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West Germany's dilemma

The Bundesbank's tight-money policies and the constraints on export markets are flashing red lights.

West German industrial and banking spokesmen have been dismissing the importance of the appearance of recessionary trends in their economy in recent public statements. Their argument is that investment and orders in the heavy equipment sector remain strong, even if indicators in the overall economy are sliding down.

If the West German economy existed in isolation, their protests that there is no need for concern would be well founded. However, the real situation is quite different. The West German economy is supporting the rest of Western Europe; in the first quarter of 1980, it did so successfully; in the second quarter, the rest of Europe began to pull the West German economy down.

In June, the volume of new foreign orders for West German capital goods plunged by 15.5 percent. Industrial production declined 2.4 percent in May from April's level and another 1.0 percent in June. This occurred as industrial production in Italy fell at a 9 percent annual rate in the second quarter. In France, industrial production was flat in April-June, and officials have forecast a significant decline for the second half of the year.

Leading West German industrial spokesmen insist they can weather these storms. A spokesman for the DIHT (Chamber of Commerce) pointed to continuing high levels of investment and the longer-term trends in foreign sales, when asked whether the economy was threatened with an official recession. In fact, the country's exports to the oil-producers in OPEC rose 10.7 percent in the first half of this year.

There is also widespread confidence that the deutschemark will remain strong despite the emergence of a massive DM25 billion current account deficit this year.

The magnitude of the current account deficit is particularly shocking when one considers that in 1978, the West Germans racked up a DM17.5 billion surplus and were constantly goaded by Washington for not acting as the world's "locomotive."

The deterioration in the current account was caused primarily by the 140 percent runups in the cost of imported oil in 1979. Thus, while the value of West German exports expanded by 15.3 percent during the first half of this year compared to the same period in 1979, imports rose even faster, by 24.5 percent. The country's trade surplus shrunk to DM4.5 billion in the first half, compared to 14.9 billion in 1979.

The Bundesbank (central bank) is insisting on maintaining tight credit restrictions to offset the current account deficit. Banking and industrial leaders have been pressing for a reduction in the discount rate—now at a record 7.5 percent—for weeks.

But Bundesbank officials, who are overly influenced by the monetarist theories of Friedman and von Hayek, argued that high rates are necessary to attract foreign capital.

The declining profitability of West Germany's leading banks, in large part due to the Bundesbank's measures, could also reduce their capacity to finance continued growth. In a recent report, the Bundesbank revealed that the combined after-tax profits of the big six banks fell 13.4 percent in 1979. The Bundesbank blamed this earnings drop on the banks' inability to adjust their loan rates rapidly enough to cover the increase in their own cost of funds. This continued to be a problem in the first half of 1980, with both Dresdner Bank and Commerzbank reporting declining profits, and Deutsche Bank doing somewhat better. Commerzbank told its stockholders to expect a dividend cut.

This is not meant to imply that the banks are in trouble; by comparison with the leading New York commercial banks, they are the Rock of Gibraltar. Last week, rumors circulated in the foreign exchange markets that the Bundesbank would ease the banks' liquidity problems by lowering the minimum reserve requirements.

Recent earnings reports by German corporations show some problem cases. BASF, the chemicals giant, reported a second-quarter profit decline caused by lower sales in domestic and European markets and an ability to pass on the full costs of higher oil and raw materials prices. Group pre-tax profits fell 5.5 percent, but the parent company's profits were down 20 percent. AEG, the giant electrical firm, expects a DM110-200 million loss in 1980, after even worse losses last year, due to declining sales of consumer durables.

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