Structural Changes in German Bank Balance Sheets

Currency Changes the Main Cause.

The main lines of the banks' balance sheets usually remain on the whole stable so long as the currency is stable. At all events the changes which occur during periods of stable currency are not revolutionary. But if the currency situation fundamentally alters, the balance sheets of banks promptly reflect this by certain shifts in emphasis: not only nor even principally through expansion or contraction of the figures, but also and more particularly through a shift in the relationships in which the individual items stand to each other. There will for example be a change in the ratio between the discounts and the advances, or in that between the advances and the deposits. There may also be large movements in the relationship between real estate (including bank premises) and participations on the one hand and the capital resources on the other. All these structural changes either occur suddenly, for example after a currency reform, or else they take place gradually in the course of a persistent deterioration of the currency. In both cases they may produce effects for a period of years or even decades.

In Germany during the last two decades there was first a slow change in the structure of bank balance sheets before and during the second world war, with liquidity increasing in the form of growth of the secondary liquid assets through the taking of Treasury bills and short-term non-interest-bearing securities of the Government (Schatzanweisungen). After the war the 1948 currency reform abruptly changed the structure. In the first place it cancelled out the gradual changes which had taken place as above; and in the second place it created new structural forms which in their turn diverged from the normal line. The rest of this article will deal more or less exclusively with this second set of structural changes, since the first set are hardly producing real effects any longer. The first set moreover were not of a kind peculiar to Germany. Similar changes took place in other countries too, and are still a factor of importance there even now. The best known case is that of bank balance sheets in the United States, where the public debt has grown to a very large size, and has not only become the chief determining factor in the money and capital markets but has also set its mark on the balance sheets of banks.

Bank balance sheets may show structural changes which obviously have nothing to do with currency reforms or alteration in the currency. There were several changes between 1870 and the first world war. The ratio of the capital to the balance sheet total dropped during this period from 40% to 20%. Already at that time this movement was correlated with the rapid rise in deposits, with which the increases in the capital did not keep up. Similarly the advances dropped from between 40% and 50% to between 20% and 30% of the total balance sheet. In a parallel but converse movement the commercial bills and Treasury Bills rose from some 20% of that total to between 40% and 50% and later, during and after the first world war, to as much as 70%. In this latter rise we have evidence of the growth of spurious liquidity which always occurs in times of war and inflation; in other words, this was the rot in the currency setting in.

One sees with special clarity the effect of the first currency reform of 1924 in the break in the trend of the Deutsche Bank's balance sheet structure. In 1920 the advances were down to as low as 15% of the total assets, but in 1924 they jumped up to 30%-40%, and later still higher, while the discounts dropped

from around 70% to 20%. Then, when the second world war impended and eventually ran its course, we find the discounts and advances again moving in precisely the same way as at the time of the first world war.

There have also been structural changes in German bank balance sheets during the latest chapter of the story, that is since 1948. Some of these movements have little to do with the 1948 currency reform, even though they may all be said to have been ultimately due to the shortage of bank capital and reserves caused by that reform, or to the weakness of the capital market. Among the structural changes of this kind, which originated especially between 1950 and 1952 and are connected with the currency reform only in limited measure, one may for instance mention the growth of long-term lendings, the increase of inter-bank indebtedness, or the relatively large rise in the savings deposits.

Shrinkage of Capital and Reserves.

The central feature of the structural change in German bank balance sheets since the currency reform of 1948 is the absolute and relative decrease in the capital resources, caused by the loss of three-quarters or more of the assets as a result of the monetary laws. At the present time efforts are still being made to alleviate to some extent the effect of this drastic reduction of the capital funds. The trouble is that the cut in the capital and reserves in relation to the alien funds does not amount to a single incised wound which can be put right by a single surgical procedure; instead, it is a persistent loss of blood that is going on. In other words, after the currency reform the banks were forced to draw up balance sheets showing the capital and reserves at a very low level; but at the time when these DM opening balance sheets were published the funds of depositors in the banks' hands were also small. Since then these deposits have risen quite fast without the growth in capital resources having in most cases kept pace with that movement. The inevitable result has been that, despite some increases of capital during the period since 1948, the relationship between capital resources and alien funds in the banks' balance sheets has not become better but has on the contrary grown steadily worse.

The trends have however not been the same in all cases. There are some banks which now have not less but more capital and reserves in relation to their deposits than in the DM opening balance sheet for 1948. This in turn is due to the fact that the basic legislation has been amended, inasmuch as some banks were subsequently permitted to draw on their post-currency reform earnings in order to replenish their capital resources to some extent. This will be discussed later in connection with what are called the « global value adjustments ». Other banks, and in particular the nine successors of the former big three with head offices in Berlin, have had the benefit of a certain relief accorded by law: that is to say, they were allowed in their opening balance sheets (which had to be drawn up to show the position at as late a date as 1st January, 1952) to have the advantage of the rise in security prices that had taken place by then. They were permitted to enter the securities at a considerably higher value than that at which they had stood in the balance sheets of the Berlin head offices from which they came, without being compelled to pay full taxes on the gains in value. The help which this gave to the successor banks however did not last long. At present it is particularly in these institutions that the ratio of the capital and reserves to the alien funds is unsatisfactory. There is however an exception in the case of the Berliner Handelsgesellschaft, now at Frankfürt/M. At the end of 1954 this bank, formerly the fifth of the big Berlin banks, showed capital and reserves equal to nearly 10% of the deposits, or 7.1% of the balance sheet total. There are also some banks of a public character with relatively large capital funds.

The naming of these ratios shows that at the present time a proportion of more than 7% of the balance sheet total, or nearly 10% of the deposits, is felt to be exceptionally high. In most cases the corresponding ratios are probably below 5% in the case of the deposits and below 4% in that of the balance

BALANCE-SHEETS OF GERMAN BANKS 1938-1954: ASSETS

Assets	Deutsche Bank				Dresdner Bank				Commerz Bank			
	31.12.1938		31.12.1954 (a)		31.12.1938		31.12.1954 (b)		31.12.1938		31.12.1954 (c)	
	Millions of RM	%	Millions of DM	%	Millions of RM	%	Millions of DM	%	Millions of RM	%	Millions of DM	%
Cash on hand	32.15	0.9	41.09	0.6	21.94	0.8	26.36	0.7	15.82	1.0	17.49	0.6
Balances at Landeszentralbanken	108.09	2.9	565.33	8.6	69.12	2.5	350.98	8.5	28.01	1.8	203.33	6.4
Postal current accounts			14.14	0.2			9.45	0.2			7.26	0.2
« Nostro » Assets	55.30	1.5	430.28	6.7	30.13	1.1	197.12	4.8	14.55	0.9	209.76	6.7
Coupons	14.96	0.4	3.32	0.1	9.25	0.3	0.49	0.01	2.32	0.1	2.73	0.1
Cheques	34.13	0.9	24.94	0.4	35.31	1.3	61.04	1.5	24.34	1.6	58.11	1.8
Bills receivable	835.63	22.3	1494.57	23.1	671.73	24.1	990.33	24.0	398.42	25.6	790.06	25.0
Treasury Bills and Notes	529.67	14.1	30.80	0.5	390.26	14.0	1.89	0.05	140.98	9.0	0.16	—
Investments	461.14	12.3	366.47	5.7	318.28 (d)	11.4	288.91	7.0	161.00	10.3	200.52	6.4
(a) Govt. bonds	(287.67)		(157.03)		(139.53)		(91.68)		(101.33)		(22.93)	
(b) Other bonds	(105.25)		(110.53)		(76.20)		(82.33)		(19.20)		(87.75)	
(c) Shares	(36.26)		(92.09)		(73.69)		(109.96)		(31.30)		(77.30)	
(d) Other securities	(31.96)		(6.79)		(21.95)		(4.93)		(9.17)		(12.55)	
Equalisation Claims	. .	. .	436.14	6.7	. .	. .	244.42	5.9	. .	. .	116.42	3.7
Participations in Syndicates	34.49	0.9	49.56	0.8	43.62	1.6	13.91	0.4	16.53	1.6	2.02	0.1
Contango loans	2.99	0.08	—	—	1.43	0.05	—	—	2.97	0.2	—	—
Advances against commodities	142.46	3.8	—	—	58.03	2.1	—	—	48.69	3.1	—	—
Loans and advances	1353.85	36.1	2313.08	35.7	1008.91	36.2	1467.72	35.5	628.99	40.4	1129.49	35.8
(a) Banks	(44.01)		(171.54)		(75.97)		(148.97)		(10.34)		(61.33)	
(b) Other	(1309.84)		(2141.55)		(932.94)		(1318.75)		(618.65)		(1068.16)	
Long term loans	10.35	0.2	456.95	7.1	22.32	0.8	325.41	7.9	10.81	0.6	280.65	8.9
Transitory credits	. .	. .	89.05	1.4	6.25	0.2	30.83	0.8	0.03	—	43.16	1.4
Participations	51.01	1.4	27.93	0.4	42.06	1.5	27.71	0.7	8.07	0.5	17.31	0.5
Premises	81.17	2.2	92.59	1.4	55.07	2.0	80.03	2.0	51.53	3.3	60.17	1.9
Furniture	—	—	7.80	0.1	—	—	7.50	0.02	—	—	9.45	0.3
Other assets	0.04	—	22.25	0.4	0.29	0.01	6.41	0.01	—	—	6.02	0.2
Correction items	0.71	0.02	6.56	0.1	1.03	0.04	0.43	0.01	0.57	—	0.20	—
Total	3748.15	100.00	6472.18	100.00	2785.02	100.00	4130.92	100.00	1553.65	100.00	3154.38	100.00

BALANCE-SHEETS OF GERMAN BANKS 1938-1954: LIABILITIES

Liabilities	Deutsche Bank				Dresdner Bank				Commerz Bank			
	31.12.1938		31.12.1954 (a)		31.12.1938		31.12.1954 (b)		31.12.1938		31.12-1954 (c)	
	Millions of RM	%	Millions of DM	%	Millions of RM	%	Millions of DM	%	Millions of RM	%	Millions of DM	%
Deposits	2744.00	73.2	4682.60	72.3	1883.76	67.6	3051.57	73.9	1035.72	66.7	2339.79	74.2
Saving deposits	408.65	10.9	759.13	11.7	274.17	9.9	419.01	10.1	183.33	11.8	323.87	10.3
« Nostro » Liabilities	124.38	3.4	95.57	1.5	150.86	5.4	80.49	2.0	76.25	4.9	67.44	2.1
Acceptances on a/c of customers	233.87	6.0	12.56	0.2	228.90	8.2	—	—	152.92	9.9	14.23	0.4
Loans taken up for long periods	0.08	—	360.79	5.6	0.66	—	210.98	5.2	0.07	—	157.07	5.0
Transitory borrowing	. .	. .	89.05	1.3	6.25	0.3	30.83	0.7	0.03	—	43.16	1.4
Capital	130.00	3.5	100.00	1.6	150.00	5.4	93.00	2.3	80.00	5.1	67.50	2.1
Reserve Fund	45.50	1.3	100.00	1.6	23.50	0.8	72.00	1.7	10.00	0.6	33.00	1.0
Pension Fund	21.00	0.6	98.20	1.5	16.00	0.6	69.48	1.6	5.25	0.3	95.44	3.1
Special Reserves	9.22	0.2	108.79	1.7	36.70	1.3	91.70	2.2	2.39	0.2		
Correction items	22.47	0.7	18.31	0.3	2.54	0.1	3.52	0.1	1.18	0.1	4.23	0.1
Net profit	9.98	0.2	9.39	0.1	11.68	0.4	8.37	0.2	6.52	0.4	5.88	0.2
Other Liabilities	—	—	38.43	0.6	—	—	—	—	—	—	2.75	0.1
Total	3748.15	100.00	6472.81	100.00	2785.02	100.00	4130.92	100.00	1553.65	100.00	3154.38	100.00
Guarantees	287.77		643.75		207.99		484.70		83.07		304.42	
Liabilities in respect of endorsements	156.17		544.36		105.78		422.27		74.64		332.34	

(a) Balance-sheet totals for the successor Banks: Norddeutsche Bank of Hamburg; Rheinisch-Westfaeliche Bank of Düsseldorf; Süddeutsche Bank of Munich. The comparability with the original Bank is affected by the fact the present balance-sheets of the successor Banks include reciprocal clearing accounts, which should be eliminated if the three Banks were considered as a single Bank. Therefore, the sum of balance-sheet totals for the three successor institutes is to a certain extent artificially inflated.

(b) Balance-sheet totals of the successor Banks: Hamburger Kreditbank of Hamburg, Rhein-Rühr of Düsseldorf, Rhein-Main-Bank of Frankfürt am Main. The same considerations apply as per Note (a) above.

(c) Balance-sheet totals of the successor Banks: Commerz-und Diskonto Bank of Hamburg; Bankverein in Westdeutschland of Düsseldorf and Commerz-und Credit Bank of Frankfürt am Main. The same considerations apply as per Note (a) above.

(d) Of which RM 6.91 million in Pension Fund bonds.

sheet total. If one compares this with the fact that as late as 1913 the capital and reserves of the large Berlin banks amounted to 24.13% of their alien funds, the scope of this first and most significant structural change in the balance sheets of the German banks becomes obvious.

As is known, bank capital is further enlarged by internal reserves which every bank takes care to accumulate. In Germany in particular the internal reserves of many banks used in the past to exceed those published. But the 1948 DM opening balance sheets of the German banks cannot have contained any undisclosed reserves, for the simple reason that the banks' liabilities were much larger than the remaining assets all along the line. There was a big gap which had to be made good through help provided by the Government. Without that help the banks would not have been able to show any capital or reserves at all in their opening DM balance sheets. In other words, with certain exceptions, they could not have been kept alive. It is true that the wide gap in the statements of position at the time of the currency reform arose more or less exclusively because the German banks' principal assets had been Treasury bills, Treasury Bonds or other claims on the Government which were cancelled by the monetary legislation. If therefore the Government's help in connection with the currency reform did enable the banks to show some capital funds, even though of abnormally small size, this was something in the nature of a small recompense for the sacrifices which the banks had been made to incur for the benefit of the Government during period of armament and war.

The Bottleneck in Liquidity since 1948.

The balance sheets of the German banks reflect their lack of capital resources in a number of ways. So far we have mentioned only the ratio of the capital and reserves to the deposits or to the balance sheet total. But that is merely the reflection which can be seen even by observers who have not much practice in the study of relationships between bank balance sheet items. Apart from that there are a number of more detailed criteria which also provide bases for measuring the structural changes that have taken place in German bank balance sheets. From among these let us take two, namely the amount of the acceptances on the one hand, the book value of the real estate, buildings, office furniture and equipment on the other.

(a) *Acceptances.*

Since the currency reform bank acceptances have had an important function in the German economy. They are the instrument by which people have been able to procure working funds again in a period during which liquid resources had largely disappeared, so that the use of these working funds has enabled them in a second stage to start rebuilding their own capital resources. True, this increased use of the bank acceptance has not conformed well with sound principles of banking policy. Acceptances are normally the most dangerous liabilities because they are in a sense due on demand, and for the sake of its standing no bank can afford to dishonour its own acceptance. For this reason acceptance liabilities exceeding the total capital resources amount to a sheer monstrosity. Of course acceptances even of that size may in certain circumstances be justifiable provided that the state of affairs is merely temporary, since every bank has the power in case of need to draw on and mobilise resources other than its own reserves. In the German bank balance sheets since the currency reform, however, the liabilities on acceptances exceeded the capital and reserves not merely by a more or less trifling margin, but several times over. The Central Bank Council of the Bank Deutscher Länder, which is the highest authority on credit policy in the German Federal Republic, adopted a new expedient at an early stage in order to help towards restoring normal relationships between items in bank balance sheets after the currency reform. It laid down certain guiding principles in regard to credits, setting limits beyond which a bank could not go without incurring censure and sanctions. These guiding principles related to the ratio between credit institutions' lendings on the one hand and their capital resources on the other, or in other cases to the ratio between the total liquid resources and the alien funds. Special attention was paid to the acceptances. Significantly enough, the rule originally laid down for these was that the total of the acceptances should not exceed seven times the capital and reserves. Even now the limit is still three times these latter, although only if the funds procured thereby serve directly to finance foreign trade or harvesting; otherwise the acceptances and drawings on debtors together must now not exceed the total capital resources.

On the whole it must be said that the structural change consisting of inflation of the volume of acceptances is now almost a thing of the past. Not only have matters in that respect by now returned to normal, but the pendulum has even swung the other way. As a result of the repeated public references to the danger of high liabilities on acceptances many banks have now gone to the other extreme of showing, so far as possible, no acceptance liabilities at all in their balance sheets. True, they still give acceptances; but they do their best to have the whole of these in their own hands on the balance sheet date. This might well be regarded as showing over-anxiety because the bank acceptance, in itself, is not objectionable as a means of providing funds. In earlier times indeed the « Privatdiskont » or prime bank acceptance was an important item on the German money market, and was favoured by the banks themselves as a vehicle for the employment of their funds. It is only the creation of too many bills accepted by banks that is wrong.

(b) *Premises and Office Equipment.*

Let us now look at the second of the ways in which we said that the shortage of capital resources shows in bank balance sheets, namely in the high level of the real estate (including bank premises) and the office furniture and equipment. That feature has certainly not yet disappeared. Inventories are normally unimportant in bank balance sheets, since banks do not carry stocks of goods. The real estate holdings of banks however ought also to be kept within narrow limits for reasons of liquidity. Banks of course have office buildings of their own, some of which are actually needed for keeping up appearances where the bank is a large one. But not even an appreciable part of the capital and reserves ought to be employed in real estate and for this purpose long-term or unrealisable participations should be equated with real estate. After all, the fact that the capital and reserves have to serve as a safeguard for depositors means that they must be employed in assets of a certain liquidity. By international customs therefore banks normally treat their own premises as the first items to be written off, so that their real estate holdings stand in their balance sheets at book values differing by a more or less wide margin from the actual current value of the buildings. Yet the present-day balance sheets of the German banks are still far from having reached that position. In the balance sheets as at the close of 1954 the real estate and participations, expressed as a proportion of the capital and reserves, amounted to beween 54% and 65% at the successors of the Deutsche Bank, to between 65% and 66% at those of the Dresdner Bank, and to between 63% and 94% at those of the Commerzbank. It is true that in relation to the balance sheet totals the real estate and participations held by the German banks cannot be described as excessively large. Still, there are cases in which they exceed the capital resources in amount. Clearly these unfavourable relationships between the real estate and the capital funds are chiefly due to the latter being too small. They of course also result from the fact that the war-time destruction obliged the banks to rebuild their office premises on a scale that is probably without precedent in the history of banking. If the German banks had kept their premises intact throughout the second world war, as they did throughout the first, then no doubt their good earning power would by now have enabled them to establish a more appropriate relation to the capital and reserves. At the least, if the banks' buildings had emerged intact from the war, this would have enabled them to write off the whole of their office furniture and equipment in the way that is customary among banks in all countries. In this connection also it must of course be remembered that the German banks were forced when they built new offices to procure fresh furniture and equipment for them as well, because this also had been largely lost owing to the war. There is no doubt that the German banks would have written off the whole of their furniture and equipment by the time when they published their opening DM balance sheets in 1948, or at all events, as in the case of the successors of the big three, when they did so in 1952, if the capital and reserves remaining in their hands had been large enough to permit such writing off. However, they were not. That is why the successors of the Deutsche Bank entered the office furniture and equipment in their opening balance sheet at DM 19.6 million, or no less than 13.3% of the capital and reserves; those of the Dresdner Bank at DM 7.71 million or 7.3%; and those of the Commerzbank at DM 5.3 million or 9.6%. By now these high values for the office furniture and equipment as assets have been appreciably reduced; but even in the 1954 balance sheets the successors of the Deutsche Bank still showed DM 7.8 million, those of the Dresdner Bank DM 7.5 million, and those of the Commerzbank DM 9.45 million for these items. In the case of the Commerzbank group indeed there has been no decrease in them at all since the opening balance sheet, but a steady increase. At the Dresdner Bank there was also for a time a rise in the office furniture and equipment, from DM 7.7 million to DM 11.6 million. Hence, although the book value of the office furniture and equipment is usually an insignificant item in bank balance sheets, a structural change such as the one in this German example can make it a typical sign of unusual circumstances.

« Equalisation Claims » (Ausgleichsforderungen) as an Aid to the Capital Rebuilding.

The loss of capital and reserves through the 1948 currency reform was in part made good by handing to the banks Equalisation Claims on the Federal Government and the Lands. Their inclusion among the assets in the banks' balance sheets produced in these latter a structural change which came to be of substantial importance in more than one respect. In the first place the very size of the new item gave it a corresponding importance. At the middle of 1950, being the first date for which complete statements of the credit institutions were available after conversion into the new currency, the Equalisation Claims received by the banks and savings banks amounted altogether to DM 5,270 million, or 21.1% of the combined balance sheet total. At the commercial banks in the narrower sense of that term they were somewhat lower at 15.4%, but appreciably higher in the case of the savings banks at 35.5%, and in that of the credit cooperatives at 33.7%. The credit institutions would no doubt have welcomed it very warmly if by this means they had either obtained a new asset bearing an adequate rate of interest, or had been given fresh liquid resources, for which they had a most pressing need after the loss of liquidity due to the currency reform. But in both these respects the Equalisation Claims were disappointing. Rather than making matters easier for the banks they amounted if anything to a burden. As to the rate of interest, this was limited in the great majority of cases to 3%. At that time, when the rate of interest on bank loans in Germany could be estimated at 10% or higher 3% was certainly not lucrative for the banks nor even a basis on which they could work at all. In fact, they actually had to pay their depositors sometimes interest at even higher rates, especially on savings deposits. And it was precisely those institutions which collect savings deposits on a large scale that had the highest proportions of Equalisation Claims, namely the savings banks and the agricultural credit cooperatives.

Moreover, the Equalisation Claims did not even represent a liquid investment, since they were unsalable: that incidentally followed from the mere fact that in 1948 a 3% claim on the Government could hardly have been valued at over a half of its par value. (The parity price of 100% at which they had to

be shown in the balance sheets was of course fictitious). Besides this, the selling of Equalisation Claims was permitted only in one single eventuality. This was that the banks were allowed to sell them to the Land Central Banks at par for the purpose of replenishing their liquid resources. They were however obliged to take an engagement to repurchase the Equalisation Claims when their liquidity improved again. Sale to the Land Central Banks thus entailed a virtual admission that the bank had reached the limit of its own liquidity, a thing which of course no bank likes to admit. Still, out of the above-mentioned DM 5,270 million of Equalisation Claims which the banks showed at the middle of 1950, some 10%-11% had been sold to the Land Central Banks. By now they have all been repurchased apart from small residues. It can be assumed that the total sold to the Land Central Banks for the purpose of improving liquidity amounted at the peak to not quite DM 600 million; but as at the close of July, 1955 only DM 44 million of the Equalisation Claims thus temporarily sold to the Land Central Banks still remained in the latter's hands.

Meanwhile the liquidity of the German banks has been built up. Only in exceptional cases do they still need to fall back on their Equalisation Claims. But there has also been a change during the past five years in regard to the volume of these latter. The Equalisation Claims no longer form a large block and blocking part of the German banks' assets; instead, they now represent merely one of the less important items in the balance sheets and this came to pass though their total amount has become greater and not smaller. At the middle of 1955 the total was just DM 6,130 million. But this was no longer 20% or 30% of the balance sheet total; it was no more than 6%. Even at the savings banks the ratio to the balance sheet total had dropped to 11.6%, and the credit cooperatives to 11.9%, while among these latter the agricultural credit cooperatives alone still had Equalisation Claims amounting to 14.8% of their balance sheet total. For these last institutions the Equalisation Claims accordingly still constitute an appreciable drag on liquidity.

Another special group of institutions for which the Equalisation Claims used to be decisively important, whereas they are now merely a minor item, is the mortgage banks. After the currency reform these were hit harder than other banks in three respects. Firstly, because they had lost their liquidity like the rest; secondly, because they could not claim capital or interest from their debtors in full, the public authorities having taken nine-tenths of these, quite apart from the war-time damage to the house property forming the security for their loans; and thirdly because they had to bear the consequences of the detaching of the German Eastern territories, including those to the East of the Oder-Neisse line. The claims on debtors in these territories were completely lost. Without Equalisation Claims it would have been even harder to restart the business of these banks than of others. They too were obliged to take a good deal of the liquidity assistance that was legally allowed through the temporary sale of Equalisation Claims to the Land Central Banks. Besides this a further special privilege had to be granted to them, inasmuch as the interest on their Equalisation Claims had to be paid at the rate of 4½% instead of 3%. If it had not been, then these institutions would have had to pay an additional 1% out of their own resources in order to meet the interest on the bonds (mostly mortgage bonds) issued by themselves, since these latter bore interest at 4% and continued to do so. No doubt the changes in the structure of balance sheets of the German mortgage banks were among the greatest of all. That still remains true at the present day. But now it is true not so much because of the Equalisation Claims and lack of liquidity, but on the contrary owing to an unprecedented liquidity surplus. The German mortgage banks in fact had a quite unique revival in 1953 and 1954. Their issues of bonds reached a record level. This brought down the ratio of Equalisation Claims to their balance sheet totals much more even than for the average of all banks. At the middle of 1950 the mortgage banks had 21.1% of their balance sheet total employed in Equalisation Claims, this being just the same as the average for the banks as a whole. By the middle of 1955 however the proportion was down to 4.0%, while the cash in hand and at banks amounted to 14.0%. This latter ratio is unusual for these specialised banks since they do not take deposits and therefore need no liquid reserves for their creditors.

Minimum Reserves and Liquidity.

The uninitiated layman might be inclined to equate Equalisation Claims, representing claims on the Federal Government and Lands as they do, with say Government bonds. He would therefore count them among the securities as a whole. That however, for reasons which have already been indicated, would be to misconceive the structure of German bank balance sheets. As Equalisation Claims cannot be sold at all they are certainly not securities in the ordinary sense, since the chief feature of these latter is precisely that they can be realised with relative promptness. Then ought one to reckon these claims on the public authorities as an addition to the advances? That would not be right either. They are an asset that is unique of its kind. All things considered, they amount to a long-term investment of the banks; and as such they are an extraneous element in the balance sheet of a commercial bank, which ought to show only a small amount of investments running for a number of years. We shall deal later with the structural change as compared with earlier times that has thus taken place in the balance sheets of German banks, namely through the fact that the long-term lendings are now incomparably greater than in former years.

Long-term investments reduce liquidity. Since they have now become more prominent than before at the German banks, in spite of the fact that the 1948 currency legislation had already entailed a drastic cut in the banks' liquid resources, one of the first things which had to be done in the field of credit policy was to pass legislation dealing with the banks' liquidity. This was done by instituting the system of minimum reserves — a system not previously known in Germany. Let it here be said that the writer of this article of course knows how far these minimum reserves are to be regarded as a reserve of liquidity, and how far they amount to an instrument of credit policy. Be that as it may, there is no doubt that the instituting of the minimum reserves produced a structural change in the German banks' balance sheets, and that it is therefore proper to mention them in this article. One result of the commercial banks' maintaining minimum reserves at the Land Central Banks has been that the cash reserves held in bank balance sheets at the present time are much larger than before either world war.

What is regarded as the cash reserve, or primary liquid reserve, in the balance sheets of German banks is the total of their notes and coin, balances at Land Central Banks and balances on postal cheque account. The maintenance of cash reserve is of course not reflected solely in the item « balances at Land Central Banks ». But since that item is usually by far the largest among the three mentioned, the movement in it does run parallel with that in the cash reserve as a whole. In earlier German bank balance sheets there were no balances at Land Central Banks because these latter did not exist. Essentially, the present balances held at them are the same as what balances at the Reichsbank or other Central Banks always were. In earlier times however there was no inducement to increase interest-free Central Bank balances, or cash holdings or balances on postal cheque account, to more than the minimum; on the contrary, considerations of profit tended all the time to keep the cash reserve down as much as possible. Since 1948 however it has been required by actual legislation that the cash reserve, or to be precise the balances at Land Central Banks, shall not be allowed to fall below the minimum ratios fixed by the Centralbank Council of the Bank Deutscher Länder. At present, in September, 1955, these ratios are 9%-12% for the sight deposits, 6%-8% for the time deposits and 5% for the savings deposits. By law the required ratios can vary from 8% to 20% of the sight deposits, and from 4% to 10% of the time and savings deposits. Up till now the top rates in these spreads as fixed by law have never been reached. Hitherto the figure has not gone above 15% for the sight deposits and 8% for the time deposits.

Since 1st May, 1952 the distinction has been no longer on the basis merely of the period to maturity of the liabilities carrying the reserve obligation, but according to other criteria as well. Even as early as 1948, or virtually from the outset, a distinction was made between sight deposits at the main banking centres and those at other places in much the same way as in the United States. Apart from that, however, a further distinction based on the size of the individual credit institutions was instituted as from 1952.

While the total primary liquid resources as shown in the end-of-month balance sheets during the year remain below the minimum requirements, the end-of-year balance sheets show a large rise above the average as a consequence of window-dressing . The expert may regard that fact as being of secondary importance on the ground that the end-of-year balance sheet is merely a snapshot picture. If however one sets out to consider the change in the structure of bank balance sheets, one is bound to look especially at what the balance sheets show on the closing day of the year; and moreover the present higher level of the cash reserve in German banks is in fact for the most part present throughout the year. Whereas in earlier times the cash reserve ratio in German bank balance sheets was not usually much above 5%, while in the course of the year it would not be much over 2%, it now reaches 9% to 10% at the end of the year and as much as 5%-7% or even more in the course of the year. To take the end of 1954 alone, for instance, the balances at Land Central Banks were equal to 9% of the deposits at the Rheinish-Westfälische Bank, to 11.9% at the Süddeutsche Bank, to 8.3% at the Rhein-Main Bank and to 8.2% at the Bankverein Westdeutschland.

Summarizing: by and large the introducing of the minimum reserve system after the 1948 currency reform caused a change in the structure of German bank balance sheets, inasmuch as cash reserves approximately twice as great as before are now maintained.

The Rise in Long-term Bank Lendings.

In the balance sheets of banks there has appeared since 1948 an item which was previously important only in the case of the specialised institutions. It is the long-term lendings. According to the definition now in force this item has to include all those loans which run for more than four years. The granting of loans running for periods as long as that was previously the function of public and private mortgage banks or of central giro institutions and savings banks, this being because those specialised institutions also procured their funds in a different way. That is to say they took no deposits withdrawable at short notice, but mainly confined their business to the taking of savings deposits and the issue of bonds. For a commercial bank the granting of a long-term loan always presents a problem of liquidity, more especially since every bank has in any case among its assets certain items of low mobility such as premises and participations, which are usually financed out of its capital and reserves. Now that long-term loans are being granted as well, this is all the more serious a matter for the German banks because at the present time, as has been repeatedly pointed out, they have capital and reserves of only relatively small amount. If one looks at the banks' mid-year statements in 1952 and 1955, one finds in the first place that for all banks together the long-term loans rose from 20.5% of the balance sheet total in the first of those years to 30.0% in the second. That however includes the mortgage banks and savings banks, in the case of which this rise reflects only the growth of their normal business. If one takes the movement at the commercial banks alone, one finds that in their case during the period mentioned the increase was from just under 8% to just under 11% of the balance sheet total, while in absolute terms the amount was nearly trebled, rising from DM 1,200 million to DM 3,100 million. It must of course be borne in mind that on the liabilities side of balance sheets also one item has become important which did not previously exist in the same form, namely the borrowed funds for periods of over four years. The funds so taken by the commercial banks rose from DM 796 million at the middle of 1952 to DM 1,955 million at the middle of 1955, or from 5.2% to 6.8% of the balance sheet total — a rise which, however, does not approach that of the corresponding items on the assets side.

In conclusion, the German banks have gone in for long-term lending on a comparatively large scale. This can be regarded as a consequence of the weakness in the capital market since the currency reform. Still it is remarkable that, as the capital market grew stronger, the long-term lendings have not decreased as one would have thought they ought to — at least relatively — in such circumstances, but have on the contrary been increasing in both absolute and relative terms. Clearly, if that rise continues, it may create a new set of problems. That is in fact realised by the German banks; and during the next few years the movements in these items in particular will be followed with special attention.

«Global Value Adjustments» (Sammelwertberichtigungen) — a Means of Replenishing Capital Resources.

In connection with what is doubtless the most important of all the structural changes, namely the relative and absolute decrease in the German banks' capital resources, it is worth while to glance briefly at two further items in the present balance sheets of German banks. One is what is known as the « global value adjustment »; the other is the pension fund.

The global value adjustment is shown visibly in German bank balance sheets only in part, because the banks have the option of either showing it among the liabilities or deducting it from the assets and so not showing it at all. Many banks have used both methods, not only writing off amounts from the assets, but also entering an item for value adjustment among the liabilities. The process forms part of the subject of structural changes in the balance sheets of German banks because this global value adjustment has provided one of the lawful means, to which reference has already been made, of building up the capital and reserves that had emerged too small from the 1948 currency reform. In point of fact earlier German bank balance sheets also used to include such a global value adjustment in addition to the individual adjustment of values, and it too used to be applied in both visible and undisclosed form. This device of the global value adjustment affords the banks a certain relief from taxation. Amounts which are taken out of the year's earnings for the purpose of such adjustment are free from tax up to a certain amount. After the 1948 currency reform, indeed, the maximum permitted levels for such global value adjustments were actually raised above what they had previously been. Such adjustments could accordingly be applied at 1½% as against 1% previously to discounted bills, guarantees and the bank's own liabilities on endorsements, and at 3% as against 2% to the advances as well as to claims arising from documentary credits and from loans against securities. Where the claims arose from foreign trade, these rates of 1½% and 3% were increased by a further 1% for the financing of imports and by a further 1½% for that of exports. Such supplements for claims in respect of foreign trade had been previously unknown. Private bankers, as distinct from the remaining credit institutions, were permitted to apply still higher rates of global value adjustment without attracting tax, namely 2½% as against 2% previously for discounted bills, guarantees and endorsement liabilities, and 5% as against 4% for claims arising from advances, contango loans and other loans against securities. The private bankers were moreover allowed in the case of claims in respect of foreign trade to raise the rates by 1% or 1½%. Thus they were able to enter up to 6½% of those claims free of tax in the « del credere » reserve, that is to say the reserve against contingencies; and they could do so quite without regard to what risk the individual claims might entail. In other words good and bad risks were treated alike. It still remained open to the banks

to apply individual value adjustments to the bad risks in addition. This gave rise to a quite substantial untaxed reserve, the only disadvantage being that the tax had to be eventually paid when the value adjustment was liquidated. But now for that a special solution was found. When the permitted rates of global value adjustment were cut by a half with effect from 1st January, 1953, a regulation having the force of law was issued providing that the sums so released could be used for increasing the capital and reserves, while the liability to tax on them was further postponed. From this source the banks were able to increase by proportions ranging up to 100% their capital and reserves as these had provisionally stood after the currency conversion: that is to say, they did this out of the profits earned on their business during the first few years after the currency reform, and did so with the benefit of a certain fiscal concession.

The global value adjustments increase the totals of bank balance sheets only in so far as they are shown, which means in practice that a part of the adjustment does not increase the balance sheet total. Nevertheless in present-day bank balance sheets the reserves for special purposes and value adjustments are an element of a size which cannot fail to attract attention. In the interim statements published by the Bank Deutscher Länder the capital funds of all credit institutions, including their reserve funds, amounted at the middle of 1955 to a total of DM 3,330 million. But the other reserves, which include reserves for special purposes and value adjustments as well as certain reserve funds not comprised in the capital and reserves in the legal sense, were as much as DM 5,560 million. And if one takes the figures for individual groups, say for the commercial banks, the savings banks or central giro institutions, one still may see that these special reserves exceeded the capital and reserves; they did so by the widest margin at the savings banks, where as against capital funds of DM 450 million there were such special reserves amounting to DM 1,120 million. This after all is not surprising, because the German savings banks have no capital such as a private company has. The safeguard for their depositors lies in the local authorities' guarantee.

The chief component among these large reserves for special purposes would seem to have been the pension funds, which all German banks have been energetically rebuilding since the currency reform. It is understandable that they should do this in view of the high rates of taxation, since allocations to the pension fund are not subject to tax. The following examples may serve to show the size of the pension reserves at the end of 1954. At the Rheinisch-Westfälische Bank they amounted to DM 36.39 million, with capital and reserves at DM 80 million; at the Süddeutsche Bank they were as much as DM 43.23 million, with capital and reserves at the same figure as for the Rheinisch-Westfälische; at the Bayerische Hypotheken-und-Wechsel-Bank DM 49.77 million against DM 54.21 million of capital and reserves; and at the Bayerische Vereinsbank DM 18.42 million against capital and reserves of DM 29 million. It has been repeatedly stated that these large pension reserves represent a kind of substitute for missing capital funds, because the banks do not really draw on their pension funds but take the pensions actually payable from current earnings. This way of looking at the matter is however of course incorrect, inasmuch as a pension fund cannot be used to cover losses if the need should arise. In any case the pension funds at their high ratio to the capital and reserves no doubt do also constitute a not unimportant feature of the structure of German bank balance sheets at the present day. The change of this proportion since prewar times is of course due to the circumstance, which have been more than once emphasised, that after the 1948 currency reform the German banks' capital and reserves were much smaller than could be called adequate.

The Bank Deutscher Länder's Guiding Principles in regard to Credit.

Mention has already been made of the work the Bank Deutscher Länder has done to lay down certain permitted ratios between the chief balance sheet items, the object being to restore a normal aspect of German bank balance sheets, which after the currency reform were showing a certain abnormality for the reasons previously described. This needs are to be borne in mind when one looks at these guiding principles, because the ratios for which they provide are not normal. By and large it can be said that the normal ratios in bank balance sheets ought in general to be « better » than according to the guiding principles, that is to say « better » in the direction of greater liquidity. The guiding principles were first drawn up in January, 1951, and have since been altered several times. The effect of the changes was in every case to make them stricter. The most important change has already been pointed out, namely the lowering of the upper limit for the banks' own acceptances in circulation from seven times to three times the capital resources, and finally its lowering to 100% of those resources for the ordinary business. The term used for the capital resources is not « *Eigenkapital* » (capital and reserves) but « *Haftende Mittel* » (liable funds), the reason being that not only the capital and reserves but also the global value adjustments can be included. The meaning of the global value adjustments has already been explained.

The very drawing up and amendment of the guiding principles in regard to credits has in itself amounted to an instrument for changing the structure of bank balance sheets, and therefore forms a proper part of the subject of this article. But the most interesting point about these guiding principles is that by going over them as a whole one can as it were recapitulate the structural changes in German bank balance sheets by comparison with earlier times, and especially by comparison with the period before the second world war.

(a) *Principle I* states that the total of the short-term and medium-term credits to *business and private customers* shall not exceed 18 times the « liable funds » of the commercial banks. For other credit institutions this limit is slightly varied, to 15 times for the savings banks and credit cooperatives and to 20 times for the central institutions of agricultural credit cooperatives. The first noteworthy point here is that the amount of the lendings is stated in relation to the capital resources. The function of those capital resources in banks is in the first place to serve as a safeguard for the depositors; that is why one normally looks at them first in any bank balance sheet, so as to see in what relation the capital resources stand to the borrowed funds. It is significant that the guiding principles have not dealt at all with this most important ratio in a bank balance sheet. This in fact indicates that owing to the inadequate size of the capital and reserves after the currency reform the position on that point was so shaky that there was no prospect of its being possible to force bank balance sheets to show a reasonable ratio. Yet, because the capital and reserves should not be entirely abandoned as a yardstick, they were used for measuring the lendings of the bank; and thus at the same time, precisely because the capital and reserves were small, a handy arm of a lever was provided to ensure that the banks' expansion of credit should not go too far. The actual requirement that no more than 18 times the so-called « liable funds » shall be lent by the banks is not hard to meet. This becomes clear if one turns the ratio round. The effect then is that the « liable funds » need not amount to more than 5½% of the lendings considered; and, if one assumes that the lendings in turn amount to roughly half the deposits, this means that the capital and reserves need not be greater than 2¾% of the deposits. From this it is clear that allowance has been deliberately made for the structural inadequacy of the banks' capital resources resulting from the special circumstances that followed the second world war.

(b) *Principle II* deals essentially with the same relationship, merely extending on both sides the bases of comparison. The standard taken is no longer only the short-term and medium-term credits to business and private customers but the *whole* of the lendings, which in German are usually described as the « Debitoren » or « debtors ». And similarly it is no longer only the « liable funds » that are used for comparison, but the « liable funds » plus the deposits. The guiding principle as laid down for the commercial banks states that the total of the debtors, defined as credits in current account and acceptance credits, shall not exceed 60% of the liable funds and deposits of the institution. For the savings banks the limit is 50%, and for the other groups of credit institutions either 70% or 80%. This again can be called a somewhat over-sized garment leaving plenty of room. And the more the balance sheets of German banks returned towards normal, the more over-sized this garment was bound to become. Some of the German banks are already well below the limit laid down. For instance the 1954 balance sheet of the Rheinisch-Westfälische Bank showed capital and reserves (without global value adjustments) at DM 80 million and deposits at DM 2,245 million against « debtors » at DM 931 million, so that the « debtors » were equal to some 40% of the liable funds and deposits. At the other successor banks the relationships were similar. At nearly all the successors of the big three indeed the proportion was below 60% if one compared the debtors not with the total of the deposits and capital resources, but only with that portion of the deposits which is known as the « customers' deposits », that is to say the total deposits less those of banks. In this respect the position at the large commercial banks in Germany has already returned to normal in quite large a measure, so that it is hardly possible to speak any longer of structural change as compared with normal relations. That however is simply due to the fact that in calculating the ratio of the debtors to the customers' deposits no account is taken of the capital resources, which are the weak spot in German bank balance sheets.

(c) *Principle III* specifies a liquidity ratio. It says that the total of the liquid resources of the commercial banks shall not be less than 20% of the « borrowed » funds. At some of the other groups of credit institutions the limit is 15%, with the added proviso that savings deposits are to be taken at the rate of only 50% when the total of the « borrowed » funds is calculated. In absolute terms the ratio of 20% for liquidity might appear relatively high. If however one looks at the definition of « liquid resources », this ratio appears in a different light. For the purposes of this guiding principle the liquid resources are defined as comprising cash, balances at Land Central Banks, postal cheque balances, cheques and bills, Treasury Bills and non-interest-bearing Treasury Bonds of the Federal Government and the Lands. Except for nostro balances at banks and securities eligible as collateral for Central Bank advances, therefore, this list includes the whole of the secondary liquid resources. The great extent to which matters have changed by comparison with earlier times is shown by the the simple fact that the German Banking Law of 1934 laid down that the required primary cash reserve could be as high as 10%, while in addition a secondary reserve of up to a further 30% might also be required. The « borrowed funds » are nowadays defined as comprising deposits, moneys moneys and loans taken, and the bank's own acceptances in circulation.

(d) As to *Principle IV*, this has already been discussed; it deals with the ratio between the acceptances in circulation and the capital resources.

This concludes our general survey designed to show the various structural changes in German bank balance sheets. It will have been seen that the balance sheets of German banks, like those of banks in other countries, go through appreciable changes even in years of undisturbed economic conditions. Changes of a far-reaching kind are however caused only by wars and by the currency deterioration which follows them. Of such changes there are many signs in the bank balance sheets of Germany. The last currency reform of 1948 is still producing its effects even now. Its main effect on bank balance sheets was to destroy the capital resources to the extent of pratctically 100%. This blow was to some extent alleviated by the provision of fresh assets, created for that particular purpose, in the form of Equalisation Claims on the Federal Government and the Lands. But the amount of this substitute for the cancelled claims on the former Reich was limited, with the result that the banks' newly arising capital funds came to be relatively too small. Since then the banks have done a good deal to close that particular gap, both by reinforcing their reserves out of the annual profits and by increases of capital through issues of new shares. Since however the deposits have grown unusually fast during these post-war years, it has in most cases not yet been possible to restore entirely normal relationships between the banks' own resources and their borrowed funds. As will have been seen, when one looks at the banks' balance sheets this shortcoming is apparent in a number of consequent features.

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