German balance of payments in 1999

Germany's economic and financial relationships with non-residents were marked by far-reaching changes last year. Firstly, new monetary policy conditions were established as a result of the changeover to monetary union and the introduction of the euro, and these have left their mark, especially in the case of cross-border financial transactions. The outcome was that the German financial system acted as a major channel for capital flowing into the other euro-area countries from outside. Secondly, the external conditions confronting German exporters improved on a lasting basis owing to the recovery of the world economy from the consequences of the crisis in Asia and thereby provided a new stimulus to the domestic economy. Real imports grew only moderately in 1999. Owing to the dramatic rise in the price of oil imports, however, the value of imports was inflated to such an extent that Germany's trade surplus was smaller than in 1998, despite the country's remarkable export achievement. Given larger deficits on both services and investment income, the deficit on Germany's current account rose to € 19½ billion in 1999 compared with one equivalent to € 4 billion in 1998. These developments in cross-border current and financial transactions will be analysed in detail below.

Current account

Exports

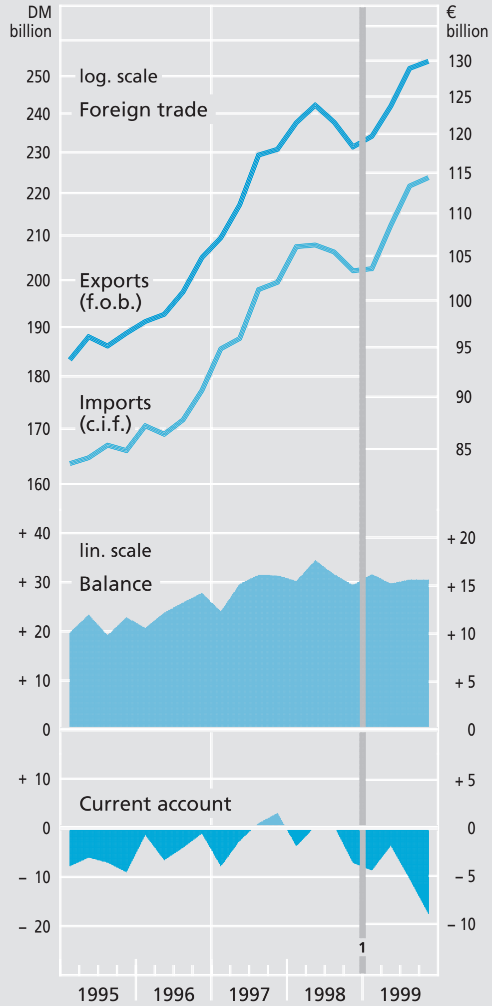
Following the distinct downturn in exports as a result of the crises in the emerging markets in South-East Asia, German exports experienced a discernible revival in the course of 1999. In the final quarter of last year the value of German exports of goods was already exceeding its corresponding 1998 level by 10 % whereas in the first quarter of 1999 the figure had still been almost 1½ % below that in the corresponding period of the previous year. Calculated at current prices over the year as a whole, German exports rose by just under 4 %. At 4 %, the increase in volume is just as great.[1] This means that Germany participated substantially in the real growth in world trade last year.

Regional breakdown of exports

The revival in German exports was triggered by sales to non-European export markets once the situation in the crisis regions in Asia had stabilised and the markets had begun to expand again. Germany's export business also received considerable stimuli from the robust and rapid economic growth in the United States, especially as the strength of the US dollar provided German exporters – and other suppliers in the euro area – with relatively favourable competitive conditions on the US market. As a result, German exports to the United States rose by 12 ½ % in 1999; their share of total German exports therefore rose to just over 10 % compared with just under 9 ½ % in 1998. Later in the year the pattern of exports changed in favour of the markets of the other euro-area countries following the significant cyclical upturn there in the summer. At 4 %, however, the annual growth rate of exports to the other euro-area countries was only average. Even so, given the large share which the euro-area countries have in Germany's total exports (just over 40 %), they had a major influence on the overall result.

Foreign trade and current account

Seasonally adjusted



1 From 1999 data in euro.

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1 Data on volumes are still provisional; as in the case of data on foreign trade by region and by category of goods, the 1999 figures on volume have not yet been subjected to the annual revision.

Breakdown of exported goods

Almost all economic sectors gradually benefited from the improved selling conditions abroad. The German car industry was one of the first to do so. According to (still) incomplete data, it increased its export sales by 3½% in 1999 and therefore accounted for just under one-fifth of total German export turnover. By contrast, suppliers of capital goods in the narrower sense of the term, e.g. electrical and mechanical engineering products, did not achieve sizeable increases in export sales until the second half of the year. Exports of basic and producer goods developed somewhat less favourably, recording a slightly lower value in the year under review than they had done in the previous year (– 1½%). However, the – in some cases appreciable – fall in prices played a role here; at all events, average export values for this category of goods declined by 4½% in 1999 compared with a year earlier. The consumer goods industry did not succeed in regaining the previous year's export level either.

Imports

German imports of goods rose less strongly than exports. In volume, the rise was no more than just over 3½%. Evidently the stocks that had been built up in 1998 as a result of the decline in energy and raw material prices at the time had led to correspondingly smaller purchases of raw materials and primary products from abroad. For example, imports of crude oil were just over 4% down in volume on the previous year. The sluggish recovery in domestic demand probably also had a dampening effect on imports. In any case, the volume of imports, excluding energy imports, in the manufacturing sector did not rise further in 1999.

Regional breakdown of foreign trade

1999

Group of countries/ Country	Exports: € billion	Exports: Change from the previous year in %	Imports: € billion	Imports: Change from the previous year in %
Industrial countries	388.8	4.4	325.1	1.2
EU countries	286.1	3.7	232.7	0.7
EMU countries	219.8	4.1	185.8	0.4
Austria	26.9	1.8	17.7	4.5
Belgium/ Luxembourg	28.1	1.2	22.9	– 3.5
Finland	5.8	18.4	4.6	6.8
France	57.7	6.6	45.9	0.9
Ireland	2.9	11.4	8.2	12.5
Italy	37.5	4.0	32.4	– 1.8
Netherlands	33.0	– 3.7	35.2	– 0.7
Portugal	5.7	5.9	4.8	2.5
Spain	22.2	12.8	14.2	– 0.1
Other EU countries	66.3	2.3	46.9	1.8
Denmark	8.5	– 0.2	6.8	– 3.6
Greece	3.9	9.0	1.7	3.5
Sweden	11.4	2.0	8.0	– 4.4
United Kingdom	42.6	2.4	30.4	4.8
Other industrial countries	102.7	6.4	92.4	2.6
of which				
United States	51.6	12.4	36.4	4.2
Japan	10.5	11.7	21.5	2.3
Countries in transition	56.8	– 3.9	62.3	12.0
of which				
Countries in central and eastern Europe	49.1	– 5.5	47.6	10.6
China 1	6.9	14.2	13.7	15.4
Developing countries	56.4	1.3	48.2	4.4
of which				
OPEC countries	9.1	– 7.0	6.4	11.9
Emerging markets in South-East Asia	18.8	0.2	22.2	2.8
All countries 2	507.3	3.9	443.5	4.7

1 Excluding Hong Kong. — **2** The totals for "All countries" include revisions for the period from January to November 1999 which are not yet available in a regional breakdown.

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Breakdown of foreign trade by category of goods

1999

Item	Change from previous year in %	Share of total exports or total imports
Exports		
Basic and producer goods [1]	– 1.4	21.5
of which		
Chemical products	2.3	12.7
Capital goods	1.9	58.0
of which		
Mechanical engineering products	– 5.2	13.1
Road vehicles	3.6	19.5
Electrical engineering products	4.0	13.3
Data processing equipment [2]	3.8	2.4
Consumer goods	– 3.8	10.1
Food, drink and tobacco [3]	– 8.5	4.6
Total [4]	3.9	100
Imports		
Sources of energy	4.6	5.7
Basic and producer goods [5] (excluding sources of energy)	– 8.1	18.1
of which		
Chemical products	– 3.9	9.1
Capital goods	3.4	43.3
of which		
Mechanical engineering products	– 1.2	5.7
Road vehicles	3.7	11.1
Electrical engineering products	2.9	11.9
Data processing equipment [2]	6.9	5.4
Consumer goods	– 6.2	13.3
Food, drink and tobacco [3]	– 11.3	8.3
Total [4]	4.7	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.

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By contrast, total nominal imports increased sharply and, on a year-on-year basis, exceeded the 1998 level by just over 4½%. Nevertheless, the rise in the course of 1999 was actually considerably faster. The nominal import bill in the final quarter of 1999 was 11% higher than a year earlier. Higher import prices accounted for approximately one-half of this. To a large extent this was due to the significant increase in the price of petroleum, which was accentuated further in terms of the domestic currency owing to the appreciation of the US dollar against the euro. Thus, the price of crude oil at the end of last year was just over two and a half times above the level a year earlier.

Regional breakdown of imports

As a result of the sharp increase in oil prices, the value of German imports from the OPEC countries again rose particularly steeply in 1999 (12%) whereas in 1998 it had declined by almost one-fifth. Large nominal growth rates were also recorded in imports from the central and eastern European countries in transition (10½%). These countries evidently enjoyed a special advantage owing to their close business ties with Germany and, moreover, are likewise major raw material suppliers to Germany. Much of the rise in imports from the United States (4%), by contrast, can probably be explained by the exchange-rate-related increases in import prices in terms of the Deutsche Mark or the euro. In the case of the United Kingdom (from which Germany imported 5% more) it was not only the appreciation of the pound but arguably also the relatively large proportion of energy sources which Germany imports from that country that played a role. On the other hand, German imports from other euro-area countries hardly changed in annual terms.

Trade balance

The deterioration in the terms of trade as a result of higher energy and raw material prices in the course of the year ultimately led to a somewhat smaller German trade surplus (just under € 64 billion) in 1999 than in 1998 despite the distinct revival in exports.

Service transactions with non-residents

The service transactions with non-residents were also a detrimental factor in the German external balance in net terms. Here the deficit rose by just over € 6 billion to just under € 41 billion. The steepest rises in expenditure occurred in the case of foreign computer services, engineering and other technical services, publicity and trade fairs as well as the film industry. Furthermore, the income from military bases declined further as a result of the reduced presence of troops on German soil. Service transactions excluding foreign travel ran a deficit of € 11 billion, which was almost € 5 ½ billion greater than in 1998.

Foreign travel

In contrast to past trends, when foreign travel, in particular, had resulted in growing deficits on Germany's services account, the foreign travel account, with a deficit of just under € 30 billion, remained practically the same as in 1998 (€ 29 billion). Spain, Portugal and Greece, in particular, again enjoyed growing popularity as tourist destinations whereas expenditure by German travellers was slightly less in Italy, France and Austria. Long-haul destinations, notably the United States, which were previously in great demand, have probably become somewhat less attractive as a result of the appreciation of the dollar. Although German tourists and business travellers raised their nominal expenditure in these countries slightly in euro terms, they did so to a much lesser extent than would have been necessary, given the appreciation of the dollar, to maintain their level of expenditure in real terms. Turkey incurred losses of as much as one-third approximately.

Factor income

Total factor payments between residents and non-residents likewise ran a larger deficit in 1999; this amounted to € 12 billion compared with just under € 6 billion a year earlier. While the balance on cross-border factor income showed a more or less unchanged deficit of € 1 billion, the increased expenditure was concentrated on investment income payments, which incurred a deficit of € 11 billion, i.e. € 6 billion more than in the previous year. In particular, interest payments on loans raised by German banks abroad rose sharply after the credit institutions had significantly increased their (unsecuritised) external liabilities in 1998 and at the beginning of 1999. Net interest payments in 1999 on loans raised abroad and on deposits received from abroad amounted to just under € 1 billion whereas in 1998 there had been net receipts of almost € 3 ½ billion from the corresponding external assets. By contrast, net investment income arising from security portfolios largely stabilised (€ 12 billion) as German investors had invested large sums in foreign paper in 1998 and 1999 and interest and dividend income had already increased for that reason alone. On the receipts side, the appreciation of the US dollar and the interest rate advantage of dollar assets also had a stabilising effect as

Major items of the balance of payments *

€ billion

Item	1997	1998	1999
I. Current account			
1. Foreign trade			
Exports (f.o.b.)	454.3	488.4	507.3
Imports (c.i.f.)	394.8	423.5	443.5
Balance	+ 59.5	+ 64.9	+ 63.8
2. Services (balance)	– 30.6	– 34.5	– 40.8
3. Factor income (balance)	– 1.3	– 5.9	– 11.9
4. Current transfers (balance)	– 27.0	– 27.3	– 25.7
Balance on current account 1	– 2.5	– 4.1	– 19.6
II. Balance of capital transfers	+ 0.0	+ 0.7	– 0.1
III. Financial account 2			
Direct investment	– 26.3	– 62.9	– 43.6
Portfolio investment	+ 0.8	+ 3.4	– 11.9
German investment abroad	– 79.8	– 126.9	– 176.3
Foreign investment in Germany	+ 80.6	+ 130.3	+ 164.4
Financial derivatives	– 7.9	– 6.0	+ 1.9
Credit transactions 3	+ 32.7	+ 74.4	+ 33.1
Overall balance on financial account	– 0.6	+ 8.8	– 20.6
IV. Change in the monetary reserves at transaction values (increase: –) 4	+ 3.4	– 3.6	+ 12.5
V. Balance of unclassifiable transactions	– 0.3	– 1.7	+ 27.8

* The euro-denominated data for 1997 and 1998 were converted from the original Deutsche Mark figures. — 1 Includes supplementary trade items. — 2 Net capital exports: –. — 3 Including Bundesbank investment and other public and private investment. — 4 Excluding allocation of SDRs and changes due to value adjustments.

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the proportion of German external assets denominated in US dollars is relatively high. By contrast, the net income of German enterprises from their outward direct investment declined more sharply.

Current transfers

The traditionally large German deficit on invisible transactions with non-residents declined slightly last year, namely by € 1½ billion to just over € 25½ billion. This was mainly due to the regular net German payments to the EU budget, which fell from € 15 billion (1998) to just under € 13½ billion in the year under review because the EU shares of German value-added tax revenue declined. Current transfers in the private sector were virtually unchanged at € 8½ billion. These transfers include the remittances of foreign workers in Germany to their home countries and pensions and other maintenance payments to beneficiaries living abroad.

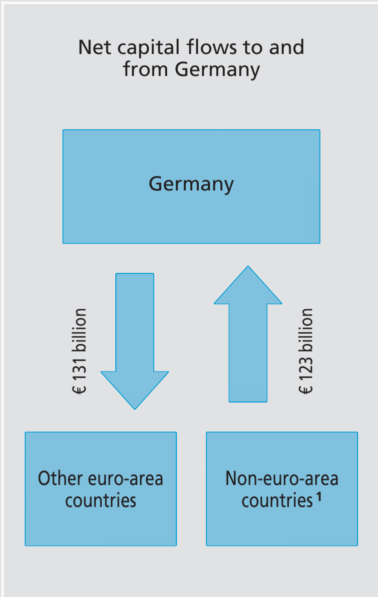
Financial account

Trends in financial transactions

Conditions on the international financial markets underwent a fundamental change as a result of the start of monetary union. The introduction of the euro in 1999 saw the creation of a new currency, which, if only because of the economic weight of the currency area concerned, has a very much greater significance than the event in itself might suggest. As an investment and reserve currency, the euro ranks after the US dollar, albeit with a fair margin; as an issue currency for international bonds, it has now caught up with the leading US currency.[2] Monetary union has ended the segmentation of the market into national currency zones within the euro area. Even if uniform conditions have (still) not been realised in all sections of the euro-area capital markets, differences in yields between the financial markets in the euro area have not been influenced by expected exchange rate movements and currency risks since the introduction of the euro. Instead, they depend solely on the liquidity of the markets and the financial standing of borrowers. Consequently, lenders and borrowers in the euro area find themselves exposed to greater competition, which extends beyond national boundaries.

The new currency regime has brought noticeable changes in the level and pattern of cross-border capital flows. In the case of Germany, portfolio investment in other euro-area countries became particularly more important while, conversely, large amounts of capital flowed into Germany from countries not participating in monetary union. Evidently Germany, as a financial centre, has taken on the function of a kind of turntable within the euro area by attracting funds from outside the euro area and rerouting them to borrowers in other participating countries (see the notes on page 62). Another striking fact has been the rapid progress made in financially integrating German and foreign enterprises. The trend towards globalisation, which has been apparent for some years, was given added impetus from the improvement in the economic outlook during the year. The cross-border mergers and acquisitions were reflected in the German financial account in the form of greater direct investment in both directions.

Germany as a financial turntable



1 Including "Countries not identified".

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Portfolio investment

German investment in foreign ...

Despite the increased investment of non-residents in the German capital markets, there was a deficit of € 12 billion on portfolio investment in 1999. A year earlier Germany had received net capital inflows amounting to the equivalent of € 3½ billion. The turnaround was due essentially to the remarkably strong momentum with which German investors have been internationalising and diversifying their portfolios since the start of monetary union. Their net purchases of for-

2 According to the BIS, the euro's market share of gross new issues of international bonds in 1999 amounted to 39 % on an annual average; the US dollar share was 43 %. In the fourth quarter of 1999 more euro-denominated paper was issued for the first time than dollar-denominated paper. See BIS, International Banking and Financial Market Developments, February 2000.

Germany's share in euro-area financial transactions

With Germany's entry into monetary union the analysis of German financial transactions with the rest of the world took on a new dimension. While questions in connection with the exchange rate movements of the euro can no longer be addressed using the national balances of payments of the participating countries but, instead, only through recourse to the balance of payments of the entire euro area, regional considerations play a greater role than hitherto in the analysis of capital flows to and from Germany.

At first sight the balances arising in the financial accounts of Germany and of the euro area appear to differ only in terms of the amount but not in terms of whether they are in surplus or in deficit. In 1999 net capital exports predominated in both balance sheets; they amounted to € 62 ½ billion for the euro area and € 8 billion for Germany. [1] This might prompt the immediate assumption that Germany accounts for about one-eighth of the net capital exports from the euro area. If German financial transactions are examined more closely, however, it becomes clear that the deficit is due solely to the transactions within the euro area (minus € 131 billion). By contrast, a net sum of € 123 billion accrued to residents through their transactions with business partners in non-euro-area countries. Consequently, if Germany had been excluded, the net capital exports of the euro area would have been much larger than shown. Evidently Germany played a key role last year in channelling financial flows within the euro area and between the euro area and elsewhere: German financial markets received (net) inflows of funds from outside the euro area; at the same time German investors provided players in other euro-area countries with substantial funds; in turn, these players invested very heavily in non-euro-area countries.

In 1999 this pattern in regional capital flows – net capital imports into Germany from non-euro-area countries and exports from Germany into other euro-area countries – can be seen in both portfolio investment and in unsecuritised credit transactions. Capital flowed in the opposite direction only in the case of direct investment: German enterprises acquired investible funds from other euro-area countries whereas these enterprises, in turn, invested heavily outside the euro area (see the chart on page 63). [2]

The present analysis of the financial flows within the euro area and to and from non-euro-area countries is based on the balance of payments data for the euro area and on the regional statistics on German financial transactions. From a methodological point of view, the analysis is "flawed" in that the recorded data on German financial transactions with non-euro-area countries are not fully consistent with the theoretical construct of a "German component" within the euro-area balance of payments. The reason is that, owing to portfolio investment in the secondary market, it is not possible to identify clear-cut national components in the euro-area balance of payments. [3] However, that does not detract from the essential truth of the aforementioned comments; on the contrary, they are supported by a somewhat different approach which is based on the gross euro-area capital flows to and from non-euro-area residents and which tries to ascertain what share German players have in this. Germany's 29 ½ % contribution to M3, which is also roughly in line with its economic weight within the euro area, is used as a yardstick. [4] Owing to the aforementioned problems in accurately recording purchases of euro-area securities by non-euro-area residents, the analysis must be restricted to selected items (see the table on page 64).

Economic agents from Germany had a 20 % share in euro-area portfolio investment in non-euro-area countries, which was relatively small in terms of the reference variable mentioned; this applies to both shares and bonds. In the case of unsecuritised loans granted to borrowers outside the euro area German creditors compared with those from other euro-area countries actually proved to be even more restrained. Their modest 12 ½ % share was due first and foremost to the fact that, in contrast to their counterparts in other euro-area countries, German enterprises and individuals substantially reduced their claims on borrowers outside the single currency area, especially as a result of the reduction in bank balances abroad. By contrast, German credit institutions participated quite considerably in the credit transactions of the MFIs domiciled in the euro area (excluding the Eurosystem) with non-euro-area countries. Thus, more than 60 % of the euro area's inflows of unsecuritised funds accrued to German institutions; at € 83 ½ billion, these funds accounted for quite a considerable share of the euro area's financial transactions in terms of value, too. This ultimately suggests that the German banking system played a key role in the channelling of financial resources back into the euro area. [5]

Furthermore, German enterprises had a disproportionately large share of the euro area's direct investment in non-euro-area countries last year. German enterprises accounted for 40 % of outward investment and more than one-quarter of inward investment.

1 In contrast to the data in the table on page • these figures on the financial transactions include the changes in monetary reserves in each case. — **2** The regional breakdown can sometimes pose problems, especially in the case of portfolio investment. This applies, for example, when buy or sell orders from residents in other euro-area countries are placed in the German market via financial centres in non-euro-area countries, e.g. London. In the system used for recording balance of payments statistics these transactions would be allocated to the United Kingdom as the first known counterparty. — **3** If, for example, a bank in the United Kingdom acquires a German security and sells it to a French investor, the two transactions must, in principle, cancel each other out in the euro-area balance of payments. To achieve this when the euro-area balance of payments is being drawn up the second transaction is "transferred" from the assets side of the (French) securities account to the liabilities side (as the sale of a euro-area security by a non-euro-area resident). As a result of such secondary market transactions, a completely accurate picture of portfolio transactions with non-euro-area countries can only be obtained for the euro area as a whole. — **4** Germany's share of the euro area's nominal GDP amounted to just under 33 % in 1998. Germany's share of the ECB's capital is of a similar magnitude if it is measured in terms of the total share of the 11 central banks participating in the Eurosystem (approximately 31%). — **5** For the role played by German banks in cross-border payments see also Deutsche Bundesbank, The integration of the German money market in the single euro money market, Monthly Report, January 2000, pages 15 to 31 (especially page 23).

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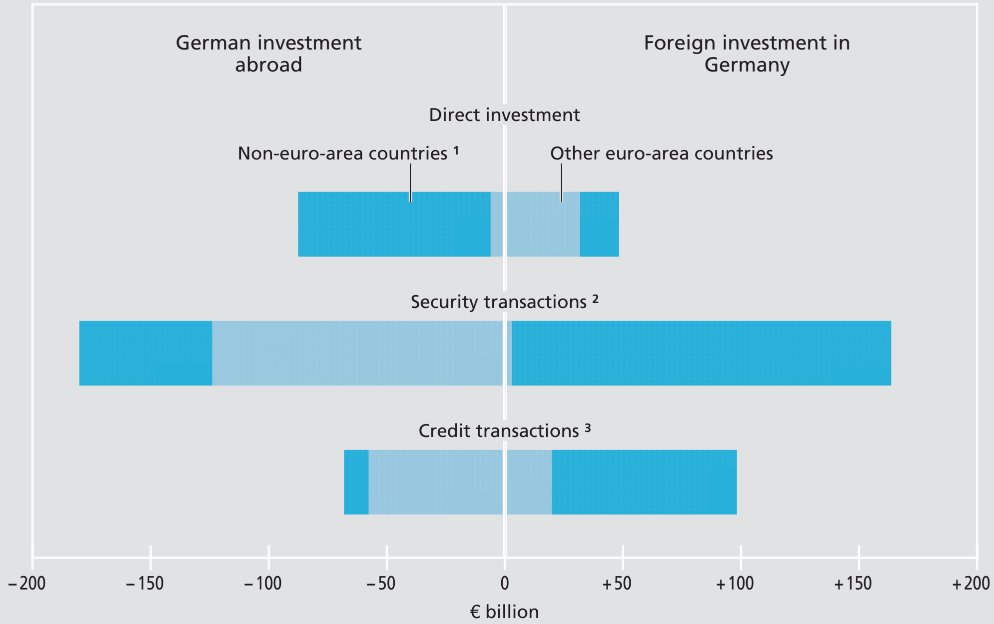
Regional breakdown of German financial transactions in 1999



1 Including "Countries not identified". — **2** Including financial derivatives. — **3** Including other financial transactions.

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eign securities amounted to € 176½ billion. That was more than their total net purchases in the seven years between 1990 and 1996 and represented a growth rate of 39 % over 1998.

... bonds and notes

Demand for foreign bonds and notes rose particularly strongly last year, at € 93 billion (1998: € 56 billion). As a result of the confusing exchange rate situation over lengthy periods in 1999, however, German residents – essentially banks and institutional investors – were hesitant about running exchange rate risks when purchasing foreign bonds. Euro-denominated bonds and notes accounted for 94 % of those purchased. Most (approximately € 70 billion) were securities issued by borrowers in other euro-area countries. In the case of long-term government bonds these offered yields that were about 20 basis points higher on average than (German) Federal bonds. In addition, German investors acquired euro-denominated bonds and notes, worth approximately € 20 billion, that were issued by borrowers domiciled outside the euro area. Owing to the extended currency area, this category of paper is comparable with the former foreign Deutsche Mark bonds. Many non-euro-area residents evidently took advantage of the lower yield in the euro area to borrow in euro and found buyers for their paper in Germany owing to the interest mark-up. By contrast, German investors avoided foreign currency bonds for the most part even though long-term paper denominated in, say, US dollars and pounds sterling was offering decidedly higher yields throughout the year than corresponding euro

Germany's share of euro-area financial transactions

1999

Selected items	Euro area	German financial transactions with non-euro-area countries	
	€ billion	€ billion	Share
Direct investment			
outside the euro area	– 212.5	– 85.2	40.1 %
in the euro area/ in Germany	65.2	16.9	26.0 %
Securities			
Assets	– 280.5	– 55.7	19.9 %
Equities	– 150.0	– 27.3	18.2 %
Debt instruments	– 130.5	– 28.4	21.8 %
Credit transactions 1			
Assets	– 63.3	– 7.8	12.3 %
of which			
MFIs	– 27.9	– 13.0	46.4 %
Other sectors 2	– 46.3	10.2	– 22.2 %
Liabilities	175.0	77.9	44.5 %
of which			
MFIs	138.8	83.6	60.3 %
Other sectors 2	29.9	5.3	17.7 %

1 Including "Other financial transactions". — 2 Enterprises and individuals, including "Other financial transactions".

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paper and – with hindsight – would also have been associated with exchange rate gains.

... equities

Perhaps the generally very favourable climate on the international equity markets made equities look more attractive than foreign currency bonds, especially as the price of these bonds was tending to fall as a result of the sharp rise in interest rates in the United States. At all events, German residents increased their investment in foreign equities by € 66 ½ billion compared with an increase of € 58 billion in 1998. A large part of these equity purchases abroad probably took place through investment funds. This is at least suggested by the fact that particularly those funds which invest partly or exclusively in equities recorded large inflows of capital. German savers subscribed not only to certificates of German investment companies but also again, and somewhat more intensively, to certificates of foreign investment companies whose range of products evidently met the wishes of customers particularly well.

... investment fund certificates

At € 14 billion, appreciably more funds flowed into investment fund certificates than in previous years. This amount was exceeded only once – in 1992 in connection with the debate on withholding tax.

Foreign investment in German ...

The extent to which the cross-border diversification strategies of internationally operating investors have augmented capital flows could be seen in 1999 not least in the fact that both sides of Germany's securities account increased sharply. Parallel to the increase in German investment abroad, for example, non-residents invested, at € 164 ½ billion, just over 26 % more in German securities than in 1998. About one-half of the invested amount, approximately € 84 ½ billion, flowed into the German bond market.

... bonds and notes

In relative terms, however, bonds were not in such great demand from investors as in earlier years. This may have been due to the difficult market situation because Germany, too, was affected by the "imported" interest rate increases. Even so, another relevant factor was that (German) Federal bonds, which had previously been particularly popular with foreign investors and which determine the lower yield limit in the capital market within the euro area, were much less in demand once exchange rate risks had disappeared in the euro area than they had been in, for example, the previous two years. Non-residents purchased public bonds worth a total of € 26 billion whereas their purchases of privately issued paper amounted to € 58 ½ billion. Bank bonds, which predominate in the latter category, not only produce a somewhat higher yield than Federal bonds; they often have special features which are specifically tailored to meet the needs of potential investors. It is also worth noting in this connection that in 1999 not only did non-residents' net purchases of Federal bonds decline but also the cross-border transaction volume (whereas foreign transactions in private bonds increased significantly at the same time). Evidently the benchmark function which Federal bonds have in the interest rate range of the euro area and the role as a hedging instrument which they have through the Bund future were not associated with an increase in cross-border trade in this paper last year. Incidentally, the same picture emerges with respect to stock market turnover in public bonds in Germany.

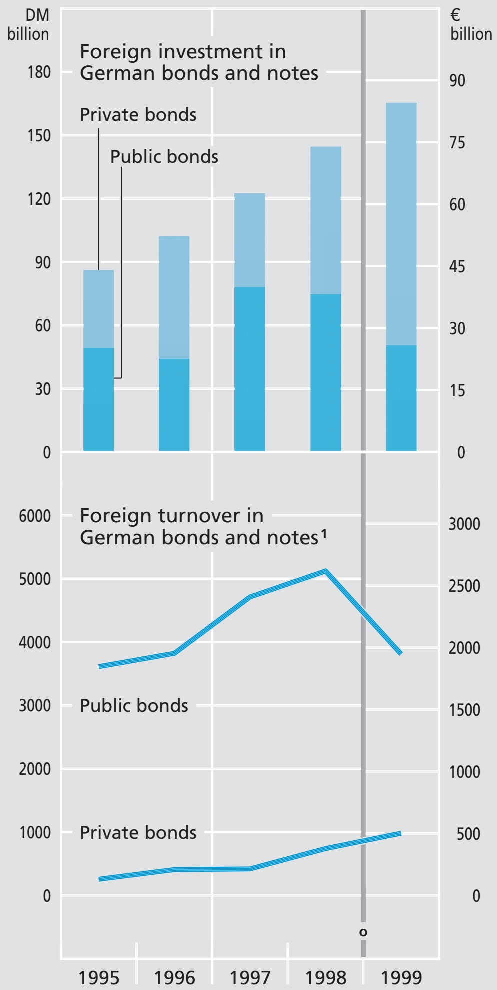
... money market paper

It is possible that, in addition to interest rate uncertainty, the year 2000 problem also adversely affected the bond market last year and prompted non-residents to increase their shorter-term investment. This is supported by the fact that foreign purchases of money market paper in Germany rose particularly sharply in the year under review, namely from € 6 ½ billion in 1998 to € 46 ½ billion in 1999. This means that non-residents appear to have taken up almost all of the new issues of this paper. According to the available statistics, these were mainly non-euro-area investors.[3]

... equities

Although, at € 27 ½ billion, non-residents invested distinctly less in the German equity market in 1999 than in the previous year (€ 51½ billion), the comparison with the previous year is distorted in that the 1998 result had been considerably influenced by the transfer of equities to non-residents in con-

Non-residents' investment in the German bond market



1 Sum of the purchases and sales. — o From 1999 data in euro.

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3 Where, in the case of the money market paper, issues of German banks (MFIs) are involved and these issues were not subscribed by the banks themselves, they show up in the "German contribution" to the money stock M3. The brisk issuance of short-dated bank bonds is therefore reflected, at least to some extent, in the strong growth in the German contribution to the money stock.

Financial transactions

€ billion, net capital exports: –

Item	1997	1998	1999
1. Direct investment	– 26.3	– 62.9	– 43.6
German investment abroad	– 36.1	– 82.0	– 92.9
Foreign investment in Germany	+ 9.8	+ 19.1	+ 49.2
2. Portfolio investment	+ 0.8	+ 3.4	– 11.9
German investment abroad	– 79.8	– 126.9	– 176.3
Equities	– 34.0	– 58.1	– 66.7
Investment fund certificates	– 3.5	– 8.9	– 13.9
Bonds and notes	– 41.9	– 56.0	– 92.8
Money market paper	– 0.4	– 3.9	– 3.0
Foreign investment in Germany	+ 80.6	+ 130.3	+ 164.4
Equities	+ 13.9	+ 51.6	+ 27.5
Investment fund certificates	– 2.1	– 1.6	+ 5.7
Bonds and notes	+ 62.6	+ 74.0	+ 84.6
Money market paper	+ 6.2	+ 6.3	+ 46.6
3. Financial derivatives [1]	– 7.9	– 6.0	+ 1.9
4. Credit transactions	+ 35.3	+ 78.6	+ 34.3
Credit institutions	+ 33.0	+ 73.6	+ 50.3
Long-term	– 1.6	– 0.1	– 8.5
Short-term	+ 34.7	+ 73.7	+ 58.7
Enterprises and individuals	+ 11.1	+ 5.4	+ 37.1
Long-term	– 0.9	+ 6.3	– 0.4
Short-term	+ 12.0	– 0.9	+ 37.5
General government	– 8.7	– 2.1	– 3.5
Long-term	– 5.3	– 5.3	– 8.7
Short-term	– 3.4	+ 3.1	+ 5.2
Bundesbank	– 0.1	+ 1.8	– 49.5
5. Other investment	– 2.6	– 4.2	– 1.2
6. Balance of all statistically recorded capital flows	– 0.6	+ 8.8	– 20.6
Memo item Change in the monetary reserves at transaction values (increase: –) [2]	+ 3.4	– 3.6	+ 12.5

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

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nection with a major corporate merger. If this special factor is eliminated, non-residents' purchases of German shares declined only slightly. Foreign investment may have been curbed by the fact that in the first half of 1999 the price trend in the German equity market was slower than trends on other stock markets. When German shares began to "catch up" towards the end of the year, however, foreign investors, too, showed renewed interest in German equities. The planned changes to tax legislation certainly also played a part in this. One of these changes provides for the tax exemption of profits made by corporations from the sale of participating interests in other enterprises.

Direct investment

As in portfolio investment, funds were exported through direct investment. At € 43½ billion, however, net capital exports were significantly lower than in 1998 (€ 63 billion). This net figure is not such a good illustration of the sustained momentum in intra-group financial flows, which were encouraged not least by the growing spate of mergers and acquisitions involving globally oriented enterprises, as the gross flows.

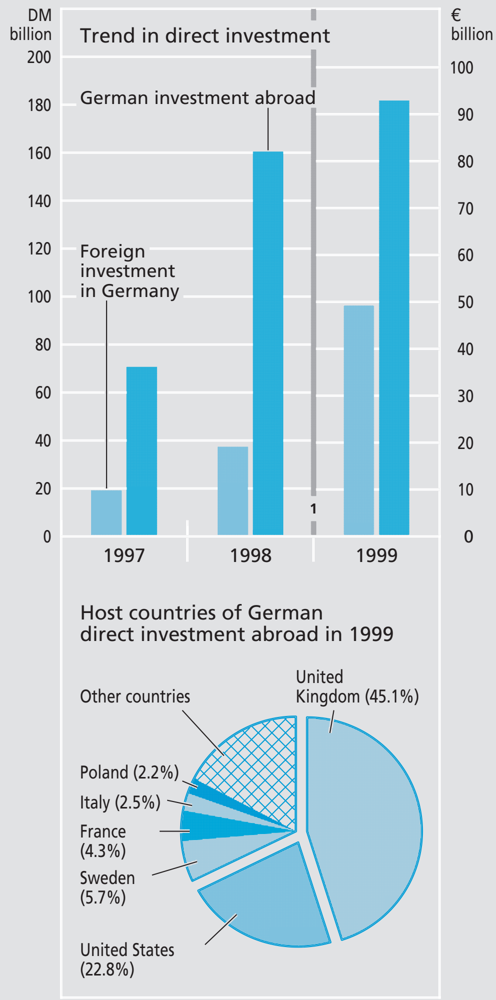
German direct investment abroad

For example, German enterprises invested € 93 billion abroad last year. This was even more than the (former) record of € 82 billion which had been reached in 1998 and which had been largely due to a major merger. The four largest mergers in which German investors participated last year contributed, alone, approximately € 50 billion to Germany's total outward direct investment.[4] Most of the cross-border acquisitions of participating interests were confined to only a few economic sectors. From the German point of view, mergers and acquisitions in the telecommunications and financial sectors were the most significant in 1999. The most important host countries for German direct investment abroad were the United Kingdom and the United States, which accounted for 45 % and 23 %, respectively.

Foreign direct investment in Germany

Not only German enterprises invested heavily abroad in 1999. The funds accruing to German firms through non-residents' direct investment in Germany were also significantly greater than in the previous year. At € 49 billion, they received almost as much in foreign funds in 1999 as in the other years of the decade put together. The main reason for the sudden increase was a merger in the chemical industry, in the course of which the newly established enterprise located its domicile abroad and acquired the majority stake in the German enterprise. Apart from that transaction, the acquisition of participating interests by foreign enterprises played a comparatively minor role in Germany. By contrast, the credits which German branches received from their foreign proprietors were, at € 28 billion, more significant in terms of the amount. These were partly short-term funds which were used for intra-group liquidity management. Borrowing by holding companies also played a role although these loans were not associated with the actual provision of funds.[5] Consequently, the overall rise in inward direct investment provides little indication of foreign investors' present assessment of the quality of Germany as a place for locating their operations.

Trend and breakdown of direct investment



1 From 1999 data in euro.

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4 In terms of German enterprises' total acquisition of participating interests abroad (i.e. excluding reinvested earnings and intra-group credit operations), these large transactions alone accounted for two-thirds of the total.
5 Evidently foreign proprietors are integrating their German subsidiaries to a greater extent into (German) holding companies, which, for their part, are financed mostly by loans from the parent company. This is reflected in the balance of payments statistics in liquidations of equity capital and increasing direct investment loans.

Credit transactions ...

... of enterprises and individuals

Part of the inflows of funds arising from portfolio investment and direct investment was offset within the financial account by unsecuritised credit transactions in 1999. German enterprises and individuals, in particular, imported comparatively large amounts of capital (€ 37 billion). In doing so, they sharply depleted their short-term bank balances abroad, on the one hand; on the other hand, they also increased their foreign short-term loans. Both trends are likely to be associated not least with entry into monetary union. For example, the uniform minimum reserve regulations in the euro area presumably enabled German banks to offer more attractive interest rate conditions. Another possible factor is that the disappearance of exchange rate risks and the convergence of interest rate levels in the euro area encouraged German enterprises to borrow in partner countries. It is evident, however, that some of the loans raised abroad were also in connection with the financing of the takeovers mentioned above.

... of public authorities

In contrast to the activities of enterprises and individuals, the cross-border financial transactions of public authorities resulted in net exports of capital amounting to € 3½ billion. Although both the Federal Government and the social security funds reduced the balances they hold with foreign banks, the relatively large repayments on loans previously taken up abroad had a larger net effect. Transactions involving borrowers' notes issued by the Federal and Länder governments played a decisive part here.

... of the banks

The unsecuritised foreign operations of the entire banking system practically cancelled out in 1999. If they are considered separately, however, the credit institutions and the Bundesbank (with its external assets that do not count towards the foreign reserves) recorded external positions which moved in opposite directions. German banks acquired foreign funds amounting to € 50½ billion net, a development which was reflected in a sharp rise in their short-term liabilities. By contrast, the banks' long-term operations resulted in net lending to non-residents.

... of the Bundesbank

In contrast to the credit institutions, the Bundesbank recorded a rise in its net external assets – excluding foreign reserves – in 1999. Its external assets increased by € 49½ billion. This was essentially due to positive balances vis-à-vis other central banks, which arose in the course of settlements in the TARGET payment system and are recorded as capital exports in the credit transactions account. Another factor was a claim of just over € 12 billion on the ECB, which arose at the start of monetary union as a counterpart to the statutorily prescribed transfer of foreign reserves to the ECB.

Change in the foreign reserves

This transfer of part of Germany's gold and foreign currency holdings is also a major reason for the transaction-related decline of € 12½ billion in the foreign reserves shown in the balance of payments. In the foreign reserves shown in the balance sheet, however, this decline is almost completely offset by holding gains. In the course of 1999 both the gold price (in euro) and the exchange rates of the US dollar and the special drawing rights increased appreciably and resulted in net write-ups in the external assets. Though considerable, these write-ups did not affect profits. All in all, the Bundesbank's foreign reserves – valued at current market prices and exchange rates – amounted to € 93 billion at the end of 1999. This means that they were just under € 1 billion lower than in the Bundesbank's opening balance sheet at the start of monetary union.

"Errors and omissions" increased sharply

The changes in the short-term external assets position of the entire banking system (credit institutions and Bundesbank) should, in principle, reflect the aggregate of all other cross-border balance of payments transactions. The fact that this accounting identity does not always hold in practice can be seen particularly clearly in 1999. The "Balance of unclassifiable transactions" amounted to € 28 billion in 1999; it was therefore considerably larger than in previous years (1998: the equivalent of – € 1½ billion). It is not easy to find a clear explanation for this reversal and for the dramatic increase. In principle, problems, for example, in allocating transactions to the period in which they actually occurred result in unclassifiable balances; however, these ought to cancel out over time. Recording gaps, too, could play a part. Where these are connected to reporting exemptions, however, extreme short-term changes in the balance of unclassifiable transactions are hardly plausible. Reporting errors could also be a reason for the discrepancies observed. For example, errors in currency designations are conceivable here. As a result of the possibility of submitting statistical reports for the balance of payments either in Deutsche Mark or in euro since the beginning of 1999 and of the changes to the statistical methodology, such inaccuracies may well have arisen, especially at the start of monetary union. Regardless of the actual reasons, the plus sign prefixed to the balance of unclassifiable transactions in the German balance of payments shows that in 1999 either the net payments shown in the current and financial accounts are too high or the incoming payments are too low.