Foreign trade and payments

Overview

The strong export momentum, which had been providing a substantial stimulus to growth until the spring, has been increasingly curbed by the after-effects of the crises in South-East Asia. By the summer German exports were already stagnating, albeit at a very high level, and since the autumn they have actually seen a slight downturn. However, turnover on the import side has also been declining at the same time. This has been due not least to the sharp fall in import prices, especially for mineral oil and other raw materials. In the three-month period under review (August to October) Germany's trade surplus, at a seasonally adjusted DM 33 billion, was therefore a little below the level in the previous period (May to July: DM 36 billion). The seasonally adjusted deficit on invisibles during the period under review rose by almost DM 4 billion to just over DM 36 billion. Consequently, Germany's current account ran a slight deficit. This amounted to DM 2½ billion between August and October compared with a surplus of DM 2 billion in the previous three-month period.

Current account in detail

Export trend

Following the discernible deceleration in the pace of German exports as early as the summer, the seasonally adjusted value of the goods that Germany exported between August and October declined by 2½% compared with the period from May to July. As export prices fell slightly at the same time, the decline in real exports was somewhat smaller at approximately 2%. The growth in exports was also substantially slower than in the corresponding period last year; between August and October the annualised growth rate was just over 1% in real terms (compared with approximately 10 % in the first six months of the year). The main reason for the decline was the more sluggish global market growth, which is now clearly influenced by the crises in Asia and their effects on the world economy. A less favourable trend in German exporters' receipts of orders from abroad was already discernible in the first six months of this year. Since the summer a slight decline in new business from foreign customers has actually emerged compared with last year. According to data released by the ifo institute, entrepreneurs' export expectations have therefore become markedly less optimistic; for the first time in five years it was the negative forecasts that predominated among the industrial enterprises surveyed in September and October.

Export trend

Seasonally adjusted, quarterly

1 Values are taken from the ifo business survey and cover Germany as a whole. Balances are from positive and negative company reports. — ● = October 1998.

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Regional breakdown of exports

As expected, German exporters incurred particularly dramatic losses in trade with the emerging markets in South-East Asia; in the third quarter (more recent data on the regional breakdown of exports are not yet available) the value of exports by German enterprises to this group of countries was approximately 31% below the figure a year earlier. The economic weakness in Japan also led to discernible sales losses (12 %). Finally, the deterioration in the opportunities to sell German products in the OPEC countries, where demand had fallen sharply since last year as a result of the fall in earnings from oil exports, also had a dampening effect. In the third quarter German exporters recorded a 10 % fall in sales in these countries compared with the same period last year. However, owing to the limited significance of these markets, which, if South-East Asia and Japan are included, account for roughly 10 % of German exports, the full effects of the dramatic sales losses in the regions mentioned were not reflected in the overall figures. Instead, the brisk demand from other regions compensated to a certain extent for the dampening effects of the Asian markets. Demand from the partner countries in the European Union, which absorb more than one-half of all German exported goods, was particularly important here; in the third quarter German exports to these countries rose by 4½ % compared with the same period last year. Substantial growth was also achieved again in trade with the United States (11½ %). Regarding the deliveries by German enterprises to countries

Regional breakdown of foreign trade

Third quarter of 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	172.7	4.5	146.0	1.5
EU countries	126.0	4.5	103.7	– 0.3
of which				
Austria	11.9	1.2	7.6	6.3
Belgium/ Luxembourg	13.0	3.2	10.9	– 5.1
France	24.4	8.5	21.4	9.7
Italy	15.8	5.2	15.0	– 1.4
Netherlands	15.4	– 3.3	14.8	– 12.1
Spain	9.1	15.4	6.3	11.7
United Kingdom	20.1	4.3	13.3	– 1.8
Other industrial countries	46.6	4.5	42.3	6.1
of which				
United States	22.2	11.5	16.5	13.7
Japan	4.5	– 12.0	9.5	4.7
Countries in transition	28.9	6.7	28.0	12.3
of which				
Countries in central and eastern Europe	25.2	6.3	21.7	14.3
China 1	3.2	13.1	6.0	4.9
Developing countries	28.4	– 9.6	22.2	– 3.8
of which				
OPEC countries	4.9	– 10.1	2.8	– 23.7
Emerging markets in South-East Asia	8.9	– 30.8	10.1	– 2.9
All countries 2	230.6	2.8	196.4	2.1

1 Excluding Hong Kong. — **2** The totals for “All countries” include data which are not yet available in a regional breakdown for 1998.

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other than the group of industrial countries, it was their exports to those countries in transition in central and eastern Europe that played a particularly important role; these exports exceeded their level last year by 6½%.

Breakdown of exported goods

German exporters in the various economic sectors were affected in different ways by the weakness in demand from South-East Asia, on the one side, and by the market growth in western and eastern Europe, on the other. The manufacturers of mechanical and electrical engineering products, a large proportion of whose export sales had been in Asia, incurred substantial losses. Accordingly, the growth in exports of mechanical and electrical engineering products in the third quarter was below average, at just under 1½%, compared with the same period last year. By contrast, sales of a number of other capital goods and, in particular, of cars were evidently less affected by the downturn in demand in the regions hit by the crises in Asia. Instead, they benefited from the prolonged favourable sales conditions in Europe and in the US market. The exports of the German car industry alone rose by 13% in the third quarter compared with the same period last year.

Imports

As in the case of exports, growth in the imports of goods has also slowed down markedly since the summer. In the three months from August to October the seasonally adjusted value of German imports actually declined by just over 1½%. If import prices, which fell at a similar rate, are taken into account, real imports remained unchanged at the level obtaining in the previous period; however, this means that they exceeded their level a year earlier by 5 %. Given the rapid pace of imports until the summer, which was largely due to the favourable prices for sources of energy and raw materials and which had resulted in the creation of considerable stocks, the weaker demand for imports could indicate a certain degree of "normalisation". In the light of the downturn in the export of goods, however, it may be that the demand for imports of inputs for the exporting industries had also declined.

Breakdown of imported goods

This is also suggested by the trend in the breakdown of imported goods. At all events, imports of intermediates in the third quarter rose considerably more slowly than a year earlier whereas the imports of products that were intended for immediate sale and not as inputs in the production chain grew more steadily. The fact that this year for the first time the imports of raw materials and semi-finished products in the third quarter were below the level at the same time in the previous year is consistent with this picture. It must be remembered, however, that the trend in import turnover, especially in the case of raw materials and energy, has also been influenced for some time by the sharp fall in world market prices. The influence of this factor can best be seen in the imports of crude oil. Although the quantity of crude oil imported in the third quarter was 29 % greater than a year earlier, the value of these imports fell by 15 ½ %. However, this is primarily due to the fall in oil prices until the spring; there was virtually no further decline in the seasonally adjusted value of energy imports in the third quarter of this year compared with the second quarter – as prices declined comparatively less markedly.

Current account

DM billion; seasonally adjusted

Item	1998 Feb.– Apr.	May– July	Aug.– Oct.
1. Foreign trade			
Exports (f.o.b.)	239.4	239.0	233.0
Imports (c.i.f.)	202.6	203.4	199.9
Balance	36.9	35.9	33.1
2. Services (balance)	– 15.4	– 14.4	– 15.1
of which Foreign travel (balance)	– 12.5	– 12.8	– 13.8
3. Factor income (balance)	– 1.8	– 7.6	– 5.1
of which Investment income (balance)	– 1.6	– 7.0	– 4.6
4. Current transfers (balance)	– 14.8	– 10.4	– 16.0
Balance on current account 1	4.2	2.1	– 2.7

1 Includes supplementary trade items.

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Regional breakdown of imports

The price trends on the energy and raw material markets also influenced the shifts in the regional breakdown of German imports in such a way that the OPEC countries' significance declined. The value of imports from these countries in the third quarter was 23 ½ % below the level last year. As already suggested, however, this trend is primarily a reflection of the sharp fall in import prices until the spring; in terms of volume, energy imports, especially in the form of oil, rose unmistakably. For the first time since 1993 imports from the EU partner countries in the third quarter fell slightly (by just under ½ %) compared with the previous quarter. While this result, too, is affected to some extent by

Major items of the balance of payments

DM billion

Item	1997 Aug.– Oct.	1998 May– July	1998 Aug.– Oct.
I. Current account			
1. Foreign trade			
Exports (f.o.b.)	227.8	243.7	229.0
Imports (c.i.f.)	197.2	204.1	196.6
Balance	+ 30.6	+ 39.5	+ 32.5
2. Balance of invisibles	– 38.8	– 34.1	– 43.2
Balance on current account 1	– 9.8	+ 4.2	– 10.2
II. Balance of capital transfers	+ 1.8	+ 0.9	+ 1.3
III. Financial account 2			
Direct investment	– 7.7	– 8.8	– 11.7
Portfolio investment 3	– 11.3	+ 6.7	– 28.0
German investment abroad	– 31.5	– 101.3	– 49.3
Foreign investment in Germany	+ 20.2	+ 108.0	+ 21.3
Credit transactions 3, 4, 5	+ 32.7	+ 32.1	+ 45.8
Overall balance on financial account	+ 13.8	+ 30.0	+ 6.1
IV. Balance of unclassifiable transactions	– 9.6	– 34.8	+ 4.0
V. Change in the Bundesbank's net external assets at transaction values (increase: +) 6 (I plus II plus III plus IV)	– 3.8	+ 0.2	+ 1.2

1 Includes supplementary trade items. — **2** Net capital exports: –. — **3** Excluding direct investment. — **4** Including other official and private investment. — **5** Excluding the changes in financial operations of German non-banks with foreign non-banks and in the trade credits for October 1998, which are not yet known. — **6** Excluding allocation of SDRs and changes due to value adjustments.

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the decline in the value of imports of petroleum products from several EU countries, imports of industrial products from other EU countries did not rise as much as before either. By contrast, there was a remarkably sharp rise in the imports from the United States, which was evidently able to compete successfully on the German market despite the relative strength of the US currency for some time. Again, above-average growth rates were recorded in imports from Japan, which benefited well into the autumn from the weakness in the yen. The dynamic trend in imported goods from the countries in central and eastern Europe continued. Germany has become one of the most important markets for these countries. On the other hand, imports from the emerging markets in South-East Asia fell by just under 3 % in value in the third quarter compared with the same period last year. In view of the dramatic depreciation of the currencies of the countries concerned and the consequent changes in prices, however, imports from this group of countries probably rose markedly in real terms.

Invisibles

The seasonally adjusted deficits in the field of invisible current transactions with non-residents, which in Germany traditionally constitute a large counterpart to the surpluses in trade in goods, increased during the period under review. The combined deficit of just over DM 36 billion resulting from service transactions, factor income and current transfers was almost DM 4 billion more than in May-July (DM 32 ½ billion).

Services

However, there was only a slight rise, to DM 15 billion, in the seasonally adjusted deficit on services during the period under review, the increase being just over DM ½ billion. The most important item here and the one which contributes most to Germany's deficit in this segment was net expenditure on foreign travel. In seasonally adjusted net terms this expenditure amounted to almost DM 14 billion between August and October and was thus DM 1 billion more than in the previous three months. When compared with last year, however, the change in the expenditure on foreign travel was only slight (both in gross terms and in the net balance after deducting the income from travel by non-residents). Nevertheless, there were shifts in the breakdown of (gross) expenditure, notably in favour of Italy, France, Spain, Portugal and Austria. In some of these countries German travellers spent appreciably more in the third quarter of this year (more recent figures are not available) than in the same quarter last year. On the other hand, Switzerland, the United Kingdom and Greece earned a somewhat smaller share of the total expenditure by Germans on foreign travel. Expenditure on long-haul journeys was also down on last year, however. Notable exceptions to this were trips to the United States and to some South-East Asian countries whose currencies have sharply depreciated.

Foreign travel

Factor income

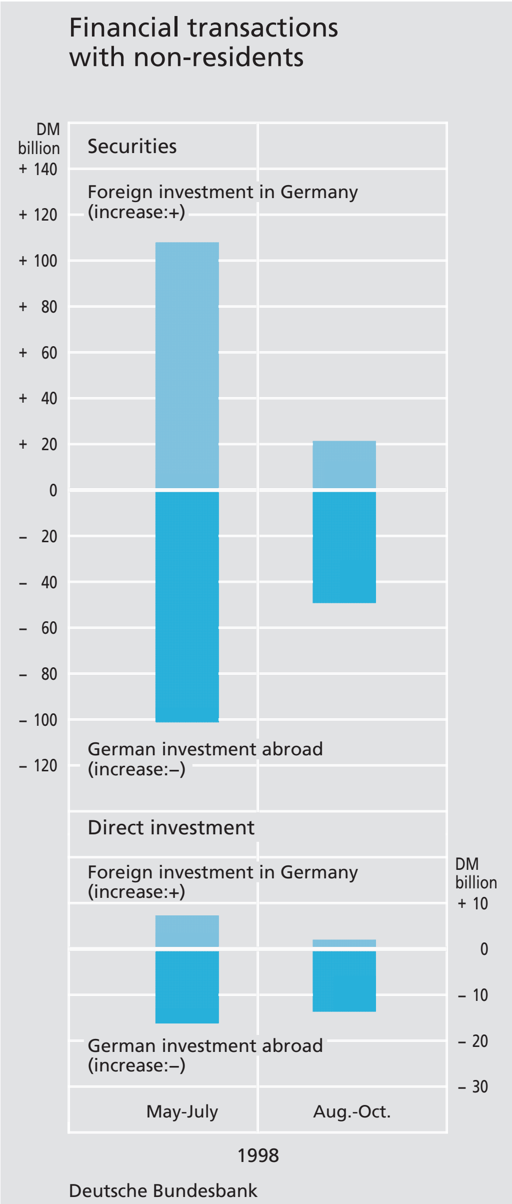
Between August and October the sub-balance factor income ran a seasonally adjusted deficit of DM 5 billion, which was much lower than in the previous three-month period (DM 7½ billion). The decline in the deficit was essentially due to the trend in investment income, which, as usual, determines the general trend. It was mainly the result of large extraordinary dividend payments by German enterprises to shareholders in the previous period. These had led at that time to unusually large investment income payments to non-residents and are now distorting comparisons.

Current transfers

The virtually unchanged deficit on services and the smaller deficit on investment income were accompanied between August and October by appreciably larger deficits in current transfers to non-residents. The deficit rose from DM 10½ billion, seasonally adjusted, in the previous period to DM 16 billion in the period under review. The main factor here was Germany's regular contribution to the EC budget. These payments are subject to fairly large fluctuations throughout the year. Following substantial contributions on the part of Germany at the beginning of the year, the payments in subsequent months were much smaller. Then in the second half of the year they increased again to their usual level. Private transfers to non-residents were just as large in the period under review as in the three months earlier (DM 4½ billion net); remittances by foreign workers in Germany to their home countries accounted for just over DM 1½ billion of this sum. Approximately DM 1½ billion net was likewise exported through pensions and other maintenance payments.

Financial transactions and reserve movements

The financial crisis in Russia and the after-effects for other emerging markets again led



Trends in financial transactions

to considerable uncertainty among globally operating investors during the summer. The risk premiums placed on issues of all but first-class debtors rose sharply for a time; there were also marked temporary price fluctuations on the international financial markets. All in all, this seems to have depressed investors' willingness to invest. At all events, the German balance of payments shows substantially smaller cross-border capital flows between August and October than in the previous three-month period. The outcome was a net outflow of capital through portfolio transactions amounting to DM 28 billion; there were net outflows, too, as a result of direct investment during the period under review. By contrast, non-securitised credit transactions yielded a substantial surplus.

Portfolio transactions

The main reason for the reversal in portfolio transactions (from plus DM 6½ billion net to minus DM 28 billion) was the downturn in non-residents' investment in Germany. Whereas foreign investors had purchased German paper worth DM 108 billion between May and July, they invested only DM 21½ billion net during the period under review.

Foreign investment in German ...

... equities

It was principally the German equity market, whose distinctly bullish mood up to the middle of July was largely due to the presence of foreign buyers, that subsequently suffered from the reluctance of non-residents to invest. Overall, foreign investors withdrew as much as DM 9 billion from the German market between August and October, thus accentuating the price correction which, given a minus on the DAX of up to 37%, was much more pronounced in Germany during this period than on other major share markets. Since then, however, approximately one-third of the price losses have been regained.

... bonds and notes

Although foreign demand for German bonds and notes likewise declined during the period under review, the fall in demand was much less pronounced than it was in the case of equities. During the period under review non-residents' net purchases of German bonds amounted to DM 25 billion compared with DM 41 billion in the three months earlier. While the desire for security evidently favoured fixed-interest paper rather than equities, public bonds, in turn, were preferred (DM 16½ billion) to bank bonds (DM 9 billion). Foreign interest in German money market paper was likewise fairly moderate between August and October (DM 1 billion compared with DM 6½ billion in the previous period). In the case of German investment fund certificates sales by foreign investors actually predominated (minus DM 1 billion).

... money market paper and investment fund certificates

German investment in foreign ...

German investors, too, were decidedly reluctant to make cross-border investments in the period under review. With capital exports of DM 49½ billion, the sum invested was almost one-half of the total in the earlier period. The main demand was again for foreign equities (DM 25½ billion compared with DM 48½ billion). Some foreign share prices had already recovered somewhat earlier than German ones. On the other hand, demand for foreign bonds and notes was much lower (DM 14 billion compared with DM 35 billion). Foreign Deutsche Mark bonds, in particular, were avoided despite the increasing interest rate differential vis-à-vis comparable domestic paper. Evidently Russia's temporary cessation of payments on its rouble-denominated issues had again reminded German investors of the greater risk of default inherent in foreign bonds, including foreign Deutsche Mark bonds, even though the latter had still been in great demand in earlier months. Purchases of lira-denominated issues predominated in

... equities

... bonds and notes

Financial transactions

DM billion, net capital exports: –

Item	1997 Aug.–Oct.	1998 May–July	1998 Aug.–Oct.
1. Direct investment	– 7.7	– 8.8	– 11.7
German investment abroad	– 10.5	– 16.2	– 13.7
Foreign investment in Germany	+ 2.8	+ 7.3	+ 2.0
2. Portfolio investment	– 11.3	+ 6.7	– 28.0
German investment abroad	– 31.5	– 101.3	– 49.3
Shares	– 2.1	– 48.3	– 25.4
Investment fund certificates	– 7.8	– 5.1	– 3.5
Bonds and notes	– 19.3	– 35.2	– 13.8
Money market paper	– 1.0	– 0.5	– 2.9
Financial derivatives [1]	– 1.2	– 12.2	– 3.6
Foreign investment in Germany	+ 20.2	+ 108.0	+ 21.3
Shares	+ 10.4	+ 54.9	– 9.2
Investment fund certificates	– 6.2	– 0.3	– 1.0
Bonds and notes	+ 16.9	+ 41.2	+ 25.2
Money market paper	+ 1.7	+ 6.4	+ 1.2
Warrants	– 2.7	+ 5.7	+ 4.9
3. Credit transactions	+ 34.4	+ 35.6	+ 47.2
Credit institutions	+ 35.0	+ 26.5	+ 44.2
Long-term	– 10.6	– 5.2	– 4.1
Short-term	+ 45.7	+ 31.7	+ 48.3
Enterprises and individuals	– 5.4	+ 14.6	– 3.1
Long-term	+ 0.0	+ 6.6	+ 5.2
Short-term [2]	– 5.4	+ 7.9	– 8.3
Public authorities	+ 4.8	– 5.5	+ 6.2
Long-term	– 0.5	– 2.4	– 0.6
Short-term	+ 5.3	– 3.1	+ 6.9
4. Other investment	– 1.6	– 3.4	– 1.4
5. Balance of all statistically recorded capital flows	+ 13.8	+ 30.0	+ 6.1
Memo item Change in the Bundesbank's net external assets at transaction values (increase: +) [3]	– 3.8	+ 0.2	+ 1.2

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

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the case of investment in foreign currency bonds – presumably because further interest rate convergence was expected before the introduction of the euro.

... investment fund certificates and money market paper

Furthermore, DM 3½ billion was invested in certificates of foreign investment funds and DM 3 billion in foreign money market paper during the period under review.

Direct investment ...

As in the case of portfolio transactions, there were net capital outflows as a result of direct investment during the period from August to October. At DM 11½ billion, this export of funds was somewhat greater than in the period from May to July (DM 9 billion). The main reason here was that foreign enterprises had recently provided their subsidiaries in Germany with smaller amounts of new funds than in the previous three-month period (DM 2 billion compared with DM 7½ billion). However, short-term fluctuations of this sort should not be accorded too much importance. If assessed over a somewhat longer term, Germany appears to have become a more interesting target for foreign outward investment again. Whereas foreign entrepreneurs had withdrawn funds from their German subsidiaries in each of the previous two years, they invested DM 18 billion in Germany in the first ten months of this year.

... in Germany

... abroad

Just how fast the internationalisation process is advancing in the corporate and financial sectors can be seen, conversely, in the equally rapid pace of German direct investment abroad. This has amounted to DM 53 billion so far this year (compared with DM 42½ billion in the same period last year). Despite a single transaction worth a particularly significant amount in the financial sector, however, German acquisitions of participating interests abroad were lower between August and October 1998, amounting to DM 13½ billion compared with DM 16 billion between May and July. The preferred target country for German outward investment in the period under review was the United States although the single transaction already mentioned distorts the picture somewhat.

Credit transactions of non-banks

In the statistically recorded credit transactions of German non-banks with non-residents there were net capital imports of DM 3 billion between August and October (compared with DM 9 billion between May and July). In the process, enterprises and individuals borrowed DM 5 billion (net) in long-term loans abroad; this was accompanied at the short end of the market by outflows (of DM 8½ billion net), mainly as a result of stocking up Euro-deposits with foreign banks. By contrast, the cross-border financial operations of the public sector led to inflows of DM 6 billion; here, too, it was short-term liquidity operations that predominated.

Credit transactions of banks

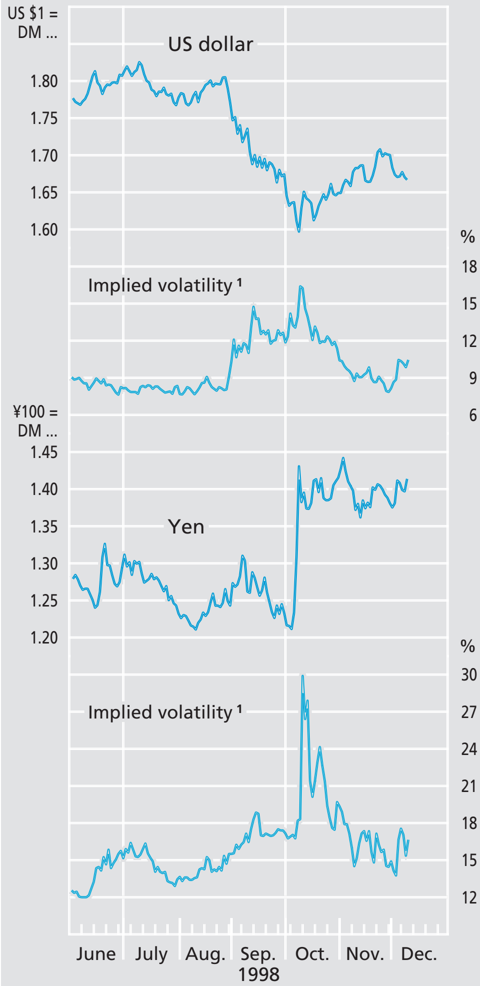
Considerably greater inflows of funds were recorded by German credit institutions in the period under review (DM 44 billion net). Although, in contrast to the general trend, the long-term credit transactions resulted in net capital exports of DM 4 billion, short-term credit transactions, which encompasses the other payment flows in current and financial transactions, produced (net) inflows of DM 48½ billion to the domestic banks. This short-term influx of liquid funds more than compensated for the aforementioned net capital outflows through portfolio transactions and direct investment.

Net external position of the Deutsche Bundesbank

In contrast to the external position of the credit institutions the net external assets of the Bundesbank changed comparatively little during the three months under review. Calculated at transaction values, these assets rose by DM 1 billion after rising only marginally in the previous three months. The background to the net change was an increase of DM 2½ billion in the Bank's external assets – primarily as a result of dollar interest income and the receipts of dollars from US troops stationed in Germany as well as a further increase in German drawing rights in the reserve tranche of the IMF. At the same time, however, the Bundesbank's liabilities to foreign monetary authorities and international organisations rose by more than DM 1 billion. This means that the net external assets at the end of October, when calculated at the balance sheet rates at the end of 1997, amounted to DM 114½ billion compared with DM 111 billion at the end of 1997.

Exchange rate trends of the US dollar and the yen

Daily rates



1 Implied volatility of financial options with a maturity of one month.

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Exchange rate trends

World foreign exchange markets

In the autumn the exchange rate relationships between the three major world currencies shifted at the expense of the dollar. At the same time a certain degree of calm descended on the foreign exchange markets of the Asian crisis regions following the appearance in some emerging markets of the first signs of stabilisation again in response to adjustment initiatives. Some of these currencies were actually able to regain some ground, especially against the US dollar. Owing to a simultaneous fall in interest rates in the countries concerned, it is likely that their liquidity situation was eased somewhat for a time.

Dollar

After soaring until the end of August, the dollar lost value discernibly against most other world currencies during the period under review. As a result of the narrowing of the growth differential between the United States and Germany and the consequent expectations that interest rates would fall in the dollar area, the US currency depreciated from approximately DM 1.80 against the Deutsche Mark in the last week of August to DM 1.60 in the first few days of October. One reason for this development was the fear that had emerged in the course of September that the US economy would be more seriously affected by the crises in Asia than had hitherto been assumed. Another detrimental factor was concern at the beginning of October that the Russian financial crisis could have a contagious effect on the currencies of other emerging markets, especially some Latin American foreign exchange markets. Finally, another reason was the worry that investors' distinct reluctance to take risks, which had already given rise to large interest rate differences between public and private paper on the US capital market, could drive the US economy into a credit crunch that would impair growth prospects from the financial side. It was not until the unexpectedly favourable results for economic growth in the third quarter had been announced that the US currency subsequently recovered somewhat. At the time this Report went to press, it was being quoted at approximately DM 1.65. However, this means that it was still roughly 9½% lower than its high during the summer.

Yen

The Japanese currency firmed against the Deutsche Mark in the autumn as a result of a pronounced leap in the first days of October. Within a short time the yen appreciated from approximately DM 1.20 to DM 1.40 (for 100 yen). The announcement of an extensive package of measures to revive the Japanese economy and to solve the structural problems in the Japanese banking sector was probably instrumental in bringing this sudden rate revision about. At the same time, however, the restoration of calm in some neighbouring emerging markets and the sharply increased surpluses in trade with the United States probably also played a role. Nevertheless, the situation was still fraught with considerable uncertainty, as indicated by the rise in the implied volatility of yen-denominated options. At the time this Report went to press, the yen, with slight fluctuations, was being quoted at the level (of about DM 1.40) reached in October and was therefore just under 13% up on its rate at the end of August.

EU currencies

Like the dollar, the pound sterling came under increasing pressure to depreciate during the autumn. The economic downturn and closely associated expectations of lower interest rates in the United Kingdom brought the British currency down from DM 2.95 at the end of August to roughly DM 2.75 in the second half of October. Again like the dollar, the pound has now recovered somewhat; at DM 2.76 when this Report went to press, however, it was still much below the peak of DM 3.10 that it had reached in the spring and was more than 6% lower than at the end of August. Some Scandinavian currencies also lost ground during the period under review; the Swedish krona was at its lowest value for five years. Moreover, by mid-October the Norwegian krone had fallen to its all-time low, at DM 21.40.

EMU currencies

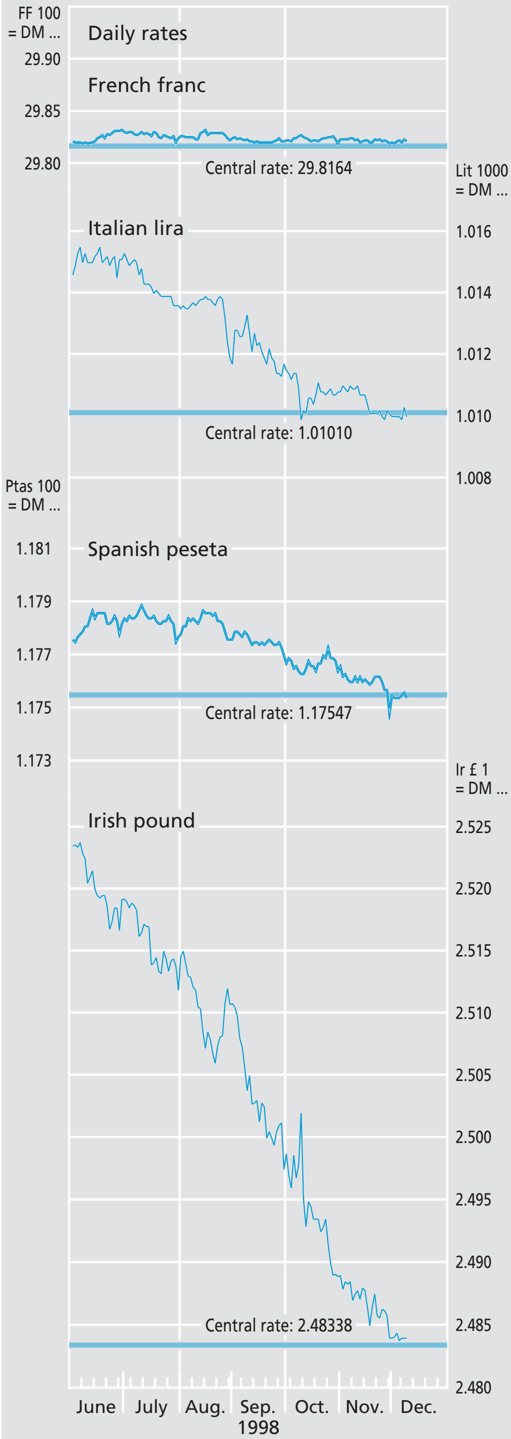
By contrast, the exchange rate relationships of the currencies of the countries scheduled to take part in the future monetary union were distinctly stable. The majority of these currencies have been very close to their central rates against the Deutsche Mark for some time now and therefore also close to the bilateral conversion rates between the participating currencies announced at the beginning of May. Fairly sizeable deviations have so far been found only in the case of the Irish pound and – to a much smaller extent – in the case of the Italian lira, the Spanish peseta and the Portuguese escudo. With the gradual convergence of money market rates, however, these currencies have been fast approaching their bilateral conversion rates since the summer. In the case of the Irish pound, and of the Italian lira, the divergence from the DM central rate has now almost disappeared. If the usual bid-ask spreads are taken into consideration, the end-of-year futures rates of all EMU currencies are now in line with the conversion rates announced.

Nominal and real external value

Despite the – in some cases fairly considerable – shifts in exchange rates, the weighted external value of the Deutsche Mark against the currencies of 18 industrial countries has remained practically unchanged overall. The appreciation of the Deutsche Mark against the dollar and the pound sterling was largely offset by the strength of the yen. Compared with its level at the end of August, the value of the Deutsche Mark on a weighted average was about ¼% greater at the time this Report went to press. After eliminating the differences in price movements in Germany and abroad, the (real) external value of the

Selected currencies of the EMU countries

Central rates and market rates 1; log. scale



1 Spot middle rates in Deutsche Mark.

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Deutsche Mark (on the basis of the prices of total sales) was still slightly below its long-term average.

If, however, a larger country group comprising 38 industrial and developing countries is considered, the Deutsche Mark appreciated somewhat more. The rise in nominal terms from August until this Report went to press amounted to just over 2 %; the real external value on the basis of this larger country group was 4 ½ % higher in the late summer than at the same time last year. This is largely a reflection of the exchange rate losses incurred by the currencies in the crisis regions. Germany is thereby contributing to the world economic adjustment process. This is also seen in the changes described in the regional trade flows between Germany and the countries in crisis.