Foreign trade and payments

Foreign trade and current account

Export trends

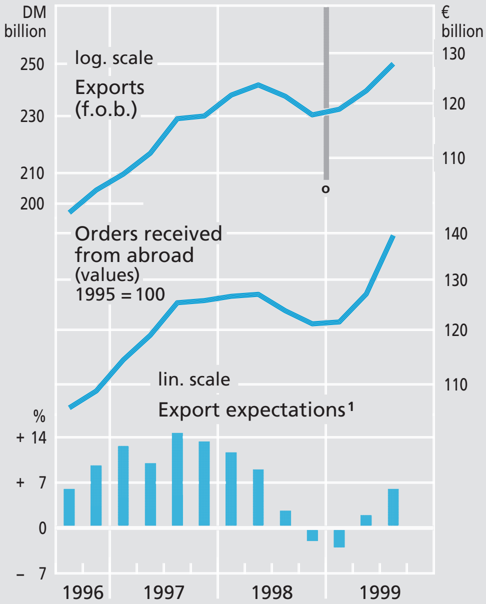
Following the – initially fairly moderate – upturn in exports in the spring, Germany's external transactions gained considerable momentum during the summer. This is particularly evident from the trend in export orders received by German industry. In the third quarter these rose by no less than 10 % compared with the previous quarter. However, exporters' regular assessment of business conditions have also improved significantly; while the opinions expressed in the spring had been mainly pessimistic, it was optimistic voices that clearly predominated later, and their number has been increasing. The necessary stimuli came from the accelerated growth in a wide range of export markets and from the underlying improvement in the global economic environment. The economic situation in North America remained buoyant while economic growth, especially in western Europe, accelerated again. With the overcoming of the financial and currency crises, the economic climate improved in most South-East Asian countries. The situation in the majority of the emerging markets in Latin America and in the countries in transition in central and eastern Europe at least stabilised.

Strong growth in exports ...

Against this background of global economic revival, German exports grew very robustly in the third quarter compared with the previous quarter. Their value rose by a seasonally adjusted 4 ½ % (or 4 % in real terms) compared with an increase of 3 % (real and nominal) in the second quarter of this year. Exports exceeded their level at the same time last year by 5 ½ % in real terms. This means that the

Export trend

Seasonally adjusted, quarterly



1 Results of the ifo business survey; balances of positive and negative company reports. — o From 1999 on all data in euro.

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slump in exports which occurred during the second half of 1998 has now been more than cancelled out.

The welcome success of German exporters is certainly being assisted by the relative strength of the US dollar and the Japanese yen. However, the impact of this should not be overrated. Competitors in other euro area countries are likewise benefiting from it. And in trade within the euro area, which accounts for almost one-half of all German exports, direct exchange rate effects of this kind do not play a role anyway.

... to the euro area

The fact that the growth in German exports during the past few months was increasingly focused on the markets within the euro area is consistent with this picture. In the three-month period June to August (regional data are not yet available for September) German industry increased its exports of goods to these countries by a seasonally adjusted 8½% compared with the previous three-month period.

... and to the United States

Exports to the United States grew even faster in the period concerned (+ 12%). The United States' share of total German exports is normally only 10%, however. During the months under review Germany also achieved substantial growth rates in exports to China. In this case, however, Germany's export share is very small, at 1½%; in addition, sales to China fluctuate relatively sharply from month to month with the result that not even the quarterly figures can give a definitive picture of the underlying trend.

Exports to other countries

Exports to most other countries (outside the euro area) rose discernibly more slowly. The revival in the growth of exports to the emerging markets in South-East Asia which had set in at the beginning of the year continued at a remarkable rate during the summer (+ 4½%), and deliveries of German goods to central and eastern Europe again increased (by 5½%) in the period under review. However, the comparable figures for most other countries were considerably lower. The trends in exports to Japan and to the OPEC countries were particularly weak.

Imports

In real terms, the growth in imports during the third quarter of this year was significantly below the sharp rise in exports, a development which doubtless was essentially due to the overall weaker demand on the domestic market. Although the value of imported goods likewise increased appreciably compared with the previous quarter (by 4 % in seasonally adjusted terms), about one-half of the increase was due to the rise in import prices.

Import growth by region

The higher prices of petroleum and mineral oil products were also reflected in corresponding shifts in weights within the turnover totals. There was a particularly sharp rise in the value of imports from the regions that supply Germany with the bulk of its energy raw materials and mineral oil products. This applies, above all, to the OPEC countries; the value of imports from these countries rose by 10 ½ % between June and August. The sharp increase in imports from the Netherlands (11 %) and the United Kingdom (8 ½ %) have likewise to be seen in this connection. There was also a steep rise in imports from the emerging markets in South-East Asia (+ 6 ½ % in seasonally adjusted terms). As a result of their export offensive, these countries succeeded in increasing the surplus in goods traded with Germany. By contrast, the trend in imports from other euro area countries (excluding the Netherlands) was less dynamic for the most part. The demand for US and Japanese goods was likewise fairly limited (+ 2 % and – ½ %, respectively) as the appreciation of their currencies had impaired the competitiveness of these two countries on the German market.

Trade balance

All in all, foreign trade therefore provided German business with substantial growth stimuli in the third quarter. However, as a result of the higher import prices and the con-

Regional breakdown of foreign trade

June–August 1999, seasonally adjusted

Group of countries/ Country	Exports: € billion	Exports: Change from March – May 1999 in %	Imports: € billion	Imports: Change from March – May 1999 in %
Industrial countries	99.0	+ 6.4	83.1	+ 4.7
EU countries	72.8	+ 5.9	60.2	+ 5.6
EMU countries	56.8	+ 8.4	48.4	+ 5.9
Austria	6.8	+ 4.9	4.5	+ 3.2
Belgium/ Luxembourg	7.2	+ 10.4	6.0	+ 10.3
Finland	1.5	+ 13.7	1.1	+ 0.0
France	12.3	+ 6.9	10.6	+ 1.8
Ireland	0.7	– 11.8	2.7	+ 25.0
Italy	9.7	+ 7.2	8.3	+ 2.2
Netherlands	8.5	+ 7.4	9.3	+ 10.9
Portugal	1.5	+ 11.4	1.2	+ 0.9
Spain	5.7	+ 7.9	3.5	– 2.2
Other EU countries				
Denmark	2.2	+ 8.1	1.7	+ 5.3
Greece	1.0	+ 11.7	0.4	– 1.3
Sweden	2.9	+ 5.2	2.1	+ 0.5
United Kingdom	10.3	+ 0.2	7.9	+ 8.5
Other industrial countries	26.3	+ 7.9	22.9	+ 2.5
of which				
United States	13.6	+ 11.8	9.2	+ 2.1
Japan	2.6	+ 0.6	5.2	– 0.5
Countries in transition	14.0	+ 4.6	15.5	+ 5.0
of which				
Countries in central and eastern Europe	12.1	+ 5.3	11.7	+ 2.9
China 1	1.9	+ 9.5	3.4	+ 4.8
Developing countries	14.3	+ 4.6	12.1	+ 6.8
of which				
OPEC countries	2.3	+ 0.9	1.6	+ 10.3
Emerging markets in South-East Asia	4.7	+ 4.6	5.6	+ 6.5
All countries 2	127.6	+ 5.6	110.7	+ 4.4

1 Excluding Hong Kong. — 2 The totals include revisions which are not yet available in a regional breakdown.

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Current account

€ billion; seasonally adjusted

Item	1999 1st qtr	2nd qtr	3rd qtr
1. Foreign trade			
Exports (f.o.b.)	119.4	123.0	128.4
Imports (c.i.f.)	102.3	107.6	112.1
Balance	17.2	15.4	16.4
2. Services (balance)	– 9.1	– 9.1	– 8.9
Receipts	18.1	19.7	19.1
Expenditure	27.2	28.8	28.0
of which Foreign travel (balance)	– 7.3	– 7.6	– 6.8
3. Factor income (balance)	– 3.8	– 0.3	– 3.4
Receipts	16.9	23.1	17.9
Expenditure	20.7	23.4	21.3
of which Investment income (balance)	– 3.6	0.1	– 3.0
4. Current transfers (balance)	– 5.6	– 5.7	– 7.0
By foreigners to Germany	3.5	4.2	3.4
By German residents to other countries	9.1	10.0	10.5
Balance on current account 1	– 1.9	– 0.4	– 3.5

1 Includes supplementary trade items.

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sequent deterioration in the terms of trade, which, at 1½ %, was fairly considerable in the third quarter, Germany's trade surplus of a seasonally adjusted € 16½ billion was only € 1 billion larger than in the previous quarter.

Current account

At the same time, the other segments of Germany's current account with non-residents incurred a larger seasonally adjusted deficit in the third quarter of 1999 than in the previous quarter (just under € 19½ billion compared with € 15 billion in the second quarter). Although the traditional deficit on services, which is largely the result of the outflow due to foreign travel, was practically unchanged, net investment income payments and current transfers to non-residents were greater in the period under review than in the previous quarter. Consequently, the overall German current account ran a slight deficit of € 3½ billion in the third quarter compared with a more or less balanced result in the second quarter.

Financial transactions

Trends in financial transactions

International financial transactions were marked during the summer by the improved prospects for the world economy. In particular, the strengthening expectation of stronger growth in Europe and the sharper rise in bond yields in the euro area compared with those elsewhere, which accompanied portfolio shifts in international securities markets, were reflected in the German balance of payments in the form of a fairly heavy demand for German bonds and notes as well as for money market paper. German residents also diversified their portfolios further and acquired additional foreign paper but continued to refrain from investing substantial amounts in foreign currency bonds. Consequently, portfolio transactions resulted in net capital imports of € 9 billion compared with net inflows of € 6 billion in the previous three months.

Foreign investment in German ...

Once again it was the very brisk investment by non-residents in German securities that contributed most to this rise. All in all, € 51 billion flowed into the German capital markets between July and September; that was just under € 6 billion more than in the preceding three-month period.

... bonds

German bonds were particularly popular with foreign investors. Altogether, non-residents invested € 40½ billion in both bonds and notes and money market paper during the period under review compared with € 25½ billion between April and June. The distinctly higher yields on German bonds and notes during the months under review was one possible reason for this surge in demand. Another factor is that international investors again appear to be favouring particularly liquid instruments, such as Federal bonds, to a greater degree. At all events, the interest rate differentials within the euro area at the longer end of the market have recently widened considerably again, a trend which tends to confirm the theory of a liquidity premium, possibly in connection with the changeover to the new millennium.

Foreign investors' noticeably keen interest in German money market paper could also point in the same direction. (This interest was not restricted to Germany but was apparent in, for example, other EMU countries, too.) It has been suggested from several quarters that, in addition to the preference for greater liquidity as a result of the increased uncertainty over interest rates, another explanation could be concern about the year 2000 problem. The latter might have led to funds being transferred to the short end of the market in order to circumvent possible price and liquidity risks.

... and shares

By contrast, demand for German equities declined discernibly (€ 10 billion). In the previous three months they had accounted for approximately one-half of non-residents' securities purchases in the German market (€ 21½ billion). In view of investors' generally greater

Major items of the balance of payments

€ billion

Item	1998 3rd qtr	1999 2nd qtr	1999 3rd qtr
I. Current account			
1. Foreign trade			
Exports (f.o.b.)	r 119.0	125.0	125.1
Imports (c.i.f.)	r 102.7	108.8	108.6
Balance	+ 16.3	+ 16.2	+ 16.5
2. Services (balance)	– 10.1	– 8.7	– 11.6
3. Factor income (balance)	– 1.6	+ 0.3	– 4.4
4. Current transfers (balance)	– 7.3	– 5.3	– 7.8
Balance on current account 1	– 3.3	+ 1.7	– 8.0
II. Balance of capital transfers	+ 0.5	– 0.1	– 0.8
III. Financial account 2			
Direct investment	– 13.2	– 12.3	– 3.8
Portfolio investment	+ 24.5	+ 6.1	+ 8.8
German investment abroad	– 19.2	– 39.2	– 42.1
Foreign investment in Germany	+ 43.7	+ 45.3	+ 50.9
Financial derivatives	+ 2.1	– 0.0	+ 2.5
Credit transactions 3	– 2.9	+ 25.4	– 15.0
Overall balance on financial account	+ 10.6	+ 19.2	– 7.6
IV. Change in the monetary reserves at transaction values (increase: –) 4	– 0.6	– 0.3	– 0.4
V. Balance of unclassifiable transactions	– 7.3	– 20.6	+ 16.8

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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Financial transactions

€ billion, net capital exports: –

Item	1998 3rd qtr	1999 2nd qtr	1999 3rd qtr
1. Direct investment	– 13.2	– 12.3	– 3.8
German investment abroad	– 3.5	– 25.1	+ 5.5
Foreign investment in Germany	– 9.7	+ 12.8	– 9.4
2. Portfolio investment	+ 24.5	+ 6.1	+ 8.8
German investment abroad	– 19.2	– 39.2	– 42.1
Shares	– 11.8	– 7.4	– 17.6
Investment fund certificates	– 1.8	– 2.9	– 3.5
Bonds and notes	– 5.9	– 28.6	– 18.4
Money market paper	+ 0.3	– 0.3	– 2.7
Foreign investment in Germany	+ 43.7	+ 45.3	+ 50.9
Shares	+ 5.2	+ 21.4	+ 10.0
Investment fund certificates	– 0.2	– 1.5	+ 0.6
Bonds and notes	+ 35.0	+ 19.2	+ 24.5
Money market paper	+ 3.8	+ 6.1	+ 15.8
3. Financial derivatives 1	+ 2.1	– 0.0	+ 2.5
4. Credit transactions	– 1.1	+ 25.8	– 14.4
Credit institutions	– 5.7	+ 14.2	– 0.4
Long-term	– 6.3	– 5.9	+ 1.3
Short-term	+ 0.6	+ 20.1	– 1.7
Enterprises and individuals	+ 3.1	+ 3.8	– 0.7
Long-term	+ 3.8	– 1.1	– 0.1
Short-term	– 0.7	+ 5.0	– 0.6
General government	+ 1.4	+ 0.2	+ 1.0
Long-term	– 0.8	– 1.2	– 1.6
Short-term	+ 2.3	+ 1.4	+ 2.6
Bundesbank	+ 0.2	+ 7.6	– 14.3
5. Other investment	– 1.8	– 0.4	– 0.6
6. Balance of all statistically recorded capital flows	+ 10.6	+ 19.2	– 7.6
Memo item Change in the monetary reserves at transaction values (increase: –) 2	– 0.6	– 0.3	– 0.4

1 Securitised and non-securitised options and financial futures contracts. — **2** Excluding allocation of SDRs and changes due to value adjustments.

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reluctance to invest in the major stock exchanges of the industrial countries, however, a certain downturn in foreign investment in Germany's equity market is not unusual – especially in the light of the earlier substantial share purchases. It is also in line with the cross-border share transactions for EMU as a whole, which likewise declined somewhat in July and August.

German investment in foreign shares ...

German investors' demand for foreign equities was again fairly buoyant during the period under review (€ 17½ billion) whereas in the second quarter they had temporarily reduced their foreign investment in this instrument to € 7½ billion.[1] Purchases were restricted mainly to shares of enterprises in other euro area countries.

... and bonds

In contrast to what occurred in the case of shares the interest of German investors in foreign bonds and notes declined in the third quarter. In all, they purchased bonds issued by foreign borrowers for € 18½ billion after spending € 35½ billion and € 28½ billion in the first and second quarters, respectively. This restraint is possibly also associated with the present interest rate uncertainty and the increasing global preference for liquidity, which is mirrored in German savers' decision to invest more in their home market. Other instruments continued to play only a subordinate role in German investors' decisions. Overall, they increased their holdings of international securities by € 42 billion, which was almost the same as the amount they had in-

1 However, the increase is due solely to large transactions in connection with lending and arbitrage business in foreign shares.

vested abroad in the previous quarter (€ 39 billion).

Deficit on direct investment as a result of inverse capital flows

In the case of direct investment, by contrast, there were net capital outflows of € 4 billion in the third quarter of 1999; this was significantly less than in the previous three-month period (€ 12 ½ billion). Credit transactions between affiliated enterprises again proved to be the dominant component of direct investment. This suggests that liquidity policy considerations rather than locational ones were behind these capital movements. The result was that German proprietors withdrew funds from their subsidiaries abroad and foreign investors withdrew funds from their subsidiaries in Germany (€ 5 ½ billion and € 9 ½ billion, respectively). The balance of these inverse direct investment flows led to the above-mentioned net amount. The interactions and the interpretation problems associated with these are explained in more detail in the box on page 44.

Credit transactions

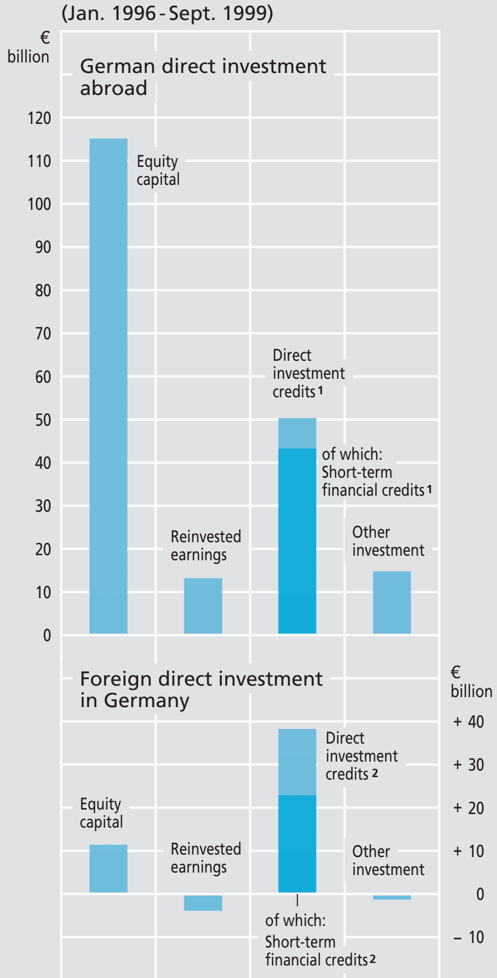
If the financial transactions recorded under direct investment are excluded, there was only a small outflow of foreign funds (€ 1 billion net) from domestic enterprises and individuals between July and September as a result of non-securitised credit transactions with non-residents, whereas public-sector credit operations with non-residents resulted in inflows of a similar amount.

Improvement in the banking system's external position

The current and financial transactions of non-banks are reflected in the change in the net external position of the banking system as a whole. Thus German credit institutions provided their foreign counterparties with short-term funds amounting to € 1½ billion net in the course of settling international payments whereas at the long end of the market they received almost the same amount in foreign funds. This means that their total non-securitised net external assets remained virtually unchanged. By contrast, the Bundesbank's short-term cross-border transactions, which are not booked under monetary reserves, resulted in a substantial improvement in the

Structure of direct investment

(Jan. 1996 - Sept. 1999)



1 Lending to less borrowing from foreign subsidiaries. — 2 Lending to less borrowing from German subsidiaries.

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Explanatory notes on direct investment

Direct investment encompasses not only equity capital and reinvested earnings but also all credit operations between the investor and his foreign subsidiaries. Credit transactions are classified in the balance of payments according to the direction of the direct investment relationship concerned: loans raised by direct investors from their foreign subsidiaries are therefore regarded as reverse flows of investment funds. [1]

In the quarter under review reverse flows of this kind played a fairly large role, especially in the case of **German direct investment abroad.** Parent companies resident in Germany raised loans amounting to approximately € 6 ½ billion from their foreign subsidiaries. (Most of these were long-term loans, some of which were granted to parent companies by (German) financing affiliates that are specialised in this area and are domiciled abroad; these affiliates finance themselves, in turn, by issuing bonds on the international capital market.) Even more important than these capital flows, however, were redemption payments on short-term financial credits, totalling € 13 ½ billion, which direct investors resident in Germany received after they had substantially expanded loans of this kind to their foreign subsidiaries during the first six months of the year. All in all, € 18 billion therefore accrued to German owners as a result of credit transactions with their subsidiaries abroad in the third quarter. This was more than the acquisition of participating interests by German enterprises abroad during the same period (€ 10 billion) with the result that capital imports of € 5 ½ billion – including estimates of reinvested earnings and the other assets classified as direct investment – accrued to German direct investors.

A fairly similar picture emerged in the previous quarter in the case of **foreign direct investment in Germany** as well. Here, too, credit flows predominated and a majority of payments was made by subsidiaries domiciled in Germany to their parent companies abroad (€ 10 billion). It was principally large collateral payments by financial service enterprises in connection with capital market operations, in addition to joint liquidity management by intra-group enterprises, that played a major role here. At no more than € ½ billion, by contrast, equity capital invested in Germany was quite insignificant compared with German direct investment abroad.

However, the "inverse" flows of direct investment from subsidiaries to parent companies that were observed in the quarter under review are not typical of the direct investment data shown as a whole in the German balance of payments; most of these were the result of single large-volume financial transactions. Normally, the direction of the aggregate investment flows is the same as the direction of the direct investment relationship. By extending the concept of direct investment to include short-term intra-group credits, which depend on various macroeconomic and – rapidly changing – enterprise-specific factors, however, the volatility of direct investment has increased sharply. As a result, even the direction of total monthly flows can hardly be forecast with any reliability and often cannot be subjected to an external economic analysis either.

The extension of the concept has also increased the **significance of credits within direct investment** considerably. The different weight of the various components becomes particularly clear **if monitored over the longer term.** The period from January 1996 to September 1999, for which data on direct investment as now defined are available, was taken as a basis.

It appears that the funding via credits in the case of **foreign direct investment in Germany** – presumably not least for tax reasons – plays a more significant role than it does in the case of German direct investment abroad. In the period under review credits, especially short-term financial credits, accounted for 86 % of the net funds which foreign owners made available to their subsidiaries domiciled in Germany. [2] By contrast, funding through equity capital and retained earnings declined substantially (see the chart on page 43). [3]

The situation is different with respect to German direct investment abroad. In the period mentioned approximately 59 ½ % of all the funds which German enterprises provided to their foreign subsidiaries was in the form of equity capital, although some major corporate mergers also played a significant role here. Intra-group credits accounted for just over one-quarter of German direct investment abroad while retained earnings and other assets, including the stock of holiday flats abroad, accounted for 7 % and 7 ½ %, respectively.

1 For the methodological changes relating to direct investment introduced at the beginning of this year see Deutsche Bundesbank, German balance of payments in 1998, Monthly Report, March 1999, page 57. — **2** The reverse flows are already deducted from these figures. — **3** In the period from 1996 to September 1999 the direct investment enterprises domiciled in Germany distributed funds which, on aggregate, amounted to more than the earnings they had earned. They did this in part by releasing revenue reserves, for example. This can be seen in negative reinvested earnings.

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Bank's net external position (€ 14 ½ billion) in the period under review. This was essentially the result of an increase in claims which the Bundesbank had acquired vis-à-vis other EU central banks in connection with the payment system TARGET and which ultimately reflect the settlement of private payment transactions with non-residents.

Monetary reserves

The Bundesbank's monetary reserves increased as a result of transactions by just under € ½ billion between July and September. In line with the agreements made within the Eurosystem, the reserves were also revalued at market prices at the end of September. As a result, they rose by € 2 billion compared with the previous valuation date at the end of June. One of the main reasons for this increase was the recovery in the gold price at the end of the third quarter. The German monetary reserves amounted to € 89 ½ billion at the end of September. During the period under review the monetary reserves of the Eurosystem as a whole increased, as a result of the revaluation, by € 8 billion to € 355 billion on balance.