Foreign trade and payments

Overview

Despite a certain weakening in the buoyancy of German exports, they continued to be a strong motor for economic growth in the spring. Although exports had not been increasing so dynamically since the autumn of last year, German exporters recorded a remarkably favourable sales trend on the whole in both the first and second quarters of this year even if there were some dramatic downturns in demand from Asian countries and from a few of the oil-producing countries. However, real imports rose only slightly less sluggishly during the same period. Even so, as a result of the significant fall in import prices, Germany's trade balance in the second quarter of 1998 showed a record seasonally adjusted surplus of just over DM 36½ billion. The trend in invisibles, which ran a much smaller deficit in the second quarter than in the previous three months, also had a positive influence on the country's external position. The overall balance on current account in the second quarter of the year was therefore in surplus by just over DM 2½ billion (seasonally adjusted) compared with a deficit of DM 7 billion in the previous quarter.

Current account in detail

Exports

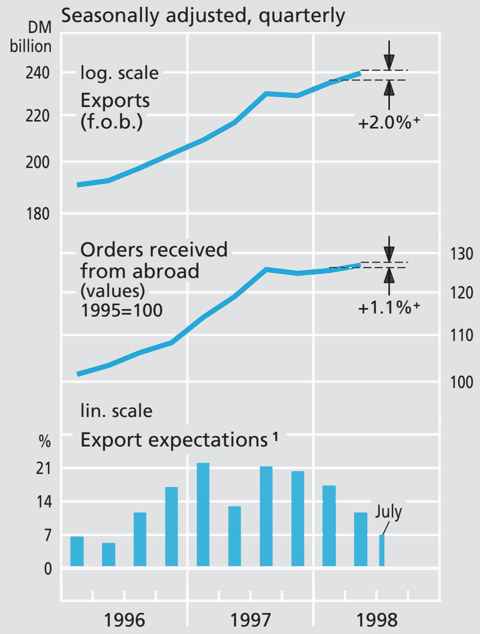
Exports, which had risen by a (seasonally adjusted) 2½% in the first quarter of 1998 compared with the last quarter of 1997, rose by a further 2% in the second quarter of the year. The slight downturn in the period under review was essentially due to the trend in export prices, which fell by ½% in the second quarter whereas at the beginning of the year they had remained virtually unchanged. Real export growth, at approximately 2½%, was equally strong in the first two quarters of the year. This means that in the period under review exports exceeded their level in the corresponding period of 1997 by 8½% in real terms and by 9% in value.[1]

However, exports, which were still remarkably brisk at the time this Report went to press, could not keep up with their performance last year when exports had grown at rates in double figures. What is particularly striking is the gradual deceleration in the trend in seasonally adjusted export orders received by the manufacturing sector. Since the autumn of last year this trend in the orders received from abroad has been rising appreciably more slowly than the exports delivered during the same period. They rose by just over 1% in the second quarter of 1998 compared with the first quarter of the year. Even so, this means that they still exceeded the comparable level last year by 6½%; in the second quarter of 1997, however, this rate had been more than twice as high. The fact that exports have recently been running at a slightly less rapid pace can also be seen from the findings of the ifo industrial surveys. While these show that the export expectations of the business community remain positive, optimism has been voiced almost consistently less frequently in surveys since the autumn of 1997.

Regional breakdown of exports

The prolonged crises in East Asia, which have had a more detrimental effect on the emerging markets concerned than many had initially expected, had a negative impact here. The sharp drop in demand there, which in some cases was particularly pronounced, and

Export trend



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

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the continued economic weakness in Japan resulted in a considerable downturn in Asian business in Germany and in other EMU countries. German exports to the emerging markets in South-East Asia were a seasonally adjusted 14% lower in the second quarter of this year than they had been in the previous three-month period and 26% lower than in the second quarter of 1997. However, exports of German goods to this region account for just under 4% of Germany's total exports. Some of the other major EMU countries recorded even greater falls in sales than

1 In its monthly report in June 1998 the Federal Statistical Office revised its published monthly figures since January of this year. The additional factors estimated for "missing returns" in the intratrade statistics (missing statistical reports for trade in goods within the EU) were reduced with the result that both exports and (to a lesser extent) imports were revised slightly downwards from the original figures.

Regional breakdown of foreign trade

Second 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	186.3	11.6	157.6	7.6
EU countries	139.5	12.3	113.8	7.4
of which				
Austria	12.7	13.2	8.2	15.0
Belgium/ Luxembourg	14.1	8.4	12.3	– 0.5
France	27.7	16.2	22.9	12.0
Italy	19.1	13.4	16.7	7.9
Netherlands	16.6	6.4	17.1	3.7
Spain	9.9	15.5	7.7	10.2
United Kingdom	21.3	12.1	14.0	5.4
Other industrial countries	46.8	9.4	43.8	7.9
of which				
United States	22.2	18.1	16.9	9.4
Japan	4.2	– 14.4	10.5	15.5
Countries in transition	30.1	19.4	26.1	13.4
of which				
Countries in central and eastern Europe	26.5	18.7	20.6	14.3
China 1	3.1	29.3	5.1	6.8
Developing countries	26.5	– 8.8	22.2	3.3
of which				
OPEC countries	4.8	– 0.6	2.8	– 12.9
Emerging markets in South-East Asia	9.3	– 26.1	10.0	7.8
All countries	241.7	9.0	205.1	7.1

1 Excluding Hong Kong.

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Germany. German exports to Japan, which had already declined substantially in 1997, weakened further in seasonally adjusted terms in the second quarter of 1998 compared with the first quarter of the year and also remained much below (14½ % lower) their level in the corresponding period last year. German exports to the OPEC countries were also somewhat lower (– ½ %) than a year earlier because the persistently low oil prices and the resultant fall in the income of the oil-producing countries had limited their absorption capabilities.

The relatively small proportion of German exports taken up by the aforementioned groups of countries was one reason for the fact that, although the sales trends in these export markets did contribute to the downturn observed in the export momentum and to the more cautious, if still positive, assessment of the situation, these trends failed to undermine the general course of foreign trade. Another reason was the stronger market growth in the industrial countries which are important for German exporters. The sharpest rise was recorded in exports to the United States, which were just over 18 % above the level in the corresponding period last year. For some time now the generally robust economic growth in the United States and the exchange-rate-related price advantages have been providing German exporters with favourable sales opportunities. Even so, the main reason for the continuation in the upward trend in exports was the much stronger growth in exports to the other countries of the European Union, which absorb more than one-half of Germany's exports. Deliveries to these countries rose by 12 ½ % in the second quarter of this year compared with the corresponding period of 1997. Exports to the central and east European countries in transition have likewise continued to rise at an above-average rate (by 18 ½ % compared with the second quarter of 1997). These countries' share of total German exports, at 11 %, now exceeds the combined share of the South-East Asian emerging markets, Japan and the OPEC states (7 ½ %). However, exports of German goods to Russia declined recently. The annual growth rate in the second quarter of 1998 did reach 18 ½ %, but the rise in exports in 1997 as a whole was no less than 43 ½ %.

Breakdown of exported goods

High-value capital goods, for which there is a particularly heavy demand abroad, traditionally make up the largest share of German exported goods. The growth in the export sales of mechanical engineering products was correspondingly sharp, and manufacturers, despite the burdens placed on some firms and industrial sectors by the Asia crisis, increased their exports in the second quarter of this year by 10 % over the same period last year. The motor industry led the field; between April and June 1998 the value of motor vehicles sold abroad was 15 % higher than in the second quarter of last year.

Imports

Imports grew only slightly less sluggishly than exports in the first six months of the year. Following a distinct rise in the first quarter of the year, the value of imports grew somewhat less slowly, at a seasonally adjusted ½ %, in the second quarter. At the same time, however, the decline in import prices continued with the result that the real growth in imports was appreciably faster at 2 % and remained only slightly below the growth in exports over the same period. The value of imports in the second quarter was 7 % higher than in the corresponding quarter of 1997; after adjustment for price changes imports actually rose by 8 ½ %. This means that in a comparison with domestic demand or overall economic output the growth in imports was again remarkably sharp. The parallel trend emerging in exports and imports, when viewed in this way, has been discernible for some time. It can be partly explained by the increasing international integration in production, especially in the case of the large enterprises operating in the export field. It might also be associated with stockpiling recently because there have been some dramatic cuts in prices, particularly in the case of mineral oil and other raw materials.

Imports by category of goods

Developments in the breakdown of the goods imported by Germany match this trend. For example, the imports of intermediates, in particular, in the second quarter of 1998 rose at rates in double figures compared with the same period last year. Although the volume of imports of raw materials and oil also increased, the value of imports of raw materials in the second quarter of the year was 11 ½ % below the level last year while the value of imported petroleum was actually 18 % lower.

Imports by region

The shifts in the respective import values caused by the sharp decline in the prices of raw materials and energy sources were reflected in corresponding shifts in the regional breakdown of German imports. The value of

Current account

DM billion; seasonally adjusted

Item	1997 4th qtr	1998 1st qtr	1998 2nd qtr
1. Foreign trade			
Exports (f.o.b.)	230.3	236.3	241.1
Imports (c.i.f.)	200.2	203.3	204.6
Balance	30.0	33.0	36.6
2. Services (balance)	– 14.0	– 15.6	– 15.7
of which			
Foreign travel (balance)	– 12.9	– 12.4	– 13.0
3. Factor income (balance)	– 3.0	– 3.7	– 6.4
of which			
Investment income (balance)	– 2.5	– 3.5	– 5.9
4. Current transfers (balance)	– 10.3	– 19.9	– 10.5
Balance on current account 1	1.1	– 7.0	2.7

1 Includes supplementary trade items.

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imports from the OPEC countries, in particular, and from Russia and Norway, too, fell substantially between April and June compared with the same quarter of 1997. By contrast, there was a sharp growth in imports from numerous EU countries, especially Austria (+ 15 %), France (+ 12 %) and Spain (+ 10 %). Imports of goods from Japan and the United States also rose sharply in the second quarter of this year compared with the corresponding period in 1997 (15½ % and 9½ %, respectively). The value of imports from the emerging markets in South-East Asia likewise increased steeply (by just under 8 %). The increase in imports from this region was probably even greater in real terms than the aforementioned figure suggests because the Deutsche Mark import prices are likely to have fallen as a result of the substantial depreciation in the currencies of most of those countries. Nevertheless, the associated "flood" of imports widely expected from East Asia has so far not materialised. This is certainly due just as much to the relatively small proportion of value added which these countries create, making them dependent on correspondingly more expensive imported intermediates, as it is to the difficulties which exporters in these countries are encountering in obtaining financial resources and which restrict the range of goods they can produce.

Invisibles

In contrast to its performance in trading goods, Germany has traditionally run a deficit on cross-border services, factor income and transfer payments. In the second quarter of 1998 the seasonally adjusted deficit on invisible current transactions with non-residents amounted to DM 32½ billion; this means that it declined by DM 6½ billion compared with the unusually high figure in the previous quarter and was again running at a level that was similar to last year's.

Current transfers

The main reason for this result was the trend in current transfers. The deficit here fell by DM 9½ billion to just under DM 10½ billion compared with the previous quarter. This primarily reflects the contributions to the EC budget, which fluctuate enormously throughout the year. As in 1997, substantial amounts of the overall sum that Germany has to contribute towards the EC budget during the year had been called in right at the beginning of the year. Consequently, correspondingly smaller payments have to be made in the subsequent months of the year.

Factor income

By contrast, the seasonally adjusted deficit on factor income rose sharply; at DM 6½ billion, it was almost DM 3 billion above the level in the previous quarter. This result had much to do with the substantially higher net investment income payments to non-residents, which account for almost 95 % of cross-border factor income and are subject to fairly sharp fluctuations in the course of the year. Unusually large dividend payments to non-residents and other profit transfers arising from foreign participating interests in Germany were the main reasons for this while the net interest payments of German issuers of securities to banks and non-banks domiciled abroad declined.

Services

After seasonal factors have been eliminated, the deficit on services, at just over DM 15½ billion, was much the same as in the previous quarter. The deficit was largely due to German net expenditure on foreign travel; at DM 13 billion, however, this expenditure was only slightly larger than in the previous quarter. This means that, overall, the stabilising trend in foreign travel that has been discernible for some time has continued whereas in the first half of the nineties Germany's current account had been adversely affected by the rapidly growing deficits in this segment.

Foreign travel by region

In the quarter under review it was primarily the substantially lower expenditure on travel to the United States and on other long-haul journeys, which had grown particularly rapidly in 1997, that had a retarding impact on the services deficit. It therefore appears that demand is responding somewhat belatedly to the persistent strength of the dollar and the

Major items of the balance of payments

DM billion

Item	1997 2nd qtr	1998 1st qtr	1998 2nd qtr
I. Current account			
1. Foreign trade			
Exports (f.o.b.)	221.8	232.3	241.7
Imports (c.i.f.)	191.5	202.6	205.1
Balance	+ 30.3	+ 29.7	+ 36.6
2. Balance of invisibles	– 24.1	– 36.1	– 28.4
Balance on current account 1	+ 4.8	– 7.2	+ 6.9
II. Balance of capital transfers	+ 0.4	+ 1.4	+ 0.7
III. Financial account 2			
Direct investment	– 11.3	– 5.9	– 13.5
Portfolio investment 3	– 16.7	– 40.1	– 16.8
German investment abroad	– 48.3	– 83.2	– 98.0
Foreign investment in Germany	+ 31.5	+ 43.2	+ 81.2
Credit transactions 3, 4	+ 36.5	+ 30.3	+ 38.3
Overall balance on financial account	+ 8.4	– 15.7	+ 8.0
IV. Balance of unclassifiable transactions	– 14.0	+ 22.5	– 13.6
V. Change in the Bundesbank's net external assets at transaction values (increase: +) 5 (I plus II plus III plus IV)	– 0.5	+ 1.0	+ 2.0

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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related increase in travel costs. It was only for travel within Europe that more money was spent in the second quarter of the year compared with the same period in 1997. The southern European holiday countries of Spain, Italy and Portugal recorded the strongest growth in revenue from spending by German tourists whereas travel expenditure by Germans in most other EU countries declined.

Financial transactions and reserve movements

Trends in financial transactions

As a result of the serious developments in Asia, the situation in the international financial markets was considerably tense during the early summer. This was reflected in the reluctance of international market players to invest in the capital markets of the emerging economies and in the "flight into safe investment havens". Not only the financial markets in the United States but also those in Germany and in Europe as a whole benefited from this. Furthermore, assets in the future European monetary union apparently have become more popular with internationally operating investors even without the impact exerted by the turbulence in the Asian financial markets. At all events, the upward trend in the German equity and bond markets continued between May and July as investors sought a home for large volumes of liquid funds. This was followed by a distinct downturn on the share markets on both sides of the Atlantic in August. Portfolio transactions between May and July resulted in net capital inflows (of DM 6 billion) while the statistically recorded credit transactions of the non-banks, too, ended in surplus. By contrast, there were net capital exports through direct investment.

Foreign investment in German ...

Nevertheless, the heavy investment by non-residents in the German equity and bond markets is visible only in the relevant "gross figures": in the period under review foreign investible funds totalling DM 108½ billion flowed into the German securities markets. A further point of particular interest is that about one-half of this sum (DM 54 billion) went into German shares. That was twice as much as in the whole of 1997 when the previous all-time high of DM 27 billion was recorded. In June alone, foreign purchases on the German equity market amounted to DM 35 billion.

... shares

... bonds and notes

Large amounts of foreign capital (DM 41½ billion compared with DM 27 billion in the previous period) also flowed into the German bond market. In contrast to what happened in the previous few months, when non-residents had clearly shown a preference for bank bonds, interest this time was fairly evenly divided between private and public-sector issues. Foreign investors transferred official paper worth DM 20 billion net to their portfolios whereas in the previous period they had reduced their holdings by DM 5 billion. Accordingly, their acquisition of bank bonds for DM 21 billion was substantially lower than in the previous three months (DM 32 billion).

... and money market paper

Non-resident investors also acquired German money market paper worth DM 6½ billion net in the period under review (previous period: DM 3 billion). As in the previous three-month period, however, holdings of German investment fund certificates were slightly reduced (by DM ½ billion at the time this Report went to press).

German investment abroad in ...

German residents, in turn, invested large sums abroad. German investment in foreign securities markets, at DM 102 ½ billion, was one-fifth greater in the period under review (May to July) than in the previous three-month period. Purchases of foreign shares, in particular, rose again, increasing from DM 46 billion in the previous three months to DM 48 ½ billion in the period under review.[2] This sum is quite remarkable in terms of the foreign investment of German savers, for example in the years prior to 1997 when, on an annual basis, amounts of more than DM 10 billion were seldom invested. Apparently, investment in the equity markets of the partner countries in the future European monetary union was again particularly heavy. Most of these funds were probably invested indirectly through the acquisition of corresponding investment fund certificates in Germany.

... shares

... foreign bonds and notes

German investors also had a greater demand for foreign bonds and notes during the period under review than in the previous three months. Overall, they increased their investment in foreign bond markets by DM 35 bil-

2 The growth of DM 2 ½ billion currently shown understates the actual trend because, owing to late reports and corrections vis-à-vis securities transactions for the first four months of the year, a substantial downward revision is to be expected in the net purchases of foreign equities. This will be done, as usual, during the annual revision of the balance of payments at the beginning of 1999.

Financial transactions

DM billion, net capital exports: –

Item	1997 May – July	1998 Feb. – Apr.	1998 May – July
1. Direct investment	– 11.4	– 9.3	– 7.6
German investment abroad	– 14.6	– 16.0	– 15.3
Foreign investment in Germany	+ 3.1	+ 6.8	+ 7.6
2. Portfolio investment	– 3.8	– 47.9	+ 6.0
German investment abroad	– 63.1	– 85.3	– 102.4
Shares	– 8.5	– 46.0	– 48.4
Investment fund certificates	– 4.2	– 8.4	– 5.2
Bonds and notes	– 38.4	– 25.0	– 35.1
Money market paper	– 2.3	– 2.0	– 0.5
Financial derivatives 1	– 9.7	– 3.9	– 13.2
Foreign investment in Germany	+ 59.3	+ 37.3	+ 108.4
Shares	+ 29.4	+ 9.3	+ 54.2
Investment fund certificates	+ 0.7	– 1.4	– 0.3
Bonds and notes	+ 27.6	+ 26.8	+ 41.3
Money market paper	+ 0.9	+ 3.0	+ 6.7
Warrants	+ 0.7	– 0.4	+ 6.5
3. Credit transactions	+ 8.8	+ 29.8	+ 36.5
Credit institutions	– 1.0	+ 53.9	+ 26.6
Long-term	+ 2.7	+ 7.4	– 5.2
Short-term	– 3.7	+ 46.4	+ 31.7
Enterprises and individuals	+ 18.1	– 26.1	+ 15.2
Long-term	+ 1.3	– 0.0	+ 6.2
Short-term 2	+ 16.8	– 26.1	+ 9.0
Public authorities	– 8.3	+ 2.1	– 5.3
Long-term	– 4.5	– 1.6	– 2.4
Short-term	– 3.8	+ 3.7	– 2.9
4. Other investment	– 0.9	– 0.9	– 3.4
5. Balance of all statistically recorded capital flows	– 7.3	– 28.3	+ 31.4
Memo item Change in the Bundesbank's net external assets at transaction values (increase: +) 3	– 3.6	+ 2.3	+ 0.2

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

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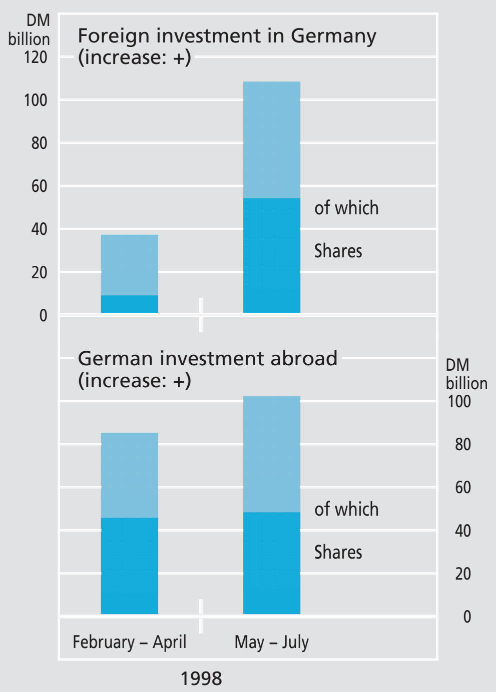
Portfolio transactions



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lion between May and July (February-April: DM 25 billion). Greater interest was shown, for example, in foreign Deutsche Mark bonds; DM 13½ billion worth of these were bought compared with DM 8½ billion in the previous three months. Their yield advantage over German Deutsche Mark bonds is apparently having a greater influence again on the investment decisions of German residents in view of the present low level of long-term interest rates. Investors sometimes forget, however, that this reflects a market-related risk assessment, which has a sound justification in the real economy.

German investment in foreign bonds, at approximately DM 21½ billion, likewise increased discernibly. There was a particularly great demand between May and July for Italian bonds (DM 9½ billion) and ECU-denominated bonds (DM 3 billion) in the light of their interest rate advantage. By contrast, German investment in most of the other segments of portfolio transactions abroad declined. For example, net German investment in foreign investment funds and in money market paper between May and July fell to DM 5 billion and DM ½ billion, respectively, compared with the preceding three months.

Direct investment

German investment abroad

In contrast to what happened in the case of cross-border portfolio transactions, there were again net capital outflows as a result of direct investment between May and July although the flow rate was somewhat slower than before. DM 7½ billion was exported, on balance, during the period under review compared with DM 9½ billion in the previous three months. German enterprises built up their financial interests abroad by DM 15½ billion compared with DM 16 billion in the previous three-month period. This means that since the beginning of the year Germany has increased its financial investment in foreign locations by DM 38½ billion, which amounts to an increase of more than DM 6 billion compared with the corresponding period in 1997. Partner countries in the European Union accounted for the lion's share (DM 7 billion) of German direct investment in the period under review. German firms also invested extensively – about DM 1½ billion in each case – in the United States and in the countries in transition in central and eastern Europe.

Foreign investment in Germany

Even more remarkable than this long-term trend on the part of German enterprises to internationalise was the comparatively keen interest of foreign enterprises in Germany as an industrial location over the past few months. Foreign enterprises, which had invested just under DM 7 billion in the previous period, increased their participating interests in Germany by DM 7½ billion between May and July. Thus, foreign direct investment in Germany in the first seven months of this year totalled DM 16 billion compared with just over DM 1 billion in the same period last year. There is no doubt that this trend has to be seen against the backdrop of the worldwide tendency to diversify on the part of internationally operating enterprises and financial institutions. If it had not been for the considerable efforts by German business to improve its competitiveness and the consequently more favourable growth prospects, however, Germany could hardly have benefited from this trend to the extent it has done.

Credit transactions of non-banks

Net inflows of DM 10 billion arose in the statistically recorded credit transactions of nonbanks, primarily enterprises and individuals, between May and July. Firstly, they increased their longer-term borrowing abroad and, secondly, they substantially reduced their shortterm financial investment in the Euro-market. Overall, over DM 15 billion accrued to them as a result. The operations of the public sector, on the other hand, led to capital outflows of about DM 5½ billion.

Unclassifiable transactions

The strikingly large negative balance of unclassifiable transactions which arose for June (DM 20½ billion) and which, according to the present available data, is to be expected for the whole period under review, could be an indication that a substantial amount of other claims arising from financial transactions with non-residents arose in addition to the statistically recorded outflows of funds from the non-banking sector. Another point that cannot be ruled out is the possibility of discrepancies in the temporal classification of financial transactions playing a greater role than before as a result of increasing turnover in portfolio transactions and the growing importance of securities lending business and therefore being reflected in – temporarily large – unclassifiable items in the balance of payments.

Bank credit transactions

During the period under review there were net capital imports of about DM 26½ billion as a result of domestic banks' credit transactions with non-residents. Capital outflows of DM 5 billion at the long end of the market were accompanied by short-term inflows of funds to credit institutions. These amounted to DM 31½ billion and are to be interpreted as being essentially a reflection of the aforementioned trends in the other segments of the financial and current accounts.

Net external position of the Bundesbank

In contrast to the external position of the credit institutions the net external assets of the Bundesbank changed only slightly between the end of April and the end of July 1998. They increased, at transaction values, by approximately DM ¼ billion compared with a rise of DM 2½ billion in the previous three months. There were contrasting changes within the monetary reserves. Germany's reserve position at the IMF rose by about DM 2 billion because during the summer the Bundesbank was called upon to make a substantial contribution within its membership quota to the refinancing of the IMF's loans to countries in Asia and to Russia. Consequently, the German drawing rights in the reserve tranche rose by just under DM 1½ billion and the credits arising from special loan agreements by DM ½ billion. Most of the funds were made available to the IMF in dollars with the result that the foreign currency reserves declined by just over DM 1½ billion between the end of April and the end of July. The net external assets of the Bundesbank increased again by just under DM ½ billion in August. This means that the net external assets at the end of August, when calculated at the balance sheet rates at the end of 1997, amounted to DM 113½ billion compared with DM 111 billion at the end of 1997.

Exchange rate trends

Events on the world foreign exchange markets have continued to be strongly influenced by the situation in Asia during the summer, a fact that was particularly apparent in the exchange rate movements of the yen against the dollar. By contrast, the financial crisis in Russia and the resultant uncertainty about exchange rate relationships between the major world currencies were initially much less discernible during this period. It was not until a few weeks ago that the progressive clouding of global economic growth prospects had a somewhat more pronounced effect on the trend in the foreign exchange markets.

US dollar

The trend in the US dollar has been somewhat erratic during the summer. In June it made up part of the relatively substantial losses it had suffered in the previous two months, but, at almost DM 1.83, it remained about two pfennigs below its April level, which was the highest point it has reached so far this year. Since the middle of July the US currency has been tending to depreciate again. This development is in line with the cyclically induced reduction that market players had been expecting in the growth differential between the two countries. Whereas the upswing in Germany appears to be gaining momentum, a certain weakness is emerging in the United States, despite the continuing robustness in growth. The larger US trade deficit due to the Asian crises may also have led to some reassessment of the dollar's exchange rate prospects. This underlying tendency was overshadowed for a time by the uncertainty in connection with Russia's financial difficulties, which meant that there was temporarily greater demand for the US currency again. At the end of August, however, the dollar tended to weaken once more when the markets began to suspect an imminent lowering of US interest rates; when this Report went to press, the US dollar was being quoted at DM 1.69, which is its lowest level so far this year.

Pound sterling

Although the traditionally close relationship between the US dollar and the pound sterling has again been manifest in the exchange rate movements of the past few months, it has also been evident that new assessments of the future prospects for the British economy and the resultant expectations regarding the Bank of England's interest rate policy have been playing a role. Thus, the pound was likewise able for a time to make up for some of its earlier losses although it failed to reach this year's record level of DM 3.10. Since the beginning of July, however, it has again come under increasing pressure after the emergence of a discernible slowdown in the rate of economic growth. The British currency was being quoted at DM 2.85 when this Report went to press. That is equivalent to a depreciation of about 3½% against the Deutsche Mark since the beginning of the year; when measured against its highest level for the year so far, which it reached in the spring, the correction was even greater.

Yen

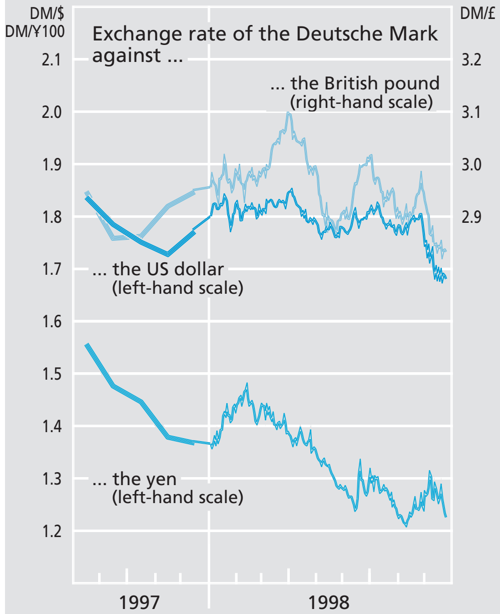
The yen, too, depreciated almost continuously from the peak it had reached in mid-February until well into August. Numerous factors played a role here although presumably the main influences were the persistent structural problems facing the financial sector and the temporary loss of confidence in the Japanese government's determination and ability to take action. It is certain that the weak domestic economy together with the fall in competitiveness as a result of the dramatic depreciation in a number of South-East Asian currencies also contributed to the downward trend in the yen. At the beginning of August the Japanese currency was being quoted at DM 1.21, which was its lowest rate since 1992. Since then, however, it has again gained ground with the result that, when this Report went to press, it was being quoted at DM 1.29.

EMU currencies

Essentially, the trend in the exchange rates of the EMU currencies against the Deutsche Mark was characterised by a general convergence towards the current central rates, which are also the same as the bilateral conversion rates which have already been announced for the currencies participating in EMU and which will come into effect at the start of monetary union at the beginning of next year. Only the Irish pound is showing a somewhat greater deviation (0.8%) from the central rate. The reasons for this are the cyclically induced interest rate differentials and the state of interest rate convergence, which is evidently expected to be achieved relatively late. During the past few months, however, this deviation, too, has been continuously reduced. Although after a period of convergence the Italian lira, the Spanish peseta and the Portuguese escudo had again moved slightly away from their respective central rates, they have not continued this trend since

Exchange rates of selected currencies *

Monthly averages, from 1998 daily rates



* Officical spot middle rates.

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then. At the time this Report went to press, the deviations were as much as 0.3 %, depending on the currency. Consequently, the current deviations are largely consistent with the present interest rate differentials despite the slightly greater exchange rate movements towards the end of August.

Nominal and real external values

During the summer there has been little change in the external value of the Deutsche Mark when measured on a weighted average against the currencies of 18 industrial countries. At the time this Report went to press, the Deutsche Mark was just less than 1 ½ % above its level at the beginning of June. This means that, after eliminating the differences in price movements in Germany and abroad, its real external value is more or less equivalent to its long-term average. Generally speaking, the present weighted external value of the Deutsche Mark is largely in line with the economic fundamentals.