German balance of payments in 2016

The German economy's current account surplus recorded a slight fall to 8¼% of nominal gross domestic product (GDP) in 2016. This drop in the annual average masks a stronger decline over the course of the year. In seasonally and calendar-adjusted terms, the surplus dwindled from 8¾% of GDP in the first quarter of the year to 7½% in the fourth quarter. Assuming there is no trend reversal in relative prices, this means there is much to indicate that Germany's current account surplus will recede markedly this year on average. In absolute terms, too, the strong expansion seen in the previous two years did not continue – at €261 billion, the balance remained virtually the same as in 2015. Looking at the sub-accounts, the goods trade surplus continued to grow. However, for the fourth consecutive year, this came about due to lower import prices. In value terms, this price effect is masking the volume decline in the trade in goods surplus. By contrast, the deficit in the services account increased further, and the surplus from investment income went down despite the renewed increase in net external assets.

One reason why the current account surplus did not expand any further in 2016 was the slight cutback in national savings, which had risen sharply in the two preceding years, in relation to GDP. This largely offset the decline in the investment ratio. The European Commission, which has found that Germany is experiencing an imbalance on account of its high current account surplus, recommends measures to reduce it. While it is true that the current account balance is the outcome of numerous, largely private-sector decisions both at home and abroad and therefore cannot be directly managed to any meaningful degree using macro policy tools, it is nonetheless worth examining whether and what adjustments to the framework conditions might be conducive to stimulating private investment and how to efficiently cover any clearly identified shortfalls in government investment.

Germany's financial account with the rest of the world last year was once again influenced by the low-interest-rate environment and the Eurosystem's large-scale purchases of assets for monetary policy purposes. At €231½ billion, net capital exports were roughly as high as they were in 2015. Portfolio investment saw domestic investors shift their demand towards securities issued outside the euro area. In the opposite direction, foreign investors parted with large volumes of German debt securities, the bulk of which were purchased by the Bundesbank under the expanded asset purchase programme (APP). The Eurosystem's asset purchases were also behind another sharp widening of the TARGET2 balance and thus of the Bundesbank's net external position.

Direct investment, which tends to be more of a longer-term instrument, likewise registered net capital outflows. This was largely because German firms continued to build up their operations abroad on balance. Other investment, meanwhile, yielded net capital imports which were largely driven by inflows of funds at enterprises, households and monetary financial institutions.

Current account

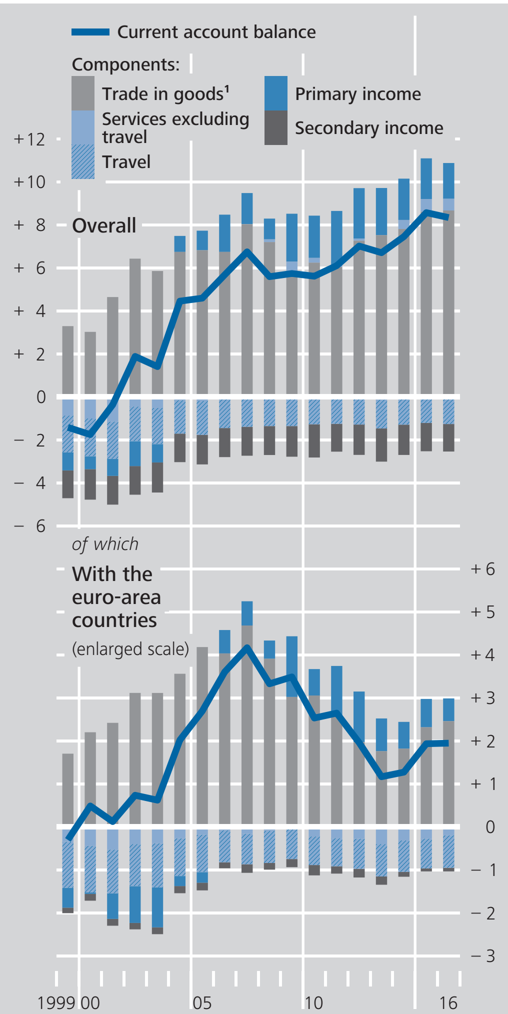
Underlying trends in the current account

Current account surplus down slightly relative to GDP

At €261 billion in 2016, the German current account surplus remained virtually unchanged on the year. The growth in the surplus seen in the two preceding years did not continue. Measured in terms of nominal GDP, the surplus was even down by ¼ percentage point at 8¼%. However, it was still well above 6% of GDP, the threshold set by the European Commission under its macroeconomic imbalance procedure, which it uses to monitor and correct imbalances. Accordingly, the European Semester Winter Package published by the European Commission at the beginning of this year includes conclusions that Germany is continuing to experience economic imbalances.[1]

Germany's current account

As a percentage of GDP



1 Special trade according to the official foreign trade statistics, including supplementary trade items, which also contain freight and insurance costs as a deduction from imports.

Deutsche Bundesbank

Expansion in the goods account surplus cancelled out by countermovements in invisible current transactions

While the current account surplus remained largely unchanged in absolute terms, there were contrasting developments in the individual sub-accounts. On the one hand, the goods account surplus continued to expand. As in the three preceding years, this sub-account was particularly influenced by the decline in crude oil prices, which significantly dampened the total value of imported goods. On the other hand, there was a wider deficit in the services account and a considerable drop in the surplus from cross-border investment income. The services sub-account saw expenditure on research and development, in particular, rise markedly. In addition, residents perceptibly increased their budgets for foreign travel. Turning to the primary income account, the surplus on investment income fell back considerably despite the continued sharp increase in net external assets; the lower level of yields overall probably had a bearing on this. The traditional deficit in the secondary income account remained broadly unchanged.

Global setting continued to have expansionary effect, but less so than in 2015

The global setting once again had an expansionary effect on balance in 2016, primarily on account of the continued decline in the price of crude oil. A barrel of Brent crude cost just under US$46 on average in 2016 – one-seventh less than in 2015. This price has more than halved in comparison to the average for the period from 2011 to 2014. The cost of energy imports in 2016 was no more than just under €70 billion – one-fifth, or almost €20 billion, down on 2015. By contrast, the exchange rate did not provide any additional expansionary stimuli, unlike in the previous year, even if the after-effects of the sharp depreciation in 2015 probably continued to make themselves felt.

1 See European Commission, European Semester Winter Package: review of Member States' progress towards economic and social priorities, press release, 22 February 2017, http://europa.eu/rapid/press-release_IP-17-308_en.htm

On average, the euro remained broadly unchanged against the US dollar in 2016, having shed one-sixth of its value in 2015. There was even an increase in the euro's nominal effective exchange rate, mainly on the back of the currency's strong appreciation against the pound sterling. Accordingly, this also eroded Germany's price competitiveness somewhat. Compared to other euro-area countries, this was a reflection of the different cyclical positions and, by association, the slightly stronger domestic price pressure in Germany.

Trade in goods less buoyant

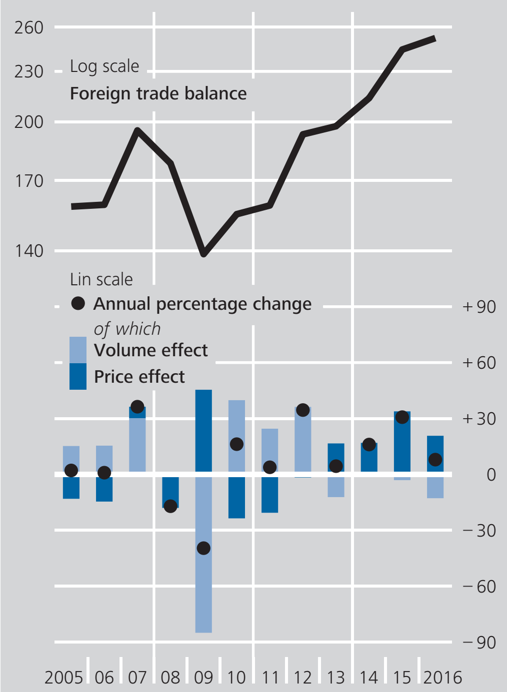
Global trade continued to lose pace in 2016, however, according to data from the International Monetary Fund (IMF). Coupled with the clearly waning expansionary effect of the euro's depreciation in 2015, this significantly decelerated the pace of goods exports. Imports likewise rose more slowly despite the robust domestic demand, one contributing factor being the particularly muted growth in the very two demand variables with the largest direct and indirect import content, ie goods exports and investment in machinery and equipment. Even so, the increase in goods imports outstripped the growth in goods exports in real terms. The stronger decline in the prices of imported goods, however, ended up inversing the ratio in nominal terms. On balance, the surplus in the goods account climbed by just over €10 billion to €272 billion. The volume component, on the other hand, showed an equally-sized reduction in arithmetical terms.

Little change in surplus against non-euro-area countries or euro area

From a regional perspective, there were no major changes in the current account surplus against the other countries of the euro area or against third countries. Expressed in terms of nominal GDP, the surplus against the euro area remained steady at almost 2%, while against non-euro-area countries, it came in at just under 6½% in the year under review. Germany widened its trade surplus with both regions, with the price effects generated by lower import prices being the predominant factor in each case.

Price and volume effects on the German foreign trade balance*

€ billion



Source of unadjusted figures: Federal Statistical Office. * Decomposed using the Shapley-Siegel index.
Deutsche Bundesbank

Surplus declines significantly over course of 2016

Germany's current account surplus fell back significantly over the course of 2016, the seasonally and calendar-adjusted figure gradually contracting from 8¾% of GDP in the first two quarters to 8% in the third quarter and 7½% in the fourth. This was mainly due to the fact that the real terms of trade with the rest of the world, which had greatly improved in previous years, deteriorated in the course of 2016 and into 2017. Assuming there is no trend reversal in relative prices, this means there is much to indicate that Germany's current account surplus has peaked and will recede markedly during this year.

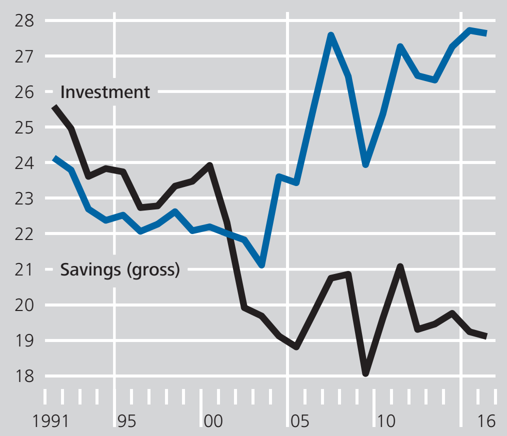
Current account balance, savings and investment

Current account surplus a reflection of savings and investment

Germany's current account surplus can also be analysed from the perspective of the investment and savings decisions made by domestic economic agents. This is because aggregate

Aggregate savings and investment

As a percentage of GDP



Source of unadjusted figures: Federal Statistical Office.
Deutsche Bundesbank

net lending/net borrowing, which broadly corresponds to the current account balance, equates to the difference between savings and investment in the accounting framework of the national accounts.[2] Viewed from this angle, the current account surplus did not increase any further in 2016 because aggregate savings, which had climbed sharply in the two preceding years, were cut back slightly relative to GDP, largely offsetting the decline in the investment ratio.

Subdued investment but, above all, high savings

Over the past few years, economic activity in Germany has been characterised by subdued domestic investment despite the robust upswing and, at the same time, strong growth in savings. These macroeconomic trends were driven notably by changes in the ratios of investment and savings at non-financial corporations and general government. Non-financial corporations have consistently reported a financial surplus since 2002, with the exception of 2008, which at last count came to 3½% of GDP. This is probably not least a reflection of efforts to counter the significant undercapitalisation identified at the turn of the millennium among German enterprises. Public finances, meanwhile, were consolidated as the investment ratio remained largely steady, and what had been a marked deficit switched to a moderate surplus. Households, on the other hand, have maintained relatively stable investment and savings ratios since the beginning of this decade.

The European Commission's recommendations

Given Germany's large current account surplus, the European Commission recommends both greater public investment as well as further measures aimed at boosting private sector investment or an improved balance between private sector savings and investment.[3] Specifically, the Commission is calling for a reform of the services sector, where it considers investment to be particularly weak, even by international standards, and a reduction of the distortions caused by some corporate taxation features which it believes are hindering investment. It also notes that delayed investment in transport, energy and telecommunications infrastructure poses an obstacle to more dynamic private investment.

Government investment must be strengthened

With regard to government investment, the Commission acknowledges that some progress has been made but believes that the pace must be stepped up and that the scope available under EU and national fiscal rules should be used to increase public investment. A good public infrastructure is undeniably important for sound economic development and locational quality. Germany probably does indeed have some catching up to do in some of these areas, even if quality standards here are still rated very highly by international standards. Expenditure on this item has been budgeted to increase over the next few years, and, not least, the burden at the level of local government has been significantly eased. However, it is not a question here of spending resources as rapidly and comprehensively as possible, but, in particular, of efficiently exploring which needs exist and taking action where needed. With regard to the general fiscal stance, moderate

2 Capital transfers can also have an impact on net lending/net borrowing, as can acquisitions less disposals of non-produced assets.
3 See European Commission, Country Report Germany 2017. Including an in-depth review on the prevention and correction of macroeconomic imbalances, Brussels, 22 February 2017.

structural surpluses are recommended in Germany, not least because of the foreseeable demographic burdens it faces.[4] At present, there is furthermore the question of whether an even more expansionary fiscal policy stance would be appropriate given the current economic situation, and also whether capacity constraints in the construction sector might curtail any attempt to rapidly and very significantly boost public sector construction investment.

Greater private investment activity on the cards

Favourable interest rate conditions, by themselves, provide an insufficient basis for enterprises to substantially expand their production capacity. Instead, investment decisions hinge to a great extent on the returns that can be expected from the prevailing economic outlook, as well as on longer-term sales prospects. The underlying trend points to an upturn in German business investment in the near future, given that utilisation of aggregate production capacity is now at a good level, and industrial activity, in particular, picked up recently.

Reasons for the high level of savings in the corporate sector

Non-financial corporations' saving mirrored their investment activity over time. After recording an average level of saving of just over 9% of GDP in the 1990s, their savings ratio climbed to more than 11% over the last decade and has averaged 13% in the current decade. There is no single explanation for this increase. Rather, it arose from several factors. First, small and medium-sized enterprises (SMEs), in particular, demonstrated a strong inclination to strengthen their equity base.[5] At the same time, they deleveraged and ran down their debt ratio. These measures strengthened firms' financial resilience. In the case of SMEs, which generally had little or no access to the capital market, a desire to reduce their reliance on the banking sector is likely to have played a role. Second, in times of heightened uncertainty, non-financial corporations seem to exhibit a preference for liquid assets. Third, tax considerations, such as the preferential treatment of business assets with respect to inheritance tax, may have been a factor in owners' decisions to leave more profits in their businesses. It should also be noted that, in this regard, profits retained at corporations that are partly foreign-owned should be regarded more as a case of foreign investors saving their percentage share of profits. Lastly, the lower interest rates have forced enterprises with pension obligations towards active and former employees to increase their provisions in recent years.[6] Extensive provisions have also been set aside in the energy sector to cover future burdens associated with nuclear energy, which also had the effect of pushing up savings.

Economic policy action needed, notably in terms of creating the framework conditions for private investment

In summary, then, the current account balance is the result of numerous, largely private-sector decisions both in Germany and abroad and therefore cannot be directly managed in a meaningful sense through macroeconomic policy. However, not least in view of the high level of saving exhibited by non-financial corporations, there is a need to consider whether, and through which adjustments, private investment activities can be meaningfully enhanced.

Goods flows and balance of trade

Foreign trade shows moderate upward tendency

German foreign trade expanded only moderately in 2016. In the case of exports, this was caused by the continued slowdown in the pace of global trade. With regard to imports, it was evident that exports, and machinery and equipment, as the two demand components with the highest import content, rose somewhat less robustly than in the previous year. On average in 2016, growth in exports of goods in real terms stood at 2%, compared with 5¼% one year earlier. The slight decline in prices meant

4 See, for example, Deutsche Bundesbank, Public finances, Monthly Report, November 2016, pp 62-63.
5 See, for example, Deutsche Bundesbank, German enterprises' profitability and financing in 2013, Monthly Report, December 2014, pp 37-48.
6 See Deutsche Bundesbank, Potential effects of the increase in pension provisions as a result of changes to the discount rate on non-financial corporations' savings, Monthly Report, December 2016, pp 60-63.

Foreign trade by region

%

Country/ group of countries	Percentage share 2016	Annual percentage change 2014	2015	2016
Exports				
Euro area	36.7	2.1	4.9	1.9
Other EU countries	22.0	10.1	10.1	2.6
of which				
United Kingdom	7.1	11.1	12.4	− 3.3
Central and east European EU countries[1]	11.3	11.3	9.8	5.5
Switzerland	4.2	− 1.5	6.2	2.6
Russia	1.8	− 18.4	− 25.9	− 0.3
United States	8.9	7.4	18.6	− 6.0
Japan	1.5	− 1.0	0.3	8.2
Newly industrialised economies in Asia[2]	3.2	7.4	8.8	1.2
China	6.3	11.1	− 4.1	6.8
South and east Asian emerging market economies[3]	2.2	− 0.1	4.5	1.6
OPEC	2.8	8.5	8.4	− 5.2
All countries	100.0	3.3	6.2	1.1
Imports				
Euro area	37.7	2.1	1.7	0.9
Other EU countries	20.2	6.2	5.7	3.2
of which				
United Kingdom	3.7	− 2.3	− 0.3	− 7.2
Central and east European EU countries[1]	13.7	10.7	9.2	6.9
Switzerland	4.6	2.8	6.8	4.3
Russia	2.8	− 7.1	− 21.5	− 12.1
United States	6.1	1.3	22.4	− 4.0
Japan	2.3	− 2.5	6.2	8.8
Newly industrialised economies in Asia[2]	2.4	3.7	8.3	− 1.1
China	9.8	7.1	15.2	2.0
South and east Asian emerging market economies[3]	3.8	6.7	14.5	3.8
OPEC	0.7	− 24.9	− 32.0	− 18.1
All countries	100.0	2.2	4.3	0.6

1 Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania. 2 Hong Kong, Singapore, South Korea, Taiwan. 3 India, Indonesia, Malaysia, Philippines, Thailand, Vietnam.
Deutsche Bundesbank

that the nominal increase was no more than just over 1%. Domestic activity remained robust overall, despite muted business investment, causing imports of goods to rise by a far stronger 3¾% in terms of volume. Owing to the sharp fall in prices, particularly for energy, the cost of imported goods went up by no more than ½% compared with 2015. This caused the foreign trade surplus to widen by €8 billion to €252 billion.

Increase in goods exports to the EU

As in the two preceding years, goods exports to EU countries developed more favourably in terms of value than those to countries outside the EU. In particular, exports to central and east European EU countries outside the euro area expanded very dynamically.[7] By contrast, the value of exports of goods to the United Kingdom decreased significantly, following two years of very high growth rates. The sharp depreciation of the pound sterling is likely to have played a key role here. As regards the euro area, demand for German goods picked up notably in Spain, thanks to the strong upturn there, but also in Italy and Portugal.

Nominal exports to third countries fall slightly

In 2016, the value of exports to countries outside the EU fell back slightly. A significant increase in goods exports to Asia, especially to China and Japan, contrasted with a strong reduction in deliveries of goods to the United States, though growth rates here had been high in previous years. Sales to the OPEC countries also dropped sharply, probably on account of the negative impact of the reduced scope for petro dollar recycling caused by the fall in oil prices.

Intermediate and consumer goods in particular demand

Demand in the international markets was particularly strong for German intermediate and consumer goods. By contrast, proceeds from the sale of capital goods increased at a below-average rate, given the ongoing subdued level of global investment activity. This was also true of sales of motor vehicles and motor vehicle

7 This group of countries includes Bulgaria, Croatia, Poland, Romania, the Czech Republic and Hungary.

parts, albeit after two highly successful years of pronounced growth in export sales.

Regional trends in imports similar to those in exports

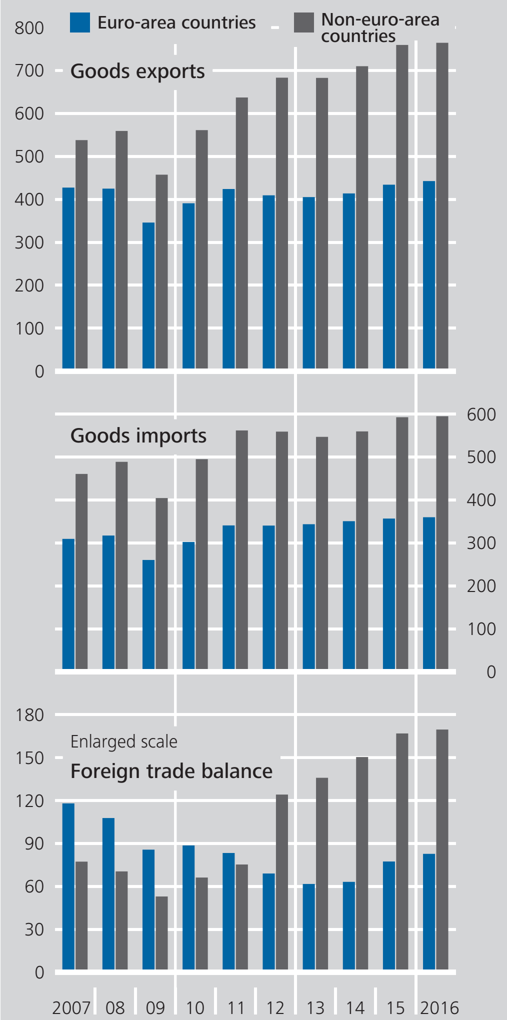
The regional development of imports of goods in 2016 was very similar to the dynamics displayed by exports of goods. Exporters from central and east European EU countries not belonging to the euro area posted substantial gains. In terms of value, Germany's partner countries in the euro area also benefited disproportionately from the vibrant domestic demand. Of the large euro-area countries, Italy and Spain increased their goods exports to Germany considerably. The same was true of Austria, from which Germany imported around one-tenth of its total imports from the euro area. However, the value of imports from the United Kingdom fell sharply. With regard to imports from non-EU countries, these produced a mixed picture in terms of their development. Imports of goods from Japan, Switzerland and China rose significantly, while the value of imports from the United States fell short of its level in 2015, when it was admittedly more than one-fifth up on the figures for 2014. Russia and the OPEC countries once again sustained a painful downturn in their proceeds from exports to Germany due to the lower energy prices.

Consumer goods and motor vehicles in particular demand

Foreign sellers of consumer goods and of motor vehicles benefited to a particular extent from the brisk consumption in Germany. After price adjustment, imports of consumer goods were up by 6%, while those of motor vehicles and motor vehicle parts even increased by more than one-tenth. That said, the demand for intermediate goods from abroad was also very strong. Conversely, the increase in imports of traditional capital goods in response to the muted investment activity in Germany was less pronounced. Lastly, the value of imported energy fell by an exceptional margin, not just because of the sharp decline in energy prices but also as a result of the subdued demand for imports of this commodity.

Germany's foreign trade within and outside the euro area

€ billion



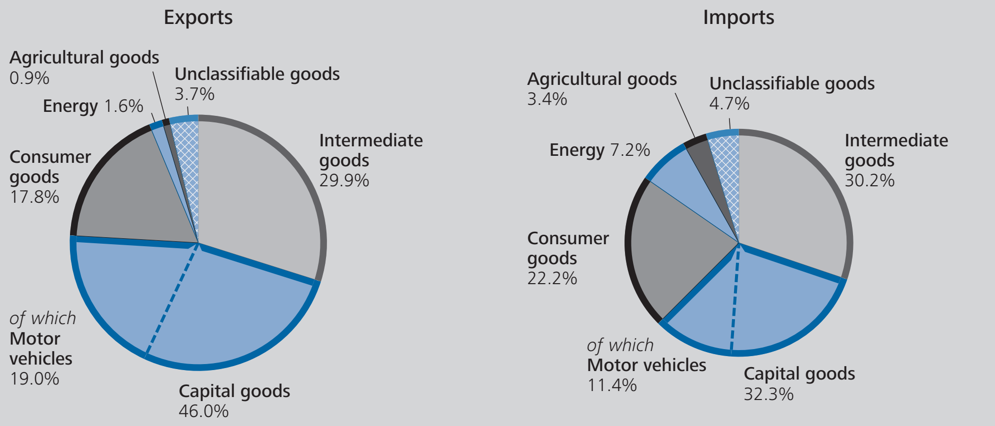
Source: Federal Statistical Office.
Deutsche Bundesbank

Breakdown of invisibles

Large rise in expenditure on services widens services deficit

In contrast to 2014 and 2015, Germany saw its cross-border services deficit widen in 2016. In the reporting period, services provided by non-residents cost €22½ billion more than the revenue generated by residents from services exports. The corresponding deficit thus widened by €4 billion compared with 2015, with expenditure on services imports rising much more strongly than the amount of revenue raised by exports of services. Euro-area countries and non-euro-area countries benefited to a similar extent from the increase in Germany's expend-

Foreign trade by selected categories of goods in 2016



Source of unadjusted figures: Federal Statistical Office. Deviations from 100% due to rounding.
Deutsche Bundesbank

iture on services. Since the higher revenue emanated mainly from business within the euro area, the result in the services account mainly deteriorated with respect to non-euro-area countries.

Increase in travel expenditure on the euro area

The increased level of expenditure in the euro area is probably in large part attributable to Germans' preference for travelling to destinations in this region. Cross-border travel, a sub-item of the services account, recorded a deficit of €39½ billion in 2016, €3 billion more than in the previous year. Year-on-year travel expenditure was up by a substantial margin (+5%); meanwhile, mounting political uncertainty in a number of holiday destinations led to an increase in visits to Italy and Spain, as well as to Croatia. Destinations in Turkey, Egypt and Tunisia were much less popular. Holidaymakers also switched to long-haul journeys to the United States, reversing the decline in 2015 that had been induced by the worsening exchange rate.

Commercial and business services see only moderate shifts

The other sub-items of the services account shifted only moderately compared with 2015. The traditionally very high level of turnover generated by German enterprises' international freight and logistics business decreased slightly during the year under review, with revenue contracting a little more than expenditure. The deficit in the transport account rose somewhat as a result. No clear trend was discernible for knowledge-based services in 2016. The international division of labour is making speedy progress in this area, with gross flows increasing enormously from year to year. Foreign demand for IT services from German suppliers is greater than German enterprises' expenditure on such services from abroad. That said, 2016 differed from previous years in that expenditure rose at a faster pace than revenue, with the result that the recorded surplus was slightly smaller than in 2015. The surplus in the research and development account fell significantly owing to the much higher foreign demand exhibited by German market players. On the other hand, the increase in revenue from the use of intellectual property bolstered the surplus in this sub-account. Professional and management consultancy services – also including commercial services, which have recorded a deficit for a long time – as well as commissions, technical services and other services showed greatly reduced deficits.

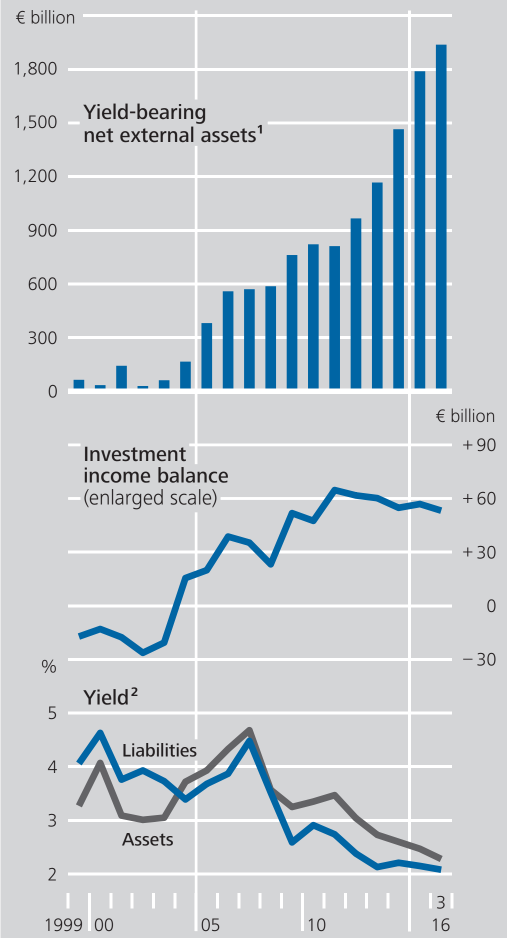
Investment income surplus narrows considerably

Germany's primary income from abroad last year exceeded its corresponding payments to the rest of the world by €52 billion. This narrowed the investment income surplus by €5 billion on the year. The main source of income here was net receipts from investment, which decreased by nearly €4 billion last year. Given the ongoing expansion of Germany's net external assets, the positive contribution of the accumulation effect is countered by stronger negative yield effects. On the one hand, the yield level effect served to offset the increase in investment income as global interest rates flattened out well into 2016. In addition, the stronger decline in yields on assets relative to the profitability of liabilities (differential effect) continued to work to the detriment of Germany in its capacity as a net creditor.[8] The narrower surplus in cross-border investment income is chiefly down to lower income. By contrast, expenditure was only slightly less down, with non-residents' holdings of domestic securities mainly generating lower income.

Almost no change in deficit from secondary income

As in the previous year, the cross-border secondary income balance closed in 2016 with a deficit of €40 billion. There were no substantial shifts within the individual items either. This meant that government transfers to international institutions – including contributions to the EU budget – remained largely unchanged. Transfers in the opposite direction, from the rest of the world to government, fell slightly. By contrast, private sector transfers to the rest of the world receded a little and inflows from outside Germany increased somewhat. This was largely down to insurance premiums and the settlement of balances by German reinsurers. In addition, initial estimates also point to a rise in personal transfers abroad; these mainly included remittances.

Key indicators of the cross-border investment income balance



1 Direct, portofolio and other investment excluding currency, financial derivatives and reserve assets. **2** Yields shown in terms of investment income / expenditure as a percentage of the annual average level of the international investment position (IIP). **3** For the IIP as at the end of 2016 Q3.
Deutsche Bundesbank

Financial transactions

Net capital exports affected by asset purchase programme

In 2016, Germany's current account surplus was mirrored by net capital exports in the amount of €231½ billion.[9] Much of this amount was attributable to portfolio investment, which was again considerably influenced last year by the Eurosystem's large-scale purchases of assets for monetary policy purposes. Given the bouts of intense political uncertainty and a backdrop of low yields, German investors continued to considerably increase their holdings of foreign fixed-income securities, though not to the same extent as in previous years. Foreign investors, on the other hand, divested themselves of domestic securities, particularly Federal bonds, most of which were ultimately taken on by the Bundesbank on balance. Direct investment likewise generated net capital exports, where continued strong international in-

8 For details of the underlying trend, see Deutsche Bundesbank, Effects on the cross-border investment income balance: asset accumulation, portfolio shifts and changes in yields, Monthly Report, March 2015, pp 81-85.
9 At the same time, the "Errors and omissions" item came to -€31 billion, following -€24½ billion in 2015.

vestment by German enterprises was crucial. Conversely, Germany recorded net capital imports in other investment. These were driven by inflows of funds at monetary financial institutions, enterprises and households. The Bundesbank once again saw another strong increase in its TARGET2 claims on account of the Eurosystem's asset purchases in the year under review.

Portfolio investment

Capital exports from portfolio investment up slightly

Portfolio investment generated net capital exports of €208 billion in 2016, following €197 billion one year earlier. German investors' demand for foreign securities and sales of German portfolio assets by non-residents contributed to this result in almost equal measure.

Reduced net demand for foreign debt securities

Last year saw domestic investors acquire a net €96½ billion worth of foreign securities (2015: €122 billion). Yet again, interest-bearing securities attracted the strongest demand. At €49 billion, however, net purchases of long-term debt securities were down on previous years. This decline undoubtedly had something to do with the sometimes unnerving effect which political events such as the Brexit decision in the United Kingdom, the US presidential election or the referendum on the constitution in Italy had on market participants, above all in the second half of the year. German investors offloaded bonds from the rest of the euro area on balance, and they extended their stocks of long-term debt securities issued outside the euro area. The APP is likely to have played a significant role in this reallocation of assets. Under the APP, the Eurosystem purchased bonds issued in the euro area worth a total of €899 billion in 2016, which sent their yields sharply lower while the yields of non-euro-denominated paper increased – distinctly in some cases – over the course of the year. Though the shift into bonds from countries outside the euro area saw demand lean more towards foreign currency bonds, net demand for bonds denominated in euro remained quite high (€26½ billion). A large part of these bonds were picked up by German investors from the United States, where issuance of corporate bonds denominated in euro has increased in recent years on account of the low euro interest rates.

Net capital imports of foreign money market instruments …

As in the previous year, German investors sold money market paper worth a net €6 billion, particularly offloading short-dated bonds that had been issued outside the euro area.

… and net capital exports of foreign shares

With equities performing well overall on international stock exchanges, domestic investors bought €17½ billion in foreign shares in 2016; however, this was less than one year earlier. Many of these equities were purchased outside the euro area, with US securities constituting a significant proportion as usual. German investors also stepped up their exposures in foreign mutual funds. Much like the previous year, they bought foreign fund shares for €36½ billion. A large number of the fund companies selling fund units in Germany are domiciled elsewhere in the euro area, which is why this region was the focus of domestic purchases of mutual fund shares.

Net sales of Bunds by foreign investors

In the opposite direction, foreign investors sold German securities worth €111½ billion in net terms in 2016, having already divested themselves of domestic securities last year (2015: €75 billion). Substantial sales and redemptions of German government bonds (€113 billion) were crucial in this regard. In the low-yield environment – ten-year Bunds even dipped into negative territory over the summer months – the APP will have been a major factor. As part of that programme, the Bundesbank also bought German debt securities issued by the public sector, the vast majority of which was purchased from foreign holders.

APP triggers shifts in German portfolio investment

The Eurosystem's decision to purchase public sector debt securities under the APP has radically transformed German portfolio investment in recent years. The years 2015 and 2016 saw non-residents offload public sector bonds worth €193 billion. Between the introduction of the euro and the end of 2014, by contrast, non-resident investors purchased German public sector bonds to the tune of €699½ billion net. Hence, the APP is impacting significantly on the investor structure of public debt securities. On balance, the purchase programme is driving Federal securities into the ownership of the Bundesbank while foreign investor stocks are shrinking.

Private sector bonds purchased instead

Meanwhile, the stocks of long-term bonds issued by German private issuers held in foreign portfolios rose by €17 billion in 2016. After a number of years in which credit institutions domiciled in Germany redeemed debt securities on balance, the year under review saw a renewed net issuance of bank debt securities, meaning that demand was also being met by a greater supply.

Foreign investment in short-term bonds, …

Foreign investors, meanwhile, reduced their stocks of German money market instruments in 2016. Redemptions and sales of short-dated private sector debt (€10 billion) contrasted with purchases of public sector issues (€2½ billion).

… shares and mutual fund shares

Stocks of dividend-bearing German securities in foreign portfolios barely budged in the year under review (-€1 billion), after German equities put in an average performance by international standards in 2016. Outflows of €7 billion were recorded for mutual fund shares.

Net capital exports of financial derivatives

The cross-border transactions associated with financial derivatives, which are aggregated to form a single item in the balance of payments, yielded net capital exports of €33 billion in the year under review. Forward and futures contracts accounted for three-quarters of this figure, while the rest was mainly attributable to options. Cross-border forward and futures contracts relating to electricity and gas sent a net €3½ billion abroad. Credit institutions were the main domestic counterparties for cross-border financial derivatives.

Major items of the balance of payments

€ billion

Item	2014r	2015r	2016r
I Current account	+ 218.0	+ 260.0	+ 261.4
1 Goods[1]	+ 228.4	+ 261.2	+ 271.7
Exports (fob)	1,115.8	1,179.2	1,195.0
Imports (fob)	887.4	918.0	923.4
Memo item			
Foreign trade[2]	+ 213.6	+ 244.3	+ 252.2
Exports (fob)	1,123.7	1,193.6	1,206.9
Imports (cif)	910.1	949.2	954.7
2 Services[3]	− 25.3	− 18.6	− 22.4
of which			
Travel	− 37.7	− 36.6	− 39.5
3 Primary income	+ 56.2	+ 57.4	+ 52.1
of which			
Investment income	+ 54.8	+ 56.9	+ 53.2
4 Secondary income	− 41.2	− 40.0	− 40.0
II Capital account	+ 2.4	− 0.6	+ 1.1
III Financial account balance[4]	+ 238.6	+ 234.6	+ 231.3
1 Direct investment	+ 72.0	+ 54.1	+ 22.6
2 Portfolio investment	+ 133.5	+ 196.9	+ 207.9
3 Financial derivatives[5]	+ 31.9	+ 26.2	+ 32.8
4 Other investment[6]	+ 3.8	− 40.4	− 33.8
5 Reserve assets[7]	− 2.6	− 2.2	+ 1.7
IV Errors and omissions[8]	+ 18.2	− 24.7	− 31.2

1 Excluding freight and insurance costs of foreign trade. **2** Special trade according to the official foreign trade statistics (source: Federal Statistical Office). **3** Including freight and insurance costs of foreign trade. **4** Increase in net external position: + / decrease in net external position: -. **5** Balance of transactions arising from options and financial futures contracts as well as employee stock options. **6** Includes in particular loans and trade credits as well as currency and deposits. **7** Excluding allocation of special drawing rights and excluding changes due to value adjustments. **8** Statistical errors and omissions, resulting from the difference between the balance on the financial account and the balances on the current account and the capital account.
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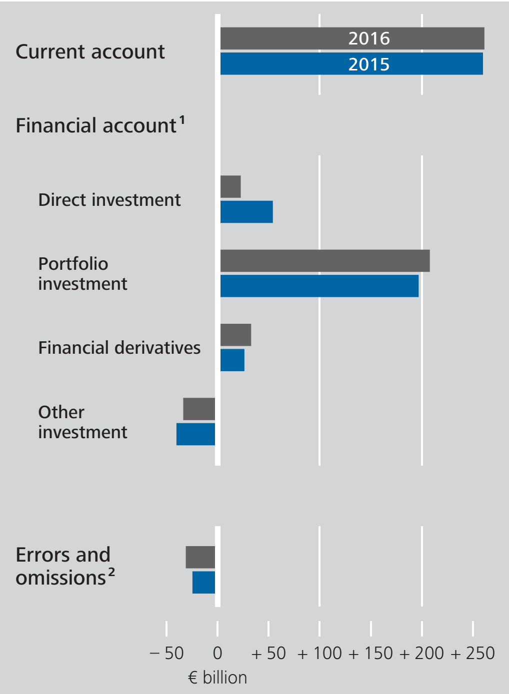
Major items of the German balance of payments

Balances



1 Excluding transaction-related changes in reserve assets; net capital exports: +. **2** Statistical errors and omissions.
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Direct investment

Fall in global direct investment

In a global setting with moderate economic growth and with different regions of the world facing diverging factors of influence and macroeconomic prospects, international direct investment flows fell overall in 2016, though developments varied from one region to the next. Preliminary estimates by the United Nations Conference on Trade and Development (UNCTAD) indicate that cross-border direct investment in 2016 was 13% down on a strong figure in the previous year which almost matched the pre-financial crisis level; this estimate put direct investment at US$1.5 trillion.[10] The downturn was notably driven by weaker investment in emerging market economies, where funding inflows were 20% lower than in 2015. This might be related to flatter economic growth and dips in commodity prices. Direct investors also invested less in industrial countries in 2016 than one year earlier (-9%). The United States and United Kingdom bucked the overall trend, however, by attracting stronger direct investment; large-scale mergers and acquisitions also played a significant role in this regard. Transition countries,[11] meanwhile, attracted stronger foreign direct investment in 2016 (+38%).

German FDI showing net capital exports

Germany's direct investment in 2016 produced net capital exports to the tune of €22½ billion. Intensive foreign direct investment by domestic enterprises combined with substantial inflows of direct investment into Germany contributed to this result.

German outbound FDI remains at high level

Direct investment abroad by German enterprises was markedly weaker last year (at €69½ billion) than in 2015 (€101½ billion), but it was still at a high level compared with earlier figures. German enterprises primarily stepped up their foreign affiliates' equity capital (€61½ billion).[12] Profits generated and reinvested abroad (not distributed) also played a role. Domestic enterprises used the intra-group credit channel to provide funds to group companies abroad in the amount of €7½ billion. This was a weak rate of growth by longer-term standards. German subsidiaries, in particular, used that channel to grant (almost exclusively short-term) loans to their foreign parent companies.

DIHK survey reveals strategic aims of German FDI

German enterprises use foreign direct investment – which is a rather long-term instrument – to pursue a range of strategic objectives. A survey by the German Chambers of Commerce and Industry (DIHK) of member

10 See UNCTAD, Global Investment Trends Monitor, No 25, 1 February 2017.
11 UNCTAD defines these countries primarily as states of the former Soviet Union.
12 According to data from Thomson One (Thomson Reuters), cross-border transactions by domestic enterprises associated with mergers and acquisitions increased by €14 billion, which is the lowest increase there has been for many years. The number of transactions was also down on the year at 87. These are closed M&A deals in which the purchaser owns 10% or more of the shares in the target enterprise after the transaction. The establishment of new foreign affiliates and increases in the equity stakes held in existing foreign subsidiaries thus play an important role for Germany.

firms from the manufacturing sector found that setting up sales and customer services was one of the most important reasons for investing abroad in 2016 (this was the case for 45% of the surveyed enterprises).[13] Furthermore, investing in foreign production sites in order to access markets (response given by 31% of companies) was again a key driver in 2016. In addition, more enterprises than in previous years (24%) stated that they invest in production abroad on cost grounds. This reason has been steadily gaining in significance since 2013, following a decade of trend decline. According to the study, many enterprises saw red tape in the target country as the greatest risk to the profitability of their direct investment. Respondents stated that political risks, currency risk and a lack of legal clarity as well in the target country could dampen future direct foreign investment.

Regional profile: Europe and USA main outbound FDI targets

Given this strategic motivation, German firms invest globally across multiple countries and in every region of the world. However, their direct investment relationships with other EU countries are particularly intense. First, these constitute important sales markets for German products, and, second, the development and production processes within Europe are often closely interlinked across borders. In 2016, around 60% of German outbound direct investment flowed to this group of countries. Looking at the individual target countries, the increase in German direct investment abroad was particularly strong in the Netherlands and Luxembourg – two key holding locations[14] – as well in the United Kingdom, Spain and Poland. Countries outside Europe likewise attracted an increased volume of direct investment from German enterprises, with particularly high levels in the United States and China. Just over half of all the new cross-border equity investments were made by financial and insurance

13 See DIHK survey – Foreign investments in manufacturing industry, Pausing for breath in China – Europe filling the gap, spring 2016.
14 It is not possible, on the basis of German balance of payments data, to ascertain where the funds of holding companies are ultimately invested.

Financial account

€ billion

Item	2014[r]	2015[r]	2016[r]
Financial account balance[1]	+ 238.6	+ 234.6	+ 231.3
1 Direct investment	+ 72.0	+ 54.1	+ 22.6
Domestic investment abroad[2]	+ 84.0	+ 101.4	+ 69.3
Foreign investment in the reporting country[2]	+ 11.9	+ 47.3	+ 46.7
2 Portfolio investment	+ 133.5	+ 196.9	+ 207.9
Domestic investment in foreign securities[2]	+ 147.0	+ 122.0	+ 96.6
Shares[3]	+ 8.9	+ 19.6	+ 17.3
Investment fund shares[4]	+ 42.1	+ 34.6	+ 36.6
Long-term debt securities[5]	+ 95.0	+ 73.5	+ 48.8
Short-term debt securities[6]	+ 1.0	− 5.7	− 6.1
Foreign investment in domestic securities[2]	+ 13.5	− 74.9	− 111.3
Shares[3]	+ 6.3	+ 9.7	− 1.0
Investment fund shares	− 3.8	+ 7.3	− 6.9
Long-term debt securities[5]	+ 14.1	− 101.2	− 95.7
Short-term debt securities[6]	− 3.2	+ 9.2	− 7.7
3 Financial derivatives[7]	+ 31.9	+ 26.2	+ 32.8
4 Other investment[8]	+ 3.8	− 40.4	− 33.8
Monetary financial institutions[9]	+ 43.8	− 49.1	− 68.1
Long-term	+ 35.7	+ 16.7	+ 39.3
Short-term	+ 8.1	− 65.9	− 107.3
Enterprises and households[10]	− 19.3	− 29.6	− 9.9
Long-term	+ 3.4	− 3.4	− 5.5
Short-term	− 22.7	− 26.1	− 4.5
General government	+ 22.9	− 0.7	− 0.6
Long-term	+ 0.5	− 3.6	− 2.5
Short-term	+ 22.3	+ 2.9	+ 1.9
Bundesbank	− 43.6	+ 39.0	+ 44.8
5 Reserve assets[11]	− 2.6	− 2.2	+ 1.7

1 Increase in net external position: + / decrease in net external position: -. 2 Increase: +. 3 Including participation certificates. 4 Including reinvestment of earnings. 5 Long-term: original maturity of more than one year or unlimited. 6 Short-term: original maturity of up to one year. 7 Balance of transactions arising from options and financial futures contracts as well as employee stock options. 8 Includes in particular loans and trade credits as well as currency and deposits. 9 Excluding the Bundesbank. 10 Includes the following sectors: financial corporations (excluding monetary financial institutions) as well as non-financial corporations, households and non-profit institutions serving households. 11 Excluding allocation of special drawing rights and excluding changes due to value adjustments.

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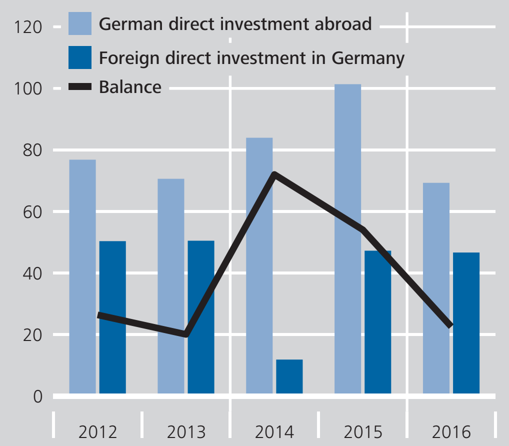
Direct investment

€ billion



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service providers, roughly one-quarter were attributable to enterprises in the manufacturing sector, primarily suppliers in the automotive industry, while just under a quarter were invested by companies that provide professional and technical services.

Inbound FDI remains strong

Non-resident investors stepped up their direct investment in Germany in 2016 by much the same amount as in 2015, providing German enterprises with funds amounting to €46½ billion, compared to €47½ billion in 2015. Specifically, they provided German enterprises with €12 billion in additional equity capital, also by way of reinvesting profits. The main channel for inbound FDI, however, was intra-group lending, which came to €34½ billion. Loans accounted for the lion's share of this amount and largely took the form of reverse flows, by which a subsidiary domiciled abroad grants a loan to a direct investor in the home country. These flows often originate from capital market transactions by financing vehicles, in which they issue securities abroad and pass on the proceeds to their parent companies in Germany. In contrast to previous practice, these reverse flows are now recorded as foreign direct investment in Germany pursuant to the rules of the Sixth Edition of the Balance of Payments Manual.[15] Flows were probably a great deal stronger in 2016 than in previous years on account of the favourable financing conditions for corporates in international capital markets.

Strong investment flows from EU and USA

The close cross-border links between corporate groups within Europe are also reflected in the regional profile of foreign direct investors, with more than three-quarters of inbound FDI in 2016 originating from EU countries. Especially large amounts flowed to Germany from the Netherlands, Luxembourg, the United Kingdom and Malta. For the Benelux countries, reverse flows were an important channel for loans. Swiss and US investors also substantially expanded their interest in Germany.[16]

Other investment

Net capital imports in other investment …

Other investment, comprising loans and trade credits (where these do not constitute direct investment) as well as bank deposits and other assets, saw net capital imports of €34 billion in 2016.

… driven by net inflows of funds to enterprises and households …

Non-banks received foreign funds worth €10½ billion net last year. These inflows were driven exclusively by transactions at enterprises and households (€10 billion), largely on account of a decline in their balances at foreign banks. By contrast, inbound and outbound transactions by general government roughly balanced each other out over the year in net terms. Public institutions increased both their balances with foreign banks and their unsecuritised liabilities to foreign creditors. In addition, they slightly scaled back claims arising from loans abroad.

… as well as to banks

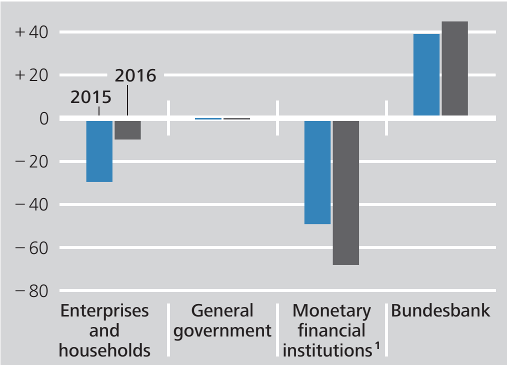
In the banking system as a whole, the net inflows of funds in 2016 amounted to €23½ billion. This was largely attributable to the net capital imports of monetary financial institu-

15 See also Deutsche Bundesbank, Changes in the methodology and classifications of the balance of payments and the international investment position, Monthly Report, June 2014, pp 57-68.
16 Foreign direct investment by Chinese investors did not play a significant role in nominal terms in 2016, although some corporate takeovers received major coverage in the press (and in some cases have since been carried out).

tions (excluding the Bundesbank) in the amount of €68 billion – a development which saw foreign investors, above all banks domiciled outside the euro area, strongly increase their deposits at German credit institutions (€87 billion). This rise might have something to do with sales of bonds by foreign banks to the Eurosystem under the APP (see also the box on pages 30 and 31). At the same time, German monetary financial institutions withdrew deposits from banks abroad, but stepped up their lending to non-banks. The Bundesbank's external position rose by €45 billion in 2016 on account of transactions. This was primarily attributable to higher claims within the TARGET2 large-value payments system. At €170 billion, 2016 saw the biggest increase within the space of a single year to date. This was mainly due to 2016 being the first full year of operation for the APP and the increased monthly purchase volume of €80 billion being effective since last April. Clearly, a notable share of the purchases – not only by the Bundesbank, but also by other Eurosystem national central banks and the ECB – is still being settled across borders by banks that participate in TARGET2 via the Bundesbank. This is ultimately behind the Bundesbank's rising claims on the ECB.[17] These higher external claims contrasted with a sharp upturn in the Bundesbank's external liabilities of €125½ billion. With yields on short-term Federal bonds deep in negative territory, this was primarily driven by an increase in deposits, predominantly by central banks outside the Eurosystem. Cross-border transactions using euro banknotes, on the other hand, yielded outflows of €14½ billion.[18]

Other investment* broken down by sector

Balances in € billion



* Includes in particular loans and trade credits as well as currency and deposits; net capital exports: +. **1** Excluding the Bundesbank.

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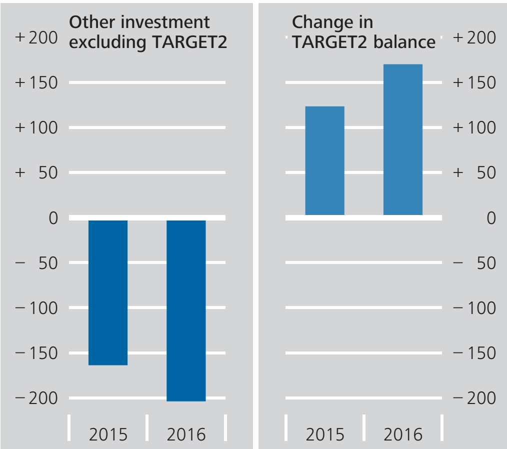
Impact of TARGET2 on other investment

€ billion



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Reserve assets

Transactions send reserve assets slightly higher

Transaction-related changes in the reserve assets are shown as a separate item in the balance of payments. Reserve assets increased by €1½ billion in 2016, mainly on account of a change in the reserve position with the IMF.

Balance sheet adjustments also had positive impact

The international reserve holdings were also influenced by balance sheet adjustments which, in line with internationally agreed accounting standards, are not recognised in the balance of payments. The end-of-year revaluation of the reserve assets at market prices boosted their value by an additional €14½ billion in 2016.

17 For more on how the APP impacts on TARGET2 balances, see Deutsche Bundesbank, The impact of Eurosystem securities purchases on the TARGET2 balances, Monthly Report, March 2016, pp 53-55.
18 For information on how transactions involving banknotes are recorded in the balance of payments, see Deutsche Bundesbank, Recording euro currency in the balance of payments and the international investment position, Monthly Report, March 2015, pp 91-93.

The increase in Germany's TARGET2 claims

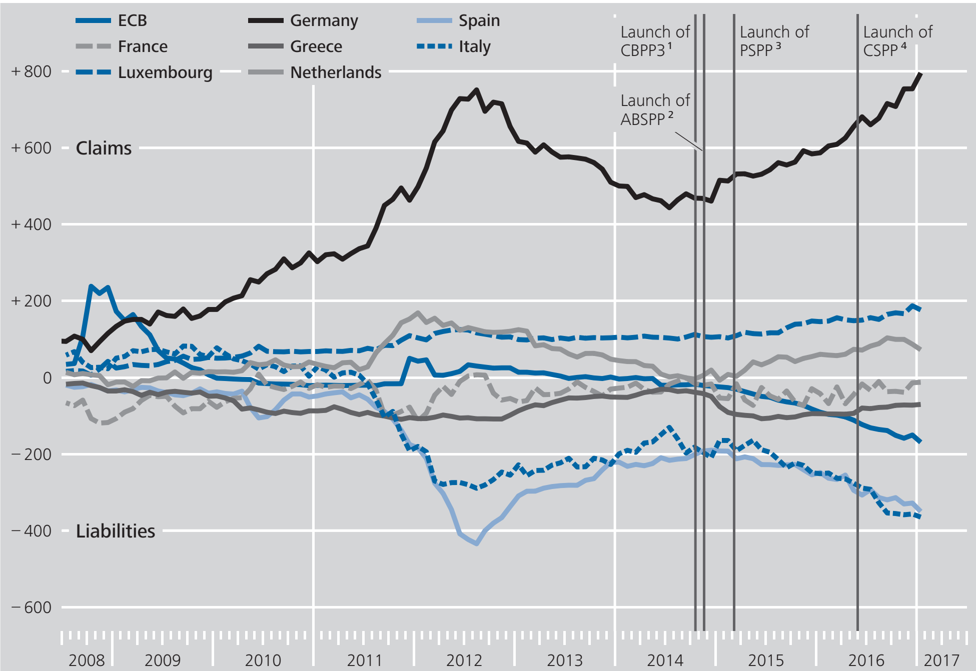
The Bundesbank's TARGET2 claims went up by €170 billion in 2016 to €754½ billion, having already risen by €123½ billion in the previous year.[1] These changes were directly reflected in the German balance of payments as capital exports. This increase also continued into the new year. As at 28 February 2017, Germany's TARGET2 claims amounted to €814½ billion and were thus significantly higher than the level reached during the peak of the European sovereign debt crisis in the summer of 2012 (see the chart below).[2]

The main reason for the strong growth in Germany's TARGET2 balances over the past two years was the implementation of the expanded asset purchase programme (APP). This was due to the fact that a significant part of the asset purchases by the Eurosystem are conducted with credit institutions located outside the euro area. This is especially true of asset purchases from credit institutions operating in the City of London, as international institutions often hold a TARGET2 account with the Bundesbank either directly or indirectly via their subsidiaries domiciled in Germany. If, for example, other Eurosystem central banks purchase securities from investors domiciled outside the euro area and the seller receives a credit entry on a TARGET2 account held with the Bundesbank, this, in itself, would lead to an increase in Germany's TARGET2 claims.[3] If this credit entry is made to an account that the seller holds with a bank domiciled in Germany, the deposits of non-resident investors held with German credit institutions also increase in the other investment

1 The sum total of TARGET2 claims/TARGET2 liabilities in the Eurosystem also rose during the reporting year by €245½ billion to €1,058½ billion.
2 At the same time, the Bundesbank's liabilities arising from the allocation of euro banknotes within the Eurosystem also rose. As at 28 February 2017, these liabilities totalled €330 billion.
3 In these cross-border transactions, any changes to the TARGET2 claims in the Eurosystem as a whole hinge on the existing TARGET2 positions of the NCBs involved in the transaction. This is explained in greater detail in: Deutsche Bundesbank, The impact of Eurosystem securities purchases on the TARGET2 balances, Monthly Report, March 2016, pp 53-56.

Selected TARGET2 balances in the Eurosystem

€ billion, month-end figures



Source: ECB. **1** Third covered bond purchase programme. **2** Asset-backed securities purchase programme. **3** Public sector purchase programme. **4** Corporate sector purchase programme.
Deutsche Bundesbank

account. Conversely, the Bundesbank's asset purchases conducted via accounts held abroad reduce Germany's TARGET2 balance when viewed in isolation. This effect is, however, lower than the one described above. The ECB plays a quantitatively important role in the increase of the TARGET2 balances, which itself purchases securities under the APP. The settlement of these purchases occurs via accounts held with the national central banks (NCBs).[4] In 2016, the ECB's deficit in the TARGET2 system rose by €68 billion.

The impact of the APP on the TARGET2 balances considered here focuses solely on the direct effects. The cross-border redistribution of the generated liquidity can result in further changes in the TARGET2 balances. It is worth noting, however, that these second-round effects do not cancel out the above-mentioned effects of the APP in a number of countries, including Germany.

TARGET2 balances could then be associated with a risk if a country with TARGET2 liabilities vis-à-vis the ECB leaves the monetary union, and if this claim has to be written off by the ECB. The Bundesbank's TARGET2 claims would not be the relevant benchmark under these circumstances, however. Instead, the key factor here would be the TARGET2 liabilities of the country leaving the monetary union. The losses which could potentially arise from a country not being able to fully fulfil its liabilities vis-à-vis the ECB would be shared among the remaining Eurosystem NCBs in line with their respective capital shares. Central banks with TARGET2 liabilities would therefore be affected in exactly the same way as those with TARGET2 claims on the ECB.

4 The ECB's role in managing accounts in TARGET2 is essentially limited to other pan-European payment systems operated by the private sector (notably EURO1 and CLS) where inpayments and outpayments mutually offset one another, therefore avoiding a build-up of TARGET2 balances at the ECB. The ECB can inter alia maintain accounts for other central banks as well as European and international organisations, but may not do so for credit institutions (ECB Governing Council's decision ECB/2007/7).

This was chiefly due to the higher price of gold, which drove up the value of German gold reserves. All in all, the year 2016 saw the carrying amount of Germany's reserve assets climb by €16½ billion to stand at a value of €176 billion as at 31 December 2016.