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Recent Economic Developments in Germany,
September-December, 1964

24 pages

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## Summary

By year-end, the rapid pace of business expansion in Germany of the first half of 1964 had distinctly slowed down. 1/ For the year as a whole, the Deutsches Institut Fuer Wirtschaftforschung estimates that GNP, in real terms, will rise by 7 per cent from 1963 to 1964 and that a continuation of the tendencies toward somewhat more moderate growth of the second half of 1964 should produce a year-to-year rise of about 6 per cent in 1965. In general, the performance of the German economy in 1964 surpassed earlier growth expectations: at the end of 1963, for example, the German authorities put the 1964 growth rate at only 4.5 per cent. The faster growth was achieved without the emergence of acute inflationary pressures which had been widely feared by German officials even at the lower rate of growth.

At the end of 1964, however, there was more evidence to support these fears than had been apparent earlier in the year. The somewhat slower growth in the second half of 1964 is attributed in part to the slowing down of demand, but to a greater degree to output limitations. A recent IFO-Institut survey put capacity utilization in the autumn months at about the level reached at the peak of the preceding cycle. As a result, productivity increases, which had been very large during the first half of 1964 when industry was moving toward fuller capacity

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1/ For a review of earlier developments, see "Recent Economic Developments in Germany, June-September, 1964," dated October 15, 1964.

utilization, are currently falling back to gains accruing from rationalization (i.e., capital-deepening) investments. In this situation, the continuing labor tightness is becoming an increasingly limiting factor to output expansion. The labor market, despite a greater than anticipated influx of foreign labor, remains very strained: unemployment was down to 0.4 per cent of the labor force in the third quarter of 1964 and the ratio of unfilled vacancies to number of unemployed was up to 6.7.

With less elasticity in supply availabilities, pressures on costs and prices are becoming more pronounced. During the first half of 1964, productivity increases consistently outpaced wage increases, but recently they appear to have fallen behind and unit labor costs have again begun to rise. Higher costs, also in part because of rising world market prices for raw materials, put extra pressure on the price level. Producer prices of industrial goods, which had risen, on the average, by 0.1 per cent a month through the first seven months of the year, moved up by 0.6 per cent in September and 0.5 per cent in October. As a consequence, the internal price level rose more rapidly than did the export price level, which had moved up earlier because of the very favorable demand situation in foreign markets.

With domestic demand continuing to expand, pressures on the price level may well continue even though order backlogs are no longer growing: recently the inflow of new orders has been matched and in some instances outpaced by deliveries. While rising imports have helped to augment domestic supplies, the increase has been particularly large for semi-finished goods which have not directly helped to keep down domestic prices. The passage of the tax cut last November and the expiration of a large number of wage contracts currently are expected to add significantly to mass incomes. There already has been a discernible quickening in the rate of increase of private consumption demand. However, as in past months, it continues to lag behind the increase in disposable incomes resulting in further rises in the rate of savings.

At a time of rising consumption demand, private investment demand, according to investment plans, continues to show a rising trend. This is particularly apparent in industrial building plans. But the general situation in the building sector is somewhat less strained than it has been in the past as a result of earlier government measures. Thus the danger that the building sector could once again become the ignition point for inflationary wage and cost advances may be less acute at this time than over the past few years.

Since the spring, external demand has no longer been a major expansionary factor. The inflow of foreign orders continues high, but is no longer growing as it did early in 1964: in September-October the flow was somewhat below the levels reached during the first four months of the year. Export deliveries also are below the high mid-year levels, although the October-November flows were above the third quarter rates.

With imports rising faster than exports, the trade surplus has been considerably reduced from the high first half 1964 levels of an annual rate of $2.4 billion. In November, there actually was a slight trade deficit (on a seasonally-adjusted basis). Nevertheless, it is estimated that the 1964 trade surplus will reach about DM 5 billion ($1.25 billion), approximately DM 1 billion below the 1963 surplus.

With the reduction in the trade balance, the balance of payments surpluses also have been much reduced. In the third quarter, there actually was a deficit of DM 156 million ($39 million) because seasonally high services expenditures (mainly for travel) cut back the current account surplus. Although there were some private capital inflows, these were not sufficient to offset continuing government capital expenditures abroad. However, with the services balance swinging into surplus again in October, a balance of payments surplus reappeared.

The Bundesbank's holdings of foreign exchange were reduced appreciably in the second half of 1964, particularly in November and early December. But a large part of this reduction was in connection with DM drawings on the International Monetary Fund by the United States. In the second half of December 1964 there again were reserve accruals, probably mainly as a result of year-end window-dressing operations.

In an effort to minimize window-dressing flows across the foreign exchanges the Bundesbank gave banks an opportunity to borrow against securities at 3/4 point below the normal (4 per cent) rate charged for such transactions and banks reportedly have made use of these facilities. Bank liquidity in general continued to be under pressure. Inflows of foreign exchange no longer offset the pressures of the requirements of an expanding economy on bank liquidity. In addition, the effects of government transactions appear to have been more contractive in 1964 than in 1963, primarily because the Federal Government financed its requirements to a large extent in the long-term securities market rather than by taking cash credits at the Bundesbank as in 1963. However, the financing of Laender government operations to some extent offset these contractive influences; they continued to draw down their cash balances.

Pressures on the capital market may well intensify in 1965 as the Laender are increasingly forced to have recourse to the capital market for their financing requirements. Even if these developments add to the upward pressures on interest rates, there is less concern about their effects on the external balance than there might have been earlier in the year. Restrictive measures in other countries have helped to push up international interest rates and given Germany slightly more room to maneuver for domestic policy purposes. In addition, approval of the 25 per cent withholding tax on interest accruing to foreigners from German fixed interest securities seems assured now that it has been accepted by the Finance Committee of the Bundestag.

The bond market, which steadied in the last few months of 1964, was not affected by the imminent passage of the tax proposal. Bond yields remained stable at about 6.4 per cent for the 6 per cent coupon issues. The stock market also had a somewhat firmer, steady tone towards year-end.

Developments in securities markets were in marked contrast with the turbulence on the foreign-exchange markets following the pressure on the pound sterling in November. The main effect of these disturbances within Germany was renewed speculation about whether the Bundesbank might also raise discount rate. However, the authorities firmly denied any such intention; but they did make it known that higher rates abroad and reduced balance of payments surpluses gave them a greater measure of control over domestic monetary developments than they had been able to exercise earlier in the year and that they would not hesitate to move accordingly if such a step should prove necessary.

Steady expansion of demand and supply

At year-end, economic activity in Germany continued to expand at a healthy rate. The growth of demand, as measured by the inflow of new orders to industry, continued to moderate somewhat, relieving some fears that too fast a growth in demand would soon overstrain available capacities. The inflow of new orders to industry in September-October was only 1.2 per cent above the July-August level, but still a very healthy 8.8 per cent above September-October, 1963. (See Table 1.) The inflow of domestic orders was virtually unchanged between July-August and September-October, while there was again a perceptible quickening in foreign demand. However, it would be too early to tell whether the previous trend--when the major stimulus had shifted from foreign to domestic demand--is in process of being reversed.

On the whole, investment continues to provide the main basis for the steady expansion, both in demand for equipment (as indicated by the steady increase in the flow of orders to the capital goods industries) and for construction (as indicated by the rise in orders flowing to the basic industries). But there also is no doubt that demand in these areas is moderating slightly.

By contrast, there are indications that consumer demand may be rising somewhat faster than in the past. Retail sales, which had remained comparatively steady during the first half of the year, rose 7.4 per cent between May-June and September-October, 1964 (after

Table 1. Germany: New orders received by industry, 1963-October 1964
(Index numbers, 1954 turnover = 100, seasonally adjusted)

| | All industries 1/ | Domestic orders | Foreign orders | Basic industries | Capital goods | Consumer goods |
|---|---|---|---|---|---|---|
| 1963 | | | | | | |
| Jan.-Feb. | 202 | 191 | 257 | 178 | 250 | 171 |
| Mar.-Apr. | 211 | 197 | 276 | 186 | 261 | 172 |
| May-June | 213 | 199 | 279 | 192 | 267 | 167 |
| July-Aug. | 220 | 206 | 289 | 196 | 277 | 173 |
| Sept.-Oct. | 228 | 215 | 292 | 204 | 281 | 184 |
| Nov.-Dec. | 224 | 208 | 298 | 204 | 274 | 177 |
| 1964 | | | | | | |
| Jan.-Feb. | 244 | 226 | 326 | 222 | 300 | 193 |
| Mar.-Apr. | 248 | 233 | 322 | 225 | 304 | 195 |
| May-June | 239 | 227 | 298 | 211 | 307 | 180 |
| July-Aug. | 245 | 233 | 302 | 224 | 299 | 200 |
| Sept.-Oct. 2/ | 248 | 234 | 317 | 228 | 303 | 192 |

1/ Excludes mining, construction, food and power
2/ Preliminary
Source: Bundesbank, Monthly Report

Table 2. Germany: Industrial Production, 1963-October, 1964
(Index numbers, 1950 = 100, seasonally adjusted)

| | All industries | Basic producer goods | Capital goods | Consumer goods | Food, beverages, and tobacco | Building |
|---|---|---|---|---|---|---|
| 1963 | | | | | | |
| Jan.-Feb. | 268 | 276 | 362 | 225 | 237 | 148 |
| Mar.-Apr. | 282 | 299 | 381 | 234 | 240 | 275 |
| May-June | 288 | 312 | 384 | 238 | 248 | 314 |
| July-Aug. | 290 | 314 | 385 | 241 | 249 | 313 |
| Sept.-Oct. | 295 | 322 | 393 | 245 | 248 | 308 |
| Nov.-Dec. | 297 | 327 | 394 | 243 | 250 | 296 |
| 1964 | | | | | | |
| Jan.-Feb. | 299 | 325 | 400 | 245 | 255 | 258 |
| Mar.-Apr. | 304 | 338 | 406 | 252 | 246 | 277 |
| May-June | 310 | 348 | 415 | 253 | 260 | 317 |
| July-Aug. | 314 | 355 | 416 | 259 | 258 | 307 |
| Sept.-Oct. 1/ | 314 | 360 | 410 | 259 | 256 | 308 |
| Oct. 1/ | 321 | 364 | 428 | 261 | 260 | 306 |

1/ Preliminary
Source: Bundesbank, Monthly Report

seasonal adjustment). But this upward trend so far has not been translated into a rising level of orders flowing to the consumer goods industries.

Industrial output kept pace with the growth in demand. The index of industrial production moved steadily upward and registered a particularly large increase in October: the September-October average was 6.4 per cent above the preceding year's level. 2/ (See Table 2.) The fact that this year-to-year increase was below the increases of preceding months may indicate that virtually full capacity utilization is beginning to be reached in a growing number of industries. A recent survey conducted by the IFO-Institut indicated that the level of capacity utilization in the fall of 1964 was about equal to the preceding cyclical peak reached in 1960. Even so, only the building sector appears to be working at a level of capacity which allows no further expansion in output this year. All other major sectors of industrial activity continue to register healthy year-to-year growth rates, indicating both the growth and elasticity of capacity in those areas.

Although supply availabilities are becoming increasingly less elastic, the moderation of growth of demand, combined with the steady pace of output expansion, has recently been sufficient to put a stop to the growth in order backlogs. In September, for the first time in 1964, deliveries exceeded order inflows in all major industrial sectors (e.g., basic, capital goods and consumer goods industries). But the Economics Ministry reported that in October order books probably did not shrink further and that, in fact, export order backlogs were growing again.

2/ The low September figures are largely explained by the trend towards longer vacations which could not be fully reflected in the seasonal adjustment factors.

Labor market very tight

As industry continues to move towards virtually full capacity utilization, the continuing labor tightness is becoming a greater limiting factor to output expansion. The unemployment rate in the third quarter of 1964 was down to 0.4 per cent, which was probably very close to a structural minimum level. (See Table 3.)

At the same time, vacancies as a ratio of unemployment continued to rise: in the third quarter, there were 6.7 vacancies for each person unemployed, as compared with 6.2 vacancies in the corresponding period of 1963. A recent government survey ascertained that more than two-thirds of all male unemployed and over 30 per cent of female unemployed were in the 55-65 age group. In addition, the same survey found that long-term unemployment (one year or more) constituted a very small percentage of overall unemployment: 11 per cent for men and 3 per cent for women; by contrast, short-term unemployment (one month or less) accounted for a large percentage: 25 per cent for men and over 40 per cent for women. These findings lend further support to the view that the labor reserve is virtually exhausted.

The continuing larger than anticipated influx of foreign labor, which brought the foreign labor force at the end of September to 986,000, helped to ease some of the strains in the labor market. In addition, labor mobility continued to increase, with slower growing industries yielding labor to faster growing branches. Thus it was possible for the investment goods and the basic industries to increase their level of employment appreciably primarily at the expense of the mining industry.

Costs and prices trend upward

With productivity increases largely related to capital deepening investment because capacities are fully utilized, pressures on costs

Table 3. Germany: Labor Market, III Quarter 1963-III Quarter 1964

| | 1963a/ | | 1964 | | |
|---|---|---|---|---|---|
| | III | IV | I | II | III |
| Employment in industry (million) | 7.970 | 7.912 | 8.215 | 8.290 | 8.358 |
| Unemployment (million) | 0.096 | 0.236 | 0.227 | 0.112 | 0.100 |
| Vacancies (million) | 0.600 | 0.427 | 0.623 | 0.662 | 0.671 |
| Vacancies as per cent of unemployment | 625 | 181 | 274 | 591 | 671 |
| Unemployment as per cent of labor force | 0.5 | 1.1 | 1.0 | 0.5 | 0.4 |

a/ Excluding West Berlin
Source: Bundesminister fuer Wirtschaft, Die Wirtschaftliche Lage in der Bundesrepublik Deutschland

Table 4. Germany: Prices and Wages, January 1963 - Oct., 1964
(Index numbers, 1958 = 100)

| | 1963 | | 1964 | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Jan. | Oct. | Jan. | April | July | Aug. | Sept. | Oct.a/ |
| Producer Prices | | | | | | | | |
| Total industrial products | 103.5 | 103.9 | 104.3 | 104.6 | 104.8 | 105.1 | 105.7 | 106.2 |
| Investment goodsb/ | 107.3 | 107.4 | 107.5 | 108.0 | 108.4 | 108.7 | 109.1 | 109.8 |
| Consumer goodsb/ | 106.0 | 107.5 | 108.5 | 109.1 | 109.2 | 109.4 | 110.1 | 110.3 |
| Consumer Prices | | | | | | | | |
| General index | 111.1 | 112.1 | 114.0 | 114.6 | 115.3 | 115.0 | 115.1 | 115.3 |
| Food | 111.0 | 110.1 | 113.6 | 114.1 | 115.0 | 114.0 | 113.8 | 113.6 |
| Export Prices | | | | | | | | |
| General index | 100.4 | 100.8 | 102.2 | 103.8 | 104.6 | 104.6 | 104.9 | 105.2 |
| Investment goodsb/ | 107.0 | 108.0 | 110.2 | 110.6 | 111.2 | 111.2 | 111.4 | c/ |
| Consumer goodsb/ | 101.2 | 101.5 | 101.7 | 102.0 | 103.1 | 103.2 | 103.3 | c/ |
| Import Prices | | | | | | | | |
| General index | 95.6 | 96.2 | 96.9 | 98.6 | 97.5 | 97.5 | 97.3 | 98.1 |
| Investment goodsb/ | 97.4 | 98.3 | 101.5 | 101.6 | 101.4 | 101.4 | 103.2 | c/ |
| Consumer goodsb/ | 94.5 | 94.5 | 94.3 | 93.7 | 94.0 | 94.1 | 94.7 | c/ |
| Earnings | | | | | | | | |
| Average hourly earnings in industryd/ | 147.2 | 156.4 | 158.1 | 163.7 | 166.9 | c/ | c/ | c/ |

a/ Preliminary
b/ Grouped according to end-use of goods
c/ Not available
d/ February, May, August, and November for 1963
Source: Statistisches Bundesamt, Wirtschaft und Statistik

and prices are becoming more pronounced. Unit labor costs, which had fallen during the first half of 1964 because productivity increases consistently outpaced wage increases, appear to be rising again.

At present, the tight labor situation is providing a favorable bargaining climate for labor and the upward movement of wages is accelerating at a time when wage contrasts are expiring in increasing numbers. Recently negotiated contracts indicate that the earlier trend towards longer contract periods is being reversed: contracts currently are being written for an average period of fifteen months, while in 1963 they averaged eighteen months or more. Furthermore, wage increases currently fall within a 8-9 per cent range, compared with 7-8 per cent in 1963. The higher contract rates combined with a continuing tendency for effective hourly earnings (because of overtime, bonuses, etc.) to rise faster than hourly wage rates are putting further pressure on unit labor costs at a time when productivity increases are moderating somewhat.

This upward movement of labor costs, jointly with rising prices for imported raw materials, is putting extra pressure on the German price level. In contrast with the current situation, price rises in earlier months were primarily attributed to the very favorable demand situation; this was particularly noticeable in the movement of export prices, which after relative stability through most of 1963, rose by 3.8 per cent between October 1963 and July 1964. (See Table 4.)

But recently the position has been reversed. Export price rises have again become more moderate and are averaging about 0.2 per cent a month. On the other hand, the internal price level, which earlier in 1964 had been much more stable than the export price level, is currently moving up faster. Producer prices for industrial products, for example, rose by only 0.9 per cent between October 1963 and July 1964; but between July and October 1964 they increased by 1.3 per cent. Consumer prices in September and October were relatively stable as seasonal declines in food prices partly offset price increases for primarily services and fuel. As compared with the preceding year, consumer prices in October 1964 were up by 2.9 per cent.

1964 economic performance satisfactory

The overall performance of the German economy in 1964 appears to have surpassed earlier growth expectations. The Deutsches Institut fuer Wirtschaftsforschung estimates that GNP, in real terms, will grow by 7 per cent in 1964 as compared with 1963. (See Table 5.) At the end of 1963, the German authorities had expected that only a 4.5 per cent growth rate could be achieved in 1964. Even this lower rate had given rise to widespread fears that acute inflationary pressures would materialize during 1964. Thus the record for the year appears to have been better than expected on all counts: not only was a much higher rate of growth achieved, but it was also much more balanced than had been deemed possible. The rise in the overall price level, estimated at 3 per cent, was virtually unchanged from the 2.9 per cent recorded in 1963.

The main reason for the relative balance between the growth of demand and supply in 1964 is to be found in the fortuitous shift in the pattern of demand during the year. The early expansion was carried by rising foreign demand, which triggered a rise in domestic investment

Table 5: Germany: Gross National Product, 1963 - 1965
(Current prices, per cent change from preceding year)

| | Year | | | 1963 | | 1964 | | |
|---|---|---|---|---|---|---|---|---|
| | 1963 | 1964 a/ | 1965 a/ | III | IV | I | II | III |
| Consumption | | | | | | | | |
| Private | 5.4 | 8 | 9 | 6 | 5.5 | 8 | 7 | 8.5 |
| Public | 10.2 | 6 | 10 | 7 | 4.5 | 5.5 | 1 | 3.5 |
| Total | 6.4 | 7.5 | 9.5 | 6.5 | 5.5 | 7.5 | 5.5 | 7 |
| Gross investment | | | | | | | | |
| Construction | 8.0 | 15 | 11 | 14.5 | 13.5 | 52 | 11.5 | 7.5 |
| Equipment | 2.1 | 11.5 | 14 | 3 | 4 | 8.5 | 11 | 8.5 |
| Total 1/ | 4.5 | 16 | 13 | 9 | 9 | 26 | 11 | 8 |
| Exports | 8.8 | 11 | 9 | 11 | 12.5 | 18 | 12.5 | 6.5 |
| Less Imports | 7.2 | 10.5 | 11 | 11 | 2 | 10.5 | 7.5 | 9 |
| Total GNP | 6.2 | 10 | 10 | 7 | 7.5 | 11.5 | 9.5 | 8.5 |
| Price change | 2.9 | 3 | 4 | 25 | 2.5 | 2 | 2 | 2.5 |
| Real GNP | 3.2 | 7 | 6 | 4.5 | 5 | 9.5 | 7 | 5.5 |

a/ estimated

1/ Excludes inventory change for quarterly data.
Source: Deutsches Institut fuer Wirtschaftsforschung.

demand. The latter, however, came into full swing only after the rise in foreign demand had begun to moderate.

Currently it appears that investment demand may be moderating just at the time when a more rapid increase in consumer demand is being anticipated. However, with the current level of capacity utilization, it is not expected that supply availabilities can accomodate rising demand fully to the extent this was possible in 1964.

Therefore, the D.I.W. expects the general price level to rise by about 4 per cent in 1965, somewhat more than in 1964, while final demand is expected to go up by 6 per cent (in real terms) somewhat less than in 1964. Both private and public consumption demand are expected to rise faster than in 1964; actually it is already expected that fourth quarter 1964 figures will reflect some of the acceleration.

Private consumption demand is expected to receive a strong stimulus not only from larger wage increases but also from the tax cut which was passed in November 1964. The bill finally enacted actually was somewhat more generous than that originally proposed by the Government bringing the total annual revenue loss to DM 3.2 billion. Under the current division of revenues between the Federal Government and the Laender, the Federal Government will bear 39 per cent of the revenue loss. Despite the loss in revenue, expectations are that government consumption expenditures, both for civil and for military purposes will go up appreciably in 1965. Private investment demand and exports, on the other hand, are estimated to grow somewhat more slowly than in 1964, while imports are expected to increase at about the 1964 rate.

Trade balance deteriorates

The trend towards slower growth of exports and continuing increases in imports has become more clearly pronounced in recent months. Although exports recovered from the third quarter low (which was primarily due to seasonally adjustment problems for the month of August), they did not rise either as fast as during the first half of the year nor as fast as imports. (See Table 6.) Consequently, the large trade surpluses of the last quarter of 1963 and the first half of 1964 have been diminishing and in November there actually was a fractional trade deficit. Nevertheless, it is estimated that the 1964 trade surplus will total about DM 5 billion, approximately DM 1 billion below the 1963 surplus.

The major factor in the slower export growth was the slowdown in demand for foreign products of other EEC countries, particularly in Italy and France. Exports of German products to other areas, on the other hand, continued to expand. In particular, exports to the EFTA-countries, and within that bloc to Great Britain, rose considerably. The effects on German exports of the surcharge on imports into Britain instituted in October probably will not become discernible until early this year. With exports to the other EEC countries, except to Belgium-Luxembourg, no longer rising faster than deliveries to other areas, the share of the EEC in total German exports dropped from 38.1 per cent in the first quarter of 1964 to 35.1 per cent in September-October 1964. A further factor explaining the slower development of exports probably derives from the favorable domestic demand situation which to some extent reduces the incentive for German producers actively to seek export opportunities.

Table 6. Germany: Merchandise Trade, 1962 - November 1964
(seasonally adjusted, monthly averages, in billions of DM)

| | Exports | Imports | Industrial goods imports | Trade balance |
|---|---|---|---|---|
| 1962 | | | | |
| I | 4.35 | a/ 4.08 | 2.91 | .27 |
| II | 4.42 | a/ 4.07 | 2.80 | .35 |
| III | 4.44 | 4.10 | 3.00 | .34 |
| IV | 4.41 | 4.22 | 3.13 | .19 |
| 1963 | | | | |
| I | 4.45 | 4.12 | 3.11 | .33 |
| II | 4.85 | 4.40 | 3.33 | .45 |
| III | 5.00 | 4.57 | 3.41 | .43 |
| IV | 5.07 | 4.30 | 3.21 | .77 |
| 1964 | | | | |
| I | 5.34 | 4.46 | 3.38 | .88 |
| II | 5.41 | 4.71 | 3.50 | .70 |
| III | 5.29 | 5.04 | 3.81 | .25 |
| June | 5.68 | 4.97 | 3.67 | .71 |
| July | 5.44 | 5.14 | 3.92 | .30 |
| August | 5.04 | 4.84 | 3.65 | .20 |
| September | 5.40 | 5.15 | 3.86 | .25 |
| October | 5.59 | 5.31 | 4.07 | .28 |
| November 1/ | 5.38 | 5.40 | n.a. | -.02 |

a/ Change in import accounting procedure raised imports for the first quarter, 1962 by DM 0.124 billion (monthly rate) and those for April by a negligible amount.
1/ Preliminary
n.a. - not available
Source: Bundesbank, Monthly Report

The continuing upsurge of imports is to a large degree associated with the expansion of the domestic economy and to a lesser degree with the rise in world market prices for raw materials. Both these factors are reflected in the shift in the import structure which took place during the year: the relative importance of raw materials and semi-finished goods in total imports rose, while that of finished goods declined. But the latter decline was to some extent explained by the lower imports of defense goods as compared with 1963, commercial imports of finished goods in the third quarter of 1964 were 22 per cent above the preceding year's level, about the same rate of increase as was recorded for semi-finished goods in that quarter.

Imports from the EEC countries expanded particularly fast and their share in German imports grew from 31.9 per cent in the first quarter of 1964 to 37.3 per cent in September-October. This may in part reflect greater competitiveness of the EEC partners in the German market both because of the higher price level in Germany and because of the unilateral tariff reduction which became effective in July.

Balance of payments reflects diminished trade surplus

The much diminished trade surplus, combined with a seasonally large deficit on service account, was the main factor in the third quarter swing of the balance of payments into deficit. (See Table 7.) The huge first quarter, 1964 surplus was much diminished in the second quarter, partly because of a reduction in the trade surplus, but primarily because of the shift from private capital inflows to a substantial outflow (after the announcement of the proposed 25 per cent withholding tax on dividends paid on foreign held fixed interest securities). In the third quarter,

Table 7. Germany: Balance of Payments, 1963-October 1964
(in millions of DM)

| | January-October 1963 | January-October 1964 | 1964 I | 1964 II | 1964 III | 1964 Oct. a/ |
|---|---|---|---|---|---|---|
| 1. Goods and Services | | | | | | |
| Trade balance | 4,031 | 5,218 | 2,236 | 1,955 | 557 | 470 |
| Services | -363 | -475 | 53 | -93 | -455 | 20 |
| Total | 3,668 | 4,743 | 2,289 | 1,862 | 102 | 490 |
| 2. Official Payments | | | | | | |
| Donations 1/ | -4,246 | -3,913 | -1,092 | -1,380 | -1,121 | -320 |
| Long-term capital | -676 | -746 | -249 | -228 | -157 | -112 |
| Short-term capital | 990 | -628 | -382 | 12 | 70 | -328 |
| Total | -3,932 | -5,287 | -1,723 | -1,596 | -1,208 | -760 |
| 3. Private Capital | | | | | | |
| Securities transactions | | | | | | |
| Foreign purchases 2/ | 2,467 | 339 | 610 | -655 | 304 | 80 |
| German purchases 3/ | -300 | -714 | -299 | -317 | -66 | -32 |
| Other long-term | 662 | 375 | 139 | 138 | -60 | 178 |
| Short-term 4/ | 838 | 60 | -618 | 193 | 131 | 354 |
| Errors and omissions | 584 | 1,864 | 936 | 440 | 641 | -153 |
| Total | 4,251 | 1,944 | 768 | -201 | 950 | 427 |
| Surplus or Deficit (-) | 3,987 | 1,400 | 1,334 | 65 | -156 | 157 |
| **Financed by** | | | | | | |
| 1. Commercial banks | | | | | | |
| Foreign exchange assets (increase-) | -1,957 | -1,280 | -942 | 288 | -165 | -461 |
| 2. Reserve Movements | | | | | | |
| Drawing rights on IMF (increase-) | -120 | -320 | -368 | -216 | -- | 264 |
| Bundesbank liabilities | -116 | 5 | 34 | 38 | -83 | 16 |
| Gold and foreign exchange (increase-) | -1,794 | 195 | -58 | -175 | 404 | 24 |
| Total | -2,030 | -120 | -392 | -353 | 321 | 304 |
| Total Financing | -3,987 | -1,400 | -1,334 | -65 | 156 | -157 |

a/ Preliminary.
1/ Also includes foreign workers' remittances.
2/ Net foreign purchases of German securities.
3/ Net German purchases of foreign securities.
4/ Includes commercial bank capital other than foreign exchange assets.
Source: Basic data from Bundesbank and International Financial Statistics, rearranged by author.

the outflow of private capital was again reversed, but the renewed inflow--this time primarily owing to borrowings abroad by German subsidiaries of foreign companies--was not sufficient to offset the continued heavy government payments abroad. In October, however, the seasonal outflow on service account had ended; the current account balance, combined with a further private capital inflow, was more than sufficient to offset government capital outflows.

For the ten-month period January-October, 1964, the combined balance of payments surplus amounted to DM 1,400 million or $350 million, with most of the inflow concentrated in the first three months of the year. This compared with a cumulative surplus of DM 3,987 million ($997 million) for the first ten months of 1963, when most of the inflow was concentrated in the second half of the year.

Official reserves decline

The change in the German balance of payments position from a large surplus during the first half of 1964 to virtual balance in the four months from July to October was reflected in a drawing down of official holdings of foreign exchange which continued through mid-December. Official holdings of gold and foreign exchange were reduced by $362 million between the end of June and mid-December, 1964. (See Table 8.) However, drawing rights on the IMF increased in December in connection with a DM drawing by the United States.[3/]

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3/ An earlier U.S. drawing in October was more than offset by repurchases by other countries.

The $180 million equivalent of DM made available to the IMF under the General Agreements to Borrow did not affect the official reserve position since this transaction only constituted a shift from freely usable assets to foreign assets of limited usability held by the Bundesbank.

Table 8. Germany: Changes in Reserve Position, 1963 - December 1964
(in millions of U.S. dollars)

| | 1963 | 1964 | | | | |
|---|---|---|---|---|---|---|
| | Jan.-Dec. | Jan.-June | July-Sept. | Oct. | Nov. | Dec. 1-15 |
| A. Bundesbank gold and foreign exchange | | | | | | |
| Gold | 164 | 238 | 68 | -- | -- | 94 |
| Foreign exchange | 491 | -178 | -167 | -7 | -109 | -241 |
| Total | 655 | 60 | -99 | -7 | -109 | -147 |
| B. Drawing rights on IMF | 35 | 146 | -- | -66 | n.a. | n.a. |
| C. Commercial banks foreign exchange | 73 | 165 | 42 | 115 | n.a. | n.a. |
| Total A through C | 763 | 371 | -57 | 42 | n.a. | n.a. |

n.a. - not available.
Source: International Financial Statistics; Bundesbank, Monthly Report.

Table 9. Germany: Exchange Rate and Forward Rate in U.S. Cents per DM and Per Cent per Annum, 1963-Dec. 1964

| | |
|---|---|
| Par Value | 25.000 |
| Upper Limit | 25.188 |
| Lower Limit | 24.875 |

| | Spot Rate 1/ | Forward Rate 2/ | | Spot Rate | Forward Rate |
|---|---|---|---|---|---|
| 1963 - Jan.-March | 24.991 | +0.3% | 1964 - Oct. 2 | 25.158 | -0.0% |
| April-June | 25.085 | -0.1% | 16 | 25.158 | -0.0% |
| July-Sept. | 25.110 | +0.2% | 30 | 25.152 | -0.0% |
| Oct.-Dec. | 25.152 | -0.2% | Nov. 13 | 25.143 | +0.3% |
| 1964 - Jan.-March | 25.160 | +0.9% | 27 | 25.151 | +0.3% |
| April-June | 25.161 | +0.6% | Dec. 11 | 25.143 | +0.4% |
| June-Sept. | 25.155 | +0.6% | 24 | 25.165 | 3/ +0.2% |
| Oct.-Dec. | 25.151 | +0.3% | 31 | 25.144 | +0.6% |

1/ Noon buying rates
2/ Quarterly and monthly data averages of Friday quotations.
3/ December 23
Source: Federal Reserve Board

Consequently, the German official reserve position actually has deteriorated only very little when the IMF transactions are taken into account.

Commercial banks, which had increased their holdings of foreign exchange only slightly during the third quarter, added substantially to their holdings in October and reportedly continued to put funds abroad subsequently. But by mid-December funds were again being repatriated for year-end window-dressing purposes.

The third quarter balance of payments deficit and money exports by German commercial banks were reflected in a slight weakening of demand for the D-mark in foreign exchange markets. (See Table 9.) The D-mark quotations moved down from 25.161 U.S. cents in the second quarter to 25.155 in the third and 25.151 in the fourth quarter of 1964. This rate was well above the par value of 25.000 U.S. cents, but somewhat below the upper limit of 25.188 U.S. cents at which the Bundesbank is committed to intervene in the foreign exchange market.

During the period there were some upward fluctuations in the D-mark quotations, particularly in November when sterling came under pressure, and in the second half of December when banks were trying to meet year-end requirements. The three-months forward rate on the D-mark averaged 0.3 per cent per annum, well below the rate prevailing in preceding months, but well above the fourth quarter rate of the preceding year, possibly indicating that year-end operations may have been less extensive than in 1963 and that foreign exchange markets in early 1965 may be less influenced by the unwinding of year-end window-dressing operations than in 1964.

Financial markets relatively quiet

The balance of payments developments combined with the restrictive action of the monetary authorities produced increasing pressure on bank liquidity. Foreign exchange operations, which had added substantially to bank liquidity in 1963 and early 1964, contributed only little during the second and third quarters of 1964. (See Table 10.) In addition, public authority transactions had a more contractive influence in 1964 than in the preceding year.

In this situation, the rise in reserve requirements in the third quarter forced the banks to increase their indebtedness at the Bundesbank substantially while at the same time reducing their holdings of government paper. These contractive influences appear to have continued during the fourth quarter of the year. In an attempt to minimize the effects of the liquidity squeeze and year-end operations on the foreign exchange market, the Bundesbank offered a 3/4 of 1 per cent rebate on advances against securities reducing the cost of such advances to 3-1/4 per cent. Banks reportedly availed themselves heavily of this opportunity towards the end of the year. As a result, call money rates in Frankfurt remained relatively easy, in view of the heavy seasonal requirements, at about 3-1/4 per cent through most of December.

The bond market steadied towards the end of the year. Although the Federal loan floated in October could be placed only slowly despite support purchases by the Bundesbank of older government issues, pressures on the bond market appear to have eased and bond yields have steadied around 6.4 per cent for 6 per cent coupon issues.

The final approval of the 25 per cent withholding tax proposal in its original form by the Finance Committee of the Bundestag on

Table 10. Germany: Factors increasing (+) or reducing (-) commercial bank reserves, 1963-- 3rd Quarter 1964
(In billions of D-marks)

| | 1963 | | 1964 | | |
|---|---|---|---|---|---|
| | 1st half | 2nd half | I | II | III |
| **Market Factors:** | | | | | |
| Notes in circulation | +.2 | -1.8 | +1.1 | -.7 | -.6 |
| Public authority deposits | -4.7 | +.4 | -3.3 | -1.5 | -.9 |
| Bundesbank foreign exchange operations | +3.8 | +4.6 | +2.0 | +.6 | +.6 |
| Other | +.4 | -.4 | -.1 | +.8 | -.2 |
| Total | -.3 | +2.8 | -.3 | -.8 | -1.1 |
| **Policy Factors:** | | | | | |
| Open market operations | -- | -.6 | -.4 | +.8 | +1.4 |
| Borrowings at Bundesbank | +.9 | -1.1 | +.5 | +.5 | +1.1 |
| Total | +.9 | -1.7 | +.1 | +1.3 | +2.5 |
| **Compare:** | | | | | |
| Change in required reserves | +.5 | +.6 | +.4 | +.4 | +1.4 |

Source: Bundesbank, Monthly Report; Annual Report for 1963

December 16 appears to have caused no further sales. It now appears likely that the tax will become effective shortly before the mid-year 1965 interest payments become due. Shortly after passage of the tax proposal had virtually become assured, the Federal Loan Consortium decided to float a DM 400 million Federal bond issue at an effective yield of 6.29 per cent on January 4, 1965. Early 1965 floatations by public authorities are expected to amount to about DM 1 billion with terms and conditions (6 per cent coupon rate, issue price of 98) about the same as prevailed at the end of 1964. This would indicate that no further weakening requiring special tailoring of issues to suit market conditions is expected.

The stock market also exhibited a firmer tendency towards the end of the year. Stock prices had weakened during October and November but recovered some lost ground in December. But prices still remained about 7 per cent below September quotations.

The relative quiet in the domestic financial markets was in sharp contrast with the hectic atmosphere of the foreign exchange markets during November when sterling came under pressure, and with the uncertainties following the discount rate changes in Great Britain, the United States and Canada. For some time, there was speculation in the press about impending Bundesbank actions in the discount rate field but this talk died down quickly after the $3 billion stabilization package for the pound sterling was announced on November 25. However, the virtual cessation of foreign exchange inflows and the rising interest rate level in neighboring countries have made the monetary authorities feel less hampered in instituting measures to control the domestic monetary situation if this should prove necessary.