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Speculations about a DM-Revaluation

The present revaluation psychosis, which is particularly prevalent abroad, seems to have led to the impression that a change in the foreign exchange value of the Deutsche Mark was already decided upon and that the question now was simply when the change was to take effect. The emphatic denials by competent German authorities seem to have done little to dispel these persisting rumours. Foreign capital has flown into the Federal Republic on a fairly large scale and is unlikely to leave the country at least as long as the suspicion lasts that the DM will yet have to be revalued. We have asked two experts to give us their views on a revaluation of the DM and to examine whether there is any economic justification for such a step.

There is no Need to Consider Revaluation

Interview with Dr Wilhelm Hankel, Bonn

QUESTION: The categorical denials by German sources of any intention to revalue has been followed on September 4 by a statement by the President of the Federal Bank, Dr Blessing. He declared that the Federal Republic might be forced to revalue, if the inflation in other great Western countries continued. How do you judge the situation, which has meanwhile become rather confused?

ANSWER: It is no discredit to a currency if its revaluation is sus-

pected, however awkward these suspicions may be for anyone concerned with economic policy. On the contrary, it is in a way a compliment from the foreign speculators and journalists inasmuch as it implies that we have done better than the others.

You are right in saying that the question of revaluation is confused. This confusion affects more the foreigners than the Germans. In the Federal Republic itself, things are being judged much more calmly. Here much more credence is being attached to the revaluation-denials by the Government. I think this is because the Federal Republic has always tried to combine the revaluation-denials with an explanation of its economic policy as a whole. The revaluation-denials are dependent on quite clear conditions. Perhaps we might talk a little about these conditions.

Conditions for a Change In the Exchange Rate

QUESTION: Right, let us start straightaway. According to the

rules of the IMF a currency should be revalued if there is a fundamental disequilibrium in a balance of payments. The Federal Republic's basic balance for the second quarter finished up with a deficit of DM 880 mn. Is it possible in view of such a result to speak at all about a fundamental disequilibrium in the balance of payments?

ANSWER: To put a question in this form is almost to answer it. When a basic balance is in equilibrium or, as in our case, in a slight deficit, there is no *prima facie* reason to suspect a fundamental imbalance in foreign trade and payments. Since the international trade is no exchange-operation, it is only natural to finance resulting balances through capital exports.

Naturally, our foreign partners and, even more so, our own Government are upset by the fact that the over-all surplus has now reached a percentage-level that is much higher than all the assets we had before. The external contribution,

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i.e. roughly speaking the surplus of the Federal Republic's balance of trade and services, is of the order of a good 3 per cent of the GNP. The quick rise of this figure is without doubt a result of the recession and its not yet completely overcome consequences. The Federal Republic, however, wants to reduce the surplus to half its actual size by 1972. This is to be achieved with an economic policy which aims at reducing the German export surpluses from within, through a well dosed and controlled policy of expansion and of changes in the internal structure. That is the reason why the Government's medium-term financial planning, which is based on tentative plans, provides structural aid specially directed to selected regions and branches. Such a policy of incentives should lead on the one hand to an increasing use of the import scope, and on the other to a diversion of the exported goods to the national markets. The excessive reliance of German producers on exports should correct itself the further we get away from the lowest point reached during the recession. As the external contribution diminishes, as planned and foreseeable, so will the need for compensatory capital exports.

QUESTION: Could revaluation also be considered as being in the interests of the Federal Government's policy to keep the economy stable?

ANSWER: The Federal Government has always said in all its statements relating to revaluation that a case for revaluation exists only when the internal monetary stability is threatened and when it should become apparent that the hitherto main instrument of equalising the balance of payments—capital exports—leads to an impairment of the internal capital market. In other words, as long as prices do not tend to rise and as long as the trend of interest rates shows that capital exports are feasible without impairing the possibilities of obtaining finance for internal purposes, i.e. that interest rates are not rising in spite of considerable capital exports,

but drop, there is no need at all for the Federal Government to consider revaluation.

Speculation against the Central Bank?

QUESTION: The Federal Bank is said to have been forced to make large-scale foreign exchange purchases. Is the Federal Bank at all in a position to stand up against the massive speculation for any length of time without revaluing?

ANSWER: Until now every wave of speculation has shown that it is a risky and as a rule costly affair for a speculator to operate against central banks or even against one Central Bank. According to its latest reports, the swap-rate policy of the Federal Bank has been highly successful. The Federal Bank has pursued a very differentiated swap-rate policy, thereby not only reducing the total cost of the exchange rate guarantee but at the same time varying the time limits. You can see from this that the means at the disposal of the swap-policy are much more varied than appears at first sight. The Federal Bank has only employed small arms when it reduced the cost of the exchange rate guarantee. These transactions have not resulted in any losses whatsoever to the Federal Bank. It could, if necessary, go much further and even pay swap-premiums, i.e. pursue a genuine open-market-policy in foreign exchange, incurring occasionally temporary losses, too. The means of stemming an even much bigger speculative wave are far from exhausted.

QUESTION: Are you expecting a new major wave of speculation in the near future?

ANSWER: I would not exclude such a possibility, the more since this is not only dependent on the strength of our currency but also on the weakness of the other currencies. At a time like the present most people are going about with a kind of amplifier in their ears which catches only such tones as confirm them in their fears. They fail to hear—and this is the fate of

our denials—the other sounds which in a more normal state of mind would certainly have come through more strongly and been understood as the voice of reason.

Revaluation no Panacea

QUESTION: Doubts are being expressed, particularly in Germany and Switzerland, whether revaluation of the DM could solve all current problems. Are not foreign states in demanding revaluation guilty of wishful thinking?

ANSWER: Foreign countries, i.e. governments and central banks, do not "demand", even at home, a revaluation of the DM. On the contrary, they see the danger of a "feedback"—with consequences for their own position—much more clearly than many of their journalists. And this is objectively the right way to see the problem. Let us take for a moment—the loudest voices come from England—the case of the Anglo-German trade relations. British imports from Germany represent about 5 per cent of total British imports. Any direct balance of payments effect that would derive from a revaluation of the DM is therefore bound to be very modest. To this must of course be added the improved competitiveness of British exporters in Germany and particularly in third markets where their goods overlap with those offered by German exporters.

But all in all, a German revaluation would relatively bring only very modest competitive advantages — advantages that would be counterbalanced by a very weighty disadvantage. Already after the previous revaluation in March 1961 the German capital balance was observed to show for months, until into September, tendencies to a massive surplus. We had an enormous capital influx even after revaluation.

Since then the volume of floating capital has multiplied. It must therefore be presumed that in the course of a German revaluation much more capital would flow into Germany than in 1961. But these capital imports come from the very countries that are having trouble

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with their balances of payments, which means that just these countries with weak currencies would have to reckon with another deterioration in their capital positions. These countries would therefore have to set against the relatively small improvements in their balance of current transactions a very great deterioration in capital account. The international cost-benefit-ratio of such a step would be very bad; the costs would inevitably rise at once, while the benefits would be small and highly uncertain.

QUESTION: Great Britain has had to learn the lesson after the latest devaluation that correcting the exchange rate is by itself not enough to improve a country's competitive position decisively. Are you at all of the opinion that a revaluation in the Federal Republic could lead to a sudden change in our balance-of-payments position?

ANSWER: At best, all we could expect from a revaluation, whatever its dosage, is a modest reduction in our export surplus. The simple reason for this is that—as became evident on the occasion of our last revaluation in 1961—neither the prices nor the incomes elasticity of our current transactions is very high. The flows of capital are, if I may say so, highly sensitive to changes in exchange and interest rates. By revaluing for the second time within a relatively brief span we would turn our foreign exchange parity into a kind of second discount rate. The

foreign investor would have the feeling that in Germany he is not only getting interest on his capital, but that his capital will appreciate in value through periodic revaluations if only he keeps his money there long enough.

Conversely, the foreign debtor would have the justified fear that he may once or twice be faced with foreign exchange losses through revaluation before he has paid back his long-term debt. He will therefore be obliged to repay more than he is required to do under the original contract. All this means that revaluation, if it becomes a habit, would paralyse our ability to export capital, particularly long-term capital, while, conversely, we would dangle before the eyes of the foreign investor the hope of a premium on any long-term investment.

Devaluation In Great Britain and France?

QUESTION: From the view expressed last week by German industrialists one thing is quite clear: There is dissatisfaction with our present monetary system which is said to punish "the good boys" while favouring those craving for inflation. Might it not perhaps be "just" first of all to devalue the franc and then possibly once again the pound sterling?

ANSWER: This is a matter for autonomous decisions by these countries. If we, for reasons I have explained, claim the right to decide whether we should revalue, then we must also for the same

reasons concede to France and Great Britain the same autonomy. Personally I do not see any reason why the two mentioned currencies should be devaluated. The British balance-of-payments position is tending towards stabilisation. The Basle-Agreement has stopped the so-called erosion of sterling balances. The French Government has reintroduced the full convertibility of the franc, showing with this that it does not plan to change the franc-parity.

Export Surplus no Long-term Problem

QUESTION: What do you think of the argument, put forward particularly by the British, that the German economic miracle and the strong export position of the Federal Republic have only been possible because the DM has been undervalued right from the beginning?

ANSWER: What do you mean in this context by "right from the beginning?" If we go back to the year 1949, that is twenty years, it seems to me impossible to maintain objectively that an undervaluation could have been kept up for twenty years. I believe the present surplus position is to a large extent a transitory problem. It is, as I said in the beginning, an unavoidable consequence of the recession. The recession was bound by its very nature to increase reliance on exports, and this increased reliance is only now in the present phase of the trade cycle gradually disappearing.

If one distinguishes several phases in this process, one can say that in 1968 the phase of stocking up is largely over. The manufactured-goods-effect—regarding imports as well as exports—has not yet fully come into play. The present boom hasn't reached its peak yet — neither in the investment-field nor in the consumer-goods-sphere. For many reasons mass-incomes have risen relatively modestly. Wage increases have remained far behind what would have been possible, possible in view of the upward trend of profits and productivity. The logical con-

sequence is, that we have—so far—experienced a setback in the income-distribution. We know from the years following the mid-fifties, that imports of manufactures react very strongly to improvements in the income-distribution. The same

can be said of the import-effect of investments; it will gain weight more than proportionally while the boom approximates gradually full utilisation of capacities. I would therefore believe that once at its height, the boom will automatically

ensure the full effect of the acceleration of imports and of the reduction of exports; the extremely high surpluses we have today should not be seen as a long-term phenomenon. The year 1969 can already be the turning-point.

Has the Federal Government an Alternative?

by Dr Hans-Jürgen Schmahl, Hamburg

Last August saw the brushfire of feverish speculation discounting a rumoured revaluation of the Deutsche Mark, thus demonstrating that a country like the Federal Republic, which carries great weight in the world's economy, will not be permitted to accumulate with impunity huge export surpluses over the longer term. Even though such speculation may have been the clear result of deliberate manoeuvres by one or the other of our trading partners in order to feather their own nests, the fact that such speculation is at all possible was symptomatic and not accidental. For a long period, it had been possible to explain extremely large export surpluses by citing the cyclical movement of the national economy, first as the "reverse side of the medal" called recession, later as its inheritance. But for over one year, the German economy has again shown steady growth, and even so, there has not been the faintest indication of these surpluses beginning to be run off. In order to eliminate the effects of all the possible accidental influences, the clearest picture will be gained by taking the average results for the months May to July, 1968. Their total export surplus amounted to DM 3,714 mn, only DM 181 mn lower than the corresponding surplus of 1967. There can therefore be no surprise that doubts are growing about the allegedly cyclical and transitory nature of such surpluses.

On the other hand, such arguments are usually countered immediately by the display of relatively narrow surpluses of the

German balance of international payments up to the end of July, that is, before speculation about a possible revaluation of the DM started. Indeed, the Federal Bank's net holdings of currency reserves had grown between the beginning of the year and the end of July "only" by DM 2,811 mn. And if to this is added the "basic" balance, i.e. this part of the balance of payment, which shows the overall total of all long-term capital transactions with those on current account—through trade, services, and transfers—, this shows a result that could not possibly attract any criticism: for the first seven months of 1968, this basic balance showed a net deficit of DM 409 mn. This reflects Germany's "Capital Export Miracle", by which the long-term net capital export to foreign countries, during the period under review, amounted to the huge sum of DM 6,128 mn. It could therefore be argued that German export surpluses, in so far as they have not already been compensated for by unilateral capital transfers to foreign countries, e.g. through development aid, remittances of foreign workers to their home countries, etc., have been financed to their full extent by long-term funds.

Equilibrium of the Basic Balance is Insufficient

This fact is frequently being used for arriving at the conclusion that there is no disequilibrium at all in Germany's economic relations with the outside world. It can easily be shown that arguing in this way discloses a definition of a state of equilibrium in international trade

and payments which is conceived too narrowly.

The narrowness in defining international equilibrium or disequilibrium, respectively, is based on the abstract clearing between some composite items in the balance of payments but not on the study of their composition. However, there is a great difference between two forms of "equilibrating" the balance of payments, say, in the one case by clearing a surplus in the balance of current transactions (export surplus of goods and services) of DM 15 billion against a money transfer deficit of about DM 6 billion and a long-term export of capital of DM 9 billion, or when exactly the same result is achieved by respective clearing operations between items of plus DM 8 billion and minus DM 6 and 2 billion, on the other side. The figures named in the first instance are those actually recorded in 1968, whilst the second, purely hypothetical composition of the balance of payments contains the approximate target figures suggested by the German government's tentative planning of economic developments up to 1972, extrapolated for 1968.¹

The West German net outgoings of goods and services supplied to foreign countries during 1968 will be the equivalent of DM 15 billion, and only half of this amount is required for covering unavoidable deficits. The remaining half could have been

¹ This "plan" aims at achieving an external contribution (surplus of the balance of current transaction in overall national accounts) of 1.5 per cent of the Gross National Product.