Foreign trade and payments

Overview

The strongest stimulus to the economic upturn in Germany came from its external trade during the third quarter of 1996. Although the remarkable recovery in foreign demand towards the end of last year was initially followed by a certain sluggishness in exports, these picked up appreciably during the summer months. As the trend in imports was much slower, Germany's export surplus in the third quarter, at DM 27½ billion, seasonally adjusted, was the highest recorded since reunification.

The trend in the balance on other current transactions with the rest of the world also had a favourable effect on Germany's current account in the third quarter. The deficit on current transfers to non-residents, in particular, declined significantly. However, refunds from the EC budget, which can be expected at such levels only on exceptional occasions, contributed to this. As a result, Germany's current account ran a seasonally adjusted deficit of only DM 4½ billion in the third quarter of this year, compared with DM 12 billion in the previous quarter and DM 7 billion in the third quarter of 1995.

Current account in detail

Exports

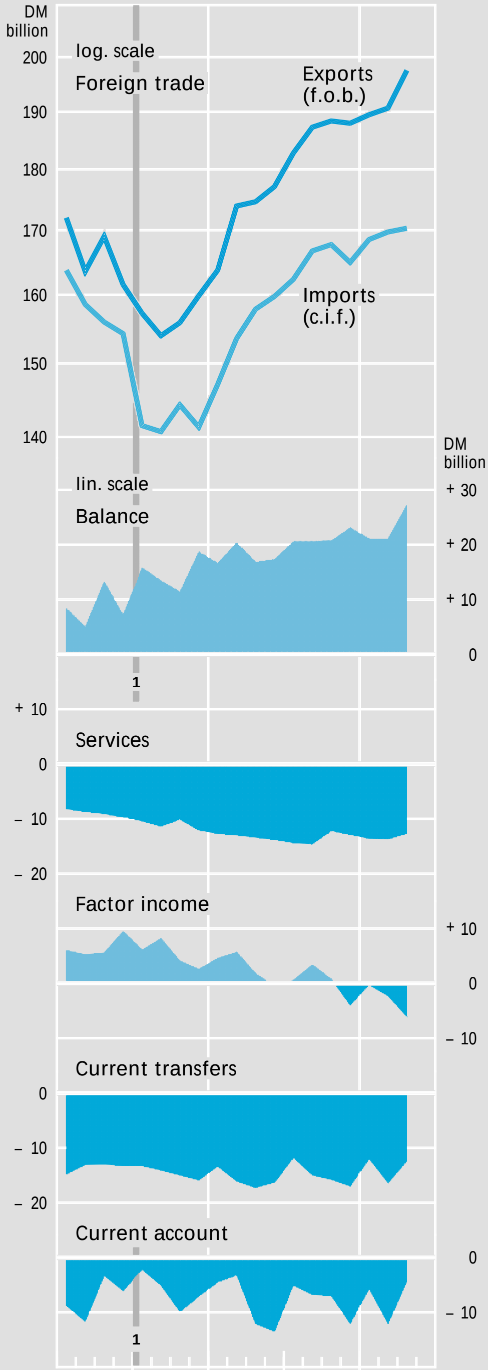
As already mentioned, the growth in German exports in the third quarter gathered pace discernibly in contrast to the moderate rise in the first half of 1996. Exports were recently increasing by just over 3½%, seasonally adjusted, compared with the third quarter and by only ½% compared with the second quarter of this year. The significant revival in deliveries to foreign customers during the summer months was not unexpected given the earlier rise in the orders received by German industry from abroad. In the third quarter the volume of export orders booked by Germany's manufacturing sector was a seasonally adjusted 10½% above the level in the final quarter of 1995 when demand from abroad had reached a low. The level of exports delivered in the period under review was not even half as high. That could be a sign that the upward trend in exports is continuing. The generally more favourable growth prospects for major export markets are also an indication of this, especially as the price competitiveness of German suppliers has decidedly improved after the normalisation of exchange rates against major partner currencies and the more moderate wage agreements reached this year, compared with those of 1995. The more favourable export expectations of industrialists established by the ifo business survey also suggest this.

Regional breakdown of exports

The regional breakdown of German exports of goods likewise shows that German exporters were quite successful on foreign markets with sufficient growth. Although the relevant figures for the third quarter of this year are not yet complete, the data available up to July show that in the past few months German exports to some regions have risen at rates of growth in double figures. This is particularly true in the case of exports to the rapidly growing countries in transition and to the OPEC states, which as a result of the recent increases in oil prices have acquired extensive amounts of foreign currency. The pace with which exports to the United States

Foreign trade and current account

Seasonally adjusted, quarterly



1 From January 1993 figures subject to major uncertainty owing to changes in the method of data collection in foreign trade.

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Regional breakdown of foreign trade *

April to July 1996; seasonally adjusted

Group of countries/ Country	Exports	Imports	Balance in DM billion 1
	Change from the period from December 1995 to March 1996 in %		April–July 1996
Industrial countries	+ 2.0	– 0.7	27.4
EU countries	+ 1.4	– 1.7	24.5
of which			
Belgium/Luxembourg	+ 5.4	– 9.2	2.7
France 2	+ 0.4	– 1.4	4.0
Italy	– 3.1	+ 0.0	1.0
Netherlands	+ 1.1	– 0.5	0.1
Spain	+ 1.1	– 1.4	2.0
United Kingdom	– 2.5	– 3.5	5.8
Other industrial countries	+ 3.8	+ 1.5	2.9
of which			
United States	+ 7.6	+ 4.5	3.6
Japan	+ 2.9	– 1.7	– 4.4
Countries in transition	+ 12.3	+ 9.3	0.4
of which			
Countries in central and eastern Europe	+ 15.7	+ 9.2	3.1
China	+ 10.3	+ 8.9	– 2.9
Developing countries	+ 3.0	– 0.8	7.8
of which			
OPEC countries	+ 13.7	+ 10.3	1.5
Newly industrialising countries in south-east Asia	+ 0.0	– 1.6	2.7
All countries	+ 1.9	+ 0.6	31.5

* Foreign trade of the Federal Republic of Germany as now territorially defined. — 1 The seasonally adjusted balances are subject to considerably greater uncertainty than the basic series from which they are derived. Discrepancies in the totals are due to separate seasonal adjustment and to rounding. — 2 Excluding aircraft.

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have grown has likewise been relatively high, whereas the expansion in the supplies of German products to the member states of the European Union has been only fairly moderate. Following the discernible downturn in the Italian economy, German exports to Italy have actually declined significantly. The virtual stagnation in exports to France is probably also to be explained in connection with the sluggish economic growth there. On the other hand, exports to Spain have increased somewhat more steeply. The decline in German exports to the United Kingdom is not quite consistent with this picture, however.

Breakdown of exported goods

The revival in the investment propensity of enterprises in major European partner countries has probably been the main contributory factor to the increase in exports in the autumn. This, at all events, is suggested by the data on the export orders which have been received by the German capital goods industry and which have risen at an above average rate, especially during the third quarter. However, this is not apparent from the figures on the breakdown of German exported goods so far available up to July. According to these, export growth concentrated on basic and producer goods, at least until the summer, whereas export sales of capital goods, which constitute a relatively large portion of Germany's product range, have practically stagnated since the end of last year.

Imports

Given the extent of Germany's economic revival, growth in imports has been fairly sluggish. It is true that the seasonally adjusted value of imports in the third quarter of 1996 rose by just under ½ %, compared with the second quarter, but it is likely that this growth was almost exclusively due to the rise in the prices of energy imports. As a result of higher oil prices in the period from April to July of this year, these prices increased by almost 11%, seasonally adjusted, compared with the previous four-month period. The value of petroleum imports alone was no less than 18% higher during this period than in the corresponding period a year earlier. The value rise itself amounted to 19½%. If sources of energy are excluded, however, imports by trade and industry declined slightly in seasonally adjusted terms right into the summer. Fewer raw materials and semi-finished goods, in particular, were imported, whereas there was only a marginal fall in the level of imported finished products (intermediates and end-products). This could have been due not least to the relatively robust state of the motor industry.

Regional breakdown of imports

The fact that the growth in total imports was dominated by energy imports is also apparent from the regional breakdown. Imports from the OPEC countries rose fastest in terms of value in the period from April to July (by a seasonally 10½%, compared with the preceding four-month period); the appreciable increase in imports from the central and east European countries in transition (+ 9%) was determined not least by the higher supplies of mineral oil and natural gas from Russia. By contrast, the seasonally adjusted imports of goods from the industrial countries fell (by just over ½%). Only the imports from the United States increased,whereas those from the member states of the European Union declined fairly sharply (– 1½%).

Revision of the monthly foreign trade figures from January 1995

The Federal Statistical Office has revised the monthly foreign trade figures for 1995 and the first seven months of 1996 significantly upwards and has therefore brought the various monthly figures into line with the total results for 1995, which had already been amended. The revisions in the case of exports in 1995 amounted to DM 17 billion; moreover, an estimate of just over DM 12 billion was added to the figures for the first seven months of 1996. The figures for imports were increased by DM 24 billion (for the whole of 1995) and by just over DM 16 billion (for the period from January to July 1996). The revisions affecting the monthly data for 1995 are concentrated on the first six months of the year.

The additional estimates became necessary because changes in the collection method had resulted in an underrecording of international transactions in goods within the European Union. Minor revisions were also made in the figures on trade with third countries. The overall picture of export and import trends during the past two years has not been substantially changed as a result of the revisions mentioned.

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Major items of the balance of payments

DM billion

Item	1995 [1]	1996 [1]	
	3rd qtr	2nd qtr	3rd qtr r
I. Current account			
1. Foreign trade [2]			
Exports (f.o.b.)	179.9	192.5	191.4
Imports (c.i.f.)	160.2	169.2	164.6
Balance	+ 19.6	+ 23.3	+ 26.9
Memo item Seasonally adjusted figures			
Exports (f.o.b.)	188.9	191.2	198.1
Imports (c.i.f.)	168.2	170.2	170.8
2. Supplementary trade items [3]	– 0.5	– 0.8	– 0.3
3. Services			
Receipts	33.6	32.5	35.1
Expenditure	51.4	46.1	53.5
Balance	– 17.8	– 13.6	– 18.3
4. Factor income (net)	– 0.4	+ 0.1	– 7.4
5. Current transfers			
from non-residents	4.8	5.4	5.8
to non-residents	19.8	21.0	17.5
Balance	– 14.9	– 15.6	– 11.7
Balance on current account	– 14.0	– 6.6	– 10.8
II. Capital transfers			
from non-residents	0.4	1.0	1.0
to non-residents	0.1	0.5	0.2
Balance	+ 0.3	+ 0.5	+ 0.7
III. Financial account (net capital exports: –)			
Direct investment	– 3.8	– 9.7	– 7.6
German investment abroad	– 7.2	– 8.2	– 11.5
Foreign investment in Germany	+ 3.4	– 1.5	+ 3.8
Portfolio investment [4]	+ 9.3	+ 21.9	+ 27.3
German investment abroad	– 14.2	– 9.4	– 13.6
Foreign investment in Germany	+ 23.4	+ 31.3	+ 40.9
Credit transactions [4]	+ 10.6	– 3.0	+ 1.4
Credit institutions	+ 2.4	+ 4.6	– 20.3
Long-term	+ 8.1	+ 5.0	+ 5.8
Short-term	– 5.7	– 0.4	– 26.2
Enterprises and individuals	+ 4.4	– 4.9	+ 12.9
Long-term	– 1.4	– 0.1	– 0.7
Short-term	+ 5.9	– 4.8	+ 13.6
Public authorities	+ 3.7	– 2.7	+ 8.8
Long-term	– 1.0	– 0.2	+ 2.0
Short-term	+ 4.7	– 2.5	+ 6.8
Other investment	– 0.8	– 0.9	– 1.0
Overall balance on financial account	+ 15.2	+ 8.3	+ 20.1
IV. Balance of unclassifiable transactions	+ 1.1	– 3.1	– 9.8
V. Change in the Bundesbank's net external assets at transaction values (increase: +) [5] (I plus II plus III plus IV)	+ 2.6	– 0.8	+ 0.2

1 Figures subject to major uncertainty owing to changes in the method of data collection in foreign trade. — **2** Special trade according to the official foreign trade statistics. — **3** Mainly warehouse transactions for account of residents and deduction of goods returned. — **4** Excluding direct investment. — **5** Excluding allocation of SDRs and changes due to value adjustments.

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Balance of invisibles

The aggregate deficit on invisible current transactions with non-residents in the form of exports and imports of services as well as cross-border factor services and current transfers rose less rapidly in the third quarter than is usual for the time of year. After elimination of regular seasonal fluctuations, the deficit, at just over DM 31 billion, was DM 1 billion lower than in the previous quarter. This was mainly due to the refunds from the EC budget which lowered the traditional deficit on Germany's transfer payments account.

Services account

The seasonally adjusted deficit on services fell to DM 12½ billion in the third quarter from DM 13½ billion in the previous quarter. The main contributory factor here was a further decline in expenditure on foreign travel during the period under review. After eliminating seasonal fluctuations, Germany's net expenditure on foreign travel amounted to DM 12½ billion, compared with approximately DM 13 billion in the first quarter. After the – sometimes substantial – growth rates in earlier years, a considerably more stable trend seems to be emerging in this area under the impact of less rapid rises in incomes.

Foreign travel

German tourists have recently been more reluctant than in preceding years to undertake long-haul trips, especially to Asian and African countries. In addition, the Alpine countries Switzerland and Austria have again sustained slight losses. On the other hand, the Mediterranean countries, in particular, again enjoyed considerable popularity with German tourists during the summer; growth was apparent in the expenditure by German tourists in Italy and Spain, in particular, but this was probably due not least to the appreciation of the national currencies concerned rather than an indication that there was a corresponding real growth in spending in these countries. However, destinations in France and in Canada as well as in Turkey and the central and east European countries in transition apparently continued to become more attractive.

Factor income

By contrast, the seasonally adjusted deficit on factor income rose further during the third quarter of 1996, from just over DM 2 billion in the second quarter to DM 6 billion in the third. The main reason for this was again the trend in cross-border investment income, whose balance has been generally subject to fairly sharp fluctuations in the course of the year. Differences in the times income from the various domestic and foreign investments is paid play just as much a role as corporate targets regarding the amount and time of profit transfers from affiliated enterprises. Even so, the persistent current account deficits and the decline in Germany's net external assets associated with this are continuing to have an adverse effect on Germany's investment income account.

Current transfers

Germany's large deficit on current transfers declined discernibly in the third quarter of 1996 for the first time in a while. At DM 12½ billion, seasonally adjusted, it was significantly lower than in the previous quarter (DM 16½ billion). As already mentioned, this was largely due to the refunds from the EC budget which accrued to Germany from the EU supplementary budget in September. Consequently, Germany's net contributions to the EC budget were distinctly lower in the third quarter than usual. The remaining current transfers were virtually unchanged. For example, DM 3 billion (net) was paid to non-residents in the form of pensions and maintenance payments, while the remittances of foreign workers to their home countries amounted to about DM 2 billion.

Financial transactions and reserve movements

Trends in financial transactions

International capital flows in the autumn were largely determined by convergence expectations associated with European economic and monetary union. Given a general fall in the interest trend, substantial capital flows into the south European EU countries resulted in a significant reduction in international interest rate differentials. Conversely, non-residents' interest in German securities waned discernibly. There were some shifts in the other sections of Germany's financial account, too, in the period from August to October 1996. For example, the seasonally adjusted net deficit on direct investment fell by one-third, compared with the previous three-month period, and domestic non-banks resorted in greater measure to short-term borrowing abroad. At the same time the net external position of the credit institutions improved slightly, as did that of the Bundesbank.

Portfolio investment

Expectations that interest rates would fall in some European countries with high interest rate levels and little hope that exchange rates would change in favour of the Deutsche Mark evidently resulted in international in-

Financial transactions

DM billion, net capital exports: –

Item	1995 Aug.–Oct.	1996 May–July	1996 Aug.–Oct. p
1. Direct investment	– 3.7	– 9.7	– 6.5
German investment abroad	– 8.2	– 10.2	– 8.9
Foreign investment in Germany	+ 4.5	+ 0.6	+ 2.4
2. Portfolio investment	+ 5.9	+ 34.4	+ 22.4
German investment abroad	– 15.4	– 11.5	– 7.9
Shares	+ 1.2	+ 1.6	– 1.3
Investment fund certificates	+ 0.4	– 1.4	+ 0.0
Bonds and notes	– 9.9	– 6.4	– 1.9
Money market paper	– 2.5	– 4.9	– 0.8
Financial derivatives 1	– 4.7	– 0.5	– 3.9
Foreign investment in Germany	+ 21.3	+ 46.0	+ 30.3
Shares	+ 2.0	+ 15.8	+ 1.2
Investment fund certificates	– 0.7	– 1.3	– 0.2
Bonds and notes	+ 15.6	+ 22.4	+ 21.5
Money market paper	– 0.0	+ 8.7	+ 5.6
Warrants	+ 4.4	+ 0.3	+ 2.3
3. Credit transactions	+ 26.2	– 31.7	+ 10.4
Credit institutions	+ 14.9	– 33.1	– 2.7
Long-term	+ 9.9	+ 6.3	+ 1.0
Short-term	+ 5.0	– 39.4	– 3.7
Enterprises and individuals	+ 13.0	– 1.8	+ 7.5
Long-term	– 0.7	– 0.5	– 0.4
Short-term 2	+ 13.6	– 1.4	+ 7.9
Public authorities	– 1.7	+ 3.2	+ 5.6
Long-term	– 2.3	+ 0.2	+ 1.2
Short-term	+ 0.6	+ 3.0	+ 4.4
4. Other investment	– 0.9	– 1.0	– 1.0
5. Balance of all statistically recorded capital flows	+ 27.4	– 8.0	+ 25.4
Memo item Change in the Bundesbank's net external assets at transaction values (increase: +) 3	+ 2.8	– 4.6	+ 3.5

1 Securitised and non-securitised options as well as financial futures contracts. — 2 Excluding the changes in financial operations with foreign non-banks and in the trade credits for October 1996, which are not yet known. — 3 Excluding allocation of SDRs and changes due to value adjustments.

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vestors revising their securities portfolios. This is reflected both in the trend and pattern of foreign demand for German securities. Whereas foreign investors had acquired German securities worth DM 46 billion net between May and July, their purchases between August and October amounted to only DM 30½ billion – and the trend fell appreciably from month to month. Much of the decline is due to the reduction in non-residents' investment in the German share market; at just over DM 1 billion, there was a much lower demand for equities from non-residents than in the period from May to July (DM 16 billion). However, a certain restraint in the period following the most important dividend payment dates is fully in tune with the behaviour of foreign investors in the German share market observed in the past.

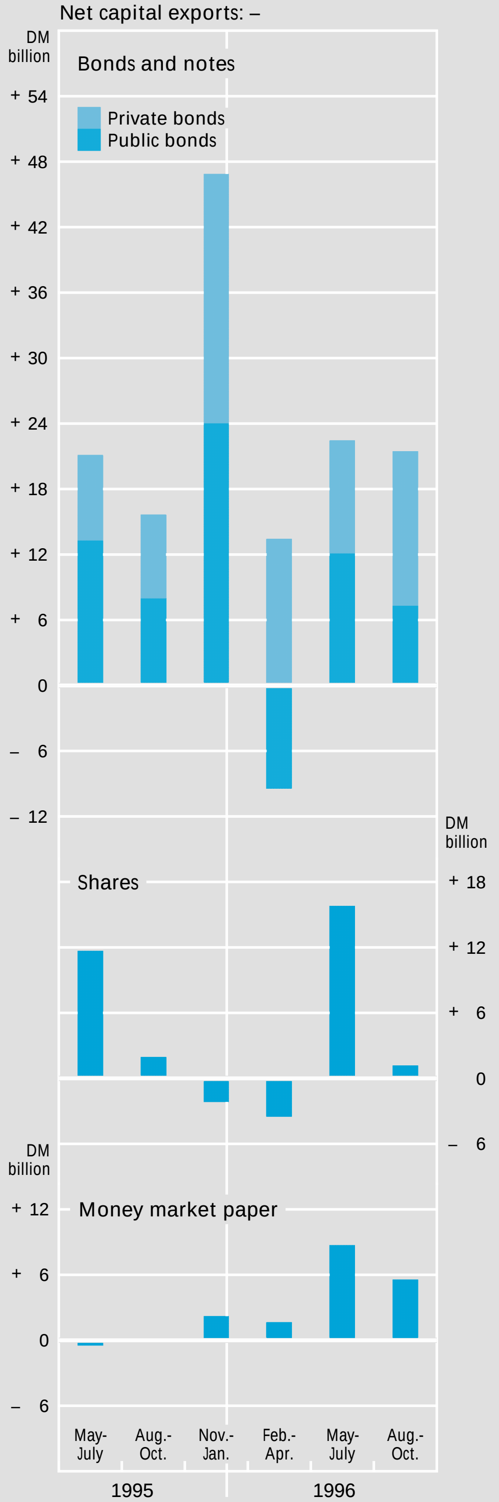
Foreign investment in Germany

In contrast to shares, bonds and notes remained fairly buoyant, if seen over the period under review as a whole. At DM 21½ billion, non-residents invested almost as much in German bonds as they had done in the previous period. After substantial inflows in August, however, demand declined sharply and finally dried up almost completely in October. There were significant shifts in the breakdown of the paper acquired in the process. Private bonds accounted for two-thirds of the net purchases of bonds and notes by non-residents, foreign currency bonds issued by credit institutions being particularly popular (+ DM 10 billion). On the other hand, public bonds, which are normally high in the list of foreign investors' preferences, recorded losses; only the two-year Treasury paper offered by the Federal Government for the first time in September attracted considerable interest from non-residents as well (+ DM 5 billion). Demand from non-residents for German money market paper (+ DM 5½ billion) continued to be buoyant, even though the record of the previous three-month period (+ DM 8½ billion) could not be repeated. In the case of this paper, too, the new products offered by the Federal Government (Bubills) played a dominant role.

German investment abroad

The interest of German investors in acquiring foreign securities had already declined discernibly some time ago. In the three-month period from August to October DM 8 billion net was spent on acquiring foreign securities (May to July: DM 11½ billion). Although interest in equities was encouraged by the favourable mood on major world exchanges (DM 1½ billion), there was much less demand for interest-yielding paper, at DM 2½ billion, than in the preceding period. German residents made a slight reduction in their holdings of foreign Deutsche Mark bonds in the process, while their propensity to buy money market paper was not very great, on balance. Only foreign currency bonds (DM 2½ billion) – particularly dollar bonds, which had an interest rate advantage over Deutsche Mark paper – attracted some demand. German credit institutions, in particular, were active as buyers of foreign securities. Generally speaking, the contraction in interest rate differentials in Europe apparently stopped German non-banks from investing substantial funds abroad, especially as significant capital gains could be achieved from shares and bonds in Germany, too. The transactions by Germans in foreign investment fund certifi-

Foreign investment in domestic securities



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cates cancelled each other out, on balance; the acquisition of certificates of traditional investment funds, at DM ½ billion, was accompanied by sales of money market fund certificates of a similar amount. In the end, payments for financial derivatives, at just under DM 4 billion, accounted for almost one-half of the funds exported through German portfolio investment abroad. This is largely a reflection of the hedging activities of the issuers of warrants.

Direct investment

In line with portfolio investment, German direct investment also declined during the period under review. German enterprises invested DM 9 billion abroad between August and October; this was just over DM 1 billion less than in the three months before. It must be remembered, however, that there are sharp fluctuations in the acquisition of participating interests abroad from month to month. If, therefore, the first ten months are taken together, the outward investment of German enterprises during this period amounted to DM 32 billion – which is just under one-fifth less than in the corresponding period last year when several large-scale transactions inflated the figures for German direct investment. The acquisition of new participating interests in central and eastern Europe and the expansion of existing interests there moved against the general trend with increases so far this year of approximately 50 %.

Foreign firms have likewise cut back on their investments in Germany; at DM 4½ billion, distinctly fewer funds were invested during the first ten months of the year than between January and October 1995 (DM 12½ billion); in the current year, however, roughly one-half of the partipating interests was acquired during the past three months. Net outflows arising from German direct investment abroad and foreign direct investment in Germany declined to DM 6½ billion during the period under review; in the previous three months (May-July) they had amounted to DM 9½ billion.

Credit transactions of non-banks

In contrast to the other sectors of the financial account, there were significantly larger net inflows arising from the statistically recorded credit transactions of non-banks between August and October, at DM 13 billion, than in the three months before (DM 1½ billion). This is primarily due to the short-term financial operations of entrepreneurs and individuals, who raised mainly short-term financial credits abroad. Like the social security funds, they also reduced their balances with foreign banks (Euro-deposits). In addition, long-term borrowing abroad brought a limited amount of funds to the public sector.

Credit transactions of credit institutions

There was very little change in the external position of the banks in the period from August to October – in contrast to the previous three-month period. Capital inflows of DM 1 billion net arising from credit transactions at the long end of the market were accompanied by outflows of short-term funds amounting to DM 3½ billion net. The most striking point here is that the borrowing of long-term funds abroad, which had played a major role in 1995, is becoming less and less important. This is in tune with the granting of long-term loans to non-residents, which has now become much less extensive than in 1995.

The significant fall in the outflows of funds at the short end of the market – from DM 39½ billion between May and July to DM 3½ billion in the period under review – is somewhat surprising in that the other current and financial transactions which had already been statistically recorded had not suggested that such a pronounced change in the banks' short-term payment flows was likely. This could indicate a swing in the unclassifiable transactions of the balance of payments, for which there are still no data available.

External position of the Bundesbank

The net external assets of the Bundesbank – at transaction values – increased by DM 3½ billion between August and October, compared with a decline of DM 4½ billion in the previous three months, primarily as a result of transactions with other central banks. The latest change is mainly due to a rise in monetary reserves; by contrast, the net external liabilities declined only slightly. As usual, interest income from foreign exchange investments and inflows of dollars from US troops stationed in Germany had a positive effect on the assets side of the Bundesbank's balance sheet. The net external assets increased further in November. At balance sheet rates, they rose to DM 109 billion at the end of November, compared with DM 104 billion at the end of July and DM 107 billion at the end of 1995.

Exchange rate trends

Dollar

The steady exchange rate trend of the Deutsche Mark, which has been characteristic of this year, continued during the autumn. Exchange rate relationships have eased discernibly again, especially against those currencies which had come under considerable downward pressure last year. The dollar, for example, has been moving within a margin of DM 1.47 to approximately DM 1.56 since the spring. In this context, however, the market tendency changed several times in line with the changes in the market participants' assessment of the future economic prospects for the economies concerned and their expectations on interest rates deriving from these. The dollar fell below the DM 1.50 mark in July, for example, then recovered quickly and broke through this mark again as early as the first half of September. The largely tension-free economic growth in the United States, however, soon forced any expectations about further interest rate policy measures by the US central bank into the background again – while the monetary policy stance of the Bundesbank precluded any basic revision of interest rate prospects for the Deutsche Mark. By the end of November the US currency had reasserted itself at a rate of just over DM 1.50. The presidential elections in the United States did not lead to any noteworthy exchange rate fluctuations either because the election result ultimately confirmed the pre-election opinion polls and therefore surprised virtually nobody. It was not until the past few weeks that the US currency again firmed significantly. When this

Entry of the Finnish markka and the Italian lira into the European exchange rate mechanism

Since the autumn of this year two further currencies have been participating in the European exchange rate mechanism. The Finnish markka, which the Finnish authorities had been preparing for its entry into the European exchange rate mechanism for some time, joined the system with effect from October 18, 1996. Finland, which had been particularly affected by the radical changes in eastern Europe, had already made sustained progress in achieving stability through a credible reform of its economic policy. The Italian lira rejoined the European exchange rate mechanism on November 25, 1996 after the exchange rate of the lira had largely recovered from its low in March 1995 and the Italian government had announced extensive consolidation measures.

The Deutsche Mark central rates were fixed at DM 32.89 per Fmk 100 and DM 1.01 per L 1,000 and allowed to move within the wider fluctuation margins of ± 15 % applying since the beginning of August 1993. Consequently, the highest exchange rate for the Finnish markka within this band is DM 38.20 and that of the lira DM 1.17; the lower intervention points are DM 28.33 for the Finnish markka and DM 0.87 for the lira.

DM central rates and intervention points

Currency	DM central rate	Highest rate	Lowest rate
Finnish markka	32.89	38.20	28.33
Italian lira	1.01	1.17	0.87

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Report went to press, it was being quoted at DM 1.55.

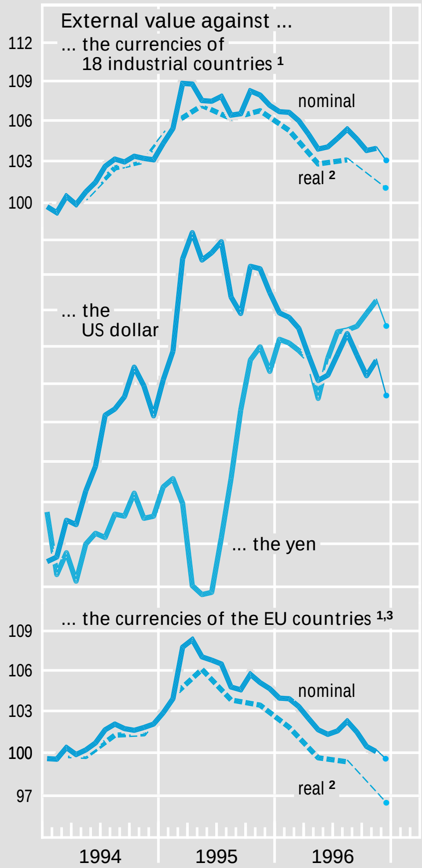
EU currencies

In the autumn the Deutsche Mark continued to move calmly against its European partner currencies, too. This applies in particular to its parity against the French franc and against the currencies which are traditionally closely linked to it, such as the Dutch guilder, the Austrian schilling and the Belgian franc, whereas other major European currencies, which had previously been losing considerable ground, firmed significantly. The substantial appreciation of the pound sterling is particularly interesting in this respect. This also had an effect on the Irish pound, which was now advancing to become the strongest currency in the European exchange rate mechanism. The British currency continued the upward trend that had already begun in the summer of this year and, at the time this Report went to press, was being quoted at DM 2.55. This means that the pound sterling has appreciated against the Deutsche Mark by approximately 8½ % during the past three months and by 15½ % since the beginning of the year. It is likely that renewed interest rate phantasies on the part of investors against the background of the sustained strong economic growth and the expectations of higher risks of inflation in the United Kingdom are one of the contributory factors to this trend. Moreover, it could be that relative to the Swiss franc, the pound sterling has become more attractive for some investors as a currency outside the EMS since the Swiss national bank lowered its discount rate to 1% at the end of September.

Another currency which has firmed further in the autumn is the Italian lira, which in October exceeded the DM 1 to L 1,000-mark and has hovered more or less at this level since then. Substantial capital inflows into Italy as a mark of confidence in the success of the consolidation measures which have been introduced have contributed decisively to this trend; on the other hand, speculation about Italy's participation in monetary union has probably also played a part. In November, the Italian government applied for the readmission of the Italian lira to the European exchange rate mechanism which the currency had left in September 1992. A month earlier the Finnish markka had accepted the rules of the exchange rate mechanism. Since the fixed central rates of the two currencies were within the expectations of market participants and therefore provided little surprise in the markets, there were no unusual exchange rate fluctuations in the case of either currency in the period following. However, in the case of the lira, in particular, the agreed central rate of L 990 to DM 1 has forced the Italian authorities to pursue their new consolidation policies consistently in order to ensure – as soon as possible and permanently – the necessary degree of convergence for participating in the European exchange rate mechanism without tensions (see page 72).

External value of the Deutsche Mark

1st qtr of 1994=100, log. scale



1 Weighted external value. — 2 External value after adjustment for the differing movements in overall prices as measured by the prices of total sales; quarterly. — 3 Including the Austrian schilling, Swedish krona and Finnish markka. — • = Latest position: average between December 1 and 11, 1996.

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Yen

To some extent the development of the Japanese currency contrasted with the fairly relaxed currency relationships in general. At any rate, the upward trend of the Deutsche Mark continued against the yen for a time in the autumn. At the end of October the yen, at DM 1.32, reached its lowest point against the Deutsche Mark so far this year. This is probably not simply a reflection of the continuing problems in the Japanese banking system. There is no doubt that the increasing uncertainty of market participants with regard to future economic developments following the expiry of stimulating fiscal policy measures also played a part. It was not until politicians seemed to give signs of an imminent change to more restrictive monetary and fiscal policies that the Japanese currency firmed somewhat against the Deutsche Mark and the dollar. When this Report went to press, the yen, at DM 1.36, was still being quoted about 7 % below its value at the end of April this year.

Nominal and real external values

On a weighted average of the currencies of 18 industrial countries, the previous appreciation of the Deutsche Mark receded further again during the autumn. When this Report went to press, it was being quoted more or less at the level it had reached two years earlier. After eliminating the different rates of price increases in Germany and its partner countries, the normalisation of exchange rate relationships became even more apparent. The real external value of the Deutsche Mark was recently the same as in mid-1994. Its real external value has declined even more against the currencies of other EU countries. This means that the competitiveness of German exporters in general, and against their major European trading partners in particular, has therefore probably improved perceptibly again recently.