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A Latent Currency Crisis

by Udo Hammer, Hamburg

After the ending of the November Conference of the Club of the Ten on the currency situation in 1968, a possible revaluation of the German Mark had ceased to be topical, at least for the time being. However, the very moment that the German business boom threatened to overheat again, in the spring of 1969, the same question of revaluation became once more a focal point of discussion. In accordance with the Federal Bank, the Experts' Council, and the Working Group of German Economic Research Institutes¹, the Federal Minister of Economics, Professor Karl Schiller, joined the advocates of DM revaluation at that point.

One of the first responses to the Federal Government's decision to forego revaluation was a declaration of protest signed by 61 professors of economics from universities of the German-speaking region. The question whether revaluation would have been practicable and beneficial led to the creation of two warring political camps. Against revaluation were ranged prominently the Federal Minister of Finances, Franz-Josef Strauss, and important business representatives including the senior of German bankers, Hermann J. Abs, and Fritz Berg, President of the Federal Association of German Industries. Among advocates of increasing the DM's exchange rate, were the Federal Minister of Economics, Professor Schiller, and the majority of German economists. At the provisional climax of the contest, the Federal Chancellor, Dr Kurt Georg Kiesinger, who is a lawyer by profession, found that the situation resembled that in an ancient Greek tragedy, the choruses on each side proclaiming that only their camp was in possession of the eternal verities.

In spite of the assertion of the Deputy Head of the Federal Press Office, Conrad Ahlers, that the Federal Cabinet's decision against DM revaluation was intended to remain in force "for ever", data which have since become available², prompt

¹ cf. Hamburgisches Welt-Wirtschafts-Archiv (HWWA), ed.: KONJUNKTUR VON MORGEN (Business Activity Tomorrow), Vol. 12 (1969), No. 286.

us to dissect critically at least one major argument which contributed to the government's decision: this is the assertion that the German balance of payments was not "fundamentally out of equilibrium", as net currency reserves were not higher than after the 1961 revaluation.

Salient Points

From an analysis of the definite statistical data, now available, on the Federal Republic's balance of payments for 1968, the following broad conclusions can be drawn:

- Current account transactions continue to produce market surpluses;
- net capital outflow has increased at an exceptionally high rate;
- short-term money transactions show a reversal of an earlier trend.

Main Balancing Items of the Balance of Payments

DM '000,000,000

Account	1967	1968
(1) Current Account	+ 9.9	+11.4
Exports and Services	+16.2	+18.5
Exports	+21.0	+22.7
Invisibles (Services, etc.)	- 4.9	- 4.2
Transfers (by German residents)	- 6.3	- 7.2
(2) Long-Term Capital Movements	- 3.2	-11.5
(3) Main Balance of Payments: (1)+(2)	+ 6.7	- 0.1
(4) Short-Term Money Transactions	- 6.3	+ 4.3
(5) Current Accounts+Capital Transactions: (1)+(2)+(4) = (3)+(4)	+ 0.4	+ 4.2
(6) Balancing Item: (7) - (5)	± 0	+ 2.9
(7) Foreign Exchange Balance of Payments (Surplus: -)	- 0.4	- 7.1

Sources: cf. Footnote 2.

Components of Current Account Transactions . . .

The very high German export surpluses that had already amounted to DM 16,200 mn in the re-

² Die Zahlungsbilanz der Bundesrepublik im Jahre 1968. Endgültige Ergebnisse und regionale Untergliederung (The Federal Republic's Balance of Payments for 1968. Definitive Figures and Regional Breakdown); in: Monthly Report of the Federal Bank, Vol. 21 (1969), No. 7, pp. 18/19, and the voluminous Appendix to this article, containing statistical tables, published in Statistische Beihefte (Statistical Supplements) of Monthly Reports of the Federal Bank, Series 3, Statistical Data on the Balance of Payments, No. 7, July, 1969.

cession year of 1967, increased in 1968 by more than DM 2,000 mn, reaching an all-time high of DM 18,500 mn. One of the reasons behind this upsurge was the striking change in Germany's trade relations with different regions of the world. In regard to non-European developed countries, including the United States, Canada, the South African Republic, Japan, Australia, and New Zealand, the German balance of payments experienced remarkable changes through German net exports to these countries rising from DM 300 mn in 1967 to more than DM 3,000 mn in 1968. Three years ago, trading accounts with these countries had been in deficit to the tune of almost DM 3,000 mn, which means that the trend of development has been reversed completely. On "invisible" account (services, etc.), Germany registered net exports to these countries of DM 5,600 mn, which is also a vastly bigger amount than the DM 1,900 mn of net surplus in 1967.

In spite of the measures to safeguard the balances of German foreign trade, which became operative in January last, a similar tendency is to be registered in 1969, which means that the basic balance of payments will again be in surplus for an estimated DM 15,000 mn, whilst net current account surpluses for the whole of 1969 will not be significantly inferior to those of 1968.

... and of Capital Movements

Whereas a strong rise of the surplus was registered in the balance of current account transactions during the past year, this was counterbalanced in 1968 by an extraordinarily steep upswing of long-term capital exports. Net outflow of long-term investments was DM 11,500 mn, against only DM 3,200 mn in 1967. This lifted the Federal Republic of Germany into the leading position among capital-exporting countries. New private investments abroad alone have jumped by 145 p.c. from DM 8,400 mn in 1967 to an unprecedented DM 20,600 mn in 1968. Of this, 64 p.c. went on purchases of foreign stocks and shares, and, as far as distinguishable, 3 p.c. were used for direct investments in foreign enterprises. In absolute figures, the 1968 (1967 figures in brackets) purchases of new holdings totalled DM 12,700 mn (4,900 mn), but direct investments crept up only to DM 1,900 mn (1,600 mn). Of total new long-term investments of DM 22,600 mn made by Germany in 1968, DM 16,200 mn, or 72 p.c., went to developed countries, i.e. to other EEC member states, member countries of EFTA, Finland, Iceland, Eire, and the above-mentioned non-European industrialised regions. Developing countries absorbed only DM 4,700 mn, or 21 p.c. of the total, and even when we add DM 1,500 mn, or 7 p.c.—the German funds transferred to international organisations—the total flowing to the underdeveloped world has reached only DM 6,200 mn, or 27 p.c.

Short-term money transactions, conversely, appear to have been under completely contrary influences, as compared with long-term capital movements. Short-term capital flow was balanced with a net surplus of DM 4,300 mn in 1968, against a net deficit of DM 6,300 mn in 1967. In spite of higher rates of interest obtaining abroad, the hopes of the speculation for a revaluation of the German currency during the autumn of 1968 drove substantial sums of "hot money" over the borders into the Federal Republic. Finally, there remained, in 1968, an additional surplus on international payments account of DM 2,900 mn, which reflects a net inflow of capital. All this had the effect of pushing up the Federal Bank's currency reserves by the vast sum of DM 7,000 mn, despite big exports of long-term capital, whilst they had increased by a mere DM 400 mn in 1967.

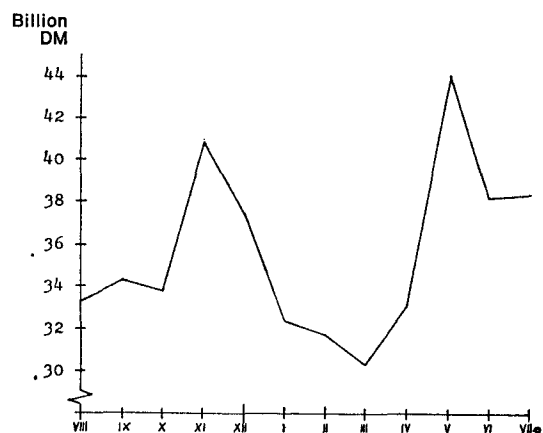
Foreign Currency Account ...

Judging developments from the moves of foreign currency reserves, the argument that these are in severe disequilibrium, is supported by the situation of the balance of payments at the end of 1968. On the other hand, like Dr Herman Abs, one might incline to the view that the stocks of currency reserves had been artificially blown up at the chosen key-date by the speculation funds that moved into Germany shortly before.

During the early months of 1969, it became possible to find some measure of confirmation for the "Abs theory", as previously accumulated speculative credit balances were then being dissolved to be followed by new waves of incoming and outgoing currency moves in April and May, 1969, comparable to those during the currency crisis of November, 1968.

Diagram

The Currency Reserves of the German Federal Bank



p) Temporary
Source: Statistische Beihefte zu den Monatsberichten der Deutschen Bundesbank, Series 3, Zahlungsbilanzstatistik, No. 8, August, 1969, Table 18a.

As to the sources from which additional foreign currency enter the coffers of the Federal Bank, conditions are now almost completely the reverse of those characteristic of the currency crisis of last November. At that time, almost two thirds of currency intake came from currency transfers by merchant banks and only over one third from net currency receipts of the Federal Bank from non-banking business. In May, 1969, which saw the latest currency crisis up to now, under one quarter of the currency reserves' growth in the Federal Bank consisted of foreign funds deposited with German banks by their foreign clients, whilst more than 75 p.c. of the total inrush was derived from foreign currency receipts of German non-banking businesses.

... and the Main Balance as a Yardstick ...

The Net Overall Surplus of the Main Balance of Payments, as a rough indicator of the extent to which the German economy, in the long-term, is deviating from the desirable equilibrium on international account, also seems to confirm the thesis that there is no basic disequilibrium but only a temporary currency crisis, caused by waves of speculation and its short-term transfers of flight capital or "hot money". Measured upon the net overall surplus of the main balance, which combines the effects of long-term capital movements and of current account transactions, the balance of payments indicates almost perfect equilibrium for Germany in 1968, as the deficit amounts to under DM 100 mn.

... for a "Basic" Disequilibrium

If one is of the opinion, on the other hand—which many observations seem to confirm as correct—that present-day net surpluses of the German balance of trade and "invisible" exports on current account are caused by economic conditions prevailing in the major trading and industrialised countries, and will therefore not easily disappear

in the future, then capital exports are being treated as an economic stopgap for balancing out a strong disequilibrium permanently through a forced outflow of capital funds.

Yet, export capital can never be a good thing in itself. Capital outflow ought to be brought into proper equilibrium with the investment requirements of the home market. The structure of long-term capital exports from Germany suggests the existence of a basic disequilibrium in Germany's balance of payments. As has been shown, most of them take the form of an easily reversible credit flow, whilst more desirable direct investments from only a small fraction of them.

Adjustment of DM Parity

The argument that the balance of payments was not basically out of equilibrium contributed strongly to the Federal Cabinet's decision against a revaluation of the DM. However, when the main measurement yardstick is applied—i.e. the analysis of long-term capital exports from Germany—it becomes apparent that the balance of payments is fundamentally out of equilibrium. The German Government is obliged under the "Stability and Economic Growth Law" to attain internal as well as external equilibrium. Therefore a policy which aims at dismantling the basic disequilibrium of the German balance of payments, and at the same time at keeping the internal stability of the German economy will consequently have to take an influence upon foreign trade streams. One of the tools to this end may be an adjustment of the DM's rate of exchange, possibly through a concerted action in agreement with one or more of the most important trading partners of the country. In this way it will be possible to guide a national economy which tends to develop chronic net surpluses or net deficits along the path towards better equilibrium.

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