Report of the Deutsche Bundesbank

for the Year 1980

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

Members on April 1, 1981

of the Directorate of the Deutsche Bundesbank

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

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

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Contents

The German original went to press on April 23, 1981

Part A: General part

The currency
and the economy in 1980

I. Economic developments and central bank policy

The primary aim of monetary policy in the Federal Republic of Germany last year was to safeguard the domestic and external stability of the Deutsche Mark. In contrast to the preceding three decades, maintaining monetary stability was greatly hampered by the fact that the value of the Deutsche Mark declined in the world's foreign exchange markets. Inflationary stimuli from abroad were thus not mitigated by an appreciation of the Deutsche Mark, as before, but reinforced by its depreciation. In this situation monetary policy was faced with a twofold problem. In the first place it had to minimise the monetary scope in Germany for passing on higher costs in prices so as to make it harder for imported price and cost increases to spread to domestic prices. Secondly, foreign confidence in the Deutsche Mark, which had been eroded by the massive deterioration in the German current account, had to be strengthened again. In these circumstances monetary policy had no choice but to continue the strategy of tight and relatively expensive money and to create interest rate relationships vis-à-vis other countries which would cause the Deutsche Mark to remain an attractive investment currency. In its money supply policy the Bundesbank aimed increasingly in the course of 1980 at the lower limit of the target range that had been set in November 1979, namely an increase of 5 to 8 % in the central bank money stock between the fourth quarter of 1979 and the fourth quarter of 1980. In continuation of this policy, the Central Bank Council of the Bundesbank fixed the target range for 1981 at 4 to 7 %.

The expansion of the central bank money stock within the target range for 1980 indicates that the Bundesbank was endeavouring to create adequate monetary conditions for economic growth. For this reason it not only replaced in the course of 1980 all the liquid funds which the banks had lost as a result of the decline in the Bundesbank's foreign exchange reserves but also supplied the banking system with considerable amounts of liquidity at almost unchanged money market rates, so that the central bank money stock (currency in circulation and required minimum reserves) could increase in accordance with the target. By trying to keep to the monetary growth target, the Bundesbank also geared its policy to the rise in overall production potential. A monetary policy guided solely by external factors would have allowed the contractionary monetary effects of the balance of payments deficit to work through in full to the domestic economy. Instead, by providing corresponding quantities of central bank money the Bundesbank kept domestic interest rates in 1980 and up to mid-February 1981 distinctly below the (rising) level of interest rates abroad. This was done not least under the impact of the slowdown in economic growth in Germany.

The new wave of oil price rises which started at the end of 1978 and continued in the course of 1980 hit the oil-importing countries at least as hard as the first oil price shock. It forced the German economy — like the economies of all other countries which are heavily dependent on oil imports — to embark on an adjustment process which at first was mainly reflected in slower growth. This was not yet apparent in the first few months of last year; on the contrary, increasing fears of inflation both in Germany and abroad led at that time to a short-lived boom in demand, which, however, was soon followed by a reaction. Under our free market system the domestic adjustment process operates chiefly through the price and cost effects of the increase in oil prices. This was shown by the reduction in the consumption of oil and petroleum products, and also by the demand for products which are strongly affected — directly or indirectly — by the rise in oil prices, such as motor vehicles. As will be shown in the following analysis of economic developments in Germany, the oil-induced cost increases and the sharp growth of domestic production costs resulted quite generally — despite a faster rise in the prices of some end-products — in a narrowing of profit margins and sometimes in a downward revision of investment intentions. If this did not lead to a self-reinforcing slowdown in economic activity, this was not least because the financial basis of enterprises at the beginning of 1980 was sounder than at the time of the first oil crisis. Enterprises' propensity to invest thus proved to be fairly robust in the face of the mounting production costs and interest rates, partly no doubt because the growing cost of energy made additional investment necessary, and even essential to the survival of some enterprises.

Owing to the combination of external and domestic difficulties, the overall economic performance in 1980 was, however, less satisfactory than had been envisaged at the beginning of the year by those responsible for economic policy. At that time, of course, it was not possible to foresee how much more expensive oil would become in the course of the year. Over the year as a whole overall economic growth fell comparatively little

Key data on overall economic developments

Period	Gross domestic product 1	Employed persons 2		Unemployment ratio 3	Consumer prices 4 Annual increase	Balance on current account
	Annual change					
	in %		in 1,000	in %	in %	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	10.3
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 p	+ 3.2	+ 0.8	+ 190	3.8	2.7	18.4
1979 p	+ 4.6	+ 1.3	+ 340	3.3	4.1	− 9.6
1980 p	+ 1.9	+ 0.9	+ 220	3.3	5.5	−29.1

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.

short of the original objective (2½ to 3%), since the real gross national product rose by about 2%. But there was a change of trend during the year: following the strong expansion of the national product in the first quarter, overall production did not increase any further later on, but rather declined. Under these conditions the growth of productivity slackened as well. Moreover, from the third quarter onwards the level of employment could no longer be maintained. In addition, as the number of people joining the labour force was comparatively large in 1980, unemployment went up in the course of the year; in the fourth quarter it reached a ratio of 3½% of the total labour force against 3% in the same quarter of the preceding year. Price movements were particularly unfavourable. In 1980 consumer prices were on average 5½% higher than a year before, compared with rises of 4% in 1979 and 2½% in 1978. A major part of the acceleration in price increases was attributable to stimuli from abroad, but the domestic contribution to inflation was also somewhat greater than it had been, primarily because wages were raised more than in the preceding year while productivity grew less.

Despite these undesirable developments, the rate of price rises in Germany remained among the lowest in the world in 1980. Seen in this light, the Deutsche Mark was — and still is — one of the world's most stable currencies. However, the valuation of the German currency in the foreign exchange markets failed to reflect this fact, since the massive current account deficit and the widening gap between interest rates in Germany and those abroad (which went on rising) exerted an increasingly adverse effect. In 1980 the current account showed a deficit which, at DM 29 billion, was three times as large as in the previous year. This growth was much steeper than that in other industrial countries which are in a comparable situation owing to their dependence on oil. The sharp deterioration in Germany's current account owed something to the fact that the German economy went through a phase of strongly expanding demand between the start of the second oil price hike in late 1978 and the beginning of 1980, whereas the business activity of Germany's principal trading partners was slightly more sluggish. This led to a marked increase in imports. Moreover, the incentive to step up exports was weaker than, say, after the start of the first oil price explosion in 1973/74, since at that time the German economy had already been slowing down. In addition, the Deutsche Mark had appreciated strongly in the foreign exchange markets in 1979 (at the beginning of 1980 one U.S. dollar cost little more than DM 1.70), which undoubtedly impaired the competitiveness of German enterprises.

In view of the size of the current account deficit, financing it turned out to be a problem. The more the impression gained ground abroad that the German current account would remain deep in deficit for some time, the smaller the "bonus" became which foreign investors had previously been willing to grant the Deutsche Mark relative to other currencies. This bonus had been reflected in the fact that substantial amounts of capital had long flowed into Germany even though German interest rates had been far lower than those in international credit markets. Although capital imports continued throughout 1980 (notably in the form of government borrowing abroad), capital outflows from the private sector meant that in the final analysis external capital transactions contributed very little to the financing of the current account deficit in 1980. From October onwards, indeed, the capital outflows were sometimes much larger than the inflows, partly because of growing interest rate differentials between Germany and other countries. The response of the foreign exchange markets to this development was a very pronounced depreciation of the Deutsche Mark. The decline in the value of the Deutsche Mark had an adverse direct impact on the German domestic economy. Owing to the high level of imports, the depreciation affected domestic prices relatively soon, while exports reacted comparatively little to the improvement of competitiveness in price terms.

Towards the middle of February 1981 the situation in the foreign exchange markets deteriorated to such an extent that the Bundesbank thought it advisable to stabilise confidence in the Deutsche Mark by considerably raising the German interest rate level, thus countering the danger of a growing importation of inflation at the same time. On February 19 the Bundesbank suspended the granting of lombard loans at the lombard rate of 9% and expressed its willingness to meet marginal requirements of central bank money by means of special lombard loans, among other things. This facility enables the Bundesbank to respond flexibly to rapidly changing conditions in the domestic money market and foreign exchange markets. The expectations that the Bundesbank had attached to this forceful use of its monetary policy instruments — namely that the exchange rate of the Deutsche Mark would be stabilised — were fulfilled in the first few weeks of March. The Deutsche Mark increased slightly in value against the dollar, and became the "strongest currency" within the European Monetary System. But the situation cannot be regarded as consolidated, if only because of the short space of time that has elapsed since then.

After this adjustment of its monetary policy, the Bundesbank remains in line with the monetary growth target announced for 1981: in March 1981 the central bank money stock, expressed as an annual rate, was 5½% above the average figure for the fourth quarter of 1980. The continuation of this monetary policy stance is likely to further contain inflationary tendencies in Germany. Of course, monetary policy cannot prevent decisions which are incompatible with macro-economic requirements from being taken in the field of price and wage policy or of fiscal policy; nor can it rectify the adverse effects of such decisions later on. Stabilisation of the economy and adjustment to the changed external circumstances are challenges facing all those involved in economic activity. Unless the fact that there is at present no scope for real increases in incomes is taken into account in all decisions concerning incomes (whether on wages and salaries, government current transfers or taxes that affect disposable income) the overall economic problems will continue to grow. This would further delay the return to greater price stability and a higher level of employment. It is imperative to realise that Germany's prosperity has suffered as a result of the steep rise in oil prices, and that this state of affairs cannot be put right simply by expanding nominal incomes.

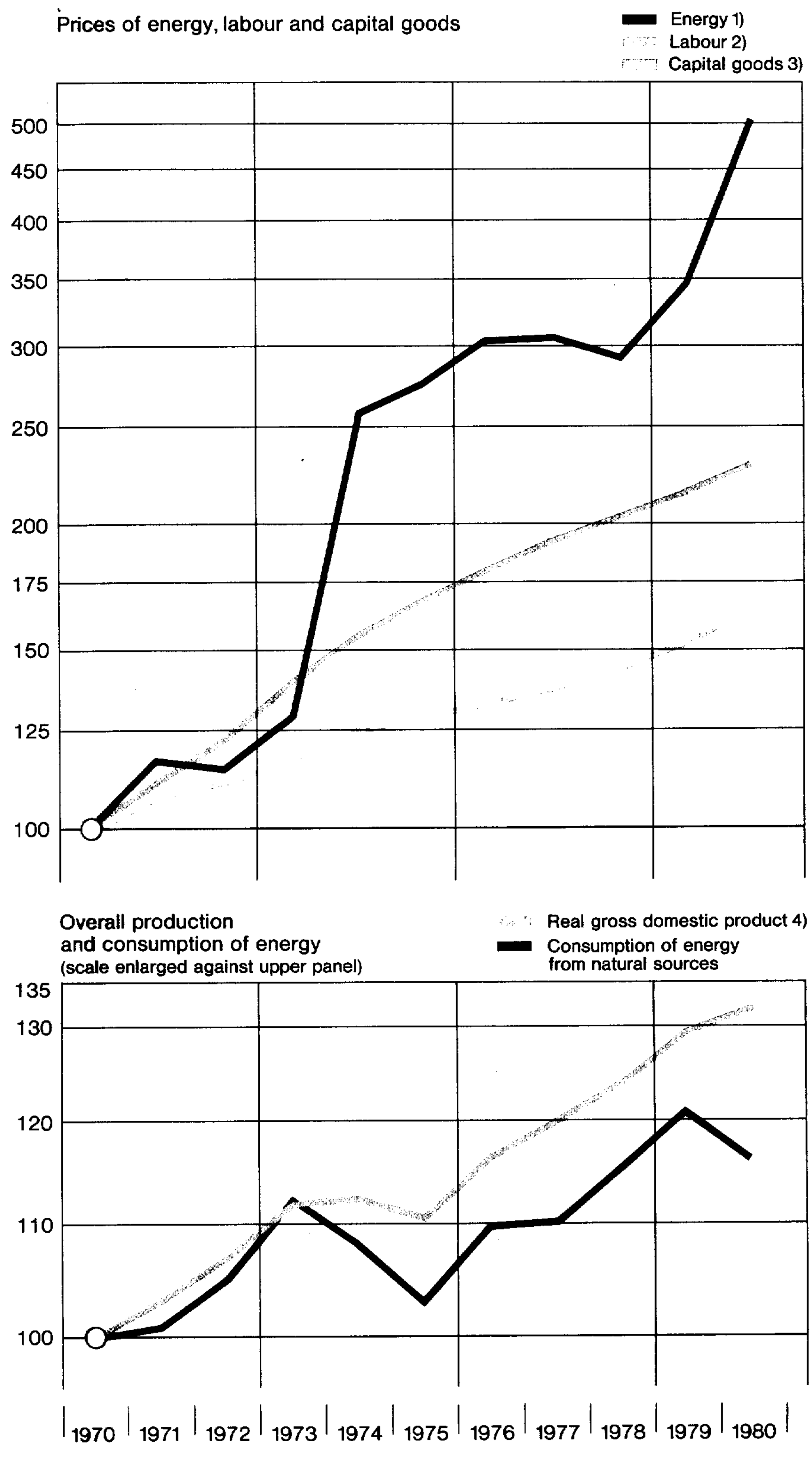
1. The economy of the Federal Republic of Germany in the adjustment process

Underlying economic conditions changed by the new oil price hike

In 1980 economic developments in the Federal Republic of Germany were greatly influenced by the massive increase in the price of petroleum and the resultant adjustment processes in the world economy. Despite the armed conflict between Iran and Iraq oil supply difficulties did not arise, but the war accelerated the upward movement of petroleum prices. In 1980 Germany had to spend on average 64% more than in 1979 to buy one tonne of imported petroleum. All oil-importing countries found that the oil price hike placed additional adjustment burdens on their balances of payments, their cost level and the distribution and use of their income; these adjustment processes finally led to a slowdown in economic growth. It was not least for that reason that the real gross national product in the OECD countries increased by only about 1% in 1980, compared with 3½% a year earlier. For the German business community this meant reduced export opportunities, since more than three quarters of German exports go to these countries. Over the whole of 1980 German industry received no more foreign orders than in 1979 in terms of volume. Towards the end of the year and in the first few months of 1981, however, there were signs of a more favourable trend, partly owing to Germany's regained

Prices of the factors of production, and consumption of energy

1970=100, log. scale



1) Price index of consumption of energy from natural sources; calculated by the Bundesbank.- 2) Gross wage and salary income per employee.- 3) Price index of fixed capital formation.- 4) At 1970 prices.

competitive edge in price terms, and partly because of the economic upturn evident from the autumn of 1980 onwards in a number of industrial countries, such as the United States, Japan and several countries on the continent of Europe.

Much higher energy bill despite lower consumption

But the effects of the increase in oil prices went far beyond the temporary adverse consequences for German exports. The oil price rise admittedly resulted in the conservation of energy: in 1980 the total consumption of energy from natural sources was 4% lower than a year before, and imports of crude oil and petroleum products went down by as much as 10% (in terms of volume), even though the real gross national product grew further. However, despite such conservation the energy bill generally rose. Expenditure on net imports of energy (petroleum, petroleum products, natural gas, coal and electricity, less the corresponding exports), at about DM 64 billion, was more than twice as large as in 1978; it made up nearly 4½% of the gross national product, compared with 2½% two years earlier. In other words, an additional 2% of current domestic output has to be devoted to settling the external energy bill if energy imports are to be "paid for" by goods and services, which is essential in the longer run.

Shift in the relative prices of the factors of production owing to the higher cost of energy

The oil price rise had immediate repercussions on the domestic price level, and particularly on the cost of energy, for the prices of sources of energy other than petroleum likewise went up steeply. Weighted with their shares in the total consumption of energy from natural sources, the average prices of all sources of energy in 1980 were some 45% higher than in the previous year, when the level of energy prices had also climbed very sharply, namely by nearly 20%. The relative increase in the cost of the "production factor" energy, as compared with labour and capital goods, thus accelerated (see the chart opposite). As a direct consequence, there is now an incentive to replace energy by means of a larger capital input through the introduction of energy-saving production and consumption methods; as a rule, this requires more capital. Another consequence is that some production facilities which were profitable only at the old, lower energy prices have become uneconomic. On the other hand, new sources of energy or sources which have been uneconomic up to the present can now be tapped; this too, of course, requires a large capital input. The upsurge in oil prices was followed at the beginning of 1980 by increases in the prices of other major raw materials in world markets, but this boom collapsed when demand subsequently fell off. However, this brought little relief to German importers since the external value of the Deutsche Mark declined in the second half of 1980. In all, average import prices in 1980 were about 15% higher than a year earlier, and excluding the prices of major sources of energy (petroleum, petroleum products, gas and coal) they increased by 7½%. The rise in import prices persisted in the first few months of 1981: in February they were 13% up on the year.

Faster rise in producer and consumer prices as a result of price stimuli from abroad

In Germany the price stimuli from foreign countries had a marked impact: the producer prices of industrial products went up by an average of about 7½% last year. Energy prices rose most steeply, but finished capital and consumer goods, too, became 5% and 6% dearer in 1980, respectively. But these price increases were far exceeded by those in the construction industry, in which prices were raised by an average of 11% during the year. To a lesser degree the wave of increases affected consumer prices as well; they went up by an average of 5½% in 1980 against 4% in 1979. Here, too, the prices of energy were an important factor. Around the middle of the year the prices of food also rose on account of the weather. If these two components are disregarded, the average rate of inflation in 1980 was lower, at 5%, but still high compared with earlier years. In the first few months of 1981 the inflation rate did not decrease, and stood at 5½% in March against the same month of 1980.

Additional cost burdens, especially on the wage front, . . .

In 1980 the business community also had to shoulder additional cost burdens that were due entirely to developments in Germany. The rises in wage costs were a particularly significant item. In the 1980 wage round management and labour generally agreed on wage and salary increases of 7 to 8% (including fringe benefits). A year earlier the growth rates had mostly ranged between 4 and 5%, and some pay agreements had run for slightly longer than twelve months. Not least for this reason, the pay settlements affected costs in full only in the course of 1980, and actual earnings rose during the year by an average of 6½%, i. e. by less than pay rates under the new agreements, which often extended into 1981. The wage cost pressure is likely to remain strong in 1981; according to the present state of the wage negotiations — at the time of going to press the pay settlements which, on past experience, have the greatest influence on the wage round had not yet been concluded — this year's wage and salary increases are likely to considerably exceed the rise in labour productivity that is to be expected from the present perspective. The burden imposed by other domestic cost components, such as depreciation (as the counterpart of the wear and tear caused by production) and indirect taxes, likewise grew substantially in 1980.

... narrow enterprises' profit margins

The steep cost rises in 1980 coincided with a slower growth of production, so that the favourable effects of increasing capacity utilisation that were evident in 1979 were no longer felt. Given an expansion of nearly 2% in the real gross national product, the average annual utilisation of capacities in the economy as a whole did not decline much (by about ½ percentage point), but in these circumstances labour productivity could not go up as fast as before (by 2% in 1980, compared with 3½% in 1979). Calculated per unit of the products sold in Germany and abroad, the business community's overall cost level (including imports) increased by 7½% in 1980; the sales prices of these products rose distinctly less in the same period, namely by 6%. Enterprises' profit margins thus came under pressure in 1980, especially in the second half of the year. On the whole this owed little to the higher interest which enterprises had to pay in 1980; when the interest rate level goes up, enterprises (excluding banks and insurance companies) not only have to pay more interest on their debts — and then only on new credits and variable-rate loans — but also benefit from the rise in the interest rates on their financial assets, such as bank balances and newly acquired securities. According to the statistics on enterprises' balance sheets, the net interest burden in 1979 came to only about 5% of wage and salary costs. In 1980 it is likely to have increased only a little relative to labour costs. The fact that overall entrepreneurial income in the narrower sense last year just failed to regain its 1979 level thus cannot be attributed to any major extent to the higher net interest burden (which presumably differed anyway in individual cases).

Brisk continuation of capital projects

At the beginning of 1980 enterprises were in a fairly good position as regards their self-financing capacity — in a better position, at all events, than in the early seventies. This partly explains why enterprises' capital spending responded comparatively little to the deterioration in their profitability; instead, projects which had been started were continued at a brisk pace. In all, in 1980 enterprises (excluding housing) spent about 9½% more than a year earlier on new machinery and equipment as well as on buildings; calculated at constant prices, this was an increase of about 4%. The investment ratio therefore went up, as in 1979, and after adjustment for price rises it regained the level of the early seventies.

Growing importance of innovation and energy conservation as motives for investment

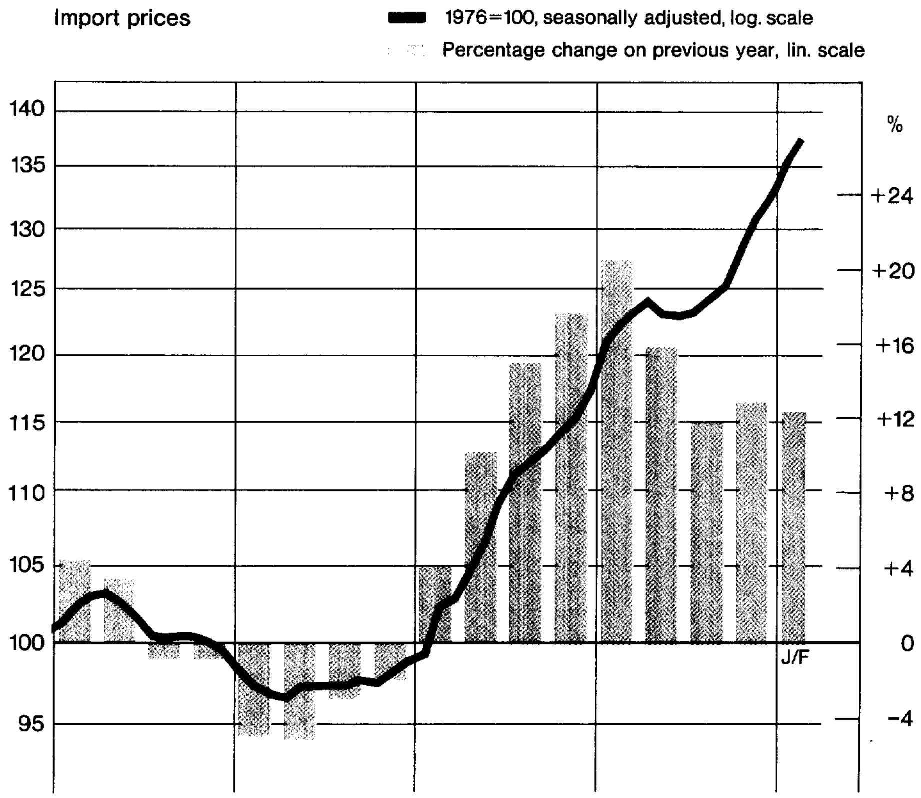
There is some evidence that enterprises are being guided in their investment policies more by their medium-term requirements than by their current earnings position and the prevailing interest rate level. Judging from the surveys of the Ifo Institute, at least, the introduction of new products and processes is the principal motive for investment, particularly if this can be combined with a reduction of the energy input per unit of output or a switch from oil to other, less expensive sources of energy. According to the Ifo Institute, almost half of the enterprises in the manufacturing sector planned investment for the purpose of cutting energy costs last year; this figure is likely to increase in 1981.

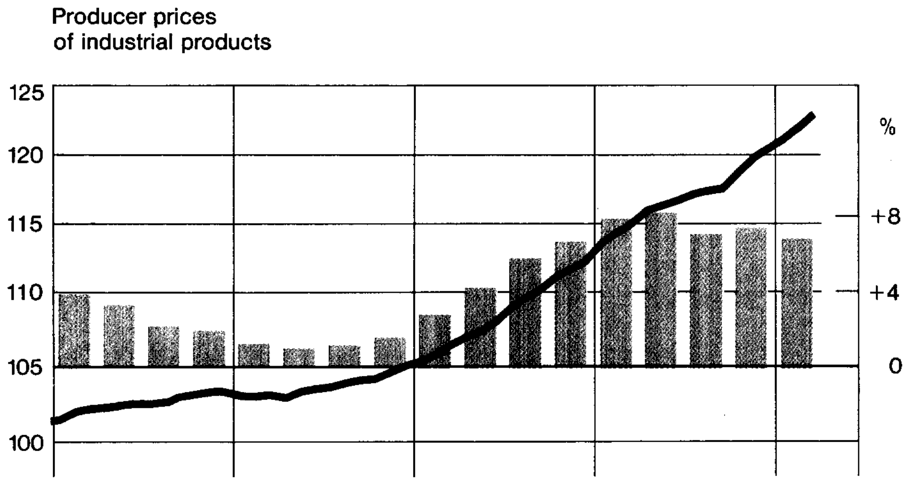
Structural change hampered by substantial hold-ups in investment

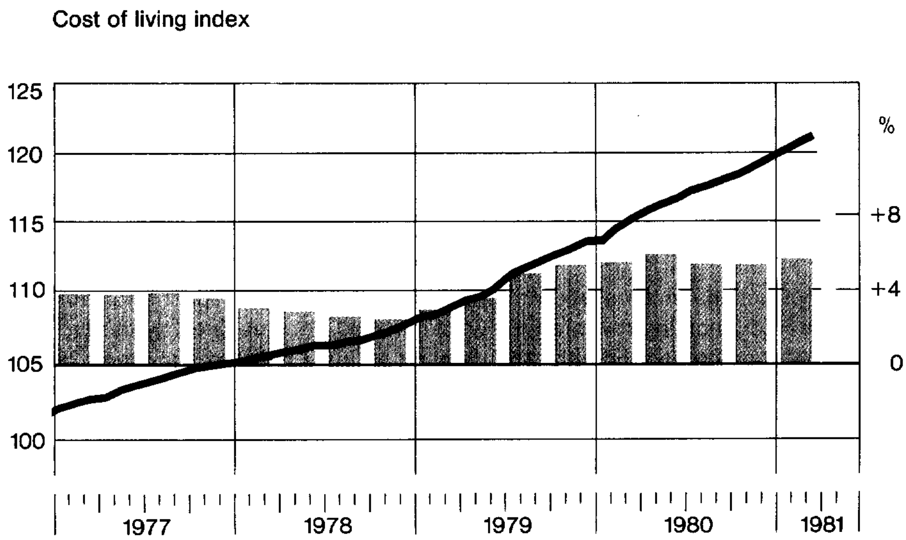
But sizeable capital projects of great importance for the structural change of the economy are still held up by administrative obstacles, objections and citizens' protests. The most significant delays are those in the construction of nuclear power stations; investment totalling DM 20 to 30 billion is awaiting implementation in this field. Not only is more time required for the authorisation procedures for such projects (as well as for coal-fired power stations and other large-scale industrial plant) but the construction periods have lengthened as well. In 1980, for instance, no new nuclear power plant was started, nor was any such plant already under construction completed, even though the existing nuclear power stations were naturally subject to wear in that period and the oldest among them are approaching the decommissioning stage. In the same year, however, some new coal-fired power stations were put into operation, although this increase in capacity was accompanied by considerable wear and tear of existing plants. There are hold-ups in investment outside the energy sector as well, for instance in the use of new technologies in the telecommunications field and in some areas of transportation.

Growing restraint in stockbuilding during the year

In the second half of 1979 and the first few months of 1980 the renewed raising of crude oil sales prices by the oil countries, and the fear that the greater international political tensions at that time might lead to supply bottlenecks (not only for petroleum but also for other raw materials), triggered a wave of speculative stockbuilding with steeply increasing prices. In the field of finished products sales prospects initially appeared to be favourable, so that stocks of finished goods, too, were built up considerably. In the further course of the year, however, when output and sales progressively slackened, the business community became more and more convinced that stocks were unduly large,

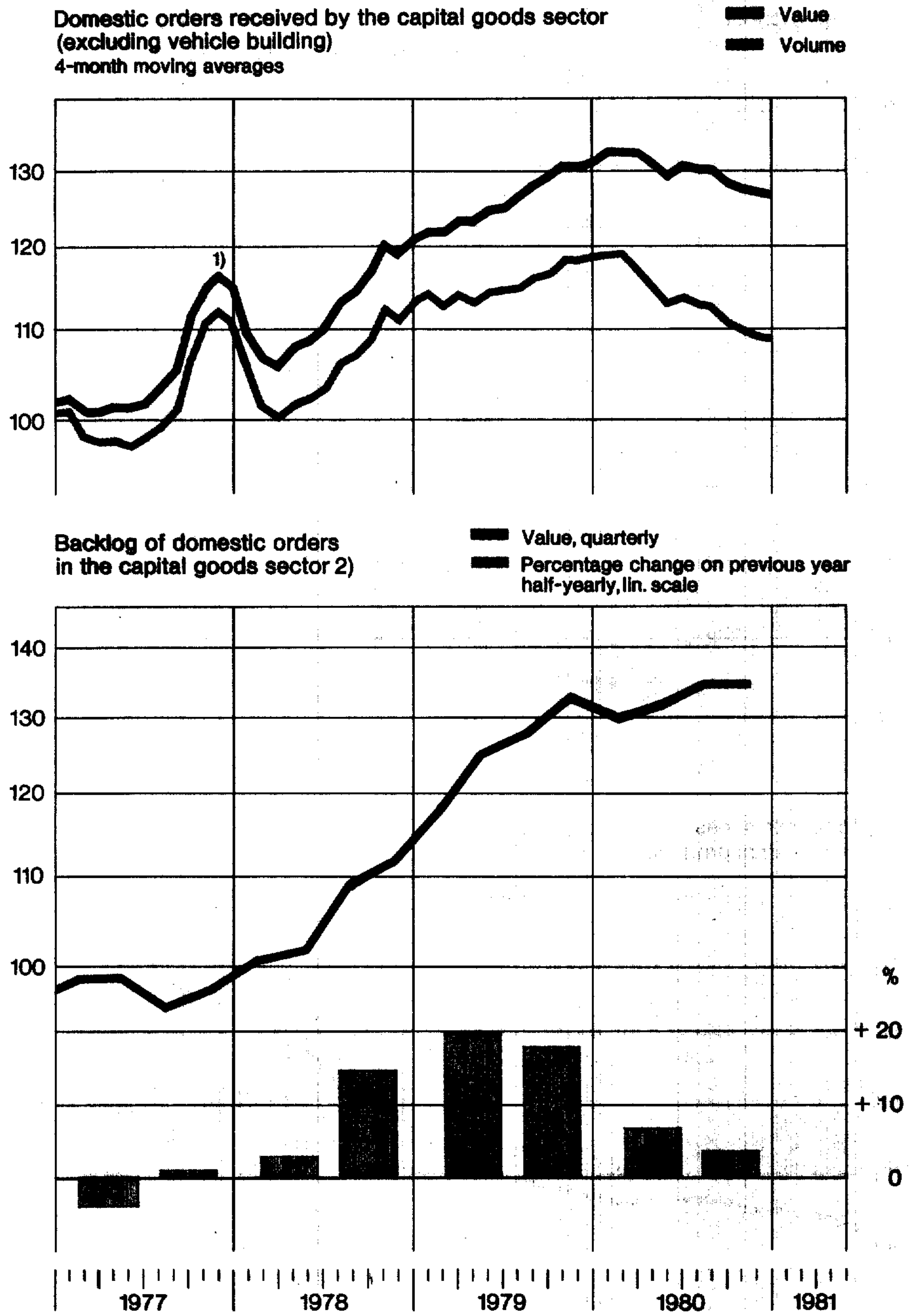

Import prices
1976=100, seasonally adjusted, log. scale
Percentage change on previous year, lin. scale
140
135
130
125
120
115
110
105
100
95
%
+24
+20
+16
+12
+8
+4
0
-4
J/F


Producer prices
of industrial products
125
120
115
110
105
100
%
+8
+4
0


Cost of living index
125
120
115
110
105
100
%
+8
+4
0
1977
1978
1979
1980
1981

Demand for capital goods

1976=100, seasonally adjusted, log. scale



1) Influenced by large-scale orders.- 2) Selected areas (incl. commercial vehicles).

partly no doubt because of the high cost of stock financing. As a result, stocks of both raw materials and finished products were increased at a much slower pace after the middle of the year, which depressed aggregate demand. However, towards the end of the year and in the first few months of 1981 this trend does not seem to have persisted.

Housing construction imparts a stimulus on the whole ...

Housing construction, which accounts for nearly 30% of fixed capital formation every year, stimulated economic growth on the whole in 1980. As measured by the orders received by the construction industry, the demand for new housing admittedly declined until the middle of the year, seasonally adjusted. However, the existing large order backlogs ensured that the level of housing construction remained relatively high. The number of dwellings completed in 1980, at about 390,000, was distinctly larger than in 1979. Overall developments in this branch of the construction industry were also stabilised by the demand for the services of the finishing trades, which seems to have increased continuously last year — inter alia owing to the greater efforts to conserve energy and mod-

Movement of real earnings in selected countries*

Percentage change on previous year

Country	1974 to 1980 **1**	1974	1975	1976	1977	1978	1979	1980 **p**
France	+ 3.3	+ 3.8	+ 6.5	+ 4.3	+ 2.7	+ 3.1	+ 2.3	+ 0.6
United Kingdom	+ 1.9	+ 2.8	+ 4.4	− 0.6	− 4.4	+ 4.6	+ 3.0	+ 4.0
Italy	+ 2.2	+ 1.0	+ 2.8	+ 2.4	+ 2.7	+ 3.5	+ 2.5	+ 0.6
Netherlands	+ 2.1	+ 5.2	+ 2.4	+ 1.9	+ 2.1	+ 2.7	+ 1.5	− 0.7
Belgium	+ 3.4	+ 5.2	+ 3.6	+ 6.8	+ 2.1	+ 3.1	+ 1.8	+ 1.4
Denmark	+ 0.5	+ 2.4	+ 3.6	+ 1.2	− 0.6	− 0.5	− 0.4	− 1.8
EEC countries 2	+ 2.5	+ 3.2	+ 4.6	+ 2.6	+ 0.8	+ 3.3	+ 2.3	+ 1.2
United States	+ 0.2	− 2.5	+ 0.3	+ 3.0	+ 5.4	− 2.2	− 0.6	− 2.0
Japan	+ 2.9	+ 4.6	+ 4.7	+ 2.1	+ 2.4	+ 1.9	+ 4.5	+ 0.5
Memorandum item								
Federal Republic of Germany	+ 2.5	+ 4.8	+ 1.5	+ 3.3	+ 2.8	+ 2.8	+ 1.7	+ 1.1

* Gross income per wage and salary earner in the economy as a whole, deflated by the price index of private consumption. — **1** Annual averages. — **2** Weight: national income of 1976; excluding Federal Republic of Germany, Ireland and Luxembourg. — **p** Provisional.
Source: Eurostat, EEC Commission, OECD; for Federal Republic of Germany: Federal Statistical Office.

ernise existing dwellings. Moreover, in the second half of the year and at the beginning of 1981 more orders were placed for new residential buildings, seasonally adjusted. This may appear surprising, since the interest rate level rose again in that period. However, decisions in the construction sector depend on many factors, including above all the expected further development of construction prices, the order situation in the construction industry, the likelihood of shorter construction periods and the tax regulations in this field. Moreover, numerous examples go to show that, even when tax legislation remains unchanged, new methods of financing construction projects which involve tax advantages are constantly being devised. Furthermore, the introduction in 1978 of tax concessions and subsidies for energy-saving investment in housing construction led to new orders, primarily for the finishing trades. This no doubt slightly reduces the absolute significance of interest rates for the construction of housing.

... but public demand for construction work declines

Public demand for construction work was strongly influenced last year by the necessity to limit the rise in expenditure. After the inflow of orders for public buildings and civil engineering projects had reached a record level in the first quarter owing to some large-scale orders, it then declined steadily, seasonally adjusted, and in the fourth quarter of 1980 it was 8 % lower than a year before in value and as much as 16 % smaller in real terms. The road construction orders of the central, regional and local authorities were particularly affected by this development (for details of public investment see page 15).

Higher cost of energy places heavy burdens on households

In 1980 households were compelled to change the pattern of their consumption expenditure owing to the sharp rises in energy prices. In all, their consumption spending went up by 7 % last year and thus hardly less than a year earlier, but a larger part of their additional expenditure than in 1979 was absorbed by the price increases, so that the expansion of consumption slowed down distinctly in real terms, i. e. from about 3½ % in 1979 to 1½ % in 1980. After the oil price hike at the beginning of 1980, gas and electricity charges, in particular, were increased in the later part of the year, and petrol prices were raised in several steps as well. Households responded by reducing their energy consumption; in the whole of 1980 the energy saved can be put at 4 to 5 %, calculated in units of energy. Households' overall spending on fuel, gas and electricity nevertheless continued to go up in 1980 (by an estimated 12 %); it accounted for almost 9 % of total consumption expenditure, i. e. for not much less than the outlays on housing (12 %). Owing to their higher spending on energy, households noticeably reduced some of their other expenditure, especially that on new passenger cars and various other consumer durables. By contrast, spending on services continued to increase relatively steeply; in particular, the boom in foreign travel remained as strong as ever regardless of the higher cost of trips abroad on account of the depreciation of the Deutsche Mark and the sharper price rises in foreign countries.

As far as can be judged at present, the tendency to mitigate the effects of the higher energy prices primarily by lessening the real consumption of energy, and particularly of petroleum, and otherwise to reduce such expenditure as can be lowered without any noticeable impairment of the standard of living, continued in the first few months of 1981. Despite the exceptionally severe and long winter, purchases of light heating oil in January and February 1981 were lower than a year before in terms of volume; petrol consumption in that period was 6% below last year's level.[1]

Sharp expansion of disposable income

With an expansion of 1½% in real consumption in 1980 (and some 1% calculated per inhabitant), Germany is in a midway position among the industrial countries, in which real wages and also real consumption not infrequently even declined after the oil price increase. In 1980 gross income from wages and salaries in Germany grew on average by 8%, and after deduction of taxes and social security contributions by 6%, i. e. more than consumer prices. Households' income from pensions and assistance payments from public cash offices went up even more steeply. Pension payments rose at a below-average rate (because the adjustment was limited to 4%), and also slightly less than consumer prices. But other transfer payments — for example those connected with educational promotion programmes, vocational training schemes, job creation and social assistance measures — grew very sharply. Some of the laws on which such payments are based contain a sort of automatic progression which causes these current transfers to rise regardless of the economic circumstances. At all events, the expansion of households' disposable income — from wages and salaries, transfer payments and the income of self-employed persons — in 1980, at 7% (while prices increased by 5½ %), did not take sufficient account of the fundamental change in the underlying conditions for the German economy. This trend would have been less serious if the saving ratio had gone up more rapidly at the same time, but it failed to do so. The growth of incomes and of households' demand for consumer goods — to a significant extent for imported products — therefore contributed a great deal to the further deterioration of Germany's current account.

Slowdown in economic growth in the course of 1980

In non-monetary terms, the deterioration in the current account was substantially equivalent to a stronger expansion of imports (in the broader sense) than of exports; it accordingly tended to depress production and employment. The real gross national product (which comprises all domestic production) increased very sharply at the beginning of 1980, not least because of some special factors, such as favourable working-day variations. However, in the later part of the year cuts in production could not be avoided, although the situation varied considerably from industry to industry. On average, overall economic growth — at almost 2%, as noted — was slightly smaller than the expansion of the production potential, which may be put at about 2½% in 1980; despite a higher investment ratio, the production potential thus grew no more than in the preceding years. In the first place, this is because an increasing share of investment is being devoted to the conservation of energy, the replacement of oil and environmental protection; from the macro-economic point of view it is thus serving mainly to cut costs and solve ecological problems, and not so much to expand productive capacity. Secondly, the replacement of older, worn-out assets has been absorbing a steadily growing part of new fixed capital formation for some time: 30% in 1980 against only about 20% in the early seventies. Both these developments call for heavier capital expenditure, but they do not primarily result in improvements in labour productivity. The rise in productivity was also adversely affected by the fact that, as mentioned before, the utilisation of overall production potential decreased slightly, viz. by an annual average of ½ percentage point to just over 99% of the standard level according to initial estimates. In line with the utilisation of overall capacity, productivity admittedly increased in the first few months of 1980, seasonally adjusted, but in the further course of the year it declined somewhat.

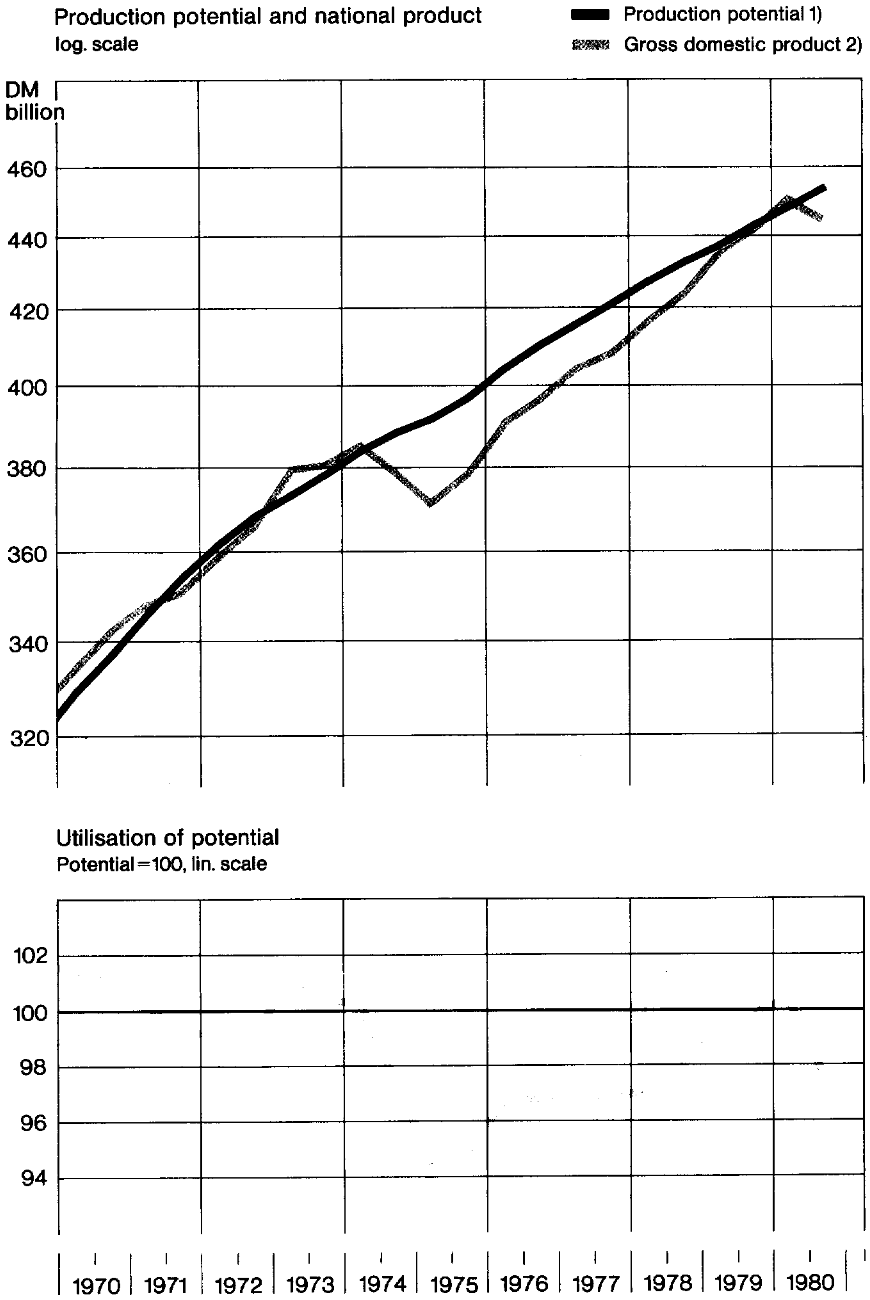
No rise in output in the producing sector

The individual sectors of the economy were affected to greatly varying degrees by the slowdown in production. Whereas the value added in the service fields of the German economy (excluding the distributive trades) continued to grow sharply last year (by about 4½%), industrial production decreased distinctly in the course of the year, partly because the decline in exports had a particularly severe impact on this sector. In the producing sector (excluding construction) overall output in 1980 was no larger than a

1 For details of households' reaction to the higher cost of energy see "Households' expenditure on energy after the second oil price shock", Monthly Report of the Deutsche Bundesbank, Vol. 33, No. 4, April 1981 p. 18.

Overall production potential

seasonally adjusted, half-yearly



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

year earlier; in the fourth quarter it was even 4% smaller than a year before, but this owed something to special factors (e. g. longer works holidays because of the position of the public holidays in December). The tendency for the goods-producing — i. e. "secondary" — sector to decline in favour of the "tertiary" sector (which produces private and public services) thus persisted, even though, given the outstanding adjustment problems, the opposite trend would have been desirable.

Output in the basic and producer goods sector declined particularly sharply in the course of the year. Stock cycle factors played a part in this; in addition, the oil refineries had to reduce their output noticeably because sales of petroleum products stagnated at times, among other things owing to the efforts to conserve energy. Production also slackened in several branches of the consumer goods sector and in the field of road vehicle building. By contrast, most other branches of the capital goods sector were able to step up their average production in 1980; the output of office machines and EDP equipment increased by more than 10%. In 1980 construction output was 4½% above

Basic economic data in the Federal Republic of Germany

Item	Unit	1977	1978	1979	1980	1977	1978	1979	1980
						Percentage change on previous year			
Aggregate demand									
Private consumption	DM billion	669.6	713.9	766.4	819.5	+ 7.4	+ 6.6	+ 7.3	+ 6.9
Public consumption	DM billion	239.4	257.1	278.6	303.4	+ 5.4	+ 7.4	+ 8.3	+ 8.9
Fixed capital formation	DM billion	249.0	273.0	314.4	351.0	+ 7.4	+ 9.7	+ 15.2	+ 11.6
Machinery and equipment	DM billion	99.9	110.4	123.7	132.2	+ 10.2	+ 10.5	+ 12.1	+ 6.8
Buildings	DM billion	149.1	162.6	190.7	218.8	+ 5.6	+ 9.1	+ 17.2	+ 14.8
Expenditure on stocks	DM billion	13.2	9.4	28.7	26.0	.	.	.	.
Domestic expenditure	DM billion	1,171.1	1,253.5	1,388.0	1,499.9	+ 6.8	+ 7.0	+ 10.7	+ 8.1
External surplus 1	DM billion	29.5	37.3	12.4	– 2.4	.	.	.	.
Exports	DM billion	330.6	348.1	382.5	428.6	+ 5.9	+ 5.3	+ 9.9	+ 12.1
Imports	DM billion	301.1	310.8	370.1	431.0	+ 6.2	+ 3.2	+ 19.1	+ 16.5
Gross national product at current prices	DM billion	1,200.6	1,290.7	1,400.4	1,497.5	+ 6.7	+ 7.5	+ 8.5	+ 6.9
Memorandum items									
Orders received by manufacturing	1976 = 100	101.3	106.3	117.8	122.2	+ 1.3	+ 4.9	+ 10.8	+ 3.8
Domestic orders	1976 = 100	103.2	108.5	118.5	122.0	+ 3.2	+ 5.2	+ 9.2	+ 3.0
Foreign orders	1976 = 100	97.2	101.5	116.3	122.8	– 2.8	+ 4.4	+ 14.6	+ 5.6
Orders received by construction	1976 = 100	115.6	142.5	160.8	165.2	+ 15.6	+ 23.2	+ 12.9	+ 2.7
Distribution of income									
Wage and salary income	DM billion	669.7	714.7	769.4	830.0	+ 6,9	+ 6,7	+ 7.7	+ 7.9
do. as a percentage of national income	%	71.5	71.0	70.8	71.8	.	.	.	.
Entrepreneurial and property income	DM billion	266.9	291.2	317.7	325.5	+ 6.0	+ 9.1	+ 9.1	+ 2.5
do. as a percentage of national income	%	28.5	29.0	29.2	28.2	.	.	.	.
National income	DM billion	936.5	1,006.0	1,087.1	1,155.4	+ 6.7	+ 7.4	+ 8.1	+ 6.3
Production									
Gross national product at 1970 prices	DM billion	814.5	843.5	881.6	897.5	+ 2.8	+ 3.6	+ 4.5	+ 1.8
Productivity 2	1970 = 100	136.6	141.4	146.6	149.4	+ 4.2	+ 3.5	+ 3.7	+ 1.9
Output in the producing sector (excluding construction)	1976 = 100	102.6	104.4	109.8	109.8	+ 2.6	+ 1.8	+ 5.2	0
Construction output	1976 = 100	103.5	110.0	117.4	114.3	+ 3.5	+ 6.3	+ 6.7	– 2.6
Employment									
Employed persons	Millions	25.0	25.2	25.6	25.8	– 0.2	+ 0.7	+ 1.4	+ 0.9
Wage and salary earners	Millions	21.3	21.6	22.0	22.3	+ 0.3	+ 1.2	+ 1.9	+ 1.3
Memorandum item									
Total number of man-hours worked	1970 = 100	87.9	87.6	88.3	88.4	– 1.0	– 0.3	+ 0.8	+ 0.1
Unemployed persons	Thousands	1,030	993	876	889	– 2.9	– 3.6	– 11.8	+ 1.5
do. as a percentage of									
the total labour force	%	3.9	3.8	3.3	3.3	.	.	.	.
the dependent labour force	%	4.5	4.3	3.8	3.8	.	.	.	.
Prices									
GNP deflator	1970 = 100	147.4	153.0	158.8	166.9	+ 3.8	+ 3.8	+ 3.8	+ 5.0
Memorandum item									
Unit labour costs in the economy as a whole 3	1970 = 100	151.3	155.2	159.0	167.8	+ 3.5	+ 2.6	+ 2.5	+ 5.5
Cost of living index for all households	1976 = 100	103.7	106.5	110.9	117.0	+ 3.7	+ 2.7	+ 4.1	+ 5.5
Producer prices of industrial products	1976 = 100	102.7	103.9	108.9	117.1	+ 2.7	+ 1.1	+ 4.8	+ 7.6
Overall construction price level	1976 = 100	104.2	110.5	120.1	133.2	+ 4.2	+ 6.0	+ 8.7	+ 10.9
Index of import prices	1976 = 100	101.5	97.7	109.1	125.3	+ 1.5	– 3.7	+ 11.6	+ 14.9

1 Balance of transactions in goods and services with other countries (including GDR). — **2** Gross domestic product at 1970 prices per man-hour worked. — **3** Index of gross wages and salaries per employee divided by index of real GNP per employed person. — The figures from the national accounts from 1978 onwards are provisional.

the previous year's figure, which, however, had been depressed by the exceptionally severe winter of 1978/79. The finishing trades were the stabilising factor in this context; by contrast, output in the main construction industry, after having run at a high level in the first quarter of 1980, declined continuously, seasonally adjusted, during the rest of the year.

Stabilisation of production in the first few months of 1981

In the first few months of 1981 the slackening of output in the producing sector (excluding construction) seems to have given way to a more stable production trend. In January and February, at least, average output in this sector was larger than in the fourth quarter of last year, seasonally adjusted. However, industrial production was still about ½ % below the very high 1980 level. In the construction industry output remained low in the first few months of this year because of the unfavourable weather.

Situation in the labour market deteriorates

As overall production declined, the situation in the labour market deteriorated in 1980. In line with the trend in production described above, employment reached a peak in mid-1980 and decreased slightly during the rest of the year. In the fourth quarter of 1980 the number of employed persons was hardly larger than a year earlier. In addition, the size of the labour force continued to increase in the course of the year. At the end of 1980 the number of persons registered as unemployed was therefore over 250,000 larger than a year before, and the gap widened further in the first few months of 1981. In 1980 3.3 % of the total labour force was out of work on average; relative to the dependent labour force (the basis of calculation used by the Federal Labour Office), the unemployment ratio came to 3.8 %. At the end of March 1981 the seasonally adjusted number of unemployed persons stood at 1.13 million, which was 4.3 % of the total labour force.

Unsolved structural problems in the labour market

Owing to the general deterioration of the situation in the labour market, the structural problems in this field remained unsolved as well. The number of unemployed young persons (under 20 years of age) rose relatively steeply in the course of the year, although the unemployment ratio for them remained below the average in 1980. The supply of trainee positions, which expanded again last year, largely corresponded to the demand, but the transition from such positions to regular jobs was difficult in many cases. The number of unemployed women was comparatively large in 1980, as for some time past; however, many of them are solely interested in part-time jobs, and they often seek employment only at their place of residence. On the other hand, the fact that qualified labour is urgently required in many sectors of the economy, while about half of those registered as unemployed have not completed any occupational training, continues to be an unsolved problem.

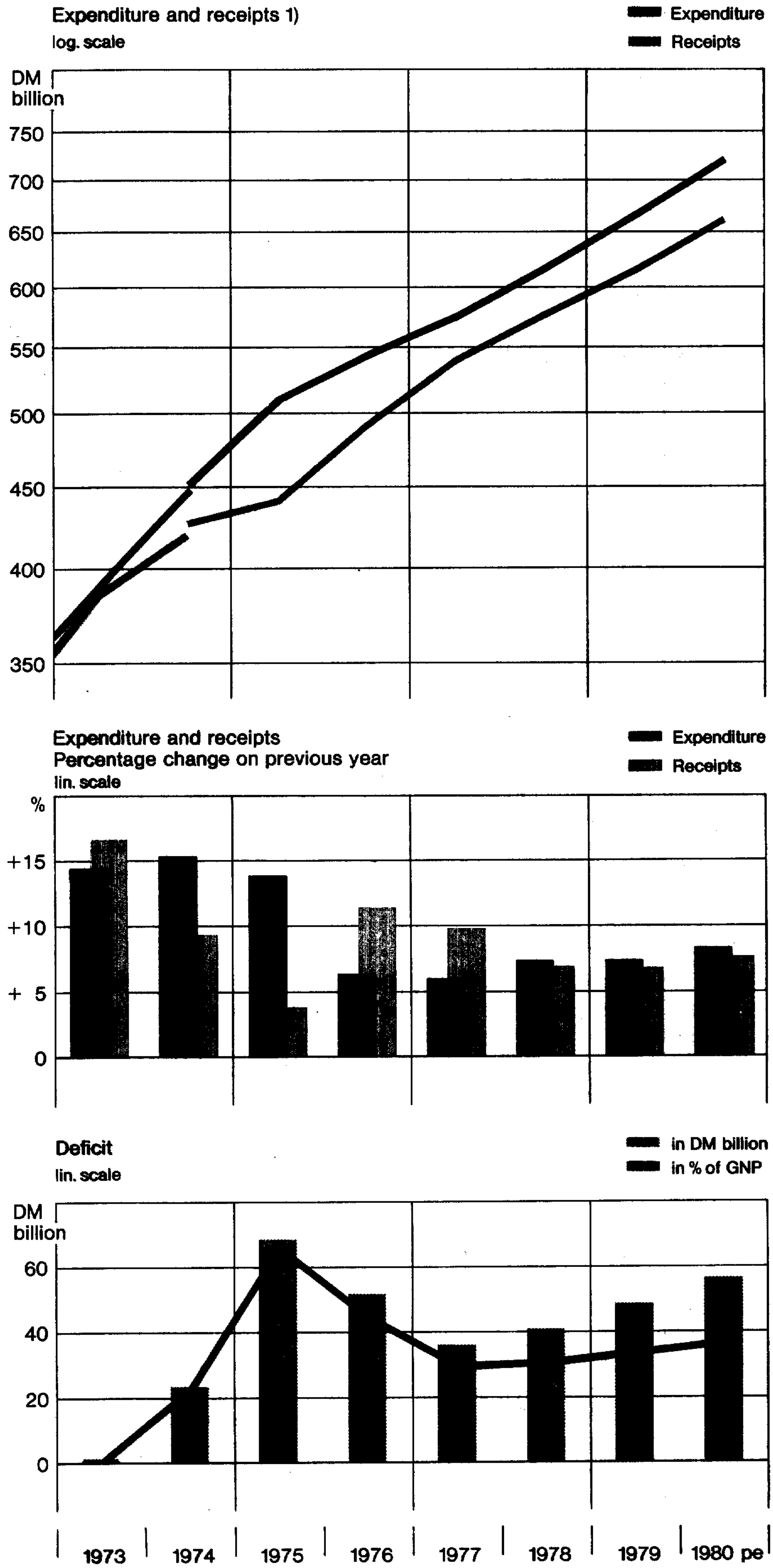
But the basic economic difficulty posed by unemployment lies deeper than that. Ultimately it is that, given the present cost of production in Germany and the exchange rate of the Deutsche Mark, the German economy has not so far been able to lessen its current account deficit, but has had to tolerate a sharp expansion which, as already indicated, has tended in itself to reduce employment. If the process of adjustment to the new external conditions could be accomplished and hence the current account deficit diminished, the employment situation could accordingly be improved; the essential precondition for this is the strengthening of Germany's competitive position.

2. Deficits of the public authorities increase further

Public authorities remain highly expansionary

The adjustment of the economy to the new situation arising from the increase in oil prices must be fostered by the public authorities as well. Like households, they should aim at reducing the absorption of goods and services for consumption purposes and creating more scope for capital formation by the public sector, and indirectly also by enterprises, in order to safeguard future developments. The Fiscal Planning Council, on which the Federal and Länder Governments and local authorities are represented, had agreed at the end of 1979 that the central, regional and local authorities should abandon the markedly expansionary budgetary policy stance they had adopted through the measures of 1977/78 and switch to the consolidation of their budgets. The objective the Council formulated was that in 1980 "the financial deficits should be kept below those of 1979". This objective was not achieved. In 1980 the deficit of the Federal and Länder Governments and local authorities again rose sharply: it totalled DM 59 billion and was thus DM 12 billion larger than in 1979. The circumstance that the small deficit recorded

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.

in 1979 in the field of social security was succeeded by a surplus of just over DM 2 billion last year, thanks to the measures taken to consolidate the pension funds' finances, does not make any significant difference to this trend.

Accelerated rise in public spending

The further increase in the budget deficits was mainly due to the fact that the central, regional and local authorities expanded their spending at a faster pace. The budgets were characterised by the intention to pursue a more restrained expenditure policy. When the budgets were implemented, however, it soon became apparent that the appropriations would not be adhered to. Over the year as a whole the expenditure of the central, regional and local authorities eventually increased by 9½ %, compared with 6 % in the original budgets and an effective growth in spending of 7½ % in 1979. The outlays of the local authorities expanded by 12 % and hence almost twice as fast as in the preceding year. The spending of the Länder Governments continued to rise strongly, viz. by 9 %. Only the Federal Government increased its cash expenditure more slowly than a year before, namely by just over 7 %.[1] Even so, it too exceeded its appropriations. Inclusive of spending by the social security funds, total public sector expenditure went up by 8½ % (to DM 720 billion); the ratio of government expenditure[2] to the gross national product reached 48 %, against 47 % in 1979 and, for example, 39 % ten years earlier. One of the principal reasons why the spending of the central, regional and local authorities increased more than had been budgeted for in 1980 was that personnel expenditure rose by 7½ % and thus more sharply than had been envisaged. In addition, the upward movement of energy (and other) prices pushed up other operating expenditure. Direct capital outlays were affected even more by the price increases. They went up by 13½ %, although the volume of public investment financed with them grew relatively little; this goes to show how rapidly public spending programmes can be swallowed up by price rises alone. When it became increasingly evident in the course of the year that the relevant budget appropriations would be exceeded (in large part owing to the higher prices), the central, regional and local authorities cut down the placing of new construction orders. However, this hardly affected the actual development of expenditure last year; not until 1981 is the reduction in new orders likely to have a significant impact on the cash position. By contrast, indirect capital expenditure (loans, participations and investment grants) was influenced before the end of 1980 by the spending cuts. The Federal Government lowered such expenditure substantially in order not to exceed its budget appropriations by too great a margin.

Interest expenditure, which grew by almost one fifth in 1980 because both indebtedness and the level of interest rates had risen, likewise contributed to the sharp increase in public spending. Last year interest accounted for 6 % of the total budget volume of the central, regional and local authorities, or over half of the net amount borrowed in that year. In the aggregate, government consumption expenditure (personnel expenditure, current transfers, interest and other operating expenditure) rose by about 8½ % in 1980, and thus more than the nominal national product; this means that the absorption of the national product by the government for consumption purposes continued to increase, even though the public sector's direct capital outlays grew still more sharply last year.

Moderate growth of tax revenue

The receipts of the central, regional and local authorities went up by 7½ % in 1980 and thus largely conformed to expectations. While the tax yield was smaller than estimated at the beginning of the year, mainly owing to the flagging of economic activity, "other" receipts grew relatively fast. Tax revenue alone rose by 6½ %, and hence slightly less than the gross national product. The overall tax ratio accordingly declined once more in 1980 (to 24.4 %). The abolition of the tax on total wages paid and the renewed raising of the allowance on trade returns tax at the beginning of 1980 had a dampening effect on receipts. Furthermore, the previous amendments to tax legislation resulted in smaller final payments of assessed income tax, and in many instances this led to smaller advance payments as well. This largely explains why the yield of assessed income tax over the year as a whole was 2 % lower than in 1979. Receipts of corporation tax, which had risen sharply every year since 1976, actually went down by 7 % in 1980. However, the advance payments of this tax had been increased particularly steeply in the preceding years, so that only small final payments fell due in 1980. In addition, many corporations had their

1 The growth according to the budgetary calculation, at 6 %, was slightly smaller than the cash rate quoted here.
2 In cash terms.

advance payments lowered as a result of the deterioration in their earnings position. Receipts of wage tax, unlike those of the assessed taxes, expanded vigorously in 1980, for the first time since 1977, because the progressive nature of the tax scale took effect once more after the previous tax reductions. Wage tax revenue grew by 15%, i. e. almost twice as fast as wages and salaries, although the yield was lessened towards the end of last year by the raising of the Christmas allowance. Receipts of turnover tax, too, went up considerably again in 1980 (+ 11%). One reason for this was the sharp expansion of consumption and of investment that is subject to value-added tax (e. g. in the field of housing construction and the public sector) last year; another was that the year-on-year comparison was still affected by the raising of the tax rates in mid-1979.

Heavy borrowing abroad for the first time

Last year it was at times rather difficult for the central, regional and local authorities to finance their growing budget deficits. Continuous recourse to the domestic credit markets frequently posed problems, notably during periods of rising interest rates. The central, regional and local authorities, and especially the Federal Government, therefore increasingly elected to procure the necessary funds abroad in 1980. This became easier from March 1980 onwards because the existing restrictions were eased owing to the fundamental change in the external situation. Of the total amount of credit raised in the market (DM 54 billion net in 1980), as much as DM 22 billion, or about 40%, was obtained abroad — partly direct, and partly indirect through banks (in 1979, when new market indebtedness had amounted to DM 43 billion, only 6% of the credit had been taken up abroad).[1] In the domestic market the central, regional and local authorities borrowed DM 32 billion in 1980; this was DM 9 billion less than in the preceding year even though the deficits had increased. The public authorities made relatively little use of bond issues as a means of raising funds. Inclusive of tap issues of Federal bonds and Federal savings bonds, they took up only DM 3.5 billion net in the bond market; this was barely half as much as in 1979. Together with shorter-term securities (discountable Treasury bonds), redemptions of which exceeded new sales, public indebtedness in the form of securities went up by only about DM 1 billion. Thus most borrowing was effected by means of loans against borrowers' notes, a financial instrument that most easily permits flexible adjustment to changing market conditions. Furthermore, the tightness of the capital market in the final months of 1980 caused the central, regional and local authorities to reduce their cash reserves and to use about DM 2 billion more Bundesbank book credit at the end of 1980 than they had done a year previously.

Fiscal support for the adjustment process required

The German economy's progress in the adjustment it now has to undertake following the massive increase in energy prices will depend not least on the amount of support it gets in future from fiscal policy. Such assistance could consist, above all, in a reduction in the share of the national product that is absorbed by public expenditure, particularly for consumption purposes; in the past this share has grown relatively sharply. This would release resources for capital formation and exports. More restraint in government spending would, moreover, lower the public sector's credit needs and ease the tensions in the credit markets.

As part of the basic budgetary policy decisions for 1981 taken at the end of last year, the short-range target of avoiding as far as possible a further increase in the deficits was adopted. Given the tax cuts and other improvements (especially in children's benefits) approved in the summer of 1980, this was a very ambitious aim from the outset. In these circumstances the central, regional and local authorities had to keep the growth of expenditure in their budgets relatively low. For 1981 they provided for an increase of only about 4% in their spending. Personnel expenditure involves particular risks for their budgets. The rise in personnel spending will fail to exceed the appropriations only if the number of employees is hardly enlarged and the pay settlement for the public service is moderate. As in recent years, interest expenditure will account for a growing proportion of the overall margin for higher spending. Finally, transfers to households, which are made on the basis of statutory provisions, have not been influenced much so far by the spending cuts.[2] The limited scope for expenditure in the current financial year therefore primarily affects capital spending, the aggregate appropriations for which are lower than last year.

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1 In 1979 virtually all such credit had consisted of purchases of public bonds by foreigners.

2 The planned reductions in savings promotion will not affect public budgets until later.

Finances of the public authorities

Item	1977	1978	1979 **p**	1980 **pe**	1977	1978	1979 **p**	1980 **pe**
	DM billion				Percentage change on previous year			
Central, regional and local authorities 1								
Expenditure								
Personnel expenditure	132.4	140.2	149.4	161	+ 6.7	+ 5.9	+ 6.3	+ 7.5
Other operating expenditure	60.0	65.3	70.6	76	+ 5.5	+ 8.9	+ 8.1	+ 7.5
Transfers	105.6	115.8	121.7	131	+ 4.3	+ 9.7	+ 4.2	+ 7.5
Interest	21.0	22.1	24.9	29.5	+ 15.7	+ 5.6	+ 12.2	+ 18
Direct capital outlays **2**	44.8	49.2	54.5	62	− 1.4	+ 9.7	+ 9.6	+ 13.5
Indirect capital expenditure **3**	22.1	28.6	34.2	36	− 6.2	**7** + 29.4	+ 19.8	+ 5.5
Other expenditure **4**	6.2	5.7	7.1	10.5	+ 2.6	− 7.1	+ 15.6	+ 46.5
Total expenditure	392.0	426.9	462.3	505.5	+ 4.4	+ 8.9	**8** + 7.7	+ 9.5
of which								
Federal Government	179.2	196.9	212.7	228.5	+ 4.5	+ 9.8	+ 8.1	+ 7
Länder Governments	160.7	175.5	191.6	208.5	+ 5.2	+ 9.2	+ 9.1	+ 9
Receipts								
Tax receipts	299.4	319.1	342.8	365	+ 11.7	+ 6.6	+ 7.4	+ 6.5
Other receipts	61.4	69.3	72.8	81.5	+ 6.6	+ 12.8	+ 3.1	+ 11.5
Total receipts	360.8	388.4	415.6	446.5	+ 10.8	+ 7.6	**8** + 6.7	+ 7.5
of which								
Federal Government	157.0	171.2	186.7	199.5	+ 11.0	+ 9.0	+ 9.1	+ 7
Länder Governments	152.4	163.5	176.6	185	+ 10.8	+ 7.3	+ 8.0	+ 5
Cash deficit (−)	− 31.1	− 38.6	− 46.7	− 59	.	.	.	.
of which								
Federal Government	− 22.2	− 25.7	− 26.0	− 29	.	.	.	.
Länder Governments	− 8.3	− 12.0	− 15.0	− 23	.	.	.	.
Social security funds								
Expenditure **5**	209.4	221.0	234.5	255.3	+ 7.6	+ 5.6	+ 6.1	+ 8
Receipts	205.0	219.3	233.9	255	+ 5.9	+ 7.0	+ 6.6	+ 9
Cash deficit (−) or surplus (+)	− 4.3	− 1.6	− 0.6	+ 2	.	.	.	.
Public authorities, total								
Expenditure **6**	574.0	615.4	663.5	720.5	+ 5.9	+ 7.2	**8** + 7.4	+ 8.5
Receipts **6**	538.5	575.2	616.2	663.5	+ 9.6	+ 6.8	**8** + 6.9	+ 7.5
Cash deficit (−)	− 35.4	− 40.2	− 47.3	− 57	.	.	.	.

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

More expansionary expenditure policy inappropriate

A growing number of observers are calling for a more expansionary expenditure policy. But it is generally overlooked in this connection that the tax cuts now in force and the larger current transfers are greatly stimulating demand anyway. Moreover, the present slowdown in economic activity will automatically lead to rising expenditure on unemployment benefits and short-time working allowances and falling receipts from taxes and social security contributions, and consequently to an expansion of the deficit on economic grounds. According to the key data of the Annual Economic Report, which are slightly less favourable than the expectations entertained at the time of the budgetary decisions of end-1980 (for instance, it is now assumed that the real gross national product will develop between 0 and -1%), the deficit incurred by the public sector (including the social security funds) in 1981 may be some DM 10 billion larger than it was last year. If the national product were to grow, the deficit would presumably increase less. Similarly, the deficit would rise even higher if the national product contracted more sharply. But if, in addition, the government were to switch to a more expansionary spending policy, there would be a great risk of this delaying the necessary process of adjustment in the economy. This would be especially likely in the event of a traditional "economic stimulation programme" involving a widely dispersed increase in expenditure. Moreover, the success of such measures would be in doubt because the funds required for the purpose would have to be raised in competition with the scarce funds of the private sector, which would tend to keep interest rates high. It would likewise be no solution for the credit needed to finance such programmes to be sought abroad. A substantial part of the deficit in prospect for the central and regional authorities will have to be financed abroad in any case. Capital imports of this kind can certainly make a welcome contribution to the financing of the balance of payments deficit, as will be indicated below. But it would be mistaken to assume that this does not involve any costs for the German economy. In its effect on the balance of payments, the interest payable on external borrowing can be put on a level with imports of goods and services, which, like all other imports, ultimately have to be paid for out of a country's national product. The more external debts grow, the more they reduce the national product that can be distributed in real terms at home. A different assessment of the situation would be possible only if it were certain that the foreign credits would result in additional domestic capital formation which would not be possible otherwise and which would generate such a large increase in productivity and real income that the interest could easily be paid to the foreign countries out of it.

3. Persistent deterioration in the balance of payments

Germany's current account deep in deficit

The unsolved problems of adjustment to the new external conditions were reflected particularly clearly in the deterioration in the balance of payments. In 1979 — for the first time for 14 years — Germany had moved into deficit on current account (almost DM 10 billion). In 1980 the deficit rose to DM 29 billion, the largest figure recorded by any industrial country. Germany thus accounted for almost one third of the deterioration in the current accounts of all industrial countries in the last two years. This time — in contrast to the first oil crisis of 1973/74, when, owing to the world-wide inflationary boom in demand, the higher expenditure on oil imports could be offset within a relatively short period by additional exports — Germany was disproportionately hard hit, under totally different basic conditions. Germany continued to show a surplus on foreign trade in 1980, namely DM 19 billion on an f.o.b. basis.[1] But the surplus fell dramatically last year (by DM 13 billion), so that it was less and less able to make up for the structural increases in net expenditure on services and transfer payments. In the aggregate, Germany is at present purchasing more goods and services from abroad than it is exporting to other countries. It is also running large deficits on transfer payments account, which likewise give non-residents a claim on the German national product. There is no doubt that, to the extent of the current account deficit, Germany is living "beyond its means" — a situation that can be tolerated for a short while but would pose serious problems in the longer run. At the beginning of 1981 the current account deficit remained as high as ever.

1 In accordance with international practice when drawing up balances of payments, not only exports but — in contrast to the official foreign trade statistics of the Federal Statistical Office — also 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 shift does not affect the overall balance on current account.

Only about half of the deterioration in the current account since 1978 is "oil-induced"...

The decrease in Germany's trade surplus was in large measure due to the continued raising of oil prices by the OPEC countries. The unit values of imports of crude oil and petroleum products increased by a further 46% in 1980, which in itself imposed an additional burden of DM 22 billion on Germany's balance of trade. However, these adverse price factors were accompanied by secondary effects which moderated the extra costs caused by the rise in oil prices. In the first place, the volume of oil imports declined by roughly 10% (mainly owing to the more economical use of this dearer source of energy), so that Germany's total oil bill increased by "only" DM 15 billion in 1980. Secondly, German exports to the oil countries went up considerably last year, likewise mainly because of the higher oil prices; but for the rise in their foreign exchange receipts, the densely populated oil countries — whose demand had previously encountered balance of payments and budgetary limits — would hardly have been able to expand their imports so much. In 1980 Germany's sales of goods to the OPEC countries were DM 3.5 billion higher than a year previously (even though exports to Iran, for instance, were greatly hampered by the political situation). In addition, a certain (albeit small) part of the rise in oil costs was passed on in export prices. This happened directly in the case of exports of petroleum products, which grew by DM 1.5 billion to DM 5 billion, almost entirely because of price increases; but attempts are also being made to pass on the higher cost of oil indirectly through other exports. This is readily apparent in the case of highly oil-intensive products, especially synthetic goods, but in other instances it can hardly be quantified. In net terms the oil price rises in 1980 are unlikely to account for much more than DM 10 billion, or roughly half, of the increase in Germany's current account deficit. Moreover, according to these calculations (and after allowing for the above-mentioned secondary effects) only about half of the negative swing of just under DM 48 billion recorded since 1978 is attributable to the price rises imposed by the oil countries. Only a German share of about this size in the total counterpart of the OPEC surpluses, which had grown to some $ 125 billion by 1980 (whereas the current account of these countries had been almost in equilibrium in 1978), could currently be regarded as appropriate.

... while the other half is mainly due to structural shifts

Other factors were responsible for the remaining half of the deterioration in the current account. Besides the constantly growing deficits on invisibles, great importance attached to the structural changes in foreign trade. A correction in this field is essential in order to prevent the adverse structural effects associated with the external deficits from becoming firmly established. Any delays in the adjustment — which is ultimately unavoidable — lead in the long run to all the greater friction and cost to the economy, e. g. to a sustained deterioration in the terms of trade (with all its negative implications for a country's standard of living), to a loss of economic growth and to prolonged unemployment, such as has been experienced not infrequently by other countries with persistent deficits.

Foreign finished goods make further headway in the German market

The full significance of the problems that have arisen in this field becomes evident if developments are viewed over the somewhat longer term. While at the beginning of the seventies exports and imports of industrial products (other than oil) grew at about the same pace, the level of imports being slightly lower, since then imports have increased distinctly faster than exports. A striking feature is that not only imports of products of a low technological standard — i. e. especially of consumer goods — have expanded rapidly, as might have been expected. Instead, even in Germany's classical industries, such as mechanical engineering and electrical engineering, the import ratio (as measured by domestic turnover) increased unusually rapidly between 1976 and 1980, namely by just under 3 and almost 4 percentage points, respectively. The growing proportion of end-products in imports (their share in total imports has gone up from one quarter in the middle of the sixties to just under 40% today) exercises a considerable impact on the external adjustment process. Unlike imports of raw materials and primary products, which fluctuate in line with domestic production and the stock cycle, imports of end-products are far less dependent on the level of economic activity; they are mainly influenced by factors such as the fairly steady growth of private consumption or the increase in world-wide specialisation, so that not even a domestic economic slowdown can ease the pressure on the current account (by curbing overall imports) as much as it used to. On the other hand, the share of exports in total turnover from domestic production rose only slightly (by ½ percentage point) between 1976 and 1980 in the field of electrical engineering, while in mechanical engineering the corresponding export ratio even fell by 3 percentage points. In those years total exports were not quite able to keep up with the

Record of economic policy measures

1980	**I. Domestic and external monetary policy**
February 28	With effect from February 29 the Bundesbank's discount rate is raised from 6% to 7% and its lombard rate from 7% to 8½%. In addition, the banks' rediscount quotas are increased by DM 4 billion (as from March 3). The lombard limits are abolished, notwithstanding the ruling principle that lombard loans are to be granted only for the short-term bridging of temporary liquidity needs.
March 17	In view of the changed external situation the existing restrictions on capital imports are relaxed; the minimum maturity of domestic bonds which may be sold to non-residents is reduced from four years to two years.
Mid-March	To offset foreign exchange outflows, the Bundesbank repurchases before maturity the mobilisation and liquidity paper held by banks (DM 3.1 billion).
April 30	With effect from May 2 the discount rate is raised from 7% to 7½% and the lombard rate from 8½% to 9½%. In view of the sustained outflows of foreign exchange from the Bundesbank the minimum reserve ratios for domestic and foreign liabilities are lowered by 8% at the same time (releasing almost DM 5 billion of liquidity); in addition, the banks' rediscount quotas are increased by DM 3 billion (as from May 5).
June 26	Following its periodical review of the monetary growth target in mid-year, the Bundesbank decides to keep the growth of the central bank money stock during the remainder of the year in the lower half of the target range (of 5 to 8%).
July 30	For the fourth time in 1980 the Bundesbank purchases securities for later resale. The interest rate charged for these transactions, at 9.2%, is for the first time lower than the lombard rate.
August 21	To offset the contractionary effects of the outflows of foreign exchange on bank liquidity, the minimum reserve ratios for domestic and foreign liabilities are lowered by 10% with effect from September 1 (releasing DM 5.5 billion of liquidity).
September 18	With effect from September 19 the lombard rate is lowered from 9½% to 9%.
October 16	The banks' rediscount quotas are raised by DM 3 billion as from October 20. In addition, the limit for discounting prime bankers' acceptances in the course of market regulation operations is increased by DM 0.5 billion.
November 4	The minimum maturity of domestic bonds which may be sold to non-residents is reduced from two years to one year.
November 27	The Bundesbank announces its monetary growth target for 1981: the rise in the central bank money stock between the fourth quarter of 1980 and the fourth quarter of 1981 is to be kept within a range of 4 to 7%. As in the two preceding years, the Bundesbank will review — in the light of current economic and price trends, the balance of payments and the exchange rate of the Deutsche Mark — whether the central bank money stock should increase more in the lower or more in the upper half of this target range.
December 9	The EEC central bank governors, in agreement with the Council, decide to extend the current arrangements of the European Monetary System for another two years.
December 29	Under the Fifth General Increase in Quotas the quota of the Federal Republic of Germany in the International Monetary Fund is increased by 50% to SDR 3.2 billion.
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 that with effect from February 20 lombard loans at the lombard rate will not be granted to the banks in principle until further notice. Since then the banks have been provided, as and when necessary, with special lombard loans at the special lombard rate of (at present) 12%. The remaining restrictions on capital imports are de facto abolished; with immediate effect the Bundesbank also authorises sales of German bonds maturing within one year and of money market paper to non-residents.

1980	**II. Economic and fiscal policy**
January 1	In accordance with decisions taken in 1978, further tax cuts enter into force, notably the abolition of the tax on total wages paid and the increase in the allowances on trade earnings tax.
January 30	The Federal Government presents the 1980 Annual Economic Report. It states that a prime object of its economic policy is to prevent price movements from getting out of hand and to distinctly reduce the pace of price rises in the later part of the year; at the same time this is conducive to the targets of sustained economic growth and a higher level of employment. Provided that developments in the oil markets and the behaviour of the social groups do not run counter to overall economic requirements, the Federal Government regards an average annual real economic growth rate of just over 2½% as being within reach.
February 20	The Federal Government approves a Tax Relief Bill for 1981. The provisions are to come into effect in stages between the end of 1980 and the beginning of 1982, but mostly in 1981. The principal measures are a further adjustment of the income tax scale and an increase in children's benefits.
April 30	The Federal Cabinet adopts a supplementary budget for 1980 totalling DM 1.8 billion. The additional expenditure and smaller receipts due to the proposed raising of the Christmas allowance in 1980 are offset by cuts in other appropriations and increases in administrative receipts.
June 4	The Federal Government approves the Brussels Resolutions, through which the EEC Council has agreed to a compromise on the reduction of the British contribution to the EEC budget. For Germany this results in additional costs amounting to DM 2.5 billion in 1980 and 1981. An increase in the taxes on petroleum and spirits is envisaged to finance them. The Fiscal Planning Council recommends, as a guideline for the 1981 budgets, that the level of new indebtedness recorded in 1980 should not be exceeded. Expenditure should therefore not grow by more than 4% in 1981.
July 4	The Bundestag and Bundesrat approve the compromise reached in the Mediation Committee concerning the 1981 Tax Relief Act. The measures will cost the public authorities DM 16.5 billion in the first year that they are fully in effect.
November 17	The Council of Economic Experts regards the slowdown in economic activity in 1980 as being mainly a consequence of the greater need for structural adjustment due to the sharp rise in petroleum prices. The most important task for economic policy is to enable the economy to return to a medium-term growth path by improving the bases on the supply side. This calls, above all, for the removal of obstacles to investment and innovation.
December 12	The Fiscal Planning Council reaffirms its recommendation to strictly limit the growth of expenditure in 1981, with the aim of preventing new public indebtedness from exceeding the level of 1980.
December 16	The Federal Government approves the draft of the 1981 Federal budget, which embodies an increase of about 4% in expenditure and a financial deficit of DM 28 billion. At the same time it adopts a Bill to Reduce Subsidies and a Bill to Increase Petroleum Tax and Spirits Tax.
1981	
January 1	Major provisions of the Tax Relief Act (especially the new income tax scale) enter into force.
January 27	The Federal Government presents the 1981 Annual Economic Report. It states that priority must be given to containing the adverse effects of the massive increase in oil prices and to strengthening the basis for renewed economic growth, while at the same time improving the external position. Provided that there are no new external or domestic constraints in the course of the year, the Federal Government considers it possible that the gross national product will increase again in real terms during 1981 and be little or no lower than a year before.
April 1	The increase in petroleum tax and spirits tax enters into force.
April 8	The Federal Government, acting in coordination with corresponding measures by the French Government, approves a credit programme to encourage investment, notably in the energy sector. For Germany the Reconstruction Loan Corporation is to take up DM 6.3 billion in the international credit markets in order to grant low-interest loans, mainly to small and medium-sized enterprises, out of the funds raised.

somewhat stronger expansion of Germany's foreign markets, so that German exporters lost some (fairly minor) market shares; but in competing with imported goods in the domestic market German industry suffered some perceptible losses.

Competitiveness of German industry declines

These shifts in foreign trade should primarily be regarded as an indication of the lower competitiveness of German industry in its domestic and foreign sales markets. It appears that the strong appreciation of the Deutsche Mark in recent years only gradually began to affect real trade flows. In other words, some time elapsed before the full severity of the structural changes became manifest. The external problems for Germany that have meanwhile come to light were compounded by the fact that the relative and absolute improvement in the terms of trade during the periods when the Deutsche Mark was appreciating was soon reflected in the real incomes of employees and other income recipients — an advantage which, as it now turns out, cannot be maintained in full.

A reduction in the large current account deficits must primarily be sought in an improvement in German competitiveness, both in the domestic market vis-à-vis imports and in foreign sales markets in the case of exports. Given the continued strong inflationary tendencies abroad and the latest exchange rate movements of the Deutsche Mark (which has depreciated markedly, also in nominal terms, especially against the dollar, sterling and the yen), the price competitiveness of German industry is already likely to have improved significantly. But it will be important to exploit the price advantage in German enterprises' sales strategy in order to improve the current account.

Relatively strong average growth of exports despite slowdown during the year

In addition to the greater competitive pressure in world markets, the slackening of economic activity in foreign countries depressed German exports increasingly during 1980. In the first quarter of last year turnover was high, but thereafter exports declined continuously (seasonally adjusted); it was not until the end of the year and the beginning of 1981 that they started to rise again. On an annual average, however, the value of exports in 1980 was still 11½ % larger than a year before. The increase in the volume of exports was much smaller, at just over 4 %, because of the accelerating rises in export prices. Germany seems to have slightly improved its position in the markets of the industrial countries (as far as this can be judged today), but it lost appreciable ground in the markets of the OPEC countries, especially to Japan, which expanded its exports to the oil countries at a far above-average pace as a result of its low-cost range of consumer and capital goods. Taken by themselves, German exports to OPEC countries rose remarkably fast (+ 19 %), as already mentioned, but in the same period the exports of all industrial countries to that region increased much more strongly (by about 30 %). However, the recent depreciation of the Deutsche Mark, especially against the U. S. dollar, as well as Germany's stability advantage are likely to contribute in future to the maintenance of the German share in the expanding OPEC markets. In addition, special sales prospects may continue to present themselves in the other countries that supply oil to Germany: in 1980 exports to the USSR increased by 20 %, those to Norway by 22 % and those to the United Kingdom (despite the pronounced economic downturn there) by 9 %. There was also a steep rise last year in exports to Italy (22 %), France (17 %), Switzerland (22 %) and Austria (17 %), i. e. to countries where economic activity was relatively buoyant. In the case of Italy and France an important factor was that their currencies remained relatively stable against the Deutsche Mark because of the exchange rate arrangement within the European Monetary System (EMS), while domestic prices there increased much more than in Germany, so that German suppliers became more competitive in those markets. However, exports to the other partner countries in the EMS (+ 4 %) and to the United States (+ 3½ %) were rather weak, not least because price advantages of the above-mentioned kind were of little significance there and because economic activity was very sluggish in some cases. Exports to non-oil developing countries went up by 12 % but, given the balance of payments problems of many of those countries, it remains to be seen whether this relatively favourable development will persist.

Steep rise in nominal imports

The growth of imports, too, slowed down noticeably in the course of 1980, in keeping with the deterioration in domestic economic activity and the reversal in the stock cycle. Nevertheless, in value terms average imports in 1980 were 17 % larger than in 1979 because of the strong rise in prices, especially those of oil. In volume terms they grew by only about 2 %, which roughly corresponded to the increase in the gross national product. This unusually low elasticity of imports owes something to the fact that oil imports decreased by about one tenth in volume, as mentioned. On the other hand, imports of end-products continued to grow far more than proportionately, namely by almost 7% in real terms. From the regional point of view it was imports from the oil-supplying countries that showed the steepest nominal growth. In 1980 imports from the OPEC countries increased in value by 39% over 1979, those from the United Kingdom by 33% and those from Norway by 45%. In the case of imports from non-oil developing countries, which also went up considerably (by 17%), price rises — especially for raw materials — likewise played a significant role. By contrast, the growth of imports from the United States and Japan was very substantial not only in value terms (+ 27% and + 32%, respectively) but also in terms of volume. For example, the Deutsche Mark sales prices of Japanese cars increased relatively little despite the depreciation of the Deutsche Mark against the yen. On the other hand, the competitiveness of some major European partner countries in the German market obviously deteriorated in view of the stable exchange rates and the sustained inflation differential. There was a below-average rise in the value of imports from France (+ 10%), the Netherlands (+ 9%), Italy and Belgium-Luxembourg (+ 5% each).

Further increase in the deficits on "invisibles"

The deterioration on current account was caused not only by the fall in the trade surplus (as already mentioned) but also to a major extent by the growth of the deficits on "invisible" transactions. In 1980 the deficits on services and transfer payments accounts (including expenditure on the transport and insurance of imports) increased by DM 6.5 billion to DM 48 billion. The deficits in this sector of the balance of payments have tended to rise year after year, sometimes very steeply; in 1975, for instance, they amounted to only DM 33 billion, and in 1970 to barely DM 18 billion, i. e. to DM 30 billion less than in 1980. Germany is thus by far the biggest net importer of invisibles in the world. Much the most significant item is foreign travel, the deficit on which rose by DM 4 billion to DM 26 billion in 1980. The expenditure of Germans travelling abroad, at DM 38 billion, was DM 5 billion larger than in 1979, despite the heavier costs incurred by households for heating and petrol. An important factor in this connection, besides the high priority that continues to be given to travel expenditure in households' budgets, is that the annual holiday entitlement has in many cases now been extended to 30 working days, so that Germany is probably one of the leading industrial nations in this respect, too. The lengthening of holidays in the last few years has therefore not only increased enterprises' costs, and thus tended to reduce their international competitiveness, but also ultimately contributed to an exceptionally heavy burden of expenditure on tourism by international standards; in the meantime the total annual spending of Germans travelling abroad distinctly exceeds the equivalent of one month's exports.

In addition to foreign travel, a number of other factors contributed to the rise in the deficits on invisible transactions. As a result of the large current account deficit and the associated decrease in Germany's interest-bearing net external assets, the surplus on investment income account fell by DM 1.3 billion to just over DM 3 billion. On transfer payments account the net payments to the European Communities increased by DM 0.5 billion to roughly DM 4.5 billion. Moreover, the debts of a number of most seriously affected developing countries were cancelled, in the amount of DM 1.5 billion. However, this — unlike the other current unilateral transfers — must be regarded as a non-recurring transaction "only" affecting the assets position; as a rule the actual burden was placed on the German economy some while ago, namely at the time when these funds were provided, although the "soft" nature of the loans was recognisable from the start (e. g. by their low rates of interest).

Growing deficits on services and transfer payments necessitate greater efforts in the export field

The growing deficits on services and transfer payments accounts, considered as a whole, could be welcomed as contributing to the international division of labour between countries with differing locational advantages, but only as long as Germany ran corresponding compensatory surpluses on foreign trade. In present circumstances the seemingly irresistible increase in these deficits imposes a heavy strain, which in the end can only be countered by greater efforts to expand exports. Administrative restrictions, especially in the field of foreign travel, are inappropriate — quite apart from the regulatory misgivings they arouse and their impracticability — because they might have adverse repercussions on German exports to those countries which profit particularly from German tourists and from the home remittances of foreigners working in Germany, since they might result in a lack of demand there or perhaps even in trade countermeasures. This, like many other factors, goes to show that the individual components of Ger-

Major items of the balance of payments

DM billion

Item	1973	1974	1975	1976	1977	1978	1979	1980
A. Current account								
1. Foreign trade								
Exports (f.o.b.) 1	178.4	230.6	221.6	256.6	273.6	284.9	314.5	350.3
Imports (f.o.b.) 1	137.7	171.9	177.1	214.6	227.7	235.8	282.7	331.4
Balance	+40.7	+58.7	+44.5	+42.1	+45.9	+49.2	+31.8	+18.9
2. Supplementary trade items 2 and merchanting trade	− 0.1	− 1.3	− 1.2	− 0.1	+ 0.0	+ 2.0	+ 0.2	+ 0.0
Overall balance of trade	+40.6	+57.4	+43.3	+42.0	+46.0	+51.2	+32.0	+18.9
3. Services	−12.7	−14.8	−15.5	−14.2	−18.2	−15.3	−20.9	−23.9
of which								
Foreign travel	−10.9	−12.4	−14.7	−14.6	−16.4	−19.0	−21.9	−25,8
Investment income	+ 1.6	+ 0.9	+ 2.4	+ 3.3	+ 0.4	+ 5.1	+ 4.5	+ 3.2
4. Transfer payments	−15.5	−16.1	−17.9	−17.9	−18.2	−17.4	−20.7	−24.1
of which								
Remittances of foreign workers	− 8.2	− 7.7	− 7.4	− 6.7	− 6.1	− 5.9	− 6.5	− 6.9
Payments to the European Communities (net)	− 2.2	− 1.9	− 3.7	− 3.5	− 3.5	− 1.9	− 4.0	− 4.5
Balance on current account	+12.4	+26.6	+ 9.9	+ 9.9	+ 9.5	+18.4	− 9.6	−29.1
B. Capital account								
1. Long-term capital transactions								
(a) German investment abroad (increase: −)	− 2.9	−11.6	−24.1	−19.9	−23.1	−24.1	−21.1	−29.1
of which								
Direct investment	− 4.4	− 5.0	− 4.9	− 6.2	− 5.1	− 7.2	− 8.4	− 8.2
Portfolio investment	+ 0.4	− 1.1	− 2.6	− 0.9	− 5.4	− 4.2	− 3.0	− 7.7
Advances and loans of banks	+ 3.7	− 2.6	−13.5	− 9.7	− 9.6	− 8.5	− 5.4	− 9.4
Official	− 2.2	− 2.1	− 2.2	− 2.4	− 2.1	− 3.3	− 2.4	− 1.7
(b) Foreign investment in Germany (increase: +)	+15.9	+ 5.3	+ 5.9	+18.4	+10.2	+21.2	+31.9	+35.8
of which								
Direct investment	+ 5.3	+ 5.5	+ 1.7	+ 2.7	+ 1.9	+ 3.1	+ 2.1	+ 2.1
Portfolio investment	+ 6.5	− 1.9	− 1.6	+ 4.8	+ 2.3	+ 3.2	+ 5.9	+ 1.0
Advances and loans of banks	+ 0.6	+ 1.3	+ 2.0	+ 4.9	+ 5.0	+14.8	+22.8	+ 8.5
Official	− 0.0	+ 1.2	+ 3.4	+ 4.8	+ 0.5	− 0.0	+ 0.9	+23.1
Balance of long-term capital transactions	+12.9	− 6.3	−18.2	− 1.5	−12.9	− 2.9	+10.8	+ 6.7
2. Short-term capital transactions (net capital exports: −)								
(a) Enterprises and individuals	+ 5.2	− 9.3	+ 6.5	− 5.7	+ 4.6	− 2.9	− 5.0	+ 8.5
Financial credits	+ 0.6	+ 3.1	+ 2.5	− 0.0	+ 8.5	+ 1.0	− 3.3	+13.3
Trade credits	+ 4.6	−12.4	+ 4.1	− 5.7	− 3.9	− 3.9	− 1.7	− 4.8
(b) Official	+ 0.2	+ 0.0	+ 0.7	− 0.6	− 0.0	+ 1.2	− 0.3	− 0.4
(c) Banks	− 5.1	− 9.7	− 2.3	+ 6.7	+ 8.1	+10.1	+ 4.3	− 9.3
Assets	− 7.9	−12.0	−13.0	− 2.7	+ 1.2	− 2.2	− 1.7	− 7.1
Liabilities	+ 2.8	+ 2.3	+10.8	+ 9.4	+ 6.9	+12.3	+ 6.1	− 2.2
Balance of short-term capital transactions	+ 0.2	−19.0	+ 4.9	+ 0.4	+12.6	+ 8.4	− 1.0	− 1.2
Balance on capital account	+13.1	−25.3	−13.3	− 1.0	− 0.3	+ 5.4	+ 9.9	+ 5.5
C. Balance of recorded transactions	+25.5	+ 1.3	− 3.3	+ 8.9	+ 9.2	+23.9	+ 0.2	−23.6
D. Balance of unclassifiable transactions (balancing item)	+ 0.9	− 3.2	+ 1.1	− 0.1	+ 1.2	− 4.1	− 5.2	− 4.3
E. Overall balance on current and capital accounts	+26.4	− 1.9	− 2.2	+ 8.8	+10.5	+19.8	− 5.0	−27.9
F. Balancing item to the external position of the Bundesbank 3	−10.3	− 7.2	+ 5.5	− 7.5	− 7.9	− 7.6	− 2.3	+ 2.2
G. Change in the net external assets of the Bundesbank (increase: +)	+16.1	− 9.1	+ 3.3	+ 1.3	+ 2.6	+12.2	− 7.3	−25.7
of which External liabilities (increase: −)	+ 1.0	− 0.3	+ 0.3	− 0.9	+ 0.8	− 4.9	+ 1.9	− 9.4

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 DM value of the external position of the Bundesbank owing to valuation adjustments.
Discrepancies in the totals are due to rounding.

many's external transactions in goods and services are very closely interrelated. It is not possible to try to extract one part (e. g. expenditure on foreign travel, purchases of certain luxury goods or the home remittances of foreign workers) without damaging the entire structure of foreign trade and payments. For Germany the solution lies in overall adjustment rather than in special measures. Considering the way Germany is integrated in the international division of labour, this means first and foremost stepping up exports of industrial goods and industrial services (above all engineering and construction work), which together account for roughly 80% of our total exports, and improving the competitiveness of industrial goods — and also of certain services — in the German market.

Large current account deficit hampers financing

The large size of the German deficits on current account made it difficult from the outset to finance them through the market, if only because of the magnitude of the resulting supply of Deutsche Mark in the foreign exchange market. The situation was further aggravated by the fact that the level of interest rates in other major countries was much higher than in Germany. A key role was played by U. S. monetary policy, which, since the end of 1979, has been pursuing a more anti-inflationary course, with interest rates that have tended to be high (and have fluctuated sharply at times). Once foreigners recognised Germany's growing external problems, the fact that Deutsche Mark interest rates were lower than those of other currencies was no longer considered to be justified (as in earlier years) even though the differences in inflation rates persisted; expectations of an appreciation of the Deutsche Mark (which had previously offset the interest rate disadvantage) diminished, although they did not disappear altogether. In view of the ruling interest rates, Deutsche Mark assets became less attractive to non-residents, while foreigners' readiness to incur Deutsche Mark debts increased. As a consequence of these two factors the net capital inflows required to finance the deficit on current account failed to materialise last year.

Growing long-term capital exports

The greater foreign demand for long-term Deutsche Mark loans led to growing German long-term capital exports in 1980; at DM 29 billion, they were DM 8 billion larger than in 1979, a year with a much smaller current account deficit. In particular, outflows in the form of long-term bank loans last year, at DM 9.5 billion, were far higher than in 1979. For the most part they consisted of loans to European industrial countries with quite considerable current account deficits (but much higher interest rate levels). At the same time residents increased their purchases of foreign Deutsche Mark bonds. The yields on these securities, the bulk of which used to be bought by non-residents, rose noticeably above the yields on domestic bonds in the second half of 1980 because of foreigners' declining interest, so that new issues were increasingly placed with residents, and such securities were bought from foreigners' holdings in the secondary market, too. The market for foreign Deutsche Mark bonds, which in earlier years had acted as a turntable for foreign funds (and had had very little effect on the balance of payments), thus tended to enhance capital exports. In the aggregate, residents invested almost DM 8 billion net in foreign securities.[1] On the other hand, new investment by enterprises (and banks) in foreign subsidiaries and branches — i. e. "direct investment"— in 1980, at just over DM 8 billion, was no larger than in the preceding year. After German participations abroad had expanded vigorously in previous years, a phase of consolidation may have started in 1980.

Decrease in private long-term capital imports

While, as mentioned, long-term capital exports rose distinctly in 1980, the simultaneous inflow of long-term foreign funds to banks, enterprises and individuals, at just under DM 13 billion, was less than half as large as in the preceding year. A particularly serious factor was that foreign investment with German banks increased by hardly more than DM 8 billion, after almost DM 23 billion of long-term funds had flowed to the banks from other countries in 1979. In particular, long-term borrowing abroad through the placing of borrowers' notes of banks (which in 1979 had accounted for almost half of the funds raised) declined to only 15% of the previous year's level. Non-residents' new investment in

1 In December 1980 the leading German banks in the field of security issuing decided not to float any new loans for the time being. Parallel to this, the German banks agreed with the Bundesbank to discontinue long-term lending to non-residents (with certain exceptions) up to the end of March 1981. Since last December, therefore, hardly any long-term funds have been exported through such transactions.

German securities (mainly bonds) in 1980 came to DM 1 billion, which was likewise only a fraction of the 1979 figure.[1]

Large official capital imports

This decrease in private capital imports was, however, largely balanced by the fact that the public sector, and particularly the Federal Government, raised a sizeable amount of loans abroad. In 1980 public authorities (including the Federal Railways and the Federal Post Office) imported a total of DM 23 billion of long-term funds; it is estimated that half of this sum was accounted for by the placing of borrowers' notes of the Federal Government (and also of the Länder Governments) in other countries by banks. These borrowers' notes, which have only been available to non-residents again since last year, were mainly placed in OPEC countries with large current account surpluses and a corresponding need to diversify. In addition, the Federal Government raised direct loans amounting to almost DM 6 billion, primarily in Saudi Arabia. Not only the OPEC countries but also official agencies in the United States invested considerable amounts in Federal Government borrowers' notes last year (DM 5 billion). These funds consisted partly of Deutsche Mark which the U. S. monetary authorities acquired in the foreign exchange market during periods when the Deutsche Mark was weak and partly of the Deutsche Mark proceeds of the "Carter Notes" issued in January 1980.

Short-term capital inflows to enterprises, but outflows from banks

In 1980 the outflows due to short-term capital transactions (including the balancing item of the balance of payments), at DM 5.5 billion net, were almost as large as the inflows through long-term capital transactions.[2] Overall, the salient feature was that the capital movements of banks and enterprises were in opposite directions. While the banks exported over DM 9 billion (net) of short-term funds, more than DM 4 billion flowed to enterprises on balance; the latter raised DM 13.5 billion (net) of short-term financial credits alone, mainly Euro-DM loans granted primarily by the foreign subsidiaries and branches of German banks. In 1980, in contrast to the previous year, such Euro-DM loans were mostly cheaper than funds obtained in Germany.

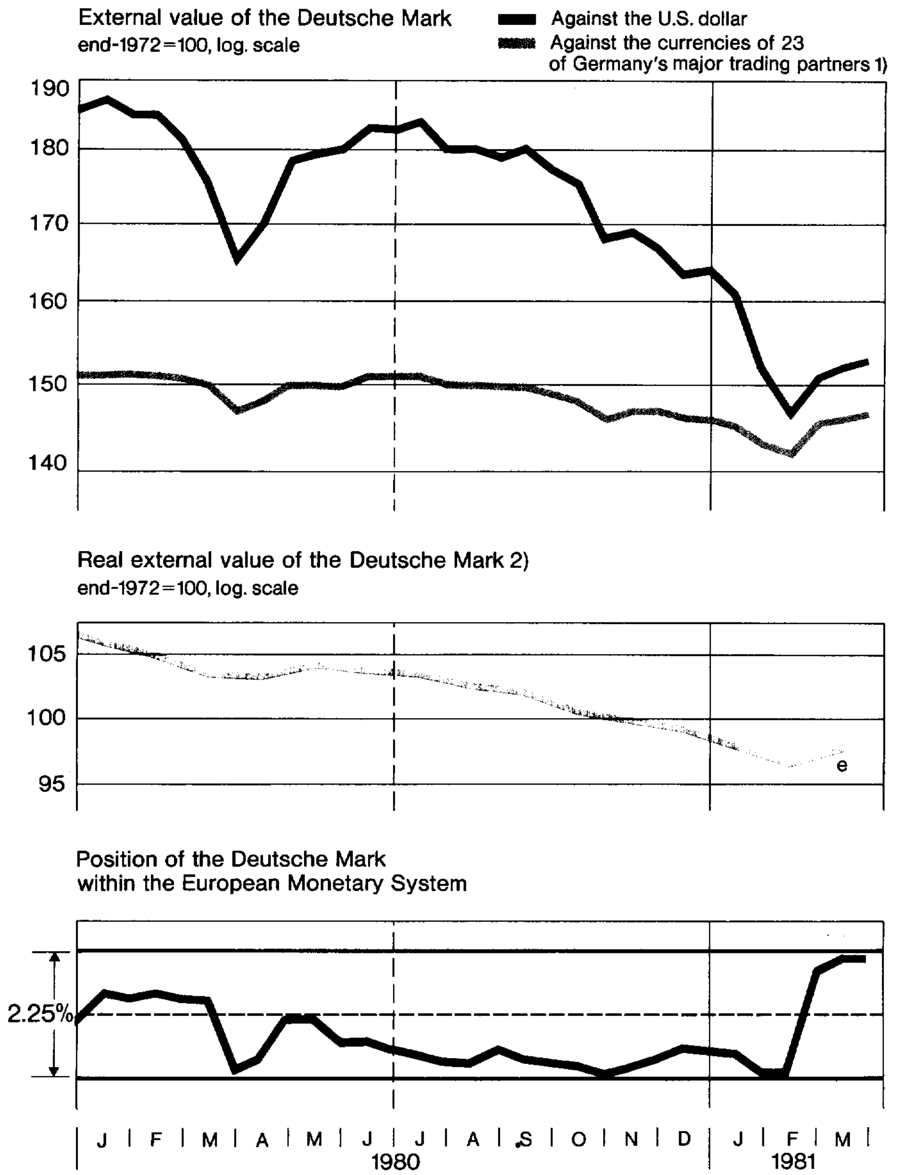
In the course of the year the short-term capital transactions of the banks fluctuated sharply — not least, it seems, as a reaction to the varying readiness of non-residents to maintain open Deutsche Mark positions. In the first quarter, when the Deutsche Mark came under pressure for the first time, substantial amounts of short-term funds flowed from the banks, not counting the swaps with the Bundesbank. When exchange rate movements temporarily reversed, short-term funds started to flow in again, but these imports gave way to exports once more in the last few months of the year. In the aggregate, the short-term external assets of the banks rose by DM 7 billion in the course of the year, implying a corresponding outflow of funds. Non-residents simultaneously ran down their short-term investments with German banks (which had gone up strongly in preceding years) by over DM 2 billion, which increased the exports of short-term capital from the banking sector to more than DM 9 billion. These outflows of short-term funds from the banking system, which persisted at the beginning of 1981, largely came to a halt after the Bundesbank had taken restrictive monetary measures in mid-February.

Deutsche Mark under strong pressure at times in the foreign exchange markets

In the wake of the mounting deficits on Germany's balance of payments, the exchange rate of the Deutsche Mark deteriorated and the prospects of completely remedying occasional setbacks dwindled. Compared with the level of exchange rates at the beginning of 1980, when the dollar reached an all-time low of approximately DM 1.70, the Deutsche Mark lost almost 13% of its value in the course of the year. At the beginning of 1981 the pressure on the Deutsche Mark increased considerably, so that by mid-February the Deutsche Mark had depreciated by about as much again. Within the European Monetary System the Deutsche Mark occupied a very weak position from the spring of 1980 onwards, but in view of the relatively stable exchange rate relationship vis-à-vis the partners in the EMS the weighted depreciation of the Deutsche Mark against the average of the currencies of 23 of Germany's major trading partners in the course of last year, at about 4%, was much smaller than that against the dollar. In 1979 the Deutsche Mark

1 In the course of last year the restrictions on purchases of domestic bonds by non-residents (and parallel to that the agreements with the banks on the placing of borrowers' notes abroad) were greatly relaxed. Since February 1981 foreigners have been permitted to buy (in principle without any restrictions) short-term bonds maturing within one year and money market paper, so that now all maturity categories in Germany's financial markets are accessible to foreign investors.

2 If short-term capital transactions are adjusted for the swaps outstanding at the beginning of 1980, in the context of which DM 2.2 billion of external assets were shifted from the banks to the Bundesbank at the end of the year for the purpose of controlling liquidity, DM 2.2 billion less flowed out in the field of short-term capital transactions.



1) Weighted external value relative to the central rates of end-1972; geometric mean.- 2) Weighted external value against the currencies of 13 industrial countries after adjustment for price discrepancies (as measured by the wholesale prices of industrial products) between Germany and abroad; geometric mean.- e Estimated.- Latest position: end of March.

had already depreciated slightly in real terms, i. e. after taking account of the price differential between Germany and other countries; as the gap between the nominal exchange rate movement of the Deutsche Mark and the price differential widened, the trend towards a real depreciation of the Deutsche Mark accelerated last year, so that the real external value of that currency (as measured by the wholesale prices of industrial products) towards the end of the year was more than 7 %, and in March 1981 just over 8 %, below the level of end-1979. In contrast to earlier years, when Germany had been shielded from the faster price rises in other countries by the appreciation of the Deutsche Mark, inflationary tendencies were thus transmitted more strongly to Germany; but in the longer run this real depreciation enhances the prospects of achieving the real adjustment necessary for reducing the current account deficit. This presupposes, of course, that the higher cost of imports owing to the depreciation does not lead to an acceleration of the rise in costs and prices in Germany, which would undo the positive effects of the real depreciation.

Current account deficit ultimately financed by the Bundesbank again

The Deutsche Mark, which was under severe pressure at times, was supported at the beginning of last year by substantial dollar sales on the part of the Bundesbank and towards the end of the year mainly by Deutsche Mark purchases by the U. S. monetary authorities and by interventions in the European Monetary System. The monetary reserves of the Bundesbank consequently decreased by DM 16.3 billion last year;[1] at the same time the external liabilities increased by DM 9.4 billion, so that the Bundesbank's net external assets fell by DM 25.7 billion; at the end of 1980 they amounted to DM 67.4 billion, and to DM 50.3 billion if gold is excluded. Hence last year's deficit on current account was reflected almost in full in the external position of the Bundesbank; in other words, private and official capital imports hardly contributed at all on balance to the financing of the deficit, just as in 1979. At the beginning of 1981 the external situation continued to deteriorate. In mid-February the Bundesbank therefore took a number of restrictive monetary measures which increased the domestic interest rate level, further reduced the supply of bank liquidity and helped to stabilise the exchange rate of the Deutsche Mark. Up to the time when this Report went to press the monetary reserves rose quite considerably.

4. Monetary policy fosters domestic and external stability

(a) Tight money supply

Slightly lower monetary growth target for 1980

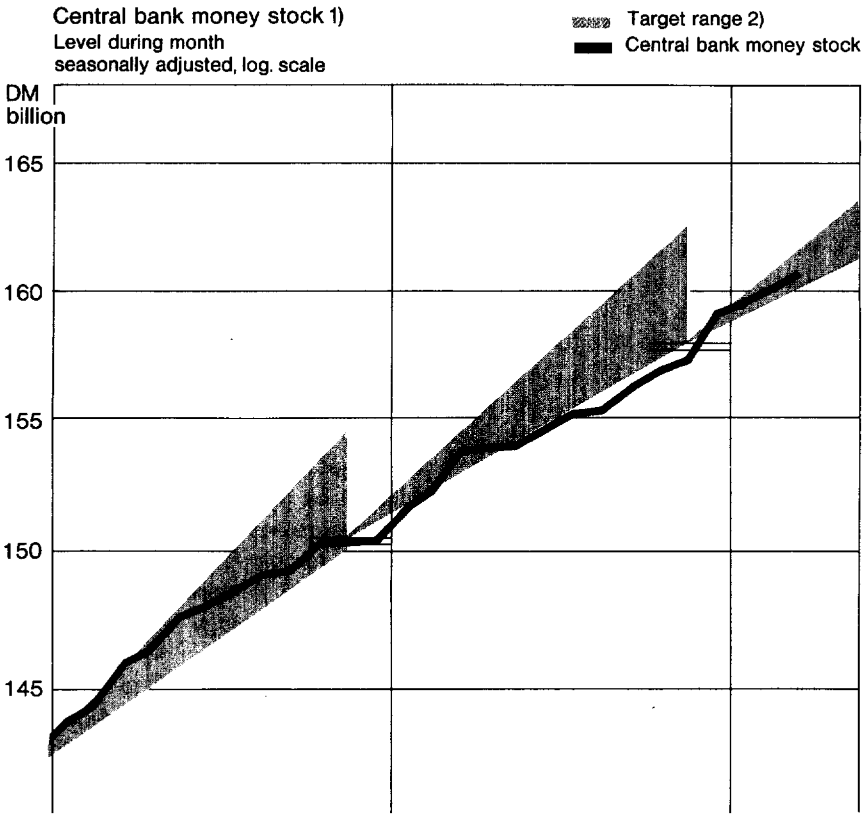
Owing to the renewed sharp increase in oil prices, the rising deficit on the current account of the German balance of payments and the temporary weakness of the Deutsche Mark in the foreign exchange markets, the principal task of monetary policy last year was to counteract the growing risks to domestic and external stability. The Bundesbank's main concern was therefore to keep as small as possible the monetary scope for passing on the higher costs in domestic prices, in order to prevent the price and cost increases that came from abroad from finally resulting in "home-made" inflation. The Bundesbank underlined this objective by adopting a comparatively restrictive monetary growth target for 1980. At the end of November 1979 it announced that it planned to keep the expansion of the central bank money stock between the fourth quarter of 1979 and the fourth quarter of 1980 within a range of 5 to 8 %. The new target range, which was 1 percentage point below that set for 1979, demonstrated the Bundesbank's intention of continuing its stabilisation policy without any relaxations and of reducing the money supply in the economy, after the undue increases of 1977/78, to proportions which were more in line with the growth of the production potential. Furthermore, the Bundesbank expressly stated that the decision as to whether monetary policy would aim more at the lower or more at the upper limit of the target range would depend on the development of prices, economic activity and the exchange rate of the Deutsche Mark.

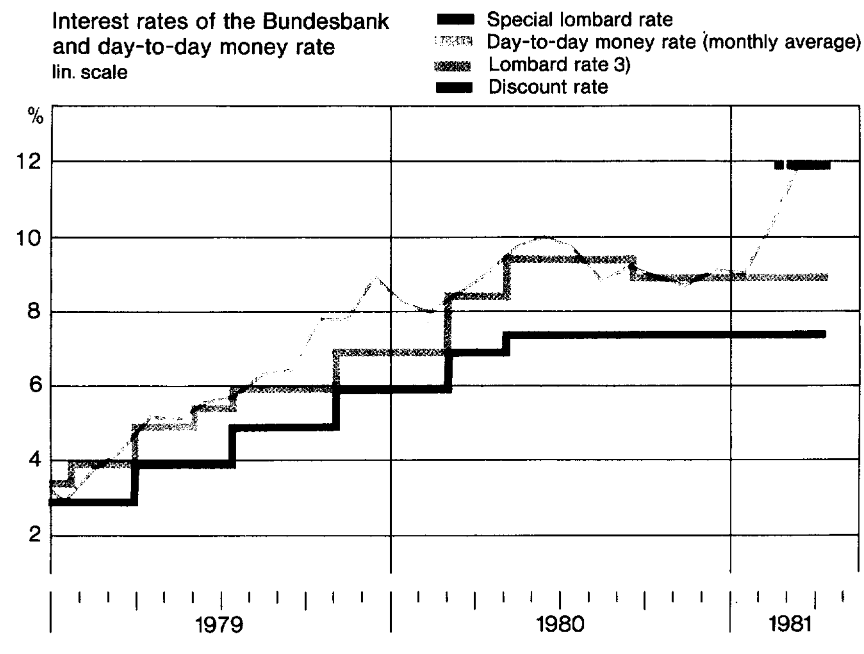
Early concretisation of the target in the course of 1980

When it became evident, on the renewed raising of oil prices and the weakening of the exchange rate of the Deutsche Mark, that the fight against inflation and the prevention of an excessive depreciation had to be made the prime objectives of economic policy, the Bundesbank indicated that, under the prevailing conditions, its aim was to keep the expansion of the central bank money stock "in the middle or perhaps in the lower half of the target range" (as formulated in the Monthly Report of February 1980). After its periodic review of the monetary growth target in the middle of the year, the Bundesbank decided to aim at the lower half of the target range for the growth of the central bank money stock in the course of 1980. As monetary expansion was slightly below the envisaged target rate of 5 % at that time, and as there were also increasing signs in the summer of a slowdown in economic activity and (at least temporarily) a slackening of price rises, the Bundesbank began to boost monetary growth by a gradual relaxation of its liquidity and interest rate policies. However, owing to the external constraints the room for manœuvre available to monetary policy was so restricted from the start that a radical change of stance was out of the question. Moreover, the policy of cautious relaxation could not be continued beyond the late summer because the exchange rate of the Deutsche Mark came under pressure again in the exchange markets, primarily as a result of the renewed sharp rise in interest rates in the United States. Nonetheless, the Bundesbank succeeded in bringing the growth of the money supply on to the target path envisaged for 1980. In the fourth quarter of last year the central bank money stock was 4.9 % larger than in the fourth quarter of 1979; it was thus virtually at the lower limit of the target range for 1980.

1 Change in the monetary reserves due to transactions less the counterpart in respect of the valuation of the gold contributed to the European Monetary Cooperation Fund; excluding the allocation of SDRs and swaps with banks.

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) 1979: 6 to 9%, 1980: 5 to 8%, 1981: 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).

Monetary "self-adjustment" owing to the contractionary effects of the balance of payments deficit

Achievement of the monetary growth target for 1980 meant that the "monetary cloak" of the economy, which had grown too large in the years when the Deutsche Mark was appreciating strongly, was cut down to more non-inflationary size. In view of the outflows of funds to other countries it was comparatively easy for the Bundesbank to realise this objective, as the continued withdrawals of funds through external current and capital transactions in themselves curbed the growth of non-banks' money balances. In addition, the foreign exchange outflows from the Bundesbank were associated with a heavy drain on bank liquidity. The Bundesbank offset these reductions in the banks' liquidity but, as the lender, it was able to set the terms in the money market flexibly in accordance with requirements.

Encouraging experience with the target range

In view of the fact that the Bundesbank, as intended, reached the lower limit of the announced three-point target range for the expansion of the central bank money stock in both 1979 and 1980 (see the chart on page 29), it has sometimes been asked whether the central bank does not unnecessarily confuse the general public by choosing such a wide spread for its monetary growth target. However, recent experience has tended to confirm, rather than disprove, the correctness of the procedure chosen. At a time when there is a threat of unforeseeable external disturbances — such as oil price shocks or sharp monetary policy changes, affecting interest rates, in other countries with which Germany has close ties — it would be too ambitious for monetary targeting and impossible in monetary policy practice to aim at a single-figure target for monetary growth. Not least for this reason, since 1979 the Bundesbank has set year-on-year targets with a spread of 3 percentage points for the increase in the central bank money stock. Since on each occasion the central bank has specified the conditions under which it will aim more at the upper or more at the lower limit of the target range, it has not been possible for the announced target to be interpreted arbitrarily by the general public or by the Bundesbank itself. In the event, the target range procedure has enabled monetary policy in the past two years to counteract unexpected threats to domestic and external stability by aiming more at the bottom of the target range, i. e. by keeping the money supply tight and thus preventing the emergence of an inflation psychology.

Restrictive monetary growth target for 1981

This on balance heartening experience encouraged the Bundesbank to announce a monetary growth target for 1981 in a similar form to that for the two preceding years (year-on-year increase with a three-point spread). The Central Bank Council accordingly adopted a target range of 4 to 7 % for the growth of the central bank money stock in the present year (between the fourth quarter of 1980 and the fourth quarter of 1981). The range was thus once more set 1 percentage point lower than a year before. As in every year since 1974, when the Bundesbank was the first central bank to announce a monetary growth target, it derived its new objective on the basis of the expected increase in the production potential in 1981 (+ 2½ %). It also assumed that, given concerted stability-oriented efforts in the fields of fiscal and wage policy and under favourable international economic conditions, domestic price rises can be kept to some 3½ to 4 %; the expansion of the production potential, after allowing for the virtually inevitable increase in prices during the year, therefore yielded a growth of 6 to 6½ % in the margin for overall expenditure which has to be accommodated by monetary policy. In purely arithmetical terms it also had to be taken into account that the "velocity of circulation" of the central bank money stock had risen further during 1980, so that its average figure for 1981 would go up again (even if — as supposed — this tendency does not continue in 1981). This gave rise to the assumption of a mean acceptable year-on-year growth of the central bank money stock between the fourth quarter of 1980 and the fourth quarter of 1981 of some 5½ %, and — after allowing for the necessary margin of flexibility — to the above-mentioned target range of 4 to 7 %. To prevent misinterpretations of this range, the Bundesbank specified that it considered the upper half of the target range appropriate only if "home-made" price and cost increases slackened, the exchange rate of the Deutsche Mark steadied and external disequilibrium lessened. The lower half was regarded as appropriate in the event of new risks to domestic and external monetary stability. Latterly (in March 1981) the growth rate of the central bank money stock has been roughly in the middle of the target range announced for 1981.

Monetary policy on a "potential-oriented path" in the medium term

In 1980, as in the preceding years, the monetary policy of the Bundesbank was oriented towards the growth of the production potential. In fighting unexpected and unwelcome monetary developments in the past, however, the Bundesbank was not always able to keep to this objective in the short run; in 1978, for instance, the money stock considerably overshot the target because a less expansionary policy would have further exacerbated the appreciation of the Deutsche Mark, which was already too strong. Conversely, monetary policy subsequently tried in the longer run to check this excessive expansion of the money stock and to slow it down to a pace that was acceptable in the medium term. But it would be unjustified to claim, on the strength of this, that the monetary policy of the Bundesbank is primarily guided by external considerations or to deny that it is geared to medium-term objectives based on the growth of the production potential. In-

Monetary developments

Change during period 1

Item	1974	1975	1976	1977	1978	1979	1980
	DM billion						
A. Creation of central bank money and central bank money requirements of banks 2							
1. Provision (+) or absorption (−) of central bank money through							
Rise in the central bank money stock 3 (increase: −)	− 5.8	− 9.5	− 7.9	−10.9	[11] − 14.1	− 7.8	− 6.5
Foreign exchange movements (excluding foreign exchange swaps)	− 2.8	− 2.1	+ 8.3	+ 8.4	+ 20.3	− 5.2	− 24.6
Cash transactions of the central and regional authorities (excluding shifts under section 17 of the Bundesbank Act)	− 3.0	− 2.8	+ 8.1	+ 5.0	− 2.1	+ 3.9	+ 0.3
Other factors	− 4.1	− 1.3	− 5.2	− 4.4	− 3.8	− 5.2	− 7.9
Total 1	−15.7	−15.6	+ 3.4	− 2.0	+ 0.3	− 14.3	− 38.8
2. Measures of monetary policy							
Change in minimum reserves	+12.7	+ 7.2	− 4.6	+ 8.1	− 1.8	− 3.2	+ 10.5
Change in rediscount quotas	+ 4.5	+ 4.5	+ 0.7	+ 6.5	+ 4.4	+ 5.1	+ 12.1
Open market operations (with non-banks, in "N paper" and long-term securities)	− 0.0	+11.4	− 8.4	− 0.7	− 3.6	+ 2.7	+ 4.5
Reversible compensatory operations 4	− 1.4	+ 4.7	− 4.7	−	−	− 2.3	+ 10.5
Total 2	+15.8	+27.8	−17.0	+13.9	− 1.1	+ 2.4	+ 37.6
3. Remaining central bank money deficit (−) or surplus (+) (1 plus 2)	+ 0.1	+12.2	−13.7	+11.9	− 0.8	− 11.9	− 1.2
met by							
Recourse to unused rediscount quotas (reduction: +)	− 2.1	−10.2	+ 7.2	− 5.5	− 0.2	+ 9.7	− 1.4
Raising (+) or repayment (−) of lombard or special lombard loans	+ 2.0	− 2.0	+ 6.5	− 6.5	+ 1.0	+ 2.2	+ 2.6
	in %						
B. Key monetary indicators							
Central bank money stock 2, 5	+ 6.3	+ 9.8	+ 8.4	+10.0	[11] + 12.1	+ 5.1	+ 5.9
Memorandum item							
As an annual average	+ 6.1	+ 7.8	+ 9.2	+ 9.0	[11] + 11.4	[11] + 9.0	+ 4.9
Lending by banks and the Bundesbank to domestic non-banks	+ 7.9	+10.4	+10.0	+ 9.5	+ 11.4	+ 11.4	+ 9.4
M1 (= currency in circulation and sight deposits)	+11.1	+14.5	+ 4.1	+11.3	+ 14.3	+ 3.9	+ 4.4
M2 (= M1 plus time deposits for less than 4 years)	+ 4.8	+ 0.1	+ 6.7	+11.1	+ 13.0	+ 8.0	+ 8.7
M3 (= M2 plus savings deposits at statutory notice)	+ 8.3	+ 8.9	+ 8.4	+11.1	+ 10.8	+ 5.7	+ 6.3
	DM billion						
C. Money stock and its counterparts							
Money stock M3 (= 1 plus 2 less 3 less 4 less 5)	+35.2	+38.4	+41.0	+58.9	+ 64.8	+ 39.2	+ 42.8
Counterparts in the balance sheet:							
1. Volume of credit 6	+59.8	+85.5	+91.2	+94.2	+125.4	+139.0	+126.3
of which							
Bank lending to domestic non-banks	+61.2	+78.9	+96.3	+95.8	+122.6	+140.9	+122.4
− to enterprises and individuals 7	+26.0	+16.6	+46.5	+42.3	+ 49.0	+ 67.5	+ 56.2
− to the housing sector 8	+15.2	+14.3	+19.3	+26.8	+ 38.9	+ 44.8	+ 44.7
− to public authorities	+20.1	+48,0	+30.5	+26.7	+ 34.7	+ 28.5	+ 21.7
2. Net external assets 9	+13.2	+16.8	+ 8.3	+10.1	+ 7.1	− 21.8	− 10.6
3. Monetary capital	+34.5	+61.3	+59.1	+42.9	+ 54.8	+ 75.8	+ 61.7
of which							
Savings deposits at agreed notice	+ 8.5	+25.9	+12.2	+ 0.8	+ 7.7	+ 3.3	− 1.9
Bank savings bonds	+ 4.8	+ 8.9	+10.4	+13.4	+ 10.3	+ 14.8	+ 17.8
Time deposits for 4 years and over	+ 8.0	+ 9.4	+11.4	+13.6	+ 17.0	+ 18.7	+ 14.6
Bank bonds outstanding 10	+10.1	+12.9	+19.3	+ 9.7	+ 14.2	+ 33.6	+ 26.8
4. Central bank deposits of domestic public authorities	+ 0.4	+ 1.4	−10.2	− 0.8	+ 2.5	− 1.7	− 1.9
5. Other factors	+ 2.9	+ 1.2	+ 9.6	+ 3.3	+ 10.4	+ 3.8	+ 13.2

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 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.

cidentally, the flexibility with which the Bundesbank responds in the short run to unusual disturbances owes much to the fact that in the last analysis the monetary growth target is only an "intermediate target variable", the final objective of the Bundesbank's policy being to safeguard the currency. Although the longer-term curbing of the expansion of the money stock is essential for this purpose, it is possible that, under very difficult conditions, it may become necessary to take short-term measures which in themselves could be regarded as a temporary departure from the path of medium-term expansion.

(b) Monetary measures and money market developments

Tightening of interest rate policy in the spring of 1980

The use of the Bundesbank's monetary policy instruments in 1980 was for a long time determined by the need to shield the domestic money market from the abrupt changes in short-term interest rates abroad and in particular to offset the drain on bank liquidity caused by outflows of funds. In the first half of 1980, when — in the light of the increased inflationary dangers and the relatively strong monetary growth, but also of the rapid deterioration in the balance of payments — it was important to underline the objectives of monetary policy, the interest rate component of the Bundesbank's policy measures became more prominent. At the end of February the discount rate was raised from 6% to 7% and the lombard rate from 7% to 8½%. This brought central bank interest rates closer to the rates at the "long end" of the market, which had gone up spontaneously under the impact of the international increase in interest rates. In order to ensure that the desired broad effect of interest rate policy was achieved, the discount and lombard rates were raised further to 7½% and 9½%, respectively, at the beginning of May. During this period of interest rate adjustment the significance of the fine-tuning measures in the money market, which had greatly increased at times in the preceding year, diminished. The main reason for this was the lifting of the "lombard limits" from March 1980 onwards; thereafter it was no longer necessary to constantly regulate developments in the money market by means of short-term compensatory operations such as foreign exchange swaps, repurchase agreements, etc., for the purpose of increasing or reducing liquidity. The Bundesbank's decision was facilitated by the fact that, owing to the rising deficit on current account, the earlier inflows of funds had given way to massive outflows, and the Bundesbank still had the option of influencing the settlement of balances in the money market by means of ad hoc fine-tuning measures if it did not wish to leave such settlement completely to the "lombard safety valve".

Offsetting the outflows of funds to other countries

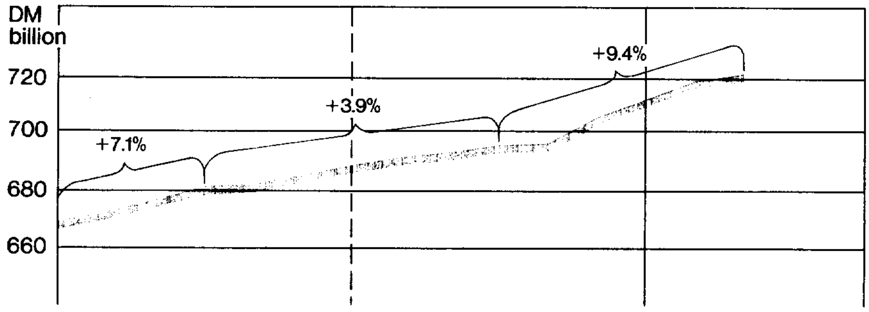
In addition, the banks were provided with a substantial quantity of central bank money on a durable basis in the first half of last year. In this way the Bundesbank largely offset the drain on liquidity which the banks were suffering as a result of the persistent foreign exchange outflows. At the beginning of March and also of May the rediscount quotas were raised by a total of DM 7 billion. At the same time minimum reserves amounting to DM 5 billion were released. To counteract the liquidity squeeze caused by the outflows of foreign exchange, in the spring of 1980 the Bundesbank also repurchased, before maturity, the mobilisation and liquidity paper held by banks (DM 3.1 billion). In addition, for several months the Bundesbank used its fine-tuning instruments to enhance bank liquidity. It mostly adopted this approach when undesirable signalling effects, such as may be associated with the traditional instruments of "coarse tuning", were to be avoided, for not infrequently it was safe to assume that unwelcome external influences would soon weaken or be reversed. The Bundesbank mainly conducted open market transactions in securities under repurchase agreements (purchases of securities for later resale) for this purpose.

Gradual easing of monetary policy in the summer

During the above-mentioned gradual release of the monetary brakes last summer, liquidity policy came more to the fore. As the international pattern of interest rates and Germany's weak current account position left no room for lowering central bank interest rates, the Bundesbank influenced rates in the interbank market solely by providing relatively large amounts of liquidity through the "open market". An easing of money market conditions was initiated in July by the resumption of security purchases for later resale, with the banks participating for the first time in the fixing of the rate ("interest rate tender"). The gradual fall in interest rates in the domestic money market was more lastingly underpinned by a reduction in the minimum reserves as from September 1 (releasing DM 5.5 billion of liquidity) and the lowering of the lombard rate on September 18 (from 9½% to 9%). The external situation did not permit more far-reaching expansionary measures. How little room for manœuvre the Bundesbank actually had at that time be-

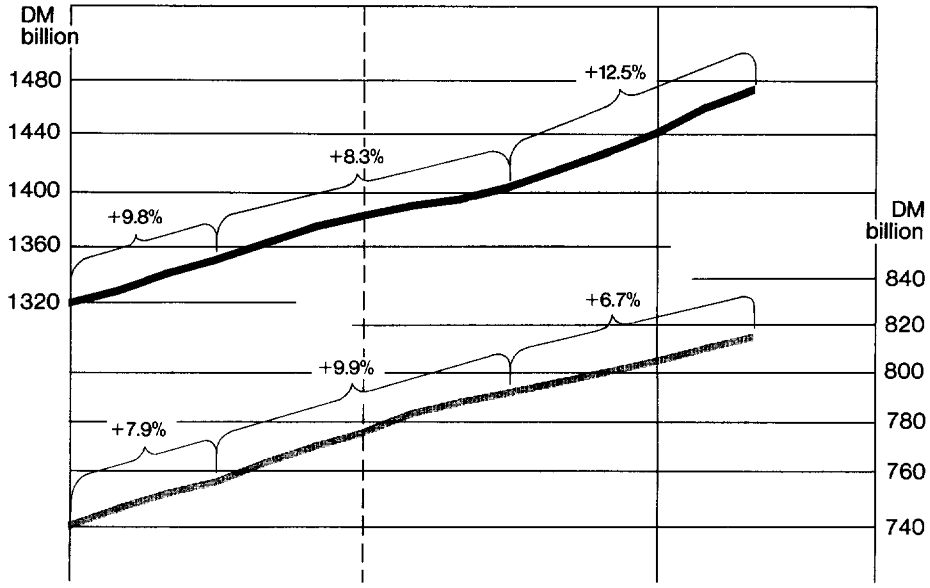
Broadly defined money stock (M3) 1)
log. scale, seasonally adjusted

Percentage change, expressed as an annual rate



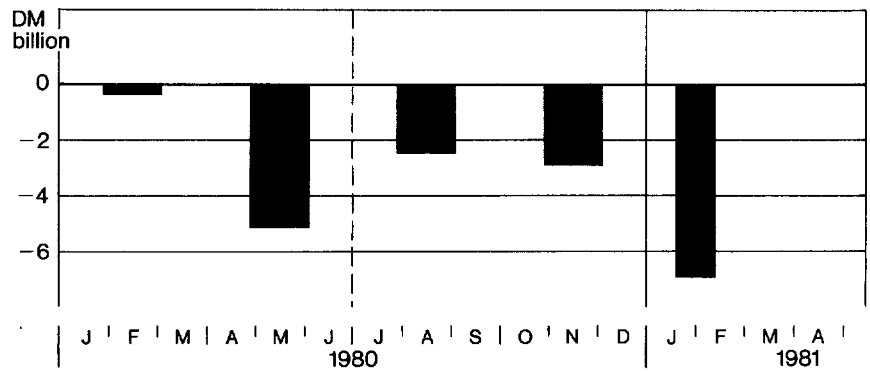
Credit expansion and monetary capital formation
log. scale, seasonally adjusted

Bank lending to domestic non-banks, total 2)
Monetary capital formation 3)



Net external assets 4)
unadjusted, lin. scale

Change during quarter



1) Currency, sight deposits, time deposits and funds borrowed for less than 4 years, savings deposits at statutory notice. - 2) Including credit based on the purchase of Treasury bills and securities. - 3) 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. - 4) Banks and the Bundesbank. - * Change in January and February 1981.

came evident from mid-October onwards, when the exchange market responded to "adjustments" to bank liquidity which did not result in additional funds (raising of the rediscount quotas and renewal of maturing security transactions under repurchase agreements) in the form of a perceptible weakening of the exchange rate of the Deutsche Mark.

Reduction in liquidity due to external constraints offset by durable release of funds

When in the early autumn the Deutsche Mark came under increasing pressure in the exchange market under the impact of rising interest rates in the United States and growing net capital outflows from Germany, the Bundesbank could not continue the policy of gradual relaxation it had adopted in the summer; it virtually confined itself to offsetting the reduction in liquidity caused by the heavy outflows of foreign exchange and to meeting the banks' large seasonal needs of central bank money towards the end of the year by means of suitable liquidity policy measures. To this end it made central bank balances available to the banks, at first through reversible compensatory operations and later on also on a durable basis. Over 1980 as a whole the Bundesbank thus provided some DM 27 billion of liquidity "durably" through two cuts in minimum reserves and three increases in the rediscount quotas as well as through longer-term open market operations. Short-term compensatory operations and the supplementary granting of lombard loans added another DM 13 billion net to bank liquidity. In all, the Bundesbank thus supplied the banks with DM 40 billion, not only offsetting the contractionary effect of the outflows of foreign exchange on bank liquidity but also financing the expansion of the central bank money stock (currency in circulation and required minimum reserves).

Control of the money market "within seeing distance" again at the beginning of 1981

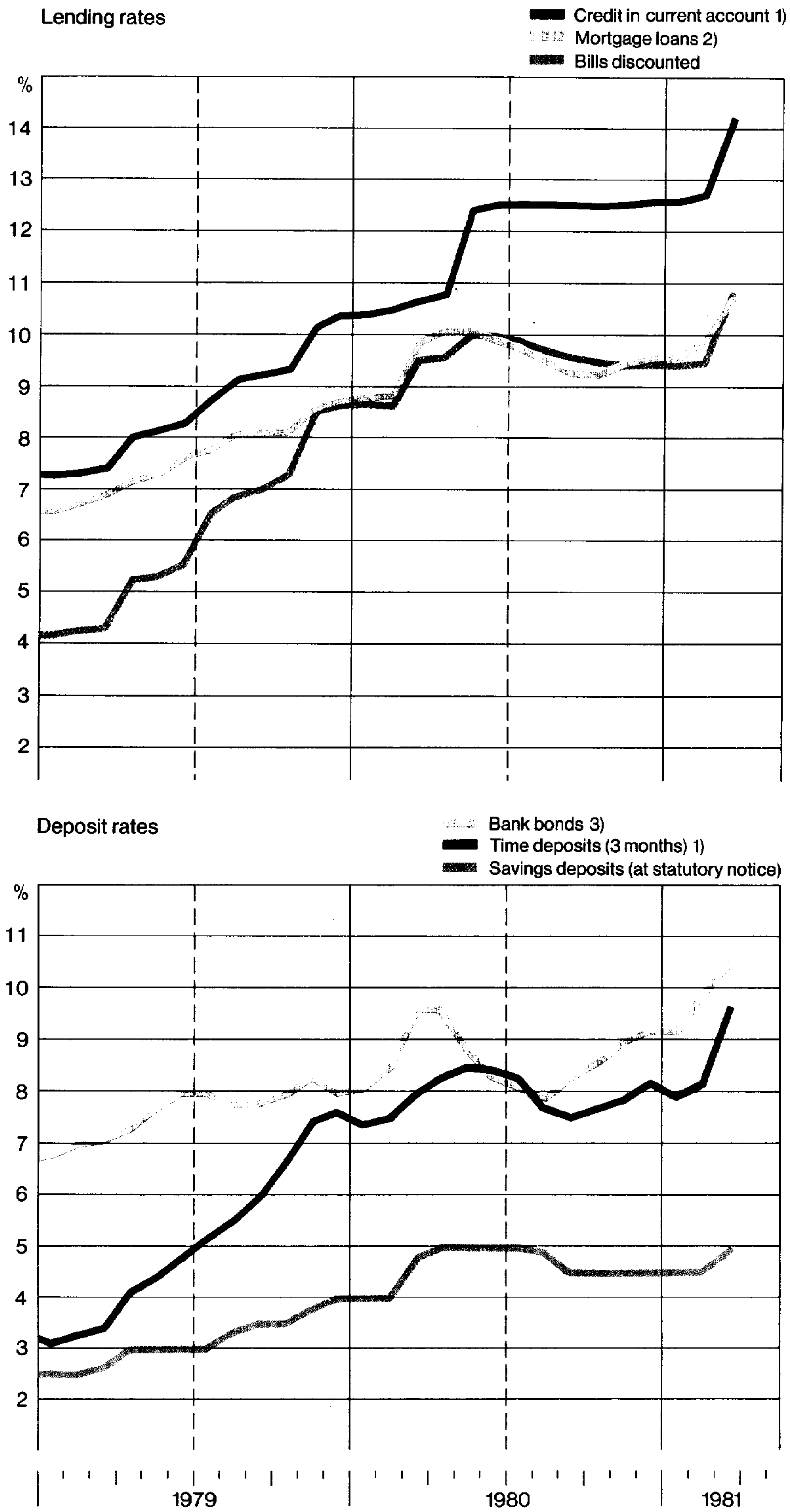
The policy of funding the banks' very short-term borrowing from the Bundesbank was continued at the beginning of February 1981 with the raising of the rediscount quotas (DM 3 billion) and the lowering of the minimum reserves (DM 3.7 billion). At that time it was already evident, however, that the "accommodating" compensation of outflows of funds to other countries, which had been practised since the beginning of 1981, was no longer compatible with the distinct weakness of the Deutsche Mark in the exchange market. The release of liquidity was therefore gauged in such a way that account was taken of the natural tendency for money market funds to become scarce and expensive owing to the massive outflows, and that the banks again needed short-term assistance from the Bundesbank. The acute weakness of the Deutsche Mark in mid-February 1981 forced the Bundesbank to drastically cut the banks' automatic central bank credit facilities for a while. With effect from February 20, 1981 the Bundesbank discontinued the granting of all "normal" lombard loans until further notice, and thereafter it granted the banks special lombard loans, initially at a rate of 12%; by suspending the special lombard loan facility at very short notice it made it clear that, under varying conditions, the banks cannot expect balances to be settled in this way every day or at a fixed interest rate.

(c) Unsteady money creation process

Weak reaction of credit expansion to the higher interest rates

Last year monetary expansion was subject to varying domestic and external influences which prevented the money supply and the volume of credit from rising steadily, even in the short run. Bank lending, the principal domestic component of money creation, underwent several changes in trend in the course of the year; in the first half of 1980 it was buoyant, then it slackened temporarily, but it picked up again from the autumn onwards. Over the year as a whole outstanding bank lending to domestic non-banks (including credit granted by the Bundesbank) went up by DM 126 billion or 9½%, compared with DM 139 billion or 11½% in 1979. Lending to private customers remained particularly brisk (see page 37), while lending to the public sector rose rather moderately (by just over 7%) as the central, regional and local authorities met a large part of their borrowing requirements, which increased steeply compared with the previous year, abroad. In the event, the reaction of domestic credit expansion to the rise in interest rates was weak and considerably delayed. Last year the upward movement of bank interest rates initially continued along a broad front in connection with the raising of the discount and lombard rates of the Bundesbank in February and May. After the gradual relaxation of monetary policy in the summer, lending rates eased only a little. Notably in the field of shorter-term retail lending the banks left their terms unchanged in the second half of the year in order to improve their tight profit margins as deposit rates fell. At the end of 1980 credit in current account therefore cost just as much as in mid-year (an average of 11½ to 12½%), but 2 percentage points more than at the beginning of the year. By contrast, the rates

Movement of selected bank interest rates since 1979



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

on bills discounted went down somewhat in the second half of the year following the raising of the rediscount quotas. Mortgage loans, the terms of which tended to follow the fluctuations in the bond rate (albeit not to the full extent), were slightly cheaper at the end of the year than at their peak in the spring. The main reason why domestic credit expansion last year was somewhat more sluggish than in 1979, apart from the slowdown in economic activity, was that enterprises and the government increased their foreign debt in the form of borrowers' note loans and financial credits by no less than DM 40 billion in 1980. This was equivalent to about one third of their borrowing from German banks in the same period.

Contractionary external influence on monetary growth

If the balance of payments is otherwise in equilibrium, such borrowing abroad has the same expansionary effect on the money stock as domestic borrowing. But given the large current account deficit recorded in 1980 and non-banks' simultaneous capital exports, it merely served to offset these outflows — and did not even fully succeed in that. In fact, the net external assets of the German banks and the Bundesbank, which reflect this net outflow of funds to other countries, fell by DM 10.5 billion; to this extent external payments had a contractionary impact on the money creation process again in 1980 and neutralised part of the expansionary effect of domestic lending by German banks.

Unsteady trend of monetary capital formation

In 1980 monetary capital formation at German banks curbed monetary growth less than it had done a year before; it came to DM 62 billion as against DM 76 billion in 1979. The inflows of longer-term funds varied markedly, but this was only in part attributable to fluctuations in the propensity to save — above all to its decline in the first quarter of 1980 and its subsequent recovery. The changes in long-term interest rates and interest rate expectations in the domestic capital market, partly reflecting the swings in international interest rates caused by U.S. monetary policy, were no less significant. Although these speculative factors not only restrained monetary capital formation but also enhanced it for short periods (as in April and May), they adversely affected the overall outcome. In particular, sales of bank bonds to domestic non-banks, at DM 27 billion, failed to reach the level of the previous year. On the other hand, the banks sold a record amount of bank savings bonds, which are not subject to price risks (DM 18 billion). Only when, towards the end of the year, the interest rate payable on these bonds fell slightly below the yields in the capital market (which were rising again) did investors' interest slacken somewhat. At the end of 1980 bank savings bonds with current interest payments and four years' maturity bore interest at a rate of 8 %, which was ½ percentage point more than at the beginning of the year but ½ percentage point less than in the spring of 1980. Savings deposit rates followed a similar pattern: deposits with agreed maturities of four years yielded some 6½ % at the end of 1980 (excluding bonus payments), while the rates paid on deposits at one year's and at statutory notice were 1 and 2 percentage points lower, respectively. These rates were not considered very attractive by investors, either because of the accelerating pace of price rises or in comparison with the interest rates obtainable on other forms of investment. Savings deposit business was therefore rather sluggish. The total amount of savings deposits increased by barely DM 7 billion in 1980 compared with DM 11.5 billion in 1979 and DM 29 billion in 1978. Savings deposits at agreed notice even went down by 1 % in 1980. The banks' interest rate policy in this field inevitably results in this type of relatively low-rate funds declining in importance.

Overall monetary growth on the desired scale . . .

The growth of the money supply and also of the central bank money stock was influenced by the above-mentioned short-term fluctuations in monetary capital formation (which were mainly due to interest rate movements) for, if the maturities of new investments shorten, liquid financial assets — i. e. the money stock — rise correspondingly faster. The broadly defined money stock M3[1] increased by just over 6 % between December 1979 and December 1980; it had expanded at about the same rate a year before. In line with the fluctuations in monetary capital formation and — to a smaller extent — in credit expansion, it grew rapidly at the beginning of 1980, but rather moderately in the second and third quarters. In 1980, as in the preceding year, the increase in the money stock M2 (M3 less savings deposits at statutory notice), at 8½ %, was faster than that in overall money holdings, but the money stock in the narrowest definition M1 (currency and sight deposits) went up much more slowly, at 4½ %. This diverging trend mainly reflects interest-rate-induced shifts from sight deposits and savings deposits at statutory notice to shorter-term time deposits during the period of rising time deposit rates up to the early summer of 1980. Once these rates had passed their peak, switching into shorter-term time deposits soon stopped; in the autumn there were even some shifts in the

. . . but marked shifts between the components of the money stock

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

opposite direction. Towards the end of the year the differences between the longer-term growth trends of the various monetary aggregates therefore decreased somewhat, but without completely offsetting the previous expansion of time deposits. Last year's shifts between the individual money stock components as a result of interest rate movements prove yet again that narrowly defined monetary aggregates are not very likely to reflect the short-term impact of monetary policy correctly. Not least for this reason, the Bundesbank chiefly gears its policy to broadly defined aggregates such as the central bank money stock or the money stock M3, which are affected less or not at all by interest-rate-induced shifts in deposits.

(d) Strong private demand for credit

Private borrowers switch to short-term financing . . .

The pace of domestic credit expansion was primarily determined by bank lending to the private sector last year. Enterprises and individuals increased their bank debt by almost 10% and thus not much less than in 1979 (just over 12%). Individuals' propensity to borrow and willingness to spend were thus hardly curbed by the fact that lending rates went on rising until the spring and remained high in the further course of the year. This was largely because of the underlying economic conditions: the rapid, and partly speculative, increase in turnover at the beginning of the year was accompanied by substantial requirements of working funds for enterprises. When the pace of economic activity slackened, credit demand still remained heavy in view of the rise in costs and the slower growth of profits, especially as enterprises' capital spending kept on growing. Furthermore, external payments resulted — as mentioned — in a persistent drain on domestic liquidity, and thus enhanced credit needs. It is also evident that the dampening effect of the high level of interest rates on credit demand was largely outweighed by fears of further price increases. As long as a general fall in interest rates was expected, borrowers preferred short-term preliminary and interim financing. Towards the end of the year expectations of declining interest rates had largely disappeared, so that the demand for longer-term loans picked up again.

. . . and to the Euro-markets

Another factor contributing to the fluctuations in borrowing was that enterprises took up Euro-credits in widely varying degrees. In 1980, in contrast to 1979, funds raised in the Euro-markets mostly had a cost advantage, which tended to increase until the summer of 1980 but subsequently diminished again. Borrowing abroad was presumably also influenced by monetary policy, in so far as monetary measures initially caused the banks to pursue a somewhat more cautious and more selective lending policy, but enabled them to expand the supply of credit after the gradual relaxation in the summer.

Growth of lending commitments slackens only temporarily

The trend of lending commitments last year also mirrors the continued strong private demand for credit. Shorter-term credit lines granted went up by 10% in 1980, and thus at much the same rapid pace as in the two preceding years. Unused credit lines rose almost as fast. In the summer and autumn months commitments increased more slowly, in connection with the slackening of economic activity and the mounting preference for longer-term credit, but at the end of the year the growth rate speeded up markedly again. Long-term lending commitments, too, were depressed only at times by the high level of interest rates. New long-term loans promised, which had declined at first, went up steeply again from the autumn of 1980 onwards. Their unsteady trend chiefly reflected the fluctuations in the demand for long-term housing loans. In the first half of the year planned building projects had frequently been postponed or temporarily financed with short-term funds since interest rates had apparently been expected to fall. Towards the end of 1980, however, the demand for long-term housing loans recovered, as expectations of a decline in interest rates dwindled and prices in the construction sector went on rising.

Demand for credit differs from industry to industry

Among the private borrowers from German banks, enterprises (outside the housing sector) and housing were of roughly equal weight last year, accounting for almost DM 45 billion each. But in relative terms lending to the housing sector expanded substantially faster, at 11½%; as already indicated, its growth was slowed down only temporarily by the high level of interest rates. Lending to enterprises went up by just over 8½% in 1980. Compared with the preceding year the growth of lending slackened in both sectors, but the slowdown of housing credit (1979: 13%) was less pronounced than that of lending to enterprises (1979: 11%). In particular, manufacturing — i. e. industry and those craft enterprises which produce goods — raised comparatively little bank credit.

Apart from the moderation of economic activity, the deceleration of lending to enterprises was mainly due to the fact that firms satisfied a large part of their borrowing requirements in the Euro-markets in 1980. (In all, enterprises took up some DM 17.5 billion of short and long-term financial credit abroad; this was equivalent to about two fifths of their borrowing from German banks.) The rise in lending to households also slowed down perceptibly in the course of last year. Consumer credit grew by "only" 9% in 1980 compared with 18½% a year before. This was probably a consequence of the decline in the overall demand for passenger cars and some other consumer durables as well as a reaction to the higher interest rates.

(e) Lending business, by banking groups

Divergent growth rates of lending among the individual banking groups

Against the background of the economic and monetary conditions described above, the growth of lending among the individual banking groups diverged fairly widely last year. This owed something not only to structural differences in lending and deposit business but also to deliberate business policy decisions. Some banks seem to have engaged less in maturity transformation, which had been carried out on a very considerable scale in previous years, and to have operated more on the principle "profit has priority over expansion". The growth rate of lending by credit cooperatives (+ 12.6%) and savings banks (+ 10.7%) remained very high; they presumably benefited both from the wide range of their customers and the favourable structure of their liabilities. The lending of mortgage banks (+ 11.3%) and central giro institutions (+ 9.6%), as well as of private bankers (+ 9.5%), also increased at an above-average pace — faster, indeed, than a year before; these are banking groups which draw more on the capital market and money market, respectively, to obtain the funds for their lending, and which had lost competitive ground when interest rates moved up in 1979. By contrast, the rate of expansion of the big banks (+ 3%) and regional banks (+ 5.9%) slowed down markedly in 1980. One reason for this was probably that customers borrowed more in the Euro-markets — in large part, in fact, from the subsidiaries of these very banks, so that the business remained "within the group". Deliberate restraint in long-term lending business seems to have been another significant factor, especially in the case of borrowers' note loans to public authorities, a line of business which had been very strongly affected in the previous year by the risk of interest rate changes. Lending by the central institutions of credit cooperatives (+ 5.1%) and by instalment sales financing institutions (+ 7.4%) also grew at a below-average pace last year, in the former case mainly because of a fall in outstanding credit to public borrowers.

5. Capital market under the impact of external constraints

Large accrual of funds accompanied by sharp interest rate fluctuations

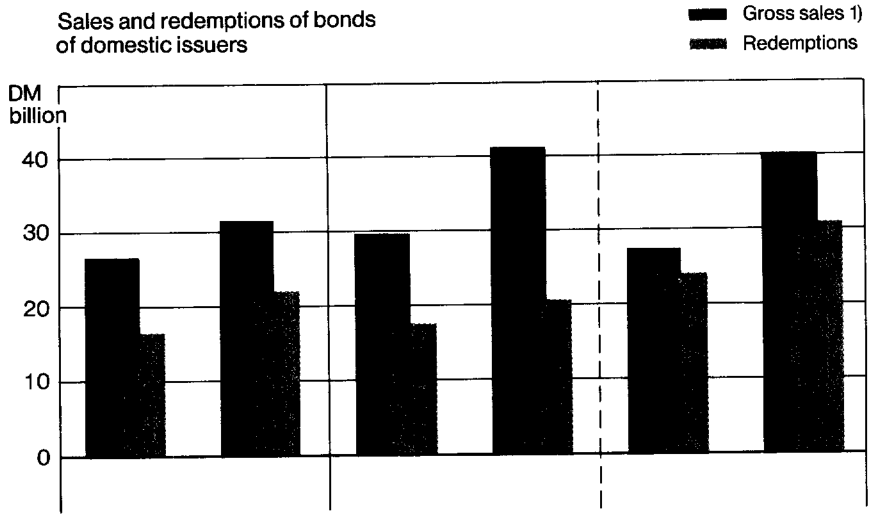
In 1980 the change in the external situation brought the German capital market under the influence of international financial markets to a greater extent than before. As a result of the sustained weakness of the Deutsche Mark and the sharp interest rate fluctuations in U.S. and international capital markets, market conditions altered rapidly, particularly in the first half of the year, even though the tensions in the domestic money market, which depend more or less on the monetary policy stance of the Bundesbank, changed comparatively little. In these circumstances it was almost surprising that in both the bond market and the share market more longer-term funds were raised than in the preceding year. The amount accruing from the bond purchases of domestic and foreign investors in 1980, at just under DM 51 billion, was nearly DM 4 billion larger than a year before. However, this overall result obscures the fact that developments in the capital market have been characterised since last summer by persistent uncertainty caused first by external but later on also by domestic factors.

Bond market exceptionally productive in the first half of 1980

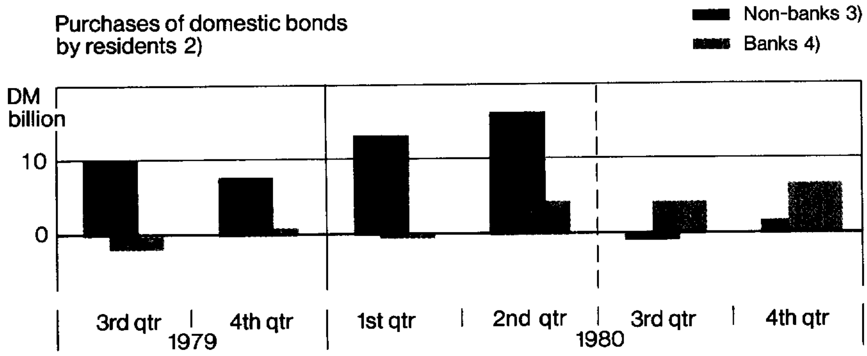
Particularly in the first half of 1980, when the yield on bonds was subject to sharp fluctuations, the bond market proved exceptionally productive. This was mainly because many investors firmly believed for a long time that interest rates had reached their peak. Even after the spectacular fall in bond prices in U.S. and international capital markets in February, which spread directly to German prices, investors' longer-term interest rate expectations did not change much. The further movement of interest rates in the first half of the year seemed to justify investors' confidence. After the yield on domestic bonds had nearly reached 10% at the end of March, interest rates on German securities started to fall steeply — in keeping with international interest rate movements — at the be-

Bond market

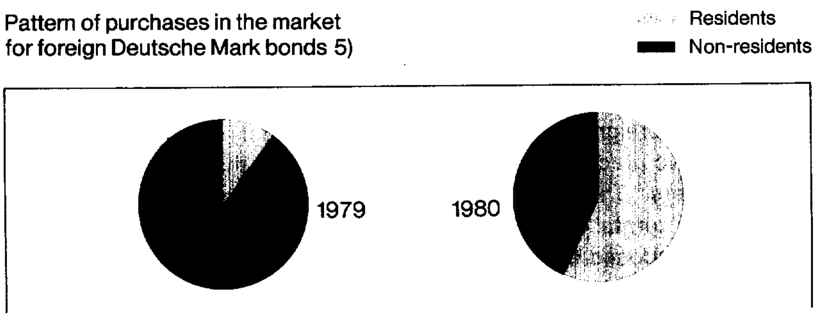
Sales and redemptions of bonds of domestic issuers



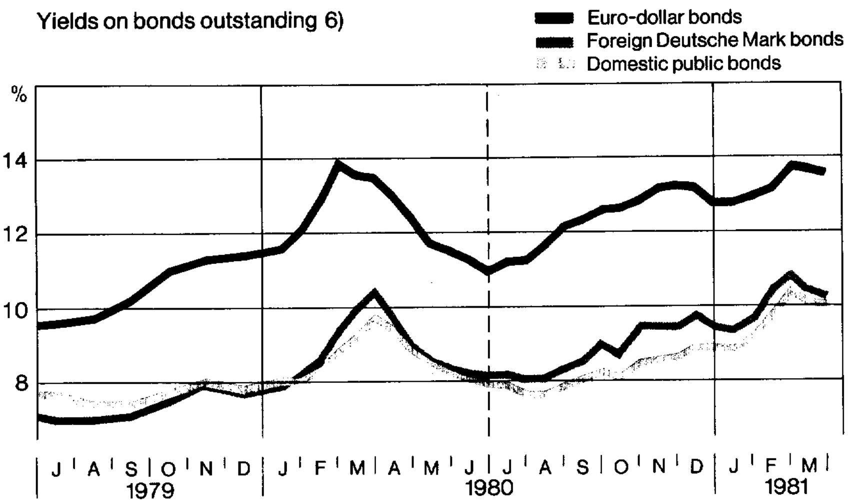
Purchases of domestic bonds by residents 2)



Pattern of purchases in the market for foreign Deutsche Mark bonds 5)



Yields on bonds outstanding 6)



1) Gross 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) Residual. - 4) Book values. - 5) Excluding medium-term notes of the United States. - 6) Until December 1979 monthly averages, as from January 1980 level at middle and end of month.

ginning of April, and did not level off until the end of July, when the yield on bonds outstanding came to just under 8 %.

Current account deficit enhances interest rate links with foreign countries

From then on, however, it became more and more obvious how closely interlinked the German capital market and international financial markets had become owing to the fundamental change in the external situation. When in the summer interest rates abroad began to move up again, yields in the German bond market consequently followed suit even though the Bundesbank was gradually easing conditions in the money market at the time and domestic economic activity was slackening perceptibly. These close links were also fostered by the fact that expectations of an appreciation of the Deutsche Mark, which had long kept the domestic interest rate level well below international interest rates, became weaker. The depreciation of the Deutsche Mark in the late autumn, the fear of new surges of inflation due to further increases in oil prices, and the expansion of the public sector deficits gave an additional boost to the rise in interest rates in the bond market, which continued until March 1981. In mid-February 1981 the yield on bonds outstanding, at 10 %, regained last year's peak (reached at end-March 1980), and remained at that level, with fluctuations, until this Report went to press.

Wait-and-see attitude of the general public in the second half of the year

The developments in the capital market were thus disappointing for domestic bond holders, and exercised an impact on their subsequent investment activity. Non-banks, which had built up their bond holdings by DM 30 billion in the first half of 1980 (and thus by almost DM 10 billion more than in the first half of 1979), cut down their bond purchases distinctly from the summer of last year onwards. Only at times when market conditions temporarily eased, as in October 1980, did they buy bonds on a larger scale again. Since the turn of 1980/81 non-banks have been more active in the bond market, partly no doubt because of their pent-up investment demand.

Sensitive reactions in the market for foreign Deutsche Mark bonds

Security transactions with non-residents also mirrored the close interest rate links between the domestic and international capital markets in 1980. The market for foreign Deutsche Mark bonds, which had long been the centre of speculative foreign demand for German securities, reacted particularly sensitively. Last year there was hardly any demand for such securities abroad, so that their prices came under growing pressure. During the first three months of 1980 the average yield advantage of foreign Deutsche Mark bonds over domestic bonds increased to up to ¾ percentage point. In the second half of the year, following the renewed upward movement of international long-term interest rates, foreign investors withdrew completely from that market at times. Last year less than half of the foreign Deutsche Mark bonds sold (net) were placed abroad on balance, while in the two preceding years an average of more than four fifths had been sold to foreign purchasers.[1] This change in the function of the market for foreign Deutsche Mark bonds from a "turntable" for foreign capital to a market predominantly funded from domestic sources imposed a perceptible burden on the German bond market and further aggravated Germany's balance of payments problem. Towards the end of last year the banks engaged in international issuing business therefore agreed not to launch any more new issues of this kind for a while. Foreigners' waning interest in longer-term Deutsche Mark securities was also reflected in 1980 in their low net purchases of domestic bonds. Even though the ban on the acquisition of shorter-term domestic bonds by non-residents had been limited last year, in two steps, to bonds in the very short maturity category of up to one year, non-residents bought less than DM 0.5 billion (net) of German bonds in 1980 against DM 4 billion in the preceding year. Even the abolition of the maturity limit of up to one year at the beginning of February 1981 made very little difference to the low level of foreign demand for German bonds.

Decline in bond purchases by domestic non-banks

In addition, the fluctuations in the capital market due to external circumstances resulted in considerable shifts of emphasis among the most important groups of domestic buyers. Until mid-1980 the strong propensity to invest of domestic non-banks, which had absorbed nearly the entire supply of bonds in 1979, had been the most stable support of the domestic bond market. An especially impressive feature had been their steady inclination to invest during the period of abrupt price falls in February and March last year. In those months all the bonds sold were placed with non-banks on balance. From the summer of last year onwards, however, they sharply reduced their bond purchases and pre-

1 Excluding DM-denominated bearer Treasury Notes of the United States ("Carter Notes"), which, under the terms of issue, could be bought by residents only.

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	1977	49.1	29.2	– 0.4	20.3	4.6	53.6
	1978	39.7	30.5	– 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
Banks	1977	30.6	19.8	0.0	10.8	1.7	32.3
	1978	20.2	16.7	– 0.2	3.7	1.2	21.4
	1979	1.1	3.3	– 0.2	– 2.0	2.6	3.7
	1980	14.0	15.3	0.2	– 1.5	3.3	17.3
Non-banks	1977	19.3	9.5	– 0.4	10.2	2.8	22.1
	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	26.5	– 1.4	4.0	4.1	33.2
Open market operations of the Bundesbank	1977	– 0.7	–	–	– 0.7	–	– 0.7
	1978	3.5	–	–	3.5	–	3,5
	1979	– 2.1	–	–	– 2.1	–	– 2.1
	1980	1.8	–	–	1.8	–	1.8
Non-residents 3	1977	0.7	e – 0.3	e – 0.0	1.0	×	0.7
	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
Purchases (= sales), total	1977	49.8	28.9	– 0.4	21.3	4.6	54.3
	1978	39.8	29.4	– 1.0	11.4	3.6	43.4
	1979	41.2	36.4	– 1.1	6.0	3.7	45.0
	1980	45.2	41.5	– 1.3	4.9	7.3	52.6

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.

ferred to invest their funds at short term or at least without price risks with banks. Over the whole of 1980 the growth of non-banks' bond holdings, at DM 33 billion, was smaller than in 1979 (DM 39.5 billion). In particular, non-banks greatly decreased their purchases of domestic bonds in 1980 (from DM 38 billion in 1979 to DM 29 billion). By contrast, they bought considerably more foreign bonds than in 1979 (DM 4 billion against DM 1 billion), the bulk consisting of foreign Deutsche Mark bonds, which had attractive interest rates.

Banks return to the buyers' side of the bond market

Virtually a mirror image of non-banks' behaviour was provided by the banks on the buyers' side of the bond market. During the period of short-term fluctuations triggered by international interest rate movements in the first few months of 1980, the banks initially reduced their bond holdings; then in the spring, after the downturn in the bond market had passed its lowest point, they built them up again at lower prices to almost the same extent. In the further course of the year, however, longer-term investment motives seem to have outweighed such speculative operations by the banks. At first the banks apparently did not consider the risk of write-downs inherent in the complex interest rate situation obtaining since mid-1980 to be very great. Moreover, their gradual return to the buyers' side of the bond market in the second half of the year was probably facilitated by the easing of their liquidity situation in the summer through the Bundesbank's policy of cautious relaxation. In all, the banks increased their bond holdings by almost DM 17.5 billion last year (against just under DM 4 billion in 1979). The bond market was also significantly bolstered by the fact that the Bundesbank bought bonds in the course of its open market operations during the last few months of the year. In 1980 the Bundesbank purchased DM 2 billion of bonds on balance.

High level of issues, particularly of bank bonds

As domestic banks and non-banks alternately generated a strong demand for bonds last year, issuing activity remained extremely brisk despite the sharp fluctuations in market conditions. Residents issued bonds to the nominal value of DM 137.5 billion, i.e. DM 31 billion more than in 1979. On the other hand, redemptions of bonds likewise went up steeply owing to the large sales of shorter-term bonds in preceding years. On balance, and after allowing for the decline in issuers' holdings of their own bonds, net sales, at DM 45 billion (market value), were no more than DM 4 billion larger than a year before. Specifically, only the banks expanded the volume of their issues. In 1980 they received DM 41.5 billion from sales of their own bonds, and thus over DM 5 billion more than in the previous year. Sales of communal bonds, which mainly serve to finance loans to public authorities, increased particularly fast. On balance, the issuing institutions sold almost DM 25 billion of these securities, about DM 10 billion more than in the preceding year. Shorter-term communal bonds with maturities of up to and including four years gained ground in the course of the year: they accounted for about one fifth of net sales, while in the previous three years only longer-term securities had been sold on balance. The shift in the maturity structure was even more striking in the case of mortgage bonds: approximately two fifths of sales consisted of securities with shorter maturities. The issuing institutions' business picked up again in the field of housing finance, lending commitments for which in 1980 were 60% higher than a year before. Net sales of "other" bank bonds, the issuing of which is not tied to definite lending transactions (in contrast to communal bonds and mortgage bonds), decreased again last year. In this case, too, shorter maturities predominated.

Sales of bank bonds include a large share of short-dated securities not subject to reserve requirements

In 1980 bonds with maturities of up to and including four years accounted for DM 15.5 billion or about two fifths of total net sales of bank bonds. This type of borrowing has in the meantime assumed very significant proportions compared with other ways of raising medium-term funds. For example, in 1980 the net increase in time deposits maturing within less than four years came to DM 25 billion; but these funds are subject to minimum reserve requirements, whereas funds obtained by issuing bank bonds are not.

Restrained issuing policy of the public sector

With net sales totalling about DM 5 billion, the public sector raised fewer funds direct in the bond market last year than in 1979 (DM 6 billion). Instead, the public authorities took up more loans against borrowers' notes, although a large part of these — unless they were placed abroad — were financed by banks in the bond market through the issue of communal bonds. If net sales of public bonds and communal bonds are added together, the public authorities' direct and indirect recourse to the bond market must be put at about DM 30 billion, which is some DM 8.5 billion more than in 1979. This is the more remarkable as the Federal Government borrowed exceptionally large amounts abroad, thus nursing the domestic capital market to a certain degree. Even so, the Federal Government remained the most important public issuer, selling DM 3 billion net (market value) of its own bonds against about DM 9 billion in 1979. However, most of its net receipts came from its regular sales of Federal bonds (DM 8 billion), which have been offered since December 1979 in the form of tap issues with maturities of five years. In the field of Federal savings bonds, by contrast, redemptions and premature repurchases exceeded new sales by DM 2.5 billion. The outstanding amount of bonds and medium-term notes of the Federal Government decreased by about DM 2 billion in 1980 owing to substantial redemptions. In that year, for the first time since 1975, the Federal Post Office issued bonds of its own, which, after deduction of simultaneous redemptions, yielded DM 1.5 billion. Other public issuers in the bond market were the Federal Railways and a number of Länder Governments.

Shifts in the maturity structure of the acquisition of financial assets ...

The unsteady movement of interest rates was determined by the external situation, shook the optimism of many investors in the course of the year and led to a fundamental reappraisal of interest rate and price risks in the capital market; it also left a distinct mark on the overall domestic flow of funds. According to the data available from the capital finance account, the financial assets acquired by the domestic non-financial sectors (i.e. enterprises, households and the government) last year were heavily concentrated in the short maturity category (up to one year), and in the longer-term field they shifted in favour of credits and investments that are not subject to price risks. Compared with the increase of only DM 1.5 billion in the overall acquisition of financial assets by the domestic non-financial sectors, new short-term investments went up exceptionally sharply last year (by DM 11.5 billion), while longer-term ones were DM 10 billion lower than a year before. This is no doubt partly ascribable to the continued low attractiveness of saving through accounts. But the sluggishness of the longer-term acquisition of financial assets also mirrors the restraint shown by non-banks in the bond market in the second half of last year. On the other hand, investors' interest in longer-term time deposits (including bank savings bonds) was greater than in the previous year; such assets — unlike purchases of bonds — do not involve price risks and at the same time (in

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

Item	1978 p DM billion	1978 p %	1979 p DM billion	1979 p %	1980 pe DM billion	1980 pe %	Memo item Change on previous year 1979p DM billion	1980pe DM billion
Acquisition of financial assets								
Longer-term	110.8	65.1	124.9	74.8	114.8	68.3	14.1	−10.1
of which								
in the security market	17.9	10.5	40.3	24.1	33.1	19.7	22.4	− 7.2
Short-term	59.4	34.9	42.0	25.2	53.3	31.7	−17.4	11.3
Total	170.2	100	166.9	100	168.2	100	− 3.3	1.3
Households	106.0	62.3	120.6	72.3	122.3	72.7	14.6	1.7
Enterprises	52.9	31.1	42.9	25.7	41.3	24.6	−10.0	− 1.6
Government	11.4	6.7	3.4	2.0	4.6	2.7	− 8.0	1.2
Incurrence of liabilities								
Longer-term	149.1	91.0	159.9	82.7	159.2	75.3	10.8	− 0.7
of which								
in the security market	14.8	9.0	8.8	4.6	8.2	3.9	− 6.0	− 0.6
Short-term	14.7	9.0	33.4	17.3	52.3	24.7	18.7	18.9
Total	163.8	100	193.3	100	211.6	100	29.5	18.3
Households	17.6	10.7	19.6	10.1	11.8	5.6	2.0	− 7.8
Enterprises	101.1	61.8	130.6	67.5	144.1	68.1	29.5	13.5
Government	45.0	27.5	43.2	22.3	55.7	26.3	− 1.8	12.5
Financial surplus (+) or deficit (−) 1	5.6	×	−26.4	×	−43.4	×	−32.9	−17.0
Households	88.4	×	101.0	×	110.5	×	12.6	9.5
Enterprises	−48.2	×	−87.6	×	−102.8	×	−39.4	−15.2
Government	−33.7	×	−39.8	×	−51.1	×	− 6.1	−11.3

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

contrast to savings deposits, which are likewise not subject to price risks) they bear a rate of interest that is more appropriate to the capital market situation.

. . . and incurrence of liabilities by the domestic sectors

In the case of the overall incurrence of liabilities by the domestic non-financial sectors, the emphasis also shifted unmistakably towards the shorter maturities. The new short-term indebtedness of these sectors rose by DM 19 billion in 1980, while their longer-term borrowing in Germany decreased steeply. Only the domestic non-financial sectors' longer-term borrowing abroad expanded strongly last year, mainly owing to the credit raised in other countries by the government. Nevertheless, the aggregate longer-term incurrence of liabilities by all domestic non-financial sectors in Germany and abroad diminished slightly on balance.

Interest rate fluctuations also affect the share market

The sharp price and interest rate fluctuations which caused investors and borrowers to exercise restraint in their longer-term financing operations last year also affected price movements in the share market. In this area of the financial market, however, those who provide or look for funds act on the basis of motives and expectations which go beyond pure profitability considerations. Seen from this angle, it is not altogether surprising that last year, when the self-financing potential of enterprises contracted, the significance of share sales in enterprises' overall financing grew perceptibly. In the aggregate, domestic shares amounting to just under DM 7 billion (market value) were sold in 1980. This was the largest volume of issues ever recorded, exceeding the previous highest annual figures reached in 1975 and 1976. Relative to enterprises' total financial requirements, however, share sales continue to play only a minor role. There are many reasons for this, and not all of them could be eliminated by the corporation tax reform in 1977. For example, the small number of German public limited companies in itself limits investors' scope for diversification and thus also the amount raised in this market. At the same time the narrowness of the German share market tends to mean that share prices react sensitively to fluctuations in the bond market, as happened last year. The weaknesses of the German share market are most regrettable, not least in view of the large deficit on the German current account. On the one hand, they hamper the inflow of urgently needed long-term capital from abroad. On the other, they restrict German enterprises' scope for expanding their capital base, which would be necessary to increase their capacity to innovate and their willingness to take risks. It would therefore be advantageous in both domestic and external terms to reactivate the share as a financing instrument in general and to open up the German share market further to foreigners.

1. General survey

In 1980 the development of the world economy was determined in the main by the second wave of oil price rises and the necessity to combat inflation. Global economic activity cooled down distinctly and the growth of world trade was minimal. Whereas the real gross national product of the OECD countries had increased by 3½ % in 1979, it rose by only 1 % in 1980. In the United States economic activity developed at a sluggish pace up to the summer but then began to recover. In practically all the countries of Western Europe demand and output weakened from the spring of 1980 onwards, with the United Kingdom, where the national product fell by over 2 %, suffering the largest drop.

Global economic activity and world trade governed by the second wave of oil price rises and the fight against inflation

Despite the very low level of economic activity, hardly any success was achieved in reducing inflation durably. On the contrary, expressed as an annual rate, inflation accelerated in the industrial countries in 1980 compared with the previous year, the rise in oil prices playing an important, but not the only, part. The weighted average increase in consumer prices in the OECD countries as a group amounted to 13 %, against 10 % in 1979 and 8 % in 1978, in relative terms the best result after the oil price crisis of 1973/74. At the same time the inflation gap between individual countries widened once again. Not until the latter part of the year did initial successes in combating inflation become evident in a number of countries owing to the weakening of economic activity and efforts in the field of stability policy. During the second half of 1980 the cost of living, seasonally adjusted and expressed as an annual rate, rose by 10½ % in the OECD area, while the comparable increase in the first half of the year had been as high as 14 %.

Further deterioration in the price climate

The extremely steep rises in the price of oil led to correspondingly large current account surpluses in the OPEC countries. According to a preliminary estimate by the OECD Secretariat, these surpluses came to about $ 125 billion in 1980 compared with $ 60 billion in 1974, i.e. at the height of the first wave of oil price increases. The "mirror image" deficits of the OECD countries and the developing countries (excluding OPEC countries) totalled an estimated $ 75 billion and $ 55 billion, respectively, in 1980 (the countries with centrally planned economies and a number of countries that are not included in other groups also ran a net deficit in 1980, leaving an unexplained balancing item of considerable size in the global balance of payments). A large proportion of the deficits within the first two groups of countries was concentrated on a few countries in a relatively good basic position (in terms of their monetary reserves and creditworthiness); in global terms this facilitated the financing of the deficits but at the same time correspondingly exacerbated the adjustment problem of these countries. Over one third of the deficit of the OECD countries was accounted for by Germany and Japan, while among the developing countries the lion's share was concentrated on a few "threshold countries" such as Brazil, Mexico and South Korea.

Balance of payments disequilibria reach record levels

The combined effect of oil price rises, inflation-induced interest rate differentials, increasing current account gaps between industrial countries and other factors produced considerable shifts in exchange rates. The U.S. dollar, which in the seventies had suffered constant erosion in terms of its value and of confidence, benefited from the improved current account position of the United States and the persistently high level of interest rates on dollar assets reflecting the fight against inflation as well as from influences of a non-economic nature. In contrast, the Deutsche Mark suffered severely from the shift into deficit of Germany's current account and the relatively low level of German interest rates. As the most important investment and reserve currency after the dollar, the Deutsche Mark became the antipole of the dollar to a very striking degree.

Large shifts in exchange rates against the Deutsche Mark

The present problems of the world economy are similar in many respects to those that had to be overcome after the oil price crisis of 1973/74. However, they demand even greater efforts this time. In numerous cases the second wave of oil price rises has further exacerbated problems which had not yet been completely solved after the first oil price hike. On the other hand, the recognition has grown that these difficulties must be tackled without delay if serious damage is not to be inflicted on the countries concerned and on the world economy as a whole.

Greater necessity and willingness to adjust

The second wave of oil price rises has made it clear to every country that domestic and external equilibrium will not readily be regained in the face of high rates of inflation, and in particular that a satisfactory level of employment cannot be lastingly ensured under

Fight against inflation in the USA in the interest of all countries

Movement of the external value of major currencies against the currencies of 23 countries *

* Weighted geometric mean based on market rates; the weights correspond to the regional pattern of the average foreign trade turnover (exports plus imports) of the individual countries between 1975 and 1977.

these conditions. Combating inflation must therefore continue to be a priority task in economic policy throughout the world. Owing to the importance of the United States in the world economy, the resolute anti-inflationary monetary policy being pursued there is in the best interest of all countries, even if last year this policy led to the exceptionally high levels of interest rates and marked shifts in exchange rates with which we still have to live today. Lower rates of inflation in the United States are also of particular significance because oil price increases must be expected to turn out so much the higher, the more the internal and external value of the dollar deteriorates. In addition, so long as rates of inflation in the United States remain high and existing inflationary expectations are not broken, U.S. interest rates are unlikely to decline on a lasting basis.

Limitations of demand policy

Moreover, the development of the world economy in the seventies has made it clear that, under the conditions of today and because of the absolute necessity to adjust to the changed global economic environment, overall demand management as a tool of growth and employment policy is more closely circumscribed than it used to be. This is meanwhile more generally accepted. The shift towards policies oriented more strongly towards the supply side of the economy, particularly in the United States and the United Kingdom, is a clear reflection of this fact. A certain move in this direction is also unavoidable in other countries: owing to the level of their public indebtedness and their weak balance of payments positions, practically all countries have very little room for manœuvre as far as large-scale measures to stimulate demand are concerned; first and foremost, however, the continuing rise in energy prices has made it absolutely essential to change the structure of existing production capacities. Economic policy must take due account of these constraints and requirements.

Shift in emphasis from financing deficits to adjustment

In 1980 it was possible to finance the unusually high current account deficits of the industrial countries and the developing countries relatively smoothly. Not a few countries ran down their monetary reserves or were prepared to accept higher costs when taking up credits. In addition, the OPEC countries substantially increased their direct loans to industrial and developing countries. In the meantime the IMF has enlarged the access to its credit facilities and has thus assumed a larger role in financing those deficits which are due in large measure to oil price rises. Its lending activities benefit in particular countries which have little access to the international credit markets or which would have to accept onerous borrowing conditions. The World Bank and the regional development banks are also alleviating the financing problems of many countries by playing a greater part in fostering structural change in the developing countries. The heavier recourse to existing monetary reserves, the tougher borrowing conditions in international financial markets and the greater need to make use of sources of official assistance reveal, however, that all in all it has become more difficult to finance deficits, and that real adjustment efforts, which are necessary in any case, must be stepped up.

Key role of energy policy in the adjustment process

In the long run the massive current account deficits can only be reduced if energy is used more efficiently and if both domestic and alternative sources of energy are exploited and developed with the objective of reducing oil imports. In other words, energy policy is of decisive importance in the adjustment process. In this area the ground must be prepared in good time because changes require time and capital. It is encouraging to note that shifts in this direction have evidently started within the industrial countries as well as in a number of developing countries. In the meantime, every means must be employed to close as far as possible the very wide current account gap between oil-exporting and oil-importing countries by exporting more goods to the oil-producing nations. At all events, there seems to be less danger of a large number of countries once again relying on recycling and neglecting adjustment in real terms, as happened initially after the first oil price crisis.

Developing countries also forced to adjust

It is apparent that the reduction of the current account deficits of the developing countries is much more painful and difficult for them than it is for most industrial countries. The substantial external debt of numerous countries (usually ones at a higher level of development) makes progress in adjustment absolutely necessary, however; in some cases this will also require cuts in excessively ambitious industrialisation programmes. The global dialogue between the industrial and developing countries which is being prepared under the auspices of the United Nations must not run counter to these needs if it is to help reduce disequilibria and not fuel world inflation.

2. Marked shifts in the global pattern of current accounts

Increasing current account gap between oil-exporting and oil-importing countries as well as between individual industrial countries

The global pattern of current accounts continued to develop in the same direction as in 1979. In 1980 the current account gap between the oil-exporting and oil-importing countries reached a record level. Moreover, within the industrial countries as a group the former surplus countries Germany and Japan moved deeper into deficit; France and Italy, which had recorded surpluses in 1979, suffered large swings in their balances on current account, while the current account balances of the United States and in particular the United Kingdom improved.

Dramatic shifts in the pattern of global payments balances within a short time

In 1978 the surplus of the OPEC countries had fallen to practically zero. According to preliminary estimates by the OECD Secretariat, it rose again within two years to about $ 125 billion. Hence the current account position of the OECD countries deteriorated over the same period by an estimated $ 84 billion and that of the developing countries by $ 32 billion. These figures clearly illustrate how dramatically the pattern of global payments balances has changed within a short period of time as a result of the rise in oil prices (by some 170 % from the end of 1978 to the end of March 1981).

The new current account deficits represent a considerable burden on the oil-importing countries — a burden which in many cases is even greater than after the first oil price shock. The deficit on current account of the OECD countries as a group corresponded to approximately 0.7 % of their gross national product in 1974, at the height of the first oil crisis; in 1980 this figure was about 1 %. In the case of the developing countries the average proportion is unchanged, at about 3 %.

It is already clear today that regaining approximate global balance on current account will be more difficult and will take longer than after the oil crisis of 1973/74. Not only are the imbalances larger today; the surpluses among the oil-exporting countries are also more heavily concentrated on thinly populated countries with a correspondingly low level of demand. The increase in OPEC imports witnessed after the first oil price crisis will therefore probably not be repeated to the same extent this time for this reason alone. Moreover, in some cases signs of saturation are becoming evident, while the experience of some OPEC countries makes it appear advisable for them, for political and social reasons, to be moderate in spending their additional income from oil.

Changed expectations regarding the price of energy . . .

The efforts to conserve energy and in particular to become less dependent on imported oil were undertaken with more determination after the second oil crisis than after 1973/74. While at that time there was a widespread expectation that the real price of oil would fall again (it did in fact drop temporarily), the opposite is more likely to happen today. The OPEC countries are obviously endeavouring to prevent the real price of oil from going down by adjusting supply accordingly, and over the course of time to even enforce higher oil prices in real terms if possible.

. . . set energy conservation in motion

The lower consumption of oil in the OECD countries in 1980 is no doubt partly a consequence of the slowdown in economic activity. However, in most countries there has meanwhile been a marked reduction in the actual amount of energy used in various fields. For the OECD area as a whole, the consumption of energy per unit of GNP over the last two years has fallen by about 4 %, much of which is accounted for by the more efficient utilisation of energy in industry and by savings in oil consumption for heating purposes. In addition, the generation of energy from domestic sources rose over the same period by about 4 %, mainly as a result of North Sea oil but also because other sources of energy (natural gas, coal, atomic power) are being utilised to a greater degree in some countries. Taken together, these factors have led to a reduction of around 10 % in the volume of oil imports of the OECD countries over the last two years.

Adjustment by the developing countries: problems and opportunities

The developing countries have considerably less room for manœuvre as regards adjustment than the industrial countries. The second oil price shock hit these countries at a time when they had by no means yet come to terms with the consequences of the first oil crisis. This time, too, the global deficit of this group of countries must be expected to decline more slowly than that of the industrial countries; according to present estimates, indeed, a further increase in their deficits is likely at first. For these reasons it is particularly important to open up new oil production capacities and other sources of energy in the developing countries. This trend seems to have been generally set in motion in the meantime on the basis of distinctly higher prices and with the assistance of international financing institutions such as the World Bank. Examples of this, and of what may be expected in this field in the coming years, are already in evidence: Mexico has developed into an important oil-exporting country; Argentina can now meet almost all its own energy needs; and success in the search for oil is being reported from other parts of the world. In this field there would appear to be much potential for cooperation between the industrial and developing countries.

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

US$ billion

Country/Group of countries	1974	1975	1976	1977	1978	1979	1980**pe**
OECD countries, total	−25.5	+ 1.0	−18.9	−24.9	+ 9.0	−35.1	− 75.3
of which							
United States	+ 4.9	−18.3	+ 4.4	−14.1	−14.3	− 0.7	+ 0.1
Canada	− 1.5	− 4.7	− 3.9	− 4.0	− 4.4	− 4.4	− 1.3
Japan	− 4.7	− 0.7	+ 3.7	+10.9	+16.5	− 8.8	− 10.8
EEC countries, total	−10.4	+ 1.2	− 6.5	+ 1.1	+15.8	−12.6	− 38.7
Germany	+10.3	+ 4.1	+ 3.9	+ 4.3	+ 8.9	− 5.6	− 15.7
France	− 6.1	− 0.1	− 5.9	− 3.0	+ 3.7	+ 1.2	− 7.4
United Kingdom	− 7.9	− 3.7	− 2.0	− 0.5	+ 1.2	− 3.5	+ 6.4
Italy	− 8.0	− 0.8	− 2.8	+ 2.5	+ 6.2	+ 5.1	− 9.9
Netherlands	+ 2.2	+ 2.0	+ 2.7	+ 0.6	− 1.4	− 2.3	− 2.5
Belgium-Luxembourg	+ 0.6	+ 0.3	− 0.0	− 0.7	− 0.9	− 3.4	− 6.0
Denmark	− 0.9	− 0.5	− 1.9	− 1.7	− 1.5	− 2.9	− 2.4
Ireland	− 0.7	− 0.0	− 0.3	− 0.3	− 0.3	− 1.3	− 1.2
Other European OECD countries	− 9.7	−11.3	−13.9	−15.3	− 0.2	− 5.7	− 20.0
of which							
Sweden	− 1.0	− 1.6	− 2.1	− 2.1	− 0.3	− 2.6	− 5.1
Norway	− 1.1	− 2.4	− 3.7	− 5.0	− 2.1	− 1.0	+ 1.0
Switzerland	+ 0.2	+ 2.6	+ 3.5	+ 3.4	+ 4.4	+ 2.4	− 0.6
OPEC countries	+60	+27	+37	+29	+ 5	+68	+125
Developing countries (excluding OPEC countries)	−26	−30	−18	−13	−23	−39	− 55

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

Reversal in the current account positions of the major industrial countries

Among the industrial countries, marked shifts in current accounts reversed the balance of payments positions of the three largest countries relative to the situation before the second oil price shock. As a result of the drastic swing in its current account balance, Germany became the country with the largest deficit in the world economy. In the last two years Japan's current account has also deteriorated to a marked degree, even though the deficit of $ 10.8 billion in 1980 is nowhere near as large as that of Germany. As a consequence these two countries — which in 1978 registered the largest surpluses — together accounted for over one third of the aggregate deficit of all the industrial countries in 1980, as has already been mentioned. In contrast, the current account of the United States, which was in extreme deficit in 1978, continued to improve and ended up close to equilibrium. The United Kingdom and Norway, as oil producers (and in the case of the United Kingdom also because of the recession there), even recorded major surpluses.

As already explained in detail elsewhere in this Report, the German current account did not move into deficit solely as a result of higher oil prices; other factors played an equally important role in the process, owing in part to the lagged effects of the real appreciation of the Deutsche Mark in the previous years. The "locomotive" package approved after the Bonn Economic Summit of July 1978 placed an additional burden on Germany's current account in subsequent years. As late as 1979, immediately after the beginning of the second wave of oil price rises, countries like Germany — with comparatively high monetary reserves, low foreign debt and a low rate of inflation — were sometimes urged to voluntarily assume a relatively large part of the global current account deficit of the oil-importing countries. In the meantime it is no longer denied even outside Germany that an extreme deficit position, like the one into which Germany moved in 1980, is a considerable burden even for a country with a high level of reserves, and demands adjustment measures that cannot be continually postponed.

Japan's success in adjustment

The current account deficit of Japan rose in 1980 by $ 2 billion compared with the previous year, i. e. by a relatively small amount; however, the swing from 1978 to 1979 had already been very marked. The deterioration in Japan's current account, though not as pronounced as in the case of Germany, was likewise not wholly due to the higher price of oil. The more buoyant state of economic activity in Japan since 1976 and the sustained appreciation of the yen since mid-1978 were important contributory factors. However, in the meantime Japan's current account deficit has been greatly reduced. In particular, Japan has succeeded in cutting down the volume of its energy imports despite the upsurge in economic activity. At the same time Japanese exports have risen strongly, supported by the competitive advantages resulting from the drop in the exchange rate of the yen from end-1978 to the beginning of 1980 as well as from the marked growth of productivity, accompanied by only minor increases in wages and incomes (which led, incidentally, to lower incomes in real terms). As a result, in the fourth quarter of 1980 Japan's current account was in sound balance.

Further improvement in the U.S. current account

Mainly as a consequence of a lower trade deficit, the current account of the United States again improved, albeit only slightly, and recorded a small surplus in 1980. Owing to the fact that the United States has an energy base of its own and has changed its energy policy, it succeeded — since consumption was falling — in reducing imports of oil by a large amount, which cushioned the effect of the oil price increases on its balance of trade. However, the improvement of the U.S. trade balance was partly due to the low level of imports of industrial goods on account of the slackening of economic activity; finally, the buoyant state of exports, which profited from earlier depreciations of the dollar, also deserves mention. With a much higher level of exports of agricultural products and a marked rise in competitiveness as regards trade in industrial goods, the U.S. trade balance with Western Europe and the developing countries improved considerably. This fully offset the deterioration in the U.S. trade balance with the OPEC countries, Japan and Canada. However, the turnaround in foreign trade only got under way in the course of 1980. On a seasonally adjusted basis, the current account showed a deficit of $ 5 billion in the first six months; this was subsequently offset, however, in the second half of the year by an approximately equal surplus.

Strengthening of the U.K. current account due to the recession

The current account of the United Kingdom improved by about $ 10 billion and showed a surplus of $ 6.4 billion in 1980, partly as a result of the rise in oil production in the British sector of the North Sea, but to a larger extent because of the worst recession since the Second World War. Despite the very marked appreciation of sterling, exports kept up surprisingly well. However, imports dropped sharply owing to the lower level of production in domestic industry; this situation was further aggravated by a reduction in stock levels induced by high interest rates. It remains to be seen whether the improvement in the current account position will continue when business activity picks up and stocks are rebuilt. At all events, the competitiveness of British industry seems to be doubly burdened by high rates of inflation and the marked appreciation of sterling.

Considerable current account deficits of other EEC countries

Among the other EEC countries, France, Italy and the Benelux countries were confronted with considerable current account deficits, which in some cases showed a tendency to rise even further. Italy suffered a swing of $ 15 billion in its current account.

3. Financing the current account deficits

Optimistic assessment of the financing problems is confirmed ...

In the year under review it was possible to finance the high current account deficits via the international financial markets and by utilising official sources of credit as well as by drawing on monetary reserves without major difficulties arising. When the problems of recycling presented themselves again in the relevant international bodies immediately after the second new increase in oil prices in 1979, the conclusion was soon reached that in 1980 only a few countries would be likely to have difficulties in financing their higher current account deficits via the international financial markets. In such cases it seemed advisable to turn to the IMF as early as possible and to use other official sources of assistance. Apart from this, it could be assumed that many countries would draw on their existing credit lines in the international markets. However, not a few countries first utilised their monetary reserves, mainly because they wanted to avoid, at least in part, the consequences that borrowing would have for their exchange rates and their interest rate level.

... but increasing caution in the financial markets

Even though no serious tensions arose in the international financial markets, the limits which a number of countries are approaching with respect to incurring new debt became more evident for the first time in 1980. Not only the rapidly industrialising countries of the Third World but also many less advanced oil-importing developing countries as well as a number of smaller industrial countries are reaching the limits of their indebtedness, now that their foreign debts and the burden placed on their balances of payments by interest and redemption payments have considerably increased. In addition, a few countries became unsafe borrowers in the light of political events. This induced banks that operate internationally to weigh up country risks more carefully when granting credit; shorter maturity periods and selective increases in interest rate spreads were the consequence.

No general shortage of funds

However, despite the toughening of borrowing conditions, the international financial markets can still be generally described as "borrowers' markets" since banks are not subject to any major constraints as regards the supply of funds. In this context, an important role continues to be played by the fact that OPEC surpluses are being invested with commercial banks to a large degree. Thus, about one third of the OPEC current account surpluses of last year flowed to banks in the countries that report to the Bank for International Settlements, partly in the form of Euro-deposits and partly as deposits in national currencies. In addition, capital investments of considerable size in other forms were undertaken by the OPEC countries in the major industrial nations, which for their part maintained a high level of capital exports and, in the final analysis, helped in this way to recycle oil money to the other oil-importing countries. Besides the United States and the United Kingdom, Japan and Germany also became "turntables" for petrofunds in 1980. However, Germany fared less well than other countries since, over the year as a whole, the balance on capital account made hardly any contribution to financing Germany's high current account deficit, which was therefore reflected in full in a loss of exchange reserves. The gradual easing of Germany's restrictions on capital imports from March 1980 onwards, and their eventual abolition, had little effect on this development owing to the low level of domestic interest rates.

(a) Developments in international financial markets

Continued growth of lending, with shorter maturity periods for developing countries and centrally planned economies

Changed market conditions have so far had no major impact on the continued growth of international lending operations. In 1980 as a whole the amount of financial resources granted in the form of short, medium and long-term bank credits as well as through the sale of bonds (on a net basis and adjusted for exchange rate changes), at an estimated $ 185 billion, was in fact larger than in the previous year ($ 140 billion). However, the growth in the volume of newly granted medium and long-term Euro-credits and international bonds, at $ 117 billion, was no higher than a year before. The cautious attitude vis-à-vis a number of borrowers is reflected in the fact that the volume of medium and long-term finance granted to developing countries, at only $ 35 billion, was about 20 % lower than in 1979. As a result, the developing countries were only able to meet their considerably higher demand for financial resources by greater recourse to short-term credits or official assistance. A similar trend was witnessed in lending operations with centrally planned economies. Although the amount of newly granted medium and long-term credits in this sector fell by more than one half against the previous year, there was a corresponding increase in the short-term indebtedness of centrally planned economies vis-à-vis western banks.

Investors in the bond market show restraint owing to monetary developments

The change in market conditions was most evident in the international bond markets. There was no further increase in the volume of issues in this market in 1980. This owed something to restraint on the part of investors on account of their fear of a fall in bond prices due to the acceleration of inflation and rising interest rates. This explains the very tight market conditions with respect to dollar-denominated bonds, particularly in the first quarter and the last third of 1980, when the long-term rate of interest was far below short-term rates as a result of the increase in U.S. money market rates to over 20 %. Conversely, in the spring and early summer of 1980 the decline in economic activity, together with the expectation of falling interest rates in the capital market and a slowdown in the rate of inflation in the United States, led to an upsurge in the supply of capital and consequently to a sharp expansion in the market. When interest rates then rose again, conditions in the market deteriorated once more. Under the impact of the restrictive monetary policy pursued in the United States, the yield on Euro-dollar bonds outstanding rose once again up to March 1981 (on a monthly average basis) to a level of 13½ %. Euro-dollar money market rates for three-month funds reached their peak of about 21 % in December 1980, but then declined again to some 14½ % at the end of March 1981.

With respect to foreign Deutsche Mark bonds and other external non-dollar bonds, changes in exchange rate expectations frequently played a decisive role in the tighten-

International credit and bond markets

US$ billion

Item	1974	1975	1976	1977	1978	1979	1980 p
Medium and long-term Euro-currency loans 1	28.5	20.6	27.9	33.8	65.8	78.3	78.0
Borrowers							
Public agencies 2	19.5	14.0	20.7	27.2	50.2	59.9	48.8
Private agencies	9.0	6.6	7.2	6.6	15.6	18.4	29.2
Borrowing countries							
OECD countries	18.3	6.2	9.9	13.0	30.4	28.5	40.3
Seven major industrial countries 3	13.2	1.8	4.4	6.2	18.2	12.4	22.8
Smaller industrial countries	3.4	3.0	3.4	4.7	8.5	7.3	11.2
Southern European developing countries	1.7	1.5	2.1	2.2	3.6	8.7	6.3
Non-European developing countries	8.0	11.0	14.2	17.8	31.5	41.3	33.6
Oil-exporting countries	0.8	3.2	3.4	6.3	9.7	8.6	6.4
Other developing countries	7.2	7.8	10.8	11.5	21.8	32.8	27.3
Centrally planned economies 4	1.1	2.7	2.5	2.6	3.6	7.9	3.0
Other 5	1.1	0.7	1.3	0.3	0.3	0.5	1.1
International bond issues 6	12.2	22.8	34.3	36.1	37.5	38.9	38.7
of which							
in U.S. dollars	8.4	11.8	20.9	20.8	14.9	15.6	17.0
in Deutsche Mark	0.9	3.7	4.2	6.7	8.2	8.2	8.4
in Swiss francs	1.0	3.6	5.6	5.0	7.7	9.5	7.7
Types of issues							
Euro-bonds 7	3.5	9.1	14.6	18.8	15.1	17.4	20.5
Traditional foreign bonds	5.2	11.6	18.3	16.3	20.7	20.0	17.5
Special issues 8	3.6	2.1	1.5	1.1	1.6	1.6	0.8
Issuers							
Public agencies 2	9.4	15.8	24.2	24.7	27.6	25.2	23.8
Private agencies	2.8	7.0	10.1	11.4	9.8	13.7	14.9
Issuing countries							
Industrial OECD countries	5.8	15.9	23.8	24.3	23.2	26.6	28.8
Developing countries	0.9	0.8	2.0	4.1	5.3	3.1	1.8
International organisations	5.4	5.3	8.3	7.2	8.4	8.9	7.7
European organisations	1.7	1.7	3.1	2.5	3.4	3.8	3.6
International development institutions	3.7	3.7	5.2	4.6	5.1	5.1	4.2
Other	0.2	0.8	0.3	0.5	0.6	0.4	0.4

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; excluding redemptions. — 2 Including public enterprises and financial institutions and including international organisations.— 3 Canada, France, Germany, Italy, Japan, United Kingdom, United States.— 4 Including CMEA institutions. — 5 Including international organisations. — 6 The country of residence of the issuer is not identical with the country or countries of sale; excluding redemptions. — 7 Internationally syndicated bond issues. — 8 Direct placements with monetary authorities and governments. — p Provisional.
Discrepancies in the totals are due to rounding. — Source: OECD and World Bank.

ing of the supply of capital. As far as Deutsche Mark issues are concerned, this tightness decreased from February 1980 and even more from the late summer onwards as an interest rate differential in favour of foreign Deutsche Mark bonds relative to domestic bonds developed. As a result, the market for foreign Deutsche Mark bonds became attractive again for residents as well.

Stagnation of medium and long-term Euro-credits in the face of widening selective contractual spreads

In the case of syndicated Euro-credits on a "rollover" basis, the changed market climate likewise caused the volume of newly granted credits only to stagnate; however, the increased interest rate spreads which the banks considered reasonable in the light of higher country risks were accepted only in part. Loans to prime borrowers were granted at practically unchanged spreads of $\frac{3}{8}$ % per annum above the London Interbank Offered Rate (LIBOR). In contrast, a number of developing countries had to accept wider spreads of 2 % or more. Some banks refrained from engaging in possible transactions because they thought the spreads were still inadequate. But other banks were often prepared to fill the gaps that arose. Nevertheless, borrowers frequently had to accept shorter maturity periods, which fell on average by more than one year to 7½ to 8 years.

Improved supervision of the international markets

While acknowledging the role of the international financial markets in financing balance of payments deficits, there is no overlooking the fact that risks have grown in international lending. For this reason the monetary authorities of the major countries have been endeavouring for years to improve the supervision of the international markets. In April 1980 the central bank governors of the Group of Ten countries and Switzerland decided to establish, under the auspices of the BIS, a comprehensive reporting system on maturity transformation in international banking based on national reports. Moreover, the central bank governors confirmed that the initiatives already undertaken under the auspices of the BIS to supervise international banking operations on a consolidated basis should continue to be given high priority.

(b) Development of official loans

More important role of the IMF

As in the previous year, the heavier recourse to IMF resources to finance balance of payments needs was limited in the period under review to the oil-importing developing countries. Loans granted under standby arrangements, including the Extended Fund Facility and the Supplementary Financing Facility ("Witteveen Facility"), rose from SDR 2.2 billion in 1979 to a record level of SDR 7.2 billion in 1980. However, the actual amount of loan disbursements was only SDR 3.3 billion (1979: SDR 1.7 billion) because these funds are in most cases disbursed only in instalments over a period of one to three years. Apart from the standby credit arrangements, the IMF provided the developing countries with a further SDR 1.3 billion in 1980 (1979: SDR 0.5 billion) in the form of interest-subsidised loans through the Trust Fund in existence since 1976.

The demand of the developing countries for IMF credits is likely to increase strongly again in 1981 because, as mentioned above, many of them are approaching the limits of their indebtedness in the private financial markets. Their willingness to accept economic policy conditions from the IMF has probably been strengthened by the fact that incurring debt has become much more expensive in the present period of high interest rates in the private markets, while balance of payments credits from the IMF carry very low rates of interest in some cases. The attractiveness of the balance of payments assistance provided by the IMF also grew because the Fund, as a result of its refinancing arrangements with various countries under the "Witteveen Facility", was able to provide members seeking loans and having a particularly large need for balance of payments assistance with credits that far exceeded previous drawing limits without endangering its liquidity.

"Enlarged access" until the acute balance of payments crisis recedes

In view of the dramatic rise in the balance of payments deficits of the oil-importing developing countries, the IMF decided in the autumn of 1980 to enlarge the access of its members to the Fund's resources for a transitional period, i.e. until present balance of payments difficulties have been overcome. In the context of such "enlarged access", members with a major balance of payments need can make drawings in the next three years up to an annual limit of 150% of the quota a member has had since the Fifth General Increase in Quotas came into effect at the end of 1980, viz. a total of 450% of its new quota. No account will be taken of drawings under the facility for the Compensatory Financing of Export Fluctuations, or under the Buffer Stock Facility. The marked rise in the volume of drawings anticipated as a result of this new arrangement is to be financed primarily by the IMF borrowing from surplus countries, i.e. mainly from certain OPEC countries. The latter are making their willingness to provide additional resources dependent on the fulfilment of certain conditions, including in particular their being given greater influence in the decision-making bodies of the IMF in accordance with their financial commitment. In the meantime the negotiations between the IMF and the countries which have been approached for loans have advanced to a stage where the refinancing of loans granted by the IMF can be considered virtually assured for the next two years. Besides taking up loans direct from certain surplus countries, the question of the IMF also drawing on national and international financial markets has reached the stage of concrete consideration. However, it has been agreed that the financial resources of the IMF should continue to be provided in the future mainly through members' quotas, which also form the basis of other functions within the IMF.

Enhanced role of international development banks

In present circumstances the international development banks — the World Bank group and the regional development banks — are becoming increasingly important as mediators between the international capital markets and the Third World in procuring long-term financial resources. The balance of payments problems of many developing countries are structural in nature and can only be tackled with any prospect of success with

World monetary reserves

US$ billion

Item	Change 1976	1977	1978	1979	1980 pe	Level at end-1980 pe
By type of reserves						
Foreign exchange holdings						
Dollar claims of monetary authorities on the United States	+11.3	+34.1	+30.8	−13.7	+13.7	156.8
Sterling claims of monetary authorities on the United Kingdom	− 2.5	− 0.1	− 0.4	+ 1.4	+ 2.3	7.6
Deutsche Mark claims of monetary authorities on Germany	+ 1.6	+ 1.3	+ 2.8	+ 1.8	+ 8.5	24.0
Other claims of monetary authorities in the currency of the debtor	+ 1.0	+ 0.8	+ 3.3	+ 3.2	**1** + 4.0	**2** 18.5
Dollar holdings of monetary authorities in the Euro-market	+ 8.4	+12.0	+ 0.1	+ 0.0	**1** + 5.8	**2** 66.8
Deutsche Mark holdings of monetary authorities in the Euro-market	+ 0.4	+ 4.0	+ 3.3	+ 3.1	**1** + 2.4	**2** 19.1
Other foreign exchange holdings of monetary authorities in the Euro-market	− 0.6	+ 0.9	− 0.5	− 0.5	**1** + 2.1	**2** 7.8
ECU claims on the EMCF	−	−	−	+42.7	+21.2	63.9
of which Gold swaps	−	−	−	+25.9	+21.7	47.6
Other foreign exchange holdings of monetary authorities	+ 5.7	− 0.5	+ 3.6	− 6.1	.	.
Memorandum item						
Foreign exchange holdings of monetary authorities in the Euro-market including quasi-official reserves according to the BIS	+10.4	+ 7.4	+ 5.9	+34.7	**1** + 9.8	**2** 128.0
Foreign exchange holdings, total	+25.3	+52.5	+43.0	+31.9	+50.1	372.6
Special drawing rights, reserve positions in the IMF, gold **3, 4**	+ 5.7	− 0.1	− 3.8	− 2.5	+ 6.0	78.4
Total monetary reserves	+31.0	+52.4	+39.2	+29.4	+54.6	451.0
Total monetary reserves including valuation adjustments due to exchange rate changes	+30.6	+60.2	+46.3	+34.5	+52.2	451.0
By country						
Industrial countries	+ 9.5	+38.6	+44.9	+11.1	+31.7	269.6
of which						
EEC countries, total	+ 1.6	+29.7	+18.7	+23.1	+17.7	160.0
Memorandum item						
EEC countries excluding the valuation adjustment of the gold share in ECUs (as from 1979)	−	−	−	(+ 1.5)	(− 8.0)	(112.6)
Germany	+ 3.8	+ 4.9	+14.1	+ 3.1	− 4.7	52.3
France	− 2.9	+ 0.5	+ 3.7	+ 7.4	+ 9.6	31.0
Italy	+ 1.9	+ 5.0	+ 3.3	+ 6.4	+ 4.8	26.1
United Kingdom	− 1.2	+16.8	− 4.0	+ 3.5	+ 0.9	21.5
Switzerland	+ 2.6	+ 0.8	+ 7.7	− 1.3	− 0.9	19.4
United States	+ 2.4	+ 1.1	+ 0.2	+ 0.4	+ 7.4	27.4
Japan	+ 3.8	+ 6.7	+10.2	−12.9	+ 5.1	25.7
Oil-exporting countries **5**	+ 8.7	+10.3	−15.3	+13.9	+19.0	93.2
Other developing countries **6**	+12.4	+11.3	+16.7	+ 9.4	+ 1.4	88.1
All countries	+30.6	+60.2	+46.3	+34.5	+52.2	451.0

1 January to September. — **2** As at end-September. — **3** Excluding changes arising from fluctuations in the value of the SDR since mid-1974. — **4** Gold valued at SDR 35 or at the ruling dollar value of the SDR per ounce. — **5** Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates, Venezuela. — **6** Including the following European countries: Cyprus, Greece, Malta, Portugal, Turkey, Yugoslavia. — **pe** Partly estimated.
Source: IMF, BIS and national statistics.

financial assistance that is designed to extend over a relatively long period of time and which must fit in with the development programmes that are needed in these countries in any case.

Structural adjustment loans of the World Bank ...

As a direct reaction to the sharp increase in the balance of payments deficits of the developing countries the World Bank agreed to grant "structural adjustment loans" at the beginning of 1980. These loans are intended to enable the developing countries to undertake necessary structural adjustment measures without suffering excessively large setbacks in their development. For this reason the condition for drawing on the new loan facility is that the developing countries submit detailed economic programmes that promise to be successful and place most emphasis on structural adjustment measures. In the view of the management of the World Bank just under $ 8 billion, or about 6 % of the total loans granted by the World Bank and the IDA, is to be earmarked for this purpose over the next five years.

... must not undermine the conditionality of finance provided by the IMF

Of course, in granting loans of this nature the World Bank is moving closer to the area of responsibility of the IMF, which according to the Articles of Agreement of both institutions is entrusted with balance of payments financing, while the World Bank is committed to granting loans to finance development projects. This could give rise to the danger that the strict and detailed economic policy conditions attached to IMF loans, which are aimed at reducing external imbalances rapidly, could be practically undermined by financing conditions of a different nature agreed with the World Bank. The World Bank and the IMF, taking their differing objectives into account, are therefore endeavouring to cooperate closely with each other to avoid this danger.

Increase in the ceiling for Community loans within the EEC

The European Community also has credit mechanisms available to finance the balance of payments deficits of its member countries. They include the system of "Community loans" which was created in 1975 and enlarged at the beginning of 1981 through a Resolution of the Council to a total of ECU 6 billion (approximately DM 15 billion). In contrast to the way the system used to be designed, resources that have been lent can now be re-lent on a revolving basis. Loans may be granted under this facility only to finance deficits that are directly or indirectly connected with the increase in oil prices. Moreover, economic policy conditions are attached to them in order to restore equilibrium to the balance of payments of the borrowing country. As and when necessary, the required financial resources can be borrowed directly from third countries, banks or in the capital markets. At the same time the details of the procedure for granting credit have been improved, particularly with respect to the decision-making process and the repayment of loans. Since the former ceiling had been practically exhausted and the new arrangement could not come into effect until the beginning of this year, this instrument was not used in 1980 and has not yet been used in 1981.

Financial assistance from the EEC for third countries

Borrowing by the European Investment Bank (EIB) to refinance loans granted to third countries can also be considered a contribution of the Community towards recycling petrofunds. In addition, the EIB and the European Development Fund contribute to recycling by borrowing petrofunds to co-finance investment projects.

4. Development of international liquidity

Steep increase in international liquidity

As already explained, in global terms the extremely high current account deficits of the year 1980 were again largely financed by taking up credit in the international financial markets and through official assistance loans. Although a greater part was played than in some earlier years by countries drawing on their reserves to finance their balances of payments (as is demonstrated in particular by the example of Germany), this method of financing was of minor importance overall. To the extent that current account surpluses are not offset by private capital outflows or official transactions, such a development — where on average deficit countries record only relatively slight reserve losses while large claims accrue to the surplus countries — is bound to lead to an increase in international liquidity. Not least on account of the economic and political structure of the OPEC countries, which generally results in foreign exchange receipts accumulating with official or quasi-official agencies, there was a steep increase in international liquidity once again in 1980.

Rise in official reserves partly due to valuation adjustments

In the year under review the officially published gross monetary reserves of all countries rose by $ 52 billion. However, no less than $ 22 billion of this amount is due to European Currency Units (ECUs) being credited by the European Monetary Cooperation Fund (EMCF) to its members in connection with the contribution to this Fund of a part (20 %) of the gold holdings of the EEC central banks; since, in accordance with the statutes of the EMCF, and contrary to the way gold is valued in the reserve statistics of the IMF, a market-related value is used, international liquidity is correspondingly inflated. The gross official reserves of the major oil-exporting countries went up by $ 19 billion. The remaining increase corresponds in the main to reserve gains by France, the United Kingdom, Japan, Norway and the United States in excess of the reserve outflows primarily from Germany and a number of developing countries. France and the United States augmented their reserves partly as a result of purchases of Deutsche Mark to support the German currency.

Reserve statistics distorted by unrecorded quasi-official reserves

However, the reserve statistics of the IMF do not cover liquid investments by quasi-official institutions or other funds with the character of reserves, which have increased considerably in recent years. This has become known on the basis of partial data, in particular information on the investment policy of the OPEC countries. The figures published by the IMF therefore give an incomplete picture of the development of international liquidity. This could tend to lead to an underestimation of the expansion of liquidity caused by the way in which high current account balances are financed, and to the neglect of the problems this raises. It therefore appears urgent to search for ways and means of adjusting international reserve statistics to the actual situation, so as to enable the development of international liquidity to be assessed accurately in future as well.

Unchanged reserve role of the Deutsche Mark

As far as the role of individual currencies as reserve currencies is concerned, no major changes occurred in 1980. The share of the Deutsche Mark in official world foreign exchange reserves, at about 12% according to preliminary statistics and estimates, is unchanged. In terms of the foreign exchange reserves of foreign monetary authorities, i.e. after eliminating the dollar holdings of the Bundesbank, the share accounted for by the Deutsche Mark was 13 to 14% at the end of 1980. Quasi-official monetary reserves held in the form of Deutsche Mark also increased. Relatively low interest rates in Germany in comparison with other countries and the persistent pressure on the exchange rate have obviously not been detrimental to the Deutsche Mark as a reserve currency in the past year, probably not least because a number of OPEC countries are pursuing a long-term investment policy. But false conclusions should not be drawn from this as regards the future: the willingness of other countries to hold the Deutsche Mark in their foreign exchange reserves by no means ensures the quasi-automatic financing of current account deficits of the size that Germany has had to finance for some time past. On the contrary, it requires monetary policy in particular to pay even greater attention to all the influences that could have a negative impact on confidence in the domestic and external value of the Deutsche Mark.

5. Exchange rate movements and exchange rate policy

Exchange rate shifts between the major currencies

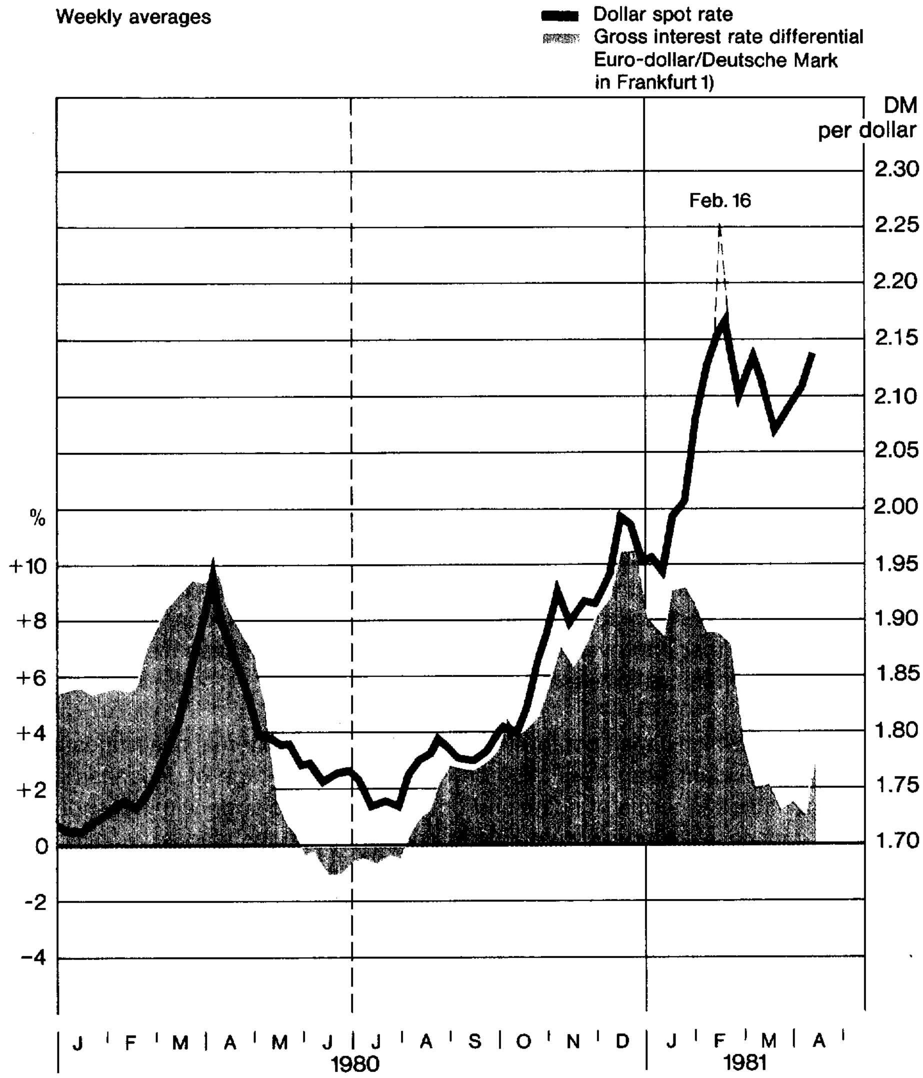
In the course of 1980 the different ways in which the balances of payments of major countries developed, together with the more determined fight against inflation and the interest rate differentials between countries that this implies, led to exceptionally large shifts in exchange rates between the major floating currencies, sometimes causing great turbulences in the foreign exchange markets. The recovery of the U.S. dollar and the strong pressure on the Deutsche Mark, as well as the dramatic change in the movement of the exchange rate of the yen, the continued appreciation of sterling and the relative stability of exchange rates within the European Monetary System, were particularly striking features of the year under review.

(a) Reversal in the exchange rate movements of the U.S. dollar and Deutsche Mark

Regained strength of the U.S. dollar ...

In the light of the high rates of inflation of over 14% and the widespread expectation that inflation would accelerate even further, the U.S. dollar began 1980 at a record low in the foreign exchange markets. However, it strengthened rapidly when the resolute anti-inflationary monetary policy introduced in October 1979 led to a rapid increase in interest rates from February 1980 onwards and, in addition, when the improvement in the U.S. trade balance became evident. This favourable development for the dollar was further enhanced by the anti-inflation programme of the Carter Administration in March 1980, accompanied as it was by a rise in the prime rate to a new record level of 20%. In relation to the Deutsche Mark, the exchange rate of the dollar went up between the beginning of the year and April from DM 1.71 to DM 1.98. However, this period of recovery for the dollar was soon interrupted; the unexpectedly sharp fall in the level of economic activity in early summer made the money supply appear to be less tight, causing a distinct drop in interest rates. The prime rate declined by almost 10 percentage points within two months; there was a steep fall in the interest rate differential between money mar-

Interest rate differential between the Deutsche Mark and the dollar, and exchange rates



1) Three-month funds, interbank rates; dollar above Deutsche Mark: +. - Latest position: April 10, 1981.

ket rates for dollar assets and those for Deutsche Mark assets, leading in the middle of the year to a slight interest rate advantage for the Deutsche Mark for a limited period. Around the middle of the year economic activity began to pick up again in the United States, accompanied by a fresh rise in interest rates and a renewed strengthening of the dollar. This trend was fostered by positive news on the development of the economy at the beginning of the fourth quarter, by the result of the Presidential election ("Reagan bonus") and by the strict adherence to an anti-inflationary policy stance by the Federal Reserve System, which resulted in a further increase in the prime rate to 21.5%. In the middle of December the dollar rose above DM 2.00 for the first time since September 1978. After a temporary drop in the exchange rate, a new upturn began at the beginning of 1981, owing not only to differences in interest rate levels but also to the expectations associated with the radical switch in U.S. economic policy by the new Administration.

... puts corresponding pressure on the Deutsche Mark

A number of factors contributed to the Deutsche Mark forming the antipole to the U.S. dollar to a particularly marked degree last year following the general improvement in the U.S. currency. On the one hand, Germany felt the burdens connected with the Deutsche Mark's role as an alternative investment currency to the U.S. dollar. Thus, an important part in the movement of exchange rates was played by capital flows between the Deutsche Mark and the U.S. dollar induced by interest rate differentials. In fact, from the spring of 1980 until the beginning of 1981 there was an almost perfect correlation between interest rate differentials and the movement of the spot exchange rate of the Deutsche Mark against the U.S. dollar. In contrast, in previous years even high rates of interest in the United States had hardly been able to change the downward trend of the U.S. currency, i.e. the expectation of a further depreciation of the U.S. dollar (or appreciation of the Deutsche Mark) was the main determinant of exchange rate movements. The fact that the expectations of an appreciation of the Deutsche Mark ceased despite its continued considerable stability bonus is due in the main to the above-mentioned differences in the current account positions of the United States and Germany. On the other hand, the fall in the exchange rate of the Deutsche Mark in the foreign exchange markets is probably also a reflection of difficulties in the energy policy field in Germany. Non-economic factors (such as the events in Poland) strengthened this basic trend at times.

(b) Other shifts in the pattern of exchange rates

Marked recovery of the yen

After the exceptionally strong deterioration of the Japanese yen as from the end of 1978, it made a marked recovery from April 1980 onwards. By the beginning of this year it had regained practically all the ground it had previously lost against the average of all other currencies. The yen also improved sharply vis-à-vis the U.S. dollar, even though it did not approach its record level of 1978 and has weakened again since the end of January 1981. The major reasons for the change in the exchange rate movement of the yen were the economic and monetary policy measures adopted in March 1980 to resolutely combat inflation, including an increase in the discount rate of the Bank of Japan to 9% as well as cooperation agreements with the Federal Reserve System and the central banks of Germany and Switzerland which were viewed by the markets as giving psychological support to the yen; finally, wage increases below the rate of inflation, which led to the expectation of a further improvement in the competitiveness of Japanese industry, also contributed to the positive assessment of the yen.

The success with which Japan confronted its domestic and external challenges became more and more evident from April 1980 onwards. The advantage of Japanese industry over other countries in terms of costs and prices became so large within a short space of time that Japanese exporters were able to cope well with the marked recovery of the yen, particularly since it only corrected the previous depreciation of the Japanese currency. As a result, Japan's current account showed clear signs of improvement from the middle of the year onwards, and this in turn led to a further appreciation of the yen in the foreign exchange markets. Furthermore, the yen benefited from the evident results of Japan's resolute energy policy (which have also been reflected in the meantime in payments for oil imports) as well as from the continued good prospects for economic activity and, finally, from large-scale capital inflows, particularly from the OPEC countries.

Further rise in sterling

The strong rise in the foreign exchange rate of sterling in the course of last year was due on the one hand to the growing level of oil and natural gas production in the British sector of the North Sea (which has meanwhile reached a volume sufficient to cover the United Kingdom's own needs) and on the other hand to the attractiveness of sterling as an investment currency owing to the very high interest rates in the United Kingdom by international standards. Only occasionally — as in March, July and December — did an interest rate differential in favour of the U.S. dollar develop, with the consequence that sterling weakened temporarily against the U.S. currency. In the initial months of the present year as well sterling remained firm. The strength of the pound has meanwhile made a major contribution to considerably reducing the inflation rate and wage increases in the United Kingdom. Admittedly, inflation is still so high that it is placing an additional burden on the price competitiveness of British industry compared with other countries, particularly since at present it is not possible for production capacities to be used to anywhere near the optimum extent.

Weakness of the Deutsche Mark in the EMS

Within the EMS tensions occasionally arose owing to a tendency of the Deutsche Mark and also of the Belgian franc towards weakness. With respect to the Deutsche Mark the development of Germany's current account balance, the prospects of its being corrected and the outlook in the sphere of energy policy, as well as its role as an alternative investment currency to the dollar, have at times influenced the movement of its exchange rate in the EMS. The less important EMS currencies, in terms of their being used as investment currencies and also for international capital transactions in general, are not affected nearly so much as the Deutsche Mark by portfolio shifts, i. e. they do not move so much in relation to the dollar. The fact that a "polarisation" of exchange rate develop-

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

DM billion

Period	Changes in the net external position, total	Caused by interventions in the Deutsche Mark/ dollar market **1**	Caused by interventions in the European narrower margins arrangement or EMS **2**	Caused by other foreign exchange movements **3**
1979, total	− 5.1	+ 7.3	+ 8.2	−20.6
1980				
January — April 8				
Strong rise in the U.S. dollar	−14.4	−15.4	− 3.9	+ 4.9
April 9 — July 9				
World-wide fall in the U.S. dollar	+ 0.5	+ 6.6	+ 0.1	− 6.2
July 10 — November 7				
Renewed rise in the U.S. dollar	−10.6	− 5.9	− 6.6	+ 1.9
November 10 — end-December				
Recovery of the Deutsche Mark in the EMS after lowering of interest rates in France	− 2.6	− 3.6	− 0.1	+ 1.1
1980, total	−27.1	−18.3	−10.5	+ 1.7
1981				
January — February 11				
Further strengthening of the U.S. dollar	− 3.3	− 3.0	− 1.2	+ 0.9
February 12 — end-March				
Decline in the U.S. dollar	+ 6.5	− 2.1	+ 5.8	+ 2.8

* Excluding changes due to valuation adjustments. Recorded according to the date on which the transaction was concluded and not according to the value date or the date of the accounting entry; these figures therefore do not correspond to those of the balance of payments. — **1** Interventions in U.S. dollars by the Bundesbank for its own and U.S. accounts and in Deutsche Mark by the Federal Reserve Bank of New York.— **2** Including intramarginal interventions.— **3** Including conversions of foreign Deutsche Mark bonds and certain other external loans through the Bundesbank; also including net liquidity swaps with domestic banks that were not settled within the periods selected.

ments is possible in the EMS was taken into account, at least by the German authorities, as early as the negotiation stage before the EMS was established, albeit with opposite expectations. The fears were not unfounded that for this reason alone large-scale interventions could become necessary within the EMS or in relation to the dollar in order to defend the agreed central rates in the EMS.

At the same time, the fact that some participants in the EMS have an inflation rate of a similar magnitude to that of the United States (which is why their interest rate level is closer to the U.S. level than interest rates in Germany) probably also contributed to the weakness of the Deutsche Mark in the EMS between March 1980 and February 1981, which tended to foster the cohesion of the system in its initial stages. Moreover, the fact cannot quite be excluded that the risk of exchange rate shifts, also within the existing margins, was at times neglected, thus strengthening the effect of the interest rate gap vis-à-vis partner countries. Even when taking due account of all the influences that were of importance for money and capital movements last year, Germany's high current account deficit must be rated the crucial factor for exchange rate developments.

(c) The role of foreign exchange market interventions

Large volume of interventions to maintain orderly market conditions

In 1980 the pressure on the pattern of exchange rates was not only reflected in distinct shifts in exchange rates but also once again demanded large-scale interventions by central banks in the market in order to counter disorderly developments or to keep exchange rates in the European Monetary System within the agreed margins. Both in the dollar market and within the EMS support operations centred on the Deutsche Mark.

At the end of March 1980 and at the turn of the months of October and November 1980 the Deutsche Mark fell within the EMS vis-à-vis the French franc and occasionally vis-à-vis the Dutch guilder to its lower intervention points, at times triggering considerable obligatory interventions. In the course of the year, however, about the same volume of intramarginal interventions were effected in favour of the Deutsche Mark. Such interventions can be undertaken by mutual agreement before the intervention points are reached, should this prove to be appropriate. Moreover, part of the dollar sales of the Bundesbank served to ease the tensions in the EMS caused by the general downward trend of the Deutsche Mark. In addition, support operations in the EMS in favour of the Belgian franc (in relation to the French franc and the Dutch guilder) were also necessary in March and April 1980 as well as from the beginning of November 1980 onwards.

No change in exchange market policy

The considerable volume of support operations in favour of the Deutsche Mark both in the dollar market and in the EMS in 1980, as reflected in the table on page 59, must not, however, be misconstrued as a greater preference in the Bundesbank's policy for using interventions in the foreign exchange markets as an instrument for supporting the exchange rate and financing the balance of payments. Of the deterioration in the Bundesbank's net foreign position through foreign exchange market interventions totalling DM 28.8 billion, only a good third (DM 10 billion) was due to support operations which the Bundesbank undertook on its own initiative in the dollar market. Just under a further third was attributable to purchases of Deutsche Mark by the U.S. central bank in New York and by the Bundesbank in Frankfurt at the request of the U.S. monetary authorities. They were mainly intended to pay back swap liabilities of the United States to the Bundesbank that were outstanding at the beginning of 1980, and in addition to build up investments in Deutsche Mark in order to cover repayments due from September 1981 onwards as a result of sales of Carter Notes totalling DM 9.5 billion. Finally, the remaining third reflects the interventions in the EMS mentioned above.

The experience gained in 1980 demonstrates that in the final analysis interventions in the foreign exchange market are just as powerless against interest-rate-induced capital movements that can quickly reach very large proportions as against one-sided market expectations, such as were evident for years in the case of the Deutsche Mark in the direction of appreciation. However, within the EMS, too, where capital movements between the participants do not play such a dominant role for exchange rates as in relation to the dollar, interventions to defend the agreed margins would have been inadequate without corresponding flanking measures in other areas. Greater harmonisation of the influences affecting exchange rates, in particular greater price stability in the individual countries, is therefore urgently necessary to safeguard the system.

(d) Exchange rate movements and international competitiveness

Inflation rate differential not offset by exchange rate movements

The exchange rate and price movements of last year, and to an even greater degree of the last two and a half years, led to considerable shifts in price relationships and hence also in the international competitive positions of individual countries. Comparing the beginning of 1981 with the average for 1978, the international competitive positions in price terms of Japan, Germany and Switzerland improved by something like 9 to 14%. This improvement is due in the main to a corresponding stability bonus of these countries in comparison with the average of their major trading partners; the weighted nominal external value of these countries' currencies roughly corresponded to the position of 1978.

Over the same period of time the competitive positions of France and the United States deteriorated to a moderate degree, mainly owing to their relatively high inflation rates. In contrast, Italy and in particular the United Kingdom suffered large inroads into their competitiveness. While in the case of Italy only about half of the continuing strong rise in inflation was offset by the depreciation of its currency, the competitiveness of the United Kingdom was doubly burdened by the high inflation rate and the steep increase in the rate of sterling.

Consequences of shifts in price competitiveness uncertain

No clear judgement can at present be made as to whether the combination of exchange rate and price movements will produce better equilibrium in the balance of payments. Many other influences besides relative prices have an effect on payments balances, beginning with the differing impact of enormous increases in oil prices and including the varying international patterns of economic activity. Moreover, relative prices are only one

The competitive position of major countries in price terms

Percentage change between the average figure for 1978 and January 1981

Country	Inflation differential 1	Nominal external value of the currency 2	Real external value of the currency
Switzerland	− 12	− 2	− 14
Germany	− 11	+ 1	− 10
Japan	− 11	+ 3	− 9
France	+ 8	− 3	+ 5
United States	+ 7	+ 0	+ 7
Italy	+ 25	− 12	+ 11
United Kingdom	+ 13	+ 28	+ 45

1 Movement of consumer prices in the country in question against the average, weighted with the shares in foreign trade, in 13 other industrial countries. — 2 Average external value of the currency in question, weighted with the shares in foreign trade, against the currencies of 13 other industrial countries.

factor among several that determine the competitiveness and export success of a country. But at least in a few cases the signals on the price front seem to be set in the right direction for correcting the pattern of current account balances. Admittedly, other countries are now in a weak balance of payments position and must fight against an additional erosion of their competitiveness. This no doubt will pose new problems for the pattern of payments balances and exchange rates.

6. Developments in the European Monetary System

Prolongation of the transitional rules by two years

In March 1981 the European Monetary System had been in existence for two years. Within this period of time — the "initial stage" originally envisaged by the EEC heads of state and government — the transition to a final system was to be prepared. For this "institutional stage" of the EMS, the European Council of heads of state and government had planned in particular the creation of a European Monetary Fund and the unrestricted use of the European Currency Unit (ECU) as a reserve asset and instrument for settling balances. In the course of the discussions in the Committee of EEC Central Bank Governors and within the EEC Monetary Committee it very soon became clear, however, that the realisation of these objectives presents numerous difficult problems of a technical, institutional and legal nature. The necessity to gather more experience with the functioning of the system also speaks in favour of a longer transitional stage. For this reason, the EEC central banks, in agreement with the Council of Ministers, decided to prolong the transitional rules without material changes for a further two years up to March 13, 1983, in order to be able to prepare the entry into the institutional stage without haste and with the requisite care.

General weakness of the Deutsche Mark fosters relative exchange rate stability in the EMS

In so far as an appraisal is possible at all after two years' existence, experience with the EMS must be evaluated against the background of the objectives being pursued by the system. On this point, the Resolution of the European Council of December 5, 1978 states that a system for "closer monetary cooperation leading to a zone of monetary stability in Europe" is to be created. As regards exchange rates this objective has been achieved since, following the devaluation of the Danish krone in November 1979, no changes in central rates were made until March 1981, when the Italian lira had to be devalued by 6 %. Although in the year under review a number of currencies moved along the limits of the agreed margins, triggering the obligatory interventions mentioned above, strong pressure on exchange rates was apparent only in a few cases and for limited periods of time. However, too far-reaching conclusions should not be drawn from this fact. Although the greater efforts in the field of stability policy in all member countries of the EMS and the associated willingness to pursue corresponding interest rate policies have fostered the cohesion of the EMS, and a few countries have clearly oriented their monetary policy towards defending their exchange rates in the EMS, this cohesion has also been enhanced by a few factors which exert only a temporary influence and which cannot be counted on for too long. As mentioned above, these include in particular the period of weakness of the Deutsche Mark, which developed despite the persistent stability bonus enjoyed by Germany. But the longer the differences in inflation rates continue to be as large as they are at present — on average the range in 1980 was from 5.5 % (Germany) to over 21 % (Italy) within the EMS — the more strongly this will be reflected in exchange rates.

Economic developments in the European Community in 1980

Country	Consumer prices (Percentage change on previous year)	Balance on current account (US$ billion)	Real gross domestic product (Percentage change on previous year)	Unemployed persons as % of the civilian labour force	Net public sector borrowing as % of the gross domestic product
Germany	5.4	−15.7	2.0	3.4	3.5
France	13.5	− 7.4	1.8	6.5	0.6
United Kingdom	16.1	6.4	− 2.0	6.9	2.3
Italy	21.2	− 9.9	3.8	7.5	7.8
Netherlands	6.5	− 2.5	0.2	5.0	2.8
Belgium	6.3	− 6.9	1.2	9.3	9.4
Denmark	11.0	− 2.4	− 0.9	6.2	4.6
Ireland	18.2	− 1.2	0.8	8.9	13.5
Luxembourg	6.3	0.9	0.4	0.7	0.9
EEC, total	12.1	−38.7	1.3	6.0	3.6

Source: EEC Commission, OECD and national statistics.

Finally, the smooth functioning of the EMS was fostered by the fact that — apart from the Greek drachma — two EEC currencies have a special status as regards their exchange rate margins (the normal margin around the bilateral central rates is ± 2.25%). The Italian lira moved and is still moving within a margin of fluctuation of ± 6%. Sterling is not yet a participant in the exchange rate arrangements of the EMS.

Still no progress towards a Community of stability

However, the stability of exchange rates cannot be the main criterion of a zone of monetary stability in Europe. If prices and costs develop very differently in the individual countries, then, under a system of fixed exchange rates, inflation stimuli are automatically transmitted to countries with greater price stability. Owing to the restrictive monetary policy being pursued everywhere, the EMS has not become a source of monetary inflation within the Community, as had to be feared originally in view of the intervention obligations and the greatly enlarged credit facilities in the system. In addition, in 1980 the EMS tended to act as a brake on the downward movement of the exchange rate of the Deutsche Mark and hence did not exacerbate the importing of inflation into Germany. In the light of the wide gaps in inflation rates, the dangers of transmitting inflation within a system of fixed exchange rates should nevertheless not be underestimated.

Lack of harmonisation endangers the existence of the system

Up to the present the achievements of stabilisation policy in all EMS countries have fallen far short of expectations. Instead of the urgently desired reduction in inflation differentials, the gap in inflation rates between the EEC countries widened further in the course of 1980 — partly, of course, owing to an exogenous factor, namely the increase in oil prices. The development of other factors particularly relevant to exchange rate movements, such as balances of payments, interest rates, growth, employment and public sector indebtedness, also deviated more strongly than appears consistent in the long run with a system of fixed but adjustable exchange rates. The greater harmonisation of economic developments within the individual economies that is absolutely essential for the existence of the EMS therefore demands that additional efforts be undertaken. The objective of greater stability both domestically and externally will only be achieved if countries with high rates of inflation continue the restrictive policy stance they have adopted with particular persistence. Under present economic conditions this requires sufficient stamina on the part of those responsible for economic policy.

Greece not yet a participant

The accession of Greece to the European Community with effect from January 1, 1981 will have little effect on the EMS for the time being. In view of its economic position, Greece does not wish to participate in the EMS exchange rate mechanism immediately. The ECU currency basket will not be extended for the moment to include the drachma.

7. Recent developments in the International Monetary Fund

Extension of drawing facilities

In the period under review the International Monetary Fund undertook great efforts to create conditions that will enable its members to enlist its assistance in the coming years to a much greater degree than in the past in order to overcome their balance of payments problems. This includes not only the steep increase in members' quotas at the end of 1980 (by 50% and more) but also the possibilities mentioned above of drawings under the arrangements for enlarged access to the facilities of the Fund.

Interest rate subsidies for developing countries

In order to facilitate the financing of the necessary adjustment, particularly for the poorest developing countries, the IMF decided at the end of 1980 to grant these countries interest rate subsidies on drawings under the Supplementary Financing Facility ("Witteveen Facility"). The interest rate subsidy account set up for this purpose is to be supplied with funds from repayments on loans made by the Trust Fund amounting to SDR 750 million and by voluntary contributions by IMF member countries. In addition, discussions are going on at present regarding the way in which financial assistance to import food can be given to countries which, through no fault of their own, find themselves in a balance of payments need as a result of a natural disaster or a sudden strong rise in the world market price of certain foodstuffs.

Termination of gold auctions in favour of the developing countries

The programme initiated by the IMF in 1976 to sell one sixth (25 million ounces) of its gold holdings in favour of developing countries was terminated in May 1980 with the last public gold auction. The total receipts from the 45 gold auctions amounted to $ 5.7 billion. After deducting the book value of the 25 million ounces of gold ($ 1.1 billion), a net yield of $ 4.6 billion remained. Of this amount, approximately 28% was distributed to the developing countries direct; the residual 72% ($ 3.4 billion) went to the Trust Fund and has in the meantime largely been made available to developing countries in special need in the form of long-term loans at a very low rate of interest.

Measures to strengthen the role of the SDR

With effect from January 1981 the IMF reduced the number of currencies in the currency basket for valuing the SDR and adjusted the method of calculating interest to bring it into line with its other interest rate calculations. In doing so, it hoped to foster the role of the SDR in the international monetary system and to strengthen the use of the SDR as a unit of account in international commercial transactions, in particular by commercial banks. The basket for valuing the SDR and calculating interest rates now contains only the five major currencies (U.S. dollar, Deutsche Mark, sterling, French franc and yen). The Deutsche Mark accounts for a 19% share.

Interruption of the discussion on a substitution account

At the meeting of the Interim Committee in Hamburg in April 1980 no agreement could be reached on the setting up of a substitution account, as suggested by the IMF, because the differences of opinion on important questions, such as the maintenance of value of SDR-denominated assets over time, were too wide. However, a number of major IMF member countries have recently shown distinct interest in resuming discussions on this project with the aim of strengthening the role of the SDR as an international reserve asset.

Further development of the world monetary system must serve monetary stability

In this context it should be stressed that all proposals on further developing the international monetary system must be measured against the criterion of whether they are compatible with the maintenance or regaining of monetary stability. This basic demand for a strong economic and monetary order must be upheld even if — as for example in the context of the North-South dialogue under the auspices of the United Nations — calls for a "new world economic order" are being discussed. Critical restraint must be shown in particular with respect to reform proposals which would expose the International Monetary Fund, as an instrument of monetary cooperation on a basis of confidence in the world, to the danger of being one-sidedly oriented towards special interests.

Part B: Notes on the Deutsche Bundesbank's annual accounts for 1980

1. Legal basis, classification and valuation

Legal basis, accounting system and annual accounts

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

Classification of the annual accounts

On the assets side of the balance sheet a new item 9

Securities bought in open market transactions under repurchase agreements

was added and the former item 23

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

was deleted.

On the expenditure side of the profit and loss account item 4 was extended to

4 Increase in provisions
4.1. for pensions
4.2. for other purposes.

Item 7

Write-downs of the monetary reserves and other foreign currency positions

was deleted.

On the receipts side of the profit and loss account item 3

Gains from the valuation adjustment of the monetary reserves and other foreign currency positions

was added.

Valuation

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

2. Annual accounts

The annual accounts for 1980 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 1980.

Balance sheet

Comparison of balance sheet figures

At December 31, 1980 the balance sheet total had increased by DM 12,207.2 million, compared with end-1979, to DM 185,720.3 million.

Comparison of balance sheet figures

DM million

Assets	December 31 1979	December 31 1980
Gold	13,693.2	13,687.5
Reserve position in the International Monetary Fund and special drawing rights		
Drawing rights within the reserve tranche	3,248.4	2,915.4
Loans under special borrowing arrangements	2,162.9	1,572.3
Special drawing rights	3,595.3	3,612.3
Claims on the European Monetary Cooperation Fund in connection with the European Monetary System	28,487.7	31,708.0
Balances with foreign banks and money market investments abroad	51,801.4	42,597.9
Foreign notes and coins	24.4	26.3
External loans and other external assets		
Loans in connection with EEC medium-term monetary assistance	–	–
Claims arising from foreign exchange offset agreements with the United States	1,549.8	1,549.8
Other loans to foreign monetary authorities	–	–
Loans to the World Bank	2,481.5	2,484.6
Foreign bills of exchange	3,089.5	4,424.7
Domestic bills of exchange	30,025.5	39,257.5
Securities bought in open market transactions under repurchase agreements	–	6,163.7
Lombard loans	3,130.7	7,707.8
Cash advances (book credits)	308.5	2,436.7
Treasury bills and discountable Treasury bonds	–	–
Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin		
Equalisation claims	8,136.4	8,136.4
Non-interest-bearing debt certificate	547.2	547.2
Securities	2,114.1	3,887.1
German coins	721.5	728.6
Balances on postal giro accounts	375.5	322.8
Other claims	951.2	985.3
Land and buildings	922.7	1,041.7
Furniture and equipment	70.4	81.7
Items in course of settlement	8,905.1	8,379.4
Other assets	1,379.8	1,432.7
Prepaid expenses and deferred income	30.6	32.9
Balancing item in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — accumulated loss —	5,759.8	–
Total	173,513.1	185,720.3
Contingent claims	0.6	0.9

Liabilities	December 31 1979	December 31 1980
Banknotes in circulation	79,385.6	83,730.3
Deposits of banks	64,780.1	53,844.6
Deposits of public authorities		
Federal Government	1,842.5	396.3
Equalisation of Burdens Fund and ERP Special Fund	290.1	124.2
Länder Governments	728.5	450.2
Other public depositors	78.1	44.6
Deposits of other domestic depositors		
Federal Railways	12.7	8.1
Federal Post Office	579.4	1,141.3
Other depositors	637.5	581.8
Liabilities arising from mobilisation and liquidity paper sold	6,687.0	4,191.9
Liabilities arising from foreign business	3,328.8	7,721.5
Counterpart of special drawing rights allocated	1,748.6	2,475.7
Counterpart in respect of the valuation of the gold contributed to the European Monetary Cooperation Fund	9,070.4	22,511.3
Provisions	2,025.0	3,136.0
Other liabilities	92.1	227.2
Deferred expenses and accrued income	837.2	669.3
Capital	290.0	290.0
Reserves	1,099.5	1,099.5
Unappropriated profit	–	3,076.5
Total	173,513.1	185,720.3
Contingent liabilities	0.6	0.9

Assets

Gold

At December 31, 1980 the gold holding amounted to DM 13,687.5 million against DM 13,693.2 million at end-1979.

Reserve position in the International Monetary Fund and special drawing rights
Drawing rights within the reserve tranche

At December 31, 1980 the drawing rights within the reserve tranche in the IMF amounted to DM 2,915.4 million against DM 3,248.4 million at end-1979. Decreases due to other members' Deutsche Mark repayments and transactions of similar effect equivalent to SDR 526.9 million were accompanied by increases equivalent to SDR 269.6 million and gains due to the valuation adjustment at the end of the year. SDR 269.5 million of the increases was accounted for by the subscription payment connected with the raising of the German quota in the IMF by SDR 1,078 million. The level of drawing rights within the reserve tranche represents the difference between the German quota of at present SDR 3,234 million and the Deutsche Mark balances at the disposal of the IMF equivalent to SDR 2,067.2 million.

Loans under special borrowing arrangements

Loans under special borrowing arrangements amounted to DM 1,572.3 million at December 31, 1980 against DM 2,162.9 million at December 31, 1979. The loans outstanding at end-1980 comprise 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 46.4 million arising from the financing of other members' drawings under the Supplementary Financing Facility. In November 1980 the outstanding claims of the Bank in respect of loans granted under the 1975 IMF Oil Facility amounting to SDR 225.0 million and the claims in respect of loans granted to the IMF until then under the Supplementary Financing Facility totalling SDR 172.0 million were transferred to another IMF member country, in compliance with that country's wishes.

Special drawing rights

The amount of special drawing rights (SDRs) held at December 31, 1980 is shown at DM 3,612.3 million against DM 3,593.3 million at end-1979. Increases resulting from the allocation of SDRs at the beginning of 1980 (SDR 224.2 million), from designations (SDR 28.5 million), from other transactions (SDR 89.5 million), from the payment of interest on SDRs purchased by the Bank (SDR 66.1 million) and from the valuation adjustment of the SDR at the end of the year were accompanied by decreases deriving from the raising of the German quota (SDR 269.5 million) and from freely agreed transactions (SDR 269.3 million). The valuation adjustment affected both the total holding (SDR 1,445.8 million) and the counterpart of SDRs allocated, which is shown on the liabilities side (SDR 990.8 million).

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

This item comprises the claims deriving from the transfer, in the form of three-month swaps, of 20% of the Bank's gold and dollar reserves to the EMCF, less the liabilities which have arisen from other EEC central banks' operations in support of the Deutsche Mark.

Balances with foreign banks and money market investments abroad

The balances with foreign banks and money market investments abroad amounted to DM 42,597.9 million at December 31, 1980 against DM 51,801.4 million at December 31, 1979. Current transactions led to a decrease of DM 10,069.5 million in the year under review. The valuation adjustment of the foreign currency assets at December 31, 1980 resulted in an arithmetical gain of DM 866 million, so that the balances and money market investments abroad declined by DM 9,203.5 million in 1980.

Foreign exchange deals

The Bank's turnover in foreign exchange spot deals (foreign currency against Deutsche Mark) amounted to DM 63,404.1 million in the year under review against DM 60,498.5 million in 1979. The number of deals rose to 6,178 compared with 5,435 in the preceding year. These deals consisted of

	1979		1980	
	Number	DM million	Number	DM million
Purchases	2,729	23,058.4	2,287	26,858.6
Sales	2,706	37,440.1	3,891	36,545.5
	5,435	60,498.5	6,178	63,404.1.

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

Cross deals (foreign currency against foreign currency) likewise increased during the year under review, at 620 deals equivalent to DM 4,547.0 million against 555 deals equivalent to DM 4,375.7 million in 1979. In addition, 172 dollar inter-centre switch transactions amounting to US$ 30.6 million were concluded, against 188 transactions amounting to US$ 26.6 million in the preceding year.

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

	US$ million	DM million
Foreign exchange swaps to increase liquidity	10,235.0	19,080.3
Foreign exchange swaps to reduce liquidity	2,630.0	4,704.8
Foreign exchange transactions under repurchase agreements to reduce liquidity	3,976.4	7,464.9.

External payments

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

External payments

Number of orders

Year	in foreign currency	in Deutsche Mark	Total	of which: Processed by automated standing order procedure	of which: Processed automatically via S.W.I.F.T. 1
	Outgoing external payment orders				
1979	486,960	1,531,194	2,018,154	1,770,356	44,462
1980	476,714	1,493,930	1,970,644	1,712,760	110,061
	Incoming external payment orders				
1979	15,484	199,350	214,834	–	88,506
1980	14,464	202,945	217,409	–	100,664

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 1980 9,435 (1979: 8,965) foreign cheques payable to order totalling DM 617.8 million (1979: DM 577.3 million) were sold. In addition, the Bank sold 38,916 traveller's cheques amounting to DM 4.0 million against 34,954 traveller's cheques amounting to DM 3.5 million in the preceding year.

Simplified collection procedure for foreign cheques

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

Foreign commission business

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

	1979 Number	1980 Number
Bills, cheques, etc.	32,399	42,125
Foreign notes and coins	5,834	5,553
	38,233	47,678.

Foreign notes and coins

The amount of foreign notes and coins held at December 31, 1980 came to DM 26.3 million compared with DM 24.4 million at end-1979. During the year under review the Bank effected 22,007 purchases (1979: 24,825) and 39,638 sales (1979: 39,148) 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 arrangements during the year under review, as during the preceding 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 no other loans were granted to foreign monetary authorities.

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 1980 the portfolio of foreign bills accumulated through purchases in Germany amounted to DM 4,424.7 million compared with DM 3,089.5 million at December 31, 1979. The share of Deutsche Mark bills in the total value of the foreign bills purchased in 1980 averaged 88% (1979: 82%).

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

	1979		1980	
Land Central Bank	Number	DM million	Number	DM million
Baden-Württemberg	29,969	1,210.7	33,379	1,760.8
Bavaria	12,768	1,817.1	20,633	2,534.2
Berlin	1,143	1,020.3	1,337	1,632.9
Bremen	1,906	171.4	2,405	236.3
Hamburg	9,135	1,327.9	11,761	2,021.7
Hesse	16,105	3,131.0	21,127	4,958.3
Lower Saxony	3,137	299.2	3,890	396.6
North Rhine-Westphalia	26,654	2,369.5	30,901	4,441.9
Rhineland-Palatinate	5,789	397.8	6,810	595.0
Saarland	2,394	471.0	2,852	641.8
Schleswig-Holstein	658	70.5	1,266	209.3
Total	109,658	12,286.4	136,361	19,428.8

Domestic bills of exchange

At the end of 1980 the Bank's portfolio of domestic bills came to DM 39,257.5 million against DM 30,025.5 million at end-1979. The Bank's average portfolio of domestic bills on all the return days of the year under review, at DM 34,600 million, was likewise substantially larger than in the preceding year (DM 25,386 million). The increase in purchases was possible owing to the raising of the rediscount quotas in March, May and October 1980 by DM 4 billion, DM 3 billion and DM 3 billion, respectively, to a total of DM 42.5 billion, which the banks used for additional rediscounting.

The domestic bill portfolio comprised	Dec.31,1979 DM million	Dec.31,1980 DM million
Domestic bills discounted	27,560.2	36,330.4
Prime bankers' acceptances acquired in the course of open market operations	2,465.3	2,927.1
	30,025.5	39,257.5.

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

Land Central Bank	1979 Thousands	1979 DM million	1980 Thousands	1980 DM million
Baden-Württemberg	508	17,744.0	553	20,560.1
Bavaria	321	18,196.5	340	21,030.5
Berlin	25	3,860.7	29	4,771.4
Bremen	42	3,513.1	46	3,698.2
Hamburg	113	11,601.3	121	13,446.3
Hesse	324	28,007.6	334	32,710.9
Lower Saxony	145	7,979.7	159	9,938.7
North Rhine-Westphalia	519	34,326.2	584	40,226.4
Rhineland-Palatinate	83	3,545.7	95	4,780.6
Saarland	22	1,588.1	27	1,936.9
Schleswig-Holstein	38	2,139.7	46	3,101.7
Total	2,140	132,502.6	2,334	156,201.7
of which Domestic bills bought in open market transactions under repurchase agreements	62	4,989.0	—	—

The average value of the bills purchased in the year under review was DM 66,900 compared with DM 61,900 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:

	1979 Number	1979 DM million	1980 Number	1980 DM million
	4,380	68.9	6,996	93.0
as % of the total purchased	0.20	0.05	0.30	0.06.

Discount rate

During the year under review the discount rate for domestic and foreign bills stood at 6% until February 28, at 7% as from February 29 and at 7½% as from May 2.

Prime bankers' acceptances

The amount of prime bankers' acceptances which the Bank is prepared to purchase in the course of its open market operations was increased by DM 500 million with effect from October 20, 1980. The banks continued to make heavy use of this source of central bank funds. The Bank's purchases of prime bankers' acceptances through the Privatdiskont-Aktiengesellschaft came to DM 10,776.8 million, which was more than in the preceding year (DM 10,224.1 million). There were no resales to the market via the broker in 1980, but DM 350 million was sold direct to a public authority.

The amount of prime bankers' acceptances that remained in the Bank's portfolio until payment on maturity, at DM 9,965.0 million, was therefore larger than in the previous year (DM 8,814.1 million). At December 31, 1980 the Bank held prime bankers' acceptances stemming from open market operations amounting to DM 2,927.1 million (end-1979: DM 2,465.3 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 seven occasions during the year under review. In the course of 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 25 and 45 days, and the interest rates between 8.55 and 9.75%. At the end of the year the Bank held DM 6,163.7 million of securities stemming from such transactions.

Lombard loans

At the end of 1980 the Bank's outstanding lombard loans to banks amounted to DM 7,707.8 million against DM 3,130.7 million at end-1979. On all the return dates of the year under review they averaged DM 4,919 million compared with DM 5,280 million in the previous year. The outstanding amount of such loans was subject to marked fluctuations, as in preceding years, and was largest in April and June.

Lombard rate

During the year under review the lombard rate stood at 7% until February 28, at 8½% as from February 29, at 9½% as from May 2 and at 9% as from September 19.

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, 1979	December 31, 1980
Federal Government	–	1,336.0
Länder Governments		
Berlin	–	128.5
Bremen	42.8	31.8
Hamburg	–	142.0
Hesse	–	156.2
Lower Saxony	187.3	131.1
North Rhine-Westphalia	–	401.2
Rhineland-Palatinate	–	20.3
Schleswig-Holstein	78.4	89.6
Total	308.5	2,436.7

No cash advances (book credits) to the Equalisation of Burdens Fund were outstanding at December 31, 1980, as in the preceding year.

Federal Railways Federal Post Office

No book credits to the Federal Railways or Federal Post Office were outstanding at December 31, 1980; 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.

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

Treasury bills and discountable Treasury bonds

In the placing of discountable Treasury bonds the Bank 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 part of the credit requirements of the Federal Government, discountable Treasury bonds amounting to DM 2,312.0 million (1979: DM 3,997.3 million) were issued.

The greater part of this total, at DM 1,437.0 million (1979: DM 1,727.3 million), was made up of sales to non-banks of a special type of discountable Treasury bond issued by the Federal Government, namely Federal "financing bonds". Since February 1975 these securities have been sold to non-banks by a standardised procedure, mostly through banks (but also by the Bundesbank and Land Central Banks direct), as discountable Treasury bonds that are not returnable before maturity.

The remaining discountable Treasury bonds, in the nominal amount of DM 875.0 million, were sold by the Bank to institutional investors.

After the redemption of DM 4,535.1 million (1979: DM 4,386.6 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, 1980 came to DM 5,963.0 million (end-1979: DM 8,186.1 million). Of this total, DM 1,125.0 million was repurchasable by the Bank (type "B").

Federal Railways

The (returnable) discountable Treasury bonds of the German Federal Railways (type "Ba") which fell due in 1980, totalling DM 100 million, were reissued. The amount of Federal Railways discountable Treasury bonds (type "Ba") outstanding at end-1980 came to DM 231 million (end-1979: also DM 231 million).

Federal Post Office

In the year under review the German Federal Post Office issued no discountable Treasury bonds, so that no such bonds of the Federal Post Office were outstanding at the end of 1980.

At December 31, 1980 the outstanding amount of money market paper issued for the account of the Federal Government and its special funds came to DM 6,194.0 million (end-1979: DM 8,417.1 million). Further details are given in the following table.

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

DM million

Type of paper	Outstanding at Dec. 31, 1979	1980 Issued	1980 Redeemed	Outstanding at Dec. 31, 1980
Discountable Treasury bonds of the Federal Republic of Germany "B" 1 and "BN" 2	8,186.1	2,312.0	4,535.1	5,963.0
of which "Financing bonds"	(2,488.4)	(1,437.0)	(1,107.4)	(2,818.0)
Discountable Treasury bonds of the German Federal Railways "Ba"	231.0	100.0	100.0	231.0
Total	8,417.1	2,412.0	4,635.1	6,194.0

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 1980, 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, 1979, increased insignificantly — namely by DM 900 — during the year under review in connection with the conversion of Berlin pre-capitulation balances.

The non-interest-bearing debt certificate in respect of Berlin (DM 547.2 million) and the equalisation claims arising from the Bank's own conversion account (DM 8,103.8 million) remained unchanged, as the combined conversion account of the institutions amalgamated to form the Deutsche Bundesbank was closed at the end of 1979.

Loans to the Federal Railways and Federal Post Office

No loans to the Federal Railways or Federal Post Office were outstanding at December 31, 1980, as in the preceding year. See also the notes on the items "Cash advances (book credits)" and "Treasury bills and discountable Treasury bonds".

Securities During the year under review the Bank's portfolio of securities – chiefly bonds of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office – increased by DM 1,773.0 million on balance to DM 3,887.1 million as a result of open market operations (end-1979: DM 2,114.1 million).

Issue of bonds In 1980 eight bond issues totalling DM 8,200 million (1979: twelve issues amounting to DM 11,650 million) were launched through the Federal Bond Consortium, which is under the direction of the Bank. Of this total, DM 1,450 million (1979: DM 1,950 million) was reserved for the issuers' own institutions and for price regulation purposes.

At the end of 1980 the outstanding amount of bonds of the Federal Republic of Germany came to DM 41,708.4 million (end-1979: DM 40,575.2 million), that of the German Federal Railways to DM 14,188.6 million (end-1979: DM 13,810.8 million) and that of the German Federal Post Office to DM 7,790.4 million (end-1979: DM 7,445.4 million).

Bond issues of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office in 1980

	Amount issued (DM million)		Terms				
Issuer	Total	of which Sold through Federal Bond Consortium	Nominal interest rate (%)	Period to maturity in years	Issue price (%)	Yield (%)	Start of sales
Federal Railways	750	600	8	12	100	8.00	Jan. 9
Federal Post Office	800	700	8	10	99.25	8.11	Feb. 13
Federal Republic of Germany	1,100	900	10	10	100.25	9.96	Apr. 1
Federal Republic of Germany	1,500	1,200	8¼	10	100.25	8.21	June 9
Federal Railways	750	600	8	10	100.50	7.93	June 26
Federal Post Office	900	750	7¾	10	99.50	7.82	Aug. 28
Federal Republic of Germany	1,500	1,200	8¼	10	99	8.40	Oct. 24
Federal Post Office	900	800	8¾	10	99.50	8.83	Dec. 3

Issue of Federal savings bonds With the assistance of the Bank DM 6,393.8 million (gross) of Federal savings bonds were sold to private investors through banks and to a certain extent by the Bank itself in 1980 (1979: DM 6,350.9 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.

During 1980 DM 6,976.0 million of Federal savings bonds from former tranches were returned to the issuer before maturity (1979: DM 4,067.5 million), and a further DM 2,026.8 million were redeemed on maturity. The amount of Federal savings bonds outstanding declined from DM 26,691.7 million (end-1979) to DM 24,082.7 million at December 31, 1980.

Gross sales, interest rates and yields of Federal savings bonds in 1980

Issues	Sales period 1980	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
1980/ 1+2	Jan. 2– Feb. 5	776.7	327.4		I 5.50	7.50	8.00	8.25	8.50	9.00	
					Y 5.50	6.47	6.94	7.24	7.45	7.66	
				449.3	I 5.50	7.50	8.00	8.25	8.50	9.00	9.00
					Y 5.50	6.50	6.99	7.31	7.54	7.79	7.96
1980/ 3+4	Feb. 7– Mar. 12	596.2	247.4		I 5.50	8.00	8.25	8.50	8.50	9.00	
					Y 5.50	6.71	7.19	7.48	7.65	7.83	
				348.8	I 5.50	8.00	8.25	8.50	8.50	9.00	9.00
					Y 5.50	6.74	7.24	7.56	7.74	7.95	8.10
1980/ 5+6	Mar. 18– May 12	2,520.3	1,064.6		I 6.75	9.00	9.00	9.50	9.50	10.00	
					Y 6.75	7.83	8.19	8.48	8.65	8.83	
				1,455.7	I 6.75	9.00	9.00	9.50	9.50	10.00	10.00
					Y 6.75	7.87	8.24	8.56	8.75	8.95	9.10
1980/ 7+8	May 20– June 13	957.5	469.0		I 6.75	8.50	8.50	8.75	9.00	9.25	
					Y 6.75	7.59	7.87	8.07	8.22	8.36	
				488.5	I 6.75	8.50	8.50	8.75	9.00	9.25	9.25
					Y 6.75	7.62	7.91	8.12	8.30	8.46	8.57
1980/ 9+10	June 20– July 29	911.0	497.8		I 6.75	8.00	8.00	8.25	8.25	8.75	
					Y 6.75	7.35	7.55	7.71	7.80	7.93	
				413.2	I 6.75	8.00	8.00	8.25	8.25	8.75	8.75
					Y 6.75	7.37	7.58	7.75	7.85	8.00	8.11
1980/ 11+12	Aug. 5– Oct. 7	367.2	167.2		I 6.25	7.50	7.50	8.00	8.00	8.50	
					Y 6.25	6.85	7.05	7.27	7.39	7.54	
				200.0	I 6.25	7.50	7.50	8.00	8.00	8.50	8.50
					Y 6.25	6.87	7.08	7.31	7.45	7.62	7.75
1980/ 13+14	Oct. 13– Dec. 19	264.9	109.8		I 6.25	8.00	8.00	8.25	8.25	8.75	
					Y 6.25	7.10	7.37	7.57	7.69	7.83	
				155.1	I 6.25	8.00	8.00	8.25	8.25	8.75	8.75
					Y 6.25	7.12	7.41	7.62	7.75	7.91	8.03
Total	Jan. 2– Dec. 19	6,393.8	2,883.2	3,510.6							

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

Issue of Federal bonds

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

In the year under review DM 7,520.6 million of newly issued Federal bonds were sold to private investors (December 1979: DM 616.1 million). During that period the terms were adjusted to market conditions on 24 occasions. Details of the various series are given in the following table.

Issues of Federal bonds in 1980

Designation Series	Start of sales	Terms (%) Nominal interest rate	Issue price	Yield	Amount issued (DM million) Sales per issue price	Sales Total	Price regulation share	Total	Date of admission to stock exchange dealing 1980
S. 1 of 1979 (1984)	Jan. 2 [1] Jan. 21	7.75	99.20 99.00	7.95 8.00	265.8 93.4	[2] 359.2	124.7	1,100	Feb. 14
S. 2 of 1980 (1985)	Feb. 5 Feb. 19	8.00	99.80 99.40	8.05 8.15	173.4 40.9	214.3	35.7	250	Mar. 4
S. 3 of 1980 (1985)	Feb. 25 Feb. 29 Mar. 10	8.25	100.00 98.50 97.50	8.25 8.63 8.89	32.1 47.5 14.8	94.4	5.6	100	Mar. 25
S. 4 of 1980 (1985)	Mar. 14 Mar. 26 Apr. 21	9.25	99.80 98.80 100.00	9.30 9.56 9.25	181.4 2,222.5 235.2	2,639.1	160.9	2,800	May 2
S. 5 of 1980 (1985)	Apr. 22 May 12 May 13 May 19	8.75	99.20 99.80 100.20 100.80	8.96 8.80 8.70 8.55	694.0 39.6 109.6 220.9	1,064.1	235.9	1,300	June 9
S. 6 of 1980 (1985)	May 28 June 10	8.25	99.40 100.30	8.40 8.17	294.6 160.9	455.5	94.5	550	July 2
S. 7 of 1980 (1985)	June 19 June 25	8.00	100.00 100.40	8.00 7.90	122.3 942.6	1,064.9	185.1	1,250	Aug. 8
S. 8 of 1980 (1985)	July 30	7.50	99.00	7.75	283.0	283.0	67.0	350	Oct. 10
S. 9 of 1980 (1985)	Oct. 1 Oct. 8 Oct. 21 Oct. 31	8.25	99.20 99.60 100.00 98.40	8.45 8.35 8.25 8.66	693.7 305.6 50.0 202.7	1,252.0	48.0	1,300	Dec. 22
S. 10 of 1980 (1986)	Dec. 11 Dec. 19	8.75	99.20 98.40	8.96 9.16	38.9 55.2	94.1	[3] –	[3] –	–

1 Start of sales on December 3, 1979. — 2 Sales between December 3, 1979 and December 31, 1979 = DM 616.1 million. — 3 Sales had not been completed on December 31, 1980.

At the end of 1980 the amount of Federal bonds outstanding came to DM 8,978.6 million.

Issue of medium-term notes

Through the agency of the Bank, DM 3,858.0 million of Treasury bonds (medium-term notes) of the Federal Government, the Federal Post Office and, for the first time, the Federal Railways were sold by tender in four issues in 1980 (1979: DM 1,401.6 million in one issue). The terms of these four issues are shown in the table below.

Treasury bonds (medium-term notes) of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office sold by tender in 1980

Issuer	Amount sold (DM million)	Nominal interest rate (%)	Period to maturity in years	Selling price (%)	Yield on issue (%)	Month of sale
Federal Republic of Germany	1,276.2	8½	4	100.10	8.47	May
Federal Republic of Germany	799.7	7½	4	99.10	7.77	August
German Federal Post Office	943.7	8¼	4	99.30	8.46	October
German Federal Railways	838.4	9	3½	98.70	9.45	November

At the end of 1980 the outstanding amount of medium-term notes of the Federal Republic of Germany came to DM 18,199.2 million (end-1979: DM 20,846.9 million), that of the German Federal Railways to DM 1,033.4 million (end-1979: DM 595.0 million) and that of the German Federal Post Office to DM 943.7 million (end-1979: no such notes were outstanding).

Borrowing by the United States in Deutsche Mark

As part of the measures to strengthen the U.S. dollar announced on November 1, 1978, the Bank assisted the United States of America in raising funds in the German capital market during the year under review (as in 1978 and 1979). By means of a Public Offer on fixed terms the U.S. Treasury issued two tranches of DM-denominated bearer U.S. Treasury Notes (Inhaberschuldverschreibungen) in January 1980 as follows:

Borrowing by the United States of America in the Federal Republic of Germany in 1980

Type of borrowing	Payment date	DM million	Period to maturity in years	Interest rate = yield in % p. a. (issued at par)
DM-denominated bearer U.S. Treasury Notes	Jan. 25, 1980	969.7	2½	8.50
DM-denominated bearer U.S. Treasury Notes	Jan. 25, 1980	1,050.5	3½	8.45

Admission to stock exchange dealing

The Bank introduced the new bond issues of the Federal Republic of Germany, the German Federal Railways and the German Federal Post Office, as well as Series 1 to 9 of Federal bonds, 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 German Federal Railways and the German Federal Post Office, as well as two tranches of DM-denominated bearer U.S. Treasury Notes, 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 Land Government, the Reconstruction Loan Corporation and the Equalisation of Burdens Bank.

The Bank as paying and collecting agent for bonds

As the paying and collecting agent for, in particular, bonds of the Federal Government (including external bonds) and its special funds, the Bank paid 4,486,898 interest coupons and matured bonds in the year under review (1979: 4,973,700). Of these, 260,451 interest coupons and matured bonds were presented to foreign agents for payment (1979: 402,297).

German coins

The amount of German coins held by the Bank came to DM 728.6 million at end-1980 (end-1979: DM 721.4 million). In 1980 the Federal Government was credited with DM 489.6 million for coins taken over from the Mints and debited with DM 10.1 million for coins no longer fit for circulation or melted down. In all, between 1948 and 1980 the Bank — acting for the account of the Federal Government — took over coins amounting to DM 9,833.4 million and redeemed DM 1,643.7 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 1980 (DM 7,461.0 million) divided by the number of inhabitants of the Federal Republic of Germany including the Land of Berlin on September 30, 1980 (61.7 million) yields a coin circulation of DM 120.92 per head of population (1979: DM 113.82).

In the year under review the DM 5 commemorative coins "Otto Hahn", "Kölner Dom" (Cologne cathedral) and "Walther von der Vogelweide" were put into circulation; for the first time they were minted from the same alloy as the standard DM 5 coins in 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 322.8 million at December 31, 1980 (1979: DM 375.5 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

Area	1979				1980			
	Transfers received from third parties		Transfers made to third parties		Transfers received from third parties		Transfers made to third parties	
	Number	DM million	Number	DM million	Number	DM million	Number	DM million
Land Central Bank								
Baden-Württemberg	65,319	17,325.8	9,598	2,137.0	56,650	17,151.7	14,927	2,224.3
Bavaria	52,629	11,817.9	13,326	6,433.0	52,344	12,353.0	13,842	6,752.5
Berlin	20,619	2,521.5	3,143	854.7	19,973	2,657.5	2,846	977.7
Bremen	5,981	424.3	2,043	0.2	5,370	380.5	2,190	0.2
Hamburg	54,200	17,642.4	1,688	225.9	70,679	17,965.9	1,735	126.4
Hesse	43,605	7,188.2	7,326	5,887.5	50,027	6,847.8	7,709	6,526.6
Lower Saxony	56,028	6,348.4	5,686	1,798.8	46,385	6,547.1	6,185	1,975.3
North Rhine-Westphalia	110,185	18,817.2	28,768	6,493.1	111,657	19,881.8	30,237	7,030.5
Rhineland-Palatinate	24,954	1,797.3	9,075	900.3	23,281	1,577.4	9,977	995.8
Saarland	5,649	1,713.9	320	0.1	5,847	1,837.0	406	1.1
Schleswig-Holstein	3,748	51.6	4,130	0.9	3,525	73.6	4,333	1.0
Total	442,917	85,648.5	85,103	24,731.5	445,738	87,273.3	94,387	26,611.4
Bundesbank — Central Office —	35,968	1,790.5	1,570	5.5	28,515	1,700.9	1,211	8.2
Grand total	478,885	87,439.0	86,673	24,737.0	474,253	88,974.2	95,598	26,619.6

Other claims

Other claims are shown at DM 985.3 million (end-1979: DM 951.2 million). They include the balance arising from intra-German settlements (commercial payments under the "Berlin Agreement"), which amounted to DM 813.7 million (1979: DM 798.0 million). The turnover on the relevant sub-accounts is shown in Part A IV of the German original of this Report.

Land and buildings

After additions totalling DM 177.9 million and depreciation totalling DM 58.9 million, land and buildings are shown at DM 1,041.7 million.

Furniture and equipment

The balance sheet value of furniture and equipment amounts to DM 81.7 million after additions totalling DM 42.9 million and depreciation totalling DM 31.6 million.

Items in course of settlement

The "Items in course of settlement" mainly comprise the intercity credit and debit transfers proceeding inside the Bank at the end of the year and the cheques and direct debit orders being cleared. At December 31, 1980 the balance of items in course of settlement stood at DM 8,379.5 million (end-1979: DM 8,905.1 million).

Other assets

The "Other assets" are shown at DM 1,432.7 million (end-1979: DM 1,379.8 million). As in the previous year, much the greater part of this amount consists of interest due in 1981 but assignable to the profit and loss account for the year under review on funds invested abroad and on securities (DM 1,328.9 million against DM 1,281.1 million at end-1979).

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

Prepaid expenses and deferred income

The prepaid expenses and deferred income comprise salary and pension payments made in the year under review but relating to 1981.

Banknotes in circulation

The amount of banknotes in circulation rose from DM 79,385.6 million at end-1979 to DM 83,730.3 million at December 31, 1980.

Currency in circulation

DM million

End of	Banknotes	Federal coins	Currency in circulation, total
1975	55,143.2	5,406.3	60,549.5
1976	59,038.3	5,699.8	64,738.1
1977	65,567.4	6,097.6	71,665.0
1978	74,799.1	6,577.5	81,376.6
1979	79,385.6	6,988.7	86,374.3
1980	83,730.3	7,461.0	91,191.3

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

In the year under review the Bank again took over new Bundesbank notes of various denominations from the printing offices 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:

	1975	1976	1977	1978	1979	1980
Number (millions)	399.4	486.4	459.1	560.9	505.9	466.4
Value (DM million)	15,110.5	18,556.5	18,086.2	22,682.1	20,829.6	18,495.1.

The number and value of the counterfeit banknotes detained in payments in the Federal Republic of Germany and Berlin (West) continued to decrease in 1980. This was mainly due to the continuation of the downward trend already apparent in 1979 in the number of counterfeit DM 100 banknotes detected.

The number of counterfeit Federal coins detained in the year under review increased on account of the steep rise in the number of counterfeit DM 1 coins; the detected counterfeits of all other Federal coins denominated in Deutsche Mark were less numerous than during the preceding year.

Counterfeits detected

Year	Banknotes		Federal coins	
	Number	DM thousand	Number	DM thousand
1975	927	92.3	14,151	65.0
1976	2,709	275.0	8,249	31.0
1977	9,754	946.0	6,754	25.7
1978	6,341	586.4	9,835	35.5
1979	3,388	296.6	7,405	24.3
1980	2,421	183.4	9,428	25.1

Deposits of banks

The banks' deposits on giro accounts mainly comprise the minimum reserves to be maintained with the Bank. The sub-item "Other" contains deposits of domestic banks on U.S. dollar accounts. Compared with end-1979 the deposits are shown as follows:

	Dec. 31, 1979 DM million	Dec. 31, 1980 DM million
Deposits on giro accounts	64,755.3	53,809.2
Other	24.8	35.5
	64,780.1	53,844.7.

Deposits of public authorities

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

	Dec. 31, 1979 DM million	Dec. 31, 1980 DM million
Federal Government	1,842.5	396.3
Equalisation of Burdens Fund and ERP Special Fund	290.1	124.2
Länder Governments	728.5	450.2
Other public depositors	78.1	44.6
	2,939.2	1,015.3.

Deposits of other domestic depositors

The deposits of other domestic depositors are composed as follows:

	Dec. 31, 1979 DM million	Dec. 31, 1980 DM million
Federal Railways	12.7	8.1
Federal Post Office (including postal giro and postal savings bank offices)	579.4	1,141.3
Other depositors	637.5	581.8
	1,229.6	1,731.2.

Giro transactions, simplified cheque and direct debit collections

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

	Number	Amount
1979	99.87	98.46
1980	99.89	98.56.

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Banknotes in circulation

The amount of banknotes in circulation rose from DM 79,385.6 million at end-1979 to DM 83,730.3 million at December 31, 1980.

Currency in circulation

DM million

End of	Banknotes	Federal coins	Currency in circulation, total
1975	55,143.2	5,406.3	60,549.5
1976	59,038.3	5,699.8	64,738.1
1977	65,567.4	6,097.6	71,665.0
1978	74,799.1	6,577.5	81,376.6
1979	79,385.6	6,988.7	86,374.3
1980	83,730.3	7,461.0	91,191.3

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

In the year under review the Bank again took over new Bundesbank notes of various denominations from the printing offices 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:

	1975	1976	1977	1978	1979	1980
Number (millions)	399.4	486.4	459.1	560.9	505.9	466.4
Value (DM million)	15,110.5	18,556.5	18,086.2	22,682.1	20,829.6	18,495.1.

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Giro transactions, simplified cheque and direct debit collections

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

	Number	Amount
1979	99.87	98.46
1980	99.89	98.56.

Mobilisation and liquidity paper sold and redeemed DM million				
	1979	1980		
Type of paper	Outstanding at December 31	Sold	Redeemed	Outstanding at December 31
Treasury bills (running for up to 90 days)	3,530.0	26,345.1	25,728.2	4,146.9
Discountable Treasury bonds (running for 6 to 24 months)	3,157.0	50.7	3,162.7	45.0
Total	6,687.0	26,395.8	28,890.9	4,191.9

Liabilities arising from foreign business

The liabilities arising from foreign business went up to DM 7,721.5 million compared with DM 3,328.8 million at end-1979. This increase is chiefly attributable to the growth of the deposits of foreign central banks. Specifically, the liabilities arising from foreign business were made up as follows:

	Dec. 31, 1979		Dec. 31, 1980	
	DM million	DM million	DM million	DM million
Deposits of foreign depositors				
Banks	2,480.3		7,071.9	
Other depositors	739.1	3,219.4	592.4	7,664.3
Other				
Provision of cover for credits, etc.	109.2		49.5	
Miscellaneous liabilities	0.2	109.4	7.7	57.2
		3,328.8		7,721.5.

Counterpart of special drawing rights allocated

The counterpart of the special drawing rights allocated by the International Monetary Fund and shown on the assets side in sub-item 2.3 corresponds to the allocations of SDRs to the Federal Republic of Germany between 1970 and 1972 and in 1979 and 1980, which totalled SDR 990.8 million.

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

In connection with the European Monetary System (EMS) the Bank temporarily contributed 20% of its gold holding to the European Monetary Cooperation Fund against ECUs at a value based on the market price of gold and therefore higher than that used in the balance sheet. During the transitional period of the EMS the resultant difference in value is shown in this item.

Provisions

Provisions for pensions

DM 125.7 million was withdrawn from the provisions for pensions in order to pay pensions and also widows' and orphans' allowances. After an increase of DM 306.7 million these provisions amounted to DM 1,906.0 million at December 31, 1980 against DM 1,725.0 million at end-1979.

Provisions for other purposes

The provisions for other purposes were increased by DM 930 million. Together with the existing provisions (of DM 300 million) they therefore now total 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 227.2 million against DM 92.1 million at end-1979.

Deferred expenses and accrued income

Deferred expenses and accrued income amounted to DM 669.3 million at December 31, 1980 (end-1979: DM 837.3 million). As before, this item mainly comprises interest received in the year under review, but relating to the following year, on domestic and foreign bills and U.S. Treasury Notes.

Capital

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

Reserves

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

Contingent liabilities and claims

The contingent liabilities and claims amounted to DM 0.9 million against DM 0.6 million at end-1979.

Profit and loss account

Comparison of expenditure and receipts

DM million

Expenditure	1979	1980	Receipts	1979	1980
Interest paid on foreign exchange transactions under repurchase agreements and swaps with domestic banks	162.0	103.3	Interest received		
Interest paid on mobilisation and liquidity paper	53.0	146.5	Funds invested abroad	6,160.9	5,849.6
Other interest paid	8.4	9.9	Loans to domestic banks	1,527.3	3,360.9
	223.4	259.7	Equalisation claims	244.1	244.1
			Securities	265.2	167.1
			Cash advances (book credits)	26.3	158.0
			Other interest received	3.3	4.9
Administrative expenditure				8,227.1	9,784.6
Staff costs	582.7	634.9	Fees received	10.1	13.9
Other	118.1	131.5	Other receipts	47.4	49.9
Note printing	157.9	164.7	Gains from the valuation adjustment of the monetary reserves and other foreign currency positions	–	1,656.1
Depreciation	84.7	90.6			
Increase in provisions					
For pensions	158.5	306.7			
For other purposes	–	930.0			
Pension payments in respect of the Reichsbank	33.7	33.8			
Other expenditure	264.0	116.3			
Write-downs of the monetary reserves and other foreign currency positions	2,868.3	–			
Profit for the year	3,793.3	8,836.3			
Total	8,284.6	11,504.5	Total	8,284.6	11,504.5

Receipts

Interest

	1979 DM million	1980 DM million
Interest received amounted to	8,227.1	9,784.6;
after deduction of interest paid, namely	223.4	259.7,
interest is shown in the profit and loss account at	8,003.7	9,524.9.

In the year under review total interest income, at DM 9,784.6 million, was DM 1,557.5 million larger than a year before. The interest received from funds invested abroad declined from DM 6,160.9 million to DM 5,849.6 million since the level of such investments fell. Interest income from lending to domestic banks – domestic bills, security transactions under repurchase agreements, lombard loans and foreign bills bought in Germany – went up by DM 1,833.6 million to DM 3,360.9 million as the volume of such lending expanded and interest rates rose. The interest received from securities decreased by DM 98.1 million to DM 167.1 million, the average security portfolio during the year under review being smaller than in the preceding year. The interest accruing from equalisation claims remained unchanged at DM 244.1 million. Other interest income went up from DM 29.6 million to DM 162.9 million, chiefly owing to a rise in the interest received from cash advances.

The interest paid, at DM 259.7 million, increased by DM 36.3 million over the preceding year. DM 103.3 million (1979: DM 162.0 million) was spent on foreign exchange transactions under repurchase agreements and swaps; DM 146.5 million (1979: DM 53.0 million) was paid on Treasury bills and discountable Treasury bonds of the Federal Government (mobilisation and liquidity paper pursuant to sections 42 und 42(a) of the Bundesbank Act).

Fees

Fees totalling DM 13.9 million were received in the year under review (1979: DM 10.1 million).

Gains from the valuation adjustment of the monetary reserves and other foreign currency positions

The valuation adjustment of the monetary reserves and other foreign currency positions at the end of 1980 resulted in gains totalling DM 1,656.1 million (end-1979: write-downs amounting to DM 2,868.3 million).

Other receipts

At DM 49.9 million, the other receipts were DM 2.5 million smaller than at end-1979.

Expenditure

Administrative expenditure
Staff costs

Administrative expenditure on personnel rose by DM 52.2 million compared with the previous year to DM 634.9 million. This was mainly due to statutory or negotiated pay rate increases for established employees ("officials") and unestablished salary and wage earners and to the rise in the Bank's staff during the year under review.

The Bank's staff — which had decreased between 1973 and 1977, mainly because of the automation of cashless payments — has been increasing again since the beginning of 1978. After a rise of 451 in 1978 and 750 in 1979, this trend continued in 1980, albeit at a somewhat slower pace. The number of employees went up by 417 in the course of the year to 14,825 (+2.9%). This growth is mainly attributable to the increased recruitment of junior staff in the clerical service (about 280 officials and salary earners in all).

Payments to serving members of the Directorate of the Bank and the Central Bank Council amounted to DM 6,709,772.11 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 6,711,086.66.

Changes in staff regulations

As a basis for the technical college training of candidates for the executive service of the Bank, the Central Bank Council issued Career, Training and Examination Regulations on January 17, 1980.

In 1980 the Bank again concluded a number of pay agreements for its wage and salary earners, thereby bringing their legal situation into line with that of the wage and salary earners of the Federal Government.

Staff of the Bank

	Beginning of 1980					Beginning of 1981				
				of whom					of whom	
	Central Office	Land Central Banks	Total 1	male	female	Central Office	Land Central Banks	Total 1	male	female
Officials	822	5,084	5,906	5,540	366	854	5,198	6,052	5,663	389
Salary earners	1,593	5,848	7,441	3,453	3,988	1,626	6,072	7,698	3,573	4,125
Wage earners	214	847	1,061	194	867	225	850	1,075	197	878
Total	2,629	11,779	14,408	9,187	5,221	2,705	12,120	14,825	9,433	5,392
1 of whom, working part time										
Officials			10					17		
Salary earners			368					416		
Wage earners			749					750		

Other

Other (non-staff) administrative expenditure increased by DM 13.4 million to DM 131.5 million in the year under review.

Note printing

Expenditure on note printing amounted to DM 164.7 million against DM 157.9 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, remained almost unchanged, at DM 33.8 million, in the year under review.

Other expenditure

Other expenditure decreased from DM 264.0 million to DM 116.3 million owing to a decline compared with the preceding year in the write-downs required on the portfolio of securities.

Profit for the year

		DM
Profit for the year	The profit and loss account for 1980 shows a profit for the year of	8,836,352,586.81;
	after the settlement of the balancing item brought forward from 1979 in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — loss brought forward — of	5,759,836,190.07
Unappropriated profit	there remains an unappropriated profit (net profit) for distribution pursuant to section 27 of the Bundesbank Act of	3,076,516,396.74.

Proposed distribution of profit

	DM	
The Directorate proposes to the Central Bank Council that the following appropriations should be made:		
to the legal reserves	615,300,000.00[1]	
to the other reserves	159,500,000.00[1]	
to the Fund for the Purchase of Equalisation Claims	30,000,000.00	804,800,000.00.
The balance of		2.271,716,396.74

will be transferred to the Federal Government.

Frankfurt am Main, April 1981

Deutsche Bundesbank
The Directorate

Pöhl Dr. Schlesinger
Dr. Emde Dr. Gleske Prof. Dr. Köhler Werthmöller

1 After these appropriations the legal reserves will amount to DM 1,584,300,000.00 and the other reserves to DM 290,000,000.00.

Part D: Report of the Central Bank Council

The annual accounts of the Deutsche Bundesbank for 1980 and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1980, 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 1980, and the bookkeeping as shown by the books at December 31, 1980, 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 1980 on April 23, 1981. At the same time it approved the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1980.

With effect from January 1, 1981 Dr. Hans Georg Emde was reappointed a member of the Directorate of the Deutsche Bundesbank. No other changes have taken place in the Central Bank Council and the Directorate of the Deutsche Bundesbank since the publication of the Report for the Year 1979.

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 1980. The Council likewise wishes to record its appreciation of the excellent collaboration with the staff representative committees.

Frankfurt am Main, April 1981

Karl Otto Pöhl
President of the Deutsche Bundesbank

Appendix to Part B

Balance sheet of the Deutsche Bundesbank as at December 31, 1980

Assets

	DM	DM
1 Gold		13,687,460,632.31
2 Reserve position in the International Monetary Fund and special drawing rights		
2.1 Drawing rights within the reserve tranche	2,915,382,563.02	
2.2 Loans under special borrowing arrangements	1,572,328,969.87	
2.3 Special drawing rights	3,612,322,428.38	8,100,033,961.27
3 Claims on the European Monetary Cooperation Fund in connection with the European Monetary System		31,707,994,739.55
4 Balances with foreign banks and money market investments abroad		42,579,858,651.07
5 Foreign notes and coins		26,320,700.63
6 External loans and other external assets		
6.1 Loans in connection with EEC medium-term monetary assistance	–	
6.2 Claims arising from foreign exchange offset agreements with the United States	1,549,812,826.93	
6.3 Other loans to foreign monetary authorities	–	
6.4 Loans to the World Bank	2,484,611,167.50	4,034,423,994.43
7 Foreign bills of exchange		4,424,676,799.79
8 Domestic bills of exchange		39,257,479,466.98
9 Securities bought in open market transactions under repurchase agreements		6,163,682,503.20
10 Lombard loans		7,707,789,600.–
11 Cash advances (book credits)		
11.1 Federal Government	1,336,000,000.–	
11.2 Equalisation of Burdens Fund	–	
11.3 Länder Governments	1,100,731,300.–	2,436,731,300.–
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		
13.1 Equalisation claims	8,136,417,363.53	
13.2 Non-interest-bearing debt certificate	547,168,481.20	8,683,585,844.73
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		3,887,137,851.61
16 German coins		728,649,511.10
17 Balances on postal giro accounts		322,769,259.04
18 Other claims		985,284,636.24
19 Land and buildings		1,041,675,813.89
20 Furniture and equipment		81,692,153.–
21 Items in course of settlement		8,379,455,995.38
22 Other assets		1,432,693,785.49
23 Prepaid expenses and deferred income		32,914,662.92
Rights of recourse in respect of contingent liabilities	896,684.63	
		185,720,311,862.63

	DM	DM
1 Banknotes in circulation		83,730,270,245.—
2 Deposits of banks		
2.1 Deposits on giro accounts	53,809,186,971.44	
2.2 Other	35,469,073.49	53,844,656,044.93
3 Deposits of public authorities		
3.1 Federal Government	396,267,527.95	
3.2 Equalisation of Burdens Fund and ERP Special Fund	124,235,080.73	
3.3 Länder Governments	450,149,591.02	
3.4 Other public depositors	44,624,839.95	1,015,277,039.65
4 Deposits of other domestic depositors		
4.1 Federal Railways	8,140,847.36	
4.2 Federal Post Office (including postal giro and postal savings bank offices)	1,141,249,755.04	
4.3 Other depositors	581,817,398.08	1,731,208,000.48
5 Liabilities arising from mobilisation and liquidity paper sold		4,191,900,000.—
6 Liabilities arising from foreign business		
6.1 Deposits of foreign depositors	7,664,250,674.35	
6.2 Other	57,240,038.32	7,721,490,712.67
7 Counterpart of special drawing rights allocated		2,475,653,544.96
8 Counterpart in respect of the valuation of the gold contributed to the European Monetary Cooperation Fund		22,511,322,909.44
9 Provisions		
9.1 Provisions for pensions	1,906,000,000.—	
9.2 Provisions for other purposes	1,230,000,000.—	3,136,000,000.—
10 Other liabilities		227,206,123.23
11 Deferred expenses and accrued income		669,310,845.53
12 Capital		290,000,000.—
13 Reserves		
13.1 Legal reserves	969,000,000.—	
13.2 Other reserves	130,500,000.—	1,099,500,000.—
14 Unappropriated profit		3,076,516,396.74
Contingent liabilities	896,684.63	
		185,720,311,862.63

Profit and loss account of the Deutsche Bundesbank for the year 1980

Expenditure

	DM	DM
1 Administrative expenditure		
1.1 Staff costs	634,931,123.40	
1.2 Other	131,498,786.23	766,429,909.63
2 Note printing		164,660,296.39
3 Depreciation		
3.1 of land and buildings	58,947,695.04	
3.2 of furniture and equipment	31,615,480.61	90,563,175.65
4 Increase in provisions		
4.1 for pensions	306,651,450.22	
4.2 for other purposes	930,000,000.–	1,236,651,450.22
5 Pension payments in respect of the Reichsbank		33,778,380.47
6 Other expenditure		116,337,607.70
7 Profit for the year		8,836,352,586.81
		11,244,773,406.87

Receipts

	DM
1 Interest	9,524,910,447.10
2 Fees	13,908,778.27
3 Gains from the valuation adjustment of the monetary reserves and other foreign currency positions	1,656,099,423.95
4 Other receipts	49,854,757.55
	11,244,773,406.87

Appendix to the profit and loss account

	DM
1 Profit for the year	8,836,352,586.81
2 Balancing item brought forward from 1979 in respect of the valuation adjustment of the monetary reserves and other foreign currency positions — loss brought forward —	5,759,836,190.07
3 Unappropriated profit	3,076,516,396.74

Frankfurt am Main, January 28, 1981

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 6, 1981

Treuarbeit Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr. Wollert — Dr. Elmendorff KG
Wirtschaftsprüfungsgesellschaft

Dr. Scholz
Certified Auditor

Goldbach
Certified Auditor

Thoennes
Certified Auditor

Dr. Geuer
Certified Auditor