Report of the Deutsche Bundesbank

for the Year 1984

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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, 1985

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

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Part A: General part

The currency and the economy in 1984

I. Economic developments and central bank policy

The economy of the Federal Republic of Germany grew strongly in 1984 in spite of a number of handicaps. In trend, output increased at an annual rate of 3%; the fact that the real gross national product rose by only 2½% in 1984 was due to the severe production losses suffered in the spring as a result of labour disputes in some key industries; these losses could not be offset in full in the later part of the year. Last year growth was stimulated most by foreign demand, but these stimuli increasingly spread to investment by trade and industry. As turnover grew and the pace of cost rises moderated, earnings went up strongly, thereby improving enterprises' capital base, strengthening their confidence and enhancing the propensity to invest.

The upward trend in foreign demand and the greater buoyancy of investment activity in the second half of 1984, together with the general improvement in underlying economic conditions, are safeguarding the continuation of the upswing in 1985. Foremost among these more favourable basic conditions is the degree of monetary stability now attained. Although the depreciation of the Deutsche Mark in itself tended to push up prices, price movements in Germany remained subdued in 1984. The growth rate of consumer prices slackened to roughly 2% in the course of last year. Judging by past experience, maintaining monetary stability is an essential prerequisite for making the economic upswing durable and thus also for laying the foundation for boosting employment and bringing unemployment down from its present high level.

The situation on the labour market started to improve during the course of 1983. To begin with, short-time working decreased; then the number of vacancies and new placements in those sectors of the economy which were faring particularly well went up. However, the slight decline noticeable from late summer 1983 onwards in the number of unemployed came to a halt in spring 1984 in connection with the industrial disputes. Not until early autumn 1984 did the downward movement resume; it ceased again during the long period of severe winter weather in 1985. Unemployment in Germany is, however, only in part of cyclical origin. It is, rather, largely a consequence of structural problems in the economy which can only be solved in the context of a longer-term policy of strengthening the underlying factors facilitating growth.

The basic economic conditions were also improved by the further consolidation of the public sector budgets. The headway made in 1984 was primarily due to the strict limitation of the growth of public expenditure. If, as planned, this policy is continued in 1985 and beyond, scope will probably be created for implementing the tax cuts envisaged for 1986 and 1988 without ushering in another period of growing deficits. Tax relief of this kind would undoubtedly be an important step towards strengthening the private sector of the economy, where after all the additional jobs are to be created.

Germany's external position was marked last year by a growing discrepancy between non-financial and financial developments. Given the buoyancy of exports, the surpluses on Germany's current account increased. The sharp rise in imports was more than offset in the process. Viewed in these terms, Germany's external position looks quite sound. This was not reflected correspondingly, however, in the exchange rate of the Deutsche Mark. On the contrary, the Deutsche Mark depreciated, especially relative to the U.S. dollar, but also against the yen and to a small extent against some European currencies. One of the main reasons for this was the tendency towards massive capital exports from Germany, which owed something to Germany's low interest rate level by international standards.

During the period under review, the Bundesbank's monetary policy was primarily directed at safeguarding the progress already made towards stability while

Key data on overall economic developments

Period	Gross national product 1	Employed persons 2		Unemploy-ment rate 3	Consumer prices; 4 annual increase	Balance on current account
	Annual change					
	%	%	Thousands	%	%	DM billion
1970 to 1973 5	+ 4.2	+ 0.5	+ 140	0.8	+ 5.3	+ 5.3
1974 to 1979 5	+ 2.4	− 0.6	− 150	3.5	+ 4.6	+10.5
1980 to 1984 5	+ 0.9	− 0.7	− 170	6.3	+ 4.5	− 0.9
1974	+ 0.5	− 1.3	− 360	2.2	+ 6.9	+26.6
1975	− 1.6	− 2.8	− 760	4.0	+ 5.9	+ 9.9
1976	+ 5.6	− 0.8	− 220	4.0	+ 4.4	+ 9.9
1977	+ 2.8	− 0.2	− 40	3.9	+ 3.6	+ 9.5
1978	+ 3.5	+ 0.6	+ 150	3.8	+ 2.7	+18.1
1979	+ 4.0	+ 1.3	+ 340	3.3	+ 4.2	−11.1
1980	+ 1.9	+ 1.0	+ 260	3.3	+ 5.4	−28.6
1981	− 0.2	− 0.8	− 200	4.8	+ 6.3	−12.4
1982 p	− 1.0	− 1.8	− 470	6.7	+ 5.3	+ 8.2
1983 p	+ 1.3	− 1.6	− 400	8.1	+ 3.3	+10.5
1984 p	+ 2.6	− 0.2	− 60	8.1	+ 2.4	+17.7

1 At 1976 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.

at the same time bolstering economic growth from the monetary angle. The Bundesbank was able to implement this course, which was underlined by the monetary target it set for 1984, with the aid of a largely unchanged interest rate and liquidity policy on the money market. The expansion of the central bank money stock by just over 4½ % was accompanied by a rate of real economic growth that was slightly greater than the increase in production potential. Gratifyingly, price rises remained lower than had been expected when the monetary target for 1984 was set (at an increase of 4 to 6 %). The considerable progress towards stabilising the value of money helped to ensure that interest rates on the German capital market, as measured by the yield on securities, fell from 8 % at the end of 1983 to 7 % at end-1984.

At the beginning of 1985 interest rates went up again slightly, rather like trends on the international financial markets. At the same time the dollar moved upwards again world-wide; the Deutsche Mark was particularly affected by this. Although the domestic economic prospects for Germany must still be rated favourable, external influences have put those responsible for monetary policy in rather a dilemma. A persistent weakening of the exchange rate of the Deutsche Mark could not but affect the level of prices and costs in Germany. This might trigger rises in domestic interest rates which would be detrimental, at least to those investments which are sensitive to interest rate changes. A certain incompatibility between domestic and external objectives is, however, not unusual in a country like Germany, which is so highly oriented towards the world economy. The Bundesbank must try through its policies to minimise the unwelcome developments that might perhaps result from this situation.

1. Economic growth without inflationary tensions

Strong cyclical upswing . . .

For the economy of the Federal Republic of Germany, 1984 was a year of a strong cyclical upswing, with simultaneous progress being made in stabilising the value of the currency. Improved conditions for the supply of goods, especially on the cost side, as well as growing domestic and foreign demand helped the economy to make a promising start at the beginning of the year: overall production in the first quarter of 1984 (after adjustment for working-day variations) was almost 3½ % higher than a year before. Soon afterwards, however, the recovery process temporarily came to a halt, as industrial action loomed in important sectors of the economy. The conflicts in the metal-working and printing industries over an approach to the 35-hour week with no loss of pay soon intensified and finally erupted in a labour dispute which paralysed large areas of industry towards the end of May and during the whole of June.

. . . in spite of production losses due to labour disputes in the metal-working and printing industries

About 11 million man-days were lost through strikes, lock-outs and indirect production stoppages in the metal-working and printing industries, this figure being much the highest of any labour dispute in the history of the Federal Republic of Germany. The direct effects alone probably pushed the gross value added in the second quarter of last year about DM 4 to 5 billion below the level which might have been expected had the labour dispute not occurred. For employees, this was associated with income losses (excluding strike money paid) estimated at DM 2 to 2.5 billion; enterprises, too, incurred considerable losses in earnings. If indirect effects (which of course can only be estimated roughly) are included, the losses of production and income in the second quarter of last year were probably twice as high as those caused by the direct effects.

Marked increase in real gross national product and improved utilisation of overall production potential

After the labour disputes ended, business made great efforts to make good as many of the losses as possible; overall production soon found its way back to its former expansionary path. In the fourth quarter of 1984, the real gross national product showed a year-on-year rise (adjusted for working-day variations) of 3½ %. During 1984 as a whole, however, the real gross national product grew distinctly less, namely by 2½ %, owing to the negative effects of the labour disputes. Nevertheless, in 1984 overall production rose more strongly than overall production potential, which is estimated to have gone up by almost 2 %. Overall capacity utilisation in 1984 will have been about 94 %, after 93 % in the previous year. It would, however, be wrong to regard the surplus capacity remaining here according to the statistics as being available in the short term. Considerable structural adjustment problems in important sectors of the economy, and particularly on the labour market, are still preventing this. These problems can be solved only over the longer term, using predominantly market means. Experience with government structural aid, at any rate, is not very encouraging, because it has frequently led to out-of-date production structures being retained.

Foreign demand strongest stimulus to economic activity

In 1984 business activity received its most important cyclical impulses from foreign demand for German products. On an average in 1984 foreign orders to the manufacturing sector recorded a year-on-year rise by value of about 16 % and, after adjustment for price movements, of 12 %. An increase of this size in foreign business had not been registered since the middle of the seventies. After the turn of 1984–85 too, export business remained very buoyant; on average for January/February 1985 the manufacturing sector received a good 17 % more foreign orders than a year before. Exporters are continuing to rate their business prospects over the next few months as being fairly favourable. Foreign customers' interest in German goods has been many-faceted of late. While the basic and producer goods sector was the first to see foreign orders increase very strongly in 1984, the orders placed with capital goods manufacturers picked up considerably in the course of the year, after an interruption due to the labour dispute. Office machines and data processing equipment especially, many mechanical engineering products and electrical engineering goods experienced lively demand from foreign buyers. Foreign orders to road vehicle building firms went up by leaps and bounds in the second half of the year, in particular. Irrespective of the fact that households' consumer demand was rather moderate in many countries, producers of consumer goods also recorded a marked expansion in their foreign business.

Key economic variables in the Federal Republic of Germany

Item	Unit	1981	1982	1983	1984	1981	1982	1983	1984
						Percentage change from previous year			
Aggregate demand									
Private consumption	DM billion	879.2	910.3	947.3	978.1	+ 5.4	+ 3.5	+ 4.1	+ 3.2
Public consumption	DM billion	317.8	325.8	335.7	349.8	+ 6.7	+ 2.5	+ 3.0	+ 4.2
Fixed capital formation	DM billion	338.2	330.6	346.5	357.5	+ 0.1	− 2.2	+ 4.8	+ 3.2
Machinery and equipment	DM billion	128.7	126.7	137.6	140.2	+ 0.6	− 1.5	+ 8.5	+ 1.9
Construction	DM billion	209.6	203.9	209.0	217.3	− 0.3	− 2.7	+ 2.5	+ 4.0
Increase in stocks	DM billion	−4.9	−4.7	+ 5.6	+ 16.1	.	.	.	.
Domestic expenditure	DM billion	1,530.4	1,562.0	1,635.1	1,701.5	+ 2.8	+ 2.1	+ 4.7	+ 4.1
External surplus 1	DM billion	+ 14.7	+ 37.9	+ 38.6	+ 48.5	.	.	.	.
Exports	DM billion	494.6	539.1	540.1	599.9	+ 14.9	+ 9.0	+ 0.2	+ 11.1
Imports	DM billion	479.9	501.2	501.6	551.4	+ 10.6	+ 4.5	+ 0.1	+ 9.9
Gross national product at current prices	DM billion	1,545.1	1,599.9	1,673.7	1,750.0	+ 4.0	+ 3.5	+ 4.6	+ 4.6
Memorandum items									
Orders received by the manufacturing sector	1980 = 100	104.5	103.4	107.9	118.2	+ 4.5	− 1.1	+ 4.4	+ 9.5
Domestic orders	1980 = 100	98.8	98.3	103.1	109.5	− 1.2	− 0.5	+ 4.9	+ 6.2
Foreign orders	1980 = 100	116.7	114.4	118.3	137.1	+ 16.7	− 2.0	+ 3.4	+ 15.9
Orders received by the construction industry	1980 = 100	85.3	85.9	94.4	88.9	− 14.7	+ 0.7	+ 9.9	− 5.8
Distribution of income									
Wage and salary income	DM billion	880.8	900.6	919.8	947.0	+ 4.6	+ 2.2	+ 2.1	+ 3.0
do. as a percentage of national income	%	74.2	73.4	71.8	70.6	.	.	.	.
Entrepreneurial and property income	DM billion	307.0	326.5	360.8	393.7	− 0.1	+ 6.4	+ 10.5	+ 9.1
Memorandum items									
Gross income of producing enterprises	DM billion	225.7	242.6	278.1	308.3	− 6.0	+ 7.5	+ 14.7	+ 10.9
do. as a percentage of national income	%	19.0	19.8	21.7	23.0	.	.	.	.
National income	DM billion	1,187.8	1,227.0	1,280.6	1,340.7	+ 3.3	+ 3.3	+ 4.4	+ 4.7
Production									
Gross national product at 1976 prices	DM billion	1,263.0	1,250.0	1,266.6	1,299.7	− 0.2	− 1.0	+ 1.3	+ 2.6
Productivity 2	1976 = 100	115.2	116.5	120.4	124.0	+ 1.7	+ 1.1	+ 3.3	+ 3.0
Output in the producing sector (excluding construction) 3	1980 = 100	98.3	95.5	96.4	99.6	− 1.7	− 2.8	+ 0.9	+ 3.3
Construction output 3	1980 = 100	92.5	88.5	89.0	89.5	− 7.5	− 4.3	+ 0.6	+ 0.6
Employment									
Employed persons	Millions	26.1	25.6	25.2	25.2	− 0.8	− 1.8	− 1.6	− 0.2
Wage and salary earners	Millions	22.8	22.4	22.0	21.9	− 0.6	− 2.0	− 1.8	− 0.3
Memorandum item									
Total number of man-hours worked	1976 = 100	97.6	95.5	93.7	93.4	− 1.8	− 2.1	− 1.9	− 0.4
Unemployed persons	Thousands	1,271.6	1,833.3	2,258.2	2,265.6	+ 43.1	+ 44.2	+ 23.2	+ 0.3
do. as a percentage of									
the total labour force	%	4.8	6.7	8.1	8.1	.	.	.	.
the dependent labour force	%	5.5	7.5	9.1	9.1	.	.	.	.
Prices									
GNP deflator	1976 = 100	122.3	128.0	132.1	134.6	+ 4.2	+ 4.6	+ 3.2	+ 1.9
Memorandum item									
Unit labour costs in the economy as a whole 4	1976 = 100	121.5	125.8	127.0	127.5	+ 4.6	+ 3.5	+ 1.0	+ 0.4
Cost of living index for all households	1980 = 100	106.3	111.9	115.6	118.4	+ 6.3	+ 5.3	+ 3.3	+ 2.4
Producer prices of industrial products	1980 = 100	107.8	114.1	115.8	119.2	+ 7.8	+ 5.8	+ 1.5	+ 2.9
Overall construction price level	1980 = 100	105.3	108.1	109.9	112.5	+ 5.3	+ 2.7	+ 1.7	+ 2.4
Index of import prices	1980 = 100	113.6	116.2	115.8	122.8	+ 13.6	+ 2.3	− 0.3	+ 6.0

1 Balance of transactions in goods and services with other countries (including the GDR). — **2** Gross national product at 1976 prices per man-hour worked; calculated by the Bundesbank. — **3** Results for kinds of activity units. — **4** Index of gross wages and salaries per employee divided by index of real GNP per employed person. — The figures from the national accounts from 1982 onwards are provisional.

Export successes owing to upswing abroad and increased competitiveness of domestic suppliers

The export successes of German business in 1984 and the early months of 1985 were a direct consequence of the business upswing in other industrial countries — particularly in the United States and Japan, but increasingly too in important European customer countries. Machinery and equipment constitute a large part of the goods offered by German exporters, and export business benefited particularly from the fact that private investment abroad was forging ahead. In addition, domestic suppliers were able to strengthen their position considerably in the international market; progress in implementing technical innovations and a lower rate of cost and price rises at home than among foreign competitors tended to have similar effects. Moreover, the changes in exchange rate relationships (which are described in more detail on pages 31 and 33 of this Report) considerably bolstered the position of German suppliers in the dollar area in the course of 1984 (and well into the new year, too). In comparison with the other major customer countries, it is true that the exchange rate of the Deutsche Mark — with differing developments in individual cases — has fallen only slightly in nominal terms. In many cases, however, price competitiveness has improved here because in these countries domestic prices have risen more strongly than the prices quoted by German suppliers.

Private demand for capital goods second mainstay of economic activity

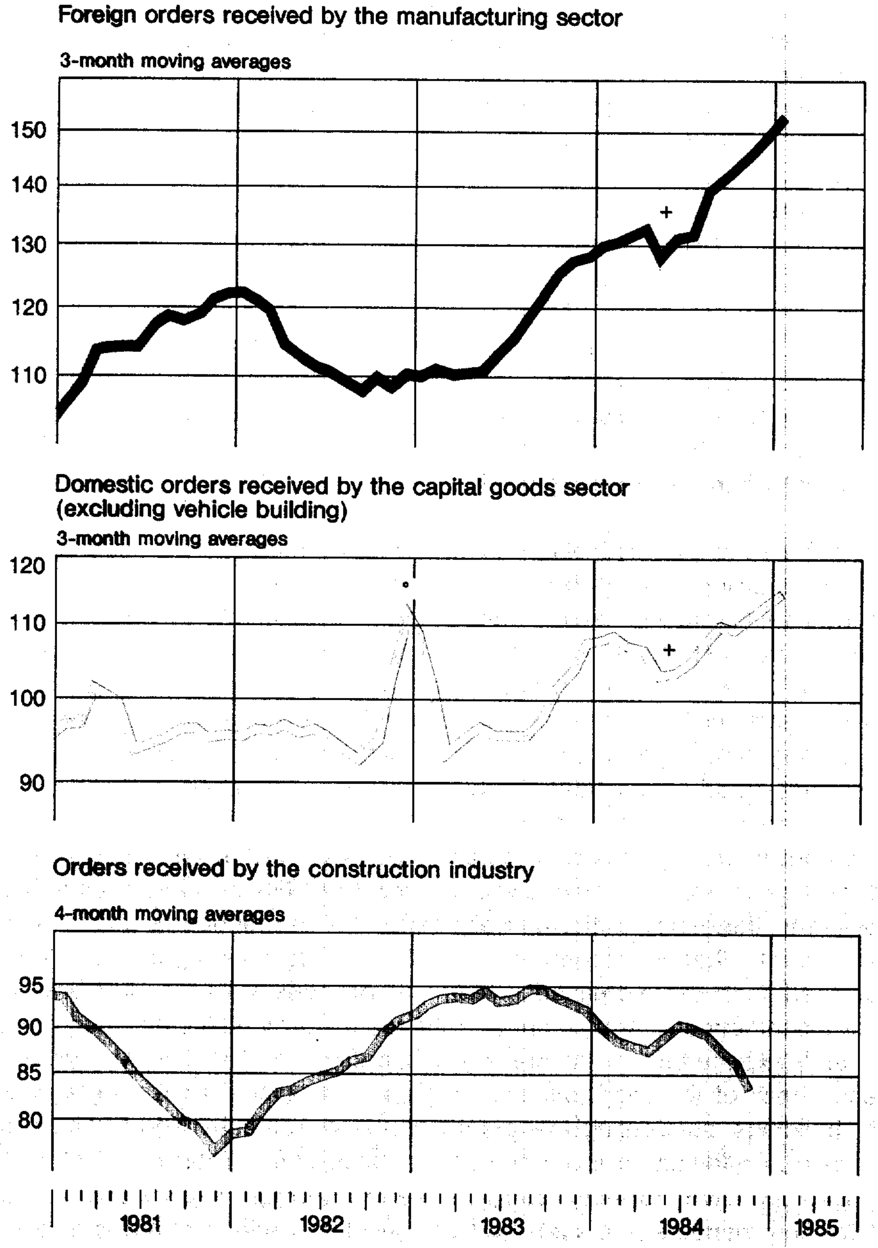
Enterprises' demand for capital goods in 1984 developed into the second mainstay of the upswing. During 1984 as a whole, domestic orders to the capital goods industry (excluding vehicle building) were a good 8% up on the year by value, and in the first months of 1985 the demand for machinery and equipment accelerated further. However, deliveries of capital goods did not keep up with orders last year, because the labour dispute led to considerable production losses among capital goods producers, in particular, and these losses could only be made good to a limited extent. Enterprises' expenditure on new machinery and equipment therefore fell slightly in the first half of 1984 (compared with the corresponding period of the previous year), but in the second half of the year it was 4½% higher than a year before; the 1983 level had already been high owing to the expiry of the delivery period for capital goods under the investment grant scheme (December 31, 1983). Foreign capital goods producers also profited from the increased investment propensity within Germany; imports of machinery and equipment in 1984 went up by 13%, i.e. much more than overall expenditure on machinery and equipment (+2%). Moreover, in the second half of the year business also began to place more orders for industrial buildings, suggesting that plant expansion was assuming more importance again in addition to investment in rationalisation. Total expenditure by enterprises on new machinery, equipment and buildings rose by 3% in 1984. For 1985 the prospects of a sustained high level of investment are fairly good. According to the most recent surveys, the investment plans of the producing sector dating from autumn last year, which had already set expenditure on new plant 10% higher for 1985, have probably been adjusted upwards in many cases since that time.

Increased investment propensity owing to positive sales expectations and improved earnings

Apart from positive sales expectations, what probably contributed most to the strengthening of investment propensity was the further improvement of business earnings. This is characteristic of the early phase of a cyclical upswing, in which earnings go up noticeably as a result of higher sales even if there are only small price rises, whereas costs increase relatively little. This was true in 1984 especially of wage costs, firstly because the rise in negotiated wages and salaries, at an average of just on 3%, was small — smaller, at any rate, than a year before (not least because reductions in working hours under collective wage agreements negotiated at the same time will apply only as from 1985). Productivity grew strongly with the rise in production, so that unit labour costs in the economy as a whole remained almost unchanged. In addition, enterprises received some relief through lower financing costs. Of the other cost elements, expenditure on imported goods and services admittedly rose consid-

Trends in demand

1980=100, seasonally adjusted, log. scale



° Affected by the deadline for qualifying for the investment grant (Dec. 31, 1982) and by large-scale orders.– + Affected by labour disputes.

erably, largely owing to the appreciation of the U.S. dollar against the Deutsche Mark. Profit margins and, in particular, earnings improved in 1984, so that the severe losses incurred at the beginning of this decade were offset again to a not inconsiderable extent. The gross income of producing enterprises,[1] which provides a yardstick for the earnings trend in current business, rose in 1984 by 11%. Its share in national income, at 23%, was back at the level of 1979; however, its level at the beginning of the seventies (over 25%) or the sixties (31½%) was not regained.

1 In this calculation the government's and households' income from financial assets (after deduction of interest on public and consumer debt) has been subtracted from total gross entrepreneurial and property income. The income of the housing sector and of financial institutions (banks, including the Bundesbank, building and loan associations, insurance enterprises) has also been deducted. The residual amount corresponds to the income generated by producing enterprises less net interest paid to other sectors, net rents, etc.

Higher return on fixed capital employed

Enterprises' increased earning power was tantamount to a further rise in the yield on fixed capital employed. An estimate of the gross income of producing enterprises in the narrower sense — i. e. after deduction of imputed entrepreneurs' remuneration for the work done by the proprietors of unincorporated enterprises — yields a return on net fixed capital in 1984 of 11 %, after 10 % a year before and a good 8 % in the years 1981–82, the lowest level to date. By contrast, the return on financial assets in the form of bonds went down somewhat in 1984. The gap between the return on fixed assets and the return on securities thus widened in 1984 on both sides; however, it cannot be said whether this will be a lasting phenomenon, nor whether the gap will be considered large enough for the higher risk of a capital investment in an enterprise to be regarded as being covered. The gap between the estimated return on fixed capital and the return on financial assets was at any rate much wider in the early seventies and in the sixties than in 1984. Even though business investment decisions depend on many different factors, the improvement in the return on capital may have contributed to enterprises' investing more strongly again in fixed assets. It may also have helped to make it easier to find private investors who are prepared to run the risk of participating in an enterprise (see also page 52).

Increased willingness to innovate through reward for entrepreneurial risks

The underlying trend towards the better rewarding of entrepreneurial risk-taking was not least also a precondition for business increasingly introducing technical innovations. Without such technology business would hardly be able to hold its own in the long run in international competition. It is small and medium-sized enterprises, in particular, which often lack an adequate capital base, and which during periods of depressed operating results have difficulty in bearing the start-up losses which occur when new technologies are introduced. Now that the profit situation is more favourable again, such firms will be able to push ahead with their development projects more quickly than heretofore. The Federal Government has been supporting them in this; in the last few years it has not only continued to raise its expenditure on research and development but has also been increasingly concerned to facilitate the implementation of the research results in business. The government has set new emphases by promoting key technologies (e.g. in information technology) and joint projects. Total expenditure by the private sector and government agencies on research and development in the Federal Republic of Germany in 1984, as in the previous year, probably ran at the level of a good 2½ % of the gross domestic product. Compared with other western industrial countries, Germany is one of the leaders as regards expenditure on research. The last two years, in particular, have seen a growing number of important product innovations being developed by enterprises to the point of series production, and this is a hopeful sign that this expenditure will lead to sustained business success.

Higher investment in stocks in the wake of the economic upswing

Given the favourable outlook for production and sales, business began to build up stocks strongly relatively early last year. At the start of the year, in particular, stocks of primary products were apparently seen in many cases as being too thin. In the first half of the year imports of raw materials and semi-finished products showed a year-on-year rise by value of 14½ % and by volume of 6 %. In the further course of the year, when it was especially imports invoiced in dollars which increased strongly in price for German importers owing to the rise in the dollar rate, stockbuilding slackened again. Stocks of finished products in industry and the distributive trades probably went up strongly in 1984; even so, according to surveys by the Ifo Institute, industrial firms by and large no longer judged their stocks of finished products as being too high. Overall, business stocks in 1984 increased by DM 16 billion on calculations of the Federal Statistical Office, after having risen by only DM 5.5 billion in 1983.

Only moderate expansion in private consumption

Last year business did not receive any notable impulses from private consumer demand. Consumption spending by households rose in 1984 by 3%, and adjusted for price changes by ½%, after having increased a year before by 4% and 1% in real terms, respectively. An exceptional feature here was that in 1984 fewer new passenger cars were purchased for private purposes than in 1983. Firstly, there were at times considerable delivery bottlenecks owing to the labour disputes in the metal-working industry; secondly, as the year went on, potential buyers found the discussion on the introduction of low-pollutant cars and the associated tax rulings very unsettling; in not a few instances, planned purchases were postponed.

Medium-term decline in consumer demand owing to fall in population

On an overall view, households' readiness to buy increased again after the turn of 1984–85. But in the somewhat longer run private consumption will probably not become a particularly dynamic component of demand. One of the reasons for this is that Germany's resident population is falling, and has in fact been doing so for a fairly long time now. According to estimates, in 1984 about 250,000 or almost ½% fewer people than a year before were resident in the Federal Republic of Germany, including Berlin (West), on an annual average. This owed something, firstly, to the greater numbers of foreign employees and their families returning to their home countries. Secondly, the number of German nationals resident in Germany, including Berlin (West), was falling because of the sustained negative birth-rate.

1984 wage round characterised by calls for cuts in working hours

Another significant factor in the trend in consumer demand was that the reduction of working hours rather than the raising of agreed earnings was at the centre of the wage negotiations between management and labour last year. The decision reached in this field after long-drawn-out industrial action in the metal-working industry led to nominal wage increases in 1984 generally being relatively low, while new regulations on working hours are not coming into force until 1985. Negotiated wage and salary rises last year, at an average of just on 3%, were about half a percentage point lower than a year before. The wage and salary compromise in the metal-working industry, which settled the outcome of the wage round, provides — in addition to an across-the-board rise in pay rates of 3.3% from July 1, 1984 — for the reduction in agreed weekly working hours aimed at by the union from 40 to an average of 38.5 hours with no loss of pay from April 1, 1985; in-house agreements can arrange for some workers in a plant to work fewer hours and others more, but the number of hours worked must average 38.5. Besides the pay adjustment for this reduction in working hours, a further rise in agreed earnings of 2% as from April 1, 1985 was negotiated; hourly earnings in the metal-working industry will then go up by a total of 6%. In other sectors, agreed increases in earnings, as far as they affected 1984, were mostly between 3 and 3½%. They were often associated with other methods of reducing working hours, such as the granting of additional days off or early retirement agreements. Moderate though last year's wage settlements seem, the agreements already negotiated for 1985 actually place an additional burden on business, especially as there will also be a rise in the health and pension insurance contributions.

Slightly faster increase in disposable income

Generally speaking, households' income increased somewhat more in 1984 than in the year before, in spite of there being a further weakening in 1984 of the rise in agreed and actual earnings. Total gross wages and salaries grew by 2½% against 2% a year earlier;[1] what had an especially positive effect here was that the drop in employment came to a halt in the course of the year. Current transfers made by public cash offices in the form of pensions and assistance payments increased relatively little in 1984. However, households' other

1 As the actual amount of income tax paid by employees is not known — it is not the same as wage tax revenue because of the tax refunds and back payments fixed under the tax assessment procedure — a sufficiently reliable indication of net income from wages and salaries is not possible at present.

income grew strongly. Their income from financial assets alone (before tax) rose by 7 % to DM 91 billion. Moreover, relatively high amounts were withdrawn by self-employed persons for private consumption purposes and saving. In total, households had 3½ % more income at their disposal in 1984 than in the previous year.

Strong fluctuations in private saving in the course of the year

Households expanded their saving in 1984 somewhat more strongly than their income grew. The share of private saving in disposable income rose slightly in 1984 to just on 13 %. In the course of the year the saving ratio nevertheless fluctuated a good deal. Private saving dropped markedly in spring 1984, inter alia owing to income losses during the labour disputes in the metal-working and printing industries; in the further course of the year, as business returned to its expansionary path, private saving quickly normalised too, because households were apparently anxious to replenish their financial reserves, which in some cases had been depleted during the labour disputes. Saving was relatively high, particularly towards year's end, a contributory factor here being, as already mentioned, that some purchases of vehicles had been postponed in view of uncertainty about the introduction of new exhaust technology and its financial consequences.

Advance of saving in securities and financial assets with attractive interest rates fixed for fairly long periods

In 1984 households turned primarily, in their financial asset acquisition, to forms of saving with relatively attractive interest rates. Especially in the first half of the year, commitments in fixed interest securities were preferred — mainly in public debt instruments and to a large extent in foreign currency bonds as well. In buying the latter, investors hoped both for interest rate advantages in view of the depreciation of the Deutsche Mark against the U.S. dollar and for corresponding exchange rate gains. In 1984 an estimated one-fifth and more of households' newly acquired financial assets consisted of bonds. Foreign bonds constituted about half of these. There was relatively strong interest too in special forms of saving offered by banks for some time now in the context of longer-term savings accounts (inter alia "plus" or "growth" saving and bonus saving) as well as in investments in bank savings bonds and in mostly shorter-term time accounts. By contrast, the flow of private funds to insurance enterprises in 1984 apparently did not quite reach the admittedly exceptionally high level of 1983. The funds accruing to savings accounts at statutory notice showed a downward trend too; there was a year-on-year fall of about one-half in net inpayments here. Inpayments to and outpayments from accounts with building and loan associations were roughly in balance. The fact that households incurred less new debt for consumption purposes in 1984 than in the year before had a positive effect on overall saving.

Construction industry bypassed by the economic upturn

Unlike most other sectors of the economy, the construction industry in 1984 saw its business decline progressively. Construction demand, which had already been falling since autumn 1983, showed a general downward trend last year as well — in spite of a temporary improvement during the summer months. On an annual average in 1984 the construction industry received almost 6 % fewer construction orders than in 1983. As at the same time real construction output ran at a higher level than in the previous year — including installation of fixtures and fittings it rose by 1½ % — many building firms must have started the 1985 construction season with extremely thin order books.

Sharp fall in demand for housing

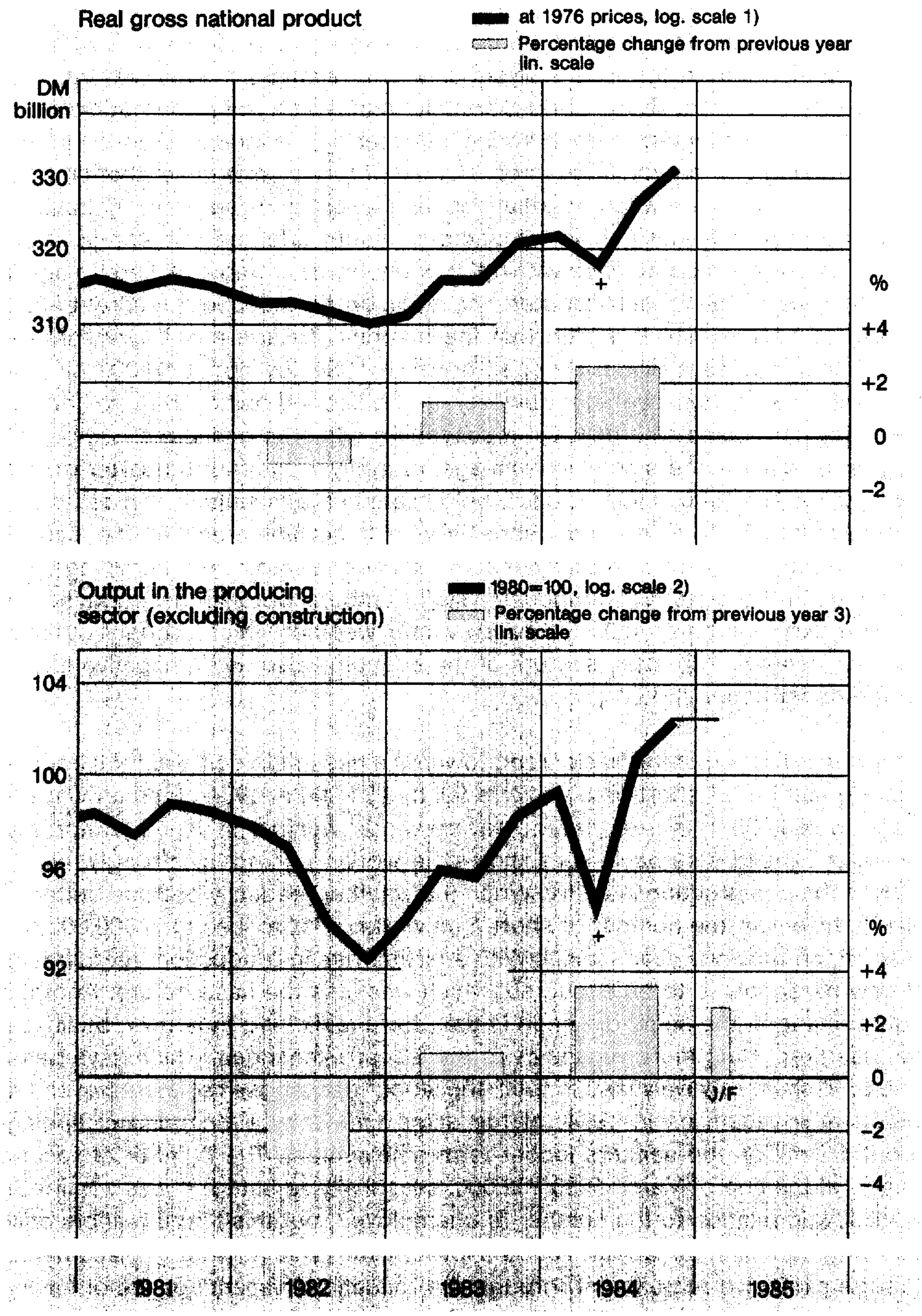
Last year housing construction suffered an especially sharp fall in demand. On an average in 1984 the construction industry received almost one-fifth fewer orders for residential buildings than in the year before. The number of building permits for dwellings decreased to the same extent, to a good 335,000. At the same time, almost 400,000 new housing units were completed. The annual requirement for new housing over the medium term is, however, probably considerably under 400,000. This is suggested by the high degree of provision with housing which has now been attained. In some regions this has led to a rise in the number of rented dwellings standing empty, and here and there a surplus supply of owner-occupied dwellings and houses has arisen. Thus the fall in demand for housing construction last year — and the picture did not change in January this year — is inter alia indicative of adjustment to new equilibria on German housing markets, which are fairly diverse in regional terms. Any new government promotional measures could curb this adjustment only for a certain period. They would not be able to change its direction over the long term; on the contrary, such programmes, as the experience of the last few years, in particular, has shown, would involve the danger of later setbacks.

Increase in demand for industrial and public construction work

In the course of last year demand for industrial and public construction work constituted something of a counterweight to the fall in demand for housing. In industrial construction it is true that in 1984 as a whole fewer orders were placed than in the year before (−5%). But, as has already been mentioned, demand here went up noticeably in the second half of last year, with private sector orders as well as new Federal Railways and Federal Post Office projects playing an important role. Demand for public construction work last year moved away sharply from the very low level of the preceding three years. In total, the central, regional and local authorities placed about 6% more orders, by value, with the construction industry in 1984 than in the year before. Road building schemes and other public civil engineering projects were well to the fore here, whereas the demand for public buildings remained muted. The main reason for the general revival in public building projects was that the local authorities — which are the most significant public investors — made fairly good progress in consolidating their budgets last year and thus gained more scope for their capital projects. In view of the fact that there are not a few public construction projects which are pressing — e. g. in the areas of urban renewal, maintenance of the road network and waste disposal facilities — it can be assumed that public construction in 1985, too, will to a certain extent act as a counterweight to the fall in housing construction.

Marked expansion in production and higher utilisation of fixed capacities

Production in the economy as a whole reacted rapidly to the impulses from the demand side. In the producing sector (excluding construction) about 3½% more was produced in 1984 as a whole than in the year before, in which output had increased by barely 1%. Fixed capacity utilisation in many areas of industry improved noticeably. In the manufacturing sector (excluding the chemical industry as well as the food, drink and tobacco industry), it was, at nearly 83% (seasonally adjusted) of the standard level in December, a good 2 percentage points higher than a year before, according to Ifo Institute data. Admittedly, this utilisation was clearly below that of the end of 1979, which represents the last cyclical peak. For the first time since 1979 almost all areas of industry (with the exception of mining) participated in the expansion in production, the economic sectors that featured especially here being those which are benefiting particularly from the buoyancy of exports and the rising investment propensity. Thus in 1984 the capital goods industry (excluding road vehicle building) took the lead in expansion, at a growth rate of about 5%. Producers of office machines and EDP equipment actually increased their production by as much as about 29%, after having raised it by 15½% in 1983. Their significance as members of the technological avant-garde, which is receiving important stimuli from the upswing and is thus contributing substantially to the competitiveness of the economy, thus increased further. 1984 was a very successful year for the electrical engineering industry, too, in that it registered a production gain of 7½% and more. In mechanical engineering and road vehicle building, areas which were particularly affected by the industrial action in the metal-working industry, the revival in production only got under way in the second half of the year; hence output merely came up to the previous year's level, viewed over the year as a whole. In the motor industry, estimates by the Automobile Industry Asso-



1) Adjusted for seasonal and working-day variations; quarterly.- 2) Seasonally adjusted, quarterly.- 3) Roughly adjusted for working-day variations.- + Affected by labour disputes.

ciation put production losses due to the labour dispute at more than 400,000 cars, and over the rest of the year only about a third of these losses seem to have been made good. Of the basic goods producers, the chemical industry stepped up its output by 5½ %. In the steel industry, raw steel production increased, for the first time since 1979. Steel production last year showed a rise of 10 % and approached a level corresponding to the medium-term capacities envisaged by the steel industry and the EEC Commission. In mineral oil refining, by contrast, annual production in 1984 did not regain the previous year's level. Production in the consumer goods sector grew at a below-average rate (by 2½ %) last year, in line with the relatively low level of consumption. In the services sector (including the distributive trades and transportation) the rise in

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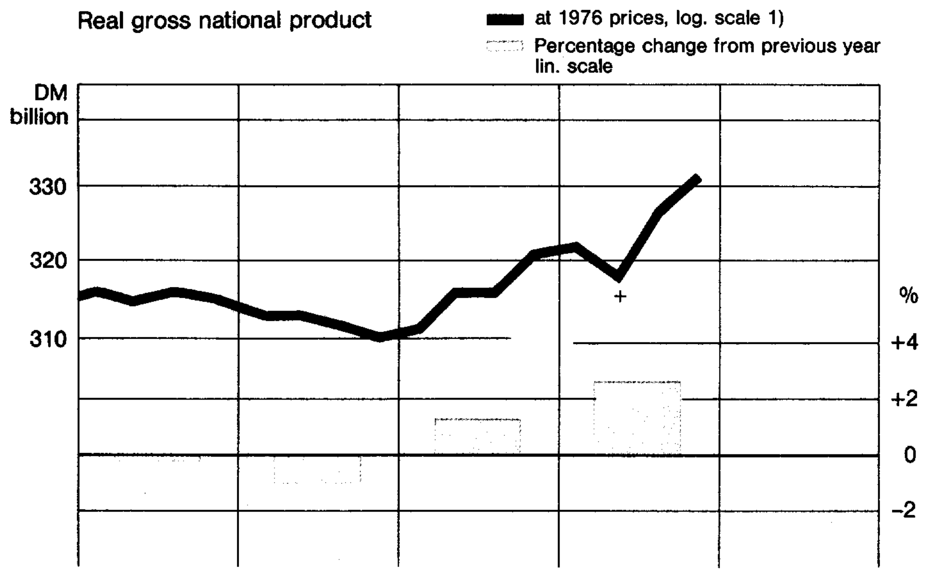

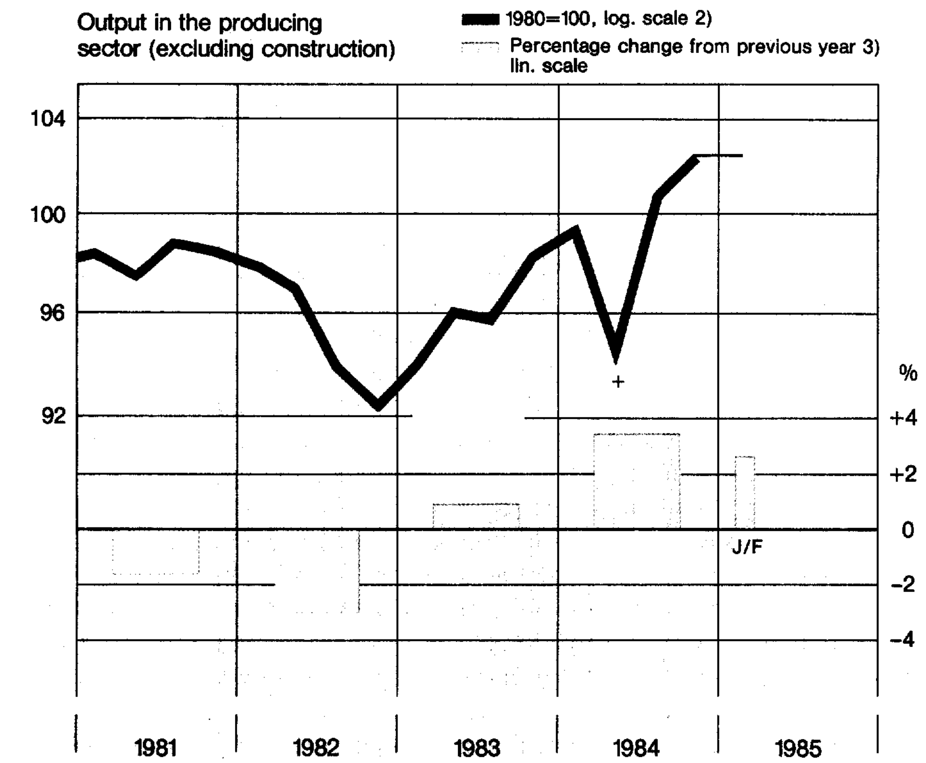

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Improvement of the labour market situation delayed by labour disputes

The economic upswing affected the labour market, too, in 1984, albeit with the usual time-lag and in the final analysis only to a relatively modest extent. The positive trend on the labour market, first signs of which were perceptible from summer 1983, was interrupted in spring last year by the industrial action in the metal-working and printing industries; in view of the uncertainty at that time as to the outcome of the wage negotiations, employers showed great restraint in engaging new staff, not only in the sectors directly affected but also in other areas. As business confidence within the economy as a whole picked up again after the end of the labour disputes, the situation on the labour market began to brighten somewhat. It is true that the number of wage and salary earners in the economy as a whole dropped again in 1984 (by about 60,000 or just on ½ %) on an annual average; however, in the second half of the year the fall in employment came to a halt. On a seasonally adjusted basis, the number of wage and salary earners actually rose again slightly in the fourth quarter of last year, for the first time in four years. Employment in the manufacturing sector, in particular, increased somewhat, especially in important areas of the capital goods sector, as well as probably in some services sectors. But in mining and, above all, in the construction industry staff numbers were further reduced. In the first two months of 1985 the harsh winter weather which brought outside work to a standstill in many sectors of the economy also had a negative effect on the construction industry.

Fall in the number of short-time workers and rise in the number of vacancies point to an increase in the demand for labour

A further indication of the basic trend towards a rise in the demand for labour is that the number of short-time workers fell by 291,000 in 1984 on an annual average to 384,000. It is true that the severe winter weather in January/February this year caused a setback, with short-time working going up strongly, especially in the construction industry. When the weather gradually became better in March, however, the number of short-time workers fell to less than 400,000 (or 64 % of the previous year's level). With a further rise in production, recruitment of new personnel is to be expected, which was less the case before. Another sign pointing in the same direction is that, for a fairly long time now, business has been reporting more vacancies to the labour exchanges, which have been able to fill them relatively fast. In total, the labour exchanges registered over 1.4 million new vacancies in 1984; at the same time they succeeded in finding about 1.1 million job-seekers longer-term employment. The number of vacancies — at the end of March 1985 102,000, seasonally adjusted — was admittedly still low in relation to the number of unemployed, but this figure reflects only part of the demand for labour. This is shown by the large number of placements and the extensive recruitment through the "situations vacant" pages of newspapers.

In the second half of the year gradual reduction in unemployment, particularly among young people

On an annual average about 2.27 million unemployed were registered at the labour exchanges in 1984; this constituted 9.1 % of the dependent or 8.1 % of the total labour force. On a year-on-year comparison, the number of unemployed has thus gone up slightly. The fact that the situation deteriorated considerably as a result of the labour disputes in May and June last year no doubt had a significant impact here. In the months September to December, however, the number of unemployed dropped noticeably — by about 60,000, seasonally adjusted. The seasonally adjusted number of unemployed admittedly climbed again in the first months of the new year because of the harsh winter weather and the unfavourable situation in the construction industry. At the end of March it stood at 2.32 million. It should nevertheless be regarded as a positive feature that last year and in the first few months of 1985 the number of unemployed young people (up to 20 years of age) showed a marked year-on-year fall. At the

Conditions on the labour market

Item	1981	1982	1983	1984	1983	1984
	Thousands, annual averages				Change from previous year, thousands	
Employment						
Employed **p**	26,101	25,632	25,228	25,173	– 404	– 55
of whom						
Wage and salary earners **p**	22,846	22,395	22,003	21,944	– 392	– 59
German citizens	20,934	20,608	20,309	°) 20,202	– 299	°) – 20
Foreigners	1,912	1,787	1,694	°) 1,627	– 93	°) – 69
Unemployed	1,272	1,833	2,258	2,266	+ 425	+ 8
Short-time workers	347	606	675	384	+ 69	– 291
Vacancies	208	105	76	88	– 29	+ 12
Structure of unemployment	Thousands, at end-September				% of total	
Unemployed, total	1,256	1,819	2,134	2,143	100	100
by vocational qualification						
qualified **1**	464	706	895	925	41.9	43.2
unqualified **2**	792	1,113	1,239	1,218	58.1	56.8
by length of time unemployed						
less than 6 months	777	975	979	961	45.9	44.8
6 months to less than 1 year	276	457	546	480	25.6	22.4
1 year and more	203	386	609	702	28.5	32.8
by age						
up to 24 years	375	551	623	582	29.2	27.2
25 to 44 years	550	813	961	959	45.0	44.8
45 to 64 years	332	455	549	601	25.7	28.0
by nationality						
German citizens	1,075	1,566	1,850	1,896	86.7	88.5
Foreigners	181	253	284	247	13.3	11.5

1 Skilled workers and salary earners of equivalent status. — **2** Unskilled workers and salary earners of equivalent status. — ° 1st half-year 1984. — **p** As from 1982 provisional.

end of March 1985, at 160,000, it was 16,000 or 9% lower than a year before. The unemployment rate for young people thus remained below the average rate for other age groups, to a greater extent than in the previous year.

Shift in the qualification structure of the unemployed to more qualified employees

In 1984 there were some noteworthy changes in the qualification structure of the unemployed. According to a study carried out by the Federal Labour Office in September last year, more qualified persons made up significantly more of the unemployed than in the previous year, most of them being white-collar workers with vocational training. By contrast, the number of less qualified persons among the unemployed in September last year was markedly lower than a year before, a trend which must be viewed in connection with the reduction in the number of foreigners registered as unemployed; the return of such foreigners to their home countries will not be the least significant of reasons that played a role here.

Increase in the number of older unemployed persons and in the average duration of unemployment

It is still the case that the unemployed who are difficult to place for age reasons constitute a problem group for labour market policy. The number of older unemployed persons (45 years and over) rose markedly last year, in both absolute and relative terms. At the end of September 1984 they accounted for 28% of all those registered as unemployed, against just on 26% a year before. The fact that the number of longer-term unemployed (unemployed for more than one year) has grown again also owes something to this circumstance; persons in this category made up almost one-third of all those registered as unemployed in September last year against 28½% a year earlier. However, the share of the unemployed who had lost their job only recently remained much higher in September last year; in the period under review about 45% of the unemployed had been without a job for less than six months.

Sustained inflow to the labour market for demographic reasons

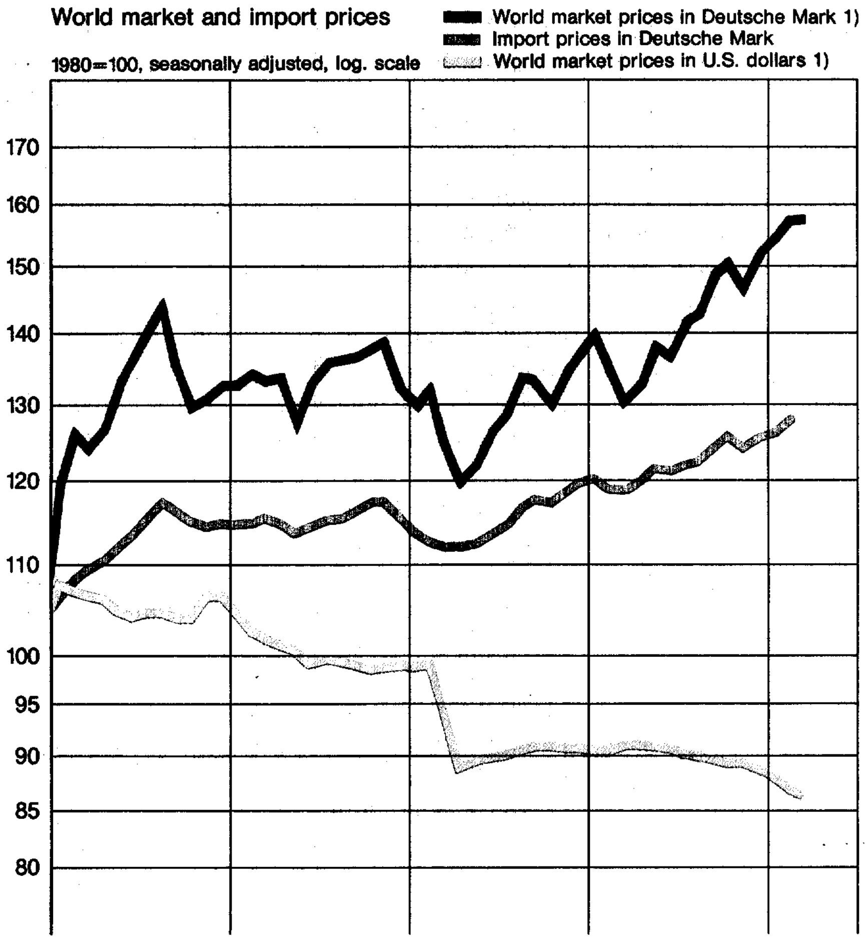
The fact that the overall labour market situation improved only sluggishly in 1984, in spite of the strong recovery in the economy as a whole, owed something to the continuing increase in the number of job-seekers entering the labour market. Firstly, about 765,000 school- and university-leavers applied for a training position in 1984, about 40,000 more than in 1983. At the same time about 725,000 training positions were on offer in the economy, roughly 30,000 (or 4½ %) more than a year earlier. At year's end just on 37,000 applicants who had not found a training position were still registered at the labour exchanges. Secondly, the trend towards a higher participation of women in the labour force, which has been visible for some time now, strengthened further last year; not a few women seem to have intensified their search for a job in 1984. On the one hand, the chances of finding a job were probably better owing to the more favourable business trend. On the other, the necessity of women going to work will probably have risen in some cases (e.g. long-term unemployment of family members).

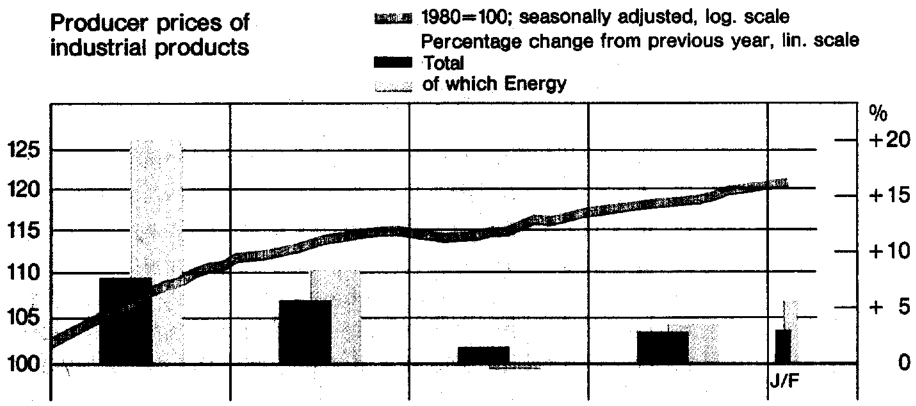
Some factors bring relief to the labour market

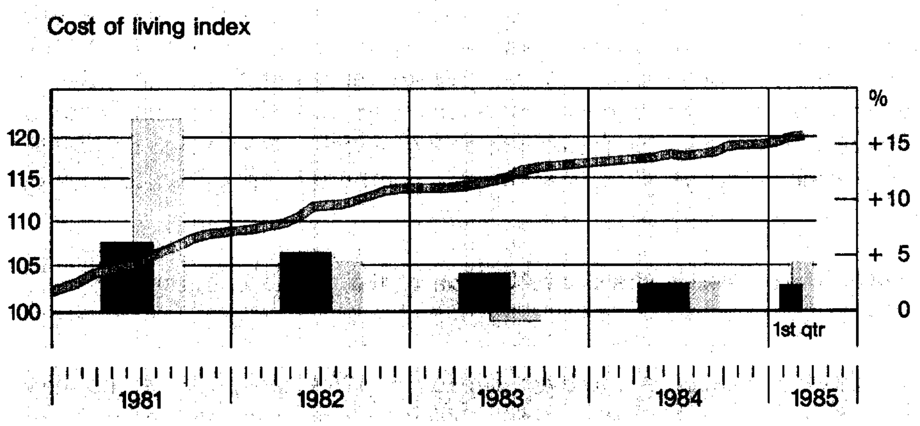
However, the labour market received a certain amount of relief in 1984 from the fact that pensions were being claimed earlier and earlier, that more persons than in the previous year participated in the work promotion measures of the Federal Labour Office and not least that many foreigners returned with their families to their home countries. The Act (of November 1983) to Promote the Willingness of Foreigners to Return to their Home Countries will have contributed to this trend. Under this Act, foreigners were able, in certain circumstances, to apply for one-off financial assistance and the immediate refund of their contributions to the pension insurance funds. Foreigners who wanted to take advantage of this offer had to leave Germany by September 30, 1984; by this date about 150,000 foreign employees had applied for a pay-out of their pension insurance contributions. However, these selective labour market policy measures only mitigate the problem of unemployment; they do not solve it completely. This requires, firstly, sustained economic growth and, secondly, an ongoing reduction of the rigidities on the labour market. Measures such as have been introduced by the Federal Government in its planned "Act to Promote Employment" will probably contribute to such a reduction, but in the final analysis legislative measures will be unsuccessful unless management and labour support them and develop them further in mutual cooperation.

Clear slowdown of the rise in consumer prices

The price climate in Germany remained relaxed in the second year of the economic upswing. Consumers, in particular, profited in 1984 from the further progress made in stabilising the value of money, progress which had not been expected to such an extent at the outset. On an annual average the cost of living index showed a year-on-year rise of 2.4 % last year (against 3.3 % in 1983); this was the lowest price increase rate since the end of the sixties. Industrial goods (excluding energy) as well as services and housing rentals all went up less in 1984 than in the previous year. Although food prices continued to rise in the first half of 1984, they fell to some extent later in the year owing to the very good harvests and the EEC agricultural price decisions of spring 1984. On the other hand, consumers had to pay considerably more for some energy sources in 1984. Prices for heating oil, petrol and to a lesser extent natural gas climbed appreciably in autumn especially, trade buying prices having shot up owing to the sustained appreciation of the U.S. dollar. Electricity and coal, too, increased in price once more last year. The lowest point of the rise in consumer prices was passed in the summer of 1984. At that time the cost of living index – covering the last six months and converted to an annual rate – registered a seasonally adjusted rise of 1.2 %. At the end of 1984 this rate was 2.2 % and in March 1985 almost 4 %.







1) Raw material price index of Hamburgisches Weltwirtschaftsarchiv; rebased from original base 1975=100.-

Price rises stimulated by the fall in the external value of the Deutsche Mark on the import side

This acceleration of the rate of price rises — while accentuated by special factors, such as the extreme winter weather — owed most to external price impulses. On the one hand, import prices went up as the external value of the Deutsche Mark fell. Although the international markets for energy sources and raw materials saw a slight tendency for prices calculated in U.S. dollars to fall, imports of raw materials and energy in Deutsche Mark became much more expensive for German businessmen because of the exchange rate trend. While the imports of other goods are generally not invoiced in dollars — a good 45 % of imports are settled in Deutsche Mark — the overall import price level rose on an annual average by 6 % in 1984. Since the beginning of 1985 import prices have actually gone up even more; from September 1984 to February 1985 they climbed at a seasonally adjusted annual rate of almost 9½ %. Of the most important German imports, energy sources registered particularly sharp price rises. In the short term, it is usually not possible to find substitutes for these goods, and an increase in their prices can hardly be avoided in many instances. As energy imports alone account for about a fifth of total imports, price rises in this area have a relatively strong impact on the total index of import prices.

Indirect price effects via exports

A further aspect of price relationships with the rest of the world concerns exports and the indirect effects which these may have on domestic prices and costs. As a result of the depreciation of the Deutsche Mark, German exports, which are for the most part invoiced in Deutsche Mark (this tendency actually intensified in the course of 1984 probably because it was being assumed less and less that the Deutsche Mark would appreciate), became cheaper for buyers in countries whose currency had appreciated against the Deutsche Mark (the United States and Japan, inter alia). German exporters were therefore able to raise the volume of their exports (see page 25), but they put up their export prices, too, in individual areas — for example in the steel industry, in electrical engineering and in some areas of the consumer goods sector — more steeply, in fact, than their domestic prices. In February 1985 export prices for manufacturing sector products showed a year-on-year rise of 3½ %, whereas domestic prices had gone up by less than 3 %. As in the long run there can be no "split" between domestic and foreign price trends, it is to be feared that when prices rise more strongly in foreign business domestic prices will be put up more markedly than has hitherto been the case.

Minor price rise at the producer level

It is true that these effects on domestic price movements remained limited in 1984 and also in the first months of 1985. Apparently business was able partially to offset the higher import costs by cutting costs in other areas, e.g. wage costs in the manufacturing sector. In addition, the scope for price increases on domestic markets remained small not least because monetary policy did not leave much room for this. Nevertheless, the sales prices of trade and industry in Germany in the second half of 1984 and the first two months of 1985 went up at a seasonally adjusted annual rate of 3½ %, which was about twice as fast as during 1983. Basic and producer goods prices went up particularly steeply in 1984. In this area, strong price rises for heating oil and non-ferrous metals had a major effect. Construction price increases remained minimal in 1984 under the influence of the fall in construction demand. The overall construction price level on an average last year was just on 2½ % higher than a year before; in the first quarter of this year the year-on-year rise here is estimated to have dwindled to barely 1½ %.

2. Further progress in the consolidation of the public budgets

Sustained decline in public sector deficits and the government ratio

Benefiting from the sustained economic recovery, and also from the additional consolidation measures approved already in 1983, the public authorities reduced their deficits further in 1984. Owing to the direct and indirect consequences of the industrial disputes in the spring, the deficits admittedly declined

Finances of the public authorities*

Item	1981	1982	1983 pe	1984 pe	1981	1982	1983 pe	1984 pe
	DM billion				Percentage change from previous year			
A. Expenditure, receipts and balances								
Central, regional and local authorities								
Expenditure								
Personnel expenditure	174.0	178.9	183.9	186.5	+ 6.1	+ 2.8	+ 2.8	+ 1.5
Other operating expenditure	81.7	85.4	88.6	93.5	+ 6.7	+ 4.6	+ 3.7	+ 5.5
Transfers	155.0	160.5	158.9	161	+ 9.1	+ 3.6	− 1.0	+ 1
Interest	36.7	45.2	51.5	54	+23.8	+23.1	+13.9	+ 4.5
Direct capital outlays	59.3	54.3	50.6	49.5	− 5.0	− 8.4	− 6.7	− 2
Financial aid 1	36.3	38.5	38.2	41	+ 2.4	+ 6.2	− 0.9	+ 7
Total expenditure 2	542.9	562.8	571.4	584.5	+ 6.4	+ 3.7	+ 1.5	+ 2.5
of which								
Federal Government	234.9	246.6	248.7	253.5	+ 7.9	+ 5.0	+ 0.9	+ 2
Länder Governments	216.6	224.2	228.9	234.5	+ 3.8	+ 3.5	+ 2.1	+ 2.5
Local authorities	152.1	153.0	151.4	154	+ 4.5	+ 0.6	− 1.1	+ 1.5
Receipts								
Tax revenue	370.3	378.7	396.6	414.5	+ 1.5	+ 2.3	+ 4.7	+ 4.5
Other receipts	97.9	115.4	121.3	124.5	+ 9.6	+17.8	+ 5.1	+ 2.5
Total receipts 2	466.8	492.8	516.8	539	+ 3.1	+ 5.6	+ 4.9	+ 4.5
of which								
Federal Government	196.9	208.9	216.8	225	+ 3.7	+ 6.1	+ 3.8	+ 4
Länder Governments	190.6	199.6	207.6	216.5	+ 2.3	+ 4.8	+ 4.0	+ 4
Local authorities	142.0	145.8	150.2	155.5	+ 1.5	+ 2.7	+ 3.0	+ 3.5
Deficit (−)	− 76.1	− 70.0	− 54.6	− 46	.	.	.	.
of which								
Federal Government	− 38.0	− 37.7	− 31.9	− 28.5	.	.	.	.
Länder Governments	− 26.0	− 24.6	− 21.3	− 18	.	.	.	.
Local authorities	− 10.1	− 7.3	− 1.2	+ 1.5	.	.	.	.
Social security funds								
Expenditure	293.2	310.4	316.7	331	+ 7.9	+ 5.9	+ 2.0	+ 4.5
Receipts	299.1	315.2	315.4	328	+ 8.7	+ 5.4	+ 0.1	+ 4
Surplus (+) or deficit (−)	+ 5.9	+ 4.8	− 1.3	− 3	.	.	.	.
Public authorities, total								
Expenditure	794.2	828.7	849.0	877	+ 6.7	+ 4.4	+ 2.4	+ 3.5
Receipts	724.0	763.6	793.1	828	+ 4.9	+ 5.5	+ 3.9	+ 4.5
Deficit (−)	− 70.2	− 65.2	− 55.9	− 49	.	.	.	.
	Level at end of year in DM billion				Change from previous year in DM billion			
B. Indebtedness of the central, regional and local authorities								
Loans against borrowers' notes	409.3	449.4	474.5	490.5	+74.9	+40.1	+25.1	+16
Securities	110.7	142.4	175.7	205	− 1.1	+31.6	+33.3	+29
Other debt	25.5	23.0	21.5	22.5	+ 3.2	− 2.5	− 1.5	+ 1
Total indebtedness	545.6	614.8	671.7	718	+77.0	+69.2	+56.9	+46.5
of which								
Federal Government	273.1	309.1	341.4	367.5	+40.8	+36.0	+32.4	+26
Länder Governments	165.2	190.6	212.0	230.5	+27.3	+25.5	+21.4	+18.5
Local authorities	95.1	101.8	104.1	105	+ 7.0	+ 6.7	+ 2.3	+ 1

* Including hospitals keeping commercial accounts and other special accounts. Receipts and expenditure are not shown here at the time of the cash inflows and outflows (as in earlier Annual Reports) but under the period for which they are intended, in accordance with budgetary practice. — **1** Expenditure on investment grants and loans to third parties, plus the acquisition of participations. — **2** This aggregate — unlike the figures below for the Federal and Länder Governments and local authorities — does not include transfers between the various levels of government (apart from differences in clearing transactions). — **pe** Partly estimated. Discrepancies in the totals are due to rounding.

less than would otherwise have been possible. The renewed acceleration of the rise in the expenditure of the statutory health insurance institutions also ran counter to the consolidation policy. In contrast to the central, regional and local authorities, the social security funds therefore incurred larger deficts. Altogether, the public authorities showed deficits totalling DM 49 billion in 1984, against DM 56 billion in 1983. As a proportion of the gross national product, the deficits came to 2¾ % in 1984 against almost 3½ % in the preceding year. The improvement in the budgetary situation derived mainly from the expenditure side; spending rose not only less sharply than receipts, but also less steeply than the national product. According to the financial statistics, the "government ratio" dropped last year by approximately 2 percentage points compared with its all-time peak (reached in 1982) to 50 %.[1] These are the first moves towards lowering the government ratio, which had climbed from 40 % to 52 % between 1970 and 1982.

Budgetary situation of the central, regional and local authorities noticeably better

Progress towards consolidation last year was confined to the central, regional and local authorities, which succeeded in lowering their budget deficits by DM 9 billion — i. e. from almost DM 55 billion in 1983 to DM 46 billion — and hence more than was to be expected according to the budgets. The crucial factor here was that the expenditure appropriations were not fully utilised, in part because the prices of the goods required by the government rose less sharply than had originally been assumed. Moreover, in 1984 the central, regional and local authorities did not have to expand their indebtedness as much as a year previously; their borrowing, at DM 47 billion net, was DM 10 billion smaller than in 1983.

Efforts to contain the rise in expenditure successful

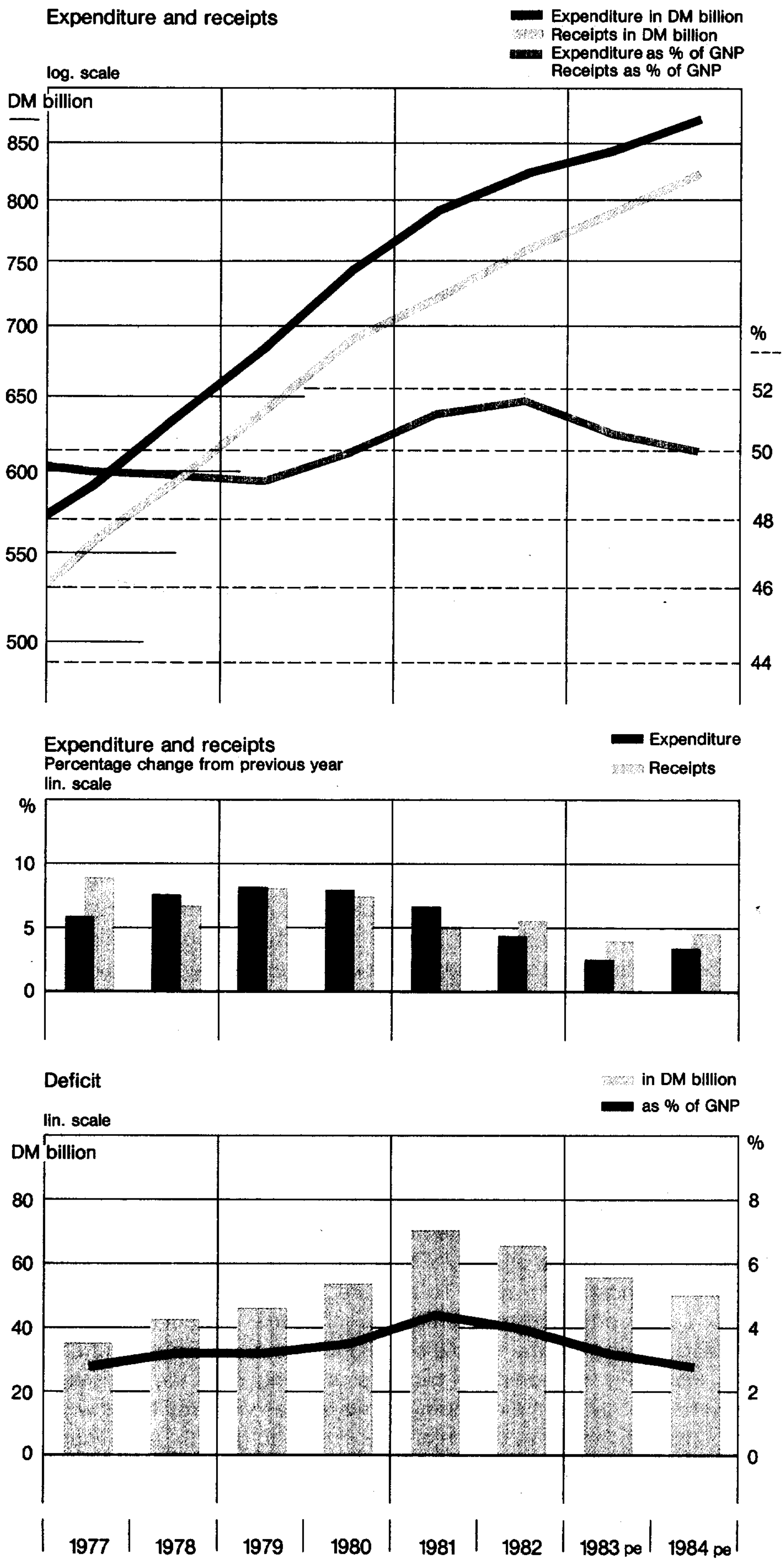
Spending by the central, regional and local authorities rose by only 2½ % in 1984. Thus, these authorities actually undershot the target they had set themselves in the Financial Planning Council — which was already ambitious enough, at 3 %. Personnel expenditure grew by only 1½ % last year. The main reason for this, apart from economies under the Act Accompanying the 1984 Budget, was the postponement of wage and salary increases in the public sector; it also appears that the central, regional and local authorities did not raise the number of their staff any further. Current transfers by the central, regional and local authorities to households and enterprises, including grants to the social security funds, went up by as little as 1 %, primarily because the amounts paid out of the Federal budget as a result of unemployment were no larger than in 1983. Although Federal expenditure on unemployment assistance was substantially higher (this was a consequence of the longer average duration of unemployment), no further Federal transfers had to be made to the Federal Labour Office. The growth of social expenditure was also curbed by cuts in maternity benefits and the changes in training promotion which had been approved as part of the Act Accompanying the 1983 Budget, but which did not take effect over a full year until 1984. Social expenditure expanded vigorously in other areas, however, notably for instance the Federal grants to the statutory pension insurance funds and the local authorities' spending on social assistance. The other operating expenditure of the central, regional and local authorities rose relatively sharply, i. e. by 5½ %; one reason for this was presumably that the local authorities, in particular, spent more on the upkeep of buildings, which outlays had in many cases become urgent.

Downward slide in public sector capital formation ends

In 1984 there were signs of a change in the trend of the central, regional and local authorities' capital spending. Although expenditure, notably that on construction work, declined slightly (by 2 %), 6 % more construction orders were placed than a year before, as stated; this was presumably due to the improved budgetary situation of the local authorities, which account for roughly two-

1 The ratio would be somewhat lower if public sector expenditure were based on the definition of the national accounts.

Finances of the public authorities *



* Central, regional and local authorities and social security funds.- pe Partly estimated.

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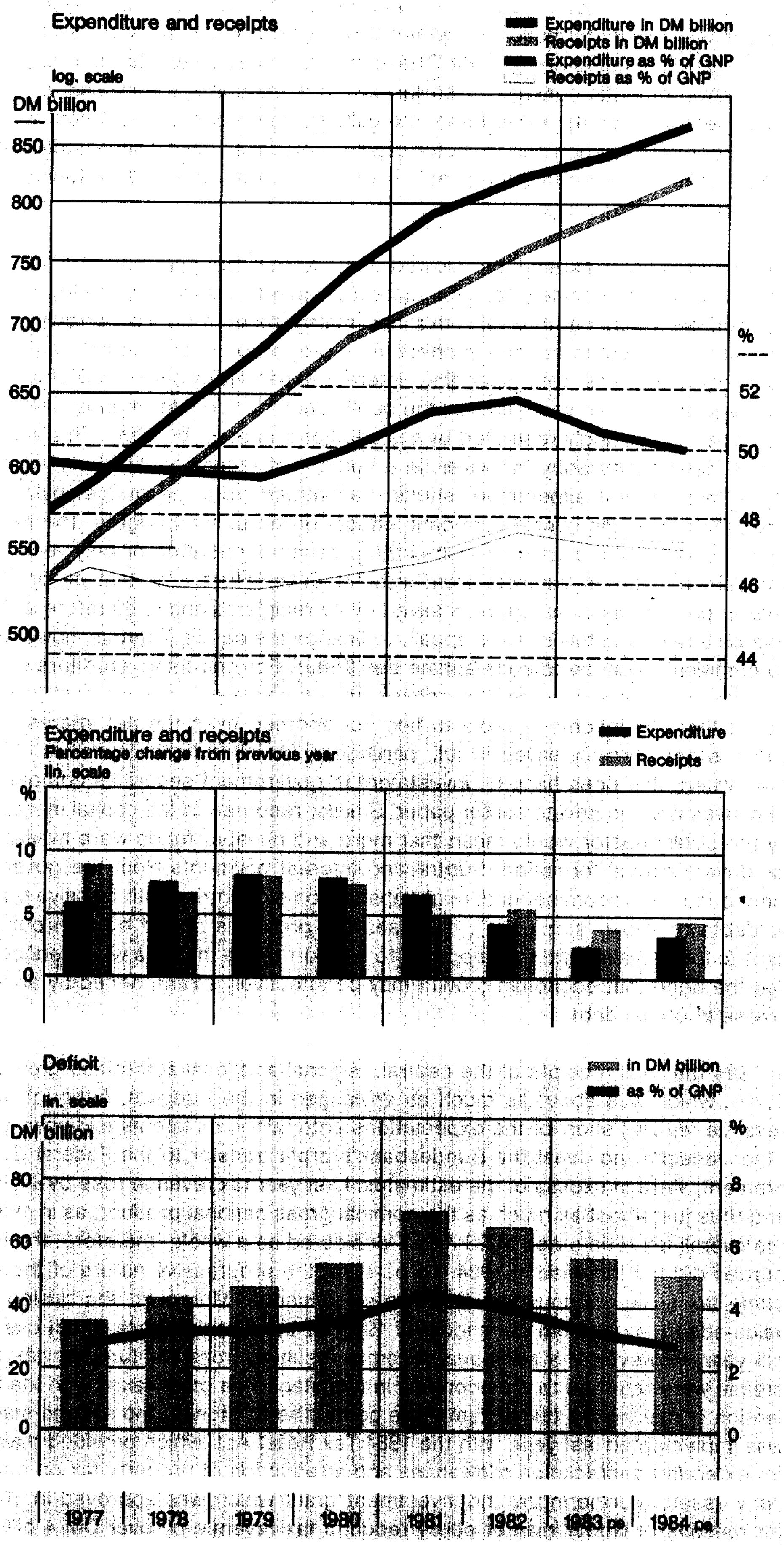

* Central, regional and local authorities and social security funds.- pe Partly estimated.

thirds of public capital spending. This suggests that public funds are again being used to a greater extent for investment purposes. From a macro-economic point of view it is important to spend larger amounts on capital projects which improve the infrastructure, especially where this is necessary parallel to private enterprises' capital formation, or where it must be done in advance, as when new industrial estates are laid out. These capital projects include ones to preclude environmental damage, in so far as this comes into the domain of the public sector. If, on the other hand, the calls for more public investment were to lead primarily to such public sector capital projects as mainly serve individual or collective consumption, the present restrictive attitude would be being relaxed in the wrong place.

Slower growth of interest expenditure

The rise in interest expenditure slowed down further last year but, at 4½ %, it was still disproportionately fast. As interest payments usually have to be made retroactively at annual intervals, this rise mainly reflects public borrowing in 1983 at the interest rates then in effect. As a proportion of the central, regional and local authorities' total spending, interest expenditure came to 9¼ % last year, against 4 % ten years earlier; the public sector's room for manoeuvre has thus been increasingly restricted by the additional interest burdens. This situation is viewed differently, however, in a number of recent publications, which argue that interest expenditure should be omitted from the budget balance when assessing the overall economic effects of the public budgets. The main reason given for such an approach is the presumption that no or only very minor demand effects emanate from interest expenditure, i. e. that all or the greater part of this expenditure is saved by its recipients and is therefore available on a revolving basis, so to speak, to finance the deficit. There is, however, no empirical evidence to substantiate this thesis. For one thing, creditors cannot use the interest income to purchase government securities, at least to the extent that this income is liable to tax. For another, even the net interest income is not normally saved in full, particularly by institutional investors. And even where this does happen, investment in government securities competes with investment in private sector paper. Smaller recourse to the capital markets by the public sector would mean that more and cheaper funds were available for private capital formation. Subtracting interest payments from the government deficit, as recommended, might enable some countries with massive public debts to show "surpluses"; it causes the problems posed by high public debt to look smaller and thus appears to support those theories which encourage the hope that economic growth may be effectively strengthened by an increase in public debt.

No change in the overall tax ratio

In 1984 the total receipts of the central, regional and local authorities grew by 4½ %, which was about as much as envisaged in the budgets. Although tax revenue fell well short of the expectations entertained as late as mid-year, the other receipts (not least the Bundesbank's profit transfer to the Federal Government) were in excess of the estimates. Last year tax revenue rose by 4½ %, and thus just about as much as the nominal gross national product; as in 1983, the overall tax ratio stood at 23.7 %. Considered as a whole, therefore, the tax burden did not increase in 1984. To be sure, the progressive nature of the income tax scale continued to exercise an influence. Moreover, the raising of value-added tax as from the middle of 1983 for the first time took effect over a full year. However, the additional receipts resulting from the turnover tax increase were returned to the economy in two stages via other taxes with the intention of making the tax system more conducive to growth; the second stage was implemented last year, with the 1984 Tax Relief Act, which provided mainly for extended depreciation allowances and a reduction of property tax on company assets. Furthermore, the investment grant which was approved in 1982 for reasons of labour market policy reduced tax revenue by over DM 4 billion last year, after DM 1.5 billion in 1983; all told, this was more than the original estimate (DM 4 billion for the period from 1983 to 1985). Last year tax revenue was also lowered by the fact that tax advantages were granted to farmers in the context of value-added tax to make up for the income losses they sustained through the dismantling of monetary compensation between the EEC member states.

Growth of tax revenue slower than expected owing to smaller price rises and the labour disputes

There were two other reasons why tax revenue fell short of the expectations originally entertained for 1984. As the stabilisation of prices progressed more rapidly than had been hoped as late as the beginning of the year, nominal income and turnover rose somewhat less than had been expected. The direct and indirect effects of the labour disputes must also be taken into account. Nevertheless, wage tax revenue rose by 6% and thus over twice as sharply as wages and salaries (plus civil servants' pensions, which are likewise subject to wage tax). This gives little indication, however, of how the burden on wage and salary income developed. Wage tax, after all, is merely the tax deducted at source from wages and salaries; the final burden does not become evident until account has been taken of back payments or refunds, which — as far as employees liable to assessment are concerned — are reflected in the yield of assessed income tax. The refunds made to wage tax payers eligible for assessment (partly excess payments of wage tax, and partly relating to other income) grew vigorously again last year (to over DM 14 billion).This, together with the increase in disbursements of investment grants and the depreciation allowances approved as part of the 1984 Tax Relief Act, was a major reason for the renewed decline (of 6½%) in receipts of assessed income tax in 1984. Corporation tax revenue, unlike the income tax yield, grew strongly again last year (by 11%), although it too was lowered by disbursements of investment grants; this was very largely because the advance payments by many incorporated enterprises had been adjusted to the further improvement in their profitability. The rise in turnover tax receipts in 1984, at 4½%, was no faster than that in the nominal gross national product, even though the higher tax rate was for the first time in effect over the whole year. One important factor here was that parts of the national product that are liable to tax, such as private consumption and public capital formation, grew at a less than proportional rate or even stagnated, while tax-exempt elements, such as exports, went up more than proportionately. Another significant factor was the drop in receipts resulting from the above-mentioned tax advantages for farmers. As a consequence of all this, the ratio of value-added tax revenue to the nominal gross national product in 1984, at 6¼%, was not very much higher than it had been in 1982, when the tax rate had been 13% instead of 14% as at present.

Consolidation process not yet completed

Over the next few years those responsible for financial policy have set themselves the target of lowering income tax in two steps — in 1986 and 1988 — while at the same time continuing the consolidation process, i. e. reducing the deficits further by means of strict restraint in spending. The Financial Planning Council therefore recommended in the middle of last year that the growth of expenditure should be limited to 3% a year over the medium term. This target merits particular emphasis because the prospects for tax revenue have deteriorated since then. In view of the changed overall economic outlook, the Working Party on Tax Estimates, at its meeting in mid-March 1985, assessed the level of tax revenue in 1988 (the final year of the last medium-term financial plan) at DM 20.5 billion below the estimate made in the middle of last year. Containing the growth of expenditure would of course be easier if the pace of price rises could be kept low in the future, so that an expansion of 3% in spending would represent a slight increase in real terms. But a more significant factor in the success of this financial policy strategy is the extent to which effective cuts can be made in individual expenditure items in order to gain more room for urgent tasks.

Record of economic policy measures

I. Domestic and external monetary policy

1984

April 12 — The Bundesbank approves its annual accounts for 1983: DM 11.4 billion of its net profit is to be transferred to the Federal Government. It has been arranged with the Federal cabinet that the profit is to be transferred in instalments this year, for the first time: DM 5 billion is to be disbursed at once and the remainder will be paid in four monthly instalments, each of DM 1.5 billion, between May and August.

June 28 — The Bundesbank raises the banks' rediscount quotas by DM 8 billion with effect from July 6 to enable them to consolidate some of their short-term central bank borrowing. This permanent release of liquidity is accompanied by a slight increase from 4% to 4½% in the discount rate, which is thus brought somewhat closer to the lombard rate and the interest rate level in the money market.

July 12 — Following its regular review of the target in mid-year, the Bundesbank reaffirms its monetary target for 1984, which provides for an increase of between 4 and 6% in the central bank money stock (from the fourth quarter of 1983 to the fourth quarter of 1984).

September 16 — In connection with its routine review of the shares of the currencies making up the European Currency Unit (ECU) — which review is to be carried out at five-yearly intervals — the EEC Council redefines the currency composition of the ECU. In particular, the weights of the Deutsche Mark and the Netherlands guilder in the ECU basket are reduced while the weights of the French franc and the Italian lira are increased. Moreover, since Greece has joined the European Community, the Greek drachma is added to the ECU basket as well.

October 3 — The Federal cabinet decides to abolish, retroactively from August 1, 1984, the "coupon tax" levied on non-residents' interest income from domestic bonds.

December 13 — The Bundesbank sets its monetary target for 1985: the increase in the central bank money stock between the fourth quarter of 1984 and the fourth quarter of 1985 is to be kept within a range of 3 to 5%. The envisaged expansion of the money stock is gauged in such a way as to safeguard the large measure of monetary stability already achieved while providing the monetary scope for strong real growth in the economy.

1985

January 31 — The Bundesbank raises the lombard rate from 5½% to 6% with effect from February 1. By offering more transactions under repurchase agreements in securities at low interest rates the Bundesbank makes it easier for the banks to run down their lombard debt. At the same time the banks are offered, until further notice, Federal Treasury bills with very short maturities (normally 3 days) at a rate of 5½% (as from April 1: 5.3%) as a temporary investment facility to preclude an undesirable fall in the day-to-day money rate. The measures taken serve the technical refinement of money market management through open market policy instruments.

II. Economic and financial policy

1984

January 1 — Major parts of the Act Accompanying the 1984 Budget come into force. They are designed to bring relief totalling approximately DM 10 billion to the public budgets. The savings on statutory benefits of the central, regional and local authorities and social security funds amount to DM 5 billion; moreover, the receipts of the social security funds are expected to increase by DM 5 billion because special payments and sickness benefits are made subject to a greater extent to compulsory contributions.

As part of the 1984 Tax Relief Act, relief from property tax and tax on earnings becomes effective for the business community.

Finally, the Personal Assets Participation Act enters into force, by virtue of which the promotional framework for participations in productive assets is extended from DM 624 to DM 936.

February 2 — In its 1984 Annual Economic Report the Federal cabinet designates a sound budgetary policy, a tax policy that encourages performance and capital formation, and the elimination of bureaucratic obstacles as preconditions for the economic recovery developing into a period of sustained growth. It considers an increase of 2½% in the real gross national product and a decline in the unemployment rate to an average of just under 8% of the total labour force in 1984 to be attainable, and a more favourable growth rate to be quite possible. Furthermore, it assumes that the rise in consumer prices can again be limited to an average annual rate of 3%.

April 5/ June 25 — The Financial Planning Council abides by the objective of limiting the growth of public expenditure to about 3% a year over the medium term and reducing new borrowing further. It emphasises in its recommendations that any measures to assist families and modify the taxation of wages and income must be in harmony with the task of consolidating the budgets, which continues to have priority.

April 30	The Federal cabinet approves the raising from 8% to 11% of the lump-sum tax credits granted to farmers. This measure is designed to offset, in the context of value-added tax, the losses of farm income arising mainly from the dismantling of EEC monetary compensation. The lump-sum tax credit is increased to 13% by virtue of a subsequent decision. The relevant act comes into force on July 1.
July 3	The Federal cabinet approves the draft Federal budget for 1985 and the financial plan for the period until 1988. In 1985 Federal expenditure is expected to rise by only 1% over the estimate for 1984; an annual growth rate of 3% is envisaged as from 1986. The financial deficit in 1985 is estimated at just over DM 24 billion.
	At the same time the Federal cabinet takes a decision of principle on tax cuts and family relief measures in two stages in 1986 and 1988, with a total volume of DM 20 billion. Owing to the consequent budgetary burdens, the Federal deficit in 1988 (the final year of the financial plan), at DM 23 billion, can be only a little smaller than in 1985.
October 3	The Federal cabinet approves the draft of a supplementary Federal budget for 1984, with a volume of DM 650 million, to finance the German contribution to the supplementary budget of the European Communities. The additional expenditure is offset by economies.
November 6	The Federal Constitutional Court declares the Investment Assistance Act, by virtue of which the recipients of higher incomes and corporations were to pay a refundable, non-interest-bearing levy in the years from 1983 to 1985, to be incompatible with the Basic Law (Constitution). The greater part of the amounts already received is refunded to taxpayers before the end of 1984.
November 7	The Federal cabinet approves a bill on tax relief for passenger cars with low-pollutant emissions.
November 20	In its Report for 1984–85 the German Council of Economic Experts notes that the upswing has stabilised again, after having been considered to be in jeopardy in many quarters during the industrial disputes. The main stimulus to economic activity in 1984 came from exports, the sharp increase in which was primarily due to the world-wide expansion of business and the improved competitiveness of German products in price terms. The propensity to invest grew further during the year. In 1985 the Council of Experts is expecting a higher growth rate than in 1984, and it estimates that overall production will rise by over 3% on an annual average. The expansion of economic activity will be fuelled mainly by investment in machinery and equipment. The reasons for this, in the view of the Council of Experts, are the distinct improvement in earnings, the favourable course of export business, the higher degree of capacity utilisation and the growing readiness to modernise.
November 23	The Financial Planning Council notes that the consolidation of public budgets has made further progress at all levels of government. As the overall public sector deficit is still too high, however, the financial policy course pursued so far is to be continued. To reduce new borrowing further, the growth of government expenditure in 1985 over the prospective out-turn for 1984 is to be limited to 3%.
November 30	The Bundestag approves the 1985 Federal budget, with an expenditure volume of just over DM 259 billion (+1% over the amount envisaged for 1984) and a financial deficit of DM 25.5 billion. As compared with the draft, a shortfall of DM 4 billion in tax revenue has been taken into account, but this has for the most part been offset by spending cuts and by raising the figure for profit transfers from the Bundesbank by DM 2 billion to DM 12.5 billion.
December 18	The Federal cabinet approves a "Bill for Performance-Promoting Tax Cuts and for Bringing Relief to Families" incorporating the features of the decision of principle taken at the beginning of July. The relief granted to taxpayers will amount to approximately DM 20 billion as a result of the improvement in the tax equalisation of family burdens (or higher children's benefits), the raising of the basic tax allowance and the levelling-off of the tax progression (in two steps in 1986 and 1988).
1985	
January 30	In its 1985 Annual Economic Report the Federal cabinet ascribes the upswing inter alia to the reorientation of economic policy towards market principles, which it had initiated. It also emphasises the fact that the degree of price stability already reached helps to guarantee future economic growth. For 1985 the Federal cabinet considers an increase of 2½% or more in the real gross national product and a decline in the unemployment rate to below 8% of the total labour force on an annual average to be within reach. In its opinion the average annual rise in consumer prices could be limited to about 2%.
March 21	The Environment Ministers of the European Communities agree on the introduction of cars with low-pollutant emissions in the EEC. As from 1988 more stringent exhaust emission standards (conforming to those in the United States) are to come into force for cars with larger engine capacities, i.e. over 2,000 cc. Cars with smaller engine capacities are to be allowed longer periods for conversion; for small cars (i.e. under 1,400 cc) these may in certain circumstances be extended until 1994.
	On April 1, 1985 the petroleum tax on lead-free petrol in the Federal Republic of Germany is lowered by 2 Pfennige per litre, whereas that on petrol containing lead is increased by 2 Pfennige to 53 Pfennige per litre.
March 26	The Federal cabinet approves inter alia a bill reorganising the tax promotion of owner-occupied dwellings. It is to enter into effect at the beginning of 1987.
March 28	The Financial Planning Council recommends that the annual volume of new borrowing should be reduced in the future, too, and that the rise in the public authorities' expenditure should be limited to 3% a year on average. The consolidation must concentrate, as hitherto, on consumption expenditure, while the measures fostering growth and employment should be intensified further.

Social security funds not yet financially stable

In the field of social security, the efforts to bring about financial stabilisation have not yet had the desired success. Considered as a whole, the financial situation of the social security funds — in contrast to that of the central, regional and local authorities — actually deteriorated last year, even though additional receipts accrued to them as a result of the extended inclusion of special payments and sickness benefits in the obligation to pay contributions, and despite further statutory interventions in benefits. Expenditure in this sector of the public budgets ultimately grew by 4½ % — i. e. significantly more than the spending of the central, regional and local authorities — and the deficits rose to DM 3 billion (after DM 1 billion in 1983). Trends diverged widely, however, in the various sectors of social security.

Budgetary situation of the Federal Labour Office better, but that of the statutory health insurance institutions much worse

The finances of the Federal Labour Office improved last year — more so, indeed, than had been expected according to the budgets. Although unemployment continued to run at a high level, the Federal Labour Office recorded a surplus of just over DM 3 billion in 1984, whereas a year before it had required liquidity assistance from the Federal Government. An important factor in this context was the sharp decline in spending on short-time-working benefits as economic activity picked up, plus the fact that more and more beneficiaries were exceeding the maximum period for the payment of unemployment benefits; as a proportion of the total number of jobless, the number of recipients of unemployment benefits dropped from 44½ % to 37½ % in 1984. The opposite trend was apparent, however, in the finances of the statutory health insurance institutions. After restraint had been shown for a while in spending, total expenditure in 1984 was 8 % higher than a year before. The sizable surplus recorded in 1983 gave way to a deficit of DM 3 billion last year.

Deficits of the pension insurance funds still substantial

Finally, the statutory pension insurance funds (the largest sector of social security) failed to overcome their financial problems last year. Their deficits in 1984, at DM 4.5 billion, were little smaller than they had been a year previously, and by the end of the year their financial reserves had fallen below the statutory minimum of one month's expenditure. The pension insurance funds' financial position was admittedly eased by the extended inclusion of special payments in the contribution obligation, by the adjustment of pensions with a shorter time-lag (for the first time), and by the raising of pensioners' own contributions to their health insurance. However, the income underlying the assessment of contributions grew less sharply than had been assumed. Moreover, the refunds of contributions required under the Act to Promote the Willingness of Foreign Workers to Return to their Home Countries were much higher than had been expected. In February 1985 it became apparent that the raising of the contribution rate by 0.2 percentage point to 18.7 % as from the beginning of that year (while the contribution rate to the Federal Labour Office was lowered by 0.2 percentage point at the same time), along with the further increase in pensioners' own contributions to their health insurance scheduled for the middle of 1985, would not suffice to stabilise the finances of the pension insurance funds. The coalition parties therefore agreed to raise the contribution rate temporarily by another 0.5 percentage point from June 1, 1985 to the end of 1986. Moreover, the Federal Government is to make an additional grant (not exceeding DM 1.5 billion) at the end of 1985 in order to bring the reserves up to the level of one month's ependiture and, finally, pensioners' own contributions to their health insurance are to be increased further by 0.7 percentage point in mid-1986 and again in mid-1987 (to 5.9 % of their pension). At the same time, however, another reduction of 0.3 percentage point in the contribution rate to the Federal Labour Office is envisaged for June 1, 1985. Nevertheless, the net outcome remains a heavier burden on insured persons and their employers. It is therefore all the more important to preclude a further raising of the contribution rates to the statutory health insurance institutions by restraining the expansion of expenditure in this sector, because rising social security contributions signify a setback in the efforts to limit the burden of taxes and other levies. Such rises run counter to the planned cuts in taxes; in some cases they may even neutralise them. But the envisaged tax reform is designed to ease the tax burden on wage and salary earners somewhat and to increase the incentives to step up economic performance.

3. Improvement in Germany's basic external position

Large surplus on current account in spite of sharp exchange-rate-induced rises in import prices

The current account of the German balance of payments improved in 1984. Although the strength of the dollar and the resulting exchange-rate-induced rises in import prices imposed considerable burdens on Germany, which is greatly dependent on imports of raw materials and energy, the surplus on current account went up by DM 7 billion compared with the preceding year to close on DM 18 billion. This is in contrast to the normal reaction of the current account in a country whose currency is depreciating, since the rise in import prices usually affects the current account more quickly than the increase in exports due to the improvement in competitiveness brought about by exchange rate movements. Nevertheless, the change in the exchange rate also had an adverse effect on current transactions. The terms of trade became less favourable in 1984, as the rise in import prices, at 6%, was much steeper than that in export prices, which went up by 3½%. A deterioration of the terms of trade by 2½%, taken by itself, corresponds to a consequent reduction of roughly ½% in the real income of the economy. The increase in the current account surplus was mainly due to the sharp growth in exports, which caused the trade surplus – on an f.o.b. basis[1] – to rise by DM 13 billion to DM 66.5 billion.

Strong growth of exports, which will probably continue in 1985

Germany's exports grew by 13% in value and more than 9% in volume in the whole of 1984, in spite of the production and export losses due to the labour disputes in the second quarter of 1984, which could be made up for only in part later on. The basis for this growth was the strong economic expansion abroad, particularly in the United States, which resulted in an increase in world trade by 9% in real terms. The fact that Germany was able to profit fully from this, and even increased its shares in its particular export markets still further, certainly also owed something to the improved price competitiveness of German exporters (see p. 5). The influx of orders from abroad, which has recently been brisk, underlines the fact that German exporters continued to benefit from the expansion of world trade, which will probably continue in 1985, though the trends will differ in individual regions.

Sharp increase in German exports to the United States, and also to other important regions

German exports to the countries of the "dollar area" rose particularly steeply in 1984. Exports to the United States showed a year-on-year increase in value of 42½%; the United States thus moved up behind France to become Germany's second biggest customer. But exports to Canada (+39%) and Japan (+23½%) also grew exceptionally strongly, not least no doubt because the Deutsche Mark depreciated against the currencies of these countries too in 1984. Germany's exports to the industrial countries of western Europe expanded somewhat less sharply, but they also showed considerable momentum. Substantial growth rates were achieved, in particular, in exports to Italy and Denmark (in each case +17%), Switzerland and Sweden (in each case +15%), the United Kingdom (+14½%) and the Netherlands (+11½%). It is also noteworthy that the sales of German products to developing countries (other than OPEC nations) increased substantially again in 1984, after these countries had shown considerable restraint in their purchases of imports in the

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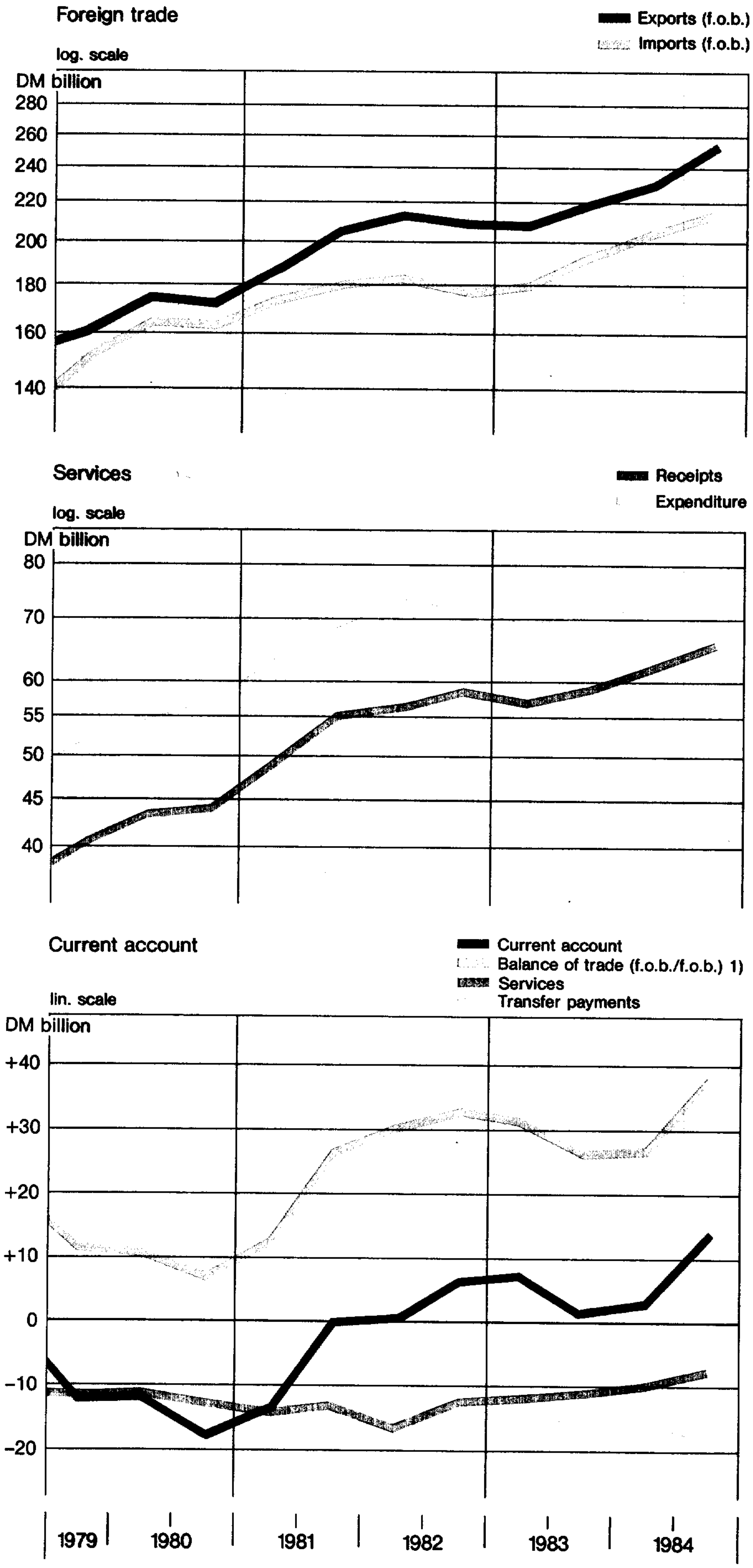
1 In contrast to the official German foreign trade statistics, both exports and imports are recorded here at their value at the border of the foreign exporting country (f.o.b. value), in accordance with international balance of payments practice. The transport and insurance costs payable on imports are included in services transactions, so that the balance on current account is not affected by this "transfer". On an f.o.b./c.i.f. basis, i. e. in accordance with the official foreign trade statistics, the export surplus, which is lower for methodological reasons, went up from DM 42.1 billion (1983) to DM 54.0 billion in 1984.

Foreign trade and current account

half-yearly, seasonally adjusted



1) Including balance of supplementary trade items and balance of merchanting trade.

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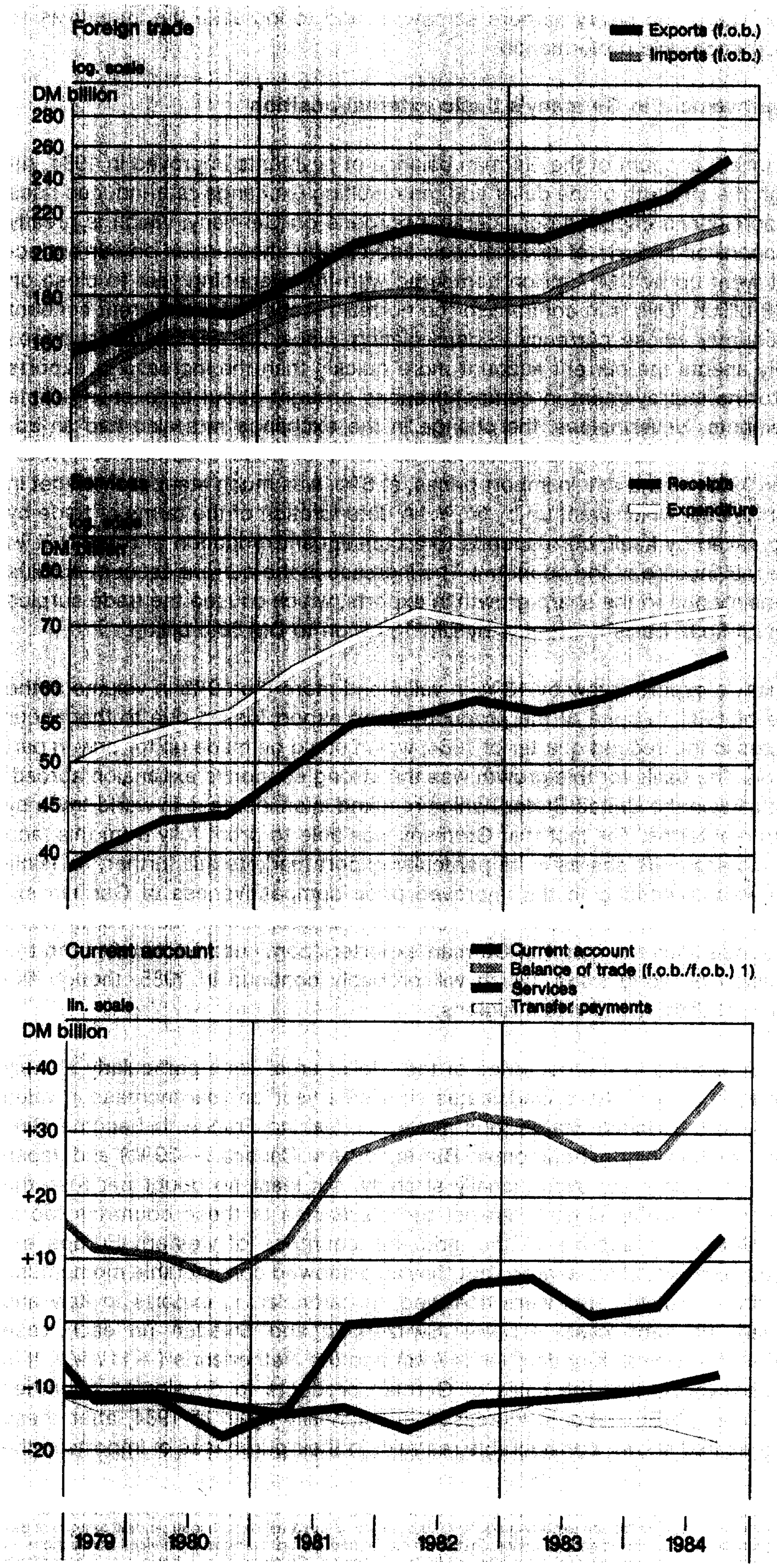


1) Including balance of supplementary trade items and balance of merchanting trade.

two preceding years because of their foreign debts, which in some cases were large. Exports to the "threshold countries" of East Asia especially, where growth is particularly marked, and to the countries of Latin America went up by 18½ % and 17½ %, respectively; these increases were well above the average. In a number of smaller centrally planned economies, like Poland or Hungary, exports also went up distinctly. Only Germany's exports to the OPEC countries were on a very modest scale, owing to the balance of payments problems of this area; they declined in value by 11½ %. Consequently, the importance of this group of countries as recipients of German exports continued to wane; its share in Germany's overall exports shrank to 5½ % in 1984 against 9 % in 1982, but, of course, only 3 % before the first oil price hike in 1973. The regional structure of Germany's exports shows that the substantial growth of foreign sales in 1984 was quite broadly based. The rapid expansion of exports to countries against whose currency the Deutsche Mark has depreciated sharply is, however, a success which can by no means be considered assured over the long term. Since the U.S. balance of trade, in particular, has started to show an exceptionally large deficit in the meantime, the question arises as to how this disequilibrium will be corrected in the longer run. If administrative restrictions are not contemplated, as is to be hoped, the slackening of domestic demand, on the one hand, and a depreciation of the dollar, on the other, should bring about corrections. Particularly in those economic sectors whose competitive position is very strongly influenced by the movement of the Deutsche Mark vis-à-vis the U.S. dollar, it would presumably be risky if investment plans failed to take account of these special features.

Appreciable rise in the value of imports, but considerable increase in their cost

In 1984 Germany's imports also went up substantially (viz. by 11½ % in terms of value), even though this rise was smaller than that of exports. Moreover, slightly more than half of the nominal growth of imports was accounted for by the increase in import prices. The cost of imports, as measured by unit values, went up by 6 % in 1984 against the preceding year. In terms of volume, imports were 5 % up on 1983; they thus rose twice as sharply as real GNP. For one thing, raw materials and primary products (excluding energy) were imported on a larger scale (in real terms: + 6½ %) in connection with the expansion of domestic output. For another, imports of finished products also increased relatively strongly (by 7½ % in volume). Either the competitiveness of numerous non-resident suppliers did not worsen appreciably, in spite of the decline in the external value of the Deutsche Mark, or exporters in partner countries, when fixing their prices, did their utmost to hold on to their market share in Germany, even if their profits were thereby reduced.

Growth of German imports greatly stimulates demand in partner countries

In regional terms, imports from Japan (+23½ %) and the developing countries of eastern Asia (+16 %) rose particularly sharply. The comparative advantages of these countries on the German market are apparently still considerable, in spite of the (real) Deutsche Mark depreciation. It is also remarkable that imports from Latin America showed a year-on-year growth of 15 % in 1984. The German market thus proved itself to be fairly receptive for products from this region, thus facilitating the undeferrable adjustment of the trade balances of the heavily indebted countries. Imports from a number of western European partner countries, e.g. the United Kingdom (+22½ %), Sweden (+18 %), Switzerland (+12 %), the Netherlands (+10 %), Austria (+9 %) and Italy (+8 %) also rose sharply, so that the increased demand in Germany stimulated economic activity appreciably in this region.

Overall deficit on "invisibles" remains unchanged, but major shifts occur in the individual balances

In the case of "invisible" external transactions, there were on the whole no additional burdens on Germany's current account in 1984 — in contrast to earlier years of economic upswing. The traditional deficits on services and transfer payments accounts (including expenditure on the transport and insurance of imports), which totalled DM 48 billion in 1984, were almost as large as in the

Regional breakdown of foreign trade in 1984

Exports (f.o.b.) by country of destination
Imports (c.i.f.) by country of origin

Group of countries/ Country	Exports DM billion	Exports Change from previous year in %	Imports DM billion	Imports Change from previous year in %	Foreign trade balance in DM billion
Industrialised western countries	395.7	+16.0	337.8	+10.9	+58.0
of which					
EEC member countries	232.8	+12.1	208.0	+ 8.7	+24.8
of which					
France 1	53.9	+ 6.1	39.4	+ 4.0	+14.6
Italy	37.7	+17.4	34.2	+ 8.2	+ 3.5
Netherlands	42.1	+11.3	53.0	+10.2	−10.9
United Kingdom	40.6	+14.6	33.3	+22.7	+ 7.3
United States	46.8	+42.6	31.1	+12.2	+15.7
Japan	6.9	+23.5	18.3	+23.5	−11.4
Centrally planned economies	23.3	+ 3.2	26.4	+19.3	− 3.1
of which					
USSR	10.8	− 4.3	14.4	+22.1	− 3.6
OPEC countries	27.9	−11.5	27.3	+ 0.0	+ 0.7
Developing countries 2	39.7	+11.6	42.5	+18.8	− 2.8
of which					
East Asian countries	10.6	+18.3	15.8	+16.2	− 5.2
Latin American countries	10.8	+17.6	13.3	+14.8	− 2.5
All countries	488.2	+12.9	434.3	+11.3	+54.0

1 Excluding aircraft. — **2** Excluding OPEC countries.
Discrepancies in the totals are due to rounding.

preceding year. However, the deficit on transfer payments account went up by DM 4.5 billion to DM 31.5 billion, mainly because Germany's net payments to the European Communities rose strongly and foreign workers who returned to their home countries availed themselves of return allowances from the government and were refunded their pension insurance contributions — in connection with the promotion of the willingness of foreign workers to return to their home countries. But at the same time the deficit on services account declined again (by just over DM 5 billion to DM 16.5 billion). This seems to have been mainly due to the high dollar rate. The Deutsche Mark equivalent of the dollar amounts exchanged by U.S. troops stationed in Germany, which was larger as a result of the strength of the U.S. dollar, led not to a reduction in expenditure in dollars but to an increase in expenditure in Deutsche Mark. The surplus on Germany's investment income account also went up more sharply owing to the depreciation of the Deutsche Mark; interest and dividends received in U.S. dollars, which either remained unchanged or rose in some cases, were reflected in a sharp increase in Deutsche Mark equivalents, while on the other hand the interest paid to foreign countries was hardly affected by the rise in the dollar rate since Germany's external liabilities are for the most part denominated in Deutsche Mark. Finally, more American tourists visited Germany because of the favourable dollar rate and also spent more money here. As a result, Germany's deficit on travel account fell from a good DM 24.5 billion in 1983 to DM 24 billion in 1984 — in spite of a slight increase in the expenditure of Germans travelling abroad.

Strength of the current account not duly reflected in the foreign exchange market

Judging from the experience of earlier years, the rise in the current account surplus might have been expected to have positive effects on the external value of the Deutsche Mark, particularly as other "fundamentals" — e.g. the high degree of price stability, the moderate pace of monetary expansion, the improved financial position of Germany's enterprises and public authorities — all favoured the Deutsche Mark in international comparisons. The fact that the

Deutsche Mark was only just able to hold its own against the other currencies during 1984, and lost more ground vis-à-vis the U.S. dollar in spite of these favourable trends, was mainly attributable to the increasing attractiveness of dollar assets to German and international investors. This was mirrored inter alia by the increasing tendency to export capital from Germany and weaker foreign demand for Deutsche Mark assets. Foreign exchange flowed into Germany on a considerable scale from current transactions with the rest of the world; however, these inflows were accompanied by similar amounts of "autonomous" capital exports, i.e. from transactions which — like direct investment, development aid and trade credits — are affected only marginally by interest rate and exchange rate movements. In addition, there were other outflows of funds from Germany where interest rate and exchange rate considerations were far more important.

Strong growth of long-term investment abroad

Long-term capital exports from Germany reached a new peak in 1984, at close on DM 39 billion, after very considerable sums (roughly DM 37 billion) had flowed out in the preceding year. These large outflows of capital, which were tending to increase, continued at the beginning of 1985. The massive exports of capital last year were mainly attributable to security transactions by residents. Thus in 1984 alone German investors bought DM 14 billion (net) of foreign currency bonds issued by non-residents. As in previous years, the U.S. dollar and the Canadian dollar were the preferred currencies of investment; obviously, German investors saw in the interest rate advantage of dollar bonds (approximately 4½ % on a yearly average) more than adequate compensation for the exchange rate risk. Moreover, at close on DM 2 billion, more funds were exported in 1984 than in the previous year through purchases of foreign Deutsche Mark bonds by residents.

Persistently high direct investment

In contrast to security transactions, the outflows of funds in the other sectors of long-term capital exports remained on the same scale as in 1983. At close on DM 9 billion, German enterprises invested slightly more in foreign subsidiaries and operating plants than in 1983 (just over DM 8 billion). In this connection it is noteworthy that the importance of the United States as a country of investment waned distinctly, although it still headed the list of countries for direct investment. The rise in the dollar made the purchase and extension of American branches much more expensive; but it was probably more significant that at the same time it became easier to serve the American market from Germany. The banks exported capital on a relatively modest scale in 1984, in comparison with earlier years; their long-term external assets rose by only DM 7 billion. The main reason for this was that the banks continued to exercise restraint with regard to long-term lending to developing countries and centrally planned economies. Long-term official external assets — mainly bilateral and multilateral development aid loans and claims of enterprises and banks which were taken over by the Federal Government under export guarantees — did not grow particularly strongly, at DM 5.5 billion.

Lower imports of long-term capital and shifts in non-residents' Deutsche Mark assets

As the outflows of long-term funds rose in 1984, the corresponding private and official capital imports fell, viz. by DM 4 billion against the previous year to just over DM 25 billion. At the beginning of 1985 too, inflows of long-term capital were tending to lag behind exports of capital. The sizable interest rate advantage of the U.S. dollar, the temporary uncertainty caused by the labour disputes in Germany and the abolition of the U.S. withholding tax on interest payments to non-residents for a time adversely affected the competitive position of the Deutsche Mark as an international investment currency in several respects. Towards year's end, however, when Germany realised its intention of abolishing the 25% withholding tax on interest income from foreign-owned domestic bonds, non-residents again showed greater interest in Deutsche Mark assets. In this connection there were substantial shifts in the Deutsche Mark assets of

Major items of the balance of payments

DM billion

Item	1977	1978	1979	1980	1981	1982	1983	1984
A. Current account								
1. Foreign trade								
Exports (f.o.b.) 1	273.6	284.9	314.5	350.3	396.9	427.7	432.3	488.2
Imports (f.o.b.) 1	227.7	235.8	282.7	331.4	357.3	365.2	378.5	421.5
Balance	+45.9	+49.2	+31.8	+18.9	+39.6	+62.6	+53.8	+66.7
2. Supplementary trade items 2 and merchanting trade	+ 0.0	+ 2.1	+ 0.2	− 0.0	+ 1.0	+ 2.2	+ 5.6	− 0.7
Balance of trade	+46.0	+51.2	+32.0	+18.9	+40.6	+64.7	+59.4	+66.0
3. Services								
Receipts	64.1	71.6	77.7	88.1	105.8	116.1	117.2	128.9
Expenditure	82.4	86.9	99.5	111.1	132.2	144.5	139.1	145.6
Balance	−18.2	−15.3	−21.9	−23.0	−26.4	−28.4	−21.9	−16.7
4. Transfer payments	−18.2	−17.8	−21.2	−24.5	−26.6	−28.1	−27.0	−31.5
of which								
Remittances of foreign workers	− 6.1	− 6.3	− 7.0	− 7.5	− 7.7	− 7.6	− 7.5	− 7.9
Transfers to the European Communities (net)	− 3.5	− 1.9	− 4.0	− 4.5	− 6.5	− 7.5	− 6.1	− 7.4
Balance on current account	+ 9.5	+18.1	−11.1	−28.6	−12.4	+ 8.2	+10.5	+17.7
B. Capital account								
1. Long-term capital transactions								
(a) German investment abroad (increase: −)	−23.1	−24.1	−20.9	−28.8	−27.6	−28.1	−36.7	−38.8
of which								
Direct investment	− 5.1	− 7.2	− 8.2	− 7.4	− 8.8	− 6.0	− 8.1	− 8.8
Advances and loans of enterprises	− 0.3	− 0.2	− 1.0	− 0.6	− 0.8	− 1.1	− 0.6	− 1.5
Portfolio investment	− 5.4	− 4.2	− 3.0	− 7.7	− 6.0	−11.4	−10.4	−14.9
Advances and loans of banks	− 9.6	− 8.5	− 5.4	− 9.4	− 5.3	− 3.7	− 8.4	− 6.9
Official	− 2.1	− 3.3	− 2.4	− 2.3	− 4.9	− 4.4	− 7.1	− 5.5
(b) Foreign investment in Germany (increase: +)	+10.5	+21.3	+33.1	+34.5	+35.9	+13.9	+29.3	+25.3
of which								
Direct investment	+ 2.2	+ 3.3	+ 3.2	+ 0.8	+ 0.8	+ 2.0	+ 4.1	+ 3.0
Advances and loans to enterprises	+ 0.5	+ 0.2	+ 0.4	+ 1.4	+ 4.2	+ 3.9	+ 1.1	− 0.8
Portfolio investment in securities and in official borrowers' notes	+ 2.1	+ 2.6	+ 6.0	+23.4	+23.3	+12.2	+25.5	+21.8
Securities	+ 2.3	+ 3.2	+ 5.9	+ 0.9	+ 1.0	+ 2.8	+13.6	+17.5
Official borrowers' notes	− 0.2	− 0.6	+ 0.2	+22.5	+22.3	+ 9.4	+11.9	+ 4.3
Advances and loans to banks	+ 5.0	+14.8	+22.8	+ 8.5	+ 7.0	− 3.9	− 1.6	+ 1.5
Official 3	+ 0.7	+ 0.6	+ 0.7	+ 0.6	+ 0.7	− 0.2	+ 0.3	− 0.2
Balance of long-term capital transactions	−12.6	− 2.8	+12.2	+ 5.7	+ 8.3	−14.2	− 7.4	−13.5
2. Short-term capital transactions (net capital exports: −)								
(a) Enterprises and individuals	+ 4.6	− 2.9	− 5.3	+ 7.6	+ 8.2	+ 1.5	− 7.2	−14.7
Financial credits	+ 8.5	+ 1.0	− 3.7	+13.3	+13.0	+ 3.6	− 1.0	− 5.6
Trade credits	− 3.9	− 3.9	− 1.7	− 5.7	− 4.8	− 2.1	− 6.3	− 9.1
(b) Official	− 0.0	+ 1.2	− 0.3	− 0.4	+ 2.8	+ 0.7	− 3.3	− 1.4
(c) Banks	+ 8.1	+10.1	+ 4.1	− 8.9	−10.3	+ 8.1	+ 1.8	+ 0.1
Assets	+ 1.2	− 2.2	− 1.7	− 7.1	−11.2	+ 4.3	+ 5.3	−17.7
Liabilities	+ 6.9	+12.3	+ 5.8	− 1.8	+ 0.9	+ 3.8	− 3.6	+17.8
Balance of short-term capital transactions	+12.6	+ 8.4	− 1.5	− 1.6	+ 0.7	+10.3	− 8.7	−16.0
Balance on capital account	+ 0.0	+ 5.6	+10.7	+ 4.1	+ 9.0	− 3.9	−16.1	−29.5
C. Balance of unclassifiable transactions (balancing item)	+ 0.9	− 3.9	− 4.5	− 3.4	+ 1.1	− 1.2	+ 1.5	+ 8.7
D. Balancing item for the external position of the Bundesbank 4	− 7.9	− 7.6	− 2.3	+ 2.2	+ 3.6	− 0.4	+ 2.4	+ 2.1
E. Change in the net external assets of the Bundesbank (increase: +) (A plus B plus C plus D)	+ 2.6	+12.2	− 7.3	−25.7	+ 1.3	+ 2.7	− 1.6	− 1.0

1 Special trade. — 2 Mainly warehouse transactions for account of residents and deduction of goods returned and of commission processing. — 3 Excluding borrowers' notes. — 4 Counterpart of changes in the Bundesbank's external position which are not caused by external current and capital transactions: mainly the allocation of IMF special drawing rights and changes in the Deutsche Mark value of the external position of the Bundesbank owing to valuation adjustments; as from 1982 also the differences between the transaction values and the changes in the external position shown in the Weekly Return at balance sheet rates.
Discrepancies in the totals are due to rounding.

international investors. Thus non-residents purchased German fixed interest securities worth just over DM 9 billion in the fourth quarter of 1984, and in January and February 1985 purchases were also fairly large (at almost DM 4 billion). At the same time, however, non-residents acquired hardly any official borrowers' notes — which had previously been exempt from coupon tax but, of course, were less fungible. Since the beginning of 1985 there have even been net outflows of funds through transactions in such borrowers' notes (nearly DM 2 billion in January/February).

Little change in other imports of long-term capital

There were no major changes in the other sectors of long-term capital imports in 1984. Foreign direct investment in Germany, at DM 3.0 billion, was DM 1 billion lower than in 1983. But the main reason for this decline was that, in view of their improved profitability, foreign-owned German enterprises repaid advances which had been granted to them by their non-resident parent companies. In comparison with the situation in even earlier years — say, in the sixties, when the Deutsche Mark was also very cheap, particularly for U.S. investors — the inflow of funds through foreign direct investment in 1984 was, however, fairly small.

Substantial outflows of funds in short-term capital transactions

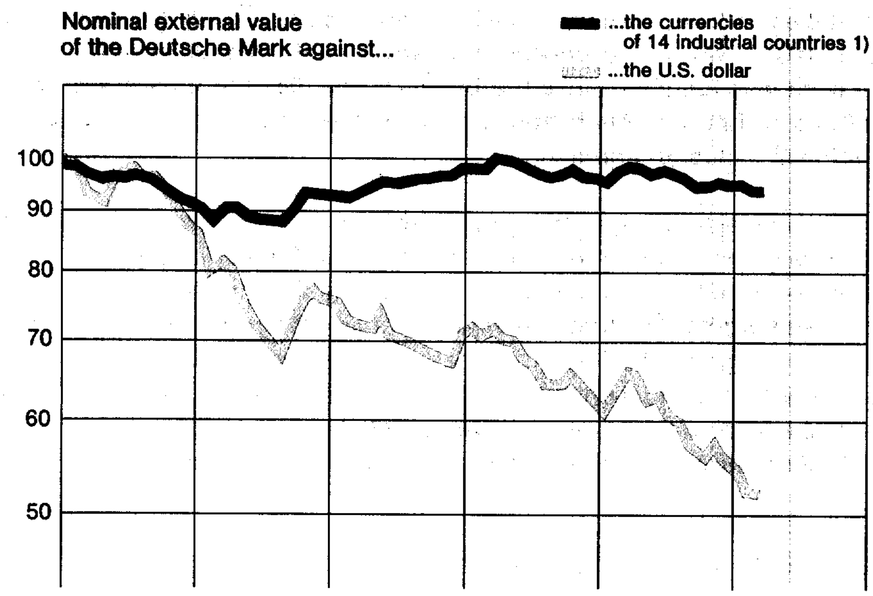
In addition to the increased exports of long-term capital, the substantial outflows of funds in short-term capital transactions, in particular, reflected the tendency of the Deutsche Mark to weaken against the dollar; at the same time they were themselves one of the elements which supported this exchange rate trend. In sum, statistically recorded net exports of short-term funds amounted to DM 16 billion in 1984, compared with only DM 9 billion in the previous year, when the exchange rate trend was more favourable. Firstly, the outstanding export claims of enterprises went up by roughly DM 12.5 billion in 1984, while their import liabilities rose by only DM 3.5 billion. The strong growth of exports and an exchange-rate-induced shift in the terms of payment to the detriment of Germany's foreign trade seem to have played a part in this. Non-residents appear to have delayed the settlement of German export claims because of the weakness of the Deutsche Mark, while residents endeavoured to pay those of their import liabilities which were denominated in foreign currencies relatively quickly. Secondly, financial credits of enterprises led to outflows of funds totalling DM 5.5 billion net as enterprises increased substantially their short-term balances abroad, particularly their Deutsche Mark deposits with foreign banks. Banks' short-term external assets also rose very sharply in 1984, i.e. by close on DM 18 billion; however, their corresponding external liabilities grew equally strongly, so that inflows and outflows of funds in this sector virtually cancelled out. This expansion of the external position was very largely ascribable to foreign currency transactions, which in the balance of payments are akin to a self-balancing item.

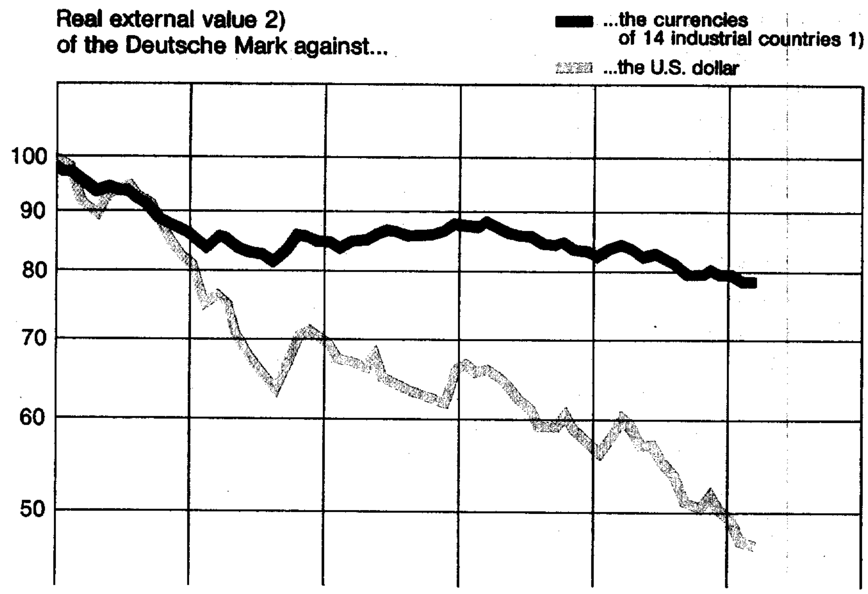
Deutsche Mark/dollar rate under pressure owing to outflows of capital

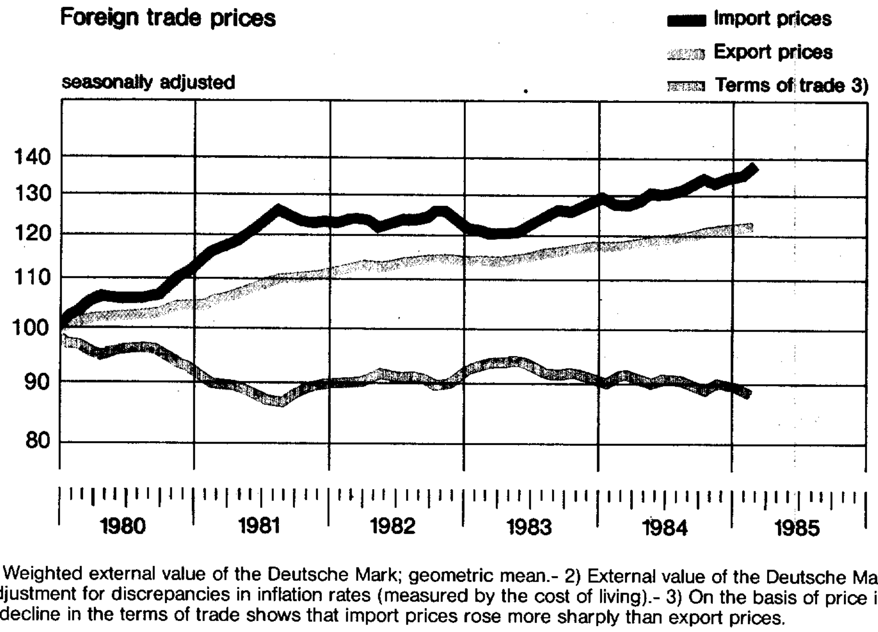
As has been indicated on several occasions, there was a correlation between the large outflows of short-term and long-term funds from Germany and the weakness of the Deutsche Mark. Firstly, the movements of capital were a reflection of the exchange rate trend; secondly, with the increasing supply of Deutsche Mark on the foreign exchange markets, they stepped up the pressure on the German currency. Naturally, exchange rates are determined by many more factors than can be deduced from such statistical variables; for instance, longer-term expectations about the countries' economic strength, political conditions and tax considerations all play a part, as do short-term elements, news items and rumours. However, in economic calculations it was no doubt most significant that the interest rate differential between the low-interest-bearing Deutsche Mark and the higher-yielding U.S. dollar was no longer adequately offset by an expectation that the Deutsche Mark would appreciate; indeed, even when the interest rate differential narrowed at the end of 1984 and the beginning of 1985, this expectation had become so slight that the Deutsche

External value of the Deutsche Mark and foreign trade prices

December 1979=100; log. scale, monthly







1) Weighted external value of the Deutsche Mark; geometric mean.- 2) External value of the Deutsche Mark after adjustment for discrepancies in inflation rates (measured by the cost of living).- 3) On the basis of price indices; a decline in the terms of trade shows that import prices rose more sharply than export prices.

Mark rate continued to fall. After the Deutsche Mark had distinctly gained ground at the beginning of 1984 — the dollar reached its low for the year, at DM 2.54, at the beginning of March — the dollar rate rose to DM 3.15 by year's end. Thus the Deutsche Mark depreciated by 13½ % vis-à-vis the dollar during the year. At the beginning of 1985 the exchange rate developed relatively smoothly at first at what was already a very high level. But early in February, when expectations that interest rates in the United States would remain high strengthened, a new, self-reinforcing upward movement began which pushed the dollar at the peak up to a rate of DM 3.47. In view of these extreme fluctuations the Bundesbank, together with other central banks, intervened in the market with substantial amounts at the end of February; this might have contributed to a growing awareness among market participants of the high exchange rate risk attached to dollar positions, so that the dollar depreciated markedly, the rate recently standing at DM 3.15.

Relatively stable exchange rate trend of the Deutsche Mark in the EMS . . .

By contrast, the Deutsche Mark largely held its own against the currencies participating in the European Monetary System (EMS) in 1984. It is true that the turnaround on the Deutsche Mark/dollar market in March 1984 also affected the position of the Deutsche Mark in the EMS; since then it has declined again in the EMS against individual partner currencies, after having been at the top edge of the exchange rate band at the beginning of the year. On the whole, however, the Deutsche Mark remained relatively stable against the average of the EMS currencies, and at the end of 1984 it was still standing at the level it had reached a year before. But the stability of the external value of the Deutsche Mark in the EMS probably also owed something to purchases of Deutsche Mark by the partner central banks, which had at times been fairly substantial. It was not until the dollar rate declined in March this year that the Deutsche Mark again strengthened autonomously somewhat against the EMS currencies.

. . . and vis-à-vis major "third currencies"

The Deutsche Mark also continued to be relatively stable in relation to major "third currencies" during 1984. In sum, i. e. against the average of the currencies of 14 industrial countries, its value at end-1984 was almost 2 % lower than a year before, but by the end of March 1985 it had made good some of the ground it had lost. In real terms, however — i. e. after taking account of the more stable price trends in Germany — the Deutsche Mark has depreciated by roughly 5 % since the beginning of 1984. In the same period its real depreciation vis-à-vis the U.S. dollar has come to approximately 18 %.

Overall monetary reserves virtually unchanged, in spite of some substantial dollar sales

On balance, the Bundesbank's net external assets remained virtually unchanged in 1984; valued at current balance sheet rates, they amounted to DM 68.9 billion at the end of the year; this was roughly DM 1 billion less than at the beginning of 1984. During the year, however — in accordance with the situation on the foreign exchange market at the time — the monetary reserves were subject to considerable fluctuations. Thus obligatory purchases in support of an EMS currency led to substantial inflows of funds in the spring of 1984, when the dollar temporarily weakened. However, after the exchange rate trend had reversed in March/April to the detriment of the Deutsche Mark, outflows of reserves predominated. In particular, the Bundesbank put more dollars on the market. Of course, the dollars sold were in the final analysis amounts which the Bundesbank had received from sources outside the market, i. e. mainly interest income from external assets and dollars bought from foreign troops stationed in Germany. As a result, the dollar holdings at the end of 1984 were virtually as high as they had been at the beginning of the year. In view of the exchange rate trend it would not have been warranted to use the "autonomous" inflows of foreign exchange to the Bundesbank to boost the reserves and thus to strengthen the dollar rate still further. However, current foreign exchange receipts were, and are, not resold immediately in every instance; instead, the current situation on the foreign exchange market is taken into account in each case. Such a reserve policy by no means excludes more substantial, "pre-financed" dollar sales in the case of excessive exchange rate movements motivated by speculation, as was made clear by the internationally coordinated measures taken in September 1984 and most recently at the end of February 1985.

4. The Bundesbank remains on its stabilisation course

(a) Implementing the 1984 monetary target — setting the target for 1985

1984 monetary target set without any economic policy "provisos"

For 1984 the Bundesbank set itself the task of safeguarding the stability gains already achieved, and if possible enhancing them in the wake of the progressive revival of domestic economic activity, so as to further improve the outlook for steady economic growth. It made these intentions clear by means of its 1984 monetary target, which, assuming that the inflation rate would fall, was geared to the estimated rise in the nominal production potential. According to the target set, the increase in the central bank money stock between the fourth quarter of 1983 and the fourth quarter of 1984 was to be kept within a range of 4% to 6%. As the uncertainties about underlying conditions seemed to be less significant than in previous years, the Bundesbank was able to narrow its target corridor to 2 percentage points in 1984 as against 3 percentage points hitherto.

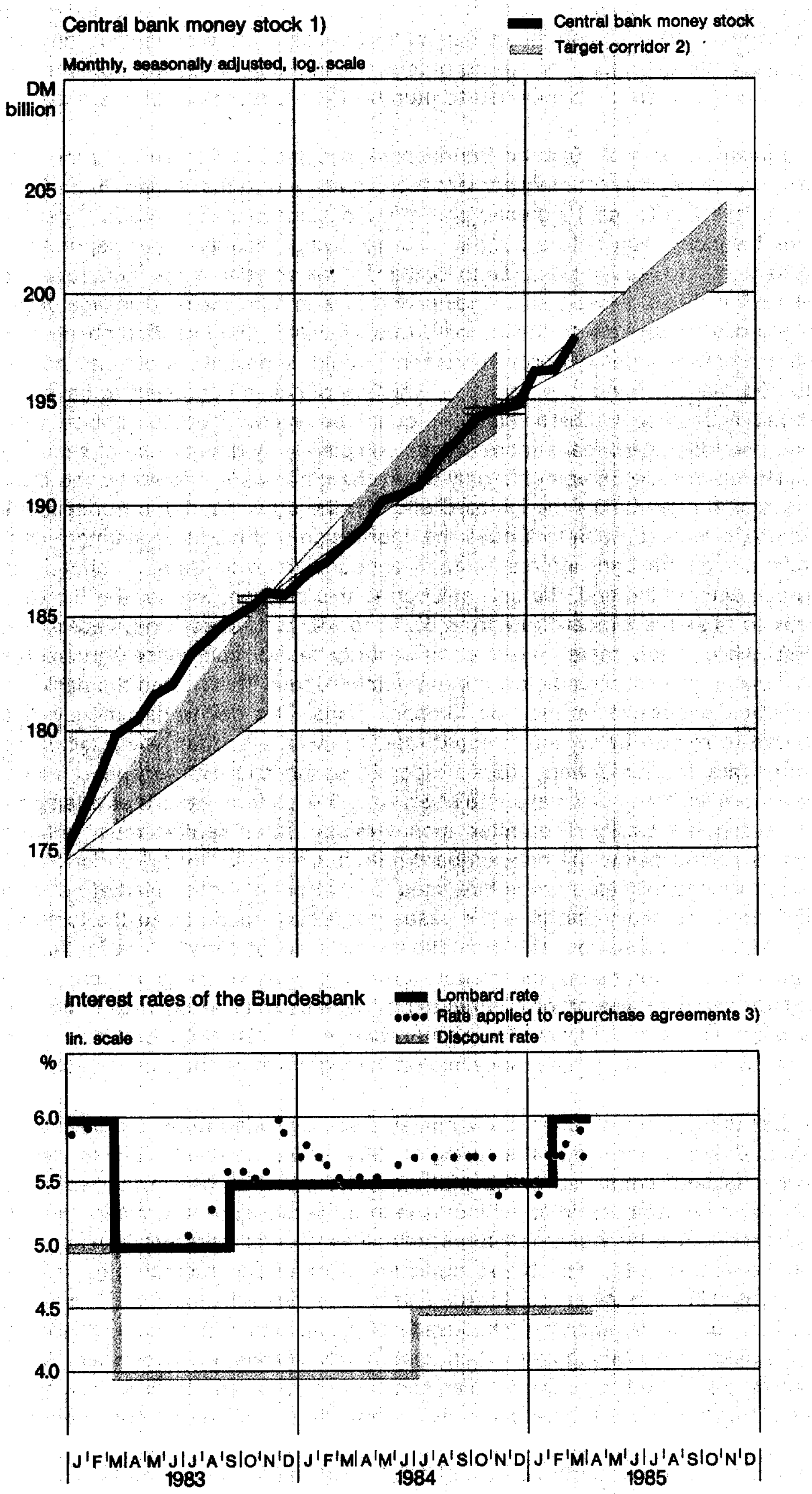
Controlling the money market "with a steady hand"

Since the expansion of the central bank money stock had moved on to the growth path envisaged for 1984 as early as the second half of 1983, the stance adopted in the domestic money market in autumn 1983 simply had to be continued. In the spring of last year the banks' need for additional central bank balances was met by reversible assistance operations and lombard lending. Open-market transactions under repurchase agreements in securities played a prominent part in this. Depending on current liquidity requirements, such transactions were concluded for varying amounts and mainly took the form of interest rate tenders. In pursuing this liquidity policy course the Bundesbank took account, as in the previous year, of the transfer of the Bundesbank profit to the Federal Government, which, by arrangement with the Federal Government, was for the first time spread over several months. The pressures which built up in the European Monetary System in February and March last year caused the Bundesbank's net monetary reserves to rise sharply at times and made it seem advisable to create a "defence line" for possible further inflows of foreign exchange; hence the Bundesbank allowed a major basic amount of short-term central bank debt to be accumulated by the banks. In the further course of the year the Bundesbank also had to bear in mind in its money market management the upward trend in the U.S. dollar and the increasing interest rate advantage of the United States; hence it continued to conclude new repurchase agreements in securities at allotment rates slightly above the lombard rate, which was kept unchanged. However, interest and liquidity policy "fine-tuning" measures remained on a limited scale. In the first half of last year the monetary policy stance was continued virtually unchanged: the money stock increased at the envisaged rate.

Package of measures adopted around mid-year has no effect on the policy stance

To consolidate some of the short-term central bank borrowing the Bundesbank raised the banks' rediscount quotas by DM 8 billion with effect from July 6, 1984. This provision of liquidity on a permanent basis was accompanied by a slight raising of the discount rate (from 4% to 4½%). As the discount rate was far below market rates and in view of the fact that the rates applied to repurchase agreements were higher, the cost of funds would have been cut on balance if the discount rate had not been increased, and this would have been undesirable, given the tendency of the Deutsche Mark to depreciate; in other words, the discount rate was thus brought slightly closer to interest rates in

Growth of the central bank money stock and interest rate movements



1) Currency in circulation and required reserves on domestic liabilities (calculated at constant reserve ratios, base: January 1974).- 2) In 1983: 4% to 7%; in 1984: 4% to 6%; and in 1985: 3% to 5% (between the fourth quarter of the preceding year and the fourth quarter of the current year).- 3) Fixed rate (volume tender) or allotment rate (interest rate tender) for open market transactions under repurchase agreements in securities on the date the transaction is credited.

the interbank money market again. This adjustment in the pattern of central bank interest rates did not in fact significantly influence the general level of interest rates in Germany. On the contrary, from the beginning of August interest rates tended to decline in the domestic financial markets — more so, indeed, in the capital market than in the money market, which is more dependent on central bank interest rates. The easing of tensions in the bond market continued in the autumn, when the banks had to step up their recourse to lombard loans.

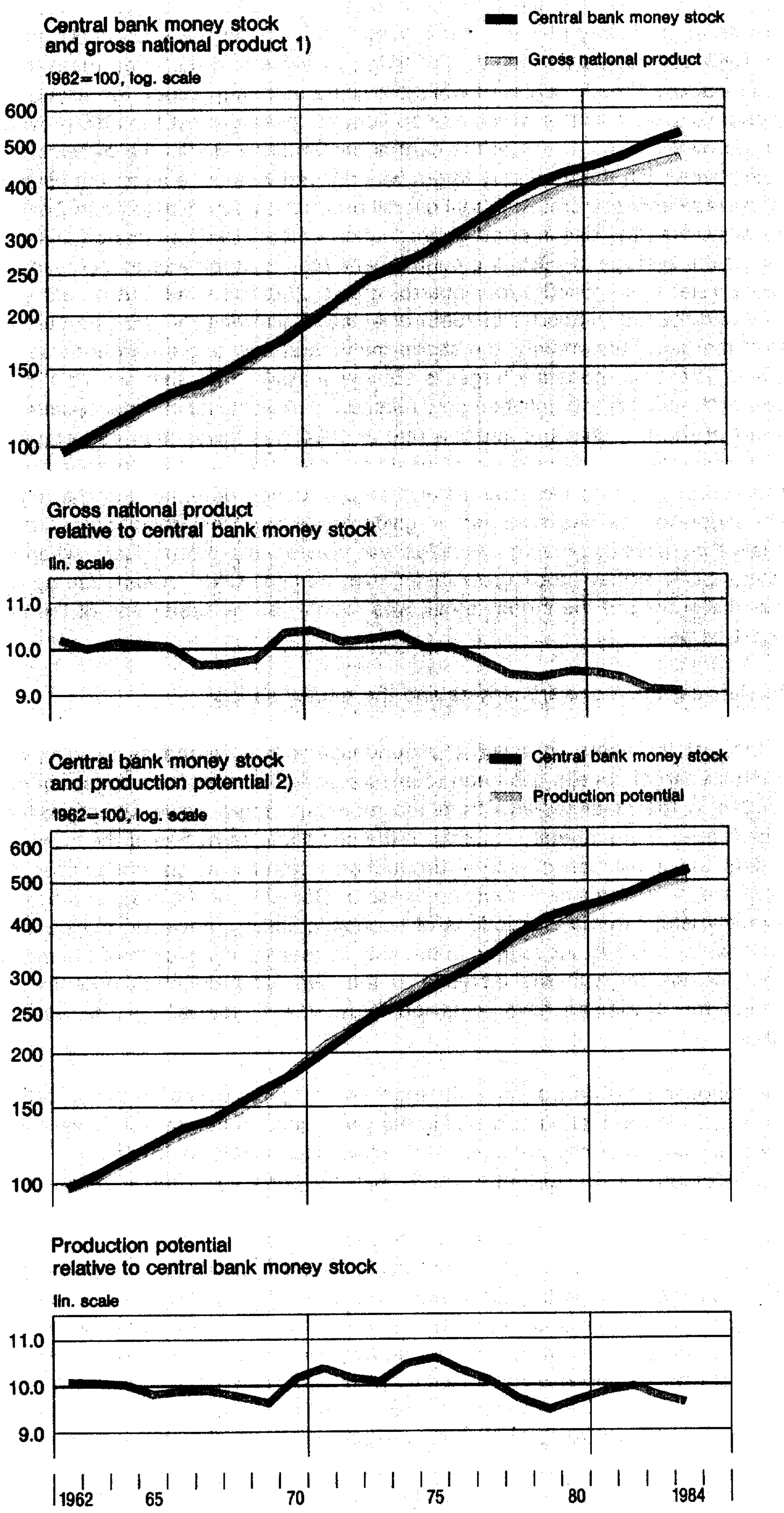
Increasing significance of security-based repurchase agreements

In the late autumn of 1984 the Bundesbank decided in principle to further develop its money market management techniques and to make them more flexible. Its aim was to meet a greater part of the banking system's needs of central bank balances than before by means of revolving security-based repurchase agreements, to reduce recourse to lombard loans so as to make them revert to their original role of last-resort lending, and thus to relax the rigid linkage of the day-to-day money rate to the lombard rate. However, the intended changes in the use of the monetary policy instruments could be brought about only gradually. On the one hand, the banks — which in principle continued to have unlimited access to lombard loans — could be encouraged to replace their recourse to lombard loans more or less completely by greater use of security-based repurchase agreements only when the latter were offered by the Bundesbank at rates below the lombard rate. On the other hand, the Bundesbank did not, of course, wish to arouse the impression that it was preparing a general cut in central bank interest rates by announcing lower rates for repurchase agreements. In the end, the only solution to this problem was for the Bundesbank to raise the lombard rate from 5½ % to 6 % with effect from February 1, 1985, while at the same time offering security-based repurchase agreements on a major scale at rates below the new lombard rate. This helped the banks to end their excessive reliance on lombard loans. The day-to-day money rate tended to remain below the lombard rate. To avoid a sudden sharp fall in the former rate, the banks were offered Federal Treasury bills with very short maturities (normally three days) at a rate of 5½ % (5.3 % as from April 1) as a temporary investment facility. Thereafter, money market rates settled down within a certain spread below the new lombard rate, but they did not fall under 5½ %. This more sophisticated procedure used to control the money market not only eliminated the heavy and in some cases permanent recourse to the lombard loan facility, but also gave the Bundesbank more scope than before for flexibly triggering a limited rise or fall in short-term money market rates. If there is any sudden sharp expansion or contraction of bank liquidity — such as is caused by large inflows or outflows of foreign exchange — "market factors" may, however, still temporarily force money market management off the planned course.

Growth of the central bank money stock on target

In 1984 the rise in the central bank money stock remained within the envisaged 4 % to 6 % corridor. Up to the spring of 1984 the Bundesbank's key monetary policy indicator continued to move at the bottom end of the corridor set. This was primarily attributable to an increase in monetary capital formation, which was encouraged by the large interest rate advantage of long-term investments and the at times very widespread expectations of a fall in interest rates. In May the central bank money stock for the first time reached the middle of the target corridor. Under the impact of the losses of production and income caused by the strikes, monetary growth then temporarily slackened somewhat. When these supply-side shocks came to an end, monetary expansion picked up again in the summer. From August onwards — with minor fluctuations from month to month — the central bank money stock moved roughly in the middle of the target corridor. In the fourth quarter of 1984 it was 4.6 % above the level of the previous year, i.e. nearly in the centre of the target range.

Central bank money stock, gross national product and production potential



1) GNP at current prices, central bank money stock calculated at constant reserve ratios (base: Jan.1974).-
2) Production potential at GDP prices.

1985 monetary target lowered slightly because of the large measure of price stability achieved

As the growth of the money stock in 1984 was on target and overall economic developments — except during the period of the strike — were also largely in line with the objectives pursued by the Bundesbank and the Federal Government, the Bundesbank saw no reason towards the end of last year to radically change its monetary policy in 1985. When announcing the quantitative target for 1985 it indicated its intention of trying to safeguard the large measure of price stability already achieved while providing monetary scope for strong real economic growth. In line with these objectives, the target set for 1985 provided for a growth of 3% to 5% in the central bank money stock. The principal variable from which the monetary target was derived was once again the estimated average annual increase in real overall production potential (a good 2%). At the same time the rise in nominal production potential was estimated at 4½%. Taking the average of 1985, the central bank money stock was to increase at a similar rate; this implied a four-quarter growth (between the fourth quarter of 1984 and the fourth quarter of 1985) of 4% and, allowing for a ±1 percentage point margin of uncertainty, the above-mentioned new target corridor was obtained. The 1985 monetary target is somewhat lower than that set for 1984 in view of the low level of inflation now reached, and not least in order to take account of the fact that the inflation rate in 1984 was lower than had originally been assumed. The monetary growth aimed at for 1985 will nevertheless permit overall production to increase faster than production potential. For the monetary scope for the desirable and — given present cyclical conditions — quite feasible increase in capacity utilisation was created in previous years, when the central bank money stock grew faster than nominal GNP. In early spring this year the growth of the money stock was roughly at the upper end of the new target range.

(b) Deriving the monetary targets and the money supply

Gearing the monetary target to production potential has proved successful

In the last ten years, in which the Bundesbank has geared its policies to a monetary target, its aim has been to ensure optimum use of the factors of production in the medium term from the monetary angle, while safeguarding a large measure of monetary stability. In the statistical derivation of the monetary targets the expansion of overall production potential (at current prices) has therefore been a major underlying variable. Because of the frequent sudden domestic and external disruptions of economic activity, however, the Bundesbank has not always succeeded in the past in keeping the growth of the money stock consistent with the increase in the nominal production potential, although the deviations have remained fairly small, especially in the last five years.

Gearing the monetary target to the actual growth of production potential

The Bundesbank's derivation of the monetary target is based on the actual expected rise in production potential in the year ahead. Some research institutes, however, have recently proposed that allowance should be made for a faster growth of production potential which may be possible in the medium term. They believe that this would permit a correspondingly faster expansion of the money stock, which is to accommodate today tomorrow's growing production potential "in anticipation" of future rises in capital spending. In the Bundesbank's view such an anticipatory expansion of the money stock would be tantamount to issuing an uncovered "bill on the future". It is quite uncertain whether an "anticipatory" expansionary monetary policy would soon trigger a strong surge of capital spending that would enlarge capacity. What weighs more heavily is the risk that, if the money supply exceeds non-banks' current cash requirements, this would fuel inflationary expectations, weaken the external value of the Deutsche Mark and then actually generate domestic inflationary pressures. For this reason the Bundesbank derives its annual monetary targets from the foreseeable short-term growth of production potential, which is based, among other things, on a reasonably realistic forecast of new capital expenditure and thus of the expansion of capacity in the year ahead. Each year, when the target is set, any rise in capital spending which causes production potential to grow faster (as was the case in 1983 and 1984) is taken into account; the monetary target therefore does not incorporate a built-in "growth brake", as is sometimes claimed.

Abiding by annual derivation of the target

The basic medium-term orientation of monetary policy has prompted some economists to recommend the Bundesbank to announce monetary targets for several years ahead, rather than derive concrete targets from projected basic economic data for the current year. However, policy requirements as well as practical considerations argue against the Bundesbank committing itself to unchanged quantitative targets for years at a time. The annual publication of the derivation procedure helps materially to explain the Bundesbank's intentions in the field of stabilisation policy to economic agents at home and abroad. Moreover, a four or five-year period is much too long for unforeseeable disruptions (such as oil price increases, sharp exchange rate changes or jumps in the level of world economic activity) to be taken into account. Finally, the practice of deriving a new target each year has also proved very useful in coordinating strategy among the economic policy-makers. In all the years in which monetary targeting has been practised, the economic data on which the Bundesbank has based its formulation of the monetary target have invariably been consistent with the macro-economic objectives outlined in the Federal Government's Annual Economic Report. Conversely, the Federal Government for its part has invariably accepted the annual monetary target as a fitting contribution by monetary policy to the implementation of the official annual forecast. This practice can be regarded as the fulfilment of the mandate assigned to the Bundesbank by law (section 12 of the Bundesbank Act), whereby the Bank is required, without prejudice to the performance of its anti-inflationary functions, to support the general economic policy of the Federal Government.

Abandoning the potential concept poses inflationary risks

In its 1984–85 Annual Report the German Council of Economic Experts endorsed the above-mentioned idea of a longer-term orientation of monetary policy, albeit with slight modifications. According to that Report, the Bundesbank should abandon the formal derivation procedure and announce a "medium-term normal" rate of expansion of the central bank money stock for several years ahead, based on generous medium-term rates of increase of GNP (at current prices) of, say, 4½ to 5% p.a. These recommendations imply that in the medium term the economy will be able to translate the "monetary cloak", which initially has expanded rather too fast, into increased capital expenditure and higher production. The advocates of this concept admit, however, that it might result in temporary price increases due to supply shortages during an economic upswing. Hence the success of the monetary stimulation experiment would depend on management and labour refraining from negotiating additional wage rises whenever the economy is approaching full capacity utilisation and prices have gone up. The "good conduct" of management and labour assumed here presupposes some measure of "money illusion" among those drawing an income; but presupposing such conduct among management and labour associations or their members runs counter to all experience. The public has a right to expect the central bank to feel responsible for monetary stability in the year immediately ahead and not to put this at risk for the sake of the doubtful success of a monetary stimulation experiment.

The price component under conditions of low inflation

Up to 1984 the Bundesbank made allowance for an "unavoidable" rate of price increases when calculating the room for monetary growth. Normally this rate was lower than the inflation rate forecast for the year ahead. The large measure of price stability achieved in the course of last year enabled the Bundesbank to drop for the first time in 1984 the concept of the "unavoidable" price increase used hitherto. Nevertheless, the annual monetary target must continue to include an addition to take account of the rate of price increases, since the production potential is used in the shape of overall demand, which is a variable expressed in nominal terms, i.e. is based on current prices. If only because of the statistical uncertainty associated with traditional price indexes (price fluctuations of a structural nature, the difficulty of taking account of quality improvements and of the value of new products), it is probably only in exceptional cases that the price level can be expected to remain constant in statistical terms. In forecasting the rate of growth of nominal production potential in 1985, allowance also had to be made for the fact that exceptionally strong dampening effects contributed to the slowdown in prices last year, while domestic and external price and cost risks are already in prospect for the new year. Hence "extrapolation" of last year's inflation rate of 2% (for the GNP deflator), which was taken into account when deriving this year's monetary target, actually implies — as in previous years — ambitious goals in the field of stabilisation policy.

Steady "velocity of circulation" on a longer-term view

A major factor on which the Bundesbank's money market management is based is the observation that over the longer term the money stock has grown largely in line with nominal production potential.[1] If changes in GNP are compared with monetary growth, it is found that the "velocity of circulation" of the central bank money stock, as determined in this way, has been declining slightly since the mid-seventies. In all probability this is due, however, to the fact that the economy did not reattain earlier growth rates because of the special circumstances prevailing in recent years (oil price increases and adjustment to the new competitive conditions in foreign trade, increase in structural unemployment, etc.). This is also suggested by the fact that utilisation of production capacity during that time has not been as high as in earlier periods. If the "velocity of circulation" of money is measured in terms of production potential at current prices — only this method is appropriate to the objectives of the medium-term potential concept — it turns out that this relationship has hardly changed at all in the long run. Econometric studies of these statistical correlations for the Federal Republic of Germany do not show any significant trend-induced decline in the velocity of circulation; the Bundesbank has therefore not had to make allowance for such a "structural break".

(c) The money creation process in 1984

Moderate expansion of the overall money supply

In line with the trend in the central bank money stock, the growth of overall money balances in the hands of domestic non-banks also slowed down last year. The money stock in the broad definition M3[2] increased by just over 4½% (or DM 41 billion) between December 1983 and December 1984, compared with just on 6% a year before. It thus expanded at virtually the same rate as the central bank money stock but less rapidly than bank lending to domestic non-banks. The more narrowly defined monetary aggregates M2 and M1 grew somewhat faster than this in 1984, namely by 5% and 6%, respectively, between the fourth quarter of 1983 and the fourth quarter of 1984. In the shorter term the various monetary aggregates and components showed fairly widely diverging trends. At the beginning of the year bank deposits which are counted as part of the money stock grew only slowly, while currency in circulation went up quite swiftly. Hence the conventional monetary aggregates increased less than the central bank money stock, in which currency in circulation has a greater weight. Up to mid-year shorter-term time deposits rose steeply whereas sight deposits were reduced. The interest paid on short-term bank deposits remained largely unchanged during this period, as it did in fact over the year as a whole. The shifts out of sight deposits into other assets were therefore probably not prompted by interest rates. They are likely to have been chiefly asso-

1 See also "The longer-term trend and control of the money stock" in Monthly Report of the Deutsche Bundesbank, Vol. 37, No. 1, January 1985, p. 13.

2 The money stock M1 comprises currency and sight deposits, M2 the money stock M1 plus time deposits and funds borrowed for less than 4 years, and M3 the money stock M2 plus savings deposits at statutory notice.

Monetary developments

Change during year 1

Item	1978	1979	1980	1981	1982	1983	1984
	DM billion						
A. Central bank money requirements of banks and liquidity policy measures of the Bundesbank 2							
1. Provision (+) or absorption (−) of central bank balances by							
Rise in central bank money 3 (increase: −)	[11] − 14.1	− 7.8	− 6.5	− 2.7	− 7.5	− 10.1	− 7.1
Foreign exchange movements (excluding foreign exchange swaps and foreign exchange transactions under repurchase agreements)	+ 20.3	− 5.2	− 24.6	− 3.1	+ 1.7	− 2.0	− 3.9
Cash transactions of the central and regional authorities (including shifts of Federal balances under section 17 of the Bundesbank Act)	− 2.1	+ 3.9	+ 0.3	+ 1.1	− 4.1	+ 7.1	+ 1.3
Transfer of the Bundesbank's profit to the Federal Government	—	—	—	+ 2.3	+ 10.5	+ 11.0	+ 11.4
Other factors	− 3.8	− 5.2	− 7.9	− 9.3	− 12.1	− 9.7	− 12.1
Total 1	+ 0.3	− 14.3	− 38.8	− 11.8	− 11.4	− 9.0	− 10.6
2. Liquidity policy measures							
Change in minimum reserves	− 1.8	− 3.2	+ 10.5	+ 4.1	+ 5.4	− 0.2	− 0.4
Change in refinancing facilities	+ 4.4	+ 5.1	+ 12.1	+ 5.1	+ 7.7	− 0.7	+ 7.8
Open market transactions (with non-banks, in "N paper" and in long-term securities)	− 3.6	+ 2.7	+ 4.5	− 0.1	+ 1.5	+ 2.4	− 3.9
Security-based repurchase agreements	—	± 0.0	+ 6.0	4.4	− 1.4	+ 6.6	+ 7.7
Other assistance measures in the money market 4	± 0.0	− 2.3	+ 4.5	− 0.5	+ 1.6	− 3.4	± 0.0
Total 2	− 1.1	+ 2.4	+ 37.6	+ 13.0	+ 14.8	+ 4.7	+ 11.3
3. Remaining deficit (−) or surplus (+) (1 plus 2)	− 0.8	− 11.9	− 1.2	− 1.2	+ 3.4	− 4.3	+ 0.7
covered or absorbed by							
Recourse to unused refinancing facilities (reduction: +)	− 0.2	+ 9.7	− 1.4	+ 1.3	− 3.5	+ 3.3	− 1.0
Raising (+) or repayment (−) of lombard or special lombard loans	+ 1.0	+ 2.2	+ 2.6	− 2.5	+ 0.1	+ 1.0	+ 0.3
	%						
B. Key monetary indicators							
Central bank money stock 2,5	[11] + 11.8	+ 5.5	+ 5.5	+ 3.1	+ 5.9	+ 6.8	+ 4.6
Memorandum item							
As an annual average	[11] + 11.4	[11] + 9.1	+ 4.8	+ 4.4	+ 4.9	+ 7.3	+ 4.8
M1 (= currency in circulation and sight deposits)	+ 14.2	+ 3.7	+ 4.1	− 0.8	+ 6.7	+ 8.1	+ 5.9
M2 (= M1 plus time deposits and funds borrowed for less than 4 years)	+ 13.2	+ 8.2	+ 9.0	+ 9.0	+ 5.2	+ 2.6	+ 5.1
M3 (= M2 plus savings deposits at statutory notice)	+ 11.1	+ 5.7	+ 6.1	+ 5.1	+ 7.2	+ 5.8	+ 4.7
Lending by banks and the Bundesbank to domestic non-banks	+ 11.5	+ 11.5	+ 9.3	+ 9.0	+ 6.4	+ 6.6	+ 5.9
	DM billion						
C. Money stock and its counterparts							
Money stock M3 (= 1 plus 2 less 3 less 4 less 5)	+ 64.8	+ 39.2	+ 42.8	+ 36.1	+ 54.8	+ 45.3	+ 41.3
Counterparts in the balance sheet							
1. Volume of credit 6	+ 125.4	+ 139.0	+ 126.3	+ 132.0	+ 104.4	+ 113.2	+ 107.6
of which							
Bank lending to domestic non-banks	+ 122.6	+ 140.9	+ 122.4	+ 129.9	+ 106.1	+ 111.3	+ 109.5
— to enterprises and individuals 7	+ 49.0	+ 67.5	+ 56.3	+ 41.7	+ 30.0	+ 44.0	+ 47.5
— to the housing sector 8	+ 38.9	+ 44.8	+ 44.5	+ 40.7	+ 36.1	+ 48.1	+ 43.0
— to public authorities	+ 34.7	+ 28.5	+ 21.6	+ 47.5	+ 40.0	+ 19.3	+ 19.0
2. Net external assets 9	+ 7.1	− 21.8	− 10.6	+ 11.9	+ 4.5	+ 1.2	+ 2.8
3. Monetary capital	+ 54.8	+ 75.8	+ 61.7	+ 86.0	+ 46.5	+ 67.1	+ 69.4
of which							
Savings deposits at agreed notice	+ 7.7	+ 3.3	− 1.9	− 2.1	+ 4.3	− 2.0	+ 6.0
Bank savings bonds	+ 10.3	+ 14.8	+ 17.8	+ 14.0	+ 11.9	+ 13.0	+ 16.3
Time deposits and funds borrowed for 4 years and over	+ 17.0	+ 18.7	+ 14.6	+ 13.8	+ 7.2	+ 27.2	+ 26.0
Bank bonds outstanding 10	+ 14.2	+ 33.6	+ 26.7	+ 53.6	+ 14.1	+ 22.6	+ 13.2
4. Central bank deposits of domestic public authorities	+ 2.5	− 1.7	− 1.9	− 0.2	+ 0.5	+ 0.9	− 1.2
5. Other factors	+ 10.4	+ 3.8	+ 13.2	+ 22.0	+ 7.2	+ 1.0	+ 0.9

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, foreign exchange swaps and foreign exchange transactions under repurchase agreements, shifts of Federal balances under section 17 of the Bundesbank Act and sales of short-term Treasury bills. — **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 banks' 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.

ciated with the persistent labour disputes, especially the resultant temporary decline in output and turnover. As economic activity picked up in the second half of the year, sight deposits rose rapidly again while time deposits were not stepped up much further. At the end of the year the temporary weakness of sight deposits was more than offset, as it was in the case of the money stock M 1, although special influences at the end of the year played a part in this. The sharp short-term fluctuations in the narrowly defined money stock M 1 demonstrated once more last year that in Germany this aggregate is not suitable as a monetary policy indicator. The money stock M 3, by contrast, in which shifts between the individual components cancel out, grew fairly steadily from the second quarter of 1984 onwards.

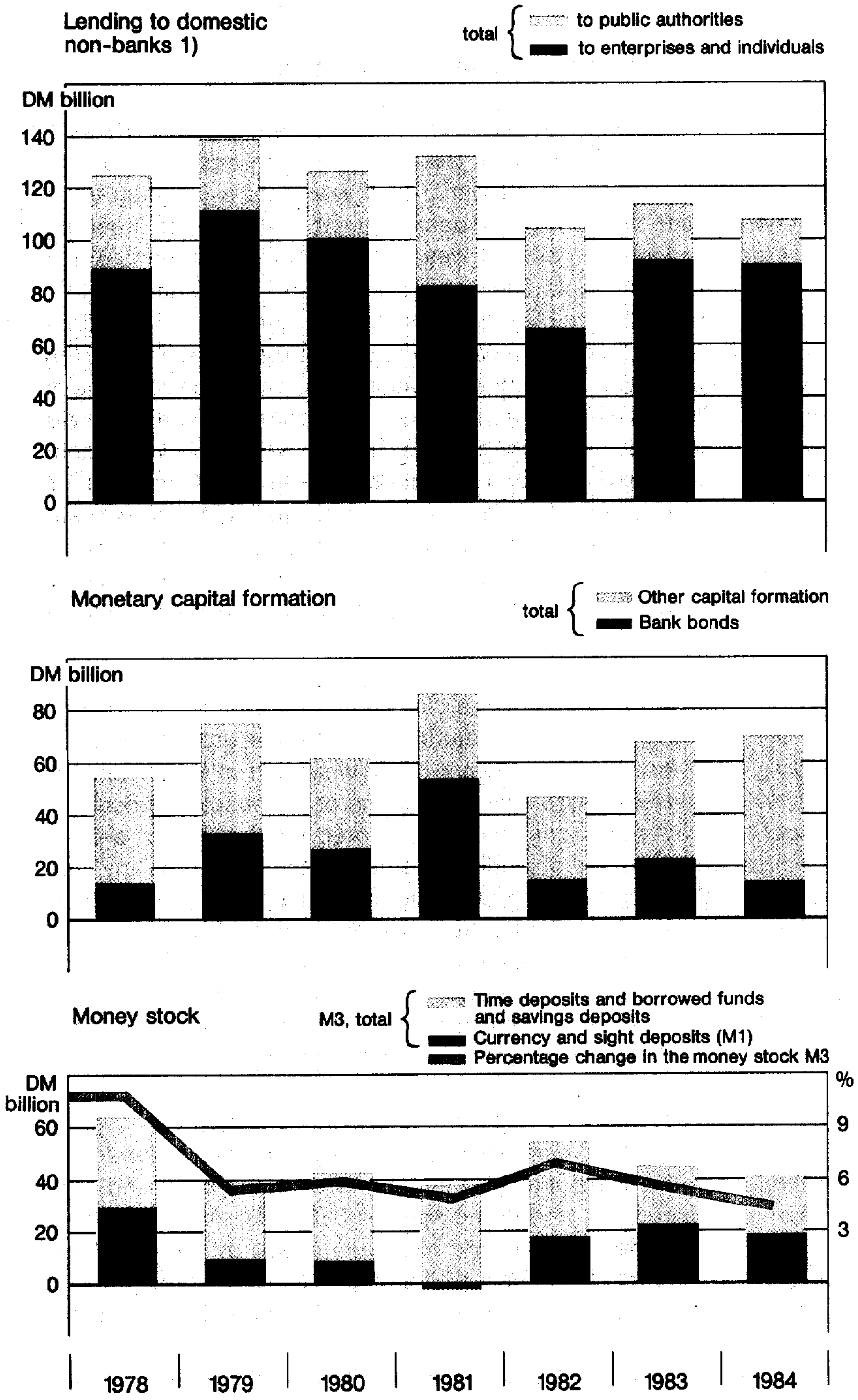
Monetary capital formation slackens in the course of the year

The slow growth of the money stock at the beginning of the year was mainly due to the exceptionally high rate of monetary capital formation. The propensity to acquire longer-term financial assets was stimulated at the time both by the temporary fall in the long-term interest rate and by the fairly large interest rate advantage of long-term assets over short-term bank deposits which had emerged in the wake of the rise in interest rates in the bond market by the end of 1983. Over 1984 as a whole monetary capital formation at banks amounted to a good DM 69 billion. Domestic non-banks thus increased their longer-term assets at much the same fast pace as a year before (DM 67 billion), and considerably more rapidly than their liquid assets. Long-term time deposits (DM 26 billion) once more accounted for the major part of monetary capital formation. These assets include the registered bonds and borrowers' note loans issued by banks with an original maturity of four years and over, which do not involve any price or write-off risks and for which institutional investors therefore show a preference in periods of low interest rates. Demand for bank savings bonds, which also carry no price risk, was likewise brisk (DM 16 billion). Savings deposits at agreed notice, which had been reduced a year earlier, were built up again (by DM 6 billion) in 1984. One reason for this was probably that banks were increasingly offering higher-yielding special savings instruments, some of which earn interest at a gradually rising rate, e. g. Federal savings bonds, and some of which carry interest bonuses if the asset is held for an extended period. Such new fund-raising instruments, which became increasingly popular among the more sophisticated savers, not only make traditional savings deposits appear less attractive — there have been indications for some time that the significance of savings deposits as a means of saving is declining in relative terms — but have also contributed to the fall in purchases of bank bonds of the traditional type. In 1984 DM 13 billion of bank bonds were sold to domestic non-banks as against not quite DM 23 billion in 1983. From September of last year onwards no such securities were bought by non-banks on balance; on the contrary, they somewhat reduced their holdings. One significant factor in this connection was probably that large amounts of short-term bank bonds matured and that their proceeds were invested — at least temporarily — in time deposits and the like. Another factor was that at the same time domestic non-banks increased their purchases of foreign currency bonds, whose interest rate was attractive and whose exchange rate risk was considered to be lower than before.

Public authorities leave greater scope for private demand for credit

Bank lending to domestic non-banks continued to stimulate the money creation process strongly last year, albeit not quite as much overall as a year before. Lending by the banking system (including the Bundesbank) to domestic non-banks went up by 6 %, compared with 6½ % in 1983. In terms of the absolute amount it rose by DM 108 billion. This increase shows the actual strength of credit expansion at too low a rate, however, as the banks again wrote large amounts off their loans in the first few months of last year, thus reducing the level of lending. Only a small part of these write-offs has been included in the banking statistics and added to bank lending again. In lending business

Monetary developments *



* Change during year.- 1) Banks and the Bundesbank, including credit based on the purchase of Treasury bills and securities.- 2) Currency, sight deposits, time deposits and funds borrowed for less than four years, savings deposits at statutory notice.

weights continued to shift from the public to the private sector in 1984. The policy of public budget consolidation thus provided more scope for private demand for credit. Lending by the banking system to public authorities (including credit based on the purchase of securities) grew by 4% over the year as a whole and thus much more slowly than bank lending to enterprises and individuals. This figure reflects only part of the government's contribution to monetary expansion, however. The Bundesbank transferred DM 11.4 billion of its profits to the Federal Government and the latter then channelled them into the money supply. If this transfer of profits and public sector borrowing from the banking system are combined, public cash transactions continued to have a considerable net expansionary impact on monetary growth last year.

(d) The private demand for credit continues to be strong

Lending to the private sector broadly based

Bank lending to the private sector, which had risen sharply as early as 1983, continued to be fairly strong last year. Bank lending to enterprises and individuals grew by over 6½% compared with 7% a year before. Lending to enterprises gathered pace in line with economic growth. Demand for credit by the housing sector declined, by contrast, despite the fact that the terms of finance were comparatively favourable last year. The rise in "consumer credit" also slowed down somewhat, notably in the later part of last year, when individuals increasingly hesitated to buy new cars. In spite of these differences in trend, the growth of bank lending to the housing sector and employees in 1984, at annual rates of 7½% and 6% respectively, remained faster than the increase in lending to trade and industry, which went up by just over 5½%. When comparing these rates it should be borne in mind, however, that because of the amounts written off loans, as mentioned before, lending to enterprises, in particular, is being shown at too low a figure. Moreover, given their favourable earnings position enterprises were able to finance a large part of their capital expenditure with internal resources, drawing on liquid funds they had accumulated.

Demand for short maturities picks up again

While in 1983 borrowers had shown a clear preference for longer maturities, they increasingly switched to short maturities in 1984. The growth rate of short-term lending, at 7½%, was faster than in 1983, while that of longer-term direct advances, at just over 6%, was slower. In terms of the absolute amount, however, longer-term advances continued to account for the largest share. The shift in the maturity structure of lending to enterprises was particularly marked. As firms' needs of working funds rose owing to cyclical factors and their stock-building increased, they borrowed about twice as much at short term, but took up fewer long-term bank loans than a year before. The decline in housing construction also contributed to the slower growth of long-term lending. This is reflected in the trend of loan commitments and outstanding promises of loans even more clearly than in the utilisation of long-term credits.

Fall in the cost of long-term borrowing

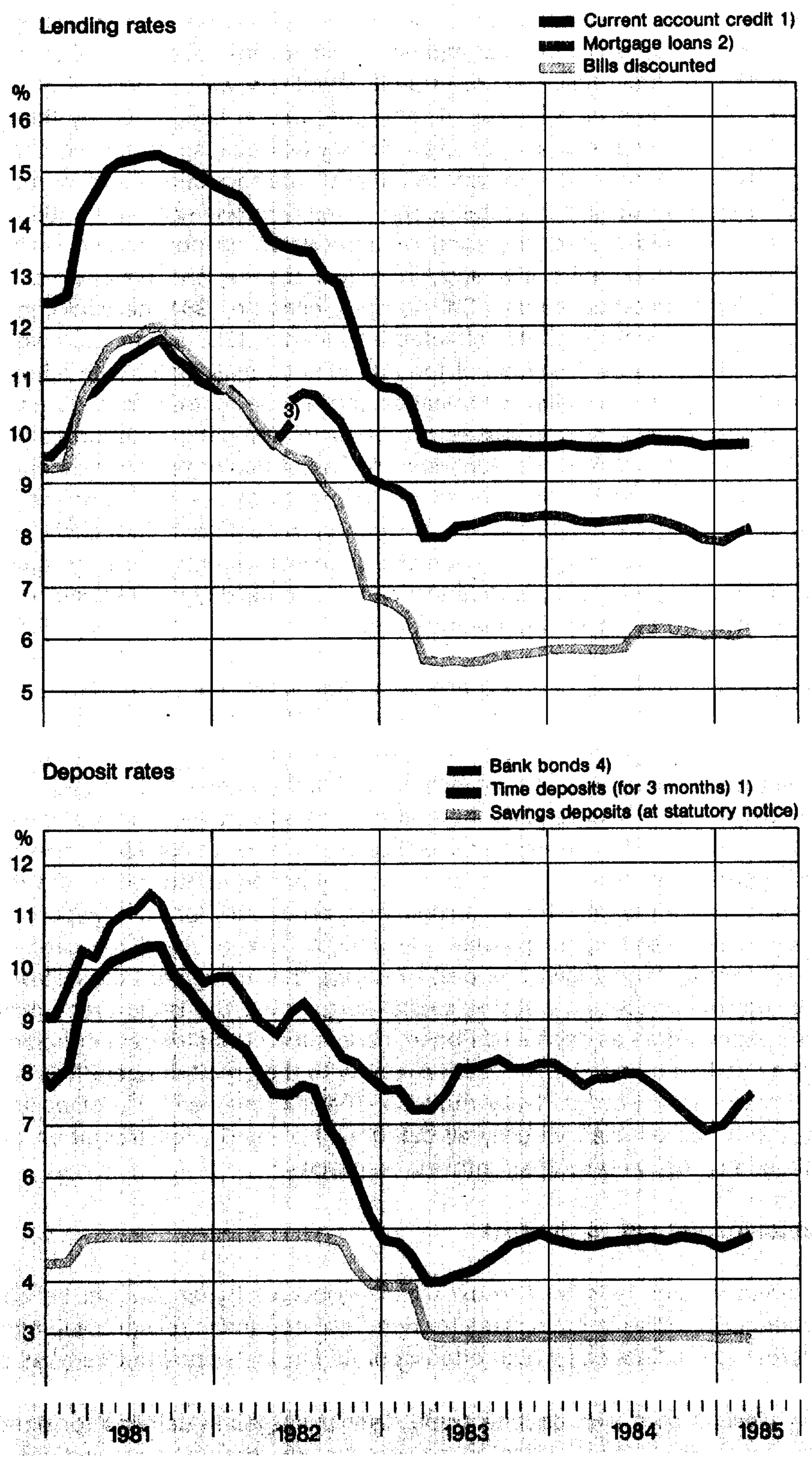
The interest rates payable for short-term bank credit changed only slightly last year. The rates charged for current account credit remained at the level they had reached when the sustained fall in interest rates at the short end of the financial markets came to an end in the spring of 1983. Basically, this situation did not change after the discount rate had been raised by half a percentage point at the end of June 1984; only the cost of bills discounted went up by roughly ⅓ percentage point. In long-term lending the rates declined markedly, above all in the last few months of the year, in line with the movement of the long-term interest rate. At the end of the year long-term fixed-rate loans cost on average more than 1 percentage point less than at the end of 1983; variable-rate mortgage lending rates were down half a percentage point. The trend in the cost of funds to enterprises was thus on the whole favourable, in particular if the rise in their profits is also taken into account.

(e) Business trends and profitability of the individual categories of banks

Banks active in short-term lending benefit from the demand for credit

Last year the surge in short-term lending to trade and industry benefited above all those categories of banks which traditionally specialise in this type of business. The growth of the outstanding amount of domestic lending by the regional institutions of credit cooperatives (13.6%), regional banks and other commercial banks (8.7%) and big banks (6.9%) was therefore much faster than

Movement of selected bank interest rates



1) Under DM 1 million.- 2) Secured by residential real estate; effective rate.- 3) As from June 1982 only average interest rate for mortgage loans with variable interest rates; the figures are not fully comparable with previous data (June 1982 estimated).- 4) Yield on bonds outstanding.

that of all the banks taken together (6.1 %). Moreover, the two first-mentioned categories of banks also stepped up their lending to public authorities. An above-average increase was also recorded in lending to domestic non-banks by savings banks (7.1 %) and credit cooperatives (6.8 %). They primarily profited from the fact that they typically serve a wide range of customers. By contrast, categories of banks which traditionally engage more heavily in providing finance to the public sector, such as regional giro institutions and mortgage banks, lost ground.

Profitability in the banking industry again satisfactory

In 1984 the profitability of banks continued to be satisfactory. The operating result, i. e. the balance of net interest and net commissions received and administrative expenses, may, however, have been slightly down on 1983 — at least relative to the volume of business. At any rate, this is suggested by the fact that the banks' interest margin narrowed somewhat because of the slight fall in lending rates, while in deposit business interest rate reductions and increases roughly cancelled out. It should be borne in mind, however, that in 1983 the banks had achieved record operating results (which do not include receipts from business for the banks' own account or loan losses), the like of which had not nearly been recorded before. On the other hand, in 1984 the banks' profit and loss accounts were probably affected less than in 1983 by amounts written off loans and securities. Because of the rise in securities prices, the amounts written off securities in 1984, for instance, were smaller than in 1983. In addition, smaller provisions for losses on loans to domestic enterprises were probably required owing to the continued revival of business activity. Hence it cannot yet be said whether the pre-tax annual profit was down at all on the year before. Quite substantial differences between individual banks are likely, however. Some banks presumably had to make quite sizable provisions for their international lending business, particularly if their profitability in 1983 had not allowed them to do so to an adequate extent.

Amendment of the Banking Act

The provisions for losses on loans and securities which the banks have had to make in recent years — some DM 12 billion in 1982 and about DM 14 billion in 1983 — have highlighted the greater risks attached to lending business. By amending the Banking Act at the beginning of 1985, Parliament sought to adjust the bank supervision regulations to the changed conditions in the financial markets and above all to strengthen the "buffer" function of capital. In principle, the amendment satisfies the need for regulatory action perceived by the Bundesbank. It meets the calls for a consolidation procedure for bank supervision purposes which will help to prevent the multiple use of the liable capital of banks with close capital ties. It is also gratifying that Parliament did not dilute the concept of capital by accepting capital surrogates. The limited recognition of participation rights as capital has been made subject to stringent conditions, while the addition of members' uncalled liability to the credit cooperatives' capital and reserves will be gradually reduced. The improvement in profitability in recent years has enabled virtually all categories of banks to strengthen their capital base by drawing on their internal resources.[1]

5. Capital market put to the test

Bond market alternates between bullish periods and spells of weakness

In the bond market 1984 was an exceptionally eventful year. Caught between expectations of falling interest rates for domestic economic reasons and external interest rate influences which often operated in the opposite direction, the German bond market alternated between bullish periods and spells of weakness in 1984. In sum, and despite some distinct surges in demand for bonds, the amount of capital newly invested in domestic and foreign bonds last year, at just on DM 87 billion net, was slightly (DM 4.5 billion) lower than in 1983. The decrease in the overall supply of funds in the bond market focused, however, on the shorter maturities, while investment in bonds with long periods to maturity grew more than in the preceding year; to this extent the "quality" of the funds channelled through the bond market improved. The average period to maturity of the net amount invested in the bond market was just under eight

1 See "Amendment of the Banking Act" in Monthly Report of the Deutsche Bundesbank, Vol. 37, March 1985, p. 35.

years in 1984, compared with six years in 1983; it thus reached a new peak for the period since 1973. The German bond market was also able to hold its own as a turntable for longer-term funds passing from lenders to borrowers other than the banks. A quarter of non-banks' longer-term financial asset accumulation took place through the bond market, against barely one-fifth in the preceding year. There was a similar shift in relationships in the field of borrowing by non-banks. The drop in the total funds flowing through the bond market last year was wholly ascribable to the decrease in banks' sales and purchases of fixed interest securities (and in their re-lending of the funds obtained through bond issues).

Growing importance of speculative investment motives on the demand side

Although the absorptive capacity of the bond market appears to be quite satisfactory as far as the annual figures are concerned, this does not disguise the fact that last year the market showed some signs of weakness which became more pronounced after the turn of 1984–85. The most striking feature in this context was the sharp shift in emphasis on the investors' side. The strong demand for bonds in the initial months of 1984 emanated almost entirely from German non-banks, which invested record amounts in domestic bonds during that period. Towards the end of 1984, however, this investor group practically ignored domestic paper and turned its attention increasingly to foreign securities. At the same time, it is true, foreign investors greatly stepped up their purchases of domestic bonds; moreover, banks substantially enlarged their own holdings and trading portfolios of domestic bonds in the second half of 1984. In the course of these shifts of emphasis, however, investment motives based on interest and exchange rate speculation necessarily gained ground over the more long-term investment motives of non-banks, and they now often determine market trends. In the first few months of 1985 the market responded correspondingly sensitively to fluctuations in sentiment in domestic and foreign financial centres.

More long-term financing

The continuing large — and at times, indeed, increased — supply of funds accruing in the bond market (for the most part with long maturities) helped to improve the financing structure of the big debtor groups. This applies particularly to the public sector, whose net financing requirements went down, while it stepped up its borrowing through the securities market. Much the same also goes for those private borrowers who by tradition likewise take up the greater part of their funds at long term, i. e. those in the housing sector.

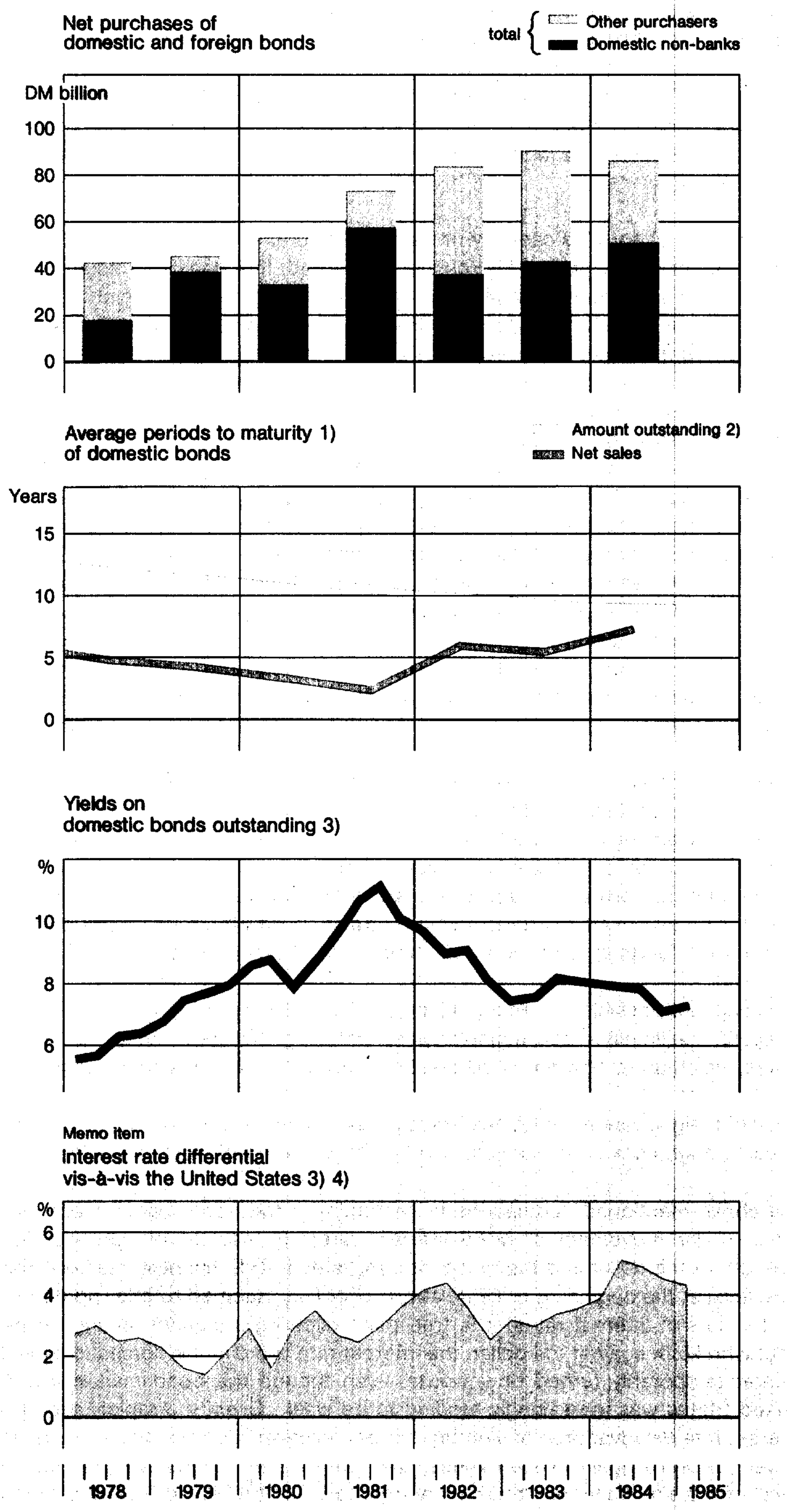
Scope for entrepreneurial financing in the bond market?

If, as appears possible, the requirements of these debtor groups should decline in future, additional scope might arise for meeting the credit needs of enterprises, which up to now have had practically no direct recourse to the domestic bond market. If this situation does not change, the bond market will presumably decline in significance, and more financial resources will then no doubt be provided through banks and via instruments with shorter periods to maturity.

Growing international interest rate differential during the first half of the year

The above-mentioned fluctuations in sentiment in the bond market were mirrored in the movement of bond interest rates. In view of the pronounced strength of the dollar and the rising interest rates in U.S. financial markets, the yield level at the beginning of 1984, at just over 8%, seemed to offer no potential for cuts in interest rates. It is true that, following a distinct firming of the Deutsche Mark against the dollar, the interest rate trend in the domestic capital market temporarily turned downwards, even though the bond market in the United States was increasingly tending to be weak. Given the rapidly growing interest rate disadvantage of German bonds, however, bond prices soon came under pressure again. Nevertheless, the rise in bond yields fell perceptibly short of the simultaneous upturn in interest rates in the United States, causing the interest rate differential to widen further in the first half of 1984. As measured by the yield on public bonds, it increased by about 2 points to 5½ per-

Trends on the bond market



1) Weighted average agreed periods to maturity.- 2) Level at end of year.- 3) Quarterly averages.- 4) Yields on public bonds in the United States less yields on public bonds in Germany.

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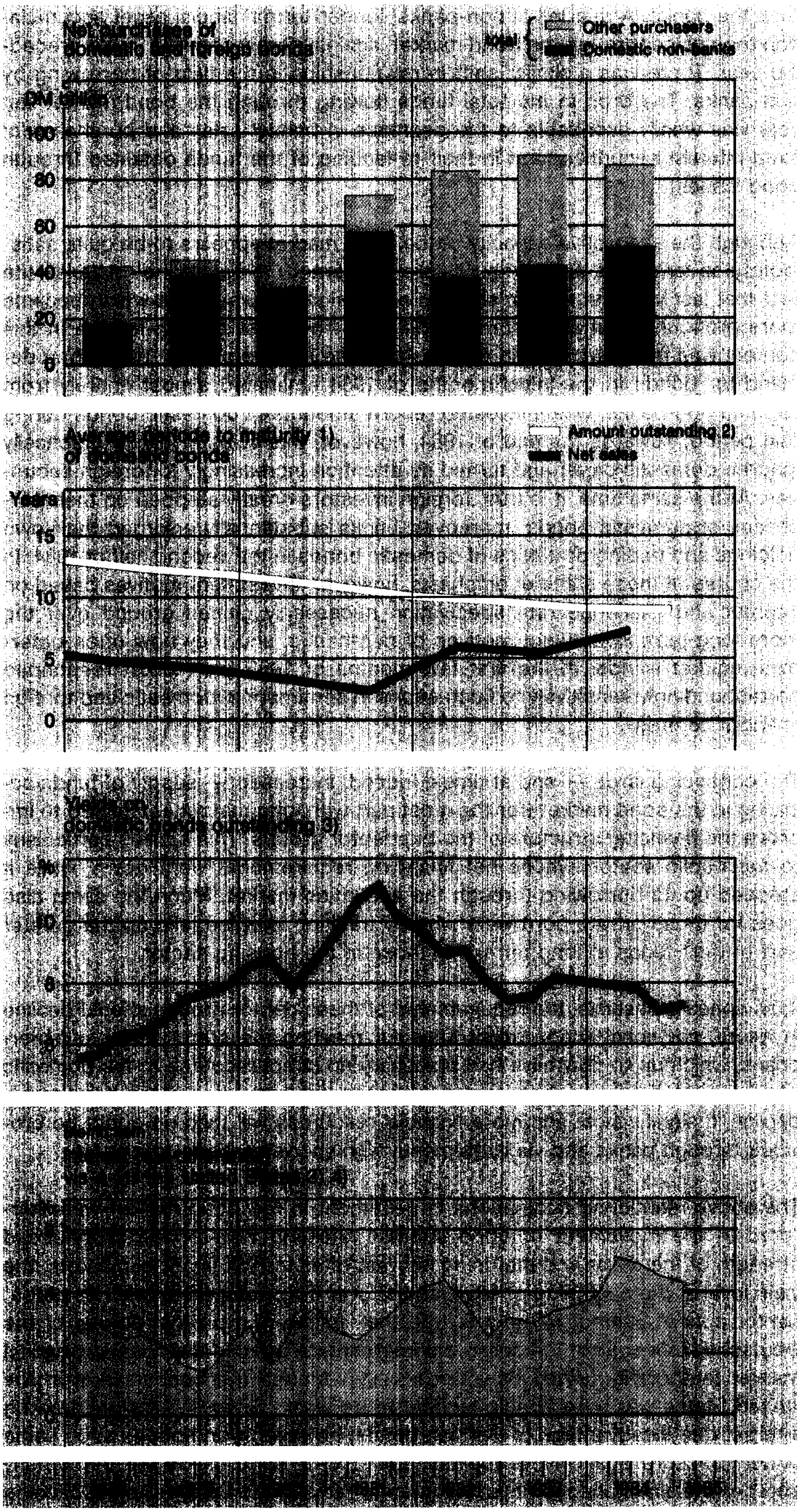
Trends on the bond market



1) Weighted average agreed periods to maturity.- 2) Level at end of year.- 3) Quarterly averages.- 4) Yields on public bonds in the United States less yields on public bonds in Germany.

centage points between the beginning of the year and early July 1984, although from March onwards this expansion was accompanied by a depreciation of the Deutsche Mark vis-à-vis the U.S. dollar.

Interest rates fall sharply in the second half of 1984, but rise again after the turn of the year

When interest rates started to fall in the United States around mid-year, the German market also benefited slightly from this, but the interest rate differential narrowed at the same time. Moreover, contrary to past experience, the downward tendency of the Deutsche Mark persisted. In view of the reversal in trend in the U.S. bond market, which made price rises in the German bond market too seem possible in future, and also encouraged by the Federal Government's announcement that it intended to abolish coupon tax (similar to measures taken by the U.S. Government), demand in the German bond market increased. Non-residents' purchases grew particularly strongly. The yield on bonds fell to 7% at the end of the year. When, at the end of January 1985, the U.S. dollar began to soar and thus probably dashed some favourable hopes with respect to the Deutsche Mark, the yield on German bonds rose again by half a percentage point to more than 7½% within a short time.

New forms of investment on the German capital market too

The abolition of coupon tax removed one of the last obstacles to the full integration of the German bond market in the international financial markets. Coupon tax had particularly hampered sales of domestic bonds abroad, especially after it had been abolished in the United States and some other countries. It was retained until 1984 for reasons connected with the tax system — not, however, as a dirigiste measure in capital transactions, although this objective had played a role at the time of its introduction in 1965. In actual fact, the freedom of international capital movements, which is guaranteed in Germany, is often not properly appreciated in international comparisons. The last remnants of administrative restrictions on security purchases by non-residents — they applied inter alia to certain money market paper, bills and short-dated securities in the bond market — were done away with as long ago as 1981. German issuing institutions' practice of coordinating the sequence of foreign Deutsche Mark bond issues among themselves, with the Bundesbank also participating, was no doubt appropriate in the first phase of the internationalisation of the German capital market, and in view of the pronounced fluctuations at times in international capital transactions. Given the degree of financial integration now achieved, however, it appears advisable to allow foreign banks domiciled in Germany as well to act as lead managers in future for issues of foreign Deutsche Mark bonds. The Bundesbank has let it be known that it would no longer object if bonds denominated in Deutsche Mark with the special terms that are popular world-wide at present (e.g. floating-rate bonds and zero bonds) were to be issued in Germany. Both issuers and buyers of such securities must weigh up for themselves the risks that may be posed by, say, the interest rate variability of such paper. As far as domestic bond issues are concerned, both sides of the market will presumably continue to prefer the traditional terms, with fixed interest rates, which provide debtors and creditors alike with a firm basis of calculation.

Long-dated bonds gain ground

Public authorities and the housing sector, which, taken together, absorb the great bulk of the funds raised in the bond market, took advantage of the favourable interest rate conditions in the capital market last year to strengthen their long-term financial base. Thus the trend which had started in 1982 towards a qualitative improvement in the pattern of the two sectors' debt persisted. In 1984 domestic issuers raised a total of DM 71 billion by selling bonds. This was distinctly less than in 1983 (DM 85.5 billion), but this fall primarily reflects the decline in the banks' shorter-term bond market debt. The long-term borrowing of domestic bond issuers, at DM 73.5 billion (net), was almost DM 5.5 billion higher than in 1983. The contrast between the very heavy sales of long-dated paper and the drop in sales of short-dated bonds was especially pronounced in

Sales and purchases of bonds in the Federal Republic of Germany

DM billion

Period	Sales, total	Sales 1 of domestic bonds: Total 2	of which Issues: of banks	of which Issues: of public authorities	Sales of foreign bonds 3	**Memo item** Balance of transactions with non-residents 4 (− = capital exports) col. 12 less col. 5
	1	2	3	4	5	6
1979	45.0	41.2	36.4	6.0	3.7	+ 0.3
1980	52.6	45.2	41.5	4.9	7.3	− 7.0
1981	73.1	66.9	70.5	− 2.6	6.2	− 7.7
1982	83.7	72.7	44.8	28.6	11.0	− 8.7
1983	91.3	85.5	51.7	34.4	5.7	+ 5.1
1984	86.8	71.1	34.6	36.7	15.7	− 1.9

	Purchases, total	Purchases by ...: banks (incl. Bundesbank)	domestic non-banks 5: Total	domestic non-banks 5: Domestic bonds	domestic non-banks 5: Foreign bonds	non-residents
	7	8	9	10	11	12
1979	45.0	1.6	39.3	38.2	1.1	4.0
1980	52.6	19.1	33.2	29.1	4.1	0.3
1981	73.1	17.4	57.1	51.5	5.7	− 1.5
1982	83.7	44.8	36.7	24.5	12.2	2.3
1983	91.3	37.6	42.9	36.4	6.5	10.8
1984	86.8	23.0	50.0	34.2	15.8	13.8

1 Net sales at market values plus/less changes in issuers' holdings of their own bonds. — 2 Including industrial bonds, which are not shown separately. — 3 Transaction values. — 4 Purchases of domestic bonds by non-residents less sales of foreign bonds to residents. — 5 Residual.
Discrepancies in the totals are due to rounding.

the case of bank bonds, where the outstanding amount of shorter-term securities actually fell somewhat in 1984. In the field of housing finance, in particular, short-term bridging loans, which used to be taken up at higher interest rates, have now given way to loans from mortgage banks at lower interest rates which are fixed for long periods.

Public sector debt management directed at improving the financial structures

In the context of public sector issues, too, shorter-term securities decreased sharply in significance in the course of last year, whereas the supply of long-term public paper grew strongly. In all, public issuers raised DM 36.5 billion through sales of their own bonds, against DM 34.5 billion in 1983. Virtually all the net sales were of securities with maturities of more than four years. Net sales of shorter-term paper — primarily public sector medium-term notes — fell from just on DM 7 billion in 1983 to less than DM 0.5 billion. As a result, the central, regional and local authorities met over three-quarters of their budget deficits out of long-term funds raised in the bond market. This was mainly because of the borrowing operations of the Federal Government, which took up a somewhat larger amount in the bond market than was consistent with its budget deficit. In the recurring bullish periods in the bond market there was a particularly strong demand for five-year special Federal bonds. They alone accounted for DM 14 billion of the funds taken up. Large amounts were also raised through traditional Federal bonds (DM 11 billion net). The remainder (DM 5 billion) was made up of Federal savings bonds, which are attractive to many investors (especially in periods of low interest rates) because they can be returned before maturity without any risk of price losses.

Brisk issuing activity in foreign Deutsche Mark bonds

Issuing activity in the field of foreign Deutsche Mark bonds was unusually brisk last year. Until the summer this market segment had benefited not least from its special tax status, which resulted from the fact that, for foreign buyers, Deutsche Mark bonds issued by foreigners (unlike those issued by German residents) were not subject to coupon tax. This had led to foreign Deutsche Mark bonds bearing lower rates of interest than comparable domestic bonds. After the abolition of coupon tax had been announced in the summer of 1984, interest rate conditions in these two market sectors returned to normal. Since then, foreign Deutsche Mark bonds have on average yielded about ¼ to ½ percentage point more than comparable domestic securities. Last year foreign borrowers issued more than DM 8.5 billion (net) of Deutsche Mark bonds, half of which were sold in the last quarter of 1984. Thus, foreign Deutsche Mark bonds remained attractive, also to foreign purchasers, even after the abolition of coupon tax. This was, however, not least because non-residents reduced their holdings of borrowers' note loans, which they had acquired earlier because they were exempt from coupon tax but which are not now as attractive as they used to be to some investors in comparison with listed bonds.

Heavy demand for dollar bonds by domestic non-banks . . .

Bond purchasers' attitude was very strongly affected in 1984 by fluctuating international interest rate differentials, expectations of interest rate changes and exchange rate expectations. As the year went on, domestic investors displayed growing interest in foreign currency securities. This applied particularly to domestic non-banks, almost one-third of whose aggregate bond purchases last year (DM 50 billion) consisted of foreign securities. If their purchases of foreign Deutsche Mark bonds are added, domestic non-banks invested nearly DM 16 billion in foreign paper. In particular, households' investment in foreign currency securities evidently went up by leaps and bounds. In part this change in investment behaviour took place indirectly, through the purchase of units of specialised investment funds, which — to the extent that they invest primarily in foreign securities — met with exceptionally strong demand for their units, especially in the second half of 1984.

. . . to the detriment of the domestic bond market

By contrast, domestic non-banks tended to withdraw from the German bond market. It is true that they provided, at DM 34 billion, almost half of the total amount raised in the bond market — i.e. hardly less than in 1983. But three-quarters of this sum was supplied in the first three months of 1984 alone; thereafter, their purchases of domestic bonds slackened perceptibly. In the last quarter of 1984 they actually allowed their holdings of domestic bonds to shrink considerably. Their portfolios of shorter-term bonds, large amounts of which had been issued by banks and bought by non-banks in the years when interest rates were high, were particularly affected thereby. At the same time, in this period of relatively low interest rates non-banks again showed greater preference for forms of investment that were free from price risks, as already mentioned elsewhere in this Report. Insurance enterprises likewise invested heavily in assets not subject to price risks last year. This presumably owed something to expectations of a possible upturn in interest rates.

Larger bond purchases by banks as a "substitute for lending business" characterised by interest rate speculation

Between summer 1984 and the end of the year domestic banks were a mainstay of the purchasers' side of the market. This is not unusual in periods of falling interest rates; indeed, the banks often determine developments in this way. On the one hand, in such periods banks regularly receive relatively large inflows of funds, especially in the long-term areas of their borrowing and deposit business, without this being accompanied by a comparable demand for longer-term bank loans in their lending business. Hence the banks channel the long-term funds increasingly lodged with them without price risks by non-banks into corresponding bond investments. For the rest, in periods of declining interest rates short-term, price-speculative considerations are of some significance among banks. This attitude seems to have been additionally fostered by foreign customers' very strong demand for Deutsche Mark bonds at times. In the second half of 1984 alone banks built up their bond holdings by DM 28 billion, whereas they had run them down by DM 2 billion in the first half of the year.

Contracting market for industrial bonds

In view of the generally favourable underlying conditions in the organised capital market, it may be considered a disadvantage that the business sector made no direct calls on the bond market last year either. In 1984, as in the preceding years, the outstanding amount of industrial bonds declined further. At DM 2 billion at the end of 1984, it made up less than 1 % of the total amount of domestic bonds outstanding. This raises questions as to whether German industrial enterprises no longer regard long-term financing in the securities market as attractive, or whether they no longer need such resources because of their ample cash flow and the short write-off periods of many assets. However, this contrasts with the keen interest German firms are showing through their foreign financing companies in bond issues — partly in the form of option loans — in the international market. Last year no fewer than eight German enterprises seeking bond issues approached the market in this way; in all they raised DM 0.9 billion by issuing bonds. One significant factor here, among others, is presumably that enterprises consider it advantageous to be able, by issuing foreign bonds, to bypass the traditional licensing procedure prescribed by German law (under section 795 of the Civil Code) for industrial bonds.

Share market put to the test

The contribution made by the domestic share market to the improvement in enterprises' capital base last year can be viewed more positively. The overall conditions offered by the market were extremely favourable in 1984. The year started off with share prices at an all-time peak. True, share prices fell somewhat at times under the impact of interest rate movements in Germany and abroad and the labour disputes; but even at their lowest level (in July 1984) they still distinctly exceeded the 1983 low. Immediately thereafter and parallel to the trend in bond prices, a steep rise in share prices began, and continued — with short interruptions — until the turn of 1984-85 and beyond. In mid-March 1985 the index of share prices calculated by the Federal Statistical Office reached a new peak which was 20 % above the comparable figure of the previous year.

Gratifyingly large number of "stock exchange newcomers" . . .

Against the background of these positive preconditions for financing through share issues, encouraging signs of a revival of the share market were visible last year. Nowadays it is not so unusual for enterprises to decide to approach the stock exchange for the first time. This gratifying development no doubt owes something to the fact that the banks are showing more interest in issuing business. In 1984 more than 20 enterprises applied to the stock exchange for the first time; this was twice as many "newcomers" as in 1983, and many times the figures of earlier years. As before, however, lead management was shared among a very small number of institutions. Moreover, it must be borne in mind that last year, too, a number of enterprises disappeared from the price list. Nevertheless, in 1984, for the first time for some years, the number of officially listed companies went up on balance, namely by seven to a total of 449 at the end of the year; until then it had fallen almost continuously (in 1956 there had been 690 such companies).

. . . but a definitive change in trend not yet in sight

In view of the favourable financing conditions prevailing in the market last year, however, this outcome — taken as a whole — must be rated very modest. A definitive turnaround in the assessment of the share as an instrument of business finance was not discernible in the issuing activity of existing public limited companies. Total sales of shares in 1984, at DM 6.25 billion, were actually DM 1 billion lower than in 1983. In a sense, this may reflect the fact that the distinctly improved profitability of many large enterprises and the financial reserves they have accumulated in the meantime have provided them with sufficient scope for meeting their current financial needs. It would, however, be desirable if — given the favourable state of the share market — enterprises and their principal bankers were to decide to consolidate more of their bank debt by issuing shares. On the one hand, this would strengthen the structure of enterprises' balance sheets with respect to future risks and, on the other, it would broaden the supply of equities on the narrow German stock exchanges. Given a rise in the amount of equities outstanding, for instance, non-residents' purchases in the German share market, desirable as they are in principle, would not lead to such extreme price fluctuations as were observed in 1984 and at the beginning of 1985.

II. International monetary developments and policy

1. The situation in the world economy

Strong economic growth in the industrial countries . . .

In 1984 the upward trend in economic activity in the industrial countries of the West continued at a stronger pace. The combined gross national product of the OECD countries rose by almost 5% in real terms in 1984 after increasing by 2½% in the preceding year. However, the degree of economic dynamism within this group of countries varied widely. Economic growth in the United States accelerated to almost 7%, with Japan and Canada also experiencing a powerful upswing in economic activity. Although the revival in activity in Europe also picked up, it did so to only a comparatively modest extent over the year as a whole; the gross national product of the OECD countries in Europe increased on average by 2½%. However, the growth differential between the United States and Europe declined markedly over the course of the year. Seasonally adjusted and expressed as an annual rate, gross national product in the United States rose by 3½% in the second half of 1984 over the first half of the year, while growth in overall economic activity in Europe accelerated slightly at the same time. These generally favourable trends are encouraging because they reflect a renewed growing propensity to invest. On the other hand, the persistent differences as regards the development of domestic demand in the individual countries are indicative of serious problems. The strongly rising level of domestic demand in the United States also encompassed foreign goods to a considerable extent as the dollar steadily went up in value, thus helping to support the economic recovery in its partner countries; but it remains to be seen how the associated growing disequilibria in international trade and current transactions can be coped with on a durable basis.

. . . without an acceleration in inflation

One of the positive elements of the most recent economic upswing is the fact that, measured in terms of the rise in consumer prices, inflation did not increase. After inflation in all OECD countries, expressed as an annual average, had reached a high point of 10.5% in 1981, the rate of price increases declined to 5.3% in 1983. It could not be reduced further below this level, however, in 1984. But the increase in the overall level of prices in the OECD area, as reflected in the GNP deflator, did slow down further. Moreover, the inflation differential among the group of industrial countries narrowed once again. The decisive reason for this was the fact that France and Italy — both of which had fallen far behind in combating inflation in comparison with other major industrial countries — now achieved substantial successes in terms of price stabilisation; the rate of increase in consumer prices in France declined by over 2 percentage points to 7.4% and that in Italy by 4 points to 10.7%. It is to be hoped that all countries will continue to give priority to combating inflation in order to help safeguard the preconditions for durable economic growth.

Unsolved labour market problems in Europe

Up to the present, the recovery in economic activity in the industrial countries has brought about a substantial easing of the labour market situation only in the United States. A large number of new jobs have been created, notably in the services sector of the U.S. economy, reducing the unemployment rate in the United States from 9½% in 1983 to 7½% last year. Japan has also registered an increase in the level of employment. By contrast, success has been achieved in Europe only in halting the decline in the number of jobs. Since in the countries of Europe a large number of new job-seekers came on to the labour market for demographic reasons, unemployment in these countries has actually increased markedly again. According to OECD calculations, after an average of 10½% of the labour force in Europe had been out of work in 1983, this figure rose to 11% in 1984. This high level of unemployment is due in considerable measure to structural factors. In order to increase the number of jobs in Europe, besides pursuing a generally moderate wage policy, it is especially necessary to eliminate existing rigidities on the labour market and, as regards wages, to take greater account than in the past of the differences in economic conditions from industry to industry and region to region.

Economic upswing in the United States not without its blemishes

However, the economic upswing in the United States is not without its blemishes either. Especially as a result of considerable tax reductions, which also benefited the corporate sector, this upswing is being accompanied by unusually high and rising budget deficits. The outcome is high interest rates; these owe something both to the rising absorption of domestic savings by the public sector and to the improved profitability of the corporate sector, which results not least from the preceding tax cuts, makes corporations less sensitive to the level of interest rates and thus stimulates the demand for credit. Up to the present, high interest rates and good earnings in the corporate sector have fostered capital flows into the United States and supported the tendency of the U.S. dollar to rise on the foreign exchange markets. However, in combination with the rising value of the dollar, the high level of domestic demand has engendered deficits of previously inconceivable proportions in the U.S. trade balance and current account. This has given rise to considerable problems and risks for the world economy, which will be all the more difficult to overcome, the longer the U.S. external deficits last. In the United States itself protectionist forces are increasingly at work, particularly since the United States' foreign competitors are in many cases hitting sectors of the U.S. economy that have not benefited fully from the upswing there. Apart from Japan and Europe, the developing countries, in particular, would also be severely affected by this. The further spread of protectionist tendencies in the rest of the world could then hardly be avoided; this would seriously jeopardise the liberal world trade system. For this reason a change in the stance of budgetary policy in the United States is imperative. If this were accompanied by lower interest rates, it could help to improve the situation of the highly indebted developing countries and reduce the risks within the international financial system. In a number of industrial countries downward scope could also be gained for long-term interest rates if dollar interest rates were less attractive.

2. International trade and current transactions

Strong increase in world trade

In line with the upward trend in global economic activity, world trade increased strongly again. In 1984 the volume of world trade went up by 9%. In the previous year the rise had been no greater than 2% and had only just made up for the preceding decline. However, this rate of growth in international trade did not quite match the buoyancy of former recovery phases; moreover, it was due in substantial measure to expansionary impulses that emanated unilaterally from the United States. Adjusted for inflation, imports into the United States in 1984 increased by about one-quarter in comparison with the preceding year; this explains almost half the growth in imports world-wide.

Rise in U.S. imports the dominant factor in the global pattern of current account positions

The powerful expansion of imports into the United States was the main reason for the simultaneous rise in the U.S. deficit on current account. Within the space of one year it grew by $ 60 billion to $ 102 billion, thus — albeit with the signs reversed — constituting a disequilibrium equivalent to the OPEC surpluses at their peak in 1980. Naturally enough, disequilibria of such proportions leave distinct marks on the current account balances of practically all other countries. Although the expansionary effects associated with such a high U.S. current account deficit are welcome to the extent that they help to foster the economic upswing in other industrial countries and at the same time to alleviate the debt problems of many developing nations, these positive effects are impaired to the extent that high U.S. interest rates and the strength of the dollar keep interest rates in other countries at a high level.

Current account balances of selected countries and groups of countries

US$ billion

Group of countries/Country	1980	1981	1982	1983	1984p
A. OECD countries					
United States	+ 2	+ 6	− 9	− 42	−102
Six other major countries	− 34	− 4	+ 4	+ 26	+ 41
Japan	− 11	+ 5	+ 7	+ 21	+ 35
Canada	− 1	− 5	+ 2	+ 1	+ 2
Germany	− 16	− 6	+ 4	+ 4	+ 6
France	− 4	− 5	− 12	− 4	− 0
United Kingdom	+ 8	+ 15	+ 9	+ 4	+ 0
Italy	− 10	− 8	− 6	+ 1	− 3
Other countries	− 38	− 29	− 22	− 10	− 2
Total	− 70	− 28	− 28	− 25	− 63
B. OPEC countries					
Low-population 1	+ 87	+ 69	+ 12	− 1	+ 5
High-population 2	+ 23	− 19	− 28	− 21	− 10
Total	+111	+ 50	− 15	− 22	− 5
C. Other developing countries					
Threshold countries 3	− 40	− 45	− 31	− 6	− 1
Other countries	− 20	− 36	− 33	− 31	− 23
Total	− 60	− 81	− 64	− 37	− 24
D. Other non-OECD countries 4	− 9	− 10	+ 8	+ 11	+ 12
E. Statistical discrepancy (Total A to D)	− 28	− 69	− 99	− 73	− 81

1 Kuwait, Libya, Qatar, Saudi Arabia, United Arab Emirates and the non-member Oman. — 2 Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Nigeria, Venezuela. — 3 Argentina, Brazil, Chile, Hong Kong, Israel, Mexico, Singapore, South Korea, Taiwan, Uruguay. — 4 Centrally planned economies (China, Indo-Chinese countries, Mongolia, North Korea, eastern European countries, USSR), Malta, South Africa, Yugoslavia. — **p** Provisional. Discrepancies in the totals are due to rounding.
Sources: OECD and national statistics.

Much improved current account balances of the industrial partner countries of the United States

The deterioration of the U.S. balance on current account was mirrored most strongly in an increase in Japan's surplus on current account, which went up by $ 14 billion to $ 35 billion. And Japan — the most important trading partner of the United States after Canada — did not even exploit its competitive advantages in full; thus, Japan's exports of cars and steel to the United States were noticeably reduced through self-restraint agreements. In contrast, Canada's current account registered only a slight improvement. Although Canada's exports also benefited to an above-average extent from the strength of economic activity in the United States, Canada's imports from the United States, unlike those of Japan, rose considerably, too. Among the other major industrial countries, France and the Federal Republic of Germany improved their current account balances by a total of $ 6 billion, whereas the current account balances of the United Kingdom and Italy deteriorated sharply. At the same time, the smaller OECD countries improved their aggregate current account balance by $ 8 billion; among them, the Netherlands — which has the strongest current account position within this group of countries — increased its surplus further. Taking all the industrial partner countries of the United States together, their combined current account position improved by $ 22 billion, accounting for some 35% of the deterioration in the position of the United States.

Current account deficit of the developing countries smaller than before the second oil price hike

The non-OPEC developing countries also succeeded in further increasing their exports last year, after they had already stepped them up sharply in 1983. This also enabled them to expand their imports again, for the first time since they had had to cut them back severely at the height of the international debt crisis. The outcome, according to OECD calculations, is a renewed decline in the foreign trade deficit of the developing countries, to its lowest level since 1953, relative to their total exports. In this context, the threshold countries — particularly those in South-East Asia that realised early on the need to create economic structures geared to exports — once again increased their exports and imports most strongly. However, the other developing countries also improved their foreign trade positions. After having fallen markedly in 1983, interest payments by the developing countries rose slightly again; this was due partly to the further increase in these countries' total foreign debt and partly to the renewed rise in the level of interest rates on the dollar markets. The aggregate current account deficit of this group of countries nevertheless declined again considerably in 1984 — by an estimated $ 13 billion to a total of $ 24 billion, according to preliminary data from international agencies; this means that it was already smaller than in 1978, the year preceding the second oil price hike.

Current account deficit of the OPEC countries largely eliminated

The current account position of all the OPEC countries taken together, which had registered their highest surplus in 1980 but increasingly shifted into deficit in 1982-83, also improved considerably last year. The aggregate deficit of this group of countries declined by $ 17 billion to only $ 5 billion, the main reason being a drastic reduction in imports. The low-population countries, which have large financial reserves, introduced such restrictions, just as the other countries did. A part was played in this process by the further decline in the OPEC countries' export earnings. On the one hand, crude oil prices were under pressure for most of last year, finally leading to the abandonment with effect from February 1984 of the OPEC countries' benchmark price, which had already been reduced to $ 29 per barrel in March 1983, and its replacement by an official price pattern that is lower on average. On the other hand, the OPEC countries did not succeed in participating in the global rise in the demand for oil, which had previously declined sharply for four years. Oil produced closer to the centres where it is consumed proved to be more competitive in many cases and, in addition, many countries were able to meet an increasing proportion of their oil needs from their own petroleum production.

3. Exchange rate developments and policy

(a) Trends in the major floating currencies

Further strengthening of the dollar

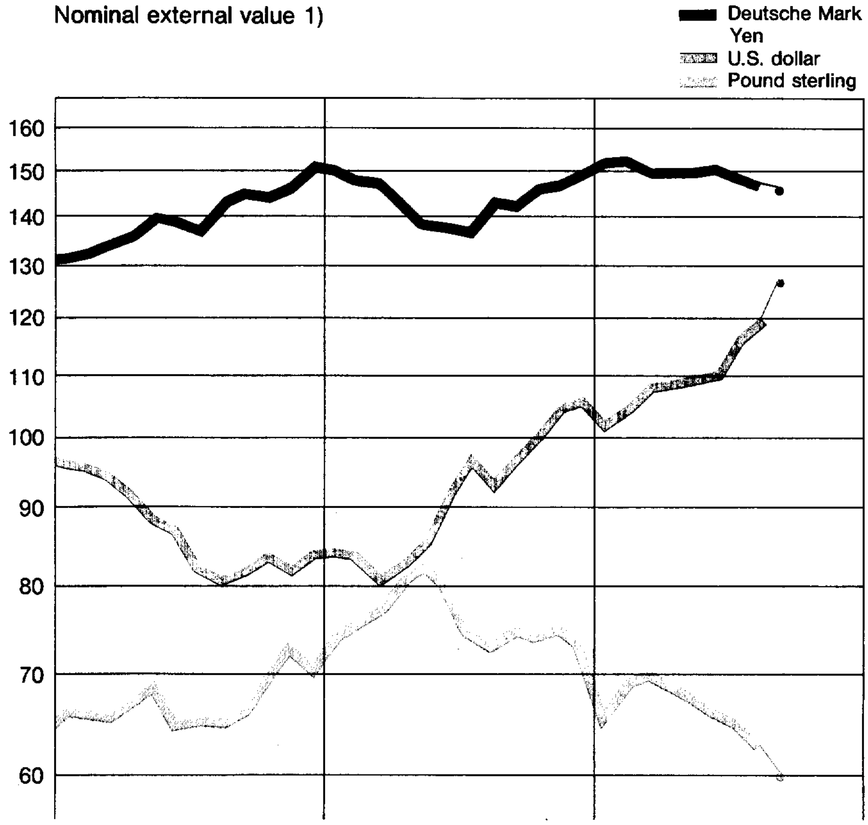
In 1984 and up to a few weeks ago developments on the foreign exchange markets continued to be determined by a strongly rising dollar. According to the Bundesbank's method of calculation,[1] its weighted external value against the currencies of 14 other industrial countries rose in the course of the year by 12 %. Since prices in the United States increased last year to a similar extent to the average of these partner countries, the U.S. currency went up to the same degree in real terms. From the end of 1972, when the system of fixed dollar parities was on the verge of collapse, up to the end of 1984 the weighted nominal external value of the U.S. currency rose by 24 %. In inflation-adjusted terms, too, the dollar increased in value over this period by 15 % after its upsurge last year. Of course, such a longer-term view obscures the fact that the exchange rate of the U.S. currency underwent considerable fluctuations during that period. From the end of 1972 to October 1978 the dollar suffered a marked loss in value; thereafter, its weighted external value improved by 55 % up to the end of 1984. The real external value of the dollar went up by as much as 61 % from its lowest level. The even stronger rise in its real external value since October 1978 in comparison with its nominal external value was due above all to the relatively high rates of inflation in the United States between 1979 and 1981, which additionally reduced the purchasing power of foreign currencies in the United States.

1 See "New calculation of the external value of the Deutsche Mark and foreign currencies" in Monthly Report of the Deutsche Bundesbank, Vol. 37, No 1, January 1985, p. 38.

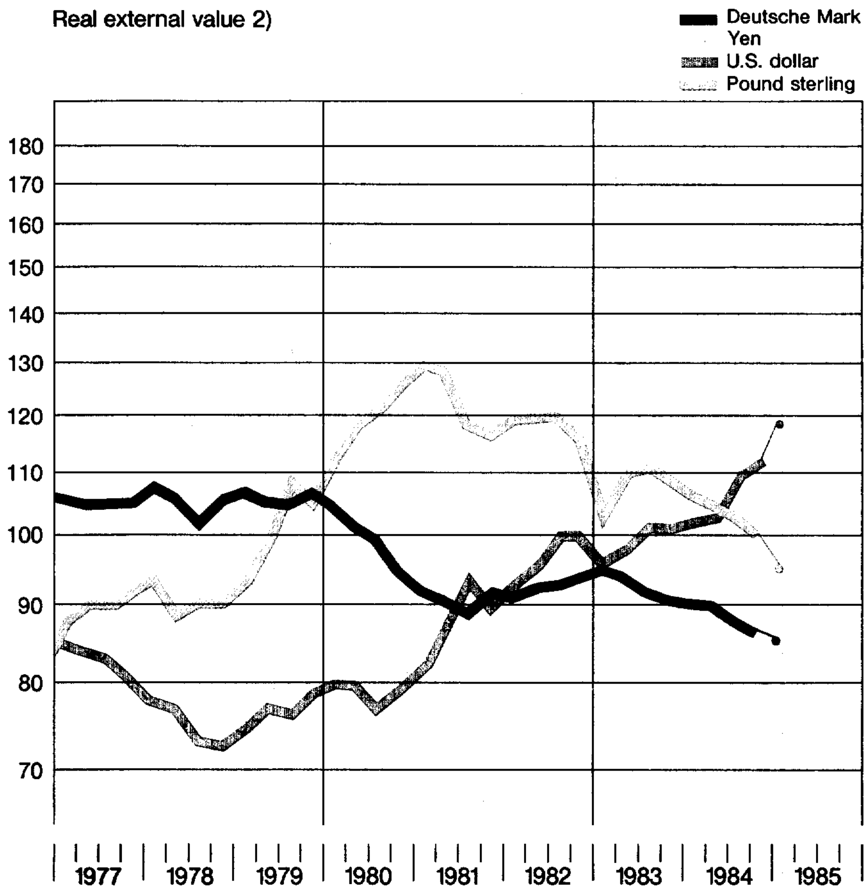
Weighted external value of major currencies

End-1972=100; quarterly averages, log. scale

Nominal external value 1)



Real external value 2)



1) In each case against the currencies of 14 other industrial countries; geometrically weighted on the basis of the trade flows of industrial products between 1980 and 1982, taking account of third-market effects.- 2) Weighted nominal external value adjusted for discrepancies in consumer price movements.- Latest position: February 1985.

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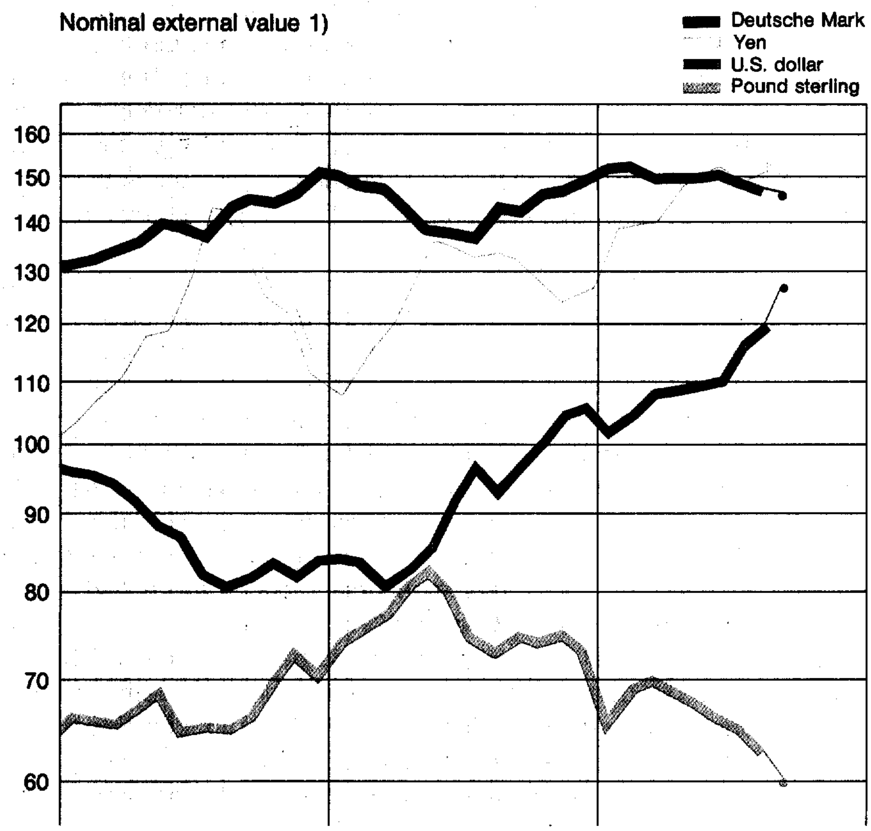
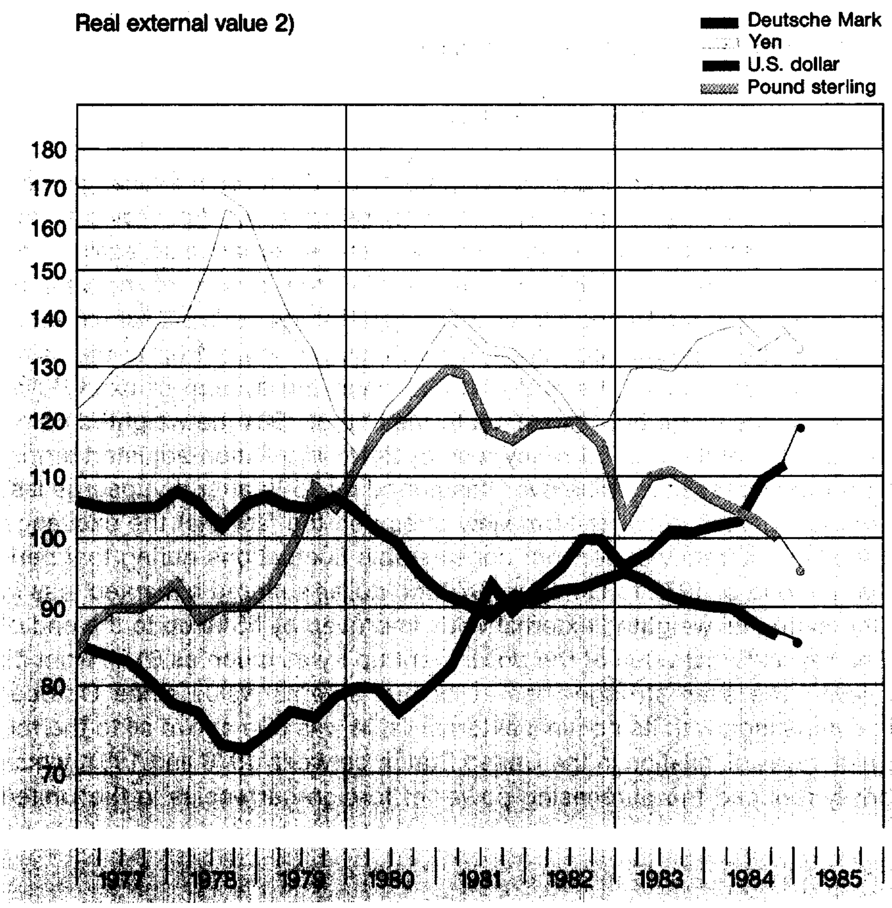
Weighted external value of major currencies

End-1972=100; quarterly averages, log. scale

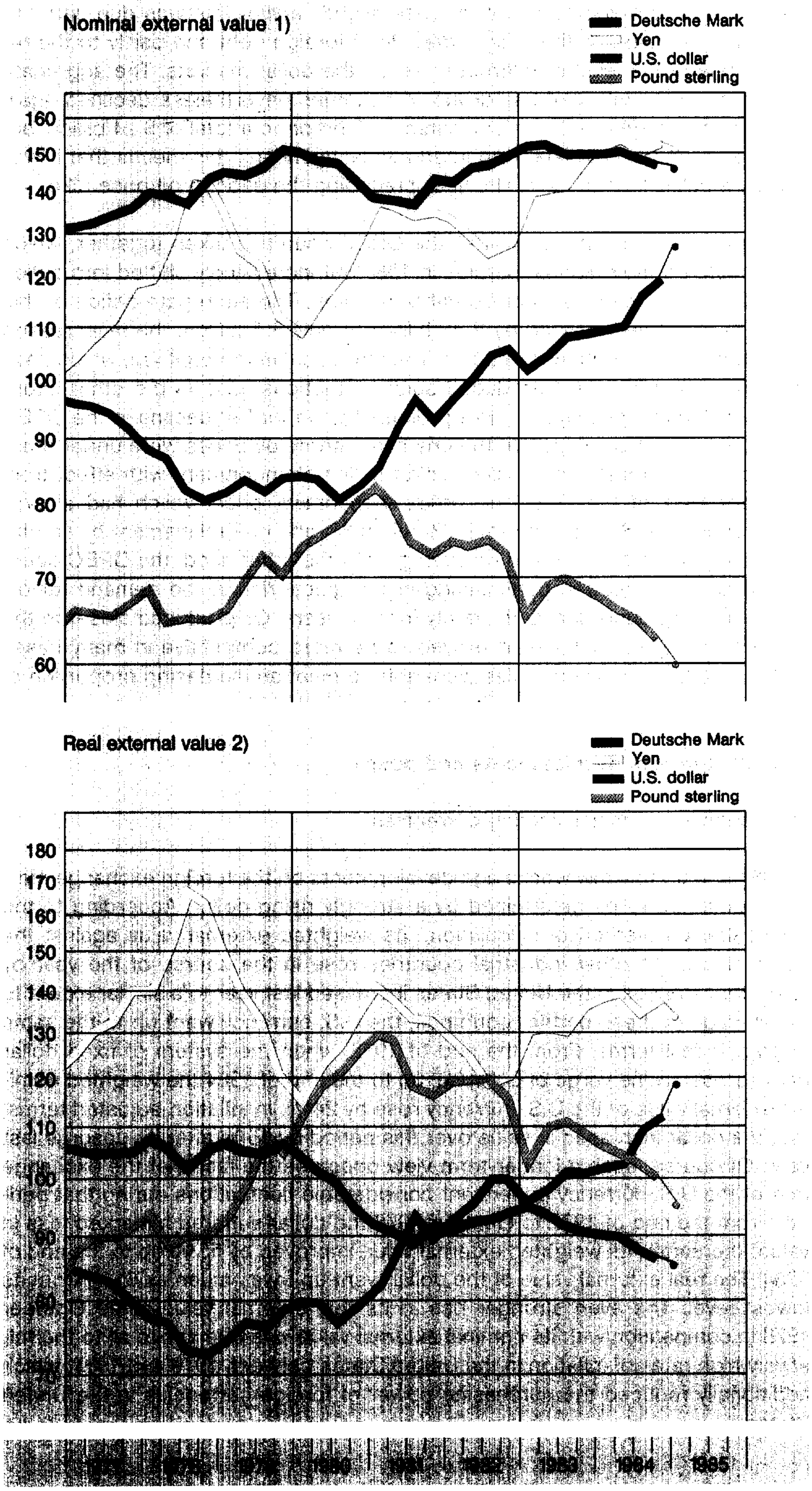




1) In each case against the currencies of 14 other industrial countries; geometrically weighted on the basis of the trade flows of industrial products between 1980 and 1982, taking account of third-market effects.- 2) Weighted nominal external value adjusted for discrepancies in consumer price movements.- Latest position: February 1985.

Weighted external value of major currencies

End-1972=100; quarterly averages, log. scale



1) In each case against the currencies of 14 other industrial countries; geometrically weighted on the basis of the trade flows of industrial products between 1980 and 1982, taking account of third-market effects.- 2) Weighted nominal external value adjusted for discrepancies in consumer price movements.- Latest position: February 1985.

Complex causes of the strength of the U.S. dollar

It is not easy to reconcile the further increase in the dollar rate with traditional experience, according to which current account deficits led to the depreciation of the currency of the country concerned on the foreign exchange markets, which in the end resulted in a reorientation of goods flows in the direction of better equilibrium in the country's current account position. In contrast to this, the dollar has constantly appreciated — albeit with fluctuations — on the foreign exchange markets despite the growing U.S. current account deficit, with its strength adding substantially to the deficit on current account. This points to sufficiently large imports of capital which — unimpressed by the size of the current account deficit — ensured its being financed despite the rise in the dollar and at times even declining dollar interest rates. The causes behind this trend in the exchange rate of the dollar are complex. They begin with an economic and fiscal policy which provided powerful impulses to economic growth through tax reductions for both the corporate sector and private households and through tolerating a growing budget deficit, with tax-policy-induced rises in the corporate sector's profits playing an important role. Given the tight, stability-oriented monetary policy stance of the Federal Reserve System, the large-scale recourse to the money and capital markets required in order to finance the budget deficit gave rise to correspondingly high interest rates — both in nominal terms and, with a declining rate of inflation, in real terms. Against the background of good profits and optimistic profit expectations, these high interest rates did not have an adverse effect on the development of activity in wide areas of the U.S. economy. Taken as a whole, rather, the U.S. economy presents the picture of a dynamic and adaptable economy that is enjoying strong growth and good returns on both fixed and financial assets. For this reason, investments in the United States appear attractive to non-residents, just as, conversely, capital exports from the United States are slowing down — all the more so as financial investments in the highly indebted developing countries are nowadays considered to be very risky anyway. In addition, the overall security that non-resident investors perceive in investments in the United States ("safe haven") is a constant support for the dollar.

Valuation of the dollar characterised by greater uncertainty of late

More recently, however, greater attention than in the past has been paid to the risks inherent in the development of the dollar rate for the U.S. economy and its growth prospects. This includes the growing indebtedness of the United States vis-à-vis third countries and the resultant rapid deterioration in the U.S. balance on investment income account, which is making the necessary reduction in the deficit on current account more and more difficult. There is, in addition, the dependence on the willingness of foreign investors to continue to invest short and long-term capital in the United States in spite of the growing exchange rate risk. Moreover, the disadvantages of high interest rates and a strong dollar for wide sections of the U.S. economy — especially for farmers and export-oriented corporations — are becoming increasingly apparent, with implications for the quality of the domestic credit portfolio of many U.S. banks. At all events, the greater attention now being paid to these risks, together with the uncertainty as to whether the growth of the U.S. economy will actually continue as expected, is subjecting the valuation of the dollar on the foreign exchange markets to greater uncertainties than for a long time past.

Growing interest rate advantage of the dollar up to August 1984

After the U.S. currency had started last year at a new high level of exchange rates, it suffered marked losses from the beginning of February 1984 onwards, first vis-à-vis European currencies and then vis-à-vis currencies in the Far East. Several factors had evidently contributed to the change in mood, including concern that the powerful upswing in U.S. economic activity might be accompanied by a rekindling of inflation. Against this background, fears grew that it could become difficult to continue to finance the burgeoning U.S. current account deficit smoothly unless the differential in international interest rates widened. The market also paid great attention to reports of shifts out of dollar assets into Deutsche Mark and other international investment currencies. But as early as March 1984, when signs of a further acceleration in economic growth in the United States appeared, the U.S. currency resumed its rise. Apart from a brief downturn in May in connection with the difficulties encountered by a large U.S. bank, the tendency of the dollar to strengthen continued into September. Parallel to this development, the interest rate advantage of dollar assets increased considerably, owing above all to the rise in U.S. interest rates; the interest rate differential between the U.S. dollar and the Deutsche Mark for 3-month funds on the Euro-market rose from 4.1 % to 6.3 % between February and August. The flow of capital to the United States seems to have been additionally stimulated by the abolition of U.S. withholding tax on newly issued foreign-owned bonds with effect from mid-July 1984, and by the fact that it was made easier for non-residents to buy U.S. fixed interest securities anonymously. Apart from this, the dollar profited from the attention paid by the general public to a number of protracted industrial disputes in Europe.

Reduction in the international interest rate differential not detrimental to the dollar

In mid-September 1984 the hectic conditions on the foreign exchange markets signalled the possibility that the rise in the dollar was approaching its peak. Short-term exchange rate fluctuations were more marked than usual and at times amounted to more than 2 % from one day to the next. In fact, the dollar fell back repeatedly from the high level it had reached in the second half of September, but it always quickly made up for the losses again. At the beginning of 1985 the U.S. currency finally exceeded the record levels it had attained in the preceding year. From then on it strengthened further in large jumps up to the end of February, before increasing exchange rate uncertainty resulted in a distinctly lower valuation of the U.S. dollar again. In contrast, the interest rate advantage enjoyed by the dollar over other major currencies declined sharply from September 1984 onwards, especially at the short end of the market.

Slight rise in U.S. capital imports

The marked deterioration in the current account position of the United States, which taken by itself would constitute a burden on the dollar on the foreign exchange markets, was counteracted last year by the fact that capital inflows into the United States went up while capital outflows from that country declined further at the same time. In 1984, statistically recorded capital imports into the United States rose by \$ 14 billion to \$ 90 billion, although this was still slightly less than in 1982. This means that the strong rise in the U.S. current account deficit was financed to only a relatively small extent by financial investment in the United States by non-residents. However, the United States registered rising capital imports last year in the form of foreign direct and portfolio investment as well as borrowing abroad by the U.S. corporate sector. By contrast, loans taken up abroad by U.S. banks decreased further.

Further decline in U.S. capital exports

The substantial improvement in the U.S. balance on capital account resulted mainly from the fact that capital outflows from the United States largely dried up, falling by \$ 30 billion to as little as \$ 18 billion. In particular, new lending by U.S. banks to non-residents, which had totalled over \$ 110 billion in 1982, dropped to only \$ 7 billion.[1] If the global economic situation improves further and the highly indebted developing countries, which accounted for a considerable part of total international lending by U.S. banks in the past, likewise make further progress towards consolidating their indebtedness, it must be expected that external lending by U.S. banks will increase again. To this extent, at the present level of exchange rates, the high net imports of capital into the United States appear to contain unstable elements, at least in part.

1 However, in 1981-82, when what are known as "international banking facilities" were established in the United States, both the claims of U.S. banks on non-residents and their liabilities to non-residents were inflated by the partial retransfer of international transactions from offshore centres to the United States.

Balance of payments of the United States

US$ billion

Item	1976	1977	1978	1979	1980	1981	1982	1983	1984 **pe**	Change in 1984 against 1983 **pe**
A. Current account										
Merchandise trade										
Exports	114.7	120.8	142.1	184.5	224.3	237.1	211.2	200.3	220.3	+ 20.1
Imports	124.2	151.9	176.0	212.0	249.8	265.1	247.7	261.3	327.8	+ 66.5
Balance	− 9.5	− 31.1	− 34.0	− 27.6	− 25.5	− 28.0	− 36.5	− 61.1	− 107.4	− 46.4
Foods, feeds and beverages	+ 8.3	+ 5.7	+ 9.8	+ 12.6	+ 17.6	+ 20.1	+ 14.5	+ 12.9	+ 11.2	− 1.8
Capital goods	+ 26.8	+ 25.8	+ 26.8	+ 33.8	+ 43.0	+ 44.9	+ 35.3	+ 27.3	+ 13.1	− 14.2
Automotive vehicles, parts and engines	− 4.6	− 5.8	− 9.3	− 8.0	− 10.4	− 11.1	− 16.7	− 23.7	− 33.1	− 9.4
Consumer goods (non-food)	− 9.1	− 12.9	− 18.5	− 17.7	− 17.8	− 22.3	− 24.9	− 31.4	− 45.9	− 14.5
Petroleum and products	− 33.5	− 43.6	− 40.7	− 58.5	− 76.3	− 73.7	− 54.8	− 48.8	− 52.9	− 4.1
Other industrial supplies and materials	+ 1.8	− 2.0	− 3.8	+ 7.7	+ 14.9	+ 8.5	+ 7.1	− 0.6	− 6.9	− 6.3
Other	+ 0.8	+ 1.7	+ 1.8	+ 2.6	+ 3.4	+ 5.7	+ 3.0	+ 3.2	+ 7.0	+ 3.9
Services	+ 18.7	+ 21.2	+ 23.6	+ 32.2	+ 34.5	+ 41.1	+ 35.3	+ 28.1	+ 17.0	− 11.2
Unilateral transfers	− 5.0	− 4.6	− 5.1	− 5.6	− 7.1	− 6.8	− 8.1	− 8.7	− 11.2	− 2.5
Balance on current account	+ 4.2	− 14.5	− 15.4	− 1.0	+ 1.9	+ 6.3	− 9.2	− 41.6	− 101.6	− 60.1
B. Capital account										
(capital imports: +)										
Foreign assets in the United States										
Direct investment	+ 4.3	+ 3.7	+ 7.9	+ 11.9	+ 16.9	+ 23.1	+ 14.9	+ 11.3	+ 21.2	+ 9.9
Portfolio investment	+ 4.1	+ 3.0	+ 4.4	+ 6.3	+ 8.1	+ 10.1	+ 13.5	+ 17.3	+ 35.5	+ 18.2
Liabilities reported by enterprises	− 0.6	+ 1.1	+ 1.9	+ 1.6	+ 6.9	+ 0.9	− 2.4	− 1.3	**2** + 5.5	**2** + 6.8
Liabilities reported by banks	+ 11.0	+ 6.7	+ 16.1	+ 32.6	+ 10.7	+ 42.1	+ 65.9	+ 49.1	+ 27.6	− 21.5
Liabilities reported by U.S. Government	+ 4.6	+ 1.4	+ 2.5	− 0.0	+ 0.6	− 0.3	+ 0.4	+ 0.2	+ 0.3	+ 0.1
Total	+ 23.5	+ 15.9	+ 32.8	+ 52.4	+ 43.2	+ 76.0	+ 92.2	+ 76.6	+ 90.1	+ 13.6
U.S. assets abroad										
Direct investment	− 11.9	− 11.9	− 16.1	− 25.2	− 19.2	− 9.6	+ 4.8	− 4.9	− 6.0	− 1.2
Portfolio investment	− 8.9	− 5.5	− 3.6	− 4.7	− 3.6	− 5.7	− 8.1	− 7.7	− 4.8	+ 2.9
Claims reported by enterprises	− 2.3	− 1.9	− 3.9	− 3.3	− 3.2	− 1.2	+ 6.6	− 5.3	**2** + 5.6	**2** + 10.9
Claims reported by banks	− 21.4	− 11.4	− 33.7	− 26.2	− 46.8	− 84.2	− 111,1	− 25.4	− 7.3	+ 18.1
Claims reported by U.S. Government	− 4.2	− 3.7	− 4.7	− 3.7	− 5.2	− 5.1	− 6.1	− 5.0	− 5.5	− 0.4
Total	− 48.7	− 34.4	− 61.9	− 63.2	− 78.0	− 105.8	− 113,9	− 48.3	− 18.0	+ 30.3
Balance on capital account										
Direct investment	− 7.6	− 8.2	− 8.2	− 13.3	− 2.3	+ 13.5	+ 19.6	+ 6.4	+ 15.1	+ 8.7
Portfolio investment	− 4.8	− 2.5	+ 0.8	+ 1.6	+ 4.5	+ 4.4	+ 5.4	+ 9.7	+ 30.8	+ 21.1
Enterprise sector	− 2.9	− 0.9	− 2.0	− 1.7	+ 3.7	− 0.3	+ 4.2	− 6.7	**2** + 11.1	**2** + 17.7
Banks	− 10.4	− 4.7	− 17.5	+ 6.4	− 36.1	− 42.0	− 45.1	+ 23.7	+ 20.2	− 3.4
U.S. Government	+ 0.4	− 2.3	− 2.2	− 3.8	− 4.5	− 5.4	− 5.8	− 4.8	− 5.1	− 0.3
Total	− 25.3	− 18.5	− 29.0	− 10.8	− 34.8	− 29.8	− 21.7	+ 28.3	+ 72.1	+ 43.8
C. Statistical discrepancy	+ 10.5	− 2.0	+ 12.5	+ 25.4	+ 25.0	+ 22.3	+ 32.9	+ 9.3	+ 30.0	+ 20.7
D. Balance on official reserve transactions										
Official reserve assets **1**	+ 2.6	+ 0.4	− 0.7	− 0.0	+ 7.0	+ 4.1	+ 5.0	+ 1.2	+ 3.1	+ 1.9
Liabilities to foreign official institutions (Increase: −)	− 13.1	− 35.4	− 31.2	+ 13.6	− 14.9	− 5.3	− 2.9	− 5.1	− 2.7	+ 2.5
Balance on official reserve transactions (A plus B plus C)	− 10.5	− 35.0	− 31.9	+ 13.6	− 7.9	− 1.2	+ 2.0	− 3.9	+ 0.5	+ 4.4

1 Excluding SDR allocations. — **2** For the fourth quarter of 1984 these transactions are included in the item "Statistical discrepancy". — **pe** Partly estimated.
Discrepancies in the totals are due to rounding.
Source: U.S. Department of Commerce.

Yen affected by the strength of the dollar, unlike the situation in 1983

After the external value of the Japanese yen vis-à-vis the dollar had strengthened somewhat in 1983, it fell by 7% in the course of last year. In so doing, however, the Japanese currency fared much better than most other currencies. At all events, it rose in value on every foreign exchange market, with the exception of those of the U.S. dollar, the Canadian dollar and the Hong Kong dollar. Nevertheless, the weighted external value of the yen rose only slightly since, owing to the pattern of Japan's foreign trade, the rate of the yen in terms of the dollar has a weight of no less than 44% in the Bundesbank's average computation. The weakness of the yen vis-à-vis the dollar is all the more surprising in that Japan's trade and current account surpluses increased considerably again, while the country forged further ahead with domestic consolidation measures. With a high rate of economic growth, which was only slightly lower than that of the United States, the price level remained largely stable, while Japan succeeded in further reducing its public sector deficits. However, despite these positive factors, the yen weakened against the dollar. Given relatively low Japanese interest rates, there were massive outflows of long-term capital, which actually exceeded last year's substantial current account surplus by $ 15 billion. About half of these huge capital exports was accounted for by purchases of foreign securities. A further quarter of the net exports of long-term capital arose from the granting of financial credits by Japan to other countries. Direct investment abroad and Japanese trade credits each contributed about one-tenth to the total.

Further liberalisation of the Japanese financial system also for exchange rate reasons

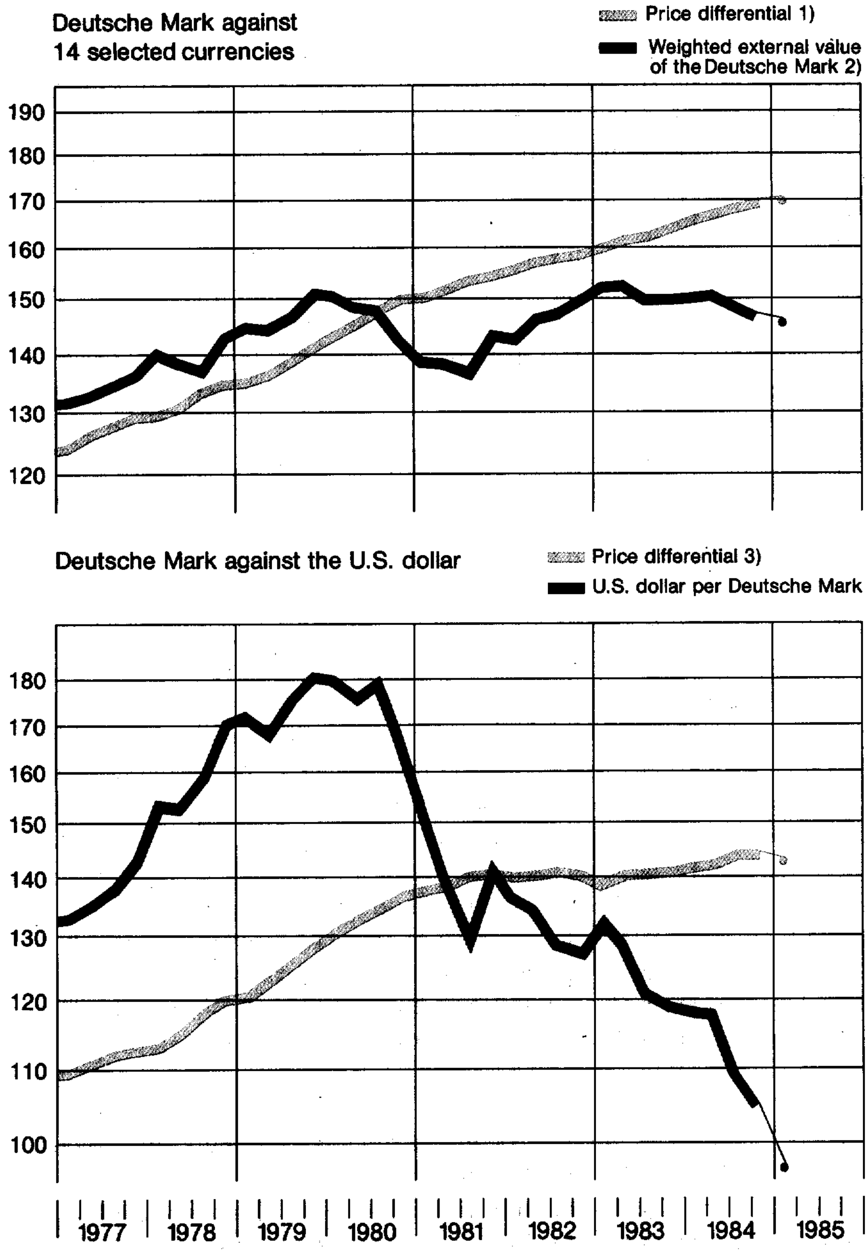
The weakness of the Japanese currency vis-à-vis the dollar was a major reason, albeit not the only one, why the United States has recently been strongly urging Japan to further liberalise its financial system and thus also pave the way for investments in yen by non-residents gaining greater importance. In the event, in bilateral negotiations with the United States, Japan agreed in May 1984 to take measures that integrate its financial market and its currency more strongly into the international financial system. These include both the dismantling of restrictions which keep interest rates in Japan relatively low and the improvement of the investment facilities for non-residents. Moreover, Japan agreed to abolish restrictions that up to now have prevented the yen from playing a greater role on the international financial markets. However, a noticeable strengthening of the yen in the short run was not to be expected from the outset from these U.S.-Japanese agreements since the measures envisaged form part of a longer-term strategy, only a small part of which will be put into effect in 1984. Apart from this, the liberalisation measures adopted so far have also tended to facilitate exports of capital from Japan.

Deutsche Mark under strong downward pressure

In the course of 1984 the exchange rate of the Deutsche Mark vis-à-vis the dollar fell by 13%, i.e. just as strongly as in the preceding year. This trend continued up to the end of February of the current year. Even so, the Deutsche Mark was by no means in an unfavourable special situation in comparison with the other currencies of Europe. Among the more important European currencies, the Swiss franc and the pound sterling were under even greater pressure. The corresponding exchange rate gains of the Deutsche Mark vis-à-vis these and other currencies were instrumental in its weighted external value declining by only 2% in the course of the year. Since prices abroad rose more strongly than prices in Germany, the German economy's competitiveness in price terms improved over and above the aforementioned effects arising from currency depreciation. This was also the case in the preceding years, with the result that the weighted external value of the Deutsche Mark — not to mention its exchange rate vis-à-vis the dollar — are at present considerably below the level at which they would be standing if exchange rates were guided by, say, international inflation differentials.

External value of the Deutsche Mark and inflation differentials

December 1972=100; quarterly averages, log. scale



1) Geometrically weighted average of consumer price movements in 14 other industrial countries relative to those in the Federal Republic of Germany; weighting pattern based on the trade flows of industrial products between 1980 and 1982, taking account of third-market effects.- 2) Geometrically weighted average against the currencies of 14 other industrial countries.- 3) Consumer price movements in the United States relative to those in the Federal Republic of Germany.- Latest position: February 1985.

Deutsche Mark tends towards weakness in the EMS at times

The decrease in the value of the Deutsche Mark on the dollar market also adversely affected its position vis-à-vis the partner currencies that participate in the exchange rate mechanism of the EMS, particularly since interest rates in the other EMS countries remained high on account of inflation, but also in connection with the greater orientation of their monetary policies towards stability. The temporary weakness of the Deutsche Mark revealed itself only partly in the form of declining Deutsche Mark exchange rates within the individual margins of fluctuation. Several partner countries countered the pressure on the Deutsche Mark by means of large-scale intramarginal purchases of the German currency. In this context, a part was played firstly by the concern of these countries that their competitiveness could suffer through a shift in exchange rates. In addition, they probably also wished to increase their Deutsche Mark reserve holdings.

Deutsche Mark in demand as a currency in which to contract debts

The at times strong pressure on the Deutsche Mark is occasionally also attributed to its special role as an international investment and reserve currency. In actual fact the preference for the dollar was reflected in a decline, compared with earlier periods, in foreign demand for Deutsche Mark assets. Even so, recorded financial investments in Deutsche Mark by non-residents, either on the Euro-market or in Germany itself, have continued to rise right up to the present. A major reason for the weakness of the Deutsche Mark was, rather, that non-residents considered it advantageous to contract debts in Deutsche Mark in view of the comparatively low level of interest rates in Germany. This idea is borne out by the amount of short-term credit granted to non-residents by German banks and enterprises as well as by the buoyancy of issuing activity on the market for foreign Deutsche Mark bonds. Our partner countries within the EMS may also have benefited from this; in France and Italy short-term interest rates were as much as 5½ percentage points and 11 points, respectively, above comparable rates in Germany last year on average; this offers a considerable inducement to take up short-term loans in Deutsche Mark as long as no realignments of central rates within the EMS are expected. To this extent, the tendency for the Deutsche Mark to be weak within the EMS as a result of its large losses in value on the dollar market would have been reinforced by influences within the Community.

Swiss franc under greater pressure than the Deutsche Mark owing to foreign borrowing

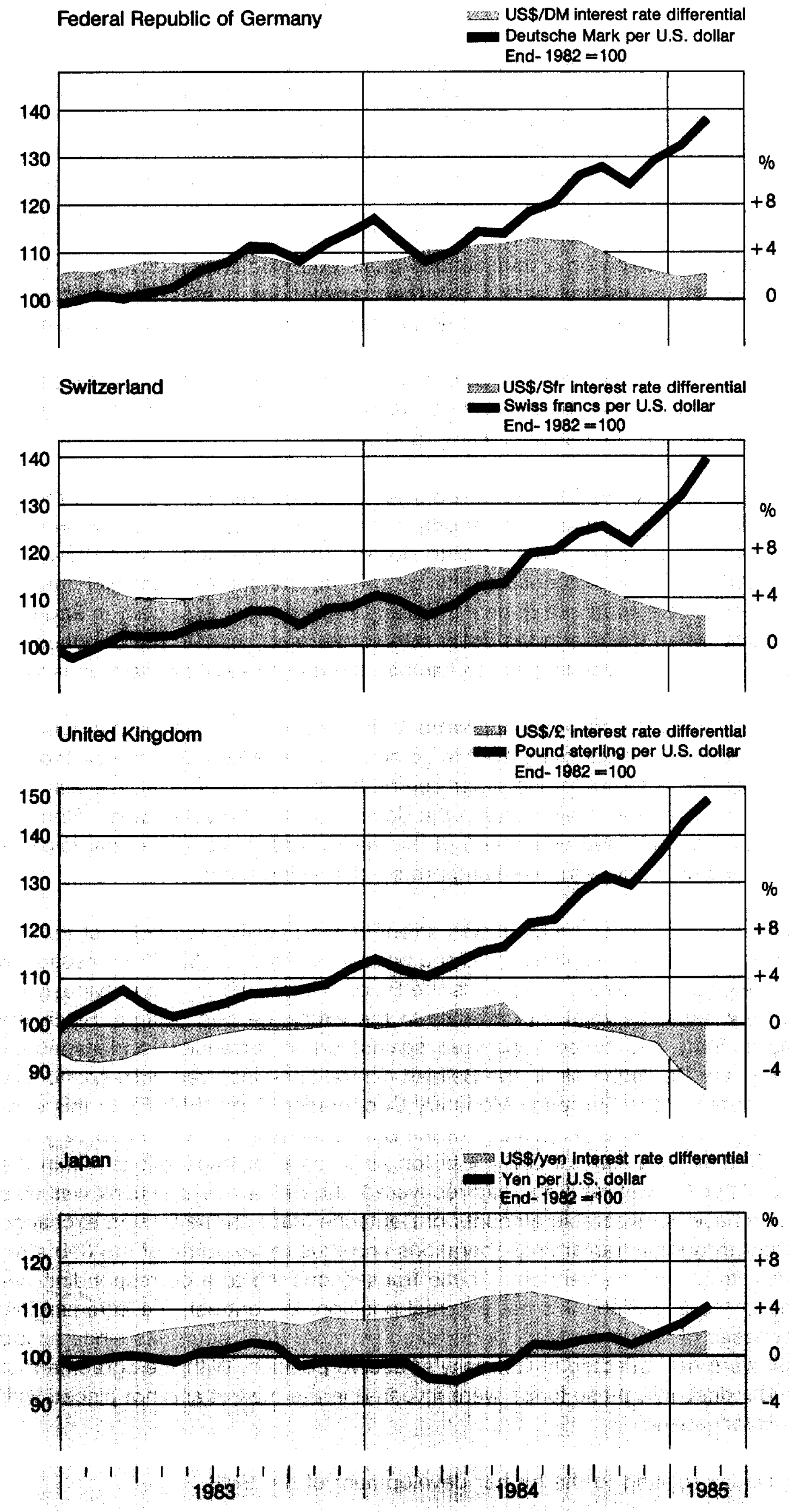
In the course of 1984 the Swiss franc fell by 16% vis-à-vis the U.S. dollar. The Swiss currency also declined appreciably against most other European currencies. This was reflected in a fall of 4% in its weighted external value. Its loss vis-à-vis the Deutsche Mark amounted to 3%, but this merely offset preceding gains in value. Incidentally, the exchange rate between the two currencies has been going up and down for some considerable time. After having reached a record level of DM 127 per Sfr 100 in March 1982, the Swiss franc fell back to DM 116 in the same year, but had risen again to DM 126 by the beginning of 1984. From this level, the Swiss franc declined to DM 121.40 at the end of last year. Since then it has continued to drop sharply. A major role in this process seems to have been played by large-scale issues of foreign bonds in Switzerland. Although interest rates in Switzerland rose last year — reducing the gap vis-à-vis the higher rates in Germany — they still remained the lowest in the world by far.

Sterling falls most strongly

From the beginning of 1984 until the end of the year sterling's rate against the dollar fell from $ 1.45 to $ 1.16. This represents a depreciation of 20%. Thus, sterling — in contrast to other major currencies which were still profiting from earlier appreciations against the dollar — went down further from an historical low. This marked weakening in value meant that sterling also dropped appreciably vis-à-vis all other major currencies. As a result, its weighted external value — as calculated by the Bundesbank — deteriorated in 1984 by 11%. When the U.K. currency came under particularly strong downward pressure last July, the Government's intention, announced shortly beforehand, to keep interest rates low for domestic economic reasons seems to have been a decisive factor in this development, after pressure on the world market prices for crude oil as well as prolonged industrial disputes in the United Kingdom had adversely affected sterling in any case. At all events, the drop in sterling's exchange rate could be slowed down appreciably only by the Bank of England — contrary to original intentions — sharply raising money market rates in London, which had been lower than U.S. rates since spring 1984, thus bringing them back into line with U.S. interest rates. When the downward trend of sterling accelerated again in early 1985, a major role seems to have been played by strong monetary expansion and corresponding fears of a rekindling of inflation. Short-term interest rates in the United Kingdom, which had declined again in line with U.S. rates after the increase of July last year, were thereupon raised sharply again in January 1985. Since then they have been considerably higher than U.S. interest

Exchange rates of the U.S. dollar and external interest rate differentials

Monthly averages



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

rates. Sterling nevertheless weakened further at first, but in March it was able to make good the losses it had suffered since the beginning of 1985.

(b) The foreign exchange policy of the Bundesbank

Dollar holdings practically unchanged

Last year the Bundesbank again sold considerable amounts of dollars on the foreign exchange market. However, these sales contrasted with U.S. dollar inflows of similar proportions resulting from transactions outside the exchange market; they stemmed primarily from the usual exchange transactions with U.S. forces stationed in Germany as well as from interest income and the collection of cheques and bills of exchange. As a result, the Bundesbank's holdings of dollars actually increased somewhat. The Bundesbank's net external position, the change in which on a transactions basis approximately indicates how the sum total of the central bank's external transactions affects the creation of central bank money in Germany, deteriorated — mainly as a result of a number of other foreign exchange transactions — by a total of DM 3.2 billion. This owed something to the fact that the ECU balances acquired by other central banks decreased further. At the same time the investments of foreign monetary authorities with the Bundesbank went up slightly.

Large sales of dollars in critical situations

Taken as a whole, the Bundesbank's sales of dollars therefore only had the effect that a large part of the total supply of dollars was not withheld from the foreign exchange market. When selling dollars, the Bundesbank was, however, repeatedly trying to influence exchange rate developments whenever the demand for dollars appeared to be particularly exaggerated. Especially in September 1984, when the rise in the dollar rate accelerated sharply, the Bundesbank attempted to intervene in order to dampen the rise by selling dollars equivalent to no less than DM 6.1 billion. Around the turn of February/March 1985, when the demand for dollars again appeared to be excessive for speculative reasons, the Bundesbank once more sold large amounts of dollars, in a concerted action together with numerous other central banks. As in the past, the aim was not to influence the basic trend in the dollar rate; the objective was, rather, to react to the one-sided orientation of the market and make market participants conscious of the growing exchange rate risks facing them.

Deutsche Mark interventions in the EMS in both directions

As long as the Deutsche Mark was strengthening against the dollar at the beginning of 1984, it was also in a strong position within the EMS. This resulted in relatively marked tensions vis-à-vis the Belgian franc, which had previously repeatedly been the weakest currency in the exchange rate system. Since the Belgian franc had to be supported against other currencies, and especially against the Deutsche Mark, the Belgian central bank incurred correspondingly large debts to the European Monetary Cooperation Fund (EMCF). In this connection, the net external position of the Bundesbank improved in February and March 1984 by a total of DM 4.4 billion as a result of transactions within the EMS. After the Belgian franc had recovered, the Belgian central bank was able to purchase considerable amounts of Deutsche Mark on the foreign exchange market through intramarginal operations and thus repay some of the debts resulting from the interventions. These transactions led to a corresponding decline in the Bundesbank's net external position. In contrast, the intramarginal purchases of Deutsche Mark undertaken by other EMS countries since spring 1984 were not reflected in Germany's reserve position. With the agreement of the Bundesbank, these funds were invested in the market and not placed with the Bundesbank.

(c) Issues relating to the further development of the EMS

Stronger cohesion of the EMS

Within the European Monetary System, a distinct tendency towards greater convergence in the economic policies of the member countries, and also in

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

DM million

Period	Net external position, total	Operations in the exchange market: Deutsche Mark/ dollar market **1**	Operations in the exchange market: EMS **2**	Other foreign exchange movements
1983 January	+ 1,853	+ 147	+ 115	+ 1,591
February	+ 5,156	+ 173	+ 2,826	+ 2,157
March	+ 4,944	+ 15	+ 1,777	+ 3,152
April	−11,464	− 2,024	− 9,037	− 403
May	− 1,356	− 578	− 1,997	+ 1,219
June	− 235	− 1,238	− 1,480	+ 2,483
July	− 45	− 827	− 12	+ 794
August	− 3,184	− 4,596	− 34	+ 1,446
September	+ 1,053	− 860	−	+ 1,913
October	+ 2,250	+ 364	−	+ 1,886
November	− 523	− 1,822	−	+ 1,299
December	− 2,486	− 3,481	−	+ 995
Total	− 4,037	−14,727	− 7,842	+18,532
1984 January	− 203	− 2,021	−	+ 1,818
February	+ 4,223	− 63	+ 2,464	+ 1,822
March	+ 3,083	− 266	+ 1,941	+ 1,408
April	+ 339	− 523	−	+ 862
May	− 324	− 2,127	−	+ 1,803
June	− 1,038	− 2,429	−	+ 1,391
July	− 1,507	− 3,007	− 85	+ 1,585
August	+ 427	− 1,881	− 114	+ 2,422
September	− 6,283	− 6,682	− 359	+ 758
October	− 786	− 1,440	−	+ 654
November	− 262	− 1,012	− 110	+ 860
December	− 916	− 1,707	− 100	+ 891
Total	− 3,247	−23,158	+ 3,637	+16,274
1985 January	− 2,942	− 1,940	− 160	− 842
February	− 6,646	− 8,272	−	+ 1,626
March	− 2,378	− 3,188	−	+ 810
1st quarter	−11,966	−13,400	− 160	+ 1,594
Memorandum items				
Beginning of 1983 to March 20, 1983 **3**	+17,071	+ 380	+12,567	+ 4,124
March 21, 1983 to February 6, 1984	−20,840	−17,128	−20,409	+16,697
February 7, 1984 to end-March 1984 **4**	+ 6,835	− 329	+ 4,405	+ 2,759
Beginning of April 1984 to end-March 1985	−22,316	−34,208	− 928	+12,820

* Excluding liquidity swaps and changes due to valuation adjustments. Recorded according to the date on which the transaction was conducted and not according to the value date; discrepancies between these figures and those of the balance of payments are therefore possible. — **1** Including U.S. interventions. — **2** Including Deutsche Mark interventions by other central banks, where they affect the external position of the Bundesbank. — **3** Last day before new central rates in the EMS became effective. — **4** Period of pronounced weakness of the Belgian franc.

economic development, has been apparent since the last realignment of central rates in March 1983. This has improved the prerequisites for the cohesion of the system. Those EMS countries which have recently made corrections to the stance of their economic policies would have had to do so even without being members of the EMS. But the decisiveness with which some governments changed course in their economic policy and the resoluteness with which they are pursuing their new policies would not have been likely without the political will not to jeopardise the existence of the EMS. Moreover, the close cooperation among the central banks of Europe in the field of monetary policy — which cooperation is increasingly being characterised by mutual understanding for the interests of the other partners and by willingness to show consideration for them — has also contributed to the smooth functioning of the system.

Reduction of the economic divergences still urgent

However, the divergences in economic development between the member countries continue to be considerable. They show up most conspicuously in the differing price movements. Although the Community has on the whole made noteworthy progress on its way out of global inflation back to greater stability, inflation in most other countries in the EEC has remained very much higher than in Germany. This gives rise to dangers for the EMS that can only be avoided if all the member countries resolutely continue their efforts in the field of stabilisation policy. At all events, there is still a long way to go before the EMS is enlarged in institutional terms.

Dismantling of special arrangements and restrictions overdue

However, the generally satisfactory functioning of the EMS must not cause us to overlook the fact that the United Kingdom is still not participating in the exchange rate mechanism, that Italy is making use of an exceptional arrangement which allows the lira to fluctuate against the other member currencies by a margin almost three times the size of the usual band of ± 2¼ %, and that Belgium continues to make use of a two-tier exchange market system. In addition, the liberalisation of financial transactions in the member countries of the system has made practically no progress. In recent years, indeed, new restrictions on foreign exchange and capital movements have been introduced and some of them are still in force. Thus, considerable differences in the degree of liberalisation of short and long-term capital movements persist, especially between Germany and other EMS countries. It would be desirable for periods when the currencies of our partner countries hold their own in the EMS to be used in particular to make further progress in the liberalisation of financial transactions, which is a necessary concomitant of the free movement of goods and services. In this respect, the example of those countries which have dismantled their foreign exchange restrictions and capital controls without suffering negative consequences should be encouraging.

ECU only of limited importance for the further development of the EMS

Convergence on the basis of domestic stability in each of the member countries and freedom of financial transactions are the fields in which progress is necessary if the EMS is to be safeguarded over the long term. In contrast, questions relating to the role of the ECU involve the danger of distracting attention from the real requirements of lasting cohesion within the EMS. At all events, the attention paid to the ECU in the public discussion is out of all proportion to its significance in the process of monetary policy integration. Above all, any extended use of the ECU, e.g. to finance balances arising from intramarginal interventions, must not lead to new obligations for central banks that might make it more difficult for them to conduct a monetary policy geared to stability. This would not be in line with the objectives behind the EMS either. It was especially these considerations by which the Bundesbank was led in discussing the proposals concerning the further development of the EMS.

Usability and attractiveness of "official" ECUs improved

At present, the official use of the ECU fulfils two functions. It is a unit of account in which the central rates of the currencies participating in the exchange rate mechanism of the EMS as well as the financial balances arising from obligatory interventions on the foreign exchange market in Community currencies are expressed. In addition, it serves as an instrument for settling balances created through the EMCF against the contribution of 20% of the central banks' holdings of gold and dollars on the basis of a market-related value. However, as a component of monetary reserves, the ECU balances of central banks have been usable to only a limited extent up to the present. Therefore, under the existing EMS rules creditor central banks are obliged to accept only up to 50% of their net claims in ECUs in settlement operations with debtor central banks. The remainder must be settled by the debtor central bank in dollars or special drawing rights. This arrangement is designed to prevent excessively large ECU claims from accumulating with individual central banks. This has not happened either up to the present. It was thus all the easier for the

Consumer price movements in the European Community

Percentage increase on previous year

Country	1979	1980	1981	1982	1983	1984 p
Federal Republic of Germany	4.2	5.4	6.3	5.3	3.3	2.4
EEC partner countries participating in the exchange rate mechanism of the European Monetary System 1	10.7	14.3	13.4	12.2	10.0	7.7
France	10.8	13.5	13.4	11.8	9.6	7.4
Italy	14.8	21.2	17.8	16.5	14.7	10.7
Netherlands	4.2	6.5	6.7	5.9	2.8	3.3
Belgium	4.5	6.6	7.6	8.7	7.7	6.3
Denmark	9.6	12.3	11.7	10.1	6.9	6.3
Ireland	13.3	18.2	20.4	17.1	10.5	8.6
Luxembourg	4.5	6.3	8.1	9.4	8.7	5.6
Other EEC partner countries 1	13.8	18.5	12.9	9.5	5.8	6.0
United Kingdom	13.4	18.0	11.9	8.6	4.6	5.0
Greece	19.0	24.9	24.5	21.0	20.5	18.5
All EEC partner countries 1	11.6	15.5	13.3	11.4	8.8	7.2
Relative rise in foreign prices compared with those in Germany in %						
EEC partner countries participating in the exchange rate mechanism of the European Monetary System	6.2	8.4	6.7	6.6	6.5	5.2
Other EEC partner countries	9.2	12.4	6.2	4.0	2.4	3.5
All EEC partner countries	7.1	9.6	6.6	5.8	5.3	4.7

1 Weighted with private consumption expenditure between 1980 and 1982. — p Provisional.
Sources: National statistics and OECD.

central banks belonging to the EMS to agree, in negotiations which were concluded in March 1985, to improve the usability and attractiveness of official ECU holdings. Specifically, they agreed on the following points:

- Part of the ECU holdings — namely the net creditor positions and a certain proportion of the ECU balances originally created against the contribution of gold and dollars — can be temporarily mobilised if a central bank needs U.S. dollars or EMS partner currencies for intramarginal interventions.

- The interest rate payable on net ECU creditor positions and on liabilities in the very short-term financing arrangement, which rate is at present based on the weighted average of the discount rates in the EMS member countries, is brought into line with market rates.

- EMS central banks can transfer their ECU balances to central banks in third countries that have close ties with the Community as well as to international institutions like the BIS.

- Under narrowly circumscribed conditions, central banks that have a net debtor position in ECUs and are simultaneously creditors in the very short-term financing arrangement must accept 100% of their net claim in ECUs.

Increasing use of "private" ECUs

Last year the private use of ECUs again increased further, both in issuing business and in banking business. However, the expansion in the banking business sector owed most to credit transactions and interbank business. Thus, of the total outstanding claims of banks in ECUs in September 1984, amounting to about $ 24 billion, only $ 7 billion was accounted for by credits to non-banks. At the same time, the ECU deposits of non-banks did not exceed the comparatively modest amount of $ 1.4 billion. Moreover, a considerable part of this sum was accounted for by funds of Community institutions. The use of units of account in international credit transactions, of which there are other examples besides the ECU, cannot however primarily be seen as a sign of growing monetary integration; it is, rather, mainly determined by cost and yield considerations which, besides the interest rate, include above all the exchange rate risk. This means that the uncertainties surrounding the future development of the dollar's exchange rate should have particularly favourable repercussions on the ECU. It remains to be seen how far interest in "private" ECUs will persist once conditions on the dollar market undergo a major change. At all events, the divergences within the Community cannot be masked by using the ECU as a private financial instrument. Nor is there much likelihood that international monetary relations could be noticeably improved by introducing the ECU as a new investment and especially reserve currency alongside the dollar and the yen. In the past, certain currencies like the dollar, sterling and Deutsche Mark have "grown into" such a role owing to specific preconditions. These have included stability at home and free usability at the international level as well as large and well-functioning financial markets which ensure that investments by central banks in particular can be liquidated at any time. The ECU markets are still a very long way from this state, quite apart from the fact that the ECU combines currencies of widely differing quality.

4. The development of global monetary reserves

Further rise in global monetary reserves

According to preliminary IMF data, the published gross monetary reserves of its member countries rose in 1984 by a total of $ 17 billion. In the year before they had increased by $ 15 billion. However, these overall figures include considerable decreases in reserve holdings due to valuation effects. On the one hand, the declining price of gold led to a considerable fall in the ECU balances created against the contribution of gold to the European Monetary Cooperation Fund at a market-related value. On the other hand, owing to exchange rate shifts, the dollar value of reserves held in currencies other than the U.S. dollar went down. Excluding these valuation effects, global monetary reserves rose in 1984 by an estimated $ 38 billion after having gone up in 1983 by $ 21 billion.

Notable increase in Deutsche Mark reserves

As usual, the chief component of the growth in reserves last year was the foreign exchange claims of monetary authorities; calculated at current exchange rates, they rose by $ 24 billion. One-fifth of this amount was accounted for by the increase in official holdings of Deutsche Mark. At the same time, the share of the Deutsche Mark in aggregate foreign exchange reserves (including the dollar holdings contributed to the EMCF) went up from 11.3% to 12%. However, the marked depreciation of the Deutsche Mark against the dollar considerably understates the rise in Deutsche Mark reserve holdings. Calculated in Deutsche Mark, they increased by no less than DM 30 billion to over DM 118 billion. This strong growth was mainly attributable to the aforementioned intramarginal purchases of Deutsche Mark by other EMS member countries. However, the developing countries also further augmented their reserve holdings of Deutsche Mark.

Developing countries account for large share of the rise in global monetary reserves

Of the increase in published global monetary reserves totalling $ 17 billion, one-third was accounted for by the OECD countries and the rest mainly by the non-OPEC developing countries. However, if the decrease in ECU balances related to the price of gold is disregarded, then the reserves of the industrial countries went up by $ 12 billion. France, Norway and Spain together accounted for $ 10 billion of this amount. The growth in the reserves of countries outside the OECD area, totalling $ 11 billion, chiefly reflects considerable inflows of foreign exchange into Brazil and Mexico.

Global reserve holdings not a determinant of world economic activity

The frequently discussed question as to whether a given overall level of reserve holdings is sufficient to ensure the satisfactory functioning of the world economy is based on the conception that the level of global monetary reserves is a decisive factor in the operation of the world economy. According to this view, global reserve holdings that grow only slowly or even decline could lead to

Gross monetary reserves of the IMF countries *

US$ billion

Type of reserves/Group of countries	Level at end of year		Change in course of year			
	1980	1984 p	1981	1982	1983	1984 p
A. Type of reserves						
Gold **1**	40.2	39.9	+ 0.0	– 0.2	– 0.1	– 0.0
Special drawing rights	15.1	16.1	+ 4.0	+ 0.5	– 4.5	+ 1.0
Reserve position in the IMF	21.5	40.7	+ 3.3	+ 3.3	+12.9	– 0.2
ECU balances	63.7	37.7	–13.5	– 8.9	+ 3.9	– 7.6
– against gold	47.6	27.6	–10,2	– 7.0	+ 3.4	– 6.2
– against U.S. dollars	13.9	10.1	– 2.4	– 1.8	+ 0.9	– 0.5
– arising from very short-term financing	2.2	–	– 0.9	– 0.0	– 0.4	– 0.9
Foreign exchange	309.9	302.2	–12.5	–21.6	+ 2.4	+24.0
U.S. dollars	205.6	194.4	– 3.4	–19.2	+ 4.5	+ 6.9
Deutsche Mark	48.6	37.6	– 7.4	– 6.4	– 2.3	+ 5.0
Yen	13.6	16.8	– 0.9	+ 0.1	+ 0.8	+ 3.2
Swiss francs	10.5	6.4	– 1.6	– 1.1	– 0.8	– 0.5
Pounds sterling	9.5	9.7	– 2.7	+ 0.1	+ 0.6	+ 2.2
French francs	5.6	3.3	– 1.1	– 0.9	– 0.5	+ 0.2
Netherlands guilders	4.2	2.5	– 0.6	– 0.5	– 0.7	–
Unidentified assets	12.3	31.5	+ 5.2	+ 6.3	+ 0.8	+ 7.0
Total reserves	450.3	436.7	–18.6	–27.0	+14.7	+17.2
Memorandum items						
1. Total reserves excluding ECU balances arising from contributions of gold **2**	406.3	412.7	– 8.4	–20.0	+11.3	+23.4
2. After additional adjustment for changes in value due to exchange rate movements **3**	406.3	**pe** 460.3	+ 7.3	–12.0	+21.0	**pe** +37.6
Gold **1**	43.8	43.6	– 0.0	– 0.2	– 0.1	– 0.0
Special drawing rights	15.1	20.7	+ 5.6	+ 1.5	– 3.6	+ 2.1
Reserve position in the IMF	21.5	48.9	+ 5.5	+ 4.7	+14.7	+ 2.5
ECU balances **4**	2.2	0.8	– 0.5	+ 0.1	– 0.2	– 0.8
Foreign exchange	323.8	**pe** 346.4	– 3.3	–18.1	+10.2	**pe** +33.8
of which						
Deutsche Mark	48.6	55.6	– 1.0	– 4.4	+ 2.3	+10.1
B. Regional distribution 5						
OECD countries	273.0	257.2	–20.2	–12.7	+11.3	+ 5.8
of which						
EEC countries	161.4	126.1	–24.9	–14.3	+ 8.5	– 4.6
United States	26.8	34.9	+ 3.3	+ 3.9	– 0.2	+ 1.2
Japan	25.7	27.5	+ 3.6	– 4.9	+ 1.3	+ 1.9
Canada	3.9	3.3	+ 0.4	– 0.5	+ 0.5	– 1.0
Germany	52.6	44.2	– 4.9	+ 1.0	– 2.1	– 2.5
France	30.8	24.4	– 5.1	– 5.7	+ 3.3	+ 1.1
United Kingdom	21.4	10.2	– 5.4	– 2.8	– 1.1	– 1.9
Italy	26.0	23.6	– 3.0	– 6.0	+ 6.0	+ 0.7
OPEC countries	89.4	70.9	– 0.8	–11.0	– 4.6	– 2.1
Low-population	43.9	36.9	+ 6.2	– 3.6	– 5.1	– 4.6
High-population	45.5	34.0	– 7.0	– 7.4	+ 0.5	+ 2.5
Other developing countries	76.1	71.7	– 4.7	– 9.4	– 0.0	+ 9.7
Threshold countries **6**	32.4	39.8	– 0.5	– 7.1	+ 2.6	+12.3
Other countries	43.7	31.9	– 4.2	– 2.3	– 2.6	– 2.6
Other IMF member countries	11.8	36.9	+ 7.2	+ 6.0	+ 7.9	+ 3.9
IMF countries, total	450.3	436.7	–18.6	–27.0	+14.7	+17.2
Memorandum items						
Total reserves excluding ECU balances arising from contributions of gold **2**	406.3	412.7	– 8.4	–20.0	+11.3	+23.4
of which						
OECD countries	229.0	233.2	–10.0	– 5.7	+ 7.9	+12.0
EEC countries	117.4	102.1	–14.7	– 7.3	+ 5.1	+ 1.6
Germany	40.4	37.5	– 2.0	+ 3.0	– 3.0	– 0.8
France	20.3	18.7	– 2.6	– 4.1	+ 2.5	+ 2.6
United Kingdom	19.0	8.9	– 4.9	– 2.5	– 1.2	– 1.5
Italy	17.4	18.9	– 1.0	– 4.7	+ 5.4	+ 1.9

* Including Switzerland. — **1** Valued at $ 42.22 per ounce of fine gold. — **2** The gold underlying the ECU balances was included in the other gold holdings again. — **3** Changes in reserve holdings not denominated in dollars (other than gold) have been converted into dollars at average rates based on end-of-year rates. The adjusted level as at end-1984 has been calculated from the original level and the cumulative changes. — **4** Only balances arising from very short-term financing. The dollar holdings underlying the ECU balances were included in other foreign exchange again. — **5** For the definition of the groups of countries see the table on p. 56. — **6** Excluding Hong Kong and Taiwan. — **p** Provisional. — **pe** Partly estimated. Discrepancies in the totals are due to rounding.
Sources: IMF and BIS.

many countries adopting an excessively restrictive stance in their economic policy out of concern about external financing difficulties or if they aim to build up their reserves gradually. However, in past decades the world has been threatened more by inflationary developments than by deflationary processes which would need to be counteracted by increasing the global supply of liquidity. Besides, one cannot help wondering whether, under the conditions obtaining in the world economy today, reserves still play the same key financial role that used to be attributed to them. Thus, in the last two decades international capital transactions have experienced an unprecedented upswing; since then the financing of balance of payments deficits has been less a question of the availability of monetary reserves than a problem of the creditworthiness of the countries in deficit. Moreover, the transition of all major countries to floating has made the need for monetary reserves appear in a completely different light, because there is no longer any obligation to defend fixed parities by using monetary reserves. At the same time, the international financial markets have become a gushing source of reserve growth, either because individual countries augment their monetary reserves by taking up credits, or because the debts incurred by the deficit countries are reflected in increased reserves in the surplus countries, as was the case in particular after the various oil price hikes. These structural shifts have led to a situation in which the volume of global monetary reserves can hardly be regarded today as a limiting factor in its own right on the development of the world economy as a whole but, on the contrary, mainly as the outcome of certain trends in the world economy and of the reserve policy stance, which varies from country to country. At all events, a global need for additional monetary reserves which would have to be met by new allocations of special drawing rights cannot be convincingly demonstrated at present. An attempt to substantiate such a creation of artificial liquidity by reference to other considerations — such as an uneven distribution of reserves — would not be in harmony with the criteria for, and objectives behind, creating SDRs as formulated in the IMF Agreement. Moreover, new allocations of SDRs would be an unsuitable means of eliminating the causes of an uneven distribution of reserves.

5. The debt problems of the developing countries

Abatement of the debt problems

The international debt problems, the causes of which were discussed in detail in the Report of the Deutsche Bundesbank for the Year 1983, abated somewhat in the year under review. The decisive factor here was that the highly indebted countries successfully continued their efforts to achieve better domestic and external economic equilibrium. As a result of resolute adjustment efforts, supported by the recovery of economic activity in the United States and other industrial countries, the highly indebted countries — especially those in Latin America — succeeded in notably improving their trade balances again. In contrast to the situation in 1983, this improvement was brought about mainly by a marked rise in exports. This at the same time enabled the debtor countries to start to expand their imports, which had previously been severely curbed, thus easing the pressure on the standard of living of their population. Additional balance of payments relief was afforded by the further rescheduling of matured credits on a considerable scale. The debt service burden of the developing countries, as measured by their receipts from exports of goods and services, declined again as a result, albeit only slightly; the persistent high level of this burden, however, makes it clear that dollar interest rates remain higher than would be desirable in the interest of the indebted countries.

Trade balances of the highly indebted countries in surplus

In many cases, the improvement in the trade balance not only implied a reduction in foreign trade deficits; moreover, a number of countries — particularly in Latin America — achieved trade surpluses of impressive proportions or even managed to increase the surpluses attained in the preceding year. For in-

External debt of the developing countries *

US$ billion

Item	1980	1981	1982	1983	1984
A. Long-term	396	464	523	580	627
Public	158	177	198	221	241
Private	239	287	325	359	385
B. Short-term	93	114	132	113	104
C. Total (A plus B)	490	578	655	694	731
By foreign trade structure					
Oil exporters	103	133	154	163	169
Oil importers	387	445	501	530	561
By area					
Latin America	194	247	288	304	318
Middle East	42	47	52	56	60
Rest of Asia	116	135	154	168	179
Africa	54	59	66	69	72
Europe	67	72	73	75	79
Other countries	17	19	23	22	23
Memorandum items					
Debt service payments	76	98	110	95	103
Interest	39	56	65	59	61
Repayment of long-term loans	37	42	45	36	42
Debt service as a percentage of receipts from exports of goods and services	17.9	21.8	25.2	21.7	21.5

* Excluding the major oil exporters, among which are Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates and Venezuela; but including European developing countries and eastern European members of the IMF. — Excluding debt to the IMF.
Discrepancies in the totals are due to rounding.
Source: IMF.

stance, Brazil's foreign trade surplus rose to $ 13 billion, almost twice as much as in 1983. The trade balances of Argentina and Venezuela also moved further into surplus. Mexico was once again among those at the top of the league in the adjustment process, with a trade surplus of likewise $ 13 billion; this was, however, slightly less than in the preceding year. The pressure to achieve trade surpluses, which in some cases also led to surpluses on current account, has sometimes been described as a transfer of resources in the wrong direction. But in the light of the heavy debt service burden that these countries had shouldered, there was no alternative to this once the capital inflows had slackened off. Moreover, such a transfer of resources only means that the countries which had got into a critical situation have to meet at least part of their debt service payments by themselves through trade and current account surpluses as long as their creditworthiness is in doubt. Besides, in the case of the principal debtor countries, the necessary transfer of resources is taking place on an economic base that has been strengthened, at least in part, by earlier large-scale imports of capital.

Only slight decline in new debt

Even with a continuing improvement in their trade balances, the net demand for credit by debtor countries is still considerable. Excluding liabilities vis-à-vis the IMF, the long and short-term debt of the developing countries rose in 1984 by $ 37 billion to $ 731 billion, leaving the major oil-exporting countries out of account. Net borrowing by these countries was thus not cut back again as markedly as it had been in 1983, when, at $ 39 billion, it was just half as large as in 1982. However, the new debt incurred in 1984 was accompanied by the above-mentioned considerable increase in the monetary reserves of these countries, after their foreign assets had remained unchanged in the preceding year.

First multi-year rescheduling arrangements

After the crisis management stage and the difficult negotiations on adjustment programmes, the task today — in a third stage — is to achieve a long-term consolidation of outstanding debts and thus make it easier for the debtor countries to resume growth on a durable basis. A long-term consolidation of debts was also recommended by the heads of state and government of the major industrial countries at the London Summit Conference in June 1984. Indeed, last year the first rescheduling agreements relating not only to credits maturing in the short term, as hitherto, but also to maturities several years ahead, were concluded in principle between banks and the highly indebted countries ("multi-year rescheduling arrangements"). Such agreements were particularly desirable because a "bunching" of maturities in the second half of the 1980s was in prospect and would once again have placed large balance of payments burdens on the countries concerned. However, multi-year rescheduling arrangements appear to be warranted only in cases where notable success in terms of adjustment is discernible and where, moreover, there is no need to fear that financial concessions will tempt countries to deviate from the indispensable path of consolidating their domestic and external position. Mexico was the first major debtor country with which foreign creditor banks agreed on a corresponding lengthening of debt maturities, covering liabilities amounting to no less than $ 48 billion. This arrangement, which was concluded in principle in August 1984, was followed last year by similar agreements in principle with Venezuela, the Philippines and Ecuador. A common feature of these arrangements is that they cover the maturities of the next three to five years and stretch the repayment of these credits over long periods of time which extend to the end of the century and in some cases also include grace periods. The other terms of the rescheduled credits differ — sometimes quite sharply — from country to country, with the debtor's creditworthiness and the progress it has made in terms of adjustment playing the major role. Apart from their multi-year character, the novel aspect of these arrangements is that they open up a possibility, for the non-American creditor banks, of converting part of their claims, which were originally denominated almost exclusively in U.S. dollars, into their respective national currency. However, the possible interest rate advantages to the debtor countries that might result from using some European currencies or the yen contrast with the exchange rate risks arising at the time in the future when the credits are repaid. Of course, the extent to which use is actually made of such conversion clauses also depends on other considerations on the part of both the debtor and the creditor. Certain creditor banks, for example, seem to prefer denomination in their national currency if they think this will facilitate the refinancing of the claims they have rescheduled at long term.

Global solutions no longer under discussion

The discussion about global solutions to the debt problem has meanwhile died away. This applies both to proposals amounting to forming debtor cartels and granting debt waivers and to proposals whose main objective was to transfer bank claims to international institutions and subsidise the interest payment obligations. The successes achieved so far, which are the result of a policy geared to solving individual problems as they arise, are obviously rated highly by all those involved. It may be hoped all the more that this policy will continue to be pursued resolutely and with perseverance in the interest of gradually overcoming the debt problems.

6. The international financial markets

Renewed rise in aggregate international new lending

The volume of finance provided by the international financial markets in 1984 was much higher than in 1983. According to BIS estimates, after allowing for double-counting and repayments as well as for exchange-rate-induced changes in interbank positions not denominated in dollars, the total volume of new short, medium and long-term lending rose by about $ 20 billion compared with the previous year to $ 150 billion. Net international new lending thus regained the level last registered in 1982, but was still much lower than in 1981. In particular, the volume of international bond issues of all kinds — some of which, however, hardly differ from bank credits — increased considerably last year; even earlier, when total net international new lending was falling sharply, the dynamism of this sector of the market was demonstrated by the fact that it was scarcely affected by the contractionary forces.

Only slight decline in new medium and long-term bank credits

In gross terms, the volume of new medium and long-term international bank credits, which had shrunk considerably in 1983, declined by only $ 7 billion to $ 60 billion. A major role was played in this process by the fact that new loans to the non-OPEC developing countries fell by $ 5 billion to $ 20 billion. Moreover, more than half of the new credits extended to them were granted only in connection with rescheduling arrangements; in this context, amounts totalling $ 6.5 billion and $ 4 billion went to Brazil and Mexico, respectively. Among the developing countries, in the main only countries in South-East Asia as well as South Korea, India and Hong Kong were able to take up new Euro-credits without being tied to such arrangements. There was also a distinct reduction in the volume of new loans granted to OPEC countries. By contrast, the industrial countries took up practically the same large amount of resources on the international credit markets as in the preceding year; however, a quarter of this sum related to the refinancing of credits taken up in the past. Only the volume of new lending to centrally planned economies rose again, for the first time for years. This generally muted development of the international market for bank credits further intensified the competition among banks for good customers, and meant that the average maturity of new internationally syndicated loans lengthened from a good 7 years to almost 8 years. At the same time, the interest rate premiums on top of LIBOR which depend on the debtor's credit standing declined on average from 1.2 percentage point to 0.9 point; excluding new loans granted in the context of rescheduling arrangements, they went down from 0.7 to 0.6 point.

Surge in international bond issues

In contrast to the subdued trend in international bank lending, the gross volume of issues on the international bond markets increased very sharply last year. However, floating-rate notes and multi-year certificates of deposit accounted for a large share of the rise of $ 34 billion to $ 112 billion, growing as they did by $ 20 billion to $ 38 billion. As usual, by far the greater part of the new issues was accounted for by borrowers in industrial countries. Issuers in the United States led the field, with an issue volume which, at $ 25 billion, was three times as high as in the preceding year. This rise owed something to the abolition of U.S. withholding tax. Issuers in Japan and France followed, with bond issues totalling $ 17 billion and $ 8.5 billion, respectively. At the same time, the significance of the U.S. dollar as a currency of issue increased; its share in the total sum of all issues rose from 57 % to 64 %. The Swiss franc remained the second most important currency of issue after the dollar; in comparison with 1983, however, there was a slight fall in the aggregate volume of issues — calculated in dollars — to $ 13.1 billion, with the result that, in terms of the total volume of the market, the Swiss currency declined in importance. Calculated in Swiss francs, however, the volume of issues in Switzerland continued to grow. Much the same is true of the Deutsche Mark, which comes third on the list of currencies of issue. The volume of Deutsche Mark bonds issued by non-residents rose from DM 17 billion to DM 19 billion. Owing to exchange rate changes, however, it reached only an (unchanged) equivalent of $ 6.7 billion. As a consequence, the market share of the Deutsche Mark fell from 9 % to 6 %. In contrast, both the yen and sterling were used to a rather greater extent for international bond issues and were able to increase their shares of the market. In the process, the Japanese currency closely approached the position of the Deutsche Mark. There was also a further rise in the volume of issues denominated in ECUs; but with a volume of $ 2.9 billion and a market share of less than 3 %, the ECU continued to play a comparatively modest role on the international bond market.

International credit and bond markets

US$ billion

Item	1980	1981	1982	1983	1984 p
A. Medium and long-term international bank loans 1	**11** 81.0	94.6	98.2	67.2	60.3
Borrowing sectors					
Public **2**	50.9	54.1	64.8	47.9	40.9
Private	30.1	40.5	33.4	19.3	19.4
Borrowing countries **3**					
OECD countries	41.8	47.4	54.4	30.5	32.3
Seven major countries	23.9	27.8	31.2	15.0	18.4
Other countries	17.9	19.7	23.2	15.5	13.9
OPEC countries	7.0	6.0	8.0	7.2	3.3
Other developing countries	28.2	38.3	32.5	24.9	19.6
Centrally planned economies **4**	3.0	1.5	0.6	1.0	3.0
Other countries **5**	1.0	1.4	2.8	3.6	2.1
Types of loans					
Euro-credits	81.0	91.3	90.8	60.2	51.7
Traditional credits	.	3.4	7.4	7.0	8.6
Memorandum items (not included in the above data)					
Back-up credits **6**	.	14.0	5.4	9.5	28.9
Other credits **7**	.	39.1	—	4.0	26.5
B. International bond issues	39.8	52.8	75.5	77.1	111.5
Borrowing sectors					
Public **2**	25.5	28.2	42.0	43.5	54.8
Private	14.3	24.6	33.5	33.6	56.7
Borrowing countries **3**					
OECD countries	28.8	39.6	60.1	60.3	94.9
OPEC countries	0.2	0.4	0.5	0.4	0.5
Other developing countries	1.5	3.8	3.6	2.2	3.1
Other countries	0.4	0.4	0.5	0.9	1.2
International organisations					
European	3.6	2.5	3.5	6.8	3.9
Other	5.3	6.0	7.3	6.6	7.9
Types of issues					
Euro-bonds **8**	20.4	31.3	50.3	50.1	81.7
Traditional foreign bonds **9**	18.0	20.5	25.2	27.0	27.8
Special issues **10**	1.4	1.0	—	—	2.0
Issue currencies and units of account					
U.S. dollar	17.1	32.9	48.2	43.9	71.6
Swiss franc	7.6	8.4	11.3	13.5	13.1
Deutsche Mark	8.7	2.7	5.4	6.7	6.7
Yen	2.1	3.3	3.9	4.1	6.1
Pound sterling	1.2	1.4	1.9	3.0	5.6
ECU	—	0.2	0.8	2.2	2.9
Other	3.1	3.9	4.0	3.8	5.5
C. Total (A plus B)	120.8	147.5	173.7	144.3	171.8

1 Publicised loans running for more than one year granted mostly by international bank syndicates (Euro-credits) or in national currency by national bank syndicates (traditional credits) and almost entirely financed on a roll-over basis which have not necessarily been taken up yet. — **2** Including public enterprises and financial institutions and including international organisations. — **3** For the definition of the groups of countries see the table on p. 56. Borrowing operations by foreign financing companies are included under the country of domicile of the parent company. — **4** Including CMEA institutions. — **5** Including international organisations. — **6** Issued by international bank syndicates for the purpose of backing up revolving issues of money market paper (Euro-notes, commercial paper, etc.). — **7** Merger-related stand-by credits to U.S. enterprises, hardly taken up at all. — **8** Primarily internationally syndicated issues. Including private placements and bonds with variable interest rates. As from 1981 also including medium-term certificates of deposit with variable interest rates. — **9** Nationally syndicated issues in domestic currency — **10** Direct placements and "specially targeted issues" of the United States. — **11** Including loan commitments of stand-by type, but excluding traditional credits. — **p** Provisional.
Discrepancies in the totals are due to rounding.
Source: OECD.

Advance of new financing techniques ...

Last year greater use was made of new financing techniques on the international financial markets, without this being reflected properly in the usual statistics. These techniques consist of credit commitments or credit guarantees serving only back-up purposes, while the actual financing operation is generally effected via the placing of money market paper on a roll-over basis with other banks or other institutional investors, for which the services of specialised selling syndicates are enlisted. According to OECD estimates, the total volume of new facilities of this nature rose in 1984 by $ 19 billion to $ 29 billion. Facilities which, depending on the particular nature of the contract in question, have become known under differing names, such as "note issuance facilities" (NIFs), "revolving underwriting facilities" (RUFs) or "multi-option funding facilities", accounted for the largest part of this total; in all, they rose in volume by $ 14 billion to $ 18 billion. To this extent, the actual development of the market is understated if only "classical" internationally syndicated loans and the international bond markets are taken into account. The reasons for the development of new financing techniques are to be seen in the banks' endeavours to take part in international lending transactions without involving their capital in the process and also in their desire for greater flexibility. The shocks caused by the debt crisis and the gradual raising in many countries of the capital adequacy requirements for banks are making themselves felt in this respect.

. . . not without problems

However, the problems associated with such novel financing techniques should not be underestimated. Such facilities — together with other new techniques such as currency and interest rate swaps, and option and futures contracts — tend to further obscure the already blurred dividing line between short and long-term financing, between credits and bonds, as well as between different credit currencies, and place considerable interest rate burdens on the borrower. For banks, the particular dangers reside in the fact that they have to fulfil their credit commitments or credit guarantees when the capital markets are less willing to provide funds. If this decreasing receptiveness were due to a deterioration in the creditworthiness of their customers, the banks would be bound to be affected. Moreover, the refinancing capacity of the banks would suffer if the receptiveness of the markets were to decline generally. Since these new facilities are only partly reflected in banks' balance sheets and are otherwise recorded to only an insufficient degree, the transparency of the market is significantly impaired. The successful efforts to improve information on international lending activities by banks as well as on the foreign debts of all countries should therefore be extended to include these new financing techniques as well.

7. Financial assistance granted by the IMF and the international development banks

Decline in IMF lending

Lending by the International Monetary Fund, which had grown strongly in 1983, declined again last year. It fell by over 40% from the preceding year's record level of SDR 12.6 billion to SDR 7.3 billion ($ 7.5 billion). At the same time, loan repayments rose again after having already increased in 1983. As a result of these developments, net new lending by the Fund declined from SDR 10.6 billion to SDR 5 billion, although this still constituted the third highest volume of lending in the history of the Fund. In the process, the volume of IMF loans outstanding went up to about SDR 35 billion. The slower rate of growth of lending by the Fund is chiefly due to the fact that the general improvement in the balance of payments position of the developing countries led to a decrease in the need for IMF adjustment assistance. Moreover, far less use was made of the Compensatory Financing Facility, seeing that the export receipts of many countries improved again. Of course, the significance of the IMF's assistance does not lie solely in its volume. An important role continues to be played, in particular, by assistance granted within the Fund's credit tranches and under the Extended Fund Facility — assistance that is coupled with economic policy conditions and is designed to keep access to private sources of finance open on an appropriate scale for countries experiencing difficulties.

Further prolongation of the "Enlarged Access" policy

The "Policy of Enlarged Access to Fund Resources", which allows countries in a weak balance of payments position, under certain conditions, to exceed the ceilings for drawings in the Fund's credit tranches as well as in the Extended

Purchases and repurchases under IMF credit facilities

SDR billion

Item	1980	1981	1982	1983	1984
Credit tranches	1.8	3.4	2.5	4.9	3.1
Extended Fund Facility	0.6	2.1	2.1	4.6	3.3
Compensatory Financing Facility	1.0	1.2	2.6	2.8	0.8
Buffer Stock Facility	—	—	0.1	0.3	0.0
Total purchases	3.4	6.8	7.4	12.6	7.3
Total repurchases	3.2	2.1	1.6	2.0	2.3
Net purchases	0.2	4.7	5.8	10.6	5.0

Discrepancies in the totals are due to rounding.
Source: IMF.

Explanatory notes on the IMF credit facilities and the conditions attached to them

Credit Tranches
Fund members may obtain balance of payments assistance in four credit tranches, each of 25% of the member's quota. Use of Fund resources in the first credit tranche requires the country to demonstrate reasonable efforts to overcome its balance of payments difficulties. Use of Fund resources in the upper credit tranches requires a country to adopt policies that give substantial assurance that the country's balance of payments problems will be resolved. Such use is almost always made under stand-by arrangements that include performance criteria and drawings in instalments.

Extended Fund Facility
As an alternative to the use of Fund resources in the upper credit tranches, a country can apply under this facility for medium-term financial assistance to overcome serious external or domestic structural maladjustments. Purchases under the facility may not exceed 140% of the member's quota. The country must present a comprehensive programme that includes a detailed statement of the policies and measures that it will follow during the period of the extended arrangement. The programme envisaged must be likely to reduce the balance of payments disequilibrium to sustainable proportions in the medium term. Extended arrangements (like stand-by arrangements) include performance criteria and drawings in instalments.

Enlarged Access
Under the policy of enlarged access to Fund resources, which is effective — for the time being — until the end of 1985, the Fund may provide, in conjunction with the use of its ordinary resources, supplementary financing that substantially exceeds the regular limits under the credit tranches and under the extended Fund facility. Present guidelines specify annual access limits of 95% to 115% of quota or of 280% to 345% over a three-year period: at the same time, a cumulative limit of 408% to 450% of quota applies on the net use of Fund resources. These limits may be exceeded in exceptional circumstances. The enlarged access policy is used only in support of economic programmes under stand-by arrangements or under extended arrangements. The amount available to a country under the policy of enlarged access depends on the size and the urgency of its balance of payments needs and the strength of the country's adjustment efforts. The Fund obtains its resources for such supplementary financing by borrowing from financially strong countries on market-related terms. The cost of borrowing by the Fund is passed on to the debtor countries.

Compensatory Financing Facility
Under this facility countries — particularly primary commodity exporting countries — encountering payments difficulties caused by temporary shortfalls in export proceeds or by a temporary excess in the cost of their cereal imports may draw on the Fund up to 105% of their quota, provided that the reasons for the export shortfall or the import excess are largely beyond the country's control.

Buffer Stock Facility
Member countries can make drawings under the buffer stock facility to finance their contributions to an international buffer stock accepted as suitable by the Fund.

Fund Facility, is to be continued for the time being. Although these easier drawing conditions granted since 1981 were originally designed only to increase the scope for drawings on the Fund in anticipation of the increase in Fund quotas that came into force at the end of 1983, it was possible to make use of them also in 1984, albeit to a limited extent. The IMF Interim Committee decided in the autumn to keep the "Enlarged Access" policy in effect, with slightly reduced drawing facilities, initially for a further year until the end of 1985. Thus, it remained possible to come to the aid of countries still encountering considerable balance of payments problems with appropriate kinds of assistance. In order to be able to procure the additional financial resources required under its "Enlarged Access" policy, the Fund has various credit lines with member countries in a strong financial position as well as with the BIS, as explained in detail in the Bundebank's Report for the Year 1983.

Growing importance of the World Bank's structural and sectoral adjustment loans

In contrast to the balance of payments loans granted by the IMF, the new long-term financial assistance extended by the international development banks has continued to rise even in recent times. In the 1983-84 financial year the World Bank group increased its loan commitments by $ 0.9 billion to $ 16.2 billion. In addition, the Inter-American Development Bank and the Development Banks for Africa and Asia stepped up the volume of their new loans by $ 0.7 billion to $ 6.6 billion in the calendar year 1984, if account is also taken of the development funds affiliated to these Banks. In the case of the World Bank, besides its classical project-financing activities, its so-called structural and sectoral adjustment loans increased further in importance. In the light of the deep-seated difficulties faced by the developing countries, these loans are designed to help the developing nations to facilitate changes in the thrust of their economic policies and, in the process, to create the preconditions for reducing their excessive current account deficits on a durable basis. Moreover, without a broadly-based rehabilitation of their economies the conditions for traditional project-financing operations to be successful are frequently lacking. Even if adjustment loans are granted without being tied to economic policy conditions, as is customary in the case of the IMF, they are disbursed in such a way that a critical review of the economic policies of the borrowers is ensured. Apart from this, discussions are currently being held between the World Bank and the IMF as to how both institutions can coordinate their policies even better within the framework of their differing tasks, with a view to fostering the adjustment process in the developing countries.

Increase in the World Bank's resources through short-term financing instruments

The international development banks once again had great recourse to world financial markets. In the financial year 1983-84 gross borrowing by the World Bank rose by $ 1 billion to $ 11.3 billion, while the regional development banks increased their new borrowing by $ 0.9 billion to $ 3.4 billion in the calendar year 1984. However, the World Bank's additional funds only constituted short-term resources. By issuing short-term notes — the World Bank had been authorised to do so for the first time in the preceding year — an additional amount of $ 500 million was raised. Moreover, the World Bank took up short-term loans under the facility newly introduced in the financial year 1983-84 for taking up dollar loans from central banks and other public agencies, whereby the prescribed ceiling of $ 750 million was immediately reached. This further strengthened the tendency of the World Bank to refinance its activities to an increasing degree with short-term funds. To ensure that no problems arise from this, the Bank should not move too far away in future from a balance between the average maturity of its loans and that of the resources which it borrows.

Part B: Notes on the Deutsche Bundesbank's annual accounts for 1984

1. Legal basis, classification and valuation

Legal basis, accounting system and annual accounts

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

Classification of the annual accounts

The classification of the balance sheet and the profit and loss account remained unchanged as against the preceding year.

Valuation

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

Comparison of balance sheet figures

DM million

Assets	December 31 1983	December 31 1984	Liabilities	December 31 1983	December 31 1984
Gold	13,687.5	13,687.5	Banknotes in circulation	96,073.0	100,636.0
Reserve position in the International Monetary Fund and special drawing rights			Deposits of banks	52,702.0	54,254.3
			Deposits of public authorities		
Drawing rights within the reserve tranche	7,705.0	9,173.6	Federal Government	1,516.8	414.1
			Equalisation of Burdens Fund and ERP Special Fund	19.1	7.4
Loans under special borrowing arrangements	2,503.7	2,632.5	Länder Governments	592.2	511.0
Special drawing rights	4,394.1	4,288.1	Other public depositors	31.9	49.4
Claims on the European Monetary Cooperation Fund in connection with the European Monetary System			Deposits of other domestic depositors		
			Federal Railways	10.4	8.6
			Federal Post Office	2,561.8	2,082.7
ECU balances resulting from the provisional contribution of gold and dollar reserves 1	12,496.1	12,539.6	Other depositors	599.6	720.9
			Liabilities arising from mobilisation and liquidity paper sold	6,296.0	6,513.7
ECU balances resulting from transfers from other central banks	2,948.3	1,801.7	Liabilities arising from external transactions	9,780.5	11,439.2
Balances with foreign banks and money market investments abroad	37,794.1	37,475.4	Counterpart of special drawing rights allocated	3,452.7	3,736.0
Foreign notes and coins	24.7	24.7	Provisions	6,192.2	8,739.2
External loans and other external assets			Other liabilities	159.9	183.9
Loans to the World Bank	2,455.7	2,455.7	Deferred expenses and accrued income	380.8	366.9
Foreign bills of exchange	9,448.4	14,814.9	Capital	290.0	290.0
Domestic bills of exchange	46,586.5	47,767.6	Reserves	4,718.7	5,093.6
Securities bought in open market transactions under repurchase agreements	16,168.4	25,735.6	Unappropriated profit	11,770.5	13,202.0
Lombard loans	13,294.8	7,967.5			
Cash advances	901.5	2,440.4			
Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin	8,683.6	8,683.6			
Securities	7,797.3	4,340.2			
German coins	1,013.6	987.4			
Balances on postal giro accounts	238.5	148.0			
Land and buildings	1,386.7	1,567.1			
Furniture and equipment	119.2	129.4			
Items in course of settlement	3,487.1	5,588.8			
Other assets	3,977.0	3,962.4			
Prepaid expenses and deferred income	36.3	37.2			
Balance sheet total	197,148.1	208,248.9	Balance sheet total	197,148.1	208,248.9
Contingent claims	0.1	0.0	Contingent liabilities	0.1	0.0

1 After deduction of the difference between the ECU value and the book value of the reserves contributed.

2. Annual accounts

The annual accounts for 1984 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 1984.

Balance sheet

Comparison of balance sheet figures

The balance sheet total at December 31, 1984 was DM 208,248.9 million, as against DM 197,148.1 million at end-1983.

Assets

Gold

The gold holding at December 31, 1984, amounting to 95 million ounces of fine gold (excluding the gold reserves provisionally contributed to the European Monetary Cooperation Fund), is shown at the same figure as at end-1983, viz. DM 13,687.5 million.

Reserve position in the International Monetary Fund and special drawing rights

Drawing rights within the reserve tranche

As at December 31, 1984 the drawing rights within the reserve tranche in the IMF amounted to DM 9,173.6 million (= SDR 2,973.0 million) against DM 7,705.0 million (= SDR 2,701.9 million) at end-1983. Increases due to other members' Deutsche Mark drawings and transactions of similar effect equivalent to SDR 455.3 million were accompanied by decreases equivalent to SDR 184.3 million due to other members' Deutsche Mark repayments and transactions of similar effect. The level of drawing rights within the reserve tranche represents the difference between the German quota of SDR 5,403.7 million and the Deutsche Mark balances equivalent to SDR 2,430.7 million at the disposal of the IMF at the end of the year.

Loans under special borrowing arrangements

Loans under special borrowing arrangements amounted to DM 2,632.5 million at December 31, 1984 against DM 2,503.7 million at end-1983. The loans outstanding at the end of 1984 comprise exclusively claims of SDR 853.1 million on the IMF arising from the financing of other members' drawings under the Supplementary Financing Facility.

Special drawing rights

The amount of special drawing rights (SDRs) held at December 31, 1984 is shown at DM 4,288.1 million (= SDR 1,389.7 million) against DM 4,394.1 million (= SDR 1,540.9 million) at end-1983. It is composed of SDR 1,210.8 million of SDRs allocated, the counterpart of which is shown on the liabilities side, and SDR 178.9 million of SDRs purchased. In the year under review the Bank received SDR 308.6 million through designations, SDR 4.1 million through repayments and SDR 271.6 million through interest payments and remunerations. The Bank sold a total of SDR 735.5 million in freely agreed transactions in the year under review.

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

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

ECU balances resulting from the provisional contribution of gold and dollar reserves

These ECU balances, amounting to DM 40,205.9 million, arose from the provisional contribution of 20% of the Bank's gold and dollar reserves to the European Monetary Cooperation Fund (EMCF) in the form of three-month swaps.

less Difference between the ECU value and the book value of the reserves contributed

The gold and dollar reserves provisionally contributed to the European Monetary Cooperation Fund in connection with the European Monetary System (EMS) against the crediting of ECUs were transferred at market prices and therefore at values higher than those shown in the balance sheet. The resulting difference of DM 27,666.3 million is deducted in this sub-item.

ECU balances resulting from transfers from other central banks

This sub-item comprises the reserve ECUs amounting to DM 1,801.7 million (end-1983: DM 2,948.3 million) transferred to the Bank by other central banks participating in the EMS.

Other claims

At end-1984 no other ECU claims arising from loans under the very short-term financing arrangement were outstanding.

Balances with foreign banks and money market investments abroad

The balances with foreign banks and money market investments abroad, the vast bulk of which are denominated in U.S. dollars and bear interest, amounted to DM 37,475.4 million at end-1984 against DM 37,794.1 million at December 31, 1983.

Foreign exchange deals

Owing to larger dollar sales on the foreign exchange market, the Bank's turnover in foreign exchange spot deals (foreign currency against Deutsche Mark) rose slightly to DM 45,555.1 million against DM 44,284.5 million in 1983. The number of deals fell from 7,593 in 1983 to 6,966. The deals consisted of

	1983		1984	
	Number	DM million	Number	DM million
Purchases	2,786	12,445.2	2,147	9,446.7
Sales	4,807	31,839.3	4,819	36,108.4
	7,593	44,284.5	6,966	45,555.1.

The volume of cross deals (foreign currency against foreign currency) almost doubled in the year under review compared with 1983, although the number of deals declined somewhat (343 deals equivalent to DM 7,306.6 million against 390 deals equivalent to DM 3,759.2 million in 1983). By contrast, the number of SDR/U.S. dollar and SDR/Deutsche Mark deals fell markedly to 70 (equivalent to DM 2,813.9 million as against 138 equivalent to DM 4,283.1 million in 1983). In addition, 195 U.S. dollar inter-centre switch transactions totalling US$ 28.7 million were concluded against 148 transactions amounting to US$ 29.5 million in the preceding year.

124 forward ("outright") sales of U.S. dollars totalling US$ 1,106.4 million were effected, compared with 49 U.S. dollar sales totalling US$ 600 million in the previous year.

To regulate the money market, 27 U.S. dollar swaps totalling DM 3,318.2 million were conducted with domestic banks to increase liquidity during the year under review, against 63 U.S. dollar swaps amounting to DM 12,967.1 million and

43 foreign exchange transactions under repurchase agreements totalling DM 10,471.8 million to reduce liquidity in 1983.

External payments

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

External payments

Number of orders

Year	Outgoing external payment orders			of which	
	in foreign currencies	in Deutsche Mark	Total	Processed by automated standing order procedure	Processed automatically via S.W.I.F.T. 1
1983	437,084	1,988,267	2,425,351	2,161,779	168,565
1984	426,074	2,116,182	2,542,256	2,270,475	174,195
	Incoming external payment orders				
				of which Payments received via S.W.I.F.T.	
1983	14,294	201,719	216,013		182,935
1984	14,977	210,584	225,561		203,477

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 Bank 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 1984 17,001 (1983: 14,679) foreign cheques payable to order totalling DM 470.2 million (1983: DM 726.1 million) were sold. In addition, the Bank sold 27,742 traveller's cheques amounting to DM 3.3 million against 24,658 traveller's cheques totalling DM 2.9 million in the preceding year.

Simplified collection procedure for foreign cheques

The number and amount of cheques received under the simplified collection procedure for foreign cheques developed along divergent lines for a while in 1984. A decrease in the number was accompanied by an increase in the amount. 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:

	1983 Number	1984 Number
Bills, cheques, etc.	41,795	39,836
Foreign notes and coins	5,439	5,711
	47,234	45,547.

Foreign notes and coins

The amount of foreign notes and coins shown at end-1984, at DM 24.7 million, is the same as at end-1983. During the year under review, the Bank effected 22,585 purchases (1983: 21,320) and 41,090 sales (1983: 41,171) of foreign notes and coins.

External loans and other external assets

As in the preceding year, only loans to the World Bank are shown in this item. Loans under the EEC medium-term monetary assistance arrangement and other loans to foreign monetary authorities were not granted in the year under review.

Loans in connection with EEC medium-term monetary assistance

Other loans to foreign monetary authorities

Loans to the World Bank

As in the 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 1984 the portfolio of foreign bills accumulated through purchases in Germany amounted to DM 14,814.9 million, compared with DM 9,448.4 million at December 31, 1983. The share of Deutsche Mark bills in the total value of the foreign bills purchased in 1984 averaged about 90% (1983: about 87%).

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

	1983		1984	
Land Central Bank	Number	DM million	Number	DM million
Baden-Württemberg	40,772	4,234.6	45,379	6,080.8
Bavaria	23,096	4,493.6	28,162	6,506.7
Berlin	1,581	2,545.6	1,903	3,199.6
Bremen	2,702	519.7	2,413	640.6
Hamburg	13,067	4,910.5	13,534	6,560.8
Hesse	23,690	12,674.7	26,860	14,802.9
Lower Saxony	4,534	895.3	6,384	1,553.9
North Rhine-Westphalia	38,302	10,007.1	40,530	12,732.5
Rhineland-Palatinate	7,288	1,028.1	9,132	1,519.0
Saarland	2,886	808.7	3,132	903.7
Schleswig-Holstein	1,642	606.3	2,558	939.2
Total	159,560	42,724.2	179,987	55,439.7

Domestic bills of exchange

At the end of 1984 the Bank's portfolio of domestic bills amounted to DM 47,767.6 million against DM 46,586.5 million at the end of 1983. The Bank's average portfolio of domestic bills on all return days, at DM 48,367 million, was also higher than in the preceding year (DM 46,308 million).

The domestic bill portfolio comprised	Dec. 31, 1983 DM million	Dec. 31, 1984 DM million
Domestic bills discounted	42,826.1	44,095.6
Prime bankers' acceptances acquired in the course of open market operations	3,760.4	3,672.0
	46,586.5	47,767.6.

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

Land Central Bank	1983 Thousands	1983 DM million	1984 Thousands	1984 DM million
Baden-Württemberg	627	27,911.2	639	30,820.1
Bavaria	385	26,952.1	401	28,876.3
Berlin	24	5,009.5	23	4,794.5
Bremen	45	3,906.2	40	3,413.1
Hamburg	114	14,715.6	120	15,061.7
Hesse	344	41,030.3	335	40,189.8
Lower Saxony	178	13,719.6	183	14,677.7
North Rhine-Westphalia	612	48,454.7	609	51,038.1
Rhineland-Palatinate	104	6,368.3	109	6,824.8
Saarland	27	2,580.0	29	2,709.9
Schleswig-Holstein	41	3,571.6	42	3,626.5
Total	2,501	194,219.1	2,530	202,032.5

The average value of the bills purchased in the year under review was DM 79,900 compared with DM 77,700 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:

	1983 Number	1983 DM million	1984 Number	1984 DM million
	13,904	232.5	13,226	168.3
as % of the total purchased	0.56	0.12	0.52	0.08.

Discount rate

During the year under review the Bank's discount rate for domestic and foreign bills was 4% until June 28 and $4^1/_2$% as from June 29.

Prime bankers' acceptances

The amount of prime bankers' acceptances which the Bank is prepared to purchase in the course of its open market operations, at DM 4 billion, remained unchanged during the year under review. Throughout the year the Bank's buying rate for prime bankers' acceptances was 0.5 percentage point below the discount rate. During the year the Bank's purchases through the Privatdiskont-Aktiengesellschaft came to DM 19,171.9 million, thus distinctly exceeding the previous year's level (DM 17,290.1 million). There were no resales to the market via the broker in 1984.

The amount of prime bankers' acceptances that remained in the Bank's portfolio until payment on maturity, at DM 17,063.7 million, was larger than in the previous year (DM 16,334.2 million). At December 31, 1984 the Bank held prime bankers' acceptances stemming from open market operations totalling DM 3,672.0 million (end-1983: DM 3,760.4 million).

Open market transactions under repurchase agreements in bills

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

Securities bought in open market transactions under repurchase agreements

To provide liquidity for a limited period, during the year under review the Bank offered the banks, by tender, open market transactions under repurchase agreements in securities on a larger scale than in earlier years. In these transactions the Bank bought bonds eligible as collateral for lombard loans on condition that the sellers repurchased them forward. The repurchase periods varied between 27 and 42 days, and the interest rates between 5.4% and 5.8%. At the end of the year the Bank held DM 25,735.6 million of securities deriving from such transactions.

Lombard loans

At the end of 1984 the Bank's outstanding lombard loans to banks amounted to DM 7,967.5 million against DM 13,294.8 million at end-1983. The average level of such loans on all return days of the year under review was DM 6,451 million compared with DM 5,779 million in the previous year. The outstanding amount of such loans was subject to marked fluctuations, as in preceding years, and was largest on September 27, 1984, at DM 20,045 million.

Lombard rate

Throughout the year under review the lombard rate was $5^1/_2$%.

Cash advances

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.

As well as cash advances, Treasury bills which the Bank holds in its portfolio or has undertaken to purchase are to be counted against these credit ceilings.

Federal Government, Equalisation of Burdens Fund, Länder Governments

Cash advances outstanding

DM million

Borrower	December 31, 1983	December 31, 1984
Federal Government	–	1,773.4
Länder Governments		
Bremen	54.1	49.7
Hamburg	130.0	–
Hesse	150.0	13.9
North Rhine-Westphalia	438.6	506.0
Saarland	42.0	9.7
Schleswig-Holstein	86.8	87.7
Total	901.5	2,440.4

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

Federal Railways, Federal Post Office

No cash advances to the Federal Railways or Federal Post Office were outstanding at December 31, 1984; such advances, together with claims arising from the purchase of Treasury bills and Treasury discount paper, are to be shown in the item "Loans to the Federal Railways and Federal Post Office" on the assets side of the Bank's balance sheet.

Throughout the year the rate of interest on cash advances was identical with the Bank's discount rate.

Treasury bills and Treasury discount paper

In the issuing of Treasury discount paper in 1984 the Bank again acted as the selling agent for the Federal Government. This paper, which serves financing purposes, is distinct from the mobilisation and liquidity paper issued pursuant to sections 42 and 42 (a) of the Bundesbank Act, which is reported on below. No Treasury bills serving financing purposes were issued during the year under review.

Federal Government

To meet the credit requirements of the Federal Government, Treasury discount paper amounting to DM 3,461.0 million (1983: DM 8,167.8 million) was issued. The sharp fall in the sales of these securities particularly affected Treasury discount paper type "BN", which is not returnable before maturity; of this paper, DM 717.7 million (1983: DM 5,441.8 million) was placed with domestic banks. The total issue figure included DM 1,903.3 million (1983: DM 2,476.0 million) of Treasury "financing" paper of the Federal Government. The residual DM 840 million, consisting of paper returnable prior to maturity (type "B"), was purchased by an institutional investor.

After the redemption of DM 9,036.5 million (1983: DM 10,217.0 million) of matured Treasury discount paper (including Treasury financing paper), the amount of Treasury discount paper types "B" and "BN" outstanding at December 31, 1984 was DM 10,605.3 million (end-1983: DM 16,180.8 million). Of this total, much as in the preceding year, DM 1,090.0 million was repurchasable by the Bank (type "B").

Federal Railways

As regards the Treasury discount paper of the Federal Railways (types "Ba" and "BaN"), changes during the year under review were confined to the redemption of DM 100 million (type "BaN"); hence at December 31, 1984 there was only (returnable) Treasury discount paper of the Federal Railways (type "Ba") to the amount of DM 131 million outstanding (end-1983: DM 231 million).

Federal Post Office

The amount of Treasury discount paper of the Federal Post Office (type "PN") outstanding at end-1983, at DM 524.9 million, was repaid in full and not renewed in the year under review.

The total amount of money market paper issued for the account of the Federal Government and its Special Funds and outstanding at December 31, 1984 was DM 10,736.3 million (end-1983: DM 16,936.7 million).

Money market paper issued for the account of the Federal Government and its Special Funds

DM million

Type of paper	Outstanding at Dec. 31, 1983	1984		Outstanding at Dec. 31, 1984
		Issued	Redeemed	
Treasury discount paper of the Federal Republic of Germany type "B" 1 and type "BN" 2	16,180.8	3,461.0	9,036.5	10,605.3
of which Treasury financing paper	(4,022.5)	(1,903.3)	(2,570.1)	(3,355.7)
Treasury discount paper of the Federal Railways types "Ba" and "BaN" 2	231.0	—	100.0	131.0
Treasury discount paper of the Federal Post Office type "PN" 2	524.9	—	524.9	—
Total	16,936.7	3,461.0	9,661.4	10,736.3

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

Länder Governments

At end-1984, as in the preceding year, the Bank had no money market paper of the Länder Governments in its portfolio.

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 and the non-interest-bearing debt certificate in respect of Berlin remained unchanged during the year under review.

Loans to the Federal Railways and Federal Post Office

No loans to the Federal Railways or Federal Post Office were outstanding at December 31, 1984, as in the previous year. See also the notes on the items "Cash advances" and "Treasury bills and Treasury discount paper".

Securities

During the year under review the Bank's portfolio of securities — chiefly bonds of the Federal Republic of Germany, the Federal Railways and the Federal Post Office — fell by DM 3,457.1 million to DM 4,340.2 million owing to redemptions on account of maturities and sales to the market (end-1983: DM 7,797.3 million).

Issue of bonds

In 1984 12 bond issues totalling DM 19,750 million (1983: 13 bond issues amounting to DM 17,900 million) were launched through the Federal Bond Consortium, which is under the direction of the Bank. Of these bonds, an amount of DM 4,650 million was reserved for the issuers' own institutions and for price regulation purposes.

At the end of 1984 the outstanding amount of bonds of the Federal Republic of Germany was DM 77,102.6 million (end-1983: DM 66,047.1 million), that of the Federal Railways was DM 15,888.7 million (end-1983: DM 15,745.3 million) and that of the Federal Post Office DM 12,686.4 million (end-1983: DM 10,708.3 million).

Bond issues of the Federal Republic of Germany, the Federal Railways and the Federal Post Office in 1984

	Amount issued (DM million)		Terms				
Issuer	Total	of which Sold through Federal Bond Consortium	Nominal interest rate (%)	Maturity (years)	Issue price (%)	Yield (%)	Start of sales
Federal Republic of Germany	2,000	1,500	8.25	10	99.50	8.33	Jan. 2
Federal Republic of Germany	2,000	1,600	8.25	10	100	8.25	Feb. 2
Federal Post Office	1,000	800	8.25	10	100.50	8.17	Feb. 15
Federal Republic of Germany	2,000	1,500	8	10	100	8.00	Mar. 1
Federal Railways	875	700	8.25	10	100.25	8.21	May 15
Federal Republic of Germany	2,000	1,500	8.25	10	100.25	8.21	June 6
Federal Republic of Germany	2,000	1,500	8.25	10	100.25	8.21	July 4
Federal Republic of Germany	2,000	1,500	8.25	10	100.25	8.21	Aug. 1
Federal Post Office	1,000	800	8	10	100.75	7.89	Sep. 3
Federal Republic of Germany	2,000	1,500	7.50	10	100	7.50	Oct. 9
Federal Railways	875	700	7.25	10	99.75	7.29	Oct. 25
Federal Republic of Germany	2,000	1,500	7	10	99.75	7.04	Dec. 5

Issue of Federal savings bonds

With the assistance of the Bank (selling operations via banks and own sales), DM 6,014.3 million (gross) of Federal savings bonds were placed with private purchasers during the year under review (1983: DM 3,815,6 million).

During the year under review the rate of interest paid on Federal savings bonds was raised once and lowered four times to bring it into line with market rates.

Gross sales, interest rates and yields of Federal savings bonds in 1984

Issue	Sales period 1984	Gross sales (DM million) Total	Federal savings bonds type A 1	Federal savings bonds type B 2	Interest rate (I) in, and yield (Y) after, . . . year after issue (% p.a.)	1st	2nd	3rd	4th	5th	6th	7th
1984/ 1+2	Jan. 2– Mar. 8	1,237.7	449.7		I	5.50	7.50	8.00	8.25	8.25	9.50	
					Y	5.50	6.47	6.94	7.24	7.41	7.69	
				788.0	I	5.50	7.50	8.00	8.25	8.25	9.50	9.50
					Y	5.50	6.50	6.99	7.31	7.49	7.83	8.06
1984/ 3+4	Mar. 9– Mar. 26	144.4	63.1		I	5.50	7.00	7.50	7.75	8.00	9.00	
					Y	5.50	6.23	6.62	6.88	7.07	7.34	
				81.3	I	5.50	7.00	7.50	7.75	8.00	9.00	9.00
					Y	5.50	6.25	6.66	6.93	7.15	7.45	7.67
1984/ 5+6	Mar. 27– Sep. 3	2,338.8	979.5		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	
				1,359.3	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
1984/ 7+8	Sep. 4– Oct. 8	713.6	338.7		I	5.50	7.50	7.75	8.00	8.25	8.50	
					Y	5.50	6.47	6.87	7.12	7.31	7.48	
				374.9	I	5.50	7.50	7.75	8.00	8.25	8.50	8.50
					Y	5.50	6.50	6.91	7.18	7.40	7.58	7.71
1984/ 9+10	Oct. 9– Dec 5	1,258.0	587.5		I	5.00	7.00	7.25	7.75	8.00	8.50	
					Y	5.00	5.97	6.37	6.68	6.91	7.13	
				670.5	I	5.00	7.00	7.25	7.75	8.00	8.50	8.50
					Y	5.00	6.00	6.41	6.74	6.99	7.24	7.42
1985/ 1+2	Dec. 6–*	321.8	140.3		I	5.00	6.50	7.00	7.25	7.50	8.00	
					Y	5.00	5.73	6.13	6.38	6.58	6.77	
				181.5	I	5.00	6.50	7.00	7.25	7.50	8.00	8.00
					Y	5.00	5.75	6.16	6.43	6.65	6.87	7.03
Total	Jan. 2– Dec. 31*	6,014.3	2,558.8	3,455.5								

1 With annual payment of interest. — 2 With accrual of interest. — * Sales not completed on December 31, 1984.

During 1984 DM 337.2 million (1983: DM 97.7 million) of Federal savings bonds from earlier tranches were returned to the issuer before maturity, and a further DM 553.0 million were redeemed on maturity. The amount of Federal savings bonds outstanding rose from DM 16,000.4 million (end-1983) to DM 21,124,5 million at December 31, 1984.

Issue of five-year special Federal bonds

With the assistance of the Bank (selling operations via banks and own sales), DM 13,289.3 million of newly-issued five-year special Federal bonds were sold (1983: DM 12,101.9 million). In addition, an amount of DM 1,766.5 million was reserved for market regulation purposes after the completion of the issue of the current series.

During the year under review the terms of special Federal bonds were brought into line with market conditions on 20 occasions.

Sales and terms of issue of five-year special Federal bonds in 1984

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
S. 45 of 1984 (1989)	Jan. 2	8.00	100.00	8.00	2,604.4				
	Feb. 6		100.80	7.80	361.7				
	Feb. 20		101.20	7.70	453.0	3,419.1	380.9	3,800	Mar. 15
S. 46 of 1984 (1989)	Mar. 6	7.50	100.00	7.50	181.5				
	Mar. 23		99.20	7.70	30.9	212.4	87.6	300	Apr. 5
S. 47 of 1984 (1989)	Mar. 27	7.75	99.80	7.80	990.0				
	Apr. 17		100.40	7.65	128.6				
	May 4		99.80	7.80	247.2				
	May 21		99.40	7.90	908.9	2,274.7	125.3	2,400	July 16
S. 48 of 1984 (1989)	July 5	7.75	99.40	7.90	1,380.2				
	Aug. 13		99.80	7.80	39.7				
	Aug. 14		100.20	7.70	1,465.1				
	Sep. 4		100.80	7.55	704.4	3,589.4	310.6	3,900	Sep. 25
S. 49 of 1984 (1989)	Sep. 14	7.50	100.40	7.40	130.7				
	Sep. 18		100.80	7.30	1,606.5	1,737.2	262.8	2,000	Oct. 18
S. 50 of 1984 (1989)	Oct. 9	7.25	100.40	7.15	27.2				
	Oct. 10		100.80	7.05	544.4	571.6	228.4	800	Nov. 5
S. 51 of 1984 (1989)	Oct. 23	7.00	100.50	6.88	20.1				
	Oct. 31		99.80	7.05	503.7				
	Nov. 6		100.40	6.90	755.3	1,279.1	370.9	1,650	Dec. 17
S. 52 of 1984 (1989)	1 Dec. 6	6.75	99.70	6.82	205.8	205.8	1 –	1 –	Feb. 26, 1985

1 Sales not completed on December 31, 1984.

In the year under review series 1 of the special Federal bond issue to the amount of DM 1,100 million was redeemed upon maturity. The outstanding amount of five-year special Federal bonds at end-1984 was DM 62,328.0 million (end-1983: DM 48,403.8 million).

Issue of medium-term notes

Through the agency of the Bank, DM 3,482.5 million of Treasury bonds (medium-term notes) of the Federal Republic of Germany, the Federal Railways and the Federal Post Office were sold in five issues by four tenders in 1984 (1983: DM 4,511.8 million by four tenders).

Treasury bonds (medium-term notes) of the Federal Republic of Germany, the Federal Railways and the Federal Post Office sold by tender in 1984

Issuer	Amount sold (DM million)	Nominal interest rate (%)	Maturity (years)	Selling price (%)	Yield on issue (%)	Month of sale
Federal Railways	489.1	7.75	4	99.20	7.99	January
Federal Republic of Germany	1,159.3	7.50	4	99.40	7.68	March
Federal Post Office	357.5	7	3	99.20	7.31	May
Federal Post Office	389.0	7.50	4	99.20	7.74	May
Federal Republic of Germany	1,087.6	6.50	4	99.30	6.71	November

At the end of 1984 the outstanding amount of medium-term notes of the Federal Republic of Germany was DM 12,924.4 million (end-1983: DM 13,053.5 million), that of the Federal Railways DM 1,394.1 million (end-1983: DM 1,543.4 million) and that of the Federal Post Office DM 1,903.7 million (end-1983: DM 2,100.9 million).

Admission to stock exchange dealing

The Bank introduced the new bond issues of the Federal Republic of Germany, the Federal Railways, the Federal Post Office and the Reconstruction Loan Corporation, as well as the five-year special Federal bonds series 44 to 51, to official dealing on all German stock exchanges; it also introduced 15 issues of bearer bonds of the Equalisation of Burdens Bank to regulated unofficial dealing on the Düsseldorf stock exchange.

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

Price regulation operations

In the year under review, as in preceding years, the Bank conducted price regulation operations for the account of the issuers on the eight German stock exchanges in respect of the bonds issued by the Federal Government and its Special Funds, five-year special Federal bonds, and the bonds issued by 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 (including external bonds) of the Federal Government and its Special Funds, the Bank paid 583,725 interest coupons and matured bonds in the year under review (1983: 731,700).

German coins

The amount of German coins held by the Bank at end-1984 was DM 987.4 million (end-1983: DM 1,013.6 million). In 1984 the Federal Government was credited with DM 323.5 million in respect of coins taken over from the Mints and debited with DM 12.9 million in respect of coins no longer fit for circulation and melted down. Between 1948 and 1984 the Bank — acting for the account of the Federal Government — took over coins amounting to DM 11,629.3 million and redeemed DM 1,685.8 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 1984 (DM 8,956.1 million) divided by the number of inhabitants of the Federal Republic of Germany and Berlin (West) on September 30, 1984 (61.1 million) yields a coin circulation of DM 146.58 per head of population (1983: DM 140.37).

During the year under review the DM 5 commemorative coins "Zollverein" and "Mendelssohn Bartholdy" were put into circulation.

Balances on postal giro accounts

At December 31, 1984 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 148.0 million (1983: DM 238.5 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								
	1983				1984			
	Transfers received from third parties		Transfers made to third parties		Transfers received from third parties		Transfers made to third parties	
Area	Number	DM million	Number	DM million	Number	DM million	Number	DM million
Land Central Bank								
Baden-Württemberg	72,236	18,646.7	5,527	2,510.9	62,319	18,930.8	5,177	2,803.5
Bavaria	41,179	13,162.0	8,048	7,337.3	40,837	13,723.8	8,484	8,227.4
Berlin	17,082	3,049.0	2,147	1,560.4	16,587	2,686.4	1,886	1,741.6
Bremen	4,741	388.0	103	0.0	4,704	370.4	111	0.0
Hamburg	115,076	19,818.7	2,031	594.7	99,456	18,863.6	1,927	676.9
Hesse	85,565	8,584.6	3,593	6,855.8	81,345	8,889.4	4,111	8,218.3
Lower Saxony	50,597	8,877.8	3,783	2,842.0	46,531	9,356.0	4,019	3,057.5
North Rhine-Westphalia	141,105	23,852.3	10,454	7,909.3	123,521	21,495.4	9,703	6,160.5
Rhineland-Palatinate	18,771	1,194.6	3,943	820.6	21,624	1,085.5	4,253	827.0
Saarland	6,056	2,044.1	132	0.1	5,541	2,079.8	137	0.1
Schleswig-Holstein	5,088	72.3	638	7.7	5,224	85.6	497	0.4
Total	557,496	99,690.1	40,339	30,438.8	507,689	97,566.7	40,305	31,713.2
Bundesbank — Central Office —	4,991	2,249.2	842	3.8	5,966	2,739.5	904	3.7
Grand total	562,487	101,939.3	41,241	30,442.6	513,655	100,306.2	41,209	31,716.9

Land and buildings

After additions of DM 272.6 million and depreciation totalling DM 92.2 million, land and buildings are shown at DM 1,567.1 million.

Furniture and equipment

The balance sheet value of furniture and equipment works out at DM 129.4 million after additions totalling DM 62.4 million and depreciation amounting to DM 52.2 million.

Items in course of settlement

The "Items in course of settlement" mainly comprise the intercity credit and debit transfers proceeding inside the Bank at the end of the year and the cheques and direct debits being cleared. At December 31, 1984 the balance of items in course of settlement stood at DM 5,588.8 million against DM 3,487.1 million at end-1983.

Other assets

In this item, other assets are shown at end-1984 at DM 3,962.4 million (end-1983: DM 3,977.0 million). This item primarily contains the interest due in 1985 but assignable to the profit and loss account for the year under review on funds invested abroad and securities (DM 3,390.6 million against DM 3,079.3 million at end-1983) and the balance arising from intra-German settlements (commercial payments under the "Berlin Agreement"), which amounted to DM 273.3 million (1983: DM 480.7 million). The regulations governing intra-German payments are outlined in Part A IV of the German original of this Report.

This item also contains the Bank's 30% share (DM 93 million in nominal terms) 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 — following a capital increase in the year under review — a maximum commitment of DM 279 million.

Prepaid expenses and deferred income

The prepaid expenses and deferred income almost exclusively comprise salary and pension payments made in the year under review but relating to 1985.

Banknotes in circulation

The amount of banknotes in circulation at December 31, 1984, at DM 100,636.0 million, was DM 4,563.0 million larger than at end-1983.

Currency in circulation

DM million

End of	Bundesbank notes	Federal coins	Currency in circulation, total
1979	79,385.6	6,988.7	86,374.3
1980	83,730.3	7,461.0	91,191.3
1981	83,790.3	7,816.6	91,606.9
1982	88,574.7	8,120.2	96,694.9
1983	96,073.0	8,619.3	104,692.3
1984	100,636.0	8,956.1	109,592.1

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

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

The following banknotes (including monetary tokens) were destroyed as being no longer fit for circulation or after having been called in:

	1979	1980	1981	1982	1983	1984
Number (millions)	505.9	466.4	662.3	834.5	582.9	569.0
Value (DM million)	20,829.6	18,495.1	28,793.9	39,604.0	24,938.5	25,098.5.

In the year under review the number and value of the counterfeit Bundesbank notes detained in payments in the Federal Republic of Germany and Berlin (West) rose in comparison with the preceding year, whereas the number and value of Federal coins fell.

Counterfeits detected in payments

	Bundesbank notes		Federal coins	
Year	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
1981	2,896	219.1	17,172	34.3
1982	3,317	250.7	19,975	43.3
1983	2,156	181.7	26,607	56.1
1984	7,318	710.3	21,365	49.3

Deposits of banks

The banks' deposits on giro accounts are mainly composed of the minimum reserves to be held at the Bank. The sub-item "Other" contains the deposits of domestic banks on U.S. dollar accounts. At the end of the year, compared with end-1983, the deposits were made up as follows:

	Dec. 31, 1983 DM million	Dec. 31, 1984 DM million
Deposits on giro accounts	52,681.2	54,239.7
Other	20.8	14.6
	52,702.0	54,254.3.

Deposits of public authorities

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

	Dec. 31, 1983 DM million	Dec. 31, 1984 DM million
Federal Government	1,516.8	414.1
Equalisation of Burdens Fund and ERP Special Fund	19.1	7.4
Länder Governments	592.2	511.0
Other public depositors	31.9	49.4
	2,160.0	981.9.

Deposits of other domestic depositors

The deposits of other domestic depositors were composed as follows:

	Dec. 31, 1983 DM million	Dec. 31, 1984 DM million
Federal Railways	10.4	8.6
Federal Post Office (including postal giro and postal savings bank offices)	2,561.8	2,082.7
Other depositors	599.6	720.9
	3,171.8	2,812.2.

Giro transactions, simplified cheque and direct debit collections

As in the previous year, almost 100% of the turnover on the Bank's giro accounts was settled on a cashless basis, in terms of both the number of transactions and the amount involved.

Annual turnover on the giro accounts of the Bank

Type of turnover	1983 Number of transactions	1983 Total amount	1983 Average amount	1984 Number of transactions	1984 Total amount	1984 Average amount
	Thousands	DM million	DM thousand	Thousands	DM million	DM thousand
(a) Credits						
Cash payments	1,066	221,792	208.1	1,060	231,831	218.7
Clearings with account-holders	4,008	4,902,191	1,223.1	3,817	5,513,711	1,444.5
Local transfers	83,408	5,373,283	64.4	80,539	5,984,224	74.3
Intercity transfers	318,135	5,486,555	17.2	334,611	5,957,454	17.8
Cheque and direct debit collections (total presented)	1,158,858	2,153,736	1.9	1,225,517	2,324,794	1.9
Total	1,565,475	18,137,557	–	1,645,544	20,012,014	–
(b) Debits						
Cash payments	1,576	231,394	146.8	1,572	238,898	152.0
Clearings with account-holders	2,993	4,760,915	1,590.7	2,908	5,329,107	1,832.6
Local transfers	83,408	5,373,283	64.4	80,539	5,984,224	74.3
Intercity transfers	318,959	5,590,432	17.5	335,542	6,135,343	18.3
Cheque and direct debit collections (total paid)	1,158,833	2,150,089	1.9	1,224,230	2,321,882	1.9
Total	1,565,769	18,106,113	–	1,644,791	20,009,454	–
(c) Percentage of total turnover (credits and debits)						
Cash payments	0.08	1.25	–	0.08	1.18	–
Clearings with account-holders	0.22	26.66	–	0.20	27.09	–
Local transfers	5.33	29.65	–	4.90	29.91	–
Intercity transfers	20.35	30.56	–	20.37	30.21	–
Cheque and direct debit collections (total presented and paid)	74.02	11.88	–	74.45	11.61	–
Total	100.00	100.00	–	100.00	100.00	–

In 1984 the turnover on the giro accounts of the Bank increased over the previous year by 5 % in terms of the number of transactions and by 10 % in terms of the amount involved. The number of intercity transfers went up by 5 % (1983: 9 %). The number of items presented by the banks under the simplified collection procedure for cheques and direct debits grew by another 6 %. The number of cash outpayments (1.6 million) and cash inpayments (1.1 million) remained practically unchanged.

In the year under review 99 % of the 539 million vouchers presented for collection and about 98 % of the 220 million paper-based credit transfers, as well as 687 million direct debits (1983: 629 million) and 115 million credit transfers (1983: 112 million) recorded on magnetic tape, were processed by the Bank's computer centres. The volume of payments executed through the paperless exchange of data media was 8 % larger than in the preceding year. Such payments now account for more than half (51.7 %) of the payment items presented under the automated procedure. Altogether, more than 99 % of intercity transfers — paper-based as well as paperless — was processed automatically in the year under review.

Automation of intercity transfers

Year	Collection orders presented							Intercity credit transfers presented						
		processed							processed					
		in paper-based operations							in paper-based operations					
	Total	conventional		automated		through the paperless exchange of data media		Total	conventional		automated		through the paperless exchange of data media	
	millions	millions	%	millions	%	millions	%	millions	millions	%	millions	%	millions	%
1974	374	142	38	232	62	0.2	0	123	75	61	48	39	0.1	0
1975	423	143	34	272	64	8	2	163	85	52	73	45	5	3
1976	501	83	17	313	62	105	21	174	62	36	83	48	29	16
1977	587	47	8	359	61	181	31	169	36	21	87	51	46	28
1978	694	31	5	412	59	251	36	183	26	14	89	49	68	37
1979	775	15	2	441	57	319	41	192	13	7	95	49	84	44
1980	873	11	1	473	54	389	45	230	7	3	125	54	98	43
1981	1,023	8	1	490	48	525	51	271	7	2	162	60	102	38
1982	1,098	7	1	512	46	579	53	291	6	2	180	62	105	36
1983	1,159	6	1	524	45	629	54	319	5	2	202	63	112	35
1984	1,226	6	1	533	43	687	56	335	4	1	216	65	115	34

If local payments and clearing transactions — which, apart from local credit transfers in Hamburg, are not yet processed automatically — are also taken into account, 80 % of cashless payments at the Bank is automated. It should be borne in mind in this connection that, as part of the conventional clearing procedure, magnetic tapes containing payments are being exchanged locally between banks on a considerable scale; however, only the total amounts of the magnetic tape data files are being cleared in this way.

Liabilities arising from mobilisation and liquidity paper sold

In the year under review sales of mobilisation and liquidity paper pursuant to sections 42 and 42 (a) of the Bundesbank Act, at DM 30,893.7 million, were roughly as large as in the preceding year (DM 30,660.9 million). As in 1983, sales of these instruments focused mainly on Treasury bills, which were issued for the purpose of the revolving investment of funds by foreign institutions and for investments by domestic public agencies; once again, there were no transactions with domestic banks in the year under review. Sales amounting to DM 30,692.5 million (1983: DM 30,519.7 million) were accompanied by redemptions totalling DM 30,515.9 million (1983: DM 28,950.7 million), so that the amount outstanding at the end of 1984 was DM 6,247.4 million (end-1983: DM 6,070.8 million).

The Bank sold DM 201.2 million of mobilisation and liquidity Treasury discount paper (1983: DM 141.2 million); after redemptions totalling DM 160.1 million (1983: DM 65.8 million), the amount of such paper outstanding at the end of the year was DM 266.3 million (end-1983: DM 225.2 million).

The total liabilities arising from mobilisation and liquidity paper outstanding amounted to DM 6,513.7 million at December 31, 1984 (end-1983: DM 6,296.0 million).

Mobilisation and liquidity paper sold and redeemed

DM million

Type of paper	1983 Outstanding at December 31	1984 Sold	Redeemed	Outstanding at December 31
Treasury bills (running for up to 90 days)	6,070.8	30,692.5	30,515.9	6,247.4
Treasury discount paper (running for 6 to 24 months)	225.2	201.2	160.1	266.3
Total	6,296.0	30,893.7	30,676.0	6,513.7

Liabilities arising from external transactions

The liabilities arising from external transactions grew to DM 11,439.2 million at end-1984 compared with DM 9,780.5 million at end-1983. It was the liabilities to foreign monetary authorities that increased most. Specifically, the liabilities arising from external transactions were made up as follows:

	Dec. 31, 1983 DM million	DM million	Dec. 31, 1984 DM million	DM million
Deposits of foreign depositors				
Banks	9,380.5		11,118.2	
Other depositors	383.1	9,763.6	313.2	11,431.4
Other				
Provision of cover for credits, etc.	12.0		4.9	
Miscellaneous liabilities	4.9	16.9	2.9	7.8
		9,780.5		11,439.2.

Counterpart of special drawing rights allocated

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

Provisions

Provisions for pensions

DM 133.2 million was withdrawn from the provisions for pensions in order to pay retirement pensions and widows' and orphans' pensions. After an increase of the same size, these provisions amounted at December 31, 1984 to DM 2,066.0 million, as in the preceding year.

Provisions for other purposes

DM 2,547.0 million was added to the provisions for other purposes. At end-1984 they totalled DM 6,673.2 million (end-1983: DM 4,126.2 million). They serve chiefly to cover the general risks inherent in domestic and external transactions as well as the risks arising from time commitments in course of settlement (see also the notes below on the receipts item "Receipts from purchases and sales of foreign currencies and from the valuation of the monetary reserves and other foreign currency positions").

Other liabilities

The other liabilities are shown at DM 183.9 million against DM 159.9 million at end-1983.

Deferred expenses and accrued income

Deferred expenses and accrued income amounted to DM 366.9 million at December 31, 1984 (end-1983: DM 380.8 million). As before, this item mainly comprised interest received in the year under review, but relating to the following year, on domestic and foreign bills and U.S. Treasury Notes.

Capital

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

Reserves

In accordance with the decision taken by the Central Bank Council on April 12, 1984, the legal reserves were increased by DM 374.9 million out of the profit for 1983. After this increase, the legal reserves totalled DM 4,803.6 million; they thus reached the maximum level permissible by law of 5% of the amount of banknotes in circulation, which came to DM 96,073.0 million at end-1983. The other reserves had already reached the statutory ceiling of DM 290 million at the end of 1980.

Unappropriated profit

See the notes on page 102 of this Report.

Contingent liabilities and claims

The contingent liabilities and claims amounted to DM 3,000 against DM 120,900 at end-1983.

Profit and loss account

Comparison of expenditure and receipts

DM million

Expenditure	1983	1984	Receipts	1983	1984
Interest paid on foreign exchange transactions under repurchase agreements and swaps with domestic banks	20.0	13.5	Interest received		
			Funds invested abroad	9,386.1	10,690.5
			Lending to domestic banks	2,922.2	3,563.9
Interest paid on mobilisation and liquidity paper	248.1	270.4	Equalisation claims	81.4	81.4
Other interest paid	10.2	10.5	Securities	594.0	540.5
	278.3	294.4	Cash advances	90.7	65.3
			Other interest received	8.3	3.1
				13,082.7	14,944.7
Administrative expenditure					
Staff costs	719.8	729.8	Fees received	19.0	17.1
Other	164.4	172.1	Receipts from purchases and sales of foreign currencies and from the valuation of the monetary reserves and other foreign currency positions	2,140.1	2,238.2
Note printing	153.9	139.5	Other receipts	99.1	223.8
Depreciation	164.4	144.4			
Increases in provisions					
for pensions	163.9	133.2			
for other purposes	1,856.2	2,547.0			
Pension payments in respect of the Reichsbank	28.9	26.3			
Other expenditure	40.6	35.1			
Profit for the year (= unappropriated profit)	11,770.5	13,202.0			
Total	15,340.9	17,423.8	Total	15,340.9	17,423.8

Receipts

Interest

	1983 DM million	1984 DM million
Interest received amounted to	13,082.7	14,944.7;
after deduction of interest paid, namely	278.3	294.4,
interest is shown in the profit and loss account at	12,804.4	14,650.3.

In the year under review total interest income, at DM 14,944.7 million, was DM 1,862.0 million larger than in 1983. The interest received from external transactions rose from DM 9,386.1 million to DM 10,690.5 million. As in 1983, this was mainly because the depreciation of the Deutsche Mark led to an increase in the Deutsche Mark equivalent of the interest income paid in dollars. Receipts from lending to domestic banks — domestic bills, transactions under repurchase agreements in securities, lombard loans and foreign bills bought in Germany — increased by DM 641.7 million to DM 3,563.9 million, mainly on account of the interest received from the greater number of transactions under repurchase agreements in securities. The interest received from securities dropped by DM 53.5 million to DM 540.5 million, the security portfolio being smaller. The interest received from equalisation claims remained unchanged at DM 81.4 million. Other interest income decreased from DM 99.0 million to DM 68.4 million, chiefly owing to the fall in interest received from cash advances.

The interest paid, at DM 294.4 million, rose by DM 16.1 million against the previous year. DM 270.4 million (1983: DM 248.1 million) was disbursed on Treasury bills and Treasury discount paper of the Federal Government (mobilisation and liquidity paper pursuant to sections 42 and 42 (a) of the Bundesbank Act): DM 13.5 million (1983: DM 20.0 million) was spent on dollar swaps.

Fees

Fees totalling DM 17.1 million were received in the year under review (1983: DM 19.0 million).

Receipts from purchases and sales of foreign currencies and from the valuation of the monetary reserves and other foreign currency positions

This item contains DM 2,238.2 million of receipts stemming from purchases and sales of foreign currencies and, in particular, from the changes in the exchange rate of the Deutsche Mark vis-à-vis the special drawing right (SDR). Any valuation gains included therein were retained among provisions. The claims denominated in U.S. dollars were valued, as before, at DM 1.7275.

Other receipts

The other receipts are shown at DM 223.8 million against DM 99.1 million in the preceding year.

Expenditure

Administrative expenditure
Staff costs

Administrative expenditure on personnel amounted to DM 729.8 million against DM 719.8 million in the preceding year.

The number of trainees rose by 33 in the year under review; overall, the number of employees dropped by 85 (= 0.6%) in 1984 to 14,939.

Staff of the Bank

Staff	Beginning of 1984					Beginning of 1985				
	Central Office	Land Central Banks	Total 1	of whom male	of whom female	Central Office	Land Central Banks	Total 1	of whom male	of whom female
Officials	905	5,484	6,389	5,894	495	907	5,504	6,411	5,879	532
Salary earners	1,575	5,984	7,559	3,534	4,025	1,549	5,903	7,452	3,485	3,967
Wage earners	225	851	1,076	200	876	233	843	1,076	199	877
Total	2,705	12,319	15,024	9,628	5,396	2,689	12,250	14,939	9,563	5,376

1 of whom 102 (1984: 88) salaried staff working outside the Bank or released to work for international institutions; 662 (1984: 704) trainees; 501 (1984: 475) part-time salaried staff and 748 (1984: 744) part-time wage earners.

Payments to serving members of the Directorate of the Bank and the Central Bank Council amounted to DM 7,216,844.37 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 7,643,407.71.

Changes in staff regulations

On March 1, 1984 the Central Bank Council approved a revised version of the regulations on the staffing of the various career groups, thereby taking account of operational changes.

In addition, in 1984 the Bank again entered into a number of pay agreements, thereby bringing the legal status of its wage and salary earners — with due regard to the special conditions prevailing at the Bank — into line with the regulations applying to the wage and salary earners of the Federal Government.

Other

Other (non-staff) administrative expenditure increased by DM 7.7 million to DM 172.1 million during the year under review.

Note printing

Expenditure on note printing amounted to DM 139.5 million against DM 153.9 million in the previous year.

Depreciation and increases in provisions

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

Pension payments in respect of the Reichsbank

Payments to members of the former Deutsche Reichsbank and other persons to whom the Act concerning Article 131 of the Basic Law applies, for whom the Bank is required to provide in accordance with section 41 of the Bundesbank Act, at DM 26.3 million, declined slightly in the year under review.

Other expenditure

Other expenditure is shown at DM 35.1 million (1983: DM 40.6 million).

Profit for the year

Unappropriated profit

		DM
The profit and loss account for 1984 shows a profit for the year of which is recorded in the balance sheet as unappropriated profit (net profit).		13,202,021,259.27

Proposed distribution of profit

	DM	
In accordance with section 27 of the Bundesbank Act, the Directorate proposes to the Central Bank Council that the following appropriations should be made:		
to the legal reserves	228,100,000.00	
to the Fund for the Purchase of Equalisation Claims	30,000,000.00	258,100,000.00.
The balance of		12,943,921,259.27
will be transferred to the Federal Government.		

After this appropriation, the legal reserves will amount to DM 5,031,700,000.00; as in the previous year, they will then come up to the statutory ceiling of 5% of the amount of banknotes in circulation, which totalled DM 100,635,953,220.00 at the end of 1984. The other reserves reached the statutory ceiling of DM 290,000,000.00 at the end of 1980.

Frankfurt am Main, April 1985

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

Part D: Report of the Central Bank Council

The annual accounts of the Deutsche Bundesbank for 1984 and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1984, 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 1984 and the bookkeeping as shown by the books at December 31, 1984, 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 1984 on April 11, 1985, and accepted the Directorate's proposal in respect of the profit distribution. At the same time it approved the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1984.

Since the publication of the Report for the Year 1983 the following changes have taken place in the Central Bank Council and the Directorate of the Deutsche Bundesbank:

Retired
as at the close of May 31, 1984
the Vice-President of the Land Central Bank in Lower Saxony
Dr. Gerhard Hauptmann,

as at the close of March 31, 1985
the Vice-President of the Land Central Bank in Hesse
Professor Dr. Dr. Adolf Hüttl,

the Vice-President of the Land Central Bank in Baden-Württemberg
Dr. Volkhard Szagunn.

Reappointed
with effect from April 24, 1984
Professor Dr. Dr. h. c. Norbert Kloten
President of the Land Central Bank in Baden-Württemberg,

with effect from September 1, 1984
Hans Wertz
President of the Land Central Bank in North Rhine-Westphalia,

with effect from October 1, 1984
Dr. Julia Dingwort-Nusseck
President of the Land Central Bank in Lower Saxony.

Appointed
with effect from June 1, 1984
Roman Flesch
Vice-President of the Land Central Bank in Lower Saxony,

with effect from April 1, 1985
Walter Kulla
hitherto a member of the Managing Board
Vice-President of the Land Central Bank in Hesse,

Heinz-Georg Völlgraf
member of the Managing Board of the Land Central Bank in Hesse,

Helmut Schieber
Vice-President of the Land Central Bank in Baden-Württemberg.

The Central Bank Council, acting also on behalf of the Directorate and of the Managing Boards of the Land Central Banks, expresses its thanks to the entire staff of the Deutsche Bundesbank for their loyal and understanding cooperation during 1984. The Council likewise wishes to record its appreciation of the excellent collaboration with the staff representative committees.

Frankfurt am Main, April 1985

Karl Otto Pöhl
President of the Deutsche Bundesbank

Appendix to Part B

Balance sheet of the Deutsche Bundesbank as at December 31, 1984

Assets

		DM	DM
1 Gold			13,687,518,821.70
2 Reserve position in the International Monetary Fund and special drawing rights			
2.1 Drawing rights within the reserve tranche		9,173,622,313.57	
2.2 Loans under special borrowing arrangements		2,632,469,499.61	
2.3 Special drawing rights		4,288,124,761.80	16,094,216,574.98
3 Claims on the European Monetary Cooperation Fund in connection with the European Monetary System			
3.1 ECU balances resulting from the provisional contribution of gold and dollar reserves	DM 40,205,914,856.73		
less Difference between the ECU value and the book value of the reserves contributed	27,666,276,563.59	12,539,638,293.14	
3.2 ECU balances resulting from transfers from other central banks		1,801,717,194.53	
3.3 Other claims		–	14,341,355,487.67
4 Balances with foreign banks and money market investments abroad			37,475,358,377.17
5 Foreign notes and coins			24,674,247.13
6 External loans and other external assets			
6.1 Loans in connection with EEC medium-term monetary assistance		–	
6.2 Other loans to foreign monetary authorities		–	
6.3 Loans to the World Bank		2,455,698,000.–	2,455,698,000.–
7 Foreign bills of exchange			14,814,928,108.63
8 Domestic bills of exchange			47,767,590,163.18
9 Securities bought in open market transactions under repurchase agreements			25,735,638,885.81
10 Lombard loans			7,967,471,700.–
11 Cash advances			
11.1 Federal Government		1,773,400,000.–	
11.2 Equalisation of Burdens Fund		–	
11.3 Länder Governments		667,026,832.–	2,440,426,832.–
12 Treasury bills and Treasury discount paper			
12.1 Federal Government		–	
12.2 Länder Governments		–	–
13 Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin			8,683,585,988.93
14 Loans to the Federal Railways and Federal Post Office			
14.1 Cash advances		–	
14.2 Treasury bills and Treasury discount paper		–	–
15 Securities			4,340,211,635.57
16 German coins			987,412,196.86
17 Balances on postal giro accounts			147,978,042.81
18 Land and buildings			1,567,062,136.01
19 Furniture and equipment			129,390,069.–
20 Items in course of settlement			5,588,777,896.65
21 Other assets			3,962,378,692.46
22 Prepaid expenses and deferred income			37,242,730.97
Rights of recourse in respect of contingent liabilities		3,000.–	
			208,248,916,587.53

	DM	DM
1 Banknotes in circulation		100,635,953,220.—
2 Deposits of banks		
2.1 Deposits on giro accounts	54,239,747,165.21	
2.2 Other	14,596,223.08	54,254,343,388.29
3 Deposits of public authorities		
3.1 Federal Government	414,095,851.10	
3.2 Equalisation of Burdens Fund and ERP Special Fund	7,344,018.91	
3.3 Länder Governments	511,001,121.93	
3.4 Other public depositors	49,409,927.14	981,850,919.08
4 Deposits of other domestic depositors		
4.1 Federal Railways	8,585,717.05	
4.2 Federal Post Office (including postal giro and postal savings bank offices)	2,082,682,660.72	
4.3 Other depositors	720,973,980.96	2,812,242,358.73
5 Liabilities arising from mobilisation and liquidity paper sold		6,513,700,000.—
6 Liabilities arising from external transactions		
6.1 Deposits of foreign depositors	11,431,427,011.79	
6.2 Other	7,789,555.34	11,439,216,567.13
7 Counterpart of special drawing rights allocated		3,736,030,024.40
8 Provisions		
8.1 Provisions for pensions	2,066,000,000.—	
8.2 Provisions for other purposes	6,673,200,000.—	8,739,200,000.—
9 Other liabilities		183,863,930.51
10 Deferred expenses and accrued income		366,894,920.12
11 Capital		290,000,000.—
12 Reserves		
12.1 Legal reserves	4,803,600,000.—	
12.2 Other reserves	290,000,000.—	5,093,600,000.—
13 Unappropriated profit		13,202,021,259.27
Contingent liabilities	3,000.—	
		208,248,916,587.53

Profit and loss account of the Deutsche Bundesbank for the year 1984

Expenditure

	DM	DM
1 Administrative expenditure		
1.1 Staff costs	729,753,641.85	
1.2 Other	172,094,229.13	901,847,870.98
2 Note printing		139,502,740.67
3 Depreciation		
3.1 of land and buildings	92,236,178.72	
3.2 of furniture and equipment	52,188,307.51	144,424,486.23
4 Increases in provisions		
4.1 for pensions	133,160,859.87	
4.2 for other purposes	2,547,000,000.–	2,680,160,859.87
5 Pension payments in respect of the Reichsbank		26,266,540.01
6 Other expenditure		35,133,788.49
7 Profit for the year (= unappropriated profit)		13,202,021,259.27
		17,129,357,545.52

Receipts

	DM
1 Interest	14,650,261,671.82
2 Fees	17,091,256.12
3 Receipts from purchases and sales of foreign currencies and from the valuation of the monetary reserves and other foreign currency positions	2,238,186,136.80
4 Other receipts	223,818,480.78
	17,129,357,545.52

Frankfurt am Main, February 13, 1985

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

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

Frankfurt am Main, March 7, 1985

Treuarbeit Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr. Scholz
Certified Auditor

Goldbach
Certified Auditor

Dr. Wollert – Dr. Elmendorff KG
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