Foreign trade and payments

Foreign trade and current account

External position ...

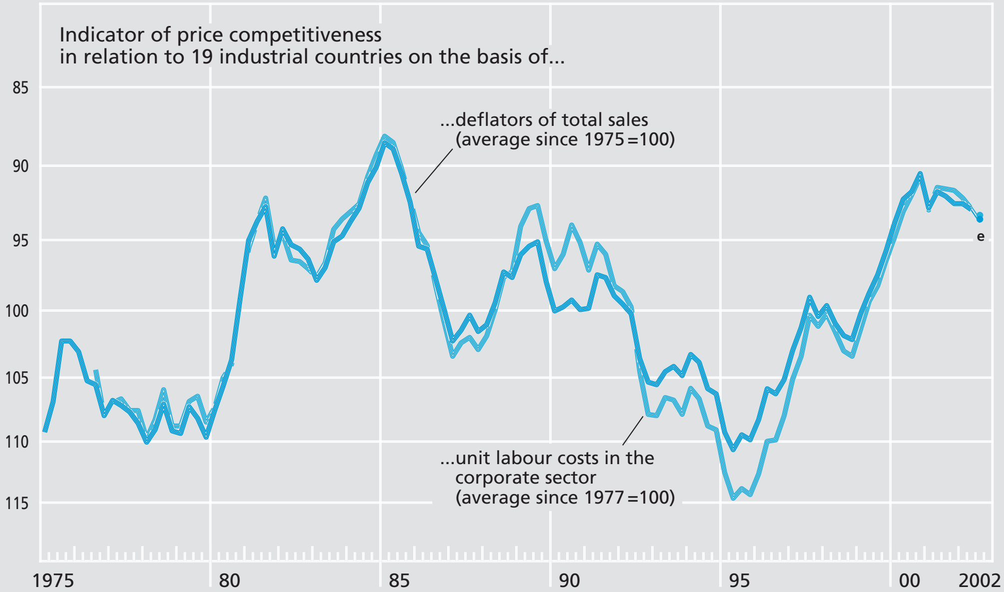
During the second quarter of the year German exports continued to provide a steady stimulus to the generally muted expansionary forces. The discernible acceleration in the flow of orders from abroad towards the end of 2001 and the beginning of 2002 was followed in the second quarter of the year by a further increase in the rate of orders received by German exporters, resulting in a 5 % rise over the previous quarter. However, it must not be forgotten that this sharp growth was partly due to large-scale orders and therefore its reliability for indicating future developments should not be overestimated. Even so, the positive trend in the export sector appears to have remained intact up to the time this report went to press. However, it is only with certain qualifications that this can be applied to the more future-oriented export expectations of German industry as recorded by the Ifo institute. Although in the second quarter of the year these expectations were generally also much more positive than in the previous quarter, business optimism has recently fallen again slightly.

... and competitiveness

It seems sensible to see exporters' more cautious assessment of the situation also in connection with the appreciation of the euro against the US dollar. In doing so, however, it is advisable to distinguish between the consequent decline in price competitiveness in the narrower sense of the term and the general, more indirect effects arising from the lower-than-expected global growth rate and the general uncertainty on the financial markets as it is these latter factors which are ultimate-

International competitiveness
of the German economy

Quarterly, log scale[1]



1 Scale inverted: rise in the curve (fall in values) denotes increase in competitiveness. — • = Latest position: 15 August 2002.

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ly behind the depreciation of the US dollar (see page 14ff). The resultant negative impact on the future growth of Germany's export markets will certainly also have a detrimental effect on the sales prospects of enterprises operating in the export field whereas the favourable competitive position that German suppliers have been enjoying as a result of the weakening dollar is only marginally affected. Experience has shown that the retarding effects of this on German exports take some time to become apparent and are also relatively limited. Experience has also shown that the crucial factor determining Germany's export momentum is the rate of world economic growth. Changes in competitiveness dictate Germany's share of this growth. If long-term averages of the appropriate indicators drawn up on the basis of macroeconomic price comparisons or the relative unit labour costs in the corporate sector are used to assess price competitiveness, German exporters, even after the recent exchange rate changes have been taken into account, still have an advantage of more than 6% compared with these long-term averages.

Exports of goods

Current developments in export sales are also consistent with the generally more cautious assessment of the business prospects of German enterprises operating in foreign markets. It is true that second-quarter sales were a further ½% up on the first quarter, but, when compared with the rate of incoming orders, export growth was fairly moderate. This can certainly be explained to some extent by the above-average length of the delivery periods that probably have to be assumed in the light

Export trend

Seasonally adjusted, quarterly

1 Monthly values adjusted to match quarterly level. — **2** Results of the Ifo business survey; balances of positive and negative company reports. — **o** From 1999 all data in euro.

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of the considerable weight of large orders. The unusually sharp fall in exports in May, which this year had an exceptionally large number of *Brückentage*, ie extra days' holiday taken between a public holiday and a weekend, was made good in June owing to the absence of such holidays. These *Brückentage* are not taken into consideration when the export figures are adjusted to take account of seasonal and working-day variations. However, the second-quarter results were probably also adversely affected by strikes in major industrial sectors. Apart from these special factors, the generally moderate export growth is probably to be seen in connection with the generally sluggish growth in the world economy rather than any competitive disadvantages which arose from the depreciation of the dollar and which probably had little effect on export deliveries in the second quarter.

Breakdown of exports

The regional breakdown of exports could normally provide certain indications of this. However, the information so far available extends only up to the end of May 2002 and can therefore be applied even less in connection with recent exchange rate developments than the complete outcome for the second quarter could, especially as it is precisely the May figures that are probably distorted by the special factors already mentioned. In the three months between March and May German exporters were particularly successful in achieving sales increases over the previous period in the emerging markets of South-East Asia (+7½ %) which have now recovered somewhat from the global slump in the information and communications technology sector. Exports to the OPEC countries, which have been enjoying substantial oil revenues over the past few years, also rose relatively sharply (+4 %). By contrast, sales by German exporters to industrial countries declined slightly during the period under review. This applies to both the United States and Japan (-1 % and -½ % respectively) as well as to German exporters' traditional sales areas in western Europe and the euro area, in particular (-½ %).

Imports of goods

German imports increased discernibly in the second quarter of this year despite the sluggish increase in domestic demand. Germany's imports of goods rose by 3 % both in real terms and in value compared with the previous period. Growth was concentrated on April and June, with May showing an unusually sharp decline. As in the case of exports both the special working-day factors already mentioned and the intermittent strikes probably had a substantial downward distorting effect on the May figures. Even so, much of the shortfall relating to working-day variations was evidently made good in June on the imports side, too. The generally strong rise in German imports in the second quarter is probably to be seen against the background of the extraordinarily weak growth in imports in the first quarter when the value of Germany's imports of goods had fallen by just over 3½ %. The greatest downturn at the time had been in the imports of energy and inputs. Enterprises evidently responded relatively late to the improvement in order books, especially in the export field, by importing foreign inputs and also increasing stocks.

Breakdown of imports

The regional breakdown of Germany's imports of goods, which, as in the case of exports, extends only to the end of May, shows that supplier countries outside the euro area benefited most from Germany's heavy demand for imports. Provided these data can be regarded as indicative for the whole of the second quarter at all, which is fairly questionable given the sharp fall in May,

Regional trend in foreign trade

March – May 2002; seasonally adjusted

Group of countries/country	€ billion	Percentage change from Dec 2001-Feb 2002
Exports		
All countries	158.8	+ 0.1
of which		
Euro-area countries	67.0	– 0.4
Other EU countries	18.7	– 2.1
United States	16.5	– 1.0
Japan	3.0	– 0.7
Central and east European countries in transition	18.4	– 1.6
OPEC countries	3.9	+ 4.0
Emerging markets in South-East Asia	6.5	+ 7.5
Imports		
All countries	128.2	+ 1.1
of which		
Euro-area countries	51.4	– 3.3
Other EU countries	12.7	+ 1.8
United States	10.2	+ 4.6
Japan	4.6	– 1.1
Central and east European countries in transition	18.1	+ 8.4
OPEC countries	1.6	– 4.8
Emerging markets in South-East Asia	7.0	+ 4.9

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Major items of the balance of payments

€ bn

Item	2001 Q2	2002 Q1 r	2002 Q2
I Current account			
1 Foreign trade 1			
Exports (fob)	160.7	156.0	162.6
Imports (cif)	139.1	124.2	132.6
Balance	+ 21.6	+ 31.8	+ 30.0
2 Services (balance)	– 12.2	– 10.6	– 8.1
3 Factor income (balance)	– 4.3	– 4.4	– 1.1
4 Current transfers (balance)	– 8.0	– 5.0	– 8.1
Balance on current account 2	– 4.4	+ 10.5	+ 11.6
Memo item Balances, seasonally adjusted			
1 Foreign trade	+ 21.2	+ 32.3	+ 29.3
2 Services	– 11.8	– 10.7	– 7.9
3 Factor income	– 5.8	– 2.4	– 2.6
4 Current transfers	– 8.9	– 6.1	– 9.0
Current account 2	– 6.6	+ 11.4	+ 9.0
II Balance of capital transfers 3	– 0.6	+ 0.2	– 0.1
III Balance of financial account 4	+ 5.4	– 24.5	– 31.5
IV Change in the foreign reserves at transaction values (increase: –) 5	+ 2.0	– 1.4	+ 2.4
V Balance of unclassifiable transactions	– 2.4	+ 15.2	+ 17.6

1 Special trade according to the official foreign trade statistics (source: Federal Statistical Office). — **2** Includes supplementary trade items. — **3** Including the acquisition/disposal of non-produced non-financial assets. — **4** For details see the table "Financial transactions" on page 47. — **5** Excluding allocation of SDRs and changes due to value adjustments.

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it was, at all events, suppliers in central and eastern Europe (+8½ %) and in the emerging markets of South-East Asia (+5 %) as well as in the United States (+4½ %) that recorded the greatest increases in sales on the German market between March and May compared with the previous period. Imports from the euro area, by contrast, declined appreciably during this period (-3½ %). The same applies to imports from the OPEC countries; despite the recent increase in oil prices, these imports fell by almost 5 % in the period under review compared with the previous period.

Current account

Owing to the heavy overall demand for imports and the mere moderate growth in exports during the second quarter of 2002, Germany's trade surplus fell in seasonally adjusted terms by €3 billion to €29½ billion. However, the deficit on current invisible transactions with non-residents remained virtually unchanged. While the deficit on the German services account was smaller than in the first quarter, this was offset by larger net current transfers to non-residents. As a result, the German current account in the second quarter of 2002 ran a (seasonally adjusted) surplus of €9 billion compared with a surplus of €11½ billion in the first quarter.

Financial transactions

Trends in financial transactions

There was a complete change in sentiment on the international financial markets in the second quarter of 2002: whereas economic expectations were optimistic in the first few months of the year, the weakness in the share markets in connection with the corporate balance sheet irregularities, particularly in the United States, resulted in a veritable flight of investors into the safety of the bond markets in the spring and early summer. Consequently, the yields on public bonds again declined discernibly, and there were extensive shifts in exchange rate patterns. Both the sombre market mood and the change in investor preferences can be seen in the international capital flows. According to the statistical data already available, the euro area recorded substantial inflows of funds through portfolio investment, evidently at the expense of the United States. In Germany portfolio transactions and direct investment also resulted in net capital imports between April and June whereas (unsecuritised) credit transactions led to the export of funds.

Portfolio investment

From the German point of view the reversal in portfolio investment is particularly marked at more than €30 billion. Between January and March this year there had been net exports of capital amounting to €21½ billion; in the following three-month period there were net capital imports of €9½ billion. This means that for the first time since the third quarter of 2001, which was marked by market participants' general uncertainty following the terrorist attacks in New York and Washington, non-residents' acquisitions of securities in Germany exceeded the portfolio investment by German residents abroad.

Foreign investment in German securities

Between April and June non-residents invested €30½ billion in German paper compared with €13½ billion in the three months earlier. Demand was heaviest for both private and public German bonds (€18½ billion). Con-

Financial transactions

€ bn, net capital exports: –

Item	2001	2002	
	Q2	Q1 r	Q2
1 Direct investment	– 25.5	+ 10.1	+ 13.3
German investment abroad	– 35.8	– 2.7	– 1.6
Foreign investment in Germany	+ 10.4	+ 12.8	+ 14.9
2 Portfolio investment	+ 27.0	– 21.3	+ 9.3
German investment abroad	– 49.0	– 34.8	– 21.2
Shares	– 14.4	– 7.3	+ 0.4
Investment fund certificates	– 4.8	– 7.4	– 3.0
Bonds and notes	– 28.6	– 15.8	– 17.6
Money market paper	– 1.1	– 4.3	– 1.0
Foreign investment in Germany	+ 75.9	+ 13.5	+ 30.5
Shares	+ 71.0	+ 6.0	+ 10.5
Investment fund certificates	– 0.7	+ 1.1	– 1.0
Bonds and notes	+ 10.6	+ 22.5	+ 18.6
Money market paper	– 5.0	– 16.1	+ 2.4
3 Financial derivatives 1	+ 8.5	+ 1.5	+ 1.5
4 Credit transactions	– 4.3	– 14.4	– 55.3
Credit institutions	– 35.3	+ 13.5	– 48.6
Long-term	– 0.5	– 5.4	– 3.2
Short-term	– 34.8	+ 19.0	– 45.4
Enterprises and individuals	+ 8.5	– 10.6	– 8.4
Long-term	+ 1.6	+ 1.0	– 0.8
Short-term	+ 6.9	– 11.6	– 7.5
General government	+ 3.4	– 0.2	+ 2.3
Long-term	– 0.0	– 0.2	+ 0.0
Short-term	+ 3.4	– 0.0	+ 2.3
Bundesbank	+ 19.1	– 17.1	– 0.7
5 Other investment	– 0.3	– 0.4	– 0.4
6 Balance of all statistically recorded capital flows	+ 5.4	– 24.5	– 31.5
Memo item Change in the foreign reserves at transaction values (increase: –) 2	+ 2.0	– 1.4	+ 2.4

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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tributory factors here were the security and liquidity advantages which characterise Federal bonds, in particular, and also other German debt securities with first-class ratings. However, shifts in interest and exchange rate patterns probably also played an important role. For example, the interest rate disadvantage of Federal bonds with ten-year maturities compared with similar US Treasury paper was transformed into an advantage during the quarter. Furthermore, the euro gained considerable ground internationally, especially against the US dollar, a development which brought additional exchange rate gains to investors who value their assets in currencies other than the euro. This was possibly also the main reason why non-residents were acquiring German money market paper (€2½ billion) for the first time in a while. They also purchased German shares worth €10½ billion although, if compared with international competitors, the German share market sustained fairly large losses between the end of March and the end of June. Evidently, purchasers saw the lower prices as another opportunity to enter the market.

German investment in foreign paper

Whereas non-residents increased their investment in Germany, German investors were somewhat reluctant to purchase securities abroad. Their acquisitions of such paper were worth a total of €21 billion in the second quarter compared with €35 billion in the previous three-month period. Most of their portfolio investment was in euro-denominated bonds, ie in paper that was not subject to exchange rate risk (€18 billion). In the case of foreign currency bonds there was, as in the previous quarter, a small amount of net sales (€½ billion). The same applies to foreign shares, which German investors likewise sold for €½ billion. By contrast, they purchased foreign investment certificates worth approximately €3 billion and money market paper worth €1 billion. The choice of investment instruments shows that resident investors were averse to running exchange rate and market risks in an environment that was marked by uncertainty and falling prices.

Direct investment

Capital also flowed into Germany outside the field of portfolio investment between April and June, namely in the form of direct investment. At €13½ billion net, the inflow of funds was actually somewhat greater than in the first three months of 2002 (€10 billion).

Foreign direct investment in Germany

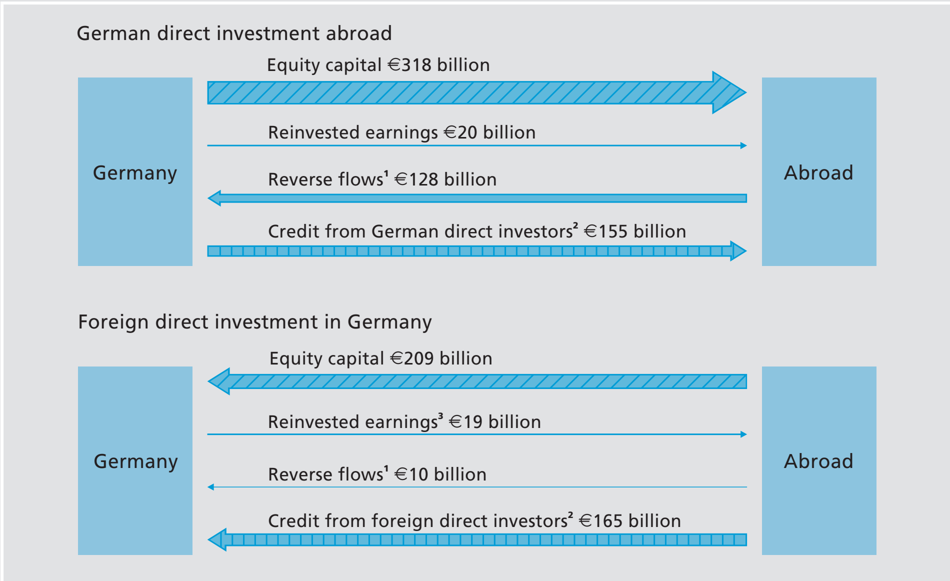
Foreign enterprises, in particular, invested more heavily in Germany, providing their branches domiciled in the country with funds amounting to €15 billion. The bulk of this money was in the form of equity capital. It is quite remarkable that the flow of inward direct investment continued to be fairly steady in that globally the climate for cross-border investment has cooled discernibly as a result of cyclical and stock exchange weakness.[1]

German direct investment abroad

German enterprises, which had been strengthening their presence abroad especially at the end of the 1990s, have also been

1 UNCTAD put the decline in global direct investment at 40 % for the year 2001 (UNCTAD Press Release TAD/INF/NC27 of 5 December 2001). In the OECD countries the downturn at 56 % in 2001 and with an estimate of between 20 % and 25 % in 2002 was even greater; see A Bertrand/H Christiansen, "Sharp fall in FDI flows into OECD countries in 2001", *The Statistics Newsletter*, OECD, July 2002, p 2 and A Bertrand/H Christiansen, "Trends and recent developments in foreign direct investment", which will appear shortly in *OECD International Investment Perspectives*, September 2002.

Direct investment flows between January 1996 and June 2002



1 Amounts borrowed by parent companies from their foreign subsidiaries; in the case of foreign direct investment in Germany the net amounts repaid by foreign parent companies to their German subsidiaries. — **2** Including "other assets". — **3** Liquidation of retained profits; loss provisions.

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operating much more cautiously for some time. Between April and June they built up the financial position of their foreign affiliates by no more than about €1½ billion net. Measured in terms of investment in some earlier quarters, this amounted to much less than one-tenth. In the period under review, however, the quite buoyant acquisition of participating interests by German enterprises abroad (about €20½ billion) was understated in the statistically recorded total figures because at the same time subsidiaries granted fairly substantial loans to their parent companies (reverse flows), which reduced Germany's direct investment abroad overall (see the notes on page 50).

Credit transactions

The net capital imports arising from portfolio investment and direct investment were accompanied by large outflows of funds through non-securitised credit transactions. The transactions of non-banks accounted for the smaller part of this. For example, enterprises and individuals transferred €8½ billion net abroad. Some firms "parked" proceeds from securities emissions temporarily with foreign banks if these funds were not required immediately, for example, for the acquisition of participating interests. A considerably larger amount, €48½ billion (net), was exported through the external operations of the credit institutions. The latter built up their non-securitised claims on foreign partners, in particular. The cross-border transactions of the public authorities and the Bundesbank which were recorded under credit transactions were fairly limited during the period

Different forms of direct investment and their relative importance for Germany

The purpose of recording direct investment is to give a comprehensive account of the cross-border financial relationships within a group of companies. Direct investment therefore comprises not only the provision of equity capital and the reinvested earnings but also all credit transactions between a parent company and its subsidiaries abroad. In other words, it includes short-term financial loans and trade credits. Loans are classified according to the directional principle. That means that, for example, the granting of a loan by a German parent company to one of its own subsidiaries abroad is regarded as German direct investment abroad (owing to the close substitutional link between loans and the provision of equity capital) while a loan received by a German parent company from a subsidiary abroad appears as a deduction (reverse flow) from Germany's direct investment abroad. Showing direct investment in this form has its origins in the *Balance of Payments Manual* of the IMF; this form of presentation was introduced into Germany at the start of European monetary union in 1999, and it has been possible to break the time series down in this form back to 1996.

It is now clear that the individual components of German direct investment abroad and those of foreign direct investment in Germany have different respective weights and that these, if short-term fluctuations are disregarded, are a reflection of economic determinants. From the beginning of 1996 to the end of June 2002 German enterprises invested €365½ billion abroad; the provision of equity capital accounted for €318½ billion (87%) of this, reinvested earnings for €19½ billion (5%) and the granting of loans and "other assets" abroad (eg acquisition of real estate) €27½ billion (7%). However, loans received by parent companies from foreign subsidiaries and amounting to €128 billion are an important element of the "loans" item and, as explained above, have been offset against the total. These partly concern proceeds which arose from securities issued on the international market by financing enterprises (operating abroad for tax reasons, among others) and which were passed on to these enterprises' owners domiciled in Germany. These reverse flows were recently so extensive, especially between April and June 2002, the period under review, that – as indicated in the main text – they dominated the entire credit transactions of German direct investors.

The situation is different in the case of foreign direct investment in Germany. It is true that, at €364½ billion, inward investment in Germany has been almost as extensive since 1996 as German direct investment abroad. Even so, only slightly more than half of these funds was in the form of equity capital (€208½ billion) and slightly less than half in the form of loans (€174½ billion); at the same time, the proceeds distributed by German direct investment enterprises among their owners abroad exceeded the total amount of profits made by foreign firms in Germany, ie there were negative reinvested earnings (€19 billion). The reasons for the difference in the financing of German direct investment enterprises include fiscal considerations (tax-reducing liquidation of retained profits, possibility of deducting loan interest from earnings) and the greater capital market orientation in other economies, notably the Anglo-Saxon ones, which has possibly made corporate acquisitions easier there than in Germany. Loans received by foreign owners from their subsidiaries in Germany played only a minor role over the period as a whole; recently, however, foreign parent companies have been repaying earlier loans from their subsidiaries domiciled in Germany in somewhat larger amounts, a development which, if taken by itself, has improved their subsidiaries' financial position.

Direct investment flows in detail

Net capital exports: –

	January 1996 to June 2002		2002 Q1	2002 Q2
	€ bn	Share 1	€ bn	€ bn
German direct investment abroad	– 365.4	100 %	– 2.7	– 1.6
Equity capital	– 318.4	87 %	– 9.2	– 20.5
Reinvested earnings	– 19.7	5 %	–	–
Loans by German direct investors 2	– 27.3	7 %	+ 6.5	+ 18.9
of which Reverse flows 3	+ 127.9	–	+ 4.5	+ 19.7
Foreign direct investment in Germany	+ 364.5	100 %	+ 12.8	+ 14.9
Equity capital	+ 208.7	57 %	+ 13.0	+ 10.9
Reinvested earnings	– 18.8	– 5 %	– 0.9	– 0.9
Loans by foreign direct investors 2	+ 174.6	48 %	+ 0.7	+ 4.8
of which Reverse flows 3	+ 9.7	–	+ 7.4	+ 12.8

1 Expressed as a percentage of the respective total item. — **2** Including "other assets". — **3** Loans received by direct investors from direct investment enterprises.

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under review and almost cancelled out in net terms.

Foreign reserves of the Bundesbank

The foreign reserves of the Bundesbank, which are shown separately from credit transactions in the balance of payments, declined by €2½ billion at transaction values between the end of March and the end of June. When valued at current balance sheet rates, ie valued at the respective market prices and exchange rates, the decline was even greater, namely from €98 billion to €86½ billion. This is mainly a reflection of the depreciation of the US dollar against the euro, which – in euro terms – reduced the value of both the foreign currency reserves and the gold holdings.