Foreign trade and payments

Foreign trade and current account

External environment

Even if the end of the conflict in Iraq and the recent decline in – speculatively excessive – oil prices meant that the severity of unfavourable influences was reduced, the external environment was still marked by uncertainty about the underlying global economic conditions in the first quarter of 2003. In particular, the economies of many major trading partners had still not fully regained their momentum. Consequently, the export expectations of German enterprises for the following few months deteriorated. Part of the reason for this was presumably the lingering impact of the geopolitical tensions. Even so, German exporters are still expecting an increase in exports this year. So far, however, these expectations have not been fully reflected in export volumes. All in all, German exports in the first quarter of 2003 only slightly exceeded those in the previous quarter after seasonal adjustment.

Euro appreciation and ...

In view of the latest appreciation of the euro, concern has grown that the German economy might be further slowed down from outside. For example, the euro has recently appreciated by about 16½% against the US dollar compared with its average value in the fourth quarter of 2002 and was trading at just under US$1.17 when this report went to press. This means that the bilateral exchange rate exceeded its low of October 2000 by 41%.

Depending on the extent to which additional costs can be passed on and the hedging instruments used, exchange rate movements

Export trend

1 Monthly values adjusted to match quarterly level. — 2 Results of the Ifo business survey; balances of positive and negative company reports.

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have an impact on export sales prices and exporters' profit margins as well as on the level of demand.[1] The US dollar has a direct impact on the exchange of goods between Germany and the United States; about 10% of German exports go to the United States. In other markets, however, German enterprises are also in indirect competition with US suppliers, with the result that in a broader sense – including the third-market effects – the weight of the US currency is greater at 13½%.

An "import-oriented" examination of exchange rate effects is likewise important, especially in view of the exchange-rate-related reduction in the prices of imports. Such an examination shows that the US dollar has a much greater impact on the import side than on the export side although imports from the United States account for only 8% of total German imports. One important reason for the greater weight of the US dollar is that an estimated 21% of imported goods are directly invoiced in US dollars whereas only 18% of exported goods are invoiced in that currency.[2] Another reason is that, no matter which currency is used for invoicing, some suppliers outside the United States also have to be ascribed to the dollar area.

... price competitiveness

Account has also to be taken of exchange rate fluctuations against major currencies other than the US dollar although these have been more moderate in recent months. Finally, it has also to be remembered that trade with the other euro-area countries is extremely important for German enterprises. The indi-

1 Hedging foreign currency claims (for example, through futures contracts or option deals) cushions the direct effects of exchange rate fluctuations on exporters' earnings for a time but gives rise to hedging costs. Over the longer term, however, the effects of exchange rate movements always work their way through either because hedging is possible only on the basis of the new exchange rate level or because hedging costs are rising sharply. Surveys show that in autumn/winter 2002/2003 an estimated four-fifths of all foreign currency claims arising from export business were hedged.
2 It is estimated that more than 70% of German exports and imports are invoiced in euro. However, the effect of the invoicing currency on the volume of foreign trade has to be qualified in that the exchange rate risk must be borne by the contracting parties regardless of the invoicing currency chosen.

cator of Germany's price competitiveness provides a comprehensive picture of all the factors mentioned.[3] In terms of this indicator the price competitiveness of German suppliers has declined by 4½% on a trade-weighted average since the fourth quarter of 2002; the decline has therefore been much smaller than the appreciation of the euro against the US dollar. This buffer provided by the currency appreciation is essentially due to the fact that about 43% of German exports are destined for the euro area and are therefore independent of nominal exchange rate movements. Consequently, Germany's current price competitiveness is fairly close to its long-term average and also more or less the same as at the beginning of 1999. To that extent, it can be regarded as almost "neutral".

Exporting has become more difficult

This means that, generally speaking, the stimuli which resulted from the euro's previous weakness and which have fostered exports in recent years have now subsided. However, they are disappearing at a time when the export markets are showing only moderate growth. Weak economic growth in the euro area and, with respect to the breakdown of goods, the sluggish growth in world demand for capital goods are having a retarding effect here. As a rule, however, it is precisely market growth which determines trends in German exports. While the appreciation of the euro also reduces cost pressures by lowering import prices, enterprises benefit from this relief to varying degrees depending on the economic sector to which they belong. If seen as a whole, the business of German enterprises exposed to foreign competition has undoubtedly become more difficult both on the exchange rate front and in terms of market conditions.

Euro exchange rate and price competitiveness

1 Against 19 industrial countries based on the price index of total sales; scale inverted: rise in curve (fall in values) denotes increase in competitiveness. — • = Latest position: 19 May 2003.

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Breakdown of exports

At the beginning of 2003 – a regional statistical breakdown is available only up to the end of February – increased demand for

3 Over the longer term, competitiveness is influenced by differences in production costs at home and abroad – in addition to the effects of exchange rate movements already being felt in the short term. The indicator of price competitiveness takes both factors into consideration.

Regional trend in foreign trade

Country/group of countries	Percentage shares in 2002	Average of Jan-Feb 2003 compared with average of Oct-Dec 2002, seasonally adjusted, as a percentage
Exports		
All countries	100.0	+ 0.9
of which		
Euro-area countries	42.6	– 4.1
Other EU countries	12.1	+ 2.8
United States	10.3	+ 3.1
Japan	1.9	– 5.3
Central and east European countries in transition	11.6	+ 4.8
OPEC countries	2.2	+ 8.8
Emerging markets in South-East Asia	3.9	+ 4.9
Imports		
All countries	100.0	+ 1.0
of which		
Euro-area countries	41.6	– 3.6
Other EU countries	9.9	+ 2.6
United States	7.7	+ 3.3
Japan	3.6	+ 0.9
Central and east European countries in transition	13.5	+ 4.0
OPEC countries	1.3	+ 9.1
Emerging markets in South-East Asia	5.1	+ 2.6

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German exports came solely from markets outside the euro area.[4] On an average of the first two months of 2003 compared with an average of the fourth quarter of 2002 German exporters recorded increased turnover in seasonally adjusted terms, especially in the central and east European transitional countries (+5%) and in the United States (+3%). Trade with customers in the emerging markets of South-East Asia also grew vigorously (+5%). Exports of goods to the OPEC countries, which had benefited from the further rise in oil prices at the beginning of the year, also grew strongly (+9%). German exporters also increased their sales (by 3%) to the EU countries outside the euro area. By contrast, exports to euro-area countries declined (by 4%) not least as a result of the persistent cyclical weakness in the euro area. A slight increase in exports to these countries had been recorded in the previous quarter.

As major trading partners were slow to overcome their reluctance to invest, exports of capital goods, German exporters' most important product range, increased only moderately at the beginning of the year (+1½%). Exports of machinery, for example, grew only marginally (+1%). Furthermore, exports of motor vehicles, which had boosted overall export growth last year, failed to maintain the level reached in the fourth quarter of 2002 (-1%). By contrast, a 3% increase in export demand for the products of the information and communication sector was a positive fac-

4 This may also be the result of catching-up effects in January as export deliveries in December were fairly low owing to the specific pattern of public holidays in that month. In the two-month period of January and February this has a relatively large impact.

tor. Exports of consumer goods, which, despite the downturn in consumer confidence in major trading countries, also grew markedly – with an increase of 2½% in the first quarter of 2003 – following a strong performance in the fourth quarter of 2002.

Imports of goods

Owing to the sluggish growth in demand in Germany at the turn of 2002-03, imports in the first quarter of the year also showed only a moderate increase over the previous quarter, rising by a seasonally adjusted 1½%. This means that, in terms of value, imports of goods rose more strongly than exports. Primarily as a result of the increase in the prices of oil imports, import prices went up by just under 1% at the same time. Consequently, imports also slightly exceeded their level in the fourth quarter in real terms.

Breakdown of imports

The low demand from German importers mainly affected imports of goods from other euro-area countries, which on an average of January and February declined by a seasonally adjusted 3½% compared with the average of the fourth quarter of 2002. By contrast, imports from non-euro-area countries, which account for just over 58% of total German imports, increased substantially. The main increase in demand was for goods from central and east European countries (+4%) and from the United States (+3½%). US goods had become discernibly cheaper owing to the appreciation of the euro against the US dollar since last year. However, the increased orders placed by German importers also benefited the emerging markets in South-East Asia and the EU countries outside the euro area (+2½% in each case). Imports from the OPEC countries experienced the highest rate of growth (9%).[5] One reason for this increase was the significant increase in the price of petroleum during the period under review. Another reason was volume since the amount of oil imported was probably influenced by the low temperatures at that time of the year and by the increase in stocks owing to the geopolitical tensions. In response to these effects, energy imports rose sharply (by 24%).[6] Foreign manufacturers of capital goods also increased their exports to Germany (+2½%). The greatest increase in demand was again for machinery (+3%) whereas imports of motor vehicles fell once more (-1½%). There was a slight rise in foreign deliveries of semi-finished goods (+2%) but imports of products from the information and communication sector did not quite match the level in the final quarter of 2002 (-½%). Imports of consumer goods grew even more sluggishly. After increasing significantly in the fourth quarter of 2002, these imports were almost 4% below the level in the previous quarter. This is a reflection of the sluggish demand from German households.

Current account

In the first quarter of 2003 the seasonally adjusted trade surplus saw a slight decline of €1½ billion, falling to €29½ billion. At the same time, the deficit on invisible current transactions with non-residents increased significantly. The main reason for this was the reversal in the balance on factor income, which

5 Even so, imports from the OPEC countries accounted for only 1½% of total German imports last year.
6 It must be remembered here that the ratio of energy imports to total imports was about six times higher than the corresponding ratio of goods imported from the OPEC countries.

Major items of the balance of payments

€ billion

Item	2002 Q1	2002 Q4	2003 Q1
I Current account			
1 Foreign trade [1]			
Exports (fob)	156.0	168.2	162.9
Imports (cif)	124.2	136.8	133.6
Balance	+ 31.8	+ 31.4	+ 29.4
2 Services (balance)	– 11.3	– 5.7	– 8.7
3 Factor income (balance)	– 4.0	+ 2.4	– 4.4
4 Current transfers (balance)	– 5.1	– 7.4	– 5.4
Balance on current account [2]	+ 10.3	+ 18.8	+ 9.6
Memo item Balances, seasonally adjusted			
1 Foreign trade	+ 32.2	+ 31.1	+ 29.4
2 Services	– 11.4	– 8.8	– 8.5
3 Factor income	– 1.1	+ 1.5	– 1.3
4 Current transfers	– 6.5	– 6.7	– 6.9
Current account [2]	+ 11.7	+ 15.2	+ 11.0
II Balance of capital transfers [3]	+ 0.2	– 0.4	– 0.0
III Balance of financial account [4]	+ 2.6	– 45.4	– 14.7
IV Change in the foreign reserves at transaction values (increase: –) [5]	– 1.4	+ 0.9	– 1.5
V Balance of unclassifiable transactions	– 11.7	+ 26.0	+ 6.6

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 45. — **5** Excluding allocation of SDRs and changes due to value adjustments.

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in the first three months of the year ran a seasonally adjusted deficit of just under €1½ billion compared with a surplus of nearly the same level in the previous quarter; however, short-term fluctuations are quite usual, especially in this current account item. Furthermore, the net payments made to non-residents in the field of current transfers increased slightly to €7 billion. By contrast, the deficit on services showed a small decline (to €8½ billion). As a result, the surplus on current account in the first quarter fell (seasonally adjusted) to €11 billion compared with a surplus of just over €15 billion in the final quarter of the previous year.

Financial transactions

Trends in financial transactions

At the beginning of the year the international financial markets were feeling the full effects of the Iraq crisis and the gloomy outlook for the global economy. The existing uncertainty on the markets was reflected in further falls in the yields of bonds issued by first-class borrowers while, conversely, the share indexes in the major financial centres again declined. With the outbreak of war and the rapid military success of the Allies, however, a certain countermovement set in at the end of the first quarter although this remained within fairly narrow bounds as market players became more aware again of the fundamental economic environment. At the same time, the euro, which had been gaining ground against most currencies since the beginning of the year and was trading very firmly as this report went to press, underwent a further upward surge. The underlying mood, which was marked by geopolitical and economic uncertainty, is also partly reflected in Germany's statistically recorded financial transactions with non-residents. Overall, there were substantial net capital inflows through portfolio transactions during the first three months of this year whereas net capital outflows in the other segments of the financial account tended to dominate.

Portfolio investment

The international influences outlined above are usually most apparent in the portfolio transactions with non-residents; these resulted in net capital imports of €37½ billion between January and March 2003. That represented a clear reversal from the previous three-month period when net capital outflows of €12½ billion were recorded. A reorganisation of portfolios was observed on the part of both resident and non-resident investors. All in all, non-resident investors acquired securitised assets in Germany worth €32 billion; in the previous quarter there had been net sales of German paper (€3 billion). In the light of the raw economic climate, the high degree of uncertainty on the financial markets and the unfavourable profitability estimates for many German enterprises in the period under review, non-residents were liquidating part of their German share holdings (€2½ billion) and sold, in addition, shares in German investment funds (€1 billion). The reluctance of non-resident investors to buy German shares has been evident for some time now and is a reflection of the unfavourable economic outlook in Germany. Over the nine months from July 2002 to March 2003 foreigners' purchases and sales of German shares more or less cancelled each other out

Foreign investment in German securities

Financial transactions

€ billion, net capital exports: –

Item	2002 Q1	2002 Q4	2003 Q1
1 Direct investment	+ 11.3	+ 1.3	– 7.8
German investment abroad	– 2.6	– 5.6	– 15.2
Foreign investment in Germany	+ 13.9	+ 6.8	+ 7.4
2 Portfolio investment	– 5.6	– 12.3	+ 37.5
German investment abroad	– 32.4	– 9.4	+ 5.5
Shares	– 7.4	– 5.4	+ 14.7
Investment fund certificates	– 5.1	+ 0.6	– 3.1
Bonds and notes	– 15.3	– 7.2	– 9.7
Money market paper	– 4.5	+ 2.6	+ 3.6
Foreign investment in Germany	+ 26.8	– 2.9	+ 32.0
Shares	+ 5.1	+ 2.5	– 2.6
Investment fund certificates	+ 1.1	– 1.3	– 0.9
Bonds and notes	+ 30.0	– 0.6	+ 22.5
Money market paper	– 9.3	– 3.6	+ 12.9
3 Financial derivatives 1	+ 1.8	+ 0.3	+ 3.0
4 Credit transactions	– 4.5	– 34.3	– 46.8
Credit institutions	+ 13.6	– 49.8	– 33.0
Long-term	– 5.4	– 6.3	– 14.6
Short-term	+ 19.0	– 43.6	– 18.4
Enterprises and individuals	– 0.7	+ 15.7	– 19.8
Long-term	+ 2.0	+ 1.1	– 6.6
Short-term	– 2.7	+ 14.6	– 13.2
General government	– 0.2	– 0.4	+ 1.1
Long-term	– 0.2	– 0.1	+ 3.6
Short-term	– 0.0	– 0.2	– 2.5
Bundesbank	– 17.1	+ 0.2	+ 4.9
5 Other investment	– 0.4	– 0.3	– 0.5
6 Balance of all statistically recorded capital flows	+ 2.6	– 45.4	– 14.7
Memo item Change in the foreign reserves at transaction values (increase: –) 2	– 1.4	+ 0.9	– 1.5

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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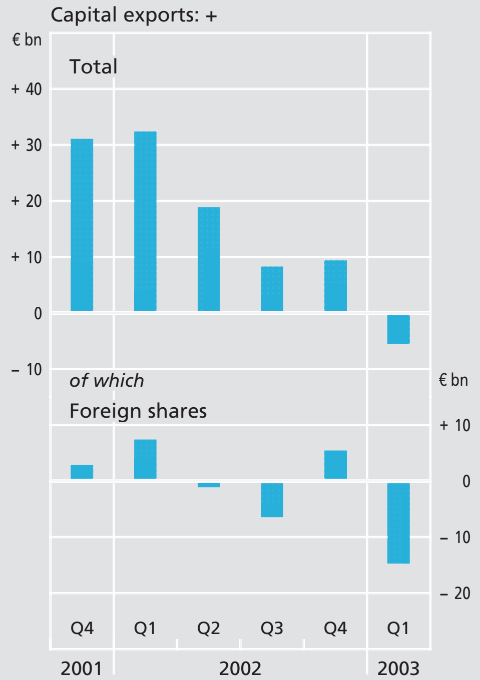
German portfolio investment abroad



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whereas on a longer-term average – for example, since the beginning of monetary union – foreign funds amounting to about €6 billion per quarter had flowed into Germany's share markets.

By contrast, foreign investors considered interest-bearing paper very attractive during the first quarter of this year and added €35½ billion worth of it to their portfolios (-€4 billion in the quarter earlier). Greatest demand was for German bonds (€22½ billion), especially government issues, which in times of global uncertainty are regarded as a safe haven. Foreign investors also spent €13 billion on German money market paper, ie debt certificates with maturities of one year or less, which, in the light of the fairly large price risks at present, they possibly use to park funds in the short term. By contrast, demand for longer-dated German bank bonds was somewhat more subdued, a development which probably had something to do with a reduction in the maturity range of foreign portfolios and a fairly tight supply on the primary market.

German investment in foreign securities

Whereas non-residents evidently increased their investment on the German market again, German investors withdrew capital from the foreign securities markets in view of the difficult market environment. They reduced their holdings of foreign securities by €5½ billion after investing €9½ billion net abroad in the previous quarter. This reversal conceals a significant reorganisation of portfolios as German investors responded to the changed underlying economic and political conditions. For example, they sold foreign equities worth as much as €14½ billion, possibly as a result of the weakness of the international share markets. However, they invested only part of the resultant liquidity in other foreign paper, namely money market fund certificates (€3½ billion) – a financial product with ready availability and a high level of security – and, once again, euro-denominated bonds issued by non-resident borrowers (€8½ billion). This paper has regularly enjoyed great popularity since the start of monetary union even if its interest advantage over German government bonds has levelled off considerably in recent months.

Direct investment

In contrast to portfolio investment, direct investment resulted in net exports of capital between January and March 2003 (€8 billion compared with net capital imports of €1½ billion in the final quarter of 2002). The main reason for the reversal was the action of resident enterprises, which again increased their investment abroad (€15 billion). Credits which German proprietors granted to their foreign subsidiaries accounted for a large part of this sum. The main targets of German direct investment were other EU countries as well as the United States.

German direct investment abroad

Foreign direct investment in Germany

Financial flows in the opposite direction, ie direct investment in Germany, continued to reflect the declining global interest in cross-border corporate mergers and acquisitions. Although a total of €7½ billion in foreign financing funds was paid to subsidiaries and branches domiciled in Germany between January and March 2003, capital injections from foreign parent companies to their German subsidiaries for the purposes of repaying long-term bank loans accounted for the lion's share of this.

Credit transactions of non-banks ...

As in the case of direct investment, non-securitised credit transactions resulted in the export of funds between January and March (€47 billion net). €20 billion net was due to the operations of enterprises and individuals. This was due mainly to the usual seasonal restocking of the balances held at foreign banks, following the reduction in these balances at the end of the previous year for balance sheet purposes, and to the aforementioned repayments of long-term credits taken up by German enterprises. By contrast, general government transactions resulted in imports of almost €1 billion in the period under review. Larger capital imports (€3½ billion) were recorded at the long end of the market – primarily through the sale to non-residents of borrower's notes issued by the *Land* governments.

... and the banking system

Besides the net amounts of capital exported by the non-banking sector, it was mainly the non-securitised external operations of the banking system – which may also be seen as the counterpart of all other cross-border transactions (including the external transactions by the Bundesbank recorded as credit operations) – that led to outflows of funds in non-securitised credit transactions (€28 billion). The long-term credit operations of the monetary financial institutions resulted in outflows of €14½ billion and their short-term operations to a further outflow of €18½ billion. The Bundesbank, by contrast, incurred a liability balance of €5 billion in the first quarter – primarily as a result of the settlement of TARGET balances.

Foreign reserves of the Bundesbank

The foreign reserves of the Bundesbank, which are shown separately from the credit transactions in the balance of payments, increased by €1½ billion at transaction values between the beginning of January and the end of March. As the euro price of gold declined particularly significantly during this period, the reserves at market prices amounted to only €82½ billion at the end of March compared with €85 billion at the end of 2002.