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Economic Conditions in Germany in 1962

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Economic Conditions in Germany in 1962

Excessive aggregate demand in the German economy was reduced somewhat in 1962 as expansionary and contracting tendencies were more nearly balanced than they have been at any time since the 1958 recession. By year-end, there was a conspicuous easing of fears about wage and price developments, which during 1962 had prompted the Federal authorities both to continue to warn against, and to act to check, upward wage and cost tendencies. The easing of these pressures together with some pick-up in business activity in the late months of 1962 contributed to a somewhat more optimistic tone about the German business outlook than had prevailed at mid-year.

During 1962, economic growth for Western Germany was about 4 per cent in real terms compared with an average of about 7 per cent for the preceding three years. The reduced tempo of economic expansion resulted from a weakening of the rate of increase in private investment and export sales balanced, in part, by continued heavy expenditures in the construction and consumer goods sectors.

The tight labor situation was the principal factor in this development. Labor shortages contributed to further rapid rises in wages in excess of increases in productivity. The resulting increases in unit costs, officially estimated at 4 to 5 per cent in 1962, pushed up prices and, where higher unit costs could not be passed on to customers, narrowed profit margins further. But there was an appreciable easing of wage pressures by year-end. It is estimated that, on a year-to-year basis, the increase in net wages and salaries fell back from 10-1/2 per cent in the first half of 1962 to 9 per cent in the third quarter and an estimated 8 per cent in the fourth quarter. By October, the Bundesbank reported that "the prospects of stabilizing the price level have distinctly improved."

Receding wage pressures contributed to an improved business tone by year-end. In addition, the continued fall in German stock prices, which brought the index of industrial shares down from a postwar peak of 264.6 on August 31, 1960 to a low of 132.9 on October 12, 1962, finally come to an end. The 26 per cent rise in stock prices between October 12 and December 31 in the face of German domestic political difficulties seemed to reflect a shift in sentiment about the business outlook. In turn, the end of the 26-month decline in stock prices may itself have removed a major barrier to business confidence.

For 1963, current estimates, private as well as official, suggest a rate of growth about equal to the expansion in 1962. Because of the more nearly balanced economic position at this time, no government action either to moderate or to stimulate demand is held to be required, according to the joint year-end report of the six major business-cycle research institutes in Germany.

Rising imports and growing competition from abroad contributed to the stabilization tendencies within the German economy during the year. In addition, after years of continued large balance-of-payments surpluses which "had led to high internal liquidity and excessive domestic demand," <sup>1/</sup>the balance of payments was in virtual equilibrium. The principal factors which brought the balance-of-payments surplus to an end in 1962 were:

- a. Reduced trade surplus as imports rose more rapidly than exports;
- b. Substantial deficit on invisibles because of the heavy rise in travel expenditures, interest and dividends paid to foreigners, and remittances of foreign workers; and
- c. Virtual elimination of the very large private capital

<sup>1/</sup> Ibid., after 196-1961, in part as a reaction to the

<sup>1/</sup> Speech of Mr. Karl Blessing at the 1962 Annual Meeting of the International Monetary Fund, Summary Proceedings, p. 70.

inflows after mid-1961, in part as a reaction to the "Berlin wall" crisis.

Large official payments to foreigners for indemnification and for military supplies helped to offset the surplus achieved in 1962 on goods and services and private capital transactions.

The authorities did not make major changes in financial policies as part of the stabilization effort during the year. On October 9, Chancellor Adenauer introduced an anti-inflation program. To cut back the building boom, Federal tax write-off provisions and Government subsidies were reduced. In addition, anti-cartel legislation was to be tightened up and retail price maintenance partially abolished; and employers and workers were asked to reach "sensible" wage agreements.

On the monetary side, the German banks and business community experienced a general contraction in liquidity during the year. Both the expansion in the note issue and net transactions of the public authorities continued to drain reserves from the banks. Reduced bank liquidity and substantial new issue offerings pushed up bond yields to about 6.1 per cent in the fourth quarter compared with a level of 5.6-5.7 per cent in early 1962. The Bundesbank has been cautious about tightening credit to avoid setting off a renewed inflow of funds from abroad. The Bank has also attempted to encourage the commercial banks to keep in domestic financial markets the liquid money-market assets which they had previously been holding in the Euro-dollar market abroad: the Bank gradually raised the yield on short-term Treasury paper and adjusted the cost of the Bank's special forward exchange cover facilities to favor 2 to 6-month contracts.

#### Final demand slackens

The growth of the German output of goods and services slowed down somewhat during 1962. While gross national product in the preceding three years grew at an

average annual rate of 7 per cent in real terms, an increase of only about 4 per cent could be achieved in 1962. Only the Government's demand for goods and services remained buoyant in 1962; the growth rate for capital formation diminished.

Table 1. German Gross National Product (excl. Berlin), 1960-62 Quarterly Rate  
(In billions of current D-marks)

	<u>1960</u>	<u>1961</u>	<u>1962</u>				IV <u>a/</u>
			I	II	III		
Personal consumption expenditures	40.1	44.2	43.4	47.1	47.6	n.a.	
Government purchases	9.6	10.9	11.4	11.8	12.7	12.8	
Gross domestic investment							
Construction	8.5	9.8	8.1	12.0	12.7)		
Plant & equipment	8.4	9.7	9.9	10.0	10.3)	22.8	
Inventory change	<u>2.0</u>	<u>1.3</u>	<u>4.1</u>	<u>0.9</u>	<u>1.0</u>	<u>n.a.</u>	
Total	18.9	20.8	22.1	22.9	24.0	n.a.	
Net exports							
Exports	17.6	18.5	18.4	19.1	19.4	n.a.	
Imports	<u>15.7</u>	<u>16.8</u>	<u>17.2</u>	<u>18.1</u>	<u>19.1</u>	<u>n.a.</u>	
Balance	1.9	1.7	1.2	1.0	0.3	n.a.	
Total Gross National Product	70.6	77.6	78.1	82.8	84.6	88.9-89.3	

a/ Estimated in joint year-end report of six German conjunctive institutes  
n.a. Not available

Source: Statistisches Bundesamt: Wirtschaft und Statistik; Deutsches Institut für Wirtschaftsforschung: Wochenbericht

The major decline in growth was concentrated in the rate of growth of demand for investment goods. The annual rate of growth, in real terms, in the first half of 1962 was only 5-1/2 per cent, and it fell to 3-1/2 per cent in the third quarter. This contrasts with a growth rate of 16 per cent in 1960 and 12 per cent in 1961. With deliveries exceeding new orders steadily since the spring of 1962, orderbooks have been shortened considerably. However, the backlog of unfilled orders, which at mid-year was estimated at equal to about six months output, is still substantial.

The decline in net exports of goods and services has helped to moderate inflationary pressures since mid-1961. Exports grew only by about 3 per cent during the first half of 1962 while imports rose by 13 per cent. However, some special factors (particularly bad harvests in 1961 and the bunching of food imports before the new Common Market agricultural tariffs became effective July 1, 1962) contributed to the large increase in imports. Accordingly, food imports fell in the third quarter, while other imports continued to rise. Exports actually rose twice as fast in the third quarter as during the first half of the year.

The volume of private consumption expenditures continued to rise substantially during 1962, but the upward impetus was not quite as strong as in the past few years. During the first half of 1962 the annual rate was only 6-1/2 per cent as compared with 7-1/4 per cent in 1961, and in the third quarter it fell further to about 5 per cent. The smaller increases in private spending were consistent with the somewhat slower increase in disposable incomes noticeable in the second half of 1962.

Government demand was the strongest expansionary factor during the year. Outlays for goods and services (primarily higher defense expenditures) rose by about 10 per cent (in real terms) as compared with a 7 per cent increase in 1961. Although a conscious effort had been made to curb government demand for construction in order to keep price and wage increases in that area within tolerable bounds, construction outlays continued to rise rapidly throughout the year.

#### Prices, wages and incomes

With general demand easing, except in the construction industry, the pressure on wages and prices also seemed to ease somewhat during the course of 1962. There was also some narrowing between the growth in hourly wages in industry and that of industrial output per manhour toward the end of 1962.

Wages had risen by about 13-1/2 per cent annual rate and output per manhour by only 6-1/2 per cent during the first half of 1962, but in the third quarter wages rose 13 per cent and output 8 per cent.

At the same time, the squeeze on profits appeared to have eased slightly. The weakness in investment-demand has produced virtual price stability in that sector since mid-1962 as cost increases could not be passed on to customers and profit margins fell. In the consumer goods industries, producer prices also were fairly stable, but started to rise towards the end of the year, with demand in that sector fairly active. (See Table 2.) Retail prices registered rather large increases during the first half of the year and then turned down slightly in the second half. This movement resulted from the violent swings in food prices, which rose more than seasonally during the first half because of crop failures in 1961. There was a steady advance in prices in all other areas of consumer spending during the year.

Table 2. Prices and Wages

Index numbers, 1958 = 100, end of quarter figures

	1960 III	1961				1962			
		I	II	III	IV	I	II	III	Nov.
<u>Producer Prices</u>									
Total industrial products	100.8	101.8	101.6	102.0	102.3	102.8	103.1	103.2	103.3
Investment goods industry	101.8	103.0	103.2	104.2	104.5	106.1	107.3	107.4	107.4
Consumer goods industry	102.0	103.8	103.6	103.9	104.4	104.9	104.8	105.1	105.4
<u>Consumer Prices</u>									
General index	102.2	104.1	105.6	105.3	106.3	108.1	109.8	108.3	108.8
Food	100.0	102.4	105.5	103.6	104.7	107.9	111.5	106.3	106.8
<u>Export Prices</u>									
General index	101.0	100.4	100.0	100.0	100.1	100.5	100.6	100.7	100.7
Investment goods	102.6	103.4	103.7	104.5	105.1	106.3	107.1	107.3	107.3 <sup>a/</sup>
<u>Earnings</u>									
Average hourly earnings in industry <sup>b/</sup>	117	122	124	129	133	137	141	143	n.a.

a/ October n.a./ - not available

b/ February, May, August and November.

Source: Statistisches Bundesamt: Wirtschaft und Statistik

On the export side, the unit-value index rose only from 100.1 in November 1961 to 100.7 in November 1962. German sources have not provided an authoritative explanation of why export prices have not accompanied the upward trends in prices and in wage costs. Three factors have probably contributed to the stability of this index:

- a. Many export industries are capital-intensive and may have a relatively lower proportion of wages to total costs than other industries;
- b. Productivity is rising much more rapidly in the export sector than elsewhere; and
- c. Common Market competition is a powerful deterrent to raising prices. In fact, the authorities used import competition as a device to try to roll back auto prices.

#### Labor market tightens

The relaxation of demand pressures contributed to an easing of pressures on the labor market in 1962. Employment, which had grown by 2.8 per cent in 1961, rose by 2.2 per cent annual rates during the first half of 1962 and by only 1.8 per cent in the third quarter of the year. (See Table 3.)

This growth was increasingly offset by a reduction in the weekly hours worked. In addition, the third quarter increase in the labor force came almost entirely from additional foreign labor; the domestic reserve of unemployed seems to have just about reached a minimum.

Table 3. Labor Market (excl. Berlin)  
(Thousands and Per Cent, end of period figures)

	1960	1961				1962		
	III	I	II	III	IV	I	II	III
Labor force (millions)	20.3	20.6	20.9	21.0	21.0	21.1	21.3	21.4
Employment (millions)	19.9	20.4	20.8	20.9	20.8	20.9	21.2	21.3
Unemployed (thousands)	112	163	99	95	223	190	98	93
Unemployed as % of labor force	0.6	0.8	0.5	0.5	1.1	0.9	0.4	0.4
Vacancies (thousands)	524	579	569	573	417	581	598	580

Source: Statistisches Bundesamt: Wirtschaft und Statistik

For the future, potential increases in labor supply may no longer be sufficient to offset further reductions in the number of hours worked. The age structure of the population will become increasingly unfavorable for an expansion in the labor force; in addition, increasing requirements for the armed forces and a suggested increase in the mandatory school age will cut further into labor supply. Thus, the cut off of the influx of (largely skilled) labor from the Soviet zone may actually have more economic significance than is generally thought because it may help to limit the rate of German economic growth in the next year to the increase in productivity.

The slackening of demand has also increased labor mobility. Apparently industries experiencing reduced new orders seem to be less inclined to hoard labor; the released workers seem to be moving to those branches of industry where activity is still growing rapidly. Thus, there has been a shift out of mining, shipbuilding and textiles principally into the aircraft and automobile industries.

Balance of payments in equilibrium in 1962

In 1962, the German balance of payments was roughly in balance, as far as can be seen from available data. The combined deficit of the second and third

quarters was offset by the combined surplus of the last quarter (October and November figures expressed as a quarterly rate) and of the first quarter (see Table 4). <sup>1/</sup> Thus, the reserve position of Germany at the end of 1962 was unchanged from the end of 1961 (see Table 7).

The D-mark was stable on the world's exchange markets. The average monthly value of the exchange rate was practically unchanged during the first half of the year, and moved very little during the second half of 1962, as may be seen from the following figures (in U. S. cents per DM):

<u>Jan.-</u> <u>June</u>	<u>July-</u> <u>Sept.</u>	<u>Oct.</u> <u>Dec.</u>	<u>Oct.</u>	<u>Nov.</u>	<u>Dec.</u>
25.018	25.033	24.981	24.996	24.947	25.033

This balanced position in 1962 was in sharp contrast with 1961, when there was a surplus of DM 6.9 billion in the first half of the year and a deficit of DM 1.1 billion in the second half. (See Table 4.)

The year 1961 was the last of the unbroken large German balance of payments surpluses extending over nearly 10 years. During the first half of 1962, the goods and services surplus was approximately DM 2.0 billion (after a DM 400 million adjustment to offset a statistical adjustment to the import figures) in contrast with a surplus of DM 4.2 billion in the first half of 1961 and the private capital accounts surplus was only DM 1.2 billion compared with a surplus of DM 4.3 billion in the first half of 1961.

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<sup>1/</sup> This analysis of the balance of payments differs from the official German presentation in the Monthly Report of the Bundesbank which uses the change in the net foreign assets of the Bundesbank (excluding certain Bundesbank loans to the IBRD) as the measure of surplus or deficit in the balance of payments. On this basis, the balance of payments shows a DM 2.0 billion deficit in the first quarter, offset by a DM 1.6 billion surplus in the period from April through November. The measure of deficit or surplus adopted in this paper includes changes in the German drawing rights on the IMF, commercial banks' foreign exchange assets, and, for 1961, special official transactions designed to offset the reserves accumulations of the Bundesbank (advance debt repayments and a special loan extended to the IBRD). The Bundesbank places these items in the capital account. In addition, this paper excludes all of the Bundesbank's "not freely usable assets" except earmarked assets.

Table 4. German Balance of Payments, 1961-62  
(in millions of deutsche mark)

	1961		1962			
	Jan.- June	July- Dec.	Jan.- Mar.	Apr.- June	July- Sept.	Oct.- Nov. <sup>a/</sup>
<b>Balance of Payments</b>						
1. Goods and Services						
Merchandise	3,634	2,857	b/ 523	819	1,039	854
Services	612	- 622	258	- 20	- 790	- 179
Total	<u>4,246</u>	<u>2,235</u>	<u>b/ 781</u>	<u>799</u>	<u>- 249</u>	<u>675</u>
2. Official Payments						
Reparations c/	-1,498	-1,985	- 944	-1,012	- 709	- 750
Long-term capital	380	821	- 483	- 68	- 430	- 379
Short-term capital	- 538	- 728	- 141	- 225	218	778
Total	<u>-1,656</u>	<u>-1,892</u>	<u>-1,568</u>	<u>-1,305</u>	<u>- 921</u>	<u>- 351</u>
3. Private Capital						
Securities transactions:						
German d/	1,345	301	523	198	358	} 314
Foreign (increase-) e/	- 113	- 86	- 340	- 168	- 23	
Other long-term	- 266	- 294	101	40	46	
Short-term f/	1,918	- 116	- 582	- 69	461	261
Errors and omissions	1,439	-1,205	b/ 1,128	359	- 412	- 540
Total	<u>4,323</u>	<u>-1,400</u>	<u>830</u>	<u>360</u>	<u>430</u>	<u>35</u>
Surplus or Deficit (-)	<u>6,913</u>	<u>-1,057</u>	<u>43</u>	<u>- 146</u>	<u>- 242</u>	<u>359</u>
<b>Financed by:</b>						
1. Special Transactions						
Advance debt payment	-3,125	--	--	--	--	--
Loans to IBRD	- 150	- 730	--	--	--	--
2. Commercial Banks Foreign						
Exchange Assets (increase-)	-3,470	2,007	-2,384	1,068	832	- 296
3. Reserve Movements						
Drawing rights on IMF (increase -)	- 543	- 778	301	- 140	247	108
Bundesbank liabilities	563	- 654	228	- 204	122	- 161
Gold and foreign exchange (increase -)	- 188	1,212	1,812	- 578	- 959	- 10
Total	<u>- 168</u>	<u>- 220</u>	<u>2,341</u>	<u>- 922</u>	<u>- 590</u>	<u>- 63</u>
Total Financing	<u>-6,913</u>	<u>1,057</u>	<u>- 43</u>	<u>146</u>	<u>242</u>	<u>- 359</u>

a/ Expressed at a quarterly rate.

b/ A change in import accounting procedure has resulted in approximately DM 400 million of goods in bonded warehouses being included in the first quarter imports. This is offset in errors and omissions.

c/ Includes some small private transfer payments.

d/ Foreign purchases of German securities.

e/ German purchases of foreign securities.

f/ Includes commercial bank capital other than foreign exchange assets.

Source: Deutsche Bundesbank, Monatsberichte. Figures rearranged by Board staff.

Rising imports was the principal factor reducing the trade surplus in 1962, as can be seen from the seasonally adjusted monthly averages for 1961-62 in Table 5. In part, the rise in imports reflected crop failures in the summer of 1961 which necessitated abnormally large food imports in the following 12 months. In addition, large quantities of U. S. agricultural produce were imported in late spring of 1962 prior to EEC restrictions which took effect in July. Imports of finished industrial products--especially consumer goods--have risen continuously: in the third quarter of 1962, these imports were 19 per cent above the third quarter of 1961. While the increases in 1961 were attributed to excess demand in Germany, the continued rise in 1962 reflected more effective foreign competition resulting from the revaluation of the DM and rising German costs.

Table 5. German Foreign Trade  
(seasonally adjusted, monthly averages  
in millions of U. S. dollars)

	1961		1962				
	Jan.- June	July- Dec.	Jan. - Mar.		Apr.- June	July- Sept.	Oct.- Nov.
			Old series	New series			
Exports	1,054	1,069	1,083	1,083	1,105	1,123	1,112
Imports	<u>891</u>	<u>933</u>	<u>936</u>	<u>a/ 999</u>	<u>1,024</u>	<u>1,032</u>	<u>1,042</u>
Surplus	163	136	147	84	81	91	70

a/ Change in import accounting procedure. As of April 1962 retroactive to January 1, goods entering and those already stored in bonded warehouses recorded as imports in contrast to old procedure of recording goods as imports upon their departure from bonded warehouses.

Source: 1961 OECD; 1962 Federal Reserve Staff.

Exports stabilized in 1961 in terms of U. S. dollars but declined somewhat in terms of D-marks. During the course of 1962, export values advanced slightly. (See Table 5.)

German service transactions with foreign countries shifted from substantial surplus to a moderate deficit over the past two years. (See Table 6.) Three factors contributed to this shift:

- a. Heavy German foreign travel expenditures, which were about DM 1.0 billion higher in the first 10 months of 1962 over the 1961 total;
- b. German net payments on capital income account rose by 50 per cent in 1961 and grew further in 1962; and
- c. Remittances of foreign workers in Germany to their home countries have become a significant debit item.

Table 6. Transactions in Services, 1960-62 <sup>a/</sup>  
(in millions of D-marks)

	<u>1960</u>	<u>1961</u>	<u>Jan. - Oct.</u>	
			<u>1961</u>	<u>1962</u>
German foreign travel	-2,808	-3,498	-3,100	-4,110
Investment income (net)	-818	-1,264	-885	-967
Foreign worker's remittances	-867	-1,322	-1,043	-1,348
Paid services to foreign troops	3,960	3,824	3,195	3,467
Freight and insurance <sup>b/</sup>	2,479	2,604	2,161	2,257
Other	<u>167</u>	<u>-354</u>	<u>-209</u>	<u>-42</u>
Total	2,113	-10	119	-743

<sup>a/</sup> No sign indicates credit; minus sign indicates debit.

<sup>b/</sup> Excluding freight and insurance on imports, which is included with imports c.i.f.

Source: Deutsche Bundesbank, Monatsberichte, December 1962.

Official outpayments were reduced in 1962. At a quarterly rate, indemnity payments were DM 200 million lower in the second half of the year than in the first half. At the same time, there was a shift from a net outflow to a net inflow of official short-term capital, representing mostly a net reduction of short-term German credits to the U.S. and the U.K. governments as advance payments

of military goods: the value of deliveries paid for out of these accounts in 1962 exceeded German pre-payments into them.

By contrast with violent fluctuations in 1961, the private short-term capital flows were relatively stable in 1962. A limited net investment in German securities, which occurred in spite of the steady decline of the stock market, was largely offset by German investment in foreign securities.

The German reserve position at the end of 1962 was practically unchanged from the end of 1961. The decline in the Bundesbank's foreign exchange assets and the reduced Germany's drawing rights on the IMF were offset by an increase in the foreign exchange holdings of the commercial banks. <sup>1/</sup>

The Bundesbank continued slightly to increase the proportion of its reserves held in gold; at the end of 1962, the proportion was 57 per cent.

(See Table 7.)

#### German dollar indebtedness

German dollar indebtedness declined only slightly in the first half of 1962 (latest data available in Table 8). Debts owed to the United States Government, which were greatly reduced during the first quarter of 1961 remained virtually unchanged, except for a slight reduction in Export-Import Bank loans outstanding. Loans held by commercial banks, which had increased substantially in 1961 because of a rise in short-term debt, were somewhat reduced during the first half of 1962.

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<sup>1/</sup> Germany's drawing rights on the IMF increase when a country draws DM from the IMF, and decline when DM drawings are repaid to the Fund.

Table 7. German Reserve Position, 1955-62  
(in millions of U.S. dollars)

	<u>1955</u>	<u>1957</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>
A. Bundesbank Gold and Foreign Exchange					
Foreign exchange	2,015	2,573	3,766	2,878	p/2,807
Gold	920	1,494	2,971	3,664	p/3,679
Total	<u>2,934</u>	<u>5,114</u>	<u>6,737</u>	<u>6,542</u>	<u>6,486</u>
B. Drawing Rights on IMF	413	413	1,096	1,425	1,305
C. Commercial Banks					
Foreign Exchange	76	185	313	695	a/869
Total (A through C)	<u>3,423</u>	<u>5,712</u>	<u>8,146</u>	<u>8,662</u>	<u>8,660</u>
Gold as a percentage of Bundesbank reserves	31	29	44	56	57

p/ Preliminary.

a/ As of November 30, 1962.

Source: I.M.F., International Financial Statistics; Deutsche Bundesbank, Monatsberichte.

Table 8. German Indebtedness to the U.S. Government and Commercial Banks  
(in millions of U. S. dollars)

	<u>Dec.</u> <u>1960</u>	<u>June</u> <u>1961</u>	<u>Dec.</u> <u>1961</u>	<u>June</u> <u>1962</u>
<u>To U.S. Government</u>				
Grants converted to credits	787.4	200.4	200.4	200.4
Sales of overseas surpluses	17.5	16.5	10.6	10.6
"American aid" country program loans a/	16.5	16.2	16.0	15.8
Export-Import Bank loans	9.1	9.6	9.6	8.1
Total	<u>830.4</u>	<u>242.7</u>	<u>236.6</u>	<u>234.8</u>
<u>To Commercial Banks</u>				
Long-term	23.0	49.0	70.0	70.0
Short-term	82.0	148.0	165.0	129.0
Total	<u>105.0</u>	<u>197.0</u>	<u>235.0</u>	<u>199.0</u>
<u>Total Indebtedness</u>	935.4	439.7	471.6	433.8

a/ Formerly known as Mutual Security Program.

Source: U.S. Department of Commerce, Foreign Grants and Credits; Federal Reserve Bulletin.