German balance of payments in 2002

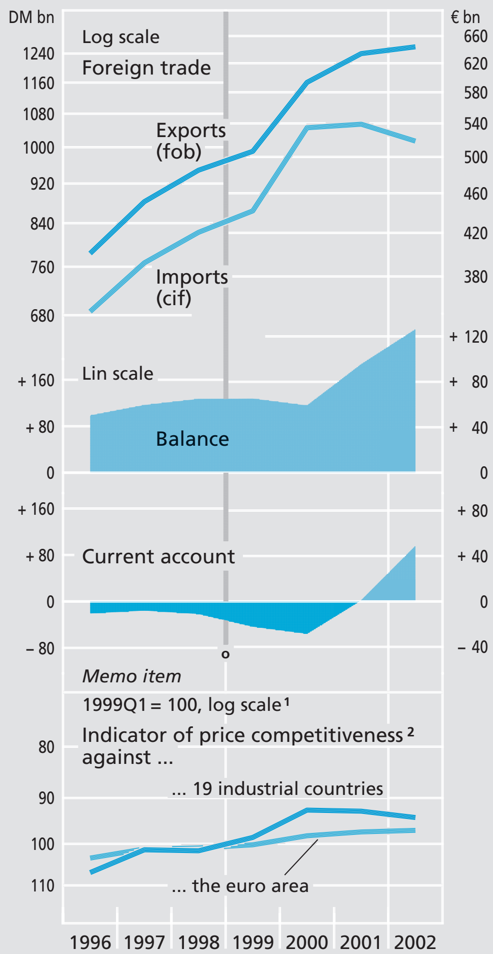
Economic and political uncertainty also left their mark on Germany's transactions with non-residents in 2002. After all, the tensions associated with the Iraq conflict, the falling prices on the stock markets and the shifts in exchange rate patterns did not provide an environment that encouraged a lasting recovery in the world economy. Despite these difficult underlying conditions, German exporters were fairly successful in maintaining their position on their foreign markets, which were growing more slowly. At the same time, weakness in domestic demand resulted in a discernible decline in the imports of goods. These factors, together with a substantial improvement in the terms of trade, enabled the trade surplus to expand to a "record" €126 billion. Consequently, the surplus on current account also rose sharply to 2.3% of gross domestic product. In the case of financial transactions the uncertainty on the part of internationally operating investors was reflected in a discernible reluctance to make cross-border investment and a preference for "safe" assets. This ultimately resulted in net capital inflows into Germany through both portfolio investment and direct investment and, at the same time, to substantial outflows of capital in the field of non-securitised credit transactions.

Current account

Exports

German exporting enterprises did not operate in an easy business environment last year. They had to contend, for example, with the detrimental effects posed by uncertainty about future developments in the world economy and demand on major export markets. It is true that world economic growth accelerated to an estimated 3% in 2002 (from 2¼% a year earlier); however, German export markets grew much more slowly. Another factor was the appreciation of the euro and the associated concerns about what effects the deterioration in price competitiveness would have on German export turnover. All of these factors were reflected in a downturn in orders received from abroad, especially in the second half of 2002. It was under these circumstances that the real expansion in the exports of German enterprises amounted to only 1½% (compared with almost 6% in 2001). Despite that, sales of German products on the more sluggishly growing export markets fared rather well. German exporters probably maintained their world market share for the most part. The appreciation of the euro has not had a very noticeable impact on the export of goods so far because, in the first place, about 43% of German exports go to other euro-area countries and because there has been virtually no change in Germany's competitive position with respect to these countries. Generally speaking, the loss in German price competitiveness on an average of 2002 therefore amounted to only 1.5% while the effective appreciation of the euro amounted to 3%. In the second place, German enterprises are still benefiting from

Foreign trade
and current account



o From 1999 data in euro. — **1** Inverted scale: rise in curve (fall in values) denotes increase in competitiveness. — **2** Based on the price index of total sales.

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the improved market conditions during the first few years of monetary union, with the result that Germany's relative competitive position was still fairly favourable even at the end of 2002. Furthermore, experience has shown that exchange rate movements take some time to influence trade flows.

Last year German exporters received their strongest stimuli from countries outside the

Regional breakdown of exports

euro area. In those countries whose general economic output grew more rapidly than that of the euro-area countries German exporters recorded a 2½% increase in turnover although this increase varied considerably from one country to another. At 7½%, growth in turnover in central and eastern Europe was particularly strong. Since trading with these countries has been growing continually more intense for some years, they now account for 11½% of total German exports. There was also a particular momentum in the trade with China (+19½%), which last year was one of the fastest growing countries in the world. German exporters also achieved significant increases in turnover (+6½%) in their trade with the OPEC countries, which continued to benefit from substantial income from oil. By contrast, trade with the United States declined discernibly. Turnover fell by almost 2% in 2002 whereas a year earlier there had been an increase of almost 10%. Exports of German products to the United States, whose share of German foreign trade amounts to approximately 10½%, have probably been curbed most by the falling demand for capital goods in the United States and possibly also by the appreciation of the euro against the US dollar. Much the same is presumably true of Japan although Japan has much less impact on the development of German foreign trade. Exports to Japan actually fell by more than 7% on an annual average of 2002. Owing to the persistent weakness in economic growth in Japan, however, exports to Japan had been declining in the previous year, too. The virtual absence of economic recovery in the euro area was probably the main reason for German producers' modest growth in

Regional trend in foreign trade

2002

Country/group of countries	Percentage share	Percentage change in absolute value from previous year
Exports		
All countries	100.0	1.6
of which		
Euro-area countries	42.6	0.3
Other EU countries	12.1	3.1
United States	10.3	– 1.8
Central and east European countries in transition	11.6	7.5
Japan	1.9	– 7.1
Emerging markets in South-East Asia	3.9	1.1
China	2.2	19.6
OPEC countries	2.2	6.7
Imports		
All countries	100.0	– 3.8
of which		
Euro-area countries	41.6	– 2.0
Other EU countries	9.9	– 6.5
United States	7.7	– 13.0
Central and east European countries in transition	13.5	2.5
Japan	3.6	– 16.9
Emerging markets in South-East Asia	5.1	– 6.9
China	4.0	5.6
OPEC countries	1.3	– 15.3

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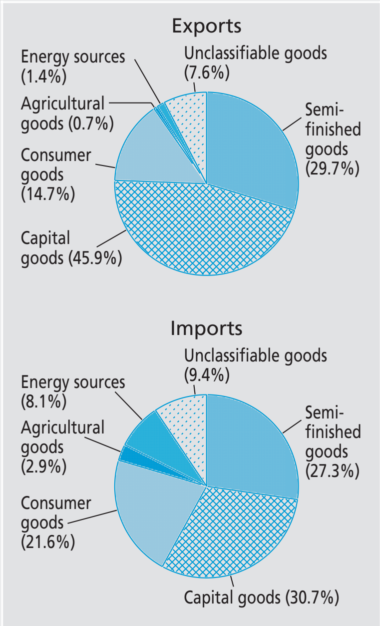
Foreign trade by selected categories of goods

2002



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sales there. Exports to the other euro-area countries grew by less than ½%, thereby putting a discernible brake on external stimuli, given these countries' enormous importance for German exporters.

Breakdown of exported goods

Almost all economic sectors in Germany were affected by the generally moderate foreign demand.[1] Given the sharp decline in investment in machinery and equipment in many countries, exports of capital goods, which, with a share of 46%, are an extremely important part of German exports, fared comparatively well (-½%). The car industry, whose export turnover in 2002 – as in the previous year – increased significantly (5%), was a major driving force here; this also enabled suppliers to increase prices. By contrast, manufacturers of ICT goods recorded a reduction in their export business (-4 ½% in nominal terms). However, lower prices, particularly in the case of IT products where prices were reduced by more than 4%, depressed the value of exports. The year-on-year fall in export turnover in the chemical industry was even sharper, at 7%, although here, too, a reduction in export prices (-1.2%) played a role.

Export prices

The divergence in export price trends in the individual economic sectors shows that enterprises responded in different ways to the specific competitive conditions in their respective export markets and to changes in their own cost structures. However, to some extent pricing might have been influenced by particular regional trading relationships and the choice of invoicing currency. While approximately 75% of all German exports are invoiced in euro and 16% in US dollars, in trade with countries outside the euro area only 54% of exports are invoiced in euro and almost 29% in US dollars. To maintain market shares, especially in the dollar area, German exporters may have reduced some of the euro selling prices. Overall, however, there was hardly any change in export prices in 2002 (-0.1%).

Imports

In the year under review imports of goods were just under 4% below those in the previous year. In 2001 they had risen by approximately 1%. To a large extent, however, the reduction in the value of imports is a reflection of price effects; import prices fell by

1 The analysis of developments in foreign trade by sector has become more difficult because for 2002 a significant percentage of foreign trade has not yet been broken down by category of goods. This has seriously impaired the informative value of a year-on-year comparison.

2.5%. Both the appreciation of the euro and, despite the increase in oil prices towards the end of the year, the more favourable prices of energy imports curbed prices on the import side. Even so, imports declined in real terms, too, owing to the depressed demand in Germany; they were down by 1½%.

Regional breakdown of imports

The declining demand for imported goods affected almost all supplier countries. For example, the imports of goods from the United States fell by 13% year on year. Much of this fall is probably the reflection of price effects stemming from exchange rate movements. At approximately 17%, the decline in the case of Japan was even greater in terms of the average rate of change over the year – and this despite the fact that Japanese exporters had already sustained huge falls in sales on the German market in the previous year (-14½%). Much the same can be said of suppliers in the emerging economies in South-East Asia, who experienced a 7% fall in sales in Germany. Imports of goods from the OPEC countries fell by 15½% in 2002; this was due not only to the decline in the import prices of crude oil but, evidently, also to a decline in the imported volume. At all events, Germany's imports of energy sources in 2002 were substantially below the level in the previous year (-11½%). Given the fact that German imports of goods from other euro-area countries are largely unaffected by exchange rate factors, the year-on-year fall of 2% in value is essentially a reflection of the lower domestic demand for imported goods. Trade with the transition countries in central and eastern Europe constituted one important exception to the generally negative development in imports even if suppliers from these countries were no longer able to achieve the former high growth rates in Germany either. After all, the sales of these countries in Germany in 2002 rose by 2½%. Owing to the close production ties, the central and east European countries further expanded their position in German foreign trade both on the import and on the export side.

Breakdown of imported goods

The lower level of output in Germany is also reflected in the breakdown of imports by category of goods.[2] For example, the value of imports of semi-finished goods in 2002 was 14% lower than in 2001. The demand for foreign capital goods was likewise down on the previous year in terms of value (-8%); this reflects a corresponding downturn in investment in machinery and equipment in Germany and affected foreign manufacturers in the IT sector (-12½%) and foreign manufacturers of mechanical engineering products (-10%), in particular. Only the imports of consumer goods slightly exceeded the previous year's level (by ½%).

Balances within the balance of trade and in current account

As a result of the divergent movements in exports and imports, the trade balance again rose sharply in 2002 and closed at a record €126 billion; this means that it was €30½ billion more than in the previous year. Furthermore, the current account benefited from a smaller deficit on invisible current transactions with non-residents. When taken together, all of these developments expanded the surplus on current account to €49 billion whereas the

2 See footnote 1.

Major items of the balance of payments

€ billion

Item	2000	2001	2002
I Current account			
1 Foreign trade			
Exports (fob)	597.4	638.3	648.3
Imports (cif)	538.3	542.8	522.1
Balance	+ 59.1	+ 95.5	+ 126.2
2 Services (balance)	– 49.9	– 51.2	– 38.3
of which Foreign travel (balance)	– 37.4	– 37.4	– 36.0
3 Factor income (balance)	– 2.4	– 10.4	– 6.7
of which Investment income (balance)	– 1.9	– 10.2	– 6.3
4 Current transfers (balance)	– 28.4	– 27.4	– 26.6
Balance on current account [1]	– 28.5	+ 1.0	+ 48.9
II Balance of capital transfers [2]	+ 6.8	– 0.4	– 0.2
III Financial account [3]			
Direct investment	+ 158.7	– 9.1	+ 14.3
Portfolio investment	– 155.8	+ 26.6	+ 37.0
Financial derivatives	– 5.5	+ 6.3	– 0.5
Credit transactions [4]	+ 39.4	– 42.0	– 129.5
Balance on financial account	+ 36.9	– 18.2	– 78.7
IV Change in the foreign reserves at transaction values (increase: –) [5]	+ 5.8	+ 6.0	+ 2.1
V Balance of unclassifiable transactions	– 21.0	+ 11.6	+ 28.0

1 Includes supplementary trade items. — **2** Including the acquisition/disposal of non-produced non-financial assets. — **3** Net capital exports: –. For details see the table "Financial transactions" on page 64. — **4** Including Bundesbank investment and other public and private investment. — **5** Excluding allocation of SDRs and changes due to value adjustments.

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current account balance in 2001 had been almost in balance (+€1 billion). In terms of gross domestic product the current account surplus therefore amounted to 2.3%.

Service transactions

The year-on-year decline in the deficit on services was much greater in 2002 for the first time since the 1980s. The deficit fell by €13 billion to just under €38½ billion. This was due to a 9% increase in income and a 2% decrease in expenditure. The main reason for this divergence was the outcome of insurance services and other services in which a broad range of different services is listed. The surplus in the case of insurance services surged from just under €1 billion in 2001 to €6½ billion last year. This was due primarily to a sharp rise on the income side. The much greater income of re-insurance companies from contributions and premiums since the terrorist attacks on 11 September 2001 was not offset in 2002 by corresponding expenditure on claims for damages. Contrary to the trend in the past few years when the deficit had steadily increased, net expenditure in the case of the other service transactions fell below the previous year's level for the first time in more than ten years. Following a deficit of almost €25 billion in 2001, the sub-balance ran a deficit of approximately €16 ½ billion last year. Net expenditure declined principally in the case of patents and licences as well as in the case of advertising and trade fairs and the film industry. Moreover, there was an increase in the net income from government services.

Foreign travel

Developments in foreign travel likewise contributed to the improvement in the services account last year.[3] In 2002 the foreign travel account ran a deficit of €36 billion, approximately €1½ billion less than in 2001. Owing to the uncertain economic and earnings prospects and possibly also as a result of terrorist attacks in holiday countries, German residents evidently reduced their expenditure on travelling abroad more sharply (-3%) than did foreigners travelling to Germany (-1½%). Expenditure by German holiday makers and business travellers on trips to the United States fell particularly markedly – by almost one-fifth. As it is precisely the longer-haul trips overseas that often have to be booked well in advance, it was evidently here that the more favourable prices in these destinations resulting from the appreciation of the euro failed to have a positive effect. Conversely, US travellers spent less in Germany in 2002 than in previous years. There was hardly any change in the amount spent on travelling to other euro-area countries which account for about half of total travel expenditure. Finally, expenditure on trips to the central and east European countries, which have been enjoying greater popularity in recent years, increased slightly (+1%).

Factor income

Net expenditure in the case of cross-border factor payments declined in 2002 by just under €4 billion to €6½ billion. This was due primarily to developments in investment income expenditure, which declined by almost €4 billion more than income and, consequently, reduced the deficit on investment earnings to just under €6½ billion. Owing to the uncertainty on the share markets, bonds have been in great demand by investors for some time, a development which is reflected in increasing cross-border payments of bond yields. Income in 2002 increased by almost €1½ billion faster than expenditure. Although this means that the shifts in interest rate and exchange rate patterns did not have a discernible effect on bond interest payments, they appear to have contributed substantially to the improvement of €1½ billion in the balance on credit interest payments to a surplus of just over €1 billion. The deficit on proceeds from direct investment was almost unchanged at just over €½ billion in 2002. Owing to the poor state of profitability in many enterprises, both domestic and foreign, income and expenditure each declined by €2½ billion.

Current transfers

The deficit on current transfers to and from non-residents declined by approximately €1 billion to €26½ billion last year. The deficit in the case of public transfers fell by almost €1½ billion to just over €15½ billion as the net payments to the EU budget went down by €1½ billion to just under €11 billion. This decrease was due both to the larger payments to Germany from the EU budget in connection with the structural policies and to the small payment by Germany to the EU, especially as a result of the smaller EU share in German revenue from value added tax. By contrast, the balance on private-sector transfers deteriorated by €½ billion and ran a deficit of €11 billion. One of the reasons for this was the increase in insurance payments to non-residents. Capital transfers were almost

3 A new method of estimating foreign travel was introduced at the time of the annual revision for 2002; this is explained in detail on p 60 ff.

Capturing foreign travel in the balance of payments statistics from January 2001

This issue of the *Monthly Report* contains data on foreign travel which have been obtained for the first time by means of a new collection system. This change became necessary because the quality of the data that had been used hitherto for estimating foreign travel declined significantly as a result of the introduction of euro banknotes and coins on 1 January 2002 or the data sources themselves ceased to exist.

Until the end of 2001 data on the receipts from and expenditure on foreign travel were collected indirectly. The relevant information was not obtained from the travellers themselves but from banks and credit card companies which settle a large proportion of travel transactions by buying and selling foreign currency and settle payments made through ec cards and credit cards. This information was supplemented by reports from tour operators on their cross-border transfers and by data from some European partner countries on the buying and selling of Deutsche Mark banknotes in their respective home markets. The monthly receipts from and expenditure on travel were estimated on the basis of this information.

As many travel-related transactions are still settled in cash, the introduction of euro banknotes and coins resulted in a not insignificant information gap, especially in the euro-area countries,[1] some of which are among the most important partner countries for German foreign travel; this applies both with respect to estimating the level of travel expenditure and establishing the regional breakdown. A direct survey of travellers on the basis of household samples now makes up for the lack of this information. The survey is based on the foreign travel of (domestic) residents and the total amount they spend on it. This survey has now been undertaken on an ongoing basis since the beginning of 2001 in order to compare the new results with the data collected under the old method for at least a year and to be able to subject the findings to a quality test.

The figures extrapolated on the basis of the survey for 2001 show that the resident population in Germany made about 167 million foreign trips during that year and spent a total of €58 billion on these. Expenditure previously shown in the balance of payments for this period had amounted to €51½ billion and was therefore 11%, or just over €6 billion, lower than the extrapolated survey result.

Generally speaking, the seasonal pattern of the new data on foreign travel is fairly consistent with the pattern of the data collected under the old system. However, the expenditure in the summer months – when travel is at its peak – had previously been underestimated. One reason for these seasonal shifts is that under the collection system used until the end of 2001 it was often difficult to establish precisely when the trips associated with the payments by ec cards and credit cards had actually been made. In the case of the household sample, by contrast, the actual date of the trip can be determined more accurately because the persons participating in the survey are asked the times of the trip and the related payments.

A comparison of the old and new compilation methods leads to different results with respect to the regional breakdown.

- In the case of the EU countries the results of the survey are almost entirely in line with the earlier data. For example, the discrepancies in 2001 amounted to slightly more than 1% in the case of these countries as a whole and to as little as ½% in the case of the euro-area countries. The new data also confirm earlier calculations, which had shown that the previous method of estimating had probably been tending to overstate German travel expenditure in the case of some countries such as Italy and the United Kingdom. The level of expenditure established by the household survey is also confirmed by the corresponding data from the partner countries in these instances.

- Larger discrepancies occur in the case of countries outside the EU. According to the results of the survey, expenditure by German travellers outside the EU was €6½ billion, or 38%, more in 2001 than had previously been estimated. Evidently the estimated use of Deutsche Mark banknotes as a payment medium in these countries had been far too

1 Problems also arose in a number of countries outside the euro area where the use of Deutsche Mark banknotes had previously played a special role. Turkey, for example, is a case in point. — **2** Less important destinations are rarely captured by the sample

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low. This appears to be particularly true in the case of a few classic holiday countries outside the EU, notably Turkey and some central and east European transition countries such as Croatia, Hungary and Bulgaria, for which earlier studies had already indicated an underestimation. The travel expenditure now being established by the new compilation method is also greater in the case of some long-haul destinations than the level previously published in the balance of payments. For example, the level of travel expenditure in 2001 was 13% higher in the case of the United States and 30% higher in the case of the developing countries.

All in all, the results of the household survey are fairly reliable in the case of foreign travel expenditure as a whole and in the case of the regional breakdown of the most important destinations. As already mentioned, this is confirmed by the corresponding results provided by the respective countries themselves. This means that the results of the sampling procedure can be used not only to close the information gap vis-à-vis the euro area. They can also be used for countries outside the EU despite the greater differences between the old and the new data.

While the direct survey provides a satisfactory quality of foreign travel data on the expenditure side, the side which is clearly of greater importance in Germany's case, the situation is less favourable on the receipts side. There is no substitute in this case for the loss of information on the use of cash. Consequently, travel receipts in the case of the euro-area countries can be estimated only on the basis of the data on payments made by ec cards and credit cards and by bank settlements that are still available. This information will be used in combination with the monitoring of possible changes in paying habits (for example, whether greater use is being made of cash instead of the ec card since the introduction of euro banknotes and coins in the destination country) to extrapolate total receipts from foreign travel. The accommodation statistics provided by the Federal Statistical Office are used to check the calculations. This provides a reliable indication of the trend for most of the euro-area countries. The corresponding data from the major partner countries are also included in the calculations. An increase of more than €1 billion is obtained on the receipts side as a result of the annual revision for 2001. However, this change is due mainly to late reports.

To prevent breaks arising from the changeover to the new system, a development which would be likely in the case of countries outside the EU in particular, country-specific and region-specific factors, which apply to earlier years (in some cases dating back to 1971), are calculated on the basis of the figures for the "link" year of 2001. Survey results for 2002 are already available up to the end of the third quarter. For the fourth quarter of 2002 and all subsequent years the initial results of the household survey will be available five months after the respective reporting period at the earliest, for example, not before the end of August 2003 in the case of the first quarter of 2003. For that reason provisional figures will have to be estimated. The existing trend up to the end of 2002 will be updated for all euro-area countries and other major destination countries and regions using an ARIMA estimate. The outcome of test calculations for 2001 has indicated that this is possible with acceptable results for a limited period. Analyses based on the remaining primary data will also be made in order to take account of special effects in 2002 – for example, the impact of the terrorist attacks of 11 September 2001.

Overall, the sample survey has reliably closed the gap that had arisen in foreign travel data in the euro area. Furthermore, the survey has the advantage that additional information on, for example, the reason for the trip (business or private), the duration of the trip, the mode of transport used and the percentage of package holidays is now available. As a result, the analyses of a wider range of issues will be possible. Owing to the increase in sampling error,[2] however, the availability of country results is restricted, and this must be seen as a disadvantage of the household survey. This is also the reason why in future quarterly and annual results will be published only for major destination countries and regions.

survey, if at all, with the result that reliable extrapolation is not possible.

in balance last year whereas in 2001 there had been a deficit of just under €½ billion.

Financial transactions

Trends in financial transactions

Sluggish growth in the world economy, financial scandals – especially in the United States – and the smouldering Iraq crisis overshadowed events on the international financial markets last year. This led to – sometimes massive – losses on the share markets, and global bond yields fell sharply again. At the same time, the euro recorded rapid and sustained gains during the year. Internationally operating investors showed greater risk-awareness in this environment and became discernibly restrained in their cross-border investments. This can be seen both in the declining flows of capital to and from Germany and in the comparatively moderate amounts of funds which residents and non-residents alike were investing internationally in securities and corporate participating interests. The upshot was net capital imports through portfolio transactions and direct investment and in the case of non-securitised credit transactions much greater outflows of funds from Germany. As a result, aggregate net capital exports far exceeded the current account surplus recorded for 2002, a development which indicates problems in the statistical recording of financial transactions and makes the analysis of the balance of payments more difficult.

Portfolio investment

Net capital imports through portfolio investment alone were somewhat greater, at €37 billion, in 2002 than in the year before (€26½ billion). However, the rise in the net flows conceals the overall restraint observed in the case of internationally operating investors last year. German investors, in particular, showed far less interest in pursuing the internationalisation of their portfolios than they had done in earlier years. For example, they acquired no more than €69 billion worth of securities issued by foreign borrowers in 2002 compared with €129½ billion in 2001. This is the smallest amount German savers have invested in such paper for six years.

German investment in ...

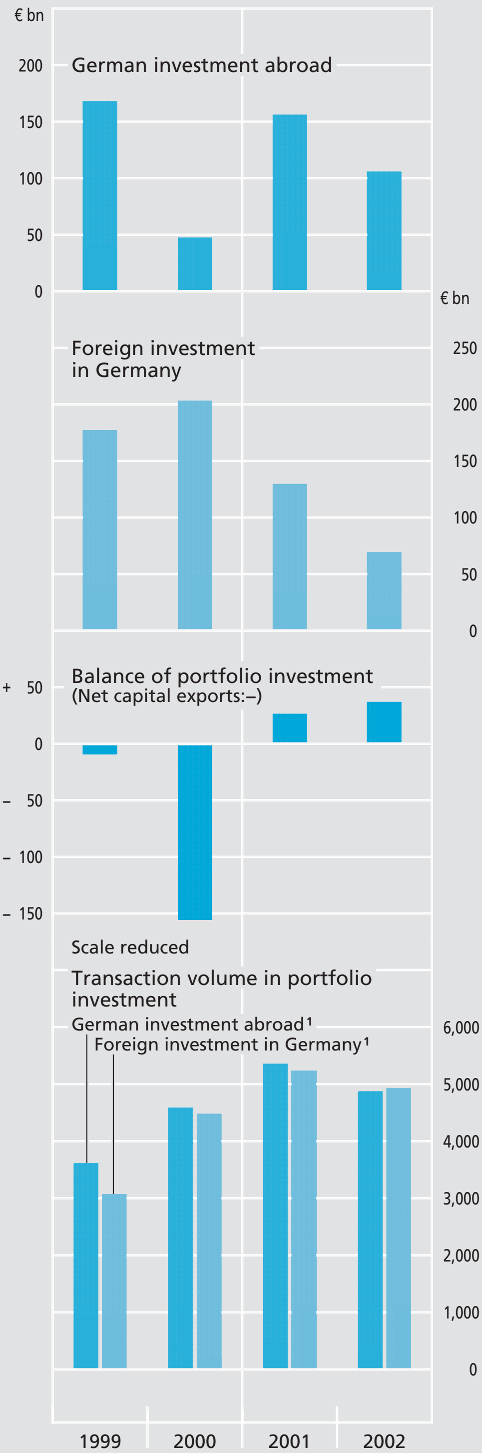
... foreign bonds and notes

Despite the fact that the falling capital market yields during the year would have provided holding gains, German residents significantly reduced their investment, especially new investment on foreign bond markets. Their investment of €51 billion in longer-term foreign debt securities in 2002 was only slightly more than half the sum they had invested in this paper the year before (€95 billion). As euro-denominated bonds have normally accounted for the bulk of German acquisitions of bonds and notes since the start of monetary union (2002: €49½ billion), it is possible that, in addition to the general increase in the preference for liquidity, the significant decline last year in the yield advantage of bonds issued in other euro-area countries over comparable German paper played a role in the downturn. At the end of 2002 the yield advantage on ten-year government bonds was only 13 basis points. However, owing to the strength of the euro and the positive interest rate spread that existed almost throughout the year vis-à-vis the United States or Japan, for example, German investors did not regard foreign currency issues as an attractive alternative either (acquisitions in 2002: €1 billion).

... foreign shares

Much the same is also true of foreign equities, which make up only a very small part of German investors' portfolios. At €5½ billion, their investments in foreign shares in 2002 amounted to only a mere fraction of the average sum that they had invested in this instrument over the past few years. Evidently, German savers responded to the uncertain economic climate and the less optimistic expectations of many enterprises about their profitability, a state of affairs that was reflected throughout the world in a sharp fall in share prices. The exchange rate risk, which was considered significant, may also have been a contributory factor in the reluctance to invest in cross-border shares outside the euro area. A clear example of this investor behaviour is provided by the United States where – notably in the first half of the year – news about balance sheet "irregularities" in major firms additionally curbed the incentive to invest in the share market. Overall, German residents purchased no more than €½ billion worth of US equities whereas on an average of 1999, 2000 and 2001 they had invested about €16½ billion in this type of paper. The reluctance to invest in foreign shares was also apparent in the equally dwindling interest in investment fund certificates of foreign origin (€7 billion), which traditionally invest a large part of the funds they receive in foreign shares. By contrast, German savers increased their demand for foreign money market paper (€6 billion) whereas in the previous year they had sold such paper for €1 billion net.

Portfolio investment



1 Calculated as the total value of purchases and sales in each case.

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Foreign investment in ...

A further downturn in portfolio investment was also observed in financial flows in the op-

Financial transactions

€ billion, net capital exports: –

Item	2000	2001	2002
1 Direct investment	+ 158.7	– 9.1	+ 14.3
German investment abroad	– 61.7	– 47.0	– 26.1
Foreign investment in Germany	+ 220.4	+ 37.9	+ 40.4
2 Portfolio investment	– 155.8	+ 26.6	+ 37.0
German investment abroad	– 203.4	– 129.6	– 69.0
Shares	– 102.3	– 15.6	– 5.3
Investment fund certificates	– 32.5	– 19.7	– 6.8
Bonds and notes	– 70.3	– 95.1	– 50.8
Money market paper	+ 1.7	+ 0.9	– 6.1
Foreign investment in Germany	+ 47.6	+ 156.2	+ 106.0
Shares	– 35.9	+ 88.6	+ 16.8
Investment fund certificates	+ 11.0	+ 1.1	– 0.2
Bonds and notes	+ 74.0	+ 81.2	+ 79.2
Money market paper	– 1.4	– 14.8	+ 10.2
3 Financial derivatives 1	– 5.5	+ 6.3	– 0.5
4 Credit transactions	+ 41.3	– 40.6	– 128.0
Credit institutions	+ 13.8	– 76.3	– 102.2
Long-term	– 24.5	– 43.2	– 13.5
Short-term	+ 38.3	– 33.1	– 88.7
Enterprises and individuals	+ 4.6	– 7.8	+ 4.1
Long-term	+ 4.1	+ 9.5	+ 4.7
Short-term	+ 0.5	– 17.3	– 0.7
General government	– 19.4	+ 16.8	+ 5.5
Long-term	– 1.5	+ 0.0	+ 0.1
Short-term	– 17.9	+ 16.8	+ 5.4
Bundesbank	+ 42.4	+ 26.6	– 35.4
5 Other investment	– 1.9	– 1.3	– 1.5
6 Balance of all statistically recorded capital flows	+ 36.9	– 18.2	– 78.7
Memo item Change in the foreign reserves at transaction values (increase: –) 2	+ 5.8	+ 6.0	+ 2.1

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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posite direction, ie in the case of foreign investment in Germany. Total securities acquisitions by non-residents in Germany in 2002 amounted €106 billion compared with €156 billion a year earlier. This means that they were actually lower than in 1998 and 1999.[4] One reason for last year's decline is the extremely weak performance in the final quarter of 2002 when foreign investors withdrew funds from the German securities markets after using German paper as a safe haven, especially in the summer months. The reversal might also have had something to do with non-residents' uncertainty about the outcome of the fiscal debate in the fourth quarter of 2002 even though non-residents would have been largely unaffected by the regulations under consideration.

... German shares

Non-residents' diminished propensity to invest was particularly noticeable on the German share market. For example, their expenditure of €17 billion on German shares was just under one-fifth of the amount that had flowed into Germany in this way in 2001. That is still an enormous slump even if account is taken of the fact that the fall in the value of share transactions captured in the balance of payments was in line with the fall in share prices.[5] It is possible that the sluggish economic growth in Germany together with the less optimistic expectations about profits

4 It was only in 2000 that net portfolio investment by non-residents in Germany in recent years was lower than in 2002. However, the result at that time was due to a statistical book transfer in connection with a major corporate acquisition. See Deutsche Bundesbank, German balance of payments in 2000, *Monthly Report,* March 2001, p 59 ff.
5 The decline in prices in terms of the end-of-year DAX index amounted to 44% last year and was therefore unusually large on an international comparison.

discouraged non-residents from investing more on the German share market. There were actually small net outflows of capital in connection with German investment fund certificates in 2002 whereas in the previous year non-residents had invested as much as €1 billion in investment companies' share certificates.

... German bonds and notes

Contrary to this general trend, the sum of investable funds which foreign investors spent on German interest-bearing securities – ie longer-term bonds and notes and money market paper – amounted to €89½ billion last year. That was €23 billion more than in 2001. However, there were divergent developments in the individual maturity segments and in the various instruments. Last year, for example, non-residents invested fairly heavily in Federal bonds (€49 billion), which are regarded as a safe haven in times of political uncertainty and which, in terms of the usual yield spreads between German government bonds and the bonds of other euro-area countries in previous years, were a comparatively favourable investment. The situation was somewhat different in the case of private-sector bonds, however. These attracted no more than €30 billion in foreign funds compared with €73 billion in 2001. Owing to investors' strong preference for liquidity, however, there also appears to have been shifts from bank debt certificates into money market paper. At all events, paper with a maturity of one year or less was very popular with foreign investors last year. They bought €10 billion worth of it after appearing as sellers (€15 billion) in this market segment the year before.

Direct investment

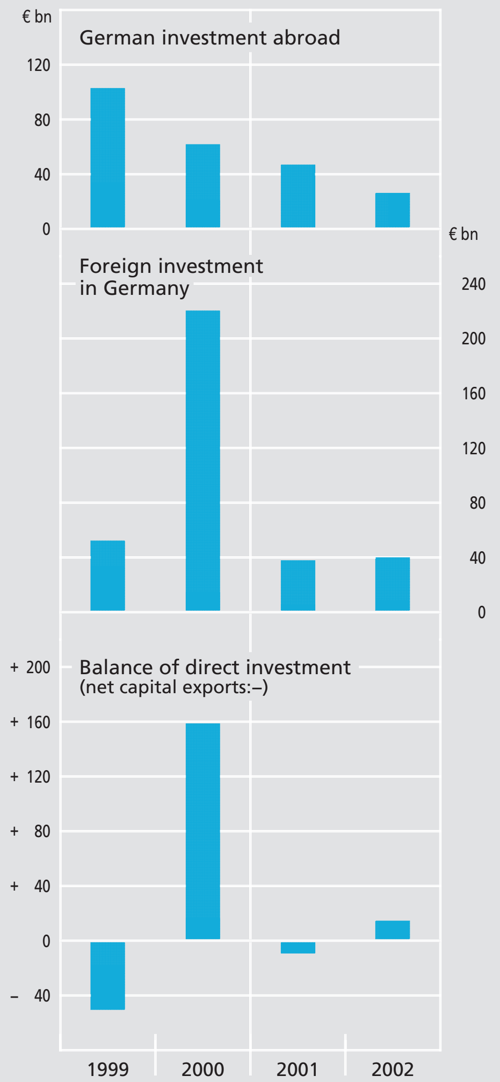
Given the rugged world economic climate, the three-year-long bear market on stock exchanges and the uncertain global security situation, Germany experienced a fairly satisfactory level of inward and outward direct investment last year.[6] €14½ billion net flowed into Germany through direct investment in 2002 whereas in the year before there had been net capital exports of €9 billion in this field.

Foreign direct investment in Germany

In 2002 foreign enterprises invested €40½ billion in Germany, which was actually somewhat more than in the previous year (€38 billion). As in previous years it was primarily enterprises domiciled in other euro-area countries, as well as some from the United Kingdom and the United States, that continued to expand their presence on the German market. Even so, despite the recent success in attracting foreign capital and given the economic strength of Germany, enterprises in non-euro-area countries still engage in less direct investment here than in other euro-area countries. Germany, with a share of just under 32% in the euro area's gross domestic product, accounted for only 13% of the investable funds that flowed into the euro area in 2002. It is possible, however, that a substantial part of direct investment from non-euro-area countries also flowed into Germany

6 According to estimated figures from UNCTAD, there was a 27% decline in direct investment worldwide last year. There also appears to have been a reversal in the direction of the main flows of direct investment. For example, countries such as the United Kingdom and the United States sustained serious reductions in inward direct investment (-75% and -67% respectively) whereas investment in the euro area fell by only 16%. The euro area attracted €130 billion, which is estimated to be just under one-quarter of total global direct investment last year. In 2001 it had amounted to about 20%.

Direct investment



Deutsche Bundesbank

via holding companies domiciled in neighbouring countries. That would explain the fairly large proportion of investment undertaken by euro-area enterprises in Germany.

German direct investment abroad

Conversely, German firms invested €26 billion abroad in 2002 after extending their sphere of activity abroad by another €47 billion a year earlier. The decline was due not only to the fall in goodwill but presumably also to poor profitability of German enterprises. Moreover, the excessively optimistic expectations in the telecommunications and IT sectors, which had long been the driving force behind cross-border acquisitions, increasingly gave way to a more realistic assessment of the situation. It is interesting in terms of a regional breakdown that German firms sold participating interests on balance in the United States last year (€1 billion) whereas in previous years the United States had almost always occupied the leading position among the host countries with respect to German direct investment. In the United Kingdom as well as in other euro-area countries, by contrast, German enterprises strengthened their international presence – even if here, too, the amounts invested were smaller.

The figures on German outward investment shown in the statistics were also depressed by the large amounts borrowed by German enterprises from their branches abroad (reverse investment). These loans are often used as a means of passing on the proceeds from international bonds which German enterprises' financing subsidiaries domiciled abroad have issued there. Loan repayments reduced Germany's participating interests abroad by approximately €28 billion.

Credit transactions of non-banks

As in the case of portfolio investment and direct investment the non-securitised cross-border financial operations of public authorities resulted in net capital imports (of €5½ billion) in 2002. The Federal Government drew on funds which had accrued to it from the auction of UMTS licences and which it was now withdrawing from its foreign accounts. Enterprises and individuals also reduced their bank balances abroad on balance and used some of the funds to finance their acquisition of cross-border participating interests. All in all, they repatriated €4 billion last year.

Credit transactions of the banking system

A substantial countermovement to the aforementioned capital imports occurred in the banking sector (including the Bundesbank's external transactions that are classified as credit transactions), which recorded net outflows of funds amounting to €137½ billion in 2002. German credit institutions accounted for €102 billion of this sum, predominantly at the short end of the market (€89 billion). As in the previous year the outflows of funds stemmed primarily from the non-securitised lending operations of German credit institutions, ie the granting of advances and loans to foreign partners, which expanded far more quickly than the corresponding deposits and borrowing operations. At the same time, funds amounting to €35½ billion were exported via the accounts of the Bundesbank. This money was primarily in connection with asset balances arising within the payment system TARGET.

Foreign reserves of the Bundesbank

The foreign reserves of the Bundesbank, which are shown separately from the credit transactions in the balance of payments, declined by a further €2 billion at transaction values last year after falling by €6 billion in each of the previous two years. If calculated at market prices at the end of 2002, the decline in the foreign reserves was even greater, at just over €8 billion, owing to the weakness in the US dollar. At 31 December 2002 the German foreign reserves amounted to €85 billion.

Balancing item

The net capital exports arising from the non-securitised credit transactions of the banking sector often greatly exceeded the net payments received from the other current and financial transactions with non-residents recently. In the balancing system used in the balance of payments this has resulted in "statistically unclassifiable transactions", ie a balancing item. Statistical recording problems in connection with the introduction of euro banknotes and coins, higher reporting thresholds and the large turnover in portfolio investment might have contributed to the tendency of this statistical "gap" to increase. To improve the data quality the portfolio transactions recorded in the balance of payments statistics were rechecked to ensure their completeness and plausibility. By virtue of the changes in stocks recorded in the safe custody account statistics it was possible to allocate part of the unclassifiable transactions to portfolio investment, with the result that the statistical discrepancies could at least be reduced through additional estimates. The balancing item for 2001 after the revisions now amounts to €11½ billion, but for 2002 it is still as much as €28 billion. As the results of the safe custody account statistics are not yet available for last year, however, this figure might be revised downwards later.