 3.3	− 1.6	7.2
French francs	+ 1.3	+ 0.4	− 0.4	− 0.9	+ 0.9	− 0.5	3.4
Netherlands guilders	+ 1.1	+ 0.3	− 0.3	− 0.4	+ 0.8	− 0.1	2.8
Unidentified assets	− 1.1	+18.4	+ 0.1	+ 0.2	− 0.9	+18.6	53.3
Total	+37.9	+ 6.8	+15.1	−26.9	+53.0	−20.1	435.0
Memorandum items							
Total, excluding gold and dollars contributed to the EMCF against ECU balances	+37.9	+ 6.8	− 6.7	−17.0	+31.2	−10.2	401.1
of which							
Gold	+ 0.4	− 0.0	− 1.4	− 3.7	− 1.0	− 3.7	42.2
Foreign exchange	+31.9	− 4.2	− 4.1	− 9.3	+27.8	−13.5	315.0
U.S. dollars	+ 5.1	−20.3	−	−	+ 5.1	−20.3	192.8
Investment of foreign exchange reserves in the Euro-market	+15.2	+ 4.3	− 3.1	− 3.8	+12.1	+ 0.5	102.0
of which							
Euro-dollars	+ 5.8	+ 1.8	−	−	+ 5.8	+ 1.8	72.5
Euro-Deutsche Mark	+ 5.0	+ 3.3	− 2.2	− 2.8	+ 2.8	+ 0.5	20.1
Regional distribution 3							
OECD countries	+14.5	− 2.2	+17.6	−20.6	+32.1	−22.8	251.4
of which							
United States	+ 8.1	+ 4.3	− 0.7	− 2.0	+ 7.4	+ 2.3	29.7
Japan	+ 5.5	+ 4.6	− 0.4	− 1.1	+ 5.1	+ 3.5	29.2
Canada	+ 0.2	+ 0.6	− 0.1	− 0.3	+ 0.1	+ 0.3	4.4
Germany 4	−10.5	− 1.2	+ 5.8	− 3.5	− 4.7	− 4.7	47.6
France	+ 4.7	− 1.9	+ 4.9	− 3.5	+ 9.6	− 5.4	25.6
United Kingdom	− 0.0	− 4.3	+ 0.9	− 1.2	+ 0.9	− 5.5	16.0
Italy	+ 1.0	− 0.4	+ 3.8	− 2.9	+ 4.8	− 3.3	22.9
EEC countries	− 1.7	−10.6	+19.6	−15.2	+17.9	−25.8	135.6
OPEC countries	+21.2	+ 4.0	− 1.1	− 3.4	+20.1	+ 0.6	95.7
Sparsely populated	+13.5	+ 8.1	− 0.6	− 1.8	+12.9	+ 6.3	50.5
Densely populated	+ 7.7	− 4.1	− 0.6	− 1.6	+ 7.1	− 5.7	45.2
Other developing countries	+ 1.3	+ 2.0	− 1.2	− 2.5	+ 0.1	− 0.5	77.9
Threshold countries	− 1.5	+ 1.7	− 0.5	− 0.5	− 2.0	+ 1.2	35.4
Other countries	+ 2.8	+ 0.3	− 0.7	− 2.0	+ 2.1	− 1.7	42.5
Remaining IMF countries	+ 0.8	+ 3.0	− 0.1	− 0.4	+ 0.7	+ 2.6	10.0
Total	+37.9	+ 6.8	+15.1	−26.9	+53.0	−20.1	435.0
Memorandum items							
Excluding gold and dollars contributed to the EMCF against ECU balances							
OECD countries	+14.5	− 2.2	− 4.2	−10.7	+10.3	−12.9	217.5
EEC countries	− 1.7	−10.7	− 2.2	− 5.2	− 3.9	−15.9	101.7

* Including Switzerland. — **1** The changes in the non-dollar components on a transactions basis were ascertained by converting the changes in SDRs (gold and IMF-related components) or national currencies at the respective average rate against the U.S. dollar. The difference between this change and the actual change on a dollar basis represents the change due to exchange rate and gold price movements. Changes due to gold price movements only affect the ECU holdings arising from the gold contributed to the European Monetary Cooperation Fund; the other gold is valued at a constant rate of SDR 35 per ounce and is thus subject only to fluctuations in value due to exchange rate movements. — **2** The change on a transactions basis includes the change in overall claims on the EMCF arising from the use of the very short-term financing facility. — **3** For the definition of the groups of countries see the table on page 57. — **4** As in the other EMS countries, the gross monetary reserves shown here include the reserves created by contributing gold to the EMCF against ECU credits on the basis of a market-related valuation. This creation of reserves due to valuation factors is eliminated from the Bundesbank's Return. — **pe** Partly estimated.

Sources: IMF, BIS and national statistics.

Subdued trend in 1981 . . .

The official monetary reserves of all IMF countries taken together — i. e. their holdings of gold, special drawing rights, IMF reserve positions and foreign exchange, including ECU balances — fell in 1981 by a total of $ 20 billion. This decline in international liquidity is, however, entirely attributable to valuation adjustments relating to shifts in exchange rates and changes in the price of gold. If changes in the value of reserve holdings are ignored, global monetary reserves increased by almost $ 7 billion (see the table on the preceding page).

. . . corrects the pronounced rise in 1980

A year before, in contrast, world monetary reserves had grown by no less than $ 38 billion on a transactions basis, with holdings of Deutsche Mark alone accounting for over $ 15 billion. At current exchange rates and including changes in ECU holdings caused by movements in the price of gold, world monetary reserves increased in all by as much as $ 53 billion. In this respect, this pronounced rise in international liquidity was corrected to a certain degree in 1981.

Further increase in monetary reserves within the IMF

The slight growth of $ 7 billion in world monetary reserves in 1981 mentioned above, which results when changes due to valuation adjustments are disregarded, must chiefly be ascribed to a further increase in special drawing rights and IMF reserve positions. Holdings of special drawing rights rose by $ 5.6 billion, primarily on account of the last of the series of new allocations of SDRs. In addition, IMF reserve positions, which the Fund also expresses in SDRs, went up by $ 5.5 billion. The bulk of this amount accrued to creditor countries (mainly the United States and Saudi Arabia) as the counterpart of drawings on the IMF by deficit countries. While the rise in IMF reserve positions in 1980 was principally attributable to the increase in quotas that came into effect in that year, in 1981 only $ 0.3 billion was accounted for by quota increases (through the selective raising of the quota of Saudi Arabia). The total growth of approximately $ 11 billion in monetary reserves within the IMF fell to $ 7.3 billion as a result of the rise in the dollar and the corresponding depreciation of the SDR against the U.S. currency.

No change in gold holdings

In 1981 there was no change in the volume of the gold holdings of member countries. Since they are shown in the IMF's reserve statistics at a constant value of SDR 35 per ounce, they declined in terms of the dollar in 1981 by $ 3.7 billion owing to the fall in the value of the SDR. However, this is of little practical significance because in case of need gold would be sold in the market at the current price, unless other ways of mobilising gold (using it at market-related prices) as collateral for loanswere to be employed. But those countries which differ widely from the IMF's method of valuation and value their gold holdings at a market-related price actually suffered a considerable statistical decrease in their monetary reserves as the gold price went down (by $ 190 to $ 400 per fine ounce between the beginning and end of 1981, and it is still tending to fall sharply). Among the major countries concerned are France, the United Kingdom and Italy.

Slight decline in exchange reserves on a transactions basis . . .

In 1981 world foreign exchange reserves declined on a transactions basis by $ 4.2 billion. There was a sharp drop in identified dollar balances; however, at the same time there was an equally considerable increase in foreign exchange holdings that cannot be identified by currency. Since a large proportion of the dollar sales were effected by EMS countries, their holdings of ECUs (the smallest part of which derives from the revolving transfer of 20 % of their dollar holdings to the European Monetary Cooperation Fund) decreased noticeably. But only dollar swaps with the EMCF were terminated, i. e. no reserves were lost additionally. Moreover, there was a distinct decline in identified reserve holdings of Swiss francs. In contrast, there was little change on a transactions basis in other identified foreign exchange reserves, including Deutsche Mark balances held by foreign official bodies.

In addition to the decline in global foreign exchange reserves on a transactions basis, there was a fall of almost $ 20 billion in the value of global holdings of foreign exchange owing to shifts in exchange rate relationships and changes in the gold price. Of this total, about half is accounted for by a reduction in the value of holdings of non-dollar reserve currencies on account of exchange rate movements, and about half by a decrease in ECU balances resulting from the fall in the price of gold. In the main, the latter represents 20 % of the gold holdings of each member country of the EMS transferred to the EMCF on specific dates at a market-related value. However, the decline in ECU balances due to the drop in the price of gold was only half as large as the corresponding increase in 1980. Of course, such wide swings in ECU holdings owing to changes in the price of gold are hardly compatible with the intentions behind the creation of this reserve instrument. Ways and means should therefore be found of avoiding these fluctuations in future. Incidentally, in its reserve statistics the Bundesbank has from the start prevented its monetary reserves from being inflated by the creation of ECUs against the provisional contribution of gold and dollars to the EMCF by eliminating the statistical increase in their value arising from the transfer of reserves to the EMCF against a corresponding credit in ECUs through entering a counterpart on the liabilities side of its balance sheet, and also adjusting its gross monetary reserves accordingly (although this is not taken into account in the statistics of the IMF).

. . . and sharp additional decrease owing to valuation adjustments

The share of the Deutsche Mark in world foreign exchange reserves, which had risen to about 10 % by the end of 1979, reached approximately 12 % at the end of 1980 and remained at about this level in 1981, if ECU balances are disregarded and the holdings of dollars on which the latter are based are included in the dollar element. This means that the Deutsche Mark is still the second most important reserve currency in the world, followed by the Japanese yen, which at present accounts for just over 3 % of global foreign exchange reserves.

Role of the Deutsche Mark as a reserve currency unchanged . . .

Of the present volume of official Deutsche Mark reserve balances, over half is held in the Euro-market, as against 70 % in 1975. The decline in the importance of the Euro-market for investing Deutsche Mark reserves no doubt owes much not only to the abolition of the last remaining German restrictions on capital imports but also to the borrowing operations of the Federal Government abroad.

. . . while reserve holdings in the Euro-DM market decline

Although global foreign exchange reserves decreased in 1981 because of shifts in exchange rates and the fall in the price of gold, there can be no talk of a global shortage of international liquidity since there was an extremely large rise in world monetary reserves in earlier years. Moreover, the greater flexibility of exchange rates has generally reduced the demand for reserves. Above all, in the last few years it has become easier than in the past to obtain monetary reserves in case of need by borrowing in the international financial markets. The extent to which recourse is taken to this possibility is, of course, a question of cost, which forces the pros and cons of adjusting rapidly to balance of payments exigencies to be weighed up. In order not to weaken the will to adjust, the greatest caution should be exercised with respect to all attempts to expand international liquidity further.

No shortage of international liquidity

Moreover, there are some signs that the development of the international financial markets has changed the role of official monetary reserves. Only a decade ago they were used in the main as a reserve for bridging over temporary deficits in the balance of trade and on current account. But since then the actual use of reserves has declined in importance in comparison with other ways of equilibrating the balance of payments. Today, a high level of reserves is first and foremost a major factor in assessing the creditworthiness of a country in the international financial markets. With this in mind, estimating the global need for reserves on the basis of the development of world trade would lead to unacceptably high figures.

5. Exchange rate developments and policy

Weighted external value of the U.S. dollar, Swiss franc and Deutsche Mark strengthens, while that of sterling and the yen declines

There were again wide swings in exchange rates in 1981. The U.S. dollar and the Swiss franc in particular were able to strengthen their position against the average of other currencies. The U.S. dollar continued the rise that began in the middle of 1980 up to August 1981, but then it suffered a marked decline before firming again from the end of the year onwards. At its present level, the dollar is not only valued much higher than when floating was introduced in 1973 but has also made good, at least on average, the losses it has sustained since 1971. The Deutsche Mark too is somewhat stronger today than at the beginning of 1981 and has thus been able to counterbalance the losses it incurred in 1980. Although the Deutsche Mark fell considerably, vis-à-vis the U.S. dollar in particular, this decline was more than offset by rises in the exchange rate against most EEC currencies; only the Netherlands guilder moved parallel to the Deutsche Mark. The average external value of the other EEC currencies deteriorated to a correspondingly large degree as a result of falls in their exchange rates vis-à-vis the dollar and the Deutsche Mark. In the process, sterling lost most of the increase in value it registered in 1980. The yen also dropped sharply vis-à-vis the U.S. dollar up to August, but less so than the European currencies. Since the United States accounts for just under half of Japan's foreign trade with the industrial countries, the trade-weighted external value of the yen nevertheless suffered a marked decline. As the mirror image to the movements of the dollar, the yen then recovered, before falling once again from the end of the year onwards (see also the chart opposite).

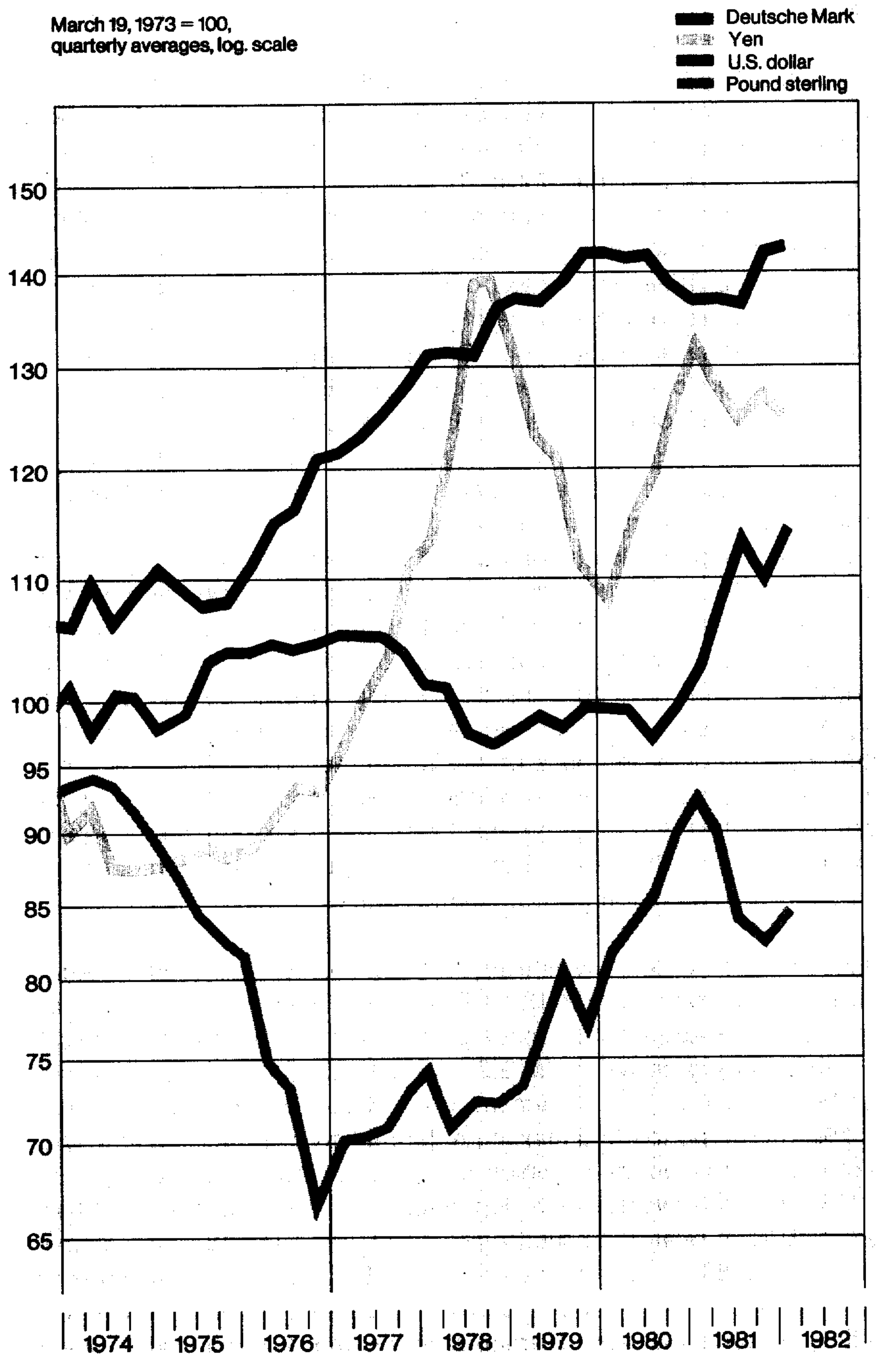
To an even greater extent than in the previous year, the recent shifts in exchange rates between the major currencies were the outcome of many different influences. Although the significance of international price and cost differentials as a factor determining exchange rate movements increased, they again failed to exert as distinct an impact as would be expected, at least over the medium term. In contrast, an important role was played by international interest rate differentials, balance of payments developments, overall economic prospects and non-economic factors.

(a) The development of major currencies over the year

U.S. dollar rises owing to confidence factors

At the beginning of last year the U.S. dollar — still the key currency in the world monetary system — rose steeply on a strong wave of confidence. This reflected the expectation that the new Administration would radically change the direction of economic policy in the United States. President Reagan did indeed announce a number of measures to revitalise the economy soon after his election and quickly turned them into government decisions. They were aimed at stimulating economic activity, resolutely fighting inflation and consolidating the Federal budget over the longer term. The dollar benefited from the sustained improvement in the U.S. current account, which contrasted strongly with the current account position of a number of other major countries. However, from the end of 1980 to March/April 1981 the interest rate differential between the United States and other countries moved against the dollar. After U.S. interest rates for short-term loans to prime borrowers had reached the record level of 21.5 % in December 1980 and the money supply had begun to develop more in line with the monetary targets, interest rates in the United States went down sharply, whereas in many European countries, including Germany, they rose. However, the general confidence in the dollar completely outweighed the declining interest rate differential in favour of the United States for a time, or led to interest-rate-induced falls in the dollar rate being only short-lived (see the chart on page 71).

Movement of the external value of major currencies since the transition to floating*



* Against the currencies of 23 countries; geometrically weighted in accordance with the regional pattern of the average foreign trade turnover (exports plus imports) of the individual countries between 1975 and 1977.

Upsurge from the spring onwards as a result of interest rate movements

The period of monetary relaxation in the United States ceased in April 1981 with a prime rate of 17%. At the beginning of July the short-term interest rate charged to prime borrowers rose again to over 20%. In the light of their domestic economic situation, however, the countries of Europe and Japan did not follow this development to the same degree, if at all. The dollar was therefore given an additional upward thrust by the interest rate differential. Moreover, there were special problems among its major partners and political events — such as the election of a new President in France and the situation in Poland — which pushed the dollar up further. Finally, as a result of the announcement by the United States in the middle of April 1981 that it would in principle no longer intervene in the foreign exchange markets, a certain psychological barrier to exaggerated movements in the dollar rate was removed.

Turnaround in the dollar rate in the summer

The abrupt swing in the development of the dollar rate in August resulted initially from the increases in the rate in preceding weeks, which were widely held to be excessive, and from large sales of dollars by countries in Europe. The dollar came under additional pressure from a changed attitude towards the economic policy of the United States. Above all, doubts arose as to whether the expenditure cuts passed by Congress would be sufficient to put the Federal budget in balance over the medium term. Besides this loss of confidence, the weakening of economic activity in the United States that became apparent in the summer had a negative impact on the dollar. The development of the economy was seen in many quarters as necessitating a change in the stance of monetary policy; moreover, international opinion was moving in the same direction. Interest rates in the United States did indeed decline for a time from August onwards. The discount rate was reduced twice after that date and by the end of the year the prime rate had fallen below 16%. The leeway this provided for lowering interest rates was exploited with great prudence in Europe and Japan — a number of countries, including France, the United Kingdom and Switzerland, even increased their interest rates — with the result that the turnaround in the development of the dollar rate was reinforced by falling interest rate differentials. Finally, the prospects of renewed deficits on current account for the United States and declining surpluses for the OPEC countries, whose petroleum exports are primarily paid for in dollars, proved to be additional contributory factors. After the dollar had weakened in the foreign exchange market, with some pronounced fluctuations at times, it settled down for a while in November at a level which as a whole and vis-à-vis most major currencies was still considerably higher than the point it had reached at the end of 1980. The dollar also benefited from the declining pace of inflation in the United States, which, after rising for a short period around the middle of 1981, has now fallen to a year-on-year rate of about 8%, and is thus far below the peak of almost 15% registered in the spring of 1980. Apart from this factor, the dollar has recently profited from a renewed increase in U.S. interest rates.

Deutsche Mark much weaker against the dollar, but gains in value against other currencies

The Deutsche Mark was hit particularly hard by the rise in the dollar. After the U.S. currency had gone up from DM 1.71 to DM 1.96 in 1980, it reached a high point of DM 2.57 in August 1981 (having last stood at this level in the middle of 1976), before moving between DM 2.20 and DM 2.40 in the main from the autumn of 1981 onwards. The movement in the dollar rate from January 1980 to August 1981 corresponds to a maximum depreciation of the Deutsche Mark of 34%, 24 percentage points of which accumulated after the end of 1980. By March 1982 (monthly average) the depreciation of the Deutsche Mark had decreased to 28% in relation to the beginning of 1980, and 18% in comparison with the end of 1980. As mentioned above, the Deutsche Mark has firmed considerably, however, vis-à-vis other currencies since 1981 and as a result has gained in value on a weighted average against the major currencies since the end of 1980, as well as relative to the pattern of exchange rates ruling at the beginning of 1980, when the Deutsche Mark reached its previous peak.

Decisive role of the German current account

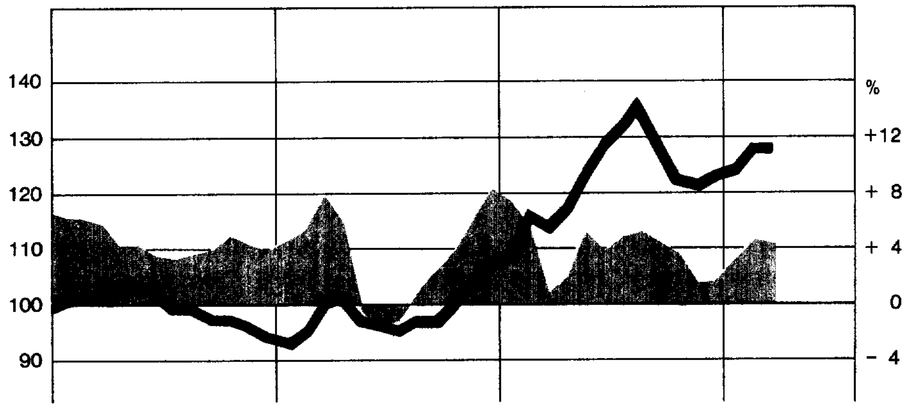
The decisive factor behind the weakness of the Deutsche Mark against the dollar and initially also against other currencies was that the deficit on Germany's current account steadily increased up to the first quarter of 1981 and that the general public did not discern an underlying trend towards an improvement for a long time. Consequently, the high deficit on current account not only directly increased the supply of Deutsche Mark in the foreign exchange market but, as in 1980, also had an unfavourable impact on the capital account. In this connection Germany once again felt the problems posed by the role of the Deutsche Mark as an international investment and reserve currency. The adjustment to the international level of interest rates in February 1981 together with the considerable volume of loans taken up by the Federal Government abroad did admittedly help to ensure the financing of the current account deficit via capital imports, particu-

Selected interest rate differentials* and exchange rate of the U.S. dollar

monthly averages

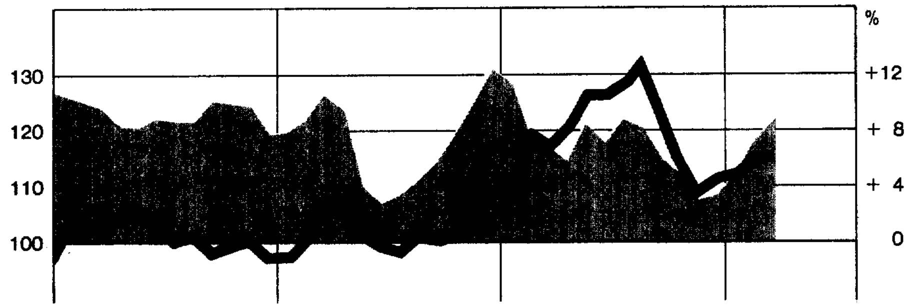
Federal Republic of Germany

US$/DM interest rate differential
Deutsche Mark per U.S. dollar
End-1978=100



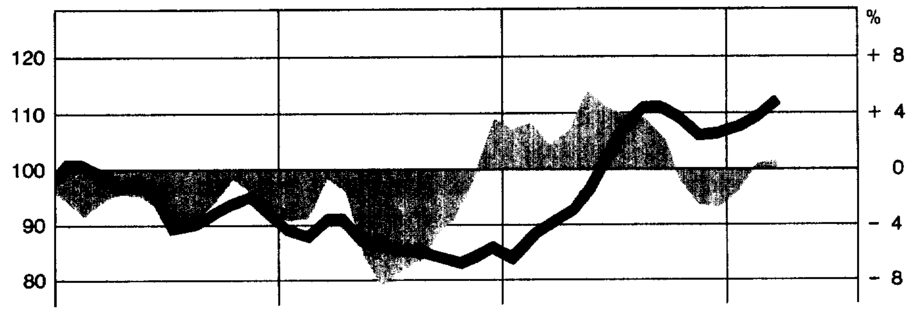
Switzerland

US$/Sfr interest rate differential
Swiss francs per U.S. dollar
End-1978=100



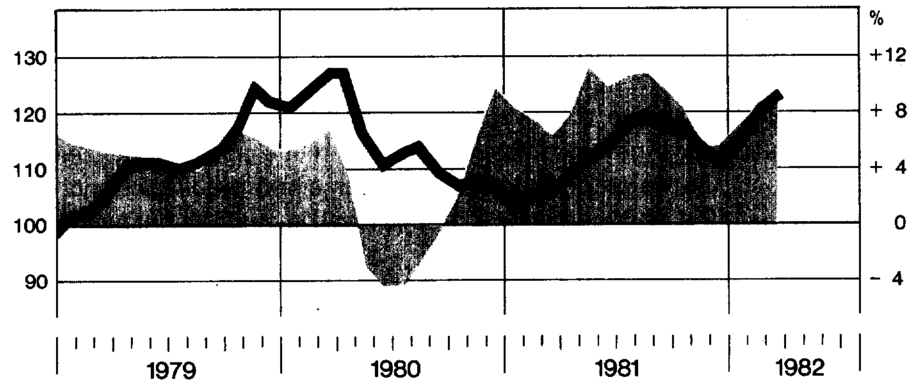
United Kingdom

US$/£ interest rate differential
Pound sterling per U.S. dollar
End-1978=100



Japan

US$/yen interest rate differential
Yen per U.S. dollar
End-1978=100



* Measured in terms of money market rates. United States: 3-month CDs; Federal Republic of Germany: 3-month funds; Switzerland: 3-month Eurofunds; United Kingdom: 3-month funds; Japan: call money.

larly since the current account deficit was gradually declining. However, it was the marked turnaround in Germany's current account balance that gave the exchange rate of the Deutsche Mark a firm basis which also withstood to a certain degree the renewed widening of the interest rate differential in favour of the dollar. Thus, the interest rate gap in favour of the dollar increased considerably once again in the initial months of the current year without the Deutsche Mark becoming weak vis-à-vis the dollar for a prolonged period.

Strong average appreciation of the Swiss franc

Up to August the Swiss franc declined in relation to the dollar to much the same extent as the Deutsche Mark, but then it recovered more than any other currency. Thus, from midsummer onwards the Swiss franc strengthened against all other currencies, and vis-à-vis the Deutsche Mark it rose by about 9% to reach a level which in March of this year, on a monthly average, even exceeded the previous peak recorded in September 1978. This owed something to the increase in interest rates in September mentioned above; this practically eliminated the interest rate differential between Germany and Switzerland for a time. Inflows of funds from the EMS area, which in Germany were absorbed by interventions in the foreign exchange market but in Switzerland pushed up the rate for the Swiss franc, were another factor explaining the rise in the exchange rate of the Swiss currency vis-à-vis the Deutsche Mark. As a result, the weighted external value of the Swiss franc has improved by no less than 17% since the end of 1980.

Sterling initially strong . . .

In contrast to the other European currencies, sterling fell only a little against the dollar in the autumn of 1980, and by January 1981 it had even almost regained its record level of the previous year. The pound correspondingly strengthened considerably vis-à-vis the other currencies of Europe. This initial special development of sterling mainly reflected an increase in confidence in the pound deriving from the marked improvement in the British current account position, due primarily to oil revenue, and from the declining inflation rate, which went down from 20% or more in the first half of 1980 to 15% in December, with expectations of a further drop.

. . . but subsequently depreciates against the other major currencies

From February 1981 onwards sterling was caught up in the general development of exchange rates vis-à-vis the dollar. In the process it fell even more strongly than the other major currencies and hence also decreased considerably in value against the Deutsche Mark. One contributory factor was that sterling lost an important buttress when the oil markets softened. In addition, complaints by British industry about a continuing loss of market shares made sterling appear overvalued. Large-scale capital outflows also occurred, including withdrawals of funds by OPEC countries and a further rise in British capital investment abroad, all restrictions on which were lifted in October 1979. The strength of the current account position, which benefited from increased oil exports as well as the weakness of demand owing to the recession, proved to be an insufficient counterweight. The fact that sterling finally became stronger again vis-à-vis the dollar from August 1981 onwards is due primarily to a change in the stance of British monetary policy, which pushed interest rates in the United Kingdom above the level ruling in the United States from October onwards. Sterling has nevertheless continued to fall against the Deutsche Mark. As a result its weighted external value remained practically unchanged between August 1981 and March 1982; at this level, it was 8% below the figure recorded at the end of 1980.

Sharp fluctuations in the yen since 1978

Since 1978 the Japanese yen has moved in protracted waves both against the dollar and also on a weighted average vis-à-vis the other major currencies, the waves being related fairly closely to the development of Japan's current account balance. The rise in the yen in 1978, with an extremely high surplus on current account in that year, was followed in 1979 by a pronounced weakening and in 1980 by a renewed strengthening of the Japanese currency, which brought it back close to the level registered at the end of 1978. Similar to sterling, this new increase in the yen lasted until January 1981 and reflected Japan's success in adjusting its economy to the higher cost of petroleum imports. Japan had managed to balance its current account by the turn of 1980/81, i.e. a year earlier than Germany, and since then has recorded growing surpluses.

Yen weakens again vis-à-vis the dollar and on a weighted average

The yen was not, however, able to escape the general strength of the dollar from February 1981 onwards. A factor that played an increasing role in this process was that Japan kept its interest rates considerably lower than every other major industrial country for reasons connected with the level of business activity and also in view of its declining rate of inflation. Thus, when interest rates on dollar assets went down in the middle of March 1981, Japan took this opportunity to lower its discount rate by 1 percentage point to 6.25 %. In addition, certain doubts arose as to whether Japan would continue its export drive in the light of increasing criticism from abroad, including in particular the United States and the European Community, especially since international agreements and voluntary self-restraint had already begun to dampen exports in a few sectors. Against this background, the greater role of the yen as an international investment currency, together with the extensive liberalisation of capital transactions which came into force at the end of 1980, led to large outflows of capital which in turn depressed the exchange rate for the yen. Against the dollar, however, the yen weakened less than other currencies. This may be partly because the Japanese authorities, in numerous public statements, stressed the fact that a pronounced decline in the yen rate was not compatible with the underlying conditions in the national economy. In this context they could point not only to the actual improvement in the current account but also to Japan's considerable success in combating inflation, which helped that country to achieve the lowest rate of inflation in the world from April 1981 onwards. After August 1981 the yen initially made good over half its preceding loss in value against the dollar, but it then suffered a marked fall again. As a result, from the end of 1980 to March 1982 the yen decreased almost as much in value against the dollar as the Deutsche Mark. The appreciation of the yen against the Deutsche Mark in the interim was thus largely reversed. Owing to the major proportion of Japan's foreign trade accounted for by the United States, the weighted external value of the yen also underwent a sharp decline, viz. 8 % from the end of 1980 to March 1982.

(b) Pronounced short-term fluctuations in exchange rates

Exchange rate fluctuations more frequent and severe because numerous influences coincide

In the light of the differing successes and prospects of success of individual countries in overcoming their balance of payments problems, a certain degree of exchange rate fluctuation and concomitant deviations of the rates from the trend of international price and cost differentials for each country seem to be quite normal. As explained above, 1981 also witnessed several rapidly changing influences which had a considerable impact on the development of exchange rates, including in particular a constantly varying interest rate differential between the United States and other countries. The consequence was that substantial short-term exchange rate fluctuations of unprecedented frequency and severity were superimposed on exchange rate trends of a longer-term nature. As regards the relationship of the dollar to the Deutsche Mark, for example, these two factors have resulted since the beginning of 1981 in four periods in which the dollar has risen by at least 6 % and at most 26 % and three periods in which it has fallen by at least 5 % and at most 15 %. Similar fluctuations have occurred between the dollar and the yen as well as vis-à-vis other currencies. In addition, there has been a pronounced increase in day-to-day exchange rate fluctuations. At over 1½ pfennigs, the average daily change in the official middle rate for the dollar in Frankfurt approximately doubled in 1981 in comparison with the previous year.

Advantages of floating jeopardised by excessive exchange rate fluctuations

Under the conditions currently governing the world economy, greater flexibility in exchange rates is practically unavoidable and to a certain extent is also necessary. Without it the foreign exchange markets could be subject to serious tensions which experience has taught can do considerable economic damage. However, excessively frequent and pronounced fluctuations in exchange rates are probably detrimental over the long term to the steady development of international economic relationships and hence of domestic economic activity as well, rather as uncertainties in a country's domestic economy are unlikely to engender a healthy investment climate. Moreover, it can be assumed that fluctuations in exchange rates have a negative impact on price movements because depreciation effects are quickly reflected as a rule in prices and costs, whereas appreciation effects tend to be passed on only with a time-lag.

Heavy exchange market interventions bring only limited success

For these reasons the monetary authorities did not generally stand idly by in the face of the greater unrest in the foreign exchange markets. At about $ 78 billion, the gross volume of dollar purchases and sales of the 14 major industrial countries in 1981 was only slightly lower than in 1980 ($ 84 billion). Excluding the United States, which after the attempted assassination of President Reagan ceased intervening in the foreign exchange market at the end of March 1981, the total volume of interventions, at approximately $ 77 billion, was even higher than in the previous year ($ 75 billion). The Bundesbank accounted for about $ 12 billion in each case, comprising in the main sales of dollars. The fact that it was not possible to calm the foreign exchange markets durably, despite the considerable volume of interventions, is probably due to the abstention of the United States from intervention operations; without its active participation, dollar interventions appear to be less convincing to the market and are therefore not so effective in the opinion of some market participants. The main thing that this once again illustrates, however, is that exchange market interventions can do little to counter interest-rate-induced fluctuations in exchange rates unless the impact of such interventions on the development of liquidity and interest rates in the domestic economy is accepted. Not only the high level of, but in particular the wide fluctuations in, the interest rates for dollar assets have made it considerably more difficult, however, for the countries of Europe and Japan to closely interlock their intervention policies with national monetary policy.

Better international coordination of monetary and exchange market policies desirable

One way of escaping the present dilemma between widely fluctuating exchange rates and pronounced movements in interest rates even outside the United States is to improve the coordination of monetary policy at the international level. However, past experience shows that this is not easy. Moreover, certain differences in present-day monetary policy methods in the major countries have created additional difficulties in this respect. Nevertheless, in the interest of the cohesion of the world economy no effort should be spared to maintain and improve mutual consideration and cooperation in international monetary policy. In this context, a minimum of cooperation in the foreign exchange markets on both sides of the Atlantic should also have its proper place.

(c) Central rate adjustments within the European Monetary System

Pronounced shifts in central rates

After a prolonged period of exchange rate stability within the EMS, comparatively large shifts in central rates occurred after the beginning of 1981. Following the devaluation of the Italian lira by 6% vis-à-vis the other partner currencies on March 23, 1981, a general realignment of central rates was agreed with effect from October 5. The outcome was a revaluation of the Deutsche Mark and the Netherlands guilder by 5½% against the Belgian and Luxembourg franc, the Danish krone and the Irish pound, and by 8¾% vis-à-vis the French franc and the Italian lira. Since February 22, 1982, finally, a new set of central rates has applied in the EMS after the devaluation of the Belgian and Danish currencies by 8½ % and 3 %, respectively. These shifts in exchange rates amount to an average revaluation of the Deutsche Mark against all other currencies in the system of approximately 9 %.

Correction of international price and cost discrepancies

The realignment of exchange rate relationships within the EMS had become necessary the price and cost discrepancies and external imbalances between the various partner countries had grown constantly larger over the course of time. From the inception of the EMS in the first quarter of 1979 to the third quarter of 1981 consumer prices in the other participant countries rose by 30 % on average (weighted by their share in Germany's foreign trade), including 36 % in France and as much as 54 % in Italy. As against this, the comparable compounded rate for Germany was only 14 %. Over the same period there was a correspondingly pronounced improvement in Germany's trade balance, especially with France and Italy. The changes in central rates undertaken in 1981 together with the minor corrections of 1979 offset a large part of this average price and cost differential in favour of Germany.

Devaluation of the Belgian franc to facilitate domestic adjustment measures

In contrast, the recent devaluation of the Belgian franc was due less to price and cost discrepancies vis-à-vis other countries than to the general imbalance of the Belgian economy as reflected in excessive domestic demand, large budget deficits, a lack of investment, high unemployment, out-of-date products, the closure of industrial plant that was no longer competitive and, last but not least, sizable current account deficits and a disturbingly high level of foreign debt. The devaluation of the currency will therefore be successful only if the resolute economic policy measures taken simultaneously by the Belgian Government can be pushed through and sustained.

Deutsche Mark in a strong position since February 1981

After a protracted period of weakness, the Deutsche Mark again became the strongest currency within the EMS in February 1981 after the Bundesbank had raised short-term interest rates sharply under the pressure of the current account deficit and large-scale capital outflows, thus bringing German interest rates more into line with those in other EMS countries, and incidentally vis-à-vis the dollar as well. After that the Deutsche Mark was increasingly thought to be a candidate for revaluation within the EMS owing to the more favourable development of prices and costs in Germany. At the same time the problems of other countries came into sharper focus, giving the Deutsche Mark an additional upward thrust. Despite the devaluation of the lira in March, Italy was able to prevent persistent large-scale outflows of foreign exchange only by introducing a cash deposit requirement for all purchases of foreign currency needed for transactions in goods and services. It was in force until February of the current year and supplemented existing extensive controls on capital and foreign exchange movements as well as a cash deposit requirement introduced in 1973 for almost all kinds of capital outflows. The French franc came under considerable selling pressure, especially in connection with the Presidential elections of April/May 1981, and had to be supported both in the dollar market and against the Deutsche Mark with massive interventions despite steep increases in interest rates and tighter controls on capital movements. From the time when the Deutsche Mark strengthened again within the EMS up to the eve of the October realignment these support operations in favour of the French franc totalled the equivalent of about DM 31 billion (net). Of this amount, approximately DM 12 billion was accounted for by dollar sales and over DM 18 billion by sales of Deutsche Mark out of the Banque de France's own holdings or borrowed from the European Monetary Cooperation Fund, or by purchases of French francs by the Bundesbank. Even earlier, the Belgian franc had been able to maintain a more or less inconspicuous position within the EMS only as a result of the exceptional weakness of the Deutsche Mark. Its fall against the German

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

DM billion

Period	Net external position, total	Interventions: Deutsche Mark/ dollar market 1	Interventions: EMS 2	Other foreign exchange movements
1980, total	−27.6	−18.3	−10.5	+ 1.2
1981				
January 2 — February 19				
Further strengthening of the U.S. dollar				
Deutsche Mark weak in the EMS	− 4.8	− 4.7	− 1.6	+ 1.5
February 20 — August 10				
U.S. dollar continues to rise				
Deutsche Mark strong in the EMS	+10.1	−12.5	+20.8	+ 1.7
August 11 — October 2				
U.S. dollar weakens				
Deutsche Mark remains strong in the EMS	+ 0.7	− 0.4	+ 1.2	− 0.2
October 5 — December 31				
Sharp erratic fluctuations of the U.S. dollar				
Deutsche Mark mostly weak in the EMS after the realignment of exchange rates	− 8.2	− 4.0	− 5.4	+ 1.2
1981, total	− 2.2	−21.6	+15.0	+ 4.4
1982				
January — March				
Slight strengthening of the U.S. dollar				
Midway position of the Deutsche Mark in the EMS	− 0.8	− 2.0	+ 0.3	+ 0.9

* Excluding allocations of SDRs and excluding changes due to valuation adjustments. Recorded according to the date on which the transaction was concluded and not according to the value date; discrepancies between these figures and those of the balance of payments are therefore possible. — 1 Including U.S. interventions until they were discontinued as from April 1981. — 2 Including intramarginal interventions.

currency now led to that country's domestic problems being clearly reflected in the position of the Belgian franc, and rapidly triggered large-scale support operations and increases in interest rates, accompanied by a growing depreciation of the financial franc in the two-tier foreign exchange market.

Foreign exchange inflows from the EMS offset by dollar sales

The considerable inflows of foreign exchange from the EMS area did not pose any difficulties for Germany on balance because the Bundesbank simultaneously sold heavily in the dollar market in the form of smoothing interventions in favour of the Deutsche Mark (see the above table). This explains why the general realignment within the EMS occurred later than had been expected in some quarters. It finally took place after the surge in the dollar rate had ebbed away and sure signs had appeared of a pronounced and lasting improvement in Germany's balance of trade and current account position.

Deutsche Mark persistently weak after the October realignment

After the October realignment the Deutsche Mark remained in a weak position within the new exchange rate margins until the beginning of December, when it gradually began to move towards a midway position, bolstered at first by renewed unrest surrounding the Belgian franc. Initial periods of weakness in revalued currencies are a familiar phenomenon. They result from a turnaround in speculative foreign exchange positions and a return to normal of the terms of payment in foreign trade. After the exchange rate changes of October, however, the initial weakness of the Deutsche Mark was much more marked and more protracted than after the first general realignment in the EMS in September 1979. The main reason for this was that the position of the Deutsche Mark against the dollar was generally weaker than before. In September 1979 the

Deutsche Mark benefited continuously from a very severe weakness of the dollar, which led to additional inflows of funds into the Deutsche Mark and improvements in the exchange rate. In the autumn of 1981, in contrast, the dollar/Deutsche Mark rate was marked by instability which did not necessarily promise additional gains by staying in the Deutsche Mark and therefore resulted in major outflows of funds, especially since the Bundesbank began to lower its special lombard rate a few days after the realignment.

Deutsche Mark quickly regains strength after the devaluation of the Belgian franc

After the devaluation of the Belgian franc in February this year, implying an appreciation of the Deutsche Mark against the Belgian franc of 9.3%, the Deutsche Mark left its initially weak position unexpectedly fast. The frequency and extent of the most recent exchange rate changes within the EMS have possibly given rise to expectations of further shifts in exchange rates and thus encouraged the tendency to stay in currencies that are rated strong over the long term.

(d) Exchange rate developments and international competitiveness

German competitiveness not impaired by exchange rate movements

The slight improvement in the weighted external value of the Deutsche Mark since the end of 1980 — which, despite a marked depreciation against the dollar, has resulted from improvements in the exchange rate vis-à-vis other major currencies — has not had a negative impact on the price competitiveness of German industry because Germany has maintained its lead over other countries in terms of price stability. Moreover, at present the weighted external value of the Deutsche Mark is still only slightly above the level registered at the end of 1979/beginning of 1980, i.e. its previous peak.

Earlier appreciation effects offset by Germany's greater price stability

However, from 1976 to 1979 the average appreciation of the Deutsche Mark vis-à-vis the other major currencies clearly exceeded the amount that was justified to offset the higher inflation rates abroad. Thus, German industry suffered a pronounced deterioration in its price competitiveness both abroad and in the domestic market. This is a further reason for the sharp deterioration in Germany's current account position since 1979. After the weighted external value of the Deutsche Mark ceased increasing from the end of 1979 onwards, and even declined for a time, the comparatively low rises in prices and costs once again worked in German industry's favour and corrected the preceding losses in price competitiveness.

In the meantime the development of the real external value of the Deutsche Mark — measured in terms of the nominal external value adjusted for the inflation differential vis-à-vis other countries — has given German products a distinct price advantage in international markets both over the whole period since the transition to floating and especially in comparison with 1978/79. In relation to the average for 1978 — the last year before the second oil price hike and a year in which a certain degree of equilibrium had been regained in the world economy — the nominal external value of the Deutsche Mark had risen by only 4% by February 1982. Over the same period, in contrast, German prices and costs had increased by 15% less than the average for our major trading partners. For the Deutsche Mark this implies a devaluation in real terms since 1978 of about 10% (see the table overleaf).

Japan highly competitive in price terms

The price competitiveness of Japan developed even more favourably over the same period. The main contributory factor was success in fighting inflation; however, as mentioned above, the weighted external value of the yen has recently fallen.

The competitive position of major countries in price terms

Percentage change between the average figure for 1978 and February 1982

Country	Inflation differential 1	Nominal external value of the currency 2	Real external value of the currency 3
Japan	− 16	− 6	− 21
Germany	− 15	+ 4	− 11
Switzerland	− 15	+ 14	− 3
France	+ 13	− 10	+ 2
Italy	+ 37	− 21	+ 8
United States	+ 6	+ 13	+ 20
United Kingdom	+ 15	+ 14	+ 32

1 Movement of consumer prices in the country in question against the trade-weighted average in 13 other industrial countries. — 2 Trade-weighted average external value of the currency in question against the currencies of 13 other industrial countries. — 3 Movement of the nominal external value of the currency as a percentage of the inflation differential.

Development of the competitive position of other countries

For Switzerland and France the development of the inflation differential and of the external value of their currencies roughly cancelled out. In contrast, Italy, the United States and especially the United Kingdom suffered considerable losses in price competitiveness. In Italy the marked rise in prices in relation to other countries was not completely offset by the simultaneous depreciation of the lira; in the United States and the United Kingdom a less favourable development of prices coupled with the simultaneous appreciation of their currencies actually led to a twofold burden. Although the relative increase of over 30% in the price of British products in comparison with those of other countries since 1978 is far smaller than a year ago because the exchange rate of sterling has fallen sharply since then, it nevertheless imposes a particularly heavy burden on British industry. A part of the high unemployment in the United Kingdom is probably a direct consequence of this development. On the other hand, shedding labour has made it possible for some firms to absorb part of the general pressure on costs and mitigate the problems arising from the appreciation of sterling. In fact, export prices in the United Kingdom have risen far less than the general level of prices there.

6. The European Monetary System

Problems in the EMS emerge more clearly as the Deutsche Mark strengthens

In the initial years after its inception in March 1979 the European Monetary System functioned better than had generally been expected as regards maintaining stable exchange rates. Up to the beginning of 1981 there were neither any large-scale support operations in favour of individual currencies nor any major changes in central rates. However, since then the volume of interventions has risen considerably and realignments have become necessary, but without posing any serious difficulties. To be sure, the promising start of the EMS owed something to special circumstances which could not be regarded either as desirable preconditions for the further existence of the EMS or as permanent features of the system. They include in particular Germany's large balance of payments deficits and the corresponding pronounced weakness of the Deutsche Mark vis-à-vis the dollar as well as most EMS currencies. The strengthening of the Deutsche Mark against most partner currencies that has now become very apparent has, however, brought into sharper focus the problems which Germany took steps to counter in the negotiations on the EMS. These problems arise in the main from Germany's greater success in combating inflation.

Economic developments and policies diverge

Initially, the outward sign of growing problems within the EMS was the considerable tensions in exchange rate relationships between the Deutsche Mark on the one hand and the French and Belgian francs on the other. They indicated that the economies of the member states were developing in widely diverging directions. Moreover, the danger began to appear that, besides the development of the economies themselves, economic policies were diverging more strongly. While efforts were widely being made to fight inflation resolutely, to redress the balance of payments and to consolidate public finance, in France expansionary policies were adopted by the new government, with recourse being taken to dirigiste measures such as price controls and restrictions on outflows of foreign exchange and capital in order to lend support to the new policies. As things stand at present, a greater degree of harmony in the economic policies of the member states is apparently further away than ever. Although the realignments of March and October 1981 were designed to eliminate imbalances that had already developed, they were at the same time an indication of a certain fresh loss of confidence. Moreover, with the marked devaluation of the Belgian franc in February this year a course was adopted that is not necessarily compatible with the purpose behind the EMS and the interests of the partner countries. All these factors raise the question of how the EMS is to develop further if the inner cohesion between the member states seems to be so insecure.

Advantages of the system . . .

Nobody can overlook the opportunities inherent in the EMS. Particularly in a world of increased unrest in the foreign exchange markets, the advantages that a system of more stable exchange rates offers the partner countries can be considerable. Germany has in fact also profited from this. When the Deutsche Mark tended to be generally weak, i. e. also in terms of the other partner currencies, the EMS helped to prevent a depreciation of the Deutsche Mark vis-à-vis Germany's major trading partners which would not be consistent with longer-term trends. This contributed to preventing the structure of German foreign trade from developing in the wrong direction. In addition, when the Deutsche Mark was generally weak the EMS helped to ensure that the inflation imported into Germany via international price relationships was not exacerbated by exchange rate fluctuations.

. . . lastingly assured only if economic harmonisation is improved

If the EMS ensured that exchange rate changes were undertaken only in line with underlying developments — i. e. if it offered the advantages of a crawling peg system — then this is certainly very little relative to what was claimed when the system was set up, namely the creation of a zone of monetary stability in Europe, thus also providing a sound basis for sustained economic growth and high employment. The greater external monetary stability which the EMS has brought the partner countries, at least in relation to each other, must be supported by greater domestic monetary stability in all countries if the system is to provide its members with lasting benefits. Otherwise there is a constant danger that the system will break apart and progress towards the planned institutional stage will become completely illusory. As is revealed by the table overleaf, the continuing divergencies between the member states leave no doubt that every partner country as well as the Community countries outside the system must make greater efforts to achieve closer harmony in the development of their economies on the basis of a maximum of price stability within the Community.

Little scope for "technical" improvements in the EMS

Owing to the continued large divergencies in economic developments, the second, institutional stage within the EMS could not be embarked upon in March 1981, as originally intended. For several months only pragmatic changes in the system that fall short of the institutional stage have therefore been discussed. The chief aim of a few partner countries and the EEC Commission, which are in favour of such "technical" improvements, is to foster the role of the ECU in the settlement of intervention balances, and also outside the EMS, and to make it easier for intramarginal interventions in EMS currencies to be undertaken and financed. Moreover, calls for a better-coordinated policy vis-à-vis the dollar are continuing.

Economic developments in the European Community

Annual average or annual figure

Country/Period		Percentage increase in consumer prices on previous year	Long-term interest rates in % p.a. 1	Balance on current account in US$ billion	Balance on current account as % of GDP/GNP	Percentage change in real GDP/GNP on previous year	Unemployed persons as % of the civilian labour force	Public sector financial balance as % of GDP/GNP 2
Germany	1980	5.5	8.4	−16.4	− 2.0	+ 1.9	3.4	− 3.3
	1981	5.9	10.1	− 7.6	− 1.1	− 1.0	4.8	− 4.4
France	1980	13.6	13.8	− 7.9	− 1.2	+ 1.2	6.5	+ 0.4
	1981	13.4	16.3	− 7.6	− 1.3	+ 0.5	7.8	− 2.1
United Kingdom	1980	18.0	13.8	+ 7.5	+ 1.4	− 1.4	6.9	− 3.5
	1981	11.9	14.7	+16.5	+ 3.4	− 2.0	10.5	− 2.5
Italy	1980	21.2	15.4	− 9.8	− 2.5	+ 4.0	8.0	− 7.8
	1981	19.5	19.7	− 8.0	− 2.3	+ 0.0	8.9	− 10.6
Netherlands	1980	6.5	10.2	− 2.7	− 1.6	+ 0.6	4.9	− 3.4
	1981	6.7	11.5	+ 4.1	+ 3.0	− 2.0	7.5	− 4.1
Belgium	1980	6.7	12.2	− 6.2	− 5.3	+ 2.5	9.3	− 9.4
	1981	7.6	13.8	− 7.2	− 7.5	− 1.3	11.5	− 13.3
Denmark	1980	12.3	18.9	− 2.5	− 3.8	− 0.2	6.2	− 5.9
	1981	11.7	19.2	− 1.9	− 3.4	− 0.5	8.3	− 10.7
Greece	1980	24.9	17.8	− 2.2	− 5.4	+ 1.7	2.8	− 3.3
	1981	24.5	17.6	− 2.5	− 6.5	− 0.3	3.1	− 6.3
Ireland	1980	18.2	15.4	− 1.4	− 7.9	+ 1.8	8.3	− 12.8
	1981	20.4	17.2	− 1.7	−10.2	+ 2.0	10.4	− 14.4
Luxembourg	1980	6.3	12.2	+ 1.0	+21.8	+ 0.4	0.7	− 1.8
	1981	8.1	13.8	+ 0.7	+18.9	− 3.3	1.0	− 3.3
European Community, total 3	1980	12.3	12.3	−40.6	− 1.4	+ 1.4	6.1	− 3.5
	1981	11.5	14.4	−15.2	− 0.6	− 0.7	7.9	− 5.0

1 Yields on long-term public bonds outstanding (Germany: average remaining periods to maturity of at least seven years). — 2 Central, state and local government and social security funds as defined in the System of National Accounts of the United Nations (SNA). — 3 Weighted with the GDP/GNP recorded in 1980.
Sources: EEC Commission, OECD and national statistics.

No major role of ECU reserves without convertibility and unambiguous control of ECU creation

As far as the role of the ECU as a reserve asset is concerned, it is very doubtful whether additional rules can replace what the ECU lacks in terms of attractiveness. At all events, the 50% acceptance limit for ECUs agreed by way of a compromise when transferring reserves to settle intervention balances among the central banks participating in the EMS has not been a real obstacle to their use within the system up to the present. The abolition of the acceptance limit should only be considered if, within the context of the institutional arrangements for the future European Monetary Fund, the unrestricted use of accumulated ECU balances, i. e. their convertibility into other reserve assets, is assured. Since ECU balances represent monetary reserves that can be used only regionally, this would be the only way of making sure that, in the light of the special role of the Deutsche Mark as an international investment and reserve currency, liquidity needs as well as the largely unrestricted usability of monetary reserves were guaranteed. Apart from this, any abolition of the acceptance limit presupposes unambiguous criteria and safeguards for the creation of ECU assets.

Further development of the intervention system poses problems

Considerable caution is also called for with respect to demands to make it obligatory, in addition to the existing intervention rules, for members to provide national currency for interventions by partner central banks within the agreed margins. At times the volume of interventions in individual currencies has been by no means small, and intramarginal interventions have in fact accounted for the major part of the total intervention volume. Intramarginal interventions can no doubt be justified, but they must continue to depend on the agreement of the partner central bank whose currency is used for the intervention operations, regardless of whether the currency employed is taken from its own holdings or comes from other sources (for instance, by borrowing abroad) or, as in the case of obligatory interventions, is included in the "very short-term financing" facility of the EMS. If this were not so, the scope for monetary policy decision-making open to individual central banks whose currencies are chiefly used for such interventions could be excessively restricted; it is limited in any case through membership of the EMS. Apart from this, the already restricted flexibility of exchange rates should not be reduced even more, thus making it impossible for interest-rate-induced and other foreign exchange movements within the margins to offset each other automatically to a certain degree in the market.

Artificial detachment of the EMS currencies from the dollar area would do more harm than good

Under the present conditions in the world economy, there are no ideal solutions to the problem of steadying the relationship between the European currencies and the dollar. The extent to which a better coordination of monetary policy between the major countries could help achieve this objective still remains to be seen. At all events, it would be wrong for countries to try instead to detach themselves from high U.S. interest rates with the aid of restrictions on capital movements and other artificial measures. Apart from the practical difficulties involved in such a policy, this would undermine confidence in European currencies and in the final analysis do more harm than good.

7. Recent developments in the International Monetary Fund

Return to financing from the Fund's own resources and reform of the quota structure

As already described above, the IMF greatly expanded its balance of payments assistance in the period under review. As a result, the Fund is also faced with certain problems with respect to refinancing its loans. In this context it once again became evident, during the discussions on the Fund's temporary policy of providing "Enlarged Access" to its resources, that the great majority of its members are of the opinion that the IMF must finance its loans mainly from its own resources, i. e. from the members' quotas. Borrowing by the Fund from central banks and other monetary authorities, such as was necessary at first, should therefore in future be considered at best a complementary source of financing and not become a permanent feature of the Fund's operations. In the opinion of the Interim Committee, the Fund should go to the international financial markets only if its liquidity comes under serious pressure which cannot be eased in any other way. At its last meeting in autumn 1981 the Interim Committee therefore recommended conducting the current eighth general review of quotas as fast as possible. As part of a general increase in quotas, the present structure of quotas is also to be corrected since the existing quotas of many major member countries do not reflect their weight in the world economy. In addition, it is intended to simplify the very complicated method of calculating quotas that has been used in the past.

No further allocations of special drawing rights

The allocation of special drawing rights on January 1, 1981 to the amount of approximately SDR 4 billion constituted the end of the series of annual allocations of SDRs totalling SDR 4 billion per year between 1979 and 1981 that had been agreed upon for the third allocation period. A proposal submitted for discussion by the Interim Committee at the Annual Meeting of the IMF in 1981 to lengthen the third allocation period beyond 1981 and maintain allocations at the previous level did not meet with a sufficient majority within the IMF. A number of major IMF members — including Germany — do not see any need for additional allocations of SDRs in the foreseeable future in the light of the present large volume of liquidity in the international financial markets. The fourth allocation period therefore began on January 1, 1982 without an allocation decision.

Additional credit facility for cereal imports

In May 1981 the IMF created the possibility, within the context of its facility for the compensatory financing of export earnings, of taking up loans to finance cereal imports. These loans are primarily meant as an aid for members with low per capita incomes if they encounter balance of payments difficulties owing to a temporary rise in the price of cereal imports because of either a poor harvest or an increase in prices in the world market for cereals. The upper limit for drawings of this nature is 100% of the member's quota. However, the total drawings of a member under the compensatory financing facility may not exceed 125% of its quota.

Part B: Notes on the Deutsche Bundesbank's annual accounts for 1981

1. Legal basis, classification and valuation

Legal basis, accounting system and annual accounts

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

Classification of the annual accounts

On the assets side of the balance sheet the item "Claims on the European Monetary Cooperation Fund in connection with the European Monetary System" (item 3) was subdivided into "Balances in European Currency Units (ECUs)" and "Other claims". Item 13 "Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin" is no longer subdivided.

On the liabilities side the former item 8 became item 7 and was expanded to read "Counterpart in respect of the valuation of the gold and dollar reserves provisionally contributed to the European Monetary Cooperation Fund". The item "Counterpart of special drawing rights allocated" became item 8.

In the profit and loss account the item "Gains from the valuation adjustment of the monetary reserves and other foreign currency positions" was renamed to read "Receipts from purchases and sales of foreign currencies". In addition, the appendix was deleted.

Valuation

The provisions of the Companies Act (Aktiengesetz) were taken into account mutatis mutandis in the valuation (section 26 of the Bundesbank Act). For details of the valuation adjustment of the dollar holdings at the end of 1981, see the article "The monetary reserves of the Bundesbank as reflected in its Weekly Return" in the Monthly Report of the Deutsche Bundesbank of January 1982.

2. Annual accounts

The annual accounts for 1981 are attached to this Report as an Appendix; as usual, the notes on them are in the same order as the items in the balance sheet and profit and loss account. At the same time a report is rendered on the Bank's activities during 1981.

Balance sheet

Comparison of balance sheet figures

At December 31, 1981 the balance sheet total, at DM 198,087.7 million, was DM 12,367.4 million larger than at end-1980.

Comparison of balance sheet figures

DM million

Assets	December 31 1980	December 31 1981
Gold	13,687.5	13,687.5
Reserve position in the International Monetary Fund and special drawing rights		
Drawing rights within the reserve tranche	2,915.4	3,120.2
Loans under special borrowing arrangements	1,572.3	2,437.1
Special drawing rights	3,612.3	3,628.5
Claims on the European Monetary Cooperation Fund in connection with the European Monetary System	31,708.0	39,940.2
Balances with foreign banks and money market investments abroad	42,597.9	37,245.6
Foreign notes and coins	26.3	26.7
External loans and other external assets		
Claims arising from foreign exchange offset agreements with the United States	1,549.8	416.0
Other loans to foreign monetary authorities	–	685.9
Loans to the World Bank	2,484.6	2,485.7
Foreign bills of exchange	4,424.7	5,367.4
Domestic bills of exchange	39,257.5	44,827.9
Securities bought in open market transactions under repurchase agreements	6,163.7	11,875.6
Lombard loans	7,707.8	5,985.4
Cash advances (book credits)	2,436.7	4,744.6
Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin	8,683.6	8,683.6
Securities	3,887.1	3,732.3
German coins	728.6	913.6
Balances on postal giro accounts	322.8	327.8
Other claims	985.3	799.5
Land and buildings	1,041.7	1,185.3
Furniture and equipment	81.7	90.2
Items in course of settlement	8,379.4	3,938.7
Other assets	1,432.7	1,907.9
Prepaid expenses and deferred income	32.9	34.5
Balance sheet total	185,720.3	198,087.7
Contingent claims	0.9	0.6

Liabilities	December 31 1980	December 31 1981
Banknotes in circulation	83,730.3	83,790.3
Deposits of banks	53,844.6	50,608.8
Deposits of public authorities		
Federal Government	396.3	293.2
Equalisation of Burdens Fund and ERP Special Fund	124.2	43.0
Länder Governments	450.2	391.7
Other public depositors	44.6	38.7
Deposits of other domestic depositors		
Federal Railways	8.1	6.2
Federal Post Office	1,141.3	1,512.1
Other depositors	581.8	628.4
Liabilities arising from mobilisation and liquidity paper sold	4,191.9	4,905.1
Liabilities arising from foreign business	7,721.5	8,910.2
Counterpart in respect of the valuation of the gold and dollar reserves provisionally contributed to the European Monetary Cooperation Fund 1	22,511.3	23,369.4
Counterpart of special drawing rights allocated	2,475.7	3,177.7
Provisions	3,136.0	3,866.0
Other liabilities	227.2	244.6
Deferred expenses and accrued income	669.3	993.1
Capital	290.0	290.0
Reserves	1,099.5	1,874.3
Unappropriated profit	3,076.5	13,144.9
Balance sheet total	185,720.3	198,087.7
Contingent liabilities	0.9	0.6

1 In 1980 relating to gold only.

Assets

Gold

The gold holding at December 31, 1981, at DM 13,687.5 million, was the same as at end-1980.

Reserve position in the International Monetary Fund and special drawing rights

Drawing rights within the reserve tranche

At December 31, 1981 the drawing rights within the reserve tranche in the IMF amounted to DM 3,120.2 million against DM 2,915.4 million at end-1980. Increases due to other members' Deutsche Mark drawings and transactions of similar effect equivalent to SDR 238.3 million and to the valuation adjustment at the end of the year were accompanied by decreases equivalent to SDR 216.2 million due to other members' Deutsche Mark repayments and transactions of similar effect. The level of drawing rights within the reserve tranche represents the difference between the German quota of SDR 3,234 million and the Deutsche Mark balances equivalent to SDR 2,045.1 million at the disposal of the IMF at the end of the year.

Loans under special borrowing arrangements

Loans under special borrowing arrangements amounted to DM 2,437.1 million at December 31, 1981 against DM 1,572.3 million at end-1980. The loans outstanding at the end of 1981 comprised a claim of SDR 582.9 million on the IMF under the General Arrangements to Borrow (GAB) arising from the financing of a Deutsche Mark drawing by the United States in 1978 and claims of SDR 345.7 million on the IMF arising from the financing of other members' drawings under the Supplementary Financing Facility; in the year under review the IMF was granted loans totalling SDR 299.3 million under this credit facility.

Special drawing rights

The amount of special drawing rights (SDRs) held at December 31, 1981 is shown at DM 3,628.5 million against DM 3,612.3 million at end-1980. It consisted of SDR 1,210.8 million of SDRs allocated and SDR 171.1 million of SDRs purchased. In the year under review the Bank received SDR 219.9 million from allocations, SDR 45.0 million from designations and SDR 123.4 million from interest payments and remuneration. The Bank paid out SDR 451.5 million in freely agreed transactions. As a result of the valuation adjustment at the end of the year, both the total holding and the counterpart of SDRs allocated (which is shown on the liabilities side) were written up.

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

This item comprises the Bank's ECU balances and the claims arising from the use of the "very short-term financing arrangement" by other central banks.

Balances in European Currency Units (ECUs)

The ECU balances amounting to DM 37,189.1 million arose from the provisional contribution of 20% of the Bundesbank's gold and dollar reserves to the European Monetary Cooperation Fund in the form of three-month swaps and from the reserve ECUs transferred to the Bundesbank by other central banks.

Other claims

Other claims totalling DM 2,751.1 million arose from the granting of loans to other central banks in connection with the very short-term financing of interventions.

Balances with foreign banks and money market investments abroad

The balances with foreign banks and money market investments abroad, the great bulk of which are denominated in U.S. dollars and bear interest, amounted to DM 37,245.6 million at December 31, 1981 against DM 42,597.9 million at December 31, 1980. The decrease was mainly attributable to interventions in the foreign exchange market.

Foreign exchange deals

The Bank's turnover in foreign exchange spot deals (foreign currency against Deutsche Mark) came to DM 63,584.1 million in the year under review against

DM 63,404.1 million in 1980. The number of deals rose to 6,596 compared with 6,178 in the preceding year. These deals consisted of

	1980		1981	
	Number	DM million	Number	DM million
Purchases	2,287	26,858.6	2,412	20,486.2
Sales	3,891	36,545.5	4,184	43,097.9
	6,178	63,404.1	6,596	63,584.1.

The number of cross deals (foreign currency against foreign currency) decreased slightly in the year under review, at 590 deals equivalent to DM 4,466.8 million against 620 deals equivalent to DM 4,547.0 million in 1980. By contrast, the number of SDR/U.S. dollar and SDR/Deutsche Mark deals rose to 68 equivalent to DM 1,310.8 million compared with 41 equivalent to DM 720.7 million in 1980. In addition, 142 U.S. dollar inter-centre switch transactions totalling US$ 34.6 million were concluded, against 172 transactions amounting to US$ 30.6 million in the preceding year.

17 forward purchases of U.S. dollars totalling US$ 600 million and 34 forward sales amounting to US$ 1,050 million were effected against 78 U.S. dollar sales totalling US$ 2,700.2 million in the previous year.

To regulate the money market the following short-term foreign exchange swaps and foreign exchange transactions under repurchase agreements were conducted with domestic banks:

	1980		1981	
	Number	DM million	Number	DM million
Foreign exchange swaps to increase liquidity	160	19,080.3	100	20,186.3
Foreign exchange swaps to reduce liquidity	23	4,704.8	1	237.2
Foreign exchange transactions under repurchase agreements to reduce liquidity	17	7,464.9	195	47,028.9.

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			of which	
	in foreign currency	in Deutsche Mark	Total	Processed by automated standing order procedure	Processed automatically via S.W.I.F.T. 1
1980	476,714	1,493,930	1,970,644	1,712,760	110,061
1981	459,727	1,546,075	2,005,802	1,752,600	145,934
	Incoming external payment orders			of which Payments received via S.W.I.F.T.	
1980	14,464	202,945	217,409	–	145,441
1981	14,205	204,221	218,426	–	153,890

1 S.W.I.F.T. (= Society for Worldwide Interbank Financial Telecommunication) is a Belgian society which transmits external payments messages by means of data telecommunication. The Deutsche Bundesbank is a member of the society and has been using the services provided by S.W.I.F.T. since the middle of 1978.

Sales of foreign cheques

During 1981 10,620 (1980: 9,435) foreign cheques payable to order totalling DM 788.7 million (1980: DM 617.8 million) were sold. In addition, the Bank sold 30,536 traveller's cheques amounting to DM 3.0 million against 38,916 traveller's cheques totalling DM 4.0 million in the preceding year.

Simplified collection procedure for foreign cheques

The number and amount of cheques received under the simplified collection procedure for foreign cheques continued to rise during the year under review. Further details are given in Appendix 3 of the German original of this Report.

Foreign commission business

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

	1980 Number	1981 Number
Bills, cheques, etc.	42,125	53,560
Foreign notes and coins	5,553	5,765
	47,678	59,325.

Foreign notes and coins

The amount of foreign notes and coins held at December 31, 1981, at DM 26.7 million, was DM 0.4 million larger than at December 31, 1980. During the year under review the Bank effected 21,151 purchases (1980: 22,007) and 39,907 sales (1980: 39,638) of foreign notes and coins.

External loans and other external assets

Loans in connection with EEC medium-term monetary assistance

No loans were granted under the EEC medium-term monetary assistance arrangement during the year under review, as during the previous year.

Claims arising from foreign exchange offset agreements with the United States

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

Other loans to foreign monetary authorities

In the year under review one loan was granted to a foreign monetary authority.

Loans to the World Bank

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

Foreign bills of exchange

At the end of 1981 the portfolio of foreign bills accumulated through purchases in Germany amounted to DM 5,367.4 million compared with DM 4,424.7 million at December 31, 1980. The share of Deutsche Mark bills in the total value of the foreign bills purchased in 1981 averaged about 90% (1980: 88%).

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

	1980		1981	
Land Central Bank	Number	DM million	Number	DM million
Baden-Württemberg	33,379	1,760.8	37,160	2,412.0
Bavaria	20,633	2,534.2	24,189	3,619.1
Berlin	1,337	1,632.9	1,388	1,837.2
Bremen	2,405	236.3	2,887	314.2
Hamburg	11,761	2,021.7	12,050	2,755.7
Hesse	21,127	4,958.3	21,701	5,895.7
Lower Saxony	3,890	396.6	4,575	563.7
North Rhine-Westphalia	30,901	4,441.9	35,262	6,117.9
Rhineland-Palatinate	6,810	595.0	7,885	770.0
Saarland	2,852	641.8	3,364	762.9
Schleswig-Holstein	1,266	209.3	1,339	281.7
Total	136,361	19,428.8	151,800	25,330.1

Domestic bills of exchange

The Bank's average portfolio of domestic bills on all return days, at DM 43,631 million, was again substantially larger than in the preceding year (DM 34,600 million). At the end of 1981 the Bank's portfolio of domestic bills came to DM 44,827.9 million against DM 39,257.5 million at end-1980. As in previous years, most of these bills were presented by banks within their rediscount quotas; more bills than in 1980 were likewise rediscounted under the rediscount lines of the Export Credit Company (Limit B) and the Industrial Plant Finance Company (Limit II).

The domestic bill portfolio comprised	Dec.31,1980 DM million	Dec.31,1981 DM million
Domestic bills discounted	36,330.4	41,974.7
Prime bankers' acceptances acquired in the course of open market operations	2,927.1	2,853.2
	39,257.5	44,827.9.

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

	1980		1981	
Land Central Bank	Thousands	DM million	Thousands	DM million
Baden-Württemberg	553	20,560.1	605	25,645.7
Bavaria	340	21,030.5	386	25,471.6
Berlin	29	4,771.4	26	5,566.3
Bremen	46	3,698.2	49	4,408.6
Hamburg	121	13,446.3	121	16,297.2
Hesse	334	32,710.9	356	39,703.9
Lower Saxony	159	9,938.7	175	13,017.0
North Rhine-Westphalia	584	40,226.4	621	47,486.9
Rhineland-Palatinate	95	4,780.6	101	5,914.5
Saarland	27	1,936.9	27	2,486.2
Schleswig-Holstein	46	3,101.7	49	3,997.9
Total	2,334	156,201.7	2,516	189,995.8

The average value of the bills purchased in the year under review was DM 75,500 compared with DM 66,900 in the preceding year.

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

	1980		1981	
	Number	DM million	Number	DM million
	6,996	93.0	10,289	153.0
as % of the total purchased	0.30	0.06	0.41	0.08.

Discount rate

During the year under review the Bank's discount rate for domestic and foreign bills remained unchanged. It has stood at 7½% since May 2, 1980.

Prime bankers' acceptances

The amount of prime bankers' acceptances which the Bank is prepared to purchase in the course of its open market operations remained unchanged in the year under review. In 1981 the Bank's buying rates for prime bankers' acceptances, which have been in effect since May 2, 1980, were slightly above the discount rate. They were thus at times substantially below the money market rates, with the result that sales of prime bankers' acceptances to the Bank continued to be a much-used source of central bank funds. The Bank's purchases of prime bankers' acceptances through Privatdiskont-Aktiengesellschaft came to DM 12,974.1 million and distinctly exceeded the 1980 figure (DM 10,776.8 million). There were no resales to the market via the broker in 1981.

The amount of prime bankers' acceptances that remained in the Bank's portfolio until payment on maturity, at DM 12,708.0 million, was therefore larger than in the previous year (DM 9,965.0 million). At December 31, 1981 the Bank held prime bankers' acceptances totalling DM 2,853.2 million (end-1980: DM 2,927.1 million).

Open market transactions in bills under repurchase agreements

In the year under review the Bank conducted no open market transactions in bills under repurchase agreements.

Securities bought in open market transactions under repurchase agreements

The Bank offered the banks, by tender, open market transactions in securities under repurchase agreements on eight occasions during the year under review. In such transactions the Bank bought bonds eligible as collateral for lombard loans on condition that the sellers repurchased them forward. The repurchase periods ranged between 28 and 50 days, and the interest rates between 9.0% and 12.5%. At the end of the year the Bank held DM 11,875.6 million of securities stemming from such transactions.

Lombard loans

At the end of 1981 the Bank's outstanding lombard loans and special lombard loans to banks amounted to DM 5,985.4 million against DM 7,707.8 million at end-1980. On all return dates of the year under review such loans averaged DM 3,528 million compared with DM 4,919 million in the previous year. The outstanding amount of such loans was subject to marked fluctuations, as in preceding years, and was largest in February, March and April. From February 20, 1981 onwards the Bank in principle granted no more lombard loans at the lombard rate for monetary policy reasons. Instead, it provided the banks with special lombard loans at a special lombard rate as and when appropriate.

Lombard rate and special lombard rate

During the year under review the lombard rate stood at 9%. The special lombard rate stood at 12% on February 25 and 26 and between March 3 and October 8, 1981, at 11% between October 9 and December 3, 1981, at 10½% between December 4, 1981 and January 21, 1982, at 10% between January 22 and March 18, 1982 and at 9½% as from March 19, 1982.

Cash advances (book credits)

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

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

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

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

Federal Government
Equalisation of Burdens Fund
Länder Governments

Cash advances (book credits) outstanding

DM million

Borrower	December 31, 1980	December 31, 1981
Federal Government	1,336.0	3,200.1
Länder Governments		
Bavaria	—	88.5
Berlin	128.5	157.6
Bremen	31.8	54.7
Hamburg	142.0	144.0
Hesse	156.2	192.1
Lower Saxony	131.1	187.1
North Rhine-Westphalia	401.2	561.4
Rhineland-Palatinate	20.3	19.4
Saarland	—	41.9
Schleswig-Holstein	89.6	97.8
Total	2,436.7	4,744.6

The Equalisation of Burdens Fund took up no cash advances during the year under review.

Federal Railways, Federal Post Office

No book credits to the Federal Railways or Federal Post Office were outstanding at December 31, 1981; such credits, together with claims arising from the purchase of Treasury bills and discountable Treasury bonds, are to be shown in the item "Loans to the Federal Railways and Federal Post Office" on the assets side of the balance sheet.

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

Treasury bills and discountable Treasury bonds

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

Federal Government

To meet the credit requirements of the Federal Government, discountable Treasury bonds amounting to DM 8,673.9 million (1980: DM 2,312.0 million) were issued; as usual, most of these securities (DM 6,115.3 million) were purchased by domestic banks. The total figure included DM 2,308.6 million (1980: DM 1,437.0 million) of Federal "financing bonds" — a special type of discountable Treasury bond which has been sold to non-banks by a standardised procedure since February 1975. These bonds have smaller denominations tailored to the needs of the general public, are not returnable prior to maturity and are mostly sold through banks, but partly also by the Bank or the Land Central Banks direct.

After the redemption of DM 3,937.7 million (1980: DM 4,535.1 million) of matured discountable Treasury bonds (including financing bonds), the amount of Federal Government discountable Treasury bonds types "B" and "BN" (the latter not being returnable before maturity) outstanding at December 31, 1981 came to DM 10,699.2 million (end-1980: DM 5,963.0 million). Of this total, DM 1,090.0 million (end-1980: DM 1,125.0 million) was repurchasable by the Bank (type "B").

Federal Railways

The (returnable) discountable Treasury bonds of the Federal Railways (type "Ba") which fell due in 1981, totalling DM 231.0 million, were reissued. The amount of Federal Railways discountable Treasury bonds (type "Ba") outstanding at end-1981 therefore came to DM 231.0 million (1980: also DM 231.0 million).

Federal Post Office

In the year under review the Federal Post Office issued no discountable Treasury bonds, so that no such bonds of the Federal Post Office were outstanding at the end of 1981.

At December 31, 1981 the outstanding amount of money market paper issued for the account of the Federal Government and its special funds came to DM 10,930.2 million (end-1980: DM 6,194.0 million). Further details are given in the following table.

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

DM million

Type of paper	1980 Outstanding at December 31	1981 Issued	Redeemed	Outstanding at December 31
Discountable Treasury bonds of the Federal Republic of Germany "B" 1 and "BN" 2	5,963.0	8,673.9	3,937.7	10,699.2
of which "Financing bonds"	(2,818.0)	(2,308.6)	(1,632.6)	(3,494.0)
Discountable Treasury bonds of the Federal Railways "Ba"	231.0	231.0	231.0	231.0
Total	6,194.0	8,904.9	4,168.7	10,930.2

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

Länder Governments

No money market paper was issued by the Länder Governments in 1981, so that no such securities were outstanding at the end of the year.

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

The Bank's equalisation claims on the Federal Government, as entered in the Federal Debt Register at December 31, 1980, increased insignificantly — by DM 144.20 — during the year under review in connection with the conversion of Berlin pre-capitulation balances. The equalisation claims arising from the Bank's own conversion account (DM 8,103.8 million) and the non-interest-bearing debt certificate in respect of Berlin (DM 547.2 million) remained unchanged, as in the preceding year.

Loans to the Federal Railways and Federal Post Office

No loans to the Federal Railways or Federal Post Office were outstanding at December 31, 1981, as in the previous year. See also the notes on the items "Cash advances (book credits)" and "Treasury bills and discountable Treasury bonds".

Securities

During the year under review the Bank's portfolio of securities — chiefly bonds of the Federal Republic of Germany, the Federal Railways and the Federal Post Office — fell slightly on balance, namely by DM 154.8 million to DM 3,732.3 million (end-1980: DM 3,887.1 million).

Issue of bonds

In 1981 eleven bond issues totalling DM 13,150 million (1980: eight issues amounting to DM 8,200 million) were launched through the Federal Bond Consortium, which is under the direction of the Bank. Of this total, DM 2,575 million (1980: DM 1,450 million) was reserved at the time of issue for the issuers' own institutions and for price regulation purposes.

At the end of 1981 the outstanding amount of bonds of the Federal Republic of Germany came to DM 44,499.3 million (end-1980: DM 41,708.4 million), that of the Federal Railways to DM 14,905.3 million (end-1980: DM 14,188.6 million) and that of the Federal Post Office to DM 8,825.8 million (end-1980: DM 7,790.4 million).

Bond issues of the Federal Republic of Germany, the Federal Railways and the Federal Post Office in 1981

Issuer	Amount issued (DM million)		Terms				Start of sales
	Total	of which Sold through Federal Bond Consortium	Nominal interest rate (%)	Maturity (years)	Issue price (%)	Yield (%)	
Federal Republic of Germany	1,500	1,200	9.00	10	100.25	8.96	Jan. 13
Federal Railways	850	725	9.00	10	100	9.00	Jan. 27
Federal Post Office	900	800	10.00	8	100.75	9.86	Feb. 16
Federal Republic of Germany	1,500	1,200	10.00	8	101.25	9.77	Mar. 27
Federal Post Office	900	750	10.25	8	99.50	10.35	May 14
Federal Republic of Germany	1,500	1,200	10.25	10	99.25	10.37	July 1
Federal Railways	900	750	10.50	10	100	10.50	Aug. 4
Federal Republic of Germany	1,600	1,200	10.75	10	99.25	10.88	Sep. 3
Federal Post Office	1,000	800	10.50	10	100.50	10.42	Oct. 6
Federal Railways	900	750	10.25	10	100.25	10.21	Oct. 26
Federal Republic of Germany	1,600	1,200	10.00	10	100.50	9.92	Nov. 12

Issue of Federal savings bonds

With the Bank assisting in the sales process, DM 4,998.8 million (gross) of Federal savings bonds were sold to private investors through banks and by the Bank itself in 1981 (1980: DM 6,393.8 million).

In the course of the year under review the rate of interest paid on Federal savings bonds was raised three times and lowered three times to bring it into line with market rates. Details are given in the following table.

Gross sales, interest rates and yields of Federal savings bonds in 1981

Issues	Sales period 1981	Gross sales (DM million) Total	Federal savings bonds A 1	Federal savings bonds B 2	Interest rate (I) in, and yield (Y) after, ... year after issue (% p. a.)	1st	2nd	3rd	4th	5th	6th	7th
1981/ 1+2	Jan. 2– Jan. 12	1,159.5	458.4		I	6.50	9.25	9.50	9.75	9.75	10.00	
					Y	6.50	7.82	8.34	8.64	8.83	8.98	
				701.1	I	6.50	9.25	9.50	9.75	9.75	10.00	10.00
					Y	6.50	7.87	8.41	8.74	8.94	9.12	9.24
1981/ 3+4	Jan. 22– Feb. 17	297.5	137.6		I	6.50	8.50	8.75	9.00	9.25	9.50	
					Y	6.50	7.46	7.86	8.11	8.30	8.46	
				159.9	I	6.50	8.50	8.75	9.00	9.25	9.50	9.50
					Y	6.50	7.50	7.91	8.18	8.40	8.58	8.71
1981/ 5+6	Feb. 23– May 5	1,069.0	421.1		I	6.75	9.75	9.75	10.00	10.00	10.00	
					Y	6.75	8.19	8.67	8.96	9.13	9.24	
				647.9	I	6.75	9.75	9.75	10.00	10.00	10.00	10.00
					Y	6.75	8.24	8.74	9.05	9.24	9.37	9.46
1981/ 7+8	May 11– July 27	923.5	313.5		I	7.00	10.00	10.00	10.25	10.75	11.00	
					Y	7.00	8.44	8.91	9.20	9.46	9.66	
				610.0	I	7.00	10.00	10.00	10.25	10.75	11.00	11.00
					Y	7.00	8.49	8.99	9.30	9.59	9.83	9.99
1981/ 9+10	July 31– Sep. 21	1,074.0	389.1		I	8.50	10.00	10.50	11.00	11.25	12.00	
					Y	8.50	9.22	9.61	9.90	10.12	10.36	
				684.9	I	8.50	10.00	10.50	11.00	11.25	12.00	12.00
					Y	8.50	9.25	9.66	10.00	10.25	10.54	10.74
1981/ 11+12	Oct. 6– Oct. 13	312.6	115.7		I	8.00	10.00	10.25	10.50	10.75	11.00	
					Y	8.00	8.96	9.35	9.60	9.79	9.94	
				196.9	I	8.00	10.00	10.25	10.50	10.75	11.00	11.00
					Y	8.00	9.00	9.41	9.68	9.90	10.08	10.21
1981/ 13+14	Oct. 15– Dec. 31*	162.7	55.3		I	7.00	8.50	8.75	9.25	9.50	10.00	
					Y	7.00	7.72	8.04	8.30	8.50	8.70	
				107.4	I	7.00	8.50	8.75	9.25	9.50	10.00	10.00
					Y	7.00	7.75	8.08	8.37	8.60	8.83	9.00
Total	Jan. 2– Dec. 31*	4,998.8	1,890.7	3,108.1								

1 With annual payment of interest. — **2** With accrual of interest. — * Sales not completed.

During 1981 DM 10,941.3 million (1980: DM 6,976.0 million) of Federal savings bonds from earlier tranches were returned to the issuer before maturity, and a further DM 4,298.8 million were redeemed on maturity. Because repurchases and redemptions by the issuer exceeded new sales, the amount of Federal savings bonds outstanding declined from DM 24,082.7 million at end-1980 to DM 13,841.4 million at December 31, 1981.

Issue of Federal bonds

With the assistance of the Bank, sales of Federal bonds (which were introduced as a tap issue in December 1979) through banks and by the Bank itself continued to rise in the year under review.

Federal bonds — which have maturities of five years — are sold in consecutive series, before admission to stock exchange dealing, only to domestic natural persons and institutions serving publicly beneficial, charitable or religious purposes. In the year under review, DM 10,625.8 million of newly issued Federal bonds were sold in the market (1980: DM 7,520.6 million). In addition, after the completion of the issue of the current series, DM 1,198.1 million was reserved for price and market regulation purposes. During the year under review the terms of issue of Federal bonds were brought into line with market conditions on 37 occasions. Details of the various series are given in the following table.

Sales and terms of issue of Federal bonds in 1981

Designation Series	Start of sales	Terms (%)			Amount issued (DM million)				Date of admission to stock exchange dealing
		Nominal interest rate	Issue price	Yield	Sales: per issue price	Sales: Total	Price regulation share	Total	
S. 10 of 1980 (1986)	Jan. 2 [1]	8.75	98.40	9.16	39.1	[2] 39.1	66.8	200	Jan. 15
S. 11 of 1981 (1986)	Jan. 6	9.00	99.20	9.21	1,358.1				
	Jan. 8		100.00	9.00	550.2				
	Jan. 13		100.40	8.90	387.9				
	Feb. 4		99.60	9.10	81.4	2,377.6	122.4	2,500	Mar. 4
S. 12 of 1981 (1986)	Feb. 18	9.75	99.80	9.80	121.7	121.7	78.3	200	Mar. 10
S. 13 of 1981 (1986)	Feb. 27	10.00	99.20	10.21	821.0				
	Mar. 13		100.00	10.00	1,086.0				
	Mar. 20		100.80	9.79	78.5	1,985.5	214.5	2,200	Apr. 14
S. 14 of 1981 (1986)	Mar. 23	9.50	99.80	9.55	72.0	72.0	48.0	120	Apr. 21
S. 15 of 1981 (1986)	Apr. 3	10.00	100.00	10.00	501.9				
	Apr. 27		99.00	10.27	278.8				
	May 15		98.00	10.54	33.1	813.8	86.2	900	June 2
S. 16 of 1981 (1986)	May 21	10.50	99.20	10.71	45.9				
	May 29		97.60	11.15	738.1				
	June 16		98.60	10.88	90.4				
	June 18		100.00	10.50	264.0				
	July 13		98.00	11.04	141.4	1,279.8	120.2	1,400	Aug. 6
S. 17 of 1981 (1986)	July 28	11.00	99.20	11.22	463.9				
	Aug. 27		98.20	11.49	473.9				
	Sep. 17		99.40	11.16	146.1				
	Sep. 21		100.00	11.00	258.4				
	Sep. 22		100.60	10.84	71.8	1,414.1	85.9	1,500	Oct. 5
S. 18 of 1981 (1986)	Sep. 23	10.50	99.80	10.55	49.8				
	Sep. 30		99.00	10.77	693.0				
	Oct. 7		100.60	10.34	43.7	786.5	113.5	900	Oct. 20
S. 19 of 1981 (1986)	Oct. 8	10.00	99.60	10.11	264.2				
	Oct. 12		100.80	9.79	43.2	307.4	92.6	400	Oct. 26
S. 20 of 1981 (1986)	Oct. 14	9.50	100.00	9.50	18.0				
	Oct. 27		97.80	10.08	7.5	25.5	74.5	100	Nov. 10
S. 21 of 1981 (1986)	Oct. 30	10.25	99.60	10.36	404.7				
	Nov. 4		100.40	10.14	120.1	524.8	25.2	550	Nov. 23
S. 22 of 1981 (1986)	Nov. 6	10.00	100.00	10.00	54.3				
	Nov. 9		100.80	9.79	225.7	280.0	70.0	350	Nov. 27
S. 23 of 1981 (1986)	Nov. 16	9.50	100.00	9.50	384.9				
	Dec. 4		100.40	9.40	92.2				
	Dec. 9		100.80	9.29	60.1				
	Dec. 21		99.80	9.55	60.8	598.0	[3] –	[3] –	–

1 Start of sales on December 11, 1980. — 2 Sales between December 11, 1980 and December 31, 1980 = DM 94.1 million. — 3 Sales not completed on December 31, 1981.

At the end of 1981 the amount of Federal bonds outstanding came to DM 20,649.4 million (end-1980: DM 8,978.6 million).

Issue of medium-term notes

Through the agency of the Bank, DM 1,238.2 million of Treasury bonds (medium-term notes) of the Federal Government and the Federal Post Office were sold by tender in two issues in 1981 (1980: DM 3,858.0 million in four issues). The terms of these two issues are shown in the following table. One issue of medium-term notes of the Federal Railways in May 1981 was not allotted.

Treasury bonds (medium-term notes) of the Federal Republic of Germany and the Federal Post Office sold by tender in 1981

Issuer	Amount sold (DM million)	Nominal interest rate (%)	Maturity (years)	Selling price (%)	Yield on issue (%)	Month of sale
Federal Republic of Germany	1,022.0	11½	4	100	11.50	September
Federal Post Office	216.1	9¾	4	97.70	10.48	October

At the end of 1981 the outstanding amount of medium-term notes of the Federal Republic of Germany came to DM 11,402.1 million (end-1980: DM 18,199.2 million), that of the Federal Railways to DM 1,033.4 million (end-1980: also DM 1,033.4 million) and that of the Federal Post Office to DM 1,159.9 million (end-1980: DM 943.7 million).

Admission to stock exchange dealing

The Bank introduced the new bond issues of the Federal Republic of Germany, the Federal Railways, the Federal Post Office and the Reconstruction Loan Corporation, as well as the Federal bond series 10 to 22, to official dealing on all German stock exchanges.

The Bank also introduced the new issues of medium-term notes of the Federal Republic of Germany, the Federal Post Office and the Reconstruction Loan Corporation to regulated unofficial dealing on the Frankfurt stock exchange.

Price regulation operations

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

The Bank as paying and collecting agent for bonds

As the paying and collecting agent for, in particular, bonds (including external bonds) of the Federal Government and its special funds, the Bank paid 2,456,670 interest coupons and matured bonds in the year under review (1980: 4,486,898).

German coins

The amount of German coins held by the Bank came to DM 913.6 million at end-1981 (end-1980: DM 728.6 million). In 1981 the Federal Government was credited with DM 552.0 million for coins taken over from the Mints and debited with DM 11.5 million for coins no longer fit for circulation or melted down. In all, between 1948 and 1981 the Bank — acting for the account of the Federal Government — took over coins amounting to DM 10,385.4 million and redeemed DM 1,655.2 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 1981 (DM 7,816.6 million) divided by the number of inhabitants of the Federal Republic of Germany, including the Land of Berlin, on September 30, 1981 (61.7 million) yields a coin circulation of DM 126.69 per head of population (1980: DM 120.92).

In the year under review the DM 5 commemorative coins "Gotthold Ephraim Lessing" and "Carl Reichsfreiherr vom und zum Stein" were put into circulation.

Balances on postal giro accounts

The postal giro account balances, including the branches' transfers in transit to the postal giro account of the Bank (Central Office) in Frankfurt am Main, amounted to DM 327.8 million at December 31, 1981 (1980: DM 322.8 million). The Bank's credit balances on the latter account and on the postal giro account of the Land Central Bank in Berlin, other than those required for current payments, are offset daily, in rounded amounts, against the giro balances of the Central Cash Office of the Federal Post Office and the Berlin (West) Postal Giro Office.

Postal giro transactions with third parties

	1980				1981			
	Transfers received from third parties		Transfers made to third parties		Transfers received from third parties		Transfers made to third parties	
Area	Number	DM million	Number	DM million	Number	DM million	Number	DM million
Land Central Bank								
Baden-Württemberg	56,650	17,151.7	14,927	2,224.3	62,138	17,806.0	11,260	2,314.0
Bavaria	52,344	12,353.0	13,842	6,752.5	51,504	13,314.9	7,772	6,665.9
Berlin	19,973	2,657.5	2,846	977.7	17,397	2,946.5	2,252	790.5
Bremen	5,370	380.5	2,190	0.2	4,954	387.9	479	0.1
Hamburg	70,679	17,965.9	1,735	126.4	108,880	18,045.4	1,090	142.5
Hesse	50,027	6,847.8	7,709	6,526.6	77,635	8,127.3	4,470	7,352.9
Lower Saxony	46,385	6,547.1	6,185	1,975.3	49,871	7,704.5	3,527	2,106.2
North Rhine-Westphalia	111,657	19,881.8	30,237	7,030.5	130,474	21,433.2	14,127	6,636.1
Rhineland-Palatinate	23,281	1,577.4	9,977	995.8	18,417	1,422.8	5,857	1,029.2
Saarland	5,847	1,837.0	406	1.1	5,828	1,885.9	214	0.1
Schleswig-Holstein	3,525	73.6	4,333	1.0	4,106	54.4	1,341	0.5
Total	445,738	87,273.3	94,387	26,611.4	531,204	93,128.8	52,389	27,038.0
Bundesbank — Central Office —	28,515	1,700.9	1,211	8.2	9,365	1,674.0	1,117	3.4
Grand total	474,253	88,974.2	95,598	26,619.6	540,569	94,802.8	53,506	27,041.4

Other claims

Other claims are shown at DM 799.5 million (end-1980: DM 985.3 million). They include the balance arising from intra-German settlements (commercial payments under the "Berlin Agreement"), which amounted to DM 582.6 million (1980: DM 813.7 million). The turnover on the relevant sub-accounts is shown in Part A IV of the German original of this Report.

Land and buildings

After additions amounting to DM 240.1 million and depreciation totalling DM 96.5 million, land and buildings are shown at DM 1,185.3 million.

Furniture and equipment

The balance sheet value of furniture and equipment comes to DM 90.2 million after additions totalling DM 48.9 million and depreciation amounting to DM 40.4 million.

Items in course of settlement

The "Items in course of settlement" mainly comprise the intercity credit and debit transfers proceeding inside the Bank at the end of the year and the cheques and direct debits being cleared. At December 31, 1981 the balance of items in course of settlement stood at DM 3,938.7 million against DM 8,379.4 million at end-1980.

Other assets

The "Other assets" are shown at DM 1,907.9 million (end-1980: DM 1,432.7 million). As in the previous year, much the greater part of this sum consisted of interest due in 1982 but assignable to the profit and loss account for the year under review on funds invested abroad and securities (DM 1,800.0 million against DM 1,328.9 million at end-1980).

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

Prepaid expenses and deferred income

The prepaid expenses and deferred income almost entirely comprise salary and pension payments made in the year under review but relating to 1982.

Banknotes in circulation

The amount of banknotes in circulation at December 31, 1981, at DM 83,790.3 million, was DM 60 million larger than at end-1980.

Currency in circulation

DM million

End of	Bundesbank notes	Federal coins	Currency in circulation, total
1976	59,038.3	5,699.8	64,738.1
1977	65,567.4	6,097.6	71,665.0
1978	74,799.1	6,577.5	81,376.6
1979	79,385.6	6,988.7	86,374.3
1980	83,730.3	7,461.0	91,191.3
1981	83,790.3	7,816.6	91,606.9

The denominations of the Bundesbank notes and Federal coins in circulation are shown in Appendix 3 to the German original of this Report.

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

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

	1976	1977	1978	1979	1980	1981
Number (millions)	486.4	459.1	560.9	505.9	466.4	662.3
Value (DM million)	18,556.5	18,086.2	22,682.1	20,829.6	18,495.1	28,793.9.

The number and value of the counterfeit Bundesbank notes and Federal coins detained in payments in the Federal Republic of Germany and Berlin (West) went up compared with the preceding year.

The steep rise in the number of counterfeit Federal coins detected was primarily due to an increase in the number of counterfeit DM 1 coins.

Counterfeits detected in payments

	Bundesbank notes		Federal coins	
Year	Number	DM thousand	Number	DM thousand
1976	2,709	275.0	8,249	31.0
1977	9,754	946.0	6,754	25.7
1978	6,341	586.4	9,835	35.5
1979	3,388	296.6	7,405	24.3
1980	2,421	183.4	9,428	25.1
1981	2,896	219.1	17,172	34.3

Deposits of banks

The banks' deposits on giro accounts mainly comprise the minimum reserves to be held at the Bank. The sub-item "Other" contains the deposits of domestic banks on U.S. dollar accounts. At the end of the year, compared with end-1980, the deposits were made up as follows:

	Dec. 31, 1980 DM million	Dec. 31, 1981 DM million
Deposits on giro accounts	53,809.2	50,583.8
Other	35.4	25.0
	53,844.6	50,608.8.

Deposits of public authorities

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

	Dec. 31, 1980 DM million	Dec. 31, 1981 DM million
Federal Government	396.3	293.2
Equalisation of Burdens Fund and ERP Special Fund	124.2	43.0
Länder Governments	450.2	391.7
Other public depositors	44.6	38.7
	1,015.3	766.6.

Deposits of other domestic depositors

The deposits of other domestic depositors were composed as follows:

	Dec. 31, 1980 DM million	Dec. 31, 1981 DM million
Federal Railways	8.1	6.2
Federal Post Office (including postal giro and postal savings bank offices)	1,141.3	1,512.1
Other depositors	581.8	628.4
	1,731.2	2,146.7.

Giro transactions, simplified cheque and direct debit collections

With respect to the turnover on giro accounts, 99.9 % of the number of transactions and 98.6 % of the amount involved were settled on a cashless basis, as in the previous year.

Annual turnover on the giro accounts of the Bank

Type of turnover	1980 Number of transactions (Thousands)	1980 Total amount (DM million)	1980 Average amount (DM thousand)	1981 Number of transactions (Thousands)	1981 Total amount (DM million)	1981 Average amount (DM thousand)
(a) Credits						
Cash payments	1,043	202,260	193.9	1,080	212,783	197.0
Clearings with account-holders	4,540	4,193,188	923.6	4,336	4,481,638	1,033.6
Local transfers	29,012	4,094,463	141.1	27,307	4,553,872	166.8
Intercity transfers	227,346	4,068,725	17.9	270,736	4,657,892	17.2
Cheque and direct debit collections (total presented)	873,027	1,776,858	2.0	1,023,578	1,924,742	1.9
Total	1,134,968	14,335,494	–	1,327,037	15,830,927	–
(b) Debits						
Cash payments	1,521	209,673	137.9	1,526	215,834	141.4
Clearings with account-holders	3,272	4,074,040	1,245.1	3,233	4,327,694	1,338.6
Local transfers	29,012	4,094,463	141.1	27,307	4,553,872	166.8
Intercity transfers	229,778	4,193,241	18.2	271,356	4,806,700	17.7
Cheque and direct debit collections (total paid)	870,837	1,782,683	2.0	1,019,432	1,923,063	1.9
Total	1,134,420	14,354,100	–	1,322,854	15,827,163	–
(c) Percentage of total turnover (credits and debits)		%			%	
Cash payments		1.43			1.35	
Clearings with account-holders		28.82			27.83	
Local transfers		28.54			28.77	
Intercity transfers		28.80			29.90	
Cheque and direct debit collections (total presented and paid)		12.41			12.15	
		100.00			100.00	

In 1981 the turnover on the giro accounts of the Bank increased over the previous year by 17 % in terms of the number of transactions and by 10 % in terms of the amount involved. The number of intercity transfers again rose at an above-average rate, namely by 19 % (1980: 20 %). The number of items presented by the banks under the simplified collection procedure for cheques and direct debits went up by 17 % (1980: 13 %). By contrast, the number of local transfers declined by 7 % and that of clearing transactions by just under 8 %.

In the year under review 98 % of the 498 million vouchers presented for collection and 96 % of the 169 million paper-based credit transfers (roughly the same proportion as in 1980), as well as 525 million direct debits (1980: 389 million) and 102 million credit transfers (1980: 98 million) recorded on magnetic tape, were processed by the Bank's computer centres. The volume of payments executed through the paperless exchange of data media was about 29 % larger than in the preceding year. Such payments thus accounted for 49 % (1980: 45 %) of the payment items presented under the automated procedure. In the aggregate, 99 % of intercity transfers — paper-based as well as paperless — were processed automatically in the year under review. The development of the automation of intercity transfers since 1973 is shown in the following table.

Automation of intercity transfers

	Collection orders presented							Intercity credit transfers presented						
		processed							processed					
		in paper-based operations				through the paperless exchange of data media			in paper-based operations				through the paperless exchange of data media	
	Total	conventional		automated				Total	conventional		automated			
Year	millions	millions	%	millions	%	millions	%	millions	millions	%	millions	%	millions	%
1973	317	175	55	142	45	–	–	113	113	100	–	–	–	–
1974	374	142	38	232	62	0.2	0	123	75	61	48	39	0.1	0
1975	423	143	34	272	64	8	2	163	85	52	73	45	5	3
1976	501	83	17	313	62	105	21	174	62	36	83	48	29	16
1977	587	47	8	359	61	181	31	169	36	21	87	51	46	28
1978	694	31	5	412	59	251	36	183	26	14	89	49	68	37
1979	775	15	2	441	57	319	41	192	13	7	95	49	84	44
1980	873	11	1	473	54	389	45	230	7	3	125	54	98	43
1981	1,023	8	1	490	48	525	51	271	7	2	162	60	102	38

If local payments and clearing transactions — which, apart from local credit transfers in Hamburg, are not yet processed automatically — are also taken into account, approximately 78 % of cashless payments at the Bank are automated. It should be borne in mind in this connection that magnetic tapes containing payments are increasingly being exchanged locally between banks in clearing transactions, although only the total amounts are being cleared by this (conventional) procedure.

As a result of the progressive automation, the concentration of the incoming payment items continued in 1981. Since 1973 the number of items entered in intercity payments has fallen from 166 million to 31.5 million on the dispatch side, in spite of the simultaneous rise in the number of payments from 430 million to 1,294 million.

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, at DM 67,916.7 million, went up strongly against the preceding year (DM 26,395.8 million); this increase was entirely attributable to sales of Treasury bills.

The Bank made greater use of mobilisation and liquidity Treasury bills to absorb the banks' liquidity surpluses for a few days at a time, by selling such bills to interested banks during several periods of 1981. The turnover in the revolving investment of funds of foreign institutions was also substantial. In the aggregate, sales amounting to DM 67,857.9 million (1980: DM 26,345.1 million) were accompanied by redemptions totalling DM 67,145.7 million (1980: DM 25,728.2 million), so that the amount outstanding rose to DM 4,859.1 million (end-1980: DM 4,146.9 million).

The Bank sold only DM 58.8 million of mobilisation and liquidity Treasury bonds — much as in 1980 (DM 50.7 million) — while DM 57.8 million was redeemed, so that the outstanding amount of such bonds came to DM 46.0 million at December 31, 1981 (end-1980: DM 45.0 million).

The liabilities arising from mobilisation and liquidity paper outstanding amounted in all to DM 4,905.1 million at December 31, 1981 (end-1980: DM 4,191.9 million).

Mobilisation and liquidity paper sold and redeemed

DM million

Type of paper	1980 Outstanding at December 31	1981 Sold	Redeemed	Outstanding at December 31
Treasury bills (running for up to 90 days)	4,146.9	67,857.9	67,145.7	4,859.1
Discountable Treasury bonds (running for 6 to 24 months)	45.0	58.8	57.8	46.0
Total	4,191.9	67,916.7	67,203.5	4,905.1

Liabilities arising from foreign business

The liabilities arising from foreign business went up to DM 8,910.2 million compared with DM 7,721.5 million at end-1980. This increase was chiefly ascribable to the growth of the deposits of foreign central banks. Specifically, the liabilities arising from foreign business were made up as follows:

	Dec. 31, 1980		Dec. 31, 1981	
	DM million	DM million	DM million	DM million
Deposits of foreign depositors				
Banks	7,071.9		8,245.6	
Other depositors	592.4	7,664.3	568.6	8,814.2
Other				
Provision of cover for credits, etc.	49.5		9.8	
Miscellaneous liabilities	7.7	57.2	86.2	96.0
		7,721.5		8,910.2.

Counterpart in respect of the valuation of the gold and dollar reserves provisionally contributed to the European Monetary Cooperation Fund

In connection with the European Monetary System (EMS) the Bank provisionally contributed 20% of its gold and dollar reserves to the European Monetary Cooperation Fund (EMCF) against ECUs at a value based on market prices and therefore higher than that used in the balance sheet. During the transitional period of the EMS the resultant difference in value — and at end-1981 (for the first time) also the amount accounted for by the dollar reserves, for which a provision was made in 1980 — is shown in this item.

Counterpart of special drawing rights allocated

The counterpart of the special drawing rights allocated by the International Monetary Fund and shown on the assets side of the balance sheet in sub-item 2.3 corresponds to the allocations of SDRs to the Federal Republic of Germany between 1970 and 1972 and from 1979 to 1981, which totalled SDR 1,210.8 million.

Provisions

Provisions for pensions

DM 131.0 million was withdrawn from the provisions for pensions in order to pay retirement pensions and widows' and orphans' benefits. After an increase of DM 201.0 million, these provisions amounted to DM 1,976.0 million at December 31, 1981 against DM 1,906.0 million at end-1980.

Provisions for other purposes

The provisions for other purposes were increased by DM 1,590 million. The provision of DM 930 million made at end-1980 for the dollar reserves provisionally contributed to the EMCF in the form of three-month swaps was deducted in the year under review. At end-1981 the provisions for other purposes thus totalled DM 1,890 million (end-1980: DM 1,230 million). They serve to cover risks arising from forward commitments and to meet the general hazards inherent in domestic and foreign business.

Other liabilities

The other liabilities are shown at DM 244.6 million against DM 227.2 million at end-1980.

Deferred expenses and accrued income

Deferred expenses and accrued income amounted to DM 993.1 million at December 31, 1981 (end-1980: DM 669.3 million). As before, this item mainly comprised interest received in the year under review, but relating to the following year, on domestic and foreign bills and U.S. Treasury Notes.

Capital

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

Reserves

In accordance with a decision taken by the Central Bank Council on April 23, 1981, the legal reserves were increased by DM 615.3 million and the other reserves by DM 159.5 million out of the unappropriated profit for 1980; as a result the legal reserves rose to DM 1,584.3 million and the other reserves to DM 290 million, the maximum amount permissible by law.

Contingent liabilities and claims

The contingent liabilities and claims amounted to DM 0.6 million against DM 0.9 million at end-1980.

Profit and loss account

Comparison of expenditure and receipts

DM million

Expenditure	1980	1981	Receipts	1980	1981
Interest paid on foreign exchange transactions under repurchase agreements and swaps with domestic banks			Interest received		
			Funds invested abroad	5,849.6	7,566.8
	103.3	172.4	Lending to domestic banks	3,360.9	4,462.6
Interest paid on mobilisation			Equalisation claims	244.1	244.1
and liquidity paper	146.5	477.4	Securities	167.1	333.7
Other interest paid	9.9	9.8	Cash advances (book credits)	158.0	215.1
	259.7	659.6	Other interest received	4.9	4.1
Administrative expenditure				9,784.6	12,826.4
Staff costs	634.9	676.9	Fees received	13.9	16.4
Other	131.5	144.5	Receipts from purchases and		
Note printing	164.7	138.5	sales of foreign currencies	1,656.1	3,945.0
Depreciation	90.6	136.9	Other receipts	49.9	55.5
Increases in provisions					
For pensions	306.7	201.0			
For other purposes	930.0	1,590.0			
Pension payments in respect of the Reichsbank	33.8	32.5			
Other expenditure	116.3	118.6			
Profit for the year	8,836.3	13,144.8			
Total	11,504.5	16,843.3	Total	11,504.5	16,843.3

Appendix	1980	1981
Profit for the year	8,836.3	13,144.8
less		
Balancing item in respect of the valuation adjustment of the monetary reserves and other foreign currency positions carried forward from the previous year — loss carried forward —	5,759.8	—
Unappropriated profit	3,076.5	13,144.8

Receipts

Interest

	1980 DM million	1981 DM million
Interest received amounted to	9,784.6	12,826.4;
after deduction of interest paid, namely	259.7	659.6,
interest is shown in the profit and loss account at	9,524.9	12,166.8.

In the year under review total interest income, at DM 12,826.4 million, was DM 3,041.8 million larger than a year before. The interest received from funds invested abroad rose from DM 5,849.6 million to DM 7,566.8 million even though the level of such investments fell. In addition to the high interest rates in the United States, this owed something to the fact that the depreciation of the Deutsche Mark led to an increase in the Deutsche Mark equivalent of the interest income paid in dollars. Receipts from lending to domestic banks — domestic bills, security transactions under repurchase agreements, lombard loans and foreign bills bought in Germany — went up by DM 1,101.7 million to DM 4,462.6 million as the volume of such lending expanded and interest rates rose. The interest received from securities increased by DM 166.6 million to DM 333.7 million, the average security portfolio during the year under review being almost twice as large as in the previous year. The interest accruing from equalisation claims remained unchanged at DM 244.1 million. Other interest income went up from DM 162.9 million to DM 219.2 million, chiefly owing to a rise in the interest received from cash advances.

The interest paid, at DM 659.6 million, increased by DM 399.9 million over the preceding year. DM 172.4 million (1980: DM 103.3 million) was spent on foreign exchange transactions under repurchase agreements and swaps; DM 477.4 million (1980: DM 146.5 million) was paid on Treasury bills and discountable Treasury bonds of the Federal Government (mobilisation and liquidity paper pursuant to sections 42 and 42(a) of the Bundesbank Act).

Fees

Fees totalling DM 16.4 million were received in the year under review (1980: DM 13.9 million).

Receipts from purchases and sales of foreign currencies

Receipts in connection with interventions in the foreign exchange market amounted to DM 3,945.0 million in the year under review.

Other receipts

The other receipts are shown at DM 55.5 million against DM 49.9 million in the preceding year.

Expenditure

Administrative expenditure
Staff costs

Administrative expenditure on personnel grew by DM 42.0 million compared with the previous year to DM 676.9 million. This was mainly attributable to statutory or negotiated pay rate increases for established employees ("officials") and unestablished wage and salary earners as well as to the rise in the Bank's staff during the year under review.

The increase in the Bank's staff since the beginning of 1978 (1978: by 451; 1979: by 750; 1980: by 417) slowed down further in 1981. The number of employees rose by 277 (= 1.9%) to 15,102. This growth was due in the main to the recruitment of trainees and other junior staff in the clerical service (about 230 officials and salary earners in all).

On January 1, 1982 the Bank had 13,733 full-time employees. In accordance with a decision taken by the Central Bank Council on December 17, 1981, this number is to be reduced by 136 by the end of 1982 (or in 1983 at the latest) by taking advantage of natural wastage and turnover. This reduction of about 1 % is in keeping with the staff cut approved for the Federal authorities, inter alia under the Second Budget Structure Act.

Payments to serving members of the Directorate of the Bank and the Central Bank Council amounted to DM 6,866,286.99 in the year under review. Former members of these bodies and of the Board of Directors and Board of Managers of the Bank deutscher Länder and the Managing Boards of the Land Central Banks, including their surviving dependants, received payments totalling DM 6,967,239.54.

Changes in staff regulations

On February 19, 1981 the Central Bank Council approved the principles governing promotion to the money-handling and office service (clerical service) and to the executive service; such promotion is provided for in the career regulations of the Bank for long-serving officials who perform special duties.

In 1981 the Bank again concluded a number of pay agreements, thereby bringing the legal situation of its wage and salary earners into line with that of the wage and salary earners of the Federal Government. In addition, it concluded an Agreement Amending and Supplementing the Pay Scale (Appendix 1 to the Pay Agreement for Unestablished Salary Earners of the Deutsche Bundesbank) for its salary earners on August 11, 1981, with retroactive effect from December 1, 1980. This Agreement primarily contains adjustments of the job characteristics to the changed situation arising from the automation of payments.

Staff of the Bank

	Beginning of 1981					Beginning of 1982				
				of whom					of whom	
	Central Office	Land Central Banks	Total 1	male	female	Central Office	Land Central Banks	Total 1	male	female
Officials	854	5,198	6,052	5,663	389	871	5,329	6,200	5,770	430
Salary earners	1,626	6,072	7,698	3,573	4,125	1,613	6,208	7,821	3,647	4,174
Wage earners	225	850	1,075	197	878	229	852	1,081	200	881
Total	2,705	12,120	14,825	9,433	5,392	2,713	12,389	15,102	9,617	5,485

1 of whom

	1981	1982
(a) Salaried staff working outside the Bank or released to work for international institutions	66	70
(b) Trainees	505	616
(c) Part-time staff		
Salaried staff	433	458
Wage earners	750	749

Other

Other (non-staff) administrative expenditure increased by DM 13.0 million to DM 144.5 million in the year under review.

Note printing

Expenditure on note printing amounted to DM 138.5 million against DM 164.7 million in the previous year.

Depreciation and increases in provisions

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

Pension payments in respect of the Reichsbank

Payments to members of the former Deutsche Reichsbank and other persons to whom the Act concerning Section 131 of the Basic Law applies, for whom the Bank is required to provide in accordance with section 41 of the Bundesbank Act, at DM 32.5 million, declined slightly in the year under review.

Other expenditure

Other expenditure rose by DM 2.3 million to DM 118.6 million in 1981.

Profit for the year

Unappropriated profit

The profit and loss account for 1981 shows a profit for the year of which is shown in the balance sheet as unappropriated profit (net profit).		DM 13,144,845,416.30;

Proposed distribution of profit

In accordance with section 27 of the Bundesbank Act, the Directorate proposes to the Central Bank Council that the following appropriations should be made:	DM	
to the legal reserves	2,605,200,000.00	
to the Fund for the Purchase of Equalisation Claims	30,000,000.00	2,635,200,000.00.
The balance of		10,509,645,416.30
will be transferred to the Federal Government.		

After this appropriation, the legal reserves will amount to DM 4,189,500,000.00; they will thus reach the statutory ceiling of 5% of the volume of banknotes in circulation, which totalled DM 83,790,297,370.00 at end-1981. The other reserves reached the statutory ceiling of DM 290,000,000.00 at the end of 1980.

Frankfurt am Main, April 1982

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

Part D: Report of the Central Bank Council

The annual accounts of the Deutsche Bundesbank for 1981 and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1981 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 1981 and the bookkeeping as shown by the books at December 31, 1981 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 1981 on April 22, 1982. At the same time it approved the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1981.

Since the publication of the Report for the Year 1980 the following changes have taken place in the Central Bank Council and the Directorate of the Deutsche Bundesbank:

Retired

as at the close of June 15, 1981
the President of the Land Central Bank in Saarland
Dr. Paul Schütz,

as at the close of December 31, 1981
the Vice-President of the Land Central Bank in Schleswig-Holstein
Erich Lange.

Reappointed

with effect from May 1, 1981
Dr. Johann Baptist Schöllhorn
President of the Land Central Bank in Schleswig-Holstein,

with effect from February 21, 1982
Dr. Alfred Härtl
President of the Land Central Bank in Hesse.

Appointed

with effect from June 16, 1981
Hans Gliem
to be President of the Land Central Bank in Saarland,

with effect from January 1, 1982
Helmuth Homp
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 Managing Boards of the Land Central Banks, expresses to the entire staff of the Deutsche Bundesbank its thanks for their loyal and understanding cooperation during 1981. The Council also wishes to record its appreciation of the excellent collaboration with the staff representative committees.

Frankfurt am Main, April 1982

Karl Otto Pöhl
President of the Deutsche Bundesbank

Appendix
to Part B

Balance sheet of the Deutsche Bundesbank as at December 31, 1981

Assets

	DM	DM
1 Gold		13,687,518,821.70
2 Reserve position in the International Monetary Fund and special drawing rights		
2.1 Drawing rights within the reserve tranche	3,120,214,529.36	
2.2 Loans under special borrowing arrangements	2,437,121,554.93	
2.3 Special drawing rights	3,628,476,051.53	9,185,812,135.82
3 Claims on the European Monetary Cooperation Fund in connection with the European Monetary System		
3.1. Balances in European Currency Units (ECUs)	37,189,096,100.83	
3.2 Other claims	2,751,077,567.65	39,940,173,668.48
4 Balances with foreign banks and money market investments abroad		37,245,634,483.02
5 Foreign notes and coins		26,666,835.55
6 External loans and other external assets		
6.1 Loans in connection with EEC medium-term monetary assistance	–	
6.2 Claims arising from foreign exchange offset agreements with the United States	415,975,492.30	
6.3 Other loans to foreign monetary authorities	685,894,938.60	
6.4 Loans to the World Bank	2,485,691,718.75	3,587,562,149.65
7 Foreign bills of exchange		5,367,371,784.05
8 Domestic bills of exchange		44,827,933,374.96
9 Securities bought in open market transactions under repurchase agreements		11,875,619,277.25
10 Lombard loans		5,985,428,600.–
11 Cash advances (book credits)		
11.1 Federal Government	3,200,100,000.–	
11.2 Equalisation of Burdens Fund	–	
11.3 Länder Governments	1,544,514,143.–	4,744,614,143.–
12 Treasury bills and discountable Treasury bonds		
12.1 Federal Government	–	
12.2 Länder Governments	–	–
13 Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin		8,683,585,988.93
14 Loans to the Federal Railways and Federal Post Office		
14.1 Cash advances (book credits)	–	
14.2 Treasury bills and discountable Treasury bonds	–	–
15 Securities		3,732,338,456.86
16 German coins		913,568,586.25
17 Balances on postal giro accounts		327,763,765.81
18 Other claims		799,530,453.26
19 Land and buildings		1,185,268,350.16
20 Furniture and equipment		90,246,647.–
21 Items in course of settlement		3,938,721,525.86
22 Other assets		1,907,911,937.48
23 Prepaid expenses and deferred income		34,447,571.43
Rights of recourse in respect of contingent liabilities	584,934.63	
		198,087,718,556.52

Liabilities

	DM	DM
1 Banknotes in circulation		83,790,297,370.—
2 Deposits of banks		
2.1 Deposits on giro accounts	50,583,839,840.68	
2.2 Other	24,991,881.89	50,608,831,722.57
3 Deposits of public authorities		
3.1 Federal Government	293,258,829.59	
3.2 Equalisation of Burdens Fund and ERP Special Fund	43,018,319.87	
3.3 Länder Governments	391,698,064.85	
3.4 Other public depositors	38,664,200.42	766,639,414.73
4 Deposits of other domestic depositors		
4.1 Federal Railways	6,195,460.13	
4.2 Federal Post Office (including postal giro and postal savings bank offices)	1,512,141,782.93	
4.3 Other depositors	628,377,500.36	2,146,714,743.42
5 Liabilities arising from mobilisation and liquidity paper sold		4,905,100,000.—
6 Liabilities arising from foreign business		
6.1 Deposits of foreign depositors	8,814,201,799.62	
6.2 Other	96,029,184.41	8,910,230,984.03
7 Counterpart in respect of the valuation of the gold and dollar reserves provisionally contributed to the European Monetary Cooperation Fund		23,369,396,591.05
8 Counterpart of special drawing rights allocated		3,177,639,620.—
9 Provisions		
9.1 Provisions for pensions	1,976,000,000.—	
9.2 Provisions for other purposes	1,890,000,000.—	3,866,000,000.—
10 Other liabilities		244,587,678.54
11 Deferred expenses and accrued income		993,135,015.88
12 Capital		290,000,000.—
13 Reserves		
13.1 Legal reserves	1,584,300,000.—	
13.2 Other reserves	290,000,000.—	1,874,300,000.—
14 Unappropriated profit		13,144,845,416.30
Contingent liabilities	584,934.63	
		198,087,718,556,52

Expenditure

	DM	DM
1 Administrative expenditure		
1.1 Staff costs	676,929,718.48	
1.2 Other	144,501,493.66	821,431,212.14
2 Note printing		138,465,118.69
3 Depreciation		
3.1 of land and buildings	96,560,880.58	
3.2 of furniture and equipment	40,356,625.72	136,917,506.30
4 Increases in provisions		
4.1 for pensions	201,013,405.65	
4.2 for other purposes	1,590,000,000.—	1,791,013,405.65
5 Pension payments in respect of the Reichsbank		32,472,842.96
6 Other expenditure		118,558,387.71
7 Profit for the year (= unappropriated profit)		13,144,845,416.30
		16,183,703,889.75

Receipts

	DM
1 Interest	12,166,792,263.09
2 Fees	16,455,826.86
3 Receipts from purchases and sales of foreign currencies	3,944,981,857.16
4 Other receipts	55,473,942.64
	16,183,703,889.75

Frankfurt am Main, February 10, 1982

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

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

Frankfurt am Main, March 8, 1982

Treuarbeit Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr. Scholz
Certified Auditor

Goldbach
Certified Auditor

Dr. Wollert — Dr. Elmendorff KG
Wirtschaftsprüfungsgesellschaft

Thoennes
Certified Auditor

Dr. Geuer
Certified Auditor