Report of the Deutsche Bundesbank

for the Year 1991

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Part A: General part

The currency and the economy in 1991

I. United Germany in the European process of transformation

National and international challenges . . .

The challenges being faced at home as a result of German unification and the 1
far-reaching transformation processes in the overall European environment are confronting the German economy with unprecedented tasks. Seemingly long-entrenched structures have begun to shift. The contrast between countries and groups of countries with previously fundamentally different economic systems has dissolved; the formerly separate economic areas are now entering into relations under comparable market economy conditions. New priorities have suddenly called long-established patterns into question, and have made it necessary for both the business community and policy makers to adjust extensively.

. . . call for adjustment to new priorities

Within Germany, the complex process of integrating the eastern and western parts of the country has already advanced quite far. But any further harmonisation of the significant regional discrepancies demands, in particular, a sustained strengthening of the productive forces in the east. A basic prerequisite for that is the complete political and institutional entrenchment of market economy conditions at all levels of economic activity. This, however, needs time. Eastern Germany will remain dependent on help from the west for a longer period than was initially anticipated. Reconstruction there cannot be effected without massive private and public investment. At a time of scarce resources, this entails the postponement of less urgent tasks in the western part of the country. The scope for income distribution in the old Länder has narrowed: the overriding tasks at home require all groups in society to show a high degree of discipline and adaptability. The same holds true in respect of the process of integration in Europe. According to the decisions taken by the European Council in Maastricht, for instance, the European Community is to be developed further into an economic and monetary union before the end of the present decade. In the next few years, the interplay of all those involved in economic policy will be required to attain this goal under stable conditions and, at the same time, to create the economic prerequisites for the accession of other countries to this community of European nations. In addition, stable and flourishing economies in western Europe are major buttresses of the countries undergoing reform in central and eastern Europe. These countries are dependent not only on sustained reconstructional aid but also on foreign markets which are accessible to them and able to absorb their products. It is of great importance for overall European cohesion that their transformation into viable market economies is successful.

Germany's increased responsibility in Europe

United Germany has an important role to play in the new continent of Europe that is currently being formed. In the first place, the size and power of its economy make it one of the key countries in the process of integration in western Europe. Secondly, Germany bears special responsibility as an "interface" in the process of transformation throughout Europe. Undesirable economic developments in Germany would inevitably have adverse repercussions on its partners in the west and east alike. It is therefore essential in the interests of Europe as a whole for Germany not to add its own, home-grown factors of uncertainty to the unavoidable risks presented by integration and transformation. This task can be duly performed only if wishes for income distribution in Germany are brought into line with what the real economy allows.

Monetary policy geared to stability in both the national and the international interest

German monetary policy makers have been acting in accordance with this basic principle for a long time now. They have been doing so not only in their own national interest but also in the enlightened interest of the international community. Under the free interplay of market forces, the Deutsche Mark has become the currency which is is second only to the US dollar in global importance, and German monetary policy serves many European countries inside and outside the EC as a benchmark for their own efforts to attain monetary stability. High hopes are being pinned, both in Germany and abroad, on the Deutsche Mark remaining stable in future, too. However, the inherent nature of the monetary policy measures required to achieve this end often makes them painful and unpopular. This is particularly true in a global economic environment which was characterised over much of 1991 by slackening growth in major partner countries. A short-sighted "relaxation" of the monetary policy stance would not have brought any lasting benefit in terms of growth and employment, but could have caused much to be lost. What is needed instead, especially in a world marked by rapid and hardly foreseeable change, is a stable currency to create a dependable basis for tension-free and sustained economic growth.

II. International trends

1. The global economic setting

The global economy torn between slackening growth and . . .

The hopes of a rapid recovery of global economic activity were not fulfilled in 1991. Above all, in the Anglo-Saxon countries and in a number of countries in northern Europe, there was in fact a fairly pronounced slackening of business activity, while similarly flagging growth forces in the major part of Continental Europe were supported by the strong import pull from Germany, so that modest increases were recorded there. In the industrial countries as a whole, the national product in the first six months of 1991 – adjusted for seasonal variations and extrapolated to yield an annual rate – rose by 1 % against the second half of 1990. Apart from western Germany, only Japan was able to detach itself from the international cyclical trend and to continue to raise its economic activity substantially at the beginning of 1991. The second half of the year initially brought a slight improvement in the global economic climate, but without a sustained upswing being set in motion. In the summer months output in, above all, the United States and the United Kingdom temporarily picked up slightly, but it started to flag again in autumn. At the same time, the formerly dynamic growth in western Germany began to slow down; in Japan, too, the rate of growth started to decline, and business propects there became more uncertain. A glance at the overall, rather mixed picture presented by business activity shows that the growth rate of the real gross national product of the western industrial countries went down from 2½ % in 1990 to just under 1 % in 1991. In view of the generally subdued pace of economic activity, world trade, too, lost momentum again; adjusted for price and exchange rate fluctuations, it grew by about 3 % in 1991, compared with twice as high an average annual growth rate in the second half of the eighties. The slowdown of world trade also owed something to the breakdown of the rouble clearing system at the end of 1990 and to the subsequent disbanding of the Council for Mutual Economic Assistance (CMEA), which encompassed the former Eastern Bloc countries.

. . . inflationary risks

It fits into this picture of a world-wide moderation of growth that the upward movement of prices in major industrial countries slowed down perceptibly in some cases in the course of 1991. At 4½ % on average over the year, consumer prices in the industrial countries rose less markedly than in the previous year (5.2 %), with stabilisation policy successes being achieved predominantly in countries with particularly grave cyclical problems (such as the United States and the United Kingdom), while the price situation deteriorated in countries with stronger growth (such as Germany and the Netherlands). Other industrial countries (e.g. Italy) were confronted with rates of inflation which were hardly any lower than before, even though the overall pressure of demand there had likewise declined perceptibly. But in spite of the growth and employment problems and the associated cyclical moderation of current price rises, the inflationary dangers, viewed as a whole, can by no means be considered to have been averted. The successes achieved in the interim in the field of anti-inflation policy could rapidly be squandered if those responsible were to drop the monetary policy reins for the sake of giving a short-lived stimulus to business activity. Labour costs continued to impose a persistent burden on both the price situation and employment conditions in 1991. Although the cyclical slowdown in major industrial countries caused collectively agreed wages and salaries to develop along more moderate lines, ancillary labour costs climbed at an accelerated pace, so that the average total cost of labour in all industrial countries in 1991 increased virtually as strongly as in the previous year.

Key macroeconomic variables in selected industrial countries

Country	Real national product 1		Real domestic demand		Consumer prices 2		Balance on current account	
	1990	1991 p	1990	1991 p	1990	1991 p	1990	1991 p
	Change from previous year in %						US$ billion	
Industrial countries 3	+ 2.3	+ 0.8	+ 2.3	+ 0.6	+ 5.2	+ 4.5	5 – 99.0	5 – 30.0
of which								
European industrial countries	+ 2.8	+ 1.2	+ 2.7	+ 1.3	+ 5.7	+ 5.1	– 7.4	– 58.0
of which								
Germany 4	+ 4.5	+ 3.1	+ 4.5	+ 3.0	+ 2.7	+ 3.5	+ 46.5 °(+ 77.4)	– 19.5 °(– 32.9)
France	+ 2.8	+ 1.3	+ 3.2	+ 1.2	+ 3.4	+ 3.1	– 9.8	– 6.1
United Kingdom	+ 1.1	– 2.6	+ 0.0	– 3.4	+ 9.5	+ 5.9	– 26.5	– 8.0
Italy	+ 1.9	+ 1.0	+ 1.9	+ 2.0	+ 6.5	+ 6.4	– 14.3	– 20.5
United States	+ 1.1	– 0.7	+ 0.5	– 1.3	+ 5.4	+ 4.2	– 92.1	– 8.6
Japan	+ 5.2	+ 4.5	+ 5.4	+ 3.3	+ 3.1	+ 3.3	+ 35.8	+ 72.6
Canada	+ 0.5	– 1.5	– 0.2	– 0.6	+ 4.8	+ 5.6	– 18.8	– 23.4

1 Real GNP/GDP. — 2 Cost-of-living index. — 3 OECD countries excluding Turkey. — 4 Western Germany only; balance on current account from July 1990 including the external transactions of the former GDR. — 5 The statistically recorded current account deficit of the industrial countries is not accompanied by corresponding surpluses on the part of other groups of countries; in fact, owing to statistical errors and omissions (= missing surpluses or overly large deficits) the aggregated "global balance on current account" shows a distinct deficit, which, according to IMF calculations, amounted to roughly US$ 100 billion in 1991. — p Provisional. — ° Calculated in DM billion.
Sources: IMF and national statistics. BBk

Structural weaknesses hamper economic development

To a certain degree, the sluggish pace of the world economy last year reflects sustained structural problems which undermined its self-healing powers. In the Anglo-Saxon countries, in particular, households and enterprises — whose savings formation was low, in any case — had relied on the unchanged continuation of the economic growth of earlier years and incurred heavy debts which could no longer be serviced smoothly in many cases after the growth forces had lost momentum. The parties involved responded by showing greater spending and borrowing restraint. Where the lending banks and financial institutions were concerned, the increase in bad debts gave grounds for increased caution in granting loans, so that the attempts to stimulate economic activity with the aid of monetary policy measures did not, in the light of consumers' and investors' changed spending and borrowing behaviour, have the cyclical effects widely hoped for. In the United States, in particular, structural difficulties prompted the affected categories of banks to apply stricter yardsticks to the assessment of possible credit risks.

Easing of monetary policy in major partner countries

Under the impact of the, all in all, disappointing economic growth and slackening inflationary pressures, the countries with distinct growth losses — in particular, the United States, the United Kingdom and Canada — gave their monetary policies a more expansionary stance in the course of 1991. Japan, too, followed suit, whereas German monetary policy was tightened further, given both heavy unification-induced demand and the tension evident in prices and costs. The divergences in economic trends which characterised last year were thus duly reflected in appropriate differences in the national monetary policies pursued. These differences were accompanied by clear shifts in international interest rate relationships. The interest rate advantage of Deutsche Mark investments over US dollar assets increased markedly, above all at the short end of the market, namely from 1½ percentage points to more than 5 percentage points. In the European Monetary System (EMS), various partner countries took advantage of the scope for interest rate reductions arising both from Germany's special economic situation and from their own stabilisation efforts, thereby narrowing their interest rate advantage over the Deutsche Mark. In view of the way in which the countries involved have conducted this exchange rate system over the past few years, the reduction of the interest rate differentials between the EMS currencies has now caused the partner countries' further scope for autonomous interest rate policy to be diminished. This fact emerged particularly clearly towards the end of 1991, when the Deutsche Mark became stronger and stronger within the exchange rate system and the central banks of most of the EMS member states were compelled to tighten the interest rate policy reins again in support of their currencies' exchange rates.

Setbacks in the consolidation of public finance

The cyclical slowdown in growth, and also a general decline in spending discipline, caused the process of consolidation in the field of public finance to waver. Whereas the eighties saw some significant progress – albeit with several grave exceptions – in the containment of new public sector borrowing, budget deficits have risen again in a number of key countries in the past two years. This turn for the worse was particularly marked in the Anglo-Saxon countries and, in the wake of unification, also in Germany. Taking the average of the seven major industrial countries, in 1991 the deficit ratio of the respective country as a whole (as defined in the national accounts), at 2.2% of the gross domestic product (GDP), was back at the level of 1987, after it had dropped to 1% towards the end of the eighties. Similarly marked increases in public sector deficits were also recorded by the other industrial countries. Although budgetary plans in a number of countries (in Italy, for instance, and in several smaller industrial countries) reflect the intention of effecting a certain change of direction, it remains to be seen whether the course corrections will actually be implemented to the degree required. In spite of serious endeavours undertaken in this respect, there currently seem to be hardly any prospects of resounding success, above all in the case of the United States – not least because the structural problems accumulated in the financial sector there simultaneously impose severe burdens on the public sector budget. To these burdens must be added, as in the case of most other countries in the west, new costly tasks, such as those arising in the health sector and in public pension insurance as a result of unfavourable demographic trends, or the assistance urgently required to build up efficient economies in both eastern Europe and the developing countries. It is questionable whether the savings in defence expenditure after the end of the "cold war" will be sufficient for these purposes, especially as cutbacks in these spending plans initially lead to a need for structural adjustment in a number of other areas. The unprecedented challenges of the years to come cannot be met without a further reduction in current public expenditure and a related review of conventional spending priorities. Too strong an absorption by the public sector of capital, which is scarce throughout the world (especially absorption for consumption purposes), could in the long run impede investment and growth prospects by way of higher real interest rates. This is another reason why it is essential that further consolidation endeavours are undertaken in the field of fiscal policy.

Balanced global pattern of current accounts

The current account positions of major industrial countries, which were long characterised by significant discrepancies, converged in 1991. In this context, however, a combination of one-off, cyclical and structural factors played a role, so that the durability of today's more balanced current account pattern must remain an open question for the time being. In 1991 the demand surge due to unification, in particular, caused Germany to run a current acoount deficit of DM 33 billion, after there had been a surplus of DM 76 billion in the year before. On the other hand, the current account deficit in the United States declined from US$ 92 billion in 1990 to US$ 8.5 billion in 1991, a development which was due in part to non-recurring factors associated with the Gulf war and to the stagnation of economic activity. Where the United Kingdom is concerned, it likewise remains to be seen to what extent the tendency towards an improvement in the current account owes more to the cyclical difficulties in the

UK economy than to any structural improvement in its external position. By contrast, Japan's current account surplus, at US$ 73 billion in 1991, more than doubled against the preceding year. On the one hand, Japan has consequently again become the world economy's most important "financier" but, on the other, Japan's trade policy problems with its partners have at the same time been exacerbated. Protectionist responses by the deficit countries would be bound to weaken the world economy's performance.

International cooperation faced with new tasks

The western industrial countries can meet the historic challenges facing them only by opening up their markets to all other nations. The dismantling of trade barriers would make it easier not only for countries in central and eastern Europe to gain a foothold in the world economy. It is essential, also in consideration of the Third World countries' need for development, to maintain and expand the open world trading system for the benefit of all nations. Developing the global economic system in this direction calls for increased international cooperation. The pressing ecological issues arising in connection with the protection of both the environment and the climate likewise make cooperation between all countries more necessary than ever before. In particular, the still unfinished GATT negotiations in the context of the Uruguay Round have become a touchstone of the political determination of all the parties involved.

2. Progressive integration in the European Community

The decisions of Maastricht give a new stimulus to integration

The "Treaty on European Union", which was approved by the EC Heads of State and of Government on December 9-10, 1991, and signed by the governments of the member states on February 7, 1992, is intended to create the basis needed for rapid headway in the process of European integration, a process which was first set in motion 40 years ago. The completion of the single European market, with the free movement of goods, labour, services and capital, is to be followed by the end of this decade by the further development of the Community into an economic and monetary union and what is more – as also propagated by the German side, in particular – a political union. Subject to the Treaty on European Union being ratified by all member states – as is due to occur before the end of the current year – the move to the economic and monetary union will become irreversible according to the timetable set under the decisions of Maastricht. This means, above all, that – upon the entry into the final stage – responsibility for monetary policy in those member states which participate in this move from the outset will be transferred irrevocably from the national to the Community level. This step is designed to allow the national currencies to be replaced by a single Community currency as soon as possible after the entry into the final stage.

Debate on economic and monetary union slow to get started in Germany

The public debate which commenced in Germany in response to the decisions of Maastricht confirms impressively that a threat to monetary stability, which is firmly associated with the Deutsche Mark in the minds of the population and which is obviously regarded as a "public commodity", would not simply be accepted, irrespective of its source. In contrast to what occurred in other Community member states, the general public in Germany started relatively late seriously to discuss the pros and cons of a European economic and monetary union. In the course of the negotiations the Bundesbank had repeatedly submitted statements to the Federal Government, statements which were also published. It attempted in manifold ways to contribute to the necessary process of clarification at an early stage, focusing attention – in line with its statutory mandate – on the need for a stable currency and for an effective monetary policy geared to achieving this end.

Transfer of monetary policy responsibility to the Community

The transition to the economic and monetary union will not take place only when a single European currency is introduced at some time still to be determined, but rather already when monetary policy responsibility is transferred to the European System of Central Banks (ESCB), which – under the terms of the Treaty – is to be established not earlier than 1997 but not later than 1999; the integral parts of that system will be the new European Central Bank (ECB) and the national central banks of the countries participating. The Treaty, and the Statute of the ESCB and of the ECB, which is attached to it in the form of a protocol having the character of a treaty, lay down that the future common monetary policy will be geared to the primary objective of price stability and will be committed to market economy principles. In exercising their responsibility for monetary policy, the system's decision-making bodies will act quite independently of instructions from any Community or national bodies whatsoever. By the time of entry into the economic and monetary union, at the latest, the national legal status of those central banks which are still required to comply with instructions from their respective governments will have to be amended accordingly. It would be desirable for this to occur as soon as possible.

External monetary policy regulations must not endanger monetary stability

With respect to external monetary policy, the Treaty gives the Council of Economic and Finance Ministers (ECOFIN) the right, in principle, to conclude agreements with non-Community countries on an exchange rate system with fixed parities, or to adopt general orientations for exchange rate policy vis-à-vis non-Community currencies. However, such agreements on a system of fixed exchange rates are subject to a unanimous decision on the part of the Council of Ministers. In the event of the recommendation to that effect not originating from the ECB, the Council of Ministers is required to consult the ECB with a view to reaching a consensus which respects the monetary policy needs of price stability. The adoption of general orientations for exchange rate policy vis-à-vis non-Community currencies calls for a qualified majority in the Council of Ministers, with basically the same procedure applying in respect of relations with the ECB as in the case of exchange rate agreements with non-Community countries. Such orientations, however, are subject to the express qualification that the ESCB's objective of price stability takes precedence over exchange rate policy considerations. Interventions in the exchange markets fall under the sole responsibility of the ECB, and will depend on its decisions. Past experience shows that any attempt to enforce certain exchange rate ratios contrary to what is demanded by the underlying determinants can all too easily lead to conflicts with internal monetary stability. Hopefully, the arrangements adopted in Maastricht have eliminated this risk.

Economic and fiscal policies remain matters of primarily national responsibility

In line with the principle of subsidiarity which is entrenched in the Treaty, responsibility for economic and fiscal policies, unlike that for internal and external monetary policies, is to remain vested primarily in the individual member states, even if these policies are geared to the goals of the Community. Action at the Community level is thus provided for only if the matter involved cannot be resolved satisfactorily at either the national or the regional level. Specifically on account of its impact on internal and external monetary policies, however, fiscal policy is subject to supervision by the ECOFIN Council. The criteria therefor, and also possible sanctions, are defined in the Treaty itself, and in a special protocol. At the same time, the fulfilment of the fiscal policy performance criteria is crucial for the decision required of the ECOFIN Council not later than six months prior to the entry into the final stage of the economic and monetary union as to which countries are capable, on the basis of their economic performance, of effecting this move. In this context, it is essential to avoid any watering-down of the prerequisites for entry.

Fulfilment of the EMU convergence criteria in 1991

EMU criterion met

Country	Change in consumer prices from previous year in %	Financial balance of the public sector as % of GDP 1	Gross indebtedness of the public sector as % of GDP 1	Yield on long-term public bonds in % p.a.
	EMU reference value 2			
	4.4	– 3	60	10.8
Belgium	3.2	– 5.7	131.5	9.3
Denmark	2.4	– 1.7	59.6	9.3
France	3.1	– 1.7	47.1	9.0
Germany	3 3.5	– 3.2	43.4	8.5
Greece	18.9	– 17.9	85.2	4 23.3
Ireland	3.2	– 2.7	113.0	9.2
Italy	6.4	– 10.1	103.8	13.0
Luxembourg	3.1	1.9	6.9	8.1
Netherlands	3.9	– 3.5	79.8	8.7
Portugal	11.3	– 5.4	64.7	17.1
Spain	5.9	– 3.9	45.3	12.4
United Kingdom	5.9	– 2.1	36.7	10.1

1 As defined in the national accounts.
2 (a) The rate of inflation must not exceed the average of the inflation rates of – at most – the three best-performing countries by more than 1.5 percentage points.
(b) The financial deficit of the public sector should not exceed 3 % of GDP.
(c) The gross indebtedness of the public sector should not exceed 60 % of GDP.
(d) The yield on long-term public bonds must not exceed the average of the corresponding yields of – at most – the three best-performing countries by more than 2 percentage points.
3 Old Länder.
4 Twelve-month Treasury bills.
Sources: EC Commission, OECD and national statistics. BBk

Institutional arrangements alone not sufficient

The Bundesbank, too, is of the opinion that the provisions of the Treaty, and of the Statute of the future ESCB and of the ECB, largely meet the institutional requirements of a monetary policy geared to the goal of price stability. In some respects – e.g. in the case of the ban on the central bank financing public sector deficits, and also where the exchange rate regulations are concerned – the provisions of the Treaty actually extend beyond what is included in the Bundesbank Act. In addition, the Statute of the ESCB and of the ECB affords better protection in legal terms than the Bundesbank Act, because the agreement of all the parties involved is required for its amendment. But the future ESCB's ability to fulfil its monetary policy mandate successfully will not depend solely on the institutional arrangements made. This is why it is legitimate to note critically, as has been done by many observers, that the differing experience of inflation in individual countries has a major impact on the willingness of both the people there and their representatives to take due account of the overall need for stability in their decisions. Not least for these reasons, the member states of the Community must provide unmistakable proof in their national economic and fiscal policies in the next few years of being able to meet the demands of an economic and monetary union.

Unequivocal criteria essential for entry into the final stage

A detailed review of the Community's economic situation gives a clear indication of which additional endeavours must be expected of individual member states before it is possible to speak of convergence in major areas of economic policy and the results thereof. If the criteria defined in the Treaty for entry into the final stage of the economic and monetary union are used as a basis, it will be found that only three member states fulfilled all of the convergence criteria in 1991. Most of the member states failed to meet – in some cases by a substantial margin – the requirement that the annual public sector budget deficit should not exceed 3 % of GDP. The burdens imposed by the process of unification caused the German public sector deficit, too, to overshoot this mark slightly. The second fiscal policy convergence criterion, which calls for the gross indebtedness of the public sector not to exceed 60 %

of GDP, was not met by half of the member states, three of which had figures roughly twice as high as that required. The size of the public sector deficits and the degree of indebtedness probably contributed to the high level of long-term interest rates in the countries concerned, a level which was – in some cases – significantly above that in the countries with the lowest interest rates, one of which is still Germany. Under the provisions of the Treaty, the level of long-term interest rates should not be more than 2 percentage points above that in the three best-performing countries.

The Community still far removed from attaining price stability

The Community still has a fairly long way to go to achieve the price stability that is described in the Treaty as the primary objective of monetary policy. Although the weighted average upward movement of the private cost of living declined to 5.1% in 1991, and although this proved possible in spite of the fact that burdens due to unification caused prices to climb significantly in Germany, the criterion in respect of inflation to be met for entry into the final stage, according to which the increase in consumer prices in a member state must not exceed the average of the three best-performing countries by more than 1.5 percentage points, was nevertheless missed by quite a number of countries in 1991, sometimes by considerable margins. As in the case of interest rates, there is a very clear link in some countries between excessive public sector deficits and levels of indebtedness, on the one hand, and high rates of inflation, on the other, something which may be an indication of the burdens that fiscal policy imposes on monetary policy in those countries.

The overall economic environment has become more problematical

It must be assumed that a number of member states of the Community will continue to face severe difficulties in their endeavours to achieve convergence in the next few years – possibly more severe difficulties, indeed, than in recent years. As explained in more detail elsewhere in this Report, the global economic climate has clouded markedly after an unusually long period of upswing. Cyclically-induced revenue shortfalls and additional public expenditure, which are accepted by fiscal policy makers as "built-in stabilisers", and – to an even greater extent – the effects of more far-reaching anti-cyclical measures to boost economic activity are threatening to conflict with the desire for a further reduction of the public sector deficits. In this situation, the unrestrained growth of public indebtedness even in a period of favourable business activity is proving to be a particular burden. Excessive pay claims and struggles over income distribution warrant fears of inflationary stimuli emanating from costs. In such a situation, monetary policy makers find it more difficult fully to comply with their mandate to ensure stability. This applies all the more if the monetary policy makers are required to "wear two hats", if they must meet the needs of both internal monetary stability and external exchange rate stability at the same time – something which is impossible to achieve, especially in the event of divergent trends in the individual member countries of the exchange rate system.

Exchange rate realignments no longer available as a "last resort" in the monetary union

In an economic and monetary union, the possibility of realigning exchange rates will, by definition, no longer act as a means of exerting pressure for additional endeavours to achieve stability, nor will it be available as a final way out of a monetary policy dilemma. The economic and monetary union can therefore be expected to work satisfactorily only if solely those countries that have no major shortcomings in respect of convergence in the core areas (prices and costs, as well as public finance) participate in it. This would make it easier for the newly established ESCB to "anchor" the common monetary policy firmly to the goal of stability from the very outset. In this respect, it is essential, above all, for the political and economic conditions to be fulfilled which ensure, on the basis of observance of the principle of subsidiarity, that major misalignments of fiscal policy need not be feared. In addition, wage policy – responsibility for which is vested in management and labour – must be flexible enough to take account of the conditions prevailing in a monetary union. This may possibly turn out to be an acid test of the member states' own sense of responsibility. It would, at any rate, be wrong and would overtax the propensity to demonstrate solidarity in an economic and monetary union if individual member states were to allow themselves to be guided by expectations of massive transfers from the Community – e.g. in the context of the agreed Cohesion Fund.

Responsibility for monetary policy remains in national hands in the second stage

The European Monetary Institute (EMI) is to start operation at the beginning of 1994, i.e. upon the commencement of the second stage of the economic and monetary union. Besides the increased coordination of the monetary policies pursued by the individual central banks, it will be responsible, above all, for the technical preparation of common monetary policy under the auspices of the future ESCB, and for the provision of the instruments and procedures required therefor. To the extent required for the envisaged closer coordination of individual central banks' monetary policies ahead of the economic and monetary union, initial preparatory work has already been set in motion by the Committee of EC Central Bank Governors. A number of partner countries would have preferred to establish the European Central Bank already at the beginning of the second stage, and to endow it with extensive functions and monetary policy powers of its own. Under the terms of the Treaty, however, responsibility for monetary policy in the second stage will remain vested in full – in line with the position held by both the Federal Government and the Bundesbank – in the monetary authorities entrusted therewith under national law. This provides sufficient scope for a discussion both of the general monetary policy objectives and of the specific policy action needed to attain them in a given situation, as is currently already the case in the Committee of EC Central Bank Governors. In the view not only of the Bundesbank, however, differences in decision-making procedures and the dependence of individual central banks on instructions from their respective governments preclude any binding coordination of individual measures, including changes in interest rates. The establishment of the EMI does not make any difference to this situation, even if the legal prerequisites for a central bank which is independent of instructions were to be created in other member states in the course of the second stage.

Easier use, but no artificial promotion, of the ECU

Under the terms of the Treaty, the EMI will also have the task of facilitating the use of the basket ECU and monitoring how its use develops, including the functioning of ECU clearing between the banks concerned. What must be done can almost only be the elimination of existing impediments, but not the artificial encouragement of the use of the ECU in a manner that would boil down to giving it preference over national currencies. Neither the active promotion of the ECU by Community institutions and government bodies in certain member states nor the involvement of individual central banks in the issue of ECU money market instruments or in the context of ECU clearing have convinced the Bundesbank that it is necessary and makes sense in terms of monetary policy to intervene in the ECU market in order to support or regulate it. Moreover, in view of the plan for it later to assume the role of a Community currency, the fact that the development of the basket ECU is dependent to a greater or lesser extent on the support of government bodies and central banks appears to be of dubious value. The Bundesbank will oppose all endeavours to make the EMI into an instrument for the artificial promotion of the ECU in competition with national currencies. As the EMI will have no capital of its own, autonomous activities in the form of an assumption of risks or the provision of credit lines will be ruled out anyway.

In addition to the transfer to it of the existing reserves of the European Monetary Cooperation Fund (EMCF), the EMI has been given the right to hold and manage monetary reserves on behalf and for the account of those central banks that desire it to do so. This option is subject to the express qualification that its activities must not have an adverse effect on the internal and external monetary policy of any member central bank. The use of the EMI as the agent of individual central banks for the holding and management of monetary reserves must therefore be governed by rules that take due account of the interests of the partner central banks (and, where necessary, also of the interests of the monetary authorities of non-Community countries). However, it is not yet clear whether and, if so, to what extent individual member states intend to transfer monetary reserves to the EMI, nor are the conditions known which such member states will impose on the investment and use of such monetary reserves.

Holding monetary reserves on behalf of central banks

3. Radical changes in central and eastern Europe

In the central and east European countries 1991 was marked by grave political and economic upheavals. The fragmentation of the political forces behind these changes, the endeavours to attain independence and the dissolution of the Soviet Union (which was sealed politically with the establishment of the Commonwealth of Independent States (CIS) in Alma Ata on December 21, 1991), together with the ongoing process of radical economic reforms, have confronted the region, and also the international community of nations, with new political, economic and social challenges, the effects of which cannot yet be assessed. At the same time, however, the breakdown of outdated political and economic structures provides an opportunity for a constructive fresh start and for cooperation in a spirit of partnership.

Dissolution of the Soviet Union gives rise to new challenges

The implementation of market-oriented programmes in Czechoslovakia at the beginning of 1991, and in Albania, Bulgaria and Romania in the further course of the year, broadened the regional scope of the reform endeavours. With the exception of the former Soviet Union, where the various reform plans initially advanced little further than a public discussion of the issues involved, all the European member states of the Council for Mutual Economic Assistance (CMEA), which was disbanded in 1991, have thus set out along the road towards a market economy system. By largely deregulating prices from the beginning of 1992, however, Russia and other members of the CIS, too, indicated that they likewise wish to move in this direction. The reform policy mix of macroeconomic stabilisation efforts and regulatory policy structural adjustment previously pursued by the "pacemakers" Poland and Hungary was continued in 1991, and was supported by IMF reform programmes.

Reform processes broaden in scope

The persistently difficult political, social and economic conditions prevailing in many countries caused the restructuring process there to proceed only slowly and hesitantly. In some countries the reform process even assumed crisis-like features because the governments failed to achieve major economic and fiscal policy objectives and because public support for reforms waned perceptibly. The pressures to which the population is subjected as a result of its economic predicament give rise to the danger of governments watering down their reform policies, or of their breaking them off completely. A failure of the reform process would inevitably lead to dangerous political and economic instability. The creation of stable and reliable underlying conditions for all economic agents is an indispensable prerequisite for improving the standards of living and for structural change in the economy. In most countries, however, structural policy should be aimed even more single-mindedly at an improvement of the supply side. The stability achieved in Czechoslovakia is encouraging, and the trends in a number of other countries are also giving reason for

Problems of acceptance endanger the policy of reforms some hope. Notwithstanding the far-advanced liberalisation processes in Poland and Hungary, where remarkable headway has been made in respect of, in particular, the integration of these two countries into the global economy, none of the reform states can as yet be said to have a stable market economy system.

Privatisation proceeds sluggishly

The privatisation of enterprises plays a key role in the endeavours to transform the economies of central and eastern Europe. In some cases, selling off small and medium-sized businesses (small-scale privatisation) has already been practised successfully. By contrast, hardly any progress has been made in the transfer of large state-owned enterprises to private hands (large-scale privatisation). Bureaucratic impediments, unresolved ownership issues, fiscal policy interests and the threat of social conflict are impeding the transfer of ownership, and are thus making the move to a market economy system more difficult. Strategic approaches alone are not enough if the conditions for their implementation are nowhere fulfilled. The voucher procedure adopted in Czechoslovakia is arousing interest. On the one hand, it seems apt to ensure a rapid and uniform distribution of corporate capital among the population; on the other hand, this procedure has the disadvantage that neither new capital nor entrepreneurial know-how is added to the economy and that effective control of privatised enterprises by the proprietors is made more difficult. In addition, the low level of domestic saving, the fear of being controlled by foreign capital and widespread restraint on the part of investors from abroad do not allow rapid progress to be expected in the field of large-scale privatisation, even though such privatisation is of major importance for the necessary restructuring of the economy.

Low effectiveness of monetary policy owing to structural weaknesses

Unresolved privatisation problems also hamper the further development of the existing rudimentary money and capital markets into efficient allocation systems. Although two-tier banking systems have been established everywhere, their viability and competitiveness are often still restricted both by oligopolistic structures and by manifold deficiencies. These include the "unwelcome legacies" that weigh upon the banks in the form of a large proportion of problem loans and structural undercapitalisation. The fact that the restructuring of banking is not moving forward also lessens the effectiveness of monetary policy, because the transmission mechanisms of monetary stimuli customary in market economies are not yet known well enough, and are scarcely controllable on account of the lack of financial markets. For this reason, among others, the central banks are all in a difficult position since the responsiveness of credit demand to interest rate changes is very low. Furthermore, owing to the dismal financial situation of many state-owned enterprises, the housing sector and agriculture, and as a result of sharply growing public sector deficits, "monetary fuelling pressures" have emerged, and are having destabilising effects. The upshot of this has been interest rates which are often well below the rates of inflation and which cannot be raised sufficiently on political grounds, so that they are unable to perform the steering function expected of them. The prerequisites for a monetary policy geared to stability are missing in such circumstances.

Adjustment problems exacerbated

The numerous difficulties arising in connection with the transformation of the system, the low level of real domestic demand, the collapse of the markets in the east and political upheavals exacerbated the adjustment problems almost everywhere in central and eastern Europe in 1991. Although private entrepreneurial activity increased to a gratifying extent, above all in Poland and Hungary (a fact that is probably not duly reflected in the statistics published), industrial production once again fell significantly, so that aggregate output probably continued to decline – by up to one-fifth in some cases. The associated increase in both unemployment and the rate of inflation gave rise to ever-more social conflicts, especially as the social security network is still inadequate. Most central banks attempted to combat inflation by tightening their monetary policies, though without being able effectively to limit the loss of confidence in their own currencies.

Global division of labour improved in some cases

In the countries which have advanced far along the road towards the liberalisation of their foreign trade and payments, last year saw a consolidation of the limited convertibility of currencies for residents, which has now also been introduced in Czechoslovakia, as occurred earlier in Poland and Hungary. This constitutes a major contribution to anchoring these currencies, in line with the needs of a market economy system. The rapid decline in the value of the rouble, by contrast, has confronted the Soviet Union's successor states with new monetary policy challenges. The presumably now irreversible move to new currencies is raising a great number of fundamental questions which have not yet been resolved, in particular with respect to the maintenance of current transactions between the member states of the Commonwealth. The tendencies towards disintegration in the monetary field there were accompanied in part by closer integration in the global division of labour and by an improvement in these states' external positions, which probably owed something to their easier access to markets in western industrial countries. Exports to the west, at any rate, increased gratifyingly almost everywhere. In order to prevent the balance on current account from deteriorating, however, the strong import pull had to be curbed by administrative measures in many cases. Another reason why this was necessary was that the high level of foreign debts and the unresolved debt servicing problems in some of the states made it difficult or impossible for them to obtain loans from abroad.

Germany supports the reform endeavours

Germany again strongly supported the reform efforts in central and eastern Europe last year. In 1991 west German imports from countries in that region rose substantially, almost without exception. In addition, the process of reform was supported to a particularly high degree by means of bilateral German aid and Germany's contributions to multilateral aid programmes, though the continuation of this support is being hampered by financial limitations imposed by the tight German budgetary situation. Germany accounted for about one-third of all the aid granted to central and eastern Europe, and for one-half of that provided to the former Soviet Union, thus contributing more than is consistent with either its reciprocal ties to this economic region or its economic capacity. Better coordination of private and public assistance, and the increased gearing of technical assistance to specific projects, could help enhance the effectiveness of the funds employed. Irrespective of the need to continue the humanitarian, technical and financial aid for central and eastern Europe, a further opening-up of western markets is of paramount importance. The conclusion of association agreements between the central European reform states and the EC will presumably open up new prospects, as will the envisaged accession of the Soviet Union's successor republics to the IMF and the World Bank.

III. Economic trends in the Federal Republic of Germany and central bank policy

1. The German economy under the impact of the unification process

First step towards the harmonisation of living conditions in west and east

In 1991 Germany took a first major step forward on the road towards the harmonisation of living conditions in the two parts of the country, which had been divided for more than 40 years. It was, above all, its sound state and, in addition, renewed strong economic growth which have so far enabled the west German economy to support and socially cushion the restructuring process in eastern Germany by means of exceptionally high public transfers. The demand from the new Länder which was induced by these transfers imparted direct or indirect stimuli to economic growth in the western part of the country, but it also had adverse effects on stability policy. In the course of last year an upturn gradually came under way in eastern Germany, an upturn based predominantly on the initial boost given by west German transfer payments; at the same time, the adjustment process showed the first successes. The standard of living of east German residents improved significantly in 1991; one of the adverse consequences, however, is the high degree of underemployment, which must be seen as an unwelcome legacy of the socialist command economy.

Strong economic growth in western Germany followed by a slowdown in business activity in the course of the year

In western Germany the real gross national product grew by just over 3% on average in 1991; the gross domestic product increased by just under 3½%, and thus more sharply than the overall production potential, average utilisation of which was consequently somewhat higher than in 1990. In the course of 1991, however, the demand pressure which had prevailed well into the first half of the year declined perceptibly, so that production increasingly returned to normal in the second half of 1991. The cost pressure, and in its wake the upward movement of prices, increased noticeably, however.

Export losses more than offset by a surge in demand from eastern Germany

Given the sharp growth, conditions in the west German economy in 1991 differed greatly from the economic slack prevailing in many major partner countries, a sluggishness which was reflected most clearly – partly as a cause and partly as a consequence of this slack – in a decline in investment activity. Given the range of products they offer, this meant correspondingly large demand losses for west German exporters. However, the manufacturers of basic and producer goods as well as of consumer goods likewise suffered losses. In 1991 the export orders received by the manufacturing sector in the old Länder, orders which had started to decline as early as autumn 1990, dipped below their previous year's level by 5% in value and 6% in volume. Compared with 1990, west German exports of goods and services were only a little higher in nominal terms and just over 1% lower in real terms. Seen over the entire year, the slowdown in export business was more than offset by the steep rise in demand from eastern Germany, which was financed indirectly or directly by west German transfer payments. To a comparatively great extent, however, the demand by east German residents reflected in this was satisfied by resorting to imports; the dramatic increase in imports contributed much to reducing the all-German current account surplus, and was thus, at the same time, a welcome counterweight to the sluggish pace of demand in Germany's partner countries. In 1991 western Germany's overall surplus of real exports of goods and services rose by approximately ¼% of GNP at constant prices. Of course, this result masks different patterns in the two halves of 1991: in the first half of the year the slack in foreign business was initially far more than offset by the surging increase in demand from eastern Germany at the beginning of the year; in the second half of the year this was no longer the case.

Buoyant consumption

The strong growth of the west German economy in the whole of 1991 was also based on domestic factors. They include private consumption, which was stimulated by the trends in incomes and employment. Wage settlements were agreed upon in the 1991 pay round which were on average, at a total of 7% (on

Key economic variables in western Germany

Item	Unit	1988	1989	1990	1991	1988	1989	1990	1991
						Change from previous year in %			
Aggregate demand (real)									
Private consumption	DM billion	1,137.0	1,156.7	1,211.1	1,241.0	+ 2.7	+ 1.7	+ 4.7	+ 2.5
Public consumption	DM billion	389.1	382.6	390.5	393.5	+ 2.2	– 1.7	+ 2.1	+ 0.8
Fixed capital formation	DM billion	393.7	421.4	458.6	489.2	+ 4.6	+ 7.0	+ 8.8	+ 6.7
Machinery and equipment	DM billion	178.3	195.7	220.9	241.7	+ 6.6	+ 9.8	+ 12.9	+ 9.4
Construction	DM billion	215.4	225.7	237.7	247.4	+ 3.1	+ 4.8	+ 5.3	+ 4.1
Increase in stocks	DM billion	+ 12.0	+ 21.9	+ 11.7	+ 11.1	.	.	.	.
Domestic expenditure	DM billion	1,931.8	1,982.6	2,072.0	2,134.8	+ 3.6	+ 2.6	+ 4.5	+ 3.0
Foreign balance 1	DM billion	+ 40.0	+ 64.2	+ 66.7	+ 71.1	.	.	.	.
Exports	DM billion	689.6	768.3	852.6	955.8	+ 5.9	+ 11.4	+ 11.0	+ 12.1
Imports	DM billion	649.6	704.1	785.9	884.6	+ 5.8	+ 8.4	+ 11.6	+ 12.6
GNP at 1985 prices	DM billion	1,971.8	2,046.8	2,138.7	2,205.9	+ 3.7	+ 3.8	+ 4.5	+ 3.1
Memorandum items									
Orders received (volume) by the manufacturing sector 2	1985 = 100	107.8	116.5	122.1	122.6	+ 7.2	+ 8.1	+ 4.8	+ 0.5
Domestic orders	1985 = 100	107.5	115.9	125.6	130.7	+ 5.9	+ 7.8	+ 8.4	+ 4.0
Foreign orders	1985 = 100	108.2	117.4	116.2	109.5	+ 9.6	+ 8.5	– 1.0	– 5.8
Orders received (volume) by the construction sector 2	1985 = 100	110.5	122.4	132.6	137.5	+ 7.5	+ 10.8	+ 8.4	+ 3.6
Distribution of income									
Wage and salary income	DM billion	1,169.4	1,221.9	1,313.9	1,417.4	+ 4.0	+ 4.5	+ 7.5	+ 7.9
do. as a percentage of national income	%	71.5	70.5	70.2	71.0	.	.	.	.
Entrepreneurial and property income	DM billion	466.2	512.4	557.7	578.9	+ 9.6	+ 9.9	+ 8.8	+ 3.8
Memorandum items									
Gross income of producing enterprises	DM billion	368.4	388.3	414.3	407.7	+ 11.8	+ 5.4	+ 6.7	– 1.6
do. as a percentage of national income	%	22.5	22.4	22.1	20.5	.	.	.	.
National income	DM billion	1,635.5	1,734.3	1,871.6	1,996.2	+ 5.5	+ 6.0	+ 7.9	+ 6.7
Output									
Output in the producing sector (excluding construction) 2, 3	1985 = 100	106.2	111.5	117.2	120.6	+ 3.6	+ 5.0	+ 5.1	+ 2.9
Construction output 2, 3	1985 = 100	110.3	117.6	124.1	127.8	+ 4.3	+ 6.6	+ 5.5	+ 3.0
GDP at 1985 prices	DM billion	1,960.5	2,024.2	2,118.4	2,191.1	+ 3.7	+ 3.2	+ 4.7	+ 3.4
Employment									
Employed residents	Millions	27.4	27.7	28.4	28.9	+ 0.8	+ 1.3	+ 2.6	+ 1.6
Memorandum item									
Employed in Germany	Millions	27.3	27.6	28.4	29.2	+ 0.8	+ 1.4	+ 2.9	+ 2.6
Unemployed	Thousands	2,241.6	2,037.8	1,883.1	1,689.4	+ 0.6	– 9.1	– 7.6	– 10.3
do. as a percentage of the total labour force	%	7.7	7.1	6.4	5.7	.	.	.	.
Prices and wages									
Cost-of-living index for all households	1985 = 100	101.4	104.2	107.0	110.7	+ 1.3	+ 2.8	+ 2.7	+ 3.5
Producer price index of industrial products 4	1985 = 100	96.3	99.3	101.0	103.4	+ 1.3	+ 3.1	+ 1.7	+ 2.4
Overall construction price level	1985 = 100	105.7	109.3	116.0	123.9	+ 1.9	+ 3.4	+ 6.1	+ 6.8
Index of import prices	1985 = 100	80.8	84.4	82.5	82.8	+ 1.3	+ 4.5	– 2.3	+ 0.4
Unit labour costs in the economy as a whole 5	1985 = 100	105.5	105.9	108.6	113.4	+ 0.2	+ 0.4	+ 2.5	+ 4.5
do. per unit of turnover in the economy as a whole 6	1985 = 100	98.7	96.5	95.7	95.7	– 1.4	– 2.1	– 0.8	– 0.1
Memorandum item									
Productivity 7	1985 = 100	107.3	110.8	113.7	116.5	+ 3.6	+ 3.2	+ 2.6	+ 2.5
Overall negotiated wage and salary level									
on a monthly basis	1985 = 100	110.0	112.9	118.1	125.4	+ 2.7	+ 2.7	+ 4.6	+ 6.2
on an hourly basis	1985 = 100	111.7	115.9	122.5	130.8	+ 3.3	+ 3.7	+ 5.7	+ 6.8

1 Balance of transactions in goods and services with the rest of the world; deliveries to and supplies from eastern Germany (including direct purchases of households in western or eastern Germany) are, in contrast to the balance of payments statistics, included in imports or exports. — 2 Adjusted for working-day variations. — 3 Results for kinds of activity units. — 4 Domestic sales. — 5 Index of gross wages and salaries per employee divided by index of real GNP per employed person. — 6 Index of gross wages and salaries per employee divided by index of nominal GNP per employed person. — 7 GNP at 1985 prices per man-hour worked; calculated by the Bundesbank.

The figures from the national accounts and the figures on employed persons are provisional from 1989 onwards.

Discrepancies in the totals are due to rounding.

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an hourly basis), far more generous than the wage increases of the preceding years; after becoming fully effective in the second half of 1991, they triggered an upward surge in labour cost pressures and caused employment, which had risen exceptionally sharply on an annual average, to expand at a slower pace in the final months of the year. In all, west German households' disposable income went up by 6% in 1991. A large part of the purchasing power of this income, however, was absorbed by the increasing erosion of the value of money caused, inter alia, by the high wage hikes. Consumers in the western Länder raised their expenditure on consumption by a nominal 6% and a real 2½%. However, retail turnover rose much more steeply. A factor in this was that east German households satisfied their demand to a considerable extent by direct purchases in the old Länder. The results for the entire year, however, are based on distinct differences in the level of consumption in the course of last year. The first half of the year was marked by a sustained sharp expansion of private consumer spending; in the second half, by contrast, the tax programme which came into force in the middle of the year tended to dampen private consumption; the solidarity surcharge reduced disposable income, the increase in indirect taxes and charges was reflected in higher prices of fuels, for instance, and thus cut the purchasing power of incomes. This was only partly offset by the fact that in the second half of last year households saved less than in the first six months – measured as a percentage of disposable income. In the whole of 1991, however, the saving ratio, at 14½%, was just as high as in 1990.

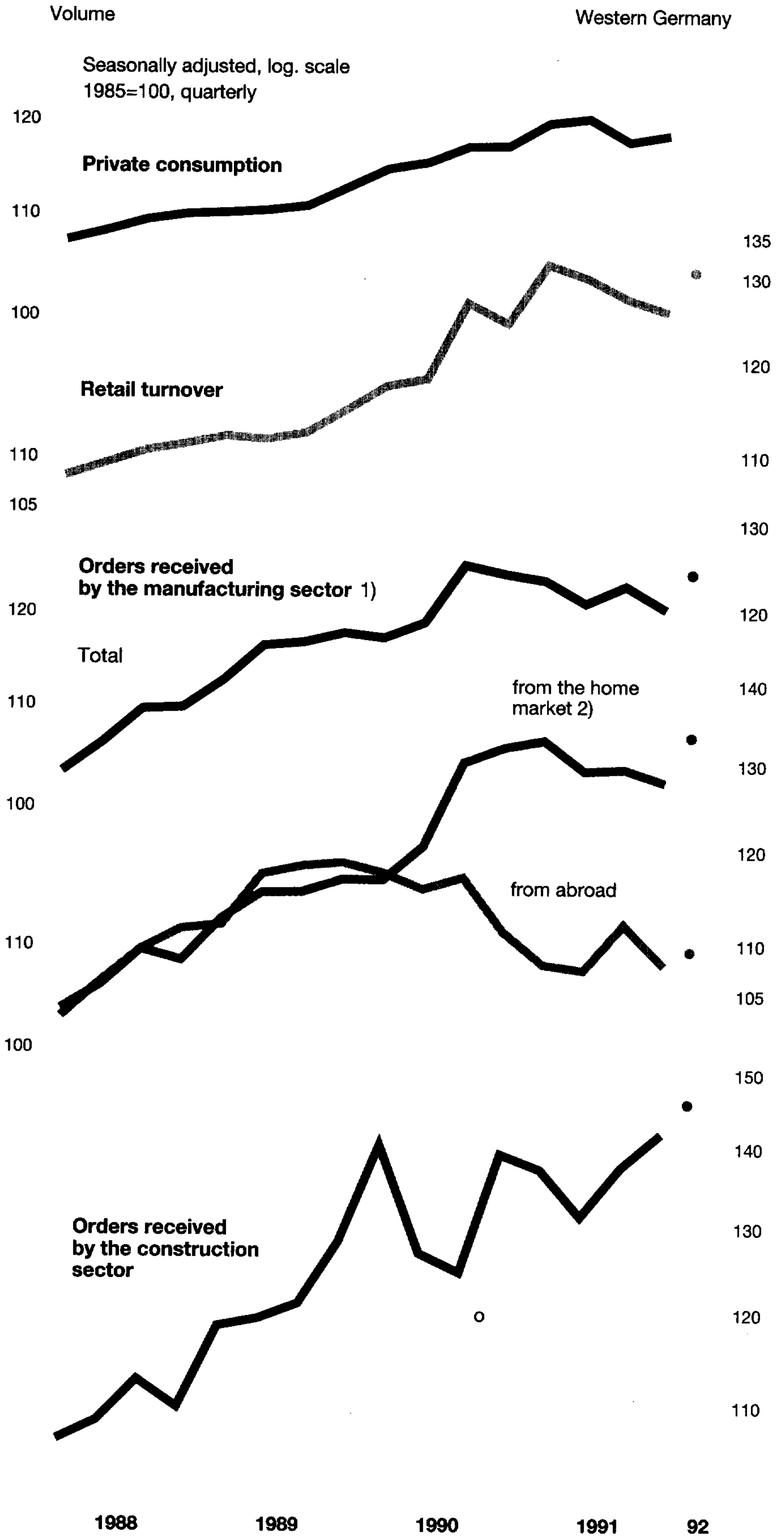
Renewed sharp increase in fixed capital formation

Gross fixed capital formation was one of the main pillars supporting growth in 1991. The producing enterprises spent a total of 13% more on machinery, equipment and buildings than a year earlier; in real terms, this was a rise of just over 8½%. The steep increase in corporate investments largely mirrors the economic conditions in western Germany, which remained favourable well into the year. Not least as a result of additional sales opportunities in eastern Germany, capacity extensions were required which were reflected, among other things, in a fairly strong rise in industrial construction expenditure. Towards the end of last year, however, west German enterprises' propensity to invest slackened, under the impact of, in particular, the heavy labour cost pressure and the deterioration of sales prospects; this is suggested, inter alia, by the drop in the orders received both by domestic capital goods producers and by industrial construction firms in the last quarter of 1991.

Brisk residential construction activity

The sustained expansion of industrial construction orders contributed much to the, all in all, very buoyant construction activity last year. The main driving force, however, was the renewed marked increase in demand for housing construction work. In the wake of the demand pressure in this sector of construction nearly 20% more dwellings were completed in the first eleven months of last year than in the comparable period a year earlier. This exceptionally favourable result also owed something to the fact that, within housing construction activity, the emphasis continued to shift towards the construction of apartment houses. In view of sizeable government promotion programmes, the construction of rented and owner-occupied dwellings, in particular, seems to have been largely insulated against the dampening effects of higher interest rates, as is suggested by the trends in these sectors. Under the impact of rising costs of finance, a considerable increase in the costs of construction work and soaring real estate prices, the construction of owner-occupied homes, by contrast, tended to be weak in 1991.

Trends in demand



1) Excluding food, drink and tobacco industry.- 2) Always including the orders received from eastern Germany.- o From October 1990 including the orders received by west German construction enterprises from the new Länder and Berlin (east).- ● = January 1992.

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Relatively sharp expansion of production potential, inter alia because of the inflow of labour from eastern Germany

In 1991, as already in 1990, the west German economy's production potential expanded more strongly than in the years before, largely on account of unification. On the one hand, this was a consequence of the high level of investments, which led to a renewed steep rise in productive assets in the old Länder. On the other hand, the sustained inflow of labour from eastern Germany played a part as well; the sparse indicators available suggest that, although fewer members of the workforce than in 1990 moved to western Germany, far more commuters from the new Länder were on average employed in the old Federal territory last year. Many of them were apparently highly skilled employees, who had been in ever-shorter supply in the growth process of the economy in the western part of Germany in the preceding years of the upswing. According to our calculations, west German real production potential grew by a total of nearly 3 % in 1991 (compared with roughly 2 % in 1983-9). In view of a rise of almost 3½ % in GDP, the already high degree to which the production potential was utilised thus increased once again, albeit only slightly, on average in 1991.

High degree of capacity utilisation, decreasing in the course of the year

In the course of last year, however, the high degree of capacity utilisation declined in large areas of the economy. In the manufacturing sector, in particular, production returned to normal. Seen over the whole year, industry expanded its output by 3 %; in the second half of the year seasonally adjusted production nevertheless remained distinctly below the level of the first six months. According to the Ifo Business Survey, utilisation of capacities in the manufacturing sector was perceptibly lower at the end of 1991 than at the start of the year, but still considerably above the multi-year average (1979-90). In contrast to industry, productive capacities in the construction sector were under substantial strain throughout 1991 – in line with the sustained demand pressure in that sector.

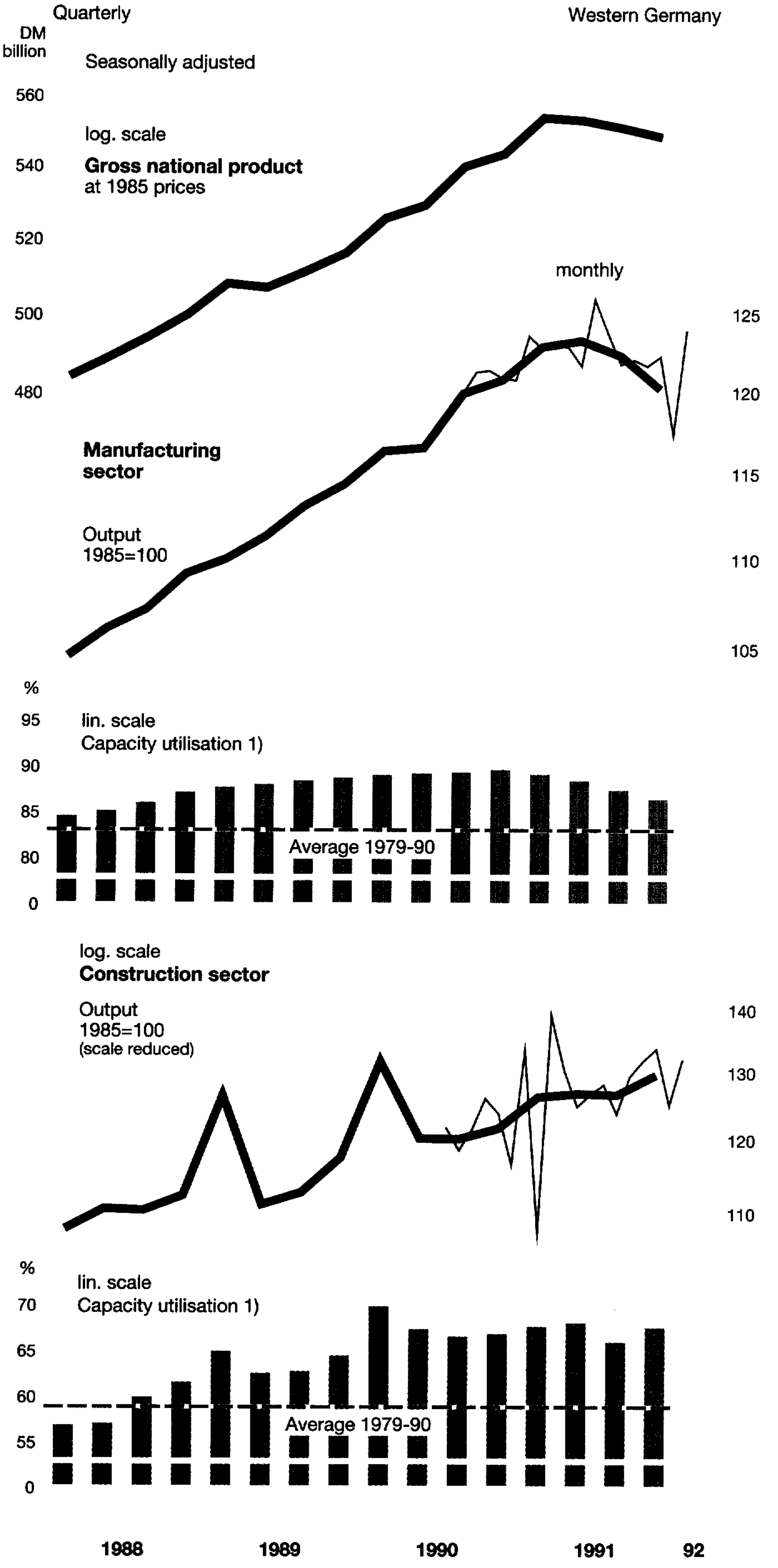
Marked rise in employment, decline in unemployment

In the wake of the strong overall expansion of output, the number of employed once more increased exceptionally sharply in 1991. At 29.2 million on average last year, nearly 750,000, or just over 2½ %, more persons were employed in western Germany than a year before. Many of them came from the east of Germany, either as commuters or because they moved to western Germany. But ethnic German resettlers from eastern Europe, too, whose number had soared in 1990 and who were consequently increasingly available on the labour market in 1991 after having attended language and vocational training courses, contributed to the exceptionally sharp growth of employment. Above all, the services sector (including the public sector) raised its staff levels considerably; the same holds true of large areas of the crafts sector, where the supply of highly skilled labour from eastern Germany, in particular, was used to raise staff numbers comparatively steeply. This was also the case in the construction industry. In the manufacturing sector, too, considerably more members of the workforce were employed on average last year than in 1990. The heavy demand for labour was moreover reflected in a marked drop in unemployment, which, at 1.69 million persons on an annual average, was some 200,000 below the 1990 figure and 600,000 below the peak of 1985. Around the turn of 1991-2 the number of employed increased but little; unemployment remained at the level it had reached previously.

Faster upward movement of prices

In the course of last year the upward movement of prices in western Germany accelerated considerably. This was probably – both indirectly and directly – a belated consequence of the excessive utilisation of productive capacities caused by the unification-induced surge in demand in 1990-1, seeing that ever-increasing use had already been made of resources throughout the upswing that had lasted since 1983. The economic situation, which still exhibited boom-like traits at the beginning of last year, was one of the triggers of the high wage settlements in last year's pay round, settlements which – as

Output



1) Results of the Ifo Business Survey.

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Conditions on the labour market in western Germany

In thousands

Item	1988	1989	1990	1991	1990	1991
	Annual average				Change from previous year	
Employment						
Employed residents **p**	27,366	27,733	28,444	28,886	+ 711	+ 442
Commuters, balance **p**	– 105	– 102	– 11	+ 287	×	×
Employed in Germany **p**	27,261	27,631	28,433	29,173	+ 802	+ 740
of whom						
Employed subject to social security contributions **1**	21,265	21,619	21,368	23,173	+ 749	+ 805
Manufacturing	8,188	8,329	8,553	8,743	+ 224	+ 190
Construction	1,412	1,406	1,468	1,521	+ 62	+ 53
Distribution, transportation, telecommunications	3,907	3,979	4,151	4,390	+ 172	+ 239
Banks, insurance sector	856	870	891	919	+ 21	+ 28
Other services	6,204	6,359	6,637	6,939	+ 278	+ 302
Short-time workers	208	108	56	145	– 52	+ 89
Vacancies	189	251	314	331	+ 63	+ 17
Unemployed	2,242	2,038	1,883	1,689	– 155	– 194
Memorandum item: Unemployment rate in % **2**	7.7	7.1	6.4	5.7	×	×
Pattern of unemployment	End-September					
Unemployed, total	2,100	1,881	1,728	1,610	– 153	– 118
by sex						
male	1,074	951	870	839	– 81	– 31
female	1,026	930	858	771	– 72	– 87
by nationality						
Germans	1,837	1,663	1,536	1,403	– 127	– 133
of whom						
resettlers from eastern Europe	73	106	155	134	+ 49	– 21
immigrants from the former GDR	10	45	75	32	+ 30	– 43
foreigners	262	218	192	207	– 26	+ 15
by vocational qualification						
unqualified	1,024	887	808	762	– 79	– 46
qualified	1,075	993	920	848	– 73	– 72

1 As at June 30. – **2** Unemployed as a percentage of the total labour force. – **p** From 1989 provisional. BBk

already mentioned – contributed much to the faster upward movement of prices. In connection with the fiscal costs of unification, some indirect taxes were moreover raised in the middle of the year, a fact which likewise resulted in soaring prices.

Continuing imports of stability

Stability tended to be imported from abroad in 1991. Primarily no doubt as a result of the world-wide economic weakness, the dollar quotations for raw materials and crude oil on the international markets fell significantly, all in all; as the US dollar rate changed but little on average in the year, imports of these goods, calculated in Deutsche Mark, cheapened substantially. Moreover, the economic slack in major partner countries caused the rise in prices of imported industrial products to remain within relatively strict limits. All in all, average import prices increased only a little last year (+ ½ %); at the end of 1991 they were as much as almost 3 % lower than a year earlier, while in February 1992 they were still a good 1 % down on the year.

Highest rise in consumer prices since 1983

The relief afforded from abroad slowed down the upward movement of prices in Germany. Together with the increased competition on domestic markets, this partly reduced German enterprises' scope for passing on the higher prices to consumers, so that home-made cost increases eroded profit margins all the more. In part, however, the lower import prices of raw materials, for instance, offered a counterweight to enterprises' internal cost increases. At the industrial producer level, industrial products in 1991 were 2½ % dearer than a year earlier (which also owed something to the aforementioned increase in indirect taxes).

Average consumer prices were 3½% higher than in 1990; if account is taken of the fact that not quite ½ percentage point was attributable to the fiscal measures which became effective in the middle of last year, the rate of price increases was higher than in any year since 1983. According to initial figures from individual old Länder, the cost-of-living index in March 1992 was a good 4½% up on the year. Under the impact of the sustained demand pressure and considerably higher costs, the prices of construction work rose by 7% last year, and thus much more than those of consumer goods.

Continued dangers to the value of money in 1992, but also risks to growth and employment, . . .

The value of money continues to be under threat in 1992. Moreover, there are imminent risks to growth and employment. The hoped-for cyclical revival in major partner countries has not yet come about, and can currently probably not be expected before the second half of this year – above all, when the fiscal policy stimuli planned or adopted in the United States, Japan and the United Kingdom take effect. Accordingly – and contrary to many forecasts of autumn last year – it cannot be expected that the weakness of foreign business will soon be overcome. In this respect, growth prospects for 1992 remain subdued. This applies all the more in view of the fact that real GNP in the fourth quarter of 1991 (adjusted for seasonal and working-day variations) was over ½ percentage point lower than on an annual average and that the start of the new year was rather unfavourable from this side. The hopes for growth in the west German economy are not based on exports alone, however. Domestic cyclical driving forces and particularly a continued rise in demand from eastern Germany must also be mentioned in this connnection. Since the entry of the former GDR into the monetary, economic and social union with the Federal Republic, there has been a surge in government transfers to the new Länder – and, in their wake, the purchasing power in eastern Germany has increased as well. These transfers will continue to grow in 1992; in addition, more and more private capital will flow into the new Länder. In the meantime, the east German economy is probably producing more for its own market, so that the demand of residents there, especially that for consumer goods, can be satisfied to a greater extent than in the past 18 months by products from the new Länder. On the other hand, however, supplies of capital goods from western Germany will rise considerably as the rebuilding of east German production plant accelerates. On balance, this presumably means a further growth of demand from eastern Germany. An expansionary impetus to west German economic activity is furthermore to be expected for the period after the middle of 1992, when the solidarity surcharge will no longer be levied; the associated increase in the disposable income of households in western and eastern Germany can be expected to stimulate, above all, consumer spending. Moreover, expansionary stimuli are emanating from the sustained rise in demand for housing construction.

. . . especially in the event of excessive wage settlements

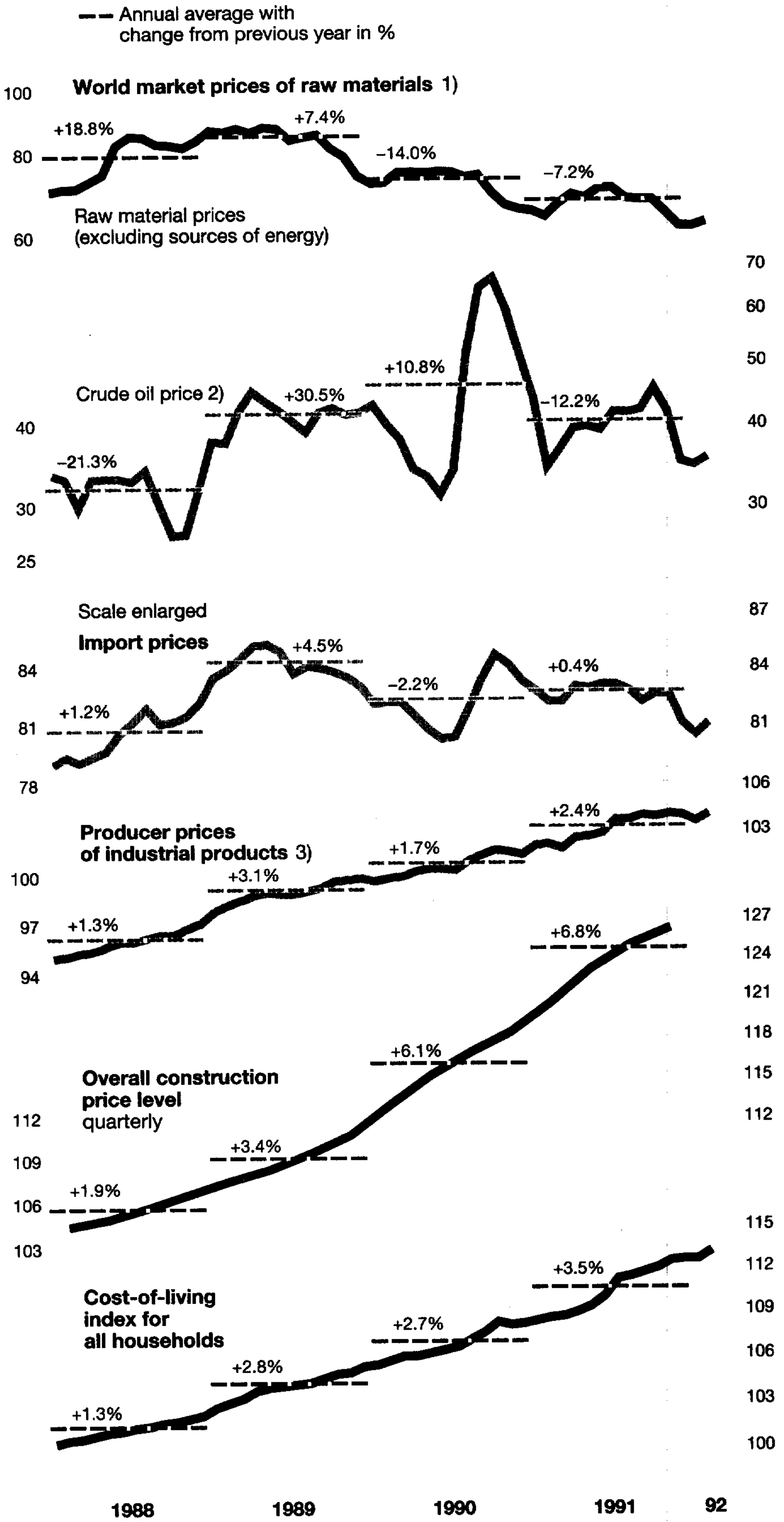
Of course, the demand prospects just described depend on appropriate wage policy decisions in the current pay round. In 1992 the scope for income distribution will be much more limited than in preceding years. Excessive wage settlements will not only mean that the stability goal will be jeopardised further (possibly beyond 1992), they could also substantially impair the trend in demand. Rising pressure on enterprises' profit margins would add to the weakening of, in particular, their propensity to invest, something which would probably affect other demand components, and thus ultimately growth and employment.

Commencement of an upswing in the new Länder in the course of 1991

Last year the east German economy passed a first difficult stage on the long and thorny road towards a fully functioning and competitive market economy. The dramatic downward slide of the economy in the new Länder came to an end in the course of last year, and conditions began to improve. In our assessment, production increased in some sectors of the east German

Prices

1985 = 100, seasonally adjusted, log. scale



1) HWWA index of raw material prices; DM basis.- 2) Not seasonally adjusted.- 3) Domestic sales.

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economy as early as towards the end of 1990, for example in some areas of the private services sector and, particularly, in the crafts sector. The upward movement in these areas continued after the turn of 1990-1. Nevertheless, overall production declined initially; for in two major sectors – the manufacturing sector, which is exposed to the heaviest restructuring pressures in the process of adjustment to market economy conditions, and construction – the losses in respect of demand and output persisted for some time. In spring a turn-round commenced in the construction sector, the initial boost for which was imparted directly or indirectly by west German transfer payments. At first, it was the public sector that placed orders with the construction industry which soared from month to month; in December last year they were nearly three times as high (not seasonally adjusted) as in January-February 1991. This was followed by ordering in industrial construction which has tended to become increasingly buoyant of late. In the autumn months, finally, demand for housing construction went up as well. All in all, construction orders at the end of 1991 exceeded the level at the beginning of the year by more than 100% (not seasonally adjusted). In spite of sharp rises in the prices of construction work, hikes which were probably caused mainly by the steep increase in labour costs, this indicates exceptionally strong growth in real terms as well. Information on construction output is not available at present. However, the trend in man-hours worked in the construction industry suggests that output grew sharply in the course of last year.

End of the rapid decline in industrial production in the new Länder

After the entry of the former GDR into the monetary, economic and social union, demand for east German industrial products fell dramatically, mainly for two reasons: with the introduction of the Deutsche Mark and the resulting access to the western supply of goods, residents in the new Länder reduced their purchases of generally (but not in each individual case) less competitive home-produced goods sharply. Moreover, foreign business with the traditional partners of the east German economy in the former CMEA states slowed down perceptibly after the breakdown of the transferable rouble system around the turn of 1990-1. The resulting massive demand losses led to a rapid decline in industrial production, which did not come to a stop until spring 1991. Since then, output in the manufacturing sector has remained at the low level reached previously – albeit with considerable fluctuations. The fact that the downward slide was stopped is to some extent due to government measures in support of foreign demand, for example. Moreover, as noted, east German residents seem to be turning more to their own products again, which have meanwhile become more competitive.

Large gap between income and demand, on the one hand, and output, on the other

Given the stabilisation in the manufacturing sector and the upturn in construction, aggregate east German output, i.e. ultimately real GNP, is likely to have been higher in the second half of 1991, seasonally adjusted, than in the first half of the year. However, the results of the GNP calculation of the Federal Statistical Office are only available for the second half of 1990 and for the whole of 1991 at current prices. According to that calculation, east German nominal GNP last year, at DM 193 billion, accounted for close on 7½% of west German and not quite 7% of all-German GNP. Calculated per inhabitant, GNP in the new Länder reached some 30% of the west German and roughly 35% of the comparable all-German level. This calculation, however, presents a highly incorrect picture of the differences in incomes and prosperity, because – according to the results of the national accounts – incomes and demand in eastern Germany were nearly twice as high as GNP there. For one thing, this large gap shows the significance of west German transfer payments for the economy in the new Länder. For another, it also reveals the extent to which demand in eastern Germany exceeds the quantity of goods, and thus of output, generated there in 1991. The degree to which this gap can be closed through increased supplies from eastern Germany will depend primarily on the compet-

Selected economic data on eastern Germany*

Item	Unit	1991 1st qtr	1991 2nd qtr	1991 3rd qtr	1991 4th qtr	1992 Jan.-Feb. o
Producing sector						
Manufacturing						
New orders **1**	2nd hf of 1990 = 100	80	75	79	83	.
	Change from previous period in %	– 14.0	– 6.3	5.3	5.1	.
Net output **1, 2**	3rd qtr of 1990 = 100	66	61	65	65	.
	Change from previous period in %	– 23.3	– 7.6	6.6	± 0	.
Turnover	2nd hf of 1990 = 100	51.7	52.4	53.9	61.7	.
Construction **3**						
New orders **1**	2nd hf of 1990 = 100	100	121	165	190	.
	Change from previous period in %	– 11.5	21.0	36.4	15.2	.
Total number of man-hours worked **4**	Millions of hours	23.2	27.1	28.4	28.1	.
Turnover **5**	DM billion	1.1	1.7	2.0	2.6	.
Labour market						
Employed **6**						
Manufacturing	Thousands	**7** 1 923.2	1 846.8	1 547.6	1 332.8	.
Construction	Thousands	**7** 288.2	284.9	274.0	280.0	.
Finishing trades	Thousands	**7** 58.8	59.9	61.6	66.1	.
Unemployed	Thousands	756.5	834.9	1 022.5	1 037.5	1 253.7
Unemployment rate **8**	%	8.6	9.5	11.6	11.8	**9** 16.7
Short-time workers	Thousands	1 925.8	1 962.1	1 464.3	1 112.6	519.7
Employed under job-creation schemes	Thousands	40.9	101.3	234.1	357.0	394.4
Commencement of vocational further training **10**	Thousands	138.7	223.7	259.4	270.2	**11** 180.3
Recipients of transitional benefits for early retirement	Thousands	.	133.9	205.3	305.2	450.7
Prices						
Cost-of-living index **12**	2nd hf of 1990-1st hf of 1991 = 100	103.2	105.5	106.9	117.8	**13** 118.8
	Change from previous year in %	.	.	13.3	21.5	**13** 15.9

* Unadjusted figures; quarterly figures: monthly averages. — **o** Average. — **1** Approximately adjusted with the aid of west German seasonal factors. — **2** Index calculated for kinds of activity units. — **3** Enterprises with 20 and more employees. — **4** Man-hours actually worked by proprietors, salary earners, wage earners and trainees on construction sites and contractors' yards. — **5** Construction turnover excluding value-added tax. — **6** Enterprises with 20 and more employees. Including active proprietors, co-proprietors and family members working without pay and including short-time workers with up to 100% hours lost. — **7** Average February-March. — **8** Unemployed as % of the dependent civilian labour force; from January 1992 calculated on the basis of new labour force figures. — **9** Average February. — **10** Quarterly total. — **11** Total. — **12** All employee households. — **13** January 1992.
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itiveness of east German enterprises, and thus largely on the trend in wages and investments. The attempt to bring east and west German wages and salaries into line with one another as soon as possible is hardly conducive to this; for excessive wage increases not only place an additional burden on east German enterprises' already low profitability, but also impair profit expectations and, judging by past experience, curb the propensity to invest. On average last year, gross wages and salaries per employee in eastern Germany came to some 46% of the west German level (against only 36½% in the second half of 1990). Owing to the large number of short-time workers, this relationship between actual earnings in the two parts of the country seems to be rather understated, while the ratio of pay rates, by contrast, which averaged about 60%, tends to overstate the approximation to the west German level, as adjustment has generally not proceeded as far in the case of subsidiary agreements — such as holiday pay.

High rate of inflation

The surge in labour costs also contributed a good deal to the sharp rise in consumer prices, particularly the prices of services. Around the middle of 1991 the cost of living in eastern Germany was nearly 14%, and at the end of the year 21½%, higher than a year earlier. These price trends, however, are not due predominantly to inflationary processes but rather to adjustments of relative prices to actual supply and demand ratios, and thus to market economy conditions. The main explanation for the difference between the rate of price increases in the middle and at the end of the year is that on October 1, 1991 rents were raised sharply from their very low level in a first step, so as to bring them closer to the actual costs of accommodation.

Extensive shedding of labour

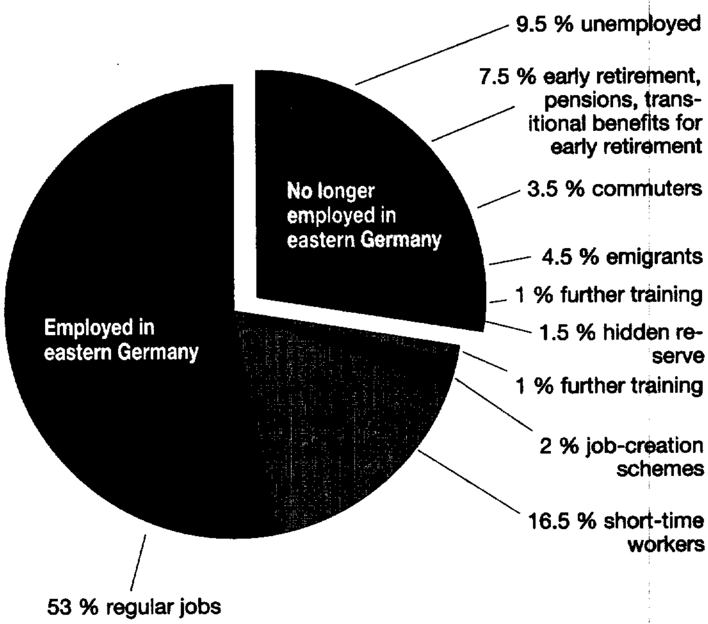
The transition from a socialist command economy to a social market economy also requires fundamental changes in the pattern of employment. In the old system the government apparatus and large sectors of the east German economy were overstaffed for manifold reasons, while other sectors were understaffed (and their development was obstructed in some cases). The necessary migration, not only between economic sectors but also within individual sectors, does not take place at the same time. Rather, labour initially becomes redundant — a process which was greatly intensified by the aforementioned decline in industrial production, for instance. A considerable number of new jobs has been created, but so far this has not sufficed to maintain overall employment levels. According to information from the Federal Statistical Office, some 7.5 million persons were employed in the new Länder on average in 1991; in 1989 this number had been nearly 10 million, i.e. about one-third higher. If account is taken of the fact that these figures include those persons who still live in the east but work in the old Länder — nearly 0.5 million in the fourth quarter of 1991 — the number of employees dropped by 2.75 million, on balance, between 1989 and 1991. This figure includes roughly 0.5 million members of the workforce who left the former GDR to live and work in western Germany. At the same time, the number of unemployed rose to nearly 1 million on average in 1991; according to calculations by the Federal Labour Office, this corresponds to an unemployment rate of about one-tenth. Some 1 million persons, including a particularly large proportion of women, whose participation in the labour force had been exceptionally high in the former GDR, withdrew from the workforce — mostly with government support. Up to 0.75 million older employees, for instance, are likely to have made use of the various schemes for drawing old-age pensions prematurely (early retirement, transitional benefits for early retirement), or to have retired because they had reached the age limit. Some employees seem to have stopped looking for a job only temporarily and are taking advantage of the numerous opportunities for retraining and further training.

Heavy recourse to labour market policy measures

By no means all existing jobs seem to be secure in the long run; quite a number of them are probably being preserved only by means of subsidies. This presumably applies to a significant number of short-time jobs. The number of short-time workers fell to just over 500,000 at the beginning of the year, compared with about 1.5 million on average in 1991, after the expiry of some special arrangements in effect only in eastern Germany (for example, the granting of short-time working benefits even in the case of long-term losses of work and the "holding pattern" arrangements in the public service). On the other hand, unemployment rose strongly to 1.3 million. A ray of hope for the labour market can be seen in the fact that at the beginning of 1992 the increase

Change in the pattern of employment in eastern Germany from 1989 to 1991

Share in %



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in the number of unemployed was smaller than the decline in the number of short-time workers. The employment situation will nevertheless remain difficult for the time being, so that extensive recourse is being had to labour market policy measures. Some of the remaining short-time jobs will hardly meet the original objective of merely bridging a temporary loss of work. In addition to short-time working benefits, the Federal Labour Office is financing sizeable job-creation schemes. Around the turn of 1991-2, some 400,000 persons were participating in such programmes, as against only 35,000 at the beginning of the year. Such measures are often organised by specially established companies to promote work, employment and structural development. Participation in programmes for further training, retraining and on-the-job training (which are likewise financed by the Federal Labour Office) increased very markedly as well; at the turn of the year the number of participants came to 440,000.

Risks to the growth process in eastern Germany

The developments which came under way in the course of last year are a first step towards a harmonisation of living conditions in Germany. They were triggered mainly by massive assistance from west German public authorities. After this encouraging start, the gap between demand and income, on the one hand, and output, on the other, must be closed in a second step with the help of internal driving forces. The fastest possible adjustment of wages and salaries in eastern Germany to west German levels is hardly conducive to this because it prevents more production facilities from becoming or remaining profitable, so as to create new jobs or to preserve old ones. In view of the linkage of east German wages and salaries to west German levels, management and labour in the old Länder bear additional responsibility. In the long run, any attempt to outmanœuvre market forces by government intervention would be doomed to failure. This applies to the preservation of uncompetitive structures by means of public funds, as would occur, for example, if the *Treuhandanstalt* privatisation agency were to attempt, for employment policy reasons alone, to preserve enterprises which are unable to survive; this would apply similarly to a pursuit by the government of an "industrial policy", or to an extension of social compensation measures (for instance, to create jobs). On the one hand, this could slow down the economic restructuring required, and thus increase the risk of eastern Germany lastingly remaining a structurally weak area. On the other hand, sustained government intervention would place a heavy burden on public sector budgets, which – given the accumulation of demands on them (besides the transfer payments to eastern Germany, inter alia assistance for central and eastern Europe and additional claims by the European Community) – are coming under an increasing threat of being overburdened.

2. Severe strain on public finance

German unification imposes heavy demands on fiscal policy

Trends in public finance in 1991 were marked above all by the substantial need for financial transfers from west to east in the wake of German unification. Since the economy of the new Länder turned out to be in a much worse shape than had initially been supposed, extensive additional assistance for the restructuring and reconstruction process in the new Länder was approved at the beginning of March. If the budgets of the central, regional and local authorities and of the social security funds are combined, and if the loans granted by public banks under special promotion schemes, for which the Federal Government pays interest subsidies, are also included,[1] the transfers from west to east probably reached a magnitude of DM 140 billion in 1991. Even though the transfer-buttressed demand from eastern Germany had an expansionary impact on the economy, and thus the tax revenue, of the old Länder, the public sector had to face up to substantial additional requirements, particularly since unforeseeable extra expenditure was incurred as a result of the German contribution towards the cost of the Gulf war.

Measures to contain the public sector deficit

In order to contain the expansion of the public sector deficit, social security contributions, in particular, were increased, indirect taxes were raised around mid-year and a "solidarity surcharge" on income and corporation tax (limited to one year) was introduced. The additional revenue arising from these measures amounted to nearly DM 30 billion last year. At the same time, the rise in levies lessened the expansionary impact of fiscal policy. This helped to moderate business activity in western Germany, which was still running at a rapid pace. However, the increase in official levies did not fail to have unfavourable effects on prices, not only owing to the mark-ups which usually follow increases in indirect taxes but also because the additional burden on incomes apparently affected the outcome of the pay round (and thus the upsurge in costs). The cuts in expenditure and reductions in tax subsidies were rather limited at first. The economies adopted in March 1991 mainly consisted of cuts in defence spending and the gradual dismantling of the assistance granted to Berlin and the area along the former intra-German border.

Expansion of the deficit in 1991 not as sharp as expected

On the basis of the budget plans, it was expected in the spring that the deficit of the central, regional and local authorities in 1991 would reach about DM 160 billion and – after offsetting the surpluses anticipated for the social security funds – that of the public sector as a whole approximately DM 150 billion. In the final analysis, however, the shortfall turned out to be much smaller. Last year's deficit (in the budgetary definition) came to about DM 120 billion for the central, regional and local authorities, and to between DM 105 billion and

1 However, the loan volume is not to be equated with the subsidy value of the interest rate concessions granted; the latter is distinctly lower.

DM 110 billion for the entire public sector (against about DM 90 billion and approximately DM 75 billion, respectively, in 1990). For one thing, tax revenue exceeded the level estimated in the spring by DM 10 billion, mainly owing to the sharper rise in wages. For another, spending both by the Federal Government and by the east German central, regional and local authorities considerably undershot the budget appropriations. In the case of the Federal Government, this applied to a large number of expenditure items. The main reason for the shortfalls in spending in eastern Germany was that far fewer funds than had been envisaged were devoted to public capital formation in the new Länder. The east German central, regional and local authorities had to replan their capital spending, starting from scratch. The requisite administrative structure had to be built up first, land utilisation and development plans were lacking, and the often unresolved question of ownership rights to real property was also an obstacle. However, public capital spending in eastern Germany picked up increasingly in the course of the year, as the inflow of orders to the construction sector shows. Admittedly, expenditure reflects these trends only with a time-lag. To this extent, the shortfalls in expenditure recorded in 1991 were due to transitional problems and did not reflect lower long-term financial requirements, particularly since the budget plans have thus far not taken due account of numerous domestic and international risks.

Budgetary trends at the individual levels of government

Only a small proportion of the expansion of the central, regional and local authority deficit in 1991 was accounted for by the Federal Government. Its deficit in 1991, at DM 52 billion,[1] was only DM 7 billion higher than in 1990, when the Federal budget was, admittedly, already very heavily burdened by German unification. Part of the Federal Government's extra expenditure on eastern Germany and on the Gulf war was covered by additional revenue from tax increases. The west German Länder Governments (including Berlin) recorded a deficit of about DM 16 billion, which was thus somewhat lower than in 1990. Admittedly, their spending grew by approximately 7% and thus more sharply than envisaged; this was attributable not least to the high pay settlement for the public sector. However, their receipts increased even more vigorously, although they suffered some losses since the new Länder were included in the distribution of the Länder Governments' share of the turnover tax yield on the basis of their population. The revenue of the local authorities in the old Länder increased at a similar pace to that of the Länder Governments; however, not least owing to increased demand for social assistance and under the impact of the upsurge in construction prices, their spending actually mounted by almost 9%. The local authority deficit consequently went up from DM 4 billion (in 1990) to approximately DM 6 billion. At an estimated DM 9 billion, the deficit of the new Länder Governments reached only about one-half of the envisaged volume, for the above-mentioned reasons, and the east German local authorities probably recorded at most a small deficit. However, the "German Unity" Fund must likewise be included in the picture; loans amounting to DM 31 billion were raised through it in 1991 (against DM 20 billion in 1990). Further costs associated with the restructuring process in the new Länder were incurred by the *Treuhandanstalt* privatisation agency, whose deficit came to DM 20 billion in 1991. Admittedly, according to the official definition, the *Treuhandanstalt* counts not as a public authority but as an enterprise; in point of fact, however, it performs important "public" functions in the process of restructuring the east German economy, and the Federal Government will later have to assume and service any debt it accumulates.

Calls on the credit markets

Particularly in the case of the Federal Government, the financing of its deficit in the credit markets was facilitated in 1991 by the fact that it was initially able to draw on substantial cash balances from the "stockpile" of loans it had built up,

1 Inclusive of that part of the Bundesbank's profit which exceeded (by DM 1.3 billion) the amount that had been budgeted for, and which, in budgetary terms, is directly used to repay due debt.

Public sector finance*

Item	1989	1990 pe Old Länder	1990 [1], pe Eastern Germany	1991 pe Whole of Germany	1989	1990 Old Länder pe
	DM billion				Change from previous year in %	
Central, regional and local authorities						
Expenditure						
Personnel expenditure	222.8	235	.	288.5	+ 2.9	+ 5.5
Other operating expenditure	110.5	119.5	.	141.5	+ 5.3	+ 8
Transfers 2	202.6	214.5	.	293.5	+ 5.2	+ 6
Interest	61.2	65	.	76.5	+ 1.2	+ 6
Fixed capital expenditure	62.2	67	.	86.5	+ 6.9	+ 7.5
Financial aid 3	41.1	47	.	66.5	+ 1.8	+ 13
Total expenditure 4	700.8	748	72	957	+ 4.1	+ 6.5
of which						
Federal Government	292.9	[6] 311.5	72	405.5	+ 5.3	+ 6.5
West German Länder Governments	282.7	300	.	[7] 322.5	+ 4.7	+ 6
East German Länder Governments	.	.	.	75.5	.	.
West German local authorities	194.3	209.5	.	227.5	+ 5.4	+ 7.5
East German local authorities	.	.	.	46	.	.
EC 5	24.4	22.5	.	33	− 3.7	− 7.5
Receipts						
Tax revenue	535.5	549.5	17	661.5	+ 9.7	+ 2.5
Other receipts	146.0	155	11	182.5	+ 9.8	+ 6
Total receipts 4	678.6	701.5	28	837	+ 9.4	+ 3.5
of which						
Federal Government	[8] 277.9	[8] 290.5	48	[8] 353.5	+ 14.7	+ 4.5
West German Länder Governments	275.1	280.5	.	[7] 306.5	+ 8.4	+ 2
East German Länder Governments	.	.	.	66.5	.	.
West German local authorities	196.0	205.5	.	221.5	+ 5.9	+ 4.5
East German local authorities	.	.	.	45	.	.
EC	24.4	22.5	.	33	− 3.7	− 7.5
Surplus (+) or deficit (−)	− 22.2	− 46	− 44	− 120	.	.
of which						
Federal Government	[8] − 15.0	[8] − 21	− 24	[8] − 52	.	.
West German Länder Governments	− 7.6	− 19.5	.	[7] − 16	.	.
East German Länder Governments	.	.	.	− 9	.	.
West German local authorities	+ 1.7	− 4	.	− 6	.	.
East German local authorities	.	.	.	− 1	.	.
"German Unity" Fund	.	.	− 20	− 30.5	.	.
Debt-Processing Fund	.	.	.	+ 0.5	.	.
ERP Special Fund	− 1.1	− 2	.	− 6.5	.	.
Social security funds						
Expenditure	400.5	425	.	544	+ 1.4	+ 6
Receipts	413.7	441	.	557	+ 5.2	+ 6.5
Surplus (+) or deficit (−)	+ 13.2	+ 16	.	+ 13	.	.
Public sector, total						
Expenditure	1051.8	1121.5	.	1431	+ 2.9	+ 6.5
Receipts	1042.8	1091	.	1323	+ 7.9	+ 4.5
Deficit (−)	− 9.0	− 30.5	.	− 108	.	.

* Including hospitals keeping commercial accounts and other special accounts. Receipts and expenditure are shown here under the period for which they are intended, in accordance with budgetary practice. — **1** Section B of the Federal budget and "German Unity" Fund; only second half of 1990. — **2** Mainly social expenditure and current grants to the enterprise sector. — **3** Expenditure on investment grants and loans to third parties, plus the acquisition of participating interests. — **4** 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 operations, which, as a result of the inclusion of the east German regional and local authorities, are particularly substantial). — **5** EC expenditure financed out of EC revenue in Germany. — **6** Including transfers from the Federal Government to the "German Unity" Fund and the social security funds in eastern Germany. — **7** Including Berlin. — **8** The Bundesbank profit transfer is included in full in the figure as Federal Government revenue. — **pe** Partly estimated.
Discrepancies in the totals are due to rounding.

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and on return flows of funds not spent in 1990. At DM 102 billion, overall net borrowing by the central, regional and local authorities in 1991 remained below the budget deficit and, unlike the deficit, was somewhat lower than in 1990 (DM 112 billion). However, if the public sector borrowers which do not count as public authorities in the strict sense (Federal Post Office, Federal Railways and *Treuhandanstalt*) are included, public sector borrowing in the credit markets increased from DM 125 billion in 1990 to DM 141 billion. Moreover, it must be taken into account that the interest subsidies paid on bank loans for corporate investment, establishing new businesses and modernising dwellings in eastern Germany, and other nromotional measures by the Government greatly stimulated private sector borrowing.

Public finance as reflected in the fiscal ratios

The strain on public finance in the wake of German unification is brought out by a comparison with the budget situation in the old Länder in 1989, which was fairly favourable owing to the consolidation policy that had been pursued for quite some time. At approximately 51 % in the whole of Germany in 1991, the "government ratio", i.e. the ratio of government spending to GNP, was about 4 percentage points higher than in western Germany two years before.[1] By contrast, the overall revenue ratio, at 47 %, remained virtually unchanged against 1989. The burden of social security contributions became heavier, while the overall tax ratio declined slightly (viz. from just under 24 % in the old Länder in 1989 to 23½ % in the whole of Germany in 1991). The latter fact was attributable to the circumstance that the tax increases that were introduced in mid-1991 were initially of less significance for the tax ratio than the tax cuts which were approved prior to German unification and which entered into effect at the beginning of 1990. However, the tax ratio will probably increase in 1992. The deficit ratio has risen from ½ % of GNP in 1989 to just under 4 % (i.e. almost to the level of the early 1980s).[2] At the end of 1991 public sector indebtedness, at DM 1,170 billion, amounted to approximately 42 % of GNP.[3] The allocation of equalisation claims, which is expected to entail additional liabilities of between DM 65 billion and DM 70 billion for the Debt-Processing Fund, was still outstanding; the debt of the *Treuhandanstalt* is not included in this figure.

First step towards reducing the deficit of the central, regional and local authorities in 1992

Public sector deficits of the magnitude recorded in 1991 are unsustainable over a prolonged period. This holds true not least from the point of view of anti-inflationary policy, since monetary policy would be overtaxed if it were expected, single-handed, to perform the task of durably containing the present relatively strong price upsurge. Besides a moderate wage policy, this task calls for a fiscal policy which, after the exceptional situation arising in the wake of German unification, is once again geared firmly to budgetary consolidation. As a benchmark, the Federal Minister of Finance has declared that the budget deficit of the central, regional and local authorities is to be reduced to 2½ % of GNP by 1995. According to the budget plans, deficit reduction is due to start in 1992. A relatively vigorous increase in tax revenue (which was put at 9 % in the latest official tax estimate of autumn 1991) will probably assist this process. While the increase in the tax allowance for children will admittedly lead to shortfalls in receipts, the raising of indirect taxes in mid-1991 now makes itself felt over a full year, and tobacco tax was raised, too, in March 1992. However, according to the budgets, spending by the central, regional and local authorities will likewise increase quite vigorously again in 1992, albeit with marked differences between the individual levels. The Federal Government intends to restrict the rise in its expenditure over the 1991 target to 3 % (which will be

1 The government ratio was calculated here on the basis of budgetary government expenditure. If spending as defined in the national accounts is taken as a basis, the government ratio is somewhat lower.
2 Pursuant to the national accounts and expressed in terms of GDP, i.e. in the definition chosen for the convergence criteria of the European Economic and Monetary Union, the government deficit in 1991 came to 3.2 % (see also page 8).
3 This figure is in line with the debt statistics and, for methodological reasons, differs slightly from that appearing in the table on page 8.

Indebtedness of the central, regional and local authorities

DM billion

Item	1989	1990	1991 pe	1989	1990	1991 pe
	Level at end of year			Change from previous year		
Borrowers' note loans	496.0	517.0	547.5	− 6.7	+ 21.0	+ 30.5
Securities	414.9	518.6	602.5	+ 32.9	+ 103.6	+ 84
Other debt	17.9	17.9	19.5	− 0.3	+ 0.0	+ 1.5
Total indebtedness	928.8	1053.5	1169.5	+ 25.8	1 + 124.7	1 + 116
of which						
Federal Government	490.5	542.2	2 586	+ 15.4	+ 51.6	2 + 44
West German Länder Governments	309.9	328.8	348.5	+ 7.3	+ 18.9	+ 19.5
East German Länder Governments	.	.	3.5	.	.	+ 3.5
West German local authorities	112.9	116.5	122	+ 1.6	+ 3.6	+ 5.5
East German local authorities	.	.	6	.	.	+ 6
"German Unity" Fund	.	19.8	50.5	.	+ 19.8	+ 30.5
Debt-Processing Fund	.	27.6	27.5	.	+ 27.6	− 0
ERP Special Fund	7.1	9.5	16.5	+ 1.1	+ 2.4	+ 7
Memorandum items						
Treuhandanstalt	.	4.4	25	.	+ 4.4	+ 20.5
Federal Railways-East German Railways	44.1	48.4	3 43	+ 1.4	+ 4.3	− 5.5
Federal Post Office	66.2	71.0	81.5	+ 2.0	+ 4.8	+ 10.5

1 The figure for net borrowing given in the text on page 30 is smaller than the increase in indebtedness, which also includes the assumption of old debt. — **2** Including bonds taken over from the Federal Railways in the amount of DM 12.6 billion. — **3** Excluding bonds in the amount of DM 12.6 billion taken over by the Federal Government. — **pe** Partly estimated. BBk

facilitated by the discontinuance of the payments towards the cost of the Gulf war); compared with the lower 1991 out-turn, however, the growth rate is higher. The west German Länder Governments and local authorities have budgeted for an expenditure growth of just over 4% and about 6%, respectively. This would mean a marked deceleration against 1991. However, considerable uncertainties persist in this context with respect to the pay settlement for the public service. In the case of the new Länder Governments and local authorities, by contrast, a very steep increase in expenditure is to be expected after the above-mentioned start-up problems have been overcome and owing to the gradual adjustment of the pay scales in the public sector to west German standards, even though some economies will be possible as a result of the shedding of staff and the reduction of consumer subsidies. The interest expenditure of the Debt-Processing Fund (one-half of which spending must be refunded by the Federal Government and one-half by the *Treuhandanstalt*) will also go up considerably, and lending by the ERP Special Fund is likewise expected to increase. Finally, a vigorous upturn in the expenditure associated with German membership of the EC is likely. All in all, as things stand today, progress towards the consolidation of the central, regional and local authority budgets in 1992 will probably not be very substantial. Admittedly, any assessment of future budget trends is still subject to numerous uncertainties.

Surpluses of the social security funds give way to deficits

Even if the growing deficit of the *Treuhandanstalt* is disregarded, the overall public sector deficit in 1992 will probably increase again over 1991, since a marked swing in the finances of the social security funds is looming. Their surplus, which amounted to as much as about DM 13 billion in 1991, will give way to a deficit of approximately DM 15 billion in 1992. This is mainly due to the deterioration in the finances of the pension insurance funds, which was caused primarily by the introduction of west German pension legislation in eastern Germany from the beginning of 1992. This means that the financial implications of German unification will not be felt in full by the pension insurance funds until 1992. The Federal Labour Office is likewise facing increasing requirements from eastern Germany. Finally, the gap in the budgets of the statutory health insurance institutions in the old Länder might widen if the steep rise in costs in the health sector were to continue. Although it will initially be possible to finance the deficit of the pension insurance funds out of the reserves, in 1994 at the latest the contribution rate will presumably have to be raised. Increases in contributions will also become necessary in the case of the health insurance scheme once the reserves have been run down; a number of health insurance institutions took this step as early as the beginning of 1992. It is as yet hard to assess the extent to which it will be possible to offset rises in contributions to the pension and health insurance funds in the medium term by cuts in the contribution rate to the Federal Labour Office, following an improvement in the labour market situation in eastern Germany. At all events, in view of the overall burden of taxes and other official charges on incomes, fiscal policy makers will not be able to ignore trends in social security contributions.

Further efforts at consolidation imperative

The prospects for public finance in 1992 make it plain what immense efforts are still required to realise the objective of medium-term consolidation. It must also be borne in mind in this connection that numerous budgetary risks still remain, e.g. with respect to restitution payments in eastern Germany, the clearing-up of environmental damage there, guarantees for export credits, assistance to eastern Europe and the growing financial demands of the EC in the run-up to European monetary union. Discharging the task of overall budget consolidation presupposes strict restraint in spending. The Financial Planning Council, which represents all central, regional and local authorities, for instance, stated in December 1991 that the growth in the expenditure of the Federal Government and the old Länder Governments and their local authorities must be limited to 3% again. In the budgets of the new Länder Governments it is imperative to give capital spending priority over consumption expenditure as far as possible. Consolidation policy would be jeopardised not inconsiderably if it were watered down by further decisions to adopt cost-intensive measures in individual policy areas; this applies not least to social policy, too. If the reconstruction process in eastern Germany is to proceed as quickly as possible without overtaxing public finance and the economy as a whole, a number of other projects (particularly extensions of benefits) must initially take second place.

Raising of value-added tax and increase in the "German Unity" Fund

In addition to the improvements in benefits for families introduced retroactively from the beginning of 1992, important decisions for the next few years were taken in mid-February 1992, in the shape of the compromise on the 1992 Tax Amendment Act and the Act Repealing the Structural Assistance Act and Increasing the "German Unity" Fund. These decisions include, in particular, the raising of the standard rate of value-added tax by 1 percentage point from the beginning of 1993; the additional revenue will be employed in the next two years to increase the "German Unity" Fund. Overall, the measures adopted will markedly improve the financial situation of the east German Länder Governments and local authorities, so as to enable them to perform their pressing tasks without undue borrowing. Compared with the decisions taken by the Bundestag in November 1991, the compromise entails considerable additional burdens on the Federal budget; where the Federal Government is no longer able to draw on "budgetary reserves", additional economies will be necessary if the envisaged policy of reducing budget deficits is to be adhered to. In view of the objective of monetary stability, it is, moreover, essential that the raising of value-added tax in favour of eastern Germany does not lead to corresponding wage increases. In terms of income distribution policy, that measure should be accepted. Apart from the primary price effects, a cumulative process of price and wage rises must not be set in motion.

3. External adjustment following German unification

Sharp reversal in the current account

The external situation changed radically after the unification of Germany. Whereas surpluses in international current transactions had continually been reaching record levels prior to 1990 and had frequently given rise to criticism in partner countries, they were significantly reduced as early as the second half of 1990 following the monetary union with the former GDR. This trend gathered pace last year. Overall, Germany's current account showed an unprecedented deficit of DM 33 billion in 1991, whereas there had been a surplus of DM 76 billion in 1990. The difference between the two years therefore amounted to DM 110 billion, or approximately 4% of the all-German gross national product. Although western Germany's production capacity was already almost fully stretched, the urgent needs of the east German population could be satisfied, without tension for the most part, through the associated rise in imports. At the same time the heavy demand from Germany provided a welcome boost to cyclical trends in partner countries and helped to achieve a more balanced current account pattern world-wide.

Buoyant imports . . .

The unprecedented reversal in the current account is mainly the result of the rise in imports. The value of all-German imports in 1991 exceeded the previous year's level (which was established for the enlarged territory as a makeshift) by 12%; the surge in imports was heaviest in the first half of the year, when purchases by residents of the new Länder were increasing particularly fast. Owing to the cyclical underutilisation of capacity, west European industrial countries, in particular, were able to meet a large part of this increased demand and, as a result, economic growth in 1991 rose by an estimated additional ½ percentage point. However, non-European trading partners also benefited from the rise in Germany's import demand although, in some cases, they did so only indirectly because other countries, particularly in the EC, in turn imported more, especially from the United States and Japan, as a result of the higher demand from Germany.

. . . and sluggish exports

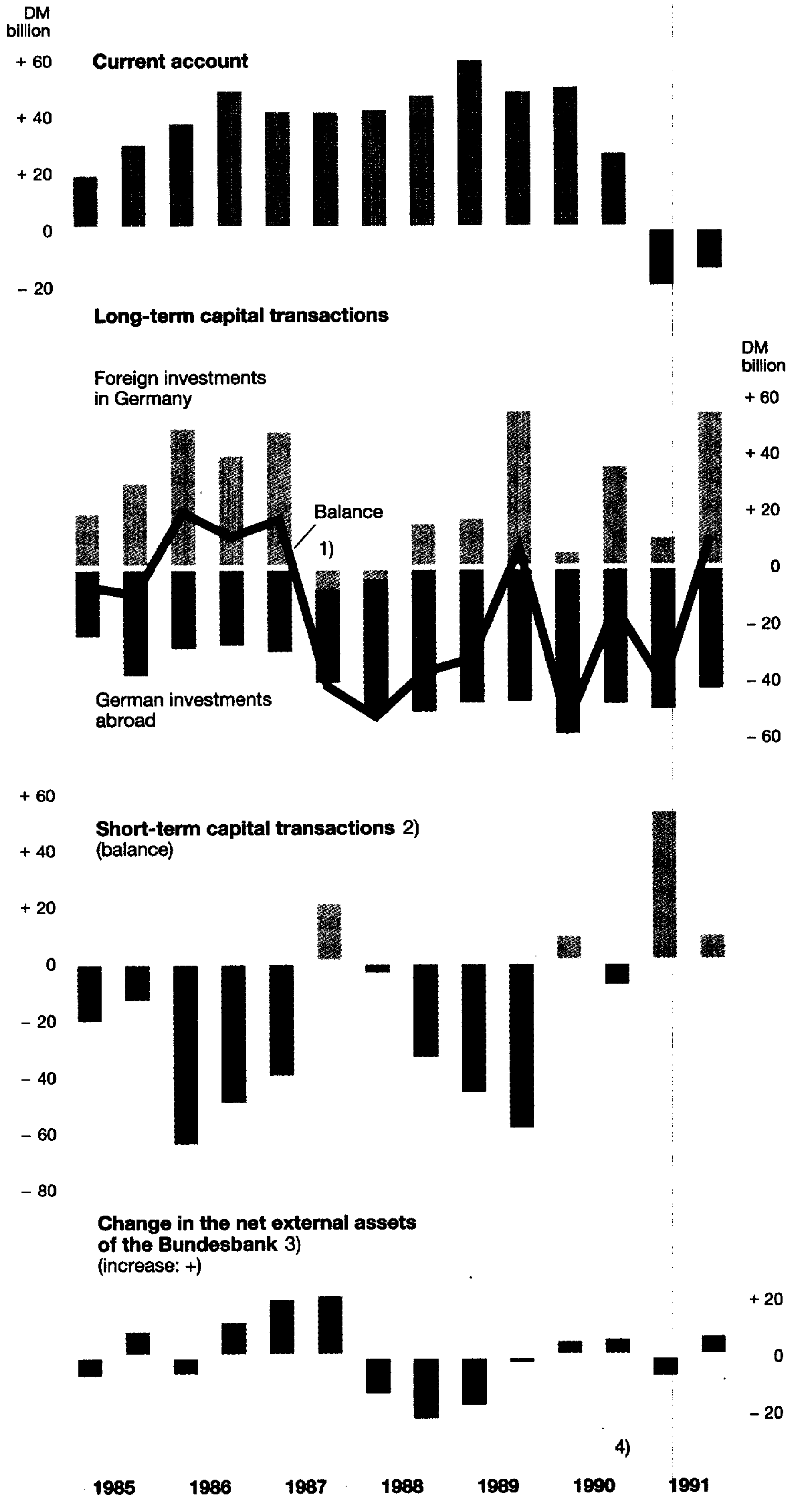
Germany's unification process left its mark clearly on the export side, too. In contrast to the buoyant trend in imports, exports declined, although there was actually another slight improvement in German exporters' price competitiveness, especially in the first six months of the year. In the end, the value of all-German exports in 1991 declined by 2%, compared with the previous year. Particularly in the first half of the year west German enterprises, whose capacity was almost fully stretched, increasingly sold their products in eastern Germany and thereby helped to meet the sharp rise in demand there. The simultaneous cyclical downturn in major export markets no doubt encouraged this "redirection" of west German goods. Another explanation for the sluggish export trend at the beginning of last year is the fact that enterprises in the new Länder lost most of their traditional customers in eastern Europe following the collapse of the barter and clearing system operated by the Council for Mutual Economic Assistance (CMEA).

Stabilisation in the second half of the year

It is therefore clear, overall, that the sharp reversal in international trade flows was primarily the result of the unusual economic situation in Germany following unification, which severely taxed the country's production capacity. Foreign trade provided a "safety valve", particularly in the first half of 1991. In the second half of last year, when this spontaneous surge in demand from the new Länder declined somewhat, market conditions began to return to normal in Germany. At the same time, there was virtually no further increase in the demand for imports, whereas exports were beginning to show a certain revival. After this spate of orders from the home market had moderated, enterprises apparently concentrated their sales efforts on their traditional foreign markets again. They may have been helped here by the fact that, for the most part, they

Balance of payments pattern

Half-yearly, surplus or net capital imports: +



1) Liquidation of foreign assets in Germany.- 2) Including the balancing item of the balance of payments.- 3) Resulting from transactions.- 4) From July 1990 including the external transactions of the former GDR.

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were able to maintain their price competitiveness, especially vis-à-vis their major trading partners. Yet by the end of last year there was still no lasting and far-reaching revival of German exports. The main reason for this is probably the generally disappointing cyclical trends in most partner countries.

Higher deficits on services and transfer payments

It was not only foreign trade but also larger deficits in the other current transactions that contributed to the serious reversal in Germany's current account. This was particularly true of transfer payments abroad, which, at over DM 59 billion (compared with DM 37 billion a year earlier), showed an unusually large deficit in 1991. In the first half of 1991 it was primarily the payment of approximately DM 12 billion as a contribution towards the cost of the Gulf war that made a difference. This was followed in the course of the year by a sharp rise in Germany's net contributions to the EC budget; at DM 19 billion, these payments were DM 7.5 billion higher in 1991 than they had been a year earlier. Another contributory factor was the fact that the Federal Government had to pay approximately DM 2.5 billion in accordance with the agreement concluded with the former Soviet Union on the withdrawal of Soviet troops from eastern Germany. The traditional deficits on services account likewise rose significantly last year. The net deficit, including the transport and insurance costs of imports, amounted to DM 14 billion and was therefore almost DM 9 billion higher than a year earlier. Firstly, expenditure on foreign travel again rose sharply, primarily as a result of the high incomes in western Germany but also because of the increase in travel by east Germans. Secondly, the higher expenditure could no longer be offset, as in previous years, by the rise in net investment income. Owing to the current account deficit, Germany's net external assets, which had risen continually in earlier years, declined somewhat in 1991. In addition, yields on investments abroad were relatively low, notably because of the fall in dollar interest rates, whereas interest payments on liabilities to non-residents, which are mainly denominated in Deutsche Mark, increased.

Smaller outflows in long-term capital transactions

The swing in long-term capital transactions was comparatively slight, given the overall change in the current account situation. With net capital exports of DM 28 billion, overall outflows of funds in 1991 were less than half as high as in the previous year (DM 66 billion). The revival of foreign investors' interest in the German capital market in the second half of the year was the main reason for this. On the other hand, at a total of DM 93 billion gross, Germany's capital exports again reached sizeable proportions, even if they did not regain the preceding year's record level of DM 107 billion. As in 1990, the direct investment of German enterprises accounted for a large share of this (DM 36 billion). These external investments are mainly associated with preparations for the single European market and are primarily for the development of bases for German enterprises and financial institutions in the European partner countries. Cost considerations also play a part in this, of course. At a total of DM 26.5 billion, Germany's investments in foreign securities markets remained roughly at the same level as in the previous year. There were, however, distinct shifts of emphasis between the various types of investment. Whereas in 1990 interest focused on foreign bonds, it was foreign investment fund units that were particularly in demand in 1991 – especially those of the funds which German banks have set up in Luxembourg since the end of 1990 and which invest largely in money-market-related Deutsche Mark assets. Demand for such units probably reflects the attractive yields on short-term investments in the first instance but is also associated with tax considerations. The fiscal aspects of financial investments came to the forefront of public interest again for a time in 1991 after the Federal Constitutional Court had demanded a revision in a ruling on the taxation of interest income in Germany. However, the Federal Government quickly made it clear that it was not considering reintroducing in an unmodified form the withholding tax of 1989 and that, instead, it

Major items of the balance of payments°

DM billion

Item	1984	1985	1986	1987	1988	1989	1990 °	1991
A. Current account								
1. Foreign trade								
Exports (f.o.b.) **1**	488.2	537.2	526.4	527.4	567.7	641.0	662.0	665.8
Imports (f.o.b.) **1**	421.4	451.1	403.0	399.5	428.4	493.4	543.5	627.3
Balance	+ 66.8	+ 86.0	+ 123.4	+ 127.9	+ 139.2	+ 147.6	+ 118.6	+ 38.5
2. Supplementary trade items and merchanting trade **2**	− 1.1	− 1.3	− 1.5	− 1.1	+ 1.1	− 1.3	− 0.5	+ 1.8
Balance of trade	+ 65.8	+ 84.7	+ 121.9	+ 126.8	+ 140.3	+ 146.4	+ 118.1	+ 40.3
3. Services								
Receipts	133.5	142.5	142.0	145.1	151.8	186.7	210.8	231.2
Expenditure	141.6	149.7	151.1	160.3	171.5	191.4	216.1	245.3
Balance	− 8.1	− 7.3	− 9.1	− 15.2	− 19.6	− 4.7	− 5.3	− 14.0
of which								
Investment income (net)	+ 10.3	+ 9.3	+ 9.0	+ 7.1	+ 9.2	+ 22.1	+ 27.6	+ 29.0
Foreign travel (net)	− 23.1	− 23.7	− 25.4	− 27.9	− 28.9	− 28.3	− 30.4	− 33.4
4. Transfer payments	− 29.7	− 29.1	− 27.1	− 29.1	− 31.8	− 33.8	− 36.7	− 59.2
of which								
Net contributions to the EC budget	− 7.3	− 8.3	− 8.2	− 10.4	− 13.0	− 13.4	− 11.6	− 19.1
Other official payments to non-residents (net)	− 10.8	− 9.9	− 8.2	− 8.4	− 7.6	− 9.7	− 13.8	− 28.7
Balance on current account	+ 27.9	+ 48.3	+ 85.8	+ 82.5	+ 88.9	+ 108.0	+ 76.1	− 32.9
B. Capital account								
1. Long-term capital transactions								
(a) German investments abroad (increase: −)	− 45.0	− 61.7	− 55.4	− 62.2	− 98.0	− 95.0	− 106.8	− 92.9
Direct investments	− 12.5	− 14.1	− 20.9	− 16.4	− 20.1	− 27.3	− 37.0	− 35.7
Foreign securities	− 15.7	− 31.5	− 21.3	− 24.5	− 72.6	− 50.2	− 23.5	− 26.3
Lending to non-residents	− 14.2	− 13.1	− 10.3	− 18.6	− 2.5	− 14.2	− 43.0	− 26.4
Other investments abroad	− 2.6	− 3.0	− 3.0	− 2.7	− 2.8	− 3.3	− 3.3	− 4.4
(b) Foreign investments in Germany (increase: +)	+ 25.2	+ 48.8	+ 88.9	+ 40.2	+ 11.2	+ 72.5	+ 40.6	+ 65.0
Direct investments	+ 1.6	+ 1.7	+ 2.6	+ 3.4	+ 2.1	+ 13.2	+ 3.7	+ 4.8
Domestic securities and official domestic borrowers' notes	+ 21.7	+ 36.3	+ 69.1	+ 22.0	− 3.3	+ 40.1	+ 15.8	+ 62.7
Securities	+ 17.4	+ 38.3	+ 74.1	+ 33.9	+ 7.6	+ 45.2	+ 17.1	+ 64.0
Borrowers' notes	+ 4.3	− 2.0	− 5.0	− 12.0	− 10.8	− 5.1	− 1.3	− 1.3
Lending to residents **3**	+ 1.9	+ 10.9	+ 17.3	+ 14.9	+ 12.6	+ 19.3	+ 21.4	− 2.4
Other investments in Germany	− 0.0	− 0.1	− 0.1	− 0.1	− 0.2	− 0.1	− 0.4	− 0.1
Balance of long-term capital transactions	− 19.8	− 12.9	+ 33.4	− 22.0	− 86.8	− 22.5	− 66.2	− 27.9
2. Short-term capital transactions (net capital exports: −)								
(a) Banks	+ 0.1	− 27.7	− 59.0	− 6.6	− 20.2	− 56.7	+ 0.6	+ 39.8
Assets	− 17.8	− 33.4	− 65.8	− 15.4	− 30.1	− 81.0	− 24.3	+ 19.0
Liabilities	+ 17.8	+ 5.7	+ 6.8	+ 8.9	+ 9.9	+ 24.3	+ 24.9	+ 20.8
(b) Enterprises and individuals	− 16.1	− 14.1	− 56.7	− 11.5	− 21.4	− 51.6	− 19.4	+ 7.1
Financial operations with foreign banks	− 3.3	− 13.5	− 49.3	− 10.8	− 10.7	− 38.1	− 24.7	+ 2.7
Financial operations with foreign non-banks	− 4.0	+ 2.8	− 2.2	− 2.6	− 2.3	− 3.3	+ 6.8	+ 9.3
Trade credits	− 8.7	− 3.5	− 5.2	+ 1.9	− 8.4	− 10.3	− 1.4	− 4.9
(c) Official	− 1.6	+ 0.1	− 0.3	+ 1.0	+ 0.8	− 4.8	− 5.2	− 4.7
Balance of short-term capital transactions	− 17.7	− 41.7	− 116.0	− 17.0	− 40.8	− 113.1	− 23.9	− 42.3
Balance on capital account	− 37.5	− 54.6	− 82.6	− 39.0	− 127.5	− 135.6	− 90.1	+ 14.4
C. Balance of unclassifiable transactions (balancing item)	+ 6.5	+ 8.1	+ 2.7	− 2.2	+ 3.9	+ 8.6	+ 25.0	+ 18.8
D. Balancing item in respect of the Bundesbank's external position 4	+ 2.1	− 3.1	− 3.2	− 9.3	+ 2.2	− 2.6	− 5.1	+ 0.5
E. Change in the Bundesbank's net external assets 5 [A plus B plus C plus D] (increase: +)	− 1.0	− 1.3	+ 2.8	+ 31.9	− 32.5	− 21.6	+ 5.9	+ 0.8

° From July 1990 including the external transactions of the former GDR. — **1** Special trade. — **2** Mainly warehouse transactions for account of residents and deduction of goods returned and of processing. — **3** Excluding official domestic borrowers' notes. — **4** Counterpart of changes in the Bundesbank's external position which are not caused by external current and capital transactions: changes in the Deutsche Mark value of the Bundesbank's assets and liabilities denominated in foreign currencies owing to the revaluation at the end of the year and differences between the transaction values of the Bundesbank's foreign exchange transactions and the changes in the external position shown at balance sheet rates. — **5** Valued at balance sheet rates.

Discrepancies in the totals are due to rounding.

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wanted to avoid the problems of this taxation model through high exemption limits for resident taxpayers and a general exemption for non-residents. The investments of German savers in foreign securities markets have so far not reflected any comparable evasive action to what was observed, for example, in 1988-9 in connection with the introduction of the withholding tax.

Large purchases of bonds by non-residents

After fairly unmistakable restraint at first, non-residents clearly revived their investment interest in the German capital market in the second half of last year. In view of the growing interest rate advantage of Deutsche Mark paper and the clear appreciation tendency of the Deutsche Mark since last summer, German bonds, in particular, became increasingly sought after. At a total of DM 60.5 billion, foreign purchasers invested about three times as much in the bond market as a year earlier, thus exceeding the previous record for capital imports of this kind (DM 59 billion in 1986). About three-quarters of this total went into public bonds, so that more than half of the average net sales thereof was placed abroad.

Balance of payments financed through short-term capital imports by banks

Overall, both the deficit in current transactions and the simultaneous outflows of funds in long-term capital transactions, which occurred, on balance, despite the extensive bond purchases by foreign investors in the German market, were fully financed by large short-term capital imports in 1991. Thus, a total of DM 61 billion in short-term foreign funds, including the balancing item of the balance of payments, flowed into the German market last year. The financial transactions of enterprises, through which the German economy received funds, on balance, for the first time in years, also contributed to this. Firstly, enterprises did not stock up their Euro-market balances as much as they had done a year earlier, and secondly, a greater proportion of their short-term loans was raised from foreign banks. However, it was mainly domestic banks which recorded considerable inflows of funds in 1991 after the relative interest rate advantage of Deutsche Mark assets increased markedly, particularly at the short end of the market. The banks' short-term external assets declined by DM 19 billion and their short-term external liabilities increased by DM 21 billion. As a result, the banks' net short-term claims on non-residents fell by DM 40 billion.

Slight decline in monetary reserves, but virtually no change in the Bundesbank's net external assets

In 1991 the Bundesbank's (gross) monetary reserves declined as a result of transactions by DM 9.5 billion, although the Bank received the equivalent of DM 21 billion through interest income and the exchange of dollars by US troops stationed in Germany. To check the rise in the rate of the US dollar, the Bundesbank sold dollars in the market at times, especially in the first half of 1991. In addition, some special transactions involved reductions in dollar holdings last year: firstly, there were outflows of US dollars as a result of Germany's payments to the US Treasury in connection with the Gulf war; secondly, the Bundesbank sold US dollars direct to a foreign monetary authority in exchange for Deutsche Mark. In the latter case, the Bundesbank's external liabilities fell at the same time by approximately DM 10 billion, with the result that these transactions did not affect the net external assets. As usual, the Bundesbank's external position was revalued at the end of 1991. The balance sheet rate for dollar assets was reduced from DM 1.4940 to the dollar to DM 1.4500; the new balance sheet rate is based on the historic low for the US dollar of February 1991. The book value of the net external assets was thus reduced by DM 2 billion. Since then, the Bundesbank's net external assets have risen again as a result of current dollar inflows and the shifting of Deutsche Mark balances of foreign monetary authorities on to the market. At the time this Report went to press, they were just over DM 5 billion higher than at the beginning of the year.

Record of economic policy measures

I. Domestic and external monetary policy

1991	
January 31	The Bundesbank raises the discount rate from 6.0% to 6.5% and the lombard rate from 8.5% to 9.0% with effect from February 1. By taking these decisions, it regains scope for a tighter liquidity policy in the money market and reduces the "subsidy nature" of its discount credit.
February 1	Some initial measures to bring the conditions for east German banks' central bank borrowing more into line with the regulations applying to west German banks come into force. They provide that east German banks may use not more than two-thirds of their refinancing quotas for discounting bank promissory notes, while the remaining third may be used only for rediscounting trade bills. At the same time, those banks are allowed to participate in securities repurchase agreements.
April 18	The Bundesbank approves its annual accounts for the financial year 1990; DM 8.3 billion of its net profit is transferred to the Federal Government.
May 15	The Federal Ministry of Finance and the Deutsche Bundesbank announce that the range of Federal securities on offer is to be extended by the addition of new-style Federal Treasury notes, to be issued by tender, initially at regular two-monthly intervals, and with a four-year maturity.
June 7	With the pegging of the Finnish markka to the European Currency Unit (ECU), the third Scandinavian currency is unilaterally linked to the European Monetary System, after the Norwegian krone (October 22, 1990) and the Swedish krona (May 17, 1991).
June 13	The Central Bank Council decides to cut east German banks' refinancing quotas by DM 6 billion to a total of DM 18 billion with effect from July 1, 1991. The banks may use not more than one-half of their quotas for discounting bank promissory notes. The other half may be used only for rediscounting trade bills.
June 28	The Council for Mutual Economic Assistance (CMEA) is officially disbanded in Budapest.
July 11	The Bundesbank reviews the 1991 monetary target and decides to lower the target corridor for the growth of the money stock M3 between the fourth quarter of 1990 and the fourth quarter of 1991 from a range of 4% to 6% to one of 3% to 5%. By this adjustment, the Bundesbank is primarily taking account of the "normalisation process" of cash-holding patterns in eastern Germany, which is progressing more rapidly than had been expected.
August 15	The Central Bank Council raises the discount rate from 6.5% to 7.5% and the lombard rate from 9.0% to 9.25% with effect from August 16. These measures are aimed at tightening monetary policy further. They are also designed to bring the discount rate more closely into line with other central bank interest rates and the comparable market rates, and to preserve some scope for flexible money market management.
December 5	The Bundesbank announces the 1992 monetary target. Pursuant to its decision, the Bundesbank will continue to conduct its monetary policy in 1992 in such a way as to ensure that the persistent threats to monetary stability are strictly contained and, at the same time, that the monetary conditions for non-inflationary economic growth remain in place. To this end the Bank regards it as appropriate for the money stock M3 to expand by 3½% to 5½% between the fourth quarter of 1991 and the fourth quarter of 1992. At the same time, the Central Bank Council decides to cut east German banks' refinancing quotas by DM 8 billion, to a total of DM 10 billion, with effect from January 2, 1992. This reduction primarily affects banks winding up or refocusing operations, which conduct virtually no new business with non-banks. They are allowed to use all their quotas until July 1, 1992, when these will be cancelled, for discounting bank promissory notes, while, among those banks which are fully operational, utilisation of the quotas for discounting bank promissory notes is limited to 25%.
December 9-10	The Heads of State and of Government of the EC member states, meeting at the EC Summit in Maastricht, adopt a draft Treaty on European Union which is intended to amend the existing treaties on the European Communities. The provisions of the Treaty envisage, for the final stage of Economic and Monetary Union (EMU), the irrevocable fixing of exchange rates between the participating currencies, followed by the transition to a single currency, and assign to the future European System of Central Banks (ESCB) the task of formulating and implementing the monetary policy of the Community from then on. The participation of the individual EC member states in the final stage of EMU, which will begin not earlier than January 1, 1997 and not later than January 1, 1999, is dependent on the fulfilment of a number of economic criteria. The second stage of EMU will begin on January 1, 1994 upon the establishment of the European Monetary Institute (EMI). The function of the EMI will be to coordinate monetary policies in Europe more closely, and to pave the way technically for the third stage of EMU.
December 19	The Central Bank Council raises the discount rate from 7.5% to 8.0% and the lombard rate from 9.25% to 9.75% with effect from December 20. In this way the Bundesbank reaffirms its determination to abide by its tight monetary policy stance and bring monetary growth back on to a potential-oriented path.
1992	
February 7	The Treaty on European Union in its final form is signed by the EC Heads of State and of Government in Maastricht and forwarded to the national parliaments for ratification.

II. General economic policy and fiscal policy

1991	
February 20	The Federal Cabinet approves the draft Federal budget for 1991, providing for expenditure totalling just under DM 400 billion and a deficit of DM 70.5 billion.
March 11	In its Annual Economic Report, the Federal Cabinet expects real GNP in the old Länder to grow by an average of between 2½ % and 3 % in 1991, and consumer prices to go up by about 3½ %. In the new Länder, it believes, the indispensable restructuring of production and employment will continue in the current year.
April 1	The raising of the contribution rate to the Federal Labour Office from 4.3 % to 6.8 % and the lowering of the contribution rate to the pension insurance funds from 18.7 % to 17.7 % enter into force.
June 7	The Bundestag approves the 1991 Federal budget, with an expenditure volume of DM 410.5 billion and a deficit of DM 67.5 billion. The *Gemeinschaftswerk Aufschwung Ost* (joint programme for the economic recovery of the new Länder), which was adopted by the Federal Cabinet on March 8 and provides DM 12 billion a year for eastern Germany in 1991 and 1992, has been incorporated in the budget.
July 1	The solidarity surcharge at the rate of 7.5 % of the income and corporation tax liability (limited until June 30, 1992) and an increase in mineral oil tax and insurance tax enter into force. At the same time the 1991 Tax Amendment Act comes into effect; it provides, among other things, for tax incentives to foster investment in the new Länder and for a gradual dismantling by the end of 1994 of the tax privileges previously granted to Berlin and the area along the former intra-German border.
July 10	The Federal Cabinet approves the draft Federal budget for 1992, with an expenditure volume of DM 422.5 billion and a deficit of DM 50.5 billion, and the financial plan for the years from 1991 to 1995. Expenditure is planned to grow by an annual 2.3 % in the medium term, and the deficit is to be reduced to DM 26 billion by 1995. At the same time the benchmark figures of the 1992 Tax Amendment Act are approved; this provides, in particular, for an improvement in the benefits granted to families, an increase in the standard rate of value-added tax to 15 % from the beginning of 1993, tax relief for enterprises and the dismantling of tax concessions.
September 2	The Federal Cabinet adopts the draft 1992 Tax Amendment Act and a bill providing for the enlargement of the "German Unity" Fund and the repeal of the Structural Assistance Act.
November 11	In response to the ruling of the Federal Constitutional Court of June 27, 1991 calling for a more consistent taxation of interest income, the coalition decides to introduce, from January 1, 1993, a flat-rate tax of 25 % on residents' interest income which will be deductible from the final tax liability; at the same time, the tax allowance for savers is to be raised to DM 6,000 for single persons and DM 12,000 for married couples, which represents a tenfold increase. In addition, higher tax allowances in respect of property tax and some relief in connection with provision for old age and the taxation of retirement income are envisaged.
November 18	In its Annual Report, the German Council of Economic Experts expects real GNP in the old Länder to grow by 2 % in 1992, while it could rise by 9½ % in eastern Germany. The Council warns that wage trends must not outpace productivity growth, which would lead to labour-shedding by enterprises.
November 30	The Bundestag approves the 1992 Federal budget, with an expenditure volume of DM 422 billion and a deficit of DM 46.5 billion (owing to higher tax revenue, this undershoots the amount envisaged in the draft budget by DM 4 billion). A supplementary budget for 1991 which is approved at the same time provides for additional expenditure totalling just under DM 6.5 billion, which is to be financed through all-round reductions in spending.
December 3	The Financial Planning Council declares that the growth in the expenditure of the Federal Government and the old Länder Governments and local authorities must be brought down to a rate of 3 % again, since this is the only way to make the necessary support available to the new Länder and to reduce borrowing at the same time.
1992	
January 1	The 1992 pension reform enters into effect; it brings the financial basis of the pension insurance funds into line with the underlying demographic conditions (which are deteriorating over the longer term), primarily by means of the switch to pension adjustments on the basis of trends in net earnings and further amendments of benefits legislation. At the same time the pension legislation of the Federal Republic is introduced in the new Länder, and the finances of the pension insurance funds in western and eastern Germany are combined.
January 30	In its 1992 Annual Economic Report, the Federal Government assumes that real GNP in the Federal Republic will grow by just over 2 % this year. As far as employment is concerned, it expects an average annual unemployment figure of about 3 million in the whole of Germany, with trends continuing to contrast in the two parts of the country.
February 14	The Bundesrat approves the "tax package" in the compromise version proposed by the mediation committee; it provides, inter alia, for the additional receipts deriving from the 1993-4 turnover tax increase being employed to increase the "German Unity" Fund and for the Länder Governments' share in turnover tax revenue being raised from 35 % to 37 %.

Changes in the net external position of the Bundesbank*

DM billion; increase in foreign exchange: +

Period	Net external position, total	Operations in the foreign exchange market 1: Total	Operations in the foreign exchange market 1: Deutsche Mark-dollar market	Operations in the foreign exchange market 1: EMS intervention and debt settlement 2	Other transactions: Total	Other transactions: Dollar interest income and dollar receipts from US troops	Other transactions: Official (net)	Other transactions: Other foreign exchange movements (net)
1990 Jan.	+ 1.0	– 0.1	– 0.1	–	+ 1.1	+ 1.5	– 0.9	+ 0.5
Feb.	+ 1.8	–	–	–	+ 1.8	+ 2.1	– 0.7	+ 0.4
March	– 1.3	– 1.5	– 1.5	–	+ 0.2	+ 1.5	– 0.8	– 0.5
April	+ 1.1	–	–	–	+ 1.1	+ 1.6	– 0.8	+ 0.2
May	+ 1.2	–	–	–	+ 1.2	+ 2.3	– 0.8	– 0.3
June	+ 1.3	–	–	–	+ 1.3	+ 1.3	– 0.6	+ 0.6
July	+ 0.6	– 1.5	–	– 1.5	+ 2.2	+ 1.8	– 0.4	+ 0.8
Aug.	+ 0.4	– 0.5	–	– 0.5	+ 0.9	+ 2.2	– 0.6	– 0.7
Sep.	+ 0.5	+ 0.3	–	+ 0.3	+ 0.2	+ 1.0	– 1.0	+ 0.2
Oct.	+ 1.8	+ 0.1	–	+ 0.1	+ 1.7	+ 1.7	– 0.6	+ 0.5
Nov.	+ 1.6	–	–	–	+ 1.6	+ 2.3	– 0.8	+ 0.1
Dec.	+ 0.9	–	–	–	+ 0.9	+ 1.5	+ 0.1	– 0.7
Total	+ 11.0	– 3.2	– 1.6	– 1.6	+ 14.1	+ 21.0	– 7.9	+ 1.0
1991 Jan.	+ 0.5	–	–	–	+ 0.5	+ 1.6	– 1.7	+ 0.6
Feb.	+ 1.1	+ 1.2	+ 1.2	–	– 0.1	+ 2.1	– 4.3	+ 2.2
March	– 8.8	– 2.2	– 2.2	–	– 6.6	+ 1.3	– 7.4	– 0.6
April	– 0.6	– 2.0	– 2.0	–	+ 1.4	+ 1.8	– 0.7	+ 0.3
May	+ 0.8	– 1.1	– 1.1	–	+ 2.0	+ 2.5	– 0.9	+ 0.3
June	+ 0.4	– 0.4	– 0.4	–	+ 0.7	+ 1.4	– 0.6	– 0.1
July	+ 0.4	– 0.8	– 0.8	–	+ 1.2	+ 1.6	– 0.7	+ 0.4
Aug.	+ 2.1	– 0.2	– 0.2	–	+ 2.4	+ 2.3	– 0.7	+ 0.8
Sep.	+ 0.9	–	–	–	+ 0.9	+ 1.2	– 0.6	+ 0.3
Oct.	+ 0.6	–	–	–	+ 0.6	+ 1.6	– 1.3	+ 0.2
Nov.	+ 3.3	–	–	–	+ 3.3	+ 2.2	– 0.7	+ 1.9
Dec.	– 0.5	–	–	–	– 0.5	+ 1.4	– 0.9	– 0.9
Total	+ 0.3	– 5.6	– 5.6	–	+ 5.9	+ 20.9	– 20.4	+ 5.4
1992 Jan.	+ 1.6	–	–	–	+ 1.6	+ 1.2	– 1.0	+ 1.3
Feb.	+ 1.1	–	–	–	+ 1.1	+ 2.0	+ 0.9	+ 0.0
March	+ 2.5	–	–	–	+ 2.5	+ 1.1	– 0.7	+ 2.1
1st qtr	+ 5.2	–	–	–	+ 5.2	+ 4.3	– 2.6	+ 3.4

* Transactions recorded according to the date of entry. — **1** Including operations by other central banks, where they affect the external position of the Bundesbank. — **2** Debt settlement: Deutsche Mark repayments to the Bundesbank by EMS partners.
Discrepancies in the totals are due to rounding. BBk

Tight monetary policy strengthens confidence in the Deutsche Mark

The exchange rate trend of the Deutsche Mark was exposed to contrasting influences in 1991. It was adverse factors, such as adjustment frictions in the east German economy and the resulting large financing claims on the government budget, that predominated up to the middle of the year. Another factor was the Deutsche Mark's relationship to the US dollar, whose strength in association with the Gulf crisis was given an additional boost later in the first half of the year by the initially optimistic expectations for the US economy. At the same time, the deterioration of the price climate in Germany began to have other adverse effects on the Deutsche Mark. During this period the Deutsche Mark depreciated rapidly against the US dollar and also lost ground within the European Monetary System. Then in the summer the trend was reversed. The first successes in adjustment in eastern Germany appeared to warrant more confidence, and tighter interest rate policy strengthened confidence in the Bundesbank's stance on stability. At the same time, the US dollar came under pressure as it emerged that expectations of an early upswing in the United States were unrealistic. In the course of the second half of 1991 the Deutsche Mark firmed significantly again as a result. However, repeated periods of weakness showed how vulnerable the German currency is to unfavourable news and what a role assessments of the US dollar play in this. In the end, the external value of the Deutsche Mark against the currencies of 18 industrial countries at the end of 1991 was just below the comparable figure for the previous year. Since then, the nominal external value of the Deutsche Mark has depreciated slightly, largely because of the appreciation of the US dollar following the publication of more favourable data on the US economy. In view of domestic and foreign price rises, the average – real – external value of the Deutsche Mark during the first quarter of 1992 was thus approximately 1 % lower than a year before.

4. Monetary policy remains geared to fighting inflation

(a) Further tightening of the monetary policy stance

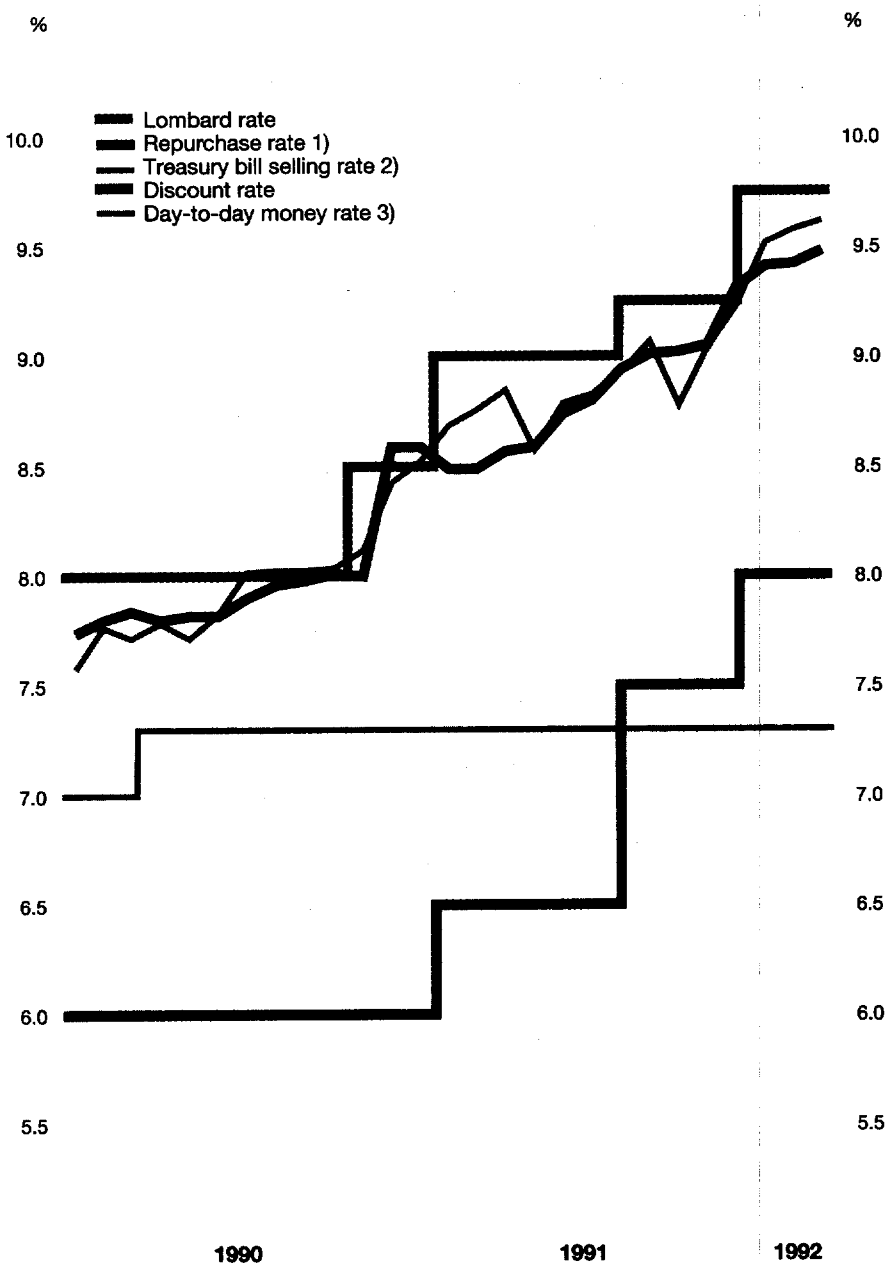
Divergent basic conditions for the Bundesbank and many partner central banks

As already described in the sections above, as a result of German unification the Bundesbank was operating in 1991 in an economic environment which differed from that of most other central banks. The west German economy once again grew vigorously under the impact of exceptionally strong demand stimuli from eastern Germany. More importantly, however, domestic cost and price rises gathered pace as the year progressed, and the Deutsche Mark tended to be weak for a while in the exchange markets. Against this background, the Bundesbank adhered to its tight policy stance. Abroad, by contrast, the economic recovery expected in many quarters was delayed, with recessionary trends even gaining the upper hand in some cases. At the same time, inflation problems tended to recede into the background in a number of countries. In the financial sector, too, the major central banks were faced with divergent challenges. In some major countries, excess indebtedness of borrowers, price slumps in the property and stock markets and the contraction of banks' capital base – in part belated consequences of earlier deregulation measures – led to bank lending and non-banks' demand for credit, as well as the growth of monetary aggregates and overall demand, being depressed. In this situation, central bank policy makers in some countries felt a particular responsibility for ensuring the stability of the financial system and the reinvigoration of the domestic economy. In Germany such disruptive factors – some of which constituted a correction of previous distortions – were of no relevance. The financial sector remained remarkably resilient. Lending by the banking system was very buoyant virtually throughout 1991. From mid-year onwards the money supply grew more rapidly than was acceptable over the medium term, despite the high level of interest rates. Liquidity in the economy, already very ample, consequently increased further.

Combating inflation in the interests of the world economy, too

Given the different economic policy challenges facing individual countries, the goal of non-inflationary growth generally accepted in the context of international cooperation did not allow a uniform policy geared to a global interest rate reduction to be pursued last year. Instead, each country had to try "to keep its own house in order", in line with its own specific needs, and thus to contribute to improving global underlying conditions. The communiqué published after the meeting of the Finance Ministers and Central Bank Governors of the seven major industrial countries in New York last January expressly reaffirmed the perception that the monetary policy makers in the individual countries must take the entire background into consideration, and that the specific mix of fiscal, monetary and structural policy is bound to vary, depending on the circumstances in each country. In the framework of the European Monetary System (EMS), the Deutsche Mark's "anchor function" called for particular efforts to be made to maintain monetary stability in Germany. Otherwise, the orientation towards stability in the EMS as a whole might be jeopardised and European monetary integration thus suffer a setback. From the European point of view, too, it was therefore essential to ensure that measures to combat inflation were taken wherever they were necessary.

Interest rates of the Bundesbank and day-to-day money rate



1) Average monthly interest rate for one-month securities repurchase agreements; uniform allotment rate (fixed-rate tenders) or weighted allotment rate ("US-style" variable-rate tenders).- 2) Normally for 3 days.- 3) Monthly averages.

BBk

Interest rates raised three times during the year

In 1991 the Bundesbank tightened its monetary policy stance in three steps. After official interest rates had remained relatively stable for about one year, the Bundesbank linked up again with the rising trend in interest rates which had emerged as early as mid-1988. With effect from February 1, 1991 the discount and lombard rates were raised by ½ percentage point each, to 6.5% and 9%, respectively. Further increases followed, from August 16 (to 7.5% and 9.25%, respectively) and December 20 (to 8% and 9.75%, respectively). As a result, these official rates reached the highest level recorded since the Second World War, if the special lombard rate applied at times in the seventies and eighties is disregarded. By these measures the Bundesbank responded to the increased risks posed to price stability. In the light of the sharp monetary expansion, it was essential to prevent permanently higher inflation expectations from arising on account of the adopted wage and fiscal policy stance and the faster pace of inflation – expectations which would have become ever more difficult and costly to restrain. Against this background, the Bundesbank had above all to seek to reduce the high level of liquidity in the economy. The interest rate increase in December, in particular, was designed to help bring monetary growth, which had accelerated further towards the end of the year, back on to the potential-oriented path. The interest rate increases in February and August were also of a "technical" nature. Thus, the raising of the lombard rate was aimed at regaining scope for flexible money market management after short-term money market rates and the rates applied to securities repurchase agreements had closely approached the level of the lombard rate. The concomitant heavy recourse by banks to lombard borrowing had impeded central bank money management by the Bundesbank. The raising of the discount rate was intended to bring it more into line with the other official interest rates and market rates and to reduce its "subsidy nature".

Central bank money provided primarily through securities repurchase agreements

In the context of its ongoing money market management, the Bundesbank mainly relied last year on revolving securities repurchase agreements concluded with banks. Rediscount credit, which temporarily increased in importance after the implementation of intra-German monetary union in mid-1990, accounted for about one-third of central bank lending. Other shorter-term assistance measures and the banks' lombard borrowing (whose significance increased only briefly in January, August and December, in connection with distortions in the pattern of money market rates) played a less prominent part again. In the course of 1991 the volume of securities repurchase agreements outstanding mounted by almost DM 30 billion to DM 145.1 billion, and thus faster than the banks' growth-induced central bank money requirements; their share in the total funding of the banking system increased to almost two-thirds. This form of flexible open-market policy has thus become the predominant channel through which central bank money is provided.

"Normalisation" of the funding of east German banks

One of the factors contributing to the rapid expansion of securities repurchase agreements last year was that the Bundesbank gradually brought the funding of east German banks into line with the arrangements applying to west German banks. This was done mainly by successively transforming the refinancing quotas, which had initially been used to grant access to central bank credit (on a highly simplified basis), into "normal" rediscount quotas in terms not only of their utilisation and computation but also of their overall volume. With effect from February 1, 1991, utilisation of the refinancing quotas for discounting bank promissory notes was limited to not more than two-thirds, while east German banks were at the same time admitted to securities repurchase agreements. From July 1, 1991 the Bundesbank reduced the refinancing quotas to DM 18 billion (from originally DM 25 billion) and limited the maximum utilisation for discounting promissory notes to one-half of the individual quotas. In December, the Central Bank Council decided to cut the refinancing quotas further, to DM 10 billion, from January 2, 1992. This primarily affects those banks in eastern Germany which are in the course of being wound up and conduct virtually no new business with non-banks. Their quotas will be completely cancelled from July 1, 1992. For the other, fully operational, banks the cut was smaller, but the method used for computing their quotas was brought more into line with west German standards, and the utilisation of the refinancing quotas for discounting bank promissory notes was limited to one-quarter.

Monetary developments*

Change during year 1

Item	1985	1986	1987	1988	1989	1990	1991
	DM billion						
A. Central bank money requirements of banks and liquidity policy measures by the Bundesbank 2							
1. Provision (+) or absorption (–) of central bank balances by							
Rise in central bank money 3 (increase: –)	– 6.6	– 13.1	– 15.5	– 18.6	– 9.4	– 29.6	– 20,2
Foreign exchange movements (excluding foreign exchange swaps and repurchase agreements)	– 0.7	+ 8.7	+ 38.7	– 30.6	– 20.0	+ 9.9	+ 1,1
Cash transactions of the central and regional authorities at the Bundesbank (including shifts of Federal balances under section 17 of the Bundesbank Act)	– 4.2	– 0.2	+ 1.8	+ 2.3	– 2.2	– 16.2	+ 9,7
Transfer of the Bundesbank's profit to the Federal Government	+ 12.9	+ 12.7	+ 7.3	+ 0.2	+ 10.0	+ 10.0	+ 8,3
Other factors	– 14.0	– 8.0	– 8.9	– 8.3	– 11.4	– 15.0	– 19.0
Total 1	– 12.5	+ 0.0	+ 23.3	– 54.9	– 32.9	– 40.8	– 20.1
2. Liquidity policy measures							
Change in minimum reserves 4	+ 0.1	+ 7.4	– 6.1	+ 0.2	– 0.1	– 0.2	– 0.1
Change in refinancing facilities	+ 3.3	– 5.6	– 7.6	+ 0.4	+ 7.5	+ 25.2	– 7.6
Open market operations (with non-banks, in "N paper" – excluding short-term sales of Treasury bills – and in long-term securities)	+ 0.1	+ 1.4	– 1.0	+ 0.4	– 0.4	– 0.3	+ 1.5
Securities repurchase agreements	+ 16.5	– 9.5	– 5.5	+ 50.4	+ 26.7	+ 13.3	+ 29.8
Other assistance measures in the money market 5	+ 0.6	+ 1.5	– 2.3	+ 0.4	+ 0.2	+ 1.0	+ 0.8
Total 2	+ 20.6	– 4.8	– 22.5	+ 51.8	+ 33.9	+ 39.0	+ 24.3
3. Remaining deficit (–) or surplus (+) [1 plus 2]	+ 8.1	– 4.8	+ 0.8	– 3.1	+ 1.0	– 1.8	+ 4.2
covered or absorbed by:							
Recourse to unused refinancing facilities (reduction: +)	– 3.1	+ 4.2	+ 0.1	+ 0.9	– 0.5	– 0.5	– 2.0
Raising (+) or repayment (–) of lombard or special lombard loans	– 5.0	+ 0.6	– 0.9	+ 2.2	– 0.6	+ 2.3	– 2.3
	%						
B. Key monetary indicators							
Money stock M3 6	+ 5.2	+ 7.2	+ 6.5	+ 6.9	+ 4.5	+ 5.5	+ 6.2
Money stock M3 extended 7	+ 4.8	+ 7.3	+ 6.1	+ 7.5	+ 8.5	+ 7.9	+ 7.4
Lending by banks and the Bundesbank to domestic non-banks	+ 5.2	+ 4.1	+ 4.1	+ 6.3	+ 5.7	+ 7.4	+ 10.1
	DM billion						
C. The money stock and its counterparts							
Money stock M3 [= 1 plus 2 less 3 less 4 less 5]	+ 45.4	+ 65.7	+ 62.6	+ 76.1	+ 66.4	+ 66.7	+ 95.6
Counterparts in the balance sheet							
1. Volume of credit 8	+ 98.1	+ 81.7	+ 87.0	+ 138.2	+ 135.8	+ 222.4	+ 287.3
of which							
Bank lending to domestic non-banks	+ 100.6	+ 77.8	+ 89.8	+ 137.6	+ 136.3	+ 222.6	+ 287.1
– to enterprises and individuals 9	+ 48.5	+ 39.9	+ 38.6	+ 69.5	+ 92.2	+ 145.0	+ 207.2
– to the housing sector 10	+ 33.2	+ 33.7	+ 22.6	+ 26.6	+ 37.1	+ 36.0	+ 52.1
– to public authorities	+ 18.9	+ 4.2	+ 28.6	+ 41.5	+ 7.0	+ 41.6	+ 27.8
2. Net external assets 11	+ 30.0	+ 55.9	+ 53.2	– 5.2	+ 36.2	+ 48.9	– 7.2
3. Monetary capital	+ 75.0	+ 69.8	+ 70.7	+ 42.8	+ 110.2	+ 161.5	+ 155,0
of which							
Savings deposits at agreed notice	+ 11.2	+ 15.3	+ 9.7	– 5.7	– 7.9	+ 13.3	+ 0.0
Bank savings bonds	+ 10.4	+ 9.9	+ 9.8	– 0.2	+ 14.2	+ 24.1	+ 10.3
Time deposits and funds borrowed for four years and over	+ 34.5	+ 37.6	+ 43.1	+ 46.4	+ 38.7	+ 32.9	+ 32.1
Bank bonds outstanding 12	+ 9.3	– 4.7	– 2.0	– 5.8	+ 48.6	+ 76.9	+ 92.6
4. Central bank deposits of public authorities	+ 1.3	– 1.1	+ 3.5	– 1.1	+ 3.3	+ 12.3	– 6.4
5. Other factors	+ 6.5	+ 3.2	+ 3.4	+ 15.3	– 8.0	+ 30.9	+ 35.9

* Items A and C: until June 1990 former area of the Federal Republic, from July 1990 overall Deutsche Mark currency area; item B: until the end of 1990 former area of the Federal Republic, from 1991 overall Deutsche Mark currency area. — **1** Unless otherwise indicated, based on end-of-month figures. — **2** Based on daily averages of the last month of the period or the last month of the previous period, respectively. — **3** Currency in circulation (excluding banks' holdings of domestic notes and coins, which are deductible from the required minimum reserves) and required reserves on banks' domestic liabilities at current reserve ratios; changes in the required reserves resulting from changes in the reserve ratios are shown in item A. 2. — **4** Including changes in minimum reserves due to growth in reserve-carrying foreign liabilities. — **5** Bill-based repurchase agreements, short-term sales of Treasury bills, foreign exchange swaps and repurchase agreements, quick tenders and shifts of Federal balances under section 17 of the Bundesbank Act. — **6** Currency in circulation and sight deposits, time deposits for less than four years and savings deposits at statutory notice held at domestic banks, from 1986 as a monthly average (of five bank-week return days, end-of-month levels included with a weight of 50%). — **7** Money stock M3 extended to include Euro-deposits and short-term bank bonds held by domestic non-banks. — **8** Banks and the Bundesbank; including lending against securities. — **9** Excluding housing loans. — **10** Excluding lending against securities. — **11** Banks and the Bundesbank. — **12** Excluding banks' portfolios.
Discrepancies in the totals are due to rounding.

BBk

(b) The monetary target and its implementation

In view of the host of adjustment problems in eastern Germany after the inception of the monetary union, the Bundesbank continued to be guided in its ongoing monetary policy in the second half of 1990 by the monetary target set for western Germany. For 1991 it for the first time set an all-German monetary target, which provided for the money stock M3 throughout the currency area of the Deutsche Mark increasing by 4% to 6% between the fourth quarter of 1990 and the fourth quarter of 1991. By leaving the target unchanged from 1990, the Bundesbank demonstrated to those concerned at home and abroad that it intended to abide by its tight monetary policy stance in the enlarged currency area, which seemed imperative in the light of the emerging risks to price stability. Moreover, the Bundesbank documented in this way the continuity of its proven strategy of monetary targeting. At the same time, it did not fail to recognise the uncertainties surrounding any assessment of the demand for money and the economic potential of eastern Germany. The Bank therefore made it clear from the outset that it would continuously monitor the adjustment processes in eastern Germany and take them into account as required.

First all-German monetary target subject to particular uncertainties

In the course of the currency conversion in eastern Germany in mid-1990, Deutsche Mark balances equivalent to almost 15% of the west German money stock M3 were created. This was more than seemed consistent with stable prices over the long term. It was to be expected, however, that the oversupply of liquidity would be reduced quasi-automatically to an acceptable level as a result of funds being switched into long-term, higher-yielding assets, which were available for the first time. This portfolio adjustment process got off to a slow start, but accelerated sharply after the turn of 1990-91, when the transitional period for east German old giro savings accounts expired and they were converted into non-interest-bearing sight deposits on the west German model. The ratio of the east to the west German money stock M3, which of course can be estimated only roughly, declined markedly until the early summer of 1991. As this "normalisation process" of money-holding patterns in the new Länder progressed more rapidly than had been anticipated, all-German monetary growth was fairly subdued in the first half of 1991. The expansion of the money stock M3 ran mostly at the bottom end of or below the target range of 4% to 6%.

Moderation of monetary expansion in the first half of 1991 on account of portfolio adjustments in eastern Germany

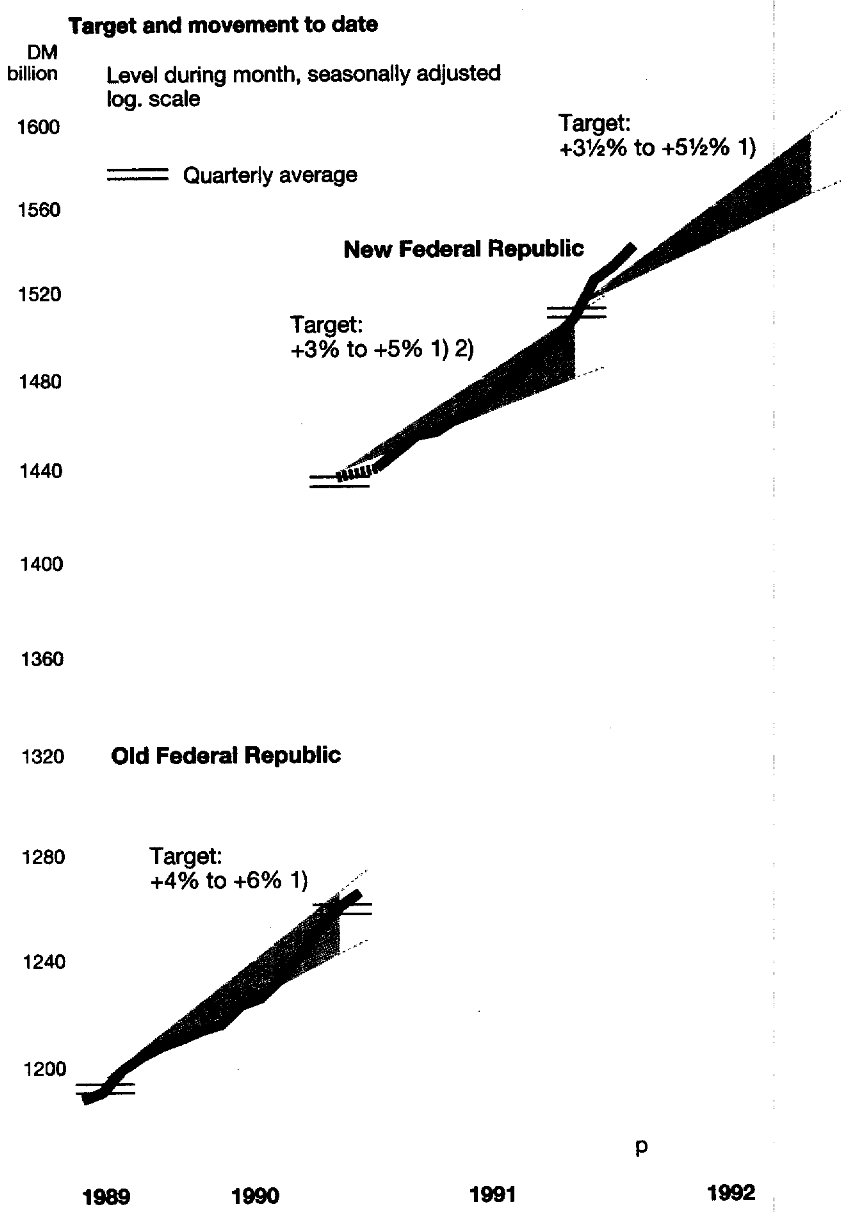
The Bundesbank tolerated this "undershooting" of monetary growth, which was attributable to a shift in the demand for money in eastern Germany rather than to insufficient growth in the west, as being consistent with its monetary policy objectives. Another significant factor was that, after the sharp downturn in output in eastern Germany, the original assumptions about the trend of production potential there turned out to be overly optimistic. For this reason, too, the monetary target set at the end of 1990 proved to be unduly high. On the occasion of its customary review of the monetary target in mid-year, the Central Bank Council therefore adjusted the target formulation and lowered the target range for the appropriate growth of the money stock M3 between the fourth quarter of 1990 and the fourth quarter of 1991 to 3% to 5%. This measure — which, in the light of the high degree of uncertainty prevailing in the first year after German unification, was anything but spectacular — did not imply any downward departure from the potential-oriented course or any tightening of the monetary policy stance.

Lowering of the target corridor on the occasion of the mid-year target review

After mid-year monetary growth accelerated despite the increase in the level of interest rates and the slackening of economic activity. In the second half of the year the money stock M3 expanded at twice the pace of the first half, and in the fourth quarter of 1991 it exceeded its average level twelve months earlier by 5.2%. The monetary target, which had been lowered in mid-year, was thus just

Faster monetary growth in the second half of the year; monetary target just met

Growth of the money stock M3 *



* Average of five bank-week return days; end-of-month levels included with a weight of 50 %.- 1) Between the 4th quarter of the preceding year and the 4th quarter of the current year.- 2) In accordance with the adjustment of the monetary target in July 1991.- p Provisional.

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met. Towards the end of the year, however, the rate of expansion was considerably higher than would be consistent with the aim of monetary stability in the somewhat longer run. The faster pace of monetary expansion after mid-year owed something to special influences which in particular caused the amount of currency in circulation to rise considerably at times. This may well have been due in part to the Deutsche Mark increasingly performing the function of a parallel currency in some central and east European countries. Another relevant factor was the hoarding of currency in the light of the planned revision of interest income taxation. These factors did not predominate, however. Thus, the sharp growth of currency in circulation slackened appreciably from November, when coalition plans to introduce a flat-rate tax, with large allowances, on residents' interest income (which tax will be deductible from the final tax liability) were publicised, while overall monetary expansion gathered further pace. In 1991 as a whole currency in circulation nevertheless went up more rapidly than would have been in keeping with the trend in interest rates and incomes. On the other hand, the trend in bank deposits, which are counted towards the money stock, followed the pattern typical of a period of high short-term interest rates. Specifically, the growth of high-yielding shorter-term time deposits was about as buoyant as a year before, while sight deposits, which bear virtually no interest, and low-interest savings deposits at statutory notice were only marginally higher at the end of 1991 than they had been a year earlier. In order to restrain switching out of savings deposits into assets carrying interest at market rates, the banks increasingly agreed to special terms for major savings deposits – terms which were geared to the conditions for comparable time deposits. They also offered some standardised special savings schemes. A more significant factor in the acceleration of monetary growth than the above-mentioned special influences was the expansionary impact of the banks' lending, particularly their lending to enterprises and individuals (for further details see page 49). Finally, monetary capital formation at banks slackened. One reason for this was the fact that the portfolio adjustment process in eastern Germany came to an end or was offset by expansionary influences. At all events, the money stock in the east – according to the evidence available – appears to have grown fairly vigorously in the second half of the year.

Liquidity remains ample; faster growth of Euro-deposits and of the extended money stock M3 once again

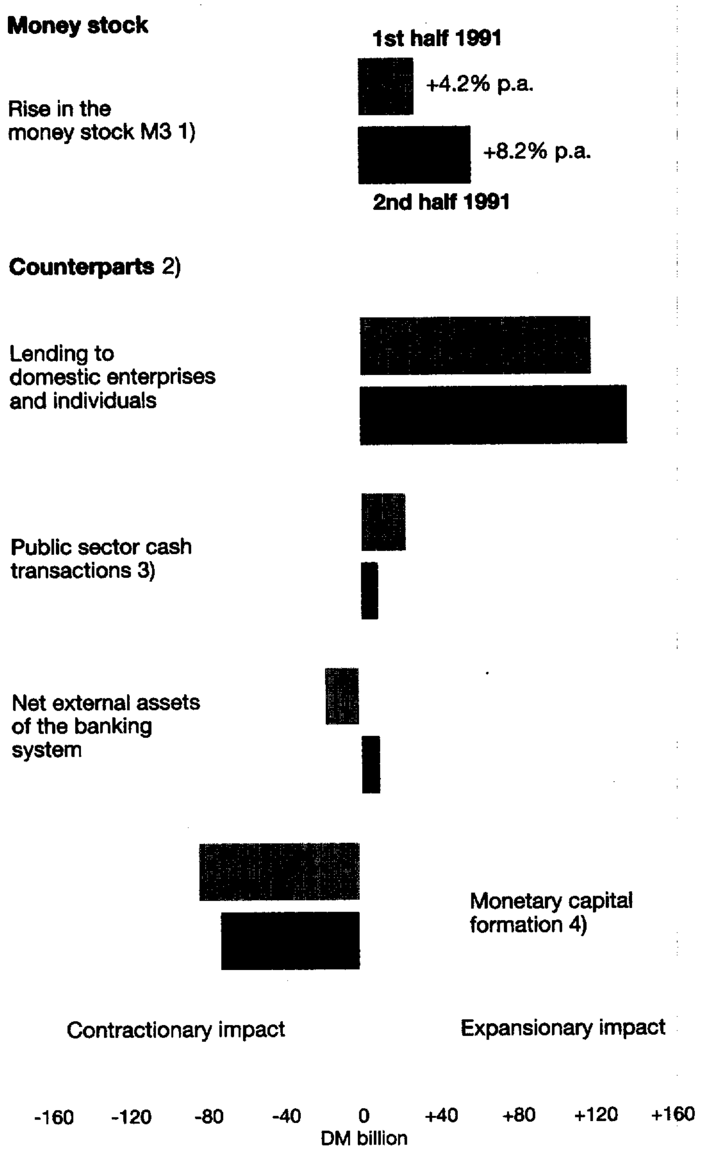
Given the remaining monetary overhang from the currency conversion and the strong monetary expansion last year, liquidity in the German economy must still be considered ample; at the end of 1991 the money stock, measured as a percentage of potential output, was markedly above its longer-term trend value. The same is true if the liquidity held outside traditional M3 is also taken into account, for domestic non-banks once again increased their financial investments abroad more rapidly than their domestic assets last year. In the course of 1991 the growth of the money stock M3, extended to include – in addition to the traditional money stock components – domestic non-banks' deposits at German banks' branches and subsidiaries abroad and short-term bank bonds, therefore outpaced that of the corresponding domestic aggregate by about 1 percentage point. Compared with the two preceding years, however, the propensity to invest funds abroad declined. Deposits at German banks abroad were enlarged by just over DM 19 billion last year, compared with DM 34.5 billion each year in 1990 and 1989.

The monetary target for 1992 and the reasons behind it

Against the backdrop of the increased threats to price stability, the Bundesbank reaffirmed its anti-inflationary policy stance in December 1991 by the announcement of its monetary target for 1992. According to this target, the Bank considers it appropriate for the money stock M3 to increase by 3½ % to 5½ % between the fourth quarter of 1991 and the fourth quarter of 1992. The slight increase in the level of the monetary target compared with the previous year's, which was lowered to 3 % to 5 % in mid-year, does not imply any relaxation of monetary policy. Instead, it reflects the fact that some special conditions obtaining in eastern Germany – such as the reduction of the excess supply of money in the wake of the currency conversion and the fall in east German production potential – have now decreased in significance. The Bundesbank was therefore able to revert to "more normal" conditions in setting its monetary target and to gear its guideline for the acceptable growth of the money stock to magnitudes deriving from periods prior to German monetary union. The macroeconomic benchmark figures on which the 1992 monetary target is based clearly reflect the continuity of the underlying monetary policy stance. In deriving the monetary target, a higher average annual growth rate of overall potential output than in 1991 was assumed, at 2¾ %, because potential output in eastern Germany is likely to pick up strongly this year after the fall in 1991. On the other hand, the assumed normative 2 % increase in the price level and the ½ percentage point trend fall in the "velocity

The money stock and its principal counterparts

Change in DM billion or %, seasonally adjusted



1) M3 as a monthly average.- 2) The changes in the counterparts as shown reflect their expansionary (+) or contractionary (-) impact on the money stock.- 3) Lending by the banking system to public authorities less public sector deposits at the Bundesbank.- 4) Monetary capital formation by domestic non-banks at domestic banks.

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of circulation" of the money stock M3 are in line with the Bank's long-standing strategy of steadying the monetary policy stance over the medium term. Finally, in view of the ample provision of liquidity at the end of 1991, the Bundesbank made a deduction in setting the target for the acceptable expansion of the money stock M3 in the course of 1992. The very ambitious price norm compared with current price forecasts, and the far higher current rate of monetary growth at the end of 1991 compared with the target rate of monetary expansion highlight the Bundesbank's determination to abide unchanged by its tight policy stance geared to price stability over the medium term. Monetary growth remained strong at the beginning of 1992. In January and February the money stock M3 exceeded its average level in the fourth quarter of 1991 by seasonally adjusted annual rates of 9% and 8½%, respectively. Its growth was thus markedly above the target corridor.

Persistently strong lending to the private sector

Monetary growth was mainly fuelled by strong private demand for credit last year. Bank lending to enterprises and individuals rose by DM 260 billion or 11½%; a similarly high rate of credit expansion in the old Federal Republic had last been seen at the beginning of the eighties. Towards the end of the year the pace accelerated further, in particular at the longer end of the market. Over the year as a whole, both short-term lending to trade and industry and longer-term loans expanded at double-digit rates; measured by the absolute figures, the focus was on medium and long-term direct lending, at DM 173.5 billion, despite the fact that bank interest rates were running at a high level by historical standards. In terms of borrowers, the credit expansion was likewise broadly based. Enterprises were in the forefront; their debt to the banking system went up by almost 15%. They had a considerable need for borrowed funds as their investment activity remained buoyant despite the slackening of economic growth in the course of the year, while at the same time their profitability and cash flow declined. Another factor of particular significance was the demand for credit associated with the economic restructuring of eastern Germany. This is suggested, firstly, by the relatively large share (of about one-ninth) of east German banks in lending by all domestic banks, and by the strong growth of lending to those sectors and industries in the new Länder where the downswing bottomed out faster than elsewhere, or which assumed a pilot function in the reconstruction process. Secondly, the east German economy registered a large inflow of loans from west German banks, many of which were granted under government-subsidised special lending programmes. Households, too, borrowed more heavily from banks in 1991 than in the preceding years. What is known as "consumer credit" expanded at a rate of over 13%, with the pace of growth increasing steadily during the year because households obviously failed to adjust their demand for consumer goods immediately to the slower growth of their real incomes. Moreover, the rise in consumer credit probably owed a great deal to the strong demand for passenger cars (also from the new Länder). Bank lending to the housing sector admittedly increased at a below-average rate, at 6%, but likewise more rapidly than before. This reflected, in particular, the increased demand in the field of rented housing construction, which employs comparatively more borrowed funds.

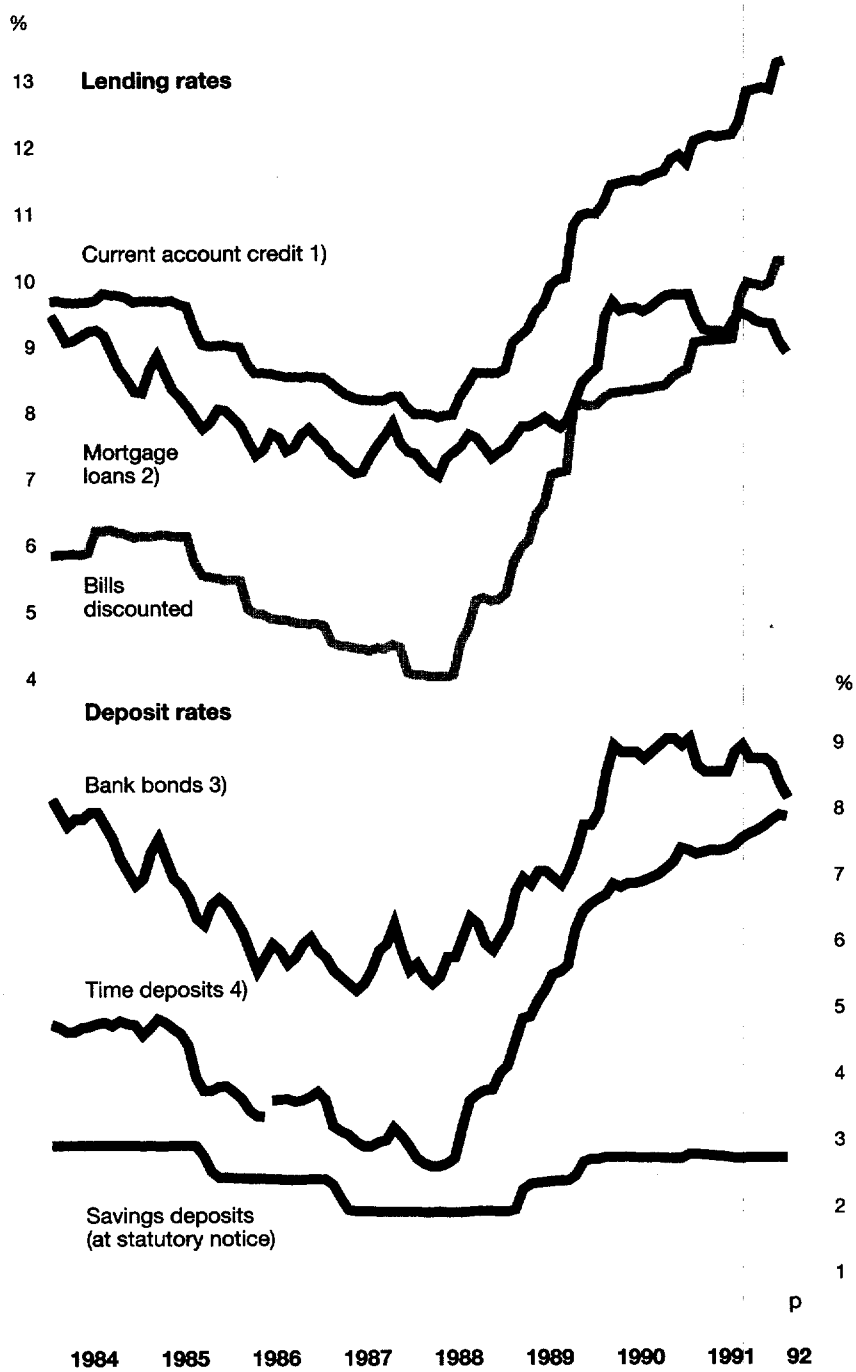
Demand for credit not perceptibly dampened by the high level of interest rates

Judging from the longer-term lending commitments, lending will probably continue to be strong. They do not suggest that the high level of interest rates is having any dampening effect. However, only short-term bank lending rates, which traditionally follow the movement of the Bundesbank's interest rates closely, continued to rise last year. The cost of credit in current account increased by 1 percentage point, that of bills discounted by 1⅓ percentage points. By contrast, long-term lending rates, which are more significant for investment decisions, eased somewhat in line with the movement of capital market rates. At the end of the year, mortgage loans secured by residential real estate with interest rates locked in for ten years cost ½ percentage point less than at the beginning. In many cases the continued high level of interest rates obviously constitutes no obstacle to capital expenditure as the interest burden is being reduced markedly by numerous government assistance measures, such as direct grants, tax relief and interest subsidies. This is especially true of corporate investment in eastern Germany. From the central bank's point of view, such subsidies pose some problems since they lessen the impact of monetary policy on the demand for credit.

Expansionary effect of public sector deficits on monetary growth

Public sector cash transactions likewise stimulated monetary growth last year. However, the higher budget deficits were accompanied only to some extent by a rise in borrowing from banks; at DM 28 billion, bank lending to the public sector was actually down on the year. On the other hand, public sector

Movements in selected bank interest rates *



* Since January 1991, including the rates in the new Länder.- 1) Under DM 1 million.- 2) Average effective rate for fixed-rate mortgage loans secured by residential real estate with interest locked in for 10 years.- 3) Yield on bonds outstanding.- 4) With agreed maturities of 1 month to 3 months inclusive and sums of DM 100,000 and over but less than DM 1 million; up to and including May 1986 under DM 1 million and maturities of 3 months.- p Provisional.

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deposits at the Bundesbank, which are not counted towards the money stock, were run down by DM 6.5 billion, whereas they had been stepped up sharply a year earlier. Most importantly, however, non-residents' purchases of public bonds, at DM 47 billion, were three times as large as in 1990. In the monetary analysis this is reflected in the net external assets of the banking system, together with other payment operations between domestic non-banks and non-residents.

Overall, external payments influenced monetary growth to only a minor extent in 1991. The net external assets of the banking system decreased by just over DM 7 billion. External payments had, however, a more marked impact on the pattern of monetary expansion over time. In the spring, when the Deutsche Mark was tending to be weak, outflows of funds predominated, and restrained monetary growth. By contrast, after mid-year, when investments in domestic assets became more attractive in the light of the strengthening of the Deutsche Mark in the foreign exchange markets and its growing interest rate advantage over dollar assets, inflows of funds were recorded on balance, and that gave an additional stimulus to monetary growth.

Fluctuating external influences on the money creation process

Taken by itself, longer-term financial asset formation at banks was quite impressive last year; domestic non-banks' monetary capital rose by DM 155 billion or almost 9½%. However, monetary capital formation no longer provided as crucial a counterweight to the impact of credit expansion on monetary growth as it had done in 1990. Especially in the second half of the year, when the banks actively sought to step up their lending business, it slackened appreciably. Temporary uncertainty about the outlook for interest rates and about interest income taxation contributed to this restraint on the part of investors, as did the tailing-off of portfolio adjustments in eastern Germany and the persistent unattractiveness of some savings instruments. Given the high level of capital market rates, the main emphasis of monetary capital formation was clearly on sales of bank bonds, which generated inflows of funds to banks totalling DM 92.5 billion. In view of the tightening of capital standards, the banks' capital and reserves were also increased substantially (by DM 20 billion). The amounts of funds accruing to banks on long-term time deposit accounts and from sales of bank savings bonds were comparatively small. Savings deposits at agreed notice, which continued to carry interest at well below-market rates in 1991, stagnated.

Level of monetary capital formation in 1991 high overall, but slackening in the second half of the year

5. The financial system highly resilient in the face of increased requirements

(a) Buoyant bond market

In 1991 the German capital market adjusted itself quite flexibly to the private and public sectors' heavy demand for credit, and coped with the additional financial burdens resulting primarily from German unification without any perceptible strains. Although the domestic non-financial sectors' financial asset acquisition decreased after the exceptionally steep rise in the previous year, it remained at a high level owing to households' strong propensity to invest. Overall, domestic households, public authorities and enterprises supplied the credit and capital markets with additional funds amounting to an estimated DM 350 billion. Liquid investments, especially high-yielding short-term time deposits, were once again built up strongly; at the same time, longer-term financial asset acquisition moved more into the forefront of interest. This is a clear token of confidence in the Deutsche Mark's stability and the Bundesbank's anti-inflation policy.

Productive capacity of the capital market as high as ever

In particular, the securities markets' share in financial asset acquisition continued to rise in 1991. Notably bonds were more in demand, while investments in shares rather tended to be neglected. In 1991 domestic non-banks invested a record amount in the domestic bond market, at DM 128 billion. In addition, they purchased foreign bonds worth DM 13 billion net. Above all in the first half of the year, when conditions in the capital market eased perceptibly and bond yields settled down at an attractive level, non-banks purchased large amounts of bonds. In the second half of the year, however, their buying lessened distinctly. At first, this was because of renewed

Domestic non-banks' bond market investments at a record level interest rate uncertainties and the discussion on the future taxation of interest income. But non-banks also showed restraint towards the end of the year, when these tensions had relaxed and the easing of interest rates had resumed. As far as can be seen, non-banks' investment behaviour was largely determined by households' operations. Non-banks cut back their purchases of shares last year (DM 22 billion net). These consisted mainly of direct investments abroad, most of which serve entrepreneurial purposes.

Non-residents' purchases of German bonds sky-rocket

Against the background of the Bundesbank's resolute anti-inflation policy, the high yield level in the German bond market also exercised a strong attraction for foreign investors. This was joined from mid-1991 onwards by a pronounced appreciation of the Deutsche Mark in the foreign exchange markets. Foreign investors increased their portfolios of German Deutsche Mark bonds by no less than DM 60.5 billion in 1991; this was about three times as much as in the preceding two years. In the second half of the year, in particular, non-residents increasingly bought German bonds, and thus counterbalanced domestic non-banks' waning interest. Besides traditional Federal bonds, non-residents mainly purchased new-style Federal Treasury notes, which were issued for the first time in May 1991; roughly one-half of the Federal Treasury notes in circulation were in foreigners' portfolios at the end of 1991. By contrast, non-residents invested only small amounts in the German share market in 1991 (DM 1.5 billion net).

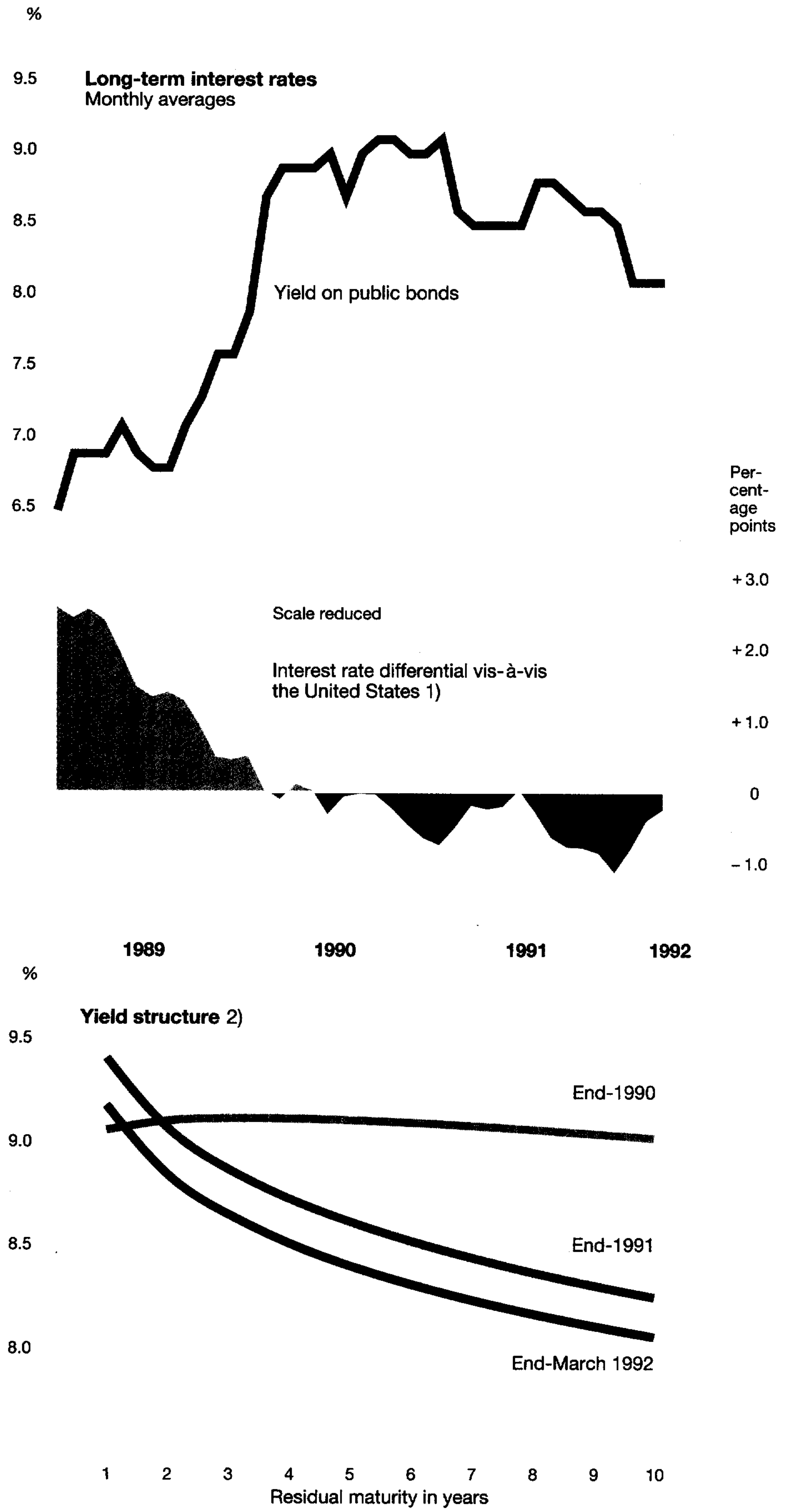
Decline in yields at the beginning of 1991, followed by a firming of interest rates

During 1991 the movement of interest rates in the domestic bond market was subject to varying domestic and external influences, but over the year as a whole a downward trend in interest rates prevailed. At the beginning of the year the bond market was initially in bullish mood against the backdrop of strong tendencies towards a downward movement of interest rates emanating from foreign financial centres. The raising of the Bundesbank's discount and lombard rates by ½ percentage point each from February 1, 1991 contributed substantially to the decline in capital market rates. By mid-February the yield on public bonds outstanding had fallen by ¾ percentage point within only a few weeks and it then settled down within a narrow band around 8½%. The capital market climate in Germany clouded over temporarily around mid-year, and bond yields rose to almost 9% up to the end of July. On the one hand, this quick change in sentiment was caused by the unexpectedly sharp increase in consumer prices. On the other, it reflected market participants' response to the ruling of the Federal Constitutional Court on the taxation of interest income, which was announced at the end of June 1991 and which at the time appeared to warrant expectations of an increase in the taxation of such income.

Sustained easing of interest rates during the second half of the year

In the second half of the year capital market rates tended to fall, with fluctuations. The main reason for this was, at first, that the downward trend in global interest rates resumed. The interest rate differential between long-term German and US Government bonds, which had largely disappeared in mid-1991, had widened again to about 1¼ percentage points by the end of the year. The trend towards an appreciation of the Deutsche Mark against the US dollar made purchases of Deutsche Mark bonds appear increasingly attractive in foreign investors' eyes, also on exchange rate grounds. The coalition government's decision to revise the taxation of interest income, which was felt to be quite favourable to the capital market (especially the planned high exemption limits and foreign investors' exemption from the future interest income deduction), gave a new stimulus from November to the downward trend in interest rates, which had been faltering at times. Much the same applies to the interest rate policy measures taken by the Bundesbank in August and December 1991, which strengthened investors' confidence in the stability of the Deutsche Mark. The yield on public bonds outstanding fell to 8% at the end of January 1992 and thus regained the level of early 1990, immediately

Interest rate movements in the bond market



1) Yields on ten-year US Treasury bonds less yields on ten-year Federal bonds in Germany; values of a yield curve. 2) Regression curves for Federal bonds, adjusted for coupon effects.

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before the announcement of the monetary union with the then GDR. Thereafter, bond interest rates edged up again in line with trends in foreign financial centres; at the end of March public bonds were yielding about 8¼ %.

Yield pattern increasingly inverse

Trends in the yield pattern reflected the effects of monetary policy even more markedly than did the downward tendencies in capital market rates. Whereas virtually no maturity-based yield differential between short and long-term Federal bonds was to be seen at the beginning of 1991, in the course of the year the interest rate pattern became increasingly inverse as money market rates went up. At the beginning of 1992 one-year Federal bonds were yielding a good 1 percentage point more than long-term paper. This markedly inverse yield pattern is probably an indication of the fact that the Bundesbank's resolute anti-inflation policy, which is reflected, inter alia, in the high level of money market rates, has strengthened investors' confidence in the longer-term stability of the Deutsche Mark and has lowered the risk premium which is included in the long-term interest rate in the light of the imponderables involved in the process of German unification. The statistical real rate of interest, i.e. the difference between the observed capital market yield and the current inflation rate, likewise fell perceptibly in the course of the year; in January 1992 it came to about 4 %, compared with over 6 % a year before.

Level of borrowing in the bond market remains high

In 1991 the German bond market provided domestic and foreign issuers with funds totalling DM 243.5 billion, or just as much as in the previous year. The borrowing pattern also changed but little. Issues by banks (DM 131.5 billion net) continued to predominate, in particular bonds launched by specialised banks (DM 59 billion net), the proceeds of which were mainly devoted to restructuring the east German economy. "Other" bank bonds and communal bonds, which were long disregarded (DM 46.5 billion and DM 21.5 billion, respectively), were also issued on a fairly large scale in view of the massive borrowing requirements of the business community and the government. The public sector drew even more heavily on the bond market by launching issues of its own (DM 87 billion net) than it had done in 1990. DM 51 billion of this sum accrued to the Federal Government, which adjusted its debt management to the increase in borrowing requirements and to investors' needs. The Federal Government improved the marketability of its paper by means of the large volumes of these issues, and it created – in the shape of its new-style Federal Treasury notes – an attractive investment opportunity in the medium-term maturity category for domestic and foreign institutional investors. Finally, in 1991 the Federal Government placed some large-scale nssues "unobtrusively" in the context of market regulation operations. In 1991 the "German Unity" Fund raised a total of DM 17.5 billion in the bond market; the sum taken up by the Federal Railways and the Federal Post Office, lumped together, came to DM 10.5 billion. The Länder Governments increased their bonded debt by DM 7.5 billion.

Remarkable upswing of DM commercial paper

After the abolition of the issue authorisation procedure (pursuant to sections 795 and 808a of the German Civil Code), which came into effect on January 1, 1991, a market emerged in Germany for DM commercial paper and soon underwent a remarkable upswing. This trend reflected, on the one hand, some well-known enterprises' efforts to meet part of their short-term financial requirements flexibly and at low cost by issuing money market paper. On the other hand, this paper constitutes an attractive alternative investment for large-scale institutional investors, in particular; since no minimum reserves are called for, and because of the inverse pattern of interest rates, such paper seems to be worthwhile in relation both to short-term bank deposits and to longer-dated bonds. By February 1992 the overall volume of the programmes launched had risen to DM 24.5 billion. In the second half of 1991 roughly one-half of the framework agreements was accounted for on average by the

Sales and purchases of bonds*

DM billion

Period	Sales: Total	Domestic bonds 1: Total	of which: Bank bonds	of which: Public bonds	Foreign bonds 2: Total	of which Investment fund units	**Memo item** Balance of transactions with non-residents 3
1980	52.5	45.2	41.5	4.9	7.3	– 0.1	– 7.0
1985	103.4	76.1	33.0	42.7	27.4	– 0.1	+ 4.1
1986	103.8	87.5	29.5	57.8	16.3	– 0.1	+ 42.8
1987	113.3	88.2	28.4	59.8	25.2	0.4	+ 9.8
1988	102.8	35.1	– 11.0	46.2	67.7	13.1	– 65.7
1989	125.5	78.4	52.4	25.6	47.1	6.3	– 24.3
1990	244.4	220.3	136.8	83.6	24.0	– 1.1	– 3,7
1991	243.4	219.3	131.7	87.0	24.0	11.3	+ 36.3
1st qtr	73.0	66.9	43.4	23.1	6.1	2.4	– 0.5
2nd qtr	52.3	42.1	30.0	11.7	10.2	2.8	– 2.1
3rd qtr	57.7	53.0	28.7	24.2	4.7	5.4	+ 13.2
4th qtr	60.4	57.3	29.5	27.9	3.1	0.7	+ 25.8

Period	Purchases: Total	Residents: Total	Banks (incl. the Bundesbank) 4	Non-banks 5: Total	Domestic bonds	Foreign bonds	Non-residents 2
1980	52.5	52.2	19.1	33.1	29.1	4.0	0.3
1985	103.4	72.0	32.5	39.4	15.9	23.6	31.5
1986	103.8	44.7	32.4	12.3	– 0.3	12.6	59.1
1987	113.3	78.4	43.6	34.7	11.3	23.4	35.0
1988	102.8	100.8	34.6	66.3	2.9	63.4	2.0
1989	125.5	102.7	14.7	88.0	46.6	41.4	22.8
1990	244.4	224.1	89.4	134.7	122.6	12.1	20.3
1991	243.4	183.0	42.3	140.7	127.8	12.9	60.4
1st qtr	73.0	67.5	10.2	57.3	52.4	4.9	5.5
2nd qtr	52.3	44.2	6.3	37.8	30.6	7.3	8.1
3rd qtr	57.7	39.9	11.2	28.6	25.9	2.7	17.8
4th qtr	60.4	31.5	14.6	16.9	18.9	– 2.0	28.9

* Including foreign investment fund units, which are incorporated in foreign bonds. From July 1990 including eastern Germany. – **1** Net sales at market values plus/less changes in issuers' holdings of their own bonds. – **2** Transaction values. – **3** Purchases of domestic bonds by non-residents less sales of foreign bonds and investment fund units to residents; – = capital exports, + = capital imports. – **4** Book values; statistically adjusted. – **5** Residual.
Discrepancies in the totals are due to rounding. BBk

issue of such paper. At the end of 1991 the maturities of this paper were concentrated in the not-too-large market segment of one month to one year.

Stagnation of foreign DM bonds

In 1991 the market for foreign Deutsche Mark bonds benefited only a little from the favourable investment conditions in the German bond market. At DM 33 billion (nominal value), gross sales ran at the level of the two preceding years. After deduction of redemptions, net sales came to DM 18.5 billion; about one-half of this sum was placed in the domestic market. The fact that the amount raised was rather small on a somewhat longer-term comparison may owe something to international issues increasingly having been denominated in ECUs in recent years. Moreover, for Deutsche Mark assets, investors have preferred domestic bonds which are launched exclusively by debtors of excellent financial standing and which are marked by a high degree of liquidity, especially in the case of Federal Government bonds.

Investment fund units more in demand again

In 1991 German investment funds (those open to the general public) got back into their stride after the marked setback of the previous year. Overall, they received investible funds totalling DM 13.5 billion net, against DM 8 billion in 1990. The additional resources flowed mainly to the bond-based funds, which sold units amounting to DM 8.5 billion, while the share-based funds, at DM 3 billion, barely regained last year's level. Thus domestic investment funds open to the general public coped with the recent period of high capital market rates better than they had done in comparable interest rate periods at the beginning of the eighties and in the middle of the seventies, when investors on balance resold investment fund units in the light of attractive direct purchases in the bond market. This more favourable response to saving instruments offered by investment companies is not least due to the flexible product policy of the companies, in the form, for instance, of the introduction of funds with limited maturities (known as "maturity funds"). The increase in charges in the case of "direct" purchases of bonds, especially by retail investors, probably also contributed to this. With inflows of DM 24 billion, domestic specialised funds once again proved to be the growth sector of investment fund business in 1991. Foreign investment fund units to the value of DM 11.5 billion were sold in the German market. The major part of this sum was made up of the units of Luxembourg-based Deutsche Mark funds which, in the light of the high level of short-term interest rates, mainly invest in securities with money-market-related maturities.

(b) Subdued trends in the share market

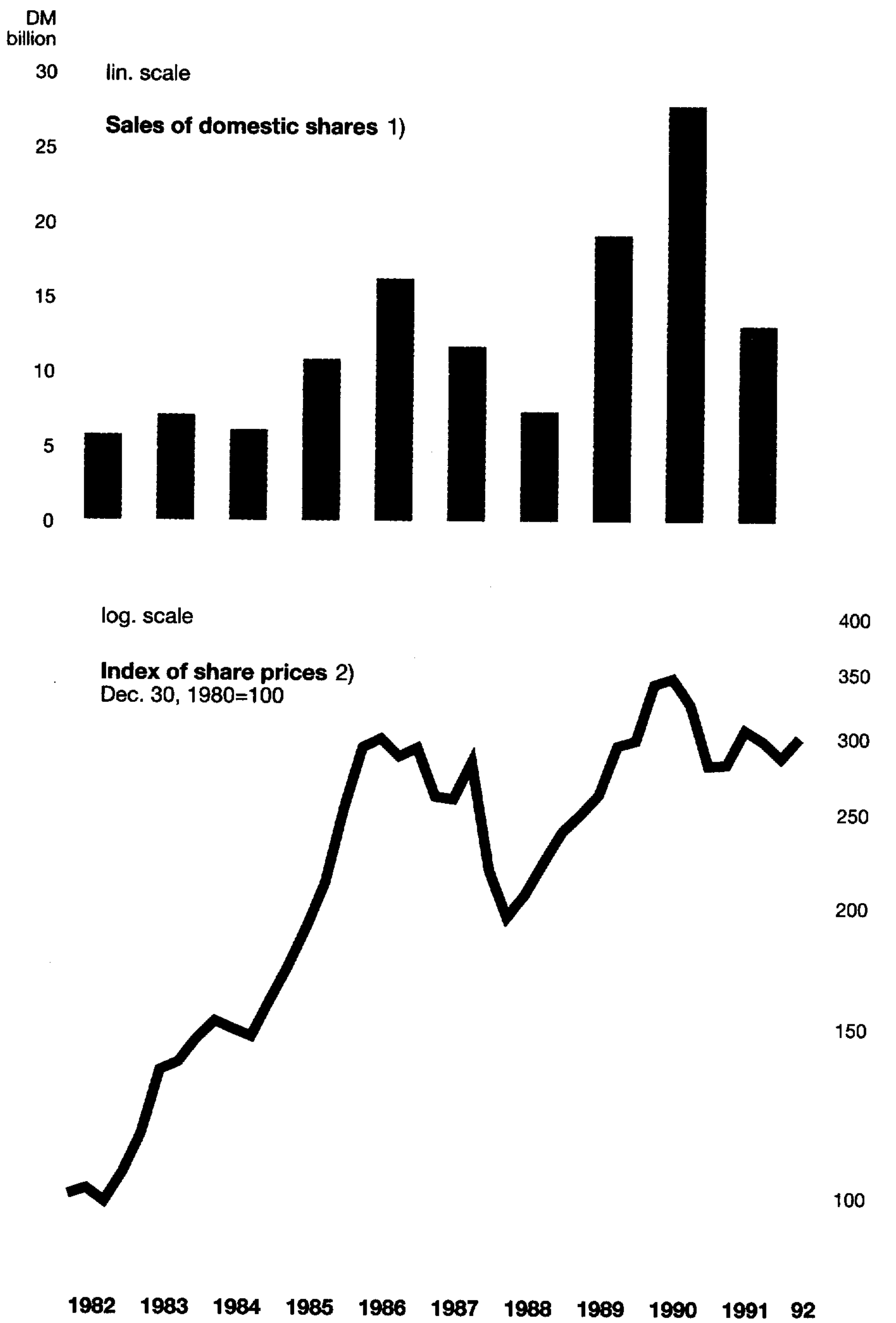
Price movements marked by global political influences and clouded earnings prospects

1991 was a year of disillusionment for the German share market. Share prices failed to recover lastingly from their nosedive in the late summer of 1990, and sales of new shares fell markedly after the high figures recorded in the preceding two years. The start of the new stock market year was overshadowed worldwide by the smouldering tensions in the Gulf. In mid-January 1991 average share prices in Germany were 30 % below their all-time peak of July 1990. Tensions in the financial markets relaxed on the outbreak of war in the Gulf and in the light of the associated expectations of the success of the allied troops. As a result of heavy turnover and the substantial participation of domestic investors, more than one-third of the losses previously sustained in the German share market were made good within a few weeks. In the ensuing period the upsurge in prices increasingly lost momentum. With major fluctuations, prices reached their peak for the year in mid-June. In the second half of 1991 share prices came under pressure. This was mainly due to adverse domestic factors, such as the temporary tightening of interest rates in the bond market and the clouded earnings prospects of German enterprises in connection with the high wage and salary increases and the economic slowdown in western Germany. On August 19, 1991 the attempted coup d'état in the former USSR caused the German share market to suffer a daily loss of almost 10 %. Although the price losses were quickly offset once conditions had returned to normal, the downturn, which was sharp by international standards, once again highlighted the special structural features of the German market, viz. its heavy dependence on non-residents and its comparatively small size. Around the turn of 1991-2 price movements were increasingly caught in the wake of a strong upswing on the New York Stock Exchange, where prices reached all-time highs on several occasions. In addition, the simultaneous relaxation of interest rates in the domestic bond market acted as a stimulus. At the end of March average German share prices were 6 % higher than at the beginning of 1992, but 17½ % lower than at their peak of July 1990.

Marked decline in borrowing

In view of the clouded earnings prospects and the unfavourable price trends in the second half of the year, investment financing through the issue of shares seems to have become less attractive in 1991. In that year German enterprises

Conditions in the share market



1) At issue prices.- 2) Quarterly averages; source: Federal Statistical Office.

BBk

sold new shares to a market value of only DM 13.5 billion, compared with DM 28 billion and DM 19.5 billion, respectively, in the two preceding years. This means that the longer-term trend towards a decline in the significance of the organised capital markets for corporate financing, which trend had been interrupted in the second half of the eighties, resumed. Last year 19 enterprises, happily including (for the first time) one from eastern Germany, initially applied for stock exchange listing. In contrast to their diminishing significance as financing instruments, shares continued to play a major role in the establishment and extension of cross-border corporate ties in 1991. German enterprises' direct investment abroad in the form of share purchases alone amounted to DM 17.5 billion (net) last year. By contrast, non-residents bought only DM 1.5 billion (net) of German equities. There are similar differences if one compares the aggregate direct investment of residents and non-residents.

(c) The German stock market in a period of radical change

German Financial Futures and Options Exchange buoyant

The measures taken by Parliament in the past few years to reform the German stock market bore fruit in 1991. In the second year of its existence the German Financial Futures and Options Exchange achieved some notable successes. With sharply increased turnover and an extended range of products, it has become an integral part of the German capital market. At the same time, it was able to hold its ground, and in part improve its position, in competition with other European financial futures exchanges. Thanks to the successive introduction of new futures and options contracts, it is now able to offer a broad range of internationally familiar derivative financial products. As far as options are concerned, the German Financial Futures and Options Exchange is meanwhile the exchange with the largest turnover in Europe. Through the variety of its product range and its trading activity it makes a major contribution to the attractiveness of the financial centre Germany. It remains to be seen whether this will be accompanied by a comparable strengthening of the German capital market in its important function, in macroeconomic terms, of being a reservoir of savings and a source of long-term funding.

Effective financial market supervision as a "hallmark of quality"

The financial system "lives" on market participants' confidence in its soundness and viability. A stable currency and a regulatory framework based on the free market system are just as indispensable in this context as effective government supervision of the financial markets and their institutions. In Germany this supervision rests mainly on three pillars, viz. the legally-based and institutionalised supervision of banks and insurance enterprises by Federal authorities, the Länder Governments' legal supervision of the stock markets, and the self-regulation and self-supervision of securities trading by various stock exchange bodies. The German system of banking and insurance supervision has proved to be a success. The high international standing of the German universal banking system can also be rated as an indication of this. On the other hand, doubts have recently arisen as to whether the present system of stock exchange and securities supervision still satisfies the changed requirements of a financial centre having to face up to international competition. Furthermore, the implementation of various EC Directives will give rise to new areas of government supervision and new supervisory reponsibilities, which, in addition to stock market trading, also affect other fields of securities business, such as supervision of off-the-floor trading and of non-members of the stock exchange. In January 1992 the Federal Minister of Finance put forward a blueprint of the financial centre Germany which provided for legislative measures to reorganise and extend stock market and securities supervision as early as the second half of 1992. A key element of this blueprint is the establishment of a centralised government market supervision body which is equipped with the necessary monitoring and sanctioning powers and which assumes responsibility for cooperation with foreign securities supervisory authorities. The present powers of the Länder Governments in the context of their legal supervisory function are, at bottom, not to be encroached upon. In addition, the enactment of insider legislation in line with international standards is planned. Rapid implementation of these measures appears to be imperative in the interests of the financial centre Germany.

Admission of money market funds risky

In the context of the debate on how to strengthen the competitiveness of the German financial market, the admission of "genuine" money market funds has often been called for – funds which are intended to enable investment companies (over and above the possibilities which already exist) to invest their resources completely in money market paper and short-term assets. This could have far-reaching effects on the structure of the German banking system. In particular, it could hamper the business operations of small and medium-sized banks which have no opportunity of offsetting liquidity outflows by means of inflows of capital from money market funds of their own. The Bundesbank continues to have reservations about the admission of "genuine" money market funds on monetary policy grounds. These doubts are based principally on the danger of the erosion of the minimum reserves as a consequence of the shifting of deposits into higher-yielding fund units, which are not subject to reserve requirements. But it is necessary, also in view of the need to equip a future European central bank with an efficient arsenal of monetary policy instruments, to preserve the effectiveness of the minimum reserve regulations, which supplement and buttress interest rate policy instruments. Moreover, following the introduction of "genuine" money market funds, the likely reduction of the investment periods might adversely affect the longer-term acquisition of financial assets, which is economically desirable.

Organisational and technical innovations

In the field of the further organisational and technical development of the German stock markets, some major decisions were taken in 1991; wider-ranging decisions with immense implications are currently under discussion. Decentralised, computer-aided stock trading systems gained much ground last year over the traditional floor-trading system with brokers. The existing "Inter-Bank Information System" IBIS was further developed into the Integrated Stock Market Trading and Information System; in February 1992 just under 6% of stock exchange bond trading was conducted via IBIS. Since October 1991 the Bundesbank, too, has been using this system, in connection with its activities as the Federal Government's fiscal agent, for selling the amounts of issues of exchange-traded Federal securities set aside for market-smoothing operations. Competition will ultimately have to decide on the future relationship between the different stock trading systems. It appears that a dual system of screen and floor-trading is emerging, which may well cater for the interests of the various groups of investors. Moreover, there is growing recognition of the necessity of further developing the federal stock exchange system in Germany, thus enhancing the efficiency of the German financial market as a whole in the competitive global environment.

(d) Trends in the banking sector

Expansion of the credit volume more evenly spread over the various categories of banks

Banks benefited on a broad front from the strong and widespread credit demand of domestic enterprises and individuals last year. Gains and losses of market shares in lending business were therefore more limited than in previous years. Big banks increased their lending to domestic non-banks by 13.7%, which was once again more than banks as a whole (+ 10%). Credit cooperatives (+ 13.2%), regional giro institutions (+ 11.6%) and savings banks (+ 11.5%) likewise recorded above-average rises in lending business. Among the smaller categories of banks, the same applies to banks with special functions (+ 12.1%), which are heavily involved in (interest-subsidised) reconstruction funding in eastern Germany. Mortgage banks' lending expanded at a below-average rate (+ 6.1%) – these banks could not participate much in the heavy demand for short-term credit to trade and industry – as did that of regional banks (+ 6.4%); in the latter case, however, the statistics are distorted by the "old banks" in eastern Germany, which are included in this category, and which conduct no new transactions. Lending to public debtors increased relatively little last year; in effect, only savings banks, Land banks, credit cooperatives and mortgage banks granted such credit. Interbank business stagnated. Overall, banks focused their lending on the more profitable types of transactions with enterprises and individuals.

Favourable interest performance, but greater need to cover risks

According to the available evidence, the profitability of the west German banking industry in 1991 was good. Good results are apparently likewise to be expected for savings banks and credit cooperatives in eastern Germany. In many cases the banks in the old Länder (including their branches in eastern Germany) recorded an increase in the net interest received as a consequence of the strong credit demand and the tendency for margins to widen. The net interest received may even have grown more sharply than the volume of business. However, the result was probably depressed slightly by the burdens deriving from the restructuring in eastern Germany, which has not yet been completed. The "extraordinary" account was probably significantly affected by the need to provide for risks in lending business, whereas write-downs on securities due to price movements were most likely of lesser significance in 1991. Viewed as a whole, profitability should form a favourable basis for a further strengthening of the capital base; such a strengthening is necessary in the light of the higher capital requirements from 1993 onwards and the keener competition in the single European market.

Restructuring of the east German banking system makes substantial headway

The process of restructuring and consolidation of the east German banking system, which was initiated in 1990, made good headway in 1991. Savings banks almost doubled their lending to non-banks (from about DM 12.7 billion to about DM 23.8 billion) and thus were able to distinctly reduce the liability-bias of their balance sheets. By contrast, lending by credit cooperatives rose appreciably less. In their business policy, east German banks are gradually coming into line with practices in western Germany. The process of amalgamation to form larger banks is in full swing. As a result of mergers already effected or decided upon, the number of savings banks had decreased by about one-tenth by the turn of 1991-2, and that of credit cooperatives by about one-fifth. The transformation of so-called passbook savings accounts into sight deposits or savings deposits complying with the requirements of the Banking Act is very largely completed, as is the replacement of the former payment system ("ESER") by procedures which conform to western standards. Hence the processing periods for cashless payments have returned to normal. By the end of 1991 equalisation claims had been allocated in the amount of about DM 1 billion (regarding the normalisation of the business operations of east German banks and their refinancing facilities at the Deutsche Bundesbank, see page 43).

IV. International monetary trends and policy

1. Exchange rates and exchange rate policy

Temporary rise in the US dollar

In the period under review developments on the foreign exchange markets were characterised by a temporary recovery of the US dollar, a distinct rise in the rate of the yen, and relative stability within the EMS. After the weighted external value of the US currency vis-à-vis the currencies of 18 industrial countries had sunk from mid-1990 to February 1991 by about 11 % to a historic low, its rate registered a distinct rise well into July, before declining again to practically the same extent. The degree of the fluctuations in exchange rates induced the monetary authorities of a number of major industrial countries to intervene strongly and repeatedly to influence the development of exchange rates, with sales of dollars dominating the picture. On balance, the countries belonging to the Group of Ten placed approximately US$ 6.3 billion onto the market, with the Bundesbank accounting for US$ 3.3 billion of this amount.

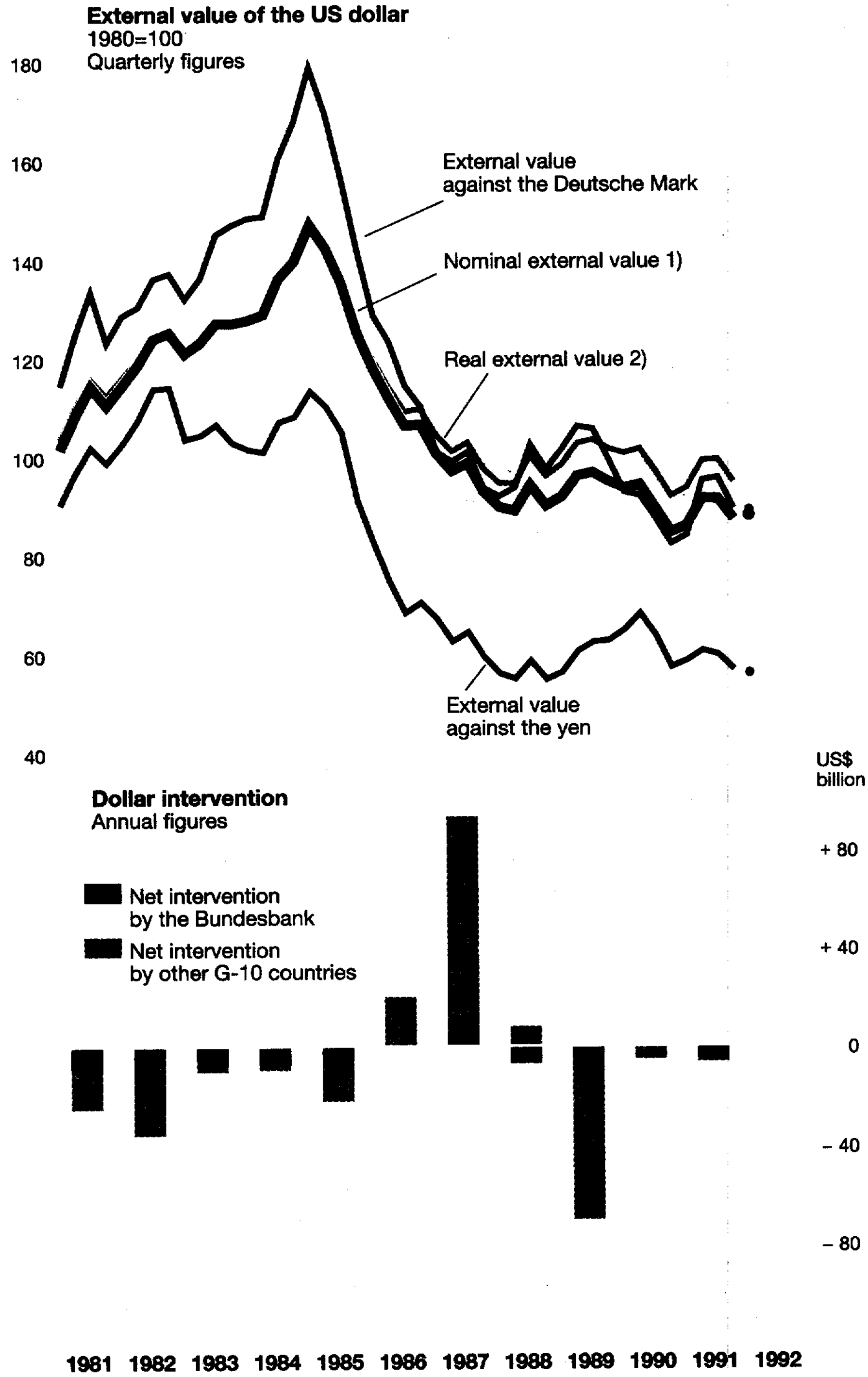
Dollar pulled between fluctuating expectations regarding economic activity and interest rates

The decline in the rate of the US dollar until February 1991 can probably be explained, above all, by the differential between the levels of economic activity in major industrial countries and the United States that repeatedly gave rise to the expectation of interest rate reductions on the part of the US Federal Reserve System. The interest rate advantage of the US dollar over other important international currencies did indeed decline rapidly and turned into its opposite, particularly at the short end of the market. When the dollar then began to rise again in mid-February 1991, a major role was played by the expectation that after the end of the Gulf war, which was already becoming apparent, economic activity in the United States, and with it interest rates, would soon go up again. However, other factors were also exerting an influence, including uncertainties about political developments in the still existing Soviet Union as well as the burdens arising from German reunification and their consequences for price stability in Germany. But the lasting revival of economic activity in the United States that had been hoped for did not materialise, while at the same time a more positive assessment of the process of German unification began to gain ground. Moreover, the tightening of monetary policy in Germany probably strengthened confidence in the Deutsche Mark. The expectation of a return to rising current account surpluses in Japan may also have contributed towards the dollar switching back to a renewed downward trend in mid-1991. In the process, according to calculations of the Deutsche Bundesbank, the weighted external value of the US currency had fallen by the end of March 1992 to a level only slightly above that of the end of 1990.

Long-term decline in the level of the dollar in line with adjustment needs

The development of the exchange rate of the US dollar vis-à-vis other major currencies since the middle of the eighties has tended to foster the competitiveness of the US economy and hence at the same time a more balanced international current account pattern. After the weighted external value of the US dollar had risen from 1980 to its highest level in March 1985 by no less than 50 %, it fell back by March 1992 to a level lower than its initial position. Since over the whole of this period no significant inflation differential between the United States and the average of the other industrial countries can be established, a decline in the real external value of the US dollar remains on balance to which, along with cyclical and other influences, part of the improvement in the external position of the United States since 1988 can be ascribed. The equilibrium to a large extent in the current account position of the United States in 1991 overstates the progress in external adjustment it has achieved, however: the comparatively weak level of domestic economic activity made a substantial contribution towards the improvement of the trade account, and the payments made by other countries to help finance the Gulf war led by way of exception to a surplus in the transfer payments account which is traditionally in deficit. According to estimates by international institutions, a

External value of the US dollar and dollar intervention by the Group of Ten countries



1) Weighted external value against the currencies of 18 other industrial countries.- 2) On the basis of the price trends of total turnover (as measured by the SNA deflators).- • = February 1992.

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higher US current account deficit is to be expected again for 1992. Against the background of the relatively weak state of domestic economic activity, this development reveals that deep-rooted structural problems, such as insufficient private saving as well as the high and still rising government budget deficits, remain unsolved. The estimated renewed increase in the US budget deficit for

1992 to an order of magnitude of US$ 400 billion is a cause for concern. This applies even if the special burdens included in this figure, such as those arising from rescuing the savings and loan associations, are left out of account.

Basic strength of the yen dampened by capital outflows

Since the end of 1990 the Japanese yen has strengthened distinctly, namely by about 10% vis-à-vis the currencies of the other industrial countries on a weighted average. However, this only offset the depreciation of the yen from the beginning of 1989 to spring 1990 that was caused by a number of special factors. The renewed strong rise in Japan's current account surpluses since last year – 1991 witnessed a doubling in their size to just over US$ 70 billion – makes it understandable that both the United States and Europe consider an appreciation of the yen to be justifiable – a view that is also shared by the Japanese authorities. However, a stronger appreciation of the yen was counteracted by autonomous capital outflows that surpassed the level of the current account surplus, primarily resulting from repayments of Euro-credits. The possibility cannot therefore be excluded that Japan's current account surpluses will once again increasingly prove to be an international problem of adjustment.

Relative stability in the EMS despite interest-rate-induced tensions

As far as the exchange rate mechanism of the EMS is concerned, the movements in the dollar rate were not a cause of noteworthy tensions. There were, however, differing assessments in some cases as regards the monetary and interest rate policy requirements between individual partner countries. In the light of the demands of stable nominal exchange rates in the EMS, the monetary authorities in most of Germany's partner countries that participate in the exchange rate arrangement have only slight scope for conducting an autonomous monetary policy. This applies, in particular, to the currencies with relatively weak exchange rates within the EMS owing to preceding reductions in interest rates in the countries concerned. Thus, the consistent orientation of Germany's monetary policy to the need to combat inflation is restricting the possibilities of its partner countries to relax their monetary policy, seeing that they consider lower interest rates on balance to be appropriate for the situation of their own economies. In a number of cases the intention to reduce money market rates for cyclical reasons had to be given up or revised, also under the pressure of sizeable official intramarginal sales of Deutsche Mark. Occasional criticism of the Bundesbank's interest rate decisions found no support, however, among most of the central banks of our partner countries because in the given situation they saw no convincing alternative either to the Bundesbank's attitude or to their being tied themselves to the Deutsche Mark. For the overall system to be geared to stability policy it is decisive for countries with particularly heavy pressure on demand and prices to adopt countermeasures at an early stage and with determination.

ECU peg of the Swedish krona and the Finnish markka

The Bank of Sweden decided to unilaterally peg the Swedish krona to the European currency unit (ECU) with effect from May 17, 1991. The margin of fluctuation was set at ± 1.5%. In taking this step, Sweden followed a similar decision by Norway adopted in 1990. The reorientation of exchange rate policy is also connected with the application to join the EC submitted in mid-1991. The Finnish monetary authorities likewise pegged the Finnish markka to the ECU with effect from June 7, 1991, setting the margin of fluctuation at ± 3%. However, after heavy pressure on the exchange rate, Finland had to devalue the Finnish markka by approximately 12% in November 1991.

Modest rise in global monetary reserves

The sales of foreign exchange associated with the at times strong upward pressure on the dollar and the strength of the Deutsche Mark within the EMS contributed towards global monetary reserves rising only relatively little in 1991. Leaving changes in holdings due to valuation adjustments out of account, the growth in global reserves declined from US$ 93 billion in 1990 to US$ 40 billion

Components of global monetary reserves*

US$ billion

Type of reserves	Level at end of year 1989	1990	1991 p	Change Total 1990	1991 p	due to transactions 1 1990	1991 p	due to valuation adjustments 2 1990	1991 p
Gold 3	39.8	39.7	39.7	– 0.1	– 0.1	– 0.1	– 0.1	–	–
Special drawing rights	26.9	29.0	29.4	+ 2.0	+ 0.4	– 0.2	+ 0.3	+ 2.2	+ 0.2
Reserve positions in the IMF	33.5	33.8	37.0	+ 0.3	+ 3.2	– 2.4	+ 3.1	+ 2.7	+ 0.2
Official ECU balances	62.0	64.1	67.1	+ 2.1	+ 3.1	+ 3.3	+ 2.7	– 1.2	+ 0.3
– against gold	37.5	37.8	36.0	+ 0.3	– 1.8	– 0.0	– 0.0	+ 0.3	– 1.8
– against US dollars	24.5	26.3	30.8	+ 1.7	+ 4.5	+ 3.3	+ 2.3	– 1.5	+ 2.2
– arising from very short-term financing	–	–	0.4	–	+ 0.4	–	+ 0.4	–	– 0.0
Foreign exchange 4	654.5	780.8	816.4	+126.3	+ 35.5	+92.5	+34.4	+33.8	+ 1.1
US dollar 5	386.1	429.9	455.2	+ 43.8	+ 25.3	+43.8	+25.3	–	–
Deutsche Mark 5	126.8	153.3	150.9	+ 26.4	– 2.3	+ 8.6	– 0.1	+17.9	– 2.2
Japanese yen 5	53.6	73.2	86.3	+ 19.6	+ 13.0	+15.5	+ 7.3	+ 4.0	+ 5.7
Private ECU balances	20.4	36.9	38.6	+ 16.5	+ 1.6	+12.9	+ 2.2	+ 3.7	– 0.6
Pound sterling 5	16.6	25.2	29.6	+ 8.6	+ 4.4	+ 4.9	+ 5.3	+ 3.7	– 0.9
French franc	8.7	17.1	27.3	+ 8.5	+ 10.2	+ 6.9	+10.4	+ 1.5	– 0.2
Swiss franc 5	11.4	13.8	14.7	+ 2.4	+ 0.9	+ 0.2	+ 1.5	+ 2.2	– 0.6
Dutch guilder	6.7	8.0	8.9	+ 1.3	+ 0.9	+ 0.4	+ 1.0	+ 0.9	– 0.1
Other and unidentified assets	24.1	23.3	4.9	– 0.7	– 18.5	– 0.7	–18.5	–	–
Total reserves	816.7	947.3	989.6	+130.5	+ 42,2	+93.0	+40.4	+37.5	+ 1.8

* Gross monetary reserves of all IMF member countries plus Switzerland and Taiwan. – **1** Where the monetary reserves are not denominated in gold and dollars, the changes in units of the reserve asset concerned have been converted into dollars at average rates based on the rates on the relevant reference dates. In the case of "Other and unidentified assets", the changes due to transactions have been equated with the changes in levels. In the case of official ECU balances, the change in the gold and dollar holdings on which they are based is shown. – **2** Difference between the change in levels and the change due to transactions; also including the gold-price-induced change in the ECU balances based on the contribution of gold to the EMCF as well as the exchange-rate-induced change in levels. – **3** Valued at US$ 42.22 per ounce of fine gold. – **4** Including private ECU balances. – **5** Including partly estimated assets of Taiwan. – **p** Provisional. Discrepancies in the totals are due to rounding.
Sources: IMF, EMCF and Committee of EC Central Bank Governors. BBk

last year. Including the valuation effects primarily due to shifts in exchange rates, the corresponding growth in global monetary reserves fell from US$ 131 billion to US$ 42 billion. Within this total, the developing countries as a group registered similarly large increases in both years (of US$ 49 billion on average), whereas in the case of the industrial countries a considerable rise in reserves was followed by a distinct decline in reserves.

Slight fall in share of Deutsche Mark reserves

According to preliminary information stemming primarily from the IMF, the statistically recorded reserves in Deutsche Mark at the end of 1991 amounted to DM 229 billion, i.e. the same amount as at the end of the preceding year. This development was counteracted by countries whose currencies were under pressure in the EMS at times in 1991, inter alia, by net sales of Deutsche Mark totalling DM 15.5 billion. The United States reduced its considerable volume of Deutsche Mark reserves stemming from earlier years in agreement with the Bundesbank by "offsetting" them against dollar reserves held by Germany. Calculated in terms of the US dollar, global holdings of Deutsche Mark reserves, at US$ 151 billion, were US$ 2 billion lower at the end of 1991 than their level in the preceding year since the Deutsche Mark was slightly weaker comparing one year's end with the other. As a result, its share in the renewed higher volume of global foreign exchange reserves (including the dollar holdings contributed to the EMCF by the EC member countries) fell from 19% to 18%. However, the Deutsche Mark still remained by far the second most important reserve currency, followed by balances in yen and private ECU.

2. International financial markets

Cyclical and structural problems dampen growth of lending on the financial markets

Last year cyclical and structural factors dampened both the expansion of the international financial markets as well as growth on a number of major national credit markets. In the United States and the United Kingdom, in particular, the cooling-down of economic activity, the high level of indebtedness of the corporate sector as well as of households together with other market-related and financing risks that had accumulated over the course of the long period of growth in the eighties (see the Report of the Deutsche Bundesbank for the Year 1990, page 67 ff.) led to a decline in the willingness to engage in financing operations and to contract debt. The closure of a credit institution with a large network of international activities as well as a number of spectacular corporate bankruptcies which revealed in some cases sensational infringements of the rules and contraventions of the law also had a negative impact on the international borrowing climate. In a number of industrial countries the weak level of economic activity compounded the decline in prices in the real estate field as well as for other assets; as a result, the earnings position and capital ratios of some banks that had granted credit in these fields in the past on a generous scale were strongly affected. As a result, leading banks in the Scandinavian countries came under such pressure that the government had to step in to save them. All in all, however, the financial markets continued to function smoothly also in countries that had to struggle simultaneously with considerable cyclical and structural problems. The concern voiced especially in the United States to the effect that, inter alia owing to a lack of capital on the part of the banks, a real credit crunch could arise was not confirmed in this general form. However, banks were distinctly more cautious in selecting new borrowers; sound borrowers remained sought after internationally. At the same time, correction processes became evident as regards the structure of corporate financing such as, for instance, the strong growth in the procurement of capital through share issues. Thus, one can speak at best of a selective restriction of lending activity, which is to be welcomed from the point of view of the efficient utilisation of available savings.

Contraction above all on the international bank credit markets

Against the background of the detrimental factors mentioned above, the banks sharply reduced their activities especially on the international markets for bank loans. In the first three quarters of 1991, for which statistics are available, the cross-border claims of banks fell by almost US$ 170 billion, after having increased by over US$ 400 billion in the same period of the preceding year. This contraction in lending that is unprecedented on this scale was primarily due to the reduction in international interbank lending, i.e. to this extent it had no impact on final borrowers. Japanese banks, above all, reduced their operations on the interbank market which they had used in the preceding years as a source of refinancing, inter alia, for purchases of real estate and securities at home with borrowed funds as well as for financial investments abroad. The main reason behind this was the drastic fall in prices on the domestic share market from which the capital ratios of Japanese banks have suffered. Their previous evident endeavours — with insufficient regard for earnings prospects — to gain market shares have given way to a more cautious business policy. In the light of small interest margins and simultaneously greater risks, banks in other countries have in some cases also withdrawn from the interbank market. By contrast, after eliminating double-counting in interbank business, there was a slight increase in international bank lending by the reporting banks in the first nine months of last year; however, owing to the sharp drop in the demand for credit as well as growing concern about the credit standing of borrowers and the need to meet the new capital ratios, its growth reached only about one-fifth of the volume of new lending in the same period of the preceding year. Banks have reduced their lending exposure to problem debtor

Net lending on the international financial markets

US$ billion

Item	1988	1989	1990	1990 January to September	1991 January to September
A. International bond markets					
1. Gross issues	220	264	239	171	234
2. Redemptions and repurchases	83	89	108	78	102
3. Net issues	137	175	131	93	132
B. Net placements of Euro-notes	20	7	32	31	26
C. Net bank lending 1	260	410	465	370	75
D. Financing facilities, total					
1. Total net financing in the market segments (A3 plus B plus C)	417	592	628	494	233
2. Double-counting among the above market segments 2	67	76	88	69	23
3. Total financing facilities, after adjustment for double-counting	350	516	540	425	210

1 Change in the cross-border claims on final borrowers of the banks reporting to the BIS, adjusted for exchange-rate-induced and statistical influences. — 2 Banks' bond purchases, as well as bonds and Euro-notes issued by banks to fund their lending.
Source: BIS. BBk

countries, i.e. both vis-à-vis eastern Europe as well as — apart from a few exceptions — the developing countries.

Continuing attractiveness of the international bond markets

By contrast, the total additional net volume of financing arranged via the international financial markets — i.e. including bond issues as well as other short and medium-term financial instruments — fell less dramatically, namely to about one-half in the first three quarters of the year in comparison with the preceding year. The weak level of international bank lending activity was partly offset by recourse to financing via bonds. As has been the case for years, Japan headed the list of international issuers by a large margin, followed by the United Kingdom and Canada. Germany took sixth place behind the United States. The interest of investors was focused, in particular, on fixed-interest-bearing bonds since the trend of interest rates in the major currencies of issue was generally downward. Although, at just under one-third, the US dollar remained the most important currency of issue, it continued to lose ground, especially vis-à-vis the European currencies. ECU-denominated bonds, in particular, gained in popularity ahead of the Maastricht decisions in part probably owing to the expectation of price gains as a consequence of a "hardening" of the basket ECU and even ousted the Japanese yen from second place among the most important issuing currencies for bonds. In the process, the interest yield fell below the rate that would result from calculating national interest rates on a weighted basis.

Structural reforms on national financial markets also necessary for reasons of competition

Despite the structural weaknesses of the US financial system the comprehensive reform of the financial sector proposed by the US Administration has not yet been implemented by the legislative authorities. Overcoming the present system of specialised banks and abolishing the regional limitations on banking activities are generally considered to be the prerequisite for US banks to remain competitive internationally, on the one hand, and to be able to offer financial services more effectively on the domestic market, on the other hand. In recent years US banks have lost market shares in international banking business, initially to Japan, in particular, but last year to a greater extent also to banks in Continental Europe. The harmonisation of structures on the major national financial markets will be given an additional impetus by the freedom of establishment to be granted as from 1993 in the member countries of the EC in the context of the single European market. This is because from the beginning of next year the admission of a foreign financial institution as a bank in any member country of the EC will allow it both to operate throughout the whole area of the EC and to provide a wide range of financial services "under a single roof", i.e. in line with the universal banking system. Crass structurally-induced differences in the banks' scope of operations are hardly acceptable internationally over the long term for reasons of competition. Just as the globalisation of the financial markets is ultimately forcing the introduction of largely harmonised accounting and supervisory rules, it will probably also have an influence on the structure of national financial markets. This process will reveal which structural characteristics of the financial markets are most competitive. All in all, the system of universal banking that has been established in Continental Europe which, inter alia, has advantages owing to the possibility of balancing risks to a greater extent among the different spheres of business as well as in the field of monetary and supervisory management, has proved to be successful.

3. International debt situation of the developing countries and eastern Europe

Light and shade in the debt situation

In 1991 the trends in the debt situation of the developing countries were variegated. Whereas a number of major problem debtor countries in the middle income range (i.e. at an advanced stage of development) came closer to overcoming their debt problems through strenuous reform efforts, the debt situation of a large number of poorer countries has hardly improved. Following the dissolution of the Eastern Bloc and the Soviet Union new debt service problems have to be coped with in central and eastern Europe the extent and duration of which cannot yet be assessed. The aggregate volume of debt of the developing countries in 1991 was about the same as in the preceding year. The debt-export ratio (176%) of these countries was also largely unchanged, whereas their debt ratio in terms of GNP fell by 4 percentage points to 38% thanks to their considerable level of economic growth in overall terms. By contrast, their debt service-export ratio (21%) rose again slightly (see the table on page 68). A look back to the year 1986, however, when the debt service burden had reached its peak level of about 30% of export earnings since the outbreak of the debt crisis, illustrates the improvement that has taken place.

Effect of the Brady initiative as a catalyst

The development of major problem debtor countries in Latin America, in particular, gives reason for cautious optimism. After several countries in this region had failed for a long time to bring about macroeconomic stability and to reform their economies thoroughly, the realisation now seems to be gaining ground that the debt problems need to be tackled at their roots. A number of countries have seriously begun to combat inflation, to redress their budgetary situation as well as to denationalise and deregulate their economies. They include several countries that have benefited from the so-called Brady initiative of spring 1989, i.e. that have chosen to accept a debt restructuring programme supported by the IMF and the World Bank which, as a rule, involves a combination of debt reduction, an easing of debt service payments and the provision of fresh funds by their creditor banks. The success of this approach – coupled as it is with strict adjustment and structural measures – in Mexico and Venezuela, as well as in other countries, has evidently set signals that other countries in Latin America are now also following. In this way, the Brady plan has provided important impulses and has brought about its intended effect of acting as a catalyst, even though the number of countries benefiting from it directly has remained comparatively small up to the present.

External debt of the developing countries *

US$ billion

Item	1987	1988	1989	1990	1991 p	Change in 1991 from 1990 p
Long-term	1,013	996	1,000	1,047	1,050	+ 3
Official creditors	449	453	474	525	534	+ 9
Private creditors	564	543	526	522	516	− 6
Short-term	138	151	167	199	194	− 5
Total 1	1,290	1,282	1,306	1,355	1,351	− 4
of which						
Problem middle-income countries	498	485	487	506	487	−19
Problem low-income countries	158	161	164	165	162	− 3
Memorandum items						
Debt service payments on long-term debt	124	135	124	123	134	+11
Interest	53	60	54	51	58	+ 7
Repayments	71	75	70	72	76	+ 4
Debt service as a percentage of receipts from exports of goods and services						
All developing countries	28.7	27.5	23.5	19.8	21.2	+ 1.4
of which						
Problem middle-income countries	39.6	41.2	34.2	25.5	29.7	+ 4.2
Problem low-income countries	24.2	28.9	30.1	23.8	31.3	+ 7.5

* Including the central and east European member countries of the World Bank. — 1 Including debt to the IMF not included above and unclassifiable debt. — p Provisional.
Source: World Bank. BBk

Greater reform efforts in Latin America

Thus, for instance, although no new rescheduling agreements on the lines of the Brady plan came about last year, the preconditions for settling their debts have improved particularly in a number of Latin American countries. In addition, benefiting from the success of their economic and structural policy measures, several countries managed to reduce the burden of their old debts through debt-to-equity swaps. Argentina, for example, succeeded in reducing 15% (US$ 7 billion) of its debts vis-à-vis private creditor banks by privatising state-owned enterprises. Chile has also reduced a considerable part of its foreign debt in this way. In addition, the consistent economic and structural policies pursued by these two countries were rewarded by return flows of flight capital. Besides Mexico and Venezuela as well as Chile, which has been successful without the need for debt forgiveness, Argentina is the latest country to have also regained access to the international financial markets despite its payment arrears. In the meantime, the prospects of a debt settlement for the largest debtor in the region, namely Brazil, have also improved through a preliminary agreement with its creditor banks on the more than US$ 8 billion of accumulated arrears in interest payments and a borrowing arrangement with the IMF concluded in January 1992. However, there is still a long way to go before the debt problems of the developing countries have been overcome on a durable basis. It must not be overlooked that the decline in interest rates on dollar assets in the last two years has reduced the burden of debt service payments to a far greater extent than was possible with the debt relief envisaged under the Brady plan.

Persistent debt problems of the poorer countries ...

Moreover, the debt figures broken down by group of debtors show that the critical point regarding the debt situation of many developing countries has not been overcome by any means. This applies especially to the heavily indebted countries with a low per capita income. Although a large proportion of the debt of many countries in this group that in most cases have debt vis-à-vis official creditors has been forgiven in the past and although many of these countries have been granted special conditions for servicing their remaining debt, their debt ratios have deteriorated again after a temporary period of consolidation. Thus, the ratio of debt service payments to exports of the problem debtors within this group of countries that had fallen to 24% in 1990 rose again last year to over 31%. But even in 1990 only about one-half of the debt service payments could be raised. Owing to insufficient efforts on their own part as well as the slowdown in economic growth in the industrial countries and the associated decline in the prices of many commodities, a large number of these countries have been confronted with a financial crisis again which they are able to overcome through their own endeavours only with difficulty.

... lead to further concessions by official creditors

The official creditors represented in the Paris Club have therefore decided to forgive the highly indebted developing countries with a very low income, under certain conditions and on a case-by-case basis, up to one-half of their debts over and above the concessions already granted to them. For a large number of poor and structurally weak countries this could bring them closer to a lasting settlement of their debt problems if they themselves help to a greater extent than in the past to combat the frequent mismanagement of their economies as well as the serious structural problems they have. As an exception to the debt policy practised in the past – and not to be seen as a precedent for other problem debtor countries – a debt forgiveness operation spread over three years and affecting 50% of the total debt involved was approved by the creditor countries in the Paris Club in favour of Egypt and Poland. This means that for the first time a far-reaching forgiveness of debt outside the group of the poorest countries was conceded. These concessions by the creditor countries are tied to IMF reform and adjustment programmes spread over a number of years and have been made in the expectation that parallel debt reduction agreements will also be concluded with the banks.

New debt problems in central and eastern Europe through the dissolution of the Soviet Union

Whereas promising ways out of the debt crisis have been pointed out for the developing countries for years, especially by the IMF, it is much more difficult for the countries of central and eastern Europe to find their bearings in the light of the political and economic upheavals there. This applies particularly to the successor states to the Soviet Union that are encountering considerable payment difficulties as well as to a number of Balkan states. By contrast, Hungary and the CSFR, which have already made greater progress in the process of reforming their economies along free market lines, as well as Poland with its continuing heavy burdens despite the debt forgiveness conceded by its official creditors are in a better position. The debt problems of the Commonwealth of Independent States (CIS) are at the centre of current international endeavours. Despite an estimated current account surplus of between US$ 5 billion and US$ 10 billion in 1991, problems in repatriating export earnings by the state enterprises operating in the field of foreign trade together with an accumulation of debt maturities have precipitated a serious liquidity crisis for the CIS. After intense discussions between representatives of the major industrial countries and the Government of the former USSR and the representatives of most of the independent individual republics, which led to a "memorandum of understanding" regarding joint and several liability, the creditor banks of the former Soviet Union as well as the official creditors in the western industrial countries agreed in October 1991 to grant the successor states a limited deferment of payment. The commercial banks have postponed the repayment of the medium and long-term loans due between December 1991 and June 1992, and the Paris Club suspended the redemption of the loans granted before 1991 until the end of 1992. However, interest payments must continue to be made. The aggregate debts of the former Soviet Union in convertible currency had probably reached approximately US$ 65 billion to US$ 70 billion at the end of 1991. The risks associated with it can be attributed

Gross external debt of the countries of central and eastern Europe in convertible currency

US$ billion

Country	1987	1988	1989	1990	1991 **p**
Former Soviet Union	39	43	54	63	65
Poland	39	38	41	48	52
Hungary	20	20	21	21	20
Bulgaria	6	8	9	11	13
CSFR	7	7	8	8	10
Romania	7	3	1	1	2
Total	117	118	134	152	162

p Provisional.
Discrepancies in the totals are due to rounding.
Source: OECD. BBk

in about equal proportion to the commercial banks and the official creditors, although considerable uncertainties exist on this point. For the time being, however, only eight republics have declared their willingness to accept joint and several liability for the old debts of the Union in the memorandum mentioned above. The western creditor countries are endeavouring to also include the republics still on the sidelines in the debt agreements that have been made or which might follow. However, protracted arguments among the republics have to be expected especially regarding the issue as to how the old debts are to be divided up, which is closely connected with the sharing out of the domestic and external assets of the former Soviet Union.

Hungary and CSFR maintain debt service payments

According to conventional criteria, of the other countries of central and eastern Europe only Poland, Hungary and Bulgaria are among the heavily indebted countries. Like the CSFR with its only moderate level of debts, Hungary has nevertheless fulfilled its debt service obligations completely. The path of reform towards a free market economy together with their sound behaviour as debtors have been rewarded in that considerable resources have flowed into both countries in the form of direct investments, while their access to the international credit and bond markets has also remained open. By contrast, international lenders have shown great reticence in the case of Poland partly because up to the present no consensus has been reached as to the amount of debt to be forgiven with respect to the old claims of the banks. The forgiveness of 50% of official claims agreed by the Paris Club entered into force in Germany at the beginning of 1992. In the case of Bulgaria as well it has been possible up to the present to arrive at a rescheduling agreement only within the Paris Club with respect to the claims held by official creditors totalling approximately US$ 2 billion, whereas a settlement still has to be reached with respect to the far larger payment obligations vis-à-vis its creditor banks. Romania constitutes a special case which redeemed its foreign debts under the Ceaucescu regime with great sacrifices but which is receiving practically no resources via the financial markets in the west or through private direct investments owing to the desparate state of its economy. As a result, like Bulgaria, Romania had to rely almost entirely on aid from western governments and international organisations.

Debt problems in central and eastern Europe no danger for the financial system of the west

At US$ 160 billion to US$ 170 billion, the aggregate debts of the countries of central and eastern Europe remained largely unchanged in 1991 and thus amount to only a fraction of the debts of the developing countries up to the present. The commercial banks, in particular, have used scheduled loan repayments to reduce their exposure. As a result, any inflows were largely restricted to official, or government-guaranteed as well as multilateral loans, not taking account of the floating of a number of international bonds by Hungary and the CSFR. As could also be observed in the case of the debts of the developing countries in recent years, there has been a further shift in the pattern of creditors in the direction of official creditors. This partly explains the relatively relaxed reaction on the part of the international financial markets to the exacerbation of the payment problems of these countries. A further reason is to be seen in the fact that value adjustments have already been undertaken with respect to a considerable proportion of the banks' remaining risks. Moreover, in the light of the endowment of the region with natural resources and its potential for development, the level of debt of central and eastern Europe seems to be considered less dramatic at least from a medium and long-term point of view.

Financial problems cannot be solved with public funds alone

Over the long term, however, it will hardly be possible for the urgent need for finance on the part of central and eastern Europe to be met primarily from government or multilateral sources of funds. A number of donor countries, and not least Germany, are already coming up against the limits to what they can provide. This is why it is especially important for these countries to become or to remain attractive for private lenders. The countries with large reserves of natural resources as well as the states that have made advances on the path to reform, in particular, must not put their comparatively good starting position at risk by setting the wrong signals in economic and regulatory policy. As developments in Latin America illustrate, the success of a rigorously pursued reform policy in a few countries can serve as an example and help an entire region to gain greater stability and growth.

4. The IMF and the international development banks

Distinct increase in new lending by the IMF . . .

At SDR 8.2 billion, the volume of new loans extended by the IMF in 1991 was distinctly larger than in the preceding year (SDR 4.8 billion). This was due, inter alia, to the granting of sizeable standby credits to countries in eastern Europe as well as to higher drawings on the Compensatory and Contingency Financing Facility, the latter above all owing to the possibility limited to the end of 1991 to offset the higher cost of imported oil; in addition, a considerable increase in loans under the Enhanced Structural Adjustment Facility was also registered. By contrast, as a result of the decline in lending by the Fund from 1984 to 1988, redemption payments fell distinctly to SDR 4.7 billion. On balance, the volume of the Fund's loans outstanding increased by SDR 3.5 billion to SDR 26.5 billion.

. . . makes it necessary to increase members' quotas soon

In the light of the persistent payment problems of many developing countries as well as the countries of central and eastern Europe, new lending by the Fund will probably continue to be at a high level in the coming years. In order to ensure that it can be financed, it is necessary for the increase in quotas agreed by the Board of Governors of the IMF in mid-1990 to enter into force soon, envisaging as it does an increase in the Fund's total quotas of 50% to SDR 136.7 billion. The prerequisite for this is that the third amendment to the Fund's Articles of Agreement requiring at least 85% of the voting rights has been accepted. This third amendment to the Agreement is intended to make it possible to suspend the voting and other rights of membership of members that have to be criticised for lacking in willingness to cooperate in meeting their repurchase obligations vis-à-vis the IMF. Like the majority of members, Germany accepted the increase in quotas and the third amendment to the Agreement in 1991; however, in a number of countries – including also the United States, which has a blocking minority – it has not yet been possible to conclude the ratification procedure.

Purchases and repurchases under IMF credit facilities

SDR billion

Item	1987	1988	1989	1990	1991
Credit tranches	1.9	1.7	1.5	1.2	2.6
Extended Fund Facility	0.2	0.2	1.2	3.0	1.9
Compensatory and Contingency Financing Facility **1**	1.2	0.7	0.8	0.1	3.0
Buffer Stock Facility	–	–	–	–	–
Structural Adjustment Facility **2**	0.4	0.4	1.0	0.5	0.8
Total purchases	3.7	3.1	4.5	4.8	8.2
Total repurchases **3**	7.9	6.7	5.9	5.9	4.7
Net purchases (net repurchases: –)	– 4.2	– 3.6	– 1.4	– 1.1	3.5

1 Comprising only the Compensatory Financing Facility up to August 1988; this was temporarily augmented in 1991 by what was known as an oil import element. – **2** Including both the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF); both facilities are financed out of special accounts administered by the Fund and are available only to countries whose per capita income is particularly low. – **3** Excluding repayments of Trust Fund loans.
Discrepancies in the totals are due to rounding.
Sources: IMF and Bundesbank calculations. BBk

Policy on Enlarged Access prolonged once again

The Policy on Enlarged Access to the resources of the Fund is to be continued until the envisaged increase in quotas enters into force; it was therefore prolonged initially to June 30, 1992 or until the increase in quotas should it enter into effect earlier, with unchanged ceilings for purchases. The Policy on Enlarged Access is being financed at present exclusively by the Fund's own resources since the borrowed funds – i.e. loans made available by members to finance this policy – have meanwhile been used up. After the increase in quotas enters into effect, the Policy on Enlarged Access is to be replaced by a new policy on purchases the design of which has already been agreed in principle: the current absolute scope for purchases is to be maintained initially and lending by the Fund is to be financed normally from its own resources because it cannot be expected in the foreseeable future that the Fund will be able to refinance its lending operations through large-scale borrowing from its members. However, in line with the temporary nature of the Policy on Enlarged Access envisaged from the start (see the Report of the Deutsche Bundesbank for the Year 1981, page 63 and page 81), a country's scope for drawings coupled to its quota should be gradually reduced to the traditional ceilings for purchases in the medium term. This would also pre-empt the possibility that excessive demands are placed on the liquidity of the Fund through the increase in IMF-supported adjustment programmes that is to be expected.

New IMF members

After Mongolia and Albania joined the Fund last year, the IMF currently has 156 members. Switzerland, two island countries in the Pacific, all the republics of the former Soviet Union, and Slovenia have submitted membership applications. Although in the case of the successor states to the Soviet Union it is proving difficult to calculate their quotas since there are gaps in the necessary data on their national economies, at the end of January 1992 the finance ministers and central bank governors of the seven major industrial countries stated that they were in favour of intensifying the membership negotiations with the aim of concluding them by the end of April this year, despite these difficulties.

Large increase in assistance to countries in central and eastern Europe

In addition to the special assistance granted by the IMF up to the end of 1991 to the countries particularly affected by the Gulf crisis, the Fund greatly expanded its loans last year to the countries of central and eastern Europe on the path of reform that are already members of the IMF. Far-reaching adjustment programmes supported by the IMF with the objective of reforming their economies in the direction of a free market system were agreed with almost all these countries, some of which joined the Fund only recently.

Moreover, after intense negotiations an association agreement with the then existing Soviet Union was concluded in autumn 1991 envisaging in particular large-scale technical assistance. Since the dissolution of the Soviet Union this agreement is being continued with its successor states. As has already been the case for some time with Poland, the Bundesbank is taking part in the technical assistance coordinated by the IMF by sending experts, providing training courses, and engaging in other activities. After the successor states to the Soviet Union join the IMF, conditional adjustment loans granted by the Fund will probably play an additional role in fostering the restructuring of the economies of these countries.

Strong rise in the loan commitments of the international development banks ...

Last year witnessed an in part considerable increase in the loan commitments of the international development banks. Thus, for example, in comparison with the previous year the loan commitments of the World Bank Group (International Bank for Reconstruction and Development (IBRD), International Development Association, and International Finance Corporation) went up in the 1991 fiscal year by US$ 2.3 billion to US$ 24 billion. A considerable role in this growth of activity was played, inter alia, by loans to countries particularly affected by the Gulf war as well as by loans in support of the process of transformation in the countries of central and eastern Europe. Thus, the loans committed by the IBRD to the latter group of countries in the 1991 fiscal year amounted to US$ 2.9 billion after having come to only US$ 1.8 billion in the preceding year. The loan commitments of the regional development banks whose operations are restricted to Latin America, Africa, and Asia, namely the Inter-American, the African, and the Asian Development Bank, went up from US$ 11.1 billion in 1990 to US$ 13.8 billion last year. This increase is primarily due to the growth in business of the Inter-American and the Asian Development Bank whose loan commitments increased in 1991 by US$ 1.5 billion to US$ 5.4 billion and by about US$ 1 billion to US$ 5 billion, respectively, in comparison with the preceding year. The European Bank for Reconstruction and Development (EBRD) established in 1991, which is intended to support the countries of central and eastern Europe in their process of transformation in the direction of open market economies through financing projects and granting guarantees, approved 14 investment projects in its borrower countries in its first period of business activity (April to December 1991). All in all, commitments totalling over ECU 400 million were undertaken with respect to loans and the acquisition of equity participations.

... and corresponding recourse to the capital markets

The lending operations of the international development banks that have now been at a relatively high level for several years and thus constitute a stabilising element in the overall inflow of funds to the developing countries have their mirror image in the strong recourse that these institutions have to the international capital markets. In the 1991 fiscal year the World Bank Group and the regional development banks together took up new medium and long-term loans totalling US$ 17.6 billion (1990: US$ 15.9 billion). Whereas direct borrowings by the international development banks on the German capital market were not as high as in earlier years, DM-denominated borrowings by these banks have continued to play an important role. Including the currency swaps conducted by the international development banks, and especially the World Bank, the Deutsche Mark accounted for a share of almost 19% in their borrowing operations.

Banking supervision,
monetary policy regulations,
issuing of foreign Deutsche Mark bonds
and monetary legislation

I. Participation of the Deutsche Bundesbank in banking supervision and amendments of banking law

In the light of the globalisation of banking business, the supervisory authorities of many states have been trying to harmonise bank supervision regulations for quite some while. This is why the Bundesbank is represented in the relevant international bodies, in addition to its involvement in bank supervision in Germany. 75

Basle Committee on Banking Supervision

In the year under review the Basle Committee on Banking Supervision made intensive efforts to reach international agreement on capital standards for securities transactions. This agreement is to apply not only to banks but also to securities firms. For this reason the Basle Committee on Banking Supervision, together with the International Organization of Securities Commissions (IOSCO), worked out a preliminary *Agreement on Minimum Capital Standards for Securities Business* at the beginning of 1992.

The starting point of the work undertaken was the Capital Accord concerning banks adopted by the Basle Committee on Banking Supervision in 1988. That accord was primarily concerned with the banks' credit risks. Other risks, in particular the market risk involved in securities business, i.e. the price risk posed by equity positions and the currency and interest rate risk, were largely disregarded. Regarding the supervision of securities firms, however, there was a need to harmonise the currently still widely diverging national regulations at an internationally binding minimum level.

The risk coverage envisaged is based on what is known as the "building block approach": a distinction is made between the specific debtor or issuer risk, which relates to the individual credit standing of the issuer of the securities, and the general market risk. The latter results from general price movements in the financial markets which are not due to changes in the credit standing of an individual issuer. This computation method has the advantage that it can be integrated into existing prudential capital standards without causing a system break. The definition of capital is to be expanded compared with that previously agreed in Basle, particularly with respect to subordinated debt. In that area there were highly divergent regulations between banks and securities firms in some countries. As a compromise it was proposed that the capital requirements resulting from the new market risk regulations may be met by an additional own funds category: it is also to be permissible to use short-term subordinated debt to the extent that it does not exceed 250 % of equity capital. The German delegation tried hard to get securities supervisors to accept a less broad definition of capital, which did not diverge too far from the capital concept used for banks. As the securities supervisors' representatives were not prepared to accept this, the Basle Committee on Banking Supervision is considering applying the wider capital concept to some extent to the banks' securities business as well. As soon as the details of the new regulations have been worked out, the banks and securities firms will be invited to comment.

Moreover, in November 1991 the Basle Committee on Banking Supervision published a modification of the Basle Capital Accord of July 1988, which states more clearly to what extent *general provisions* may be included in the capital. The German banking industry and the banking supervisory authorities of the countries concerned have not raised any substantive objections to this proposal. The change is to be implemented not later than the end of 1993.

The Committee also concerned itself with *the consequences resulting from the collapse of an internationally operating bank with a highly ramified structure.* Its deliberations focused on improving the exchange of information between supervisors, on measures to avoid unclear group structures, on better control of share ownership and on coordinated measures in the event of bank closures.

The work of the Basle Committee on Banking Supervision on the prudential treatment of *netting procedures* for executory foreign exchange forward contracts was continued in the year under review. Progress has been made in the field of bilateral netting. The assessment of multilateral netting, by contrast, is turning out to be particularly difficult. This is due not least to the fact that bankruptcy provisions diverge considerably in those countries which are of particular importance for the assessment of the risk involved in netting.

Current state of banking law coordination in the EC

In the European Community, too, the supervisory framework and the provisions governing market access in the field of securities business are due to be harmonised. However, the relevant *Investment Services Directive* could not be approved in the year under review. Under this Directive independent securities houses are to be given the right to set up in business freely in other EC member states. There is still some disagreement, particularly with regard to the envisaged comprehensive reporting requirements and the requirement to publish prices and turnovers in securities markets. Another controversial issue is the direct access of banks to the stock exchanges, which is of major importance to German banks in particular.

Headway has been made, on the other hand, in the debate on the *Capital Adequacy Directive,* which is intended to regulate at EC level the capital standards for credit institutions' and investment firms' securities business. It is planned to exclude securities on the trading book from the previous coverage by the Solvency Ratio Directive and, instead, to make them subject to separate capital standards applying equally to banks and investment firms. This draft Directive is identical over wide areas with the above-mentioned preliminary agreement between the Basle Committee on Banking Supervision and the IOSCO on minimum capital standards for securities business. The Directive is likely to be approved in 1992.

The *Directive on the Supervision of Credit Institutions on a Consolidated Basis* will presumably be approved by the EC Council of Ministers as early as the first half of 1992. Compared with a forerunner directive of 1983, it provides, firstly, for supervision on a consolidated basis being extended to cover all groups of companies comprising at least one credit institution plus another credit or financial institution. Secondly, the consolidation requirement will also apply to groups of companies whose parent company is not a credit institution but a financial holding company. As regards the consolidation method, the rule envisaged is: full consolidation in the case of majority participations. The issue of the consolidation of investment firms whose parent company is a credit institution has not been settled finally in the Directive. Instead, the method of consolidation is to be regulated in the above-mentioned Capital Adequacy Directive. Until then, the consolidation method will be left to the discretion of the respective national supervisors. The Consolidation Directive also provides for some supervision of financial conglomerates by banking supervisors as banking supervisors will be given extensive rights to information on those parts of a conglomerate which are not subject to supervision.

The proposal for a Directive on Large Exposures is aimed at lowering the limit on exposures to a single client, as better risk-spreading contributes materially to the stability of the banking system. However, another reason why it became necessary is that the own funds concept on which the definition of a large exposure is based was diluted not inconsiderably by the Own Funds Directive adopted in 1989. Hence the EC Commission envisages a limit of 25% of the lending institutions' own funds for large exposures to a single client (current limit under the German Banking Act: 50%). Adjustment is to be made easier for the banks by transitional provisions. A lasting exemption for small banks could not be obtained in the negotiations at EC level; extended transitional arrangements are therefore envisaged for these banks.

In the year under review the EC Commission presented the preliminary draft of a Directive on the Coordination of Laws, Regulations and Administrative Provisions relating to *deposit guarantee schemes.* This takes due account of the recommendations of the EC Banking Advisory Committee. The draft provides for the mandatory membership of all banks in a deposit protection scheme which also protects the depositors of the branches of these credit institutions in other EC member states (home country principle). In addition, it is to be ensured that branches in the host country can join the deposit guarantee scheme there, so as to supplement the protection afforded by the home country. In line with the principle of minimum harmonisation, a very low amount is set – from the German point of view – up to which depositors must be protected. A more comprehensive depositor protection scheme may be retained or introduced. Whether ultimately the German system of voluntary self-help schemes set up by the banking associations, which offers comprehensive depositor protection and has proved its worth as a stabilising factor in the banking industry (which is particularly sensitive to fluctuations in confidence), can be retained unchanged will depend on the further discussions.

Translation of EC Council Directives into German law

In 1991 the preparations for the translation of major prudential EC Council Directives into German law were largely completed. The *Fourth Act Amending the Banking Act* is intended to translate the Second Banking Coordination Directive and the Own Funds Directive. At the centre of the provisions of the *Second Banking Coordination Directive* is what is known as the "EC passport" for banks. This allows EC banks to open branches in all member states without a new banking licence having to be obtained from the host country. The supervision of bank offices of dependent legal status is governed by the home country principle, i.e. is effected by the supervisory authority responsible for the head office. An essential precondition for this is that the capital standards (the most important banking supervisory rules) are harmonised in future in the context of a minimum standard. The *Own Funds Directive* defines the items acceptable as capital for prudential purposes. As part of its translation into German law, the authorities are considering accepting revaluation reserves in respect of securities and real estate as own funds to a limited extent. The Bundesbank has voiced its serious misgivings about this. The value of these reserves depends heavily on developments in the financial and property markets. Examples abroad have highlighted the fact that the soundness of individual institutions, and also of the banking system as a whole, is affected when adverse price influences work through to the banks' capital. A strictly limited recognition of items which are so highly sensitive to fluctuations and trigger such procyclical responses would at the utmost be acceptable in the case of those banks whose higher-quality capital elements distinctly exceed the minimum standard provided for by the EC Council Directive. The *Solvency Ratio Directive* is closely associated with the Own Funds Directive and prescribes a minimum capital of 8 % in respect of the weighted risk assets of a bank. This Directive is being translated into German law by means of an amendment of Principle I, which is drawn up by the Federal Banking Supervisory Office in agreement with the Bundesbank. Work on the amendment of Principle I has started; the amendment is due to come into force together with the forthcoming amendment of the Banking Act.

Accounting rules for banks

Pursuant to section 330 of the German Commercial Code, the Federal Minister of Justice, acting in agreement with the Federal Minister of Finance and in consultation with the Bundesbank, has issued the *Accounting Ordinance* for banks dated February 10, 1992. It includes the forms for the balance sheet and the profit and loss account, and the regulations which are necessary for translating the EC Bank Accounts Directive into national law and which have not already been incorporated in the German Commercial Code (sections 340 to 340o) by the Bank Accounts Directive Act. The Ordinance supersedes both the Forms Ordinance of September 14, 1987 and the accounting rules of the Federal Banking Supervisory Office dated February 8, 1988 and, like the provisions of the Bank Accounts Directive Act, is to be applied for the first time to the financial years beginning after December 31, 1992.

Compliance with the Principles concerning the Capital and Liquidity of Banks

Some 4,300 banks have submitted reports regarding Principles I, II and III. Since the entry into force of the new Principle Ia in October 1990, reports have had to be submitted by those institutions where the sum of the nominal amounts

- of the assets and liabilities denominated in foreign currency and precious metals exceeds DM 1 million (December 1991: 804 institutions)
- of the interest rate contract positions exceeds DM 4 million (December 1991: 141 institutions)
- of the contracts involving other price risks exceeds DM 500,000 (December 1991: 76 institutions)

or if the sum of the Principle Ia ratios exceeds 10% of their liable capital.

In the last few years the cases in which the limits set under the individual Principles have been exceeded in terms of the average of four end-of-quarter dates can be broken down as follows:

Number of banks which exceeded the limits set in the Principles *

Annual averages

Year	Principle I	Principle Ia (2) — Risk position — No. 1 1	No. 2 2	No. 3 3	Principle II	Principle III
1981	41	2	.	.	47	118
1982	19	2	.	.	20	59
1983	17	3	.	.	10	42
1984	16	5	.	.	9	41
1985	10	6	.	.	8	30
1986	6	6	.	.	11	19
1987	3	2	.	.	7	12
1988	2	4	.	.	11	14
1989	3	3	.	.	25	15
1990	8	3	.	.	40	38
1991	11	2	1	0	54	33

* Excluding institutions in the new Länder and excluding branches of enterprises domiciled in another country, instalment sales financing institutions and public mortgage banks. — **1** Foreign exchange and precious metal positions. — **2** Interest-rate contract positions (from Oct. 1, 1990) — **3** Positions involving other price risks (from Oct. 1, 1990).

While the number of instances in which the above-mentioned limits set under Principles I, Ia and III have been exceeded has changed only marginally, it has increased more rapidly than in the previous year in the long-term liquidity area (Principle II). The overshooting of the limits set under the Principles is predominantly due to special circumstances obtaining in the banks involved, and is therefore generally tolerated by the Banking Supervisory Authorities.

For the trend in the average ratios of Principles I, Ia, II and III, see the table on the next page.

Average ratios of Principles I, I a, II and III pursuant to sections 10 and 11 of the Banking Act*

Annual averages

Year	Total	Commercial banks	Regional giro institutions 1	Regional institutions of credit cooperatives 1	Savings banks	Credit cooperatives
	Principle I (counterparty failure risk) — ceiling 18 times —					
1981	14.3	15.1	15.9	10.1	13.9	13.2
1982	14.1	15.1	15.5	9.9	13.5	13.1
1983	13.7	14.7	14.9	9.4	13.0	12.9
1984	13.6	14.7	14.8	9.1	12.9	12.7
1985	13.4	14.6	14.9	8.5	12.6	12.3
1986	12.7	13.3	14.9	7.1	12.3	11.6
1987	12.3	12.7	14.6	6.7	12.0	11.2
1988	12.4	13.2	14.8	6.4	11.8	11.1
1989	12.6	13.3	14.8	6.2	12.1	11.3
1990	12.6	12.7	15.1	7.1	12.4	11.7
1991	12.9	12.9	15.3	6.9	12.7	12.2
	Principle I a (2) 1 (foreign exchange and precious metal positions) — ceiling 30 % —					
1981	7.2	10.4	6.1	6.6	1.1	2.2
1982	6.6	9.5	5.9	7.2	1.1	2.4
1983	6.9	10.5	5.4	7.4	1.1	2.8
1984	6.7	10.8	5.1	5.4	0.9	2.9
1985	6.9	11.0	5.6	5.3	1.0	4.0
1986	6.8	10.1	5.7	7.1	1.2	4.4
1987	8.1	9.5	11.0	9.2	1.4	7.1
1988	9.7	12.1	10.3	12.9	1.4	8.7
1989	7.8	10.7	6.5	13.9	2.1	7.3
1990	6.9	9.0	5.8	12.6	3.2	5.9
1991	5.0	6.3	3.6	7.2	3.3	4.6
	Principle I a (2) 2 (interest-rate contract positions) — ceiling 20 % —					
1991	2.3	2.2	3.8	0.7	1.0	0.9
	Principle I a (2) 3 (positions involving other price risks) — ceiling 10 % —					
1991	0.6	0.8	0.3	0.1	0.3	0.7
	Principle II — ceiling 100 % —					
1981	92.1	90.4	95.5	91.8	94.5	83.3
1982	91.0	87.4	96.4	91.5	92.7	82.9
1983	90.1	85.0	96.6	90.2	92.3	81.5
1984	89.9	83.8	96.0	90.0	92.9	82.8
1985	90.2	85.1	95.5	89.6	92.9	83.6
1986	87.9	83.6	92.9	86.9	90.1	82.4
1987	86.7	84.1	91.7	83.2	87.7	81.6
1988	88.4	87.6	93.4	85.5	88.0	83.2
1989	89.5	87.5	92.7	86.9	90.1	86.6
1990	88.8	85.5	89.4	86.9	91.6	88.9
1991	90.2	85.6	93.2	89.3	92.9	89.2
	Principle III — (ceiling 100 %) —					
1981	85.1	92.9	86.8	74.3	75.2	83.7
1982	83.4	92.5	88.1	73.5	71.6	81.1
1983	80.9	92.3	84.6	66.0	68.0	77.4
1984	80.4	91.6	79.8	67.9	68.3	77.8
1985	78.2	90.8	74.2	65.9	66.0	75.2
1986	71.3	87.5	61.8	48.8	58.3	67.7
1987	65.2	83.2	55.2	47.6	52.1	61.1
1988	65.6	86.0	55.3	51.3	50.6	59.4
1989	66.9	86.5	53.4	50.1	53.0	61.5
1990	69.6	88.0	56.5	57.1	56.2	63.0
1991	76.1	93.2	70.6	66.2	61.1	65.0

* Excluding institutions in the new Länder and excluding branches of enterprises domiciled in another country, instalment sales financing institutions and public mortgage banks. — 1 Principles I, II and III excluding Deutsche Girozentrale and Deutsche Genossenschaftsbank.

Measured in terms of the average ratio of the new Principle I, the banks, other than the regional institutions of credit cooperatives, used the scope for lending to a somewhat greater extent than a year before. The average ratio in respect of the risk position pursuant to no. 1 of the new Principle Ia improved relatively markedly against the previous year in almost all categories of banks. For the most part, this is due to the fact that positions which tend to reduce the ratio are now to be included in the calculation.

The average ratios of Principles II and III increased both in terms of the overall average and in all categories of banks.

Pro-rata-consolidated Principle I

Since July 1, 1985, banking groups, too, have had to comply with Principle I. On that date 20 banking groups exceeded the ceiling of 18 times the liable capital, so that they had to take advantage of the transitional arrangements provided for by the Federal Banking Supervisory Office in order to reduce their overshooting of the limits set under the Principle. As at December 31, 1991 no banking group was exceeding the pro-rata-consolidated Principle I.

The average ratios of the pro-rata-consolidated Principle I can be seen from the list below:

Ratio of the pro-rata-consolidated Principle I	as at December 1991
Total (88 banking groups)	15.4
of which: 43 commercial banks	15.9
10 regional giro institutions	15.2
16 instalment sales financing institutions	14.6

Participation in ongoing banking supervision activities

At the end of 1991 a total of 4,508 banks were covered by banking supervision (including institutions in process of winding up and building and loan associations of dependent legal status). That was 250 fewer banks than in the preceding year; most of the reduction was due to mergers in the credit cooperative sector (225, including 43 east German institutions). In the savings bank sector there were 45 mergers (including 10 east German institutions). Overall, 39 banks were covered for the first time in the period under review (30 west German and 9 east German banks, including 5 guarantee banks).

An overview of the operations conducted by the Land Central Banks and the Provisional Administrative Office in Berlin in the course of ongoing banking supervision activities is provided by the table below:

Current banking supervision activities

Number of operations conducted

Item	1987	1988	1989	1990	1991
Individual reports pursuant to section 13 of the Banking Act	50,392	51,209	54,619	60,793	69,593
Borrowers included in the lists submitted in accordance with section 13 of the Banking Act	74,391	62,035	69,354	70,411	73,012
Reports on loans of DM 1 million or more pursuant to section 14 of the Banking Act	1,482,235	1,534,653	1,570,350	1,683,592	1,875,105
Reports pursuant to section 16 of the Banking Act	17,049	8,452	8,949	10,068	23,755
Reports pursuant to section 24 of the Banking Act	9,327	9,475	10,283	12,124	16,905
Monthly returns pursuant to section 25 of the Banking Act	55,908	54,179	53,057	53,306	53,147
Reports on the volume of external lending	780	796	894	953	983
Annual accounts of banks	5,070	4,964	4,614	4,811	4,652
Auditors' reports on annual accounts	2,710	2,746	2,670	2,767	2,317
Reports on the auditing of safe custody accounts	502	541	470	471	393
Routine, special and deposit guarantee fund audit reports	423	457	510	693	738
Audits commissioned by the Federal Banking Supervisory Office pursuant to					
section 44 (1) of the Banking Act	22	17	19	15	33
section 44 (2) of the Banking Act	88	89	113	117	117
Reports under the Capital Accord of the Basle Committee on Banking Supervision	–	–	–	112	105

During 1991 many of the reporting requirements under the Banking Act were for the first time applied to the banks in eastern Germany. Some of the resulting increase in the workload involved in ongoing banking supervision could only be coped with by temporarily curtailing certain activities. Considerable increases in the number of individual reports — and in the borrowers shown in the lists — on large loans pursuant to section 13 of the Banking Act and of reports on staffing, financial and organisational changes pursuant to section 24 of the Banking Act were therefore accompanied by declines in other areas. The surge in reports pursuant to section 16 of the Banking Act (loans to managers, etc.), however, is due to the fact that the five-yearly list of the loans to managers etc. subject to reporting requirements had to be filed during the year under review.

Credit information exchange for loans of DM 1 million or more

The credit information exchange for loans of DM 1 million or more reported the following on the reporting date of December 31, 1991:

The volume of such loans rose by DM 536 billion or 27.8% against December 1990 to DM 2,463 billion. The loans to domestic borrowers increased by DM 462 billion or 35.7% to DM 1,755 billion and those to non-resident borrowers by DM 74 billion or 11.7% to DM 708 billion. 83 foreign subsidiaries of domestic banks reported loans of DM 1 million or more totalling DM 182 billion, i.e. about DM 10 billion or 5.8% more than a year before.

Overall, the credit information exchange recorded 413,000 borrowers on the said reporting date (as against 367,000 in the preceding year), of whom 207,000 (186,000) were lumped together in 75,000 (69,000) borrower units pursuant to section 19 (2) of the Banking Act. In the case of 130 (91) borrower units, the debt as defined in section 14 of the Banking Act was in excess of DM 1 billion; the total debt amounted to DM 264 billion.

Since 1971, when a mere 70,000 loans were reported per reporting period, the number of registered loans of DM 1 million or more has risen to some 511,000 per reporting period, and thus has more than septupled over a period of twenty years. To limit the workload associated with the processing of the reports, which has been growing all the time, the Bundesbank has proposed raising the reporting threshold of DM 1 million, which has been in force since the currency reform of 1948, to DM 3 million as part of the amendment of the Banking Act planned for 1992.

The table below provides an overview of the trends in loans of DM 1 million or more since 1981:

Credit information exchange for loans of DM 1 million or more*

Year	Volume of loans of DM 1 million or more		Number of reported loans of DM 1 million or more		Number of reporting	
	DM billion	Change in %	Number	Change in %	banks	insurance enterprises
1981	746	+ 9.1	206,667	+ 11.9	2,821	498
1982	786	+ 5.4	222,784	+ 7.8	2,887	500
1983	829	+ 5.5	239,098	+ 7.3	2,944	536
1984	889	+ 7.2	256,623	+ 7.3	3,051	547
1985	916	+ 3.0	277,281	+ 8.1	3,095	550
1986	1,339	+ 46.2	365,610	+ 31.9	3,280	501
1987	1,437	+ 7.3	380,537	+ 4.1	3,243	495
1988	1,533	+ 6.7	392,644	+ 3.2	3,264	492
1989	1,687	+ 10.0	417,801	+ 6.4	3,311	508
1990	1,927	+ 14.2	452,696	+ 8.4	3,280	525
1991	2,463	+ 27.8	511,255	+ 12.9	3,665	537

* Up to and including 1985, the data refer to the two-month reporting period October-November in each year; from 1986 the data are based on the three-month reporting period October-December. Banks domiciled in the new Länder were subject to reporting requirements pursuant to section 14 of the Banking Act for the first time on June 30, 1991.

The number of insolvencies of enterprises and individuals recorded by the credit information exchange, in respect of which loans as defined in section 14 of the Banking Act were reported at the time of the announcement of insolvency, increased by 144 in 1991 to 792. This figure includes 90 insolvent debtors of loans of DM 1 million or more in the new Länder, who were included in the reporting requirements pursuant to section 14 of the Banking Act for the first time as from the reporting date June 30, 1991. The volume of loans of DM 1 million or more raised by the insolvent enterprises and individuals went up by DM 1.4 billion to DM 3.6 billion, with DM 0.8 billion being accounted for by insolvent debtors in the new Länder.

Text of the Principles

The Principles pursuant to sections 10 and 11 of the Banking Act, on the basis of which the adequacy of banks' capital and liquidity is normally assessed, were not amended during the year under review.

The currently applicable Principles read as follows:

Principles of January 20, 1969 Concerning the Capital and Liquidity of Banks, as last amended by the Announcement of May 15, 1990

Preamble

(1) The Federal Banking Supervisory Office, acting in accordance with section 10 (1) sentence 3, section 10a (1) sentence 2 and section 11 sentence 3 of the Banking Act *(Gesetz über das Kreditwesen – KWG)* in the wording of the Announcement of July 11, 1985 (Federal Law Gazette I, page 1472), hereby announces the Principles, drawn up in agreement with the Deutsche Bundesbank and after consultation of the central associations representing the banks, according to which it will as a rule assess whether a bank's capital and the entire capital of a banking group are adequate (section 10 (1) and section 10a (1) of the Banking Act) and whether a bank's liquidity is sufficient (section 11 of the Banking Act).

(2) If a bank exceeds the upper limits laid down in the Principles by more than an insignificant amount, or repeatedly, then there is normally reason to

suppose that the bank does not possess the necessary capital (Principle I and Principle Ia) or that its liquidity leaves something to be desired (Principles II and III). If a banking group exceeds the upper limits set by Principle I, sentence 1 applies as appropriate. When assessing the adequacy of a bank's or banking group's capital or a bank's liquidity, special conditions which warrant lower or higher requirements, as the case may be, can be taken into consideration.

(3) Only Principles I and Ia apply to private mortgage banks which do not exercise their right to conduct extended business in accordance with section 46 (1) of the Mortgage Bank Act *(Hypothekenbankgesetz)*, building and loan associations (including those operated as units of dependent legal status), public mortgage banks, instalment sales financing institutions and banks exclusively conducting banking business within the meaning of section 1 (1) sentence 2 nos. 7 and 8 of the Banking Act.

(4) Only Principle Ia applies to ship mortgage banks and central securities depositories. If they belong to a banking group within the meaning of section 10a (2) of the Banking Act, they are to be included as part of the group when applying Principle I to a banking group; central securities depositories are included only if they are a parent bank within the meaning of section 10a (2) of the Banking Act.

(5) The Principles do not apply to investment companies.

(6) The Principles in the wording of January 20, 1969 will first be applied for the month of January 1969. Announcement no. 1/62 of the Federal Banking Supervisory Office of March 8, 1962 (Federal Gazette no. 53 of March 16, 1962), as amended by Announcement no. 1/64 of August 25, 1964 (Federal Gazette no. 161 of September 1, 1964), is hereby revoked.

Principle I

(1) The risk assets of a bank (including a building and loan association operated as a unit of dependent legal status) shall not exceed eighteen times its liable capital. The following shall be regarded as risk assets:

1. participating interests,

2. loans,

3. financial swaps,

4. forward contracts and option rights involving fungible underlying instruments.

(2) In the case of banking groups (section 10a (2) of the Banking Act), the ceiling pursuant to subsection (1) sentence 1 above applies as appropriate to the ratio of total liable capital to total risk assets (other than participating interests in enterprises belonging to the group), as calculated by the pro-rata consolidation method (section 10a (3) of the Banking Act), and to asset-side balancing items resulting from the consolidation of capital in accordance with section 10a (3) sentence 4 of the Banking Act.

(3) The following shall be regarded as loans within the meaning of subsection (1) sentence 2 no. 2 above:

1. bills of exchange in the bank's portfolio and bills sent for collection from the bank's portfolio prior to maturity,

2. receivables from banks and customers (including the trade receivables of banks trading in goods),

3. risk assets which the borrower has sold to the lender, and which are transferred subject to the condition that they must be retransferred or redeemed at the lender's request (sale and repurchase agreements),

4. assets in respect of which a bank or an enterprise within the meaning of section 10a (2) sentence 5 no. 1, no. 2 or no. 3 of the Banking Act has concluded leasing contracts as the lessor,

5. contingent claims in respect of
   (a) bills of exchange in circulation drawn by the bank, discounted and credited to borrowers,
   (b) endorsement liabilities on rediscounted bills,
   (c) guarantees, guaranteed bills and cheques and other warranties, and in respect of the provision of collateral for third-party liabilities,
   (d) unconditional commitments by building and loan associations to fund interim loans granted by third parties to savers with such associations.

(4) The basis of assessment for counting the risk assets is,

1. in the case of participating interests: the book value, less loan-loss provisions,

2. in the case of loans as defined in subsection (3) nos. 1 to 3 and no. 5 above (other than guarantees for forward contracts, option rights and financial swaps): the book value, less loan-loss provisions and less fees booked but chargeable to subsequent accounting years,

3. in the case of assets leased in accordance with subsection (3) no. 4 above: the book value, less rentals paid by the lessee or a purchase of lease receivables, with the book value as the maximum deduction,

4. in the case of financial swaps and the guarantees assumed in connection therewith: the principal amount,

5. in the case of forward contracts, option rights and the guarantees assumed in connection therewith: the bank's claim to the delivery or purchase of the underlying instrument, on the assumption that the contracts are actually performed.

Where, in the case of forward contracts or financial swaps involving a swap of interest and principal, all claims and obligations between two parties denominated in the same currency and having the same value date are netted by novation under the terms of a contractual agreement, the claim arising from the remaining balance shall be regarded as the basis of assessment. Risk assets denominated in a foreign currency shall be converted into Deutsche Mark at the exchange rate ruling on the respective reporting date (reporting date rate); instead of the reporting date rate, the bank, when converting those participating interests which it does not treat as an integral part of its foreign currency position, may use the exchange rate obtaining at the time such interests were first entered in its books. For the currencies officially quoted on the Frankfurt Currency Exchange, the spot middle rates of exchange shall be used and, for other currencies, the middle rates derived from the determinable buying and selling rates quoted on the respective reporting date shall be applied.

(5) Financial swaps within the meaning of subsection (1) sentence 2 no. 3 above, forward contracts and option rights within the meaning of subsection (1) sentence 2 no. 4 above and guarantees assumed in connection with these risk assets shall be counted uniformly, at the bank's discretion, either by the original-exposure method or by the marking-to-market method; a bank may switch at any time from the original-exposure method to the marking-to-market method. If the original-exposure method is used, the risk assets enumerated in sentence 1 above shall be counted by applying "maturity-related" percentages to the relevant basis of assessment as defined in subsection (4) sentence 1 no. 4 or no. 5 above. If the marking-to-market method is employed, the risk assets enumerated in sentence 1 above shall be counted at the potential replacement cost which, according to the daily assessment, would arise if the counterparty were to fail, plus a factor (the "add-on") specified in subsection (6) sentence 2 below to reflect the potential future increase in risk; no add-on is applied to single-currency floating/floating interest-rate swaps. The amount of the potential replacement cost is determined by the level of the additional expenditure or of the lower earnings which would arise in the event of contracting an equivalent position.

(6) The "maturity-related" percentages within the meaning of subsection (5) sentence 2 above are,

1. if the replacement cost is due entirely to changes in interest rates, given a residual maturity of

up to one year:	0.5 %,	
more than one year:	1.0 %	for each full and each incomplete year, less 1 %;

2. if the replacement cost is due entirely or partly to changes in exchange rates or other prices, given an original maturity of

up to one year:	2.0 %,	
more than one year:	3.0 %	for each full and each incomplete year, less 1 %.

The "add-on" within the meaning of subsection (5) sentence 3 clause 1 above, as a percentage of the basis of assessment as defined in subsection (4) sentence 1 no. 4 or no. 5 above, is,

1. if the replacement cost is due entirely to changes in interest rates, given a residual maturity of

   more than one year: 0.5 %;

2. if the replacement cost is due entirely or partly to changes in exchange rates or other prices, given a residual maturity of

up to one year:	1.0 %,
more than one year:	5.0 %.

(7) Of the loans included in subsection (3) above and granted by building and loan associations to savers with them who are neither banks within the meaning of subsection (8) no. 6 below or subsection (9) below nor public corporations within the meaning of subsection (10) no. 1 below, the following shall be counted at only 70 % of their value:

1. loans granted by building and loan associations under allocated savings contracts (including loans granted in accordance with subsection (8) no. 2 below),

2. interim and bridging loans granted by building and loan associations to savers with them pending receipt of a building loan,

3. contingent claims of building and loan associations in accordance with subsection (3) no. 5 (d) above.

(8) Of the risk assets enumerated in subsection (1) sentence 2 above, the following shall be counted at only 50% of their value:

1. loans serving as cover for communal bonds or communal ship mortgage bonds,

2. loans satisfying the requirements of section 12 (1) and (2) of the Mortgage Bank Act *(Hypothekenbankgesetz)*, to the extent that they do not exceed three-fifths of the value of the real estate,

3. loans with maturities not exceeding fifteen years secured by ship mortgages satisfying the requirements of section 10 (1) and (4) sentence 2, section 11 (1) and (4), and section 12 (1) and (2) of the Ship Mortgage Bank Act *(Schiffsbankgesetz)*, to the extent that they do not exceed three-fifths of the value of a ship or ship under construction,

4. receivables from customers in accordance with subsection (3) no. 2, no. 3 or no. 4 above, to the extent that they are guaranteed or secured in some other way by public corporations domiciled in the area of validity of the Banking Act,

5. contingent claims on customers in accordance with subsection (3) no. 5 (c) above,

6. loans in accordance with subsection (3) above to banks domiciled outside the area of validity of the Banking Act,

7. risk assets in accordance with subsection (1) sentence 2 no. 3 or no. 4 above, where the claim to performance is directed against a bank which is domiciled outside the area of validity of the Banking Act and was licensed in a country other than those specified in subsection (9) no. 2 (a) below,

8. risk assets in accordance with subsection (1) sentence 2 no. 3 or no. 4 above, unless the preconditions for the application of lower weights are satisfied.

(9) Of the risk assets enumerated in subsection (1) sentence 2 above, the following shall be counted at only 20% of their value:

1. risk assets in accordance with subsection (1) sentence 2 no. 2, no. 3 or no. 4 above, where the claim to performance is directed against a bank which is domiciled in the area of validity of the Banking Act (including branches within the meaning of section 53 of the Banking Act, and including banks that are public corporations domiciled in the area of validity of the Banking Act),

2. risk assets in accordance with subsection (1) sentence 2 no. 3 or no. 4 above, where the claim to performance is directed

   (a) against a bank which is domiciled outside the area of validity of the Banking Act and was licensed in a country that is a full member of the Organisation for Economic Cooperation and Development (OECD) or a country that has concluded special lending arrangements with the International Monetary Fund under the Fund's General Arrangements to Borrow, or

   (b) against a multilateral development bank in which at least one of the major industrial countries that have concluded special lending arrangements with the International Monetary Fund under the Fund's General Arrangements to Borrow has a participating interest.

(10) The following shall attract a zero weight:

1. risk assets in accordance with subsection (1) sentence 2 no. 2, no. 3 or no. 4 above, where the claim to performance is directed against public corporations (other than banks) in the area of validity of the Banking Act or against a special fund of the Federal Government,

2. risk assets in accordance with subsection (1) sentence 2 no. 3 or no. 4 above, where the claim to performance is directed against

   (a) a country that is a full member of the Organisation for Economic Cooperation and Development (OECD) or a country that has concluded special lending arrangements with the International Monetary Fund under the Fund's General Arrangements to Borrow, or

   (b) the central bank of one of these countries,

3. risk assets in accordance with subsection (1) sentence 2 no. 3 or no. 4 above, the replacement cost of which is due entirely or partly to changes in exchange rates, if the original maturity of the contract is less than fifteen calendar days,

4. risk assets in accordance with subsection (1) sentence 2 no. 4 above, the performance of which is owed or guaranteed by a stock exchange institution.

Principle I a

(1) The total amount of certain positions of a bank involving price risks ("risk positions") shall not exceed 60% of the bank's liable capital at the close of business on any day.

(2) The following are risk positions within the meaning of subsection (1) above:

1. the sum of the differences, as determined in accordance with subsections (3) and (4) below, between the bank's assets and liabilities denominated in foreign currency or in gold, silver or platinum (precious metals),

2. the sum of the risk coefficients, as determined in accordance with subsections (5) to (7) below, for counting the risk-enhancing positions arising under interest-rate forward and interest-rate option contracts (interest-rate contract positions),

3. the sum of the differences, as determined in accordance with subsection (8) below, between delivery claims and delivery obligations arising under forward and option contracts involving other price risks.

The risk positions as defined in sentence 1 above shall not exceed the following percentages of the bank's liable capital at the close of business on any day:

1. the risk position pursuant to no. 1 above: 30%,

2. the risk position pursuant to no. 2 above: 20%, and

3. the risk position pursuant to no. 3 above: 10%.

(3) The following items constitute assets and liabilities within the meaning of subsection (2) sentence 1 no. 1 above if they are denominated in foreign currency or in gold, silver or platinum in an unprocessed state (i.e. excluding products made of these precious metals):

A. Assets

1. receivables from banks and customers, and balances in foreign currency accounts carried by the Deutsche Bundesbank,

2. bills of exchange,

3. Treasury bills and Treasury discount paper,

4. securities, other than shares and other participatory securities,

5. stocks of
   (a) gold,
   (b) silver,
   (c) platinum,

6. delivery and payment claims arising under spot and forward contracts, and claims to the payment of principal amounts under financial swaps,

7. claims and contingent claims under sale and repurchase agreements to the redelivery of items listed under assets nos. 1 to 6 above, to the extent that such items are not included in these assets,

8. rights of the bank as an option writer, arising when third parties exercise option rights, to receive the purchase price represented by the strike price and to receive the underlying instrument,

9. rights of the bank, arising when exercising its own option rights, to receive the purchase price represented by the strike price and to receive the underlying instrument, to the extent that this reduces a difference which would otherwise exist and constitute a liability in accordance with subsection (4) sentence 1 clause 1 below.

B. Liabilities

1. liabilities to banks and other creditors,

2. bonds,

3. own acceptances and promissory notes outstanding,

4. delivery and payment obligations arising under spot and forward contracts, and obligations to pay principal amounts under financial swaps,

5. obligations and contingent obligations under sale and repurchase agreements to redeliver items listed under assets nos. 1 to 6 above, to the extent that such items are included in these assets,

6. obligations of the bank as an option writer, arising when third parties exercise option rights, to pay the purchase price represented by the strike price and to deliver the underlying instrument,

7. obligations of the bank, arising when exercising its own option rights, to pay the purchase price represented by the strike price and to deliver the underlying instrument, to the extent that this reduces a difference which would otherwise exist and constitute an asset in accordance with subsection (4) sentence 1 clause 1 below.

(4) The differences for determining the risk position pursuant to subsection (2) sentence 1 no. 1 above shall be calculated separately for each currency and each precious metal by ascertaining the balance in absolute terms deriving from the assets and liabilities computed in accordance with subsection (3) above. Regardless of how the specific loan-loss provisions in respect of assets in foreign currency or Deutsche Mark have been made, they must be deducted from these assets. When converting assets and liabilities denominated in a foreign currency into Deutsche Mark, spot middle rates shall be used for the currencies officially quoted on the Frankfurt Currency Exchange, and middle rates derived from the determinable buying and selling rates shall be used for other currencies. Assets and liabilities in gold shall be converted into Deutsche Mark at the rate quoted on the Frankfurt Gold Exchange for 12.5 kg bars (1 kg = 32 fine ounces). Assets and liabilities in silver and platinum shall be converted at the rates per fine ounce quoted on the London Metal Exchange.

(5) The risk coefficients for determining the risk position pursuant to subsection (2) sentence 1 no. 2 above shall be calculated separately for each currency, using a risk-recording system classified by time with four consecutive zones, each of which is subdivided into periods of calendar quarters or calendar years. The following are combined to form zones within the meaning of sentence 1 above:

1. all the calendar quarters specified in sentence 3 clause 2 below (the short-term zone),

2. the five calendar years following the short-term zone (the medium-term zone),

3. the five calendar years following the medium-term zone (the medium-to-long-term zone), and

4. the three calendar years following the medium-to-long-term zone (the long-term zone).

The extent of the short-term zone within the risk-recording system changes over time at the end of each quarter upon the compilation of the fixed-interest-rate balance sheet pursuant to subsection (7) sentence 2 clause 2 below; the short-term zone which starts in the second calendar quarter following the relevant reporting date within the meaning of clause 1 of this sentence comprises

as at March 31:	the last two calendar quarters of the current year and all calendar quarters of the following year (six quarters),
as at June 30:	the last calendar quarter of the current year and all calendar quarters of the following year (five quarters),
as at September 30:	all calendar quarters of the following two years (eight quarters),
as at December 31:	the last three calendar quarters of the following year and all calendar quarters of the next year but one (seven quarters).

(6) To determine the risk coefficient of each zone, asset-side and liability-side risk ratios and, to the extent specified in subsection (7) sentence 4 below, non-nettable add-ons shall be derived from the risk-enhancing elements of the interest-rate contract positions in the individual periods of each zone, and subsequently aggregated over all the periods. In the risk-recording system the interest-rate contract positions shall be computed as the balance of all the asset and liability components of interest-rate forward contracts and option-writer positions arising from interest-rate option contracts that are attributed to the same period; the bank's own interest-rate option rights, which shall be recorded separately (classified by asset options and liability options), are included in the calculation of the interest-rate contract position in the individual periods with the differences (which shall be determined separately) between the asset and the liability components of each overall option contract, provided that their volume, as ascertained in accordance with clause 1 of this sentence, is reduced by netting against either of these differences. Interest-rate forward and interest-rate option contracts for the immediate hedging of individual fixed-interest-rate items within the meaning of subsection (7) sentence 2 below – which contracts have been entered into after the reporting date of the latest fixed-interest-rate balance sheet to be compiled – are left out of account in the calculation of the interest-rate contract positions until the following fixed-interest-rate balance sheet is drawn up, provided that the express purpose of hedging was documented at the time the contracts were concluded. The interest-rate forward and interest-rate option contracts to be incorporated in the calculation of the interest-rate contract positions are included with all their asset and liability components, in line with the effect in terms of interest rates, and on the assumption that the contracts are actually performed. In the risk-recording system each asset and liability component shall be attributed to those periods which precede the period in which it matures; components which mature in a calendar year subsequent to the long-term zone within the meaning of subsection (5) sentence 2 no. 4 above shall be attributed to all periods of the recording system.

(7) In any period of the risk-recording system, the risk-enhancing element of an interest-rate contract position, as calculated in accordance with subsection (6) above, consists of the difference by which the absolute amount of the overall interest-rate position (which is composed of the interest-rate contract position plus the open fixed-interest-rate position) exceeds the absolute amount of the open fixed-interest-rate position; depending on the underlying

interest-rate contract position, the risk-enhancing element is either an asset or a liability. The open fixed-interest-rate positions are determined in each case by computing the balance of the nominal amounts of all the on-balance-sheet and off-balance-sheet fixed-interest-rate items (other than the components of the interest-rate contracts specified in subsection (6) sentence 2 above) that are attributed to the same period; these positions are to be taken from the latest of the fixed-interest-rate balance sheets which the bank must compile within one month by a consistent method, at least as at the end of each calendar quarter, in line with the breakdown by periods of the risk-recording system. In the fixed-interest-rate balance sheet every fixed-interest-rate item shall be attributed to those periods which precede the period in which its interest rate ceases to be fixed. To compute the risk ratios which are to be found in the periods of all the zones and the add-ons which are likewise to be taken into account in the first three quarters of the short-term zone, the risk-enhancing elements within the meaning of sentence 1 above are weighted with period-related percentages; these percentages are,

1. if the risk ratios are derived
   for each quarter: 0.5 %,
   for each year: 2.0 %;

2. if the add-ons are derived
   for each quarter: 0.5 %.

In each of the zones as defined in subsection (5) sentence 2 nos. 2 to 4 above, the risk coefficient is formed by the absolute amount of the balance of the asset-side and liability-side risk ratios of the respective periods, and in the zone as defined in subsection (5) sentence 2 no. 1 above it is formed by the sum of the absolute values of this balance and the add-ons in accordance with sentence 4 above.

(8) The differences for determining the risk position pursuant to subsection (2) sentence 1 no. 3 above shall be calculated separately, classified by the type of instrument posing a price risk underlying the forward and option contracts; in each case the differences are formed by the absolute amount of the balance computed in respect of all forward contracts and option-writer positions under option contracts (on the assumption that the contracts are actually performed) from the bank's delivery claims and delivery obligations, provided that these contracts do not hedge the price risk posed by a portfolio of instruments of the same type. The bank's own option rights are included in the balance along with its aggregate delivery claims under call options and its aggregate delivery obligations under put options, provided that the level of the balance, as determined in accordance with sentence 1 clause 2 above, is reduced by netting against either of these aggregates.

(9) The asset and liability components of option contracts shall be included in the calculation of the risk positions pursuant to subsection (2) sentence 1 above to the extent of the minimum percentages prescribed by sentence 5 below or of higher ratios deriving from a computer-assisted option-price model consistently used by the bank. The minimum percentages are determined by the value of the ratio (*Anrechnungskoeffizient — AK*) which is to be calculated for every option contract at the close of business every day. This ratio shall be calculated,

1. in the case of contracts
   (a) involving call options included in the risk positions pursuant to subsection (2) sentence 1 no. 1 or no. 3 above, and

(b) involving asset-side interest-rate options included in the risk position pursuant to subsection (2) sentence 1 no. 2 above,

by the formula $$AK = \frac{FR - SP}{SP} \times \frac{360}{RM},$$

2. in the case of contracts
   (a) involving put options included in the risk positions pursuant to subsection (2) sentence 1 no. 1 or no. 3 above, and

   (b) involving liability-side interest-rate options included in the risk position pursuant to subsection (2) sentence 1 no. 2 above,

   by the formula $$AK = \frac{SP - FR}{SP} \times \frac{360}{RM},$$

where "FR" = the Forward Rate applying to the underlying instrument,
"SP" = the agreed Strike Price, and
"RM" = the Residual Maturity of the option in days.

Where the residual maturity is less than thirty days, the number "30" is to be inserted in place of "RM". The minimum percentage is as follows:

for ratios (*Anrechnungskoeffizienten*)	
of less than − 0.02	0 %,
from − 0.02 to less than ± 0	20 %,
from ± 0 to less than + 0.08	50 %,
from + 0.08 to less than + 0.14	70 %,
of + 0.14 and more	95 %.

Principle II

A bank's assets in the form of

1. receivables from banks and customers with agreed maturities or periods of notice of four years or over,

2. unlisted securities,

3. participating interests,

4. shares in a controlling company or a company holding a majority interest,

5. land and buildings, and

6. furniture and equipment,

less loan-loss provisions, shall not exceed the sum of the long-term financial resources specified below.

The following shall be regarded as long-term financial resources:

1. capital and reserves,

2. liabilities (other than savings deposits) to banks and customers with agreed maturities or periods of notice of four years or over,

3. 10 % of liabilities (other than savings deposits) to customers payable on demand and with agreed maturities or periods of notice of less than four years,

4. 60 % of savings deposits,

5. bonds outstanding and bonds sold prior to issue with maturities of more than four years,

6. 60 % of bonds outstanding and bonds sold prior to issue with maturities of up to four years,

7. 60 % of provisions for pensions,

8. 20 % of liabilities to affiliated banks with agreed maturities or periods of notice of six months and over but less than four years (only for the regional institutions of savings banks and of credit cooperatives[1]).

Principle III

1. 20 % of receivables from banks with agreed maturities or periods of notice of three months and over but less than four years,

2. receivables from customers with agreed maturities or periods of notice of less than four years (including the trade receivables of banks trading in goods),

3. bills of exchange drawn by the bank, discounted and credited to borrowers, and promissory notes drawn by borrowers, discounted and credited to them, in the bank's portfolio (other than promissory notes of the Bank for International Settlements and the Import and Storage Agencies *(Einfuhr- und Vorratsstellen)*[2] and promissory notes drawn for the purpose of taking up loans of the Export Credit Company *(Ausfuhrkreditgesellschaft mbH)* and the Industrial Plant Financing Company *(Gesellschaft zur Finanzierung von Industrieanlagen mbH)*), as well as contingent claims in respect of such bills and notes in circulation,

4. listed shares and investment fund units,

5. "other assets" (including stocks of goods held by banks trading in goods),

less loan-loss provisions, shall not exceed the sum of the financial resources specified below.

The following shall be regarded as financial resources:

1. 10 % of liabilities to banks payable on demand and with agreed maturities or periods of notice of less than three months, other than loans and advances to customers on behalf of the bank,

2. 50 % of liabilities to banks with agreed maturities or periods of notice of three months and over but less than four years, other than loans and advances to customers on behalf of the bank,

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1 Renamed *"Genossenschaftliche Zentralbanken"* (from *"Zentralkassen"*).
2 Renamed "Federal Office for Agricultural Market Regulation" *("Bundesanstalt für landwirtschaftliche Marktordnung")*.

3. 80% of liabilities to banks in respect of loans and advances to customers on behalf of the bank,

4. 20% of savings deposits,

5. 60% of other liabilities to customers payable on demand and with agreed maturities or periods of notice of less than four years,

6. 80% of liabilities in respect of business in goods and trade payables, other than the liabilities of banks trading in goods included in no. 8 below,

7. 20% of bonds outstanding and bonds sold prior to issue with maturities of up to four years,

8. 80% of a bank's own acceptances and promissory notes in circulation, of the bills of exchange drawn by the bank, discounted and credited to borrowers, and of the promissory notes drawn by borrowers, discounted and credited to them, in circulation (other than promissory notes of the Bank for International Settlements and the Import and Storage Agencies[1] and promissory notes drawn for the purpose of taking up loans of the Export Credit Company and the Industrial Plant Financing Company)

plus the financial surplus or less the financial deficit in Principle II, as the case may be.

1 Renamed "Federal Office for Agricultural Market Regulation" *("Bundesanstalt für landwirtschaftliche Marktordnung")*.

II. The current monetary policy regulations of the Deutsche Bundesbank

1. Discount credit

(a) Rediscount quotas for banks

Method of calculation

The banks' scope for recourse to the Bundesbank through the rediscounting of bills is limited by rediscount quotas, quite apart from any other central bank policy measures. The calculation of the standard quotas is based on a bank's liable capital; amounts of liable capital in excess of DM 200 million are included in the calculation on a diminishing scale. A participating interest of 25% and more in the capital of another bank for which a rediscount quota has been set normally results in a corresponding reduction in the standard quota. In addition, a bank's individual business structure is taken into account by means of a structural component. This is derived primarily from the ratio of a bank's short and medium-term lending to non-banks to its volume of business, after adjustment for loans on a trust basis and a number of other items. The extent to which a bank holds bills which can be rediscounted under the rediscount quota is also taken into consideration. In order to eliminate, as far as possible, short-term random fluctuations in the structural component and in acceptance and discount credit, the calculation is based on more than one end-of-month level. Finally, the calculation procedure includes a multiplier which is uniform for all banks and whose size is determined by the total amount of rediscount quotas set by the Central Bank Council in accordance with its current monetary policy intentions.

In principle, the quotas apply for one year; changes in a bank's capital, its business structure and acceptance and discount credit are thus normally included in the next general recalculation. However, the Bundesbank reserves the right to raise or lower the total amount of rediscount quotas at any time, whenever and as far as it deems this to be necessary for monetary policy reasons.

Setting the rediscount quotas

A bank's rediscount quota is set individually on the basis of the standard quota. In this connection, due account is taken of whether the bank is complying with the Federal Banking Supervisory Office's Principles Concerning the Capital and Liquidity of Banks. Quotas below the standard level may also be warranted by other special circumstances affecting an individual bank. Rediscount quotas are set for newly-established banks and newly-opened branches of foreign banks not earlier than six months after the bank has been established.

The rediscount quotas are set by the Managing Boards of the Land Central Banks for the banks in their area. The rediscount quota of a bank operating nation-wide is set by the Managing Board of the Land Central Bank in whose area the bank has its head office. The rediscount quotas of those banks which perform central functions in the whole of the Federal territory (section 7 (1) 2 of the Deutsche Bundesbank Act) are set by the Directorate of the Bundesbank.

The rediscount quota, once set, must not be exceeded, not even for a limited period. All bills rediscounted which are not yet due, other than the so-called Limit B bills of the Export Credit Company *(AKA Ausfuhrkredit-Gesellschaft mbH)* – which are dealt with in more detail below – are counted towards the rediscount quota.

The total amount of rediscount quotas set is published regularly in the Monthly Reports of the Deutsche Bundesbank (Statistical Section, Table II 1 (b)).

(b) Bills of exchange eligible for rediscounting at the Bundesbank

General provisions

Bills of exchange presented for purchase should be backed by three parties known to be solvent. The bills must fall due within three months of the date of purchase. They should be good trade bills (section 19 (1) 1 of the Deutsche Bundesbank Act).

For the rest, the granting of discount credit is governed by the "General Terms and Conditions of the Deutsche Bundesbank" (section V. Purchase of domestic bills; section XI. B. Purchase of foreign bills).

Solvency of the parties liable on bills

The Central Bank Council has laid down the following guidelines for assessing a signature: anybody who is liable on a bill presented to the Bundesbank for purchase or as collateral for a loan and who, in spite of being requested to disclose his financial circumstances, fails to provide sufficient (or any) information, and with respect to whom no other records permitting an adequate assessment of his financial position are on hand or obtainable, shall not be regarded as a party known to be solvent within the meaning of section 19 (1) 1 of the Deutsche Bundesbank Act. A bill may not be purchased or accepted as collateral if it is clear that the acceptor cannot be regarded as a party known to be solvent (decision of February 20, 1957).

Trade bills

As trade bills within the meaning of section 19 (1) 1 of the Deutsche Bundesbank Act, the Bundesbank buys bills which have been drawn on the basis of goods or services supplied between enterprises and/or self-employed persons. Prolongations of trade bills may be accepted provided that the prolongations are not due to payment difficulties on the part of the parties liable on them (decision of March 3, 1977).

Banker's acceptances

As banker's acceptances, when received, usually bear only two signatures, the statutory provision that the need for a third signature may be dispensed with only if the security of the bill is ensured in some other way (section 19 (1) 1 of the Deutsche Bundesbank Act) must be duly observed.

Bills to finance export orders

Other items which are eligible for rediscounting at the Bundesbank are the promissory notes of German exporters, endorsed by the exporter's bank and the Export Credit Company, and their contractually agreed prolongations, as issued in order to finance medium and long-term supply and service transactions under a rediscount line granted to the Export Credit Company (decision of March 5-6, 1952). This rediscount line (known as Limit B of the Export Credit Company) has amounted to DM 2.25 billion since January 1, 1991 (decision of July 12, 1990).

This rediscount line may be used only to fund lending with a term of not less than one year and not more than four years. Generally, the exporter's own share must amount to 30 % of the contract value (decisions of October 6, 1954 and July 14, 1966); for credits which the Export Credit Company extends at fixed interest rates, the exporter's own share amounts to 20 % of the contract value, after adjustment for advance payments and interim payments (decision of November 18, 1976). Only individual transactions can be financed. The financial assistance should generally bridge the period from the start of production to the receipt of the export proceeds. In the case of exports of mass-produced and serially-produced goods made as part of a manufacturer's normal production programme or sold from stock, the duration of the production and storage must not be included in the term of the financial assistance. For this type of export transaction, the Bundesbank's assistance is therefore granted only to bridge the period between the shipment of the goods and the receipt of the export proceeds (decisions of May 18, 1956, July 25, 1956 and February 6, 1957). The rediscount line must not be used to provide capital or working funds for exporters' general export operations.

The Bundesbank grants its financial assistance subject to the condition that the rates applied must not lie below specific minimum interest rates for export credit. The Federal Cabinet has fixed these rates as a contribution to international discipline in government-sponsored export credit. The criterion for complying with these minimum rates is the exporter's refinancing rate which arises from the total interest burden of refinancing his supplier's credit.

Foreign bills of exchange

Foreign bills are purchased only if they have been drawn on the basis of domestic enterprises' foreign trade transactions. In addition to the discounting party, at least one other domestic (non-bank) party must be liable on such bills – in the case of drafts, as the drawer; in the case of promissory notes, as the payee.

Pursuant to section 19 (1) 8 read in conjunction with section 22 of the Deutsche Bundesbank Act, the Bundesbank is entitled to purchase bills denominated in foreign currencies from anyone. At present, the Bank takes advantage of this right only vis-à-vis banks and public authorities.

Bills denominated in foreign currencies are purchased at the Bundesbank's discount rate (decisions of May 18, 1956 and January 22, 1958). The purchase rates are set in keeping with the ruling forward rates.

2. Lombard loans

General provisions

Lombard loans (loans at interest against the collateral of securities) to banks are granted only in accordance with general monetary policy conditions and in line with the particular circumstances of the bank requesting the loan. In principle, a lombard loan is to be granted only for the sake of the short-term bridging of a temporary liquidity need and only if the lombard borrowing appears to be appropriate and acceptable in terms of both magnitude and duration (decision of December 17-18, 1952). The granting of lombard loans at the lombard rate can be generally curtailed or discontinued altogether for monetary policy reasons.

During their six-month start-up period, newly-established banks and newly-opened branches of foreign banks are granted lombard loans for settling debit balances only; the loans are to be repaid on the next following business day.

For the rest, the granting of lombard loans is governed by the "General Terms and Conditions of the Deutsche Bundesbank" (section VI. Lombard transactions).

Special lombard loans

The Bundesbank reserves the right to grant loans at a special lombard rate ("special lombard loans"), after prior announcement, to the extent that this appears desirable in the light of monetary policy considerations. The special lombard rate can be changed daily and the decision to grant special lombard loans at all can be revoked daily (decision of September 6, 1973).

Collateral for lombard loans

Lombard loans to banks may be granted against the collateral of the securities and Debt Register claims (including zero bonds and floating-rate notes) listed in section 19 (1) 3 of the Deutsche Bundesbank Act. Particulars of the eligible securities and of the relevant lending limits are set out in the "List of Securities Eligible as Collateral for Loans from the Deutsche Bundesbank (Lombard List)" as published in the Federal Gazette and the Bundesbank's Notices.

The inclusion of a security in the Lombard List does not compel the Bundesbank to grant lombard loans, nor does it inhibit the Bundesbank's right to specify the collateral which the borrower is to provide.

In principle, bills which cannot be purchased under the current provisions may not be used as collateral for lombard loans either (decision of May 10, 1949). The promissory notes issued under Limit A of the Export Credit Company constitute an exception to this rule: while they may be used as collateral for lombard loans, they cannot be purchased (decision of December 5-6, 1951).

3. Open market operations

General provisions

In order to regulate the money market, the Bundesbank buys and sells the following securities from time to time as part of its open market operations (section 21 of the Deutsche Bundesbank Act), in accordance with the varying requirements of monetary policy:

Mobilisation and liquidity paper

It buys and sells for its own account Treasury bills and Treasury discount paper which the Federal Government supplies to it on request pursuant to sections 42 and 42a of the Deutsche Bundesbank Act (so-called "mobilisation and liquidity paper"). Generally, Treasury discount paper cannot be returned before maturity (so-called "N-paper"; decision of March 31, 1971). In order to fine-tune the money market, the Bundesbank offers – subject to change – Treasury bills usually running for three days.

Prime acceptances

At the end of 1991 the Bundesbank discontinued its money market dealing in prime acceptances (Deutsche Mark acceptances of the acceptance banks admitted to the prime acceptance market, which were used to finance import, export and merchanting transactions or cross-border commission processing deals), in which it conducted business only with the *Privatdiskont-Aktiengesellschaft.* Prior to that, the ceiling for purchases of prime acceptances had been lowered from DM 3 billion to DM 2 billion from January 1, 1990 and to DM 1 billion from January 1, 1991 (decision of September 7, 1989).

Bonds

If and to the extent that it seems necessary and acceptable for liquidity policy reasons, the Bundesbank buys and sells for its own account bonds issued by the Federal Government, the "German Unity" Fund, the Federal Railways, the east German Railways and the Federal Post Office. In order to regulate the bond market – i.e. not as open market operations within the meaning of section 21 of the Deutsche Bundesbank Act – it buys and sells these bonds for account of the issuers.

Open market transactions under repurchase agreements in securities

In addition, as part of its open market operations, the Bundesbank buys officially listed bonds (including zero bonds and floating-rate notes) eligible as collateral for lombard loans, bonds listed in the Regulated Market and issued by the Federal Government, the "German Unity" Fund, the Debt-Processing Fund, the Federal Railways, the east German Railways, the Federal Post Office, the Länder Governments, as well as Treasury discount paper issued by the said borrowers, with a residual maturity of up to one year from banks subject to minimum reserve requirements, subject to the condition that the seller simultaneously repurchases the securities forward ("securities repurchase agreements"). These transactions are usually offered by tender (decisions of May 31, 1979, November 18, 1982, June 1, 1983, July 26, 1990, September 6, 1990 and October 4, 1990).

Open market transactions under repurchase agreements in bills of exchange

The Bundesbank reserves the right to purchase domestic bills of exchange eligible for rediscounting at the Bundesbank outside the rediscount quotas in the open market subject to the condition that the seller simultaneously repurchases the bills forward ("bill-based repurchase agreements"). Only those banks to which rediscount quotas have been granted may be counterparties (decision of April 12, 1973).

4. Minimum reserve regulations

The minimum reserve ratios have been unchanged since February 1, 1987. A table showing the changes in the reserve ratios is presented on page 106f. of this Report. The Deutsche Bundesbank's Minimum Reserves Order has remained unaltered, and reads as follows:

The Deutsche Bundesbank's Minimum Reserves Order *(Anweisung über Mindestreserven — AMR)* of January 20, 1983, as amended up to January 5, 1990

The Deutsche Bundesbank, acting in accordance with section 16 of the Deutsche Bundesbank Act *(Gesetz über die Deutsche Bundesbank)* of July 26, 1957 (Federal Law Gazette I, p. 745) — as last amended by article 10 (17) of the Act Concerning the Fourth, Seventh and Eighth EC Council Directives on the Annual Accounts of Certain Types of Companies *(Bilanzrichtlinien-Gesetz)* of December 19, 1985 (Federal Law Gazette I, p. 2355) — hereby issues the following Minimum Reserves Order:

I. General provisions

Section 1

Minimum reserves are required of all banks as defined in section 1 (1) and section 53 (1) of the Banking Act *(Gesetz über das Kreditwesen — KWG)* in the revised text of July 11, 1985 (Federal Law Gazette I, p. 1472), as last amended by article 23 of the 1990 Tax Reform Act *(Steuerreformgesetz 1990)* of July 25, 1988 (Federal Law Gazette I, p. 1093), with the exception of

(a) the enterprises specified in section 2 (1) 4, 5, 8 and 9 of the Banking Act,[1]

(b) investment companies in accordance with the Act on Investment Companies *(Gesetz über Kapitalanlagegesellschaften)* in the text of the Announcement of January 14, 1970 (Federal Law Gazette I, p. 127), as last amended by article 9 of the 1990 Tax Reform Act of July 25, 1988 (Federal Law Gazette I, p. 1093),

(c) central securities depositories *(Wertpapiersammelbanken)*,

(d) banks in liquidation, other banks whose operations are confined to winding up their business, and dormant banks,

(e) enterprises which the Federal Banking Supervisory Office, acting in accordance with section 2 (4) of the Banking Act, has ruled not to be subject to the provisions of the Banking Act specified therein,

(f) enterprises recognised on December 31, 1989 under the Non-Profit Housing Act *(Wohnungsgemeinnützigkeitsgesetz — WGG)*, as revised and

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1 In accordance with the provisions of section 2 (1) 4, 5, 8 and 9 of the Banking Act, these comprise: the social security funds and the Federal Labour Office, private and public insurance enterprises, enterprises engaged in pawnbroking and risk-capital investment companies.

published in the Federal Law Gazette III, no. 2330-8, as last amended by article 2 (7) of the Act of December 8, 1986 (Federal Law Gazette I, p. 2191),
1. as non-profit housing enterprises *(gemeinnützige Wohnungsunternehmen)*, or
2. as organs of government housing policy not predominantly conducting banking business.
For enterprises offering savings facilities, the exemption from minimum reserve requirements applies until December 31, 1994.

Section 2

(1) Minimum reserves shall be held in respect of liabilities arising from deposits and borrowed funds, namely

(a) book liabilities, including liabilities arising from registered bonds, or from order bonds not forming part of an issue, with maturities of less than four years,

(b) liabilities arising from bearer bonds, or from order bonds forming part of an issue, with maturities of less than two years,

other than liabilities to banks which themselves are required to hold minimum reserves (reserve-carrying liabilities).

(2) Reserve-carrying liabilities as defined in subsection (1) above also include

(a) a debit balance on inter-branch settlement account of a bank within the meaning of section 53 of the Banking Act,

(b) liabilities arising from transactions under repurchase agreements *(Pensionsgeschäfte)* whereby the creditor is required to return the asset transferred to him and the asset continues to be included among the debtor bank's assets.

(3) When determining the reserve-carrying liabilities, liabilities to an account holder payable on demand and free of all obligations may be offset against

(a) claims payable on demand,

(b) claims in special loan accounts ("English accounting method")

on the same account holder, provided that it can be proved that the claims and liabilities are treated as a unit when calculating interest and commission. Such offsetting is not permissible if the account holder is an association under civil law or an association of which corporations or partnerships are members, or if sub-accounts on behalf of third parties are carried for an account holder. Liabilities and claims in different currencies may not be so offset.

(4) The following liabilities are exempt from reserve requirements:

(a) liabilities to the Bundesbank;

(b) liabilities to residents arising from earmarked funds which have already been passed on to the recipients or to an intermediary bank. For the purposes of this provision, earmarked funds are funds to be lent in accordance with instructions given beforehand by the lender (particularly with respect to the lending conditions) to borrowers named by the lender or, where a public or publicly-assisted lending operation is concerned, to borrowers that satisfy the requirements for participating in the operation; the agreed maturity or period of notice of both the earmarked funds and the loans granted or to be granted out of these funds must be at least one year, unless a public or publicly-assisted lending operation is involved;

(c) (repealed)

(d) liabilities arising from deposits with building and loan associations in accordance with section 1 (1) of the Act on Building and Loan Associations *(Gesetz über Bausparkassen)* of November 16, 1972 (Federal Law Gazette I, p. 2097), as last amended by article 2 (22) of the Act of March 29, 1983 (Federal Law Gazette I, p. 377), which deposits the saver may not withdraw until he is awarded a loan, without prejudice to his right to terminate his contract with the building and loan association;

(e) liabilities as defined in section 2 (1) (a) above to non-residents expressed in foreign currencies (including the foreign currency share of liabilities denominated in the European Currency Unit – ECU – or in the special drawing right of the International Monetary Fund – SDR), to the extent of the book claims on non-residents expressed in foreign currencies (including the foreign currency share of the book claims denominated in the European Currency Unit – ECU – or in the special drawing right of the International Monetary Fund – SDR), with maturities of less than four years;

(f) liabilities arising from loans taken up from banks abroad on behalf of resident customers, provided that the proceeds are used directly and without delay to make payments to non-residents and to discharge the resident customers' payment obligations in respect of goods or services which, as must be proved in detail, have been or will be supplied to them across national frontiers by non-residents. This exemption is subject to the condition that the bank has thereby become, simultaneously and with the same maturity, both the debtor of the bank abroad and the creditor of the customers, and that the liabilities and claims in question are denominated in the same currency. This exemption does not apply to liabilities which are payable on demand, in respect of which a period of notice has been agreed or which have been prolonged;

(g) liabilities to banks in the customs enclaves of Kleines Walsertal (municipality of Mittelberg) and Jungholz.

(5) For minimum reserve purposes, branches of foreign banks (section 53 of the Banking Act) may deduct from a debit balance on inter-branch settlement account those debits to their own enterprise which, in the case of a bank of independent legal status, would constitute liabilities in accordance with subsection (4) (e) or (f) above.

(6) If a liability is exempted or offset under the minimum reserve regulations to the extent of a particular asset, that asset may not be used again to exempt or offset liabilities. In the case of the branches of foreign banks (section 53 of the Banking Act), this also applies to the assets used for determining a debit balance on inter-branch settlement account.

Section 3

(1) Liabilities payable on demand, liabilities in respect of which a period of notice or a maturity of less than one month has been agreed and, in the case of a bank within the meaning of section 53 of the Banking Act, a debit balance on inter-branch settlement account are deemed to be sight liabilities.

(2) Liabilities in respect of which a period of notice or a maturity of at least one month has been agreed are deemed to be time liabilities.

(3) Savings deposits are deposits within the meaning of sections 21 and 22 of the Banking Act.

II. Holding minimum reserves

Section 4

Minimum reserves shall be held at the Bundesbank as balances on giro accounts. Agricultural credit cooperatives not having a giro account at the Bundesbank shall hold their minimum reserves as balances payable on demand in a special account at their regional institution *(Genossenschaftliche Zentralbank);* the regional institution shall hold at the Bundesbank balances identical in amount to the balances in these accounts.

III. Calculation of required reserves and actual reserves

Section 5

(1) The required reserves are determined by multiplying the monthly average of the bank's reserve-carrying liabilities (section 2 above), as calculated in accordance with section 6 below, by the percentages (reserve ratios) stipulated by the Bundesbank.

(2) Banks may deduct from the amount calculated in accordance with subsection (1) above their average holding of domestic legal tender at the close of business on all days from the first day to the last of the current month. The deduction of the average holding of domestic legal tender may not exceed 50% of the amount calculated in accordance with subsection (1) above. Credit cooperatives which hold their minimum reserves in accordance with section 4 sentence 2 above may deduct their average holding in the period from the first day to the last of the previous month.

(3) To facilitate minimum reserve management at the end of a month, the calculation of the deductible average holding in accordance with subsection (2) above may be based not on the actual daily holding on the last two business days but rather on the average of the holdings on the corresponding business days of the preceding twelve months. Banks must decide at the beginning of each calendar year to adopt either this method of calculation or that in accordance with subsection (2) above. The method adopted shall be employed throughout the calendar year.

Section 6

(1) Subject to the provisions of subsection (2) below, the monthly average of a bank's reserve-carrying liabilities shall be calculated from the levels at the close of the business and non-business days in the period from the sixteenth of the previous month to the fifteenth of the current month (daily calculation method), or from the levels at the close of the following four reporting days:

twenty-third day of the previous month,
last day of the previous month,
seventh day of the current month,
fifteenth day of the current month.

(2) The daily calculation method may be wholly or partly prescribed for particular banks if

(a) there is reason to believe that the bank has influenced the level of reserve-carrying liabilities on the four reporting days in order to reduce it below the level which would result from the use of the daily calculation method,

(b) the level of reserve-carrying liabilities determined on the basis of reporting days is in other than exceptional cases considerably below the monthly average calculated by the daily method.

(3) Banks whose reserve-carrying liabilities amount to less than DM 10 million may, in place of the monthly average, use the level of reserve-carrying liabilities at the close of the last day of the previous month. Subsection (2) above applies as appropriate.

Section 7

The monthly average of the balance held in accordance with section 4 above is deemed to constitute the actual reserves. It is calculated from the levels at the close of all days in the month, and is communicated to the bank by the Bundesbank (or the regional institution) at the end of the month.

Section 8

IV. Special interest

If in any month a bank's actual reserves fall short of its required reserves, the bank shall pay special interest on the deficiency for thirty days at the rate currently stipulated by the Bundesbank. The special interest payable on the deficiencies of credit cooperatives which hold minimum reserves in accordance with sentence 2 of section 4 above shall be paid to the Bundesbank by the regional institution.

Section 9

V. Reserve reports

(1) Not later than the fifth business day after the fifteenth of each month – except as otherwise provided in subsections (2) and (3) below – each bank subject to reserve requirements shall communicate the data needed for calculating the required reserves in accordance with section 5 (1) above to the office of the Bundesbank which carries its account, using form 1500 (individual report).

(2) (a) If banks have more than one branch, each branch shall in principle submit an individual report. However, a combined individual report indicating the number of branches included may be submitted for several branches, provided that the bank's records enable the liabilities to be classified by individual branches at any time. At the request of the Land Central Bank, a classification of this kind shall be made for any period it specifies.

Banks with branches in more than one Land Central Bank area shall classify the liabilities recorded in the combined individual reports by the individual branches, as at September 30, broken down by Land Central Bank area. Form 1500 (d) shall be used for this purpose, and shall be submitted to the office of the Bundesbank which carries the account of the bank's head office not later than October 31 of each year.

(b) If several individual reports are submitted by one bank, its head office shall in addition submit a collective report using form 1500.

(c) Likewise not later than the fifth business day after the fifteenth of each month, the collective report, together with the individual reports, shall be submitted to the office of the Bundesbank which carries the account of the bank's head office.

(d) In exceptional cases, the responsible Land Central Bank may permit banks with numerous branches to submit the reports (form 1500) up to two business days later. Such permission is subject to the condition that the banks communicate provisional figures on the level of their required reserves, classified by liabilities to residents and liabilities to non-residents, to the Land Central Bank by telephone or by telex on the fifth business day after the fifteenth of each month.

(3) Credit cooperatives which hold minimum reserves in accordance with section 4 sentence 2 above shall communicate the data needed for calculating the required reserves, as requested in the individual report, to their regional institution. Not later than the fifth business day of each month, with respect to the previous month, the regional institution shall submit to the responsible office of the Bundesbank a special collective report covering the credit cooperatives which hold reserves at it; in an annex, the regional institution shall indicate the monthly averages (section 6 above) of the reserve-carrying liabilities (showing each type separately and classified by reserve stages), the required reserves and the actual reserves, for each of the credit cooperatives included in the collective report.

(4) Moreover, not later than the fifth business day of each month, with respect to the previous month, each bank subject to reserve requirements – other than the credit cooperatives which hold minimum reserves in accordance with section 4 sentence 2 above – shall submit a compliance report (form 1501) to the office of the Bundesbank which carries its account or to the office of the Bundesbank which carries the account of its head office. The regional institutions to which credit cooperatives holding minimum reserves in accordance with section 4 sentence 2 above are affiliated shall indicate separately in their compliance report the actual reserves of these credit cooperatives in a single sum.

(5) The Bundesbank may require the calculation of the reserve-carrying liabilities to be explained in the reserve report or in an annex thereto. It reserves the right to satisfy itself that the calculation is in order. The documents on which the calculation of the required reserves is based (e.g. balance ledgers, records of cash holdings, work sheets) are therefore to be preserved for at least four years.

VI. Entry into force

Section 10

(1) This Order comes into force with effect from April 1, 1983. On the same date the Deutsche Bundesbank's Minimum Reserves Order of November 11, 1968 (Notice no. 5008/68 – Federal Gazette no. 215 of November 15, 1968), as last amended by the Announcement of December 18, 1980 (Notice no. 5014/80 – Federal Gazette no. 240 of December 24, 1980) ceases to be effective.

(2) (repealed)

5. Interest rates and minimum reserve ratios of the Deutsche Bundesbank

Discount and lombard rates, and special rate of interest charged for failing to comply with the minimum reserve requirements

Applicable from			Discount rate [1]	Lombard rate	Special interest rate charged for failing to comply with the minimum reserve requirements
			% p. a.	% p. a.	% p. a. above the lombard rate
1948	July	1	5	6	1
	Dec.	1	5	6	3
1949	May	27	4 1/2	5 1/2	3
	July	14	4	5	3
1950	Oct.	27	6	7	3
	Nov.	1	6	7	1
1951	Jan.	1	6	7	3
1952	May	29	5	6	3
	Aug.	21	4 1/2	5 1/2	3
1953	Jan.	8	4	5	3
	June	11	3 1/2	4 1/2	3
1954	May	20	3	4	3
1955	Aug.	4	3 1/2	4 1/2	3
1956	March	8	4 1/2	5 1/2	3
	May	19	5 1/2	6 1/2	3
	Sep.	6	5	6	3
1957	Jan.	11	4 1/2	5 1/2	3
	Sep.	19	4	5	3
1958	Jan.	17	3 1/2	4 1/2	3
	June	27	3	4	3
1959	Jan.	10	2 3/4	3 3/4	3
	Sep.	4	3	4	3
	Oct.	23	4	5	3
1960	June	3	5	6	3
	Nov.	11	4	5	3
1961	Jan.	20	3 1/2	4 1/2	3
	May	5	3	[3] 4	3
1965	Jan.	22	3 1/2	4 1/2	3
	Aug.	13	4	5	3
1966	May	27	5	6 1/4	3
1967	Jan.	6	4 1/2	5 1/2	3
	Feb.	17	4	5	3
	April	14	3 1/2	4 1/2	3
	May	12	3	4	3
	Aug.	11	3	3 1/2	3
1969	March	21	3	4	3
	April	18	4	5	3
	June	20	5	6	3
	Sep.	11	6	7 1/2	3
	Dec.	5	6	9	3
1970	March	9	7 1/2	9 1/2	3
	July	16	7	9	3
	Nov.	18	6 1/2	8	3
	Dec.	3	6	7 1/2	3
1971	April	1	5	6 1/2	3
	Oct.	14	4 1/2	5 1/2	3
	Dec.	23	4	5	3
1972	Feb.	25	3	4	3
	Oct.	9	3 1/2	5	3
	Nov.	3	4	6	3
	Dec.	1	4 1/2	6 1/2	3

Applicable from			Discount rate [1]	Lombard rate [2]	Special interest rate charged for failing to comply with the minimum reserve requirements
			% p. a.	% p. a.	% p. a. above the lombard rate
1973	Jan.	12	5	7	3
	May	4	6	8	3
	June	1	7	[4] 9	3
1974	Oct.	25	6 1/2	8 1/2	3
	Dec.	20	6	8	3
1975	Feb.	7	5 1/2	7 1/2	3
	March	7	5	6 1/2	3
	April	25	5	6	3
	May	23	4 1/2	5 1/2	3
	Aug.	15	4	5	3
	Sep.	12	3 1/2	4 1/2	3
1977	July	15	3 1/2	4	3
	Dec.	16	3	3 1/2	3
1979	Jan.	19	3	4	3
	March	30	4	5	3
	June	1	4	5 1/2	3
	July	13	5	6	3
	Nov.	1	6	7	3
1980	Feb.	29	7	8 1/2	3
	May	2	7 1/2	9 1/2	3
	Sep.	19	7 1/2	[4] 9	3
1982	Aug.	27	7	8	3
	Oct.	22	6	7	3
	Dec.	3	5	6	3
1983	March	18	4	5	3
	Sep.	9	4	5 1/2	3
1984	June	29	4 1/2	5 1/2	3
1985	Feb.	1	4 1/2	6	3
	Aug.	16	4	5 1/2	3
1986	March	7	3 1/2	5 1/2	3
1987	Jan.	23	3	5	3
	Nov.	6	3	4 1/2	3
	Dec.	4	2 1/2	4 1/2	3
1988	July	1	3	4 1/2	3
	July	29	3	5	3
	Aug.	26	3 1/2	5	3
	Dec.	16	3 1/2	5 1/2	3
1989	Jan.	20	4	6	3
	April	21	4 1/2	6 1/2	3
	June	30	5	7	3
	Oct.	6	6	8	3
1990	Nov.	2	6	8 1/2	3
1991	Feb.	1	6 1/2	9	3
	Aug.	16	7 1/2	9 1/4	3
	Dec.	20	8	9 3/4	3

1 Until July 31, 1990 this was also the rate for cash advances. Until May 1956 lower rates, too, applied to foreign bills and export drafts; fixed special rates were charged for certain credits which had been granted to the Reconstruction Loan Corporation and which expired at the end of 1958 (for details see footnotes to the same table in the Report of the Deutsche Bundesbank for the Year 1961, page 91). — **2** Since August 1, 1990 this has also been the rate for cash advances. — **3** An allowance of 3/4% p. a. was granted to banks in respect of the lombard loans taken up between December 10 and December 31, 1964. — **4** Lombard loans were generally not granted to banks at the lombard rate during the following periods: from June 1, 1973 to July 3, 1974 and from February 20, 1981 to May 6, 1982.

Reserve ratios

(a) July 1973 to February 1977

% of reserve-carrying liabilities

Applicable from	Sight liabilities: Places with a Bundesbank office, Reserve class 1: 1	2	3	4	Places without a Bundesbank office: 1	2	3	4	Time liabilities: 1	2	3	4
Reserve-carrying liabilities to residents												
1973 July 1	19.55	18.05	16.55	15.05	15.05	13.55	12	10.5	13.55	12	10.5	9
Nov. 1	20.1	18.55	17.05	15.5	15.5	13.95	12.4	10.85	13.95	12.4	10.85	9.3
1974 Jan. 1	19.1	17.65	16.2	14.7	14.7	13.25	11.75	10.3	13.25	11.75	10.3	8.8
Sep. 1	17.2	15.9	14.55	13.25	13.25	11.9	10.6	9.25	11.9	10.6	9.25	7.95
Oct. 1	15.85	14.6	13.4	12.2	12.2	10.95	9.75	8.5	10.95	9.75	8.5	7.3
1975 June 1	15.05	13.9	12.7	11.55	11.55	10.4	9.25	8.1	10.4	9.25	8.1	6.95
July 1	13.55	12.5	11.45	10.4	10.4	9.35	8.35	7.3	9.35	8.35	7.3	6.25
1976 May 1	14.2	13.1	12	10.95	10.95	9.85	8.75	7.65	9.85	8.75	7.65	6.55
June 1	14.9	13.75	12.65	11.5	11.5	10.35	9.2	8.05	10.35	9.2	8.05	6.9
Reserve-carrying liabilities to non-residents												
1973 July 1	40	40	40	40	40	40	40	40	35	35	35	35
Oct. 1	40	40	40	40	40	40	40	40	35	35	35	35
1974 Jan. 1	35	35	35	35	35	35	35	35	30	30	30	30
Oct. 1	32.2	32.2	32.2	32.2	32.2	32.2	32.2	32.2	27.6	27.6	27.6	27.6
1975 July 1	29	29	29	29	29	29	29	29	24.85	24.85	24.85	24.85
Aug. 1	13.55	13.55	13.55	13.55	13.55	13.55	13.55	13.55	9.35	9.35	9.35	9.35
1976 May 1	14.2	14.2	14.2	14.2	14.2	14.2	14.2	14.2	9.85	9.85	9.85	9.85
June 1	14.9	14.9	14.9	14.9	14.9	14.9	14.9	14.9	10.35	10.35	10.35	10.35

(b) Since March 1977

% of reserve-carrying liabilities

Applicable from	Reserve-carrying liabilities to residents: Sight liabilities, Stage on the progressive scale 3: 1 DM 10 mn and under	2 DM 100 mn and under, but more than DM 10 mn	3 more than DM 100 mn	Time liabilities, Stage on the progressive scale 3: 1 DM 10 mn and under	2 DM 100 mn and under, but more than DM 10 mn	3 more than DM 100 mn	Savings deposits, Stage on the progressive scale 3: 1 DM 10 mn and under	2 DM 100 mn and under, but more than DM 10 mn	3 more than DM 100 mn
1977 March 1 4	9.35	12.7	14.9	6.6	8.8	10.45	6.15	6.4	6.6
June 1 4	8.9	12.05	14.15	6.3	8.4	9.95	5.85	6.05	6.3
Sep. 1 4	8	10.85	12.75	5.65	7.55	8.95	5.3	5.45	5.65
1978 Jan. 1 4	8	10.85	12.75	5.65	7.55	8.95	5.3	5.45	5.65
March 1	8.65	11.7	13.75	6.1	8.15	9.65	5.7	5.9	6.1
June 1	8.05	10.9	12.8	5.7	7.55	9	5.3	5.5	5.7
Nov. 1	8.75	11.85	13.95	6.2	8.25	9.8	5.8	6	6.2
1979 Feb. 1	9.2	12.45	14.65	6.5	8.65	10.3	6.05	6.3	6.5
1980 May 1.	8.45	11.45	13.45	6	8	9.45	5.6	5.8	6
Sep. 1.	7.65	10.3	12.1	5.4	7.2	8.5	5	5.2	5.4
1981 Feb. 1	7.1	9.6	11.25	5	6.7	7.95	4.65	4.85	5
1982 Oct. 1	6.4	8.65	10.15	4.5	6	7.15	4.2	4.35	4.5
1986 May 1 5	6	9	11	4.5			3.75		
1987 Feb. 1	6.6	9.9	12.1	4.95			4.15		

1 Classification based on the total level of reserve-carrying liabilities: reserve class 1: DM 1,000 million and over; reserve class 2: DM 100 million and over, but less than DM 1,000 million; reserve class 3: DM 10 million and over, but less than DM 100 million; reserve class 4: less than DM 10 million. — 2 Notwithstanding the ratios shown here, between July 1, 1972 and October 31, 1973 the ratio applied to the savings deposits of residents with banks in reserve class 4 in places with a Bundesbank office was the current reserve ratio for time liabilities. Between November 1 and December 31, 1973 the reserve ratio for these savings deposits was 9%. — 3 The ratio of stage 1 on the progressive scale applies to the first DM 10 million of reserve-carrying

Savings deposits: Places with a Bundesbank office 2	Savings deposits: Places without a Bundesbank office	Growth of liabilities: Sight liabilities	Growth of liabilities: Time liabilities	Growth of liabilities: Savings deposits	Explanatory notes on the growth reserve regulations	Applicable from
9.25	7.75					1973 July 1
9.25	7.75					Nov. 1
8.8	7.35					1974 Jan. 1
7.95	6.6					Sep. 1
7.3	6.1	no special ratios				Oct. 1
6.95	5.8					1975 June 1
6.25	5.2					July 1
6.55	5.45					1976 May 1
6.9	5.75					June 1
30	30		60		Additional reserve ratio for growth over 75% of the average level of the return dates October 23 and 31, and November 7 and 15, 1971 or over 60% of the average level of the corresponding return dates of 1970	1973 July 1
30	30		60		Additional reserve ratio for growth over 63.75% of the average level of the return dates October 23 and 31, and November 7 and 15, 1971 or over 51% of the average level of the corresponding return dates of 1970	Oct. 1
25	25					1974 Jan. 1
23	23					Oct. 1
20.7	20.7	no special ratios				1975 July 1
6.25	6.25					Aug. 1
6.55	6.55					1976 May 1
6.9	6.9					June 1

Reserve-carrying liabilities to non-residents

Sight liabilities	Time liabilities	Savings deposits	Growth of liabilities: Sight liabilities	Growth of liabilities: Time liabilities	Growth of liabilities: Savings deposits	Explanatory notes on the growth reserve regulations	Applicable from
14.9	10.45	6.6					1977 March 1
14.15	9.95	6.3	no special ratios				June 1
12.75	8.95	5.65					Sep. 1
20	15	10		80		Additional reserve ratio for growth over the average level during the period from September 16 to December 15, 1977	1978 Jan. 1
20	15	10		80			March 1
12.8	9	5.7					June 1
13.95	9.8	6.2					Nov. 1
14.65	10.3	6.5					1979 Feb. 1
13.45	9.45	6					1980 May 1
12.1	8.5	5.4	no special ratios				Sep. 1
11.25	7.95	5					1981 Feb. 1
10.15	7.15	4.5					1982 Oct. 1
11	4.5	3.75					1986 May 1
12.1	4.95	4.15					1987 Feb. 1

liabilities, the ratio of stage 2 to the next DM 90 million, and the ratio of stage 3 to liabilities exceeding DM 100 million. — **4** Between March 1, 1977 and February 28, 1978 the following discounts were in force for liabilities to residents in places without a Bundesbank office: 1 percentage point for sight liabilities, 0.5 percentage point for savings deposits. — **5** Since May 1, 1986 the differentiation of the reserve ratios by stages on the progressive scale has no longer been applicable to time liabilities and savings deposits.

III. Statement by the Deutsche Bundesbank concerning foreign Deutsche Mark issues

In a "Statement concerning foreign Deutsche Mark issues" of June 20, 1989 the Deutsche Bundesbank defined the principles governing the issuing of Deutsche Mark securities by non-residents. This statement, which came into force on July 1, 1989, superseded the "Statement on issues of foreign Deutsche Mark bonds" of April 12, 1985 (as amended up to February 20, 1986). The guiding principle of the "Statement" is that the market for Deutsche Mark issues should remain based in Germany and thus that the syndicate should be lead-managed by a German bank — which may also be foreign-owned — of independent legal status. In the case of tap issues, the arrangers and dealers must likewise be German banks. The "Statement" reads as follows:

Statement by the Deutsche Bundesbank concerning foreign Deutsche Mark issues

1. The Deutsche Bundesbank attaches importance to the market for Deutsche Mark issues continuing to be based in the Federal Republic of Germany. Deutsche Mark securities launched by foreigners ("foreign Deutsche Mark issues") are to be issued only under the lead management of a German bank (bank of independent legal status domiciled in the territory of the Federal Republic of Germany, including Berlin (West)). In the case of securities which are not underwritten by a syndicate (e.g. tap issues), this applies as appropriate to the bank commissioned by the issuer to act as arranger and dealer. In the case of issues of foreign currency bonds with a Deutsche Mark option and of dual currency bonds with interest or redemption payments in Deutsche Mark, it is sufficient if a German bank is the joint lead-manager of the syndicate.

2. If the syndicate is lead-managed by a foreign-owned German bank, the same options are to be available to German-owned banks in the home country of the bank in question.

3. DM-denominated bonds and notes issued by foreigners are to have a maturity of not less than two years. This minimum maturity also applies to foreign currency bonds with interest or redemption payments in Deutsche Mark.

   Shares in Deutsche Mark money market funds are not to be issued by foreign or domestic institutions.

4. Lead-managers are requested to notify the Deutsche Bundesbank by telex on the date of issue of the following particulars about the issue: issuer, amount, date, terms, type of placement.

   In the case of tap issues, the corresponding particulars about placement are to be communicated monthly in retrospect; any new issue programmes being arranged are to be reported without delay by the arranging bank.

5. New financial products involving a Deutsche Mark element are to be submitted to the Deutsche Bundesbank early enough for it to be able to express its opinion before the issue is launched.

6. In addition, the following specific requirements apply to foreign Deutsche Mark issues:

   (a) Lead management comprises the handling of all syndicate business, especially negotiations with the issuer, the invitation to underwrite the issue, transactions with the underwriters, the allocation of underwriting shares, the bookkeeping for the issue, the monitoring of payments, etc.

(b) In the case of a public offering, the securities are to be officially listed on a German stock exchange. In the case of private placements, the lead-manager has to arrange for a listing in the Regulated Market on a German stock exchange or for a price quotation in the domestic market by some other means. If it is planned to have the securities listed on a foreign stock exchange, this is not to be done until after they have been listed on a German stock exchange.

(c) German law is to be applied. The principal paying agent for interest and redemptions must be located in Germany. The securities are to be included in the German securities clearing system.

IV. Authorisations under monetary law

110 Decisions on the authorisation of value guarantee clauses are taken by the Deutsche Bundesbank in accordance with its "Principles governing decisions on applications for authorisations pursuant to section 3 of the Currency Act (no. 2(c) of the Currency Ordinance for Berlin)".[1]

Under article 3 of Annex I to the Treaty of May 18, 1990 between the Federal Republic of Germany and the German Democratic Republic Establishing the Monetary, Economic and Social Union, the authorisation requirement of section 3 of the Currency Act was extended to include the new Länder; the general authorisations and authorisation principles under section 3 of the Currency Act were put into effect for the new Länder by Notice No. 1006/90.[2]

A record of the course of authorisation applications and the decisions taken is given below:

Applications for authorisations pursuant to section 3 sentence 2 of the Currency Act, and the decisions taken

Year	Applications	Authorisations	Certificate of non-applicability of authorisation requirement	Applications rejected
1960	10,485	7,122	1,840	1,523
1961	12,482	9,293	1,738	1,458
1962	14,913	11,333	2,010	1,570
1963	16,588	12,903	2,205	1,480
1964	21,012	16,322	2,837	1,853
1965	23,822	17,497	3,686	2,639
1966	26,415	20,321	3,734	2,360
1967	24,261	19,026	3,614	1,621
1968	25,595	20,324	3,943	1,328
1969	29,363	22,776	5,127	1,460
1970	33,796	24,999	6,585	2,212
1971	40,884	31,189	7,554	2,141
1972	42,964	33,254	7,583	2,127
1973	49,033	36,747	10,045	2,241
1974	44,975	33,830	8,813	2,332
1975	39,686	29,712	7,778	2,196
1976	38,529	29,189	7,494	1,846
1977	39,344	30,145	7,323	1,876
1978	40,002	30,617	7,555	1,830
1979	41,761	32,231	7,632	1,898
1980	43,375	33,237	8,032	2,106
1981	43,375	35,129	7,960	2,286
1982	44,036	34,096	7,798	2,142
1983	43,078	33,654	7,293	2,131
1984	42,526	32,997	7,416	2,113
1985	46,629	37,343	7,312	1,974
1986	40,064	30,998	7,367	1,699
1987	37,083	28,069	7,523	1,491
1988	37,812	29,899	6,313	1,600
1989	38,633	30,349	6,448	1,836
1990	42,552	33,232	7,123	2,197
1991	48,806	37,837	8,197	2,772

1 Deutsche Bundesbank Notice no. 1015/78 of June 9, 1978, published in Federal Gazette No. 109 of June 15, 1978; for the Bundesbank's policy in granting authorisations, see also the article "Value guarantee clauses — synopsis of the Bundesbank's policy in granting permits" in Monthly Report of the Deutsche Bundesbank, Vol. 23, No. 4, April 1971, page 24; regarding the incurrence of liabilities denominated in the European currency unit ECU or the special drawing right of the International Monetary Fund (SDR), see Deutsche Bundesbank Notice No. 1002/90 of January 5, 1990, published in Federal Gazette No. 3/90, page 54.
2 Deutsche Bundesbank Notice No. 1006/90 of June 13, 1990, published in Federal Gazette No. 114/90, page 3215.

Special aspects of the integration of the east German banking system

I. Banking law and banking supervision

112 Developments in the east German banking system

The restructuring and consolidation process in the east German banking system initiated in mid-1990 after the intra-German monetary union made considerable headway last year. The previously rather one-sided balance sheet structures normalised distinctly thanks to the strong growth of lending to customers and customers' increasing preference for longer-term investment products. Mergers into larger units are supplementing the successful efforts to form competitive institutions. The west German banking industry continued to make a major contribution – in particular through its associations and training facilities – to the restructuring of the east German banking sector. But for the mobilisation of its financial and labour resources, a much longer adjustment period would have had to be expected. The expertise of employees in the east German banking industry has increased markedly. Customers are now being offered the full range of banking services.

East German savings banks and credit cooperatives have been able to maintain and in some cases even expand their strong position in deposit business, relative to that of the branches of west German banks. The withdrawal of deposits which persisted until the summer of 1991 has now been largely offset again. As far as deposits are concerned, considerable shifts into higher-yielding forms of deposits were made during the period under review, in addition to the statutory reclassification of the former passbook savings deposits. As investors became more discriminating, time deposits in particular rose markedly; at the same time, there apparently continued to be a pronounced liquidity preference, as indicated by the fact that sight deposits remained mostly at a relatively high level.

Many east German banks' lending to customers expanded, sometimes quite briskly. The savings bank sector almost doubled its lending to non-banks (from about DM 12.7 billion at the end of 1990 to some DM 23.8 billion at the end of 1991). Traditional local authority loan business continues to be of practically no significance for east German savings banks, given the ample inflows of funds to public authorities from other sources (allocations in the context of reconstruction financing; interest-subsidised funds from institutions with special functions). Among the credit cooperatives, by contrast, the increases in lending to customers were perceptibly smaller. Overall, the share of lending to customers in the savings banks' and credit cooperatives' volume of business remains appreciably below the comparable west German figures. Another factor which had an adverse effect on lending was that the large loan provisions are to be applied to old loans. As a result, there is often no scope left for new lending. Other impediments include the shortage of experienced staff in many banks and the fact that not all of the real estate registries are in a position to produce evidence of ownership promptly and to register real security.

Restructuring

When the monetary union came into force, there were 571 banks in the new Länder. The number has now fallen to 493. They have a total of 4,552 branches. To these must be added 1,259 branches of west German and a large number of representative offices of foreign banks. Hence the bank density in eastern Germany is one-half the average figure in western Germany. On account of mergers already implemented or approved, the number of institutions in the savings bank sector had fallen by almost 10% and that in the credit cooperative sector by some 20% by the end of the period under review. The trend towards larger and thus more efficient units will persist. To date, east German savings banks' volume of business is only one-third and that of the credit cooperatives only one-half of the average figures registered by corresponding west German institutions. As economic activity picks up and concentration continues, the gap will narrow rapidly.

"Unwelcome legacies"

The salient feature of trends in the banking system in the new Länder last year continued to be the need to cope with the "unwelcome legacies". In the case of the former central institutions (State Bank Berlin, German Credit Bank, German Foreign Trade Bank), a start was made on winding-up the assets and liabilities that originated before July 1, 1990. The assets and liabilities created under the former foreign trade and foreign exchange monopoly could be run down on a substantial scale (and in part prematurely). In the context of the debt clearance of the originally state-owned enterprises, the *Treuhandanstalt* privatisation agency took over, with debt-discharging effect, some initial tranches of the loans originally granted by east German banks to state-owned enterprises. In a further step, the *Treuhandanstalt* intends to repay these loans to the original lenders and fund them itself. Moreover, on the strength of section 25 (3) of the Unification Treaty, the *Treuhandanstalt* will to a limited extent clear the debt of farms in which it does not hold a participating interest in order to foster structural adjustment. To ease the burden on those enterprises' balance sheets, credit cooperatives may, pursuant to section 16 (3) of the Deutsche Mark Balance Sheet Act, allow other creditors to take precedence over their claims, thus obviating inclusion of these amounts as liabilities in farms' Deutsche Mark opening balance sheets. In some cases, the winding-up of old business will have a marked impact on the balance sheets of the banks involved.

Conversion accounts, capital base

As at the date of the entry into force of the monetary union, east German banks have to prepare conversion accounts covering all assets and liabilities denominated in Deutsche Mark deriving from the currency conversion. The conversion account is deemed to be the opening balance sheet as at July 1, 1990. As provided for by the Ordinance on the Confirmation of Conversion Accounts, the audited and approved opening balance sheets, accompanied by a certificate of confirmation and together with other records, had to be submitted to the Federal Banking Supervisory Office and the Bundesbank not later than March 15, 1991. As the drawing-up and auditing of the opening balance sheets proved to be more difficult than had been expected, the banks were unable to meet this deadline. In the meantime, the opening balance sheets of all east German banks have been drawn up and audited. In many cases, however, the records have still not been submitted.

The equalisation claims are to be calculated in such a way that banks will have a capital equal to at least 4% of their balance sheet total, and that their Principle I ratio pursuant to section 10 of the Banking Act does not exceed 13 times their liable capital. On the date of the currency conversion, east German banks' capital ratio thus almost complied with the recommendation of the Basle Capital Accord; what is more, only core capital is involved here. The Deutsche Mark Balance Sheet Act in addition provides that, in the opening balance sheets, banks must also include general provisions for the total amount of their lending to customers equivalent to 1% of their loans and advances to customers and 0.5% of their contingent claims on customers.

These provisions are designed not only to safeguard the banks' continued existence but also to give them adequate scope for growth. In order to preserve their market prospects in view of the large business potential, many east German savings banks and credit cooperatives applied the profits generated to increasing their reserves.

Under the State Treaty, the equalisation claims bear interest at three-month FIBOR. From July 2, 1990 a new FIBOR was introduced in the Frankfurt market alongside the old FIBOR. The new rate is calculated according to the method of computation used in the Euromarket, and on a broader basis. The payment of interest on equalisation claims was switched to the new FIBOR from July 1, 1991, upon the adoption of the Act Accompanying the 1991 Budget.

Because of the delays in drawing-up and auditing the Deutsche Mark opening balance sheets, the processing of only eight equalisation claims of savings banks and credit cooperatives totalling DM 102 million and of the equalisation claims of the Post Office bank had been completed by the Federal Banking Supervisory Office by mid-March 1992. Until the end of 1994 the allocations are provisional only, so that any changes to the Deutsche Mark opening balance sheet (which are possible until that date pursuant to section 36 (4) of the Deutsche Mark Balance Sheet Act) will affect the level of the equalisation claims. Provisionally allocated equalisation claims may be converted into bearer bonds at the creditor's request up to a limit of 75%. This will make it easier for the banks to respond to interest rate movements in the market and to customers' investment needs. Moreover, the banks are provided with a broad basis for lombard borrowing and for securities repurchase agreements.

Transitional and adjustment provisions

After the entry into force of the monetary union, east German banks were granted various concessions for a transitional period. These related to prudential needs and reporting requirements, the statistical reporting system and the minimum reserves. All the transitional and adjustment arrangements have now expired.

Owing to the special features of east German banks' former accounting system, particular problems were encountered in bringing passbook savings accounts into line with the provisions of the Banking Act. A transitional period up to the end of 1990 was envisaged for the conversion. Many east German banks failed to meet this deadline. They were therefore granted an extension until June 30, 1991 and at the same time given the option of making a blanket conversion. Moreover, until the beginning of 1992 they were allowed to use a flat-rate procedure for computing the deposits converted. By now, almost the entire original stock of deposits — over ten million passbook savings accounts — has been brought into line with the provisions of the Banking Act.

The quality of the prudential and statistical reports to be submitted by east German banks did not at first come up to the required standards. The requisite corrections imposed a burden on the banks, the associations and the supervisory authorities. Meanwhile, a marked quality improvement and the necessary reliability of the information basis have been achieved.

Involvement of the Bundesbank

The Provisional Administrative Office of the Bundesbank, the setting-up of which was provisionally completed last year, and its branches in the new Länder are involved in banking supervision. They are able in particular to take advantage of their familiarity with the local conditions under which the banks they supervise operate. For some of the territory of the new Länder, the Provisional Administrative Office performs all the functions of a Main Office of the Bank. The remaining part is covered by west German Main Offices.

Improvement in the banks' performance

The banking associations and the Bundesbank arranged a large number of training schemes for east German bank staff and managers last year. Moreover, staff was temporarily seconded on a large scale by west German partner banks. This meant that east German banks' performance improved markedly. The accounting system of east German banks was converted to the west German standard last year. Many offices and the technical facilities of east German banks were modernised. In view of the existing market potential and the business expansion consequently to be expected, however, there still remains a heavy demand for staff with banking experience. This is particularly true of loan business. Every effort must therefore continue to be made by the banks and their central associations in the east and the west to enhance the professional expertise of east German bank staff. All in all, great personal commitment was called for on the part of all those employed in the east German banking system.

Structure of the banking associations, deposit guarantee schemes

On March 20, 1990 the east German savings banks formed the Savings Bank Association of the GDR, which became the East German Savings Bank and Giro Association on September 20, 1990. Initially it covered the whole territory of the new Länder, but the Thuringian savings banks have now decided to join the Hessian regional association. The credit cooperatives in Saxony formed the Saxon Cooperative Society Association on December 19, 1990. On December 31, 1990 the Berlin Cooperative Society Association merged with the Brandenburg Raiffeisen Association to form the Berlin-Brandenburg Cooperative Society Association. The credit cooperatives in the three other new Länder became members of west German regional associations. The private banks in the new Länder have become members of the Banking Association of the Central and East German Länder (which derived from the Berlin Banking Association). With only a few exceptions, all east German banks have joined the deposit guarantee schemes of their respective category of banks. East German bank customers' deposits therefore enjoy the same protection as those in western Germany.

II. Adjustments in payments

Structure of the Bundesbank

The Unification Treaty provides that an amended version of the Deutsche Bundesbank Act will replace the existing transitional regulations not later than October 3, 1991. The amendment is aimed at restructuring the Bundesbank, with the objective of adapting it to the new conditions obtaining in reunited Germany. The legislative process has not been completed yet. Hence the Bundesbank continues to have only 15 branches in the new Länder and a Provisional Administrative Office in Berlin, which performs the functions of a Main Office. Similarly, several Land Central Banks continue to provide assistance to particular branches as regards staffing and in technical and organisational respects, as well as affording support in administrative and constructional matters. During 1991 the number of employees of the Bank in the new Länder went on rising from some 1,500 to almost 1,900, including more than 1,500 staff members from the new Länder.

Currency conversion

Under the State Treaty Establishing the Monetary, Economic and Social Union, applications for the conversion of balances denominated in GDR Mark had to be filed with the financial institutions not later than July 6 or 13, 1990, and in exceptional cases not later than November 30, 1990. Since December 1, 1990, financial institutions in the former GDR have been unable to process any applications for currency conversion that are still coming in. As at the end of November 1991, a total of some GDR Mark 497 billion had been converted, whereas some GDR Mark 3 billion had not been converted.

A bill proposed by the Federal Cabinet on the retroactive conversion of account balances, the redemption of rights to the old balances redemption loan, the amendment of provisions of equalisation of burdens law and the amendment of the Act Establishing the "State Insurance of the GDR in Liquidation" *("Staatliche Versicherung der DDR in Abwicklung")* provides, among other things, for the reopening, in cases of hardship, of the period set for the filing of conversion applications. Natural persons are to be given an opportunity of retroactively filing an application for the conversion of their account balances with their account-carrying financial institution up to June 30, 1993, provided that the balances amount to not less than GDR Mark 500. A retrospective conversion of currency is not envisaged in order to preclude abuses.

The 1, 5, 10, 20 and 50 pfennig coins of the former GDR left in circulation in the new Länder for a transitional period were withdrawn from circulation with effect from July 1, 1991. The coins thus ceased to be legal tender. Until September 30, 1991, however, they were exchanged at their face value for current legal tender of the Federal Republic of Germany by the State Bank Berlin and its branch offices, as well as at the counters of the Federal Post Office and the Deutsche Bundesbank in the new Länder. The metal from the reflux of coins is being recycled as far as possible. The banknotes of the former GDR in the amount of some GDR Mark 29 billion which flowed back to the State Bank Berlin in the wake of the currency conversion have meanwhile been checked and subsequently disposed of by that Bank.

Cashless payments

Completely different, incompatible payment systems existed in eastern and western Germany, which had to be harmonised by a gradual adjustment of the GDR arrangements to the procedures applied in the Federal Republic and by an ongoing conversion of east German banks' accounting system from the former system *(Einheitliches System der Elektronischen Rechentechnik (ESER)* = Standard System of Electronic Accounting) to west German systems. In this context it was necessary to apply, for a transitional period, certain restrictions to current payment agreements, in the shape of a special conversion agreement signed in June 1990. This transitional period expired as scheduled on December 31, 1991 upon the conversion of the last few credit institutions. In 1991 over 37 million credit transfers (amounting to some DM 40 billion) and over 78 million direct debits (totalling some DM 15 billion) were carried out under the conversion procedure for western payments into the ESER system, with the State Bank Berlin or the Banking Industry Data-Processing Company being used as the interfaces. With the expiry of the conversion agreement, west German banks and the east German banks already converted to western standards ceased to be required to convert into data records all paper-based credit transfers and direct debits they received for ESER banks as part of west-east payments ("EZÜ" or "EZL requirement").

Normalisation of processing periods

The increasing adoption by banks and their customers of west German accounting and payment methods, the reduction of transport times and the further expansion of processing capacities in the computer centres of the banking industry and the Bundesbank in 1991 helped to ensure that, in both paperless and paper-based payments, the banking industry largely managed to achieve the processing periods customary elsewhere in west-east and east-west payments as well as within the new Länder. Hardly any complaints have reached the Bundesbank any more about unduly long processing periods for credit transfers. Temporary backlogs which occurred in individual payments computer centres in the processing of requests for the investigation of the whereabouts of credit transfers and cheque or direct debit collections not carried out at all, or in time, have meanwhile been eliminated by means of elaborate staff and organisational measures.

Payments outstanding at the State Bank Berlin

The above-mentioned conversion agreement provided that unpaid direct debits arising from west-east payments should be returned on the reversed collection route to the first collecting agencies in paper-based form (and thus necessarily in accordance with the western standard, bypassing the State Bank Berlin). In many instances, however, direct debits were returned through the ESER system to the State Bank Berlin, and on account of the incomplete data provided by that system the State Bank Berlin was unable to forward them to the first collecting banks. A large part of the returned items was attributable to an automatic procedure which could be used under the ESER system to return direct debits to the submitter, with no individual checks for sufficient funds, etc., being made. Sometimes the items were returned by the paying agents in accordance with the western standard, but likewise to the State Bank Berlin rather than to the first collecting agency direct. The upshot was that by September 1991 some 133,000 unpaid direct debits and – for similar reasons – also about 30,000 credit transfers had accumulated at the State Bank. The clearing and settlement of these problem cases has been effected since the end of 1991 under a special procedure agreed between all the parties involved. Under this procedure, the original paying agents in the new Länder first try to pay the direct debits, in agreement with the payer, retrospectively to the latter's debit. If the renewed attempts at having the items paid fail, the paying agents issue return debits (return envelopes) and forward these via the State Bank Berlin to the first collecting agencies. Normally, these then re-debit the submitters of the direct debits. Outstanding credit items are returned to the first instructed institutions using a similar procedure. Clearing is due to be completed by June 1992.

1. Discount credit

Refinancing quotas for east German banks

The rediscounting of bills of exchange by east German banks is limited by refinancing quotas. Refinancing quotas are set for east German banks of independent legal status and for branches of foreign banks not represented in the west German Länder. If a west German bank has a participating interest of 25% or more in an east German bank for which a refinancing quota has been set, the west German bank's standard rediscount quota is reduced accordingly.

Normally, a bank's refinancing quota is equal to the standard quota. It may be set at a level below the standard quota if special circumstances make this seem appropriate.

Refinancing quotas were first set as at July 1, 1990, in the amount of some DM 25 billion. The quotas were initially calculated on the basis of the balance sheet total; the standard quota was computed by multiplying the balance sheet total by a percentage based on the total amount of refinancing quotas set in a blanket decision by the Central Bank Council (decision of May 17, 1990). After the east German banks had been allowed to participate in securities repurchase agreements from February 1, 1991, the total amount of refinancing quotas was reduced to some DM 18 billion with effect from July 1, 1991, with the balance sheet total being retained as the basis for computing the standard quotas (decision of June 13, 1991).

With effect from January 2, 1992 the total amount of refinancing quotas was lowered to DM 10 billion. Of this amount, a total of DM 4 billion is available to those east German banks which are fully operational as lending banks. One-half of this sum was allocated on the basis of the balance sheet total and the other half on the basis of the usual calculation criteria (equity capital, structural component, discounting of bills eligible for rediscount at the Bundesbank). For a number of other banks whose activities are confined to the settlement of old loans in the territory of the former GDR ("banks winding-up") refinancing quotas totalling DM 6 billion were set. These quotas, whose calculation remains based on the balance sheet total, will be cancelled at the close of business on June 30, 1992 (decision of December 5, 1991).

These measures were in line with earlier declarations by the Central Bank Council of its intention to reduce east German banks' relatively large rediscount volume and to meet their refinancing requirements increasingly through securities repurchase agreements. In the course of 1992 it is planned to transform the refinancing quotas into normal rediscount quotas, which are computed solely on the basis of the liable capital, the individual business structure and the banks' discounting of bills eligible for rediscount at the Bundesbank.

Bills of exchange eligible for rediscount at the Bundesbank

Notwithstanding the Central Bank Council decision of February 20, 1957 (see page 96) parties liable on bills who are domiciled in eastern Germany are for the time being regarded as "parties known to be solvent" within the meaning of section 19 (1) 1 of the Deutsche Bundesbank Act unless payment irregularities or other circumstances which preclude solvency are known (decision of May 17, 1990). It is planned, however, to check the solvency of east German parties liable on bills in accordance with the usual criteria applied to west German enterprises (non-banks) once records are available on such east German parties which enable their financial circumstances to be duly assessed (e.g. Deutsche Mark opening balance sheets, 1991 annual accounts).

The refinancing quotas are to be used in principle for rediscounting trade bills which have been drawn on the basis of goods or services supplied between enterprises and/or self-employed persons and which as a rule must bear the signatures of three parties known to be solvent. Since trade bills were not normally available to east German banks on the inception of the monetary, economic and social union with the former GDR on July 1, 1990, they were allowed, instead, to rediscount their own promissory notes (bank promissory notes) not bearing any further signature (decision of May 17, 1990). These bank promissory notes were additionally backed to the extent that provisional – if necessary, unquantified – claims on the Currency Conversion Equalisation Fund had to be assigned to the Bundesbank.

Until January 31, 1991 the refinancing quotas could be utilised in full for rediscounting such bank promissory notes. Thereafter, the presentation of bank promissory notes was gradually curtailed, viz. to not more than two-thirds of the quota from February 1, 1991 and to not more than 50% from July 1, 1991. Accordingly, a growing part of the quota could be utilised only for rediscounting trade bills, including a minimum share of the quota (10% from February 1, 1991 and 20% from July 1, 1991) for rediscounting bills on which at least one east German non-bank enterprise was liable (decisions of November 29, 1990 and June 13, 1991).

In connection with the reduction of the refinancing quotas from January 2, 1992 the Central Bank Council once again changed the rules for their utilisation. Since then, east German banks which are fully operational as lending banks have not been allowed to utilise more than 25% of their refinancing quota for rediscounting their own promissory notes not bearing any further signature; the remaining 75% of the quota may be used only for rediscounting trade bills; at the same time, however, a minimum share of bills bearing the signature of east German non-bank enterprises is not required. Institutions winding up may – notwithstanding the above – use all their refinancing quotas, which will expire on June 30, 1992, until that date for rediscounting their own promissory notes (decision of December 5, 1991).

This recent modification of the utilisation rules is aimed at gradually bringing the conditions for utilising the refinancing quotas into line with the refinancing regulations applying to west German banks. After the conversion of the refinancing quotas into normal rediscount quotas, bank promissory notes not bearing any further signature will no longer be rediscountable.

2. Lombard loans

Collateral for lombard loans

East German banks, if the collateral specified in the "List of securities eligible as collateral at the Deutsche Bundesbank (Lombard List)" is not available to them in sufficient quantities, or at all, may be granted lombard loans against the collateral of their own promissory notes (bank promissory notes) not bearing any further signature (decision of May 17, 1990). In principle, however, these bank promissory notes have to be backed by assigning allotment claims on the Currency Conversion Equalisation Fund.

It is planned to replace bank promissory notes as collateral for lombard loans as soon as securities eligible as collateral for lombard loans are available to east German banks on a substantial scale – possibly, for instance, officially listed bearer bonds deriving from the conversion of equalisation claims on the Currency Conversion Equalisation Fund allotted on a provisional basis.

3. Open market operations

Open market transactions under repurchase agreements in securities

Owing to their lack of suitable securities, east German banks could not at first be allowed to participate in open market transactions under repurchase agreements (securities repurchase agreements). By way of compensation, they were granted higher refinancing quotas. They have been permitted to participate in securities repurchase agreements since February 1, 1991 (decision of November 29, 1990).

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

Legal basis

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)* in the wording of December 19, 1985. In accordance with that section, the provisions of the Commercial Code *(Handelsgesetzbuch)* relating to corporations are to be applied as appropriate to the valuation.

The annual accounts for 1991 are attached to this Report as an Appendix; as usual, the notes on them are presented in the order in which the items appear in the balance sheet and the profit and loss account. At the same time a report is rendered on the Bank's business operations. The trends in major balance sheet items in the course of the year are shown in the Weekly Returns of the Bank, which are published as Appendix 3 of the German original of this Report. Interest expenditure and interest receipts are now shown separately in the profit and loss account. The addition of sub-item 6.4 "Other external assets" to asset item 6 represents a reclassification of assets which have been in existence for some time.

1. Balance sheet

The balance sheet total at December 31, 1991 was DM 359,859.9 million, against DM 349,548.5 million at the end of 1990.

Assets

Gold

The gold holding, amounting to 95 million ounces of fine gold (excluding the gold reserves provisionally contributed to the European Monetary Cooperation Fund), is shown at December 31, 1991 at the same figure as at end-1990, viz. DM 13,687.5 million.

Reserve position in the International Monetary Fund and special drawing rights

At December 31, 1991 the level of drawing rights within the reserve tranche in the International Monetary Fund (IMF) amounted to DM 5,407.7 million (= SDR 2,493.7 million), against DM 4,565.0 million (= SDR 2,147.8 million) at end-1990. It represents the difference between the German quota of SDR 5,403.7 million and the Deutsche Mark balances equivalent to SDR 2,910.0 million at the disposal of the IMF at the end of the year. Increases equivalent to SDR 693.5 million due to other members' Deutsche Mark drawings and other Deutsche Mark payments to other members were accompanied by decreases equivalent to SDR 347.6 million due to other members' Deutsche Mark repayments and other transactions.

During the year under review the Bank did not grant any new loans to the IMF under special borrowing arrangements. At present only one credit line amounting to SDR 2.4 billion in favour of the IMF is outstanding under the General Arrangements to Borrow, but the IMF can utilise it only subject to certain conditions.

The amount of special drawing rights (SDRs) held at December 31, 1991 came to DM 2,905.8 million (= SDR 1,340.0 million), against DM 2,808.2 million (= SDR 1,321.2 million) at end-1990. It was composed of 1,210.8 million SDRs allocated, the counterpart of which is shown on the liabilities side, and 129.2 million SDRs purchased. Increases totalling SDR 140.8 million due to interest payments and remunerations on the part of the IMF were accompanied by decreases amounting to SDR 122.0 million in the context of freely agreed SDR transactions.

Claims on the European Monetary Cooperation Fund

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

The ECU balances amounting to DM 29,128.6 million arise mainly 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. In addition, these balances include to a small extent the reserve ECUs transferred to the Bank by other central banks participating in the European Monetary System (EMS). The gold and dollar reserves provisionally contributed to the European Monetary Cooperation Fund under the terms of the 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 11,799.9 million is deducted from the ECU balances. At the end of 1991 there were no other claims denominated in ECUs arising from lending under the very short-term financing mechanism.

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 US dollars and bear interest, amounted to DM 55,403.9 million at the end of 1991, against DM 64,454.0 million at December 31, 1990 (excluding the dollar reserves provisionally contributed to the EMCF). The assets and liabilities denominated in US dollars were valued at the balance sheet rate of US$ 1 = DM 1.4500, which is geared to the lowest level of the dollar in 1991.

Foreign exchange deals

The Bank's turnover in spot foreign exchange deals increased distinctly in the year under review owing to larger sales of US dollars. The decisive factor here was transactions (conducted outside the market) with foreign monetary authorities. Specifically, the deals consisted of

	1990		1991	
	Number	DM million	Number	DM million
Purchases	1,872	4,400.1	2,070	5,474.2
Sales	2,267	11,173.9	2,628	19,444.3
	4,139	15,574.0	4,698	24,918.5.

In addition, six US dollar sales equivalent to DM 6,000.0 million in all were conducted forward, in the context of switch transactions of Deutsche Mark balances held at the Bundesbank by foreign monetary authorities into US dollars.

The volume of cross deals (foreign currency against another foreign currency) decreased to DM 1,182.2 million in the year under review, compared with DM 2,324.5 million in 1990. The number of deals likewise fell (from 64 to 16). The volume of SDR-US dollar and SDR-Deutsche Mark deals declined from the equivalent of DM 463.1 million to the equivalent of DM 267.0 million, whereas the number of transactions increased from 36 to 56. In addition, 256 US dollar inter-centre switch transactions totalling US$ 68.7 million were entered into (1990: 204 transactions amounting to US$ 58.7 million).

With a view to fine-tuning the German money market, the Bank conducted 33 foreign exchange repurchase transactions equivalent to DM 16,931.2 million with domestic banks during the period under review in order to absorb liquidity.

External payments

The Bank executed the following 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 SWIFT 1
1990	370,092	2,876,048	3,246,140	2,972,025	203,449
1991	364,803	3,045,119	3,409,922	3,125,628	224,091
	Incoming external payment orders				
				of which Payments received via SWIFT	
1990	17,143	248,896	266,039	253,097	
1991	17,392	238,015	255,407	244,358	

1 Society for Worldwide Interbank Financial Telecommunication.

Foreign cheques

During 1991 27,124 (1990: 25,218) foreign cheques payable to order totalling DM 259.5 million (1990: DM 204.6 million) were sold. In 1991 the number of cheques presented under the simplified collection procedure for foreign cheques was larger than in the preceding year; for details see Appendix 4 of the German original of this Report.

Foreign commission business

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

	1990	1991
		Number
Bills, cheques, etc.	17,529	20,569
Foreign notes and coins	3,989	3,164
	21,518	23,733.

Foreign notes and coins

The amount of foreign notes and coins held at the end of 1991, at DM 20.0 million, was DM 10.9 million lower than at end-1990. During the year under review the Bank effected 21,468 purchases (1990: 19,523) and 45,722 sales (1990: 44,811) of foreign notes and coins.

External loans and other external assets

The main constituents of this item are loans to the World Bank (which were mostly granted against borrowers' notes denominated in Deutsche Mark). Loans under the EC medium-term monetary assistance arrangement and other loans to foreign monetary authorities were not outstanding in the year under review. Among the other external assets there are some fairly long-standing claims, including some limited investments with regional development banks.

Lending to domestic banks

This item reflects domestic banks' recourse to the Bank's refinancing facilities.

Securities repurchase agreements

In the year under review the Bank again regularly offered the banks, by tender, open market transactions under repurchase agreements in securities on a considerable scale in order to provide liquidity for a limited period. Since February 1, 1991 east German banks, too, have been allowed to participate in these transactions. In the course of such transactions the Bank buys securities eligible as collateral for lombard loans subject to the condition that the sellers repurchase them forward. At the end of the year the claims deriving from these transactions amounted to DM 148,456.9 million (end-1990: DM 117,434.8 million); DM 143,091.1 million of this sum was accounted for by west German banks, DM 5,365.8 million by east German banks.

Domestic bills of exchange

At the end of 1991 the Bank's portfolio of domestic bills amounted to DM 36,244.0 million against DM 54,116.3 million at the end of 1990. DM 27,493.5 million of the total holding stemmed from west German banks' presentations under their rediscount quotas or under the special rediscount facilities (ceiling B) granted to the *AKA Ausfuhrkredit-Gesellschaft mbH.* Under the refinancing quotas granted to them, east German banks rediscounted domestic bills of exchange amounting to DM 8,750.5 million.

Purchases of domestic bills of exchange

	1990		1991	
Area	Thousands	DM million	Thousands	DM million
Land Central Bank				
Baden-Württemberg	445	25,963.0	409	24,937.2
Bavaria	310	23,883.7	282	23,429.4
Berlin	13	2,479.8	12	2,684.5
Bremen	28	2,880.2	26	2,816.9
Hamburg	69	7,369.5	60	7,734.4
Hesse	242	33,308.3	211	29,724.7
Lower Saxony	109	10,828.9	95	10,666.8
North Rhine-Westphalia	434	35,322.0	403	34,592.5
Rhineland-Palatinate	75	4,936.3	68	4,753.0
Saarland	18	1,398.9	16	1.258.5
Schleswig-Holstein	22	1,995.8	18	1,944.3
Provisional Administrative Office	3	59,880.4	8	55,922.0
Total	1,768	210,246.8	1,608	200,464.2

The average value of the bills purchased in the year under review was DM 124,700 (1990: DM 119,000).

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

	1990		1991	
	Number	DM million	Number	DM million
	5,675	114.5	4,489	125.4
as % of the total purchased	0.32	0.05	0.28	0.06.

Discount rate

During the year under review the Bank's discount rate for domestic and foreign bills was 6% until January 31, 6½% from February 1, 7½% from August 16, and 8% from December 20.

Prime bankers' acceptances

By way of the structural adjustment of refinancing facilities, the presentation facility of the *Privatdiskont AG* was lowered to DM 2 billion from January 1, 1990 and to DM 1 billion from January 1, 1991; it was abolished altogether at the end of 1991.

Throughout the year the Bank's buying rate for prime bankers' acceptances was 0.5 percentage point below the discount rate, and thus remained well below the level of money market rates; hence heavy recourse was once again had to that refinancing facility. During the year under review the Bank's purchases through the *Privatdiskont Aktiengesellschaft* on balance came to DM 4,251.6 million (1990: DM 8,372.0 million). No prime bankers' acceptances were left in the Bank's portfolio at the end of 1991.

Foreign bills of exchange

At the end of 1991 the portfolio of foreign bills accumulated through purchases in Germany amounted to DM 38,715.5 million (end-1990: DM 30,792.6 million). The share of Deutsche Mark bills in the total value of the foreign bills purchased averaged 98.9% in 1991 (1990: 98.6%).

Purchases of foreign bills of exchange

	1990		1991	
Area	Number	DM million	Number	DM million
Land Central Bank				
Baden-Württemberg	49,567	16,699.7	44,717	17,498.0
Bavaria	35,542	17,196.7	33,910	19,367.9
Berlin	4,602	8,325.6	4,871	9,268.4
Bremen	2,358	1,569.2	2,143	1,588.6
Hamburg	16,673	15,187.6	14,012	14,374.6
Hesse	34,447	34,437.8	32,074	38,783.3
Lower Saxony	9,856	6,035.3	9,430	6,569.0
North Rhine-Westphalia	44,472	30,255.9	41,136	32,684.9
Rhineland-Palatinate	8,191	2,622.7	7,146	2,515.2
Saarland	4,141	1,808.5	3,658	1,718.1
Schleswig-Holstein	4,239	2,069.3	4,048	2,048.6
Provisional Administrative Office	201	500.5	6,951	20,976.0
Total	214,289	136,708.8	204,096	167,392.6

Lombard loans

At the end of 1991 the outstanding amount of lombard loans which the Bank had granted to banks was DM 1,901.7 million, against DM 6,179.9 million at end-1990. At the end of the reporting year DM 1,624.4 million of the total amount was accounted for by west German banks and DM 277.3 million by east German banks. Recourse to lombard loans is normally subject to marked fluctuations; the highest level in 1991 was reached on January 11, at DM 19,570.3 million.

Lombard rate

During the year under review the lombard rate was 8½% until January 31, 9% from February 1, 9¼% from August 16, and 9¾% from December 20.

Cash advances

Section 20 (1) 1 of the Deutsche 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.

Not only cash advances but also Treasury bills which the Bank holds in its portfolio or has undertaken to purchase are to be counted towards these credit ceilings.

Cash advances outstanding

DM million

Borrower	December 31, 1990	December 31, 1991
Federal Government	–	–
Länder Governments		
Baden-Württemberg	79.8	–
Bavaria	309.3	37.4
Berlin	–	–
Brandenburg	–	19.3
Bremen	10.7	–
Hamburg	–	–
Hesse	147.2	–
Lower Saxony	–	–
Mecklenburg-Western Pomerania	–	–
North Rhine-Westphalia	29.4	–
Rhineland-Palatinate	135.3	28.0
Saarland	30.3	35.0
Saxony	–	69.2
Saxony-Anhalt	–	–
Schleswig-Holstein	–	–
Thuringia	–	–
Total	742.0	188.9

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

Federal Railways and Federal Post Office

No cash advances to the Federal Railways and Federal Post Office were outstanding at December 31, 1991; any such advances, together with claims arising from the purchase of Treasury bills and Treasury discount paper, are to be shown in the item "Lending to the Federal Railways and Federal Post Office" on the assets side of the Bank's balance sheet.

The interest rate charged for cash advances is identical to the ruling lombard rate.

Treasury bills and Treasury discount paper

For issues of Treasury discount paper *(U-Schätze)* in 1991, the Bank acted as the selling agent for the Federal Government, the Debt-Processing Fund *(KAF)* and the east German Railways. This paper, which serves financing purposes, is distinct from the mobilisation and liquidity paper issued under sections 42 and 42a of the Deutsche Bundesbank Act, which is reported on elsewhere. No Treasury bills serving financing purposes were issued during the year under review.

Federal Government

DM 16,307.2 million of "Treasury financing paper" was sold in 1991 (1990: DM 17,881.4 million). As in the previous year, there were no sales of other Treasury discount paper not returnable before maturity (type "BN").

DM 600.0 million of paper returnable before maturity (type "B") was redeemed; DM 630.0 million of such paper was newly issued. After the redemption of DM 15,854.2 million (1990: DM 9,937.7 million) of matured Treasury discount paper (including "Treasury financing paper"), the total amount of Treasury discount paper of the Federal Government (types "B" and "BN") outstanding at the end of 1991 was DM 22,764.4 million (end-1990: DM 21,681.4 million). Of this total, DM 1,470.0 million was repurchasable by the Bank (Treasury discount paper type "B").

Debt-Processing Fund

In 1991 the Debt-Processing Fund issued Treasury discount paper not returnable before maturity (type "KAF N") amounting to DM 15,589.8 million. Treasury discount paper issued by the former GDR (type "DDR N") totalling DM 19,446.0 million was redeemed; upon German unification, those securities became liabilities of the Debt-Processing Fund. At December 31, 1991 Treasury discount paper amounting to DM 16,210.8 million was outstanding (end-1990: DM 20,087.0 million).

Federal Railways and east German Railways

DM 131.0 million of returnable Treasury discount paper (type "Ba") which had been issued by the Federal Railways in 1989 was redeemed; there were no new issues of Treasury discount paper. For the first time, the east German Railways issued Treasury discount paper not returnable before maturity (type "RBa N") to the value of DM 1,136.0 million.

Federal Post Office

No Treasury discount paper of the Federal Post Office was outstanding during the year under review.

The total amount of money market paper issued for account of the Federal Government and its Special Funds and of the GDR outstanding at the end of 1991 was DM 40,111.2 million (end-1990: DM 41,899.4 million).

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

DM million

Type of paper	1990 Outstanding at December 31	1991 Issued	Redeemed	Outstanding at December 31
Treasury discount paper of the Federal Republic of Germany types "B" **1** and "BN" **2**	21,681.4	16,937.2	15,854.2	22,764.4
of which: "Treasury financing paper"	(20,241.4)	(16,307.2)	(15,254.2)	(21,294.4)
Treasury discount paper of the Debt-Processing Fund type "KAF N" **2, 3**	20,087.0	15,589.8	19,466.0	16,210.8
Treasury discount paper of the Federal Railways type "Ba"	131.0	–	131.0	–
Treasury discount paper of the east German Railways type "RBa N" **2**	–	1,136.0	–	1,136.0
Total	41,899.4	33,663.0	35,451.2	40,111.2

1 The letter "B" serves to distinguish these bonds from mobilisation and liquidity paper. — **2** The Bundesbank has not undertaken to buy securities distinguished by the letter "N" before maturity. — **3** Including the Treasury discount paper issued in 1990 on behalf of the former GDR ("DDR N").

Länder Governments

At the end of 1991, just as in the preceding year, the Bank had no money market paper of the Länder Governments in its portfolio.

Equalisation claims

The Bank's equalisation claims on the Federal Government (which yield interest at the rate of 1 % p.a.) and the non-interest-bearing debt certificate in respect of Berlin remained unchanged during the year under review.

Lending to the Federal Railways and Federal Post Office

No lending to the Federal Railways or Federal Post Office was outstanding at December 31, 1991, 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 issued by the Federal Republic of Germany, the Federal Railways and the Federal Post Office) on balance increased by DM 694.4 million to DM 4,796.8 million (end-1990: DM 4,102.4 million) on account of transactions in the open market, after the deduction of redemptions due to maturity.

In 1991 nine bond issues totalling DM 61 billion (1990: twelve issues amounting to DM 64 billion) were launched through the Federal Bond Consortium. Of these, five issues by the Federal Republic of Germany and the "German Unity" Fund totalling DM 44 billion were placed by the combined syndicate and tender procedure (1990: four issues). Two bond issues amounting to DM 17 billion were launched on behalf of the "German Unity" Special Fund. Of the bonds issued, an amount of DM 21,684.3 million was reserved for the issuers' own institutions and for market regulation purposes (1990: DM 16,228.8 million).

At the end of 1991 the outstanding amount of bonds issued by the Federal Republic of Germany was DM 266,962.5 million (end-1990: DM 239,283.1 million), that issued by the Federal Railways was DM 29,100.7 million (end-1990: DM 27,750.8 million), that issued by the Federal Post Office was DM 41,800.6 million (end-1990: DM 36,800.7 million) and that issued by the "German Unity" Fund was DM 26,000.0 million (end-1990: DM 9,000.0 million).

Bond issues of the Federal Republic of Germany, the Federal Railways, the Federal Post Office and the "German Unity" Fund in 1991

	Amount issued (DM million)			Terms					
		of which					Yield		
Issuer	Total	Allotment procedure	Tender procedure	Nominal interest rate (% p.a.)	Maturity (years/months)	Issue price/average allotment rate (%)	Issue price (% p.a.)	Tender (% p.a.)	Start of sales
Federal Republic of Germany	10,000	3,000	4,933.0	9.00	10/0	100.70/ Ø 99.97	8.89	Ø 9.01	1 Jan. 2
"German Unity" Fund	2 10,000	2,000	2,161.6	8.50	10/0	100.70/ Ø 100.40	8.39	Ø 8.44	Feb. 7
Federal Republic of Germany	10,000	3,000	4,388.2	8.375	10/0	100.70/ Ø 99.96	8.27	Ø 8.38	May 7
Federal Post Office	3,000	2,400	–	8.375	10/0	100.70	8.27	–	June 7
Federal Railways	2,000	1,800	–	8.50	10/0	Ø 100.70	8.39	–	July 1
"German Unity" Fund	7,000	2,000	2,804.7	8.75	10/0	101.00/ Ø 100.35	8.60	Ø 8.70	July 30
Federal Post Office	3,000	2,400	–	8.50	10/0	100.60	8.41	–	Sep. 5
Federal Railways (increase)	2,000	–	1,620.0	8.50	9/9	Ø 99.96	–	Ø 8.49	Sep. 27
Federal Republic of Germany	3 14,000	3,000	3,808.2	8.25	10/0	100.60/ Ø 99.76	8.16	Ø 8.29	Oct. 8

1 Start of sales on December 27, 1990. – 2 Increase from DM 7,000 million to DM 10,000 million; sale of the increased amount through the stock exchange. – 3 Increase from DM 10,000 million to DM 14,000 million; sale of the increased amount through the stock exchange.

Issue of Federal savings bonds

With the assistance of the Bank (selling operations through banks and sales of its own), Federal savings bonds to the value of DM 14,239.2 million (gross) were placed with private purchasers in 1991 (1990: DM 15,149.3 million). During the year under review the rate of interest paid on Federal savings bonds was raised three times and lowered once to bring it into line with market conditions. In 1991 DM 5,135.2 million (1990: DM 13,492.3 million) of Federal savings bonds from earlier tranches were returned to the issuer before maturity. A further DM 5,238.5 million of such bonds were redeemed on maturity. The amount of Federal savings bonds outstanding accordingly increased from DM 30,891.7 million (at end-1990) to DM 34,757.2 million at December 31, 1991.

Issues of Federal savings bonds in 1991

Issue	Sales period 1991	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, the respective year after issue (% p.a.)	1st	2nd	3rd	4th	5th	6th	7th
1990/ 9+10	Jan. 2– Jan. 8 [3]	[4] 684.2	271.6		I	7.50	8.50	8.75	9.00	9.00	9.25	
					Y	7.50	7.98	8.22	8.39	8.49	8.59	
				412.6	I	7.50	8.50	8.75	9.00	9.00	9.25	9.25
					Y	7.50	8.00	8.25	8.44	8.55	8.67	8.75
1991/ 1+2	Jan. 9– Feb. 24	3,210.4	1,257.1		I	7.50	8.50	8.75	9.00	9.25	9.50	
					Y	7.50	7.98	8.22	8.39	8.53	8.66	
				1,953.3	I	7.50	8.50	8.75	9.00	9.25	9.50	9.50
					Y	7.50	8.00	8.25	8.44	8.60	8.75	8.86
1991/ 3+4	Feb. 25– July 2	6,118.8	2,741.1		I	7.50	8.50	8.50	8.75	8.75	9.00	
					Y	7.50	7.98	8.14	8.27	8.35	8.44	
				3,377.7	I	7.50	8.50	8.50	8.75	8.75	9.00	9.00
					Y	7.50	8.00	8.17	8.31	8.40	8.50	8.57
1991/ 5+6	July 3– Oct. 31	2,695.8	1,204.4		I	7.50	8.50	8.50	8.75	9.00	9.00	
					Y	7.50	7.98	8.14	8.27	8.40	8.48	
				1,491.4	I	7.50	8.50	8.50	8.75	9.00	9.00	9.00
					Y	7.50	8.00	8.17	8.31	8.45	8.54	8.61
1991/ 7+8	Nov. 1– [5]	1,530.0	772.4		I	7.50	8.50	8.75	8.75	9.00	9.00	
					Y	7.50	7.98	8.22	8.33	8.45	8.52	
				757.6	I	7.50	8.50	8.75	8.75	9.00	9.00	9.00
					Y	7.50	8.00	8.25	8.37	8.50	8.58	8.64

1 With annual payment of interest. — 2 With accrual of interest. — 3 Start of sales on November 7, 1990. — 4 Sales from November 7 to December 31, 1990: DM 2,123.2 million, of which FSB/A DM 894.6 million and FSB/B DM 1,228.6 million. — 5 Sales not completed on December 31, 1991.

Issue of five-year special Federal bonds

With the assistance of the Bank (selling operations through banks and sales of its own), newly-issued five-year special Federal bonds to the value of DM 14,631.7 million were sold in the year under review (1990: DM 22,776.7 million). In addition, an amount of DM 19,128.4 million was reserved for market regulation purposes. During the year under review the terms of these special Federal bonds were brought into line with changed market conditions on sixteen occasions. Series 60 to 67 of these special Federal bonds, in the amount of DM 24,900.0 million, were redeemed upon maturity during 1991. At the end of the year the amount of five-year special Federal bonds outstanding was DM 137,653.8 million (end-1990: DM 126,915.8 million).

Issues of five-year special Federal bonds in 1991

Designation of series	Start of sales	Amount issued (DM million): Sales: per issue price	Sales: Total	Price regulation share	Total	Terms: Nominal interest rate (% p.a.)	Issue price (%)	Yield (% p.a.)	Date of stock exchange listing
S. 94 of 1990 (1995)	Jan. 2 1	2 3,532.1				8.875	99.80	8.93	Feb. 18
	Feb. 5	533.4					100.20	8.82	
	Feb. 7	697.1	4,762.6	3,789.8	10,000		100.60	8.71	
S. 95 of 1991 (1996)	Feb. 11	1,472.8				8.625	100.20	8.57	Apr. 19
	Feb. 18	686.8					100.60	8.47	
	Feb. 25	823.9					100.80	8.42	
	Mar. 13	543.1	3,526.6	4,473.4			101.00	8.36	
				3 2,000.0					
				4 2,000.0	12,000				
S. 96 of 1991 (1996)	Apr. 12	511.1				8.500	100.60	8.35	Oct. 7
	May 16	1,203.5					100.00	8.49	
	May 29	33.9					100.50	8.35	
	May 30	385.9					100.70	8.30	
	July 3	143.3					99.80	8.52	
	July 16	857.1	3,134.8	4,865.2			99.20	8.68	
				5 2,000.0	10,000				
S. 97 of 1991 (1996)	Sep. 27	1,303.8				8.500	99.30	8.68	6 ...
	Oct. 9	326.9					99.80	8.55	
	Nov. 1	541.8					99.20	8.69	
	Nov. 13	1,035.2	3,207.7	6 ...	6 ...		99.60	8.58	

1 Start of sales on December 12, 1990. — 2 Sales from December 12 to 31, 1990: DM 1,447.6 million. — 3 Increase from July 18, 1991. — 4 Increase from August 28, 1991. — 5 Increase from December 18, 1991. — 6 Sales not completed on December 31, 1991.

Issue of Treasury notes

After issues of Federal bonds had been rendered more flexible and more competitive in 1990 by the introduction of a combined syndicate and tender procedure, a liquid security was created in 1991 through the restructuring of Treasury notes. Treasury notes of the Federal Republic of Germany (Federal Treasury notes) are issued by tender at regular intervals, and may be purchased by anybody. They are officially listed on all German stock exchanges.

In consultation with the Bank, during 1991 there were four issues of Treasury notes by the Federal Republic of Germany totalling DM 25.0 billion, one issue by the Federal Post Office (DM 2.0 billion) and one issue by the east German Railways (DM 1.5 billion). At the end of 1991 the outstanding amount of Treasury notes (including old-style medium-term notes) of the Federal Republic of Germany was DM 47,860.8 million (end-1990: DM 38,762.6 million), that of the Federal Railways was DM 911.2 million (end-1990: DM 911.2 million), that of the Federal Post Office was DM 5,592.7 million (end-1990: DM 3,592.7 million) and that of the east German Railways was DM 1,500.0 million.

Issues of Treasury notes of the Federal Republic of Germany, the east German Railways and the Federal Post Office in 1991

Issuer	Amount issued (DM million) Total	of which Market regulation share	Terms: Nominal interest rate (% p.a.)	Maturity (years/months)	Average allotment rate (%)	Average yield (% p.a.)	Value date
Federal Republic of Germany	6,000	1,452.4	8.625	4/0	99.84	8.67	May 23
Federal Republic of Germany	6,000	3,042.8	8.875	4/0	99.33	9.08	July 24
Federal Republic of Germany	6,000	2,047.6	8.75	4/3	99.56	8.88	Sep. 25
East German Railways	1,500	95.3	8.75	4/0	99.22	8.99	Oct. 28
Federal Republic of Germany	7,000	2,588.6	8.75	4/0	99.61	8.84	Nov. 25
Federal Post Office	2,000	485.7	8.75	4/0	99.35	8.95	Dec. 9

Admission to stock exchange dealing

In 1991 the Bank introduced the newly issued bonds and Treasury notes of the Federal Republic of Germany, the "German Unity" Fund, the Federal Railways, the east German Railways and the Federal Post Office, as well as series 94 to 96 of five-year special Federal bonds and a bond issue of the Reconstruction Loan Corporation, to official dealing on all German stock exchanges. Fifteen issues of funding bonds of the Federal Republic of Germany relating to interest arrears of external debt of the German Reich under the London Debt Agreement of 1953, as well as thirteen issues of corresponding fractional rights, were officially listed on the Frankfurt stock exchange by order of the Federal Government. The Bank also introduced a bond issue and new issues of bearer bonds and Treasury notes of the Reconstruction Loan Corporation to the Frankfurt stock exchange, as well as floating-rate notes and bearer bonds of the *Deutsche Ausgleichsbank* to official dealing on particular German stock exchanges.

Price regulation operations

In the year under review, as in the previous years, the Bank conducted price regulation operations for account of the issuers. This affected the bonds and Treasury notes of the Federal Government and its special Funds, five-year special Federal bonds and the bonds issued by the Reconstruction Loan Corporation on the eight German stock exchanges, as well as the bonds and bearer bonds of the *Deutsche Ausgleichsbank* officially listed on particular German stock exchanges.

The Bank as paying and collecting agent for bonds

The Bank continued to act as paying and collecting agent for bonds of the Federal Government and its Special Funds, and paid 310,765 interest coupons and matured bonds in 1991 (1990: 249,101).

German coins

The amount of coins held by the Bank at the end of 1991 totalled DM 1,556.5 million (end-1990: DM 1,118.7 million). In 1991 DM 1,190.5 million was credited to the Federal Government in respect of coins received from the mints and DM 26.6 million was debited to it in respect of coins no longer fit for circulation. Between 1948 and 1991 the Bank – acting for account of the Federal Government – received coins amounting to DM 16,697.9 million and redeemed coins which were no longer fit for circulation or had been called in to the value of DM 1,826.5 million. The GDR small coins temporarily circulating in the new Länder after monetary union were withdrawn from circulation as from July 1, 1991 and debited back to the State Bank Berlin. At the end of 1991 coins totalling DM 13,315.0 million were in circulation, equivalent to DM 168 per head of the population. During the year under review the DM 10 commemorative coins "Octocentenary of the Teutonic Order" and "Bicentenary of the Brandenburg Gate" were put into circulation.

Balances on postal giro accounts

At December 31, 1991 the balances on postal giro accounts, including the branch offices' transfers in transit to the postal giro account of the Bank (Central Office) in Frankfurt am Main, amounted to DM 152.4 million (1990: DM 106.0 million). The Bank's credit balance on the latter account, other than what is required for current payments, is offset daily against the giro account balance of the Central Cash Office of the Federal Post Office.

Postal giro transactions with third parties

	1990				1991			
	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	47,019	23,861.4	4,086	6,217.3	11,372	27,070.9	2,948	7,657.2
Bavaria	29,076	15,356.0	6,850	14,821.1	9,235	18,190.2	4,966	18,040.2
Berlin	4,431	3,504.6	956	2,695.2	3,514	3,756.1	1,126	3,693.9
Bremen	5,661	269.0	53	0.0	0	0.0	0	0,0
Hamburg	14,663	24,513.7	1,862	1,287.6	11,659	21,361.6	1,883	2,510.2
Hesse	44,788	6,947.7	3,578	12,984.2	22,987	7,190.7	2,829	13,982.0
Lower Saxony	27,665	8,684.0	3,488	5,616.0	8,117	9,611.0	2,932	6,981.0
North Rhine-Westphalia	81,764	21,358.8	7,320	4,560.3	11,323	21,193.1	6,212	4,922.7
Rhineland-Palatinate	63,300	689.2	3,455	2,211.0	363	210.9	2,550	2,592.1
Saarland	2,786	1,023.8	45	0.1	720	762.3	7	0.0
Schleswig-Holstein	23,480	134.3	202	0.1	0	0.0	0	0.0
Provisional Administrative Office	14	0.7	17	0.7	0	0.0	0	0.0
Central Office	11,969	1,684.4	1,025	4.3	10,867	3,056.0	1,025	330.6
Total	356,616	108,027.6	32,937	50,397.9	90,157	112,402.8	26,478	60,779.9

Land and buildings

After additions of DM 190.7 million and depreciation totalling DM 206.6 million, land and buildings are shown at DM 2,835.3 million (1990: DM 2,851.1 million).

Furniture and equipment

The balance sheet value of furniture and equipment, after additions of DM 175.1 million and depreciation amounting to DM 138.5 million, is DM 275.7 million (1990: DM 239.1 million).

Items in course of settlement

The "Items in course of settlement" mainly consist of the cheques and direct debits in transit within the Bank at the end of the year and the intercity credit and debit transfers in course of settlement. At December 31, 1991 the balance of items in course of settlement stood at DM 15,129.6 million against DM 13,275.1 million at end-1990.

Other assets

At the end of 1991 other assets amounted to DM 3,530.0 million (end-1990: DM 3,266.5 million). They primarily comprise the interest receipts from external assets and securities repurchase agreements falling due in 1992 but assignable to the profit and loss account for the year under review (DM 2,480.4 million against DM 2,526.1 million at end-1990).

This item also includes the Bank's 30% interest (DM 93 million in nominal terms) in the capital of the *Liquiditäts-Konsortialbank GmbH*, Frankfurt am Main. The clause in the articles of association of this bank that, if necessary, further capital is to be paid up in proportion to the existing stake entails for the Bank a maximum commitment of DM 279 million.

Prepayments

The prepayments consist almost entirely of salary and pension payments made in the year under review but relating to 1992.

Liabilities

Banknotes in circulation

The amount of banknotes in circulation at December 31, 1991, at DM 181,300.2 million, was DM 14,391.5 million (8.6%) larger than at end-1990.

The Bank continued to issue its new series of banknotes, the new DM 10 note appearing on April 16, 1991 and the new DM 50 note on September 30. The new DM 20 note is due to follow on March 30, 1992. The series is expected to be completed in autumn 1992 with the issue of the new DM 5, DM 500 and DM 1,000 notes. At the end of the period under review the new banknotes accounted for as much as 74.6% (DM 100), 65.1% (DM 10), and 43.9% (DM 50) of the total amounts of the respective denominations in circulation. The banknotes of the old series will remain fully valid legal tender until further notice. When they are withdrawn from circulation at a later date, the period set for the purpose will be long enough to give everybody ample time to exchange the old banknotes for new ones at any bank. And even after the expiry of the official deadline for exchanging the old notes, the Bank will go on replacing them at their face value.

The following banknotes (including monetary tokens) were destroyed as being no longer fit for circulation or after having been called in, including notes of the old series detained by the Bank:

	1986	1987	1988	1989	1990	1991
Number (millions)	595.7	578.0	553.5	719.3	506.0	1,098.7
Value (DM million)	27,035.3	25,895.5	29,221.9	27,432.2	25,786.3	62,623.5.

Currency in circulation

DM million

End of	Currency in circulation, total	Banknotes	Coins
1986	123,732.8	113,983.0	9,749.8
1987	135,900.7	125,608.0	10,292.7
1988	154,822.4	143,941.7	10,880.7
1989	162,143.8	150,548.0	11,595.8
1990	179,690.1	166,908.7	12,781.4
1991	194,615.2	181,300.2	13,315.0

The denominations of the banknotes and coins in circulation (currency) are shown in Appendix 4 of the German original of this Report.

The number and amount of the counterfeit banknotes detained in payments and scrutinised by the Bank increased distinctly during the year under review. All denominations other than the DM 5 note were counterfeited, DM 100 note forgeries predominating. Almost 50% of the counterfeits were colour photocopies. The counterfeiting of Federal coins declined sharply.

Counterfeits detained in payments

Year	Banknotes		Coins	
	Number	DM thousand	Number	DM thousand
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
1985	7,585	712.2	24,617	57.7
1986	8,257	807.4	17,111	46.6
1987	6,010	598.4	11,758	38.0
1988	6,232	538.8	9,861	31.5
1989	3,425	304.2	8,324	31.0
1990	4,120	326.8	12,132	48.8
1991	6,632	754.4	4,412	16.1

Deposits of banks

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

	Dec. 31, 1990	Dec. 31, 1991 DM million
Deposits on giro accounts	76,647.1	72,407.9
Other	31.2	31.0
	76,678.3	72,438.9.

Deposits of public authorities

This item contains the current balances of the public sector, and breaks down as follows:

	Dec. 31, 1990	Dec. 31, 1991 DM million
Federal Government	15,348.5	11,638.4
Equalisation of Burdens Fund, ERP Special Fund, "German Unity" Fund	13.8	8.8
Länder Governments	3,684.8	1,010.2
Other public depositors	97.7	65.0
	19,144.8	12,722.4.

Deposits of other domestic depositors

The deposits of other domestic depositors were composed as follows:

	Dec. 31, 1990	Dec. 31, 1991 DM million
Federal Railways	308.7	9.0
Federal Post Office	5,222.1	8,833.5
East German Railways	15.2	16.1
Other depositors	875.2	898.5
	6,421.2	9,757.1.

Giro transactions, simplified cheque and direct debit collections

In the field of intercity payments, virtually all the collection and credit transfer orders presented were processed on an automated basis at the Bank's computer centres in the year under review. The volume of payments executed through the paperless exchange of data media (EDM) was again distinctly greater (+ 20%) than in the preceding year. Such payments now account for 76% of the payment items presented under the automated procedure. In addition to the sustained trend in the banking industry towards replacing paper-based payments by paperless procedures, this strong rise owes a great deal to the increase in payments in the five new Länder. The use of paperless procedures was encouraged by the obligation – introduced on the inception of the monetary union – to convert paper-based credit transfers and direct debits into EDM data records vis-à-vis banks which were still operating in accordance with the east German ESER standard. The volume of Express Payments (telegraphic credit transfers and credit transfers from DM 20,000 upwards) executed by means of data telecommunication between the branch offices or branches of the Bank likewise continued to increase significantly in the year under review; barely one-half of the credit transfers in direct transactions were executed by conventional methods. The efficient and low-cost paperless payment procedures are being fostered still further by the conversion obligation for intercity transfers of amounts from DM 10,000, which came into force early in 1992. The Bank's former conventional payment procedures are thus being superseded almost completely by Express Payments.

Since July 1, 1991 all giro account holders (other than certain public cash offices) have been charged transaction fees for payment services provided by the Bank. These fees are intended to defray some of the Bank's expenditure on the processing of cashless payments, to foster cashless procedures by means of relatively low charges, and to keep the Bank's share of bulk payments (especially in the area of collections) down to a reasonable level.

Automation of intercity transfers

	Collection orders presented							Intercity credit transfer orders presented						
		of which: passed on							of which: passed on					
				via computer centres							via computer centres			
	Total	in direct operations between branch offices or branches		in automated paper-based operations		through the paperless exchange of data media		Total	in direct operations between branch offices or branches		in automated paper-based operations		through the paperless exchange of data media	
Year	Millions	Millions	%	Millions	%	Millions	%	Millions	Millions	%	Millions	%	Millions	%
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
1985	1,316	6	1	511	39	799	60	350	4	1	224	64	122	35
1986	1,405	5	0	412	29	988	71	372	3	1	238	64	131	35
1987	1,489	5	0	364	25	1,120	75	415	3	1	254	61	158	38
1988	1,568	3	0	355	23	1,210	77	464	3	1	270	58	191	41
1989	1,655	3	0	346	21	1,306	79	500	4	1	289	58	207	41
1990	1,807	7	0	324	18	1,476	82	627	5	1	353	56	269	43
1991	2,023	5	0	320	16	1,698	84	749	6	1	347	46	396	53

In contrast to intercity payments, which are largely processed on an automated basis, only about 10% of the payment items presented in the field of local payments and clearing operations are processed automatically, namely paper-based credit transfers in local payments in Hamburg and paperless credit transfers via Electronic Clearing with File Transfer (ECFT) in Frankfurt am Main. In terms of the amount involved, this represented more than 43% of the total volume of local payments and clearing operations processed by ECFT in the year under review, but in terms of the number of items, little more than 1%. Local payments, which are not yet automated, have increased in significance, especially because the areas served by individual banks in the new Länder are relatively large. In the year under review the degree of automation of the aggregate cashless payments of the Bank consequently fell from 90% to 88%. The opening of the "electronic window" for local credit transfers, too, which is envisaged for mid-1992, will presumably cause this trend to reverse.

Liabilities arising from mobilisation and liquidity paper sold

Mobilisation and liquidity paper as defined in sections 42 and 42a of the Deutsche Bundesbank Act — viz. short-term Treasury bills (running as a rule for three days) — was again sold to domestic banks in the year under review in order to regulate liquidity. The volume of such transactions came to DM 9,040.0 million (1990: DM 15,845.0 million); at the end of last year the amount outstanding was DM 3,900.0 million. In addition, Treasury bills and Treasury discount paper were issued to permit the interest-bearing investment of excess deposits. At the end of last year paper of that kind to the value of DM 2,885.9 million (end-1990: DM 3,104.4 million) was held by non-residents, while DM 127.9 million was owned by domestic public authorities (end-1990: DM 1,651.3 million).

Mobilisation and liquidity paper

DM million

Type of paper	1990 Outstanding at December 31	1991 Sold	Redeemed	Outstanding at December 31
Treasury bills (running for up to 90 days)	4,551.3	38,451.9	36,173.3	6,829.9
Treasury discount paper (running for 6 to 24 months)	204.4	84.4	204.9	83.9
Total	4,755.7	38,536.3	36,378.2	6,913.8

Liabilities arising from external transactions

The liabilities arising from external transactions declined from DM 49,154.4 million to DM 39,449.2 million in the year under review. It was mainly the deposits of foreign monetary authorities which decreased. Specifically, DM 39,216.4 million of this sum (1990: DM 48,843.0 million) was accounted for by foreign banks' balances and DM 232.8 million (1990: DM 311.4 million) by other deposits.

Counterpart of special drawing rights allocated

The counterpart of the special drawing rights allocated by the IMF and shown in sub-item 2.3 on the assets side of the balance sheet 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 for pensions

After an increase of DM 145.0 million, the provisions for pensions amounted to DM 2,391.0 million; they are in line with the actuarially calculated requirements.

Provisions for other purposes

At December 31, 1991, DM 3,533.1 million net was added to the provisions for other purposes, which serve primarily to cover general risks presented by domestic and external transactions and inherent in doubtful liabilities; this was mainly in order to take due account of the risks posed by the dollar position. As a consequence, these provisions have since amounted to DM 6,759.3 million, against DM 3,226.2 million at end-1990 (see also the notes below on the expenditure items "Write-downs of monetary reserves and other foreign currency positions" and "Other operating expenditure").

Other liabilities

At the end of 1991 the other liabilities amounted to DM 643.0 million, against DM 696.3 million at the end of 1990. They mainly comprise the interest expenditure falling due in 1992 but relating to 1991.

Accruals

Accruals amounted to DM 720.6 million at December 31, 1991 (end-1990: DM 523.1 million). This item consists chiefly of the interest received during the year under review, but relating to the following year, from domestic and foreign bills of exchange and US Treasury notes.

Capital

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

Reserves

In accordance with the decision taken by the Central Bank Council on April 18, 1991, the legal reserves were increased by DM 818.0 million out of the unappropriated profit for 1990. Since this increase, the legal reserves have totalled DM 8,345.4 million; they have thus reached the maximum level permissible by law of 5% of the amount of banknotes in circulation, which was DM 166,908.7 million at the end of 1990. The other reserves reached the statutory ceiling of DM 290 million as long ago as end-1980.

Unappropriated profit

See the notes on page 141 of this Report.

2. Profit and loss account

Expenditure

Interest expenditure

Interest expenditure increased only marginally against the previous year to DM 4,303.7 million (1990: DM 4,239.2 million). The rise in the domestic interest rate level was of significance here, although – taking the average of the year – it was almost offset by the lower level of liabilities arising from external transactions. The interest paid on mobilisation and liquidity paper came to DM 348.6 million (1990: DM 327.6 million).

Staff costs

Staff costs rose during the year under review by DM 271.1 million to a total of DM 1,388.6 million. Not counting the increase in the provisions for pensions, staff costs were 11.3% higher than in 1990. In 1991 the staff level of the bank went up by 718 to 18,237 employees (+ 4.1%). This increase was mainly due to staff expansion in connection with the further extension of the Provisional Administrative Office in Berlin and the fifteen east German branches. In this context the number of trainee civil servants and other trainees likewise grew. On January 1, 1992 about 200 staff members from western Germany were working in the new Länder, with permanent employment there being envisaged in most cases.

Staff of the Bank

Staff	Central Office	Provisional Administrative Office	Land Central Banks	Total 1	of whom male	of whom female
	Beginning of 1991					
Civil servants	1,017	–	5,818	6,835	6,069	766
Other salaried staff	1,680	1,253	6,660	9,593	4,255	5,338
Wage earners	242	–	849	1,091	217	874
Total	2,939	1,253	13,327	17,519	10,541	6,978
	Beginning of 1992					
Civil servants	1,037	170	5,774	6,981	6,137	844
Other salaried staff	1,679	1,640	6,801	10,120	4,544	5,576
Wage earners	257	32	847	1,136	221	915
Total	2,973	1,842	13,422	18,237	10,902	7,335

1 Including: 1,199 (1991: 957) trainees, 998 (1991: 896) part-time salaried staff and 742 (1991: 720) part-time wage earners; 33 (1991: 30) staff members were seconded to work abroad. Not included in the staff figures: 393 (1991: 307) members of the Bank released without pay.

Payments to serving members of the Central Bank Council and the Directorate of the Bank amounted to DM 9,355,142.51 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 of the Managing Boards of the Land Central Banks, including their surviving dependants, received payments totalling DM 10,067,840.10. DM 322.8 million (1990: DM 170.8 million) of these staff costs was accounted for by retirement pensions. This sum includes the increase of DM 145 million in the provisions for pensions and the payments made to staff members of the former Deutsche Reichsbank and to 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 Deutsche Bundesbank Act (DM 15.5 million).

Changes in staff regulations

In 1991 the Bank – in agreement with the trade unions – entered into a number of wage and salary agreements under which the legal status of its wage earners and salaried staff in the old and new Länder was brought into line with the regulations applying to the corresponding employees of the Federal Government, while paying due regard to the special conditions obtaining at the Bank. Special wage and salary agreements apply to the new staff members at the Provisional Administrative Office in Berlin and at the fifteen branches of the Bank in the new Länder. For instance, notwithstanding the regulations in the old Länder, the number of working hours in eastern Germany is set at 40 per week. Since July 1991 wages and salaries there have been paid at the level of 60 % of the comparable rates prevailing in the old Länder. For a transitional period there will continue to be separate wage and salary agreements for staff members in the old and the new Länder.

Other operating expenditure

During the financial year 1991 the other (non-staff) operating expenditure went up by DM 98.8 million to DM 657.5 million. This was mainly on account of the increase in the provisions for doubtful liabilities and because of additional spending in the new Länder.

Banknote printing

Compared with the previous year, expenditure on banknote printing rose by DM 136.7 million to a total of DM 331.0 million (+ 70.4 %). This rise was accompanied by an increase of 85 % in the banknotes produced, which were required to provide banknotes of the new series for payments.

Depreciation of fixed assets

Depreciation both of land and buildings and of furniture and equipment was discussed in connection with the respective balance sheet items. Further depreciation relates to computer software, which was shown on the assets side under other assets.

Write-downs of monetary reserves

This item contains the outcome of the valuation of the monetary reserves and other foreign currency positions. It also includes the profits and losses arising from purchases and sales of foreign currencies and the changes in provisions, which also affect the external position. Overall, expenditure totalling DM 2,935.7 million was incurred, mainly as a result of providing for the risk posed by the movements of the US dollar.

Other expenditure

Other expenditure is shown at DM 57.2 million (1990: DM 200.8 million).

Receipts

Interest

In the year under review interest received, at DM 25,072.2 million, was DM 4,202.8 million higher than in 1990. The crucial factor here was interest income from lending to domestic banks, which rose by DM 4,290.6 million. This increase was the upshot of the larger volume of refinancing and the higher level of central bank interest rates. Interest income from securities and cash advances, at DM 317.1 million and DM 61.5 million respectively, had only a minor impact on the overall interest figure. Interest income from financial investment abroad declined marginally (from DM 7,570.9 million to DM 7,513.5 million). This fall owed something to the fact that the average holding of external assets was smaller than in the previous year, and that the rates of interest on it were lower, although this decrease was largely offset by the higher average rate for the dollar.

Fees

Fees, which mostly accrued in connection with payments, totalled DM 63.2 million in the year under review (1990: DM 21.5 million). The increase is due to the introduction in mid-1991 of charges for the payment services provided by the Bank.

Other receipts

The other receipts amounted to DM 108.0 million (1990: DM 118.6 million).

Unappropriated profit

The profit and loss account for 1991 shows a profit for the year of which is entered in the balance sheet as unappropriated profit (net profit).		DM 15,213,420,257.77,

Proposed distribution of profit

In accordance with section 27 of the Deutsche Bundesbank Act, the Directorate proposes to the Central Bank Council that the following appropriations should be made:

to the legal reserves	719,600,000. – ;	
to the Fund for the Purchase of Equalisation Claims	30,000,000. –	749,600,000. – ;
the balance of		14,463,820,257.77
is to be transferred to the Federal Government.		

After the above appropriation, the legal reserves will amount to DM 9,065,000,000.00; they will thus again reach the statutory ceiling of 5% of the amount of banknotes in circulation, which came to DM 181,300,222,010.00 at the end of 1991.

Frankfurt am Main, April 1992

Deutsche Bundesbank
The Directorate

Prof. Dr Schlesinger Dr Tietmeyer
Gaddum Prof. Dr Issing Dr Storch

Part D: Report of the Central Bank Council

The annual accounts of the Deutsche Bundesbank for 1991 and the Report on the Fund for the Purchase of Equalisation Claims as at December 31, 1991 were audited by *Treuarbeit Aktiengesellschaft Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft* of Frankfurt am Main and *Wollert-Elmendorff Deutsche Industrie-Treuhand GmbH Wirtschaftsprüfungsgesellschaft* of Düsseldorf, whom the Central Bank Council had appointed to be auditors in accordance with section 26 of the Deutsche Bundesbank Act.

In their certificates of audit the auditors confirmed without qualifications that the annual accounts for 1991 and the bookkeeping comply with German law and present a true picture of the Bank's assets and liabilities, financial position and profitability, and that the Fund for the Purchase of Equalisation Claims has been properly administered.

The Central Bank Council approved the annual accounts for 1991 on April 2, 1992 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, 1991.

The following changes have taken place at the Bank between April 2, 1991 and April 1, 1992, i.e. since the publication of the Report for the Year 1990:

Resigned

as at the close of July 31, 1991

Karl Otto Pöhl
President of the Deutsche Bundesbank;

Retired

as at the close of June 15, 1991

Hans Gliem
President of the Land Central Bank in Saarland

as at the close of December 31, 1991

Helmut Röthemeier
Vice-President of the Land Central Bank in North Rhine-Westphalia

Johannes Kremers
Vice-President of the Land Central Bank in Bremen

Erhard Dauzenroth
Vice-President of the Land Central Bank in Saarland

as at the close of March 31, 1992

Prof. Dr Kurt Nemitz
President of the Land Central Bank in Bremen;

Appointed

with effect from June 17, 1991

Hans-Jürgen Koebnick
to be President of the Land Central Bank in Saarland

with effect from August 1, 1991

Prof. Dr Drs h. c. Helmut Schlesinger
to be President of the Deutsche Bundesbank,
formerly Vice-President of the Deutsche Bundesbank

Dr Hans Tietmeyer
to be Vice-President of the Deutsche Bundesbank,
formerly Member of the Directorate of the Deutsche Bundesbank

with effect from January 1, 1992

Jürgen von der Ahe
to be Vice-President of the Land Central Bank in North Rhine-Westphalia

Hans-Georg Herrmann
to be Vice-President of the Land Central Bank in Bremen

Dr Erich Stoffers
to be Vice-President of the Land Central Bank in Saarland

The Central Bank Council (acting also on behalf of the Directorate and of the Managing Boards of the Land Central Banks) would like to express its gratitude to the entire staff of the Deutsche Bundesbank – civil servants, other salaried employees and wage earners alike – for their loyal and understanding efforts during 1991. It also wishes to record its appreciation of the continued excellent collaboration with the staff representative bodies.

Frankfurt am Main, April 1992

Prof. Dr Helmut Schlesinger
President of the Deutsche Bundesbank

Appendix to Part B

Balance sheet of the Deutsche Bundesbank as at December 31, 1991

 Assets

		DM	31.12.90 DM million
1 Gold		13,687,518,821.70	13,687.5
2 Reserve position in the International Monetary Fund and special drawing rights			
2.1 Drawing rights within the reserve tranche	5,407,712,063.08		(4,565.0)
2.2 Loans under special borrowing arrangements	–		(–)
2.3 Special drawing rights	2,905,788,327.85		(2,808.2)
		8,313,500,390.93	7,373.2
3 Claims on the European Monetary Cooperation Fund (EMCF) in connection with the European Monetary System			
3.1 ECU balances 29,128,667,920.07 less Difference between the ECU value and the book value of the gold and dollar reserves contributed to the EMCF 11,799,931,620.71	17,328,736,299.36		(18,445.2)
3.2 Other claims	–		(–)
		17,328,736,299.36	18,445.2
4 Balances with foreign banks and money market investments abroad		55,403,937,126.74	64,454.0
5 Foreign notes and coins		19,971,792.87	30.9
6 External loans and other external assets			
6.1 Loans in connection with EC medium-term balance of payments assistance	–		(–)
6.2 Other loans to foreign monetary authorities	–		(–)
6.3 Loans to the World Bank	2,422,825,000.–		(2,423.5)
6.4 Other external assets	168,925,000.–		(181.5)
		2,591,750,000.–	2,605.0
7 Lending to domestic banks			
7.1 Securities bought in open market transactions under repurchase agreements	148,456,885,000.–		(117,434.8)
7.2 Domestic bills of exchange	36,244,027,950.81		(54,116.3)
7.3 Foreign bills of exchange	38,715,451,183.88		(30,792.6)
7.4 Lombard loans	1,901,740,500.–		(6,179.9)
		225,318,104,634.69	208,523.6
8 Cash advances			
8.1 Federal Government	–		(–)
8.2 Equalisation of Burdens Fund and ERP Special Fund	–		(–)
8.3 Länder Governments	188,885,038.–		(742.0)
		188,885,038.–	742.0
9 Equalisation claims on the Federal Government and non-interest-bearing debt certificate in respect of Berlin		8,683,585,988.93	8,683.6
10 Lending to the Federal Railways and Federal Post Office			
10.1 Cash advances	–		(–)
10.2 Treasury bills and Treasury discount paper	–		(–)
		–	–
11 Securities		4,796,750,183.62	4,102.4
12 German coins		1,556,493,092.69	1,118.7
13 Balances on postal giro accounts		152,374,553.54	106,0
14 Land and buildings		2,835,267,335.41	2,851.1
15 Furniture and equipment		275,743,904.–	239.1
16 Items in course of settlement		15,129,551,260.73	13,275.1
17 Other assets		3,530,018,410.10	3,266.5
18 Prepayments		47,703,304.33	44.6
		359,859,892,137.64	349,548.5

		DM	31.12.90 DM million
1 Banknotes in circulation		181,300,222,010.–	166,908.7
2 Deposits of banks			
2.1 Deposits on giro accounts	72,407,944,242.05		(76,647.1)
2.2 Other	31,000,617.60		(31.2)
		72,438,944,859.65	76,678.3
3 Deposits of public authorities			
3.1 Federal Government	11,638,414,789.47		(15,348.5)
3.2 Equalisation of Burdens Fund, ERP Special Fund, "German Unity" Fund	8,830,172.77		(13.8)
3.3 Länder Governments	1,010,165,181.39		(3,684.8)
3.4 Other public depositors	64,950,069.68		(97.7)
		12,722,360,213.31	19,144.8
4 Deposits of other domestic depositors			
4.1 Federal Railways	8,966,173.52		(308.7)
4.2 Federal Post Office	8,833,534,225.56		(5,222.1)
4.3 East German Railways	16,087,614.22		(15.2)
4.4 Other depositors	898,505,433.18		(875.2)
		9,757,093,446.48	6,421.2
5 Liabilities arising from mobilisation and liquidity paper sold		6,913,800,000.–	4,755.7
6 Liabilities arising from external transactions			
6.1 Deposits of foreign depositors	39,372,973,691.29		(49,105.0)
6.2 Other	76,190,170.94		(49.4)
		39,449,163,862.23	49,154.4
7 Counterpart of special drawing rights allocated		2,625,569,382.80	2,573.4
8 Provisions			
8.1 for pensions	2,391,000,000.–		(2,246.0)
8.2 for other purposes	6,759,300,000.–		(3,226.2)
		9,150,300,000.–	5,472.2
9 Other liabilities		642,973,178.38	696.3
10 Accruals		720,644,927.02	523.1
11 Capital		290,000,000.–	290.0
12 Reserves			
12.1 Legal reserves	8,345,400,000.–		(7,527.4)
12.2 Other reserves	290,000,000.–		(290.0)
		8,635,400,000.–	7,817.4
13 Unappropriated profit		15,213,420,257.77	9,113.0
		359,859,892,137.64	349,548.5

Profit and loss account of the Deutsche Bundesbank for the year 1991

 Expenditure

			DM	1990 DM million
1	Interest expenditure		4,303,712,651.34	4,239.2
2	Staff costs			
	2.1 Wages and salaries	930,899,031.12		(831.8)
	2.2 Social security contributions and spending on retirement pensions and maintenance payments	457,730,413.84		(285.7)
			1,388,629,444.96	1,117.5
3	Other operating expenditure		657,546,169.59	558.7
4	Banknote printing		330,980,329.07	194.3
5	Depreciation			
	5.1 of land and buildings	206,551,545.36		(192.0)
	5.2 of furniture and equipment and of other assets	149,683,930.84		(135.5)
			356,235,476.20	327.5
6	Write-downs of monetary reserves and other foreign currency positions		2,935,724,831.35	5,258.5
7	Other expenditure		57,201,214.15	200.8
8	Profit for the year (= unappropriated profit)		15,213,420,257.77	9,113.0
			25,243,450,374.43	21,009.5

Receipts

		DM	1990 DM million
1	Interest	25,072,193,362.04	20,869.4
2	Fees	63,235,512.51	21.5
3	Other receipts	108,021,499.88	118.6
		25,243,450,374.43	21,009.5

Frankfurt am Main, February 12, 1992

Deutsche Bundesbank
The Directorate
Prof. Dr Schlesinger Dr Tietmeyer
Gaddum Prof. Dr Issing Dr Storch

According to the audit which we have carried out in line with our mandate, the bookkeeping and the annual accounts comply with German law. The annual accounts conform to the principles of orderly bookkeeping and present a picture of the Bank's assets, liabilities, financial position and profitability which is consistent with the actual state of affairs.

Frankfurt am Main, March 16, 1992

Treuarbeit Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Prof. Dr Dr h.c. Forster
Certified Auditor

Kern
Certified Auditor

Wollert-Elmendorff
Deutsche Industrie-Treuhand GmbH
Wirtschaftsprüfungsgesellschaft

Thoennes
Certified Auditor

Brückner
Certified Auditor