

The Situation of German Banks during (Hyper-) Inflation

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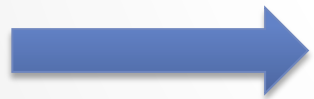
Outset

1. Germany had suspended the gold convertibility of its currency to pay for World War I.

2. The War was financed through borrowing and led to a steady decline of the value of the Mark against the dollar.

3. The Treaty of Versailles demanded reparations to be repaid in either gold or foreign currency.

- Reparations accounted for 10% of the German GDP from 1920 – 1923.
- Without the necessary gold reserves the government bought the foreign currency necessary to pay the debt with Mark.
- The government intended to finance the state through a combination of printing more money and running a constant high budget deficit.



This strategy of course increased the amount currency in circulation and likewise reduced its value.

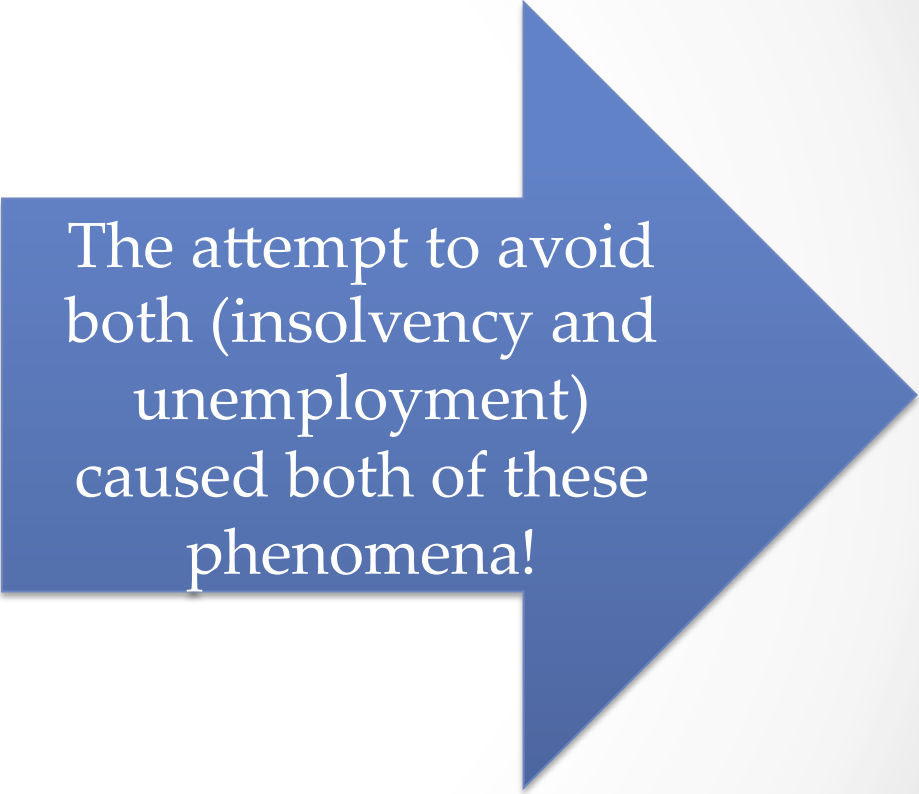
- In August 1921 Germany purchased foreign currency at any rate – in so doing only increasing the speed in which the Mark declined in value.
- An international reparations conference was called in, but could not find a workable solution.



TRUST WAS LOST

The government and the banks had 2 alternatives how to react:

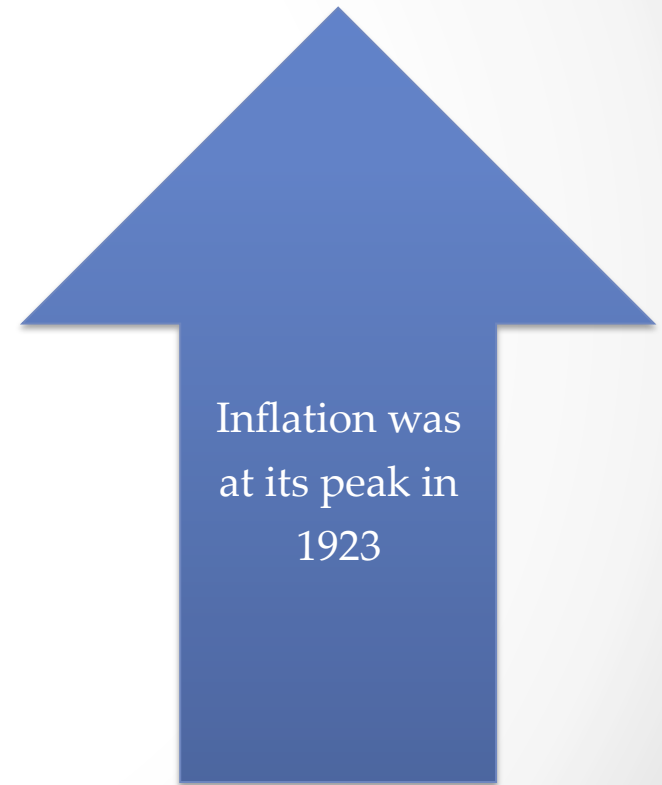
1. Either stop printing money immediately and hence cause bankruptcies and unemployment
2. or default on their foreign debt



The attempt to avoid both (insolvency and unemployment) caused both of these phenomena!

Hyperinflation

- December 1922
1 Dollar was worth 800 Marks
- November 1923
1 dollar was worth 4,210,500,000,000 Marks
(around 4 trillion!)





- A vicious cycle was created when people started to spend their money as quickly as possible only increasing the overall amount in circulation.

Dimensions

In 1923, 135 printing houses and 35 paper factories were busy printing money every day!



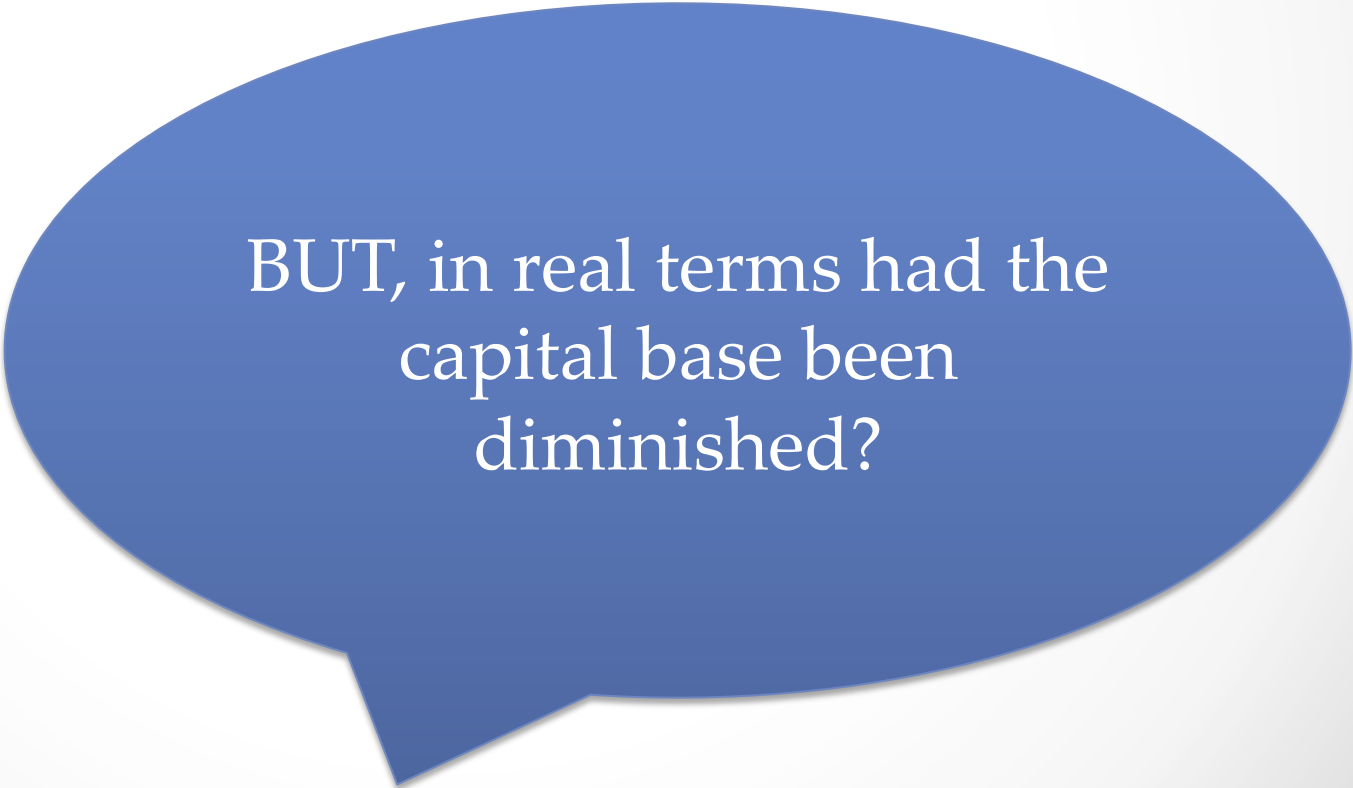
Consequences for the Banking Sector

1. Increasing demand for credit of small clients
2. Banks could not serve the needs: reacted with the creation of difficult credit conditions for small clients
3. Clients switched from private banks to savings banks and cooperative banks
4. Ratio equity capital – loan capital was significantly reduced
5. Increased tendency towards short term deposits

6. Capital base of banks diminished

(Equity capital of the Berlin banks: 1105 Mio M 1913;
474 Mio M in 1924


Reserves: 359 Mio M 1913; 185 Mio M in 1924)



BUT, in real terms had the
capital base been
diminished?

In 1919 – 1923 German banks obtained substantial amounts of foreign deposits denominated in marks.
(liabilities that diminished in real value as the mark depreciated)

What did they do with these foreign deposits?

 They used them to directly invest in industry and thus acquired direct equity participation in key industries.

 They became investment banks.

Where do these assets show up on the balance sheet?

Mostly as 'Aktienkapital' carried at its nominal value.
(which is not necessarily its true value)

The understated profit was possibly substantial.



Simple profit and loss figures may not accurately reflect the real position of German banks either during the inflation or the following years of stabilization.

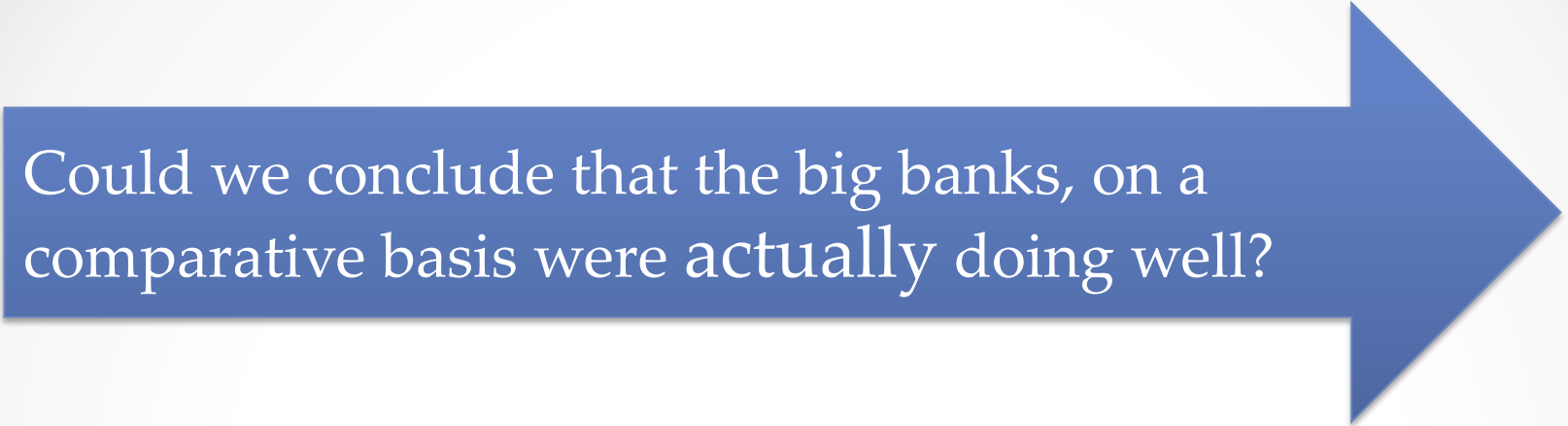
7. Quantitative expansion of the banking business

(Deutsche Bank 1913: 290 000 clients; 1919: 600.000 clients, after Inflation: 281.000 client)

Mergers and Acquisitions: many regional and private banks disappeared



hence increasing client base AND including more industry shares (Daimler) to their portfolios.



Could we conclude that the big banks, on a comparative basis were actually doing well?

Not through maintaining their traditional role!

- a precarious spread between demand deposit and commercial loan rates - but by participating actively as equity partners in the industry.

9. High increase in number of staff

(Deutsche Bank: 1913: 9587 employees;
1924: 18000 employees; 1926: 14000 employees)

Reasons: many zeros to write and count, increase in cashless payments



Change of social structures within banks

- More 'unskilled' persons were employed
- The first women were employed after World War I and an increasing number during the hyperinflation

Some thoughts to end

- Research is difficult, most of the numbers, balance sheets of the time are useless
- Is comparative analysis useful since inflation today is a global (often artificially caused) phenomenon not to speak of 'hidden inflation' not showing in consumer prices?
- Germany still seems to be traumatized by the historical events of the hyperinflation time. Why?

Thank you very much for your attention!

Sources

- Pohl, Manfred:
'Konzentration im deutschen Bankwesen (1848 – 1980), Frankfurt am Main, 1982.
- Büsch, Otto und Feldman, Gerald D. (Hrsg.): 'Historische Prozesse der deutschen Inflation 1914 – 1924', Berlin 1978. (Referat Manfred Pohl und Kommentare von Martin Vogt, Stephen A. Schuker, Gerald D. Feldman und Otto Pfeleiderer)