

Recent trends in Germany's external relations with the south-east Asian emerging economies

The crises in the south-east Asian financial markets have led to a dramatic slump in the region's economic activity, following its prolonged dynamic growth, which has initiated a major reversal in the current account positions of the countries concerned. The region's economic relations with Germany have likewise been affected. German exporters have felt the effects most, having sustained in part sizeable turnover losses in this region for approximately one year now. But the crises have left their mark on financial relations, too, since German banks contributed to financing the south-east Asian growth in the last few years through quite considerable lending. The following article describes the changes evident so far in the external economic relations between Germany and the countries of this region in the context of the growing mutual economic interdependence that has developed in the past few years.¹

The crises in south-east Asia: causes and consequences

Although the origins and causes of the crises in south-east Asia differ from country to country, certain similarities are evident. Unlike the other recent major international debt cri-

*Causes of the
crises*

¹ This report follows an earlier article on economic relations between Germany and south-east Asian countries. See Deutsche Bundesbank, Developments in external relations between Germany and the growth area of south-east Asia, Monthly Report, July 1994, pages 51-62.

ses in Mexico in 1994 and in Latin America in the early eighties, the massive dislocations in the financial markets in the Asian case were ultimately caused mainly by structural imbalances in the enterprise and financial sectors and in their financing relations. However, these structural weaknesses of the south-east Asian countries only became apparent from 1995 onwards, after the sharp appreciation of their currencies, most of which were pegged to the US dollar, increasingly impaired their competitiveness and led to growing current account deficits. On balance, these deficits were financed by revolving foreign currency capital imports on a substantial scale. However, growing external imbalances and the dwindling credibility of fixed pegging to the dollar began to undermine the fragile financing structures once short-term capital inflows slackened and capital was increasingly withdrawn from the region. In this context, the fact that the external debt was overwhelmingly short-term and denominated in foreign currencies played a fateful role.

*Abandonment
of exchange
rate pegging*

At the beginning of July 1997, under the pressure of the steep fall in prices in the real estate and equity markets and the resulting increase in foreign exchange outflow, Thailand was the first country to float the exchange rate of its currency, which until then had been pegged to a currency basket dominated by the dollar. Subsequently most other south-east Asian countries adopted a similar response. The next countries to be hit by the crisis in the course of the summer were Malaysia, the Philippines and Indonesia (ASEAN 4 states). In the autumn, the turbulence spread to Hong Kong, Taiwan, Singapore

and, in particular, to South Korea which suffered an especially serious crisis at the end of the year. Only Hong Kong, which has pegged its currency to the dollar in a currency board regime since 1983, was able to maintain its exchange rate peg and to fend off the "speculative" attack – although at the price of a steep rise in interest rates which heavily burdened its economy. Even Hong Kong was therefore unable to avoid dramatic falls in equity prices. All the other above-mentioned south-east Asian emerging economies suffered sizeable depreciations of their currencies vis-à-vis the US dollar, which at their peak amounted to more than 80 %.

The depreciations of the south-east Asian currencies vis-à-vis the Deutsche Mark were slightly smaller. The currencies of Thailand, Malaysia, South Korea and the Philippines depreciated by between 35 % and 50 % from mid-1997 to the peak of the crises at the beginning of 1998. Of late, the Indonesian rupiah has depreciated by as much as around 80 % against the Deutsche Mark owing to the country's particularly deep-rooted economic and political difficulties and the persisting problems regarding the implementation of the agreed IMF assistance programmes. Taiwan and Singapore were hit less hard; at the extremes their currencies lost just under 20 % of their value vis-à-vis the Deutsche Mark.

However, the sharp nominal depreciation of these countries' currencies has not led to a commensurate improvement in their price competitiveness compared with Germany. In part, the depreciation has merely offset the

*Depreciations
of the south-
east Asian
currencies*

*Inflation and
real exchange
rate
movements*

External value of selected south-east Asian currencies against the Deutsche Mark

1st qtr of 1990=100, quarterly, log. scale



1 Based on consumer prices.

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competitive disadvantage which these countries faced in recent years owing to their higher level of inflation. But even the real depreciation remaining after subtracting the cumulative inflation differential can hardly be considered to constitute a lasting improvement in south-east Asia's competitive position, since the increase in these countries' import prices caused by the devaluation of their currencies is triggering new inflationary impulses which may rapidly cancel out at least part of this competitive lead. Already at the beginning of this year inflation rates increased markedly in many of the countries in question. For instance, the rate of price increases in South Korea doubled to 9% in the first quarter of 1998 in a year-on-year comparison. In Indonesia inflation accelerated to almost 45% in April 1998, compared with just over 11% in 1997. Owing to the relatively high imported share of many products that form part of the exported goods of the countries affected by the crisis, as well as the difficulties which some faced in financing their imports, other direct negative effects occurred which diminish the size of the competitive lead which these countries appeared to have gained at first sight.

*Nominal and
real external
value*

Furthermore, part of the extreme falls in value in the foreign exchange markets recorded up to January of this year were later reversed. This applies particularly to countries which initiated the necessary reforms (South Korea and Thailand). In June the (trade-weighted) average nominal value of the currencies of the south-east Asian group of countries analysed in this article vis-à-vis the Deutsche Mark was 47% lower than last

year. In real terms – i.e. after making allowance for these countries' higher inflation rates – this depreciation against the Deutsche Mark was much smaller. If the preceding loss of competitiveness owing to higher inflation is also taken into account, e.g. by using the weighted real external value of the currencies in question vis-à-vis the Deutsche Mark in the early nineties as a yardstick, the scale of the depreciation comes "only" to an estimated 18%. Moreover, the depreciation of the south-east Asian currencies does not have a major impact on the Deutsche Mark's effective real external value vis-à-vis 27 currencies (which also include these south-east Asian currencies) owing to the relatively small weighting of these countries in German foreign trade. Provisional calculations indicate that the Deutsche Mark's real external value based on this expanded measure was latterly virtually at the same level as at the beginning of 1990.

However, from the perspective of German exporters, the perceptible slackening of the growth momentum in the south-east Asian markets is probably more important than the changes in the exchange rate relations. Prior to the outbreak of the crises this region was one of the world economy's most important growth areas, providing something of a compensatory effect to the German economy, particularly in the years of sluggish sales in Germany's traditional markets in Europe. The south-east Asian emerging economies provided strong stimuli to growth up to the mid-nineties, in particular. From 1990 until then, output in this region had increased at an average annual rate of more than 7%.

*Dramatic
deceleration
of economic
growth*

Owing to the retrenchment measures introduced in 1996 the rate of expansion subsequently slowed down, but it was still very strong compared with the growth of the European industrial countries. The drastic slump in the economic activity of south-east Asia did not occur until autumn last year. Provisional figures suggest that output in the ASEAN 4 states and in South Korea, which were hit hardest by the crises, actually dropped in the first quarter of 1998. In the estimation of the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD), the impact of the crises on the affected countries' economies will only become fully apparent in the course of this year.² This implies that the output of Indonesia, Thailand and South Korea will contract noticeably this year. However, a reversal of growth is also expected for Malaysia, Hong Kong, the Philippines and Singapore. In view of the Japanese economy's ongoing problems, which are having a negative impact on the entire Asian region and beyond owing to the close economic ties between Japan and the south-east Asian emerging economies, the slump may well continue for some while. The fact that implementing the necessary reform measures designed to overcome the structural deficiencies of some countries affected by the crisis will take some time likewise suggests that the slump will not end immediately.

*Improved
current account
position*

The dramatic slump in south-east Asia's economic growth is already being mirrored in the

² See OECD, Economic Outlook, June 1998, pages 141-148, and IMF, World Economic Outlook, May 1998, pages 3-7.

Economic indicators of selected south-east Asian countries

Item	1996	1997	1998 fore- cast ¹
Thailand			
GDP growth	6.4	-0.4	-1.5
Inflation	5.8	6.0	12.0
Current account (as % of GDP)	-7.8	-2.2	5.2
Malaysia			
GDP growth	8.6	7.8	1.4
Inflation	3.5	2.7	7.5
Current account (as % of GDP)	-4.9	-5.1	-0.5
Philippines			
GDP growth	5.7	5.1	1.8
Inflation	8.4	5.0	10.2
Current account (as % of GDP)	-4.7	-5.0	-0.7
Indonesia			
GDP growth	8.0	4.7	-8.5
Inflation	7.9	11.1	35.0
Current account (as % of GDP)	-3.3	-2.8	6.5
South Korea			
GDP growth	7.1	5.5	-0.2
Inflation	6.0	4.5	10.5
Current account (as % of GDP)	-4.8	-1.8	4.8
Taiwan			
GDP growth	5.7	6.0	5.9
Inflation	3.1	0.9	2.0
Current account (as % of GDP)	.	2.6	3.5
Hong Kong (China)			
GDP growth	4.9	5.2	0.9
Inflation	6.0	5.9	4.3
Current account (as % of GDP)	.	3.0	2.1
Singapore			
GDP growth	7.0	7.5	3.2
Inflation	1.3	2.2	2.5
Current account (as % of GDP)	15.0	14.9	15.4

¹ Source: OECD. As at June 1998 (OECD Economic Outlook).

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trade flow trends. Since the autumn and winter months of 1997 the import demand of the countries in question has fallen substantially in the wake of the restrictive stabilisation measures designed to overcome the crisis, the withdrawal of international creditors and the reluctance of the hard-hit domestic banks to lend. The widely expected increases in exports following the depreciations have largely failed to materialise so far. Nonetheless, the current account of the ASEAN 4 states and South Korea, which recorded an aggregate deficit of 27 billion dollars (i. e. 3 % of the GDP of this group of countries) in 1997, improved distinctly at the beginning of 1998.

Current account transactions between Germany and the south-east Asian countries³

Overview

German businesses made good use of the buoyant development in what was for a long time the world's most dynamic growth area and strengthened their position in these sales markets during the nineties. Following an accelerated rise in exports up to the mid-nineties, the share of goods exported to this region amounted to roughly 5½ % of the German export total, i. e. approximately twice as much as the average of the eighties, and remained more or less constant until 1997. But given the importance of these markets, which account for roughly 15 % of world trade, the German share is still rather modest. Germany correspondingly plays a fairly small role in the foreign trade of the group of countries under consideration; German partners account for

barely 4 % of their foreign trade. By contrast, Japanese and US enterprises are much more significant both as suppliers and customers (Japan: just over 16 %, United States: 17½ %).

Nevertheless, German exports to south-east Asian customers helped to stimulate the country's business activity, especially in the years of stagnating growth in western Europe. In 1993, for instance, the exports of German enterprises to the south-east Asian emerging economies increased by 15½ %, whereas overall German exports declined. Similarly, even in 1994, when the cyclical outlook for Germany and its west European trading partners brightened more rapidly and perceptibly than many people had initially expected, German deliveries to the south-east Asian emerging economies grew by 23 %, which was again much faster than overall export growth (+ 10 %). In 1995, too, German export trade with the south-east Asian emerging economies achieved a rate of expansion that was well above the average (13 %), while Germany's foreign trade with the industrial countries of Europe grew distinctly less rapidly (9 %).

This situation was only reversed in the course of 1997. With a 9 % increase in exports to the south-east Asian emerging economies, the German economy's sales growth in south-east Asia for the first time lagged behind the rise in demand in the other export markets, which had clearly picked up by that time (12½ %). The severity of the decline in sales

Export trends

³ Brunei, Hong Kong (China), Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand.

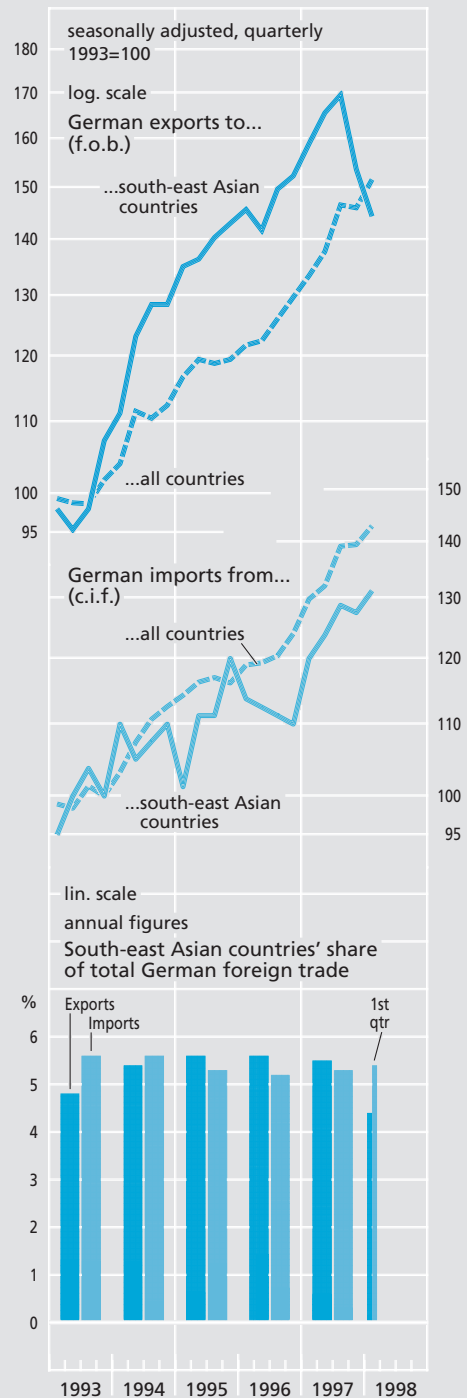
concealed behind this annual average was even greater than one might assume at first sight. Exports to south-east Asia dropped by no less than 9½% in the fourth quarter of 1997 against the preceding quarter in seasonally adjusted terms and by another 6% in the first quarter of 1998; as a result, they were just over 6½% down over twelve months.

However, this decline did not visibly affect the overall performance of German export activities, since the brisker European demand, which accounts for more than half of total German exports, more than offset the losses in the Asian region. Consequently, the share of the south-east Asian emerging economies in German exports fell by as much as 1 percentage point from 5½% in the summer of last year to 4½% in the spring of 1998. The individual branches of the German export trade were affected to varying degrees by the slump in business with Asia.

*Sectoral
breakdown of
exported goods*

Particularly for the German mechanical engineering industry, the south-east Asian emerging economies play a more important role as a sales market than the overall figures indicate. This industry delivers almost one-tenth of its exports to south-east Asia, which means that this region's share in the industry's exports is roughly twice as high as the overall average. Just over one-quarter of all the goods exported to this group of countries are produced by the mechanical engineering

German foreign trade with south-east Asian countries *



* Brunei, Hong Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Thailand.

industry.⁴ But the sharp decline in turnover in south-east Asia was accompanied by a notable improvement in the market situation in other regions, e. g. in Europe thanks above all to the higher level of investment, and orders from domestic customers have likewise picked up perceptibly of late, so that the losses in Asia – even for this important industry considered in isolation – were more than offset by the more favourable developments in other markets.

Besides machinery and equipment, German enterprises mainly supply electrical and chemical products to the south-east Asian emerging economies; they accounted for just under 6 % and 5 ½ %, respectively, of the overall exports of the two industries in 1997. The countries in question play a relatively small role as a sales market for the German automobile industry with an export share of only about 2 ½ %. But this owes less to the decline in turnover in south-east Asia than to the robust demand from Europe and the United States, which has led to a shift in the relative weights to the detriment of the region under consideration.

Import trends

With an average annual growth rate of just over 3 ½ %, imports of goods from the south-east Asian emerging economies increased by a much smaller margin than exports to this region throughout the period from 1993 to 1996. It was only last year that German goods imports from these countries picked up appreciably. In 1997, they exceeded the previous year's total by 11 ½ %, and in the first quarter of 1998 they rose by a further 3 % after seasonal adjustment compared

with the fourth quarter of 1997. Although the rate of increase in German imports from south-east Asia was relatively subdued over a long period, south-east Asia's share in total German imports, which amounted to almost 5 ½ % in 1997, was as high as the corresponding export share. Given the merely moderate rise in the overall export volume of the south-east Asian region, the recent sales trend in the German market appears remarkable.

The important role that the Asian emerging economies play as world-wide suppliers of electronic products is also reflected in the breakdown of goods which Germany imports from this region. This group of countries account for roughly one-quarter of all office machinery and computers imported by Germany and for approximately 16 % of the country's other electronic and electrical imports. The main suppliers in this field are Taiwan, South Korea, Malaysia and Singapore. The south-east Asian emerging economies have also become major suppliers of medical, precision and optical instruments to the German market. In 1997, they had a market share of 8 ½ % of the total imports of this category of goods. In addition, these countries are important centres of the textile and clothing industry, providing roughly 8 ½ % of Germany's imports in this subsector.

*Sectoral
breakdown of
imported goods*

⁴ At the beginning of 1997 a new system (GP 95) was introduced for the classification of goods in foreign trade statistics. This system has improved the comparability of production and foreign trade statistics. However, the associated changes in the classification and definition of goods categories mean that only a limited comparison is possible between individual product groups in the new and old classification systems.

*Invisible
transactions*

Compared with merchandise trade, the "invisible" current account transactions with the south-east Asian countries are much less significant. Whereas, from 1994 to mid-1997 merchandise trade resulted in a sizeable and growing surplus for Germany, which most recently reached an annual figure of around DM 8½ billion, the "invisibles" account showed annual net outflows to the countries under review amounting to between DM 2½ billion and DM 3 billion.

Foreign travel

The main factor in this context was German foreign travel spending, which amounted to DM 2.2 billion last year, compared with DM 1.7 billion in 1993. The expenditure of German tourists in Thailand accounted for the largest amount (DM 0.7 billion), while Singapore and Hong Kong also netted major sums from foreign travel (roughly DM ½ billion each).

*Current
transfers*

Furthermore, Germany regularly records an annual deficit in unrequited transfers to the tune of roughly DM ½ billion. Government transfers account for only a minor part of the net transfers to the south-east Asian countries. More than half are private sector transfers. Current transfers for pension and maintenance payments to the Philippines figure prominently (DM 0.2 billion p. a.).

Factor income

In the area of factor services and the labour and investment income they yield, receipts from south-east Asia were slightly predominant in recent years. Last year's surplus amounted to DM 0.7 billion net, compared with DM 0.1 billion in 1993. The chief component was the interest income which Ger-

German current account balance with south-east Asian countries

DM billion					
Item	1993	1994	1995	1996	1997
I. Goods ¹					
Exports (f.o.b.)	30.2	37.2	42.0	44.3	47.9
Imports (f.o.b.)	31.3	34.0	36.7	34.9	39.5
Balance	-1.1	3.2	5.3	9.3	8.4
II. Services (balance) ²	-2.6	-3.4	-2.5	-2.5	-2.8
of which:					
Foreign travel (balance)	-1.3	-1.7	-1.5	-1.5	-1.5
III. Factor income (balance)	0.1	0.6	0.0	0.6	0.7
IV. Current transfers (balance)	-0.4	-0.5	-0.4	-0.6	-0.6
Current account balance	-4.0	-0.1	2.4	6.8	5.7

¹ Including supplementary trade items. — ² Including freight and insurance costs of imports.

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man banks received on their loans to south-east Asia. In 1997 the credit institutions received DM 1.7 billion net (1993: DM 0.7 billion) with the lion's share coming from Hong Kong, Indonesia and Singapore. In addition, Germany received net inflows of direct investment income totalling DM 0.5 billion. Net outflows arose from interest payments on German securities held in south-east Asian portfolios (DM 2.1 billion); particularly Taiwan (DM 1.4 billion) and Singapore (DM 0.5 billion) generated sizeable investment income from their holdings of German (mainly fixed-rate) securities. The bulk of this is probably income earned on these countries' foreign exchange reserves denominated in Deutsche Mark.

Financial links with the south-east Asian emerging economies

Sharp expansion of financial links with the south-east Asian countries

Alongside the increase in the exchange of goods over the last five years, the mutual financial links between Germany and the south-east Asian emerging economies have also expanded substantially, although the degree of financial integration is not yet as high as the respective trade shares. This development was facilitated by the partial liberalisation of the south-east Asian financial markets, the expansion of the region's financial centres and its high growth rate up to the outbreak of the crisis. Between 1993 and 1997 German capital exports to these countries totalled roughly DM 46 ½ billion, which was almost four times as high as over the previous five years. On the other hand, the inflow of funds from this region to Germany, at DM 35 ½ billion, was likewise much higher than during the previous five-year period (DM 9 billion).⁵ On balance, the outflows nevertheless predominated, at roughly DM 10 ½ billion. Thus Germany's quite appreciable surpluses of late in its current account transactions with the south-east Asian emerging economies were accompanied by corresponding net capital exports in the medium-term perspective.

German investment in the south-east Asian emerging economies

Germany provided the south-east Asian emerging economies mainly with loans in the period under review (1993 to 1997: DM 30 ½ billion). The credit institutions in particular perceptibly increased their loans to borrowers in these countries, with loans to the financial centres of Hong Kong and Singapore accounting for the biggest share in terms of

amount. However, domestic enterprises, too, markedly increased their financial involvement in this region in the context of the rising exchange of goods. Given the region's growth potential – which has not been fundamentally called into question by the crisis – and low production costs, German enterprises not only granted trade credits but also made direct investments. Of late, domestic enterprises invested between DM 1 ½ billion and DM 2 billion per year on average in their subsidiaries in the south-east Asian emerging economies, after having invested approximately DM ½ billion a year in the early nineties. Only in the last three years did purchases of securities – especially the acquisition of shares on the Hong Kong stock exchange – gain slightly in importance on account of the growing interest of domestic investors in the “emerging markets” and the liberalisation of the financial markets in this area.

Conversely, investors from the south-east Asian emerging economies also invested quite sizeable amounts in Germany (totalling DM 35 ½ billion over the last five years). In this connection, securities purchases in the German market were to the fore, with the volume varying from year to year (totalling DM 17 ½ billion since 1993). They were main-

Investment by the south-east Asian emerging economies in Germany

⁵ The regional classification of financial transactions in the German balance of payments is largely based on the foreign counterparty's country of domicile; only portfolio transactions of German investors involving foreign securities are assigned to the country in which the traded securities were issued. Correct classification becomes difficult when cross-border financial transactions are not carried out directly with the actual lender's or borrower's country of domicile but via other financial centres. For instance, this would apply to transactions with partners in the international financial centres of Hong Kong and Singapore or to German securities purchased by south-east Asian investors via London-based securities firms.

Financial transactions with south-east Asian countries

DM billion; net capital exports: –

Item	1988 to 1992	1993 to 1997	1993	1994	1995	1996	1997
Capital exports to south-east Asia	– 12.3	– 46.4	– 7.5	– 3.2	– 13.3	– 13.8	– 8.4
Direct investment	– 2.2	– 7.3	– 0.5	– 1.1	– 1.9	– 2.1	– 1.5
Portfolio investment	– 1.3	– 8.4	– 0.4	– 1.1	– 1.5	– 2.8	– 2.6
Credit transactions ¹	– 9.4	– 30.7	– 6.6	– 1.0	– 9.9	– 8.9	– 4.3
of which:							
Credit institutions	– 7.2	– 22.0	– 6.0	– 0.7	– 6.2	– 6.7	– 2.4
Enterprises and individuals	– 1.6	– 8.1	– 0.3	– 0.2	– 3.6	– 2.2	– 1.8
Capital imports from south-east Asia	9.1	35.6	6.9	5.4	13.5	3.4	6.3
Direct investment	0.2	0.6	0.2	– 0.3	0.2	0.3	0.2
Portfolio investment	16.1	17.4	7.5	2.0	8.3	– 1.2	0.8
Credit transactions ¹	– 7.1	17.6	– 0.8	3.8	5.0	4.4	5.3
of which:							
Credit institutions	– 6.4	12.1	– 1.0	4.1	4.0	2.6	2.4
Enterprises and individuals	0.7	6.3	0.9	– 0.3	1.1	1.7	2.9
Balance of statistically recorded financial transactions	– 3.5	– 10.7	– 0.7	2.2	0.2	– 10.4	– 2.1

¹ Including other investment.

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ly focused on Federal Government bonds.⁶ As Taiwan, Hong Kong and Singapore, who form part of the group of countries studied in this article, are among the world's ten largest holders of foreign exchange reserves, it is likely that these securities represent in part invested monetary reserves.⁷ Capital imports in the form of unsecuritised credit transactions were just as high in terms of amount as the securities purchases. German credit institutions, in particular, received a substantial volume of short-term funds from interbank transactions with their own institutions based in Hong Kong and Singapore.

The crises in Asia represent a break in the generally positive development of financial relations. However, as in the case of merchandise trade, this break does not become fully

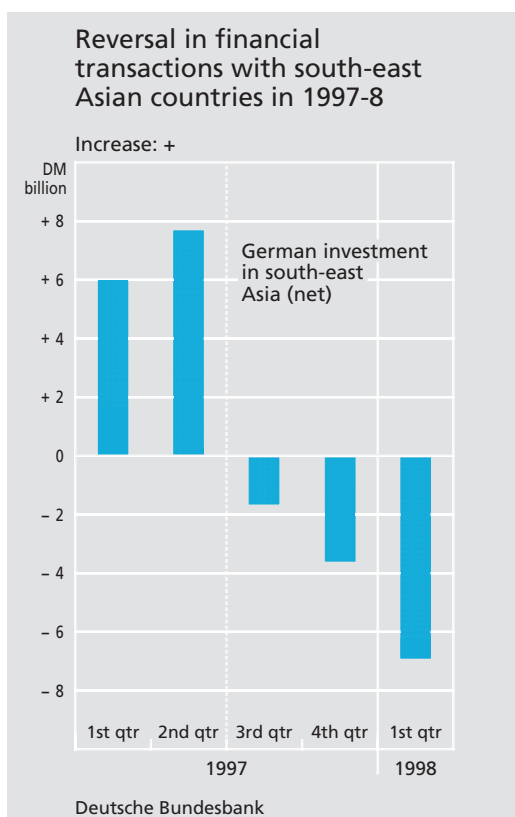
apparent in the annual figures. It is only the figures on the financial transactions from the autumn of last year that reveal the full scale of the marked turnaround in capital flows. Thus, whereas German capital donors had invested almost DM 15 billion in this region in the first half of 1997, they withdrew more than DM 5 billion in the second half and a further DM 7 billion in the first quarter of 1998. Above all, unsecuritised loans – and of these, primarily the short-term bank loans – were run down rapidly during the crisis; since

Consequences of the crises in south-east Asia for German financial transactions with this region

Withdrawals of funds by German investors

⁶ At the end of 1996 – more recent data are not yet available – the south-east Asian emerging economies held securities in Germany worth an estimated DM 56 billion, of which public-sector bonds accounted for around 90 %.

⁷ At the end of 1997 the combined foreign exchange reserves of the south-east Asian emerging economies amounted to roughly US \$ 320 billion, of which Taiwan accounted for US \$ 84 billion, Hong Kong for US \$ 75 ½ billion and Singapore for US \$ 71 billion.



mid-1997 the return flow amounted to roughly DM 14 billion. This tightening of credit lines is probably connected with a rescaling of the activities of many banks in the financial centres of Hong Kong and Singapore.

Furthermore, the turbulence prompted many German investors to sell securities emanating from the south-east Asian emerging economies – although only for a time and on a small scale (slightly more than DM ½ billion in the third quarter of 1997). But already in the last quarter of 1997 they took advantage of the drastically reduced prices in order to re-enter the market, and in the first quarter of 1998 – this time against the background of an at times quite buoyant stock market mood – they made further purchases on bal-

ance (just under DM ½ billion in each quarter).

German direct investment in the south-east Asian emerging economies proved even more stable. The data available so far do not indicate that the crises have had any negative impact on the establishment and expansion of foreign branches and subsidiaries in this region. This again proves that enterprises' equity investments are based on more longer-term considerations than the transactions in other financial segments. Nevertheless, it should be borne in mind that one of the prime motives for German direct investment in the south-east Asian emerging economies has deteriorated in the wake of the dramatic slump in economic activity. In view of the long planning and implementation times required for direct investment, however, it is still too early to reliably forecast the longer-term effects on this financial segment.

The investment behaviour of investors from the countries under review in the German market has also proved comparatively stable during the crisis so far. They drew on their assets invested in Germany only in the fourth quarter of 1997 and to a limited extent (just under DM 3 billion). But the beginning of this year already saw new investments amounting to DM 4½ billion.

The degree of financial interdependence between Germany and the south-east Asian emerging economies is reflected not so much in the capital flows, which fluctuate at times drastically from year to year, as in the stocks of assets and liabilities. At the end of March

Fairly steady investment behaviour of south-east Asian investors

Investment by German banks in the south-east Asian emerging economies

1998 German credit institutions had outstanding loans and advances to borrowers from the group of countries under consideration totalling DM 59 billion on their books. That represented roughly 4½ % of the total external assets of German credit institutions; this percentage was thus of a similar size to the region's share in German foreign trade.

*Loans and
advances*

Approximately half of the loans and advances were short-term interbank loans mostly granted to institutions in Hong Kong and Singapore. These financial centres have been well established as key hubs in the Asian region for many years, so that the actual borrowers do not necessarily come from these two countries. In addition, loans granted to Indonesia (DM 9 billion), South Korea (DM 8 billion) and Thailand (DM 5 billion) have recently also gained perceptibly in importance. But they are predominantly long-term loans to non-banks, many of which (with the exception of South Korea) appear to be related to project financing (through development banks).

Amounts owed

The south-east Asian emerging economies are much less significant for the borrowing business of domestic credit institutions than for their lending business. With deposits amounting to DM 24½ billion at the end of March 1998, creditors from the group of countries under consideration accounted for no more than 2½ % of the external liabilities of German banks. The bulk of these deposits (around three-quarters) resulted from short-term cash-clearing operations with south-east Asian banks, mainly in Hong Kong and Singapore.

The turbulence in south-east Asia has prompted many people to enquire about the "risk position" of the German banking system arising from lending operations with the crisis region. However, an analysis of domestic credit institutions is itself not sufficient to evaluate this position, since the loans and advances granted by German banks' branches and subsidiaries abroad to borrowers from the south-east Asian emerging economies are far more important.⁸ A comprehensive assessment of the value at risk must assign these claims to the German parent institutions and hence to the German banking system. In its semi-annual consolidated international banking statistics the Bank for International Settlements (BIS) publishes such lending business data classified according to the nationality of the banks involved.⁹ According to these statistics, the loans and advances of German banks to the south-east Asian emerging economies amounted to US \$ 103 billion (DM 184 billion) at the end of 1997, which accounted for just under 15 % of all bank loans and advances to the

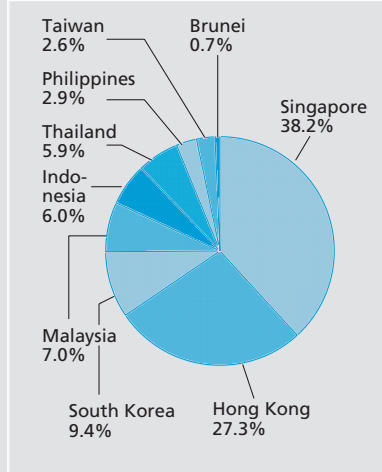
*Total risk
position of
German banks*

⁸ At the end of March 1998 the foreign branches of German banks recorded loans and advances to the south-east Asian emerging economies amounting to DM 126 billion, and their foreign subsidiaries DM 18 billion.

⁹ See BIS Press Release: Consolidated international banking statistics for end-1997. The BIS data for Germany are based on the banks' reports which the Bundesbank prepares in a special procedure according to internationally agreed criteria. In addition to the loans and advances granted by domestic credit institutions, the assets of their foreign branches and subsidiaries are also included in line with the nationality principle, whereas the loans of foreign banks established in Germany, which are included in the data on domestic credit institutions, are disregarded and assigned to their countries of origin (if the parent institutions or head offices are subject to reporting requirements). Further differences, for instance, relate to the loans and advances granted by German banks' branches and subsidiaries abroad to residents in the host country, which are included in the BIS statistics only if they are not denominated in the currency of the host country.

International claims of the German banking system on south-east Asian countries *

As at the end of 1997: US\$ 102.6 billion



* The German banking system is here defined as domestic German banks plus their branches and subsidiaries abroad. — Source: BIS.

Deutsche Bundesbank

group of countries under consideration as recorded by the (17) reporting countries.

*Informative
value of the
consolidated
international
banking
statistics*

Yet even this risk indicator requires qualification. The consolidated international banking statistics aggregate bank assets solely according to regional criteria. They are designed to provide an idea of the overall exposure of national banking systems to individual countries or groups of countries; however, the actual risk content of the recorded lending operations is not covered. The payment difficulties of Asian countries also showed how hard it can be even to fully capture a given country's bank liabilities. This is the case, in particular, if foreign subsidiaries of enterprises from a "crisis country" act as borrowers and if – as in the current system of classification – these loans are not assigned to the country in

which the parent company is based. Consolidation according to the "ultimate risk" principle on the borrowers' side is to ensure greater transparency in this area in the future.

Besides the credit institutions, domestic business enterprises (including individuals) also have close financial contacts with the south-east Asian emerging economies. Their investment is closely related to their commercial activities in the region. At the end of March 1998 their debtors totalled just under DM 18 billion and their creditors just over DM 17 billion. The trade debtors of German exporters accounted for two-thirds of these debtors, while more than half of the creditors consisted of advance payments on account of large-scale projects awarded to German enterprises. The regional structure of corporate debtors and creditors is much more uniform than in the banking sector. However, it does not accurately reflect the shares of the individual emerging economies in German foreign trade. Hong Kong, South Korea and Singapore have the closest corporate financial ties to Germany. The reports filed by domestic enterprises on their external position do not reveal the extent of their risk exposure to the crisis region; it may be assumed, however, that a significant part of the trade credits are secured by guarantees.

*Debtors and
creditors of
domestic
business
enterprises*

In addition to granting loans, domestic enterprises (including credit institutions) were involved in direct investment in the south-east Asian emerging economies amounting to an estimated DM 12½ billion at the end of

*Direct
investment*

1997.¹⁰ Owing to substantial investments in the financial sector, Hong Kong (with DM 2 ½ billion) and Singapore (with DM 4 billion) are the most important target countries in this region for German equity investments. Compared with these figures, the participations of the south-east Asian emerging economies in Germany are rather modest (totalling an estimated DM 3 billion), of which investments by South Korean enterprises in Germany accounted for just under DM 2 ½ billion.

Conclusion

Germany's financial integration with the south-east Asian emerging economies had progressed quite dynamically until the outbreak of the crises in the region. The turbulence triggered a reversal in some sectors, particularly in credit operations between German banks and their south-east Asian part-

ners. For the time being, the euphoria that was frequently connected with financial operations in south-east Asia seems to have dissipated. The future development of the mutual financial involvement will depend crucially on the containment and resolution of the problems in these countries, which needs to be accomplished as quickly as possible. Certain countries appear to have achieved some initial successes – in part with the assistance of the IMF.

¹⁰ These data are based on the statistics on German enterprises' international capital links. As these statistics are only available up to the end of 1996, the data were updated using the 1997 balance of payments transactions. The data only cover primary direct investment in the countries under consideration, whereas secondary participations through foreign holding companies are disregarded, although these do not play a major role in this context.