German balance of payments in 1998

Last year German foreign trade was increasingly influenced by the impact that the currency and financial crises in South-East Asia were having on global economic growth and the expansion of world trade. On the one hand, German exports therefore declined discernibly in the course of the year. On the other hand, the improved competitiveness of suppliers in the crisis regions following the sharp depreciation of their currencies, together with the dramatic fall in the prices of petroleum and other raw materials, resulted in relatively buoyant imports. Even so, Germany's trade surplus increased in nominal terms to its highest level since reunification, primarily as a result of the more favourable terms of trade. The deficit on invisibles rose at the same time, however, and this meant that, despite the large trade surplus, Germany's current account again ran a slight deficit in 1998. The crises and their aftermath also left their mark on financial transactions with non-residents but, taking the year as a whole, the trend towards international portfolio diversification and further globalisation in corporate activity which had been observed for some time prevailed. These developments will be analysed in detail below.

Current account

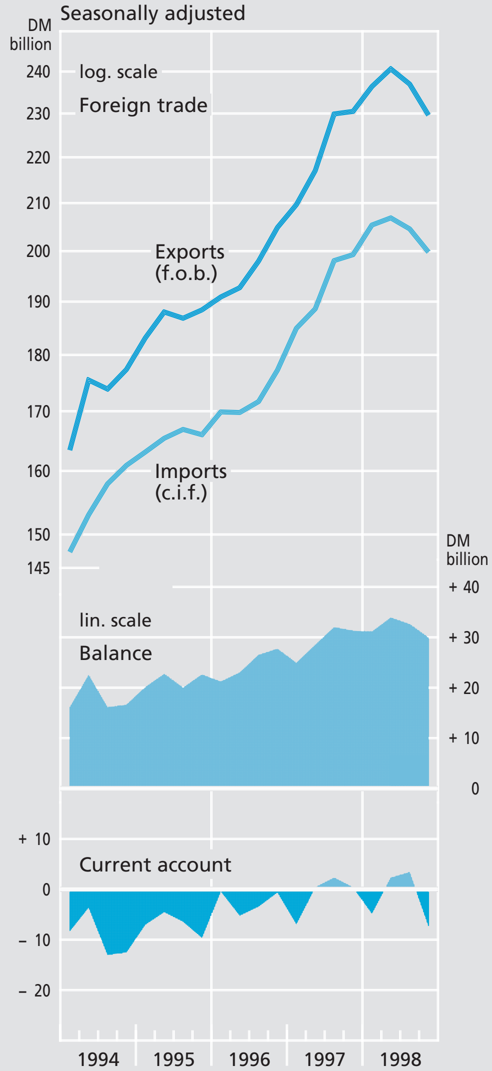
Exports

The export boom in 1997 was followed by a distinct downturn in exports in 1998. Given nominal and real growth rates of almost 7 % over the previous year, the overall result for 1998 appears quite favourable, but the corresponding rates in 1997, 12 ½ % (nominal) and 11% (real), were considerably higher. However, the underlying sluggishness in the pace of exports was more pronounced during 1998 than this comparison of annual results suggests. For example, Germany's exports of goods, which had risen by a seasonally adjusted 3 ½ % in the first half of 1998 compared with the second half of 1997, fell by more than 2 % in the second half of 1998 compared with the first half of the year.

Regional breakdown of exports

A considerably smaller volume of goods was exported last year, especially to the emerging markets of South-East Asia, where the decline amounted to 24 ½ %. At 10 ½ %, the rate of decline in German exports to Japan was likewise in double figures. There was also a decline (of 4 %) in exports to the OPEC states, whose foreign currency earnings had fallen sharply as a result of the downturn in oil prices. Again, exports to Russia decreased substantially when measured over the year as a whole. Whereas large growth rates vis-à-vis this country were still being achieved at the beginning of 1998, German exports ultimately sank below the level in 1997. The fact that German exports did not fall even more sharply under these conditions is partly due to the relatively minor significance of the aforementioned crisis regions for German foreign trade; they accounted for no more than approximately one-tenth of German exports. Another reason was the 8 ½ % rise in exports to other EU countries, which absorb more than one-half of German exports and therefore largely determine the overall trend. Even so, most of the growth occurred in the first half of the year; the growth in exports to the EU countries weakened substantially from the summer. By contrast, German exporters recorded above-average growth in sales to the

Foreign trade and current account



Deutsche Bundesbank

United States, which was running at 16½% up to the end of the year. However, the US market accounts for less than one-tenth of German exports.

Breakdown of exported goods

The mechanical and electrical engineering industries were affected most by the retarding effects emanating from the crisis regions, especially from those in South-East Asia, as these markets are of greater importance to these industries than they are to the other German exporting sectors. The foreign sales of these two industries therefore rose in 1998 by no more than just under 4% and 3%, respectively; during the year they actually recorded substantial falls. Export sales by the basic and producer goods sectors were similarly weak although this was primarily a reflection of declining prices for chemical and mineral oil products. These lower prices were due to the dramatic fall in petroleum prices rather than an indication of real losses in sales. By contrast, the German motor industry, which is more strongly geared to the markets in the other industrial countries, can look back on extremely buoyant exports in 1998 (+ 13½%).

Imports

Compared with the less favourable export trend and with the downturn in domestic output which began to emerge around the middle of the year, imports remained distinctly brisk. This had just as much to do with the improved competitiveness of the products from the countries of South-East Asia as with the falling prices of raw materials and energy, which in the course of 1998 had evidently given rise to a sharp increase in stockbuilding. Total imports of goods increased by just over

Regional breakdown of foreign trade

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	723.7	8.5	615.2	5.1
EU countries	535.5	8.5	440.7	3.8
EMU countries	408.7	8.8	352.0	4.3
Austria	50.1	7.3	32.1	10.2
Belgium/ Luxembourg	53.9	4.3	45.9	– 3.2
Finland	9.4	15.5	8.4	11.0
France	105.8	12.0	90.1	11.2
Ireland	5.1	21.0	9.0	2.1
Italy	70.4	8.2	63.3	3.7
Netherlands	65.1	3.2	65.6	– 2.9
Portugal	10.5	11.5	9.3	4.8
Spain	38.4	16.2	28.3	9.1
Other EU countries	126.8	7.7	88.7	2.0
Denmark	16.4	2.2	13.3	– 9.5
Greece	6.9	11.1	3.3	2.4
Sweden	21.7	5.3	16.0	7.9
United Kingdom	81.8	9.2	56.2	3.5
Other industrial countries	188.2	8.5	174.5	8.2
of which				
United States	89.3	16.6	67.3	14.0
Japan	18.3	– 10.7	40.7	8.5
Countries in transition	115.2	11.9	108.4	12.0
of which				
Countries in central and eastern Europe	101.2	12.1	84.1	13.2
China 2	11.9	12.0	23.0	6.6
Developing countries	108.9	– 6.2	89.3	0.6
of which				
OPEC countries	19.2	– 4.0	11.2	– 19.6
Emerging markets in South-East Asia	36.7	– 24.3	41.7	4.0
All countries 1	949.7	6.9	821.1	6.3

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

Deutsche Bundesbank

Breakdown of foreign trade by category of goods

in %; 1998

Item	Change from previous year	Share of total exports or total imports
Exports		
Basic and producer goods 1	1.2	22.2
of which		
Chemical products	2.3	12.7
Capital goods	8.1	57.9
of which		
Mechanical engineering products	3.8	14.1
Road vehicles	13.3	19.4
Electrical engineering products	2.9	12.9
Data processing equipment 2	13.3	2.4
Consumer goods	4.2	10.6
Food, drink and tobacco 3	0.1	4.9
Total 4	6.9	100
Imports		
Sources of energy	– 23.2	5.5
Basic and producer goods 5 (excluding sources of energy)	4.5	19.4
of which		
Chemical products	6.6	9.1
Capital goods	10.2	42.1
of which		
Mechanical engineering products	11.0	5.7
Road vehicles	7.8	11.1
Electrical engineering products	6.6	11.6
Data processing equipment 2	14.6	4.9
Consumer goods	0.1	14.2
Food, drink and tobacco 3	– 2.9	9.3
Total 4	6.3	100

1 Including mining and energy. — **2** Including office machines. — **3** Including agricultural products. — **4** Including corrections not broken down by category of goods. — **5** Including mining.

Deutsche Bundesbank

9 % in real terms last year and therefore actually somewhat faster than in the previous year. Owing to the fall in import prices, however, the rise in terms of value was considerably smaller; at just under 6 ½ %, the growth rate was only slightly more than half as fast as in 1997, when it was approximately 12 %.

Breakdown of imported goods

As expected, the diverging impact of falling import prices on the volume of imported goods, on the one hand, and on the corresponding import values, on the other, is particularly noticeable in the case of crude oil imports, the value of which – free German border – went down by no less than 32 %. At the same time, the volume of oil imported in 1998 rose by just over 7 ½ % and therefore more sharply than in the previous five years taken together. In terms of value, however, oil imports declined by 26 ½ %. At DM 45 ½ billion, just over DM 13 ½ billion (or 23 %) less was spent on total energy imports in 1998 than in 1997. Another substantial source of relief for German business was the fall in the prices of other imported raw materials; according to the HWWA index of raw material prices, the Deutsche Mark prices fell by 12 ½ % in 1998. Consequently, there was virtually no increase in the German import bill compared with last year, despite the considerable rise in the volume of raw materials imported. Instead, the breakdown of (nominal) expenditure on imports shifted significantly in favour of industrial products last year as a result of the factors outlined.

Regional breakdown of imports

When interpreting the changes in the regional breakdown of German imports, the pronounced price movements in the case of energy and raw materials last year have to be taken into account just as much as the lower prices of products from the crisis countries in South-East Asia, which came about because of the depreciation of currencies. At all events, the 4 % increase in imports from these countries compared with the previous year probably greatly underrepresents the real increase in the percentage of goods from this region on the German market. For the reasons given, much the same applies to the imports from the OPEC countries, whose value fell by approximately 20 %. Against this background, the sharp rise (of 13 %) in the value of imports from the central and east European countries in transition is remarkable, especially as Germany's imports of energy and raw materials from this group of countries are not insignificant either. In real terms the rate of growth is therefore likely to have been even higher. Over the years Germany is thereby making an important and lasting contribution to the integration of the countries in transition into the world economy.

Trade balance

The sharp decline in import prices ultimately resulted in a further increase in the trade surplus in 1998 despite the downturn in real export growth and the virtually unchanged buoyancy in the demand for imports. Germany's foreign trade surplus rose (in nominal terms) by DM 12 billion to almost DM 129 billion, which is equivalent to just under 3½ % of German gross domestic product and represents a record for the nineties.

Invisibles

On the other hand, sharply increased deficits on invisible current account transactions had quite a detrimental effect on the German current account last year. The overall deficit on invisibles increased from DM 113 billion in 1997 to DM 131 billion in the year under review with the result that the current account as a whole ran a slight deficit of approximately DM 6 billion. This development was primarily due to the fact that (net) investment income payments to non-residents rose significantly last year whereas the balances on service transactions with non-residents and on current transfer payments changed only marginally.

Factor income

In 1997 investment income from German external assets had been just under DM 1½ billion less than the interest payments arising from German external liabilities, but in 1998 this deficit amounted to DM 14½ billion.

Current account

DM billion

Item	1996	1997	1998
1. Foreign trade			
Exports (f.o.b.)	788.9	888.6	949.7
Imports (c.i.f.)	690.4	772.1	821.1
Balance	+ 98.5	+ 116.5	+ 128.6
2. Services (balance)	– 53.1	– 56.9	– 61.8
of which			
Foreign travel (balance)	– 50.5	– 51.7	– 53.7
3. Factor income (balance)	+ 1.7	– 3.0	– 16.1
of which			
Investment income (balance)	+ 3.5	– 1.3	– 14.3
4. Current transfers (balance)	– 51.3	– 52.8	– 53.3
Balance on current account 1	– 8.4	– 2.4	– 6.2

1 Includes supplementary trade items.

Deutsche Bundesbank

Large dividend payments by German firms to foreign shareholders as well as a special dividend payment by one large German enterprise played a role here. Furthermore, the profit transfers as a result of foreign direct investment in Germany increased sharply. The distribution of earnings by German firms to their foreign proprietors together with the larger dividend payments rose by DM 5 billion to DM 26 billion in 1998. In addition, net interest income from loans was lower, at DM 7 billion, in 1998 than in the previous year (DM 11½ billion). If the more or less constant deficit of almost DM 2 billion on income from employment is included, total factor payments to non-residents, which are combined in the balance on factor income, ran a deficit of just over DM 16 billion in 1998 compared with one of DM 3 billion in 1997.

Services

Germany's traditionally large deficit on services rose by just under DM 5 billion to approximately DM 62 billion last year. As usual, the deficit on foreign travel, at DM 53½ billion, accounted for the lion's share; nevertheless, the increase in the deficit here remained relatively small, at DM 2 billion, and was scarcely above the level in the previous four years. However, there are substantial changes in the breakdown of foreign travel expenditure behind this trend. These suggest that the more moderate growth in expenditure is mainly at the expense of expensive long-haul trips. At all events, substantial growth was recorded in spending in the "classic" holiday countries in the Mediterranean region whereas expenditure on trips to more distant destinations, which have long been particularly popular, increased at a below-average rate. Spending by German tourists and business travellers in the United States fell particularly sharply whereas in 1997 it had still been rising significantly. German travellers also spent less in most north African countries and in Turkey than they had done in 1997.

The deficits in sub-sectors of the services account other than foreign travel rose faster in 1998 than in the previous year. This is particularly true in the case of insurance services and in the field of "technical" services. The fact that the income which Germany derives from foreign military bases declined further as a result of the reduced presence of troops on German soil had a similar effect. If foreign travel is excluded, the deficit on transactions in the services sphere increased by DM 3 billion to DM 8 billion.

Current transfers

Current transfers to non-residents constitute the second of the large deficit items which partly offset the surpluses achieved in foreign trade. In 1998 these unilateral transfers to non-residents amounted to DM 53½ billion net, which was only DM ½ billion more than in the previous year. (It must be remembered here that, owing to the methodological adjustments in the balance of payments statistics, certain development aid payments are now being booked under capital transfers instead of under current transfers.)

Most of these regular current transfer payments to non-residents were in the public sector. Total net transfers by public authorities amounted to DM 37½ billion in 1998, with regular net payments to the EU budget alone amounting to DM 29½ billion. After deduction of the payments received from the EU budget, which are allocated not to current transfers but to services and capital transfers, Germany's net contribution to the EU budget in 1998 was just under DM 24 billion compared with DM 22½ billion in 1997. The remittances of foreign workers in Germany to their home countries accounted for DM 7 billion of the transfers of DM 16 billion net in the private sector; pensions and other maintenance payments to beneficiaries living abroad accounted for a further DM 3½ billion.

Financial account

Trends in financial transactions

For German financial transactions with non-residents 1998 was a year of extremes: turnover in cross-border financial transactions was extraordinarily inflated, various sub-balances of the financial account showed large surpluses or deficits and rapid changes of mood brought a high degree of volatility in capital flows from one month to the next. This is a remarkable scenario, given the comparatively relaxed exchange rate relationships between the major world currencies and the largely smooth transition to stage three of European economic and monetary union (EMU). On the other hand, the trend towards the internationalisation of investments, which had been under way for some time, appears to have been given a boost by EMU. National borders are evidently playing an ever decreasing role in the locational decisions by enterprises and in credit operations. The increasing significance of cross-border mergers – including those of large enterprises – and the rapid

Methodological changes with respect to the current account

A number of methodological changes were made in the course of this year's revision of the current account data for 1998. This means that the Bundesbank has now brought its statistics into line with the new version of the internationally agreed guidelines on balance of payments statistics issued by the International Monetary Fund and, at the same time, has taken account of the changes required as a result of the start of European monetary union.

The major changes occur in **factor income.** Transactions in connection with various financial market operations (interest rate swaps), which had formerly been booked as "Interest on credits" under investment income, are now recorded as **financial derivatives** under financial transactions with non-residents (see the explanatory notes on page 57).

Methodological adjustments have also been made to the recording of **earnings from direct investment.** Total earnings and therefore re-invested earnings, too, are derived from balance sheet data and consequently are not available until the year following the year in which the earnings are distributed (dividend payment). As a result, the re-invested earnings used to be booked in the year after they had arisen; in the annual revision for 1998 the computed figures, including those ascertained retroactively, are allocated to the balance sheet year. The data for the current period must be estimated initially. After taking account of the revisions relating to interest rate swaps and re-invested earnings and including data contained in late reports, the total balance of investment income in 1998 declined from the original sum of (minus) DM 21.5 billion to (minus) DM 14.3 billion. The deficit on current account was likewise reduced accordingly.

Finally, a change was also made in the case of **current transfers.** Thus, certain amounts of the development aid payments were transferred from the current transfers to **capital transfers.** The classification of the transactions depends on whether or not the transfers change the assets position of the countries concerned. As a result of this change (and the customary annual revisions), last year's deficit on current transfers declined from DM 57.3 billion to DM 53.3 billion.

Deutsche Bundesbank

Major items of the balance of payments

DM billion

Item	1996	1997	1998
I. Current account			
1. Foreign trade			
Exports (f.o.b.)	788.9	888.6	949.7
Imports (c.i.f.)	690.4	772.1	821.1
Balance	+ 98.5	+ 116.5	+ 128.6
2. Balance of invisibles	– 102.8	– 112.8	– 131.2
Balance on current account 1	– 8.4	– 2.4	– 6.2
II. Balance of capital transfers	– 3.3	+ 0.1	+ 1.3
III. Financial account 2			
Direct investment	– 68.0	– 53.2	– 117.4
Portfolio investment 3	+ 96.0	+ 4.4	+ 9.4
German investment abroad	– 46.0	– 154.1	– 246.0
Foreign investment in Germany	+ 142.1	+ 158.5	+ 255.5
Financial derivatives	– 8.8	– 15.1	– 12.0
Credit transactions 3, 4	+ 4.0	+ 63.2	+ 143.4
Overall balance on financial account	+ 23.2	– 0.7	+ 23.5
IV. Change in the monetary reserves at transaction values (increase: –) 5	+ 1.9	+ 6.6	– 7.1
V. Balance of unclassifiable transactions	– 13.4	– 3.5	– 11.4

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

Deutsche Bundesbank

spread of "news" to the most distant financial centres are a reflection of globalisation. This development was accompanied last year by a number of crises in the international financial markets which led to rapid shifts in the portfolios of internationally operating investors and therefore contributed to the large degree of volatility in financial flows.

Increasing turnover in portfolio transactions

These trends can be clearly seen in Germany's portfolio transactions with non-residents. The financial flows to and from Germany again increased distinctly last year, and turnover rose sharply. The sum of German investors' purchases and sales of foreign paper alone increased by two-thirds in 1998. For one thing, this shows that Germans are becoming more interested in an international diversification of their investments. For another, it indicates that investment terms are clearly becoming shorter; in purely arithmetical terms, German investors turned over the securities in their external portfolios more than twice last year – which means that the average investment term in securities was approximately five months. That is roughly the same as the duration of non-residents' investment in German paper, which has been at this level for some years now.

German securities investment abroad

German residents invested DM 246 billion in foreign securities in 1998, which is approximately 60 % more than in the previous year. Their demand was focused on foreign shares, and total net purchases amounted to DM 108 ½ billion compared with DM 62 ½ billion a year earlier. The basic conditions for acquiring foreign shares were particularly favourable last year. Firstly, fixed-interest securities

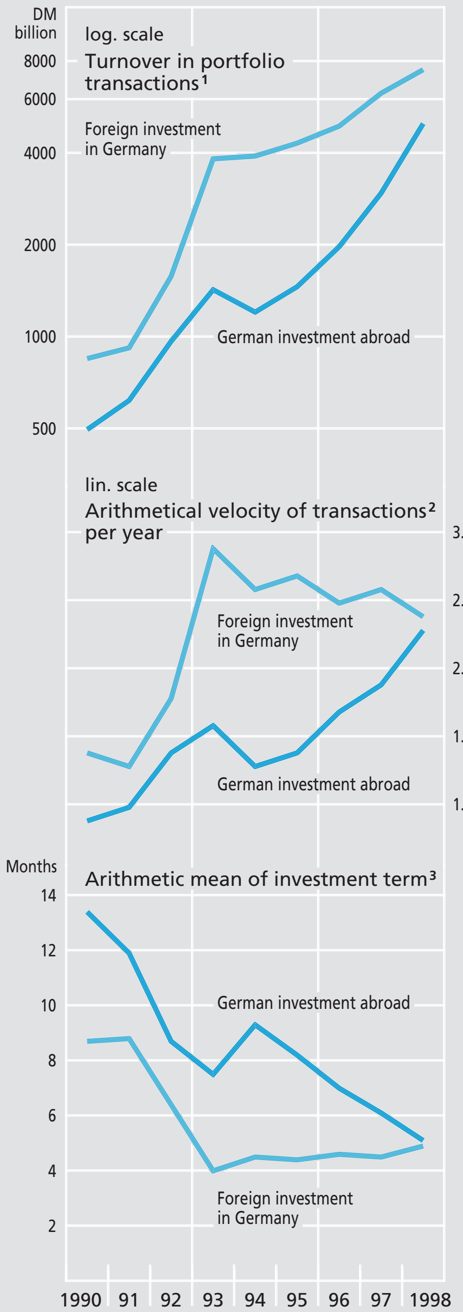
Foreign shares

had become increasingly less attractive for savers in the light of declining yields; secondly, the climate on major international stock exchanges was extremely friendly for most of the time, and this spurred investors' expectations regarding price movements. Just how eager German investors were to buy can also be seen in the fact that the crises on international financial markets hardly had any noticeable impact on Germans' cross-border acquisition of shares. This indicates that there are "structural" reasons behind the German demand for foreign shares. Given the growing integration of the share market in the euro area, it was possibly the operations of institutional investors that played the greatest role here as shares in the single currency area were in particular demand. They accounted for approximately two-thirds of all German share purchases abroad in 1998.

Foreign bonds and notes

German residents' investment in foreign bonds and notes likewise increased last year, albeit not quite so steeply as in the case of shares. Their total purchases of bonds issued by foreign borrowers were worth DM 109 billion (1997: DM 76½ billion). The lion's share of the paper acquired landed in the portfolios of German credit institutions, which were presumably laying in considerable stocks of foreign currency issues by partner countries in expectation of further interest rate convergence in the run-up to EMU. For example, lira-denominated bonds, with a total value of DM 29 billion, were in greater demand than dollar paper (DM 9 billion), which, despite its increasing interest rate advantage over German paper during the year, lost ground compared with 1997. Sales of foreign Deutsche

Turnover in portfolio transactions and investment term



1 Sum of the purchases and sales of securities. — **2** Quotient of (half) the turnover in securities and the average securities holdings; 1998: mid-year stocks. — **3** Inverse value of the velocity of transactions converted into months.

Deutsche Bundesbank

Financial transactions

DM billion, net capital exports: –

Item	1996	1997	1998
1. Direct investment	– 68.0	– 53.2	– 117.4
German investment abroad	– 76.5	– 69.9	– 152.4
Foreign investment in Germany	+ 8.5	+ 16.7	+ 35.0
2. Portfolio investment	+ 96.0	+ 4.4	+ 9.4
German investment abroad	– 46.0	– 154.1	– 246.0
Equities	– 21.9	– 62.6	– 108.5
Investment fund certificates	– 4.3	– 14.9	– 21.0
Bonds and notes	– 20.6	– 76.6	– 109.2
Money market paper	+ 0.8	+ 0.1	– 7.2
Foreign investment in Germany	+ 142.1	+ 158.5	+ 255.5
Equities	+ 22.1	+ 27.4	+ 97.2
Investment fund certificates	– 2.3	– 4.1	– 2.8
Bonds and notes	+ 102.8	+ 122.9	+ 147.9
Money market paper	+ 19.5	+ 12.2	+ 13.2
3. Financial derivatives 1	– 8.8	– 15.1	– 12.0
4. Credit transactions	+ 8.0	+ 68.3	+ 151.1
Credit institutions	– 5.0	+ 63.9	+ 140.8
Long-term	+ 23.1	– 3.9	– 3.2
Short-term	– 28.2	+ 67.8	+ 144.1
Enterprises and individuals	+ 9.4	+ 21.6	+ 10.0
Long-term	– 1.1	– 1.5	+ 13.8
Short-term	+ 10.5	+ 23.1	– 3.8
Government	+ 4.9	– 17.1	– 3.2
Long-term	+ 0.9	– 10.5	– 10.1
Short-term	+ 4.0	– 6.6	+ 6.9
Bundesbank	– 1.3	– 0.1	+ 3.4
5. Other investment	– 4.0	– 5.1	– 7.6
6. Balance of all statistically recorded capital flows	+ 23.2	– 0.7	+ 23.5
Memo item Change in the monetary reserves at transaction values (increase: –) 2	+ 1.9	+ 6.6	– 7.1

1 Securitised and unsecuritised options as well as financial futures contracts. — **2** Excluding allocation of SDRs and changes due to value adjustments.

Deutsche Bundesbank

Mark bonds also grew strongly (DM 28½ billion compared with DM 12 billion). From the point of view of investors significantly larger yields could be obtained in some cases from this paper than from German issues – although a greater risk was involved. As far as foreign issuers were concerned, the possible conversion into euro-denominated bonds together with the low interest rate level in Germany may have been an incentive to draw more heavily on the Deutsche Mark segment in the international capital market.

Foreign investment fund certificates and money market paper

German investors also purchased shares in foreign investment funds worth DM 21 billion net (1997: DM 15 billion). The increase was solely the result of a reversal in the sales of foreign money market funds, which in 1998 acquired approximately DM 5 billion from the sale of certificates in Germany. In 1997 more than DM 2 billion had been withdrawn from these funds. There was also a noticeable upturn in German investors' interest in foreign money market paper (DM 7 billion), for which there had hardly been any demand in the previous year, on balance.

Non-residents' portfolio investment in Germany

Like the investment of Germans abroad, the investment by non-residents in German securities increased steeply last year; overall, non-residents invested approximately DM 255½ billion in the German market in 1998 compared with DM 158½ billion a year earlier. This means that even shortly before the introduction of the euro non-residents were showing great interest in German – notably DM-denominated – paper. Most of the influx of funds – namely DM 148 billion – was spent in the German bond market. Foreign invest-

Purchases of German bonds

ors' purchases were divided more or less equally between public bonds and private issues, almost exclusively bank bonds. As has happened on many occasions in the past when there was growing uncertainty in the financial markets, Federal bonds, in particular, benefited for a time from their status as secure and highly liquid investment instruments. By contrast, foreign demand for bank bonds, whose terms of issue take greater account of the individual needs of foreign investors, was subject to a very much lower degree of fluctuation. Among the attractive features of these aforementioned terms of issue are denomination and the manner of remuneration. About one in every two of the German bank bonds purchased by non-residents in 1998 was denominated in foreign currency and almost one in five had a variable rate of interest.

Purchases of German shares

Last year foreign investors acquired German shares worth DM 97 billion. However, this sum includes just over DM 50 billion for new shares which were transferred to foreign shareholders in connection with one cross-border corporate merger.[1] Even if this transaction is excluded, however, foreign investment in the German share market increased sharply last year compared with the previous few years. In 1997 non-residents had spent DM 27 ½ billion on the purchase of shares in Germany. Foreign investors' interest in German shares and the favourable stock exchange climate in Germany – notably in the first six months of the year – were probably mutually stimulating. Even if the regional breakdown of the recorded share purchases requires cautious interpretation (because this breakdown can be made only on the basis of the countries in which the parties directly involved are resident and not on the basis of the residence of the final purchaser), it does reveal greater cross-border diversification of shareholding in Europe, a development which may have something to do with the start of EMU. At all events, if the large aforementioned transaction with the United States is excluded, most of the German shares bought by non-residents were bought by investors resident in partner countries within the European Union. This is consistent with the finding that there is a buoyancy in the market for German shares in the EU.

Acquisition of domestic money market paper and investment fund certificates

Compared with events in the share and bond markets, business in the other segments of portfolio transactions were held fairly well in check. Greatest foreign interest was shown in German money market paper, with acquisitions by non-residents amounting to DM 13 billion (1997: DM 12 billion). Foreign investors purchased only short-dated issues by banks on the whole, while reducing their holdings of corresponding paper from public

1 The merger was organised in such a way that the two existing enterprises were fused into a newly established German public limited company. The takeover of the foreign company was shown in the balance of payments as German direct investment abroad whereas the shares of the newly established public limited company consigned to the foreign shareholders of the enterprise taken over by way of compensation were classified as portfolio transactions. Any shares in the foreign company which had been held by German residents were initially reascribed to non-residents and consequently booked as sales of foreign shares. If the entire operation is seen as a whole, the payment flows cancel each other out; in view of the magnitude of the merger, however, the transactions recorded in the various segments of the financial account cannot be ignored. For details see Deutsche Bundesbank, Monthly Report, February 1999, page 71.

borrowers.[2] In contrast to their actions with respect to money market paper, non-resident investors sold certificates of German investment funds, as they had done the year before (1998: DM 2½ billion); however, this paper plays only a subordinate role in cross-border portfolio transactions in any case.

Financial derivatives

In the new presentation of the balance of payments foreign transactions in financial derivatives are no longer classified as portfolio transactions but represent a category of their own within financial transactions (see the explanatory notes on the adjacent page). In net terms transactions in derivatives in 1998 resulted in a deficit of DM 12 billion compared with net capital exports of DM 15 billion in 1997.

Direct investment

As in the case of portfolio transactions, the cross-border financial flows resulting from direct investment increased discernibly in 1998. Thus, German enterprises provided their foreign subsidiaries with funds amounting to DM 152½ billion – after deducting the credits these subsidiaries received – in 1998; this compares with DM 70 billion a year earlier. Foreign parent companies also provided their subsidiaries in Germany with a greater amount of additional funds last year. As a result, there was a total influx of DM 35 billion compared with DM 16½ billion in 1997. This ultimately led to a record deficit in direct investment of approximately DM 117½ billion.

Methodological changes

However, as significant methodological changes have been made in the recording and presentation of direct investment (see the explanatory notes on the adjacent page), the recent figures are not fully comparable with those of previous years. The extension of the term direct investment to include the short-term credit operations between affiliated enterprises means that this variable can now indicate the entire intra-group financial integration. It therefore reflects corporate decisions on strategic and locational policy as much as short-term deliberations on liquidity policy. In order to take account of this the following analysis will deal in more detail than hitherto with the various components of direct investment in the form of participating interests and credits.

German direct investment abroad

Besides, one single corporate merger made a difference of more than DM 50 billion in the annual figure for 1998. This affected German acquisition of participating interests abroad, which rose to approximately DM 105 billion. If this transaction is excluded, the new equity investment by German enterprises in foreign firms remained much the same as in 1997 (DM 42 billion). In addition, the granting of credits (DM 34½ billion compared with DM 15 billion in 1997) played a significant role in the funding of foreign investment.[3] The provision of short-term financial credits, which is possibly to be seen in connection with liquidity management within companies belonging to the same group, predominated here. The most important target country for German

---

2 These figures include returns of liquidity paper issued by the Bundesbank to foreign borrowers. The reinvestment of some of the funds was in the form of unsecuritised deposits and is therefore shown under credit transactions. See the explanatory notes on the adjacent page.
3 Borrowings by German parent companies from their foreign subsidiaries have been deducted from these figures. A breakdown of the data is given in the table on page 60.

Methodological changes in the financial account

For the reasons already explained, a number of adjustments were likewise made to the methodology and presentation of the financial account statistics.

Portfolio investment/financial derivatives

In the previous presentation of the financial account, transactions in financial derivatives were shown under portfolio investment. However, derivatives have special features which distinguish them from other securities. They are often products which are not traded on organised markets. Another point is that payments in connection with derivatives are not necessarily associated with the purchase or sale of a security. It therefore seems to make sense to record derivatives business with non-residents separately from portfolio transactions in the balance of payments.

Furthermore, in line with agreements on statistics within the euro area the transactions are generally shown net – that is to say, as a balance of all domestic and external payments arising in connection with these instruments. This seems advisable principally because classifying some payments as German investment abroad and others as foreign investment in Germany cannot always be done with complete certainty.

Finally, all payments in connection with interest rate swaps, which were previously classified as investment income, are now shown consistently under financial derivatives.

External position/monetary reserves of the Bundesbank

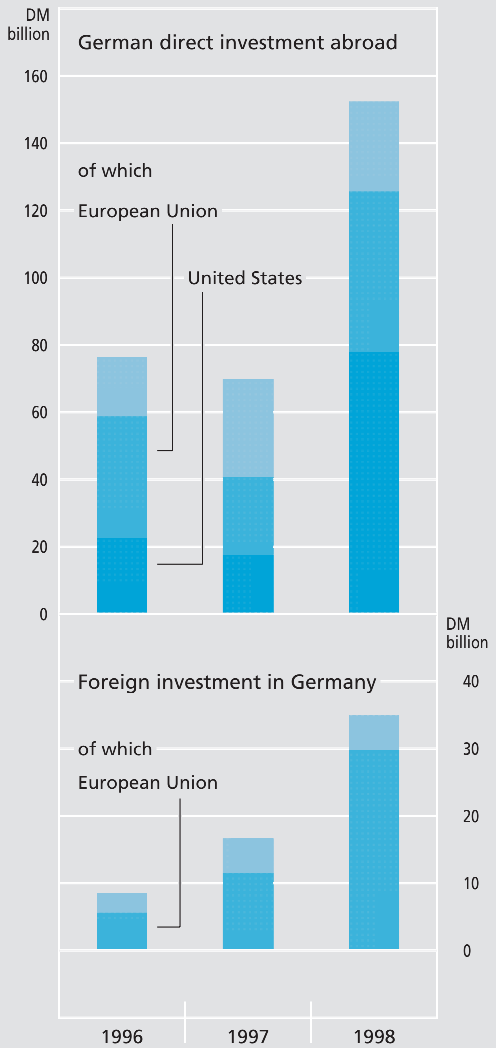
All external transactions by the Bundesbank were formerly included in the item "Change in the Bundesbank's **net external assets**" in the German balance of payments. In accordance with the guidelines of the IMF and the ECB, however, the Bundesbank now concentrates more on the change in the "actual" **monetary reserves** in the balance of payments. The changes in the Bundesbank's other assets and liabilities vis-à-vis non-residents are shown under the relevant instruments in the financial account section. Consequently, the Bundesbank now appears as a separate item under credit transactions, which, in future, will be affected most by the changes.

Another point is that, with the start of EMU, there has been a change in the definition of monetary reserves within the ESCB. As defined in the balance of payments statistics, these reserves now comprise – in addition to the gold holdings and the IMF position – only the liquid claims denominated in foreign currency that the monetary authorities have on non-euro area residents. This means that, regardless of the currency in which they are denominated, all of the Bundesbank's external claims on the other countries participating in EMU are allocated to the other external assets of the Bundesbank instead of to the monetary reserves. This primarily affects the Bundesbank's assets within the ESCB. Much the same applies to the euro-denominated claims on third countries, such as those arising from settlement balances within the payments system TARGET.

A comprehensive and detailed account of the Bundesbank's external assets and liabilities (including the monetary reserves) is given in tables X.7 and X.8 in the statistical section of the Monthly Report.

Deutsche Bundesbank

Trend in and breakdown of direct investment



Deutsche Bundesbank

direct investment in 1998 was the United States, which – if the aforementioned single transaction is included – absorbed about one-half of all funds. The largest investment operations in the EU were in France and the Netherlands.

Foreign direct investment in Germany

It is gratifying with respect to locational policy that after years of restraint more long-term foreign capital was again invested in Germany, too, in 1998. This applies both to the acquisition of participating interests, which increased from DM 6 billion to DM 12½ billion, and to the granting of long-term loans within corporate groups (DM 7 billion), which traditionally plays an important role in the funding of foreign firms resident in Germany. By far the greatest proportion of the funds for direct investment came from partner countries in the EU. Not only Italy and the United Kingdom but also Belgium and the Netherlands were fairly important as investor countries. As major holding companies are involved in the case of the last two countries mentioned, however, it is impossible to break down the actual investors by region.

Credit transactions ...

Large net capital imports (DM 151 billion) were recorded in unsecuritised credit transactions last year. The smaller share of these was due to credit transactions by non-banks. Thus, inflows of DM 10 billion net accrued to enterprises and individuals – mainly as a result of raising long-term loans, although these were accompanied at the short end of the market by fairly small outflows of funds arising from the investment of liquid capital with foreign banks. These figures no longer include credit operations between affiliated companies as these operations are now classified as direct investment, owing to the conceptual changes already mentioned.

... of enterprises and individuals

... government agencies

Net capital exports by the government (DM 3 billion) were of little significance last year. Substantial redemption payments on long-term loans previously raised abroad were largely offset by capital imports arising from

Methodological changes in the case of direct investment

Since January 1999 enterprises' cross-border participating interests amounting to 10 % or more (formerly more than 20 %) of the capital or voting rights are deemed to be direct investment. Not only the equity capital but also re-invested earnings and credits granted to shareholders count towards direct investment. Cross-border acquisition of land, too, continues to count as direct investment – regardless of whether the land concerned is held privately or commercially.

In accordance with the new method of computing, all earnings arising from enterprises' participating interests – and therefore including re-invested earnings – are now allocated to the year in which the earnings arose (accrual principle). The re-invested earnings of the current year were formerly obtained from the difference between the earnings in the previous year and the current dividend payments.

A more fundamental change than this temporal shift of earnings is the inclusion of the short-term credit operations between companies belonging to the same group in the direct investment statistics and the presentation of all credit transactions according to the so-called "directional principle". The long-term credits issued between affiliated enterprises have always been classified as direct investment because the funding of participating interests and of credits should not be treated differently provided it is made on a long-term basis. In line with international custom, **every** type of funding by the parent company – including short-term financial credits and trade credits – will now be termed direct investment. This will certainly improve the international comparability of the figures but must be taken into account when interpreting them.

Another point is that, as a result of the new method of computation, all credit operations will now be classified according to the direction of the direct investment (directional principle). Consequently, credits granted by subsidiaries to their parent company (reverse flows) will be regarded as returns of funds which the parent company had already placed at the subsidiaries' disposal (disinvestment). Previously, such credits granted to the parent company were shown as direct investment in their own right provided their duration exceeded one year.

The methodological innovations have also been applied to earlier years where this has been possible using the available statistical base. There was no difficulty in applying the change in the temporal allocation retroactively when calculating re-invested earnings in the past. The short-term credits issued in the past three years could be included in direct investment in any case; the same is true of the application of the directional principle. The detailed account of the various components in the statistical supplement *Balance of payment statistics* enables a link to be made to the earlier form of presentation and a comparison for at least a few years. The most important consequences of the innovations will become apparent from the table on page 60.

Deutsche Bundesbank

Direct investment

DM billion

Item	1996	1997	1998
Balance of direct investment	– 68.0	– 53.2	– 117.4
German direct investment abroad (increase/capital exports: –)	– 76.5	– 69.9	– 152.4
Equity capital	– 35.6	– 41.9	– 105.0
Re-invested earnings	– 9.2	– 6.2	– 6.0
Credit transactions of German direct investors	– 25.7	– 15.0	– 34.3
Financial credits			
Long-term			
Lending	– 2.3	– 3.5	– 9.8
Borrowing from foreign subsidiaries	– 1.1	+ 2.8	+ 12.4
Short-term			
Lending	– 25.1	– 13.3	– 28.7
Borrowing from foreign subsidiaries	+ 9.5	+ 5.4	– 3.8
Trade credits			
Lending	– 7.5	– 7.5	– 4.0
Borrowing from foreign subsidiaries	+ 0.8	+ 1.1	– 0.4
Other investment	– 6.0	– 6.8	– 7.1
Foreign direct investment in Germany (increase/capital imports: +)	+ 8.5	+ 16.7	+ 35.0
Equity capital	+ 3.6	+ 6.2	+ 12.4
Re-invested earnings	– 6.8	– 0.8	–
Credit transactions of foreign direct investors	+ 12.6	+ 11.9	+ 23.4
Financial credits			
Long-term			
Lending	+ 2.8	+ 5.1	+ 7.2
Borrowing from German subsidiaries	+ 0.8	– 0.2	– 0.2
Short-term			
Lending	+ 13.1	+ 3.4	+ 17.3
Borrowing from German subsidiaries	– 4.4	– 1.0	– 1.0
Trade credits			
Lending	+ 0.3	+ 4.5	+ 1.0
Borrowing from German subsidiaries	+ 0.1	+ 0.2	– 0.8
Other investment	– 0.9	– 0.6	– 0.8

Deutsche Bundesbank

the modest reduction in bank balances abroad.

... and banks

The credit transactions between the banks and non-residents had a much greater impact on the overall result than the operations of the non-banks. Capital outflows (DM 3 billion) predominated at the long end of the market, as they had done in the previous year. However, the modest net capital flow concealed the fact that the banks' international lending also increased further; credits granted to non-residents and those raised abroad with maturities of more than one year both increased appreciably compared with 1997. In the banks' foreign operations, however, it was short-term financial flows that dominated once again. As a result, German credit institutions received net foreign funds amounting to DM 144 billion – which was more than twice as much as in 1997 (DM 68 billion). If the balance of payments is considered as a whole, these inflows of funds represent the more important counterpart to the deficits in the other segments of the current and financial accounts.

Deutsche Bundesbank

The changes in the external position of the Bundesbank, with the exception of those concerning the monetary reserves or portfolio transactions, are now likewise shown under credit transactions. Nevertheless, such movements on the Bundesbank's foreign accounts were fairly limited on the whole; net capital inflows of DM 3 ½ billion were recorded. The rise in unsecuritised deposits of other monetary authorities and international organisations at the Bundesbank had the greatest impact. As already mentioned, most of this was due to the transfer of liquidity paper.

Change in monetary reserves

The monetary reserves of the Bundesbank, at transaction values, increased by DM 7 billion in 1998. This rise is entered as a capital export with a negative sign in the revised form of the balance of payments.

Breakdown of the monetary reserves

The monetary reserves also rose by approximately DM 7 billion last year when calculated at balance sheet rates as the revision of the dollar and SDR holdings at the end of the year largely cancelled each other out. Consequently the monetary reserves amounted to DM 134 billion at the end of 1998 (end-1997: DM 127 billion). Foreign exchange and foreign notes and coins accounted for DM 100½ billion of this, mostly in the form of dollar assets. Gold holdings amounted to just over DM 17 billion. These figures include the gold and dollar holdings that had been transferred temporarily to the ECB pending the abolition of the EMS. Finally, the reserve position at the IMF (including the special drawing rights allocated) stood at DM 16½ billion. There was an increase of more than DM 2½ billion here, primarily as a result of the international assistance measures for the various countries in crisis.