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International Monetary Trends

In the following interview Dr Otmar Emminger, Deputy Governor of the Deutsche Bundesbank, Frankfurt, gives his opinion on the IMF meeting in Washington, the EEC Paris Summit and the monetary situation in the Federal Republic of Germany.

Dr Emminger, according to the IMF balance of payments disequilibria should in future be corrected at an early stage. Which indicators are in your opinion suited as objective criteria for identifying such imbalances?

It has long been accepted by virtually everybody that disequilibria should in future be adjusted more promptly, i.e. before they lead to disruptive crises in the international economy and to distortions in the countries affected by them. There are several more or less reliable indicators for identifying an imbalance that calls for correction: foremost, of course, the trends in the balance of payments itself, whether in its most general form as the balance of reserve movements, or in its more significant constituents, such as the current and the basic account. The main problem is how to distinguish between temporary imbalances that correct themselves over time, and more permanent ones that call for action. Temporary cyclical factors at home or abroad can have a great influence; therefore the concept of "cyclically ad-

justed" balances on current account, as developed by Working Party Three of the OECD, is of great significance in this context. One has also to look at relative price and cost trends at home and abroad, and at possible structural trends in foreign trade, in order to form a reliable judgment.

Application of Objective Criteria

Almost all IMF members seem to reject the application of objective indicators. How could effective rules of conduct nevertheless be established?

I don't think anybody can reject "objective indicators" as such; especially if they are not used onesidedly. What is often objected to is the idea that a simple indicator like the increase or decrease of exchange reserves beyond a certain point should be taken as a more or less automatic trigger-point for action, e.g. on the exchange rate parity, and that this would in case of need be enforced by international sanctions. This is the controversial idea which the American Secretary of the

Treasury put forward at the last Annual Meeting of the IMF. Reserve movements are, of course, often influenced by very temporary and volatile factors, and they can also be temporarily manipulated. Moreover, in cases where a country visibly moved towards any such trigger-points, be they defined by reserve movements or other indicators, there could be enormous reactions in the foreign exchange markets which would force the issue. Nevertheless I believe that a set of rules on the responsibilities for correcting imbalances could be set up; and once imbalances of a certain kind (or amount) are identified, countries should be obliged to consult with the Fund (or its Managing Director), even on such sensitive matters as their exchange rate.

Demand for Parity Changes

The demand for more frequent parity changes appears to be in contradiction to the aim of the EEC countries to create a currency bloc with fixed parities. How can this conflict be solved?

During the transition period, that is to say until 1980, the EEC countries will, as they have reconfirmed at their recent Summit Conference, maintain between their currencies "fixed but adjustable parities". This will probably rule out the *isolated* floating of an individual member currency in relation to the others. But it does not rule out occasional changes in parities inside the EEC currency bloc. Thus there is no inevitable conflict, at least in theory. In practice, things may perhaps turn out differently, as there will be pressure inside the EEC not to change parities too often or in smaller steps.

As is well known, some experts are pinning their hopes on other possible solutions, namely that the EEC bloc of countries would jointly adjust its parities more promptly vis-à-vis the dollar (and other outside currencies), or would carry out a *common float* vis-à-vis the dollar. In practice, however, this is a very remote possibility. Any such decision—whether a common parity adjustment or a common European floating—would require unanimity. It is very unlikely that all the EEC countries, or even only the major ones, would feel at any time to be in such a similar position concerning fundamental imbalances or disruptive money inflows that they would unani-

mously agree on joint exchange rate action vis-à-vis the dollar (or that a common float would yield reasonable results). This unlikely eventuality could only arise in the event that the dollar itself were hit by some catastrophic development which would affect all the EEC countries alike.

Decisions of the Paris Summit

Do you believe that the decisions taken during the Paris Summit to establish the Monetary Fund in 1973 and to let the second phase of the economic and monetary union start in 1974 could contribute towards a permanent solution of the international monetary problems?

No, at least not directly. The mere establishment of the European Monetary Fund and the transition to the second phase will not, by themselves, alter the problems and difficulties of international monetary reform to any substantial degree.

Is it not dangerous for the EEC to continue to approach monetary union, while the economic union is still in a sad state as far as the fixing of common economic aims, the order of economic priorities and concrete measures for their realisation—catch-word "stability"—are concerned?

I do not believe that economic unification will be much promoted by the mere "fixing of common economic aims and economic priorities". We have had unanimous agreement on goals, priorities, and what not, already for two or three years *on paper*, namely in the EEC Committee on Medium-Term Economic Policy. Such decisions and agreements on paper do not greatly change actual policies and events. The movements towards better harmonisation of price and balance-of-payments developments has to come about by patient work in the *actual policies* of EEC countries. The implementation of the recent decisions of the EEC Finance Ministers on the "Fight against Inflation" will be a good test of whether we have made progress in this field. Of course, present developments in Great Britain do not augur too well for effective economic unification in the near future.

Gold Discussion

The IMF discussion concerning gold circles around the question whether the official price of 38 US-Dollar per fine ounce should be maintained or increased without a compromise within reach. What is your opinion on the suggestion to abolish in future the official gold price?



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There is at least a possibility that over the longer run—not in the next few years!—gold will gradually be phased out of our monetary system. One suggestion to this effect has been to allow central banks to sell gold to the private market at their discretion. Whether then an official gold price would still be maintained, e.g. for gold transactions with the IMF, remains to be seen.

SDRs are to be made more attractive. Do you believe that by doing this they will replace to a larger extent than up to now the "traditional" reserve assets?

No, not necessarily. It will not be possible to make SDRs fully competitive with foreign exchange reserves in terms of interest rates. Why should countries with payments surpluses then not continue to pile up reserves in the form of dollars, or sfrs or DMarks, when these are convertible into SDRs and yield high interest rates? Rather, it would be necessary to lay down general rules which would limit the amount of reserves that may be held in national currencies, e.g. to the level of working balances. Unfortunately, at the IMF Annual Meeting the Americans (and others) came out against this idea.

Diversification of Currency Reserves

The trend towards diversification of currency reserves has continued during the last year. Within this context the DMark is increasingly being held as a reserve currency. How do you view this development with regard to the functioning of the international monetary system and to the interests of Germany?

The diversification of currency reserves into other national currencies is unwelcome (a) be-

cause it leads to an inflation of international liquidity, and (b) because it increases the vulnerability of the international monetary system. A foreign central bank that diversifies out of dollars into DMarks maintains its volume of reserves unchanged; however, in the process, it sells dollars against DMarks, and these dollars end up, *ceteris paribus*, with the Deutsche Bundesbank in the form of increased dollar reserves with us. In Germany, this inflow of foreign reserve holdings is a potentially inflationary factor. Internationally, the expansion of reserves held in various national currencies increases the possibility and magnitude of disruptive money flows from one currency to another, depending on the ups and downs of confidence in one or the other such currency, or on varying interest rate spreads.

The reserves of the Federal Republic amount to nearly 80 billion DMarks and are therefore the highest in the world. Are these reserves really needed and how could they be reduced?

Our official reserves are at present 77 billion DMarks, which corresponds to about 24 billion dollars. Since the beginning of 1970 up till the end of last September, we had a reserve inflow from abroad which totalled 55 billion DMarks. Nearly the whole of this reserve inflow was due to the fact that during this period our economy, including our banks, became heavily indebted abroad. Thus, nearly two thirds of our present official reserves represent in reality "borrowed reserves". A large part of this foreign indebtedness of our economy is in short-term or other liquid form. So we have to keep a major part of our reserves as a counterpart to our foreign indebtedness in case of a reversal in these capital flows. The rest

is relatively small in proportion to our trade and payments.

German Controls on Capital Movements

Has the set of controls on capital movements decided upon by the Federal Government in July 1972 proven to be effective?

Yes, even beyond our expectations. This is especially true of the regulation which has made the sale of domestic bonds to foreigners subject to licence. In the six months from January through June 1972, no less than 6.2 billion DMarks flowed in from the Euromarket through such "bond sales" (which circumvented both the "Bardepot" regulation and the minimum reserve requirements). In the three subsequent months, namely from July through September, the net movement was practically zero (!).

As concerns the "Bardepot" (cash deposit), this had already been introduced in March 1972, but at first with only meagre success. It has since become more effective, partly because from July onward the regulation itself was strengthened, partly because the speculative fever in the exchange markets has subsided and interest rates on DMarks in the Euromoney market have recovered to a more normal level. With the defences working quite well, the Bundesbank is now feeling reasonably secure against further disruptive inflows from abroad, and so it felt able to increase, in two stages, its rediscount rate from 3 to 4 p.c. and its lombard rate from 4 to 6 p.c. It is particularly gratifying that we have been able to set up the defence against inflationary inflows from abroad without any bureaucratic control machinery. A mere handful of people has sufficed to administer the regulations.