Foreign trade and payments

Overview

The buoyancy of Germany's export business, which was the driving force behind the country's economic upturn last year, continued to underpin the upward economic trend in Germany during the first few months of this year. Although the crises in some countries in South-East Asia have had a detrimental effect on the sales opportunities of German enterprises in this region since last autumn, they have not adversely affected the underlying upward trend in German foreign trade as a whole. Despite the equally sharp rise in imports, the export surplus in the first quarter of 1998 rose by DM 2½ billion to DM 34½ billion, seasonally adjusted, compared with the previous quarter; this was almost DM 9 billion more than the comparable figure during the same period last year.

The trend in the case of invisibles was exactly the opposite of that in foreign trade; in the first three months of this year invisibles ran an overall seasonally adjusted deficit of DM 39½ billion compared with one of DM 27 billion in the final quarter of 1997. This was mainly due to the current transfers to non-residents, which rose sharply on balance owing to payments to the EC budget that had been brought forward. As a result, the larger export surplus was more than offset in the end. The German current account ran a seasonally adjusted deficit of DM 6 billion in the first quarter of 1998 compared with a surplus of DM 3 billion in the final quarter of 1997 and a deficit of DM 9½ billion in the first quarter of last year.

Current account in detail

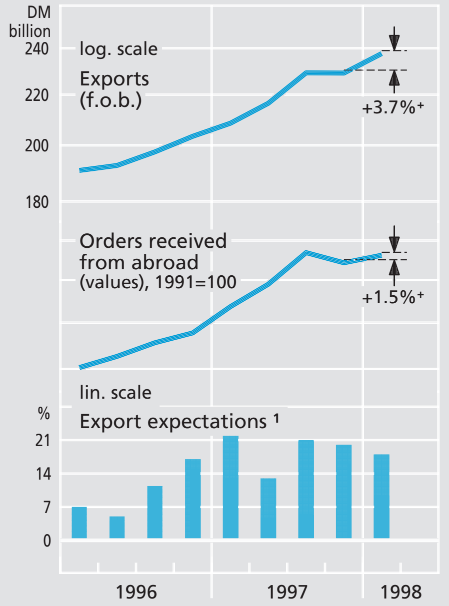
Exports

Following the temporary weakness in German export growth in the final quarter of 1997, exports again picked up significantly at the beginning of this year. In the first quarter of 1998 the seasonally adjusted value of exports rose by just over 3½ % compared with the previous quarter; this means that it was16 % above the figure in the corresponding period last year. In real terms, too, i.e. after eliminating the price increases (of approximately 1½ %) since the first quarter of 1997, there was a similar growth rate, at 14½ %. One of the reasons for this was the steep growth in the world economy, which – normally – is accompanied by an even greater upturn in the world trade volume. According to the latest estimates by international organisations, it is probable that, despite the disruption in growth in the crisis countries in South-East Asia, world trade expanded last year by something in the order of 9 % to 10 %; growth in 1998 is expected to be somewhat less pronounced.

German exporters were able to benefit from this growth to an above-average degree. The preconditions for this were created in 1996 and 1997 by radical restructuring and moderate wage rises, whose effects were steadily reinforced externally by the correction in exchange rate patterns. German exporting enterprises were evidently able to make substantial gains in market shares owing to the fillip they enjoyed from the general improvements in the price competitiveness of German products on the world markets arising from the interplay of domestic and external factors.

Export trend

Seasonally adjusted, quarterly



1 Values taken from the ifo business survey. Balances from company reports. — + Change from the previous quarter in %.

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The concurrently weakening demand in the crisis countries in South-East Asia was not reflected in the overall result, especially as these countries account for a relative small share of German exports (about 5 %). Nevertheless, export growth rates are now beginning to flatten out at the high level reached although this should be seen as a process of normalisation rather than a likely reverse in the trend. The rate at which export orders were received in the industrial sector likewise slowed down at the beginning of the year, in contrast to the exceptionally rapid growth during the previous two years.

Regional breakdown of exports

According to the data already available on the breakdown of German exports by country of destination, that is to say, figures up to February of this year, developments in the crisis areas of South-East Asia did have an impact on Germany's foreign trade with this region after all. For example, German exports to the group of South-East Asian emerging economies, which had been showing growth rates in double figures, were 5½% down in the first two months of this year, when compared with their level a year before. Exports to Japan, which, as a result of the pronounced weakness in the growth of the Japanese economy, had been in decline for some time, also showed another distinct downturn (– 14%). Overall, however, the upturn in demand in Europe and the United States more than compensated for the sales losses in the Asian export markets mentioned. For example, exports of German goods to the member states of the European Union (EU), which absorb about 55% of these, exceeded, in the first two months of the year, the level they had reached in the corresponding period of 1997 by 15½%. German exports to the United States, which account for 8½% of Germany's export total, actually rose by no less than 23% compared with the same time last year. German foreign trade with the countries in transition in central and eastern Europe again showed even slightly greater rates of growth (at 27%). Trade between Germany and these countries has been growing significantly over the past few years and, with a 10% share of the total, is now more important than the US market.

Regional breakdown of foreign trade

January – February 1998

Group of countries/ Country	Exports: DM billion	Exports: Change from the previous year in %	Imports: DM billion	Imports: Change from the previous year in %
Industrial countries	116.9	14.8	101.9	15.3
EU countries	88.2	15.5	74.3	16.0
of which				
Austria	8.2	13.6	5.1	16.0
Belgium/ Luxembourg	8.6	4.4	7.5	7.8
France	17.2	14.1	14.9	16.9
Italy	11.8	18.7	10.3	11.9
Netherlands	11.5	19.2	12.2	22.9
Spain	6.2	19.6	4.9	20.6
United Kingdom	13.4	19.1	9.4	16.6
Other industrial countries	28.7	12.8	27.6	13.3
of which				
United States	13.3	23.1	10.5	21.7
Japan	3.2	– 14.0	6.5	13.2
Countries in transition	17.0	25.1	16.4	10.4
of which				
Countries in central and eastern Europe	15.2	27.1	12.2	9.0
China 1	1.5	5.9	4.0	12.8
Developing countries	16.9	2.5	14.8	2.8
of which				
OPEC countries	2.8	5.8	1.9	– 18.4
Emerging markets in South-East Asia	6.6	– 5.4	7.2	7.9
All countries 2	151.1	14.3	133.2	11.6

1 Excluding Hong Kong. — **2** Totals here include figures which are not yet available in a regionally disaggregated form for 1997.

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Imports

The value of Germany's imports of goods in the first quarter of this year rose more or less at the same rate as that of exports. The seasonally adjusted increase was 3 % against the previous period and about 13 % compared with the first quarter of 1997. It must be remembered here, however, that import prices – in contrast to the prices of exported goods – fell substantially in the first quarter of 1998 (by a seasonally adjusted 1½ % compared with the previous quarter). If price changes are eliminated, the real rise in imported goods was therefore even slightly sharper, at about 4½ %, compared with the fourth quarter of 1997 than the real growth in exports. The main reasons for this were probably the general upturn in output in manufacturing during the first few months of this year and the favourable export trend, which had resulted in a growing demand for imports of primary products, semi-finished goods and raw materials. However, a price-related desire to lay in stocks may also have played a role.

Import prices

The decline in import prices became apparent as early as the autumn of last year after the international commodity markets had weakened significantly. Prices of petroleum fell particularly strongly. The dollar price for North Sea oil in March this year was only $ 13½ a barrel compared with an average of $ 19 in the fourth quarter of 1997. In terms of the Deutsche Mark and weighted by the shares of the various supplier countries in German petroleum imports, oil prices in March were 28 % below the level at the same time last year. Following OPEC decisions to reduce production, the situation on the oil markets stabilised considerably.

Imports by region

As a result of the close integration of European trade, Germany's increased demand for imports was mainly directed at the EU countries. At all events, the value of goods imported from other EU countries in the first two months of this year – more up-to-date figures are not yet available – exceeded the figure a year earlier by 16 %. Although the value of imports from the United States rose appreciably faster, it is likely that this is partly a reflection of the appreciation of the dollar over the past year, which made imports from the United States more expensive in Deutsche Mark. In real terms imports of US goods rose virtually no faster than those from EU countries. At just under 8 %, the rise in imports from the emerging economies in South-East Asia was also significant. One of the possible reasons for this is the improvement in the price competitiveness of these countries' products, given the – in some cases marked – depreciation of the currencies of these countries since the late summer of 1997. By contrast, the value of imports from the group of OPEC countries declined by 18½ % compared with the corresponding period a year earlier, notably as a result of the fall in the prices of crude oil.

Invisibles

As usual, the surplus in the trade in goods was accompanied by deficits on invisible transactions with non-residents, which comprise services, factor income and current transfers. The combined seasonally adjusted deficit of DM 39½ billion in the areas mentioned was distinctly greater in the first quarter of this year than it had been in the previous quarter (DM 27 billion).

Current account

DM billion; seasonally adjusted

Item	1997 3rd qtr	1997 4th qtr	1998 1st qtr
1. Foreign trade			
Exports (f.o.b.)	230.5	230.4	239.0
Imports (c.i.f.)	196.2	198.4	204.5
Balance	34.3	31.9	34.4
2. Services (balance)	– 13.9	– 14.1	– 15.6
of which			
Foreign travel (balance)	– 12.7	– 13.0	– 12.4
3. Factor income (balance)	0.7	– 2.5	– 3.9
of which			
Investment income (balance)	1.3	– 2.0	– 3.7
4. Current transfers (balance)	– 16.2	– 10.4	– 20.0
Balance on current account 1	3.1	3.2	– 6.0

1 Includes supplementary trade items.

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Current transfers

Unrequited transfers to non-residents rose particularly steeply; consequently, the rise in the deficit in this area was the main cause of the more substantial deficit on invisibles as a whole. In seasonally adjusted terms, the current transfers to non-residents in the first quarter of this year were, at DM 20 billion (net), almost twice as great as in the final quarter of 1997. Larger contributions to the EC budget were the primary reason for this. As in 1997, the rise was due to unusually large advance payments on the contributions which Germany has to make to the EC budget in the course of 1998 as a whole and which are then balanced out by correspondingly smaller transfers in subsequent months of the year.

Services account

The deficit on service transactions with non-residents in the first three months of this year (DM 15½ billion, seasonally adjusted) was likewise above the level in the previous quarter (just over DM 14 billion). German expenditure on imported services declined by 2%, partly as a result of the stabilisation in the previously increasing expenditure on foreign travel. Expenditure here actually fell slightly in seasonally adjusted terms compared with the preceding quarter. However, German receipts from exported services declined appreciably faster, at approximately 7%, than expenditure, notably as a result of reduced income from insurance services.

Factor income

Net seasonally adjusted expenditure in the case of factor income likewise increased. The deficits in this area amounted to approximately DM 4 billion in the first quarter of 1998 compared with DM 2½ billion in the final quarter of 1997. The marked rise of DM 3½ billion in the deficit on investment income is due largely to a downturn in the income generated abroad through direct investment. This development counteracted on the income side the positive effect which had led to significant increases in investment income from securities as a result of the increased propensity of German residents to invest in higher-yielding foreign currency paper and of the appreciation of the US dollar. Consequently, net receipts were marked by a significantly greater decline than investment income expenditure, which in view of the trend towards lower capital market rates likewise declined in the period under review.

Major items of the balance of payments

DM billion

Item	1997 1st qtr	1998 4th qtr	1998 1st qtr
I. Current account			
1. Foreign trade			
Exports (f.o.b.)	202.8	239.3	235.0
Imports (c.i.f.)	180.7	204.4	204.1
Balance	+ 22.0	+ 34.9	+ 30.9
2. Balance of invisibles	– 30.4	– 25.5	– 36.1
Balance on current account 1	– 9.9	+ 7.6	– 6.0
II. Balance of capital transfers	+ 0.9	+ 0.0	+ 1.4
III. Financial account 2			
Direct investment	– 16.4	– 20.2	– 5.9
Portfolio investment 3	– 4.2	+ 6.5	– 40.1
German investment abroad	– 45.6	– 20.1	– 83.2
Foreign investment in Germany	+ 41.4	+ 26.6	+ 43.2
Credit transactions 3, 4	+ 31.2	– 1.7	+ 30.3
Overall balance on financial account	+ 10.7	– 15.4	– 15.7
IV. Balance of unclassifiable transactions	– 3.6	+ 8.2	+ 21.3
V. Change in the Bundesbank's net external assets at transaction values (increase: +) 5 (I plus II plus III plus IV)	– 1.9	+ 0.4	+ 1.0

1 Includes supplementary trade items. — 2 Net capital exports: –. — 3 Excluding direct investment. — 4 Including other official and private investment. — 5 Excluding allocation of SDRs and changes due to value adjustments.

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Financial transactions and reserve movements

Trends in financial transactions

Fairly diverse trends were at play on the international financial markets at the beginning of 1998. While the situation in South-East Asia still appears unstable following the serious turbulences last year and despite a temporary period of calm, the equity and bond markets in the industrial countries looked in decidedly good shape for the most part. Against this background the capital flows recorded in Germany's balance of payments again increased strongly, and net capital exports arose in portfolio transactions and in direct investment; there were inflows of funds only in credit transactions. Furthermore, there was a slight rise in the net external assets of the Bundesbank.

Turnaround in portfolio transactions

The changed views of internationally oriented investors are reflected in the distinct turnaround in portfolio transactions. There were net capital outflows of DM 43 billion between January and April following net capital imports of DM 15 ½ billion between September and December 1997.

German investment in foreign ...

... shares

The main reason for the turnaround was the reawakened interest on the part of German investors in additional foreign assets, which more than trebled to just over DM 104 billion compared with the previous period. A record DM 54 billion went into foreign equities compared with only DM 12 billion in the final four-month period of 1997. Steep price rises in major foreign stock exchanges evidently raised demand considerably. For some time now German investment funds have been investing very heavily in foreign shares, and the substantial amounts of capital flowing into these funds at the beginning of the year have also to be seen in this connection. German investors' efforts at cross-border diversification in the run-up to European monetary union may also have played a part here. At any rate, this is suggested by the fact that in many cases shares in European partner countries were in particular demand.

... bonds

Bonds and notes were also in heavy demand. Overall, German investors – primarily German credit institutions – built up their holdings of foreign bonds by DM 32½ billion between January and April compared with DM 14½ billion in the previous period. Foreign currency bonds (DM 22½ billion), which had clearly suffered earlier from the crises in East Asia, again became the focus of increased interest. Investors favoured dollar assets, which – given the almost unchanged dollar exchange rate – benefited from the slightly increased interest rate differentials vis-à-vis longer-term Deutsche Mark paper. In contrast to what happened last year, however, "convergence trading" in European bonds and notes played only a minor role. In the period under review German investors also increased their purchases of foreign Deutsche Mark bonds (DM 10½ billion compared with DM 5 billion in the previous four-month period). Depending on the status of the issuers these bonds have been providing greater – in some cases considerably greater – yields than German paper.

Generally speaking, increased foreign activity on the part of German investors could like-

Financial transactions

DM billion, net capital exports: –

Item	1997 Jan. – April	1997 Sep. – Dec.	1998 Jan. – April
1. Direct investment	– 19.5	– 25.2	– 18.4
German investment abroad	– 17.4	– 23.5	– 27.0
Foreign investment in Germany	– 2.0	– 1.7	+ 8.6
2. Portfolio investment	– 18.1	+ 15.4	– 43.0
German investment abroad	– 57.7	– 32.2	– 104.2
Shares	– 32.1	– 12.1	– 53.9
Investment fund certificates	– 3.0	– 3.6	– 11.3
Bonds and notes	– 20.1	– 14.3	– 32.5
Money market paper	– 2.5	– 0.8	– 0.5
Financial derivatives 1	– 0.0	– 1.3	– 5.9
Foreign investment in Germany	+ 39.6	+ 47.6	+ 61.2
Shares	– 10.2	+ 5.5	+ 7.6
Investment fund certificates	+ 1.1	– 5.8	– 0.1
Bonds and notes	+ 45.6	+ 44.9	+ 49.0
Money market paper	+ 6.4	+ 2.9	+ 5.5
Warrants	– 3.2	+ 0.1	– 0.8
3. Credit transactions	+ 46.9	– 10.3	+ 33.7
Credit institutions	+ 92.9	– 39.9	+ 95.1
Long-term	+ 18.6	– 20.0	+ 7.2
Short-term	+ 74.3	– 19.9	+ 87.8
Enterprises and individuals	– 36.3	+ 30.7	– 60.3
Long-term	+ 0.6	+ 0.1	– 0.0
Short-term 2	– 36.9	+ 30.6	– 60.3
Public authorities	– 9.6	– 1.1	– 1.0
Long-term	– 5.3	– 0.3	– 1.2
Short-term	– 4.3	– 0.8	+ 0.2
4. Other investment	– 1.5	– 1.1	– 1.8
5. Balance of all statistically recorded capital flows	+ 7.8	– 21.2	– 29.6
Memo item Change in the Bundesbank's net external assets at transaction values (increase: +) 3	– 2.2	– 0.4	+ 1.9

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 April 1998, which are not yet known. — 3 Excluding allocation of SDRs and changes due to value adjustments.

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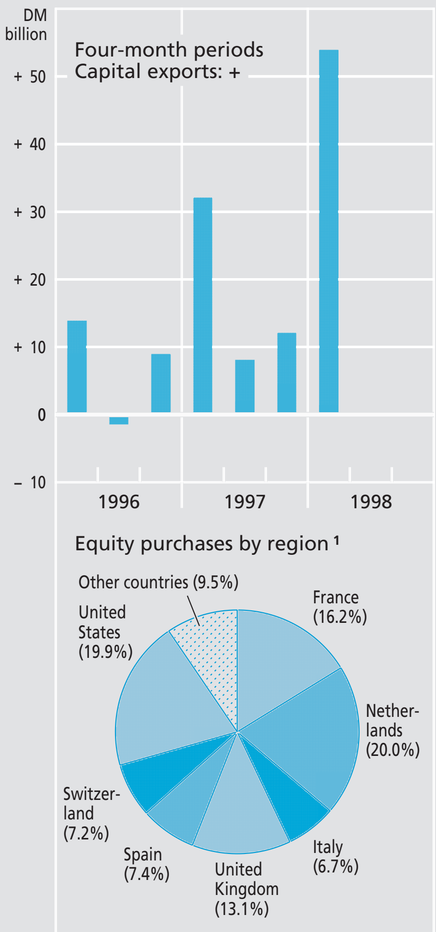
Purchases of foreign equities by German residents



1 Net purchases of foreign equities (excluding the breakdown of lending operations with foreign equities) from January to April 1998.

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wise be detected in the other segments of portfolio transactions. For example, investment in foreign investment funds rose by just under DM 11½ billion, including outflows of DM 2 billion into foreign money market funds, from which in the previous period German investors had withdrawn funds to a slight extent. By contrast, net acquisitions of money market paper (DM ½ billion) remained virtually unchanged at the low level already reached.

Foreign investment in German ...

The prolonged trend to internationalise investments was not only reflected in the increased foreign investment of German residents. It was also seen in the greater presence of non-residents on the German market. Foreign investors' net purchases of securities in Germany amounted to just over DM 61 billion between January and April compared with DM 47½ billion in the previous four months. However, the level of accrued funds here fluctuated quite considerably from month to month. For example, foreign investors sold domestic paper in March on balance whereas in the other months they made substantial net purchases. It is possible that in March foreign investors' activities were influenced by the discussions on the convergence reports published prior to the Council decision on participation in stage three of European economic and monetary union or by the end of the Japanese financial year.[1]

... bonds

Bonds and notes, at DM 49 billion, accounted for the lion's share of foreign investment during the period under review. In contrast to the previous period, however, interest was focused on the bonds of private borrowers. Foreign investors added bank bonds worth DM 38½ billion net to their portfolios (previous period: DM 10½ billion). Most of the demand

1 To some extent these fluctuations can also be attributed to securitised lending business, which in the German balance of payments is booked as portfolio transactions. As this lending business has now reached sizeable proportions, it can affect the overall result of portfolio transactions in particular months and only cancels out over the longer term when the coresponding reverse transactions are included.

here was for foreign currency bonds (DM 19½ billion) and public mortgage bonds (DM 15 billion). By contrast, purchases of public bonds (DM 10½ billion) declined discernibly compared with the final four months of 1997. Essentially, more extensive net purchases of government paper could only be seen in the case of two-year Federal Treasury notes *(Schätze)* (DM 12 billion), the Federal Government having launched a new issue of these in March 1998. The shift in international investors' asset preferences may be a reflection of a certain normalisation in portfolio management during the period under review; in the closing months of last year the "flight into the quality" of first-class government borrowers had formed the main thrust of the investment decisions of international financial market players.

... shares and other securities

In addition to their interest in bonds and notes non-residents showed continued interest in German shares (DM 7½ billion), whose prices rose sharply during the period under review. Domestic money market paper was likewise in heavy demand (DM 5½ billion), with purchases of short-term bank issues predominating towards the end of the period. By contrast, foreign investors made virtually no changes to their holdings of German investment fund certificates; in the previous period they had reduced them by DM 6 billion.

Direct investment

As in the case of cross-border portfolio transactions, there were net capital exports due to direct investment in the first four months of the year. At DM 18½ billion, however, these outflows were much smaller than in the previous period (just over DM 25 billion) as foreign enterprises were again investing in Germany to an appreciable extent for the first time in a while (DM 8½ billion); in the final four months of 1997 they had reduced their participating interests in Germany by DM 1½ billion. Partly as a result of a large single transaction in the financial sector, German purchases of participating interests abroad at the beginning of this year clearly exceeded, at DM 27 billion, the level of the previous period (DM 23½ billion). The preferred targets of German investors were undoubtedly the partner countries in the EU whereas the United States – where there had been a high level of investment in the previous year – appears to have become somewhat less important again.

Credit transactions of non-banks

Substantial amounts of funds also went abroad through the credit transactions of domestic non-banks between January and April. Thus, the (net) claims of enterprises and individuals on non-residents increased by no less that DM 60½ billion whereas between September 1997 and the end of the year they had decreased by DM 30½ billion. Most of these capital exports were the result of the usual reinvestment of short-term funds on the Euro-market at the beginning of the year. The management of public budgets likewise resulted in net outflows of funds (DM 1 billion); however, it was the long-term credit transactions with non-residents that predominated here.

Credit transactions of banks

Inflows of funds into the German banking system constitute the balance sheet counterpart to the net capital exports just described. The net external assets of the German credit institutions declined by DM 95 billion in the period under review whereas they had risen by DM 40 billion in the final four months of 1997. The banks' long-term credit transactions accounted for capital imports of only DM 7 billion between January and April 1998. The substantial inflows of short-term funds are to be seen as a reflection of the above-mentioned build-up of Euro-deposits by non-banks and of the capital exports arising from portfolio transactions.

Net external position of the Bundesbank

In contrast to what happened in the case of the external position of the credit institutions, the net external assets of the Bundesbank changed comparatively little during the first four months of 1998, increasing (at transaction values) by DM 2 billion whereas between September 1997 and the end of the year they had declined slightly (by DM ½ billion). The rise of DM 3½ billion in the external assets during the period under review was partly due to inflows of foreign exchange from dollar interest income and to receipts of dollars from US troops stationed in Germany. At the same time, however, the Bundesbank's liabilities to foreign monetary authorities and international organisations rose by DM 1½ billion. In May the net external assets of the Bundesbank increased by a further DM 1 billion. This means that the net extenal assets at the end of May, calculated at the (new) balance sheet rates fixed on May 14, 1998, amounted to DM 113½ billion compared with DM 111 billion at the turn of 1997-8.

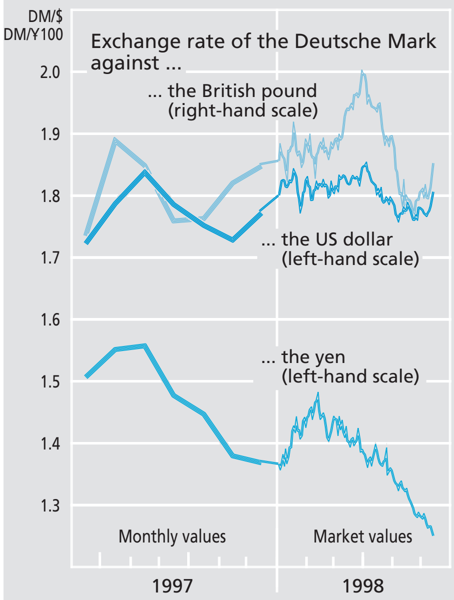
Exchange rate trends

Developments in the world foreign exchange markets in the spring of 1998 were still being influenced to some extent by the crises in East Asia and their after-effects. Movements in the currencies of the Asian crisis region itself and trends in the countries which are closely integrated with it economically were particularly marked by the continuing uncertainty. However, the foreign exchange markets in Europe were only marginally affected by this and, instead, were focusing their full attention on the forthcoming introduction of the euro at the beginning of next year and on the political measures which are associated with it and to which the markets have reacted in a thoroughly favourable manner. If some minor distortions are disregarded, the exchange rate environment in the spring may therefore be described as comparatively calm on the whole from Germany's point of view, a scenario that was reflected in the relatively stable trend in the trade-weighted external value of the Deutsche Mark.

US dollar

That also applies to the bilateral exchange rate of the Deutsche Mark against the US dollar, which in the spring initially moved – with few exceptions – in a relatively narrow corridor between DM 1.80 and DM 1.85. The robust economic growth in the United States is probably the main reason for the relatively firm position of the US currency. Despite the relatively high level of capacity utilisation, US economic growth has been showing hardly any sizeable inflationary tensions and therefore appears to have a solid base which will remain intact in the foreseeable future. How-

Exchange rates of selected currencies *



* Exchange rates calculated on the basis of the official spot middle rates.

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ever, the picture also includes the assessments of the growth prospects for the German economy in the first few months of this year, and these, in comparison, tend to be rather cautious. It was not until very recently that a more favourable view of development prospects in Germany gained acceptance, which, together with the favourable reception of the decisions at the beginning of May on the start of European monetary union, tended to strengthen the Deutsche Mark. At the time this Report went to press, the US dollar was being traded at DM 1.82.

Pound sterling

Initially, the pound sterling continued its upward trend against the Deutsche Mark and the continental European currencies closely linked to it. The faster and sustained growth rate of the British economy and the resultant expectations regarding interest rate trends probably played a decisive role in this. Another factor – of a temporary nature – may be that uncertainty with respect to the eventual form of European monetary union increased investor interest in the pound after the British government made it clear as early as last autumn that the United Kingdom would not be participating during the initial years of the union. At the end of March the British currency was being quoted at DM 3.10, which was its highest level so far this decade. However, the dampening effects which this was having on British exports had become increasingly apparent by then and were reflected in rising trade deficits. At the beginning of April the markets perceived this as a reason to make a certain adjustment to the hitherto prevailing trend of the pound. International investors' increased confidence in the euro following the decisions made at the beginning of May had a similar effect. The outcome was that in only six weeks up to the middle of May the British currency lost 20 pfennigs, or 6.5 %, against the Deutsche Mark. The exchange rate has stabilised since then and, at the time this Report went to press, was running at DM 2.97.

EMU currencies

The relationship of the Deutsche Mark to the other currencies participating in EMU had already been characterised by a remarkable degree of stability and an increasing rate of convergence towards the central rates agreed within the EMS. That applied even more so after the 3 % revaluation of the Irish pound in the middle of March, a move which restored parities to a balanced relationship in terms of the prevailing economic fundamentals. Discrepancies which still exist between the spot rates of the Irish pound, the Italian lira and Spanish peseta, on the one hand, and their DM parities, on the other, reflect the present interest rate differentials and the expected speed with which interest rates will be harmonised during the present run-up to monetary union at the beginning of next year.

Yen

The interest rate trend against the yen is still influenced by the East Asian currency turbulences and the ever-changing assessments of the economic and structural solutions. The initially sharp fall in value sustained by the Japanese currency during the second half of 1997 was checked towards the end of the year, and in the first few weeks of this year the yen actually appreciated again somewhat. Optimistic expectations with respect to assistance measures announced by the government were essentially responsible for this. When more detailed information about the real extent of the recession and about the state of the Japanese financial sector, in particular, was subsequently published, the yen again weakened. Awareness of the likely consequences of further depreciations on the already large trade surplus and trade relations, especially with the United States, were able to stop this trend only for a time. Even the – at times massive – intervention operations by the Japanese central bank were unable to reverse the yen's downward trend. When this Report went to press, the yen was being quoted at DM 1.24 and therefore much below its rate at the turn of the year (DM 1.38). Existing uncertainty about the state and future development prospects of the Japanese economy are reflected even more clearly in the high degree of implied volatility of the exchange rate of the yen than it is in the spot rate quotations themselves.

Weighted external value: nominal and real

On a weighted average the external value of the Deutsche Mark (against the currencies of 18 industrial countries), which had been relatively stable during the first three months of this year, has shown a slight upward tendency since April. When this Report went to press, it was 1.3 % above its value at the beginning of the year. However, after eliminating the differences in price movements in Germany and abroad, the real appreciation, at 0.8 %, was slightly lower. In view of the fact that the economic recovery appears to be accelerating and that the real external value of the Deutsche Mark against the currencies of other industrial countries was also slightly below its long-term average recently, this trend may be treated as quite appropriate. Consequently, virtually nothing has changed in the competitiveness of German products abroad.